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**Board of Supervisors**

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**Brad Wagenknecht**
Chair

August 19, 2008

FILED
AUG 21 2008
Clerk of the Napa Superior Court
By: C. Brennan
Deputy

The Honorable Raymond Guadagni
Presiding Judge
Superior Court of California, County of Napa
825 Brown Street
Napa, CA 94559

Dear Judge Guadagni:

As required by Penal Code Section 933(c), enclosed is the response to the following 2007-08 Grand Jury Final Reports:

- Napa County Retirement Benefits for County of Napa and City of Napa Employees
- Napa County Alcohol and Drug Prevention and Treatment Programs for Napa County Youth

Responses to findings and recommendations affecting local government entities other than the County are not included in the Board's response when those entities are not under the jurisdiction of the County Board of Supervisors.

Once again, the Board acknowledges the members of the 2007-08 Grand Jury for the time they have devoted in preparing their report.

Sincerely,

Brad Wagenknecht, Chair
Napa County Board of Supervisors

Received
Napa Superior Court
AUG 20 2008
Court Executive Office

Enclosure

cc: Foreman, 2007-08 Grand Jury

**Brad Wagenknecht** District 1 | **Mark Luce** District 2 | **Diane Dillon** District 3 | **Bill Dodd** District 4 | **Harold Moskowite** District 5

# NAPA COUNTY
# RESPONSE TO THE NAPA COUNTY GRAND JURY FINAL REPORT ON BENEFITS FOR COUNTY OF NAPA AND CITY OF NAPA EMPLOYEES

Finding 1.a: The County of Napa pension benefit for employees is a defined-benefit plan.

*Response, County Executive Officer*: The County Executive Officer agrees with this finding.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 1.b: The County of Napa plan for its non-safety employees and the Board of Supervisors is a "2.5% at 55" plan.

*Response, County Executive Officer*: The County Executive Officer agrees with this finding. Essentially, under this pension plan, a non-safety (or "miscellaneous") employee is eligible to retire at age 55 with full benefits, which are calculated by multiplying 2.5% times the number of years the employee has worked for the County times the employee's highest year salary or average three consecutive highest years salary, depending on when they were hired.[1] So, for example, if an employee worked for the County for 30 years (starting at age 25 and working to age 55), that employee would be entitled to a pension that is equivalent to 75% of the average of her or his highest year's or three highest years' salary. If the employee worked for the County for 20 years, she or he would be entitled to a pension that is equivalent to 50% of the average of his or her highest year's or three highest years' salary. It should also be noted that Napa County does not participate in Social Security, so, for many employees, this pension is the only guaranteed retirement income they will receive. Finally, it should be noted that average retirement age for all current non-safety County retirees is 60 years.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 1.c: The County of Napa plan for safety employees is a "3% at 50" plan.

[1] If an employee worked for another PERS agency, their pension calculation would also include the number of years worked for that entity, times that entities retirement formula rate at the time the employee left (for example, 2.5% at 55 or 2% at 55, etc.).

*Response, County Executive Officer*: The County Executive Officer agrees with this finding. At Napa County, "safety employees" include Sheriff's Deputies and District Attorney Investigators.[2] Essentially, under this pension plan, a safety employee is eligible to retire at age 50 with full benefits, which are calculated by multiplying 3% times the number of years the employee has worked for the County times the employee's highest year's salary. So, for example, if an employee worked for the County for 25 years (starting at age 25 and retiring at age 50), that employee would be entitled to a pension that is equivalent to 75% of his or her highest year's salary. It should be noted that the average retirement age for all of the County's current safety retirees is 56 years.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 1.d: The County of Napa vesting period for County employees is 5 years and for the Board of Supervisors 8 years.

*Response, County Executive Officer*: The County Executive Officer agrees in part and disagrees in part with this finding. The vesting period for pension benefits for all employees – including the Board of Supervisors – is 5 years. Essentially, this means that in order to draw a pension at retirement age, an employee must have worked for the County for at least 5 years[3]. If an employee leaves PERS-covered employment without 5 years of service, the employee can withdraw the assets in their retirement account generated by the employee's PERS contribution, but not the employer's contribution.

For the Board of Supervisors and County department heads, to be eligible to receive certain retiree health insurance benefits the vesting period is currently 8 years as a County employee and 5 years as a Board member or department head.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 1.e: Total cost to Napa County taxpayers to fund employee retirement benefits over the next two years will be $39,377,900.

*Response, County Executive Officer*: The County Executive Officer agrees in part and disagrees in part with this finding. For FY2008/09, the cost to the County of funding employee retirement benefits, including pensions and retiree health insurance, is estimated to be approximately $23.6 million. This represents approximately 25% of the County's estimated payroll costs in this period and 9% of the County's total budget. At this point, it is not possible to say with certainty what the County's employee retirement

[2] It should be noted that State law allows local governments to include other categories of employees in a safety retirement plan, including Probation Officers, Juvenile Hall staff and Correctional Officers (if the Jail is under the authority of a sheriff). In many counties some or all of these positions are included in safety plans. Napa County has chosen to not include Probation Officers and Juvenile Hall staff in the safety retirement plan and, since the County has a civilian (non-sheriff) administered jail, Napa County's Correctional Officers are not eligible for safety retirement.

[3] Or another PERS agency. The vesting period is actually a PERS requirement, not a County requirement.

costs will be in FY2009/10, though it is likely they will increase slightly, assuming the number of County employees does not increase or decrease significantly and the County maintains the same amortization schedule for retiree health insurance. Further, while this represents the cost to the County of these benefits, it does not necessarily represent the cost to the County's taxpayers. This is because a substantial portion of the County's budget is funded by State and Federal revenue (part of which comes indirectly from local taxpayers), fees and certain other revenue sources. It is difficult to determine exactly how much of the County's employee retirement costs are paid for by local property, sales and other local taxes. However, those taxes fund approximately 33% of the County's overall budget. Thus it is probably reasonable to assume that somewhere between a third and a half of the County's annual employee retirement costs are funded by local taxes.

*Response, Board of Supervisors:* The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 1.f: BOS monthly salary is currently $7,017, with full medical and dental coverage for themselves and their family. They also enjoy a defined-benefit pension that includes a monthly annuity.

*Response, County Executive Officer*: The County Executive Officer agrees with this finding. The members of the Board of Supervisors receive the same health and pension benefit package as other County employees, and are required to pay the same share of cost. In the case of health insurance, this means the County pays a portion of health insurance premium equivalent to 100% of the employee-only cost of the most popular health insurance plan offered by the County (currently Kaiser) and 92.5% of the cost for an employee plus one or more family members.[4] The County's contribution for dependent coverage will drop to 87.5% for health insurance plan year 2009. In the case of the pension benefit, as required by State law, the Board members are covered by the same formula as all non-safety County employees (2.5% at 55) and pay the same share of cost as other miscellaneous (non-safety) County employees.

*Response, Board of Supervisors:* The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 2: The City of Napa:

a. pension benefit for employees (with limited exceptions) is a defined benefit plan.
b. Plan for its non-safety employees and the Mayor and Council members is a "2.7% at 55" plan.
c. Plan for its safety employees is a "3% at 55" plan.
d. Vesting period for the City of Napa employees is 5 years and for the Mayor and City Council members 8 years.
e. Current annual cost to provide medical benefits to retired employees is $1,400,000, a more than six-fold increase from $227,240 in 2002.

[4] Family includes spouse or registered domestic partner and children under age 23.

f. Estimates it will spend approximately $44,000,000 over the next six years to fund pension benefits, assuming a flat salary increase of 5%.

*Response, County Executive Officer*: The County Executive Officer neither agrees nor disagrees with this finding. All of these findings relate to the City of Napa and Napa County staff have no independent way to verify the information. Consequently, the County Executive Officer defers to the City of Napa on these findings.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 3.1 OPEB: The County of Napa also provides OPEB for its retired employees and elected officials, some for their lifetime.

*Response, County Executive Officer*: The County Executive Officer agrees in part and disagrees in part with this finding. For all employees the County provides some County-paid Other Post-Employment Benefits (OPEB). If a regular employee has worked for the County for 20 years or more, the County pays the same portion of the health insurance premium cost for the employee as it does for active employees– 100% of the most popular health insurance plan provided by the County – until that employee is 65 years of age. Unlike active employees, the County does not pay any of the premium costs for the retiree's family-member's health insurance. In addition, all retirees, whether they have worked for the County for 20 years or not, can convert accumulated sick leave to paid health insurance at the rate of 8 hours of sick leave (16 hours for management and safety employees) per 1 month of retiree health insurance coverage, up to a total of 1,800 hours of sick leave for safety employees and 1,248 hours for other employees[5]. For department heads and Board members who have worked for the County for at least 8 years and been a department head or Board member for at least 5 years, the County provides an enhanced benefit. Upon retirement, those employees are entitled to County-paid health, vision and dental insurance for themselves and either their spouse (or domestic partner) or their dependent family, depending on when the employee was hired, for life[6].

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 3.b: The City of Napa also provides OPEB to its retired employees and elected officials, some for their lifetime.

[5] Though, since employees may also convert unused sick leave to service credit for retirement purposes, it is difficult to determine the degree to which accumulated sick leave will be converted to health insurance. Retiree health insurance funded through sick leave conversion can be for the retiree and one other family member.

[6] Department heads and Board members who came into office prior to July 10, 2007 receive total family coverage; those hired after July 10, 2007 receive the spouse-only coverage. In either case, after the employee reaches age 65 and becomes Medicare eligible, the County only covers the cost of his or her Medicare Part B premiums and a supplemental Medicare policy as well as dental and vision insurance.

*Response, County Executive Officer*: The County Executive Officer neither agrees nor disagrees with this finding. This finding relates to the City of Napa and County staff have no independent means of verifying this information. Consequently, the County Executive Officer defers to the City of Napa to respond to this finding.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 3.c: The costs of OPEB, particularly health insurance have experienced double-digit percentage increases in the past 5 years.

*Response, County Executive Officer*: The County Executive Officer agrees in part and neither agrees nor disagrees in part with this finding.

The County Executive Officer neither agrees nor disagrees with the finding as it relates to the City of Napa's OPEB costs. County staff have no independent way of verifying the City's OPEB costs and therefore the County Executive Officer defers to the City of Napa for a response.

The County Executive Officer agrees that the County's OPEB costs have experienced double-digit cost increases in the past five years. The increase in OPEB costs between FY2002/03 and FY2006/07 was due in part to the increase in health insurance premiums and, more significantly, to an increase in the number of eligible retirees (during this period, the County's OPEB costs consisted entirely of pay-as-you-go costs for health insurance premiums). The increase in OPEB costs from $1.4 million in FY2006/07 to $5.3 million in FY2007/08 was due almost entirely to the Board's decision to begin paying down the County's OPEB unfunded liability on a very aggressive 14 year amortization schedule.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 3.d: Early retirement of City and County employees, allowed by the pension plans, obligates the City and County to provide OPEB for a longer period of time until a retiree becomes eligible for Medicare at age 65.

*Response, County Executive Officer*: The County Executive Officer agrees in part and neither agrees nor disagrees in part with this finding.

The County Executive Officer neither agrees or disagrees with this finding as it relates to the City of Napa. As previously noted, County staff have no way of independently verifying information regarding the City of Napa and, therefore, defers to the City of Napa to respond to this finding as it relates to that organization.

The County Executive Officer agrees with this finding as it relates to the County.

*Response, Board of Supervisors:* The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 3.e: The unfunded OPEB for the County of Napa is between $37 million and $51 million and the City $2.8 million.

*Response, County Executive Officer*: The County Executive Officer agrees in part and disagrees in part and neither agrees nor disagrees in part with this finding.

The County Executive Officer neither agrees nor disagrees with this finding as it relates to the City of Napa. County staff are unable to independently verify the City's OPEB status and, consequently, the County Executive Officer defers to the City of Napa to respond to this finding as it relates to that organization.

The County Executive Officer agrees in part and disagrees in part with the finding as it relates to Napa County. The Grand Jury's finding that the County's OPEB unfunded liability is between $37 million and $51 million, is based on an actuarial study done before the Board made the decision to pre-fund the unfunded liability with CalPERS. That study indicated that the County's unfunded actuarial liability as of June 30, 2006 would be between $37 million (if the plan was pre-funded and the assets were diversified) and $51 million (if the plan was not funded). With the County now pre-funding with CalPERS, the estimated unfunded liability on June 30, 2006 was $34.2 million.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 3.f: The County has started reducing its unfunded OPEB liability and intends to be fully funded in 14 years.

*Response, County Executive Officer*: The County Executive Officer agrees with this finding.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 4.a: Pensions: The costs to both the City and County for pension benefits are rising so rapidly that they can adversely impact the provision of other governmental services.

*Response, County Executive Officer*: The County Executive Officer neither agrees nor disagrees in part with this finding and disagrees in part with this finding.

The County Executive Officer neither agrees nor disagrees with this finding as it relates to the City of Napa. County staff are unable to independently verify the pension and budget status of the City of Napa. Consequently, the County Executive Officer defers to the City of Napa to respond to this finding as it relates to that organization.

The County Executive Officer disagrees with this finding as it relates to Napa County. The Grand Jury Report indicates that the County's costs of providing pension benefits have increased by 1,156% in five years and concludes that this is unsustainable and that the cost to the County " . . . for pension benefits are rising so rapidly that they can adversely impact the provision of other governmental services." This is misleading at best. To illustrate its point, the Grand Jury chose a five year period that was not reflective of the longer-term historical trend. The County's pension costs five years ago were at an all-time low because of the late 1990's stock market gains. The following table shows the County's pension contributions as a percent of payroll from the PERS actuarial valuations for the fiscal years 1996/97 (just before the stock market started its steep increase) through 2008/09.

| **Napa County** | | **MISCELLANEOUS PLAN** | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | **Employer Portion** | | | | | **Who Pays?** | |
| Fiscal Year | Market Return | Normal Cost | UAAL Amort | Total Employer Contrib. | Employee Contrib. | Total PERS Contribution | Employer | Employee |
| 1996/97 | 2.0% | 8.4% | 1.8% | 10.2% | 7.0% | 17.2% | 12.7%* | 4.5%* |
| 1997/98 | 16.3% | 8.4% | 1.6% | 10.0% | 7.0% | 17.0% | 12.5%* | 4.5%* |
| 1998/99 | 15.3% | 8.8% | 0.1% | 8.9% | 7.0% | 15.9% | 13.8% | 2.1% |
| 1999/00 | 20.1% | 7.4% | -5.7% | 1.7% | 7.0% | 8.7% | 7.7% | 1.0% |
| 2000/01 | 19.5% | 7.4% | -7.4% | 0.0% | 7.0% | 7.0% | 7.0% | 0.0% |
| 2001/02 | 12.5% | 7.5% | -7.5% | 0.0% | 7.0% | 7.0% | 7.0% | 0.0% |
| 2002/03 | 10.5% | 7.7% | -7.7% | 0.0% | 7.0% | 7.0% | 7.0% | 0.0% |
| 2003/04 | -7.2% | 7.7% | -7.7% | 0.0% | 7.0% | 7.0% | 7.0% | 0.0% |
| 2004/05 | -5.9% | 7.9% | -1.0% | 6.9% | 7.0% | 13.9% | 13.9% | 0.0% |
| 2005/06 | 3.9% | 9.2% | 4.7% | 13.9% | 8.0% | 21.9% | 17.4% | 4.5% |
| 2006/07 | 16.7% | 9.3% | 4.0% | 13.3% | 8.0% | 21.3% | 17.2% | 4.1% |
| 2007/08 | 12.7% | 9.1% | 4.5% | 13.6% | 8.0% | 21.6% | 17.2% | 4.4% |
| 2008/09 | 12.3% | 9.0% | 4.6% | 13.6% | 8.0% | 21.6% | 17.4% | 4.2% |
| **Napa County** | | **SAFETY PLAN** | | | | | | |
| | | **Employer Portion** | | | | | **Who Pays?** | |
| Fiscal Year | Market Return | Normal Cost | UAAL Amort | Total Employer Contrib. | Employee Contrib. | Total PERS Contribution | Employer | Employee |
| 1996/97 | 2.0% | 12.6% | -0.1% | 12.5% | 9.0% | 21.5% | 15%* | 6.5%* |
| 1997/98 | 16.3% | 12.6% | -1.7% | 12.5% | 9.0% | 21.5% | 12.5% | 9.0% |
| 1998/99 | 15.3% | 12.9% | -2.7% | 10.2% | 9.0% | 19.2% | 10.2% | 9.0% |
| 1999/00 | 20.1% | 10.5% | -8.2% | 2.3% | 9.0% | 11.3% | 2.3% | 9.0% |
| 2000/01 | 19.5% | 12.5% | -10.4% | 2.1% | 9.0% | 11.1% | 2.1% | 9.0% |
| 2001/02 | 12.5% | 12.6% | -12.6% | 0.0% | 9.0% | 9.0% | 0.0% | 9.0% |
| 2002/03 | 10.5% | 17.8% | -5.0% | 12.8% | 9.0% | 21.8% | 12.8% | 9.0% |
| 2003/04 | -7.2% | 17.4% | -1.6% | 15.8% | 9.0% | 24.8% | 14.8% | 10.0% |
| 2004/05 | -5.9% | 17.4% | 1.2% | 18.6% | 9.0% | 27.6% | 15.8% | 11.8% |
| 2005/06 | 3.9% | 14.8% | 11.9% | 26.7% | 9.0% | 35.7% | 26.2% | 9.5% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| 2006/07 | 16.7% | 16.2% | 11.7% | 27.9% | 9.0% | 36.9% | 26.9% | 10.0% |
| 2007/08 | 12.7% | 15.8% | 10.6% | 26.4% | 9.0% | 35.4% | 25.3% | 10.1% |
| 2008/09 | 12.3% | 17.4% | 10.5% | 27.9% | 9.0% | 36.9% | 26.7% | 10.2% |

*Percent is estimated. County paid approximately $55 per pay period per employee toward employee's cont.

As shown in the above-table, the County's required "employer" pension contribution consists of two components:

- The Normal Cost, which represents the cost of benefits earned by employees during the year; and
- The amortization of the Unfunded Actuarial Accrued Liability (UAAL), which is an amortized cost reflecting investment gains and losses, changes in benefits and changes in actuarial methods and assumptions.

In addition, through agreement with the union, the County has historically paid a share of the miscellaneous employees' pension contribution (PERS pension costs include an employer and employee contribution). The employee's contribution is a fixed amount and ranged from 7% to 8% of payroll during this period. In the case of Safety employees, for the last 10 years those employees have paid their entire employee contribution but the County recently negotiated an agreement with the union that the County and employees would share in any cost increases or decreases. The columns entitled "Who Pays?" show the actual cost to the County and employees in each of the last 13 years.

As the table also shows, the total cost to the County of the Miscellaneous (non-safety) Plan, which represents approximately 82% of the County's total pension costs, was approximately 12.7% of pay in FY1996/97 and then began to generally decrease, due to assumption changes and because the performance of the stock market in the late 1990s. In fact, for four years – FY2000/01 through FY2003/04 – the total County cost decreased to zero, except for the employer paid portion of the employee's contribution (which the County actually agreed to increase during this period). The Grand Jury chose a year in the middle of this latter period as the base year for calculating the 1,156% increase in pension costs mentioned in the Report.

Beginning in FY2004/05 the annual pension cost to the County as a percent of payroll for the miscellaneous employee group began to increase, due in part to a change in the County's miscellaneous benefit formula from 2% at 55 to 2.5% at 55 and in part to the decline in the stock market in 2001 through 2003. During the most recent four year period - from FY2005/06 through FY2008/09 - the total pension cost to the County for the miscellaneous group has remained fairly constant as a percent of payroll – fluctuating between 17.2% and 17.4%.

All-told, over the 12 year period between FY1996/97 and FY2008/09 the total cost to the County for miscellaneous employee pension benefits, as a percent of payroll, increased by approximately 4.7%. But that reflects the impact of a number of discretionary decisions the County made during this period to revise employee cost-sharing formulae. For example, in FY1996/97 the County was paying approximately 2.5% of the employees' contribution, while by FY2008/09 that amount had increased to 3.8% of payroll. To focus more clearly on factors outside the County's control, it useful to look just at the County's required "Employer Contribution," which increased by 3.4% of payroll during this same period. However, according to the County's actuarial consultants, 3.5% of the FY2008/09 employer contribution is due to the County's decision in FY2004/05 to change benefit plan from 2% at 55 to 2.5% at 55. If that discretionary change is factored out, the County's required Employer contribution rate actually **decreased** by .1% over the 12 year period.

In addition, the Normal Cost for the Miscellaneous Plan - which is the cost assuming the plan had no unfunded liability - increased from 8.4% to 9% of payroll, a total increase over the 12 years of only .5%, despite the increase in benefit levels implemented by the County. According to the County's actuarial consultants, the County can consider a Normal Cost of 9 to 9.5% of payroll to be representative of the on-going plan costs after the unfunded liability is paid off (the current amortization schedule provides for full payment of the unfunded liability in roughly 21 years, assuming no changes in actuarial assumptions regarding return on investment, etc).

The situation with regard to the safety plan is similar, though there are also some significant differences. As can be seen, in FY1996/97 the total cost to the County for safety pensions was approximately 15% of payroll. This decreased to zero in FY2001/02 and then began increasing, reaching 27.6% in FY2004/05. For the last four years the County's safety pension cost has remained in the 25% to 26% of payroll range, partly due to the agreement with the Deputy Sheriff's union to have employees share the cost of any impact on the County's employer contribution rate. As with pension costs for miscellaneous employees, the primary reason for the decrease in County cost between FY1998/99 and FY2001/02 was the strong performance of the stock market in the late 1990s. The increase in County costs between FY2001/02 and FY2004/05 was due in part to the decline in the stock market during this period and in part to the following:

- In 2001, the County approved a change in the safety benefit formula from 2% at 50 to 3% at 50.
- In FY2004/05 the County's safety account was moved by PERS to a pooled fund and a very aggressive amortization schedule for the unfunded liability.

According to the County's actuarial consultants, 10.7% of the County's FY2008/09 employers contribution is due to the County's decision to change the benefit plan from 2% at 50 to 3% at 50. Thus if that discretionary change is factored out, the County's FY2008/09 employers contribution for safety pensions would be 17.2% compared to the FY1996/97 employers contribution of 12.5%.

The County's actuarial consultants have also indicated that the County can consider a normal cost of 15% to 17% of payroll to be representative of on-going safety plan costs after the unfunded liability is paid off (the current amortization schedule provides for full payment of the unfunded liability in roughly 9 years).

The bottom line is that it is likely that the County's safety and non-safety pension costs will increase over the long term because the County's payroll will no doubt grow. However, barring another change in benefit formulae by the County, a change in the County's unfunded liability amortization schedules, or significant and sustained earnings losses at CalPERS, it is likely that pension costs as a percent of payroll will remain roughly the same or even decline over time and the year-to-year fluctuation in cost will be relatively small.

As suggested above, one reason for this is that, over time, the County is scheduled to pay down its current unfunded liability. It is true that the County's unfunded liability could increase if PERS' investment earnings do not keep pace with the assumptions used by PERS' actuaries. Currently, PERS assumes that the pension fund will earn a long-term rate of return of 7.75%. Since market returns vary by year, this means that it is expected that investment gains in years with returns greater than 7.75% will offset investment losses for years with returns less than 7.75%. As an example, over the 13 years listed in the above table, PERS' annual rate of return ranged from a negative 7.2% to a positive 20.1%, but the average annual rate of return was a positive 9.9%.

In addition, starting in 2005 CalPERS introduced changes to the amortization methodology to reduce the volatility of future pension costs and provide for greater rate stability. These changes included:

- Spreading investment gains and losses over 15 years rather than 3 years as had previously been the case. This means that short term volatility of the stock market will not cause short term contribution volatility, as happened in the late 90's and early 2000's. For example, CalPERS' market value investment return for its June 30, 2004, 2005 and 2006 fiscal year ends were 16.7%, 12.7% and 12.3% respectively. Despite this exceptional investment performance, the County's contribution rates remained virtually unchanged due to the 15 year "smoothing."

- Allowing the Actuarial Value of assets to vary further from the market. Prior to this change, the actuarial value of assets could never drop below 90%, or exceed 100%, of the market value. CalPERS' new policy is to expand this range to 80% and 120% respectively. The increased corridor allows short term investment return fluctuations to correct themselves, while the earlier policy required immediate corrections.

- Amortizing gains and losses over a 30 year rolling period rather than including 10% of the unamortized gain and loss balance in the annual cost. This means that, since gains and losses should offset each other over time, contribution rates will be significantly less volatile.

- Requiring a minimum employer contribution equal to the Normal Cost less a 30-year amortization of any surplus. This means that, unlike in prior years, it is highly unlikely the County's contribution rate will drop to zero.

All that having been said, we do not want to imply that we don't think it is important to make every effort to reasonably control employee pension costs. Although employee pension costs constitute less than 10% of the County's overall budget, the amount involved is not insignificant. Regardless of the rate of growth, any cost of doing business ultimately impacts the resources available to the County to provide services. There are a number of tools available to the County to control pension costs, including negotiating with the unions for revised benefit formulae and additional employee cost-sharing. These tools should be used as appropriate.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer. The County has been diligent in proactively working to control pension costs, including negotiating employee cost-sharing agreements with the unions and limiting access to more expensive safety pensions to appropriate job classifications. The County will continue its efforts in this area.

Finding 4.b: The unfunded liability by the County of Napa for pension benefits is $52.5 million.

*Response, County Executive Officer*: The County Executive Officer agrees in part and disagrees in part with this finding. $52.5 million is the unfunded liability for the pension plan for the County's miscellaneous (non-safety) employees.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 4.c: The unfunded liability by the City of Napa for pension benefits is $49.3 million.

*Response, County Executive Officer*: The County Executive Officer neither agrees nor disagrees with this finding. The County Executive Officer defers to the City of Napa to respond to this finding.

*Response, Board of Supervisors:* The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 5: The City needs to budget more funds to more rapidly reduce its unfunded pension liability.

*Response, County Executive Officer*: The County Executive Officer neither agrees nor disagrees with this finding. The County Executive Officer defers to the City of Napa to respond to this finding.

*Response. Board of Supervisors:* The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 6: The consequences of the failure to manage these unfunded pension liabilities can result in tax increases, reduced services and impaired borrowing ability.

*Response. County Executive Officer*: The County Executive Officer agrees with this finding[7]. As the Grand Jury notes, the County's miscellaneous plan is approximately 90.5% funded. The Grand Jury indicates that the Safety Plan is 83% funded, but, as of June 30, 2007, the Safety Pool (in which the County participates) is actually 89% funded. More importantly, as indicated above, the County is pre-funding its unfunded liability on fairly aggressive amortization schedules.

The County has also taken a number of actions to address the impact on the County of potential PERS rate increases, including:

- For miscellaneous employees, in 2005/06, as the County's pension costs started to increase, the County negotiated with the union a reduction of the share of the employees' cost paid by the County. Prior to this agreement, the County paid the full 7% employee contribution. With the new agreement, the County now pays approximately 3.8% out of the total 8% employee contribution.

- For Safety employees, in 2005/06 the County negotiated with the union a cost-sharing agreement. Now, whenever the County's safety rate increases, the County and the employees share equally in the cost of that increase. Conversely, if the County's safety PERS costs decrease, the County and employees share in any cost reduction. Currently, Safety employees are picking up 1.2% of the County's share of safety PERS costs.

- During the first 5 or so years of the 21st century, when the County's PERS costs were zero or close to zero, the County recognized that that the County's fiscal conditions would not always be so positive and set aside some of the savings in a designation for fiscal uncertainties. Further, with the changes PERS made to its amortization practices described in response to Finding 4a above, it is now less likely that the County will experience the significant annual cost increases and decreases of previous years.

Notwithstanding this, we agree that the County needs to continue to aggressively monitor and manage our employee retirement costs as well as employee compensation generally and other cost centers.

*Response. Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

[7] However, it should be noted that that Propositions 13 and 218, for all intents and purposes, prohibit increases in taxes without a majority or two-thirds vote of the people, depending on the nature of the tax involved.

Finding 7: GASB 45 government agencies providing retiree health care and other non-pension retirement benefits must disclose the future and accrued cost of those benefits to the public within the next four years.

*Response, County Executive Officer*: The County Executive Officer agrees with this finding. Effective with the Fiscal Year 2007/08 Comprehensive Annual Financial Report, Napa County will be in compliance with this GASB (Government Accounting Standards Board) requirement.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 8: Government agencies pay more of their compensation in the form of benefits than in the private business sector.

*Response, County Executive Officer*: The County Executive Officer agrees with this finding to the extent it is meant to characterize state and local governments and private sector employees generally, not necessarily the situation with regard to specific individual local government agencies or private sector employers. According to the Employee Benefit Research Institute study cited by the Grand Jury, on the average, benefits comprise approximately 33.5% of total compensation for state and local government employees and 29.4% of total compensation for private sector employees.[8]

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 9: Government entities do not need to provide these high level of pension benefits to attract and retain employees.

*Response, County Executive Officer*: The County Executive Officer disagrees with this finding as it is worded because we do not have sufficient information about compensation and recruitment issues at other local governments to evaluate whether such a broad statement is true or not. And we would contend that the more important question is how the level of pension benefits provided by local governments impacts our ability to attract and retain the best qualified employees.

With regard to Napa County, we must recruit employees within the market conditions that exist in the State for the various County positions. For safety employees (like Sheriff's Deputies), the County is competing primarily against other counties and cities. Over the last 5 to 10 years, 3% at 50 has become the standard retirement formula for safety employees at cities and counties in California. Given that, we believe that if the County were to substantially reduce our safety retirement benefit we could experience recruitment and/or retention difficulties for Sheriff's Deputies and District Attorney

[8] Employee Benefits Research Institute, "Benefit Cost Comparison Between State and Local Government and Private Sector Employers," EBRI Notes, June, 2008, p. 3.

Investigators. Even with the 3% at 50 safety retirement formula, the County has difficulty recruiting qualified Deputy Sheriff candidates.

In the case of miscellaneous employees, the situation is somewhat different. For many management and professional positions the County is also competing against other cities and counties, but there is less uniformity in the market in terms of retirement formulae. Though an enhanced retirement formula (like 2.5% at 55) is common among Napa County's comparator jurisdictions, throughout the State – and for most counties - 2% at 55 is the most prevalent local government retirement formula among jurisdictions contracting with PERS.[9] It is unclear whether reducing the retirement benefit for miscellaneous employees would negatively impact recruitment and retention of these management and professional positions, however, even with the 2.5% at 55 retirement formula the County is having difficulty recruiting for senior management and experienced professionals like doctors, psychologists, nurses, engineers and accountants.[10] This is a difficulty that many employers are now experiencing as the baby-boomer generation retires to be replaced by the generation x cohort which is only approximately half the size. Given all of this, our sense is that the County's pension benefit level could likely be reduced for entry level miscellaneous employees without negatively impacting recruiting effectiveness, but that reducing the pension benefit could possibly negatively impact recruitment and retention of mid-career managers and professionals, for whom retirement issues are more exigent.

Of course, it is important to keep in mind that pension benefits are only one factor in recruiting and retaining employees and it is difficult to evaluate that factor in isolation from other factors.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 10: Having the Board of Supervisors and the City Council negotiate or approve wages and benefits on behalf of themselves, although legally permissible, is a classic conflict of interest.

*Response, County Executive Officer*: With regard to the Board of Supervisors, the County Executive Officer disagrees with this finding as a matter of law, though we acknowledge that an appearance of conflict of interest may exist.

According to County Counsel, the common law doctrine which prohibits conflicts of interest might very well prohibit members of the Board of Supervisors from setting its

[9] The County uses certain agencies as comparators for salary setting and other compensation purposes. These comparator organizations (6 counties and the City of Napa) are agreed to by the County and the unions representing County employees.

[10] For example, it recently took 9 months and two separate recruitments to hire a Principal Transportation Engineer, over 8 months and two recruitments to hire Staff Psychiatrists (and there are still vacant positions), over 7 months to fill two Public Health Nurse positions and the County has conducted three recruitments over a year and a half and not been able to successfully fill the Assistant Chief Probation Officer position.

own salary if there were no other statutory or constitutional provisions involved. But there are statutes and constitutional provisions controlling the manner in which a Board of Supervisors must set its own salary and therefore this mandated process by definition does not constitute a legal conflict of interest.

Prior to 1970 the California Constitution provided that the Legislature was required to provide for an elected governing body in each county (the Board of Supervisors) and was required to prescribe the compensation of its members. However, in 1970 a Constitutional Amendment was proposed and adopted by the people relating to compensation of members of the Board of Supervisors. That Constitutional Amendment provided that in the case of general law counties, like Napa, the Board of Supervisors of each County shall by ordinance prescribe the compensation for its members but such compensation shall be subject to referendum. As a result of that approval by the people, any common law conflict of interest doctrine that may have existed relating to a Board of Supervisors setting its own compensation was abrogated.

Government Code section 25123.5 provides that any ordinance setting supervisorial salaries cannot take effect for 60 days. This provides citizens of a county with a 60 day period to file a referendum on the salary increase. This sixty day period is double the normal period of time during which an ordinance is subject to the referenda process.

The bottom line is that the people of California have specifically directed boards of supervisors of general law counties to set their own compensation level and the members of those boards of supervisors are ultimately accountable for their decisions to the voters through both the re-election process and the referenda process. However, perhaps recognizing that there is an appearance of conflict in setting their own salary, the Napa County Board of Supervisors has, by Ordinance, set their salaries at 47.09% of the salary of Superior Court Judges.[11] Judges salaries are set by the Legislature. Supervisorial retirement benefits, though, cannot be set in the same way. State law requires that all miscellaneous employees in a local government who are hired at the same time receive the same pension benefit formula.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 11: Private sector defined-benefit pensions are a thing of the past, retiree health care is virtually non-existent and wages, on average, are no greater than their public-sector counter-parts.

*Response, County Executive Officer*: The County Executive Officer disagrees with this finding as written either because the claim made by the Grand Jury is not subject to

[11] In 1993 the Board initially set their salary at 34% of the salary of Superior Court judges. In 1999 the rate was increased to 45%. The current rate of 47.09% was adopted in 2005, due to a change in the manner in which compensation must be reported to PERS for retirement purposes. This 2005 increase in the percentage did not increase the gross compensation of the members of the Board of Supervisors.

factual verification or because the Grand Jury has provided little or no evidence to support the claim. Each claim made by the Grand Jury is addressed below:

*"Private sector defined-benefit pensions are a thing of the past:"* Clearly, the number of private sector companies providing their employees a defined benefit pension plan has declined significantly over the last 20 years. However, a sizeable number of private sector employers – particularly larger employers – continue to provide defined benefit pension plans and the rate of decline in the provision of these plans has slowed. Whether this makes private sector defined benefit pension plans a "thing of the past" is a matter of opinion or conjecture.

According to the U.S. Bureau of Labor Statistics (BLS), in 1986 76% of private sector employees were covered by a defined benefit pension plan. In 1997 that number had dropped to 27% and by 2007 the number had declined further to 20%. Among employers with 100 or more employees, BLS data shows a similar trend: in 1997 45% of their employees participated in a defined benefit pension plan, while by 2007 that number had declined to 32%. Nevertheless, this data indicates that in 2006 roughly a third of the employees in medium to large private sector employers continued to be covered by defined benefit pension plans and the number is even higher for the largest private sector employers.[12]

A May 2008 study by Watson Wyatt Worldwide, the international human resources and management consulting firm, indicated that 54% of Fortune 100 companies still offered new employees a defined benefit pension plan and that the decline in such benefit plans had leveled off for these companies. According to Watson Wyatt, "Thanks in large part to the pension reform legislation [the federal Pension Protection Act of 2006] the peak rate of replacing DB [defined benefit] plans with defined contribution-only plans appears to be behind us. In fact, as companies evaluate what the new rules mean for them, we could very well see a renewed commitment to hybrid and other DB plans."[13] Further, some consultants are predicting that employers will reconsider defined benefit pension plans as they try to retain and hire mid-career experienced employees to replace retiring baby boomers.

Finally, it should be noted that almost all private sector employees participate in the Social Security system, which is a form of defined benefit plan.

[12] Data for 1986 is from William J. Wiatrowski, "Comparing Employee Benefits in the Public and Private Sectors," Monthly Labor Review, U.S. Bureau of Labor Statistics, December, 1988, pp 3-8. Data for 1997 is from Ann C. Foster, Private Sector Employee Benefits, 1996-97," Compensation and Working Conditions, U.S. Bureau of Labor Statistics, Summer, 2000, pp 17-22. Data for 2007 is from U.S. Bureau of Labor Statistics, National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2007, U. S., Bureau of Labor Statistics, August, 2007, p. 7. Interestingly, in 2007, 69% of unionized workers in the private sector participated in a defined benefit pension plan, suggesting that part of the decline in the prevalence of defined benefit plans may be related to the decreased rate of unionization in the private sector workforce.

[13] Watson Wyatt Worldwide, "Large Employers Slow Changes to Retirement Plans," Watson Wyatt Worldwide Press Release, May 22, 2008.

" [private sector] *Retiree health care is virtually non-existent:* " This may or may not be true, but the Grand Jury did not provide evidence to support this claim, at least if the term "virtually non-existent" is meant to be taken literally. According to a February 2006 report from the California Legislative Analyst, in 2005 approximately 33% of large U.S. firms provided their employees with some form of retiree healthcare, a decline from approximately 66% in 1988.[14] The Legislative Analyst's report also noted that even companies continuing to offer retiree health benefits have cut costs in some cases, through things like imposing caps, increasing co-payments or establishing defined-contribution plans. A slightly more recent survey, conducted by Mercer Human Resources Consulting and cited in a February 2008 report from the Employee Benefit Research Institute, found that in 2006, 29% of employers with 500 or more employees provided health insurance coverage to early retirees, while 19% provided coverage to Medi-Care eligible retirees.[15]

" [private sector] *wages, on average, are no greater than their public sector counter-parts:* " Comparing national data on average wages between the public and private sectors is difficult because, as the Grand Jury rightly points out in its report, there are significant differences in the composition of the two workforces. For example, a much higher percentage of government workers are employed in occupations that require a high level of education (such as teachers, medical professionals, lawyers) or consist of a high level of danger (such as police officers or firefighters), while a higher percentage of private sector employees are employed in lower-paid occupations such as the service and trade industries. This is certainly true in the case of Napa County: approximately 54% of our 1,300 employees are classified as administrators, professionals or protective service workers (like Sheriff's Deputies and Correctional Officers).

This difference is illustrated by the fact that while the Bureau of Labor Statistics (BLS), reports that the average hourly wage cost for private sector employers in March 2008 was $18.91, compared to an average hourly wage cost for state and local government workers of $24.95,[16] wage costs for the "Management, Professional and Related" occupational group in the public sector averaged $31.54 per hour worked, while those costs in the private sector averaged $33.75 per hour worked; wage costs for the "Sales and Office" occupational group in the public sector averaged $16.13 an hour compared to $15.22 in the private sector; and wage costs for the "Services" occupational group in the public sector averaged $25 an hour compared to $9.93 in the private sector.

As can be seen, the Services group had the largest gap in compensation between state and local government and private sector workers. However, this difference is a function of the type of occupations in the services category: for state and local governments, the BLS categorizes police and firefighters among the service occupations. For private sector

[14] California Legislative Analyst, Retiree Health Care: A Growing Cost for Government," California Legislative Analyst's Office, February, 2006, p 14.

[15] Employee Benefit Research Institute, "The Future of Employment-Based Health Benefits: Will Employers Reach a Tipping Point," EBRI Notes, February, 2008, p 7.

[16] U.S. Bureau of Labor Statistics, "Employer Costs for Employee Compensation – March 2008," News Release, U.S. Bureau of Labor Statistics, June, 11, 2008, pp.8 – 10.

employers, occupations such as waiters/waitresses and cleaning and building services functions are categorized as service occupations.

Given all of the difficulties with these kinds of gross comparisons, we would be reluctant to draw any firm conclusions from just this data. However, when this data is taken together with data comparing Napa County's wage costs for specific positions with private sector wage costs in California, we believe it reasonable to conclude that:

- Generally speaking, senior managers in comparably sized organizations and certain highly skilled and experienced professionals are paid higher salaries in the private sector than the public sector;

- Office and service-type positions (like clerical support, janitorial and maintenance, laborers, etc) and some professional positions are paid higher salaries in the public sector than the private sector; and

- Some public sector positions, like police and firefighters, do not have sufficient private sector comparables and so credible comparisons are not possible.

The following information compiled by the County's Human Resources Division illustrates this point:[17]

[17] This is provided for illustration purposes only. There was some judgment involved in correlating private sector job classifications used by Economic Research Institute with County classifications.

***Executive Level Positions***

***(Private Sector Comparisons-California Statewide All Industries $270 Million Revenue)***

| *Private Sector Title* | *Napa County Match* | *Napa County Top Step (7-1-08)* | *Private Sector-All Incumbent Avg. (7-1-08)* | *Difference* |
|---|---|---|---|---|
| Vice President-Engineering | Director of Public Works | $174,616 | $208,731 | -$34,115 |
| Vice President-Human Resources | Human Resources Director | $151,715 | $238,477 | -$86,762 |
| Vice President-Legal | County Counsel | $191,838 | $293,612 | -$101,774 |

***Staff and Professional Level Positions***

***(Private Sector Comparisons-California Statewide All Industries)***

| *Private Sector Title* | *Napa County Match* | *Napa County Top Step (7-1-08)* | *Private Sector-All Incumbent Most Experience Avg. (7-1-08)* | *Difference* |
|---|---|---|---|---|
| Accountant | Accountant-Auditor III | $77,210 | $64,476 | $12,734 |
| Attorney Corporate | Attorney III-County Counsel | $124,966 | $137,174 | -$12,208 |
| Civil Engineer | Associate Engineer | $96,283 | $91,179 | $5,104 |
| Systems Analyst | Information Systems Specialist II | $81,245 | $87,808 | -$6,563 |
| Maintenance Worker | Maintenance Worker II | $54,392 | $38,711 | $15,681 |
| Psychiatrist | Staff Psychiatrist | $177,923 | $256,675 | -$78,752 |
| Secretary | Secretary | $46,925 | $40,970 | $5,955 |

Source for private sector data: Economic Research Institute

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 12: The average age at which current City of Napa employees retire is 57 years for miscellaneous employees and 52 years for safety employees.

*Response, County Executive Officer*: The County Executive Officer neither agrees nor disagrees with this finding, due to lack of information. The County Executive Officer defers to the City of Napa for a response.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 13: The average age at which current Napa County employees retire is 62 for miscellaneous employees and 57 for safety employees.

*Response, County Executive Officer*: The County Executive Officer disagrees with this finding because we do not have information on the average retirement age for current retirees. Our information is that the average retirement age (for all existing retirees) for miscellaneous employees is 60 and the average retirement age for safety employees is 56.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 14: A defined-contribution plan allows the plan to define the level of contribution that the employer and employee will make.

*Response, County Executive Officer*: The County Executive Officer agrees in part and disagrees in part with this finding, in part because it is not entirely clear what it means. If what the Grand Jury is saying is that defined contribution plans involve a fixed annual contribution by the employer, employee or both, we agree. If the Grand Jury is saying that a defined contribution plan somehow establishes a contribution level without agreement by the employer or, in the case of California local governments, the relevant unions, and that that contribution level cannot be changed over time, we do not agree.

As discussed above, with a defined benefit plan a certain benefit level is guaranteed and the employer and/or employee contribution needed to achieve that benefit level is variable depending on investment earning and actuarial assumptions. With a defined contribution plan, the contribution level is fixed and the benefit level can vary, depending on things like investment earnings. For California local governments, in the case of defined benefit plans, the benefit level (within certain parameters) and the apportionment of the contribution between the employer and employees must typically be agreed to by both the local government and the employee union or unions and can be changed by agreement between the parties. With a defined contribution plan, the overall contribution level and the apportionment of that contribution level between the employer and employees must also be agreed upon by the local government and the employee unions and can be changed by agreement between the parties.

*Response, Board of Supervisors:* The Board of Supervisors concurs with the response of the County Executive Officer.

Finding 15: A defined-contribution plan provides advantages to the employees and reduces the cost of retirement benefits over time.

*Response, County Executive Officer*: The County Executive Officer agrees in part and disagrees in part with this finding.

The County Executive Officer agrees that a defined contribution plan can offer some advantages to employees, though it can also entail certain disadvantages compared to a defined benefit plan. Whether a particular plan feature is an advantage or a disadvantage depends in part on an individual's perspective. The following are two of the main advantages for employees that have been attributed to defined contribution plans as compared to defined benefit plans.

*Portability:* As the Grand Jury's report indicates in Appendix 4 (which includes information provided by the Reason Foundation, a Libertarian think tank), under a defined-contribution plan, it is relatively easy for workers to take their accumulated funds with them when they change jobs. When an employee leaves an employer, both the employer and employee contributions can be cashed out and "rolled over" into a future employer's plan. Under a defined benefit plan, only employee contributions may be cashed out. According to the Grand Jury, this is a major benefit of defined contribution plans given the increasing mobility of the workforce, with workers changing employers frequently throughout their careers.

This would likely not be a major concern for most career California public employees. Since most cities and counties in California either provide their employees pension coverage through CalPERS or another pension system that has reciprocity with CalPERS, employees can move from one public agency to another in California and, essentially, take their pension account with them. For local government employees in California, lack of portability would be primarily an issue for those employees who fail to "vest" in the defined benefit pension plan or who leave public service in the State many years before retirement. Once an employee vests in the plan – the vesting period is 5 years – that employee is then entitled to draw a pension when they reach retirement age, regardless of when they may have left the County's employment. However, if an employee retires many years after leaving public employment in California, the benefit level will likely not have kept up with inflation since it is tied to the last salary the employee was making with the California public employer.

*Investment Choices:* As the Grand Jury's report indicates, within the context of investment choices a defined contribution plan allows employees the freedom to manage their own retirement account and invest their own money. This allows employees to tailor their investment strategy to suit their particular risk tolerance as well as their political, economic or demographic needs or interests.

The potential downside of this is that an employee may fail to prudently invest his or her account and manage withdrawals in a manner that will assure lifetime income. This can be a difficult proposition given the different level of investment savvy among employees, the uncertainty of market returns and the length of a particular retiree's lifetime. Defined benefit plans address these concerns by leaving the investment risk with the employer, who is in a better position to hire competent investment managers to invest fund prudently and efficiently. Recent studies have shown that defined benefit pension plan returns (net of expense) surpassed defined contribution plan returns by 1% to 2% per year. Further, it can be argued, employers are in a better position to deal with longevity risk, since defined benefit plans pool the mortality experience of all participants. Individuals are less able to predict how to invest and withdraw monies from a defined contribution plan account so that it will last a lifetime on an individual basis, though private sector employers have begun to address this concern by experimenting with annuity purchase options in their plans.

With regard to the claim that defined contribution plans reduce the cost of retirement benefits over time compared to defined benefit plans, the County Executive Officer agrees that this is possible, though not a certainty since it would depend on the relative investment performance of the different plans, the employer contribution level provided in either plan and the cost to the employer of administering the different plans. And, for California local governments, those contribution levels would be a matter subject to negotiations with the unions representing local government employees. For example, during the 13 year period discussed in response to Finding 4a above, if, instead of a defined benefit plan, the County had provided employees a defined contribution plan with the employer contribution rate at 17%, the County's costs would have been higher with the defined contribution plan than with the defined benefit plan because employer rates would not have been reduced during the period PERS earnings were so high. Further, since defined contribution plans typically earn a lower rate of return on investments than defined benefit plans, even if employers contributed at the same rate as for a defined contribution plan, benefits paid to retirees would likely be lower. Any reduction in plan cost would likely mean that there would be an additional reduction in benefits paid to retirees.[18]

What is more certain is that defined contribution plans generally provide greater cost stability and predictability for the employer than defined benefit plans. This is because, as noted, defined contribution plans shift the risk to the employee or retiree. However, as also indicated above, this difficulty with defined benefit plans can be somewhat mitigated if the employer or plan adopts certain cost smoothing efforts, as CalPERS has done.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the response of the County Executive Officer.

Recommendation 1: A shift to defined-contribution plans for all new employees of the City and the County be considered as a priority.

*Response, County Executive Officer*: With regard to the City of Napa employees, this recommendation will not be implemented because it is not reasonable. The County has no authority over the type and level of pension benefits provided by the City of Napa to its employees.

With regard to Napa County employees, the ultimate decision as to what policy issues are to be considered a priority for County staff rests with the Board of Supervisors. However, absent direction to the contrary from the Board, this recommendation will not be implemented because it is not reasonable or warranted. We take this position for the following reasons:

[18] Mercer Human Resources Consulting explains why defined contribution plans generally require a higher employer and/or employer contribution to generate the same level of pension benefit as defined benefit plans. See, Mercer Human Resources Consulting, "Defined Benefit Plans: Still a Good Solution?", Mercer Human Resources Consulting, April, 2004, p.2.

- CalPERS does not currently offer a defined contribution benefit plan and therefore if all new employees were to be shifted from a defined benefit to a defined contribution plan those new employees could not be PERS members. State law currently provides that, in order for any employees of a local government to be members of PERS, all employees must be PERS members. Thus, implementing this recommendation would require the County to withdraw from PERS and establish a separate defined benefit pension plan for all existing employees, and presumably one with exactly the same benefit levels. Even assuming the County could reach agreement on this matter with our employee unions, the costs and risks of taking this action would be significant and not warranted in the circumstances.

- In the current local government labor market in California, for the County to unilaterally shift new employees to a defined contribution benefit plan could put us at a significant disadvantage in terms of recruiting and retaining employees, particularly senior managers and experienced professionals. We believe that any move to implement a defined contribution plan in lieu of a defined benefit plan would only be feasible if done on a state-wide basis so that there is a level playing field for all local governments.

- We believe that as a public employer, we have an ethical obligation to provide our employees with a reasonable retirement benefit package – one that provides employees with the means of maintaining their quality of life in retirement. In our view that should include a defined benefit component, though it could also include a defined contribution component. Recognizing that, as indicated above, there are different levels of investment savvy among employees, we do not believe that it is appropriate to shift the entire retirement income risk onto the employee.[19] Further, if properly managed, we do not believe that a defined benefit pension plan need necessarily cost the County more than a defined contribution plan.

That having been said, we agree that it would be appropriate for the County to review the current level of County retiree benefits relative to their adequacy, sustainability, relationship to other local governments and in the context of overall compensation levels. Controlling all County costs is critical for the County to be able to provide adequate service levels within available resources. Thus, it may be appropriate to establish a different retirement benefit level for new employees or to include a defined contribution plan as part of the County's retirement program or to ask the employees to assume responsibility for a greater share of employee or employer pension costs.

[19] A recent study by Ernst & Young, the accounting and consulting firm, found that married couples making $75,000 a year with guaranteed retirement income beyond Social Security, such as defined benefit plans and annuities, have a 31% chance of outliving their assets if they retain their pre-retirement standard of living. Those same couples, with Social Security as their only guaranteed income, have a 90% chance of outliving their assets during retirement. Ernst & Young estimates that, on average, retirement income must be between 59% and 71% of pre-retirement income for a retiree to maintain their pre-retirement standard of living. Ernst & Young, LLP, "Retirement Vulnerability of New Retirees: The Likelihood of Outliving Their Assets," Ernst & Young, LLP, July 2008.

We also believe that the issue of competition for employees that has helped drive escalating pension benefit packages at the local level is best addressed at the statewide level. In many states there is only one miscellaneous benefit package and one safety benefit package available for all government agencies.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the County Executive Officer's response. This recommendation will not be implemented because it is not reasonable or warranted for the reasons outlined in the response from the County Executive Officer.

Recommendation 2: The City of Napa and County of Napa each adopt a resolution stating that it will participate in talks regarding healthcare reform.

*Response, County Executive Officer*: As it relates to the City of Napa, this recommendation will not be implemented because it is not reasonable. The County has no authority with regard to what resolutions the City of Napa may or may not adopt.

With regard to the County, the ultimate decision regarding such policy issues rests with the Board of Supervisors. However, absent policy direction to the contrary, this recommendation will not be implemented because it is not warranted. The rising cost of healthcare is an issue affecting all public and private agencies as well as individuals. The County has a particular interest in this issue not just as an employer, but also as a provider of health care services to the poor and uninsured. The County would certainly be willing to participate in any relevant discussions, but it is not clear what purpose would be served by the Board adopting a resolution stating that the County will participate in talks with unidentified parties concerning this problem.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the County Executive Officer's response. This recommendation will not be implemented because it is not reasonable or warranted for the reasons outlined in the response from the County Executive Officer.

Recommendation 3: A commission or task force be established to recommend and/or to vote on any wage, pension or OPEB for the BOS or City Council.

*Response. County Executive Officer*: As it relates to the City of Napa this recommendation will not be implemented. The County has no authority over how compensation is set for the Napa City Council

With regard to Napa County, this recommendation will not be implemented by the County Executive Officer because it is not reasonable. This is purely a policy matter for the Board of Supervisors.

*Response, Board of Supervisors*: This recommendation will not be implemented by the County because it is not warranted. State law specifies that boards of supervisors are to set their own compensation levels. In Napa County, the Board of Supervisors has, by ordinance, tied their salaries to the salaries of Superior Court Judges. By state law, there can only be one retirement benefit formula for all miscellaneous employees who are employed as of the same date, so it is not possible for the Board to set a pension benefit level different from that of other miscellaneous employees.

Ultimately, responsibility for setting Board compensation levels rests with the Board members, who are directly accountable to the voters for their decisions. It's not clear that inserting a Board-appointed advisory body into the process would result in greater insulation from political influence or enhance the clear line of accountability that currently exists.

Recommendation 4: Both the City of Napa and Napa County review the time period of the OPEB coverage to determine if it could be reduced, e.g., by adjusting the retirement age percent formulas to reflect a 2.5% at 62 instead of age 55 for miscellaneous employees, or to reflect a 3% at 55 instead of age 50 for safety employees, the OPEB liability could be significantly reduced.

*Response, County Executive Officer*: As it relates to the City of Napa this recommendation will not be implemented because it is not reasonable. Napa County has no authority over the City of Napa's policies and practices with regard to retirement or OPEB issues.

As it relates to Napa County, this is ultimately a policy matter for the Board of Supervisors, but, absent policy direction from the Board to the contrary, this recommendation has not yet been implemented but will be implemented in the future.

County staff has already begun the process of reviewing and analyzing various options for addressing OPEB costs, in preparation for the upcoming contract negotiations with the County's unions. For non-safety employees, negotiations are scheduled to begin in February or March of 2009 with the intent of having a new agreement in place by June 26, 2009. For the Deputy Sheriff's union, bargaining will probably begin around June of 2009, with the intent of having a new agreement in place by October 2, 2009.

The issue of the appropriate pension plan formula for miscellaneous and safety employees is not part of the above review, but will be looked at in preparation for this upcoming round of labor negotiations or a subsequent round, as appropriate. Staff believes it is important to look at all aspects of employee compensation to insure that they are at the appropriate level, the costs are sustainable and that they do not create perverse incentives (for example, by encouraging employees to retire too early or to leave the County for jobs with other organizations).[20]

As alluded to above, staff believes that good public policy requires that pension benefits be designed to provide retiring employees with some assurance they can maintain their

[20] It should be noted, though, that the 2.5% at 62 formula suggested in the Grand Jury's recommendation is not a formula that is currently offered by PERS.

quality of life in retirement, but not provide more than is necessary to do that. The County also needs to be concerned about the ability to continue to recruit and retain skilled and experienced staff as well as the cost of benefits specifically and compensation generally. Ideally, the issue of the appropriate retirement formulae available to local governments is one that should be addressed by the Legislature on a statewide basis.

*Response, Board of Supervisors*: The Board of Supervisors concurs with the County Executive Officer's response. With regard to Napa County, this recommendation has not yet been implemented but will be implemented in the future, as described in the above response from the County Executive Officer.