The Sonoma County Pension Crisis

How Retroactive Benefit Increases, Overly Generous Salaries, and Poor Financial Management Have Destroyed the County's Finances

By Ken Churchill

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I. EXECUTIVE SUMMARY

As a result of its overly generous salaries and pension benefits, Sonoma County now has the highest pension debt per capita of any county in California and maybe the nation. And even with all this debt, which stands at over $500 million, the pension fund is underfunded by $380 million and the health insurance fund is underfunded by $250 million. In the last 4 years alone, due to the poor performance of its investments, the unfunded liability has increased by $600 million.

The county is now in such a financial bind it can no longer afford to maintain 84% of its roads and pension costs may double over the next decade unless there the current Board of Supervisors and employees can agree to drastic cuts in salaries and benefits, which they seem unwilling to do.

In an effort to determine how we got here and what could be done to fix the problems, about eight months ago I began requesting and receiving thousands of pages of documents from the County. I have also received and reviewed 10 years worth of pension fund actuarial reports, the documents surrounding the actuarial studies for the cost of the benefit increases, the 400 page County Employee Retirement Law, and the Memorandum of Understandings regarding the pension benefit increases and how they were to be paid for.

When I started this project, I had no idea what I would find. Unfortunately, what I discovered was a system with no checks and balances. A system where laws designed to protect the integrity of the system were changed by union groups and the legislators they support. That when increases in benefits were made the rules were not followed and laws were broken. That the County made the disastrous mistake of retroactively increasing benefits which highly rewarded long-term employees and shifted their additional pension costs onto current and future employees and the County.

I have come to understand that if the pension problem is not solved, we will be turning our County into a place where most of the roads have turned into gravel, where there is no money to maintain or improve infrastructure or keep parks and libraries open, and no money to help those in need. And that as the infrastructure decays, all our property values will decrease along with the tax revenues they generate.

I learned that as a result of the pension benefit increases:

- The unfunded pension liability stands at $380 million as of September 2011. Adding the bond debt, the number is a staggering $895 million. Adding the unfunded $250 million in health care liability, the unfunded liability and bond debt totals $1.14 billion or $6,600 per household.

- And the unfunded liability assumes an investment rate of return of 7.75%. According to a Stanford Study, if the investment performance of the pension fund continues at 4% (near the rate of return of the past decade), Sonoma County's actuarial liability would be over $2.3 billion. Each Sonoma County taxpayers share of that liability is $27,600, an amount that is probably higher than most people have in their own retirement account.

- The County's cost for pensions as a percentage of payroll has climbed from 7.4% in 2002, when the benefit increases were enacted, to 32.6% in 2011, a 440% increase. And if we were fully funding the pensions over the last 10 years the employees and County should have put 43% of payroll into pensions.

- There is no relief in sight because the annual disbursement to retirees of $43 million per year in 2002 has grown to $103 million in 2010, a 230% increase. This number will continue to grow as more people retire earlier at the lower retirement age and enhanced benefit level.

- The average compensation for Sonoma County employees for 2011 will be $127,000 including $82,500 in wages and $44,300 in benefits. This means that Sonoma County employees receive a 153% higher compensation than the average private worker in the United States in 2008 and 87% more than the national average for state and local government workers.

- These compensation numbers do not include the County's cost for the increase in unfunded liabilities due to the investment portfolio not making its assumed rate of return of 7.75%. Over the past 4 years from 2008 to 2011, the investment income has fallen $600 million short of the assumed rate of return. This amount is equals an additional cost to the County of $40,000 per year per employee.

- Sonoma County is the first County in California to have more retirees than employees, and if trends continue, within the next six to eight years there could be almost twice the number of retirees as employees.

In reviewing the County's documents I also learned that the Sonoma County pension system had served County employees well since the 1940's, providing fair pensions, combined with social security benefits. The following rules and policies were in place up until 2000 to ensure the fund had adequate income to pay the promised benefits:

- Only 30% of the fund's assets could be invested in stocks and the earnings were based upon a conservative rate of return of 5%.

- State law capped pension rates at 2% per year of service.

- Retroactive increases to benefits were not allowed.

- Retirement ages were 60 for Safety employees and 65 for General employees.

- The County and the employees shared equally in the funding of the plan, each contributing about 7% of payroll.

- Salaries were reasonable and adjusted annually at about the rate of inflation.

- Pensionable compensation was based upon base, not gross pay.

However, in 1985 the cap on stocks in the investment portfolio was increased to 65% and since 2000, the following changes have been made:

- The pension cap was raised to 3% per year of service, a 50% increase.

- Retroactive pension increases became legal and were immediately enacted.

- Retirement ages dropped to 50 for Safety employees and 60 for General employees.

- The County's pension costs in 2011 are now 32.6% of payroll, an amount that is 2.6 times the 12% average employees now contribute. If you were to fully fund the pensions the percentage of payroll over the past 5 years would be 60% of payroll.

- In the last decade, while the earnings of average Americans have stayed flat and people actually lost purchasing power, Safety employee salaries, the other multiplier in pension funds, have increased by 68%, and General employee salaries have increased by 76%, double the rate of inflation.

- Pensionable salaries now include all compensation including pension contributions, social security contributions, unused vacation pay, hazard and bilingual pay, and uniform allowances.

- The assumed rate of return for investments went as high as 8.5% and now stands at 7.75%. If the assumed rate of return is not met, the County is required to fund the shortfall. Ironically enough, if the County had kept 70% of its money in bonds versus stocks, its compound rate of return over the past decade would have been 7%. However, by gambling on the stock market, with the S&P 5000 gaining only 1.66% in compound returns during the past decade, the County's portfolio only returned 4%.

The Cost of the Benefit Increase

In 2003, Safety employees went to a 3% at 55 formula, in 2004 General employees went to a 3% at 60 formula, and in 2006 Safety employees went to a 3% at 50 formula. The big problem however was that the benefit increases did not begin when they were passed, they were effective retroactively back to the date people were hired. So people who paid into a lower benefit formula made out like bandits if they retired after the benefits took effect.

Essentially, long-term County employees who retired after the increases paid into a 2% per year system and walked away with a 3% per year retirement benefit and transferred the costs so far onto the County.

In the 2002, the County's actuary determined the benefit increase would cost $92 million over 20 years without adding in an amount for accelerated retirements for General employees. And he estimated that if both current and future employees paid an additional employee contribution of 3% of payroll for Safety employees and 3.71% for General employees that 100% of the benefit increase would be paid for by the employees. Those numbers have turned out to be way off and still the Sonoma County Retirement Association and employee unions refuse to have the employee contributions adjusted upward to cover the true costs, leaving the County to cover both the cost of the benefit increase and investment shortfalls.

Unfortunately, since the benefit increases started in 2003, a total of 1823 new retirees and beneficiaries have entered the retirement system and unless there are changes to the rules and they are required to have money taken from their pension checks, their benefit increases will only be picked up the existing and future employees and the County. And since the County due to it's budget situation cannot hire new employees, and current employee unions refuse to increase their contributions, the cost is falling on the County.

So the County has a big problem. The Board of Supervisors never approved having money taken from the General Fund to pay for the benefit increase and the employee contributions are not nearly enough to cover the cost. So far, the County has been paying the additional cost and County management is now claiming that the County can only raise the employee contribution through contract negotiations, even though the County Employee Retirement Law says that the SCERA Board has the power to raise the employee contribution whenever they feel it is necessary. One would have to wonder when they feel that will be or when our Supervisors will insist the employees honor their agreement to pay for the increased benefits.

Pension Obligation Bonds

In 1993, Sonoma County was one of the first counties in the state to issue Pension Obligation Bonds. The first bond was a 20-year bond for $97 million at a 6.75% interest rate. A second bond was issued in 2003 for $210 million at a 4.8% interest rate. A third bond was issued in 2010 for $297 million at a 4.8% interest rate. With principal and interest these bonds have created an $820 million liability for the County.

Article XVI, Section 18 of the California Constitution requires that long-term debt exceeding $300,000 issued by cities and counties be approved by two-thirds of the electorate. However, there are judicially created exceptions to the limit including the "mandated-by-law-exception", which applies to bonds issued to fund an obligation imposed on a local agency by State statute.

The state only required cities and counties provide "reasonable" pensions so many attorneys have argued that since pension benefit levels are set the city or county they are a voluntary liability and not a state mandated expense.

What I learned after reviewing the 2002 Annual Actuarial Study for Sonoma County is that the County was unable to borrow the $210 million in Pension Obligation Bond proceeds unless the pension was underfunded by that amount. So the actuary was instructed to add the cost of the benefit increase into the unfunded liability. Basically, the bond proceeds were used to pre-fund the pension increase, which means they should have required voter approval.

How CERL Was Not Followed in Increasing Benefits

Before increasing benefits, the Sonoma County Employee Retirement Association was required by the County Employee Retirement Law (CERL) in Section 31515.5 to have an enrolled actuary prepare an estimate of the actuarial impact of the salary or benefit increases. The actuarial data is required to be reported to the Board of Supervisors.

To ensure accuracy of the retirement association's estimate, Section 31516 of the County Employee Retirement Law requires the Board of Supervisors to secure the services their own enrolled actuary to provide a statement of the actuarial impact upon future annual costs before authorizing increases in benefits. Future annual costs include, but are not limited to annual dollar increases or the total dollar increases involved, when available. There is not any evidence that the County ever complied with this requirement and hired their own actuary to determine the costs.

CERL also requires that the annual costs as determined by the County's actuary are required be made public at a meeting at least two weeks prior to the adoption of any increases in benefits. Since the Board of Supervisors did not hire their own actuary the annual costs were never calculated nor were any documents discussing the pension increases provided to the public. I have talked with the Press Democrat newspaper and they cannot find anything in their archives about pension increases in 2002. The entire section of CERL requiring this actuarial study was ignored by the Supervisors. Generally speaking, the Supervisors should have been advised of this requirement by the County Council. Why County Council never make this recommendation to the Board of Supervisors if that is the case, requires an investigation.

In addition, the Sonoma County Employee Retirement Association Board in their actuarial study did not follow the actuary's advice and include the cost of accelerated retirements in the cost study for General employees before the increase was approved. From 2000 to 2003 there were a total of 600 people who retired or became new beneficiaries for an average of 150 per year. From 2004 to 2010 there were a total of 1,832 people who retired or became new beneficiaries for an average of 261 people per year, a 74% increase. It is obvious that leaving accelerated retirements out of the cost analysis created an estimate that severely understated the cost. But an underestimated cost appears to be what SCERA wanted, because the County would then be required to pick up the shortfall as has happened.

According to my conversation with Rick Roeder, the SCER's actuary at the time, the SCERA Board could have instructed the actuary to add the cost of the benefit increase into the new employee contribution rate each year as the cost became obvious, but SCERA did not give the actuary that instruction and as a result, the entire cost above the 3% employee contribution has been paid by the County.

The 2005 Annual Actuarial Valuation stated "The glut of recent retirees has been fueled by recent benefit increases. When more people immediately retire than is projected, the impact is an actuarial loss. The actuarial liability for members in pay status (current and retired employees) has increased by a whopping 51% over the past two valuations." So it is very obvious that leaving out the accelerated retirements was in my opinion fraud on the part of SCERA.

The Agreement for Employees to Pay for the Increases

When the Board of Supervisors approved the pension increases in 2002, the Memorandum of Understanding and documents presented to the Board of Supervisors and the public in Board minutes stated clearly that General employees would pay for the ENTIRE prospective and retroactive cost of the 3% at 60 enhancements.

- On the financial summary of SEIU MOU from Board Minutes for May 4, 2005: "The County Board of Supervisors established direction to staff that the marginal increase in costs associated with the "3% at 60" plan be borne by the employees."

- In the resolution between the County and SEIU Local 707 (2002-2008 MOU) board date July 23, 2002: "Retirement: 3% at 60 retirement program effective in the 3rd year. Employees paying for prospective normal cost and past service (retroactive cost), primarily through increased retirement contributions."

- In the Agenda Item Summary Report for the 2003 Pension Obligation Bonds on April 29, 2003: "It should be noted that the additional cost of these negotiated benefits are to be fully paid for by employees starting in July 2004."

It is clear that the 1% being paid by Safety employees and the 3% being paid by the General employees has not been nearly enough to cover the benefit increase. In fact according to County documents, the General employees had a 3.5% pay increase the year the 3% was added to their pension contribution. So essentially the General employees gave up one year's pay increase for a 50% increase in their retirement benefits and the Board of Supervisors let it happen.

Recommended Solutions

The County Civil Grand Jury should be called upon to investigate the pension increase process. If it is determined that the benefit increases cannot be rolled back on legal grounds, the County should implement the following reforms:

1. The first step would be for the Supervisors to hire an independent actuary to determine the exact cost to date and the future costs for the benefit enhancement the employees agreed to pay for. Once the numbers are determined, the employee contribution should be adjusted upward to pay for the increase or the employees should agree to have their pensions rolled back to the pre-increase level.

2. Once that is reconciled, the Board of Supervisors should require the employees and the County to share all future pension costs 50/50. The cost sharing should include contributions to the pension fund, the debt service on the Pension Obligation Bonds and investment gains and losses. And if the County is to remain responsible for investment losses, the fund should be required place 70% of their money into fixed income and stop having the taxpayers guarantee their risky investment portfolio.

3. The Supervisors should also look into what can be done to have the 1,832 employees who have retired since the benefit increase pay for their benefit increase through a deduction from their current retirement check due to the fact that the flawed actuarial and approval process for the increase.

4. The retirement ages for employees should return to 65 for General employees and 60 for Safety employees.

5. The Board of Supervisors should change how pensionable salaries are calculated to eliminate spiking. Averaging the last 3 years of wages would be one solution.

6. All future Pension Obligation Bonds should be required to be approved by the voters.

7. New hires should be enrolled at the old benefit levels or a hybrid plan should be created that includes a smaller defined benefit plan and 401k.

8. New hires should not receive other post employment benefits, such as retiree health care and dental benefits. Post retirement benefits like these are never provided for private pension retirees.

9. The Supervisors should eliminate all cost of living increases for retirees and freeze all salaries unless the plan is debt free with no unfunded liability.

10. The Supervisors should amendment the County's charter to require that all future increases to retirement benefits be approved by a majority of the voters, as is currently required under the City and County of San Francisco's Charter.

11. The Supervisors should immediately freeze all salaries and require the County to perform an evaluation of wages and benefits offered in the private sector in the County and adjust all current and future employee compensation so that it is in line with this standard.

12. The Supervisors should cap retirement benefits at a specific amount per year. Some have suggested $140,000 per year.

13. The Supervisors should create more balance on the SCERA Board by placing reform advocates and financial experts on the Board.

14. The Supervisors should eliminate survivor's benefits. These are better handled by each employee purchasing their own life insurance policy in the amount they feel is appropriate.

15. The Supervisors should eliminate the 5% 401k contribution for managers and 6% 401k contribution for supervisors.

16. The Supervisors should eliminate the 5% increase in salary for managers and supervisors giving 12 months notice before leaving their position. This is also a pensionable benefit and makes no sense.

17. The Supervisors should extend the number of years of service required to qualify for a pension from 10 to 15 or more years.

There seems to be conflicting opinions regarding whether benefits can be changed for existing employees going forward. Hopefully, this issue will soon be clarified by the state. However, we can still start freezing salaries, by increasing employee contributions and enrolling new hires into the old benefit levels or a 401k hybrid plan.

And if the current Board of Supervisors continues to take money from the General fund to pay for the increased benefits to both newly retired and current employees, a lawsuit on the basis that it violates state law because it is a gift or waste of taxpayer funds to pay for retroactive benefit increases that provided no value to the County and were agreed to be paid for by the employees may be necessary.

Who Should be Negotiating Salary and Benefit Increases

Finally, we need to fix the way the system works. At the state, city and county level, generally speaking, union employees in the human resources department negotiate on the behalf of their agency with the various employee unions. Since the people negotiating with the unions are also union members, there is little taxpayer representation at the bargaining table. Elected officials provide final approval of salary and benefit increases and are supposed to represent the interests of the taxpayers. But since unions have gained so much power and political influence, they can intimidate politicians for not going along with the increases; provide financial support for politicians who support their increases and oppose those that don’t.

The Supervisors should solve this problem by creating an employee compensation and pension review board made up of taxpayer representatives, independent legal counsel, and staff members to negotiate with the unions on the County’s and taxpayers behalf before the approvals are submitted to the Supervisors.

II. COMPARISON OF SONOMA COUNTY WITH PRIVATE AND PUBLIC SECTOR COMPENSATION

The Cato Institute performed a study in 2010 that looked at trends in state and local government compensation since 1950. Between 1950 and about 1980, average compensation in the public and private sectors moved in lockstep. But after 1980, public sector compensation growth began to outpace private sector compensation growth, and by the mid-1990s public sector workers had a substantial pay advantage. In the boom years of the late-1990's, private sector workers closed the gap a bit, but public sector pay moved ahead again in the 2000's and is now 35% higher than private sector compensation.

The public sector pay advantage is most pronounced in benefits. Bureau of Economic Analysis data show:

> Average compensation in the private sector nationwide was $59,909 in 2008, including $50,028 in wages and $9,881 in benefits.
>
> Average compensation for state and local government workers across the United States was $67,812 in 2008, including $52,051 in wages and $15,761 in benefits.

The Cato Institute study also determined that private sector workers worked an average of 12% more hours per year than public sector workers, 2050 hours versus 1825.

So how do these numbers compare with average compensation for Sonoma County employees? The average compensation for Sonoma County employees for 2011 will be $127,000 including $82,500 in wages and $44,300 in benefits. This means that Sonoma County employees receive a 153% higher compensation than the average private worker in the United States in 2008 and 87% more than the national average for state and local government workers.

When you look at hours worked, the average pay and benefits per hour nationwide for private sector workers is $29.22 per hour, while Sonoma County employees receive over double that amount, an average of $69.58 per hour.

These numbers do not include the County's cost for the increase in unfunded liabilities due to the investment portfolio not making its assumed rate of return of 7.75%. Over the past 4 years from 2008 to 2011, the investment income has fallen $600 million short of the assumed rate of return. This amount is equal to about $40,000 per year per employee.

Comparison of Federal Government and Sonoma County Pensions

Federal employees receive 1% of the highest 3-year average pay per year of service. The retirement age is 62 with 5 years of service, 60 with 20 years of service and 55 with 30 years of service. Federal employees contribute 7% of pay to their retirement. They also receive Social Security.

Sonoma County General employees receive 2% of pay per year of service if they retire at 50, 2.5% per year of service if they retire at 55 and 3% per year of service if they retire at 60 (3 times the Federal level). To qualify for a pension, county workers only need 10 years of service, no matter what their retirement age. To retire at 60, a Federal employee needs 20 years of service or twice the County amount. County employee's retirement pay is based upon their highest single year of pay (usually their last year) versus an average of the highest 3 years for Federal employees. This enables Sonoma County employees to spike their final years pay. County employees contribute 12% of pay to their retirement, versus 7% for Federal employees. County employees also receive Social Security benefits.

Comparison of Sonoma County with Other California Counties

It is noteworthy that only 3% of California public non-safety workers receive the 3% times years of service retirement factor at 60 years of age that Sonoma County employees receive.

Most counties in California pay Safety employees 3% at 50, but for General employees there is a very large range of ages where benefits reach their maximum and a variety of maximum percentages.

Of all the counties in California, Trinity County pays the highest retirement benefit for General employees of 3% at 55.There are 5 counties in the next highest benefit level, Sonoma, San Diego, Riverside, Kern, Merced and Colusa that pay a 3% at 60.

Nine counties, Mono, Sierra, Mariposa, Sutter, Humboldt, Nevada, Orange, Solano, Madera pay 2.7% at 55. Six counties, Napa, Fresno, Yolo, Placer, Santa Clara, and Glenn that pay 2.5% at 55

Twenty eight counties, Lassen, El Dorado, San Luis, San Luis Obispo, Marin, Siskiyou, Contra Costa, Tuolumne, Alpine, Amador, Butte, Calaveras, Del Norte, Inyo, Kings, Lake, Modoc, Monterey, Plumas, San Benito, San Bernardino, San Joaquin, San Mateo, Santa Cruz, Shasta, Stanislaus, Tehama, and Yuba pay 2% at 55

Three counties, Mendocino, Santa Barbara, and Tulare pay 2% at 57 and the lowest are Imperial at 1.95% at 55, San Francisco at 2.3% at 62, Ventura at 2% at 61.5, Los Angeles 2% at 61 and Alameda 2% at 62.

III. HISTORY OF PENSION INCREASES IN CALIFORNIA AND SONOMA COUNTY

Senate Bill 400 – How California's Pension Crisis Began

Senate Bill 400 was enacted in 2000 and was sponsored by the California Public Employees Retirement System (CalPERS). It raised the pension formula from 2% per year to 3% per year for state Safety employees and reduced their retirement age to 50. The bill was signed into law by Governor Gray Davis, a politician who received hundreds of thousands of dollars in campaign contributions from the state employee unions. The bill passed the State Assembly with 70 votes in support and 7 votes against and passed the State Senate with 39 votes in support and 0 votes against.

When SB 400 was drafted, there were three actuary's estimates provided for the long-term cost to the state. The lowest, the one selected for use in the bill, estimated the cost to the state would be about $379 million per year. However, the actual cost was $4 billion in 2009, $3.1 billion in 2010 and is estimated to be $3.5 billion in 2011. So the average cost over the past 3 years is $3.5 billion, or almost 10 times the estimated cost in the bill. The highest actuarial estimate, which used a lower rate of investment return and was not provided to lawmakers, actually ended up being the true cost of the bill. This demonstrates the risk of presuming a certain rate of return for investment income when calculating the cost of enhancements to retirement benefits.

The Domino Effect

Once SB 400 passed, unions went to cities and counties; including Sonoma County and told legislators that if they did not provide their Safety employees with benefits similar to the new 3% at 50 level, they would lose a large number of their current personnel to state agencies. Local politicians fell for this tactic and started raising pension multipliers and lowering retirement ages for Safety employees in cities and counties throughout the state.

Seeing what Safety employees had accomplished, other employee associations sponsored similar legislation that paved the way for them to receive higher pension benefits retroactively, and retire at an earlier age. In 2000, under Senate Bill 1696, retroactive pension benefit increases became legal for California counties. In 2001, under Senate Bill 616, the pension formula cap was increased by 50% from 2% to 3% per year. These two laws effectively paved the way for Sonoma County and other counties throughout California to retroactively raise pensions to 3% per year of service. However, Sonoma County was only one of six counties to provide General employees with a formula as high as 3% at 60.

How Public Employee Salaries and Retirement Benefits are Negotiated and Approved

At the state, city and county level, generally speaking, union employees in the human resources department negotiate on the behalf of their agency with the various employee unions. Since the people negotiating with the unions also belong to unions, there is little taxpayer representation at the bargaining table. Elected officials provide final approval of salary and benefit increases and are supposed to represent the interests of the taxpayers. But since unions have gained so much power and political influence, they can intimidate politicians for not going along with the increases; provide financial support for politicians who support their increases and oppose those that don't.

In some cases, legislators may be voting to approve their own pensions when they increase General employee pension benefits, which was the case in Sonoma County when the Board of Supervisors increased benefit levels for General employees in 2002.

The True Cost of the Increases over the past 7 Years

Many County employees and SCERA Board members claim most of the unfunded liability problems were caused by the stock market crash in 2008. However this chart shows that is not the case. As the chart indicates:

- Even though employee contributions were increased by 3% to pay for the benefit increase, it amounts to only $54 million over the past 7 years. During this period, disbursements increased by over $225 million or 4 times the amount paid into the system by the employees

- As a result of higher benefit levels and lower retirement ages, the number of new retirees has almost doubled from and average of 97 per year before the increase to 176 after, causing people who contributed to the system to become collectors from the system.

Year	**Changes**	**Covered Payroll**	**Additional Employee Contribution**	**Disbursements to Retirees**	**Increase over Previous Year**	**# New Retirees**	**Disbursement Increase over the year 2002**
2000		$197,231,000		$35,807,465		116	
2001		$227,585,000		$40,949,621	$5,142,156	109	
2002		$251,946,000		$43,890,371	$2,940,750	80	
2003	3% at 55 for Safety 7/01	$260,347,000	$2,603,470	$51,604,881	$7,714,510	52	$7,714,510
2004	3% at 60 for General 6/22	$253,025,000	$5,060,500	$53,368,598	$1,763,717	223	$9,478,227
2005		$265,248,000	$7,957,440	$65,511,380	$12,142,782	217	$21,621,009
2006	3% at 50 for Safety 2/01	$273,548,000	$8,206,440	$69,944,932	$4,433,552	156	$18,340,051
2007		$292,772,000	$8,783,160	$78,661,885	$8,716,953	187	$34,771,514
2008		$334,391,000	$10,031,730	$68,583,023	$(10,078,862)	117	$24,692,652
2009		$322,484,000	$9,674,520	$93,175,322	$24,592,299	171	$49,284,951
2010		$323,601,000	$9,708,030	$103,271,476	$10,096,154	210	$59,381,105
Total			**$54,361,320**	**$704,768,954**			**$225,284,019**

Salary Increases

Since the final year's salary is the other pension multiplier it is a very important factor in determining the final pension amount so I evaluated the salary increases over the past decade. As the table below indicates, the average salary for General employees in Sonoma County increased by 68% from $48,948 in 2000 to $82,360 in 2010 for an average increase of 4.9% per year, double the rate of inflation.

The chart also shows that the average salary for Safety employees in Sonoma County increased by 77% from $56,101 in 2000 to $99,204 in 2010 for an average increase of 6% per year.

Year	Covered Payroll	Average Salary General	Percent Increase General	Average Salary Safety	Percent Increase Safety
2000	$197,231,000	$48,948	5.2%	$56,101	7.0%
2001	$227,585,000	$52,132	6.5%	$59,007	5.2%
2002	$251,946,000	$55,473	6.4%	$62,630	5.4%
2003	$260,347,000	$58,991	6.3%	$65,630	5.5%
2004	$253,025,000	$58,759	-0.3%	$68,353	4.1%
2005	$265,248,000	$60,741	3.3%	$71,525	4.6%
2006	$273,548,000	$63,237	4.1%	$72,485	1.3%
2007	$292,772,000	$67,353	6.5%	$75,767	4.5%
2008	$334,391,000	$78,110	16.0%	$86,847	14.6%
2009	$322,484,000	$77,619	-0.6%	$95,008	9.4%
2010	$323,601,000	$82,360	6.1%	$99,204	4.4%
		Average	**4.9%**	**Average**	**6.0%**

IV. SONOMA COUNTY PENSION FUND FINANCIAL PERFORMANCE

The numbers speak for themselves. The decision to increase pension benefits has been a very costly one for Sonoma County and their financial impact has far exceeded the estimated cost presented to the Board of Supervisors before they agreed to the increase. That plan was for the increases to be completely paid for through an increase in employee contributions, not an increase in County contributions. As the chart below indicates, the employee contributions went from 7.31% in 2002 to 11.71% in 2011, while the County's contribution with the Pension Obligation Bond debt service added in went from 10.8% in 2002 to 32.6% in 2011. So the question is, why did the County's pension cost triple since the increase and the employee contributions stay the same, when the employees were supposed to pay for the increase?

In 2000, pension costs to the County were $21 million, and for the next 2 years, the County's costs increased by about $3 million per year. From 2003 to 2010, after the increased benefits in 2003, 2004 and 2006 kicked in, the County paid a total of $574 million in pension costs for an average of $63 million per year, triple the 2002 amount. The estimated cost for the County for 2011 when the Pension Obligation Bond debt service is added in is $107 million, five times the amount the County paid in 2000.

Year	County Pension Contribution	Percentage Of Payroll	County Pension Debt Service	Total County Contribution	Percentage Payroll with POB
2000	$13,565,990	6.9%	$7,962,000	$21,527,990	10.9%
2001	$15,676,915	6.9%	$8,281,000	$23,957,915	10.5%
2002	$18,656,108	7.4%	$8,672,000	$27,328,108	10.8%
2003	$21,443,500	8.2%	$14,387,000	$35,830,500	13.8%
2004	$22,812,696	9.0%	$21,820,000	$44,632,696	17.6%
2005	$24,993,498	9.4%	$23,124,000	$48,117,498	18.1%
2006	$29,370,771	10.7%	$24,078,000	$53,448,771	19.5%
2007	$34,272,865	11.7%	$25,286,000	$59,558,865	20.3%
2008	$38,552,971	11.5%	$26,556,000	$65,108,971	19.5%
2009	$47,576,576	14.8%	$27,881,000	$75,457,576	23.4%
2010	$48,425,700	15.0%	$36,307,000	$84,732,700	26.2%
2011	$60,519,000	18.7%	$47,063,000	$107,582,000	32.6%

The Retroactivity Problem

The majority of the cost increase was caused by several factors, the 68% increase in General employees salaries over the past decade, the 77% increase in salaries for Safety employees, the doubling of the rate of retirements from 97 to 176 per year, the 50% increase in benefits, and the retroactive nature of the benefit increase back to the date of hire.

Here is the problem with retroactive benefit increases according to David Kehler, Plan Administrator of the Tulare County Employee Retirement Association

"Many plan sponsors have taken on much of the employee cost of retirement obligations through granting retirement benefit formula improvements on a retroactive basis. <u>Doing so allows a significant number of employees to receive large increases in benefits at only a fraction of the cost that would have normally been charged to the plan members had the higher formulas been in place throughout the length of the employees' careers.</u> Under such conditions, the plan sponsor has really only two options for financing the increased pension costs: take them on as an obligation of the plan sponsor, or pass them on to new employees. Higher contribution rate increases may be sustainable during periods of economic growth, but when pension rates increase during periods of economic decline, other government services can suffer as the plan sponsor struggles to meet its pension promises to employees. Passing along contribution rate increases to newly hired employees can allow many current employees to retire without paying their "fair share" of the pension benefit costs."

What David Kehler described above is exactly what has happened in Sonoma County. Essentially, long-term County employees who recently retired paid into a 2% per year system and walked away with a 3% per year retirement benefit.

> Here is an example of the retroactivity problem: Let's say a General employee retires at 60 with a $100,000 salary and 30 years of service in 2007. Under the pre-2006 level they would be entitled to 60% (2% x 30) of their salary or $60,000 per year in retirement. Under the new 3% at 60 formula, this person is entitled to 90% of their salary (3% x 30) or $90,000 per year. Since this person worked for 1 year after the benefit increase, they paid in 3% of their salary or $3,000 towards the enhancement. However, they are receiving an additional $30,000 per year in retirement even without their cost of living increase. If this person lives until 75 and receives checks for 15 years, they will collect an additional $450,000 in benefits and would have only paid $3,000 towards them. This does not include the benefits that would be paid to a surviving spouse upon the death of the employee, which is 60% of the employees benefit amount.

Another way to Look at the Cost

In the 2002 Annual Actuarial Study the County's actuary determined the benefit increase would add $163 million to the pension funds unfunded liability ($210 million - $47 million). In 2004 when the benefit increase kicked in, there were 3,406 county employees. If you divide the $163 million by the 3406 employees, each employee's share of the $163 million in principal is $47,856. So the typical employee would have to work 16 years to contribute that amount to the fund at $3,000 per year.

If you add the interest charge of 4.8% on the bonds, the total interest and principal obligation to the County grows to $523 million or $153,552 per employee. This means an employee would have to work 51 years to pay off the principal and interest on the bonds at with their additional 3% of salary contribution.

The Cost Impact System-wide

To determine what the cost impact has been on a system-wide basis I analyzed the SCERA Annual Actuarial Valuations from 2000 to 2010. They provide a good picture of what is going into the retirement fund from county and employee contributions and investment income, and what is going out to retirees in the form of disbursements. Here is what my analysis determined:

1) From 2003 to 2010 the annual valuations indicated the County contributed a total of $267.5 million for an average of $33.4 million per year.

2) The employees contributed a total of $249.6 million to the fund for an average of $31.2 million per year.

3) The fund received a total of $633.5 million in investment income for an average of $79.2 million per year.

So contributions and investment income totaled $1.15 billion from 2003 to 2010 for an average of $143.8 million per year. What went out of the fund in the form of disbursements to retirees was $584 million for an average of $73 million per year. The difference is a surplus to the fund of $566.4 million or $70.8 million per year.

So you would think with an additional $70 million going into the fund each year the unfunded liability would be shrinking correct? Well you would be wrong. Even with this surplus, because of the long-term effect of the increased salaries, retirement formula, and accelerated number of retirements, the fund required $500 million in new Pension Obligation Bond funds and even with this additional funding, the unfunded pension liability increased from $47 million in 2002 to $380 million as of September of 2011. And this unfunded level is still understated because SCERA went from a 13-year amortization of the fund to a 20-year amortization and smoothed the investment losses by averaging them over a 5-year period carrying the $500 million in investment losses in 2008 into 2009, 2010, 2011 and 2012.

The Accelerated Number of New Retirees

From 2000 to 2003 there were a total of 600 people who retired or became new beneficiaries for an average of 150 per year. From 2004 to 2010 there were a total of 1,832 people who retired or became new beneficiaries for an average of 261 people per year, a 74% increase.

The 2005 Annual Actuarial Valuation stated “The glut of recent retirees has been fueled by recent benefit increases. When more people immediately retire than is projected, the impact is an actuarial loss. The actuarial liability for members in pay status (current and retired employees) has increased by a whopping 51% over the past two valuations."

These two facts prove that when SCERA ignored the actuary's recommendation for adding the cost of accelerated retirements into the estimated cost, as described in Chapter VII, the cost of the benefit was significantly understated to the Board of Supervisors. Had the accurate costs been presented, the benefit increase may not have been approved, or approved with additional employee contributions.

It is my opinion that SCERA presenting these numbers as the actual cost and ignoring the actuaries' advice to add them is fraudulent behavior that needs to be dealt with the Board of Supervisors or Civil Grand Jury.

Distributions to Retirees Up 635% Over 18 Years

The annual pension distributions from the fund are soaring as a result of the benefit increases. From 1992 to 1996, the average distribution to retirees was $18 million per year. From 1997 to 2002, the average climbed to $33 million. From 2003 to 2006, the average climbed to $60 million and from 2007 to 2010, the average climbed to $86 million per year.

Year	Pension Distribution	Increase	Percent
1992	$14,432,361		
1993	$17,927,130	$3,494,769	24.2%
1994	$17,466,459	-$460,671	-2.6%
1995	$19,269,947	$1,803,488	10.3%
1996	$21,986,217	$2,716,270	14.1%
1997	$23,185,945	$1,199,728	5.5%
1998	$25,994,238	$2,808,293	12.1%
1999	$30,167,000	$4,172,762	16.1%
2000	$35,807,465	$5,640,465	18.7%
2001	$40,949,621	$5,142,156	14.4%
2002	$43,890,371	$2,940,750	7.2%
2003	$51,604,881	$7,714,510	17.6%
2004	$53,368,598	$1,763,717	3.4%
2005	$65,511,380	$12,142,782	22.8%
2006	$69,944,932	$4,433,552	6.8%
2007	$78,661,885	$8,716,953	12.5%
2008	$68,583,023	-$10,078,862	-12.8%
2009	$93,175,322	$24,592,299	35.9%
2010	$103,271,476	$10,096,154	10.8%

In 2003, the average starting individual pension was $22,468 and in 2004 the average starting pension, due to the retroactive increase was $37,715 for a total increase of 67% over a single year. And that number has continued to grow. The average starting pension for new retirees in 2010 has hit $47,000, over double the 2003 amount.

Employee and Employer Contributions

Up until 2003, pension costs were shared almost equally between the employee and employer, but that is certainly not the case today. General employees in 2010 contributed 12.17% of their salary to the retirement fund, while safety employees contributed 12.29%. The County's 2011 pension contribution is going to be 17.11%. The County's debt service in 2011 is going to be $47 million on its Pension Obligation Bonds or 15.5% of payroll for a total pension cost to the County of 32.6% or 2.7 times the employee contribution. In addition, the County is responsible for funding the investment shortfall which has hit an average of 46% of payroll over the past 4 years.

But it gets even worse. The County also contributes 5% of salary to manager's 401k accounts and 6% of salary to supervisor's 401k accounts. So the total contribution for managers and supervisors with their 401k contributions is 37.6% and 38.61% respectively, triple the 12% they are contributing.

The chart below demonstrates how the employee's contributions have increased by 155% over the past 11 years, while the County's contributions have increased by 350%. These numbers do not include the additional costs the County is incurring as a result of underperformance of the funds investment which is over $600 million in the last 5 years alone. The numbers are in thousands.

Year	Employee Contribution	Employer Contribution	Pension Bond Debt Service	Total Employer Contribution
2001	14,822	15,677	8,281	23,958
2002	18,428	18,656	8,672	27,328
2003	20,006	21,364	14,387	35,751
2004	25,332	22,857	21,820	44,677
2005	30,579	24,993	23,124	48,469
2006	32,235	29,391	24,078	53,469
2007	32,751	34,283	25,286	59,569
2008	34,109	38,553	26,556	65,109
2009	37,337	47,576	27,881	75,457
2010	37,322	48,461	36,307	84,768
2011	37,892	60,519	47,063	107,582

Comparison of Sonoma with Tulare County

It is difficult to determine exactly what the enhanced benefits are costing Sonoma County since salaries, investment returns, number of retirees and benefit levels are all part of the equation. One way to estimate the economic affect of the benefit enhancement was to find a County similar in size to Sonoma County who did not increase their benefits to 3% at 60 for General employees. As it turns out, Tulare

County provides a very good comparison because it has 11% more employees than Sonoma County and both counties are governed by the same County Employee Retirement Law of 1937 and both counties have gone through the a drop in investments. However, there are two major differences between Tulare County and Sonoma County. First, Tulare County has controlled salaries and secondly, they never increased their pension costs to the higher benefit formula. The table below compares what has happened with both counties pension plans. The data source is the Annual Actuarial Reports for 2010 for both Counties.

- Sonoma County has 11% fewer employees yet its payroll is 48% higher than Tulare's.
- Sonoma County employees are paid 62% to 68% more than their Tulare County counterparts.
- In 2010, Tulare County is contributing what Sonoma County was contributing in 2002 before the benefit enhancements, about $30 million per year.
- Because Sonoma County has had to take on debt to cover its pension obligations, Sonoma County has 13 times the pension debt and 13 times the annual debt service of Tulare County.
- With the debt service for Sonoma County now reaching $47 million per year plus the $48 million pension contribution, Sonoma County is paying $95 million per year in pension costs, over 3 times the $30 million Tulare County is paying.
- Even though Sonoma County has double Tulare's assets in their investment fund, $1.7 billion versus $833 million, due to accelerated retirements, their 65% higher salaries and enhanced benefit formula, Sonoma County has 6 times the unfunded liability of Tulare County, $128 million versus $845 million.

	Tulare County	**Sonoma County**	**Difference**	**Percent**
# of Safety Employees	828	729	-99	-12%
# of General Employees	3413	$ 3,051	-362	-11%
Total # of Employees	4241	$ 3,780	-461	-11%
Total Payroll	$ $217,811,354	$ 322,483,489	$ 104,672,135	48%
Average Salary – General	$ 48,934	$ 82,360	33,426	68%
Average Salary – Safety	$ 61,350	$ 99,204	$ 37,854	62%
Employee Contribution	$ 16,778,000	$ 37,321,820	$ 20,543,820	122%
Employee Contribution % of Payroll	7.8%	11.5%	3.73%	48%
Employer Contribution	$ 26,992,000	$ 48,425,700	$ 21,433,700	79%
Employer Contribution % of Payroll	12.39%	15.02%	2.63%	21%
Total Amount of POB's	$ 41,460,000	$ 596,632,000	$ 55,172,000	1339%
POB Debt Service	$ 3,283,404	$ 47,063,000	$ 43,779,596	1333%
Employer Contribution w/ Debt Service	$ 30,275,404	$ 95,488,700	$ 65,213,296	215%
Contribution & Dept Service % Payroll	13.90%	26.17%	12.27%	88%
Retired Participants and Beneficiaries	2181	3780	1599	73%
Benefit Payments to Retirees	$ 46,073,059	$ 103,271,476	$ 57,198,417	124%
Market Value of Assets	$ 833,327,605	$ 1,751,870,332	$ 918,542,727	110%
Market Value of Assets w/o POB Funds	$ 791,867,605	$ 1,155,238,332	$ 63,370,727	46%
Unfunded Liability	$ 86,570,284	$ 248,568,000	$ 61,997,716	187%
Unfunded Liability w/o Bond Contribution	$ 128,030,284	$ 845,200,000	$ 717,169,716	560%

V. PENSION OBLIGATION BONDS

In 1993, Sonoma County was one of the first counties in the state to issue Pension Obligation Bonds. The first bond was a 20-year bond for $97 million at a 6.75% interest rate. A second bond was issued in 2003 for $210 million at a 4.8% interest rate. A third bond was issued in 2010 for $297 million at a 4.8% interest rate. With principal and interest these bonds have created an $820 million liability for the County.

Using Pension Obligation Bonds as a means of financing pension liabilities allows the plan sponsor the opportunity to utilize interest rate arbitrage – similar to a consumer who transfers a credit card balance from a high-rate card to a lower rate card – to reduce costs. For the pension plan, the infusion of capital resulting from the bond proceeds increases plan assets and improves the plan's unfunded status.

However, according to David Kehler, Plan Administrator for Tulare County there are three concerns with Pension Obligation Bonds:

First, there is no guarantee that the returns on the investments of the bond proceeds will meet the investment assumption rate of the retirement plan. As a result, the plan sponsor's efforts to "pay off" the unfunded liability may fall short. While it is entirely possible that using POB's may ultimately prove to be a wise decision by the issuer, the plan sponsor must fully understand that this outcome will be determined in large part by how the bond proceeds are invested and how well those investments perform.

The second problem is connected to the confusion that exists with understanding the funded ratio of the plan. The proceeds from the POB's once placed in the plan will reduce the unfunded liability of the plan, but because the cost of the bonds are not included in the plans underfunded status, a confusion is created for policy makers, plan members, taxpayers and other interested parties because the unfunded liability is understated.

The third problem is that as the funded status of the plan improves with the use of the POB's, so does the possibility that there will be a demand by plan members for increases to levels of retirement benefits. As a result, a better gauge for the health of a plan is to show the unfunded liability as the total obligations carried by the plan sponsor necessary to meet the pension liabilities of plan benefits.

A fourth problem is because bonds are paid back over 20 years; they stretch out the unfunded liability and push the payback obligation onto future generations.

Sonoma County's Pension Obligation Bonds

All four of the above concerns have become a reality for Sonoma County. First, the investment returns over the past decade have averaged 4%, an amount lower than the interest rate being paid by the County on the bonds and half the 8% investment returns the plan is based upon. The pension fund currently shows a $245 million unfunded liability at the end of 2010, however, due to stock market losses in 2011 the fund has a $380 million unfunded liability as of September. The unfunded status is actually $980 million when the POB debt is taken into account. Finally, the POB debt, which lowered the unfunded liability and shifted it to the county's balance sheet, helped plan members obtain the benefit increases in 2003, 2004 and 2006. In fact, as described below, the pension bonds issued in 2002 were used to pre-fund the pension benefit increase.

Voter Approval Requirement

Article XVI, Section 18 of the California Constitution requires that long-term debt exceeding $300,000 issued by cities and counties be approved by two-thirds of the electorate. There are judicially created exceptions to the limit including the "mandated-by-law-exception", which applies to bonds issued to fund an obligation imposed on a local agency by State statute.

So the question of voter approval depends on whether you consider Pension Obligation Bonds obligations imposed by the state or liabilities Counties and Cities, who set their own pension benefit levels they create for themselves. My opinion and also the opinion of attorneys I have talked with is that because they are a voluntary obligation the County imposed on themselves, Pension Obligation Bonds should require voter approval.

What I learned after reviewing the 2002 Annual Actuarial Study for Sonoma County is that the $210 million in Pension Obligation Bond proceeds were used to pre-fund the pension increase and obviously not due to a state mandated expense.

Here is what the County's actuary said in the comment section of his 2002 actuarial study:

"The County is planning to issue a Pension Obligation Bond (POB) later this Spring. We were asked to calculate what the level of accrued liabilities is using Basis #4 (the new benefit levels). The rationale for this approach is that bond counsel has opined that all contractually negotiated benefit increases, even if not in place for this year, could be considered in determining the maximum bond issuance. Legally, the bond issuance cannot exceed the amount of System unfunded liability at the time of issuance."

"We have calculated a discounted unfunded actuarial liability of $209,599,293 as of May 1, 2003 and $210,836,103 as of June 1, 2003. The "discounting" takes into consideration that the General benefit increase does not occur until mid-2004 and the safety increase does not occur until mid-2006."

So what happened is the County borrowed the money to pay for their benefit increase, not to reduce the unfunded liability which stood at the end of 2001 at $47 million.

Several questions come to mind:

> How was this having the employees pay for the benefit increase when the bond debt service is being paid for the by County?
>
> Shouldn't the employees versus the county be paying for the debt service on the bond money being used to pay for their retirement benefit increase?
>
> If the money is being used to pre-fund the benefit increase, how is a voter approval not required?

These are all questions the taxpayers of Sonoma County deserve answers to.

This chart below shows the County's Cost for Pension Obligation Bond Debt Service. These numbers were taken from the County's budget. These costs will continue until 2030 when the final bonds are paid off.

Year	Amount
1995	$6,329,000
1996	$6,599,000
1997	$6,917,000
1998	$7,247,000
1999	$7,596,000
2000	$7,962,000
2001	$8,347.000
2002	$8,756,000
2003	$9,179,000
2004	$23,669,000
2005	$22,412,000
2006	$23,552,000
2007	$24,739,000
2008	$25,990,000
2009	$27,291,000
2010	$36,307,000
2011	$47,063,000
2012	$48,580,000
2013	$52,828,000
2014	$40,506,000
2015	$42,600,000

VI. SONOMA COUNTY PENSION BENEFIT INCREASE PROCESS

Before increasing benefits, the Sonoma County Employee Retirement Association was required by the County Employee Retirement Law (CERL) in Section 31515.5 to have an enrolled actuary prepare an estimate of the actuarial impact on the salary or benefit increases. The actuarial data is required to be reported to the Board of Supervisors.

To ensure accuracy of the retirement association's estimate, Section 31516 of the CERL requires the Board of Supervisors to secure the services of their own enrolled actuary to provide a statement of the actuarial impact upon future annual costs before authorizing increases in benefits. Future annual costs include, but are not limited to annual dollar increases or the total dollar increases involved, when available.

Under the law, the annual costs as determined by the County's actuary are required be made public at a meeting at least two weeks prior to the adoption of any increases in benefits.

Basically, none of these requirements were followed in increasing the benefits. According to documents I reviewed, in 2002, SCERA asked their actuary Rick Roeder of Gabriel, Roeder & Smith (GRS), to provide cost estimates for the enhanced benefits for Safety and General employees and this is what I learned.

Safety Employee Actuarial Benefit Enhancement Study

Mr. Roeder estimated the cost impact of a 3% at 50 benefit formula for Safety employees including retroactivity with and without Accelerated Retirements (AR) and with AR amounts advocated by another actuary John Bartel (JB). The analysis was also based upon only the CURRENT employees paying for their increased benefit. The estimated costs outlined in the letter were as follows:

Based on 2001 Actuary Report	Liability Increase	Net Contribution Increase
3% at 50 no Accelerated Retirement	$18,542,937	6.96% of payroll
3% at 50 with Accelerated Retirement	$22,578,745	8.51%
3% at 50 with AR advocated by JB	$25,182,565	9.48%

According to the analysis, if current Safety employees paid for their retroactive benefit increase, they would have had their contribution increased by 9.48%, from 7.31% to 16.79% of payroll to cover the increased benefit cost. Later, SCERA asked Rick Roeder what the cost would be if all CURRENT and FUTURE Safety employees had their contributions increased and his estimated cost dropped to just 3.71% of payroll. However, it required employees who had not even been hired yet, to pay for the retroactive pension increase of their predecessors. In addition this cost assumed there would be an equal number of employees in the system. Due to pension costs and budget cutbacks the number of new employees has dropped significantly so the County is going to be responsible for the cost unless something is done to change the system.

The 3.71% number appears to be what was presented by SCERA to the Board of Supervisors as the actuary's cost estimate to cover the benefit enhancement for Safety Employees. No annual cost was provided by the actuary, as required by CERL, only the total cost of the increase which was estimated to be about $25 million. In addition, a separate study by the County as required by CERL was not performed.

When the benefit increase was passed for Safety employees in 2002, it included a 3% at 55 formula from 2004 to 2005, and then it became a 3% at 50 formula in 2006. According to agreement between the employee union and the County, it was to be paid for with a 1% increase in employee contributions in 2003, a 1% increase in 2004 and a 1% increase in 2005.

I reviewed the 2002-2008 contract with the Safety unions. It states that the employees were required to contribute 3% to pay for the increase in benefits, however, in the same agreement, the County agreed to pick up 2% of the employees previous contribution to the pension fund. So the net contribution from the Safety employees to cover a 50% retroactive benefit increase was 1% of their pay, not nearly enough to cover the cost, which was what was represented to the Board of Supervisors and the public. So if a Safety employee tells you they are paying for their benefit increase, please tell them they are completely wrong unless their increase is costing the County 1% of their pay per year.

General Employee Actuarial Benefit Enhancement Study

In the actuary's letters for the General employee cost for the benefit increase there was a lot less information provided by SCERA and John Bartel, the County's actuary was not retained to assist with estimating the cost impact of accelerated retirements, as recommended by the actuary, and as he had for the Safety employees.

The first document estimating the total cost for the increased General employee benefits is a letter dated March 20, 2002 from Rick Roeder of GRS to Robert Nissen, Plan Administrator and Gary Bei, Assistant Plan Administrator (at the time) of SCERA. Mr. Bei is the current Plan Administrator. The letter said the cost was based upon the year 2000 Annual Actuarial Valuation. It estimated the 3% at 60 benefit enhancement cost was $60,016,104 for a 5.43% contribution increase from CURRENT employees. At the end of the letter Rick Roeder states "If you like, we can perform additional analysis to reflect the fact that increased benefits may trigger earlier retirement."

The second and only other document is a letter dated June 5, 2002 that updates the benefit enhancement to 3% at 60 based upon the 2001 valuation indicating the cost is $68,614,650 for a net contribution increase of 5.78%. At the end of the document, Rick Roeder states that "It is IMPORTANT to consider that the combination of increased benefits and earlier ages at which multipliers hit a ceiling may trigger earlier retirements, especially for the 2.7% at 55 proposal. This in turn, would have some cost increase impact. Please let us know if you wish to do additional analysis in this regard (as we did for safety 3% at 50 analyses)."

When I talked with Gary Bei of SCERA, he confirmed that SCERA never performed an actuarial study with accelerated retirements per Rick Roeder's recommendation and the estimate did not include annual costs as required by CERL. In addition, the Board of Supervisors failed to hire their own actuary to provide a cost estimate of the increase in benefits, also a violation of the CERL. The failure of SCERA to follow the actuary's advice to include accelerated retirements, and to represent to the Board of Supervisors an inaccurate number is a serious issue that deserves further investigation by the current Board of Supervisors and the Sonoma County Civil Grand Jury.

The Agreement for Employees to Pay for the Increases

When the Board of Supervisors approved the pension increases in 2002, the Memorandum of Understanding and documents presented to the Board of Supervisors and the public in Board minutes stated clearly that General employees would pay for the ENTIRE prospective and retroactive cost of the 3% at 60 enhancements.

- On the financial summary of SEIU MOU from Board Minutes for May 4, 2005: "The County Board of Supervisors established direction to staff that the marginal increase in costs associated with the "3% at 60" plan be borne by the employees."

- In the resolution between the County and SEIU Local 707 (2002-2008 MOU) board date July 23, 2002: "Retirement: 3% at 60 retirement program effective in the 3rd year. Employees paying for prospective normal cost and past service (retroactive cost), primarily through increased retirement contributions."

- In the Agenda Item Summary Report for the 2003 Pension Obligation Bonds on April 29, 2003: "It should be noted that the additional cost of these negotiated benefits are to be fully paid for by employees starting in July 2004."

It is clear that the 1% being paid by Safety employees and the 3% being paid by the General employees has not been nearly enough to cover the benefit increase. In fact according to County documents, the General employees had a 3.5% pay increase the year the 3% was added to their pension contribution. So essentially the General employees gave up one year's pay increase for a 50% increase in their retirement benefits and the Board of Supervisors let it happen.

In conclusion, I believe SCERA and the County Supervisors violated the CERL when it increased benefits for General employees in several ways:

SCERA did not properly calculate the cost of the benefit increases for General employees because it left out the cost impact of accelerated retirements, as recommended by their actuary

The Board of Supervisors did not hire their own actuary, John Bartel who was an expert on the affect of accelerated retirement.

The actuarial study did not present the annual cost impact on the pension fund so at this point it is very difficult to make adjustments to employee contributions to ensure they are paying for their increased benefits each year as the actual cost of the increases become known.

The information that was required to be provided to the Supervisors by SCERA was not accurate and because the Board of Supervisors did not hire their own actuary, accurate information was never made public. If the citizens of Sonoma County and the Board of Supervisors had known the true costs of the benefit increases and that the County would pay for anything in excess of 3% as we are now doing, the benefit increase may never have been approved. As it is, the citizens of the County were misled and the County is currently violating the law by paying for the benefit increase out of the General Fund, something that was never approved by the Board of Supervisors in 2002.

As a result, my belief is that the benefit increase should be repealed and benefit levels should go back to the pre-2002 enhancement levels on the grounds that the County Supervisors and SCERA did not comply with the proper procedures required by law. If that cannot happen, then the employees should be required to pick up 100% of the past and future costs of the benefit increases, as they agreed to do.

VII. THE LEGAL CHALLENGE – DECREASING BENEFTIS PROSPECTIVELY

The law firm of Chang, Rothenberg and Long provided an interesting analysis looking at case law regarding what benefits can be reduced in California under state law. Here is what they said:

Much of the confusion over the rights of public employees to retirement benefits stems from the way California courts have described these rights. In San Bernardino Public Employees Association v City of Fontana, the Court of Appeal quoted Kern v City of Long Beach "While payment of these benefits is deferred and subject to the condition that the employee continue to serve for the period required by the statute, the mere fact that performance is in whole or in part dependent upon certain contingencies does not prevent a contract from arising, and the employing governmental body may not deny or impair the contingent liability any more than it can refuse to make the salary payments which are immediately due."

The common understanding of this language is that a governmental body cannot modify or reduce a promised pension or retirement benefit that is vested and earned without running afoul of the Constitutional prohibition against impairment of contracts. However, we believe that local governments actually have considerably more latitude to change retirement benefits for future service, as do private entities.

For the uninitiated, the principal constraint upon California governmental agencies against making changes to pension and retiree medical benefits stems from language in both the U.S. Constitution and the California State constitution that generally prohibits California from impairing any contract it has entered into. A number of public employee organizations and individual public employees have aggressively litigated the impairment issue so as to create a general impression that pension and post-employment benefits of practically every sort cannot be changed, reduced or eliminated. In a number of important cases, such as Kern, the facts of the case practically cried out for a resolution in favor of the employee. However, a close reading of the pertinent cases suggests that a public employee's right to a pension benefit is not inviolate, but may be changed or even eliminated under appropriate circumstances.

In the Kern case the court recognized that the rule permitting modifications of pensions is a necessary one since pension systems must be kept flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system and carry out its beneficent policy.

Overall, an employee may acquire a vested contractual right to a pension that has been earned, although that right is not rigidly fixed by the terms of the legislation (i.e., charter) at any particular time. Instead it is subject to the implied qualification that the governing body may make modifications and changes in the system.

The employee does not have a right to any fixed or definite benefits, but only to a substantial or reasonable pension.

There is nothing inconsistent about conferring a vested right to a pension for past service, but at the same time holding that the amount, terms, and conditions of the benefits may be altered for future service.

Although a public employee may have a right to participate in a public pension program, the governing body has the right to make modifications and changes to the system – particularly if the changes are necessary to address changing conditions facing the agency (such as a budget crisis) and the changes do not deprive employees of pension or retirement benefits to the extent that have been "earned" under the system.

We do not think these court decisions would prevent a local government from reducing or modifying pension benefits to the extent they have not yet been earned.

Therefore, it is critically important for local government employers to review the various charter, ordinance and administrative code sections authorizing their plans to make sure that they have expressly reserved the right to modify and change benefits.

Although there is surprisingly little case law on the subject, it appears that benefits that are properly the subject of the collective bargaining can be bargained away in exchange for other consideration."

Therefore, it appears to me that reductions to employee benefits that have not been earned, is legal, especially considering the financial crisis facing the County, the errors of their actuarial study that misstated costs for the benefit increases and improper approval process.

This analysis seems to make a good argument that the County has the right to change benefit levels going forward.

VIII. COUNTY BUDGET IMPACT OF PENSION COSTS ON OUR ROADS

The Supervisors Current Plan for Road Maintenance

There are 1,384 miles of road in the unincorporated area of Sonoma County. According to the County, it would cost $120 million per year to pave and maintain all the roads throughout the County. Since this money is no longer available, due mainly to pension and salary increases, the County has decided to maintain paving on only 219 miles or 16% of the County's roads. The other 1,200 miles or 84% will not be maintained as paved roads.

I believe that this will have a significant economic impact on the economy of Sonoma County and our quality of life and that the Board of Supervisors should commission a study of the economic impact of not maintaining a large percentage of the County's roads.

We should be asking then the Board of Supervisors the following questions:

1. What will happen to assessed property values when roads fall apart and become difficult to travel?

2. How will it affect the safety of our roads and liability to the County if unsafe roads cause injury and accidents?

3. How will lower property values as a result of poor roads affect property tax revenues?

4. How will traffic be affected if most traffic moves on only the maintained roads?

5. How will emergency vehicles (fire and ambulance) response times be affected?

6. How much traffic will a gravel road accept?

7. What will the safe rate of speed be on a gravel road and how will that affect commute times and quality of life in general?

8. How will gravel roads affect our world class bicycling in Sonoma County?

9. Who will maintain and fix the potholes on the gravel roads and how much will they cost to maintain? (According to my research, gravel roads cost more to maintain than paved roads).

10. How will lack of paved roads affect overall economy and our wine, agriculture, and tourism industries?

11. Will typical cars be able to travel on the gravel, pothole filled roads?

IX. SOLUTIONS FOR THE PENSION CRISIS

The Sonoma County pension system had served County employees well for five decades, providing fair pensions, combined with social security benefits to the employees of Sonoma County. There were rules in place that ensured the fund had adequate income to pay the promised benefit:

> Only 30% of the fund's assets could be invested in stocks and the assumed compound rate of return for investments was a conservative 5%
>
> State law capped pension rates at 2 % per year of service
>
> Retroactive increases to benefits were not allowed
>
> Retirement ages were 60 for Safety employees and 65 for General employees (changed in 2004)
>
> The County and the employees shared equally in the funding of the plan, each contributing about 7% of payroll
>
> Salaries were reasonable and adjusted annually at about the rate of inflation
>
> Pensionable compensation was based upon base pay. Employee contributions to the pension fund, social security, hazard pay and unused vacation pay were not included in as pensionable compensation

In 1985 the cap on stocks in the portfolio was increased to 65%, the assumed compound rate of return climbed 3.5% to 8.5% and since 2000, the following changes have been made:

> The pension cap was raised to 3% per year of service, a 50% increase
>
> Retroactive pension increases became legal
>
> Retirement ages for Safety employees dropped to 50 and for General employees to 60
>
> Instead of contributing 6.7% of payroll, the County now pays 32.6%, 2.6 times the 12% employees contribute and due to the drop in investment income, over the past 4 years the County should have been contributing an additional 45% of payroll to the investment fund
>
> Safety employee salaries, the other multiplier in pension funds has soared 68% (twice the rate of inflation) from an average of $48,940 per year in 2000 to $82,360 per year in 2010
>
> General employee salaries have soared 76% from an average of $56,101 per year in 2000 to $99,202 per year in 2010
>
> Pensionable salaries now include all compensation including pension contributions, social security contributions, unused vacation pay, additional hazard and bilingual pay, and uniform allowances.

As a result of these changes, the pension fund in the last decade has cause the County to have sell $500 million worth of Pension Obligation Bonds and the pension fund still has $380 million in unfunded liabilities. And financial experts think when accounting rules change next year; the County will have to report much higher unfunded pension liabilities.

How Do We Solve the Pension Crisis?

First we need to understand how we got here. In my opinion the pension crisis has occurred because lawmakers were happy to support bills sponsored by the unions who provide them with political and financial support.

At the bargaining table, County employees negotiate salary and benefit increases with other County employees. There is no taxpayer representation at the bargaining table. The only protection we had as taxpayers were our elected officials, but they have become more beholden to the unions than us.

I believe the major problems with current Sonoma County pension system include:

1. Allowing Safety employees to retire at 50 with up to 100% of their pay or 3% per year of service.

2. Allowing General employees to retire at 60 with up to 100% of their pay or 3% per year of service

3. Qualifying employees for a pension after only 10 years of service

4. Providing managers and supervisors with a 5% 401k contribution on top of their pension and social security

5. Providing $6,000 annually in medical benefits after retirement

6. Using the last year's gross salary for the pension calculation

7. Using the employees last year of pay versus a 3-year average, which enables them to spike the final year's pay.

8. Not adjusting the employee's contribution to the pension system on an annual basis as the County's contribution has increased. A power the SCERA Board and Board of Supervisors currently have.

The system needs to be reformed so that the citizens of Sonoma County will receive the services they pay for and deserve and the county can avoid the financial disaster we are headed towards under the current pension system.

Here are my recommendations:

1. The first step would be for the Supervisors to hire an independent actuary to determine the exact cost to date and the future costs for the benefit enhancement the employees agreed to pay for. When the benefits were increased, the Board of Supervisors never approved using General funds to pay for the increase and for the current Board to continue to do so is not legal.

Once the numbers are determined, the employee contribution should be adjusted upward to pay for the increase.

2. The Supervisors should also look into what can be done to have the 1,800 employees who have retired since the benefit increase pay for their benefit increase through a deduction from their current retirement amount.

3. The retirement ages for General employees should be increased back to 65 and 55 for Safety.

4. The Board of Supervisors should require the employees and the county to share all future pension costs 50/50. The cost sharing should include contributions to the pension fund, the debt service on the Pension Obligation Bonds and investment gains and losses.

5. The Board of Supervisors should change how pensionable salaries are calculated and eliminate spiking. The retirement benefits should be based on the employee's base salary after deductions for pensions, social security and other compensation. Then they should be averaged over the last 3 or 5 years of service, which is what the majority of government pensions in the country base their pension calculation on.

6. All new Pension Obligation Bonds should be required to be approved by the voters.

7. New hires should be enrolled at the old benefit level of 2% per year of service with the old retirement age or in a hybrid plan should be created that includes a smaller defined benefit plan and 401k. New hires should not receive other post employment benefits, such as retiree health care and dental benefits. Post retirement benefits like these are never provided for private pension retirees.

8. The Supervisors should eliminate all cost of living increases for retirees and staff unless the plan is debt free with no unfunded liability.

9. The Supervisors should create an amendment to the County's charter to require that all future increases to retirement benefits be approved by a majority of the voters, as is currently required under the City and County of San Francisco's charter.

10. The Supervisors should immediately freeze all salaries and require the County to perform an evaluation of wages and benefits offered in the private sector in the County and adjust all current and future employee compensation so that it is in line with this standard.

11. The Supervisors should cap retirement benefits at a specific amount per year. Some have suggested $140,000 per year.

12. The Supervisors should change the negotiators for all compensation issues and increases in salaries and benefits. Instead of having the county's Human Resource Department Managers, who are also pension participants negotiate with the employee unions, they should create an employee compensation and pension review board made up of taxpayer representatives, independent legal counsel, and staff members to negotiate with the unions on the County's and taxpayers behalf.

13. The Supervisors should create more balance on the SCERA board by placing reform advocates and financial experts on the board.

14. The Supervisors should eliminate survivor's benefits. Currently, when a County employee dies, 60% of their benefits continue to be paid to their surviving spouse or beneficiary. Considering the already generous salaries they receive while working and the benefits they are receiving during their retirement, and the fact that the surviving spouse will receive the diseased spouse's social security payments, the benefits should end upon the death of the employee. If the retiree is concerned about lack of money for their spouse, they can purchase a life insurance policy like the rest of us.

15. The Supervisors should eliminate the 5% 401k contribution for managers and 6% 401k contribution for supervisors. At the current 3% at 60 pension levels, and with social security which could add another 30 to 40%, funding a 401k plan is excessive.

16. The Supervisors should also eliminate the 5% increase in salary for managers and supervisors giving 12 months notice before leaving their position. This is money that also becomes pensionable income for the retiree. A career employee with a $150,000 salary, currently receives an additional $6,700 per year added to their retirement pay or $101,250 if they live 15 years after retirement due to this perk.

17. The Supervisors should extend the number of years of service to qualify for a pension from 10 to 15 or more years.

Until we change the system the abuses are going to continue. The citizens of Sonoma County need to elect pension reform candidates who will fight to roll back salaries and benefits to affordable levels, place citizens at the bargaining table and place reformers on the SCERA board. If we don't, we will all be driving down pot hole filled gravel roads.

Attachment 1

Summary of Calendar Year Actuarial Study Comments for Years 2000 to 2010

This document presents the comments made by the County's actuary each of the past 11 years with my notes added. As you can see, it was a decade where increased benefits, the soaring number of retirements associated with the benefit increase, and devastating stock market losses destroyed the financial health of the Sonoma County retiree pension fund. As the document indicates, the losses were almost completely absorbed by the County, whose contributions with POB debt service went from 10.9% of payroll in 2000 to 32.6% in 2010.

You will see many places where the actuary commented on higher than expected number of retirees. As previously noted in the report, when the cost for the benefit increase for General employees was presented to Gary Bei and Robert Nissen of the Sonoma County Employee Retirement Association by the Board's actuary, they opted to not take the actuary's advice and did not have him include the cost of accelerated retirements in the estimate.

I added the POB debt service to the unfunded liability in each year.

Year 2000 Actuarial Study Comments

The unfunded liability is $10,831,127 but would be $107,831,127 without the $97,000,000 in 1993 POB proceeds.

Overall County contribution rate increased from 8.09% to 8.42%, up .33%.

The average employee rate increase is .03% for General and .23% for Safety.

In February of 1994, the Retirement Systems unfunded liability of $428.25 million was retired due to the Pension Obligation Bond ($93 million) *Note: how does a $93 million POB erase a $428.25 million liability?*

Pay increases, higher than projected accounted for $5 million in losses.

Gross market value of investment portfolio declined by $18 million.

Market stabilization reserve plunged from $120.4 million to $22.3 million.

Using market value, in contrast to actuarial values, there was a $83.8 million shortfall in 2000 from the 8.42% assumed investment return.

If fund performance continues in this manner in 2001, buffers will come close to being eliminated.

Year 2001 Actuarial Study Comments

The unfunded liability is $47,115,774, but would be $144,115,774 without the 1993 POB funds.

Contribution rates for the County increased from 8.42% to 10.85% up 2.43%.

Contribution rate increase is .03% for General and .23% for Safety employees.

Gross market value of investments declined by $73 million.

The market stabilization reserved plunged from $22.3 million to $104.9 million

Using market value, in contrast to actuarial values, there was a $141.6 million shortfall in 2001 from the 8.42% assumed investment return.

Five-year actuarial smoothing again acted as a buffer against the poor performance experience. However, if fund performance continues in this manner in 2002, all buffers are now exhausted. If the System does not have a reasonable investment year in 2002, one can almost envision John Fogerty singing "Bad Moon Rising." *Note: Those are the actuary's words, not mine.*

Note: So with this news, why did they continue to push for a 50% retroactive increase in benefits?

Year 2002 Actuarial Study Comments

The unfunded liability, due to the anticipated benefit increase jumps from $47 million in 2001 to $201,361,414 in 2002, but would be $298,361,414 without the 1993 POB funds.

This is the year they incorporated the increases in benefits into the actuarial study. As a result, they performed the evaluation using four basis:

> Basis 1: Same benefits and actuarial assumptions as December 31,, 2001
>
> Basis 2: Using the same benefits as in the 2001 valuation but using updated economic assumptions, employee turnover assumption when eligible to service retire and the newly adopted amortization period of 20 years (up from 13 years)
>
> Basis 3: Using the same updated assumption as in Basis #2 but using the new Safety benefits (3% at 55) scheduled to be in place on July 1, 2003 and the new General benefits (3% at 60) scheduled to be in place on July 1, 2004
>
> Basis # 4 Using the 3% at 60 General benefits in conjunction with the 2006 Safety benefits of 3% at 50. *Note: This is the benefit option the County chose to implement.*

The unfunded liability is $201,361,414, up $154,245,640 million from the $47,115,774 in 2001.

Here is the explanation as to why:

The County is planning to issue a Pension Obligation Bond (POB) later this Spring. We were asked to calculate what the level of accrued liabilities is using Basis #4. The rationale for this approach is that bond counsel has opined that all contractually negotiated benefit increases, even if not in place for this year, could be considered in determining the maximum bond issuance. Legally, the bond issuance cannot exceed the amount of System unfunded liability at the time of issuance.

We have calculated a discounted unfunded actuarial liability of $209,599,293 as of May 1, 2003 and $210,836,103 as of June 1, 2003. The "discounting" takes into consideration that the General benefit increase does not occur until mid-2004 and the safety increase does not occur until mid-2006.

Note: So they borrowed the money to pay for their benefit increase, not to reduce the unfunded liability which stood at the end of 2001 at $47 million. How was this having the employees pay for the benefit increase when the bond debt service on the bonds was being paid for the by County? Shouldn't the employees be paying for the debt service on the $145 million of the bond money being used to pay for their pay increase? Also, the argument for issuing POB's without voter approval is that they are a mandated expense imposed by the state. Here they are basically admitting that the POB is necessary to fund their pension increase. So how is a voter approval not required in this case?

The rates for the County increased from 12.01% to 14.97% up 2.96% (Basis #4)

Gross market value of investment portfolio declined by $108 million. This on the heels of $73 million and $18 million declined in 2000 and 2001, respectively.

The market stabilization reserve kept plunging from ($104.5) million to ($225.8 million). Put another way, the actuarial value of assets exceed the market value of assets by $226 million. In three years, the market stabilization reserve has had a negative swing of $346 million! The market stabilization reserve has grown to 32% of the market value of assets.

Using market values in contrast to actuarial values, there was a $169 million shortfall in 2002 from the 8.42% assumed investment return.

The year-to-year change in computed rates will sometimes not reflect the magnitude of the actuarial gains or losses in the previous year. This has occurred in recent years. Before 2003, SCERA had four ways to smooth out gains or losses:

1) Five-year smoothing of the actuarial value of assets to the extent that earnings differ from the assumed investment assumption. The Market Stabilization Reserve reflects such smoothing.

2) Amortization of the unfunded liability over a period of years. Last year the Board substantially increased the power of this smoothing device by extending the amortization period from 13 to 20 years. *Note: So they used an accounting trick to put the problem out into the future.*

3) The interest Fluctuation Reserve can be tapped during the current times

4) Undistributed Earnings can also be tapped as it was in 2002 to the tune of $54.3 million.

Given your large negative Market Stabilization Reserve, it is very important that all parties understand there will almost certainly be some reemergence of some level of unfunded liability in the next few years.

Year 2003 Actuarial Study Comments:

Note: This the year the 3% at 55 kicks in for Safety employees.

The unfunded liability is $40,325,398, but due to the POB bond income of $210,200,000 this year and the 1993 bond it would have been $347,525,398.

Funded ratio increased from 81.7% to 98.6%. Contribution rates decreased from 14.59% to 10.63% primarily due to the Pension Obligation Bond issuance and the $43.8 million transfer of monies to Undistributed Earnings from the uncommitted portion of the COLA reserve.

Note: So even though most of the POB money was the estimated cost to fund the pension increase in 2002, the actuary let the county reduce their contribution from 14.59% to 9.39%, a reduction of 5.2% of payroll. So now how was the benefit increase being paid for?

The actuarial loss for the year was $57.9 million prior to the reflection of $43.8 million transfers to the Undistributed Reserve from uncommitted COLA monies. In turn, the undistributed Reserve was exhausted. This was largely due to investment losses on the actuarial value of assets, a third consecutive year of higher pay increases than expected and extremely low employee turnover. *Note: The employees are waiting for the new benefits to kick in next year.*

The County issued a $210.2 million Pension Obligation Bond on May 28, 2003. The short-term timing of the issue was excellent because a large infusion of money was invested in a very favorable investment climate for the balance of 2003. *Note: don't count on that lasting.*

In evaluating ongoing costs of retirement benefits, it is essential to incorporate the bond financing of the 1992 and 2003 POB's. There was a cost related to the POB payments during the 2003 year – roughly 5.24% of the valuation payroll. Adding this cost to the Basis 2 overall contribution rate of 10.63% gives a MUCH truer picture of the overall benefit costs to the county: 15.87%.

We were not surprised that the number of new Safety retirants increased by almost 150% in 2003. There were 31 new retirants in 2003 compared to only 13 in 2002, undoubtedly due to the wait for the new 3% at 55 benefits. What did surprise was the amount of benefits for these new retirants – an average starting pension of $56,038. The comparable number for the 13 new retirants in 2002 was $35,803. *Note: Why did this surprise the actuary given the new formula and retirement age?*

Year 2004 Actuarial Study Comments

Note: This is the year the 3% at 60 kicks in for General employees

The unfunded liability is $54,484,758 but without the two POB's would have been $307,200,018.

The County contribution rates increased from 10.63% to 11.82% up 1.19%.

The actuarial loss for the year was $54 million. The majority of the loss was attributed to investment experience.

Other areas of actuarial loss did impact rates, largely related to the high incidence of new retirees and retirant mortality. Our economic model is long term in nature. The glut of new General retirees, pursuant to the 2004 benefit increase, *reflects a one-time reflection of "pent up" activity.* When more people retire than is projected, the impact is generally an actuarial loss. This is because more people than anticipated will be receiving a benefit for a longer period of time than projected in our model. *Note: They were wrong, the number retirees was not just "pent up" activity but, the start of a trend as the number of retirees climbed from an average of 97 per year to 176.*

We were not surprised that the number of new General retirants increased by 470% in 2004. There were 217 new retirants in 2004 compared to only 38 in 2003. However, the amount of benefits for these new General retirants was noteworthy – an average annual starting pension of $37,714. The comparable number of the 38 new retirants in 2003 was $22,486. *Note: that represents a 67% increase in average benefit.*

As a result, the present value of allowances for current retirants markedly increased by 27% -- easily the largest increase in recent years. The $100 million dollar increase in this liability closely correlates to the overall liability increase in this valuation. *Note: so $100 million is now the estimated cost of the General employees benefit increase? The actuary estimated this cost to be $68 million in their letter study.*

Year 2005 Actuarial Study Comments

The unfunded liability is $75,863,560 but without the two POB's would have been $347,525,398.

The impact of the 2006 benefit increase results in a decrease in funded ratio from 95.3% to 94.4% county contribution rates increased from 11.82% to 12.33% up .51%.

The actuarial loss for the year was $52.4 million.

The glut of recent retirees has been fueled by recent benefit increases. The actuarial liability for members, currently in pay status has increased by a whopping 51% over the past two valuations. Experience relating to new retirants created an actuarial loss of $9.9 million. *Note: Gary Bei did not have the actuary include accelerated retirement numbers so all these costs are being borne by the county, not the employees as what was "sold" to the Supervisors and the public.*

Year 2006 Actuarial Study Comments

Note: This is the year the 3% at 50 kicks in for Safety employees

The unfunded liability is $139,943,868 but without the two POB's would have been $447,143,868.

The average benefit for new safety retirees increased from $34,094 to $60,696 and the number of new retirees increased from 33 to 47. *Note: so the average benefit for Safety employees increased 78% because the 3% at 50 formula just kicked in.*

Other areas of actuarial loss did impact rates, largely related to the continued high incidence of new retirees. Our economic model is long term in nature. The increase in recent retirees has been fueled by recent benefit increases. The actuarial liability for members currently receiving benefit payments has increased by 35% over the past two valuations. Experience relating to new retirees created an actuarial loss of $2.3 million.

Total debt financing for the year is 8.06% of active member payroll. When this percent is added to the valuation computed rate of 15.21% under Basis 3, the total rate of 23.27% more accurately reflects total pension costs for the county.

The employee contribution is 11.7% of payroll. *Note: So now the county is paying twice as much as the employees even though the increase was suppose to be paid for by the employees.*

The increase in liability due to the assumption changes is $49.4 million. The largest sources for this increase are the change in mortality rates and the change in retirement rates. *Note: so now is the cost for the benefit increase up to $149.4 million with the $100 million for last year, less the mortality rate increase?*

Year 2007 Actuarial Study Comments

The unfunded liability increased to $177,351,000, but without the POB's would have been $484,551,000.

The total employer contribution rate increased from 15.32% to 16.07% up .75%. If you add the 8.06% of debt financing, the total contribution rate is 24.13%.

The increase was primarily due to difference in methods and procedures between Segal and the Association's prior actuary, higher than expected salary increases, and more retirants than expected.

The average member rate in the valuation remained at 11.7% of payroll.

General members pay an additional contribution amount equal to 3.03% of payroll during a 20-year period from July 2004 to June 30, 2024. Effective July, 1 2024, the employer contribution rate will have to increase to offset for this expiration of the 3.03% rate paid by the General members.

Year 2008 Actuarial Study Comments

The unfunded liability increased to $301,900,000, but without the POB's would have been $609,143,000. *Note: if the market losses were $483 million, how come the unfunded liability only increase by $124.5 million?*

As the recognition of the $483 million market losses is expected to have a very significant impact on the Association's future contribution rate requirements, we will provide under separate cover a report to illustrate such rate impact. However, here are some summary results:

- The deferred losses of $483.4 represent 45.7% of the market value of assets. *Note: That is horrible investing and a bigger loss than the overall stock market.*

- <u>If the deferred losses were recognized immediately in the valuation value of assets, the funded percentage would decrease from 83.6% to 57.4%.</u> *Note: What would the funding percentage be without $307 million of POB proceeds that were placed in the fund?*

- If the deferred losses were recognized immediately in the valuation value of assets, the aggregate employer contribution rate would increase from 17.26% to 27.59%. *Note: If you add the 8.06% of debt financing, the total contribution rate would be 35.65%. By using accounting tricks, they are moving the problem into the future.*

The average member rate calculated in this valuation has remained at 11.7% of payroll. *Note: the employees are completely off the hook. Now the county should be paying 36% to fund the pension and debt and the employees are paying a third of that amount. No sharing of the cost at all.*

<u>As a result of the phase-in of the employer's rate for the second half of calendar year 2008, we have determined that the employer's actual contribution does equal 100% of an Annual Required Contributions but determined using an amortization period of 29 years (an amortization period of up to 30 years is allowed by the Governmental Accounting Standards Board or GASB). *Note: how can the plan be 100% of the required contribution after this staggering loss. Is it because they have gone from a 20 year to 29 year amortization period? How much would the unfunded liability be today under the original 13-year amortization? Now we are using another accounting trick, extending the amortization period.*</u>

The $483.4 million investment loss will be recognized in the determination of the actuarial value of assets for funding purposes over the next few years, to the extent it is not offset by recognition of investment gains derived from future experience. This implies that earning the assumed rate of investment return of 8.00% per year on a market value basis will result in very substantial losses on the actuarial value of assets in the next few years.

Year 2009 Actuarial Study Comments

The unfunded liability increased to $402,100,000, but without the POB's would have been $709,228,000.

The total employer contribution rate calculated in the valuation increased from 17.44% of payroll to 20.04% up 2.60%. If you add the 8.06% of debt financing, the total contribution rate would be 28.10%.

The average member rate calculated in this valuation has increased from 11.70% to 11.79%. *Note: County paying 2.5 times as much as employees.*

The total unrecognized investment loss was $292.1 million. The deferred losses represent about 23% of the market value of assets. *Note: over the last 2 years, the fund has lost 47.5% and 23% of its market value of assets respectively.*

The impact of the market losses is expected to have a significant impact on the Association's future funded percentage and contribution rate requirements. This potential impact may be illustrated as follows:

- If the deferred losses were recognized immediately in the valuation of assets, the funded percentage would decrease from 79.6% to 64.7%.

- If the deferred losses were recognized immediately in the valuation value of assets, the aggregate employer contribution rate would increase from 20.4% to 26.51%. *Note: if you add the 8.06% of payroll the County contribution would be 34.57% to recognize the value of assets.*

Note: Finally they discuss the additional contributions of the Safety employees:

Safety members pay an additional contribution amount equal to 3% of payroll effective February 1, 2005. <u>*Note: at the same negotiations for the 3% increase the County agreed to pick up 2% of their former contribution rate. So they only contributed 1% to their two benefit increases and told the public they were paying for all of it.*</u>

General members pay an additional contribution amount equal to 3.03% of payroll. *Note: According to Veronica Fergusson, County Administrator, it was suppose to be 4.27% for the retroactive and proactive portions of the increase. Why are they only paying 3.03%?*

We have determined that the employer's actual contributions do equal 100% of an Annual Required Contribution, but determined using an amortization period of about 29 years. *Note: What would it be at 13 years as was the case before 2002.*

Year 2010 Actuarial Study Comments

The total unrecognized investment loss was $139 million or 8% of the market value of assets. This investment loss will be recognized in the determination of the actuarial value of assets for funding purposes over the next few years. This implies that earning the assumed rate of investment return of 7.75% per year (net of expenses) on a market value basis will result in substantial investment losses on the actuarial value of assets in the next few years.

The total employer contribution rate calculated in this valuation decreased from 20.03% of payroll to 17.11% of payroll. This reduction in rate was from the issuance of Pension Obligation Bonds offset to some degree by lower than expected returns on the smoothed value of investments, changes in actuarial assumptions, and increase in UAAL rate due to lower than expected increases in payroll.

If the deferred losses were recognized immediately the contribution rate would increase from 17.11% to 20.12%. If you add the POB debt service of 13.74%, the total would be 33.86%.

The average member rate has increased from 11.76 to 12.17% of payroll. The change was due to the changes in actuarial assumptions. *Note: Not because the employees were asked to contribute to the shortfall. Why would they be asked to do that?*

The unfunded liability decreased from $402,100,000, to $248.6 million but without the POB's would have been $845,103,000. <u>*Note: First drop in unfunded liability in the decade but required $289 million in POB funds.*</u>

Attachment 2 - The True Cost of Sonoma County Pensions Over the Past Decade if Fully Funded Each Year

Year	County Cost w/ Bond Debt	Increase in Unfunded Lia.	Total County Cost plus Liability Increase	Increase Over Year 2000	Percent over 2000	Payroll	County Pension Cost as % of Payroll With Unfunded Lia.	Employee Cost as % of Payroll	Percentage Each if Costs Shared
2000	$21,527,009	$ 6,993.00	$ 21,534,002			$ 197,231,000	11%	6%	8.67%
2001	$23,957,915	$ 36,284,647	$ 60,242,562	$ 38,708,560	180%	$ 227,585,000	26%	7%	16.49%
2002	$27,328,108	$ 154,245,640	$ 181,573,748	$ 160,039,746	743%	$ 251,946,000	72%	7%	39.53%
2003	$35,830,500	$ 49,164,000	$ 84,994,500	$ 63,460,498	295%	$ 260,347,000	33%	7%	19.82%
2004	$44,632,696	$ 25,094,374	$ 69,727,070	$ 48,193,068	224%	$ 253,025,000	28%	10%	18.78%
2005	$48,117,449	$ 40,325,380	$ 88,442,829	$ 66,908,827	311%	$ 265,248,000	33%	12%	22.67%
2006	$53,448,771	$ 99,618,470	$ 153,067,241	$ 131,533,239	611%	$ 273,548,000	56%	12%	33.98%
2007	$59,558,865	$ 37,407,132	$ 96,965,997	$ 75,431,995	350%	$ 292,772,000	33%	12%	22.56%
2008	$65,108,971	$ 124,592,000	$ 189,700,971	$ 168,166,969	781%	$ 334,391,000	57%	10%	33.37%
2009	$75,475,576	$ 100,123,000	$ 175,598,576	$ 154,064,574	715%	$ 322,484,000	54%	12%	33.23%
2010	$84,732,700	$ 135,837,000	$ 220,569,700	$ 199,035,698	924%	$ 323,601,000	68%	12%	40.08%
Total	**$539,718,560**	**$ 802,698,636**	**$ 1,342,417,196**	**$ 1,105,543,174**		**Averages**	**43%**	**10%**	**26.29%**

In 2002 the employees and County agreed to increase retirement benefits retroactively in 2004 in exchange for the employees paying for the cost of the increase.
To determine how much the County and the employees are paying towards pension costs I took the County's pension contribution amount, added on the County's pension obligation bond debt service and the additional unfunded liability incurred for each year since 2000. The unfunded liability is mostly the shortfall of investment returns which the County is responsible for if the employees contributions remain at their current levels. Since 2000, the true cost to the County has grown from 11% of 11 years and the true pension costs were paid each year, each should have paid 26% of payroll. So how is it possible the employees are paying for the benefit increase?

Attachment 3- Financial Performance Summary 2003 to 2010

Year	Payroll	Avg. Salary General	Avg. Salary Safety	Employee Contribution	Percent Payroll	Employer Contribution	Percent Payroll	Pension Debt Service	Total County Contribution	Total Percent
2003	$ 260,347,000	$ 58,991	$ 65,630	$ 19,983,413	7.68%	$ 21,443,500	8.2%	$ 14,387,000	$ 35,830,500	13.8%
2004	$ 253,025,000	$ 58,759	$ 68,353	$ 25,332,099	10.01%	$ 22,812,696	9.0%	$ 21,820,000	$ 44,632,696	17.6%
2005	$ 265,248,000	$ 60,741	$ 71,525	$ 30,578,922	11.53%	$ 24,993,498	9.4%	$ 23,124,000	$ 48,117,498	18.1%
2006	$ 273,548,000	$ 63,237	$ 72,485	$ 32,234,592	11.78%	$ 29,370,771	10.7%	$ 24,078,000	$ 53,448,771	19.5%
2007	$ 292,772,000	$ 67,353	$ 75,767	$ 32,751,128	11.19%	$ 34,272,865	11.7%	$ 25,286,000	$ 59,558,865	20.3%
2008	$ 334,391,000	$ 78,110	$ 86,847	$ 34,109,379	10.20%	$ 38,552,971	11.5%	$ 26,556,000	$ 65,108,971	19.5%
2009	$ 322,484,000	$ 77,619	$ 95,008	$ 37,336,845	11.58%	$ 47,576,576	14.8%	$ 27,881,000	$ 75,457,576	23.4%
2010	$ 323,601,000	$ 82,360	$ 99,204	$ 37,321,820	11.53%	$ 48,425,700	15.0%	$ 36,307,000	$ 84,732,700	26.2%
Total				$249,648,198		$ 267,448,577		$199,439,000	$ 466,887,578	

Year	Unfunded Lia. w/o bonds	New Retirees	Disbursements to Retirees	Investment Income
2003	$ 347,525,398	125	$ 51,604,881	$ 205,316,510
2004	$ 307,200,018	280	$ 53,368,598	$ 122,008,312
2005	$ 347,525,398	275	$ 65,511,380	$ 110,699,699
2006	$ 447,143,868	249	$ 69,944,932	$ 193,809,000
2007	$ 484,551,000	260	$ 78,661,885	$ 126,599,000
2008	$ 609,143,000	210	$ 68,583,023	$ (556,235,000)
2009	$ 709,266,000	250	$ 93,175,322	$ 224,056,000
2010	$ 845,103,000	290	$ 103,271,476	$ 207,173,000
Total		1939	$ 584,121,497	$ 633,426,521

Notes

All information on this spreadsheet comes from SCERA Annual Actuarial Studies

In 2003 pension benefit increased to 3% at 55 for Safety employees from 7/01

In 2004 pension benefit increased to 3% at 60 for General employees from 6/22

In 2006 pension benefit increased to 3% at 50 for Safety employees from 2/01

County takes on $499 million in Pension Obligation Bond debt during this period

SCERA tells Board of Supervisors a $9 million employee contribution per year will over cost of increases. Actuary's letters never support this estimate or include accelerated retirements impact as recommended by the actuary. Income to fund from 2003 to 2010 was $1.1 billion.

Disbursements totaled $584 million for a net income of $566.4 million

Unfunded liability grows form $298 million in 2002 to $845 million in 2010 for a $547 million increase.