



CITY of NAPA

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June 17, 2014

**FILED**

**JUL 21 2014**

The Honorable Rodney G. Stone  
Presiding Judge of the Napa County Superior Court  
The Honorable Mark S. Boessenecker  
Supervising Judge of the Napa County Superior Court  
825 Brown Street  
Napa, CA 94559

Clerk of the Napa Superior Court  
By: C. Baenna  
Deputy

Subject: **City of Napa Response to Napa County Grand Jury 2013-2014 Final Report on A Review of Public Employee Retirement Benefits for Each Napa County Jurisdiction: Working Together for a Sustainable Future**

The City of Napa has received and reviewed the subject Grand Jury report. Pursuant to California Penal Code Section 933, this letter serves as the City's response to findings and recommendations as noted below.

**Finding 1** - *Pension and OPEB benefits amount to less than 10% of Napa County and its jurisdictions' total annual budgets.*

**Response** – Agree with respect to the all funds budget for the City of Napa. However, for the City of Napa, comparing costs to the total budget reduces the impact of pension and OPEB costs because the biggest impact of labor, pension and OPEB costs is to the City's General Fund. Pension costs were 5.18% of the total budget in FY 2012-13, with OPEB costs at 0.58%, for a total of 5.76% of the annual expenditures for all funds. For the General Fund, pension costs came in at 11.27%, with OPEB costs at 1.2% for a total of 12.47% of the General Fund budget. This number is expected to increase to 16% of the General Fund budget by FY 2014-15.

**Finding 2** – *Napa County jurisdictions had pension liability funding levels that ranged from 70.3% in Calistoga to 84.3% in St. Helena for the 2012/2013 fiscal year.*

**Response** – Agree that the pension liability funding levels for the City of Napa are in this range. The City of Napa's Miscellaneous pension plan was funded at 74% as of June 30, 2012 and Safety pension plan was funded at 77% as of June 30, 2012, the last full year reported in the CalPERS actuarial reports received in December 2013. There is only one year since FY 2006-07 that the pension plans fell below the 70% funding level, and that was as of June 30, 2009, after the CalPERS investment portfolio experienced a negative return (investment loss) of approximately 25.9%. As of June 30, 2009, both of the City's pension plans were funded at between 55 and 57%, a significant drop from the previous year

funding levels of 82-83%. Since FY 2009-10, the City of Napa's pension plans have been consistently funded at between 74 and 78%. This number is expected to increase slightly as the City recently made a payment to CalPERS of approximately \$0.4 million on top of the annual contributions to fully fund the former Redevelopment Agency's outstanding unfunded pension liability based on an actuarial report prepared after the dissolution.

**Finding 3** – *All jurisdictions have introduced employee sharing of pension (PERS) costs, although many of those plans only apply to future employees.*

Response – For the City of Napa, partially agree, since all employees share pension costs. The City of Napa employees have been sharing in the cost of pension benefits for years beginning with negotiated cost share of the **employer** rates between 14% and 19%, whereby Safety employees have contributed 2.5% since FY 2005-06 and Miscellaneous employees paid a portion of the employer contribution beginning in FY 2007-08 and increasing to 1.5% in FY 2011-12. In 2012, City employees agreed to an additional cost share of 3%, with Safety employees picking up 5.5% of the employer rate and Miscellaneous employees picking up 4.5% of the employer rate, resulting in Safety employees paying 14.5% and Miscellaneous employees paying 12.5% toward pension benefits. While PEPRAs call for new employees to pay at least 50% of the cost of retirement benefits and does not allow municipalities to impose the cost share until 2018, Napa employees have been picking up at least 50% of the normal cost of retirement benefits for several years. All MOUs continue this employee cost share commitment into the future.

**Finding 4** – *Some jurisdictions are phasing in employee share for OPEB where possible via memorandums of understanding but will only apply to new employees.*

Response – Disagree with respect to the City of Napa. While this is an option, and it is our understanding that the City of St. Helena has implemented an employee cost share of OPEB benefits, the City of Napa has taken other measures to reduce the unfunded liability for OPEB benefits. The City was successful in negotiating changes in retiree medical benefits for future and most current Public Safety Fire Department employees by converting a portion of each employee's annual sick leave accrual and matching 1.75% of each employee's salary with a contribution to a Health Retirement Account (HRA) on an annual basis, thereby funding retiree medical benefits with a defined contribution rather than a defined benefit and reducing the City's liability by \$0.3 million. The introduction of the HRA also eliminated the option to convert unused sick leave to additional PERS service credits, thus reducing the City's pension liability. Additionally, the City has implemented a Retiree Medical Trust (RMT) for police officers in exchange for reduced or eliminated retiree medical benefits, which served to reduce both the pension and OPEB unfunded liability in a similar way as the HRA did for the Fire bargaining groups. In addition, the City was successful in separating the active and non-Medicare retiree health care benefits, thereby removing the implied subsidy for retiree medical costs. The combination of those changes (except Police RMT which was implemented after the last actuarial analysis was performed), along with projected contributions to the Trust, has resulted in a **reduction to the City's OPEB unfunded liability from \$18 million in 2006 to a projected \$9.8 million in 2013**. The City continues to look for ways to reduce the unfunded pension and OPEB liabilities through creative benefit changes and employee cost share programs.

**Finding 5** – *Jurisdiction OPEB funded ratios are estimated to range from 27.8% to 35%.*

**Response** – Agree with respect to estimated funded ratios for the City of Napa. The City set aside funds in FY 2007-08 and 2008-09 with the intention of funding an OPEB trust; however, decided to hold the funds internally as CalPERS was experiencing large investment losses at that time, including the significant 25.9% approximate loss in FY 2008-09. In 2010, the City opened a California Employment Retirement Benefits Trust (CERBT) with an initial contribution of \$1.5 million from the funds set aside in previous years. Since 2010, the City has funded the annual required contribution (ARC) as a percentage of payroll on a bi-weekly basis, and has contributed more than the ARC in three of the past four years. The last OPEB Actuarial Report was prepared based on June 30, 2011 balances, and at that time showed the City's OPEB liability funded at 17.3%. That same actuarial report projected a funded ratio of 27.8% as of June 30, 2013. The City is currently working with the actuary to update the actuarial report for OPEB benefits as of June 30, 2013, and we expect the funded ratio to exceed the initially estimated 27.8% due to over funding the ARC the past few years as well as the agreement by the Police employees to convert the defined benefit retiree medical program to a defined contribution program by which the City contributes to a Retiree Medical Trust during the employee's working career, which is then used to fund retiree medical costs for the employee.

**Finding 7** – *Most Napa County jurisdictions are trying to achieve full funding of their OPEB liability well before 2040, the 30 year amortization rate recommended by the Government Finance Officers' Association in March 2013.*

**Response** – Agree with respect to the City of Napa. The City of Napa's June 30, 2011 OPEB actuarial shows full funding of the City's OPEB liability by 2040. As stated above, the City has been overfunding the OPEB trust and has made additional changes to the post-employment benefit structure for various bargaining groups which is anticipated to result in full funding of the OPEB liability by 2040, if not before.

**Recommendation 1** – *Napa County Board of Supervisors and the incorporated Napa jurisdictions form a pension/OPEB committee with appropriate financial and human resources management to establish a communication process and a planning best practices platform to share insights and collaborate on strategies for addressing and managing pension/OPEB funding.*

**Response** – This recommendation will not be implemented because it is not warranted. Each jurisdiction has vastly different circumstances and different options available for managing pension and OPEB funding - what may be a solution for one agency will not necessarily be the best fit for another. However, we believe that there is still value in meeting together to discuss pension funding strategies and managing the pension and OPEB liabilities. The Finance Directors of the various cities and town meet with the County Auditor-Controller on a quarterly basis and discuss various issues impacting all agencies. The City Managers from each agency also meet on a monthly basis and share policies, status, suggestions and ideas for various issues, including the pension and OPEB liabilities, options and funding mechanisms. These regularly scheduled meetings provide beneficial information for addressing the intent of the recommendation by the Grand Jury with respect to a county-wide pension/OPEB committee to share strategies and collaborate to address and manage pension and OPEB funding.

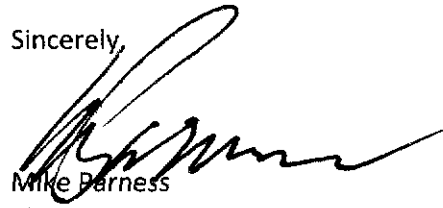
**Recommendation 2** – *Napa County Board of Supervisors and the incorporated Napa jurisdictions through the pension/OPEB committee issue an annual report that summarizes each entity’s pension/OPEB funding status at the end of each fiscal year.*

**Response** – This recommendation will not be implemented because it is not warranted. All agencies are issued an actuarial report from CalPERS on an annual basis, and are required to have an actuarial valuation performed on the OPEB liability every 2-3 years, depending on agency size. All of these reports are public information and most are available on each agency’s website. In addition, each agency is required to provide this information in the same format for “apples to apples” comparisons between agencies in a footnote to the basic financial statements each fiscal year for both pensions and OPEB, and with the recent release of the new Governmental Accounting Standards Board (GASB) pronouncement No. 68 which requires government agencies to begin reporting the unfunded liabilities in the financial statements rather than simply in the footnotes, this information will be even more transparent and available to interested parties through the agencies’ Comprehensive Annual Financial Reports (CAFR). This information is readily available and posted to each agency’s respective website. Because the agencies are so different, and unfunded liabilities in one agency have absolutely no bearing on the other agencies’ funding or services provided to citizens, re-creating an annual report to combine the annual reports already provided by each agency would have little to no added benefit to citizens. We do agree that the public should be informed about post-employment benefit funding obligations and believe that sufficient public information is readily available that would address the Grand Jury’s recommendation.

**Exhibit**

City of Napa Labor and Post-Employment Benefits Cost Containment Report

Sincerely,



Mike Parness  
City Manager

Cc: ✓ Grand Jury Foreman  
Mayor and Council  
City Attorney



*Issue Paper*

To: City Council  
Mike Parness, City Manager

From: Nancy Weiss, Assistant City Manager  
Roberta Raper, Finance Director

Subject: Labor and Post-Employment Benefits Cost Containmentment

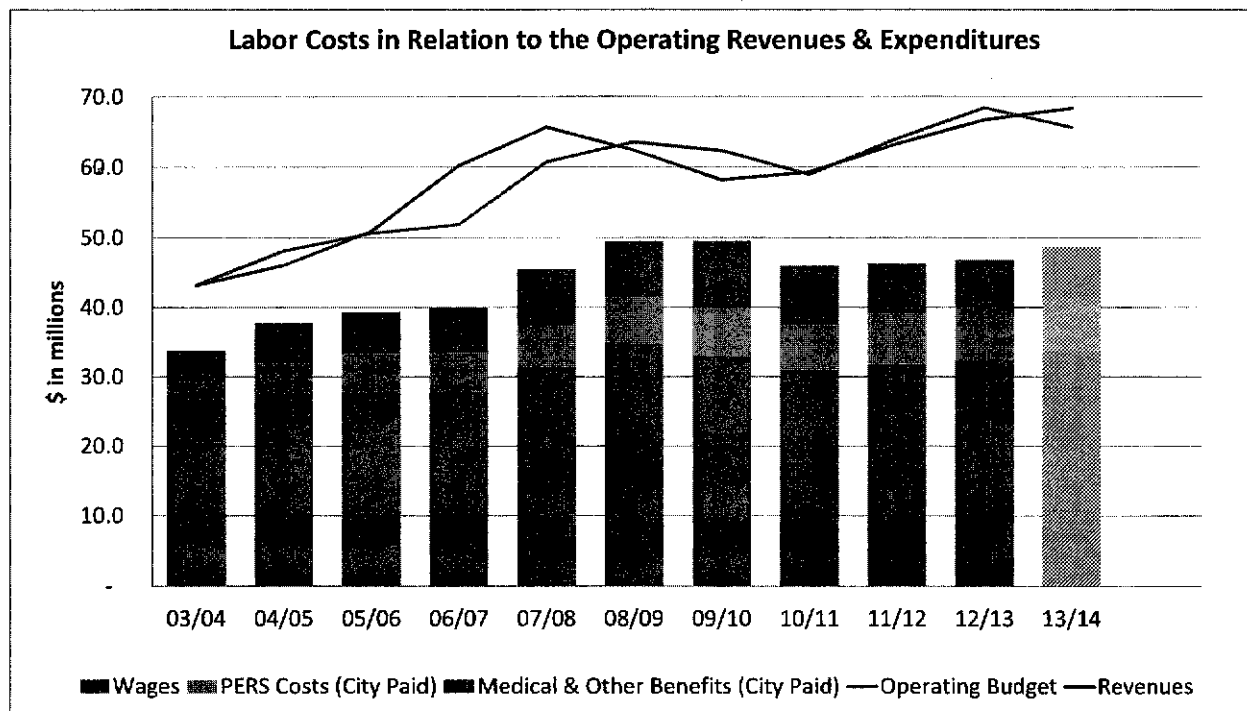
**ISSUE STATEMENT:**

Provide updated status for labor and post-employment benefits cost containment

**BACKGROUND:**

In early 2000, during Napa's robust economy, employee contracts were negotiated that spanned anywhere from seven to ten years and included high cost, employer paid benefit plans and retiree medical benefits which far exceeded industry standards. When the economy declined, these contracts, which still had an expiration date of three to five years later, obligated the City to continue to pay for high cost benefit plans. In 2009, a "State of the City" address was presented to the City Council, the general public and City employees that clearly demonstrated the unsustainability of the projected steady increase in salaries and benefits when combined with the City's projected declining revenues due to the economic downturn. In response, the City Council directed management to develop a plan to balance the City's budget by FY 2012-13. The City Administration then developed, and began implementing, a plan to bring the City into structural balance through a combination of departmental cuts, reorganizations and labor concessions.

Following is a series of charts and graphs that illustrates budget conditions and the impacts of labor cost containment measures. The chart below is a graphical representation of the City's operating position from FY 2003-04 through FY 2012-13 (Actual costs) and FY 2013-14 (projected costs). The red and blue lines represent the City's total revenues and expenditures. The green and purple bars show the City's actual costs for medical and other benefits and PERS costs, respectively. The red bar represents the total wages. For fiscal years 2003-04 through 2009-10, the combination of medical and PERS costs paid by the City were on a steady increase. The decrease from FY 2009-10 to FY 2010-11 is indicative of when the City began capping its medical contributions and employees began sharing more of the employer cost of pension benefits. The decrease in FY 2010-11 is also indicative of reduced staffing levels based on the early retirement incentive provided to non-safety employees in 2010. While measures taken to contain labor costs have been successful, the chart below shows that PERS costs are on the rise and are expected to continue to increase.



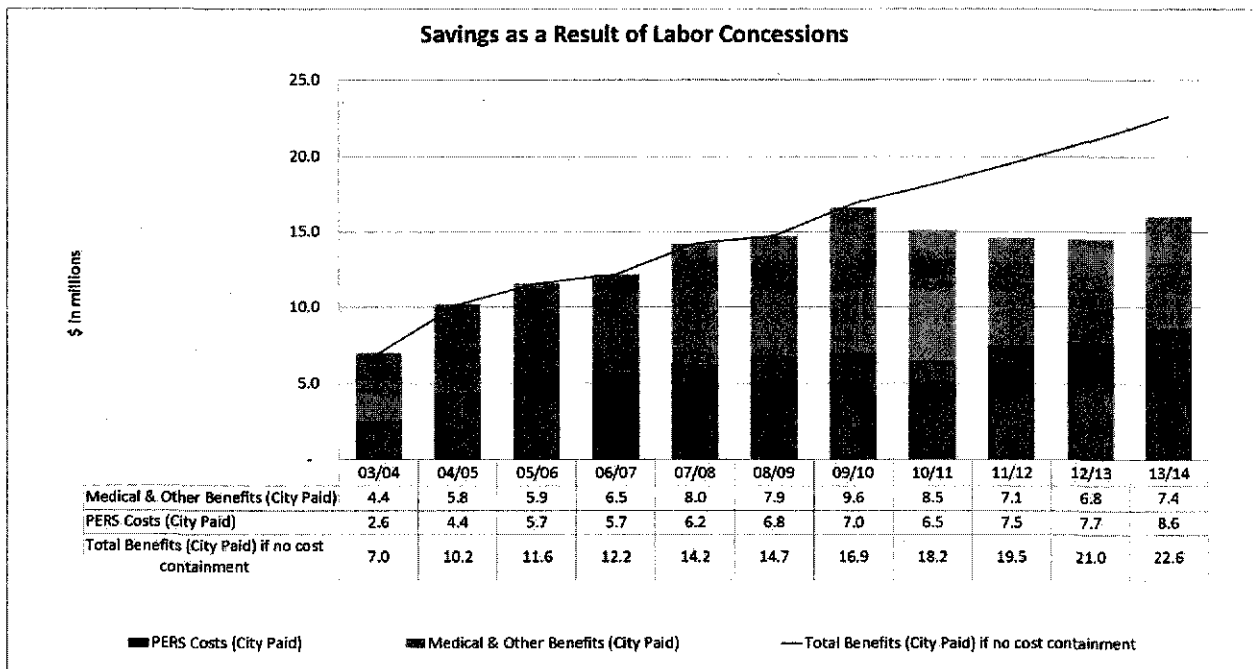
Considering the fact that the City is a service organization and 77% of its operating General Fund budget is attributable to salaries and benefits, a primary focus for achieving fiscal sustainability has been placed on labor cost containment.

Funding for medical contributions is a significant part of labor costs and any increases in medical contributions or premium costs can significantly impact the City budget. With the average increase in medical premium rates projected to progressively increase by over 8% per year, when combined with the City's required medical contribution at the full cost of the premium for which the employee was eligible, the cost of medical coverage alone was projected to increase by at least \$1.0 million between FY 2010-11 and FY 2011-12. In addition, an actuarial valuation of the City's cost of providing health care benefits to retirees concluded blending the active and retiree medical premium rates was unsustainable. The blending of these rates or "implicit subsidy" of retirees would prove counter-productive to the City's efforts in reducing retiree medical liability and therefore increase future budget obligations for funding retiree health.

Between FY 2010-11 and FY 2012-13 the City, through negotiated agreements with bargaining groups, made significant progress towards containing labor costs through the following measures: (1) Foregoing COLAs for employees during the economic decline, (2) capping the City's contribution for medical and dental premiums, (3) addressing retiree health costs and (4) increasing the employee's share of PERS pension costs. **This has resulted in an estimated cumulative 5% savings to the General Fund and a balanced budget**, when combined with other budget saving measures. With the exception of Police and Fire bargaining groups, the majority of these concessions were achieved while bargaining groups were still in closed contracts.



The chart below reflects the actual General Fund budget reductions achieved by implementing the cost saving measures described above. FY 2010-11 marked the initial ongoing reduction to the budget of \$1.5 million dollars, which is approximately a 3% reduction of the total Operating Budget. In FY 2011-12, the labor budget was reduced by an additional \$400,000, which can be attributed to capping the City's contribution to medical premiums and employee's contributing more to their pension costs. The blue line in the chart below estimates what the total benefit costs would be if the City had not implemented cost containment measures. The savings in FY 13-14 are estimated at \$7.5 million, with nearly 75% of that savings attributable to health insurance premiums.



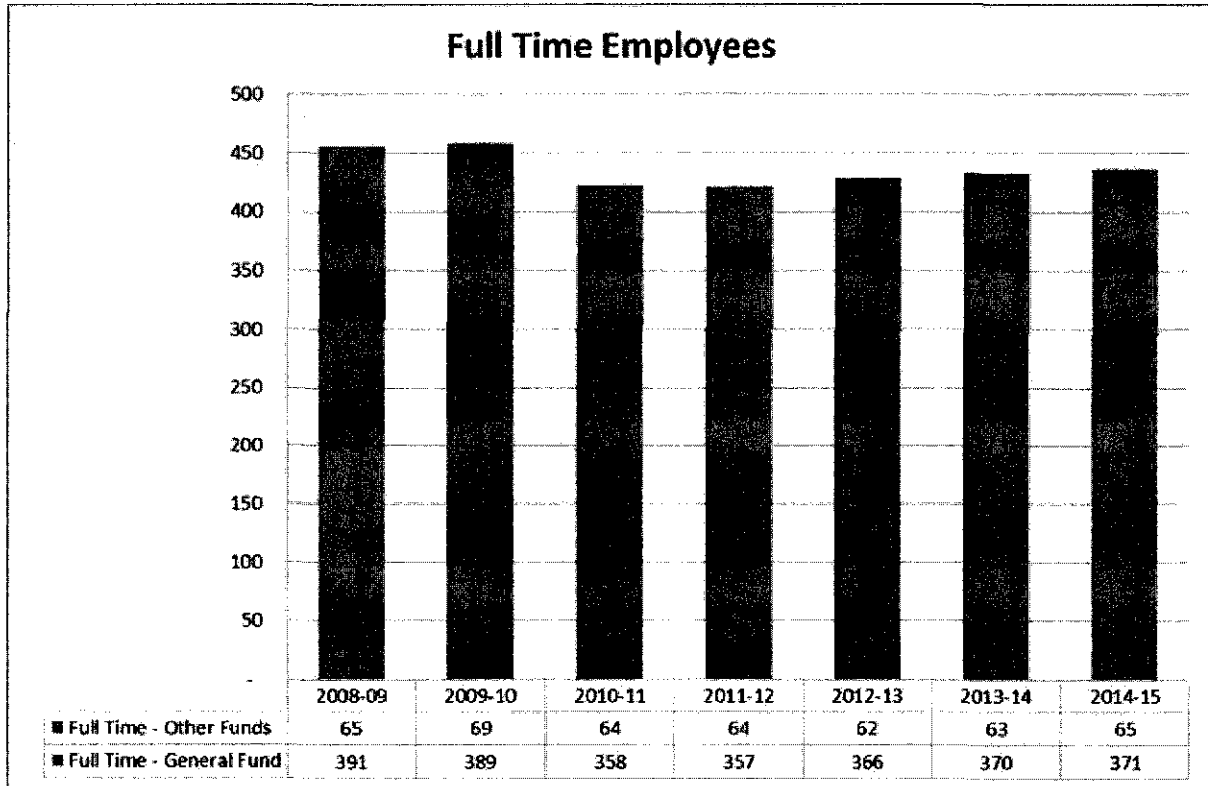
The following are some of the major items addressed in our continuing efforts to contain labor costs in order to achieve fiscal stability:

**Position Reductions**

In order to realize immediate salary savings in 2010, the City offered an early retirement incentive to qualified employees in the non-safety labor groups and agreed to either eliminate or hold the vacated positions in an "unfunded" status for a minimum of two years. Beginning in that same year, and up to the FY 2011-12 Mid-Cycle Budget, the City eliminated 32 full-time positions in the General Fund through departmental reorganizations, layoffs, and elimination of vacant positions. The combination of early retirements and strategic position reductions has resulted in ongoing savings to the City of approximately 18 Full Time positions or an estimated \$2.3 million. This includes the 14 full time positions expected to be restored or added through FY 2014-15. Without the labor concessions during the past few years allowing the City to contain the rapidly



rising cost of benefits, the addition or restoration of positions would not be possible, even with the large increase in revenues experienced in the past two years.



**Caps on City’s Medical and Dental Contributions**

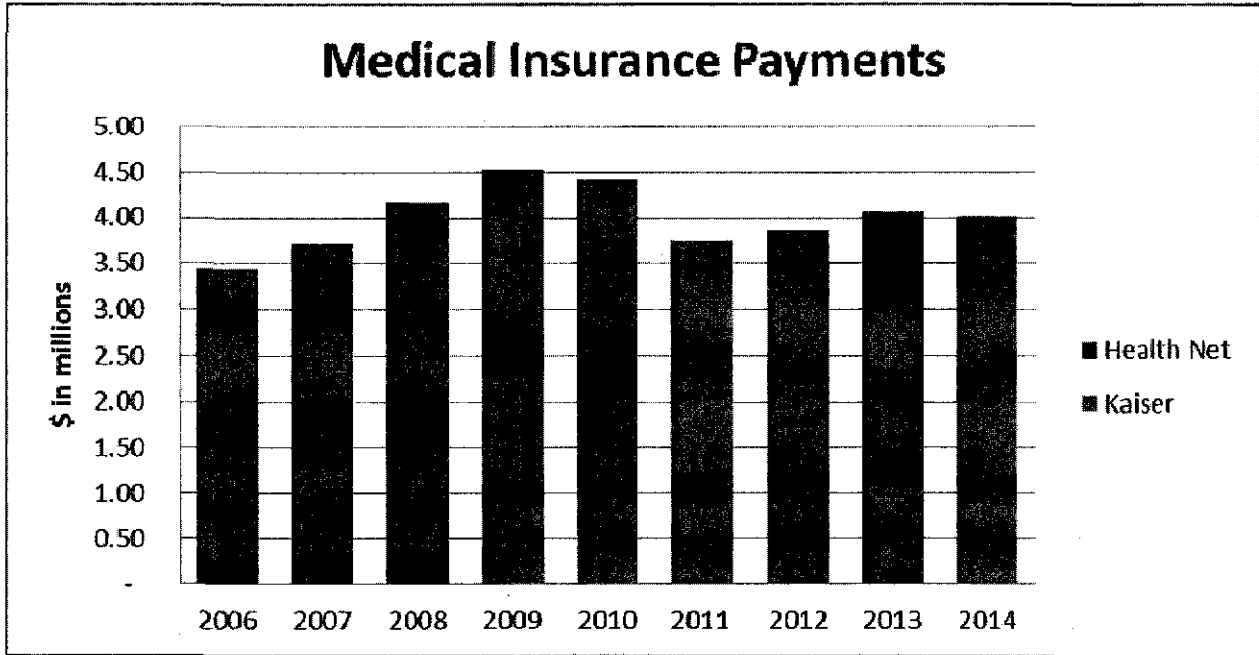
Prior to restructuring the current labor agreements, the City offered a defined benefit plan for both medical and dental benefits whereby the City paid the full premium rate for which the employee was eligible, regardless of the plan or number of covered parties. The two plans offered by the City ranged widely in premium cost with the 2010-11 full premium rate for HealthNet an average of 84% higher than the comparable premium for Kaiser. In FY 2011-12, the City took the first step in a transition to a defined contribution for medical benefits by capping its contribution rate to medical premiums at the Kaiser HMO premium rate, based on covered parties, and capping its contribution to dental premiums at the FY 2010-11 rate for Delta Care, the lowest cost dental plan offered by the City. This resulted in an ongoing savings of \$1.5 million. Unfortunately, that savings was negated by the increase in PERS rates for that same fiscal year.

In FY 2012-13, the City brought the medical cap one step closer to a defined contribution by capping the City’s monthly contribution to medical benefits at the FY 2011-12 Kaiser HMO premium rate. The MOUs covering FY 2013-14 through 2014-15 provide for either an 8% increase each year in the City contribution or 85% of that fiscal year’s Kaiser HMO premium, whichever is higher. The contribution cap has resulted in a cumulative savings for medical benefits costs of approximately \$3.5 million





since 2010. As a result of these changes, City enrollment moved primarily to the Kaiser plan, resulting in Health Net discontinuing group coverage to Napa employees. The City has been able to continue the caps on monthly medical contributions, increasing the caps by 8% per year, or to 85% of the monthly medical premium, whichever is greater. This results in increased costs for medical while continuing to shield the City from large increases in health insurance costs in future years. It also mitigates out of pocket medical costs to employees.



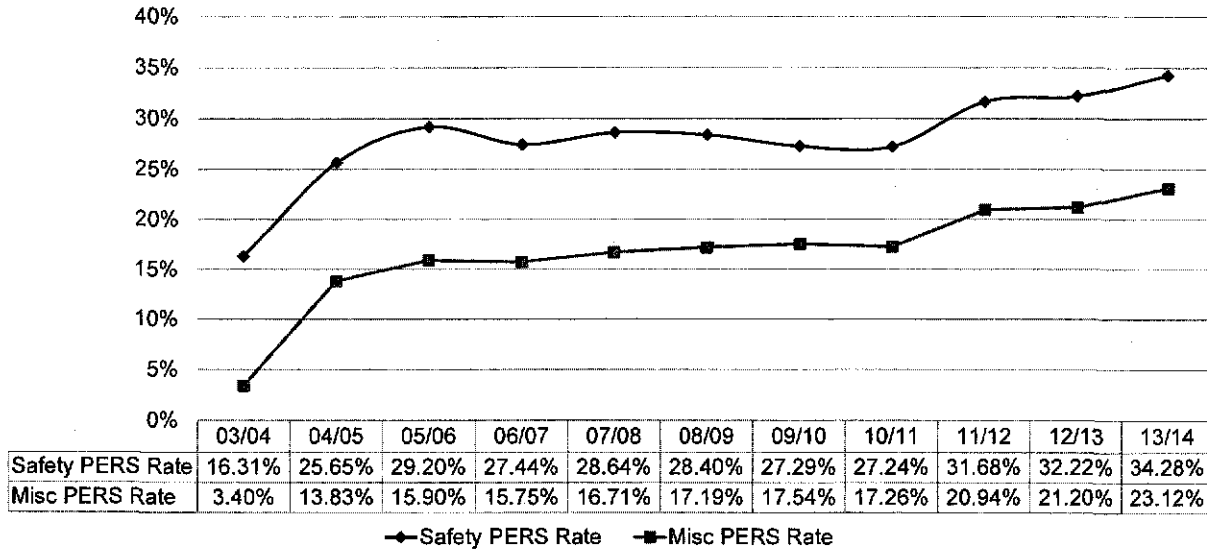
**CalPERS Pension Changes**

The City participates in the statewide Public Employees' Retirement System (PERS) along with most other California municipalities and public agencies. The City does not control pension rates or cost increases, only the level of benefits and employee contributions. Below is a graphical representation of a 15 year trend in PERS rate increases. FY 2004-05 rates mark the beginning of the contributions for the enhanced benefit of 2.7% @ age 55 negotiated in Miscellaneous employee contracts in 2002. Public Safety employees received enhanced retirement formula of 3% @ age 50 in FY 2004-05. Since FY 2004-05, PERS rates have increased from 13.8% to 23.1% (FY 2013-14) for Miscellaneous employees and from 20.8% to 34.28% (FY 2013-14) for Safety Employees. Since FY 2004-05, PERS contributions have increased by 75%, representing 12% of the General Fund operating budget.

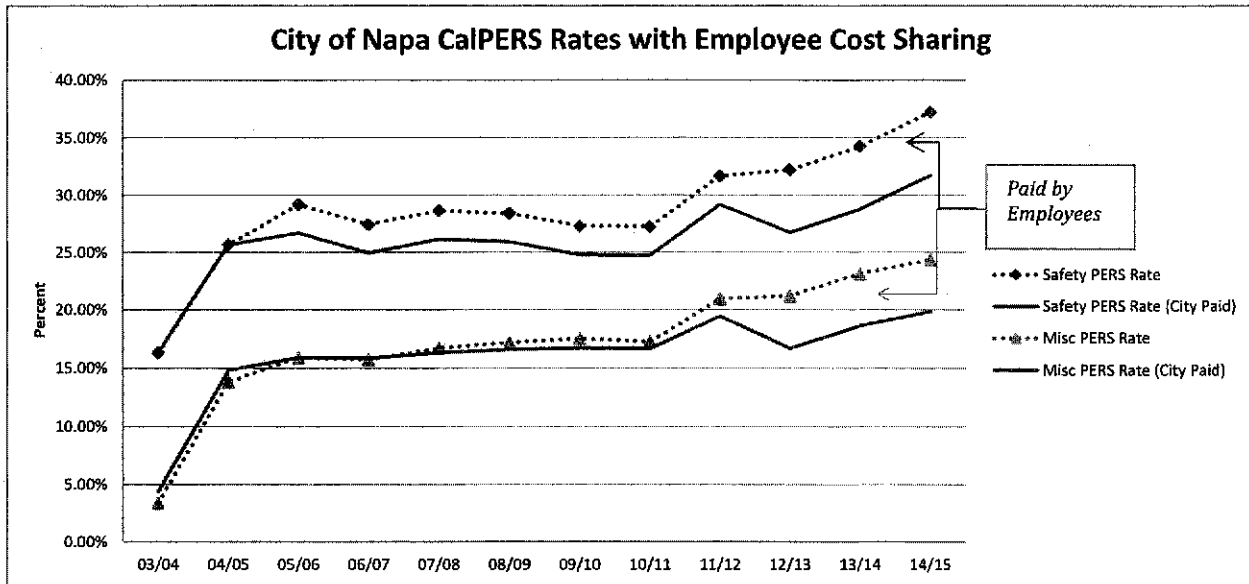


EXHIBIT 1

City of Napa CalPERS Contribution Rates



Compared to most California cities, Napa is in a better position with respect to employees sharing in the cost of PERS pension benefits. Since 2000, our employees have contributed full member contribution of 7% for miscellaneous (non-safety) employees and 9% for safety employees. When the City upgraded the Miscellaneous benefit to 2.7% @ 55 in FY2004-05, the City picked up the 1% member contribution increase. In 2005, all employees agreed to a cost share formula of up to 2.5% on top of their required member contribution and in FY 2012-13 agreed to contribute an additional 3% (for Miscellaneous employees this is actually 2% as they picked up the 1% previously paid by the employer at the time of the benefit enhancement). This results in Miscellaneous employees paying 12.5% and Safety members paying 14.5% toward the cost of pension benefits. These most recent changes result in an **annual cost savings of \$1 million**. In addition, all employee groups have agreed to a “two-tier” pension system with reduced benefits for new employees. This produced **an estimated savings of \$195,000 in the first two years** of implementation and is expected to generate long-term savings for the City as newly hired employees replace the current workforce and the number of employees eligible for the higher benefits is reduced. The following chart shows the actual PERS rates paid by the City and the amount of the cost shared by employees since FY 2003-04. The PERS rates are represented by the dotted lines. The solid lines represent the actual rate paid by City of Napa, and the space in between represents the cost share picked up by employees.

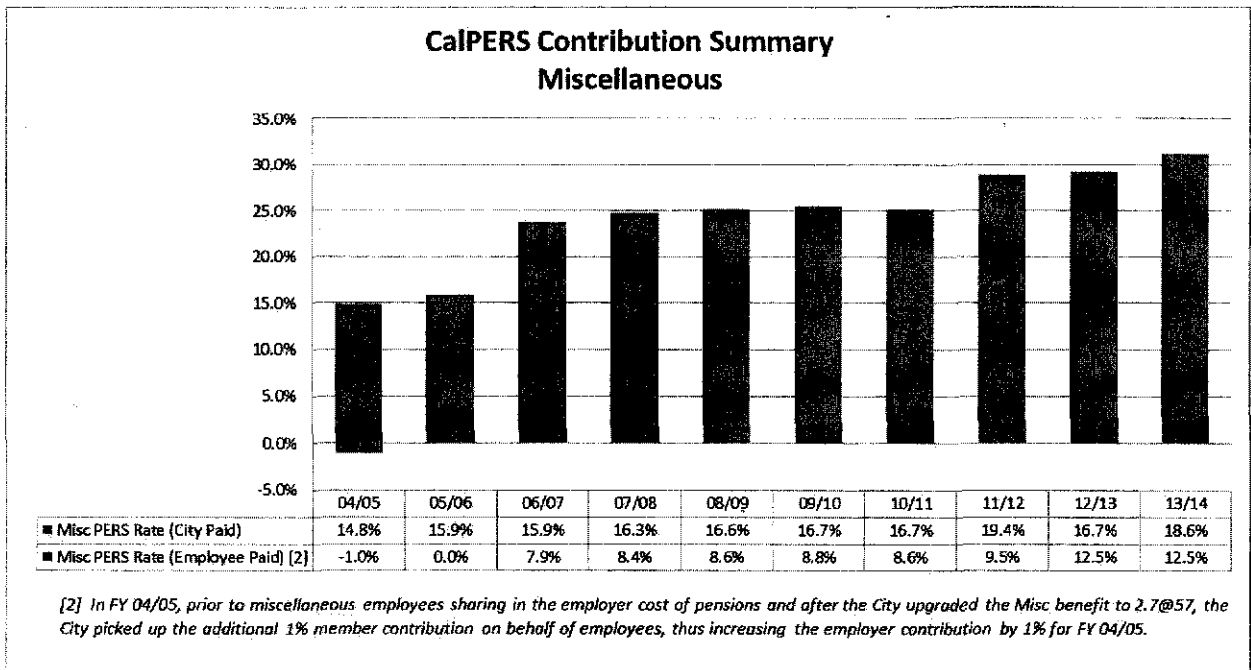
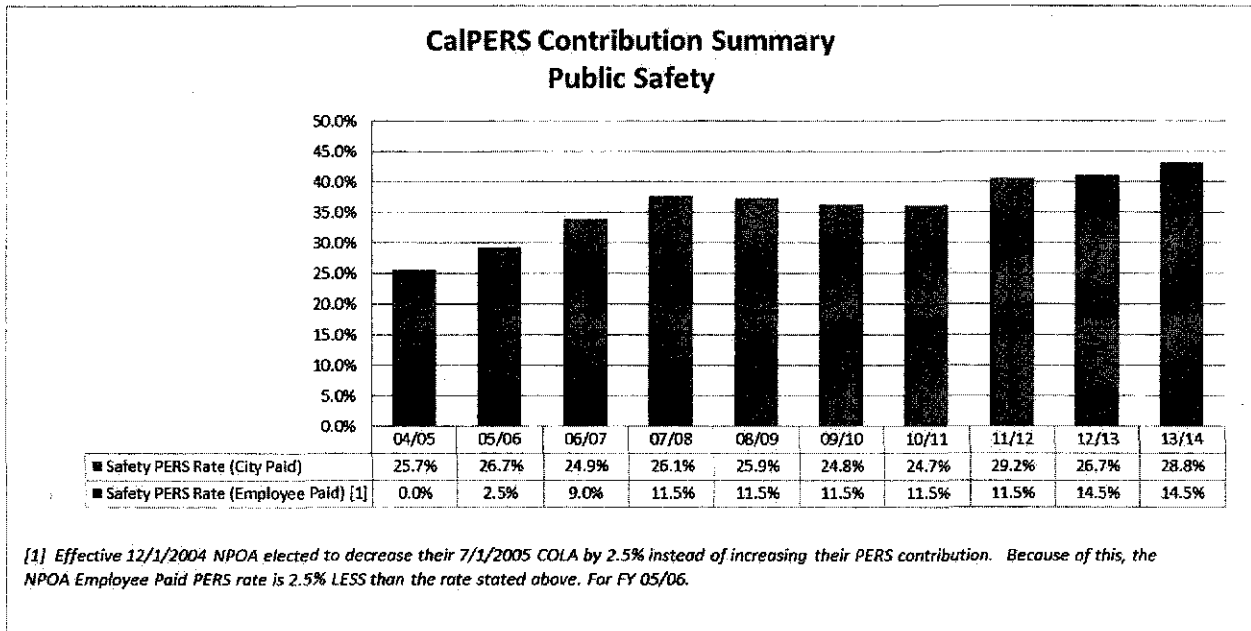


In September 2012, the Governor signed the Public Employees’ Pension Reform Act of 2013 (PEPRA), which became effective January 1, 2013. PEPRA applies to all “new” PERS members who enter the system on January 1, 2013 or later, or who were previously members of PERS but had no active contributions in the six (6) months preceding new employment. PEPRA provides for a 2%@60 benefit for Miscellaneous members and a 2.7%@57 benefit for Safety members in the City of Napa. This Act will further contain pension costs by adding the reduced retirement tiers, as well as imposing a mandatory cost share on employees who are new to the PERS, 37 Act or PERS reciprocity system equal to a minimum of 50% of the normal cost of the benefits. Employers are able to impose this same mandatory cost share on “classic” members (PERS members currently or within the six months preceding employment) beginning in 2018; however, Napa employees are already paying at least 50% of the normal contribution due to the concessions agreed to in the past few years.

On February 19<sup>th</sup>, 2014, CalPERS adopted changes in actuarial assumptions for mortality and retirement age, but maintained the five-year phase in and 20 year smoothing model for employer rates, with the changes to impact employer retirement contribution rates starting in FY 2016-17. The City can expect to see an additional increase in rates of up to 6.5% for Miscellaneous and 9% for Public Safety members by year five of the phase in, specifically attributable to these changes in actuarial assumptions. In addition, PERS rates are expected to rise again (over 4% increase in required employer contribution equivalent to approximately \$0.5 million) in FY 2015-16 as the 5 year smoothing model begins to recover for investment losses experienced by CalPERS in prior years.

The following charts show the total CalPERS contributions for Miscellaneous and Safety employees and the actual cost borne by the City and by the employees.

## EXHIBIT 1



While the City is in better fiscal shape than most other municipalities in respect to pension benefits and costs, this is still an area that needs significant attention toward continued cost containment as rates are expected to continue to rise significantly in the future. The City has few options other than employee agreement through MOU negotiations or implementing a reduced pension benefit tier from PEPR, to reduce the cost of pension benefits into the future.



One option that does remain for the City is to prefund or otherwise increase funding for pension benefits on an annual basis. The City currently contributes the required percentage of payroll for pension benefits on a bi-weekly basis, which works well to manage cash flows throughout the year. If the City were to contribute the entire required employer contribution rather than funding with actual payroll costs, it could be possible to get to an 80% funding level sooner than later. Unfortunately, the actuarial reports are always a year or two behind reality, so some years the City contributes more than the required employer contribution, and some years we contribute less, depending on several factors including the vacancy rate, number of new positions, time it takes to fill the new positions, etc. For fiscal year 2013-14, the budget for employer contributions plus the expected total employee cost share contribution is projected to be approximately \$0.2 million below the employer required contribution for the year; however, the City recently made a payment to CalPERS in the amount of \$0.4 million to fund the former Redevelopment Agency's unfunded liability for pension benefits, which will result in the City fully funding or over funding the annual required employer contribution for FY 2013-14. For fiscal year 2014-15, the budget is approximately \$0.2 million more than the required employer contribution. This is due, in part, to the increase in positions approved for FY 2014-15. The Council recently approved the reservation of \$0.9 million toward future pension costs, which will be used to fund the difference between the budgeted and actual pension costs to ensure that Napa is able to contribute the total required employer contribution each year.

The Governmental Accounting Standards Board (GASB) recently released Statement Number 68 requiring governments to report the unfunded pension liability in their annual financial statements. While this information has historically been presented in a footnote, reporting the liability in the financial statements will have a significant impact on the City's net equity/fund balances, and provides greater incentive to fund the unfunded liability related to pension costs.

**Other Post Employment Benefit (OPEB) Liability for Retiree Health Care Benefits**

Government employee pensions and other post-employment benefits (OPEB) have existed for years, but were paid little attention until July 2004 when the Governmental Accounting Standards Board (GASB) issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. GASB 45 requires public agencies to calculate and report the cost and financial obligations of providing post-employment healthcare and other post-employment benefits (OPEB) in a footnote to the annual financial statements. Other Post-Employment Benefits are retiree welfare benefits that an employee will receive at the start of retirement. For Napa, these include retiree healthcare premiums and any subsidy to those premiums and in some instances, life insurance premiums. This *does not* include pension benefits paid to the retired employee, because those benefits are accounted for under separate financial and reporting requirements of GASB. GASB 45 *does not* require that the City fund its OPEB unfunded liability; however, *not* funding the recommended annual funding produces a future cost for the City that is unsustainable and will in time exceed the cost of providing health care benefits to active employees.



GASB 45 does however, encourage employers to begin *pre-funding* the unfunded liability for OPEB benefits. Employers are required to have an actuarial report prepared to calculate the Annual Required Contribution (ARC), which determines the annual amount to be set aside in order to fund current and future OPEB liabilities in full within 30 years. Employers are encouraged to pre-fund this liability by depositing the ARC into an irrevocable trust fund established for OPEB. In general, the way that governments (including the City of Napa) have paid for those OPEB benefits is on a "pay-as-you-go" basis, making annual payments towards their current OPEB costs obligations, without paying for any future, anticipated OPEB costs. This method obviously creates budget uncertainty because annual "pay as you go" requirements may change drastically from year to year with increased insurance costs and due to the growing number of retirees, and makes strategic planning for municipal operations difficult. It is the simplest method in the short run because it does not require actuarial analysis, but over the long run, usually results in increasing unfunded obligations as current payment requirements do not make any headway in funding future liabilities.

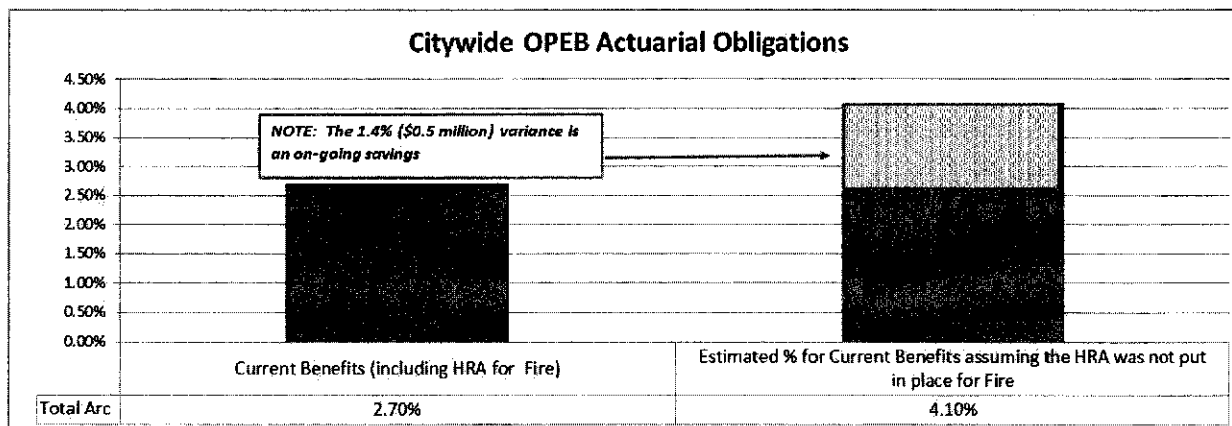
A significant factor for the increase in the City OPEB unfunded liability has been the nature of the City's prior employee agreements where the City agreed to pay for lifetime retiree medical benefits and/or to pay the full premiums with no cap. This resulted in a lack of control over costs that continued to increase every year as more people retired and as the cost of health benefits continues to rise significantly. Since the beginning of FY 2009, the city has taken strategic steps to address OPEB liability funding issues and contain increasing current and future funding obligations for retiree medical costs. This has largely been accomplished through reframing the City's commitment to provide retiree medical benefits through a defined contribution rather than a defined benefit agreement.

The City has established its contribution for Fire bargaining groups as a defined dollar amount, contributed during the Firefighters' active service with the City. In exchange for eliminating the City paid medical benefit premiums provided in retirement in prior MOUs, the City negotiated to open a Health Reimbursement Arrangement (HRA) for fire employees that would be funded through a conversion of accrued sick leave benefits on an annual basis, and at the time of retirement, through which the retiree may fund his or her own medical premiums and other medical costs in retirement. At the same time, the City was successful in negotiating the elimination of sick leave conversion to CalPERS service credits at retirement, thereby reducing the increases to the unfunded pension liability resulting from employees converting sick leave to additional PERS service credit (and thus, increased pension payments) at retirement. These changes are required for new members of the Napa City Firefighters' Association (NCFA) and Napa City Fire Officers (NCFO), and employees who were age 45 or under at the time the change in the MOU was negotiated in 2009. Members within 10 years of age 55 at the time the MOU became effective were allowed the opportunity to "opt out" of the HRA and maintain the sick leave conversion benefits to either CalPERS service credit or City paid retiree medical benefits. This change resulted in elimination of future OPEB liability for employees hired after the change was made, and for employees who "opted in" to the



HRA as all of the contributions are made during the active working career of the firefighter. The implementation of the HRA resulted in a decrease in the Actuarial Accrued Liability (AAL) of \$0.3 million.

The chart below shows the current OPEB annual obligation (blue bar) compared to what the annual OPEB obligation would have been had the City not implemented the HRA (green bar). The shaded portion of the green bar represents the ongoing annual savings attributed to the conversion of retiree medical benefits for the Fire group to the HRA.



The employees in the Napa Police Officers' Association (NPOA) and the Management Unit of the Napa Police Department (MUNPD) later agreed to convert the City's retiree medical benefit to a defined contribution during the working career into a Retiree Medical Trust (RMT). In 2012, the NPOA entered into the PORAC Retiree Medical Trust (RMT), a defined contribution program similar to the NCFR HRA, whereby the City contributes \$100 per month to the Trust for each member to fund medical costs in retirement.

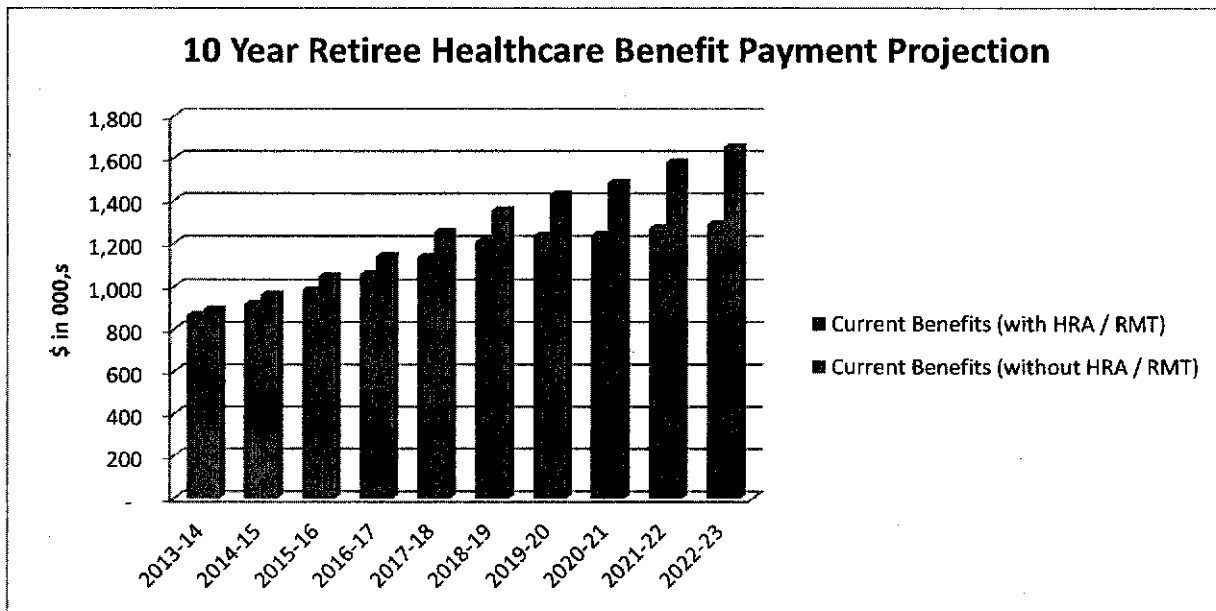
In 2010, the City also successfully negotiated with the employee bargaining groups and retirees to separate the active and non-Medicare retiree health care benefits. Blending the benefits for active employees and retirees resulted in a single, higher rate for premiums for both employees and retirees, increasing the City's annual medical costs for employees. By separating the benefits, the City was able to reduce annual benefit costs for active employees. This resulted in increased premium rates for retirees enrolled in the City's medical program, however, other less expensive health benefit options were made available for retirees to mitigate the impacts of higher premiums. Due to the removal of the active "implied subsidy" for retiree costs, the unfunded liability was reduced by \$5.7 million. The City also achieved an additional annual cost savings of approximately \$200,000 due to lower premiums for active employees.

The last key factor in lowering the City's OPEB unfunded liability was the City's decision to pre-fund future OPEB benefits through the use of a restricted trust specifically for this purpose. The City set aside funds in FY 2007-08 and 2008-09 with the intention of funding an OPEB trust; however, decided to hold the funds internally as CalPERS was



experiencing large investment losses. In 2010, the City opened a California Employment Retirement Benefits Trust (CERBT) with an initial contribution of \$1.5 million from the funds set aside in previous years. Participation in the CERBT trust requires an actuarial valuation every two years to determine the annual required contribution. The City continues to fund OPEB on a bi-weekly basis through the payroll process. In addition, the City recently funded an additional \$34,000 for the former Redevelopment Agency's unfunded liability using Redevelopment Property Tax Trust Funds (RPTTF) revenues. This payment fully funds the unfunded liability attributable to the former Redevelopment Agency.

The combination of these changes, along with projected contributions to the CERBT trust, has resulted in a reduction to the City's OPEB unfunded liability from \$18 million in 2006 to a projected \$9.8 million in 2013. In addition, moving from a defined benefit to a defined contribution system for active and retiree medical benefits has created an additional \$450,000 in annual savings as well as provided greater sustainability for maintaining an affordable retiree medical benefit for the City and for retirees.



The most recent actuarial valuation shows the City fully funding its OPEB liability by 2040. While many municipalities are still funding this liability on a pay-as-you-go basis, Napa is in good shape by funding the CERBT trust to cover both current and future liabilities.

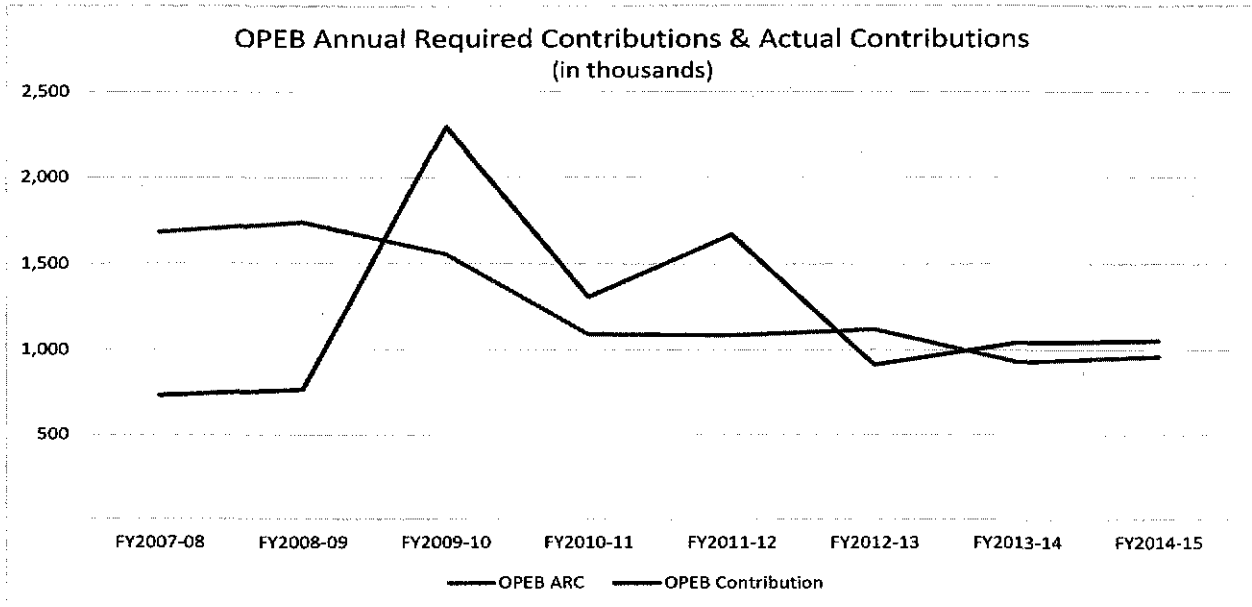
Other options for funding the OPEB liability include increasing contributions above the minimum required to meet the Annual Required Contribution, funding the entire ARC in the beginning of each fiscal year rather than on a bi-weekly basis with payroll as it is currently paid, or implementing an employee cost share for the OPEB contribution.





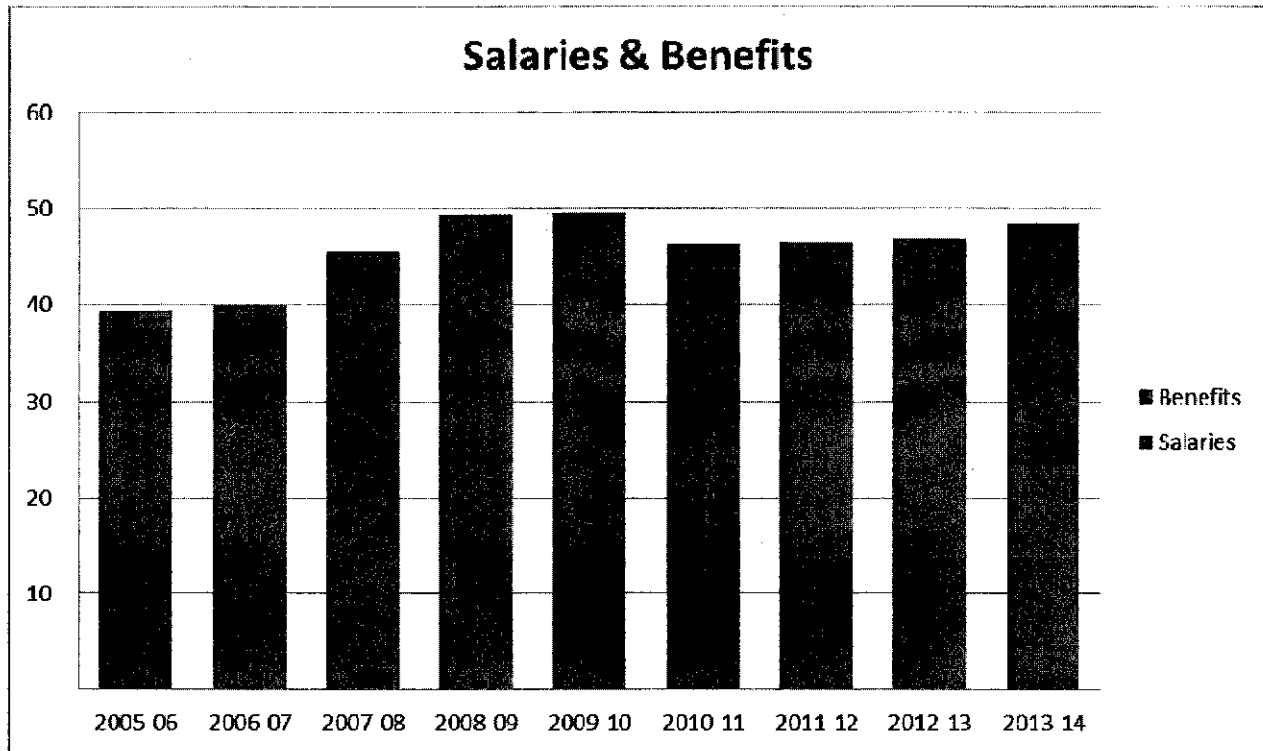
EXHIBIT 1

Through all of the measures described above, the City has been able to reduce its Annual Required Contribution from \$1.7 million in 2008 to just under \$1 million in 2015, as shown in the chart below. In addition, in most years, the City is meeting or exceeding the Annual Required Contribution to OPEB liability, which will serve to fully fund the outstanding liability earlier than 2040, as projected in the 2011 actuarial report.



**Cost of Living Adjustments**

To help the City address its budget deficit during the economic downturn, City employees have voluntarily foregone Cost Of Living Adjustments (COLAs) since 2009, resulting in a savings of approximately \$2.4 million between FY 2008-09 and FY 2012-13. This was a significant move toward balancing the budget, but not sustainable in the long term. The City has recently negotiated cost of living adjustments of 5% over the next two years with most employee groups, and is able to fund these increases through increased revenues experienced as the economy recovers and begins to stabilize. These increases; however, along with the restoration/addition of 14 of the positions eliminated from the General Fund through FY 2014-15, serve to increase the cost of labor over the next two years. The restoration of positions in this budget cycle would not have been possible if not for the cost containment measures taken in the past few years.



**GOING FORWARD**

During the last four years, the City has taken a strategic and balanced approach to address shrinking revenues and increasing expenses. Through collaboration with employee bargaining units, we have successfully taken steps to contain labor costs which have enabled the City to achieve a balanced General Fund operating budget. As revenues have significantly improved over the past two years, returning to pre-recession highs, the City has slowly restored necessary positions and negotiated cost of living adjustments and slight increases in benefits to employees. These small changes have huge lasting impacts, as we have seen in the past. As revenues continue to improve, the need will remain to continue to contain labor costs to the best extent possible while maintaining a sustainable compensation package that retains and attracts the best employees for our organization and keeps us competitive in the market.

Since nearly 77% of the General Fund budget is related to labor costs, any increases in salary and benefit costs can have a significant short term and long term budget impact. It is estimated that for every 1% increase in cost of living adjustments, the impact to General Fund costs is \$0.4 million.

Some of the areas that will continue to be addressed include the following:

**Compensation:** As the economy recovers, the City will need to provide appropriate cost of living adjustments for wages. In the most recent two-year agreements for all groups except for the Napa Police Officers' Association whose MOU expires in June, 2014, the City has negotiated 5% increases over the next two years, in 1.25% increase



increments every few months. The Long Term Financial Plan (LTFP) includes assumptions of 3% increases per year, thereafter.

**Retirement benefits:** The goal of containing pension costs will continue into the foreseeable future. While the City is ahead of the curve in negotiating employee contributions of at least 50% of the normal cost of retirement benefits, there are few options remaining in addressing rising pension costs and the increasing long term liability. The City is currently considering options to fund the annual required employer contribution in full rather than funding a percentage of payroll based on actual costs and/or pre-funding the annual required employer contribution to maximize the time value of money and increase the funded rate of the City's pension plans.

**Health Benefits:** While the City has been successful in addressing rising health care costs through implementing caps on the employer contribution toward medical and dental insurance premiums, we must continue to address the impacts of the Health Care Reform Act and the introduction of the State Insurance Exchanges; review health care options through the City Health Benefits Advisory labor-management committee to maintain affordable health care plans for all city employees; and review employee contribution levels for medical benefits. One of the ways the City has offset reductions in benefits for employees, at little to no cost to the City, is to pick up the nominal cost of the flexible benefits program, resulting in lower taxable income to participating employees, and by offering additional voluntary supplemental insurance options that provide greater benefit to employees while reducing taxable income through pre-tax payroll deductions for these benefits. City staff continues to look for better, less expensive ways to provide necessary benefits to employees.

**Retiree Medical:** The City has made great strides in reducing retiree medical, or OPEB, liability. As greater attention is provided to OPEB benefits, it is incumbent upon the City to do everything we can to reduce the unfunded liability for OPEB benefits. The City is currently working to update the actuarial report for the unfunded OPEB liability as of June 30, 2013. It is expected that the unfunded liability will be further reduced based on the successful negotiation to exchange NPOA retiree medical benefits to the RMT. However, the City still has a significant unfunded OPEB liability that will need to be addressed over continued negotiations with bargaining groups and funding options that will be examined in the future.