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Grand Jury: Hermosa Beach must deal with skyrocketing pension costs

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Hermosa Beach is on the hook for nearly $14 million in unfunded pension liabilities and will face skyrocketing retiree costs that could cripple the city's ability to provide essential services if changes aren't made, according to a report released this week.

The audit by the county civil grand jury - titled "Whoa! The State of Public Pensions in Los Angeles County" - investigated five public pension plans. The volunteer pool of 23 residents is charged with investigating public agencies to ensure they are being governed honestly and effectively.

The report contained no allegations of criminal wrongdoing or negligence. It did note, however, that Hermosa Beach's contribution level to the retirement funds and health care plans of retired police officers is the highest in the county. Hermosa was the only South Bay city cited.

City Manager Steve Burrell forwarded a copy of the 292-page document to the Daily Breeze on Thursday afternoon. A statement from his office was issued a short time later.

In a brief interview, Burrell said that tackling pension reform is a top priority and city officials have begun taking steps to curb spending.

"We've started on things already, and we are going to continue to be open minded about changes," he said.

The report comes three months after a new pension system was put in place for newly hired Hermosa Beach employees, including police and fire personnel.

The City Council approved a

new labor deal with employees in April that includes a two-tiered pension system. The move made Hermosa the first South Bay city to adopt the two-tier structure, which will affect employees hired after July 16.

The new system is expected to save the city 34 cents for every $1 in payroll for each new police officer, 19 cents for every $1 in payroll for each new firefighter and 8 cents for every $1 in payroll for all other new employees.

Under the two-tier system, new hires to the police and fire departments will be eligible to retire at age 50, earning 2 percent annually of their highest year's salary multiplied by the number of years of service. Using the same formula, other city employees will be able to retire at 60.

Current police employees can retire at age 50 at 3 percent and fire employees can retire at 55,

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also at 3 percent. City workers can retire at 55 and earn 2 percent of their highest year's salaries multiplied by the years of service.

Hermosa Beach offers pension benefits to its employees through CalPERS, the California Public Employees Retirement System. The city pays the full contribution amount - the employer's and employee's share - to the pension funds of workers. Those contribution levels are having a "significant effect" on the city's costs, according to the report.

Hermosa Beach this year is projected to pay a total of $4.1 million to CalPERS for employee retirement plans, excluding retiree health benefits.

Hermosa Beach Mayor Howard Fishman said the current pension liabilities can be traced back to the early 1990s, when CalPERS investments were generating large amounts of interest, with returns so high cities were informed they did not have to pay pension obligations.

"Cities got free rides for several years, saving significant money towards their pension plans," said Fishman, a retired risk manager for the city of Manhattan Beach.

The economic boom of the 1990s and high returns on investments left cities flush with money, Fishman added, which they put back into public works projects and enhanced pension plans to recruit new employees.

Then the recession hit. Investment market crashes in 2008 and 2009 dramatically affected pension systems for public employees, rapidly deteriorating retirement fund assets across the United States.

Today, Hermosa is left with $13.9 million in unfunded pension liabilities. Faced with rising costs and declining revenues, city officials last fiscal year assumed $2.4 million in "revenue enhancement initiatives" - including increases for parking lot fees and extended meter enforcement hours. The city also has cut funding for 17 positions and reduced contracts for services and supplies, while aggressively seeking government grants and public donations to fill the gaps.

The initiatives amounted to a 8.2 percent cut in spending, according to the report.

Still, the rising costs of paying retired workers could affect residents.

"The significant costs of retirement benefits for employees, as well as the general revenue losses from the recession, have impacted the city's ability to fully fund historical service levels," the report states.

Councilman Kit Bobko, a vocal critic of the city's pension contributions and an advocate of reform, said he believed the city was on an unsustainable path.

"Over the years we've given away more and more taxpayer dollars in return for labor peace," Bobko said.

He sees the pension issue as a top concern - second only to the long-running lawsuit with the MacPherson Oil Co. The Santa Monica-based

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company, which claims the city illegally broke a lease agreement, is seeking $700 million in damages. City officials have said the suit - set for trial in January 2012 - could bankrupt the beach town.

In the report, the civil grand jury recommends that Hermosa Beach and its labor unions agree to reduce or eliminate the employee retirement "pick up" - or the share of contribution to worker's retirement accounts.

But that option can't be renegotiated until next year. In exchange for keeping the current contribution levels, the city's labor unions agreed to the two-tier system.

"I think that was horrible mistake and we should not have done that," Bobko said.

Bobko has asked the council to authorize a study by an independent third-party accountant to e valuate the city's long-term pension liabilities. The study is estimated to cost about $15,000.

According to documents obtained from CalPERS through a records request, 10 retired workers in Hermosa Beach earn more than $100,000 a year through their pension funds. The information is posted in an online database on the California Pension Reform website.

Representatives from the city's first responder unions did not return requests for comment by press time.

Fishman, acknowledging the importance of pension reform and city officials' desire to work with employee groups to cut spending, said he was optimistic the city's pension liabilities could be fulfilled.

"We're paying our bills and we have a balanced budget," Fishman said. "It's not as if the sky is falling."

Still, he said the city has embarked upon a new path.

"We will figure out a way to fund the pension plans," Fishman said. "The way it's going to have to work is with the help of the unions to help subsidize a portion of their retirement. We need their help in order to sustain this. We just can't move forward like we have been."

Among the report's findings:

The first public records request made by the civil grand jury to CalPERS for info was on Dec. 29. The requested information was not received until March 10. In the report, the civil grand jury said the "delays were unreasonable, given that these are standard reports that are produced annually for all member agencies, should be publicly available to the taxpayers, and should be easily retrievable by CalPERS staff for dissemination to the general public."

Hermosa Beach pays some of the highest retirement system employer rates in the county and the highest employer contribution rate for its CalPERS Police Safety Plan. In addition, Hermosa picks up the full amount of the employees' contributions at 7 percent of salaries for miscellaneous employees and 9 percent for uniformed police and fire employees.

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The high cost of employee retirement benefits, plus the effects of the recession, have caused the city to make significant budget reductions in the past year.

Hermosa has taken action to create a second retirement tier for new workers pursuant to policy direction from the council. However, the city is not pursuing other alternatives that would result in more immediate savings, such as reducing or eliminating the pick-up of the employee contribution rates.

The Hermosa Beach Police Safety Plan was chosen for an in-depth review based on the annual required contribution and retiree health benefits, which amounted to more than 62 percent of "pensionable" salaries in 2009. That amount is expected to rise by more than 70 percent by 2012.

The employer contribution rate for its police safety plan was the highest in the county at a reported rate of 48.9 percent of salaries.

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Pension problem

$13.9 million

Hermosa Beach's unfunded pension liabilities

$2.4 million

amount of 'revenue enhancement initiatives' - increases for parking lot fees, extended meter enforcement hours - in the past fiscal year