

Council/Agency Meeting Held: _____	_____ City Clerk's Signature
Deferred/Continued to: _____	
<input type="checkbox"/> Approved <input type="checkbox"/> Conditionally Approved <input type="checkbox"/> Denied	
Council Meeting Date: August 15, 2005	Department ID Number: FN 05-005

**CITY OF HUNTINGTON BEACH
REQUEST FOR CITY COUNCIL ACTION**

SUBMITTED TO: HONORABLE MAYOR AND CITY COUNCIL MEMBERS

SUBMITTED BY: *Penelope Culbreth Graft*
PENELOPE CULBRETH-GRAFT, DPA, CITY ADMINISTRATOR

PREPARED BY: DAN VILLELLA, CPA, FINANCE OFFICER *DV*

SUBJECT: **ADOPT RESOLUTION TO ESTABLISH FISCAL YEAR 2005/2006
TAX RATE**

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 HUNTINGTON BEACH, CA
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Statement of Issue, Funding Source, Recommended Action, Alternative Action(s), Analysis, Environmental Status, Attachment(s)

Statement of Issue:

Should the City of Huntington Beach adopt a tax rate to fund the portion of retirement costs that can be legally collected in accordance with court cases, state law, and the City Charter?

The fiscal year 2005/2006 General Fund proposed budget contains estimated retirement tax revenue of \$1.4 million to fund a portion of the cost of pre-1978 employee retirement benefits. This amount is consistent with the adopted tax rate for FY 2004/2005.

Funding Source:

Not applicable.

Recommended Action:

Adopt Resolution Number **2005-56** "A Resolution of the City Council of the City of Huntington Beach Levying a Retirement Property Tax for Fiscal Year 2005/2006 to pay for Pre-1978 Employee Retirement Benefits" of \$.00696 per \$100 of assessed valuation to pay for pre-1978 employee retirement benefits.

Alternative Action(s):

1. Do not adopt a tax rate that will cause a reduction of \$1,475,000 in estimated General Fund revenue for FY 2005/2006.
2. Adopt a tax rate that will fully recover the allowable portion of the safety employer contribution rate. This will result in an additional \$6.3 million of General Fund revenue for FY 2005/2006.
3. Adopt an alternative less than the maximum rate.

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REQUEST FOR ACTION

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Analysis:

History of the Retirement Levy

The city receives a pro-rata (approximately 16 percent) of the one percent basic levy collected as property taxes on all real property within the city limits. In addition, the city can legally levy taxes to recover costs related to pre-1978 retirement benefits.

The city has levied a retirement property tax since 1966, when a City Charter amendment allowed the city to recover retirement costs. Section 607(b)2 of the City Charter states, "There shall be levied and collected at the same time and in the same manner as other property taxes for municipal purposes are levied and collected...tax sufficient to meet all obligations of the city for the retirement system in which the city participates, due and unpaid or to become due during the ensuing fiscal year." In 1978, after the passage of Proposition 13, the city was still allowed to levy tax overrides above the one percent basic levy. This authority was limited by Revenue and Taxation Section 96.31(a)(4), which effectively set the city's maximum retirement tax rate at \$.04930 per \$100 of assessed valuation.

In 1999, the Howard Jarvis Taxpayer's Association filed a lawsuit against the city concerning the levying of these taxes. The court determined that the city could only levy taxes for retirement costs that were in effect prior to 1978. Determining the exact amount of pre-1978 benefits in any given year requires an actuarial report. In 2004, the city commissioned a report from an actuary, John Bartel of Bartel Associates, which made assumptions and recommendations concerning how to determine these amounts. Subsequently, the California Attorney General issued an opinion supporting the assumptions made by the city.

Staff is recommending that the City Council adopt the same tax rate as in the prior year (FY 2004/2005), which is \$.00696 per \$100 of assessed valuation. This will yield approximately \$1,475,000 of revenue to the city in FY 2005/2006.

Calculation of Possible Tax Rates

The city may levy any tax rate between zero and the maximum allowable tax rate. To compute the maximum tax levy, the pre-1978 retirement costs are divided by the assessed valuation. For FY 2005/2006, the city's secured assessed valuation (not including Redevelopment Agency incremental assessed valuation) was \$21,194,964,629. This was an increase of approximately \$1.4 billion, or 7.03 percent from the prior year. Unsecured valuation is levied at the prior year secured rate so it is not used in determining the current year tax rate.

On July 5, 2005, the City Council approved a prepayment of retirement costs that will result in savings to the city and taxpayer. Since the city can recover only its actual costs, only the discounted amounts can be recovered.

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The calculation of the amount of estimated FY 2005/2006 retirement costs that can be recovered through an override levy is summarized in the following table:

	FY 2005/2006 Budget Amounts
Full Amount of Estimated Employer Safety Costs	\$ 9,535,740
Discount Amount from PERS Prepayment	\$ (349,331)
Discounted Safety Costs	\$ 9,186,409
Less Amount Related to Post-1978 Benefits (3% at 50)	\$ (1,408,724)
Costs Recoverable Through Property Tax	\$ 7,777,685

The amount of retirement costs related to the post-1978 benefits was computed as follows:

	Employer Safety Retirement Rate FY 2005/2006	Ratio of Costs	Estimated Employer Safety Retirement Costs FY 2005/2006
Retirement Percentage Attributable to Pre-1978 Benefits	25.3970%	84.67%	\$ 7,777,685
Retirement Percentage Attributable to Post-1978 Benefits	4.6000%	15.33%	\$ 1,408,724
Total Safety Employer Rate FY 2005/2006	29.9970%	100.00%	\$ 9,186,409

The following table summarizes the results of levying the maximum allowable rate versus levying the prior year tax rate (**staff recommendation**):

	Maximum Allowable Rate	Staff Recommendation
Total Pre-1978 Retirement Costs	\$ 7,777,685	\$ 7,777,685
Amount of Pre-1978 Costs to be Recovered	\$ 7,777,685	\$ 1,475,000
Divided by Assessed Valuation	\$ 21,194,964,629	\$ 21,194,964,629
Tax Rate for FY 2005/2006 (per \$100)	\$ 0.03670	\$ 0.00696
Estimated Cost for Parcel with Assessed Valuation of \$500,000	\$ 183	\$ 35

The maximum allowable rate is the lesser of the above calculation (\$.03670 per \$100 of assessed valuation) and the amount allowed under Revenue and Taxation Code 96.31(a)(4) (\$.04930 per \$100 of assessed valuation for Huntington Beach).

Environmental Status:

Not applicable.

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REQUEST FOR ACTION

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Attachment(s):

City Clerk's Page Number	No.	Description
5	1.	Resolution Number 005-50 , "A Resolution of the City Council of the City of Huntington Beach Levying a Retirement Property Tax for Fiscal Year 2005/2006 to pay for Pre-1978 Employee Retirement Benefits" of \$.00696 per \$100 of assessed valuation to pay for pre-1978 employee retirement benefits.
9	2.	February 11, 2005 memo from Jennifer McGrath, City Attorney, subject: "Attorney General Opinion Regarding Retirement Property Tax".

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ATTACHMENT 1

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RESOLUTION NO. 2005-56

A RESOLUTION OF THE CITY COUNCIL
OF THE CITY OF HUNTINGTON BEACH
LEVYING A RETIREMENT PROPERTY TAX FOR
FISCAL YEAR 2005/2006 TO PAY FOR PRE-1978
EMPLOYEE RETIREMENT BENEFITS

WHEREAS, since 1948, the City has provided for employee pensions through a contract with the California Public Employees Retirement System (CalPERS). Pursuant to the 1966 and 1978 Charter, the voters of the City authorized the City Council to pay for the cost of employee pensions through a separate retirement property tax. Section 607(b)(2) of the 1978 Charter provides that the City may impose a retirement tax "sufficient to meet all obligations of the City for the retirement system in which the City participates"; and

Proposition 13 was added to the California Constitution in 1978. It limits the local property tax to 1% of assessed value, except that the City may levy an override tax in excess of 1% to pay "any indebtedness approved by the voters prior to July 1, 1978"; and

In the case entitled *Carman v. Alvord*, 31 Cal. 3d 318 (1982), the California Supreme Court determined that under Proposition 13, an override property tax in excess of 1% of assessed value may be levied to pay for employee pension benefits the voters approved prior to 1978. Consequently, after Proposition 13, the City Council continued to levy an override tax to pay for employee pensions. Since 1983-84, Revenue and Taxation Code Section 96.31(a)(4) has limited the City to levying a maximum override tax of \$0.04930 per \$100 of assessed value to pay for its retirement system; and

In 2001, Proposition 13, as applied to the City Charter, was interpreted in *Howard Jarvis Taxpayers Association, et al., v. County of Orange, and City of Huntington Beach as Real Party in Interest*, Orange County Superior Court Case No. 81-87-80. The Court held that the override tax may only be levied to pay for retirement benefits the City contracted for before July 1, 1978, and may not encompass the benefits the City added after the passage of Proposition 13. This interpretation was upheld in *Howard Jarvis Taxpayers Ass'n v. County of Orange* (2003) 110 Cal.App.4th 1375, 2 Cal.Rptr.3d 514, Court of Appeal Case No. G029292; and

Prior to July 1, 1978, the City entered into collective bargaining agreements with employee associations representing its safety employees providing that, effective July 1, 1978, they would be entitled to a CalPERS retirement benefit known as "2% @ 50." Subsequently, on June 30, 1999, pursuant to collective bargaining agreements the City had entered into with its safety employees, the City provided its safety employees with the CalPERS retirement benefit known as 3% @ 50. Consequently, it is necessary to allocate the employer contribution to CalPERS for safety retirement between 2% @ 50 and 3% @ 50, because only the employer contribution for 2% @ 50 may be paid through the override property tax; and

The City has received a report from John Bartel of Bartel Associates, a professional actuary experienced in pension calculations, entitled, "City of Huntington Beach CalPERS Actuarial Issues - "Cost" of 3% @ 50," dated August 10, 2004. The Report identified the

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additional cost of 3% @ 50 as what CalPERS refers to as the "normal cost" of the benefit, which represents the present value of future benefits employees earned during the current year. Under this approach, the incremental cost of 3% @ 50 is 4.6% of safety payroll, and the remainder of the employer contribution represents the cost of 2% @ 50; and

In April 2004, Assemblyman Harman formally asked the Attorney General regarding the correct method of allocating the employer contribution to CalPERS between its pre-1978 and post-1978 components. In his February 7, 2005, Opinion (Opinion No. 04-413) the Attorney General opined that "any reasonable accounting method may be used for purposes of determining which costs are not subject to the 1% property tax limitation of the Constitution"; and

The City Council has determined that the allocation approach presented in the Bartel Report is a reasonable accounting method for determining which costs are not subject to the 1% property tax limitation of the Constitution; and

In 2003/2004, CalPERS required the City to contribute 9% of safety employee payroll as the City's employer's contribution. In order to set the tax override, the City subtracted the 4.6% normal cost of 3% @ 50 from the 9% to set the override tax at the equivalent of 4.4% of safety employee payroll. The cost to the City of 4.4% of safety employee payroll for 2003/2004 was \$1,279,113, and consequently, the City set the override tax for 2003/2004 at \$0.00696 per \$100 of assessed value, which amount was designed to yield \$1,279,000; and

For 2005/2006, CalPERS is requiring the City to contribute 29.9970% of safety employee payroll as the City's employer's contribution. In order to set the tax override, the City may subtracted the 4.6% normal cost of 3% @ 50 from the 29.9970% to set the override tax at the equivalent of 25.3970% of safety employee payroll. The cost to the City of 25.3970% of safety employee payroll for 2005/2006 will be \$ 7,777,685, and consequently, the City may set the override tax for 2005/2006 at \$0.03670 per \$100 of assessed value; and

Notwithstanding this authority, the City Council chooses to set the override tax rate for 2005/2006 at \$0.00696 per \$100 of assessed value, the same rate imposed for 2003/2004, which will yield approximately \$1,475,000 in revenues. This amounts to an override tax of approximately \$7.00 per \$100,000 of assessed value.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Huntington Beach that a retirement property tax levy of Zero and 0.00696/100th Dollars (\$0.00696) per \$100 of assessed value shall be levied for employee retirement costs for Fiscal Year 2005/06;

BE IT FURTHER RESOLVED that the remainder of the Zero and 0.0367/100th Dollars (\$0.0467) per \$100 of assessed value levy authorized under Revenue & Taxation Code Section 96.31(a)(4) is suspended for Fiscal Year 2005/2006;

BE IT FURTHER RESOLVED that the City Council declares that although it is suspending a portion of the retirement property tax for Fiscal Year 2005/2006, it retains the authority to levy the tax in future years up to the rate of \$0.0493% per \$100 of assessed value.

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PASSED AND ADOPTED by the City Council of the City of Huntington Beach at a regular meeting thereof held on the _____ day of _____, 2005.

Mayor

ATTEST:

City Clerk

APPROVED AS TO FORM:

Jennifer McGeater

City Attorney

(SFF)

8/1/05

REVIEWED AND APPROVED:

Linda Cullum

City Administrator

INITIATED AND APPROVED:

Ray T. Villalva

Finance Officer

PA
8/2/05

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ATTACHMENT 2

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CITY OF HUNTINGTON BEACH

TO: HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL
PENELOPE CULBRETH-GRAFT, City Administrator
CHUCK THOMAS, Acting Director of Administrative Services
DANIEL VILLELLA, Finance Officer

FROM: JENNIFER McGRATH, City Attorney

DATE: February 11, 2005

SUBJECT: Attorney General Opinion Regarding Retirement Property Tax

In August 2003, the City Council directed this Office to request through Assemblyman Harman an Attorney General opinion regarding the proper methodology to determine the amount of retirement property tax the City may levy after the decision in *Howard Jarvis Taxpayers Association v. County of Orange* (2003) 110 Cal.App.4th 1375. The Attorney General issued the Opinion on February 7, 2005. The Opinion validates the methodology the Council adopted in August 2003 to determine the retirement tax rate.

Background. Since 1948, the City has provided retirement benefits through a contract with the Public Employees Retirement System (PERS). Under its PERS contract, the City must make an annual employer contribution to PERS. This contribution—a percentage of payroll—fluctuates from year to year.

In 1976, the City Council agreed through MOUs with the police and lifeguard employee associations to amend the PERS contract to increase police and marine safety benefits to 2% @ 50 by July 1, 1978. (The City was already offering the 2% @ 50 benefit to fire employees.) However, the effective date of the PERS contract amendment was September 1978. This increase in benefits effected the employer contribution to PERS.

Since 1978, the City instituted several additional retirement benefits, including amending the PERS contract to offer 3% @ 50 for safety personnel.

Since at least 1966, the City has levied a retirement property tax to pay for at least a portion of the cost of the retirement program. In June 1978, the voters of the City of Huntington Beach adopted a new City Charter. The Charter continued to authorize the City Council to levy a retirement property tax.

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HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL
PENELOPE CULBRETH-GRAFT, City Administrator
CHUCK THOMAS, Acting Director of Administrative Services
DANIEL VILLELLA, Finance Officer
February 11, 2005
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Also in June 1978, California voters approved Proposition 13, which limited the property tax to one percent of property value. One exception to Proposition 13's 1% limit is "indebtedness approved by the voters prior to July 1, 1978." In 1982, the California Supreme Court held in the case of *Carmen v. Alvord* that pension plans were such indebtedness up to the level of benefits approved by the voters before July 1, 1978.

One difficulty in applying the *Carmen* decision was determining which retirement obligations were approved prior to 1978. For example, the Huntington Beach Charter, as approved by voters in 1978, merely states that the City shall "participate in a retirement system," but the voters never approved a specific retirement system. For many years after Proposition 13, determining what retirement system could be supported by the retirement tax was never an issue because the employer contribution to PERS substantially exceeded the maximum retirement tax rate of .049%.¹ However, when the employer contributions to PERS declined between FY 1997/98 through FY 2000/01, a portion of the retirement property tax was used to pay for retirement-related benefits first offered after July 1, 1978.

In December 1999, the Howard Jarvis Taxpayers Association (HJTA) filed suit challenging whether the retirement tax could be used to pay for benefits approved after 1978. In April 2001, the Superior Court held in *Howard Jarvis Taxpayers Association v. County of Orange* that the use of the retirement tax was limited to those retirement benefits in place prior to July 1, 1978. The Court of Appeal affirmed this ruling in July 2003.

During FYs 2001/02 and 2002/03, the period following the Superior Court decision until the Court of Appeal decision, the City suspended the tax levy because its employer contribution to PERS for those years was 0%. Then for FY 2003/04, PERS set the safety employer contribution at 9% of payroll. Given that the Court ruling permitted the City to levy the retirement tax to pay for employer contributions associated with pre-1978 retirement programs, it was necessary for the City to allocate the 9% employer contribution rate between pre-1978 benefit of 2% @ 50 and the post-1978 benefit of 3% at 50. Based upon the recommendation of John Bartel, a professional actuary, the City allocated the first 4.6% of the employer contribution to the incremental cost of 3% at 50, and the remaining 4.4% contribution to 2% @ 50. The tax levy was then set at a rate sufficient to pay 4.4% of safety payroll. This recommendation was based principally on a 1999 PERS actuarial study identifying the "normal cost" attributable to the benefit increase to 3% at 50 as 4.6% of payroll.

¹ After Proposition 13 was adopted, the Legislature adopted a statute limiting a retirement tax to no more than the highest rate charged in 1981 or earlier. For Huntington Beach, this rate was .049% of assessed value.

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HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL
PENELOPE CULBRETH-GRAFT, City Administrator
CHUCK THOMAS, Acting Director of Administrative Services
DANIEL VILLELLA, Finance Officer
February 11, 2005
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The Attorney General Opinion. The *Jarvis* opinion presented three immediate questions regarding how to set the retirement tax in the future. First, after suspending the tax for two years, did the levy of the retirement property tax for 2003/2004 require new voter approval under Proposition 218? Our office opined that this was not a new tax under Proposition 218.

Second, did the 2% @ 50 retirement program for police and marine safety officers approved prior to July 1, 1978, but implemented afterwards constitute a pre-1978 indebtedness? In August 2003, the City Attorney opined that this was a pre-1978 retirement obligation and the Council set the 2003/04 retirement tax in reliance on that Opinion.

Third, how should the City Council allocate the employer contribution between the pre-1978 component of 2% @ 50 for safety officers, and the 2001 amendment of 3% @ 50? Our office recommended using a "reasonable" actuarial approach, such as recommended by Mr. Bartel.

In April 2004, Assemblyman Harman formally asked the Attorney General to answer these three questions.

In the attached Opinion, the Attorney General answers all three questions consistent with the City Attorney's earlier advice. First, suspending and then re-levying a tax does not amount to a new tax that must be voter-approved under Proposition 218. Notably, the HJTA advised the Attorney General that it agreed with this conclusion, so the Attorney General's Opinion is of little surprise.

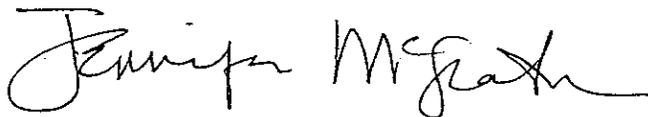
Second, the Attorney General agreed that where the 2% @ 50 retirement program for police and marine safety officers was approved prior to July 1, 1978, but offering the benefit was delayed until after July 1, 1978, it still constituted a pre-1978 indebtedness. Again, HJTA had agreed with our Opinion.

Most importantly, the Attorney General agreed with our conclusion that any reasonable accounting method could be used to allocate the employer contribution to PERS between the 2% @ 50 and the 3% @ 50 safety program. The Attorney General states that: "any reasonable accounting method may be used for purposes of determining which costs are not subject to the 1% property tax limitation of the Constitution." While the Attorney General has not specifically approved the allocation Mr. Bartel recommended, we do conclude his approach is a reasonable accounting method, and consequently, we recommend continuing to use his allocation in the future.

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HONORABLE MAYOR AND MEMBERS OF THE CITY COUNCIL
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CHUCK THOMAS, Acting Director of Administrative Services
DANIEL VILLELLA, Finance Officer
February 11, 2005
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For the Council's further information, prior to the Attorney General issuing his Opinion, we had forwarded to his Office the most current revised versions of Mr. Bartel's analysis. A copy of that analysis is attached along with the Attorney General Opinion.



JENNIFER McGRATH
City Attorney

Attachments: Attorney General Opinion
Bartel Associates Report

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