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$1.6 Million Bill Tests Tiny Town and 'Bulletproof' Public Pensions

By MARY WILLIAMS WALSH OCT. 9, 2016

Until the certified letters from Sacramento started coming last month, Loyalton, Calif., was just another hole in the wall — a fading town of just over 700 that had not made much news since the gold rush of 1849. Its lifeblood, a sawmill, closed in 2001, wiping out jobs, paychecks and just about any reason an outsider might have had for giving Loyalton a second glance.

"It's a walking ghost town," said Don Russell, editor of the 163-year-old Mountain Messenger, a local newspaper that refuses, fittingly, to publish on the web.

But then came those letters, thrusting Loyalton onto center stage of America's public pension drama. The California Public Employees' Retirement System, or Calpers, said Loyalton had 30 days to hand over $1.6 million, more than its entire annual budget, to fund the pensions of its four retirees. Otherwise, Loyalton stood to become the first place in California — perhaps in the nation — where a powerful state retirement system cut retirees' pensions because their town was a deadbeat.

"I worked all those years, and they did this to me," said Patsy Jardin, 71, who kept the town's books for 29 years, then retired in 2004 on an annual pension of about $48,000. Now, because of Loyalton's troubles, Calpers could cut it to about $19,000.

"I couldn't live on it — no way," she said. "I can't go back to work. I'm 71 years old. Who's going to hire me?"

Public pensions are supposed to be bulletproof, because cities — unlike companies — seldom go bankrupt, and states never do. Of all the states, experts say, California has the most protective pension laws and legal precedents. Once public workers join Calpers, state courts have ruled, their employers must fund their pensions for the rest of their careers, even if the cost was severely underestimated at the outset — something that has happened in California and elsewhere.

Across the country, many benefits were granted at the height of the 1990s bull market on the faulty assumption that investments would keep climbing and cover most of the cost. And that flawed premise is now hitting home in places like Loyalton.

There and elsewhere, local taxpayers are paying more and more, and some elected officials say they want to get off the escalator. But Calpers is strict, telling its 3,007 participating governments and agencies how much they must contribute each year and going after them if they fail to do so. Even municipal bankruptcy is not an excuse.

The showdown in Loyalton is raising the possibility that California's pension promise is not absolute. There may be government backstops for bank failures, insurance collapses and pensions owed to workers by bankrupt airlines and steel mills — but not, apparently, for the retirees of a shrinking town.

"The State of California is not responsible for a public agency's unfunded liabilities," said Wayne Davis, Calpers's chief of public affairs. Nor is Calpers willing to play Robin Hood, taking a little more from wealthy communities like Palo Alto or Malibu to help luckless Loyalton. And if it gave a break to one, other struggling communities would surely ask for the same thing, setting up a domino effect.

Some see a test case taking shape for Loyalton and for other cities with dwindling means. “Nobody has forced this issue yet,” said Josh McGee, vice president for public accountability for the Laura and John Arnold Foundation, which focuses in part on sustainable public finance, and a senior fellow of the Manhattan Institute.

When Stockton, Calif., was in bankruptcy, for instance, the presiding judge, Christopher M. Klein, said the city had the right to break with Calpers — but it could not switch to a cheaper pension plan without first abrogating its labor contracts, which would not be easy. Stockton chose to stay with Calpers and keep its existing pension plans, cutting other obligations and pushing through the biggest sales tax increase allowed by law.

Loyalton — which sits in a rural area of Northern California near the Nevada border, less than an hour’s drive from Reno — severed ties with Calpers three years ago. It has no labor contracts to break. Though the town is not bankrupt, its finances are in disarray: It recovered more than $400,000 after a municipal employee caught embezzling was fired. But a recent audit found yet another shortfall of more than $80,000.

“If a city doesn’t have the funds to pay, it’s just completely unclear how the legal plumbing would work,” Mr. McGee said. “I don’t know what would happen if the retirees sued.”

The retirees say they are open to filing a suit but cannot afford to hire lawyers for a titanic legal clash with Calpers.

“Nobody does squat for you with Calpers,” said John Cussins, Loyalton’s retired maintenance foreman, who now serves on the City Council. “I contacted every agency possible. To me, it’s just unbelievable that there isn’t some kind of help out there with the legal side of things. It leaves us at the mercy of the city and Calpers.”

Mr. Cussins said he had a severe stroke last year and was recently told he had Parkinson’s disease. He needs continuing care and said he might not be able to afford his health insurance if his pension were cut. Every time the pension issue comes up at City Council meetings, he is told to leave because, as a retiree, he is deemed to have a conflict of interest.

"I'd like to see somebody go to jail for this," he said.

Calpers has total assets of $290 billion, so an unpaid bill of $1.6 million would hardly be a deathblow. But if Calpers gave one struggling city a free ride, others might try the same thing, causing political problems. Palo Alto may have lots of money, but its taxpayers still do not want to pay retirees who once plowed the snow or picked up the trash in far-off Loyalton.

"I think this is all about precedent setting," Mr. McGee said.

In September, Calpers sent "final demand" letters to Loyalton and two other entities, the Niland Sanitary District and the California Fairs Financing Authority. The Niland Sanitary District has struggled with bill collections, and the fairs financing authority was disbanded several years ago when the state cut its funding. Both entities stopped sending their required contributions to Calpers in 2013 but have continued to allow Calpers to administer their pension plans.

In Loyalton, the City Council voted in 2012 to drop out of Calpers, hoping to save the $30,000 a year or more that the town had previously sent in, said Pat Whitley, a former mayor and a City Council member. (She is not one of the four Loyalton retirees but earned a Calpers pension through previous work on the Sierra County Board of Supervisors.)

"All our audits said that our benefits were going to break the city," Ms. Whitley said. "That's exactly why we decided to withdraw. We decided it would be a perfect time to get out, because everybody was retired."

Loyalton did not plan to offer pensions to new workers, she said. And it had been paying its required yearly contributions to Calpers, so officials thought its pension plan must be close to fully funded.

But Calpers calculates the cost of pensions differently when a local government wants to leave the system — a practice that has caught many by surprise. If a city stays, Calpers assumes that the pensions won't cost very much, which keeps annual contributions low — but also passes hidden costs into the future, critics say. If a city wants to leave, Calpers calculates a cost that doesn't rely on any new money and requires the city to pay the whole amount on its way out the door.

That is why Calpers sent Loyalton the bill for $1.6 million.

"I never dreamed it was going to be that, ever. Ever!" Ms. Whitley said. "It defies logic, really."

Loyalton's expenditures for all of 2012 were only $1.2 million, and much of that money came from outside sources, like the federal and county governments. Local tax collections yielded just $163,000 that year, according to a public finance website maintained by the Stanford Institute for Economic Policy Research.

Ms. Whitley said Calpers had snared Loyalton in a Catch-22. The agency would not tell the town the cost of terminating its contract until the contract was ended, she said. But once that was done, it was too late to go back.

"We were very confused about why we owe $1.6 million, and why didn't they tell us that before we signed all the papers," she said.

Mr. Davis, the Calpers spokesman, said that since 2011, Calpers had been giving its member municipalities a "hypothetical termination liability" in their annual actuarial reports, so there was little excuse for not knowing.

Ms. Whitley disagreed. "It's just too confusing," she said. "I looked at what's been happening with all the other entities, and I saw that eventually it's got to collapse. It's almost like a Ponzi scheme."

The bill was due immediately, but Loyalton did not pay it. It has been accruing 7.5 percent annual interest ever since.

Meanwhile, Calpers has continued to pay Loyalton's four retirees their pensions. But at a Calpers board meeting in September, some trustees said it was time to find Loyalton in default and cut the pensions. The board is expected to make a final decision at its next meeting, in November.

In Loyalton, Mr. Cussins, the retiree and City Council member, said he was so frustrated about being barred from the council's pension discussions that he and another former town worker drove to Sacramento to attend Calpers's last board meeting.

The trustees were cordial, he said, but they held out little hope.

"We had a bunch of them come and shake our hands," he said. "I said, 'We need some guidance.' They told us the city could apply to get back into Calpers next spring. But they made it very clear that they will not allow the city to get back into Calpers until that $1.6 million is paid."

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