



CITY OF HAYWARD
AGENDA REPORT

AGENDA DATE 07/19/05

AGENDA ITEM 8

WORK SESSION ITEM _____

TO: Mayor and City Council
FROM: City Manager
SUBJECT: Public Employees Retirement System

This item appears on the agenda at the request of Mayor Roberta Cooper.

In California, cities and counties have been providing a "defined benefit" retirement plan to their employees for many decades. This type of plan provides a specified pension based on variety of factors, including salary while an active employee, age at retirement, and years of service. For most cities in California, the retirement plan is administered by the Public Employees Retirement System.

During this legislative session, legislation was introduced calling for a constitutional amendment to change the retirement system, from a defined benefit plan to a "defined contribution" plan. As is the case in a defined benefit plan, employers would continue to make certain contributions under a defined contribution plan. However, and most importantly, under a defined contribution plan a retired employee would not be guaranteed a specific pension amount. Rather, the pension amount could fluctuate based how well the contributions from employers and employees have been invested. Some have characterized this approach to be similar to President Bush's proposal to "privatize" Social Security.

Under the legislation introduced this session, new employees hired after July 1, 2007, would only be eligible to participate in a defined contribution plan. Thus, a city such as Hayward, could find itself in a situation where employees who work side-by-side and perform identical duties would be covered by entirely different retirement plans.

As the Mayor mentioned at a recent worksession, Firefighters Local 1909 has prepared a resolution in opposition to the proposed changes to the retirement system, and seeks the City Council's adoption of the resolution. As presented, the resolution opposes a change to the current retirement system, noting negative ramifications on the ability of a local agency to hire and retain qualified public employees. Moreover, the resolution underscores the point that changes to wages and benefits are a matter of local control and should not be dictated (mandated) by the state.

The resolution is consistent with the City Council's past practice in support of local control and staff endorses its approval. For background purposes, also attached is a position paper issue prepared by the League of California Cities.


Jesús Armas, City Manager

Attachments

PENSION REFORM IN CALIFORNIA
League of California Cities
March 1, 2005

For close to 60 years California state and local governments have offered “defined benefit” retirement plans to their employees which provide a guaranteed annual pension based upon retirement age, years of service, and some period of highest salary (typically the last one or three years of work). These plans generally provide an annual cost-of-living adjustment and additional inflation protection that maintains the purchasing power over time at a specified minimum level. The Public Employee’s Retirement System (PERS), the State Teachers’ Retirement System (STRS), and a variety of individual cities and counties administer these retirement plans.

Over the years local and state government retirement costs have risen and fallen based on two principal factors: (1) the investment returns of the various systems; and (2) the level of benefit payments provided to employees. In the late 1990s the California legislature enacted dramatic benefit enhancements for public employees in the PERS system that were optional for participating local governments. Some local governments adopted these benefit enhancement plans—for a variety of reasons, typically to retain employees and at times at a shared cost with the employees. When the retirement systems suffered serious investment losses in the early part of this decade, these losses combined with the benefit enhancements to cause dramatic increases in employer contribution rates.

Defined Contribution Mandate Proposed

In the fall of 2004 a proposed constitutional and statutory initiative (File No. SA2005RF0007) was filed that would close all state and local public sector defined benefit plans (including locally administered plans) to new entrants effective July 1, 2007. Employees hired after that date could only enroll in defined contribution retirement plans. Defined contribution plans provide fixed annual employer contributions to employee accounts that are invested, along with employee contributions. Unlike defined benefit plans, the employee has no guaranteed pension benefit and employers never incur any unfunded liabilities.

The initiative (which has a legislative counterpart by Assembly Member Richman) would establish maximum employer contributions of 9 percent for police officers and firefighters and 6 percent for other employees, assuming participation in federal Social Security (3 percent higher if no Social Security). Local agencies could exceed these limits with a two-thirds vote of their electorate. The state could do so with a three-fourths vote of both houses of the Legislature in two consecutive sessions. Mr. Richman has informed the League in a letter dated February 17 that he is willing to enter into negotiations to avoid the need for the initiative.

In his 2005 State of the State message, Governor Schwarzenegger recommended a defined contribution pension mandate for new state and local employees. In a presentation to the League board of directors on February 25, 2005 Tom Campbell,

Director of Finance, explained the Governor's proposal contains no caps on employer contribution and would not require lower state or local contributions. It would simply remove the risk of increased costs to the taxpayer due to future stock market declines by requiring that all new state and local employees be provided a defined contribution plan in place of the traditional defined benefit plan. Mr. Campbell indicated that in all other respects (e.g., PERS administration, employer contributions, employer contributions, etc.) the plans would be identical.

League Pension Reform Task Force

In late 2004 the Executive Director asked the City Manager's Department's standing task force on PERS to undertake a study of the defined contribution proposal and potential other defined benefit reforms. A group of other appointed and elected officials were subsequently added to the task force to provide broader input, and since early December it has met regularly to study the problems with the existing defined benefit retirement systems and to evaluate the defined contribution proposal. The task force is chaired by Bob LaSala, Lancaster City Manager.

The League also retained the services of a retirement actuary, John Bartel of Bartel Associates, LLC, who worked with the Task Force to ensure its recommendations for reform of the defined benefit system were actuarially sound. He assisted the Board in its discussions. His report to the Pension Reform Task Force, dated February 26, 2005 and entitled *Replacement Ratio Study: Preliminary Results*, is available from the League.

Review and Comment on Discussion Draft Sought

The task force report was reviewed by subcommittee of the Public Employee Relations Policy Committee on Wednesday, February 23, 2005 and forwarded to the League board of directors with a favorable recommendation. On Saturday, February 26, 2005 the board accepted the report, with modifications, and authorized staff to circulate the report as a discussion draft for review and comment. It is important to note the ideas contained in this report represent an initial assessment by the League on pension reform. It is offered for discussion and consideration in the pension reform debate. Comments are requested from League member cities, other local government associations, local government labor organizations, state legislators and the Administration. Comments should be sent to the League of California Cities, c/o Anthony Thomas, Legislative Representative, 1400 K St., Sacramento, CA 95814 athomas@cacities.org.

A Framework for Public Pension Reform¹

March 1, 2005

General Pension Reform Principles

Any serious discussion of public pension reform must begin with a set of principles/goals to guide any following recommendations. Until questions about the appropriate role and purpose of public pension benefits in local government compensation packages are answered, it would be at least premature and perhaps self-defeating to make any specific benefit recommendations. In keeping with this philosophy, it is recommended that the following principles precede any benefit recommendations:

- The primary goal of a public pension program should be to provide a full-career employee with pension benefits that maintain the employees' standard of living in retirement.
- The proper level of public pension benefits should be set with the goal of providing a fair and adequate benefit for employees and fiscally sustainable contributions for employers and the taxpayers.
- Public pension benefits should be supported with proper actuarial work to justify pension levels. The Legislature should reject any and all attempts to establish pension benefits that bear no relation to proper actuarial assumptions and work.
- Pension benefits should be viewed in the context of an overall compensation structure whose goal is the recruitment and retention of employees in public sector jobs. In recognition of competitive market forces, any change in the structure of retirement benefits must be evaluated in concert with other adjustments in compensation necessary to continue to attract and retain an experienced and qualified workforce.
- The reciprocity of pension benefits within the public sector should be maintained to ensure recruitment and retention of skilled public employees - particularly in light of the retirement of the post World War II "Baby Boom" generation which will result in unprecedented demand for public sector employees.
- Perceived abuses of the current defined benefit retirement programs need to be addressed. Benefit plans which result in retirement benefits which exceed the levels established as appropriate to maintain employees' standard of living should be reformed. It is in the interest of all public employees, employers and taxpayers that retirement programs are fair, economically sustainable and provide for adequate benefits for all career public employees, *without providing excessive benefits for a select few.*

¹ This report constitutes the recommendations of the League Pension Reform Task Force that was accepted by the League of California Cities Board of Directors for distribution as a discussion draft.

- The obligation to properly manage public pension systems is a fiduciary responsibility that is shared by PERS, employers and employees. This joint responsibility is necessary to provide quality services while ensuring long-term fiscal stability. These parties need to be held responsible to ensure a high level of protection against mismanagement of public resources that could jeopardize a community's ability to maintain services and provide fair compensation for its workforce.
- Charter cities with independent pension systems should retain the constitutional discretion to manage and fund such pension plans.

Reform Recommendations

Public employee defined benefit programs have been appropriately criticized in a number of areas. The following reform recommendations address short-comings within some defined benefit retirement programs, while preserving the aspects of the program that have served the employees, employers and taxpayers of California well for over 60 years.

Pension Benefit Levels

Principles: Public pension benefit plans should:

- Allow career-employees to maintain standard of living post-retirement.
- Be designed with consideration of age at retirement, length of service, compensation level and applicability of Social Security.
- Be supported with proper actuarial work to justify pension levels. The Legislature should reject any and all attempts to establish pension benefits that bear no relation to proper actuarial assumptions and work.
- Promote career public service without creating incentives to work past retirement age, nor disincentive to early retirement. Employees who voluntarily choose to either work beyond retirement age or retire early should not be penalized or rewarded.

Recommendations

- Maintain the defined benefit plan as the central pension plan for public employees in California.
- Rollback/repeal public retirement plans that provide benefits in excess of levels required to maintain a fair, standard of living² that are not financially sustainable and may have no actuarial justification. The new and exclusive benefit formulas to achieve these goals should be:

² This should be determined in accordance with a Cal PERS 2001 target replacement benefit study and/or the Aon Georgia State Replacement Ration Study (6th update since 1988).

1. **Safety Employees:** 3% @ 55 formula, offset by 50% of anticipated social security benefit for safety employees with social security coverage. Safety employees retain the current cap on retirement at 90% of final compensation.
 2. **Miscellaneous Employees(Non-safety):** 2% @ 55 formula, offset by 50% of anticipated social security benefit for miscellaneous employees with social security coverage. A cap of 100% of final compensation is placed on newly-hired, miscellaneous(non-safety) employees.
- The above formulas would incorporate “Three-Year-Average” for “final compensation” calculation. All “Highest Final Year” compensation calculations would be repealed for newly-hired employees.
 - Provide alternatives to a defined benefit plan for job classifications not intended for career public service employment.
 - Give employers greater flexibility to determine when a part-time employee is entitled to public pension benefits. The current hourly threshold in PERS is too low.

Rate Volatility

Principles

- Responsible fiscal planning suggests the need to “manage” volatility in defined benefit plan contribution rates.
- Rates have historically been relatively constant and comparable to rates currently paid by most public agency employers.
- Recent rate volatility is primarily due to large fluctuations in annual investment returns for the retirement plan investment portfolios, causing significant changes in plan funding status.
- Normal Costs for defined benefit plans have remained relatively constant over time.

Recommendations

- Public Agency retirement contribution rates, over time, should be constructed to stay within reasonable ranges around the historical “normal cost” of public pension plans in California. Sound actuarial methods should be adopted to limit contribution volatility while maintaining a sound funding policy.
- Establish “reserve” funding for public pension systems that will help smooth the volatility of pension benefit costs. Plan surpluses are to be retained within plan

assets, but should be reserved for amortization of future unfunded liabilities, and should not be used to offset plans' normal cost contribution rates.

Shared Risk

Principles

- Currently, in most local jurisdictions, employers shoulder the burden of rate volatility risk – both positive and negative. This principle should be carefully examined with the intent of better spreading the risk of rate volatility among both employers and employees.
- Negotiated labor agreements containing language whereby employers “pick-up” employees’ retirement contributions are assumed to be part and parcel of a “total compensation” package; this implies that agencies with Employer Paid Member Contributions would also typically reflect correspondingly lower base salaries.

Recommendations

- When employer contribution rates exceed the “normal costs” threshold, employees should be expected to take some of the financial responsibility for those excessive increases.

Disability Retirement

Principles

- Retirement-eligible employees who are injured in the workplace should be entitled to full disability retirement benefits; disability retirement benefits should, however, be tied to individual’s employability and be structured so as to encourage return to work, where applicable.
- Larger disability reform measures should be considered outside of the scope of general pension reform.

Recommendations

- Full tax-exempt disability retirement should be retained for employees who are injured and can not work in any capacity
- Reform the disability pension provisions of public retirement systems to restrict benefits when a public employee can continue to work at the same or similar job after sustaining a work-related injury.

- Employees eligible for disability retirement should be first afforded applicable service retirement benefits, and THEN provided disability retirement benefits up to applicable “cap” on total retirement benefits.

Portability of Plan Benefits

Principles

- Reciprocity of public agency retirement benefits is critical to recruitment of qualified, experienced public sector employees.
- Limiting portability of retirement plan benefits to non-public sector employment helps in the retention of senior and management level employees.

Recommendation

- Any pension reform package should retain transferability of retirement benefits across public sector employers. No employee currently in a defined benefit plan should be required to involuntarily give up a defined benefit formula before retirement.

Tiered Plans

Principles

- Agencies should strive to avoid multi-tiered compensation structures where there are large discrepancies in benefits accruing to employees. In addition to having adverse impacts on recruitment and employee morale, multi-tiered approaches can raise issues of comparable worth and equity.

Recommendations

- Any pension reform measures should seek to minimize disparity between current and prospective public agency employees.
- Any reduction(s) or change(s) to current Defined Benefit plans should be considered in context of other compensation issues that will tend, over time, to “equate” compensation plans within and across public agency employers.

Management Oversight

Principles

- The obligation to properly manage public pension systems is a fiduciary responsibility that is shared by PERS, employers and employees. This joint responsibility is necessary to provide quality services while ensuring long-term fiscal stability. These parties need to be held responsible to ensure a high level of protection

against mismanagement of public resources that could jeopardize a community's ability to maintain services and provide fair compensation for its workforce.

Recommendations

- Public agencies that do not make the Annual Required Contribution under GASB 27 should be made subject to appropriate oversight.
- The membership of the Public Employees and Retirement System Board should be changed to achieve both a better balance of employer and employee representatives as well as a better balance of public agency representatives.

Conclusion

Defined benefit retirement plans have been the traditional approach for close to 60 years in California and have produced fair and sustainable retirement benefits that have been central to recruiting and retaining quality public employees. Defined benefit plans should be retained as the central component of public pension systems in California.

HAYWARD CITY COUNCIL

RESOLUTION NO. _____

Introduced by Council Member _____

DRAFT

**RESOLUTION REAFFIRMING LOCAL CONTROL
AND OPPOSING STATE MANDATE FOR A
DEFINED CONTRIBUTION RETIREMENT PLAN**

WHEREAS, Hayward residents have a clear interest in attracting and retaining the highest caliber of employee to public service in order to assure that taxpayers get the quality of service they deserve and have come to expect; and

WHEREAS, the people of Hayward, through their elected officials, have determined to extend defined benefits to public employees as a means of attracting the best and brightest employees, as well as providing retirement security for our employees engaged in high-risk occupations such as firefighting and law enforcement; and

WHEREAS, a privatized defined contribution retirement system will dramatically increase an employee's risk of losing their hard-earned retirement, making public service a far less attractive career choice for the best and brightest; and

WHEREAS, legislation was introduced during the current legislative session mandating that every local government create an entirely new and separate lower-tier retirement system, requiring enormous additional unfounded expenses for administrative and human resources management; and

WHEREAS, the net effect of such legislation, if adopted, would be to vitiate the reasoned judgment of local elected officials and in its place mandate a hastily conceived, and entirely new, defined contribution retirement system for new public employees; and

WHEREAS, the principle that is at the core of local sovereignty is local control. Decisions regarding labor negotiations, compensation, and benefit levels have historically rested, and should remain, exclusively within the jurisdiction and province of local government, without meddling and interference from state or federal legislators; and

WHEREAS, the above-discussed state mandate shatters the concepts of local control and sovereignty and interferes with the ability of local governments to attract qualified employees and negotiate benefits with its labor force.

NOW, THEREFORE, BE IT RESOLVED by the City Council of the City of Hayward that Hayward strongly opposes the imposition of any mandatory defined contribution retirement system, whether for new or existing employees. Hayward also vehemently opposes any mandate to create an optional play for converting employees from a defined benefit plan to a defined contribution plan.

BE IT FURTHER RESOLVED that the City of Hayward urges California lawmakers and other stakeholders to develop meaningful reform within the current defined benefit retirement structure that assists in stabilizing employer contribution rates, while also protecting and preserving the right of local governments to recruit and retain skilled public employees to serve the taxpayers of California.

IN COUNCIL, HAYWARD, CALIFORNIA _____, 2001

ADOPTED BY THE FOLLOWING VOTE:

AYES:

NOES:

ABSTAIN:

ABSENT:

ATTEST: _____

City Clerk of the City of Hayward

APPROVED AS TO FORM:

City Attorney of the City of Hayward