CITY OF San Rafael

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| **Agenda Item No:** | 6 a. |
| **Meeting Date:** | **May 7, 2012** |

## SAN RAFAEL CITY COUNCIL AGENDA REPORT

**Department:** Management Services

**Prepared by:** Jim Schutz, JS
Assistant City Manager

**City Manager Approval:** N Nadell

**SUBJECT: Consideration of a Resolution of the City Council of the City of San Rafael in Support of Pension Reform Efforts**

### BACKGROUND:

Public pensions can be a complicated topic especially when considering multiple types of public employers, federal and state retirement law, contract clauses of federal and state constitutions, court decisions, labor law, differences in actuarial methodology, differences in organizational make-up and financing, etc. Rather than a more comprehensive review, the "Background" section of this report will 1) offer a quick update on pension reform at the State level, 2) provide the basics of pension benefits in San Rafael, and 3) review actions that the City has taken to date. The "Analysis" section will focus on what happens from this point and actions the Council can take.

***Pension Background - Statewide***

Pension benefits are currently a key focus at the State level. In October 2011, Governor Brown released a 12-point public pension reform plan. In February 2012, the Governor delivered the statutory and constitutional language of this plan to the Legislature. The Governor's plan would apply to all state, local, school, and other public employers, new public employees, and current employees in some cases. Also in February, State Senate Republican Leader Bob Huff introduced legislation that duplicated the Governor's proposal as Senate Constitutional Amendment 18 and Senate Bill 1176. The same legislation was duplicated in the Assembly by Republican Cameron Smyth (AB 2224 and ACA 22).

A State Conference Committee on Public Employee Pensions, co-chaired by Senator Gloria Negrete McLeod and Assembly Member Warren Furutani, started meeting in October 2011 to study public pension issues. As of this writing, the Committee has formally met five times to discuss current conditions and reform efforts, explore hybrid plan design options, examine retirement age, and other issues. Other members of the Committee include: Senators Mimi Walters and Joe Simitian and Assembly Members Jim Silva and Michael Allen.

The Committee will release a report that will require a vote of the Legislature and signature from the Governor to become law. On April 18, 2012, Assembly Member Furutani, as Chair of the

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**Disposition:** ____________________

Public Employee, Retirement and Social Security Committee and Co-Chair of the Conference Committee mentioned above, advised that all bills "addressing pension reform and benefit changes of any kind should be referred to interim study so that their topics can be considered once the Conference Committee has issued its report." In other words, the Conference Committee's work will be the sole venue for potential pension/benefit changes this session. According to media reports, the Committee hopes to issue a report in June or July with the intent certainly being in advance of the November election.

***Pension Background - San Rafael***

The City of San Rafael offers the following two post-employment benefits: retiree health and a pension. Like most, if not all, California municipalities, the pension benefit in San Rafael is a "defined-benefit" plan rather than a "defined contribution" plan. This means that the pension benefit is based on years of service, age of retirement, and salary as an active employee. A defined contribution plan is based on regular contributions made by the employee, employer, or both to a fund intended to grow over time to create savings for retirement. The City is a member of the Marin County Employees' Retirement Association (MCERA) which is governed by the County Employees' Retirement Law of 1937, a division of the California Government Code.

Regarding pensions, the City's annual costs have been increasing over the last decade. These increases have taken place due to factors including, but not limited to, pension fund investment losses, benefit improvements, actuarial assumption changes, and demographic changes such as the decreasing number of city employees while the number of retirees increase. These increases are typical across a huge number of cities, counties, and special districts in California. They are not limited to impacting MCERA, but have also impacted the California Public Employees' Retirement System (PERS) and other retirement systems.

The extraordinary investment losses brought on by the "Great Recession" have increased the contributions required by employers to fully fund pension systems. For fiscal year 2008-09, MCERA's investment loss was nearly 20%. The real loss is higher due to their then annual actuarial assumption of a 7.75% gain (since lowered to a 7.5%). This sort of loss, which followed a loss the prior year as well, drives up our unfunded liability, increases our rates and therefore our pension payments to MCERA, and reduces our funding ratio – or the ratio of our assets to our liabilities. Based on the most recent actuarial study, the City of San Rafael has pension actuarial assets totaling $259 million and actuarial liabilities totaling $413 million.

The dual disadvantage is that with the Great Recession also came plummeting City revenues, such as sales taxes, making cost increases described above even more difficult to address. For the current Fiscal Year, the City expects to spend approximately $15 million on pension costs for active employees and retirees. The costs of pensions will remain a considerable budgetary issue for the foreseeable future.

***San Rafael Pension Actions***

The City of San Rafael has taken numerous steps to control retirement costs over the short and long terms. These actions were detailed in an August 15, 2011 staff report to the City Council which responded to the 2011 Grand Jury report on public pensions. The below is a summary of the actions taken to date:

- beginning in 2002, employees paid an increasing amount and now pay the maximum amount allowed towards their pensions (on average, San Rafael employees pay 11.5% of their salary towards their pension),
- as San Rafael does not pay any of the employees' contribution, there are no compensable earnings related to employer paid contributions,

- new, lower benefit pension tiers were created for all new safety and non-safety employees in 2011,
- the pension formula for new non-safety employees was reduced in 2011 from "2.75 @ 55" to "2% @ 55,"
- pensions for all new employees (after 7/1/11) are based off of an average of three years of earnings (the longest currently allowed under the law) rather than a single year, which is a provision that limits "pension spiking,"
- annual adjustments to pension benefits for all new employees (after 7/1/11) were lowered to "up to 2%" from "up to 3%." In addition, all employees are required to pay 50% of the normal cost for any such adjustments,
- starting 7/1/11, all employees agreed to a two year labor agreement that included a four percent reduction in compensation, which lowered the City's required pension contribution,
- the City, in 2009, designed and offered an early retirement program that, unlike the "Golden Handshake" used in many jurisdictions, did not improve employee pension benefits and did not add to the City's unfunded liability,
- regarding retiree healthcare, the retiree health benefit for all new hires (starting in 2009) was reduced to the minimum allowed under the law,
- San Rafael Councilmembers and staff participated in the 2010-11 Marin County Council of Mayors and Councilmembers (MCCMC) Pension and Other Post Employment Benefits (OPEB) reform process,
- San Rafael played a lead role in the 2009 pension reform policy paper of the Marin Managers' Association,
- the City Council, in 2012, created a Pension and OPEB Subcommittee which has subsequently met several times to review pension reform actions to date and consider additional steps to reduce the City's cost of post employment benefits.

The above section attests that San Rafael has been taking the issues of retirement costs very seriously and implementing specific actions to reduce costs now and also over the long run both in regards to pensions and retiree health.

**ANALYSIS:**

According to MCERA projections, San Rafael's near term pension costs are anticipated to continue to rise due to the lingering effects of the recession and anticipated actuarial changes related to reducing the amortization period. This is true even considering an excellent investment return year ending June 30, 2011 (23.36%) and assuming a 7.5% return each year thereafter.

The attached Resolution offers a set of 12 guiding principles and practices for the Council's consideration. Rather than a more generic set of principles that might apply to any retirement system or jurisdiction, the Resolution attempts to address San Rafael specifically in its context of actions to date and membership in MCERA.

Some of the principles are within the control of the City of San Rafael and agreement with its bargaining units under existing laws while other items would require changes at the State level. The first four recommended principles and practices are:

1. Employee Relations: Employees are the City's most valuable resource and should be fairly compensated for the work that they perform on behalf of the citizens of San Rafael. The City Council has a responsibility to ensure that employees are adequately compensated while at the same time being fiscally responsible regarding short and long term budgets and financial realities.

2. Reserve Funding: In 2010, the City created a separate "Retirement System Fund" in an attempt to set aside funds to mitigate the effect of rising pension costs. The City has been maintaining a similar fund for retiree healthcare costs. The City should seek to augment these funds over time to assist in addressing unfunded post employment liabilities.

3. Retiree Health: In 2009 and 2010, the City took actions to cap retiree medical benefits due to increasing costs as shown in the Governmental Accounting Standards Board Statement No. 45 (GASB 45) required actuarial reports. The City Council does not intend to increase retiree health benefits other than those required by law or existing resolutions.

4. Pension Cost Control: The Council will continue to seek pension cost controls under the current framework of the law, such as further reductions to benefit tiers, and also supports Statewide measures such as those shown below.

The remaining eight principles and practices would require Statewide legislative changes in the respective areas.

5. Benefit formulas: There are currently an inadequate number of legally available options for pension benefit formulas both in terms of benefit percentage and retirement age. Statewide legislative changes should occur that would allow additional alternatives including "hybrid" plan options, such as defined contribution (including cash balance plans) and defined benefit plans which would address benefit levels, minimum retirement ages, and benefit caps.

6. Pension Tier Elements: Greater flexibility is needed in setting pension tier elements such as the number of years that a pension is based on, COLAs, etc.

7. Employee Contributions: Greater flexibility is needed regarding employee pension contributions. For example, employees, by agreement, should be able to pay portions of the employer cost.

8. Compensable Earnings: Greater flexibility is needed so that employers may include only base pay as pension-eligible as a way of controlling pension costs and prevent "pension spiking." Currently, many pay items have already been excluded as pension-eligible, such as overtime or bonuses, but this principle supports a legislative change to include only base pay.

9. Excess Payments to Retirees ("Ad Hoc COLAs"): In addition to the retirement board approval, consent of the local governing board (City Council) should be required before any excess payment is made by a retirement system to a retiree, such as an ad-hoc COLA.

10. Retroactive Benefit Adjustments: Unfunded retroactive pension increases should be prohibited.

11. Pension Payment Requirement: Pension payments should be regulated when the system is over-funded, rather than simply declaring a pension "holiday." While MCERA required pension payments even when the plan was over-funded, this principle seeks further regulation to set aside additional funds in over-funded years.

12. Service Credit Purchases: The purchase of "air time" service credit for time not actually worked under the retirement system should be prohibited. Currently, none of the MCERA member agencies have adopted the "air time" provisions, but this principle supports a legislative change to eliminate the practice altogether.

The above 12 principles and practices would set the framework for City Council action on further retirement benefit changes. In addition to existing options, they would add through legislative changes a number of new options for controlling retirement benefits in the short and long term while not negatively impacting the ability to attract and retain high performing employees.

**RECOMMENDED ACTION:**
Staff recommends that the City Council adopt the attached Resolution.

**OPTIONS:**

- Approve the Resolution
- Modify Resolution and/or Direct Staff to Return with Modifications

**ATTACHMENTS:**
Resolution

**RESOLUTION NO. ______________**

**A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF SAN RAFAEL IN SUPPORT OF PENSION REFORM EFFORTS**

**WHEREAS,** local government retirement benefits (such as pensions and retiree health) have been at the forefront of public debate across the nation; and

**WHEREAS,** addressing long-term retirement liabilities is a primary concern to local agencies across the State; and

**WHEREAS,** there are a number of legal parameters that exist that frame the discussion of pension reform including, but not limited to, federal and state retirement law, contract clauses of the federal and state constitutions, court decisions, and labor law; and

**WHEREAS,** the extraordinary investment losses brought on by the Great Recession have increased the contributions required by employers to fully fund pension systems including the California Public Employees' Retirement System (CalPERS) and the Marin County Employees' Retirement Association (MCERA); and

**WHEREAS,** the City of San Rafael's annual pension costs have been increasing and the City has taken numerous steps to control pension costs over the short and long terms, including actions such as:

- beginning in 2002, employees paid an increasing amount and now pay the maximum amount allowed towards their pensions (on average, San Rafael employees pay 11.5% of their salary towards their pension),
- as San Rafael does not pay any of the employees' contribution, there are no compensable earnings related to employer paid contributions,
- new, lower benefit pension tiers were created for all new safety and non-safety employees in 2011,
- the pension formula for new non-safety employees was reduced in 2011 from "2.75 @ 55" to "2% @ 55,"
- pensions for all new employees (after 7/1/11) are based off of an average of three years of earnings (the longest currently allowed under the law) rather than a single year, which is a provision that limits "pension spiking,"
- annual adjustments to pension benefits for all new employees (after 7/1/11) were lowered to "up to 2%" from "up to 3%." In addition, all employees are required to pay 50% of the normal cost for any such adjustments,
- starting 7/1/11, all employees agreed to a two year labor agreement that included a four percent reduction in compensation, which lowered the City's required pension contribution,
- the City, in 2009, designed and offered an early retirement program that, unlike the "Golden Handshake" used in many jurisdictions, did not improve employee pension benefits and did not add to the City's unfunded liability,
- regarding retiree healthcare, the retiree health benefit for all new hires (starting in 2009) was reduced to the minimum allowed under the law,
- San Rafael Councilmembers and staff participated in the 2010-11 Marin County Council of Mayors and Councilmembers (MCCMC) Pension and Other Post Employment Benefits (OPEB) reform process,
- San Rafael played a lead role in the 2009 pension reform policy paper of the Marin Managers' Association,

- the City Council, in 2012, created a Pension and OPEB Subcommittee which has subsequently met several times to review pension reform actions to date and consider additional steps to reduce the City's cost of post employment benefits; and

**WHEREAS,** the City Council believes the City needs to further examine pension options. Under current law, there are limited options available which include: 1) for non-safety employees, two lower benefit formulas (2% at 58.5 and 2% at 61.25) and, 2) for safety employees, there is one lower benefit formula available (2% at 50). These options for non-safety and safety employees could be examined with a Defined Contribution component to create a hybrid plan; and

**WHEREAS,** the City Council believes the City must carefully consider additional options as they are made available by legislative change to control pension costs in the short and long term, while not negatively impacting its ability to attract and retain high performing employees; and

**WHEREAS**, the City Council believes it would be appropriate to create and adopt a set of guiding principles for the City with respect to its retirement benefits.

**NOW, THEREFORE, BE IT RESOLVED** that the City Council of the City of San Rafael does hereby confirm, acknowledge, and agree to abide by the following guiding principles and practices:

1. <u>Employee Relations:</u> Employees are the City's most valuable resource and should be fairly compensated for the work that they perform on behalf of the citizens of San Rafael. The City Council has a responsibility to ensure that employees are adequately compensated while at the same time being fiscally responsible regarding short and long term budgets and financial realities.

2. <u>Reserve Funding:</u> In 2010, the City created a separate "Retirement System Fund" in an attempt to set aside funds to mitigate the effect of rising pension costs. The City has been maintaining a similar fund for retiree healthcare costs. The City should seek to augment these funds over time to assist in addressing unfunded post employment liabilities.

3. <u>Retiree Health:</u> In 2009 and 2010, the City took actions to cap retiree medical benefits due to increasing costs as shown in the Governmental Accounting Standards Board Statement No. 45 (GASB 45) required actuarial reports. The City Council does not intend to increase retiree health benefits other than those required by law or existing resolutions.

4. <u>Pension Cost Control:</u> The Council will continue to seek pension cost controls under the current framework of the law, such as further reductions to benefit tiers, and also supports Statewide measures such as those shown below.

**NOW, THEREFORE, BE IT FURTHER RESOLVED** that the City Council of the City of San Rafael supports Statewide legislative changes in the following areas:

5. <u>Benefit formulas</u>: There are currently an inadequate number of legally available options for pension benefit formulas both in terms of benefit percentage and retirement age. Statewide legislative changes should occur that would allow additional alternatives including "hybrid" plan options, such as defined contribution (including cash balance plans) and defined benefit plans which would address benefit levels, minimum retirement ages, and benefit caps.

6. Pension Tier Elements: Greater flexibility is needed in setting pension tier elements such as the number of years that a pension is based on, COLAs, etc.

7. Employee Contributions: Greater flexibility is needed regarding employee pension contributions. For example, employees, by agreement, should be able to pay portions of the employer cost.

8. Compensable Earnings: Greater flexibility is needed so that employers may include only base pay as pension-eligible as a way of controlling pension costs and prevent "pension spiking." Currently, many pay items have already been excluded as pension-eligible, such as overtime or bonuses, but this principle supports a legislative change to include only base pay.

9. Excess Payments to Retirees ("Ad Hoc COLAs"): In addition to the retirement board approval, consent of the local governing board (City Council) should be required before any excess payment is made by a retirement system to a retiree, such as an ad-hoc COLA.

10. Retroactive Benefit Adjustments: Unfunded retroactive pension increases should be prohibited.

11. Pension Payment Requirement: Pension payments should be regulated when the system is over-funded, rather than simply declaring a pension "holiday." While MCERA required pension payments even when the plan was over-funded, this principle seeks further regulation to set aside additional funds in over-funded years.

12. Service Credit Purchases: The purchase of "air time" service credit for time not actually worked under the retirement system should be prohibited. Currently, none of the MCERA member agencies have adopted the "air time" provisions, but this principle supports a legislative change to eliminate the practice altogether.

I, Esther C. Beirne, Clerk of the City of San Rafael, hereby certify that the foregoing Resolution was duly and regularly introduced and adopted at a regular meeting of the City Council of the City of San Rafael, held on Monday, the 7th of May 2012, by the following vote, to wit:

AYES: Councilmembers:
NOES: Councilmembers:
ABSENT: Councilmembers:

Esther C. Beirne, City Clerk