San Rafael 2019 Independent Committee
On Employee Retirement Benefits

June 20, 2019

BY HAND	***BY HAND***
Hon. Gary O. Phillips Mayor City of San Rafael City Hall, Room 203 1400 Fifth Avenue San Rafael, CA 94901	Hon. John Gamblin Councilmember City of San Rafael City Hall, Room 203 1400 Fifth Avenue San Rafael, CA 94901

Re: Report by San Rafael 2019 Independent Committee on Employee Retirement Benefits

Dear Mayor Phillips and Councilmember Gamblin:

Enclosed herewith is report, dated June 20, 2019, referenced above.

We thank you for the opportunity to provide our service to the City of San Rafael.

Yours very truly,

Jim Holden

Megan Hutchinson

Jack Nixon

Alan Piombo

Jeff Schoppert, Chair

REPORT BY SAN RAFAEL 2019 INDEPENDENT COMMITTEE ON EMPLOYEE RETIREMENT BENEFITS

TO: **Hon. Gary O. Phillips, Mayor, and**
Hon. John Gamblin, Councilmember:
City of San Rafael Council Ad Hoc Pension/Other Post-Employment Benefits (OPEB) Subcommittee

DATE: **June 20, 2019**

I. BACKGROUND

A. 2014 Committee

In March 2014, the Citizens' Group on Pension Reform (the "2014 committee") prepared a written report (the "2014 report") for the City of San Rafael City Council Subcommittee on Pension/OPEB ["other post employment benefits"]. The report was produced in response to the council subcommittee's request that the 2014 committee to look into issues related to the costs of pensions and OPEB for City of San Rafael (the "City") and the effect of those costs on the City's ability to fund needed infrastructure and capital improvements. The subcommittee further asked the 2014 committee to offer an unbiased opinion as to steps already then taken by the City to reduce pension and OPEB costs and to identify what further actions might be taken to reduce and manage such costs.

The 2014 committee report provided factual background about different types of pension plans generally, as well as about the plan administered by Marin County Employees' Retirement Association ("MCERA") specifically for the benefit of current, former and retired City of San Rafael employees.

The 2014 report found that the City had, through negotiation and agreement with the City's employees, made structural changes to the City's pension plans to reduce future pension costs. These changes were made before the enactment of the Public Employees Pension Reform Act of 2013 ("PEPRA"), but the City reforms were consistent with, and in some respects, more aggressive than those authorized by, PEPRA. For ease of reference, a copy of the 2014 report is attached to this report as Appendix A. The present report should be read in conjunction with the 2014 report, which provides a more comprehensive discussion of some of the matters discussed in this report.

The 2014 committee reported it had discussed various suggestions for additional actions to be taken by the City to address the budget concerns related to the costs of retiree benefits, including repayment of the substantial unfunded pension actuarial liability ($134.1 million as of June 30, 2018 – the most recent date for which information has been made available by MCERA). These suggestions were identified in the 2014 Report as "Additional Thoughts." (Pages 7-8 of 2014 report.)

B. 2019 Committee Charge

In late 2018, Mayor Gary Phillips asked five community members from varied backgrounds to form a new committee to review and update the work of the 2014 committee. On January 28, 2019, Mayor Phillips met with this newly formed committee (the "2019 committee") and explained his desires with respect to the committee's work.

First, the Mayor asked that the committee update any of the findings and other content contained in the 2014 report.

Second, the Mayor asked that committee to explore any additional actions that could be taken to reduce pension liabilities.

The Mayor asked that whatever report issued from the 2019 committee's work provide answers to potential questions that might arise concerning each of the potential actions.

C. Committee Mission Statement

Upon acceptance of the Mayor's charge, the 2019 committee adopted the following mission statement to guide its work:

The committee will review existing reports related to past investigations into current and unfunded future liabilities for City of San Rafael employee retirement benefits. The committee will analyze the existing and any alternative means to manage such liabilities, taking into account the City's future employee hiring and retention needs or requirements.

D. 2014 Committee Unfinished Business

Since the 2014 committee could not reach unanimous agreement to recommend the adoption or implementation of the report's suggestions, the 2014 report characterized the suggestions for potential further action as additional thoughts and options for consideration.

The current committee analyzed and evaluated each of the numbered additional thoughts in the 2014 report. This report includes the results of that analysis and, where

appropriate, the current committee's evaluation with respect to each item. Additionally, the 2019 committee identified potential options not discussed in the 2014 report.

II. 2019 COMMITTEE APPROACH

In preparing this report, the committee took the following approach.

First, the committee determined which 2014 report Additional Thoughts items have not been obviated by actions or events occurring since the publication of the 2014 report.

Second, the committee identified ideas for potential approaches or action items not addressed in the 2014 report.

Third, where possible, the committee identified and articulated the pros and cons for each thought or suggestion and the practicality of implementing each such item.

Fourth, the committee attempted to categorize each thought or additional potential action by (i) the time horizon for its implementation; (ii) which decision making body would be required to implement the action, *e.g.,* the City; MCERA; the state legislature; courts; voters; employees/bargaining unit representation organizations (unions); and (iii) whether such decision-making body action is exclusive of, or complimentary to, the action of a different body.

A table summarizing results of this approach is attached to this report as Appendix B.

A. Materials Reviewed and Discussed in Connection with Preparation of 2019 Report

The 2019 committee reviewed the following written materials:

(i) 2014 report;
(ii) 2018 and 2019 MCERA Actuarial Valuation Reports prepared by Cheiron;
(iii) MCERA Financial Statements with Independent Auditor's Report for fiscal Year ended June 30, 2017;
(iii) City of San Rafael Retiree Healthcare Plan June 30, 2017 Actuarial Valuation Plan Funding for 2018/19 and 2019/20;
(iv) Numerous Marin County Grand Jury reports, dated beginning in 2005, related to pension and other post employment benefits (OPEB) and responses by MCERA and City of San Rafael thereto;
(v) MCERA Retirement System Overview prepared for City of San Rafael, dated January 2019;

(vi) California League of Cities City Managers Department Pension Sustainability Working Group White Paper, dated January 2019;

(vii) California Supreme Court decision in *CalFIRE Local 2881 v. California Public Employees Retirement System* (March 4, 2019) _____ Cal. 4th ____, (no. S239958) [the air time case] and media reporting related thereto and to other pension-related cases pending before the California Supreme Court; and

(viii) the California Department of Tax and Fee Administration (CDTFA) website discussion of sales tax collection from out-of-state sellers following the United States Supreme Court decision in *South Dakota v. Wayfair, Inc.* (2018) 585 U.S. ____, (Docket no. 17-494), and California's enactment of Revenue and Taxation Code section 6203.

In addition, City Manager Jim Schutz, Assistant City Manager Cristine Alilovich, City Finance Director Nadine Atieh Hade, and City Economic Development and Innovation Director Danielle O'Leary provided oral briefings to, and answered questions posed by, the committee.

B. Recently Decided and Pending California Supreme Court Cases Affecting Pension Obligations

Following the enactment of the Public Employees Pension Reform Act of 2013 ("PEPRA"), some California public employee retirement benefit providers applied PEPRA reforms to employees hired before the reforms were enacted. These reforms did not generally affect the core pension, but rather benefits granted earlier by the local entities that had the effect of boosting the manner in which the final compensation base was calculated. Public employee unions have challenged the application of the reforms to the calculation of pensions due employees hired before the reforms took effect.

The California Supreme Court recently decided one case involving the removal of the right of pre-reform hires to enhance their pension amount calculations by purchasing credit for years not actually worked, so called "air time". In that case, *CalFIRE Local 2881 v. California Public Employees Retirement System*, __ Cal. 4th __, (no. S239958), decided March 4, 2019, the court ruled the right to purchase such credits was not a vested contractual right and therefore the pension enhancement benefit could be eliminated by statute.

Other cases pending before the California Supreme Court will provide additional opportunities for the court to address and refine the contours of the judicially created doctrine called the California Rule, which provides constitutional protection to vested pension rights. The outcome of those cases could affect the amounts of pension benefits due retired City of San Rafael employees and, thus, the City's required contributions to the MCERA-administered retirement plan. However, at this point, there is no clear indication about how, or how broadly, the Supreme Court will rule on the issues raised in

the now pending cases. For a further explanation of the cases remaining to be decided, see the March 11, 2019 online blog post by *San Diego Union-Tribune* reporter, Ed Mendel: "New pension-cut rulings begin with little change," found at https://calpensions.com/ 2019/03/11/new-pension-cut-rulings-begin-with-little-change/ [explaining court decision analysis of difference between unchangeable vested contractual pension rights and statutorily granted rights, which can be modified].

C. Additional Thoughts Implemented to Date or Combined with Other Items for Discussion

Some of the items identified in the 2014 report as Additional Thoughts have been implemented or are naturally included in the discussion of one or more other Additional Thoughts. For example, Additional Thought number 6 called for items 1 through 5 to be implemented in combination. For this report, the chart, attached as Appendix B, indicates whether any of the measures discussed would be exclusive of another, or complementary to one or more other measures.

2014 report Items numbers 7 and 8 both relate to negotiations with bargaining groups and are thus discussed jointly under item number 6 below.

2014 report Item number 9, related to a public educational effort, is part and parcel of the discussion of the proposal to increase taxes and is thus subsumed into the discussion of item number 5 below.

Item number 11 called for the implementation of GASB 68 rules for financial reporting of accrued actuarial liabilities and for public education of the meaning of such reporting. The City and MCERA have implemented this accounting standard. In addition, the City has implemented the similar financial reporting standard, GASB 75, for the City's unfunded OPEB obligations. (See section below re: OPEB at pages 6-7.) The discussion of the public education recommendation with respect to GASB 68 or GASB 75 disclosures would take part in the context of any tax increase ballot measure campaign, discussed below in the context of item number 5, "Increased Sales Tax."

D. Analysis of 2014 Report Additional Thoughts

1. *Freeze or reduce salaries* (2014 report Additional Thought no. 1)

Overview: The 2014 report identified salary freezes or reductions as possible ways to free up money "to pay into the pension fund." This committee considered what the potential benefits and drawbacks of these ideas might be.

Action to date: The City has frozen or reduced salaries for two positions in 2018, both of which are non-represented roles.

Analysis: Freezing or reducing salaries could reduce City costs as soon as the freezes or reductions were implemented, and they could reduce some associated pension costs in the future for new hires brought in at lower starting salaries.

However, salary freezes or reductions could end up lowering employee morale, as employees are unlikely to be happy to perform the same work for less or without the hope of pay raises. Additionally, pay freezes or reductions could lead existing employees to leave for higher paying jobs in other municipalities or the private sector. Finally, lower or frozen pay could result in potential new hires taking jobs elsewhere.

Additionally, the majority of City jobs are unionized, so changes to pay for most City positions would require negotiation with the unions, which could result in the City having to give more elsewhere to make up for reduced or frozen salaries if the unions were even to agree at all.

Summation: Reducing or freezing salaries would reduce costs immediately but would be an extreme measure that could have immediate negative impacts on City functioning by reducing morale for existing employees, by causing employees to leave for higher paying jobs, and by making positions less attractive to potential new hires. The City has frozen or reduced salaries for two non-union positions in the past year, so evaluating the effects of those salary changes could inform future decisions regarding salary reductions or freezes.

In order for salary freezes or reductions to be a practical option, the City would have to: (1) compare its salaries with other municipalities to determine whether frozen or reduced pay would allow it to remain competitive; (2) consider its existing contractual obligations and future negotiating positions; and (3) determine how it would market this as a positive change to keep employee morale up and to retain and attract employees in the future.

2. *Reduce OPEB (retiree healthcare) commitments* (2014 report Additional Thought no.2)

Overview: The 2014 report discussed retiree health care benefits and suggested cost savings could be achieved through reducing health care benefits and applying the savings to the pension issue. (See "Retiree Health Benefit Costs," at page 7 of the 2014 report.) The committee believes the City has reduced its future OPEB liabilities to the greatest practical extent, and that the section 115 funding mechanism to reduce accrued liabilities over time (discussed below) is appropriate. Moreover, the amount of any further benefit reduction would be relatively small when compared to other pension costs. Thus, any

budgetary impact from further benefit reduction would likely be minimal and could affect the City's competitive hiring and retention status.

Action to date: The 2014 report described the City's efforts to cap retiree benefits and the establishment of a trust, tax exempt under section 115 of the Internal Revenue Code, to fund future liabilities for those benefits. (A detailed description of the City's efforts in this regard is contained in the City's response, dated August 8, 2013, to the Marin County Civil Grand Jury Report entitled "Marin's Retirement Health Care Benefits: The Money Isn't There," dated May 21, 2013, and in the updated grand jury report entitled "Marin's Retirement Health Care Benefits: The Money Still Isn't There," dated May 10, 2017 and the City's response, dated July 17, 2017. (The reports and the City responses are available online at https://www.marincounty.org/-/media/files/departments /gj/reports-responses/ 2012/opeb_report.pdf [2013 report]; https://www.marincounty.org /-/media/ files/ departments/gj/reports-responses/2012/responses/ san_rafael_retirement_ health_care.pdf [2013 City response]; http//cityofsanrafael.granicus.com/MetaViewer. php?viewid =38&event_id=801&meta_id=109143 [2017 report and City response]. Information about section 115 trusts generally is available online at http://www.gfoa. org/establishing-and-administering-opeb-trust.)

In 2017, the City Council adopted a formal policy with respect to funding OPEB, reducing the OPEB accrued actuarial liability (the unfunded future obligations) and the financial reporting related thereto. The 2017 council resolution also identified the actions to be taken to implement the policy. The policy and action plan adopted by the council is described in the staff report entitled "Retiree Healthcare Reporting and Funding," dated September 18, 2017. The staff report is available online at http://cityofsanrafael. granicus.com/DocumentViewer.php?file=cityofsanrafael_1fab60cd70c93627274a8c9c6d b9f329.pdf.

Analysis: While these reforms were needed and appropriately implemented by the City, the reduction in the unfunded actuarial liability related to retiree health care costs has not been immediately obvious. Beginning in 2013, the City began making payments into the trust to reduce the outstanding accrued actuarial liability. This amount is being amortized over 23 years. As of the date of the 2014 report, the City section 115 trust was approximately 35% funded. As of June 30, 2017, the unfunded actuarial accrued liability for retiree healthcare benefits was $33.524 million, representing a trust funding ratio (calculated in accordance with GASB 75 accounting standard) of 35%.

Summation: While the City's efforts to fully fund future OPEB obligations are a step in the right direction, the failure to increase, in the short term, the funding ratio for the section 115 trust shows the intractable effects of investment earning and demographic change sensitivities. However, the City must maintain its annual efforts to reduce the OPEB unfunded accrued actuarial liability if it hopes to avoid a future funding crisis.

3. *Outsource certain functions with acceptance of existing pension obligations* (2014 report Additional Thought no. 3)

Overview: The 2014 report suggested outsourcing certain functions of City government in order to transfer pension liabilities to a third party and cap existing obligations. The 2014 committee did not address this suggestion in depth. Given the pension costs associated with each City position, this committee deemed it worth considering outsourcing certain functions (particularly those that are not unique to City business) if such a move could lower pension obligations in the future.

The committee's expectation is that certain roles currently filled by City employees could be performed at a cost savings (now and in the future) because the work could be performed for less by someone in the private sector or because the City would not accrue any new pension obligation for employees in the private sector. This is of unknown value, as the committee has not compared the current salary and pension obligations for any particular City job with what the City would have to pay a private sector company to perform the same work.

Action to date: The City has staffed some of its information technology functions with technicians who are not City employees and has some other, specific roles filled by fixed-term employees where the nature of the work is temporary in some sense and where the employees participate in the Public Agency Retirement Services pension plan, which is a less costly pension plan than MCERA. The majority of City positions are union positions, so the City is required to meet and confer with the union before changing a position from a union-represented bargaining group position to some other categorization.

Analysis: Since the majority of City positions are unionized, the committee believes the city would not likely be willing to expend the time and resources needed to engage in the bargaining process to effect meaningful payroll and pension contribution reductions through outsourcing. Accordingly, the outsourcing solution, while it might ultimately save money, seems impractical at this time.

Aside from the practicality of its implementation, there are a number of potential drawbacks to outsourcing. These include: (i) loss of administrative control; (ii) the potential negative effect on morale; and (iii) potential negative political repercussions. The potential for these negative outcomes would likely be more concerning for - and therefore less suitable for certain City functions, such as those where the community expects a particular quality of service that the City could not guarantee if such services were provided by private sector contractors. Additionally, outsourcing any functions could have the negative effect of lowering remaining employees' morale, as employees might disagree with the positions selected for outsourcing or might fear their jobs could be the next to be outsourced.

While there might be negative political repercussions to outsourcing work, there is also the possibility that the public would see this as a positive step toward governmental efficiency.

To make this a practical option for cost-savings, the City would have to analyze its workforce to identify which roles are less necessary for the City to exercise control over and, which, if any, of those roles could be performed by private sector contractors at a lower rate without violating agreements with the unions.

This option could potentially be implemented at any point for non-union positions, but the exact timing of implementation could depend on existing employment contracts. Without contractual obstacles, the cost reduction could be immediate with associated lower pension costs in the future.

Summation: The City could consider whether any current City positions could be performed by private sector companies for the same or less than what the City currently pays its employees in salary and benefits to perform that work, without reducing the quality of the services the City provides and without violating union or other employment agreements. If functions can be performed by the private sector for less or equal to what current employees receive in pay and benefits without a decline in quality (and assuming all contractual obstacles are addressed), then outsourcing those positions would allow the City to stop accruing additional pension obligations. Eliminating payroll expense would reduce the amount of the annual normal cost contribution of the City to MCERA. However, it would not reduce the amount of the annual City contribution to the reduction of the UAL balance, which would continue to be calculated in the same manner with no variation due to a change in the size of the current city payroll.

4. Combine services and facilities with other jurisdictions to reduce ongoing and future costs. **(2014 report Additional Thought no. 4)**

Overview: The 2014 report suggested combining services with other municipalities and using the payroll savings to pay down pension obligations. This committee believes combining appropriate services and facilities with other jurisdictions will save payroll, pension, and operating costs. Nonetheless, such combinations could prove to be politically difficult and the City may not be willing to cede direct control of certain services and their attendant facilities and equipment costs.

Action to date: After many years of discussions, the City of San Rafael recently agreed in writing to provide fire chief services to the fire agency of the Marinwood Community Services District. Shared services with other jurisdictions are informal and relatively insignificant.

Analysis: The balkanization of municipal services among Marin County jurisdictions results in the over-staffing for some services and unnecessary duplication of physical facilities. Although the staffing and facilities within each jurisdiction may be appropriate for it standing alone, the combination of San Rafael's services with one or more other jurisdiction's services would allow for the reduction in staffing and facility requirements and accordingly payroll, pension, and facility costs. As a practical matter it may be politically difficult to arrange for the combining of services, since each jurisdiction would lose its direct and exclusive control over the shared personnel and the priorities for them. In any event it does not appear to be an action readily available.

Summation: Combining services and facilities with other jurisdictions presents seemingly obvious cost savings opportunities. The committee believes the City should continue to pursue opportunities as they arise and take the lead in encouraging other jurisdictions to participate. However, the committee recognizes the long entrenched barriers to service consolidation with the City and does not view this approach as likely to produce near term pension obligation savings.

5. *Increase sales tax* (2014 report Additional Thought no. 5)

Overview: Both the 2014 committee and the current Mayor have suggested the possibility of increasing the sales tax rate in San Rafael to generate revenue. The current San Rafael sales tax of 9% can be broken down as shown in the table below.

Sales Tax Distribution for San Rafael, CA

State of California General Fund	3.94%
County of Marin (Health and Safety)	1.56%
City of San Rafael	1.00%
City of San Rafael Transactions & Use Tax	0.75%
County of Marin (Public Safety)	0.50%
Transportation Authority of Marin (TAM)	0.50%
County-Wide Transportation	0.25%
SMART (in Marin County)	0.25%
Marin Parks/Open Space/Farmland Preservation	0.25%
Total	9.00%

State law limits the total sales tax rate to 10.25%. Thus, the difference between the current 9% and the ceiling of 10.25%, i.e., 1.25%, represents is what is legally, if not pragmatically, available for a sales tax increase in San Rafael.

Action to date: Since the 2014 report, no action has been taken to increase the City's sales tax revenue.

Analysis: A sales tax increase can generate substantial additional City income which may or may not be attributed to a specific use, e.g., the defrayment of future pension costs. A one-quarter percent (.25%) additional sales tax will generate about $4 million using the current sales volume. To give this perspective, note that an infusion of four million dollars into the projected revenues for fiscal year 2018-19 would increase the current total revenue by about 5.1%.

However, there are potential downsides to increasing the San Rafael sales tax. Any sales tax increase will make shopping in San Rafael more expensive for all shoppers regardless of the size of the purchase.

The sales tax is a regressive tax: it takes a greater percentage of the pay of low- and middle-income citizens than it does of higher income citizens. Thus, low- and moderate-income residents of San Rafael are more negatively impacted by an increased sales tax.

The sales tax Increases the cost of doing business. Businesses now face a significant sales tax burden in San Rafael, and business purchases account for roughly 40% of all sales and use tax collected by state and local governments.

Finally, the sales tax is subject to fluctuation caused by changes in the volume of sales in San Rafael. While the once anticipated loss of sales tax collections due to untaxed online purchases may now be largely prevented by the *Wayfair* decision and subsequent California rules, there is still one negative economic factor that should be recognized and given due weight. The inevitable recession stemming from the current business cycle would reduce the amount of new sales tax collected from the original projection because economic activity, particularly the purchase of large-ticket items such as vehicles, would be reduced, albeit by an unknown amount. This circumstance will, of course, also reduce the current sales tax.

Economic markers, such as the recently inverted yield curve and the six-month slowing of the advance in the Leading Economic Index suggest the real possibility of an economic downturn (a euphemistic term for a recession) in the next several years. We are overdue, having been in an economic expansion for over ten years. The person who says “this time it’s different” has been mistaken every time.

Recessions occur when economic output declines after a period of growth. They are a natural and necessary part of every business cycle. However, as one consequence, when unemployment rises, consumers typically reduce spending, which further pressures economic growth and fuels a negative cycle that exacerbates the economic downturn. Our concern here is that the next recession, whenever it comes, will cause a reduction in the sales revenue of San Rafael merchants and, consequently, San Rafael’s sales tax revenue, both existing and any new.

It behooves our City Council to prepare to deal with this real possibility of a reduction in the projection of new and existing sales tax revenue when deciding whether to seek voter approval for an increase in the sales tax rate.

Summation: As a practical matter, the ability to pass a new sales tax measure may be limited. A new sales tax measure will require majority support by the San Rafael City Council plus a 50% or 2/3 approval by voters depending on whether the tax is "general purpose" or "special purpose." San Rafael voters may be feeling tax fatigue following both recent and future local (wildfire protection parcel tax, *e.g.*), regional and statewide tax measures.

Depending on political will, the earliest time frame for enacting an new sales tax measure is estimated at one and a half to two years.

6. *Substitute third party negotiators for management negotiators* (2014 report Additional Thought nos. 7 and 8)

Overview: The 2014 report suggested the manner in which the City conducts labor negotiations with union-represented City employees is flawed and leads to higher labor costs. The 2014 report suggested two potential solutions to the perceived negotiation problems. First, the report suggested the City employ an "independent" third party specialist negotiator. Second, the report, suggested that management representative negotiators not have the manager's compensation increased in parity with the negotiated raises for the bargaining unit employees. The committee believes the City Council has always had the power to hire third party negotiators when it deems it desirable. Since the City council sets the parameters of a negotiator's power, in general it should not be necessary to hire third parties. The city manager and council should be able to oversee and prevent any other perceived negotiation shortcomings.

Action to date: None.

Analysis: Negotiators, whether management or third-party, are operating under the instructions and parameters set by the city council and presumably in concert with the attorneys hired by the City. In general, it does not seem that management negotiators would have significant self-interest in the outcome that would outweigh the responsibilities inherent in their jobs. The city council always has the power to hire third party negotiators when it deems it necessary to do so, for reasons of skill or perceived self-interest or bias on the part of existing management negotiators.

Summation: The committee does not believe that implementation of the suggested negotiation reforms would produce negotiation results superior to those currently conducted under the supervision of the city manager and the city council.

7. *Support Reed initiative or similar legislative efforts to modify California Rule* (2014 report Additional Thought no. 10)

Overview: The 2014 report discussed attempts to change legislatively the judicially created California Rule. This rule gives constitutional protection to pension rights as of the date of first employment and prevents a public employer from later reducing the formula by which such pensions are calculated. (See "Vested Rights" at page 3 of 2014 report.)

Action to date: In 2013-2014, then-San Jose Mayor Chuck Reed, and former San Diego City Council member, Carl DeMaio proposed an amendment to the state constitution which would alter the California Rule. Their proposed amendment (sometimes referred to as the "Reed-DeMaio initiative," or, more simply, as the "Reed initiative") would have allowed workers to keep already earned retirement benefits, but also have permitted public entity employers to modify the accrual of future benefits through the collective bargaining process or by public referendum.

As a constitutional amendment, the proposal would have required statewide voter approval. The Reed initiative never made it to the ballot, however, based in part on the description of the measure drafted by the California Attorney General for inclusion in the ballot pamphlet. That language informed voters that the proposal "eliminates constitutional protections for vested pension and retiree healthcare benefits for current public employees, including teachers, nurses, and peace officers, for future work performed." For further information see the *Los Angeles Times* article (Apr. 7, 2017) "The cost of California's public pensions is rising fast. But efforts to fix the problem by ballot measure have fizzled," discussing the proposed initiative and the reasons its sponsors declined to move forward with seeking voter approval of the state constitutional amendment. (Available at https://www.latimes.com/projects/la-me-pension-crisis-initiatives/.)

Analysis: The 2014 committee identified as Additional Thought number 10 the support of the Reed initiative, or other like modifications to state law, whether by initiative or legislative action. The 2019 committee believes this thought continues to be worthy of consideration, but believes such legislative change is unlikely to occur given the current state political climate.

The 2019 committee is unable to predict the financial effect on San Rafael's pension liabilities of reforms like those proposed in the Reed initiative. Such liabilities could be reduced if the City could bargain for reduced benefits. However, reduced benefit accrual for future work could have an adverse effect on the City's ability to attract and retain employees, depending upon what competing employer jurisdictions would choose to do if statewide law permitted changes like those proposed in the Reed initiative.

Summation: Statewide reforms like those proposed in the Reed initiative offer the best hope for leveling the playing field among all jurisdictions that compete to hire and retain

the best possible workforce. Nonetheless, these efforts appear to face an uphill battle in the current political climate.

8. ***Raise retirement age*** **(2014 Additional Thought no. 12)**

Overview: The 2014 report suggested the retirement age could be raised (meaning, presumably, the age at which the full amount of the pension benefit could begin to be collected could be deferred beyond age 55, 57, or 62, depending upon tier). The 2014 committee suggested the upward change because people are living longer.

Action to date: Since the date of the 2014 report, neither the City nor any of the surrounding jurisdictions appear to have made efforts to raise any retirement age.

Analysis: Raising the retirement age would require legislative action to create new pensions formulas for safety and non-safety employees. The increased retirement age could serve to lower pension costs by extending the period of time the employee and employer contribute to the retirement system and lowering the amount of time the employee would collect a pension. Any new retirement formulas would only apply to future employees, unless there were favorable rulings in the pending court cases, which could allow changes for existing employees, prospectively.

Legislative action supporting such changes could occur within a two-year timeframe but would require broad support at the state-level. Any associated saving or cost reductions would be realized in the 3-10 year range as current employees enter retirement and new employees enter the system at lower contribution rates. Additionally, unless there is an opportunity reduce benefits for current employees, there is no impact on the current unfunded actuarial liability (UAL). The increased retirement age may impact costs associated with worker compensation claims and disability retirements, particularly for safety employees.

Summation: Without statewide action and a comprehensive cost/benefit analysis, this suggestion seems unlikely to advance further at this point in time.

9. ***Move toward defined contribution retirement system*** **(2014 report Additional Thought no. 13)**

Overview: The 2014 report suggested the City switch from a defined benefit retirement plan to a defined contribution system, if and when such changes become possible, in order to bring the City retirement benefit program more in line with the kinds of benefits provided by private employers. Such a change could shift the risk of adequately funding future retirement benefits, and thus their current costs, from the employer to the employee.

Action to date: Nothing has occurred to date with respect to switching from a defined benefit to a defined contribution form of retirement plan. Nonetheless, while not a defined contribution plan, and not one calling for a City contribution, the 457 plan should be mentioned. The City offers to all City employees the opportunity to enroll in a 457 deferred compensation plan through one of two providers, either of which invests the employee's money based on given choices. Contribution is voluntary by the employee and the City does not contribute. Employee contributions are tax-deferred until withdrawn as are the earnings on the contributions.

The normal contribution limit for elective deferrals to a 457 deferred compensation plan is increased from $18,500 to $19,000 in 2019. Employees age 50 or older may contribute up to an additional $6,000 for a total of $25,000. Employees taking advantage of the special pre-retirement catch-up may be eligible to contribute up to double the normal limit, for a total of $38,000.

Withdrawals are generally taxable but, unlike other retirement accounts, the 10% penalty tax does not apply to distributions prior to age 59 ½ (the penalty tax may apply to distributions of assets that were transferred to the 457 plan from other types of retirement accounts). In other words, participants could access the assets in their 457 account upon separation of service without a penalty, no matter what their age.

Required Minimum Distributions ("RMD") are required beginning at age 70 1/2, based on the IRS Uniform Lifetime Table or the Joint Uniform Lifetime Table.

This plan is likely to most benefit the higher paid employee who can afford to make significant contributions.

Analysis: A defined contribution plan calls for the employer to guarantee the contribution as a percentage of the employees' salary, thus defining what the employer pays into the plan. This gives the employer the ability to budget for a known quantity as a percentage of total base payroll.

Since it behooves the employee to make the investment decisions, the City does not assume the investment risk, thereby relieving it of (i) any guarantee of retirement income for the employee and (ii) criticism for the performance of the investments.

Arguments against are few to nil for the employer, but for the employee are several. The employee must assume the investment risk, since the employee must make the investment decision. Some will like that control, while others who do not wish to make those decisions and/or who do not wish to understand the relative risks and machinations of the stock and bond market will not. In a downturn, such employee may unwittingly and undeservedly criticize the employer and that criticism may lead to disharmony.

The employer may not sufficiently fund the plan (as a percentage of pay), leaving the employee with less than an adequate pension at retirement when the employee wishes to convert the employee's lump sum account into a lifetime annuity. In short, a defined contribution plan requires that the employee fully understand the consequences of his investment decisions and the outcome of such.

The practicality of this change is low. For the City to change from a defined benefit plan to a defined contribution presumably would require changes by the legislature and the Governor plus a buy in by the public employee unions and any other stakeholders. Changes of this nature would likely require that the City be on the brink of bankruptcy.

While defined benefit ("DB") plans have proven to be overly costly to government agencies to the point of service insolvency, and while the defined contribution ("DC") plan concept does not offer the guaranteed retirement income upon which employees have relied, adoption of a combination of the two could achieve a satisfactory outcome for both employer and employee.

A base DB plan, offering benefits reduced substantially from current formulas, will still provide a floor of guaranteed retirement income for the employee for which the employer will still have a cost that varies by actuarial factors and investment yields beyond its control. The DC plan, on the other hand, establishes a known contribution (as a per cent of salary) for the employer which the employee can invest to supplement the DB plan: the account can be converted to retirement income at the time of retirement or later, thereby allowing the fund to continue to grow and giving the employee flexibility in his retirement income planning. In short, a combination of the two allows the employer more budgeting control (the DC plan) and the chance for cost savings while still giving the employee a guaranteed basic floor of retirement income (the DB plan).

Moreover, a well-promoted voluntary 457 plan, which is tax-deferred, can further an employee's ability to accumulate funds for retirement.

To know what the potential outcomes might be both for the employer and the employee would require actuarial calculations and conservative investment projections, both of which are beyond the scope of the analysis presented in this report.

It should be noted that the League of California Cities City Manager's Department supported a combination retirement plan in its January 2019 white paper, to wit, reasonable, dependable, and financially sustainable, employer-employee funded Defined Benefit plans for career employees, supplemented with other retirement savings options including personal savings (e.g. 457 Plan" and/or 401a Defined Contribution Plan (DCP)).

The timeframe for accomplishing a change would be long and indeterminate. It would depend on the state of the City in the long view.

Summation: A defined contribution plan does not offer the guarantees to the employee which a defined benefit provides. But when the cost of a defined benefit plan becomes unsustainable and creates service insolvency (meaning the City can no longer provide the level of services mandated and necessary), the issue of whether the benefits of a defined benefit plan are excessive becomes problematic and consequential.

10. ***Extend income averaging period used to calculate pension payment*** **(2014 report Additional Thought no. 14)**

Overview: The 2014 report suggested extending the final compensation calculation period from one year or three years to five to seven years.

Action to date: Since the date of the 2014 report, neither the City nor any of the surrounding jurisdictions appear to have made efforts to extend the final average compensation calculation period as suggested.

Analysis: Extending the income averaging period from three years to five to seven years would require legislative action to create new pensions formulas. The extended income averaging could serve to lower pension costs by lowering final compensation for retirement benefit calculations. The significance of any new retirement formulas would only apply to future employees unless there were favorable rulings in the pending court cases, which could allow changes for existing employees, prospectively.

Legislative action could occur within a two-year timeframe but would require broad support at the state-level. Any associated saving or cost reductions would be realized in the three to ten year range as current employees enter retirement and new employees enter the system at lower contribution rates. Additionally, unless there is an opportunity to reduce benefits for current employees, there would be no impact on the current unfunded actuarial liability (UAL).

E. New Potential Actions

1. ***Eliminate existing positions/Do not backfill vacated positions***

Overview: There are two options within this item: eliminating positions or not filling positions as they are vacated. Although the 2014 report did not address the possibility of reducing pension obligations in the future by eliminating positions or not filling positions as they become open, this committee identified these as two possible ways to reduce future pension obligations and to reduce costs in the present.

Action to date: The City has not performed a comprehensive audit to determine if positions should be eliminated or not backfilled, but it does an iterative, reevaluation of

the need for positions, especially when they become open. In this process, the City identifies the needs of the position and determines if the work needs to be realigned or reorganized and if the position needs to be filled or not. The City has found this to be an effective method of evaluating positions and needs. The City has not decreased its total number of authorized positions (Full Time Equivalent "FTE" count), but it has eliminated positions as part of department reorganizations, rather than because of budget cuts. Specifically, the City has had three positions unfilled in the past three years.

Analysis: Assuming every position currently filled is important to the City serving its residents, eliminating positions or not filling positions as they are vacated could have significant drawbacks. First, reducing positions or not filling available positions could result in remaining employees taking on greater workloads, which could affect morale. Not back-filling vacated positions would likely have less of a negative effect on morale, as it would at least not involve the City eliminating existing employees' positions. Additionally, either eliminating positions or not filling vacated positions could result in increased overtime pay due to the additional work employees would have to take on, and such pay could affect these options' potential cost-savings. Finally, reducing or not filling positions could also lead to reduced services, which (depending on the service) could be unpopular and/or could affect effective City management.

On the other hand, assuming that not every position filled is critical to the City serving its residents, evaluating positions to identify inefficiencies would be in the public interest and could result in immediate cost-savings in terms of current salaries and future pension obligations.

Importantly, most City positions are unionized, so the elimination of positions would be complicated but not impossible.

Summation: Not backfilling positions as they are vacated would allow the City to avoid taking on new pension obligations, and eliminating positions could limit associated pension obligations to those accrued to date, but these potential benefits would have to be considered in light of potential overtime costs, lower morale, and reduced City services. To make eliminating or not backfilling positions a practical option for cost-savings, the City would therefore have to analyze its workforce to identify where employees have room to take on more work to make up for eliminated or vacant positions and/or which roles may have become less necessary. It has been reported that the City is evaluating positions as they become open, so this may not be a new way for the City to save money. It would also be difficult to eliminate many positions because they are unionized and would therefore require discussion and negotiation with the union. Moreover, because the City reduced its FTEs by 12% during the recession, it is operating in a manner it already considers to be lean, so position elimination may not be a realistic way to save significantly. Finally, as with the potential for cost savings through outsourcing (pages 8-9, above) further reductions in force would not reduce the City's ongoing annual UAL payment to MCERA.

2. ***Analyze effect on City hiring and retention of (i) potential impact of increased PERS contribution requirements in neighboring jurisdictions and (ii) outcome of pending California Supreme court cases***

Overview: Contribution rates for the statewide CalPERS retirement system are projected to increase over the next few years, which may serve to mitigate or balance the competitive disadvantage that currently exists between MCERA participant employers and local PERS agencies. The cost comparisons are not significantly difficult calculations and could provide a better understanding of projected employer costs differences in the local market over the next three to ten years.

Analysis: Favorable decisions on the pending court cases could allow employers to renegotiate future benefits for current employees, which could serve to lower retirement costs. It could also create a favorable environment for additional legislative changes (*i.e.*, PEPRA 2.0). However, there are potential risks associated with waiting for the CalPERS changes or further legislation to take effect. Delaying action to lower current retirement costs or raise additional revenue to balance compensation in the local market could result in further deterioration in competitive salaries and further losses of experienced personnel to other regional agencies.

Summation: The City must balance the risk of short term loss of competitiveness in the employee hiring and retention arena against the substantial long term benefits that could accrue from waiting to increase employee compensation until the CalPERS/MCERA playing field has leveled.

3. ***Provide housing benefits within Marin County to fire, safety, and other employees to improve City's competitive position***

Overview: High housing costs in Marin County force some City employees to leave their employment by San Rafael for employment by lower housing cost jurisdictions closer to their homes with shorter commutes. A housing benefit in the form of financing and/or down payment benefits to employees for the purchase of homes in Marin might prevent movement of employees to lower housing cost jurisdictions by making employee housing in Marin more affordable and significantly reducing employee commute times. It could also reduce the necessity of higher wages and pension benefits, but the advantages produced by the benefits in total would have to be weighed against the costs of the benefit program.

Action to date: None.

Analysis: The object of a financing or down payment benefit to enable the purchase of homes within Marin County would be to mitigate (i) the high cost of housing within Marin County (ii) lengthy commute times, both of which have been causes of employee

loss to lower cost jurisdictions. Such benefits might eliminate or mitigate the competitive disadvantage to a great extent and perhaps reduce, to some extent, the necessity of raising wages, assigned percentage for COLA increases, and other pension costs deemed necessary to compete.

Housing benefits for residences within the County could be provided potentially in essentially two areas, financing and/or down payment, although a third more complicated area might be to develop housing for City employees on existing City property. This analysis will discuss only financing and down payment benefits.

a. *Financing.* The committee has been informed it may be possible for MCERA to provide low cost financing (perhaps under 3%) for City employees so long as loan repayment is guaranteed by the City. Alternatively, the City could arrange for financing from an institutional home lender (probably at a higher rate), once again with a City guaranty. The City could make such financing available to personnel who had completed a specified number of years of employment by the City, for instance five years, and contract to keep the financing in place for so long as the employee continued (i) to be an employee of the City and (ii) to own and reside in the financed home as the employee's primary residence. The portion of the financing provided by the city or MCERA could be limited to an amount acceptable to the City, presumably with a dollar limitation on the amount financed. The City would contribute a proportion of the monthly payment according to a pre-determined schedule. In the event that prior to a specified term the employee's employment by the City was terminated voluntarily or involuntarily or the employee ceased to own and reside at the home as the employee's primary residence, the debt would become due within one year following the termination event and paid off proportionally between the employee and the City in accordance with a scheduled allocation. The City could arrange for insurance to pay off the debt in the event of early death.

b. *Down payment*. The City could pay/lend all or a portion of the down payment for a residence within Marin County. In general, it would carry the same conditions as the financing above, except that in the event of employment termination or cessation of residence before the specified term, the portion of any down payment made or financed by the City would be allocated for repayment in accordance with a pre-determined schedule.

The housing benefit would be attractive only to certain employees. There would be some complications, foreseen and unforeseen, from its use. The cost of any benefits to be gained would have to be carefully considered against the costs of the program, both monetarily and otherwise. If appropriate, it would be used to retain important seasoned employees who now leave the City employment on or soon after the five year mark. The City could join with other jurisdictions with high housing costs to seek any legislation required to make the housing benefit effective, if PEPRA limits its implementation as a pension cost savings tool.

Summation: Without statewide action allowing exemptions to the PEPRA mandated pension floor, this suggestion seems unlikely to advance further at this point in time. Moreover, federal law governing non-discrimination in the offer and provision of employee benefits, could hamper the City's ability to implement such a change to the current pension regime.

4. *Limit or reduce retiree COLAs*

Overview: Cost of living adjustments ("COLA") to pension benefits have a compound effect over time and can greatly increase the cost of providing such pensions as retirees live longer and collect benefits over their longer lifetimes. Some advocacy groups have suggested that a reduction in the COLA benefit is necessary to prevent a potential collapse of the state's pension systems. The committee believes it is not practical to try to reduce potential COLA benefits for current and former employees and retirees already collecting MCERA benefits. Nonetheless, a potential negotiation of such a benefit reduction for future hires could reduce long term pension plan funding costs.

Analysis: City of San Rafael retirees are entitled to an annual upward cost-of-living adjustment to the amount of the pension benefit. The percentage amount of the COLA depends upon the tier to which a retiree belongs. (See chart at page 4 of 2014 report.) The maximum percentage amounts (3% or 2%) are determined by reference to increases in the Consumer Product Index, as published by the federal government. Since anticipated COLA's are included in the actuarial assumptions used to determine both the employer and employee portions of the normal cost contribution, employees are prefunding, to a certain extent the COLA's they will eventually receive when they begin to collect retirement benefits.

The 2014 report did not address COLA adjustments as a way to strengthen the financial stability of the pension plan and the amount of the City's required annual contributions to the plan. Recently, however, the League of California Cities, City Managers Department Pension Sustainability Working Group produced a white paper on the subject of the COLA in the context of the CalPERS retirement system.

In that paper, the working group advocates attempting to scale back the COLA percentage for current CalPERS retirees to avoid the deleterious effects of the compounding COLAs and the effect of increasing retiree longevity. Arguably, the MCERA CPI increases history and changing longevity assumptions have similar effects on the MCERA plan finances.

The committee thinks the likelihood of achieving pension funding costs saving through either (i) a voluntary reduction in the COLA percentage or (ii) through Reed initiative type modification for future work, is low. Although, as demonstrated in the

League white paper, the cost savings could be significant and have an immediate effect, such measures face serious political headwinds, as discussed above with respect to the Reed initiative. Moreover, retirees would seem unlikely to agree to forego a benefit they are currently receiving at this time, without being pressured to do so by the threat of a retirement system insolvency. Finally, any reduction in potential retirement benefits could adversely impact the City's ability to hire and retain employees, if other jurisdictions did not either lead the way or follow suit with similar COLA limitations.

Summation: The prospects for a short term or immediate reduction in COLA benefits for either future hires, or those employees and retirees whose benefits have already vested, seems very unlikely at this point in time. That situation might change if, and when, the MCERA pension plan appears to be in danger of failing to be able to meet its ongoing payment obligations.

Respectfully submitted,

San Rafael 2019 Independent Committee
On Employee Retirement Benefits

CITIZENS' GROUP ON PENSION REFORM

Report to the City of San Rafael City Council Subcommittee on Pension/OPEB Benefits

For a number of years, the City has been concerned that the costs of pensions and other post employment benefits (OPEB) have been taking resources which might otherwise be used to provide services to the public and repair and improve the City's infrastructure and capital assets. In that past several years the City has taken action to reduce those costs to some extent, and formed a City Council Subcommittee on Pension/OPEB Benefits to look into the issues. Looking for an unbiased opinion on the steps already taken and what actions the City might still take to contain those costs, The subcommittee called for formation of a citizen group to study the issues and report its thoughts.

Dirck Brinckerhoff was asked to choose and chair the group. The other members are Laura Bertolli, David Hellman, David Holsberry and Michael Lotito.

The members studied materials produced by others conversant with the issues, including, among other things,

Analyses of the current state of pension and health benefit funds of various entities, including San Rafael, by the Marin County Civil Grand Jury, the Marin County Council fo Mayors and Councilmembers, the Committee for Sustainable Pension Plans, the actuarial consultant for the Marin County Employees' Retirement Association, City of San Rafael staff and others;

Summaries and analyses of portions of pension law by the League of California Cities and by SEIU;

Legal analyses of the vested rights theories;

The Reed Initiative;

Staff reports to the San Rafael City Council on the progress made in negotiations with employee groups within the city.

The members also met with City staff and with Jeff Wickman, administrator of the Marin County Employees' Retirement Association.

The report below summarizes what the group learned, the actions so far taken by the City, the members' analysis of what may still be possible within the current legal structure, and a listing of additional approaches, not as suggestions, but as thinking points.

BACKGROUND INFORMATION:

There are Two Basic Types of Pension Plans:

1. Defined Contribution plans, under which the employer and employee contribute specified percentages of the employee's pay during the course of employment, and the retiree is entitled to collect, in one manner or another, the payments and the amounts they have earned by virtue of investment by the pension administrator.

In a defined contribution plan, the obligation of the employer to make payments into the plan lasts only as long as the employee is employed. The employer must simply deposit the correct amount monthly during employment. The pension administrator is then obligated to pay out, according to schedules, the total of the contributions and whatever gains the administrator has been able to garner by investment.

2. Defined Benefit plans, which are the type common for public employees, provide the retiree with monthly payments for life in an amount calculated on formulas based on years of service, type of service, retirement age, and the amount of earnings at retirement.

In this case, if the contributions plus the investment earnings are not enough to make those payments, the employer (in this case the City) must make up the difference.

Recently, governmental entities have come to realize that the obligations to which they have been bound by law and by agreement with employees, whether directly, through union agreements, or by virtue of the rules of their pension administrators, are taking and will take in the future, so much of their income that they will not be able to continue to provide the services expected and deserved by the citizens.

In reaction, the California legislature has passed laws which allow for, and in some cases mandate, changes in the entitlement formulas and funding processes for pensions for newly hired employees in particular and for all employees in some cases.

We will first look at how the defined benefits for retirees are expressed and calculated (Benefit Formulas), and then how they are paid for (Funding the Benefits).

Benefit Formulas:

Tiers --

Pension benefits are defined by formulas which provide for payments of a certain percentage of the employee's salary for each year served, depending on the age at retirement. These formulas (called "tiers") have changed over the years and have been different depending on the category of employee (Safety Fire, Safety Police, Miscellaneous).

The tiers are usually described by the percentage of final average salary which would be payable per year of employment to an employee retiring at a particular age after having worked within the system for 10 years. Thus "2.7% at 57" is the shorthand reference to a whole chart showing benefit amounts payable to retirees depending on retirement age and years of service where an employee retiring at age 57 after 10 years of service is entitled to 27% of final average salary. Below is an example of a tier chart for a "2% at 55" tier, in which the intersection of the age column and the years of service row indicate that the benefit for a 55 year old employee retiring after 10 years of employment would be 20% of the employee's final average salary (2% X 10 years):

Years of Service	Age													
	50	51	52	53	54	55	56	57	58	59	60	61	62	63+
10	14.26	15.22	16.28	17.42	18.66	20.00	20.52	21.04	21.56	22.10	22.62	23.14	23.66	24.18
11	15.69	16.74	17.91	19.16	20.53	22.00	22.57	23.14	23.72	24.31	24.88	25.45	26.03	26.60
12	17.11	18.26	19.54	20.90	22.39	24.00	24.62	25.25	25.87	26.52	27.14	27.77	28.39	29.02
13	18.54	19.79	21.16	22.65	24.26	26.00	26.68	27.35	28.03	28.73	29.41	30.08	30.76	31.43
14	19.96	21.31	22.79	24.39	26.12	28.00	28.73	29.46	30.18	30.94	31.67	32.40	33.12	33.85
15	21.39	22.83	24.42	26.13	27.99	30.00	30.78	31.56	32.34	33.15	33.93	34.71	35.49	36.27
16	22.82	24.35	26.05	27.87	29.86	32.00	32.83	33.66	34.50	35.36	36.19	37.02	37.86	38.69
17	24.24	25.87	27.68	29.61	31.72	34.00	34.88	35.77	36.65	37.57	38.45	39.34	40.22	41.11
18	25.67	27.40	29.30	31.36	33.59	36.00	36.94	37.87	38.81	39.78	40.72	41.65	42.59	43.52
19	27.09	28.92	30.93	33.10	35.45	38.00	38.99	39.98	40.96	41.99	42.98	43.97	44.95	45.94
20	28.52	30.44	32.56	34.84	37.32	40.00	41.04	42.08	43.12	44.20	45.24	46.28	47.32	48.36
21	29.95	31.96	34.19	36.58	39.19	42.00	43.09	44.18	45.28	46.41	47.50	48.59	49.69	50.78
22	31.37	33.48	35.82	38.32	41.05	44.00	45.14	46.29	47.43	48.62	49.76	50.91	52.05	53.20
23	32.80	35.01	37.44	40.07	42.92	46.00	47.20	48.39	49.59	50.83	52.03	53.22	54.42	55.61
24	34.22	36.53	39.07	41.81	44.78	48.00	49.25	50.50	51.74	53.04	54.29	55.54	56.78	58.03
25	35.65	38.05	40.70	43.55	46.65	50.00	51.30	52.60	53.90	55.25	56.55	57.85	59.15	60.45
26	37.08	39.57	42.33	45.29	48.52	52.00	53.35	54.70	56.06	57.46	58.81	60.16	61.52	62.87
27	38.50	41.09	43.96	47.03	50.38	54.00	55.40	56.81	58.21	59.67	61.07	62.48	63.88	65.29
28	39.93	42.62	45.58	48.78	52.25	56.00	57.46	58.91	60.37	61.88	63.34	64.79	66.25	67.70
29	41.35	44.14	47.21	50.52	54.11	58.00	59.51	61.02	62.52	64.09	65.60	67.11	68.61	70.12
30	42.78	45.66	48.84	52.26	55.98	60.00	61.56	63.12	64.68	66.30	67.86	69.42	70.98	72.54
31	44.21	47.18	50.47	54.00	57.85	62.00	63.61	65.22	66.84	68.51	70.12	71.73	73.35	74.96
32	45.63	48.70	52.10	55.74	59.71	64.00	65.66	67.33	68.99	70.72	72.38	74.05	75.71	77.38
33	47.06	50.23	53.72	57.49	61.58	66.00	67.72	69.43	71.15	72.93	74.65	76.36	78.08	79.79
34	48.48	51.75	55.35	59.23	63.44	68.00	69.77	71.54	73.30	75.14	76.91	78.68	80.44	82.21
35	49.91	53.27	56.98	60.97	65.31	70.00	71.82	73.64	75.46	77.35	79.17	80.99	82.81	84.63
36	51.34	54.79	58.61	62.71	67.18	72.00	73.87	75.74	77.62	79.56	81.43	83.30	85.18	87.05
37	52.76	56.31	60.24	64.45	69.04	74.00	75.92	77.85	79.77	81.77	83.69	85.62	87.54	89.47
38	54.19	57.84	61.86	66.20	70.91	76.00	77.98	79.95	81.93	83.98	85.96	87.93	89.91	91.88
39	55.61	59.36	63.49	67.94	72.77	78.00	80.03	82.06	84.08	86.19	88.22	90.25	92.27	94.30
40	57.04	60.88	65.12	69.68	74.64	80.00	82.08	84.16	86.24	88.40	90.48	92.56	94.64	96.72
41	58.47	62.40	66.75	71.42	76.51	82.00	84.13	86.26	88.40	90.61	92.74	94.87	97.01	99.14

“Compensation” for purposes of Tiers:

The compensation to which the tier percentages are applied is the “Final Average Compensation” for a specific period. That had commonly been the last 12 months of employment.

The compensation included in that average (called “Pensionable Compensation”) has been comprised of regular salary, payments for additional services outside normal working hours, certain types of unused leave, and certain other payments. By saving up these add-ons and taking them in their last year of employment, employees were able to increase dramatically the Final Average Compensation used to calculate their pensions. This practice is known as pension spiking.

Vested Rights:

Currently, the unions and most courts take the position that the benefit tier (and definition of Final Average Compensation) applicable to any employee at retirement is the most beneficial one applicable to members of his or her category during the period of his or her employment. The theory, supported by the Constitutions of the United States and of California, is that, as a part of the employee’s whole compensation package, the employee accepted (or continued) employment based on the promise of that tier’s benefits. As a result, it is said that the employee’s rights to the benefits in that tier become “vested” and irrevocable once he or she has worked under it, even though new employees may be entitled only to less beneficial tiers, and regardless whether the employee and employer had, during the period of employment, contributed enough to the pension administrator to fund those payments.

<u>State Legislative Moves</u>:

While it was somewhat like shutting the barn door after the cow has left, when people realized that the promised benefits were unsustainable without either increasing taxes or reducing services, the California legislature passed The Public Employee Pension Reform Act of 2013 ("PEPRA"), which made a number of changes in public pensions in California. Because of the vested rights theory, these changes affect mostly "new employees", who are those hired on or after 1/1/2013.

Among other things, PEPRA established:

1. New tiers, which provide for pensions calculated at a lower percentages of salary and at higher retirement ages,
2. A 36 month Final Average Compensation period rather than the12 month period which had been the previous standard.
3. A cap on "Pensionable Compensation" at 120% of the maximum salary used to calculate Social Security contribution for the rest of the population
4. Exclusions of certain types of payments (mentioned earlier) from the calculation of "Pensionable Compensation" to prevent pension spiking.
5. A cap on cost of living increases (COLA) which pension administrators are allowed to pay.

San Rafael's Progress:

The chart below shows the changes in benefit tiers, final average compensation and maximum cost of living increases applicable to San Rafael's employees depending on the date of their employment. As can be seen, the City and the employees had agreed to significant reductions in benefits before the passage of PEPRA.

Dates	Min Age to Retire	Formula	Max COLA	FAC* Period
Before 7/1/11				
Safety	50	3% at 55	3%	1 yr.
Miscellaneous	50	2.7% at 55	3%	1 yr.
7/1/11 to 12/31/12 (Negotiated before PEPRA)				
Safety	50	3% at 55	2%	3 yrs.
Miscellaneous	55	2% at 55	2%	3 yrs.
1/1/13 to Present (PEPRA)				
Safety	50	2.7% at 57[1]	2%	3 yrs.
Miscellaneous	52	2% at 62	2%	3 yrs.

*Final Average Compensation

[1]Safety Option Plan Two (required by PEPRA based on prior formula)
Lower tier could be applied to new hires if agreed in collectively bargained MOU without impasse.

Funding the Benefits:

The retirement plans are funded by a combination of contributions by the employer and employee paid to a pension administrator. For many government entities the administrator is the California Public Employee's Retirement System. For San Rafael and numerous other Marin entities, the Marin Employees' Retirement Association ("MCERA") which invests the contributed money with the goal of having enough funds available when employees retire to make the promised payments to them and to any eligible beneficiaries for the rest of their life.

Normal Cost

Using assumptions as to the rate of return on the invested funds, the rate of inflation, and the expected retirement age of employees, the pension administrator calculates the amount of contributions needed each year to invest so that there will be enough in the fund to make the pension payments. The contribution needed if we were starting with a clean slate is called the "Normal Cost".

Normal Cost is the amount needed to be contributed in each year to have enough available to pay the defined benefits when the employees retire. (Assuming past contributions had been sufficient.)

In making its projections of the amount needed, the actuaries for MCERA currently calculate the needs based on the following assumptions:

Investment Return/Discount Rate	7.50%	
Inflation:	3.25%	
Real Rate Of Return	4.25%	(Investment minus Inflation)
Salary Growth	3.25%	
Membership Growth (# employees)	0.00%	i.e., total number of employees remains stable

It is common with most governments that the employer and employees each pay a portion of the Normal Cost.

As a result of negotiations with the employee unions, most of the San Rafael employees are paying very close to half of the Total Normal Cost.

Cost Sharing: The PEPRA requirement is that new employees pay at least half of Total Normal Cost. For pre-1/1/2013 employees, that is a "goal".

Unfunded Liability:

In the case of most every government entity's pension fund, a history of benefit increases, optimistic actuarial assumptions, and investment losses has created a situation in which the past contributions have not built the fund's assets to sufficient size to make the benefit payments required by the formulas. The difference between the amounts now in the funds and the amounts needed to cover the expected pension obligations to retirees is referred to as the "Unfunded Liability".

The shortfall arose for many reasons, among them:

1. In the past, to attract and keep good employees, cities have agreed to increase benefits beyond what they originally planned for (the result is like saving for a trip to Disneyland and then paying for an excursion to Europe instead),

2. people have lived longer than projected, thus collecting payments longer than expected,

3. the value of investments has not grown at the projected rate (and in recent years, dramatically decreased)

4. employees have negotiated or found ways to increase their income just before retirement ("pension spiking") so that the contributions during their regular employment income turn out not to be enough to cover the retirement payments under the defined benefit formulas (which use only the final year(s)' compensation to determine benefits).

To assure payment of the promised pension benefits, it is necessary to make payments in addition to the Normal Cost to make up the Unfunded Liability.

To make up the Unfunded Liability, MCERA is requiring contributions in addition to Normal Cost to bring the plan to 100% funded within 17 years. (I.e., based on a 17 year amortization.)

Because the 2008 loss in asset value was so great, and making it up would put such a strain on the City's finances, to soften the load, MCERA is requiring contribution for half of the 2008 losses based on a 30 year amortization.

Last year, in addition to its portion of the Normal Cost and the two portions of the Unfunded Liability, San Rafael made an additional contribution of $1,000,000.

FINDINGS:

1. Before the passage of PEPRA, the City had, through negotiation and agreement with its employees, taken many of the measures required or allowed by PEPRA.

2. Possible Additional Measures for the City:

<u>For New Members:</u>

Under PEPRA, the City can agree with New Members in a MOU to pay some or all of the employer's share of Normal Cost. (Negotiation and agreement is required; unilateral imposition is not allowed.)

New employees can also agree to pay some or all of the payments toward the Unfunded Liability

This agreement may be reached with individual bargaining units; agreement with the whole classification is not required.

Payment of part of the unfunded liability may seem fair if it is for that portion of the unfunded liability which relates to the costs for that employee's future benefits (i.e., not that part which covers benefits for employees already retired.

New tiers for new employees could be devised, but they would have to be certified as having no greater risk or cost than the PEPRA tiers and must be approved by the Legislature. Presumably they would also have to be negotiated with employees, and with the requirement of legislative approval, it would be foolhardy to try to obtain that without first having agreed with employees.

For Members hired before 1/1/2013:

It appears that, after Jan 1, 2018, similar negotiating is allowed with existing members with respect to payment of some or all of the employer's share of Normal Cost and some or all of the payments toward the Unfunded Liability.

Also, after January 1, 2018, the City can, after exhausting impasse, impose a requirement that employees pay 50% of Normal Cost, provided the employee contribution doesn't exceed 8% of salary for misc., 12% for safety and 11% for other employees. – San Rafael is near or at those maximums already.

General:

Since the structure of government pensions and the allowable changes to them are so tightly prescribed by state law, the most effective way to accomplish dramatic changes will be to pressure our legislators to pass laws which go beyond PEPRA and somehow allow changes to benefits for those who have worked or are working under more advantageous tiers and rules.

Reduce rights in emergency

Retiree Health Benefit Costs:

For all past employees, San Rafael is committed to paying anywhere from $386 per month to the full premium for retirees' health insurance. In 2009 and 2010, the City negotiated to cap those benefits so that they would not increase over time. Starting with employees hired in 2009, the City will be paying the legal minimum (currently $115 per month) for retirees to use toward purchasing their own coverage, regardless of employment category, age of retirement, or health status.

The City has a trust fund, currently administered by CalPERS, to fund the liability for these benefits. This liability is currently approximately 35% funded.

Additional Thoughts:

The following ideas, outside the pension laws as they now stand, have been suggested by some, but are not agreed by all. They are not presented as recommendations of the group, and may not be desirable or feasible, but are mentioned as options for consideration.

1. Salary freezes or reductions from what might be agreed to so those funds are used to pay into the pension fund;

2. Since the health care benefits are not 'vested' in accordance with law, consider reducing that benefit in some fashion and use those funds towards the pension issue (consider, however, whether "promissory estoppel" may prevent this – see Retired Employees Assn of Orange County v. County of Orange and IBEW Local 1245 v. City of Redding,);

3. Consider outsourcing certain functions to transfer the liability to a third party or cap the liability to those who have accrued 'benefits' and have the private sector employer assume the risk instead of the taxpayer (however, see unpublished appellate decision in Costa Mesa City Employees' Assn. v. City of Costa Mesa, which questions a city's ability to contract out essential services);

4. Consider combining services with other towns to reduce costs and place the savings into the pension fund (though, depending on the benefits available in each of the combined agencies, consider whether Govt. Code Sec. 31,485.9 may require increasing all benefits to the highest of the combining agencies);

5. Increase taxes;

6. Any combination of the above;

7. Consider retaining an 'independent' third party specialist to negotiate the agreements to avoid the emotional pain that comes from the current system;

8. Ensure that the management representatives who negotiate the deals do not receive parity to improvements agreed to with the unit employees;

9. Engage in a massive educational effort for all voters to have them understand how the quality of services are being and will continue to be impacted by the debt which exists;

10. Support the Reed initative, or other like modifications to state law, whether by initiative or legislative action.

11. Use the GASB68 standards requiring the City to report pension unfunded liabilities on the Statement of Net Assets as an opportunity to educate the public and the public employees so that all may be more receptive to taking actions necessary to resolve the issues we now face.

12. Since people are living longer, raise the age at which people can retire (this would likely require creation of new tiers – see above on the practicality);

13. Move towards defined contribution when/if this ever becomes possible, and bring agreements for new hires be more in line with private industry, where benefits are being cut.

14. Extend the wage average used to calculate the pension amount, over a longer period, say 5 or 7 years?

Appendix B
Potential Solutions Table

Proposed Solution	Pros	Cons	Practicality	Timeline*	E/C**
City Actions Without Legislative Changes					
1. Salary Freeze or Reductions	Could reduce costs now and in the future	Potential employee losses, reduced morale, retention issues and difficulty in hiring replacements	Low - could be difficult to negotiate with unions, could be difficult politically, and could negatively affect morale, retention, hiring	(a)	C
2. Reduce OPEB	Reduce required payments by City for current and future healthcare expenses. Accelerate paydown of unfunded retiree healthcare actuarial liability	City has already taken actions to amortize paydown of unfunded actuarial liability; reduce money available for other purposes; reduce competitive hiring and retention advantage.	Low, unless investment earnings or retirement demographics show favorable changes in the future.	(a), (b)	C
3. Outsource Work	Potential to reduce current costs and future pension liabilities	Varies according to type of service outsourced, but all would involve loss of administrative control, might affect remaining employees' morale, and could have negative political repercussions	Medium, as could be difficult politically and certain city functions might not make sense to outsource	(a)	C
4. Combine Services	Cost savings	Loss of local control	Low to medium, depending on type of service to be combined	(b)	C

Proposed Solution	Pros	Cons	Practicality	Timeline*	E/C**
5. Increase Taxes	Will provide new revenue: each ¼% sales tax increase will equal about $4 million	Voter opposition, may not pass; regressive tax: may suffer reduction due to economic downturn	Medium; depends on voter approval by one-half or two-thirds, depending on stated purpose	(a)	C
6. Outside Negotiators	Reduce potential conflicts of interest; potential improvement in negotiation skills	Shifts responsibility from leaders directly responsible for negotiations	Depends entirely on management and council desire to implement changes	(a)	C
City Actions Requiring Legislative Support or Changes					
7. Reed Initiative	Would allow modification of pre PEPRA hire pension rights resulting in potential significant Normal Cost and UAL paydown expense	City could lose competitive hiring and retention advantages if other jurisdictions did not follow suit.	Low - would require statewide voter approval and be subject to further litigation challenges	(a)	C
8. Raise Retirement Age	Lowers retirement costs	Requires legislative changes; would only apply to future employees; may have cost impacts related to workers comp claims	Medium. Will require broad legislative support.	(b)	C
9. Defined Contribution	Remove investment risk for employers: easier to budget for pension outlay	Puts investment risk on employee: no guaranteed retirement benefit	Low: all stakeholders have to agree. May require legislative action	(b)-(c)	E
10. Extend Averaging	Lowers retirement costs	Requires legislative changes; would only apply to future employees; may have cost impacts related to workers comp claims	Medium. Will require broad legislative support.	(b)	C

Proposed Solution	Pros	Cons	Practicality	Timeline*	E/C**
2019 Report New City Actions Without Legislative Changes					
1. Elimination of existing positions/No backfill	Immediate savings; could streamline the city's functions by eliminating any positions that may have become unnecessary	Increased workload for remaining employees could lead to overtime pay and could lower employee morale; could be politically difficult.	Medium, depends greatly on the position and existing employees' workloads	(a)-(c)	C
2. Do nothing	Rising PERS costs may level costs with MCERA. Positive court decisions may allow flexibility to alter current agreements and lower costs.	Waiting to take action may create greater imbalance in local job market and increased loss of experienced personnel. Court decisions may not be favorable to employers.	High. PERS rates and court decisions will likely be recognized within the timeframe of potential tax measures.	(a)	C
2019 Report New City Actions Requiring Legislative Support or Changes					
3. In Lieu Housing Benefit	Reduce City MCERA normal cost contribution; retain skilled employees	May not be authorized under PEPRA; may not appeal to employees; administrative burden; loan default risk	Low to medium	(b) [to implement]; (c) [realize benefits]	C
4. Reduce COLAs	Reduce Normal Cost and UAL payments	Loss of inflation protection for retirees; COLA's already partially paid for by employees; reduce hiring and retention competitiveness	Low	(a)	C

*For timeline column (time for impact to be felt): (a) Short term: one to two years; (b) Medium term: three to ten years; and (c) Long term: longer than ten years
**E = Exclusive / C = Complimentary