Marin Manager's Association

TO: North Bay, League of California Cities
California State Association of Counties
Association of California Water Agencies

FROM: Marin Manager's Association (MMA)

DATE: November 3, 2009

SUBJECT: Proposal for Regional City and County Pension Standard

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Introduction

Beginning in June, 2009, the Marin Manager's Association (MMA) began to explore alternatives to the current pension standards provided to public employees within our agencies. This topic has been under review and consideration for some time, as evidenced by publications over the past few years from the League of California Cities (League) and the California State Association of Counties (CSAC). Regional efforts regarding pension reform and new standards have been occurring as well, including multi-agency efforts in Santa Mateo and San Diego counties.

Marin city and county governments recognize public employee defined benefit plans have served career employees well for many decades. These same agencies also recognize the current public pension systems are not sustainable. A myriad of factors contribute to this conclusion, including, but not limited to, current economic and investment climates, pension changes in the private sector, longer life expectancies, and shrinking work forces.

One might consider any discussion of public sector retirement benefits should not be limited to just pension systems. Local agencies need to examine all of the post-employment benefits provided to long term employees who retire from city and county governments. Each agency should examine both its willingness and capacity to offer and financially sustain post employment benefits. Given the complexity of these subjects, and a desire to offer regionalized solutions for retirement, the focus of this proposal coming from the MMA will be limited to pension reform.

The Problem

Much has been written and publicized about public employee pension problems over the last several years. There is no question isolated abuses, such as 'pension spiking' have contributed to this media coverage. Conversion of benefits to salaries, although allowed with system regulations, has resulted in some annual retirements (mostly for positions of high level directors and managers) beyond what is fair and reasonable for long term public employees.

Over the past two decades, court rulings and other changes in laws have added to member agency retirement burdens. At present, overtime pay, administrative leave at termination and health care benefits paid by local employers are not considered 'annual earnings' for retirement purposes. However, inclusion of specialty pays (such as education incentives) and other compensation components has been declared compensable earnings at retirement.

These compensable earnings changes have compounded the growth in defined benefit plan employer costs in recent years due to other factors, particularly poor returns on investments assets due to the overall equity market downturn. In the late 1990's, when CalPERS was earning extraordinary returns on its portfolio, actions by the California Legislature enacted significant benefit enhancements for public employees in the CalPERS and MCERA systems that were optional for participating local governments. At that point in time, investment returns created persuasive (but ultimately unsustainable) new pension tiers. It is now common for career public safety officers to retire close to age 50 with close to a full salary under the 3% at 50 plan. Many non-safety career employees can also retire near their salary levels prior to retirement, with additional years of service. What has taken place over this past decade demonstrates that these late 1990s' actions need to be amended, and soon.

In order to address these problems, the Marin Manager's Association is committed to providing recommendations for a reduced tier pension offering that could be implemented by the great majority of Marin cities as well as the County of Marin. New pension tiers would not affect existing city employees who have vested rights to the current pension program, but would affect new employees after a date certain. A standardized new hire pension tier can, and should be, both sustainable and defensible.

Background and History

For several decades, the State of California and local governments have offered a "defined benefit" retirement plan for employees. This system guarantees annual pension payments based on retirement age, years of service, and salary. Most cities in California are members of the Public Employees Retirement System (CalPERS).

All cities in Marin County, with the exception of the City of San Rafael and the County of Marin, are CalPERS members. San Rafael and the County are members of the Marin County Employee Retirement Association (MCERA).

The goal of this report is to recommend pension levels for full career employees with pension benefits which maintain a reasonable standard of living into retirement. The benefit level should be fair and adequate, but fiscally sustainable for employers and taxpayers. Any proposal for such a regional pension standard must be based on sound actuarial work. In order to support the understanding of a reasonable standard of living beyond public sector employment, we have gathered data from the current pension providers. According to a recent publication, CalPERS reported $25,200 as the average annual pension for their retirees in their system. 78 percent of all CalPERS service retirees receive less than $36,000 a year or less. 32% of total CalPERS members are in local government service, with the balance being in the State of California and school agencies.* Similarly, MCERA reports the average income for their members is $32,000 per annum.

We acknowledge the defined benefit plan has worked for decades and should be retained, but with reforms to maintain principles of sound fiduciary management – including elimination of abuse, sharing of risk between employer and employee, and establishing more predictable costs – that preserve the ability to recruit and retain quality employees for key positions.

Over the past two decades, defined benefit pensions have become increasingly rare in the private sector. Most private employers offer "defined contribution" plans where the employer contribution is a fixed dollar amount and the benefits are based on contributions and investment earnings. Given their structure and limitations (per IRS regulations), these defined contribution plans put the great majority of investment planning and market risk on the employee. Each individual is tasked with building sufficient retirement assets to provide for their needs (and those of immediate family members) after retirement. Recently, defined contribution plans (commonly known as 457 and 401(k)) have delivered poor investment performance. There exists an increasing opinion amongst the public at large, and opinion leaders, that State and local government workers should be forced solely into defined contribution plans.

We feel this would be mistaken for several reasons. First and foremost, defined benefit plans have proven to be more efficient than defined contribution plans for delivering pension benefits. Defined benefit plans generally earn more over time than defined contribution plans because they are professionally managed. Defined benefit plans offer lower fees and cover disability retirements and death benefits that are not included in defined contribution plans. Further, defined benefit plans offer a protection for inflation and manage longevity risk better than defined contribution plans by pooling larger numbers of people. Moving from a defined benefit plan to a defined contribution plan entails large start-up costs and forces change in asset allocations that will produce lower investment results in the defined benefit formula plans that remain for existing employees. Hence, it would likely cost the taxpayers more for many years to force future local government employees into a defined contribution plan.

Defined benefit plans are funded from three sources. Employees are required under law to contribute rates established for each plan tier. These rates are set as a constant amount of salary (such as 9% for public safety employees). County 1937 Act plans like MCERA require employees to pay a rate based upon age of entry (age at hire date). These employee rates can range from 5% to 12% - the older the employee hired – the higher the rate.

The second level of funding comes from actual trust fund investment returns. Actual returns vary from one year to the next but expected returns are set by the MCERA and CalPERS Boards, with extensive input from actuarial firms. These expected investment rates have always taken a long view – and are currently expected to generate 7.75% to 8.0% annual rates of return. This leads us to the final level of funding coming into play – employer contribution rates. Whatever funding is not handled by member contributions and investments returns must be made up by employer contributions.

City and county costs for these defined benefit plans are largely rooted in two factors: the benefit paid to retirees, and returns earned by investment managers. CalPERS and MCERA are not impervious to stock market declines and real estate losses. Both MCERA and CalPERS have suffered significant losses in their respective portfolios since mid 2008, like any other investor in the market at the time. While the investment markets have provided some portfolio rebound in recent months, member agencies are going to be required to pay significantly increased contributions to fund pensions for current employees and make up for the huge losses in FY '08-'09. Amortization of these losses into employer rates over the next few years will differ for MCERA and CalPERS agencies, based upon respective Board directions. It is clear these huge losses will add mounting financial and budgetary pressure on Cities/Towns and the County at a time when local budgets are already in distress.

Public pension reform has been studied locally and on a statewide level over the past several years. Local government budgets and tax revenues rebounded after the dot.bomb implosion in the early 1990's. Growth in sales taxes, housing markets and business expansion overtook the pension reform ideas. When local economic recovery occurs, the current financial challenges facing local government indicates improved fiscal condition will be slow and gradual. This is in sharp contrast to prior recoveries and reinforces the need to stay the course to implement pension reform strategies.

Local revenues for Marin cities and towns are depressed at a time when pension rates will be increasing. The major sources of revenue to pay for basic services include property, sales, and hotel occupancy taxes. Statewide consulting experts HdL, which audits sales tax for many California cities and counties, does not anticipate a return to 2005 sales tax levels until 2013 or later due to changes in consumer behavior, restructuring of industries (e.g. autos) and access to credit. Property tax revenues, long considered the most reliable for steady growth of all municipal revenues, are flat in Marin County this year and only modest growth is expected in the ensuing years relative to annual 7%-9% growth experienced before the housing decline. Job losses and inflation pressures, coupled with devalued dollars, resulted in fewer travelers to Marin, and double digit declines in hotel occupancy taxes.

The CalPERS policy adopted June 16, 2009, spreads the deep losses from FY 2008-09 over the next thirty years, beginning in fiscal year 2011/2012 and rising through fiscal year 2013/2014. The increased rates will catch cities just as they are beginning to recover from the nastiest recession in at least 60 years. MCERA has yet to determine the June 30, 2009 impacts to the City of San Rafael and County of Marin. They will no doubt be substantial, and extend well into the next decade.

As such, employer agency pension costs are climbing beyond our ability to manage them without impairing basic service levels to the public. Many taxpayers are not being provided defined benefits at current public sector levels. This current economic and community climate allow for reexamining pension benefit levels today and into the future. In short, local government pensions are in need of several levels of major reform.

The MMA working group has met on the subject several times since June. Further, we have developed an outline of our timing and process, including meetings with local labor representatives and others to discuss our report. These meetings were intentionally designed to be informal and share our findings, conclusions and recommendations being put forth to the League of California Cities, CSAC and other professional government organizations.

To Date We Have

- ✓ Reviewed *CSAC Guiding Principles for 2005-06 Pension Reform* and the League of California Cities' *Pension Reform in California*, dated March 1, 2005.
- ✓ Gathered other resources of information, such as the *Proposal for Regional City Pension Standard* issued by the San Diego City/County Manager's Association and the San Mateo County Civil Grand Jury's 2009 report, *Summary of Reversing the Upward Trajectory of Employee Costs in the Cities of San Mateo County.*

- ✓ Heard from Bartel Associates, a long standing actuarial firm serving many municipalities throughout California, about trends, opportunities, challenges and impacts concerning pension reform across California communities.
- ✓ Obtained information about California Foundation for Fiscal Responsibility, whose mission is ...*committed to educating the public and key decision makers about California public employee retirement benefit issues and developing fiscally responsible solutions that are fair to employees, employers and taxpayers.*
- ✓ Surveyed all of the Marin member agencies to determine current pension plans for all miscellaneous and safety employees.
- ✓ Reviewed other industry publications, including *"New Normal" Retirement Plan Designs*, authored by Girard Miller and Jim Link for the Government Finance Review, August 2009 publication.
- ✓ Reached out to other areas outside of Marin County to examine solutions to this problem. Since a sizeable portion on Marin's local government workforce lives outside of our County, we have taken input and acquired data from nexus counties so we are aware of their efforts and recommendations in the area of public pension reform.

Guiding Principles:

Our work on pension reform is rooted in determining a series of goals, from which findings, conclusions and recommendations can be developed and implemented. The work of this MMA group has determined a set of common goals, many of which have already been codified in other local government documents. The work of the MMA regarding pension reform is rooted in the following series of mutually shared goals by our Marin Managers:

- ↳ Pension reforms:
  - o Must be developed within the boundaries of existing and future laws and regulations, whether these come from pension system providers, court decisions or State legislative action.
  - o Should be designed to mitigate employer contribution (budget) fluctuations.
  - o Work to share a greater portion of the risk\reward associated with investment rate volatility and other pension system elements between employers and employees.
  - o Recognize changing demographics (locally and nationally), and develop programs to encourage later retirement ages, as appropriate.

- Place additional options into pension system benefits, allowing for greater participant choice, cost control and other prudent practices.
- Be supported by verifiable actuarial data and professional advice.
- Eliminate 'spiking' abuses which cause excessive retirement compensation to a small number of public employees
- Eliminate elements of existing plans which cause undue financial burdens to local agencies, including any components or one time employee elections which produce deviations from long term actuarial assumptions and planning.
- Should be examined in the context of an overall compensation structure whose long term goal is the recruitment and retention of high caliber, professional public sector employees. In recognition of competitive and ever-changing market forces, any reforms to retirement benefits must be assessed in concert with overall compensation strategies required to sustain an experienced and well qualified workforce.

Findings and Conclusions

Regional and Local Level:

Acting on a regional basis for reforms could provide solutions whereby no one local agency is advantaged, or disadvantaged, by pension reform. MMA supports a reduced level of retirement benefits for all new city and county employees in our region as a goal to be achieved in the future. We recommend current employees pay for a portion of their pensions and a new pension tier for those city employees hired on or after July 1, 2010 or as soon thereafter, consistent with existing contracts, with the following features:

1) Employee contributions – Through negotiations over time, establish employee paying 100% of his/her share as required by CalPERS and MCERA. To the extent employees are not already paying toward pension system funding, reform would generate immediate budgetary savings to those cities to the extent current employees pay for their own share of retirement. Savings could range from 1 – 9% of payroll annually.

2) Eliminate the practice of reporting of employee pension pickups (EPMC) as compensable earnings.

3) To the extent a limit is not in place for current local agency members, negotiate retirement plan annual COLA's to a maximum of 2%.

4) Negotiate reduced retirement benefits (new tier) for new hires:

   New tier options such as those listed below would be in keeping with our overall guiding principles, but do not represent the only alternatives to bringing about meaningful pension reform. We are suggesting these specific new hire plan tiers to reflect the extent of change needed to take place in order to meet our pension reform guiding principles.

- Safety employees – 2% at 50 for both MCERA and CalPERS agencies
- Miscellaneous employees – 2% at 60 for CalPERS, 2% at 61.25 for MCERA ; and
- Utilizing average of highest three years formula.

The reduced tier proposal will deliver savings over a much longer time period as it only affects new hires. When the majority of employees are under the second tier, cities can expect to save approximately 2% of payroll per year. Within 30 years, annual savings of 5% of payroll can be expected. The second tier will also lower each city's volatility index (ratio of assets held for pension payments to payroll), which will help stabilize future rate increases.

Each City, MMWD and the County have an obligation and duty to meet and confer in good faith to reach agreement with respective bargaining units. These new tiers could be added to all levels of each municipality, ranging from management to those employees covered under collective bargaining agreements. These actions are implementable by each local agency, and handled via local legislative body action.

Legislative Level:

In an ideal world, substantive and meaningful reform to public pensions would be dealt with at a statewide level with consistent pension standards for all government employees. History has demonstrated that waiting for a California solution is difficult, largely due to the budget fiasco, political standoffs occurring all too frequently in Sacramento, and the sometimes competing interests of such a diverse state. The initiative process has created outcomes which have often gone astray, and could offer solutions for pension reform that may do more harm than good.

Nevertheless, MMA recommends the following actions be taken at the State level as part of pension reform proposals. The statewide changes noted below should be directed toward both CalPERS laws and regulations as well as those pension systems governed by the 1937 Retirement Act (MCERA like plans). MMA recommends:

1. Allow for prospective benefit changes to be developed and implemented under regulations and laws pertaining to the CalPERS and the County Employees Retirement Law of 1937, as amended. New, lower benefit tiers should be created to better reflect changing life expectancy trends and an aging population; as well as take into account segments of our workforce who are living longer and may wish to have longer public service careers.
2. Legislative action to develop new pension tiers should better reflect employer and employee choice, and could include a hybrid of defined benefit and defined contribution plans established for new hire employees, as well as offered on a once in a life time basis to existing public sector staff;
3. Develop, as an option for local governments, programs and incentives for agencies to put defined contribution plans in place for classes of employees or workgroups;
4. Work to eliminate several existing defined benefit tiers as options for all local government agencies. This would include elimination (for future hires) of the 3%@50 safety plans and the 3%@60 and 2.7%@55 miscellaneous plans;
5. Establish a 80% benefit cap for miscellaneous employees and 90% benefit cap for safety employees; examine existing salary cap limitations and set new ceilings for maximum annual retirement pay.
6. Employer Paid Member Contribution (EPMC – IRS Code Section 414(h)) should be prohibited as compensable earning for retirement calculation purposes;
7. Provide employer flexibility to determine when part-time employees are entitled to pension benefits;
8. Obtain flexibility from CalPERS and 1937 Act Pension Systems to allow employees to move into a lower level tier in the case of two-tier plans if advantages exist for an employee to do so;
9. Establish additional reserve funding in CalPERS and 1937 Act systems to reduce employer rate volatility;
10. Retain full disability benefits for those who are injured and cannot work in any capacity, but restrict disability benefits for those who are able to work (in same or similar job) after work-related injury;
11. Reform disability presumptions, and tighten up the definition of safety employees, both of which currently drive up employer costs; and
12. Change CalPERS Board membership to achieve better employee/employer balance and greater public agency representation.

MMA City and Town Managers have been working closely with our counterparts in Sonoma, Mendocino and Napa Counties. When including Marin, these areas represent the North Bay Division of the League of California Cities. We further recommend the North Bay Division of the League advocate these changes to the greater League Board and to our State representatives.

The proposed reforms would provide adequate and sustainable pensions for long-term employees in the County of Marin, MMWD and its eleven incorporated cities and towns.

Next Steps

MMA has been working through the League's City Manager's Department in sharing and communicating these pension reform proposals to other regional manager groups in the hopes of obtaining wider support for pension reform. The City Manager's Department of the League of California Cities has asked the regional approaches to pension reform be a topic of a panel discussion at the annual meeting in February, 2010. We would encourage the League to begin including similar sessions at other annual conferences (e.g. Finance, Human Resources groups).

The subject of public employee pensions is complex. One key next step is to offer education opportunities for MMA agency employees to learn of how these systems work, why they need change, and to explain the results of this MMA pension reform report. We look forward to union representatives and other stakeholders working with their local governments to achieve pension reform.

City Managers, the County Administrator and the MMWD General Manager will discuss this report, including our findings and conclusions, with their city councils or governing boards and seek direction to begin negotiating pension reform as labor agreements expire. In this way, sustainable and defensible public employee pension plans will become the norm over time among Marin County local city, county and other government agencies.

MMA includes the cities of San Rafael, Novato, Belvedere, Larkspur, Mill Valley, and Sausalito; the towns of San Anselmo, Fairfax, Ross, Tiburon and Corte Madera, Marin Municipal Water District and the County of Marin.

Respectfully Submitted,

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Dave Bracken, Corte Madera

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Retirement Plan Types - CalPERS and MCERA		
	CalPERS	MCERA
Local Miscellaneous Benefits		
2% at 55	X	X
2% at 55.5		X
2% at 58.5		X
2% at 60	X	
2% at 61.25		X
2.5% at 55	X	
2.7% at 55	X	X
3% at 60	X	
Local Safety Benefits		
2% at 50	X	X
2% at 55	X	
2.5% at 55	X	
3% at 55	X	X
3% at 50	X	X

- CalPERS Facts at a Glance – Retirement and Membership, published September 2009

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