LCW Liebert Cassidy Whitmore

Strategies to Manage Increasing Pension Costs

League of California Cities Annual Conference | September 13, 2018

Presented By:

Steven M. Berliner and Kenneth Domer

City of Fullerton California

Agenda

- Rate increases and what is on the horizon
- Legal obstacles to change
- What you can do now to change benefits and cut costs
- Meet and confer issues
- Pension from a local perspective: Fullerton

Reason for Rate Increases

- Employer rates increasing at an accelerating. Why?

Change in assumptions

(1) Retirees are living longer

(2) Investment return lowered

Result of Rate Increases

- Still low funding ratio – approximately 68% last year (as low as 61% in 2009)
- Unfunded liabilities continue to grow
- Likely more increases in the future. Why?

Returns expected to be 6.1% over next decade - still looking to increase funding level.

California Rule

- Court decisions have created rule
- Pension promises become vested when employment starts
- No impairment of vested right
- Changes to vested rights limited:
  - When change is required to preserve the system
  - Alternative equivalent benefits are provided in exchange for the change in the pension benefits

Statutory Restrictions

1. No statutory basis to lower benefits for prospective service
2. PEPRA prohibits any new tiers of benefits (limited exception: lower tiers allowed for prospective new safety members)

Possible Changes on the Horizon

- California Supreme Court will decide if California rule still applies
  - If not: (1) may be able to reduce pension benefits promised to employees so long as the resulting benefit is reasonable; and (2) alternative replacement benefits may not be required
  - May not apply to current retirees
- Statutory changes
  - Without statutory changes, erosion of California rule will have limited impact

Are Retiree Medical Benefits Different?

- They should not be treated differently
- Retiree medical benefits used to be given the same protection as pension benefits
- Recent case law makes it much harder to prove a promise vested
- Now easier to revise or reduce retiree medical benefits promised to current employees

What Can You Do Now To Change Benefits and Cut Costs

Create new tiers for subsequently hired employees? **No**

Reduce benefit promises on prospective service for current employees? **No**

Reduce current retiree vested pension benefits? **No**

What is left?

Reduce EPMC for Classic

- Lowest hanging fruit
- Can be imposed after meet and confer
- Also saves cost of reporting EPMC
- Many agencies have done this already
  - Many other agencies kept it and exchanged it for cost sharing

EPMC Reported by CalPERS Contract Amendment

- Government Code section 20692
  - Not common, but can not reduce EPMC completely.

Increase Cost Sharing of Employer Contribution

Government Code section 20516

- Can be by CalPERS contract amendment or just by MOU
- Can apply to classic and/or new members
- Can be for any or all of employer contribution
- Can be different percent for classic and new members
- BY AGREEMENT ONLY

Impose Additional Costs on Classic Employees?

- PEPRA added Government Code section 20516.5
  - Allows limited imposition of additional employee costs
  - Limit of maximum employee contribution is lesser of:
    1. 50% of normal cost; or
    2. 8% for miscellaneous

    12% for local police officers, local firefighters and county peace officers

    11% for local safety other than local police officer, local firefighters or county peace officers
- Must exhaust meet and confer requirement
- If already paying 50% of normal cost, including 20516 cost sharing, statute inapplicable

Example

Classic City miscellaneous employees receive the 2% @ 55 formula. In a 2016 MOU, the employees agreed to pay an additional 2% of compensation earnable under Government Code section 20516(f) and agreed to continue doing so as part of negotiations for a successor MOU. City proposes to add 2% more costs on employees via section 20516.5.

Can the City do so?

Eliminate or Reduce Reportable Compensation

- Negotiate swaps: e.g., salary for healthcare contributions – special compensation for car allowance
- Provide non-”PERSable” forms of payment for both classic and new members
  - More time off
  - Health benefits
  - Contributions to retiree medical trusts
  - Structure specialty pays to NOT satisfy CalPERS regulations, making them non-reportable (e.g., hybrid specialty pays)
  - Purely discretionary bonuses

Example

MOU states that employees with five or more years of service with the City will receive longevity pay of 1% of base salary each year in which they receive a satisfactory or higher performance evaluation.

What is the issue?

For Classic Employees Only

- Compensate via one time payments in same fiscal year as minimal salary increase

For New Members Only

- Uniform allowance not reportable
- Any one time payment not reportable (even if no salary increase in fiscal year)
- Bonuses of any kind are not reportable

Reduce or Eliminate Retiree Medical

- Check documents promising benefit to determine if vested (less likely under current case law)
- Negotiate, and impose, if necessary, reductions in future retiree medical benefits for current employees
- Current retirees? Still risky

Meet and Confer Issues

- Compensation and retirement benefits subject to negotiations
- Short-term contracts to be more flexible as rates change
- Alternatively, reopeners if employer rates hit set thresholds
- Cannot impose section 20516 cost sharing
- EPMC reductions can be imposed
- Can impose swaps of PERSable for non-PERSable forms of compensation

What You Can Do Now

- Determine if you have low hanging fruit – eliminate or reduce EPMC
- Utilize sections 20516 and 20516.5 to the extent applicable
- Take inventory of all reportable items of pay, then negotiate to swap reportable compensation for non-reportable compensation
- Have governing body adopt a policy of not increasing reportable compensation prospectively and stick to it
- Structure future compensation to be non-reportable and state that is intention

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Pensions From a Local City Perspective: Fullerton

Background on Fullerton

- Population: 142,000 (approx.)
- General Fund Budget: $ 93,127,055
- Total Fund Budget: $194,238,884
- GF Salaries/Benefits: $ 68,652,203 (74%)
- 615 FT 1,300 Retirees
- Current GF Pension Costs are 18% and expected to rise to over 23%+

Fullerton's Fiscal Outlook

- Two primary revenue sources:
  - Property tax and sales tax
- Employee concessions in 17/18 and most MOUs expire 6/30/19
- Revenue outlook weak. Traditionally conservative Council against taxes
- Department reviews & expenditure reductions. Be more effective & efficient

What We've Done

- Adopted 2nd Safety Tier 3@55 prior to PEPRA
- Employer Paid Member Contributions (EMPC)
  - Eliminated for City Manager
  - Reducing for Executive Team
  - Negotiating for elimination with others…. but…
- Cost Sharing by contract and MOU
- Elimination of Retiree Health Options →(RHSA)
- 115 Trusts – OPEB and Pension
- Eliminated positions

What We Are Trying To Do!

- Involve employees. It’s OUR problem.
- Educate: employees, electeds, public
- Buy time by spreading out contracts: POA
- Gain long term savings and cost sharing FFA increase from 9% to 12%. Less 3 FF
- Shared Fire Command: Potential JPA
- Question of EPMC or wait it out…

Pension 101 Basics

- Understanding and fully stating the issue
- The usual resources:
  - http://www.cacities.org/Policy-Advocacy/Hot-Issues/Retirement-System-Sustainability
  - http://www.californiacityfinance.com/ (Michael Coleman)
- Educating everyone on pension issue.
  - Make it front and center, not an unreal subject
- The basics: All employees pay EE share. Cost share increased amounts. Reduce PERSable compensation

What Others Have Done

- Many cities have implemented 115 Trusts
- Majority have EE pay full EE share
- Pay unfunded liability payment to PERS in lump sum to save money – invest savings
- Strategically plan to reduce one UAL item over others
- Reiterate the cost and benefit of the City’s pension expenditures to employees

Driving the Hard Bargain…

- During negotiations, clearly focus on pension costs. The future year costs are NOT a part of doing business for the City. They are compensation to the employee
- Gain some additional time for the City through no increase or non-PERSable items
- Convert % pays into set amounts and reduce specialty pays that are PERSable
- Lead by example: Pay more for EE PERS than others.
- Be innovative
- Advocate that it is easier to make one change at the top, than almost 500 through negotiations

The End Thoughts

- Absolutely most pressing issue for cities
- Pension costs squeezing out road improvements, facility maintenance, higher wages for employees
- For most cities, relief will not come for 15 years
- Cities are increasingly going to enhanced sales tax to maintain operations and pay pension liability
- Greater disparity between ‘haves’ and ‘have nots’ for revenue opportunities

Thank You!

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2018 ANNUAL CONFERENCE

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