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CALIFORNIA SOCIETY OF MUNICIPAL FINANCE OFFICERS (CSMFO) ANNUAL CONFERENCE

Strategies to Manage Increasing Pension Costs

1/10/2019

PRESENTED BY:


Steven M. Berliner & Monica Irons

Strategies to Manage Increasing Pension Costs

California Society of Municipal Finance Officers (CSMFO) 2019 Annual Conference
January 10, 2019

Presented by: Monica Irons & Steven M. Berliner

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Agenda




- Background
- Legal Challenges
- Strategies
- Meet and Confer
- What Can You Do Now?

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Background


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Reason for Rate Increases




- Why are employer rates increasing at an accelerating rate?
- Change in assumptions:
 - Retirees are living longer
 - Investment return lowered

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Result of Rate Increases




- Still low funding ratio – approximately 68% in last few years (as low as 61% in 2009)
- Unfunded liabilities continue to grow

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Future Rate Increases



- Why are more increases likely in the future?
- Returns expected to be 6.1% over next decade - still looking to increase funding level.

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Legal Challenges

Statutory Restrictions




- No statutory basis to lower benefits for prospective service
- PEPPRA prohibits any new tiers of benefits
 - Limited exception: lower tiers allowed for prospective new safety members

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Vested Benefits- General Principles



- Constitutionally Protected
 - Both U.S. and State Constitutions
 - Contracts Clause
 - The Government may not impair vested contractual rights
- Retirement benefits are earned as worked, but payment is deferred
 - Once the employee begins to work, the employee “vests” in a future benefit

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California Rule




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

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Possible Changes on the Horizon




- California Supreme Court will decide if California rule still applies
 - Ruling may not apply to current retirees
- Statutory changes
 - Without statutory changes, erosion of California rule will have limited impact

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Retirement



- Prospective Changes in a Pension Plan Which Disadvantage Current Employees Must Not Always be Accompanied by Comparable New Advantages.
 - *Marin Association of Public Employees v. Marin County Employees' Retirement Association* (2016) 2 Cal.App.5th 674, REVIEW GRANTED.
- Elimination of Airtime by PEPRAs upheld
 - *Cal Fire Local 2881 v. California Public Employees' Retirement System* (2016) 7 Cal. App. 5th 115.
- Changes In Public Employee Pensions Caused By PEPRAs In 2013 May Deny Employees and/or Retirees Their 'Vested Rights'.
 - *Alameda County Deputy Sheriff's Assn. v. Alameda County Employees' Retirement Assn.* (2018) Cal.App.5th 61, REVIEW GRANTED.
- ... Stay tuned...

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Important Statutes to Know




- Gov. Code § 20474 states, in part:
 - Any election made by amendment to the contract shall be irrevocable until the contract is terminated. However, benefits provided by the amendment may be increased or improved from time to time by further amendment to the contract.

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Are Retiree Medical Benefits Different?




- Same vesting principles apply
- Retiree medical benefits used to be given the same protection as pension benefits
- Recent case law makes it much harder to prove a promise of retiree medical is vested
- Now easier to revise or reduce retiree medical benefits promised to current employees

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PEMHCA Statutory Limitation



- Gov. Code § 22892 states, in part:
 - "(a) The employer contribution of a contracting agency shall begin on the effective date of enrollment and shall be the amount fixed from time to time by resolution of the governing body of the agency. The resolution shall be filed with the board and the contribution amount shall be effective on the first day of the second month following the month in which the resolution is received..."
- Still subject to minimum and equal contribution rules

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Vested Benefits – Redding




- Since 1979, the MOUs between the city and the union stated essentially:
 - “The city will pay 50% of the group medical insurance program premium for each retiree and dependents, if any, presently enrolled and for *each retiree in the future* who goes directly from active status to retirement and continues the group medical insurance without a break in coverage.”

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Vested Benefits – Redding (cont.)




Similar language was contained in job postings and internal city communications. In 2008, when the parties were unable to agree on a successor MOU, the city unilaterally imposed terms and conditions of employment, including a provision that for current and future employees the City would pay “2% per year of service, up to 50 percent, of retirees' medical insurance premiums.”

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Vested Benefits – Redding (cont.)



- Is there a contract?
- Does the contract provide vested rights to future retiree medical?
- *International Brotherhood v. City of Redding* (2012) 210 Cal.App.4th 1114

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Strategies

What Can You Do Now to Change Benefits and Cut Costs




- Create new tiers for subsequently hired employees?
- Reduce vested pension benefits on prospective service for current employees?
- Reduce current retiree vested pension benefits?

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Strategies



- Employees share the burden
- Reduce "PERSable" items
- Restructure retiree health benefits

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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

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EPMC Reported by CalPERS Contract Amendment




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

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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**

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Cost Sharing

Section 20516(a)

- Amendment to CalPERS contract
- Considered employee contributions
- Requires election
- Generally accepted as pre-income tax

Section 20516(f)

- Agreement in MOU
- Considered employer contributions
- Usually treated as pre-income tax, but still a gray area

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Cost Sharing

- Are unrepresented employees subject to cost sharing?
 - If represented employees have cost sharing under Section 20516(a), then YES.
 - If represented employees have cost sharing under Section 20516(f) only, then... ???

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Impose Additional Costs on Classic Employees?

- PEPPRA added Government Code section 20516.5
 - Allows limited imposition of additional employee costs
 - Limit on maximum employee contribution
- Must exhaust meet and confer requirement
- Inapplicable if already paying 50% of normal cost, including 20516 cost sharing
- Not for new members

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Compare 20516.5 with 20516




- Is Section 20516.5 the same thing as 20516(a) or (f)? **No**
 - Section 20516.5 does not require an employee election to amend the CalPERS contract unlike Section 20516(a)
 - Section 20516.5 does not require an MOU unlike Section 20516(f)
 - Section 20516.5 contribution increases = member contributions; Section 20516(f) cost-sharing = employer contributions

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Unilateral Imposition




- How is Section 20516.5 implemented if an employer unilaterally imposes?

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Strategy for Cost Sharing



- Many agencies only seek cost sharing contributions from classic members.
- Why?
 - New members already paying more for lower benefits
 - Easier to negotiate
- What about offsetting cost sharing with salary increase?
 - Pros and cons

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Eliminate or Reduce Reportable Compensation



- Negotiate swaps to reduce reportable compensation.
- Examples:
 - Salary for healthcare contributions
 - Special compensation for car allowance


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Eliminate or Reduce Reportable Compensation

- 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

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Hypothetical



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?

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For Classic Employees Only




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

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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

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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

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PEMHCA Agencies

- Must comply with equal and minimum contribution rules
- Contributions for retirees will never be completely eliminated
- 2019 minimum contribution is \$136 per month

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Meet and Confer

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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

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Negotiating Retiree Medical




- Any changes to retiree medical benefits or contributions are subject to bargaining
- Negotiate cost-containment strategies
 - Defined Contribution Savings Plan
- Phase out of future employee retiree medical benefits

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MOU Language




When drafting MOU language:

- Avoid “future tense”
 - “for the life of the employee”
 - “for future retirees”
- Tie benefit to term of MOU
 - “employees who retire during term of this MOU, are eligible...”
- Provide that benefit is not vested / subject to revision or termination

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What Can You Do Now?

Possible Action Items




- 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

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Possible Action Items




- 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
- Review retiree medical benefits for vested status. If not vested, reduce benefits that current employees and future employees can expect (Reduce current retiree benefits? More risk)

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San Luis Obispo

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Overview

- Accepting the reality of pension impacts
- Educating others
- Developing a plan
- Keys to bargaining success

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San Luis Obispo Overview

- Central Coast of CA
 - Population: 47,5414
 - 4 Labor Groups
 - 393.55 FTE

General Fund Revenue Sources

Revenue Source	Percentage
General Sales Tax	35%
Transient Occupancy Tax	16%
Property Tax	17%
Utility Users Tax	10%
Other Tax & Franchise Revenues	14%
Non-Tax Revenues	8%

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Accepting the Reality

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What is Reality?


- Consult an actuarial
- Project long-term impacts
- Be conservative in your projections
 - CalPERS may make further adjustments



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The City's Fiscal Forecasting Assumptions

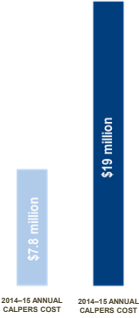
- Based on continuing current levels of service
- Continued the commitment to capital investment including a slight increase due to ongoing maintenance
- Modest long-term revenue growth and inflation
- Continuing Local Revenue Measure Funds
- Enterprise Funds revenue projections are based on approved and historic rates and revenue growth




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What is the Problem?

- Similar to 3,000 other agencies in CA, **SLO faces an increase in required pension contributions**
- The annual costs to CalPERS will more than double in 10 years
- To address these increases, **SLO needs to reduce expenditures by \$8.9 million in the General Fund & Enterprise Funds over the next three years**



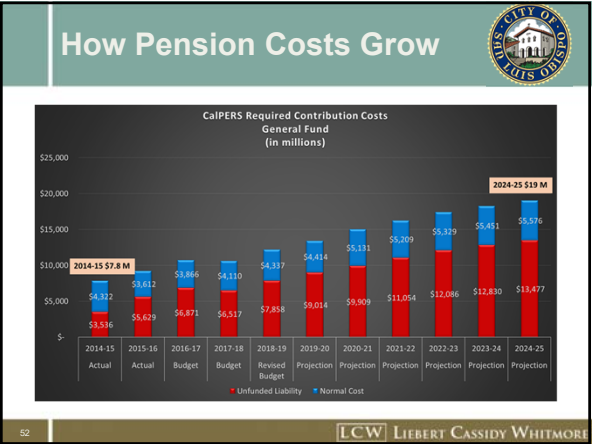
2014-15 ANNUAL CALPERS COST: \$7.8 million
2016-17 ANNUAL CALPERS COST: \$19 million

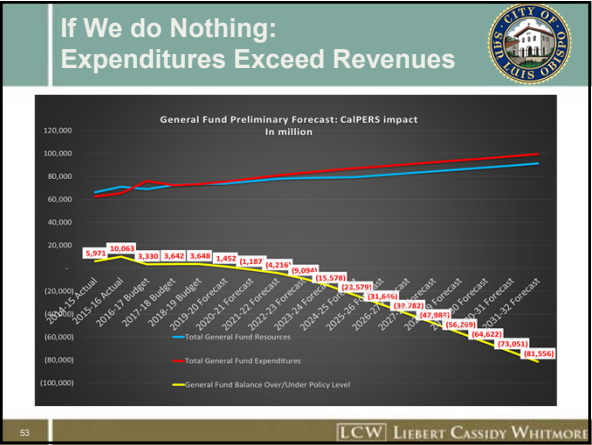


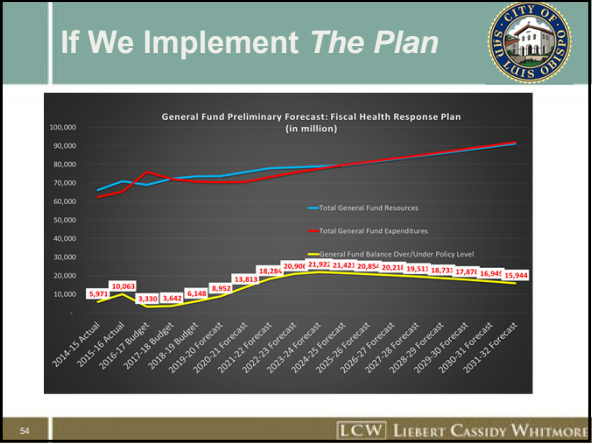
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Educate Others on the Fiscal Realities

Develop Key Messages:




- This is not an agency specific problem
- Defined benefit retirement plans serve a useful purpose
- We can't invest our way out of this issue
- Doing nothing increases the impact of the problem
- Employees must be part of the solution

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Tips for Educating Others



- Invite your expert to share the information
 - In an easy to understand manner
- Invite someone from the League
 - To discuss the broader issue
- Collaborate with other cities in your area

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Share the Forecast With:

- Employees
 - Meetings
 - Newsletters
 - Surveys
- Community Members
 - Workshops
 - Presentations
 - Surveys
- Council Members

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Develop a Plan:
Fiscal Health Response Plan
(FHRP)

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The Objective


- Address budget/forecast gaps
- “Bank” one time money to put towards unfunded liability
- Continue reasonable investment in infrastructure
- Continue investment in critical City services, major city goals/community priorities

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Address Unfunded Liability




- Two Options
 - PERS
 - Direct Payments
 - Trust
 - Fund Future Payments

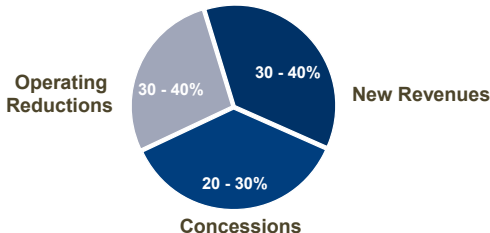
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The Key Components



General Fund



Operating Reductions 30 - 40%


New Revenues 30 - 40%

Concessions 20 - 30%

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The Timeframe



- New revenues take time to fully develop
- Efficiencies need to be identified and implemented
- Concessions must be bargained in good faith

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Keys to Bargaining Success

Grounded in Strong Policy




- Compensation Philosophy (2007, 2011)
 - Competitive compensation must be financially sustainable
- Fiscal Responsibility Philosophy
 - Ongoing increases in compensation must be offset by ongoing increases in revenue
 - Cost sharing on retirement and health
- **Labor Relations Objectives**

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Council Adopted Concession Objective



- Objective was \$1.9m by the end of the third year
 - Assumed “model” could be negotiated with all employee groups
 - Considers timing of current contract terms
 - Adopted in open session

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Concessions Redefined




- Historically
 - Reduction from present
- In FHRP
 - Reduction from forecasted growth

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Bargaining Strategies




- Be open with the objective and stay focused on ways to achieve it
- Present the Plan to the bargaining team
- Model an approach to achieve objective ("give to get")
- Have every retirement tier participate
- Know bargaining group demographics

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Bargaining Strategies




- Get an early win
- Differentiate between ongoing and one-time costs
 - Special pays at flat rates, not percentage of base pay
 - Lump-sum payments
- Align contract term with Plan
- Be consistent (support of City Manager and Council is key)

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Questions?



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