REPORT TO MAYOR AND COUNCIL NO: 10-067

Council Meeting: March 9, 2010

SUBJECT: Consider Strategies to Address the Rising Costs of the City's Pension Plans (Study Issue)

REPORT IN BRIEF

Council adopted a 2010 Study Issue, FIN 10-02, to consider pension reform in light of the significant rate increases the City faces beginning in FY 2012/2013 for the California Public Employees Retirement System (CalPERS), the provider of the City's pension plans (Attachment A).

In FY 1999/2000, the City paid a total of $5.3 million for retirement costs. For FY 2013/2014, the City is projected to pay $36.3 million. At the same time, the City is dealing with the effects of the Great Recession and a reduced revenue base. Under these circumstances, creating a sustainable retirement plan for its employees is an important piece to achieving long term financial stability for the City.

There are three primary strategies to achieve a financially sustainable retirement plan, with several variations possible within each one: 1) create a reduced benefit retirement plan for new hires – setting up a two tier plan; 2) increase the employee's share of retirement costs; 3) terminate the City's contract with CalPERS and create an alternative retirement plan. Because termination of the City's contract would require a charter change and the set up of the City's own retirement plans, this strategy is considerably less viable than the other two strategies and is not recommended by staff. Therefore, this report focuses on the first two strategies.

A two tier plan will provide a savings of $45 million over twenty years. Every 1% pick up of retirement costs by employees will save the City $23 million over twenty years. A combination of a two tier plan for new hires and a 1% pick up of retirement costs by current employees will result in a $54 million savings over twenty years.

Staff recommends Council direct the City Manager to pursue a two tier retirement plan and/or increased employee contribution for retirement costs with all bargaining units at the earliest opportunity for adoption in 2012, when all MOU's expire. Staff also recommends Council adopt the joint Santa Clara County/Cities Managers' Association and San Mateo County City Managers Association "Policy Statement on Local Government Retirement Benefits."

BACKGROUND

By City Charter, the City of Sunnyvale is a member of the State's retirement system, CalPERS. The contract with CalPERS can only be terminated through an ordinance that must be adopted by a majority vote of Sunnyvale residents. CalPERS offers several defined benefit retirement plans. The City contributes to two plans for and on behalf of all regular full and part time City employees: a Safety plan for all sworn employees and a Miscellaneous plan for all other employees. Since 1974, the City's Safety plan provided 2% @ 50. This provided 2% of salary for every year of service, capped at 90% of salary with full retirement benefit eligibility at age 50. For every year of service past 50, the benefit factor increased until age 55, maxing out at 2.7%. In 2001, the Safety plan was enhanced to 3% @ 50, which is a 50% increase in the value of retirement benefits for Public Safety members who retire at 50. Since 1994, the City's Miscellaneous plan provided 2% @ 55. This provided 2% of salary for every year of service, no cap, with full retirement benefit eligibility at age 55. For every year of service past 55, the benefit factor increased until age 63, when the percentage maxed out at 2.418%. In 2007, the plan was enhanced to 2.7% @ 55, representing a 35% increase in the value of retirement benefits for miscellaneous members who retire at 55.

In addition to the service retirement formula, CalPERS offers several optional benefits that agencies can add. For example, both of the City's plans have the optional benefit "One-Year Final Compensation", which calculates the retirement formula on the single highest year of salary.

The retirement plans are funded through employee and employer contributions. The employee contribution rate is set by law. It is a minimum of 9% for Safety plans and 7% for Miscellaneous plans and can be higher with enhanced benefit plans and optional benefits. For the City of Sunnyvale, the employee contribution rates are higher for both plans due to these reasons. The employee contribution for the Safety plan is 11.25% and is currently paid by the City. For the Miscellaneous plan, the employee contribution rate is 8% and the City currently pays 7% of the 8% employee contribution.

The employer contribution rate, currently fully paid by the City for both plans, is not a set rate and instead is adjusted annually by CalPERS through an actuarial analysis. Therefore, the employer rate is impacted by investment gains and losses, changes in benefits, and adjustments to actuarial assumptions. This is an important point as the City's employer contribution rates for both plans has been increasing over the past ten years due to the benefit enhancements, salaries rising faster than CalPERS assumptions, and the three consecutive years of market losses the CalPERS investment portfolio suffered around FY 2003/2004.

In FY 2008/2009, the CalPERS investment portfolio lost approximately 24% of its asset value as a result of the financial market meltdown and global recession. This is on top of a 5% loss for FY 2007/2008. Since CalPERS assumes a rate of return of 7.75% each year, CalPERS has realized a total loss of 45% in two years. This unprecedented loss was so severe that CalPERS modified its rate smoothing methodology to ease into the significantly higher rates necessary to make up for this loss. Because the loss is recognized gradually over three years, higher rates are necessary over the next 30 years to fully make up for this loss. The modification to the methodology is in acknowledgement that this was a unique event that cannot be made up through the normal gains and losses experienced over time.

For the City of Sunnyvale, the 24% loss of asset value equates to approximately $134 million. The following table provides a history of Sunnyvale's employer contribution rates for both plans and the projected rates that have been estimated by the City's CalPERS actuary. The estimated rates factor in the known increases required to cover the CalPERS investment portfolio loss of FY 2008/2009.

City of Sunnyvale
Employer Contribution Rates

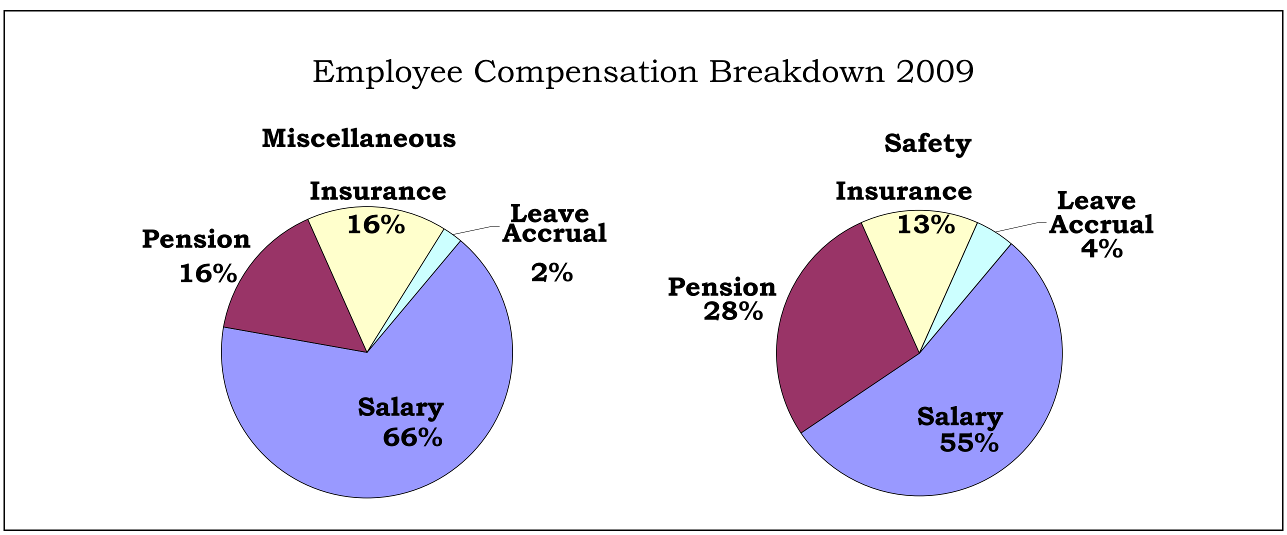
Fiscal Year	Miscellaneous	Safety
FY 1999/2000	0.0%	0.0%
FY 2000/2001	0.0%	0.0%
FY 2001/2002	0.0%	0.0%
FY 2002/2003	0.0%	6.7%
FY 2003/2004	1.0%	16.9%
FY 2004/2005	6.6%	29.6%
FY 2005/2006	11.4%	32.9%
FY 2006/2007	11.4%	28.6%
FY 2007/2008	16.7%	29.0%
FY 2008/2009	16.0%	30.0%
FY 2009/2010	15.2%	29.8%
FY 2010/2011	16.6%	29.8%
FY 2011/2012 (Estimated)	18.3%	29.8%
FY 2012/2013 (Estimated)	21.2%	33.7%
FY 2013/2014 (Estimated)	24.2%	38.4%

This table covers a fifteen year time period, during which the City's contribution rate started at 0.0%, when the plans had a surplus of assets, and has risen to 24.2% and 38.4% of salary for FY 2013/2014. The magnitude of these rate increases is even more evident when the dollar value of these increases is reviewed. The next table shows the dollar amount the City has and is projected to contribute to both plans, and includes the employee share paid by the City as well as the employer contributions.

City - Paid PERS Costs			
Fiscal Year	Miscellaneous	Safety	Total
FY 1999/2000	$2.9M	$2.4M	$5.3M
FY 2000/2001	$3.5M	$2.5M	$6.0M
FY 2001/2002	$3.9M	$2.7M	$6.6M
FY 2002/2003	$4.2M	$4.5M	$8.7M
FY 2003/2004	$4.3M	$7.5M	$11.8M
FY 2004/2005	$7.2M	$11.2M	$18.4M
FY 2005/2006	$9.8M	$12.0M	$21.8M
FY 2006/2007	$10.3M	$11.2M	$21.5M
FY 2007/2008	$12.5M	$11.7M	$24.2M
FY 2008/2009	$13.1M	$11.9M	$25.0M
FY 2009/2010 (Estimated)	$12.8M	$13.0M	$25.8M
FY 2010/2011 (Estimated)	$13.7M	$13.3M	$27.0M
FY 2011/2012 (Estimated)	$15.1M	$13.4M	$28.5M
FY 2012/2013 (Estimated)	$17.1M	$15.2M	$32.3M
FY 2013/2014 (Estimated)	$19.3M	$17.0M	$36.3M

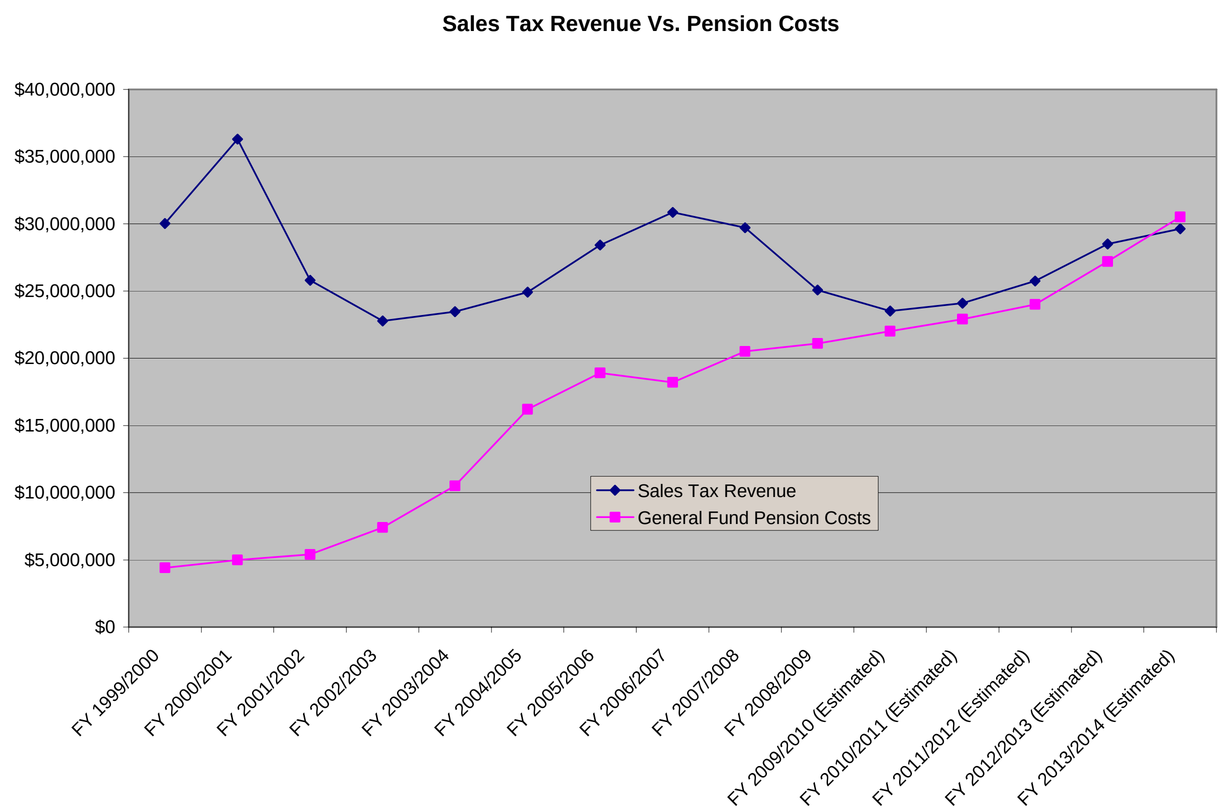
In fifteen years, the cost of the City's pension plans will increase six and seven fold: $16.4 million for Miscellaneous and $14.6 million for Safety. For the City's General Fund, retirement expenses now make up 19% of total operating expenditures.

By FY 2013/2014, for every dollar of salary spent on a public safety employee, another fifty cents must be paid for the employee's pension. For miscellaneous employees, 31% of salary must be added on to cover retirement costs. As the pie charts below indicate, pension benefits are now a significant piece of an employee's compensation.



At the same time, the City itself is dealing with the effects of the Great Recession, especially a reduced revenue base. As this recession is unlike any other in the last 70 years, the long term trends for revenues are uncertain, but likely not to come back to the same levels seen during the housing and credit bubble years. In fact, with serious discussions on a possible "double dip" recession when government stimulus spending pulls back, it is reasonable to forecast that revenues will remain low in the near term and recover slowly to a lower base. In this financially precarious environment, it is critical to re-align expenditures and revenues to ensure a stable level of services is provided to the community over the long term. Currently, the City is not in alignment and drawing down on the Budget Stabilization Fund reserve while working to bring the long-term General Fund financial plan back into balance. With the City projected to spend about $30.5 million in the General Fund for retirement in FY 2013/2014, creating a sustainable retirement plan for its employees is an important piece to achieving long term financial stability for the City.

To understand the magnitude of the pension costs and its impact on the General Fund, it is helpful to compare the costs with one of the major General Fund revenue sources, Sales Tax. Sales Tax is the second largest revenue source in the General Fund and makes up approximately 25% of the General Fund revenue. The $30.5 million the General Fund is estimated to spend for pension costs is more than the total Sales Tax revenue projection of $29.6 million expected to come in for FY 2013/2014. In other words, the entire City Sales Tax revenue will be applied to pension costs and it will not be enough. The following chart shows the ten year history and five year estimates for the General Fund pension costs and sales tax revenue.



EXISTING POLICY

The following existing policies are from the Fiscal Sub-Element of the General Plan:

7.A.1.3 A balanced Twenty-Year Resource Allocation Plan shall be presented to the City Council annually.

7.G.1.5 Pension obligations will be fully funded annually and current pension contributions will not be deferred to balance current expenditures.

DISCUSSION

Before discussing strategies, it is important to clarify the City's obligation to discuss a change in retirements with employee bargaining units. State law, known as the Meyers-Milas-Brown Act ("MMBA"), requires cities to "meet and confer in good faith regarding wages, hours, and other terms and conditions of employment" with recognized employee organizations. Sunnyvale currently has six recognized bargaining units as follows: Sunnyvale Employees Association, Service Employees International Union, Public Safety Officers Association, Communication Officers Association, Sunnyvale Managers Association, and Public Safety Managers Association.

With the exception of the Public Safety Managers Association, the City has entered in Memoranda of Understanding with all the bargaining units. An MOU is a binding agreement between the employee organization and the City. Unless the parties agree otherwise, the terms and conditions of employment contained in the MOU are fixed for the duration of the agreement. The five MOU's, currently in place, contain language concerning retirement benefits. **Therefore, retirement benefits may not be changed during the term of the MOU's unless agreed upon by the bargaining units**. All five agreements expire during the calendar year 2012.

The City will have the ability to negotiate revised MOUs in 2012 which could provide for a two tier system. After an existing MOU has expired in 2012, the City may unilaterally implement changes to retirement benefits, provided the City negotiates in good faith on a successor agreement, the parties reach a bona fide impasse, and the City exhausts its impasse procedure obligations in good faith.

It should also be noted that there are approximately 50 unrepresented employees in the City (Council appointed positions, Department Directors and confidential employees). These employees do not have collective bargaining agreements and retirement benefits could be changed for future employees. These employees are primarily in the Miscellaneous plan. The Director of Public Safety is in the Safety plan.

A Fiscally Sustainable Retirement Plan

Because getting to a financially sustainable retirement plan requires either reduced benefits or increased costs for employees, it is important that the strategies the City chooses to pursue reflect an appropriate level of benefit for employees; in other words, a sufficient retirement plan. A sufficient retirement plan should keep the City competitive to attract quality employees and should help retirees maintain a reasonable quality of life. These principles have recently been discussed across the State.

In July 2009, the Santa Clara County/Cities Managers' Association and San Mateo City Managers Association jointly adopted a white paper entitled "Policy Statement on Local Government Retirement Benefits" (Attachment B). This policy statement recognizes that current retirement benefit formulas are not fiscally sustainable. While "providing adequate retirement benefits is an important part of attracting and retaining public employees…", the guiding principles also include "…the cities of Santa Clara and San Mateo counties support implementation of a reduced and sustainable level of retirement benefits for all new employees of agencies in the region" and "every city is committed to moving toward a two tier system for all new contracts." This policy statement has been adopted by the cities of Campbell, Gilroy, Morgan Hill and Cupertino. It is also up for adoption by the Los Altos City Council tonight. Adoption of this policy statement by Sunnyvale City Council will provide a framework for addressing retirement costs that is supported by many cities across Santa Clara and San Mateo counties.

To achieve a financially sustainable retirement plan, there are two viable strategies Council could consider, with several variations within each one: 1) create a reduced benefit retirement plan for new hires – setting up a two tier plan and 2) increase the employee's share of retirement costs. Each strategy has several pros and cons, as well as its own set of implementation issues that are discussed further below. The financial effect of these strategies is laid out in the Fiscal Impact section of this report.

Create a Two Tier Plan

When considering a lower benefit retirement plan for employees, due to contract law, the lower benefit plan cannot be applied to retirees or current employees. Therefore, under this strategy, current employees would retain their existing pension plan and a new reduced benefit plan would be implemented for all new hires. There are many benefit levels offered by CalPERS. The following plans are the most common amongst local agencies (the City's current plans are in bold):

CalPERS Retirement Plans		
Safety		Miscellaneous
2% @ 55		2% @ 60
2% @ 50		2% @ 55
3% @ 55		2.5% @ 55
3% @ 50		**2.7% @ 55**
		3% @ 60

A potential selection could be the plans that were in place before the enhancements: 2% @ 50 for Safety and 2% @ 55 for Miscellaneous. Since this strategy only impacts those who are not yet employed with the City, it does not result in immediate cost savings. This strategy is a solution for fiscal sustainability over the long term with considerable savings over a twenty to thirty year period. A potential difficulty with this strategy is the long transition period during which employees working in the same classifications are receiving different benefit levels. This could create employee relations issues.

An important factor to keep in mind with the lower benefit plans is that the percentage applied for each year of service continues to increase if an employee retires past the defined age. For the 2% @ 60 and 2% @ 55 Miscellaneous plans, the benefit factor increases until age 63, when the percentage maxes out at 2.418%. For the 2% @ 50 Safety plan, the benefit factor increases until age 55 and maxes out at 2.7%. As a result, these plans are actually more generous than they appear, and even come close in benefit level to some of the enhanced benefit plans within five to eight years. This is a particularly important point as it is becoming increasingly common for people to work through and past their 50's. In fact, the City's demographics support this trend. Currently, there are 22 public safety employees who are over 50, representing 10% of the total employees in the Safety plan. In the Miscellaneous plan, of 659 active employees, 155 are over 55, or 24%.

Implementing a two tier plan has specific requirements and procedures as set by CalPERS. CalPERS does not allow different retirement benefits for any subgroup, such as a bargaining unit. All sworn employees (Public Safety and Public Safety Managers) must have the same plan and all miscellaneous employees (SMA, SEA, SEIU, COA, and unrepresented employees) must have the same plan. The plans can only differ by date of hire which would allow for a two tier plan for all sworn and/or all miscellaneous employees. This means that all bargaining units within the Safety Plan and the Miscellaneous Plan must agree to the same two tier benefit plans before it could be implemented.

Once the collective bargaining process is complete, the contract amendment process with CalPERS can begin. This process takes approximately 90 days as follows:

- 30 days-CalPERS prepares the contract amendment documents.
- 30 days-City Council adopts resolution of intention and adopts an ordinance after two readings.
- 30 days-Ordinance effective date must be 30 days after second reading, unless adopted by an urgency ordinance.

<u>Increase Employee's Share of Retirement Costs</u>

As described earlier, the City currently pays the entire employee and employer contributions for the Safety plan, and 7% of the 8% employee rate and the entire employer contribution for the Miscellaneous plan. Miscellaneous employees pay their 1% on a pre-tax basis. With this strategy, employees could share in the costs and risk at a variety of levels. For example, employees could take on their employee share, 11.25% for Safety and the full 8% for Miscellaneous, or a portion of it. Shifting the cost to employees can be implemented at once or over several years. Another option would be to set a maximum City paid rate and have the employees responsible for any increase over that maximum rate. This would shift some of the risk to the employees. The percentage to be picked up by employees can vary between bargaining units so it can be negotiated by unit and implemented separately with each agreement.

An attractive element of this strategy is that cost savings would be realized as soon as the change is implemented. Additionally, these costs would be paid on a pre-tax basis so the employee's tax basis is lowered and the net effect is less than the percentage shift to the employee. For example, the average annual salary for a full time employee in the Miscellaneous plan is about $92,500. 1% of this salary is $925. Deducted before taxes, the employee's salary on which taxes are calculated is reduced to $91,575. At a 25% tax bracket, the employee would save $231 in taxes. As a result, a 1% contribution to retirement costs would actually cost the employee $694 annually rather than $925, or $23.08 each pay period.

This strategy could be pursued together with the two tier plan. One option would be to increase the employee's share for the current retirement plans and implement a reduced benefit plan for new hires. In addition to containing costs on both the short and long term, this combination could assist in alleviating the difference in retirement benefits between employees that will occur during the transition phase of a two tier plan.

FISCAL IMPACT

The tables below provide the estimated cost savings for the two strategies and a combination of implementing a two tier plan and increasing the employee pick up of retirement costs. For the Miscellaneous plan, the two tier plan savings assume that new hires would go to the 2% @ 55 benefit level. For the Safety plan, the second tier is calculated with the 3% @ 55 plan. For both plans, the tables show that while a 1% employee pick up provides higher immediate savings, over the long term, the two tier plan will produce the greatest savings. Of course, every additional percentage pick up results in higher savings and depending on the percentage implemented can provide much greater savings than the two tier plan.

Miscellaneous Plan – General Fund				
	Year 1	Year 2	Years 3-20	Total
Current Plan Estimated Cost	$10.6M	$12.0M	$332.6M	$355.2M
Strategy Savings				
Two Tier Plan	($205K)	($373K)	($32.6M)	($33.2M)
1% Employee Pick-up	($586K)	($598K)	($13.5M)	($14.7M)
Two Tier + 1% Employee Pick-Up Combination	($739K)	($874K)	($36.8M)	($38.4M)

Safety Plan				
	Year 1	Year 2	Years 3-20	Total
Current Plan Estimated Cost	$13.4M	$15.2M	$425.9M	$454.5M
Strategy Savings				
Two Tier Plan	($59K)	($110K)	($11.3M)	($11.5M)
1% Employee Pick-up	($326K)	($332K)	($7.5M)	($8.2M)
Two Tier + 1% Employee Pick-Up Combination	($370K)	($414K)	($14.9M)	($15.7M)

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, at the Sunnyvale Senior Center, Community Center and Department of Public Safety; and by making the agenda and report available at the Sunnyvale Public Library, the Office of the City Clerk and on the City's Web site.

ALTERNATIVES

1. Council directs the City Manager to pursue a two tier retirement plan and/or increased employee contribution for retirement costs with all bargaining units at the earliest opportunity for adoption in 2012, when all MOU's expire.
2. Council adopts the joint Santa Clara County/Cities Managers' Association and San Mateo County City Managers Association "Policy Statement on Local Government Retirement Benefits."
3. Take no action and continue with the City's current retirement benefit plans and funding structure.
4. Other action(s) as directed by Council.

RECOMMENDATION

Staff recommends Alternatives 1 and 2: Council directs the City Manager to pursue a two tier retirement plan and/or increased employee contribution for retirement costs with all bargaining units at the earliest opportunity for adoption in 2012, when all MOU's expire and Council adopts the joint Santa Clara County/Cities Managers' Association and San Mateo County City Managers Association "Policy Statement on Local Government Retirement Benefits."

Reviewed by:

Mary J. Bradley, Director, Department of Finance
Prepared by: Grace K. Leung, Finance Manager

Reviewed by:

Erwin Young, Director, Department of Human Resources

Approved by:

Gary M. Luebbers
City Manager

Attachments

A. 2010 Council Study Issue – FIN 10-02 Pension Reform
B. Policy Statement on Local Government Retirement Benefits

Attachment A

Proposed 2010 Council Study Issue

FIN 10-02 Pension Reform

Lead Department Finance

Element or Sub-element Fiscal Sub-element

New or Previous New

Status Pending **History** **1 year ago** None **2 years ago** None

1. **What are the key elements of the issue? What precipitated it?**

   In FY 2008/2009 the California Public Employees Retirement System (CalPERS) lost over 25% of its asset value. This will cause our employer contribution rates to increase significantly beginning in FY 2012/2013 and remain high for the foreseeable future. It is estimated that the new rates will result in additional cost of $8.5 million, with $5 million attributable to the General Fund alone. It is imperative that we begin to develop and implement a strategy to contain these costs as soon as possible if we are to ensure the financial health of the City into the future. The product of this study issue will be a strategy and an implementation plan. Also included will be discussions with the City's bargaining units as needed.

2. **How does this relate to the General Plan or existing City Policy?**

   Fiscal Sub-element policies:
   7.A.1.3 A balanced Twenty-Year Resource Allocation Plan shall be presented to the City Council annually.
   7.G.1.5 Pension obligations will be fully funded annually and current pension contributions will not be deferred to balance current expenditures.

3. **Origin of issue**

   Council Member(s)
   General Plan
   City Staff Staff
   Public
   Board or Commission none

4. **Multiple Year Project?** No **Planned Completion Year** 2010

5. **Expected participation involved in the study issue process?**

   Does Council need to approve a work plan? No
   Does this issue require review by a Board/Commission? No
   If so, which?
   Is a Council Study Session anticipated? Yes
   What is the public participation process?

6. **Cost of Study**

   Operating Budget Program covering costs
   Program 710 Financial Management and Analysis
   Project Budget covering costs
   Budget modification $ amount needed for study

Explain below what the additional funding will be used for

7. **Potential fiscal impact to implement recommendations in the Study approved by Council**

Capital expenditure range	None
Operating expenditure range	None
New revenues/savings range	$501K or more

Explain impact briefly
If the decision is made to go to a two-tier or reduced pension benefits, about $33 million can be saved over the twenty-year planning period.

8. **Staff Recommendation**

Staff Recommendation For Study

If 'For Study' or 'Against Study', explain

9. **Estimated consultant hours for completion of the study issue**

0

Managers

Role	Manager				Hours
Support	Corbett, Drew	Mgr CY1:	80	Mgr CY2:	0
		Staff CY1:	0	Staff CY2:	0
Support	Leung, Grace	Mgr CY1:	40	Mgr CY2:	0
		Staff CY1:	0	Staff CY2:	0
Support	Young, Erwin	Mgr CY1:	40	Mgr CY2:	0
		Staff CY1:	0	Staff CY2:	0

Total Hours CY1: 160
Total Hours CY2: 0

Note: If staff's recommendation is 'For Study' or 'Against Study', the Director should note the relative importance of this Study to other major projects that the Department is currently working on or that are soon to begin, and the impact on existing services/priorities.

Reviewed by

10/27/09

Department Director **Date**

Approved by

10/28/09

City Manager **Date**

Addendum

A. Board / Commission Recommendation

☐ **Issue Created Too Late for B/C Ranking**

Board or Commission	Rank	Rank 1 year ago	Rank 2 years ago
Arts Commission			
Bicycle and Pedestrian Advisory Committee			
Board of Building Code Appeals			
Board of Library Trustees			
Child Care Advisory Board			
Heritage Preservation Commission			
Housing and Human Services Commission			
Parks and Recreation Commission			
Personnel Board			
Planning Commission			

Board or Commission ranking comments

B. Council

Council Rank	(no rank yet)
Start Date	(blank)
Work Plan Review Date	(blank)
Study Session Date	(blank)
RTC Date	(blank)
Actual Complete Date	(blank)
Staff Contact	

Santa Clara County/Cities Managers' Association

San Mateo County City Managers Association

Policy Statement on Local Government Retirement Benefits

Background

For more than 70 years, the State of California and local governments have offered a "defined benefit" retirement plan to employees. This system provides a guaranteed annual pension based upon retirement age, salary, and years of service. Most, but not all, municipalities in California are part of the Public Employees' Retirement System (PERS).

Over the years, local government retirement costs have risen and fallen based on two key factors: investment returns and the level of benefit payments provided to employees. In the late 1990's the California legislature enacted significant benefit enhancements for public employees in the PERS system that were optional for participating local governments. At that time, some retirement plans were deemed to be "super funded" and many local governments adopted benefit enhancement plans. For example, most public safety personnel are on the "3% @ 50" plan, which provides a pension benefit of up to 90% of salary after 30 years of service as early as age 50.

When the retirement system suffered serious investment losses in the early part of this decade, these losses, combined with newly approved benefit enhancements, caused dramatic increases in employer contribution rates. Cities in our two counties have seen the percentage of their General Fund budget dedicated to PERS costs increase while their retirement liability funding had decreased from over the past decade. For example, in Mountain View, General Fund PERS costs have gone from $2.8 million in FY00 to $7.7 million in FY10; in San Bruno, it has gone from $240,000 to $4 million. Daly City's percent of the General Fund budget spent on retirement benefits has increased from 4.3% to 10.4% between FY00 and FY10; in Belmont, it has gone from .5% to 11.4%. And Campbell has seen its public safety retirement system fall from 122% funded to 70% funded over ten years.

In the past five years, a number of proposals have been introduced to reform or dramatically revise the public pension system in California. In 2004, a task force of the League of California Cities began an extensive study of the defined benefit system and proposed reforms. In 2005, the League board of directors accepted a report on pension reform from the task force as an initial assessment and for consideration in the ongoing debate of this issue. The report included a number of "general principles" and specific reform recommendations. To date, no concrete action has been taken by the legislature.

Recently, the city managers of San Diego County have prepared a white paper on this issue calling for a new and lower second tier retirement benefit for new hires. Other manager groups across the state have begun a similar dialogue in recognition that the costs of the current system are not sustainable. Additionally, Governor Schwarzenegger has proposed returning pension formulas to 1999 levels for new hires – a move he says will save the state $74 billion through 2040. The City of Sunnyvale has done a preliminary analysis of a lower tier and has estimated it could save a total of $44 million over 20 years. The cities of San Carlos and Brisbane have already initiated a lower, second tier for new hires (among other cities statewide).

Discussion

While the debate is ongoing, no clear consensus has been achieved on addressing the high cost of pension benefits and no action appears imminent. The city managers of Santa Clara and San Mateo counties believe it is important to take a proactive stance on this issue which has long-term implications for the fiscal stability of our cities. This issue is even more important now, given the tremendous losses suffered in the stock market in the past year. At fiscal year end in June 2009, PERS annual returns were down 23.4% from the previous year. This is on top of losses of 5.1% in Fiscal 2008. PERS assumes a 7.75% gain annually to maintain its pension obligations, but clearly there is no guarantee this rate can be achieved. Based on this year's negative returns, employer rates are expected to jump significantly as of July 1, 2011.

Therefore, as a matter of public policy, we endorse the following principles for a revised pension system.

Guiding Principles

- Our residents deserve fiscal policies that preserve local government's ability to meet community needs, while attracting competent and motivated employees to public service.

- Providing adequate retirement benefits is an important part of attracting and retaining public employees; this continues to be an issue as, demographically, there are fewer young people to enter the public sector.

- Current retirement benefit formulas are not fiscally sustainable. The costs are escalating beyond our ability to fund them and diverting limited resources from direct service delivery to our communities. In addition, current pension benefits exceed what private sector employees receive and what is reasonably needed to attract public employees.

- Ideally, this situation would be addressed at a statewide level and there would be consistent standards for all. We cannot, however, afford to wait for a statewide solution. Therefore, the cities of Santa Clara and San Mateo counties support implementation of a reduced and sustainable level of retirement benefits for all new employees of agencies in the region.

- Each city has different histories, perspectives, and fiscal conditions; a "one size fits all" approach may not be realistic, but all cities in the region compete for the same employees and therefore should move in the same direction to a lower-cost benefit.

- Each city has the legal duty to meet and confer in good faith with its recognized bargaining unit representatives concerning changes to existing terms and conditions of employment.

- Every city is committed to moving toward a two tier system for all new contracts.

- Any new system or tier should be fair to employees, sustainable for taxpayers and employers, and based on objective actuarial data.

Action Steps

The city manager associations of Santa Clara County and San Mateo County support the statements in this document and their members pledge to work with their elected officials and labor groups to implement its principles. We further pledge to work with other city managers across the state and the League of California Cities to advocate for changes consistent with this document.

Dave Anderson, SCCCMA

Connie Jackson

Connie Jackson, SMCCMA

Adopted July, 2009