2011 Council Study Issue

FIN 11-03 Options for a Hybrid Pension Model

Lead Department Finance

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

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

   The cost of the City's pension plans have increased significantly over the past 10 years, and costs are expected to continue to rise significantly into the foreseeable future. A greater and greater portion of the City's revenues are required to cover pension expenses, which comes at the expense of providing services. As such, over the past 18 months, alternatives to the City's current defined benefit pension plans have been studied and estimated cost savings have been quantified. To date, the focus on alternatives has considered lower-tiered defined benefit plans and increases in employee contributions. A hybrid defined benefit/defined contribution plan has not been studied and brought forward for Council consideration; however, this is an alternative that could save the City significant money if implemented and help create a more sustainable retirement plan for the City with more predictable costs. It also requires significant study to understand the administrative, legal, and operational elements, as well as the financial implications of the transition. A hybrid defined benefit/defined contribution plan would combine a low-tier defined benefit pension formula with a 401(k)-style defined contribution plan.

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

   Current policy in the fiscal sub-element of the General Plan calls for full annual funding of the City's pension obligation. With costs increasing dramatically, a larger portion of the City's available resources are going to funding this obligation, which is not sustainable over the long-term.

3. **Origin of issue**

   Council Member(s) Moylan, Whittum

4. **Staff effort required to conduct study** Major

5. **Multiple Year Project?** Yes **Planned Completion Year** 2012

6. **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

7. **Briefly explain cost of study, including consultant hours, impacted budget program, required budget modifications, etc. and amounts if known.**

   This study issue represents another alternative to consider in the City's ongoing evaluation of its pension plans. While there is no additional cost to looking into a hybrid defined benefit/defined contribution plan in conjunction with the ongoing evaluation of other alternatives, this alternative is considerably more complex in its implementation and will require a significant amount of staff resources to fully study.

8. **Briefly explain potential fiscal impact of implementing study results (consider capital and operating costs, as well as potential revenue).**

   A hybrid defined benefit/defined contribution pension model would have significant long-term operating savings if implemented. Initial savings would not be substantial, as this model would only apply to employees hired after the implementation date. However, over the long-term, this model would greatly reduce pension costs for the City and would result in less volatility in the City's annual funding requirements.

9. **Staff Recommendation**

   Staff Recommendation None

   If 'For Study' or 'Against Study', explain
   Exploring alternatives to our current defined benefit pension plan administered by CalPERS has become imperative. In addition to considering two-tiered options and employee contributions, another alternative suggested by a Council member for consideration is a hybrid defined benefit/defined contribution plan. However, there are a number of significant barriers to implementing a hybrid plan, with CalPERS membership being the most significant. CalPERS does currently have a lower-tiered benefit formula (Miscellaneous 1.5% @65) that could work well with a defined contribution component. The major issue, however, is that entities on this low-tier formula are required to supplement it with Social Security, which is not an ideal option. Therefore, implementing a hybrid plan that was designed with more flexibility would require the City to leave CalPERS. Leaving CalPERS is not feasible for a number of reasons:

   1) The City would have to pay off its unfunded liability of approximately $150 million over a 10-year period, and the City does not have the resources to do this.
   2) Current employees must be removed from CalPERS and, based on California Vested Rights Law, be provided with an equivalent benefit to what they currently have (2.7% @55 for Miscellaneous and 3% @ 50 for Safety). This would require us to either create our own pension fund or combine with another non-CalPERS pension fund with comparable benefits. The City of Sunnyvale does not have the financial resources to take on the risk of its own pension fund, and the performance of the non-CalPERS funds has not been any better than CalPERS' performance, making CalPERS the better option.
   3) Because of the size of the CalPERS portfolio, there are still a number of advantages to remaining in CalPERS. There is no other option that offers the investment expertise that CalPERS offers, nor do other pension funds have the financial resources needed to smooth gains and losses over time in an attempt to create less-volatile rates.
   While the City has seen volatility in its rates, especially in recent years, this volatility is

not as great as it would have been in a smaller pension fund that had similiar investment return results.

The City nor its consulting actuary are aware of any jurisdiction that has left CalPERS. Furthermore, even if it were feasible to get out of CalPERS, there are currently no viable options outside of CalPERS to provide the City with a hybrid pension model at this point.

The study of the creation of a hybrid defined benefit/defined contribution model could be undertaken to develop the parameters of the model and to quantify the resulting savings to the City. However, given the barriers listed above, the City currently has no feasible implementation option for this type of model.

Regardless of what Council decides with respect to moving forward on this study issue, it is imperative that we take action to contain the City's pension costs, and staff will continue in these efforts. Maintaining the status quo is not an option, as the costs for the City's pension plans are no longer sustainable.

Reviewed by

11/29/10

Department Director **Date**

Approved by

11-29-10

City Manager **Date**