Agenda Item No. 11

File Code No. 430.08

CITY OF SANTA BARBARA

COUNCIL AGENDA REPORT

AGENDA DATE: October 16, 2012

TO: Mayor and Councilmembers

FROM: City Administrator's Office

SUBJECT: Pension Reform Update

RECOMMENDATION:

That Council receive an update on the California Public Employees' Pension Reform Act of 2013 and its expected effects on the City's CalPERS administered pension plans.

DISCUSSION:

On March 7, 2012, Council held a special work session on pensions during which staff provided a comprehensive overview of the CalPERS pension program, reform options being considered by various municipalities, and potential state legislation to address pension reform. On September 12, 2012, the Governor signed AB 340, which included the California Public Employees' Pension Reform Act of 2013 (the Act). The Act affects most public retirement systems in California, including CalPERS and the City's CalPERS-administered plans.

The Act will significantly change the pension plans that public employers may offer to employees who are new to public employment, or who reenter public employment after a break of more than six months. The Act has only limited application to benefits for existing employees, but includes some structural changes that will limit pension enhancements and prevent pension abuses. A "Preliminary Summary of Pension Reform Provisions", prepared by CalPERS, is attached.

In follow up to the March 2012 work session, staff plans to present an abbreviated review of the City's pension plan benefits and funding, and to focus on the expected effects of the Act on the benefits payable to the City's existing and future employees, and on the potential financial impacts to the City of such changes. The general context for future collective bargaining related to other retirement benefit changes will also be discussed.

ATTACHMENT: CalPERS Preliminary Summary of Pension Reform Provisions (September 26, 2012 Update)

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SUBMITTED BY: Marcelo López, Assistant City Administrator

APPROVED BY: City Administrator's Office

CalPERS

Preliminary Summary of Pension Reform Provisions

These preliminary comments of CalPERS staff are based on its current understanding of AB 340 as set forth in Conference Report. These comments are not intended to address all issues that could arise if the bill becomes law.

Brief Summary	PROPOSED STATUTE	IMPACTS CURRENT MEMBERS	IMPACTS FUTURE MEMBERS
Reduced Benefit Formulas & Increased Retirement Ages Would create a new defined benefit formula of 2% at age 62 for all new non-safety employees with an early retirement age of 52 and a maximum benefit factor of 2.5% at age 67, and three new defined benefit formulas for safety public employees with a normal retirement age at 50 and a maximum retirement age at 57 as follows: Normal Ret Age / Maximum Benefit Factor Basic Formula: 1.426% at Age 50 / 2% at Age 57 and older Option Plan 1: 2% at Age 50 / 2.5% at Age 57 and older Option Plan 2: 2% at Age 50 / 2.7% at Age 57 and older Also would require the formula offered be the closest to the formula presently offered to the same classification and that provides a lower benefit at 55 years of age.	**7522.10** **7522.15** **7522.20** **7522.25**		**X**
Cap Compensation that Counts Toward Pension Benefits Would cap the annual salary that counts towards final compensation for all new employees, excluding judges, at $110,100 (2012 Social Security Contribution and Benefit Base) for employees that participate in Social Security or $132,120 (120% of the Contribution and Benefit Base) for those employees that do not participate in Social Security. This compensation cap would adjust annually based on the CPI for All Urban Consumers.	**7522.10**		**X**

* Although these provisions would not impact curret members directly, they would prohibit public employers from offering such a benefit or option to current members in the future.

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Eliminate Replacement Benefit Plans Would prohibit a public employer from offering a plan of replacement benefits for new members whose retirement benefits are limited by IRC Section 415. Also would prohibit a public employer from offering a replacement benefit plan for any employee if the employer does not offer a plan of replacement benefits prior to January 1, 2013.	**7522.43**	*	**X**
Federal Compensation Limit for Determining Retirement Benefits (1) Would require all public retirement systems in California to adhere to the federal compensation limit when calculating retirement benefits for new members; and (2) would prohibit a public employer from making contributions to any qualified public retirement plan based on any portion of compensation that exceeds this limit. *(Note: CalPERS already adheres to the federal compensation limit)*	**7522.42**		**X**
Actuarially Reduced IDR Benefits for Public Safety Would allow a safety member, who qualifies for an IDR, to receive the greater of: 1) 50% of the member's final compensation plus any annuity purchased with his/her accumulated contributions, if any; 2) A service retirement, if the member qualifies for service retirement; or 3) An actuarially reduced retirement formula, as determined by the actuary, for each quarter year of service age less than age 50, if that amount would be higher than 50% of salary.	**7522.66 21400**	**X**	**X**
Equal Sharing of Normal Cost • For new and current employees, the bill provides that "the standard shall be that	**7522.30**	**X**	**X**

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employees pay at least 50% of the normal costs and that that employers not pay any of the required employee contribution." • For new employees of contracting agencies and schools, the initial employee contribution rate may not be less than 50% of the total annual normal cost of pension benefits. • For employees of contracting agencies and schools, the employer and employee organization may mutually agree to pay cost sharing agreement for pension benefits between January 1, 2013 and December 31, 2017. Beginning on January 1, 2018 the employer may unilaterally require employees to pay 50% of the total annual normal cost up to an 8% contribution rate for miscellaneous employees and an 11 or 12 percent contribution rate for safety employees. • For state employees, contribution rates increase by a fixed percentage at specific dates beginning July 1, 2013. Rates increase and vary by bargaining unit and classification.	**20516.5** **20683.2**		
Close LRS For New Members Would prohibit new members from participating in the LRS. However, new statewide constitutional and legislative statutory officers would still be eligible for optional membership in CalPERS.	**9355.4**		**X**
Equal Health Benefit Vesting Schedule for Non-Represented and Represented Employees	**7522.40**	**X**	**X**

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Would eliminate the ability of an employer to provide a better health benefit vesting schedule to non-represented employees than it does for represented employees.			
Prohibit Purchases of Airtime Would eliminate the ability of any public employee to purchase nonqualified service or "airtime," unless an official application was received by the system prior to January 1, 2013.	**7522.46**	**X**	**X**
Prohibit Retroactive Pension Increases Would prohibit public employers from granting retroactive pension benefit enhancements that would apply to service performed prior to the date of the enhancement. This would apply to current and future employees.	**7522.44**	**X**	**X**
Prohibit Pension Holiday Would require the combined employer and employee contributions, in any fiscal year, to cover that year's normal cost.	**7522.52**	**X**	**X**
Calculate Benefits Based on Regular or Base Pay to Stop Spiking: New Employees Would require that pensionable compensation for all new employees be defined as the normal monthly rate of pay or base pay of the member paid in cash to similarly situated members of the same group for services rendered on a full-time basis during normal working hours, pursuant to a publicly available pay schedule. Would also exclude all	**7522.40**		**X**

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bonuses, overtime, pay for additional services outside normal working hours, cash payouts for unused leave (vacation, annual, sick leave, CTO, etc.,), severance pay and various other types of pay as specified. Also would exclude any compensation determined by the retirement board to have been paid to increase a member's retirement benefit and any other form of compensation determined to be inconsistent with the statutory definition.			
Require Three-Year Final Compensation Would require that final compensation for new employees of all California public agencies be defined as the highest average annual final compensation during a consecutive 36 month period, subject to the cap. Also would prohibit a public employer in the future from modifying a benefit plan to provide a final compensation period of less than a three year period for existing employees.	**7522.33**	*	**X**
Felons Forfeit Pension Benefits Would require both current and future public officials and employees to forfeit certain specified pension and related benefits if they are convicted of a felony in carrying out their official duties, in seeking an elected office or appointment, or in connection with obtaining salary or pension benefits, subject to certain requirements.	**7522.70 7522.72 7522.74**	**X**	**X**
Limit Post-Retirement Public Employment • Would limit all employees who retire from public service from working more than 960 hours or 120 days per year for any public employer in the same public retirement	**7522.56**	**X**	**X**

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Brief Summary	PROPOSED STATUTE	IMPACTS CURRENT MEMBERS	IMPACTS FUTURE MEMBERS
system without reinstating from retirement. • Would require a 180-day "sit-out" period before a retiree could return to work without reinstating from retirement except under certain circumstances. • Would require a 180-day "sit-out" period for retirees who received either a golden handshake or some other employer incentive to retire. • Would require a public retiree appointed to a full-time position on a state board or commission to suspend his or her retirement allowance and become a member of CalPERS.			
Contracting Agency Liability for Excessive Compensation Would require CalPERS (for plans it administers) to define a "significant increase" in actuarial liability for a former employer caused by increased compensation paid to a nonrepresented employee by a subsequent public employer. Would also require CalPERS develop a plan to assess the cost of that excess liability to the employer who paid the excessive compensation and the provision would apply to any significant increase that is determined after January 1, 2013 regardless of when that increase occurred.	**20791**	**X**	**X**

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Pension Reform Update

October 16, 2012

Purpose

- To provide a refresher to Council on City employee pensions
- To explain the effect of the California Public Employees Retirement Reform Act of 2013 on the City ("*the Act*")
- To review options for future negotiations

Agenda

- Background
  - City's Pension Plan
  - Funding of Plan
- The California Public Employee Pension Reform Act of 2013
  - Effect on benefits
  - Effect on funding
- City Collective Bargaining Context

City’s Pension Plans

City Pension Plan

- City participates in CalPERS
  - 93% of Cities are in CalPERS
  - City does not participate in Social Security, but does participate in Medicare
- CalPERS plans are “defined benefit” plans
- Plan options are set by state statute, with limited local flexibility
- Limited ability to leave the system

Retirement Benefits

- 3 factors determine retirement benefit
  - Years of Service
  - Final Compensation (Single Highest Year)
  - Retirement “factor” at age of retirement (e.g. 2%, 2.7%, 3%)
- The “factor” at age of retirement depends on which retirement formula employer offers, e.g. “2% at [age] 60”

Example Benefits
Misc at 2.7% at 55 w/o EPMC

Age Factor	Times Years of Service	Times Final Monthly Salary	Monthly Benefit
2% (age 50)	x 20 years = 40%	x $5,000	= $2,000
2.7% (age 55)	x 25 years = 67.5%	x $5,000	= $3,350

Example Benefits
Safety 3% at 50 with 9% EPMC

Age Factor	Times Year of Service	Times Monthly Salary +9% EPMC**	Monthly Benefit
3% (age 50)	x 20 yrs = 60%*	x $5,000+450 = $5,450	= $3,270
3% (age 55)	x 25 yrs = 75%*	x $5,000+450 = $5,450	= $3,815

**Retirement capped at 90% = 30 years*

** City pays 9% member contributions for safety groups (“EPMC”), and that is reported as compensation, increasing final compensation for retirement calculations (“Roll-up”)

PERS Retirement Plan Funding Basics

CITY PENSION PLANS
Funding Method

- Funding Objective
  - To accumulate enough money to fully fund benefits before the employee retires
- PERS makes many actuarial assumptions that fall into 2 broad categories
  - Demographics of employees & retirees
  - Financial assumptions (inflation, investment return, etc.)
- "Normal Cost" is the contribution that must be made to fund future benefits for current year of service, if all actuarial assumptions come true

Current Normal Costs

Expressed as a percentage of employee's salary compensation

	Employer "Normal Cost"	Plus Employee Member Portion	TOTAL NORMAL COST
Miscellaneous	9.958%	8%	17.958%
Police	19.457%	9%	28.457%
Fire	17.397%	9%	26.397%

Member portion of the normal cost is fixed by statute. Employer may all or part of the member contribution ("EPMC")

CITY PENSION PLANS
Impacts on Funding

- If actuarial assumptions do not come true, plan will have:
  - Excess Assets, or
  - Unfunded Liability

- Most public employer plans in California currently have significant unfunded liabilities, primarily due to:
  - Retroactive benefit increases
  - Investment losses
  - Other causes : wages above assumptions, life longer than life expectancy, etc.

Current Required Contributions Fiscal Year 2013

Expressed as a percentage of employee's salary compensation

Plan	Employer "Normal Cost"	Employer Payment on Amortized Unfunded Liability	TOTAL Employer Rate	Plus Employee Portion of "Normal Cost"	TOTAL CURRENT REQUIRED CONTRIBUTION
Misc	9.958%	12.390%	22.348%	8%	30.348%
Police	19.457%	14.939%	34.396%	9%	43.396%
Fire	17.397%	14.809%	32.206%	9%	41.206%

For Fiscal Year 2013, based on June 30, 2010 plan valuation date

SB RETIREMENT PLANS
Funding Status as of 6/30/2010

	Police	Fire	Misc	Total
Accrued Liability	$ 180,792,452	$ 136,668,712	$ 383,255,437	$ 700,716,601
Market Value of Assets	111,407,667	86,568,984	234,911,462	432,888,113
Unfunded Liability	$ 69,384,785	$ 50,099,728	$ 148,343,975	$ 267,828,488
Funded %	61.62%	63.34%	61.29%	61.78%

STATEWIDE AVERAGES
Funding Status as of 6/30/2010

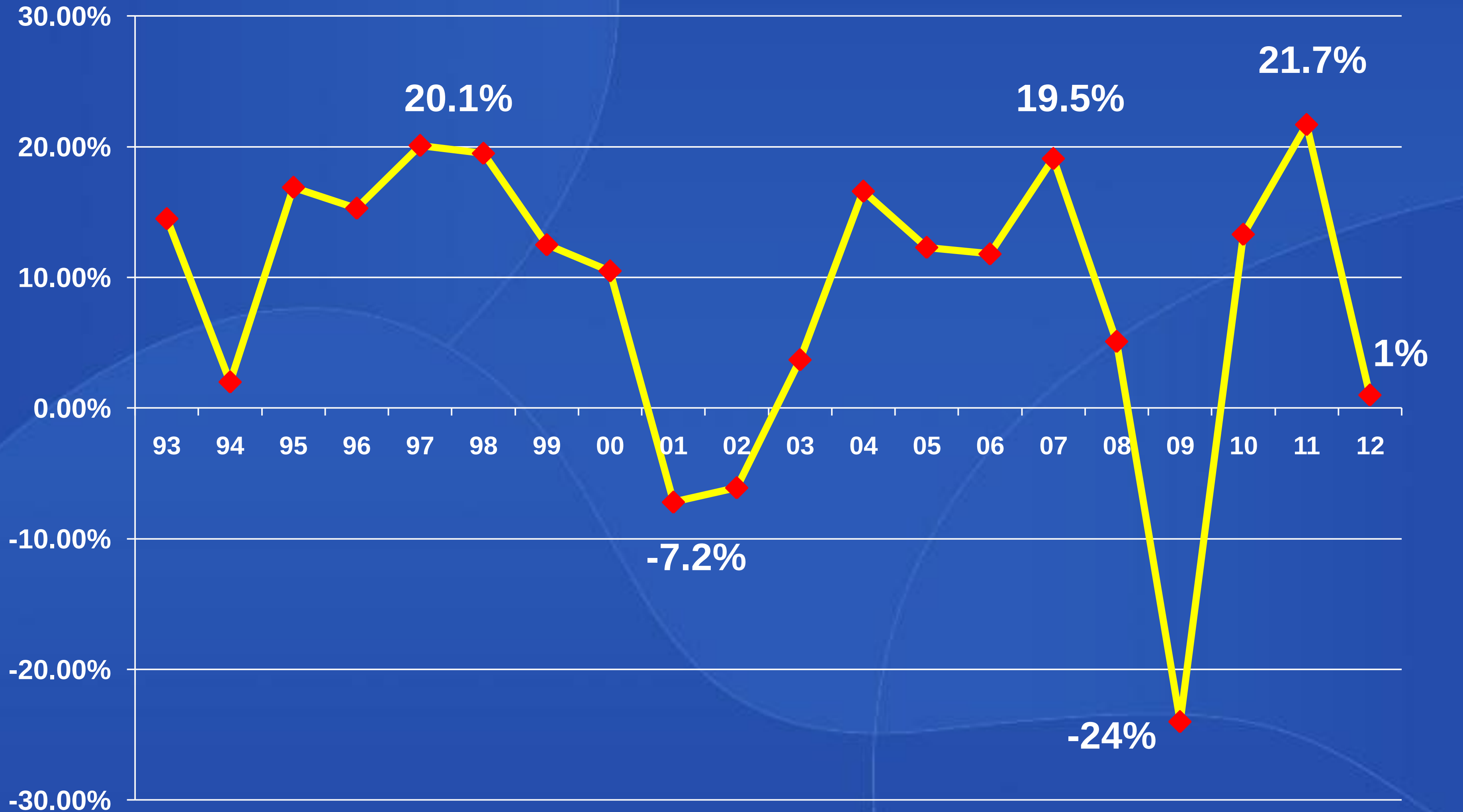
Average Funded Status June 30,	Miscellaneous Plans	Safety Plans
2008	90.7%	88.0%
2009	61.5%	60.3%
2010	66.3%	64.9%
2010 – City of SB	61.29%	61.62% & 63.34%

CITY PENSION PLANS
How PERS Pensions are Funded

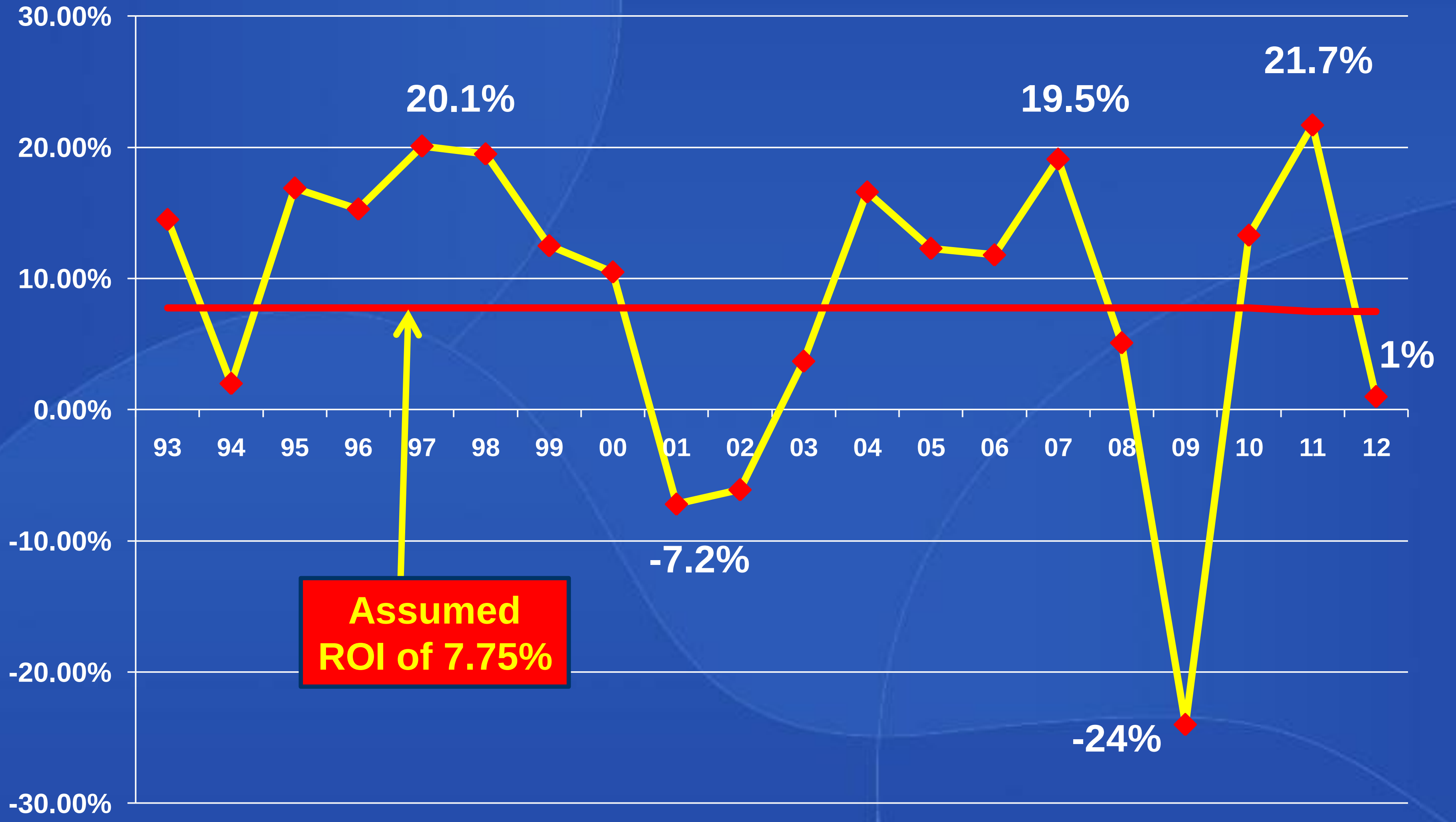
- Only two sources of funding for pensions, including unfunded liabilities
    1. Contributions (Variable Employer contributions + fixed Employee contributions)
    2. Investment Returns

- Investment returns and employer contribution rates are inversely related

CalPERS Investment Returns
20-Year History



CalPERS Investment Returns
20-Year History



Conclusions

- Retroactive benefit enhancements granted a decade ago, combined with investment portfolio not meeting assumed investment gains, have led to unfunded liabilities

- City' employer rates have grown to pay the unfunded liabilities
  - Current employer rates are calculated to reduce unfunded liabilities to zero over 20-30 years

Predictions

- Under Current Benefit Structure
  - Employer rates likely to continue to increase and remain high for many years
  - Slight underperformance of investments will have big impacts on rates
- Future changes to actuarial assumptions could worsen estimates, further increasing employer rates

California Public Employees' Pension Reform Act of 2013 (*The Act*)

General Provisions

- Primarily affects newly hired employees (after 1/1/2013) who are new to CalPERS and reciprocal public retirement plans, or returning after a break of 6+ months
  - = "new employees"
- Current employees <u>and</u> new employees hired from another public agency w/out 6 month break will be under the terms of our old plans
  - = "legacy employees"

New Plans for New Employees

- New benefit formula effective 1/1/2013

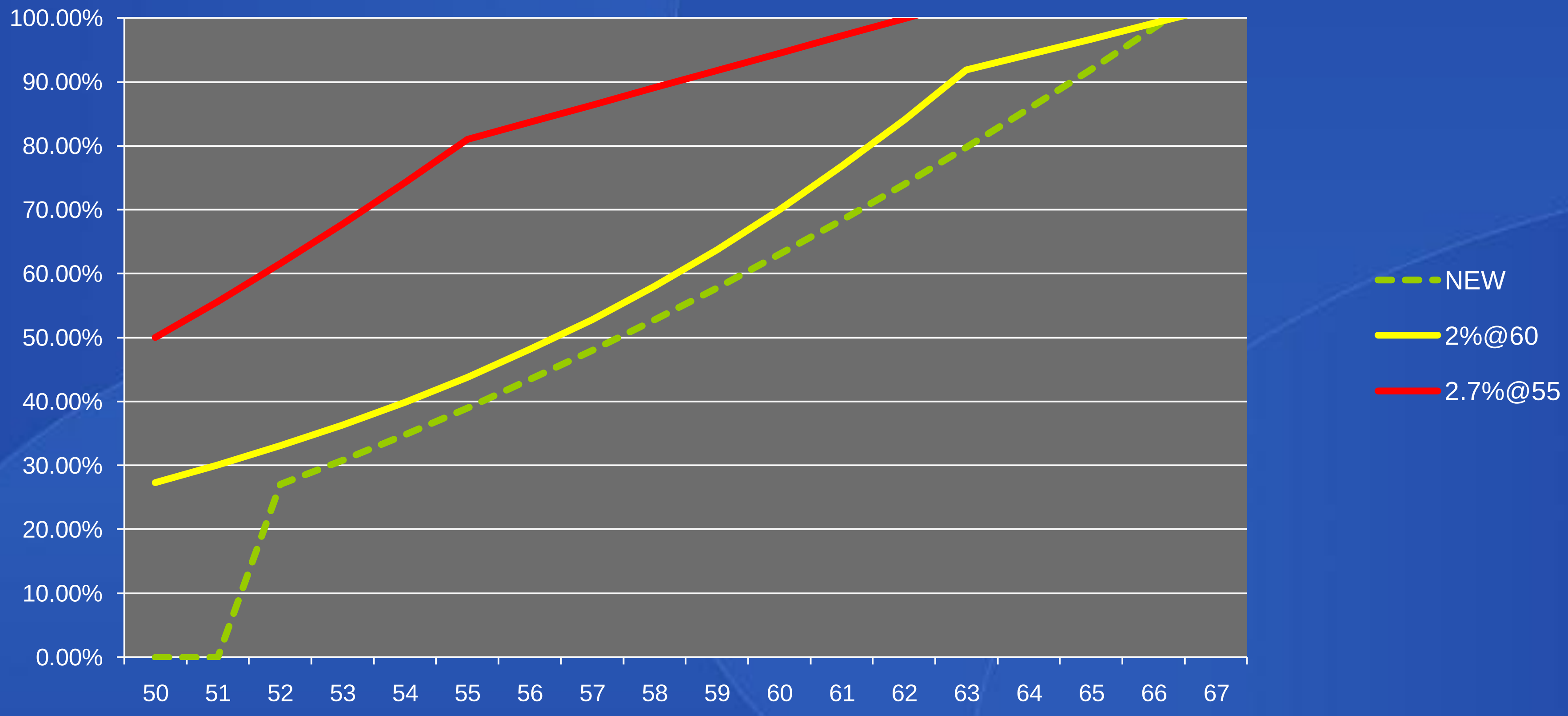
Plan	Minimum	Maximum
Miscellaneous "2% at 62" Plan	1% at age 52	2.5% at age 67
Safety (Option Plan II) "2.7% at 57" Plan	2% at age 50	2.7% at age 57

- Miscellaneous plan retirement age increases
  - Early retirement age 50 → 52 years
  - Normal retirement age increased: 55→62 years
- 3 highest years compensation (vs. single highest year)

New Plans for New Employees

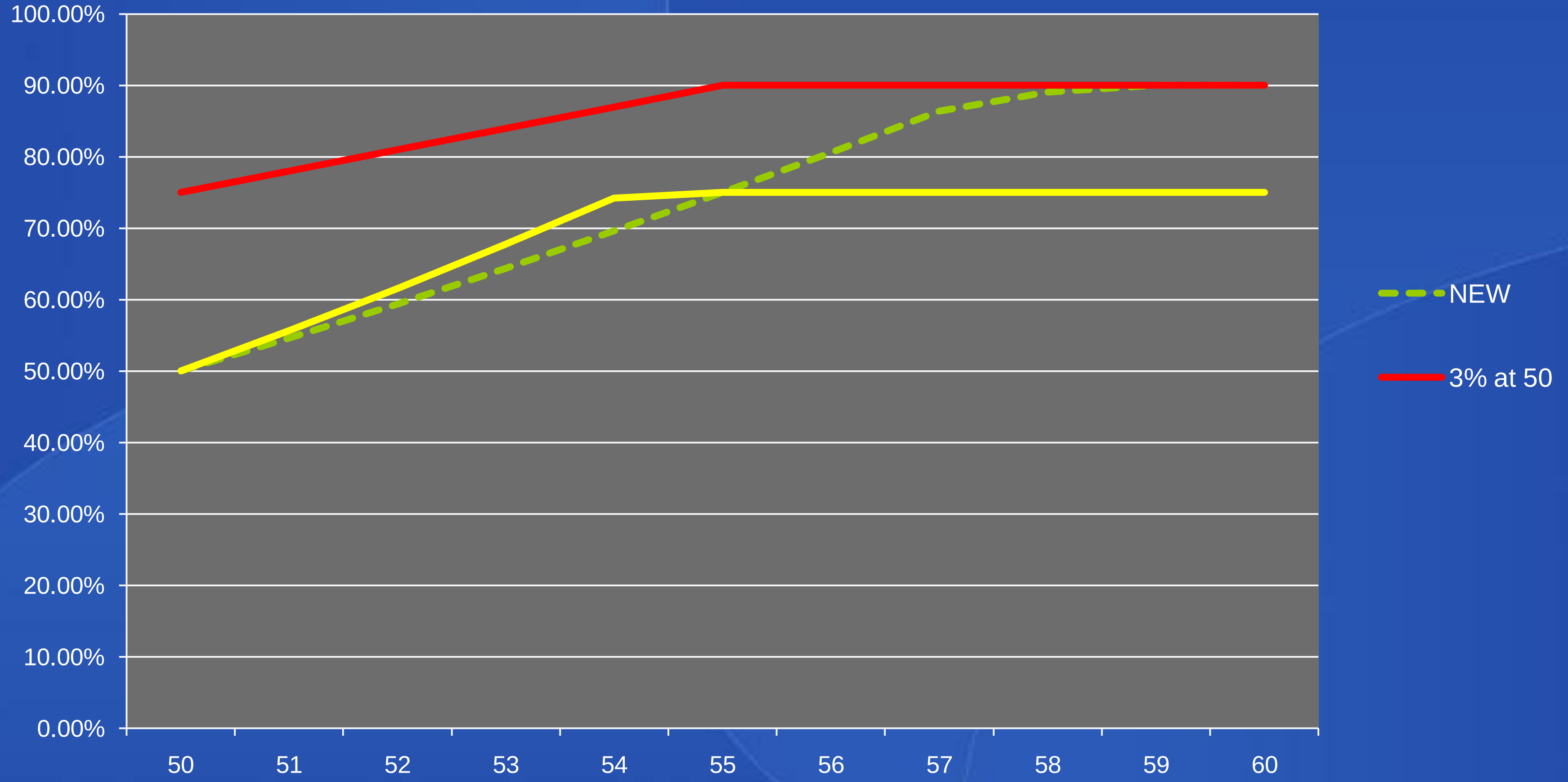
- Limits on PERS considered compensation
  - 120% of the Social Security Contribution and Benefit Base = $132,120 (+CPI)
  - May not offer new supplemental defined *benefit* plan
  - May offer supplemental defined *contribution* plan, up to IRC 415 compensation limit = $250,000 (+CPI)
- No “spiking” compensation

Effect of Formula Change
Misc Employee Started at Age 25



Shows difference between “2% at 60” (former); “2.7% at 55” (current); and the NEW “2% at 62” plan

Effect of Formula Change
Safety Employee Started at Age 25



Shows difference between “2% at 50” at a 75% cap (former); “3% at 50” at a 90% cap (current); and the NEW 2.7% at 55 at 90% cap

Summary- New Employees

	Current	Under PEPRA
Plan	2.7% at 55 & 3% at 50	New plans effective 1/1/2013
Member Contribution	8% misc and 9% safety	Greater of ½ normal cost or what other employees pay
Employer Paid Member Contributions (EPMC)	Allowed	Not Allowed
Report EPMC as compensation ("Roll-Up")	Allowed	Not Allowed
Ability to negotiate greater employee contribution	8%/9% maximum Unless related to benefit enhancement (§20516)	No limit on negotiated employee contributions
Ability to impose employee contribution	8%/9% maximum	Full member contribution above

½ normal cost not know, but estimated to be 7-8% Misc and 10-12% safety

Summary-Legacy Employees

	Current	Under PEPRA
Plan	2.7% at 55 & 3% at 50	No change
Member Contribution	8% misc and 9% safety	As negotiated: “Standard” of ½ normal cost
Employer Paid Member Contributions (EPMC)	Allowed	Still allowed
Report EPMC as compensation (“Roll-Up”)	Allowed	Still allowed
Ability to negotiate greater employee contribution	8%/9% maximum Unless related to benefit enhancement (§20516)	No limit on negotiated employee contributions
Ability to impose employee contribution	8% misc & 9% safety maximum	- Same until 1/1/2018 - 8/12% after 1/1/2018

Legacy Employees

- *The Act* sets "standard" of ½ normal cost
- What is half the normal cost?

	HALF NORMAL COST	MAX THAT CAN BE IMPOSED (2018)
Miscellaneous	8.98%	8%
Police	14.23%	12%
Fire	13.20%	12%

- NO requirement that City negotiate/impose these contributions

Other Relevant CPEPRA Provisions

- Changes to end perceived pension abuses
  - No “airtime” purchases
  - Restrictions related to plan funding: no retroactive benefits, no funding holidays, etc.
  - Limits on continued work after retirement
  - Forfeiture of pension for work related felony
- Other union wins: health benefit vesting, industrial disability

Effect of Pension Changes for New Employees

- CalPERS estimate of normal cost savings for larger local agency (actual not yet released)

	Miscellaneous	Safety
Formula Change	5.8%	6.2%
3 Highest Years	0.2% - 0.7%	0.4% - 1%

- City will also save on new employees through Prohibition on “EPMC” (up to 9% for safety) and Roll-up (up to 3.9% for safety)

- Savings will be small at first, and gradually increase as more turnover occurs and more employees are covered under new plan.

Effect of Pension Changes for New Employees

Actual hiring data for 3 fiscal years

	Total Hired	Previous Public Service	% "New"	% "Legacy"
Miscellaneous	112	26	76.8%	23.2%
Safety	38	7	81.6%	18.4%
Total	150	33	78.0%	22.0%

At that rate, and making assumptions about % turnover is into jobs previously held by legacy employees:

	January 2013	June 2023
Miscellaneous Legacy	100%	75%
Miscellaneous New Plan	0%	25%
Safety Legacy	100%	74%
Safety New Plan	0%	26%

Effect of Pension Changes Legacy Employees

- *The Act* does not provide any relief for current unfunded liability
- Any cost savings for existing employees will still need to be achieved through negotiations
- Possible cost savings through:
  - Eliminating Employer Paid Member contributions for safety (up to 9%)
  - Eliminating “roll up” for safety (up to 3.9%)
  - Negotiating greater employee contributions (e.g., greater than current 8%/9% maximums)

Conclusions

- Overall, *The Act* is a good solution to the need for two tiers
- CalPERS employer rates are likely to continue to increase and stay high due to payment on unfunded liabilities, actuarial changes, etc.
- Saving from *The Act* will help alleviate this over the long-term, as new employees are hired
- Short-term savings may still be achieved through labor negotiations affecting “legacy” employees