



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Councilmembers
Pyle and Rocha

SUBJECT: RETIREMENT REFORM

DATE: December 2, 2011

Approved

Don Rocha Pyle Date 12/2/11

RECOMMENDATION

1. Accept the memo from the Mayor, Vice Mayor and Councilmembers Herrera, Liccardo and Constant dated December 1st with the following amendments:
 - a. Defer Council action to officially place the measure on the ballot until the March 6, 2012 council meeting in order to provide more time for discussion with our bargaining units.
 - b. At the point at which the Council does decide to put a measure on the ballot, amend the recommendations in the December 1st memo as follows:
 - i. Allow the City Clerk to accept arguments in opposition to the measure for the sample ballot, and authorize members of the City Council to submit such arguments.
 - ii. Amend the description of the ballot measure contained in paragraph 4 of the December 1st memo to read as follows: "and requiring voter approval for increases or decreases in future pension benefits."
2. Provide the following additional direction to staff:
 - a. Direct staff to analyze the recent proposal submitted by IAFF Local 230 and POA, and provide a savings estimate.
 - b. Direct staff to reach out to bargaining units in order to determine whether they would be willing to waive impasse procedures in order to allow the resumption of retirement reform negotiations.

3. For the purpose of establishing a revised bargaining position, revise the draft ballot measure language dated November 22, 2011, as outlined below:

Issue	Section	Revision
Reservation of Voter Authority	4	Revise to say: "The City Council shall have no authority to agree to or provide an increase <u>or reduction</u> in pension and/or retiree healthcare benefits without voter approval."
Current Employees	6(c)	Employee share of the unfunded liability amortization shall be 3% of pensionable pay starting June 24, 2012, and shall increase 3% annually until the employee's share of the cost reaches 50% of the amortized pension unfunded liability. Each employee's share shall be capped at 18% of pensionable pay.
	6(d)	If the VEP has not been implemented by June 24, 2012, implementation of employee compensation adjustments shall be deferred until such time as the VEP is implemented and any barriers to implementation (such as legal issues or lack of IRS approval) have been resolved.
VEP	7(b)(i)	Revise the accrual rate to 2.33% for Police and Fire
Tier 2	8(a)	Eliminate the cap on pension costs of 9% of base salary.
	8(c)	Revise COLA to be limited to Bay Area CPI and capped at 1.5% per year
	8(e)	Revise accrual rate to 2% for Federated and 2.33% for Police and Fire
	8(h)	Eliminate this section in order to maintain a vested retirement benefit
Retiree COLA	10	Accept the recommendation in the December 1 st memo from the Mayor, Vice Mayor and Councilmembers to make the COLA change contingent upon declaration of fiscal emergency.

ANALYSIS

Circumstances have changed in the last 48 hours: our deficit for next years seems to be declining for the time being, our firefighters union and police union submitted new proposals that show an unprecedented willingness to roll back benefits to mid-90's levels, and there's renewed willingness on the Council to consider a June election. There are some things, however, that haven't changed: we still need to enact pension reform and we still need to make every reasonable attempt to reach a negotiated settlement. Our recommendations here are intended to advance both of those goals.

We wholeheartedly welcome the recommendation by the Mayor, Vice Mayor and Councilmembers Herrera, Liccardo and Constant to defer the retirement reform ballot measure to a June election. We are puzzled, however, that they do not also recommend

deferring Council action to place the measure on the ballot until March. As we all know, there is considerable legal risk inherent in any pension reform effort; if we were able to come to an agreement with one or all of our bargaining units over the next few months, we would make great progress in controlling that risk. Especially in light of the new proposal from the firefighters and police, the two sides are closer than we might ever have expected. Extra time to find a path to agreement is a gift that we should not pass up. We believe it may be possible simply to go back into the mediation process, and, as we mention above, seek waiver of any additional impasse procedures.

Some may argue that we need to get our determination letter into the IRS as soon as possible. We would simply point out that other agencies have been waiting for years for the IRS to deal with this issue. It seems unlikely that a letter from San Jose in December rather than March is going to be the tipping point for the IRS to take action.

To the Council's credit, the City's reform proposal has improved greatly over the past few months, despite the failed direction that came out of our June 24th meeting and months of wasted time that ensued. In our opinion, there are a few additional improvements that need to be made. Our recommendations in this memo are intended to first of all, make sure that our strategy actually works: we shouldn't lock provisions into the charter that we may regret later. Just as important, our recommendations intend to make the proposal fair, so that it will stand the test of time—in good years and in bad—as a workable and sustainable retirement system.

Proposed Revisions

Now that we have some breathing room to continue negotiations with our unions, we believe it's time to make some new amendments to the City's bargaining position. Our recommended changes should both enhance the City's ability to meet its goals and enhance fairness for employees.

Reservation of Voter Authority

Currently Section 4 requires voter approval for increases to retirement benefits. In the interest of fairness, we recommend that we also require voter approval for benefit reductions as well. Requiring approval for increases effectively limits what unions can negotiate for; out of consideration for that loss, we believe it's fair to give some certainty that what benefits remain to them can't be eliminated by a simple vote of the Council. If we believe that the voters will make wiser decisions than future Councils about when to increase benefits, it stands to reason that they will also make wiser decisions about when to decrease them.

Current Employees

We recommend changing two parts of Section 6 with respect to current employees. First, in Section 6(c), we recommend that we reduce the phase-in of increased employee contributions from 5% per year to 3% in order to give employees more time to adjust their finances, and reduce the cap on the share of an employee's salary that can go to the unfunded liability from 25% to 18% to give employees more certainty as to what they'll

pay over the long run. The advantage of this approach is that neither of these changes is likely to affect the ultimate level of cost savings we realize after the phase-in is complete. Based on current year unfunded liability payments, the employee share would be well below 18%—it's unlikely that we'd ever come up against that limit. At the end of the day, both the current proposal and our suggested revision are likely to provide the same level of help with the unfunded liability over the long run; the only difference is that our approach does so at a reduced pace with lower impact to our employees.

Second, we believe it is critical to the City's interests that we change Section 6(d). This section would automatically increase the employee contribution to the unfunded liability in June 2012, whether or not the Voluntary Election Program (VEP) is in place. It's unlikely that the VEP will be up and running by next July (even if the IRS is uncharacteristically speedy) which means that all employees will see a reduction in take-home pay on top of previous year reductions, regardless of their willingness to opt-in to a lower pension benefit. With no option to avoid the higher contributions by opting in to a new pension system, we are setting up the very opposite of a "voluntary" program and forcing our employees to take what amounts to an additional mandatory cut in take-home pay. In our opinion, this approach is clearly unfair to our employees. It's also against the City's interest: if we continue to cut take-home pay, we could suffer an exodus of staff capacity that could damage our ability to provide core services.

VEP and Tier 2

In the latest draft of the ballot language, the Council increased the benefit levels in the VEP to a more reasonable level. In our opinion, those changes make just as much sense for the Tier 2 system. To give a sense of just how low the currently proposed Tier 2 benefits are, we've prepared an example of Tier 2 pension amounts assuming that an employee retired with final compensation equal to current-year average pay in each retirement system (please see Attachment A for full analysis.) The results are distressing: a Federated employee with 30 years of service would have a pension so small that they would qualify as very low income under current-year affordable housing criteria for Santa Clara County. This to us is unacceptable and in no way qualifies as a dignified and livable retirement.

Some may respond that the 2nd Tier is set up to be a hybrid system, and can thus provide a richer benefit than just the pension numbers might suggest, but as we understand it the proposed charter language limits all retirement benefits, including any future 401k match, to 9% of payroll. The 9% cap is so low that it would likely allow little to no additional pre-tax contribution to an employee's retirement, even if it were in the form of a defined contribution match.

We shouldn't let the current crisis cloud the fact that we will need to provide fair and competitive retirement benefits for decades to come, through all phases of the business cycle. We believe that our proposed VEP and Tier 2 benefit levels are reasonable and sustainable; they will serve us in good times and in bad.

Ballot Arguments

We firmly believe that at the time at which the Council puts the measure on the ballot it should allow opposition arguments on the sample ballot, and authorize members of the Council to submit such arguments. Allowing dissenting voices to be heard is a basic tenant of democracy that we as democratically elected officials have a moral obligation to protect. On an issue as controversial as retirement reform, it would be especially irresponsible to attempt to stifle debate. We are a public agency, not a special interest group, and thus should provide as much opportunity as possible for elected officials and residents to be heard.

Conclusion

Some have suggested that those of us who express independent opinions on pension reform don't "get it." Rest assured, we "get" the need for pension reform, but we also get that running any large organization requires more than just adding up budget numbers. The City is an organization of values and of people. Our charge as elected officials is to be a light in dark times not just for the public whom we represent, but for the workforce whom we lead. In the process of dealing with this difficult issue of retirement reform, we believe that, on occasion, we have lost our way as leaders of the workforce. Not surprisingly, our employees are voting with their feet.

The good news is that even at this late hour we still have the power to lead. We ask for your support in allowing more time for negotiation and crafting a ballot measure that we can be proud of today and ten years from now.

Attachment A

Example Pension Amounts Under Current 2nd Tier Proposal¹

Assumptions:

- 1.5% Formula and
- Final Compensation Equal to Average Pay

Years of Service	Federated (final comp assumption: \$69,869 ²)		Police and Fire (final comp assumption: \$109,954 ³)	
	Yearly Pension	Income Category ⁴	Yearly Pension	Income Category ⁴
20 years (30% of final comp)	\$20,960	Extremely Low Income	\$32,986	Very Low Income
30 years (45% of final comp)	\$31,441	Very Low Income	\$49,479	Low Income
40 years (60% of final comp)	\$41,921	Low Income	\$65,972	Median Income

For reference purposes, here's the table we used to determine income category:

Affordable Housing Income Eligibility Criteria 2011⁵

INCOME LEVEL	HOUSEHOLD SIZE							
	1	2	3	4	5	6	7	8
Extremely Low Income	21,800	24,900	28,000	31,100	33,600	36,100	38,600	41,100
Very Low Income	36,300	41,450	46,650	51,800	55,950	60,100	64,250	68,400
Lower Income	55,550	63,500	71,450	79,350	85,700	92,050	98,400	104,750
Median Income	72,500	82,900	93,250	103,600	111,900	120,200	128,450	136,750
Moderate Income	87,000	99,450	111,850	124,300	134,250	144,200	154,150	164,100

¹ Please note that amounts are an example of one possible benefit scenario intended to give a general sense of benefit levels

² Equal to average pay for Federated members. Source: Cheiron presentation on the June 30, 2011 actuarial valuation of the Federated Retirement System, Page 4 (item 5.1 for the November 17, 2011 Federated Retirement Board meeting)

³ Equal to average pay for P&F members. Source: Cheiron presentation on the June 30, 2011 actuarial valuation of the Police and Fire Retirement System, Page 28 (item 3.1 for the December 1, 2011 Police and Fire Retirement Board meeting)

⁴ In the interest of simplicity we assume a household size of one person

⁵ Source: Housing Department Website: www.sjhousing.org/data/eligible.html