CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

RULES COMMITTEE: 6-15-05
ITEM: C(1)(a)

Memorandum

TO: RULES COMMITTEE

FROM: Alex Gurza
Betsy Shotwell

SUBJECT: SEE BELOW

DATE: June 13, 2005

Approved Deanna J Santana Date 6-14-05

THE STATUS OF STATE PENSION REFORM LEGISLATION INCLUDING ASSEMBLY CONSTITUTIONAL AMENDMENT 5 (RICHMAN): PUBLIC RETIREMENT SYSTEMS

RECOMMENDATION

Recommend that Council direct staff to continue to monitor and work with the League of California Cities, the Governor's administration and the Legislature to promote pension reform legislation to address the City's priorities for reform. These priorities include:

- Stabilization of the City's contribution rates;
- Reducing the long-term cost of its retirement benefits;
- Maintaining authority to manage its retirement benefits through the collective bargaining process.

Efforts to reform pension systems should focus on cost containment while providing adequate benefits for City employees and maintaining the City's ability to manage its own current retirement systems and their fiscal integrity.

BACKGROUND

On March 2, 2005, the Rules Committee directed staff to analyze the provisions of ACA 5 and to return to the Rules Committee with a recommendation for a City position.

As proposed, ACA 5 would have amended the California Constitution to establish the California Public Employee Defined Contribution Plan. The measure would have required all state, school and local public employers (including a charter city or county) to offer new employees hired on or after July 1, 2007 defined contribution retirement plans only. The measure would have also allowed current public employees the option of transferring money from their existing defined benefit retirement plan to the employer-sponsored defined contribution plan offered to new employees.

Since the Rules Committee referral, the Governor's original pension reform proposal has been pulled back, and revised. Most recently the Legislature considered ABX1 3 (Richman), and ACAX1 8 (Richman). (X1 denotes first, extraordinary session). These measures, if passed by the Legislature and approved by the voters, would have amended the State Constitution to establish the California Public Employee Defined Contribution and Hybrid Plans, prohibit newly hired public employees from enrolling in a defined benefit plan beginning July 1, 2007, and make various changes to the laws governing public employee retirement systems as specified. ABX1 3 and ACAX1 8 failed to pass the Assembly Public Employee, Retirement and Social Security Committee meeting in the first extraordinary session.

The Legislature, both in the regular session, and the first extraordinary session, has held hearings to study and analyze pension reform issues. The relevant policy committees have approved three Assembly and four Senate pension reform bills relating to public pension plans, (ABX1 4 (Torrico), ABX1 5(Torrico), ABX1 6(Evans), SBX1 2 (Dunn), SBX1 3 (Speier), SB 4 (Soto), and SBX1 5 (Ducheny). The Democratic sponsored proposals address rate stabilization, benefit manipulation, preventing abuses of disability retirement, and protection of workers and retirees in public service while bringing general fund stability that the State budget needs. Administration-supported legislation which would have revised the Governor's original pension reform proposal has been defeated in committee including the two bills authored by Assemblymember Richman as referenced above, ABX1 3 and ACAX1 8.

Unlike the initiative process, the introduction of pension reform related legislation does provide the opportunity for local government to work with the Legislature and the Governor's administration to resolve major policy issues and potential substantial cost implications for local agencies. There continues to be disagreement on those issues that could lead to substantial cost or savings for local government and potential for litigation. Lack of an agreement on an acceptable pension reform package could result in Governor Schwarzenegger calling for a second special election in 2006.

ANALYSIS

A review of the competing pension reform proposals has identified potential costs and policy implications which must be addressed to achieve the desired pension reform. The degree of controversy and complexity of the issues combined with the political landscape increases the pressure to achieve agreement.

As an example, proposed pension reform measures purport to preempt the City's authority over its independent defined retirement benefit plans. The City of San Jose currently has the power to make and enforce all laws and regulations in respect to municipal affairs subject only to such restrictions and limitations as may be provided in the Charter and in the

Constitution of the State of California. Under Section 1500 of the City's Charter, the Council is required to provide, by ordinance or ordinances, for the creation, establishment and maintenance of a retirement plan or plans for all officers and employees of the City. The Charter establishes minimum requirements for certain employee retirement benefits, including the requirement that such benefits be paid on a defined benefit basis.

In addition, enhancements to the minimum retirement benefits have been negotiated through the collective bargaining process in order for the City to recruit and retain skilled and highly qualified workforce. For these reasons, and with local and state government retirement costs escalating, the City of San Jose, as a Charter City, should retain the right to determine the retirement benefits for its employees through the collective bargaining process. However, significant concerns do exist with respect to the escalating cost of providing retirement benefits. In recent years government agencies, including the City of San Jose, have enhanced their defined benefit plans, while the private sector has been moving towards defined-contribution programs (such as 401(k) plans). The City recognizes that it needs to reduce its retirement costs. In the fiscal year 2004-2005, the City paid $100.6 million in retirement contributions. Currently non-public safety employees covered by the Federated City Employees' Retirement System contribute 6.06%, and the City contributes 17.12%. Public Safety employees covered by the Police and Fire Department Retirement Plan contribute 11.16% and the City contributes 24.59%. These contributions are expected to increase even if there are no further retirement benefit enhancements.

The Santa Clara County Civil Grand Jury reviewed the financial impact of defined-benefit retirement plans on the County of Santa Clara and the City of San Jose budgets. In May 2004, the Grand Jury made the following Finding: "The San Jose and County governments have negotiated generous pension programs that have an increasingly large negative impact on their budgets. These defined-benefit programs rely on future increases in the financial markets to pay pension benefits. The government is responsible for any shortages in fund performance." On January 11, 2005, in a response to this finding, the Mayor and Councilmembers agreed and recognized that the costs of the City's retirement systems are projected to escalate over the short term. The City continues to develop strategies that will mitigate the potential further escalation of the cost of retirement benefits.

CONCLUSION

For cities' public pension systems, the League of California Cities (LOCC) Board of Directors voted in March to accept a report from the LOCC's Pension Reform Task Force that highlighted specific ways to stabilize the cost of California Public Employees Retirement System (PERS) and other defined benefit retirement systems. This report is available at the LOCC 's website, www.cacities.org. LOCC representatives have met with the Governor's staff to discuss the LOCC's proposals and it is likely that we will see discussions occurring over the next several months as various proposals are considered. According to the LOCC, key issues to be addressed include long term cost savings, reducing the financial risk of pension systems to taxpayers, and reform of the disability payments system.

As the public pension reform debate continues, the City must work towards achieving the following:

- Stabilization of the City's contribution rates.
- Reducing the long-term costs of its retirement benefits.
- Maintaining authority to manage its retirement benefits through the collective bargaining process.

If proposed legislative changes for new employees retirement plans were to pass into law, the City would still have to maintain the current systems for existing employees and pay the promised benefits. This raises concerns about what actual cost-savings there might be and an analysis of impacts to the City would need to be done regarding this issue.

It is recommended that the City continue to monitor pending pension reform related legislation and work with the LOCC in order to ensure that if legislation is ultimately passed and signed by the Governor it will maintain the City's authority to manage its retirement benefits through the collective bargaining process, maintain a skilled, highly qualified workforce, while enhancing the City's ability to stabilize pension contribution rates and reduce the long-term costs of its retirement benefits.

COORDINATION

This memorandum was coordinated with the Office of Employee Relations, the Department of Employee Services, City Attorney's, Office the Director of Intergovernmental Relations and the City's Legislative Representative in Sacramento.

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