Agenda Item 4A

CITY OF NEWPORT BEACH
FINANCE COMMITTEE STAFF REPORT

December 12, 2011

TO: HONORABLE CHAIR AND MEMBERS OF THE COMMITTEE

FROM: Finance Department
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SUBJECT: **PERS: Analysis of Pension Reform & Fiscal Sustainability**

ABSTRACT:

Staff presented the latest PERS valuation dated 6/30/2010 to Finance Committee on November 7, 2011. The annually required contribution rates and changes in the PERS valuation were discussed. The committee requested staff to return with additional analysis on total dollar cost of pensions and how much, in dollars, the City is paying and how much the employees are paying. The committee also asked to see, in dollars, the impact of previously approved fiscal reforms (Early Retirement Incentive Plan "ERIP", cost sharing with employees).

BACKGROUND:

The City contributes to the California Public Employees Retirement System (PERS) to provide retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Newport Beach has always paid the Annually Required Contribution (ARC) as calculated by PERS, and even then we have an estimated unfunded pension liability of $256.5 million, on a market value basis, as reported in the most recent actuarial valuation dated June 30, 2010. This represented a ($6.4) million decrease from the year before. Total market value of pension assets was $395.3 million; this equates to a funded status on a market value basis of 64.9%. Some standards set a healthy funded status at 80% or higher.

There are multiple reasons for the unfunded liability, but the primary factors are the 2008 market losses experienced during the Great Recession and enhanced benefit formulas given without corresponding cost sharing by employees.

Our City Council has been a leader in fiscal sustainability and pension reform among municipalities, and this was made clear in 2010 with the adoption of the City's 15 point-Fiscal Sustainability Plan.

> "Point #13: *The City will work in partnership with its employees to ensure fair compensation and that costs related to pension and other benefits are appropriately allocated between employer and employees."*

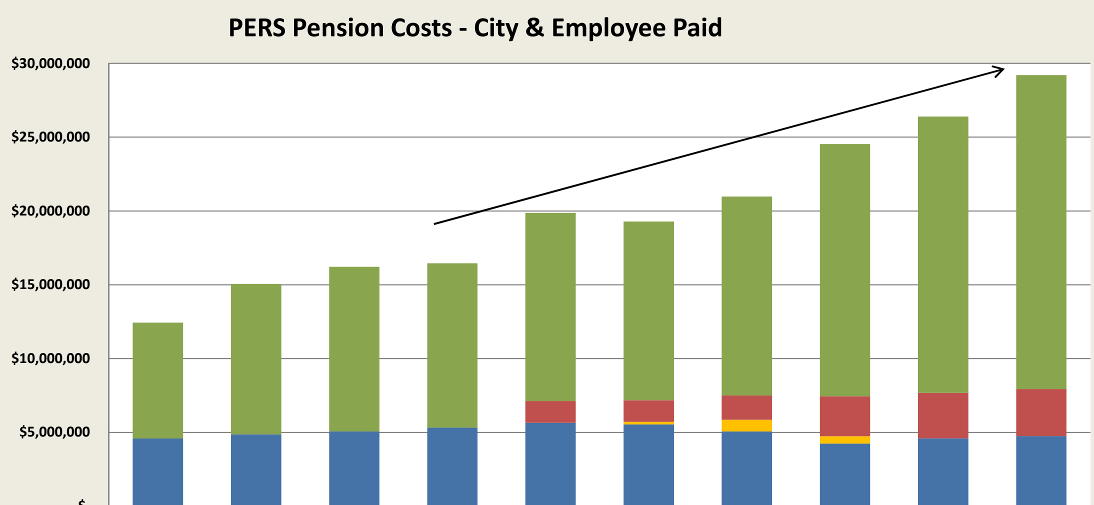
Two important items to address before discussing specific reform actions approved by Council, and their dollar impact on pension costs:

1) The valuation is dated June 30, 2010. The City has no control over the timing of the reports, and the schedule is obviously stale. The fiscal sustainability and pension reform changes approved by Council began in October 2009; therefore, this report does not include many of the benefits from changes already approved by Council.

2) The City has worked with PERS to project dollar amounts of reforms past and future and we will discuss the cost savings of actions past so as not to jeopardize current labor negotiations.

Pension Costs – City Paid vs. Employee Paid

Total PERS costs are projected to be $29 million by FY 2014, with the City expected to pay $26 million and miscellaneous employees paying $3 million.



Fiscal Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Total Payments to PERS (ER & EE)	$12,441,624	$15,064,213	$16,207,423	$16,453,906	$19,872,003	$19,115,311	$20,161,194	$24,035,497	$26,390,890	$29,193,547
Total City Paid	$12,441,624	$15,064,213	$16,207,423	$16,453,906	$18,405,078	$17,648,479	$18,520,608	$21,316,822	$23,308,898	$26,011,390
Employer	$7,858,785	$10,191,613	$11,148,523	$11,124,682	$12,749,804	$12,112,032	$13,466,314	$17,076,812	$18,708,442	$21,261,419
Employee Misc (Contribution)	0	0	0	0	$1,466,925	$1,466,832	$1,640,586	$2,718,675	$3,081,992	$3,182,157
Employee Safety (Contribution)	0	0	0	0	0	$173,224	$804,416	$496,935	$-	$-
EPMC	$4,582,839	$4,872,600	$5,058,900	$5,329,224	$5,655,274	$5,536,447	$5,054,294	$4,240,011	$4,600,456	$4,749,971

The City payment of $26 million is further broken down by bargaining unit; $8.2 million, 31.5%, attributable to miscellaneous employees and $17.8 million, 68.5%, for the public safety employees.

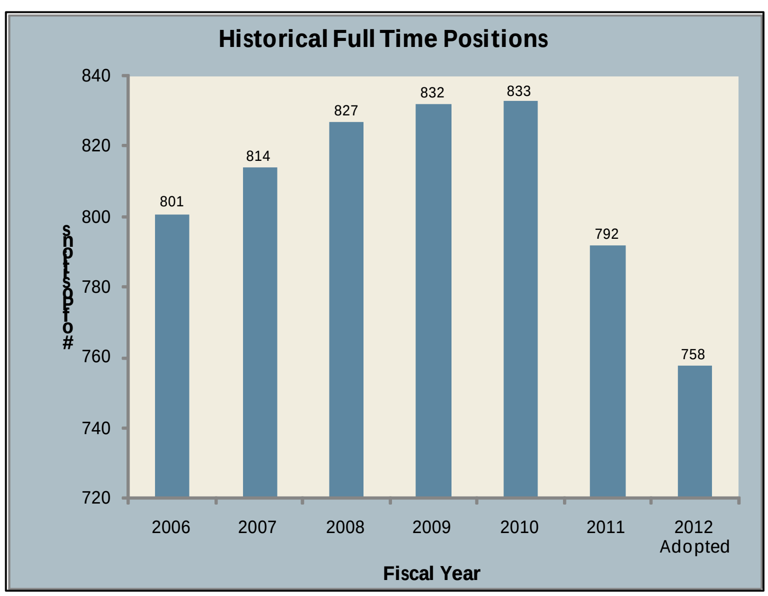
Public safety employees are approximately 35% of the workforce, but they have a more expensive formula than miscellaneous employees. There was not an offsetting cost sharing agreement with safety employees when the 3%@50 plan was approved in FY 2001, FY 2008, and FY 2009. The miscellaneous employees received a benefit enhancement in FY 2008, and agreed to a cost sharing arrangement of 3.42% to offset the increased cost to the City. In later negotiations, miscellaneous units increased their contributions to 8%, this was phased in over 18 months and will be fully implemented by January 2012. *[Note, there are approximately 90 miscellaneous employees represented within the safety MOUs. These miscellaneous employees are currently paying the 3.42% as approved in FY 2008, but are not subject to the same 8% required in the other MOUs.]*

The primary reason for the pension costs rising between FY 2012 and FY 2014 is attributable to the PERS FY 2008/09 market losses, a -25% loss in one year. In dollars, this equates to a **-$125 million loss** in the City's pension assets in a single year. Due to the late timing of the valuations, FY 2012 was the first year of loss recognition related to the 2008/09 market decline. Over the three-year period (FY 2012-FY 2014) this will cause an increase to the City's cost of $6 million.

ERIP

In October 2009, the City Council approved Resolution 2009-73 authorizing an ERIP to eligible employees. Conditions of the approval required the program to meet the immediate and future fiscal, managerial and operational goals of the City to help mitigate declining General Fund revenues, and institute long-term structural changes to avert future budget shortfalls and ensure fiscal sustainability.

A total of 51 employees, non-safety, participated in the program. After considering the costs of implementing the ERIP, approximately $950,000/year for five years, the net savings is approximately $3 million/year and is recognized as cash savings from reduced payroll costs. This was the beginning of a significant city-wide restructuring effort resulting in a reduction in the workforce as illustrated in the chart to the right.



The long-term benefit of saving $3 million/year on payroll costs has a complicated impact on our PERS valuation; our actuary was not able to calculate the impact numerically, but we will attempt to discuss next. The increase of 51 ERIP retirees in FY 2010 represented an 8.5% increase over the assumed rate of retirees in earlier valuations. This resulted in an increase to our unfunded liability in order to amortize this unexpected increase in new benefit payments as well as the reduction of pension contributions for the retirees that would have been made had they not left employment early. The investment returns for FY 2010 were offset by the impacts of the ERIP and cause our liability, and our miscellaneous contribution rates, to increase this 2010 valuation year. While these retirees are collecting benefits sooner and most likely longer than assumed, they are also collecting a reduced benefit payment as they have reduced their years of service and potentially their one high year of salary. The actuary was not able to provide a numerical value as stated earlier, but this is long term savings that will offset the initial increases to the liability and rates.

Miscellaneous Employees – Pension Cost Sharing

In March 2008, miscellaneous employees received an enhanced benefit, 2.5% @ 55; in exchange they agreed to pay 3.42% of their pension costs, "Optional Benefits: Cost Sharing agreement dated March 15, 2008". This was split between the employer and employee rate but equates to 3.42% of pensionable salaries, or $1.5 million per year paid by employees. This cost sharing agreement applies to all miscellaneous employees including those represented by public safety unions.

During FY 2010, Council adopted the Fiscal Sustainability Plan which documented their desire to work in partnership with all employees on sharing the cost of pensions. The Miscellaneous Bargaining Units and Council negotiated and adopted new agreements which increased the miscellaneous employee's contribution toward retirement to equate to the employee rate of 8%. This was phased-in over three periods and is fully implemented this January 1, 2012. The additional contributions will provide $1.7 million in additional pension costs paid by employees. [Note: these agreements do not apply to the 90 miscellaneous employees represented by the public safety unions.]

As mentioned earlier in the report, this combined contribution by miscellaneous employees represents $3.2 million in payments once paid by the City and now being shared by the employees.

Public Safety Bargaining Units – Pension Cost Sharing

Also during FY 2010, Council partnered with the Fire Bargaining Unit to discuss pension cost sharing in accordance with the Fiscal Sustainability Plan. Fire employees agreed to contribute toward pension by reimbursing the City costs equal to 3.5% of their base pay; this was approximately $175,000 in FY 2010 – partial year.

In FY 2011, police and remaining fire employees (safety only) also began to contribute the 3.5% of base pay as a reimbursement to the City for pension costs. This was $800,000 for the full year. The public safety union contracts expire 12/31/2011; in an effort to be conservative we have removed the 3.5% base pay contribution in our analysis today.

In closing, like almost all government agencies, the City's pension costs have increased significantly in the past decade. This is the result of enhanced benefits without corresponding cost sharing agreements with employees, dramatic market losses, and a host of other factors. Newport Beach has been quick to address this issue in combination with its commitment to Fiscal Sustainability. While we have made significant strides toward ensuring our fiscal strength, we obviously have to continue to work with employees toward pension reform so we can also have a sustainable pension plan.

Prepared by:

/s/ Tracy McCraner
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