

JOINT INITIATIVE PUBLIC POLICY PROJECT

PENSION & BENEFIT REFORM AGENDA

Two Tier Retirement System

Establish two-tier retirement and benefits system for Federated Employees.

Reduce Pension Spiking

Reduce “spiking” by returning to 36-month average, instead of 12-month average.

Increase Employee Contribution

Gradually increase employee contributions for Pensions & Health benefits.

Public Vote for Pension Bonds

Amend the City Charter to require public vote for Pension Obligation Bonds.

Hiring Freeze

Implement an immediate hiring freeze on Federated/non-public safety personnel until pension reforms are completed.

POLICY RECOMMENDATIONS:

The city should seek similar concessions from the other city union groups to ensure that new employees are hired with benefit levels comparable to what was in place in the mid-1990s or limitations recently proposed by Governor Arnold Schwarzenegger (R).

For federated city employees (city employees other than police and fire), the city allows retirement at age 55 with five years of service and at any age with 30 years of service. The city provides 2.5% per year with a cap of 75% of maximum annual salary.

As mentioned earlier in this report, beginning in July 1, 2001 Federated City Employees “final compensation” for purposes of calculating pension benefits was changed to be based on the average monthly salary for the previous twelve months of employment. Prior to July 1, 2001 “final compensation” was based on an average of the previous three years of employment.

The city should increase the retirement age for both classifications, reduce the retirement factor, and base pension benefits on the average of the highest three years of salary.

Under the governor’s proposed reforms, federated city employees on the first tier would be given 2.4% at age 63 or 2% at age 60. The second tier would be given 1.25% at age 65. Summary of pension/benefit reforms for new Federated City Employee hires:

► **Increase Federated Employee Pension Contributions and Reduce City Pension Contributions.** For federated city employees, employees contribute 8.93% of base salary and the city contributes 23.56%. The gap between these contribution rates should be reduced.

► **Enact Second Tier Health Benefits for Federated Employees:** As mentioned above, Gurza said the city should consider a second tier of health benefits for new hires because the city currently provides “very generous benefits.” This should include increasing co-payments and employee contribution levels, and reducing maximum allowable expenses for certain benefits.

► **Link Cost-of-Living Adjustments to the Consumer Price Index.** Retirees are currently granted a 3% annual automatic cost-of-living adjustment. The city should return to the old system which tied cost of living adjustments to the consumer price index which is more reflective of the actual increase in the cost of living.

Additional Policy Recommendations

Form a Pension/Benefit Blue-Ribbon Commission or Working Group To Propose a Plan To Reduce Public Employee Pension and Health Benefit Costs. San Diego, San Francisco and the city managers of San Diego County all formed groups to examine pension costs and propose reforms. The City of San Jose could form a working group or blue-ribbon commission to try to propose a reform plan.

Institute a Hiring Freeze on the Hiring of New City Employees. The City of San Diego recently implemented a hiring freeze on the hiring of new city workers, including police and fireman. The City of San Jose could consider implementing a similar hiring freeze to contain costs.

Enact Health Benefit Reforms. A June 2009 report by the Office of the City Auditor recommended a number of reforms that the city should undertake to reduce the costs of employee health benefits for both current employees and retirees (<http://www.sanjoseca.gov/auditor/AuditReports/0906/0906.pdf>). The report recommends a number of administrative reforms, including processing terminated employees on a timely basis, collecting outstanding premium contributions from employees on leave and terminated employees, submitting eligibility reports to medical providers more often, improving employee training and coordination with the Finance Department, and preventing double-coverage.

Reevaluate Actuarial Assumptions of Current System. Both city retirement systems are based upon an unrealistic 8% annual return in the pension investment funds. This return assumption encourages risky investments to meet that number and results in placing taxpayers on the hook for bad investments. This annual rate of return and other actuarial assumptions such as health care costs need to be reevaluated in light of the recent stock market crash.

Enact Pension Board Governance Reform. The recently released report by Cortex Applied Research Inc. issued a number of recommendations to reform the governance of the city's two pension boards which would improve accountability and reduce overall costs. The report recommended enhancing the relevant expertise on the boards and reducing conflicts of interest, among other things. The report is available at: <http://www.sanjoseca.gov/auditor/AuditReports/0906/0906.pdf>.

Identify and Prefund Financial Obligations. The Governor's Public Employee Post-Employment Benefits Commission recommended that public agencies formally adopt a policy of prefunding post-employment benefit obligations and that the ultimate goal of a prefunding policy should be to achieve full funding. The City of San Jose should develop a prefunding plan and make it public. If the city does not establish a prefunding plan, it should clearly identify an alternative approach for addressing its pension liability and make public its reason for not prefunding.

JOINT INITIATIVE

PUBLIC POLICY PROJECT

PENSION REFORM TALKING POINTS

The problem: Public employee pension and benefits costs have skyrocketed in San Jose – driving up cost of service as well as fees/taxes that impact businesses and economic development.

Pension Facts & Justification:

- San Jose faces serious economic crisis: a \$78 million budget shortfall and \$50 million unfunded pension liability – and the long term issues are even more dire.
- The Federated City Employee Retirement System (FCERS) is dangerously underfunded In FY2008 FCERS system lost 27.3% of its value or \$694 million – and under the current system, taxpayers are forced to make up the difference.
- San Jose’s current unfunded pension liability of and unfunded retiree healthcare liability of \$1.65 Billion.
- San Jose is considering a \$100 million Pension Obligation Bond w/o a public vote. The city of San Francisco requires a public vote.
- An audit of pension payments during 2006-2007 found that over 133 pensions reviewed, the city was overpaying 10% (13 of 133), costing taxpayer \$1.5 million.
- Cortex study found SJ Pension Boards lacked expertise to manage pension relied on unrealistic returns and had insufficient protections against conflicts of interest.
- Cities throughout California are enacting reasonable pension and benefit reforms to stabilize funds, protect municipal finances and control costs.
- Since 2000, average pay for Federated employees have increased 38%.
- Since 2000, average cost for benefits have increase 110%.
- In 2001, the city changed the salary calculation for pensions from 36-month average to just 12-months, which dramatically raised pension levels.
- That same year, the city increased cost of living increases from CPI to 3%.
- Public believes public safety should be treated differently/separately.
- 66% of the public favors *pension reform* to reduce costs.
- Voters believe unions have too much power 53% to 35%.

The Solution: San Jose needs to consider (separately) changes in Federated City and Public Safety pension programs to avoid fiscal disaster and ensure viability of pension funds. Pension reforms for Public Safety will be addressed in a separate paper/program.

Recommended Proposals:

1. Establish two-tier retirement and benefits system for Federated Employees.
2. Reduce “spiking” by returning to 36-month average, instead of 12-month average.
3. Gradually increase employee contributions for Pensions & Health benefits.
4. Amend the City Charter to require public vote for Pension Obligation Bonds.
5. Implement an immediate hiring freeze on Federated/non-public safety personnel.
6. Work with public safety leaders and union representatives on separate reforms to the Public Safety Retirement system.

September 2009

Public Employee Pension/Benefit Reform in the City of San Jose.

Executive Summary

Since 1999 the City of San Jose has granted generous enhancements to public employee pensions and health benefits, particularly for police and firefighters, that the city can no longer afford. This paper seeks to outline the problems with the current pension benefit system in the City of San Jose and provide the policy justification for enacting a series of reforms.

Recent media reports indicate that the city's projected budget deficit for next year is projected to climb to more than \$78 million and the deteriorating stock market could force taxpayers to contribute an additional \$50 million next year to cover losses in the city's retirement funds.

The city's long-term revenue picture is even worse—projecting that city taxpayers will be forced to pick up tens of millions of dollars every year in out-of-control pension costs as far as the eye can see. City documents project that the growth in public employee pension and health benefit costs will significantly outpace the growth in city revenues. Public employee pension and health benefit costs will eventually bankrupt the city and other state and local governments unless decisive action is taken to curb costs.

The State of California and many other local governments up and down the state have either implemented cost cutting reforms or are considering implementing reforms. This paper reviews how the state and other local governments have addressed out-of-control pension and health benefit costs and proposes a series of recommended policy actions to address the problem:

- ▶ **Form a pension/benefit blue-ribbon commission or working group to propose a plan to reduce costs.**
- ▶ **Implement a two-tier pension system that grants reduced pensions and health benefits for new hires while retaining the current system for existing employees.**
- ▶ **Increase employee pension contributions and reduce city pension contributions.**
- ▶ **Rollback pension benefits to Pre-1999 levels.**
- ▶ **Institute a hiring freeze on the hiring of new city employees.**
- ▶ **Enact pension board governance reform.**

Summary

- ▶ Description of Problem
- ▶ Background
- ▶ Summary of Problems with City's Current Pension/Benefit System
- ▶ Governor's Proposed Pension Reforms Stall But Local Governments Take Action
- ▶ Recommendations for Pension/Benefit Reform in the City of San Jose

Description of Problem

The current and projected costs for the City of San Jose public employee pension and retirement benefits are increasingly crowding out the city's ability to fund essential city services and provide for a healthy business climate. Such costs will ultimately bankrupt the city if the costs of the city's pension and health benefit system are not scaled back.

Background

Recent media reports indicate that the city's projected budget deficit for next year is projected to climb to more than \$78 million and the deteriorating stock market could force taxpayers to contribute an additional \$50 million next year to cover losses in the city's retirement funds.

But the long-term picture is even worse, with city officials saying that taxpayers will have to pay tens of millions of additional dollars into the city's two pension programs in the coming years to keep them solvent, according to the San Jose Mercury News. An independent analysis by Cortex Applied Research, Inc. indicates that the city's contributions for the city's Police and Fire Department Retirement Plan are projected to climb to 50% of overall payroll by 2014-15, from the current rate of 28% under optimistic assumptions.

The recent decline in the stock market has led to a situation where the city's two retirement systems are severely underfunded. As of June 30, 2009, the Federated City Employees Retirement System (FCERS) is funded at 60% of total projected liabilities and the city's Police and Fire Department Retirement Plan is funded at 76% of total projected liabilities. From June 30, 2008 to March 31, 2009, the FCERS system lost 27.3% of its value or \$694 million while the police and fire system lost 25.6% of its value or \$452 million, according to the Cortex report. City taxpayers are currently on the hook to make up the difference in the years to come.

"We can no longer persist in the delusion that our taxpayers can afford the current level of employee benefits," said Councilman Sam Liccardo, who was appointed this year to serve as a trustee on the public safety retirement plan, according to a San Jose Mercury News report.

Alex Gurza, director of the city's Employee Relations Department, says the city has a great opportunity to enact cost savings reforms because every city bargaining unit has a contract negotiation up between now and the end of 2011. The chart on the next page summarizes the contract expirations that are approaching.

Summary of Contract Renegotiations through 2011

Bargaining Unit	Contract Expiration	FTEs*
International Union of Operating Engineers, Local No. 3 (OE#3)	04/17/2009	817
International Association of Firefighters (IAFF), Local 230	06/30/2009	739
Association of Building, Mechanical and Electrical Inspectors (ABMEI)	12/10/2009	57
International Brotherhood of Electrical Workers (IBEW), Local No. 332	03/06/2010	81
City Association of Management Personnel (CAMP)	06/30/2010	410
San Jose Police Officers' Association (POA)	06/30/2010	1375
Association of Maintenance Supervisory Personnel (AMSP)	06/30/2010	86
Association of Engineers and Architects, IFPTE, Local 21 (AEA) Unit 41/42/43	06/30/2010	236
Municipal Employees' Federation (MEF), AFSCME, Local No. 101	06/30/2011	2293
Confidential Employees' Organization (CEO), AFSCME, Local No. 101	09/17/2011	215
Total Represented Employees		6309

**Full Time Equivalents (FTE's) are the combined total number of budgeted full-time positions. For example, one full-time position equals one FTE. Similarly, two half-time positions equal one FTE. In addition, the FTE numbers presented are based upon the 2009-2010 Adopted Operating Budget.*

Source: City of San Jose

Summary of Problems with City's Current System

The recent stock market crash has highlighted the problems in the current system but the city's pension system was in trouble long before the recent economic turmoil began. In a nutshell, over the past decade the city followed the lead of the State of California and other California cities in granting overly generous pension benefit increases to public employees, particularly for police and firefighters.

State Government Sets a Dangerous Precedent. In 1999, the Legislature and Governor Gray Davis enacted SB 400 to retroactively and prospectively boost pension benefits for any employee who retired on or after January 1, 2000. SB 400 also enhanced the average monthly compensation formula used in computing retirement allowances and provided a cost of living retirement allowance increase for state and school retirees who retired prior to 1998.

Specifically, SB 400 established a new retirement benefit factor for state and local employees of 2% per year of service at age 55, increasing to 2.5% at age 63 and above. The new formula replaced the prior retirement factor which provided for 2% at age 60 for state employees. It also added a 3% at age 50 retirement contract option for state and local public safety employees. The formula replaced the prior formula for public safety employees which was 2% at age 50.

Two years later in 2002, the Legislature passed and the Governor signed two addition bills, AB 616 and SB 183, which expanded the definition of the State Safety retirement category to include many non-safety classifications and further enhanced the retirement benefit for employees in those classifications. The legislation extended the 3% at age 50 retirement formula to a number of non-safety classifications.

Local governments were given the option to opt into the enhanced retirement benefit formulas. Shortly thereafter, public employee unions representing state and local government workers successfully lobbied local elected officials in the City of San Jose and other cities up and down the state to approve the enhanced benefit levels.

Moving from 2% to 3% at retirement age resulted in a 50% increase in the pensions of public employees.

Employee Benefits for San Jose Police and Firefighters Have Increased Significantly Over the Past Decade: Over the last decade, City of San Jose police and firefighter pension benefits have been increased on several occasions. Overall, police and firefighter staffing increased a mere 3.4 percent over the past decade, but the city's cost for their pensions has risen 167 percent, to \$72.7 million in 2009, according to the San Jose Mercury News.

City of San Jose contribution rates for police have increased from 15.7% of payroll to 25.8% since 2000, according to the San Jose Mercury News. For firefighters, the city's contribution rate is now 28.3% of payroll. Employee contributions are less than half of what the city pays (12.4% of base salary for Police and Fire). The increase in the city's payout reflects a series of retirement enhancements either approved by the city council or awarded through binding arbitration. According to the San Jose Mercury News:

- ▶ The maximum police and fire pension was 80% of salary in 1996, but has risen twice since the year 2000 to 90% of annual salary. The 75-percent-of-salary maximum pension for other city employees whose contracts are not subject to binding arbitration has been unchanged since 1975.
- ▶ A 2007 arbitration award boosted pensions for firefighters who retired before logging 30 years of service required for the maximum pensions.
- ▶ In 2002, public safety retirees were given a more generous automatic 3% per year annual cost of living increase in their pension. The prior cost-of-living adjustment was based on the more modest consumer price index (CPI).
- ▶ In 2001, the San Jose City Council granted police and firefighters a benefit that pays bonus checks in years when the pension funds exceed their earnings targets even when the pension accounts are underfunded.
- ▶ In 2000, the maximum benefits for police and firefighters' surviving family members rose from 37.5% to 42.5% of the former employee's salary. The council also hiked medical benefits for retired officers and firefighters in 2000 and 2001.

The charts on the following pages summarize the benefit increases granted and the impact on overall pension benefit costs.

Police Retirement Formulas

Effective Date	Sept 1970	Feb 1996	Feb 2000	Jul 2006
Max. Benefit	75%	80%	85%	90%
Formula	Yrs 0-30: 2.5% per yr	Yrs 0-20: 2.5% per yr Yrs 21-30: 3.0% per yr	Yrs 0-20: 2.5% per yr Yrs 21-25: 3.0% per yr Yrs 25-30: 4.0% per yr	Yrs 0-20: 2.5% per yr Yrs 21-30: 4.0% per yr

Fire Retirement Formulas

Effective Date	Sept 1970	Feb 1996	Feb 2000	Jul 2007
Max. Benefit	75%	80%	85%	90%
Formula	Yrs 0-30: 2.5% per yr	Yrs 0-20: 2.5% per yr Yrs 21-30: 3.0% per yr	Yrs 0-20: 2.5% per yr Yrs 21-25: 3.0% per yr Yrs 25-30: 4.0% per yr	Yrs 0-20: 2.5% per yr At 20 Yrs, 3% per year

Source: San Jose Employee Relations Department

Police and Fire Department Retirement Plan

Time Retired	Average Annual Pension			Average Age	Average Years of Service
	Base	COLA	Total Pension *		
Last 5 Years	\$ 94,980.15	\$ 6,690.05	\$ 101,670.19	55.13	28.29
Last 10 Years	\$ 86,804.27	\$ 11,578.89	\$ 98,383.16	55.04	28.46
Last 15 Years	\$ 76,598.59	\$ 14,447.12	\$ 91,045.71	54.71	28.42
ALL	\$ 67,726.02	\$ 17,187.28	\$ 84,913.30	54.70	28.51

Notes: Data includes approved retirements as of November 17, 2009

Excludes Deferred Vested and Disability Retirements that do not meet the Service Retirement Eligibility Requirements below:

- 50 yrs old with 25 years service
- 55 yrs old with 20 years service
- 30 years service at any age

* Does not include the value of Retiree Healthcare Benefits

Source: City of San Jose

Police & Fire Department Retirement Plan
(Police Contribution Rates)

Effective Date	Total City Contribution Rate	Total Employee Contribution Rate
06/28/09	26.89%	12.96%
06/29/08	25.80%	11.96%
07/01/07	28.90%	11.67%
12/17/06	28.51%	11.67%
07/02/06	25.22%	11.26%
07/03/05	25.04%	11.16%
07/04/04	24.59%	11.16%
06/23/02	14.22%	10.25%
06/25/00	15.70%	9.79%

Source: Retirement Services Department

Police & Fire Department Retirement Plan
(Fire Contribution Rates)

Effective Date	Total City Contribution Rate	Total Employee Contribution Rate
06/29/08	28.31%	12.40%
07/01/07	25.61%	11.26%
07/02/06	25.22%	11.26%
07/03/05	25.04%	11.16%
07/04/04	24.59%	11.16%
06/23/02	14.22%	10.25%
06/25/00	15.70%	9.79%

Source: Retirement Services Department

Employee Benefits for Federated City Employees Have Increased, But More Modestly Than for Police and Firefighters: City employees included under the Federated City Employees Retirement System have received enhanced employee benefits but the increases have been more modest, according to the city’s Employee Relations Department.

Since 2000, the average total compensation of a full-time city employee has risen 53%--38% in salary and 110% in benefits, primarily health costs—from \$74,000 to \$112,000, according to the San Jose Mercury News.

Gurza confirmed that there have been two recent significant expansions of Federated Employee pension benefits since the system went into effect in 1975.

Effective July 1, 2001, the City Council changed the calculations of retirees’ pensions to based “final compensation” to be based on an employee’s highest average monthly salary during the previous 12 consecutive months. Prior to July 1, 2001 “final compensation” was based on highest monthly salary during the previous 36 months.

This change represents a significant increase in pension benefits in many cases and can lead to pension “spiking” know as the practice where employees take a higher paying management position for a few years to significantly increase their pension benefit.

In 2002, public employee retirees (both public safety and other city employees) were given a more generous automatic 3% per year annual cost of living increase in their pension. The prior cost-of-living adjustment was based on the more modest consumer price index (CPI).

The charts on the following page summarize the benefits for Federated Employees and the impact of the recent benefit expansions on overall pension costs.

Federated City Employees' Retirement System

Effective Date	July 1975
Max Benefit	75%
Formula	Yrs. 0-30: 2.5% per year

Source: San Jose Employee Relations Department

Federated City Employees' Retirement System

Time Retired	Average Annual Pension			Average Age	Average Years of Service
	Base	COLA	Total Pension *		
Last 5 Years	\$ 40,491.37	\$ 3,322.64	\$ 43,814.01	58.56	20.98
Last 10 Years	\$ 38,237.91	\$ 4,684.47	\$ 42,922.38	58.45	21.00
Last 15 Years	\$ 35,624.68	\$ 5,479.62	\$ 41,104.29	58.42	20.53
ALL	\$ 30,629.68	\$ 8,036.73	\$ 38,666.41	58.34	20.25

Notes: Data includes approved retirements as of November 17, 2009

Excludes Deferred Vested and Disability Retirements that do not meet the Service Retirement Eligibility Requirements below:

- 55 yrs old with 5 years service
- 30 years service at any age

* Does not include the value of Retiree Healthcare Benefits

Source: City of San Jose

Federated City Employees' Retirement System Contribution Rates

Effective Date	Total City Contribution Rate	Total Employee Contribution Rate
06/28/09	24.01%	9.35%
06/29/08	23.56%	8.93%
07/02/06	21.98%	7.58%
07/04/04	17.12%	6.06%
06/23/02	15.20%	5.08%
08/19/01	17.40%	4.96%
06/25/00	16.09%	4.76%
01/11/98	16.52%	5.31%

Source: Retirement Services Department

Both the police and fire and city employee retirement systems are based upon an unrealistic 8% annual return in the pension investment funds which encourages risky investments to meet that number and places taxpayers on the hook for bad investments. The city must make up the difference between what the pension funds generate, or lose in a given year, and the amount that it costs to provide employee benefits.

Pension Fund Governance Reform Needed: The Cortex study concluded that the “governance models of the retirement plans do not support the long-term effective management of the plans and therefore do not effectively serve the interests of the key plan stakeholders, i.e. members, retirees, and taxpayers,” according to city documents.

The study highlighted two major problems: 1) the governance models do not ensure that relevant expertise will exist on the retirement boards to effectively guide and oversee the retirements systems, and 2) the governance models do not ensure that the retirement boards will be free of significant conflicts of interests, thus allowing them to focus freely on the administration of the systems and the best interests of the members and beneficiaries.

Governor’s Proposed Pension Reforms Stall But Local Governments Take Action

In late July, Governor Arnold Schwarzenegger acknowledged the unsustainable costs of public employee pensions and proposed reform, but the California Legislature has yet to act.

The Governor proposed to adjust the unsustainable retiree pension formulas for new hires only, essentially setting up a two-tier system which would be estimated to result in savings of \$74 billion in reduced pension payouts and \$19 billion in reduced costs of retiree health benefits through 2040.

For new employees hired on or after July 1, 2009 the Governor’s proposal would:

- ▶ Return to the pre-SB 400 retirement formulas for public employees
- ▶ Repeal the SB 183 expanded definition of the State Safety retirement category
- ▶ Change the benefit formula for firefighters and highway patrol from 3% at age 50 to 3% at age 55
- ▶ Compute the final compensation for peace officers, firefighters, and highway patrol based on the highest three years instead of the highest one year.

Summary of Governor's Proposed Changes

Retirement Category	Current Retirement Formulas	Proposed Formulas
Miscellaneous - First Tier	2.5% at Age 63+ (2% at Age 55)	2.418% at Age 63+ (2% at Age 60)
Miscellaneous - Second Tier	1.25% at Age 65+	1.25% at Age 65+
Industrial	2.5% at Age 63+ (2% at 55)	2.418% at Age 63+ (2% at 60)
State Safety (Pre-SB183)	2.5% at age 55+	2% at Age 55+
Peace Officer	3% at Age 50+*	2.5% at Age 55+
Firefighter	3% at Age 50+*	3% at Age 55+
Highway Patrol	3% at Age 50+	3% at Age 55+

**SB 400 changed the formula to 3% at age 55, but 3% at age 50 was collectively bargained under the previous Administration.*

Source: Governor's Office

Many other California local governments are currently struggling to curb the skyrocketing costs of their public employee pension systems in the wake of the stock market crash. The two most notable cases are the City of San Diego and Orange County, which were both forced to confront their unsustainable pension costs to help avert bankruptcy.

Both cities have adopted similar cost-cutting pension reforms—a hybrid pension plan that combines a monthly retirement check with an individual investment account, according to a report in Calpension. The reforms would be classified as setting up a two-tier pension system because it would provide new employees with a less generous retirement plan, while leaving the pension plan for existing employees unchanged.

San Diego Reforms

Unions representing general employees (not police and firefighters) in San Diego agreed to the hybrid plans in recent weeks, according to Calpension. The hybrid plan is a compromise between a “defined benefit plan” where retirees receive a guaranteed monthly pension check regardless of how well funded their pension plan is and 401(k) investment accounts, known as a defined contribution plan.

The hybrid agreement in San Diego came about in the wake of a pension scandal in which the City created a blue-ribbon commission to investigate pension reforms. The unions only agreed to the reforms after the Mayor threatened to put the hybrid measure on the ballot. San Diego’s plan for new hires will not save much money in the initial years, but is estimated to eventually save \$22.5 million a year as the percentage of new hires increases. The city’s

retirement contribution for a new hire was cut nearly in half, dropping from 15.92% of payroll to 8.75%. The benefit for a 30-year employee retiring at age 65 would drop from 119% of final pay to 84%, according to the Calpensions report.

Pension costs continue to remain a major problem and hot issue in the City of San Diego. On September 18 the city of San Diego's retirement board rejected an accounting shift that would have reduced the city's payment to the pension fund by \$30 million next year by shifting pension costs to the future.

The city of San Diego is projected to have to make a record breaking \$225 million pension payment next year, according to a KPBS report. The city has recently implemented a hiring freeze to help cut costs. San Diego's Chief Operating Officer, Jay Goldstone says it would not be financially smart or fair to hire an employee and have to lay them off next year. The hiring freeze will include public safety departments, which represent over half of the general fund budget.

Orange County Reforms

The hybrid pension reforms adopted by the Orange County Board of Supervisors in late July are more ambitious and are likely to yield significant savings within the first few years. Orange County declared bankruptcy in 1994 after losing \$1.7 billion on risky securities.

The reform proposal creates a new tier for new employees and gives both new hires and current employees the option of choosing the existing defined benefit plan or new hybrid that combines a smaller defined benefit payment with a 401(k)-style individual investment plan. According to a report by the Los Angeles Times, the reform package is estimated to save at least \$10 million in the first year and more in future years.

The portion of the proposal which affects current employees requires the approval of the California Legislature. The bill, SB 752 (Correa), is currently on the Governor's desk.

Under the proposal, incoming employees as of March 1, 2010, would have the option to choose the older pension plan of 2.7% per year of service of the average of an employee's 36 months of highest salary at age 55, or 1.62% per year of service at age 65, which includes a 401(k)-style retirement account with up to a 2% matching employer contribution. Existing county employees would be given the option to move down to the new tier. The lower tier is expected to appeal to younger hires who want more take home pay and do not care as much about buying into the retirement system for the long term because they plan on changing jobs.

Action Taken by Other California Local Governments

Many other California cities and counties are currently in the process of discussing pension reforms, and some have already taken action. Given that current employee benefits cannot be touched unless renegotiated with the unions or the passage of state legislation allowing an opt-in to a second tier, the consensus has been to move to a two-tier system which provides less generous benefits to new hires.

San Diego City Managers Issue Report: The San Diego City/County Management Association, an organization formed by the city managers in San Diego County, recently issued a report recommending a second tier pension offering that could be implemented by the great majority of cities. The pension program would not affect existing city employees who have vested rights in the current pension program, but would only affect new employees hired after a certain date.

The study supports the continuation of the defined benefit pensions, as opposed to the defined contribution programs, but recommends a return to the benefit levels that were provided prior to 1999 and require workers to make annual payments to help fund their pensions, which is the norm in the private sector but rare in the public sector. The city managers' report concluded that the "defined contribution" 401(k)-style individual investment plan has a number of shortcomings such as high fees, lack of professional investment management, and lack of protection against stock market crashes, according to a Capitol Weekly report.

The city managers propose to give new hires the same benefits provided by their cities prior to the CalPERS-sponsored legislation, SB 400 in 1999. In the years that followed the enactment of that legislation, it became common for public safety officers to retire close to age 50 with almost a full salary under the 3% per year of service at age 50 plan, but "these benefits have proven to be unsustainable and need to be rolled back to more appropriate pre-1999 levels," states the report. The report proposes that public safety employees receive 2% per year of service at age 50 and that general employees receive 2% per year of service at age 60, as opposed to the current norm for general employees which is 2.5% at age 55, according to Capitol Weekly.

The city managers estimate that their two-tier plan would save 2% of payroll per year when a majority of employees are receiving the lower benefits. After 30 years, the savings are expected to be 5% of payroll.

The City of La Mesa was one of the first cities to take action to increase employee contributions, according to a report by Capitol Weekly. In July, firefighters in La Mesa agreed to contribute 9 percent of their pay to help fund their pensions and in August general employees agreed to contribute 8 percent. The public employees were given half of the money back in the form of a salary increase, but the city expected to save \$1 million a year.

In July, the Escondido City Council authorized the city manager to pursue overhauling the pension system by asking employees to contribute to their pensions, and by giving new hires less generous retirement benefits.

In September, the City of Long Beach recently reached a tentative deal for a police officer contract that mandates a reduced pension benefit for new police officers of 3% at age 55 if any three of nine agreed-upon police departments enact the formula and guarantees that the city and police officers' association discuss pension reform at any time with a specific re-opening date on March 1, 2011. The City of Long Beach has been projecting an \$11 million general fund deficit in the 2011 fiscal year, followed by a \$21.7 million deficit in the 2012 fiscal year—half of which is caused by the pension deficit, according to a report by the Long Beach Press Telegram.

The City of Bakersfield is currently considering pension modifications for new employees, but the public employee unions have mounted a stiff public relations campaign against change.

San Francisco Mayor Gavin Newsom established the Pension and Benefits Working Group to address pension costs following the July 16 release of a civil grand jury report titled “Pensions Beyond Our Ability to Pay,” which found that public employee pension costs are outpacing revenue growth. The city of San Francisco contributed about \$175 million to the pension fund for the fiscal year 2005-06, but contributions are projected to grow to \$544 million for the 2011-12 fiscal year, according to a report by the city controller’s office.

The report found that public officials and unions “negotiated extraordinary pension and retirement benefits...without consideration of the unfair financial burden placed on future generations,” according to the San Francisco Examiner. The Department of Human Resources Director Micki Callahan heads the group, which includes Supervisor Sean Elsbernd, City Controller Ben Rosenfield, retirement system director Clare Murphy and Newsom Chief of Staff Steve Kawa. The group is expected to invite labor union representatives to the table, according to the Examiner report.

On September 22, 2009, the City of Menlo Park held a public meeting for the City Council to consider a presentation on public employee salaries to set the stage for labor negotiations with two non-police unions scheduled to begin next month. City leaders decided to hold the meeting after dozens of residents sent messages questioning the wages and rising benefit costs of city employees. Some residents suggested that city officials initiate a two-tier pension system.