Beverly Hills Safety Employees Retirement Obligations

a Presentation of the Beverly Hills Pension Task Force

August 2, 2011
Introduction

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Purpose of the Task Force

• Safety employee pension obligations are one of the biggest long-term financial threats to Beverly Hills.
  – The political reality is: we cannot afford to perpetuate the current defined benefit pension plan.

• The City Treasurer organized a task force of citizens with financial and related backgrounds to:
  – Promote better community understanding of Beverly Hills pension obligations.
  – Quantify those obligations.
  – Estimate what our City can sustainably afford.
  – Recommend improvements.

• OPEB (Other Post Employment Benefits) obligations, the other major threat, were not addressed.
Who We Are

• Eliot Finkel, City Treasurer and founder of Eliot Finkel Investment Counsel, LLC
• Abner D. Goldstine, Deputy City Treasurer and Senior Vice President of Capital Research and Management Co.
• Eugene Krieger, Vice-Chairman and Chief Operating Officer of Shamrock Holdings, Inc.
• David A. Schwarz, member of the California Little Hoover Commission and Attorney with Irell & Manella, LLP.
• Joan B. Seidel, former City Treasurer and President of Morton Seidel & Co. Inc.

The views expressed herein are solely those of the task force members.
What We Did

Reviewed:
• Safety Employees Memoranda of Understanding (MOUs)
• Beverly Hills Comprehensive Annual Financial Report (CAFR)
• 2011-2012 City budget.
• California Public Employees Retirement System (CalPERS) documents.
• Stanford Institute for Economic Policy Research April 2010 policy brief “Going for Broke: Reforming California’s Public Employee Pension Systems.”
• California’s Little Hoover Commission February 2011 report entitled “Public Pensions for Retirement Security.”
• Remedies proposed by Long Beach, Santa Barbara, San Jose, Los Altos, Costa Mesa and other California cities.

Developed models and charts to clarify the issues.
Overview of the Issue

- Safety employee pension obligations are a major long-term financial threat to Beverly Hills.
- There is a need to develop a pension plan for our safety employees that is both fair to our safety employees and fair, sustainable and predictable for our residents.
- Safety employees did not cause the problem.
- State Government, CalPERS and prior City Councils all participated in bringing us to this point.
- No easy solutions though steps toward financial predictability and sustainability can be taken.
- California courts complicate the issue.
  - Consensual agreements with employees should be okay.
CalPERS History

• Predecessor “State Employees Retirement System” formed in 1932.
• In 1991, Governor Pete Wilson wanted to use pension funds to help cover a state budget deficit.
• Proposition 162, the "California Pension Protection Act of 1992," gave CalPERS board the sole and exclusive fiduciary responsibility over the assets.
• In the late 1990’s, after a decade-long bull market, CalPERS declared that:
  – The retirement fund was over-funded.
  – Further contributions would not be required for an indefinite period.
  – State and municipal governments should consider increasing benefits.
CalPERS History (cont.)

- In 1999, State Senate Bill 400 raised the permitted (not required) limit on safety employee retirement formulas to 3% per year of the final year’s salary, with a maximum of 90%, beginning at age 50 (3% at 50).
- In 2001, Beverly Hills raised it safety employees pension benefits from 2% at 50 to 3% at 50.
- Overly optimistic rate of return estimates led to significant underfunding with a subsequent rise in the cost to the taxpayer.
Conclusion: California public pension liabilities are substantially understated.

Recommendations:

• Adopt probability-based funding targets.
• Make contributions at “Normal Rate” without exception.
• Invest in less volatile assets (predominantly fixed income).
• Offer employees a hybrid system of both defined benefit and defined contribution (401k) plans.
Little Hoover Commission

An independent California watchdog agency created in 1962.


Conclusions:

• Pension costs will crush government.
• The math doesn’t work.
  – Retirement age dropping.
  – People living longer.
  – Benefits increasing.
  – Expected rate of return is unreasonable.
Little Hoover Commission (cont.)

Recommendations:

• Move to a sustainable Hybrid System - lower level defined benefit plan plus defined contribution plan.
  – Cap salary for defined benefit plan.
  – Set appropriate pension age eligibility.
  – Add defined contribution plan above salary cap.
  – Defined benefit computed only on base pay for final five years average pay.
Little Hoover Commission (cont.)

Recommendations (cont.):

• Improve transparency and accountability.
  – Modify CalPERS board to include a majority of independent, public members.
  – Submit all pension increases to the voters.
  – Present pension fund liabilities using a sensitivity analysis of high, medium and low discount rates.
Proposals by Other Jurisdictions

• Governor
  – Prohibit pension holidays wherein no contributions are made.
  – Prohibit employers from making employee contributions.
  – Prohibit retroactive increases.
  – Prohibit pension spiking.
Proposals by Other Jurisdictions (cont.)

- **Initiative 2012 – Center for Fiscal Responsibilities.**
  - Employers may not contribute to employee’s share.
  - Defined contribution only for new hires.
  - Benefits based on last 3 or more years compensation.
  - Two-thirds of trustees independent.

- **Assemblyman Roger Niello - ballot measure to:**
  - Set minimum retirement age at 62.
  - Cap retirement benefits at 60% average of highest three years.

- **Long Beach - Safety employees pay 50% of all pension obligations or face layoff of 20%.**
Proposals by Other Jurisdictions (cont.)

• San Jose Mayor proposed declaring a state of “Fiscal Emergency.”
  – Can amend contracts and benefits of employees going forward
    (already accrued benefits not affected).
• League of California Cities City Managers Pension Reform Action Plan:
  – Employees pay full 9% employee share.
  – 2-tier system for new hires.
  – Retirement benefit restricted to base pay.
  – 2% per year with maximum benefit of 65%
  – Minimum retirement age = 55

• GASB (Government Accounting Standards Board)
  – Use corporate bond return, currently 5.1%, for calculations.
# Beverly Hills Pension Obligations

## Average Employee Salaries

<table>
<thead>
<tr>
<th>Employees</th>
<th>Police Officer</th>
<th>Firefighter</th>
<th>Non-Safety</th>
</tr>
</thead>
<tbody>
<tr>
<td>128</td>
<td>79</td>
<td>468</td>
<td></td>
</tr>
<tr>
<td><strong>Average Base Salary</strong></td>
<td><strong>$93,600</strong></td>
<td><strong>$99,800</strong></td>
<td><strong>$55,100</strong></td>
</tr>
<tr>
<td><strong>Special Pays (Education, Assignment Bonuses)</strong></td>
<td><strong>$9,400</strong>*</td>
<td><strong>$8,400</strong>*</td>
<td><strong>$3,500</strong></td>
</tr>
<tr>
<td><strong>Overtime</strong></td>
<td><strong>$13,000</strong></td>
<td><strong>$23,500</strong></td>
<td><strong>$470</strong></td>
</tr>
<tr>
<td><strong>Other Benefit Cost (Medical, Dental, Etc.)</strong></td>
<td><strong>$23,200</strong></td>
<td><strong>$16,500</strong></td>
<td><strong>$13,500</strong></td>
</tr>
<tr>
<td><strong>City’s portion of the pension cost</strong></td>
<td><strong>$26,300</strong></td>
<td><strong>$27,600</strong></td>
<td><strong>$6,100</strong></td>
</tr>
<tr>
<td><strong>Employee portion of pension (currently paid by the City)</strong></td>
<td><strong>$9,300</strong>*</td>
<td><strong>$9,700</strong>*</td>
<td><strong>$4,700</strong></td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>$174,800</strong></td>
<td><strong>$185,500</strong></td>
<td><strong>$83,370</strong></td>
</tr>
</tbody>
</table>

* Currently included in final year salary for pension calculation.
# Beverly Hills Pension Obligations (cont.)

## History

<table>
<thead>
<tr>
<th>Liability in $ millions</th>
<th>Safety</th>
<th>Non-Safety</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1999</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Liability</td>
<td>$144</td>
<td>$88</td>
<td>$232</td>
</tr>
<tr>
<td>Overfunded</td>
<td>$19</td>
<td>$37</td>
<td>$56</td>
</tr>
<tr>
<td><strong>2009</strong> (latest available)</td>
<td>$313</td>
<td>$227</td>
<td>$540</td>
</tr>
<tr>
<td>Unfunded</td>
<td>($56)</td>
<td>($27)</td>
<td><em>(83)</em></td>
</tr>
</tbody>
</table>

* Additional funding needed to pay $83m unfunded liability in 16 years = $8.6m per year.
Beverly Hills Pension Obligations (cont.)

Annual Percentage Returns

<table>
<thead>
<tr>
<th>Period Covered</th>
<th>CalPERS</th>
<th>30-year U.S. Treasuries</th>
</tr>
</thead>
<tbody>
<tr>
<td>20-years</td>
<td>7.9%</td>
<td>9.75%</td>
</tr>
<tr>
<td>10-year</td>
<td>3.95%</td>
<td>7.08%</td>
</tr>
</tbody>
</table>

Current U.S. Treasury yield = 4.3%
### Beverly Hills Pension Obligations (cont.)

#### Pension Obligation for Safety Employees

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Actual</th>
<th>Projected</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2002-03</td>
<td>2010-11</td>
</tr>
<tr>
<td>% of Salary</td>
<td>6%</td>
<td>26%</td>
</tr>
<tr>
<td>Expense</td>
<td>$2.7m</td>
<td>*$9.2m</td>
</tr>
<tr>
<td>% of General Fund Revenues</td>
<td>2.5%</td>
<td>5.6%</td>
</tr>
</tbody>
</table>

* Includes additional cost of repaying unfunded obligations.
Cost Analysis

Many moving parts
• Retirement formula – 3% or less?
• Employee contribution – 9% or less?
• Maximum benefit – 90% or less?
• Basis for pension
  – Final year or multiple years
  – What is included (bonus, overtime, accrued vacation, etc.)
• Minimum retirement age – 50 or more?
• Expected rate of return on pension investments – 7.75% or less?
• Life expectancy – 79 or more?
• Defined contribution plan?
Cost Analysis (cont.)

Plan/Proposal Assumptions

- Age Hired: 20
- Life Expectancy: 79
- Starting Salary: Police = $76,268, Fire = $73,119
- Safety employees: Police = 128, Fire = 79
- Percent Annual Increase: 1.50%

<table>
<thead>
<tr>
<th>Plan</th>
<th>% Annual Benefit</th>
<th>Max Benefit</th>
<th>Retirement Age</th>
<th>Bonus included</th>
<th>Employee Obligation included</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current</td>
<td>3%</td>
<td>90%</td>
<td>50</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>California League of Cities Proposal</td>
<td>2%</td>
<td>65%</td>
<td>55</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>
Cost Analysis (cont.)

Current Plan vs. California League of Cities Proposal

<table>
<thead>
<tr>
<th>Rate of Return</th>
<th>Department</th>
<th>Contribution as % of Salaries *</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Plan</strong></td>
<td>7.75%</td>
<td>Police</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fire</td>
</tr>
<tr>
<td><strong>California League of Cities Proposal</strong></td>
<td>7.75%</td>
<td>Police</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Fire</td>
</tr>
</tbody>
</table>

* Excludes contributions for current unfunded obligations.
Recommendations

- Implement California League of Cities Proposal
  - Employees to contribute 9% employee pension obligation.
  - Pension benefits restricted to base salary.
  - Maximum benefit of 65%.
  - Increase in minimum retirement age to 55.
  - Pension benefits based on average of final three years salary.
  - Two-tier pension system for new employees.
  - Supplement defined benefit cap with defined contribution plan.
Recommendations (cont).

• Support reform of CalPERS governance.
  – Majority of board to be independent (not government workers).

• Use corporate bond return as basis of calculations (GASB).
  – Using 5.1% expected return would more than double annual obligations.

• Set overall City goal for safety employee benefit contributions.

• Alternative ways to reach target should be analyzed, compared and discussed with employee organizations.