Beverly Hills Safety Employees Retirement Obligations

a Presentation of the
Beverly Hills Pension Task Force

August 2, 2011

Introduction

- Purpose of the Task Force
- Who we are
- What we did
- Overview of the Issue
- CalPERS History
- Stanford Institute Policy Brief
- Little Hoover Commission
- Proposals by Other Jurisdictions
- Safety Employees Pension Obligations
- Cost Analysis
- Recommendations

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.**

Stanford Institute Policy Brief

Stanford Institute for Economic Policy Research - April 2010.

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.

<u>Public Pensions for Retirement Security - February 2011.</u>

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

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

*** Currently included in final year salary for pension calculation.**

Beverly Hills Pension Obligations (cont.)

History

Liability in $ millions		Safety	Non-Safety	Total
1999	Total Liability	$144	$88	$232
	Overfunded	$19	$37	$56
2009 (latest available)	Total Liability	$313	$227	$540
	Unfunded	($56)	($27)	*($83)

*** Additional funding needed to pay $83m unfunded liability in 16 years = $8.6m per year.**

Beverly Hills Pension Obligations (cont.)

Annual Percentage Returns

Period Covered	CalPERS	30-year U.S. Treasuries
20-years	7.9%	9.75%
10-year	3.95%	7.08%

Current U.S. Treasury yield = 4.3%

Beverly Hills Pension Obligations (cont.)

Pension Obligation for Safety Employees

	Actual		Projected		
Fiscal Year	2002-03	2010-11	2011-12	2012-13	2013-14
% of Salary	6%	26%	32%	33%	39%
Expense	$2.7m	*$9.2m	*$11.6m	*$12.3m	*$15.0m
% of General Fund Revenues	2.5%	5.6%	7.1%	7.3%	8.7%

*** 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%

Plan	% Annual Benefit	Max Benefit	Retirement Age	Bonus included	Employee Obligation included
Current	3%	90%	50	Yes	Yes
California League of Cities Proposal	2%	65%	55	No	No

Cost Analysis (cont.)

Current Plan vs. California League of Cities Proposal

	Rate of Return	Department	Contribution as % of Salaries *
Current Plan	7.75%	Police	15.0%
		Fire	14.9%
California League of Cities Proposal	7.75%	Police	6.1%
		Fire	6.5%

*** 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.