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CITY OF OAKLAND
AGENDA REPORT

2011 APR 28 PM 6:20

TO:	Office of the City Administrator
ATTN:	P. Lamont Ewell, Interim City Administrator
FROM:	Department of Human Resources Management
DATE:	May 10, 2011
RE:	**Informational Report From the City of Oakland's Department of Human Resources Management Outlining Potential Pension Rate Reductions Associated With Having A Two-Tier Retirement Plan**

SUMMARY

The California Public Employees' Retirement System (CalPERS), its Board of Administration and the City of Oakland entered into a contract effective September 1, 1970 making City of Oakland employees members of CalPERS. CalPERS is a defined benefit plan administered by the State and covers all non-uniformed employees hired after September 1, 1970, all uniformed employees hired after June 30, 1976, as well as former members of the Police and Fire Retirement System and Oakland Municipal Retirement System who opted into membership prior to the respective plan closures. The City contributes to CalPERS on behalf of its employees. The Plan offers a defined retirement pension and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries.

Since Fiscal Year 03/04, the City's annual cost for its CalPERS contribution has nearly doubled from $45M to an estimated $74.5M in FY09/10. The cost of the City's participafion in CalPERS has increased due to a growing retirement-age population, market trends, poor portfolio performance, and enhancements to the benefits the City offers.

The current CalPERS retirement formulas for City of Oakland employees are 2.7% @ 55 for Miscellaneous employees and 3% @ 50 for Safety employees (sworn police and fire). California Government Code Section 20475, *Different Level of Benefits*, allows contracted agencies to amend its contract to provide a different level of retirement benefits for new employees - those who become employed for the first time after the effective date of the contract amendment or former members who return to service and elect to redeposit withdrawn contributions prior to 90 days after returning to service. Former employees who did not withdraw contributions and existing members retain the current benefit 2.7% @ 55 for Miscellaneous employees or 3% @ 50 for Safety employees (sworn police and fire). An agency may amend its contract for this section only once every three (3) years with respect to each category of employees (Miscellaneous and/or Safety).

FISCAL IMPACT

This report is informational and has no fiscal impact in and of itself. However the information presented provides options that the City may consider to reduce pension rates that in turn will result in cost reductions over the long term. Cost reductions can only occur when new employees are hired who are not members of CalPERS. The City is currently planning for significant layoffs. The city will not experience costs savings, if former employees return to work who either have not withdrawn their CalPERS contribution or who repay their contribution prior to 90 days of re-employment. Therefore, actual cost projection cannot be reliably estimated, because there is no way to forecast the rehire rate of new employees.

BACKGROUND

On June 21, 2003, the City increased its benefits for Police to provide 3.0% of highest salary at age 50. On June 19, 2004, the City increased its benefits for Fire to provide 3.0% of highest salary at age 50 and increased its benefits for Miscellaneous employees, increasing retirement benefits to 2.7% of highest salary per year of employment at age 55. These changes in benefits to employees resulted in higher costs to the City and impacted the contribution rates that the City pays to CalPERS.

The current Employer Contribution Rates for FY ending June 30, 2011 are:

- Safety 28.1%
- Miscellaneous 19.9%

The Employer Contribution Rates for FY beginning July 1, 2011 will increase to:

- Safety 28.9%
- Miscellaneous 23.6%

Effective July 1, 2011, the Safety rate will include the Fire Cost Sharing agreement approved by Council in January 2010. This agreement authorizes sworn Fire members to pay an additional 4% on their employee rate for a total of 13%. The additional 4% is used to offset the employer cost for the 3% @ 50 benefit that became effective in 2003. The cost sharing agreement with Fire reduced the City's employer contribution safety rate by 1.415% effecfive July 1, 2011. The employer reduction was not the full 4% because the rate is based on a combination of Police and Fire employees. Police do not pay the additional 4%.

The following table includes three years of actual CalPERS Employer Contribufion rates and two years of projected rates as provided in the CalPERS Annual Valuation Reports and expected general fund payments to CalPERS for retirement benefits under the current retirement formulas. The Safety Payroll in FY 2012-2013 includes a negotiated 4% salary increase for sworn Police effecfive January 1, 2013 and assumes no salary increases for sworn Fire and Miscellaneous employees through June 30, 2014. The 1.415% cost sharing decrease is applied to the fiscal years ending 2012, 2013, and 2014 Safety Rate. CalPERS projections for both Miscellaneous and Safety are static assuming no staff growth or reductions.

	Safety 3% @ 50			Miscellaneous 2.7% @ 55			
Fiscal Year Ending	Rate [1][3]	Covered Payroll [2]	Contribution Amount [3]	Rate [1]	Covered Payroll [2]	Contribution Amount	Total Contribution
2010	27.9%	$146,388,385	$40,842,359	19.6%	$146,057,691	$28,627,307	$69,469,667
2011	28.1%	146,388,385	41,135,136	19.9%	146,057,691	29,065,481	70,200,617
2012*	28.9%	146,388,385	42,306,243	23.6%	146,057,691	34,469,615	76,775,858
2013*	29.8%	148,263,000	44,182,374	24.9%	146,057,691	36,368,365	80,550,739
2014*	32.5%	150,138,000	48,794,850	28.4%	146,057,691	41,480,384	90,275,234

(1) CalPERS' actual rate for FY 2010 - FY 2012; projected rates thereafter.
(2) Safety payroll projections are based on a negotiated 4% increase for Police effective January 1, 2013 and no increases for Fire and Miscellaneous over the projection period.
(3) The Safety Rates for Fiscal Years ending 2012, 2013 and 2014 include a reduction of 1.415% to recognize the Fire cost sharing.
(4) Based on 2011 Staffing level.

The current City contract with CalPERS includes the key benefits summarized below:

BENEFIT	GROUP 1 Miscellaneous	GROUP 2 Fire	GROUP 3 Police
Retirement Formula	2.7% at age 55	3% at age 50	3% at age 50
Employee Cost Sharing (PERL Section 20516)	--	4% (1)	--
Employee Contribution to Employer	8%	13% 9% + 4% (1)	0 (2)
Employer Paid Member Contribution (EPMC)	--	--	9% (2)
Final Compensation	Highest consecutive 12 months	Highest consecutive 12 months	Highest consecutive 12 months
Cost of Living Allowance (COLA)	2%	2%	2%
Post Retirement Survivor Allowance (PERL Section 21624/26/28)	Yes	Yes	Yes
Retired Death Benefit $500 (PERL Section 21620)	Yes	Yes	Yes

(1) Fire employees pay an additional 4% employee contribution which offsets a portion of the City's contribution rate for the 3% @ 50 benefit in addition to the 9% employee share.
PERL = Pubhc Employees Retirement Law
(2) Police will begin paying 2% of the employee contribution beginning July 1, 2013; the EPMC will be reduced from 9% to 7%.

Certain optional benefits may be added to the City's contract with CalPERS by amendment. Our contract with CalPERS includes optional benefits that increase the City's CalPERS Employer Contribution rate: One Year Final Compensation (Government Code Section 20042), and Post Retirement Survivor Allowance, (Government Code Sections 21624, 21626 and 21628) increase the City's contribution rate. The City has one optional benetit that reduces the City's Contribution Rate--Cost Sharing (Government Code Section 20516). Again, Cost Sharing results in a 1.415% reduction to the City's contribution rate. The full 4% rate reduction is not realized because Police are included in the Safety rate, but do not participate in the Cost Sharing program.

KEY ISSUES AND IMPACTS

Different Level of Benefits (Second Tier)

CalPERS offers member agencies three (3) additional retirement rate options for Miscellaneous employees and three (3) additional options for Safety employees (police and fire) to consider as shown in the table below. Note that the Employee contribution rate is reduced for certain refirement formulas.

CalPERS Retirement Formula Options/Corresponding Employee Contribution Rate			
Safety	**EE Rate**	**Miscellaneous**	**EE Rate**
2% @ 50	9%	2% @ 60	7%
3% @ 55	9%	2% @ 55	7%
2% @ 55	7%	2.5% @ 55	8%

With the exception of Cost Sharing, any changes to benefits will only impact employees hired after a CalPERS contract is amended.

Impact of Different Level of Benefits (Second -Tier) on Employer Contribution Rates

Implementation of a Second-Tier Pension Plan results in long-term cost savings. Exisfing employees retain the current benefit formula while new employees (as previously defined) are given a lesser benefit. The plan builds toward increased savings as the current workforce retires or separates from City employment for other reasons. A decrease in the City's Employer Contribution Rate occurs, as an increasing portion of the workforce receives the lesser benefit. An additional key unknowledgeable factor is the average entry age of the new employees. According to the CalPERS actuary, 85% of what matters when making adjustment to benefits, such as final compensation or post retirement survivor allowance, is the average entry age since that change affects the normal cost. Older employees work less years and as a result receive less retirement pay. If a second tier is adopted and an optional benefit is modified, we will have one blended rate. It will be set taking into account the employees remaining in the older tier (those who will continue to receive the final one year highest compensation and/or post retirement survivor allowance) and new employees who will have different benefits.

Actuarial valuations were requested from CalPERS to determine the reduction in the Employer Contribution Rate that can be realized by adding a second-tier formula benefit option for new hires. The projections are a good faith effort to characterize the magnitude of anticipated rate reductions at a point when all employees are covered in the new tier. If the Council adopted a second tier, CalPERS would recalculate their estimates.

CalPERS offers two options for the employer to consider when deciding how to set the rate—the Standard Method and the Temporary Second Tier Option.

Standard Method

Under the Standard Method of rate setting, there will be no immediate Employer Contribution Rate impact. However, the employer normal cost will decrease over time. There is always a 2 ½ year lag before a rate change is actually experienced, as compared to when the membership composition changed. The following chart demonstrates an example of the Employer second tier formula rate reductions, based on assumption that 1/10 of the employee population has been hired as new employees, effective June 30, 2011:

Miscellaneous				Safety			
Second Tier Option	7-1-11 Rate for 2.7%@55 Benefit	Ultimate % Savings to Employer Rate	*Cumulative Rate Reduction in Second Tier	Second Tier Option	7-1-11 Rate for 3% @ 50 Benefit	Ultimate Savings to Employer Rate	*Cumulative Rate Reduction in Second Tier
2% @ 60	23.6%	3.7%	0.37%	2% @ 50	28.9%	4.1%	0.41%
2% @55	23.6%	2.5%	0.25%	2% @ 55	28.9%	6.5%	0.65%
2.5% @ 55	23.6%	1.2%	1.12%	3% @ 55	28.9%	2.1%	0.21%

*Cumulative Rate Reduction assumes second tier employees represent 1/10 of total employees in old tier as of 6/30/11.

The rate reduction will occur gradually beginning on July 1, 2013 if there are second tier employees hired on or before June 30, 2011. For fiscal years 2013/2014 and beyond, the projected cumulative amount of rate reduction that can be expected from introducing a second tier is equal to the ratio of the City's second tier to the total plan payroll two and a half (2 ½) years earlier.

> ***Calculation Example: if 1/10 of the City's Miscellaneous members were in second tier on June 30, 2011 and the ultimate expected normal cost decrease is 3.7%, the cumulative rate reduction that can be expected by the 2013/14 fiscal year would be 1/10 x 3.7% = 0.37%.***

This method will be used annually to determine subsequent rate decreases. How quickly the ultimate rate decrease is achieved depends on how rapidly the new tier grows and the old tier is reduced. Given the composition of our current workforce, it is highly likely that a Safety second tier would produce rate reductions at a faster rate than Miscellaneous. Based on the current Police attrition rate, we are more likely to hire new employees as Miscellaneous hiring would more likely be based on returning laid off employees.

Temporary Second Tier Pool Rate Option

The Temporary Second Tier Rate Option allows the City to realize immediate savings for its new hires (as previously defined). Under this option, CalPERS creates a temporary second tier rate that the employer would pay. Using the 2% @ 60 rate for Miscellaneous, the Temporary Second Tier Rate is 20.591% compared to the July 1, 2011 Employer Contribution rate of 23.6% for 2% @ 55.

The Temporary Pooling Option is effective immediately upon amendment of the contract and it lasts for about two and a half (2 ½) years. *(Ex. Begin hiring second tier employees in FY 2010/11; the first annual valuation following that is June 30, 2011 so the temporary second tier rate would last until June 30, 2013.)* After the two and a half years, the actual rates for new hires, based on an actuarial analysis, are blended into a single rate. The reduced contributions made on behalf of the new second tier employees through June 30, 2013 will cause the blended rate to be slightly larger than it would have been under the Standard Method.

The following table illustrates the second tier rates under the pooled method compared to the July 1, 2011 rate for the Miscellaneous and Safety groups:

Miscellaneous				Safety			
Current Formula	**7-1-2011 Employer Contribution Rate**	**Second Tier Option**	**Second Tier Temporary Pooling Option Rates**	**Current Formula**	**7-1-2011 Employer Contribution Rate**	**Second Tier Option**	**Second Tier Temporary Pooling Option Rates**
2.7%@ 55	23.6%	2% @ 60	20.591%	3% @ 50	28.9%	2% @ 50	28.145%
		2% @ 55	21.806%			2% @ 55	26.950%
		2.5% @ 55	23.022%			3% @ 55	30.336%

*** These rates do not include the current cost sharing arrangement with Fire employees. Under the 2% @ 50 and 2% @ 55 formulas, cost sharing is not available. It is available for the 3% @ 55, but CalPERS would have to recalculate the rate.**

Impact of **Different** Level of **Benefits** (Second **Tier**) on Fire **Employee** Cost Sharing **Agreement**

Impact of Implementing Safety Employee Second Tier 2% @ 50 and 2% @ 55

If the City implements a second tier for the Safety group with a benefit that is less than 3%, Cost Sharing through a CalPERS contract amendment must be reduced to zero. Current Fire employees are sharing the cost to support the 3% @ 50 benefit. CalPERS law will not allow employees in the new tier who are receiving a lesser benefit to pay an additional contribution for a benefit they could never receive.

Impact of Implementing Safety Employee Second Tier 3% @ 55

If the City opts to offer the 3% @ 55 benefit as the Safety second tier, cost sharing could still occur. This is possible because new second tier employees will still be entitled to the same percentage benefit as the existing group, but at an older age. CalPERS will determine the maximum Cost Sharing rate if the 3% @ 55 benefit is selected.

ADDITIONAL ALTERNATIVES

Impact on **Employer** Contribution Rates **if Amending Other** Optional **Benefits**
Final Compensation – One Year Final Compensation to Three Years
The City's contract with CalPERS includes the most expensive option for calculating final compensation - The highest year (Government Code Section 20042). The one-year final compensation option allows the employee to select the twelve (12) highest paid consecutive months to calculate final compensation. The final compensation option of three (3) years uses the highest

average annual compensation earnable by an employee during the three consecutive years of employment immediately preceding the effective date of retirement. If the City opts to change to the average three years option, it would have the effect of lowering the employer rate to CalPERS.

According to information provided by CalPERS Actuarial Division, the estimated impact on the Employer rate based on the current formulas (3% @ 50 and 2.7% @ 55) if the City opted to change from the one year method to the three years method is:

- A reduction of approximately 1.1% off of the Safety employee rate and
- A reduction of approximately .7% off of the Miscellaneous employee rate.

With the exception of cost sharing, any changes to these benefits will only impact employees hired after the amendment date of the contract.

Post Retirement Survivor Allowance

The contract also includes a Post Retirement Survivor Allowance (Government Code Section 21624, 21626 and 21628) which, in general, allows employees, upon death after retirement, to provide a continued benefit to the surviving spouse or domestic partner, or if there is no spouse or domestic partner, to children up to age 18. Benefits may also extend to surviving parents under certain conditions.

CalPERS Actuarial indicated that the potential decrease in the rate based on the current formulas (2.7% @ 55 for Miscellaneous and 3% @ 50 for Safety) is:

- A reduction of approximately 1.7% off of the Safety employee rate and
- A reduction of approximately 1% off of the Miscellaneous employee rate.

Formal Cost Sharing

Cost Sharing under Government Code Section 20516 allows a contracting agency to share the cost of additional retirement benefits with the employees as a result of a written agreement with the employee group. Currently, we only have an agreement with Fire for this benefit.

Informal Cost Sharing

CalPERS law allows employees to informally Cost Share. This can be achieved through labor agreements and the CalPERS contract is not amended. When this occurs, it has the effect of reducing the City's actual contribution rate. However, the employees would not receive CalPERS credit for their increased contribution. From CalPERS' perspective, the City would still appear to be paying its normal share and CalPERS would have no involvement in the cost sharing decision.

Potential Savings by Implementing Change to Optional Benefits with no Change to the Retirement Formulas

The table below provides an example of the estimated impact the optional benefits described above have on the Employer Rate if the contract is amended and there is no change to the current retirement formulas.

Optional Benefits	Employer Rate Miscellaneous 2.7% @ 55 FY Ending 2012 (7-1-11 to 6-30-12)			Employer Rate Benefit Safety 3% @ 50 FY Ending 2012 (7-1-14 to 6-30-12)		
	With	W/out	% +/-[1]	With	W/out	% +/-
Formula Change from 1 Yr. Final Compensation to Avg 3 Yrs.	23.6%	22.9%	-.7%	28.9%	27.8%	-1.1%
Post Ret Survivor Allowance	23.6%	22.6%	-1.0%	28.9%	27.2%	-1.7%
Cost Sharing @ 4% (assumes that both Police & Fire and Misc. participate)	19.6%	23.6%	-4.0%	26.3%	28.9%	-2.6%

[1] Ultimate rate reduction when all employees are covered by the change.

The following table provides information on what the impact can potentially be on the Employer Contribution Rate if modifications are made to the optional benefits and second tier options are adopted for Miscellaneous and Safety. The information assumes that 1/10 of the employees are in the Second Tier as of 6-30-11, using the Standard Rate Method.

Miscellaneous

Current Retirement Formula	Employer Rate 7-1-11	Second Tier Formula Options	Impact on Rate +/- **	Avg. 3 Yrs Final Comp. % Impact +/-***	Post Ret Surv Allow % Impact +/-***	New Projected Rate Effective FY 13-14	Employee Contribution*
2.7%@55	23.6%	--	--	-.7%	-1.0%	21.9%	8%
		2%@55	-.25%	-.5 %	-.8 %	22.05%	7%*
		2.5%@55	-.12%	-.6 %	-.9 %	21.98%	8%
		2%@60	-.37%	-.7 %	-.5 %	22.03%	7%*

* Employee contribution is reduced based on the reduced formula
**Assumes 1/10 of employees in second tier as of 6/30/11 using the Standard Rate Method
*** Represents pool estimates. City would be required to request an actual valuation to get more specific rate impacts.

Safety

Current Retirement Formula	Employer Rate 7-1-11	Second Tier Formula Options	Impact on Rate +/- **	Avg. 3 Yrs Final Comp. % Impact +/-***	Post Ret Surv Allow % Impact +/-***	New Projected Rate Effective FY 13-14	Employee Contribution*
3%@50	28.9%	--	--	-1.1%	-1.7%	26.1%	9%
		2%@50	-.41%	-.8%	-1.3%	26.39%	9%
		2%@55	-.65%	-.8%	-1.2%	26.25%	7%*
		3%@55	-.21%	-.9%	-1.7%	26.09%	9%

* Employee contribution is reduced based on the reduced formula
**Assumes 1/10 of employees in second tier as of 6/30/11 using the Standard Rate Method
*** Represents pool estimates. City would be required to request an actual valuation to get more specific rate impacts.

Timetable for Implementation of Two Tier Benefit

The contract amendment process with CalPERS generally takes 60 to 90 days to complete. The valuation information received from CalPERS on the two-tier options is valid until July 1, 2011. If the decision is made to implement any of the two tier options presented above, the CalPERS Resolution of Intention to amend the contract must be completed by July 1, 2011. Given the CalPERS implementation process and the City Council meeting schedule, a contract amendment cannot be completed by July 1, 2011. New valuations will be required if the process is not complete by that date which will add a minimum of 30 days to the process.

Implementation Example

Date	Implementation Step
5/3/11	Council authorize contract amendment to include second-tier option
7/5/11	Receive CalPERS documents required to amend the contract
8/1/11 – 8/31/11	Summer Recess
9/6/11	Council adopt CalPERS Resolution of Intention to amend contract and first reading of Ordinance
10/4/11	Final adoption of Ordinance (must be 20 days after the date the Council adopts the Resolution of Intention
10/5/11	Effective Date of Ordinance
10/29/11	Effective Date of Contract Amendment. First impact on Rate July 1, 2014

SUSTAINABLE OPPORTUNITIES

There are no direct economic, environmental, or social equity opportunities resulting from this action.

DISABILITY AND SENIOR CITIZEN ACCESS

The proposed action does not impact disability and senior citizen access.

RECOMMENDATION(S) AND RATIONALE

Staff recommends that the Council accept the informational report on Pension Cost Savings Associated With Having A Two-Tier Retirement Plan.

ACTION REQUESTED OF THE CITY COUNCIL

Staff recommends that the City Council accept the report on the pension cost savings associated with having a two-tier retirement plan.

Respectfully submitted,

Andrea R. Gourdine, Director
Department of Human Resources Management

Prepared by: Yvonne S. Hudson-Hannon, HR Manager
Retirement and Benefits

APPROVED AND FORWARDED
TO THE FINANCE AND MANAGEMENT COMMITTEE:

Office of the City Administrator