

City of Carlsbad Voter Approval of Pension Benefit Increases

June 2010

Board Recommendation:

SUPPORT

Rationale:

The City of Carlsbad has made tremendous strides in implementing pension reform, serving as a leader for the region. Passage of this proposed measure would require voter approval for pension increases of any employee currently enrolled in a specific retirement benefit formula group (earning 2% of salary for every year of service upon retirement), further strengthening recent reform efforts. This measure is similar to the City of San Diego’s 2006 Proposition B which SDCTA supported and voters approved. Proposition B requires voter approval of increases for any employee retirement benefits (for the exception of cost of living adjustments). Our rationale for Proposition B was as follows:

“While recognizing that Prop B alone will not solve our pension system problems, this measure allows for additional voter scrutiny that may prevent the City from assuming additional unfunded pension obligations in the future. The measure will provide for disclosure of the actuarial analysis of any potential pension benefit cost increase. This is critical because pension benefits, once approved, create long-term obligations for taxpayers.”

Carlsbad’s proposed measure does not affect benefit components outside of the 2% at 50 formula. Unlike the City of San Diego measure, Carlsbad does not have a provision for the requirement of preparation and publication of an actuarial analysis summary in the voter pamphlet. SDCTA recommends the addition of this provision to improve the ballot measure.

Background:

City of Carlsbad Safety Employee Pension Benefits

Previously all Carlsbad fire employees and police employees fell within the public safety 3% at 50 retirement formula and used the highest single year salary for reporting purposes. Safety employees contributed one percent (1%) of their salary to their pension plans while the City “picked-up” the remaining seven percent (7%). Additionally, the value of the “pick-up” paid by the City was reported as additional compensation when calculating the final retirement benefit.

Figure 1: Pension Benefit Calculation

<p>Annual Pension Benefits</p> <p style="text-align: center;">=</p> <p>years of service <small>(the number of years an employee worked at an agency)</small></p> <p style="text-align: center;">x</p> <p>final average compensation (FAC) <small>(the average highest consecutive 12 or 36 months of salary)</small></p> <p style="text-align: center;">x</p> <p>benefit factor <small>(A multiplier received for each year of service, usually between 2% and 3% of the final average compensation)</small></p>

Example 1: Safety Employee Retirement Benefit 3% @ 50, 12 month FAC

Assume John Lee, a safety employee, is working for the City of Carlsbad and has a 3% @ 50 retirement formula with a final average compensation of the 12 highest consecutive months of salary.

Using the formula provided in Figure 1, if John worked for the City for 30 years, retired at age 50, and made \$100,000 per year at his peak, then he would receive \$90,000 annually (90% of final salary) in retirement benefits (plus cost of living adjustments).

On May 18, 2010, the City of Carlsbad imposed a one-year labor contract for the City's fire employees. The contract sets a new pension benefit level (2% at 50) for new fire safety employees hired on or after October 4, 2010 and requires a final three-year average salary calculation for their final retirement benefit. The new contract also requires all fire employees to contribute the full required eight percent (8%) to their pension plans and eliminates the reporting of the City's "pick-up". Under California law, current employees have a vested right to receive the pension benefit they were hired into, and that benefit cannot be reduced during the time of their employment.

On June 8, 2010, the City approved a three-year agreement with the Police Officer's Association (POA). The agreement grants all POA represented employees to receive a two percent (2%) salary increase in 2010 and another two percent (2%) salary increase in 2011. Beginning in FY11, all sworn police employees will begin contributing five percent (5%) of the required nine percent (9%) CalPERS required pension contribution. Non-sworn employees will contribute four and one-half percent (4.5%) of the eight percent (8%) required contribution. Beginning in FY12, both sworn and non-sworn employees will be required to cover their full required pension contribution. The City will continue to report the value of the City's pick-up as additional compensation. Finally, both sides are required to immediately re-open negotiations regarding the creation of a second tier for new employees and requiring voter approval of any increases to that second tier retirement formula.

On June 29, 2010, the Council approved a one-year contract with the Police Management Association. The contract establishes a second-tier for new employees at the 2% at 50 benefit level and a final three-year average salary calculation for the final retirement benefit. The City will continue to pick-up eight percent (8%) of the employee's nine percent (9%) required pension contribution. The City will also continue to report the value of the City's pick-up as additional compensation.

Example 2: Safety Employee Retirement Benefit 2% @ 50, 36 month FAC

Now assume Jane Smith, a fire employee, is working for the City of Carlsbad and has a 2% @ 50 retirement formula with a final average compensation of the 36 highest consecutive months of salary. The final three years salaries are \$90,000, \$95,000 and \$100,000

Using the formula provided in Figure 1, if Jane worked for the City for 30 years, retired at age 50, and averaged \$95,000 for the final three highest years, then she would receive \$57,000 annually (60% of average salary) in retirement benefits (plus cost of living adjustments).

As part of the agreements with the City's safety employees, a provision states the Council's intent to place a measure on the November 2010 ballot asking voters to amend the City's Charter to prohibit increases to the 2% @ 50 retirement formula absent majority approval of voters.

City of Carlsbad Pension Costs

When adjusting for inflation, the City's total pension costs have increased 174% between FY 1999 and FY 2009. During much of this time, the City's pension fund was super-funded (where assets far exceeded liabilities), which meant that the City had a very low payment on its required contribution to CalPERS. During this time, however, payment toward the pick-up of employee contributions did not stop.¹

City of Carlsbad Annual Pension Costs (not adjusted for inflation) <i>Source: City of Carlsbad FY 1999 - 2009 financial statements</i>				
Fiscal Year	City Annual Required Contribution (ARC)	Pick-up	Total Pension Costs	Ratio of Total Pension Costs to General Fund
1999	\$2,284,512	\$1,973,190	\$4,257,702	8.28%
2000	\$963,142	\$2,148,775	\$3,111,917	4.83%
2001	\$376,051	\$2,402,368	\$2,778,419	4.07%
2002	\$472,638	\$2,566,898	\$3,039,536	4.34%
2003	\$473,370	\$2,630,411	\$3,103,781	2.84%
2004	\$2,283,841	\$2,922,496	\$5,206,337	6.48%
2005	\$7,030,146	\$3,326,086	\$10,356,232	11.69%
2006	\$9,819,997	\$3,632,020	\$13,452,017	13.62%
2007	\$10,199,902	\$3,818,759	\$14,018,661	12.91%
2008	\$11,935,983	\$4,334,339	\$16,270,322	13.23%
2009	\$12,511,382	\$3,841,141	\$16,352,523	15.11%

Payment toward pensions will continue to consume greater portions of the City's General Fund. This past fiscal year, CalPERS lost nearly 1/3 of its portfolio. These losses, in return, get pushed back onto cities in the coming years through higher rates.

Past SDCTA Position

In November 2006, City of San Diego voters approved Proposition B, a Charter amendment that requires majority voter approval of any pension benefit increases (for the exception of cost of living increases) for San Diego City employees. SDCTA supported this measure, stating:

“While recognizing that Prop B alone will not solve our pension system problems, this measure allows for additional voter scrutiny that may prevent the City from assuming additional unfunded pension obligations in the future. The measure will provide for disclosure of the actuarial analysis of any potential pension benefit cost increase. This is critical because pension benefits, once approved, create long-term obligations for taxpayers.”

The Charter amendment also requires the San Diego City Employees Retirement System to prepare an actuarial valuation to outline the cost of the proposed benefit increase. This analysis is required to be included in the ballot pamphlet that is sent out to voters.

The measure adopted within the City of San Diego applies to all City employees while the proposed measure in Carlsbad would only apply to those safety employees that fall under the 2% at 50 retirement formula.

Proposal:

¹ SDCTA Updated City of Carlsbad Municipal Analysis.

If approved by voters, the proposed Charter amendment would read as follows:

“Section 502 Retention of Benefits

Safety employees hired on or after October 4, 2010 shall not have their retirement benefit formula increased without an amendment to this section. The City Council may reduce this formula as provided in state law without an amendment to this section.”

Further Policy Implications & Analysis:

Impact on Employee Benefits

The proposed measure would not impact the need of the City and employees to negotiate regarding benefits. Furthermore, the measure does not impose, limit or void any employee benefits that have previously been agreed upon. Passage of this measure would require voter approval of any increase in the benefit formula for those employees that fall within the “2% @ 50” formula, should an increase be negotiated and agreed upon by the two parties. A reduction in this benefit that is either agreed upon or imposed by the Council does not require voter approval.

This measure may also have impacts on the collective bargaining process as there are benefits that can be increased that do not fall under the requirement of a public vote. A potential impact of the measure includes the Council and labor representatives negotiating salary increases during the bargaining process in lieu of increases to pension benefits and a subsequent public vote. This strategy has a direct impact on pension benefits and pension costs, as salary is used in calculating pension benefits. Any increase in salaries will ultimately lead to an increase in pension cost once the final compensation of the employee is calculated. Other potential benefit increases that affect an employee’s retirement calculation include uniform allowance, increasing the City’s pick-up rate, reporting the value of the City’s pick-up as compensation, etc.

If the Council and employee groups do agree to an increase in retirement benefits, the City would be required to pay for the cost of an election to place the measure on the ballot. Depending upon when the negotiations and agreements take place, there could be a chance a special election is required.

Approval of the proposed measure would limit the ability of the Council to unilaterally increase pension benefits and incur further pension obligations without voter approval. The language of the measure that will be put before voters does not require the City to outline both the short-term and long-term costs of the benefit increase should voters be asked to approve a benefit increase. While the measure does not prohibit the City and the Council from negotiating benefit increases for employees, any increase and therefore any measure put before voters would most likely though require justification as to why the increase in benefits is needed and how the City intends to pay for the additional pension costs.