



AGENDA REPORT

Meeting Date: August 2, 2011
Item Number: C-5
To: Honorable Mayor & City Council
From: Eliot Finkel, City Treasurer
Subject: PRESENTATION OF THE BEVERLY HILLS PENSION TASK FORCE
TO THE BEVERLY HILLS CITY COUNCIL REGARDING BEVERLY
HILLS SAFETY EMPLOYEES RETIREMENT OBLIGATIONS
Attachments: PowerPoint Presentation

An oral report will be presented by City Treasurer Eliot Finkel for City Council consideration/discussion.

A handwritten signature in black ink, appearing to be "Eliot Finkel", is written over a horizontal line.

Eliot Finkel, City Treasurer
Approved By

**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 its 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.
Public Pensions for Retirement Security - February 2011.**

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%

| | | | | | |
|--------------------------------------|----|-----|----|-----|-----|
| | | | | | |
| 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

| | | | |
|---|--------------|---------------|--------------|
| | | | |
| 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.**