INFORMATION CALENDAR
June 26, 2012

To: Honorable Mayor and Members of the City Council

From: Christine Daniel, City Manager

Submitted by: Teresa Berkeley-Simmons, Budget Manager

Subject: Status Report - Employee Benefits: Tough Decisions Ahead

SUMMARY
On November 16, 2010, the City Auditor issued the report Employee Benefits: Tough Decisions Ahead (Audit Report) (PDF). The objective of the report was to prepare an easy-to-read informational report addressing the City’s underfunded liabilities related to employee benefits, illustrate the impact these liabilities have on budgeting and staffing due to the annual benefit costs, and offer possible solutions to address the pressures caused by increasing costs for these benefits.

The City Auditor’s report focused on CalPERS, Police Employees Retiree Income Plan (Police Retiree Medical), and Sick Leave and Vacation Payout. The report contained several options for the City Manager’s consideration and several policy related recommendations for the Council’s consideration (see Background section below).

As requested by the City Auditor, the City Manager agreed to adopt in principle the City Auditor’s recommendations by September 2011. The City Manager also agreed to report on implementation of the recommendations by September 2012. On November 16, 2010, the City Manager presented to Council a report titled Employee Benefits: Tough Decisions Ahead - Response to Audit Report (Item #17).

This information item summarizes action taken since the November 2010 audit report. This report also indicates that staff will return to the Council by September for the Council’s consideration and adoption of various policy statements. Another status report will be submitted to the Council by October 30, 2012.

CURRENT SITUATION AND ITS EFFECTS
Following the Auditor’s report, staff has been providing information to the Council to enable the Council to make informed policy decisions about various underfunded liabilities. Since November 2010 there have been several presentations made to Council reporting on unfunded liabilities related to employee benefits.
1. January 18, 2011 - A dedicated workshop on unfunded liabilities presented by the City Auditor and the Budget Manager. [Unfunded Liabilities](#)

2. March 22, 2011 - A presentation to Council on increasing benefit costs (CalPERS and Healthcare) and the impact they were having on the budget. [FY 2012 & 2013 Proposed Balancing Measures](#)

3. December 6, 2011 - A presentation by the City’s actuary on pension liability. [Presentation of Pension Costs and Liabilities by City Actuary](#)

4. February 14, 2012 – A second presentation by the City’s Actuary regarding CalPERS obligations. [Fiscal Year 2012 Mid-Year Budget Update](#)

Additionally, a series of work sessions were conducted in fall 2011 regarding underfunded capital needs.

September 27: [Parks, Pools and Waterfront Capital Needs](#)

October 25: [Watershed Management Plan (Clean Storm Water)](#)

November 8: [Solid Waste Operation and Financial Update](#)

November 15: [Streets Pavement Management System and Capital Needs](#)

December 13: [Public Facilities Capital Needs](#)

**BACKGROUND**

Underfunded liabilities are defined as identifiable obligations of an organization for which the organization’s liabilities exceed the assets. In other words the organization does not have 100% of the funding (cash or other assets) set aside to cover the cost should all obligations become immediately due. Generally, an organization manages a balance between funding a portion of all of those obligations and the associated risk that the obligations will be due at the same time. Managing this balance is considered a practical and responsible approach since payment demands for these obligations rarely, if ever, occur simultaneously (i.e., 100% of all obligations are due at the same time). The alternative would be to fully fund the maximum amount of all of these future obligations, thereby requiring a great portion of the City’s cash to be reserved and not available for funding City services and operations.

Audit recommendations and responses are as follows:
Auditor’s Recommendation:
1. Council should adopt formal policies for negotiating, awarding, and monitoring employee benefits and benefit funding levels. This should include a policy to take into consideration the costs to administer new and existing benefits.

Status: Not Implemented

City Manager’s Response:
The City Council has historically relied on a number of policies regarding contract negotiations to protect the City’s short and long-range economic health. These policies were formally acknowledged with Council item 12 on September 16, 2008. However, they have not been formally adopted by the City Council. Staff will return by September 2012 with an item for the Council’s consideration regarding formal adoption of such policies.

a) Assure that labor organizations and their members are treated fairly and with respect.
b) Negotiate in good faith and within the process established by the parties including honoring the traditional confidentiality of the negotiation process.
c) Negotiate contracts based on a “Total Compensation Package” model (changes in current and future salary, and health and welfare benefits) within the City’s overall financial conditions.
d) Any Equity Adjustments to base salary must be included in the overall Total Compensation Package. Council policy has been to establish salary ranges at the median of comparable jurisdictions.
e) Assure that the City’s Total Compensation salary and benefit package is competitive in the marketplace, is fair to existing employees and is competitive with public employers in the Bay Area so that the City is able to recruit and retain quality candidates particularly in critical classifications.

Auditor’s Recommendation:
2. Council should adopt policies aimed at increasing the transparency of City benefits and compensation, to the extent consistent with existing law. This should include a policy to attempt to simplify pay and benefits rules, which could also reduce costs and complexity.

Status: Partially Implemented

City Manager’s Response:
The Council has articulated during work sessions in December 2011 and February 2012, the following interests with respect to managing the costs of employee benefits. However, these have not been formally adopted by the City Council as policies. Staff will include consideration of such policies along with those noted above with the item for Council consideration by September 2012.
a) Include the sustainability of benefits as part of negotiating considerations.
b) Conduct regular actuarial studies of major unfunded benefit liabilities including CalPERS, retiree health care, etc.
c) Use long-term, multi-year strategies to achieve sustainability of contributions and an appropriate funded status for each benefit to reduce unfunded liabilities.
d) Consider options within CalPERS including a two tier plan and other options.

On May 29, 2012, the City Council adopted Resolution No. 65,748 requiring the City Manager to develop and publish a biennial report of current City liabilities and projections of future liabilities. The report will increase the transparency of the financial impact of City benefits and compensation.

With respect to additional information being made more easily accessible, the Human Resource Department website contains direct links to more user friendly information such as information about when the contracts run out, links to all the contracts, number of employees (FTEs) in each bargaining union, etcetera. Union Agreements / Employee Manual.

Auditor’s Recommendation:
3. Budget reports should include some additional information on the analysis of funding levels for each employee-benefit. This includes detailed explanation for target funding ranges. For CalPERS, provide information on the possible need for additional funding. Changes in CalPERS demographic assumptions, as well as the smoothing mechanism used by CalPERS, are expected to result in a higher unfunded liability percentage. Incorporate this information into standard reports prepared for Council.

Status: Partially Implemented

City Manager’s Response:
On May 29, 2012, Item #39 City Manager’s Report of Projections of Future City Liabilities was approved by the City Council, (Resolution No. 65,748), requiring the City Manager to develop and publish a biennial report of current City liabilities and projections of future liabilities. The report is designed to aid the Council, the public and staff in understanding various important aspects of the City’s financial situation prior to preparation of the City’s biennial budget. The report will be published initially in February 2013 and subsequently in February of the second year of the City’s biennial budget.

The FY 2011 Mid-Biennial Budget Update (June 22, 2010) includes a section titled “Unfunded Liabilities (employee benefits) Summary” (pages 11-20), which contains charts and information disclosing the funding levels and rate increases for employee benefits.
The FY 2012 and 2013 Adopted Budget (June 28, 2011) book includes a section titled “Unfunded Liabilities” (pages 49 – 59) which contains charts and information disclosing the funding levels and rate increases for employee benefits, as well as an expanded discussion on the funding status of each benefit.

The City’s Comprehensive Annual Financial Report for Year Ended June 30, 2011 (CAFR - 2011) also contains a section in the Notes to the Financial Statements (pages 102 – 124) which discloses details such as plan descriptions, funding policies, status and funding progress, and actuarial methods and assumptions about the City’s defined benefit pension plans, other post-employment benefits, and defined contribution plans.

**Auditor’s Recommendation:**

4. Formalize the policy to perform an actuarial study prior to approving a significant new benefit, as Human Resources states has been done since 1998. The City Manager should document exceptions.

Status: Not Implemented

**City Manager’s Response:**

The City has been conducting regular actuarial studies of major benefits including CalPERS and retiree health care for some time. As set forth in the response to Recommendation 5 below, those studies will continue. However, despite the fact that these studies are being conducted, no formal policy has been adopted by the City Council. Accordingly, staff will include such a policy in the September 2012 report noted above.

**Auditor’s Recommendation:**

5. Determine which employee benefits are the highest risk to the City and, if appropriate, perform actuarial valuations annually, rather than biennially.

Status: Implemented

**City Manager’s Response:**

For the last 15 years the City has obtained actuarial studies for an expanded group of benefits which includes CalPERS, Worker’ Compensation, Retiree Medical Health (all plans), and Police Retiree Sick Leave Entitlement benefit, as well as increased the frequency of the studies. Actuarial studies are now conducted annually for the CalPERS retirement benefit and every other year for Workers’ Compensation. An actuarial evaluation of the Safety Members Pension Fund also occurs on an annual basis, but this, like SRIP, is a closed group and thus the costs are more predictable. Actuarial studies help to measure the future cost impact of benefits. Knowing what these future impacts will be is critical to making prudent decisions for the fiscal health of the organization.
Excluding the CalPERS benefit, which is a multi-employer pension plan, the benefit that has the potential for the highest risk to the City is the retiree health care benefit. It is important to understand that the City was advised by outside actuaries, Milliman, Inc., when the plans were created. The amount of increased expenditure that the City is required to make toward payment of the premium is limited to no more than 4.5% per year regardless of the percentage of the premium increase. The City’s targeted funding policy and annual required contribution (ARC) is equal to the normal cost for active employees plus an amount to amortize unfunded liabilities over 30 years as a level percentage of payroll. Contributions are deposited into an Internal Revenue Code Section 115 trust fund and benefits are paid from this fund. The intent is to comply with Governmental Accounting and Standards Board (GASB) Statement 45 on financial disclosure of Other Post Employment Benefits.

The individual retiree health care plans include a requirement that the City Manager periodically shall have an actuarial study performed to determine if Trust assets are sufficient to meet the Plan's projected liabilities. The City generally has had actuarial studies done biennially due to the cost of the actuarial report. This meets the GASB 45 requirements.

Staff will include in the September report regarding Council policies a recommendation that the City conduct actuarial studies for the retiree health benefit no less frequently than biennially and more frequently if determined to be necessary.

For the CalPERS benefit, staff works with the City’s outside actuary to establish funding goals to prefund the benefit over a 30 year amortization period. A similar amortization period is used for some of the City’s other liabilities including the Retiree Health Premium Assistance Plan for non-sworn employees, the Berkeley Police Retirement Supplemental Income Plan and Berkeley Fire Employees Retiree Health Premium Assistance Plan. In addition, the City routinely obtains actuarial reports as a part of the collective bargaining process in order to determine the costs of proposed new, existing, or modified benefits.

CONCLUSION
Both the Human Resources Department and the Budget Office have been consistently working in alignment with the Auditor’s proposed policies in order to more effectively monitor and manage the City’s unfunded liabilities. There is uniform agreement that it is critical that the City continue to manage its liabilities to ensure long-term fiscal stability.

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