

ATTACHMENT

City and County of San Francisco

Gavin Newsom
Mayor



Department of Human Resources

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DEPARTMENT OF HUMAN RESOURCES' RESPONSE ON THE 2009-2010 GRAND JURY REPORT – PENSION TSUNAMI: THE BILLION DOLLAR BUBBLE

RESPONSES TO FINDINGS:

C. Proposition H (Police and Firefighter Retirement Plan)

C1. Proposition H, passed by voters in 2002, requires that if the City's contribution rate to the pension fund exceeds 0% then the City and the Safety employees unions must "meet and confer" to implement a "cost-sharing" arrangement to reduce the cost impact of the employer's contributions on the City's General Fund. The City's contribution rate has exceeded 0% for fiscal 2004-05 to the present.

The City and County of San Francisco is not in compliance with the requirements of the City Charter resulting from the passage of Proposition H. There have been no "meet and confer" sessions to establish a "cost-sharing" arrangement.

The City Attorney has not mandated that the SFERS Board comply with these requirements of the Charter Amendment resulting from Proposition H

Disagree. Charter §A8.595-11(e) (Proposition H) states that in "[a]ny year in which, based upon the Retirement Systems annual actuarial valuation, the employer contribution rate exceeds 0%, the employee organizations representing safety members shall jointly meet and confer with City representatives to implement a cost sharing arrangement between the City and employee organizations." The Grand Jury notes that since Fiscal Year 2004-05, the employer contribution has exceeded 0%. Further, the Grand Jury holds that the City has not been in compliance with this Charter section as there have been no "meet and confer" sessions to establish a "cost-sharing" agreement.

DHR disagrees that the City is not in compliance with Proposition H mandates. The City met and conferred with the Police and Fire groups in the spring of 2003, during the first round of labor negotiations following passage of Proposition H, and negotiated provisions in the collective bargaining agreements covering police officers and firefighters to address Charter obligations as to cost-sharing. At that time, both the Police and Fire unions agreed to pay the maximum employee pension contribution allowed under the Charter (7.0%, old plan; or 7.5%, new plan). These agreements were reached in recognition of the parties' cost-sharing obligations, the fact that the City's pension costs were projected to increase above 0%, and to facilitate balancing the City's budget. Proposition H specifically provides that, "Such cost sharing arrangement shall not require an employee contribution in excess of the limits set elsewhere in this Charter." The Charter specifically provides that employee contributions are limited to 7.5% for new plan members. As a result of the agreements reached during these meet-and-confer sessions, Police and Fire employees pay the maximum employee pension contribution.

By way of background, the City and virtually all of its labor organizations had negotiated an Employer-Paid Member Contribution (EPMC) during the 1990's, under which the City "picks up" the employee pension contribution. During the early 2000's, the City negotiated a temporary elimination of the EPMC for its unions,

to achieve budget savings during a recessionary period. By July 2006, the City’s miscellaneous employee unions had had the EPMC restored, or received a wage increase in lieu of that restoration. However, the police and fire labor agreements did not include a restoration of the EPMC, nor did they provide for a wage increase in lieu thereof. Instead, their labor agreements provided that the obligation to pay the employee pension contribution would continue, in recognition of the Charter’s cost-sharing obligations as indicated above. As reflected in both the Police and Fire collective bargaining agreements (located on the Department of Human Resources' website at www.sfgov.org/DHR):

San Francisco Firefighters Union, Local 798 (Section 11):

Employees shall pay their own employee retirement contributions in an amount equal to 7.0% (old plan) or 7.5% (new plan) of covered gross salary. The parties acknowledge that said contributions satisfy the requirements of Charter Sections A8.596-11(e) and A8.598-11(d).

San Francisco Police Officers' Association (Section 9):

For the duration of this Agreement, employees shall pay their own retirement contributions. Tier 1 employees will contribute an amount equal to 7% of covered gross salary; Tier 2 employees and Harbor Police Officers will contribute an amount equal to 7.5% of covered gross salary. The parties acknowledge that said contributions satisfy the requirements of Charter Sections A8.595-11(d) and A8.597-11(d) for the duration of this Agreement.

(Please also see the City Attorney’s response for more information on negotiations with Police and Fire since the passage of Proposition H.)

Not only have these contributions had “a material reduction of the cost impact of employer contributions on the City’s general fund” as required by Proposition H, they have actually almost completely covered the increased costs under Proposition H.

According to the San Francisco Employee Retirement System’s estimations, increased costs since Fiscal Year 2004-2005 (the year that the City’s rate first exceeded 0%) attributable to the Police and Fire pension improvements under Proposition H amount to \$205,693,993. However, the retirement contributions by Police and Fire since 2003 amount to approximately \$202,042,321. See the chart below for further details.

Fiscal Year	Approximate Retirement Contributions by Police and Fire			Prop H Increased Costs
	Police	Fire	Total for Police and Fire	
FY03-04	\$13,275,000.00	\$ 9,750,000.00	\$ 23,025,000.00	
FY04-05	\$14,043,750.00	\$10,200,000.00	\$ 24,243,750.00	\$30,792,593
FY05-06	\$14,798,407.35	\$11,025,221.85	\$ 25,823,629.20	\$32,418,548
FY06-07	\$16,580,467.65	\$12,021,110.78	\$ 28,601,578.43	\$35,643,372
FY07-08	\$16,871,911.20	\$12,542,837.10	\$ 29,414,748.30	\$35,920,662
FY08-09	\$20,805,085.50	\$14,382,645.60	\$ 35,187,731.10	\$37,467,254
FY09-10	\$21,655,563.30	\$14,090,321.25	\$ 35,745,884.55	\$33,451,564
FY10-11	\$21,391,609.80	\$14,271,636.08		
		Totals	\$ 202,042,321.58	\$205,693,993

* Notes:

- The Prop H figures are based on information provided by SFERS.
- The Prop H increased cost in Fiscal Year 2009-10 is an estimate.
- The retirement contribution amounts for Fiscal Years 2002-03, 2003-04 and 2004-05 are estimates, since DHR does not have payroll data for those years at this time.
- The retirement contribution rates for Fiscal Years 2005-06 to 2010-11 are estimates based on the Controller's Office payroll data.
- Contribution rates are calculated based on adjusted base and premiums.

(It should be noted that the 7.5% amount of the Police and Fire pension contribution during Fiscal Year 2011-12 will be \$35,663,245. Extrapolating from the downward trend in increased costs under Proposition H, we assume that the 7.5% employee pension contribution will actually exceed the cost of Proposition H pension improvements for Police and Fire in that period).

Further, in addition to their agreement to pay the employee retirement contributions in recognition of their cost-sharing Charter obligations, Police and Fire also agreed additional give-backs. It is important to note that, as these agreements reduce pensionable income, the City’s pension costs are also reduced.

- In negotiations, consistent with the Charter, the City includes pension costs as an element of total employee compensation, and adjusts its economic positions accordingly. City strategies to address increases in pension costs have also taken the form of reducing wages or other economic benefits. To illustrate:
 - For Fiscal Years 2004-05 and 2005-06, Fire agreed to partially defer wage increases they were entitled to pursuant to their parity relationship with Police.
 - Beginning in Fiscal Year 2004-05, Fire agreed to:
 - increase their average work week from 48 hours to 48.7 hours;
 - work the first 5 hours of overtime at straight-time;
 - exclude sick pay and use of compensatory time from weekly overtime calculations.
 - Beginning in Fiscal Year 2007-08, Fire agreed to work the first 106 hours per pay period at straight-time; the average work schedule per pay period for fire is 97.4 hours.
- In addition, the City was able to renegotiate provisions of closed labor contracts with Police and Fire unions, which achieve additional savings in the Fiscal Years 2008-09 through 2011-12. For example:
 - Beginning in Fiscal Year 2008-09 through Fiscal Year 2010-11, Fire agreed to temporarily reduce their Holiday Pay premium that they receive in lieu of paid holidays.
 - In the Spring of 2009, Police and Fire agreed to defer 2% of their 4% wage increase from July 1, 2009 to January 8, 2011.
 - In the Spring of 2010:
 - Police agreed to a temporary wage reduction, the value of 6 unpaid days, in Fiscal Year 2010-11 and the value of 4 unpaid days in Fiscal Year 2011-12 and agreed to move their 2% wage increase from January 8, 2011 to January 7, 2012.
 - Fire agreed to move their 4% wage increase from July 1, 2010 to July 1, 2011 and to move their 3-5% survey based wage increase from July 1, 2011 to July 1, 2012.

Labor concessions this fiscal year alone amount to \$18 million from Police and \$11.5 million from Fire. See the chart on the following page for additional information.

Additional Give-Backs from Closed Contracts			
Fiscal Year	Police	Fire	Total for Police and Fire
FY08-09	-	\$ 4,000,000	\$ 4,000,000
FY09-10	\$ 10,000,000	\$ 7,000,000	\$ 17,000,000
FY10-11	\$ 18,000,000	\$ 11,500,000	\$ 29,500,000
FY11-12	\$ 9,500,000	\$ 7,000,000	\$ 16,500,000
Totals	\$ 37,500,000	\$ 29,500,000	\$ 67,000,000

* Note: Again, these figures are estimations based on payroll data from the Controller’s Office.

Lastly, it is important to note that while our Police Officer wages are at or slightly above market for the region (less than 0.5% above market, actually), our retirement benefit is much lower than that of other jurisdictions. Safety employees throughout California receive a “3% at 50” benefit, while San Francisco’s safety members receive “3% at 55.”

<u>Jurisdictions</u>	<i>Age at Which 3% Benefit is Received for Safety Employees</i>
San Francisco	55
State of California	50
Alameda County	50
Contra Costa County	50
Marin County	50
Sacramento County	50
San Mateo County	50
Santa Clara County	50
Solano County	50
Sonoma County	50
Oakland	50
San Jose	50

Although the City Attorney opines that the City has met the requirement that it negotiate with representatives of police officers and firefighters to effect a material reduction in General Fund costs in years in which it faces a positive contribution to the Retirement System, we are amenable to his recommendation that the process be undertaken on an annual basis and that it be made more transparent to the public.

C2. The unfunded pension liability for Proposition H as of July 1, 2009 was approximately \$276 million, amortized over thirteen years to about \$26 million annually.

Disagree. Negotiated employee contributions to fund the pension improvement have actually almost completely covered the increased costs under Proposition H. DHR will continue to negotiate with Police and Fire as necessary to ensure compliance with the cost-sharing obligations under Proposition H.

While DHR cannot comment on amortization rates, we note that the 7.5% amount of the Police and Fire pension contribution during Fiscal Year 2011-12 will be \$35,663,245. Extrapolating from the downward trend

in increased costs under Proposition H, we assume that the 7.5% employee pension contribution will actually exceed the cost of Proposition H pension improvements for Police and Fire in that period. Again, Proposition H does not require Police and Fire to cover the entire increased costs; rather, it requires that their contributions have a “material reduction” on those increased costs.

E. Health Benefits

E1. For current employees and retirees, health benefits are “vested” after 10 years.

Disagree.

Current employees who were hired prior to January 10, 2009 “vest” after 5 years of City service; and pursuant to Proposition B (passed by the voters in June 2008), employees hired on or after January 10, 2009 vest for retiree health insurance based on the following years of service:

- 5 years – access to City Health Plans
- 10 years – access to City Health Plans with 50% of City Contribution
- 15 years – access to City Health Plans with 75% of City Contribution
- 20 years – access to City Health Plans with 100% of City Contribution

We also note that pursuant to Proposition B, employees hired on or after January 10, 2009 must effectuate retirement within 180 days of separation from the City to maintain the eligibility for retiree health insurance. Prior to Proposition B, an employee could separate upon vesting and effectuate a retirement decades later and receive retiree health.

E1. Unlike pensions, health benefits for most City workers are not pre-funded, but are paid directly out of the City’s General Fund. In 2001, the City expended \$17 million on retiree health care. By 2007, that amount had grown to \$130 million and continues to rise. Mercer Consulting reported on June 30, 2008, that the City’s unfunded liability for retiree health benefits was \$4 billion.

Partially agree.

Retiree healthcare is not paid solely out of the General Fund, as 40% is paid by self-supported department funds. The largest element of this increase was the voter-approved expansion of spousal health benefits.

Nevertheless, DHR concurs that retiree health benefits have not historically been pre-funded, and that the City has a substantial, unfunded retiree health liability. DHR and the City have taken steps to address this issue as indicated in our response to Recommendation E1 below.

RESPONSES TO RECOMMENDATIONS:

B. Pension Costs

B2. The Department of Human Resources should not enter into agreements with the employee unions which increase the City’s future pension obligations without voter approval.

This recommendation has already been implemented in part, and cannot be implemented in remainder.

At the outset, we would like to respond to the Civil Grand Jury’s findings upon which this recommendation is based.

The Civil Grand Jury’s Finding B states: The Department of Human Resources and SEIU Local 1021 entered into an agreement that Miscellaneous employees would pay their own 7.5% contribution, and, in return, the base wages were increased by 6% effective July 1, 2010. There was no actuarial valuation to estimate the resulting pension liability for the City. This agreement resulted in a substantial increase in pension obligations for the City without voter approval. DHR disagrees with several aspects of this finding.

First, the effective date of the “swap” for SEIU Miscellaneous (non-MTA) employees is on July 1, 2011, not July 1, 2010. DHR specifically delayed the implementation of this “swap” to prevent enticing the 1,000+ SEIU Miscellaneous employees that were likely to retire in Fiscal Year 2009-2010 from delaying their retirement. There was a large number of employees planning to retire this year, as they sought to obtain sick pay cash-outs under the Wellness Program before it expired on June 30, 2010. Those employees not retiring this fiscal year likely felt that the benefits of the Wellness Program did not outweigh the benefits of continued employment, which means they will likely work for many more years. The impact of this is that they will be earning and contributing to retirement based on this new wage for a number of years prior to their retirement.

Second, the Civil Grand Jury’s statement that the agreement with SEIU resulted in a “substantial increase” in pension obligations for the City is incorrect.

The City agreed to pick-up the employee pension contribution for most unions in 1995 (not in 2002 as indicated in the Civil Grand Jury report) in lieu of wage increases. Therefore, if the City had not paid the employee contribution and instead given employee wage increases at that time, there would have been pension cost increases dating back to 1995.

While it is true that SEIU Miscellaneous (non-MTA) employees will receive a base wage increase on July 1, 2011 in exchange for resuming the employee pension contribution, it will in fact be on a cost-neutral basis to the City. In calculating the base wage increase that could be provided in exchange for employees agreeing to pay their own retirement contribution, costs such as contributions to retirement and social security are taken into account. This is why only a 6% wage increase was provided in exchange for employee payment of the 7.5% member contribution. As this increase is across the board (i.e., provided to all covered employees regardless of the number of years of service), there should not be disproportionate increase in employer contributions to retirement. Although an increase in pensionable compensation will result in a corresponding increase in employer contributions to retirement, it is only if a significant increase is made to pensionable income solely at the end of one’s career that there is a significant financial impact on the City’s future pension obligations; however, most SEIU employees will

continue working (and contributing to the retirement fund) for years after the “swap” takes effect.

The Civil Grand Jury estimates that, “the swap arrangement between the City and [it’s unions] will result in approximately \$136 million in unfunded pension obligations.” Although the Civil Grand Jury does not cite the source of this data, this assertion is a gross overestimation if it based this number on the example of the SEIU employee the Civil Grand Jury proffers. The Civil Grand Jury asserts that, “The 6% increase in wages would provide a comparable 6% increase in pension; therefore, an SEIU employee who would have retired with, say, a \$20,000 annual pension would realize an additional \$1,200 annual lifetime benefit...[and that] the present value of this benefit would be \$13,784.” This estimate is based on the Civil Grand Jury’s incorrect assumption that there is a 100% benefit formula for SEIU members, when by Charter the maximum contribution is limited to 75%, which would require nearly 33 years of service at age 62. However, the average age and service of the Miscellaneous Plan retirees is 62+ and 25.8 for Fiscal Year 2009-10. This calculates to an average benefit formula percentage of 59.34%, far below the 100% cited in the report.

More importantly, the SFERS pension fund has been funded assuming 4.5% annual wage increases for miscellaneous employees—increases that the City’s miscellaneous unions did not receive and are not scheduled to receive—thereby offsetting the impact on pension costs. Please see the SFERS response for more information. Therefore, the increase in benefit liability as a result of the swap is not an “unfunded” liability.

As to the recommendation that DHR not enter into agreements with the employee unions which increase the City’s future pension obligations without voter approval, we note again that under Charter §A8.409, the City is obligated to bargain with recognized employee organizations over wages and benefits. Any increase in pensionable compensation necessarily results in a corresponding increase in employer contributions to retirement. It also increases the amount that the employee is required to contribute, since the employee’s contribution is based on a set percentage rate of salary by Charter mandate.

Pursuant to the City’s Charter, DHR has no ability to change employee retirement plans, as all such changes must be approved by the voters. Accordingly, all of the retirement enhancements that are noted in the Grand Jury’s report were approved by the voters.

B2. DHR should engage the City’s professional Actuary to investigate any increase in pensionable compensation.

This recommendation will not be implemented.

During collective bargaining, DHR already engages SFERS and the Controller’s Office to evaluate cost increases to any pensionable compensation. Both of these agencies employ actuaries on which DHR relies. It would not be practical—nor cost-effective—for the City to engage an actuary in every discussion with the City’s 48 labor groups over possible wage increases and the corresponding impact on pensions. Moreover, we note that the Charter does not specifically include impact on employer pension costs as a factor that must be determined by an arbitrator in determining wage increases.

B3. DHR should compare the retirement benefits in other California cities to determine whether the pension benefits are excessive. The results should be reported to the Mayor and the Board of Supervisors.

This recommendation has been implemented.

DHR has compared the retirement benefits provided by the City to those of other cities and counties in California and has determined that our retirements plans for both miscellaneous and safety are on the lower end of those provided across California (see below). This information was shared with both the Mayor’s Office and the Board of Supervisors pursuant to the formulation of Proposition B in the winter and spring of 2008.

<u>Jurisdictions</u>	<u>Miscellaneous</u>		<u>Safety</u>
	<i>Benefit at Age 60</i>	<i>Benefit at Age 65</i>	<i>Age Receive 3% Benefit</i>
San Francisco	2.10%	2.30%	55
State of California	2.26%	2.42%	50
Alameda County	2.34%	2.62%	50
Contra Costa County	2.26%	2.42%	50
Marin County	2.26%	2.42%	50
Sacramento County	2.44%	2.61%	50
San Mateo County	3%	3%	50
Santa Clara County	2.50%	2.50%	50
Solano County	2.70%	2.70%	50
Sonoma County	3%	3%	50
Oakland	2.70%	2.70%	50
San Jose	2.50%	2.50%	50

C. Proposition H (Police and Firefighter Retirement Plan)

C1. The Grand Jury recommends that the City Attorney and/or his representatives present to the Board of Supervisors and SFERS Board the following documents regarding §A8.595(e) of the City Charter:

- 1. A legal opinion on the Charter**
- 2. Documentation regarding the dates and times that the City and Police and Firefighters union met to confer and to implement a cost-sharing arrangement as required in this section.**
- 3. A legal opinion regarding fiduciary duties of the SFERS Board to comply with it.**
- 4. A legal opinion regarding SFERS duty to revise the Safety employee contribution rate to comply with the Charter section.**
- 5. A legal opinion regarding possible remedies to enforce compliance.**

This recommendation cannot be implemented by DHR, as this is recommendation is directed to the City Attorney’s Office. Accordingly, we defer to the City Attorney’s Office for response to these recommendations.

However, regarding documentation of the implementation of cost-sharing arrangements pursuant to the applicable Charter sections, DHR points the Grand Jury to the list of agreements in DHR’s response to Finding C1 above.

C2. The City and Safety employees should establish an arrangement to share the annual \$26 million cost as required by the Charter.

This recommendation has already been implemented – the parties have met Charter obligations for Proposition H. Please see DHR’s response to Finding C1. DHR will continue to negotiate with Police and Fire to ensure compliance with the cost-sharing obligations under Proposition H.

To the extent that the Civil Grand Jury is recommending that Safety employees contribute more than otherwise required under Proposition H, we defer to the City’s policy makers for direction. As detailed in the City Attorney’s response to the Civil Grand Jury Report, the Charter vests in the Mayor, acting through the Director of Human Resources, and in consultation with the Board of Supervisors, the exclusive responsibility of meeting and conferring with all employee representatives about the terms of the labor agreements (see Charter Section 11.100 and 11.101).

D. Pension Spiking

D1. San Francisco should take steps to curb abuses from pension spiking by limiting the final pensionable income an employee can claim at retirement and from pension-pyramiding.

The Jury suggests the following:

- **Use a three-year average to determine pensionable income, similar to Federal rules.**
- **Limit final pensionable compensation to 120% of the rank pay rate as determined by the Civil Service job classification.**
- **The Controller should perform an independent review of pensions to determine whether the practice of pension spiking is ongoing.**
- **Disallow employees from drawing pensions from two simultaneous City jobs.**
- **Pensionable compensation should not include pay for two separate pay types, known as pension-pyramiding.**

DHR’s responses to the Grand Jury’s suggestions:

- DHR cannot implement this recommendation. The Mayor and Supervisor Elsbernd proposed 3 years, but this was reduced by the Board of Supervisors to 2 years. Pursuant to Proposition B on the June 2010 ballot, the voters approved moving from a formula based on the single highest year of earnings to the average of 2 highest years.
- DHR cannot implement this recommendation, as this would require a Charter amendment.
- As the third recommendation is directed to the Controller’s Office, DHR cannot implement this recommendation. However, DHR welcomes any analysis of whether there is any pension spiking occurring and how it can be prevented.
- The fourth bullet-point recommendation requires further analysis, but will be implemented if possible. DHR recently completed an audit and determined that there are a few instances in which employees at the Department of Public Health (DPH) are earning more than 2088 hours in pensionable compensation because of multiple appointments. DHR is working with DPH to implement a mechanism in the system to prohibit these anomalies from occurring in the future.
- As to the fifth bullet point, changes in the definition of pensionable compensation can only be effectuated by changes in the Charter, state law or ruling by a court of competent jurisdiction. DHR therefore cannot implement this recommendation.

E. Health Benefits

E1. Department of Human Resources and collective bargaining units should meet and confer to determine a cost-sharing arrangement to pre-fund the \$4 billion unfunded liability for retiree health care obligations.

This recommendation has been partially implemented.

Pursuant to Proposition B (June 2008 Ballot), all employees hired on or after January 10, 2009 must contribute 2% of their salary into the City’s Retiree Health Care Trust Fund Contribution, and the City contributes an additional 1% for each corresponding 2% contribution. Approximately 10% of the City’s workforce is making this mandatory contribution. This amount serves to entirely prefunds those new employees’ retiree health benefits and a portion of the City’s unfunded liability for retiree health benefits for employees who were hired prior to January 10, 2009.

Further, DHR has, and will continue to seek contributions to the Retiree Health Care Trust Fund from non-contributing employees through the collective bargaining process. DHR proposed contributions for active employees during the last two rounds of labor negotiations and was able to successfully negotiate it for one of the City’s labor unions.