TO:          HONORABLE CITY COUNCIL  
FROM:      CITY MANAGER               DEPARTMENT: HUMAN RESOURCES  
DATE:      NOVEMBER 13, 2006                CMR: 409:06  

SUBJECT: APPROVAL OF RESOLUTIONS AND AN ORDINANCE TO APPROVE AN AMENDMENT TO THE CONTRACT BETWEEN THE BOARD OF ADMINISTRATION OF THE CALIFORNIA PUBLIC EMPLOYEES RETIREMENT SYSTEM (CALPERS) AND THE CITY OF PALO ALTO TO PROVIDE SECTION 21354.5 (2.7% @ 55 FULL FORMULA) FOR MISCELLANEOUS EMPLOYEES

RECOMMENDATION

Staff recommends that Council approve the attached Resolution of Intention of the Council of the City of Palo Alto stating its intent to amend the contract between the California Public Employees’ Retirement System (CalPERS) and the City of Palo Alto to provide Section 21354.5 (2.7% @ 55 Full Formula) for the Local Miscellaneous employees; adopt an ordinance of the Council of the City of Palo Alto authorizing an Amendment to the Contract between the City Council of the City of Palo Alto and the Board of Administration of the California Public Employees’ Retirement System; and adopt additional resolutions implementing the contract amendment.

BACKGROUND

On October 10, 2006, the City Council approved a 38 month agreement effective May 1, 2006 through June 30, 2009 with employees represented by Service Employees’ International Union (SEIU) Local 715. The SEIU agreement included a change from the current retirement formula, 2 percent at 55 Full Formula, to an enhanced formula, 2.7 percent at 55 Full Formula, which increases the monthly pension benefits for all employees aged 50 and over retiring after January 6, 2007. This change was a result of the City’s continuing efforts to contain escalating healthcare costs for existing employees and future retirees while retaining a competitive market position. The City will reduce the maximum payments of medical premiums paid to current employees and future retirees in return for providing a more competitive retirement benefit. Nine of eleven labor market cities have enhanced or are in process of enhancing their retirement formula beyond 2 percent at 55 within the last several years. This benefit change will affect not only the 589 SEIU employees, but also the 254 non-safety management and professional employees who are also combined in the Local Miscellaneous employees group as established by CalPERS.
DISCUSSION

The change in pension formula increases the City’s CalPERS pension expense by 6.9 percent. This change is comprised of a 5.9 percent increase to the City’s employer rate and a 1 percent increase to the employee rate. The result is an increase to the City’s combined employee and employer pension rate, which increases from 18.4 percent of total salary to 25.3 percent based on 2006-07 rates.

Currently City employees do not contribute anything to their pension costs. With the new retirement formula, two percent of this increase will be paid by the employee. Under the 2 percent at 55 formula, between the years 1998 to present, employees were not required to pay toward any retirement contribution. Effective January 6, 2007, all SEIU employees will pay 1 percent share of the expense increase, reducing the additional cost to the City to 5.9 percent. Effective the pay period inclusive of July 1, 2007, all SEIU employees will pay an additional 1 percent, for a total of 2 percent, towards the implementation of 2.7 percent at 55, reducing the additional cost to the City to 4.9 percent. The remaining employees in the Miscellaneous group will be required to pay up to 2 percent on a pre-tax basis (see attached resolution). Staff is in the process of finalizing the details for these employees.

This benefit change is expected to increase the number of employee retirements in 2007 and therefore provide an opportunity for the organization to restructure. Over 40 percent of the 589 SEIU employees are age 50 or over and over 50 percent of the Management and Professional employees are age 50 or over. Executive staff is currently analyzing the potential number of employees who may retire and the feasibility of reduced staffing and other economically beneficial staffing options.

RESOURCES IMPACT

The 6.9% cost increase of this benefit change consists of two elements: (1) repayment of an unfunded liability that covers retirement costs of employees who retire prior to the increased benefit being fully funded and (2) increased future premiums for the added benefits. CalPERS requires payment of the unfunded liability to be amortized over 20 years. The net present value (NPV) of the 2.7 percent at 55 retirement benefit for all miscellaneous employees is approximately $25.0 million amortized over the next 20 years as required by CalPERS. This translates into future annual costs of approximately $3.3 million in current dollars over the next 20 years. The majority of the cost increase represents the City’s contribution for previous years of service for current employees. This cost is 5 percent of the 6.9 percent increase to the City’s CalPERS pension contribution. At the end of 20 year amortization period, the City will have
completed its contribution for previous years of service for current employees and the 5 percent will be reduced from the City’s CalPERS pension rate. The cost of the 2.7 percent at 55 retirement benefit will be covered by the cost avoidance that comes from placing a cap on medical costs and the employees’ 2 percent contribution.

Implementation of this retirement benefit does not require a budget adjustment for fiscal year 2006-07 since there are sufficient funds included in the adopted budget. The budget impacts for future years will be included in the 2007-09 proposed budget.

**POLICY IMPLICATIONS**

This recommendation is consistent with existing City policies.

**ENVIRONMENTAL REVIEW**

This action does not require an environmental review.

**ATTACHMENT**

1. Resolution of Intention to approve an Amendment to Contract between the Board of Administration California Public Employees’ Retirement System and the City Council City of Palo Alto to adopt 2.7% at 55 for Local Miscellaneous Members

2. Resolution of the Council of the City of Palo Alto describing Employer Paid Member Contributions to the Public Employees’ Retirement System for Local Miscellaneous Members

3. Resolution of the Council of the City of Palo Alto implementing the Provisions of Section 414(h)(2) of the Internal Revenue Code on Behalf of Local Miscellaneous Members

4. Ordinance of the Council of the City of Palo Alto authorizing an Amendment to the Contract between the City Council of the City of Palo Alto and the Board of Administration of the California Public Employees’ Retirement System (to provide section 21354.5 (2.7% @ 55 Full Formula) for Local Miscellaneous Members)