Summary Title: Binding Interest Arbitration Provision

Title: Review of Binding Interest Arbitration Provision in City Charter for Public Safety

From: City Manager

Lead Department: Human Resources

Recommendation
Staff recommends the Committee review the City's Binding Interest Arbitration (BIA) provision in the City Charter for public safety and consider making a recommendation to the Council. If the Committee decides the existing provision does not meet the City’s needs, there are 2 options: 1) modify the Charter language or 2) eliminate the Charter language. Any Charter changes, of course, must be submitted to the voters.

Executive Summary
At the Council meetings of July 26, 2010 and August 2, 2010, the City Council discussed and considered whether to place a measure on the ballot proposing repeal of Charter Article V, Compulsory Arbitration for Fire and Police Department Employee Disputes (see Attachment F). At that time the Council determined not to move forward with a measure, but directed staff to return with further analysis and information on this issue. This report provides background information on impasse resolution procedures, the City’s experience with binding interest arbitration, and analysis of options for the Council to consider if it decides
to propose modifying or repealing the binding interest arbitration provision in the City's charter.

Background

1. Labor Relations Rules Require Parties to Meet and Confer in Good Faith to the Point of Impasse

The Meyers-Millas-Brown Act ("MMBA") and Chapter 12 of the City's Merit System Rules and Regulations ("local rules") govern labor-management relationships between recognized employee organizations and the City. Generally, the MMBA sets forth basic obligations and standards of conduct for labor relations and requires public agencies to bargain in good faith over matters pertaining to wages, hours, and working conditions. The City's local rules were adopted pursuant to section 3507 of the MMBA, which allows agencies to develop additional procedures for administration of employee-employer relations under the MMBA. If the City and a union negotiate in good faith but cannot reach agreement on issues pertaining to wages, hours, and working conditions either party may declare an impasse.

2. Impasse Resolution Procedures in the City are Different for Safety and Non-Safety Groups

A declaration of impasse triggers resolution procedures. The City's local rules do not have mandatory impasse resolution procedures. Therefore, section 3505.4 of the MMBA allows the City to unilaterally implement its last, best and final offer after impasse has been declared in negotiations with must units.

For public safety groups, however, Article V of the City's Charter establishes binding interest arbitration as the required impasse resolution procedure. That procedure requires a three member board of arbitrators, one selected by each side.
and a neutral jointly selected by both parties. Following a hearing, the arbitration panel must decide each disputed issue by majority vote. Following receipt of the decision, the City and the union have ten days (or mutually agreed upon time) to meet to attempt to resolve their differences. If the parties do not reach agreement, the decision of the arbitrators is binding at the end of the resolution period and must be implemented.

3. **Background on Binding Interest Arbitration for Public Safety**

Article V was added into the Charter in 1978 by initiative after a 1975 strike by public safety employees in San Francisco prompted some cities in the state to pass binding interest arbitration measures as a method that was perceived to be more peaceful and equitable in resolving disputes that might otherwise lead to strikes.

California Labor Code section 1962 has contained an explicit prohibition on strikes by firefighters since it was enacted in 1959, but the law prohibiting general public safety strikes has been clarified since 1985. California Courts have repeatedly held that employees providing essential public services may not strike when such an action would create a substantial and imminent threat to the health and safety of the public. (See, e.g. County Sanitation Dist. No. 2 v. Los Angeles County Employees' Ass'n. (1985) 38 Cal.3d 564; City of Santa Ana v. Santa Ana Police Benevolent Ass'n. (1989) 207 Cal.App.3d 1568; County of Sonoma v. Sup. Court (2009) 173 Cal.App.4th 322. Thus, the rationale that binding interest arbitration protects the City from work actions by public safety employees is weaker now than it was when the initiative passed in 1978 because the law prohibiting public safety strikes is settled.

4. **Binding Interest Arbitration Decisions in Palo Alto**

The binding interest arbitration procedure has been used approximately six times total by police and fire since the City Charter provision was approved in 1978. Generally, the decisions have provided mixed results for the City. For example, in
a 1980 arbitration with three issues in dispute, an arbitrator selected the City’s proposal on salary (awarding increases for the first two years of a contract instead of all three years as proposed by the fire fighters), rejected the City’s proposal to reduce the retirement formula for new city employees by establishing a second tier, and accepted the fire fighters’ proposal to change the retirement allowance formula from an average of three years to the highest single year. The attached charts (Attachment C and Attachment D) summarize the issues and results in each of the six arbitrations. At the same time, we are in an era where significant organizational changes and transformation of how services are provided is required, and where concessions from labor may be fundamental to the fiscal health and effectiveness of a city. Discussion of maintenance of binding arbitration in its current form is truly warranted.

5. In the Absence of Charter Requirements to Proceed to Interest Arbitration, Local Impasse Rules and MMBA Provisions for Implementation Apply

In cities that have repealed or do not have binding interest arbitration, impasse procedures are governed by local rules and the MMBA provisions related to unilateral implementation. Thus, if voters approved a repeal of Article V, the City would remain subject to the provisions of the MMBA; if impasse were reached after meeting and conferring in good faith with a public safety unit the City would follow its local rules related to impasse (as it did in the 2009 SEIU negotiations). Those rules simply allow, but do not require, the parties to mutually agree on a method of resolving the dispute. If they do not agree on a method of resolution, the impasse procedures are deemed exhausted and the City can then implement its last, best and final offer pursuant to section 3505.4 of the MMBA.

Within Santa Clara County, only 3 of 15 cities provide binding interest arbitration: Gilroy, Palo Alto and San Jose. There is a recent trend toward eliminating interest arbitration as a method for resolving impasse with public safety units among cities that currently have arbitration as a requirement. On
June 8, 2010 voters in the City of Vallejo repealed that city’s charter provisions mandating binding interest arbitration as the last step of the impasse procedure. Voters in the City of San Jose modified their binding interest arbitration provisions in November 2010. The City of San Luis Obispo is currently considering elimination. In addition, the May 2010 Santa Clara County Civil Grand Jury Report also recommended repealing binding interest arbitration provisions to provide cities with greater control over employee costs.

Discussion and Analysis
The Charter provision on binding arbitration is over 30 years old, and recent discussion by the Council and residents have raised questions about whether it continues to adequately serve the needs and best interests of the City. Whether this process continues to be an effective and efficient way to settle labor disputes is a policy decision for the council. Any provision for addressing and resolving disputes will have trade offs. The question is whether the existing arbitration process for resolving disputes is structurally sound and if the citizens and City are comfortable with the resulting trade offs.

If the Council determines that the existing process no longer meets the needs of the City, there are two primary options for change: eliminate binding interest arbitration or modify the provisions to require the arbitrator to consider the factors that are important to the City. Tables 1 and 2 (Attachment A and Attachment B) provide a summary and analysis of these options and the different factors to consider in evaluating the options.

One of the primary criticisms of binding arbitration is that it delegates decision-making authority on pay levels, benefits, and work rules to a third party, unelected person (the arbitrator) who has no accountability to the citizens. Elected council members are typically responsible for determining appropriate service levels for the entire range of services provided to the community, while an arbitrator is generally focused only on the service of the particular public safety department at issue in arbitration. This narrower scope for an arbitrator has the
potential to create an imbalance in the Council's service level decisions for the City as a whole. If arbitration results in a decision that is not consistent with the adopted budget, the Council may have to adjust other already established service levels to compensate because arbitration is binding and there is no procedure for challenging a decision.

Moreover, under the existing rules, the determination of whether an individual has sufficient knowledge, skill and experience to serve as the arbitrator is left to the State Mediation and Conciliation Service ("SMCS") and its screening criteria. The criteria for arbitrators are very broad and general. For example, SMCS criteria for qualified arbitrators are: 1) graduation from college (or may substitute qualifying experience for required education on a year-for-year basis); and 2) four (4) years experience in addressing labor disputes or in negotiation, administration, interpretation of MOAs (as the primary job function) with at least one year experience in CA and at least one year experience within the last 5 years.

The issue of appropriate decision-makers is particularly highlighted now given the difficult budget environment and the challenging decisions on resource allocation and service levels facing the City Council.

Another potential criticism is that arbitration can be seen as a conservative institution insofar as it may prove difficult to persuade an arbitrator to make an important and arguably needed change or group of changes when the parties themselves have not agreed to such changes. The City's experience in the 6 prior arbitration cases show that in one case Fire prevailed, in one case the City prevailed, and in the others the issues were split between the Union (Police or Fire) and City. The City's own results indicate that the conservative nature of the existing process is not conducive to making substantial change.

In addition to the format of arbitration, another key element to consider is whether the criteria the arbitrator must apply when formulating his or her...
decision remain appropriate. The City's Article V lists the following factors for the arbitrator to consider when making his or her decision:

- Changes in average Consumer Price Index for goods and services
- Wages, hours, terms and conditions of employment of other employees performing similar services (surveys of the affected classifications in other agencies)
- Financial conditions of the City and ability to meet cost of the award

In comparison, in San Jose's newly modified interest arbitration language these are the primary factors in decisions regarding compensation:

"The City's financial condition, and in addition, its ability to pay for employee compensation from on-going revenues without reducing City services. No arbitration award may be issued unless a majority of the Arbitration Board determines, based upon a fair and thorough review of the City's financial condition and a cost analysis of the parties' last offers, that the City can meet the cost of the award from on-going revenues without reducing City services. The arbitrators shall also consider and give substantial weight to the rate of increase or decrease of compensation approved by the City Council for other bargaining units."

(for full amendment to San Jose City Charter, see Attachment E)

The new factors in the San Jose ordinance more closely match the current concerns expressed by local policy makers. For further analysis of Palo Alto's existing factors and a comparison to the San Jose amendments, refer to Table 2 (Attachment B).

Timeline

May 10, 2011
There is no set timeline for Council action. Dates of future elections and rough cost estimates are listed below:

<table>
<thead>
<tr>
<th>Election Date</th>
<th>Deadline for Council Approval of Ballot Language</th>
<th>Rough Estimate of Election Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>11/8/11</td>
<td>8/1/11</td>
<td>$50,000*</td>
</tr>
<tr>
<td>4/10/12</td>
<td>1/9/12</td>
<td>$550,000</td>
</tr>
<tr>
<td>6/5/12</td>
<td>3/5/12</td>
<td>$550,000</td>
</tr>
<tr>
<td>11/6/12</td>
<td>8/6/12</td>
<td>$250,000</td>
</tr>
</tbody>
</table>

* Green Energy Initiative measure has qualified for November 8, 2011 ballot.

**Conclusion**

In conclusion, the issue before the Committee is whether the existing binding interest arbitration provision in the City Charter is the appropriate method for resolving labor disputes with the City's police and fire employee units. If the Committee decides this provision does not meet the City's and community's needs, the Committee may recommend modification or elimination of binding interest arbitration to the City Council for further discussion and action. Ultimately, any change to the City's Charter would have to be submitted to the voters.

cc: Tony Spitaleri, Firefighter's Union Local 1319 and Fire Chiefs' Association
    Ron Watson, Police Managers' Association
    Wayne Benitez, Police Officers' Association
Attachments:

- Attachment A Table 1-General Options (DOC)
- Attachment B Table 2-Factors to Consider (DOC)
- Attachment C Fire - IAFF Binding Interest Arb Cases (XLS)
- Attachment D PAPOA Binding Interest Arb Cases (PDF)
- Attachment E San Jose Modifications Approved by Voters 2010 (PDF)
- Attachment F CPA Charter Provision On Binding Arbit (PDF)
- Attachment G Grand Jury Report On Pensions (PDF)

Prepared By: Elizabeth Egli, Administrative Assistant

Department Head: Sandra Blanch, Interim Director, Human Resources Department

City Manager Approval: James Keene, City Manager
## TABLE 1
General Options for Public Safety Impasse Procedures

<table>
<thead>
<tr>
<th>PUBLIC SAFETY IMPASSE PROCEDURE OPTION</th>
<th>PROS</th>
<th>CONS</th>
<th>NOTES</th>
</tr>
</thead>
</table>
| Retain Existing City Provision- Binding Interest Arbitration: Retain existing “issue-by-issue” binding interest arbitration provisions | -Each issue stands alone- not necessarily a win-all or lose-all result  
-Predictability- award on each issue will be at least what one side proposes (arbitrator does not get to develop own language) so parties know in advance what terms may be | -Arbitrator, not elected representatives, has final choice of which issues go to each side  
-Arbitrator may tend to “split the difference,” so that no party wins entirely  
-Detrimental if either party has made package proposal because arbitrator is not required to adopt all components  
-Arbitration process and final decision falls outside City Council purview  
-Process provides little incentive for parties to narrow agenda | See Palo Alto Charter Article V  
Gilroy, San Francisco, Santa Cruz, Anaheim Monterey, Napa San Luis Obispo Sacramento (City) Sacramento (County) Redwood City |
| Eliminate binding arbitration entirely: MMBA Unilateral Implementation of Last, Best Final Offer would apply | -Unilateral implementation of terms and conditions gives Council final authority to approve spending for salaries, benefits and terms/conditions of work  
-Leaves decisions in the hands of elected officials  
-Al lows more timely action, particularly for issues with financial impacts affecting City budget and operations  
-Saves cost of arbitration (legal, arbitrator, expert witness costs) | -Perception that City would hold balance of power  
-Potential negative impact on labor relations | For example, Carlsbad 1, Bakersfield 2 Salinas have unilaterally implemented.  
Voters in Vallejo and Stockton approved eliminating binding arbitration. |

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1 Carlsbad City Council implemented 2%@50 effective October 4, 2010; Employee contribution to PERS increased from 1% to 9%; 3 year Final Average Earnings rather than single highest year. Available online at [http://www.carlsbadca.gov/services/departments/hr/Documents/CFA%20MOU%201-2010.pdf](http://www.carlsbadca.gov/services/departments/hr/Documents/CFA%20MOU%201-2010.pdf)

2 Bakersfield City Council implemented removal of staffing requirements language in MOU. (Impasse hearing held 9/8/10 and implementation approved 9/22/10)
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<tbody>
<tr>
<td>Modify binding arbitration: Amend existing arbitration provisions to change (a) arbitration style, and/or (b) factors arbitrator must consider in making a decision</td>
<td>See below for arbitration style options. See Table Two for discussion of potential factor options.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Potential Options for modifying the style of arbitration

<table>
<thead>
<tr>
<th>Option</th>
<th>PROS</th>
<th>CONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Option A: Modify arbitration provisions to “package final offer” format, choosing entire final offer of one party or the other</td>
<td>-“All or nothing” approach may encourage parties to reach negotiated settlement</td>
<td>-“All or nothing” approach creates high risk for both parties, especially where parties take an extreme position or propose a large number of contract changes -May reward small or incremental change and preclude significant shifts -Risk that even small errors in a proposal would result in arbitrator choosing other package, even if flawed package is otherwise superior</td>
</tr>
<tr>
<td>Option B: Modify arbitration provisions to provide a “Med-Arb” process- arbitrator has authority to attempt to mediate and gain voluntary agreement between the parties as well as make a final arbitration decision if mediation is unsuccessful</td>
<td>-Addition of mediation may help encourage voluntary resolution -May be combined with other modification options related to how arbitrator makes final decision</td>
<td>-Skilled arbitrator required to ensure effectiveness of process</td>
</tr>
</tbody>
</table>
## TABLE 1
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</table>
| **Option C:** Modify arbitration provisions to allow “dual final offer” in which each party submits 2 final package offers and arbitrator picks one of four. | -Each party has opportunity to submit a package that is more or less aggressive in seeking changes to terms and conditions  
-Choice of 4 packages gives arbitrator greater flexibility to address real problems  
-Party may have the opportunity to send “signals” indicating importance of an issue between the 2 offers  
-Multiple options/packages may facilitate mediation | -Increases uncertainty about likely outcome  
-Arbitrator will still end up picking entire proposal of one side | Ex- Eugene OR |
# TABLE 2
Factors to Consider for Modifications to Binding Arbitration

<table>
<thead>
<tr>
<th>ISSUE</th>
<th>PROS</th>
<th>CONS</th>
<th>NOTES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Arbitrator Selection</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Existing: Each side selects one panel member, 2 panel members select third neutral chair via alternate strike from arbitrator list provided by SMCS</td>
<td>- To the extent entire panel discusses matters at issue, representatives of each side can promote respective positions to arbitrator, answer questions, etc.</td>
<td>- Arbitrator is effectively the final decision maker and final decision falls outside of Council purview</td>
<td></td>
</tr>
<tr>
<td>Possible alternative: Appoint retired judge if parties</td>
<td>-Retired judge likely to be more neutral than arbitrator with either labor or management background</td>
<td>-Judge may not have expertise in labor issues or operational work experience -Final decision outside of council purview</td>
<td>See San Jose</td>
</tr>
</tbody>
</table>

## Factors Arbitrator may take into consideration in making decision

**Existing Decision Factors:**

“those factors traditionally taken into consideration in the determination of wages, hours, and other terms and conditions of public and private employment, including, but not limited to, changes in the average consumer price index for goods and services, the wages, hours, and other terms and conditions of employment of other employees performing similar services, and the financial condition of the city and its ability to meet the cost of the award.”

**Status quo**

-Relies heavily on services other agencies provide—ties City to market comparison, but not necessarily to internal equity for all city employees
-Somewhat vague standard - subject to arbitrator’s own views on financial condition of City
-No emphasis on structural change
**TABLE 2**

Factors to Consider for Modifications to Binding Arbitration

| Possible alternative factors: | Combination of factors more closely represents what elected officials consider in making budget and labor decisions for City. For example, factor (a) requires consideration of city-wide level of service, not just service provided by members of applicable unit—requires arbitrator to consider “big picture” for city rather than individual department; factor (c) requires arbitrator to compare employee compensation and benefits internally, goes toward all city employees receiving similar benefits/cuts; and factor (d) establishes that interests of the public in city services should take precedence over compensation demands of unit | See San Jose |
| Change to require City’s financial condition to be primary decision factor, including: (a) Ability to pay from applicable fund (?) without reducing City services, (b) Ability to pay with on-going revenues (c) Compensation (defined as salary and benefits) approved by Council for City’s other units (d) Best interest and welfare of the public | |

Other factors related to arbitrator’s ability to make final decisions

| Existing: Proposal of one side selected on an issue-by-issue basis based on factors in 3. | See above for analysis of issue-by-issue style of arbitration |

### ISSUE

| Possible alternative: Impose Constraints on Final Decision: -Decision may not increase compensation at a rate higher than revenues -No new unfunded liability -Nothing that interferes with management right to make operational decisions | Alternative factors are more closely aligned with City’s operational issues and must be considered by arbitrator in making decision | See San Jose |

### ANALYSIS OF ALTERNATIVE

### NOTES
<table>
<thead>
<tr>
<th>IAFF Binding Interest Arbitration History</th>
<th>Dates of Arbitration</th>
<th>Issue # 1</th>
<th>Issue # 2</th>
<th>Issue #3</th>
<th>Findings ( ) indicate whether City or Union proposal selected</th>
<th>Cost of Arbitration</th>
<th>Arbitrator</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980 Hearing dates August 11, 12 &amp; 13 of 1980 Decision issued 12/11/80</td>
<td>City salary proposal: 9.5% on Jan '80 4.5% on July '80 Union salary proposal: 9.5% on Jan '80 4.5% on July '80 6.5% on Jan '81</td>
<td>Cost of Arbitration Arbitrator $12,000 Court Reporter $1,420 $13,420 split by parties Attorney Fees paid by City: $8,000 City portion + atty fees equivalent to $38,949 in 2010 dollars*. Per CMR 116:1 dated 1/8/81 staff estimated Single Highest YR benefit added cost was $50,000 or 1.4% of sal &amp; bens. Cost to implement total Arbitrator Award $568,000 or 16.7% of sal &amp; bens.</td>
<td>Pension Formula: City proposed 2nd tier for new hires of 2%@55. Union position status quo</td>
<td>Pension Calculation: City position status quo of highest 36 mos Union proposed Single Highest Year</td>
<td>1. Wage increase (City) proposal of 9.5% and 4.5% salary increases 2. Pension Formula (Fire) Status quo (no 2nd tier) 3. Pension Calculation (Fire) Single Highest Year</td>
<td>Adolph Koven</td>
<td></td>
</tr>
<tr>
<td>1999 Hearing dates February 29, March 9 and 10 of 2000. Decision on 6/19/2000</td>
<td>Union proposed to broaden City’s nepotism policy to allow employment by Fire Dept of relatives by “blood, marriage or adoption” of current employees but could not supervise/fire City position: status quo</td>
<td>Not able to find data on costs</td>
<td>Comparable Survey Agencies City proposal: 15 regional comparable fire agencies [Alameda, Berkeley, Fremont, Hayward, Livermore/PLEASANTON, Menlo Park, Milpitas, Mountain View, Redwood City, San Jose, San Mateo, San Ramon, Santa Clara County, Santa Clara City, South San Francisco] Union proposal: 9 regional comparable fire agencies [Santa Clara City, Santa Clara County, Milpitas, Mountain View, San Jose, Sunnyvale, Menlo Park, Redwood City, Fremont]</td>
<td></td>
<td></td>
<td>Phillip Tamouch</td>
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</table>
That Section 1111 of the City Charter be amended to read as follows:

SECTION 1111. Compulsory Arbitration for Fire and Police Department Employee Disputes.

(a) It is hereby declared to be the policy of the City of San Jose that strikes by firefighting and peace officers are unlawful in the state of California and not in the public interest and should be prohibited, and that a method should be adopted for peacefully and equitably resolving disputes that might otherwise lead to such strikes.

If any firefighter or peace officer employed by the City of San Jose willfully engages in a strike against the City, said employee shall be dismissed from his or her employment and may not be reinstated or returned to City employment except as a new employee. No officer, board, council or commission shall have the power to grant amnesty to any employee charged with engaging in a strike against the City.

(b) The City, through its duly authorized representatives, shall negotiate in good faith with the recognized fire and police department employee organizations on all matters relating to the wages, hours, and other terms and conditions of City employment, including the establishment of procedures for the resolution of grievances submitted by either employee organization over the interpretation or application of any negotiated agreement including a provision for binding arbitration of those grievances. Unless and until agreement is reached through negotiations between the City and the recognized employee organization for the fire or police department or a determination is made through the arbitration procedure hereinafter provided, no existing benefit or condition of employment for the members of the fire department or police department bargaining unit shall be eliminated or changed.

(c) All disputes or controversies pertaining to wages, hours, or terms and conditions of employment which remain unresolved after good faith negotiations between the City and either the fire or police department employee organization shall be submitted to a three-member Board of Arbitrators upon the declaration of an impasse by the City or by the recognized employee organization involved in the dispute. All issues concerning the scope of the Arbitration Board's authority, jurisdiction or powers shall, upon the request of either party, be resolved by petition to the Superior Court.

(d) Representatives designated by the City and representatives of the recognized employee organization involved in the dispute, controversy or grievance shall each select one arbitrator to the Board of Arbitrators within three (3) days after either party has notified the other, in writing, that it desires to proceed to arbitration. The third
member of the Arbitration Board shall be selected by agreement between the two arbitrators selected by the City and the employee organization, and shall serve as the neutral arbitrator and Chairman of the Board. In the event that the arbitrators selected by the City and the employee organization cannot agree upon the selection of the third arbitrator within ten (10) days from the date that either party has notified the other that it has declared an impasse, then either party may request the State of California Conciliation Service to provide a list of seven (7) persons who are qualified and experienced as labor arbitrators. If the arbitrators selected by the City and the employee organization cannot agree within three (3) days after receipt of such list on one of seven (7) to act as the third arbitrator, they shall alternatively strike names from the list of nominees until only one name remains and that person shall then become the third arbitrator and chairman of the Arbitration Board, the Superior Court of the County of Santa Clara to appoint an arbitrator who shall be a retired judge of the Superior Court.

Any arbitration convened pursuant to this section shall be conducted in conformance with, subject to, and governed by Title 9 of Part 3 of the California Code of Civil Procedure to the extent that such procedures do not conflict with this Charter Section. Unless otherwise mandated by state or federal law, all arbitration hearings shall be open to the public and all documents submitted in arbitration shall be public records. Notwithstanding any other provision of this Charter to the contrary, the authority, jurisdiction and powers of the Board of Arbitrators are limited by the provisions of this Section.

(e) At the conclusion of the arbitration hearings, the Arbitration Board shall direct each of the parties to submit, within such time limit as the Board may establish, a last offer of settlement on each of the issues in dispute. The Arbitration Board shall decide each issue by majority vote by selecting whichever last offer of settlement on that issue it finds by the preponderance of the evidence submitted to the Arbitration Board satisfies section (f) below, is in the best interest and promotes the welfare of the public, and most nearly conforms with those factors traditionally taken into consideration in the determination of wages, hours, and other terms and conditions of public and private employment, including, but not limited to, changes in the average consumer price index for goods and services, the wages, hours, and other terms and conditions of employment of other employees performing similar services, and the financial condition of the City and its ability to meet the cost of the award.

(f) In all arbitration proceedings conducted pursuant to this section, the primary factors in decisions regarding compensation shall be the City's financial condition and, in addition, its ability to pay for employee compensation from on-going revenues without reducing City services. No arbitration award may be issued unless a majority of the Arbitration Board determines, based upon a fair and thorough review of the City's financial condition and a cost analysis of the parties' last offers, that the City can meet the cost of the award from on-going revenues without reducing City services. The arbitrators shall also consider and give substantial weight to the rate of increase or decrease of compensation approved by the City Council for other bargaining units.
“Compensation” shall mean all costs to the City, whether new or ongoing, for salary paid and benefits provided to employees, including but not limited to wages, special pay, premium pay, incentive pay, pension, retiree medical coverage, employee medical and dental coverage, other insurance provided by the City, vacation, holidays, and other paid time off.

(g) Additionally, the Board of Arbitrators shall not render a decision, or issue an award, that:

1. increases the projected cost of compensation for the bargaining units at a rate that exceeds the rate of increase in revenues from the sales tax, property tax, utility tax and telephone tax averaged over the prior five fiscal years; or
2. retroactively increases or decreases compensation, including, but not limited to, enhancements to pension and retiree health benefit for service already rendered, but excluding base wages; or
3. creates a new or additional unfunded liability for which the City would be obligated to pay; or
4. deprives or interferes with the discretion of the Police Chief or Fire Chief to make managerial, operational or staffing decisions, rules, orders and policies in the interest of the effective and efficient provision of police and fire services to the public.

(h) Compliance with the provisions of this Section shall be mandatory and enforceable pursuant to section 1085 of the Code of Civil Procedure; failure to comply with these provisions shall also constitute an act in excess of jurisdiction.

(i) After reaching a decision, the Arbitration Board shall mail or otherwise deliver a true copy of its decision to the parties. The decision of the Arbitration Board shall not be publicly disclosed and shall not be binding until ten (10) days after it is delivered to the parties. During that ten-day period the parties may meet privately, attempt to resolve their differences, and by mutual agreement amend or modify any of the decisions of the Arbitration Board. At the conclusion of the ten-day period, which may be extended by mutual agreement between the parties, the decision of the Arbitration Board together with any amendments or modifications agreed to by the parties shall be publicly disclosed and shall be binding upon the parties. The City and the recognized employee organization shall take whatever action is necessary to carry out and effectuate the award.

(j) The expenses of any arbitration convened pursuant to this section, including the fee for the services of the Chairman of the Arbitration Board, shall be borne equally by the parties. All other expenses which the parties may incur individually are to be borne by the party incurring such expenses.

(k) This Section shall be effective immediately upon passage by the voters, and shall apply to any arbitration in which hearings commence after November 2, 2010.
The voters declare that the provisions of this Section are not severable, and none would have been enacted without the others. Should any portion of this Section be enjoined or declared invalid, all provisions shall be deemed invalid and inoperative and there shall be no compulsory arbitration for fire and police department employee disputes.
City of Palo Alto
Charter Provision on Binding Interest Arbitration
(Palo Alto Municipal Code)

Article V. Compulsory Arbitration for Fire and Police Department Employee Disputes

Sec. 1. Declaration of policy.

It is hereby declared to be the policy of the city of Palo Alto that strikes by firefighters and police officers are not in the public interest and should be prohibited, and that a method should be adopted for peacefully and equitably resolving disputes that might otherwise lead to such strikes.

Sec. 2. Prohibition against strikes.

If any firefighter or peace officer employed by the city of Palo Alto wilfully engages in a strike against the city, said employee shall be dismissed from his or her employment and may not be reinstated or returned to city employment except as a new employee. No officer, board, council or commission shall have the power to grant amnesty to any employee charged with engaging in a strike against the city.

Sec. 3. Obligation to negotiate in good faith.

The city, through its duly authorized representatives, shall negotiate in good faith with the recognized fire and police department employee organizations on all matters relating to the wages, hours, and other terms and conditions of city employment, including the establishment of procedures for the resolution of grievances submitted by either employee organization over the interpretation or application of any negotiated agreement including a provision for binding arbitration of those grievances. Unless and until agreement is reached through negotiations between the city and the recognized employee organization for the fire or police department or a determination is made through the arbitration procedure hereinafter provided, no existing benefit or condition of employment for the members of the fire department or police department bargaining unit shall be eliminated or changed.

Sec. 4. Impasse resolution procedures.

All disputes or controversies pertaining to wages, hours, or terms and conditions of employment which remain unresolved after good faith negotiations between the city and either the fire or police department employee organization shall be submitted to a three-member board of arbitrators upon the declaration of an impasse by the city or by the recognized employee organization involved in the dispute.

Representatives designated by the city and representatives of the recognized employee organization involved in the dispute, controversy or grievance shall each select one arbitrator to the board of arbitrators within three days after either party has notified the other, in writing, that it desires to proceed to arbitration. The third member of the
City of Palo Alto
Charter Provision on Binding Interest Arbitration
(Palo Alto Municipal Code)

The arbitration board shall be selected by agreement between the two arbitrators selected by the city and the employee organization, and shall serve as the neutral arbitrator and chairman of the board. In the event that the arbitrators selected by the city and the employee organization cannot agree upon the selection of the third arbitrator within ten days from the date that either party has notified the other that it has declared an impasse, then either party may request the State of California Conciliation Service to provide a list of seven persons who are qualified and experienced as labor arbitrators. If the arbitrators selected by the city and the employee organization cannot agree within three days after receipt of such list on one of seven to act as the third arbitrator, they shall alternately strike names from the list of nominees until only one name remains and that person shall then become the third arbitrator and chairman of the arbitration board.

Any arbitration convened pursuant to this article shall be conducted in conformance with, subject to, and governed by Title 9 of Part 3 of the California Code of Civil Procedure.

At the conclusion of the arbitration hearings, the arbitration board shall direct each of the parties to submit, within such time limit as the board may establish, a last offer of settlement on each of the issues in dispute. The arbitration board shall decide each issue by majority vote by selecting whichever last offer of settlement on that issue it finds most nearly conforms with those factors traditionally taken into consideration in the determination of wages, hours, and other terms and conditions of public and private employment, including, but not limited to, changes in the average consumer price index for goods and services, the wages, hours, and other terms and conditions of employment of other employees performing similar services, and the financial condition of the city and its ability to meet the cost of the award.

After reaching a decision, the arbitration board shall mail or otherwise deliver a true copy of its decision to the parties. The decision of the arbitration board shall not be publicly disclosed and shall not be binding until ten days after it is delivered to the parties. During that ten-day period the parties may meet privately, attempt to resolve their differences, and by mutual agreement amend or modify any of the decisions of the arbitration board. At the conclusion of the ten-day period, which may be extended by mutual agreement between the parties, the decision of the arbitration board together with any amendments or modifications agreed to by the parties shall be publicly disclosed and shall be binding upon the parties. The city and the recognized employee organization shall take whatever action is necessary to carry out and effectuate the award.

The expense of any arbitration convened pursuant to this article, including the fee for the services of the chairman of the arbitration board, shall be borne equally by the parties. All other expenses which the parties may incur individually are to be borne by the party incurring such expenses.

(Added by amendment filed with the city clerk, July 17, 1978)
CITIES MUST REIN IN UNSUSTAINABLE EMPLOYEE COSTS

Issue

Employee costs are escalating in the cities of Santa Clara County (County), revenues are not keeping pace with these increases and cities are cutting services. How do cities contain these escalating employee costs?

Summary

In this report, the 2009-2010 Santa Clara County Civil Grand Jury (Grand Jury) takes a broad look at employee costs in the County's fifteen cities and recommends solutions to control costs so that cities over time can achieve fiscal and organizational stability and eliminate budget deficits.

There is widespread concern that the cost of employee total compensation continues to increase while revenues and services decrease. Wages and salaries climb, even as the economy struggles. Pension and health care benefits have risen substantially since 2000. Vacation, holiday and sick leave policies are overly generous and exceed those of private industry. The overall costs to cities are not sustainable. Cities need to negotiate, approve and implement considerable cost containment measures so that employee financial obligations do not continue to escalate.

Cities should expand the comparison of salaries and benefits beyond other nearby cities to include the private sector. Options for additional cost savings include: outsourcing some activities to private industry; consolidating services with other cities or the County; optimizing job functions; and introducing lower cost pension and health care plans for new employees.

It is important for the cities to solicit community input so that taxpayer money is spent prudently and fairly, while maintaining the obligations of local government to its citizens, and ensuring that services and infrastructure improvements are not neglected.

Background

During the last decade, cities significantly increased the total compensation that employees receive, but city leaders did not adequately forecast and plan, nor allocate enough money to pay for these long-term obligations. In order to attract qualified workers during the dot-com boom, the cities, flush with revenue, increased wages and benefits, especially pension benefits, with unrealistic expectations that the economy and
the stock market would continue to expand. These increases are largely guaranteed by union collective bargaining agreements. Binding arbitration in public safety has compounded the situation in the City of San Jose.

Two recessions later, most cities are experiencing chronic budget deficits. The economic downturn that started in December 2007 is exacerbating the cities' poor financial health. The following major factors are contributing to the cities' problems:

- Increased wage and salary costs
- Increased retirement and health care costs
- Reduced property tax revenues
- Reduced sales tax, occupancy tax, and construction tax revenues
- Reduced revenue from the state

In order to balance budgets, cities are dipping into "rainy day" funds and reserve funds, shifting funds, and reassigning redevelopment money. Many of the cities are facing looming general fund deficits ranging from $3 million to more than $100 million. Overall, the cities are taking a multi-pronged approach in tackling these projected deficits by generating new revenue, reducing operating expenses, and curbing employee compensation costs.

The opportunity for generating revenue is primarily limited to increasing taxes and fees, or in some cities, selling surplus property. Voter approval of a ballot measure is necessary to increase taxes and few cities are considering this option. To achieve cost recovery for all programs, cities have raised or are raising fees—business license fees, parking lot and meter fees, parks and recreation fees, building fees, sewer connection fees, etc.

Cities are reducing operating expenses by streamlining operations, implementing technology improvements, delaying infrastructure projects, cutting support to nonprofits, and reducing or eliminating services. Service reductions are across all departments, such as code enforcement, arson investigation, customer service, tree trimming, landscape maintenance, graffiti abatement, canine units, street repairs, fleet services, and hours of operation in parks, libraries and community centers.

Long-term, cities have few options to control employee costs. Among these are:

- Renegotiate contracts for existing employees with the unions.
- Change pension and retiree health benefits for new hires.
- Alter personnel policies and workplace practices.
- Recommend ballot measures that could mandate changes.
Short-term, cities can control employee costs by:

- Ordering furloughs
- Imposing temporary wage freezes
- Enforcing a hiring freeze
- Eliminating vacant positions
- Laying-off staff

**Methodology**

The Grand Jury took the following actions:

Reviewed the 2008-2009 San Mateo County Civil Grand Jury report “Reversing the Upward Trajectory of Employee Costs in the Cities of San Mateo County”.

Requested from each city in the County:

- 2009-2010 City Budget
- Latest Certified Annual Financial Report
- Any amended agreements or Memoranda of Understanding (MOUs) of union contracts that were negotiated, imposed and/or implemented in 2009

Surveyed the cities for information on number of employees, employee benefits, employee salary/wages, total revenues, retirement formulas, and contributions to pension plans and other post-employment benefits (OPEB). (Survey Forms; Appendix A-C)

Interviewed the city manager or finance/budget director in each city and gathered information on the city’s financial health, deficits, labor negotiation practices, strategies to balance the budget, and specific actions to increase revenue and reduce employee costs.

Interviewed the president of Santa Clara County/Cities Managers' Association and the former president of the Santa Clara County Cities Association (comprised of elected officials) and discussed pension reform and how the cities can work together on issues of mutual concern.

Interviewed the president of the San Jose Police Officers' Association and talked about the contract negotiation process and the role of labor in a city’s financial health.

**Discussion**

Without deliberate, collaborative action, employee wages and benefits will continue to increase substantially year-over-year. The percentage of general fund money spent on employee costs is escalating. During Grand Jury interviews, most of the city managers and finance directors indicated that their current percentages are unsustainable and additional increases would lead to drastic changes to city services. San Jose Mayor Chuck Reed in his State of the City Address on Feb. 18, 2010 stated that employee costs shot up 64% in the last nine years while revenues climbed just 18%.
Table 1: Comparison of Overall Employee Costs in Selected Full-Service Cities

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gilroy</td>
<td>61%</td>
<td>72%</td>
<td>64%</td>
<td>76%</td>
</tr>
<tr>
<td>Los Gatos</td>
<td>61%</td>
<td>79%</td>
<td>76%</td>
<td>77%</td>
</tr>
<tr>
<td>Milpitas</td>
<td>73%</td>
<td>83%</td>
<td>78%</td>
<td>77%</td>
</tr>
<tr>
<td>Mountain View</td>
<td>71%</td>
<td>78%</td>
<td>67.6%</td>
<td></td>
</tr>
<tr>
<td>Sunnyvale</td>
<td></td>
<td></td>
<td>77%</td>
<td>77%</td>
</tr>
<tr>
<td>Santa Clara</td>
<td></td>
<td></td>
<td></td>
<td>77.6%</td>
</tr>
</tbody>
</table>

As this table shows, controlling employee costs is imperative for the ongoing financial health of our cities. For all cities, the Grand Jury investigated the main components of total compensation, work force practices, labor negotiations, and public involvement.

TOTAL COMPENSATION

The cities' median total compensation cost per full-time equivalent (FTE) for:

- Regular employees (non-safety) increased 37% from an average median of $71,379 in fiscal year 2000-2001 to an average median of $113,704 for fiscal year 2009-2010.
- Safety employees (police and fire) increased 41% from an average median of $102,646 to $173,714.

Table 2: Changes in Median Total Compensation, includes Wages and Benefits

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Campbell</td>
<td>$63,784</td>
<td>$106,476</td>
<td>$100,412</td>
<td>$172,422</td>
</tr>
<tr>
<td>Cupertino</td>
<td>$85,481</td>
<td>$132,982</td>
<td>Contract/district</td>
<td>Contract/district</td>
</tr>
<tr>
<td>Gilroy</td>
<td>$54,078</td>
<td>$85,940</td>
<td>$97,273</td>
<td>$156,231</td>
</tr>
<tr>
<td>Los Altos</td>
<td>$59,000</td>
<td>$97,000</td>
<td>$74,000</td>
<td>$131,000</td>
</tr>
<tr>
<td>Los Altos Hills</td>
<td>N/A</td>
<td>$118,842</td>
<td>Contract/district</td>
<td>Contract/district</td>
</tr>
<tr>
<td>Los Gatos</td>
<td>$72,460</td>
<td>$110,243</td>
<td>$119,940</td>
<td>$183,725</td>
</tr>
<tr>
<td>Milpitas</td>
<td>$77,072</td>
<td>$121,924</td>
<td>$113,117</td>
<td>$181,855</td>
</tr>
<tr>
<td>Monte Sereno</td>
<td>$66,946</td>
<td>$128,992</td>
<td>Contract/district</td>
<td>Contract/district</td>
</tr>
<tr>
<td>Morgan Hill</td>
<td>N/A</td>
<td>$104,545</td>
<td>N/A</td>
<td>$160,890</td>
</tr>
<tr>
<td>Mountain View</td>
<td>$79,033</td>
<td>$123,754</td>
<td>$106,654</td>
<td>$190,591</td>
</tr>
<tr>
<td>Palo Alto</td>
<td>$75,814</td>
<td>$113,841</td>
<td>$89,059</td>
<td>$146,061</td>
</tr>
<tr>
<td>San Jose</td>
<td>$66,264</td>
<td>$101,043</td>
<td>$101,928</td>
<td>$182,604</td>
</tr>
<tr>
<td>Santa Clara</td>
<td>$62,836</td>
<td>$120,792</td>
<td>$109,350</td>
<td>$178,950</td>
</tr>
<tr>
<td>Saratoga</td>
<td>$66,314</td>
<td>$114,783</td>
<td>Contract/district</td>
<td>Contract/district</td>
</tr>
<tr>
<td>Sunnyvale</td>
<td>$78,847</td>
<td>$124,403</td>
<td>$114,722</td>
<td>$236,524</td>
</tr>
</tbody>
</table>

Note: Contract/district means that services are provided via a contract with the County or via a special district.

The cumulative increase in the total compensation is the result of increases to base payroll, health/dental benefits, retirement benefits, and other benefits. The rate of increase in total compensation for city employees has been higher than growth in the local economy, and employee costs are escalating at a higher rate than the growth in the cities' general fund revenues. For the 10 years from 2000-2009, the Consumer Price Index for the Bay Area increased by a total of 26.8%, or an average of 2.7% a year.
1. Salary/Wages

At present, the cities utilize a traditional public sector salary schedule with five 5% salary steps for most job classifications. Step increases occur automatically unless action is taken to withhold the 5% increase based on poor performance. The typical time it takes an employee to reach the top step of the salary range is three and a half years.

During the time employees are moving from the first to the top step, they also receive any general salary increases negotiated by bargaining units. After they reach the top step, they continue to receive annual negotiated cost-of-living adjustment (COLA) increases. In the three years starting July 1, 2008, and ending June 30, 2011, the COLA increase in typical contracts is scheduled to rise by 6% to 9.5%. In this scenario, an employee in step progression could receive a salary increase of 26% to 29.5% in those three years. During Grand Jury interviews, city managers indicated that automatic step increases cause undue hardship on the cities’ finances.

2. Health Benefits

Employees in each city receive a generous contribution from the city toward numerous health care benefits: medical insurance, vision insurance, dental insurance, employee assistance programs, and cash-in-lieu of medical coverage. Medical expenses continue to rise, and the cities have been pressured into identifying new strategies to minimize the impact of rising medical insurance costs. Medical insurance expenses are increasing at rates that exceed public employers’ revenue growth.
Table 3: Cities' Monthly Contributions to Health Care Benefits

<table>
<thead>
<tr>
<th></th>
<th>2000 - 2001</th>
<th></th>
<th>2009 - 2010</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Individual</td>
<td>Family</td>
<td>Individual</td>
<td>Family</td>
</tr>
<tr>
<td>Campbell</td>
<td>$295</td>
<td>$493</td>
<td>$668</td>
<td>$1,224</td>
</tr>
<tr>
<td>Cupertino</td>
<td>$634</td>
<td>$634</td>
<td>$792</td>
<td>$869</td>
</tr>
<tr>
<td>Gilroy</td>
<td>Average was $453</td>
<td></td>
<td>Average was $1024</td>
<td></td>
</tr>
<tr>
<td>Los Altos</td>
<td>$569</td>
<td>$569</td>
<td>$550</td>
<td>$1,400</td>
</tr>
<tr>
<td>Los Altos Hills</td>
<td>$228</td>
<td>$594</td>
<td>$592</td>
<td>$1,540</td>
</tr>
<tr>
<td>Los Gatos</td>
<td>$262</td>
<td>$586</td>
<td>$629</td>
<td>$1,442</td>
</tr>
<tr>
<td>Milpitas</td>
<td>$318</td>
<td>$621</td>
<td>$760</td>
<td>$1,622</td>
</tr>
<tr>
<td>Monte Sereno</td>
<td>$490</td>
<td>$800</td>
<td>$600</td>
<td>$1,300</td>
</tr>
<tr>
<td>Morgan Hill</td>
<td>$475</td>
<td>$475</td>
<td>$600</td>
<td>$1,250</td>
</tr>
<tr>
<td>Mountain View</td>
<td>$303</td>
<td>$739</td>
<td>$777</td>
<td>$1,824</td>
</tr>
<tr>
<td>Palo Alto</td>
<td>$296</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>San Jose</td>
<td>$289</td>
<td>$545</td>
<td>$540</td>
<td>$1,139</td>
</tr>
<tr>
<td>Santa Clara</td>
<td>Average was $498</td>
<td></td>
<td>$720</td>
<td>$720</td>
</tr>
<tr>
<td>Saratoga</td>
<td>$201</td>
<td>$523</td>
<td>$611</td>
<td>$1,609</td>
</tr>
<tr>
<td>Sunnyvale</td>
<td>Average was $534</td>
<td></td>
<td>$635</td>
<td>$1,666</td>
</tr>
</tbody>
</table>

In the table above, the monthly premiums increased significantly from 2000 to the present. To reduce costs while preserving essential medical benefits, the cities have implemented or are considering various cost-sharing initiatives. Among these are:

- Cost sharing of monthly premiums; some cities set a certain dollar amount that employees contribute, others set a percent, e.g. San Jose has a 90/10% split (employee share is 10)
- Co-pays for doctor visits, hospital stays and prescription drugs; co-pays currently are relatively low, usually $5.00
- High deductible plans
- Health savings plans for new employees

3. Retirement Pension Benefits

Defined-Benefit Plan

Employees in a defined-benefit retirement system are guaranteed a specific, annual pension at retirement. The annual benefit is distributed in monthly payments. Monthly benefits are calculated using a formula based on the employees' years of service and the salary they received at the time of retirement. In addition, after retirement, retirees are eligible for cost-of-living increases. Most pension plans also provide benefits for disability and death, and in some cases, provide benefits to survivors or beneficiaries.

In the cities of Santa Clara County, similar to most public sector organizations, full-time and many part-time employees are enrolled in a defined-benefit retirement system.
a. CalPERS

California Public Employees’ Retirement System (CalPERS) is the defined-benefit plan in which employees in the majority of the cities of the County are enrolled. The cities and employees make contributions for retirement benefits to CalPERS. CalPERS invests, manages, and distributes money to employees when they retire. Cities are required to increase their contributions when the costs of benefits increase and/or when investment returns decline.

Examples of How the CalPERS Formula Works for Regular Employees

Each city chooses among legislatively-approved formulas that determine the amount of lifelong pensions. The most common formula for regular employees is 2.7% at age 55. To apply this formula: 1) take 2.7% of the employee’s last year’s salary; and 2) multiply it by the number of years of service to determine the amount received upon retiring at 55.

- Regular city employees with 30 years of service will receive 81% of their last year’s salary for life.
- Regular city employees with 20 years of service will receive 54% of their last year’s salary for life.
- Regular retirees will receive an annual COLA of up to 2% a year.

Examples of How the CalPERS Formula Works for Safety Employees

The typical formula for safety employees is 3% at age 50. Upon retirement, an employee will annually receive 3% of their last year’s salary, multiplied by the number of years of service.

- Safety employees with 30 years will receive 90% of their last year’s salary.
- Safety employees with 20 years will receive 60% of their last year’s salary.
- Safety retirees will receive an annual COLA of up to 2% a year.

b. San Jose Pension Plan

San Jose does not participate in CalPERS, but instead has two retirement plans: the Police and Fire Department Retirement Plan and the Federated City Employees’ Retirement System. Both the City and its employees make contributions for retirement benefits. The formulas used to calculate pensions for San Jose employees are similar to those used for CalPERS.

- Regular employee formula: 2.5% at 55; maximum base benefit of 75% of final average salary
- Police formula: 2.5% for first 20 years; 4% starting at 21st year; maximum base benefit of 90% of final average salary
- Fire formula: 2.5% for first 20 years; 3% starting 21st year; maximum base benefit of 90% of final average salary
- All retirees receive annual COLA increases of 3%.
Calculating Pension Benefits

Employee pensions are based on general formulas that are agreed on between the City and the labor unions. A typical pension formula takes into account salary, number of years served, age eligibility for retirement, and a percentage rate of an employee’s recent salary level. Table 4 provides some examples.

Table 4: Examples of Lifetime Retirement Pensions
(Does Not Include Health Care Benefits or Annual COLAs)

<table>
<thead>
<tr>
<th>Employee and Formula</th>
<th>Example Salary*</th>
<th>No. Years Worked and Age</th>
<th>Percentage of Final or Highest Year Salary</th>
<th>Annual Retirement Pension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular employee 2.5%@55</td>
<td>$74,005 (1)</td>
<td>30 years, age 55</td>
<td>75%</td>
<td>$55,504</td>
</tr>
<tr>
<td>Regular employee 2.0%@55</td>
<td>$76,956 (2)</td>
<td>30 years, age 55</td>
<td>60%</td>
<td>$46,174</td>
</tr>
<tr>
<td>Safety employee 3%@50</td>
<td>$114,004 (3)</td>
<td>25 years, age 50</td>
<td>75%</td>
<td>$85,503</td>
</tr>
<tr>
<td>Safety employee 3%@55</td>
<td>$103,093 (4)</td>
<td>25 years, age 55</td>
<td>75%</td>
<td>$77,320</td>
</tr>
<tr>
<td>Safety employee 2.5% plus (police get 4% after 20 years)</td>
<td>$116,210 (5)</td>
<td>25 years, age 50</td>
<td>70%</td>
<td>$81,347</td>
</tr>
<tr>
<td>Safety employee 2.5% plus (fire get 3% after 20 years)</td>
<td>$120,206 (6)</td>
<td>25 years, age 50</td>
<td>65%</td>
<td>$78,134</td>
</tr>
</tbody>
</table>

* Depending on the city, employee retirement pension is based on final or highest years’ salary.

(1) This example salary is the median 2010 salary for regular employees in San Jose
(2) This example salary is the median 2010 salary for regular employees in Saratoga
(3) This example salary is the median 2010 salary for police officers in Los Gatos
(4) This example salary is the median 2010 salary for firefighters in Gilroy
(5) This example salary is the median 2010 salary for police officers in San Jose
(6) This example salary is the median 2010 salary for firefighters in San Jose

The cities use retirement formulas that vary somewhat from one city to another. The table below shows the retirement formulas used by the cities for the 2009 - 2010 fiscal year. In the past decade, these pension formulas have been modified substantially. Most cities increased their formulas from 2% at age 55 to the current 2.7% at age 55 for regular employees, and changed their formulas for safety employees to the more generous 3% at age 50. The cities also vary on the base salary on which retirement benefits are calculated. The highest or final year of salary is now most commonly used as the base salary; earlier, more cities calculated employee pension amounts based on an average of the last three years’ salary.
### Table 5: Retirement Formulas for Cities

<table>
<thead>
<tr>
<th>City</th>
<th>Retirement Formula – Percentage Gained for Each Year Worked &amp; Age Needed to Retire</th>
<th>Pension Based on Last Year's Salary or the Average of Three Years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Safety</td>
<td>Regular</td>
</tr>
<tr>
<td>Campbell</td>
<td>3% @50</td>
<td>2.5% @55</td>
</tr>
<tr>
<td>Cupertino</td>
<td>None; contracted out</td>
<td>2.7% @55</td>
</tr>
<tr>
<td>Gilroy</td>
<td>3% @50 (Police)</td>
<td>2.5% @55</td>
</tr>
<tr>
<td>Los Altos</td>
<td>3% @50</td>
<td>2.7% @55</td>
</tr>
<tr>
<td>Los Altos Hills</td>
<td>None; contracted out</td>
<td>2% @55</td>
</tr>
<tr>
<td>Los Gatos</td>
<td>3% @50</td>
<td>2.5% @55</td>
</tr>
<tr>
<td>Milpitas</td>
<td>3% @50</td>
<td>2.7% @55</td>
</tr>
<tr>
<td>Monte Sereno</td>
<td>None; contracted out</td>
<td>2% @55</td>
</tr>
<tr>
<td>Morgan Hill</td>
<td>3% @50</td>
<td>2.5% @55</td>
</tr>
<tr>
<td>Mountain View</td>
<td>3% @50</td>
<td>2.7% @55</td>
</tr>
<tr>
<td>Palo Alto</td>
<td>3% @50</td>
<td>2.7% @55</td>
</tr>
<tr>
<td>San Jose</td>
<td>2.5% 1st 20 yrs; 3% starting 21st yr (Fire) 2.5% 1st 20 yrs; 4% starting 21st yr (Police)</td>
<td>2.5% @55</td>
</tr>
<tr>
<td>Saratoga</td>
<td>None; contracted out</td>
<td>2% @55</td>
</tr>
<tr>
<td>Santa Clara</td>
<td>3% @50</td>
<td>2.75% @55</td>
</tr>
<tr>
<td>Sunnyvale</td>
<td>3% @50</td>
<td>2.7% @55</td>
</tr>
</tbody>
</table>

In Grand Jury interviews, some city managers reported that these formula changes are causing a systemic problem for their cities. The changes in the formulas provide for a generous but costly increase to the monthly benefits. Estimates project that annual pension benefits will increase approximately 25% to 50% from the previous formulas.

### 4. Other Post-Employment Benefits (OPEB)

Most of the cities in the County provide OPEBs in addition to pension benefits to their retirees. OPEBs typically include health, dental, vision, or prescription drug care to eligible retirees, their families, and in some cases, their beneficiaries. However, benefits vary widely from no additional contributions after retirement, to full retiree and dependent coverage for life, after a vesting period. These benefits are tax free.

Retiree health insurance premiums have been escalating. The increased number of baby boomers reaching retirement age and employees retiring at a younger age are affecting this cost.

Cities are required by the federal Governmental Accounting Standards Board (GASB) to calculate their long-term retiree health obligations by June 2010, depending upon the annual amount of city revenue. Therefore, complete information is not yet available. However, the magnitude of the obligations reported to the Grand Jury for the next several years shows a dramatic increase in projected yearly expenditures and future liabilities.
Funding Pensions and OPEBs

To cover pension obligations city employees pay fixed rates into CalPERS, while the rate the cities pay is adjusted every three years. Rates are determined by the performance of CalPERS investments and the anticipated pension obligations for each city. The payment is made as a percentage of employee salaries.

Similarly, in San Jose, city employees contribute a fixed rate as a percentage of salary into the applicable pension plan. The City’s contributions are established by its retirement boards and are based on many factors, including the cost-sharing arrangement with the employees and the level of benefits provided. Rates can increase if there is a decline in the assets of the retirement fund, which has occurred recently with the steep decline in the stock market.

The cities are responsible for the mounting unfunded pension liability. Unfunded pension liability is an estimate of the cost of future retirement payments for which the city does not have funds already set aside. This is one of the reasons that the cities' contribution rates are notably higher than employees' contribution rates, as set forth in the table below.

Table 6: Employer Contributions as a Percentage of Salary to Pension Plans and OPEB

<table>
<thead>
<tr>
<th>City</th>
<th>Police</th>
<th>Fire</th>
<th>Regular Employees</th>
<th>Police</th>
<th>Fire</th>
<th>Regular Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Campbell</td>
<td>35.2%</td>
<td>None</td>
<td>10.7%</td>
<td>5.0%</td>
<td>None</td>
<td>4.0%</td>
</tr>
<tr>
<td>Cupertino</td>
<td>None</td>
<td>None</td>
<td>21.56%</td>
<td>None</td>
<td>None</td>
<td>13.9%</td>
</tr>
<tr>
<td>Gilroy</td>
<td>35.25%</td>
<td>35.25%</td>
<td>12.64%</td>
<td>0.02%</td>
<td>0.02%</td>
<td>0.02%</td>
</tr>
<tr>
<td>Los Altos</td>
<td>28.99%</td>
<td>None</td>
<td>22.69%</td>
<td>CALPERS Minimum Health Benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Los Altos Hills</td>
<td>None</td>
<td>None</td>
<td>21.69%</td>
<td>None</td>
<td>None</td>
<td>14.2%</td>
</tr>
<tr>
<td>Los Gatos</td>
<td>33.84%</td>
<td>None</td>
<td>14.58%</td>
<td>2.21%</td>
<td>None</td>
<td>5.19%</td>
</tr>
<tr>
<td>Milpitas</td>
<td>21.68%</td>
<td>21.68%</td>
<td>14.58%</td>
<td>7.9%</td>
<td>7.9%</td>
<td>7.9%</td>
</tr>
<tr>
<td>Monte Serano</td>
<td>None</td>
<td>None</td>
<td>19.66%</td>
<td>N/A</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Morgan Hill</td>
<td>28.05%</td>
<td>None</td>
<td>19.69%</td>
<td>0.00%</td>
<td>None</td>
<td>0.00%</td>
</tr>
<tr>
<td>Mountain View</td>
<td>25.56%</td>
<td>25.56%</td>
<td>15.59%</td>
<td>7.34%</td>
<td>7.34%</td>
<td>7.34%</td>
</tr>
<tr>
<td>Palo Alto</td>
<td>33.7%</td>
<td>33.7%</td>
<td>23.55%</td>
<td>9.9%</td>
<td>(08/09)</td>
<td>9.9%</td>
</tr>
<tr>
<td>San Jose</td>
<td>21.61%</td>
<td>24.12%</td>
<td>18.31%</td>
<td>5.28%</td>
<td>4.19%</td>
<td>5.7%</td>
</tr>
<tr>
<td>Santa Clara</td>
<td>26.12%</td>
<td>26.12%</td>
<td>17.02%</td>
<td>2.29%</td>
<td>2.24%</td>
<td>2.31%</td>
</tr>
<tr>
<td>Saratoga</td>
<td>None</td>
<td>None</td>
<td>18.55%</td>
<td>None</td>
<td>None</td>
<td>N/A</td>
</tr>
<tr>
<td>Sunnyvale</td>
<td>41.09%</td>
<td>41.09%</td>
<td>22.25%</td>
<td>8.0%</td>
<td>8.0%</td>
<td>8.0%</td>
</tr>
</tbody>
</table>

Source: Data from Fiscal Year 2009-2010, except as otherwise noted

Notes:
1 Includes percentage of employee contribution that the city pays
2 Service provided by County or special district
Employee Contributions to Pensions and OPEB

Employee contribution rates as a percentage of salaries are as follows:

- Regular employees: 8% to CalPERS when the formula is 2.7% at 55, and 7% if the formula is less
- Safety employees: 9% to CalPERS when the formula is 3% at 50, and 8% if the formula is less
- San Jose Regular employees: 4.28% to The Federated City Employees’ Retirement System
- San Jose Police employees: 8.18%, Fire employees 8.62% to Police and Fire Department Retirement Plan
- Cupertino Regular employees: 2.4% for OPEB
- San Jose Regular employees: 5.7% for OPEB
- San Jose Police employees 5.28%, Fire employees 4.19% for OPEB
- Employees in the other cities contribute nothing for OPEB

Nine of the 15 cities -- Cupertino, Gilroy, Los Altos, Los Altos Hills, Monte Sereno, Morgan Hill, Palo Alto, Saratoga, and Sunnyvale -- pay all or a portion of the employees’ pension contributions. For example, Gilroy pays 100% of safety employees' contributions; Morgan Hills pays 100% of regular employees' contributions. This means those employees do not make any contributions to their own pensions.

Social Security Contributions

Of the 15 cities, only Monte Sereno and Santa Clara contribute to Social Security for regular employees. Such participation requires both the city and the employee to contribute 6.2% of the employee’s salary to the Social Security system. The employees of most cities will not be able to receive Social Security unless they have worked and contributed for 40 quarters at another employer.

Pension Reform: Two-Tier System

The pension benefit is the most expensive benefit provided to employees and has significant cost implications, which is why cities must ensure that the costs of pension benefits are sustainable in the long term. During Grand Jury interviews, many city managers and finance directors stated that pension costs are skyrocketing and diverting limited resources from community services. For example, in Mountain View, CalPERS costs have increased over the past decade from $2.8 million to $7.7 million. San Jose will contribute approximately $138 million into its two retirement plans for 2009 - 2010; more than double that of just 10 years ago. Pension costs are increasing due to benefit enhancements and losses in investment returns.
City managers recognize the challenge they are facing and are working together through the Santa Clara County/Cities Managers' Association to investigate ways to reduce pension costs. Since pension benefits are considered vested, there are limitations on what can be changed. Recently the city managers of Santa Clara County and San Mateo County agreed on a joint policy statement that recommends that all cities adopt a two-tier pension system. (Appendix D) In the two-tier system, cities would implement a reduced level of retirement benefits for all new employees in all agencies in the region. This solution would take detailed planning and communication to implement. The Santa Clara County Cities Association has asked the city managers to present the proposal to their respective city councils and start preliminary discussions with the unions.

Among other cities statewide, San Carlos and Brisbane have already initiated a lower, second tier for new hires. Palo Alto is in the process of implementing a second tier for new Service Employees International Union workers. Sunnyvale completed a preliminary analysis of a second tier and estimated it could save approximately $45 million over 20 years. The goal of two-tier system would be to provide a competitive pension at a more sustainable long-term cost by increasing the age of retirement and lowering the retirement payout.

Other suggested options to reduce pension costs are 1) convert to defined contribution plans for new hires, which are common in private industry and 2) eliminate “double dipping”, which occurs when a public employee retires and subsequently enrolls in a new public retirement fund while continuing to collect from the earlier one.

Retiree Health Care Reform

Retiree health care costs continue to increase and cities are facing significant unfunded liability for their retirees' health care benefits. San Jose is working on a plan that provides for the costs of retirees' medical benefits to be split 50/50 by the city and the employees, which over time would reduce the city's unfunded liability.

Other cities are looking at modified health care plans for their new employees. In some of these plans, the obligations of the city end when the employee retires. One example is establishing a health savings account for each employee hired after a certain date; the city contributes to the account each month, which after vesting the employee can take into retirement. Health savings plans are tax sheltered and the employee can contribute to them.

5. Days Off

Employees receive paid time off for holidays, vacations, personal leave days and sick days; the number of days granted each employee vary by city and by union.

The number of vacation days increase based on length of employment with an allotted number of hours or days granted each year. In some cities vacation days can be accumulated year after year and converted to cash at termination or retirement, or added to the number of years of service and calculated into the retirement benefit. Other cities have imposed limits on accrual time, and require cash out at that time.
Employees receive approximately 12 days of sick leave each year. Disability insurance is available for extended sick leaves. Depending on union affiliation, employees are eligible to receive accrued sick leave as a cash payment or added into their number of years of service and calculated into their retirement benefit. Some are eligible to receive up to 100% of their sick leave paid out at retirement, with no cap on the number of hours. Other employees are eligible to receive up to 75% of their sick leave paid out to a maximum of 1200 hours at retirement.

Although payouts of accrued sick leave are common in government agencies, these benefits are not common in the private sector and could be reduced and capped to save costs.

Table 7: Days Off Per Year by City

<table>
<thead>
<tr>
<th>City</th>
<th>Vacation Days</th>
<th>Holidays</th>
<th>Floating or Personal Days</th>
<th>Total Possible Days Off (retainable)</th>
<th>Sick Leave</th>
</tr>
</thead>
<tbody>
<tr>
<td>Campbell</td>
<td>11 to 21</td>
<td>10</td>
<td>5</td>
<td>24 to 38</td>
<td>12</td>
</tr>
<tr>
<td>Cupertino</td>
<td>10 to 22</td>
<td>12</td>
<td>3 (FLSA exempt)</td>
<td>22 to 44</td>
<td>12</td>
</tr>
<tr>
<td>Gilroy</td>
<td>10 to 20</td>
<td>9</td>
<td>4.5</td>
<td>20 to 40</td>
<td>12</td>
</tr>
<tr>
<td>Los Altos</td>
<td>10 to 20</td>
<td>10</td>
<td>2 (5 for mgmt.)</td>
<td>N/A</td>
<td>12</td>
</tr>
<tr>
<td>Los Altos Hills</td>
<td>12 to 20</td>
<td>12</td>
<td>12 (FLSA exempt)</td>
<td>30</td>
<td>12</td>
</tr>
<tr>
<td>Los Gatos</td>
<td>10 to 25</td>
<td>10 to 12</td>
<td>3 (6 for mgmt.)</td>
<td>40</td>
<td>12</td>
</tr>
<tr>
<td>Milpitas</td>
<td>11 to 31</td>
<td>12</td>
<td>1</td>
<td>Note 4</td>
<td>12</td>
</tr>
<tr>
<td>Monte Sereno</td>
<td>10 to 20</td>
<td>12</td>
<td>0</td>
<td>25</td>
<td>12</td>
</tr>
<tr>
<td>Morgan Hill</td>
<td>10 to 20</td>
<td>11.5</td>
<td>2</td>
<td>20 to 40</td>
<td>12</td>
</tr>
<tr>
<td>Mountain View</td>
<td>12 to 25</td>
<td>11³</td>
<td>2</td>
<td>30 to 60</td>
<td>12</td>
</tr>
<tr>
<td>Palo Alto</td>
<td>10 to 25</td>
<td>12</td>
<td>0</td>
<td>30 to 75</td>
<td>12</td>
</tr>
<tr>
<td>San Jose</td>
<td>10 to 25</td>
<td>14</td>
<td>3 (some classifications)</td>
<td>20 to 50</td>
<td>12</td>
</tr>
<tr>
<td>Santa Clara</td>
<td>10 to 24</td>
<td>13 to 14</td>
<td>3</td>
<td>50 (fire 84)</td>
<td>12</td>
</tr>
<tr>
<td>Saratoga</td>
<td>22 to 32</td>
<td>13</td>
<td>0</td>
<td>75</td>
<td>0</td>
</tr>
<tr>
<td>Sunnyvale</td>
<td>11 to 26</td>
<td>11</td>
<td>2.5 – 3.5</td>
<td>62 (safety 50)</td>
<td>0</td>
</tr>
</tbody>
</table>

Notes:
1 Number of days varies by length of service.
2 In most cities vacation and sick leave days above the allowed retainable number can be cashed out annually; the retainable amounts can be cashed out at retirement or resignation.
3 Mountain View fire and police receive 5.55 days in lieu of holidays; San Jose fire and police receive 5.6 days in lieu of holidays.
4 Employees may annually cash out up to 50% of their balance of sick days and 80 hours of vacation; the rest is retainable.

In the past year, a few cities have imposed furlough days; although this reduces costs, it also impacts services provided to the community. Some cities are considering substituting certain paid days off for unpaid days, instead of imposing furloughs to reduce the impact on services.
WORK FORCE PRACTICES

1. Determining Wage and Benefits Packages

The Grand Jury learned from interviews that most cities set their compensation packages by surveying the wages paid to public employees in a handful of like cities in the general area, rather than wages for the employment market at large. In union negotiations, cities will often negotiate to a place on the comparable wage index rather than negotiating what they think are reasonable salaries by job classification. If the wages in a salary range increase due to negotiations, all negotiated salaries increase.

Limiting comparisons to other cities in the same geographic area results in "a follow the leader" or "keeping up with the Jones" mentality in the cities, rather than real market-based compensation. Neither cities nor the labor unions appear to see a value in comparing private and public sector wages and benefits, or in tracking compensation trends in general. Recently, the Bureau of Labor Statistics reported that high-tech wages in the Bay Area (54% were in Santa Clara County) dropped 12% in the past nine years following the collapse of the dot-com bubble. During this time period, wages in city government increased substantially.

Private industry has wrestled with the same benefit issues as the public sector, and has been quicker to implement solutions that have reduced or contained employer-paid costs, especially pension and health care costs. A report published by the Employee Benefit Research Institute (EBRI) noted that, "State and local governments have sharply higher costs for health and retirement benefits than private-sector employers, since their workers participate in these benefits at far higher rates and public-sector workers are far more likely to have defined benefit retirement benefits than are private-sector workers." The EBRI stated that government employers' overall total compensation costs were 51.4% higher than private-sector employers' costs; the costs were 42.6% higher for wages and salaries and 72.8% higher for benefits.

2. Consolidating Services with Other Cities or the County

All cities provide core services for their residents and perform operational activities to keep the city running properly. With 15 cities performing similar functions, there are opportunities to reduce duplication, decrease costs and improve efficiency by sharing or consolidating services among cities or the County.

Currently, four cities obtain police services from the County Office of the Sheriff; others utilize the County's fire services or have special fire districts. Several cities have consolidated their animal control functions. The Grand Jury learned through interviews that these arrangements are successful and provide a sizeable cost savings. Additional merging of services, such as trash collecting, library functions, payroll activities, and parks and recreation work, could be pursued to reduce employee costs while providing effective and efficient services to the community.
3. Outsourcing to Private Industry

Outsourcing to private industry is another avenue for cities to pursue to decrease employee costs while maintaining services. Through interviews, the Grand Jury learned that Saratoga and Monte Sereno utilize this service delivery model extensively. Saratoga identifies itself as a “contract city.” Several cities have limited contracts with private firms and other cities are beginning to examine the option.

Functions currently being contracted out include landscaping, street sweeping, tree trimming, recreation services, road surfacing, janitorial services, fleet maintenance, trash collection, and traffic engineering. Santa Clara has outsourced the bulk of its information technology functions.

Outsourcing services traditionally performed by employees requires proper planning, effective communication, reliable cost comparisons, and performance-based contracts. And for many cities, it means negotiating with and working with their unions to accomplish this transition.

4. Optimizing Staff

Organizational, the cities should ensure that their staffing models are efficient, effective and are operating at the optimum level to decrease employee costs. It is important to analyze the functions performed by all job classifications and make adjustments in the work force. As appropriate, cities should reassign functions to lower paid job titles, consolidate functions with similar jobs in the same or similar work group, and trim unnecessary functions.

In 2009, Sunnyvale retained a consulting group to conduct an optimal staffing study of seven departments. Many of the staffing and operational improvements recommended by the group have been adopted and other changes will be implemented in the future.

The Office of the City Auditor in San Jose recently completed a study that identified 88 positions being performed by public safety employees that could be performed by civilian employees at a lower cost. These positions are in Administration, Investigations, Technical Services, and the Office of the Police Chief. Some examples of the positions that could be switched to civilians are: Public Information Officer, Police Artist, Watch Bulletin Police Officer and Main Lobby Police Officers. The estimated annual savings would be $5,077,500.

LABOR NEGOTIATIONS

1. Collective Bargaining Agreements

In the cities, with the exception of Los Altos Hills and Monte Sereno, the majority of the work force is represented by labor unions and operates under collective bargaining agreements. Salaries, health care benefits, retirement pension plans, other post-employment benefits plans, and workplace rules are negotiated by the unions on behalf of their members.
Each city negotiates with from three to 11 unions. For instance, Los Gatos has three unions; San Jose has 11 bargaining units, representing approximately 96% of the work force. The cities and each bargaining unit negotiate legally-binding contracts, which are known as either a Memorandum of Agreement (MOA) or a Memorandum of Understanding (MOU), and they are effective for a designated period of time, usually two or three years.

Pursuant to the Meyers-Milias-Brown Act (MMBA), the cities have a right to insist that contract negotiations take place at the bargaining table between the designated representatives of each city and the designated representatives of the various bargaining unit employees. Both the cities and the unions have an obligation under applicable law to negotiate in good faith. It is the goal of both parties to reach a negotiated collective bargaining agreement.

2. Mediation and Arbitration

Under the MMBA, if negotiations do not result in a tentative agreement, impasse procedures allow either party to invoke mediation. If there is still no agreement after impasse procedures are exhausted, the MMBA states that the public agency may implement its last, best and final offer. Additionally, after mediation the bargaining units have the right to strike, except for police officers or firefighters who do not have the right to strike.

For San Jose police and firefighters, if parties fail to reach agreement after mediation, City Charter Section 1111, approved by voters in 1980, allows the parties to submit the dispute to binding arbitration. A three-member panel comprised of a city representative, a union representative, and a neutral arbitrator selected by the city representative and the union representative, decides each issue by majority vote. The arbitration is not open to the public.

3. Negotiating Team

Each city delegates the authority to negotiate labor contracts on behalf of the city to the city manager or the city manager's designee. The city manager generally delegates the lead negotiating responsibility to one of these job titles: assistant city manager, human resources director, employee relations director, or administrative services director. Other key members of the city negotiating team may include the city attorney or an outside labor attorney, the department head or a high-level manager of the applicable work group, the finance director, and occasionally an outside consultant.

The negotiating team members do not belong to unions, and they do not operate under a financial incentive. But as employees of the city, their compensation is proportional with union employees; when salaries and benefits increase for union members, they are generally awarded similar increases. In some cities, members of negotiating teams have worked for the cities for a number of years, and many have come "up through the ranks" and have strong connections to the union employees. Some of the city managers told the Grand Jury that this can be problematic, as these negotiators may experience peer pressure and concede to the unions. For this reason, among others, a few cities are considering adding outside consultants to their teams.
4. Role of the City Manager

Prior to labor negotiations, the city manager provides to the mayor and city council a detailed fiscal analysis of current and projected economic conditions, and the current and projected budget. The city manager also meets with the mayor and council in closed session to recommend the city's position on contract renewal, itemize issues, and receive direction about the intended outcome of negotiations. In upcoming negotiations, it is anticipated that cities will ask for concessions for both current wages and current and future benefits. Prior to negotiations, some of the city managers conduct informal meetings with union leadership, as well as the rank and file members, to provide data on the city's financial health and employee costs.

The city manager is integral to negotiations and is responsible for setting strategy, direction, and parameters for the negotiating team. The city manager is closely engaged with the team prior to negotiations to determine the areas the city would like to negotiate and those it would not like to negotiate. The MMBA, however, defines and controls the areas that are subject to negotiation. Throughout negotiations, the city manager is briefed regularly on progress and issues. The negotiating team will consider the union proposals during the length of the negotiations, and discuss and counter the proposals within the confines of the council's guidance.

5. Role of the City Council and Mayor

The mayor and council are responsible for setting policy direction and guidelines for labor negotiations, overseeing the city manager, and approving labor contracts. The mayor is the public spokesperson.

Although the mayor and council are supposed to represent the best interests of the city and ultimately the taxpayers during negotiations, it is difficult to separate politics from bargaining sessions. If the council approves a package that is favorable to labor, some council members could benefit if they keep or earn union support. Throughout the County, many city councils are dominated by labor-endorsed candidates, and unions play an active role in elections. Unions often support their candidates' campaigns with endorsements and contributions. They print and distribute literature, manage phone banks, make personal appearances at campaign events, and canvass neighborhoods. Conversely, unions will sometimes negatively campaign against a candidate they oppose.

During its investigation, the Grand Jury learned that labor representatives sometimes go directly to council members while negotiations are occurring to solicit their support for various proposals. For this reason, the Santa Clara City Council and the city manager developed and approved "Employer Notification Principles" for the negotiating team and the council to observe during negotiations. These principles govern the commitment, responsibility and behavior of the city manager and the council and have improved the city's negotiations. These principles discourage council and labor discussions during the negotiation process. San Jose has a similar policy that sets guidelines for the council to ensure labor negotiations are conducted in good faith and to avoid actions that would circumvent the city's designated bargaining team.
PUBLIC INVOLVEMENT

In the past year, many articles have appeared in newspapers and other publications about the dire fiscal straits of our cities. The public is becoming aware of the growing cost of employee obligations. Until recently most residents were relatively uninformed about long-term financial costs and how they came about.

During Grand Jury interviews, four of the cities indicated that they did not hold public discussions before the start of their last contract negotiations; other cities stated that they did encourage public comment in regard to the salaries or benefits being negotiated, but that these sessions did not garner a lot of public attention. Some of the city managers acknowledged that the taxpayer is often unaware of the long-term financial impact of negotiations, especially concerning pensions.

The negotiated MOAs and MOUs are either on a council’s consent calendar for approval or appear as a separate agenda item. In either case, there is seldom lengthy discussion around this approval. Approved contracts are posted to a city’s web site.

Many city leaders are currently engaged in a variety of activities to better inform the public about the cities’ financial health and to solicit input. These activities include publishing quarterly newsletters, posting reports on city web sites, conducting budget sessions, sending out surveys, and creating task forces.

Ballot Measures

Escalating public employee costs are a problem occurring throughout California. In some cities and counties, recent ballot initiatives have given citizens an opportunity to vote on retirement and health care benefits.

Orange County, San Francisco, and San Diego voters passed ballot measures as follows:

- In November 2008, Orange County voters decided that future retirement increases must be voter approved.
- In June 2008, San Francisco approved two measures increasing pension benefits for existing employees, but limiting the future costs of retiree health care benefits:
  - New employees will contribute 2% of salary and the employing agency will contribute 1% to a new retiree health care fund.
  - New employees must work ten years to receive half of their health care costs upon retirement and 20 years for full coverage; previously employees were 100% vested after five years.
- In November 2006, San Diego required voter approval of any increase in retiree benefits.
Conclusion

In the past decade, reasonable, intelligent people – city and labor representatives – negotiated generous employee wage and benefit packages through collective bargaining agreements under which the cities are currently operating. As these expire, both groups must recognize the financial impact of these agreements, coupled with the economic downturn, and negotiate contracts that will:

- Assist the cities in returning to fiscal health.
- Preserve the services the taxpayers deserve and expect.
- Provide competitive and affordable compensation for employees.

For many years, there was a common belief that public sector employees earned lower wages than the private sector, but this was balanced by more generous public benefits. Current data shows wages have increased in the cities and are at least on par with private sector jobs, while benefits in the cities have escalated dramatically, thus increasing total compensation to a point that it is out of sync with private industry and is unsustainable for the cities. Unfortunately the taxpayers, who come from both public and private sectors, are funding this inequity.

The cities’ leadership must look beyond political barriers and focus on total compensation and on workplace practices to contain escalating employee costs. All parties – city administrators and labor unions – need to negotiate in good faith to implement lasting, vigorous, sustainable change for our cities.

Findings and Recommendations

Finding 1

The costs of total compensation for employees have grown substantially in the past decade and now threaten the cities’ fiscal stability.

Recommendation 1

All of the cities in the County need to implement measures that will control employee costs. As a starting point, each city should determine the percentage of savings required from the total compensation package to reach budget stability, and provide choices of wages and benefits in collective bargaining sessions for the unions to choose to achieve that percentage goal.
Finding 2

Salary and wage increases do not reflect changes in economic conditions; e.g. even with minimal inflation, yearly COLAs are granted with little bearing on the actual increase in cost of living or market conditions.

Recommendation 2

Cities should not increase salaries and wages that are not supported by planned revenue increases. Cities should tie COLA increases to clear indicators and retain the ability to adjust or withhold based on current economic data.

Finding 3

Step increases are arbitrary and do not adequately represent an employee’s added value to a city. Combined with COLAs, new employees’ wages increase quickly and are not necessarily reflective of improved knowledge and skills.

Recommendation 3

Cities should negotiate step progressions from the current three and a half years to seven years. Employees should not receive COLA increases while in step progression.

Finding 4

Medical insurance costs for active employees are growing year after year at rates that exceed most cities’ revenue growth, while the employee contribution to medical care is minimal.

Recommendation 4

Cities should negotiate that employees assume some of these increased costs for their medical benefits. To contain medical costs cities should consider the following:

A. Split monthly premiums between the city and the employee and increase the employee’s share, if already cost splitting, and remove any employee caps.
B. Establish reasonable co-pays for doctors’ visits, prescription drugs, and in-patient and out-patient hospital care.
C. Prohibit an employee from being covered by both city-provided medical benefits and as a dependent of another city employee.
D. Reduce cash-in-lieu payments.
E. Introduce a new lower premium, high-deductible medical plan.
Finding 5

Pension formula changes instituted in the past decade, stock market losses, the aging "baby boomer" work force, and the growing unfunded pension and OPEB liability all contribute to making retiree pension and health care costs the most problematic and unsustainable expense the cities are facing. The city contribution to pension plans and OPEBs far exceeds the employee contribution.

Recommendation 5a

Cities should:

1) Renegotiate and make provisions for increasing the employees’ contribution for current pension plans.
2) Renegotiate to stop paying the employees’ contribution amount to pension plans.
3) Renegotiate to implement a contribution amount for employees to OPEB; this contribution should provide for a reasonable split of costs between a city and the employee for retiree medical and dental benefits.

Recommendation 5b

Cities should thoroughly investigate reverting to prior pension formulas that were less costly.

Recommendation 5c

To provide a meaningful, long-term solution, the cities should negotiate agreements to:

1) Institute a two-tier system for pension and retiree health care for new hires.
2) Increase the retirement age from 50 or 55 to 60 or 65.
3) Calculate pensions on the last three to five years of salary.
4) Replace current post-employment health care plans with health savings plans.

Finding 6

Public sector employees are granted a generous number of holidays, personal days, vacation days and sick leave annually. Rules and limits on accrual vary by city and union, but vacation days and sick leave can be accumulated and converted to cash or calculated into the pension benefit within those limits.
Recommendation 6a

Cities should renegotiate with the bargaining units to 1) reduce vacation time; 2) reduce the number of holidays and/or personal days; 3) cap sick leave and eliminate the practice of converting accumulated sick leave to cash or adding into their years of service for inclusion in their retirement benefit.

Recommendation 6b

Cities should negotiate to substitute paid days off for unpaid days instead of imposing furloughs. For example, reduce paid holidays to major holidays only, consistent with private industry; and convert minor holidays to unpaid. Therefore, the public is not impacted by fewer services caused by furloughs, and the city saves the employee cost.

Finding 7

Cities traditionally determine their compensation packages by surveying the wages and benefits of other public sector employees in the same geographic area. There is major resistance to comparing themselves or mirroring trends with the private sector. This has allowed wages and benefits to become artificially high and out of sync with market trends.

Recommendation 7a

Cities should research competitive hiring practices and alter the approach to determine fair wages and benefits for each city by using public and private sector data.

Recommendation 7b

Cities should renegotiate salaries and wages using valid market comparisons and not only the current wage index. Cities should utilize more market-oriented compensation practices so that salaries can adjust as competition for labor changes. Cities should reduce entry-level compensation for positions for which there are many qualified applicants.

Finding 8

All cities perform certain core functions to run smoothly and provide services to their residents. To reduce employee costs and streamline operations, the cities are in various stages of contracting services to private industry or partnering with other cities, special districts or the County to deliver services.
Recommendation 8a

Cities should explore outsourcing some functions and services to private industry. Cities should discuss the prospect with cities that are successfully doing this to determine best practices and areas for success. Cities should develop contracts with measurable objectives, performance goals, and timelines.

Recommendation 8b

Cities should create partnerships with other cities, special districts and/or the County for services, such as payroll, human resources, animal control, police and fire. Cities should investigate sharing the cost of new information technology systems.

Finding 9

Cities can gain operational efficiencies and effectiveness with lower employee costs by making sure they are staffed with the correct numbers of people in the appropriate job classification in all departments and work groups.

Recommendation 9

Cities should analyze the functions performed by all job classifications and make adjustments in the work force. Consolidate functions within the same group or a similar group. Reassign appropriate work to lower paid job classifications. Eliminate unnecessary functions.

Finding 10

The San Jose City Auditor identified 88 positions currently being performed by public safety employees that can be performed by civilian employees at lower costs. The safety employees could be moved to positions that require their expertise and training. The auditor estimated this could be accomplished in less than 90 days and save approximately $5 million annually.

Recommendation 10

San Jose should negotiate this suggested transfer with the San Jose Police Officers' Association and set realistic timeframes to move these safety positions to civilian positions.
Finding 11

In many cities, the contract negotiation process is completed by placing the negotiated collective bargaining agreements on the consent calendar for approval, which is acted on quickly at the start of council meetings by a single motion and vote of the council.

Recommendation 11

Cities should consider holding well-publicized public hearings about the cities’ goals of negotiations before negotiations begin, and again at the end of negotiations to report to citizens clearly what changes have been made in contracts.

Finding 12

Current contracts were negotiated in good faith by representatives of the cities and the bargaining units; they were approved by the city councils. Promises made to employees were made by elected officials, past and present. Responsibility for formulating and approving solutions to restore the cities’ financial stability resides squarely with our elected officials. The economic downturn has placed additional pressure on the situation.

Recommendation 12a

City council members and mayors should become better informed about the fiscal realities in their cities, long-term costs and commitments, and be cognizant of potential issues in labor agreements.

Recommendation 12b

City councils and mayors should direct city administrators to (re)negotiate collective bargaining agreements that reverse the escalation of employee costs through concessions, cost sharing, and a second tier for new employees.

Recommendation 12c

City councils and mayors should meet with the bargaining units to clearly outline the cities’ financial health and show how employee costs are impacting the budget.

Recommendation 12d

City councils and mayors should inform citizens of their plans for controlling unsustainable employee costs and remove politics from the equation.
Finding 13

Binding arbitration is not open to the public and results in an adversarial process between the city and employee groups. Binding arbitration limits the ability of city leaders to craft solutions that work for the city's budget. The process has resulted in wage and benefit decisions that have been greater than the growth in basic revenue sources.

Recommendation 13a

San Jose City Council should make binding arbitration open to the public.

Recommendation 13b

San Jose City Council should prepare a ballot measure asking voters to repeal Section 1111 of the City Charter that addresses binding arbitration.
Appendix A

Retirement Information Form Sent to Cities

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Appendix B

City Contribution Form Sent to Cities

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<td>City Contribution to OPEB as % of pay</td>
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Non-Public Safety Employees

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Question: Does City/Employee contribute to Social Security? Yes/No ________

*Does the city pay a portion of the employee’s required share of retirement contribution? If so what is that percent? ________
Appendix C

City Information Form Sent to Cities

City of ____________________________

CITY INFORMATION

1. What is the population of your city based on the 2000 census? __________
2. What is the estimated current population? __________

3. How many total FTE's (Full Time Equivalents) did your city have in 2000/01? __________
4. How many total FTE's does your city have now (2009/10)? __________

5. How many FTE were in the Police department in 2000/01? _______ Now _______
6. How many FTE were in the Fire department in 2000/01? _______ Now _______

7. What was your Total Revenue in fiscal year 2000/01 __________
8. What is your Total Budgeted Revenue for 2009/10? __________

9. What per cent of the General Fund were employee costs with benefits in 2000/01? __________
10. What per cent are employee costs of the 2009/10 budget? __________

Employee costs include payroll, retirement benefits, health/dental benefits and other benefits.

11. How much did the city contribute to non-safety Retirement benefits in 2000/01? _______
    How much did the city contribute to Police/Fire in 2000/01? _______

12. What is the non-safety Retirement cost for 2009/10? __________
    What is the Police/Fire Retirement cost for 2009/10? __________

13. How much did the City pay for Health/Dental Benefits in 2000/01? __________
14. What is the 2009/10 City cost for Health/Dental Benefits? __________

15. What was the average monthly premium the City paid for employee Health/Dental Care in 2000?
    Individual __________ Family __________
16. What are the current average premiums for Health/Dental Care?
    Individual __________ Family __________

17. What was the median salary for non-safety employees without benefits in 2000? _______
    With benefits _______
18. 2009/2010 median salary without benefits _______ With benefits _______

19. What was the median salary for police employees without benefits in 2000/01? _______
    With benefits _______
20. Current median salary without benefits _______ With benefits _______

21. What was the median salary for fire employees without benefits in 2000? _______
    With benefits _______
22. Current median salary without benefits _______ With benefits _______
Appendix C - continued

City Information – continued

23. What is the average number of years for your non-safety employees? ________
   What is the average number of years for police? ________
   What is the average number of years for fire employees? ________

24. How many vacation days, floating days, holidays, personnel leave days and sick days are employees entitled to annually?

25. What are the vacation and sick leave accrual and buy out policies?

26. Did you impose any furlough days this year? Y N  If yes, which work groups? How many people are affected? How often?

27. Prior to entering into each of your current agreements with organized labor, did your city Council, as part of regular business, encourage public comment in regard to the salaries or benefits being negotiated? Y N

28. Are the MOU’s resulting from contract negotiations typically on the consent calendar when coming to the City Council for approval? Y N
Policy Statement on Local Government Retirement Benefits

Background

For more than 70 years, the State of California and local governments have offered a "defined benefit" retirement plan to employees. This system provides a guaranteed annual pension based upon retirement age, salary, and years of service. Most, but not all, municipalities in California are part of the Public Employees' Retirement System (PERS).

Over the years, local government retirement costs have risen and fallen based on two key factors: investment returns and the level of benefit payments provided to employees. In the late 1990s the California legislature enacted significant benefit enhancements for public employees in the PERS system that were optional for participating local governments. At that time, some retirement plans were deemed to be "super funded" and many local governments adopted benefit enhancement plans. For example, most public safety personnel are on the "3% @ 50" plan, which provides a pension benefit of up to 90% of salary after 30 years of service as early as age 50.

When the retirement system suffered serious investment losses in the early part of this decade, these losses, combined with newly approved benefit enhancements, caused dramatic increases in employer contribution rates. Cities in our two counties have seen the percentage of their General Fund budget dedicated to PERS costs increase while their retirement liability funding had decreased from over the past decade. For example, in Mountain View, General Fund PERS costs have gone from $2.8 million in FY00 to $7.7 million in FY10; in San Bruno, it has gone from $240,000 to $4 million. Daly City's percent of the General Fund budget spent on retirement benefits has increased from 4.3% to 10.4% between FY00 and FY10; in Belmont, it has gone from .5% to 11.4%. And Campbell has seen its public safety retirement system fall from 122% funded to 70% funded over ten years.

In the past five years, a number of proposals have been introduced to reform or dramatically revise the public pension system in California. In 2004, a task force of the League of California Cities began an extensive study of the defined benefit system and proposed reforms. In 2005, the League board of directors accepted a report on pension reform from the task force as an initial assessment and for consideration in the ongoing debate of this issue. The report included a number of "general principles" and specific reform recommendations. To date, no concrete action has been taken by the legislature.
Recently, the city managers of San Diego County have prepared a white paper on this issue calling for a new and lower second tier retirement benefit for new hires. Other manager groups across the state have begun a similar dialogue in recognition that the costs of the current system are not sustainable. Additionally, Governor Schwarzenegger has proposed returning pension formulas to 1999 levels for new hires—a move he says will save the state $74 billion through 2040. The City of Sunnyvale has done a preliminary analysis of a lower tier and has estimated it could save a total of $44 million over 20 years. The cities of San Carlos and Brisbane have already initiated a lower, second tier for new hires (among other cities statewide).

Discussion

While the debate is ongoing, no clear consensus has been achieved on addressing the high cost of pension benefits and no action appears imminent. The city managers of Santa Clara and San Mateo counties believe it is important to take a proactive stance on this issue which has long-term implications for the fiscal stability of our cities. This issue is even more important now, given the tremendous losses suffered in the stock market in the past year. At fiscal year end in June 2009, PERS annual returns were down 23.4% from the previous year. This is on top of losses of 5.1% in Fiscal 2008. PERS assumes a 7.75% gain annually to maintain its pension obligations, but clearly there is no guarantee this rate can be achieved. Based on this year’s negative returns, employer rates are expected to jump significantly as of July 1, 2011.

Therefore, as a matter of public policy, we endorse the following principles for a revised pension system.

Guiding Principles

➤ Our residents deserve fiscal policies that preserve local government’s ability to meet community needs, while attracting competent and motivated employees to public service.

➤ Providing adequate retirement benefits is an important part of attracting and retaining public employees; this continues to be an issue as, demographically, there are fewer young people to enter the public sector.

➤ Current retirement benefit formulas are not fiscally sustainable. The costs are escalating beyond our ability to fund them and diverting limited resources from direct service delivery to our communities. In addition, current pension benefits exceed what private sector employees receive and what is reasonably needed to attract public employees.

➤ Ideally, this situation would be addressed at a statewide level and there would be consistent standards for all. We cannot, however, afford to wait for a statewide solution. Therefore, the cities of Santa Clara and San Mateo counties support
implementation of a reduced and sustainable level of retirement benefits for all new employees of agencies in the region.

» Each city has different histories, perspectives, and fiscal conditions; a "one size fits all" approach may not be realistic, but all cities in the region compete for the same employees and therefore should move in the same direction to a lower-cost benefit.

» Each city has the legal duty to meet and confer in good faith with its recognized bargaining unit representatives concerning changes to existing terms and conditions of employment.

» Every city is committed to moving toward a two-tier system for all new contracts.

» Any new system or tier should be fair to employees, sustainable for taxpayers and employers, and based on objective actuarial data.

Action Steps

The city manager associations of Santa Clara County and San Mateo County support the statements in this document and their members pledge to work with their elected officials and labor groups to implement its principles. We further pledge to work with other city managers across the state and the League of California Cities to advocate for changes consistent with this document.

Dave Anderson, SCCMA

Connie Jackson, SMCCMA

Adopted July, 2009
This report was PASSED and ADOPTED with a concurrence of at least 12 grand jurors on this 13th day of May, 2010.

Angie M. Cardoza
Foreperson

Judy B. Shaw
Foreperson pro tem

Mary Nassau
Secretary