THE PERS PATH FORWARD
RISKS, OPPORTUNITIES & OPTIONS

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May 2, 2018

LEAGUE OF CALIFORNIA CITIES
CITY ATTORNEYS' SPRING CONFERENCE

BARTEL ASSOCIATES, LLC

RPLG
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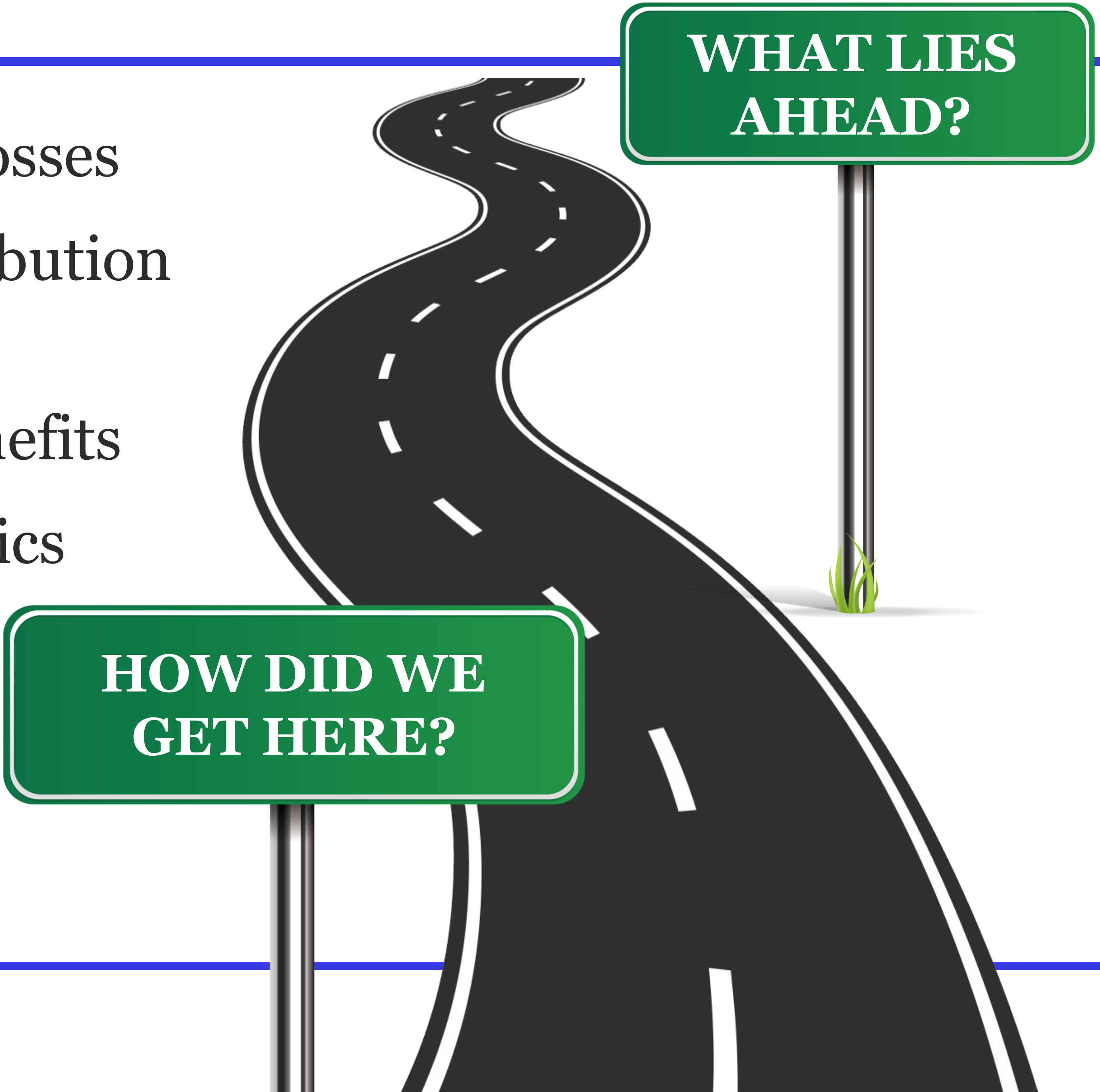
AGENDA

Investment Losses

CalPERS Contribution Policy

Enhanced Benefits

Demographics



Progress in the Courts

Shared Service Model

Bankruptcy?

HOW DID WE GET HERE?

How Did We Get Here?

- Investment Losses
- CalPERS Contribution Policy
- Enhanced Benefits
- Demographics

Projected Contribution Rates

CalPERS Recent Changes

- Designed to strengthen funded status
  - Contribution increases phased in over time
- Result: Steeply increasing contributions
  - Often double (in dollars) over next 7 to 10 years
  - Typical rates above current levels for 20+ years
- In the very long run: more sustainable system

CalPERS Projected Rates

- Generally higher if:
  - Mature City with large retiree liability
  - Enhanced formulas for Classic employees
- Generally lower if:
  - Younger City with small retiree liability
  - No enhanced formulas for Classic employees
- Implementation of an unenhanced 2nd benefit tier before PEPRA has very little impact on projected rates

CalPERS Projected City Miscellaneous Rates By County - 2024/25

		Color
No Cities		
	< 22.5%	
22.5%	27.5%	
27.5%	32.5%	
32.5%	37.5%	
	>37.5%	

League of California Cities, "Retirement System Sustainability Study and Findings", January 2018

CalPERS Projected City Safety Rates By County - 2024/25

	Color
No Cities	
< 40%	
40% 50%	
50% 60%	
60% 65%	
>65%	

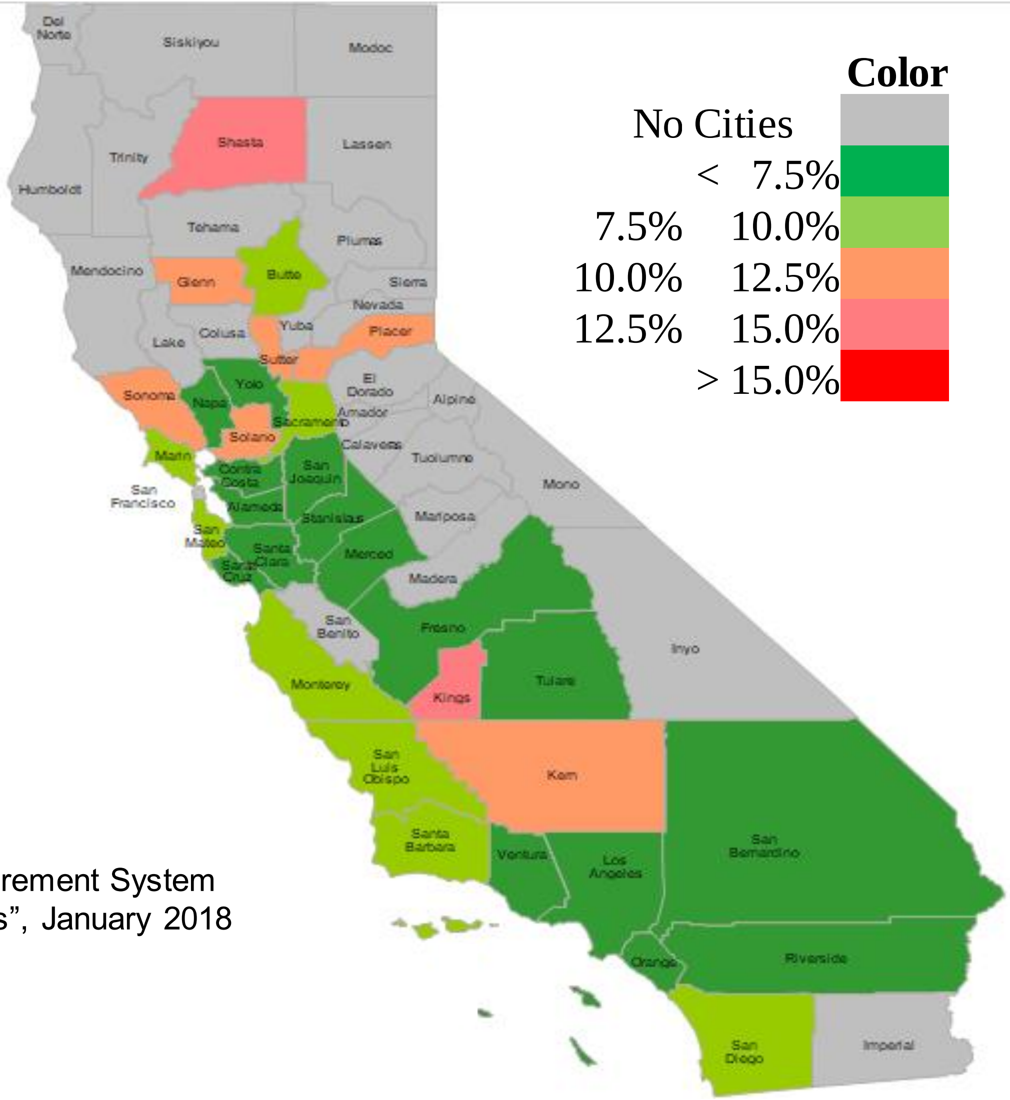
League of California Cities, "Retirement System Sustainability Study and Findings", January 2018

Projected General Fund CalPERS Contributions

City General Fund Projection Assumptions

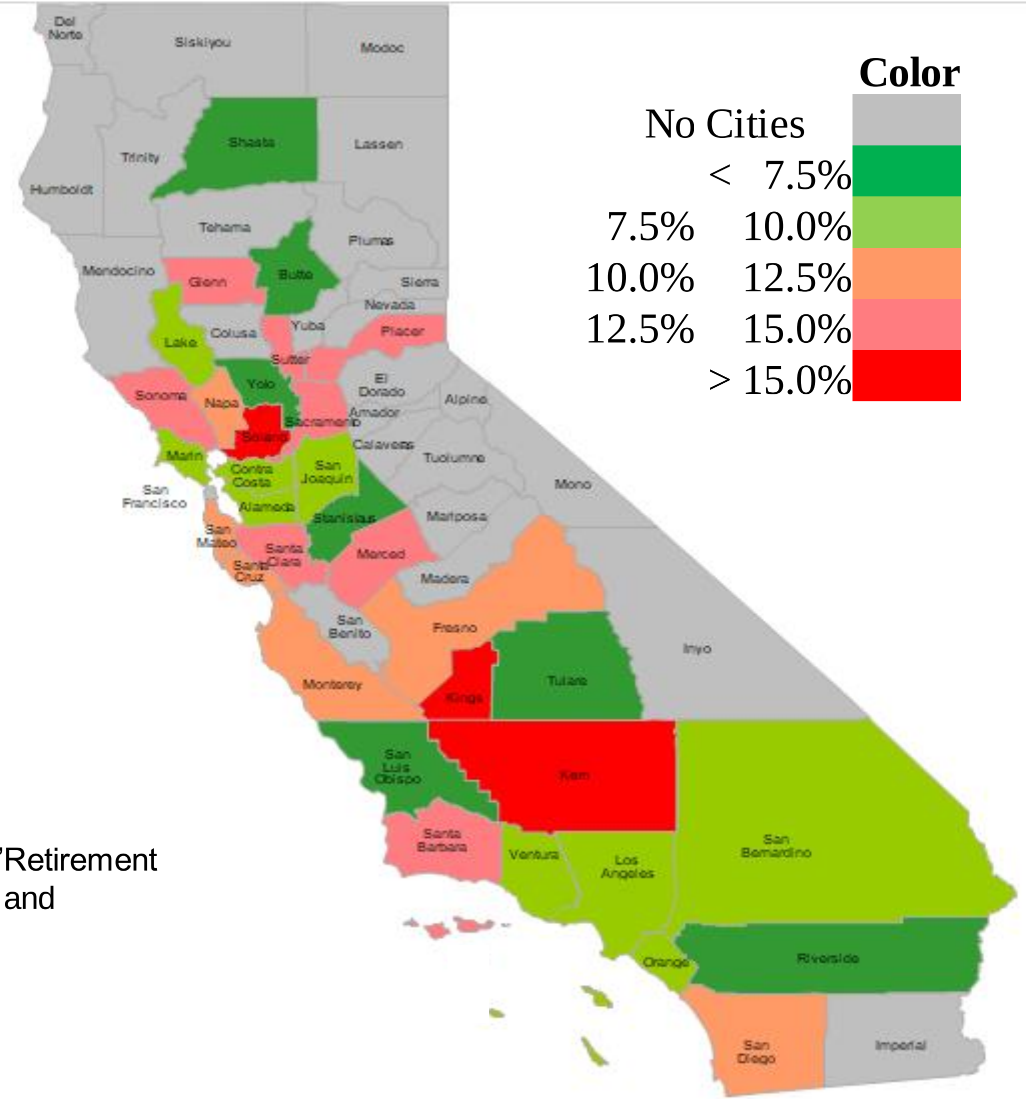
- 2006/07 and 2017/18:
  - General Fund budgets and CalPERS contributions from League survey data
- 2024/25 Projection:
  - GF budgets projected from 2017/18 assuming 3% annual growth
  - CalPERS contributions from CalPERS data adjusted for new tiers and 2016/17 investment gain
  - Assumes 100% of Safety contributions paid from GF
  - Misc GF contributions allocated on Misc % of GF payroll x projected positions / actual positions

CalPERS City 2006/07 Contributions As % General Fund Budget By County



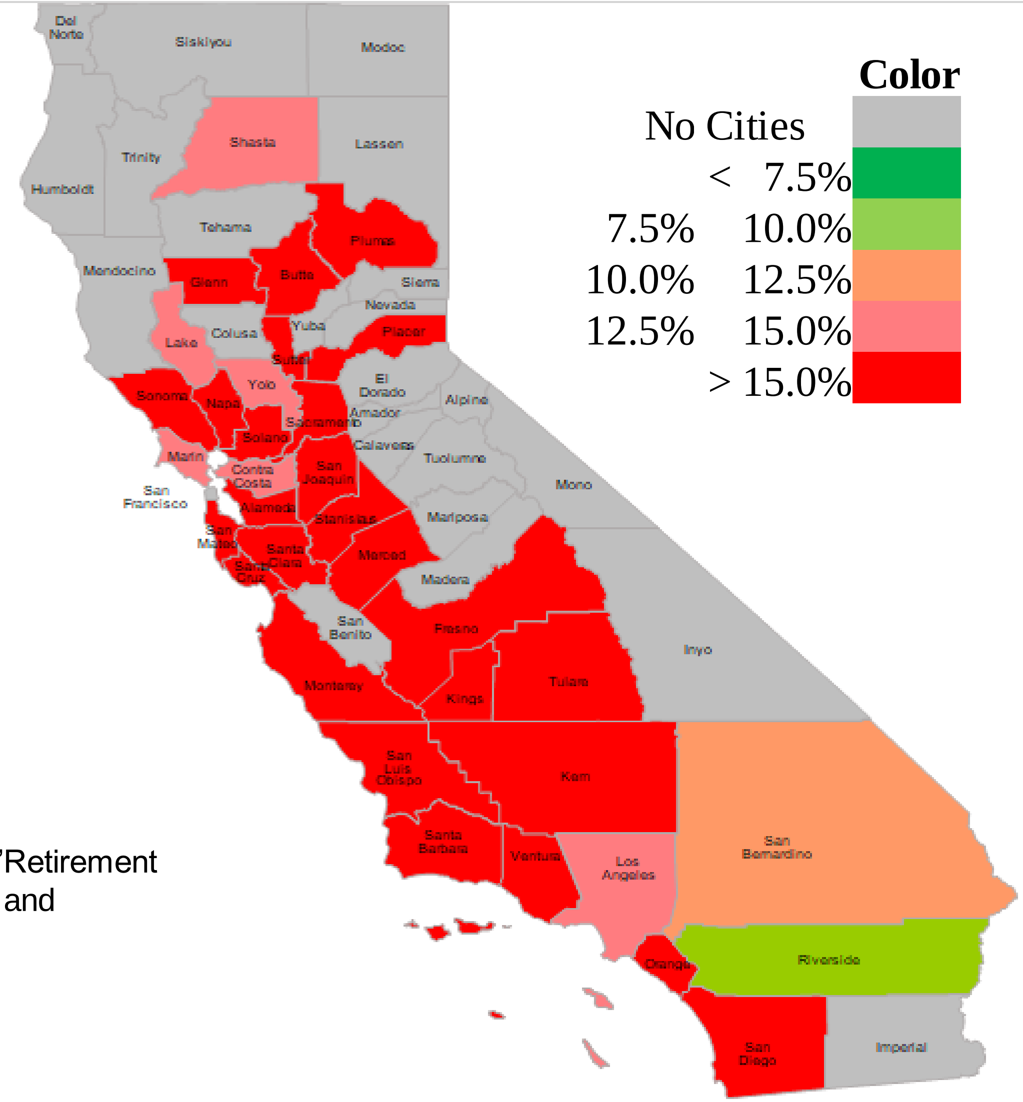
League of California Cities, "Retirement System Sustainability Study and Findings", January 2018

CalPERS City 2017/18 Contributions As % General Fund Budget By County



League of California Cities, "Retirement System Sustainability Study and Findings", January 2018

CalPERS City – Projected 2024/25 Contributions As % General Fund Budget By County



League of California Cities, "Retirement System Sustainability Study and Findings", January 2018

WHAT LIES AHEAD?

WHAT LIES AHEAD?

THE OPTIONS ARE LIMITED.


Reduce Wasteful Pension Practices
Reduce Workforce
Shared Service Models
Reduce Pensionable Compensation
Reduce Pension Benefits
CalPERS Governance
115 Trusts
Bankruptcy

CAN PENSION BENEFITS BE REDUCED?

THE "CALIFORNIA RULE"

- Based on contract clauses of U.S. and Cal. constitutions.
- "[P]ublic employment gives rise to certain obligations which are protected by the contract clause of the constitution, including the right to the payment of salary which has been earned." *Miller v. State*, 18 Cal. 3d 808, 815 (1977).
- "A public employee's pension constitutes an element of compensation, and a vested contractual right to pension benefit accrues upon acceptance of employment. Such a pension right may not be destroyed, once vested, without impairing a contractual obligation of the employing entity." *Betts v. Board of Administration*, 21 Cal. 3d 859, 863 (1978).

Once a pension benefit is provided, employees obtain a "vested contractual right" to the benefit, meaning that the public employer may not discontinue the benefit prospectively

LIMITED EXCEPTIONS UNDER "CALIFORNIA RULE"

- Even where vested rights exist, public employers still possess the ability to modify vested pension benefits for current employees, albeit subject to "**strict limitations**." *Betts*, 21 Cal. 3d at 863-864.
- In particular, courts have held that employers may modify current employees' vested rights provided that:
  1. Changes are reasonable and bear a **material relation to the underlying retirement plan's success**; and
  2. Changes in benefits that result in a disadvantage to employees must be offset by **new, comparable advantages**.

PENSION BENEFITS SHOULD BE FLEXIBLE

Notwithstanding such limitations, the Courts have been clear that pension benefits should be flexible, particularly pensions that have yet to be earned:

- Vested benefits "**may be modified prior to retirement for the purpose of keeping a pension system flexible to permit adjustments in accord with changing conditions and at the same time maintain the integrity of the system.**" (*Betts v. Board of Admin*. (1978) 21 Cal.3d 859, 863.)
- "**Constitutional decisions 'have never given a law which imposes unforeseen advantages or burdens on a contracting party constitutional immunity against change.**'" (*Allen v. Board of Admin. Of the Public Employees' Retirement System* (1983) 34 Cal.3d 114, 120, [citations omitted].)

BA RPLG

PENDING CASES

1. **Marin Assn. of Public Employees v. Marin County Employees Retirement Sys., 2 Cal. App. 5th 674** (2016): largely dispensed with the "offsetting benefit" requirement and takes a much more expansive view on what constitutes "reasonable changes" to vested pension benefits (focusing more on the need to preserve the overall benefit).

2. **Cal. Fire Local 2881 v. CalPERS, 7 Cal. App. 5th 115** (2016): adopted reasoning in Marin Assn. and held that pension benefits may be modified prospectively, before retirement, so long as reasonable or substantial pension remains.

3. **Alameda Deputy Sheriffs' Assn., et al. v. Alameda County Employees' Retirement Assn, et al. 19 Cal.App.5th 61, 227 Cal.Rptr.3d.** (2018): the Alameda decision departed from Marin in requiring an onerous financial burden to justify any modification.

PROGRESS IN THE COURTS

The cases could lead to progress on the following fronts:

- The Court could confirm application of the **unmistakability doctrine** to pension cases, finding that the benefits at issue are not vested.
- The Court could go further and conclude that a **comparable advantage** is not required when benefits are modified
- The Court could clarify the distinction between **prospective benefits** and **benefits already earned**.

PROGRESS IN THE COURTS

If the Court takes on the CA rule, the question is what standard will it adopt for changes to prospective changes to vested benefits of current employees.

- CalFire & Marin argue that employees need only be left with a "**reasonable pension**".

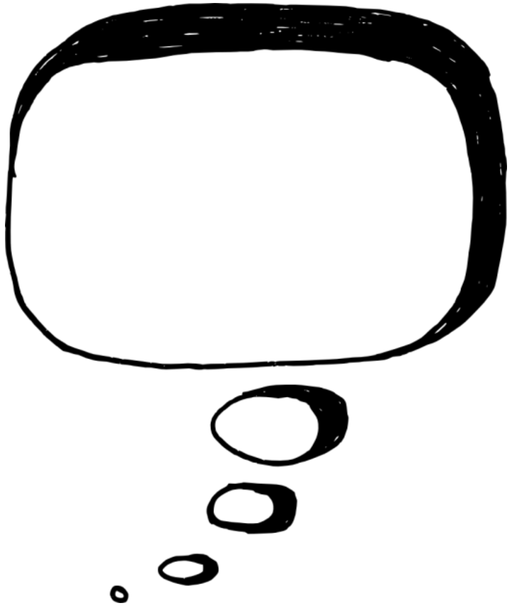
- Alameda argues for a stricter standard - especially in cases where the change is motivated by **economic necessity**.

WHAT IF WE WIN?

- Cases under consideration are **limited in scope** (e.g., airtime, terminal pay, and other abuses), and judicial action is also likely to be limited.
- Around 60% of **Accrued Liability** is due to retirees and will not be reduced by prospective plan changes
- Even if the Court loosens restrictions, the **Legislature** would need to change PERL

MY VIEW

- Requiring a comparable advantage makes no sense – especially because prior cases have held that pension benefits must be flexible to account for **unforeseen advantages and burdens**
  - Airtime is a perfect example.



- The risk is that the Court does not reach the issue or agree on this point, but concludes that the bar is high when the change is due to **economic concerns**.

DOES THE SHARED SERVICE MODEL OFFER HOPE?

SHARED SERVICE MODEL

Address public needs that require regional and/or statewide collaboration.

Simultaneously limit administrative and personnel costs.

Shared service models offer a creative way to address public needs while possibly reducing pension obligations.

AB 1912: THE NEW THREAT TO JPAs

- AB 1912, the brainchild of CalPERS and SEIU, would **cripple** JPAs rather than support them.
- AB 1912 was prompted by the recent failure of the East San Gabriel Valley Human Services Consortium (”LA Works”) which resulted in nearly 200 employees having their CalPERS benefits reduced.
- AB 1912 **retroactively and prospectively** requires that all existing and new CalPERS contracts provide for joint and several liability for all retirement related obligations. If enacted, member agencies would be “on the hook” for active employee normal pension costs, retiree UAL, active and retiree healthcare, and other post-employment retirement benefits (OPEB).

If enacted, cities would incur significant additional debt overnight.
In many cases, the increase could exceed annual revenues.

AB 1912: LEGAL CONCERNS

- Public agencies cannot rely on the **Contracts Clause**.
- Public agencies cannot bring a **Due Process** action.
- Significant issues regarding the **debt limit**.
- Significant **Home Rule** issue for charter cities.
- Gift of public funds?

115 TRUSTS

WHAT ARE §115 TRUSTS?

- §115 Trusts were historically only used for prefunding OPEBs.
- Following a private letter ruling, public agencies began to use them for prefunding pension benefits as well.
- §115 Trusts are **irrevocable trusts** controlled by City; City determines asset allocation (target rate of return).
  - Can be used to cover unexpected rate increases or strategically pay down UAL (dollar cost averaging strategy).

SHOULD AGENCIES USE §115 TRUSTS?

ADVANTAGES

- Would be reported as an **asset on balance sheet** (offset to pension and OPEB liabilities).
- Could ultimately increase agency's **bond rating**.
- §115 assets subject to greater investment **flexibility** compared to general fund investments.

CONCERNS

- Could §115 Trusts lead to **irresponsible investment** choices?

BANKRUPTCY

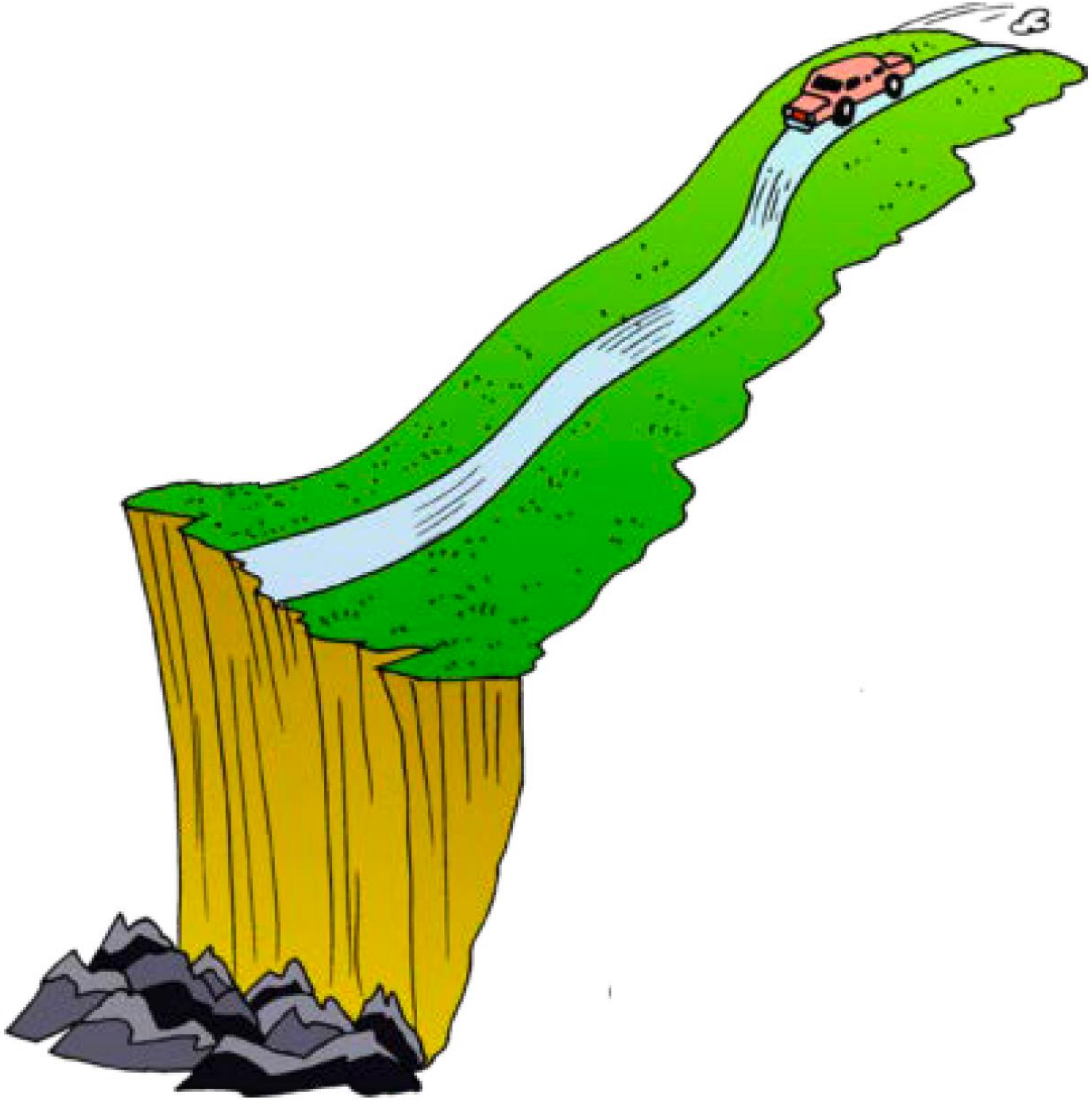
BANKRUPTCY

In re City of Stockton, California (Bankr. E.D. Cal. 2015) 526 B.R. 35, aff'd in part, dismissed in part (B.A.P. 9th Cir. 2015) 542 B.R. 261

- The court explained that the law of vested rights did **not** insulate pensions from reduction.
- Employee pension payments **can** be reduced as part of a bankruptcy plan.

“The **fatal flaw** in the “vested rights” analysis of California public pensions is that neither the Contracts Clause of the California Constitution nor the Contracts Clause of the Federal Constitution prevents Congress from enacting **a law impairing the obligation of contract**. The Supremacy Clause of the Federal Constitution resolves conflicts between a clear power of Congress and a contrary state law in favor of Congress.” (Id. at 56.) – Judge Klein

CONCLUSION



CONCLUSION

- CalPERS rates will continue to climb dramatically straining local resources.
- Things are looking up on the judicial front, but even a judicial victory may not provide much relief.
- AB 1912 poses an immediate risk to all cities that are members of JPAs.
- CalPERS has made significant progress toward insuring more appropriate funding of pension benefits and attacking abuses.
- Although deferring rate increases through smoothing and inflated discount rates would help protect cities, doing so is costly in the long run.

It is important for cities to insist upon a greater role in CalPERS decision-making