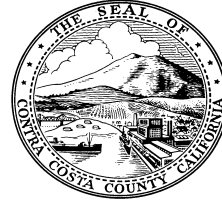


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Contra  
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**For Immediate Release:**

**Executive Summary**

## **Reduce Pension Tension**

### **Grand Jury asks that County act now to control pension costs**

The last two Contra Costa County Grand Juries issued reports concluding that pension benefit increases threatened future County financial stability and would contribute to budget woes and layoffs. These conclusions are now facts.

Retirement benefit costs are growing at a rate the County cannot sustain. Total retirement expense has increased nearly fourfold in the last ten years and is projected to increase 27% from \$140 million to \$177 million between fiscal year 2004-2005 and fiscal year 2005-2006.

Addressing rising retirement costs is not new to the County. When faced with a similar situation in the 1980s, the County made significant changes to retirement benefits. A number of the County's union contracts expire on September 30, 2005, providing the County an opportunity to tackle the problem.

Generally, for state and local government employees in California, reductions to retirement benefits only apply to future hires. To reduce and stabilize retirement costs and to share risk between employer and employee, the Grand Jury recommends reducing some retirement benefits and shifting a portion of the retirement benefit from a defined benefit plan to a defined contribution plan, for employees hired after June 30, 2006.

The complete report is available on the Grand Jury web site: [www.cc-courts.org/grandjury](http://www.cc-courts.org/grandjury).

# CONTRA COSTA COUNTY GRAND JURY REPORT NO. 0509

## Reduce Pension Tension

**TO: Contra Costa County Board of Supervisors**

### INTRODUCTION

Grand Jury Report No. 0301, issued in November 2002, concluded that pension benefit increases adopted in 2002 threatened future County financial stability. Grand Jury Report No. 0409, issued in June 2004, again concluded that the pension benefit increases would contribute to budget woes and layoffs. These conclusions are now facts.

### BACKGROUND

Contra Costa County (“County”) employees are covered by a defined benefit pension plan (“DB Plan”) administered by the Contra Costa County Employees Retirement Association (“CCCERA”) and governed by California’s County Employees Retirement Law of 1937 (“37 Act”). In general, DB Plans provide a lifetime monthly benefit based on age, years of service, and final compensation.

The CCCERA Board is comprised of ten members. Four are appointed by the County Board of Supervisors (“BOS”), four are elected by CCCERA’s active membership, and one is elected by the retirees. The County Treasurer-Tax Collector serves as an ex-officio member.

County and employee contributions, plus investment earnings, cover the cost of the retirement plan. If employee contributions or investment earnings are not adequate, the County, and ultimately the taxpayers, must make up any shortfall. All County contributions, including shortfalls, must be paid before other County expenses can be paid.

Retirement benefit costs are growing at a rate the County cannot sustain without major reductions in County programs and services. Total retirement expense has increased nearly fourfold in the last ten years and is projected to increase 27%, from \$140 million to \$177 million, between fiscal year 2004-2005 and fiscal year 2005-2006. To produce a balanced budget, the BOS will be compelled to make cuts in programs, employment, or both.

The County is not alone. Throughout California, public employee pensions are devastating government budgets, threatening priorities such as education, transportation, public safety, and health care. There has been at least one bill in the legislature and one initiative circulated to address this issue. It has also been challenging for private industry to sustain the cost of DB Plans; many have ceased those programs or adopted a defined contribution plan (“DC Plan”).

**FINDINGS**

1. County employees are covered by a DB Plan that provides a pension based on the employee’s age at retirement, years of service, and final average salary (“FAS”).
2. A DC Plan, as the name implies, defines the contribution to be made each year the plan is in operation. An allocation formula specifies a percentage of compensation to be contributed by the employer and the employee. The money grows tax-deferred until withdrawn from the plan. Each employee’s benefit depends on how much was contributed in his or her name and how well the plan's investments performed. The cost to the employer of a DC Plan is more predictable than for a DB Plan.
3. Equitable sharing of pension costs and risks between employer and employees promotes shared responsibility for the financial health of the pension plan. It reduces the incentive for either employer or employees to advocate changes that result in disproportionate costs to the other party.
4. In addition to the DB Plan, County employees may participate in a DC Plan.
5. In the early 1980s, to deal with rising retirement costs, the County established a new benefit tier (“Tier 2”) that offered a lower level of benefits and lowered costs.
6. In 2002, the County and most of its unions agreed to increase retirement benefits significantly for County employees. The maximum retirement benefit for safety employees (generally law enforcement personnel and others whose job may put them in harm’s way) was increased from 2% per year of service at age 50 to 3% per year of service at age 50. As for non-safety employees, the maximum retirement benefit increased from 1.67% to 2% per year of service at age 55. Employees represented by the California Nurses Association received the improved retirement benefits beginning on January 1, 2005.
7. Total retirement expense for the County in various fiscal years (“FYs”) has increased as follows:

<u>Fiscal Year</u>	<u>Amount (millions)</u>
1994-1995	\$ 37.4
1998-1999	54.8
2001-2002	69.6
2004-2005 (County estimate)	140.1
2005-2006 (County estimate)	177.3

8. According to data compiled by the California Association of Public Retirement Systems, as of December 31, 2003, the percentage of the County's salaries going for retirement benefits is higher than any other county in the state. For every salary dollar

paid, the County pays an additional 49 cents for safety employee pensions and 23 cents for general employee pensions.

9. The County pays 50% of an employee's portion of the Basic Cost, or basic rate, component of his or her pension plan. For FY 2003-2004, this subsidy amounted to \$13.6 million.
10. About one-third of the counties in California base FAS on the employee's highest thirty-six consecutive months' compensation.
11. For County employees, FAS is computed based on the employee's highest twelve consecutive months' compensation, except for the service of employees with service in Tier 2, where FAS is based on the highest thirty-six consecutive months' compensation.
12. Pension benefits may not exceed 100% of FAS.
13. A 1997 California Supreme Court decision in the Ventura case ("Ventura") included various types of payments in salary computations to establish FAS for pension purposes. The Paulson case ("Paulson") was brought by retired County employees to obtain essentially the same treatment. Paulson was settled and the settlement binds the County.
14. FAS is computed using an employee's base pay, increased by salary differentials (e.g., shift premiums) and other items named in Ventura and Paulson.
15. As a result of Ventura and Paulson, proceeds to the employee from the sale of unused vacation time are included in FAS for purposes of calculating retirement benefits. In addition, accrued but unused vacation paid on the retirement date is also included in the calculation.
16. Employees eligible for sale of unused vacation are allowed to conduct such sales once in a calendar year. Two such sales, occurring in two separate calendar years, but both within the twelve-month period before retirement, may both be counted in the employee's FAS. In one instance, vacation related adjustments exceeded thirty-seven percent of base salary. Adjustments such as these may make the twelve months of compensation used for calculating retirement benefits substantially greater than the employee's base salary.
17. Generally, for state and local government employees in California, reductions to retirement benefits only apply to future hires.
18. Several parties – Governor Schwarzenegger, the Howard Jarvis Taxpayers Association, and Assemblyman Keith Richman, among others – have proposed major changes to the structure of public employee pension systems. These parties have acknowledged the difficulty in changing the rules for calculating pension benefits for

current employees in that the changes they have proposed would apply only prospectively to employees hired after June 30, 2007.

19. Assembly Bill 55 (“AB55”), enacted in 2003, allows the County to permit employees to buy up to five additional years of service toward their retirement. The County has not adopted the provisions of this bill.
20. Senate Bill 274 (“SB274”), enacted in 2003, authorized a deferred retirement option program (“DROP”) for specified safety members. Under a DROP, an employee enters into an agreement with the pension system to “retire” but actually keeps working. During the DROP time, the pension system invests the employee’s retirement benefit in a special account, while the employee continues to earn a regular paycheck. At the end of the DROP period, the employee retires and receives an additional check from the retirement system based on how well the DROP investment account has done. The County has not adopted the provisions of this bill.
21. A significant number of the County’s union contracts (Memorandums of Understanding) (“MOUs”) expire on September 30, 2005.

## CONCLUSIONS

1. The costs of the County’s DB Plan are rising rapidly, with no end in sight. The County cannot sustain these costs without major cuts in programs or staffing levels. Changes must be made.
2. Currently, there is substantial interest in reform of California public pensions. Before local governments can make major reductions, many legal and public policy issues must be resolved at the state level.
3. Addressing rising retirement costs is not new to the County. In the 1980s, the County made significant changes to the retirement plan and benefits when faced with a similar situation –so addressing it is not without precedent.
4. Frequently, FAS is significantly greater than the employee’s base pay, because of adjustments mandated by law and permitted by County policies, together with a one-year calculation period.
5. The upcoming expirations of the County’s MOUs provide an opportunity to decrease retirement benefits for new employees.

## RECOMMENDATIONS

The 2004-2005 Contra Costa County Grand Jury recommends that the Board of Supervisors:

1. Vigorously support major pension reform at the state level.
2. Put a moratorium on all enhancements to retirement benefits.
3. Negotiate to reduce and stabilize County retirement costs for **new employees** hired after June 30, 2006, such as:
  - a. Establish a new DB Plan benefit tier that bases FAS on the employee's highest consecutive thirty-six months' compensation.
  - b. Establish a hybrid (part DB Plan and part DC Plan) approach to retirement benefits, where approximately 75% of the benefit would come from the DB Plan and the remainder would come from a new DC Plan. This approach would of necessity have to comply with the 37 Act and many computational details would have to be worked out.

One way to accomplish this would be to roll back retirement benefits for new employees to the levels that existed before the increases negotiated in 2002 and use all of the County's savings to fund the DC plan. Any resulting reduction in the employee's DB Plan contribution would also be contributed the DC Plan. To enhance further his or her retirement program, the employee could contribute additional amounts to the DC plan, as allowed by Internal Revenue Service regulations.
  - c. Change the County's vacation policy to limit the amount of vacation carryover to no more than the vacation earned in one year.
  - d. Limit the frequency of vacation sales to once in any twelve-month period, rather than once every calendar year.
  - e. Eliminate the County's subsidy of the employee's contribution to the pension plan.
4. Negotiate a reduction in County retirement costs for **current employees** such as:
  - a. Change the County's vacation policy to limit the amount of vacation carryover to no more than the vacation earned in one year.
  - b. Limit the frequency of vacation sales to once in any twelve-month period, rather than once every calendar year.

- c. Phase out the County's subsidy of the employee's contribution to the pension plan.
- 5. Negotiate flexibility in the MOUs to permit renegotiation with respect to changing retirement benefits when statewide pension reform occurs. Either establish a specific trigger for renegotiation if certain state laws are changed, or negotiate an MOU of short duration (for example, two years) at least with respect to retirement benefits.
- 6. Adopt a written policy that prohibits granting benefits retroactively.
- 7. Do not adopt the provisions of AB55 and SB274.

## **REQUIRED RESPONSES**

### **Findings:**

Contra Costa County Board of Supervisors: 1-17, 19-21.

### **Recommendations:**

Contra Costa County Board of Supervisors: 1, 2, 3a-3e, 4a-4c, 5-7.