City of Alexandria, Virginia

MEMORANDUM

DATE: MARCH 11, 2011

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER

SUBJECT: BUDGET MEMO # 15 : OPTIONS TO MITIGATE THE IMPACT ON EMPLOYEES TAKE HOME PAY OF PROPOSALS IN THE FY 2012 PROPOSED BUDGET TO INCREASE THE EMPLOYEE SHARE OF THE COSTS OF RETIREMENT AND HEALTH INSURANCE COSTS

This memorandum responds to requests from City Council to review the negative impact to full-time City employees based on the FY 2012 Proposed Budget's changes to the employee's share of supplemental retirement and health insurance costs. The Proposed Budget includes:

(1) A 1% employee contribution to the supplemental retirement plan for employees hired pre-FY 2010 (post-FY 2010 pay 2%). Currently, the City pays the entire 7.26% required contribution to the plan including the employee share of 2% of salary.

(2) An increase from 8% to 9% in the employee contribution to those members of the Fire and Police Pension Plan.

(3) An increase in the employee share of health insurance from 13% to 16% for employees hired pre-FY 2011 (those hired in FY 2010 or 2011 already pay 20%).

(4) Merit step increases of 5%, 3.5%, and 2.3% to be paid on the employees "anniversary date" assuming a satisfactory level of performance.

Analysis of these compensation and benefits issues reveal that about half of all City employees will see a negative take home pay impact during the course of FY 2012 based on the implementation of these three policies.

Vice Mayor Donley asked for City staff to price out the budget impact of delaying the implementation of the 1% increase in the employee retirement share to the employee's anniversary date. Councilman Krupicka asked for City staff to price out options that would prevent any employee from having a negative take home pay impact.

There are three items to consider before reviewing available options to offset a FY 2012 negative compensation impact:

(1) Calculations of the negative impact on employee take home pay are based on pre-tax numbers. Achieving true neutrality would require individual tax calculations to ensure employees are whole after considering all compensation and benefits adjustments unique to each employee.

(2) Options presented in this memorandum are related to City government only, not the Alexandria City Public Schools (ACPS). The School Board is separately addressing pay and compensation issues within the amounts available to the Schools under City

Council's budget guidance in their review of the Superintendent's Proposed FY 2012 Operating Budget.

(3) The figures below do not account for the impact on any City employee's take home pay of adjustments to be funded from $661,000 set aside in Council contingent reserves to fund competitive pay compensation adjustments aimed at moving Alexandria pay closer to that of our comparator jurisdictions.

City staff has identified six additional options for City Council consideration. A summary of these options is provided in the table below, with specifics on each option provided after. These options are presented in no particular priority order. Some of these options are designed to eliminate the negative impact associated with the 1% supplemental retirement increase. Others are designed to eliminate the impact of the retirement contribution and health insurance increase.

Option	Description	FY 2012 City Cost
A	Do Not Implement 1% Employee Retirement Contribution Increase in FY 2012	$1,600,000
B	Provide 1% Salary Adjustment Offsetting 1% Retirement Contribution	$2,400,000
C	Delay 1% Retirement Contribution to Anniversary Date (Response to Vice Mayor Donley's request)	$700,000
D	Delay 1% Retirement Contribution & Health Insurance Increase to Anniversary Date	$1,000,000
E	Address Negative Impacts by Individual Employee (Response to Councilman Krupicka's request)	$625,000
F	Delay 1% Retirement Contribution to Anniversary Date & Address Negative Impacts of Health Insurance Increase by Individual Employee (Response to Councilman Krupicka's request building on Option C above.)	$900,000

Option A: Do Not Implement 1% Retirement Contribution in FY 2012 - City Cost: $1,600,000

The proposed 1% employee contribution (for employees hired before FY 2010) to the supplemental retirement plan would not be enacted in FY 2012. This is a scalable option in that City Council could decide an amount between 0% - 1% for the employee share of the supplemental retirement plan, reducing City costs proportionately. This option would make any FY 2012 negative impact directly related to the employee's health insurance plan; is fairly simple to implement as there is no change from the City's current employee cost sharing practices; and continues the current two-tier system of employee contributions to the supplemental retirement plan (pre-FY 2010, 0%; post-FY 2010; 2%). The breakdown of costs of the $1,600,000 include: $1,000,000 for General Services employees; $400,000 for Public Safety employees; and $200,000 for Sheriff/EMT employees. Approximately $1,600,000 would need to be identified to fund this option in FY 2012.

Option B: Provide 1% Salary Adjustment to Employees to Offset 1% Retirement Contribution - City Cost: $2,400,000[1]

Under this option, all City employees would receive a 1% compensation adjustment on July 1, 2011 to offset the 1% employee contribution to the supplemental retirement plan, which would be implemented July 1, 2011, effectively cancelling the negative impact on employees caused by the increased retirement contribution. This is a scalable option in that City Council could decide an amount between 0% - 1% for the compensation adjustment, reducing City costs accordingly, and could be aligned with any adjustment made to the employee contribution to the supplemental retirement plan under Option A, effectively offsetting each other.[2] It should be noted that some employees will still see a FY 2012 negative impact based on the health insurance plan in which they have enrolled and their anniversary date. (Those employees in more expensive POS plans, and those employees with anniversary dates late in the fiscal year would be those who are likely to still be negatively impacted. However, these employees would realize the full impact of the merit step increase on their anniversary date and be whole thereafter.) Payroll and ITS have indicated that this would be relatively easy to implement on the first pay period of the new fiscal year. This option mirrors the policy decision recently made by the Commonwealth of Virginia, requiring employees to pay 5% for the employee share of retirement costs and offsetting that with a pay adjustment of an equal 5%, resulting in a net zero impact to employees.

This option would provide the 1% compensation adjustment to <u>all</u> employees, not just those determined to be negatively impacted, and thus is the most costly of all the options provided. The fiscal impact could be greater than indicated depending on the final competitive pay adjustment strategy. Approximately $2,400,000 would need to be identified to fund this option.

City staff does not believe that option B requires City Council to provide funding for a similar 1% pay adjustment to the Schools (this would cost approximately $1.5 million). Since FY 2010, the Schools have been handling their own employee salary and benefit issues in their own fashion within the funding available to them from the City and the Commonwealth.

- In fiscal year 2010, the Schools implemented merit pay adjustments half-way through the contract year, when City staff did without for the entire year. The full-year step for school employees was considered prohibitively costly in FY 2010. Implementation of the merit half-way through the year saved ACPS $1.8 million in FY 2010.
- This year the Superintendent has proposed shifting merit pay adjustments back to the start of the contract year which results in an additional cost of $1.8 million in FY 2012, above the full-year cost for a merit ($3.7 million).
- Also, he has proposed increasing the school year by two days and adding 21 additional hours during the school year resulting in a 2.3% pay increase for teachers on the 192-day schedule and an average 5.3% increase when including the impact of merit step increases.

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1 The cost to the City of a 1% Salary adjustment is more than the cost savings to the City of a 1% increase in employee retirement contributions because (1) various benefits are paid in proportion to the increase in salary (including retirement, social security and life insurance) and (2) some employees would be exempt from the 1% increase (those newer employees already paying 2% or 6% toward retirement as a result of previous policy decisions).

2 A matching 0.75% increase in employee retirement contribution and 0.75% offsetting pay adjustment would cost $2.2 million. A matching 0.5% increase in employee retirement contribution and 0.50% offsetting pay adjustment would cost $2.0 million.

- Other employees on the 192 day schedule will receive a 1.2% across-the-board increase related to the increase in the school year and school day, and the average support employee (bus drivers, monitors, cafeteria workers, and paraprofessionals) paid at Grade 25 will receive a 1.1% salary increase due to the increase in school time. Both of these groups will also be eligible for merit increases.
- Note that the Superintendent is recommending that all School employees pay 2.5% toward the ACPS supplemental retirement plan, and that new (VRS plan 2) employees pay an additional 1% toward their VRS pension.

Option C: Delay 1% Retirement Contribution to Anniversary Date - City Cost: $700,000

Vice Mayor Donley asked what the cost would be if the 1% minimum retirement contribution to the supplemental retirement plan would not be implemented until the employee's anniversary date, when the employee would be eligible for a merit increase. Since this option would be tied to the anniversary date when employees are eligible for merit step increases, this option effectively lowers the take home pay adjustments for eligible employees from 5%, 3.5%, and 2.3% to 4%, 2.5%, and 1.3% respectively. This option effectively offsets the FY 2012 negative impacts associated with the 1% retirement contribution. However, employees could still see a negative impact based on the type of health insurance they choose coupled with the anniversary date of the employee. (We estimate that an estimated 30-35% of all employees would still see a negative impact, albeit a lower negative impact than if the 1% were put into effect at the beginning of FY 2012.) Approximately $700,000 would need to be identified to fund this option in FY 2012.

Option D: Delay 1% Retirement Contribution & Health Insurance Increase to Anniversary Date - City Cost: $1,000,000

As a follow-on to the Vice Mayor's question, we also have looked at an option in which both the 1% retirement contribution and the health insurance increase would be implemented on the employee's anniversary date when the employee would be eligible for a merit step increase.

This option would greatly reduce the FY 2012 negative impact for all full-time City employees by offsetting the FY 2012 negative impact associated with the 1% retirement contribution and some, if not all, of the impact of the health insurance cost sharing increase, again depending on the plan chosen and the anniversary date. Some employees would still be negatively impacted if the combined impact of the 1% supplemental retirement contribution and health insurance increase exceeds the merit step increase. Like option C, this option effectively lowers the take home pay adjustments for eligible employees from 5%, 3.5%, and 2.3% to 4%, 2.5%, and 1.3% respectively. This option could set a precedent for FY 2013, due to the plan to increase the employee share of health insurance from 16% to 20% for all employees hired before FY 2010. Approximately $1,000,000 would need to be identified to fund this option in FY 2012.

Option E: Address Negative Impacts by Individual Employee - City Cost: $625,000

Councilman Krupicka asked for options to ensure that no employee would have his or her cumulative take home pay in FY 2012 negatively impacted (again without consideration of tax consequences). One option to do that is to have a one-time payout provided on an individual employee basis to address any FY 2012 negative impact caused by the increased contributions to the supplemental retirement plan and health insurance. This option ensures that all full-time city employees would not be negatively impacted in FY 2012. The range of one-time payments to negatively impacted employees is from approximately $2 to $1,860. The timing of these payments would be made on the employee's anniversary date, so there would be "cash flow" impact prior to the anniversary date.

Implementing this option would be fairly complex as each employee's negative take home impact would have to be calculated individually. It should be pointed out that employees who are enrolled in a higher cost health insurance plan would essentially receive additional compensation based on that choice. Additionally, there is the possibility that employees could elect to "upgrade" health insurance plans during this spring's open season if they know that the City will pick up any increase in cost (assuming that the employee would otherwise be eligible for the one-time payout). This possibility would increase the City share of health insurance costs, and is an unknown number in calculating the fiscal impact associated with this option. The FY 2013 operating budget could be impacted if this policy were repeated next year when we plan to move to a minimum 20% employee health care premium share. Approximately $625,000 would need to be identified to fund this option in FY 2012.

Option F: Delay 1% Retirement Contribution & Address Negative Impacts Associated with Health Insurance by Individual Employee - City Cost: $900,000

Another way to ensure that no employee would have his or her cumulative take home pay in FY 2012 negatively impacted (again without consideration of tax consequences) is based on option C (implementing the 1% supplemental retirement contribution on the employee's anniversary date), with a one-time payout calculated for each individual employee to address any FY 2012 negative impact caused by the increased employee share of health insurance. The range of one-time payments to negatively impacted employees is from approximately $53 to $678. The timing of these payments also would be made on the employee's anniversary date.

Implementing this option would be fairly complex as each employee's negative impact would have to be analyzed individually. Like options C and D, this option effectively lowers the take home pay adjustments for eligible employees from 5%, 3.5%, and 2.3% to 4%, 2.5%, and 1.3% respectively. The same issues pointed out in the discussion of option E concerning possible impacts on employee choice of health care plans are applicable to this option. Approximately $900,000 would need to be identified to fund this option.

Recommendation

If City Council wishes to mitigate or eliminate the negative impact on any or all employees of increased cost sharing of retirement and health care premiums, then City staff would recommend option B.

- This option has the collateral benefit of raising the mid-point of each grade by 1%, thus closing the 7% gap with our comparator jurisdictions for general schedule employees, and eliminating the 1% gap for Police officers and Fire fighters.
- Option B also helps equalize the percentage of pay contributed towards retirement for general schedule employees since now some newer employees pay either 2% or 6% toward retirement.
- Also, few local or state governments have absolutely nothing charged to employees for retirement.
- For the fire and police pension plan it establishes the idea that the City cannot itself absorb all the increase in payments required to keep the pension plan on sound financial footing. Even with police officers and fire fighters paying a 1% increase (from 8% to 9%), the City will be paying more than 2% increase as a percent of pay (from 25.58% to 27.63%.
- This option mirrors the policy decision made by the Commonwealth of Virginia, requiring employees to pay 5% for the employee share of retirement costs and offsetting that with a pay adjustment of an equal 5%.
- We believe that this option is the simplest option to understand and the easiest to administer.
- It has fewer potential unintended consequences.