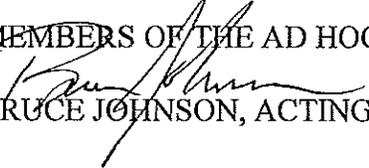


City of Alexandria, Virginia

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10/11/2011

MEMORANDUM

DATE: OCTOBER 11, 2011
TO: MEMBERS OF THE AD HOC RETIREMENT ADVISORY GROUP
FROM:  BRUCE JOHNSON, ACTING CITY MANAGER
SUBJECT: RESPONSE TO THE GROUP'S OBSERVATIONS AND RECOMMENDATIONS

This memorandum responds to the recommendations and observations concerning the City's pension plans included in the Ad Hoc Retirement Advisory Group Chairman's Draft (the "Draft"). For brevity and clarity, most of these recommendations and observations are only summarized below. The full text of each can be found in draft number 1A of the *Ad Hoc Retirement Advisory Group Report* (pp. 50 – 64).

RECOMMENDATIONS:

Recommendation 1: The Draft included a recommendation for the creation of a joint pension plan board either through the expansion of the Fire & Police Pension Board or through the creation of a parallel board. The Draft also included a recommendation that, if such a board is created, City Council include public members nominated by Mayor Euille.

Response: City staff recommend that the wording be changed to highlight **efficient time management** and the precise mechanics would be determined at a later date. It is possible to expand the Fire & Police Pension Board; however, other approaches are also viable to create a joint or parallel Board. Having one unified board would allow for efficiencies, such as ensuring that persons who are members of multiple boards could, for instance, hear presentations once rather than multiple times. However, because of the amount of time already spent in Fire & Police Pension Board meetings, staff needs to weigh the pros and cons of having combined or separate boards to do this efficiently.

Recommendation 2: The Draft included a recommendation that City Council consider terminating SRP coverage for state employees who work in the Health Department.

Response: Michele Evans will provide a memorandum on this topic and her arguments for maintaining SRP coverage for State employees in the Health Department. It should be noted that there are 87 State Health Department employees. Seventy-four of them were hired before July 1, 2009, and contribute 1.0% to the SRP, and 13 were hired after

that and pay 2% to the SRP. The Health Department employees have been on the SRP since the early 1970s. These employees are on the City pay scale and work side-by-side with City employees. Fairfax and Arlington Counties both have taken over the operation of their local Health Departments from the State, and the Health Department employees are County employees. While the City has not taken over the Health Department, it has chosen to treat the Department employees much like City employees over the last 40 years.

Recommendation 3: The Draft included a recommendation for the creation of a “trigger mechanism” plan to control costs.

Response: This issue was covered in detail in a previous memorandum from me dated September 19, 2011. In brief, City staff favor a trigger mechanism that is based on the total contribution rate exceeding that of the FY 2013 Budget. Representatives of City employees in each retirement group would work with City management to determine the appropriate formula to use for their group.

Recommendation 4: The Draft included a recommendation that the retiree health policy and retiree life insurance policy be described in a plainly written document and made readily available to all potentially eligible employees.

Response: I will ask representatives of Human Resources and the Finance Department to develop a summary plan description and to post it on the City website.

Recommendations 5 & 6: The Draft included a recommendation that the City request that the Virginia Retirement System (VRS) calculate the cost of providing a full retirement benefit at age 50 with 25 years of service for Deputy Sheriffs, Medics and Fire Marshals. The Draft also included a recommendation that any “tinkering” with the Fire & Police Plan be conducted by the Fire & Police Pension Board and that any “tinkering” with the SRP be conducted by the board recommended in Recommendation 1.

Response: Since any changes to the VRS retirement eligibility (age & service) could lead to earlier retirement under the SRP, City staff recommend that a request to develop costs for the VRS Plan be deferred until the City’s actuaries complete their work on the valuation of the SRP and City Council creates the joint or parallel board recommended in Recommendation 1. If City Council chooses not to create such a joint board, this work should be done through the City Manager’s Office. Because of the way VRS allocates contributions, the total contribution rate as a percentage of salary would increase to fund any changes in benefits for Deputy Sheriffs, Medics and Fire Marshals. Through cost sharing or trigger mechanisms, this change may lead eventually to higher employee, as well as employer, costs.

Recommendation 7: The Draft included a recommendation that the City not abandon its defined benefit plans or create new defined contribution plans.

Response: The resolution creating the Ad Hoc Retirement Benefits Advisory Group specifically calls for a review of the high level defined benefit vs. defined contribution structure. City staff's view is that defined benefit plans should remain as the core of the City's retirement benefit package. However, the federal government's split plan, which comprises both defined benefit and defined contribution elements, has merit for new employees and should be considered. New employees may desire more portability in their pension benefits, particularly younger employees or older, but new, employees, who do not plan a long career in Alexandria City government.

Recommendation 8: The Draft included a recommendation that the City not impose additional employee contribution requirements.

Response: It is important to note that:

- Pensions are long term commitments, so funding and benefit decisions should be set and left in place for long periods and not revisited as a matter of routine;
- Pension contributions are a significant percentage of the budget so their impact is significant and they should be monitored and addressed when they become too large; and
- Pension funding, disclosure, benefits, and contributions are deceptively complex, so it is important to resist the temptation to "tinker" and end up with unintended consequences.

The trigger mechanism should greatly diminish any other reasons to change employee contributions in any expected (normal) environment. However, City staff do not want to be absolute and rule out future changes except for the application of trigger mechanisms.

OBSERVATIONS: For brevity's sake, observations with which the City Manager concurs without comment will be left out of this memorandum.

Observation 4: The Draft included the observation that defined contribution plans presented significant risks for employees and provided uncertain returns that may not last for the employee's lifetime while defined benefit plans provide employees with a stable life-long retirement (and disability retirement) income and cost of living increases, but place most risks on the employer. City Council has previously approved a defined contribution plan for fire and police employees and later approved moving these employees back to a defined benefit plan and rejected a change to defined contribution plans. The draft says that employees would object to such a switch. Finally, the Draft included the observation that the City would be responsible for maintaining "frozen" defined benefit plans in the event that the City changes to defined contribution plans.

Response: The City acknowledges the value of the defined benefit plan for career employees and, as discussed above, City staff believe that such plans should remain the core of the City's retirement benefit package. However, there is also value in defined

contribution plans. Observation 4 does not adequately portray the risk borne by the employer in defined benefit plans, a full consideration of which would bring more balance to the observation. New employees may appreciate an option to choose between a defined benefit and defined contribution plan.

Observation 5: The Draft included the following observation: “Notwithstanding the broad language used by City Manager Sunderland, it is unreasonable to expect the City to absorb limitless investment risk for the VRS, FPOPP, and SRP, just as it would be unfair for employees to bear the investment risk. Neither the City Manager’s memoranda nor the City Council’s action thereon constitute a legally binding commitment never to increase employee contributions, reduce future benefits, or terminate the plans, even though they obviously created expectations among employees. Raising taxes or reducing services to cover unexpected pension costs may not be possible, and pressures would inevitably rise to reduce labor costs to the detriment of the employees. Some accommodation must be reached to protect the City and its workforce against long-term investment under-performance. Our recommendations at the end of this report suggest such an accommodation.”

Response: In addition to the investment risk mentioned, potential issues include mortality risk, salary/inflation risks, administrative risks, regulatory expenses, etc. A full discussion of some of these issues will provide greater balance to the observation.

Observation 6: The Draft included the observation that the City has taken multiple steps in response to pending funding challenges and notes that increasing employee pension contributions is similar in effect to decreasing employee salary; that benefits are “substitute salary,” so City contributions are equivalent to employee contributions; and that employees have certain expectations based on earlier actions and statements by City Council and City management.

Response: The City Manager acknowledges that take-home pay that is one to two percentage points lower than expected financially disadvantages employees; however, it is also true that a layoff of one to two percent of the City workforce is difficult for all involved, both those who are laid off and those who remain but have to do more with less. Decisions that decrease employee income (directly or indirectly) or reduce the City’s workforce are difficult; however, exigent fiscal circumstances may require these difficult decisions to be made, as they have in several of the last few years.

Observation 7: The Draft included the observation that the City has made use of the VRS 2 plan for new employees, that this decision produced “pros” and “cons,” and that the City would experience costs savings for employees under VRS 2 even if these employees did not make contributions to the plan.

Response: It is important to note that the SRP also has a two-tiered contribution rate structure for employees based on membership before or after June 30, 2009. The Fire & Police Plan is the only City defined benefit plan that has not been modified since the financial crisis of 2008 and the ensuing Great Recession. No new platform has been created under this plan for new hires.

Observation 8: The Draft included the observation that comparing the City's retirement package to those of comparator jurisdictions is a difficult exercise due to significant variation in plan terms and conditions and that, on the whole, the City's pension coverage is "about the same" as comparator jurisdictions' coverage. The Draft also included the observation that a useful assessment of the relative value of the City's pension coverage would require a comprehensive study of the entire compensation package.

Response: City staff acknowledge the difficulty of such comparisons but feels that, given the complexity of the subject matter; such comparisons can still provide useful information.

Observation 11: The Draft included the observation that providing SRP coverage to state employees working in the Health Department is a significant expense and that consideration should be given as to whether this practice should be continued.

Response: Michele Evans is preparing a memorandum for the Group concerning the Virginia Department of Health and the SRP. (See also Recommendation 2 above.)

Observation 12: The Draft included the observation that the Government Accounting Standards Board (GASB) would be releasing new standards concerning the reporting of public pension plan obligations and expressed concerns about how this would affect the City.

Response: So far, the new standard has proven to be significantly less onerous than anticipated and the final outcome, at this time, may be fiscally and administratively workable for the City. I will ask staff to continue to monitor the new accounting standard's implementation.

Observation 16: The Draft noted a need for more employee education concerning retirement income and post-retirement benefits.

Response: City staff agree that communication with employees regarding this matter is appropriate. Subject to budget limitations, the City Manager encourages department managers to approve employee requests to attend City-sponsored retirement seminars. As stated in the response to Recommendation 4, I will ask representatives of Human Resources and the Finance Department to develop a summary plan description regarding retiree health insurance and life insurance and to post it on the City website and on AlexNet since it is applicable to current and retired City employees.

Observation 17: The Draft included the observation that the Resolution appears to request the Group's opinion on the "sustainability" of the City's pension obligations and states that the Group does not feel competent to make this assessment.

Response: The statements in the Draft relating to the fiscal solvency of the plan do speak to this issue in various other sections.