A. Watson Wyatt Benefits Study: 2008 data

A-1. The City commissioned the Watson Wyatt consulting firm to perform a comparative study of Alexandria's employee compensation package, including pensions and other benefits, relative to other local jurisdictions using a proprietary methodology for determining "value". Watson Wyatt produced a "Preliminary Results Report" in February 2009 which was based on 2008 data from Alexandria, Arlington County, Fairfax County, Montgomery County, Prince Georges's County, and Prince William County

The study's results have less value than it might once have had due to the passage of time. The 2008 data pre-dated (a) the City's adoption of VRS-2 with lower benefits and a 4% employee contribution for employees hired after June 30, 2010, and (b) the City's imposition of a 2% employee contribution requirement for General Schedule employees hired after June 30, 2009. In addition, there is a sense that changes have been made in the other jurisdiction's plans since 2008.

A-2. The study's results included the following:

(a) General Schedule employees: Alexandria's retirement pension plan coverage value was ranked 1st; retiree medical ranked 4th; retiree life insurance ranked 1st.

(b) Police: Alexandria's retirement pension plan coverage value was ranked 4th; retiree medical ranked 3d; retiree life insurance ranked 1st.

(c) Deputy Sheriffs: Alexandria's retirement pension plan coverage value was ranked tied for 3d; retiree medical ranked 3d; retiree life insurance ranked 1st.

(d) Firefighters: Overall ranking considering pension, retiree medical and retiree life insurance was 4th.

(e) Medics: Overall ranking considering pension, retiree medical and retiree life insurance was 4th.

B. Informal Inquiries By City Staff

The City staff assigned to the Advisory Group, particularly Steven Bland, obtained information from the "comparator jurisdictions" and other jurisdictions regarding their employee pension plans and prepared a series of helpful, data-rich charts comparing the features of the various plans. Those charts are set forth in Addendum ___ to this report.

VIII. Costs: Pension Plans & Retirement Income Programs

The costs and projected costs of maintaining the above-described pension plans and retirement income programs for the City and its employees are described in this section.

A. Overall Costs To City

A-1. The City's contribution costs for the following pension programs: VRS, Firefighters and Police Officers Pension Plan; City Supplemental Retirement Plan, and the "Old, Old" Fire & Police Plan

FYI	Contribution Total	Total City Budget	Pension as % of Budget	Contribution Total w/Soc Sec	% of Budget w/Soc Sec
2012*	$39.7m*	$699m	5.6%*	$49.9m	7.1%
2011	$37.0m	$660m	5.6%	$46.9m	7.1%
2010	$34.8m	$642m	5.4%	$44.6m	6.9%
2009	$35.2m	$658m	5.3%	$45.1m	6.8%
2008	$31.5m	$630m	5.0%	$41.5m	6.6%
2007	$31.7m	$616m	5.1%	$41.3m	6.7%
2006	$24.2m	$563m	4.3%	$33.4m	5.9%
2005	$21.3m	$520m	4.1%	$29.6m	5.7%
2004	$18.6m	$478m	3.9%	$26.5m	5.5%
2003	$17.3m	$437m	4.0%	$24.6m	5.6%

* Projected.

These figures do not include: (a) employee contributions actually made by employees (as opposed to "employee contributions" made by the City); (b) Social Security / Medicare payroll taxes paid by the City; or (c) the cost of any other post-retirement benefits provided by the City.

A-2. The City's contribution obligations to VRS, the City's employee pension plans, and Social Security are affected by the number of employees and the amount of the employees' basic salaries. So, as the City adds employees or increases salaries, it is to be expected that the City's pension costs will increase.

B. Costs By Employee Group

B-1. City Contributions To Current Firefighters & Police Officers Pension Plan

Fiscal Year	City's Contribution: $ and % of Salary		Total "Pensionable" Salary
FY2012*	$9.5m*	28.22%*	$34m

FY2011	$8.3m	25.17%	$33m
FY2010	$8.6m	26.79%	$32m
FY2009	$8.8m	26.41%	$33m
FY2008	$7.5m	22.35%	$33m
FY2007	$7.3m	22.35%	$33m
FY2006	$7.1m	22.35%	$32m
FY2005	$6.5m	22.35%	$29m
FY2004	$5.6m	22.35%	$25m
FY2003	$6.0m	23.00%	$26m

* Projected and not adjusted for smoothing or investment gains through FY2011. If adjusted for investment gains, smoothed in, could be 22-23%.

These figures include the basic and disability portions of the FPOPP, but do not include: (a) the 8% of salary employee contributions to the FPOPP; (b) the City's annual contributions to the closed "Old, Old" Firefighters & Police Officers Pension Plan; (c) Social Security / Medicare payroll taxes paid by the City; (d) cost of any other post-retirement benefits provided by the City.

B-2. City Contributions For Deputy Sheriffs, Medics, Fire Marshals To VRS, City Supplemental Plan, And Retirement Income Plan

Fiscal Year	City's Contribution: $ and % of Salary		Total "Pensionable" Salary
FY2012*	$4.2m	25.59%	$16.6m**
FY2011	$4.0m	24.52%	$16.2m
FY2010	$3.6m	22.35%	$15.9m
FY2009	$3.6m	22.35%	$16.0m
FY2008	$3.6m	22.41%	$16.2m
FY2007	$3.5m	22.41%	$15.5m
FY2006	$3.2m	22.35%	$14.2m
FY2005	$2.9m	22.35%	$13.1m
FY2004	$2.7m	22.35%	$12.0m
FY2003	$2.5m	22.35%	$11.2m

* Projected. ** Assumes 2% salary increase.

These figures do not include: (a) employee contributions actually made by employees (as opposed to "employee contributions" made by the City); (b) Social Security / Medicare payroll taxes paid by the City; or (c) the cost of any other post-retirement benefits provided by the City.

B-3. City Contributions For General Schedule Employees To VRS and City Supplemental Plan

Fiscal Year	City's Contribution: $ and % of Salary		Total "Pensionable" Salary
FY2012*	$22.6m	19.96%*	VRS-$100m / CSP-$113m**

FY2011	$21.3m 19.17%	VRS-$98m / CSP-$111m
FY2010	$19.3m 17.67%	VRS-$96m / CSP-$109m
FY2009	$19.5m 17.71%	VRS-$100m / CSP-$110m
FY2008	$18.7m 16.98%	VRS-$98m / CSP-$110m
FY2007	$18.3m 16.98%	VRS-$93m / CSP-$108m
FY2006	$11.3m 11.00%	VRS-$86m / CSP-$103m
FY2005	$10.0m 11.00%	VRS-$80m / CSP-$91m
FY2004	$8.4m 9.25%	VRS-$78m / CSP-$90m
FY2003	$7.0m 8.75%	VRS-$74m / CSP-$80m

* Projected. ** Assumes 2% salary increase.

These figures do not include: (a) employee contributions actually made by employees (as opposed to “employee contributions” made by the City); (b) Social Security / Medicare payroll taxes paid by the City; or (c) the cost of any other post-retirement benefits provided by the City.

C. Costs By Plan: Virginia Retirement System

C-1. FY2011 actual contributions to VRS

(a) City contributions:

(1) For VRS-1, the City contributed 12.78% of each covered employee’s basic salary. Of this amount, 7.78% was “employer contributions” and 5% was “employee contributions” assumed by the City.

(2) For VRS-2, the City contributed 8.78% of each covered employee’s basic salary. Of this amount, 7.78% was “employer contributions” and 1% was “employee contributions” assumed by the City.

(3) In total, the City contributed $_________ to the VRS for FY2011

(b) Employee contributions:

VRS-2 employees contributed 4% of their salaries, which amounted to $___________________ in contributions

C-2. FY2012 projected contributions to VRS

(a) City contributions

(1) VRS-1: 12.78% of each covered employee’s basic salary

(2) VRS-2: 8.78% of each covered employee's basic salary.

(3) Total contribution by City to VRS (projected): $________________

(b) Employee contributions:

VRS-2: employees are contributing 4% of their salaries

C-3: VRS projections beyond FY2012

(a) In the June 30, 2010 VRS valuation for the City of Alexandria, VRS projected that the City's contribution obligations (net of the 5% employee contribution) would be as follows:

FY2011 (ending 6/30/11): 7.78%
FY2012 (ending 6/30/12): 7.78%
FY2013 (ending 6/30/13): 12.34%
FY2014 (ending 6/30/14): 12.34%
FY2015 (ending 6/30/15): 14.63%

(b) This projection assumes a 7% per year investment return, a level covered employee population, and plan experience matching exactly all other actuarial assumptions.

(c) Projections are guesses about future developments and are inherently uncertain. There is some sense that these projected rates may be inflated because they use a historically conservative investment return assumption.

(d) VRS contribution rates are set for two-year periods, and may not reflect most recent developments (good and bad).

C-4. Contributions history:

FY	City Contributions %	Contributions Amount
2010	12.07%	$________________
2009	12.07%	$________________
2008	11.66%	$________________
2007	11.66%	$________________
2006	6.50%	$________________
2005	6.50%	$________________
2004	5.75%	$________________

Note: increases reflect increases in the number of covered employees and creditable salaries.

D. Costs By Plan: Firefighters & Police Officers Pension Plan

D-1. FY2011 actual contributions to the FPOPP

(a) City contributions: 25.17% of each employee's basic salary; $8.3 million

(b) Employee contributions: 8% of salary, which amounted to $____________________ in contributions

D-2. FY2012 projected contributions

(a) City contributions: 28.22% of each employee's basic salary; $9.5 million

(b) Employee contributions: 8% of salary, which amounted to $______________________ in contributions

D-3. Contributions history:

FY	City Contributions %	Contributions Amount
2010	26.79%	$8.6 million
2009	26.41%	$8.8 million
2008	22.35%	$7.5 million
2007	22.35%	$7.3 million
2006	22.35%	$7.1 million
2005	22.35%	$6.5 million
2004	22.35%	$5.6 million

E. Costs By Plan: Supplemental Retirement Plan

E-1. City contributions:

(a) For employees hired before July 1, 2009: 7.18% of each covered employee's basic salary

(b) For General Schedule employees hired on or after July 1, 2009: 5.18% of each covered employee's basic salary

(c) For Deputy Sheriffs, Medics and Fire Marshals hired on or after July 1, 2009: 7.18% of each covered employee's basic salary

(d) In total, the City contributed $_________ to the SRP for FY2011

E-2. Employee contributions:

General Schedule employees hired on or after July 1, 2009 contributed 2% of their basic salaries, which amounted to $___________________________ in contributions

F. Costs By Plan: Closed "Old, Old" Firefighters & Police Officers Pension Plan

F-1. City's contributions for FY2011 amounted to $1.7 million, and are projected to be at the same level for FY2012.

F-2. The City contributes annually to continue funding already earned benefits. Contributions will continue at about $1.7 million for 2 - 3 years, and then drop by about $500,000 to about $1.2 million another 15 years. The plan will eventually terminate once all retirees and surviving spouses die.

F-3. History of contributions:

Fiscal Year	City's Contribution
2010	$1.7m
2009	$1.7m
2008	$0.9m
2007	$1.5m
2006	$1.1m
2005	$0.9m
2004	$1.0m
2003	$0.9m

G. Costs By Plan: Deputy Sheriffs, Medics, Fire Marshals Retirement Income Plan

G-1. FY2011: No City contributions were made to the DS, M & FM RIP.

G-2. FY2012: No City contributions are projected

G-3. History of City contributions:

Fiscal Year	City's Contribution: % of salary & dollars	
2012	0.00%	$0.00

2011	0.00%	$0.00
2010	1.58%	$__________
2009	1.78%	$__________
2008	0.00%	$0.00
2007	0.00%	$0.00
2006	5.10%	$__________
2005	5.10%	$__________
2004	13.10%	$_____________
2003	13.10%	$_____________

H. Costs By Plan: Social Security

H-1. As noted earlier in this report, Social Security coverage is funded by payroll taxes paid to the Federal Government by both the City and each employee. The amount of the total tax paid by the City varies with the number of employees, their salaries, and the tax rates set by Congress. The payroll taxes paid during FY2011 and projected to be paid in FY2012 are as follows:

(a) City payroll tax paid for FY2011:

(1) 6.2% of employee earnings up to the annual maximum earnings limit of $106,000

(2) total amount of tax paid for Social Security coverage: $__________

(b) Employees payroll tax paid for FY2011:

(1) 4.2% of employee earnings up to the annual maximum earnings limit of $106,000

(2) total amount of tax paid for Social Security coverage: $__________

H-2. Projected Social Security payroll taxes for FY2012

(a) City payroll tax:

(1) 6.2% of employee earnings up to the annual maximum earnings limit of $106,000

(2) total amount of projected tax: $_______________________

(a) Employees payroll tax:

(1) 6.2% of employee earnings up to the annual maximum earnings limit of $106,000

(2) total amount of projected tax: $________________________

H-3. It is problematic to project Social Security tax obligations beyond FY2012 because of the ongoing deficit reduction / economic stimulus discussions between Congress and the Administration.

IX. Costs: Non-Pension Post-Retirement Benefit Programs

A. Retiree Health Policy

As described above, the City pays a retiree health plan premium subsidy of up to $260 per month to eligible retirees.

(1) The actual cost of this subsidy in FY2011 for _____ retirees was $______________.

(2) For FY2012, it is projected that 256 City retirees will be eligible for some subsidy and that the City will pay a total of $627,548 in subsidies.

B. Medicare

B-1. As noted earlier in this report, basic Medicare coverage is funded by payroll taxes paid to the Federal Government by both the City and each employee. The amount of the total tax paid by the City varies with the number of employees, their salaries, and the tax rates set by Congress.

B-2. The payroll taxes paid during FY2011 are as follows:

(a) City payroll tax paid for FY2011:

(1) 1.45% of employee earnings

(2) total amount of tax paid for Medicare coverage: $__________

(b) Employees payroll tax paid for FY2011:

(1) 1.45% of employee earnings

(2) total amount of tax paid for Medicare coverage: $__________

B-3. The projected Medicare payroll taxes for FY2012 are as follows:

(a) City payroll tax projected for FY2012:

(1) 1.45% of employee earnings

(2) total projected amount of tax for Medicare coverage: $__________

(b) Employees payroll tax projected for FY2012:

(1) 1.45% of employee earnings

(2) total projected amount of tax for Medicare coverage: $__________

B-3. It is problematic to project Medicare tax obligations beyond FY2012 because of the ongoing deficit reduction / economic stimulus discussions between Congress and the Administration.

C. Retiree Life Insurance

For FY2012, the City's projected premium costs are as follows:

Coverage Amount	No. of Retirees	Annual Premiums
1 x salary:	225	$8,948.16
2 x salary	707	$194,790.76
Total	932	$203,738.92

X. Employee Groups' Views

During our proceedings, the Advisory Group requested that representatives of each employee group make a presentation describing the covered employees' perspective on the City retirement benefit programs. Presentations were made by Michael Cross, Chairman of the FPOPP's Retirement Board, on behalf of the Firefighters and Police Offices, by Robert Gilmore on behalf of Deputy Sheriffs, by Lonnie Phillips on behalf of Medics, and by Shane Cochran and Brenda D'Sylva on behalf of the General Schedule employees. These presentations were very helpful to the Advisory Group. A summary of each group's presentation is set forth in Addendum ___ to this report.

XI. Observations

Based on the Advisory Group's proceedings as well as our collective knowledge and experience, we offer the following observations.

1. Introduction: The City of Alexandria participates in the VRS and sponsors the FPOPP and the SRP to provide its employees with a sound and decent retirement income after years of service to the Alexandria community. A pension is not a gift. Rather, a pension is deferred compensation earned by an employee for the labor he or she provided to the City over a period of years. The City's "employer contributions" to the pension plans are really substitute salary. If the City did not make these contributions, all or at least some portion of this money would have been paid to the employees as salary.

   Recognizing the importance of retirement savings to individuals, as well as to the public at large, Federal and State tax laws provide valuable incentives for the creation and maintenance of employee pension plans. Employer contributions to plans are not treated as taxable income for the employee for purposes of income and payroll taxes. Taxable employers are entitled to immediately deduct the contributions from their taxable income. The investment income of the plans is not subject to taxation. Pension benefits are taxable to a retiree as income when paid in the future, but presumably at lower tax rates.

   Alexandria must compete in the labor market to attract and retain qualified employees who are able and motivated to provide quality public services for the City's citizens. Pension plan coverage is a part of the total compensation package that the City offers to current and prospective employees. Cuts in pensions could require the City to offer higher salaries or other benefits to maintain a competitive compensation package. [CHERYL ORR TO DRAFT LANGUAGE FOR THIS PARAGRAPH]

   On the other hand, sustained increases in pension costs could force the City to reduce other components of the compensation package or otherwise reduce labor costs (salary freezes and reductions, reductions in other benefits, reductions in force through attrition or layoffs, etc.).

   In short, although not explicitly stated in the charge to the Advisory Group by the City Council, the members are mindful of the balance that must be struck between the need for a comprehensive and responsive compensation and benefits program for employees and the demand on taxpayers to pay for such a program. One should never be at the sacrifice of the other and when this report and recommendations are read in their entirety, the Advisory Group believes that the employees and taxpayers of the City and the City Council will fund that a fair balance has been struck.

2. Overview of funding: Since the historic investment markets crash of 2008 and the onset of the economic downturn, news media and professional publications have carried a steady stream of articles about public employee pension plan

funding troubles and the related political and labor relations battles. Some articles have been thoughtful and constructive, while many others have been overblown and designed to advance political agendas. It is no surprise that the public is confused and worried, that public employees feel scapegoated, and that some public officials are choosing to simply follow current trends.

No doubt, there are a significant number of public employee pension plans that are seriously under-funded. Many pension plans and retirement savings programs, public and private, suffered deep investment losses in 2008, and it will take time for investment portfolios to recover, particularly with the return of highly volatile markets. A lingering recessionary economy and battered housing market have reduced the revenues of most jurisdictions. Unexpected pension plan obligations have been blamed for cutbacks in public services, tax increases, layoffs, hiring freezes, wage and benefit cuts, and similar unpleasant actions.

But, for many public employee pension plans, the causes of under-funding go beyond the investment markets and revenue declines. Some State and municipal governments irresponsibly failed to make appropriate contributions to their employees' pension plans over the years in the hope that investment performance would cover the shortfall or that later administrations or legislatures would find extra money to fill in the hole. Some public pension plan sponsors deliberately used unreasonable actuarial assumptions to reduce funding obligations, or gambled on risky investments. And, some governmental pension plans have provided overly generous benefits or have been subject to manipulations and mal-administration that drove up costs.

We are pleased to report that the City of Alexandria government and its employees have made a number of significant policy decisions and contributions to ensure that Alexandria is not one of those jurisdictions whose employee benefit plans are in jeopardy. Among those actions are the following:

(a) The City has consistently made all of the required annual contributions to the Virginia Retirement System.

(b) The City has consistently made all contributions to Firefighters and Police Officers Pension Plan and Supplemental Retirement Plan recommended by the actuary for those plans.

(c) The City uses reasonable actuarial assumptions as recommended by the plans' actuaries, including the assumption that the plans will earn an average annual investment return of 7.5% over the long term.

(d) The City has developed a professionally managed investment program with prudent investment policies that reflect the long-term objectives of the pension plans and produce market returns.

(e) The City has adopted pension plans whose benefits are not overly generous and that minimize the risk of costly manipulation, such as excluding non-basic salary amounts from the benefit formula.

(f) Firefighters and police officers are contributing 8% of their salaries to their pension plan.

(g) New City employees are placed in the lower tier VRS-2.

(h) New City employees are required to contribute a percetnage of their salaries towards their pension coverage.

(i) The City and employees are working to implement various administrative efficiencies that will reduce costs of plan administration.

(j) The Pension Administration Division of theCity's Finance Department is fully staffed by experienced benefits professionals who carefully monitor the City's employee benefit plans.

3. Solvency of Plans: The City's pension obligations have been increasing as a percentage of pay, in dollars, and as a percentage of the City's overall budget. They are not, at the moment, out of control. But, there is cause to be concerned about the future, primarily because those obligations are heavily affected by investment performance; lower than expected investment returns eventually translate into higher contribution obligations. Even prudent investment programs are necessarily hostage to the vicissitudes of the investment markets. The recent return of turmoil in the investment markets and stall in our Nation's economic recovery have heightened uncertainty about the future.

The City has no control over the VRS' investment performance. VRS investments are overseen by a Board of Trustees appointed by the Governor. The City's contribution obligations to VRS will continue to be determined in large measure by the Board's investment program, and the City cannot mitigate that effect other than by reducing the number of VRS covered employees or controlling creditable salaries.

The City does control the investment program of the SRP and the City's Firefighters and Police Officers Pension Plan Retirement Board oversees the FPOPP's investment program. The plans are long-term investments that need not be overly concerned by short-term fluctuations, and there are actuarial tools for mitigating the impact of such fluctuations on contribution obligations (*e.g.* "smoothing" of asset values). However, there is no denying that the City's contribution obligations will be greatly affected by the investment markets.

4. Defined Benefit vs. Defined Contribution: Some State and municipal governments have abandoned or are considering abandoning pooled defined benefit pension plans and substituting individual account, defined contribution retirement savings plans, as a way of capping their pension contribution obligations.

Under a defined contribution plan, the employer simply makes a pre-determined annual contribution to each employee's account. The employee self-directs the investment of his or her account, usually from among a platform of investment funds provided by a third-party administrator. At retirement, the employee gets only what is in his or her account, which may or may not last for the rest of the retiree's life. In other words, the employee takes all of the risks: the investment risk (that the account will lose money or otherwise underperform under his or her direction); the early withdrawal risk (that loans or hardship withdrawals will reduce the account's assets before retirement); the longevity and inflation risks (that the account will be exhausted before death); and the expense risk (the loss of assets due to investment fees and other expenses charged to the account directly or netted from investment returns). The impact of these risks on employees has been sadly demonstrated by the 2008 investment crash that slashed defined contribution account values, and by stories of retirees who are returning to any job they can find before they run out of money.

An advantage of defind contribution plans is that they provide ready portability if an employee changes employer. Typically, the employee can take a distribution of his or her account or roll the account over tax-free into another qualified retirement savings vehicle.

In contrast, under a defined benefit plan, the plan promises each employee a monthly retirement income that he or she cannot outlive. The amount of that income is determined by the plan's formula (average salary, years of credited service, accrual rate or multiplier, etc.). The employer periodically contributes to the plan (along with employee contributions, if required) an amount calculated by the plan actuary--on the basis of various assumptions, including investment return, turnover, and longevity–to fund over a period of years each employee's pension. In other words, the employer takes the risk that it will be required to contribute more (or less) than expected due to investment performance and plan experience.

Further, a defined benefit plan can provide a decent, life-long disability pension to employees who become unable to work at a relatively young age. An employee who becomes disabled before retirement under a defined contribution plan is entitled to no more than the amount in his or her account.

Similarly, a post-retirement cost-of-living increase in monthly pension benefits has been a common feature of defined beenfit plan, although a defined contribution plan could offer an insurance company variable annuity as a form of distribution.

Finally, defined benefit plans generally produce higher investment returns than defined contribution plans. They are usually directed by trustees who hire professional advisors who are better able to make prudent investment decisions than individuals managing their own defined contribution accounts, usually have a wider range of investment options available to them, and generally have higher allocations to long-term equities.

The City Council has visited this issue of defined benefit versus defined contribution before; indeed, as recently as 2004 when it deliberately chose to replace the Firefighters and Police Officers Retirement Income Plan (a defined contribution plan) with the Firefighters and Police Officers Pension Plan (a defined benefit plan). The City came out definitively in favor of defined benefit pension coverage, as noted in City Manager Sunderland's memoranda:

> *"Conclusion: As a long-term policy, we believe that, instead of having the public safety employees bear 100% of the investment risk for their entire pension, it is more appropriate for the City to assume the risk. The City is far better able to handle fluctuations in the equity and bond markets and in earnings over time than individual employees. An employee near retirement is especially less able to handle such fluctuations. Moreover, the City now takes this same type of risk under the retirement programs that cover most other City employees (through VRS and other pension programs). It is reasonable for the City to take a similar risk for sworn police officers and fire fighters.*
>
> *"The proposed DB program ensures that a definite retirement income not-affected-by-investment-returns will be available throughout the retirement years of a firefighter and police officer. For some, this might be less than they would have been able to receive under the DC plan. For others, this will be more than what the DC plan would have delivered. But for all there will be no investment risk. We believe it is desirable that public safety employees receive similar retirement benefits for similar service to the City, regardless of their investment acumen or the state of the economy, particularly in their later years of service.*

"Fiscal Impact: The City has been and is currently paying 20% of payroll into the firefighters and police officers DC plan. This percentage does not change over the years as the investment market changes. If the City adopts a DB pension plan, initially the cost to the City will be 20% of payroll. However, the City's 20% cost could increase if the market value of the pension plan assets and investment earnings decrease or if plan retirement cost experience is higher than projected. Conversely, the City's 20% cost could decrease if the market value of the pension plan assets and investment earnings increase beyond projected returns or if plan retirement costs are lower than projected."

It cannot be said that the City was naive about the investment markets in 2004. During 2000-2003, the Nation had experienced what was then considered the worst investment market in 50 or more years: three consecutive years of negative returns.

The City's employees have expressed strong opposition to replacing the defined benefit plans with a defined contribution model. As noted during our proceedings, and borne out by national experience[9], many employees feel incompetent to properly direct and monitor the investment of their pension accounts. The market crash of 2008 devastated many self-directed 401(k) plan accounts, and that experience has further soured employee groups on defined contribution plans.

Note also that if the City did decide to "freeze" the FPOPP and SRP and substitute defined contribution plans, the City would still be required to continue contributing to the frozen plans, for many years in the future, to fund the already-earned benefits under those plans. The City has some experience with such dual contribution obligations; it is still continuing to fund the "Old, Old" firefighters and police officers defined benefit plan that was closed in 1979 when the Firefighters and Police Officers Retirement Income Plan was established as a substitute. In other words, the City would be required to continue contributing to the frozen defined benefit plans as well as to the new defined contribution plans.

5. City and Employee Contributions: 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

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[9] [insert note about Pension Protection Act of 2006 and qualified default investments]

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.

Some State and local governments have imposed or increased employee contribution requirements in response to pension funding challenges. The City of Alexandria has taken steps in this direction. Firefighters and police officers have been contributing 8% of their salaries to the FPOPP since its inception in 2004. Newly hired General Schedule employees are required to contribute 2% of their salaries to the SRP in addition to 4% of their salaries to VRS-2. New deputy sheriffs, medics and fire marshals covered by VRS-2 are required to contribute 4% of their salaries too, although they have been exempted from the 2% contribution to the SRP.

Salary rate, currently and prospectively, is the most attractive component of a compensation package. Imposing or increasing employee contribution requirements is the equivalent of a salary reduction for employees. Their current income is reduced to help fund pensions that will not be payable until, for most employees, many years later. Even a 1% or 2% cut in take-home pay can have a significant adverse impact on an employee, yet an employee’s pension contribution at that rate would be insignificant to the funding needs of the pension plan.

Moreover, as discussed earlier in this section, the City’s contributions to the various pension plans are really substitute salary in whole or in part. That is, the City is contributing to the pension plans money that it would have paid to the employees in salary but for the existence of the pension plans. In a real sense, the City’s contributions are employee contributions.

Further, there is the matter of the City employees’ expectations based on earlier actions by City Council. There is a strong belief among the City’s employees that the City Council made deals not to impose an employee contribution requirement on current employees in exchange for groups of employees foregoing salary increases (step and market adjustments) for some periods or accepting other changes in terms and conditions of employment. In addition, the February 2004 memoranda from City Manager Sunderland discussed above reflect a view that City employees should not have to bear the cost investment losses in the FPOPP or SRP, if not the VRS.

6. New Employees-New Deal: Another commonly used approach among public employee plan sponsors is to create a new plan or a new plan tier with lower benefits or employee contribution requirements for new employees only. The rationale for this approach is that the employer has no pre-existing obligations or commitments to new employees, and a new employee who accepts employment on these inferior pension terms cannot legitimately complain. Furthermore, the employer can improve the pension coverage in the future, prospectively or retroactively.

   The City has used this approach by covering new employees under VRS-2 and requiring them to contribute 4% of their salaries to VRS. Even if the employees were not required to contribute, the City's contribution obligations would be less for these employees than for VRS-1 employees because of the lesser benefit package under VRS-2. In addition, new General Schedule employees are required to contribute 2% of salary to the SRP.

   Disadvantages of this new employee approach include the following:

   (a) It does not provide cost relief in the near term, but only as more senior employees leave and new employees are hired. Eventually all employees will be covered under the less costly plan, but that transition can take many years.

   (b) It can create resentment among employees and human resources problems. These risks can be particularly acute where one employee hired just before the cutoff date works with an employee hired just after the cutoff.

   (c) Multiple tiers of benefit programs can make administration difficult and more costly.

7. Comparability With Other Jurisdictions: Comparing the City's pension coverage to that provided by other jurisdictions, including Alexandria's "comparator jurisdictions", is a difficult exercise because there are many variations in plan terms and conditions from jurisdiction to jurisdiction and some favorable provisions in one plan may be offset by some unfavorable provisions in the same plan. Some plans might require employee contributions, and others not. Some plans might allow salary enhancements in determining benefit levels, and others not. Some plans might have a relatively higher normal retirement age but a less favorable benefit formula. And, in any event, there is a moving target problem; most jurisdictions are reviewing their employee pension plans and considering adjustments based on their specific circumstances. In short, a true "apples to apples" comparison is difficult to achieve.

What can be said is that the City's pension coverage is about the same on the whole as local jurisdictions, although there are some specific outlying issues (such as the higher retirement age for Alexandria's deputy sheriffs, medics and fire marshals) and some anecdotal evidence that some employees have left City employment for jurisdictions with more generous retirement terms. It may also be said that the attractiveness of one City pension plan's terms (FPOPP) relative to other pension coverage (VRS & SRP) may affect decisions by City employees to transfer positions within City employment.

A more useful assessment of the relative value of Alexandria's pension coverage requires a professional study of the entire employee compensation package, including pensions, like that performed for the City by the Watson Wyatt consulting group in 2008-2009.

8. Social Security: In discussing the pension coverage provided to City employees, Social Security benefits are often overlooked. They should not be. Even though full retirement benefits are not available until age 66 or 67 (with reduced early retirement benefits available at age 62), these benefits will add significantly to a retiree's monthly income from VRS and SRP or from the FPOPP.

   Notably, there is no offsetting of benefits under VRS, the FPOPP or the SRP by the amount of Social Security benefits received by the retiree. Some public plans do have offset provisions. The City contributes a substantial amount towards its employees' Social Security benefits, and these benefits should be included in valuing the City's pension coverage.

9. Legacy Plan's Lingering Costs: A significant part of the City's annual pension contribution costs relates to the legacy firefighters and police officers defined benefit plan that was closed to new participation in 1979 (the "Old, Old Plan"); about $1.7 million per year for the next 2 to 3 years, but projected to continue at about $1.2 million per year for some years thereafter until the survivors pass on. These contributions fund benefits that were earned by retired employees many years ago. They are legacy costs for which current employees should not be held accountable.

10. State Employees Under City Plan: For reasons unknown to the Advisory Group, the City has been providing coverage under the SRP to State employees who work in the Health Department located in Alexandria but are not employed by the City. Coverage of these 89 employees (annual salaries $5,350,297) is a significant cost to the City. It may be that the City receives something of value from the State for providing this coverage, but consideration should be given to whether this practice should be continued.

11. GASB: The Resolution requested that the Advisory Group consider the effects on the City's pension costs of the Government Accounting Standards Board's (GASB) proceedings to set new accounting standards for the reporting of public pension plan liabilities. The Advisory Group received briefings on GASB's proposals and their effect on the City from Steve McElhaney of Cheiron and Laura Triggs. And, in July 2011, GASB issued an Exposure Draft of its proposed new standards.

    Importantly, the proposed new standards distinguish between pension plan funding and accounting by employer for pension plan obligations. The standards, once finalized, are not expected to have any effect on the City's pension contribution obligations so long as the City continues its longstanding policy of contributing 100% of actuary's annual recommended contribution. Further, the FPOPP and SRP should be able to continue using 7.5% as their long-term investment return assumption, according to Cheiron.

    But, the new standards, once they become effective, will affect City's accounting for its pension obligations: unfunded actuarial liability will go on the City's balance sheet rather than merely be disclosed in the notes. This change in reporting may create a false impression of the City's pension obligations to the general public, but it should not affect the more expert perceptions of the City's creditors and rating agencies.

12. VRS: As noted in the Resolution, VRS contribution requirements are a major driver of the City's cost increases. The VRS contribution costs are largely beyond the City's control, as discussed above. The City can affect its contribution obligations through the number of employees it hires and retains in VRS-covered positions and the salaries they are paid. The City may also be able to exercise some influence over VRS decisions through the normal political process inasmuch as the VRS is a creature of State government.

    The State's Joint Legislative Audit and Review Commission is currently conducting a formal study ("Followup Review of Retirement Programs for State and Local Employees") to update its 2008 report. The results of this study are due by the end of 2011, and JLARC may make recommendations for reducing VRS costs.

13. Federal Legislation: The Resolution also asks the Advisory Group to assess the prospects for Federal legislation that would impose additional pension costs on the City.

    The proposed "Public Pension Transparency Act" (HR 567 / S. 347) was re-introduced in the current Congress by its Republican sponsors. Generally the bill would require sponsors of State and local government employee pension plans to annually report specific financial information to the Federal Government (Department of Treasury). Governments failing to report this information would lose their ability to issue tax exempt bonds until they comply with the reporting requirements. However, the legislation also states that it does not alter the existing funding standards for State and local governments or require Federal funding standards for such plans.

The bill has generated a lot of controversy among public officials, and is viewed by many as more of a political stunt than a serious measure. While supporters claim that the legislation would improve financial transparency, the opponents argue that the legislation would impose costly, duplicative and misleading reporting requirements.

The bill has been referred to committees in the House of Representatives and Senate, but no further action has been taken on it in either chamber and none is expected in the foreseeable future.

14. City Retirement Board: All City employees have a big stake in the management of the City's pension plans, particularly in light of the employee contribution requirements. The City has recognized the value of employee input in pension matters in establishing and maintaining the FPOPP's Retirement Board.

    Expansion of that joint City-employee Board, or creation of a new board, to include representatives of employees covered by the SRP and the DS, F & FM RIP could be constructive. Ongoing involvement of employee representatives in pension plan oversight would advance employee understanding and appreciation of the plans. Moreover, such a joint board would be a valuable forum for resolving controversies, addressing employee concerns, and discussing future changes in the City's pension coverage. There will be more developments affecting the City's pension obligations (*e.g.* when JLARC reports on VRS at the end of 2011), and a joint board would provide a permanent structure for discussion between partners–City government and its employees.

    The appointment of a few public members to a unified pension board is also worthy of consideration. Other jurisdictions have retirement boards on which public members serve by appointment of the chief executive.

15. Employee Education: There appears to be a need for more education of City employees about the retirement income and post-retirement benefits provided by the City. This is particularly true with regard to the retiree health policy and the retiree life insurance program for which there is no descriptive document for employees; or at least none that was brought to the Advisory Group's attention.

Some members of the Advisory Group who are City employees commented that they learned a lot about the City's retirement programs through our proceedings. This is surprising and speaks volumes about the need for more employee benefits education, and argues for the pension board discussed above.

16. "Sustainability": The Resolution appears to request the Advisory Group's opinion on the "sustainability" of the City's pension obligations. Implicit in the concept of "sustainability" are political judgments that we are not competent to make; that is the province of the City's elected leaders. To assess whether the City can sustain its current or projected obligations, one must take into consideration a myriad of factors and choices such as the City's revenues prospects, its other obligations, the types and levels of public services to be provided, the levels of employment, salaries and other employee benefits, etc.

XII. Recommendations

Mindful of the foregoing observations, the Advisory Group makes the following recommendations for the Mayor's and City Council's consideration.

1. We recommend that you establish as soon as possible a meaningful joint pension plan board in which representatives of all City employees can participate. This may be accomplished by expanding the existing Pension Plan Retirement Board that oversees the FPOPP, preserving the rights of the firefighter and police officer members of the Board with regard to the FPOPP. This may also be accomplished by creating a parallel board for employees not covered by the FPOPP.

   In either case, as discussed above, a joint pension board can be a very valuable forum for discussion and resolution of pension-related matters on an ongoing basis. The somewhat crazy-quilt character of the City's pension coverage is the product of various deals and arrangements made over the years. Whatever the merits or conveniences of such an approach, we believe that the City would be better served with a regular process for addressing pension plan issues.

   We further recommend that the City Council consider including a few public members, by appointment of the Mayor, on a unified pension board, if it is created.

2. We recommend that you seriously consider terminating the City's contributions to the SRP for State employees. As discussed above, the Advisory Group is not privy to the reasons for coverage of non-City employees under a City sponsored pension plan, so we cannot opine on whether the City is receiving value in exchange that is worth the substantial cost of the contributions. Only the City

Council can make that judgment.

3. We recommend that a “trigger mechanism” be developed to protect the City and its employees from the future risk of runaway contribution costs. As discussed above, all parties have a strong interest in avoiding runaway pension costs. Working out the details of the mechanism is beyond the abilities of the Advisory Group; certainly within the time constraints set by the Resolution. However, we offer the following ideas.

(a) The occurrence of a certain event (or events) in the future would trigger a reduction in the pension benefit accrual rate under the FPOPP and / or the SRP. The reduction would remain in effect, year-to-year, until the event that triggered the accrual rate reduction ends.

(b) The triggering event could be:

(1) the City’s required contribution rate for a year exceeds a certain level (*e.g.* if the City’s total required contribution to the VRS and SRP for a year exceeds a certain percentage of payroll, the future accrual rate under the SRP would be reduced);

(2) the actuarial funding percentage of the plan (e.g. if the funding percentage of the FPOPP falls below a certain level, the future accrual rate would be reduced).

(c) In addition to deciding what would be the triggering event (or events), factors to be decided include:

(1) by how much the future benefit accrual rate would be reduced; and

(2) when a benefit accrual rate reduction would end and the prior rate restored in whole or in part.

(d) Advantages of this trigger mechanism include:

(1) It provides comfort that future pension contribution costs can be controlled.

(2) The reduction of future benefits is generally preferable to a reduction in employees’ current income. Employees’ salaries would be reduced if the City imposed employee contribution requirements or if salary reductions or unpaid furloughs became necessary to contain costs. Salary rates are the most important

condition of employment for retaining and attracting qualified employees.

(3) This approach focuses on what future benefits can be provided for the contributions that the City is able or willing to pay.

(4) A reduction in the accrual rate is a quicker way to reduce contribution costs than imposing employee contributions or lower benefits on new employees.

(5) If future conditions permit, the reduced accrual rate can be retroactively increased (past service benefit increase).

(e) Disadvantages include:

(1) If the accrual rate is reduced, employees will receive lower monthly pensions when they retire (unless the rate is retroactively restored). This may more severely affect employees who are in the latter stage of their careers and closer to retirement when the reduction occurs.

(2) [Others???]

4. We recommend 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.

5. We recommend that the City Council or other appropriate City official request VRS to calculate the cost of providing a full retirement benefit at age 50 with 25 years of service for Deputy Sheriffs, Medics and Fire Marshals, recognizing that VRS will charge a modest fee for performing the calculation. The performance of this calculation will provide some relief from a long-festering grievance and enable the City management and the affected employees to engage in an informed discussion about whether and under what terms such a benefit improvement might be provided.

6. We recommend that any tinkering with the plan design of the FPOPP be done through the FPOPP Pension Board, and that tinkering with the SRP's design be done through the expanded or to-be-created joint pension board. The Advisory Group is not equipped to engage in plan design decisions that require consideration of a myriad of factors and variables.

7. We do not recommend the City abandon its defined benefit plans or create new

defined contribution plans. Whatever the public sector or private sector "herd" may be doing, we do not believe that this would be the right move for Alexandria. As noted above, there is good reason for the City, its taxpayers and its employees to be concerned about runaway pension costs. But, we believe that defined benefit plan costs can be controlled by use of a trigger mechanism like that we recommend.

8. We also do not recommend that the City impose additional employee contribution requirements. To the extent that consideration of additional employee contribution requirements is motivated by cost control concerns, the trigger mechanism should be given a fair trial before the City further reduces salaries by requiring more employee contributions.

XIII. Sunset

In accordance with Section 6 of the Resolution, the submission of this report constitutes the final act of the Advisory Group. The Advisory Group is thereby terminated.

Respectfully submitted,

[List names of AG members and date]