THE BILL IS DUE

Now What? Infrastructure, Pensions and the Environment

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BEST BEST & KRIEGER LLP

Pension Pain

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The Pension Bill is way past due.

- Municipal Challenges
  - Service Insolvency
  - Negative cash flow
  - Limited capital improvements

Overview

- Increasing contributions
- Reduced amortization
- Unreasonable termination costs

CalPERS

- California and National Reform Efforts

Reform Efforts

Employers Project Future Negative Cash Flow

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CalPERS increases contribution rates.

Employers cut services and expenses and project negative cash flow.

CalPERS reduces amortization rates from 30% to 20%.

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Employers in the Headlines
Fiscal Distress

Antioch

Barstow

Santa Cruz

Martinez

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Retirees Receiving Reduced Payments

Trinity County Waterworks District No. 1

Niland Sanitary District

East San Gabriel Valley Human Services Consortium

Loyalton

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CalPERS

- CalPERS has reduced discount rate to 7.0% and raised employers' contribution rates (phased in over 8 years).
- CalPERS has implemented a 20 year amortization schedule in 2021 for unfunded pension liability instead of 30 years to be phased in over three years.
- CalPERS has refused to adjust steep discount rate to terminate.

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Standoff with CalPERS

- Termination Fee is financially unworkable with current discount rate calculation.
- Need to focus on revised procedures and costs for exiting CalPERS and renegotiating amortization terms.
- Need to deal with CalPERS' public response that **"cities are still paying"** and **"we are giving them enough time and notice."**

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Increasing Contribution Payments Because . . .

- People living longer and drawing on pensions longer as a result.
- Fewer active employees for each retiree.
- Volatile return on CalPERS investment over the last 20 years.
- CalPERS implementing conservative projections for return on investments.

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Impact on Employers, Employees, Taxpayers

- Cities expect to spend at least 50% more on retiree benefits in the next 7 years.
- Service insolvency and severely reduced services is increasing.
- Reduced employee salaries, benefits and staffing levels are also increasing.
- Difficult to identify new sources of revenue.

Why Pension Reform is Absolutely Necessary

- Delivery of essential social, welfare and educational services.
- Adequate infrastructure spending and capital investment.
- Maintenance of appropriate police and fire in terms of numbers and salaries.
- Service reductions and tax increases are not sufficient to pay increasing pension contributions.

Statutory Reform

- California Public Employees' Pension Reform Act of 2013 **("PEPRA")**
- Reforms by Alameda, Contra Costa, Marin, San Diego, San Francisco – Litigation followed
  - Reduction of benefits
  - Increased employee contribution
  - Change in final salary calculation
  - Eliminated spiking

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2018 Statutory Efforts

- **Pending CA Senate Bills-**
  - **Hearings set on April 23, 2018**
  - SB 1031 proposes to permit employers to freeze COLA's for retirees if pension isn't 80% funded
  - SB 1032 would make it easier for employers to exit CalPERS without paying termination fees
  - SB 1033 proposes to shift burden of increased pension costs to employer that last hired the employee
  - SB 1149 proposes to offer employees the option of choosing a more portable 401(k) plan and opt out of CalPERS

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Impediment to Legal Reform: the California Rule

- Cases pending before California Supreme Court that may result in modification of the California Rule
- Briefing has been completed
- Many amicus briefs have been filed
  - Governor took brief drafting away from Attorney General's office
  - At least 7 briefs in support of modification
  - At least 8 briefs against modification

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PEPRA Litigation

- Trial and Appellate courts found that pensions need to be “reasonable”
- Potential reshaping of California rule
- Cases involve elimination of:
  - Spiking
  - Airtime

Political Change

Employers	Taxpayers	Options
• Focused on current and future cash flow • Recognition that shortfalls are likely	• Active reform groups • Ballot initiatives • Election of pension reform advocates	• Sales tax increases • Out of court restructuring • Bankruptcy

Pension Reform Efforts

Propositions	Local Ballot Initiatives
Voter Initiatives	State Wide Ballot Initiatives

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Attempted Modifications

- Reduce benefits and COLA’s
- Plan conversion
- Change final salary calculation
- Increase employee contribution
- Require voter approval
- Cap employer contributions
- Litigation to eliminate 2002 increases (voter initiative)

National Pension Reforms

- Eliminate, reduce or cap COLA's
- Voter approval
- Increased employee contributions
- Hybrid plans-defined benefit/defined contribution
- Change final salary calculations
- Provide new funding source *e.g.*, lottery funds

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Unfunded Pension Liability: Examples

- Recent State bailout of Hartford to address bond debt and unfunded pensions and OPEB
- New Jersey: state backed Atlantic City bonds
- Houston reaches $40M settlement with pension actuarial firm- prediction more actuaries are going to be sued
- Reform initiatives helpful in many cases but do not address lack of short term liquidity

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Wish List

- Implementation of state oversight, supervision and assistance for troubled municipalities
- Improved municipal governance and transparency in connection with budget, actual and projected financial performance and results of employee contract negotiations
- Efficient use of out-of-court restructuring process that includes bondholders and other capital market creditors
- Recognition that Chapter 9 bankruptcy is a hammer.

Predictions I

- Employer expenditures will continue to rise faster than revenues.
- Absence of legal or statutory reform will delay needed reform.
- Budgets will remain unbalanced and service insolvency more severe.
- Employers will become more active lobbying for reform.
- Voters will continue pension reform agenda.

Predictions II

- Employers will explore different solutions.
- Employers will modify disclosure of collective bargaining.
- Employers will come to recognize that they can negotiate with bondholders.
- Employers and Employees will become more adept at compromise out of necessity.

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