<u>BURLINGTON RETIREMENT COMMITTEE</u>

Summary Paper

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I. <u>**Introduction**</u>:

This summary paper outlines several central findings of the Burlington Retirement Committee (the Committee) in the introduction before providing the relevant historical context to the Committee's work, outlining problem statements and associated reform principles discussed by the Committee, and offering recommendations of relevant solutions with precedent in different communities in the sections that follow.

The 16-member Committee was established by the City Council and Weinberger Administration to explore the challenges of the City's retirement system, develop goals and principles for the system, and develop proposals and implementation strategies to carry out those goals and principles while meeting the values of participants and informing all retirement system stakeholders – specifically employees both union and non-union. These goals and principles, along with possible options, will then be further explored through the City's Human Resources and collective bargaining processes.

At the conclusion of its discussions, there was no objection to a framework through which to view this report's recommendations and to inform the next round of collective bargaining. The framework is as follows: (i) A retirement system that is 85 percent funded within 7 years and after that still on a trajectory headed in a positive direction; (ii) No increase in City contributions for three years, after which point increases are pegged to an index that is relatable to the pension system; and (iii) Automatic adjustments (or "triggers") would be activated if the City failed to hit these targets in a given year, with the nature of the automatic adjustment agreed to in advance and shared between employees and the City; and (iv) the City will meet its Retirement Ordinance requirement and make the full Actuarially Required Contribution.

With the assistance of an outside consultant contracted by the Committee, the group also identified a number of important characteristics, challenges, and opportunities connected with the Burlington Employee Retirement System (BERS), which are bulleted below:

- **The relative funding level of BERS has deteriorated both more rapidly and more substantially than the national average**. In fiscal year (FY) 2001, public pension plans' were funded at roughly 101 percent and lost about 28 percent on average by FY13. The City of Burlington's plan, by contrast, has fallen from about 112 percent funded in FY01 to 69 percent funded across the same timeframe, a drop of about 38 percent (or 43 percentage points).

- **Burlington is out of line with several national norms, contributing to increasing fiscal anxiety and a growing unfunded liability**. Burlington taxpayers pay substantially more to finance the retirement system than the national average, while Class B employee (or general employee) contributions are below the national average and Class A employee (or public safety employee) benefit levels exceed the benefit levels of other Class A workers nationally.

- **The City currently bears a disproportionate share of mortality, market, and inflation risks within BERS**. If the system requires additional revenue due to unexpected costs from these factors, taxpayers make up that difference but for any changes later negotiated at the bargaining table.

- **Committee participants share the view that uncertainty generated by steadily increasing taxpayer contributions – and repeated negotiations to address the issue – is unhealthy and could be improved by instituting a system of automatic adjustments**. Establishing agreed upon, automatic adjustments of elements of the plan design that share new costs between employees and taxpayers if, for example, the BERS funding condition falls or remains below a specified threshold could stabilize the system and end the need for frequent, problematic pension system negotiations.

- **Nationally, public pension plans have experienced the most significant period of reform since the 2008 – 2009 market collapse**. These changes have generally included establishing hybrid plans, higher employee contributions, reduced cost-of-living adjustments (COLAs), higher vesting periods, a higher age or greater number of years of service (or both) needed to qualify for normal, unreduced retirement, and others. BERS and the City's unions have agreed upon some reforms, but the cumulative effect of these reforms has not slowed the rising taxpayer contributions or the growing unfunded liability.

During its discussions, the Committee considered the idea of converting the City's current defined benefit (DB) plan to a purely defined contribution (DC) plan. Though DC plans are comparatively simpler to administer and would reduce uncertainty about future City liabilities, there was not consensus among members of the Committee that a DC plan alone would provide reliable retirement income. Further, Burlington has the benefit of observing the many other public retirement system reforms that have taken place across the country since 2008. Relatively few cities made the conversion from a DB to a DC plan, the experience of some cities, like Phoenix, AZ, suggests that meaningful reform of the current DB system could actually result in greater taxpayer savings (see the Summary Paper Appendix, "How Other Municipalities Have Addressed Pension Reform," p. 10).

Given the difficulties associated with a conversion to a DC system, and the uncertain benefits for taxpayers, the Committee is not recommending such a course at this time. The Committee did, however, envision the possible range of plan designs as a spectrum anchored at one end by a pure DC system and at the other by a pure DB plan and discussed hybrid options integrating both DC and DB components as described in later sections of this report.

II. Historical Context:

A public Pension Summit in November of 2013 identified a number of issues about BERS that warranted further discussion, such as an unfunded liability that has grown despite dramatically-increased taxpayer contributions and discussions about how to recruit and retain good employees. There was widespread agreement that the challenge should be approached collaboratively with the involvement of many different stakeholders in a jointly-designed process.

To design such a process and ensure the long-term viability of BERS consistent with the parameters established by the August 12, 2013 City Council Resolution "Convening of a Summit to Discuss the Underfunding of the City's Pension Plan and to Explore Options to Address Unfunded Liability," the City Council and the Mayor established the Committee with representatives from each stakeholder group in the BERS system to facilitate discussion about the challenges our community faces.

This Committee and its discussions do not replace the Human Resources and collective bargaining processes or impose any Committee-recommended modifications about the City's retirement fund. Rather, the 16-member Committee's work is meant to inform the Mayor, the City Council, retirement system stakeholders, and the public at large about the challenges the system faces and to identify possible paths forward. The Committee's goals are as follows:

- Define the root cause challenge(s) facing our current pension system
- Define goals consistent with the identified challenges
    - These goals should be specific, measurable and achievable within a defined time frame
    - Suggestions from the City Council on potential goals would be welcome at the outset of the process
- Develop principles by which to guide goals
- Identify the value for all stakeholders impacted by the pension system of developing solution goals
- Develop proposals with associated costs and implementation strategies

The Committee membership is as follows:

- Each of the four bargaining units (Police, Fire, IBEW, and AFSCME) has a representative selected by the union (4)
- A non-union, non-management employee, selected by the City Council President and approved by the City Council, is on the Committee (1)
- The City Council has four representatives selected by the Council President with input from the caucuses (4)
- The BERS Board has two non-City-employee representatives selected by BERS (2)
- The Administration has representatives from the Human Resources Department, City Attorney's Office, Clerk/Treasurer's Office, and Mayor's Office (4)
- The Mayor is on the Committee (1)

III. <u>Problem Statements and Reform Principles</u>:

Problem statements within this section are divided into two types – challenges related to system design and challenges related to actuarial methods and assumptions.

System Design

1. **Taxpayer contributions have risen rapidly since the early 2000s at the same time the retirement system's unfunded liability has grown substantially.** This trajectory, with taxpayer contributions rising from $274,878 in FY01 to $8,175,505 in FY13 even as a $12.5 funding surplus in FY01 became to a $63.4 million unfunded liability by FY13, calls the system's long-term sustainability into question.

    <u>Principles</u>:

    1. Restore, and subsequently maintain, the taxpayer contribution to a sustainable level
    2. Reduce the plan's unfunded liability to increase confidence in the system
    3. Any changes to employee benefits and/or contributions should consider income sensitivity concerns

2. **BERS is out of line with several national norms, and some of these factors contribute to the fiscal concerns**. In Burlington, taxpayers pay a greater cost for the retirement system than the average national taxpayer because of some specific elements of the plan:

   i. In FY15, the City is contributing about $9 million to BERS while employees are contributing about $2.3 million. This means the City is paying approximately 80 percent of total contributions. This is about 10 percentage points (or 14 percent) higher than the national average of public employers who pay approximately 70 percent of all pension contributions.
   ii. About 7.9 percent of the City's FY15 General Fund is to be spent on retirement contributions. Comparisons across comparable municipalities are difficult to make reliably, but the City's contribution appears somewhat higher than the national average.
   iii. Burlington's Class B employees contribute 3.05 percent, compared with a national average of about 5.7 percent. (For reference, Class A workers contribute 10.8 percent, roughly commensurate with Class A workers nationally; the higher contribution is because they do not participate in Social Security).
   iv. In Burlington, there are different tiers within employee classes. The benefit level for some Class A workers exceeds benefit levels for most other Class A employees nationally; further, because Class A workers can retire at a relatively young age, this benefit has a substantial effect on the City's unfunded liability.
   v. Burlington's seven-year full vesting period is somewhat longer than typical (5 years)
   vi. The Class B retirement multiplier is below national average, which effectively undercompensates Class B employees relative to their peers.
   vii. The 6 percent COLA ceiling for Class A employees and 4 percent COLA ceiling for Class B employees is substantially higher than comparable plans; most plans reviewed by the City's consultant fell in the 2-3 percent range.

   Principle:
      1. Establish a plan whose cost and benefit levels are in line with national norms

3. **The City currently bears a disproportionate share of mortality, market, and inflation risks within BERS**. When investment returns are not realized, for example, the system's current arrangement puts a disproportionate share of risk on the City. As currently established, active employees pay a fixed percentage of income and retirees make no contributions, altered benefit levels, or adjustments, so any increases are made up entirely by the taxpayers' share. For example, in the FY13 valuation, the City was expected to pay $5.9 million in past service payments. In FY14, that figure is estimated at $6.1 million, and the City alone (through ratepayers and taxpayers) bears the cost of this difference.

   Principle:
      1. Establish a more equitable means to share risk

4. **BERS is an unusually complex system**. As a result of repeated "tinkering" with plan design (which itself has contributed to some of the uncertainty about BERS's sustainability) and a unique arrangement with each of the four unions representing City employees (and numerous tiers within each class based on hiring dates or other factors), administration of BERS has become complex, and the possibility of administrative error is non-trivial. In the

words of the Committee's consultant, "Without the benefit of city code or reference sources, understanding the Burlington retirement plan's benefit design is a nearly insurmountable task."

Principles:

1. No reforms should further complicate the system
2. Simplify BERS where possible and appropriate

5. **BERS stakeholders have experienced repeated negotiation and a lack of predictability that erodes trust, diminishes confidence, contributes to the systems complexity, and lacks flexibility.** Burlington needs a system all stakeholders have confidence in if the City is going to be able to continue to recruit and retain talented employees and maintain broad voter support for the retirement system.

   Principles:

   1. Establish a system that is predictable, self-correcting, and no longer requires frequent renegotiation
   2. Develop a system that inspires public confidence
   3. Prioritize a system that contributes to the effective recruiting and retaining talented employees
   4. Modify system to ensure long-term solvency and voter support

Actuarial Methods and Assumptions

1. **BERS uses a combination of factors – projected unit credit and closed group method, for example, that front load taxpayer costs.**

   Principle:

   1. Take advantage of the time-value of money and a growing tax base to retire the City's debt

2. **Over the past 6 years, BERS investment has underperformed relative to the market**.

   Principle:

   1. Balance capital preservation with reasonable investment returns
   2. Invest for a return consistent with actuarial assumptions.

3. **VPIC and Dahab charge substantial fees for their services.** These fees apply whether BERS's investment return exceeds market returns or not.

   Principle:

   1. Seek appropriate ways to reduce costs to the City's investment returns

4. **BERS's investment return expectation of 8 percent is toward the high end of investment expectations nationally**. Failure to meet the actuarial investment return expectation contributes to growth of BERS's unfunded liability.

   Principle:

   1. Consider adjusting this actuarial assumption if appropriate and make reasonable assumptions about the future

5. **BERS has been using an outdated mortality table**. An incorrect mortality table contributes to the growth of the unfunded liability

   Principle:

      1. Make reasonable assumptions about the future

IV. Possible Solutions and Recommendations:

Across the country, public pension plans have experienced the most significant period of reform since the 2008 – 2009 market collapse. The consultant hired by the Committee has examined many of these reforms in light of the challenges outlined above, and offered the recommendations in the following "System Design" section regarding the design of the City's retirement system. A section on potential changes to actuarial methods and assumptions follows the section on system design recommendations.

Following its discussion, there was no objection to the following framework through which to view the report's recommendations and for the next round of collective bargaining. The framework is focused on four major goals:

- 85 percent funding in no more than 7 years and after that still on a trajectory that is headed in a positive direction
- For three years, no increase in City contribution and after that point in time tie increases to an index
- If we don't hit the target in a given year, there would be automatic triggers agreed upon in advance and shared between employees and the City
- The City will meet its Retirement Ordinance requirement to make the full Actuarially Required Contribution

System Design

1. **Direct the actuarial evaluation of the impact of the reforms proposed by the consultant on BERS to better understand their implications.** As a result of time and cost constraints, the consultant's work for this Committee involved did not include actuarial projections of the impact of potential changes to the BERS system. That work should now be done to inform the collective bargaining process and changes to the system for non-union employees. The Committee believes that changes that impact new employees and then current employees should be pursued prior to discussing any change impacting current retirees. Any proposed changes relating to current employees should not attempt to modify currently earned benefits.

2. **Explore the possibility of bringing Burlington back into line with national norms to reduce fiscal anxiety about BERS and reduce the BERS's unfunded liability**. Moving to national norms would mean a reduction in the City's percentage of total contribution, an increase in Class B contributions, a reduction in Class A benefits, and increase in the Class B retirement multiplier, a shorter vesting period, and a lower COLA ceiling.

3. **Explore the possibility of sharing mortality, market, and inflation risks more equitably within BERS,** with unexpected costs stemming from mortality, market, and

inflation risks split ___ percent to ___ percent between the City and employees. Or alternatively, plan components like benefit levels, actuarial assumptions, or employee contribution rates could be adjusted based on actuarial and investment performance.

4. **Explore the possibility of instituting a system of agreed upon adjustments triggered automatically by changes in system health to address the lack of predictability in BERS**. Establishing agreed upon, automatic adjustments of elements of the plan design (such as employee or employer contribution rates) in the event BERS funding condition falls or remains below a specified threshold would stabilize the system naturally. An example of one such possible adjustment would be suspending COLAs for a pre-determined period of time should the plan fall below, for example, 70 percent funded or the unfunded liability reach a threshold percentage of the City's payroll.

5. **Simplify the retirement system by exploring the possibility of establishing one Class A plan and one Class B plan** (while still allowing variation between, for example, Police and Fire). The consultant has indicated that Burlington's separate plan with each separate bargaining unit is unusual, if not unique.

Actuarial Methods and Assumptions

To reduce front loading of costs that are contributing to rapid tax increases, Burlington could adopt the open-group method. A transition to the open-group method, under which City contributions and payrolls are projected with a level workforce assumption, would more accurately project the impact of future employees with less expensive retirement benefits entering the system and would lower City contributions in the short-term (until about 2027) while also produces a more stable City contribution rate. This is currently under consideration by the BERS Board.

Evaluate the efficacy of the BERS current asset allocation and investment strategies. This is currently under consideration by the BERS Board.

Explore the possibility of transferring BERS assets to a passive index fund to reduce fees (and potentially increase returns relative to the current asset allocation).

Consider lowering BERS investment return expectation in light of national norms and repeated failures to meet this target. The BERS Board has considered this decision and elected not to do so at this time.

Update BERS mortality table to accurately reflect its population. This change could largely or entirely offset any short-term benefit gained from a change to the open-group valuation method. The BERS Board has considered and adopted this change.

Consider implementing a tiered amortization schedule to reduce the front-loading of costs and more fairly share payments between current and future City taxpayers. The BERS Board is considering this issue.