CITY COUNCIL ACTION REPORT

November 4, 2008

TO: Phillip L. Nelson, City Manager

FROM: John M. Lamerato, Assistant City Manager/Finance & Administration

SUBJECT: Voluntary Separation Retirement Incentive Programs

The preliminary projections for the 2009/10 City budget show an approximate $5 million short fall in revenues versus expenditures. As one means to address this situation City management recommends City Council approve two Voluntary Separation Retirement Incentive Programs. The goal in offering this type of incentive is to realize permanent efficiencies in staffing through re-assignment of remaining employees; combining like services; and helping to fund highly rated services while at the same time addressing some of our budgetary concerns.

The cost benefit analysis attached to this report covers different scenarios based on the number of employees retiring under the incentive programs. The first year's savings takes into consideration actual savings of not replacing a given number of retiring employees, the time other positions will likely remain vacant and the cost to the retirement system. The 2nd – 5th yearly savings reflects the savings of not replacing a given number of employees vs. the cost to the retirement system. The 6th – 30th yearly savings reflects the savings of not replacing a given number of employees vs. the cost to the retirement system for health care.

City management recommends a five-year funding recovery for pension benefits and thirty-year funding recovery for retiree health care benefits in line with our Other Post Employment Benefits (OPEB) report. Even though we have an over-funded pension plan, we are following the Government Finance Officers Association's recommended practice of not allocating any actuarial surplus to finance the incremental costs of the retirement incentive.

Following is a description of the two Voluntary Separation Retirement Incentive Programs.

Voluntary Separation Defined Contribution (DC) to Defined Benefit (DB) Program for Retirement

The City of Troy has seen a reduction of taxable value of real estate which is adversely affecting the operating revenues. City management predicts significant budget short-falls for fiscal years 2010, 2011, and 2012. Operational expenses need to be reduced while continuing the effectiveness of City services.

In order to reduce operational expenses and simultaneously restructure the City's operations, it is suggested to provide a voluntary separation DC to DB program for those who are eligible to retire.

City management has come up with a plan supported by the Troy Command Officers Association (TCOA) bargaining team on a retirement incentive program that would permit current TCOA DC members who are eligible to retire as of December 31, 2008 to revert back to the DB plan with their pension based solely on their accumulated DC account balance, as long as they retire by December 31, 2008. Approximately 13 TCOA employees are eligible to retire as of December 31, 2008.

During contract negotiations with the TCOA the topic of retirement incentives was discussed and the DC to DB conversion and the Voluntary Separation Incentive Program are two measures City management would like to offer to meet the goals of reducing expenditures and re-organizing the department.

The cost associated with the implementation of this program will be funded by employee DC funds (see the attached report from Gabriel Roeder Smith & Company).

Voluntary Separation Incentive Program for Retirement

In order to reduce operational expenses and simultaneously restructure the City's operations, it is suggested to provide a Voluntary Separation Incentive Program for Retirement for those who are eligible to retire. Approximately 69 City of Troy employees are eligible to retire and 24 are eligible for early retirement.

The cost associated with the implementation of this program will be absorbed by the Employee Retirement System. See attached report from Gabriel Roeder Smith & Company.

As always, if Council has any questions or requires further clarification, please contact us.

JML/mr\AGENDA\2008\11.10.08 –Voluntary Separation Retirement Incentives Programs

Cost Benefit Analysis - Retirement Incentives

	Percentage of Eligible Members Assumed to Retire Under the Program			
	100%	50%	20%	10%
Number Assumed to Retire From ERS (DB) Plan	44	22	9	4
Number Assumed to Retire From (DC) Plan	49	25	10	5
	93	47	19	9
5-Year Amortization of Pension Cost	$ 806,502	$ 403,251	$ 161,300	$ 80,650
30-Year Amortization of Retiree Health Costs	138,033	69,017	27,607	13,803
	$ 944,535	$ 472,268	$ 188,907	$ 94,453
Non-Replacement of 14 Employees	$ 1,300,000			
Four Month Vacancy of 79 Employees	3,400,000			
Incremental Cost due to Vacancies	(200,000)			
	$ 4,500,000			
Net 1st Years Savings	$ 3,555,465			
Net 2nd - 5th Yearly Savings	$355,000 +			
Net 6th - 30th Yearly Savings	$1,162,000 +			
Non-Replacement of 7 Employees		$ 650,000		
Four Month Vacancy of 40 Employees		1,720,000		
		$ 2,370,000		
Net 1st Years Savings		$ 1,897,732		
Net 2nd - 5th Yearly Savings		$178,000 +		
Net 6th - 30th Yearly Savings		$581,000 +		
Non-Replacement of 3 Employees			$ 279,000	
Four Month Vacancy of 16 Employees			689,000	
			$ 968,000	
Net 1st Years Savings			$ 779,093	
Net 2nd - 5th Yearly Savings			$90,000 +	
Net 6th - 30th Yearly Savings			$251,000 +	
Non-Replacement of 1 Employee				$ 93,000
Four Month Vacancy of 8 Employees				344,000
				$ 437,000
Net 1st Years Savings				$ 342,547
Net 2nd - 5th Yearly Savings				$1,500 +
Net 6th - 30th Yearly Savings				$79,000 +

GRS Gabriel Roeder Smith & Company
Consultants & Actuaries

One Towne Square
Suite 800
Southfield, MI 48076-3723

248.799.9000 phone
248.799.9020 fax
www.gabrielroeder.com

a)

October 29, 2008

Mr. John Lamerato
Assistant City Manager-Finance
City of Troy
500 W. Big Beaver Road
Troy, Michigan 48084

Re: Amendment to Allow Transfers from DC to DB

Dear John:

We understand the City of Troy is considering offering TCOA Police members who are currently in the Defined Contribution Plan and eligible to retire an opportunity to convert back to the Defined Benefit Plan. As a condition of the offer, these members will have to retire and their pensions will be based solely on their accumulated balance in the Defined Contribution Plan. We believe this offer will have no material effect on contributions to or obligations of the Defined Benefit Plan provided all amounts are in accordance with our October 15, and October 29, 2008 correspondence on this topic, and Defined Contribution Plan accumulated balances equal to those shown are transferred into the Defined Benefit Plan by December 31, 2008.

This document is provided to comply with MI PA 728 of 2002 Sec. 20h. (3) which requires that a System provide a supplemental actuarial analysis of any proposed pension benefit change to the Board and to the decision-making body (City Council) at least 7 days before adoption.

Respectfully submitted,

Brad Lee Armstrong

Brad Lee Armstrong

BLA:bd
Enclosure

GRS Gabriel Roeder Smith & Company
Consultants & Actuaries

One Towne Square
Suite 800
Southfield, MI 48076-3723

248.799.9000 phone
248.799.9020 fax
www.gabrielroeder.com

b)

October 31, 2008

CONFIDENTIAL

Mr. John Lamerato
Assistant City Manager - Finance
City of Troy
500 West Big Beaver Road
Troy, Michigan 48084

Re: A Supplemental Valuation of the Effect of a Proposed Voluntary Separation Incentive Program (VSIP) for the City of Troy

This report presents the results of a supplemental valuation of the potential impact of the proposed Voluntary Separation Incentive Program on the City of Troy Employees Retirement System (ERS). A summary of the Voluntary Separation Incentive Program provisions is shown on the following page.

Except where indicated, this valuation was based on the actuarial assumptions and methods used in the ERS annual actuarial valuation as of December 31, 2007 and the December 31, 2006 Other Postemployment Benefits valuation.

Both of the undersigned are Members of the American Academy of Actuaries (MAAA) and meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein.

Sincerely,

Brad Lee A

Brad Armstrong, ASA, MAAA

Randall J. Dziubek, ASA, MAAA

RJD:BLA:mrb
Enclosures

CITY OF TROY EMPLOYEES RETIREMENT SYSTEM (ERS)
VOLUNTARY SEPARATION INCENTIVE PROGRAM (VSIP)
PROPOSED PROVISIONS

BACKGROUND: The proposed Program will be offered to eligible employees who retire on or before February 28, 2009. Eligibility for the Program and the associated benefits are shown below:

Eligibility for the Program: Member is eligible for regular or early retirement as of December 31, 2008. Members of both the ERS and the Defined Contribution Plan (DC) are eligible for the Program.

Benefits provided by the Program:

1. ERS and DC Members - Lump sum payment equal to one week's pay as of December 31, 2008 for each full year of pensionable service.
2. ERS and DC Members - Immediate retiree health benefits with additional service equal to one week for each full year of service.
3. ERS Members - Additional pensionable service equal to one week for each full year of service.

Lump sums for DC members are assumed to be paid from the ERS assets.

DATA PROVIDED TO THE ACTUARY: The City provided a listing of all of the active members that are believed to be eligible for the Program. The listing was reviewed for reasonableness, but was not audited by the actuary. The listing contained credited service projected to December 31, 2008.

A summary of individuals deemed eligible for the Program and included in this report is shown below:

	Data as of December 31, 2008				
	Number	Total	Average	Average Service	
Group	Count	Annual Payroll	Age	Benefit	Eligibility
ERS	44	$ 3,343,594	57.2 yrs.	23.4 yrs.	25.5 yrs.
DC Plan	49	$ 4,470,161	56.4 yrs.	28.3 yrs.	28.9 yrs.

RESULTS OF THE VALUATION

The estimated impact of the proposed Program as of December 31, 2008 is shown below, assuming 100% of eligible members retire. The "Pension" results include the value of the lump sum payments for both ERS and DC Plan members, the additional service credit for ERS members, and the impact of immediate retirement for ERS members. All of these benefits are assumed to be paid from ERS assets. The "Health" results represent the impact of immediate retirement for both ERS and DC Plan members plus the effect of additional service credit granted under the Program.

Annual employer contribution results shown below were determined by amortizing the increase in the present value of benefits over a five-year period as a level percentage of pay. These contribution results are not the expected increases in the Annual Required Contributions (ARC) that will be determined in the actuarial valuations following the Program, but are a good representation of the expected overall costs of the Program if paid off over a five-year period.

	Increase in Present Value (PV) of Pension Benefits	**Annual Employer Contribution to Amortize PV Increase Over 5 Years**
Pension	$3,694,096	$806,502
Health	$1,807,929	$394,710

The most recent actuarial valuation of the ERS, as of December 31, 2007, determined the ARC using the Aggregate actuarial cost method. This method calculates contributions necessary to pay off the total unfunded present value of future benefits as a level percentage of future pay. We estimate that under this method, the increase in the ARC as a result of the Pension portion of this Program (assuming 100% utilization) is **$429,550**. This is a much lower result than the amount shown above, since the current actuarial cost method will pay for the cost of the Program over many more years than five.

The Annual Required Contribution for retiree health benefits provided by the City of Troy was most recently determined in our report dated December 28, 2007. Calculation of the ARC was based on 30-year amortization of the unfunded actuarial accrued liability. The estimated increase in the ARC that would result from this proposed Program (assuming 100% utilization) is estimated to be **$138,033**. As with the Pension results, this result is also much lower than the amount shown above due to the longer amortization period.

RESULTS OF THE VALUATION

It is likely that less than 100% of eligible members will choose to retire under this Program. In the table below, we show the estimated increase in employer contributions based on various election percentages (please refer to Comment 4 on page 4).

	Percentage of Eligible Members Assumed to Retire Under the Program			
	100%	**50%**	**20%**	**10%**
Number Assumed to Retire from ERS	44	22	9	4
Number Assumed to Retire from DC Plan	49	25	10	5
Increase in PV Benefits				
Pension	$3,694,096	$1,847,048	$738,819	$369,410
Health	1,807,929	903,965	361,586	180,793
Total	$5,502,025	$2,751,013	$1,100,405	$550,203
5-Year Amortization of PV Benefits				
Pension	$806,502	$403,251	$161,300	$80,650
Health	394,710	197,355	78,942	39,471
Total	$1,201,212	$600,606	$240,242	$120,121
Estimated Increase to Annual Required Contribution (ARC)				
Pension	$429,550	$261,247	$114,630	$58,927
Health	138,033	69,017	27,607	13,803
Total	$567,583	$330,264	$142,237	$72,730
5-Year Amortization of Pension Costs and 30-Year Amortization of Retiree Health Costs				
Pension (5-year amortization of costs)	$806,502	$403,251	$161,300	$80,650
Health (30-year amortization of costs)	138,033	69,017	27,607	13,803
Total	$944,535	$472,268	$188,907	$94,453

Please see the Comments on the following page for important information essential to understanding this report.

COMMENTS

Comment 1: This report is based on an assumption that individuals reported by the City as eligible for the Program, elect the Program and then retire on February 28, 2009. Data used for this report was based on the data provided by the City regarding eligible members, service as of December 31, 2008, and the lump sum payment available under the Program. Pay data provided for the December 31, 2007 annual actuarial valuation of the ERS was used to estimate pensionable earnings at retirement. Pensionable earnings for 2008 for ERS members were assumed to be 3.5% higher than 2007 pensionable earnings.

Comment 2: This report is based on the data and assumptions noted above and the proposed Program provisions shown on page 1. If you have reason to believe that the assumptions that were used are unreasonable, that the plan provisions are incorrectly described, that important and relevant plan provisions are not described, or that conditions have changed since the calculations were made, you should contact the author of this report prior to relying on information in the report.

Comment 3: This report shows the potential impact of the proposed Program on ERS pension and retiree health care costs as of December 31, 2008. The non-retirement costs/savings in other areas (payroll savings, fringe benefit savings, employer contributions to new hire defined contribution accounts, etc.) are not included in this report.

Comment 4: The cost of the proposed Program has been developed assuming that all of the individuals shown in this report are eligible for the Program and will elect to retire on February 28, 2009. Please be aware that the cost of the Program will vary for each individual member. For example, if half of the eligible employees elect to retire, and these employees are the ones who would benefit most from the incentive, the cost would be more than 50% of the maximum (100% retire) cost shown in this report. In other words, in the examples of 50%, 20%, and 10% election percentages on page 3, the cost would be increased if the employees electing to retire are the employees who would benefit most from the proposal.

Comment 5: The Government Finance Officers Association (GFOA) recommended practice for evaluating the use of early retirement incentives has been included in the Appendix of this report. The GFOA recommends the use of a short amortization period (such as 3-5 years) to finance the incremental cost of an early retirement incentive program. Since savings are typically realized over a short period, the costs should also be recognized over a similar period. Regardless of the time period selected for funding, we recommend that policy makers carefully consider the 5 year results shown in this correspondence in the decision making process.

COMMENTS

Comment 6: The calculations are based upon assumptions regarding future events, which may or may not materialize. They are also based upon present and proposed plan provisions that are outlined in the report. If you have reason to believe that the assumptions that were used are unreasonable, that the plan provisions are incorrectly described, that important plan provisions relevant to this proposal are not described, or that conditions have changed since the calculations were made, you should contact the author of this report prior to relying on information in the report.

Comment 7: If you have reason to believe that the information provided in this report is inaccurate, or is in any way incomplete, or if you need further information in order to make an informed decision on the subject matter of this report, please contact the author of the report prior to making such decision.

Comment 8: No statement in this report is intended to be interpreted as a recommendation in favor of the changes, or in opposition to them.

Comment 9: This report is intended to describe the financial effect of the proposed plan changes on the retirement system. Except as otherwise noted, potential effects on other benefit plans were not considered.

Comment 10: The reader of this report should keep in mind that actuarial calculations are mathematical estimates based on current data and assumptions about future events (which may or may not materialize). Please note that actuarial calculations can and do vary from one valuation year to the next, sometimes significantly if the group valued is very small (less than 30 lives). As a result, the cost impact of a benefit change may fluctuate over time, as the demographics of the group changes.

APPENDIX

GFOA Recommended Practice

Evaluating Use of Early Retirement Incentives - 2004

Background. Governments occasionally offer early retirement incentives (ERIs)[1] to employees as a strategy to reduce payroll costs or stimulate short-term turnover among staff. ERIs are temporary, offered during a window that usually covers a period of months. They increase the economic value of the standard retirement benefit. Historically, ERIs rarely have succeeded, since costs are often greater than initially anticipated by the government offering the incentive, and savings are lower than projected.

Recommendation. GFOA recommends that governments exercise extreme caution if considering ERIs. Governments should take several actions prior to the decision to offer an ERI in terms of (1) goal-setting, (2) cost/benefit analysis, and (3) budgetary analysis. Governments should also develop an implementation plan.

1. Goal-Setting for ERIs

Governments should be explicit in setting documented goals for the ERI. Goals can be financial in nature, such as realizing permanent efficiencies in staffing or achieving budgetary objectives. ERIs can also be designed to achieve human resource goals, such as creating vacancies that allow for additional promotion opportunities and allowing management to bring in new staff. Any ERI goals should not conflict with other retirement plan goals (e.g., features to reduce turnover or increase retention).

An explicit statement of goals is needed to judge the ultimate success of the initiative and to develop performance measures. Further, having a statement of goals promotes transparency. Inappropriate goals such as rewarding a select group of staff should be explicitly rejected. Potential conflicts of interest among decision-makers who design an ERI should be monitored closely, since any self-dealing is costly and could harm the long-term credibility of the government entity.

2. Cost/benefit analysis

In judging whether an ERI should be offered, governments should assess the potential costs and benefits of ERI proposals, and the cost/benefit analysis should be linked to the goals of the ERI. For example, if a government sets a financial goal of obtaining long-term staffing efficiencies, then an independent cost/benefit analysis should determine whether the ERI will actually bring about such

[1] The scope of this recommended practice does not cover deferred retirement option plans (DROP) or partial lump-sum option plans (PLOP), which often promote employee retention. The CORBA Committee may address this issue separately.

staffing efficiencies. A cost/benefit analysis should be comprehensive. It should take into account direct and indirect impacts, such as the impact on the government for providing retiree health care and additional contractor costs. In addition, it should take into account the effect upon both the plan sponsor and the pension fund (if the pension fund is a separate organization). Governments should retain an actuary to assist in conducting a cost/benefit analysis.

Material changes to the ERI proposal during the legislative process should trigger adjustments to the cost/benefit and budgetary analyses.

Regarding financially-driven ERIs, a cost/benefit analysis should compare long-term benefits and costs against the "default" scenario of a hiring freeze. Most financially-driven ERIs project financial benefits based on payroll savings related to staff departures. However, any such savings should be discounted, because a hiring freeze also creates payroll savings (owing to the normal rate of staff departures). Thus, the ERI benefit is limited to the marginal increase in staff departures attributable to the ERI. Governments that attribute all staff departures to an ERI would over-state the ERI benefit, thus distorting the cost/benefit analysis.

Financially-driven ERIs may also obtain savings by replacing highly compensated staff with lower-paid staff. Analysis of such ERIs must take into account the fact that newly hired staff tend to experience faster salary increases than other employees.

If early retirement incentives are offered, they should be offered very infrequently and without a predictable schedule to avoid the expectation that another ERI will be offered. Such an expectation would distort normal employee retirement patterns.

The incremental costs of an ERI should be amortized over a short-term payback period, such as three to five years. This payback period should match the period in which the savings are realized. To calculate the incremental costs of an ERI, governments should conduct an actuarial analysis that discloses the present value of the liabilities associated with an ERI. Governments that have over-funded pension plans should avoid allocating any actuarial surplus to finance the incremental costs of the ERI.

3. Budgetary considerations

In order to develop accurate budgetary estimates for the ERI, it is necessary to estimate the incremental cost of the ERI, which will vary according to the level of employee participation. Any budgetary analysis should project multiple scenarios for employee participation levels.

A budgetary analysis should be comprehensive. It should take into account direct and indirect impacts, such as the impact on the government for providing retiree health care and additional contractor costs.

Because a collective bargaining agreement may affect potential ERI costs and benefits, it should be reviewed prior to developing budgetary estimates.

4. Implementation considerations

If implementing an ERI, at a minimum, governments should take into account the following points:

- A communication plan is desirable to help employees understand the ERI in the context of overall retirement planning;

- It may be necessary to gain input from collective bargaining units;

- Governments should consider the impact upon service delivery after employees retire, with identification of critical personnel whose services must be maintained;

- The duration of the window should take into account the ability of retirement staff to manage retirement application workloads, among other factors; and

- Performance measures should be used to ensure ERI goals are met. For financially-driven ERIs, governments should track and report direct and indirect costs and benefits to determine if goals are met, such as for vacancies and contract costs.

References:

A Primer on Early Retirement Incentives, GFOA, 2004.

Approved by the GFOA Executive Board, October 15, 2004.