

City of Palo Alto
Office of the Mayor and City Council

September 10, 2012

Kathryn G. Janoff
Foreperson
2011-2012 Civil Grand Jury of Santa Clara County
Office of the Civil Grand Jury
Superior Court of California
County of Santa Clara
191 North First Street
San Jose, CA 95113

FILED

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DAVID H. YAMASAKI
Chief Executive Officer/Clerk
Superior Court of CA County of Santa Clara
BY D. ALDYCKI

Dear Foreperson Janoff and other Members of the Civil Grand Jury:

This letter is in response to your final report, "An Analysis of Pension and Other Post Employment Benefits," in which you addressed the following questions: "Is the cost of providing pension and other post employment benefits interfering with the delivery of essential City services and is the ultimate cost to the taxpayers a bearable burden?"

We in the City of Palo Alto are equally concerned about the current and future costs of post-employment benefits. In July, the City Council approved a Colleagues Memorandum (Exhibit 2) that raised many of the issues contained in your Report. In the Memorandum, the Council requested a series of community discussions about pensions, health care and other employee benefits to take place in September and October, 2012.

Therefore this response to your Grand Jury Report is a prelude to a broader discussion in the community of these very same issues.

The City of Palo Alto has taken a number of steps in the direction of containing these benefit costs, as will be described below. However, its efforts are proscribed by the limitations of the CalPERS pension system and by the actions of the Legislature. An initial review of the California Public Employees' Pension Reform Act of 2013 (PEPRA), enacted August 31 2012, offers hope of some additional flexibility in addressing these costs. However, staff is still examining the legislation to better understand the options it offers.

Overall, however, the City believes that unless the issue of vested rights is reexamined in California, the cost of providing pension and other post employment benefits **will** interfere with the delivery of essential City services, and the ultimate cost to the taxpayers **will not** be a bearable burden.

The City of Palo Alto would like to offer the following point-by-point discussion of the seven recommendations included in the Grand Jury Report.

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Recommendation 1: Cities should adopt pension plans to extend the retirement age beyond current retirement plan ages.

Response: Agree. Palo Alto has already created a second tier for Miscellaneous (non-public safety) employees extending the retirement age for new hires from 55 to 60. In the past year it has also extended the retirement age for new safety employees from 50 to 55.

Because the City participates in the CalPERS retirement system, it is limited to the retirement formulas offered by CalPERS. Retirement age is a factor in those retirement formulas and cannot be altered by the City. In addition, although the extended age retirement formulas set the standard retirement age at a higher level, employees may still choose to retire at an earlier age. For example, with respect to the Miscellaneous 2% at 60 tier, retirement at the age of 60 is not required; an employee may retire beginning at age 50 for a lower benefit factor, or after age 60 for a higher benefit factor. In fact, the formula would go as high as 2.418% for an employee who retires at the age of 63 or as low as 1.426% at the age of 50. Lastly, CalPERS offers a 1.25% at 65 formula, but only for state employees who are in the Social Security system; Palo Alto would not qualify because it does not participate in Social Security.

AB 340, the California Public Employees' Pension Reform Act of 2013 (PEPRA), includes a provision requiring that newly hired employees receive a pension benefit lower than Palo Alto's second tiers: the PEPRA-mandated formulas are 2% at 62 for Miscellaneous (which translates to about 1.8% for those who retire at 60), and a choice of 3 formulas for Safety, all of which are less than the City's recently approved second tier for safety of 3% at 55.

Recommendation 2A: Some cities, including Palo Alto, have adopted second tier plans, but further changes are needed. Second tier plans should be implemented for both Miscellaneous and Public Safety.

Response: Agree. Since the Grand Jury questionnaire was submitted, Palo Alto has now adopted second tier plans for safety employees as well as miscellaneous.

Recommendation 2B: Cities which have not already done so should implement second tier plans for Miscellaneous and public safety employees.

Response: Agree. As discussed above, Palo Alto has already implemented this recommendation.

Recommendation 2C: All Cities' new tier of plans should close the unfunded liability burden they have pushed to future generations. The new tier should include raising the retirement age, increasing employee contributions, and adopting pension plan caps that ensure pensions do not exceed salary at retirement.

Response: Agree. However, as discussed above, the City's options are currently limited to the pre-determined formulas and other optional benefits established by CalPERS. The City has taken steps to address issues associated with some of its optional benefits, but also would like

to see CalPERS offer more options for additional cost containment. As discussed in the response to Recommendation 1, the City has already raised the retirement age for new employees in the Miscellaneous and Safety groups. In addition, as discussed in Recommendation 4, nearly all employee groups are now paying (or will be paying in the near future) the full amount of the PERS employee share.

For current employees, CalPERS does not offer the option of adopting pension caps within its current formulas. The City has taken steps to minimize increases to final compensation. State law establishes several “optional benefits” that CalPERS offers to employers that may result in increasing an employee’s final compensation beyond the actual final salary amount. In some cases, the application of these benefits may result in an annual pension allowances that exceed the take-home pay the employee received before retiring. The City has taken steps to reduce or eliminate some of these benefits in recent years. For example, the City had an optional benefit that allowed employer-paid member contributions to be converted to pay-rate in the final compensation period. To the extent that employees are now paying all or part of the member contribution, that conversion and the resulting increase have been reduced or eliminated. Similarly, the City had adopted an optional benefit that designates the final year as the final compensation period. The City has now moved back to the three-year averaging for new tier employees, and intends to implement it for all formulas by August 2013. The City believes that these types of reforms are important and appropriate and will continue pursuing them to the extent possible under existing law.

However, the newly-approved PEPPRA legislation includes pension caps, although those caps will apply only to new employees. The pension cap included in PEPPRA is as follows: for new hires, the amount of compensation that can be used to calculate a retirement benefit is capped at \$110,100 for employees who participate in Social Security and \$132,120 for employees who do not.

Recommendation 3: The Cities should adopt policies that do not permit benefit enhancements unless sufficient monies are deposited, such as in an irrevocable trust, concurrent with enacting the enhancement, to prevent an increase in unfunded liability.

Response: Agree. This recommendation is addressed by the Labor Guiding Principles adopted by City Council on April 9, 2012 (Exhibit 1). The Principles include #2, which provides that “The City should be able to meet the cost of any compensation commitment from current and projected on-going City revenues,” and principle #8 which provides that “The City should pursue short term and long term strategies to curtail increasing employee benefit costs. It should move away from providing benefits that place the burden on the City to pay the cost of automatic increases and toward benefit structures that require negotiations to determine how much and who will pay for such costs.” Therefore the Council has in effect already taken the first step in implementing this recommendation.

Recommendation 4A: The Cities should require all employees to pay the maximum employee contribution rate of a given plan.

Response: Agree. This recommendation has been a key goal of the City in recent negotiations and has now been implemented across all employee groups with the exception of the Fire Chiefs Association (FCA), Police Managers Association (PMA), and the Utility Managers Association. These groups comprise 55 positions out of a total of 1,016 citywide. The City has proposed this contribution level for FCA and for the Utility Managers Association and expects to bring PMA in line with the other groups in the next round of negotiations.

Recommendation 4B: Cities should require employees to pay some portion of the Past Service Cost associated with the unfunded liability in proportion to the Benefits being offered.

Response: Agree. The first step in this direction was to bring employees up to paying their entire employee share of pension costs. In future labor contract negotiations, the City may explore with employee groups additional measures to ensure that past service costs are distributed in an equitable and sustainable manner. Moreover, the City would welcome legislative change that would prohibit retroactive improvements. Unfortunately, PEPRA did not address this issue.

Recommendation 5: Cities should immediately work toward implementing policy changes and adopting measures aimed at making full OPEB ARC payments as soon as possible.

Response: Agreed. Palo Alto approved a policy to make full Retiree Medical Annual Required Contributions (ARC) payments in 2007 (CMR:438:07) when the City established the trust with CalPERS for Retiree Medical benefits.

Recommendation 6: This recommendation pertains to the City of San Jose and is not applicable to Palo Alto.

Recommendation 7: Cities should transition from defined benefit plans to defined contribution plans as the new tier plans are implemented.

Response: Agree in principle. The Council has recognized the importance of new and more creative options for post-employment benefits going forward and views defined contribution plans as an important option. The City already offers all employees, in addition to their CalPERS pension, the option of participating in a IRC 457 retirement plan and contributing a portion of their pre-tax earnings for retirement.

However, this is another area where CalPERS currently limits the City's ability to make changes. As a CalPERS participant, the City cannot opt out of the defined benefit plans offered by CalPERS without a prohibitive exit cost, or otherwise reduce the proportion of retirement needs to be met through the defined benefit program. As a result, changes in state law would be necessary before the City could fully implement this recommendation.

If PEPRA is any indication, the state may only make it more difficult to introduce or switch to a defined contribution model. In the recently-approved legislation, it appears a public employer may not adopt a new defined benefit formula unless it is the same as those in PEPRA or is

certified by the retirement system’s chief actuary and approved by the Legislature. PEPRRA also places restrictions on the ability of employers to contribute to defined contribution plans, so the City’s ability to transition away from defined contribution may also be limited.

Additional Information and Clarification

Unfunded Liability

On page 10 of the Report, Table 3 shows unfunded liability for pension and OPEB for 8 cities in Santa Clara County, as well as the County itself, in total and on a per-resident basis. Staff has reproduced that table below:

FY 2010 Unfunded Liabilities				
City	Pension	OPEB	Total	Liability per Resident
Santa Clara County	1,455,835,322	1,300,000,000	2,755,835,322	\$ 1,547
Cupertino	18,581,728	18,069,366	36,651,094	\$ 629
Gilroy	35,100,000	4,900,000	40,000,000	\$ 819
Milpitas	70,166,975	31,230,798	101,397,773	\$ 1,518
MV	104,121,296	29,396,467	133,517,763	\$ 1,803
Palo Alto	153,941,000	105,045,000	258,986,000	\$ 4,021
San Jose	1,434,696,471	1,706,081,881	3,140,778,352	\$ 3,320
Santa Clara	223,667,947	23,855,000	247,522,947	\$ 2,125
Sunnyvale	149,300,000	92,800,000	242,100,000	\$ 1,728

It appears from the above Table that Palo Alto has a high ratio of unfunded liability per resident; however several factors must be considered to place this ratio in perspective.

The table does not appear to take into account the level of service and the unique services that Palo Alto provides in comparison to other cities in the County. First, Palo Alto is the only of the above cities operating its own utilities: gas, electric, water, waste water collection, refuse, storm drain, waste water treatment and fiber optic. Utility operations account for 40% of the Palo Alto workforce. The General Fund administration provides services (HR, finance, etc.) to the Utilities which they reimburse annually. The other cities would not have the same staffing levels as a result of Palo Alto having more utilities. Furthermore, the compensation offered to Utilities employees must be competitive with equivalent private-sector utilities; salaries in the

Enterprise Funds tend to be higher, and they participate in the CalPERS pension based upon their salaries.

Second, Palo Alto offers regional services, such as our Water Quality Control Plant, our Animal Services, and our Fire Services provided to Stanford, for which we receive offsetting revenue. However the full liability is captured in the table.

Fourth, the Cities have unique attributes that make up the OPEB liability, which should be considered in detail. For instance, comparing Palo Alto to Mountain View's OPEB liability, Palo Alto's is higher due, in part, to covering the cost of dependent healthcare coverage for retirees while Mountain View does not. Palo Alto also has a greater number of retirees, 860 compared to Mountain View's 304. The actuarial calculation of OPEB liability for the two cities differs in a key assumption related to assumed annual increase in healthcare expense, which increases the cost of future year liability. Palo Alto's OPEB actuarial report assumes that healthcare will increase 9.4% in 2013 and then at least 7.8% per year through 2020. Mountain View's, on the other hand, assumes healthcare will increase 7.6% in 2012 down to 5.5% through 2019 and beyond. Palo Alto's healthcare cost estimates are very likely to materialize given the recent trend in healthcare increases. These important differences are a significant factor in while Palo Alto's valuation is higher than Mountain View's.

An additional factor not examined in the table is what the total liability for pension and OPEB is in each City. Comparing unfunded liabilities disregards the level of "go-forward" savings that each City has achieved towards its liabilities. The following table compares total liability for the General Fund of each of the seven cities.

If we isolate the liabilities of the General Fund only, this eliminates the Enterprise Fund effect from the figures, and the table looks a bit different:

FY 2010 Unfunded Liabilities*				
City	Pension	OPEB	Total	Liability per Resident
Santa Clara County	1,455,835,322	1,300,000,000	2,755,835,322	\$ 1,547
Cupertino	18,581,728	18,069,366	36,651,094	\$ 629
Gilroy	35,100,000	4,900,000	40,000,000	\$ 819
Milpitas	70,166,975	31,230,798	101,397,773	\$ 1,518
MV	104,121,296	29,396,467	133,517,763	\$ 1,803
PA General Fund only	101,711,687	73,900,776	175,612,463	\$ 2,727
San Jose	1,434,696,471	1,706,081,881	3,140,778,352	\$ 3,320
Santa Clara	223,667,947	23,855,000	247,522,947	\$ 2,125
Sunnyvale	149,300,000	92,800,000	242,100,000	\$ 1,728

*Other cities' liabilities shown in table may include non-General Fund amounts.

Palo Alto's General Fund's liability of \$2,727 per resident is more of an apples-to-apple comparison than the \$4,021 figure that includes liabilities for Enterprise Fund employees. Palo Alto's General Fund liability of \$175,612,463 is 115 percent of the General Fund budget of \$152,807,000. By comparison, Mountain View's liability of \$133,517,763 is 138 percent of General Fund budget of \$96,644,000.

If we next compare the unfunded liability per employee or per retiree, rather than per resident, for each city, Palo Alto does not particularly stand out. The following table shows the relative (unfunded) post-retirement expense of each staff person – current and former – for each agency.

City	Number of Active Employees	Number of Retirees	Combined Number of Active Employees and Retirees	Unfunded liability/active Employee or Retiree
Cupertino	262	212	374	\$ 97,998
Gilroy	230	255	485	\$ 82,474
Milpitas	372	206	578	\$ 175,429
Mountain View	521	288	809	\$ 165,040
Palo Alto Gen'l Fund	556	842	1,398	\$ 125,615
Santa Clara	947	621	1,658	\$ 157,859
Sunnyvale	896	1009	1,905	\$ 127,087

Among the seven cities shown in the table above, Palo Alto's average unfunded liability per active plus retired employee is close to the median.

Sick Leave Payout

A recent article in the press described the option in some local governments for employees to get cash for unused sick leave at the time of retirement. Palo Alto made changes to this practice in the 1980s. Presently there are only 9 long-term employees eligible to receive sick leave payout. Eventually, all employees eligible will have left the city.

Additional Clarifications

1. On page 15 of the Grand Jury Report, Table 5: Pension Benefit Plan Changes, does not capture Palo Alto's second tier and employee contribution changes.

The Palo Alto line items should read as follows:


City	1 st Tier Plan				2 nd Tier Plan		
	Original Plan	Year of Change	Benefit Increase	Employee-Paid contrib.	Plan Name	Year Adopted	Employee-Paid contrib.
Palo Alto	Public Safety 2% at 50	2002	Public Safety 3% at 50	0%-9%	3% at 55	2011-2012	6.25%- 9%
Palo Alto	Misc. 2% at 55	2007	Misc. 2.7% at 55	7%-8%	2% at 60	2010	7%-8%

2. On page 17 of the report, it mentions "Mountain View, Sunnyvale and Cupertino are commended for having begun to implement a "pay forward" strategy [for Retiree Medical], which demonstrates fiscal responsibility." Palo Alto would like to point out that we have executed a "pay forward" strategy since 2007.

3. On page 20 of the report, it mentions that "all Cities surveyed [with a few exception] ... either reimburse for accrued unused sick time or permit it to be converted into service time for purposes of determining pension. Palo Alto wishes to point out that in our city, sick leave payouts do not count towards pension credit.

In conclusion, we in the City of Palo Alto share the Grand Jury's concern about the present and future costs of employee benefits. We have taken concerted action to contain these costs and will continue to look both strategically and operationally at how to reduce the City's benefit-related liabilities. The City's options are limited by the rules and structures of CalPERS, however, and we look forward to additional changes both within the CalPERS system and in state law to provide cities with greater flexibility in reducing these costs.

Sincerely,



Yiaway Yeh
Mayor
City of Palo Alto
250 Hamilton Avenue
Palo Alto, CA 94301



City of Palo Alto
City Council Staff Report

(ID # 2716)

Report Type: Consent Calendar

Meeting Date: 4/9/2012

Summary Title: Labor Guiding Principles

Title: Recommendation from Policy & Services Committee to Approve Labor Guiding Principles

From: City Manager

Lead Department: Human Resources

Recommendation

Staff and the Policy and Services Committee recommend that the Council approve the attached Labor Guiding principles.

Background

The concept of Labor Guiding Principles arose when the City modified its Impasse procedure last year to incorporate a new state law allowing employee organizations to request nonbinding fact finding after impasse is declared. Staff originally proposed incorporating key principles as a reference for City in making employee compensation decisions into the Impasse procedure, requiring the fact-finder to consider these principles when making a recommendation. However, after several discussions staff decided that the concept of guiding principles applied to many labor related issues and should not be limited to impasse. Thus, Staff proposed draft Labor Guiding Principles as a stand-alone document to the Policy & Services Committee on February 14, and after review and discussion brought a second draft with revisions on March 13 to provide for public, employee and labor input to Council before adoption of the Principles. The Committee recommends Council consideration and adoption of the attached Labor Guiding Principles.

Discussion

One purpose of Labor Guiding Principles is to establish a transparent policy framework to guide labor relations. The City has 7 recognized bargaining units and one unrepresented group of managers and professionals. The contract terms and specific issues vary from unit to unit. While the City is required to meet and confer in good faith to set compensation and terms and conditions of work with each bargaining unit, the City values labor's input and strives to work collaboratively with all employees and labor to solve problems and develop creative solutions to meet bargaining objectives.

The Labor Guiding Principles may also help all bargaining teams by providing a common understanding between all the parties involved in labor negotiations; allowing them to look at how specific proposals fit with overall Council objectives. Given that the City continues to face budget challenges driven in part by significantly rising employee benefit costs, the Principles support a balance between the need for strong financial stewardship and maintenance of a productive and positive work environment.

While each of the Labor Guiding Principles are important, Principle #3, Timing of Negotiations, was the focus of much discussion at the Committee level. Labor expressed some concern that to achieve this goal bargaining time would be limited. Committee members expressed strong desire to complete bargaining for a successor contract by the time the current contract expires yet not truncate the process. Language was added by the Committee stating the parties should work together to begin negotiations at such time that allows for sufficient bargaining in good faith in order to reach agreement by the time the current contract expires. That will require, at a minimum, starting formal negotiations earlier than in the past.

The Council is not required to adopt guiding principles for labor negotiations. However as the challenging fiscal environment continues at the City, State and national levels, it is important for City staff and labor to partner to explore and find solutions to these challenges, at the same time enhancing collaboration and communication. Guiding Labor Principles can help create a uniform, clear framework to guide labor relations and the efforts of staff and labor. The Committee unanimously recommended the attached Labor Guiding Principles for consideration and adoption by the Council.

Environmental Review

This is not a project under the California Environmental quality Act (CEQA).

Attachments:

- : Revised Labor Principles 3-26-12 (PDF)
- : 03-13-12 LABOR GUIDING PRINC EXCERPT (PDF)
- : CMR ID#2643 3-13-12 (PDF)
- : CMR ID#2550 2-14-12 (PDF)

Prepared By:
Department

Sandra Blanch, Interim Director, Human Resources

Department Head:
Department

Sandra Blanch, Interim Director, Human Resources

City Manager Approval:



James Keene, City Manager

Labor Guiding Principles
Palo Alto City Council
Adopted _____

To help maintain and support stronger working relationships between the City and Labor that are grounded in the standards of good faith bargaining, transparency, open communication and mutual respect, the Council hereby adopts the following principles to provide Labor, employees and the public with a policy framework of principles intended to guide the City's labor relations policies and priorities:

1. **City Services/Programs/Activities:** The City's core mission is to provide services, programs, and activities that align with the priorities of the public and the City Council; levels of employee compensation should support the City's long-term ability to continue providing those services.
2. **City Finances:** The City should be able to meet the cost of any compensation commitment from current and projected on-going City revenues.
3. **Timing of Negotiations:** The City shall, to the maximum extent possible, reach agreement on the successor MOA with recognized employee organizations on matters within the scope of representation prior to expiration of their existing MOA. The City will work with employee groups to set an appropriate starting time for negotiations.
4. **Total Compensation:** In making compensation decisions, the City shall consider the total costs of a position including salary, pension, and all other benefits and shall communicate such information to all employees, labor and the public.
5. **Equity Across Employee Groups:** The City should strive to set and make similar structural changes to compensation and benefits for all employee groups, while recognizing that some flexibility may be required to fairly address issues specific to individual units and/or achieve the objectives of other guiding principles.
6. **Recruitment & Retention:** When economically feasible, the City's compensation should be set at levels sufficient to recruit, train and retain qualified employees who are committed to the City's goals, programs and delivery of high quality services. The City should pursue hiring and training strategies that further the City's goal of finding and growing staff that are critical to maintaining its goals, programs, and services.
7. **Transparency:** The structure and components of compensation of City employees should be easy for Councilmembers, employees, labor and the public to understand, and as efficient as possible for staff to administer.
8. **Management of Increasing Benefit Costs:** The City should pursue short term and long term strategies to curtail increasing employee benefit costs. It should move away from providing benefits that place the burden on the City to pay the cost of automatic

increases and toward benefit structures that require negotiations to determine how much and who will pay for such costs.

9. **Innovation in Employment and Compensation:** Providing broader and more creative choices regarding benefits may further the concepts set forth in Guiding Principles 1-8. The City should consider innovative alternatives to traditional models of public employment and public employee benefits such as Governor Brown's 2011-2012 public employee pension proposal and other innovative alternatives including, for example, but not limited to hybrid pension plans, cafeteria plans, scaled compensation in lieu of guaranteed benefits, benefit buyout options, and similar ideas.



POLICY AND SERVICES COMMITTEE

Regular Meeting
March 13, 2012

Chairperson Holman called the meeting to order at 7:05 p.m. in the Council Conference Room, 250 Hamilton Avenue, Palo Alto, California.

Present: Holman (Chair), Espinosa, Klein, Schmid

Absent:

2. Recommendation Regarding Approval of Labor Guiding Principles.

Sheila Tucker, Assistant to the City Manager, reminded Committee Members this item was heard in February. She indicated Staff was directed to make revisions to the Principles. She stated Marci Scott would present the suggested changes.

Marci Scott, Acting Assistant Human Resources Director, had two areas of comment: 1) an overview of the main changes made since the last meeting; and 2) feedback from one labor group. She reported the introductory paragraph had been changed to provide an overview of the purpose of the Guidelines, and to state the goal of maintaining positive and strong relationships with labor. She indicated Staff and labor had maintained open communication and continued to work together to solve problems over the last few years. She stated there were minor changes, but she would focus on four areas of major adjustment. She said Guiding Principle No. 3 was probably the most important discussion item at the last meeting. She indicated the new language was clear and direct in stating that successor contracts would be finalized by the expiration of the current contract. She stated this would not necessarily mean a shorter process, but rather earlier start times. She reported Staff was re-evaluating resource needs to make this happen, and proposed that this Guiding Principle become effective for contracts expiring in Fiscal Year 2013 and beyond. She indicated Guiding Principle No. 5 was newly added regarding equity across

employee groups. She noted Guiding Principle No. 6 was recruitment and retention, which had a few changes focusing on recruiting, training and retaining qualified employees committed to the City's goals and delivery of services. She said this would be an increasingly important element to discuss in the future. She reported Guiding Principle No. 9, innovation in employment and compensation, now contained a reference to Governor Brown's Public Employee Pension proposal as an example of an innovative reform of the City's pension plan. She stated she sent a copy of the packet to Labor prior to the February 14 meeting, and sent a communication to all labor groups last Thursday. She received feedback from one labor group, and was in a discussion today with Service Employees International Union (SEIU) representatives in the monthly labor management meeting. She indicated the group's main concern was their belief that the City conveyed a disinterest in the bargaining process, specifically in Guiding Principle No. 3. She reported they discussed the City's commitment to the meet-and-confer process, the City's proposal to phase in this provision, and the City's intention not to shorten or limit the bargaining process.

Council Member Espinosa asked if the labor group suggested language for changing Item No. 3.

Ms. Scott stated they did not.

Brian Ward, SEIU Representative, questioned why the City would need these Guiding Principles, when they had worked well together and the Guiding Principles did not contain any objectionable ideas. Regarding Item 3, protracted negotiations, he felt the City was saying it did not want protracted negotiations. He asked how they were to work collaboratively. He explained interest-based bargaining. He indicated SEIU wanted to understand the purpose of the Guiding Principles in order to report to its members.

Council Member Klein stated the general idea of the Guiding Principles was to express the general principles to which everyone could agree. He supported No. 3 whether it was a Guiding Principle or policy, because the current system was in the union's favor. He explained the lack of savings to the City due to the recent negotiations with the Public Safety unions. He thought both sides should have an incentive to complete negotiations by the date of the contract expiration.

Mr. Ward agreed. He thought they were in agreement with all of the Principles. He asked if the Guiding Principles needed to be exerted

and drawn out. He felt it was a valid point that the City did not realize a savings in extended negotiations. He asked what would happen if negotiations extended past the contract expiration date. He indicated union members wanted to know if there was a "stick" coming.

Council Member Klein indicated there would be further changes if the economic situation continued and referred to Governor Brown's 12 principles.

Mr. Ward stated lobbying efforts should be concentrated on the Public Employees' Retirement System (PERS) to effect changes.

Council Member Schmid stated the term "protracted negotiations" implied an emotional content, which was not true. He noted Molly Stumps' statement at the prior meeting that it was difficult to begin serious negotiations until the budget process began with the long-range financial forecast. He said waiting until the budget process began would provide approximately four months for negotiations, which would not be enough time for serious negotiations. He asked if it was possible to begin bargaining earlier, and if some issues could be dealt with prior to the budget process. He suggested that Guiding Principle No. 3 not start with the term protracted, but contain language acknowledging the fact that negotiations involve important long-term issues for both sides and could take some time to resolve. He thought the ending time was important.

MOTION: Council Member Klein moved, seconded by Council Member Espinosa to Change Labor Guiding Principle No. 3; 1) by removing the first sentence, Protracted negotiations creates uncertainty for the City and employees, and 2) make the beginning sentence: The City shall to the maximum extent possible reach agreement on the...

Council Member Klein thought this was an important policy as he noted earlier. He believed the City could begin negotiations earlier and disagreed with the idea of needing the long-range forecast to begin bargaining. He noted historically not all labor contracts ended on June 30, and there was no legal requirement for union contracts to end on June 30.

Council Member Espinosa noted that Guiding Principle No. 1 and No. 3 did not begin with "the City shall" as the other Principles did. He pointed out there had been broad support for formalizing guiding principles.

INCORPORATED INTO THE MOTION WITH THE CONSENT OF THE MAKER AND SECONDER TO include in Labor Guiding Principle No. 3; The City will work with the employee groups to set the appropriate starting time for negotiations.

Council Member Espinosa thought people supported this type of language, because it provided a clear understanding that the City was not attempting to truncate in any way the amount of time for negotiations.

Ms. Scott explained that the City was preparing for negotiations with SEIU, and SEIU was open to the City's goal of starting negotiations earlier. She said Staff planned to discuss the budget and financials, and set a foundation for moving forward. She indicated discussions thus far had been positive.

Chair Holman supported the Motion and appreciated the Amendment. She felt the Amendment highlighted the importance of having a fair and collaborative process.

Council Member Klein expressed concerns over Principle No. 4 and Principle No. 7. He noted his conversation with a City employee regarding increased compensation. He referenced Council Member Shepherd's suggestion of publicizing true compensation costs. He referenced the language in Principle No. 4. He suggested the City needed to publicize more or in a better way. He felt the average employee did not view the City's increased payments to health insurance and pension as being increases in compensation.

Ms. Scott reported Staff had discussed this issue and was reviewing a means to produce an annual compensation statement. She thought employees did not understand the City's contribution to pension. She said Staff was interested in providing a statement which would list each benefit.

Council Member Klein recalled discussions during negotiations with Public Safety people and SEIU concerning listing all benefits. He asked if Staff could suggest language for the Principle, whether it was a combination of their discussions or language contained in Principle No. 7 and Principle No. 4.

Council Member Espinosa inquired if Council Member Klein's goal was to share total compensation information with employees in a way that they could understand.

Council Member Klein stated his goal was for employees to understand their true compensation. He suggested adding language regarding publicizing compensation information, so that union members and the general public had an understanding of these costs.

Ms. Scott said this language would provide compensation costs to all bargaining-unit members and all employees, and indicated Staff could do this.

Council Member Espinosa expressed concern over using the word "publicize." He suggested "share" or "communicate."

INCORPORATED INTO THE MOTION WITH THE CONSENT OF THE MAKER AND SECONDER to add to the last sentence of Labor Guiding Principle No. 4; and shall communicate information so the public and employees understand the costs.

Chair Holman indicated these language revisions were for Guiding Principle No. 4, and asked if there was a revision to Guiding Principle No. 7.

Council Member Klein did not have any revisions to No. 7.

Chair Holman agreed with Guiding Principle No. 7, but felt they needed to understand compensation costs as well.

Council Member Espinosa asked if, by "they", Chair Holman meant the City Council.

INCORPORATED INTO THE MOTION WITH THE CONSENT OF THE MAKER AND SECONDER to change the first sentence of Labor Guiding Principle No.7 to; compensation of City Employees should be easy for Council Members, employees, and the public.

Council Member Espinosa stated this expressed the idea of the Council also needing to understand the costs.

Chair Holman agreed, and felt this language was inclusive.

Council Member Klein thought No. 7 was slightly different from No. 4 in that No. 7 discussed pay grades.

Council Member Schmid suggested clarifying the language in No. 5 regarding changes in benefits at similar levels to focus on structural change.

INCORPORATED INTO THE MOTION WITH THE CONSENT OF THE MAKER AND SECONDER to change the first sentence Guiding Principle No. 5 to; The City should strive to set and make similar structural changes to compensation and benefits for all employee groups.

Council Member Schmid referenced data stating the City had 50 percent of employees within ten years of retirement. He noted the City had to search for employees to fill senior positions. He thought the City should hire young people and grow them to fill senior positions. He suggested a revision to No. 6 to place emphasis on hiring and training young people with talent.

INCORPORATED INTO THE MOTION WITH THE CONSENT OF THE MAKER AND SECONDER to change the last sentence Guiding Principle No. 6 to; that further the City's goal of finding and growing Staff that are critical to maintaining.

Molly Stump, City Attorney, thought his point was hiring people earlier in their career irrespective of chronological age.

Ms. Scott reported Staff was reviewing apprenticeship programs in order to build and train employees.

Council Member Espinosa was not opposed to the proposed revision to No. 6, but did not agree with the reasons for the revision.

Council Member Schmid said the City would be filling many retirement positions. He recalled the previous City Manager stating the biggest problem was Staff retirements and the City needed to be ready. He noted the City was in the same position eight years later.

MOTION AS AMENDED PASSED: 4-0



City of Palo Alto

Policy and Services Committee Staff Report

(ID # 2643)

Report Type: Meeting Date: 3/13/2012

Summary Title: Labor Guiding Principles

Title: Recommendation Regarding Approval of Labor Guiding Principles

From: City Manager

Lead Department: Human Resources

Recommendation

Staff recommends that the Policy & Services Committee review and recommend that Council approve guiding principles for labor negotiations.

Background

City staff presented a first draft of proposed labor guiding principles on February 14th. These principles are intended to express the main values that guide bargaining with all 7 bargaining units, which vary in terms of timing of negotiation schedules and specific issues addressed.

Discussion

Committee members provided feedback at the February 14th meeting, requesting changes to the language in the principles on Timing of Negotiations, Recruitment & Retention and Innovation in Employment and Compensation. The Committee also requested a new principle to incorporate the concept of equity across bargaining groups.

Staff has edited the proposed guiding principles based on Committee feedback. A new introductory statement was added as well as minor changes to Guiding Principle 6 (Recruitment & Retention) and Guiding Principle 9 (Innovation in Employment and Compensation). Most significantly, Committee members requested specific changes to Guiding Principle 3, Timing of Negotiations. Committee members asked that the language be clearer and more direct to indicate that successor agreements should be reached with Labor before expiration of the current Memorandum of Agreement (MOA). However, given the current workload, staffing levels and active bargaining

tables, a transition period is necessary in order to ensure that the City can implement this principle. Staff requires additional time to evaluate the resources needed to effectively meet this expectation and is developing a strategy to satisfy this guideline. Therefore, staff recommends that Guiding Principle 3 (Timing of Negotiations) be implemented beginning with MOAs that expire in FY 13.

Conclusion

The Council is not required to adopt guiding principles for labor negotiations. However as the City continues to face a challenging fiscal environment in the current and future years, it is important for City staff and Labor to partner to explore and find solutions to these challenges, at the same time enhancing collaboration and communication. Guiding principles can help create a transparent policy framework to guide labor relations and the efforts of staff and Labor.

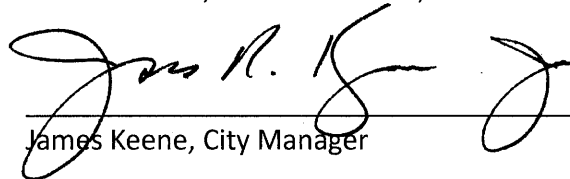
Attachments:

- -: Labor Guiding Principles 3-13-12 (PDF)
- -: ID# 2550 Recommendation Re Approval of Labor Guiding Principles 2-14-12 (PDF)
- -: 2-14-12 PS Item 2 Labor Excerpt (PDF)

Prepared By: Elizabeth Egli, Administrative Assistant

Department Head: Sandra Blanch, Interim Director, Human Resources
Department

City Manager Approval:



James Keene, City Manager

**Labor Guiding Principles
Palo Alto City Council
Adopted _____**

To help maintain and support stronger working relationships between the City and Labor that are grounded in the standards of good faith bargaining, transparency, open communication and mutual respect, the Council hereby adopts the following principles to provide Labor, employees and the public with a policy framework of principles intended to guide the City's labor relations policies and priorities:

1. **City Services/Programs/Activities:** The City's core mission is to provide services, programs, and activities that align with the priorities of the public and the City Council; levels of employee compensation should support the City's long-term ability to continue providing those services.
2. **City Finances:** The City should be able to meet the cost of any compensation commitment from current and projected on-going City revenues.
3. **Timing of Negotiations:** Protracted negotiations create uncertainty for the City and employees; the City shall reach agreement on the successor MOA with recognized employee organizations on matters within the scope of representation prior to expiration of their existing MOA.
4. **Total Compensation:** In making compensation decisions, the City shall consider the total costs of a position including salary, pension, and all other benefits.
5. **Equity Across Employee Groups:** The City should strive to set and make changes to compensation and benefits at similar levels for all employee groups, while recognizing that some flexibility may be required to fairly address issues specific to individual units and/or achieve the objectives of other guiding principles.
6. **Recruitment & Retention:** When economically feasible, the City's compensation should be set at levels sufficient to recruit, train and retain qualified employees who are committed to the City's goals, programs and delivery of high quality services. The City should pursue hiring and training strategies that further the City's goal of filling positions that are critical to maintaining its goals, programs, and services.
7. **Transparency:** The structure and components of compensation of City employees should be easy for employees and the public to understand, and as efficient as possible for staff to administer.
8. **Management of Increasing Benefit Costs:** The City should pursue short term and long term strategies to curtail increasing employee benefit costs. It should move away from providing benefits that place the burden on the City to pay the cost of automatic increases and toward benefit structures that require negotiations to determine how much and who will pay for such costs.

∴ Labor Guiding Principles 3-13-12 (2643 : Labor Guiding Principles)

Revised 3/13/12

9. **Innovation in Employment and Compensation:** Providing broader and more creative choices regarding benefits may further the concepts set forth in Guiding Principles 1-8. The City should consider innovative alternatives to traditional models of public employment and public employee benefits such as Governor Brown's 2011-12 public employee pension proposal and other innovative alternatives including, for example, but not limited to hybrid pension plans, cafeteria plans, scaled compensation in lieu of guaranteed benefits, benefit buyout options, and similar ideas.

ATTACHMENT B
ID# 2550
Recommendation Regarding Approval of Labor Guiding Principles
2-14-12

Recommendation

Staff recommends that the Policy & Services Committee review and recommend that the Council approve guiding principles for labor negotiations.

Background

The concept of guiding principles for labor negotiations arose in Palo Alto in late 2011 when the City amended its local impasse resolution rules to address the new Meyers-Milias Brown Act rule which allows employee organizations to request nonbinding fact-finding after impasse is declared and before a local agency may implement the terms of its last, best and final offer. Staff originally proposed including decision "factors" describing key considerations for labor negotiations that the fact-finder would be required to consider in making recommendations. However, in refining those factors and discussing the issue with labor, staff ultimately determined that such considerations are not and should not be limited to impasse resolution. More importantly, approval of stand-alone guiding principles gives the Council and the public the opportunity to have a broader discussion about main values that it wants to guide the City's approach to labor issues.

Discussion

The City currently has 7 recognized bargaining units and one unrepresented group of managers and professionals. While the City is required to engage in the bargaining process to set compensation and terms and conditions of work with each bargaining unit, the City's goal is to work collaboratively with all employees and labor to solve problems and develop creative solutions to meet bargaining objectives. Goals for bargaining units and managers have much in common and labor and management have engaged together effectively in the past. The focus of collaboration should continue to be on ways to contribute positively to the organization and maintain effective services for the community. Developing and communicating Guiding Principles will inform ongoing, meaningful dialogue between managers and bargaining units at all levels.

At the same time the City is partnering with labor in a collaborative manner, the City must properly distribute responsibility and accountability to ensure management and delivery of services consistent with Council and community expectations. In order to

meet these expectations the City must maintain management rights and direct operational decision-making.

Analysis

A. Current challenges to City budget and rising employee costs have been and will continue to be key issues in labor negotiations for the foreseeable future.

The City exists to provide a forum for governance and to effectively and efficiently deliver services to the community. A substantial portion of the general fund operating budgets for those services, approximately 66%, goes to fund salaries and benefits for the staff necessary to deliver services. As the City heads into its fourth consecutive year of budget shortfalls, it must continue examining the cost of employee salaries and benefits and their impacts to the budget.

Recent negotiations with employee groups have helped to address some of the budget shortfalls. For example, where the City once paid the entire amount of the employee PERS contribution (in addition to the Employer contribution) and the full amount of health care premiums, most groups now pay at least a portion of the employee PERS contribution and up to 10% of the medical premium.

However, even with these and other cost-saving measures, personnel costs associated with pension, health, and retiree medical have continued to increase at rates that exceed revenue growth. The average budgeted cost for an employee position has increased 20% since 2009, and the benefit portion of salary and benefits has increased approximately 12% in just the past two years. Continued increases in costs for employee salaries and benefits are projected, driven primarily by health and pension costs. Additionally, the valuation of the liability for post-employment health care is growing and has grown from \$105 million to \$133 million in the last 2 years. The fact that on-going revenues have not been able to cover expenditure growth over the past few years and into the projected future years indicates a fundamental structural imbalance that needs long-term solutions to restore balance and provide a sustainable means to deliver services to the community.

This is due to more than the recent economic crisis in the United States. Past local government decisions in California over the past 10-15 years granted significant benefit increases that would not be granted today. Yet those decisions have cost implications that will last for years many years into the future. Additionally, the local government tax structure is increasingly disconnected from the economy itself, so that even improvements in today's economy do not translate into commensurate increases in

local government revenue. In short, the slope of increase for expenses can be expected to rise more sharply than revenues going forward, without continued expense reductions.

Because personnel costs are such a large part of operating expenditures, and salaries and benefits are determined through the labor negotiations process, it is important for the City to address these issues in current and future labor negotiations. Guiding principles for those negotiations can help the City, including managers, employees and labor, remain mindful of the fiscal challenges and service needs of the City, align the bargaining process with the City's primary function of providing services to the community, and establish transparent principles to guide the City in making decisions about employee salaries and benefits.

B. Proposed Guiding Principles.

Based on the issues identified above, staff has identified the following key principles to guide adoption of labor agreements and compensation plans:

- 1. City Services/Programs/Activities:** The City's core mission is to provide services, programs, and activities that align with the priorities of the public and the City Council; levels of employee compensation should support the City's long-term ability to continue providing those services.
- 2. City Finances:** The City should be able to meet the cost of any compensation commitment from current and projected on-going City revenues.
- 3. Timing of Negotiations:** Protracted negotiations create uncertainty for the City and employees; the City should endeavor to reach agreement with recognized employee organizations on matters within the scope of representation prior to adoption of the City's budget for the ensuing fiscal year.
- 4. Total Compensation:** In making compensation decisions, the City should consider the total costs of a position including salary, pension, healthcare and all other benefits.
- 5. Recruitment & Retention:** The City's compensation should be set at levels sufficient to attract and retain qualified employees who are committed to the City's goals, programs and delivery of high quality services, understanding that those levels must be economically feasible.

6. **Transparency:** The structure and components of compensation of City employees should be easy for employees and the public to understand, and as efficient as possible for staff to administer.
7. **Management of Increasing Benefit Costs:** The City should pursue short term and long term strategies to curtail increasing employee benefit costs. It should move away from providing benefits that place the burden on the City to pay the cost of automatic increases and toward benefit structures that require negotiations to determine how much and who will pay for such costs.
8. **Innovation in Employment and Compensation:** Providing broader and more creative choices regarding benefits may further the concepts set forth in Guiding Principles 1-7. The City should consider innovative alternatives to traditional models of public employment and public employee benefits including, for example, hybrid pension plans, cafeteria plans, scaled compensation in lieu of guaranteed benefits, benefit buyout options, and similar ideas.

In addition, staff recommends that the Council consider reviewing the Principles annually to ensure that they remain relevant and accurately convey the City's priorities.

Policy Impacts

The Council is not required to adopt guiding principles for labor negotiations. However, Guiding Principles can help establish a transparent policy framework to guide the City's labor relations and clearly communicate City priorities regarding labor issues to employees, labor, and the community. The Principles can also assist the negotiating team by establishing overall objectives against which it can measure specific proposals, as well as enhance accountability by providing a more concrete way to measure or evaluate the outcome of negotiations. The City's bargaining team will continue to meet and confer in good faith with flexibility to partner with labor to craft solutions to individual unit issues that also meet the uniform policy framework provided by these Guiding Principles.

ATTACHMENT C
2-14-12 P&S ITEM 2 LABOR EXCERPT



POLICY AND SERVICES COMMITTEE

DRAFT EXCERPT

Regular Meeting
February 14, 2012

Labor Guiding Principles

Marcie Scott, Acting Assistant Human Resources Director gave a brief presentation. The concepts being presented rose in discussion in May of 2011 with the changes to the Binding Interest Arbitration provision. The Governor approved a new law, AB646, which implemented a fact finding process in the impasse procedure for labor disputes. Palo Alto had decided to modify the impasse procedures to incorporate the fact finding process. Through the course of discussions with the labor groups it was agreed the Guiding Principles were not in the appropriate location. Staff felt the Guiding Principles should not be limited to impasses but could serve a broader purpose which was open for Council discussion. The concepts in the Guiding Principles were not new to labor discussions in Palo Alto and some had been specifically negotiated at the table. The City currently did not have a document that described the Council's goals and vision on priority issues such as managing pension costs. Staff believed there was value in having a written document expressing what the Council would be looking for in terms of labor principles. Written principles would be a useful communication tool for employees and for the public. Staff believed the employee groups and the City had common interests in addressing and resolving issues and having a written guiding policy would make the negotiations more efficient. The City needed to maintain management rights and directed operational decision making as the labor processes were in motion.

Council Member Espinosa asked Staff to focus on the Guiding Principles and allow time for questions if they arose.

Ms. Scott stated there were eight Guiding Principles that should support the City's delivery of services to the community. The bargaining efforts should result in efficiencies, improved services, and quality of life. Additionally; technology use should be reviewed, approaches to working smarter, and the primary focus should be on City services. City Finances were the second principle and Staff had taken Council direction to locate structural long term changes in the budget

-: 2-14-12 PS Item 2 Labor Excerpt (2643 : Labor Guiding Principles)

**ATTACHMENT C
2-14-12 P&S ITEM 2 LABOR EXCERPT**

process. It was important to discuss City finances at the negotiation table and inform the employees so there was a common understanding. The third principle was the timing of the negotiations which was not intended as a hard and fast timeline but a goal statement to help communicate to all parties involved to avoid long periods of limbo. Total compensation was the fourth principle focusing on the full cost of City benefits including base salary, City paid pension, City paid healthcare, workers compensation costs, unemployment insurance, special pay such as K-9 and bilingual Recommended principle number five was recruitment and retention which was challenging because it required trade offs between the budget status and attracting and retaining skilled personnel. Proposed principle six was transparency which was more important now than previously determined because of public expectations with regard to understanding public sector salary and compensation, sharing information at the bargaining table to ensure both sides were equally familiar, and a goal was to make compensation easily understood for the employee and the public. Management of increasing benefits costs was principle number seven; an example would be the 90/10 percent medical cost sharing program so as healthcare premiums rose the employees would be contributing different amounts while maintaining the 10 percent cost share. The final proposed principle was innovation in employment and compensation. The function of the principle was for the City to look for ways to provide flexibility for employees within compensation. She noted there were other public agencies exploring new approaches such as an incentive for employees to opt out of their retiree medical program.

Council Member Klein had a concern with principle number three. He felt the timing and negotiation should be a hard and fast deadline and not a goal statement. His understanding was Staff was bringing a standardized guideline with each contract so the City could reach the goal of having a resolution by the budget discussion time. The past few years the goals had not been met and the end result had been a higher cost for the City.

Ms. Scott said the challenge Staff faced was there was an obligation to meet and confer in good faith; although, there was no clear definition on the number of meetings or a specific amount of type of discussion. She understood the concern.

Council Member Klein said in order to make the budget deadline the schedule to meet and confer may need to be moved back. At the present time there was no incentive or reason for the union to live within the goals set by Staff. He had an issue with the verbiage between should and shall; he was comfortable with should in most cases. In principle number four he preferred "shall" since he did not see the argument for not considering total compensation. He felt there

-: 2-14-12 PS Item 2 Labor Excerpt (2643 : Labor Guiding Principles)

**ATTACHMENT C
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should be a paragraph added that reflected the idea in conducting the negotiations, the City was respectful of the unions' positions and their legal rights, and the City wanted to hear their views on how to improve the organization. He saw the aspiration of having a good ongoing relationship with the unions as one of the Guiding Principles. He requested the equality across the bargaining units be incorporated.

Ms. Scott noted the equality had been a driving principle but not without challenges.

Council Member Klein said Staff recommended reviewing the Guiding Principles on an annual basis; he was not in favor of the recommendation.

Council Member Schmid endorsed the deadline of having the agreements needing negotiations end with appropriate time to have resolved for the budget cycle. Under total compensation he felt it was important to make a distinction between the current obligations and an honest assessment of future obligations. With regard to recruitment and retention; Staff had a remarkable number of the eligible retirement populations, he suggested verbiage be added to note hiring and training employees to fill the positions rather than merely filling the retirement gaps. He felt strongly about identifying Governor Brown's proposed Pension and Benefits Reform Plan into principles seven and eight.

Council Member Espinosa had concern with the lack of a timeline for principle three since the matter had been discussed in previous conversations and was an important element. In order to have a goal it was a necessity to have a specific start time, milestones that needed to be reached by a certain point so when the budget time was reached the resolution was accomplished. He stated he wanted verbiage of mutual respect incorporated.

Ms. Scott said Staff could take the concept of building and maintaining a relationship with labor and incorporate it into the Guiding Principles. She confirmed the verbiage with respect to the timeline was a critical piece and the language could be stronger, acknowledging the obligation to meet and confer and yet incorporating a strong statement of the intended accomplishment.

Council Member Espinosa understood there were parameters out of the City's control; he merely was surprised to not see the information included after the discussions.

Council Member Klein reiterated his concern was not to have the deadlines met

:- 2-14-12 PS Item 2 Labor Excerpt (2643 : Labor Guiding Principles)



City of Palo Alto

(ID # 2550)

Policy and Services Committee Staff Report

Report Type: Meeting Date: 2/14/2012

Summary Title: Labor Guiding Principles

Title: Recommendation Regarding Approval of Labor Guiding Principles

From: City Manager

Lead Department: Human Resources

Recommendation

Staff recommends that the Policy & Services Committee review and recommend that the Council approve guiding principles for labor negotiations.

Background

The concept of guiding principles for labor negotiations arose in Palo Alto in late 2011 when the City amended its local impasse resolution rules to address the new Meyers-Millias Brown Act rule which allows employee organizations to request nonbinding fact-finding after impasse is declared and before a local agency may implement the terms of its last, best and final offer. Staff originally proposed including decision "factors" describing key considerations for labor negotiations that the fact-finder would be required to consider in making recommendations. However, in refining those factors and discussing the issue with labor, staff ultimately determined that such considerations are not and should not be limited to impasse resolution. More importantly, approval of stand-alone guiding principles gives the Council and the public the opportunity to have a broader discussion about main values that it wants to guide the City's approach to labor issues.

Discussion

The City currently has 7 recognized bargaining units and one unrepresented group of managers and professionals. While the City is required to engage in the bargaining process to set compensation and terms and conditions of work with each bargaining unit, the City's goal is to work collaboratively with all employees and labor to solve problems and develop creative solutions to meet bargaining objectives. Goals for bargaining units and managers have much in common and labor and management have engaged together effectively in the past. The focus of collaboration should continue to be on ways to contribute positively to the organization and maintain effective services for the community. Developing and communicating Guiding Principles will inform on-going, meaningful dialogue between managers and bargaining units at all levels.

At the same time the City is partnering with labor in a collaborative manner, the City must properly distribute responsibility and accountability to ensure management and delivery of services consistent with Council and community expectations. In order to meet these expectations the City must maintain management rights and direct operational decision-making.

Analysis

A. Current challenges to City budget and rising employee costs have been and will continue to be key issues in labor negotiations for the foreseeable future.

The City exists to provide a forum for governance and to effectively and efficiently deliver services to the community. A substantial portion of the general fund operating budgets for those services, approximately 66%, goes to fund salaries and benefits for the staff necessary to deliver services. As the City heads into its fourth consecutive year of budget shortfalls, it must continue examining the cost of employee salaries and benefits and their impacts to the budget.

Recent negotiations with employee groups have helped to address some of the budget shortfalls. For example, where the City once paid the entire amount of the employee PERS contribution (in addition to the Employer contribution) and the full amount of health care premiums, most groups now pay at least a portion of the employee PERS contribution and up to 10% of the medical premium.

However, even with these and other cost-saving measures, personnel costs associated with pension, health, and retiree medical have continued to increase at rates that exceed revenue growth. The average budgeted cost for an employee position has increased 20% since 2009, and the benefit portion of salary and benefits has increased approximately 12% in just the past two years. Continued increases in costs for employee salaries and benefits are projected, driven primarily by health and pension costs. Additionally, the valuation of the liability for post-employment health care is growing and has grown from \$105 million to \$133 million in the last 2 years. The fact that on-going revenues have not been able to cover expenditure growth over the past few years and into the projected future years indicates a fundamental structural imbalance that needs long-term solutions to restore balance and provide a sustainable means to deliver services to the community.

This is due to more than the recent economic crisis in the United States. Past local government decisions in California over the past 10-15 years granted significant benefit increases that would not be granted today. Yet those decisions have cost implications that will last for years many years into the future. Additionally, the local government tax structure is increasingly disconnected from the economy itself, so that even improvements in today's economy do not translate into commensurate increases in local government revenue. In short, the slope of increase for expenses can be expected to rise more sharply than revenues going forward, without continued expense reductions.

Because personnel costs are such a large part of operating expenditures, and salaries and benefits are determined through the labor negotiations process, it is

important for the City to address these issues in current and future labor negotiations. Guiding principles for those negotiations can help the City, including managers, employees and labor, remain mindful of the fiscal challenges and service needs of the City, align the bargaining process with the City's primary function of providing services to the community, and establish transparent principles to guide the City in making decisions about employee salaries and benefits.

B. Proposed Guiding Principles.

Based on the issues identified above, staff has identified the following key principles to guide adoption of labor agreements and compensation plans:

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5. **Recruitment & Retention:** The City's compensation should be set at levels sufficient to attract and retain qualified employees who are committed to the City's goals, programs and delivery of high quality services, understanding that those levels must be economically feasible.
6. **Transparency:** The structure and components of compensation of City employees should be easy for employees and the public to understand, and as efficient as possible for staff to administer.
7. **Management of Increasing Benefit Costs:** The City should pursue short term and long term strategies to curtail increasing employee benefit costs. It should move away from providing benefits that place the burden on the City to pay the cost of automatic increases and toward benefit structures that require negotiations to determine how much and who will pay for such costs.
8. **Innovation in Employment and Compensation:** Providing broader and more creative choices regarding benefits may further the concepts set forth in Guiding Principles 1-7. The City should consider innovative alternatives to traditional models of public employment and public employee benefits including, for example, hybrid pension plans, cafeteria plans, scaled compensation in lieu of guaranteed benefits, benefit buyout options, and similar ideas.

In addition, staff recommends that the Council consider reviewing the Principles annually to ensure that they remain relevant and accurately convey the City's priorities.

Policy Impacts

The Council is not required to adopt guiding principles for labor negotiations. However, Guiding Principles can help establish a transparent policy framework to guide the City's labor relations and clearly communicate City priorities regarding

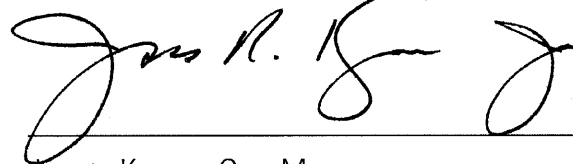
labor issues to employees, labor, and the community. The Principles can also assist the negotiating team by establishing overall objectives against which it can measure specific proposals, as well as enhance accountability by providing a more concrete way to measure or evaluate the outcome of negotiations. The City's bargaining team will continue to meet and confer in good faith with flexibility to partner with labor to craft solutions to individual unit issues that also meet the uniform policy framework provided by these Guiding Principles.

Prepared By: Elizabeth Egli, Administrative Assistant

Department Head: Sandra Blanch, Interim Director, Human Resources

Department

City Manager Approval:

A handwritten signature in black ink, appearing to read "James Keene", written over a horizontal line.

James Keene, City Manager



CITY OF PALO ALTO OFFICE OF THE CITY CLERK

July 2, 2012

The Honorable City Council
Palo Alto, California

Colleagues Memo From Vice Mayor Scharff and Council Members Burt, Holman, and Schmid on Council Direction Regarding “Benefits Strategy”

BACKGROUND

In recent years, the cost of employee benefits and pensions has risen dramatically for the City of Palo Alto, reducing the funds available for our community’s necessary and valued services and infrastructure:

- The proportion of dollars paid for employee benefits to salaries rose from 23% in 2002 to 54% in 2010;
- The Long Range Financial Forecast projects employee benefits exceeding salaries by 2022;
- Employee benefits now make up 27% of total General Fund expenditures;
- Governor Brown and the California League of Cities have outlined a Pension Reform Plan that attempts to put state and local government employers “on a more sustainable path to providing fair public retirement benefits”. In addition, San Jose and San Diego voters have recently adopted significant pension and benefit reform initiatives.

PURPOSE

The Council should provide policy direction regarding future reforms and innovations in employee benefits, pensions, compensation and other aspects of employment with the goal of building a modern, flexible workplace environment for Palo Alto City employees while also assuring sustainable costs for its citizens. This initiative will invite creative solutions from employee and employer

perspectives, providing policy direction and long term strategies. Many of these issues are subject to bargaining and would be negotiated with the City's recognized bargaining units.

The considerations will address the issues raised in the Governor's and the League of Cities' pension reform proposals as well as broader considerations, including:

- How should the costs of pensions be shared between employers and employees?
- Should the City encourage changes in state law that would allow the City to establish a hybrid plan combining defined benefits, defined contributions and social security?
- What is the appropriate and sustainable vesting for pension rights? Should any part of health benefits vest on retirement?
- What retirement age would make for a proper transition to Medicare coverage for retiree healthcare? Should the City encourage changes in state law to give cities the option of setting a later retirement age?
- Are retroactive pension increases justifiable and, if not, how can they be prohibited?
- How do we establish fair criteria for retirees' contributions to health benefits?
- Should the city move toward fixed health benefit contributions?
- How can the city provide greater employee choice in health benefits?
- Should the city encourage changes in state law that would allow the City to

offer employees a choice of significantly reduced pension packages in exchange for more desirable near term compensation and employment terms?

- Can and should the City structure and finance an optional program to buy out existing post-employment obligations that may be vested?
- How should training, education, job flexibility, at-will employment and seniority operate within a modernized employment program that seeks to attract and retain a high-performing workforce and foster a desirable workplace during a time of changes to traditional benefits?
- How should the timing of negotiations and the City's position in negotiations relate to the Long Range Financial Forecast?
- How should the timing of negotiations relate to the City's annual budget process?
- Are there alternative considerations that merit discussion on how to accomplish a healthy work place and foster job satisfaction and cost savings thru non-economic employee benefits?

PROPOSAL

The Council will agendize a public discussion of sustainable pension, retiree health care, other benefits and terms of employment. Discussion will include whether the Council supports the proposals of the Governor and the League of Cities. In addition, the Council will establish a vision toward sustainable benefit options and a more flexible, modern workplace environment.

Representatives from the City's bargaining units will be invited to participate in the discussion of the proposals and the current dynamic between benefits and salaries. The Council recognizes that changes in terms and conditions of employment that are within the scope of bargaining under state law are subject to collective bargaining.

TIMING

Discussion of the topics raised in this Memo will occur by September of 2012. Whether further consideration of these and related topics should be necessary will be determined during this discussion.

RESOURCES

Staff support in outlining the options available under current law, key cost elements in the current benefits program and the cost impacts of various reform proposals.

Department Head: Donna Grider, City Clerk