CITYSPEAK

“The Courage to Work at City Hall: A CalPERS Reflection”

It can take courage to work at City Hall, especially when a sensitive matter or high stakes initiative is on the table.

> To be clear, this CitySpeak article is about “prudent financial management,” NOT “whistleblower” issues. Any discussion about **whistleblower matters is *beyond the scope of the work we do at CitySpeak***.

Having said that, because doing the right thing is not always the popular thing to do, so many of us keep our mouths closed when we know a subject is touchy. In the same way that fear is a powerful motivator, it is also a powerful silencer. The cycle of silence is a strong one, and history repeats itself, especially if we don’t learn from it.

I was working at City Hall in 1990 when high stakes stakeholders began their campaign to raise City pensions and employee benefits. CalPERS employees stood to receive outrageous benefits and very few people were aware of the long term impact to the City of providing those benefits. Sadly, those few people who did know were often silenced by fear.

Whether you were a City Finance Director or a City Manager, you were not at all popular when you attempted to openly challenge the proposals to increase City pensions, especially amid the enthusiasm, euphoria, and frenzied praise coming from the stakeholders at City Hall who stood to profit from these costly proposals.

We all know what role we had, if any, on the team that crafted the generous CalPERS pension benefits of today, but this article is not about placing blame. It is rather an opportunity to discuss the mistakes made due to the fear of be labeled NOT a “team player”.

CAN’T BE A TEAM PLAYER WHEN PUBLIC TRUST IS AT STAKE

Here’s the thing: when the position you hold is one that requires maintaining public trust, you simply cannot hide behind the “team player” line. While City work is noble and absolutely deserving of healthy compensation, there comes a point when that compensation begins to smack of self service, and can even bleed into corruption.

Our number one job is to uphold the faith and trust of the citizens of our City. If an issue or an agenda item is not in the best interest of the City as a whole, further, if said issue is high-risk and actually detrimental to the City, *those who know the truth have an obligation to speak it*.

Unfortunately, some of us City Finance Directors and City Managers were labeled troublemakers and "not team players" during the Naughty Nineties (okay so that was the 1890s, but honestly, the 1990s were pretty "naughty" too); we used every opportunity to remind stakeholders at City Hall that the beefed-up pension benefits were going to cost a lot more than disclosed during labor negotiations with employees.

Some were improperly presenting this vital information to the City Council for approval, playing it fast and loose with numbers, tables, and graphs to side skirt the very real, and very probable, potential fiscal consequences of expanded municipal pensions. Many others simply stayed silent. *But how should we speak up against this locomotive pension train coming at us at 70+ miles per hour*?

Again, we all know what official action we proposed or took with regard to expanding CalPERS pension benefits during last 20+ years. **It's all in the public record**.

Could we hide behind the academics of municipal finance and allow **Economics 101** principles to strengthen the argument on behalf of taxpayers, the ultimate "consumers" of the public services that we City employees provide, and "charge" our taxpayers as salary and pension benefits? Yes, however, unfortunately, even basic economic principles are often ignored "when convenient". And many in municipal government ignored the City Managers and Finance Directors who argued regarding the long-term sustainability of fat pensions.

SOME IGNORE ECONOMICS 101 WHEN CONVENIENT

There are 10 basic principles in Economics. Principle #4 is **"people respond to incentives"**.

The salary and pension benefits a CalPERS employer offered its employees during the last 20+ years should have been driven by Economics 101 Principle #4. **We should NOT have paid a nickel more (in City pension benefits) than was required by "the market" to incentivize public employees** to choose a City job and come work for our municipality. *It was our duty to ensure competitive market forces were used to ensure our community and taxpayers got a "good deal" when employee pensions were bargained for*.

Is not the City working under free market assumptions? Shouldn't the market dictate the level of pension benefits that the City needs to provide in recruiting a candidate as a City employee? Doesn't the City have the ability to "shop the marketplace" for City employees just like it shops for City vehicles?

Think: If you were replacing a City vehicle, would you pay $50,000 for a Ford F150 when you could pay the $27,000 competitive "market" price? Would you say, "Well I could get this Ford F150 for $27,000 but I'm going to pay $50,000 because I want to do good for our economy"? Of course you would NOT say that! No, *you would have followed self-interest* (and *City purchasing policies*), and paid ONLY the competitive "market" price of $27,000 for that F150!

Self-interest is a basic Economics 101 assumption, whether that is for you as an individual or for your municipality as an organization as an agent of the municipality you represent. However, you cannot follow self-interest when you are approving pension benefits *you* yourself will receive *from* your organization because you are acting as an "agent" of the organization in your official capacity for your municipality.

This could defeat the whole notion of **fiduciary duty** in **"agency theory"**, which is more commonly understood in private industry than in municipal corporations. However, the concept can still apply to managers of municipal organizations who take managerial risks and make financial decisions and proposals, for the benefit of all stakeholders. Click here to learn more.

In the end, agency theory did not serve City governments well. Agency theory could have provided internal management controls (checks and balances) when an individual in a leadership role proposes or approves pension benefits, so the municipal manager does not self-deal, but rather negotiates for the economic benefit of the organization and its stakeholders (taxpayers). However, agency theory did not work well in City government pension decisions, or rather, not did really even take place in many cases.

Thus, we must ask another question, whose self-interest was followed when City pension decisions were made?

WHOSE SELF-INTEREST FOLLOWED IN DECISIONS REGARDING PENSIONS

Self-interest refers to actions that elicit the most personal benefit. **Adam Smith**, the **father of modern economics**, explains that the best economic benefit for all can usually be accomplished when individuals act in their own self-interest. His explanation of the invisible hand reveals that when dozens or even thousands act in their own self-interest, goods and services are created that benefit consumers and producers. Click here to read more.

Does Adam Smith's dictum on self-interest apply to government decisions that are made in a non-competitive environment, where we approve our own pension benefits without regard to what the market requires to "incentivize" workers to come work for our municipality?

Were the generous CalPERS pension benefits given to municipal employees during the 1990s "required by the market", under Adam Smith's "invisible hand", to "incentivize" people to come work for local government?

Did City governments lack the ability to "compete in the marketplace" to "incentivize" talented workers to come work for their City (a municipal corporation) as apposed to some private corporation?

Could we apply the same reasoning for paying out augmented pensions for City employees that we used in economic development deals, where the City paid extra money, land, and tax incentives to developers to "incentivize" developers (closing the GAP between "market" and the value of the City's offer) to bring development into the City?

These are questions that will be answered differently by different people. Certainly, it takes a basic understanding of Economics 101, and more specifically Principle #4 on "incentives", to *make a rational explanation for our numbers*. In the end, the public at large has to pay for our pension benefits as municipal employees. And CalPERS is a basically a numbers game!

CalPERS NUMBERS GAME

It was anything but easy for City Hall to argue against CalPERS pension increases (and other employee benefits). CalPERS members directly benefitted, and quite favorably, from those increases. So not only were we being silenced by the fear of "not being a team player" on a very close knit team, but speaking out actually meant working against our own self-interest. Talk about a pickle!

For example: I signed up for my City job as Administrative Analyst in 1990 making a $30,000 annual salary with **2% @ 60** CalPERS benefit formula. When I left my last City job as Finance Director making $145,000 annually, I held a **2.7% @ 55** CalPERS benefit! Would I have quit City work if my pension benefit had stayed 2% @ 60? No. The pension I was offered was greatly appreciated, but it was NOT the reason I continued serving my City government or stayed at my job!

For those not familiar with CalPERS, the basic "rough" calculation of the pension benefit I describe above is as follows: I would receive 2.7% per year for every year (28 years total) I worked for a CalPERS employer with that pension contract plan, multiplied by $145,000 (highest single year salary). Under 2.7% @ 55 I would receive $109,620 per year for the rest of my life if I retired at age 55 for full benefit. Under the 2% @ 60 CalPERS formula, I would have received $81,200 per year for the rest of my life. Still a pretty dang good pension, but *I would have had to give my community **an extra 5 years of service***! Only in City work!

TWO CLASSES OF CITY EMPLOYEES FOR PENSION BENEFITS TODAY

Local governments (and the State) finally realized we can't afford to continue to offer the generous pension benefits gained during the 1990s. In 2012, PEPRA (Public Employees Pension Reform Act) was born to pare back the fiscally-unsustainable generous pension benefits previously approved, creating two classes of public employees for pension benefits.

As of 2013, most, if not all, CalPERS employers have two classes of MISCELLANEOUS (non-public safety) employees (with some variation, but I'm using above pension benefit example for consistent comparison):

- Classic Pension Formula: 2.7% @ 55
- PEPRA: 2% @ 60

This means that you can have a City Director being paid under the 2.7% @ 55 CalPERS pension benefit formula, and right next door in the same City Hall building, you have another "equally talented" City Director being paid under the 2% @ 60 pension benefit!

In a future CitySpeak newsletter I will talk about how **55 is too young to retire** for most, if not all, **non-public SAFETY** CalPERS members, and also about the recruiting impact of the two classes of employees offered differential CalPERS pension benefits.

BOTTOM LINE: If you were a municipal Finance Director desperate to shed light on the harsh fiscal reality of pension increases in California in the 1990s, like me, you may still be trying to forget the frustrating financial discussions we were engaged in. Certain stakeholders sought to upgrade CalPERS contracts without disclosing the "true" financial impacts on the City's future balance sheet. And you were labeled a troublemaker who was not a team player.

It wasn't as though the numbers needed to be unclear. The data wasn't difficult to understand, nor were the calculations complex to figure out. Honestly, you didn't have to be an actuary to do the math. It was a simple matter of multiplying with "exponents" to at least provide "scenarios" of ***best case*** and ***worst case*** assumptions. But many of those with the real power, power to hire and fire, power to control the microphone, power to ridicule and ostracize, prevaricated.

IT'S LESS SCARY TO LET GASB SOUND THE ALARM

In these types of tense and scary situations, where City Finance Directors feared being outcast, or worse, fired for speaking out, we often had to look to a more neutral party to tell our tale for us. And in stepped the GASB.

The GASB (Governmental Accounting Standards Board) started working on standards for financial reporting of OPEB (Other Post Employment Benefits) in 1994. But because of how slow moving and inefficient government can be (which is, of course, by design) GASB did NOT actually finish outlining these standards until 2004.

It was then, in 2004, that I finally began to see some from among the ranks of executive management at City Hall begin to "try" to scale back or at least to report with transparency the real numbers and consequences to City Council. Now these executives had GASB standards being followed by the City's independent auditors at City Hall to audit financial statements, revealing the true fiscal impact of the expanded CalPERS pension benefits approved for City employees during the 1990s. Government mandated oversight sheds light where darkness has long prevailed. For this reason alone it was less scary to let GASB sound the alarm. GASB was simply doing its job, the only real job it was created for.

With GASB requiring audited financial statements to include the present value cost of future CalPERS pension benefits, we now had support. We had real numbers and a big bad backup system we could point to. Without this very solid protection, City Finance Director or City Manager could just be labeled a naysayer or even a troublemaker.

FALLOUT EFFECT DUE TO LACK OF OVERSIGHT

This decade I'm referencing (1994-2004) was the time period during which many City governments and other municipalities participating in CalPERS boosted pension benefits for millions of public employees. It is with clarity and certainty that I say these boosted benefits cost our communities billions of dollars *unnecessarily*. We City employees not only did not ask for these enormous increases, we did not require them to stay at our posts, or even to continue on for years to come. In my time, and I would argue the same for City employees today, we did not get into City work to get rich.

Note: while I am not directly addressing the SAFETY CalPERS benefits here, (for this newsletter, I will focus on MISCELLANEOUS CalPERS pension benefits) the points raised apply to both MISCELLANEOUS and SAFETY pension costs.

The fallout from these uneducated and miscalculated decisions during this decade from 1994 to 2004 was enormous. Municipal government organizations added billions of dollars of debt and pension liabilities. They also added millions of promises to pay enhanced employee pensions that went beyond a local government's (and residents and taxpayers) ability to pay. I will present the actual fiscal impact, which is obviously in the billions in a future CitySpeak newsletter, in great detail, after further critical research.

In the end, the point that must be made clear is that the courage required to advance *full disclosure* of real Budget impacts is the job of the City (not the GASB). The reason for this is that the required advance full disclosure takes place "*before*" decisions are made. GASB disclosure *happens* "after" decisions are made. By then, it is too late. And history repeats itself.

WHY WERE CALPERS DISCUSSIONS SO FRUSTRATING?

What is the lesson here? Why were the CalPERS discussions so frustrating? They didn't have to be. As public administrators, we could have all simply said, "Oh yes, 2.7% @ 55 is an excellent proposal sir! Why we're even Superfunded at CalPERS; this will not impact our budget." Unfortunately, the CalPERS contract proposals did not get the full disclosure in the **Fiscal Impact** section of staff reports because we relied too heavily on CalPERS "experts" to do the math for us. Those of us who did raise our voices were told to "shush," and let the "experts to their job." Frustrating.

It took *courage* to vocalize our concerns about CalPERS proposals back in 1999, and for the following decade, *especially because everybody at City Hall stood to benefit*. Many public administrators knew these generous benefits would shackle the City's budget with exponential cost increases in future years' budgets, resulting in greater non-discretionary spending in the budget. Many of us did our best to reveal this knowledge, to no avail.

HISTORY DOES NOT HAVE TO REPEAT ITSELF

Today, CalPERS pension costs are just something we have to fund in the budget, which is why they're "non-discretionary". Just Google "pension budget issues" and you'll get 37.6 million results!

However, there are many other financial decisions and transactions in the works that will again test the public administrator's courage to force full disclosure "before" the decision is made. It is the job of City Finance Directors and City Manager to sign off on the Fiscal Impact section of all staff reports. Of course, some of those reports will include proposals in which full disclosure will not be appreciated. You will be tested. What will you do?

The question we must ask ourselves is this: Will I have the courage to vocalize my concerns when a City proposal does not provide full disclosure. Will I stand up, will I speak up, when I believe the true and complete cost impacts are NOT being disclosed on the staff report?

FINANCE DIRECTOR HAS FISCAL RESPONSIBILITY OF FULL-DISCLOSURE

You may not have the final say with the recommendation made, but you have the *primary duty*, as City Finance Director, to vocalize (often times against much opposition) the FULL fiscal impact of proposals, especially when transparency is missing in the recommendation of the staff report.

My dear colleagues, it takes courage to force discussions to present the "true" fiscal impact of important proposals (like CalPERS pensions of the 1990s), *especially when nobody wants to hear it*. I have spent 28 years of my career in City Finance Departments. I know how tough and lonely it can be when various stakeholders are pushing forward proposals which you KNOW lack *full* disclosure on fiscal impact.

My recommendation to you is to be respectful and wait for the "appropriate" forum to voice your concerns. But make your voice heard. Finance Directors and public administrators ***never compromise on integrity***. However, remember that ONLY you as City Finance Director have ultimate responsibility for disclosing the full fiscal impact of proposals. Yes, this is a great burden, and as Peter Parker's Uncle Ben says, with great power comes great responsibility. If you don't speak up as finance officer, nobody else will. Nobody else holds that post at your City! You alone have that power. Use it wisely.

PENSION BENEFITS PROTECTED BY CONSTITUTION?

Don't worry, your CalPERS pension benefits are largely protected by constitutional contracts impairment laws. It is unlikely that municipal pensions could be jeopardized for retirees, however, we do not know what the future holds. For those of us serving in City government during the recession in 1992-1993 and during the Great Recession of 2008, it become in vogue to say, "desperate times call for desperate measures".

Everything could change if the communities that approved the large pensions have to cut public safety and other vital City services because of pension obligations.

As a greater share of the City government budget becomes non-discretionary because of pension payments and obligations, the voters of your communities may become more vocal and change fiscal policies of the past.

Another common saying among City officials during my 28 years in City government, "prior City Councils cannot TIE THE HANDS of future City Councils".

Nobody really knows what the future holds for City pensions, which is a good reason for all public administrators involved in pension reform to be as transparent, diligent, and prudent in crafting proposals to "fix" the unsustainable pension obligations created by prior administrations at City Hall and the thousands of municipal organizations.

You can read more about the constitutional protection of public pensions. **Click here**.

I LOVE YOUR FEEDBACK…

As always, please call me if you want to share your thoughts on customer service or any other subject I write about in my newsletter; I would love to talk to you about your ideas for interesting municipal topics for my future CitySpeak newsletters.

MUNITEMPS IS HERE TO HELP…

And remember, MuniTemps is here for you should you need temporary help to fill a staff vacancy in your Department. We can help you with closing the books during the July to September audit season, or with any budget cleanup work to kick off next year's budget with a clean set of books.

As president of **MuniTemps – Municipal Staffing Solutions**, I am passionate about implementing best practices with budgeting. I have worked hard during the past 28 years, serving many Cities and Special Districts as Finance Director and can provide your municipality with tried and tested organizational solutions.

My team and I understand municipal organizations, the budget, the CAFR, **CalPERS pension issues**, and the nuances of municipalities in serving their communities.

Call my office to learn how you can make your "temporary" workers compliant with pensions requirements with our **P.R.E.P.** (**Pension Risk Examination Program**).

I wish us all success as we work through the execution of municipal best practices and the continuous professional work ethic of serving our City organizations!

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