MOVE OVER PENSIONS—THE SILENT KILLER OF LOCAL JURISDICTION BUDGETS IS RETIREE MEDICAL BENEFITS: HOW INGLEWOOD'S CHANGE IN POLICY CHANGED THE GAME

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December 4, 2016

"Managers are people who do things right and leaders are people who do the right things."[1]

-- Warren Bennis and Burt Nanus

Creating effective policy involves more than just being smart, creative, or innovative. It also requires an understanding of the complexities of the problem/issue to be solved/addressed (which is not always obvious), the multidimensional aspects of the landscape in which the policy will be implemented (which can change dynamically before, during, and after the policy is implemented), the various stakeholders involved (which can include a host of people including unrelated parties), and most importantly, the political will of the legislative or rule-making body (which can be heavily influenced by the public who put them in power, the parties intended to be affected by the policy implementation, and the politician's own personal biases and self-serving attitudes). Looking first at Birkland's definition of policy, which he regards as "a statement by government of what it intends to do such as a law, regulation, ruling, decision, order, or a combination of these,"[2] how a government (or its leaders) make public policy decisions and the challenges associated with implementing them is far from academic. The practical aspects of public policy making and evaluating its relative success or failure are much more complex. This is certainly true at the municipal government level where elected officials (e.g., mayors, city council members, county supervisors, etc.) are expected to espouse what is in the best interests of the public even when they themselves may not understand (intentionally or otherwise) the many aspects of policymaking.

The case that follows involves the city of Inglewood, California, and their pressing need to avoid fiscal insolvency. With revenues shrinking and expenses increasing as the U.S. economy crept into turmoil, Inglewood was consuming its precious financial reserves with wild abandon. Like a roomful of school children consuming candy during Halloween, money was being spent like there was no tomorrow. Something had to be done, or municipal bankruptcy would be imminent. Sadly, the composition of the city council at that time was not conducive to effective problem-solving let alone effective policymaking.

Economic Landscape (The Past)

Much like the private sector, virtually every municipal agency was impacted by the U.S. economic downturn, or 'Great Recession' as it has been labeled, that began in late 2007 and continued through 2008 and the subsequent global recession that continued through most of 2012. The city of Inglewood certainly suffered its share of fiscal difficulties, as all primary revenue streams such as property taxes, sales taxes, utility user taxes, and vehicle in-lieu taxes were down sharply. Coupled with this significant decrease in revenues, expenditure lines comprised predominately of salaries and benefits continued their mad dash toward the stratosphere mostly due to the increased costs of health-related benefits and the rising costs of state pension premiums.

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[1] Bennis, Warren G., and Burt Nanus. 2007. *Leaders: Strategies for taking charge / warren bennis and burt nanus*. 2nd, 1st Collins Business Essentials pbk; CSZA; ed. New York: Collins Business Essentials. p. 20.

[2] Birkland, Thomas A. 2010. *An introduction to the policy process: Theories, concepts, and models of public policy making*. Armonk, N.Y.: M.E. Sharpe. p. 9

To make matters worse, many jurisdictions including Inglewood chose a terrible path as it relates to retiree medical benefits. First, they offered a completely unsustainable benefit whereby a retiring employee and his/her spouse could obtain medical coverage for the rest of their lives at the expense of the city for the mere exchange of a handful of accrued sick and/or vacation hours at the time of retirement. Second, the city did not pre-fund in any way this massive liability, which according to actuarial analyses would amount to nearly $200 million over 30 years—just for existing employees (e.g., those who had already retired and were receiving fully vested retiree medical benefits created another $117 million liability over 30 years). As such, the city was facing an unfathomable $316 million unfunded liability.[3]

How and why did Inglewood and other similarly situated municipal agencies create such a terrible and fiscally unwise situation? The answer is actually easy. Some two decades prior when healthcare premiums were only a few hundred dollars a month for family coverage, the city council negotiated with its represented labor groups to provide this lifetime benefit in lieu of salary increases. What nobody took into consideration were the uncapped medical premiums and the increasing longevity of retirees. Adding to this dilemma, the average age for retirees was actually going down not up because retiree pension benefits had also increased, which motivated employees to retire sooner and begin drawing their pensions even if they continued to stay in the workforce—just not in the public sector (e.g., "double-dipping"[4]). After all, being able to retire in their early 50s, draw a decent-sized retirement check every month, and not have to worry about paying for medical insurance was a deal few could pass up. Thus, the retiree ranks swelled substantially, their medical claims history increased proportionally, and when coupled with the increasing costs associated with medical procedures and pharmaceuticals, premiums began to skyrocket. Finally, the Affordable Care Act simply added gasoline to the already raging inferno by shifting the burden of healthcare costs on a national level to the insurers who simply passed those costs directly on to the employers through significantly increased fee structures.

One other significant item to note in this cause-and-effect situation is the fact that when an employee retired, typically a new hire was brought in to replace him or her. Thus, the agency now had double the medical expenses (e.g., medical coverage for the new hire and continuing medical coverage for the new retiree). For municipal agencies where major decisions such as these rely on the collective bargaining process, this can quickly spell disaster because once something is bargained for, it is extremely difficult (if not nearly impossible) to take it away. When you add this to the likelihood that most jurisdictions are not able (or not fiscally responsible enough) to allocate budgetary resources in a dedicated reserve to fund the future costs of this benefit, you end up with a pay-as-you-go situation.

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[3] Michael Falkow created the actuarial analysis that was used as the basis for this policy. The section entitled *Creating the Model* describes the process by which he went about constructing this highly complex, detailed, and crucial analysis.

[4] The concept of "double-dipping" is one whereby a pensioner stays in the workforce or returns to the workforce after retiring from a job where he or she earned a pension. The typical lifetime-based annuity (some with periodic cost of living adjustments built in) are paid regardless of whether or not the retiree obtains gainful employment outside the auspices of the pension system. As such, the pensioner would received both his or her pension check and his or her paycheck.

The Political Conundrum

In virtually all governments, the electorate make demands of those they put in office. Usually in the form of services, some of which we may take for granted on a day-to-day basis (e.g., public safety [police and fire], infrastructure such as water, sewer, and roadways, tree trimming and median maintenance, parks, recreation, and library services, etc.), the costs associated with these efforts involve two basic components: maintenance and operations expenses (referred to as M & O, these costs are usually for physical things such as paper, computers, software, consultants, etc.) and personnel costs (e.g., all costs related to the organization's employees such as salary and benefits), the latter of which is almost always greater by an order of magnitude with the exception of service costs related to outside service providers in lieu of having employees (e.g., when consultants are predominately used as with outsourcing).

A strong and fiscally prudent public administration (e.g., management) will seek to reduce costs and maintain organizational solvency while continuing to provide necessary public services. At odds with this perspective are labor groups who are comprised of the very employees of the entity performing the services (often in the form of a union or organized collective bargaining group). Their objective is almost universally to obtain more pay and greater benefits. Elected policymakers must find a balance…they answer to their constituency, direct management to execute their vision, and want (need) to appease labor. This creates a complex yet real conundrum, which becomes clear when one discovers that those in the role of making policy often do so focusing more on what Volden describes as the balance between getting "credit" for providing something of value versus "blame" from the costs of the policy decision.[5] The costs in this case typically refer to the impacts (often negative) to the politician's career, as there is as an axiom in politics that politicians need only follow two rules—get elected and stay elected. This perspective can easily go against the basic principle in a represented democracy where elected officials should put their own desires second to the needs of those they serve.

Most of the difficult situations governments find themselves in can be traced back to poor decisions, inadequate understanding of the problem or concern at the onset, or efforts to avoid addressing the real 'elephant in the room' so to speak—the labor groups and/or unions for the reasons pointed about above. Because the policymakers are often elected with the help of labor either through direct campaign contributions or in-kind service during campaigns such as staffing call centers, walking the streets to get the word out, or helping distribute campaign materials and literature, these elected officials become beholden to them. This is a serious dilemma because it can create an inherent conflict of interest when it comes to the elected policymakers having to make tough decisions that negatively impact labor (e.g., layoffs, furloughs, reductions in benefits, etc). They will do everything in their power to avoid making the arduous decisions (e.g., kicking the proverbial can down the road) often letting problems fester until they are nearly unsolvable hoping someone else will take the political hit and do something. Of course, at that time (if they are still there in office), they will try to take the credit and avoid the blame.

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[5] Volden, Craig. 2005. Intergovernmental political competition in American federalism. *American Journal of Political Science* 49 (2): 327-42. p. 328.

The Policymakers' Motivation

In late 2009, sensing impending doom, the finance director went out on medical leave never to return (he waited three months until he reached his 50th birthday and 'remotely' retired). In January of 2010, the mayor resigned from office, and the remaining council members terminated the city manager's contract less than two months later. Faced with a huge $13 million budget deficit[6] that was growing at almost $50,000 per day and the realization that reserves had been pilfered, the city council needed to act quickly and decisively. Despite this strong motivation to address the catastrophic budget problems at hand, three of the four council members were vying for mayor leaving the group in political paralysis and unwilling to act. Four months and an additional $4.6 million dollars in deficit later, the council finally acted by doing the only thing they could—implement dramatic layoffs.

Once numbering over 1,000 full-time employees, the city's workforce had steadily dwindled down to 731 full-time employees over the course of several years. The city council was forced to eliminate 82 full-time positions and another 33 permanent part-time and part-time positions. To soften the blow somewhat (politically), the assistant city manager proposed an early retirement incentive that helped 22 of the employees depart with an early retirement incentive.[7] This reduction in force coupled with massive employee concessions in the form of three years of 10% furloughs each year[8] (to avoid an even larger number of layoffs that would have rendered the city unable to adequately provide services) helped bring the city's budget back into some semblance of alignment. Of course, these 'fixes' were only temporary and merely addressed the symptoms of the disease not the cause.

A New Leader is Elected

The bandages used to triage the city's budget slowed the hemorrhaging, but it was clear that longer-term and more permanent solutions were still needed. Unfortunately, addressing the cause of the problem (e.g., dealing with the ballooning liability associated with retiree medical benefit costs) was a topic the existing members of the council were not willing to even entertain at least until a new mayor was elected. Even then, making sure they fully understood the depth of the problem would be a challenge as well. After a run-off election in January of 2011, a long-time public servant (including more than two decades in Inglewood) but a newcomer to the political scene unseated a short-term incumbent who had completed the term of the mayor who resigned in January of 2010.

James T. Butts, Jr., brought significant change to Inglewood. Mayor Butts is a retired Chief of Police from Santa Monica, California (he was the first and the youngest African-American police chief selected in California at the age of 37). Prior to Santa Monica, Mayor

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[6] http://www.cityofinglewood.org/agendastaffreports/04-01-10/ca-1.pdf

[7] City Workforce Reduction Plan, October 12, 2010: http://www.cityofinglewood.org/civicax/filebank/blobdload.aspx?blobid=6446

[8] City Hall would be closed through a negotiated shut down every Friday of a 9/80 work schedule meaning civilian employees were only paid for 72 hours per bi-weekly pay period instead of 80 resulting in a loss of 208 hours per year. Also, the sworn police officers had negotiated salary and benefit reductions equal to 10% using a combination of items necessary for a department that operates 24/7 regardless of City Hall's hours.

Butts began his career as a police officer in Inglewood rising to the rank of Deputy Chief of Police. After Santa Monica, Mayor Butts served for five years as the head of public safety and counterterrorism at the Los Angeles World Airports (e.g., LAWA), and after his retirement from LAWA chose to run for mayor in Inglewood.

His leadership took the airport from worst to first, and he aimed to do the same in Inglewood. He promised change to an electorate in Inglewood that was replete with despair. His campaign slogan was "Running for Change," and it marked the beginning of the city's reversal from hopelessness to hopefulness, as the small urban city was saddled with crushing debt, enormous unfunded liabilities, and no vision or strategy for getting back on track. With dwindling financial reserves that were more than spoken for in terms of existing liabilities, the city was functionally insolvent and headed for municipal bankruptcy. This new mayor was not a typical politician. He was a career civil servant who moved his way up the ladder quickly to become general manager of several large public agencies. His very strong business acumen coupled with is dynamic interpersonal skills and communicative abilities serve as the core of his unique talents. He is highly driven and very passionate about success. Although he had campaign support and assistance from the police labor groups in Inglewood, he was not beholden to them. Furthermore, during his campaign, he was vocal when it came to areas that needed to be addressed immediately, the most obvious of which was the burgeoning deficit.

As the new mayor took office, several of the other members of the council still refused to address the burgeoning unfunded liabilities associated with retiree medical. On the surface, it appeared as though the members simply did not want to deal with the complexities of the issue at hand—perhaps it was just too much to bite off (e.g., dealing with a huge deficit was certainly more pressing). Delving deeper into the quagmire, however, unveiled the reality that the political will necessary to stand firmly against labor and actually take what many believed was a sacrosanct benefit away could be detrimental to their respective political livelihoods and might result in losing the support of labor, who were actually instrumental in keeping them in office. It soon became apparent with the 'jockeying for position' that the road was going to be rough and treacherous. The mayor quickly recognized this and developed a strategy that would ultimately lead his colleagues down the path one step at a time leaving them little room to 'wiggle out' and deviate from the goal of solving the problems at hand.

Inglewood's *Perfect Storm*

As the economic downturn continued to take its toll on many municipal agencies, Inglewood had no escape. All primary revenue streams such were still trending downward, and all expense lines comprised predominately of salaries and benefits (as maintenance and operations were already cut to the bone) were continuing their meteoric rise despite a third year of 10% furloughs—city hall had been closed through a negotiated shut down every Friday of a 9/80 work schedule meaning civilian employees only worked 72 hours per bi-weekly pay period instead of 80 resulting in a loss of 208 hours per year (e.g., 10% of a typical 2,080-hour work year). Also, employees could not use or cash out sick or vacation time to offset the furlough. Similarly, the sworn police officers negotiated salary and benefit reductions equal to 10% using a combination of items given that their department operates 24/7 regardless of city hall's hours (e.g., furloughing a police officer makes no operational or fiscal sense because you would likely have to backfill that furloughed officer with a different officer who would be getting overtime).

With furloughs set to expire at the end of 2013, low morale, and the need to continue with significant employee expenditure reductions across the board due to a projected structural deficit of more than $7.08 million on a General Fund[9] budget of $79.3 million (nearly 9%)[10], Inglewood faced a Perfect Storm, as all six (6) labor contracts would also expire at the end of 2013. To make matters worse (if that was possible), the labor groups in general showed little trust in management. In the past, whenever a labor group's leadership did not like the facts the city's negotiation team presented, they did an 'end run' to the elected officials and cut a side deal. After all, labor often 'controls' the elected officials who rely (detrimentally) on their financial and in-kind support. This had the effect of undermining the city's negotiation team and its strategy—thus crippling the city's ability to collectively bargain—this clearly threw 'good faith' negotiations out the window, but holding so much power and influence over elected officials they supported financially during election season was like holding a guaranteed winning hand in poker every time the cards were dealt.

As the "Category Five" storm approached, the mayor launched an aggressive campaign to sweep away two seated council members (both of whom were heavily supported by labor). The mayor espoused replacing the two council members with two brand new, never-before-elected members with no affiliations or allegiance to labor. The mayor was successful in his efforts and both of the council candidates he supported won their seats. This realignment of the legislative body occurred one month before negotiations with the six (6) labor groups began and gave Inglewood's negotiation team a fighting chance at saving the city from insolvency.

Strategy Development: Identifying the Players and Framing the Problem

With a city council now willing to deal with the depth of the challenge, it was the negotiation team's responsibility to frame the problem in such a way as to not overwhelm them since that might push them into *paralysis by analysis*. At the same time, it was imperative to understand the players involved (e.g., the primary stakeholders) in order to effectively design a solution that would be both understandable and implementable. First you have the legislative body itself—the mayor and council members. Second, you have the six bargaining groups[11] and their members (e.g., the city's employees), which collectively can be referred to as labor. Third, you have the city's labor negotiators, who by default are employees (e.g., part of labor) and are

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[9] General Fund typically refer to unrestricted tax-based revenues such as sales tax, property tax, motor vehicle in-lieu tax, and utility users tax, as opposed to federal, state, or county funds allocated for a specific purpose such as low-to-moderate-income housing (e.g., Section 8), state highway and roadway repair, gas tax, water/sewer funds, grant funds, special funds that are by law earmarked for a specific purpose such as public safety, etc.

[10] http://www.cityofinglewood.org/agendastaffreports/09-10-13/dr1.pdf

[11] The Inglewood Executive Organization [**IEO**] represents the department heads and above; the Inglewood Management Employee Organization [**IMEO**] represents the non-sworn management and professional employees; the Service Employee International Union [**SEIU**] Local 721 represents the general, non-management hourly employees; the Inglewood Police Management Association [**IPMA**] represents the sworn police management; the Inglewood Police Officer Association [**IPOA**] represents the non-management sworn police officers; and, the Inglewood Police Civilian Management Association [**IPCMA**], which represents the non-sworn management and professional employees who work in the police department)

impacted (positively or negatively) by whatever is negotiated. While it might seem self-serving on the surface that the city's labor negotiators could effectively negotiate on their own behalf, the power of collective bargaining, the required level of transparency in local government, and the duties of the legislative body to be fiscally prudent and responsible provide very defined boundaries of operation often preventing unethical or opportunistic negotiations. Fourth, one cannot discount the impact of the existing retirees who are enjoying a fully vested benefit. Any attempt to curtail the benefit or alter its structure, which could impinge on their fully vested benefit would certainly be met with immediate and costly legal challenges. Finally, as described in the Multiple Streams Approach policy theory, there is a policy entrepreneur, who has access to the policymakers, watches carefully for the policy windows to open, and just happens to be part of labor, which meant he would surely feel the effects of the intended policy firsthand just like everyone else.

With a good understanding of the key players, the next step was to determine the best and most efficient way to express the magnitude of the unfunded liability associated with retiree medical premium costs over time. This, of course, would involve a detailed discussion of the underlying mathematical mechanisms necessary to calculate it. Thus, it was the team's task to put together an easy-to-understand actuarial analysis that was not only accurate (to withstand the inevitable critique by labor and their leadership), but also to make it clear and convincing enough for the city council and general public to understand. Compounding the issue was the fact that hiring an actuarial firm to complete the task would be both costly and time-consuming—two luxuries the city did not have.

Before the actuarial task could be undertaken, it was important to ensure that the members of city council were all on the same page as far as understanding the scope of the problem. The mayor undoubtedly understood, but he is an exception to the rule given his business and finance acumen. The other four members needed what Elinor Ostrom defined as a framework, which is a structure that identifies "the elements and general relationships among these elements that one needs to consider for institutional analysis."[12] This framework would eventually lead toward the creation of a model that would describe, as Ostrom put it, the "precise assumptions about a limited set of variable and parameters to derive precise predictions about the results of combining these variables into a particular theory."[13]

The framework started with the primary objective, which was to dramatically reduce the OPEB (Other Post-Employment Benefits) Liabilities—specifically those that were a function of the retiree medical benefit in all the existing labor contracts. Just looking at the surface, 72% or $5.1 million of the $7.08 million structural deficit for fiscal year 2013-2014 was solely attributable to retiree medical costs for existing retirees (not current or future employees—only those employees that had already retired).[14] This was caused by the city's faulty approach to handling its rising retiree medical premium costs each year by using a "pay-as-you-go" method of budgeting. The second aspect of the framework involved the trend associated with medical premium increases. Up until fiscal year 2013-2014, premiums had steadily increased over the

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[12] Ostrom, E. (2011). Background on the institutional analysis and development framework. *Policy Studies Journal, 39*(1), 7-27. p. 8
[13] Ibid.
[14] http://www.cityofinglewood.org/pdfs/admin/budget/14/FY2013-14_Budget.pdf (p. ii)

past six fiscal years creating an average of 6.5% annually. [15] For fiscal year 2013-2014, the increase was 9.4%.[16] This trend, unfortunately, would become the new normal.

With the main context of the problem defined, the real work was set to begin. Looking at the process needed to give depth to the problem, it was clear that a simple linear approach would not be effective because of the multivariable nature of determining future costs associated with retirees (e.g., at what age an employee will likely retire, how old a spouse might be [if any], their expected longevities, their health status both now and in the future, and of course the premium costs). Weible suggests that "policy process is best imagined as a complex phenomenon of continuous interactions involving public policy and its context, events, actors, and outcomes."[17] To put all the pieces together and create a new public policy for the city council to consider and approve meant that they had to understand exactly what they would be effectively doing to the current and future budgets of the city—even ones that would be generated well after they were gone from office. After all, most retirees and their spouses live 30 years or more post-retirement. Thus, any actuarial analysis had to calculate at least a 30-year horizon (10-year, 15-year, 20-year, and 25-year increments would be preferable to illustrate the trend and also provide a yardstick for periodically measuring the future success/failure of the proposed policy).

Although complicated to a degree, this cost analysis was only part of the problem at hand. The costs associated with any alternative benefit plan would also have to be calculated, and these costs, which include all the same variables (and more) would be dynamic based upon what exactly was negotiated. To further complicate the policy process, even if the city council fully understood and approved a new policy, there was no guarantee that exact policy would ultimately be implemented because the collective bargaining process with all six labor groups could lead to impasse and/or a mangled mutation of the original policy alternative. Therefore, the policy had to be elastic enough to allow for some give and take during the negotiation process with labor, which meant that the model had to be flexible enough to recalculate on the fly based upon the changing conditions of the collective bargaining process.

Creating the Model

Fortunately for the city, the negotiation team's leader[18] was able to leverage his strong analytical, mathematical, and technical expertise and disassemble the problem into manageable, bite-sized pieces and take actual values directly from the city's financial system to create an elaborate, sophisticated, and expansive spreadsheet model that actually calculated the projected cost of retiree medical for each and every current employee, as it was a given that new employees would not be added to the mix. Starting with each employee's date of birth, labor group affiliation, hire date, and current medical benefit (e.g., Kaiser, Aetna, etc., and whether it was employee-only or employee-plus-one, as a retiring employee with family coverage would have to pay the difference between the family coverage and employee-plus-one if he or she retired and still had other family dependents), he set out to develop a working model that would

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[15] Ibid.
[16] Ibid.
[17] Sabatier, Paul A., and Christopher M. Weible. 2014;2009;. *Theories of the policy process*. Third;2nd; ed. Boulder, CO: Westview Press, a member of the Persus Books Group. p. 391
[18] The Assistant City Manager (Michael Falkow) who oversees human resources.

not only produce extraordinary results, but also serve as a benchmark for the future. He knew that having a yardstick with which to compare against would be necessary going forward because there would be a need to determine whether or not the policy achieved success and whether or not the costs outweighed the benefits in terms of the components of the intended policy solution.

The model was constructed using the following characteristics:

1. A conservative approach was used to ensure that the calculations would be more likely to be accepted by labor and not frighten the city council or public. If they were too aggressive, labor would immediately dig their heels in and do nothing but poke holes in the theories used to justify the costs, and the city council and public might react harshly at how bad the economic picture was, which could limit rational decision-making. If they were too lenient, the values would not be useful.

2. All existing employees would work until retirement even though there would likely be some attrition prior to employees reaching eligible retirement age. One statistic that was leveraged was the average age for all existing employees, which was actually a high number (e.g., 46.29). This tended to indicate that the city workforce was aging and based upon the economic conditions at that time would be less likely to leave. As such, for sworn employees, age 55 was used as the average retirement age. For non-sworn employees, age 60 was used as the average retirement age. For employees who were at or exceeded these ages, they were given an additional year prior to being 'retired' as far as the model was concerned. These values closely matched the average retirement rate of 3.5% that the city experienced.

3. For the purposes of mortality, all retirees (e.g., both male and female) 'left' the system upon reaching their 86th birthday. Even though this value was slightly higher than the mortality tables for males and females used by the federal government in calculating social security benefits and the like, it is important to note that dependent age-related data was not readily available, but it was clear from the retiree information that dependents on average outlived the employee given there were a large number of dependents (e.g., spouses) still being covered even after the retiree passed away.

4. The starting premium used at retirement was the premium currently in place (e.g., if the employee had Kaiser employee-only, then it was assumed the employee would not marry prior to retirement, which may not always be accurate). Furthermore, if the current premium was employee-plus-family (e.g., more than just a spouse), the premium was reduced to account for the reduction in cost to the city upon retirement. It is worth noting that age-banding[19] is not used to calculate the city's medical

[19] Age-banding is used by insurance companies to provide pricing that is based upon a given age range with lower premiums for younger age ranges and steadily higher premiums for older age ranges. Since the city pays between 95% and 100% of all of the premiums for employees and their dependents and 100% for eligible retirees and their spouse, there is no inherent benefit/savings to the city to using age-banding.

premiums, and there is no reduction in premium when an employee or retiree reaches age 65 (e.g., they are Medicare eligible).

5. A growth factor function was built in to all premiums (e.g., it was a modifiable factor that could be set globally to calculate different results). This proved to be very valuable during negotiations, as many labor groups did not initially accept the 7% growth rate that was used, which was simply a midpoint between the 5% that was budgeted and the 9% that was actual. Ultimately, the city and labor settled on using 5% for the purposes of calculating the OPEB liability, but as rates continued to rise even after the benefit was negotiated away, the ability to 'plug in' a different value helped solidify the original theme and provide further justification for the success of the policy.

Once the OPEB liability was determined, the model was used to create the various options that helped to generate the policy alternatives. This proved to be highly valuable, as the amount of net savings per labor group could be easily determined (virtually on-the-fly) based upon components or values that were modified during negotiations or during closed session discussions with the city council.

The Puncture in the Equilibrium

Borrowing from the Punctuated Equilibrium Theory, which is a policy theory that seeks to explain how new policies are often a result of "explosive change" within an organization leading to "the establishment of a new policy equilibrium"[20] after the 'shock' or 'puncture' of the policy in the original static continuum, the results of the actuarial analysis was that the city faced a $199 million unfunded liability over the next 30 years due to the existing employees in the six labor groups. The following table summarizes the projected unfunded liability associated with each labor group broken down in five-year increments beginning ten years out:

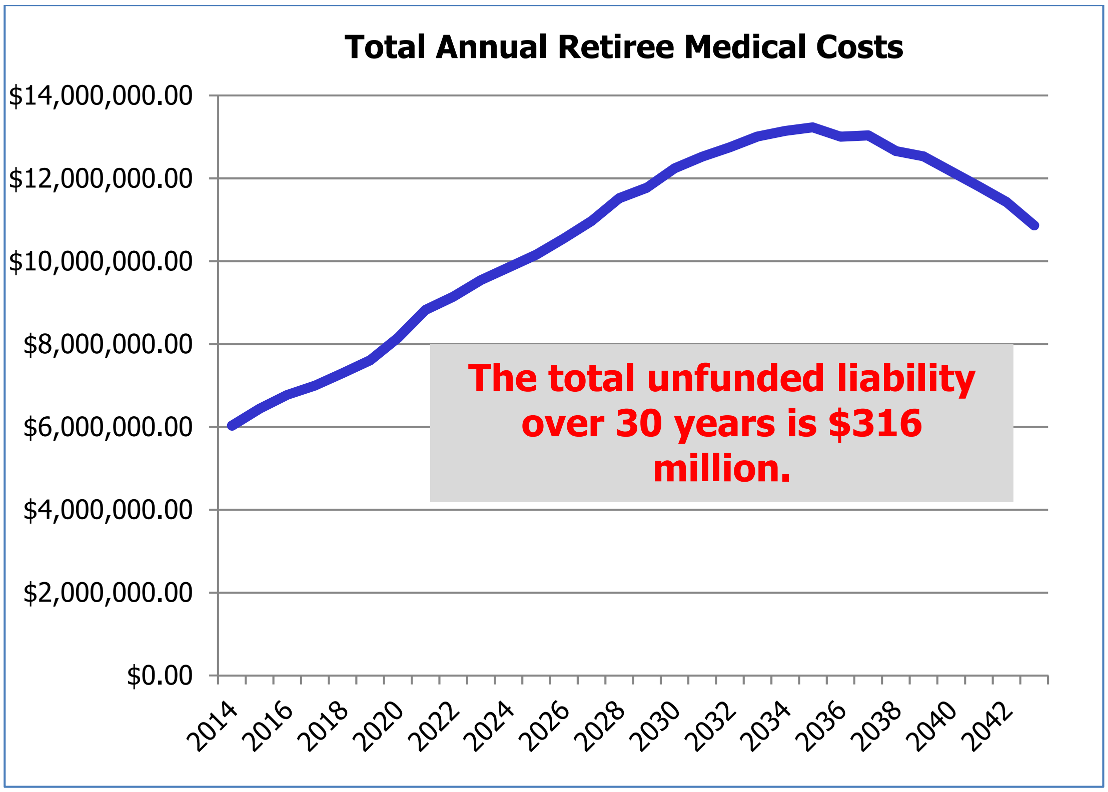
	Retiree Medical Unfunded Liability (Current Employees Only—No New Hires)				
Labor Group	10 Years	15 Years	20 Years	25 Years	30 Years
IEO	$ 1,025,110.02	$ 1,738,023.80	$ 2,470,641.13	$ 3,161,985.68	$ 3,932,052.51
IMEO	$ 10,977,152.34	$ 21,037,192.40	$ 34,850,055.22	$ 51,776,570.33	$ 68,891,744.51
SEIU	$ 2,787,444.33	$ 6,746,684.28	$ 11,687,949.80	$ 17,288,298.62	$ 23,600,275.91
IPMA	$ 4,042,050.70	$ 8,627,926.57	$ 14,322,844.93	$ 19,714,612.75	$ 25,575,929.16
IPOA	$ 5,234,693.62	$ 14,627,832.20	$ 30,216,480.46	$ 50,354,242.52	$ 72,255,917.89
IPCMA	$ 643,892.53	$ 1,164,908.54	$ 1,991,367.25	$ 3,261,337.19	$ 4,725,797.33
Totals	$ 24,710,343.55	$ 53,942,567.79	$ 95,539,338.78	$ 145,557,047.09	$ 198,981,717.31

To make matters worse, the existing unfunded liability associated with existing retirees and their applicable dependents was a horrifying $117 million over the next 30 years using the

[20] Sabatier, Paul A., and Christopher M. Weible. 2014;2009;. *Theories of the policy process*. Third;2nd; ed. Boulder, CO: Westview Press, a member of the Persus Books Group. p. 61

same projections for medical premiums and a declining population based upon conservative death rate expectations. This brought the total unfunded liability associated with retiree medical premiums to an astounding $316 million, which would leave the city bankrupt in less than five years since the city's total reserves would be completely wiped out attempting to cover the increasing annual expenditures.

Using the data from the model, the following graph depicted the projected impact (annually over the next 30 years) of the unfunded liability solely attributable to medical premium costs for existing and future retirees.



The "area" under the curve (e.g., the sum of each year's costs) represents the total unfunded liability over 30 years. To provide a simple perspective, the average cost per employee (including a potential eligible spouse) for retiree medical is more than $300,000. This translates into annual "slices" that each year represented more and more of a burden to the already fragile general fund. Based upon the reduction in retirees (e.g., their death and the death of their spouse), the annual amounts were projected to increase from just over $6 million in 2014 to a peak value of approximately $13.2 million per year in 2035 before beginning their downward trend until all retirees and their dependents were gone and no longer a burden to the city's general fund. It is important to keep in mind that the costs attributable to this massive problem do not end in 30 years. Rather, they would continue until the youngest employee and his or her dependent passes away. Based upon the actual employee census data, that would not be until approximately 2068. So, with the issue of retiree medical now defined and broken down, the city's negotiation team could focus on the overall strategic vision.

Creating a Way Out

Despite the major effort that went into the creation and explanation of the actuarial analysis, the real work had yet to be done. The city council needed an alternative to offer the labor groups that (1) did not leave the city teetering on the cliff of insolvency, (2) would not be so offensive (or too complex) that the labor groups would break off negotiations and dig in their heels ready for a protracted battle, (3) took into account the other important objectives the city needed to address such as the Public Employee Pension Reform Act of 2013 (PEPRA) and the need for employees to begin paying for most if not all of the employee premiums for CalPERS, (4) the increasing liability associated with the unlimited accrual of sick and vacation leave, which is paid out upon termination or retirement at 50% for sick leave and 100% for vacation leave (at the current hourly rate of the employee regardless of when the leave was earned), and (5) would provide the employees at all levels of tenure across all labor groups with something beneficial in exchange for the unsustainable benefit virtually all employees believed (incorrectly) was a vested right like their pension.

The Assistant City Manager took the problem from the vantage point of the employee, coupled it with the primary and secondary objectives of the city council, and fashioned proposed solutions tailored to each of the six labor groups comprised of the following key criteria:

1. Significantly modify the retiree medical benefit by substituting a lesser yet still valuable alternative that also put some reality into the equation by having the employees carry some of the burden (e.g., have proverbial 'skin in the game').

2. Provide an increase in salaries across the board for non-sworn employees of approximately 10.5% in exchange for employees paying the full employee rate for CalPERS, which is 8% plus 2 points of the employer's rate for a total of 10% (a virtual net zero cost that inured to the benefit of the employee because their hourly rate increased meaning overtime calculations would be higher and pension values would be higher because they would be based on a higher annual salary level).

3. The need to address the unlimited accrual of sick leave and vacation leave, which was a partially funded liability approaching $14 million. (Fortunately, not every employee would leave the city at the same time causing a "run on the bank.")

The alternative solution focused on the basic premise that employees should pay for part of their retiree medical insurance.[21] This became the first major hurdle during the negotiation process because virtually every employee (and their attorneys/chief negotiators) had grown to believe the city was unconditionally obligated to pay their medical insurance post-retirement forever…no questions asked. Despite the fact the city and its legal counsel believed that no vested legal right existed prior to retirement[22] and were willing to go the distance to prove it, the

[21] The Assistant City Manager's theory was to leverage the same argument that pension funds such as CalPERS use when suggesting that future annuitants should pay a larger portion of their pension premiums while still employed.

[22] Most MOUs provided for employees to receive retiree medical benefits (and possibly dependent spousal coverage also) for the rest of their lives (and possibly the lives of any dependent spouses) at the point when the employees retired and "exchanged" accrued sick or vacation leave hours (e.g., anywhere from 300 hours to 1,000 hours

"entitlement mentality" of the labor groups sustained this misguided belief, which was ingrained in their version of reality, and even hinting that this was false sent shockwaves through the entire organization and brought threats of massive lawsuits and immediate impasse. Also, morale among the city's employees was at rock bottom because of the three years of mandatory furloughs, workforce reductions, and merit pay freezes. The storm had clearly grown worse.

Developing Proposals and Meeting with the Labor Groups

With a unanimously supportive city council, the city's negotiation team began meeting with each of the six labor groups. Clearly, the major issue was retiree medical. While the groups begrudgingly accepted the actuarial analysis with limited discourse (even the union with their high-priced financial analysts quickly surrendered to its accuracy and validity), it was clear they were not going to simply give into the city's demands. And so began the cyclic redundancy among the groups: meeting after meeting, proposal followed by counter-proposal followed by another counter-proposal followed by another and another and another.

After dozens of sessions with the six groups, the executive group (the smallest but most highly compensated), which typically understands the issues the city might be facing since they are the department directors and administrative leadership, began to accept the new reality. Using this group as the high watermark (e.g., they would likely get the highest benefit given their rank in the organization), it was possible to determine what success would look like as far as how the problem was initially framed, how it was explained to city council and the public, and how it impacted the budget now and in the foreseeable future, as clearly the benefits must outweigh the costs at least in the long-term.

Nearing Agreement with the First Group

Not even the executive group, whose first counter-proposal early in the negotiations process addressed every component of what the city asked for, was really interested in being the first group to ratify an agreement for fear larger groups might negotiate something better. The city council, on the other hand, needed a deal to establish a baseline that other labor groups would hopefully follow, and they would not agree to a 'me-too clause.'[23] As the city neared final agreement with the executive group, the city council, who had become quite adept at understanding the fiscal implications of the proposals, made it known that they would make a limited *deficit spending commitment*[24] to try to solve the retiree medical issue meaning that those labor groups who came to the table and reached an agreement with the city the quickest would likely get the best deal, and those labor groups that stalled or refused to participate would get the

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depending upon which labor group an employee belonged to at the time of retirement and/or how many years of fulltime service he or she had with Inglewood).

[23] A 'me-too' clause is a term used in labor agreements that if agreed to provides the group who reaches accord to still benefit if another labor group in the near future negotiates something better or more valuable. Since it does not apply to something negative or a take-away, it is virtually never beneficial to an agency who agrees to it.

[24] The city's negotiations strategy called for the use of General Fund reserves to initially pay for the implementation costs associated with eliminating retiree medical. The city council agreed to earmark approximately $10.5 million over the next three fiscal years, with a cap during the current fiscal year of $3.25 million, to implement the alternative policy that eliminated retiree medical.

least attractive deal. In other words, there was only so much pie to go around, and the labor groups had better get it while it was still there or risk going hungry.

The New Policy—A Deal is Reached

In early February of 2014, the executives ratified a deal with the following basic terms:

1. Cash out of up to 1,000 hours of sick leave at 100% value instead of the typical 50% and have that money deposited into an employee-based Retiree Health Savings (RHS) Plan.[25]

Even though this provision resulted in several hundred thousand dollars of deficit spending out of the city's reserves, it provided two significant benefits to the city beyond the elimination of the unsustainable retiree medical. First, it eliminated a large piece of the predominately unfunded liability associated with accrued sick leave that would have to be paid out at 50% and most likely at higher hourly rates than when it was earned. Second, it put half of the burden of saving for future healthcare costs onto the employee (e.g., half the value of the sick hours converted was already owed to the employee). The benefit to the employee was also significant, as the city essentially matched the value of the employee's sick leave, which in some cases equated to almost 25% of a year's pay. Furthermore, this money avoids federal or state income taxes both at the time of deposit and the time of withdrawal based upon the features of an RHS Plan. This leveraged the U.S. Income Tax system as a way to help ease the pain.

2. One-time contribution to the employee's RHS Plan (e.g., 3%, 5%, 10%, or 15% of annual base pay determined by current tenure).

This provision was designed to "seed" the employee's RHS Plan account and provide more value for employees with higher levels of tenure yet provide something to those employees who perhaps did not have as much accrued sick leave.

3. Ongoing RHS contribution: employee—2% of salary; city match of 2% of salary.

This provision was designed to achieve an on-going "cost sharing" as it relates to retiree healthcare savings. When coupled with the tax-advantaged nature of the RHS Plan, the value to the employee is even greater. In essence, this was a 100% match of funds ongoing.

4. One-time departure contribution to the employee's RHS Plan (e.g., 3%, 5%, 10%, or 15% of annual base pay determined by tenure) upon separation from the city.

This provision was something the city agreed to with the executives only because they were the first to come to an agreement. No other labor group received both an initial "seed"

[25] A Retiree Health Savings (RHS) Plan is a tax-advantaged savings vehicle exclusively for qualifying medical expenses where the contributions, which can come from the employee and/or the employer, are made pre-tax, and earnings and withdrawals (e.g., distributions) are tax-free. Finally, unlike deferred compensation plans (e.g., 457 Plans, 401a Plans, 401k Plans, 403b Plans, etc.), there is no annual limit as far as contributions are concerned.

deposit and a departure payment, and similar to item 2 above, it includes a mechanism that provides more value for longer tenure, which in this case helps to retain executives.

5. Fixed Medical Premium Stipend/Allotment starting at retirement for 15 years of $850/month or $650/month depending upon tenure with the city at the time of the agreement.

This provision was the result of a spark of creative ingenuity—one of those moments where a person thinks they have looked at things from every possible angle and *voilà*…it hits you! One of the biggest problems with the retiree medical benefit was that it was an unbudgeted and uncapped payment. That is, the city was imprisoned by constant increases in medical premiums year after year, and making things worse, the pool of retirees (and their dependent spouses) also grew as longevities increased. This plus the impact of the economic downturn many have labeled the Great Recession made it virtually impossible from a budgetary perspective to allocate funds to cover these rising costs.

As such, the assistant city manager came up with the idea of offering a fixed dollar amount for a fixed term (15 years [180 months][26] or until the employee and dependent both passed away) in the form of a stipend or allotment toward the retiree's medical premiums. Provided the stipend/allotment goes directly from the city to its third-party benefits administrator and not to the retiree, it is considered tax-free. This allowed the city to amortize itself out of this crisis while still providing a very worthwhile benefit. Finally, employees have an irrevocable option of converting the total value of their stipend/allotment (if applicable) at forty percent (40%) value into a one-time RHS contribution at retirement. This was done to allow employees who may choose not to continue on the city's medical insurance after retirement to have a way to exchange the value of the stipend/allotment for "up-front" tax-free dollars . The idea behind the 40% exchange provision was similar to the 'net present value' calculation that is often akin to a person exchanging a winning lottery ticket with a guaranteed payout (e.g., an annuity) over a specific time period for a smaller amount of immediate cash. This provision also benefited those employees whose spouse may be covered by medical insurance.

Since the city council was adamant that the first labor group to come to an agreement would get the best deal, and the next groups that came forward would received a little less. As such, what was ultimately proposed and agreed upon with the remaining labor groups was slightly less than what was detailed above. The only major deviation from this structure was with the IMEO group whose consultant negotiators convinced them (erroneously) to argue for a simple buyout of the retiree medical benefit. This buyout involved two options: A $1,000 per year of fulltime service payable all at once or a tier-based payment arrangement based upon the tenure of the group's employees. Those with longer tenure received a higher dollar amount. The breakdown looked like this:[27]

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[26] The 15-year term for the stipend/allotment was designed to carry a retiring employee through to Medicare eligibility. Since the youngest a person could retire in the CalPERS system is age 50, this would take them to 65.
[27] IMEO MOU Adopted by the city council on June 17, 2014. (p. 27 of the MOU; p. 256 of linked document) http://www.cityofinglewood.org/agendastaffreports/06-17-14/dr1.pdf

Tiers Total Fulltime Years of Service to the City Prior to June 17, 2014	**Option B** Amount and Payment Terms
Tier 1 Twenty-five (25) or more years *(e.g., 300 months or more)*	**$90,000 paid over five (5) years** (e.g., $18,000 per fiscal year per person) Each payment shall be deferred into the unit employee's 457 Plan, and any portion remaining that exceeds the maximum allowable contribution as set forth by the IRS shall be deferred into the unit employee's 401(a) Plan.
Tier 2 More than twenty (20) but less twenty five (25) years *(e.g., 240 months to less than 300 months)*	**$75,000 over eight (8) years** (e.g., $9,375 per fiscal year per person) Each payment shall be deferred into the unit employee's 457 Plan, and any portion remaining that exceeds the maximum allowable contribution as set forth by the IRS shall be deferred into the unit employee's 401(a) Plan.
Tier 3 More than fifteen (15) but less twenty (20) years *(e.g., 180 months to less than 240 months)*	**$55,000 over eight (8) years** (e.g., $6,875 per fiscal year per person) Each payment shall be paid to the unit employee as taxable compensation. Each unit employee may choose to have all or part of each payment deferred into his/her 457 Plan provided he/she completes and files with Human Resources in a timely manner the appropriate paperwork at least two weeks prior to each payment, and any portion remaining that exceeds the maximum allowable contribution as set forth by the IRS shall be paid to the employee as taxable compensation.
Tier 4 More than ten (10) but less fifteen (15) years of service *(e.g., 120 months to less than 180 months)*	**$35,000 over eight (8) years** (e.g., $4,375 per fiscal year per person) Each payment shall be paid to the unit employee as taxable compensation. Each unit employee may choose to have all or part of each payment deferred into his/her 457 Plan provided he/she completes and files with Human Resources in a timely manner the appropriate paperwork at least two weeks prior to each payment, and any portion remaining that exceeds the maximum allowable contribution as set forth by the IRS shall be paid to the employee as taxable compensation.
Tier 5 More than five (5) but less ten (10) years of service *(e.g. 60 months to less than 120 months)*	**$20,000 over eight (8) years** (e.g., $2,500 per fiscal year per person) Each payment shall be paid to the unit employee as taxable compensation. Each unit employee may choose to have all or part of each payment deferred into his/her 457 Plan provided he/she completes and files with Human Resources in a timely manner the appropriate paperwork at least two weeks prior to each payment, and any portion remaining that exceeds the maximum allowable contribution as set forth by the IRS shall be paid to the employee as taxable compensation.
Tier 6 Less than five (5) years *(e.g., less than 60 months)*	**$1,000** per year of fulltime service to the City Each payment shall be paid to the unit employee as taxable compensation. Each unit employee may choose to have all or part of each payment deferred into his/her 457 Plan provided he/she completes and files with Human Resources in a timely manner the appropriate paperwork at least two weeks prior to each payment, and any portion remaining that exceeds the maximum allowable contribution as set forth by the IRS shall be paid to the employee as taxable compensation.
Tier 7 Existing City employees who promote or transfer into IMEO	***Employees shall retain the benefits of their previous bargaining unit.***

On June 17, 2014, the assistant city manager presented five of the six MOUs to the city council for adoption.[28] This left SEIU, which declared impasse, as the only labor group without an MOU. The city's team put together an impressive presentation for the fact finding panel, which persuaded the fact finder to ask SEIU's representatives on several occasions during the hearings why they had not taken the city's offer. This dramatically turned the tide. SEIU, fearing a lower Last, Best, and Final offer, called for an emergency ratification meeting and overwhelmingly ratified the once-rejected "concept" deal a week later.

[28] http://www.cityofinglewood.org/agendastaffreports/06-17-14/dr1.pdf

The projected savings inherent to the implementation of the alternative retiree medical benefit plans contained within the six MOUs reduced the unfunded liability from the staggering $199 million projected in the actuarial analysis to $35.2 million over 30 years. This represented a reduction of almost $164 million or 82%, effectively saving the city from insolvency.[29]

Policy Implemented—Moving Forward to the Present

While only three and a half years have transpired since the implementation of this policy, it is clear that the policy is a success. There are several metrics that serve to justify this success. First, the city used reserves to pay the upfront 'down payment' on the amortized costs eliminating a significant portion of the initial costs. Second, the city now budgets annually for the costs associated with the retiree medical alternative because those costs are not only quantifiable, but also manageable. Third, and probably most importantly, the employees are starting to adjust downward their entitlement expectations. Hopefully, this trend will continue well into the future.

Conclusions—What the Future Could Look Like?

The success of this policy implementation will unless a future city council reverses the trend and is pressured to give into the demands of labor and provide an unsustainable benefit like the one that was eliminated. This is extremely unlikely, as the nature of collective bargaining is such that once a benefit is eliminated, it is very difficult to negotiate it back. Plus, as time marches on, the memory of the benefit will dissipate and be replaced with new desires from labor, which are likely to focus more on salary and possibly trying to preserve their unsustainable pension benefits. Fortunately (or not), pension benefits are dictated by state law here in California making them less likely to be impacted by the local jurisdiction but more susceptible to global modification by the state legislature.

Overcoming the resistance to this change—one on the part of the employees and the other on the part of the legislative body—also provides vision and direction to other entities that must grapple with the same or similar scenarios. While this policy and the research that went into it cannot undo the bad practices of the past, it can provide guidance for the future, as other jurisdictions facing similar situations can use this as a guide for effectively solving their unfunded (or partially funded) liabilities related to retiree medical. As more jurisdictions recognize what Inglewood has done, the stage is set for them to begin these discussions. Thus far, several other agencies have begun the process of trying to eliminate their retiree medical benefits in favor of something similar to what Inglewood has done. This is a perfect example of what at Sabatier and Weible describe as the Diffusion of Innovations Framework, which intimates that adoption of a policy or new program is predicated on two components: internal determinants and diffusion. Internal determinants are those factors such as politics, economics, or social characteristics specific to that jurisdiction that lead it toward innovation.[30] Diffusion[31]

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[29] See Exhibit A of the agenda staff report dated June 17, 2014 (p. 11) http://www.cityofinglewood.org/agendastaffreports/06-17-14/dr1.pdf

[30] Sabatier, Paul A., and Christopher M. Weible. 2014;2009;. *Theories of the policy process*. Third; 2nd; ed. Boulder, CO: Westview Press, a member of the Persus Books Group. p. 308

on the other hand describes the way in which a policy or program transcends from one government entity to another (e.g., 'jurisdiction x adopted it, therefore it is good enough for us').

Recommendations

Many local government agencies are facing a crisis as it relates to their ability to fund ongoing costs associated with pensions and medical benefits. Despite the pickup in the overall economic conditions since the Great Recession, the public sector is still dealing with massive increases in pension costs and medical benefit costs. When these costs are related to anticipated future payments (e.g., future pension costs due to *smoothing*[32] or medical benefits for retirees and their dependents), they typically require that the jurisdiction allocate a portion of their General Fund to support the future liabilities created by these costs. When local governments budget (e.g., set aside) funds in a reserve account for these future costs, these costs are said to be funded (or partially funded, if the expected full amount is not set aside). When a local government has no designated reserves for these liabilities, they are said to be unfunded. GASB-based accounting regulations[33] require that agencies list these unfunded liabilities on their financial statements, which can negatively impact their bond rating (e.g., their ability to borrow funds). The two primary contributors to unfunded liabilities within a government agency are future pension increases and the future costs associated with medical benefits promised to existing employees when they retire, the latter of which is often called an OPEB (Other Post-Employment Benefit) Liability.

While it is somewhat obvious that all jurisdictions that have not evaluated their current and future ability to cover these obligations begin to implement corrective action before it is too late, simply recommending it is not enough. Many agencies must be forced to address their problems. As such, there should be at the very least state-level (if not federal-level) mandates that force local governments to move toward fixing their OPEB Liabilities. This is clearly easier said than done. Thus, it will require some out-of-the-box solutions, which might include combining geographically connected jurisdictions together (or at least implementing a shared-services model much like a county providing police or fire services for multiple jurisdictions within its boundaries or a larger adjacent city extending certain services to a smaller neighbor for a fee that would hopefully create economies of scale), increasing the number of public-private collaborative-based solutions (which could lead to outsourcing), and what might be the most impactful, which is reducing the promised benefits and requiring a greater degree of recipient participation. Whether or not these recommendations are politically feasible depends upon a host of variables, but the inability to continue paying for them will create the puncture in the equilibrium that will lead to change.

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[31] Diffusion according to Rogers is "the process by which an innovation is communicated through certain channels over time among the members of a social system." Rogers, Everett M. 1995. *Diffusion of innovations*. 4th ed. New York: Free Press. p. 5

[32] *Smoothing* is the term used by most pension systems whereby participant agencies are not burdened with abrupt increases or decreases in pension-related premiums due to significant changes in the market. Typically, the pension system will phase the increases or decreases in over a period of 5 to 10 years (e.g., they *smooth* out the change) so the jurisdictions can more easily budget for the change in premiums year to year.

[33] GASB (Governmental Accounting Standards Board) is the entity that generates what are often referred to as generally accepted accounting principles (GAAP), which virtually every State and local government agency uses when preparing their budgets and financial statements.

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