
How to Retire Using Other Peoples' Money--1/5/09

Another in a series of reports that looks at the benefits Vallejo Public Safety Union (PSU) Employees receive.

ASSUMPTIONS

For all calculations wages of workers were \$114,000 per year. The \$114K figure was chosen as this is the current average salary of a Fire Fighter who is receiving Educational and Longevity Incentives (without any overtime). The full contract rate (if reinstated) is \$130,000.

Maximum Social Security Contribution was estimated to be \$7,000.

For a 401K it was assumed that if an employee sets aside \$15,000 in their 401K, the employer would provide a match of \$7,500--this is an optimistic assumption.

The yearly withdrawal from the 401K was assumed to be between 4% and 5% per year. Thus from a 401K initially worth \$1,000,000 a person would be able to withdraw (adjusted for inflation) \$40,000 to \$50,000 per year for 30 years.

The chart below compares the retirement benefits that Vallejo PSU members receive versus other Vallejo City Workers, Federal Employees and Private Sector Workers .

EMPLOYEE
Other CITY

Employees
Federal Govt
Private

Sector

Retirement Age
50
55
55
66

Years Required

to retire
30
30
30
Typically

42 to 45 years

Employee Contribution

for \$114K Gross wages
\$10.3K
\$10.3K
\$8K
Maximum
\$15K to \$20K

EMPLOYER Contribution

for \$114K gross wages
\$32.0K
\$19.1K
????
Maximum match
\$7.5K

Amount of Pension

per year if final

Gross Pay \$114K
\$102K
\$92.3K
\$63.8K
Estimate-\$56K+

Cost of Living Guarantee
YES
YES
YES
NO

NOTES
Get 90% of

Highest yr

Compensation
Get 81% of

Gross Wage+

Soc Security
Get 56% of

last 3 yr average
includes SS& 401K

assumes contributed

max amts for 40+ yrs

Non PSU also contribute 7.65% for Soc Security.

Gross wage

includes:

a)clothing

allowance

b)unused sick days

c) holiday pay

In most instances

employees making

more than 100K will

need to create other

taxable pension funds
to reach 90%+ of
final salary

FINDINGS

1) The City must contribute an extra \$2,580,000 to \$3,000,000 (for current employees) per year to the PSU retirement plan because PSU employees can retire at age 50 (3.0%@50) instead of age 55 (2.7%@55).

2) Vallejo PSU members receive an unusually rich retirement package. They are able to retire at age 50 and receive 90% of their highest compensation adjusted for cost of living. In comparison, other City/Government workers retire at age 55 while most in the private sector retire at age 66. As with other City employees they also receive FREE health insurance when they retire.

3) Despite being able to retire at a younger age Vallejo City Employees contribute less to their retirement than do workers in the private sector.

Although Federal Employees contribute slightly less than Vallejo City workers, Government Employees would have to work 48 years (versus 30 for a PSU member) to receive a pension worth 90% of their final salary.

4) The City's Employer's pension match is extremely generous--about 3 to 1 for PSU members.

Employees in the Private Sector normally get no more than a 0.5 to 1 match --in many instances this match is being eliminated. For the private sector the percent of the employer match goes down for those making more than \$100,000.

While the average City of Vallejo pension match for a Fire Fighter is about \$32,000 per year it rises to \$51,500 per year for an Assistant Fire Chief.

COMMENTS

The City of Vallejo is in the worst of all situations with its current pension plan.

Not only does Vallejo have a defined benefits plan (the size of the pension is guaranteed) with adjustments for cost of living but, the amount it contributes per employee is about 2.5 times more than the private sector.

All of the above factors put the City at risk as the City has to make up for any future shortfalls.

While non PSU employees gave up pay raises to have their pension plan increase from 2%@30 to 2.7%@30 the City was the loser.

For employees, the extra contribution made by the City is initially sheltered from Income Tax and Social Security. The City's liability is that it has to guarantee that the pension pays an additional 35% (adjusted for inflation) per year--not bad for giving up a 5% raise for one year.

RECOMMENDATIONS

If possible the City should change from a defined benefit pension plan to a defined contribution plan similar to what is offered in the private sector. A defined contribution plan would remove the large unfunded risk the City currently has with defined benefits.

If employee's contributions were increased to 15% and the average wage for of the last 3 years, the City would also experience a significant and immediate savings.

As a fallback the City needs to roll back the current PSU pension plan to a 2.7%@55, have all employees contribute more and use the last 3 year average of wages.

If the 3%@50 plan cannot be changed then the PSU employee contribution should increase to at least 22%.