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TO: Board of Finance

FROM: Jonathan P.A. Leopold, Jr.

DATE: November 12, 2010

RE: Funding for Retirement Benefits and FICA for School Department Employees

I am writing this memo pursuant to the discussion we had regarding this issue at a meeting of the Board of Finance last month. As you know, the Budget Consultant Report by George Cross dealt extensively with the issue of the appropriateness and potential cost savings to Burlington taxpayers by funding the costs for School employees' FICA and retirement benefits through the School budget and tax rate rather than the municipal tax rate. Mr. Cross' report details the magnitude of the retirement system and FICA costs for non-teacher School employees that are currently paid under the municipal retirement tax rate. The report also provides a calculation of the significant financial benefit to a majority of Burlington taxpayers of properly funding these costs through the School Department budget and tax rate.

The transference of these costs from the municipal tax rate does not adversely affect the overall tax rate for either residential or commercial taxpayers. In general, the transfer of this funding source would result in an increase in the School Department tax rate and an equivalent or potentially larger decrease in the municipal tax rate. More importantly, if these costs are born through the School Department tax rate, a majority of Burlington taxpayers would benefit from the income sensitivity factors for school taxes.

There are three other significant issues not covered in the Cross Report. These issues are the concept of governance and financial obligation, the funding of retirement and FICA benefits for employees who are not funded from general tax revenues and the determination of the assets and liabilities to assign to these employees.

In the past ten years retirement benefits have become a matter subject to collective bargaining. Previously, retirement benefits were not bargained and were determined by the City Council. As you know, the City is currently bargaining with all four municipal unions to change retirement benefits to reduce the magnitude of the City's unfunded liability. The City Council which is responsible for setting the tax rate to pay for retirement benefits for municipal employees also has direct responsibility for the bargaining with City municipal employees.

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However, the City Council and Mayor do not have any direct or substantial indirect role in collective bargaining with School employees. The employees of the School Department are represented by five different bargaining units not including non-union employees not in a bargaining unit or association. The School Department administration and School Board have sole authority relative to the collective bargaining process and determination of retirement benefits for School employees.

Thus, there is a significant dichotomy between the authority and responsibility for bargaining and determining retirement benefits and the responsibility for funding the costs of those same benefits. Under the current construct, the City Council is responsible for funding the costs of retirement benefits while the School Board and administration are responsible for determining what those benefits will be. I believe it is a fundamental principle of good governance that the party responsible for defining and determining the costs should also be responsible for funding those same costs. It is problematic to dichotomize the authority for defining the benefits and the responsibility for funding those same benefits.

The second major issue relative to this matter is the current funding of FICA and retirement benefits for School employees who are funded through grants and/or special revenues separate and distinct from the School Department General Fund. As you know, the retirement property tax is for the retirement benefits and FICA for General Fund employees. All non-General Fund employees in enterprise funds, special revenue funds or grant-funded programs pay the cost of retirement benefits and FICA from these revenue sources. However, currently the retirement benefits costs and FICA costs for School Department non-General Fund employees are being billed to and paid by the municipal property tax rate. This practice is contrary to City policy and to the intent of this property tax rate authority. School Department employees who are funded in general by grants and special revenues should either have the retirement and FICA costs paid for from these same revenues or, alternatively, these employees should be deemed "limited service" employees such that they do not qualify for retirement benefits and the costs of their FICA is paid for from these same revenue sources.

Finally, the third issue is the unfunded liability for School Department employees. In 2006 when City and School employees began contributing to the cost of the Retirement System, it was determined by the School Department that there were a significant number of School employees who had not previously been reported as retirement eligible and should have been. As a result, there was a significant increase in the number of School employees with a significant liability for prior years' service that had not previously been funded prior to their identification in 2006. This issue has not been previously reviewed in detail and I am not able to provide a sense of the magnitude of this liability. However, it is clear that there is a higher portion of unfunded liability associated with School employees generally than the overall liability for municipal employees. As a consequence, in the event that the responsibility for funding benefits for School Department employees is actuarially segregated from the funding for all municipal employees, it will be necessary to determine the proper amount of assets to be credited to the liability for

School employees and thereby determine the appropriate level of unfunded liability and the consequent annual cost to amortize that liability.

CONCLUSION

In conclusion, I strongly urge the Board to begin discussions in earnest with the School Administration and School Board on how best to proceed to resolve these issues. I think it is particularly important to also request a legal analysis of how best to structure the transference of funding responsibility and capacity for the retirement and FICA benefits for School employees. Ideally it should be possible to propose either a charter change or a separate tax rate item that would transfer this authority, provide the School Board and Department capacity to insure proper funding for these costs and to clearly demonstrate to voters that this is simply a transfer of costs and not a net increase.

While I appreciate that the School Department and Board are well into the preparation of the Fiscal Year 2012 budget, the resolution of this matter is effectively budget and tax rate neutral. While this is a complicated issue, there is the potential for a significant financial benefit to Burlington taxpayers. Moreover, this matter has been discussed now for several years and it is overdue to resolve this.

Cc: Jeanne Collins
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Ken Schatz
Mike Gilbar
Fred Lane