PATH TO FISCAL SOLVENCY

ORIGINS OF A FIRE DISTRICTS' FISCAL DEFICIT

Intended to provide background information about a Fire Districts' operating deficit.

Introduction

This document was written in an attempt to memorialize events that have taken place within the El Dorado County Fire Protection District. Like many public agencies across the nation, this Fire District faced many challenges after the housing market collapse, and subsequent events during the "Great Recession". This District was forced to make changes to its financial business model, in an effort to avoid further fiscal demise. The majority of changes this District has made have come in the form of salary and benefit concessions from active duty and retired firefighters that have always provided our citizens with a high level of service and professionalism. While this document makes every effort possible to list the events in an accurate and sequential fashion, it must be emphasized that no specific individual or specific group is solely responsible for the financial challenges this District has faced. It would be erroneous and unfair to project or determine that the culminated financial events that had transpired within this Fire District belong to anything other than systemic events and conditions that were many years within the making. Through a collective interest-based effort, this District has continued to seek economies of scale and models of efficiency that provide the highest level of service possible to our constituency. If there are any noted errors or omissions within this document, please feel free to contact us and we will be willing to consider all opposing viewpoints for possible further amendments.

Background

In the spring of 2012, the Uniformed Firefighters Association of Local 3556's ("Local") Union President was advised by the Fire Chief of the El Dorado County Fire Protection District ("District") that the District was experiencing significant financial challenges. The Chief indicated there was a very high probability that salary concessions equal to 5% of pay would be necessary to address the financial challenges of the District. The Union President communicated this information to a Captain within the District, who was also assigned as the lead negotiator for the Local's MOU contract negotiations.

Formal contract negotiations began between the District and the Local. At that time, the Local's bargaining team maintained that a transparent picture of the overall financial situation of the District was critical to enable both the Local and the District to gauge the financial path of the District and to accurately articulate this information to the members of the Local and to the Board.

Initially, several inconsistent variations of the District's overall financial health began to surface at the bargaining table. In response, an in-depth vetting of the District's financial situation was undertaken by the Local. What would ultimately be revealed at the bargaining table by the Locals' negotiation team was that there was a lack of fiscal accountability, oversight, and transparency within the District.

As the full extent of the financial crisis was unveiled, it became apparent to the Local that it would be necessary for it to make salary concessions in order to put the District's financial house in order. While members of the Local were aware of the global effects of the 2008 housing crisis and the following recession, the magnitude of the impact was never properly reflected in the District's financial documents. Up until 2012, it was a widely held belief within the organization that the Districts' financial position was solvent enough to endure the recession.

Although the District suffered decreases in annual property taxes, it was later revealed that the District maintained an internal insulator within Prop. 13, as most of the homes within the Districts' constituency were of older construction and the District had not seen a large amount of residential development within recent history. These factors are viewed in comparison to other municipalities throughout the U.S. that had seen large housing booms within their municipalities prior to the recession and contributory decreases in annual revenue with the housing market crash. The District suffered an annual loss in the secured property tax revenue in Fiscal Year 2009 – 2010 of approximately $300,000. This was followed by an additional annual secured property tax loss of $400,000 in Fiscal Year 2010-2011. After this time, the District began to experience revenue stabilization, followed by marginal annual tax revenue growth.

While the decrease in property tax revenue certainly contributed to the fiscal problems of the District, it was readily apparent that the cornerstone of the problem was centered on the ever increasing costs of the District. Unfortunately, administration failed to identify the full extent of the problem until a severe budget catastrophe was upon us. Up to this point in time the fiscal situation had been described as difficult but manageable. In fact, as time progressed, it became apparent that unless significant changes were implemented, the District would not be able to meet its financial obligations. Ultimately the following financial status and municipal debt obligations within the District were revealed:

- Fiscal Year 2009/2010, Revenue Less Expenditure = Deficit $584,000
- Fiscal Year 2010/2011, Revenue Less Expenditure = Deficit $1,036,878
- Fiscal Year 2011/2012, Revenue Less Expenditure = Deficit $1,426,371
- Fiscal Year 2012/2013, Revenue Less Expenditure = Deficit $1,419,048
- JPA loan-labor dispute resulting in a debt obligation of approximately = $750,000
- Miscalculation on the funds required to pay-off the loan received to rebuild Fire Station No. 28, resulting in a debt obligation of approximately = $1,000,000
- Administrative budgeting miscalculation resulting in an increase in costs of approximately = $600,000
- Total deficit(s) and debt(s) obligations, approximately = $6,816,297

As this information was later presented to the Local, it would ultimately culminate in a vote of no confidence in the leadership of the Fire Chief.

How the deficit was closed

After the vote of no confidence in the Fire Chief took place, an Assistant Chief within the District was appointed as the interim Fire Chief and assigned the colossal challenge of formulating a plan to help guide the District away from a looming fiscal crisis that seemed inevitably to be heading towards the municipal bankruptcy process. The interim-Fire Chief began to proactively engage the leadership of the Local and both parties began to engage in true interest based negotiations that brought concrete solutions to the negotiation table. As the gravity of the fiscal state of the District began to be revealed, several difficult measures were employed in an effort to close an annual deficit of roughly $1.4 million dollars. The following lists the source of the funds used to fill the deficit:

- A 9% concession with NO offset for the employees was made by employees picking up 9% of the "Employer Paid Member Contribution" (EPMC) of the calPERS costs, which yielded roughly $385,000 of annual savings towards closing the $1.4M deficit.
- Administrative position contraction: 3 Chief Officers, 1 IT position, 1 Maintenance position, and 1 Administrative Specialist position were eliminated within the District, which would yield roughly $850,000 of annual savings towards closing the $1.4M deficit.
- Overtime costs: Overtime costs are derivatives of employee sick and vacation use. All rank classifications within the District forfeited and reduced their annual sick and vacation leave accruals to reflect the following; Vacation days forfeited from maximum accrual eligibility = 2 days annually, Sick days forfeited = 3 days annually, employee personal holiday forfeited = 1 day annually. Additionally, annual vacation allowance is now a 1 time, annual stipend, so the vacation leave budget is 100% funded for the District. Total savings from sick, vacation, and personal holiday forfeiture = roughly $200,000 of annual savings towards closing the $1.4M deficit.
- Training costs: Firefighters within L3556 previously received training reimbursement provisions within their MOU. Restructuring within the parameters of this provision provided the District with roughly $40K of annual savings towards closing the $1.4M deficit.
- Total savings that were derived from employee concessions and elimination of positions within the District = approximately $1.5 million, essentially eliminating the operating deficit.

Additionally, during this time period Medic 26 was removed from service. The District was required to absorb individuals into its annual budget, for which it had not previously budgeted. Through continued collaborative efforts between the District and the Local, the Local had agreed to side letters of understanding to allow for the use of firefighters assigned to Engine 28 and Engine 72 to function as "floaters" within the District, essentially assisting with overtime costs, as the District attempted to regain control of its finances.

The District and Local would ultimately agree to dissolve the side letters in recognition that a mutual relationship with shared goals insuring long-term fiscal sustainability would be necessary as the District emerged from its previous financial state. The ability to absorb these firefighter positions into the annual budget provided a framework that allowed these mutual goals to be identified, and conceptual conversations began to take place recognizing the importance of rebuilding the District reserve fund and the priority of fire apparatus replacement within the District. A slow, but forward progression began to be implemented within the District.

Material changes and paradigm shifts towards maintaining solvency

After closing the structural deficit, both parties acknowledged that financial planning for the future of the District would require an analysis of the increasing costs that were outstripping the somewhat static revenue of the District. One of the major costs that were continuing to increase significantly on an annual basis was healthcare. It was apparent that a realistic solution moving toward fiscal stability would require some of the additional health care costs to be borne by both the active and the retired employees of the District. With many agencies and municipalities in the United States, annual healthcare increases are automatically built into budget proposals as a passive process, rather than an interactive collective bargaining process. Maintaining this passive practice within the District would have prevented the District from moving toward a stable financial future. The District's annual revenue post the recession had been marginal, at best. Any revenue growth projections would have been quickly eroded by annual healthcare increases. The problem was magnified by a projection of active-duty employees continuing to enter into the retiree healthcare demographic. Success was achieved in being able to inoculate and cap monthly healthcare limits and by shifting away from healthcare budgeting as a passive tenet. Now, the ever increasing health care costs were included in the collective bargaining process, where increases would only be awarded if the District was financially in a position to do so. Acknowledging that retiree health care was a significant and ever increasing component of these costs, the District also implemented a paradigm shift for retirement healthcare. This paradigm shift only affected active-duty personnel who were hired after 1991, reducing their previous post-retirement benefit from employee + dependent healthcare, to employee only healthcare. Although it was stressed by the Locals' negotiation team in 2012 that all active-duty employees, irrespective of their hire date needed to accept the paradigm shift for post-retirement healthcare, not all members of the Board of Directors at that time were willing to make the changes and agreed only to paradigm shifts for employees hired after 1991. A description was offered that described how retirement healthcare costs would continue to increase as more retirees entered into the retirement demographic, and ultimately, the post-retirement monthly allowance would need to be reduced in an effort to accommodate these demographic changes. Although these projections were not accepted in 2012; ironically, further monthly healthcare reductions have occurred to retired employees in an effort to accommodate an equitable distribution for additional retirees entering into the retirement demographic, which accurately reflect the predictions in 2012.

Infusing capital within the District

Although the District was successful in closing the deficit and implementing components of long-term economic sustainability through the reduction of costs, the ongoing economic fatigue had taken its toll within the agency. The entire reserve fund was virtually eliminated, many equipment repairs and replacement needs had been deferred, and the entire fleet of first-out fire apparatus was in dire need of replacement. The timing of these factors came with the unfortunate news from the County Auditor's Office that the District did not have sufficient unrestricted reserve funds necessary for the remaining fiscal year of 2013-2014 in order to hedge against costs until the tax revenues were actually received by the District throughout the fiscal year. The District was forced to "brown-out" Engine 21, located in Camino, in an effort to satisfy its financial obligations for the remainder of the fiscal year.

During this time, a Division Chief and Captain within the District realized the potential for a much needed salary savings scenario within the District. A conceptual 3 year operational plan that included an economic syntax was utilized in an effort to address the financial needs within the District. A plan and proposal was made to reorganize the service delivery model within the District, and strategically re-deploy the personnel off of Engine 21 throughout the District as hiring recommenced in phases. This phased in model would require a calculated, hands-on approach in order to allow the District to realize the much needed reduction in costs and corresponding capital infusion under this plan. It was obvious that relying on marginal property tax revenue increases alone would never allow the District to fully upright its financial ship. The primary goals of the District reorganization process were intended to accomplish the following:

- Rebuild the District reserve fund
- Pay-off municipal long-term debt obligations
- Purchase new fire apparatus
- Budget for projected employer calPERS increases, and assist with hedging against these increases through the hiring of FF/EMT vs. FF/Paramedic positions, and acknowledging the decrease in costs associated with <u>2.7%@57</u> vs. 3%@50 benefit formulas for future hiring

The District’s fiscal state in Fiscal Year 2015/2016

The District reorganization process was built on a conservative platform, that allowed flexibility if needed due to unforeseen financial constraints. Although it was a “working document” it provided a much needed plan for addressing needs that could no longer be ignored within the District. Although it was the first of its kind within the 25 year history of the District, it has proven to be immensely successful. The following bulleted items reflect its year to date success:

- 5 fire engines and 3 command vehicles purchased in cash in FY 15/16, to avoid interest payments
- District year to date reserve(s) at the writing of this document, approximately $2.3M
- District reserve(s) fund projection at the end of FY 16/17 = approximately $3.5M

Addressing comments, concerns and items of interest

This District tremendously values our employees, both active and retired, and their service to the community. While this District remains steadfast in acknowledging our previous mistakes and learning from them, we are also committed to remaining transparent with the public on all items of compensation that have been awarded to the employees of the District, including our retired employees. The District offers the following response(s) to items of interest that have been raised by retirees of the District:

“Did the District pay cash for their new fire engines?”

Yes. The District paid cash for 5 new fire engines and 3 command vehicles during the FY 2015-2016. This enabled the District (and ultimately the taxpayers) to avoid unnecessary charges on interest payments. It also provided additional savings as a discount was applied to the overall cost for pre-payment of the vehicle production. We feel strongly that these engines ultimately belong to the taxpayers, and the taxpayers deserve to have a modern force in readiness responding to their emergency, should the need arise.

Additionally, the District is now setting aside a general obligation of $250K/year, to allow for the replacement of the fleet on a 10 year cycle. This was not able to be accomplished in the past, as that money was consumed by salaries and benefits. We believe you will not find many fire departments that have general obligation “set asides” that will allow them to replace their fleet of fire engines in a timely fashion. The District is proud to have taken this step to further demonstrate our commitment to be prepared to handle the emergencies of our community not only today, but in the future as well.

“Did the District make cuts to retiree healthcare to pay for fire engines?”

No. This document explains the origin of the fiscal crisis and how the deficit was closed. Changes to retirement healthcare were necessary in an effort to accommodate future employees joining the retirement demographic. The description of this increase in cost and conversely, the cuts that would be required to sustain the increase in costs associated with more employees joining the retirement demographic, was estimated with almost complete accuracy in 2012. There was a reluctance of the Board at that time to change the retirees’ contribution toward health care costs. However, it soon became apparent that any true resolution of the health care cost issue would require a paradigm shift to accommodate the additional firefighters retiring and the resulting increase in retiree health care costs. The following illustration is provided as an example to acknowledge how this scenario would be unsustainable:

Retirement healthcare costs with employee + dependent(s) eligibility	Number of retirees	Year (age eligible employees)	Increase (total)
$900,000	52	2012	
$1,092,000	62	2015	$192,000
$1,168,800	66	2019	$268,800

“The Union is paying for their retirement, but they received raises to pay for it”

This statement misrepresents the facts regarding the employees paying for the “employer paid member contribution”, and the District and the Local engaging in “cost sharing”. Beginning in 2013, all safety employees within the District began paying for the “employer paid member contribution”, which equals 9% of employee pay. This was part of the concession package employees contributed to, in an effort to close the $1.4M deficit. The employees did not receive any offset for this contribution. From 2014 – 2016, all safety employees began a process of what the Public Employee Pension Reform Act (AB 340) of 2013 refers to as “cost sharing”.

The “normal cost” for the District is roughly 20% annually. From the 20%, all “classic” safety employees have agreed to assist the District in paying for 6% of the 20%. Through the sharing with this contribution, the District has awarded a total of a 5% offset, for a combined total of a 6% pick up. In total, all “classic” safety employees will be contributing 15% of their salary towards pension costs, and have received a total of a 5% offset for doing so. Additionally, this 5% offset was created in the form of an additional step raise, only eligible for an employee who had reached all step pay increases. Not all employees have received this last step raise, because they have not met the time in service requirement; however, irrespective of a step classification, ***ALL*** “classic” employees will be paying 15% of their salary towards pension costs in 2016.

Also, AB 340 requires all “PEPRA” employees (employees hired after 1/1/2013) to contribute towards half of the employer normal costs, upon employment, which is equal to 11.5%. The Local agreed to an MOU provision that will have ***ALL*** employees contributing 15% of their salary towards pensions in 2016, irrespective of their classification being either a safety “classic” employee, or safety “PEPRA” employee.

“Did the District take from the retirees to give to the active employees?”

No. Some individuals have chosen to speculate that with all of the financial challenges the District has faced, the District has started to award compensation increases, which have not had containment measures associated with them. Since both active and retired public employees’ salary and pension information is considered public information, the following table will help to clarify that inaccuracy.

Rank	Active or retired	Annual PERS contribution	Adjusted Gross Income after PERS contribution (Pension data as recent as 2014)
Fire Chief	Retired	0%	$136,920
Fire Chief	Active	15%	$132,600
Captain/PM	Retired	0%	$92,905
Captain/PM	Active	15%	$86,275
Firefighter/EMT	Retired	0%	$71,315
Firefighter/EMT	Active	15%	$65,450

"Retired employees were promised lifetime healthcare"

The negotiated MOUs with all employee groups always acknowledged that health care costs could spiral out of control and necessitate contributions from both active and retired employees. This District does not relish in any of the reductions it has had to make to the employees' salary and benefit package, whether they are an active-duty employee, or a retired employee. When the District discovered the operating deficit in 2012, it became very apparent that it was struggling with an expenditure issue. Looking the other way and not bringing solutions to the table was not going to solve the problem and could have resulted in the District filing for bankruptcy. One of the items the District takes complete ownership in is the fact that it had given extremely generous benefits to its employees, even when it was to the District's own detriment. The District has been able to make the difficult, yet necessary decisions in the spirit of cooperation with the Local. Active duty and retirement healthcare is a negotiated item, and shall be provided pursuant to the terms of each applicable MOU. The following illustration is provided as an example to acknowledge how without freezing the annual retirement healthcare costs, the annual increases would have not been sustainable:

Year	Retirement Healthcare costs	Annual Increase	Increase from previous year
2012	$900,000	12%	$108,000
2013	$1,008,000	8%	$80,640
2014	$1,088,640	5%	$54,432
2015	$1,143,072	11%	$125,737
2016	$1,268,809	4%	$50,752
2017	$1,319,561	5%	$65,978

There are retired firefighters that retired prior to others, and in doing so, receive less of a pension benefit, as they were not working when certain salary increases were awarded"

Most of our retired firefighters were eligible for the Senate Bill 400, pension enhancement known as "3%@50". When this benefit was awarded, it provided prospective pension enhancements, as well as retroactive pension enhancements to many of our active, and now retired employees. There were many employees in our District that received credit for over 20 years of service, through retroactive pension enhancements. These enhancements equated to a 50% salary increase for some employees, an example is illustrated below.

Salary	Benefit	Years of Service	Age at retirement	Total Pension eligibility	Pension benefit increase
$50,000	2%@50	25	50	$25,000	
$50,000	3%@50	25	50	$37,500	50%
$75,000	2%@50	25	50	$37,500	
$75,000	3%@50	25	50	$56,250	50%

Additionally, the pension formula of 3%@50 allowed an employee to retiree with a maximum of 90% of their base salary, in comparison to 75%, prior to the enactment of SB 400. While at the time of the SB 400 enactment, it may have appeared that these changes would minimally impact employers throughout the State of California as the calPERS fund was considered to be "super funded". Unfortunately, these enhancements to pension benefits are still being paid for by the District. The magnitude of the costs for these benefits would surface for the El Dorado County Fire Protection District in 2015, as the Governmental Accounting Standards Board (GASB) adopted GASB statement no. 68, requiring our District to report our net pension liability. As of 2015, the El Dorado County Fire Protection District reported the following net pension liability for safety and miscellaneous classifications:

Safety = $15,421,789 of an unfunded actuarial liability

Miscellaneous = $ 500,000 of an unfunded actuarial liability

When the Public Employee Pension Reform Act of 2013 was implemented, all employees who were hired prior to 2013, whether they are safety or miscellaneous classifications, are now considered “classic” employees. This definition is irrespective of a retirement formula of 2%@50, 3%@50, 3%@55, etc, ***for both safety, and miscellaneous classifications***.

The following graph(s) illustrate the ***annual*** payment the District is required to pay to calPERS, for all “classic” active and retired safety and miscellaneous employees. This payment represents the unfunded actuarial liability, “UAL”. It is being paid in addition to the Districts’ normal costs. As mentioned earlier in this document, the District pays roughly 20% of covered payroll for “classic” employees, on an annual basis. The normal cost represents the current year’s benefit accruals. Typically, contributions in a given year are enough to cover that year’s normal cost, with additional contributions applied to any of the previous years’ obligations, if they are not fully funded. The “UAL” is the amount that is still “owed” to fund for past obligations.

*Safety	Required Contribution	Required Contribution	Required Contribution	Required Contribution	Required Contribution	Required Contribution
	2016/2017	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022
Normal Cost%	19.5%	19.5%	19.5%	19.5%	19.5%	19.5%
UAL $	$834,541	$1,029,444	$1,235,289	$1,452,559	$1,544,926	$1,646,477

*Misc. employees	Required Contribution	Required Contribution	Required Contribution	Required Contribution	Required Contribution	Required Contribution
	2016/2017	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022
Normal Cost%	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%
UAL $	$43,563	$48,490	$53,673	$59,124	$62,011	$65,067

As illustrated in the previous graphs, it can be observed that the Districts' annual unfunded actuarial liability payments towards calPERS, has an upward and outward trajectory of roughly greater than 50% for both safety and miscellaneous active and retired personnel. It must be emphasized that the projected employer contributions are a snapshot from year to year. There are 3 main components that reflect an employer's unfunded actuarial liability. These components reflect the following:

- Retroactive enhancements
- Return on investment greater or less than calPERS projected annual return on investment(s) of 7.5%
- Changes in the actuary such as life expectancy increases or decreases, and more retirees being added to the retirement demographic, through future retirements.

With more projected time in service retirements within the next few years for the District, and the global investment volatility that is currently being experienced, it is a likely scenario that the Districts' UAL only increases. There is speculation that calPERS will lower its expected annual return on investment from 7.5%, to 6.5% in the future. While this may be a more conservative approach to the return(s) that are likely to be achieved in the investment market(s), it is an unfavorable situation for employers as it only increases the employers' costs, it does not decrease them. A higher return on investment such as the 7.5% that is currently being used by the calPERS fund, allows a "discounting" to be applied to future benefit payments in order to calculate a present value, or the value in ***today's dollars.*** A key fact about the discount rate is that the higher the discount rate, the lower the present value, and vice versa. In other words, based off of a return on investment of 7.5%, an employer would have to contribute ***less money*** today, to equal a specific sum in the future. Conversely, based off of a return on investment of 6.5%, an employer would have to contribute ***more money*** today, to equal a specific sum in the future.

Today, the District finds itself taking calculated measures to insure that it is able to endure these costs; hopefully avoiding the scenario impacting cities such as Detroit, Stockton, Vallejo and San Bernardino. Arguably many other agencies and municipalities risk not being able to sustain the trajectory of the increased costs associated with maintaining these benefits. It has been a delicate and challenging balance for the District to insure that it is able to meet its mission for the public, while insuring it can continue to sustain the increased costs associated with calPERS, while also simultaneously acknowledging and attempting to maintain a competitive and retainable workforce. As a tremendous amount of information and education has been gained recently regarding the Districts' financial challenges, one piece of information that has come to light is that when an employee enters into service with the District and later leaves to continue service with another agency, that employee still remains in the Districts' calPERS actuarial snapshot. In essence, that employee may have only worked for 5 years at the beginning of their career for the District, and left to finish their career with another agency. In doing so, the District will pay 5 years of that employee's calPERS time upon retirement. However, that calculation will be based off of the eligibility of that employees' "last highest year" calculation, not the sum of the employee's salary while they worked for the District.

All questions, comments or concerns regarding the financial events that have taken place within the El Dorado County Fire Protection District that were illustrated within this document can be directed to the contact information below.

Paul Dutch, Captain
Email: dutchp@eldoradocountyfire.com
Phone: 530-644-9630