An LAO Report

State Employee Compensation: The Recently Approved Package

Background

In September, the Legislature approved an employee compensation package that included (1) salary increases and changes to terms of employment adopted in new memoranda of understanding (MOUs) and (2) enhanced retirement benefits.

MOUs. The Legislature approved MOUs for all of the state's 21 collective bargaining units to replace the MOUs that expired June 30, 1999. Generally, the provisions provide all employees:

- A 4 percent salary increase retroactive to July 1, 1999 and another 4 percent effective September 1, 2000.
- Increased state contributions for health benefits.
- Increased retirement benefits.

Retirement Benefits. The package enhanced retirement benefits for state employees by increasing the retirement "factor" at any given age. For example, "miscellaneous" employees receive 2 percent of compensation for each year of service at age 55 (rather than at 60).

LAO Findings

Compensation Package. We estimate that the compensation package will cost $286 million (all funds) in the current year, increasing to almost $1.3 billion in 2001-02 when all full-year costs are realized.

Retirement Benefits. These benefits will cost over $400 million (all funds) per year (beginning in 2001-02). These costs will be offset in part by actuarial changes adopted by the Public Employees' Retirement System board.

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December 6, 1999

The Legislature and the administration took several actions in September to enhance state employees' salaries and benefits. The Legislature approved memoranda of understanding (MOUs) for all of the state's 21 collective bargaining units, which represent approximately 164,000 state employees (see Figure 1). These agreements replace the MOUs that expired June 30, 1999. In addition, the Department of Personnel Administration (DPA) approved a compensation package similar to that approved in the MOUs for employees not covered by collective bargaining (such as managers and supervisors).

Figure 1

State Collective Bargaining Units

Bargaining Unit	Number of Employees Represented[a]
1 Administrative, Financial, and Staff Services	35,437
2 Attorneys and Administrative Law Judges	3,002
3 Education and Library	2,854
4 Office and Allied	32,877
5 Highway Patrol	5,651
6 California Correctional Peace Officers' Association	26,256
7 Protective Services and Public Safety	6,341
8 California Department of Forestry Firefighters	2,677
9 Professional Engineers	8,935
10 Professional Scientific	2,266
11 Engineering and Scientific Technicians	3,344
12 Craft and Maintenance	11,109
13 Stationary Engineers	831
14 Printing Trades	588
15 Custodial and Services	4,073
16 Physicians, Dentists, and Podiatrists	1,409
17 Registered Nurses	3,321
18 Psychiatric Technicians	5,931
19 Health and Social Services/Professional	3,726
20 Medical and Social Services	2,326
21 Educational Consultants, Library, and Maritime[b]	624
Total	**163,578**

[a] As of March 1999.

[b] Maritime employees are now in the California State University system and are not represented by Unit 21.

TERMS OF NEW MOUs

The new MOUs are effective for a two-year period beginning July 1, 1999. The employee compensation portions of the MOUs vary by bargaining unit; however, the MOUs provide all represented employees with:

- A 4 percent salary increase retroactive to July 1, 1999 and another 4 percent effective September 1, 2000.
- Increased state contributions for health benefits.

- Increased retirement benefits (subject to separate legislative action—Chapter 555, Statutes of 1999 [SB 400, Ortiz]).

The MOUs include numerous other provisions that are unique to particular bargaining units. Figure 2 shows the additional salary adjustments

Figure 2

Additional Salary Increases in New MOUs[a]

Unit		Unit	
1	2.4 percent to 20 percent for specified classes (8,458 employees).	12	2.5 percent to 17 percent for specified classes (556 employees).
2	2 percent for specified employees at top of salary range.	13	1 percent of Unit 13 salary base ($0.5 million) to be allocated within 90 days.
3	2.5 percent for all employees.	14	1 percent of Unit 14 salary base ($0.2 million) to fund five new classes.
4	5 percent for specified classes (282 employees) plus 1 percent of Unit 4 salary base ($10.5 million) to be allocated within 90 days.	15	1 percent of Unit 15 salary base ($1.1 million) to be allocated within 90 days.
5	1 percent of Unit 5 salary base ($3.6 million) to be allocated within 90 days.	16	Return classes to five-step, four-step, and three-step ranges.
6	Approximately 0.1 percent of Unit 6 salary base ($1.4 million) to be allocated within 90 days.	17	5 percent for specified classes (466 employees).
7	2.5 percent to 5 percent for specified classes (2,137 employees).	18	1 percent of Unit 18 salary base ($2.2 million) to be allocated with 90 days.
8	In lieu of 4 percent salary increase, salary range of Firefighter I classification increased to 5 percent above minimum with four additional 5 percent steps (effective June 30, 1999).	19	2.5 percent to 10 percent for specified classes (877 employees).
9	5 percent for Registered Engineer class. Parity realignment for deep classes.	20	Extend maximum salaries to return salary ranges to 5 percent increments.
10	1 percent to 5 percent for specified classes (1,132 employees).	21	1 percent of Unit 21 salary base ($0.4 million) to be allocated within 90 days.
11	4.6 percent to 5 percent for specified classes (879 employees).		

[a] Changes effective July 1, 1999 unless otherwise noted.

granted on top of the basic 4 percent granted all employees in the current year. These increases range from 1 percent to 20 percent and cover about 15,000 of the 164,000 represented state employees.

Figure 3 shows other provisions bargained in certain units. The most common (1) provide more flexibility for the employee to choose to receive compensating time off (CTO) for overtime and (2) count sick leave time off as hours worked for determining when overtime begins.

To partially offset the state's costs for certain retirement benefit increases (discussed below), the MOUs for bargaining units with employees in the Safety, Police Officer/Firefighter, and Highway Patrol plans increase the employee share of retirement contributions effective July 1, 2001:

- Safety—from 6 percent to 8 percent.
- Police Officer/Firefighter (Units 6 and 8)—increased employee contribution by 2 percent.
- Highway Patrol—from 0 percent to 1.5 percent.

Figure 3

Other Major Provisions in New MOUs[a]

Provision	Affected Units
Sick leave time off counts as hours worked for determining when employees begin to earn overtime pay (effective November 1, 1999).	1, 2, 3, 4, 6, 9, 10, 11, 12, 13, 14, 15, 17, 18, and 19
Employees may choose whether to be paid with cash or compensating time off (CTO) for the first 40 hours of overtime in a fiscal year.The state has the discretion beyond 40 hours and may cash out unused CTO above 40 hours at the end of each fiscal year.	12, 13, 14, and 18
State picks up $12 of each employee's monthly retirement contribution (effective January 1 to August 31, 2000).	4 and 15
Employees receive retirement credit, calculated using the sick leave crediting formula, for unused education leave (effective January 1, 2000).	3 and 21
Negotiate a $4 million benefit within 90 days.	6
State and union agree to continue fair share fees after contract expires.	6
Establish a $150,000 reserve fund for administrative investigations (effective January 1, 2000).	16
Establish a $250,000 scholarship fund for further education for registered nurses.	17

[a] Changes effective July 1, 1999 unless otherwise noted.

Other retirement provisions in the MOUs include a state "pick-up" of $12 of Units 4 and 15 employee's monthly contribution from January 1 to August 31, 2000 and crediting accumulated education leave toward retirement for employees in Units 3 and 21.

Health Benefits

Basic Program. The state provides health insurance benefits under several programs. For most state employees, the state pays the premium cost for employees' health, dental, and vision insurance up to a maximum monthly amount. These payments vary based on the number of individuals covered for the employee and the health provider the employee selects. For each type of insurance, if the premium exceeds the maximum state contribution, the employee pays the difference.

Consolidated Benefits Program. Some represented employees—Units 8, 16, 18, and 19—as well as most nonrepresented employees are in a Consolidated Benefits (CoBen) program. In this program, the state pays a monthly *combined* maximum for health, dental, and vision insurance premiums. Employees can choose whether to enroll in the health and dental insurance programs, but vision insurance is automatic and cannot be declined. If the total cost of the employee's insurance premiums exceeds the maximum state contribution, the employee pays the difference. If the total cost is less, the employee is paid the difference as taxable income.

Unit 13 Program. For employees in Unit 13, the state pays a single maximum amount, regardless of the number of parties covered, for health, dental, and vision premiums. In this case, if the combined cost is *less* than the state maximum, the state saves the difference.

Figure 4 (see page 6) summarizes the changes in state contributions for insurance premiums under the new MOUs and by administrative action for nonrepresented employees. The MOU for Unit 6 also requires the state to contribute $1 million effective July 1, 1999 and another $1 million effective July 1, 2000 to the California Correctional Peace Officers' Association Health Benefits Trust Fund for increased vision benefits.

Rural Areas Program. In addition to the changes shown in Figure 4, Chapter 743, Statutes of 1999 (SB 514, Chesbro) establishes a program to subsidize health care costs for state employees in rural areas that are not in the service territory of any HMOs approved by the Public Employees' Retirement System (PERS). This program will reimburse health premium costs, as well as out-of-pocket expenses that would normally be covered by a PERS-approved HMO (such as copayment charges), up to an amount agreed upon through collective bargaining. The new MOUs set this maximum amount at $1,500 annually.

Retirement Benefits

Chapter 555 enhances retirement benefits for all state employees (see Figure 5 on page 7). As the figure indicates, the benefit increases occur by granting employees a greater retirement "factor" at a given age (for example, 2 percent of compensation for each year of service at age 55).

Under Chapter 555, the improved benefits become effective January 1, 2000 subject to three conditions. One condition is that the new benefits for represented employees must be agreed to in collective bargaining. This condition was met in each of the new MOUs. Another condition is that nonrepresented employees receive the new benefits only if approved by DPA. This approval was granted October 21, 1999. The third condition required the PERS board to approve the changes to the actuarial valuation methods that the board committed to when it proposed enhanced benefits earlier this year. At its October meeting, the board approved the changes, which include (1) modifying the June 30, 1998 valuation using 95 percent (rather than 90 percent) of the market value of state employer assets and (2) reducing from 30 years to 20 years the amortization of the June 30, 1998 excess assets beginning July 1, 1999.

In addition to these benefit improvements, Chapter 555 allows employees in Miscellaneous or Industrial Second Tier retirement plans to switch to First Tier plans. This option also provides these employees the opportunity to "buy back" First Tier coverage for prior service under the Second Tier plan. In addition, employees in the Modified First Tier retirement program—an intermediate plan approved in 1998 for Miscellaneous and Industrial employees in Units 8, 16, and 19—who opted out of the Second Tier retirement program will automatically move

Figure 4

State Contributions for Health Benefit Programs

Bargaining Unit/Benefit	1-Party/2-Party/3-Party[a] Existing	1-Party/2-Party/3-Party[a] New[b]
Units 1, 2, 3, 4, 7[c], 9, 10, 11, 14, 15, 17, 20, and 21		
Health	$174/332/432	$174/346/452
Dental	24/43/64	31/56/81[d]
Vision	9/9/9	9/9/9
Units 7[c], 8, 16, 18, and 19[d]		
Consolidated Benefits (CoBen) program	$200/384/505	$214/411/542[e]
Unit 5		
Health	$165/328/427	$179/355/464[e]
Dental	26/47/69	26/47/69
Vision	9/9/9	9/9/9
Unit 6		
Health	$147/331/452	$161/358/489[e]
Dental	44/44/44	44/44/44
Vision	9/9/9	9/9/9
Unit 12		
Health	$174/329/418	$174/344/438
Dental	24/46/68	31/56/81[d]
Vision	9/9/9	9/9/9
Unit 13		
Combined per employee contribution for health, dental, and vision benefits	$420	$440
Excluded		
CoBen program	$201/394/518	$215/422/556[e]

[a] Three-party covers three or more individuals.
[b] Effective January 1, 2000 unless otherwise noted.
[c] Unit 7 transfers to the CoBen program effective January 1, 2000. Until then, Unit 7 employees are subject to the separate schedules for health, dental, and vision benefits applicable to most bargaining units.
[d] New rates retroactive to August 1, 1999.
[e] Intermediate rate increases effective between August 1 and December 31, 1999 not shown.

into First Tier plans with service since 1998 credited as First Tier service. Chapter 555 also increases the maximum retirement benefit for Highway Patrol employees in Unit 5 and Peace Officer/Firefighter employees in Units 6, 7, and 8 to 90 percent of final compensation. (The current limit is 80 percent for Unit 7 employees and 85 percent for employees in Units 5, 6, and 8.)

Figure 5

Retirement Benefit Changes Compared to Current System

	Current	Effective January 1, 2000
Miscellaneous/Industrial		
Standard formula (per year of service)	2 percent at 60	2 percent at 55
Minimum benefit	1.092 percent at 50	1.1 percent at 50
Maximum benefit	2.418 percent at 63	2.5 percent at 63
Safety		
Standard formula	2 percent at 55	2.5 percent at 55
Minimum benefit	1.426 percent at 50	1.7 percent at 50
Maximum benefit	2 percent at 55	2.5 percent at 55
Peace Officer/Firefighter		
Standard formula	2.5 percent at 55	3 percent at 55
Minimum benefit	2 percent at 50	2.4 percent at 50
Maximum benefit	2.5 percent at 55	3 percent at 55
Highway Patrol		
Standard formula	2 percent at 50	3 percent at 50
Minimum benefit	2 percent at 50	3 percent at 50
Maximum benefit	2.7 percent at 55	3 percent at 50

COST OF COMPENSATION PACKAGE

The state employee compensation package includes MOUs, DPA-approved provisions for nonrepresented employees, and enhanced retirement benefits. As shown in Figure 6 (see page 8) , the estimated net cost of $286 million in the current year increases to nearly $1.3 billion in 2001-02 when all full-year costs are recognized. The costs of various major components are discussed below.

MOUs

The MOUs include provisions that become effective in 1999-00 and in 2000-01. The DPA estimates that the 1999-00 provisions will cost about $453 million (all funds) in the current year. According to DPA, the provisions effective beginning in 2000-01—primarily the 4 percent salary increase effective September 1, 2000—will cost an additional $275 million (all funds) in 2000-01. As summarized in Figure 6, the annualized cost of the MOUs will total $799 million (all funds) beginning in 2001-02.

Additional costs not accounted for in these figures include (1) counting sick leave time off as hours worked for determining when overtime pay begins; (2) expanding employee flexibility to choose CTO or cash payment for overtime in Units 12, 13, 14, and 18; and (3) allowing Unit 7, 8, 16, 18, and 19 employees to keep the balance of their CoBen allowance that they do not spend on health care coverages.

Retirement Benefits

The most notable additional cost of the compensation package is that associated with the retirement package, which includes benefit increases for current employees and a one-time cost-of-living adjustment (COLA) of varying amounts for current retirees. Based on information provided by PERS, we estimate that the total cost of the retirement package will be 4.22 percent of payroll beginning in 2001-02—the first year that PERS recognizes the increased liability in setting the state employer contribution rates. This amounts to about $420 million in 2001-02 (see Figure 6) and will grow with payroll.

Figure 6

Cost of 1999-00 Employee Compensation Package[a]

(In Millions)

	1999-00			2000-01			2001-02		
	General Fund	Other Funds	Total	General Fund	Other Funds	Total	General Fund	Other Funds	Total
MOU provisions									
1999-00[b]	$226	$227	$453	$234	$237	$471	$234	$237	$471
2000-01[b]	—	—	—	142	133	275	169	159	328
Subtotals	**$226**	**$227**	**$453**	**$376**	**$370**	**$746**	**$403**	**$396**	**$799**
Nonrepresented provisions									
1999-00[b]	$77	$60	$137	$78	$62	$140	$78	$62	$140
2000-01[b]	—	—	—	50	54	104	61	61	122
Subtotals	**$77**	**$60**	**$137**	**$128**	**$116**	**$244**	**$139**	**$123**	**$262**
Totals	**$303**	**$287**	**$590**	**$504**	**$486**	**$990**	**$542**	**$519**	**$1,061**
Retirement provisions									
Benefit increases[c]	—	—	—	—	—	—	$230	$190	$420
Actuarial changes[c]	-$167	-$137	-$304	-$130	-$110	-$240	-118	-97	-215
Totals[c]	**-$167**	**-$137**	**-$304**	**-$130**	**-$110**	**-$240**	**$112**	**$93**	**$205**
Totals, net	**$136**	**$150**	**$286**	**$374**	**$376**	**$750**	**$654**	**$612**	**$1,266**

a Estimated costs provided by the Departments of Personnel Administration and Finance, and the Public Employees' Retirement System.
b Legislative Analyst's Office (LAO) estimate of annualized total MOU cost distribution between General Fund and other funds based on 1999-00 distribution.
c LAO estimate of cost distribution between General Fund and other funds based on information provided by the Department of Finance.

Coupled with the benefit increases, PERS agreed to change the two actuarial valuation methods discussed above, but *only* if the increases were adopted. (PERS could have made these changes independent of the improved benefits.) Beginning this year, these valuation changes recognize excess assets more quickly, thereby partially offsetting the state's costs that result from the benefit improvements. As shown in Figure 6, we estimate that the valuation changes result in savings of $304 million this year, gradually declining to $215 million by 2001-02. However, 2001-02 is the first year that PERS includes the new benefits in its calculations to determine the state's contribution. Thus, beginning in 2001-02, the state will incur a *net* cost increase of about $205 million. Figure 7 shows the changes in the state's retirement contribution rates due to the benefit enhancements and actuarial changes. Based on these rates, the increased cost to the state, as a result of the benefit enhancements, grows to around $280 million in 2004-05 and then declines and levels off at about $260 million by 2008-09.

Nonrepresented Employee Salary Increases

Salary increases for employees not covered by collective bargaining have been partially addressed by administrative action. In September, DPA approved for these employees (primarily managers and supervisors) the general salary

Figure 7

State Composite Retirement Contributions
Existing Benefits (Through 12/31/99) Compared to New Benefits (Effective 1/1/00)[a]

(Dollars in Millions)

	Existing Benefits		New Benefits[b]		Difference	
Fiscal Year	Rate	Amount	Rate	Amount	Rate	Amount
1999-00	4.98%	$464	1.71%	$160	-3.27%	-$304
2000-01	3.58	345	1.07	105	-2.51	-240
2001-02	2.60	260	4.65	465	2.05	205
2002-03	1.87	195	4.26	445	2.39	250
2003-04	1.33	145	3.83	415	2.50	270
2004-05	1.02	115	3.53	395	2.51	280
2005-06	0.96	110	3.32	385	2.36	275
2006-07	0.94	115	3.16	380	2.22	265
2007-08	0.93	115	3.03	380	2.10	265
2008-09	0.93	120	2.93	380	2.00	260
2009-10	0.93	125	2.85	385	1.92	260
2010-11	0.93	130	2.78	390	1.85	260

[a] Estimated rates and dollar amounts provided by the Public Employees' Retirement System and represent the cumulative state contribution for all retirement plans.

[b] These figures account for actuarial valuation changes adopted in Chapter 555, Statutes of 1999 (SB 400, Ortiz).

increase included in the new MOUs—4 percent retroactive to July 1, 1999 and another 4 percent effective September 1, 2000—with additional increases of 1 percent to 16.5 percent for about one-third of nonrepresented employees in particular classes. In general, these additional increases parallel similar increases given to represented employees these employees supervise to maintain a salary differential of about 10 percent.

Funding

As noted in Figure 6, the total 1999-00 cost of the compensation provisions for represented and nonrepresented employees is $590 million ($303 million General Fund). Chapter 776, Statutes of 1999 (SB 339, Burton) appropriates a total of $601.2 million ($341.5 million General Fund) to pay for both the 1999-00 compensation provisions and a portion of the cost for compensation provided in 1998-99. The General Fund portion of these two-year costs totals $330 million—$11.5 million less than the amount in Chapter 776.

Acknowledgments

This report was prepared by Todd R. Clark, under the supervision of Gerald Beavers. The Legislative Analyst's Office (LAO) is a nonpartisan office which provides fiscal and policy information and advice to the Legislature.

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