



August 26, 2010

Honorable Judge Jacobs-May
Presiding Judge
Santa Clara County Superior Court
191 North First Street
San Jose, CA 95113

FILED

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DAVID H. YAMASAKI
Chief Executive Officer/Clerk
Superior Court of CA County of Santa Clara
BY D. ALDYCKI 

Dear Judge Jacobs-May:

Thank you for the opportunity to review and respond to the 2009-2010 Santa Clara County Civil Grand Jury's Report regarding "Cities Must Rein in Unsustainable Employee Costs dated May 26, 2010. The Report and response to the finding below were reviewed by the City Council at its August 25, 2010 Council Meeting.

The City of Morgan Hill shares the Grand Jury's concerns about escalating employee costs and has taken actions over the last couple of fiscal years to slow the rate of growth. The City has three employee associations that each has a Memorandum of Understanding through June 30, 2013. During the negotiation of new Memorandum of Understanding with each of the associations, the City intends to continue the efforts of reducing the per unit cost of employees. Specifically, the City Council has indicated their interest in implementing two-tier retirement for both safety and miscellaneous as well as reduce the amount of City-paid health care contributions. Below are the specific responses to each of the SCCCJ's findings and recommendations.

Finding 1

The costs of total compensation for employees have grown substantially in the past decade and now threaten the cities' fiscal stability

Response: Agree

Recommendation 1

All of the cities in the County need to implement measures that will control employee costs. As a starting point, each city should determine the percentage of savings required from the total

compensation package to reach budget stability, and provide choices of wages and benefits in collective bargaining sessions for the unions to choose to achieve that percentage goal.

Response: The recommendation has not been implemented but will be implemented in the future. In establishing negotiating parameters, the City intends to set dollar savings targets which could calculate as a percent.

Finding 2

Salary and wage increases do not reflect changes in economic conditions; e.g. even with minimal inflation, yearly COLAs are granted with little bearing on the actual increase in cost of living or market conditions.

Response: The City of Morgan Hill agrees in part and disagrees in part with the finding. Salary and wage increases reflect a number of factors, with market comparability being a critical one. For example, if Morgan Hill's total compensation is 6% below average and inflation is 3%, an increase greater than inflation might be agreed to (if resources are available to fund it). In reality, Morgan Hill employees are generally below market and have in the past taken zero wage increases and given back agreed to increases.

Recommendation 2

Cities should not increase salaries and wages that are not supported by planned revenue increases. Cities should tie COLA increases to clear indicators and retain the ability to adjust or withhold based on current economic data.

Response: The recommendation has been implemented. Morgan Hill gives wage increases consistent with multi-year budget projections.

Finding 3

Step increases are arbitrary and do not adequately represent an employee's added value to the city. Combined with COLAs, new employees' wages increase quickly and are not necessarily reflective of improved knowledge and skills.

Response: Agree

Recommendation 3

Cities should negotiate step progressions from the current three and a half years to seven years. Employees should not receive COLA increases while in step progression.

Response: The recommendation has not yet been implemented but the City intends to implement during future labor negotiations. The City of Morgan Hill's six step progression is based on a five year process, not the current three and a half years discussed in this recommendation. As part of future negotiations, the City plans to discuss the issue of step increases with its employee associations. This may include narrowing salary ranges and tying step increases to performance.

Finding 4

Medical insurance costs for active employees are growing year after year at rates that exceed most cities' revenue growth, while the employee contribution to medical care is minimal.

Response: Agree

Recommendation 4

Cities should negotiate that employees assume some of these increased costs for their medical benefits. To contain medical costs cities should consider the following:

- A. Split monthly premiums between the city and the employee and increase the employee's share, if already cost splitting, and remove any employee caps.

Response: The recommendation requires further analysis. The City agrees conceptually that employer paid medical expenses need to be reduced but the method in which to accomplish that objective will be evaluated further prior to the City's next formal negotiation process with the City's three employee associations. During future negotiations with the employee associations in 2013, the City will negotiate in good faith to reduce City-paid health care cost.

The City Council has already taken action to amend the City's Sustainable Budget Principles on October 7, 2009 to add the following statement indicating future policy direction:

"To reduce the rate of increase in labor costs, the City will engage in good-faith negotiations with bargaining units to make cost-saving change in retirement plans and to reduce the City-paid share of health benefits".

- B. Establish reasonable co-pays for doctors' visits, prescription drugs, and in-patient and out-patient hospital care.

Response: The recommendation requires further analysis. The City agrees conceptually that employer paid medical expenses need to be reduced but the method in which to accomplish that objective will be evaluated further prior to the

City's next formal negotiation process with the City's three employee associations. During future negotiations with the employee associations in 2013, the City will negotiate in good faith to reduce City-paid health care cost.

The City Council has already taken action to amend the City's Sustainable Budget Principles on October 7, 2009 to add the following statement indicating future policy direction:

"To reduce the rate of increase in labor costs, the City will engage in good-faith negotiations with bargaining units to make cost-saving change in retirement plans and to reduce the City-paid share of health benefits".

- C. Prohibit an employee from being covered by both city-provided medical benefits and as a dependent of another City employee.

Response: The recommendation will not be implemented because it is not warranted or reasonable. This recommendation is not relevant to the City of Morgan Hill since it is already prohibited through CalPERS PEHMCA rules (CalPERS, Health Benefits Program: Public Agency Procedure Manual, Page 03-01)

- D. Introduce a new lower premium, high deductible medical plan.

Response: The recommendation requires further analysis. The City agrees conceptually that employer paid medical expenses need to be reduced but the method in which to accomplish that objective will be evaluated further prior to the City's next formal negotiation process with the City's three employee associations. During future negotiations with the employee associations in 2013, the City will negotiate in good faith to reduce City-paid health care cost.

The City Council has already taken action to amend the City's Sustainable Budget Principles on October 7, 2009 to add the following statement indicating future policy direction:

"To reduce the rate of increase in labor costs, the City will engage in good-faith negotiations with bargaining units to make cost-saving change in retirement plans and to reduce the City-paid share of health benefits".

Finding 5

Pension formula changes instituted in the past decade, stock market losses, the aging "baby boomer" work force, and the growing unfunded pension and OPEB liability all contribute to making retiree pension and health care costs the most problematic and unsustainable expense

the cities are facing. The city contribution to pension plans and OPEBs far exceeds the employee contribution.

Response: Agree

Recommendation 5a

Cities should:

- 1) Renegotiate and make provisions for increasing the employees' contribution for current pension plans.

Response: The recommendation requires further analysis. The City agrees conceptually that employer paid retirement costs need to be reduced but the method in which to accomplish that objective will be evaluated further prior to the City's next formal negotiation process with the City's three employee associations in 2013.

The City Council has already taken action to amend the City's Sustainable Budget Principles on October 7, 2009 to add the following statement indicating future policy direction:

"To reduce the rate of increase in labor costs, the City will engage in good-faith negotiations with bargaining units to make cost-saving change in retirement plans and to reduce the City-paid share of health benefits".

- 2) Renegotiate to stop paying the employees' contribution amount to pension plans.

Response: The recommendation has been partially implemented. The City agrees conceptually that employer paid retirement costs need to be reduced but the method in which to accomplish that objective will be evaluated further prior to the City's next formal negotiation process. Currently, employees represented by three of the four employee associations (including unrepresented management) pay their own employee contribution to their retirement. The one employee association that the City pays a portion of their employee contribution towards retirement will be evaluated prior to the next formal negotiation process with that employee association in 2013.

The City Council has already taken action to amend the City's Sustainable Budget Principles on October 7, 2009 to add the following statement indicating future policy direction:

“To reduce the rate of increase in labor costs, the City will engage in good-faith negotiations with bargaining units to make cost-saving change in retirement plans and to reduce the City-paid share of health benefits”.

- 3) Renegotiate to implement a contribution amount for employees to OPEB; this contribution should provide for a reasonable split of costs between the city and the employee for retiree medical and dental benefits.

Response: The recommendation will not be implemented because it is not warranted. The City’s OPEB liability was only \$1.3 million in 2008 in large part because the City does not offer retiree medical or dental similar to other local entities. The City does not provide for retiree medical or dental above the CalPERS PEHMCA minimum amount of \$57.75 per retiree per month. To pay for these costs on a current basis requires \$12,926 annually. The issue of OPEB funding has been thoroughly analyzed and discussed in the City’s Adopted Budget.

Recommendation 5b

Cities should thoroughly investigate reverting to prior pension formulas that were less costly.

Response: The recommendation requires further analysis. The City agrees conceptually that employer paid retirement costs need to be reduced *but the method in which to accomplish that objective will be evaluated further prior to the City’s next formal negotiation process with the City’s three employee associations in 2013.*

The City Council has already taken action to amend the City’s Sustainable Budget Principles on October 7, 2009 to add the following statement indicating future policy direction:

“To reduce the rate of increase in labor costs, the City will engage in good-faith negotiations with bargaining units to make cost-saving change in retirement plans and to reduce the City-paid share of health benefits”.

Recommendation 5c

To provide a meaningful, long-term solution, the cities should negotiate agreements to:

- 1) Institute a two-tier system for pension and retiree health care for new hires

Response: The recommendation requires further analysis. The City agrees conceptually that employer paid retirement costs need to be reduced *but the method in which to accomplish that objective will be evaluated further prior to the*

City's next formal negotiation process with the City's three employee association in 2013.

The City Council has already taken action to amend the City's Sustainable Budget Principles on October 7, 2009 to add the following statement indicating future policy direction:

"To reduce the rate of increase in labor costs, the City will engage in good-faith negotiations with bargaining units to make cost-saving change in retirement plans and to reduce the City-paid share of health benefits".

Regarding the recommendation on retiree medical, the City does not offer retiree medical or dental similar to other local entities. The City does not provide for retiree medical or dental above the CalPERS PEHMCA minimum amount of \$57.75 per retiree per month.

- 2) Increase the retirement age from 50 or 55 to 60 or 65

Response: The recommendation requires further analysis. The City agrees conceptually that employer paid retirement costs need to be reduced *but the method in which to accomplish that objective will be evaluated further prior to the City's next formal negotiation process with the City's three employee associations in 2013.*

The City Council has already taken action to amend the City's Sustainable Budget Principles on October 7, 2009 to add the following statement indicating future policy direction:

"To reduce the rate of increase in labor costs, the City will engage in good-faith negotiations with bargaining units to make cost-saving change in retirement plans and to reduce the City-paid share of health benefits".

- 3) Calculate pensions on the last three to five years of salary

Response: The recommendation requires further analysis. The City agrees conceptually that employer paid retirement costs need to be reduced *but the method in which to accomplish that objective will be evaluated further prior to the*

City's next formal negotiation process with the City's three employee associations in 2013 .

The City Council has already taken action to amend the City's Sustainable Budget Principles on October 7, 2009 to add the following statement indicating future policy direction:

"To reduce the rate of increase in labor costs, the City will engage in good-faith negotiations with bargaining units to make cost-saving change in retirement plans and to reduce the City-paid share of health benefits".

- 4) Replace current post-employment health care plans with health savings accounts

Response: The recommendation will not be implemented because it is not warranted. The City does not offer retiree medical or dental coverage similar to that offered by other local entities. The City does not provide for retiree medical or dental above the CalPERS PEHMCA minimum amount of \$57.75 per retiree per month.

Finding 6

Public sector employees are granted a generous number of holidays, personal days, vacation days and sick leave annually. Rules and limits on accrual vary by city and union, but vacation and sick leave can be accumulated and converted to cash or calculated into the pension benefit within those limits.

Response: Partially agree and disagree. The City does not have enough information to agree or disagree with the Grand Jury's statement regarding public sector employees being granted a generous number of holidays, personal days, vacation days and sick leave annually, which would require further analysis. However, from page 13 of the Grand Jury Report, Table 7: Days Off Per Year by City, the City of Morgan Hill ranks near the bottom of the other Santa Clara County cities.

Recommendation 6a

Cities should renegotiate with the bargaining units to 1) reduce vacation time; 2) reduce the number of holidays and/or personal days; 3) cap sick leave and eliminate the practice of converting accumulated sick leave to cash or adding into their years of service for inclusion in their retirement benefit.

Response: The recommendation requires further analysis. As with all items provided for in the City's Memorandum of Understanding (MOU) with employee associations, the City

will review the various leave policies and negotiate in good faith any warranted changes with the respective employee association(s) at that time. The City has three recognized employee associations and the contracts expire in June 2013.

Recommendation 6b

Cities should negotiate to substitute paid days off for unpaid days instead of imposing furloughs. For example, reduce paid holidays to major holidays only, consistent with private industry; and convert minor holidays to unpaid. Therefore, the public is not impacted by fewer services caused by furloughs, and the city saves the employee costs.

Response: The recommendation will not be implemented because it is not warranted or reasonable. The City of Morgan Hill does not currently impose, nor is it considering unpaid furloughs as a means to reduce expenses so this recommendation is not relevant.

Finding 7

Cities traditionally determine their compensation packages by surveying the wages and benefits of other public sector employees in the same geographic area. There is a major resistance to comparing themselves or mirroring trends with the private sector. This has allowed wages and benefits to become artificially high and out of sync with market trends.

Response: The City of Morgan Hill disagrees in part with the finding. While the City traditionally has based compensation on comparisons with similar public sector positions, there is not "major resistance" on the part of management to include comparisons to comparable private sector positions. Any private sector comparisons have to be true "apples to apples" including total compensation and may not be possible for all job classifications, such as public safety. In addition, the current system has not, de facto, led to "artificially high and out of sync" wages and benefits compared to the private sector. For many professional positions, similar jobs in the private sector would have higher compensation. In fact, a study by the Center for State and Local Government Excellence and the National Institute on Retirement Security, using data from the US Bureau of Labor Statistics, found that wages and salaries of local employees are typically 12% less than similar private sector employees, and the gap has grown in the past 15 years. "The picture is clear. In an apples-to-apples comparison, state and local government employees receive less compensation than their private sector counterparts," according to Professor Keith Bender of the University of Wisconsin-Milwaukee, coauthor of the study.

Recommendation 7a

Cities should research competitive hiring practices and alter the approach to determine fair wages and benefits for each city by using public and private sector data.

Response: The recommendation requires further analysis. For those classifications that have comparable counterparts in the private sector, total compensation data analysis would be a useful tool.

Recommendation 7b

Cities should renegotiate salaries and wages using valid market comparisons and not only the current wage index. Cities should utilize more market-oriented compensation practices so that salaries can adjust as competition for labor changes. Cities should reduce entry-level compensation for positions for which there are many qualified applicants.

Response: The recommendation has been implemented. The City uses market comparisons as the primary factor in negotiating wage agreements. Due to limited resources, many classifications in the City are below the comparable market average.

Finding 8

All cities perform certain core functions to run smoothly and provide services to their residents. To reduce employee costs and streamline operations, the cities are in various stage of contracting services to private industry or partnering with other cities, special districts or the County to deliver services.

Response: Agree

Recommendation 8a

Cities should explore outsourcing some functions and services to private industry. Cities should discuss the prospect with cities that are successfully doing this to determine best practices and areas for success. Cities should develop contracts with measurable objectives, performance goals, and timelines.

Response: This recommendation has been partially implemented and the City will continue to explore opportunities to outsource where it there is financial and operation advantages in the future. The City currently outsources several City provided services to private contractors such as:

- *Janitorial services in the recreation facilities*
- *Management and operations of the Outdoor Sports Center*

- *Street median maintenance, signal maintenance and streetlight maintenance*
- *Landscape and park maintenance at various City locations*
- *Specialized legal and engineering services*

Recommendation 8b

Cities should create partnerships with other cities, special districts and/or the County for services, such as payroll, human resources, animal control, police and fire. Cities should investigate sharing the cost of new information technology systems.

Response: This recommendation has been partially implemented and the City will continue to explore opportunities to partner with other agencies where it there is financial and operation advantages in the future. The City currently partners with other jurisdictions on the following services:

- *Contract for Fire Services with Santa Clara County*
- *Morgan Hill provides Environmental Program services to the City of Gilroy*

Finding 9

Cities can gain operational efficiencies and effectiveness with lower employee costs by making sure they are staffed with the correct numbers of people in the appropriate job classification in all departments and work groups.

Response: Agree

Recommendation 9

Cities should analyze the functions performed by all job classifications and make adjustments in the work force. Consolidate functions within the same group or a similar group. Reassign appropriate work to lower paid job classifications. Eliminate unnecessary functions.

Response: This recommendation has been partially implemented and will continue to be implemented as priorities and objectives of the City change. The City is continually evaluating operations, but particularly during the past two fiscal year budget processes in which the City has reduced staffing overall by 15%, the City Council has evaluated service levels with the first three principles of the City's Sustainable Budget Principles, which are 1.) Critical Services should be maintained to the greatest extent possible; 2.) Resources should be allocated to the highest priority services; and 3.) No city services should be exempt from evaluation.

Specifically, the City has eliminated two department head level executive positions through consolidation and is currently evaluating whether to collapse three department head level executive positions into one, thus reducing the City's Executive Management Team from 11 to 7, or 36%.

Finding 11

In many cities, the contract negotiation process is completed by placing the negotiated collective bargaining agreements on the consent calendar for approval, which is acted on quickly at the start of council meeting by a single motion and vote of the council.

Response: Agree

Recommendation 11

Cities should consider holding well-publicized public hearings about the cities' goals of negotiations before negotiations begin, and again at the end of negotiations to report to citizens clearly what changes have been made in contracts.

Response: The recommendation has not yet been implemented but the City intends to implement during future negotiations. The City of Morgan Hill, along with all cities, holds publicly noticed meetings all year long. Meeting agendas and minutes are posted on the web and meetings are now webcast. The specifics of any contract negotiated are posted on our website in advance of any final Council action. The public has ample opportunities to weigh in on issues of concern at any given meeting. One of the many public discussions of a city's budget is a particularly good time for residents to express any general concerns about labor costs. However, the City is supportive of additional public disclosure and is supportive of the recommendation.

Finding 12

Current contracts were negotiated in good faith by representatives of the cities and the bargaining units; they were approved by the city councils. Promises made to the employees were made by elected officials, past and present. Responsibility for formulating and approving solutions to restore the cities' financial stability resides squarely with the elected officials. The economic downturn has placed additional pressure on the situation.

Response: Agree

Recommendation 12a

City council members and mayors should become better informed about the fiscal realities in their cities, long-term costs and commitments, and be cognizant of potential issues in labor agreements.

Response: The recommendation has been implemented. The Council has numerous meetings devoted to the budget and cost implications of labor negotiations.

Recommendation 12b

City councils and mayors should direct city administrators to (re)negotiate collective bargaining agreements that reverse the escalation of employee costs through concessions, cost sharing, and a second tier for new employees.

Response: The recommendation has been implemented. The City and the three labor associations have renegotiated MOUs in each of the last two fiscal years. In FY 10, all labor groups "opened up" their MOUs with the City by renegotiating agreed-to and binding wage increases. In FY 11, all groups renegotiated their MOUs with the City by forgoing any FY 11 salary increases including agreed-to and binding wage increases as well as scheduled step increases.

Recommendation 12c

City councils and mayors should meet with the bargaining units to clearly outline the cities' financial health and show how employee costs are impacting the budget

Response: The recommendation will not be implemented because it is not warranted or is not reasonable. The City Council is the policy-setting body and appoints the City Manager to administer the operations of the City and manage all personnel matters. It is not appropriate for Council to meet directly with bargaining units.

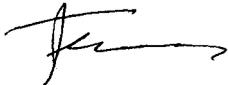
Recommendation 12d

City councils and mayors should inform citizens of their plans for controlling unsustainable employee costs and remove politics from the equation.

Response: The recommendation has been implemented. The City of Morgan Hill has done extensive outreach over the past two years to discuss fiscal issues with the community, to get input and to share recommended budget correction strategies, including efforts to reduce labor costs.

Please feel free to contact me at (408) 779-7271 if you seek additional information or have any questions regarding this response to the SCCCGJ Report.

Sincerely,



J. Edward Tewes
City Manager

cc: Mayor & Members of the City Council