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CITY OF LA VISTA
MAYOR AND CITY COUNCIL REPORT
FY 2012/2013 BUDGET

Subject:	**Submitted By:**
COMPENSATION INFORMATION AND PFP UPDATE	RITA RAMIREZ ASSISTANT CITY ADMINISTRATOR

Compensation

The City's Pay-for-Performance compensation plan went into effect in October of 2009 and the Council Policy statement governing this plan calls for Council to make two determinations annually regarding the PFP compensation system.

1. Establish a "base factor" which is the salary increase percentage that employees who receive an overall performance rating of "Meets Expectations" will be eligible to receive.

2. Adjustment to the salary ranges in order to keep La Vista's salaries comparable to the market. *(This adjustment only changes the salary ranges—it does not increase employee pay.)*

Staff has compiled the following data regarding actual and projected compensation increases. We were also able to find some data regarding salary range increases and projected increases for pay based on performance.

In conjunction with the salary increase trends, we also looked at the Consumer Price Index for the Midwest Region. The CPI rose 2.3% from April 2011 to April 2012. This follows last year's 3.8% increase which was the largest yearly advance since September of 2008.

Based on the data collected and initial budget projections, staff is recommending that the Pay for Performance base factor for 2012-2013 be set at 2% and the salary ranges be increased by 1% (salary ranges were not increased this current fiscal year). The draft budget has been prepared with these assumptions and Council will officially set these rates as part of the budget process. The base factor is what actually results in salary increases for employees. Under our current PFP system employees who meet expectations would receive a 2 or 2.5% increase, those exceeding expectations would receive a 3 or 3.5% increase, and those classified as exemplary would receive a 4% increase. (You will recall that changes were made to the policy last year to add half percent increments to the performance pay.) Below is salary survey information showing projected increases broken out by level of employee performance--high performing, mid-range performing and low performing. More of this type of information is becoming available as Pay for Performance is becoming an increasingly popular compensation strategy.

Projected Increases for Pay Based on Performance			
	High	Mid	Low
Hay Group	4.0%	2.7%	0.7%
Mercer	4.4%	2.8%	0.4%
World at Work	4.0%	2.7%	0.7%

The chart below provides general salary survey information from a variety of sources. Generally, the projections are higher than our recommended base increase. We took into consideration the base factor increases that were given over the past three years and the City's overall financial situation when recommending a 2% base factor for FY2013. While many private companies went from giving higher percentage increases (4-7%) a few years ago, to giving zero increases when the economy took a downturn, the City's strategy has always been to attempt to provide employees with a fair base increase and minimize the large swings.

	Average Wage Increases 2011	Projected Wage Increases 2012
Bureau of Labor Statistics (State & Local Government)	1.3%	
Buck Consultants	2.7%	2.8%
Culpepper Salary Survey	2.9%	2.9%
Hay Group	2.2%	3.0%
Hewitt Associates	2.7%	2.9%
Mercer	2.7%	2.9%
Robert Half International		3.4%
SHRM	2.9%	2.9%
Sibson Consulting	2.6%	2.8%
Towers Watson	2.6%	2.8%
World at Work	2.8%	2.9%
World at Work (Nebraska)	2.7%	3.0%

Salary ranges were adjusted in FY10 by 3% and again in FY11 by 2.5%. The salary ranges were not increased in FY12. The chart below shows actual and projected salary range increases. We are recommending salary range increases of 1%. Adjustments to the salary ranges do not increase employee pay, but do increase the range maximum. Additionally, in accordance with the Pay for Performance policy, we will be requesting funding of a market study in this year's budget to ensure comparability.

	Salary Range Increases 2011	Projected Salary Range Increases 2012
Sibson Consulting	1.5%	1.9%
World at Work	1.4%	1.9%

Pay for Performance

Since the PFP Policy was adopted in August 2009, we have continued to monitor the implementation of this compensation system and have made several adjustments including reducing the number of both core and role-specific competencies, changing the weighting of various sections of the performance evaluation form, and changing the rating scale to include half-percent increments. We are continuing to review the number of competencies and will likely reduce the number even further. After two years of completing performance evaluations under the new system, it continues to be apparent that many of the competencies overlap and the time it is taking supervisors to complete the forms is prohibitive.

Over the last year Councilmember Crawford has requested that we look at the concept of Variable Pay. Variable Pay is a performance-based program where the "award" for performance must be earned each year. In other words, the incentive amount that is paid over and above the base increase is given as a one-time award annually and does not calculate into the employee's ongoing base salary. There are several options regarding this type of compensation system, but typically, companies that use a Variable Pay compensation strategy will establish a base increase or cost of living increase for all employees and designate another fixed amount of their salary budget to these types of awards. The philosophy is to reward high performers with these one-time payments and encourage continued high performance by providing an opportunity to earn these awards on an annual basis.

You will recall that when we implemented our Pay for Performance strategy, we discussed the fact it was a somewhat modified version of true Pay for Performance where supervisors have an allocated amount of money and complete discretion as to how the money will be distributed. We opted for a program with fixed percentages of increases based on a numerical rating system. Theoretically, in our existing system you could take any percentage to be awarded over and above our base factor (which is typically one-half to one percent) and make it a one-time payout rather than calculating it into the employee's salary. For an employee making $50,000 who qualifies for an extra half percent they would receive $250; if they qualified for an extra 1% they would receive $500. It is difficult to calculate the difference between just paying this out one time and putting it into the base, as the factors differ each year, but for the sake of providing an example, we can use a 2% base factor consistently. The example makes an assumption that the employee continues to earn the PFP incentive each year, which may or may not be the case.

Year One -	$50,000 salary + 2% base increase + .5% PFP incentive = $51,250 base
Or	$50,000 salary + 2% base increase = $51,000 base + one time pay out of $250
	No Difference
Year Two	$51,250 salary + 2% base increase + .5% PFP incentive = $52,531 base
Or	$51,000 salary + 2% base increase = $52,020 base + one time pay out of $255
	Difference - $256
Year Three	$52,531 salary + 2% base increase + .5% PFP incentive = $53,844 base
Or	$52,020 salary + 2% base increase = $53,060 base + one time pay out of $260
	Difference - $524

This scenario illustrates that under our current modified PFP system there is not a great deal of difference in actual dollars paid (at least in the first few years) if you remove the incentive pay from the base salary. Considering this, and the fact that employees are still adjusting to the Pay for Performance concept and supervisors are still working through challenges with the performance evaluation system, it would be our recommendation that we not switch to a variable pay system at this time.

This is not to say that Variable Pay shouldn't be a long-term goal. The research we do each year continues to confirm that Pay for Performance is definitely the trend. Mercer's *Next Generation of Pay for Performance Survey* indicates that more than two-thirds (69 percent) of employers in the U.S. are working to increase differentiation of pay based on performance. Additionally, the survey shows that organizations' primary objectives for focusing on Pay for Performance are to attract and retain top talent, drive specific behaviors or results, and encourage engagement. While companies are realizing the importance of these types of programs to encourage high performance and employee retention, they are also coming to understand that this strategy comes at a price. In order to fund Variable Pay at a level that makes an impact, some organizations are reducing merit or base increases for other workers, reducing the overall number of employees, freezing base pay and reducing the amount spent on benefits. This is a deliberate strategy that focuses on the high performer, and in the current economy where resources are limited, decisions have to be made that impact other employees or other aspects of the organization in order to fund Variable Pay.

We feel that at this juncture the City of La Vista has found a way to reward those employees performing at a higher level, at least to some degree, without negatively impacting other employees or the organization. It is our belief that PFP as a compensation strategy will continue to become more engrained in La Vista's work culture and employees will ultimately come to expect to be rewarded for their performance, not their attendance. As that culture shift takes place and the economy continues to improve, a Variable Pay component would certainly be something to consider and discuss.

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