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Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Alex Gurza

SUBJECT: Pension and Retiree Healthcare
Valuations Update

DATE: March 19, 2013

Approved

Date

3/20/13

INFORMATION

The Retirement Boards' actuary, Cheiron, has completed the valuations for Fiscal Year 2013-2014, using data as of June 30, 2012. The purpose of this memorandum is to provide the City Council with an update on these valuations. These latest actuarial valuations estimate an over **\$2.9 billion** total unfunded liability from the pension and retiree healthcare benefits programs in both the Federated City Employees' Retirement System and Police and Fire Department Retirement Plan.

The City has undertaken efforts to address the significant unfunded liabilities in both retirement plans. These latest valuations include the following significant changes:

- Implementation of Tier 2 in the Federated Retirement System
- Elimination of the Supplemental Retiree Benefit Reserve (SRBR)
- Healthcare plan design changes

The Federated City Employees' Retirement System and the Police and Fire Department Plan use Cheiron, Inc. to provide actuarial valuations of the respective retirement systems' pension and retiree healthcare programs. The information contained in this memorandum is based on Cheiron's valuations as of June 30, 2012. Please note that the Boards' actuary conducts valuations on an annual basis, as of June 30th of each year. The most recent completed actuarial valuations as of June 30, 2012, will serve as the basis for the contribution rates for Fiscal Year 2013-2014. This memorandum has been issued at this time due to the completion and the Boards' approval of all actuarial valuations by the Boards' actuary.

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM

Federated Pension Actuarial Valuation

The following chart compares contribution rates from Fiscal Year 2012-2013, to the contribution rates for Fiscal Year 2013-2014. This information can be found in the June 30, 2011, and June 30, 2012, pension actuarial valuations.

Federated Tier 1 and Tier 2 Pension¹	Federated Tier 1 Valuation as of 06/30/11²	Federated Tier 1 Valuation as of 06/30/12³	Federated Tier 2 Valuation as of 6/30/12⁴
Employee Pension Contribution Rate	5.74%	5.97%	6.68%
City Pension Contribution Rate	44.45%	50.85%	6.68%
Total Pension Contribution Rate	50.19%	56.82%	13.36%
Net Change in Total Pension Contribution Rate	6.63%		N/A

As of September 30, 2012, any new hire or rehire into the Federated City Employees' Retirement System has been placed in Tier 2. As of February 13, 2013, there are 118 employees in Tier 2. Tier 2 significantly reduces the City's costs for retirement benefits. The Tier 2 contribution rates are shared 50/50 between employees and the City. The chart above also includes the Tier 2 contribution rates.

Cheiron's Federated pension actuarial valuation report, as of June 30, 2012, indicates that there is an unfunded liability of approximately \$1.08 billion. As part of the implementation of the retirement changes, the Supplemental Retiree Benefit Reserve (SRBR) was eliminated. Without elimination of the SRBR, the Federated pension unfunded liability would have been \$1.12 billion. However, even with the elimination of the SRBR, there was a 9.82% increase in the unfunded actuarial liability from the previous fiscal year.

The following chart for the Federated pension actuarial valuation describes the unfunded actuarial liability and funding ratios for the Plan as of June 30, 2011, and June 30, 2012.

Federated Tier 1 Pension¹	Valuation as of 06/30/11²	Valuation as of 06/30/12³
Discount Rate (Earnings Assumption)	7.50%	7.50%
Unfunded Actuarial Liability (UAL)	\$981.568 Million	\$1.078 Billion
Net Change in UAL	\$96.432 Million 9.82%	
Funding Ratio – Actuarial Value of Assets	65.00%	62.00%
Funding Ratio – Market Value of Assets	64.00%	58.00%

¹ The Federated pension actuarial valuation numbers include the elimination of the SRBR as of June 30, 2012

² Cheiron's Federated pension actuarial valuation as of June 30, 2011 (Report dated November 2011)

³ Cheiron's Federated pension actuarial valuation as of June 30, 2012 (Report dated December 2012)

⁴ Cheiron's Federated pension actuarial valuation as of June 30, 2012 (Report dated December 2012)

Federated Retiree Healthcare Valuation

Cheiron also completed a valuation on the Federated Retirement System's retiree healthcare plan as of June 30, 2012. The retiree healthcare plan design changes that were implemented in the last few years had a significant impact on lowering the unfunded liability. In the Federated System alone, these plan design changes were the primary factor in an approximate \$200 million reduction in the Federated retiree healthcare unfunded liability.

In 2009, the City and most bargaining units began a five year phase-in to fully pre-fund the Annual Required Contribution (ARC) for retiree healthcare. The end of this five year phase-in is this year and the City and employees in the Federated retirement system will begin paying the full Annual Required Contribution. Even with the \$200 million decrease in the unfunded liability, this will result in a 3.48% increase for employees in retiree healthcare contribution alone and a 4.02% increase for the City.

The June 30, 2012, actuarial valuation takes into account employees and the City paying the full Annual Required Contribution. These contribution rates will go into effect for Fiscal Year 2013-2014, unless an agreement is reached with the Federated bargaining units on retiree healthcare.

The following chart compares contribution rates from Fiscal Year 2012-2013, to the contribution rates for Fiscal Year 2013-2014. This information can be found in the June 30, 2011, and June 30, 2012, retiree healthcare actuarial valuations.

Federated Retiree Healthcare	Valuation as of 06/30/11⁵	Valuation as of 06/30/12⁶
Employee Contribution Rate	7.26%	10.74%
City Contribution Rate	7.91%	11.93%
Total Contribution Rate	15.17%	22.67%
Net Change in Retiree Healthcare Contribution Rate	7.50%	

The following chart for the Federated retiree healthcare actuarial valuation describes the unfunded actuarial liability and funding ratios for the Plan as of June 30, 2011, and June 30, 2012. This shows the significant decrease in the unfunded liability and the resulting increase in the funding ratio due primarily to the retiree healthcare plan design changes.

⁵ Cheiron's Federated retiree healthcare actuarial valuation as of June 30, 2011 (Report dated January 2012)

⁶ Cheiron's Federated retiree healthcare actuarial valuation as of June 30, 2012 (Report dated January 2013)

Federated Retiree Healthcare	Valuation as of 06/30/11	Valuation as of 06/30/12
Discount Rate (Earnings Assumption)	7.5%	7.5%
Unfunded Actuarial Liability (UAL)	\$800.505 Million	\$604.668 Million
Net Change in UAL	-\$195.837 Million -24.46%	
Funding Ratio – Actuarial Value of Assets	14%	19%

POLICE AND FIRE DEPARTMENT RETIREMENT PLAN

Police and Fire Total Pension Unfunded Liability

During the December 2012, Board meeting, the Police and Fire Department voted to change the earnings assumption from 7.50% to 7.25%. It should be noted that the Federated Board voted to keep the earnings assumption the same (7.50%). The Police and Fire Retirement Board approved the contribution rate resolutions at the March 2013, Board meeting. These contribution rates include the elimination of the SRBR.

Police and Fire have different contribution ratios, but the actuarial valuation aggregates the unfunded liability and the ARC for the Plan as a whole. The unfunded liability for the Police and Fire pension plan increased by 36.06%.

Police and Fire Pension⁷	Valuation as of 06/30/11⁸	Valuation as of 06/30/12⁹
Discount Rate (Earnings Assumption)	7.50%	7.25%
Unfunded Actuarial Liability (UAL)	\$510.3 Million	\$694.3 Million
Net Change in UAL	\$184 Million 36.06%	
Funding Ratio – Actuarial Value of Assets	84.0%	79.6%
Funding Ratio – Market Value of Assets	82.2%	75.9%

⁷ The Police and Fire pension actuarial valuation numbers include the elimination of the SRBR as of June 30, 2012

⁸ Cheiron's pension actuarial valuation as of June 30, 2011 (Report dated March 2012)

⁹ Cheiron's memo regarding FYE 2014 contribution rates assuming the SRBR is eliminated (Report dated December 21, 2012)

Police Pension Contribution Rates

The following chart compares contribution rates from Fiscal Year 2012-2013, to the contribution rates for Fiscal Year 2013-2014. This information can be found in the June 30, 2011, and June 30, 2012, pension actuarial valuations.

Police Pension Contribution Rates	Valuation as of 06/30/11¹⁰	Valuation as of 06/30/12¹¹
Employee Pension Contribution Rate	11.13%	11.65%
City Pension Contribution Rate	56.57%	65.31% ¹²
Total Pension Contribution Rate	67.70%	76.96%
Net Change in Contribution Rate	9.26%	

Fire Pension Contribution Rates

The following chart compares contribution rates from Fiscal Year 2012-2013, to the contribution rates for Fiscal Year 2013-2014.

Fire Pension Contribution Rates	Valuation as of 06/30/11¹³	Valuation as of 06/30/12¹⁴
Employee Pension Contribution Rate	11.21%	11.72%
City Pension Contribution Rate	58.43%	66.79% ¹⁵
Total Pension Contribution Rate	69.64%	78.51%
Net Change in Contribution Rate	8.87%	

Police and Fire Retiree Healthcare Actuarial Valuation

The health plan changes also resulted in a decrease in the retiree healthcare unfunded liability in the Police and Fire Department Retirement Plan. A net \$66.93 million (-11.21%) decrease was experienced in the total unfunded liability for retiree healthcare.

The following chart compares contribution rates from Fiscal Year 2012-2013, to the contribution rates for Fiscal Year 2013-2014.

¹⁰ Cheiron's pension actuarial valuation as of June 30, 2011 (Report dated March 2012)

¹¹ Cheiron's memo regarding FYE 2014 contribution rates assuming the SRBR is eliminated (Report dated December 21, 2012)

¹² The City contribution rates for Police include the elimination of the SRBR for Fiscal Year 2013-2014

¹³ Cheiron's pension actuarial valuation as of June 30, 2011 (Report dated March 2012)

¹⁴ Cheiron's memo regarding FYE 2014 contribution rates assuming the SRBR is eliminated (Report dated December 21, 2012)

¹⁵ The City contribution rates for Fire include the elimination of the SRBR for Fiscal Year 2013-2014

Police and Fire Retiree Healthcare	Valuation as of 06/30/11	Valuation as of 06/30/12
Discount Rate (Earnings Assumption)	7.50%	7.25%
Unfunded Actuarial Liability (UAL)	\$596.764 Million	\$529.839 Million
Net Change in UAL	\$-66.925 Million -11.21%	
Funding Ratio – Actuarial Value of Assets	9.2%	11.1%
Funding Ratio – Market Value of Assets	9.1%	10.6%

Police Retiree Healthcare Contribution Rates

The Police Officers’ Association (POA) and the City reached an agreement in 2009 that limited the maximum annual contribution rate increase to 1.35% for the City and 1.25% for employees in the POA, with a cap of 10% for employees and 11% for the City. The numbers below reflect the maximum amount of increase for the members and the City. The contribution rates do not result in the full funding of the Annual Required Contribution.

The following chart compares contribution rates from Fiscal Year 2012-2013, to the contribution rates for Fiscal Year 2013-2014.

Police Retiree Healthcare	Valuation as of 06/30/11¹⁶	Valuation as of 06/30/12¹⁷
Employee Contribution Rate	8.26%	9.51%
City Contribution Rate	8.96%	10.31%
Total Contribution Rate	17.22%	19.82%
Net Change in Retiree Healthcare Contribution Rate	2.6%	

The following chart demonstrates what the full ARC contribution rates would be for Police retiree healthcare in Fiscal Year 2012-2013, and Fiscal Year 2013-2014, if a cap was not in place.

¹⁶ Cheiron’s retiree healthcare valuation as of June 30, 2011 (Report dated March 2012)

¹⁷ Cheiron’s retiree healthcare valuation as of June 30, 2012 (Report dated January 2012)

Police Retiree Healthcare	Full ARC 2012-2013 Contribution Rates	Full ARC 2013-2014 Contribution Rates
Employee Contribution Rate	13.48%	12.74%
City Contribution Rate	14.63%	13.95%
Total Annual Required Contribution Rate	28.11%	26.69%
Net Change in Retiree Healthcare Annual Required Contribution Rate	-1.42%	

Fire Retiree Healthcare Contribution Rates

In 2011, the San Jose Fire Fighters (IAFF, Local 230) entered into an agreement with the City to cap the maximum increase in contributions rates for retiree healthcare. As with the POA, the IAFF agreed that the City maximum contribution increase would be 1.35% and the maximum employee contribution increase would be 1.25%, with a cap of 10% for employees and 11% for the City.

The following chart compares contribution rates from Fiscal Year 2012-2013, to the contribution rates for Fiscal Year 2013-2014.

Fire Retiree Healthcare	Valuation as of 06/30/11¹⁸	Valuation as of 06/30/12¹⁹
Employee Contribution Rate	6.11%	7.36%
City Contribution Rate	6.62%	7.97%
Total Contribution Rate	12.73%	15.33%
Net Change in Retiree Healthcare Contribution Rate	2.6%	

The following chart demonstrates what the full ARC contribution rates would be for Fire retiree healthcare in Fiscal Year 2012-2013, and Fiscal Year 2013-2014, if a cap was not in place.

¹⁸ Cheiron's retiree healthcare valuation as of June 30, 2011 (Report dated March 2012)

¹⁹ Cheiron's retiree healthcare valuation as of June 30, 2012 (Report dated January 2012)

Fire Retiree Healthcare	Full ARC 2012-2013 Contribution Rates	Full ARC 2013-2014 Contribution Rates
Employee Contribution Rate	13.31%	11.79%
City Contribution Rate	14.49%	12.94%
Total Annual Required Contribution Rate	27.80%	24.73%
Net Change in Retiree Healthcare Annual Required Contribution Rate	-3.07%	

Total Minimum City Contribution Amounts (if made at the beginning of the Fiscal Year) and Rates

In 2010-2011, the Retirement Boards adopted an annual required contribution methodology, which requires the City to pay a minimum ARC or a percentage of payroll, whichever is greater, for the Federated Retirement System and the Police and Fire Department Retirement Plan. In November 2012, the Federated Retirement System Board approved that for the Federated Retirement System Tier 2 plan, however, the City's contribution shall only be based on a percentage of payroll. Due to the independently estimated payroll projections by the Retirement Boards' actuary and the City Manager's Budget Office, the City calculations for the City retirement contributions for the Federated Retirement System Tier 1 plan and the Police and Fire Department Retirement Plan are based on the minimum ARC as required by the Boards or the ARC based on Board approved percentage of budgeted payroll as calculated by the City Manager's Budget Office, whichever is greater.

Because of this difference in methodology, as reported in the 2014-2018 General Fund Forecast, the 2013-2014 City contributions to the retirement plans is estimated to be \$275.8 million for all funds, which differs from the tables below. Please note that this figure will change based on recommendations included in the forthcoming City Manager's 2013-2014 Proposed Budget and City Council approval of the 2013-2014 Adopted Budget.

The following charts have been provided as an overview of the respective changes in the Board approved minimum contribution amounts and Board approved rates from Fiscal Year 2012-2013, and Fiscal Year 2013-2014.

PENSION	Total City Minimum Contribution 2012-2013	Total City Minimum Contribution 2013-2014
Police and Fire Pension ARC	\$106.145 Million	\$119.6 Million
Federated Pension ARC	\$102.972 Million	\$102.470 Million
Total Pension ARC	\$209.117 Million	\$222.07 Million
Net Change in Total Pension Minimum ARC	\$12.953 Million 6.19%	

RETIREE HEALTHCARE	Total City Minimum Contribution 2012-2013	Total City Minimum Contribution 2013-2014
Police and Fire Retiree Healthcare Minimum Contribution	\$14.922 Million	\$17.073 Million
Federated Retiree Healthcare Minimum Contribution	\$18.033 Million	\$26.833 Million
Total Retiree Healthcare Minimum Contribution	\$32.955 Million	\$43.906 Million
Net Change in Total Retiree Healthcare Minimum Contribution	\$10.951 Million 33.23%	

City and Employee Total Retirement Contribution Rates Fiscal Year 2013-2014

	City Contribution Rate (Pension & Retiree Healthcare)	Employee Contribution Rate (Pension & Retiree Healthcare)	Total Contribution Rate (Pension and Retiree Healthcare)
Police	75.62%	21.16%	96.78%
Fire	74.76%	19.08%	93.83%
Federated Tier 1	62.78%	16.71%	79.49%

Total Pension Unfunded Liability as of June 30, 2011, and June 30 2012

TOTAL PENSION UNFUNDED LIABILITY	Total Pension Unfunded Liability as of June 30, 2011	Total Pension Unfunded Liability as of June 30, 2012
Police and Fire Pension Unfunded Liability	\$510.3 Million	\$694.3 Million
Federated Pension Unfunded Liability	\$981.568 Million	\$1.078 Billion
Total Pension Unfunded Liability	\$1.492 Billion	\$1.772 Billion
Net Change in Pension Unfunded Liability	\$280 Million 18.77%	

Total Retiree Healthcare Unfunded Liability June 30, 2011, and June 30, 2012


TOTAL RETIREE HEALTHCARE UNFUNDED LIABILITY	Total Retiree Healthcare Unfunded Liability as of June 30, 2011	Total Retiree Healthcare Unfunded Liability as of June 30, 2012
Police and Fire Retiree Healthcare Unfunded Liability	\$596.764 Million	\$529.839 Million
Federated Retiree Healthcare Unfunded Liability	\$800.505 Million	\$604.668 Million
Total Retiree Healthcare Unfunded Liability	\$1.397 Billion	\$1.135 Billion
Net Change in Total Retiree Healthcare Unfunded Liability	-\$262 Million -18.75%	

Conclusion

These most recent actuarial valuations reflect the City's efforts to reduce the cost of our plans. For example, these actuarial valuations reflect the elimination of the Supplemental Retiree Reserve Benefit (SRBR) and healthcare plan changes. Although we have made significant progress, the most recent actuarial valuations reflect that the total unfunded liability for both pension and retiree healthcare is \$2.9 billion.

We will keep the City Council informed of any significant developments.

The full actuarial valuations used in this information memorandum can be found at <http://www.sanjoseca.gov/index.aspx?nid=2421>.


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Deputy City Manager

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