SENT TO COUNCIL:

Distributed on:

MAR 22 2012

City Manager's Office

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: Retirement Cost Projections

DATE: March 22, 2012

INFORMATION

This memo is in response to the memo from Councilmembers Kalra, Chu, Campos, Rocha and Pyle dated February 23, 2012, regarding the Director of Retirement Services' statement at a February 14, 2011, budget study session relating to the potential increase in retirement costs projections for Fiscal Year 2015-2016.

On February 14, 2011, the annual Budget Priority Setting Study Session occurred with the City Council and Senior Staff. The purpose of this session was to provide an update on budget planning to address the 2011-2012 General Fund shortfall that was estimated at that time to be $110 million, discuss options for addressing the projected City Retirement Contributions and Retirement Reform and to conduct a prioritization of workload, including discussion of ordinance changes and major referrals. This and other study sessions are designed to encourage conversation and discussion with the Council and City staff and often different hypotheticals are discussed.

As noted above, a significant portion of this Study Session was related to retirement. During the presentation, a conversation regarding actuarial assumptions occurred. Attached to this memo is one slide from that presentation that shows future actuarial issues that could increase retirement costs. Those areas are:

- Modification to Assumed Rate of Return
    - 7.00% or lower Rate of Return
- Modification to amortization schedule
- Including expenses as a projected cost
- Modification to mortality table for Police and Fire
- Modification to projected merit increases for Police and Fire
- Modification to projected retirements for Police and Fire

During this conversation regarding actuarial assumptions, a variety of questions were being posed to the Retirement Services Director regarding retirement costs. The Retirement Services Director made the statement below, which has been taken directly from the transcript of this meeting. It is extremely important to understand the context of this statement, and I encourage everyone to view this video at:
http://sanjose.granicus.com/MediaPlayer.php?view_id=22&clip_id=4824.
For the relevant portion, please view the tape starting at 2 hours and 5 minutes.

> *The benefits are going to be whatever the benefits are, but in order to fund them and accurately project for them, to actually project forward how much it's all going to cost, we need to fix all of these things inside the valuations that we already know about, and we're nowhere near fixing those. If you fixed all of that, you're looking at probably another 250 million above your 400 million. So the 400 is really just a basic starting point that recognizes the losses that have occurred and doesn't really fix anything going forward.*

As you will see in the video, Russell Crosby, Director of Retirement Services, was being asked a variety of questions about what has happened in the retirement plans and what could happen in regards to retirement costs. At one point he was asked by a Councilmember to just give "an estimate." There is absolutely nothing wrong with this, and I encourage these types of discussions. I expect staff with knowledge and experience, to be able to provide these types of responses based on their expertise. This happens throughout the City on a daily basis.

It is important to note that the accuracy of projected future retirement costs are unknown until the actual experience is known and the annual valuation is completed. Current projections that are performed by the Boards' actuary include a specific note that the projections are based on the June 30, 2011, Actuarial Valuations for the Plans, and assume that all assumptions are **exactly met** since June 30, 2011, and are exactly met each and every year into the future. This includes that the Plans' investments earn 7.5% each and every year into the future. Despite this, it is important to consider different hypotheticals, particularly in the context of budget study sessions. However, the only estimates used by City Administration for budgetary forecasting or negotiation purposes were those that were developed by actuaries, as noted in my memorandum dated February 9, 2012, which is available at:
https://www.piersystem.com/external/content/document/1914/1306487/1/02-09-12%20CMO.PDF.

In closing, because of the misrepresentations surrounding this issue, I'd like to remind the City Council of two important facts:

1. All Council approved labor negotiations and budgetary estimates involving retirement and retirement related issues that have involved projections of retirement costs have not been based on worst case or pessimistic scenarios, such as the $650 million scenario.

2. The direction from the City Council to achieve a 10% total compensation reduction for all City employees occurred prior to February 14, 2011. In fact, the previous year, most employees had already taken the 10% total compensation reduction. The 10% total compensation reduction was needed in balancing the Fiscal Year 2011-2012 budget, which faced a $115 million deficit after two previous years of significant deficits. Without it, there would have been more layoffs of City employees and further service reductions to the community. This difficult decision was made prior to this Study Session and had nothing to do with a $650 million scenario.

DEBRA FIGONE
CITY MANAGER

Attachment

Future Actuarial Issues

- Modification to Assumed Rate of Return
  - 7.00% or lower Rate of Return
- Modification to amortization schedule
- Including expenses as a projected cost
- Modification to mortality table for Police and Fire
- Modification to projected merit increases for Police and Fire
- Modification to projected retirements for Police and Fire

CITY OF SAN JOSE CAPITAL OF SILICON VALLEY