

# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Norberto L. Dueñas

**SUBJECT:** SEE BELOW

**DATE:** July 24, 2015

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## INFORMATION

**SUBJECT: APPROVAL OF THE TERMS OF THE ALTERNATIVE PENSION REFORM SETTLEMENT FRAMEWORK AGREEMENT CONCERNING THE LITIGATION ARISING OUT OF MEASURE B WITH THE SAN JOSE POLICE OFFICERS' ASSOCIATION (SJPOA) AND THE SAN JOSE FIRE FIGHTERS, INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS, LOCAL 230 (IAFF, LOCAL 230) AND RELATED APPROPRIATION ACTIONS**

The attached memorandum entitled *Approval of the Terms of the Alternative Pension Reform Settlement Framework Agreement Concerning the Litigation Arising Out of Measure B with the San Jose Police Officers' Association (SJPOA) and the San Jose Fire Fighters, International Association Of Fire Fighters, Local 230 (IAFF, Local 230) and Related Appropriation Actions* will be on August 11, 2015 City Council agenda. The final agenda and materials will be posted and released on Friday, July 31, 2015.



Norberto L. Dueñas  
City Manager

Attachment





# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Jennifer Schembri  
Jennifer A. Maguire

**SUBJECT:** SEE BELOW

**DATE:** July 24, 2015

Approved

Date

7/24/15

**SUBJECT: APPROVAL OF THE TERMS OF THE ALTERNATIVE PENSION REFORM SETTLEMENT FRAMEWORK AGREEMENT CONCERNING THE LITIGATION ARISING OUT OF MEASURE B WITH THE SAN JOSE POLICE OFFICERS' ASSOCIATION (SJPOA) AND THE SAN JOSE FIRE FIGHTERS, INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS, LOCAL 230 (IAFF, LOCAL 230) AND RELATED APPROPRIATION ACTIONS**

## RECOMMENDATION

It is recommended that the City Council approve the following actions:

- a) Approval of the terms of the Alternative Pension Reform Settlement Framework agreement between the City and the San Jose Police Officers' Association (SJPOA) and San Jose Fire Fighters, International Association of Fire Fighters, Local 230 (IAFF, Local 230).
- b) Authorize the City Manager to negotiate and execute a Tripartite Retirement Memorandum of Agreement between the City, the SJPOA, and IAFF, Local 230.
- c) Adopt the following 2015-2016 Appropriation Ordinance amendments in the General Fund:
  - i. Establish a City-Wide Measure B Settlement appropriation to the City Manager's Office in the amount of \$1,500,000; and
  - ii. Decrease the Fiscal Reform Plan Implementation Reserve in the amount of \$1,500,000.

## OUTCOME

Approval of the terms of the Alternative Pension Reform Settlement Framework agreement, and authorize the City Manager to negotiate and execute the Tripartite Retirement Memorandum of Agreement between the City, the SJPOA and IAFF, Local 230.

## **BACKGROUND**

The City of San Jose is currently in litigation with the San Jose Police Officers' Association (SJPOA), the San Jose Fire Fighters, International Association of Fire Fighters, Local 230 (IAFF, Local 230), and other employee and retiree groups over the pension reform ballot measure known as Measure B. Measure B was approved by the voters on June 5, 2012, and has subsequently been the subject of various forms of litigation. In an effort to settle these cases for budget stability and to provide certainty to the City's workforce, the City Council directed the City Administration to make any and all reasonable efforts to reach and implement a settlement this year.

In April 2015, settlement discussions with the SJPOA and IAFF, Local 230 commenced and, on or about July 15, 2015, the City, the SJPOA and IAFF, Local 230 reached an agreed upon settlement on an Alternative Pension Reform Settlement Framework (Framework). The attached Framework presents a path toward the settlement of litigation over Measure B. The settlement framework is subject to a final overall global settlement with all parties related to Measure B litigation. It is also contingent on the City and the SJPOA reaching agreement on a successor Memorandum of Agreement (MOA). Those discussions are currently ongoing.

The City Council has not yet made a decision regarding the path by which to implement the framework, such as through a 2016 ballot measure to modify Measure B or through the quo warranto process to remove the language attributable to Measure B from the City Charter. The City Council will consider that issue at a subsequent meeting.

In summary, the Alternative Pension Reform Settlement Framework will:

- Settle significant litigation with SJPOA and IAFF, Local 230 with the Framework's alternative strategy to pension reform. This agreement should avoid further litigation costs with these groups.
- Over the next 30+ years, provide savings of approximately \$1.7 billion from the revised Tier 2 compared to Tier 1 (\$1.15 billion), the revised retiree healthcare program compared to the current retiree healthcare program (\$244.2 million), and from the elimination of the SRBR (\$270 million).
- Modify Tier 2 pension benefits for sworn employees to levels similar to other Bay Area agencies to attract and retain sworn employees, providing a competitive Tier 2 pension benefit at a reduced cost. The new Tier 2 benefit has several differences from the California Public Employees' Retirement System (CalPERS) second tier benefit (the Public Employees' Pension Reform Act, or PEPRA) that reduce costs. For example, the accrual rate is back loaded so that the more years of service an employee has, the higher accrual rate they receive, which is a significant difference from the Tier 2 benefit in other agencies and reduces the cost of the Tier 2 benefit significantly. This also incentivizes longevity. This Tier 2 benefit also has a maximum benefit of 80%, while other agencies have no maximum benefit.

- Allow Tier 1 employees who left the City and either subsequently have returned or return in the future to return into the Tier 1 benefit, incentivizing employees who have left to return to City service.
- Preserve 50/50 risk sharing with employees through the cost sharing of a 50/50 split in normal costs and any future unfunded liability associated with the Tier 2 benefit. In other agencies, the cost sharing is just 50/50 of normal cost.
- Close the retiree healthcare defined benefit plan to new and Tier 2 employees, and allow an opt-out for Tier 1 employees, into a defined contribution Voluntary Employee Beneficiary Association (VEBA) subject to legal and IRS approval. The VEBA has no employer contribution and is completely funded by the employee. Because the VEBA has a lower contribution than the existing defined benefit plan, it reduces retiree healthcare costs for sworn employees and increases their take home pay, while reducing the City’s liability for retiree healthcare.
- Implement a new lowest cost healthcare plan in order to reduce retiree healthcare costs.
- Allow retirees with alternate coverage to receive 25% credit towards future premiums instead of being covered by the City in order to reduce costs (similar to “in lieu” programs commonly used for active employees).
- Reinstate the Police and Fire Retirement Plan’s previous definition of disability which is comparable to other agencies.
- Create an Independent Medical Panel appointed by the Retirement Board which will determine disability eligibility instead of the Retirement Board. The agreement creates a process and minimum qualifications for the Independent Medical Panel.
- Create a workers’ compensation offset to disability retirements received by Tier 2 employees represented by the SJPOA and IAFF, Local 230.
- Create a committee for the City and the SJPOA and IAFF, Local 230 to continue discussions on wellness and workers’ compensation to streamline the process and reduce costs.
- Continue the elimination of the Supplemental Retiree Benefit Reserve (SRBR) from the Police and Fire Retirement Plan, solidifying \$9 million in General Fund savings.
- Allow for continued discussions regarding the following provisions of Measure B not addressed in this agreement:
  - Actuarial soundness
  - Voters’ ability to vote on any benefit increases

The below chart depicts the realized savings from Measure B and retirement reform as shown to the Council during the January 20, 2015, Study Session regarding General Fund Structural Budget Deficit History and Service Restoration Priorities and Strategies:

Retirement Reform Estimate	GF Savings
<b>Implemented</b>	
SRBR Elimination	\$13 M
Retiree Healthcare Changes (lowest cost plan)	\$7 M
New Tier 2 Retirement Plans	\$5 M
<b>Subtotal Implemented</b>	<b>\$25 M</b>

The Settlement Framework preserves these savings, including \$9 million from the continued SRBR elimination for the Police and Fire Retirement Plan (the remaining \$4 million is attributable to the Federated Retirement System). Additionally, the new lowest cost plan saves additional retiree medical funds (including an estimated \$4.6 million in the first year) while the prior savings continue. The exception is the increased cost for the revised Tier 2 benefit. In the first year of the revised Tier 2 Police and Fire pension benefit, the cost will increase from the current Tier 2 by \$400,000.

The Alternative Pension Reform Settlement Framework was ratified by IAFF, Local 230 on July 21, 2015, and is pending ratification by the SJPOA, which will notify the City of the ratification results as soon as ratification is completed.

### **ANALYSIS**

A complete copy of the Alternative Pension Reform Settlement Framework is attached (Attachment A). The following is a summary of the key provisions of the Framework applicable to employees represented by the SJPOA and IAFF, Local 230.

#### **Tripartite Retirement Memorandum of Agreement**

A Tripartite agreement between the City, the SJPOA and IAFF, Local 230, will be finalized to memorialize all agreements related to retirement.

The term of the Tripartite MOA shall be July 1, 2015 – June 30, 2025.

#### **Revised Tier 2**

In order to address recruitment and retention issues, this agreement modestly increases the Tier 2 benefits; however, the City's portion of the Normal Cost will go from 11.2% to an estimated 14.7%, which is still drastically lower than the City's portion of the Normal Cost for Tier 1, which is 31.6%.

Employees hired on or after the effective date of the ordinance implementing these changes will be subject to the following pension benefits. Any current Tier 2 members will be retroactively placed in the revised Tier 2.

#### **Pension Formula Accrual Rate**

Years: 1-20	2.4%
21-25	3.0%
<u>26+</u>	<u>3.4%</u>

#### **Maximum Benefit**

The above accrual rate is subject to a maximum of 80% of final compensation.

#### **Final Compensation**

Average annual earned pay of the highest three consecutive years of service. Final Compensation will include base pay, holiday in lieu pay, anti-terrorism training pay, POST pay, and base FLSA pay.

**Revised Tier 2**    **Minimum Service**  
**(cont'd)**

Tier 2 employees shall be eligible for a service retirement after earning five (5) years of retirement service credit and meeting the age requirement.

**Normal Age of Retirement**

Employees shall be eligible to retire at age 57 with at least five (5) years of retirement service credit.

Tier 2 employees have the ability to retire at age 50 with a 7% reduction per year below age 57, prorated to the closest month.

**Retiree Cost of Living Adjustment (COLA)**

Plan members shall receive a cost of living adjustment limited to the increase in the consumer price index, or CPI (San Jose – San Francisco – Oakland U.S. Bureau of Labor Statistics index, CPI-U, December to December), capped at 2.0% per fiscal year. The first COLA will be prorated based on the number of months retired.

**No Retroactive Pension Increases or Decreases**

Any changes in pension benefits will be on a prospective basis only.

**Current Tier 2 Employees**

The Police and Fire employees currently in Tier 2 will be retroactively moved to this revised Tier 2 benefit.

Any costs, including unfunded liabilities associated with moving the current Tier 2 employees into the revised structures, will be shared between the employees and the City on a 50/50 basis with no ramp up and amortized as a separate liability over a minimum of 16 years.

**Vesting Language**

The City will remove the language currently contained in City Charter Section 1508-A referring to limiting vesting of benefits.

**Cost Sharing**

Employees and the City will share equally in all costs of Tier 2 to the pension plan, including all normal costs and unfunded liabilities.

If an unfunded liability exists for Tier 2 members, employees will contribute based on a “ramp up” to paying 50% of the liability. In years where an unfunded liability exists, the member contribution will be increased by increments of 0.33% per year until such time that the contribution associated with the unfunded liability is shared 50/50. Until such time, the City will pay the balance of the contribution associated with the unfunded liability of the Tier 2 plan.

**Revised Tier 2**  
**(cont'd)**

For example, if the unfunded liability contribution rate of the Police and Fire Tier 2 plan is 2% for three years, the following ramp-up schedule will occur:

<b>Year</b>	<b>Total UAL Rate</b>	<b>City UAL Rate</b>	<b>Employee UAL Rate</b>
1	2.00%	1.67%	.33%
2	2.00%	1.34%	.66%
3	2.00%	1.01%	.99%

**Disability Benefits**

*Service Connected*

Plan members eligible for a service connected disability retirement benefit shall receive an annual benefit equal to the greater of 50% of final compensation, a service retirement allowance if the member is eligible, or an actuarially reduced factor, determined by the plan's actuary, for each quarter year that the member's service age is less than 50 years, multiplied by the number of years of safety service subject to the applicable formula, if not eligible for a service retirement.

*Non-Service Connected*

Plan members eligible for a non-service connected disability retirement benefit shall receive an annual benefit equal to the either 1.8% per year if the member is less that age 50 or the amount of the service pension benefit if the member is older than age 50.

**Survivorship Benefits**

The survivorship benefits for Tier 2 shall be the same as the survivorship benefits for Tier 1; however, these benefits will be reduced to reflect the 80% pension benefit maximum.

**Rehired Employees/New Hires From Outside Agencies**

Former City Tier 1 sworn employees who have been rehired since the implementation of the Police and Fire Tier 2 plans, or rehired after the effective date of this agreement, will return to Tier 1. Any lateral hires that are defined as "Classic" members under the Public Employees' Pension Reform Act (PEPRA), regardless of the tier of their previous employer, will also become Tier 1 members. Employees who are considered "new" employees under PEPRA will enter the revised Tier 2 plan.

The costs associated with the transition of current Tier 2 employees into Tier 1 will be shared between the employees and the City on a 50/50 basis with no ramp up. This will be a separate liability amortized over 16 years.

**Revised Tier 2**  
**(cont'd)**

**Service Credit Purchases**

Tier 2 members shall be eligible to make the same service credit purchases as Tier 1, with the exception of purchases of service credit related to suspension. All costs associated with service credit purchases will be paid for by the Tier 2 member.

**Actuarial Assumptions**

The City, the SJPOA and IAFF, Local 230 will work with their respective actuaries to jointly request that the Police and Fire Department Retirement Plan Board of Administration and its actuary carefully consider the new Tier 2 actuarial assumptions. In particular, the parties will request that the Board and its actuary incorporate assumptions similar to the CalPERS PEPRAs rates of retirement, which are expected to reduce the cost of the benefit.

**Tier 2 Costing**

The below chart indicates the difference in the current Tier 1 and Tier 2 pension normal cost rates for Fiscal Year 2015-2016 in comparison to the revised Tier 2 estimated normal cost based on calculations by the City's actuary. The retirement board's actuary, Cheiron, will be asked to calculate the final contribution rates. The City's actuary, Bartel Associates, valued the revised Tier 2 benefit using two methods: Cheiron's current Tier 2 retirement rates and the retirement rates used by CalPERS for a similar pension formula. Please refer to Attachment B.

	Current Tier 1	Current Tier 2	Agreement Tier 2 Formula using	
			Cheiron Tier 2 Retirement Rates	CalPERS Retirement Rates for Similar Formula
<b>Total</b>	43.0%	22.4%	30.5%	29.4%
<b>City</b>	31.6%	11.2%	15.25%	14.7%
<b>Member</b>	11.4%	11.2%	15.25%	14.7%

The City's actuary estimates that the savings between the revised Tier 2 benefit and the current Tier 1 normal cost would be \$1.15 billion over 30 years.

**Retiree**  
**Healthcare**

The current retiree healthcare defined benefit program will be closed to new employees and current Tier 2 employees.

**Voluntary Employee Beneficiary Association (VEBA)**

The City will implement a defined contribution retiree healthcare benefit in the form of a VEBA.

New and current Tier 2 members shall contribute 4% of base pay to the VEBA. There will be no City contribution into the VEBA.



**Retiree**  
**Healthcare**  
**(cont'd)**

**New Lowest Cost Medical Plan**

Effective after the final overall agreement is reached, the Kaiser NCAL 4307 Plan shall be available to all active sworn employees, in addition to the existing plan options for active sworn employees. Currently, the lowest cost medical plan for Police and Fire employees is the Kaiser \$25 co-pay plan. This plan will reduce the total premium payment by an estimated \$199 for single coverage and an estimated \$496 for family coverage per month. The Kaiser 4307 Plan has a \$3000 deductible and qualifies for a Health Savings Account (HSA).

The current cost sharing arrangement of the City paying 85% of the lowest cost non-deductible HMO plan will continue for active employees but active employees have the option of selecting the new lowest cost healthcare plan. For retiree healthcare, the retirement plan pays 100% of the lowest cost plan available to active employees. The Kaiser 4307 Plan will be the lowest cost plan available to active employees after implementation.

The lowest cost plan for any future or current retirees will be set so that any plan may not be lower than the “silver” level of health insurance as specified by the current Affordable Care Act as of the date of the agreement. The “silver” plans are estimated to be 70% of healthcare expenses.

**Tier 1 Opt-Out**

Upon legal and IRS verification, Tier 1 employees will be offered a one-time, irrevocable election to opt-out of the current defined benefit retiree healthcare plan and instead be placed in the VEBA. Tier 1 employees will be offered individual, independent financial counseling to assist with their decision.

If legally permissible, deferred vested rehires will also be offered a one-time irrevocable opt-out upon return to City employment.

Tier 1 members who choose to opt-out will contribute 5% of base pay to the VEBA. Tier 1 members who elect to remain in the defined benefit plan will contribute 8% to the defined benefit plan. The difference between the 5% contribution to the VEBA and the 8% contribution to the plan will be taxable to the employee.

The City will contribute the amount necessary (when combined with the mandatory employee contributions) to ensure the defined benefit plan receives the full Annual Required Contribution (ARC). City contributions will be expressed as a percentage of payroll for all bargaining unit members and the City will contribute based on all members (including Tier 2). If the City portion reaches 11% of payroll, the City may decide to contribute a maximum of 11%.

**Retiree  
Healthcare  
(cont'd)**

If, subsequent to IRS approval, a Tier 1 employee elects to opt-out of the defined benefit retiree healthcare plan, they will receive from the 115 retiree healthcare trust an amount estimated to equal the employee only contributions into the retiree healthcare plan, with no interest included. These funds will be placed in the employee's VEBA.

The City will be seeking an IRS private letter ruling regarding the funding of the VEBA through the 115 trust. Should the City not receive a favorable ruling from the IRS or the amounts of funds returned to those employees who opt-out exceeds the amount of funds in the VEBA, the parties will meet and confer over the opt-out and whether or not it can be implemented through other means.

**Medicare Part A and B Enrollment**

A member of the Police and Fire Department Retirement Plan shall be required to enroll in Medicare Part A and B based on federal regulations and insurance provider requirements.

**Retiree Healthcare In-Lieu Premium Credit**

At the beginning of each plan year, a qualified retiree may choose to forego the defined benefit retiree healthcare plan and instead receive a 25% credit for the monthly premium of the lowest cost healthcare plan and dental plan. This credit may only be used for future City retiree healthcare premiums. Retirees may choose this option at the beginning of the plan year or upon a qualifying event. Retirees must verify dependent enrollment on an annual basis if they are receiving a credit for any tier other than single.

Accumulated credits that are never used by the retiree or survivor/beneficiary are forfeited. There is no cap on the amount of credit accumulated.

**Catastrophic Disability Healthcare Program (CDHP)**

VEBA members who receive a service-connected disability will be eligible for 100% of the single premium for the lowest cost healthcare plan until the member is eligible for Medicare (usually age 65). The member must not be eligible for an unreduced service retirement, must exhaust the funds in the VEBA before becoming eligible for the CDHP, and submit an affidavit on an annual basis verifying the member does not have employment that offers healthcare. A member may re-enroll in the CDHP if they lose employment that offers healthcare coverage before Medicare eligibility.

**30 Year Fresh Start Amortization**

The City will continue considering whether to recommend that the retirement boards use a 30-year fresh start amortization for the Police and Fire retiree healthcare actuarial valuation.

**Retiree  
Healthcare  
(cont'd)**

**Retiree Healthcare Costing**

The City's actuary estimates that the changes in the lowest cost healthcare and the opt-out will lower the actuarial liability by 21%. The actuary assumed that 50% of those at younger ages with shorter service grading to 0% of those at older ages with longer service currently in the defined benefit plan will opt-out. Please refer to Attachment C.

	<b>Current Valuation</b>	<b>With Kaiser 4307 Plan</b>	<b>With Opt Out</b>	<b>Total \$ Impact</b>	<b>Total % Impact</b>
<b>Active</b>	\$ 208.4	\$ 180.7	\$ 135.8	\$ (72.6)	-35%
<b>Inactive</b>	<u>347.4</u>	<u>305.8</u>	<u>305.8</u>	<u>(41.5)</u>	-12%
<b>Total</b>	555.7	486.5	441.6	(114.1)	-21%

The City's actuary estimates that, over the next 35 years, the total dollar savings between the existing retiree healthcare plan and the new plan (without the fresh start) would be \$244.2 million. It is important to note that the actual cost impact will be determined by the retirement board's actuary.

**Disability  
Definition  
and Process**

The City will reinstate the previous disability retirement definition for all sworn employees.

**Disability Process Deadlines**

Applications for disability retirement must be filed within one month of separation from City service rather than the previous one year time period. Exceptions contained in the Municipal Code will still apply. The applicants must submit medical paperwork including, but not limited to, the initial nature of the disability and current medical treatments. The medical paperwork must be filed within one year of separation unless the independent medical review panel grants a longer deadline due to extenuating circumstances. Application must not be deferred past four (4) years of the date of application unless the independent medical review panel grants a longer deadline due to extenuating circumstances.

**Disability Hearing Process**

The Police and Fire Retirement Board will appoint an independent medical review panel of three (3) experts to grant or deny disability retirement applications. The panel will make decisions based on a majority vote. The independent medical review panel may decide, based on its own motion or request from a member, to determine if a disability retirement recipient is capable of returning to work.

The appointment shall be approved by a vote of six (6) of nine (9) trustees.

**Disability  
Definition  
and Process  
(cont'd)**

Each member of the independent medical review panel will serve four year terms and meet the following minimum qualifications:

- I. 10 years of practice after completion of residency.
- II. Currently in practice or retired.
- III. Not a prior or current City employee.
- IV. No prior experience providing the City or retirement boards with medical services. The exception shall be prior service as an independent panel member seeking reappointment.
- V. No prior experience as a qualified medical examiner or agreed medical evaluator.
- VI. Varying types of medical practice experience.

**Administrative Law Judge (ALJ)**

Decisions to grant or deny a disability retirement made by the independent medical review panel may be appealed to an ALJ. Either the applicant or the City has forty-five (45) days to appeal the decision made by the independent medical review panel. The appeal hearing must happen within ninety (90) days of the notice of appeal, unless a later date is mutually agreed upon. The ALJ decision will be considered final.

**Modified Duty (SJPOA – Article 39)**

The City and the SJPOA will discuss the modified duty positions during collective bargaining. Until the parties agree, the number of modified duty positions will increase to 30. On an annual basis, the independent medical review panel will review the status of the employees on modified duty until the program is modified.

**Workers' Compensation Reform**

Tier 2 members will have the Federated workers' compensation language as currently contained in the Municipal Code apply to qualifying disability retirement allowances to a maximum aggregate total of \$10,000 per Tier 2 employee.

The parties will convene a Public Safety Wellness Improvement Committee to discuss wellness and workers' compensation in order to streamline the process, reduce costs, decrease the number of work-related injuries through prevention, and expedite the return to work of those injured or ill.

**Supplement  
Retiree Benefit  
Reserve  
(SRBR)**

The elimination of the SRBR will continue.

**Guaranteed Purchasing Power (GPP)**

The SRBR will be replaced with a Guaranteed Purchasing Power provision for all current and future Tier 1 retirees, but the GPP will be applied prospectively after its implementation. The GPP is designed to maintain the monthly allowance for Tier 1 retirees at 75% of purchasing power effective the date of the retiree's retirement.

**Supplemental  
Retiree Benefit  
Reserve  
(SRBR)  
(cont'd)**

A retiree's pension benefit will be recalculated annually to determine if the allowance has kept up with inflation per the CPI-U. The actual benefit will be compared to what would have been required to maintain the same purchasing power at the time of retirement. If the benefit for Tier 1 retirees falls below 75%, a separate check will be issued to make up the difference, beginning in February 2016.

The number of Tier 1 retirees who currently fall below 75% purchasing power is approximately 55.

The SJPOA and IAFF, Local 230 will have a right to tender defense of the litigation to the City in the event of litigation brought forward by a retired member or members of the SJPOA or IAFF, Local 230, against SJPOA or IAFF, Local 230 challenging this settlement framework agreement.

**SRBR Costing**

By continuing the elimination of the SRBR, the City will solidify the \$9 million General Fund savings already achieved by the City as a result of Measure B. Assuming the savings of \$9 million continues annually, using simple arithmetic, the elimination of the SRBR is estimated to result in an approximate savings of \$270 million over 30 years. It should be noted that the calculation of the \$9 million was based on the information available to the City when the SRBR was initially eliminated. Please refer to Attachment D.

**Memorandum  
of Agreement**

This Settlement Framework agreement is contingent on reaching a successor MOA with the SJPOA.

**Attorneys'  
Fees**

To settle attorneys' fee related to Measure B legal matters, the City shall pay the SJPOA and IAFF, Local 230, \$1.5 million within thirty (30) days of the settlement framework agreement being approved by City Council.

There will be final and binding arbitration before a JAMS judge to resolve any additional claims for attorneys' fees related to Measure B litigation (including administrative proceedings) and resolution.

**Quo Warranto**

In the Mayor's March 11, 2015, letter to all bargaining units sent on behalf of the City Council, the direction was that a quo warranto process would be used to replace the provisions of Measure B, contingent on the following conditions being met:

**Quo Warranto**  
**(cont'd)**

1. Agreement on an alternative strategy to implement pension reform and replace Measure B. Such agreement must achieve all reform objectives that the Council deems necessary to the public interest, including improved city services, and the sustainability of our retirement plans.
2. The quo warranto strategy is legally viable and can be carried out on a timeline that would allow the Council sufficient time to pursue a 2016 ballot measure should a quo warranto strategy fail.
3. All bargaining units have agreed to pursue the quo warranto strategy.
4. The Council is satisfied that the quo warranto strategy does not impair the public interest.

Should an agreement with the Federated litigation plaintiffs and Retirees' Association not be reached or the quo warranto process does not permit the replacement of Measure B, the SJPOA and IAFF, Local 230 will stay all Measure B litigation and permit this agreement to appear on a November 2016 ballot as a measure to replace Measure B.

Currently, no decision has been made on the process by which to enact this agreement. This information will be brought forward on a later date. If the agreement is implemented through the Quo Warranto process, the City and the bargaining units will discuss the City Charter provisions requiring voter approval of benefits and actuarial soundness for consideration in a November 2016 ballot measure.

**EVALUATION AND FOLLOW-UP**

The City, the Federated bargaining units, and the Federated Retirees' Association are continuing settlement discussions related to litigation arising out of Measure B. The goal of these discussions is to reach a global settlement with all parties to the litigation. The City Administration will continue to keep the Council apprised of any updates related to this matter.

Once a decision has been made on the recommended process by which to enact this Settlement Framework agreement, the City Administration will bring it forward to City Council for consideration.

**PUBLIC OUTREACH/INTEREST**

This memorandum will be posted on the City's website in advance of the August 11, 2015, City Council Agenda.

July 24, 2015

**Subject: Approval of Terms of an Agreement with the SJPOA and IAFF, Local 230**

Page 14 of 14

### **COORDINATION**

This memorandum was coordinated with the City Attorney's Office and the City Manager's Budget Office.

### **COST SUMMARY/IMPLICATIONS**

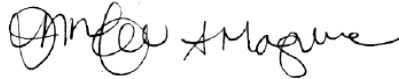
Appropriation actions in the amount of \$1.5 million, funded from the Fiscal Reform Plan Implementation Reserve, are recommended as part of this memorandum to pay attorney's fees related to the settlement of Measure B. The cost/savings estimates of each element of the framework are noted above and in the attachments, and it is estimated that, over 30+ years, the City will realize savings of approximately \$1.7 billion from the revised Tier 2 compared to Tier 1 (\$1.15 billion), the revised retiree healthcare program compared to the current retiree healthcare program (\$244.2 million), and from the elimination of the SRBR (\$270 million). With the exception of the SRBR, it is important to note that these estimates were done by the City's actuary and actual costs/savings will be determined by the Retirement Board's actuary.

### **CEQA**

Not a Project, File No. PP10-069(b), Personnel Related Decisions.



JENNIFER SCHEMBRI  
Director of Employee Relations



JENNIFER A. MAGUIRE  
Senior Deputy City Manager / Budget Director

For questions please contact Jennifer Schembri, Director of Employee Relations, at (408) 535-8150.

Attachment A – Alternative Pension Reform Settlement Framework Agreement

Attachment B – Letter from John Bartel dated July 23, 2015 on Tier 2 Costing

Attachment C – Letter from John Bartel dated July 23, 2015 on Retiree Healthcare Costing

Attachment D – Letter from John Bartel dated July 23, 2015 on Guaranteed Purchasing Power

# ALTERNATIVE PENSION REFORM SETTLEMENT FRAMEWORK

## (Evidence Code Section 1152)

### Settlement Discussion Framework Language

*The City of San Jose, the San Jose Fire Fighters, IAFF Local 230, and the San Jose Police Officers' Association have engaged in settlement discussions concerning litigation arising out of a voter-approved ballot measure, known as Measure B. The parties have reached the below framework for a tentative settlement of San Jose Police Officers' Association v. City of San Jose, Santa Clara Superior Court, No. 1-12-CV-22926, Sapien, et. Al. v. City of San Jose, et. al., Santa Clara County Superior Court, No. 1-13-CV-225928 (and associated actions), The People of the State of California ex rel. San Jose Police Officers' Association v. City of San Jose, Santa Clara County Superior Court, No. 1-13-CV245503 (quo warranto proceedings), International Association of Firefighters, Local 230 vs. City of San Jose, Public Employment Relations Board Unfair Practice No. SF-CE-969-M, and various other actions, including grievances. This settlement framework shall be presented for approval by the City Council and the respective Union Board of Directors.*

*It is understood that this settlement framework is subject to a final overall global settlement. In the event the settlement framework is not accepted, all parties reserve the right to modify, amend and/or add proposals. Each individual item contained herein is contingent on an overall global settlement/agreement being reached on all terms, by all parties/litigants (including the retirees), and ratified by union membership and approved by the City Council.*



## MARCH 11<sup>th</sup> LETTER

*In accordance with Mayor Sam Liccardo's letter on behalf of the City Council to all bargaining units dated March 11, 2015, inclusive of the direction from Councilmember Don Rocha's March 6, 2015, memorandum, the City Council is willing to pursue settlement of Measure B litigation through a quo warranto process in 2015, contingent on the Council's satisfaction that the following conditions have been met before the quo warranto process begins:*

- 1. Agreement on an alternative strategy to implement pension reform and replace Measure B. Such agreement must achieve all reform objectives that the Council deems necessary to the public interest, including improved city services, and the sustainability of our retirement plans.*
- 2. The quo warranto strategy is legally viable and can be carried out on a timeline that would allow the Council sufficient time to pursue a 2016 ballot measure should a quo warranto strategy fail.*
- 3. All bargaining units have agreed to pursue the quo warranto strategy.*
- 4. The Council is satisfied that the quo warranto strategy does not impair the public interest.*

*If agreements are not reached to end litigation with all plaintiffs in Measure B litigation, or if the process of quo warranto does not permit the replacement of Measure B with this or any other agreement, the City Council, Local 230 and the POA shall request a stay of all Measure B litigation to which they are involved in to permit this agreement to appear on a 2016 ballot as a measure to replace Measure B in its entirety with respect to police and fire participants of the Police & Fire Retirement Plan. If this ballot measure is enacted, all Measure B litigation involving Local 230, the POA and the City would be terminated and dismissed.*

## **Retirement Memorandum of Agreement**

1. The parties (The City of San Jose, San Jose Police Officers' Association and San Jose Fire Fighters, IAFF Local 230) shall enter into a Tripartite Memorandum of Agreement to memorialize all agreements related to retirement. The Tripartite MOA shall expire June 30, 2025.
2. The Tripartite MOA will be a binding agreement describing the terms of the final agreement between the parties and will be subject to any agreed-upon reopeners herein.

### **The current Tier 2 retirement plans for Police and Fire employees will be modified as follows:**

1. Pension benefit based upon a back-loaded accrual rate as follows:
  - a. For each year from years 1-20: 2.4% per year
  - b. For each year from years 21-25: 3.0% per year
  - c. For each year 26 and above: 3.4% per year
2. Retirement Age
  - a. The eligible age for an unreduced pension benefit will be age 57
  - b. The eligible age for a reduced pension benefit will be age 50. The reduction for retirement before age 57 will be 7.0% per year, prorated to the closest month.
3. 80% cap
  - a. The maximum pension benefit will be 80% of an employee's final average salary
4. Three-year final average salary
5. A member is vested after 5 years of service
6. No retroactive pension increases or decreases

- a. Any such changes in retirement benefits will only be applied on a prospective basis.
7. No pension contribution holiday
8. Pensionable pay will include base pay, holiday in lieu pay, EMT pay, anti-terrorism training pay, POST pay, and base FLSA pay as per Tier 1 members.
9. Current Tier 2 sworn employees will retroactively be moved to the new Tier 2 retirement benefit plan except as provided in Paragraph 16a (returning Tier 1).
  - a. Any costs, including any unfunded liability, associated with transitioning current Tier 2 employees into the restructured Tier 2 benefit will be amortized as a separate liability over a minimum of 16 years and split between the employee and the City 50/50. This will be calculated as a separate unfunded liability and not subject to the ramp up increments of other unfunded liability.
10. Removal of language limiting vesting of benefits from City Charter (Section 1508-A (h))
11. Tier 2 cost sharing
  - a. Employees and the City will split the cost of Tier 2 including normal cost and unfunded liabilities on a 50/50 basis
  - b. In the event an unfunded liability is determined to exist for the Police and Fire Tier 2 retirement plans, Tier 2 employees will contribute (the "Ramp Up") toward the unfunded liability in increments of 0.33% per year until such time that the unfunded liability is shared 50/50 between employee and employer
  - c. Until such time that the unfunded liability is shared 50/50, the City will pay the balance of the unfunded liability
12. Cost of Living Adjustment (COLA)

- a. Tier 2 retirees will receive an annual cost of living adjustment based on the Consumer Price Index – Urban Consumers (San Francisco-Oakland-San Jose, December to December) or 2.0%, whichever is lower
  - b. In the first year of pension benefits, the COLA will be pro-rated based on the date of retirement
13. Disability Benefit (Tier 2)
- a. A Tier 2 member who is approved by the independent medical review panel for a service-connected disability retirement is entitled to a monthly allowance equal to the greater of:
    - i. 50% of final compensation;
    - ii. A service retirement allowance, if he or she qualified for such;
    - iii. An actuarially reduced factor, as determined by the plan's actuary, for each quarter year that his or her service age is less than 50 years, multiplied by the number of years of safety service subject to the applicable formula, if not qualified for a service retirement.
  - b. A Tier 2 member who is approved by the independent medical review panel for a non-service connected disability is entitled to a monthly allowance equal to:
    - i. If less than age 50: 1.8% per year of service; or
    - ii. If older than age 50: The amount of service pension benefit as calculated based upon the service pension formula.
14. If there is any Tier 1 or Tier 2 benefit not mentioned in this framework, the parties agree to meet to discuss whether or not that benefit should be included in the Tier 2 benefit.
15. Tier 2 members will be provided with 50% Joint and Survivor benefits, which provide 50% of the retiree's pension to the retiree's surviving

spouse or domestic partner in the event of the retiree's death after retirement.

- a. Tier 2 members will be provided with survivor benefits in the event of death before retirement. These benefits will be the same as Tier 1 members but reduced to reflect the new 80% pension cap versus the current 90% pension cap.
16. "Classic" Lateral will become Tier 1, including former San Jose Fire Department /San Jose Police Department sworn employees
- a. Former Tier 1 sworn City employees who have been rehired since the implementation of Tier 2 or rehired after the effective date of a tentative agreement based on this framework will be placed in Tier 1
  - b. Any costs, including any unfunded liability, associated with transitioning current Tier 2 employees who were former Tier 1 sworn City employees who have since been rehired will be amortized as a separate liability over a minimum of 16 years and split between the employee and the City 50/50. This will be calculated as a separate unfunded liability and as Tier 1 employees these members are not subject to a ramp up in unfunded liability.
  - c. Any lateral hire from any other pension system who transfers as a "Classic" employee under PEPR, regardless of tier, will be placed in Tier 1.
  - d. Any lateral hire from any other pension system who transfers as a "new" employee under PEPR will be placed in Tier 2.
17. Tier 2 members will be provided the same service repurchase options as Tier 1 members (excluding purchases of service credit related to disciplinary suspensions) so long as all costs for the repurchase are paid for by the employee.

18. The City and the Unions agree to work with their actuaries to jointly request that the Police and Fire Retirement Board of Administration and its actuary carefully consider retirement rate actuarial assumptions with regard to the new Tier 2 plan. Specifically, the parties will request that the Board and its actuary incorporate retirement rate assumptions similar to the CalPERS retirement rates of the similarly designed CalPERS PEPRA plan rather than that of the existing San Jose Police and Fire Tier 1 plan.

**Retiree Healthcare - All provisions below are contingent on final costing by the City's Actuary and review for legal and/or tax issues**

1. Close the current defined benefit retiree healthcare program to new employees and current Tier 2 employees
2. The parties will implement a defined contribution healthcare benefit in the form of a Voluntary Employee Beneficiary Association (VEBA). The plans would not provide any defined benefit, would not obligate the City to provide any specific benefit upon member retirement, and therefore create no unfunded liability. This agreement does not require the City to contribute any future funds to an employee's VEBA, nor does it preclude an agreement to allow future City contributions
3. New lowest cost medical plan
  - a. Kaiser NCAL 4307 Plan (305/\$3,000 HSA-Qualified Deductible HMO Plan) will be adopted as the new lowest cost healthcare plan, for active and retired members

- b. The City will continue the cost sharing arrangement for active employees of 85% of the lowest cost non-deductible HMO plan
  - c. The “lowest cost plan” for any current or future retiree in the defined benefit retirement healthcare plan shall be set that it may not be lower than the “silver” level as specified by the current Affordable Care Act in effect at the time of this agreement. This specifically includes the provision that the healthcare plan must be estimated to provide at least 70% of healthcare expenses as per the current ACA “silver” definition.
4. Potential Tier 1 opt-out
- a. So long as it is legally permitted, Tier 1 employees may make a one-time election to opt-out of the defined benefit retiree healthcare plan into an appropriate vehicle for the funds, i.e. a Voluntary Employee Beneficiary Association (VEBA). Members of the current defined benefit plans will be provided with one irrevocable opportunity to voluntarily “opt out” of the current retiree medical plan. Those members who “opt out,” and are thus not covered by the City defined benefit retiree medical plan, will be mandated to join the VEBA plan.
5. Enrollment in Medicare Parts A and B as required by any applicable federal regulations or by insurance providers
6. The current defined benefit retiree healthcare plan is modified to enable retired members to select an “in lieu” premium credit option. At the beginning of each plan year, retirees can choose to receive a credit for 25% (twenty-five percent) of the monthly premium of the lowest priced healthcare and dental plan as a credit toward future member healthcare premiums in lieu of receiving healthcare coverage. On an annual basis,

or upon qualifying events described in the “special enrollment” provisions of the Health Insurance Portability and Accountability Act of 1996, retirees and their spouses/dependents can elect to enroll in a healthcare plan or continue to receive an “in lieu” premium credit. Enrollees receiving in lieu credit at any tier other than retiree only must verify annually that they are still eligible for the tier for which they are receiving the in lieu credit. If a member selects the “in-lieu” premium credit, but the member, their survivor or beneficiaries never uses their accumulated premium credit, the accumulated credit is forfeited. At no time can a member or survivor/beneficiary take the credit in cash or any form of taxable compensation. There is no cap on the size of the accumulated credit.

7. Members of the VEBA and their spouses/dependents, during retirement, may also elect to enter or exit coverage on an annual basis or upon a qualifying event (however, members in the VEBA will not receive an “in lieu” benefit).
8. The VEBA contribution rate for all new hires and Tier 2 members will be 4.0% of base pay. The VEBA contribution rate for all members who opt out of the defined benefit plan and are mandated to join the VEBA plan will be 5.0% of base pay.
9. Members who remain in the Defined Benefit retirement healthcare plan will contribute 8.0% of their pensionable payroll into the plan. The City will contribute the additional amount necessary to ensure the Defined Benefit retirement healthcare plan receives its full Annual Required Contribution each year. If the City’s portion of the Annual Required Contribution reaches 11% of payroll, the City may decide to contribute a maximum of 11%.



10. The parties have been advised that the difference between the defined benefit contribution rate (8.0%) and the VEBA opt-out contribution rate (5.0%) will be taxable income.
11. Upon making such an irrevocable election to opt-out of the defined benefit retiree healthcare plan, an amount estimated to equal the member's prior retiree healthcare contribution, with no interest included, will be contributed by the City to the member's VEBA plan account (pending costing and tax counsel advice). In making these contributions, the City may transfer funds from the 115 Trust to the members' VEBA plan account to the extent permitted by federal tax law and subject to receipt of a favorable private letter ruling. If it is determined by the IRS that the funds may not come out of the 115 trust, the parties will meet and confer regarding the opt-out and whether or not it can be implemented through other means. In addition, if the amount needed based on the number of employees who chose to opt out is more than the funds in 115 trust, the parties will also meet and confer. Members will be provided with individual, independent financial counseling to assist them with any decisions to remain in or "opt out" of the defined benefit retiree medical plan.
12. Pending legal review by tax counsel, deferred-vested Tier 1 members who return to San José will be given a one-time irrevocable option to "opt out" of the defined benefit retirement healthcare option. Upon choosing to "opt out", they will become a member of the VEBA and their VEBA account will be credited for their prior contributions. If they choose not to "opt out", they will return to the Defined Benefit retirement healthcare plan.

13. Catastrophic Disability Healthcare Program –Members of the VEBA who receive service-connected disability retirements will be eligible for 100% of the single premium for the lowest cost plan until the member and is eligible for Medicare (usually age 65).
  - a. Qualifications - The member must not be eligible for an unreduced service retirement.
  - b. The member must exhaust any funds in their VEBA account prior to becoming eligible for the Catastrophic Disability Healthcare Program.
  - c. Upon reaching Medicare eligibility, the benefit will cease
  - d. Any retiree who qualifies must submit on an annual basis an affidavit verifying that they have no other employment which provides healthcare coverage.
  - e. If a retiree is found to have other employment which provides healthcare coverage, their eligibility to participate in the Catastrophic Disability Healthcare Program will automatically cease, subject to re-enrollment if they subsequently lose said employment-provided healthcare coverage.

### **Disability Definition and Process**

1. Reinstate the previous City definition for disability for all sworn employees
2. Applications for disability must be filed within one month of separation from City service subject to the exceptions reflected in Municipal Code § 3.36.920 A (4).
3. All applicants must submit medical paperwork indicating the initial nature of their disability including the affected body part if applicable, the current level of disability, and current treatments underway. Such medical paperwork must be filed within one year of separation unless

- the independent medical review panel grants a longer deadline due to extenuating circumstances.
4. Applications for disability may not be deferred by the applicant past four (4) years of the date of application submittal, unless the independent medical review panel grants a longer deadline due to extenuating circumstances.
  5. The member and the City may have legal representation at hearings
  6. Independent panel of experts appointed by 6 of 9 retirement board members will evaluate and approve or deny disability retirement applications
    - a. Using the established Request for Proposal process, the retirement boards will recruit potential members of the independent medical panel
    - b. Each member shall have a four-year term and meet the following minimum qualifications
      - i. 10 years of practice after completion of residency
      - ii. Practicing or retired Board Certified physician
      - iii. Not a prior or current City employee
      - iv. No experience providing the City or retirement boards with medical services, except for prior service on medical panel
      - v. No experience as a Qualified Medical Evaluator or Agreed Medical Evaluator
      - vi. Varying medical experience
    - c. A panel of three independent medical experts will decide whether to grant or deny all disability applications, whether service or non-service connected. The panel's decision will be made by majority vote.
    - d. Upon its own motion or request, the independent medical panel may determine the status of a disability retirement recipient to

confirm that the member is still incapacitated or if the member has the ability to return to work

7. Administrative law judge

- a. A decision to grant or deny the disability retirement made by the independent medical panel may be appealed to an administrative law judge.
- b. Applicant or City has forty-five (45) days to appeal a decision made by the independent medical panel. The appeal hearing must commence within ninety (90) days of the notice of appeal, unless a later date is mutually agreed to by the parties.
- c. The decision rendered by the administrative law judge is to be based on the record of the matter before the independent medical review panel.
- d. The decision of the administrative law judge will be a final administrative decision within the meaning of Section 1094.5 of the California Code of Civil Procedure.

8. Modified Duty (POA – Article 39)

- a. The City and the POA will continue to discuss the modified duty positions during collective bargaining
- b. While these discussions take place, the number of modified duty positions will be increased to 30
- c. The independent medical review panel will evaluate the status of the employees in the modified duty program on a yearly basis until the program is modified through bargaining

9. Worker's Compensation Reform

- a. For Tier 2 participants, the workers' compensation offset currently in place for Federated Plan participants will apply to a maximum aggregate total of \$10,000.00 per Tier 2 employee in workers'

compensation cash disability benefit awards only using the same pension benefit offset formula.

- b. In an effort to streamline the workers' compensation process, reduce costs, decrease the number of work related injuries through prevention and expedite the return to work of those injured or ill, the parties agree to convene a Public Safety Wellness Improvement Committee to discuss modifications to, or creation of, wellness and/or workers' compensation policies, procedures and protocols.

### **Supplement Retiree Benefit Reserve (SRBR)**

1. Continue elimination of SRBR
  - a. The funds credited to the SRBR will continue to be credited to the Police and Fire Department Retirement Plan to pay for pension benefits
2. City will replace SRBR with guaranteed purchasing power (GPP) provision for all Tier 1 retirees, prospectively. The GPP is intended to maintain the monthly allowance for Tier 1 retirees at 75% of purchasing power effective with the date of the retiree's retirement
  - a. Beginning January 2016 and each January thereafter, a retiree's pension benefit will be recalculated annually to determine whether the benefit level (including any increases due to cost of living adjustments) has kept up with inflation as measured by the CPI-U (San Francisco-Oakland-San Jose). The actual benefit level will be compared to what would have been required to maintain the same purchasing power as the retiree had at the time of retirement, with a CPI-based increase.

- b. Those Tier 1 retirees whose benefit falls below 75% of purchasing power will receive a supplemental payment that shall make up the difference between their current benefit level and the benefit level required to meet the 75% GPP.
- c. The supplemental GPP payment to qualifying retirees will be paid annually in a separate check, beginning February 2016, and each February thereafter.
- d. The number of Tier 1 retirees whose benefit level was below 75% GPP at the time of costing was approximately 55.
- e. In the event of litigation by a retired member or members of POA and/or IAFF Local 230 challenging this provision of the Settlement Agreement against POA and/or IAFF Local 230, the Unions will have a right to tender the defense of the litigation to the City. City will accept the defense of the litigation and will defend POA and/or IAFF Local 230 with counsel of City's choice, including the City Attorney's Office. If the City is also named defendant in any such suit, Unions will not claim that joint representation of either or both of them and the City constitutes a legal conflict for the attorney(s) defending the suit. This defense obligation will not apply to lawsuits challenging or in any way relating to this provision filed more than five years after the effective date of this agreement.

### **Memoranda of Agreement (MOA)**

1. This agreement is contingent upon reaching a successor MOA agreement with the POA.


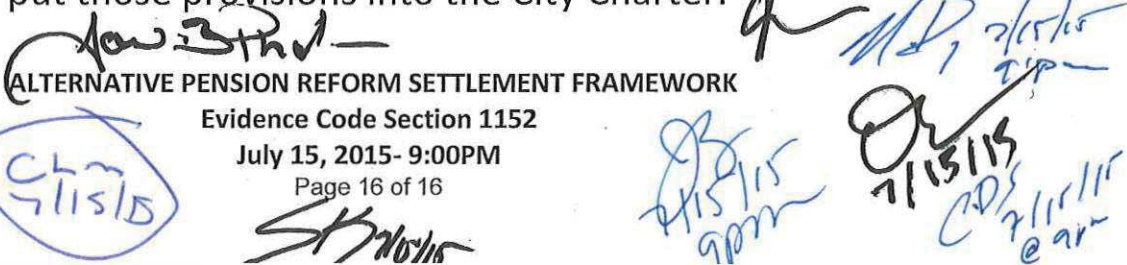
### **Attorney's Fees**

1. \$1.5 million within 30 days of settlement framework being approved by Council in open session
2. The parties agree to final and binding arbitration to resolve additional claims over attorneys' fees and expenses related to the litigation and resolution of Measure B
3. The arbitration will be before a JAMS judge formerly of San Francisco or Alameda County
4. The City shall pay the arbitrator's fees and costs, including court reporter
5. The parties agree that the issue presented shall be: Whether the Unions are entitled, under any statutory or common law basis, to additional attorneys' fees and/or expenses related to litigation (including administrative proceedings) and resolution of Measure B? If so, in what amounts?

### Implementation Timeline

1. Each party will receive approval of this settlement framework from their respective principals (for the City, this means the City Council; for the Unions, this means their respective Boards of Directors) by August 4<sup>th</sup>, 2015.

This settlement framework is an outline of the agreement reached by the parties that will need to be implemented through various means, such as ordinances. Successful implementation of this agreement will satisfy and terminate the "Retirement (Pension and Retiree Healthcare) Reopener" agreed upon by SJFF Local 230 or SJPOA. If this agreement is implemented through the quo warranto process, the parties agree to discuss provisions for voter approval of benefits and actuarial soundness for consideration of a 2016 ballot measure to put those provisions into the City Charter.

ALTERNATIVE PENSION REFORM SETTLEMENT FRAMEWORK

Evidence Code Section 1152

July 15, 2015- 9:00PM

Page 16 of 16



July 23, 2015

Jennifer Schembri  
 Interim Director  
 City Manager's Office of Employee Relations  
 200 E. Santa Clara Street, 3rd Floor Wing  
 San José, CA 95113-1905

**Re: San Jose Police Officers and Fire Fighters Tier 2 Pension Benefit**

Dear Ms. Schembri:

This letter provides our analysis of the San Jose Police Officers and Fire Fighters Tier 2 pension benefit agreement. We understand the agreement will redefine Tier 2 pension benefits as:

■ Benefit formula based on City service:

Years of City service	Benefit Accrual Rate
1-20	2.4%
21-25	3.0%
26+	3.4%

■ Normal retirement age 57 with 7% reduction for each year retirement precedes age 57

■ Provide the following ancillary benefits:

- Cost of Living Adjustments based on the lesser of CPI and 2%
- Automatic 50% survivor benefit
- Disability benefit the greater of:
  - 50% of current pensionable wages
  - Service retirement benefit if eligible to retire
  - Actuarial equivalent of service retirement benefit if not eligible to retire
- 5 year vesting

**Analysis**

We priced the agreement Tier 2 formula using both Cheiron's current Tier 2 retirement rates and retirement rates used by CalPERS for a similar pension formula. The following table shows the estimated impact on the Tier 2 Normal Cost:

	Current Tier 1	Current Tier 2	Agreement Tier 2 Formula using	
			Cheiron Tier 2 Retirement Rates	CalPERS Retirement Rates for Similar Formula
<b>Total</b>	43.0%	22.4%	30.5%	29.4%
<b>City</b>	31.6%	11.2%	15.25%	14.7%
<b>Member</b>	11.4%	11.2%	15.25%	14.7%

We believe the CalPERS retirement rates for similar formulas are reasonable retirement rates and would recommend Cheiron consider using these retirement rates rather than the existing Tier 2 retirement rates.





The following table projects out City cost assuming Tier 2 benefits were the same as Tier 1, under current Tier 2 benefit formula and under the agreed to Tier 2 benefit formula over the next 30 years (note agreed to projections are based on the CalPERS retirement rates for a similar benefit formula):

<b>City of San Jose</b>							
<b>Police &amp; Fire</b>							
<b>Projection of Additional City Cost of Agreed to Pension Tier 2 Benefit Formula</b>							
(\$ millions)							
		<u>Tier 2 Benefit Unchanged</u>		<u>Tier 2 Benefit Restored to Tier 1 Level</u>		<u>Tier 2 Benefit As Bargained</u>	
	Total	22.4% Tier 2 NC		43.0% Tier 2 NC		29.4% Tier 2 NC	
	Proj.	<u>Total City Cost</u>		<u>Total City Cost</u>		<u>Total City Cost</u>	
FYE	Payroll	% of pay	\$	% of pay	\$	% of pay	\$
2016	194.3	11.2%	1.4	31.6%	3.9	14.7%	1.8
2017	200.6	11.2%	2.0	31.6%	5.8	14.7%	2.7
2018	207.0	11.2%	2.9	31.6%	8.1	14.7%	3.8
2019	213.9	11.2%	3.9	31.6%	10.9	14.7%	5.1
2020	220.9	11.2%	5.0	31.6%	14.1	14.7%	6.6
2021	228.1	11.2%	6.2	31.6%	17.6	14.7%	8.2
2022	235.5	11.2%	7.8	31.6%	22.0	14.7%	10.2
2023	243.1	11.2%	9.5	31.6%	26.9	14.7%	12.5
2024	251.0	11.2%	11.5	31.6%	32.3	14.7%	15.0
2025	259.2	11.2%	13.4	31.6%	37.9	14.7%	17.6
2026	267.6	11.2%	15.2	31.6%	43.0	14.7%	20.0
2027	276.3	11.2%	17.1	31.6%	48.3	14.7%	22.4
2028	285.3	11.2%	19.2	31.6%	54.1	14.7%	25.2
2029	294.6	11.2%	21.2	31.6%	59.7	14.7%	27.8
2030	304.2	11.2%	23.1	31.6%	65.2	14.7%	30.3
2031	314.0	11.2%	25.0	31.6%	70.5	14.7%	32.8
2032	324.2	11.2%	27.0	31.6%	76.2	14.7%	35.4
2033	334.8	11.2%	29.1	31.6%	82.0	14.7%	38.2
2034	345.7	11.2%	31.4	31.6%	88.6	14.7%	41.2
2035	356.9	11.2%	33.9	31.6%	95.5	14.7%	44.4
2036	368.5	11.2%	36.3	31.6%	102.4	14.7%	47.6
2037	380.5	11.2%	38.5	31.6%	108.7	14.7%	50.6
2038	392.8	11.2%	40.7	31.6%	114.7	14.7%	53.4
2039	405.6	11.2%	42.7	31.6%	120.6	14.7%	56.1
2040	418.8	11.2%	44.9	31.6%	126.7	14.7%	59.0
2041	432.4	11.2%	47.0	31.6%	132.7	14.7%	61.7
2042	446.5	11.2%	49.1	31.6%	138.4	14.7%	64.4
2043	461.0	11.2%	51.0	31.6%	143.9	14.7%	66.9
2044	475.9	11.2%	52.9	31.6%	149.2	14.7%	69.4
2045	491.4	11.2%	54.8	31.6%	154.5	14.7%	71.9
Total			763.6		2,154.5		1,002.3



The agreement also provides that Tier 2 members will pay 50% of the unfunded liability contribution. Even though there is ramp up feature to this cost sharing we believe, if unfunded liabilities do materialize this will be a cost savings feature for the City.

**Assumptions**

Study results were estimated using the same assumptions, except as noted above for retirement rates, as the Cheiron June 30, 2014 actuarial valuation.

\* \* \*

To the best of our knowledge, this letter is complete and accurate and has been prepared using generally accepted actuarial principles and practices. As a member of the American Academy of Actuaries meeting the Academy Qualification Standards, I certify the actuarial results and opinions herein.

Please call Cathy Wandro (650-377-1606) or me (650-377-1601) with any questions about this letter.

Sincerely,

A handwritten signature in blue ink, appearing to read 'John E. Bartel'.

John E. Bartel  
President

c: Cathy Wandro, Bartel Associates  
Marilyn Oliver, Bartel Associates

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July 23, 2015

Jennifer Schembri  
Interim Director  
City Manager's Office of Employee Relations  
200 E. Santa Clara Street, 3rd Floor Wing  
San José, CA 95113-1905

**Re: San Jose Police Officers and Fire Fighters Retiree Healthcare Agreement**

Dear Ms. Schembri:

This letter provides our analysis of the San Jose Police Officers and Fire Fighters retiree healthcare agreement. We understand the agreement will:

- Establish a VEBA
  - New hires will participate in the VEBA only and will not be eligible for current plan benefits (except as noted below for subsidized premiums).
  - Current retiree healthcare participants would be given the option to “opt-out” of the current plan and join the VEBA. This, in conjunction with closing the plan to new hires will effectively mean the current benefit will wear away over time.
    - Historical contributions to the current plan would be transferred for anyone opting out of the current plan.
- Contributions:
  - City will contribute the full ARC, less member contributions, to the current plan based on total pensionable pay regardless of whether an individual participates in the current plan or the VEBA. (note the City, per the agreement, may cap its contribution at 11% of total pensionable pay)
  - City will not contribute to the VEBA.
  - Members remaining in the current plan will contribute 8% of their pensionable pay.
  - Members participating in the VEBA will not contribute to the current plan.
- All retirees, whether participating in the current plan or the VEBA would be allowed to participate in the City's medical plan paying subsidized premiums.
- Adoption of the Kaiser 4307 medical plan for actives and retirees.
- Proposal is contingent on cost analysis determining that funding will be adequate for the current plan.
- Add an “in lieu” feature to the current plan that would allow retirees to receive a credit for 25% of the lowest cost plan as a credit toward future healthcare premiums, in lieu of receiving healthcare coverage.



**Analysis – Funding Valuation Basis**

The following table shows the estimated impact of the proposed changes on the Actuarial Liability under the Funding Valuation basis which uses a 7% discount rate and includes the explicit subsidy only (millions):

	<b>Current Valuation</b>	<b>With Kaiser 4307 Plan</b>	<b>With Opt Out</b>	<b>Total \$ Impact</b>	<b>Total % Impact</b>
<b>Active</b>	\$ 208.4	\$ 180.7	\$ 135.8	\$ (72.6)	-35%
<b>Inactive</b>	<u>347.4</u>	<u>305.8</u>	<u>305.8</u>	<u>(41.5)</u>	-12%
<b>Total</b>	555.7	486.5	441.6	(114.1)	-21%

The following table shows the estimated impact of the proposed changes on the contribution rates for the explicit subsidy under the Funding Valuation basis. This table is based on current amortization periods (24 years for Police and 26 years for Fire).

	<b>Uncapped</b>			<b>Capped</b>		
	<b>Current Valuation</b>	<b>With Opt Out</b>	<b>% of Total Payroll Impact</b>	<b>Current Valuation</b>	<b>With Opt Out</b>	<b>% of Total Payroll Impact</b>
<b>Police Member</b>	11.71%	8.00%	-7.26%	10.00%	8.00%	-5.55%
<b>Police City</b>	<u>12.82%</u>	<u>11.98%</u>	<u>-0.84%</u>	<u>11.00%</u>	<u>11.00%</u>	<u>0.00%</u>
<b>Total<sup>1</sup></b>	24.53%	16.43%	-8.10%	21.00%	15.45%	-5.55%
<b>Fire Member</b>	10.54%	8.00%	-6.09%	9.74%	8.00%	-5.29%
<b>Fire City</b>	<u>11.56%</u>	10.26%	-1.30%	<u>10.62%</u>	10.26%	-0.36%
<b>Total<sup>1</sup></b>	22.10%	14.71%	-7.39%	20.36%	14.71%	-5.65%

We are also attaching a table that projects City contributions under three scenarios: current plan with current amortization periods, agreement plan with 30 year fresh start amortization period and agreement plan with current amortization periods. Please note the projections based on the agreement include an assumption of additional Tier 2 payroll growth over the next 3 years.

The following table shows the impact of the proposed changes on FY 2015/16 dollar contributions for the explicit subsidy with total contributions uncapped but member contributions capped and with current amortization periods, rounded to the nearest \$100,000:

	<b>Current</b>	<b>With Opt Out</b>	<b>Savings</b>
<b>Police Total NC</b>	\$ 9,100,000	4,100,000	5,000,000
<b>Police UAL</b>	<u>19,500,000</u>	<u>15,000,000</u>	<u>4,500,000</u>
<b>Total Police</b>	28,600,000	19,100,000	9,500,000
<b>Member</b>	<u>11,600,000</u>	<u>5,200,000</u>	<u>6,500,000</u>
<b>Net Police</b>	17,000,000	13,900,000	3,000,000
<b>Fire Total NC</b>	\$6,100,000	2,800,000	3,300,000
<b>Fire UAL</b>	<u>11,100,000</u>	<u>8,700,000</u>	<u>2,400,000</u>
<b>Total Fire</b>	17,200,000	11,500,000	5,700,000
<b>Member</b>	<u>7,600,000</u>	<u>3,500,000</u>	<u>4,100,000</u>
<b>Net Fire</b>	9,600,000	8,000,000	1,600,000
<b>Total Net Safety</b>	\$ 26,600,000	21,900,000	4,600,000

<sup>1</sup> The proposal requires member contribution rate be applied only to pensionable pay for those remaining in the current plan while the City contribution rate would be applied to total pensionable pay. Since the member and City rates apply to different pensionable pay the total percentages were calculated for the “With Opt Out” scenario based on total pensionable pay, including those assumed to opt out.



The Net contributions are calculated with a cap on Member contribution rates but without regard to any cap on City contribution rates.

**Analysis – GASB Valuation Basis**

The following table shows the estimated impact of the proposed changes on the Actuarial Liability under the GASB Valuation basis which uses a 6% discount rate and includes both the explicit and implicit subsidy (millions):

	<b>Current Valuation</b>	<b>With Kaiser 4307 Plan</b>	<b>With Opt Out</b>	<b>Total \$ Impact</b>	<b>Total % Impact</b>
<b>Active</b>	\$ 277.7	\$ 247.7	\$ 188.6	\$ (89.1)	-32%
<b>Inactive</b>	<u>429.0</u>	<u>380.6</u>	<u>380.6</u>	<u>(48.4)</u>	-11%
<b>Total</b>	706.7	628.4	569.2	(137.5)	-19%

The following table shows the estimated impact of the proposed changes on the Annual Required Contribution for the implicit and explicit subsidy under the GASB Valuation basis (millions):

	<b>Current Valuation</b>	<b>With Opt Out</b>	<b>Total Impact</b>
<b>Total ARC \$</b>	\$ 51.0	\$ 34.0	\$ (17.0)
<b>Total ARC %</b>	27.09%	18.07%	-9.02%

The ARC %'s are based on total pensionable pay, including those assumed to opt out.

**Assumptions**

The above calculations are based on the assumption that the following percentage of employees will opt into the VEBA:

<b>Age</b>	<b>Service</b>						
	<b>x &lt; 5</b>	<b>5 &lt;= x &lt; 10</b>	<b>10 &lt;= x &lt; 15</b>	<b>15 &lt;= x &lt; 20</b>	<b>20 &lt;= x &lt; 25</b>	<b>25 &lt;= x &lt; 30</b>	<b>30 &lt;= x</b>
< 25	100%	n/a	n/a	n/a	n/a	n/a	n/a
25 - 29	100%	100%	n/a	n/a	n/a	n/a	n/a
30 - 34	100%	100%	100%	n/a	n/a	n/a	n/a
35 - 39	100%	100%	80%	60%	n/a	n/a	n/a
40 - 44	100%	80%	60%	33%	0%	n/a	n/a
45 - 49	100%	67%	33%	0%	0%	0%	n/a
50 - 54	100%	67%	33%	0%	0%	0%	n/a
55 - 59	n/a	n/a	33%	0%	0%	0%	n/a
60 - 64	n/a	n/a	33%	n/a	n/a	n/a	0%
≥ 65	n/a	n/a	n/a	n/a	n/a	n/a	n/a

In addition, the results under the GASB valuation basis assume 50% of those who opt out will remain in the City's medical plans and continue to have a liability for the implicit subsidy.

Study results were estimated based on the Cheiron June 30, 2014 actuarial valuation for both funding (explicit subsidy only) and GASB purposes (explicit and implicit subsidy). However, even though the City is not pre-funding the implicit subsidy, it still exists as long as the retiree participates in the City's medical plans whether the member stays in the current plan or opts out for the VEBA. The liability for the implied subsidy will remain with the City and only decrease to the extent that opt outs leave the City plans.

\* \* \*

Jennifer Schembri  
July 23, 2015  
Page 4



To the best of our knowledge, this letter is complete and accurate and has been prepared using generally accepted actuarial principles and practices. As a member of the American Academy of Actuaries meeting the Academy Qualification Standards, I certify the actuarial results and opinions herein.

Please call Cathy Wandro (650-377-1606) or me (650-377-1601) with any questions about this letter.

Sincerely,

A handwritten signature in blue ink, appearing to read 'John E. Bartel'.

John E. Bartel  
President

c: Cathy Wandro, Bartel Associates  
Marilyn Oliver, Bartel Associates

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**San Jose Police & Fire Retiree Medical Plan**

**City Contribution Projections**

**Projections are based on the 6/30/14 Funding Valuation and do not include any liability associated with the Implied Subsidy**

**Projection of City Contributions - Combined Police & Fire (\$millions)**

	Current Plan		3a		3b	
EE %	50% Med/25% Dent		8%		8%	
City %	50% Med/75% Dent		ARC less EE%		ARC less EE%	
UAL Amort. P/F	24/26		30/30		24/26	
Modify Pay?	No		Yes		Yes	
FYE	%	\$	%	\$	%	\$
2016	12.32%	\$ 23.9	9.51%	\$ 19.4	10.8%	\$ 21.9
2017	12.32%	24.7	9.09%	20.1	10.3%	22.7
2018	12.32%	25.5	8.70%	20.8	9.8%	23.5
2019	12.32%	26.4	8.73%	21.5	9.9%	24.3
2020	12.32%	27.2	8.76%	22.3	9.9%	25.2
2021	12.32%	28.1	8.79%	23.1	9.9%	26.1
2022	12.32%	29.0	8.84%	24.0	10.0%	27.1
2023	12.32%	29.9	8.88%	24.9	10.0%	28.1
2024	12.32%	30.9	8.93%	25.8	10.1%	29.1
2025	12.32%	31.9	8.98%	26.8	10.1%	30.2
2026	12.32%	33.0	9.02%	27.8	10.2%	31.3
2027	12.32%	34.0	9.05%	28.8	10.2%	32.5
2028	12.32%	35.1	9.09%	29.9	10.2%	33.7
2029	12.32%	36.3	9.13%	31.0	10.3%	34.9
2030	12.32%	37.5	9.16%	32.1	10.3%	36.1
2031	12.32%	38.7	9.19%	33.2	10.3%	37.4
2032	12.32%	39.9	9.21%	34.4	10.4%	38.7
2033	12.32%	41.2	9.24%	35.6	10.4%	40.1
2034	12.32%	42.6	9.27%	36.9	10.4%	41.5
2035	12.32%	44.0	9.30%	38.2	10.4%	43.0
2036	12.32%	45.4	9.33%	39.6	10.5%	44.5
2037	12.32%	46.9	9.35%	41.0	10.5%	46.0
2038	12.32%	48.4	9.36%	42.4	10.5%	47.6
2039	12.32%	50.0	9.38%	43.8	10.5%	49.2
2040	7.06%	29.6	9.39%	45.3	3.9%	18.6
2041	7.06%	30.5	9.40%	46.8	3.9%	19.2
2042	4.06%	18.1	9.41%	48.4	0.0%	-
2043	4.06%	18.7	9.42%	50.0	0.0%	-
2044	4.06%	19.3	9.42%	51.7	0%	-
2045	4.06%	20.0	9.43%	53.4	0%	-
2046	4.06%	20.6	0%	-	0%	-
2047	4.06%	21.3	0%	-	0%	-
2048	4.06%	22.0	0%	-	0%	-
2049	4.06%	22.7	0%	-	0%	-
2050	4.06%	23.4	0%	-	0%	-
Totals		1,096.7		1,019.1		852.5
PV at 3% Int.		686.2		625.5		573.2
PV at 7% Int.		414.6		366.8		366.9



July 23, 2015

Jennifer Schembri  
Interim Director  
City Manager's Office of Employee Relations  
200 E. Santa Clara Street, 3rd Floor Wing  
San José, CA 95113-1905

**Re: San Jose Police Officers and Fire Fighters Guaranteed Purchasing Power (GPP)**

Dear Ms. Schembri:

This letter provides our analysis of the San Jose Police Officers and Fire Fighters Guaranteed Purchasing Power (GPP) agreement. We understand the agreement provides for a GPP benefit in exchange for agreement to eliminate the Supplemental Retirement Benefit Reserve (SRBR). Elimination of the SRBR has already resulted in significant savings. The GPP benefit will provide current and future Tier 1 retirees a guaranteed 75% of purchasing power benefit after retirement. This benefit will be calculated by comparing the ratio of actual pension benefits to what pension benefits would have been had retirees received 100% of Bay Area CPI increases. If that ratio is less than 75% then retirees would receive an additional check equal to the difference.

**Analysis**

We believe the cost of this benefit will only be significant if inflation returns to high levels. Inflation has generally been less than 3% (Tier 1 Cost of Living Adjustments) over the last 20 years so only retirees who retired several years ago (prior to 1981) would have ratios less than 75%. As of May 2015 there were approximately 56 retirees with an average age of 80.

The estimated liability for this group of earlier retirees is approximately \$2.4 million and because this is an increase for current retirees we think it is possible (if not likely) Cheiron will recommend a shorter (5 year) amortization period. If so then the first year payment will be about \$550,000. However, if they do not recommend a shorter amortization then using 20 years the first year payment will be about \$180,000. Both of these would increase with the aggregate payroll assumption of 3.25%.

Due to time constraints, our analysis did not include a volatility assumption for inflation. While we believe Cheiron will price the GPP for other (current and future) retirees using some volatility assumptions for inflation, we also would generally expect any additional cost to be fairly modest.

**Assumptions**

Study results were estimated using the same assumptions as the Cheiron June 30, 2014 actuarial valuation. Our analysis also assumes Cheiron will price this using stochastic simulations based on a median inflation assumption of 3% or less.

\* \* \*



Jennifer Schembri  
July 23, 2015  
Page 2



To the best of our knowledge, this letter is complete and accurate and has been prepared using generally accepted actuarial principles and practices. As a member of the American Academy of Actuaries meeting the Academy Qualification Standards, I certify the actuarial results and opinions herein.

Please call Cathy Wandro (650-377-1606) or me (650-377-1601) with any questions about this letter.

Sincerely,

A handwritten signature in blue ink, appearing to read 'John E. Bartel'.

John E. Bartel  
President

c: Cathy Wandro, Bartel Associates  
Marilyn Oliver, Bartel Associates  
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