CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

# City of San José Federated City Employees' Retirement System

**Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2012**

A Pension Trust Fund of the City of San José, California

# City of San José Federated City Employees' Retirement System

**Donna Busse**
***Acting Director***

Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2012

Department of Retirement Services
1737 North First Street, Suite 580
San Jose, California 95112-4505
Phone 408-794-1000
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www.sjretirement.com

A Pension Trust Fund of the City of San José, California

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CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

*Department of Retirement Services*

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM
POLICE AND FIRE DEPARTMENT RETIREMENT PLAN

November 28, 2012

The Honorable Mayor and City Council
Members of the Federated City Employees' Retirement System
City of San José
San José, California

Dear Mayor, Council Members, and System Members:

On behalf of the members of the Board of Administration, I am pleased to present the Federated City Employees' Retirement System's (System) Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2012.

The System earned a time-weighted gross of investment fees rate of return of -3.0% and net of investment fees rate of return of -3.2% on investments for the fiscal year, compared to a -2.3% return for its policy benchmark and a 1.1% return for the Master Trust Public Funds Median. Additionally, the System earned a time-weighted gross of investment fees rate of return of 9.6% and 1.2% for the three-year and five-year periods ending June 30, 2012, respectively, while the Master Trust Public Funds Median earned a time-weighted rate of return of 11.9% and 1.9% for the same periods. In contrast, the net rate of return assumed by the System's actuary is 7.50%. The net asset value of the System decreased from $1,896,072,000 to $1,787,047,000 net of pending purchases and sales (see the Financial Section beginning on page 19). The net decrease in System net assets for fiscal year 2011-2012 was $109,025,000.

At the beginning of the fiscal year 2011-2012, much of the System's assets were invested in index funds and optimized portfolios designed to earn index returns. During the fourth quarter of calendar year 2011, the Board adopted a new asset allocation in response to the results of an asset-liability study. The Trustees continued implementation of the new asset allocation during the year, which aims to better position the System for potential future market environments.

A major focus for the Board during the fiscal year 2011-2012 was the implementation of the governance structure. The Board hired a governance consultant to develop policies and charters relating to roles and responsibilities of the Board and staff, staffing structure, strategic planning, education and training, and communications protocol.

In May 2012, the Director of Retirement Services, Russell Crosby, announced his intentions to retire. The Trustees conveyed their appreciation for Mr. Crosby's leadership and management of the System during a time when significant beneficial changes were realized. Following Mr. Crosby's retirement in September 2012, the Chief Operations Officer, Donna Busse, was appointed as the Acting Director to lead the Retirement Services Department.

Ms. Busse has over sixteen years of experience with the City and brings a wealth of knowledge across all groups of the Department. The System also saw the departure of its Chief Investment Officer (CIO), Carmen Racy-Choy, in July 2012.

The Board has engaged an executive recruiting firm to search for a Director and a CIO, as well as four Investment Officers, and is working closely in a collaborative process with the City and the Board of Administration for the Police & Fire Department Retirement Plan to select highly qualified candidates to fill

1737 N. First St. Suite 580, San Jose, CA 95112-4504 *tel* (408) 794-1000 *fax* (408) 392-6732 www.sjretirement.com

these key leadership positions.

During the fiscal year, the Board hired Albourne America LLC to provide absolute return asset class consulting as well as Russell Investments to provide policy overlay service on the System's assets in order to reduce the unintended risk of asset allocation drift. In addition, the Board sold its sole individually owned real estate property with the assistance of American Realty Advisors. The Board also hired Reed Smith LLP as the System's general and investment counsel, Ice Miller LLP as the System's tax counsel, and Saltzman and Johnson Law Corporation to provide domestic relations order services.

The Board believes that the professional services rendered by the staff, the auditors, investment counselors, the actuarial consultants, and the System's performance evaluators have produced a sound fund capable of continued growth. The Board of Administration and its staff are available to provide additional information when requested.

Sincerely,

Matt Loesch, Chairman
Board of Administration

# Table of Contents

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# Introductory Section

City of San José
Federated City Employees' Retirement System
Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2012

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CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

*Department of Retirement Services*

FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM
POLICE AND FIRE DEPARTMENT RETIREMENT PLAN

November 28, 2012

Board of Administration
Federated City Employees' Retirement System
1737 North First Street, Suite 580
San Jose, CA 95112

Dear Trustees:

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the Federated City Employees' Retirement System (System) for the fiscal year ended June 30, 2012. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the System's management. This CAFR was prepared to conform to the principles of governmental accounting and reporting set forth by the Governmental Accounting Standards Board. Transactions of the System are reported on the accrual basis of accounting. For an overview and analysis of the financial activities of the System for the fiscal years ended June 30, 2011 and 2012 refer to the Management's Discussion and Analysis on page 22.

Macias Gini & O'Connell LLP, the System's independent auditor, has audited the accompanying financial statements. Management believes internal control is adequate and the accompanying statements, schedules, and tables are fairly presented and free from material misstatement. Sufficient internal controls over financial reporting exist to provide reasonable assurance regarding the safekeeping of assets and fair presentation of the financial statements and supporting schedules.

The financial audit provides reasonable assurance that the System's financial statements are presented in conformity with generally accepted accounting principles and are free of material misstatements. The System recognizes that even sound and well-designed internal controls have their inherent limitations in that errors may still occur as a result of factors such as carelessness, faulty judgment, communication breakdowns, and/or that internal controls can be circumvented by internal or external collusion. The System continuously reviews internal controls to ensure that the System's operating policies and procedures are being adhered to and that the controls are adequate to ensure accurate and reliable financial reporting and to safeguard the System's assets.

Information contained in this report is designed to provide a complete and accurate financial review of the year's operations. I am proud to report that the Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the System for its CAFR for the fiscal year ended June 30, 2011. The Certificate of Achievement is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government financial reports. This report must satisfy both generally accepted accounting principles and applicable legal requirements. We believe our current report continues to conform to the Certificate of Achievement Program Requirements and staff will submit it to the GFOA to determine its eligibility for another certificate for the fiscal year ended June 30, 2012. The System also received the Public Pension Standards Award in recognition of meeting professional standards for plan design and administration by the Public Pension Coordinating Council.

I encourage you to review this report carefully. I trust that you and the members of the System will find this CAFR helpful in understanding the System.

## Funding

The System's funding for both its defined benefit pension plan and its defined benefit other postemployment healthcare (OPEB) plan is to meet long-term benefit obligations through contributions

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and investment income. As of June 30, 2011, the funding ratio of the defined benefit pension plan was 65% and for the defined benefit OPEB plan was 12% based on the actuarial value of assets.

For the valuation of pension and OPEB benefits, the actuarial assumption for the net rate of return to be earned by the System is currently 7.50% and 6.10%, respectively. The impact of the difference between the actual net rate of return earned by the System and the 7.50% and 6.10% assumptions will result in deferred investment losses that will be reflected in the pension and OPEB, respectively, unfunded liabilities in next year's CAFR. The net decrease in System assets for fiscal year 2011-2012 was $109,025,000. Details of the components of this decrease are included in the Statement of Changes in Plan Net Assets on page 34. The defined benefit pension plan's funding progress is presented on page 55 and the defined benefit OPEB plan's funding progress is presented on page 56.

## Financial and Economic Summary

The 2011-2012 fiscal year began with heightened market volatility and risk aversion affecting the markets, due in part to a renewed focus on the faltering global economy and sovereign debt issues in the Eurozone. The third quarter of calendar year 2011 was the worst quarter for equities since 2008 despite efforts by policymakers, including the announcement of the U.S. Federal Reserve's "Operation Twist" and an expansion of the European Financial Stability Facility. During the fourth quarter of calendar year 2011, investors returned to risky assets due partly to improved economic data and hopes of a resolution to the sovereign debt issues in the Eurozone. Investor optimism persisted during the first few months of calendar year 2012, as global equity markets soared and U.S. stocks experienced their best quarter since 1998. However, a number of near-term issues remained unresolved, including sovereign debt issues in Europe, the potential for a "hard landing" in China, and a stalled recovery in the U.S. economy.

Fiscal year 2013 promises continued volatility in the markets and, while the System is diversified in a way that provides the best possible chance for achieving long-term returns to meet its obligations and objectives, it is of critical importance that the System continues to focus on low volatility and stability of returns going forward.

## Investment Summary

The Board of Administration has exclusive control of all investments of the System and is responsible for the establishment of investment objectives, strategies, and policies. Members of the Board serve in a fiduciary capacity and must discharge their duties with respect to the System and the investment portfolio solely in the interest of, and for the exclusive purposes of providing benefits to, members of the System and defraying the reasonable cost of administration.

Over the past fiscal year, the System's gross of fees rate of return was -3.0% and net of investment fees rate of return was -3.2%, while the policy benchmark returned -2.3% and the Master Trust Public Funds Median returned 1.1%. Additionally, the System's gross of fees rate of return was 9.6% and 1.2% for the three-year and five-year periods ending June 30, 2012 respectively, while the Master Trust Public Funds Median was 11.9% and 1.9% for the same periods. The net asset value of the System decreased from $1,896,072,000 to $1,787,047,000, net of pending purchases and sales (see the Financial Section beginning on page 19).

At the beginning of the fiscal year 2011-2012, much of the System's assets were invested in index funds and optimized portfolios designed to earn index returns. During the fourth quarter of calendar year 2011, the Board adopted a new asset allocation in response to the results of an asset-liability study. During the fiscal year, the Trustees continued implementation of the new asset allocation, which aims to better position the System for potential future market volatility.

## Major Initiatives

In May 2012, the Director of Retirement Services, Russell Crosby, announced his intentions to retire. The Trustees conveyed their appreciation for Mr. Crosby's leadership and management of the System. Under Mr. Crosby's leadership, the System was named Mid-Sized Public Pension Plan of the Year in 2009 for dramatic changes implemented in a complex environment with two separate pension plans and multiple consultants and money managers. Mr. Crosby was also instrumental in the City of San Jose's governance study that resulted in the seating of four public trustees independent of the City on the Board.

The System also saw the departure of its Chief Investment Officer (CIO), Carmen Racy-Choy, who resigned in July 2012. Ms. Racy-Choy was instrumental in the implementation of policy overlay on the Plan's assets and transitioning the assets from active management to optimized portfolios designed to earn index returns. The Board has engaged an executive recruiting firm to search for a Director and a CIO, as well as four Investment Officers.

During the fiscal year 2011-2012, the Trustees continued implementation of the governance structure by hiring a governance consultant to develop policies and procedures relating to roles and responsibilities of the Board and staff, staffing structure, strategic planning, education and training, and communications protocol.

In July 2011, a new Internal Revenue Code Section 115 trust was established by the San Jose City Council to provide an alternative to the existing 401(h) account within the pension fund for retiree healthcare benefits funding. The City Ordinance required the healthcare trust initially be invested in liquid asset classes according to the pension trust investment policy statement until a separate policy is developed, which is expected to be completed during fiscal year 2013.

During the fiscal year, the Board hired Albourne America LLC to provide absolute return asset class consulting as well as Russell Investments to provide policy overlay service on the System's assets in order to reduce the unintended risk of asset allocation drift. In addition, the Board sold its sole individually owned real estate property with the assistance of American Realty Advisors. The Board also hired Reed Smith LLP as the System's general and investment counsel, Ice Miller LLP as the System's tax counsel, and Saltzman and Johnson Law Corporation to provide domestic relations order services.

The Retirement Services staff participated in the Vision and Life Insurance Provider selection for the City of San Jose in conjunction with the City's Human Resources and Labor Groups. A mid-year special open enrollment was conducted for retirees to select a vision provider due to the expiration of the current provider's contract. The special open enrollment allowed retirees the opportunity to enroll or change their Personal Accident Insurance policy. Over 5,000 letters were mailed out and close to 2,000 documents were received.

The agreements between the City and certain bargaining groups stipulated that employees be not allowed to have dual coverage under the medical and dental coverage with City retirees. Retirement Services assisted in identifying affected employees and in providing clarification of the San Jose Municipal Code provisions as it pertained to survivorship benefits. As a not-for-profit health plan committed to provide access to high quality care at an affordable price, Blue Shield of California pledged to limit their annual net income to 2% of revenue collected and give back any excess to its customers starting with their 2010 revenues. Retirement Services received a total of $1.6 million of which 17% was refunded to retirees. The retiree participation during Open Enrollment continues to increase, and in addition to the free flu shots, staff organized bio-metric screenings for retirees for the duration of the Retiree Health Fair.

On June 5, 2012, the voters of San Jose enacted the Sustainable Retirement Benefits and Compensation Act (Pension Act). The Pension Act amended the City Charter to change benefits for current employees to establish different benefits for new employees and to place other limitations on benefits.

### Conclusion

I would like to take this opportunity to thank the members of the System for their confidence in the plan management during the past year. I also want to express my thanks to the Board of Administration for its dedicated effort in supporting the staff through this past year. I thank the consultants and staff for their commitment to the System and for their diligent work to assure the System's continued successful operation.

Respectfully Submitted,

Donna Busse
*Acting Director*

# Certificate of Achievement for Excellence in Financial Reporting

## Certificate of Achievement for Excellence in Financial Reporting

Presented to

### San Jose Federated City Employees' Retirement System California

For its Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2011

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.

GOVERNMENT FINANCE OFFICERS ASSOCIATION OF THE UNITED STATES AND CANADA CORPORATION SEAL CHICAGO

Linda C. Davison

President

Jeffrey R. Esser

Executive Director

# Certificate of Meeting Professional Standards in Public Pensions

*Public Pension Coordinating Council*

## Public Pension Standards Award For Funding and Administration 2011

*Presented to*

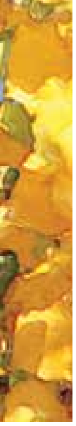
## City of San Jose Federated City Employees' Retirement System

In recognition of meeting professional standards for
plan funding and administration as
set forth in the Public Pension Standards.

*Presented by the Public Pension Coordinating Council, a confederation of*

National Association of State Retirement Administrators (NASRA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)

*Alan H. Winkle*
*Program Administrator*

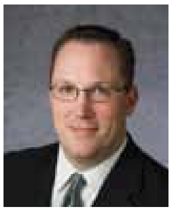


# Board of Administration, Administration, and Outside Consultants

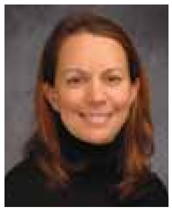
## BOARD OF ADMINISTRATION

The Retirement System is administered by a seven-member Board of Administration composed of two City employees elected by members of the system, a Retiree Representative, and three public members, who are not connected with the City and have significant banking or investment experience, and another public member selected by the six Board members and approved by the City Council. The Board is appointed by the City Council and serves in accordance with Section 2.08.300 of the San Jose Municipal Code.

As of June 30, 2012, the members of the Board were as follows:

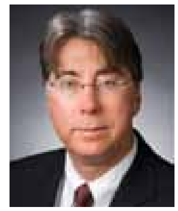


**MATT LOESCH, CHAIR**, CHAIR
*Employee Representative appointed to the Board in December 2007. His current term expires November 30, 2015.*

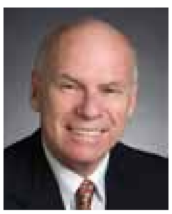


**LARA DRUYAN,** VICE CHAIR
*Public member appointed to the Board in December 2010. Her current term expires December 31, 2014.*

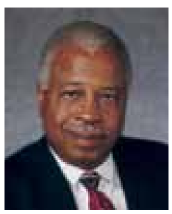
**ARN ANDREWS**, TRUSTEE
*Employee Representative appointed to the Board in December 2009. His current term expires November 30, 2013.*



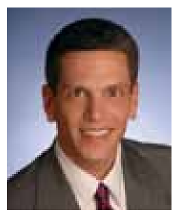
**MARTIN DIRKS**, TRUSTEE
*Public member appointed to the Board in March 2011. His current term expires February 28, 2015.*



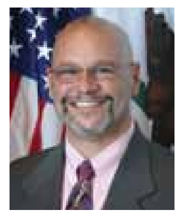
**MICHAEL ARMSTRONG**, TRUSTEE
*Public member appointed to the Board in December 2010. His current term expires December 31, 2014.*



**EDWARD F. OVERTON,** TRUSTEE
*Retired Plan member appointed in January 2009. His current term expires November 30, 2012.*



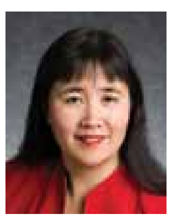
**STUART ODELL,** TRUSTEE
*Public member appointed to the Board in December 2010. His current term expires November 30, 2012.*



**PETE CONSTANT,**
NON-VOTING BOARD MEMBER

## DEPARTMENT OF RETIREMENT SERVICES ADMINISTRATION

**RUSSELL U. CROSBY**
DIRECTOR OF RETIREMENT SERVICES
(Position vacant as of September 6, 2012)



**DONNA BUSSE**
DEPUTY DIRECTOR
CHIEF OPERATIONS OFFICER

**CARMEN RACY-CHOY**
DEPUTY DIRECTOR
CHIEF INVESTMENT OFFICER
(Position vacant as of July 31, 2012)

## STANDING PUBLIC MEETINGS

**Board Meetings**: Third Thursday of the Month, 8:30 AM

Agendas for all public meetings are posted on the bulletin board at City Hall and on the department's website at http://sjretirement.com/fed/meetings/agendas.asp or they can be obtained from the retirement office at 1737 North First Street, Suite 580, San Jose, CA 95112. Meeting times and locations are subject to change; please call our office at (408) 794-1000 for current information.

## OUTSIDE CONSULTANTS

### ACTUARY
Cheiron, Inc.
Encinitas, CA

### GENERAL & FIDUCIARY COUNSEL
Reed Smith LLP
San Francisco, CA

### INVESTMENT COUNSEL
Reed Smith LLP
Falls Church, VA

### INVESTMENT CONSULTANTS
Albourne America LLC - Absolute Return
San Francisco, CA

Meketa Investment Group, Inc. - General Consultant
Carlsbad, CA

### AUDITOR
Macias Gini & O'Connell LLP
Walnut Creek, CA

*A list of Investment Professionals begins on page 80 of the Investment Section of this report.*

# 2012 Department of Retirement Services Organizational Chart

## Department of Retirement Services

- City Manager
  - **Director (vacant)**
    - Assistant Director Chief Investment Officer (vacant)
      - Deputy Director Investments (vacant)
        - Retirement Investment Officer
        - Retirement Investment Officer
        - Financial Analyst
        - Retirement Investment Analyst
        - Retirement Investment Officer (vacant)
        - Retirement Investment Officer (vacant)
        - Retirement Investment Officer (vacant)
        - Retirement Investment Officer (vacant)
        - Retirement Investment Analyst (vacant)
      - Principal Accountant
        - Senior Accountant
        - Senior Accountant
        - Accounting Technician
        - Senior Account Clerk
        - Account Clerk
    - Deputy Director Chief Operations Officer
      - Information Systems Analyst
        - Systems Analyst
        - Network Technician II (PT)
      - Benefits Division Manager
        - Senior Analyst – Pension Benefits
          - Benefits Analyst
          - Benefits Analyst
          - Benefits Analyst
          - Benefits Analyst
          - Staff Technician
          - Staff Technician (PT)
        - Analyst – Health Benefits
        - Analyst – Education/Training (vacant)
        - Office Specialist
        - Office Specialist
      - Administrative Assistant
      - Staff Specialist (vacant)


**DEPARTMENT OF RETIREMENT SERVICES**

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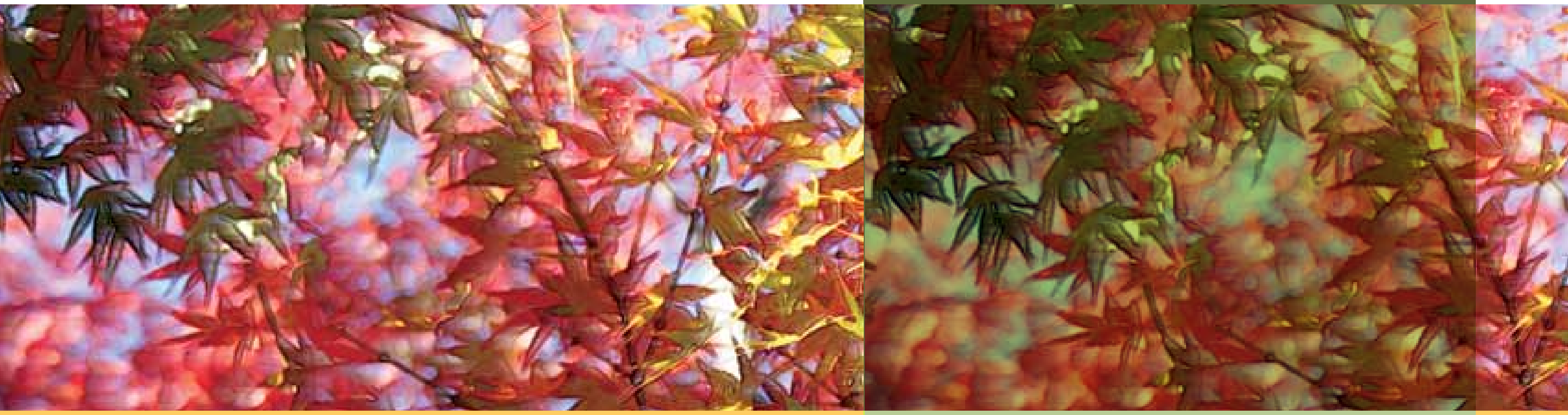
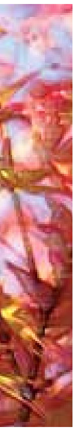


# Financial Section

City of San José
Federated City Employees' Retirement System
Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2012

# Independent Auditor's Report



MGO Certified Public Accountants.

Walnut Creek
2121 N. California Blvd., Suite 750
Walnut Creek, CA 94596
925.274.0190

Sacramento

Oakland

LA/Century City

Newport Beach

San Diego

Seattle

Board of Administration of the City of San José
Federated City Employees' Retirement System
San José, California

We have audited the accompanying statements of plan net assets of the City of San José Federated Employees' Retirement System (System), a pension trust fund of the City of San José, California, as of June 30, 2012 and 2011, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion

As discussed in Note 2(a), the financial statements of the System are intended to present only the plan net assets and changes in plan net assets of the System. They do not purport to, and do not, present fairly the financial position of the City of San José, California, as of June 30, 2012 and 2011, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the System as of June 30, 2012 and 2011, and the changes in plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 5, based on the most recent actuarial valuation as of June 30, 2011, the System's independent actuaries determined that, at June 30, 2011, the value of the defined benefit pension plan's actuarial accrued liability exceeded the actuarial value of its assets by $982 million. The most recent actuarial value of assets as of June 30, 2011 does not reflect the impact of deferred investment losses of $28 million that will be recognized in future valuations. As described in Note 6, based on the most recent actuarial valuation as of June 30, 2011, the System's independent actuaries determined that, at June 30, 2011, the value of the postemployment healthcare plan's actuarial accrued liability exceeded the actuarial value of its assets by $1.0 billion.

In accordance with *Government Auditing Standards,* we have also issued our report dated November 27, 2012 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters for the year ended June 30, 2012. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide

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an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit..

Accounting principles generally accepted in the United States of America require that management's discussion and analysis and the Schedules of Funding Progress and Employer Contributions, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The introductory section, other supplementary information in the financial section, investment section, actuarial section and statistical section as listed in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements. The other supplementary information in the financial section is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory, investment, actuarial and statistical sections have not been subjected to the auditing procedures applied in the audits of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Macias Gini & O'Connell LLP

Walnut Creek, California
November 27, 2012

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Board of Administration
Federated City Employees' Retirement System
1737 North First Street, Suite 580
San José, California 95112-4505

Donna Busse
*Acting Director, Retirement Services*

The Department of Retirement Services is pleased to provide this overview and analysis of the financial activities of the Federated City Employees' Retirement System (the System) for the fiscal years ended June 30, 2012, and 2011. The System, consisting of a single employer Defined Benefit Pension Plan and a Postemployment Healthcare Plan, was established to provide retirement benefits for eligible non-sworn employees of the City of San José (City) and thier beneficiaries. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our Letter of Transmittal, which begins on page 11 of this report, and in the financial section which follows this discussion.

## Financial Highlights for Fiscal Year 2012

- As of June 30, 2012, the System had $1,787,047,000 in total net plan assets held in trust for pension benefits and postemployment healthcare benefits. Net pension assets of $1,649,249,000 are available to meet the System's ongoing obligations to plan participants and their beneficiaries except the Supplemental Retiree Benefit Reserve of $43,109,000. The postemployment healthcare net assets of $137,798,000 are only available for the exclusive use of retiree medical benefits.
- The System's total net assets held in trust for pension benefits and postemployment healthcare benefits decreased by $109,025,000 or 5.75% from the prior fiscal year, primarily as a result of the depreciation in the fair value of investments caused by a decline in the equity markets and a delay in the implementation of the System's asset allocation adopted by the Board in December 2011 to align the System's expected rate of return with the expected pension benefits liability as determined in the June 30, 2011 valuation.
- Additions to plan net assets for the year were $64,423,000, which includes member and employer contributions of $138,466,000, net investment income losses excluding securities lending of $74,182,000 and net securities lending income of $139,000.
- Deductions in plan net assets increased from $150,731,000 to $173,448,000 from the prior fiscal year, or approximately 15.1%, due to an increase in retirement benefits and healthcare premiums, which were attributable to an increased number of retired members and beneficiaries and increased health care premium costs.

## Overview of the Financial Statements

The following discussion and analysis is intended to serve as an introduction to the System's financial statements, which are comprised of these components:

1. Statements of Plan Net Assets
2. Statements of Changes in Plan Net Assets
3. Notes to the Basic Financial Statements

Please note, however, that this report also contains required supplementary information and supplemental information in addition to the basic financial statements themselves.

The *Statements of Plan Net Assets* are a snapshot of account balances at fiscal year-end. It indicates the assets available for future payments to retirees and any current liabilities that are owed at this time.

The *Statements of Changes in Plan Net Assets*, on the other hand, provide a view of current year additions to and deductions from the System.

Both statements are in compliance with Generally Accepted Accounting Principles (GAAP) as set forth by the Governmental Accounting Standards Board. GAAP requires certain disclosures and state and local government pension plan and other postemployment benefit plan reports use the full accrual method of accounting. The System complies with all material requirements of these pronouncements.

The Statement of Plan Net Assets and the Statement of Changes in Plan Net Assets report information about the System's activities. These statements include all assets and liabilities, using the full accrual basis of accounting, which recognizes contributions as revenue when due pursuant to formal commitments as well as statutory and contractual commitments and benefit and refunds of contributions when due and payable under the provision of the System. All of the current year's additions and deductions are taken into account regardless of when cash is received or paid. All investment gains and losses are reported at the trade date, not the settlement date. In addition, both realized and unrealized gains and losses on investments are reported.

These two statements report the System's net assets held in trust for pension benefits and postemployment healthcare benefits (net assets)—the difference between assets and liabilities. Over time, increases and decreases in the System's net assets are one indicator of whether its financial health is improving or deteriorating. Other factors, such as the System's funding progress and funded status, should also be considered in measuring the System's overall health (see the schedules of funding progress and schedules of employer contributions on pages 55 - 57 of this report).

*Notes to the Basic Financial Statements* provide additional information that is essential to a full understanding of the data provided in the financial statements (see Notes to Basic Financial Statements on page 36 of this report).

*Other Information* In addition to the financial statements and accompanying notes, this report presents certain required supplementary information concerning the System's progress in funding its obligations to provide pension and other postemployment healthcare benefits to members and employer contributions (see Required Supplementary Information beginning on page 55 of this report).

The schedule of funding progress of the Defined Benefit Pension Plan prepared using the market value of plan assets, combining schedules of Defined Benefit Pension Plan net assets and changes in net assets, schedules of administrative expenses and other, investment expenses, and payments to consultants are presented immediately following the required supplementary information.

## Financial Analysis

As previously noted, net assets may serve over time as a useful indication of the System's financial position (see Tables 1a and 1c on page 24). At the close of fiscal years 2012 and 2011, the System's total assets exceeded the System's total liabilities. The System's financial statements do not include the actuarial accrued liability for the Defined Benefit Pension Plan and other Postemployment Healthcare Plan.

The funded status of the System should also be considered when evaluating the System's financial health. As of June 30, 2011, the System's most recent valuation, the funded status of the System decreased from 69% to 65% for the Defined Benefit Pension Plan and remained at 12% for the other Postemployment Healthcare Plan. The increase in the unfunded actuarial accrued liability (UAAL) was primarily due to changes in actuarial assumptions as recommended by the Board's actuary and adopted by the Board for the June 30, 2011 valuations. For more information on the results and impact of the June 30, 2011 valuations, please see Notes 5 and 6 to the financial statements on pages 48 - 53.

## NET ASSETS FOR THE FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S DEFINED BENEFIT PENSION PLAN

**(Table 1a)** *As of June 30, 2012, and 2011 (In Thousands)*

| | 2012 | 2011 | Increase/(Decrease) Amount | Increase/(Decrease) Percent |
|---|---|---|---|---|
| Receivables | $ 6,715 | $ 18,714 | $ (11,999) | -64.1% |
| Investments at Fair Value | 1,649,987 | 1,894,775 | (244,788) | -12.9% |
| **Total Assets** | **1,656,702** | **1,913,489** | **(256,787)** | **-13.4%** |
| Current Liabilities | 7,453 | 152,871 | (145,418) | -95.1% |
| **Total Liabilities** | **7,453** | **152,871** | **(145,418)** | **-95.1%** |
| **Net Assets** | **$ 1,649,249** | **$ 1,760,618** | **$ (111,369)** | **-6.3%** |

## NET ASSETS FOR THE FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S DEFINED BENEFIT PENSION PLAN

**(Table 1b)** *As of June 30, 2011 and 2010 (In Thousands)*

| | 2011 | 2010 | Increase/(Decrease) Amount | Increase/(Decrease) Percent |
|---|---|---|---|---|
| Receivables | $ 18,714 | $ 10,199 | $ 8,515 | 83.5% |
| Investments at Fair Value | 1,894,775 | 1,669,536 | 225,239 | 13.5% |
| **Total Assets** | **1,913,489** | **1,679,735** | **233,754** | **13.9%** |
| Current Liabilities | 152,871 | 166,933 | (14,062) | -8.4% |
| **Total Liabilities** | **152,871** | **166,933** | **(14,062)** | **-8.4%** |
| **Net Assets** | **$ 1,760,618** | **$ 1,512,802** | **$ 247,816** | **16.4%** |

## NET ASSETS FOR THE FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S POSTEMPLOYMENT HEALTHCARE PLAN

**(Table 1c)** *As of June 30, 2012 and 2011 (In Thousands)*

| | 2012 | 2011 | Increase/(Decrease) Amount | Increase/(Decrease) Percent |
|---|---|---|---|---|
| Receivables | $ 960 | $ 2,507 | $ (1,547) | -61.7% |
| Investments at Fair Value | 137,425 | 144,820 | (7,395) | -5.1% |
| **Total Assets** | **138,385** | **147,327** | **(8,942)** | **-6.1%** |
| Current Liabilities | 587 | 11,873 | (11,286) | -95.1% |
| **Total Liabilities** | **587** | **11,873** | **(11,286)** | **-95.1%** |
| **Net Assets** | **$ 137,798** | **$ 135,454** | **$ 2,344** | **1.7%** |

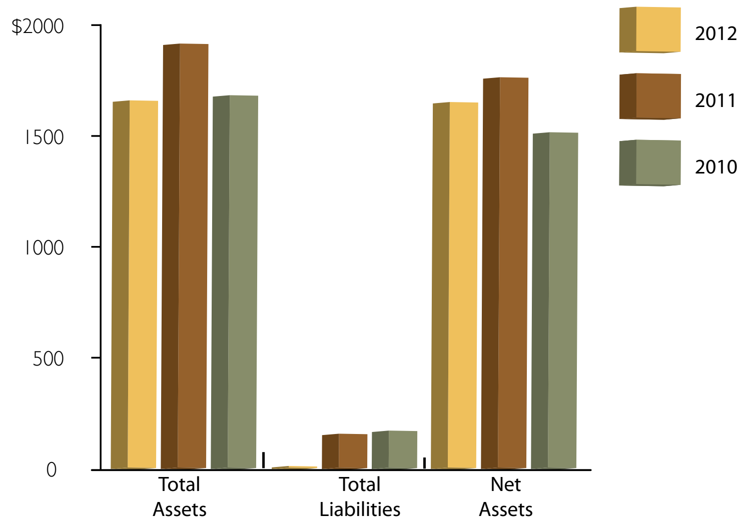
## NET ASSETS FOR THE FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S POSTEMPLOYMENT HEALTHCARE PLAN

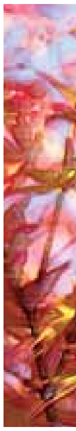
**(Table 1d)** *As of June 30, 2011 and 2010 (In Thousands)*

| | 2011 | 2010 | Increase/(Decrease) Amount | Increase/(Decrease) Percent |
|---|---|---|---|---|
| Receivables | $ 2,507 | $ 2,125 | $ 382 | 18.0% |
| Investments at Fair Value | 144,820 | 117,920 | 26,900 | 22.8% |
| **Total Assets** | **147,327** | **120,045** | **27,282** | **22.7%** |
| Current Liabilities | 11,873 | 12,034 | (161) | -1.3% |
| **Total Liabilities** | **11,873** | **12,034** | **(161)** | **-1.3%** |
| **Net Assets** | **$ 135,454** | **$ 108,011** | **$ 27,443** | **25.4%** |

**FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S DEFINED BENEFIT PENSION PLAN NET ASSETS**

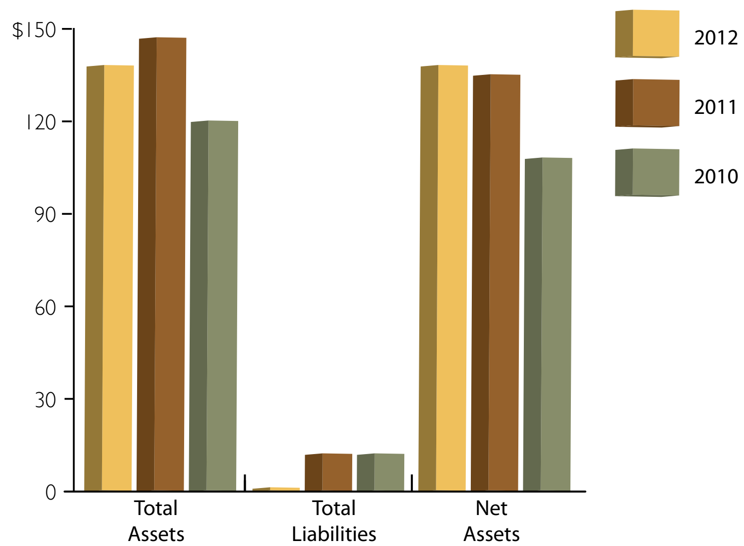
*June 30, 2012, 2011 and 2010*
*(Dollars in Millions)*

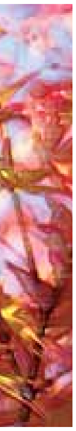


**FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S POSTEMPLOYMENT HEALTHCARE PLAN BENEFITS NET ASSETS**

*June 30, 2012, 2011 and 2010*
*(Dollars in Millions)*





As of June 30, 2012 $1,649,249,000 and $137,798,000, in total net assets are held in trust for pension benefits and postemployment healthcare benefits, respectively (see Tables 1a and 1c on page 24). Net pension assets of $1,649,249,000 are available to meet the System's ongoing obligations to plan participants and their beneficiaries except assets held in the Supplemental Retiree Benefit Reserve (a reserve in the defined benefit pension plan), of $43,109,000, which is used to provide supplemental benefits to retirees on a discretionary basis. Postemployment healthcare net assets of $137,798,000 are only available for the exclusive use of retiree medical benefits.

As of June 30, 2012, total net assets for the pension benefits decreased by 6.3% and increased by 1.7% for the postemployment healthcare benefits plan from the prior year primarily due to the net depreciation in the fair value of investments of $98,855,000 and $7,811,000 for the Defined Benefit Pension Plan and Postemployment Healthcare Plan, respectively. The depreciation in the fair value of investments was caused by the decline in the international equity and commodities market. During the transition to the new asset allocation the Board hired Russell Investments to provide asset overlay services to rebalance the System's assets to the Board approved long-term targets. The System's current asset allocation is discussed in detail in Note 2(c) of the financial statements on page 38.

As of June 30, 2011, total net assets for the pension benefits and postemployment healthcare benefits plan increased by 16.4% and 25.4% from the prior year primarily due to the net appreciation in the fair value of investments of $252,848,000 and $19,238,000 for the Defined Benefit Pension Plan and Postemployment Healthcare Plan, respectively. The appreciation in the fair value of investments was caused by the recovery in the investment markets and the System's implementation of a new diversified asset allocation, adopted by the Board in fiscal year 2010, which included an asset allocation to a more diversified structure that includes commodities, absolute return, and opportunistic investments.

As of June 30, 2012, receivables decreased by $11,999,000 or 61.4% and $1,547,000 or 61.7% in the Defined Benefit Pension Plan and Postemployment Healthcare Plan, respectively, due to a decrease in receivables from the City for contributions and brokers and others for year-end investment trades. The prior fiscal year receivables included a pension contribution receivable of approximately $8,000,000 due from the City to fund the annual required contribution. The City elected not to phase-in the impact of the June 30, 2009 assumption changes on the contribution rates over a five-year period as originally adopted by the Board; see note 5 of the financial statements. In the previous year, receivables for the Defined Benefit Pension Plan and Postemployment Healthcare Plan increased by $8,515,000 or 83.5% and $382,000 or 18.0% due to a year-end contribution receivable from the City to fund the annual required contribution for the fiscal year then ending.

As of June 30, 2012, total liabilities for the Defined Benefit Pension Plan and the Postemployment Healthcare Plan decreased by $145,418,000 or 95.1% and $11,286,000 or 95.1%, respectively, compared with June 30, 2011, due to the System's exit from securities lending activity. The System received securities lending revenue from July 1 - September 30, 2011. The System exited securities lending activity in September 2011, when the System transitioned custodial services from Northern Trust Company to State Street Bank. As of June 30, 2011, total liabilities for the Defined Benefit Pension Plan and the Postemployment Healthcare Plan decreased by $14,062,000 or 8.4% and $161,000 or 1.3%, respectively, compared with June 30, 2010, due to decreases in payables for administrative and health expenses and securities lending collateral due to borrowers. The System's investment in securities lending fluctuated with demand for the System's securities.

## System Activities

In fiscal year 2012, the System's combined Defined Benefit Pension Plan and Postemployment Healthcare Plan net assets decreased by $109,025,000 or 5.75%, primarily due to the decline in the equity markets experienced in the first half of the fiscal year. In December 2011, the Board adopted a new asset allocation policy to meet the System's long-term expected rate of return and meet future benefit obligations. The fair value of the System's combined Defined Benefit Pension Plan and Postemployment Healthcare Plan investments declined by $252,183,000 thereby accounting for a 12.36% decrease from the prior year. Key elements of the System's financial activities are described in the sections that follow.

## Additions to Plan Net Assets

The assets needed to finance retirement benefits are accumulated through the collection of employer and employee contributions and through earnings on investments (net of investment expense). Additions to the Defined Benefit Pension Plan and Postemployment Healthcare Plan for the fiscal year ended June 30, 2012, were $28,734,000 and $35,689,000, respectively (see Tables 2a and 2c on Pages 28 - 29).

In fiscal year ended June 30, 2012, overall additions for the Defined Benefit Pension Plan and Postemployment Healthcare Plan decreased by $342,227,000 and $19,340,000, or 92.3% and 35.1%, respectively. The primary cause of the decrease from the prior year was net investment losses, excluding securities lending income, of $69,032,000 and $5,150,000, respectively, compared to investment income of $287,726,000 and $21,808,000 in 2011. The net investment losses were a result of the decline in the equity markets during the first half of the fiscal year. The System's time-weighted gross rate of return, as determined by the System's Investment Consultant on an investment (non GAAP) basis, for the fiscal year ended June 30, 2012, was -3.0% compared to 19.0% for fiscal year 2011. On a net of manager fee basis, the System's time-weighted rate of return for the fiscal year ended June 30, 2012, was -3.2% compared to 18.8% for fiscal year 2011.

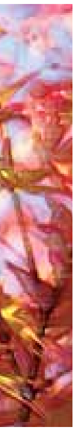
In fiscal year ended June 30, 2011, overall additions for the Defined Benefit Pension Plan and Postemployment Healthcare Plan increased by $105,244,000 and $8,335,000, or 39.6% and 17.9%, respectively. The increase from the prior year was primary due to increases of $91,139,000 and $8,105,000, respectively, in net investment income excluding securities lending income, which was a result of general investment market increases and the System's implementation of a diversified asset allocation adopted by the Board in fiscal year 2010. The System's time-weighted gross rate of return, as determined by the System's Investment Consultant on an investment (non GAAP) basis, for the fiscal year ended June 30, 2011, was 19.0% compared to 14.3% (corrected from 15.9% as previously reported) for fiscal year 2010. Fiscal year 2010 gross and net returns were amended by the System's Investment Consultant in performance reporting due to corrections in their market value and cash flow data for the System. The Investment Consultant's correction did not impact investment values reported in the prior years' financial statements. On a net of manager fee basis, the System's time-weighted rate of return for the fiscal year ended June 30, 2011, was 18.8% compared to 13.7% (corrected from 15.3% as previously reported) for the fiscal year 2010.

## Deductions from Plan Net Assets

The System was created to provide lifetime retirement annuities, survivor benefits, permanent disability benefits, and postemployment healthcare benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments and healthcare premium payments, as designated by the San Jose Municipal Code, refunds of contributions to terminated employees, and the cost of administering the System.

Deductions for the fiscal year ended June 30, 2012, totaled $140,103,000 and $33,345,000 for the Defined Benefit Pension Plan and Postemployment Healthcare Plan, respectively. Deductions for the Defined Benefit Pension Plan increased 13.8% from the previous year due to an increase in benefit payments and administrative costs (see Table 2a on page 28). The increases in benefit payments are primarily due to continued increases in retirees and beneficiaries with higher final average salaries. The increases in administrative costs are primarily due to additional professional fees for legal, actuarial and external staffing services. The Deductions for the Postemployment Healthcare Plan, increased by 20.9% from the previous year due to continued increases in healthcare insurance premiums for retirees and beneficiaries (see Table 2c on page 29).

Deductions for the fiscal year ended June 30, 2011, totaled $123,145,000 and $27,586,000 for the Defined Benefit Pension Plan and Postemployment Healthcare Plan, respectively. Deductions for the Defined Benefit Pension Plan increased 12.4% from the previous year due to an increase in retirees and beneficiaries and final average salaries (see Table 2b on page 28). Deductions for the Postemployment Healthcare Plan, increased by 13.8% from the previous year due to increased healthcare insurance premiums for retirees and beneficiaries (see Table 2d on page 29).



## CHANGES IN PLAN NET ASSETS FOR THE DEFINED BENEFIT PENSION PLAN

**(Table 2a)**

*For the Fiscal Years Ended June 30, 2012 and 2011 (In Thousands)*

| | 2012 | 2011 | Increase/(Decrease) Amount | Increase/ (Decrease) Percent |
|---|---|---|---|---|
| Employee Contributions | $ 10,555 | $ 24,602 | $ (14,047) | -57.1% |
| Employer Contributions | 87,082 | 59,180 | 27,902 | 47.1% |
| Net Investment Income/(loss)* | (69,032) | 286,726 | (355,758) | -124.1% |
| Net Securities Lending Income | 129 | 453 | (324) | -71.5% |
| **Total Additions** | **28,734** | **370,961** | **(342,227)** | **-92.3%** |
| ** Net of Investment Expenses of $7,073 and $3,387 in 2012 and 2011, respectively.* | | | | |
| Retirement Benefits | 126,001 | 110,415 | 15,586 | 14.1% |
| Death Benefits | 8,601 | 7,883 | 718 | 9.1% |
| Refund of Contributions | 2,195 | 1,980 | 215 | 10.9% |
| Administrative | 3,306 | 2,867 | 439 | 15.3% |
| **Total Deductions** | **140,103** | **123,145** | **16,958** | **13.8%** |
| **Net Increase/(Decrease) in Plan Net Assets** | **(111,369)** | **247,816** | **(359,185)** | **-144.9%** |
| **Beginning Net Assets** | **1,760,618** | **1,512,802** | **247,816** | **16.4%** |
| **Ending Net Assets** | **$ 1,649,249** | **$ 1,760,618** | **$ (111,369)** | **-6.3%** |

## CHANGES IN PLAN NET ASSETS FOR THE DEFINED BENEFIT PENSION PLAN

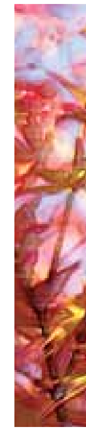
**(Table 2b)**

*For the Fiscal Years Ended June 30, 2011 and 2010 (In Thousands)*

| | 2011 | 2010 | Increase/(Decrease) Amount | Increase/ (Decrease) Percent |
|---|---|---|---|---|
| Employee Contributions | $ 24,602 | $ 13,396 | $ 11,206 | 83.7% |
| Employer Contributions | 59,180 | 54,566 | 4,614 | 8.5% |
| Net Investment Income* | 286,726 | 195,587 | 91,139 | 46.6% |
| Net Securities Lending Income | 453 | 2,168 | (1,715) | -79.1% |
| **Total Additions** | **370,961** | **265,717** | **105,244** | **39.6%** |
| ** Net of Investment Expenses of $3,387 and $5,026 in 2011 and 2010, respectively.* | | | | |
| Retirement Benefits | 110,415 | 98,110 | 12,305 | 12.5% |
| Death Benefits | 7,883 | 7,583 | 300 | 4.0% |
| Refund of Contributions | 1,980 | 1,219 | 761 | 62.4% |
| Administrative | 2,867 | 2,641 | 226 | 8.6% |
| **Total Deductions** | **123,145** | **109,553** | **13,592** | **12.4%** |
| **Net Increase in Plan Net Assets** | **247,816** | **156,164** | **91,652** | **58.7%** |
| **Beginning Net Assets** | **1,512,802** | **1,356,638** | **156,164** | **11.5%** |
| **Ending Net Assets** | **$ 1,760,618** | **$ 1,512,802** | **$ 247,816** | **16.4%** |

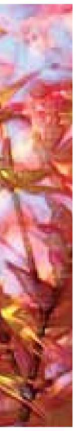
## CHANGES IN PLAN NET ASSETS FOR THE POSTEMPLOYMENT HEALTHCARE PLAN
**(Table 2c)**
*For the Fiscal Years Ended June 30, 2012 and 2011 (In Thousands)*

| | 2012 | 2011 | Increase/(Decrease) Amount | Increase/ (Decrease) Percent |
|---|---|---|---|---|
| Employee Contributions | $ 14,995 | $ 16,041 | $ (1,046) | -6.5% |
| Employer Contributions | 25,834 | 17,146 | 8,688 | 50.7% |
| Net Investment Income/(loss)* | (5,150) | 21,808 | (26,958) | -123.6% |
| Net Securities Lending Income | 10 | 34 | (24) | -70.6% |
| **Total Additions** | **35,689** | **55,029** | **(19,340)** | **-35.1%** |
| ** Net of Investment Expenses of $547 and $256 in 2012 and 2011, respectively.* | | | | |
| Healthcare Insurance Premiums | 33,077 | 27,370 | 5,707 | 20.9% |
| Administrative | 268 | 216 | 52 | 24.1% |
| **Total Deductions** | **33,345** | **27,586** | **5,759** | **20.9%** |
| **Net Increase in Plan Net Assets** | **2,344** | **27,443** | **(25,099)** | **-91.5%** |
| **Beginning Net Assets** | **135,454** | **108,011** | **27,443** | **25.4%** |
| **Ending Net Assets** | **$ 137,798** | **$ 135,454** | **$ 2,344** | **1.7%** |



## CHANGES IN PLAN NET ASSETS FOR THE POSTEMPLOYMENT HEALTHCARE PLAN
**(Table 2d)**
*For the Fiscal Years Ended June 30, 2011 and 2010 (In Thousands)*

| | 2011 | 2010 | Increase/(Decrease) Amount | Increase/ (Decrease) Percent |
|---|---|---|---|---|
| Employee Contributions | $ 16,041 | $ 15,815 | $ 226 | 1.4% |
| Employer Contributions | 17,146 | 17,027 | 119 | 0.7% |
| Net Investment Income* | 21,808 | 13,703 | 8,105 | 59.1% |
| Net Securities Lending Income | 34 | 149 | (115) | -77.2% |
| **Total Additions** | **55,029** | **46,694** | **8,335** | **17.9%** |
| ** Net of Investment Expenses of $256 and $345 in 2011 and 2010, respectively.* | | | | |
| Healthcare Insurance Premiums | 27,370 | 24,066 | 3,304 | 13.7% |
| Administrative | 216 | 181 | 35 | 19.3% |
| **Total Deductions** | **27,586** | **24,247** | **3,339** | **13.8%** |
| **Net Increase in Plan Net Assets** | **27,443** | **22,447** | **4,996** | **22.3%** |
| **Beginning Net Assets** | **108,011** | **85,564** | **22,447** | **26.2%** |
| **Ending Net Assets** | **$ 135,454** | **$ 108,011** | **$ 27,443** | **25.4%** |



### Reserves

The System is required by the City of San José Municipal Code to establish various reserves in the System's net assets. The System's net assets are allocated between the Defined Benefit Pension Plan (which includes the Retirement Fund and the Cost-of-Living Fund) and the Postemployment Healthcare Plan (which includes the 401(h) and 115 Trust). Within the Defined Benefit Pension Plan Retirement Fund there are three reserves: the General Reserve, Employee Contributions Reserve, and Supplemental Retiree Benefit Reserve. The Defined Benefit Pension Plan Cost-of-Living Fund and the Postemployment Healthcare Plan both have a General Reserve and Employee Contributions Reserve (see table on page 39 for a complete listing and year-end balances of the System's reserves).

The System's reserves are established from contributions and the accumulation of investment income, after satisfying investment and administrative expenses. Additionally, the appreciation in the fair value of investments is held in the unrealized gain/loss account, a component of the General Reserve.

### The System's Fiduciary Responsibilities

The System's Board of Administration and management staff are fiduciaries of the defined benefit pension and other postemployment healthcare trust funds. Under the California Constitution and the San José Municipal Code, the assets can only be used for the exclusive benefit of plan participants and their beneficiaries, and defraying reasonable costs of administration.

### Economic Factors and Rates Affecting Next Year

The System's most recent valuation as of June 30, 2011, was used to determine the annual contribution rates effective for payroll periods beginning on June 24, 2012, for fiscal year 2012-2013. The June 30, 2011 valuations include Board adopted actuarial assumption changes recommended by the System's actuary in the June 30, 2010 experience study presented on May 12, 2011. The June 30, 2011 valuations also included the Board adopted funding policy of setting the annual required contribution to be the greater of the dollar amount reported in the actuarial valuation and the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll for the fiscal year. On July 1, 2011, the City funded the fiscal year 2011-2012 annual required contribution dollar amount as reported in the June 30, 2011 valuations. See Notes 5 and 6 of the financial statements on pages 48 - 53 for a full listing of the actuarial assumption changes.

### Defined Benefit Pension Plan

The System's funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2011, the System's most recent valuation, the funded status of the pension plan decreased from 69% to 65%. The decrease in the pension plan funded status was due primarily to actuarial assumption changes.

The June 30, 2011 valuation included a change in the expected rate of return from 7.95% to 7.50% and a change in the payroll wage inflation assumption from 3.90% to 3.25%. In addition, the Board approved the actuary's recommendation to explicitly include administrative expenses and SRBR costs as additions to normal cost (valued at 0.70% of payroll for administrative expenses and 0.35% of the market value of assets for the SRBR) in the June 30, 2011 valuation. The expected rate of return of 7.50% is now only net of investment manager fees.

The June 30, 2011 valuation contains the Board adopted 30/20 layered amortization methodology which includes the level amortization of the unfunded liability as of June 30, 2009 over a closed period of 30 years from that date, and the amortization of subsequent gains and losses or assumption changes over 20 years from the valuation in which they are first recognized. The equivalent single amortization period for the June 30, 2011 valuation is 25.2 years.

In addition, the System's actuarial valuation uses a five year smoothing method for investment returns. This means that the current year's gains or losses in greater or less than the actuarially assumed rate of return, as calculated at year-end, are recognized over five years. The unfunded actuarial accrued liability of $982 million, as of June 30, 2011, does not include the impact of approximately $28 million of deferred investment losses primarily resulting from unfavorable investments returns in fiscal years 2008 and 2009. It is anticipated that future actuarial valuations will recognize the remaining deferred investment losses of approximately $28 million as described above and the smoothing of any new gains or losses over a five year period.

Additionally, the System is exposed to general investment market risk. In a public pension plan context, this is the risk that the long-term rate of return earned on the Defined Benefit Pension Plan assets could be below the actuarially assumed rate of return, which is 7.50%, net of investment expenses. Underperforming the assumed rate of return would negatively impact the financial condition of the System and require an increase in the City's required contribution to the plan. The contribution rate impact from general market risk depends in large measure on how deep any future market downturn is and how long it lasts.

Contribution rates for fiscal year 2012-2013, as determined by the June 30, 2011 valuation included the impact of the continued effect of the layered 20-year closed amortization period, the decrease in the discount and wage inflation rates, the impact of decreases in covered payroll due to budget cuts, and the recognition of smoothed deferred investment losses.

The valuation for June 30, 2012 and beyond will include the impact of *The Sustainable Retirement Benefits and Compensation*

*Act (Pension Act)* enacted by the voters of San Jose on June 5, 2012. The Pension Act amended the City Charter to change benefits for current employees, to establish different benefits for new employees and to place other limitations on benefits.

Section 1508-A of the Pension Act applicable to new employees was adopted on August 28, 2012 by San Jose City Council Ordinance No. 29120 to provide Tier 2 pension benefits for new System members hired on or after September 30, 2012. The new tier includes significant benefit changes from the existing Tier 1 plan including, but not limited to, a decrease in the benefits multiplier from 2.5% per year to 2.0% per year, an increase from 55 years to 65 years of age for retirement eligibility at full benefits, a consumer price index driven cost-of-living increase with a maximum of 1.5% instead of the existing annual fixed 3.0% increase, a decrease in maximum benefit to 65% of final average salary from 75%, no survivor benefits for death after retirement unless the member elects a reduced benefit, pensionable compensation to be based on base salary only, rather than base compensation plus premium pays; members to contribute 50% of the total Normal Cost, any accrued unfunded actuarial liability and administrative costs of the System; year of service credit to require 2080 hours of work rather than 1730 hours of work and final average compensation based on the highest consecutive 3 years of compensation compared to highest 1 year. Significant portions of the Pension Act applicable to existing employees and effective June 23, 2013 are currently subject to legal challenge by members of the System. Additionally, various bargaining units representing members of the System have filed unfair labor practice charges with the California Public Employment Relations Board related to the Pension Act.

Additionally, the System's financial reporting will be impacted in fiscal year ending June 30, 2014 as a result of the implementation of Statement No. 67 of the Governmental Accounting Standards Board (GASB), *Financial Reporting for Pension Plan.* GASB Statement No. 67 will replace GASB 25, ***Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,*** and No. 50, *Pension Disclosures*. This statement establishes standards of financial reporting and specifies the required approach to measuring the pension liability of employers. The statement relates to accounting and financial reporting and does not apply to how pension plans approach funding.

## Postemployment Healthcare Plan

The System's fifth GASB Statement No. 43-compliant Other Postemployment Benefits (OPEB) valuation study as of June 30, 2011, was prepared by Cheiron, Inc., the System's actuary. A summary of the results is presented in Note 6 to the Financial Statements. Fiscal year ended June 30, 2012 was the third year of the Memorandum of Agreement (MOA) entered into by the bargaining units representing the System members and the City to increase the contribution rates for retiree health and dental benefits in order to phase-in to full funding of the GASB Statement No. 43 annual required contributions over a five period. The MOA also provides that the five year phase-in of the ARC will not have an incremental increase of more than 0.75% of pensionable pay in each fiscal year for the employee or City contributions. Upon the end of the five year phase-in the City and active members' contributions for retiree medical benefits will be split evenly and the retiree dental benefits will be split in a ratio of 8 to 3 with the City contributing 8/11 of the total contribution. Fiscal year ending June 30, 2013, will mark the end of the five year phase-in and per the MOA will require the employees and City to contribute at the GASB Statement No. 43 contribution rate. As of the June 30, 2011 valuation the contribution rate determined by applying the GASB Statement No. 43 parameters for the City as a percentage of pay was 29.26% compared to 7.91% phase-in funded basis.

On June 24, 2011 a new Internal Revenue Code Section 115 trust was established by the San José City Council (Ordinance number 28914) outside of the Pension Trust for retiree healthcare benefits funding and for the payment of retiree healthcare benefits in order to provide an alternative to the existing 401(h) account. Employer contributions to the new trust were made in fiscal year 2012. Employee contributions continue to be made into the 401(h) account. The City Council has requested advice from outside tax counsel on the tax treatment of employee contributions deposited into the 115 Trust prior to determining whether to direct employee contributions into the 115 Trust. Pursuant to the Municipal Code, the Board has been named as the Trustee of the 115 Trust. The Board has directed that no employee contributions be accepted into the 115 Trust pending further clarification of the tax treatment and refundability of employee contributions.

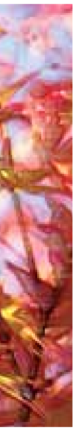
## Requests for Information

This financial report is designed to provide the Board of Administration, Mayor and City Council, our membership, taxpayers, and investment managers with a general overview of the System's finances and to account for the money it receives. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

Federated City Employees' Retirement System
1737 North First Street, Suite 580
San José, California 95112-4505

Respectfully Submitted,

**Donna Busse**
*Acting Director*



## STATEMENTS OF PLAN NET ASSETS

*June 30, 2012 and 2011 (In Thousands)*

| | 2012 | | |
|---|---|---|---|
| | Defined Benefit Pension Plan | Postemployment Healthcare Plan | Total |
| Assets: | | | |
| **Receivables:** | | | |
| Employee contributions | $ 1,659 | $ 304 | $ 1,963 |
| Employer contributions | 369 | 318 | 687 |
| Brokers and others | 1,611 | 117 | 1,728 |
| Accrued investment income | 3,076 | 221 | 3,297 |
| **Total receivables** | **6,715** | **960** | **7,675** |
| **Investments, at fair value:** | | | |
| Securities and other: | | | |
| Domestic fixed income | 153,150 | 12,756 | 165,906 |
| International fixed income | 2,013 | 167 | 2,180 |
| Collective short-term investments | 230,176 | 19,171 | 249,347 |
| Corporate convertible bonds | 47,294 | 3,940 | 51,234 |
| Pooled fixed income | 32,886 | 2,739 | 35,625 |
| Global equity | 326,054 | 27,157 | 353,211 |
| Pooled global equity | 451,236 | 37,583 | 488,819 |
| Private equity | 88,137 | 7,341 | 95,478 |
| Forward international currency contracts | 418 | 34 | 452 |
| Opportunistic investments | 77,427 | 6,449 | 83,876 |
| Real assets | 154,547 | 12,872 | 167,419 |
| Real estate | 86,649 | 7,216 | 93,865 |
| **Total investments** | **1,649,987** | **137,425** | **1,787,412** |
| **TOTAL ASSETS** | **1,656,702** | **138,385** | **1,795,087** |
| Liabilities: | | | |
| Payable to brokers | 4,089 | 295 | 4,384 |
| Other liabilities | 3,364 | 292 | 3,656 |
| **TOTAL LIABILITIES** | **7,453** | **587** | **8,040** |
| Net Assets Held In Trust For: | | | |
| Pension benefits | 1,649,249 | | 1,649,249 |
| Postemployment healthcare benefits | - | 137,798 | 137,798 |
| **TOTAL NET ASSETS** | **$ 1,649,249** | **$ 137,798** | **$ 1,787,047** |

*See accompanying notes to basic financial statements.*

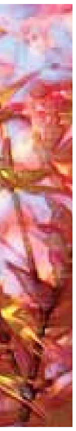
*(Continued)*

## STATEMENTS OF PLAN NET ASSETS (continued)

*June 30, 2012 and 2011 (In Thousands)*

| | 2011 | | |
|---|---|---|---|
| | **Defined Benefit Pension Plan** | **Postemployment Healthcare Plan** | **Total** |
| Assets: | | | |
| **Receivables:** | | | |
| Employee contributions | $ 1,165 | $ 842 | $ 2,007 |
| Employer contributions | 11,731 | 1,211 | 12,942 |
| Brokers and others | 2,206 | 173 | 2,379 |
| Accrued investment income | 3,612 | 281 | 3,893 |
| **Total receivables** | **18,714** | **2,507** | **21,221** |
| **Investments, at fair value:** | | | |
| Securities and other: | | | |
| Domestic fixed income | 378,497 | 28,862 | 407,359 |
| International fixed income | 2,096 | 160 | 2,256 |
| Collective short-term investments | 33,206 | 2,532 | 35,738 |
| Corporate convertible bonds | 48,943 | 3,732 | 52,675 |
| Pooled fixed income | 19,912 | 1,518 | 21,430 |
| Global equity | 444,594 | 33,903 | 478,497 |
| Pooled global equity | 461,370 | 35,182 | 496,552 |
| Private equity | 86,079 | 6,564 | 92,643 |
| Forward international currency contracts | 84 | 6 | 90 |
| Opportunistic investments | 30,462 | 2,323 | 32,785 |
| Real assets | 155,126 | 11,829 | 166,955 |
| Real estate | 84,141 | 6,532 | 90,673 |
| Securities lending collateral investment pool | 150,265 | 11,677 | 161,942 |
| **Total investments** | **1,894,775** | **144,820** | **2,039,595** |
| **TOTAL ASSETS** | **1,913,489** | **147,327** | **2,060,816** |
| Liabilities: | | | |
| Payable to brokers | 1,304 | 101 | 1,405 |
| Securities lending collateral due to borrowers | 150,265 | 11,677 | 161,942 |
| Other liabilities | 1,302 | 95 | 1,397 |
| **TOTAL LIABILITIES** | **152,871** | **11,873** | **164,744** |
| Net Assets Held In Trust For: | | | |
| Pension benefits | 1,760,618 | - | 1,760,618 |
| Postemployment healthcare benefits | - | 135,454 | 135,454 |
| **TOTAL NET ASSETS** | **$ 1,760,618** | **$ 135,454** | **$ 1,896,072** |

*See accompanying notes to basic financial statements.* *(Continued)*



## STATEMENTS OF CHANGES IN PLAN NET ASSETS

*For the Fiscal Years Ended June 30, 2012 and 2011 (In Thousands)*

| | 2012 | | |
|---|---|---|---|
| | **Defined Benefit Pension Plan** | **Postemployment Healthcare Plan** | **Total** |
| Additions: | | | |
| **Contributions:** | | | |
| Employee | $ 10,555 | $ 14,995 | $ 25,550 |
| Employer | 87,082 | 25,834 | 112,916 |
| **Total contributions** | **97,637** | **40,829** | **138,466** |
| **Investment income:** | | | |
| Net depreciation in fair value of investments | (98,855) | (7,811) | (106,666) |
| Interest income | 27,026 | 2,031 | 29,057 |
| Dividend income | 9,350 | 1,138 | 10,488 |
| Net rental income | 520 | 39 | 559 |
| Less investment expense | (7,073) | (547) | (7,620) |
| **Net investment loss before securities lending income** | **(69,032)** | **(5,150)** | **(74,182)** |
| Securities lending income: | | | |
| Earnings | 88 | 7 | 95 |
| Rebates | 84 | 6 | 90 |
| Fees | (43) | (3) | (46) |
| **Net securities lending income** | **129** | **10** | **139** |
| **Net investment loss** | **(68,903)** | **(5,140)** | **(74,043)** |
| **TOTAL ADDITIONS** | **28,734** | **35,689** | **64,423** |
| Deductions: | | | |
| Retirement benefits | 126,001 | - | 126,001 |
| Healthcare insurance premiums | - | 33,077 | 33,077 |
| Death benefits | 8,601 | - | 8,601 |
| Refund of contributions | 2,195 | - | 2,195 |
| Administrative expenses and other | 3,306 | 268 | 3,574 |
| **TOTAL DEDUCTIONS** | **140,103** | **33,345** | **173,448** |
| **NET INCREASE/(DECREASE)** | **(111,369)** | **2,344** | **(109,025)** |
| Net Assets Held In Trust For Pension Benefits and Postemployment Healthcare Benefits: | | | |
| **BEGINNING OF YEAR** | **1,760,618** | **135,454** | **1,896,072** |
| **END OF YEAR** | **$ 1,649,249** | **$ 137,798** | **$ 1,787,047** |

*See accompanying notes to basic financial statements.*

*(Continued)*

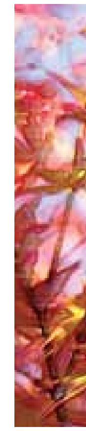
# Basic Financial Statements *(Continued)*

## STATEMENTS OF CHANGES IN PLAN NET ASSETS (continued)

*For the Fiscal Years Ended June 30, 2012 and 2011 (In Thousands)*

| | 2011 | | |
|---|---|---|---|
| | **Defined Benefit Pension Plan** | **Postemployment Healthcare Plan** | **Total** |
| Additions: | | | |
| **Contributions:** | | | |
| Employee | $24,602 | $16,041 | $40,643 |
| Employer | 59,180 | 17,146 | 76,326 |
| **Total contributions** | **83,782** | **33,187** | **116,969** |
| **Investment income:** | | | |
| Net appreciation in fair value of investments | 252,848 | 19,238 | 272,086 |
| Interest income | 26,157 | 1,984 | 28,141 |
| Dividend income | 8,293 | 629 | 8,922 |
| Net rental income | 2,815 | 213 | 3,028 |
| Less investment expense | (3,387) | (256) | (3,643) |
| **Net investment income before securities lending income** | **286,726** | **21,808** | **308,534** |
| Securities lending income: | | | |
| Earnings | 520 | 39 | 559 |
| Rebates | 84 | 6 | 90 |
| Fees | (151) | (11) | (162) |
| **Net securities lending income** | **453** | **34** | **487** |
| **Net investment income** | **287,179** | **21,842** | **309,021** |
| **TOTAL ADDITIONS** | **370,961** | **55,029** | **425,990** |
| Deductions: | | | |
| Retirement benefits | 110,415 | - | 110,415 |
| Healthcare insurance premiums | - | 27,370 | 27,370 |
| Death benefits | 7,883 | - | 7,883 |
| Refund of contributions | 1,980 | - | 1,980 |
| Administrative expenses and other | 2,867 | 216 | 3,083 |
| **TOTAL DEDUCTIONS** | **123,145** | **27,586** | **150,731** |
| **NET INCREASE** | **247,816** | **27,443** | **275,259** |
| Net Assets Held In Trust For Pension Benefits and Postemployment Healthcare Benefits: | | | |
| **BEGINNING OF YEAR** | **1,512,802** | **108,011** | **1,620,813** |
| **END OF YEAR** | **$ 1,760,618** | **$ 135,454** | **$ 1,896,072** |

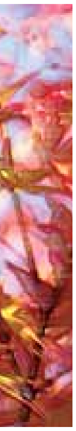
*See accompanying notes to basic financial statements.*



# Notes to Basic Financial Statements

## NOTE 1 – DESCRIPTION OF THE PLAN

The following description of the City of San José Federated City Employees' Retirement System (System) is provided for financial reporting purposes only. Employees and members should refer to the City of San José Municipal Code for more complete information.



### (a) General

The System, consisting of a single employer Defined Benefit Pension Plan and a Postemployment Healthcare Plan, was established in 1941 to provide retirement benefits for certain employees of the City of San José (City) and includes all provisions of San Jose Municipal Code Chapters 3.28, 3.44, and 3.52.

The Defined Benefit Pension Plan was established pursuant to Internal Revenue Code (IRC) Section 401(a) and is held and administered in the 1975 Federated City Employees Retirement Plan (Pension Trust) and includes all provisions of San Jose Municipal Code Chapter 3.28.

The Postemployment Healthcare Plan is comprised of an IRC 401(h) plan and an IRC 115 trust and is held and administered in the 1975 Federated City Employees' Retirement Plan and the Federated City Employees' Healthcare Trust Fund, respectively, and includes all provisions of San Jose Municipal Code Chapters 3.28 and 3.52, respectively.

The Postemployment Healthcare Plan was established under Internal Revenue Code Section 401(h) and is an account within the Pension Trust for retiree healthcare benefits funding and for the payment of retiree healthcare benefits. As a 401(h) plan the healthcare plan benefits must be subordinate to the pension plan benefits. The medical benefits are considered subordinate if the cumulative actual contributions for medical benefits are no greater than 25% of actual contributions to both pension and medical benefits, ignoring contributions for past service benefit (normal cost only). The System's actuary performs periodic reviews and projections of the Internal Revenue Code 25% subordination test.

On June 24, 2011, a new Internal Revenue Code Section 115 trust was established by the San José City Council under the provisions of San Jose Municipal Code Chapter 3.52 (Ordinance number 28914) to provide an alternative to the existing 401(h) account within the Pension Trust for retiree healthcare benefits funding and for the payment of retiree healthcare benefits Employer contributions to the new trust were made in fiscal year 2012. Employee contributions continue to be made into the 401(h) account The City Council has requested advice from outside tax counsel on the tax treatment of employee contributions deposited into the 115 Trust prior to determining whether to direct employee contributions into the 115 Trust. Pursuant to the Municipal Code, the Board has been named as the Trustee of the 115 Trust. The Board has directed that no employee contributions be accepted into the 115 Trust pending further clarification of the tax treatment and refundability of employee contributions.

On August 18, 2012, the System received a favorable tax determination letter from the Internal Revenue Service for the Pension Trust, which includes the Defined Benefit Pension Plan and the 401(h) portion of the Postemployment Healthcare Plan.

All full-time and eligible part-time employees of the City, except employees who are members of the City's Police and Fire Department Retirement Plan, are required to be members of the System.

The System is considered to be a part of the City's financial reporting entity and is included in the City's basic financial statements as a pension trust fund. The System is administered by the Director of Retirement, an employee of the City and by the Federated City Employees' Retirement System Board of Administration (Board of Administration). The contribution and benefit provisions and all other requirements are established by City ordinance. The System is responsible for all direct administrative costs, which are funded by investment earnings, except for certain support services, which are provided and funded directly by the City. The System is not subject to the provisions of the Employee Retirement Income Security Act of 1974.

Participants of the Postemployment Healthcare Plan are also participants of the Defined Benefit Pension Plan. As of June 30, 2012 and 2011, employee membership data related to the System was as follows

| Defined Benefit Pension Plan: | 2012 | 2011 |
|---|---|---|
| Retirees and beneficiaries currently receiving benefits * | 3,688 | 3,430 |
| Terminated vested members not yet receiving benefits | 969 | 672 |
| Active members | 3,076 | 3,519 |
| **Total** | **7,733** | **7,621** |
| **Postemployment Healthcare Plan:** | **2012** | **2011** |
| Retirees and beneficiaries currently receiving benefits | 3,062 | 3,073 |
| Terminated vested members not yet receiving benefits | 111 | 86 |
| Active members | 3,076 | 3,519 |
| **Total** | **6,249** | **6,678** |

** The combined domestic relations orders are not included in the count above as their benefit payment is included in the retiree member count.*

## NOTE 1 – DESCRIPTION OF THE PLAN (Continued)

### (b) Pension Benefits

An employee with five or more years of service who reaches the normal retirement age of 55, or an employee of any age with 30 years of service, is entitled to annual pension benefits equal to 2.5% of final average annual salary for each year of service up to a maximum benefit of 75% of final compensation. Final compensation is the average annual salary during the highest 12 months of consecutive service, not to exceed 108% of compensation paid to the member during the second highest consecutive 12 month period, excluding the months used to calculate the highest 12 months. Final average salary excludes overtime pay and expense allowances. In addition, retirement benefits are adjusted for an annual cost-of-living allowance (COLA) of 3% per year.

If employees terminate employment and elect to receive a return of contributions, the accumulated plan benefits attributable to the City's contributions are forfeited; however, an employee's accumulated contribution plus earnings thereon is refunded. Refunds are paid out on a lump-sum basis. The forfeited amount of the City's contributions remains in the System. In the case of reciprocity, a member with less than five years of service may leave contributions in the System.

Effective December 9, 1994, the System entered into an agreement with the California Public Employees' Retirement System (PERS) that extends reciprocal retirement benefits to members. In certain situations, this agreement results in improved retirement benefits for members who move from one eligible retirement system to another.

### (c) Death Benefits

If an employee's death before retirement is service related, or is non-service related (and the employee has at least five years of service), a surviving spouse or domestic partner (at the time of retirement and time of death) is paid an annual annuity benefit equal to 2.5% of final compensation multiplied by the number of years of service (minimum of 40% and maximum of 75% of final compensation) until he or she remarries or dies. Deferred vested members are not eligible for the 40% minimum. The allowance will continue even if the spouse or domestic partner remarries if the member was at least 55 years old and had at least 20 years of service. If there is no surviving spouse or domestic partner, unmarried children up to 18 years of age, or up to 22 years of age if a full-time student, are entitled to a benefit payment based on the spousal or domestic partner benefit such that no one child shall receive more than 25% of the spousal or domestic partner benefit and the sum for all eligible children shall not exceed 75% of the spousal or domestic partner benefit. If no family members are eligible, the employee's contributions plus one month's salary for each year of service up to a maximum of six years of service are returned to the employee's beneficiary or estate.

If an employee dies after retirement, $500 is paid to the employee's beneficiary or estate. In addition, the employee's eligible surviving spouse or eligible domestic partner continues to receive, for life, 50% of the employee's annual pension benefit as defined above. If there is no surviving spouse or domestic partner, 25% of the spouse or domestic partner's benefit payment is made to each eligible child as defined above, but the maximum benefit to children cannot exceed 75% of the benefit that would have been paid to a surviving spouse or domestic partner. An optional retirement allowance is available.

### (d) Disability Benefits

If an employee suffers a service related disability before retirement, the annual disability benefit paid is 40% of the final average salary. For members with more than 16 years of service, the annual disability benefit is the final average salary multiplied by 40% plus the final average salary multiplied by 2.5% for each year over 16. The maximum benefit is 75% of the final average salary.

If an employee with at least five years of service suffers a non-service related disability, the annual disability benefit is equal to the greater of: (1) 2.5% of final compensation multiplied by the number of years of service, up to a maximum of 30 years; or (2) 40% of final compensation. The benefit is reduced by 0.5% of final compensation for each year an employee's age is under 55.

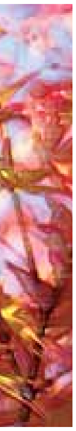
If an employee was hired on or after September 1, 1998, the benefit is calculated using the following formula: 20% of final compensation, plus 2% for each year of service in excess of six but less than 16, plus 2.5% of final compensation for years of service in excess of 16.

For recipients of a disability retirement allowance who are under 55 years of age, the amount of the allowance is subject to reduction for outside employment as set forth in the San Jose Municipal Code.

### (e) Postemployment Healthcare Benefits

The City of San José Municipal Code provides that retired employees with 15 or more years of service, their survivors, or those retired employees who are receiving at least 37.5% of final compensation are entitled to payment of 100% of the lowest priced medical insurance plan available to an active System City employee. Members and eligible survivors must pay for the difference between the amount of the premium for their selected plan and the portion paid by the System. However, the System pays the entire premium cost for dental insurance coverage if the member retires directly from City service.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES



### (a) Basis of Presentation

The System is reported in a pension trust fund in the City of San José's basic financial statements. The financial statements of the System present only the financial activities of the System and are not intended to present the financial position and changes in financial position of the City of San José in conformity with accounting principles generally accepted in the United States of America (GAAP).

### (b) Basis of Accounting

The financial statements of the System are prepared on the accrual basis of accounting. Contributions are recognized as additions when due pursuant to formal commitments as well as statutory and contractual commitments (at the end of the pay period). Benefits and refunds of contributions are recognized when due and payable under the provisions of the plan. Activities of the Defined Benefit Pension Plan and the Postemployment Healthcare Plan are accounted for separately. It is required by the municipal code that transactions of the Defined Benefit Pension Plan be accounted for in two funds: a Retirement Fund and a Cost-of-Living Fund.

The preparation of the financial statements in conformity with GAAP requires management to make certain estimates and assumptions that affect certain reported amounts and disclosures. Actual results could differ from those estimates.

### (c) Investments

The City of San José Municipal Code Section 3.28.355 delegate's authority to the Board of Administration to reinvest the monies of the System as provided in Section 3.28.355. The Board has adopted detailed investment guidelines consistent with conditions and limitations set forth in Section 3.28.355.

On December 15, 2011 the Board accepted the asset-liability study prepared by staff and approved a new asset allocation increasing the level of allocation to absolute return strategies and real assets and reducing the allocation to equity and fixed income. The new asset allocation was prepared to align the expected returns of the System to the liabilities as determined in the June 30, 2011 valuations. The System's investment asset allocation is as follows:

Equity and Real Estate – Target of 45%
Fixed Income – Target of 10%
Absolute Return Strategies – Target 25%
Real Assets – Target 20%

The System's prior asset allocation was as follows.

Global Equity – Target of 49%, minimum 43% and maximum 55% of the fair value of the aggregate portfolio.

Fixed Income – Target of 20%, minimum 15% and maximum 25% of the fair value of the aggregate portfolio.

Alternatives – Target of 31%, minimum 26% and maximum 36% of the fair value of the aggregate portfolio

- Real Estate – Target 5%
- Real Assets – Target 10%
- Hedge Funds – Target 5%
- Private Equity – Target 6%
- Opportunistic – Target 5%

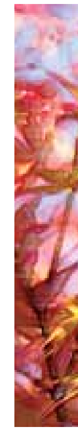
The System's investment policy authorizes the System to invest in global equity; global fixed income; alternatives including real estate, real assets (infrastructure, timber, natural resources, and commodities), hedge funds (absolute return), private equity, and opportunistic assets; short-term investments; and securities lending. Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market, such as private equity, commingled real estate funds and certain pooled fund investments, are reported at estimated fair value based the most recently available investor reports or audited financial statements issued by the manager of those funds. The fund manager provides an estimated unrealized gain/loss of the fund based on the most recently available audited financial statements and other fund information. Derivative investments are reported at fair value. Futures contracts are marked-to-market at the end of each trading day, and the settlement of gains or losses occur on the following business day through variation margins. The fair value of international currency forwards represents the unrealized gain or loss on the related contracts, which is calculated as the difference between the specified contract exchange rate and the exchange rate at the end of the reporting period. The fair value of the separate real estate properties are based on annual independent appraisals. Per the System's Real Estate Investment Guidelines, mortgage loans at fair value on the separate real estate properties are not allowed to exceed 50% of the property's fair value. As of June 30, 2011, the System held a warehouse located in Northern California with no outstanding mortgage loans. On June 26, 2012, the System sold the Northern California warehouse.

Purchases and sales of securities are reflected on the trade date. Investment income is recognized as earned. Rental income is recognized as earned, net of expenses.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### (d) Plan Net Assets Held in Trust for Pension and Postemployment Healthcare Benefits

The System is required by the City of San José Municipal Code to establish various reserves in the plan net assets. The Plan Net Assets are allocated between the Defined Benefit Pension Plan (which includes the Retirement Fund and the Cost-of-Living Fund) and the Postemployment Healthcare Plan, which includes the 401(h) and 115 Trust. As of June 30, 2012 and 2011 the net assets, totaling $1,787,047,000 and $1,896,072,000, respectively, are allocated as follows (In Thousands):



| | Retirement Fund | Cost-of-Living Fund | Defined Benefit Pension Plan | Postemployment Healthcare Plan 401(h) | Postemployment Healthcare (115) | Postemployment Healthcare Plan | Total |
|---|---|---|---|---|---|---|---|
| **June 30, 2012:** | | | | | | | |
| Employee contributions | $ 183,840 | $ 40,331 | $ 224,171 | $ 46,270 | $ - | $ 46,270 | $ 270,441 |
| Supplemental retiree benefit | 43,109 | - | 43,109 | - | - | - | 43,109 |
| General reserve | 980,853 | 401,116 | 1,381,969 | 69,707 | 21,821 | 91,528 | 1,473,497 |
| **TOTAL** | **$ 1,207,802** | **$ 441,447** | **$ 1,649,249** | **$ 115,977** | **$ 21,821** | **$ 137,798** | **$ 1,787,047** |
| **June 30, 2011:** | | | | | | | |
| Employee contributions | $ 192,822 | $ 41,739 | $ 234,561 | $ 32,719 | $ - | $ 32,719 | $ 267,280 |
| Supplemental retiree benefit | 30,677 | - | 30,677 | - | - | - | 30,677 |
| General reserve | 1,067,986 | 427,394 | 1,495,380 | 102,735 | - | 102,735 | 1,598,115 |
| **TOTAL** | **$ 1,291,485** | **$ 469,133** | **$ 1,760,618** | **$ 135,454** | **$ -** | **$ 135,454** | **$ 1,896,072** |

*Employee Contributions Reserve* represents the total accumulated employee contributions of current active and deferred members plus credited interest. The reserve is accounted for separately due to the possibility of a return of accumulated employee contributions, plus credited interest, to the member upon separation from City employment. Terminated members returns of contributions are paid from the Defined Benefit Pension Plan only.

*Supplemental Retiree Benefit Reserve* (SRBR) is a reserve that represents funds required by statute to be set aside from the Retirement Fund's net investment earnings to provide supplemental benefits to eligible retirees and beneficiaries. The reserve represents the accumulation of 10% of total accumulated excess earnings of the Retirement Fund plus credited interest on the reserve balance at the lesser of the Plan's actual rate of return or the actuarial rate of return for the fiscal year, but never less than 0%, minus distributions to eligible retirees and beneficiaries from the reserve. Transfer amounts to the SRBR have been prepared by the System's actuary from the fiscal year ended June 30, 2009 onward. Interest on the SRBR balance is calculated and transferred at the end of the fiscal year. Excess earnings transfers are computed based on audited financial statements and if applicable the transfer is made effective on the first day of the next fiscal year by Board Resolution.

The System's actuary, Cheiron, prepared the excess earnings and SRBR primary interest amounts based on the audited June 30, 2011 and 2010 financial statements. Cheiron prepared and the Board adopted and declared excess earnings transfer amounts of $12.53 million and $6.95 million from the pension general reserve to the SRBR effective July 1, 2011 and 2010, respectively. In addition, Cheiron computed SRBR distribution amounts in accordance with Board policy of approximately $6.6 million and $1.60 million to eligible retirees and beneficiaries as per San José Municipal Code for fiscal years ended June 30, 2011 and 2010, respectively, based on excess earnings transfers and interest credits. However, due to San José City Council resolution number

# Notes to Basic Financial Statements *(Continued)*

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

75635, adopted on November 16, 2010 and amended in resolutions 76204 and 76235, distribution of funds from the SRBR were suspended for fiscal years 2012 and 2011.

*General Reserve* is a reserve that represents net earnings resulting from interest earnings, realized and unrealized investment gains and losses. It also represents an accumulation of funds necessary to pay all accumulated vested retirement obligations.

## NOTE 3 – INVESTMENTS

Investments are subject to certain types of risks, including interest rate risk, custodial credit risk, credit quality risk, foreign currency risk, and concentration of credit risk. The following describes those risks:

*Interest Rate Risk* – The fair value of fixed income investments fluctuate in response to changes in market interest rates. Increases in prevailing interest rates generally translate into decreases in fair value of those instruments. The fair value of interest-sensitive instruments may also be affected by the creditworthiness of the issuer, prepayment options, and other general interest rate conditions. Certain fixed income investments have call provisions that could result in shorter maturity periods. As of June 30, 2012, $12,215,000 of bank loan securities were floating rate securities tied to the one and three month London Interbank Offered Rate (LIBOR). As of June 30, 2011, $23,145,000 of bank loan securities were floating rate securities tied to the one and three month LIBOR.

The System also had exposure to interest rate risk on its fully collateralized infrastructure swaps. The System invested in infrastructure swaps with a notional amount of $74,041,000 at June 30, 2012, in which it receives the total return S&P Global Infrastructure Index, net of the 3-month LIBOR plus 50 to 55 basis points. The System also invested in commodities swaps with a notional amount of $226,788,000 at June 30, 2012, in which it receives the total return United States three month treasury bill rate plus 10 to 12 basis points. As of June 30, 2011, the System invested in infrastructure swaps with a notional amount of $37,408,000 in which it received the total return S&P Global Infrastructure Index, net of the 3-month LIBOR plus 55 basis points. The System does not have a policy regarding interest rate risk, however, the System does settle swap activity on a transaction plus one day basis (T+1), therefore limiting the System's exposure to counterparty risk

The following tables provide the segmented time distribution for fixed income investments based on expected maturity (in months and years) as of June 30, 2012 and 2011, concerning the fair value of investments and interest rate risk:

### INVESTMENT MATURITIES AT FAIR VALUE AS OF JUNE 30, 2012

*(Dollars In Thousands)*

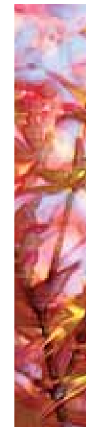
| | Maturities | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 0-3 Months | 3-6 Months | 6 Months - 1 Year | 1-5 Years | 5-10 Years | More Than 10 Years | Total Fair Value | Cost |
| **Fixed Income** | | | | | | | | |
| **Domestic fixed income** | | | | | | | | |
| Asset backed securities | $ 2,025 | $ - | $ - | $ 2,020 | $ - | $ - | $ 4,045 | $ 6,042 |
| Bank loans | - | 1,142 | - | 11,375 | - | - | 12,517 | 11,036 |
| Corporate bonds | - | 636 | - | 15,073 | 5,367 | 3,799 | 24,875 | 20,602 |
| TIPS | - | - | - | 82,931 | 41,538 | - | 124,469 | 120,522 |
| **Total Domestic fixed income** | **2,025** | **1,778** | **-** | **111,399** | **46,905** | **3,799** | **165,906** | **158,202** |
| **International fixed income** | **-** | **-** | **-** | **2,176** | **4** | **-** | **2,180** | **1,987** |
| **Collective short-term investments** | **1,917** | **-** | **260** | **-** | **-** | **247,170** | **249,347** | **249,701** |
| **Corporate convertible bonds** | **-** | **-** | **4,369** | **32,015** | **3,601** | **11,249** | **51,234** | **50,560** |
| **Pooled fixed income** | **-** | **-** | **-** | **-** | **2,672** | **32,953** | **35,625** | **29,216** |
| **TOTAL FIXED INCOME** | **$ 3,942** | **$ 1,778** | **$ 4,629** | **$ 145,590** | **$ 53,182** | **$ 295,171** | **$504,292** | **$ 489,666** |

## NOTE 3 – INVESTMENTS (Continued)

### INVESTMENT MATURITIES AT FAIR VALUE AS OF JUNE 30, 2011

*(Dollars In Thousands)*

| | Maturities | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 0-3 Months | 3-6 Months | 6 Months - 1 Year | 1-5 Years | 5-10 Years | More Than 10 Years | Total Fair Value | Cost |
| **Fixed Income** | | | | | | | | |
| **Domestic fixed income** | | | | | | | | |
| Asset backed securities | $ - | $ - | $ - | $ 960 | $ - | $ 408 | $ 1,368 | $ 1,059 |
| Bank loans | - | - | 1,635 | 21,595 | 1,103 | - | 24,333 | 21,684 |
| Corporate bonds | - | 1,122 | - | 19,751 | 15,412 | 3,534 | 39,819 | 34,249 |
| FHLMC | - | - | 2,179 | 6,104 | - | - | 8,283 | 8,155 |
| FNMA | - | - | - | 7,290 | - | - | 7,290 | 7,125 |
| Other U.S. Government agency | - | 3,341 | 1,519 | - | - | - | 4,860 | 5,057 |
| TIPS | - | - | - | 83,297 | 85,061 | 28,656 | 197,014 | 179,921 |
| U.S. Treasury | - | - | 19,085 | 55,934 | 49,373 | - | 124,392 | 120,365 |
| **Total Domestic fixed income** | **-** | **4,463** | **24,418** | **194,931** | **150,949** | **32,598** | **407,359** | **377,615** |
| **International Fixed Income** | **-** | **-** | **-** | **565** | **1,133** | **558** | **2,256** | **1,865** |
| **Collective short-term investments** | **35,738** | **-** | **-** | **-** | **-** | **-** | **35,738** | **35,774** |
| **Corporate convertible bonds** | **-** | **-** | **3,244** | **38,330** | **4,330** | **6,771** | **52,675** | **47,883** |
| **Pooled fixed income** | **-** | **-** | **-** | **-** | **-** | **21,430** | **21,430** | **19,500** |
| **TOTAL FIXED INCOME** | **$35,738** | **$4,463** | **$27,662** | **$233,826** | **$156,412** | **$61,357** | **$519,458** | **$482,637** |



*Custodial Credit Risk* – Custodial credit risk is the risk that the System will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party if that outside party fails. The System does not have a policy regarding custodial credit risk. As of June 30, 2012 and 2011, all of the System's investments, excluding invested securities lending collateral, are held in the System's name, and/or not exposed to custodial credit risk. Securities lending collateral is invested in the lending agent's investment fund (see Note 4 – Securities Lending Program).

*Credit Quality Risk* – Nationally recognized statistical rating organizations provide ratings of debt securities quality based on a variety of factors, such as the financial condition of the issuers, which provide investors with some idea of the issuer's ability to meet its obligations. The System's investment policy dictates that assets shall generally be invested in investment grade, marketable, fixed-income securities. Domestic fixed income investment grade shall be defined as being rated Baa/BBB or better by Moody's Investors Service (Moody's) or Standard & Poor's Corporation (S&P). "Yankee" bonds issued by foreign countries and denominated in U.S. dollars are allowed so long as they are rated Baa/BBB or better by Moody's or S&P. If a security is not rated by S&P or Moody's, the equivalent rating determined by the investment manager's research department will be used. Should a current holding fall below this standard, the manager shall notify the System of the downgrade and confer with the System staff as to whether the security will continue to be held or disposed. Up to 10% investment in BB or B securities will be permitted with written authorization of the Board. The investment managers employed to manage fixed-income securities will have discretion in the day-to-day management of the funds under their control.

The System may hedge against the possible adverse effects of currency fluctuations on the System's portfolio of international fixed income obligations when it is considered appropriate. This is typically achieved using forward currency contracts. Short-term investments may consist of commercial paper rated at least A1 or P1, repurchase agreements, short-term U.S. securities, and other money market investments.

On August 5, 2011, S&P lowered its long-term credit rating on debt of the U.S. government from AAA to AA+. That

## NOTE 3 – INVESTMENTS (Continued)

action affected S&P's view of U.S. public finance debt instruments that are directly or indirectly backed by the U.S. As a result, on August 8, 2011, S&P lowered its long-term credit ratings of U.S. government-sponsored enterprises and public debt issues that have credit enhancement guarantees by those government-sponsored enterprises to AA+. These credit downgrades relate to the credit risk associated with the System's investments in U.S. Treasury securities, U.S. government agency securities, U.S. government bonds, and U.S. government mortgage-backed securities.

### RATINGS OF FIXED INCOME INVESTMENTS
*as of June 30, 2012 (Dollars In Thousands)*

| S&P quality rating | Fair Value | Fair Value as a % of Total Fixed Income |
|---|---|---|
| AAA | $ 2,696 | 0.7% |
| A | 8,844 | 2.3% |
| BBB | 15,559 | 4.1% |
| BB | 15,186 | 4.0% |
| B | 10,083 | 2.6% |
| CCC & Below | 1,718 | 0.5% |
| Not Rated | 325,736 | 85.8% |
| **TOTAL** | **$ 379,822** | **100.0%** |

The following table provides information as of June 30, 2012 and 2011 concerning credit risk. Investments issued or explicitly guaranteed by the U.S. government of $124,470,000 and $321,406,000 as of June 30, 2012 and 2011, respectively, are not considered to have credit risk and are excluded from the tables below.

### RATINGS OF FIXED INCOME INVESTMENTS
*as of June 30, 2011 (Dollars In Thousands)*

| S&P quality rating | Fair Value | Fair Value as a % of Total Fixed Income |
|---|---|---|
| AAA | $ 5,927 | 3.0% |
| AA | 874 | 0.4% |
| A | 9,827 | 5.0% |
| BBB | 21,190 | 10.7% |
| BB | 32,876 | 16.6% |
| B | 22,768 | 11.5% |
| CCC & Below | 2,811 | 1.4% |
| Not Rated | 101,779 | 51.4% |
| **TOTAL** | **$ 198,052** | **100.0%** |

The following tables provide information as of June 30, 2012 and 2011, concerning the fair value of investments and foreign currency risk:

### FOREIGN CURRENCY RISK ANALYSIS
*as of June 30, 2012 (Dollars In Thousands)*

| Currency Name | Cash | Private Equity | Equity | Fixed Income | Pending Foreign Currency Exchanges | Total Exposure |
|---|---|---|---|---|---|---|
| Australian dollar | $ 19 | $ - | $ 10,014 | $ - | $ 39 | $ 10,072 |
| British pound sterling | 685 | - | 43,257 | - | 82 | 44,024 |
| Canadian dollar | (26) | - | 5,757 | - | 31 | 5,762 |
| Danish krone | 245 | - | 3,203 | - | - | 3,448 |
| Euro currency | 640 | 9,252 | 36,405 | 5,016 | 285 | 51,598 |
| Hong Kong dollar | 93 | - | 4,526 | 125 | - | 4,744 |
| Israeli shekel | 2 | - | 384 | - | - | 386 |
| Japanese yen | 405 | - | 38,855 | 5,536 | (31) | 44,765 |
| New Taiwan dollar | - | - | - | - | 11 | 11 |
| Norwegian krone | 91 | - | 4,371 | - | 43 | 4,505 |
| Polish zloty | - | - | - | - | - | - |
| Singapore dollar | 30 | - | 3,389 | 1,835 | - | 5,254 |
| Swedish krona | 114 | - | 4,594 | 1,100 | (8) | 5,800 |
| Swiss franc | 236 | - | 15,536 | - | - | 15,772 |
| Turkish lira | 1 | - | - | - | - | 1 |
| **TOTAL** | **$ 2,535** | **$ 9,252** | **$ 170,291** | **$ 13,612** | **$ 452** | **$ 196,142** |

## NOTE 3 – INVESTMENTS (Continued)

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. To mitigate this risk, the System's investment policy permits individual investment managers to defensively hedge currency to mitigate the impact of currency fluctuation on the underlying asset value.

### FOREIGN CURRENCY RISK ANALYSIS

*as of June 30, 2011 (Dollars In Thousands)*

| Currency Name | Cash | Private Equity | Equity | Fixed income | Pending Foreign Currency Exchanges | Total Exposure |
|---|---|---|---|---|---|---|
| Australian dollar | $ 25 | $ - | $ 12,131 | $ - | $ - | $ 12,156 |
| British pound sterling | 364 | - | 41,929 | 2,739 | 100 | 45,132 |
| Canadian dollar | 7 | - | 4,308 | - | 21 | 4,336 |
| Danish krone | - | - | 3,979 | - | - | 3,979 |
| Euro currency | 63 | 8,774 | 47,886 | 3,206 | (5) | 59,924 |
| Hong Kong dollar | 5 | - | 4,234 | 440 | 3 | 4,682 |
| Indian rupee | - | - | - | - | (3) | (3) |
| Indonesian rupiah | - | - | - | 107 | - | 107 |
| Japanese yen | 331 | - | 41,991 | 3,004 | (40) | 45,286 |
| New Taiwan dollar | - | - | - | - | 4 | 4 |
| Norwegian krone | 1 | - | 3,904 | - | - | 3,905 |
| Singapore dollar | - | - | 2,905 | - | - | 2,905 |
| South Korean won | - | - | - | - | (3) | (3) |
| Swedish krona | 21 | - | 5,746 | - | 13 | 5,780 |
| Swiss franc | - | - | 19,242 | - | - | 19,242 |
| **TOTAL** | **$ 817** | **$ 8,774** | **$ 188,255** | **$ 9,496** | **$ 90** | **$ 207,432** |

*Concentration of Credit Risk* – The System's investment policy limits investment managers to no more than 10% of the System's assets under their management to be invested in securities of any single issuer with exception of the U.S. Government and its agencies. As of June 30, 2012 and 2011 the System did not hold investments in any one issuer, excluding investments issued by or explicitly guaranteed by the U.S. Government, that represented five percent or more of the total System net assets.

*Derivatives* – The System's investment policy allows for investments in derivative instruments that comply with the System's basic objective of achieving the highest return on investment funds, consistent with safety, and in accordance with accepted investment practices. Due to the level of volatility associated with certain derivative investments in general, the System specifically prohibits investment managers from using derivative or synthetic securities that expose the System to potentially high price volatility or are leveraged, or whose marketability may become severely limited. Derivative investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price on the last business day of the fiscal year at current exchange rates, if applicable. Investments that do not have an established market are reported at estimated fair value based on the most recently available investor reports or audited financial statements issued by the manager of those funds. The fund manager provides an estimated unrealized gain/loss of the fund based on the most recently available audited financial statements and other fund information. Futures contracts are marked-to-market at the end of each trading day, and the settlement of gains or losses occur on the following business day through variation margins. As a result, futures have no fair value as of June 30, 2012 or 2011. The fair value of international currency forwards represents the unrealized gain or loss on the related contracts, which is calculated as the difference between the specified contract exchange rate and the exchange rate at the end of the reporting period.

## NOTE 3 – INVESTMENTS (Continued)

The fair values and notational amounts of derivative instruments outstanding as of June 30, 2012 and 2011, classified by type, and the changes in fair value of such derivative instruments for the years then ended as reported in the 2012 and 2011 financial statements are as follows (In Thousands):

### DERIVATIVE INSTRUMENTS

*as of June 30, 2012 (Dollars In Thousands)*

| | Net Appreciation/(Depreciation) in Fair Value of Investments through June 30, 2012 | | Fair Value at June 30, 2012 | | |
|---|---|---|---|---|---|
| **Investment Derivative Instruments** | **Classification** | **Amount** | **Classification** | **Amount** | **Notional Amount/ Shares** |
| Total Return Swaps | Investment Income | $ (7,849) | Real Assets | $ 13,552 | 300,829 |
| Foreign Currency Forwards | Investment Income | (421) | Foreign Currency Contracts, net | 445 | 46,207 |
| Futures Options Bought/Written | Investment Income | (4,951) | Fixed Income - collective short-term investments | - | 38,650 |
| Rights/Warrants | Investment Income | 99 | Global equity | 39 | 22 |
| **Total Derivative Instruments** | | **$ (13,122)** | | **$ 14,036** | |

### DERIVATIVE INSTRUMENTS

*as of June 30, 2011 (Dollars In Thousands)*

| | Net Appreciation/(Depreciation) in Fair Value of Investments through June 30, 2011 | | Fair Value at June 30, 2011 | | |
|---|---|---|---|---|---|
| **Investment Derivative Instruments** | **Classification** | **Amount** | **Classification** | **Amount** | **Notional Amount/ Shares** |
| Total Return Swaps | Investment Income | $ 12,781 | Real Assets | $ 1,269 | $37,408 |
| Foreign Currency Forwards | Investment Income | (1,184) | Foreign Currency Contracts, net | 90 | - |
| Futures Options Bought/Written | Investment Income | 697 | Fixed Income - collective short-term investments | - | - |
| Rights | Investment Income | 912 | Global equity | 2 | 279,280 |
| **Total Derivative Instruments** | | **$ 13,206** | | **$ 1,361** | |

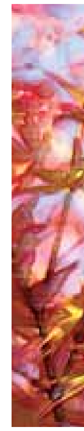
## NOTE 3 – INVESTMENTS (Continued)

Derivative investments are subject to certain types of risks, including counterparty credit risk (non-exchange traded), interest rate risk, and foreign currency risk. The following describes the risks applicable to the investment derivative instruments that are reported as of June 30, 2012 and 2011:

*Counterparty Credit Risk* – The System is exposed to credit risk on derivative instruments that are in asset positions and non-exchange traded. As of June 30, 2012, the System entered into infrastructure and commodity swaps with notional amounts of $74,041,000 and $226,788,000, respectively, held by counterparties with S&P ratings of A. The System's investments in forward currency contracts bear counterparty credit risk in that parties to the contracts may fail to perform according to the terms of the contract. As of June 30, 2012, total commitments in forward currency contracts to purchase and sell international currencies were $46,207,000 and $46,207,000 respectively, with fair values of $46,424,000 and $45,979,000, respectively, held by counterparties with S&P rating of A and above. As of June 30, 2011, the System entered into an infrastructure swap with a notional value of $37,408,000 held by a counterparty with an A+ rating. As of June 30, 2011, total commitments in forward currency contracts to purchase and sell international currencies were $26,265,000 and $26,265,000 respectively, with fair values of $26,244,000 and $26,154,000, respectively, held by counterparties with S&P rating of at least AA-.

*Interest Rate Risk* – The System had exposure to interest rate risk on its fully collateralized commodity and infrastructure swaps. The fair values of the commodity swaps were marked-to-market daily based on their applicable indices, net values are adjusted with unrealized gains and losses and are collateralized to minimize counterparty risk. As of June 30, 2012, the System invested in infrastructure and commodity swaps with notional amounts of $74,041,000 and $226,788,000, respectively. The System receives the total return S&P Global Infrastructure Index, net of the 3-LIBOR plus 50 to 55 basis points. The System also receives the total return United States three month Treasury bill rate plus 10 to 12 basis points for the commodities swaps. The infrastructure swaps were executed in December 2011 and April 2012 and mature in December 2012 and April 2013 with a quarterly rate reset frequency. The commodity swaps were executed in June 2012 and matured in August 2012 with a monthly rate reset frequency. The System does not have a policy regarding interest rate risk, however, the System does settle on a transaction plus one day basis (T+1), therefore limiting the System's exposure to counterparty risk.

As of June 30, 2011, the System invested in an infrastructure swap with a notional amount of approximately $37,408,000 in which it received the total return S&P Global Infrastructure Index, net of the 3-month LIBOR plus 55 basis points. The System executed the infrastructure swap in April 2011, which matured in April 2012 with a quarterly rate reset frequency. As of June 30, 2012 and 2011, the System's derivative investments had maturity dates of less than one year.



*Foreign Currency Risk* – This is the risk that changes in exchange rates will adversely affect the fair value of underlying investments. To mitigate this risk, the System's investment policy permits individual investment managers to mitigate the impact of currency fluctuation on the underlying asset value. The System's investment managers enter into international forward currency contracts, which are commitments to purchase or sell stated amounts of international currency. The System utilizes these contracts to control exposure and facilitate the settlement of international security purchase and sale transactions. At June 30, 2012 and 2011 the System's net position in these contracts is recorded at fair value as international currency contract investments. The fair values of international currency contracts are determined by quoted currency prices from national exchanges. The System's commitments relating to forward currency contracts are settled on a net basis.

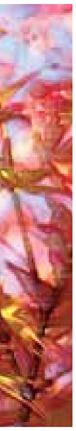
The following tables provide information as of June 30, 2012 and 2011, concerning the fair value of forward currency contracts and foreign currency risk:

### FAIR VALUE OF FORWARD CURRENCY CONTRACTS AND FOREIGN CURRENCY RISK

*as of June 30, 2012 (In Thousands):*

| | 2012 | |
|---|---|---|
| **Currency Name** | **Pending Foreign Currency Exchanges** | **Rights** |
| Australian dollar | $ 39 | $ - |
| British pound sterling | 82 | - |
| Canadian dollar | 32 | - |
| Euro currency | 279 | 39 |
| Japanese yen | (31) | - |
| New Taiwan dollar | 11 | - |
| Norwegian krone | 41 | - |
| Swedish krona | (8) | - |
| **TOTAL** | **$ 445** | **$ 39** |

## NOTE 3 – INVESTMENTS (Continued)



### FAIR VALUE OF FORWARD CURRENCY CONTRACTS AND FOREIGN CURRENCY RISK

*as of June 30, 2011 (In Thousands):*

| | 2011 | |
|---|---|---|
| **Currency Name** | **Pending Foreign Currency Exchanges** | **Rights** |
| Australian dollar | $ - | $ 2 |
| British pound sterling | 100 | - |
| Canadian dollar | 21 | - |
| Euro currency | (5) | - |
| Hong Kong dollar | 3 | - |
| Indian rupee | (3) | - |
| Japanese yen | (40) | - |
| New Taiwan dollar | 4 | - |
| South Korean won | (3) | - |
| Swedish krona | 13 | - |
| **TOTAL** | **$ 90** | **$ 2** |

## NOTE 4 – SECURITIES LENDING PROGRAM

The San José municipal code and the investment policy adopted by the Board permit the use of a securities lending program with its principal custodian bank. The System does not have a threshold for securities lending activity. The investment policy requires that loan maturities cannot exceed one year, and no more than 15% of the portfolio can be lent longer than six months. The System had a custodial agreement with the Northern Trust Company, which authorized the Northern Trust Company to lend securities in the System's investment portfolio under such terms and conditions as the Northern Trust Company deemed advisable and to permit the lent securities to be transferred into the name of the borrowers. As of August 15, 2011, the System exited the Northern Trust securities lending program.

While in the Northern Trust securities lending program the System received a fee from the borrower for the use of the lent securities. The System had no exposure to borrower credit risk related to the securities lending transactions as the Northern Trust Company was responsible for replacement of the lent securities with other securities of the same issuer, class and denomination, or if such securities were not available on the open market, the Northern Trust Company was required to credit the System's account with the market value of such unreturned loaned securities if the lent securities were not returned by the borrower. All securities loan agreements could be terminated on demand within a period specified in each agreement by either the System or borrowers.

Securities lending collateral represents investments purchased with cash collateral, as well as securities collateral that may not be pledged or sold without a default by the borrower. Securities lending collateralized with securities that cannot be pledged or sold without borrower default are not reported as assets and liabilities in the statement of net assets. The System does not match the maturities of investments made with cash collateral with the securities on loan.

The System authorized The Northern Trust Company to invest and reinvest cash collateral in Northern Trust's pooled investment vehicle, which must have a weighted average life of 60 days or less. Securities with maturities of 13 months or more must have a rating of A or better. Securities with maturities of less than 13 months are rated at least P-3. As of June 30, 2011, the size of the cash collateral pooled vehicle was $27.8 billion and the weighted average life was 21 days. The cash collateral investments included time deposits (12% of the pool), repurchase agreements (22%), asset backed securities (4%), certificates of deposit (20%), variable rate securities (9%), and commercial paper and other bank notes (33%).

The loaned securities as of June 30, 2011 consisted of U.S. Treasury securities, U.S. government agency securities, domestic corporate bonds, domestic equity securities, and international equity securities. In return, the System received collateral in the form of cash or securities equal to 102% for U.S. securities and 105% for non-U.S. securities of the market value of transferred securities plus accrued interest for reinvestment.

As of June 30, 2011, the underlying securities loaned by the System as a whole amounted to approximately $162,705,000. The cash collateral and the non-cash collateral totaled $161,942,000 and $4,345,000, respectively. The System was exposed to investment risk including the possible loss of principal value in the cash collateral pool due to the fluctuation in the market value of the assets held by the cash collateral pool. As of June 30, 2011, the net asset value (NAV) of the cash collateral pool was 100% based on a combination of mark-to-model and mark-to-market basis.

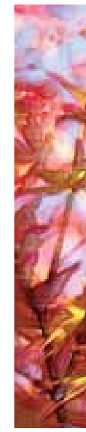
# Notes to Basic Financial Statements *(Continued)*

## NOTE 4 – SECURITIES LENDING PROGRAM (Continued)

### SECURITIES LENDING – INVESTMENT AND COLLATERAL RECEIVED

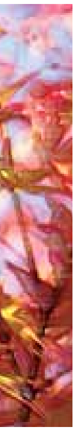
*(at Fair Value in Thousands)*

| | 2011 |
|---|---|
| **Type of Investment Lent** | |
| For Cash Collateral | |
| U.S. government and agencies | $ 4,097 |
| Domestic corporate bonds | 24,297 |
| Domestic equity securities | 66,279 |
| U.S. treasury notes and bonds | 53,217 |
| International equity securities | 10,570 |
| Total Lent for Cash Collateral | 158,460 |
| For Non-Cash Collateral | |
| Domestic corporate bonds | 146 |
| Domestic equity securities | 90 |
| U.S. treasury notes and bonds | 3,321 |
| International equity securities | 688 |
| Total Lent for Non-Cash Collateral | 4,245 |
| **Total Securities Lent** | **$ 162,705** |
| **Type of Collateral Received** | |
| Cash Collateral | $ 161,942 |
| Non-cash Collateral | |
| For lent domestic corporate bonds | 149 |
| For lent domestic equity securities | 92 |
| For lent U.S. treasury notes and bonds | 3,391 |
| For lent international equity securities | 713 |
| Total Non-Cash Collateral | 4,345 |
| **Total Collateral Received** | **$ 166,287** |



# Notes to Basic Financial Statements *(Continued)*

## NOTE 5 – DEFINED BENEFIT PENSION PLAN: CONTRIBUTIONS, FUNDED STATUS AND FUNDING PROGRESS



Contributions to the Defined Benefit Pension Plan by both the City and the participating employees are based upon an actuarially determined percentage of each employee's pensionable and earnable salary sufficient to provide adequate assets to pay benefits when due. On June 24, 2008, the City Council adopted ordinance No. 28332 amending Chapter 3.28 of Title 3 of the San José Municipal Code to provide the City with the option to make lump sum payments of City required contributions to the System.

In addition, in November 2010, the Board adopted a funding policy setting the annual required contribution to be the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year. The annual required contribution determined in the June 30, 2010 valuation for fiscal year ending June 30, 2012 was the greater of $86,888,000 (if paid at the beginning of the fiscal year) or 28.34% of actual payroll for the fiscal year. The actual payroll for the fiscal year of $224,742,000 was less than the actuarial payroll of $318,544,000 resulting in an annual required contribution of $86,888, 000 as of July 1, 2011, excluding year end contributions receivable and prior year contribution adjustments.

On July 1, 2010, the City paid the actuarially determined prepayment amount of $66,986,000 for biweekly pension and postemployment health contributions to be made for the 26 pay dates from July 2, 2010 through June 17, 2011. The City also paid $503,000 for the reconciliation of fiscal year 2010-2011 pension and postemployment health contributions per San José Municipal Code 3.28.940(F), which requires the Board to determine whether the lump sum advance payment(s) and the payments that otherwise would have been required in the absence of the lump sum advance payment are actuarially equivalent. At year end the accrued contributions receivable included the City funding the Defined Benefit Pension Plan ARC for fiscal year 2011 based on the June 30, 2009 valuation. In order to avoid creating a net pension obligation the City elected not to phase-in the impact of the June 30, 2009 assumption changes on the contribution rates over a five-year period as originally adopted by the Board.

In addition, effective June 27, 2010 through June 25, 2011, the bargaining unit representing Association of Maintenance Supervisory Personnel (AMSP), Association of Engineers and Architects (AEA), Operating Engineers Local No. 3 (OE#3), City Association of Management Professionals (CAMP), and the International Brotherhood of Electrical Workers (IBEW) entered into a Memorandum of Agreement (MOA) with the City to make one-time additional retirement contributions that would be applied to reduce the contributions that the City would otherwise be required to make during that time period for the pension unfunded liability. The one-time contribution amounts varied by bargaining unit, but all summed to 10.83% of applicable payroll for the fiscal year. The MOA's also included language recognizing that the additional contributions could not be implemented by June 27, 2010, and allowed for the Finance Department of the City to compute a rate that would generate the total amount of additional retirement contributions over the remaining pay periods in the fiscal year as if the contribution rate had been implemented on June 27, 2010. The City's Finance Department calculated and implemented an additional 13.05% of contributions effective on August 22, 2010. The contribution rates provided below do not reflect the additional retirement contributions made by employees.

The significant actuarial assumptions used to compute the actuarially determined contribution requirement are the same as those used to compute the actuarial accrued liability shown in the Schedule of Funded Status for the Defined Benefit Pension Plan.

The City and the participating employee contribution rates in effect during the fiscal years ended June 30, 2012 and 2011 were as follows:

| Period | City* | Employee |
|---|---|---|
| 06/24/12- 06/30/12 | 44.45% | 5.74% |
| 06/26/11- 06/23/12 | 28.34% | 4.68% |
| 07/01/10- 06/25/11 | 25.75% | 4.54% |

** The actual contribution rates paid by the City for fiscal year ended June 30, 2012 differed due to the City funding the annual required contribution amount based on the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year. In fiscal year 2011 the actual contributions rates paid by the City differed as a result of the City exercising its option to make annual lump sum payments and due to the additional contributions paid by the employees. In addition, in fiscal year 2011 the City elected to fund the actuarial required contribution amount and not the phase-in contribution amount.*

## NOTE 5 – DEFINED BENEFIT PENSION PLAN: CONTRIBUTIONS, FUNDED STATUS AND FUNDING PROGRESS (Continued)

The funded status of the Defined Benefit Pension Plan as of June 30, 2011, the most recent actuarial valuation date, is as follows (In Thousands):

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) | Unfunded AAL (UAAL) | Funded Ratio | Annual Covered Payroll | UAAL as a Percentage of Covered Payroll |
|---|---|---|---|---|---|---|
| | (a) | (b) | (b-a) | (a) / (b) | (c) | ((b-a)/c) |
| 06/30/2011 | $ 1,788,660 | $ 2,770,227 | $ 981,567 | 65% | $ 228,936 | 429% |

The UAAL of $982 million does not include the impact of approximately $28 million of accumulated deferred investment losses resulting primarily from unfavorable investment returns in fiscal years 2008 and 2009. The System's actuarial valuation uses a five-year smoothing method for investment returns. This means that the current year's gains or losses, as calculated at year-end, are smoothed with the results from the prior four years. The deferred investment loss also includes 80% or approximately $131 million in investment gains for fiscal year 2011. It is anticipated that future actuarial valuations will recognize the remaining deferred investment losses of approximately $28 million as described above.

The June 30, 2011 valuation included a change in the expected rate of return from 7.95% to 7.50% and a change in the payroll wage inflation assumption from 3.90% to 3.25%. In addition, the Board approved the actuary's recommendation to explicitly include administrative expenses and SRBR costs as additions to normal cost (valued at 0.70% of payroll for administrative expenses and 0.35% of the market value of assets for the SRBR) in the June 30, 2011 valuation. The expected rate of return of 7.50% is now only net of investment manager fees. The valuation also includes significant experience changes of the System including a 14% reduction in the number of active members and a 24% reduction in the expected payroll.

The June 30, 2011 valuation contains the Board adopted 30/20 layered amortization methodology which includes the amortization of the unfunded liability as of June 30, 2009 over 30 years from that date, and the amortization of subsequent gains and losses or assumption changes amortized over 20 years from the valuation in which they are first recognized. The equivalent single amortization period for the June 30, 2011 valuation is 25.2 years.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and investment return. Experience studies are performed by the Board's actuary to determine continual revision to the actuarial assumptions as actual results are compared with past expectations and new estimates are made about the future.

The System transitioned from biennial to annual valuations beginning June 30, 2010. The contribution rates for fiscal years ended June 30, 2012 and 2011, were based on the actuarial valuations performed on June 30, 2010 and 2009, respectively, except for the period June 24 through June 30, 2012, which were based on the June 30, 2011 valuation; the significant actuarial methods and assumptions used to compute the actuarially determined annual required contributions and the funded status are as follows:

### NOTE 5 – DEFINED BENEFIT PENSION PLAN: CONTRIBUTIONS, FUNDED STATUS AND FUNDING PROGRESS (Continued)

| **Description** | **Method/Assumption** | | |
|---|---|---|---|
| Valuation date | June 30, 2011 | June 30, 2010 | June 30, 2009 |
| Actuarial cost method | Entry age normal cost method | Entry age normal cost method | Entry age normal cost method |
| Amortization method for actuarial accrued liabilities | Level percentage of payroll | Level percentage of payroll | Level percentage of payroll |
| Remaining amortization period | 20-year layered, closed, level percentage of payroll with the 6/30/2009 UAAL amortized over a closed 30-year period. | 20-year layered, closed, level percentage of payroll with the 6/30/2009 UAAL amortized over a closed 30-year period. | 20-year layered, closed, level percentage of payroll with the 6/30/2009 UAAL amortized over a closed 30-year period. |
| Actuarial asset valuation method | 5 year smoothed market | 5 year smoothed market | 5 year smoothed market |
| **Actuarial assumptions:** | | | |
| Assumed rate of return on investments (net) | 7.50% per annum | 7.95% per annum | 7.75% per annum |
| Postretirement mortality | For healthy annuitants, the male and female RP-2000 combined employee and annuitant mortality tables projected to 2015 and set back two years. For disabled annuitants, the CalPERS ordinary disability table from their 2000-2004 study for miscellaneous employees. | The 1994 Group Annuity Mortality Table set back three years for males and one year for females was used for healthy retirees and beneficiaries. The disabled mortality table used was the 1981 Disability Mortality Table. | The 1994 Group Annuity Mortality Table set back three years for males and one year for females was used for healthy retirees and beneficiaries. The disabled mortality table used was the 1981 Disability Mortality Table. |
| Active service, withdrawal, death, disability service retirement | Tables based on current experience | Tables based on current experience | Tables based on current experience |
| Salary increases | The base annual rate of salary increase is 3.25% wage inflation rate plus a rate increase for merit/longevity for years 0 to 15+ ranging from 4.50% to 0.25% at the 14th year of service. | The base annual rate of salary increase is 3.90%wage inflation rate plus a rate increase for merit/longevity for the first 5 years of service ranging from 5.75% to 0.25% at the 5th year of service. | The base annual rate of salary increase is comprised of a 3.67% inflation rate plus 0.41% for wage inflation for a total rate of 4.08%. This is added to a rate increase for merit/longevity for the first 5 years of service ranging from 5.50% to 0.75% at the 5th year of service. |
| Projected total payroll increases | 3.25% | 3.90% | 3.83% |

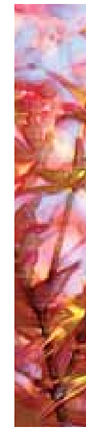
The schedules presented as required supplementary information following the notes to the financial statements present multiyear trend information. The Schedule of Funding Progress for the Defined Benefit Pension Plan presents information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. The Schedule of Employer Contributions for the Defined Benefit Pension Plan presents trend information about the amounts contributed to the plan by the employer in comparison to the annual required contribution (ARC). The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

## NOTE 6 – POSTEMPLOYMENT HEALTHCARE PLAN CONTRIBUTIONS, FUNDED STATUS AND FUNDING PROGRESS

Contributions to the Postemployment Healthcare Plan are made by both the City and the participating employees. Contribution rates for fiscal years ended June 30, 2012 and 2011 were based on the actuarial valuation performed as of June 30, 2010 and 2009, respectively. The contribution rates for the majority of fiscal year ended June 30, 2012 (through period ended June 23, 2012) were based on the actuarial valuation performed on June 30, 2010. The System's most recent valuation as of June 30, 2011, was used to determine the contribution rates effective June 24, 2012.

Prior to July 1, 2009, annual contributions for the Postemployment Healthcare Plan were based on the cost for funding, as a level-percentage of payroll, based upon a 15-year projection of premiums (Policy method). The contributions were not sufficient to meet the requirements of an annual required contribution under GASB Statement No. 43. After June 30, 2009, the contribution rates represent the cost to phase in to the full annual required contribution under GASB Statement No. 43 over a five year period. Effective June 28, 2009, the bargaining units representing the Federated members of the System agreed in a Memorandum of Agreement (MOA) with the City to increase contribution rates for retiree health and dental benefits in order to phase-in full funding of the GASB Statement No. 43 annual required contributions over the next five years; fiscal year ended June 30, 2012 was the third year of the phase-in. The MOA also provides that the five year phase-in of the ARC will not have an incremental increase of more than 0.75% of pensionable pay in each fiscal year for the employee or City contributions. Notwithstanding these limitations on incremental increases, the MOA further provide that by the end of the five-year phase-in the City and the employees shall be contributing the full ARC in the ratio currently provided in the relevant sections of the San José Municipal Code.

In addition, in November 2010, the Board adopted a funding policy setting the annual contribution to be the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year. The annual contribution determined in the June 30, 2010 valuation for fiscal year ending June 30, 2012 was the greater of $21,471,000 (if paid on 07/01/2011) or 7.16% of actual payroll for the fiscal year. The actual payroll for the fiscal year of $224,742,000 was less than the actuarial payroll of $318,544,000 resulting in an annual contribution of $21,471,000 as of July 1, 2011, excluding year end contributions receivable, the implicit subsidy, and prior year contribution adjustments.



The City and the participating employee contribution rates in effect during the fiscal years ended June 30, 2012 and 2011 for the Postemployment Healthcare Plan were as follows:

| Period | City* | Employee |
|---|---|---|
| 06/24/12 – 06/30/12 | 7.91% | 7.26% |
| 06/26/11 – 06/23/12 | 7.16% | 6.52% |
| 07/01/10 – 06/25/11 | 6.41% | 5.76% |

** The actual contribution rates paid by the City for fiscal year ended June 30, 2012 differed due to the City funding the annual required contribution amount based on the greater of the dollar amount reported in the actuarial valuation or the dollar amount determined by applying the percentage of payroll reported in the valuation to the actual payroll, if actual payroll exceeds the actuarial payroll, for the fiscal year. In fiscal year 2011 the actual contributions rates paid by the City differed as a result of the City exercising their option to make annual lump sum payments.*

The funded status of the Postemployment Healthcare Plan as of June 30, 2011, the most recent actuarial valuation date, is as follows (In Thousands):

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) | Unfunded AAL (UAAL) | Funded Ratio | Annual Covered Payroll | UAAL as a Percentage of Covered Payroll |
|---|---|---|---|---|---|---|
| | (a) | (b) | (b-a) | (a) / (b) | (c) | ((b-a)/c) |
| 06/30/2011 | $ 135,454 | $ 1,145,359 | $ 1,009,905 | 12% | $ 228,936 | 441% |

# Notes to Basic Financial Statements *(Continued)*

## NOTE 6 – POSTEMPLOYMENT HEALTHCARE PLAN CONTRIBUTIONS, FUNDED STATUS AND FUNDING PROGRESS (Continued)

As of June 30, 2011, the System's most recent valuation, the System's UAAL increased by approximately $192 million primarily due to the decrease in the blended GASB investment rate of return from 6.71% to 6.10% and changes in actuarial assumptions as recommend by the Board's actuary in the June 30, 2010 experience study. The System's OPEB discount rate is based on a blended rate that ranges between the expected return on the City's unrestricted assets (4.0%) and the expected return on the System's invested assets (7.50%) resulting in a blended discount rate of 6.10%. The June 30, 2011 valuation included a reduction in expected return on City assets from 4.5% to 4.0% and in the System's expected return from 7.95% to 7.5%. Actuarial assumption changes in the June 30, 2011 valuation also included changes in the wage inflation, salary merit increases, family composition, termination rate, disability rate, retirement rate, healthy and disabled mortality, and refund rates assumptions. In addition, the June 30, 2011 OPEB valuation included retirees paying the difference between the actual premium for the elected plan and the $25 co-pay plans offered for the first time by the City.

The System's valuation as of June 30, 2010 included actuarial assumption changes recommended by the actuary and approved by the Board including increases in the following: the System's expected rate of return from 7.75% to 7.95%, payroll wage inflation assumption from 3.83% to 3.90%, and lengthening the select period for healthcare trends from 9 years to 15 years. The increase in the discount rate and payroll wage inflation rate assumptions were due to the transition to phasing in the discount and wage inflation rate over two-years instead of phasing in the impact of the assumption changes on the contribution rates over a five-year period as originally adopted by the Board.

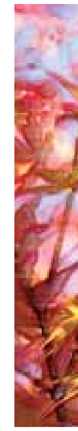
The lengthening of the select period for the healthcare trend assumption was recommended by the Board's actuary due to the actuary's expectations for the future.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan in effect and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The System transitioned from biennial to annual valuations beginning June 30, 2010. The contribution rates for fiscal years ended June 30, 2012 and 2011, were based on the actuarial valuations performed on June 30, 2010 and 2009, respectively, except for the period June 24 through June 30, 2012, which were based on the June 30, 2011 valuation; the significant actuarial methods and assumptions used to compute the actuarially determined annual required contributions and the funded status are as follows:

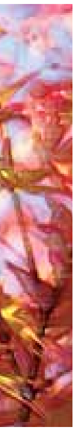
## NOTE 6 – POSTEMPLOYMENT HEALTHCARE PLAN CONTRIBUTIONS, FUNDED STATUS AND FUNDING PROGRESS (Continued)



| **Description** | **Method/Assumption** | | |
|---|---|---|---|
| **Valuation date** | **June 30, 2011** | **June 30, 2010** | **June 30, 2009** |
| Actuarial cost method | Entry age normal cost method | Entry age normal cost method | Entry age normal cost method |
| Amortization method | Level percentage of payroll | Level percentage of payroll | Level percentage of payroll |
| Remaining amortization period | 20-year layered closed, level percentage of payroll with the 6/30/2009 UAAL amortized over a closed 30-year period. | 20-year layered, closed, level percentage of payroll with the 6/30/2009 UAAL amortized over a closed 30-year period. | 20-year layered, closed, level percentage of payroll with the 6/30/2009 UAAL amortized over a closed 30-year period. |
| Actuarial asset valuation method | Market value | Market value | Market value |
| **Actuarial assumptions:** | | | |
| Discount rate (net) | 6.10% † | 6.71% † | 6.70% † |
| Wage inflation rate | 3.25% | 3.90% | 3.67% |
| Salary increases | The base annual rate of salary increase is 3.25% wage inflation rate plus a rate increase for merit/longevity for years 0 to 14+ ranging from 4.50% to 0.25% at the 15th year of service. | The base annual rate of salary increase is 3.90% wage inflation rate plus a rate increase for merit/longevity for the first 5 years of service ranging from 5.75% to 0.25% at the 5th year of service. | The base annual rate of salary increase is comprised of a 3.67% inflation rate plus 0.41% for wage inflation for a total rate of 4.08%.This is added to a rate increase for merit/longevity for the first 5 years of service ranging from 5.50% to 0.75% at the 5th year of service. |
| Projected total payroll increases | 3.25% | 3.90% | 3.83% |
| **Healthcare cost trend rate:** | | | |
| Medical | The valuation assumes that future medical inflation will be at a rate of 9.17% to 4.5% per annum graded down over a 15 year period for medical-pre age 65 and 6.83% to 4.5%per annum graded down over a 15 year period for medical-post age 65. | The valuation assumes that future medical inflation will be at a rate of 9.50% to 4.5% per annum graded down over a 15 year period for medical-pre age 65 and 7.0% to 4.5%per annum graded down over a 15 year period for medical-post age 65. | The valuation assumes that future medical inflation will be at a rate of 10% per annum graded down each year in 0.50% increments to an ultimate rate of 4.5% for medical-pre age 65 and 7.5% per annum graded down each year in 0.25% increments to an ultimate rate of 4.5% for medical-post age 65. |
| Dental | Dental inflation is assumed to be 4.50% graded down to 4% over a three year period. | Dental inflation is assumed to be 5% graded down to 4% over a four year period. | Dental inflation is assumed to be 5% graded down to 4% over a four year period. |

*† Determined as a blended rate of the expected long-term investment returns on plan assets and on the City's investments, based on the funded level of the plan at the valuation date.*

## NOTE 6 – POSTEMPLOYMENT HEALTHCARE PLAN CONTRIBUTIONS, FUNDED STATUS AND FUNDING PROGRESS (Continued)



The schedules presented as required supplementary information following the notes to the financial statements, present multiyear trend information. The Schedule of Funding Progress for the Postemployment Healthcare Benefit Plan presents information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits. The Schedule of Employer Contributions for the Postemployment Healthcare Benefit Plan presents trend information about the amounts contributed to the plan by employers in comparison to the annual required contribution (ARC) determined in accordance with the parameters of GASB Statement 43. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost for each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years.

## NOTE 7 – SUBSEQUENT EVENTS

*Commitments* – As of June 30, 2012, the System had unfunded commitments to contribute capital for private equity fund investments in the amount of $105,377,000.

*New Benefit Tier* – On June 5, 2012, the voters of San Jose enacted the Sustainable Retirement Benefits and Compensation Act (Pension Act). The Pension Act amended the City Charter to change benefits for current employees to establish different benefits for new employees and to place other limitations on benefits.

Section 1508-A of the Pension Act applicable to new employees was adopted on August 28, 2012 by San Jose City Council Ordinance No. 29120 to provide Tier 2 pension benefits for new System members hired on or after September 30, 2012. The new tier includes significant benefit changes from the existing Tier 1 plan including, but not limited to, a decrease in the benefits multiplier from 2.5% per year to 2.0% per year, an increase from 55 years to 65 years of age for retirement eligibility at full benefits, a consumer price index driven cost-of-living increase with a maximum of 1.5% instead of the existing annual fixed 3.0% increase, a decrease in maximum benefit to 65% of final average salary from 75%, no survivor benefits for death after retirement unless the member elects a reduced benefit, pensionable compensation to be based on base salary only, rather than base compensation plus premium pays; members to contribute 50% of the total Normal Cost, any accrued unfunded actuarial liability and administrative costs of the System; year of service credit to require 2080 hours of work rather than 1730 hours of work and final average compensation based on the highest consecutive 3 years of compensation compared to highest 1 year. Significant portions of the Pension Act applicable to existing employees and effective June 23, 2013 are currently subject to legal challenge by members of the System. Additionally, various bargaining units representing members of the System have filed unfair labor practice charges with the California Public Employment Relations Board related to the Pension Act.

# Required Supplementary Information (Unaudited)

## SCHEDULE OF FUNDING PROGRESS – DEFINED BENEFIT PENSION PLAN (Unaudited)

*(Dollars In Thousands)*

| Actuarial Valuation Date | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) | Unfunded AAL | Funded Ratio | Annual Covered Payroll (b) | Unfunded AAL as a % of Annual Covered Payroll |
|---|---|---|---|---|---|---|
| June 30, 2007 | $ 1,622,851 | $ 1,960,943 | $ 338,092 | 83% | $ 291,405 | 116% |
| June 30, 2009 | 1,756,588 | 2,486,155 | 729,567 | 71% | 308,697 | 236% |
| June 30, 2010 | 1,729,414 | 2,510,358 | 780,944 | 69% | 275,869 | 283% |
| June 30, 2011 | 1,788,660 | 2,770,227 | 981,567 | 65% | 228,936 | 429% |

*Actuarial valuations have been performed biennially through June 30, 2007. The System transitioned to annual actuarial valuations after June 30, 2009.*

*(a) Reported at "smoothed market" value determined using a technique that smooths the effect of short-term volatility in the market value of investments over a five-year period.*

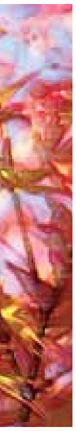
*(b) Annual covered payroll represents the actuarial estimate of annual covered payroll for the subsequent year for the June 30, 2011 and the 2007 and prior valuations. The amount presented for the June 30, 2009 and 2010 valuations represents actual annual covered payroll.*

As of June 30, 2011, the System's most recent valuation, the System's funded ratio declined from 69% to 65%, the AAL increased by $259.9 million, and the UAAL increased by $200.6 million. The increase in the UAAL was primarily due to the assumption changes. The June 30, 2011 valuation included a change in the expected rate of return from 7.95% to 7.50% and a change in the payroll wage inflation assumption from 3.90% to 3.25%. In addition, the Board approved the actuary's recommendation to explicitly include administrative expenses and SRBR costs as additions to normal cost (valued at 0.70% of payroll for administrative expenses and 0.35% of the market value of assets for the SRBR) in the June 30, 2011 valuation. The expected rate of return of 7.50% is now only net of investment manager fees.

The June 30, 2011 valuation contains the Board adopted 30/20 layered amortization methodology which includes the amortization of the unfunded liability as of June 30, 2009 over a 30 years from that date, and the amortization of subsequent gains and losses or assumption changes amortized over 20 years from the valuation in which they are first recognized. The equivalent single amortization period for the June 30, 2011 valuation is 25.2 years.

As of the June 30, 2010, the System's funded ratio declined from 71% to 69%, the AAL increased by $24 million, and the UAAL increased by $51.4 million primarily due to recognition of deferred investment losses in accordance with the System's actuarial valuation method. The June 30, 2010, valuation also included assumption changes for the expected rate of return from 7.75% to 7.95% and a change in the payroll wage inflation assumption from 3.83% to 3.90%. The increase in the discount rate and payroll wage inflation rate assumptions are due to the transition to phasing in the discount and wage inflation rate over two-years ending June 30, 2011 instead of phasing in the impact of the assumption changes on the contribution rates over a five-year period, which was originally adopted by the Federated Board for fiscal year 2010-2011 contributions. However, the City elected to fund the annual required contribution amount for fiscal year 2010-2011 and not fund the phase-in impact of the assumption change.

In the System's June 30, 2009 valuation, the AAL increased by $525 million primarily due to demographic experience losses and changes in actuarial assumptions as recommended by the Board actuary in the June 30, 2009 experience study. The June 30, 2009 valuation included actuarial assumption changes approved by the Board including phasing in the impact of changes in economic assumptions on contribution rates of the following over a five-year period: a reduction in the investment return assumption from 8.25%, net of expenses, to 7.75%, net of expenses; a reduction in the underlying inflation assumption from 4.0% to 3.67%; a reduction in the payroll growth assumption from 4.00% to 3.83%; and a reduction in the ultimate salary increase assumption from 4.25% to 4.08%. The impact of the economic assumption changes increased the AAL by approximately $142,000,000 and the total contribution requirement by 3.64% prior to the impact of the 5-year phase in changes. Changes in pre-mortality and post-mortality demographic assumptions increased the AAL by $87,000,000 and the total contribution requirement by 1.58%.



## SCHEDULE OF EMPLOYER CONTRIBUTIONS - DEFINED BENEFIT PENSION PLAN (Unaudited)

**For the six fiscal years ended June 30, 2012**
*(Dollars In Thousands)*

| Fiscal Year Ended June 30, | Annual Required Employer Contributions* | Percentage Contributed |
|---|---|---|
| 2007 | $ 51,004 | 100% |
| 2008 | 54,958 | 100% |
| 2009 | 57,020 | 100% |
| 2010 | 54,566 | 100% |
| 2011 | 59,180 | 100% |
| 2012 | 87,082 | 100% |

** The annual required employer contributions (ARC) provided above are based on the Board adopted ARC rates adjusted for the timing of actual contributions including year-end contributions receivable and prior year contribution adjustments. In addition, in fiscal year ended June 30, 2011, the ARC has been reduced to reflect the additional employee contributions pursuant to MOAs with certain bargaining units.*

## SCHEDULE OF FUNDING PROGRESS - POSTEMPLOYMENT HEALTHCARE PLAN (Unaudited)

*(Dollars In Thousands)*

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) | Unfunded AAL (UAAL) | Funded Ratio | Annual Covered Payroll | UAAL as a Percentage of Covered Payroll |
|---|---|---|---|---|---|---|
| | (a) | (b) | (b-a) | (a) / (b) | (c) | ((b-a)/c) |
| 06/30/2007 | $ 96,601 | $ 616,749 | $ 520,148 | 16% | $ 271,833 | 191% |
| 06/30/2009 | 85,564 | 796,448 | 710,884 | 11% | 308,697 | 230% |
| 06/30/2010 | 108,011 | 926,371 | 818,360 | 12% | 275,869 | 297% |
| 06/30/2011 | 135,454 | 1,145,359 | 1,009,905 | 12% | 228,936 | 441% |

As of June 30, 2011, the System's most recent valuation, the System's UAAL increased from $818.4 million to $1009.9 million. The System's UAAL increased by approximately $191.5 million due to the decrease in the blended GASB discount rate from 6.71% to 6.10% and changes in actuarial assumptions as recommend by the Board's actuary in the June 30, 2010 experience study. The System's discount rate is based on a blended rate that ranges between the expected return on the City's unrestricted assets (4.0%) and the expected return on the System's invested assets (7.50%) resulting in a blended discount rate of 6.10%. The June 30, 2011 valuation included a reduction in the expected return on the City assets from 4.5% to 4.0% and in the System's expected return from 7.95% to 7.50%. Actuarial assumption changes in the June 30, 2011 valuation also included changes in the wage inflation, salary merit increases, family composition, termination rate, disability rate, retirement rate, healthy and disabled mortality, and refund rates assumptions. In addition, the June 30, 2011 OPEB valuation included retirees paying the difference between the actual premium for the elected plan and the $25 co-pay plans offered for the first time by the City.

The June 30, 2011 valuation contains the Board adopted 30/20 layered amortization methodology which includes the amortization of the unfunded liability as of June 30, 2009 over a 30 years from that date, and the amortization of subsequent gains and losses or assumption changes amortized over 20 years from the valuation in which they are first recognized. The equivalent single amortization period for the June 30, 2011 valuation is 25.1 years.

The System's UAAL increased from $710.9 million as of June 30, 2009 to $818.4 million as of June 30, 2010. Changes to the UAAL were primarily the result of interest on the UAAL and changes in the actuarial assumptions including the following: increases in claims costs, the extension of the select period for healthcare trends from 9 years to 15 years, and the increase in the payroll wage inflation assumption from 3.83% to 3.90%. The System's OPEB discount rate was based on the blended rate between the expected return on City assets (4.5%) and the expected return on System's assets (7.95%) resulting in a blended discount rate of 6.71% in the June 30, 2010 valuation. The lengthening of the healthcare trend assumption select period was recommended by the Board's actuary due to the System's current retiree experience and the actuary's expectation for the future.

In the System's June 30, 2009 valuation, the UAAL increased from $520.1 million as of June 30, 2007 to $710.9 million as of June 30, 2009. Changes to the UAAL were primarily the result of unfavorable investment returns during the prior two years and changes in the actuarial assumptions including healthcare trend assumption changes, changes in economic assumptions and demographic changes in pre-mortality and post-mortality demographic assumptions.

The June 30, 2009 valuation included actuarial assumption changes approved by the Board including phasing in the impact of changes in economic assumptions on contribution rates of the following over a five-year period: a reduction in the investment return assumption from 8.25%, net of expenses, to 7.75%, net of expenses; a reduction in the underlying inflation assumption from 4.0% to 3.67%; a reduction in the payroll growth assumption from 4.00% to 3.83%; and a reduction in the ultimate salary increase assumption from 4.25% to 4.08%. The June 30, 2009 valuation also included the transition from a 30 year closed amortization period to a 30/20 layered amortizations methodology. There was no impact of this change on the June 30, 2009 valuation as the amortization for the first year of a 30 year closed amortization period was the same as a 30 year open period.

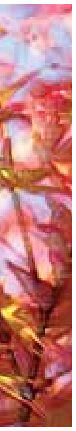
### SCHEDULE OF EMPLOYER CONTRIBUTIONS - POSTEMPLOYMENT HEALTHCARE PLAN (Unaudited)

*(Dollars In Thousands)*

| Fiscal Year Ended | Annual Required Contributions* | Actual Contributions | Percentage Contributed |
|---|---|---|---|
| 06/30/2008 | $ 38,526 | $ 11,560 | 30% |
| 06/30/2009 | 33,381 | 16,368 | 49% |
| 06/30/2010 | 38,599 | 17,027 | 44% |
| 06/30/2011 | 47,593 | 17,146 | 36% |
| 06/30/2012 | 67,583 | 25,834 | 39% |

** The annual required employer contributions (ARC) provided above are based on the Board adopted ARC rates adjusted for the timing of actual contributions and include the actuarially determined implicit subsidy amounts of $1,551 million for 2008; $1,648 million for 2009; $3,987 million for 2010; $3,925 million for 2011; and $4,383 million for 2012. The actual contributions include year-end contributions receivable and prior year contribution adjustments. The June 30, 2011 ARC has also been corrected from $48,529 to $47,593.*

# Other Supplementary Information



## COMBINING SCHEDULE OF DEFINED BENEFIT PENSION PLAN NET ASSETS

*For the Fiscal Years Ended June 30, 2012 (Dollars in Thousands)*

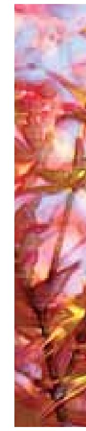
| | Retirement Fund | Cost-of-Living | Total |
|---|---|---|---|
| **Assets** | | | |
| **Receivables:** | | | |
| Employee contributions | $ 1,600 | $59 | $ 1,659 |
| Employer contributions | - | 369 | 369 |
| Brokers and others | 1,216 | 395 | 1,611 |
| Accrued investment income | 2,304 | 772 | 3,076 |
| **Total receivables** | **5,120** | **1,595** | **6,715** |
| **Investments, at fair value:** | | | |
| Securities and other: | | | |
| Domestic fixed income | 112,196 | 40,954 | 153,150 |
| International fixed income | 1,475 | 538 | 2,013 |
| Collective short-term investments | 168,624 | 61,552 | 230,176 |
| Corporate convertible bonds | 34,647 | 12,647 | 47,294 |
| Pooled fixed income | 24,092 | 8,794 | 32,886 |
| Global equity | 238,863 | 87,191 | 326,054 |
| Pooled global equity | 330,570 | 120,666 | 451,236 |
| Private equity | 64,568 | 23,569 | 88,137 |
| Forward international currency contracts | 306 | 112 | 418 |
| Opportunistic investments | 56,722 | 20,705 | 77,427 |
| Real assets | 113,219 | 41,328 | 154,547 |
| Real estate | 63,478 | 23,171 | 86,649 |
| **Total investments** | **1,208,760** | **441,227** | **1,649,987** |
| **TOTAL ASSETS** | **1,213,880** | **442,822** | **1,656,702** |
| **Liabilities** | | | |
| Payable to brokers | 3,063 | 1,026 | 4,089 |
| Other liabilities | 3,015 | 349 | 3,364 |
| **TOTAL LIABILITIES** | **6,078** | **1,375** | **7,453** |
| **Net Assets Held In Trust For:** | | | |
| Pension benefits | 1,207,802 | 441,447 | 1,649,249 |
| **TOTAL NET ASSETS** | **$ 1,207,802** | **$ 441,447** | **$ 1,649,249** |

# Other Supplementary Information *(Continued)*

## COMBINING SCHEDULE OF CHANGES IN DEFINED BENEFIT PENSION PLAN NET ASSETS

*For the Fiscal Years Ended June 30, 2012 (Dollars in Thousands)*

| | Retirement Fund | Cost-of-Living | Total |
|---|---|---|---|
| **Additions** | | | |
| Contributions | | | |
| Employee | $ 7,994 | $ 2,561 | $ 10,555 |
| Employer | 69,496 | 17,586 | 87,082 |
| **Total contributions** | **77,490** | **20,147** | **97,637** |
| Investment income: | | | |
| Net depreciation in fair value of investments | (74,013) | (24,842) | (98,855) |
| Interest income | 20,199 | 6,827 | 27,026 |
| Dividend income | 6,983 | 2,367 | 9,350 |
| Net rental income | 389 | 131 | 520 |
| Less investment expense | (5,267) | (1,806) | (7,073) |
| **Net investment loss before securities lending income** | **(51,709)** | **(17,323)** | **(69,032)** |
| Securities lending income: | | | |
| Earnings | 66 | 22 | 88 |
| Rebates | 63 | 21 | 84 |
| Fees | (32) | (11) | (43) |
| **Net securities lending income** | **97** | **32** | **129** |
| **Net investment loss** | **(51,612)** | **(17,291)** | **(68,903)** |
| **TOTAL ADDITIONS** | **25,878** | **2,856** | **28,734** |
| **Deductions** | | | |
| Retirement benefits | 100,007 | 25,994 | 126,001 |
| Death benefits | 5,180 | 3,421 | 8,601 |
| Refund of contributions | 1,918 | 277 | 2,195 |
| Administrative expenses and other | 2,456 | 850 | 3,306 |
| **TOTAL DEDUCTIONS** | **109,561** | **30,542** | **140,103** |
| **NET INCREASE/(DECREASE)** | **(83,683)** | **(27,686)** | **(111,369)** |
| **Net Assets Held In Trust For Pension Benefits** | | | |
| **BEGINNING OF YEAR** | **1,291,485** | **469,133** | **1,760,618** |
| **END OF YEAR** | **$ 1,207,802** | **$ 441,447** | **$ 1,649,249** |



# Other Supplementary Information *(Continued)*

## COMBINING SCHEDULE OF OTHER POSTEMPLOYMENT PLAN NET ASSETS

*For the Fiscal Years Ended June 30, 2012 (Dollars in Thousands)*

| | Postemployment Healthcare 401(h) | Postemployment Healthcare (115) | Postemployment Healthcare Plan |
|---|---|---|---|
| **Assets:** | | | |
| **Receivables:** | | | |
| Employee contributions | $ 304 | $ - | $ 304 |
| Employer contributions | - | 318 | 318 |
| Brokers and others | 117 | - | 117 |
| Accrued investment income | 221 | - | 221 |
| **Total receivables** | **642** | **318** | **960** |
| **Investments, at fair value:** | | | |
| Securities and other: | | | |
| Domestic fixed income | 10,759 | 1,997 | 12,756 |
| International fixed income | 141 | 26 | 167 |
| Collective short-term investments | 16,171 | 3,000 | 19,171 |
| Corporate convertible bonds | 3,323 | 617 | 3,940 |
| Pooled fixed income | 2,310 | 429 | 2,739 |
| Global equity | 22,907 | 4,250 | 27,157 |
| Pooled global equity | 31,701 | 5,882 | 37,583 |
| Private equity | 6,192 | 1,149 | 7,341 |
| Forward international currency contracts | 29 | 5 | 34 |
| Opportunistic investments | 5,440 | 1,009 | 6,449 |
| Real assets | 10,858 | 2,014 | 12,872 |
| Real estate | 6,087 | 1,129 | 7,216 |
| **Total investments** | **115,918** | **21,507** | **137,425** |
| **TOTAL ASSETS** | **116,560** | **21,825** | **138,385** |
| **Liabilities:** | | | |
| Payable to brokers | 294 | 1 | 295 |
| Other liabilities | 289 | 3 | 292 |
| **TOTAL LIABILITIES** | **583** | **4** | **587** |
| **Net Assets Held In Trust For:** | | | |
| Postemployment healthcare benefits | 115,977 | 21,821 | 137,798 |
| **TOTAL NET ASSETS** | **$ 115,977** | **$ 21,821** | **$ 137,798** |

*See accompanying notes to basic financial statements.* *(Continued)*

## COMBINING SCHEDULE OF OTHER POSTEMPLOYMENT PLAN NET ASSETS (continued)

*For the Fiscal Years Ended June 30, 2012 (Dollars in Thousands)*

| | Postemployment Healthcare 401(h) | Postemployment Healthcare (115) | Postemployment Healthcare Plan |
|---|---|---|---|
| **Additions:** | | | |
| **Contributions:** | | | |
| Employee | $ 14,995 | $ - | $ 14,995 |
| Employer | 4,044 | 21,790 | 25,834 |
| **Total contributions** | **19,039** | **21,790** | **40,829** |
| Investment income: | | | |
| Net depreciation in fair value of investments | (7,445) | (366) | (7,811) |
| Interest income | 2,032 | (1) | 2,031 |
| Dividend income | 702 | 436 | 1,138 |
| Net rental income | 39 | - | 39 |
| Less investment expense | (530) | (17) | (547) |
| **Net investment income (loss) before securities lending income** | **(5,202)** | **52** | **(5,150)** |
| Securities lending income: | | | |
| Earnings | 7 | - | 7 |
| Rebates | 6 | - | 6 |
| Fees | (3) | - | (3) |
| **Net securities lending income** | **10** | **-** | **10** |
| **Net investment income (loss)** | **(5,192)** | **52** | **(5,140)** |
| **TOTAL ADDITIONS** | **13,847** | **21,842** | **35,689** |
| **Deductions:** | | | |
| Healthcare insurance premiums | 33,077 | - | 33,077 |
| Administrative expenses and other | 247 | 21 | 268 |
| **TOTAL DEDUCTIONS** | **33,324** | **21** | **33,345** |
| **NET INCREASE/(DECREASE)** | **(19,477)** | **21,821** | **2,344** |
| **Net Assets Held In Trust For Pension Benefits and Postemployment Healthcare Benefits:** | | | |
| **BEGINNING OF YEAR** | **135,454** | **-** | **135,454** |
| **END OF YEAR** | **$ 115,977** | **$ 21,821** | **$ 137,798** |

# Other Supplementary Information *(Continued)*

## SCHEDULES OF ADMINISTRATIVE EXPENSES AND OTHER

*For the Fiscal Years Ended June 30, 2012 and 2011*

| | 2012 | | | 2011 |
|---|---|---|---|---|
| | Original Budget | Actual | Variance Positive (Negative) | Actual |
| Personal services | $ 2,498,250 | $ 1,931,311 | $ 566,939 | $ 1,995,925 |
| Non-personal/equipment | 1,097,594 | 693,031 | 404,563 | 611,197 |
| Professional services | 974,732 | 949,233 | 25,499 | 475,678 |
| **TOTAL ADMINISTRATIVE EXPENSES & OTHER** | **$ 4,570,576** | **$ 3,573,575** | **$ 997,001** | **$ 3,082,800** |

## SCHEDULES OF PAYMENTS TO CONSULTANTS

*For the Fiscal Years Ended June 30, 2012 and 2011*

| Firm | Nature of Service | 2012 | 2011 |
|---|---|---|---|
| Cheiron Inc | Actuarial consultant | $ 306,144 | $ 140,550 |
| Cortex Applied Research, Inc. | Governance consultant | 92,888 | - |
| Financial Knowledge/Peter Sepsis | Educational services | 11,348 | 22,529 |
| Gabriel, Roeder, Smith & Company | Actuarial consultant | - | 24,749 |
| Ice Miller | Legal tax counsel | 469 | 70,929 |
| L.R. Wechsler, LTD | Pension system consultant | 145,478 | - |
| Legal - City Attorney's Office | Legal counsel | 48,740 | 49,820 |
| Levi, Ray, & Shoup | Web development and maintenance | 11,595 | 11,711 |
| Levi, Ray, & Shoup | Programing changes and business continuance services | 7,474 | 8,979 |
| Macias Gini & O'Connell LLP | External auditors | 55,186 | 67,445 |
| Medical Director/Other Medical | Medical consultant | 59,842 | 42,245 |
| Pension Benefit Information | Reports on deceased benefit recipients | 1,999 | 1,721 |
| Reed Smith LLC | Fiduciary and general counsel | 75,463 | - |
| Robert Half Mangement Resources | Temporary staff | 50,579 | 6,090 |
| Saltzman & Johnson | Legal counsel | 35,691 | 28,910 |
| Silicon Valley Professional Staffing | Temporary staff | 15,090 | - |
| Trendtec Inc. | Temporary staff | 31,246 | - |
| **TOTAL** | | **$ 949,233** | **$ 475,678** |

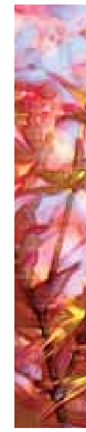
## SCHEDULES OF INVESTMENT EXPENSES

*For the Fiscal Years Ended June 30, 2012 and 2011*

| | 2012 | 2011 |
|---|---|---|
| **Investment Managers' fees** | | |
| Global Equity: | $ 2,480,131 | $ 1,676,343 |
| Private equity* | 1,050,762 | - |
| **Total equity** | **3,530,893** | **1,676,343** |
| Global fixed income | 582,779 | 605,635 |
| **Total fixed income** | **582,779** | **605,635** |
| Real estate | 1,367,162 | 519,641 |
| Real assets | 463,684 | - |
| Opportunistic | 1,026,055 | 437,071 |
| **TOTAL INVESTMENT MANAGERS' FEES** | **6,970,573** | **3,238,690** |
| **Other Investment Fees** | | |
| Investment consultant | 410,000 | 310,000 |
| Custodian bank** | 198,607 | - |
| Proxy voting | 14,495 | 13,496 |
| Real estate legal fees | 1,097 | 7,776 |
| Real estate appraisals** | - | 4,600 |
| Investment legal fees | 25,289 | 68,773 |
| **Total other investment service fees** | **649,488** | **404,645** |
| **TOTAL INVESTMENT EXPENSES** | **$ 7,620,061** | **$ 3,643,335** |

** In fiscal year 2011 private equity and real asset income was reported net of fees.*

*** In fiscal year 2012 the System transitioned custodian banks and began incurring fees. Also, in fiscal year 2012 the System sold its only separately held real estate property and no longer incurred real estate appraisal fees.*



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# Investment Section

City of San José
Federated City Employees' Retirement System
Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2012

# Report of Investment Activity

M E K E T A   I N V E S T M E N T   G R O U P

BOSTON   MIAMI   SAN DIEGO

September 6, 2012

Ms. Donna Busse
Acting Director
San Jose Federated City Employees' Retirement System
1737 North First Street, Suite 580
San Jose, CA 95112-4505

Dear Ms. Busse:

Fiscal year 2012 began with heightened market volatility and risk aversion plaguing the markets, due in part to a renewed focus on the faltering global economy and sovereign debt issues in the Eurozone. Despite efforts by policymakers, including the announcement of the U.S. Federal Reserve's "Operation Twist" and an expansion of the European Financial Stability Facility ("EFSF"), the third quarter of calendar 2011 was the worst quarter for equities since 2008. International equities trailed domestic equities, and returns for U.S. investors were further hampered by a rising dollar. Emerging markets were the worst performing asset class, due in part to inflationary concerns in Asia and fears over slowing global demand for exports from the region. Treasury Inflation-Protected Securities ("TIPS") and investment grade bonds were top performers as investors continued to reduce risk in light of global economic uncertainties.

During the fourth quarter of calendar 2011, investors returned to risk assets due partly to improved economic data and hopes of a resolution to the sovereign debt issues in the Eurozone. Real GDP growth in the U.S. was 2.8% during the quarter, 1.0% above the level of the prior quarter, the U.S. unemployment rate declined somewhat, and in late December 2011, the European Central Bank ("ECB") announced that it would make over $600 million in liquidity available to banks across Europe. The domestic equity market, as proxied by the Russell 3000 Index, rose 12.1% during the quarter, though returns for international and emerging markets were more subdued. The MSCI EAFE Index, a proxy for the developed international equity market, returned 3.3%, while the MSCI Emerging Markets Index returned 4.4%.

Investor optimism persisted during the first few months of calendar 2012, as global equity markets soared and U.S. stocks experienced their best quarter since 1998. However, a number of near-term issues remained unresolved, including sovereign debt issues in Europe, the potential for a "hard landing" in China, and a stalled recovery in the U.S. economy. After posting the weakest returns for major asset classes during calendar year 2011, emerging market equities were the top performers, with a return of 14.1% for the first quarter of 2012. The U.S. equity market, as proxied by the Russell 3000 Index, returned 12.9%, and developed market foreign equities recouped the majority of their 2011 losses, with the MSCI EAFE Index gaining 10.9%. Credit spreads compressed for the second consecutive quarter as investors continued to prefer riskier assets.

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760 795 3450   fax 760 795 3445   www.meketagroup.com

Unfortunately, after posting strong returns in the prior two quarters, global equity markets retreated again in the final quarter of fiscal year 2012. Renewed concerns over the European debt crisis, particularly the solvency of Spain, as well as the potential of Greece exiting the Eurozone, contributed to investors' renewed risk aversion. Additionally, increased political uncertainty in Greece and France, disappointing U.S. labor reports, and slowing growth in China and India further contributed to market volatility.

In the Eurozone, GDP was negative, after declining 0.1% in the first quarter of calendar 2012. The ongoing weakness in Europe's economy was attributable in part to decreased spending resulting from austerity programs, coupled with declining demand for European exports from China and other emerging markets. In May of 2012, unemployment reached a record high of 11.1% in the Eurozone. In addition, China's economic growth during the first quarter fell to its slowest rate in three years, and China reduced its bank reserve requirement for the third time in six months due to a decline in inflation and weaker economic data. The central banks of emerging market countries including Brazil also cut interest rates in an attempt to stimulate slowing economies. During the quarter, the MSCI EAFE Index fell -7.1%, the MSCI Emerging Markets Index fell -8.9%, and U.S. equities fell -3.1%.

Globally, developed markets outperformed emerging markets during the full fiscal year, as the MSCI EAFE and the MSCI Emerging Markets indices fell -13.8% and -16.0%, respectively. International small cap stock returns, as proxied by the MSCI EAFE Small Cap Index, fell -15.1% for the fiscal year. U.S. equity returns were positive for the year, with a return of 3.8% for the Russell 3000 Index. Global equity markets as a whole, as proxied by the MSCI All Country World Index ("ACWI") fell -4.7% for the year.

During the first and last quarter of the fiscal year, U.S. Treasuries and other high quality fixed income securities benefited from a "flight to quality,"stemming from the European debt crisis and concerns over the strength of the global economic recovery. The Barclays Aggregate index returned 7.5% for the year, while the Barclays U.S. TIPS Index was up an impressive 11.7%. The 10-year Treasury yield fell to 1.6% at the end of June, down from 3.2% at the beginning of the fiscal year.

In the alternative assets space, commodities, as proxied by the Dow Jones-UBS Commodity Index, fell -14.4% for the year. The Hedge Fund Research Institute Fund of Funds Composite fell -4.5% for the fiscal year, while fiscal year returns for private market assets were modestly positive. The National Council of Real Estate Fiduciaries Property Index returned 12.4% and the Venture Economics Private Equity Composite returned 9.6%. Returns for both private market indexes are lagged by one quarter due to the availability of data.

**Fiscal 2013 Outlook**

Meketa Investment Group believes that three issues remain of primary concern over the next year: the solvency of sovereign governments and banks in Europe, slowing growth in China, and a slow growing U.S. economy that is susceptible to recession. We expect that global GDP growth will be positive, but will continue to be slow for the remainder of calendar year 2012. This slow growth will be due to lower demand for exports, continued austerity measures and high unemployment in developed economies. Slowing growth globally should keep inflation at moderate levels, and deflation continues to be a risk in the developed world.

We anticipate that additional monetary stimulus will be implemented in Europe and the emerging markets, and possibly in the U.S. The U.S. Federal Reserve may implement a third round of quantitative easing

("QE3") to induce demand for credit, though the upcoming general election may diminish the likelihood of such a move. Tax increases and spending cuts scheduled to take place in early 2013 create a "fiscal cliff" that could weigh substantially on the U.S. economy and potentially lead to another recession. It is likely that a short-term resolution will be reached, though it may not happen until after the general election.

The volatility in the markets, while concerning, is not unexpected, and we believe that the Retirement System's portfolio is diversified in a way that provides a good chance for achieving long-term returns to meet the Retirement System's obligations and objectives. In general, we believe actions should be focused on the long-term and should be consistent with the Retirement System's investment policies.

**Plan Investment Results and Asset Allocation for Pension Trust**

For fiscal year 2012, the San Jose Federated City Employees' Retirement System returned -3.0% gross of fees and -3.2% net of fees[1], while the Custom Benchmark return for the same time period was -3.2%. The Retirement System underperformed the median fund in the InvestMetrics universe of public funds greater than $1 billion, which returned 1.1% gross of fees for the fiscal year.

The Retirement System's allocations to international equity and alternatives, particularly commodities, were higher than the median allocations for these asset classes among funds in the InvestMetrics universe during the fiscal year (and the fixed income allocation correspondingly lower), causing the relative underperformance. While the Retirement System's long-term return expectations are at a level that would support the Fund's long-term assumed rate of return, the return in any single fiscal year may vary significantly from this long-term average. However, in the 12-month periods ending June 30, 2011 and June 30, 2010, the Retirement System returned 19.0% and 14.0%, respectively. The long-term return expectation takes into account both the years when returns are higher than expected and those when they are lower.

During the fourth quarter of calendar 2011, the Board of Trustees adopted a new asset allocation in response to the results of an asset-liability study, and in order to position the Retirement System to better weather future market downturns. The Retirement System is a multi-generational entity that needs to make benefit payments for many years in the future. Therefore, it is important for the Trustees to focus on investment performance over a long-term horizon, allowing assets to grow to meet future benefit obligations. The Retirement System moved toward the new asset allocation beginning when it was adopted using an overlay, and is currently completing the process of fully completing the move using physical securities. Given the Retirement System's use of passive investments to implement the majority of its asset allocation, the investment management expenses paid by the Retirement System are much lower than the expenses paid by peer institutions.

**Plan Investment Results and Asset Allocation for Health Care Trust**

In July 2011, a separate Health Care Trust was established with an initial $21.5 million contribution from the City of San Jose. Prior to the establishment of this Trust, postemployment health care assets were invested alongside the Pension Trust. For fiscal year 2012, the San Jose Federated Retiree Health Care Trust Fund returned 0.6% net of fees. The City Ordinance required the Health Care Trust initially be invested in liquid asset classes according to the Pension Trust Statement of Investment Policy until a separate investment policy was developed, which is expected to be completed during fiscal year 2013.

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[1] Meketa Investment Group uses the Global Investment Performance Standards (GIPS) developed by the CFA Institute as a guide to calculating performance.

**Summary**

The Retirement System Staff and Board of Trustees accomplished a great deal from an investment standpoint during fiscal year 2012 through the implementation of the new asset allocation, which aims to better position the Retirement System for potential future market environments. During fiscal year 2013, Meketa Investment Group looks forward to working with Staff and the Board of Trustees to further implement the target asset allocation and enhance the investment manager roster, so that the Retirement System can continue to meet its obligations to participants.

Sincerely,

Laura Wirick, CFA, CAIA
Vice President

Stephen P. McCourt, CFA
Managing Principal

Brad Regier, CFA, CAIA
Vice President

LBW/cds

# Statement of Investment Policy

## The following policy applies to both Pension and Healthcare Trusts

### General Environment

It is the policy of the San Jose Federated City Employees' Retirement System (SJFCERS) to effect economy and efficiency in the public service by providing a means whereby career employees or employees who have become incapacitated may leave public service without hardship or prejudice, and to that end provide a retirement system consisting of retirement allowances and death benefits.

Investments in such retirement system are subject to the restrictions specified in the San Jose Retirement Code sections 3.24.350, 3.24.360, 3.28.350 and 3.28.355. Further investment management guidelines are imposed by the San Jose Federated City Employees' Retirement Board ("Board"). The Board retains its official oversight of the System but has designated the Investment Committee to act as a conduit for investment issues to be presented to the Board.

### Purpose

The purpose of this Investment Policy Statement (IPS) is to assist the San Jose Federated City Employees' Retirement System's Board ("Board") and its delegate in effectively supervising, monitoring and evaluating the investment of the System's assets. The System's investment program is defined in the various sections of the IPS by:

- Stating in a written document the Board's attitudes, expectations, objectives and guidelines for the investment of all the System's assets.
- Setting forth an investment structure for managing the System's assets. This structure includes various asset classes, investment management styles, asset allocation and acceptable ranges that, in total, are expected to produce a sufficient level of overall diversification and total investment return over the long-term.
- Providing guidelines for the investment system that control the level of overall risk and liquidity assumed in that system, so that all the System's assets are managed in accordance with stated objectives.
- Encouraging effective communications between the Board, the investment consultant (Consultant) and the money managers.
- Establishing formalized criteria to monitor, evaluate and compare the performance results achieved by the money managers on a quarterly basis, or as deemed appropriate.
- Complying with applicable fiduciary, prudence and due diligence requirements that experienced investment professionals would utilize, and with applicable laws, rules and regulations from various local, state, federal and international political entities that may impact the System's assets.

This IPS has been formulated, based upon consideration by the Board of the financial implications of a wide range of policies, and describes the prudent investment process that the Board deems appropriate.

The objectives of the System have been established in conjunction with a comprehensive review of the current and projected financial requirements. The Board shall:

(1) Attempt to ensure that the Retirement System is sufficiently funded to ensure that all present and future disbursement obligations will be met.

(2) Attempt to ensure that the investment earnings be sufficiently high to provide a funding source, along with contributions from City employees and the City, in order to offset liabilities in perpetuity.

(3) Strive for the highest total return on investment funds consistent with safety in accordance with accepted investment practices and maintain an appropriate asset allocation policy that is compatible with the objectives of the System.

(4) Control the costs of administering the System's assets and managing the investments.

### Asset Allocation Policy

The following policy has been identified by the Board as having the greatest expected investment return and the resulting positive impact on asset values and funded status without exceeding a prudent level of risk. The Board determined this policy after evaluating the implications of increased investment return versus increased variability of return for a number of potential investment policies with varying commitments to asset classes.

It shall be the Policy of the System to invest its assets in accordance with the maximum and minimum range, valued at market value, for each asset class as stated below:

#### Long-term Asset Allocation - Pension Trust

| Broad Asset Class | Minimum | Target | Maximum |
|---|---|---|---|
| Equity (Public and private equity, and real estate) | 38% | 45% | 52% |
| Fixed Income (Public and private debt) | 5% | 10% | 20% |
| Hedge Funds | 20% | 25% | 30% |
| Real Assets | 15% | 20% | 25% |
| **Total** | | **100%** | |

# Statement of Investment Policy *(Continued)*

### Long-term Asset Allocation - Healthcare Trust

| Broad Asset Class | Minimum | Target | Maximum |
|---|---|---|---|
| Global Equity | 53% | 59% | 65% |
| Fixed Income | 23% | 28% | 33% |
| Real Assets | 8% | 13% | 18% |
| Cash | 0% | 0% | 0% |
| **Total** | | **100%** | |

The investment policy is expected to have a high likelihood of meeting the objectives outlined in the "Statement of Objectives" section, which preceded this section.

The Investment Policy, including asset allocation, is intended to provide a means for controlling the overall risk of the portfolio while ensuring that investment earnings will be sufficiently high to provide a funding source to offset liabilities in perpetuity. The policy should not unduly constrain the discretionary, tactical decision-making process of the investment managers so that the funds earn the highest total returns while remaining in accordance with accepted investment practices.

The Investment Policy and the asset allocation are generated using certain market assumptions. These assumptions include the expected return and standard deviation for each asset category and the expected correlation coefficients among asset classes. When these presumptions change, the policy needs to be re-evaluated and possibly modified to compensate for those changes.

### Time Horizon

The asset allocation ranges established by this investment policy represent the long-term perspective. As such, rapid unanticipated market shifts or changes in economic conditions may cause the asset mix to fall outside the policy range. These divergences should be of a short-term nature. The Director of Retirement Services will review the asset mix of the Plan on a monthly basis and cause the asset mix to be rebalanced to within the policy range as necessary and in accordance with the rebalancing guidelines set forth in this IPS. Additionally, the Board will review the strategic asset allocation on at least an annual basis to determine if there is a need to make any changes.

### Risk Tolerances and Volatility

The Board recognizes the difficulty of achieving the System's investment objectives in light of the uncertainties and complexities of contemporary investment markets. The Board also recognizes that some risk must be assumed to achieve the System's long-term investment objectives.

In establishing the risk tolerances of the IPS, the ability to withstand short and intermediate term variability were considered.

Consistent with the desire for adequate diversification, the Investment Policy is based on the expectation that the volatility (the standard deviation of returns) of the total System will be similar to that of the market. Consequently, it is expected that the volatility of the total System will be reasonably close to the volatility of a commitment weighted composite of market indices.

### Re-balancing of Strategic Allocation

The System's asset allocation will be reviewed relative to the targets on a semi-monthly basis and action will be taken to re-balance to within the target ranges by means of asset transfers among the categories.

When necessary and/or available, cash inflows/outflows will be deployed in a manner consistent with the strategic asset allocation of the System.

General guidelines for re-balancing the portfolio are as follows:

(1) When the allocation to a particular asset class deviates from its target, the asset class will be re-balanced to within the policy range over the following 60 days. The cash surplus within the Fund will be used to rebalance the portfolios. If the cash surplus is not sufficient, the following rebalancing procedures shall be implemented.

(2) Transfers shall first be taken from asset classes above the maximum range, then from asset classes above the target but below the maximum. If there is only one manager in the asset class, transferred assets shall first consist of cash in the portfolio. If the cash is not sufficient, then the manager will be requested to liquidate that portion of the portfolio, which will result in the manager's portfolio coming within the specific target range.

(3) Transfers shall first be made to asset classes below the minimums, then to asset classes below the targets, unless the managers in those classes are already holding excess cash or they feel it would be imprudent to increase their size.

(4) All transfers should be made in accordance with the cash management policy.

(5) Rebalancing for asset classes that have deviated from their targets, but are still within their respective target ranges, may remain at their allocations if the Director and Consultant determine it would not be detrimental to the overall portfolio.

# Statement of Investment Policy *(Continued)*

## Liquidity

The Board has authorized the Director of Retirement Services to review the projected cash flow needs of the System at least annually and indicate to the investment managers the required liquidity. If necessary, cash flow needs will be coordinated through the System's rebalancing procedures as described in the previous section. If additional funds are required from the System's equity managers, the Director will communicate the cash flow requirements giving advanced written notice so the managers have sufficient time to comply.

## Diversification

Investments shall be diversified with the intent to minimize the risk of large investment losses. Consequently, the total portfolio will be constructed and maintained to provide prudent diversification with regard to the concentration of holdings in individual issues, issuers, or industries.

Specifically, no single investment shall exceed the guidelines established under the Manager and Securities Guidelines section.

As a general rule, System assets placed with an investment manager should not represent more than 10% of that manager's assets.

## General

Every investment manager selected to manage the System's assets must adhere to the following guidelines.

- The investment manager will at all times be expected to exercise due diligence regarding his/her account and to perform in a prudent manner and within the specific terms of appointment.
- The manager will have full discretion to direct and manage the investment and reinvestment of assets in accordance with this document, applicable federal and state statutes and regulations, and the executed contract.
- Benchmarks shall be specified for the investment manager. It is expected that the managers will adhere to the style concepts and the investment principles that were in use at the time the Board appointed the firm to manage a portion of the System's assets.
- It is the Board's desire that an investment manager be fully invested in his/her own asset class. However, the manager shall retain the discretion to invest a portion of the assets in cash reserves. The Board prefers that the managers hold under 6-7% cash. Any manager who holds over 7% in cash on average over two months shall notify staff in writing.

  If market conditions dictate, the manager may exceed 10% cash holdings with written approval of the Director of Retirement Services. The manager will be evaluated against their peers on the performance of the total assets under their management. Any intent to deviate from this strategy should be communicated to the Board prior to implementation.
- Turnover standards shall be set whenever it is appropriate to the investment manager's style, the asset class, or the return target. Trading expenses shall be minimized and managed by the investment manager and all transactions shall be governed by general "best execution" guidelines.
- Transactions that would jeopardize the tax-exempt status of the System should not be undertaken.
- The Board has the authority to "vote" on all issues presented to stockholders, but as a matter of practice will designate an authorized third party to vote the proxies. It is expected that the designee will vote for the sole purpose of benefiting the beneficiaries of the System and in accordance with the adopted general proxy voting guidelines.
- The investment manager is expected to comply with all laws, regulations, and standards of ethical conduct.

## Global Equity Investments

The primary emphasis of the global equity portfolio should be on high quality, readily marketable securities. The investment managers employed to manage equity securities will have discretion in the day-to-day management of funds under their control, subject to the following guidelines:

(1) Global equity securities (with the exception of preferred stocks) shall be traded on a national exchange (including NASDAQ) and be substantially diversified.

- The number of issues held, their geographic and economic sector diversification shall be left to the investment manager's discretion provided, however, that the portfolio shall be appropriately diversified as consistent with the manager's stated investment approach.

(2) The following transactions are prohibited:

- Purchase of stocks that are not publicly traded.
- Purchase of restricted stock.
- Short sales and purchases of securities on margin.

# Statement of Investment Policy *(Continued)*

(3) American Depository Receipts (ADR's ) and Real Estate Investment Trusts are permitted equity investments.

(4) The manager may enter into currency exchange contracts (forward exchange or future) provided that such contracts have a maximum maturity of one year. Furthermore, any currency hedging shall be limited to a defensive posture only. The use of such contracts is designed to dampen portfolio volatility rather than lever portfolio risk exposure. There shall be no direct foreign currency speculation or any related investment activity. Cross-hedging will be permitted. Securities held in the portfolio may be denominated in any currency at the discretion of the investment manager. The investment manager will include in his/her quarterly report to the Director of Retirement Services and the Board a report on the status of the outstanding hedged positions.

## Cash Investments

The following investment vehicles are approved for the investment of short-term funds of the System:

(1) All U.S. Government and federal agency issues.

(2) All U.S. Dollar denominated foreign commercial paper that is rated either A1 or P1 by Moody's or by Standard & Poor's. If the issuer had public debt outstanding, said debt should not be rated below the top three letter ratings (AAA, AA, A) of either Moody's or Standard & Poor's.

(3) If the issuer of commercial paper (CP) is a bank, purchase of its CP is approved only when purchase of its certificates of deposit (CD's) is also approved.

(4) Domestic and foreign Certificates of Deposit (CD's) and Banker's Acceptances.

(5) Repurchase Agreements with banks and with broker-dealers registered under the Securities and Exchange Act of 1934.

(6) Reverse Repurchase Agreements - Only upon the specific approval of the Retirement Board.

(7) Insured time deposits.

(8) The custodial bank's Short Term Investment Fund provided that said Fund satisfies the requirements of 1 through 7 above.

## Investment Grade Fixed Income

The investment grade fixed income portion of the System's assets shall generally be invested in investment grade, marketable, fixed-income securities, although up to 10% investment in below investment grade securities will be permitted with written authorization of the Board. The investment managers employed to manage domestic fixed-income securities will have discretion in the day-to-day management of the funds under their control.

The following instruments are acceptable for purchase:

(1) Commercial Paper or Variable Rate notes of P-1 or equivalent rating. Pools containing lower quality issues of this security type (P-2 and P-3 or equivalent ratings) may be used where diversification reduces the quality risk.

(2) Certificates of Deposit and Bankers Acceptances.

(3) United States Treasury Bonds, Notes, and Bills.

(4) Repurchase agreements with U.S. Treasury securities and agencies of the U.S. Government as collateral. No reverse repurchase agreements will be allowed without specific written approval by the Board.

(5) Debt instruments of the U.S. Government or its agencies.

(6) "Yankee" bonds issued by foreign countries and denominated in dollars so long as they are rated Baa/BBB or better by Moody's or Standard & Poor's.

(7) Investment grade U.S. pay corporate debt issues including those rated Baa/BBB or better by Moody's or Standard & Poor's. Should a current holding fall below this standard, the manager shall immediately notify staff of the downgrade and confer with staff as to whether the security will continue to be held or disposed. However, investments in non-investment grade securities of BB or B classification will be permitted up to 10% with written authorization of the Board.

The Fixed-Income investments shall be appropriately diversified. The investment manager may engage in "active" bond management and it is therefore anticipated that there may be turnover as shifts are made between and within sectors, quality and maturity.

No more than 10% of a single manager's assets shall be invested in securities of any single issuer with the exception of the U.S. Government and its agencies.

### High Yield Fixed Income and Bank Loans

The High Yield Bonds and Bank Loans portion of the plan assets shall be invested predominantly in below investment grade securities and bank loans. The investment managers employed to manage high yield and bank loan instruments will have discretion in the day-to-day management of funds under their control. The High Yield and bank loan managers shall have discretion to invest in all the instruments allowed for investment by the domestic bond managers, plus the investments that meet the following criteria:

(1) U.S. corporate bonds, including zero-coupon, step-up, convertible, toggle and pay-in-kind bonds and Non-dollar corporate bonds (which should be hedged), Private placement securities, bank loans, participations and assignments.

(2) U.S. dollar denominated bonds issued by entities not domiciled in the United States (Yankee bonds/ euro bonds).

(3) U.S. Treasury futures, currency forward or futures contracts, and credit default swaps may be used for hedging purposes.

(4) No more than 3% of the portfolio shall be invested in obligations of a single non-governmental issuer.

(5) The number of issues held, the sector and the industry diversification constraints shall be detailed in each manager's investment guidelines. The portfolio shall be appropriately diversified as consistent with the manager's stated investment approach.

### Convertible Bonds

The convertible bonds portion of the plan assets shall be invested predominantly in convertible securities. The Manager may invest in investment grade or below investment grade U.S. and non- U.S. convertible securities, including convertible bonds, convertible preferred stock, bonds or preferred stock with warrants, and zero-and low-coupon convertibles across the entire credit quality spectrum. In addition, the investment manager can utilize convertible structured notes issued by third parties, as well as synthetic convertible securities created by the investment manager. The investment manager(s) employed to manage the convertible instruments will have discretion in the day-to-day management of funds under their control. The convertible bond manager(s) shall have discretion to invest in all the instruments allowed for investment by the domestic bond managers, plus the investments that meet the following criteria:

(1) At the time of purchase at least 95% of the instruments must have a minimum rating of B- or B3, or if unrated, of a comparable quality rating as determined by the investment manager. Should more than 5% of a portfolio fall below this standard, the investment manager shall notify the Board of the downgrade immediately and submit a plan for returning the portfolio to the standard. Other eligible investments are U.S. Treasuries, U.S. corporate bonds, (including zero-coupon, step-up, toggle and pay-in-kind bonds), non-U.S. corporate bonds, private placement securities, bank loans, participations, and assignments.

(2) U.S. dollar denominated bonds issued by entities not domiciled in the United States (Yankee bonds/ euro bonds).

(3) U.S. Treasury futures, currency forward or futures contracts, and credit default swaps may be used for hedging purposes.

(4) No more than 3% of the portfolio shall be invested in obligations of a single non-governmental issuer.

(5) The portfolio shall be appropriately diversified by the number of issues held, sector, industry, and country weightings, consistent with the manager's stated investment approach.

### Real Estate

The Board may elect to invest in commercial, industrial, and residential real estate or real estate related debt instruments provided that:

(1) The real estate is defined as any real property within the United States improved by multifamily dwelling, industrial or commercial buildings.

(2) Real estate debt instruments shall be defined as first mortgages.

(3) The fund shall at no time invest directly more than 5% of the Fund's assets, valued at market, in any one property, project, or debt instrument regardless of the manner of the instrument.

### Private Equity

Private markets investments include, but are not limited to, venture capital partnerships, leveraged buyout funds, private debt, and private placements. While it is expected that the majority of these assets will be invested within the United States, a portion can be allocated to non-U.S. investments. Investments may be made in secondary investments on an opportunistic basis.

It is expected that these investments will typically be structured as Limited Partnerships, with the System serving as one of the Limited Partners, but not as a General Partner. It is also expected that the System will not engage in direct investments or co-investments, in which the System would purchase majority control in individual corporate entities, unless authorized by the Board.

### Opportunistic Strategies

Investment in any of the instruments or vehicles allowed in other sections is also allowed in this section. Other investments are acceptable as long as they are approved by the Board in writing. In addition, investment in the credit market is also allowed and may be implemented through:

1. Pooled funds; Separate accounts; Limited Partnerships; or Limited Liability Companies;
2. Credit linked notes;
3. Direct investment.

### Absolute Return

Absolute Return Funds, also called Hedge Funds, are private investment vehicles that may not be registered with the U.S. Securities and Exchange Commission (SEC); they may be offered in Limited Partnerships or Limited Liability Company form.

The allowed Absolute Return Strategies include but are not limited to :

1. Any of the following single strategies:
   a. Equity long/short including absolute return strategies specializing in emerging markets, market capitalization, regional, sectoral or global market subsets;
   b. Equity Market timing;
   c. Short or dedicated short;
   d. Distressed securities;
   e. Merger Arbitrage;
   f. Event driven or Risk Arbitrage;
   g. Fixed Income Arbitrage;
   h. Convertible Bond Arbitrage;
   i. Equity Market Neutral;
   j. Statistical Arbitrage;
   k. Relative Value Arbitrage;
   l. Global Macro or Global Tactical Asset Allocation;
   m. Managed Futures and Commodity Trading Advisors (CTA's).
2. Multi-Strategy or Fund of Funds are also allowed and combine several individual Absolute Return strategies into a single portfolio. The combination provides, in some circumstances, diversification of risk in a single investment.

### Real Assets

The following strategies are allowed, through both direct investments and through equity investments in companies that are involved with the following strategies:

a. **Commodities**
The strategy targets liquid investments in the commodities markets via derivatives (e.g. futures and swaps). Certain strategies may also include, to a lesser extent, investment in physicals for forward delivery. Exposure includes four major commodity market sectors: Energy, Agriculture/Livestock, Industrial Metals, and Precious Metals. Expected total return is due primarily to spot price appreciation; secondarily to contract roll forward dynamics, or the differential between spot and future price (between near and longer term contracts); and thirdly to modest collateral income.

The Real Asset program may employ both passive and active commodity management. Examination of cash collateral, in particular the quality of fixed income market exposure, will be considered in risk mitigation.

b. **Energy**
The strategy targets both public and private energy-related entities. The Energy investment strategy consists of three segments: upstream, midstream, and downstream businesses. Opportunities include core diversified global conglomerates that may span across segments and specific, concentrated satellite investments that may focus on a specific Energy market segment. Investments may include both traditional (oil, natural gas, coal) and alternative (wind, solar) energy sources.

The Upstream Investment Strategy focuses on the production of oil and gas, and includes petroleum Exploration and Production (E&P) businesses and power generation.

The Midstream Investment Strategy focuses on transporting the upstream products from the source to the end user, and includes storage and processing, as well as oilfield services (the equipment and services required to produce petroleum) and electricity transmission equipment and services. Midstream assets include pipelines, gathering and storage facilities, refining, power lines, and transformer stations. Services are also considered midstream elements, such as oilfield equipment like drill bits, drill rigs, well trees, and geologic and mapping services.

# Statement of Investment Policy *(Continued)*

The Downstream Investment Strategy focuses on the end users of upstream production. Power generation is an end user of petroleum products, while households and businesses are the downstream users of power generation. Downstream assets can also be local distribution centers, such as home heating oil distributors or gas stations.

Each segment of the strategy has different investment characteristics, income profiles, and risks.

c. **Metals & Mining**
Public equities in the Industrial and Precious metals-related industries. Investment opportunities include large core diversified global conglomerates and more specific, concentrated investments. Supply chain position may include upstream, midstream, and downstream companies. Expected total return is due primarily to appreciation and some income.

d. **Public Agriculture-related**
These investments are made primarily in Agriculture-related companies. Exposure may include both traditional agriculture and livestock investments and renewable energy sources. Supply chain position may include upstream, midstream, and downstream companies. Equity-based agriculture exposure ranges from upstream producing companies (i.e. growers) or those who are closely related to them, such as seed and agricultural chemicals companies, to downstream packaged foods producers. Opportunities include core diversified global conglomerates that may span across segments and specific, concentrated satellite investments that may focus on a specific market segment. Expected total return is due primarily to appreciation and some income.

e. **Timberland**
The strategy targets both public and private Timberland Investment Management Organizations, TIMO. The Investment strategy includes investing in entities that derive their returns from the growth and harvest of timber, a renewable and biologically growing asset. The investments may include both plantations who utilize intensive management techniques to enhance biological growth and naturally regenerating strategies. The investment strategy has varying time horizons to liquidity, shorter term for softwoods (e.g. for pulp and lumber) to longer term time horizon (e.g. hardwoods).

f. **Infrastructure**
Public and private investments in direct physical assets, or a company that operates assets that provide essential services to society. Ranges from publicly held equities to very illiquid private partnerships. Exposure includes toll-oriented projects (e.g. roads, bridges, tunnels), transport-focused (e.g. railroads, airports, seaports); regulated utilities (e.g. gas pipelines; water/sewer treatment facilities); and social services (e.g. schools, hospitals). High toll-orientation offers inflation protection. Expected total return is due primarily to current income and to a lesser extent capital appreciation. Satellite strategies typically use more leverage than core.

Typically, infrastructure assets exhibit one or more of the following qualities: monopolistic or quasi-monopolistic, high barriers to entry, long term assets, and significant regulatory or permitting constraints.

g. **Farmland/Agribusiness**
This investment strategy targets the market segment of agriculture. Farmland consists of two main property types: row and permanent crop properties. Row crops are harvested from soil and are categorized as commodity, (corn and soybean) and vegetable, (potatoes and lettuce). Permanent crops grow on trees and have three categories: citrus fruit, (oranges and grapefruits); fruit, (apples and grapes); and nuts.

h. **Infrastructure**
This investment strategy targets the market segment of water-related infrastructure, assets, and properties. Investors may soon view water as an increasingly scarce commodity, not unlike oil. Increasingly stringent water quality standards and the adaptation of water systems to meet changing climactic and hydrological conditions may result in investment opportunities in the water industry.

# Statement of Investment Policy *(Continued)*

## Supervision

The Investment Manager shall continually supervise the investment securities in the Fund, and shall purchase, sell, substitute, redeem, or convert securities, as they should deem advisable.

## Brokerage Policy

All transactions effected for the System will be "subject to the best price and execution." The lowest commission rate need not mean the best realized price. Execution capability, price, and overall effectiveness shall be considered, along with commission rate.

Any manager who is engaged in or has a direct pecuniary interest in a business other than investment counseling, such as a broker or dealer in securities shall not be permitted to use such business with regard to the System assets without prior written approval by the Board.

If a manager utilizes brokerage from the plan assets to effect "soft dollar" transactions, detailed records will be kept and communicated to the Board.

The System's investment managers shall follow the direction of the Board. It is the policy of the Board to instruct the investment managers to direct transaction orders to particular broker-dealers, including equity, fixed income, both domestic and international. The instructions from the Board currently is for the investment managers to direct as much as possible of the System's commission business as is practicable, subject to the best price and execution. The instruction and direction is to be construed within the normal activity of the investment manager, with no increased or decreased trading activity to occur because of the instruction. Where given discretion to establish and execute transactions through accounts with one or more broker-dealer firms as it may select, the manager must attempt to obtain "best available price and most favorable execution" with respect to all of the portfolio transactions.

Soft dollars accumulated through the System's brokerage program may be used to pay for any System expense permitted under the regulations of the Department of Labor (including, but not limited to, legal, accounting, education, management, etc.) and approved by the Board.

## Performance Objectives

Investment performance will be measured quarterly but it is not expected that the performance goals identified below will be satisfied in any single quarter or year. It is expected that these goals will be satisfied over a rolling five-year period or a full market cycle. However, action by the Board with regard to retention or dismissal of investment managers is not precluded by virtue of these time periods.

## Total Fund Investments

The total fund's performance, in aggregate, will be expected to achieve a rate of return, which exceeds a fund benchmark representative of the Asset Allocation objective as follows:

| Benchmark |
|---|
| Russell 3000 |
| MSCI ACWI |
| MSCI EAFE |
| MSCI Emerging Markets |
| Barclays Capital Aggregate Bond Index |
| Credit Suisse First Boston Leveraged Loan Index |
| Merrill Lynch High Yield Master Index |
| Merill Lynch Global 300 Convertible Index |
| NCREIF Property Index |
| Venture Economics Private Equity Index |
| Hedge Fund Research Institute Equity Hedge Index |

Specific guidelines and benchmarks are established below for each category of managers. Generally, however, investment managers are expected to perform within the top half of an appropriate database, rank in the top half of a database of similarly styled managers, and earn an average return, which exceeds an appropriate index over rolling five year periods.

Managers are considered to have achieved this objective if their performance meets all guidelines on a cumulative five year annualized period. If the performance is longer than five years, the manager is expected to satisfy the performance objectives in a majority of the rolling five year periods.

Investment managers with less than five years of experience with the Fund are considered to have achieved performance objectives if their performance meets guidelines in the majority of the annualized time periods since inception.

If managers with less than five years experience with the Fund fail to meet any investment objectives, the following should be applied:

- If a manager fails to meet investment objectives for one or two consecutive quarters, this may not be a cause for concern.
- If a manager fails to meet investment objectives for three consecutive quarters, they merit probationary status.
- If a manager fails to meet investment objectives for four consecutive quarters, they should be critically reviewed by the Board and considered for termination. The Board may grant the manager an extended probation after officially recognizing the substandard performance.

# Statement of Investment Policy *(Continued)*

## Passive Fixed Income Investments

The objective for investment managers of the passive fixed income component of the total portfolio is to achieve returns equal to the appropriate index with minimal tracking error.

## Active Fixed Income Investments

The objectives for investment managers of the domestic fixed-income component of the total portfolio are:

(1) Earn an average annual return from income and capital appreciation, which exceeds an appropriate index (i.e. Barclays Credit Index, etc.) over a rolling five year time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

## Global Equity Investments

The objectives for investment managers of the domestic equity component of the total portfolio are:

(1) Achieve returns which exceed an appropriate index, (i.e. Russell 3000, etc.) over a rolling five year time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

## Passive Equity Investment

The objective for investment managers of the passive domestic equity component of the total portfolio is to achieve returns equal to the appropriate index with minimal tracking error.

## Global and International Equity Investments

The objectives for investment managers of the international equity component of the total portfolio are:

(1) Achieve returns which exceed an appropriate index over a rolling five year time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

## High Yield and Bank Loan Investments

The objective for the investment managers of the High Yield and Bank Loan component of the total portfolio are:

(1) Achieve rates of return, which exceed an appropriate index (i.e. Merrill Lynch US High Yield Master Index, CSFB Leveraged Loan Index) over rolling five year time periods net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

## Convertible Bond Investments

The objective for the investment managers of the Convertible Bond component of the total portfolio are:

(1) Achieve rates of return, which exceed the Merrill Lynch Global 300 Convertible Index over a rolling five year time period net of fees. If the performance history extends beyond five years, the manager will be required to exceed the index over a majority of the rolling five year periods.

## Real Estate Investments

(1) Achieve returns which exceed an appropriate index, (i.e. NCRIEF) net of fees over a five-year market cycle.

## Private Equity Investments

(1) Achieve returns, which exceed an appropriate index (i.e., Venture Economics Private Equity Index) net of fees over a five-year market cycle.

## Real Assets

(1) Achieve returns which exceed an appropriate index (i.e., Dow-Jones UBS Commodity Index, SSgA Brookfield Infrastructure Index) net of fees over a five-year market cycle.

## Hedge Funds

(1) Achieve returns which exceed an appropriate index (i.e., HFRI Equity Hedge Index) net of fees over a five-year market cycle.

## Monitoring of Money Managers

It is the Board's policy to monitor the portfolios of the investment managers for prudent adherence to the approved performance guidelines. Quarterly performance should be evaluated to test progress toward the attainment of longer term targets. It is understood that there are likely to be short term periods during which performance deviates from market indices. During such times, greater emphasis shall be placed on peer-performance comparisons with managers employing similar styles. In addition, manager holdings will be periodically monitored to ensure that they are adhering to expected investment styles and disciplines.

# Statement of Investment Policy *(Continued)*

On a timely basis, the Board shall meet to focus on:

- Manager's adherence to the IPS guidelines;
- Material changes in the manager's organization, investment philosophy and/or personnel; and,
- Comparisons of the manager's results to appropriate indices and peer groups as described in the performance objectives and control section.

The risk associated with the manager's portfolio, as measured by the variability of quarterly returns (standard deviation), must not exceed that of the benchmark index and the peer group without a corresponding increase in performance above the benchmark and peer group.

Major organizational changes also warrant immediate review of the manager, including:

- Change in professionals
- Significant account losses
- Significant growth of new business
- Change in ownership

The performance of the System's investment managers will be monitored on an ongoing basis and it is at the Board's discretion to take corrective action by replacing a manager if they deem it appropriate at any time.

## Periodic Reviews of Manager Performance

The performance of each manager should be reviewed versus its benchmark at least every quarter. These benchmarks will normally consist of both asset class indexes and peer group universes. Each manager's performance should exceed their passive index benchmark net of fees and each manager should be above the median of an appropriate universe over most full market cycles.

As good managers will occasionally have poor performance for several periods, there is some grace period permitted for performance to improve. Conversely, the performance should be reviewed with sufficient frequency to permit identification of substandard performance as quickly as possible.

All managers will be reviewed continuously by the Consultant, Staff, and the Director. Underperforming managers will be reviewed on a case by case basis, and written records shall be kept. All managers are subject to termination at the Board's request, based on advice from the Consultant, Staff, and the Director.

## Extraordinary Reviews of Managers

If an event occurs within a manager's organization or is likely to impact the manager's organization, the Director of Retirement Services, shall make a determination whether such event compromises the investment process or in any other manner might negatively impact the management of the System's assets.

Such events would include but are not limited to:

a) Loss of any significant investment professional directly involved with the management of Plan assets or of such significance to the manager's overall investment process as to call into question the future efficacy of that process.

b) Sale, offer for sale, or offer to purchase the manager's business to/by another entity.

c) Significant financial difficulty or loss of a sizable portion of the manager's assets under management.

d) Filing or announcement of regulatory action of non-trivial nature, particularly that involving violations of the Investment Advisers Act of 1940, the Securities Act of 1933, or the Securities Exchange Act of 1934, or any state Blue Sky Law to which the manager is subject.

e) Any other event which in the discretion of the Director appear to put the System's assets at risk of loss, either actual or opportunity.

Any of these events may trigger a due diligence visit to the firm by the Investment Committee, Consultant, and/or Staff, being placed on the watch list, being put on probation or termination depending on the seriousness of the event and the probability of impacting the management of the System's assets.

Please visit http://www.sjretirement.com/Fed/Investments/Investments.asp for a complete and most current Statement of Investment Policy.

# Investment Professionals

*As of June 30, 2012*

## Global Equity

Artisan Partners LP
Global Value Equity
San Francisco, CA

Calamos
Global Convertibles
Naperville, IL

Northern Trust Global Investments
MSCI ACWI Index
Chicago, IL

Vanguard (Healthcare Trust)
Russell 3000
Developed Markets Index
Emerging Markets Stock Index
Valley Forge, PA

## International Equity

Russell Investments
MSCI EAFE Growth
MSCI EAFE Small Cap
Seattle, WA

## Emerging Equity

Northern Trust Global Investments
MSCI Emerging Markets Index
Chicago, IL

## Domestic Equity

Eagle Asset Management
Small Cap Growth
St. Petersburg, FL

Northern Trust Global Investments
Russell 3000 Index
Chicago, IL

RS Investments
Small Cap Value
San Francisco, CA

## Private Equity

Great Hill Partners
Boston, MA

Pantheon Ventures
San Francisco, CA

Partners Group (US) LP
New York, NY

Pathway Capital Management, LLC
Irvine, CA

## Domestic Fixed Income

MacKay Shields LLC
High Yield Active Core
New York, NY

Northern Trust Global Investments
Long Term Credit Bond Index
Chicago, IL

Russell Investments
Barclays U.S. TIPS
Seattle, WA

Seix Investment Advisors LLC
Credit Dislocation
Upper Saddle River, NJ

Vanguard (Healthcare Trust)
Total Bond Market Index
Inflation-Protected Securities
Valley Forge, PA

## Infrastructure

Russell Investments
S&P Global Infrastructure Swap
Seattle, WA

## Commodities

First Quadrant (Pension &
Healthcare Trusts)
Risk Parity Commodity Index
Pasadena, CA

Credit Suisse (Pension &
Healthcare Trusts)
Compound Risk Parity Commodity Index
San Francisco, CA

## Real Estate

American Realty Advisors
Glendale, CA

DRA Advisors, Inc.
New York, NY

Fidelity Investments
Boston, MA

GE Asset Management
Stamford, CT

Prudential Real Estate Investors
Newark, NJ

## Opportunistic

GSO Capital Partners
Direct Lending Account
New York, NY

Medley Capital LLC
Opportunity Fund II
San Francisco, CA

White Oak Global Advisors, LLC
Direct Lending Account
San Francisco, CA

## Consultants

Albourne America LLC – Absolute Return
San Francisco, CA

Meketa Investment Group
– General Consultant
Carlsbad, CA

## Custodian

State Street Bank & Trust Company
Boston, MA

## Proxy Voting

Glass Lewis & Co. LLC
San Francisco, CA

## Portfolio Overlay Services

Russell Investments
Seattle, WA

# Schedule of Investment Results for Pension Trust

## GROSS PERFORMANCE SUMMARY BY ASSET CLASS

*For the Fiscal Year Ended June 30, 2012*

| | One Year | Three Years | Five Years | Ten Years |
|---|---|---|---|---|
| **Total Fund** (gross of fees) | **-2.4%** | **9.8%** | **1.3%** | **6.4%** |
| **Total Fund** (net of manager fees) | **-2.5%** | **9.6%** | **1.1%** | **6.1%** |
| **Total Fund With Overlay** (gross of fees) | **-3.0%** | **9.6%** | **1.2%** | **6.4%** |
| **Total Fund With Overlay** (net of manager fees) | **-3.2%** | **9.4%** | **1.0%** | **6.1%** |
| Policy Benchmark | -2.3% | 10.1% | 1.9% | 6.1% |
| Master Trust Public Funds > $1 Billion (Median) | 1.1% | 11.9% | 1.9% | 6.6% |
| **Total Global Equity** | **-7.1%** | **N/A** | **N/A** | **N/A** |
| MSCI ACWI IMI | -6.9% | 11.3% | -2.4% | 6.2% |
| **Total Private Equity** | **9.7%** | **13.2%** | **4.7%** | **N/A** |
| Venture Economics PE Composite (lagged one quarter) | 9.6% | 17.1% | 6.3% | 10.5% |
| **Total Real Estate** | **12.1%** | **-0.3%** | **-3.6%** | **7.1%** |
| NCREIF Property Index (lagged one quarter) | 12.4% | 8.9% | 2.6% | 8.3% |
| **Total Public Fixed Income** | **7.8%** | **9.4%** | **7.7%** | **6.8%** |
| Barclays U.S. TIPS | 11.7% | 9.6% | 8.4% | 7.2% |
| Barclays U.S. TIPS 1-5 Year | 1.7% | 4.8% | 5.1% | N/A |
| Barclays Intermediate Government Bond Index | 5.0% | 4.4% | 5.8% | 4.6% |
| **Total Private Debt** | **13.6%** | **N/A** | **N/A** | **N/A** |
| 3-month LIBOR + 5% | 5.5% | 5.4% | 6.7% | N/A |
| **Total Real Assets** | **-10.9%** | **N/A** | **N/A** | **N/A** |
| Custom Risk Parity Benchmark | -9.5% | N/A | N/A | N/A |
| S&P Global Infrastructure Index | -4.2% | 10.5% | -1.8% | N/A |
| Dow Jones Commodities U.S. Index | -14.4% | 3.4% | -4.4% | 3.8% |
| CPI-U + 5% | 6.7% | 7.2% | 7.0% | 7.6% |

*Basis of Calculation: Time-Weighted Rate of Return*

**Source:** Meketa Investment Group's Fund Evaluation Report dated June 30, 2012

# Schedule of Investment Results for Healthcare Trust

## GROSS PERFORMANCE SUMMARY BY ASSET CLASS

*For the Fiscal Year Ended June 30, 2012*

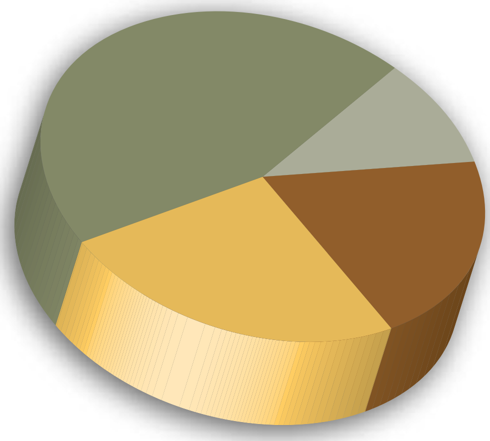
| | 2Q2012 | Calendar YTD | One Year | Since Inception |
|---|---|---|---|---|
| **Total Fund** (net of manager fees) | **-3.1%** | **4.2%** | **0.6%** | **0.6%** |
| Policy Benchmark | -3.0% | 4.2% | -2.1% | -2.1% |
| **Total Global Equity** | **-5.3%** | **6.4%** | **N/A** | **5.3%** |
| Global Equity HC Policy Benchmark | -5.5% | 6.0% | -6.4% | 5.8% |
| MSCI ACWI IMI | -5.7% | 5.8% | -6.9% | 5.5% |
| **Total Fixed Income** | **2.6%** | **3.1%** | **N/A** | **3.8%** |
| Fixed Income HC Policy Benchmark | 2.6% | 3.1% | 9.4% | 3.8% |
| Barclays Aggregate | 2.1% | 2.4% | 7.5% | 3.5% |
| Barclays U.S. TIPS | 3.2% | 4.0% | 11.7% | 4.1% |
| **Total Real Assets** | **-5.4%** | **-4.5%** | **N/A** | **-14.2%** |
| Custom Risk Parity Benchmark | -4.2% | -2.7% | -9.5% | -12.2% |

*Basis of Calculation: Time-Weighted Rate of Return*

**Source:** Meketa Investment Group's Fund Evaluation Report dated June 30, 2012

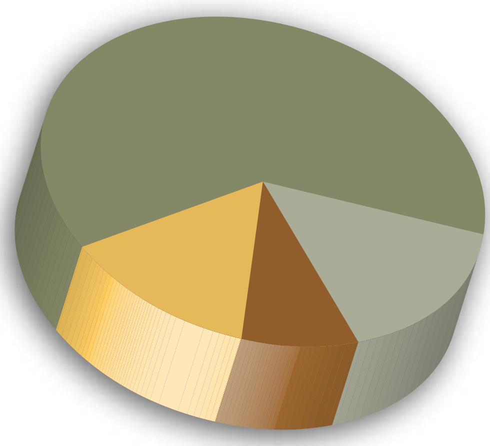
# Investment Review

## TARGET ASSET ALLOCATION *As of June 30, 2012*



| | | |
|---|---|---|
| Equity *(Public and private equity, and real estate)* | | 45% |
| Fixed Income | | 10% |
| Real Assets | | 20% |
| Hedge Funds | | 25% |
| **TOTAL** | | **100.0%** |

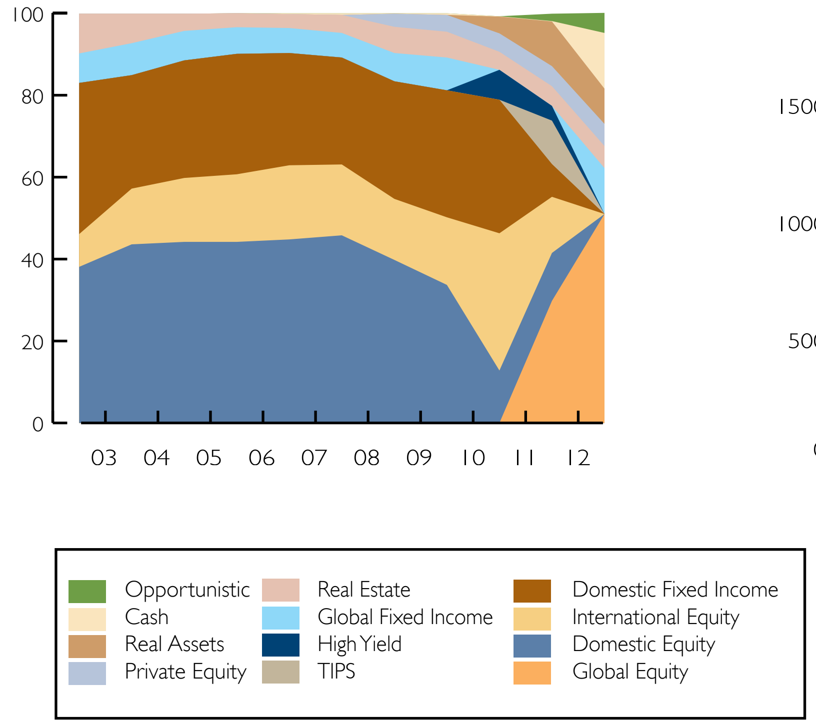
## ACTUAL ASSET ALLOCATION (Dollars in Millions) *As of June 30, 2012*



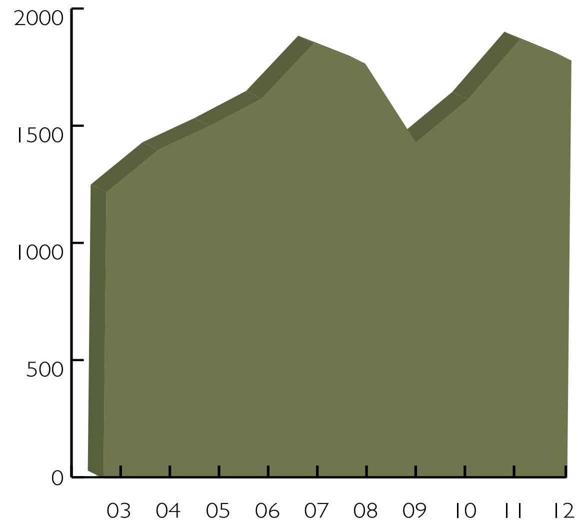
| | | $ in millions | |
|---|---|---|---|
| Equity *(Public and private equity, and real estate)* | $ | 1,103.35 | 61.7% |
| Fixed Income | $ | 287.34 | 16.1% |
| Real Assets | $ | 153.87 | 8.6% |
| Short Term Investment Funds | $ | 242.85 | 13.6% |
| **TOTAL** | **$** | **1,787.41** | **100.0%** |

Non-GAAP Basis

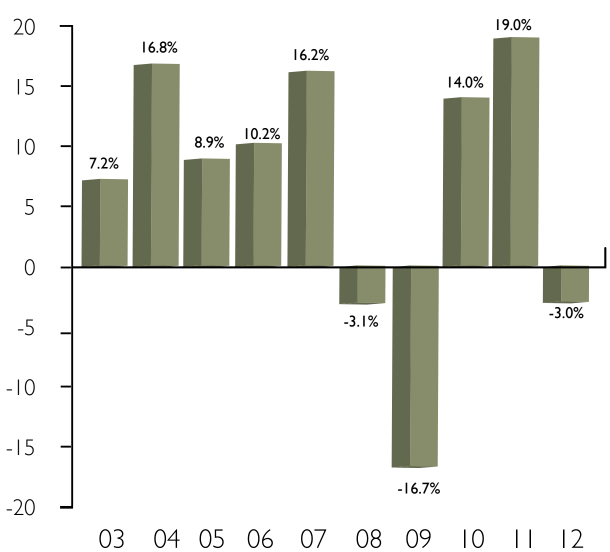
## HISTORICAL ASSET ALLOCATION (Actual)
*June 30, 2003- June 30, 2012*



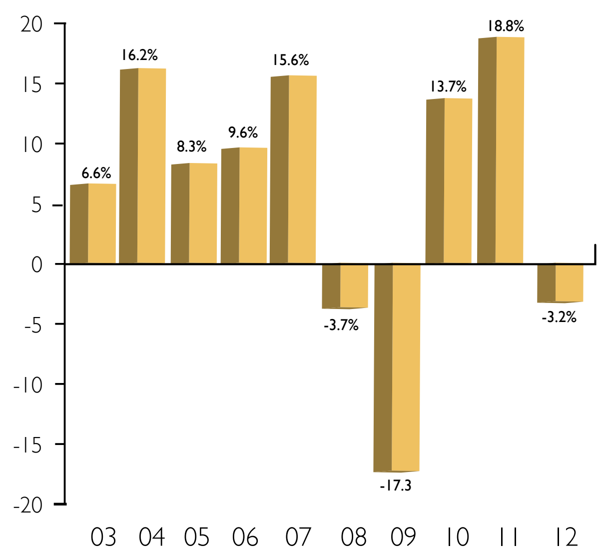

## MARKET VALUE GROWTH OF PLAN ASSETS
*For Ten Years Ended June 30, 2012 (Dollars in Millions)*




## HISTORY OF GROSS PERFORMANCE FOR FISCAL YEARS 2003 - 2012
*(Based on Market Value)*




## HISTORY OF NET PERFORMANCE FOR FISCAL YEARS 2003 - 2012
*(Based on Market Net Value)*



# List of Largest Assets Held

### LARGEST STOCK HOLDINGS (By Market Value) For both Pension and Healthcare Trust *As of June 30, 2012*

| Description | Country | Shares | Market Value ($US) |
|---|---|---|---|
| VANGUARD RUSSELL 3000 INDEX (VRTTX) * | United States | 50,629 | $ 6,133,638 |
| VANGUARD DEVELOPED MARKETS INDEX (VIDMX) * | Various Countries | 641,129 | $ 5,609,875 |
| COMPASS GROUP PLC | United States | 395,271 | $ 4,147,552 |
| ORACLE CORP | United States | 110,342 | $ 3,277,157 |
| GOOGLE INC CL A | United States | 5,582 | $ 3,237,951 |
| TE CONNECTIVITY LTD | United States | 101,361 | $ 3,234,430 |
| ARCH CAPITAL GROUP LTD | United States | 79,217 | $ 3,144,123 |
| DIAGEO PLC | United States | 119,581 | $ 3,079,684 |
| AON PLC | United States | 65,330 | $ 3,056,137 |
| BANK OF NEW YORK MELLON CORP | United States | 137,878 | $ 3,026,422 |

*A complete list of portfolio holdings is available upon request.*
** Represents investments in the Healthcare Trust portfolio*

### LARGEST BOND HOLDINGS (By Market Value)
*As of June 30, 2012*

| Security Name | Country | Maturity Date | Interest Rate | Par Value | Market Value ($US) |
|---|---|---|---|---|---|
| TSY INFL IX N/B | United States | 04/15/2014 | 1.25 | 80,327,083 | $ 82,931,287 |
| TSY INFL IX N/B | United States | 01/15/2020 | 1.38 | 35,727,051 | $ 41,538,413 |
| MICROSOFT CORP | United States | 06/15/2013 | 0.00 | 2,540,000 | $ 2,695,575 |
| SHIRE PLC | United States | 05/09/2014 | 2.75 | 1,850,000 | $ 2,097,438 |
| ANDERSON PLANT, LLC | United States | 04/05/2012 | 1.00 | 2,025,000 | $ 2,025,000 |
| ITALKITCHEN INTERNATIONAL, INC | United States | 04/15/2014 | 1.00 | 4,016,889 | $ 2,019,883 |
| TEMASEK FINANCIAL III PR | United States | 10/24/2014 | 0.01 | 2,250,000 | $ 1,835,274 |
| GOLDCORP INC | United States | 08/01/2014 | 2.00 | 1,500,000 | $ 1,689,375 |
| SIEMENS FINANCIERINGSMAT | United States | 08/16/2017 | 1.05 | 1,750,000 | $ 1,682,275 |
| SYMANTEC CORP | United States | 06/15/2013 | 1.00 | 1,635,000 | $ 1,673,831 |

*A complete list of portfolio holdings is available upon request.*

# Schedule of Investment Fees

*For the Fiscal Year Ended June 30, 2012*

| | Assets Under Management at Market Value* | Fees | Basis Points |
|---|---|---|---|
| **Investment Managers' Fees** | | | |
| Global Equity | $ 910,753,920 | $ 2,480,131 | 27 |
| Private Equity | 96,589,741 | 1,050,762 | 109 |
| Real Estate | 96,010,542 | 1,367,162 | 142 |
| Global Fixed Income | 199,373,206 | 582,779 | 29 |
| Opportunistic | 87,968,655 | 1,026,055 | 117 |
| Real Assets | 153,867,397 | 463,684 | 30 |
| Short Term | 242,848,623 | - | N/A |
| **TOTAL INVESTMENT MANAGERS' FEES** | **$ 1,787,412,085** | **$ 6,970,573** | **39** |

** Includes Cash in Managers' Accounts; Non-GAAP Basis*

| | Fees |
|---|---|
| **Other Investment Service Fees** | |
| Investment Consultant | $ 410,000 |
| Custodian Bank | 198,607 |
| Proxy Voting | 14,495 |
| Real Estate Legal Fees | 1,097 |
| Investment Legal Fees | 25,289 |
| **TOTAL OTHER INVESTMENT SERVICE FEES** | **$ 649,488** |

# Schedule of Commissions

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| **A** | | | |
| ABG SECURITIES LIMITED | 3,242,841.00 | $ 102.03 | $ 0.0000 |
| ALLEN & COMPANY LLC | 19,136.00 | 765.44 | 0.0400 |
| ANCORA SECIRITIES INC | 1,787.00 | 71.48 | 0.0400 |
| AQUA SECURITIES LP | 17,485.00 | 349.70 | 0.0200 |
| ASSET TRANSFER | 44,832,255.08 | 2,181.95 | 0.0000 |
| AUTREPAT-DIV RE | 88,351.00 | 1,481.06 | 0.0168 |
| AVONDALE PARTNERS LLC | 6,224.00 | 205.72 | 0.0331 |
| **B** | | | |
| BANCO SANTANDER DE NEGOCIOS | 10,999.00 | 406.94 | 0.0370 |
| BANQUE NATIONALE DU CANADA | 35,273.00 | 1,398.06 | 0.0396 |
| BARCLAYS CAPITAL | 4,712,757.36 | 11.28 | 0.0000 |
| BARCLAYS CAPITAL INC LE | 1,694,093.00 | 8,362.86 | 0.0049 |
| BLOOMBERGTRADEBOOK LLC | 471,806.00 | 9,436.12 | 0.0200 |
| BMO CAPITAL MARKETS | 16,085.00 | 643.40 | 0.0400 |
| BNP PARIBAS SECURITIES CORPORATION | 15,363.00 | 614.52 | 0.0400 |
| BTIG, LLC | 37,438.00 | 790.24 | 0.0211 |
| **C** | | | |
| CANACCORDGENUITY CORP | 2,000.00 | 48.19 | 0.0241 |
| CANACCORDGENUITY INC | 12,186.00 | 384.96 | 0.0316 |
| CANTOR FITZGERALD & CO | 65,731.00 | 1,575.04 | 0.0240 |
| CHARLES RIVER BROKERAGE | 210.00 | 2.63 | 0.0125 |
| CIBC WORLD MARKETS CORP | 1,500.00 | 60.00 | 0.0400 |
| CIBC WORLD MKTS INC | 7,450.00 | 298.17 | 0.0400 |
| CITATION GROUP | 36,082.00 | 1,443.28 | 0.0400 |
| CITIGROUPGLOBAL MARKETS INC | 53,897,040.60 | 8,469.11 | 0.0041 |
| CITIGROUPGLOBAL MARKETS LIMITED | 30,746.00 | 615.91 | 0.0200 |
| CITIGROUPGLOBAL MARKETS UK EQUITY LTD | 11,338.00 | 83.62 | 0.0074 |
| CONVERGEXEXECUTION SOLUTIONS LLC | 483.00 | 19.32 | 0.0400 |
| COWEN ANDCOMPANY, LLC | 17,494.00 | 691.12 | 0.0395 |
| CRAIG - HALLUM | 4,800.00 | 149.00 | 0.0310 |
| CREDIT AGRICOLE INDOSUEZ CHEUVREUX | 1,749.00 | 80.83 | 0.0462 |
| CREDIT AGRICOLE INVESTOR SERVICES BANK | 1,036.00 | 84.03 | 0.0811 |
| CREDIT LYONNAIS SECURITIES (USA) INC | 108,174.76 | 53.19 | 0.0005 |
| CREDIT SUISSE SECURITIES (EUROPE) LTD | 30,014,591.00 | 383.73 | 0.0000 |
| CREDIT SUISSE SECURITIES (USA) LLC | 2,983,297.00 | 3,515.11 | 0.0012 |
| **D** | | | |
| DAVIDSON D.A. & COMPANY INC | 20,851.00 | 601.72 | 0.0289 |
| DEN NORSKE BANK | 6,094.00 | 33.22 | 0.0055 |
| DEUTSCHE BANK SECURITIES INC | 2,988,927.03 | 2,268.52 | 0.0008 |

Non-GAAP Basis

# Schedule of Commissions *(Continued)*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| **D** (continued) | | | |
| DOWLING & PARTNERS | 8,315.00 | $ 332.60 | $ 0.0400 |
| DOWLING & PARTNERS SECURITIES, LLC | 36,384.00 | 1,455.36 | 0.0400 |
| **E** | | | |
| EVERCORE GROUP LLC | 4,833.00 | 193.32 | 0.0400 |
| **F** | | | |
| FIDELITY CLEARING CANADA | 1,900.00 | 56.59 | 0.0298 |
| FIRST ANALYSIS SECURITIES CORP | 400.00 | 16.00 | 0.0400 |
| FRIEDMAN BILLINGS & RAMSEY | 41,349.00 | 1,579.36 | 0.0382 |
| **G** | | | |
| G TRADE SERVICES LTD | 2,100.00 | 14.72 | 0.0070 |
| GMP SECURITIES LP | 10,031.00 | 401.24 | 0.0400 |
| GOLDMAN SACHS & CO | 1,311,475,628.89 | 3,427.40 | 0.0000 |
| GOLDMAN SACHS INTERNATIONAL | 53,885.00 | 774.03 | 0.0144 |
| GUGGENHEIM CAPITAL MARKETS LLC | 9,104.00 | 364.16 | 0.0400 |
| **H** | | | |
| HSBC BANKPLC | 72,810.00 | 591.05 | 0.0081 |
| **I** | | | |
| INSTINET | 30,890.00 | 432.70 | 0.0140 |
| INSTINET U.K. LTD | 12.00 | 0.05 | 0.0042 |
| INVESTMENT TECHNOLOGY GROUP INC | 797,351.00 | 24,914.81 | 0.0312 |
| INVESTMENT TECHNOLOGY GROUP LTD | 23,286.00 | 180.66 | 0.0078 |
| ISI GROUPINC | 58,141.00 | 2,325.64 | 0.0400 |
| ISLAND TRADER SECURITIES INC | 14,131.00 | 565.24 | 0.0400 |
| ITG INC | 7,693.00 | 118.90 | 0.0155 |
| ITG SECURITIES (HK) LTD | 2,000.00 | 7.68 | 0.0038 |
| **J** | | | |
| J P MORGAN | 4,800.00 | 47.00 | 0.0098 |
| J P MORGAN SECURITIES INC | 654,418.00 | 376.72 | 0.0006 |
| J.P. MORGAN CLEARING CORP | 1,390,618.00 | 1,736.73 | 0.0141 |
| J.P. MORGAN SECURITIES ASIA PRIVATE DBS | 2,600.00 | 26.13 | 0.0101 |
| J.P. MORGAN SECURITIES INC | 3,094,395.00 | 858.13 | 0.0003 |
| JANNEY MONTGOMERY, SCOTT INC | 11,374.00 | 454.96 | 0.0400 |
| JEFFERIES & COMPANY INC | 2,052,428.00 | 2,908.47 | 0.0014 |
| JMP SECURITIES | 8,941.00 | 357.64 | 0.0400 |
| JONES & ASSOCIATES INC | 1,785.00 | 35.70 | 0.0200 |
| JONESTRADING INSTITUTIONAL SERVICES LLC | 2,764.00 | 61.24 | 0.0222 |
| JP MORGANSECURITIES PLC | 1,492,902.00 | 1,440.61 | 0.0010 |
| JPMORGAN CHASE BANK, N.A. | 3,200.00 | 128.45 | 0.0401 |

# Schedule of Commissions *(Continued)*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| **K** | | | |
| KEEFE BRUYETTE & WOODS INC | 41,034.00 | $ 1,624.02 | $ 0.0396 |
| KEYBANC CAPITAL MARKETS INC | 23,963.00 | 794.36 | 0.0331 |
| KIM ENG SECURITIES (HK) LTD | 592.00 | 6.00 | 0.0101 |
| KING, CL, & ASSOCIATES, INC | 4,309.00 | 129.27 | 0.0300 |
| KNIGHT CLEARING SERVICES LLC | 1,500.00 | 60.00 | 0.0400 |
| KNIGHT EQUITY MARKETS LP | 24,102.00 | 618.52 | 0.0257 |
| **L** | | | |
| LAZARD CAPITAL MARKETS LLC | 1,339.00 | 24.69 | 0.0184 |
| LEERINK SWANN AND COMPANY | 22,938.00 | 900.17 | 0.0392 |
| LEK SECURITIES CORP | 22,910.00 | 458.20 | 0.0200 |
| LIQUIDNETASIA LIMITED | 1,621.00 | 12.24 | 0.0076 |
| LIQUIDNETINC | 75,159.00 | 1,217.13 | 0.0162 |
| **M** | | | |
| MACQUARIEBANK LIMITED | 4,246.00 | 392.23 | 0.0924 |
| MACQUARIESECURITIES (USA) INC | 3,924.00 | 156.96 | 0.0400 |
| MAINFIRSTBANK DE | 1,322.00 | 101.92 | 0.0771 |
| MERRILL LYNCH INTERNATIONAL | 27,474.00 | 396.77 | 0.0144 |
| MERRILL LYNCH PIERCE FENNER & SMITH INC | 2,121,359.00 | 42,511.13 | 0.0200 |
| MERRILL LYNCH PROFESSIONAL CLEARING CORP | 569.00 | 22.76 | 0.0400 |
| MONNESS, CRESPI, HARDT & CO INC | 4,309.00 | 129.27 | 0.0300 |
| MORGAN KEEGAN & CO INC | 995.00 | 39.80 | 0.0400 |
| MORGAN STANLEY CO INCORPORATED | 740,002.00 | 5,907.05 | 0.0080 |
| **N** | | | |
| NATIONAL FINANCIAL SERVICES CORP | 2,550.00 | 76.50 | 0.0300 |
| NBC CLEARING SERVICES INCORPORATED | 3,600.00 | 144.80 | 0.0402 |
| NEEDHAM & COMPANY | 3,069.00 | 122.76 | 0.0400 |
| NESBITT BURNS | 19,250.00 | 752.95 | 0.0391 |
| NOMURA SECURITIES INTERNATIONAL INC | 823,811.00 | 601.65 | 0.0007 |
| **O** | | | |
| OPPENHEIMER & CO. INC | 328,643.00 | 1,225.72 | 0.0037 |
| **P** | | | |
| PENSON FINANCIAL SERVICES CANADA INC | 18,076.00 | 709.96 | 0.0393 |
| PERSHING LLC | 179,095,181.05 | 69,074.99 | 0.0004 |
| PERSHING SECURITIES LIMITED | 4,600.00 | 75.63 | 0.0164 |
| PICKERINGENERGY PARTNERS, INC | 11,649.00 | 465.96 | 0.0400 |
| PIPER JAFFRAY | 497,559.00 | 5,311.52 | 0.0107 |
| PIPER JAFFRAY & HOPWOOD | 9,181.00 | 367.24 | 0.0400 |
| PULSE TRADING LLC | 9,289.00 | 92.89 | 0.0100 |

# Schedule of Commissions *(Continued)*

| Brokerage Firm | Number of Shares Traded | Total Commissions | Commission Per Share |
|---|---|---|---|
| **R** | | | |
| RAYMOND JAMES AND ASSOCIATES INC | 28,406.00 | $ 701.75 | $ 0.0247 |
| RBC CAPITAL MARKETS | 47,886.00 | 1,509.60 | 0.0315 |
| RBC DOMINION SECURITIES INC | 12,614.00 | 495.40 | 0.0393 |
| REDBURN PARTNERS LLP | 76,787.00 | 802.16 | 0.0104 |
| REYNDERS, GRAY & COMPANY, INC | 858.00 | 25.74 | 0.0300 |
| ROBERT W.BAIRD CO INCORPORATE | 95,744.00 | 2,688.88 | 0.0281 |
| ROCHDALE SEC CORP (CLS THRU 443) | 5,950.00 | 119.00 | 0.0200 |
| ROSENBLATT SECURITIES LLC | 2,669.00 | 53.38 | 0.0200 |
| ROYAL BANK OF CANADA | 36,400.00 | 1,463.89 | 0.0402 |
| **S** | | | |
| SANFORD C. BERNSTEIN LTD | 14,420.00 | 546.76 | 0.0379 |
| SANFORD C BERNSTEIN CO LLC | 51,441.00 | 1,484.82 | 0.0289 |
| SCOTIA CAPITAL (USA) INC | 18,654.00 | 373.08 | 0.0200 |
| SCOTT & STRINGFELLOW, INC | 6,095.00 | 216.60 | 0.0355 |
| SG AMERICAS SECURITIES LLC | 3,472.00 | 138.88 | 0.0400 |
| SIMMONS & COMPANY INTERNATIONAL | 6,175.00 | 247.00 | 0.0400 |
| SKANDINAVISKA ENSKILDA BANKEN LONDON | 7,008.00 | 38.23 | 0.0055 |
| SOCIETE GENERALE PARIS ZURICH BRA | 408.00 | 48.44 | 0.1187 |
| STATE STREET GLOBAL MARKETS, LLC | 279,757.00 | 5,905.74 | 0.0211 |
| STERNE AGEE & LEACH INC | 5,251.00 | 210.04 | 0.0400 |
| STIFEL NICOLAUS & CO INC | 68,940.00 | 1,663.77 | 0.0241 |
| SUNTRUST CAPITAL MARKETS, INC | 4,715.00 | 162.46 | 0.0345 |
| SVENSKA HANDELSBANKEN | 31,187.00 | 359.89 | 0.0115 |
| **T** | | | |
| TD WATERHOUSE CDA | 34,491.00 | 1,377.61 | 0.0399 |
| THINKPANMURE LLC | 1,016.00 | 40.64 | 0.0400 |
| **U** | | | |
| UBS AG | 26,572.00 | 216.15 | 0.0081 |
| UBS SECURITIES LLC | 150,414,424.22 | 554.73 | 0.0000 |
| **W** | | | |
| WEDBUSH MORGAN SECURITIES INC | 20,190.00 | 806.79 | 0.0400 |
| WEEDEN & CO | 2,497.00 | 74.91 | 0.0300 |
| WELLS FARGO SECURITIES, LLC | 1,791,421.00 | 2,056.96 | 0.0011 |
| WILLIAM BLAIR & COMPANY LLC | 21,328.00 | 663.95 | 0.0311 |
| WUNDERLICH SECURITIES INC | 38,980.00 | 1,559.20 | 0.0400 |
| **TOTAL** | **1,803,890,024** | **$ 254,996.30** | **$ 0.0001** |

# Investment Summary

*As of June 30, 2012*

| Type of Investment | | Fair Value | % of Portfolio |
|---|---|---|---|
| **Total Equity** | | | |
| Global Equity | $ | 910,753,921 | 50.96% |
| Private Equity | | 96,589,741 | 5.40% |
| Real Estate | | 96,010,542 | 5.37% |
| **Total Equity** | **$** | **1,103,354,204** | **61.73%** |
| **Total Fixed Income** | | | |
| Global Fixed Income | | 199,373,206 | 11.15% |
| Opportunistic | | 87,968,655 | 4.92% |
| **Total Fixed Income** | **$** | **287,341,861** | **16.07%** |
| **Alternatives** | | | |
| Real Assets | | 153,867,397 | 8.61% |
| **Total Alternatives** | **$** | **153,867,397** | **8.61%** |
| Short Term* | | 242,395,820 | 13.56% |
| International Currency Contracts | | 452,803 | 0.03% |
| **Total Fair Value**** | **$** | **1,787,412,085** | **100.00%** |

*Note: The amounts presented above may vary from the amounts presented in the financial statements due to the investment summary presenting amounts at the manager level and the financial statements presenting amounts at the security level.*

* Includes cash to support synthetic exposure.
**Includes Healthcare Trust assets.

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# Actuarial Section

City of San José
Federated City Employees' Retirement System
Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2012

# Actuary's Certification Letter

CHEIRON Classic Values, Innovative Advice

April 23, 2012

Retirement Board of the Federated City
Employees' Retirement System
1737 North 1st Street, Suite 580
San Jose, CA 95112

Dear Members of the Board:

At your request, we performed the June 30, 2011 actuarial valuation of the City of San Jose Federated City Employees' Retirement System ("System"). The detailed valuation results with respect to the System are contained in our actuarial valuation report issued January 17, 2012. The purpose of the actuarial valuation is to report on the financial condition, including historical and expected future trends, of the System as of the valuation date; to determine the City's and member contribution rates for the fiscal year ending June 30, 2013; and to provide other disclosure information required under Government Accounting Standards Board Statements No. 25 and 27. Historically, actuarial valuations were performed every two years. Since June 30, 2009, actuarial valuations have been performed annually.

The funding methods adopted by the System are designed to spread the cost of benefits over each employee's working career as a level percentage of pay. The funding ratio indicates the percentage of assets in the System compared to the amount targeted by the funding method as of the valuation date. Variations in the expected cost of the plan are amortized as a level percentage of expected payroll over closed 20-year periods (except the entire unfunded actuarial liability as of June 30, 2009 is amortized over a closed 30-year period).

At its October 2011 meeting, the Board adopted a number of assumption changes based on recommendations from our experience study. In particular, the Board reduced its investment return assumption from the 7.95% that was used in the prior valuation and the 7.75% that had been previously adopted for this valuation to 7.50%. The wage growth assumption was also reduced from 3.90% in the prior valuation to 3.25% in this valuation. Administrative expenses and the Supplemental Retiree Benefit Reserve (SRBR), which had been implicitly valued as part of the investment return assumption, are now explicitly valued as an addition to normal cost (0.70% of payroll for administrative expenses and 0.35% of the market value of assets for the SRBR). The changes in assumptions are summarized in the Actuarial Assumptions and Methods exhibits.

During the year, the System also experienced very significant changes in its assets and liabilities, including a 14% reduction in the number of active members and a 24% reduction in the expected payroll. The investment return for the year was nearly 19%, but due to asset smoothing, prior investment losses are still being phased in and as a result the return on the actuarial value of assets was only 5.5%.

- *Unfunded Actuarial Liability (UAL)/Surplus:* The UAL increased by approximately $200 million primarily due to the assumption changes ($188 million).

- *Funding Ratio:* The ratio of the actuarial value of assets to the actuarial liability declined since the last valuation from 69% to 65% due to the assumption changes. The actuarial value of assets is smoothed in order to mitigate the impact of investment performance volatility on employer contribution rates. Without the asset smoothing, the ratio of the market value of assets to the actuarial liability increased from 60% to 64% even with the impact of the assumption changes.

1750 Tysons Boulevard, Suite 1100, McLean, VA 22102 Tel: 703.893.1456 Fax: 703.893.2006 www.cheiron.us

- *Member Contribution Rate:* The member contribution rate is a proportion (3/11ths) of the service normal cost rate. The Member contribution rate increased from 4.68% to 4.82% due to demographic experience and from 4.82% to 5.74% due to the changes in assumptions.

- *City Contributions:* City contributions are a proportion (8/11ths) of the service normal cost rate plus the reciprocity normal cost rate plus an amortization payment on the UAL. City contributions as a percent of payroll increased significantly from 28.34% of payroll to 44.45% of payroll. However, the decrease in payroll exaggerates the increased cost to the City. The beginning of year contribution amount increased from $87 million to $103 million due primarily to the assumption changes. Based on the prior valuation, the contribution amount had been expected to increase to $105 million without all of the assumption changes.

More details on the plan experience for the past year, including the changes listed above and their impact on the June 30, 2011 valuation results can be found in our full report. In preparing our report, we relied without audit, on information (some oral and some written) supplied by the City of San Jose Department of Retirement Services. This information includes, but is not limited to, the plan provisions, employee data, and financial information. We performed an informal examination of the obvious characteristics of the data for reasonableness and consistency in accordance with Actuarial Standard of Practice #23.

We have prepared the following information for inclusion in this Comprehensive Annual Financial Report (CAFR) based on the June 30, 2011 actuarial valuation:

- Summary of Actuarial Assumptions and Methods
- Schedule of Active Member Valuation Data
- Schedule of Retirees and Beneficiaries Added to and Removed from Rolls
- Notes to Required Supplementary Information
- Analysis of Financial Experience
- Solvency Test
- Schedule of Funding Progress
- Summary of Plan Benefits

All historical information prior to the June 30, 2010 actuarial valuation shown in these exhibits is based on information reported by the prior actuary, Gabriel, Roeder, Smith and Company.

This letter and these exhibits were prepared exclusively for the purpose of completing required disclosures for this CAFR.

We hereby certify that, to the best of our knowledge, this letter and the exhibits named above, which are based on the information and data supplied by the City of San Jose Department of Retirement Services, are work products of Cheiron, Inc. These work products are complete and have been prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this letter and these exhibits. This letter does not address any contractual or legal issues. We are not attorneys and our firm does not provide any legal services or advice.

Sincerely,
Cheiron

| | |
|---|---|
| Gene Kalwarski, FSA, FCA, EA, MAAA | William R. Hallmark, ASA, FCA, EA, MAAA |
| *Consulting Actuary* | *Consulting Actuary* |

# Actuarial Assumptions and Methods

## Actuarial Assumptions

### 1. Investment Return Assumption

Assets are assumed to earn 7.5% net of investment.

### 2. Interest Credited to Member Contributions

3.00%, compounded annually.

### 3. Administrative Expenses

0.70% of payroll is added to the normal cost of the system for expected administrative expenses.

### 4. Future SRBR transfers

0.35% of the Market Value of Assets is added to the employer normal cost to estimate the average net transfer to the SRBR.

### 5. Salary Increase Rate

Wage inflation component: 3.25%

In addition, the following merit component is added based on an individual member's years of service:

**Table B-1**

**Salary Merit Increases**

| Years of Service | Merit/ Longevity | Years of Service | Merit/ Longevity |
|---|---|---|---|
| 0 | 4.50% | 8 | 0.60 |
| 1 | 3.50 | 9 | 0.50 |
| 2 | 2.50 | 10 | 0.45 |
| 3 | 1.85 | 11 | 0.40 |
| 4 | 1.40 | 12 | 0.35 |
| 5 | 1.15 | 13 | 0.30 |
| 6 | 0.95 | 14 | 0.25 |
| 7 | 0.75 | 15+ | 0.25 |

### 6. Family Composition

Percentage married is shown in the following Table B-2. Male retirees are assumed to be three years older than their partner, and female retirees are assumed to be two years younger than their partner.

**Table B-2**

**Percentage Married**

| Gender | Percentage |
|---|---|
| Males | 80% |
| Females | 60% |

### 7. Rates of Withdrawal/Termination

Sample rates of termination are shown in the following Table B-3.

20% of terminating employees are assumed to subsequently work for a reciprocal employer and receive 3.25% pay increases per year.

**Table B-3**

**Rates of Termination**

| Age | 0 Years of Service | 1-4 Years of Service | 5 or more Years of Service |
|---|---|---|---|
| 20 | 20% | 10.00% | 5.50% |
| 25 | 20 | 10.00 | 5.30 |
| 30 | 20 | 9.50 | 4.85 |
| 35 | 20 | 7.20 | 4.20 |
| 40 | 20 | 5.60 | 3.00 |
| 45 | 20 | 4.60 | 1.85 |
| 50 | 20 | 4.00 | 1.75 |
| 55 | 20 | 4.00 | 0.00 |
| 60 | 20 | 4.00 | 0.00 |
| 65 | 0 | 0.00 | 0.00 |

** Withdrawal/termination rates do not apply once a member is eligible for retirement*

### 8. Rates of Refund

Sample rates of vested terminated employees electing a refund of contributions are shown in the following Table B-4.

**Table B-4**

**Rates of Refund**

| Age | Refund |
|---|---|
| 20 | 40.0% |
| 25 | 30.0 |
| 30 | 25.0 |
| 35 | 20.0 |
| 40 | 15.0 |
| 45 | 10.0 |
| 50 | 4.0 |
| 55 | 0.0 |

### 9. Rates of Disability

Sample disability rates of active participants are provided in Table B-5.

| Table B-5 | |
|---|---|
| **Rates of Disability at Selected Ages** | |
| **Age** | **Disability** |
| 20 | 0.030% |
| 25 | 0.033 |
| 30 | 0.056 |
| 35 | 0.098 |
| 40 | 0.162 |
| 45 | 0.232 |
| 50 | 0.302 |
| 55 | 0.376 |
| 60 | 0.455 |
| 65 | 0.504 |
| 70 | 0.000 |

50% of disabilities are assumed to be duty related, and 50% are assumed to be non-duty.

### 10. Rates of Mortality for Healthy Lives

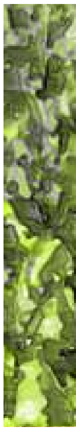
Mortality rates for actives, retirees, beneficiaries, terminated vested and reciprocals are based on the male and female RP-2000 combined employee and annuitant tables. To reflect mortality improvements since the date of the table and to project future mortality improvements, the tables are projected to 2015 using scale AA and setback two years. The resulting rates are used for all age cohorts.

| Table B-6 | | |
|---|---|---|
| **Rates of Mortality for Active and Retired Healthy Lives at Selected Ages** | | |
| **Age** | **Male** | **Female** |
| 20 | 0.0237% | 0.0152% |
| 25 | 0.0297 | 0.0155 |
| 30 | 0.0365 | 0.0196 |
| 35 | 0.0585 | 0.0344 |
| 40 | 0.0881 | 0.0484 |
| 45 | 0.1100 | 0.0747 |
| 50 | 0.1460 | 0.1092 |
| 55 | 0.2154 | 0.1841 |
| 60 | 0.4140 | 0.3639 |
| 65 | 0.8104 | 0.7094 |
| 70 | 1.4464 | 1.2471 |
| 75 | 2.4223 | 2.0673 |
| 80 | 4.3489 | 3.3835 |

### 11. Rates of Mortality for Retired Disabled Lives

| Table B-7 | | |
|---|---|---|
| **Rates of Mortality for Disabled Lives at Selected Ages** | | |
| **Age** | **Male** | **Female** |
| 20 | 0.664% | 0.478% |
| 25 | 0.719 | 0.492 |
| 30 | 0.790 | 0.512 |
| 35 | 0.984 | 0.548 |
| 40 | 1.666 | 0.674 |
| 45 | 1.646 | 0.985 |
| 50 | 1.632 | 1.245 |
| 55 | 1.936 | 1.580 |
| 60 | 2.293 | 1.628 |
| 65 | 3.174 | 1.969 |
| 70 | 3.870 | 3.019 |
| 75 | 6.001 | 3.915 |
| 80 | 8.388 | 5.555 |

Mortality rates for disabled retirees are based on the CALPERS ordinary disability mortality tables from their 2000-04 study for miscellaneous employees.



### 12. Rates of Retirement

Rates of retirement are based on age according to the following Table B-8.

| Table B-8 | | |
|---|---|---|
| Rates of Retirement by Age and Service | | |
| Age | Less than 30 Years of Service | 30 or more Years of Service |
| 50 | 0.0% | 60.0% |
| 51 | 0.0 | 60.0 |
| 52 | 0.0 | 60.0 |
| 53 | 0.0 | 60.0 |
| 54 | 0.0 | 60.0 |
| 55 | 17.5 | 50.0 |
| 56 | 8.5 | 50.0 |
| 57 | 8.5 | 50.0 |
| 58 | 8.5 | 50.0 |
| 59 | 9.5 | 50.0 |
| 60 | 9.5 | 50.0 |
| 61 | 16.0 | 50.0 |
| 62 | 16.0 | 50.0 |
| 63 | 16.0 | 50.0 |
| 64 | 16.0 | 50.0 |
| 65 | 25.0 | 60.0 |
| 66 | 25.0 | 60.0 |
| 67 | 25.0 | 60.0 |
| 68 | 25.0 | 60.0 |
| 69 | 25.0 | 60.0 |
| 70 & over | 100.0 | 100.0 |

### 13. Deferred Member Benefit

The benefit was estimated based on information provided by the Department of Retirement Services. The data used to value the estimated deferred benefit were credited service, date of termination, and last pay rate. Based on the data provided, highest average salary was estimated.

### 14. Other

The contribution requirements and benefit values of a plan are calculated by applying actuarial assumptions to the benefit provisions and member information, using the actuarial funding methods described in the following section.

Actual experience of Federated will not coincide exactly with assumed experiences, regardless of the choice of the assumptions, the skill of the actuary or the precision of the many calculations made. Each valuation provides a complete recalculation of assumed future experience and takes into account all past differences between assumed and actual experience. The result is a continual series of adjustments to the computed contribution rate. From time to time it becomes appropriate to modify one or more of the assumptions, to reflect experience trends, but not random year-to-year fluctuations.

### 15. Changes Since Last Valuation

Actuarial assumptions have been changed, based upon recommendations from the 2011 actuarial experience study that were adopted by the Board in October 2011. The changes affected the investment return, wage inflation, salary merit increase, family composition, termination rate, disability rate, retirement rate, healthy and disabled mortality, reciprocal rate, and refund rate assumptions. For a complete description of these changes, please refer to the experience study report dated May 12, 2011.

## Actuarial Methods

### 1. Actuarial Funding Method

The Entry Age Normal actuarial funding method was used for active employees, whereby the normal cost is computed as the level annual percentage of pay required to fund the retirement benefits between each member's date of hire and assumed retirement. The actuarial liability is the difference between the present value of future benefits and the present value of future normal costs and represents the target amount of assets the System should have as of the valuation date to fund the benefits as a level percentage of payroll.

### 2. Asset Valuation Method

For the purpose of determining the Employer's contribution, an actuarial value of assets is used. The asset smoothing method dampens the volatility in asset values that occur because of fluctuations in market conditions, resulting in a smoother pattern of contribution rates.

The actuarial value of assets is calculated by recognizing 20% of the difference in each of the prior four years of actual investment returns compared to the expected return on the market value of assets.

### 3. Amortization Method

The unfunded actuarial liability is the difference between the actuarial liability and the actuarial value of assets. The unfunded actuarial liability as of June 30, 2009 is amortized as a level percentage of pay over a closed 30-year period commencing June 30, 2009. Actuarial gains and losses, assumption changes, and plan changes are amortized as a level percentage of pay over 20-year periods beginning with the valuation date in which they first arise.

# Actuarial Assumptions and Methods *(Continued)*

### 4. Supplemental Retiree Benefit Reserve (SRBR)

Beginning with this valuation, the SRBR balance is added to the actuarial liability and the assets are included in the actuarial value of assets. In prior valuations, the SRBR balance was excluded from both the actuarial liability and the actuarial value of assets.

### 5. Contributions

At its November 2010 meeting, the Board adopted a policy setting the City's contribution to be the greater of the dollar amount reported in the actuarial valuation (adjusted for interest based on the time of the contribution) and the dollar amount determined by applying the percent of payroll reported in the actuarial valuation to the actual payroll for the fiscal year. The City and Member contributions determined by a valuation become effective for the fiscal year commencing one year after the valuation date.

# Member Valuation Data

SCHEDULE OF ACTIVE MEMBER DATA

| Valuation Date | Active count | Annual Payroll | Average Annual Pay | Percentage Change in Average Pay* |
|---|---|---|---|---|
| 2011 | $ 3,274 | $ 228,936,398 | $ 69,926 | -11.2% |
| 2010 | 3,818 | 300,811,165 | 78,788 | -0.5% |
| 2009 | 4,079 | 323,020,387 | 79,191 | 7.1 |
| 2007 | 3,942 | 291,404,606 | 73,923 | 7.0 |
| 2005 | 4,148 | 286,445,861 | 69,056 | 5.6 |
| 2003 | 4,479 | 292,961,371 | 65,408, | 15.6 |
| 2001 | 4,466 | 252,696,000 | 56,582 | 7.9 |
| 1999 | 3,694 | 193,650,000 | 52,423 | 8.3 |
| 1997 | 3,642 | 176,284,000 | 48,403 | 6.8 |
| 1995 | 3,397 | 153,918,000 | 45,310 | 4.4 |

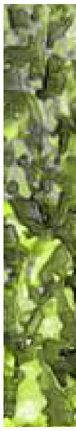
*Years prior to 2009 are increases over a two-year period, not an annual increase

# Changes in Retirants (Including Beneficiaries)

SCHEDULE OF RETIRANTS AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

| | Beginning of Period | | Added to Rolls | | Removed from Rolls | | End of Period | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Period | Count | Annual Allowances | Count | Annual Allowances | Count | Annual Allowances | Count | Annual Allowances | % Increase in Annual Allowances* | Average Annual Allowances |
| 2010-11 | 3,111 | $ 112,660,000 | 398 | $ 16,830,000 | 81 | $ 2,406,000 | 3,428 | $ 129,869,000 | 15.3% | $ 37,885 |
| 2009-10 | 2,930 | 101,194,000 | 206 | 10,700,373 | 79 | 2,203,960 | 3,111 | 112,660,000 | 11.3% | 36,213 |
| 2007-09 | 2,691 | 84,723,000 | 376 | 14,890,021 | 137 | 3,450,015 | 2,930 | 101,194,000 | 19.4 | 34,537 |
| 2005-07 | 2,426 | 69,466,000 | 389 | 13,818,131 | 124 | 2,721,303 | 2,691 | 84,723,000 | 22.0 | 31,484 |
| 2003-05 | 2,172 | 54,687,000 | 398 | 16,679,642 | 144 | 2,070,047 | 2,426 | 69,466,000 | 27.0 | 28,634 |
| 2001-03 | 2,030 | 45,208,000 | 313 | 10,151,748 | 171 | 503,802 | 2,172 | 54,587,000 | 21.0 | 25,178 |
| 1999-2001 | 1,824 | 37,137,000 | 230 | 6,655,000 | 24 | 268,000 | 2,030 | 45,208,000 | 21.7 | 22,270 |
| 1997-1999 | 1,745 | 32,630,000 | 202 | 4,642,000 | 123 | 1,514,000 | 1,824 | 37,137,000 | 13.8 | 20,360 |
| 1995-1997 | 1,636 | 29,029,000 | 190 | 4,143,000 | 81 | 946,000 | 1,745 | 32,630,000 | 12.4 | 18,699 |

*Years prior to 2009-2010 are increases over a two-year period, not an annual increase



# Solvency Test

| GASB SOLVENCY TEST<br>Actuarial Liabilities for: | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Valuation Date** | **Active Member Contributions** | **Retirees, Beneficiaries and Other Inactives** | **Remaining Active Members' Liabilities** | **Reported Assets*** | **Portion of Actuarial Liabilities Covered by Reported Assets** | | |
| June 30, ** | (A) | (B) | (C) | | (A) | (B) | (C) |
| 2011 | $ 234,574 | $ 1,848,254 | $ 687,400 | $ 1,788,660 | 100% | 84% | 0% |
| 2010 | 242,944 | 1,504,698 | 762,716 | 1,729,414 | 100% | 99% | 0% |
| 2009 | 228,967 | 1,393,114 | 864,074 | 1,756,588 | 100% | 100% | 16% |
| 2007 | 214,527 | 1,003,001 | 743,415 | 1,622,851 | 100% | 100% | 55% |
| 2005 | 230,027 | 824,043 | 657,300 | 1,384,454 | 100% | 100% | 50% |
| 2003 | 224,875 | 635,092 | 451,724 | 1,280,719 | 100% | 100% | 93% |
| 2001 | 210,377 | 529,853 | 332,103 | 1,060,144 | 100% | 100% | 96% |

*Amounts in thousands*

* *Actuarial Value of Assets*

** *Results prior to June 30, 2010 were calculated by the prior actuary*

# Actuarial Analysis of Financial Experience

*For the Ten-Year Period Ending June 30, 2011*

| | Change in Contribution Rate |
|---|---|
| **For Plan Year Ended June 30, 2011** | |
| Investment Performance | 2.69% |
| Liability Experience | 1.93% |
| Change in Assumptions | 12.55% |
| Change in Benefit Provision | 0.00% |
| **TOTAL** | **17.17%** |
| **For Plan Year Ended June 30, 2010** | |
| Phase-in of Contribution Rates | 2.91 % |
| Investment Performance | 3.03 % |
| Liability Experience | 1.24 % |
| Change in Assumptions | -1.88 % |
| Change in Benefit Provision | 0.00% |
| **TOTAL** | **5.30%** |
| **For Plan Year Ended June 30, 2009** | |
| Investment Performance | 1.63 % |
| Liability Experience | 1.19 % |
| Change in Assumptions | 5.22 % |
| Change in Benefit Provision | 0.00 % |
| **TOTAL** | **8.04 %** |
| **For Plan Year Ended June 30, 2007*** | |
| Investment Performance | (0.99)% |
| Liability Experience | 1.14 % |
| Change in Assumptions | 0.00 % |
| Change in Benefit Provision | 0.00 % |
| **TOTAL** | **0.15 %** |
| **For Plan Year Ended June 30, 2005** | |
| Investment Performance | 1.77% |
| Liability Experience | 2.37 % |
| Change in Assumptions | (0.59)% |
| Change in Benefit Provision | 0.00 % |
| **TOTAL** | **3.55 %** |
| **For Plan Year Ended June 30, 2003** | |
| Investment Performance | 2.78 % |
| Liability Experience | 2.60 % |
| Change in Asset Valuation Method | (2.48)% |
| Change in Assumptions | 0.00 % |
| Change in Benefit Provision | 0.00 % |
| **TOTAL** | **2.90 %** |
| **For Plan Year Ended June 30, 2001** | |
| Investment Performance | (0.46)% |
| Liability Experience | (1.62)% |
| Change in Assumptions | 0.00 % |
| Change in Benefit Provision | 1.51 % |
| **TOTAL** | **(0.57)%** |

** Change in employer contribution rate for retirement only*

# Summary of Plan Provisions

**1. Membership Requirement**

Participation in the Plan is immediate upon the first day of full-time employment.

**2. Final Compensation**

*Members who separated from city service prior to June 30, 2001:*

The highest average annual compensation earnable during any period of three consecutive years.

*Members who separated from city service on or after June 30, 2001:*

The highest average annual compensation earnable during any period of twelve consecutive months.

**3. Credited Service**

One year of service credit is given for 1,739 or more hours of Federated city service rendered in any calendar year. A partial year (fraction with the numerator equal to the hours worked, and the denominator equal to 1,739) is given for each calendar year with less than 1,739 hours worked.

**4. Member Contributions**

*Member:*

The amount needed to fund 3/11 of benefits accruing for the current year. These contributions are credited with interest at 3.0% per year, compounded annually.

*Employer:*

The Employer contributes the remaining amounts necessary to maintain the soundness of the Retirement System.

**5. Service Retirement**

*Eligibility*:

Age 55 with five years of service, or any age with 30 years of service.

*Benefit - Member:*

2.5% of Final Compensation for each year of credited service, subject to a maximum of 75% of Final Compensation.

*Benefit - Survivor:* 50% of the service retirement benefit paid to a qualified survivor.

**6. Service-Connected Disability Retirement**

*Eligibility*:

No age or service requirement.

*Benefit - Member*:

2.5% of Final Compensation for each year of credited service, subject to a minimum of 40% and a maximum of 75% of Final Compensation. Workers' Compensation benefits are generally offset from the service-connected benefits under this system.

*Benefit - Survivor:*

50% of the disability retirement benefit paid to a qualified survivor.

**7. Non-Service Connected Disability Retirement**

*Eligibility*:

5 years of service.

*Benefit - Member:*

Members who were hired prior to September 1, 1998:

The amount of the service-connected benefit reduced by 0.5% for each year that the disability age preceded 55.

Members who were hired on or after September 1, 1998:

20% of Final Compensation, plus 2% of Final Compensation for each year of credited service between six and 16 years, plus 2.5% of Final Compensation for each year of credited service in excess of 16 years, subject to a maximum of 75% of Final Compensation.

*Benefit - Survivor*:

50% of the disability retirement benefit paid to a qualified survivor.

**8. Death while an Active Employee**

*Less than five Years of Service, or No Qualified Survivor:*

Lump sum benefit equal to the accumulated refund of all employee contributions with interest, plus one month of salary for each year of service, up to a maximum of six years.

*Five or more Years of Service:*

2.5% of Final Compensation for each year of credited service, subject to a minimum of 40% and a maximum of 75% of Final Compensation. The benefit is payable until the spouse or registered domestic partner marries or establishes a domestic partnership. If the member was age 55 with 20 years of service at death, the benefit is payable for the lifetime of the member's spouse or registered domestic partner.

**9. Withdrawal Benefits**

*Less than five Years of Service:*

Lump sum benefit equal to the accumulated employee contributions with interest.

# Summary of Plan Benefits *(Continued)*

*Five or more years of credited service:*

The amount of the service retirement benefit, payable at age 55.

**10. Additional Post-retirement Death Benefit**

A death benefit payable as a lump sum equal to $500 will be paid to a qualified survivor upon the member's death.

**11. Post-retirement Cost-of-Living Benefit**

Benefits are increased every April 1 by 3.0%, regardless of actual inflation.

**12. Supplemental Retiree Benefit Reserve (SRBR)**

Each year, 10% of Excess Earnings, if any, are transferred to the SRBR, and the SRBR balance is credited with interest equal to the actual rate of return up to the actuarially assumed investment return, but not less than $0. The interest credited to the SRBR balance is distributed to retirees and beneficiaries along with any balance (before interest crediting) in excess of the minimum balance established by the Board ($7,000 per retiree/beneficiary).

CHEIRON Classic Values, Innovative Advice

April 23, 2012

VIA ELECTRONIC MAIL

Retirement Board of the Federated City
Employees' Retirement System
1737 North 1st Street, Suite 580
San Jose, California 95112

Dear Members of the Board:

At your request, we performed the June 30, 2011 actuarial valuation of the City of San Jose Federated Retiree Health Care Plan ("Plan"). The detailed valuation results with respect to the Plan are contained in our actuarial valuation report issued January 13, 2012. The purpose of the actuarial valuation is to report on the financial condition, including historical and expected future trends, of the Plan as of the valuation date; to determine the City's and member contribution rates for the fiscal year ending June 30, 2013; and to provide other disclosure information required under Government Accounting Standards Board Statements No. 43 and 45. Historically, actuarial valuations were performed every two years. Since June 30, 2009, actuarial valuations have been performed annually.

The funding methods adopted in collective bargaining and reflected by the Plan in this valuation are designed to spread the cost of benefits over each employee's working career as a level percentage of pay. The funding ratio indicates the percentage of assets in the Plan compared to the amount targeted by the funding method as of the valuation date. Because the effort to fully fund the Plan was started relatively recently with the entire unfunded actuarial liability as of June 30, 2009 being amortized over 30 years, the current funded status is relatively low. Variations in the expected cost of the Plan since June 30, 2009 are amortized as a level percentage of expected payroll over closed 20-year periods.

At its October 2011 meeting, the Board adopted a number of assumption changes for the pension plan based on recommendations from our experience study that also applies to the valuation of this Plan. In particular, the Board reduced its investment return assumption from the 7.95% that was used in the prior valuation and the 7.75% that had been previously adopted for this valuation to 7.50%. The wage growth assumption was also reduced from 3.90% in the prior valuation to 3.25% in this valuation. At its November 2011 meeting, the Board adopted assumptions specific to the OPEB valuation, including changes in assumed claims costs and a reduction in the expected return on employer assets from 4.5% to 4.0%. The changes in assumptions are summarized in the Actuarial Assumptions and Methods exhibits.

During the year, the Plan experienced very significant changes in its census, including a 14% reduction in the number of active members, a 10% increase in the number of retirees and spouses covered for retiree medical benefits, and a 24% reduction in expected payroll. Other key results from the valuation are as follows:

- *Unfunded Actuarial Liability (UAL)/Surplus:* On a financial reporting basis, the UAL increased $191.5 million from $818.4 million to $1,009.9 million. The Actuarial Liability increased $219.0 million and assets increased $27.5 million.
- *Funding Ratio:* The ratio of the actuarial value of assets to actuarial liabilities remained at 12% since the last valuation.
- *Member Contribution Rate:* The City has negotiated contracts with its labor unions that require both employee and City contributions to fund the Plan. The agreements call for a five year transition to fully funding the Annual Required Contribution (ARC) under GASB 43 and 45 using a straight line method with a limit of an annual increase of 0.75% of payroll for the member and the City rate. The contributions for retiree medical benefits are split evenly between employees and the City, and the contributions for retiree dental benefits are split in the ratio of eight to three with the City

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contributing 8/11 of the total contribution. The member contribution rate increased from 6.51 % to 7.26% of payroll. Without the phase-in, the member contribution rate would have been 14.47%.

- *City Contribution Rate:* The City contribution rate increased from 7.16% to 7.91% of payroll. Without the phase-in, the City contribution rate would have been 15.74%.

More details on the plan experience for the past year, including the changes listed above and their impact on these June 30, 2011 valuation results can be found in our full report. In preparing our report, we relied without audit, on information (some oral and some written) supplied by the City of San Jose Department of Retirement Services. This information includes, but is not limited to, the plan provisions, employee data, and financial information. We performed an informal examination of the obvious characteristics of the data for reasonableness and consistency in accordance with Actuarial Standards of Practice #23.

We have prepared the following information for inclusion in the Actuarial Section of this Comprehensive Annual Financial Report (CAFR) based on the June 30, 2011 actuarial valuation:

- Summary of Actuarial Assumptions and Methods
- Schedule of Active Member Data
- Schedule of Retirees and Beneficiaries Added to and Removed from Rolls
- Solvency Test
- Analysis of Financial Experience
- Summary of Key Substantive Plan Provisions

In addition, we have prepared the following information for inclusion in the Financial Section of this CAFR.

- Notes to Required Supplementary Information
- Schedule of Funding Progress
- Schedule of Employer Contributions

All historical information prior to the June 30, 2010 actuarial valuation shown in these exhibits is based on information reported by the prior actuary, Gabriel, Roeder, Smith and Company.

This letter and these exhibits were prepared exclusively for the purpose of completing required disclosures for this CAFR.

We hereby certify that, to the best of our knowledge, this letter and the exhibits named above, which are based on the information and data supplied by the City of San Jose Department of Retirement Services, are work products of Cheiron, Inc. These work products are complete and have been prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this letter and these exhibits. This letter does not address any contractual or legal issues. We are not attorneys and our firm does not provide any legal services or advice.

This letter and the exhibits named above do not reflect future changes in benefits, penalties, taxes, or administrative costs that may be required as a result of the Patient Protection and Affordable Care Act of 2010, related legislation, or regulations.

Sincerely,
Cheiron

William R. Hallmark, ASA, FCA, EA, MAAA
*Consulting Actuary*

Margaret A. Tempkin, FSA, EA, MAAA
*Principal Consulting Actuary*

Attachment

# Actuarial Assumptions and Methods

## Economic Assumptions:

**1. Expected Return on Plan Assets:** 7.50% per year

**2. Expected Return on Employer Assets:** 4.00% per year

**3. Blended Discount Rate:** 6.10% per year

**4. Per Person Cost Trends:**

| Date | Annual Increase | | |
|---|---|---|---|
| To Year Beginning July 1 | Pre-Medicare | Medicare Eligible | Dental |
| 2012 | 9.17% | 6.83% | 4.50% |
| 2013 | 8.83 | 6.67 | 4.50 |
| 2014 | 8.50 | 6.50 | 4.00 |
| 2015 | 8.17 | 6.33 | 4.00 |
| 2016 | 7.83 | 6.17 | 4.00 |
| | | | |
| 2017 | 7.50 | 6.00 | 4.00 |
| 2018 | 7.17 | 5.83 | 4.00 |
| 2019 | 6.83 | 5.67 | 4.00 |
| 2020 | 6.50 | 5.50 | 4.00 |
| 2021 | 6.17 | 5.33 | 4.00 |
| | | | |
| 2022 | 5.83 | 5.17 | 4.00 |
| 2023 | 5.50 | 5.00 | 4.00 |
| 2024 | 5.17 | 4.83 | 4.00 |
| 2025 | 4.83 | 4.67 | 4.00 |
| 2026+ | 4.50 | 4.50 | 4.00 |

Deductibles, Co-payments, Out-of-Pocket Maximums, and Annual Maximum are assumed to increase at the above trend rates.

## Demographic Assumptions:

**1. Retirement Rates:**

The following rates of retirement are assumed for members eligible to retire.

| Retirements by Age and Service | | |
|---|---|---|
| Age | Less than 30 Years of Service | 30 or more Years of Service |
| 50 | 0.0% | 60.0% |
| 51 | 0.0 | 60.0 |
| 52 | 0.0 | 60.0 |
| 53 | 0.0 | 60.0 |
| 54 | 0.0 | 60.0 |
| 55 | 17.5 | 50.0 |
| 56 | 8.5 | 50.0 |
| 57 | 8.5 | 50.0 |
| 58 | 8.5 | 50.0 |
| 59 | 9.5 | 50.0 |
| 60 | 9.5 | 50.0 |
| 61 | 16.0 | 50.0 |
| 62 | 16.0 | 50.0 |
| 63 | 16.0 | 50.0 |
| 64 | 16.0 | 50.0 |
| 65 | 25.0 | 60.0 |
| 66 | 25.0 | 60.0 |
| 67 | 25.0 | 60.0 |
| 68 | 25.0 | 60.0 |
| 69 | 25.0 | 60.0 |
| 70 & over | 100.0 | 100.0 |

# Actuarial Assumptions and Methods *(Continued)*

## Demographic Assumptions (Continued):

**2. Termination / Refund Rates:**

Sample rates of refund/termination are show in the following table

| Rates of Termination | | | |
|---|---|---|---|
| **Age** | **0 Years of Service** | **1-4 Years of Service** | **5 or more Years of Service** |
| 20 | 20% | 10.00% | 5.50% |
| 25 | 20 | 10.00 | 5.30 |
| 30 | 20 | 9.50 | 4.85 |
| 35 | 20 | 7.20 | 4.20 |
| 40 | 20 | 5.60 | 3.00 |
| 45 | 20 | 4.60 | 1.85 |
| 50 | 20 | 4.00 | 1.75 |
| 55 | 20 | 4.00 | 0.00 |
| 60 | 20 | 4.00 | 0.00 |
| 65 | 0 | 0.00 | 0.00 |

***** *Termination rates do not apply once a member is eligible for retirement*

| Rates of Refund | |
|---|---|
| **Age** | **Refund** |
| 20 | 40.0% |
| 25 | 30.0 |
| 30 | 25.0 |
| 35 | 20.0 |
| 40 | 15.0 |
| 45 | 10.0 |
| 50 | 4.0 |
| 55 | 0.0 |

**3. Rate of Mortality:**

*Healthy Lives:*

Mortality rates for actives, retirees, beneficiaries, terminated vested and reciprocals are based on the male and female RP-2000 combined employee and annuitant tables. To reflect mortality improvements since the date of the table and to project future mortality improvements, the tables are projected to 2015 using scale AA and setback two years. The resulting rates are used for all age cohorts.

| Rates of Mortality for Active and Retired Healthy Lives at Selected Ages | | |
|---|---|---|
| **Age** | **Male** | **Female** |
| 20 | 0.0237% | 0.0152% |
| 25 | 0.0297 | 0.0155 |
| 30 | 0.0365 | 0.0196 |
| 35 | 0.0585 | 0.0344 |
| 40 | 0.0881 | 0.0484 |
| 45 | 0.1100 | 0.0747 |
| 50 | 0.1460 | 0.1092 |
| 55 | 0.2154 | 0.1841 |
| 60 | 0.4140 | 0.3639 |
| 65 | 0.8104 | 0.7094 |
| 70 | 1.4464 | 1.2471 |
| 75 | 2.4223 | 2.0673 |
| 80 | 4.3489 | 3.3835 |

### Demographic Assumptions (Continued):

*Disabled Lives:*

Mortality rates for disabled retirees are based on the CALPERS ordinary disability mortality tables from their 2000-04 study for miscellaneous employees.

| Rates of Mortality for Disabled Lives at Selected Ages | | |
|---|---|---|
| Age | Male | Female |
| 20 | 0.664% | 0.478% |
| 25 | 0.719 | 0.492 |
| 30 | 0.790 | 0.512 |
| 35 | 0.984 | 0.548 |
| 40 | 1.666 | 0.674 |
| 45 | 1.646 | 0.985 |
| 50 | 1.632 | 1.245 |
| 55 | 1.936 | 1.580 |
| 60 | 2.293 | 1.628 |
| 65 | 3.174 | 1.969 |
| 70 | 3.870 | 3.019 |
| 75 | 6.001 | 3.915 |
| 80 | 8.388 | 5.555 |

**4. Disability Rates:**

Sample rates of disability are show in the following table

| Rates of Disability at Selected Ages | |
|---|---|
| Age | Disability |
| 20 | 0.030% |
| 25 | 0.033 |
| 30 | 0.056 |
| 35 | 0.098 |
| 40 | 0.162 |
| 45 | 0.232 |
| 50 | 0.302 |
| 55 | 0.376 |
| 60 | 0.455 |
| 65 | 0.504 |
| 70 | 0.000 |

50% of disabilities are assumed to be duty related, and 50% are assumed to be non-duty.

**5. Salary Increase Rate:**

Wage inflation component 3.25%

In addition, the following merit component is added based on an individual member's years of service.

| Salary Merit Increases | |
|---|---|
| Years of Service | Merit/ Longevity |
| 0 | 4.50% |
| 1 | 3.50 |
| 2 | 2.50 |
| 3 | 1.85 |
| 4 | 1.40 |
| 5 | 1.15 |
| 6 | 0.95 |
| 7 | 0.75 |
| 8 | 0.60 |
| 9 | 0.50 |
| 10 | 0.45 |
| 11 | 0.40 |
| 12 | 0.35 |
| 13 | 0.30 |
| 14 | 0.25 |
| 15+ | 0.25 |

## Demographic Assumptions (Continued):

**6. Percent of Retirees Electing Coverage:**

100% of employees are assumed to elect coverage at retirement. Future retirees' plan elections are assumed to mirror current retiree plan elections. Retirees who turn age 65 are assumed to be eligible for Medicare. The following rates are used to determine blended claims and contributions for future retirees.

| Assumed Plan Elections for Future Retirees | | |
|---|---|---|
| **Plan** | **Pre-Medicare** | **Medicare Eligible** |
| **Medical** | | |
| • Kaiser | 46% | 45% |
| • Kaiser $25 Co-pay | 19% | |
| • HMO | 22% | 7% |
| • HMO $25 Co-pay | 6% | |
| • PPO / POS | 6% | 45% |
| • PPO / POS $25 Co-pay | 1% | |
| • Secure Horizons | N/A | 2% |
| • Pacificare | N/A | 1% |
| **Dental** | | |
| • Delta Dental PPO | 97% | |
| • DeltaCare HMO | 3% | |

**7. Family Composition:**

90% of married males and 70% of married females will elect spouse coverage in a medical plan at retirement. 100% of employees with a spouse will elect spouse coverage in a dental plan at retirement.

**8. Dependent Age:**

For current retirees, actual spouse date of birth was used when available. For future retirees, male retirees are assumed to be three years older than their partner, and female retirees are assumed to be two years younger than their partner.

**9. Married Percentage:**

| Percentage Married | |
|---|---|
| **Gender** | **Percentage** |
| Males | 80% |
| Females | 60% |

**10. Administrative Expenses:**

Included in the average monthly premiums.

**Changes Since Last Valuation**

Actuarial assumptions have been changed, based upon recommendations from the 2011 actuarial experience study for the San Jose Federated City Employees' Retirement System that were adopted by the Board in October 2011. The changes affected the investment return, wage inflation, salary merit increase, family composition, termination rate, disability rate, retirement rate, healthy and disabled mortality, and refund rate assumptions. For a complete description of these changes, please refer to the experience study report dated May 12, 2011. In addition, the expected return on employer assets was reduced from 4.5 percent to 4.0 percent, and the blended discount rate was reduced from 6.71 percent to 6.1 percent.

## Claim and Expense Assumptions:

### 1. Average Annual Claims and Expense Assumptions:

The following claim and expense assumptions are applicable to the 12-month period beginning July 1, 2011 and are based on the premiums in effect on the valuation date. Subsequent years' costs are based on the trended first year cost adjusted with trends listed above.

*Active Employees:*

| | Medical | |
|---|---|---|
| **Age** | **Male** | **Female** |
| 40 | $ 3,289 | $ 5,847 |
| 45 | 4,119 | 6,190 |
| 50 | 5,456 | 7,341 |
| 55 | 7,169 | 8,749 |
| 60 | 9,318 | 10,444 |
| 64 | 12,036 | 12,904 |
| | | |
| 65 | 5,516 | 5,883 |
| 70 | 6,477 | 6,497 |
| 75 | 7,243 | 7,005 |
| 80 | 7,695 | 7,231 |
| 85 | 7,798 | 7,156 |

*Current Retirees:*

| | Kaiser - Male | | | Kaiser - Female | | |
|---|---|---|---|---|---|---|
| **Age** | **Blended Premium** | **Age-Based Cost** | **Implicit Subsidy** | **Blended Premium** | **Age-Based Cost** | **Implicit Subsidy** |
| 45 | $ 6,329 | $ 3,992 | $ (2,337) | $ 6,329 | $ 5,999 | $ (330) |
| 50 | 6,329 | 5,287 | (1,042) | 6,329 | 7,115 | 786 |
| 55 | 6,329 | 6,948 | 619 | 6,329 | 8,479 | 2,150 |
| 64 | 6,329 | 11,665 | 5,336 | 6,329 | 12,506 | 6,177 |
| 65 | 5,570 | 4,845 | (725) | 5,570 | 5,167 | (403) |
| 70 | 5,570 | 5,689 | 119 | 5,570 | 5,706 | 136 |
| 75 | 5,570 | 6,361 | 791 | 5,570 | 6,152 | 582 |
| 80 | 5,570 | 6,758 | 1,188 | 5,570 | 6,350 | 780 |

*Current Retirees, continued*

| | Kaiser $25 Co-pay Plan - Male | | | Kaiser $25 Co-pay Plan - Female | | |
|---|---|---|---|---|---|---|
| Age | Blended Premium | Age-Based Cost | Implicit Subsidy | Blended Premium | Age-Based Cost | Implicit Subsidy |
| 45 | $ 5,952 | $ 3,755 | $ (2,197) | $ 5,952 | $ 5,643 | $ (309) |
| 50 | 5,952 | 4,973 | (979) | 5,952 | 6,692 | 740 |
| 55 | 5,952 | 6,535 | 583 | 5,952 | 7,975 | 2,023 |
| 64 | 5,952 | 10,972 | 5,020 | 5,952 | 11,763 | 5,811 |
| 65 | 5,570 | 4,845 | (725) | 5,570 | 5,167 | (403) |
| 70 | 5,570 | 5,689 | 119 | 5,570 | 5,706 | 136 |
| 75 | 5,570 | 6,361 | 791 | 5,570 | 6,152 | 582 |
| 80 | 5,570 | 6,758 | 1,188 | 5,570 | 6,350 | 780 |

| | HMO - Male | | | HMO - Female | | |
|---|---|---|---|---|---|---|
| Age | Blended Premium | Age-Based Cost | Implicit Subsidy | Blended Premium | Age-Based Cost | Implicit Subsidy |
| 45 | $ 6,749 | $ 4,451 | $ (2,298) | $ 6,749 | $ 6,689 | $ (60) |
| 50 | 6,749 | 5,896 | (853) | 6,749 | 7,933 | 1,184 |
| 55 | 6,749 | 7,747 | 998 | 6,749 | 9,454 | 2,705 |
| 64 | 6,749 | 13,006 | 6,257 | 6,749 | 13,944 | 7,195 |
| 65 | 5,153 | 5,241 | 88 | 5,153 | 5,590 | 437 |
| 70 | 5,153 | 6,154 | 1,001 | 5,153 | 6,172 | 1,019 |
| 75 | 5,153 | 6,881 | 1,728 | 5,153 | 6,656 | 1,503 |
| 80 | 5,153 | 7,311 | 2,158 | 5,153 | 6,870 | 1,717 |

| | HMO $25 Co-pay Plan - Male | | | HMO $25 Co-pay Plan - Female | | |
|---|---|---|---|---|---|---|
| Age | Blended Premium | Age-Based Cost | Implicit Subsidy | Blended Premium | Age-Based Cost | Implicit Subsidy |
| 45 | $ 6,370 | $ 4,201 | $ (2,169) | $ 6,370 | $ 6,313 | $ (57) |
| 50 | 6,370 | 5,564 | (806) | 6,370 | 7,488 | 1,118 |
| 55 | 6,370 | 7,312 | 942 | 6,370 | 8,923 | 2,553 |
| 64 | 6,370 | 12,276 | 5,906 | 6,370 | 13,161 | 6,791 |
| 65 | 5,153 | 5,241 | 88 | 5,153 | 5,590 | 437 |
| 70 | 5,153 | 6,154 | 1,001 | 5,153 | 6,172 | 1,019 |
| 75 | 5,153 | 6,881 | 1,728 | 5,153 | 6,656 | 1,503 |
| 80 | 5,153 | 7,311 | 2,158 | 5,153 | 6,870 | 1,717 |

*Current Retirees, continued*

| | PPO / POS - Male | | | PPO / POS - Female | | |
|---|---|---|---|---|---|---|
| Age | Blended Premium | Age-Based Cost | Implicit Subsidy | Blended Premium | Age-Based Cost | Implicit Subsidy |
| 45 | $ 9,370 | $ 4,786 | $ (4,584) | $ 9,370 | $ 7,192 | $ (2,178) |
| 50 | 9,370 | 6,338 | (3,032) | 9,370 | 8,529 | (841) |
| 55 | 9,370 | 8,329 | (1,041) | 9,370 | 10,164 | 794 |
| 64 | 9,370 | 13,984 | 4,614 | 9,370 | 14,992 | 5,622 |
| 65 | 7,282 | 6,320 | (962) | 7,282 | 6,740 | (542) |
| 70 | 7,282 | 7,420 | 138 | 7,282 | 7,443 | 161 |
| 75 | 7,282 | 8,297 | 1,015 | 7,282 | 8,025 | 743 |
| 80 | 7,282 | 8,816 | 1,534 | 7,282 | 8,284 | 1,002 |

| | PPO / POS $25 Co-pay Plan - Male | | | PPO / POS $25 Co-pay Plan - Female | | |
|---|---|---|---|---|---|---|
| Age | Blended Premium | Age-Based Cost | Implicit Subsidy | Blended Premium | Age-Based Cost | Implicit Subsidy |
| 45 | $ 8,841 | $ 4,516 | $ (4,325) | $ 8,841 | $ 6,786 | $ (2,055) |
| 50 | 8,841 | 5,981 | (2,860) | 8,841 | 8,048 | (793) |
| 55 | 8,841 | 7,859 | (982) | 8,841 | 9,591 | 750 |
| 64 | 8,841 | 13,195 | 4,354 | 8,841 | 14,146 | 5,305 |
| 65 | 7,282 | 6,320 | (962) | 7,282 | 6,740 | (542) |
| 70 | 7,282 | 7,420 | 138 | 7,282 | 7,443 | 161 |
| 75 | 7,282 | 8,297 | 1,015 | 7,282 | 8,025 | 743 |
| 80 | 7,282 | 8,816 | 1,534 | 7,282 | 8,284 | 1,002 |

| | Secure Horizons - Male | | | Secure Horizons - Female | | |
|---|---|---|---|---|---|---|
| Age | Blended Premium | Age-Based Cost | Implicit Subsidy | Blended Premium | Age-Based Cost | Implicit Subsidy |
| 65 | $ 5,868 | $ 4,427 | $ (1,441) | $ 5,868 | $ 4,722 | $ (1,146) |
| 70 | 5,868 | 5,199 | (669) | 5,868 | 5,214 | (654) |
| 75 | 5,868 | 5,813 | (55) | 5,868 | 5,622 | (246) |
| 80 | 5,868 | 6,176 | 308 | 5,868 | 5,803 | (65) |

| | Pacificare - Male | | | Pacificare - Female | | |
|---|---|---|---|---|---|---|
| Age | Blended Premium | Age-Based Cost | Implicit Subsidy | Blended Premium | Age-Based Cost | Implicit Subsidy |
| 65 | $5,189 | $4,129 | $(1,060) | $5,189 | $4,404 | $(785) |
| 70 | 5,189 | 4,849 | (340) | 5,189 | 4,863 | (326) |
| 75 | 5,189 | 5,422 | 233 | 5,189 | 5,244 | 55 |
| 80 | 5,189 | 5,760 | 571 | 5,189 | 5,413 | 224 |

*Current Retirees, continued*

| Dental | |
|---|---|
| **Plan** | **Annual Premium (every age)** |
| Delta Dental PPO | $ 1,303 |
| DeltaCare HMO | 561 |

**2. Medicare Part D Subsidy:**

Per GASB guidance, the Part D Subsidy has not been reflected in this valuation.

**3. Medicare Part B Premiums:**

Assumed that Medicare eligible retirees pay the Medicare Part B premiums.

**4. Medicare Eligibility:**

Age 65

**5. Annual Limits:**

Assumed to increase at the same rate as trend.

**6. Lifetime Maximums:**

Are not assumed to have any financial impact.

**7. Geography:**

Implicitly assumed to remain the same as current retirees.

**8. Retiree Contributions:**

Current retirees pay the difference between the actual premium for the elected plan and the Kaiser $25 Co-pay Plan rate, if the retiree is eligible to receive the explicit subsidy.

Future retirees are assumed to pay the following annual rates (after reflection of the explicit subsidy).

| | Retiree | Spouse |
|---|---|---|
| Pre-Medicare | $ 631 | $ 1,144 |
| Medicare Eligible | 364 | 0 |

# Actuarial Assumptions and Methods *(Continued)*

## Actuarial Methods

**1. Actuarial Cost Method**

The Entry Age Normal actuarial funding method was used for active employees, whereby the normal cost is computed as the level annual percentage of pay required to fund the postemployment benefits between each member's date of hire and assumed retirement. The actuarial liability is the difference between the present value of future benefits and the present value of future normal cost. The unfunded actuarial liability is the difference between the actuarial liability and the actuarial value of assets.

The claims costs are based on the fully insured premiums charged to the City for the active and retiree population.

**2. Asset Valuation Method**

The Actuarial Value of Assets is equal to the Market Value of Assets

**3. Amortization Method**

The UAL as of June 30, 2009 is amortized over a closed 30-year period as a level percentage of payroll, and subsequent gains and losses, changes in assumptions, and changes in plan provisions are amortized over 20-year periods from the first valuation recognizing the change.

SCHEDULE OF ACTIVE MEMBER DATA

| Valuation Date *as of June 30,* | Active Member Counts | | | Annual Payroll |
|---|---|---|---|---|
| | Under Age 65 | Age 65+ | Total | |
| 2011 | 3,201 | 73 | $ 3,274 | $ 228,936,398 |
| 2010 | 3,721 | 97 | 3,818 | 300,811,165 |
| 2009 | 3,988 | 91 | 4,079 | 323,020,387 |
| 2007 | 3,853 | 66 | 3,919 | N/A |
| 2006 | 3,734 | 75 | 3,809 | N/A |

SCHEDULE OF RETIREES AND BENEFICIARIES ADDED TO AND REMOVED FROM ROLLS

| Period | Beginning of Period | Added to Rolls | Removed from Rolls | End of Period | Net Change |
|---|---|---|---|---|---|
| **Medical** | | | | | |
| 2010-11 | 2,245 | 429 | 117 | 2,557 | 312 |
| 2009-10 | 2,078 | 243 | 76 | 2,245 | 167 |
| 2007-09 | 1,976 | N/A | N/A | 2,078 | 102 |
| 2006-07 | 1,891 | N/A | N/A | 1,976 | 85 |
| **Dental** | | | | | |
| 2009-11 | 2,588 | 413 | 95 | 2,906 | 318 |
| 2009-10 | 2,375 | 291 | 78 | 2,588 | 213 |
| 2007-09 | 2,248 | N/A | N/A | 2,375 | 127 |
| 2006-07 | 2,220 | N/A | N/A | 2,248 | 28 |

# Actuarial Assumptions and Methods *(Continued)*

## OTHER POSTEMPLOYMENT BENEFITS (OPEB)

| SOLVENCY TEST | | | | | |
|---|---|---|---|---|---|
| | **Actuarial Liabilities** | | | | |
| **Valuation Date** | **Retirees, Beneficiaries and Other Inactives** | **Remaining Active Members** | **Reported Assets** | **Portion of Actuarial Liabilities Covered by Reported Assets** | |
| June 30, | (A) | (B) | | (A) | (B) |
| 2011 | $ 652,157 | $ 493,203 | $ 135,454 | 21% | 0% |
| 2010 | 515,284 | 411,087 | 108,011 | 21% | 0% |
| 2009 | 421,367 | 375,081 | 85,564 | 20% | 0% |
| 2007 | 335,798 | 280,951 | 96,601 | 29% | 0% |
| 2006 | 370,886 | 332,052 | 81,288 | 22% | 0% |

*Amounts in thousands*

| ANALYSIS OF FINANCIAL EXPERIENCE | | |
|---|---|---|
| **Type of Activity** | **Gain (or Loss) for Year Ending June 30, 2011** | **Gain (or Loss) for Year Ending June 30, 2010** |
| Investment Income | $ 14,186 | $ 6,705 |
| Liability Experience | (35,166) | (43,746) |
| Gain (or Loss) During Year from Financial Experience | (20,980) | (37,041) |
| Non-Recurring Gain (or Loss) Items | (131,557) | (36,785) |
| **Composite Gain (or Loss) During Year** | **$ (152,537)** | **$ (73,826)** |

*Amounts in thousands*

### Summary of Key Substantive Plan Provisions:

**Eligibility:**

*Medical:*
Employees who retire (include deferred vested members) at age 55 with 15 years of service, or with a monthly pension equal to at least 37.5% of final compensation, are eligible to elect medical coverage upon retirement.

Employees who become disabled with at least 15 years of service or have a monthly pension equal to at least 37.5% of final compensation are eligible to elect medical coverage upon retirement.

Spouses or domestic partners of retired members are allowed to participate if they were enrolled in the City's medical plan at the time of the member's retirement. Dependent children are eligible to receive coverage until the age of 19 (24 if a full-time student).

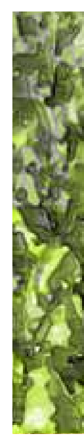
Surviving spouses / domestic partners / children of deceased members are eligible for coverage if the following conditions are met:

1. the employee has 15 years of service at time of death or is entitled to a monthly pension of at least 37.5% of final compensation; and
2. both the member and the survivors were enrolled in the active medical plan immediately before death; and
3. the survivor will receive a monthly pension benefit.

*Dental:*

Employees who retire or become disabled directly from City service with at least five years of service or with a monthly pension equal to at least 37.5% of final compensation, and are enrolled in a City dental plan at retirement are eligible to elect dental coverage upon retirement. Spouses, domestic partners, or children of retired members are allowed to participate if they were enrolled in the City's dental plan at the time of the member's retirement.

Surviving spouses / domestic partners / children of deceased members are eligible for coverage if the following conditions are met:



## OTHER POSTEMPLOYMENT BENEFITS (OPEB)

1. the employee has five years of service at time of death or is entitled to a monthly pension of at least 37.5% of final compensation; and
2. both the member and the survivors were enrolled in the active dental plan immediately before death; and
3. the survivor will receive a monthly pension benefit.

### Benefits for Retirees:

**Medical:**

The Retirement System, through the medical benefit account, pays 100% of the premium for the lowest cost health plan available to active City employees. The member pays the difference if another plan is elected.

Effective January 1, 2011, the lowest cost health plan is the Kaiser $25 Co-pay plan. The single coverage amount is $496.04 per month, and the family coverage amount is $1,235.16 per month. These amounts are not adjusted once a retiree is eligible for Medicare.

**Dental:**

The Retirement System, through the medical benefit account, pays 100% of the dental insurance premiums.

**Premiums:**

Monthly premiums before adjustments for 2011 are as follows:

| MONTHLY PREMIUMS FOR 2011 | | | | |
|---|---|---|---|---|
| | **Single** | **% Increase** | **Family** | **% Increase** |
| **Medical** | | | | |
| Non-Medicare Monthly Rates | | | | |
| Kaiser – Traditional (CA) | $ 527.38 | 8.9% | $ 1,313.18 | 9.0% |
| Kaiser $25 Co-pay Plan | 496.04 | N/A | 1,235.16 | N/A |
| Blue Shield HMO | 562.40 | 4.1% | 1,444.76 | 4.1% |
| Blue Shield HMO $25 Co-pay | 530.82 | N/A | 1,363.58 | N/A |
| Blue Shield PPO or POS | 780.84 | 4.1% | 2,006.70 | 4.1% |
| Blue Shield PPO or POS $25 Co-pay | 736.78 | N/A | 1,893.48 | N/A |
| Medicare Monthly Rates | | | | |
| Kaiser – Senior Advantage | $ 464.16 | 8.0% | $ 928.32 | 8.0% |
| Secure Horizons | 489.02 | 10.0% | 978.04 | 10.0% |
| Blue Shield Medicare PPO | 606.82 | 4.1% | 1,213.64 | 4.1% |
| Blue Shield Medicare HMO | 429.41 | 4.1% | 858.82 | 4.1% |
| Pacificare Senior Supplement | 432.40 | 9.3% | 864.80 | 9.3% |
| **Dental** | | | | |
| Delta Dental PPO | $ 108.62 | (2.6)% | $ 108.62 | (2.6)% |
| DeltaCare HMO | 46.78 | (6.4)% | 46.78 | (6.4)% |

**Cost Sharing Provisions:**

It is assumed for the purpose of this valuation that the City of San Jose will in the future maintain a consistent level of cost sharing for benefits with the retirees. This may be achieved by adjusting benefit provisions, contributions or both.

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The Statistical Section provides additional historical perspective, context, and detail in order to provide a more comprehensive understanding of this fiscal year's financial statements, note disclosures, and supplementary information, which cover Pension Plan, and Other Postemployment Medical Benefits. This section also provides a multi-year trend of financial and operating information to facilitate comprehensive understanding of how the organization's financial position and performance has changed over time. More specifically, the financial and operating information provides contextual data for the System's net assets, benefits, refunds, contribution rates, and different types of retirement benefits. The financial and operating trend information is located on the following pages.

# Statistical Section

City of San José
Federated City Employees' Retirement System
Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2012

# Statistical Review

### CHANGES IN NET ASSETS FOR FISCAL YEARS 2003-2012 *(In Thousands)*
### PENSION BENEFITS (Schedule 1a)

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Additions** | | | | | | | | | | |
| Employee contributions | $ 11,776 | $ 12,394 | $ 12,393 | $ 12,395 | $ 12,370 | $ 13,366 | $ 13,848 | $ 13,396 | $ 24,602 | $ 10,555 |
| Employer contributions | 38,411 | 39,534 | 41,552 | 41,267 | 51,004 | 54,958 | 57,020 | 54,566 | 59,180 | 87,082 |
| Investment income/ (loss)* | 71,179 | 192,373 | 115,618 | 132,873 | 244,210 | (60,101) | (295,773) | 197,755 | 287,179 | (68,903) |
| **Total additions to plan net assets** | **121,366** | **244,301** | **169,563** | **186,535** | **307,584** | **8,223** | **(224,905)** | **265,717** | **370,961** | **28,734** |
| **Deductions (See Schedule 2a)** | | | | | | | | | | |
| Benefit payments | 46,814 | 53,578 | 60,438 | 68,438 | 75,135 | 83,291 | 89,767 | 98,110 | 110,415 | 126,001 |
| Death benefits | 4,752 | 5,454 | 5,437 | 5,721 | 5,867 | 6,263 | 6,923 | 7,583 | 7,883 | 8,601 |
| Refunds | 714 | 1,188 | 927 | 1,246 | 1,008 | 972 | 1,395 | 1,219 | 1,980 | 2,195 |
| Administrative expenses and other | 1,532 | 1,799 | 1,588 | 1,790 | 1,845 | 2,358 | 2,108 | 2,641 | 2,867 | 3,306 |
| **Total deductions from plan net assets** | **53,812** | **62,019** | **68,390** | **77,195** | **83,855** | **92,884** | **100,193** | **109,553** | **123,145** | **140,103** |
| **Change in Net Assets** | **$ 67,554** | **$ 182,282** | **$ 101,173** | **$ 109,340** | **$ 223,729** | **$ (84,661)** | **$ (325,098)** | **$ 156,164** | **$ 247,816** | **$(111,369)** |

**Net of Expenses*

### POSTEMPLOYMENT HEALTHCARE BENEFITS (Schedule 1b)

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|
| **Additions** | | | | | | | | | | |
| Employee contributions | $ 3,032 | $ 3,191 | $ 5,219 | $ 5,226 | $ 9,612 | $ 10,403 | $ 15,076 | $ 15,815 | $ 16,041 | $ 14,995 |
| Employer contributions | 3,866 | 3,948 | 5,996 | 5,961 | 10,728 | 11,560 | 16,368 | 17,027 | 17,146 | 25,834 |
| Investment income/ (loss)* | 4,193 | 11,066 | 6,539 | 7,273 | 13,343 | (3,715) | (18,485) | 13,852 | 21,842 | (5,140) |
| **Total additions to plan net assets** | **11,091** | **18,205** | **17,754** | **18,460** | **33,683** | **18,248** | **12,959** | **46,694** | **55,029** | **35,689** |
| **Deductions (See Schedule 2b)** | | | | | | | | | | |
| Healthcare insurance premiums | 9,191 | 11,438 | 13,393 | 15,904 | 18,265 | 20,195 | 21,725 | 24,066 | 27,370 | 33,077 |
| Administrative expenses and other | 99 | 114 | 95 | 103 | 105 | 134 | 132 | 181 | 216 | 268 |
| **Total deductions from plan net assets** | **9,290** | **11,552** | **13,488** | **16,007** | **18,370** | **20,329** | **21,857** | **24,247** | **27,586** | **33,345** |
| **Change in Net Assets** | **$ 1,801** | **$ 6,653** | **$ 4,266** | **$ 2,453** | **$ 15,313** | **$ (2,081)** | **$ (8,956)** | **$ 22,447** | **$ 27,443** | **$ 2,344** |

**Net of Expenses*

**Source:** Pension Administration System

# Statistical Review *(Continued)*

## BENEFIT AND REFUND DEDUCTIONS FROM NET ASSETS BY TYPE *(In Thousands)*
## PENSION BENEFITS **(Schedule 2a)**

| Type of Benefit | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|---|---|
| **Age and Service Benefits** | | | | | | | |
| *Retirees* – Service | $ 109,662 | $ 95,562 | $ 84,606 | $ 77,444 | $ 71,849 | $ 64,978 | $ 59,391 |
| *Retirees* – Deferred Vested | 9,261 | 8,047 | 6,996 | 6,219 | 5,730 | 4,860 | 4,134 |
| *Survivors* – Service | 4,791 | 4,425 | 4,207 | 3,867 | 3,561 | 3,320 | 3,195 |
| *Survivors* – Deferred Vested | 161 | 130 | 138 | 126 | 122 | 108 | 87 |
| **Death in Service Benefits** | 2,349 | 2,202 | 2,161 | 2,032 | 1,815 | 1,722 | 1,750 |
| **Disability Benefits** | | | | | | | |
| *Retirees* – Duty | 3,609 | 3,493 | 3,498 | 3,256 | 3,102 | 2,920 | 2,702 |
| *Retirees* – Non-Duty | 2,011 | 2,039 | 1,899 | 1,884 | 1,835 | 1,737 | 1,640 |
| *Survivors* – Duty | 402 | 356 | 338 | 263 | 218 | 197 | 187 |
| *Survivors* – Non-Duty | 827 | 770 | 739 | 635 | 547 | 519 | 502 |
| **Ex-Spouse Benefits** | 1,529 | 1,274 | 1,111 | 964 | 775 | 640 | 571 |
| **Total Benefits** | **$ 134,602** | **$ 118,298** | **$ 105,693** | **$ 96,690** | **$ 89,554** | **$ 81,002** | **$ 74,159** |
| **Type of Refund** | | | | | | | |
| Separation | $ 2,195 | $ 1,980 | $ 1,219 | $ 1,395 | $ 972 | $ 1,008 | $ 1,246 |
| **Total Refunds** | $ 2,195 | $ 1,980 | $ 1,219 | $ 1,395 | $ 972 | $ 1,008 | $ 1,246 |

*Fiscal Year 2004-05 data not available due to system limitations.*

**Source:** Pension Administration System

## BENEFIT AND REFUND DEDUCTIONS FROM NET ASSETS BY TYPE *(In Thousands)*
## POSTEMPLOYMENT HEALTHCARE BENEFITS (Schedule 2b)

| Type of Benefit | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|---|---|
| **Age and Service Benefits** | | | | | | | |
| *Retirees* – Service | | | | | | | |
| Medical | $ 20,262 | $ 18,971 | $ 16,344 | $ 14,772 | $ 13,524 | $ 12,029 | $ 10,341 |
| Dental | 3,083 | 2,840 | 2,474 | 2,150 | 2,148 | 2,022 | 1,870 |
| *Retirees* – Deferred Vested* | | | | | | | |
| Medical | 1,418 | 1,241 | 1,180 | 1,063 | 949 | 767 | 652 |
| Dental | 23 | 24 | 27 | 26 | 29 | 35 | - |
| *Survivors* – Service | | | | | | | |
| Medical | 954 | 1,024 | 938 | 862 | 800 | 730 | 628 |
| Dental | 339 | 329 | 308 | 268 | 269 | 251 | 235 |
| *Survivors* – Deferred Vested* | | | | | | | |
| Medical | 24 | 18 | 16 | 11 | 10 | 9 | 11 |
| Dental | 2 | - | - | 1 | - | - | - |
| **Death in Service Benefits** | | | | | | | |
| Medical | 389 | 412 | 366 | 335 | 327 | 313 | 293 |
| Dental | 78 | 79 | 74 | 67 | 69 | 72 | 71 |
| **Disability Benefits** | | | | | | | |
| *Retirees* – Duty | | | | | | | |
| Medical | 1,217 | 1,253 | 1,241 | 1,166 | 1,113 | 1,098 | 956 |
| Dental | 157 | 162 | 161 | 142 | 143 | 145 | 131 |
| *Retirees* – Non-Duty | | | | | | | |
| Medical | 462 | 530 | 513 | 510 | 483 | 478 | 433 |
| Dental | 87 | 92 | 84 | 79 | 81 | 78 | 73 |
| *Survivors* – Duty | | | | | | | |
| Medical | 125 | 125 | 100 | 80 | 75 | 69 | 59 |
| Dental | 32 | 30 | 27 | 20 | 19 | 18 | 17 |
| *Survivors* – Non-Duty | | | | | | | |
| Medical | 192 | 195 | 171 | 139 | 123 | 119 | 103 |
| Dental | 45 | 45 | 42 | 34 | 33 | 32 | 31 |
| **Ex-Spouse Benefits** | | | | | | | |
| Medical | 4 | - | - | - | - | - | - |
| Dental | 1 | - | - | - | - | - | - |
| **Implicit Subsidy Medical** | 4,383 | | | | | | |
| **Total Benefits** | **$ 33,077** | **$ 27,370** | **$ 24,066** | **$ 21,725** | **$ 20,195** | **$ 18,265** | **$ 15,904** |

*Fiscal Year 2004-05 data not available due to system limitations.*

## EMPLOYER AND EMPLOYEE CONTRIBUTION RATES FOR FISCAL YEARS 2003-2012 (Schedule 3)

| Fiscal Year | Employee Rate (%) | Employer Rate (%) |
|---|---|---|
| 2003 | 5.08 | 15.20 |
| 2004 | 5.08 | 15.20 |
| 2005 | 6.06 | 17.12 |
| 2006 | 6.06 | 17.12 |
| 2007 | 7.58 | 21.98 |

| Fiscal Year | Employee Rate (%) | Employer Rate (%) |
|---|---|---|
| 2008 | 7.58 | 21.98 |
| 2009 | 8.93 | 23.56 |
| 2010 | 9.35 | 24.01 |
| 2011 | 10.30* | 29.59** |
| 2012 | 11.20 | 35.50 |

* *Some Bargaining units negotiated temporary higher rates.*
** *Some bargaining units negotiated temporary higher member contribution rates, which directly offset the City's contribution rate.*

# Retired Member by Type of Benefit

## PENSION BENEFITS

*As of June 30, 2012*

| | | Type of Retirement* | | | | | | | Option Selected** | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Monthly Benefit Amount | Number of Retirees & Beneficiaries | 1 | 2 | 3 | 4 | 5 | 6 | 7 | A | B | C | Total |
| $1-500 | 139 | 32 | 3 | 1 | 1 | 33 | 50 | 19 | 101 | 19 | 19 | 139 |
| 501-1000 | 281 | 90 | 9 | 3 | 3 | 75 | 75 | 26 | 219 | 19 | 43 | 281 |
| 1001-1500 | 375 | 138 | 8 | 10 | 13 | 98 | 88 | 20 | 261 | 45 | 69 | 375 |
| 1501-2000 | 400 | 185 | 14 | 39 | 21 | 75 | 51 | 15 | 290 | 36 | 74 | 400 |
| 2001-2500 | 379 | 234 | 13 | 23 | 13 | 42 | 44 | 10 | 267 | 34 | 78 | 379 |
| 2501-3000 | 328 | 231 | 6 | 22 | 15 | 28 | 22 | 4 | 230 | 35 | 63 | 328 |
| 3001-3500 | 323 | 258 | 7 | 13 | 10 | 3 | 28 | 4 | 213 | 35 | 75 | 323 |
| 3501-4000 | 287 | 247 | 7 | 8 | 3 | 4 | 17 | 1 | 186 | 29 | 72 | 287 |
| 4001-4500 | 274 | 242 | 4 | 3 | 0 | 4 | 19 | 2 | 202 | 23 | 49 | 274 |
| 4501-5000 | 210 | 192 | 4 | 2 | 0 | 1 | 11 | 0 | 147 | 27 | 36 | 210 |
| 5001-5500 | 164 | 153 | 2 | 1 | 0 | 2 | 6 | 0 | 105 | 18 | 41 | 164 |
| 5500-6000 | 180 | 174 | 1 | 1 | 0 | 0 | 4 | 0 | 123 | 18 | 39 | 180 |
| 6000-6500 | 104 | 96 | 1 | 1 | 0 | 0 | 6 | 0 | 67 | 11 | 26 | 104 |
| 6501-7000 | 67 | 66 | 0 | 0 | 0 | 0 | 1 | 0 | 49 | 2 | 16 | 67 |
| Over $7000 | 177 | 171 | 0 | 1 | 0 | 0 | 5 | 0 | 139 | 13 | 25 | 177 |
| **TOTAL** | **3,688** | **2,509** | **79** | **128** | **79** | **365** | **427** | **101** | **2,599** | **364** | **725** | **3,688** |

***Retirement Codes**

*1 Service*
*2 Survivor (survivor of active employee)*
*3 Service Connected Disability*
*4 Non-Service Connected Disability*
*5 Continuance (survivor of retired employee)*
*6 Deferred Vested*
*7 Ex-Spouse*

****OPTION DESCRIPTIONS**

*A Unmodified - 50% Continuance*
*B Option 1: 100% Continuance/reduced pension*
*C No Survivor - No Continuance*

## POSTEMPLOYMENT HEALTHCARE BENEFITS

*As of June 30, 2011*

| | Type of Subsidy | |
|---|---|---|
| Amount Monthly Benefit | Health | Dental |
| Ineligible/Deferred | 1,057 | 626 |
| $1 - 60 | 0 | 92 |
| $61 - 250 | 357 | 2,970 |
| $251 - 500 | 329 | 0 |
| $501 - 750 | 772 | 0 |
| $751 -1000 | 84 | 0 |
| Over $1,000 | 1,089 | 0 |
| **TOTAL** | **3,688** | **3,688** |

**Source:** Pension Administration System

# Average Benefit Payment Amounts

## PENSION BENEFITS

*As of June 30, 2012*

| | Years of Service Credit | | | | | | |
|---|---|---|---|---|---|---|---|
| **Retirement Effective Dates** | **0-5** | **6-10** | **11-15** | **16-20** | **21-25** | **26-30** | **31+** |
| **As of 6/30/2012** | | | | | | | |
| Average Monthly Benefit* | $ 914 | $ 1,329 | $ 2,140 | $ 2,982 | $ 4,080 | $ 5,255 | $ 5,722 |
| Average Final Average Salary | $ 3,516 | $ 4,803 | $ 4,975 | $ 5,280 | $ 5,975 | $ 5,920 | $ 6,513 |
| Number of Retired Members** | 113 | 402 | 433 | 619 | 586 | 831 | 159 |
| **Period 7/1/2010 to 6/30/2011** | | | | | | | |
| Average Monthly Benefit* | $ 842 | $ 1,267 | $ 2,036 | $ 2,835 | $ 3,851 | $ 5,036 | $ 5,577 |
| Average Final Average Salary | $ 4,303 | $ 4,570 | $ 4,580 | $ 4,991 | $ 5,360 | $ 5,544 | $ 6,056 |
| Number of Retired Members** | 131 | 371 | 388 | 566 | 465 | 726 | 139 |
| **Period 7/1/2009 to 6/30/2010** | | | | | | | |
| Average Monthly Benefit* | $ 838 | $ 1,179 | $ 1,980 | $ 2,700 | $ 3,714 | $ 4,852 | $ 5,410 |
| Average Final Average Salary | $ 4,203 | $ 4,221 | $ 4,393 | $ 4,778 | $ 5,129 | $ 5,311 | $ 5,929 |
| Number of Retired Members** | 124 | 343 | 367 | 537 | 417 | 664 | 130 |
| **Period 7/1/2008 to 6/30/2009** | | | | | | | |
| Average Monthly Benefit* | $ 778 | $ 1,139 | $1,899 | $ 2,585 | $ 3,545 | $ 4,671 | $ 5,281 |
| Average Final Average Salary | $ 3,898 | $ 4,045 | $4,201 | $ 4,629 | $ 4,898 | $ 5,151 | $ 5,807 |
| Number of Retired Members** | 120 | 329 | 359 | 529 | 392 | 624 | 123 |
| **Period 7/1/2007 to 6/30/2008** | | | | | | | |
| Average Monthly Benefit* | $ 765 | $ 1,133 | $ 1,856 | $ 2,550 | $ 3,470 | $ 4,600 | $ 5,231 |
| Average Final Average Salary | $ 3,828 | $ 3,963 | $ 4,144 | $ 4,585 | $ 4,796 | $ 5,099 | $ 5,761 |
| Number of Retired Members** | 119 | 325 | 355 | 524 | 382 | 611 | 120 |
| **Period 7/1/2006 to 6/30/2007** | | | | | | | |
| Average Monthly Benefit* | $ 732 | $ 1,049 | $ 1,728 | $ 2,398 | $ 3,129 | $ 4,253 | $ 4,947 |
| Average Final Average Salary | $ 3,455 | $ 3,627 | $ 3,867 | $ 4,316 | $ 4,263 | $ 5,030 | $ 5,505 |
| Number of Retired Members** | 115 | 307 | 344 | 476 | 342 | 564 | 105 |
| **Period 7/1/2005 to 6/30/2006** | | | | | | | |
| Average Monthly Benefit* | $ 665 | $ 981 | $ 1,638 | $ 2,252 | $ 2,971 | $ 4,142 | $ 4,679 |
| Average Final Average Salary | $ 3,073 | $ 3,413 | $ 3,704 | $ 4,123 | $ 4,067 | $ 4,755 | $ 5,324 |
| Number of Retired Members** | 116 | 294 | 337 | 449 | 322 | 536 | 100 |

* *Includes Cost of Living Increases*

** *Does not include Survivors and Ex-Spouses*

*Information presented in the above table is not readily available prior to fiscal year 2006.*

**Source:** Pension Administration System

# Average Benefit Payment Amounts

## POSTEMPLOYMENT HEALTHCARE BENEFITS

*As of June 30, 2012*

| | Years of Service Credit | | | | | | |
|---|---|---|---|---|---|---|---|
| Retirement Effective Dates | 0-5 | 6-10 | 11-15 | 16-20 | 21-25 | 26-30 | 31+ |
| **As of 6/30/2012** | | | | | | | |
| Average Health Subsidy | $ 698 | $ 426 | $ 645 | $ 797 | $ 873 | $ 902 | $ 768 |
| Number of Health Participants* | 27 | 66 | 218 | 580 | 547 | 800 | 150 |
| Average Dental Subsidy | $ 107 | $ 107 | $ 107 | $ 108 | $ 107 | $ 107 | $ 106 |
| Number of Dental Participants* | 63 | 245 | 325 | 540 | 542 | 800 | 151 |
| **Period 7/1/2010 to 6/30/2011** | | | | | | | |
| Average Health Subsidy | $ 866 | $ 773 | $ 764 | $ 855 | $ 898 | $ 928 | $ 848 |
| Number of Health Participants* | 21 | 39 | 191 | 544 | 448 | 711 | 138 |
| Average Dental Subsidy | $ 108 | $ 110 | $ 109 | $ 110 | $ 110 | $ 109 | $ 108 |
| Number of Dental Participants* | 64 | 233 | 300 | 500 | 430 | 708 | 139 |
| **Period 7/1/2009 to 6/30/2010** | | | | | | | |
| Average Health Subsidy | $ 587 | $ 461 | $ 650 | $ 797 | $ 828 | $ 867 | $ 816 |
| Number of Health Participants* | 28 | 65 | 212 | 515 | 402 | 649 | 128 |
| Average Dental Subsidy | $ 103 | $ 104 | $ 103 | $ 103 | $ 103 | $ 103 | $ 103 |
| Number of Dental Participants* | 61 | 218 | 289 | 474 | 384 | 646 | 130 |
| **Period 7/1/2008 to 6/30/2009** | | | | | | | |
| Average Health Subsidy | $ 596 | $ 449 | $ 636 | $ 757 | $ 779 | $ 817 | $ 764 |
| Number of Health Participants* | 26 | 65 | 209 | 505 | 377 | 608 | 121 |
| Average Dental Subsidy | $ 94 | $ 93 | $93 | $ 94 | $ 93 | $ 93 | $ 93 |
| Number of Dental Participants* | 61 | 212 | 286 | 467 | 360 | 608 | 122 |
| **Period 7/1/2007 to 6/30/2008** | | | | | | | |
| Average Health Subsidy | $ 761 | $ 674 | $ 681 | $ 727 | $ 738 | $ 785 | $ 738 |
| Number of Health Participants* | 20 | 42 | 192 | 492 | 356 | 582 | 114 |
| Average Dental Subsidy | $ 98 | $ 98 | $ 98 | $ 98 | $ 98 | $ 98 | $ 98 |
| Number of Dental Participants* | 59 | 206 | 286 | 456 | 339 | 580 | 115 |
| **Period 7/1/2006 to 6/30/2007** | | | | | | | |
| Average Health Subsidy | $ 728 | $ 683 | $ 654 | $ 678 | $ 679 | $ 736 | $ 700 |
| Number of Health Participants* | 23 | 45 | 195 | 459 | 331 | 555 | 104 |
| Average Dental Subsidy | $ 97 | $ 97 | $ 97 | $ 97 | $97 | $ 97 | $ 97 |
| Number of Dental Participants* | 62 | 202 | 286 | 431 | 318 | 552 | 105 |
| **Period 7/1/2005 to 6/30/2006** | | | | | | | |
| Average Health Subsidy | $ 616 | $ 635 | $ 613 | $ 614 | $ 615 | $ 670 | $ 641 |
| Number of Health Participants* | 24 | 49 | 189 | 416 | 305 | 520 | 98 |
| Average Dental Subsidy | $ 95 | $ 94 | $ 94 | $ 94 | $ 94 | $94 | $ 94 |
| Number of Dental Participants* | 62 | 191 | 280 | 397 | 297 | 521 | 99 |

# Retirements During Fiscal Year 2011-2012

## SERVICE RETIREMENTS

ADAMS, JOHN
ADIKARA, THERESIA
AIZUMI, SUSAN
AJLUNI, DIANE
ANNINO, SUSAN
ARECHIGA, LAURA
AREVALO, MANUEL
AVILA, TERESA
AYALA, ANNA
BALES, ALAN
BARBACCIA, SHARON
BARROS, JOHN
BEDARD, ANN
BETTENCOURT, MANUEL
BICKFORD, JAMES
BOGGESS, EILEEN
BORTOLUSSI, RICHARD
BOUJA, SANDRA
BOWSER, ROBERT
BRATEN, PAUL
BRIM, THOMAS
BUCKERT, SABRA
BURNETT, JAMES
BURNTHORN, KENNETH
CANCHOLA, MARIA
CARMICHAEL, KARIN
CASTRO, GUILLERMO
CAVA, BERNADETTE
CAZARES, YOLANDA
CHAN, THIN-JUAN
CHEN, ANGELA
CHEUNG, ALICE
CHEUNG, DAVID
CHING, CHRISTOPHER
CLANTON, DANIEL
CLARK, WILLIAM
CLEMMONS, DERIEK
CORONADO, ROSALYN
COVICH, SUSAN
DA SILVA, CAROL
DARDIS, WILLIAM
DAVIS, GREG
DAVIS, SANDRA
DAWKINS-THAMES, PHYLLIS
DEISENROTH, LORIE
DENT, MOLLIE
DIAZ, MICHAEL
DIAZ, YOLANDA
DIRIGE, MHARR
DOMINGUEZ, REBECA
DONOVAN, IRENE
EMAMI, PATRICIA
ERNST, DON
EYCHNER, JANET
EZZATYAR, PARVIZ
FAY, PATRICIA
FERRIER, DENNIS
FITZHUGH, MARILYN
FORMAN, KATHLEEN
FREITAS, DAVID
GALE, GAY
GAMBELIN, CHRISTOPHER
GANGAR, KARNAIL
GARCIA, ERNEST
GARCIA, MICHAEL
GILL, MIKE
GLEATON, DONALD
GREEN, ESTLE
GREENBERG, CLIFFORD
GROVER, CHARLES
GUTIERREZ, NASARIO
HALL, CHARLES
HAM, JAMES
HANNON, MICHAEL
HARTWELL, KAREN
HAYNES, LAURA
HERNANDEZ, JOHN
HETNAR, MERED
HINAU, NEAL
HO, MICHAEL
HOLLOWAY, SANDRA
HOLMES, CARLA
HOM, MARY
HORSTMAN, ELLEN
HOUSTON, PATRICIA
HSIEH, MICHAEL
IDEMOTO, DIANE
JACOBS, TRACY
JAMISON, DIANA
JENSEN, PETER
JOHNSON, CYNTHIA
JOHNSON, SCOTT
JOHNSON, VICTORIA
JUSTO, RUBY
KAR, ANIL
KELSO, CHARLOTTE
KNIGHT, MARIA
LANGHORST, HILARY
LARSON, ELIZABETH
LEA-FUJIMOTO, DONNA
LEDOUX, KAREN
LEE, YOLANDA
LIGHT, JANE
LOMIBAO, GLORIA
LOWENSTEIN, PAUL
LUDWIG, DONALD
MACHADO, ROBERT
MAHAN, MARY
MAIRE, ROSEMARY
MANHEIM, THOMAS
MANUEL, ROMEO
MANZUR, NAGUIB
MAUNG, MAUNG-WIN
MAYO, LORRAINE
MC CARTHY, SUSAN
MC LAUGHLIN, DOROTHY
MENZIES, STEPHANIE
MERRILL, THERESE
MERRILL, THOMAS
MERRIOTT, BONNIE
MEYERS, CHRISTINE
MILLICK, SHERRI
MINKS, DORENE
MIRANDA, MATILDE
MOJICA, MICHAEL
MOORE, JANIS
MURILLO, SANDRA
MURRAY, ANGELITA
MURRAY, RICHARD
NGUYEN, TRUNG
NIMITZ, STEPHANIE
OCHOA, LETICIA
OLIVEROS, LIGAYA
OPHEIM, ROBIN
ORTIZ, RICHARD
PAMBID, MERLYN
PARDO, MOSES
PEREZ, ANTONIO
REILLY, THOMAS
RENTERIA, SARAH
RILEY, CURTIS
RIVAS, JUAN
RODRIGUEZ, GENEVIEVE
ROGERS, LARRY
ROSALES, MARY
RUIZ, RICHARD
SANTOMAURO, ANTHONY
SHERR, LAURIE
SMITH, DANNY
SOHRABI, EBRAHIM
SOMERO, ROGER
SOTIRHOS, JERRY
STAUFFER, SUZAN
STENDER, STEVEN
STUFFLEBEAN, JOHN
SUEN, ROWENA
THEISEN, JOSEPH
TONG, DANIEL
TORRECILLAS, BENITO
TORRES, JANET
TREADWELL, MARK
TUCKER, MARY
UEMURA, SUSAN
URIBE, JOSE
VADER, FRAN
VARGAS, FRANK
VASQUEZ, ILDA
WANG, CHUNG-WAN
WEST, KATINA
WHARTON, JAMES
WHITE, ROBERTA
WOLFRAM, JOHN
YAEGER, STEPHEN
YORK, ROBERT
YOUNG, JUDY
ZONIC, DONALD

**Source:** Pension Administration System

# Retirements During Fiscal Year 2011-2012 *(Continued)*

## DEFERRED VESTED RETIREMENTS

BARRERAS, TODD
BOWENS-ATKINS, SHERYL
CARNAHAN, PATRICK
CARRILLO, ALMA
CARSON, CONNIE
CHAN, BRIAN
COFFMAN, DOUGLAS
COMPOST, SHALOM
CUETO, MARIA
DIMOND, ELLEN
DISHER, WAYNE
DONATELLI, PEGGY
FELKER, CYNTHIA
FREDERICK, SCOTT
FUNG, VINCENT
GADD, GEORGE
GERVIN, LORRIE
GONZALEZ, MIKEL
HORWEDEL, LINDA
JORDAN, BARBARA
KENELLER, KARIN
LINDEMUTH, MARY
LINO, AYUMURA
MARTINEZ, JOSE
MATHUS, PAMELA
MC DONALD, BRUCE
MORENO, DAVID
MOTTE-PETERS, LYNETTE
NGUYEN, PATRICIA
NOSTAJA, JACKIE
NOVAK, SCOTT
QUINTANA, DANIEL
QUINTERO, GUADALUPE
ROEMER, STEVEN
STONE, NEIL
TAA, LEO
TIJANI, RICKY
UNEBERG, ERIC
UNGSON, EMMANUEL
WENDLING, ANGELINA
WOLF, RICARDO

## SERVICE CONNECTED DISABILITY RETIREMENTS

NONE

## NON-SERVICE CONNECTED DISABILITY RETIREMENTS

STOLLMAN, DEBORAH

# Deaths During Fiscal Year 2011-2012

## DEATHS AFTER RETIREMENT

AFONSO, LIONEL
ALLAN, LORRAINE
AUST, RICHARD
BACA, ROBERT
BONIOR, AILIE
BORDER, NICHOLAS
BYERS, ELENORE
CHAVEZ, FRANK
COLLA, JOHN
DAVILA, ESTHER
DETMERS, LORIS
DORFMAN, LORRAINE
GATHERS, JOAN
HALL, JAMES
HALL, KENNETH
HERNANDEZ, PEDRO
HERNANDEZ, RALPH
HERRON, STEVE
HIRATA, BOB
HURSH, FRANK
IHORI, LARRY
KEEHEN, TIMOTHY
KENNEDY, JOYCE
KUO, CYNTHIA
LARAGIONE, JOSEPH
LYND, ODUS
MASSUCCI, LOUIS
MC GOWAN-MIRABELLA, BETT
MONTIJO, RAYMOND
MOORE, MAXINE
NELLANY, JOHN
NORWOOD, LINDA
NUNES, SANDRA
O'NEIL, DIANE
OLIVER, ROBERT
OVERSON, DIANA
PADILLA, DAVID
PATONAI, RICHARD
PATTEE, MARGARET
PONCE, LILY
RAMIREZ, TENNIE
RUDY, EUGENE
RUSCIGNO, RONALD
SALISBURY, DOROTHY
SAUCEDO, ALFONSO
SCHELL, CAROL
SGAMBATI, ROBERT
SHIELDS, BEVERLY
SPALDING, JOHN
TAKATA, NATSUYE
TENORIO, FLORENCIO
TERSHUREN, ERNEST
TOMLIN, JOHN
TUCKER, GAIL
VAUGHN, MERLE
VEGA, ROBERT
WEAVER, VERNA
WESTHEIMER, RICHARD
ZUNIGA, RODOLFO

## DEATHS BEFORE RETIREMENT

BELTRAN, LEON
JOHNSON, GORDON
PETTIGREW, JEFFREY
SHIRALDI, JEANNE

**Source:** Pension Administration System

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