# City of San Jose -VEBA Decision

# VEBA Option

- The City of San Jose is offering eligible employees a one-time irrevocable opportunity to participate in the Voluntary Employee Beneficiary Association (VEBA) or stay in the Defined Benefit Retiree Healthcare plan

- The VEBA is a self directed, tax advantaged, savings plan with portability and survivor benefits which may be used to pay for post-retirement healthcare premiums (including San Jose City retiree healthcare and dental plans), prescriptions, co-pays, and other healthcare related expenses

- Mandatory employee contributions to the VEBA; Unit 99 at 0%, Federated Management 2.5%, Federated Non-Management at 3.5%, and Police and Fire at 4.0%

- The VEBA opt-in deadline is December 1, 2017

- To learn more about the VEBA, please review the "VEBA Information" page on the Human Resources website (https://www.sanjoseca.gov/index.aspx?NID=5626). This website includes the VEBA Election Form , program description, and other related information

**SUPPORT**

Parallel Advisors, LLC will be providing group events, One-on-One meetings, and webinars. These education events will provide you with information related to the VEBA decision and the option to ask questions specific to your personal financial situation

# What to Consider

- Spouse or Domestic Partner's Benefits (Military, Federal, etc.):
Next to your current health situation, a spouse or domestic partner's employer's medical benefits, before and during retirement, may have a significant impact on your decision.  For example, if a spouse's employer's retirement benefits are more attractive that your City of San Jose benefits, then choosing the VEBA may be more beneficial for your situation

- For City of San Jose employees, with a spouse or domestic partner also employed by the City, consider the advantages of one or both of you selecting the VEBA option

- Must have 15 years of City service (and Retiree Healthcare contributions) to be eligible for the Defined Benefit Retiree Healthcare plan

- Special Medical Needs:
Pre-existing conditions require treatment that can be costly.  Treatment can be costly.

- Early retirement before Medicare eligibility (age 65)

- VEBA participants will have a higher take-home pay since VEBA contribution requirements are lower than the Defined Benefit Retiree Healthcare plan contribution rates

- Use VEBA savings to increase retirement savings (457 Plan)

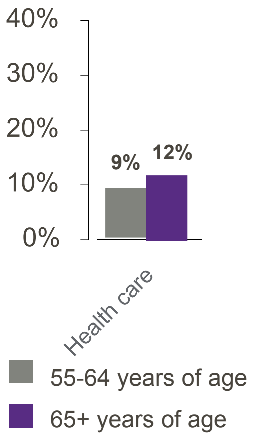
- Other assets, investments, rental property, etc.

- Inheritance and significant lottery winnings
- Pension income can be used to pay for healthcare related expenses in retirement

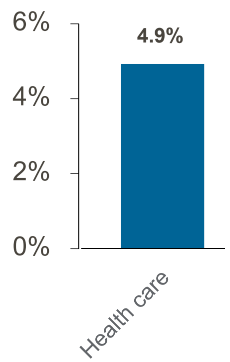
# Healthcare Costs in Retirement

# Spending and Inflation

### Spending by age and category



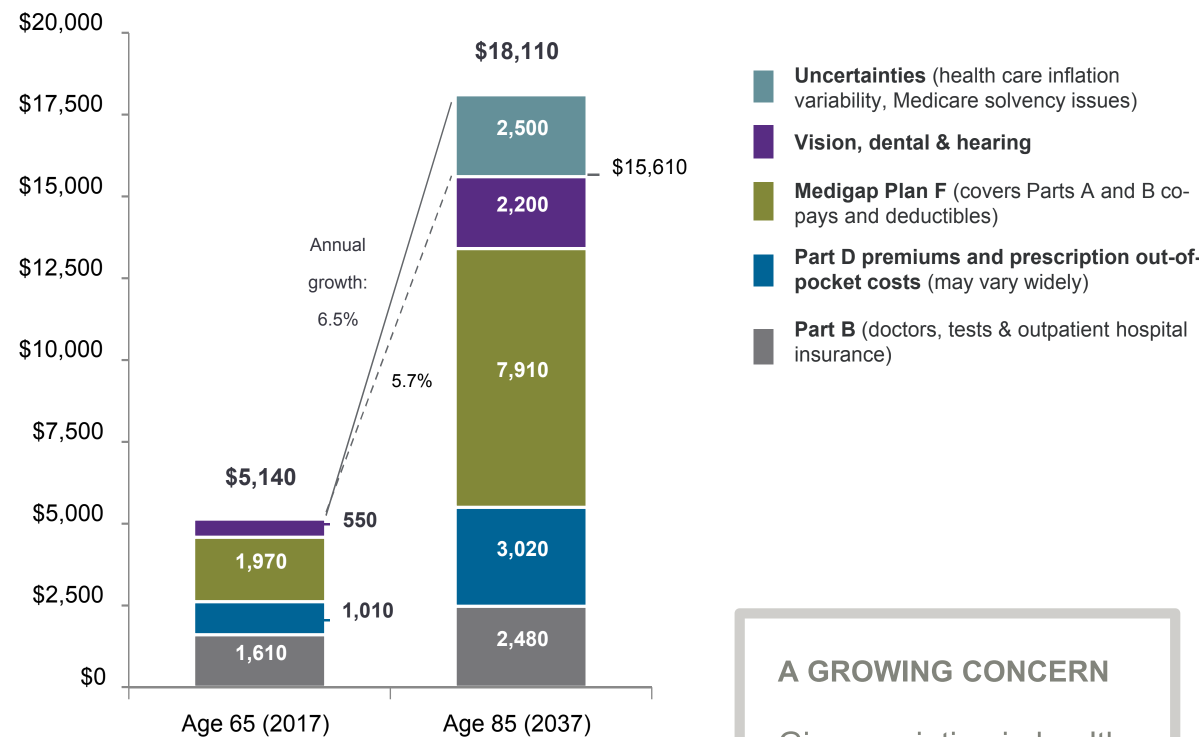

### Average inflation by spending category 1982-2016




**LOSING GROUND**

Inflation disproportionately affects older Americans due to differences in spending habits and price increases in those categories.

### Traditional Medicare estimated median health care costs per person




**A GROWING CONCERN**

Given variation in health care cost inflation from year to year, it may be prudent to assume an annual health care inflation rate of 6.5%, which may require growth as well as current income from your portfolio in retirement.

*There are no individual inflation measures for these specific subcategories.

Source (top chart): BLS, 2015 Consumer Expenditure Survey for households where at least one member has a bachelor's degree. Charitable contributions include gifts to religious, educational and political organizations, and other cash gifts. Spending percentages may not equal 100% due to rounding.

Source (bottom chart): BLS, Consumer Price Index. Data represent annual percentage increase from December 1981 through December 2016 with the exception of entertainment and education, which date back to 1993. The inflation rate for the Other category is derived from personal care products and tobacco. Tobacco has experienced more than 7% inflation since 1986 but each age group only spends 0.4%-0.7% on tobacco (27%-37% of combined personal care products and tobacco), which is a lower proportion than represented in the Other inflation rate.

# What is Medicare?

**Medicare is a government health care program available to those who have paid Medicare taxes while working or to non-working spouses of such individuals. Medicare is available when these individuals reach age 65. Citizens who have never paid Medicare taxes may be eligible if they pay a Medicare premium. Individuals under age 65 may also be eligible if they are considered disabled by Social Security or the Railroad Retirement Board for more than 24 months.**

| | Traditional Medicare | Medicare Advantage (usually limited to a network of providers) |
|---|---|---|
| Part A: inpatient hospital insurance | ✓ | ✓ |
| Part B: doctors, tests and outpatient hospital insurance | ✓ | ✓ |
| Medigap: standardized plans that cover Part A and Part B co-pays and deductibles | ✓ | Not available |
| Part D: prescription drug insurance | ✓ | ✓ Most plans include Part D |
| Prescription drug co-pays and deductibles | Not covered | Not covered |
| Most vision, dental and hearing expenses | Not covered | ✓ Coverage varies by plan |
| Long-term care* | Not covered | Not covered |



* Medicare does not cover most long-term care costs. Medicare does pay for medically necessary skilled nursing facility or home health care on a very limited basis. Custodial care is not covered.

# Hypothetical Sample Employee Projections

# Hypothetical Example - Employee #1

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## City of San Jose - Sample VEBA Projection

Assumptions:

| | | | |
|---|---|---|---|
| VEBA Eligible Cont. Amount (Rollover) | $63,000 | Current Years of Service | 16 |
| Current Salary | $90,000 | Starting Pension Amount | $48,709.50 |
| Age | 51 | Pension COLA | 3% |
| Spouse (SP) or Domestic Partner (DP)(Same Age) | Yes | Annual Investment Gain | 5% |
| Years to Retirement | 4 | VEBA Contribution Rate | 3.5% |
| Tier | 1 | Health Care Inflation | 4.25% |
| Salary COLA | 2% | Retirement Combined Fed and State Tax Rate | 30% |
| Lowest Cost Plan Available | $980.40 | | |

| Year | Age | Annual Salary/ Pension | Initial Rollover Amount | Annual VEBA Contribution | Investment Gain | Low Cost Plan | Medicare (Age 65) | Health Care Costs | Cumulative VEBA Balance | Cumulative 457 Balance: Contributions (4%) + Investment Gain (5%) |
|---|---|---|---|---|---|---|---|---|---|---|
| 2018 | 51 | $90,000 | $63,000 | $3,150 | $3,150 | | | | $69,300 | $3,600 |
| 2022 | 55 | $48,710 | | $0 | $4,527 | $13,896 | | ($13,896) | $81,181 | $15,218 |
| 2023 | 56 | $49,684 | | | $4,059 | $14,487 | | ($14,487) | $70,754 | $15,979 |
| 2024 | 57 | $50,677 | | | $3,538 | $15,102 | | ($15,102) | $59,189 | $16,778 |
| 2025 | 58 | $51,691 | | | $2,959 | $15,744 | | ($15,744) | $46,405 | $17,617 |
| 2026 | 59 | $52,725 | | | $2,320 | $16,413 | | ($16,413) | $32,312 | $18,498 |
| 2027 | 60 | $53,779 | | | $1,616 | $17,111 | | ($17,111) | $16,816 | $19,423 |
| 2028 | 61 | $54,855 | | | $841 | $17,838 | | ($17,838) | $0 | $20,394 |
| 2029 | 62 | $55,952 | | | $0 | $18,596 | | ($18,596) | | $21,414 |
| 2030 | 63 | $57,071 | | | | $19,386 | | ($19,386) | | $22,485 |
| 2031 | 64 | $58,212 | | | | $20,210 | | ($20,210) | | $23,609 |
| 2032 | 65 | $59,377 | | | | | $17,935 | ($17,935) | | $24,789 |
| 2037 | 70 | $65,557 | | | | | $22,781 | ($22,781) | | $31,638 |
| 2042 | 75 | $72,380 | | | | | $28,937 | ($28,937) | | $40,379 |
| 2047 | 80 | $79,913 | | | | | $36,756 | ($36,756) | | $51,535 |
| 2052 | 85 | $88,231 | | | | | $46,688 | ($46,688) | | $65,773 |

*Healthcare costs paid out of pension income after VEBA account is depleted.

# Hypothetical Example - Employee #2

## City of San Jose - Sample VEBA Projection

Assumptions:

| | | | |
|---|---|---|---|
| VEBA Eligible Cont. Amount (Rollover) | $33,800 | Years of Service | 10 |
| Current Salary | $64,000 | Starting Pension Amount | $50,668.20 |
| Age | 46 | Pension COLA | 3% |
| Spouse (SP) or Domestic Partner (DP)(Same Age) | No | Annual Investment Gain | 5% |
| Years to Retirement | 14 | VEBA Contribution Rate | 3.5% |
| Tier | 1 | Health Care Inflation | 4.25% |
| Salary COLA | 2% | Retirement Combined Fed and State Tax Rate | 30% |
| Lowest Cost Plan Available | $490.20 | | |

| Year | Age | Annual Income | Initial Rollover Amount | Annual VEBA Contribution | Investment Gain | Low Cost Plan | Medicare (Age 65) | Health Care Costs | Cumulative VEBA Balance | Balance: Contributions (4%) + Investment Gain (5%) |
|---|---|---|---|---|---|---|---|---|---|---|
| 2018 | 46 | $64,000 | $33,800 | $2,240 | $1,690 | | | | $37,730 | $2,560 |
| 2022 | 50 | $69,276 | | $2,425 | $2,555 | | | | $56,071 | $13,322 |
| 2027 | 55 | $76,486 | | $2,677 | $3,956 | | | | $85,758 | $31,198 |
| 2032 | 60 | $50,668 | | $0 | $5,818 | $10,535 | | ($10,535) | $111,635 | $52,536 |
| 2037 | 65 | $58,738 | | | $4,269 | | $11,391 | ($11,391) | $78,260 | $67,050 |
| 2042 | 70 | $68,094 | | | $1,994 | | $14,469 | ($14,469) | $27,401 | $85,575 |
| 2047 | 75 | $78,939 | | | | | $18,378 | ($18,378) | | $109,218 |
| 2052 | 80 | $91,512 | | | | | $23,344 | ($23,344) | | $139,393 |
| 2057 | 85 | $106,088 | | | | | $29,652 | ($29,652) | | $177,904 |

*Healthcare costs paid out of pension income after VEBA account is depleted.

# Hypothetical Example - Employee #3

## City of San Jose - Sample VEBA Projection

Assumptions:

| | | | |
|---|---|---|---|
| VEBA Eligible Cont. Amount (Rollover) | $26,000 | Years of Service | 4 |
| Current Salary | $88,000 | Starting Pension Amount | $98,054.62 |
| Age | 34 | Pension COLA | 2% |
| Spouse (SP) or Domestic Partner (DP)(Same Age) | Yes | Annual Investment Gain | 5% |
| Years to Retirement | 28 | VEBA Contribution Rate | 2.5% |
| Tier | 2a | Health Care Inflation | 4.25% |
| Salary COLA | 2% | Retirement Combined Fed and State Tax Rate | 30% |
| Lowest Cost Plan Available | $980.40 | | |

| Year | Age | Annual Income | Initial Rollover Amount | Annual VEBA Contribution | Investment Gain | Low Cost Plan | Medicare (Age 65) | Health Care Costs | Cumulative VEBA Balance | Cumulative 457 Balance: Contributions (4%) + Investment Gain |
|---|---|---|---|---|---|---|---|---|---|---|
| 2018 | 34 | $88,000 | $26,000 | $2,200 | $1,300 | | | | $29,500 | $3,520 |
| 2019 | 35 | $89,760 | | $2,244 | $1,475 | | | | $33,219 | $5,940 |
| 2024 | 40 | $99,102 | | $2,478 | $2,527 | | | | $55,535 | $20,719 |
| 2029 | 45 | $109,417 | | $2,735 | $3,936 | | | | $85,384 | $40,949 |
| 2034 | 50 | $120,805 | | $3,020 | $5,808 | | | | $124,989 | $68,278 |
| 2039 | 55 | $133,379 | | $3,334 | $8,280 | | | | $177,204 | $104,825 |
| 2044 | 60 | $147,261 | | $3,682 | $11,524 | | | | $245,685 | $153,309 |
| 2046 | 62 | $98,055 | | $0 | $13,086 | $37,732 | | ($37,732) | $237,078 | $172,966 |
| 2049 | 65 | $104,056 | | | $8,953 | | $40,447 | ($40,447) | $147,575 | $200,229 |
| 2054 | 70 | $114,887 | | | | | $51,376 | ($51,376) | | $255,549 |
| 2059 | 75 | $126,844 | | | | | $65,259 | ($65,259) | | $326,153 |
| 2064 | 80 | $140,046 | | | | | $82,892 | ($82,892) | | $416,262 |
| 2069 | 85 | $154,622 | | | | | $105,291 | ($105,291) | | $416,262 |

*Healthcare costs paid out of pension income after VEBA account is depleted.

# Hypothetical Example - Employee #4

## City of San Jose - Sample VEBA Projection

Assumptions:

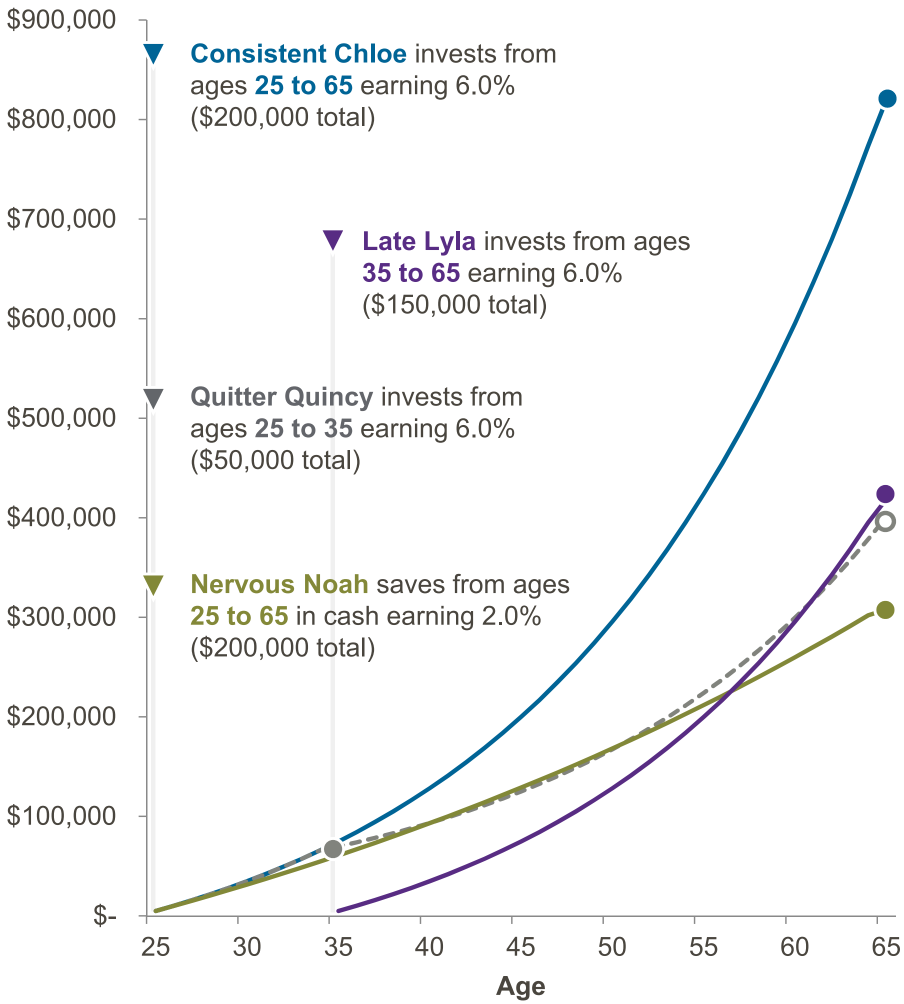
| | | | |
|---|---|---|---|
| VEBA Eligible Cont. Amount (Rollover) | $98,000 | Years of Service | 21 |
| Current Salary | $124,000 | Starting Pension Amount | $93,955.11 |
| Age | 45 | Pension COLA | 3% |
| Spouse (SP) or Domestic Partner (DP)(Same Age) | Yes | Annual Investment Gain | 5% |
| Years to Retirement | 5 | Veba Contribution Rate | 4% |
| Tier | Police Teir 1 | Health Care Inflation | 4.5% |
| Salary COLA | 2% | Retirement Combined Fed and State Tax Rate | 30% |
| Lowest Cost Plan Available | $980.40 | | |

| Year | Age | Annual Income | Initial Rollover Amount | Annual VEBA Contribution | Investment Gain | Low Cost Plan | Medicare (Age 65) | Health Care Costs | Cumulative VEBA Balance | Balance: Contributions (4%) + Investment Gain (5%) |
|---|---|---|---|---|---|---|---|---|---|---|
| 2018 | 45 | $124,000 | $98,000 | $4,960 | $4,900 | | | | $107,860 | $4,960 |
| 2023 | 50 | $93,955 | | $0 | $7,705 | $14,717 | | ($14,717) | $147,081 | $30,469 |
| 2028 | 55 | $108,920 | | | $5,370 | $18,694 | | ($18,694) | $94,068 | $38,887 |
| 2033 | 60 | $126,268 | | | $1,183 | $23,745 | | ($23,745) | $1,104 | $49,630 |
| 2038 | 65 | $146,379 | | | | | $23,897 | ($23,897) | | $63,342 |
| 2043 | 70 | $169,693 | | | | | $30,355 | ($30,355) | | $80,843 |
| 2048 | 75 | $196,721 | | | | | $38,557 | ($38,557) | | $103,178 |
| 2053 | 80 | $228,054 | | | | | $48,976 | ($48,976) | | $131,684 |
| 2058 | 85 | $264,377 | | | | | $62,210 | ($62,210) | | $168,066 |

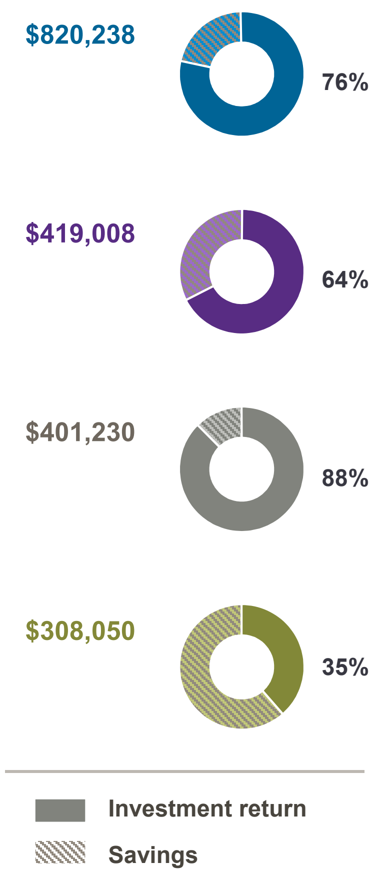
*Healthcare costs paid out of pension income after VEBA account is depleted.

# Saving and Investing Early

**SAMPLE VEBA account growth of $5,000 invested/saved annually**




**SAMPLE VEBA ENDING PORTFOLIO**




**SAVING FUNDAMENTALS**

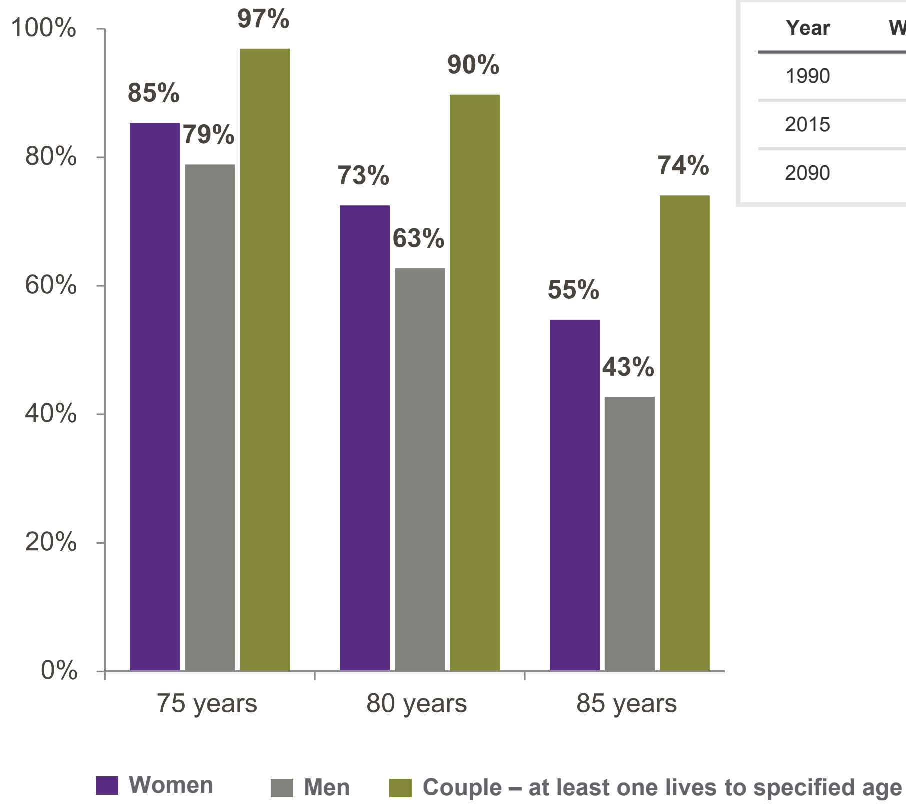
Saving early and often, and investing what you save, are some of the keys to a successful retirement due to the power of compounding over the long term.

The above example is for illustrative purposes only and not indicative of any investment. Account value in this example assumes a 6.0% annual return and cash assumes a 2.0% annual return. Source: J.P. Morgan Asset Management, Long-Term Capital Market Assumptions. Compounding refers to the process of earning return on principal plus the return that was earned earlier.

# Preparing for Retirement

# Life Expectancy

**If you're 65 today, the probability of living to a specific age or beyond**




Average life expectancy at age 65

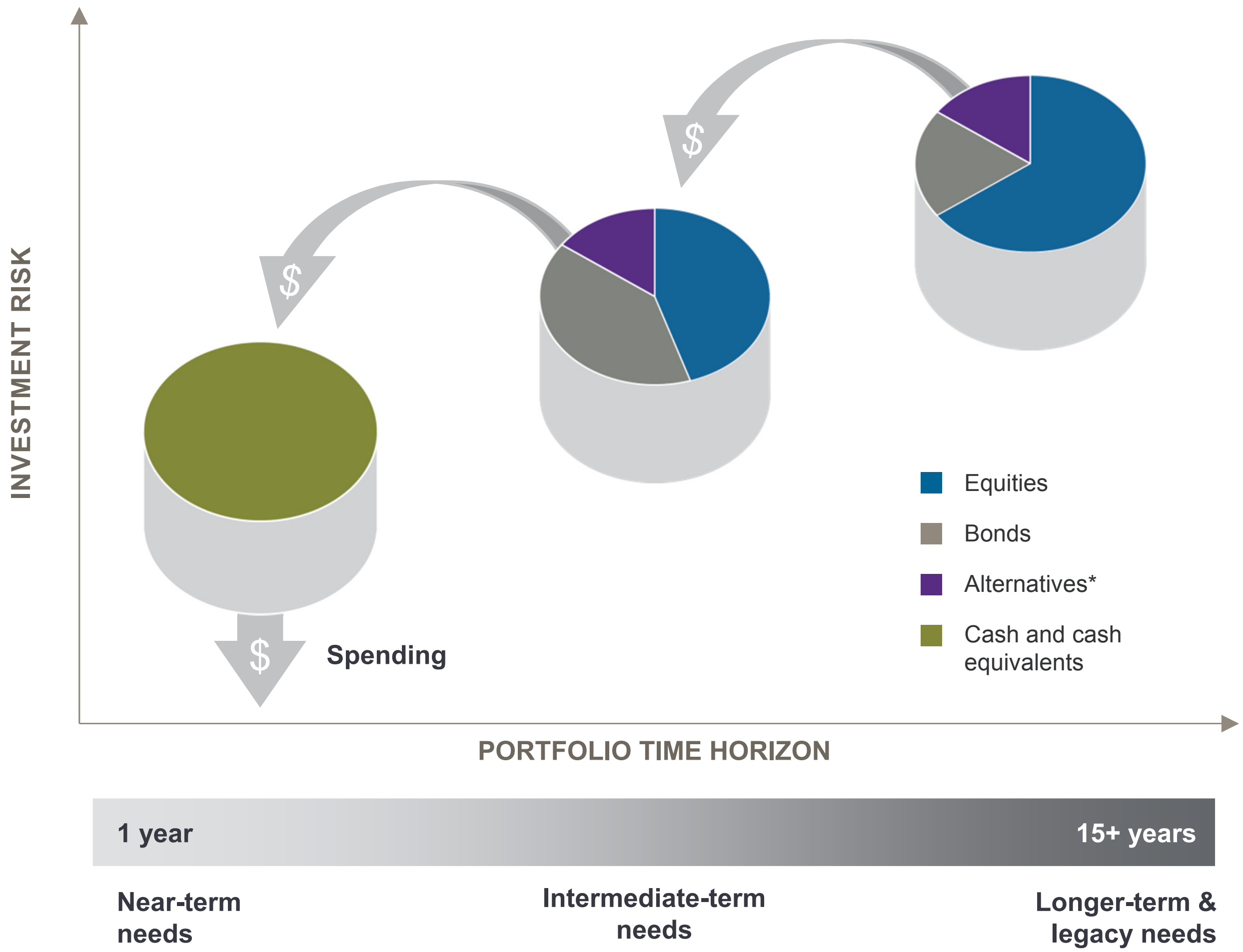
| Year | Women | Men | Difference |
|---|---|---|---|
| 1990 | 84.1 | 80.1 | 4.0 |
| 2015 | 85.5 | 83.1 | 2.4 |
| 2090 | 89.6 | 87.6 | 2.0 |

**PLAN FOR LONGEVITY**

Average life expectancy continues to increase and is a mid-point not an end-point. You may need to plan on the probability of living much longer – perhaps 30+ years in retirement – and invest a portion of your portfolio for growth to maintain your purchasing power over time.

Chart: Social Security Administration, Period Life Table, 2013 (published in 2016), J.P. Morgan Asset Management. Table: Social Security Administration 2016 OASDI Trustees Report. Probability at least one member of a same-sex female couple lives to age 90 is 55% and a same-sex male couple is 39%.

# The Portfolio Bucket Strategy




**TIME-BASED SEGMENTATION**

Aligning your time horizon with an investment approach may help you be more comfortable with maintaining diversified portfolio allocations in retirement.

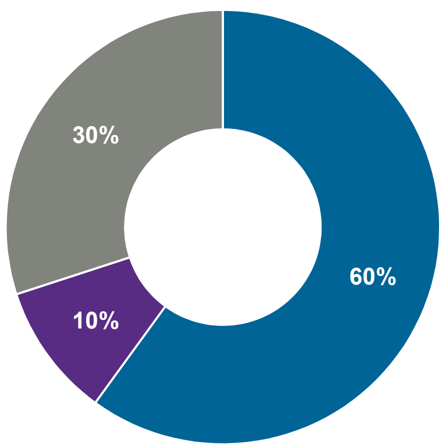
For illustrative purposes only. Bonds are subject to interest rate risks. Bond prices generally fall when interest rates rise. The price of equity securities may rise or fall because of changes in the broad market or changes in a company's financial condition, sometimes rapidly or unpredictably. Equity securities are subject to "stock market risk," meaning that stock prices in general may decline over short or extended periods of time. Investing in alternative assets involves higher risks than traditional investments and is suitable only for the long term. They are not tax efficient and have higher fees than traditional investments. They may also be highly leveraged and engage in speculative investment techniques, which can magnify the potential for investment loss or gain.

*Equity, fixed income and cash are considered "traditional" asset classes. The term "alternative" describes all non-traditional asset classes. They include private and public equity, venture capital, hedge funds, real estate, commodities, distressed debt and more.

# Diversification

**Maximizing the power of diversification** 2001–2016

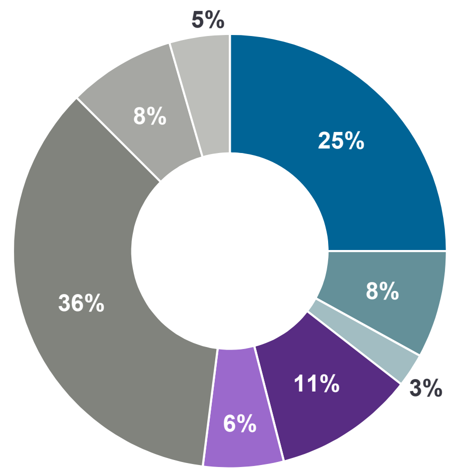
### Less diversified portfolio




**Return: 6.4%**
**Volatility: 12.0%**

- S&P 500
- EAFE Equity
- Barclays Aggregate

### More diversified portfolio




**Return: 7.2%**
**Volatility: 11.1%**

- S&P 500
- Russell 2000
- REIT
- EAFE Equity
- Emerging Market Equity
- Barclays Aggregate
- US High Yield
- Emerging Market Debt

**MIX IT UP WISELY**

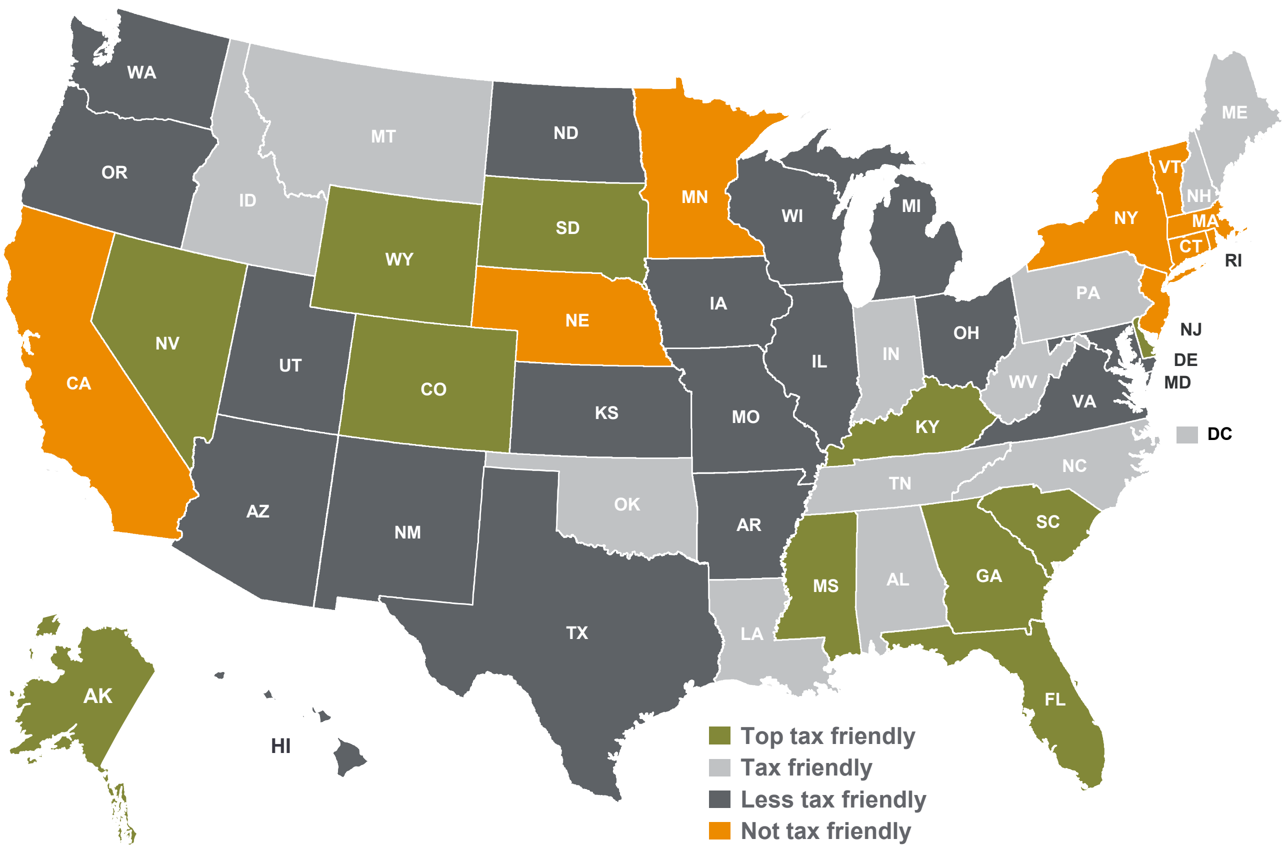
Diversification may provide better returns with less risk.

Indexes and weights of the less diversified portfolio are as follows: U.S. stocks: 60.00% S&P 500; International stocks: 10.00% MSCI EAFE; U.S. bonds: 30.00% Barclays Capital Aggregate. More diversified portfolio is as follows: U.S. stocks: 25.00% S&P 500, 8.00% Russell 2000, 2.50% NAREIT Equity REIT Index; International stocks: 10.50% MSCI EAFE, 6.00% MSCI Emerging Markets; U.S. bonds: 35.50% Barclays Capital Aggregate, 8.00% Barclays U.S. High Yield; International bonds: 4.50% J.P. Morgan EMBI Global Diversified. Source: Bloomberg.

Charts are shown for illustrative purposes only. Percentages may not sum due to rounding. Past returns are no guarantee of future results. Diversification does not guarantee investment returns and does not eliminate risk of loss. Data as of December 30, 2016.

# Comparison of state taxes paid by a retiree household

**City of San Jose Medical Benefit Plan offering and related costs may be higher if moving out of state**




**ASSUMPTIONS**

Scenario based on retired married couple filing jointly

**State income tax** on[1] –

- Annual retirement plan distribution: $80,000
- Total Social Security benefits: $42,000

**Property tax** on[2]: 2.5x median home value by state

**Sales/average local sales tax** on[3]: Remaining income net of federal & state income tax and property tax

Tax favorability based on household overall effective state tax rate: Top tax friendly (<8%), Tax friendly (8%-9.9%), Less tax friendly (10%-13%), Not tax friendly (>13%). Retired married household age 65. [1] State income tax liability is based on all taxable sources of retirement income minus allowable state personal exemptions and a standard deduction. State-specific exemptions, deductions and/or credits related to eligible retirement income and Social Security are included. States with no income tax: AK, FL, NV, SD, TX, WA, WY. States that tax interest and dividends only: TN and NH.

States that tax Social Security: CO, CT, KS, MN, MO, MT, NE, NM, ND, RI, UT, VT, WV. States that do not tax retirement plan distributions or Social Security: IL, MS, PA. [2] State property tax applies to home value only and includes state-specific homestead exemptions/credits. [3] States with no sales tax: AK, DE, MT, NH, OR (local taxes may apply).
Of note: CA imposes a 1% surtax on taxpayers earning more than $1M ($1,052,886 married) for a top marginal tax rate of 13.3%. NYC levies an additional 2.907-3.876% on taxable income. HI top marginal income tax rate reduced to 8.25% in 2017.

Source: J.P. Morgan Asset Management. The presenter of this slide is not a tax or legal advisor, and this slide should not be used as such. Clients should consult a personal tax or legal advisor prior to making any tax- or legal-related investment decisions.

## Additional Resources

- San Jose City web site (https://www.sanjoseca.gov/VEBA
- For questions: veba@sanjoseca.gov and 408-535-VEBA (8322)
- Pre-Retirement calculator (https://paralleladvisors.com/financial-planning)

# Disclosures

Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable, but do not warrant its accuracy or completeness. References to future returns are not promises or even estimates of actual returns a client portfolio may achieve.

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NOT FDIC INSURED. NO BANK GUARANTEE. MAY LOSE VALUE.

# Parallel Advisors

- Founded in 2006
- $1.8 billion in assets under management
- 42 employees; PhD, CFA, CFP, JD, & CPA

- Independent, Inclusive, and Innovative
- Retirement plan services, investment management, financial planning, estate and tax planning

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