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# Memorandum

**TO:** HONORABLE MAYOR AND  
CITY COUNCIL

**FROM:** Alex Gurza

**SUBJECT:** Analysis of SRBR ("13<sup>th</sup>" Check)  
Payments and SRBR Options

**DATE:** January 18, 2011

Approved

Date

1/18/11

## INFORMATION

On October 26, 2010, the City Council suspended payments from the Supplemental Retiree Benefit Reserve (SRBR) or "13<sup>th</sup>" check for Fiscal Year 2010-2011 and directed staff to analyze options for the SRBR. On January 12, 2011, staff provided the City Council an Information Memorandum, which analyzed pension payments from the Police and Fire Department Retirement Plan and Federated City Employees' Retirement System.<sup>1</sup> The memorandum provided information related to the SRBR. One of the concerns that has been raised at City Council and retirement board meetings is that there are many retirees whose pension benefits fall below the poverty level. The analysis in the memorandum indicated that those retirees with the lowest pension payments on average have the lowest years of service and thus receive a lower pension payment. In addition, the memorandum pointed out the difficulty of making a poverty level analysis without knowing a retiree's total household income and assets, since pension benefits from San Jose may not be the retiree's sole source of income.

As follow up to the prior memorandum, this memorandum serves to provide the City Council further information regarding the SRBR, including information on the distribution of SRBR payments and the primary options for the SRBR.

## BACKGROUND

The SRBR provides retirees a "13<sup>th</sup>" check, which is a cash payment to retirees payable under certain circumstances in addition their regular monthly pension checks. When the retirement plans investment income exceeds their expected returns, 10% of those "excess" earnings are credited to the SRBR. Under the current definition, "excess" earnings can be declared and transferred to the SRBR even if other actuarial assumptions have not been met and even if the plans are significantly underfunded, as they are currently.

As of June 30, 2010, the unfunded liability and funding ratios under both calculations for each pension plan are detailed below. Based on the current difference between the market value of assets and the actuarial value of assets, a further decline in the funded status is expected over

<sup>1</sup> [www.sanjoseca.gov/employeeRelations/retirementbenefits/reports/InfoMemo-AnalysisOfPensionPaymentsDated01.12.11.pdf](http://www.sanjoseca.gov/employeeRelations/retirementbenefits/reports/InfoMemo-AnalysisOfPensionPaymentsDated01.12.11.pdf)

the next few years, as the asset losses for the 2008-2009 market downturn are fully recognized in the actuarial value of assets.

<b>Pension Unfunded Liability As of June 30, 2010</b>			
	<b>Federated</b>	<b>Police and Fire</b>	<b>Total</b>
Market Value	\$1.0 billion	\$1.0 billion	\$2.0 billion
Funding Ratio	60%	69%	65%
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Actuarial Value	\$0.78 billion	\$0.65 billion	\$1.43 billion
Funding Ratio	69%	80%	75%

<b>Retiree Healthcare (OPEB) Unfunded Liability As of June 30, 2010</b>			
	<b>Federated</b>	<b>Police and Fire <sup>2</sup></b>	<b>Total</b>
Market Value	\$0.82 billion	\$0.72 billion	\$1.54 billion
Funding Ratio	12%	7%	9%
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Actuarial Value	\$0.82 billion	\$0.71 billion	\$1.53 billion
Funding Ratio	12%	6%	10%

When there is a distribution from the SRBR, the criteria for determining the payment amount for each retiree in both plans are based on a "point" system. Retirees receive points based on years of service, number of years retired, and final average salary. Under this methodology, the largest payments are made to retirees that have been retired the longest and have rendered the longest service to the City.

Additional background information regarding the SRBR can be found in the memorandum to the City Council, dated October 22, 2010.<sup>3</sup>

**ANALYSIS**

Staff conducted an analysis of the two most recent payouts from the SRBR. In 2007 and 2008, SRBR payments were made to retirees in both the Police and Fire Department Retirement Plan and the Federated City Employees' Retirement System. For the analysis, retirees' pensions were segmented based upon the annual pension payments received, which include base pension payments and COLA's.

**Police and Fire Department Retirement Plan SRBR Payments**

The total SRBR payments for retirees in the Police and Fire Department Retirement Plan for 2007 and 2008 were \$1.87 Million and \$2.24 Million respectively. As illustrated in the two charts below, Police and Fire Department Retirement Plan retirees received SRBR payments

<sup>2</sup> The June 30, 2010, OPEB (retiree healthcare) valuation has not been completed. It is anticipated that the report, including the contributions will be available in February. The retiree healthcare liability for Police and Fire demonstrated on this chart is the unfunded liability as of the June 30, 2009 valuation.

<sup>3</sup> [http://www.sanjoseca.gov/clerk/Agenda/20101026/20101026\\_0303sup.pdf](http://www.sanjoseca.gov/clerk/Agenda/20101026/20101026_0303sup.pdf)

regardless of their annual pension amounts. Individual payments for retirees ranged from \$278 to \$6,496 and the retirees' years of service with the City ranged from 1 year to 43 years.

Police and Fire Department Retirement Plan  
 2008 SRBR Payments

Annual Pension <sup>4</sup>	Average Total Pension	Average SRBR Payment	Total SRBR Payments	% of Total SRBR Payments
\$125,001 and above	\$144,592	\$1,324	\$54,291	2.42%
\$100,001 to \$125,000	\$108,114	\$1,268	\$145,763	6.50%
\$75,001 to \$100,000	\$86,457	\$1,386	\$462,927	20.63%
\$50,001 to \$75,000	\$63,393	\$1,525	\$741,027	33.02%
\$25,001 to \$50,000	\$39,180	\$2,494	\$718,234	32.01%
Up to \$25,000	\$19,911	\$3,120	\$121,677	5.42%

Police and Fire Department Retirement Plan  
 2007 SRBR Payments

Annual Pension <sup>4</sup>	Average Total Pension	Average SRBR Payment	Total SRBR Payments	% of Total SRBR Payments
\$125,001 and above	\$142,750	\$1,118	\$31,317	1.68%
\$100,001 to \$125,000	\$108,735	\$1,121	\$88,530	4.74%
\$75,001 to \$100,000	\$86,369	\$1,181	\$348,420	18.65%
\$50,001 to \$75,000	\$63,200	\$1,309	\$651,858	34.89%
\$25,001 to \$50,000	\$39,200	\$2,021	\$622,369	33.31%
Up to \$25,000	\$20,064	\$2,737	\$125,902	6.74%

Federated City Employees' Retirement System

The total SRBR payments for retirees in Federated City Employees' Retirement System for 2007 and 2008 were \$1.32 Million and \$131,440 respectively. Similar to the Police and Fire Department Retirement Plan, retirees in the Federated City Employees' Retirement System received SRBR payments regardless of their annual pension amounts. Individual payments for retirees ranged from \$1 to \$1,307 and the retirees' years of service with the City ranged from 1 year to 40 years.

<sup>4</sup> Based on current pension payments

Federated City Employees' Retirement System  
 2008 SRBR Payments

Annual Pension <sup>4</sup>	Average Total Pension	Average SRBR Payment	Total SRBR Payments	% of Total SRBR Payments
\$100,001 and above	\$112,792	\$74	\$1,844	1.40%
\$75,001 to \$100,000	\$85,086	\$76	\$7,404	5.63%
\$50,001 to \$75,000	\$60,101	\$74	\$31,843	24.23%
\$25,001 to \$50,000	\$36,440	\$62	\$60,314	45.89%
Up to \$25,000	\$15,106	\$35	\$30,036	22.85%

Federated City Employees' Retirement System  
 2007 SRBR Payments

Annual Pension <sup>4</sup>	Average Total Pension	Average SRBR Payment	Total SRBR Payments	% of Total SRBR Payments
\$100,001 and above	\$110,709	\$806	\$15,308	1.16%
\$75,001 to \$100,000	\$84,906	\$786	\$62,103	4.71%
\$50,001 to \$75,000	\$59,707	\$782	\$286,827	21.77%
\$25,001 to \$50,000	\$36,082	\$658	\$624,801	47.41%
Up to \$25,000	\$14,963	\$372	\$328,790	24.95%

3% Fixed Cost of Living Adjustment (COLA)

It is important to note that in addition to the monthly pension that retirees receive, retirees also receive an automatic 3% annual cost of living increase, compounded annually. The 3% COLA is currently given to all retirees in the plans every year, regardless of the actual change in the Consumer Price Index (CPI). This is a significant and expensive feature in both plans, which increases retirees' pensions annually.

Options for SRBR

The Council has directed the Administration to explore various options for the SRBR. Prior to discussing the options with stakeholders, the Administration will need further direction from the City Council.

In the City Auditor's recent audit entitled Pension Sustainability Rising Pension Costs Threaten The City's Ability to Maintain Service Levels – Alternatives For A Sustainable Future, the City

Auditor emphasized the need for retirement reform.<sup>5</sup> One of the City Auditor's recommendations was to consider eliminating the SRBR or at least prohibiting SRBR payments when the retirement plans are underfunded.

The Administration concurs with the two primary options for the SRBR's identified by the City Auditor:

1. **Modify the SRBR's**
2. **Eliminate the SRBR's**

#### Modification of the SRBR's

There are many options for modification of the SRBR's. Some of the major categories for possible modification are the following:

1. Create formal funding arrangement for the SRBR's
2. Redefine regular and excess earnings for transfers to the SRBR's and allow negative earnings to be shared by the SRBR's
3. Change the distribution methodology for SRBR payments

If the City Council decides to maintain a modified version of the SRBR's, the Administration recommends that the priority modification be a requirement that the plans be more than fully funded for several years before any transfer to the SRBR could take place. This serves to prioritize the funding of the base benefits before any supplemental payments are made.

In addition, if the City Council decides to maintain a modified version of the SRBR, the Administration recommends pursuing a payment method that is significantly different than the current "point" system. One option is to use available funds, if any, for a "purchasing power protection" feature that serves to help retirees whose pension payments have fallen below a certain percentage of the purchasing power of their original pension, when combined with the 3% fixed COLA. This feature would avoid the subjective nature of trying to choose those retirees that need a SRBR payment. Payments would only be made when there are funds available, as defined under a modified program.

#### Elimination of the SRBR's

Over the next several years, retirement benefit costs, both pension and retiree healthcare, are projected to continue to increase. The fiscal health and cost of the current retirement benefits is a very significant concern. Per the chart above, there is currently between **\$3-3.5 billion** in unfunded liabilities for pension and retiree healthcare benefits. The benefits currently received by retirees are not fully funded, particularly retiree healthcare benefits. A 2<sup>nd</sup> tier of retirement benefits will **not** reduce that very significant liability.

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<sup>5</sup> <http://www.sanjoseca.gov/auditor/AuditReports/1010/1010.pdf>

Given the significant unfunded liabilities related to retirement benefits for current City employees and retirees, the Administration recommends pursuing the elimination of the SRBR's. If legally possible, the Administration recommends pursuing transferring the current funds back into the main pension accounts to fund current retirement benefits

Pursuing elimination of the SRBR program may raise concerns among retirees that they would lose purchasing power if they did not receive SRBR payments because of increases in the cost of living. However, the effect of increases in the cost of living is greatly diminished with the retirement plans' current 3% fixed COLA. Since the 3% fixed COLA went into effect for the Police and Fire Department Retirement Plan in 2002, CPI rose on average of 2.0% per year.<sup>6</sup> The 3% fixed COLA contributions over that same period of time have risen 3.40% per year, due to annual compounding. During that nine-year period, retirees' COLAs have outpaced inflation by approximately 1.4% per year or 12.40% in total. Consequently, retirees have actually gained purchasing power over that period of time.

The 3% fixed COLA went into effect in 2006 for the Federated City Employees' Retirement System. Since then, CPI rose on average of 1.8% per year.<sup>6</sup> The 3% fixed COLA contributions over that same period of time have risen 3.2% per year, due to annual compounding. During that five-year period, retirees have outpaced inflation by approximately 1.4% per year or 6.8% in total and retirees have also gained purchasing power over that period of time.

#### Next Steps

The City Administration will seek further direction from the City Council regarding the SRBR before discussions with various stakeholders. It is important to note that depending on the Council's direction, additional research on the options, including legal and labor relations issues, may be needed.



Alex Gurza  
Director of Employee Relations

For questions, please contact Alex Gurza, Director of Employee Relations, at 535-8155.

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<sup>6</sup> Source: Bureau of Labor Statistics; San Francisco-Oakland-San Jose CPI Index