CITY OF SAN JOSÉ

Retirement Reform
Budget Study Session

May 18, 2011

Retirement Information

www.sanjoseca.gov

- Click on **City Departments** (left column)
- Click on **Employee Relations** (Under City Manager's Office)
- Click on **Retirement Benefits Information**

http://www.sanjoseca.gov/employeeRelations/RetirementBenefits.asp

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Agenda

- Retirement Benefits Overview
- Retirement Reform
- Retirement Costs- History and Projections
- Fiscal Reform Plan

Retirement Benefits Overview

Defined Benefit vs. Defined Contribution

	Benefit	Risk to City/Taxpayers
Defined Benefit	Benefit regardless of amount of money contributed and investment performance of retirement fund	Very high (under current structure)
Defined Contribution	Benefit determined by amount contributed and investment performance	None

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Current City of San Jose Benefits

- Defined Benefit Plan
  - Independent Plan
    - Not a member of CalPERS
  - Administered by two independent boards
    - Fiduciary responsibility to ensure that there are sufficient assets to pay for the benefits
- Defined Contribution Plan
  - 457 plan (401k equivalent)
    - No City match

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How Are Defined Benefit Costs Determined?

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"The actuarial assumptions do not determine the 'actual cost' of the plan. The actual cost is determined solely by the benefits and administrative expenses paid out, offset by investment income received."

- The Segal Company

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What Are The Elements That Affect Cost?

1. Retirement Age
2. Benefit Formula
3. Maximum Benefit
4. Final Salary Calculation
5. Cost-of-Living Adjustments
6. Survivorship Benefits
7. Retiree Healthcare Benefits
8. Disability Retirements
9. Supplemental Benefits (SRBR)

Annual Required Contribution

*"The **amount of money** that actuaries calculate the employer needs to contribute to the plan during the current year for benefits to be fully funded by the end of the amortization period."* (Emphasis added)

-- Pew Center Report Glossary

- As directed by the City Council, the City must continue to make the full retirement contribution each year as determined by the Retirement Boards.

"The use of realistic actuarial assumptions is important to maintain adequate funding, while fulfilling benefit commitments to participants already retired and to those near retirement… ***it is desirable to estimate as closely as possible what the actual cost will be so as to permit an orderly method for setting aside contributions today to provide benefits in the future, and to maintain equity among generations of participants and taxpayers."***

\- The Segal Company

Actuarial Valuations

- Performed by independent actuaries selected by the Retirement Boards
- Performed annually using data as of June 30^{th}
- Sets Annual Required Contribution for the following year
  - Example:
    - Valuation as of June 30, 2010 establishes Annual Required Contribution for Fiscal Year 2011-2012

What Are The Elements That Affect the Annual Required Contribution?

- Combination of past experience and assumptions going forward
- Key Assumptions
  - Rate of return/earnings assumption
  - Life expectancy
  - Number of disability retirements
  - Salary increases
  - Retirement age

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Assumed Rate of Return/ Earnings Assumption

Earnings Assumption	Probability of Achieving Assumed Rate of Return (Net of expenses and SRBR)
7.75%	25%
6.75%	50%
5.50%	75%
4.00%	100%

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Rate of Return Examples

2nd Tier Pension Benefit as proposed by San Jose Fire Fighters				
	Local 230 estimated cost	City's estimated cost using current earnings assumption of 7.75% 25% Probability	City's estimated cost using earnings assumption of 6.75% 50% Probability	City's estimated cost using earnings assumption of 4.00% 100% Probability
Normal Cost	28%	28.38%	36.65%	72.28%

•Age 50 w/25 years of service, 55 w/20 years of service, 30 years at any age
•10 years vesting if 20 years have lapsed from date of proposal
•75% maximum benefit, 2.5% per year of service
•3 years final average salary
•2% maximum COLA based on CPI

Assumed Rate of Return/ Earnings Assumption

- Valuations will self correct
  - Ultimately the benefit costs what the benefit costs
  - Plan and pay for it over time using a realistic earnings assumption or the valuation will correct it and create additional unfunded liabilities
- Intergenerational transfer
  - Paying for the cost of services many years or generations after service is rendered to the residents

How Are Defined Contribution Costs Determined?

- City determines the contribution level, which determines the cost
  - Potential match to employee contribution

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Retirement Reform

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Primary Retirement Reform Categories

1. Improving governance and investment oversight
2. Keeping up with funding requirements
3. Sharing the risk with employees
4. Increasing employee contributions
5. Reducing benefits or increasing the retirement age

-The Pew Center on the States: The Trillion Dollar Gap-
Underfunded State Retirement Systems and the Road to Reform

Options to Change Benefits

1. 2nd Tier for New Employees
   - No effect on current unfunded liability
   - Important, but long term step
2. Changes to Retiree Benefits
3. Changes to Retirement Benefits for Current Employees

Key Issues/Principles

- Legal issues
- No changes to accrued benefits for current employees under existing formulas (2.5% per year for Federated for example)
- No changes to current pensions received by retirees
- Sharing in solutions among retirees and City employees

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Key Issues/Principles (continued)

- Reasonable and necessary solutions to ensure fiscal stability of City and retirement funds
- Avoid continuing to cut City services and jobs to fund retirement benefits
- Continue making the Annual Required Contribution (ARC) as determined by the Retirement Boards

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Key Issues/Principles (continued)

- Avoid shifting liability for pension benefits to future generations of employees and taxpayers
- Reduce risk for the City, employees, retirees, and taxpayers inherent in the current defined benefit structure
- Utilize realistic assumptions for projections of savings/costs for changes in defined benefit programs

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Key Questions:

- How much risk is the City/taxpayers willing to take in defined benefit retirement plans for City employees?
- How confident would the City Council like to be that the cost estimates of the new or revised benefits will be accurate?

25%
50%
75%
100%

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Retirement Costs
History and Projections

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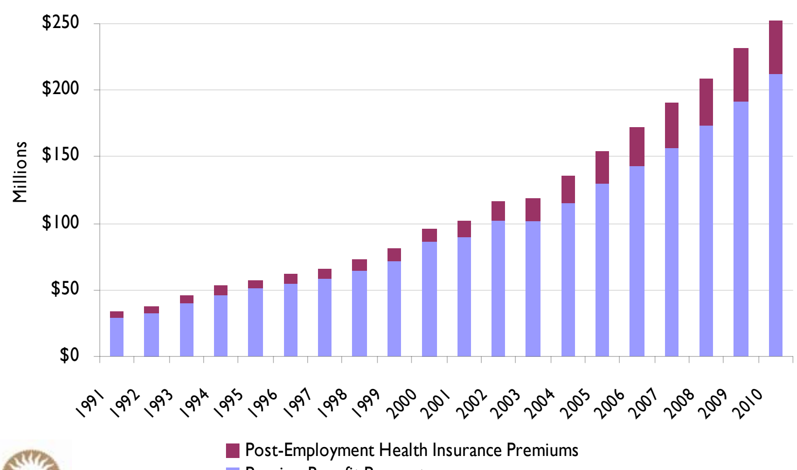
Benefit Payments Grew Seven Fold Over 20 Years



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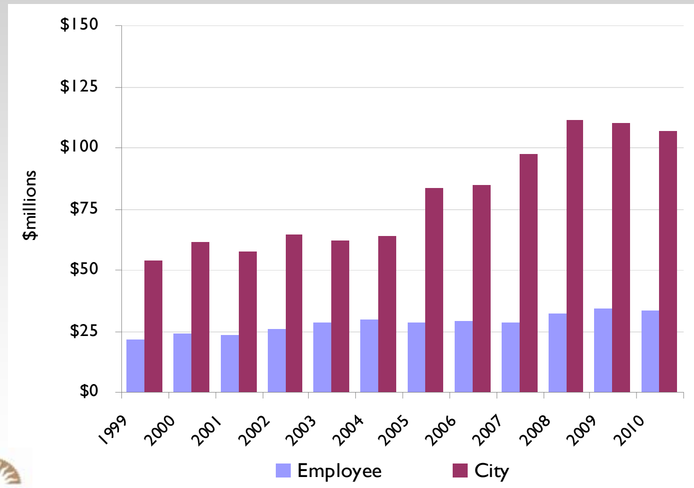
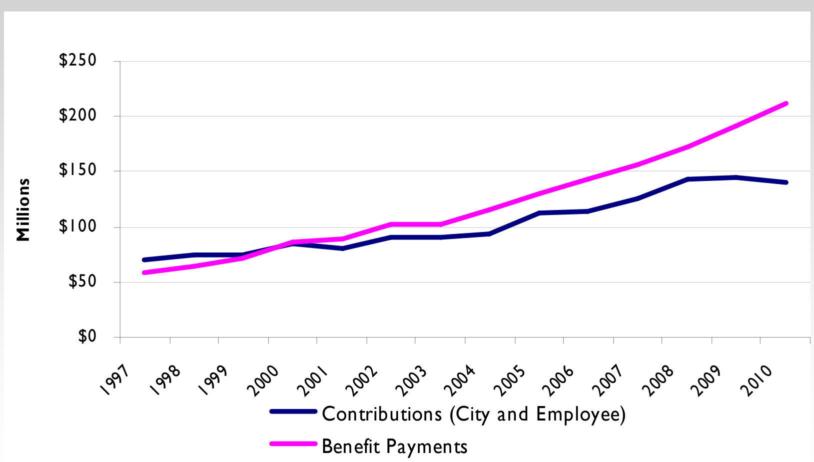
Audit of Pension Sustainability

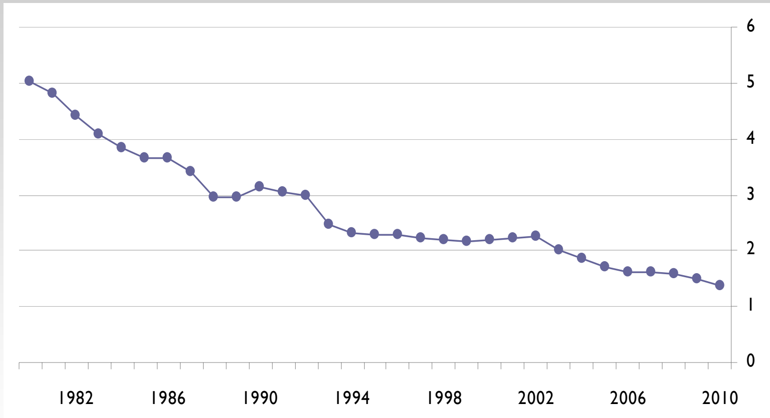
City and Employee Contributions Up Significantly Over the Past Decade



Pension Benefit Payments Have Exceeded Contributions Since 2001



Declining Ratio of Employees to Retirees and Beneficiaries Creates a Risk of Even Higher Future Contribution Rates



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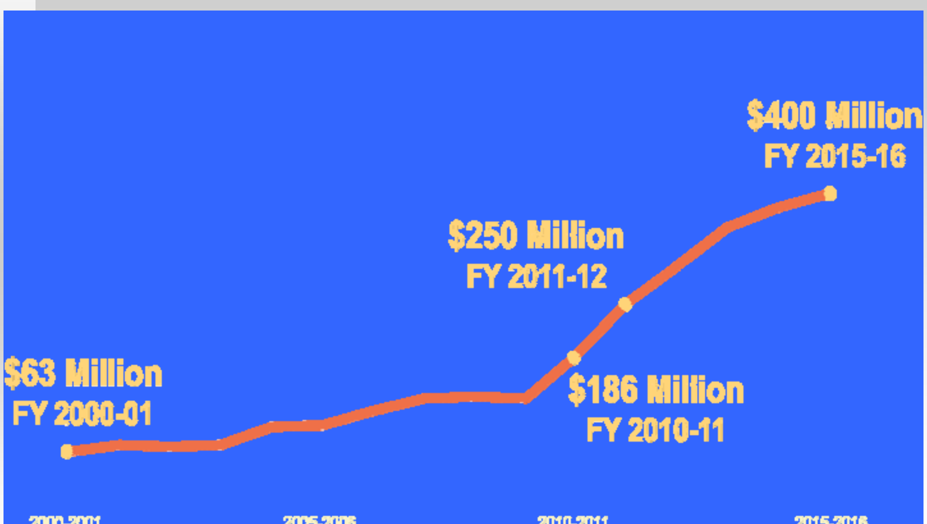
Audit of Pension Sustainability

Projected ALL FUNDS City Retirement Contributions



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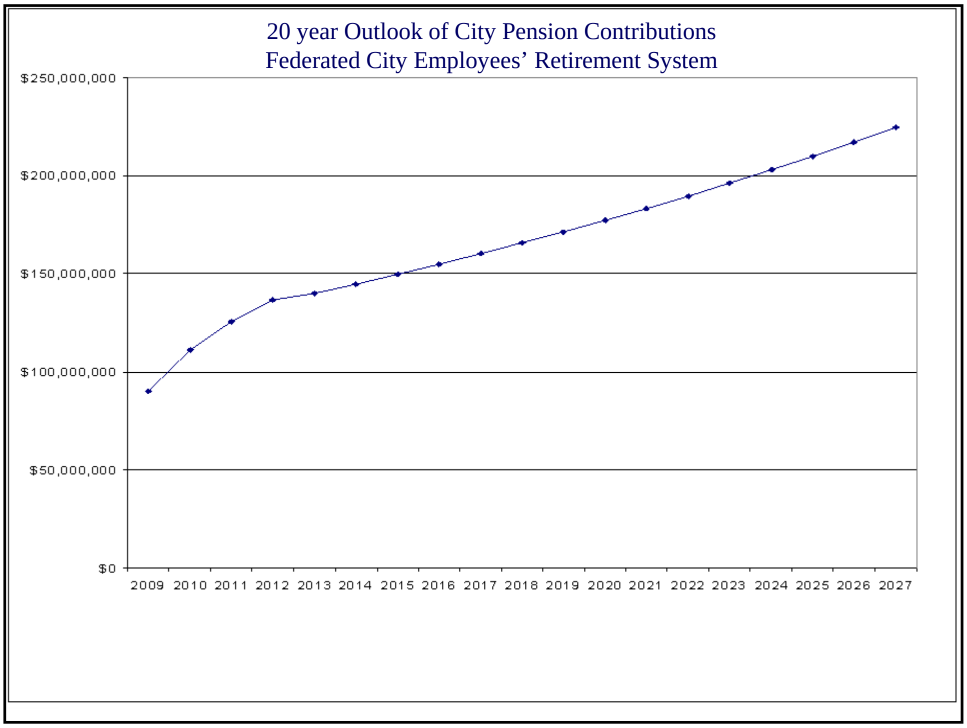
Smoothing

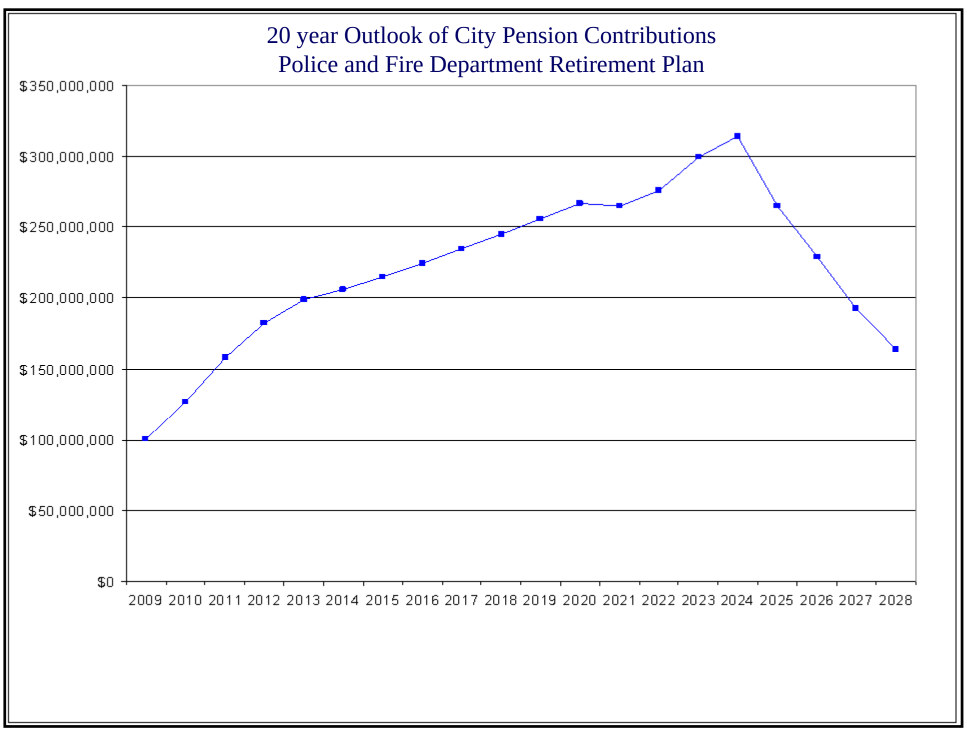
Method "*…that average[s] out the effects of increases or decreases in market values each year over several years (generally four or five). The effect of this approach is to mute the immediate impact during a severe market drop or spike in growth and to spread it out over time.*"

-- Pew Center Report Glossary

Federated Actuarial Experience Study

- Recommend reductions in wage inflation and investment return assumptions
- Liability for future transfers to the Supplemental Retiree Benefit Reserve be advance funded


20 year Outlook of City Pension Contributions
Federated City Employees' Retirement System
$250,000,000
$200,000,000
$150,000,000
$100,000,000
$50,000,000
$0
2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027

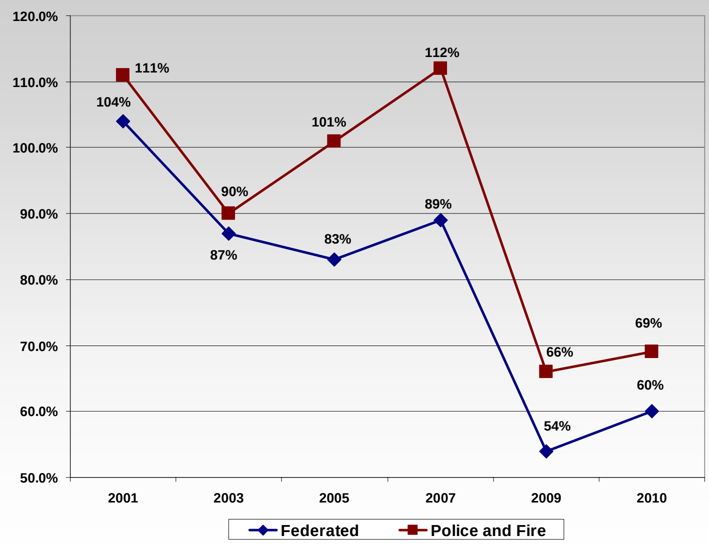

20 year Outlook of City Pension Contributions
Police and Fire Department Retirement Plan
$350,000,000
$300,000,000
$250,000,000
$200,000,000
$150,000,000
$100,000,000
$50,000,000
$0
2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023 2024 2025 2026 2027 2028

Unfunded Liability

Retirement System/Plan	Pension		Retiree Healthcare (OPEB)		Total Unfunded Liability	
	Market	Actuarial	Market	Actuarial	Market	Actuarial
Federated	$1.0B	$0.78B	$0.82B	$0.82B	$1.82B	$1.60B
Police and Fire	$1.0B	$0.65B	$0.72B	$0.71B	$1.72B	$1.36B
Total	**$2.0B**	**$1.43B**	**$1.54B**	**$1.53B**	**$3.54B**	**$2.96B**

Note: Unfunded Liability as of June 30, 2010

Pension Funding Ratios (Market Value)



Mercury News- Letter to the Editor

“The city is misleadingly basing its projections on numbers from almost one year ago. Seeing as the S&P has risen over 30 percent since that time, this does not reflect the current health of the plan. It would be more accurate for the city to talk about the value of the plan today; however, it has refused to do so because it doesn't fit into the doomsday scenario. The city's retirement plans are facing difficulties, not because they are unsustainable, but due to the downturn in the stock market.”

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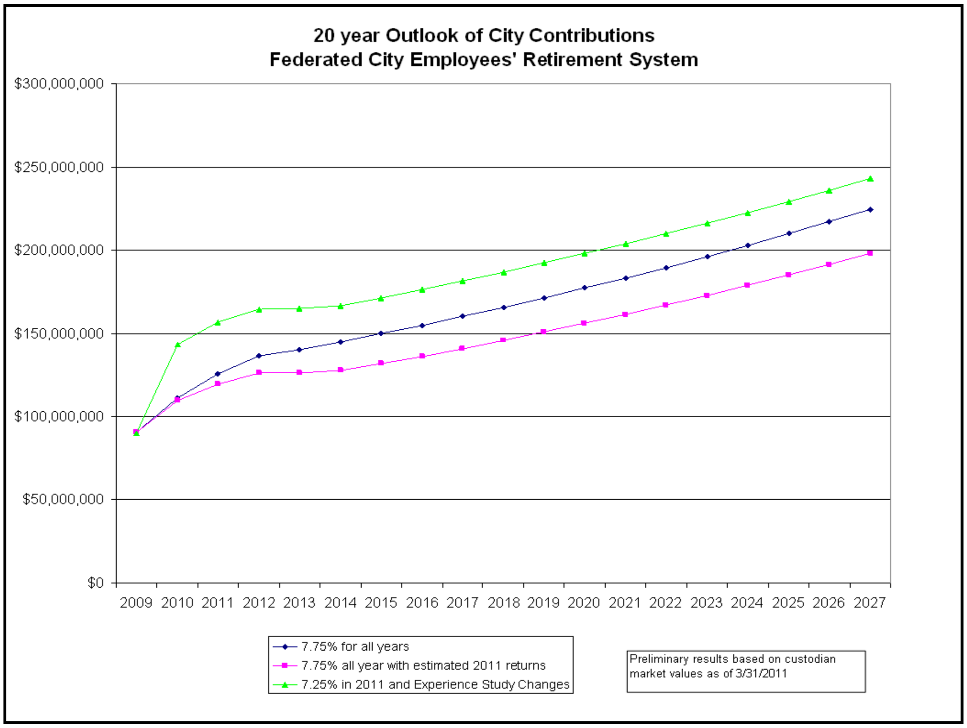

What Happens If We Do Nothing?

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"[I]t is important that the City move aggressively to rein in pension costs that threaten the stability of the General Fund and the services it provides to the residents of San Jose."

\- Pension Sustainability Audit Report
City Auditor's Office

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"California's pension plans are dangerously underfunded, the result of overly generous benefit promises, wishful thinking and an unwillingness to plan prudently. Unless aggressive reforms are implemented now, the problem will get far worse, forcing counties and cities to severely reduce services and layoff employees to meet pension obligations."

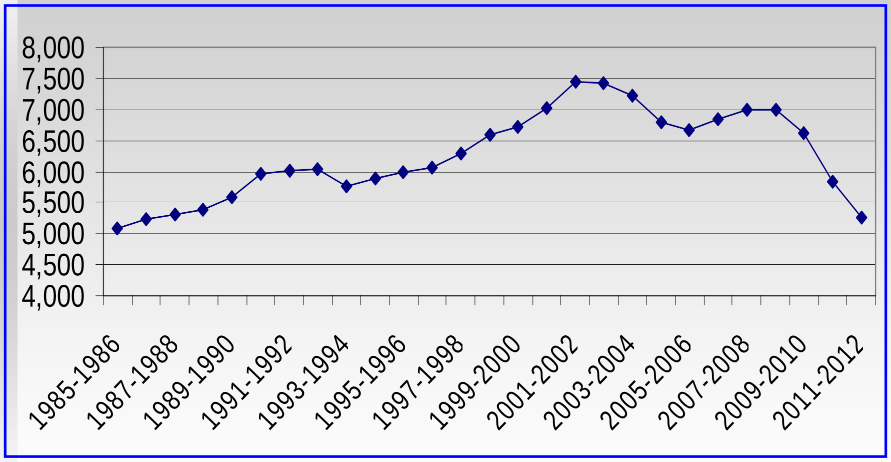
- Little Hoover Commission Report: Public Pensions for Retirement Security- February 2011

Rising Retirement Costs Account for Half of 2011-2012 General Fund Budget Shortfall

	2011-2012 General Fund Shortfall
Carry-Over from 2010-2011 Adopted Budget	$ 20.5 M
Increased Retirement Contribution Rates (Police - $25.4 M; Fire - $17.2 M; Federated - $14.6 M)	57.2 M
Increased Health and Other Fringe Benefits	6.4 M
Salary Step/Performance Increases	3.3 M
2011-2012 Committed Additions	6.7 M
Public Safety Vehicle Replacement	4.7 M
Other Expenditure Adjustments	(7.0 M)
Decreased Revenue Estimates	23.3 M
TOTAL 2011-2012 GENERAL FUND SHORTFALL	$ 115.1 M

* *Note: Reflects Federated and Police and Fire Retirement Boards' decisions through May 6, 2011.*

City Positions At 1986 Levels



Considerations

1. No changes to current level of benefits and continue to pay the bill
   - Reduction in service and layoffs to continue to pay for retirement costs

2. Lower the bill through reduced benefits and/or increase in employee cost sharing

Fiscal Reform Plan

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City Council Direction

- Develop a plan to achieve $216 million in savings in five years through cost reductions and/or new revenues
- Keep retirement costs at the Fiscal Year 2010-2011 level
- Restore/keep Police, Fire, libraries and community centers to the January 1, 2011 level
- Open the libraries, community centers, and fire stations built or under construction and the police substation within five years

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City Council Direction

- Cost Savings From:
  - Reducing compensation for existing employees
  - Avoiding increases in retirement costs beyond the amounts paid for this fiscal year
  - Reforming workers' compensation and disability retirement systems
  - Reducing costs for sick leave payouts, vacation buybacks, and overtime pay
  - Modifying healthcare plans and cost sharing
  - Organizational changes and efficiencies

Fiscal Reform Plan Considerations

- Fairness to taxpayers/residents, employees, and retirees
- Reasonable as possible
- Legal risks and financial consequences
- Shared sacrifice between employees and retirees

Fiscal Reform Plan- Retirement Savings Needed

Fiscal Year	ALL FUNDS Retirement Costs
2015-2016[1]	**$400.7 million**
2010-2011	**$186.0 million**
Difference	**$214.7 million**

[1] **These are projected costs and are subject to change.**

Fiscal Reform Plan Retirement Recommendations

	ALL FUNDS Annual Savings
SRBR: Eliminate Supplemental Retiree Benefit Reserve (SRBR)	$4.7 million
Retiree Healthcare: Reduce healthcare premiums by 25%	$17.9 million
New Employees: Implement a second tier for new employees that is a hybrid plan not to exceed 12.4% normal cost, cost sharing 50/50	N/A
Retirees: Reduce COLA for retirees to 1% maximum based on CPI	$28 million
Current Employees: Reduce future benefits accrual and COLA to 1% maximum based on CPI	$166 million
TOTAL	**$216.6 million**

If NO changes are made for Retirees and Current Employees

Savings Needed ALL FUNDS	Corresponding Increase in Employee Contribution Rate
$194 million	**35%**

Note: Assumes Retiree Healthcare and SRBR Changes

	Fiscal Year 11-12 Employee Contribution Rate	Contribution Rate with Increase of 35%
Police	**17.47%**	**52.47%**
Fire	**15.62%**	**50.62%**
Federated	**11.19%**	**46.19%**

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Opt In Program

- Employees could opt into a defined benefit program that costs less
- Considerations:
  - Presumes no changes will be made to first tier
    - Different path than making first tier changes
  - Impact dependent on number and demographics of employees who opt in
    - Cost savings very difficult to estimate
  - Is it the same plan offered to new employees?
  - Do you create strong incentives to move into opt in program such as employees paying higher contributions and/or reduce pay to stay in Tier 1?
  - What is an acceptable cost of the opt in program?

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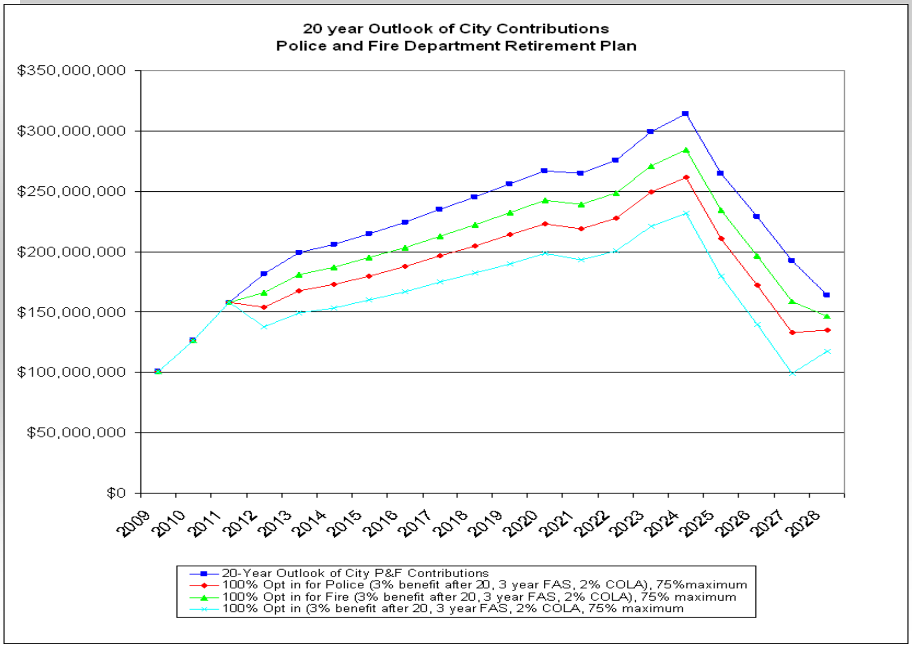
Opt In Program



Next Steps

- May 24th: Council direction on Fiscal Reform Plan
  - Provide direction on key issues/questions

Questions and Discussion

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