

SUPPLEMENTAL

COUNCIL AGENDA: 10/27/09
ITEM: 3.5



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Alex Gurza

SUBJECT: ANNUAL SUMMARY OF LABOR
NEGOTIATIONS

DATE: October 23, 2009

Approved

Date

10/24/09

SUPPLEMENTAL

REASON FOR SUPPLEMENTAL MEMORANDUM

The Annual Summary of Labor Negotiations Memorandum, dated October 13, 2009, provided a summary of background information related to labor negotiations, a summary of bargaining unit information for those bargaining units that the City will be in negotiations with at the end of 2009 and through 2010, personnel cost information, and a summary of labor negotiations cost saving strategies.

Questions arose after the distribution of the Annual Labor Negotiations Memorandum, a majority of which fell into two main areas:

1. Retirement benefits
2. How the compensation provided to City employees compares to compensation of other public agencies

This memo provides additional information related to these two areas.

ANALYSIS

Retirement Benefits – Pension

As reported on pages 9-11 in the Analysis Section of the original memorandum, the retirement benefit is the most expensive benefit provided to employees. Although the original memorandum mentioned that both the City and employees make contributions for retirement benefits, this memorandum expands upon the information provided in the original memorandum related to City and employee contributions to the retirement plans, as well as additional information on the recent decline in retirement assets.

Defined Benefit Retirement Plan

Since the City provides alternate retirement benefits, neither the City nor employees pay into Social Security. However, for employees hired after 1986, contributions are made for Medicare.

The City provides a **defined benefit plan** to all regular full-time employees. There are certain part-time employees who are eligible for benefits. Benefits for part-time employees are specified in the applicable union contract (Memorandum of Agreement). Some part-time employees who previously held a full-time position can remain in the retirement system.

A **defined benefit plan** guarantees the participant a specific annual benefit at retirement. The annual benefit is distributed in monthly payments. Monthly benefits are calculated through a formula based upon the employee's final average salary and years of service. Unlike defined contribution plans, the participant is not required to make investment decisions and has no investment risk. In addition, after retirement, retirees are eligible for cost of living increases. The monthly pension is increased annually by 3%, regardless of the actual increase in CPI or the plans' performance.

The retirement formula for plan members in the retirement plans is as follows:

Federated City Employees' Retirement System	Police and Fire Department Retirement Plan (Police)	Police and Fire Department Retirement Plan (Fire)
0-30 years of service: 2.5% per year	0-20 years of service: 2.5% per year 21-30 years of service: 4% per year	0-20 years of service: 2.5% per year At 20 years of service each year is converted to 3% per year
Maximum Base Benefit: 75% of final average salary	Maximum Base Benefit: 90% of final average salary	Maximum Base Benefit: 90% of final average salary
Annual COLA Increase: 3% increase in pension each year	Annual COLA Increase: 3% increase in pension each year	Annual COLA Increase: 3% increase in pension each year

For example, in the Federated City Employees' Retirement System, an employee who retires with a final average salary of \$100,000 after working 30 years would receive an annual retirement benefit for life of \$75,000 (30 years x 2.5% x \$100,000). In the Police and Fire Department Retirement Plan, an employee who retires with a final average salary of \$100,000 after working 30 years would earn an annual retirement benefit for life of \$90,000. Each year thereafter, the pension increases by 3% each year as a cost of living allowance. It should be noted that the COLA is paid on a fixed date each year, regardless of the employee's date of retirement.

Supplemental Retirement Savings Account

The City also offers an optional 457 defined contribution plan, which is similar to a 401(k) plan in the private sector. Employees may elect to make contributions to the defined contribution plan to supplement the pension benefit that they will receive in retirement.

Funding Arrangement for Pension Benefits

The current pension funding arrangement provides for the following cost sharing of benefits:

1. The current service cost, or "Normal Cost", is the cost of funding the retirement benefits for each year of service. Current service rate cost sharing is set in the City Charter as an eight-to-three ratio between the City and the employees. Thus, for every \$3 contributed by a City employee, the City contributes \$8.
2. The Unfunded Actuarial Liability ("UAL") is the difference between the Plans' assets and liabilities. The San Jose Municipal Code provides that the City is responsible for **100%** of the unfunded liability for the pension benefit.

As a result of this funding arrangement, the City is responsible for a significantly higher portion of the cost for the pension benefits that are provided to employees. The City also bears 100% of the investment risk for the pension fund.

Funding Arrangement for Retiree Healthcare Benefits

It is important to note that retiree healthcare benefits have a different cost sharing arrangement than pension benefits. Contributions for retiree medical benefits are split 50/50 by the City and employees (approximately 75/25 for dental). The City and eight bargaining units reached significant agreements in 2009 to begin a five-year phase-in to fully pre-funding retiree healthcare benefits. With the exception of employees represented by the San Jose Fire Fighters (IAFF, Local 230), both the City and employee contributions to fund retiree healthcare benefits increased in July 2009 and will continue to increase incrementally pursuant to the new funding methodology.

As noted on page 11 of the original memorandum, full pre-funding of retiree healthcare benefits does not mean that the existing liability (that was estimated to be as high as \$1.4 billion) will be paid off immediately. It will take 30 years to pay off the existing unfunded retiree healthcare liability.

City and Employee Contributions

Retirement contributions have progressively increased. Public entities throughout the State of California have also seen significant increases in retirement contributions. Even those agencies in CalPERS that were once deemed "super-funded"¹ and as a result paid no contributions are now experiencing significant increases in pension retirement contributions. Please note that the

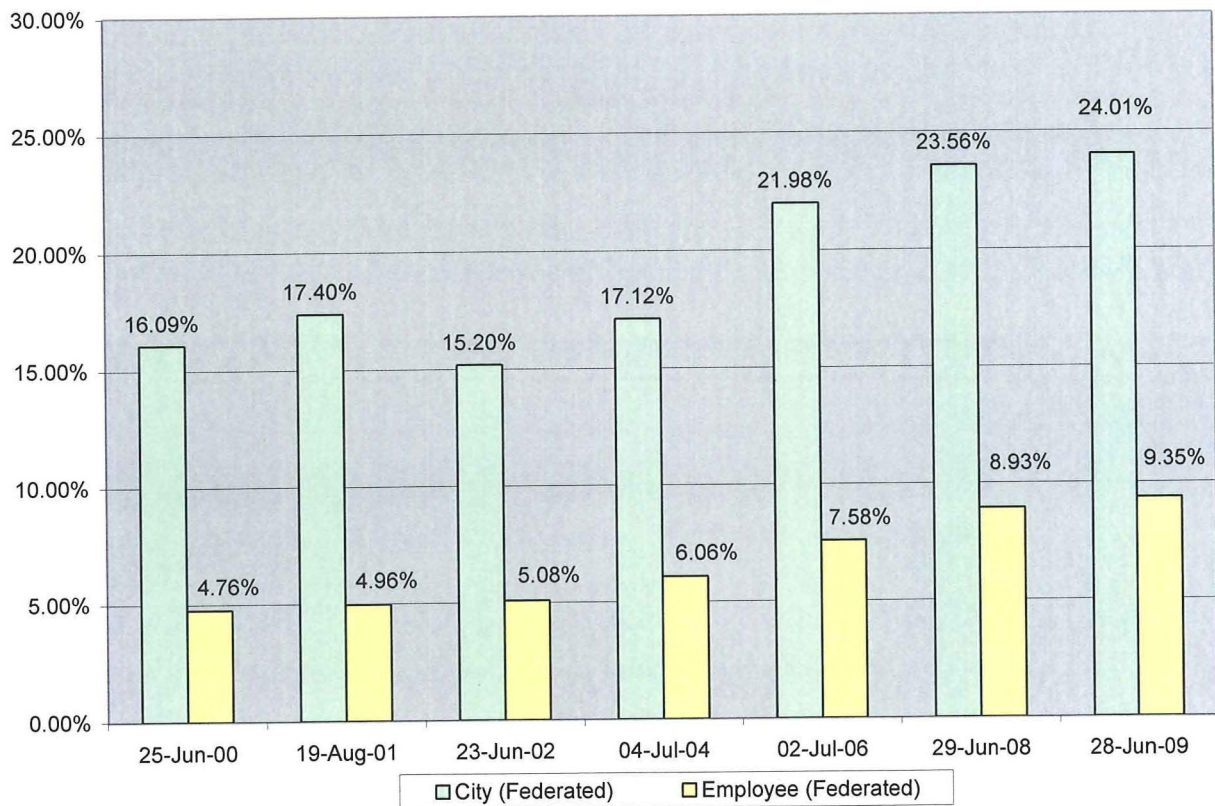
¹ Actuarial value of assets exceeds the present value of benefits.

City's contribution rates were never 0%, as they were for agencies in CalPERS. City and employee contributions have always been necessary.

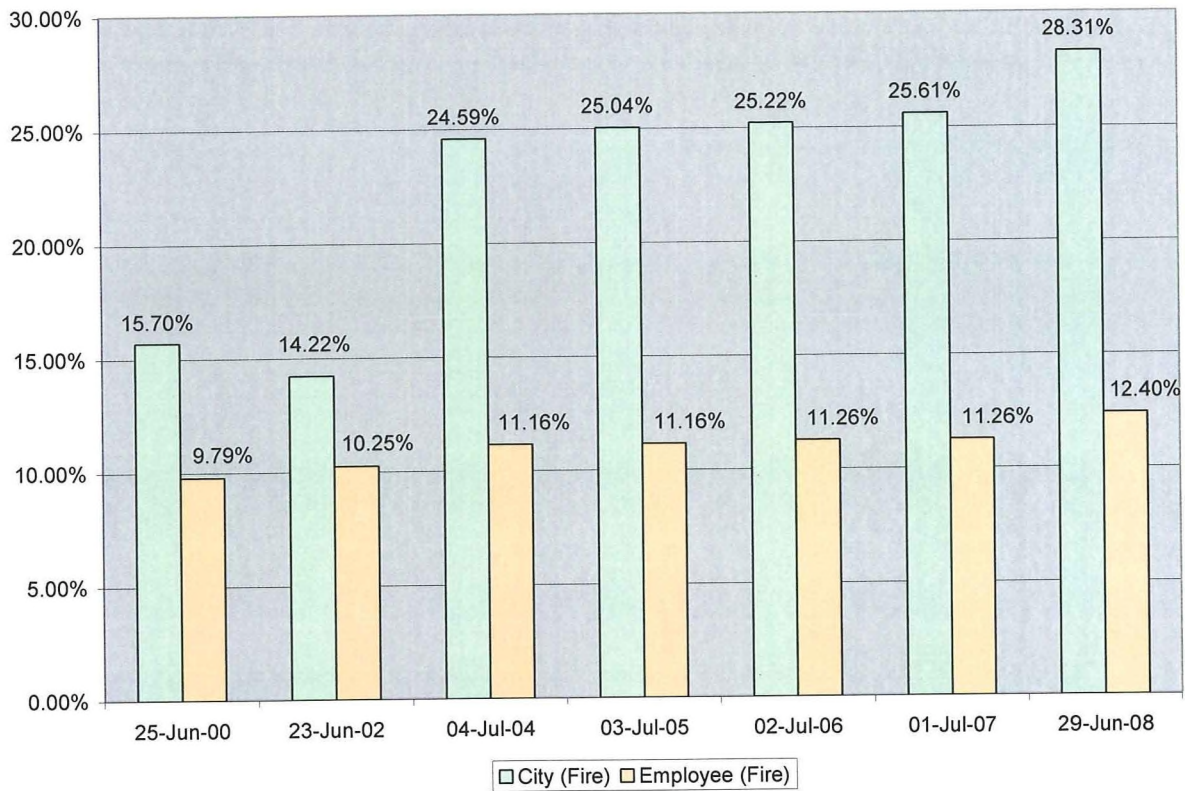
Both the City and employees make contributions for retirement benefits, which are calculated as a percentage of payroll. Employee contributions are made pre-tax.

The following charts display the City and employee contribution rates for both pension and retiree healthcare benefits since 2000.

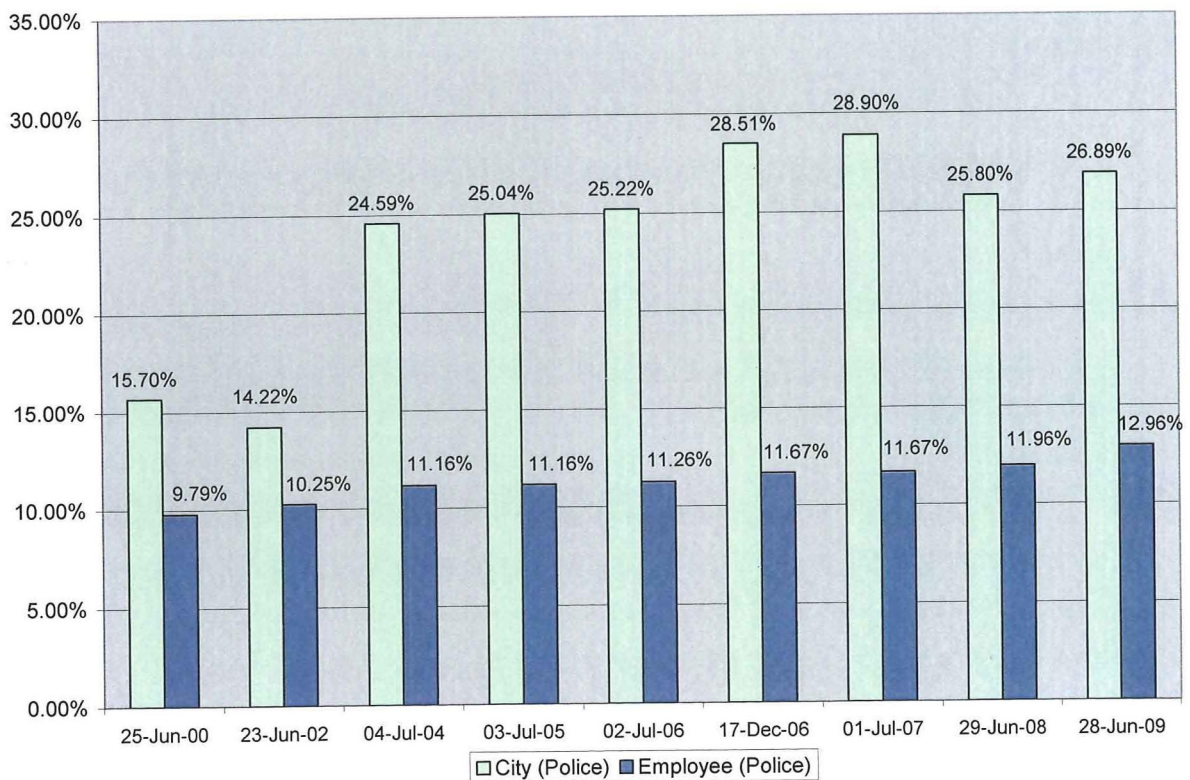
Federated City Employees' Retirement System



Police and Fire Department Retirement Plan (Fire)



Police and Fire Department Retirement Plan (Police)



Although employees do contribute to the pension system, as noted above, the City's contributions are significantly higher. One primary factor affecting the City's contribution rates is that the City is responsible for paying 100% of the unfunded pension benefit liability.

Decline in Total Net Assets

As mentioned above, the San Jose Municipal Code provides that the City is responsible for **100%** of the unfunded liability for the pension benefit. Thus, the City bears 100% of the investment risk for the pension fund.

Since the last actuarial valuation two years ago, the total market value of assets in the two retirement plans has declined by approximately **\$1.1 billion**. The following chart summarizes the decline in the Plan's Total Net Assets by Plan.

Decline in Total Net Assets		
Fiscal Year	Police & Fire	Federated
2008-2009	(\$516 Million)	(\$334 Million)
2007-2008	(\$175 Million)	(\$87 Million)
Total	(\$691 Million)	(\$421 Million)
Grand Total	(\$1.112 Billion)	

This decline in the assets of the retirement funds will result in increased City contribution rates because currently the City is responsible for 100% of the unfunded pension liability. The exact impact of this decline in assets on the City's contribution rates for Fiscal Year 2010-2011 and beyond are not yet known for certain. The contribution rates for the Police and Fire Department Retirement Plan on page 10 of the original memorandum are only projections. However, the projections do indicate very significant increases in the City's contribution rates. For example, the City's contribution rate for the Police and Fire pension benefit is projected to be 46% of payroll in 2013, not including the contributions for retiree healthcare.

The contribution rates for Fiscal Year 2010-2011 are anticipated to be established by both retirement boards over the next several months.

Comparability of Pay and Benefits

In addition to questions about retirement benefits, questions arose regarding how the compensation provided to City employees compares to that of employees in other cities. It is important to note that the City has 618 different job classifications that provide a wide variety of different services and vary significantly in compensation. Although the City of San Jose does provide competitive pay and benefits, it is difficult to make a generalization of how the total compensation of all the different City jobs compare to the total compensation in other agencies.

Survey Data

Compensation surveys (also known as market surveys) are sometimes exchanged during contract negotiations comparing the City to other public agencies. Most cities compare pay and benefits to other public sector agencies, and generally do not include comparisons to private sector

employment. In the Bay Area, the City of San Jose's surveys normally include cities and counties that serve populations of 100,000 or more. While these agencies are geographically close in proximity to San Jose, with the exception of San Francisco, they all have less than half the population of San Jose. In some instances, surveys are conducted of the ten largest cities in California and the ten largest cities in the United States.

Survey Methodology

In addition to selecting which other agencies to include in a compensation survey, some surveys only compare base pay and not all of the various forms of compensation. The major categories are:

1. Base Pay
2. Other Cash Compensation (such as premium pays)
3. Employer Paid Benefits (such as retirement benefits, health benefits, etc.)
4. Paid Time Off (paid holidays, vacation and other paid leave)

Most surveys conducted include base pay. However, base pay only surveys do not include the value of an employee's total compensation.

Recent Surveys

The last comparability surveys completed by the City were compiled in 2008 for the classification of "Police Officer" for negotiations with the San Jose Police Officers' Association (SJPOA). These surveys were made available to the public in June 2008, and copies are available upon request.

Recruitment and Retention

The City strives to recruit and retain high quality employees. According to data from the Employment Development Department, in September 2009 the unemployment rate was 12% in California and 13.1% in San Jose. With these unemployment rates, there is a greater pool of job seekers than in past years to fill current and future job vacancies. In general, the City is not experiencing a shortage of qualified candidates for most positions. Typically, the City receives a high volume of responses to job postings. For entry level positions, the City typically receives between 100-400 applications. For some jobs, the City receives a far greater number of applications. For example, for the last Fire Fighter recruitment in 2008, the City received over 2,600 applications. The current unemployment and economic situation will change, and we will continue to monitor recruitment and retention.



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