

April 22, 2013

Bill Pope
Business Representative
International Union of Operating Engineers, Local #3 (OE#3)
1654 The Alameda, Suite 110
San Jose, CA 95126

RE: Retiree Healthcare Modified Proposal

Dear Bill:

On December 12, 2012, we presented OE#3 with a proposal on retiree healthcare with a goal of reaching an agreement quickly. Unfortunately, that has not occurred since our proposal has not been accepted, and we have not reached an agreement. We appreciate the discussions we have had in our meetings because it provided us with the opportunity to understand concerns about the City's December proposal. Since we have not been able to reach an agreement, we are providing a modified proposal. We hope that this modified proposal addresses some of the concerns that have been raised about our December proposal.

There were concerns related to the impact of new employees not being eligible for the retiree healthcare benefit. Specifically, the concerns were that new employees would no longer be paying towards the existing unfunded liability. However, we believe that it is important to not require new employees to belong to a plan with such a high cost to the employee for a benefit that will likely have little value since they will be in Tier 2 with a retirement age of 65. As you know, the biggest value of the retiree healthcare benefit occurs in the pre-Medicare years. To address the concern, for Fiscal Year 2013-2014, the City will pay the amount the new employee would have otherwise paid towards the existing unfunded liability had they gone into the current retiree healthcare benefit plan. During the next year, we will continue to work together on solutions to the significant unfunded liability of the current retiree healthcare benefit.

As we have discussed, the changes to healthcare plan design options has shown through the actuarial valuation conducted by the retirement board's actuary to have significant impacts on the City and employee contribution rates because of the \$200 million reduction in the unfunded liability. We both have acknowledged that, even with this significant reduction, the costs for employees and the City are still too high. In addition, we both acknowledged that there needs to a broader solution to retiree healthcare. Since we have seen the impact that a lower priced healthcare plan has had in lowering the unfunded liability and the costs that employees and the City have to pay, we believe it is important to continuing to work towards reducing the costs. As such, we are proposing putting in place a new lower priced healthcare plan that will be available to active employee and retirees effective in January 2014. This plan will further reduce the costs to employees and the City. We will be providing you with more information about this lower priced healthcare plan for your review.

In summary, this modified proposal achieves the following:

- Extends the ramp up to the Annual Required Contribution (ARC) by one year. Employee and City contribution rates will increase by 0.75% in Fiscal Year 2013 -2014 and the full ARC will be paid beginning in Fiscal Year 2014-2015.
- Provides that new employees will not be eligible for the retiree healthcare benefit and will not be required to make the contributions.
- The City will pay what the new employee would have contributed towards the existing unfunded liability for the next year while we continue to work together on solutions.
- Adds a lower cost healthcare plan that will be available to active employees and retirees beginning in January 2014.

This modified proposal contains several similar elements to our December 12, 2012, proposal, including:

- Provides for an opportunity to meet and confer at any time upon request of the City or the bargaining units to discuss solutions that could reduce costs for both the City and employees.
- Provides an opportunity to continue exploring retiree healthcare benefit options for current employees.
- Effective January 2014, the City will institute a four tier rate program for both active employees and retirees for health and dental benefits. This means that all plans will have single, single plus spouse/domestic partner, single plus child(ren) and family rates.
- Employee contributions will start going into the 115 trust in time to avoid any potential of reaching the IRS limits on the current medical benefits account.

Please refer to our proposal for details and specific provisions.

We look forward to discussing this modified proposal further with you.

Sincerely,



Alex Gurza
Deputy City Manager

Enclosure

CITY PROPOSAL – RETIREE HEALTHCARE

Proposed Language:

ARTICLE 27 RETIREE HEALTHCARE FUNDING AND BENEFITS

- 27.1 ~~Effective June 28, 2009, the City and the Union began transitioning~~have agreed to transition from the current partial pre-funding of retiree medical and dental healthcare benefits (referred to as the “policy method”) to pre-funding of the full Annual Required Contribution (ARC) for the retiree healthcare plan (“Plan”). The transition shall ~~be accomplished by phasing into fully funding the ARC over a period of five (5) years beginning~~began on June 28, 2009. The Plan’s initial unfunded retiree healthcare liability shall be fully amortized over a thirty year period so that it shall be paid by June 30, 2039 (closed amortization). Amortization of changes in the unfunded retiree healthcare liability other than the initial retiree healthcare liability (e.g. gains, losses, changes in actuarial assumptions, etc.) shall be determined by the Plan’s actuary. The City and Plan members (active employees) shall contribute to funding the ARC in the ratio currently provided under Section 3.28.3850 (C) (1) and (3) of the San Jose Municipal Code. Specifically, contributions for retiree medical benefits shall be made by the City and members in the ratio of one-to-one. Contributions for retiree dental benefits shall be made by the City and members in the ratio of eight-to-three. When determining the contribution rates for the Plan, the Plan actuary shall continue to use the Entry Age Normal (EAN) actuarial cost method and a discount rate consistent with the pre-funding policy for the Plan as outlined in this Article.
- 27.2 The Municipal Code and/or applicable plan documents shall be amended to the extent necessary in accordance with this agreement ~~above~~.
- 27.3 The phase-in to the ARC shall be ~~divided in five steps (using a straight line method), each to be effective on the first pay period of the City’s fiscal year in each succeeding year.~~ The ~~the~~ first increment of the phase-in shall be which was effective on June 28, 2009. It is understood that because of changes resulting from future actuarial valuations, the amount of each ~~increase~~the ARC may vary upward or downward. The Plan member cash contribution rate shall not have an incremental increase of more than .75% of pensionable pay in each fiscal year and the City cash contribution rate shall not have an incremental increase of more than .75% of pensionable pay in each fiscal year. For example, if the members’ contribution rate is 4% of pensionable pay, the subsequent fiscal year’s contribution rate for retiree healthcare cannot exceed 4.75% of pensionable pay. Notwithstanding the limitations on the incremental increases, by the ~~end~~first pay period of the five year phase in Fiscal Year 2014-2015, the City and plan members shall be contributing the full Annual Required Contribution in the ratio currently provided under Section 3.28.3850 (C) (1) and (3) of the San Jose Municipal Code.

27.4 The City has established a qualified 115 trust ("Trust"). Employee contributions will begin going into the Trust in time to avoid any potential of reaching the IRS limits on the existing medical benefits account or whenever the City receives advice of Tax Counsel or ruling from the IRS that the contributions can be treated as pre-tax, whichever occurs first.

~~27.4 Until such time as a Trust is established, the City and employee contributions shall be made into the existing Medical Benefits Account for as long as the contributions can be made into the Medical Benefits Account in accordance with IRS limitations. If the Trust is not established prior to reaching the IRS limitation, the parties will meet to discuss alternative funding vehicles.~~

27.5 It is the objective of the parties that the Trust created pursuant to the above shall become the sole funding vehicle for Federated retiree healthcare benefits, subject to any legal restrictions under the current plan, or other applicable law.

27.6 Employees hired into full-time benefited positions on or after the first payperiod following the effective date of the ordinance implementing this provision ("Effective Date") will not participate in or be eligible for the defined benefit retiree healthcare program. For Fiscal Year 2013-2014, the City will pay the unfunded liability contribution that these employees would have otherwise paid had they gone into the retiree healthcare defined benefit program.

ARTICLE 9 FULL UNDERSTANDING, MODIFICATION AND WAIVER

9.1 This Agreement sets forth the full and entire understanding of the parties regarding the matters set forth herein, and any and all prior or existing Memorandums of Agreement, understandings and agreements, whether formal or informal, are hereby superseded and terminated in their entirety.

9.2 Existing benefits provided by ordinance or resolution of the City Council or as provided in the San Jose Municipal Code and which are referenced in the Agreement shall be provided in accordance with the terms of the Agreement.

9.3 It is the intent of the parties that ordinances, resolutions, rules and regulations enacted pursuant to this Memorandum of Agreement be administered and observed in good faith.

9.4 Although nothing in this Agreement shall preclude the parties from mutually agreeing to meet and confer on any subject within the scope of representation during the term of this Agreement, it is understood and agreed that neither party may require the other party to meet and confer on any subject matter covered herein or with respect to any other matter within the scope of representation during the term of this agreement.

9.5 Healthcare Cost Mitigation.

9.5.1 Notwithstanding any other provision of this Agreement, the parties agree to meet and confer over retiree healthcare benefits and funding upon request of either party. This may include but is not limited to alternatives to reduce the cost of retiree healthcare benefits and options for current employees that comply with IRS regulations.

9.5.2 Negotiations between the City and Union shall commence within 14 days upon notice of either party. The City and Employee Organization shall negotiate in good faith in an effort to reach a mutual agreement. Applicable impasse dispute resolution procedures shall apply.

5.5 Health Insurance

5.5.1 Effective January 1, 2014, all available plans will have a 4-tier rate structure (Employee, Employee plus spouse/domestic partner, Employee plus Child(ren) and Family). The premiums will be adjusted effective the first payperiod in payroll calendar year 2014, which starts December 22, 2013.

~~5.5.2 Effective pay date July 1, 2011, the City pays eighty-five percent (85%) of the cost of the lowest priced plan for the employee or the employee and dependent coverage and the employee pays fifteen percent (15%) of the premium for the lowest priced plan. If the employee selects a plan other than the lowest priced plan, the employee pays the difference between the total cost of the selected plan and the City's contribution towards the lowest priced plan.~~

5.5.2 Effective December 23, 2012, the City pays eight-five percent (85%) of the cost of the lowest priced Non-Deductible HMO plan for the employee or the employee and dependent coverage and the employee pays fifteen percent (15%) of the premium for the lowest priced Non-Deductible HMO plan. If the employee selects a plan other than the lowest priced Non-Deductible HMO plan, the employee pays the difference between the total cost of the selected plan and the City's contribution toward the lowest priced Non-Deductible HMO plan.

Effective January 1, 2013, Kaiser Permanente Deductible 1500 HMO Benefit Plan 3800 will be available to employees represented by OE#3 in addition to the existing plan options.

Effective January 1, 2014, Kaiser Permanente 3000 Deductible HMO Benefit Plan will be available to employees represented by OE#3. This plan will replace the Kaiser Permanente 1500 Deductible HMO Benefit Plan.

- 5.6 Dental Insurance. The City will provide dental coverage for eligible full time employees and their dependents in accordance with one of the two available plans. Effective January 1, 2014, all available plans will have a 4-tier rate structure (Employee, Employee plus spouse/domestic partner, Employee plus Child(ren) and Family). The premiums will be adjusted effective the first payperiod in payroll calendar year 2014, which starts December 22, 2013.