

# CITY OF SAN JOSÉ

## Item 3.4 Retirement Reform: 2<sup>nd</sup> Tier Benefits

January 25, 2011

# Retirement Information

[www.sanjoseca.gov](http://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>

# Agenda

- Council Direction
- Retirement Reform
- Why is a 2<sup>nd</sup> Tier Needed?
- Overview of Current San Jose Retirement Benefits
  - What They Cost and Who Pays
- 2<sup>nd</sup> Tier Retirement Benefit Options
- Recommendations
- Status of Negotiations

# Council Direction – November 18<sup>th</sup>

- Direct staff to continue analysis of options for a 2<sup>nd</sup> Tier retirement program and return to Council with recommendations in early 2011
- Options should include:
  - Input from the General Fund Structural Deficit Elimination Plan (GFSDEP) Stakeholder Group
  - The City Auditor's recommendations

# Retirement Reform

# Primary Retirement Reform Categories

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

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

# Why is a 2nd Tier Needed?

*“[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



*“There is widespread concern that the cost of employee total compensation continues to increase while revenues and services decrease.... Pension and health care benefits have risen substantially since 2000.... The overall costs to cities are not sustainable. Cities need to negotiate, approve and implement considerable cost containment measures so that employee financial obligations do not continue to escalate.”*

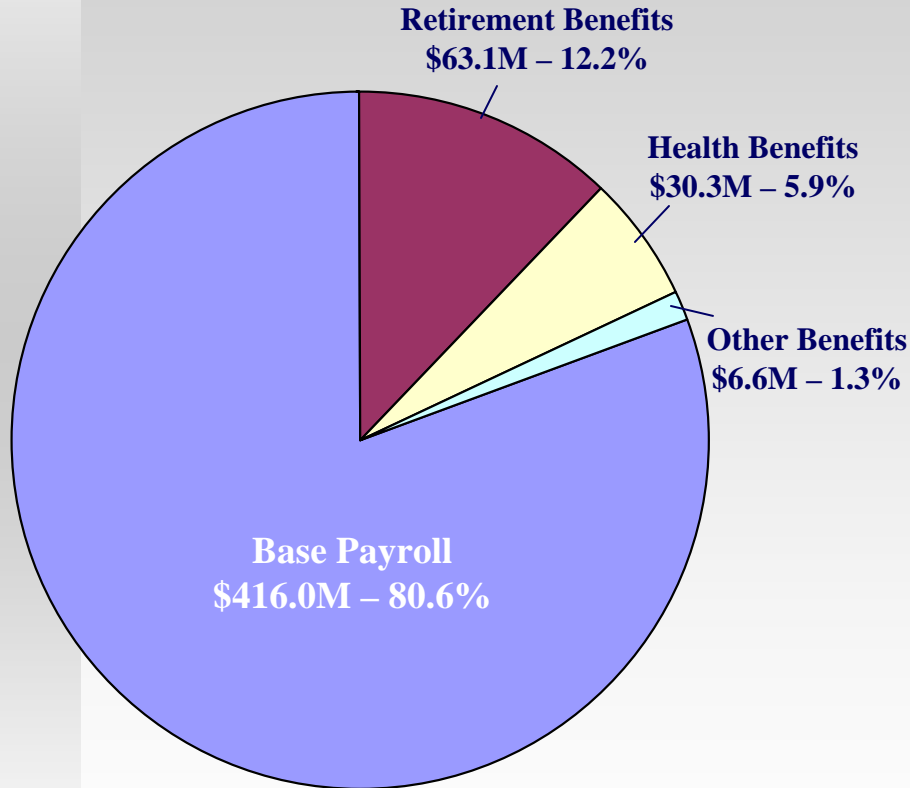
- Cities Must Rein In Unsustainable Employee Costs  
Santa Clara County Civil Grand Jury

# 10-Year Growth in Total Compensation

Fiscal Year 2000-2001

\$516 Million

7013 FTEs

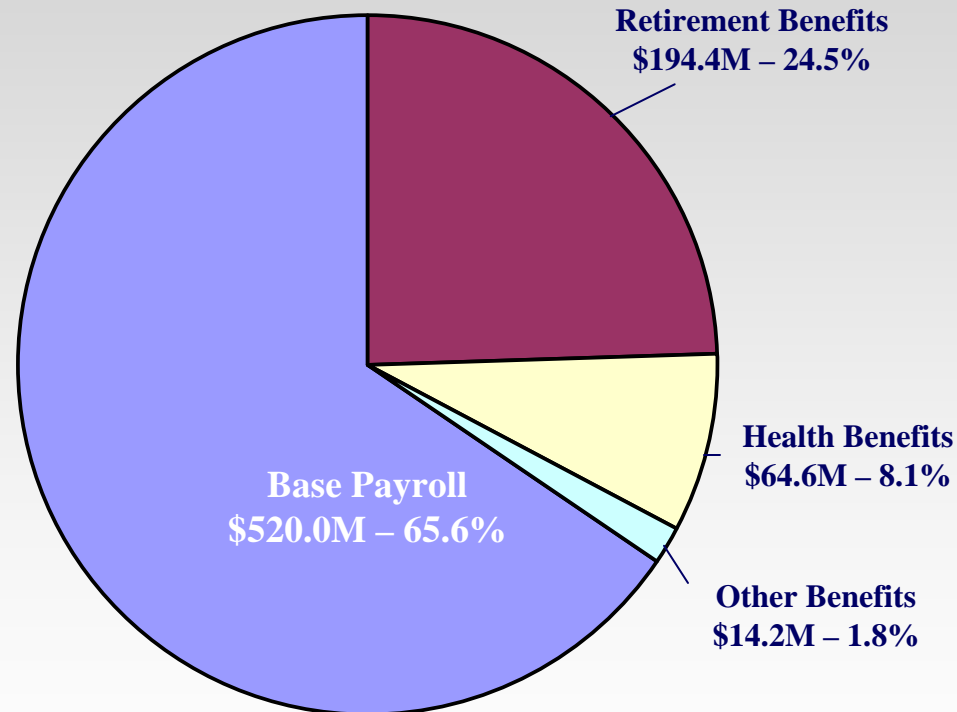


**Source:** Salary and Fringe Benefit Costs by Bargaining Unit & Fund for the 2000-2001 Adopted Budget

Fiscal Year 2011-2012

\$793 Million

5669 FTEs



**Source:** Salary and Fringe Benefit Costs by Bargaining Unit & Fund for the 2011-2012 Base Budget

# Overview of Current San Jose Retirement Benefits

# Pension Benefits Summary

	<b>Federated</b>	<b>Police/Fire</b>
<b>Minimum Age</b>	55 Any age with 30 years of service	50 Any age with 30 years of service
<b>Maximum Benefit (at 30 years of service)</b>	75%	90%
<b>Annual Cost of Living Adjustment (COLA)</b>	3% Fixed (compounded)	3% Fixed (compounded)

# Average Annual Pension

2006-2010 <sup>1</sup>		
	Total Pension <sup>2</sup>	Average Years of Service
Federated	\$43,729	20.22
Police and Fire	\$100,202	26.32

Note:

<sup>1</sup> Includes approved retirements through October 31, 2010

<sup>2</sup> Does not include the value of Retiree Healthcare Benefits

# Other Pension Benefits

- Survivorship Benefits
- Supplemental Retiree Benefit Reserve (SRBR) (“13<sup>th</sup> Check”)
- Reciprocity
- Disability Retirements
- No offset for Workers’ Compensation benefits received (Police and Fire Only)

# Current Retiree Healthcare Benefits

	<b>Federated</b>	<b>Police and Fire</b>
<b>Maximum Benefit</b>	100% of Lowest Priced Plan for Single or Family	100% of Lowest Priced Plan for Single or Family
<b>Eligibility</b>	Medical: 15 years of service Dental: 5 years of service	Medical and Dental: 15 years of service or 20 years for those who leave prior to retirement

<b>Kaiser</b>	<b>Single Coverage (Annual)</b>	<b>Family Coverage (Annual)</b>
2011	\$5,952	\$14,822

# **Current Benefits: What They Cost and Who Pays**

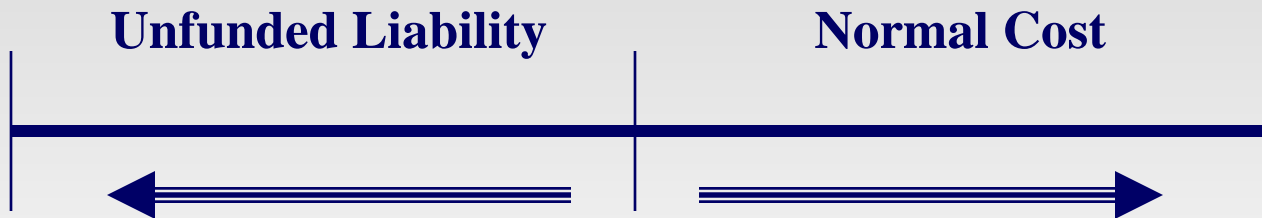


*The actuarial assumptions do not determine the “actual cost” of the plan. The actual cost is determined solely by the benefits and administrative expenses paid out, offset by investment income received. However, it is desirable to estimate as closely as possible what the actual cost will be so as to 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 report dated November 22, 2010*

# Retirement Contribution Rates

$$\text{Total Contribution} = \text{Normal Cost} + \text{Unfunded Liability Amortization}$$

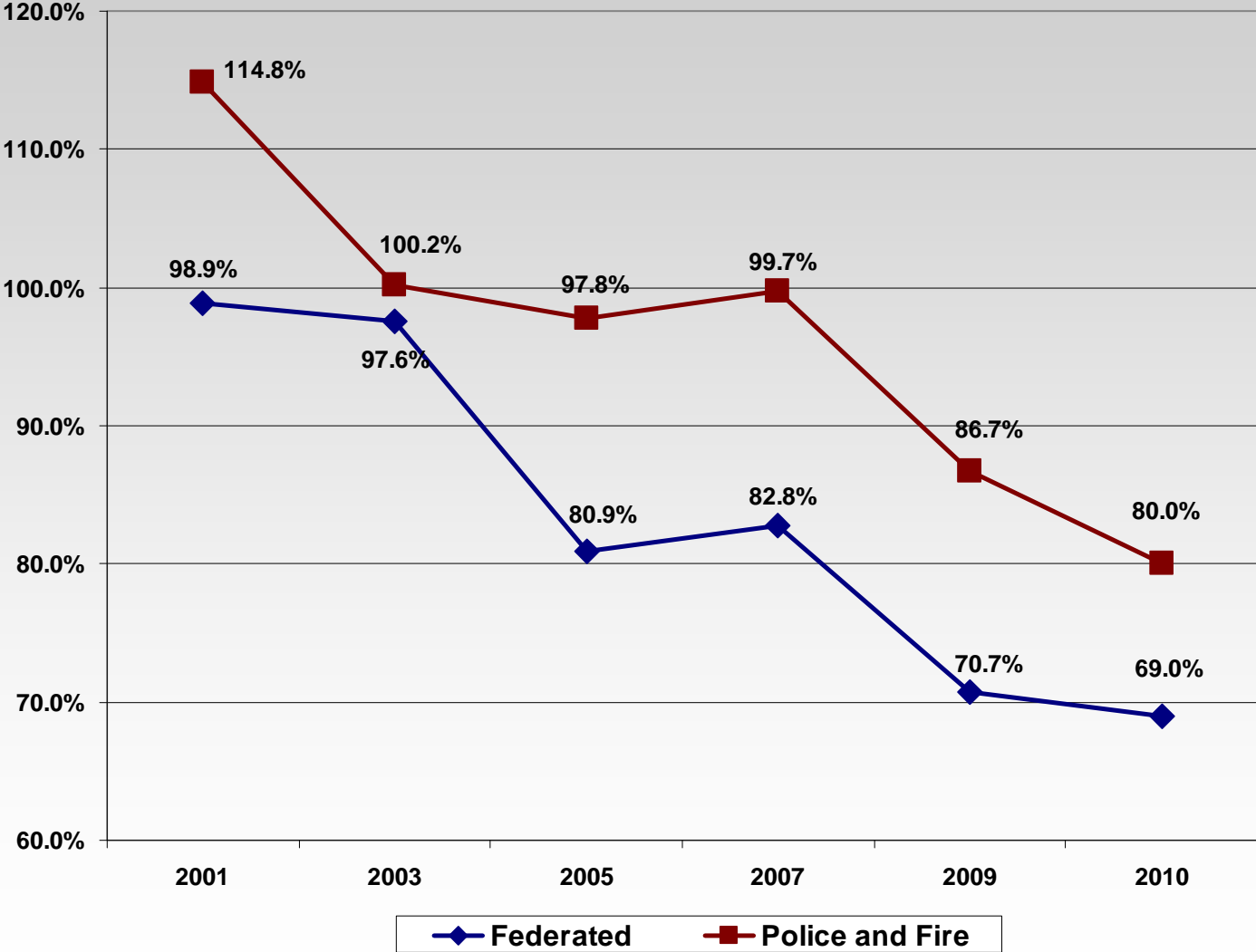


# Unfunded Liability

	Federated	Police & Fire	Total
Actuarial Value: Unfunded Accrued Actuarial Liability	\$1.6B	\$1.36B	<b>\$2.96B</b>
Market Value: Unfunded Accrued Actuarial Liability	\$1.82B	\$1.72B	<b>\$3.54B</b>

**Source: Valuation Date: June 30, 2010 (with exception of Police and Fire Retiree Healthcare – June 30, 2009 Valuation)**

# Pension Funding Ratios (Actuarial Value)



# Funding Ratios – June 30, 2010

Retirement Funding Ratios As of June 30, 2010		
Pension	Federated	Police and Fire
Market Value	60%	69%
Actuarial Value	69%	80%

Retiree Healthcare (OPEB) Plans	Federated	Police and Fire
Market Value	12%	7%
Actuarial Value	12%	6%

# Key Factors That Impact Retirement Costs

- Benefit Levels/Enhancements
  - Pension Formula
  - Cost of Living Adjustment (COLA)
  - Final Average Salary
  - Retirement Age
  - Retiree Healthcare

# Fiscal Year 2011-2012 City Costs

	<b>Pension</b>	<b>Retiree Healthcare</b>
Total for All Funds	\$208.7 M	\$39.0 M
<b>Grand Total for FY 11-12</b>	<b>\$247.7 M</b>	

Note: Includes City's pre-payment discount

# Fiscal Years 10-11 & 11-12 Retirement Contribution Rates

Federated City Employees' Retirement System				
	City		Employee	
	FY 10-11	FY 11-12	FY 10-11	FY 11-12
Pension	23.18%	28.34%	4.54%	4.68%
Medical and Dental	6.41%	7.16%	5.76%	6.51%
<b>Total</b>	<b>29.59%</b>	<b>35.50%</b>	<b>10.30%</b>	<b>11.19%</b>
Police and Fire Department Retirement Plan (Police)				
	City		Employee	
	FY 10-11	FY 11-12	FY 10-11	FY 11-12
Pension	38.32%	49.78%	9.81%	10.46%
Medical and Dental	6.26%	6.26%	5.76%	5.76%
<b>Total</b>	<b>44.58%</b>	<b>56.04%</b>	<b>15.57%</b>	<b>16.22%</b>
Police and Fire Department Retirement Plan (Fire)				
	City		Employee	
	FY 10-11	FY 11-12	FY 10-11	FY 11-12
Pension	40.24%	51.54%	10.09%	10.76%
Medical and Dental	3.92%	3.92%	3.61%	3.61%
<b>Total</b>	<b>44.16%</b>	<b>55.46%</b>	<b>13.70%</b>	<b>14.37%</b>

Does not include City's pre-payment discount

5 unions paying a % of City's UAAL

Police and Fire Medical and Dental rates for the City and employees are for FY 10-11. It is anticipated that the FY 11-12 rates will be available in February.



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

	2011-2012 PRELIMINARY FORECAST SHORTFALL	2011-2012 UPDATED FORECAST-RETIREMENT*
Carry-Over from 2010-2011 Adopted Budget	\$ 20.5 M	\$ 20.5 M
<b>Increased Retirement Contribution Rates*</b>	<b>21.5 M</b>	<b>60.9 M</b>
Increased Health Care Costs	4.1 M	4.1 M
Salary Step/Performance Increases	3.1 M	3.1 M
2011-2012 Committed Additions	6.6 M	6.6 M
Public Safety Vehicle Replacement	4.4 M	4.4 M
Other Expenditure Adjustments	0.2 M	0.2 M
Decreased Revenue Estimates	9.5 M	9.5 M
<b>TOTAL 2011-2012 GENERAL FUND SHORTFALL</b>	<b>\$ 69.9 M</b>	<b>\$ 109.3 M</b>

\* Updated Retirement Contribution information only, updated 2012-2016 Forecast to be issued in late February; Increased Retirement Contributions: Police (\$26.7 M), Fire (\$18.7 M), Federated (\$15.5 M); Does not include updated Police & Fire retiree healthcare changes.

# Projected City Retirement Contributions Exceed \$1.7 Billion Over Next Five Years (All Funds)

<b>Retirement Plan</b>	<b>FY 11-12</b>	<b>FY 12-13</b>	<b>FY 13-14</b>	<b>FY 14-15</b>	<b>FY 15-16</b>
<b>Federated</b>	<b>\$112.6M</b>	<b>\$133.6M</b>	<b>\$158.6M</b>	<b>\$171.2M</b>	<b>\$176.2M</b>
<b>Police</b>	<b>\$89.7M</b>	<b>\$110.6M</b>	<b>\$126.1M</b>	<b>\$136.2M</b>	<b>\$140.4M</b>
<b>Fire</b>	<b>\$53.9M</b>	<b>\$66.3M</b>	<b>\$75.5M</b>	<b>\$81.5M</b>	<b>\$84.1M</b>
<b>TOTAL</b>	<b>\$256.2M</b>	<b>\$310.5M</b>	<b>\$360.2M</b>	<b>\$388.9M</b>	<b>\$400.7M</b>
<b>% Increase</b>		<b>21.19%</b>	<b>16.01%</b>	<b>7.97%</b>	<b>3.03%</b>

**Note: Does not include the City's pre-payment discount**

# **2<sup>nd</sup> Tier Retirement Benefits for New Employees**

# City Charter Amendment

- November 2<sup>nd</sup> Passage of Measure W
- Allows for adoption of an ordinance to exclude future City officers and employees from any existing retirement plans or benefits
- Allows City to establish retirement plans for future employees that do not provide for the current minimum requirements and cost sharing

# City Auditor Recommendations

- Pursue one or a combination of pension cost-containment strategies:
  - Additional cost sharing
  - Eliminating or limiting SRBR transfers/distributions
  - Negotiate prospective changes for existing employees
  - Establish a 2<sup>nd</sup> tier for new employees
  - Consider joining CalPERS to reduce administrative costs

# General Fund Structural Deficit Elimination Plan Stakeholder Group

- Top 5 high-level ideas for potential changes
  - Create a 2<sup>nd</sup> Tier pension system for new employees
  - Increase the retirement age
  - Change automatic 3% COLA to link increases to CPI or to increase given to Social Security
  - Change to a defined contribution plan or hybrid
  - No City Pension holiday; always pay full normal cost

# Goals of 2<sup>nd</sup> Tier Retirement Benefits

- Minimize intergenerational transfers of the cost of retirement benefits
  - Unavoidable given the current unfunded liability
- Long-term sustainable benefits
- Reduce future costs
- Reduce risk

# Competitiveness

- Can't use model that relies primarily on comparisons of retirement benefits of other cities
  - State started 90% benefit for public safety
  - Spread throughout California
  - Competitiveness was main reason given for need to provide a 90% retirement benefit



# Competitiveness

*“Designing a retirement plan that attracts and retains all workers is not possible because of lifestyle differences. This is further complicated by the age differences of new employees and their life priorities. Increased job marketplace mobility means that workers of all ages enter employment at different stages of their careers and stay for differing lengths of time. What attracts older workers may be very different from what attracts younger workers. Further, what attracts younger workers today may provide a source of regret as they age and wish they had chosen differently.”*

*-Maine Unified Retirement Task Force Study and Report, March 2010*

# Competitiveness

- Primary consideration should be to fiscal health of the City and the City's ability to provide basic City services to residents
- Recruit employees who are interested in a career in public service
- San Jose is a major employer
  - More employees than every city in Santa Clara County (combined)
  - San Jose can drive the market

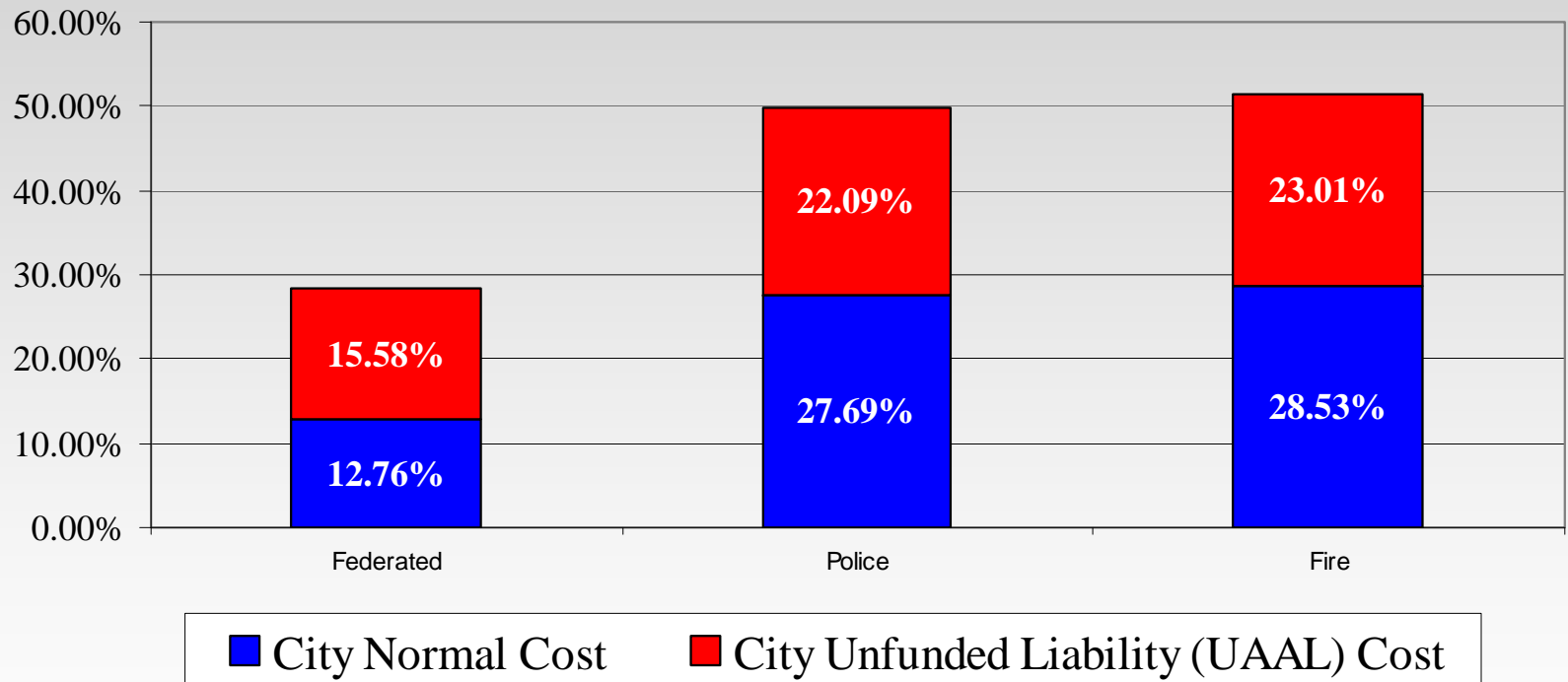
# Goals of 2<sup>nd</sup> Tier Retirement Benefits

- A cost and structure of retirement benefits that provides for future flexibility
  - Allows for total compensation dollars to be directed at pay or other benefits in the future
  - Allows for flexibility to react to the labor market

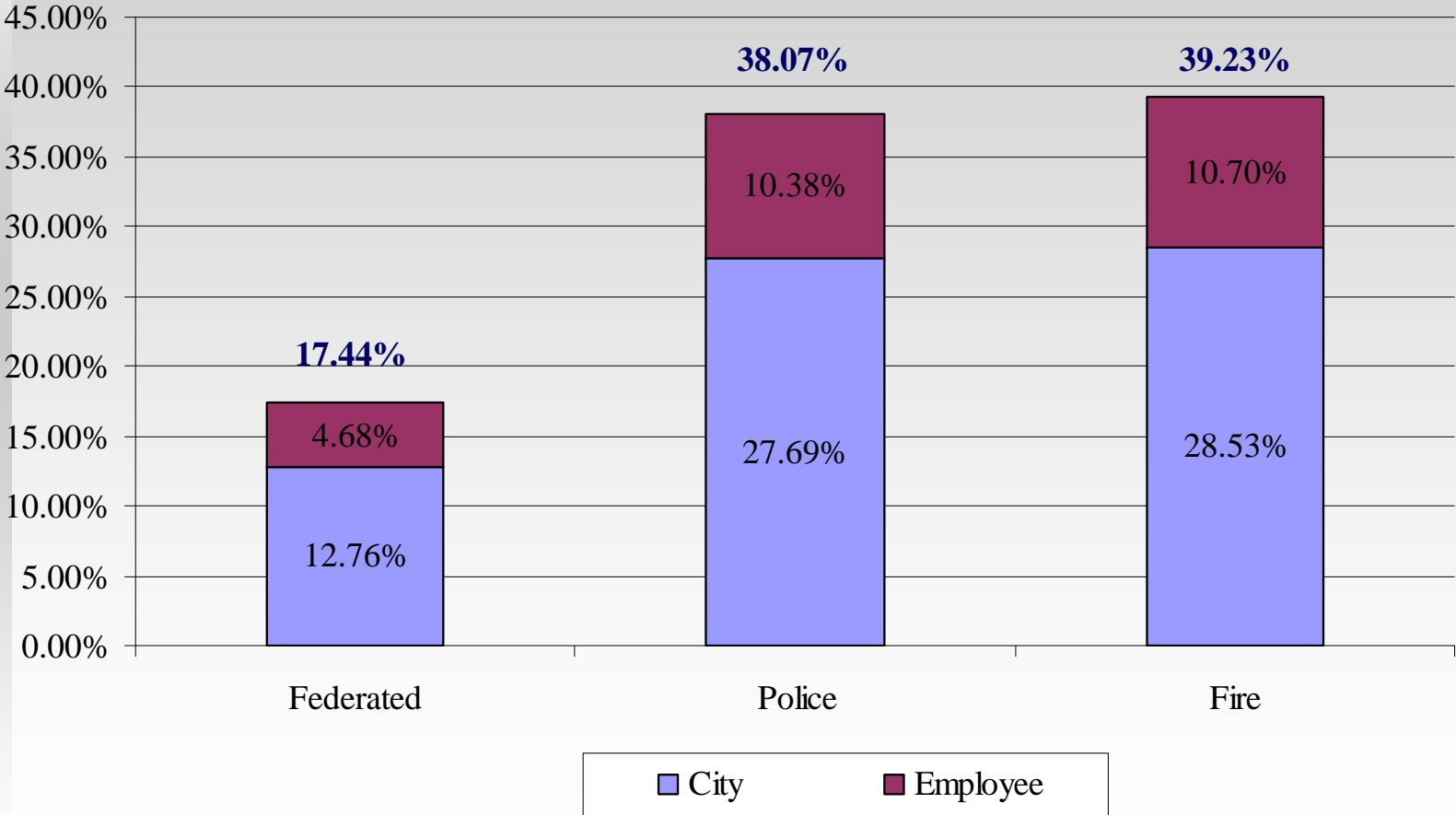
# Alternatives for a 2<sup>nd</sup> Tier

- Defined Benefit Plan
- Defined Contribution Plan
- Social Security
- Hybrid

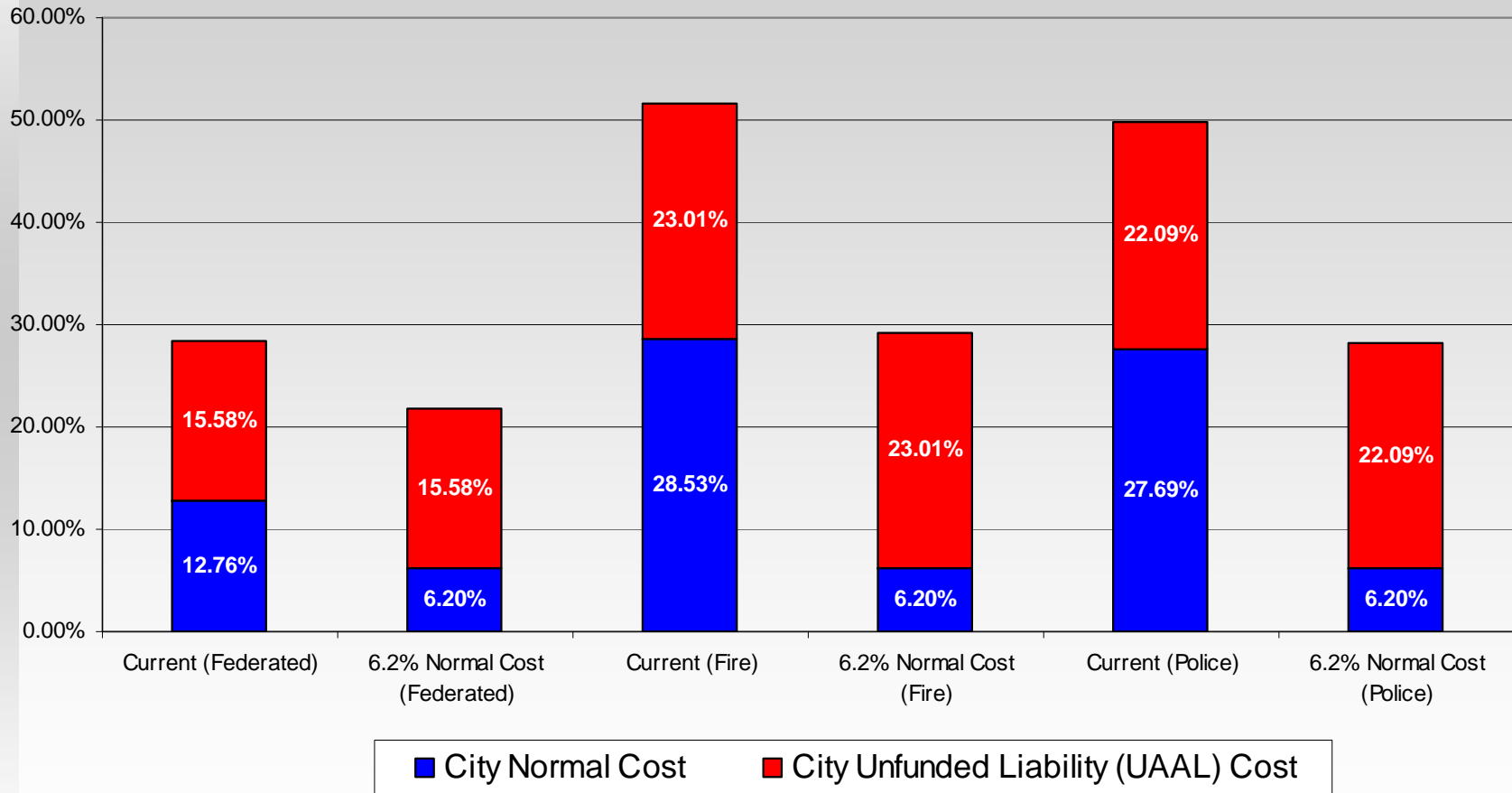
# City's FY 11-12 Pension Costs – Normal & Unfunded Liability



# FY 11-12 Pension Normal Cost – City and Employees



# Current City Pension Costs compared to 6.2% Normal Cost (12.4% Total)



# Alternative Defined Benefit Plan Designs: Maximum 12.4% Normal Cost

Alternative Pension Benefit	
Formula	1.25% – 2.00% per year of service
Age	58 – 65
COLA	0 – 2%
Calculation of Pension	Modify from current highest final year



# Estimated Future Annual Savings

Assumes City's Normal Cost is 6.2%

New Hires	Savings
33% in 5 Years	\$21.9 M
50% in 10 Years	\$33.1 M

Note:

- Assumes FY 11-12 Base Budget for estimated savings as of October 2010 Base Budget.
- Assumes rates that have been approved by the retirement boards to date.
- Assumes that FY 11-12 rates would remain unchanged for the next 10 years.

**2<sup>nd</sup> Tier Retirement Benefits  
for  
New Employees  
Recommendation/Direction**

# Recommendations for 2<sup>nd</sup> Tier Retirement Benefits for New Employees

- 2<sup>nd</sup> Tier Normal Cost not to exceed 6.2% for the City
  - Defined Benefit or Hybrid Plan
- Considerations for Defined Benefit
  - Cost Sharing – Pension Unfunded Liability
  - Cost of Living Adjustment (COLA)
  - Retirement Age
  - Pension Formula
  - Determination of Final Compensation
  - Retirement Service Credit

# Recommendations for 2<sup>nd</sup> Tier Retirement Benefits for New Employees

- Considerations for Defined Benefit (cont'd)
  - Minimum Service Requirements (Vesting)
  - Joint and Survivor Benefits
  - Retiree Healthcare Benefit
  - Cost Sharing – Retiree Healthcare
  - Retiree Dental Benefit
  - Retroactive Disability Retirement Applications

# Other Retirement Reforms

- Options for current employees
- Supplemental Retiree Benefit Reserve (SRBR) (“13<sup>th</sup> Check”)
- Workers’ Compensation Offset in the Police and Fire Department Retirement Plan

# Status of Retirement Benefits Negotiations

<b>Bargaining Unit</b>	<b>Negotiation Start Date</b>
<b>POA</b>	<b>January 12, 2011</b>
<b>MEF</b>	<b>January 19, 2011</b>
<b>CEO</b>	<b>January 19, 2011</b>
<b>ABMEI</b>	<b>January 21, 2011</b>
<b>IBEW</b>	<b>January 21, 2011</b>
<b>AEA</b>	<b>January 21, 2011</b>
<b>CAMP</b>	<b>January 21, 2011</b>
<b>AMSP</b>	<b>January 21, 2011</b>
<b>ALP</b>	<b>January 24, 2011</b>
<b>OE#3</b>	<b>February 2, 2011</b>
<b>IAFF</b>	<b>N/A</b>

# Questions and Discussion