



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Alex Gurza

SUBJECT: SANTA CLARA COUNTY CIVIL
GRAND JURY REPORT - INQUIRY
INTO THE FINANCIAL IMPACT OF
RETIREMENT PROGRAMS ON
SANTA CLARA COUNTY AND THE
CITY OF SAN JOSE

DATE: January 7, 2005

Approved

Kay Winter

Date

1/10/05

RECOMMENDATION

It is recommended that the Mayor and City Council accept this response to the 2003-2004 Santa Clara County Civil Grand Jury's Report entitled "Inquiry Into The Financial Impact of Retirement Programs on Santa Clara County and The City of San Jose."

BACKGROUND

The Grand Jury has reviewed the financial impact of defined-benefit retirement plans on the County of Santa Clara and the City of San Jose budgets. In recent years, government agencies have enhanced pension benefits, while the private sector has been moving towards defined-contribution programs (such as 401k plans). The purpose of this memorandum is to respond to the findings and recommendations in the Grand Jury's Report (copy attached).

The Grand Jury Report states that the County has contracted with the California Public Employees' Retirement System (CalPERS) and over the years amended the agreement to add certain options. The County's cost for funding retirement plans has increased almost 50%, from \$66 million to a projected \$95 million over the same period.

The City of San Jose has established and maintains its own retirement plans. Contributions to the retirement plans are made by both the City and the participating employees. Non-public safety employees covered by the Federated City Employees' Retirement System are eligible for a pension at age 55 with 5 years of service or with 30 years of service at any age. The pension accrues at 2.5% times the number of years of service (up to a 75% maximum) multiplied by the highest average monthly salary, during the highest 12 consecutive months. In the fiscal year 2004-2005,

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BACKGROUND (cont'd.)

the City paid \$100.6 million in retirement contributions. During the 2005-2006 fiscal year, the City is expected to pay \$102 million in retirement contributions.

The Police and Fire Department Retirement Plan covers San Jose police officers and firefighters. They are eligible to retire with a maximum monthly allowance of 85% of their final compensation after 30 years of service. In January 2004, Mercer Human Resource Consulting prepared an actuarial report to calculate the cost of enhancing the public safety pension to mirror the CalPERS 3% per year at age 50 model. Enhancing the pension benefit from an 85% maximum to a 90% maximum is estimated to have an annual cost of \$24.07 million (11.68% of payroll). After revisiting the cost of implementing the new benefit formula with modified service retirement assumptions the actuary estimated the annual cost to be \$19.68 million (9.55% of payroll).

RESPONSE TO GRAND JURY FINDINGS

Grand Jury Finding I

The Grand Jury has made the following Finding I: “The San Jose and County governments have negotiated generous pension programs that have an increasingly large negative impact on their budgets. These defined-benefit programs rely on future increases in the financial markets to pay pension benefits. The government is responsible for any shortages in fund performance.”

Response to Finding I

The City agrees with the finding of the Grand Jury and recognizes that the costs of the City’s retirement systems are projected to escalate over the short term. In mid 2002, the City’s cost for the Police and Fire Retirement Plan was 14.22% of payroll and increased to 24.59% of payroll by mid-2004 due to a combination of factors, including poor market performance and greater than anticipated salary increases. The Federated City Employees’ Retirement System has also increased, but not as significantly. In mid-2002, the City’s cost for the Federated Employees’ Retirement Plan was 15.20% of payroll and increased to 17.12% of payroll by mid-2004. Over the next few years, these rates are expected to increase without any retirement benefit enhancements. We have concluded our negotiations with 65% of our workforce and have not increased retirement benefits for these non-public safety employee groups. The City is currently in negotiations with the Public Safety unions in order to address their concerns while at the same time developing strategies that will mitigate the potential further escalation of the cost of retirement benefits.

RESPONSE TO GRAND JURY RECOMMENDATIONS

Grand Jury Recommendation I-A

Grand Jury Recommendation I-A is: “The San Jose and County governments should not further increase the defined-benefit pension benefits of existing employees and, instead, work with unions to limit the costs of employee pension programs.”

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RESPONSE TO GRAND JURY RECOMMENDATIONS (cont'd.)

Response to Recommendation I-A

The City agrees that increased costs in retirement systems have become a large financial burden for public employers on a State and National wide level. Research on this issue also indicated significant cost increases for agencies that have provided enhanced retirement benefits, such as the 3% per year at age 50 model. The research revealed that few agencies accurately predicted the significant cost increases they could encounter subsequent to granting the enhanced benefits.

Grand Jury Recommendation I-B

Grand Jury Recommendation I-B is: "To reduce the financial risk, San Jose and County governments should explore changing to defined-contribution pension programs for new employees, retirement programs that are comparable to the private sector."

Response to Recommendation I-B

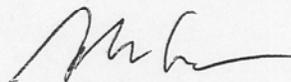
The City accepts this recommendation and will perform additional analysis to evaluate the potential ramifications of this kind of a change in providing benefits to our employees. Any such changes would be subject to negotiation with the unions and would require amendments to the City Charter.

PUBLIC OUTREACH

Not applicable.

COORDINATION

This memorandum was coordinated with the Office of the City Manager, Budget Office, and the City Attorney's Office.



Alex Gurza
Director of Employee Relations