



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Alex Gurza

SUBJECT: SEE BELOW

DATE: April 22, 2008

Approved

Date

4/22/08

SUBJECT: ORDINANCE TO IMPLEMENT A BENEFIT ENHANCEMENT FOR FIRE DEPARTMENT MEMBERS OF THE POLICE & FIRE DEPARTMENT RETIREMENT PLAN

COUNCIL DISTRICT: N/A

RECOMMENDATION

Approval of an ordinance amending Chapter 3.36 of Title 3 of the San Jose Municipal Code to provide increased retirement benefits for members of the Police and Fire Department Retirement Plan who are employed in the Fire Department and retire on or after July 1, 2008.

OUTCOME

Adoption of the ordinance amending the Police and Fire Department Retirement Plan would implement the enhanced retirement benefit that was awarded in arbitration between the City and the San Jose Fire Fighters, International Association of Firefighters, Local 230 ("San Jose Fire Fighters"). The enhanced benefit would be extended to all current fire department members of the Plan who retire on or after July 1, 2008.

EXECUTIVE SUMMARY

An interest arbitration award between the City of San Jose and the San Jose Fire Fighters was issued on or about August 11, 2007. The award contains an enhancement to the retirement benefit formula effective July 1, 2008, for employees in classifications represented by the San Jose Fire Fighters.

Although the arbitration award applies only to employees in classifications represented by the San Jose Fire Fighters, it is recommended that the enhanced retirement benefit apply to all current Fire Department members of the Plan, including Deputy Fire Chiefs, the Assistant Fire Chief and the Fire Chief.

Adoption of the ordinance will amend the San Jose Municipal Code to provide the increased retirement benefits for members of the Police and Fire Department Retirement Plan who are employed in the Fire Department and retire on or after July 1, 2008.

BACKGROUND

An interest arbitration award between the City of San Jose and the San Jose Fire Fighters was issued on or about August 11, 2007. The award applies to employees in classifications represented by the San Jose Fire Fighters and contains changes to retirement benefits, including an enhancement to the benefit formula. The change to the benefit formula is effective for eligible employees who retire on or after July 1, 2008.

ANALYSIS

Current Benefits

The current formula for calculating retirement benefits for Police and Fire Department Retirement plan members who are in classifications in the San Jose Fire Department is two and one half (2 ½%) percent of final compensation for each year of service with the City up to twenty (20) years, plus three (3%) percent of final compensation for each year of service with the City between 21 and 25 years, and four (4%) from 26 – 30 years subject to a maximum of 85% of final compensation at 30 years of service.

As part of contract negotiations for the current agreement between the City and the San Jose Police Officers' Association, retirement benefits were enhanced for Police Department members of the Plan who retire on or after July 1, 2006. The following table summarizes the current benefit formulas in the Police and Fire Department Retirement Plan:

Years of Service	Current Fire Benefit	Current Police Benefit
1-20	2.5% per year	2.5% per year
21-25	3% per year	4% per year
26-30	4% per year	4% per year
Maximum Benefit	85% at 30 years of service	90% at 30 years of service

Fire Arbitration Proposals and Costs

In arbitration with the San Jose Fire Fighters, the City offered to match the 90% benefit that had been negotiated with the San Jose Police Officers' Association. The San Jose Fire Fighters offer in arbitration was to change the benefit formula to 3% of final compensation for each year of service once an employee completes twenty (20) years, with a maximum of 90%. The Retirement Board's actuary developed cost estimates of these benefit alternatives, and these cost estimates were provided to the Arbitration Panel. (Please see attached.)

The following is a summary of the proposals made in arbitration and the costs of each proposal:

	City Proposal (eff. July 2007)	Union Proposal (eff. July 2008)
Formula	1-20 2.5% per year 21-30 4% per year	1-20 2.5% per year Once member earns 20 years of service: 1-30 3% per year
Maximum Benefit	90% at 30 years of service	90% at 30 years of service
Increase in Unfunded Liability	\$19.22 million	\$30.423 million
Increase in City's Unfunded Liability Contribution Rate	2.29% of payroll	3.63% of payroll
Increase in City's Normal Cost	1.03% of payroll	1.95% of payroll
Total Increase in City's Contribution Rate	3.32% of payroll ¹	5.58% of payroll
Total Annual City Cost (in dollars)	\$2.884 million	\$4.846 million
Total Increase in Employee's Rate (Normal Cost)	0.38%	0.73%

“Normal Cost” and Unfunded Liability

The normal cost and the unfunded liability is reflected in the preceding chart as calculated by the Board's actuary in the attached report.

“Normal cost” is the cost of benefits earned by employees in any given year. For the pension benefit, the Retirement Plan provides that the normal cost is divided between the City and employees in a ratio of 8:3. (The City contributes \$8 for every \$3 paid by the employee.) The normal cost of the two benefit proposals were calculated by the Board's actuary and are included in the preceding chart.

Enhancing retirement benefits for current employees that results in an increase in the benefit for prior years of service increases the Unfunded Actuarial Accrued Liability, or UAAL. For example, an employee who has 20 years of service under the existing formula would receive a benefit equivalent to 50% of the employees' final compensation. Under the San Jose Fire Fighters' proposal, the employee would receive **60%** of final compensation. This 20% increase results in an

¹ The annual costs to the City of these benefit enhancements are based on the payroll costs that are considered “pensionable.” This includes base salary and additional pays such as holiday-in-lieu pay, EMT pay, and Anti-Terrorism Training Pay. The dollar costs in the chart above are effective 2008-2009 and are based upon the 2008-2009 proposed budget.

unfunded obligation for the past service since neither the City nor the employees have been contributing into the Plan an amount during the employee's prior years of service specifically to pay for this enhanced benefit.

The preceding chart includes the Board's actuary's calculations of the increase in the Unfunded Actuarial Accrued Liability which reflects the unfunded obligation for past service and the annual cost to the City to pay that unfunded liability. Currently, under the City's retirement plan the City pays **100%** of the unfunded liability for these enhanced benefits, which is amortized and paid as part of the City's retirement contribution rate.

As noted in the chart, the annual contribution rate required to pay the unfunded liability created by the enhanced benefit is significantly greater than the normal cost of the benefit. For example, the total contribution rate for the San Jose Fire Fighter's proposal paid by the City is 5.58% of payroll. Of that amount, approximately 65% (3.63% of payroll) is for the Unfunded Actuarial Accrued Liability.

Arbitration Award

The Chair of the Arbitration Panel selected the proposal made by the San Jose Fire Fighters, rather than the benefit proposed by the City. The proposal as drafted by the union reads as follows:

ARTICLE 28 RETIREMENT

28.6 The current formula for calculating retirement benefits is 2 ½% of the final compensation for each year of service with the City up to 20 years, plus 3% of final compensation for each year of service with the City between 21 and 25 years, and 4% from 26-30 years subject to a maximum of 85%.

Effective July 1, 2008, the benefit formula will be changed to 3% of final compensation for year of service once an employee completes twenty (20) years of service to a maximum of 90%.

For the first 20 years of service under the new formula, the benefit remains at 2.5% for each year of service. For example, an employee with 19 years of service with the City would receive a benefit equivalent to 47.5% (2.5% x 19) of the employee's final compensation. However, once an employee reaches 20 years of service with the City, all years of service are calculated at 3% per year of service. An employee with 20 years of service will receive a benefit equivalent to 60% (3% x 20) of the employee's final compensation. Thus, the benefit under this formula increases significantly from 47.5% of final compensation at 19 years of service to 60% at 20 years of service.

This enhanced benefit formula will be effective for all Police and Fire Department Retirement plan members who are in classifications in the San Jose Fire Department who retire on or after July 1, 2008. Although the arbitration award applies only to employees in classifications represented by Local 230, it is recommended that the enhanced benefit apply to all current Fire Department members of the Plan, including Deputy Fire Chiefs, the Assistant Fire Chief and the Fire Chief. This makes the retirement benefits consistent with all sworn-personnel within the Fire Department and

also is consistent with prior benefit enhancements. For example, when retirement enhancements were implemented that resulted in the increase in maximum benefit from 75% to 80% and then subsequently from 80% to 85%, the changes applied to all members of the Plan. Similarly, when the 90% benefit was recently negotiated with the POA, the benefit was extended to the Police Chief and the Assistant Police Chief although those two positions are not represented by the POA.

Alternative Benefit Formula for Service-Connected Disability Retirements

A proposed ordinance to implement the formula as awarded in arbitration was not brought forward earlier in order to determine if an agreement could be reached between the City and the San Jose Fire Fighters on an alternative formula that varied from the arbitration award in cases of service-connected disability retirements for employees with more than 20 years of service.

In drafting the ordinance to implement the new benefit formula, the attorney from the City Attorney's Office assigned to the Board identified a potential consequence of the new formula related to the portion of the retirement benefit that is excluded from the income tax payable by a retiree with over 20 years of service who receives a service-connected disability retirement. The attorney from the City Attorney's Office assigned to the Board referred this issue to the City Administration and to the Union and asked if the parties were amenable to an alternative formula for service-connected disability retirement benefits that would preserve the exclusion from retirees' income taxes.

This alternative benefit formula would apply only in cases of service-connected disability retirements for employees with more than 20 years of service. Rather than receiving 3% per year of service at 20 years per the formula in the arbitration award, employees would receive 50% of final compensation for the first 20 years, an additional 10%, plus 3% for each additional year over 20, up to a maximum of 90%. Although this alternative results in the same benefit paid by the Plan, it varies from the arbitration award in that the first twenty years would not be at 3% per year.

The discussions with the San Jose Fire Fighters have included the need for a tax expert/attorney and the Board's actuary to review the alternative formula. After discussions with the San Jose Fire Fighters about this issue, as well as other unresolved issues resulting from the arbitration award, an agreement has not been reached on the alternative formula.

The proposed ordinance (attached) implements the formula as awarded in arbitration in order to ensure that employees can retire under the enhanced benefits effective July 1, 2008, without delay. If an agreement is subsequently reached with the San Jose Fire Fighters, an ordinance may be brought forward to the City Council that amends the formula in a manner that maintains the exclusion from the retirees' income taxes that exists under the current retirement benefit formula.

Retirement Board Review

San Jose Municipal Code Section 3.36.485 (A) (copy attached) requires that prior to adoption of any ordinance amending the Police and Fire Department Retirement Plan, a copy of the proposed ordinance be provided to the Board for the Board's review and recommendation. Although the Board is not required to do so, the Board may submit a report or recommendation on the proposed

amendment to the City Council within sixty (60) days upon receipt of the proposed ordinance by the Secretary of the Board.

Pursuant to Municipal Code Section 3.36.485 (B), in any case where the City Council finds that there is a need to adopt an ordinance amending the system within a time period which would not allow for a sixty-day review period, the Council may act on the ordinance without first submitting it to the Board. At the time the Council passes the ordinance for publication of title, the Council refers the ordinance to the Board for study and consideration. The Board can then make recommendations to the Council, and the Council may amend the adopted ordinance with any further changes, subject to the meet-and-confer process if applicable.

In order to allow for the full sixty day review period under Section 3.36.485 (A), the proposed ordinance would have needed to be provided to the Board in early March. However, given the discussions with the San Jose Fire Fighters about the possibility of an alternative formula, an ordinance was not provided to the Board earlier in the event that an agreement could have been reached on the alternative formula. In order to implement the enhanced retirement benefit in the arbitration award by July 1, 2008, the proposed ordinance will allow employees to retire and receive the increased benefits without delay.

A copy of this memorandum, including the proposed ordinance, will be provided to the Board.

PUBLIC OUTREACH/INTEREST

- X **Criteria 1:** Requires Council action on the use of public funds equal to \$1 million or greater. **(Required: Website Posting)**

- Criteria 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**

- Criteria 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

This item will be placed on the May 6, 2008, Council Agenda and the memorandum will be available to the public on the City's website.

COORDINATION

This memorandum was coordinated with the City Attorney's Office and the City Manager's Budget Office. A copy of this memorandum and the proposed ordinance will be provided to the San Jose Fire Fighters and the Police and Fire Department Retirement Board.

April 22, 2008

**Subject: Retirement Benefit Enhancement for Fire Department Members
of the Police & Fire Department Retirement Plan**

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COST IMPLICATIONS

The Board's actuary estimated that providing the enhanced retirement benefit for Police and Fire Retirement plan members who are in classifications in the San Jose Fire Department would increase the City's contribution rate to the Police and Fire System by approximately 5.58% percent of covered payroll annually. The Board has not yet approved the change in contribution rates, but it is anticipated that the contribution rates for this benefit change will be effective on July 1, 2008.

The estimated annual on-going cost to the City of the enhanced retirement benefits as awarded in arbitration is approximately \$4.846 million.



Alex Gurza
Director of Employee Relations

For questions please contact Alex Gurza, Director of Employee Relations, at (408) 535-8150.

Attachment 1: Proposed Ordinance to amend the San Jose Municipal Code

Attachment 2: The Segal Company Report, dated January 12, 2007

Attachment 3: San Jose Municipal Code, Section 3.36.485

c: Police and Fire Department Retirement Board
San Jose Firefighters, IAFF, Local 230