COUNCIL AGENDA: 06-17-08
ITEM: 3.5

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Scott P. Johnson

SUBJECT: **ORDINANCE PROVIDING CITY OPTION FOR LUMP SUM PAYMENT OF EMPLOYER RETIREMENT CONTRIBUTIONS**

DATE: May 29, 2008

Approved Christine J. Shippey Date 6-3-08

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

Approval of an ordinance amending Chapters 3.28 and 3.36 of the San José Municipal Code to:

1) provide the City with the option to make lump sum payments of the City's required fiscal year 2008-09 pension and retiree medical benefits account contributions to the Police and Fire Department Retirement Plan and the Federated City Employees' Retirement System (the "Retirement Plans") on or before August 1, 2008 for the balance of fiscal year 2008-09;

2) provide the City with an annual option, commencing with fiscal year 2009-10, to select the periodic basis on which the City's required contributions will be made in advance to the Retirement Plans;

3) provide for each of the Retirement Plan Boards to establish the amounts of the City's required contributions for the August 2008 lump sum payment and for such alternative periodic basis as the City may select commencing with fiscal year 2009-10, as determined by the Boards' actuaries to be actuarially equivalent to the bi-weekly payments that would otherwise have been required;

4) provide that the City's required contributions to the medical benefits accounts within said Retirement Plans shall be made on the same periodic basis that the City's pension contributions are made; and

5) provide for adjustment of the City's required contributions in the following fiscal year after any lump sum payment is made to reflect any difference in contributions due to a variance between the actual payroll amount for the fiscal year in which the payment was made as compared to the projected payroll amount on which the lump sum payment was calculated.

OUTCOME

Approval of this recommendation will provide the City with the option to make lump sum payments of its pension and retiree medical benefits account contributions. Making a lump sum payment may result in a net benefit to the City that will be realized immediately through a reduced annual pension and retiree medical benefits contribution and possibly, in the form of a lower unfunded accrued actuarial liability ("UAAL").

BACKGROUND

As outlined in the Mayor's March Budget Message for Fiscal Year 2008-09, and approved by the City Council, direction was given to the City Manager to "analyze the most cost effective prepayment strategy and report back to the City Council".

The City currently makes biweekly contributions to the Federated City Employees' Retirement System (the "Federated Plan") and the Police and Fire Department Retirement Plan (the "Police and Fire Plan" and together with the Federated Plan, the "Retirement Plans") in conjunction with each payroll distribution. These contributions are calculated based on estimated payroll amounts and contribution rates determined by Gabriel Roeder Smith & Company ("GRS") for the Federated Plan and by the Segal Company ("Segal") for the Police and Fire Plan. The pension contribution rates are set such that the City's annual contributions will equal eight-elevenths (8/11) of the normal cost plus any adjustments related to amortization payments or credit on the unfunded liability for each of the plans, as required by the San José Municipal Code (the "Municipal Code"). For the contributions to the Federated Plan related to retiree medical benefits account, the City pays approximately 50% of the health benefit's total costs and 8/11th of the dental benefit's total costs. For the contributions to the Police and Fire Plan related to retiree medical benefits account, the City pays approximately 50% of the health benefit's total costs and 75% of the dental benefit's total costs.

At the Police and Fire Plan Board meeting on April 3, 2008 and the Federated Plan Board meeting on April 10, 2008, the Retirement Plan Boards directed their respective actuaries to provide an analysis of retirement contributions if the City chose to prepay its employer retirement contributions. Other public retirement systems, such as The California Public Employees' Retirement System (CalPERS) and the Los Angeles City Employees' Retirement System (LACERS), have established policies permitting prepayment of employer retirement contributions at a discount. The current CalPERS discount for annual prepayments is 3.66%.

Based upon this direction in the Mayor's March Message, the Proposed 2008-2009 Operating Budget included a proposal to recognize ongoing savings that would result from the prepayment of employer retirement contributions for the Retirement Plans beginning in fiscal year 2009-10.

ANALYSIS

Analysis of the Prepayment Benefit

As requested at the Police and Fire Plan Board meeting on April 3, 2008, Segal prepared an analysis dated April 21, 2008, calculating the discounted contribution amount for the Police and Fire Plan for fiscal year 2008-2009 to be $60.7 million, assuming that the prepayment would include both pension and retiree medical and dental and would be made on July 1, 2008. This prepayment amount is $2.5 million, or 3.89%, less than the $63.2 million contribution the City would make if it continued making biweekly contributions. All retirement contributions to the Police and Fire Plan are attributable to the General Fund.

As requested at the Federated Plan Board meeting on April 10, 2008, GRS prepared an analysis dated May 7, 2008 calculating the discounted contribution amount for the Federated Plan for fiscal year 2008-2009 to be $68.5 million, assuming that the prepayment would include both pension and retiree medical and dental and would be made on July 1, 2008. This prepayment amount is $2.9 million, or 4.01%, less than the $71.4 million contribution the City would make if it continued making biweekly contributions. Approximately 54.3% of the retirement contributions to the Federated Plan are attributable to the General Fund, however there is a small reimbursement from Airport funds for police and fire personnel assigned to the Airport.

The discounts presented above do not take into consideration budgetary impacts such as foregone interest earnings associated with the prepayment. At the 3.41% assumed earnings rate for the City's Investment Pool in the Fiscal Year 2008-09 Proposed Budget, staff estimates that those budgetary impacts will reduce the benefit of the discount by $1.2 million for the prepayment to the Federated Plan and $1.1 million for the prepayment to the Police and Fire Plan.

Based on a July 1, 2008 prepayment date, therefore, the net savings in all City funds is approximately $3.1 million for this strategy; of this amount approximately $2.3 million would be generated in the General Fund. It should be noted that the 2008-2009 Proposed Operating Budget assumed that net General Fund savings of $1.5 million beginning in 2009-2010 from the implementation of this prepayment strategy and the issuance of pension obligation bonds (currently under study) would be achieved after accounting for necessary program expenditures. Once the pension obligation bond work is completed, a reconciliation of total revenues and costs anticipated for these two financing strategies will be brought forward for City Council review and incorporated into the budget process.

Although the preliminary analyses assumed a July 1, 2008 prepayment date, a lump sum payment cannot occur until changes to the Municipal Code become effective. Staff is currently targeting a lump sum payment on August 1, 2008 to coincide with the end of the first pay period which is subsequent to the amendment to the Municipal Code taking effect. Updated analyses are being prepared by Segal and GRS to reflect the prepayment occurring on August 1, 2008 instead of July 1, 2008 as initially assumed. A supplemental memo and updated cost savings impacts will be issued to Council when this information is released by GRS and Segal.

Amendment to the Municipal Code

The San José Municipal Code currently does not allow for the prepayment of pension contributions and is silent on the timing of contributions for the retiree medical benefits account. The Municipal Code specifically requires that "retirement [pension] contributions will be made monthly (or biweekly if members contribute biweekly)". In order to allow for a prepayment of pension and retiree medical benefits account contributions, it is necessary to amend the Municipal Code and modify this language. To provide additional flexibility for future business purposes, staff recommends that the amendment to the Municipal Code allow for quarterly and other periodic prepayments in addition to annual prepayments.

Cash Availability for Prepayment

Finance staff has developed a model of General Fund cash flows that incorporates the three most recent complete fiscal years as well as the current fiscal year through April 2008. Projections for fiscal year 2008-09 on a cash basis indicate that the General Fund will have sufficient cash available in the City's Investment Pool to make the prepayment on August 1, 2008 and remain in a positive cash position throughout fiscal year 2008-09. Finance staff expects that all other funds that make retirement contributions will also remain in a positive cash position throughout the fiscal year after making a prepayment of their respective retirement contributions.

Adjustment of City Contribution in Fiscal Year Following Lump Sum Payment

Because lump sum payment of City required contributions will be calculated based on assumptions concerning the City's payroll, there will need to be an adjustment following the close of the fiscal year in order to reflect the actual payroll amount. This adjustment will take the form of an additional payment if the actual payroll amount should be higher that the assumed payroll amount and a credit if the actual payroll amount should be lower than assumed payroll amount. Any additional required City payment will be made to the Plans immediately; while any credit will be taken the next time that the City's contribution rates are set, or a lump sum payment is made, whichever occurs first.

EVALUATION AND FOLLOW-UP

The amendment to the Municipal Code requires two readings. The first reading will take place on June 17, 2008 and the second reading will take place on June 24, 2008. The ordinance will become effective on July 25, 2008.

PUBLIC OUTREACH/INTEREST

☐ **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)**

COORDINATION

This staff report has been prepared by the Finance Department in coordination with the City Manager's Office, City Attorney's Office, Retirement Services Department, Human Resources Department, and Office of Employee Relations.

FISCAL/POLICY ALIGNMENT

The proposed prepayment is consistent with the Mayor's March Budget Message for Fiscal Year 2008-09 that was approved by the City Council in which direction was given to the City Manager to "analyze the most cost effective prepayment strategy and report back to the City Council".

CEQA

Not a project.

Scott P. Johnson
SCOTT P. JOHNSON
Director, Finance

For questions please contact David Persselin, Debt Administrator, at (408) 535-7012.