City Council Agenda: 6/07/11
Item: 3.3

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

To: Mayor & City Council

From: Councilmember Pete Constant

Subject: Council Salary Setting Commission Report

Date: June 6, 2011

Approved:

Recommendation

I recommend the City Council accept the Salary Setting Commission report dated May 6, 2011, with the following modifications:

1. Limit future elected councilmembers to participation in the city's PTC 457 Defined Contribution Plan, exclusively.
2. Direct the City Attorney to seek a determination letter from CalPERS clarifying the method by which we can opt-out from participation in the CalPERS retirement plan for future councilmembers.
3. Direct the City Attorney and the City Clerk to research all possible options for the discontinuance of the CalPERS contract. This research should include, but not be limited to:
   a. options for moving all members who are currently participating in the CalPERS plan into the city's PTC 457 Defined Contribution Plan;
   b. opt-in options for members who choose to move out of the CalPERS plan and into the city's PTC 457 Defined Contribution Plan;
   c. any other option that would allow the complete elimination of participation in defined benefit plans by elected officials;
   d. alternative options for moving participants to a lower cost CalPERS formula, e.g. 1.0/1.5% per year of service, to reduce or eliminate the unfunded liability.

Background

The fiscal health of the City of San José must remain the top priority for the city council. The city council has been discussing the impact of the decade-long deficits for quite some time. Central in these discussions has been the topic of escalating pension costs, key drivers of growing unfunded liabilities, and pension reform.

The councilmembers participate in the *CalPERS Miscellaneous Plan of the City of San José* defined benefit retirement plan. A defined benefit pension plan is a type of pension plan in which an employer promises a specified monthly benefit upon retirement that is predetermined by a formula based on the employee's earnings history, tenure of service and age, rather than depending on investment returns. Traditionally, this type of benefit plan is offered to attract career employees and encourage employee longevity. This stands in stark contrast to existing term limit legislation that specifically requires no more than two four-year terms, a maximum of 8 years, for councilmembers.

Given the short-term nature of councilmembers' tenure, I do not believe it is reasonable to have taxpayers' bear the burden of a providing a lifetime benefit for what amounts to 20% of the average private sector career of 40 years.

While serving the residents of San José, it is reasonable for the city to provide an avenue for elected councilmembers to save for retirement. The most appropriate vehicle for this type of savings is a defined contribution plan, such as the city's PTC 457 Defined Contribution Plan. A defined contribution plan is a type of retirement plan in which the amount of the employer's annual contribution is specified. Individual accounts are set up for participants and benefits are based on the amounts credited to these accounts (through employer contributions and employee contributions) plus any investment earnings on the money in the account. Only employer contributions to the account are guaranteed, not the future benefits. In defined contribution plans, future benefits fluctuate on the basis of investment earnings. Defined contribution plans offer a high level of portability, which is actually beneficial for a participant who does not plan on working a full career with one employer.

It is important to point out that elected members of the state assembly and state senate *do not* participate in CalPERS or any other type of a defined benefit retirement plan.

Analysis

There has been significant discussion related to reforming the city's pension plans to reduce escalating costs and reducing the associated unfunded actuarial accrued liabilities (UAAL) that have occurred as a result of providing defined benefit retirement benefits. While these discussions have placed a spotlight on the Federated and Police & Fire retirement plans, there has been no discussion regarding the CalPERS plan that the elected officials participate in.

The elected officials' retirement plan that is administered through CalPERS provides the following benefit:

Table 1: Benefit Summary – Misc. 2% at 55 Risk Pool
(Source CalPERS Annual Valuation Report, June 30, 2009)

Benefit Formula	2.0% @ 55
Social Security Coverage	No
Final Average Compensation Period	36 mos.
Industrial Disability	No
Non-industrial Disability	Yes
Pre-retirement Death Benefits	Yes
Post-retirement Death Benefits	$500
COLA	2%

Additionally, this plan requires a five year vesting period. It is important to note that while this benefit is significantly less than the benefits provided by either the Federated or Police & Fire retirement plans, the plan has also been experiencing increases to the Normal Cost and the UAAL (referred to as "Risk Pool" and "Side Fund" in CalPERS valuation report). The following table summarizes the ongoing costs associated with the plan:

Table 2: Required Employer Contributions (Source CalPERS Annual Valuation Report, June 30, 2009)

	FY2010-11	FY2011-12	FY2012-13
Employer Normal Cost	$71,565	$79,101	
Risk Pool Payment	6,796	19,096	
Amortization of Side Fund	52,366	61,630	
Total Employer Contribution	130,727	159,827	
Employer's Contribution Rates			
Normal Cost	7.740%	7.684%	
Risk Pool Payment	0.735%	1.855%	
Amortization of Side Fund	5.664%	5.987%	
Total Employer Contribution	14.139%	15.526%	16.0% (projected)
Employee Contribution Rate	7%	7%	7%
Total Contribution Rate	**21.139%**	**22.526%**	**23%**

Similar to the city's retirement plans, this CalPERS plan is experiencing a decline in its funded status, dropping from 92.9% as of June 30, 2008 to 64.9% as of June 30, 2009. This equates to an unfunded liability of approximately $450,000. This is the most recent information available pending the next annual valuation report which is expected to be available in October 2011.

Clearly this plan does not pose an imminent threat to the general fund; however we can clearly see that it is moving towards a declining funding status and increased employer contribution rates. It is important to note that the city's contribution rates to this plan significantly exceed the targets that the city council has set for future employer contribution rates related to retirement reform and cost containment.

Conclusion

The mayor and city councilmembers should personally lead by example, as we have previously in total compensation reductions, by starting with reforming the pensions of elected officials. This action is consistent with the council discussions of fiscal reform and Mayor Reed's overall strategy of ensuring our pension plans are sustainable.