CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: **Making Government Work Better Committee**

FROM: **Edward F. Overton**
Larry D. Lisenbee
Scott P. Johnson

SUBJECT: **Public Pension Systems Problems and Lessons**

DATE: November 21, 2005

Approved　　　　　　　　　　　　　　　　　　　　　Date

Background

This memorandum is in response to Council Member Chuck Reed's memorandum dated August 24, 2005, "Public Pension Systems Problems and Lessons Learned" that requests responses to questions relating to the City of San Jose's pension plans for discussion during the December 1, 2005 Making Government Work Better Committee meeting.

Article XV of the San José City Charter imposes a requirement on the City Council to provide a defined benefit pension plan for all full-time employees. The Charter sets out minimum benefits for all City employees and, in the case of Police & Fire, mandates actuarial soundness. The requirement for actuarial soundness in the Federated Plan is contained in Chapter 3.28 of the San José Municipal Code. Section 3.28.160 states: "…the board shall cause an actuarial investigation to be made from time to time and as often as it may deem such to be reasonably necessary to keep the plan actuarially sound." In addition, Section 3.28.200 provides: "…on the basis of such investigation… the board shall fix and from time to time make… revision or change in the rate of contribution required of members and the City… reasonably necessary to provide the benefits provided by this retirement system". Both Plans are similar in this requirement and have caused actuarial investigations to be conducted every two years for the past 30 years.

The Boards have historically adopted contribution rates recommended by the actuary, and the City has always paid the annual required contributions (ARC). The biannual contribution rates are set to cover current plan benefits. If new benefits are approved, all interested parties have automatically required an actuarial evaluation of the cost impact of the benefit changes. This is the process that has been followed to comply with both the Charter and the Municipal Code.

Analysis

The following are the specific questions raised in the August 24, 2005 memorandum from Councilmember Chuck Reed with responses to each:

Analysis (Cont'd)

1. What percentage of our retirement obligations is funded?

- As of the actuarial study completed as of June 30, 2003, the Police & Fire Plan was 100.2% funded, and the Federated System was 97.64% funded. Both Plans have excellent funded ratios. The assets on hand for the Federated Plan cover annual benefit payments 24.68 times. Police & Fire's annual coverage is 29.84. This is another way of measuring funded status of a plan.

2. What is the dollar amount of any unfunded obligations?

- The funded status of pension plans measures the progress of accumulating assets over the working life of the average employee. As of the last actuarial valuation, the Police & Fire Plan was ahead of its funding schedule by approximately $3 million. The Federated Plan is behind schedule by about $31 million. Both Plans' contribution rate structures include these amounts.

3. What percentage of our healthcare benefits for retirees is funded?

- Health benefits in both Plans are partially funded, and in full compliance with the current policies of the two Retirement Boards. The overall percentage of funding will be determined when the actuaries make the calculation required by the Governmental Accounting Standards Board (GASB) for FY 2006-2007. The Federated Plan is 100% funded for 15 years and Police & Fire is 100% funded for 10 years. At each biannual actuarial review, the fund is calculated for a new 10-year and 15-year period. The funding is based on the assumption that the health plan will terminate after the 10th and 15th years. That sunset date is changed every two years. The funding level for a different period has not been calculated. The combined actuarial balance sheet for the Health Fund for both plans, expressed in thousands, at June 30, 2003 is as follows:

Assets ($000)

Current Assets		$108,275
Present Value of Future Contributions		
City of San Jose	$134,071	
Employees	$114,665	
Total		$248,736
Total Present Value of Current and Future Assets		$357,011

Liabilities

Present Value of Future Healthcare Benefits	$357,011

4. What is the dollar amount of any unfunded obligations for healthcare?

- As noted above, the health care plans are fully funded for the stated periods considering the actuarial determined liabilities as compared to current assets and

Analysis (Cont'd)

future anticipated contributions over the stated funding period. Based on GASB 43 requirements, the Boards are looking at the cost of funding the health care benefit over the same period as the pension plans, i.e. 30 years. The dollar amount for the expanded years has not been calculated, but will be included in the GASB 43 calculation. It is anticipated that each Plan's actuary will work with the Boards to develop any unfunded liability as well as a funding strategy.

5. **If there are any unfunded obligations, have those amounts been included in the City's public disclosures to the municipal debt market?**
   - Currently GASB requires limited disclosure in governmental agencies' financial statements related to post employment benefits. We have consistently made the disclosures that are required by the Governmental Accounting Standards Board in our financial statements. The City and its financing agencies have also complied with the required disclosure of the funded status (Police and Fire at 100.2% and Federated at 97.64%) in our offerings through each "Official Statement" issued. GASB 43 mandates new disclosure and accounting requirements for public pension plans for fiscal year 2006-2007, and GASB 45 mandates the same requirements for sponsoring agencies of our size beginning in fiscal year 2007-2008. Both GASB Statements are generally consistent with the disclosure requirements adopted for defined benefit pension plans. We are working with our accountants and actuaries to develop our disclosure information.

6. **Have there been any agreements between the City and the Retirement Boards that provided for payments to the retirement system at rates less than actuarially calculated rates?**
   - We have contribution rate history back to 1951 and there is no indication that the City has ever paid less than what is actuarially required.

7. **Have there been any other agreements been the City and the Retirement Boards that affect retirement benefits or payments to the retirement funds?**
   - Benefit increases to the Retirement Plans are achieved through the meet and confer process. Prior to the City and the employee organizations agreeing to a benefit change, an actuarial report is always required. The City, the Boards and the employee groups are made aware of the potential cost of changes. If benefit increases are approved, the Boards, which are not a party to the meet and confer process, are required to set new rates to cover the cost of any benefit changes.

8. **Has the City financed any contributions to the retirement funds over a multi-year period or borrowed money to make contributions?**
   - The City has always made the actuarially required contributions on an annual basis. The City has never made financial contributions through borrowing or any other deferred means other than the amortization period set by the Boards for prior service obligations.

<u>Analysis (Cont'd)</u>

9. **Have there been any years in which the City did not pay its contribution at rates determined by the Funds' actuaries?**
   - The Retirement Boards have an actuarial study completed every 2 years. From the work done by the actuary, each Board sets contribution rates. Information about new rates is provided to the City Managers' Budget Office, the Finance Department and the Employee Services Department. Making sure that contributions are collected in accordance with the rates, as set by the Boards, is the responsibility of the Retirement Services Department. The City has always made the ARC.

10. **Has the City used earnings by the retirement funds above the rate projected by the Funds' actuaries as necessary to pay future liabilities ("surplus earnings") for any use other than to support the underlying soundness of the retirement system?**
    - The City's contribution rate fluctuates based on excess earnings and other actuarial gains or losses. The City pays less when the plans have gains and more when there are losses. Actuarial gains result from such things as higher investment earning than expected, lower salary increases than expected, higher turnover rate than expected, and higher mortality rates. Things that may create actuarial losses include more retirements granted than expected, lower mortality than expected and the opposite of the gain scenarios. Under the Municipal Code requirements, actuarial gains and losses are folded into the City's contribution rate. The City has never directly taken funds from the retirement plans.

11. **Do the retirement funds have any reserves that have been created from "surplus earnings" that are earmarked for any specific use?**
    - Both Plans have Supplemental Retiree Benefit Reserves (SRBR) that are created and maintained by excess earnings. Each Plan allows 10% of excess earnings to support the SRBR. (By contrast the City of San Diego takes 50% of its excess earnings to fund its SRBR program.) SRBR funds are used to pay a 13th check to retirees. The extra check helps to dampen the impact of inflation on our pension benefits to the extent that inflation is higher than 3%.

12. **Does the City suffer from any of the problems that undermined the reliability of San Diego's public disclosures?**
    - The City's retirement program is well designed, managed and properly funded, and therefore does not, in our opinion, suffer any of the problems which contributed to the situation in San Diego. The plans are actuarially reviewed every fiscal year ending in an odd number. Therefore we are in the process of completing a study for the year ended June 30, 2005. The contribution rates that result from this study will be implemented at the beginning of the next fiscal year.

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Coordination

This memorandum has been coordinated with the City Auditor's Office, the Department of Employee Services, the Office of Employee Relations and the City Attorney's Office.

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