
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

Date Issued: July 9, 2008

IBA Report Number: 08-72

City Council Docket Date: July 15, 2008

Item Number: 336

The Waterfall

Amendments to the San Diego Municipal Code Eliminating the Surplus Undistributed Earnings ("Waterfall") Relating to the City Employees' Retirement System.

OVERVIEW

This report is an update to IBA Report 08-55 (attached), wherein we discussed some technical aspects of two ordinances presented for Council consideration which would eliminate "The Waterfall". At this time, both Version A and Version B have been revised. This report will point out some changes to the versions and their effects, and review the continuing differences between the two versions.

FISCAL/POLICY DISCUSSION

As in our previous report, we continue to believe that both Version A and Version B accomplish the intended action to eliminate the surplus earnings concept and reform the Municipal Code. The two versions have been updated and differ from each other as described below.

Contingency of Corbett and 13th Check

In a difference from both current practice and Version A, Version B makes both Corbett payments and the 13th Check benefit non-contingent. This continues to be the case as it was in the previous Version B. Please see the attached IBA Report 08-55 for further discussion.

Payment of 13th Check

The new Version B makes a change to the 13th Check calculation and payment. Under current practice, the 13th Check amount is calculated by taking the amount of Surplus Undistributed Earnings (as defined in the code) and dividing by the total number of service years of retirees to get the dollar amount per year that will be paid out to those retirees. Under Version B, Surplus Undistributed Earnings have been eliminated entirely, but it does not appear that a new mechanism has been put into place to calculate how much the 13th Check should be (i.e. What dollar amount should be divided by the total number of years to calculate the amount to pay retirees). The IBA has brought this concern to the attention of the City Attorney (author of Version B) and, at the time of this writing, awaits information as to how the 13th Check could work under this ordinance. The IBA suggests that this be adequately addressed prior to Council action, if any, on this version.

Version A also eliminates using “Surplus Undistributed Earnings” as a concept and as the dividend for the formula. However, Version A establishes a new formula that uses total investment earnings, less crediting all of the other priority functions (such as crediting member contribution accounts and paying the expenses of the system). The amount left over is then divided by the total number of years to arrive at the per annum dollar amount that shall be paid to the retirees. As such, the IBA does not see a similar obstacle to payment of this benefit as seen in Version B.

Supplemental COLA

The modifications to Version A are limited to removing the establishment of a reserve for the Supplemental COLA benefit, but would maintain the funding that is currently provided for that benefit (as well as interest accrual) and we believe the effect would be transparent to retirees. The intention is to eliminate the establishment of these set-aside reserves as part of the overall reform of the Municipal Code with respect to the Waterfall. This is similar to Version B in that the benefit is continued, but the reserve no longer exists. It is our understanding that these changes come as recommended by the SEC Independent Consultant, Mr. Stanley Keller.

In Version B (as with Version A), the Supplemental COLA reserve is eliminated, but the funding for it and the benefit itself remains. In an update to Version B, the benefit is continued for the life of the funding amount, also in Version A. The only difference between the two versions with respect to Supplemental COLA appears to be that Version B does not include crediting interest to this benefit, so it may be assumed that the benefit will run out more quickly in Version B than in Version A. The IBA does not have data at this time on when the reserve would be projected to run out in either case.

Charter Section 143.2(a)

Since this item was continued at Council at its last scheduled hearing, the IBA notes that our questions with respect to Charter Section 143.1(a) still stand as referenced in our

attached report, including whether or not a vote of the members of the system may be required, since benefits are changing in Version B, or if a vote of the people may be required, since benefits actually may be increasing as well (inasmuch as the 13th Check payment will be made every year, rather than having the potential to be skipped in certain years and not paid at all). The IBA continues to suggest that the City Attorney provide a legal opinion as to these matters.

CONCLUSION

As with our previous report, we note that both versions achieve the desired reform in the Municipal Code. However, in this report, we have highlighted several outstanding questions with respect to Version B that we believe must be addressed before Council action, if any, on this version:

1. How will the 13th Check payment be calculated?
2. Must there be a vote of the system members in accordance with Charter Section 143.1(a) since the 13th Check benefit is being “changed” under this ordinance?
3. Must there be a vote of the people in accordance with Charter Section 143.1(a) since the 13th Check benefit is arguably increasing under this ordinance?

With adequate answers in place for the above, the IBA supports the reform of the Waterfall in the Municipal Code through either Version A or B.

[SIGNED]

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[SIGNED]

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Attachment: IBA Report 08-55