

EXECUTIVE SUMMARY

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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IBA REVIEW OF CITY AGENCIES BUDGETS

Attached to this summary is the IBA's review of the City Retirement System, or San Diego City Employees' Retirement System (SDCERS), and San Diego Data Processing Corporation's (SDDPC) FY 2013 Proposed Budgets. The review of the Housing Authority budget will be released under separate cover. These agencies are scheduled to be heard on Thursday, May 10th. Items of note from our review include:

City Retirement System (SDCERS)

- The City's budget document does not reflect the amounts in the SDCERS proposed budget, as it was not available at the time of publication.
- SDCERS' FY 2013 proposed budget was presented as a non-action item to its Business and Governance Committee and full Board of Administration in mid-April 2012. The Committee and full Board will consider the budget in May 2012. Upon approval by the Committee on May 17, 2012, the full Board of Administration will consider the budget on May 18, 2012.
- The FY 2013 proposed budget presented to the SDCERS Board totals \$44.9 million, an increase of \$546,000, or 1.2%, from the \$44.3 million FY 2012 budget. There are 58.0 budgeted positions, unchanged from FY 2012.
- The full City Retirement System report contains information on budget changes, as well as other issues, including the September 2011 performance audit by the City Auditor, underpriced purchased service credit contracts, and experience studies.

SDDPC

- The FY 2013 Proposed Operating Budget for SDDPC totals \$31.4 million, a decrease of \$7.6 million, or 20% from FY 2012.
- \$27.7 million or 88% of SDDPC's total revenue is from the City of San Diego. The other estimated 12% in revenue is from agencies other than the City of San Diego including the County, ARJIS, and SDCERS.
- It should be noted that SDDPC's Proposed Operating Budget assumes the same service levels as in FY 2012 and assumes "business as usual" with no transition impacts as a result of the City contracting out with new vendors to provide IT services historically provided by SDDPC.

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City Retirement System

The San Diego City Employees' Retirement System (SDCERS) FY 2013 proposed budget was presented as a non-action item to its Business and Governance Committee and full Board of Administration in mid-April 2012. The Committee and full Board will consider the budget in May 2012. Upon approval by the Committee on May 17, 2012, the full Board of Administration will consider the budget on May 18, 2012.

The City's budget document does not reflect the amounts in the SDCERS proposed budget, as it was not available at the time of publication.

The SDCERS proposed budget is scheduled to be presented as an informational item at the May 10, 2012 hearing of the Budget Review Committee.

SDCERS maintains that its budget is approved by its Board of Administration and does not require approval of City Council. Article XVI, Section 17 of the California

Constitution conveys to the Board "plenary authority and fiduciary responsibility for investment of moneys and administration of the [pension] system..." However, per City Attorney's Report to Council 2005-18, the City maintains the authority to examine and audit the Board's accounts and records.

FY 2013 Budget Adjustments

The table below presents a summary of the SDCERS proposed budget, by major category.

The \$44.9 million proposed budget presented to the SDCERS Board shows an increase of \$546,000, or 1.2%, from the \$44.3 million FY 2012 budget. There are 58.0 budgeted positions, unchanged from FY 2012.

Investment Management Expenses represent 68.7% of the total SDCERS FY 2013 proposed budget, at \$30.9 million. It is esti-

SUMMARY OF BUDGET CHANGES

	FY 2012 Budget	FY 2013 Proposed	Increase/ (Decrease)	Percent Change
Salaries and Personnel	\$7,133,000	\$7,427,000	\$294,000	4.1%
Data Processing and Special Projects	2,195,000	1,960,000	(235,000)	-10.7%
Legal/External	2,646,000	1,525,000	(1,121,000)	-42.4%
General Operations	3,187,000	3,121,000	(66,000)	-2.1%
<i>Subtotal Administration</i>	<i>\$15,161,000</i>	<i>\$14,033,000</i>	<i>(\$1,128,000)</i>	<i>-7.4%</i>
Investment Management Expenses	29,182,000	30,856,000	1,674,000	5.7%
<i>Subtotal Investment Management Expenses</i>	<i>\$29,182,000</i>	<i>\$30,856,000</i>	<i>\$1,674,000</i>	<i>5.7%</i>
TOTAL	\$44,343,000	\$44,889,000	\$546,000	1.2%

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mated that Investment Management Expenses will be 0.54% of assets under management, or 54 basis points, for FY 2013. Note that the most recent SDCERS CAFR indicates that for FY 2011, investment returns were at 24.2%, adding approximately \$1 billion to the pension system assets. Investment Management Expenses were 0.47% of assets under management for FY 2011.

The FY 2013 Investment Management Expenses budget is increasing over the FY 2012 budget by \$1.7 million, or 5.7% (from \$29.2 million to \$30.9 million). This increase is largely due to increased allocation of assets to private equity, infrastructure and real estate investments, as well as growth in assets under management.

Specific budgeted investment expense increases identified in SDCERS 2013 proposed budget include: a \$2.5 million increase related to growth in private equity assets and related fees; an \$850,000 increase in fees for infrastructure assets (including utilities, transportation, and energy sectors); and a \$119,000 increase in real estate fees. These increases are partially offset by \$1.9 million in fee reductions resulting from reallocation of assets toward passive equity and fixed income investments, which have relatively lower fee structures.

Budgeted Administration expenses are declining by \$1.1 million (7.4%), from \$15.1 million in FY 2012 to \$14.0 million in FY 2013. These expenses are 31.3% of the total SDCERS budget. Components of Administration expenses are discussed below.

The Salaries and Personnel budget category reflects an increase of \$294,000, largely due to increases in fringe expenditures of \$215,000. It is estimated that fringe costs will be higher for staff that will replace retired employees. While those retirees were still employed in FY 2012 as DROP participants, their associated fringe costs were lower than estimated fringe costs for new employees in FY 2013 (largely due to lower contribution rates to the pension system for DROP participants). Additionally, the preservation of benefits cost allocation to SDCERS, which was not included in the FY 2012 budget, is budgeted at \$49,000 for FY 2013. The budget for salaries is increasing by \$87,000, due to step increases and promotions.

There are no general salary increases budgeted, and the labor concessions that apply to City employees also apply to SDCERS employees. Note that the City manages the payment of SDCERS employees' salaries and fringe, and invoices SDCERS for those costs.

The Data Processing and Special Projects budget for FY 2013 is decreasing by \$235,000 from FY 2012. This figure may be revised, depending on the status of contract negotiations with vendors to replace the San Diego Data Processing Corporation.

The Legal/External budget category reflects a decrease of \$1.1 million. The decrease in fees for outside counsel is largely due to the decline in workload associated with both the substantially equal case and the Purchased Service Credit (PSC) Voluntary Correction Program filing with the IRS. However, FY 2013 projected costs for the sub-

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stantially equal case are being re-evaluated, and may be increased before Board approval of the budget. Underpriced PSC contracts are briefly discussed under the Issues to Consider heading below.

In addition to the operating budget, SDCERS presented a proposed capital budget to its Board. The capital budget is decreasing from approximately \$2.6 million in FY 2012 to \$1.6 million in FY 2013. The largest decline, of \$802,000, is associated with the pension administration system replacement project. The FY 2012 budget for the project was approximately \$2.3 million and is \$1.5 million for FY 2013. The project is anticipated to cost \$6.65 million in total, and is anticipated to be implemented in 2014.

Issues to Consider

Performance Audit by the City Auditor

In September 2011 the Office of the City Auditor released a performance audit of SDCERS, which provided 12 recommendations, five findings and background information on the retirement system.

The City Auditor's report was discussed at the December 5, 2011 Audit Committee meeting, and is linked to the agenda for that meeting. The report was also presented to the full City Council on February 7, 2012.

SDCERS, and the City, where appropriate, provided responses to the City Auditor's recommendations. The responses are included in the City Auditor's report. Ten of the City Auditor's recommendations were directed toward SDCERS, and SDCERS responses demonstrate past analysis or implementation of the recommendations or an-

anticipated future actions.

For example, Recommendation #4 indicates that once the new pension administration system is implemented, SDCERS should re-assess its staffing level. SDCERS responded to this recommendation that when the new system is implemented in 2014, they expect to be able to further streamline staffing levels. A possible 7.0 FTE's could be considered for reduction.

Recommendation #7, which was directed toward the City, proposed that the Risk Management Department make a request of the City Attorney's Office to review the permissibility of offsetting Industrial Disability Retirement (IDR) benefits with income from outside employment and/or Workers' Compensation awards. Additionally, if such an offset was to be determined feasible by the City Attorney, the Council should be presented with implementation options.

On February 1, 2012, the City Attorney's Office produced a report to the City Council stating that such an offset (related to Workers' Compensation benefits) was previously in existence and was eliminated in the late 1980's. Reinstitution of an IDR offset would require labor negotiations, a successful City Charter section 143.1 membership vote and a Municipal Code amendment.

Underpriced Purchased Service Credit Contracts

SDCERS is in the process of correcting underpriced purchased service credit contracts that occurred during what is known as the 2003 "window period." These contracts must be corrected pursuant to a court order, which was upheld on appeal.

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At the time of this report, SDCERS has completed the corrections process with approximately 95% of the affected employees and retirees.

Experience Studies

In June 2011 the SDCERS actuary, Cheiron, completed an experience study for the City's pension plan, for the period covering FY 2008 through FY 2010. The experience study involves historical analysis of pension plan assumptions, including the rate of investment return, salary inflation and retirement and mortality rates. The plan experience study is the basis for recommended changes to the plan's actuarial assumptions, and is required to be completed at least once every five years.

On September 30, 2011 the SDCERS Board voted to adopt Cheiron's recommended assumption changes. Those changes include lowering the investment return assumption from 7.75% to 7.50% and lowering the inflation assumption from 4.00% to 3.75% after a two-year freeze on inflationary pay increases. These and other approved assump-

tions were used by Cheiron to prepare the June 30, 2011 actuarial valuation, which provides the City with the FY 2013 ARC, totaling \$231.1 million. This is the ARC amount incorporated into the City's FY 2013 Proposed Budget.

Note that although the Municipal Code requires experience studies be conducted at least once every five years, the most recent experience studies have been completed every three years – for each of the three year periods ending FY 2004, FY 2007 and FY 2010. In response to Recommendation #10 of the City Auditor's report, SDCERS indicated that it may be appropriate to increase the timeframe between experience studies to avoid over-reacting to short-term experience variations. At the SDCERS Board meeting in April 2012, Cheiron recommended that a full experience study be performed once every five years. Cheiron also recommended that the Board annually review the existing economic assumptions (investment return and salary inflation) for appropriateness.

San Diego Data Processing

The Fiscal Year 2013 Budget for the San Diego Data Processing Corporation (SDDPC) was approved by its Board of Directors on April 26, 2012. The SDDPC Budget is developed based on the Information Technology needs and requirements of all City Departments, and other non-City customers.

The FY 2013 Proposed Operating Budget for SDDPC totals \$31.4 million, a decrease of \$7.6 million, or 20%, from FY 2012. \$27.7 million, or 88% of SDDPC's total revenue is from the City of San Diego. The other estimated 12% in revenue is from agencies other than the City of San Diego including the County, ARJIS, and SDCERS.

It should be noted that SDDPC's Proposed Operating Budget provides the City with the same service levels as in FY 2012 and assumes "business as usual" with no transition impacts as a result of the City con-

tracting out with new vendors to provide IT services historically provided by SDDPC.

Significant Operating Budget Adjustments

The FY 2013 Proposed Budget includes the net reduction of 60.77 positions for a total of \$4.7 million. In addition, the proposed budget includes a \$2.9 million reduction to Non-Personnel Expenses. SDDPC management states that the majority of reductions in personnel and expenditures are related to continuous improvements in productivity and streamlining of operations. The following are items to note regarding personnel expenses:

- The FY 2013 Proposed Budget reflects the reclassification of 6.00 Resource Manager positions to Account Managers. SDDPC management states that the duties for these positions have not

SUMMARY OF SDDPC OPERATING BUDGET CHANGES				
	FY 2011 ACTUAL	FY 2012 BUDGET	FY 2013 PROPOSED	BUDGET CHANGE
Personnel (FTEs)	228.00	213.62	152.85	(60.77)
Salaries & Wages	18,501,312	16,872,890	12,842,871	(4,030,019)
Overtime	232,501	162,031	162,031	-
Fringe Benefits	5,849,550	5,696,640	5,002,414	(694,227)
<i>Subtotal</i>	\$ 24,583,363	\$ 22,731,561	\$ 18,007,316	\$ (4,724,246)
Non-Personnel				
Data/Voice Circuits & Lines	4,285,681	4,426,906	3,934,394	(492,512)
Professional Services	2,054,060	2,017,593	1,287,074	(730,519)
Equipment & Software Maintenance	3,917,062	4,241,695	3,077,446	(1,164,249)
Depreciation	3,716,070	3,975,449	3,827,042	(148,407)
Facilities	950,347	1,057,594	706,694	(350,900)
Supplies & Others	517,170	600,191	591,904	(8,287)
<i>Subtotal</i>	\$ 15,440,390	\$ 16,319,428	\$ 13,424,554	\$ (2,894,874)
TOTAL	\$ 40,023,753	\$ 39,050,989	\$ 31,431,870	\$ (7,619,120)

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changed but the new titles more accurately reflect their responsibilities.

- 4.00 of the position reductions are related to the transfer of IT procurement activities from SDDPC to the City's Purchasing and Contracting Department.
- The FY 2013 Proposed Budget does not include any merit or Cost of Living Increases.

Revenue Adjustments

The FY 2013 Proposed Budget reflects a \$7.7 million, or 20% reduction in revenue. \$6.7 million is related to the reduction in revenue from the City of San Diego and an estimated \$1.0 million from other non-City agencies. Per SDDPC management, with the exception of the procurement services transferring to the City, the revenue reductions related to City services (\$6.7 million) are related to streamlining and do not constitute a reduction in services provided. For the \$1.0 million related to non-City customers, this revenue was related to projected new business for non-City customers. SDDPC management stated that per the SDDPC board, management was to stop pursuing new services from non-City customers that would generate additional revenue due to the pending RFP to change vendors.

Procured Services Budget Adjustments

Procured Services include items that are above those included in on-going operating expenses and typically are department specific. A few examples include PCs for Police patrol cars and software related to the

City's SAP System. Historically, SDDPC has procured these items on behalf of City departments with funding originating in the specific department requesting the item or service. Starting in FY 2012, the City of San Diego's Purchasing and Contracting Department has assumed procurement services for the City. As a result, SDDPC's FY 2013 Budget for Procured Services reflects a reduction of \$14.5 million.

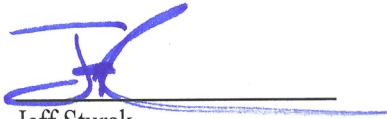
Capital Expenditures Budget Adjustments

The FY 2013 Proposed Budget for Capital Expenditures is \$3.5 million, a \$3.6 million reduction from FY 2013. SDDPC management states that the reduction in expenditures is a combination of decreased needs and also putting on hold the installation of an upgraded switch related to voice services due to the City changing IT vendors.

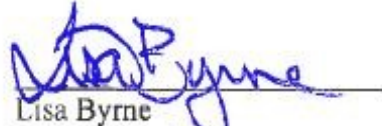
Issues to Consider

On April 18, 2012 the Rules Committee heard a report from the Department of Information Technology regarding the approval of IT services contracts with outside vendors to provide services currently provided by SDDPC and En Pointe. As we noted in our report regarding these contracts (Report #12-15), if these contracts are approved the future of SDDPC would need to be discussed. Specifically, what will happen to SDDPC if the City transitions to the new vendors. As part of the motion to forward to the full City Council, the committee requested that a transition plan for SDDPC be provided. Depending on this plan, SDDPC's FY 2013 budget could change.

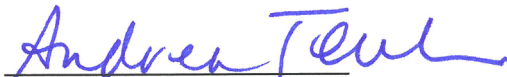
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