City Manager's Initial Analysis and Action Plan Related to the Recommendations of the Pension Reform Committee

DATE ISSUED: [Leave date blank] REPORT NO. [Leave blank]

ATTENTION: Honorable Mayor and City Council
Docket of

SUBJECT: City Manager's Recommended Action Plan and Initial Analysis Related to the Recommendations in the Pension Reform Committee's Final Report

REFERENCE: Final Report Pension Reform Committee, September 21, 2004

SUMMARY

Issue(s) –

1. Should the City Council approve the City Manager's recommended action plan and initial analysis related to the recommendations in the Pension Reform Committee's Final Report?
2. Should the City Manager engage an external expert labor advisor to assist City staff in the Meet and Confer Process?
3. Should the City Council direct the City Attorney to conduct a legal analysis of recommendations from the Pension Reform Committee related to contingent benefits and retiree health care benefits?
4. Should the City Council direct the City Manager and City Auditor to identify and bring a recommendation within 30 days to City Council to fund the balance of FY2005 retiree health care benefits (approximate balance is $6.5 million, of which $4.3 million is needed for general fund and $2.2 million for other governmental funds)?

5. Should the City Council direct the City Manager to consider the funding of contingent benefits as a high priority in FY2006 Proposed Budget?
6. Should the City Manager appoint a committee by October 30, 2004 to review the entire disability retirement system and provide a status report by January 15, 2005?

Manager's Recommendation(s)

1. Approve the City Manager's recommended action plan and initial analysis related to the recommendations in the Pension Reform Committee's Final Report.
2. Direct the City Manager to engage an expert labor advisor to assist City staff in the Meet and Confer Process. The City Manager has directed staff to immediately prepare for discussions with all labor groups regarding a successor agreement to the MOU including consideration of the Pension Reform Committee's recommendations.
3. Direct the City Attorney to conduct a legal analysis of recommendations from the Pension Reform Committee related to contingent benefits and retiree health care benefits.
4. Direct the City Manager and City Auditor to identify and bring a recommendation within 30 days to City Council to fund the balance of FY2005 retiree health care benefits (approximate balance is $6.5 million, of which $4.3 million is needed for general fund and $2.2 million for other governmental funds). The City Manager supports the Pension Reform Committee recommendation that retiree health care benefits no longer be funded in a manner that reduces the assets of SDCERS.
5. Direct the City Manager to consider the funding of contingent benefits as a high priority in FY2006 Proposed Budget.
6. Direct the City Manager to appoint a committee by October 30, 2004 to review the entire disability retirement system and provide a status report back by January 15, 2005.

Other Recommendation(s) – None

Fiscal Impact

The fiscal impact of the City Manager's recommendation to identify a funding source for the balance of FY2005 retiree health care benefits will be approximately $6.5 million based upon current projections of monthly health care insurance premiums. The fiscal impact of the remaining elements of the City Manager's Action Plan outlined in this report cannot be fully determined at this time. The staffing and resource requirements for the Action Plan need to be assessed and brought back to City Council or they will be folded into the budgetary process.

BACKGROUND

On September 9, 2003, the Mayor and City Council established the Pension Reform Committee (Committee) to address concerns about the current unfunded liability of San Diego City Employees Retirement System (SDCERS.) On September 24, the nine Committee members were officially appointed by the Mayor and City Council.

The Committee held its first meeting on October 1, 2003 and met on a weekly basis until its final meeting on September 14, 2004. The following objectives of the Committee were established by the Mayor and City Council:

1. Report back to the City Council no later than 120 days from the date appointments are confirmed.
2. After reviewing and considering the scope and depth of audit activity currently being conducted by SDCERS, conduct any additional or supplemental independent audits, studies, or investigations deemed necessary and appropriate.
3. Provide recommendations to address any unfunded liability problems of the system.
4. Examine how the existing pension system has performed compared to other similar systems, including examination of actions other systems have taken to address funding shortfall problems, such as issuance of pension obligation bonds.
5. Examine whether changes should be made to the existing pension system. Examine whether the make-up and representative constitution of the Retirement Board should be restructured.
6. Examine whether the system should be changed from a defined benefit plan to a defined contribution plan for new employees.
7. Examine whether the City should join the California Public Employees Retirement System or any other retirement system.
8. Make any other recommendations as appropriate.

In order to meet its objectives, the Committee invited numerous professionals to present information to the Committee on topics related to the City and SDCERS. A special web page was set-up on the City's web site to provide the public with copies of these background materials as well as the minutes and agendas of the meetings. In addition, the Committee hired SDCERS' actuary, Rick Roeder, of Gabriel, Roeder, Smith and Company to perform specific actuarial analyses for the Committee.

The Committee provided the Mayor and City Council with two interim reports on the status of their work. The first report, delivered on January 26, 2004, focused on the Committee's efforts to educate themselves about pension issues and their efforts to review the scope of SDCERS' audits. The second report, delivered on April 19, 2004, focused on the current funded status of the retirement system and the underlying causes of the unfunded liability.

DISCUSSION

On September 21, 2004, the Committee presented the City Council with the findings of their final report. The Committee's final report included seventeen specific recommendations. Following discussion of the Committee's report and hearing public testimony, the City Council directed the City Manager to report back in two weeks with an action plan indicating those recommendations that can be implemented immediately. During the City Council discussion following the Committee's presentation, it was requested that the following issues be addressed when the City Manager responded to the recommendations. Due to the short amount of time between the Committee report and this response, it was not possible to comprehensively address these issues within this timeframe. They will be responded to as the analyses are completed.

These issues are:

1) Pension Reform Committee (Committee) recommendations should be tied to the annual budget process:
2) Committee recommendations need to be referred to the Meet and Confer Process;
3) An analysis needs to be performed on each of the recommendations and options developed to fund them;
4) The impact on the funding-level of SDCERS if the City does not provide pay increases in FY2006;
5) How City property and land can be used to address the pension issue;
6) Information on DROP (Deferred Retirement Option Program) – description of the program, impact on the City, and impact on SDCERS;
7) Impact of different tiers of retirement benefits; impact on service, the impact on recruitment and retention of City staff; and the impact on staff morale; and
8) Alternatives to the pension system – has real structural change been considered?

Below is the list of the recommendations made in the final report of the Committee followed by an action plan for the City to take at this time and an initial analysis. A chart summarizing the City Manager's Action Plan is attached (Attachment 2.) A more thorough analysis will be needed on several of the recommendations of the Committee due to the complexity of the issue and the impact these recommendations will have on SDCERS, the City's budget and the Meet and Confer Process.

It is important to emphasize the issues surrounding the Meet and Confer Process as it relates to the implementation of the Committee's recommendations. From time to time, the City has retained outside legal and labor expertise during complex labor negotiations.

It is the City Manager's intent to utilize that process and engage an external export labor advisor. The City currently has Memorandums of Understanding (MOUs) with all four of its labor unions. These agreements expire on June 30, 2005, and cannot be unilaterally re-opened by the City. The City has an obligation to meet and confer with the unions on matters affecting wages, hours and terms and conditions of employment. In the opinion of the City Attorney, all of the recommendations regarding changes to the pension benefit structure of new employees (Recommendations 6-10) are subject to the Meet and Confer Process. Because the City has an obligation to "meet and confer in good faith" as described in the Meyers-Milias-Brown Act, the City Council should not take a final position on these recommendations until completion of the negotiation process.

Furthermore, in Recommendations # 5, #11 and #13 it is our understanding that the Committee is recommending that the City actuarially account for retiree health care benefits and that these benefits be funded directly by the City. These recommendations raise many legal and financial concerns that should be analyzed prior to implementation. These issues are described more fully under the respective recommendations.

Recommendation #1
$600 Million in assets should be infused into the plan over the next three fiscal years. Of that amount, no less than $200 Million should be placed in the plan during FY 05 (preferably by December 31, 2004) and that amount should be attained through the issuance of Pension Obligation Bonds. Subsequent infusions, bringing the total to $600 million can be through POBs, or some form of real estate secured transaction.

City Manager Action Plan: Continue to pursue the issuance of POBs already underway.

Initial Analysis: On July 7, 2004, Mayor Murphy sent a memorandum to City Council outlining a four-point program to begin addressing the challenges facing SDCERS (Attachment 3.) One of those four points was a recommendation to issue at least $200 million in POBs during FY2005. In response to this memorandum, on July 19, 2004, the City Manager received authorization from Mayor and Council to assemble a financing team to assess the issuance of Taxable POBs in early 2005 to reduce the outstanding pension Unfunded Actuarial Accrued Liability (UAAL).

Public Financial Management ("PFM"), an independent financial consultant firm, has been retained as the financial advisor for the assessment of the issuance of POBs. PFM was selected through a competitive process from an as-needed financial advisors list maintained by the City. PFM has extensive experience in advising municipal issuers on bond financings, including POBs. Previously, PFM assisted the City in connection with the Gleason litigation by examining pension funding levels and assessing options to enhance the funding status. Experience in the field of POBs and familiarity with SDCERS were the basis for retaining PFM as the financial advisor, from the as-needed list, for the issuance of POBs.

Authorization for the City Manager to execute an agreement with Hawkins, Delafield & Wood, LLP for bond and disclosure counsel for the POBs is pending City Council action. As the City has not previously undertaken such a financing, the City requires the assistance of a bond and disclosure counsel with experience in the issuance of POBs, specific knowledge of the City's pension matters, and the City's General Disclosure obligations under the Securities and Exchange Commission regulations. Hawkins is a proven leader in the field of POBs, having successfully served as bond and disclosure counsel for several issuers within the United States and the state of California. Hawkins is currently serving as General Disclosure Counsel for the City, and as such has gained unique expertise with both recent developments pertaining to the City's pension issues and the City's General Disclosure obligations.

An RFP for underwriting services for the proposed POBs was issued by the City on July 21, 2004. Based on written proposals submitted by the firms in response to the RFP, and interviews conducted by a selection panel consisting of City staff, City Attorney staff, and PFM, a syndicate of firms was selected for providing underwriting services. Citigroup Global Markets and Lehman Brothers were determined to be the most qualified firms to serve as the co-senior managing underwriters. In addition, it was determined that M. R. Beal and E. J. De La Rosa were the most qualified and best suited to serve as co-managers within the syndicate. These firms complement Citigroup and Lehman Brothers by bringing additional retail distribution capabilities and minority owned business underwriting participation. The selection criteria included firms' experience with issuance of POBs, ability to structure and market POBs in a manner that will result in the lowest possible cost of capital, and reasonableness of fees.

It is presently estimated that a financing plan and the bond documents for the proposed POBs could be submitted for City Council consideration in January, 2005 and the POBs could be sold in March/April, 2005 time-frame upon receiving judgment of validation from the court authorizing the issuance of bonds. Based on this schedule, proceeds from the sale of POBs are estimated to be available in April/May, 2005 and the transfer of funds to SCDERS can be accomplished within the current fiscal year.

Recommendation #2
The City Charter should be amended to require that, when amortizing net actuarial gains or losses, a period of no longer than 15 years be used for the amortization of losses and that a period of no shorter than 5 years be used for the amortization of a surplus. This change should be effective for FY08 contributions.

City Manager Action Plan: Recommendation already initiated by the City.

Initial Analysis: This recommendation was also included in the Mayor's July 7, 2004 memorandum to City Council and has been initiated by the City. On July 19, 2004, Mayor and City Council adopted an ordinance submitting to the voters of the City at the Municipal Election to be held on November 2, 2004, Proposition G to amend the City Charter by amending Article IX, Section 143 regarding the City's contribution to the Retirement System. Proposition G on the November 2 ballot reads as follows:

"Shall the City Charter be amended to preclude any future multi-year agreement between the City and the Retirement Board delaying full actuarial funding of City contributions to the Retirement System, and defining the amortization schedules to be used for payment of costs associated with past service liability and costs associated with reducing the unfunded accrued actuarial liability of the pension system?"

If approved, Proposition G will amend the City Charter to change the amortization of the cost associated with net accumulated actuarial losses on no greater than a fifteen year amortization schedule and the benefit associated with net accumulated actuarial gains on no less than a five year amortization schedule. The effective date of this change is different than the recommendation of the Committee. If approved, this change will be effective July 1, 2008, which is the beginning of FY2009. This date was used to comport with the terms of the recent Gleason class action settlement.

Recommendation #3
The City Charter should be amended to require that for all new pension benefit improvements to the currently existing plan, SDCERS will, when setting actuarial assumptions and methodologies for funding purposes, use an amortization period no greater than straight-line 5 years fixed for any past service liability for each new benefit improvement. This change should be effective immediately.

City Manager Action Plan: Recommendation already initiated by the City.

Initial Analysis: This recommendation is also included in the Mayor's July 7, 2004 memorandum and is included in the language of Proposition G outlined above. If Proposition G is approved, the following language will be added to City Charter Article IX, Section 143: "When setting and establishing amortization schedules for the funding of the unfunded accrued actuarial liability, the Board shall place the cost of the past service liability associated with a new retirement benefit increase on no greater than a fixed, straight-line, five year amortization schedule."

Recommendation #4
The City's annual required contribution to the Plan for a given year should be defined as the total of Normal Cost, UAAL amortization (including interest), and an amount equivalent to the estimated contingent liabilities related to that year.

Committee Report Findings:

Currently, contingent benefits such as the Corbett Settlement and the 13th check are paid from the earnings of SDCERS rather than through the City's contribution to SDCERS as actuarially determined by the calculation of normal cost. The Committee is concerned that the calculation of normal cost without including contingent benefits increases the UAAL by the amount of the contingent benefits. The Committee believes an amount equal to the value of the contingent benefits removed from SDCERS earnings should be replaced by the City annually based on an estimate calculated at the beginning of the fiscal year for that fiscal year. For example, the amount of the 13th check related to FY2006 should be calculated on the assumption that it will be paid. That amount should be added to the FY2006 contribution to SDCERS by the City.

City Manager Action Plan: The recommendation to directly fund contingent benefits through the City's annual contribution to SDCERS should be considered by the City however, there are issues which need further analysis before the City Council takes action on this recommendation. The following three actions should be initiated immediately:

1) Refer recommendation to City Manager and City Attorney to evaluate and report back by December 15, 2004 on whether this recommendation would have any unintended effects on the contingent nature of these benefits such as creating a vested benefit which requires actuarial funding;
2) Direct City Manager to make it a priority to identify a funding source in the FY2006 Proposed Budget for contingent benefits that does not diminish SDCERS assets;
3) Request that the SDCERS Actuary identify the annual value of all contingent benefits in the June 30, 2004 valuation to be included in the evaluation of funding options by the City.

Initial Analysis: Contingent benefits include the "13th Check", Corbett and Supplemental COLA. The 13th Check and Corbett are both outcomes of class action lawsuit settlements. Before implementation of this recommendation, the City Attorney has requested the opportunity to consult with the outside attorneys who drafted the settlement agreement to determine if direct funding impacts the nature of the benefit that was agreed upon. If direct funding of these contingent benefits changes the nature of the benefit, this issue should be referred to the Meet and Confer Process.

As outlined in the settlements, these contingent benefits are only payable in years when the realized earnings from SDCERS investments are sufficient and paid from earnings. (However, the terms of the settlement provide that the Corbett settlement payments are cumulative if there are not sufficient earnings in any one year.) The City Council can retain the contingent nature of these benefits and still comply with the Committee's recommendation to pay for them annually in a manner that does not diminish assets going into SDCERS.

It is recommended that this recommendation be forwarded to the SDCERS Administrator with a request that the SDCERS' actuary of record perform a cost analysis along with the June 30, 2004 actuarial valuation. The actuarial cost could then be used in the evaluation of funding options by the City in the FY2006 Proposed Budget. It is anticipated that this information will be available by January, 2005.

Also related to this recommendation, the SDCERS Board will be considering a recommendation from its actuary to include the cost of the Corbett benefit as a SDCERS liability when determining the unfunded liability and resultant employer contribution rate. This matter should be included in the City Council's consideration of this recommendation when the analysis is brought back in December. This is done in light of the fact that Corbett settlement payments are cumulative.

<u>Recommendation #5</u>
Payments for retiree health care benefits should no longer be funded via the retirement plan. SDMC 24.1502(a)(5) should be eliminated thereby removing health care benefits from the Plan=s distributionAwaterfall@.

City Manager Action Plan:
1) Pay balance of the FY2005 retiree health care benefits from City funds.
2) Retiree health care benefits will be funded in a manner that does not reduce the assets of SDCERS, and
3) Refer the recommendation to the Meet and Confer Process to address the five issues below.

Initial Analysis: The City Manager supports the recommendation that retiree health care benefits no longer be funded in a manner that reduces assets of the retirement fund. However, given the complexities of issues related to retiree health care benefits, it is recommended that the following issues be evaluated prior to adopting an alternative to the current practice:

1) What should the future level and nature of this benefit be?
2) How should the costs for retiree health care benefits be calculated and funded (pay-as-you-go or amortized over a specific period)?
3) How should the costs for current and future retiree health care benefits be apportioned among employer, employee and retiree?
4) What impacts would any changes in these areas have on the issue of vesting and the City's ability to make changes in the future?
5) How might recent GASB rule changes related to booking liability for retiree health care benefits affect vesting expectations and/or rights of current and future retirees?

The current Municipal Code provides that in years when SDCERS realized earnings are sufficient, a portion of the City's new normal contributions be deposited into the 401(h) health care trust (separate from the basic SDCERS pension trust) established in the Municipal Code to be used exclusively for eligible retiree's health care benefits. As noted by the Committee, this has the effect of reducing the amount of new contributions entering the SDCERS pension trust, which makes those funds unavailable to pay pension benefits and are excluded when determining the funded ratio. While this long term practice has been determined legal, in compliance with Internal Revenue Code, and one that is done in other governmental plans including San Diego County, the City Manager concurs with the recommendation to cease this practice.

Municipal Code 24.1204 states that retiree health care benefits will be paid from the 401(h) Fund until exhausted, and then from the City directly from any source available to it. No new contributions have been made into the 401(h) since FY2003 as earnings have not been sufficient until the year ending June 30, 2004. As part of the Gleason settlement, the City agreed to pay $130 million as its employer contribution. In past years, a portion of these new contributions would be deposited into the 401(h) health care trust with the understanding that sufficient earnings would flow into SDCERS to make up the full employer contribution. This did not occur in FY2005.

The entire $130 million was deposited directly into the employer's reserve, helping to reduce the UAAL. The balance remaining in the 401(h) retiree health care trust will be exhausted in mid-January of 2005, and consequently, the City will be obligated pursuant to the current Municipal Code to fund retiree health from other sources. When the FY2005 budget was developed and approved, it was still contemplated that SDCERS would develop a new IRC115 Health Insurance Trust and transfer $25 million from the employer contribution reserve. Given the current status of SDCERS unfunded liability, the recommendations from Vinson & Elkins as well as the Committee to cease this practice, the City Manager and City Auditor will need to identify another source to fund the balance of FY2005 retiree health insurance. The balance for FY2005 is approximately $6.5 million, of which $4.3 million is needed for general fund and $2.2 million for other governmental funds based on monthly heath insurance premiums.

<u>Recommendation #6</u>
The normal retirement age should be raised by seven years for all employees and the early retirement age should be set at a number of years that are five years less than the normal retirement age. Any retirement earlier than normal age will be cost-neutral, actuarially reduced.

City Manager Action Plan: Recommendations 6-10 are all mandatory subjects of bargaining through the Meet and Confer Process as described earlier in this report. It is recommended that these recommendations be included in the direction from the City Manager to immediately initiate meet and confer with all four of its labor organizations and report back as appropriate with progress.

<u>Recommendation #7</u>
The annual accrual rate for the percentage of final base payroll to be used in calculating the pension benefit is reduced 20%.

City Manager Action Plan: See City Manager Action Plan following Recommendation #6

<u>Recommendation #8</u>
The final base payroll should be based on an average of the employee=s highest three years of salary rather than on the highest one year of salary.

City Manager Action Plan: See City Manager Action Plan following Recommendation #6.

Recommendation #9
The final base payroll should exclude salary differentials such as second shift differential, bilingual differential, etc.

City Manager Action Plan: See City Manager Action Plan following Recommendation #6.

Recommendation #10
Eliminate specific programs that permit DROP and purchase of years of service credit, except those that are federally protected.

City Manager Action Plan: See City Manager Action Plan following Recommendation #6.

Recommendation #11
The City should establish either a separate trust or a separate accounting within the pension trust to account for the assets and liabilities of the retiree medical benefit plan. Retiree Medical Plan assets may be commingled with Retirement Plan assets for investment purposes, but be accounted for separately for all other purposes. Annual contributions to the Retiree Medical Plan should be separately identified in the City budget and in no way be confused or commingled with Retirement Plan contributions.

Committee Report Findings:

Currently, retiree medical benefits (also referred to in this report as retiree health care benefits) are paid for out of earnings of SDCERS on a pay-as-go-basis. The Committee believes this liability should be clearly stated on the books of the City.

City Manager Action Plan: We agree that it is prudent to create a separate trust for retiree health care. The City Attorney and the City Auditor are currently working to develop an Internal Revenue Code 115 trust for this purpose. It is recommended that the City Auditor and City Attorney provide an update on the status of this trust in December, 2004.

Recommendation #12
Adopt GASB #43 effective July 1, 2005.

Committee Report Findings:

GASB has acknowledged that there are problems nationally with the current accounting practices for liabilities such as the City's retiree health care plan. As result, GASB issued Statement 43 to provide a framework for transparent financial reporting by governmental agencies that have fiduciary responsibility for other post employment benefits such as retiree health care benefits. GASB 43 will not be effective until 2007, but the Committee believes the standard should be adopted early.

City Manager Action Plan: Recommendations 12 and 13 are complex, interrelated, and could have long-term fiscal impacts to the City. Therefore, these recommendations will be referred to the City Auditor and the City's Independent Auditor for analysis. It is recommended that they provide a status report on these issues in 60 days.

Recommendation #13

When amortizing the unfunded liability for retiree medical benefits, a method should be used that does not create negative amortization of the liability.

Committee Report Findings:

The Committee acknowledged that an in-depth review of retiree health care benefits was outside their charter. However, they suggested that the City determine whether current employees have a vested right to retiree health care benefits. In order to make this determination, the City Attorney will need to analyze the issue and provide an opinion on the employee's vested rights to receive retiree health care benefits.

City Manager Action Plan: See City Manager Action Plan for Recommendation #12

Recommendation #14

Change the composition of the Retirement Board to seven members appointed by the City Council. These members will serve with staggered terms of four years each, with a two consecutive term maximum. Such appointees will have the professional qualifications of a college degree and/or relevant professional certifications, fifteen years experience in pension administration, pension actuarial practices, investment management (including real estate), banking, or certified public accounting. Such appointees will be U.S. Citizens and residents of the City of San Diego but cannot be City employees, participants (direct or indirectly through a direct family member) of the SDCERS, nor a union representative of employees or participants, nor can such appointees have any other personal interests which would be, or create the appearance of, a conflict of interest with the duties of a Trustee.

City Manager Action Plan: Alternative recommendation already initiated by the City.

Initial Analysis: A modified version of this recommendation was included in the Mayor's July 7, 2004 memorandum to City Council. On July 19, 2004, Council adopted an Ordinance submitting to the voters of the City at the Municipal Election to be held on November 2, 2004, Proposition H to amend Article IX, Section 144 and amend Article X, all regarding the composition of the Retirement Board. The language of Proposition H, which is outlined below, was endorsed by a majority of the members of the Committee.

Proposition H reads: "Shall the Charter be amended to change the composition of the Retirement Board as follows: seven highly qualified citizen appointees without interests in the City's pension system, four members elected from classifications of active membership (one police, one fire, two general), one member elected from the ranks of the retired, and one member appointed by the City Manager from City management?"

Recommendation #15

An additional provision should be made to the City Charter that would codify the current disability retirement determination process as it is now except that the hearing officer=s decision would be final rather than a recommendation to the Board for approval.

City Manager Action Plan: City Manager to send a letter from the City to the SDCERS Board encouraging the implementation of this recommendation by an amendment to SDCERS Board rules.

Initial Analysis: In reviewing this recommendation, the City Council decided not to forward this proposed City Charter change to the voters of the City at the Municipal Election to be held on November 2, 2004. In order to implement the Committee's recommendation, the SDCERS' Board would need to amend their rules on the disability retirement determination process. It is our understanding that the SDCERS Board will be considering an amendment to their rules to accomplish this recommendation in the near future. The City Manager will send a letter from the City encouraging this change to the disability retirement determination process as quickly as possible.

Recommendation #16

The City should establish a committee to review the entire disability retirement system. Representatives on this committee should include knowledgeable employees of both the City and SDCERS as well as outside professionals with experience in this area.

City Manager Action Plan: City Manager to appoint a committee to review the entire disability retirement system by October 30, 2004 and provide a status report by January 15, 2005.

Initial Analysis: This recommendation can be implemented by the City immediately. The City Manager will appoint a committee by October 30, 2004 consisting of representatives of the City, SDCERS, labor organizations and outside professionals. The Committee will provide an interim report by January 15, 2005. The timing of this report will allow for possible inclusion in the FY2006 Proposed Budget.

Recommendation #17

The City Council Rules Committee should require a report (with recommendations) from SDCERS on the issue of the 50/50 employer/employee cost split by the end of the calendar year.

Committee Report Findings:

Section 143 of the City Charter states: "The City shall contribute annually an amount substantially equal to that required of the employees for normal retirement allowances, as certified by the actuary, but shall not be required to contribute in excess of that amount, except in the case of financial liabilities accruing under any new retirement plan or revised retirement plan because of past services of the employees." This section of the Charter has apparently been loosely interpreted to mean that the employees bear 50% of Normal Cost and that all other costs are borne by the City. Another reading would be that past service costs (discussed earlier) are the sole responsibility of the City, but that any other costs should be split 50/50. Even if one agrees that the 50/50 split applies to Normal Costs only, then it appears that the Charter may not be being followed.

City Manager Action Plan: City Manager to request SDCERS initiate immediately.

Initial Analysis: This recommendation can be implemented by the City immediately. The City Manager will send a letter to SDCERS Board requesting a report be prepared for the Rules Committee agenda by the end of this calendar year.

ALTERNATIVE(S)

1. Do not approve the City Manager's recommended action plan and initial analysis related to the recommendations in the Pension Reform Committee's Final Report.

Respectfully submitted,

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P. Lamont Ewell
City Manager

Ewell/mlb

Attachment(s):
1. Pension Reform Committee Final Report, September 21, 2004
2. Chart summarizing City Manager's Action Plan.
3. Memorandum from Mayor Dick Murphy to San Diego City Council, July 7, 2004 on Pension Reform
4. Memorandum from City Attorney to Committee on Rules, Finance and Intergovernmental Relations, June 25, 2004 on Pension Reform Committee Ballot Proposals.

City Manager's Initial Analysis and Action Plan Related to the Recommendations of the Pension Reform Committee

	CITY MANAGER'S INITIAL ANALYSIS	ACTION PLAN
	Several of the recommendations of the Committee involve issues that are subject to the Meet and Confer Process.	Direct staff to immediately prepare for discussions with all labor groups regarding a successor agreement to the MOU and engage an external expert labor advisor to assist City staff in this process.
	Several of the recommendations related to contingent benefits and retiree health care raise legal concerns that should be analyzed prior to implementation.	Direct the City Attorney to conduct a legal analysis of certain recommendations of the Committee related to contingent benefits and retiree health care.
	SPECIFIC PENSION REFORM COMMITTEE RECOMMENDATIONS	**ACTION PLAN**
1	***$600 Million in assets should be infused into the plan over the next three fiscal years. Of that amount, no less than $200 Million should be placed in the plan during FY 05 (preferably by December 31, 2004) and that amount should be attained through the issuance of Pension Obligation Bonds. Subsequent infusions, bringing the total to $600 million can be through POBs, or some form of real estate secured transaction.***	Continue to pursue the issuance of POBs already underway.
2	***The City Charter should be amended to require that, when amortizing net actuarial gains or losses, a period of no longer than 15 years be used for the amortization of losses and that a period of no shorter than 5 years be used for the amortization of a surplus. This change should be effective for FY08 contributions.***	Recommendation already initiated by the City.

	SPECIFIC PENSION REFORM COMMITTEE RECOMMENDATIONS	ACTION PLAN
3	***The City Charter should be amended to require that for all new pension benefit improvements to the currently existing plan, SDCERS will, when setting actuarial assumptions and methodologies for funding purposes, use an amortization period no greater than straight -line 5 years fixed for any past service liability for each new benefit improvement. This change should be effective immediately.***	Recommendation already initiated by the City.
4	***The City's annual required contribution to the Plan for a given year should be defined as the total of Normal Cost, UAAL amortization (including interest), and an amount equivalent to the estimated contingent liabilities related to that year.***	1) Refer recommendation to City Manager and City Attorney to evaluate and report back by December 15, 2004 on whether this recommendation would have any unintended effects on the contingent nature of these benefits such as creating a vested benefit which requires actuarial funding; 2) Direct City Manager to make it a priority to identify a funding source in the FY2006 Proposed Budget for contingent benefits that does not diminish SDCERS assets; 3) Request that the SDCERS Actuary identify the annual value of all contingent benefits in the June 30, 2004 valuation to be included in the evaluation of funding options by the City.

	SPECIFIC PENSION REFORM COMMITTEE RECOMMENDATIONS	ACTION PLAN
5	***Payments for retiree health care benefits should no longer be funded via the retirement plan. SDMC 24.1502(a)(5) should be eliminated thereby removing health care benefits from the Plan=s distributionAwaterfall@.***	1) Pay balance of the FY2005 retiree health care (approximately $6.5 million) from City funds; 2) Retiree health care benefits will be funded in a manner that does not reduce the assets of SDCERs. 3) Refer recommendation to the Meet and Confer Process
6	***The normal retirement age should be raised by seven years for all employees and the early retirement age should be set at a number of years that are five years less than the normal retirement age. Any retirement earlier than normal age will be cost-neutral, actuarially reduced.***	Recommendations 6-10 are all mandatory subjects of bargaining. City Manager to direct staff to immediately prepare for Meet and Confer Process with all four labor organizations.
7	***The annual accrual rate for the percentage of final base payroll to be used in calculating the pension benefit is reduced 20%.***	See Action Plan #6
8	***The final base payroll should be based on an average of the employee=s highest three years of salary rather than on the highest one year of salary.***	See Action Plan #6
9	***The final base payroll should exclude salary differentials such as second shift differential, bilingual differential, etc.***	See Action Plan #6

	SPECIFIC PENSION REFORM COMMITTEE RECOMMENDATIONS	ACTION PLAN
10	***Eliminate specific programs that permit DROP and purchase of years of service credit, except those that are federally protected.***	See Action Plan #6
11	***The City should establish either a separate trust or a separate accounting within the pension trust to account for the assets and liabilities of the retiree medical benefit plan. Retiree Medical Plan assets may be commingled with Retirement Plan assets for investment purposes, but be accounted for separately for all other purposes. Annual contributions to the Retiree Medical Plan should be separately identified in the City budget and in no way be confused or commingled with Retirement Plan contributions.***	We agree that a separate trust is prudent for retiree health care. City Attorney and City Auditor are developing an IRC 115 Trust for this purpose. City Manager to request an update in December, 2004 on the status of the Trust.
12	***Adopt GASB #43 effective July 1, 2005***	Recommendations 12 & 13 are complex, interrelated and could have long-term fiscal impacts on the City. Refer recommendations to City Auditor and City's Independent Auditor for analysis with a status report in 60 days.
13	***When amortizing the unfunded liability for retiree medical benefits, a method should be used that does not create negative amortization of the liability.***	See Action Plan #12

	SPECIFIC PENSION REFORM COMMITTEE RECOMMENDATIONS	ACTION PLAN
14	***Change the composition of the Retirement Board to seven members appointed by the City Council. These members will serve with staggered terms of four years each, with a two consecutive term maximum. Such appointees will have the professional qualifications of a college degree and/or relevant professional certifications, fifteen years experience in pension administration, pension actuarial practices, investment management (including real estate), banking, or certified public accounting. Such appointees will be U.S. Citizens and residents of the City of San Diego but cannot be City employees, participants (direct or indirectly through a direct family member) of the SDCERS, nor a union representative of employees or participants, nor can such appointees have any other personal interests which would be, or create the appearance of, a conflict of interest with the duties of a Trustee.***	Alternative recommendation already initiated by the City.
15	***An additional provision should be made to the City Charter that would codify the current disability retirement determination process as it is now except that the hearing officer=s decision would be final rather than a recommendation to the Board for approval.***	City Manager to send a letter from the City to the SDCERS Board encouraging the implementation of this recommendation by an amendment to SDCERS Board rules.
16	***The City should establish a committee to review the entire disability retirement system. Representatives on this committee should include knowledgeable employees of both the City and SDCERS as well as outside professionals with experience in this area.***	City Manager to appoint a committee by October 30, 2004 to review the entire disability retirement system with a status report due by January 15, 2005.
17	***The City Council Rules Committee should require a report (with recommendations) from SDCERS on the issue of the 50/50 employer/employee cost split by the end of the calendar year.***	City Manager to request SDCERS initiate immediately.