



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of City Agencies FY 2024 Budgets: San Diego City Employees' Retirement System

The IBA has reviewed the San Diego City Employees' Retirement System (SDCERS) FY 2024 budget, which is scheduled to be heard Tuesday, May 9, 2023. Our review is attached.

Handwritten signature of Lisa Byrne in blue ink.

Lisa Byrne
Principal Fiscal and Policy Analyst

Handwritten signature of Charles Modica in blue ink.

APPROVED: Charles Modica
Independent Budget Analyst

City Agencies: City Retirement System

City Retirement System

The San Diego City Employees' Retirement System (SDCERS) FY 2024 budget was approved by the SDCERS Board of Administration in March 2023. The SDCERS budget is scheduled to be presented as an informational item at the May 9, 2023 hearing of the City's Budget Review Committee.

SDCERS' 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..." Per City Attorney's Report to Council 2005-18, the City maintains the authority to examine and audit the Board's accounts and records.

This review covers the SDCERS' operating and capital budgets, as well as a brief discussion on investments and investment expenses.

FY 2024 Operating Budget

SDCERS' operating budget, or administrative budget, is summarized in the table below. We discuss highlights of the budget changes in the following sections.

The administrative budget of \$17.1 million is increasing by \$460,000, or 2.8%, from the \$16.6 million FY 2023 budget. The FY 2024 budget includes 54.00 FTEs, up 3.00 from the

51.00 included in the FY 2023 budget.

Based on the FY 2022 actuarial valuations, 8.7% of shared administrative expenses are allocated to the other SDCERS plan sponsors (the Unified Port District and Airport Authority), with the remainder to the City of San Diego. These administrative expenses will be charged to the City and other plan sponsors with the FY 2024 Actuarially Determined Contribution (ADC) pension payment.

Components of SDCERS' FY 2024 administrative budget are outlined below.

Salaries and Benefits

The \$10.8 million Salaries and Benefits budget category is increasing by \$376,000 from the FY 2023 budget. This includes an increase in salaries and wages which is partially offset by a decrease in budgeted fringe benefits as discussed below.

The salaries and wages *increase* totals \$767,000, or 12.6% (from \$6.1 million to \$6.9 million). The increase is largely due to raises and market comparisons for unrepresented employees and negotiated FY 2023 and FY 2024 compensation increases for represented employees. Note that the full impact of represented employees' compensation increases

SDCERS ADMINISTRATION - BUDGET CHANGES					
	FY 2022 Actual	FY 2023 Budget	FY 2024 Budget	Increase/ (Decrease)	Percent Change
Budgeted Staff	51.00	51.00	54.00	3.00	5.9%
Salaries and Benefits	\$9,922,000	\$10,429,000	\$10,805,000	\$376,000	3.6%
Information Technology	2,386,000	2,754,000	2,881,000	127,000	4.6%
Legal Fees	232,000	320,000	250,000	(70,000)	(21.9%)
General Operations	3,553,000	3,125,000	3,153,000	27,000	0.9%
TOTAL	\$16,093,000	\$16,628,000	\$17,088,000	\$460,000	2.8%

NOTE: Table may not total due to rounding.

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related to FY 2024 negotiations with the City's non-public safety recognized employee organizations was unknown at the time the SDCERS budget was approved, and actual amounts are anticipated to vary.

Another component of the salaries and wages increase is related to the addition of three new positions to the budget. Two of the new positions support the increased benefits administration workload resulting from increased SDCERS membership related to Proposition B unwinding.¹ These are both unbudgeted positions (for FY 2023), one of which is currently filled. The filled position is an unclassified Program Coordinator but is considered a limited (temporary) position. The third new position is an unclassified Program Manager that was exempted from classified service by the City Council on January 24, 2023. This position is also currently filled and supports development and implementation of the SDCERS' information technology strategy and management of its information technology operations.

The partially offsetting *decrease* in the fringe benefits budget is \$396,000 (from \$4.3 million in FY 2023 to \$3.9 million in FY 2024). The FY 2024 budget is based on FY 2023 fringe benefits rates provided by the City, as FY 2024 rates were unavailable at the time the SDCERS budget was approved. The City manages the payment of SDCERS employees' salaries and fringe, and invoices SDCERS for those costs. Because final FY

2024 fringe rates were not available when the SDCERS Board approved the FY 2024 budget, the actual fringe amounts are anticipated to vary.

Non-Personnel Expenditures

The \$2.9 million information technology expenditures budget for FY 2024 is increasing by \$127,000, or 4.6%. This increase is largely related to contracts for application services (with CGI Technologies and Solutions) and data center and desktop support (with Zensar Technologies). SDCERS leverages the same terms and rates as the City for these contracts.

The \$250,000 legal fees budget is decreasing by \$70,000 and includes costs for litigation, disability, tax, general, and fiduciary counsel. The largest components of this decrease are for anticipated reductions in litigation costs and general legal fees of \$50,000 and \$25,000, respectively.

The \$3.2 million general operations budget is increasing by \$27,000, or 0.9%, which includes two large decreases, combined with offsetting increases. The office expense budget component is decreasing by \$216,000, largely due to completion of moving the SDCERS office to a smaller leased space. The other decreasing component is \$113,000 for actuarial services, largely related to the triennial experience study.² The largest offsetting increases include \$223,000 in building expenses (rent), largely due to recognition of lease expense and the timing for the start of the rent abatement period (related to

¹ Over 2,700 active employees have been transferred to SDCERS as part of the Proposition B unwinding. For additional information on Proposition B unwinding, see the Independent Budget Analyst's review of the FY 2024 Proposed Budget, [IBA Report #23-08](#), in the Pension section under Key Citywide Issues.

² An experience study involves historical analysis of pension plan assumptions and a consideration of future expectations and trends, including the rate of investment return, salary inflation, and retirement and mortality rates. The plan experience study is the basis for the actuary's recommended changes to the plan's actuarial assumptions.

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SDCERS' office move). The next largest increases in the general operations budget are \$65,000 for travel and training and \$50,000 for fiduciary insurance.

Capital Budget

In addition to the administrative/operating budget, SDCERS maintains a capital budget. The capital budget is decreasing by \$17,000, from \$718,000 to \$701,000. SDCERS' capital budget is primarily associated with information technology infrastructure.

The FY 2023 budget projects included:

- Equipment relocation to 8th floor – \$250,000 (Completed in FY 2023, with \$191,000 spent in FY 2023 and an additional \$75,000 spent in FY 2022.)
- Sagitec pension process and application workflow development project – \$188,000 (Projected to spend \$104,000 in FY 2023, with an additional \$73,000 spent in FY 2022. The project will continue into FY 2024.)
- Sagitec IRIS (pension administration system) framework architecture upgrade – \$180,000 (Projected to be completed for \$158,000 in FY 2023.)
- Email server migration – \$35,000 (Project has been cancelled, and SDCERS will utilize its current Microsoft support, with a plan to move to Microsoft 365 in the next few years.)
- Replacement of applications and perimeter load balancers – \$25,000 (Project originally budgeted in FY 2021, but delayed until FY 2024.)
- Annual office computer equipment replacement – \$25,000 (The full amount is

projected to be spent in FY 2023.)

- Annual server replacements – \$15,000 (The full amount is projected to be spent in FY 2023.)

FY 2024 budget projects include:

- Sagitec pension process and application workflow development project – \$151,000 (Projected to spend \$104,000 in FY 2023, with an additional \$73,000 spent in FY 2022. The project will continue into FY 2024.)
- Replacement of applications and perimeter load balancers – \$30,000 (Project originally budgeted in FY 2021, but delayed until FY 2024.)
- Annual office computer equipment replacement – \$45,000
- Annual server replacements – \$20,000
- IRIS (pension administration system) workflow engine replacement – \$230,000
- HVAC replacement – \$110,000
- Security information and event management system – \$40,000
- OnBase agenda upgrade – \$40,000
- Website content management – \$35,000

Investments

Investment Expenses

Investment expenses are authorized periodically as various investment and investment consultant contracts are brought to the SDCERS Board. Investment expenses are paid with SDCERS investment earnings and are not included as part of the budget approved by the Board.

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The following table presents SDCERS' long-term strategic target asset allocation percentages for each asset category as of June 30, 2022; the FY 2022 fair value of assets under management; FY 2022 investment expenses by asset category; and investment expenses as a percent of the fair value in each asset category.

Investment expenses for the last completed fiscal year, FY 2022, were about 0.72% of the fair value of assets under management, or 72 basis points³. The \$73.6 million in FY 2022 investment expenses increased by \$30.5 million, from \$43.1 million in FY 2021, largely due to legal fees. SDCERS had filed a lawsuit

against Allianz Global Investors (AllianzGI), et. al., settled the lawsuit in FY 2022, and related legal fees paid to its attorneys were approximately \$25.9 million.⁴ Without the inclusion of the \$25.9 million legal fees, investment expenses as a percent of the fair value of assets would be closer to 0.47%. Other increases in investment expenses from FY 2021 to FY 2022 include \$2.1 million for Opportunistic Strategies and \$1.9 million for Private Equity & Infrastructure.

Investment Return

The most recent SDCERS Annual Comprehensive Financial Report indicates FY 2022 investment loss was 1.7%, with a net

SDCERS FY 2022 Investment Information				
Asset Category	Long-Term Target Asset Allocation	Fair Value of Assets (\$ in billions)	Expenses Paid	Expenses as % of Fair Value of Asset Category
Domestic Fixed Income	22.0%	\$2.18	2,712,000	0.12%
Domestic Equity	19.0%	1.83	1,481,000	0.08%
Private Equity & Infrastructure	13.0%	1.79	9,807,000	0.55%
International Equity	12.0%	1.20	3,942,000	0.33%
Real Estate	11.0%	1.15	12,010,000	1.05%
Global Equity	8.0%	0.80	4,828,000	0.60%
Opportunistic Strategies	10.0%	0.77	6,945,000	0.91%
Return-Seeking Fixed Income Strategies	5.0%	0.37	\$2,356,000	0.63%
Cash and Cash Overlay	n/a	0.15	214,000	0.14%
Other Investment Expenses ^{a, b}	n/a	n/a	29,328,000	0.29%
TOTAL	100.0%	\$10.23	\$73,623,000	0.72%

NOTES: Table may not total due to rounding.

Target allocations, asset values, and investment expenses are based on information presented with the FY 2022 Annual Comprehensive Financial Report.

^a Other Investment Expenses include \$26.1m for legal services and \$1.5m for certain SDCERS personnel expenses, as well as fees for investment consultants, taxes, expenses related to cash holdings, and other expenses.

^b For Other Investment Expenses "Expenses as % of Fair Value of Asset Category" is as a percent of total fair value of asset:

³ The investment expenses at 0.72% of the fair value of assets is slightly different from the 0.70% included in SDCERS' March 10, 2023 budget materials presented to the SDCERS Board, which do not include SDCERS' personnel and general operations expenditures in the investment expenses calculation.

⁴ Per the SDCERS Annual Comprehensive Financial Report for FY 2021, "[i]n December 2020, SDCERS filed a lawsuit in New York state court against AllianzGI and others related to the losses SDCERS suffered in its investment in the AllianzGI Structured Alpha Fund 500. Among other things, SDCERS alleges the defendants breached their contract with and fiduciary duties to SDCERS."

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investment loss of \$149.6 million. Note that the pension system's rate of return assumed for FY 2022 (in the FY 2021 actuarial valuation) was 6.5%. The return assumption for FY 2023 (in the FY 2022 actuarial valuation) is also 6.5%.