



THE CITY OF SAN DIEGO

OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Review of City Agencies FY 2025 Budgets: San Diego City Employees' Retirement System

The IBA has reviewed the San Diego City Employees' Retirement System (SDCERS) FY 2025 budget, which is scheduled to be heard Tuesday, May 7, 2024. Our review is attached.

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City Agencies: City Retirement System

City Retirement System

The San Diego City Employees' Retirement System (SDCERS) FY 2025 budget was approved by the SDCERS Board of Administration in March 2024. The SDCERS budget is scheduled to be presented as an informational item at the May 7, 2024 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 2025 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 \$18.3 million administrative budget is

increasing by \$1.2 million, or 7.1%, from the \$17.1 million FY 2024 budget. The FY 2025 budget includes 53.00 FTEs, down 1.00 from the 54.00 included in the FY 2024 budget.

Based on the FY 2023 actuarial valuations, 9.3% 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 2025 Actuarially Determined Contribution (ADC) pension payment.

Components of SDCERS' FY 2025 administrative budget are outlined below.

Salaries and Benefits

The \$11.8 million Salaries and Benefits budget category is increasing by \$1.0 million from the FY 2024 budget. This includes an \$898,000 increase in salaries and wages and a \$113,000 increase in budgeted fringe benefits as discussed below. Note that the City manages the payment of SDCERS employees' salaries and fringe, and invoices SDCERS for those costs.

The \$113,000 fringe benefits budget increase

SDCERS ADMINISTRATION - BUDGET CHANGES					
	FY 2023 Actual	FY 2024 Budget	FY 2025 Budget	Increase/ (Decrease)	Percent Change
Budgeted Staff	51.00	54.00	53.00	(1.00)	(1.9%)
Salaries and Benefits	\$10,694,000	\$10,805,000	\$11,816,000	\$1,011,000	9.4%
Information Technology	2,625,000	2,881,000	3,089,000	208,000	7.2%
Legal Fees	292,000	250,000	400,000	150,000	60.0%
General Operations	3,382,000	3,153,000	2,994,000	(159,000)	(5.0%)
TOTAL	\$16,993,000	\$17,088,000	\$18,299,000	\$1,210,000	7.1%

NOTE: Table may not total due to rounding.

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is based on FY 2024 fringe rates provided by the City, as the FY 2025 rates were not available at the time the SDCERS budget was approved. As such, the actual fringe amounts are anticipated to vary from the approved budget.

As mentioned, salaries and wages are increasing by \$898,000, or 13.1% (from \$6.9 million to \$7.8 million). The increase is largely due to general salary increases and 2023 raises for unrepresented staff that occurred after the FY 2024 budget was completed. Note that the full impact of FY 2024 general salary increases (which was based on negotiations with the City's non-public safety recognized employee organizations) was unknown at the time the FY 2024 SDCERS budget was approved. Only the 5% increase on July 1, 2023 was anticipated in the FY 2024 budget; the 5% increase which occurred on January 1, 2024 has now been factored into the FY 2025 budget. The FY 2025 budget also includes FY 2025 general salary increases: 4% on July 1, 2024 and 2% on January 1, 2025.

Realignment of Retiree Healthcare Positions

We note that there is an operational change anticipated for FY 2025: SDCERS will no longer be managing the City's retiree healthcare program. This function will be transferred to the City beginning in FY 2025, although there will be some work for SDCERS in FY 2025 as the program transitions to the City. On April 29, 2024 the Risk Management Department requested City Council approval of a retiree health administration contract; the contract is anticipated to come back to Council in the next several weeks for its second required hearing and

final approval.

SDCERS anticipates reallocating positions that have dealt with retiree healthcare to the Benefits Administration Division. Also, in FY 2024 1.00 FTE was added to the budget on a temporary basis to support increased benefits administration workload. It has been determined that this position is needed on a permanent basis. The unwinding of Proposition B¹ caused an increase in membership workload; and the transition of eligible separated employees who elected to participate in SDCERS is ongoing.

Non-Personnel Expenditures

The \$3.1 million information technology expenditures budget for FY 2025 is increasing by \$208,000, or 7.2%, which is largely related to contractual increases for services. SDCERS leverages the terms and rates in certain City IT contracts, including for application services and data center and desktop support.

The \$400,000 legal fees budget is increasing by \$150,000 and includes costs for litigation, disability, tax, general, and fiduciary counsel. Components of this increase include \$105,000 for fiduciary counsel, \$40,000 for disability and administrative hearings, and \$35,000 for compliance, including with privacy laws. These increases are partially offset with a reduction of \$30,000 in litigation costs.

The \$3.0 million general operations budget is decreasing by \$159,000, or 5.0%, which includes one large decrease, combined with offsetting increases. Depreciation expense is decreasing by \$552,000 because the IRIS pension system is almost fully depreciated. The largest offsetting increase is \$224,000 in

¹ For a brief overview of Proposition B unwinding, see the Independent Budget Analyst's review of the FY 2025 Proposed Budget, [IBA Report #24-09](#), in the *Pension* section under *Key Citywide Issues*.

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building expenses (rent), largely related to a rent abatement provision in SDCERS' lease for office space. This brings SDCERS office space rent to \$880,000; future increases are expected to be around 3.5% per year. The next largest increase in the general operations budget is \$55,000 for actuarial services. The RFP process for actuarial services is currently underway; results are anticipated to be presented at the July 12, 2024 Board meeting. The chosen actuary will be completing the FY 2024 actuarial valuation which will determine the City's FY 2026 Actuarially Determined Contribution (ADC).

Capital Budget

In addition to the administrative/operating budget, SDCERS maintains a capital budget. The capital budget is increasing by \$3,000, from \$701,000 to \$704,000. SDCERS' capital budget is primarily associated with information technology infrastructure.

FY 2025 budgeted projects include:

- IRIS (pension administration system) workflow engine replacement – \$120,000
- Annual office computer equipment replacement – \$54,000
- Annual server replacements – \$50,000
- Storage Area Network Modernization – \$160,000

- Microsoft 365 Migration – \$125,000
- Boardroom Modernization (largely technical equipment enhancements) – \$100,000
- Wide Area Network Enhancements – \$50,000
- Infrastructure Continuity Project – \$45,000

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.²

The table on the following page presents SDCERS' long-term strategic target asset allocation percentages for each asset category as of June 30, 2023; the FY 2023 fair value of assets under management by asset category; FY 2023 investment expenses by asset category; and investment expenses as a percent of the fair value of assets in each asset category.

Investment expenses for the last completed fiscal year, FY 2023, were about 0.40% of the fair value of assets under management, or 40 basis points³. Investment expenses decreased by \$3.3 million, from \$47.7 million⁴ in FY

² Certain budgeted personnel expenses for SDCERS are reported as investment expenses, which totaled \$1.4 million for FY 2023.

³ The investment expenses at 0.40% of the fair value of assets is slightly different from the 0.39% included in SDCERS' March 8, 2024 budget materials presented to the SDCERS Board, which do not include certain SDCERS' personnel and general operations expenditures in the investment expenses calculation.

⁴ In addition to the \$47.7 million, investment expenses for FY 2023 included non-recurring legal fees related to a specific lawsuit. 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. Including the \$25.9 million legal fees, investment expenses totaled \$73.6 million.

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2022 to \$44.4 million in FY 2023. The largest decreases were \$1.4 million for Private Equity & Infrastructure and \$1.0 million for Global Equity.

Investment Return

The most recent SDCERS Annual Comprehensive Financial Report indicates FY 2023 investment return was 5.2%; and net investment income was \$515.1 million. Note that the pension system's rate of return assumed for FY 2023 (in the FY 2022 actuarial valuation) was 6.5%. The return assumption for FY 2024 (in the FY 2023 actuarial valuation) is also 6.5%.

SDCERS FY 2023 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%	\$2.48	\$2,644,000	0.11%
Domestic Equity	19.0%	2.20	1,357,000	0.06%
Private Equity & Infrastructure	13.0%	1.65	8,413,000	0.51%
International Equity	12.0%	1.43	3,545,000	0.25%
Real Estate	11.0%	1.22	11,883,000	0.98%
Opportunistic Strategies	10.0%	0.64	7,410,000	1.16%
Global Equity	8.0%	0.62	3,789,000	0.61%
Return-Seeking Fixed Income Strategies	5.0%	0.57	1,725,000	0.30%
Cash and Cash Overlay	n/a	0.18	213,000	0.12%
Other Investment Expenses ^{a, b}	n/a	n/a	3,445,000	0.03%
TOTAL	100.0%	\$10.99	\$44,424,000	0.40%

NOTES: Table may not total due to rounding.

Target allocations, asset values, and investment expenses are based on information presented with the FY 2023 Annual Comprehensive Financial Report.

^a Other Investment Expenses include \$1.4m 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 assets.