The following transcript is provided for your convenience, but does not represent the official record of this meeting. The transcript is provided by the firm that provides closed captioning services to the City. Because this service is created in real-time as the meeting progresses, it may contain errors and gaps, but is nevertheless very helpful in determining the gist of what occurred during this meeting.

>> Mayor Reed: Good morning. I'd like to call the city council meeting to order. This is a continuation of our budget study sessions. Today's topic is just on retirement. Retirement reform. Related issues. We have tomorrow, we have the Redevelopment Agency budget, and that is the last of the study sessions. But today we have just the retirement. And we'll go until either we get tired, or we run out of time. Whichever comes last. Because I know we have a lot to cover. So with that I want to start -- we'll have a staff presentation and then we'll have time for council questions and answer, and of course we'll take public testimony and we usually do at each of these sessions. We will start I believe the City Manager's going to kick this off. So Deb.

>> City Manager Figone: Thank you, Mr. Mayor, members of the council. We are here today to present a presentation on retirement. This presentation will be made jointly by Alex Gurza, director of employee relations, Russell Crosby, director of retirement services and Sharon Erickson, the City Auditor. I would also like to thank them and all of their staffs seated over there on the right, in addition to the City Attorney for all the outstanding work that has gone into this plan to date. We have key issues and principles regarding retirement that we will be discussing during this presentation. It will be very important that we all have the same level of understanding when we begin to make the very critical decisions about how to solve this problem, which is that we are cutting services and laying off employees to pay for retirement costs and this can't continue. We also need to ensure that there is a solvent retirement plan for our current retirees and future retirees. It's important that everyone understand that this is not imaginary. Everyone should be concerned that these plans are at risk. I commend the San José Police Officers Association, who recognized this is concern, and who has been educating their members on these issues using some of the very same information that we will be presenting here today. The fiscal reform plan that was released on May 2nd outlined a strategy in accordance with city council direction to achieve $216 million in General Fund savings in five years. And to roll back retirement costs to fiscal year 2010-11 level. We will briefly discuss this plan at the end of the presentation, but first, lay out the problems and key issues that we think need to be considered. In laying out the problems and issues I want to direct my comments for a moment to our employees. Surfacing these issues is not about assessing blame. It's about dealing with the reality of our situation, and coming up with reasonable and necessary solutions. I want to be clear, as I have stated many times in the past, that the financial state of the City's pension system is not the fault of our employees. That said, we should work together to come up with a solution that is necessary and reasonable, so

that we all have a sustainable system, to ensure that there is a pension benefit for city employees when they retire whether that be five years from now or 20 years from now. Reasonable solutions are also necessary in order to keep from eliminating and reducing city services to the public in order to pay retirement costs. As public service employees we must care about this goal. And now, a comment for the mayor and city council. All of us who are city employees and who are working to address this issue have a conflict as we are members of the retirement system. This includes myself, as City Manager, the City Auditor, the City Attorney, and all of our staffs. However, we have set personal interests aside to bring the council the facts as we know them from the plan actuaries. I and my staff have brought you our best professional thinking and recommendations in the retirement reform plan. If we allowed our personal interest to interfere with our professional responsibilities we would want to minimize the pension problem, not exaggerate it. We will continue to do our professional best to assist you in solving this problem. Wand that, I will now turn it over to Alex Gurza.

>> Alex Gurza: Good morning mayor members of the city council, Alex Gurza, Director of Employee Relations. As the City Manager indicated, we will be providing you with a presentation that's going to be presented not only by myself but also by City Auditor Sharon Erickson and director of retirement services Russell Crosby. I also want to mention people at the table, Mike Maley, who works for Russell in the Department of Retirement services, who is also an actuary. Jennifer Schembri of my staff at the back table, Assistant City Manager Ed Shikada, Budget Director Jennifer Maguire and Margaret McCann from the budget office. I've said this in other forums, but I'm glad the City Manager mentioned that we are all city employees. I started my career with the city in 1994, working in the Department of Human Resources in the then-retirement division. That was before it separated out into a separate department. And over those many years I picked up a little bit about retirement. But every day and I've said this before I learned how much there is to know and how incredibly complex of a subject that it is. So in planning this presentation, we were trying to best assess how to present the information that would be helpful not only to the mayor and to the city council but to employees, retirees and the public. So we do have somewhat of a lengthy presentation but we do want to leave plenty of time for you to ask questions of any of us, here that we might be able to answer for you. Although we are certainly not fortunate to be in this crisis, not only the fiscal crisis of the City's budget but also our pension system, but I do believe that we're fortunate to have two retirement boards, that have just added to the -- to their expertise in significant ways by

having people that have come and been added to the boards that have significant experience. And also, and I would say even more importantly, we have the professionalism of the Department of Retirement services and the people and the expertise that they have there to be able to assist the city through this very, very difficult issue. So with that I want to just -- for anybody who doesn't know the city has made significant efforts to provide a lot of information about many things on our Website, for employees, retirees, the public. We have a section on our Website dedicated to retirement benefits, that is in addition to the Department of Retirement services Website. We have actuarial reports, we have memos provided to the city council and much more information for anybody who wants to read items for themselves, just for those to be aware of that. To go over very briefly an overview about our retirement benefits. Talk about retirement reform. Look a little bit backwards on the history of how we got here and looking forward on the costs of our retirement system and then summarize the fiscal reform that the City Manager issued recently. So in terms of retirement benefits, there are a lot of terms that are used and I think for the most part people know most of them. But there are two main categories of retirement benefits. A defined benefit program otherwise referred to as a DB plan or a defined contribution plan, otherwise known as a D.C. plan. Defined benefit plans are what the city has in its two retirement systems. And really essentially in some it is a benefit that is provided regardless of the amount of money contributed either by employees and investment performance of the retirement funds. So in other words generally it is a benefit that is determined by age, by years of service, by the average salary. And the person gets a monthly pension for the rest of their life. We have a category over there about risk. And we put that in a very early slide, because as we've thought about this issue, and the issue of risk is really at the forefront of our minds and we'll be talking about the risk. The defined benefit has high risk. If not enough money is set aside the costs grow exponentially in the future. A divined benefit plan, is something that's put aside for someone's retirement, otherwise known as a 401K plan. There's not much risk to city or taxpayers because there is a set amount of money that's put aside and then that's managed by the employee and the investment company that runs it. So we have defined benefit plans as you know. One important thing is, we have independent pension plans. We are not a member of Cal PERS which most every city and county, not all, but most are members of the Cal PERS system. They're administered by two independent boards and those boards are made up of trustees who have fiduciary responsibilities, to ensure that there are sufficient assets to pay for the benefits. We do have a defined contribution plan, and it's -- in the public sector it's referred to as a 457 plan. However, there is no city match. Employees can choose to put part of their money aside to supplement the defined benefit plan up to the IRS maximum amounts. So how are defined benefit costs determined? This is part of a quote that I've shown before in other city council meetings, from a actuarial firm by the name of the Segal company. We've heard a lot of talk about actuarial assumptions. Things like what's the earnings assumption, what should it be? But this quote is significant in our minds because it says the assumptions do not determine actual cost of the plan. The actual cost is determined solely by the benefits and administrative expenses paid out. Offset by investment income received. We think this is a very simple statement but really important. So when we think about what does a defined benefit plan cost? It really is a function of what the benefits are. And again, offset by the investment that is earned. So what are the elements then that affect cost? These are not the only items in a defined benefit plan that affect cost but definitely the primary ones. Retirement age, how early can someone retire? The earlier you can retire, the higher the cost. For clearly logical reasons, that would mean the more years a person will probably be receiving the benefits. What is the benefit formula? How much do you get for every year of service and then what is the maximum? In our Federated system, for example, we have a formula that says 2.5% for every year of service up to a maximum of 75%. Number 3, the maximum benefit again, we have, as I mentioned, in the Federated system a 75% maximum, in Police and Fire it's 90. And it goes down the list, all of these things affect the ultimate cost of the plan. And some very significant. Can't leave that slide without mentioning cost of living adjustments. The cost of living adjustments in plans can be a very significant amount of the cost of the overall plan. And both of our plans provide for a 3% fixed cost of living, meaning it's guaranteed to be 3 every year regardless of CPI, that's a very big cost driver in our defined benefit plans. Then we move to another term that's used a lot called the annual required contribution. Shortened for arc. The pew center has put out -- published several reports on pensions, this is from a glossary that they put out, just to have an easy reference for definition of terms that are used. And they define the annual required contribution as the amount of money that actuaries calculate that the employee needs to contribute to the plan during the current year for benefits to be fully funded by the end of the amortization period. Employees also put in in our system. So in our system for the pension plan this is a formula in the charter that says for every $8 the city puts in employees put in $3. Not just the employer pays but the employee pays as well. This arc is not set by the city. It is set by the independent retirement boards through the actuaries that they hire. They do actuarial studies and determine the amount of the payment. And as directed recently by the city council, it made it a principle that the city should continue to make the full retirement contribution each year as determined by the retirement boards so that the systems are appropriately funded. So back to this issue of assumptions and what's the importance of the assumptions if they don't actually determine the cost? This is the remaining quote from the actuarial firm of the Segal company where they say the use of realistic actuarial assumptions is important to maintain adequate funding. It is desirable to estimate as closely as possible what the actual cost will be, so you can set aside sufficient money every year to pay for the benefits. The last part of that quote says, and to maintain equity among generations of participants and taxpayers. And this concept of generational equity or an intergenerational transfer is very commonly talked about in defined benefit plans. The idea to avoid it is to make sure that the amount of money that is being set aside every year so there's enough money to pay for it. If you think about it from a public employee's standpoint whether you have police officers, firefighters, librarians, community workers, the cost of those employees are their pay, and their benefits. And the taxpayers that are receiving those services are paying for them at the time. At the time they're receiving the benefits of those services. However, if unfunded liabilities get created where they're paid decades later, it is really taxpayers in the future, future generations of taxpayers are paying for services that they actually didn't receive. They were received by the people decades earlier. So the concept of the defined benefit plan is trying to make sure that you're estimating as closely as possible what should be set aside so that that benefit is paid for by the time they receive it. So talk a little bit about these actuarial valuations. Again, they are performed by independent actuaries that are selected not by the city but by the retirement boards. They are now performed annually. That was a recent change. They used to perform them every two years and they use data as of June 30th of every year. When June 30th comes and they later do the actuarial valuation in the months following they use all the data that was in effect at that time. What I mean by all the data, the investments that were earned in the prior year, everything about employees, how many employees we have, all of the information is as of June 30th. What they then do is produce reports, present them to the boards and then, it sets the annual required contribution. But that contribution actually doesn't take effect until the year later. Sow so as an example that I put on the slide, if there's a valuation that's done on June 30th of 2010, which is the most recent one, it establishes the annual required contribution, for the year 11-12. So a year later. And you might have heard this issue of a one-year lag. That's why. There's a one-year lag in between when the valuation is done and when the contribution is made into the system. So what are the elements that affect that annual required contribution? It really is a combination of the past and the future. And what I mean by that, it looks backwards to see how do things turn out? How did the investments do? How many people retired, more than we thought, less than we thought, all kinds of things that they look in the past and then what are the assumptions going forward? What do they assume is going to happen in the future? They could either -- the boards could maintain the assumptions they had in the past or adjust them. That really determines what the arc is going to be. What are those key assumptions that the boards use based on advice from their actuaries, the rate of return as I mentioned before. It's a very key assumption. How much do they predict that the funds will earn. What's the life expectancy of our retirees? Clearly the longer people live which is a good thing the more they will be receiving the benefit. They have estimates on that. The number of disability retirements, what salary increases will be, what is the benefit age? All of those key things that drive the annual required contribution. So again on this issue of earnings assumption, which is a topic not just here in San José but in defined benefit pension plans across the country is what is the right earnings assumption? The -- as you see on the left there's a variety of earnings suggestions here and it starts with 7.75. Now the boards have both lowered that assumptions. It was a high in Federated of 8.25 and 8 in Police and Fire and they've been gradually reducing them. But what I want to point out is the column on the right. Which is, what is the probability of achieving that earnings assumption? And this really gets to the issue of risk. So and these were calculated, provided to us by the Department of Retirement Services doing calculations saying, what is the possibility of achieving it? So at a 7.75 assumption there is only a 25% chance of achieving that rate of return. So it's one in four. Now let's go down to the very bottom which is 4%. That's commonly referred to as a risk-free. Why do they call it risk-free? Because there's pretty much 100% chance that you're going to be able to hit the 4% earnings assumption. And then we have numbers in again. So if you're at 6.75, it's about a 50% or 50-50 chance of hitting that earnings assumption. So that earning assumption is very, very critical in ensuring that there's enough money being set aside. To the extent that the number is too high or overly optimistic then not enough money would have been put aside by the city and employees and it creates unfunded liabilities. So this is an example of how the rate of return assumption can dramatically have an impact on the estimated cost. We provided an info memo to the city council at the request of the council, analyzing the second-tier pension benefit that was proposed by the San José firefighters. It was a benefit that is less than the current one. So the current one has a -- it's somewhat of a complex formula but at 30 years it's a 90% maximum. Their second tier was back to a 75% maximum which is what Police and Fire used to have back beginning in the -- up until the mid 90s. So they provided us an estimated what's called the normal cost. Now normal cost doesn't count any unfunded liability, it's just the cost moving forward. They had estimated the cost to be 28% for normal cost, 28% of payroll. So again, I know we talked about this a lot. But if someone -- just to use round numbers, if someone makes $100,000, that means $28,000 has to be put aside for every year to put aside money to pay that benefit. Our estimated cost was very close to what the firefighters had provided us, 28.38, but that's using the 7.75% earnings assumption, which is what I had mentioned sort of was the 25% probability of achieving it. But then if you look to the right if you use assumptions that provide you more assurance that the rate of return will be met, the normal cost escalates dramatically. So you can see if you have a 6.75% assumption which is just a 50-50 chance probability, the cost jumps to almost 37% of payroll. And on the risk-free side of 4%, you can see it's 72% of payroll. So the earnings assumption, again I want to emphasize, does not determine the actual cost of the benefit. The actual cost of the benefit is going to be based on the benefits that are paid out. This is really what's used to set aside enough money that we think is going to be needed to be there. But this really does show how dramatically it could impact the normal cost. So in terms of that, the actuarial evaluation are self-correcting in that sense. So if these assumptions don't turn out to be correct one way or the other, they will adjust in the next valuation over time. And ultimately, to put it very plainly, the benefit cost, what's the benefit cost? It really is what the payouts are. So if the employee under the formula is going to get the benefit of X, that's really what it costs. So all this talk about assumptions is really the talk of how much is going to be put aside to ensure that enough money is there and it doesn't create unfunded liabilities. Because you want to plan for these costs. Again I've mentioned already, so I won't belabor the point, intergenerational transfer, which is what you want to try to avoid, which is to pay for the cost of salary and benefit at the time the services are being provided. Moving to a defined contribution plan, just have one slide. It's pretty simple to calculate the coast of a defined contribution. It really is, the city could determine the contribution level which would determine the cost. And there could be a potential match to employee contributions that is -- that is very common. Up obviously to the maximum that the IRS allows. So moving on to the next section of retirement reform. Again, I will go quickly over this, but this is a slide that showed in the February 14th study session. It comes from the -- another pew center report. And it puts retirement reform into several categories. One is improving governance and investment oversights. That is something I mentioned that the council did change the composition of the retirement boards to add people with expertise that are from the outside, that don't have a vested interest in the plan, meaning that they are not employees or retirees and they are people that are independent and significant progress there. And the boards and the staff are doing tremendous work on the investments and analyzing that very carefully. The second is keeping up with funding requirements. It's paying the arc, as I discussed previously. Three is sharing the risk with employees. Currently in our pension benefit the risk is 100% born by the city and the taxpayers. Four is increasing employee contributions. That's another reform area that's having employees just really cost-shifting, having employees pay more for the cost of the benefit. And five is reducing the benefits or increasing the retirement age. Which really is the focus of this particular presentation. So what are the options to change benefits? As we've talked a lot before, having a second tier for new employees, the important part we've mentioned this many times, having a new tier for new employees does not effect the current unfunded liability. So it is a very important but it is a long term step. Two is changes to retiree benefits and 3 is changes to retirement benefits for current employees. So the next two slides are identifying what we consider to be key issues in principle and also key issues that the city council has already set. The first one is there for a reason, listed number one, is the legal issues. As we know, the legal issues with retirement benefits or the potential of changing benefits for retirees or employees is a significant issue. The second one is there was a key issue that was set by the council that there is no consideration of changing accrued benefits for current employees under existing formulas. So for example in the Federated plan, 2.5% per year, if an employee worked 20 years already, that's 50%, there is no consideration for changing that 50% that has already been earned. No changes to current pensions received by retirees is being considered. And also, another principle is sharing in the solutions among retirees and employees. As the City Manager mentioned, reasonable and necessary solutions to ensure the fiscal stability of not only the city but the retirement funds. Another key principle would be to avoid continuing to cut city services and jobs to fund retirement benefits, and lastly, to continue making the annual required contribution. Next is avoid shifting the liability for pension benefits to future generations. Reduce the risk for not just the city but for the city, for employees, retirees and taxpayers, that are inherent in the current defined benefit structure and lastly utilizing realistic assumptions for projections of savings or cost for changes in defined benefit programs. I want to mention this for a minute. The assumptions are not decided by the city. The assumptions are decided by the retirement boards. But when we estimate the cost or the savings of a change in benefits, we really think it's very important to use realistic assumptions so that if we think a benefit change or even if it's for a second tier is going to cost X is we want to use assumptions that have some confidence level that that benefit will turn out to be accurately costed. So one key question that we think is important in this, probably the most important in the entire issue is how much risk is the city and taxpayers willing to take in the divined benefit retirement plans for city employees? And secondly, how confident would the city council like to be that the cost estimates of the newer revised benefits will turn out to be accurate. 25%, 50, 75 or 100% confident? That's a key question that will help us determine if actual cost of the benefits and the assumptions we use in calculating how close we will be to achieving the savings goals set 50 city council. So the next section is on the history and projections of retirement cost and I'm going to turn it over to City Auditor Sharon Erickson.

>> Sharon Erickson: Last September my office issued a report sounding yet another alarm about rising pension costs. I'd like to show you four graphs from our report that show what's happened to our pension plans. This is part of a presentation that I've presented probably -- you saw these graphs last fall, and in the meantime I've probably presented this presentation about a dozen times to groups of city employees to ensure that city employees also understand how we got into this situation. This graph shows that benefit payments, so this is what we're talking about, where these are the actual payments out of the pension plans, grew sevenfold over the last 20 years. So in answer to the question have costs really skyrocketed? Absolutely. The graph shows that pension benefits have grown from about 30 million in 1990-91 to 72 million, in 1998-99, to $210 million in 09-10. I want to stress, this is not San José's problem alone. Retirement costs across the country have skyrocketed. I would like to say that because of our early retirement ages, we may be seeing those costs growing sooner as the baby boomers roll through our system. There are a number of reasons for this graph which I always stress. One thing is the number of retirees and beneficiaries is two and a half times what it was in 1990, '91. In part, that's baby boomers rolling through early in our system. The average salary increased, they've more than doubled over the same time period, and there were benefit enhancements over that period. The average annual pension benefit increased over that time, as well. In the second graph here, I'd like to show how this graph compares the city and employee pension contributions into the fund. They're up significantly over the last decade. City contributions more than doubled, you can see here, employee contributions increased as well. One thing I stress, is that in San José employees do contribute to the pension systems. And are defendant stakeholders in this process. So why the increases? Well, there are three reasons for these. When times were good, benefits were enhanced sometimes retroactively, and those costs were amortized and are rolling through the pension system. Meanwhile employees were living longer and retiring earlier and the actuaries had to take that into account. Those costs are

rolling through these numbers. And these factors would have led to increases all by themselves but then San José's funds like every other pension fund in the country took significant losses in the economic downturn, and the impact of those losses are also rolling through the funds. So when you juxtapose those two graphs you get the third graph which shows you that pension benefit payments out of the systems have exceeded contributions since 2001. Which means we're drawing down the plan assets that were set aside to -- and as investments for the future and even if investments yield expected returns pension benefits are expected to grow faster than those assets unless we raise contribution rates. That's where we have another problem. This slide shows the declining ratio of employees to retirees and their beneficiaries, which creates a risk of even higher contribution rates as a percent of salary. 30 years ago there were about five active employees for every one retiree. 20 years ago that number had fallen to 3 to 1. Last year that number was 1.4 to 1 and it's falling. This means that the annual cost to pay down the unfunded liability is spread across fewer and fewer active employees. If the pension fund were fully funded, it wouldn't be so much of an issue. But when the plan is underfunded, it makes payouts burdensome. So what's the impact, the city's making larger annual contributions to its retirement plans to ensure there's enough assets in the plan to pay for pension benefits already promised, forcing -- all of this is forcing cuts to basic services, cuts in the very staff that we're trying to provide for. So two questions that we asked in our audit were, can the city maintain existing service levels without compromising service levels for future generations, and can the city meet its future obligations? Our audit conclusion was, it's not sustainable.

>> Alex Gurza: For the next section of the presentation I'm going to turn it over to director of retirement services, Russell Crosby.

>> Russell Crosby: Many of you have seen these numbers several times before. There is a lot of focus on the $400 million number in 2014-15. I just want to say that that's really a best-case number. All we are doing in that period from the projection of this line from, say, 2010 to 2015 is simply recognizing the losses that occurred in 2008. Next slide. Actuaries don't recognize significant losses like that all at one time. They do something called actuarial smoothing meaning over a period of years, they recognize a certain percentage of a loss that occurred in a particular year. In this case, we use five-year smoothing which is really an industry standard and we recognize those losses over that period of time. So that's what's really driving the numbers that you saw on the previous

slide. Just to address that even in integrating the losses, that doesn't recognize demographic changes, other kinds of assumption changes that will be occurring. So the $400 million really is call it a rosy picture because we can recognize that there are demographic issues in both of the plans. This slide addresses some of the issues that the actuary for the Federated plan will be discussing with the trustees tomorrow. He is recommending that wage inflation be reduced which I think all of us know that's going on here. And then he wants to discuss return assumptions. And is proposing some fairly significant changes that still wouldn't get us to the 50-50 ratio or possibility of actually achieving those returns but would move us in the correct direction. Also, they're recommending that we explicitly recognize the cost of the SRBR program and that is roughly 35 basis points or five to $6 million a year going forward. Next slide. This really gives you a longer term picture of what the contributions in Federated look like with what we know today. Before integrating any of the demographic changes or anything else that might be going on, this is simply a 20-year picture which corresponds to the amortization period in Federated. And you see they are going -- the contributions are expected to peak somewhere in 2027 at around $225 million just for Federated. You could show Police and Fire, now Police and Fire has a shorter amortization period of 16 years. And that's why you see starting in 2022, 23, the contribution rates beginning to come down again, as you've fully recognized the losses and then amortized the losses from 2008. So you see what happens out in the out years with this. But the contribution rate peaks at around $315 million in 2022, 23. Again, that's before recognizing any demographic changes or the earnings assumption changes that might be recommended by the actuaries in the coming years. So it's important then to see how this flows through in temps of unfunded liability. On the pension plans you'll see that on a market basis, which is where we're heading, you're recognizing those losses that occurred in 2008, going forward, as of June 30th, 2010, our total unfunded liability on a market basis for Federated was $182 billion -- $1.82 billion and on an actuarial basis was 1.60 billion. It's important to note though, over time those losses will be recognized and the funded status will continue to deteriorate at least through 2014-15. Same story in Police and Fire. You see the divergence between market and actuarial and then you see the bottom line. Next slide. And that's what I was talking about is the deterioration in the funded status of the two plans on a market basis because that's what you're really moving toward. You're integrating the lows that have occurred and over the next five years or so the funded status will continue to fall. This question comes up a lot. And it has really two elements. One is, that the plans have done very well. And yes, we've tended to outperform certainly in the last three years or so. We've outperformed entities like CalPERS, we've outperformed most of the public plans in California, I'm not aware of anybody who has outperformed us. But it doesn't change the overall picture and that is, that yes, our asset base has probably returned to something close to where it was in 2007. Unfortunately, the liabilities marched on. And you're still roughly 40% underfunded. Because during the period and we don't have a graph on this today, but if you imagine that the liabilities continue to grow with each of the five years while you're integrating the losses that occurred in 2008, they've continued to move up at like a 30 degree angle. Your assets took a big dive, a V shape that have come up underneath the liabilities that there's still a 40% wedge between liabilities and assets. So although we've made progress, although we've done well, although we're making a lot of money for the plans it's not enough to eradicate the problem. And when people focus further, when people focus on just the S&P 500, and said, oh, the S&P 500 have done X during a period of time, that doesn't recognize that less than, it's a relatively small percentage, 10% of the portfolio is S&P 500. We have small cap assets, we have mid cap, we have a very substantial bond portfolio and then we have alternative assets, some of which are liquid and some are illiquid. Just because you say S&P 500 has done X, that doesn't translate to an overall pension portfolio return. Then -- and then I've addressed the liability question. This next slide I think is important for everyone to focus on for a minute. The middle line is the blue line that you saw earlier. Which is simply integrating the losses, recognizing and then paying for them over the next 20 years. The lower line, the lighter colored line with the little square, is recognizing our actual returns all the way through March 31st of this year, and assuming that weed earn another 2% or so during the final quarter which you know is questionable. But giving ourselves the benefit of the doubt that we're going to continue with the earnings we've achieved so far this fiscal year, all the way through end of the fiscal year, you see that lower line. Unfortunately at the same time, the upper line is what's going to be reflected at tomorrow's board meeting, is the demographics that the actuary is going to recommend that we recognize and a change in the earnings assumption. And when you integrate those pieces. What you see is yes, we've done wonderful things from investment standpoint. But the plan is still in essentially the worse condition than it was with what we knew a year ago. And none of these actually reflects as the real population in terms of, on June 30th, when we take that snapshot of the population, there's going to be substantially more retirements this year than were ever projected in any of the valuations. That's going to have a significantly negative effect, as well. So even -- even integrating what we know, the pieces we don't know are likely to make the story even worse than the upper line. So the problem doesn't go away with earnings. The problem is perhaps lessened a bit with our superior earnings and we anticipate that we'll continue to outperform most of the other public plans in the state and entities like Cal PERS, but it's not going to be enough to bail you out of the problem.

>> Alex Gurza: Okay. So moving the second section or the third section, would be what if we did nothing? As you know, the City Auditor published a report, on pension sustainability, in which she said that it's important that the city move aggressively to rein in pension cost that threaten the stability of the General Fund and the services it provides to the residents of San José. External reports, there are many. The little Hoover commission said that California's pension plans are dangerously underfunded, as I think can you see in looking at the data on our plans. And that unless aggressive romps are implemented now the problem will get far worse forcing counties and cities to severely reduce services and lay off employees to meet pension obligations. Unfortunately this is not a future issue. This is an issue that we are facing and our employees are facing now in terms of the layoffs and layoffs this year and unfortunate unanticipated continued layoffs in future years. A slide that the budget director has shown in the past is our rising retirement costs account for half of the '11-12 General Fund budget shortfall. Another slide that has been shown during the budget process is with the proposed budget, as Tuesday, we are going to be as with a number of city employees that we had in 1986. Which is a little bit of a sobering statistic considering how long ago 1986 was. And the fact that our population and demand for services has definitely not fallen to 1986 levels but have increased significantly. So what are some considerations? One is to not make any changes to the current level of benefits for either active employees or retirees, and just continue to pay the bills. Continue to pay the arc as it comes in from the retirement board. But we know however that's going to require continued reduction in services and layoffs to continue to pay for those growing retirement costs. The second is to lower the bill, so to speak, through reduced benefits or an increase in employee cost-shaving. So we want to summarize the fiscal reform plan that the city council directed the City Manager to produce. And the fiscal reform plan was not only about retirement, although it was a significant portion of it. The direction was to develop a plan to achieve $216 million in savings in five years, through coast reductions, and also, potential new revenues. The second one, which was to keep retirement costs at the fiscal year 10-11 level. And I'm going to come back to that a little bit later, with the goal of being able to restore or maintain police, fire, library and community centers to the January 1, 2011 level. The direction was come up with some savings so we can at least get back to where we were in terms of service to the community in January 2011. In terms of being able to open

the libraries, the community centers, the fire stations under construction and police substation within that five years. So that was the idea of the council's direction to come up with a plan that could accomplish that. The council direction specifically said that the cost savings could come from reducing compensation for existing employees. Now the 10% total compensation reduction is part of that. So we have captured the achieving, we haven't been successful quite yet completely, but if we were to be able to achieve the 10% total compensation reduction that would satisfy that goal. Avoiding increases in retirement cost, as I mentioned, reforming workers comp, disability retirement system, reducing cost of sick leave payouts, vacation buy-backs, overtime pay, health care plans and other organizational changes and efficiencies. So it was a wide variety of things that the council asked us to look at that are contained in the fiscal reform plan that is also available on the Internet for anybody to review, it is a quite a lengthy document but it goes through all of the recommendations. So with that I'm going to turn it over to the City Manager.

>> City Manager Figone: Thank you, Alex. Actually I just wanted to highlight one slide here for you, and that is the kinds of things that we considered in the fiscal reform plan. Certainly council had principles for us to follow, direction, and I think that the strategies in the plan successfully accomplish the goals that you set out for us. But we also, as staff, wanted to consider a few very important things. First of all, in our strategies, to consider the fairness to taxpayers, our residents, our employees and our retirees. We want to be as reasonable as possible as we balanced all the interests with the solutions that we brought before you. We did want to factor in and I think we did to the best of our ability, the legal risks. We've commented on those risks in the past, they're mentioned extensively in the document but certainly weighing those risks against the other very significant risks which would be the financial consequences that we are facing. And then finally, having a shared sacrifice between employees and retirees. As Alex has mentioned in the past and has clearly stated in the report, if any one population is off the table as we deal with this problem in particular in the area of retirement, the remaining burden falls to the rest of the populations and to the issue of fairness to our employees as well as our retirees, we just didn't think that was right. So Alex.

>> Alex Gurza: So in terms of the council's direction in the fiscal reform plan specifically related to retirement, as I mentioned the council asked us to try to lower the cost to maintain them at the 10-11 number. So that is in 10-11

the city was responsible for $186 million. I want to clarify. If you see a lower number it's because during that 10-11 year some of our employees paid for part of the City's contribution. What the city otherwise would have paid is $186 million. And we talked about the estimate of $400 million in 15-16. So if you subtract the two, we needed to come up with 214.7 million in savings. I mentioned one thing that is important, it is all funds. 214 million in all funds not just the General Fund. So this is a very quick summary of how we came up to the almost $217 million in savings. As I mentioned before, there is a much more lengthy explanation of each of the items in the fiscal reform plan that's available for then's review. We did recommend eliminating the supplemental retiree benefit reserve, at the very minimum, while there are unfunded liabilities. That would save $4.7 million annually. We are recommending reducing the health care premiums by coming up with a plan that is less costly than our current structure. And if we reduce health care premiums by 25%, it would have a direct savings to the unfunded liability on pensions. And this is something that employees and the city share a significant interest in. Because unlike pensions, the city and employees share the cost of the retiree health care include the unfunded liability. And there are increasing amount every year of contributions coming out of city and employee paychecks to pay for that benefit. So to the extent that we can reduce the coast it will have a reduction in the coast to employees and to the city, but on the city's side it would save almost $18 million. Now, in terms of a second tier for new employees, that reality, what our main consideration the more we thought about that comes back to the issue of risk. Because when we came back to the council on the second tier the council asked us to try to find a plan that would include total cost of city and employees of 12.4%. When we started analyzing it the issue of risk came back over and over again, because part of the council's direction was that part of the risk should be shared 50-50 with employees. What we started thinking about was if we instituted a defined benefit plan again, with earnings assumptions, for example, that may not turn out to be true down the road, the new group of employees, when there is another big loss in the retirement system, that 50% of an employee's check, 50-50 unfunded liability could turn out to be most of an employee's paycheck. We thought how realistic is that to develop a plan that has a potential of not being realistic? Can't have a situation where we would put a plan into place that would have employees make almost their entire paycheck to a benefit plan. And it gets down to the element of risk of the defined benefit plan. Our hybrid plan that would include Social Security plus a defined contribution plan that could be an amount to be determined as to what the city would put in. It really addresses that risk issue on the long term basis. For retirees, we -- our recommending is to reduce the cola from the current 3% to 1%. As well, retirees would also be affected by the lower benefit in the retiree health care side. But if you see on the lowering the cola to 1%, you can see that is $28 million. So that's a significant item. I want to go back to a minute on the new employees you see not applicable, on the cost of a new tier. The cost of a new tier, the savings really doesn't happen immediately, it's really with that configuration employee going forward so it really is a long term issue not an immediate savings as I mentioned before. And then for current employees to reduce the future benefits accrual, again, not the multiplier that has been used for years of services already worked, but the accrual rate for years moving forward, and the reducing the cola, that is a significant portion, $166 million. We did use examples in our report and I want to stress that those are merely examples. They also sort of dramatize that issue of risk. Depending on what level of confidence you want to have, the benefits are -- the lower the benefit can be, because you are trying to make sure that the costs are going to turn out to be correct. Now I need to explain this slide a little bit. This is again, this is not a recommendation. This really is only to show the impact that if the council still wanted to achieve the savings goal? What is the savings goal? Try to maintain the City's contribution in the retirement plans at the ten-11 level but didn't make any changes to the benefits of the retirees or current employees other than eliminating the SRBR which we're still recommending and lowering the retiree health care premiums by about 25%. You come up with we would need to still save $194 million. That takes the 216 minus the employee health care changes we are recommending and the SRBR, we would be left with 194. What would it be like if the city still wanted to achieve that savings, but just shifted the cost to employees? And again, we're not recommending this, we're simply showing it to show that it would require a 35% increase in the employees' contribution rates. When you add it to what employees already pay for pension and retiree health care, that's the chart on the bottom. If you look to the right, you are already at 50% of the employee's paycheck, which again, I can't say it enough, we are not recommending and do not think is viable. So if the council's goal is still to try to maintain these costs and try to keep them from heading to that 400 million, not touching benefits, it makes it, as you can see, impossible to do. The last thing that we wanted to cover is the concept of an opt-in program. There's been a lot of discussion about an opt-in program. An opt-in program is a very general term. There are many types of opt-in programs that could be structured. It is really that you provide an alternate retirement plan that the employees that are in the current benefit structure could choose or opt-in to. There is simply an option. You have a current employee and you develop an optional plan. And you say would you like to go into this new, reduced plan? There are a lot of considerations for opt-in programs, these are not all of them. Generally it presumes that no change should be made to first tier. It doesn't have to be this way, but generally when they're discussed or proposed, we have had a couple of bargaining units that proposes them. It doesn't do anything for the employees who choose to stay in tier 1, and then people would go into the tier 2. So it is a much different path than making changes in the first tier. The impact is clearly dependent on the number of people who choose to opt in but also on the demographics of the employees who opt in. As our retirement staff had told us, it could be very significant difference depending on the demographics, meaning the age, years of service. Who is it that ends up opting in? Not by name, but by demographics, can have significant effects because you can have adverse selection issues. Certain people in certain demographics are the ones that opt in. That could really impact the ultimate cost and/or savings. So in an opt-in program like this it is very difficult to estimate the actual savings. There are things one could do about having people sign up in advance to get a sense of it. We've had some bargaining units do surveys in how many people would opt in. It's difficult to count the savings, would you have to look back and see how it worked out. One other key question, is it the same plan offered to new employees? So in other words, is this opt-in program the same one that's going to be for new employees, or is it a third one? So are there three choices, the current employees, current employees who choose to have another one, or the second -- would be third tier for new employees. Other consideration is, do you create strong incentives to move into the opt-in program, such as employees paying higher contributions or even reduced pay if you choose to stay in tier 1. Again, that's just one way it could be structured. It could be structured more of just a choice to move and the employees could see a benefit from paying a lower normal cost or contribution rate, or it could be designed so that there are incentives to move into this program. Lastly, but definitely not least, is if there's an opt-in program, what is an accessible cost to the opt-in program? In other words, what benefit structure would it be, and what would the cost of that program be in terms of then you could then estimate the savings. So we have one slide that has a lot of lines on it and I'm going to do my best to try to explain. First of all, both the police unit and fire unit have proposed a fire -- an opt-in program. They are different from each other. About the for this purpose, we are showing what would the impact be if we had an opt-in program for Police and Fire, that was at a 75% benefit level? So the 75% maximum benefit that was in place for decades up until the mid 90s as I had mentioned before. So what you see here is the impact of doing that. So the blue line is the line you've seen before. So those are the contributions rates that we see if we didn't have an opt-in program and we didn't change anything, and it starts to go up precipitously as Russell had mentioned with a drop when the amortization period ends. The green line is if -- this is important to point out, is that if everybody in fire opted in, 100%, this is just to show you the maximum amount of savings. We do not think that 100% of the people will opt in but just for displays purposes, what would it be like if the 100% of the people opted in? That is the green line. The red line is police, if 100% of police opted into that program, that would be the projected cost. And the last line is that if 100% of current police officers and firefighters opted in. So you can see that there are savings, right? But it does not achieve the city council's goal of maintaining the cost at the 10-11 level. The key is how many savings and this is way overly optimistic, because we definitely don't think 100% of the employees would opt in to the second tier. What are the next steps? On may 24th the city council will be hearing the City Manager's fiscal reform plan and providing direction on key issues and questions. And with that, that is the end of our presentation and any of us would be happy to answer any questions you may have. Thank you.

>> Mayor Reed: All right. I'm sure we'll have quite a few questions to go with, start with Councilmember Pyle.

>> Councilmember Pyle: Thank you. That was quick. You're right, we probably would not ever achieve 100% from both of those. But it looks to me like it's a step in the right direction. In other words, as I see it, in a very simplistic fashion, if you had two boxes, one is the current retirement plan and the other one is the hybrid that is being proposed, it would take more people out of the first box, and therefore, cut the unfunded. I don't know any other way that we would -- but is that thinking accurate, Russell? Okay, I'm not off base on that?

>> Mayor Reed: I need to get the answers on the mic because other people are trying to hear this as well.

>> Russell Crosby: Sorry, yes.

>> Councilmember Pyle: I can't think anything else would help the unfunded as much as the opt-in would.

>> Russell Crosby: I don't know. I mean -- that is one -- the opt-in is one option.

>> Councilmember Pyle: Right.

>> Russell Crosby: And certainly the union --

>> Councilmember Pyle: So the main conflict with this is that it doesn't satisfy the requirement of the '10-11 or the '11-12 that council has come up with?

>> City Manager Figone: Excuse me, I think that's one issue councilmember. But if I could build upon your question a moment if you would indulge me. Because what I heard in your question is, would it help the unfunded? And I guess what I want to know from staff because I don't know the answer to that, is does it help the unfunded if people completely opt in and leave their old plan behind? Or if they freeze their tier 1 and then move in for the remaining years of services in an opt-in?

>> There would still be a reduction in the unfunded liability if they move only for future years, but it would be less than shown up there.

>> Councilmember Pyle: Okay, it is a step in the right direction so to speak. So a lot of that depends on how many people would be interested in moving and we don't know that demographic yet. So we wouldn't be able to come up with accurate figures.

>> Russell Crosby: And it's not just the number that want to move. It's the whole demographic package around the group that moved.

>> Councilmember Pyle: Exactly. Okay. So what would have to happen there? The people who are in the first package, of retirement plan as it is now, would have to be cashed-out, and put into the hybrid plan? In other words there would have to be some transfer of the money that's already been accrued I would think.

>> Russell Crosby: My assumption has been in would be done within the same trust fund so there wouldn't be transfers or anything of that going on.

>> Councilmember Pyle: So that entire step would be avoided.

>> Russell Crosby: Oh, yeah, you wouldn't want to go there.

>> Councilmember Pyle: So -- I wasn't quite as red as I thought I was here. But you -- would I like to ask, given a percentage, how much has our economic tsunami played in any of this? Let me give you a for instance. About the only country that I know right now that is out of their whole economic crisis is Germany -- well, Luxembourg as well. The whole world. So that problem is certainly going to cause problems for PERS as well. That really isn't an option for us to, say, scrap this plan and go with PERS. I've heard people ask about that. So I wanted to get some ideas.

>> Russell Crosby: I don't know that that's really the answer to your problem. And if you do go to PERS, you keep your liabilities. So your unfundeds would still be unfunded, and you would still have to deal with that in some fashion.

>> Councilmember Pyle: Right, there's the rub, yeah, okay. In other words they don't want us with all this unfunded.

>> Russell Crosby: No, you come with your baggage.

>> Councilmember Pyle: All right, well, that's a good answer to that one. And then on the --

>> Russell Crosby: And it's also important to note that PERS has notified its contributing employers to expect ongoing increases in contribution rates for the foreseeable future. So it's not like the city here is alone. Other employers that use Cal PERS are having contribution rate increases as well.

>> Councilmember Pyle: Well I'd like to think the city is ahead of the problem and I congratulate you, and Deb, and of course Alex, for being out there and trying to make it happen. I don't know of any other city that has taken quite as bold a step to curb the problem. And I may not sound like it all the time but I do appreciate that. That's pretty much it for now. But I may come back for a couple of others. But thank you. This is -- if this isn't like a pail of cold water in your face, I don't know what is. Thank you.

>> Mayor Reed: I have a couple of questions I'd like to ask. On your slide number 14, the assumed rate of return and earnings assumption. Probability of achieving the assumed rate of return. So I'm going to make sure I understand this. Five years from now, you think we'll be putting $400 million a year into the plans. That's the line that is the best case scenario probably. But even if we're doing that, we only have a 25% probability of having enough money, is that what this probability means?

>> Russell Crosby: Correct, that's what it means.

>> Mayor Reed: So if we want to have a 50-50 chance, we could have less or we could have more, but if we want to have a 20-50 chance we're going to have to put in more than $400 million to get there.

>> Russell Crosby: Correct.

>> Mayor Reed: And what happens out there in the future if we don't put enough money into the plans? Or we're putting in 400 million and that's not enough?

>> Russell Crosby: The beauty of actuarial.

>> Mayor Reed: Somebody eats in the future?

>> Russell Crosby: Absolutely and it will be more costly in the future than it is today.

>> Mayor Reed: The question is who is going to eat it in the future, is it going to be the city or is it going to be the retirees when the plans run out of money?

>> Russell Crosby: Well, both.

>> Mayor Reed: Potentially both?

>> Russell Crosby: Potentially both, absolutely.

>> Mayor Reed: One of the things that wasn't mentioned, what if we do nothing, if we cut more people or we cut salaries and we end up 50-50, 50% of your salary you get to keep, the other 50% goes into the plans.

>> Russell Crosby: Uh-huh.

>> Mayor Reed: The other alternative is what happens if we end up in bankruptcy court, with the powers of a bankruptcy judge to cram down, as they say in bankruptcy court, benefits? That's a risk that the retirees share and current employees share, we all share, a risk that we're desperately trying to avoid, because we're trying to manage this today so that we don't ever have to figure that one out.

>> Russell Crosby: There's one element I think is important to understand, too. That because of the funding ratio in the plans if for some reason the city shut off contributions into those plans, you've only got eight to nine years of money. The plans would exhaust themselves in roughly eight to nine years.

>> Mayor Reed: Another sobering fact. Your slide number 30, the projected all funds city retirement contributions, the $400 million problem slide. I understand that the police union hired outside actuaries and forensic accountants and came in and looked at the books. And I've been told that basically, they say yes, these numbers, including the $400 million number is something that we need to be worried about. Is that right?

>> Russell Crosby: That's correct. I've seen a presentation that the POA is using in their town hall meetings and they are mostly the slides that we've done the verification on for Alex. And they carry a label across the top, verified by POA actuary. So these numbers have been vetted by the POA actuary.

>> Mayor Reed: And I think they used Deloitte out of Chicago, is that right?

>> Russell Crosby: They did.

>> Mayor Reed: So they brought in good people, they looked at it.

>> Russell Crosby: Absolutely.

>> Mayor Reed: And they said, we have a problem, we collectively have a problem, they have a problem, the city has a problem, and the retirees have a problem. Have any of the other unions hired actuaries to take a look at the numbers?

>> Russell Crosby: Not that we had contact with. We actually met with the POA actuary, particularly Michael after that meeting to go over all his models and all the work that's been done by the outside actuaries to bring comfort to the ones hired by the POA.

>> Mayor Reed: And then I don't know what number the slide is of the opt-in program, slide 53 I think. What you've run there were sort of the proposals made by Police and Fire during the most recent negotiating process, modeled on those, right?

>> Alex Gurza: Yeah, those slightly modified again and I should be clear to be complete, the proposals are online. But for example, fire's proposal is the employees would actually share in part of the savings that the city would yield. So this is really overstating the savings, because that's their proposal. Police's proposal doesn't have that feature, of sharing what the city would save but it's a different benefit structure than that. So I want to be

clear, it's not exactly the proposals. We just took the -- to show sort of a maximum savings, we showed the lowest benefit, 75%, assuming the city would achieve all of the savings.

>> Mayor Reed: And as Councilmember Pyle pointed out this could be a step in the right direction. But it seems to me just looking at this chart, you could model an opt-in program that would flatten out those numbers. Now, whether or not anybody would opt into it, I think is the big question. I mean, that's the great unknown in any of this discussion about opt-ins is who, what, when and where and what are the demographics. But a variety of opt-ins you know could save in more money than these potentially if you get enough people opting into it.

>> Alex Gurza: Yes, Mayor, that's correct. And that's why I mentioned that one of the key issues is what is the benefit design of that opt-in, how much does it cost? As I mentioned in the slide that we showed earlier, the normal cost on the fire side can 38% or so normal cost. 38, I think it is. Yes, current. It's 39%. And that compares to the opt-in program, of 28% under the 7.75 assumption. So although yes, it's cheaper, is 28% of payroll under that assumption, affordable or sustainable for the city.

>> Russell Crosby: And I'd like to interject on this too, this is again using your best case scenario.

>> Mayor Reed: Oh, yeah, this is 100% opt-in.

>> Russell Crosby: Beyond that your base for --

>> Mayor Reed: The $400 million problem, which is the best case scenario. God I love it when the best-case scenario is horrible. But back to the opt-in issue. One of the incentives for our employees to want to opt into something else is the fact that they're paying already a substantial part of their paycheck into the retirement system. And if you designed an opt-in that would save them more money, then that may be more incentive and I guess that's sort of the task in the design of any opt-in program is for people have an incentive. So saving off of their existing retirement contributions and some of our people are above 10%, unlike some cities, our employees are paying a lot. So there's that potential to save some money for the working employees. And the other side of

that was the stick of layoffs, or cuts in pay, or increased cost-sharing as things that might have to happen. So there's the incentive to do it for a good reason, incentive to do it for a negative reason, and that all affects how many people and what the demographics are.

>> Alex Gurza: Mayor, I did want to mention however that this opt in program does not consider the contributions that the city and employees are making to retiree health care. Because we are right now simply phasing in to actually paying the arc that I mentioned before. So at the end of that we expect employees to be having 10% of their paycheck and the city, 10% just for the retiree health care portion. Even if the employees opt in with the same benefit there is still going to be substantial contribution for the retiree health care benefits.

>> Mayor Reed: Councilmember Constant.

>> Councilmember Constant: Thank you, mayor. Russell, I know there's been a lot of talk and I think Councilmember Pyle asked a little bit about how much of this is related to the stock market. You mentioned the S&P in there. But as a percentage of unfunded liability, how much is due to market factors, versus actuarial assumptions, and how did we get to this particular point? Have there been changes that have been made that have exasperated it?

>> Russell Crosby: Both of us are on the same wavelength. It's about 50-50 now and getting worse. But at this current moment it's about half, the loss half demographic and actuarial assumptions.

>> Councilmember Constant: And when you say getting worse does that mean the demographic actuarials are becoming a bigger part of the pie problem or a smaller part?

>> Russell Crosby: Smaller at this point, but it's likely that the new experience studies will cause that to continue or to go back the other way.

>> Councilmember Constant: Okay. And that actually leads me right into my next question. On the graphs that we have of the 20-year outlooks, which are on I think slides 33 and 34, and then again in the opt-in program slide that we have. So these are based on current assumption, is that correct?

>> Russell Crosby: Correct. And -- that's a good --

>> Councilmember Constant: So just a modest change of diagnose down to an assumed rate of return of 7.25 net or 7 what would happen to these numbers?

>> Russell Crosby: They would go up substantially.

>> Councilmember Constant: Do you have any idea how much?

>> Russell Crosby: If you look at the chart --

>> City Manager Figone: Slide 38.

>> Russell Crosby: Slide 38. Look at slide 38. And that upper line, the top line.

>> Councilmember Constant: Okay, so that's the Federated.

>> Russell Crosby: Yeah and that's probably, 60% of the change between the call it the mid-line and the upper one is related to the earnings assumption. The other 40% is demographics.

>> Councilmember Constant: And we could expect that the delta between those lines would be about the same in the other plan? It would just mirror the --

>> Russell Crosby: Assuming same changes are made but my guess is the demographics in Police and Fire are going to be more substantial. They're bigger issues over there.

>> Councilmember Constant: So that delta could become larger is what you're saying?

>> Russell Crosby: Yes. But they're likely to suggest the same discount rate. It's that they're bigger issues on Police and Fire.

>> Councilmember Constant: On slide 9 you list nine elements that affect cost. Is the reciprocity provision a driver of cost at all?

>> Russell Crosby: Yes, but it's small.

>> Councilmember Constant: Very small driver?

>> Russell Crosby: It's a tiny piece but it does have a cost.

>> Councilmember Constant: Then Alex, sorry I'm jumping around, I've got notes in several places. Alex on the defined contribution plan we have, the 457 plan, do we have an estimate of the percentage of employees is citywide?

>> Sharon Erickson: Actually, Sharon Erickson here. June 30, 2009 it was 72%.

>> Councilmember Constant: So 72% of our employees in addition to the defined benefit plan participate in a defined contribution plan on top of that, okay. Just wanted to make sure I understood that. And then Russell, I've received conflicting comments from different people. Do we allow employees to buy back time in our system, so if they were, I know some plans have air time where you can just buy time for nothing. I don't believe we have

that. But I also hear there's like if you are on a leave of absence or suspension or something for a certain period can you buy that time back?

>> Alex Gurza: Yeah, there's a variety of provisions Councilmember Constant in each plan, not all the same. But we generally do not have that concept of air time that exists in some PERS agencies. For people who don't know what we mean about air time, you just buy a year of service. You go into a system and say I'd like to buy a year. Those have been problematic for systems, because they are not putting in as much money as that year of service actually costs. We don't have that, but we do have various buy-back programs. Like for example, if you left city service, took your contributions out, then come back, it allows you to buy back that service. There is other miscellaneous provisions that exist in both plan but no air time provisions.

>> Councilmember Constant: I think this is my last question. On the Federated side, how much does the fact that we allow people to accrue a year of service without working 2080 hours, affect our plan? In effect that's air time, in my perspective.

>> Alex Gurza: While I think of the answer, I just wanted people, who don't know what that is, in Federated plan, if somebody works 1739 hours, paid hours, and I have no idea why, 1739, you get a whole year of retirement service credit. A normal year would be 2080. That doesn't exist in the Police and Fire plan. You have to have 2080 paid hours. But in the Federated plan if you took for example a leave of absence, you could still get a year of service credit or in your first and last year of employment. So see if they have --

>> Councilmember Constant: And that's about 15% of a working year in hours, somewhere around there, significant hours.

>> I think to the extent that employees work 2080 hours there is no quote-unquote purchase of air time. But if there is someone that works 1800 hours and gets a full year that person's cost is about -- there is about a 10% differential there. I don't know how many of those that work let's say 1800 versus 2,000.

>> Councilmember Constant: And then I did have one other line of questioning sorry for Alex on this. In defined contribution plans, not defined benefit plans, but if we were to look at a defined contribution plan, where is the risk overall, broadly? Is there a risk to the city? Other than the risk of making those contributions?

>> Alex Gurza: I'm going to defer to Russell on this one.

>> Russell Crosby: No, the risk on the city goes away, the risk is shifted completely to the employee.

>> Councilmember Constant: There's no unfunded liabilities?

>> Russell Crosby: Right.

>> Councilmember Constant: It's a very predictable percentage of contribution that can you calculate?

>> Russell Crosby: And predictable. Some of them based on the returns if you will, did you have a good year, a bad year and you make a contribution based on that.

>> Councilmember Constant: And even on the administration of those systems, we don't directly administer those systems, it would be like our deferred comp plan where we may have an oversight board but it is a private plan administrator that administrates it?

>> Russell Crosby: Normally that's the way it's done in that environment, yes.

>> Councilmember Constant: And are there defined contribution plans where they are self-administered by the employer?

>> Russell Crosby: Sure, absolutely.

>> Councilmember Constant: Is that fairly common?

>> Russell Crosby: In most plans there is a hybrid. The retirement system, the retirement folks deem with the defined contribution plan as well as the defined benefit plan.

>> Councilmember Constant: And then I already asked about the participation, but even if we have 72% participating, that could be participating as low as $20 a pay period or up as high as the max, whatever number that is?

>> Russell Crosby: Correct, yes. And it's important to note that's just employee money. It's just a tax deferred savings plan for employees.

>> Councilmember Constant: There's no match?

>> Russell Crosby: There's no match. Yeah.

>> Councilmember Constant: Okay, thank you.

>> Mayor Reed: Councilmember Herrera.

>> Councilmember Herrera: Thank you, mayor I wanted to go back to the unfunded liability, and Russell, can you tell me what, in terms of the investment losses, what's the total number again that we recognize the -- I know we're going to recognize it over five years but what's our total investment loss back in 2008?

>> Russell Crosby: It's roughly a billion.

>> Councilmember Herrera: So if I understand this right in the five year smoothing rate we are recognizing 20%?

>> Russell Crosby: Each year correct.

>> Councilmember Herrera: That's where we get the additional underfund?

>> Russell Crosby: That's correct.

>> Councilmember Herrera: And each of those tranches if you will, that's recognized in the 20% per year that's being paid 16 per year?

>> Russell Crosby: 16 in Police and Fire and 20 in Federated. The initial tranche was 20 in Federated but then subsequent ones are 20.

>> Councilmember Herrera: Okay. If we were to extend, if we were to amortize the tranches over 20 in Police and Fire, would that be best practice, and would that help us any, and how would that help us?

>> Russell Crosby: Best practice, it would be closer to standard practice, I wouldn't necessarily call it best practice.

>> Councilmember Herrera: Would it be with the realm of approved accounting practices?

>> Russell Crosby: Oh, absolutely, absolutely, and we've discussed that with some of the labor groups.

>> Councilmember Herrera: And what would that do, though, to our numbers, what would that do to contribution?

>> Russell Crosby: Well, in the near term it would lower them. You would end up paying for a longer period of time. In Police and Fire where you see that peak that goes up to 320, 315 million, that peak would be lowered, but then you'd run --

>> Councilmember Herrera: Extend out?

>> Russell Crosby: Like in Federated if you flip back one, you'll see -- the graph would look like this. For the 20-year period it would just go up.

>> Councilmember Herrera: What would it do for the next five years, though? And if you don't have the answer can you get back to me? I want to understand what that would do.

>> Russell Crosby: It would roughly -- $7 million a year roughly.

>> Councilmember Herrera: 7 million a year less of a contribution weed have to make?

>> Russell Crosby: Correct. Yeah but it's important to keep in mind that at the same time, you're going to be integrating demographic changes and other issues into these planned. So even if you extend to 20 years you're still going to have contribution rates go up over time. Don't assume that you're actually going to see that 9 million by extending the amortization period.

>> Councilmember Herrera: But even if that's true if you had the other factors adding to it, it would still be less of an increase.

>> Russell Crosby: Correct.

>> Councilmember Herrera: I'm trying to look at anything it is within best practice that will help us tone down the pain. I mean it's -- you know anything we can do that is reasonable within good accounting practices.

>> Russell Crosby: Absolutely and in our meetings with certainly the POA actuaries, our discussions revolved around we certainly would be -- we staff would recommend to trustees an extension from 16 to 20 years but in the context of fixing some of the demographics in the plan at the same time. We would not recommend to trustees that they just change the amortization schedule without recognizing other issues within the plan statement. But changing the amortization schedule would help lower the overall impact of recognizing those demographic issues.

>> Councilmember Herrera: Now, it was my understanding that in terms of this unfunded liability, that demographics are not included in that, this is all the investment losses that we're looking at right now.

>> Russell Crosby: No.

>> Councilmember Herrera: Okay.

>> Russell Crosby: It's 50-50. It's roughly 50-50 at in point. There's demographics and then there are the losses as well.

>> Sharon Erickson: If coy pop in, Sharon Erickson again. The governmental accounting standards board is talking about changes to the way that we account for some of these things. Those changes, we won't know what they are until summer of 2012. But they could be effective as early at 2013. A lot of it is just accounting changes but one of the things that concerns me is just another risk that we face, is that they could require the city to recognize unfunded liabilities on reducing the amortization period. So the 16 and 20 that we have now, one of the things they're talking about is that retirees remaining service life would be zero. And they would require us to do some kind of an average. So those amortization periods that are sanctioned by GASB, which is slightly different than what actuaries will use, but it could be relevant in the near future and those amortization periods could be coming down. So I would just caution against lengthening amortization periods at a time when we're hearing from the accounting standards board that they may be forcing us to take those numbers down, rather than a --

>> Councilmember Herrera: Erin said she brought up GASB. Can you explain how that affects us, do they really set standards for us, do we have to follow that? How does GASB work and what other changes are we expecting that might -- I know there's retiree health care and I know that's another issue that might be changing.

>> Sharon Erickson: You know I'll take the first shot at it. The amortization period is the one I was most worried about. The rest of it is actually accounting changes recognizing on our balance sheet what we already recognize in the back of our financial statements. Now, one thing that they would do is require everybody to recognize what we have already recognized, and fully disclosed in our financial statements. It is not clear that any of those accounting changes would affect the arc. The annual required contribution. So that's where it kind of separates. Right now I'm seeing our problem as a cash problem more than a balance sheet problem. Most of the GASB changes would affect the balance sheet. But I am concerned about the amortization period, if they bring that down, that could affect our annual required contribution.

>> Councilmember Herrera: Now, the balance sheet changes you talk about how would that -- would that impact the city? Could that impact us in terms of credit, in terms of how the financial sector sees us? So that would be more --

>> Sharon Erickson: Yes, so what would happen on the balance sheet for the City of San José is relative minor compared to what other jurisdictions would face in part because we always pay our annual required contribution. For those jurisdictions that don't, they would have to recognize the arc, as an expense. So it really is going to hit financial statements hard, and is a reason why San José is in much better shape. Because for decades we have always paid that annual required contribution.

>> Russell Crosby: Maybe I can add a little bit, too. The GASB changes are not going to impact the trust funds. They are really directed at the employer's accounting. In that regard, at least the proposals that have been floated would require the employer to book potentially a different number as an arc and as a liability than what the trust fund at the other end calculates. So GASB is, in effect, introducing a disconnect between the trust funds and

the employers. The employers are going to have to reflect on their books in a standardized fashion, the liabilities related to their trust funds. The trust can still develop a contribution rate that's different, it can still develop the liability picture that's different. But where GASB is heading is forcing employers to disclose on a consistent basis and that's really their driving effort. They don't want to take on the issue of fiduciary discretion, trustee discretion, but by forcing the employer to disclose on a consistently basis eventually it will get back into the trust fund.

>> Councilmember Herrera: Thank you. That's all my questions for now.

>> Mayor Reed: Councilmember Rocha.

>> Councilmember Rocha: Thank you, mayor. I'm going to follow up on the demographic changes that you talked about. How are they implemented? You mentioned that they are not instituted and you're suggesting to the board that they do that. How does that process go if you don't mind?

>> Russell Crosby: In the next valuation, the actuary will come forward and say that among other things, police officers and firemen are living longer in retirement than anticipated. The merit increases that have not taken place over time, certainly in recent years will be certainly reflected in there. Early retirements, yeah, particularly the flow-through of pushing people, not pushing people but people retiring in droves during this year, that's going to be reflected in there. And that's a negative influence. So you've got some positive items, some negative items and, we believe, overall, the direction is going to be negative.

>> Councilmember Rocha: And salary reductions would be included in that?

>> Russell Crosby: Would be reflected there. The actual -- what gets transmitted to the actuary is the actual salary amount for the year and that becomes the basis for them then projecting salary going forward.

>> Councilmember Rocha: Sounds like this is an agreeable thing, it is not a negotiation that these are included, you just include those based on what's happening in the real world?

>> Russell Crosby: Normally, that's what happens. If you don't, the board could take the recommendation and say well, we're not going to do that. What happens is like the mortgage, the longer you delay implementing those kinds of changes, the more expensive when you do implement them, it will be.

>> Councilmember Rocha: Okay, thank you. The unfunded liability is measured out in how many years? Is that the 16 and 20 you talked about or is that -- is it a 30-year? And you can't measure it in my mind, you can't measure it forever because eventually those commitments end, unfortunately.

>> Well, the calculation of the unfunded goes up 80 years.

>> Councilmember Rocha: Okay.

>> But it's recognized or amortized as a cost by the city over 16 years for Police and Fire, and 20 for Federated. But there is a large component of the Federated unfunded that's now at 28 years. And it used to be 30 and the board decided to close that, so that it would decline eventually, one year at a time. But anything that was recognized beyond that is that 20. But most of the asset, a good portion of the asset losses that took place, you know, over the last three years is on the 28-year schedule but it's going to be then 27, 26.

>> Councilmember Rocha: Okay, so then I'm looking at that, we've got a -- that's measured out in a long time here. And I feel as though we're pushing the envelope to try to fix the structural problem in a year or two or whatever it may be. And it's always good to try to fix structural problems absolutely we need to. But in your professional opinion the aggressive time line, is that a good move? I'm assuming, just being fiscally conservative you're going to say yes, fix it in six months if you can. But if I may ask your professional opinion on that.

>> Russell Crosby: Well, it's -- I don't see it as an aggressive time line at all. The change that was implemented in Federated was initially on a -- in reducing the earnings assumption was put on a five year schedule ramp-in and that's been reduced to two. But you're still -- and even with these changes it's important to note that San José is

now just catching up to the world. It's not like we're way out in front and doing something different or special particularly compared to other California plans. I looked at a report yesterday that of the 18 or so large public plans in the state the vast majority are at or below where San José is, in its earnings assumption, for example. There are only five plans that are more call it aggressive. What's being done here is not precipitous in actuarial terms. Is not fast-moving or dramatic. I mean, it really is, things in some cases that needed to have been recognized some time ago, particularly the demographics.

>> Councilmember Rocha: This sounds a little different than the comment I heard from the City Auditor about San José being on the front end of paying its full --

>> Russell Crosby: Well --

>> Councilmember Rocha: Help me understand that difference of opinion.

>> Russell Crosby: I'm looking inside the operations and rather than kind of the headline aspects of it. But what's going on here, and the auditor is correct, it's going on in every public plan, everywhere in the country. There are no plans that are exempt from this problem. So --

>> Councilmember Rocha: Which I don't think anybody disputes.

>> Russell Crosby: It's everywhere, and everyone has the same set of issues. And the plans are by and large and the actuarial profession by and large is dealing with it in the same fashion. The actuaries regardless are coming forward with recommendations to lower the earnings assumption, to recognize what's been going on with demographics, earlier retirement, later death, longer periods of actually receiving pension benefits. Those things are -- and actuaries true them up every year. That's what goes on. And that's what's happening here. And we're not recommending any kind of aggressive go to the maximum on day 1. That would be an earnings -- that would get you to an earnings assumption of 50-50. And in Segal's view that would be 6.93 for Police & Fire and that would be 6.75 for Federated. So we're not talking anything like going -- or going to a risk-free rate, taking risk out

of the system entirely. You couldn't afford that, you've seen those contribution rates, there's no way to get there. This is not precipitous, it's not overly conservative. It is measured, it is on a consistent, call it progress towards more accurate valuation results.

>> Councilmember Rocha: So your answer to my question then, is it specific to the assumptions you're talking about? The returns, the infinite liability, the health care, our are you talking about the fiscal reform that's presented by the mayor or the City Manager?

>> Russell Crosby: No I'm not --

>> Councilmember Rocha: So what are you talking about, in terms of not being overly aggressive time line?

>> Russell Crosby: Our changes within the plan, our changes within the valuation. I've expressed no opinion on anything else.

>> Councilmember Rocha: Gotcha, thank you, just being clear on my question. You had mentioned the defined benefit and defined contribution, zero liability on the defined contribution model. Can you design a defined benefit that has language in there that states that the liability is completely borne by the employees or retirees?

>> Russell Crosby: Sure, but that's the slide that Alex had that shows --

>> Councilmember Rocha: But you can do that.

>> Russell Crosby: Yes.

>> Councilmember Rocha: Okay.

>> Russell Crosby: But the problem is the contribution rate would be so high and particularly in any kinds of future downturn, you potentially could wipe out all the employee salaries for some period of time.

>> Councilmember Rocha: Well then so for me to understanding that if we look back and jump back to where our funds were 80% funded which was the industry projected norm or where you should be, could you make that statement then?

>> Russell Crosby: Can you rephrase the question?

>> Councilmember Rocha: When you said the contribution would be so high, it wouldn't be affordable, well, if we --

>> Russell Crosby: No, it's the same problem. You end up with-d doesn't matter whether they plan 60% funded 80% funded or 100% funded. If, in the event, that you are having the employees completely share in the unfunded, any unfunded liability that might occur, even though none exists at that moment in time, the next valuation, you could have a, in 2022, a 2008 plus 10%, could you have a 50% crash.

>> Councilmember Rocha: Well you could but --

>> Russell Crosby: Well what you're building is something that's going to be in place for 20 or 30 years, potentially even more. And from the get-go you don't set up something that is going to shift so much of the liability offer to the employees, that there's no way that they could accept that liability.

>> Councilmember Rocha: I'm not suggesting that. I'm just wondering if you can do that.

>> Russell Crosby: Hope I'm addressing that, there is no way to shift all the risk in a defined benefit plan off to the employee. They can't withstand that type of risk.

>> Councilmember Rocha: A recession drop.

>> Russell Crosby: A recession drop. Any number of things. Maybe the demographics begin to change over time to where instead of dying at 85, we're all dying at 100. That's a huge impact on the trust fund.

>> Councilmember Rocha: In your experience though that doesn't happen annually.

>> Russell Crosby: Not annually but it happens over time.

>> Councilmember Rocha: You also mentioned the Cal PERS increase, there's some increases that they are asking their participants.

>> Russell Crosby: Right.

>> Councilmember Rocha: That would seem to me and given the market crash, everyone is affected. But noting the Cal PERS increase everyone has an increase as well.

>> Russell Crosby: Uh-huh.

>> Councilmember Rocha: You also in the city budget had listed in the returns I thought were pretty interesting. 270 million the funds outperformed. Can you maybe explain a little bit, let me find the page, what that means? Because there's also some numbers that followed immediately thereafter. And what they are in real dollars -- excuse me I have all kinds of papers here. So it states, outperformed expected actual return by approximately $277 million based on combined assets of $3.9 billion. The out-performance to that of Cal PERS translated to approximately $139 million, basically $140 millions in dollar terms. What does that mean?

>> Russell Crosby: Means you should say thank you to your retirement staff.

>> Councilmember Rocha: Thank you.

>> Russell Crosby: For starters.

>> Councilmember Rocha: What's the difference between 140 and 270 so I understand what that means?

>> Russell Crosby: Sure. The big number is against your actuarial assumptions and we blew that away. Then compare ourselves to the performance of Cal PERS, because there are questions about well, shouldn't we be in CalPERS, well there's the answer.

>> Councilmember Rocha: Gotcha.

>> Russell Crosby: Is that we sent you an additional $100 million. And then the last number is I think against the median public plan in California.

>> Councilmember Rocha: Can you explain what that means?

>> Russell Crosby: Well that's everybody else in the state.

>> Councilmember Rocha: When I asked this question in the budget meeting it was 8% in one fund and 7.75 in the other fund is that correct?

>> Russell Crosby: No Police and Fire is down to 7.75 now and Federated because they're in this ramp up thing they're I think 7.95, 7, at this point. But they're headed towards 7.75 as well.

>> Councilmember Rocha: Okay, would you project, so this is looking at 10-11 to date.

>> Russell Crosby: Uh-huh.

>> Councilmember Rocha: And then looking forward projection wise, when do you establish those projections or have you already?

>> Russell Crosby: Well, they're not projections, we'll know the actual year shortly.

>> Councilmember Rocha: For 11-12, though, do you project forward?

>> Russell Crosby: We can only project using the actuarial assumption --

>> Councilmember Rocha: In your line of work you don't project forward?

>> Russell Crosby: -- various aspects of the market. Well, and what we've done with these charts is, we've assumed that our returns through -- because the question is, well, the returns have been great this year, you know, isn't the problem gone? And so what we've done is take our actual return through March 31st and then we've thrown some extra based on what happened earlier in the year, just assuming it's a straight line and that would give us returns of 19 and -- 18 and 19 between the two plans. And we run that through the system. And we're anticipating that certainly I'm anticipating we should again outperform Cal PERS and we should outperform the other plans in the state.

>> Councilmember Rocha: Okay. Want to jump back to again questions outside of the presentation. We've looked at and commented on and critiqued second-tier proposals or opt-ins from some of our bargaining units. So yet we have yet to design one ourself. But yet we critique other ones and point out the flaws but we don't design one ourselves. Now can I ask if you've been asked to design a retirement system or run?

>> Russell Crosby: No, we haven't.

>> Councilmember Rocha: Okay.

>> Russell Crosby: And quite frankly we're not really in that business. I've spent a lifetime administering trust funds that are negotiated between unions and employers and Mike is an actuary. But to sit down and design a plan is a different kind of consultant than either one of us. It's a benefits consultant, it's an HR type individual. And that's a whole different skill set than an actuary and a pension trust administrator.

>> Councilmember Rocha: So then if you were given the framework of the design of a system you could run it to show what --

>> Russell Crosby: Correct.

>> Councilmember Rocha: That system would look like and no one asked to you do that?

>> Russell Crosby: Correct. We are best at costing a system, we're best at costing things out.

>> Councilmember Rocha: Were you asked to have input into the fiscal reform plan from the MBA from the City Manager's office?

>> Russell Crosby: Well, in the sense that yes we provide the analysis, yes we provide the numbers.

>> A lot of the charts.

>> Russell Crosby: A lot of the charts, most of the charts, any number you see up there has been vetted by us.

>> Councilmember Rocha: So you were given information then you put it into a slide?

>> Russell Crosby: We've been working on scenarios for some of the large unions and for the city. We provide, call it both sides, with you give us a scenario and we'll give you back the cost. And in the negotiations I believe

that's been helpful, with Alex and certainly the police POA, to get to a common understanding, and acceptance that our model for POA -- for Police and Fire is good.

>> Councilmember Rocha: I agree, it's been helpful.

>> Russell Crosby: If you want to drop stuff into it, make a suggestion and we'll modify the structure and away we go and here is a cost, here's the contribution rate.

>> Councilmember Rocha: That's what I'd like to do, have us design and hand it to you and you can show us what that system is look like. In my mind you can use historical trends, was that sustainable pre-2008, was it sustainable post? I'm also interested in looking at what the benefit looks like at the end of the day, at the outside to the employee. Because we talk about a lot of numbers in here and what the savings are so those are savings. I still don't know what those look like to a retiree. And I'd really think that would be helpful to understand, when we debate these issues and talk about you know significant fiscal year reform, I don't even know what it looks like at the end of the day for an employee and that's hard to make decisions on something like that without knowing what the impact is.

>> Are you talking about like a replacement income when someone retires are they getting 20%, 30% of their final salary?

>> Councilmember Rocha: Yes, generally.

>> Something like that.

>> Alex Gurza: Councilmember Rocha --

>> Mayor Reed: Before you move on the City Manager has something.

>> City Manager Figone: I wanted to clarify a couple of things councilmember. Just to remind everyone, the retirement director works for the City Manager. The role he tries to play is one that certainly balances in terms of his credibility with the board's the unions and then whatever the administration might need based on council direction. And so one of the challenges in designing a new plan is getting back to the fundamental question of what is the council's goal in that plan. And so I think that it becomes somewhat circular and I completely understand what your interest and maybe even frustration is. So one of the things we're going to want and need as the council debates this issue is what is it that the council is trying to achieve so that then we can design a plan with the right people, and the right costing, that then can convey to you not only what the city saves, the employee saves but what that means in terms of the employee's benefit and what they will have to sustain themselves. So that's really why that initial direction is so important for us.

>> Councilmember Rocha: Gotcha and I wouldn't want to try and compromise anyone's credibility. But so to your point then when you're looking for that direction from council, so let's just hypothetically we adopt the fiscal reform plan. Are we going to know what that input output is before we decide on that?

>> City Manager Figone: Excuse me, Alex can help you. The direction would initiate the process by which we would work on options, design those through the meet-and-confer process, through our own calculations, and then ultimately at the end of the day, it's going to be council, who will be part of that ultimate decision-making process through contracts, hopefully where we've reached agreement. And is that a fair representation, Alex?

>> Alex Gurza: Yes, I don't think it's that different when we were negotiating retirement benefit increases. When we were negotiating retirement benefit increases, they happened at the bargaining table with direction from the city council. So I want to mention a couple of things to be clear. The city council has not directed the administration to negotiate an opt-in program. If the city council at a future date wants to go down that path, that's why we mentioned we're not critique the program, we're saying it is an alternative, but there are some considerations for the city council to decide. But it's a different path, so we have to decide what path are we going down. If the council directs us to go down the path of an opt-in program, we would be seeking council sort of parameters, around how much do you want it to cost, how much do you want it to save. And the actual design of

the program is negotiated with the bargaining units. In our fiscal reform plan we used examples, and we went to great lengths to say they are simply examples. But the actual design of the program is the subject of collective bargaining, as it was when we were negotiating benefits upward.

>> Councilmember Rocha: So when we talk about concessions we often talk about to my point earlier what the savings are. This is the savings that we need to achieve and this is the benefit to the employee. These are the savings we need to achieve, this is the impact, but I still don't know what the dollar value is or impact is to the employee. So designing a system to me we can talk about all the guiding principles. We've got a lot of direction that we've approved, from the January 25th meeting with cola, retirement age, pension formula, final compensation some average over three years, hours needed, full time equivalent, survivorship benefits, retiree health care benefits, 50-50 cost sharing, I can go on and on in the Mayor's Budget Message, we've got a lot of unanimously approved direction from the council, and I'm still looking at now an MBA that is -- it talks about what -- a lot of these things to do and to get there and the cost savings, but I still don't know what that system's going to look like. And I'm concerned that manifest destiny, we'd move forward on that, and I still am not going to know at some point what that benefit looks like to an employee, and it should be a factor in my consideration. I'm interested in the cost savings, and it's necessary. And I don't dispute the necessity of it but I really would like to know what that outcome is prior. And to only have one outcome. Because in some cases we've often as a council in the past I've seen we've had two options to look at. One this one, the one we need, two another version or three another version. One a nice version one a poor version one a moderate version. But in my mind I'm not going to have that to my advantage to make a decision. I'm going to be left with just this. And I understand there's the meet-and-confer process but we can still run -- design a system and run one out to take a look at what the outcome of that benefit is.

>> Alex Gurza: Councilmember Rocha I apologize that I don't think we met our goal in the presentation this morning to really emphasize enough of the key questions we think the city council needs to make, and they're really on this slide. We need to know how confident the city council would like to be in the cost estimates. Because we can design the program that looks like the benefit is very generous, estimate the cost but it turns out to be much more expensive on that. There are key questions that the council last to decide. If we use

a 7.75 assumption, regardless of what the board uses, to calculate the benefit it could buy we could then run those scenarios and look at that benefit. The question for the city council is how much risk do you want to take on that those costs are going to be accurate. We've designed and shown examples, there are key examples that the city council has to grapple with then send us off to what the scenarios are. We've shown the impact of the risk and I think it all comes down to risk.

>> Councilmember Rocha: Gotcha. Got it. But again we go back too when we make a decision it's a one decision and we don't have another version. So let's just say hypothetically, we have 90% and 75% right now payout in salary on that. If we dropped it down to 50 and 60, could we sustain that? What would that do to our unfunded liability? What would that do to our retirement contribution, I rolled through, cola increases, I don't know what that's going to look like. If we don't have that exercise I can go back on the same path and talk about my concern and make a decision without knowing what that is. So I'll skip off this topic. I'll let some of my colleagues go and I'll come back if you don't mind.

>> Mayor Reed: That will be fine. Return to anybody who's got questions before we get done. I'm sure Councilmember Oliverio.

>> Councilmember Oliverio: Thank you, mayor Reed. I just want to first comment on the presentation. I've sat through a lot of these, and I think it was a very good presentation. I think it was slow, step-by-step, it explained very well the system, some of the things that are always quoted in the paper, whether it's unfunded liability, et cetera. The question for you, because I believe it's a good presentation and explains everything between Russell, Alex and Sharon, do we plan on doing these for the retirees association, for example, to have that discussion, I know there's several retirees in the audience. But do we plan on doing that? Would that be something we'd be looking forwards to City Manager?

>> City Manager Figone: Yes, absolutely. A lot of going to depend on the direction we receive and the amount of time to both bring everybody up to speed and meet and confer but yes absolutely we will do our very best.

>> Councilmember Oliverio: Because I've been to several of the brown bag luncheons where you provide with Sharon Erickson and others, that talk about the budget with the employees, I think it's good to get the Q&A. I think it's good for people if they have a particular question for the particular slide they ask the question on the particular slide. We need to be on the same page. I know our Police Officers Association, which mayor covered, hired the actuarials, has found that the current systems, as is quoted many times, unsustainable. Russell, when you took this job, did you do your due diligence?

>> Russell Crosby: Well, as I've explained to Alex a couple of times, it's not about the job. It's your location.

>> Councilmember Oliverio: Fair enough. But you know, but coming in, you sort of -- did you sort of examine what you were getting into, okay I want to be in sunny San José but it's a system that I'm going to have a nice fun time or I'm going to have some challenges in my career?

>> Russell Crosby: I knew from people in the industry that there was a mess here and people in the industry encouraged me to come here. Very strongly. That a contribution could be made, that there's a need, in San José. And that, plus your 45 minutes away from San Francisco.

>> Councilmember Oliverio: Fair enough. Well, thank you Russell, I've enjoyed your comments here and your insight and you've been doing this for a long time. Here's a question and this might be a little bit odd but since our fund performance better than other funds, as a way to keep the fund alive or as a way to bring in new revenues to support it is a pension fund allowed to sell shares to the private market outside the closed fund?

>> Russell Crosby: I've mentioned to Alex a couple of times, what I'd like to do is sell our services. I believe that there's real possibilities there.

>> Councilmember Oliverio: You would manage another portfolio?

>> Russell Crosby: Oh, absolutely. It's called CIO in a box. My problem though and I've told this to Alex is a lot of those newly hired high-powered folk have decided to go. So we're back to square 1 on building the staff.

>> Councilmember Oliverio: Okay, fair enough. And then I think we've covered multiple times the arc and I sometimes think well, you know if we just don't pay it and then you said to the mayor well if you don't pay it, you're going to run out of money to make the payments as Sharon Erickson and you both said in eight to nine years so sometimes I think well couldn't we just walk away, it's like a house that I got a funny business with but in the end it's kind of like walking away from a louse that your friends are still in and you've left your friends in with no heat and no food. So I think in the end there's this responsibility to pay because we have a set of people that are dependent on it, on keeping that up. And I think your presentation acknowledges that the math does not work. Since the chart says, you know, you don't have the probability of actually getting the return. And it's a very simple thing, saying, I don't have a chance of actually hitting it. And if I don't hit it, it's an unfunded liability. And that unfunded liability is either going to go to the employees, reductions to the retirees or to the taxpayer. Now, we keep talking about the losses of 2008. And that those will get burned off on a chart I saw around 2025. But my guess is between 2011 and 2025, I'm bound to have recessions, more than one, that may affect that burn. Correct?

>> Russell Crosby: And you're also going to have bad news on the demographics. So between the two pieces, most actuaries in the U.S. don't recognize the ongoing improvement in longevity. That's going to happen. Whether you recognize it or not, people are going to continue to live longer. Who knows where the upper bound is? Maybe right now, 85 is check-out time. But it could well be, during that next 20 years, 90, 95 becomes the norm. In that case, the extra ten years has never been funded.

>> Councilmember Oliverio: And then to the actuarial on your left, and pardon I forget your name.

>> Russell Crosby: Mike Maley.

>> Councilmember Oliverio: Mike, as an actuarial, I know you're into statistics but when you look at the average life expectancy, does your industry look at advances in medical technology to allow people to live longer or is that based on when people die and it's a number?

>> It's really a number. They use statistics from basically large life insurance companies, it is a very convenient gathering organizations, because the insurers have large databases. But our view is that you know you have to have some margin for improvements. And Russell has mentioned demographics on the Police and Fire side. We know there's no margin there. In fact it is in the other direction. So that's one thing we're concerned about.

>> Councilmember Oliverio: So it's sort of interesting just on this point, you have two sides rooting you on, right, you have medical technology and healthy lifestyles and you've got McDonald's, right? So it seems like where are people going to end up? But I think we'll figure it out, the plan will figure itself out. The new employee, we're getting to the point that I've said all along, which is defined contribution. A 401(k) plan is the only plan that has no risk. Any other plan you design that tries to have no risk is going to be too expensive to the employee, because no one's going to want to work here if 72% of their paycheck is gone and they're making a pittance.

>> Russell Crosby: If I could though, if there's no risk to the employer, all of the risk is then shifted to the employee. I feel that needs to be understood that there are people graduating out of systems that have worked 30 years in a 401(k) based environment and they've contributed maximum levels and done tall right stuff tall way along the way you potentially end up with not enough to retire on.

>> Councilmember Oliverio: And I'm glad you brought that up because coming from private sector and having a 401(k) I sort of looked at the math that even if I max it out every year and unfortunately I've never worked for a company that matched me a penny and the average match is 3 to 6%, it really, for the person in the private sector to retire, not only do they have to have their 401(k) but they actually have to save additional money to try to make it based on that. So even before this perception issue became an issue, as soon as I understood the ratio was a 250% match with a guaranteed rate of return, I was like, I don't understand how you do it. Because eventually, especially with the things of lower amount of workers, supporting retirees which is the same thing we have in our

Social Security system, we know we used to have I forget what the number was but I know it's the same, we are northern hemisphere part of the world that has a lower birth rate and less people working and we have to figure a way to pay it out. I see that as the way we have to go for the new employees. And I think then the city can offer a match. And a salary for the positions that are hard to recruit. I mean I think that's where we're going. And then, how would we, if we chose, close the plan? If we decided that the liability was too much, I know we're sort of on the hook for it. But is there a way -- I know they close private pension plans. How do you close a public pension plan?

>> Russell Crosby: I don't know. I've seen private plans close before. One thing to keep in mind, when you do that. The contributions, I hate to draw graphs in my hands, but the contributions in the current system are back-loaded. Meaning that they go up over time, and that the actuaries are counting on new employees coming into the system and all the minute that you close the plan, that upward sloping graph of contributions over time shifts the other way. And you have much higher initial contributions to kind of close and pay off the plan. Maybe Mike can describe some of that.

>> That's correct. In fact if you were to go to an insurer, then this plan would be much more expensive than the current actuaries say it is. Because the current actuaries assume about 7.75% return. The forward actuary would give you maybe four or 5% on your money. It is also very difficult for them to build in this 3% cola. So it would be extremely expensive if you went out to buy an annuity contract, even if you could do it, it would be extremely expensive.

>> Councilmember Oliverio: The reason I ask, is it going to be a difficult thing for this city or other cities or other states to manage, then maybe taxpayers have to be talked into raising revenue to pay it off so then can you move forward. I mean, I don't know. Otherwise you know, as Councilmember Pyle and others talked about, then there's the opt-in thing to sort of remove some of that cost. But I think it's important to note that you mention that we're not -- what's looking forward here is not taking anything away from a current retiree, granted you are deciding to put open here that the automatic escalator, the compounding escalator is a little bit different number than it is. And if I'm correct Social Security hasn't paid any cola in the past few years and many pension plans are on 1%

cola. And then when we look at the billion dollars that was lost by the retirement funds, my quick analysis is, it's the independent retirement boards who chose to take a high amount of risk, to get the anticipated rate of return was a reason for some of those losses. Or how would you typify that?

>> Russell Crosby: I might share the wealth of blame a little bit more broadly. It's not just the trustees, but the others.

>> Councilmember Oliverio: But if you have to shoot for this number right, and that's my rate of return then I need to eventually try do something to get it, which is a higher level of risk than just sitting in a bond?

>> Russell Crosby: Exactly. And certainly the plans that I worked for in the past during the '90s when you were looking at stock markets going straight up and that's when these plans appeared to be either close to or fully funded, those plans stepped back from the market at that point and said okay yes, markets have been great, everything's wonderful but let's start de-risking the plan. And certainly the mine workers plans, retail workers went the opposite direction of improving benefits and increasing earnings assumptions, they went the other way. They lowered earnings assumptions and sealed benefits and paid for things and cleared the decks for a day when in 2001 you've got a crash, in 2008 you've got another crash. You may have another crash in, call it, 2012, you know, the world is coming to an end in 2012, so you may well have another crash. And when you look at the economy and what's actually going on in it. You've had quantitative easing going on, you've been printing money and issuing debt like nobody's business, that comes to an end in June of this year. The economy's going to continue on for some period of time, six months, nine months a year, but there's a day of reckoning coming next year, that what props up the markets anymore? Once the printing press is disengaged and what's really happening, it's flowing into commodities and it's flowing into stock market and it's propping up both of those asset classes very nicely. But what happens next year when all the effects of quantitative easing have moved out of the economy, that you potentially have another crash coming. So you can't disregard -- and we call it in the investment business volatility drag. That's why we're working so hard on volatility reduction strategies. So that you don't have these ups and downs. You'd be better off to shoot for a 7% or a 6% across time and actually achieve it without any crashes than you are to have an 8% that have ups and downs in it. Because the volatility drag as

you're seeing, you could have great returns after that event. We've got 19%, 20% something in those ranges, it's not enough to get you out of the problem. Because you lost the money on the big base. That's why it's not such a problem in the health care trust or the health care plans. They didn't have any assets. There was nothing to lose there. You know, they were unfunded plans so there was really no impact, very modest impact from the stock market crash on either of the health care plans. Just doesn't exist because there was no money to lose. The closer you get to full funding the more conservative you need to be. You need to take your foot off the accelerate and let the car slow down some so you don't lose the big bucket of assets once you've got it under control. Once you got the plan funded, you need to get into -- and I've talked to unions about this, too, so that there's some institutional memory about what happened. Down the road you don't want to be with your foot sitting on the accelerator when you're looking at great returns out of stock markets, great returns out of bond markets, everything is going right. That's the point you better step back and take some things off the table or you're going to have a crash. That's the nature of financial markets. Most people in particularly places like San José they look at the period in the '90s when they were young adults and everything was going great and San José and other kinds of cities were booming along and everything was wonderful. Well, that's the moment when the well-run historic plans that had very long perspective, 100 years in the mine workers said oh, this was very anomalous, this is very different, there is something different here, we don't believe in new paradigms, let's make these plans more conservative, let's seal plans. One of the plans of the mine workers was a cash matched immunized bond portfolio that it didn't matter what happened in the world, those pensioners were going to get their pensions, regardless and those companies were never going to be contributing to those trusts again. It was simply sealed and put away and then you match the actual decay of the population to the bond decay underneath, and guess what, you don't have to worry about economic down turns, you don't have to worry about anything going on in the market and if you manage that correctly, you can sling off surpluses, and that plan slung off surpluses every single year because they sent the bond portfolio a little bit higher than the decay of the population. That's the kinds of things that plans need to do as they get towards full funding. You're nowhere near it, you're not going to see it in this generation. But at some point people need to recognize, the closer you get to full funding, the more conservative you get to make the plan.

>> Mayor Reed: Before your last question, we reset time in the schedule, we need shorter questions and shorter answers so we get through this.

>> Councilmember Oliverio: So does your retirement board today, better understanding these challenges than four years ago?

>> Russell Crosby: Of course. We've hired some of the -- probably the best public plan board if not in the United States, certainly in California. There is nothing comparable.

>> Councilmember Oliverio: Thank you.

>> Mayor Reed: Councilmember Chu.

>> Councilmember Chu: Thank you, mayor. Thank you very much for this report. As trained as an engineer, I was trained to solve the problem that we have on hand. I really admire your ability to be able to see, to massage the number and be able to see ten, 20 years from now. And I just also wanted to caution my colleagues here, that defined benefit program was designed way before my time, for a reason. And that at that time, I can imagine probably many of talented people like you are, sitting at a table looking at a chart before they make a decision. So I guess what I'm trying to say is that I know that we have a crisis here. But I want to caution my colleagues on the council, as well as the staff, that we don't overcorrect the problem. We don't let the pendulum swing too far back. Again, I believe those people that made those decisions back then, have a lot of the actuary data and so on, and so forth. And just the fact that we're stating this problem here and we immediately think, redo the defined benefit and get rid of them, I don't think is the best move for the council. I say the same for the SRBR. I don't agree with the amount paid out. I don't agree with the formula that, how to distribute the amount. But I don't agree to get rid of them because it was there for a reason. We can go in and change the payout amount. We can go in and change the formula so that it will be more equitable. But just to -- you know because it doesn't work, we want to just get rid of them, is really not the best policy. And secondly, I would just want to comment, one of your charge -- oh, I see slide 50, we're talking about physical reform plan. Retirement recommendation. Looking at the

-- there's another chart somewhere. The -- what is that? The problem that we're talking about, the problem that gets us where we are today, repeatedly mentioned was a demographic issue, right? And to solve the demographic issue, one way to solve it, is to increase the retirement age. And I don't see it on page 15 -- 50. And I would just challenge the staff, if we extend the retirement age by five years, okay, what would change this presentation in terms of the future numbers, and all your charts and the numbers?

>> Alex Gurza: Councilmember Chu, actually changing the age was one of the examples we provided in the fiscal reform plan as one of the things that you could do. So given the fiscal target that the city council set, there are various ways that at the bargaining table we can look at how to achieve that savings goal. So if you, as you suggested, if you raise the age, the higher you raise the age the better the benefit could be. Right? So it's just a matter of sitting down and negotiating what that would be like. And we simply provided examples within our report.

>> City Manager Figone: Which is included in the 166, councilmember, so that box doesn't break out all the examples but raising the age is assumed in the 166.

>> Councilmember Chu: Okay. So if we increase the retirement age, a lot of those numbers will have to be revised?

>> Alex Gurza: No, again, assuming the council still wants us to achieve the fiscal target, maintain the cost at the 10-11 level there are a variety of ways to accomplish that. One of them is increasing the age. If you look at slide 9 --

>> Councilmember Chu: That's what I was looking for but I didn't see it at slide 50.

>> Alex Gurza: Yes, right. That slide 50 is just a summary of where we think we could achieve the savings. Again we put aim number one on this page for a reason. Because it is one of the significant drivers of the

cost. Once we came down to actually negotiating that benefit again we will be able to see that the higher you make the age the higher you'll make the annual multiplier as an example.

>> Councilmember Chu: Knowing the demographic is a problem, looking at the list of nine items, which one will fix the demographic problem? And I will hint, number 1?

>> Russell Crosby: Well, it won't entirely fix it, but retirement age is the single biggest thing.

>> Councilmember Chu: Thank you very much. I would like to ask the staff to -- pay more attention on the retirement age. And on the retirement age, interestingly enough, Michelle Obama was saying because of the obesity problem in the next generation, they're life expectancy could be even shorter than ours. So when you bring up that, hey, the next generation could live to 85, 95, you know, I want to bring it up to say there's a lot of uncertainty on when we look at the projection, ten, 20 years ago, that was just my point.

>> Russell Crosby: And we're not even though talking about a future generation. It's the current generation. And so that's -- yes, Michelle is probably correct that the children who are growing up now. But you still got the adults who were --

>> Councilmember Chu: I know. Again, I just wanted to caution the colleagues here, that we've fixed the demographic problem, we don't want -- which is more than 50% of what gets us in this slump here. And if we can -- concentrating on fixing the demographic problem of asking, taking the step of increasing the retirement age, we can solve a big chunk of the problem.

>> Alex Gurza: Councilmember Chu as a point of clarification, are you referring to increasing the age for current employees to be able to retire?

>> Councilmember Chu: Right, the retirement -- yeah, isn't that the retirement age interpreted to you?

>> Alex Gurza: It could be a variety of things, it could be the second tier and the first tier. So I just wanted to make sure I understood. We included it both, in our fiscal reform plan we --

>> Councilmember Chu: I said for second tier, I said that before. And since you brought up I do not support reducing the benefit of those people that already retired. So thank you very much. [applause]

>> Alex Gurza: Councilmember Chu, just wanted a point of clarification, that is not our recommendation. Any pension that's part of the principles that were approved by the council that any pension received by current retirees does not get reduced. We are however recommending future changes to future colas and also the retiree health care benefit.

>> Councilmember Chu: Thank you very much. I just love those principles and I must keep -- just cannot help to thinking that when they design the defined benefit program, they probably have the very similar principle that was being presented today. So thank you very much.

>> Mayor Reed: Councilmember Kalra.

>> Councilmember Kalra: Thank you. I don't know if any of us are going to be here after Saturday this might be moot. I really appreciate the questions asked by my colleagues particularly Councilmember Rocha who asked some very direct questions that started to talk a little bit about the impact to our city and our ability to provide services. And so I have a number of different questions, one of them Russell, you had indicated earlier, about the 20% each year, over the next five years and trying to make up for the market losses from the recession.

>> Russell Crosby: No. All we're doing is recognizing the losses over the five years, not trying to make them up.

>> Councilmember Kalra: Sorry, yeah, I apologize.

>> Russell Crosby: Each of those layers is to be made up over a 20-year cycle.

>> Councilmember Kalra: I apologize, yes, recognizing the losses over the next five years, how much is that in dollars for that 20% each year?

>> Russell Crosby: Roughly $250 million -- or $200 million, excuse me.

>> Councilmember Kalra: So 200 million a year we're going to spend over the next five years?

>> Russell Crosby: No, no, no, you're not going to spend, it simply gets recognized in the system. And then amortized over 20 years. So each year -- like this year we're going to recognize 200 million, but you're going to pay for it over 20 years. Next year you're going to recognize another 200 million, you'll pay for that over 20 years.

>> Councilmember Kalra: Understood, and so what is the annual cost for doing that, like to the city and/or to the fund? I understand to the fund because you're amortizing it over the years. But how much do we have to pay in additional cost in that recognition?

>> Russell Crosby: Roughly 20, 25 million each year. Because you also have an interest charge. It's like a mortgage. You've taken out a billion dollar mortgage which at that moment in time it was an 8% mortgage in Police and Fire and 8.25 in Federated, your mortgage has dropped to 7.75 in Police and Fire, 7.95 in Federated.

>> Councilmember Kalra: Okay and you indicated earlier that that's a industry standard, to smooth it over five years, a loss of that nature?

>> Russell Crosby: Correct. We actually talked to the actuaries about lengthening that period and they were not willing to go there.

>> Councilmember Kalra: Well, you talked to the --

>> Russell Crosby: The actuarial firms, the outside consultants.

>> Councilmember Kalra: And you indicated that over the last three years, I mean clearly, the fund, and I do definitely give you and the board credit, outperformed over the last three years. What are the percentages over the last three years?

>> Russell Crosby: So for example in 2010 Cal PERS actual return was 13.3, Federated was 15.9. Police and Fire was 14.3.

>> Councilmember Kalra: Okay.

>> Russell Crosby: I'm not sure does that --

>> Councilmember Kalra: That's fine. I think a one year's snapshot gives a sense of the last three years. It certainly has improved. And looking at the chart on slide 36 it shows that in 2007, Police and Fire was funded at 112% and Federated 89%, and the next year they crash, due to the recession. And so, you know, when we discuss sharing, I have a question about -- when we discuss sharing unfunded liabilities between the employee and the employer, what -- and clearly, you know, as has been indicated by several folks up here that a certain percentage of which just becomes unbearable to expect an employee to be able to pay 40, 50, 60, 70% of their paycheck to make up an unfunded liability, but when there is -- what is a more appropriate accounting practice when there is unfunded liability? Like you just indicated that the '08 losses were taken over five years or recognized over five years and then amortized over a number of years. How is that translated into how an employee can also -- the employees can be treated in a similar fashion as your fund treats the loss? Understand my question, so that they don't pay for the total unfunded liability for that year that that happens?

>> Russell Crosby: Oh no no no it would flow through in the same fashion as the employer's contribution. But the difference is you have some ability to, you the employer, have some ability to recognize a dramatically increased contribution rate over, say, a five-year period where the employees may not be able to share in that. I mean you

may.wipe out all the salaries during that five year period and then go forward for 20 years as you amortize that, the employees are going to pay for that as well over the 20-year period. It just -- it gets very, very difficult to shift that element of risk off to the employee population.

>> Councilmember Kalra: It's just not realistic.

>> Russell Crosby: Correct.

>> Councilmember Kalra: It doesn't happen, and we can't do that. You do it, but you won't have employees. No one would work here. I mean, all the folks that have been here for a number of years, some folks in management, would you come here if you had to do that? Would you come here if you had Social Security as your retirement? I mean, let's be realistic about these things.

>> Russell Crosby: Well, you can't necessarily say that. Certainly the staff that I have, in investments, would prefer a self-managed 401(k) with a substantial employer match. None of them are planning to be here for 20 years, or 30 years, or anything like that.

>> Councilmember Kalra: But I think that's part of my point is that we don't have employees that plan to be here for 20 years or 30 years, but plan to be here for a very short period of time.

>> Russell Crosby: Could be, just like in the private sector, employees don't stay with an employer much more than three to five years. But yet they make tremendous contributions for the three years they are there or the four years or the five years. I would point to the small staff in retirement and say during the three years that that group has been together we've probably produced for you, you know, three, $400 million that you wouldn't have had. Was that valuable to have those people around for that three years? Yes. Are we going to lose them all? Yes.

>> Councilmember Kalra: Sure, but at the same time, when we look at -- when we look ought our ability to recruit individuals across the board, in all departments, I think that it may be challenging to find people of high caliber like yourself that may want to come to this city with some of the projected outcomes of some of these assumptions or of some of the dramatic adjustments you'd like to make. Again, I'm with the other councilmembers, I'm not saying that we don't have to do something and do something very seriously. It's the pace at which we do it. Because you're in the system, you're the numbers, you're uh looking at the numbers you're providing data but in terms of the impact on the city, the move is not precipitous, it's not fast-moving or not dramatic and we're making up for past mistakes but the reality is we have to lay off a thousand people and be able to recruit people to be in our workforce.

>> Russell Crosby: My concern and I've expressed this to Alex and to Deb is that from call it a private sector perspective you're in a death spiral. Each year, you're having a contribution increase, which causes you to lay off people. To then, the next year, have a contribution increase, to then lay off more people. To then, the following year, lay off even more people, because you've had a further contribution -- and the population collapses, to the point that you are just in a death spiral, heading down, unless you do something.

>> Councilmember Kalra: And you have less and less people paying into the system.

>> Russell Crosby: Correct.

>> Councilmember Kalra: Which causes a greater problem.

>> Russell Crosby: Correct.

>> Councilmember Kalra: That causes a problem that needs to be recognize and I think that's accurate and that's definitely a concern.

>> Councilmember Oliverio: But we have good weather.

>> Councilmember Kalra: What is that?

>> Councilmember Oliverio: But we have good weather.

>> Councilmember Kalra: When we look at effects on the workforce, I think there are two sentiments that I believe we aren't recognizing and part of the discussion that we're having right now, is that compensation and benefits be lowered to practically any level without really damaging the feasibility to recruit and retain personnel. I don't believe that's true. I think there is a certain limit you hit where you're just not going to be able to recruit. People like we have right now in our city, we're not going to be able to recruit that same kind of caliber of people. And also, I guess the parallel to that is that there's no effect on services based on the quality of personnel you can recruit. And so yes, we do have to have some dramatic changes to how in order to have a sustainable pension system. But similarly we still have the function of the city. And I think that when we consider, you know, hiring accountants and folks in I.T. and electricians and police officers, and engineers, and lawyers, for certain -- I've mention they had to Rick that if I was a lawyer in this city would I get the heck out immediately and have no offense to Rick, I'd be out of here, because of the nature and the manner in which we're dealing with this issue, that's not inclusive, and not really -- it's not sincerely inclusive of what the bargaining units have to say. As Councilmember Rocha indicated we're not thinking about the impact the real outcome of the impact on the employee. [applause]

>> Councilmember Kalra: This problem was back in January and February we were talking about this and here we are in May you know months later talking about what the real impacts are going to be and what we have to do when we could have been talking about this for the last three months and finding ways voluntarily that the bargaining units would come forward like opt in programs, get the numbers we don't have now, could have gotten over the last two or three months which cause us to face much less severe legal risk. A lot of what we're putting on here as suggestions face enormous legal risk and case law, frankly, doesn't support a lot of what you would like to do without the bargain units and employees being a part of it and agreeing to it. And I think our approach to this budget has somewhat given an impression, I don't think anyone's said it and I don't think anyone needs to say

it, I think the impression based on how we've been handling this looking at just the numbers, gives the impression that anyone can come in off the street at any pay level and do the job that our employees do. And I think the employees have recognized that sentiment, whether it's been spoken or not and I think they resent it and I think that's part of what we see some of the ill feelings that we're seeing here in City Hall. [applause]

>> Councilmember Kalra: And so Russell you have to deal with the numbers. But we have to deal with it all. And that includes making sure that we can provide services. And I have a great worry that we're not going to be able to do that given not just the approach we're taking, but the way that we're heading there. And I don't think it's realistic to be able to recruit -- I mean cities and private sector are two different things. I think that we've gotten some great value out of city employees that have been here for 15, 20, 30 years, and have dedicated themselves to public service. It's not the private sector, and private sector, I know, is very different, and people move around and find different opportunities and challenges. Here people serve and I think there's a distinction in the kind of person that's drawn to public service. And Deb, there's a reference to a hybrid Social Security deferred contribution plan, I think on page -- on page 46 I recall seeing that it says given the City's current fiscal situation there might not initially be an employer contribution into a defined benefit plan if there was a hybrid plan, which essentially implies that we would jut be getting Social Security. And I don't know how many police officers or engineers or anyone we're going to recruit, if we're offering them Social Security. Just as a practical matter. When there are plenty of other opportunities they may have around the state, in the private and public sector, that will get the best of the best. And we're not going to be able to recruit, we're just going to get the leftovers and we're just going to train people and they're going to leave after three or four years after we train them as building inspectors and librarians and firefighters they're just going to leave and that's a great concern of mine as well. The last area of interest is the number, $400 million over the next five years. How much of that is General Fund obligation, of the 400 how much of it is out of -- I think the 400 million is out of all funds. I don't know how much you have --

>> Alex Gurza: We do have that.

>> Jennifer Maguire: Jennifer Maguire budget director. For the General Fund that 400 million translates into 304 or 305 million.

>> Councilmember Kalra: That translates into --

>> Jennifer Maguire: Yes.

>> Councilmember Kalra: And the cost to the -- the FY 11-12 cost in the FY 15-16 cost in the General Fund, the target -- well let me put it this way. Instead of the 400 approximately, the 304.5 million if we're just speaking General Fund, is the target in terms of what makes the city vulnerable, again, to other funds, if we take the other funds out?

>> Jennifer Maguire: If I understand your question correctly, the General Fund portion of that target would have been about $170 million. If you try to keep the General Fund costs at the 10-11 level.

>> Councilmember Kalra: And that brings me to a couple of other things. One is I would like to see kind of the separation of the General Fund kind of to just to see the breakdown as well as how much of that retirement cost is fully funding retiree health care as opposed to pension. Because -- and I don't know Russell if you have thoughts on this based on your experience the pace at which we're fully funding retiree health care is that something seen in the private sector, do they fund retiree health care to the extent we do and if they do do they ramp up at the pace that we are? Because clearly that's causing a huge liability in the short term that we have to make up for out of our General Fund.

>> Russell Crosby: On the health care side, you're ramping in towards an arc. I mean you're not even paying the arc. So I'm not sure exactly -- maybe rephrase the we.

>> Councilmember Kalra: Well I guess the pace at which we're ramping up to that arc.

>> Alex Gurza: The pace if I could cover that you know when we talk about arc and all these things it's like starting paying your mortgage payment. We're not even paying the mortgage payment on retiree health care. Retiree health care is severely underfunded. I've heard recently comments about our pace. We were very successful in reaching an agreement with our bargaining units on starting to pay for this benefit, starting to pay the mortgage payment. Once we start paying the mortgage payment we ramp it up over five years, we've got -- it was a 30 year mortgage we took out on that retiree health care. The issue is very different, I think the recognition that our bargaining units came to that if we didn't start funding that retiree health care benefit, that benefit was not going to be there. But what we also are now recognizing is that it is an extremely expensive benefit. So to the point you're making Councilmember Kalra about recruiting employees, so an employee walks in the door, and in a few short years they're going to walk in the door on day 1 paying 10% of their paycheck to retiree health care, have to work 15 or more years to get there and they may come in the door, and Russell can tell you this from some of his own staff, they don't even plan to stay here 15 years. That is the scope of our problem. It is not that we're all of a sudden paying it off in five years, we're just beginning to make the mortgage payment.

>> Councilmember Kalra: Okay, I mean, I am and always have been supportive of a fund for retiree health care, as have the bargaining units, as you indicated. But I think that when we're doing all these things at one time coming out of the greatest recession in our lifetimes, that we have to start to recognize that at what cost? And I think when we look at the targets that have been put in place, the target of maintaining service levels, January 1, 2011 levels and preventing requirement costs from increasing beyond the amount paid in fiscal year 10-11, those are targets that we set and we can change. Now again I am not saying and will never say that we should ignore these issues. But in setting these targets we have to be accepting of the consequences that they cause and if they are unacceptable consequences to our city in terms of public safety, in terms of services that we provide we have to recognize that. So everything we are discussing today is tremendously helpful and I think all of you are providing data that's very helpful to me to inform myself as to how we get out of this pension retirement mess, that has been created over many, many years. But I have to balance that with the ability to provide services to our city. And I think that's what puts us in a more unique situation than all of you is that you look at the numbers, this is the fiscally responsible, this is the industry practice, well you know what? I'm not going to be okay with laying off 300 police officers or closing libraries for half the week. I mean those are -- that's what we have to balance it

with. And so I want to find out a way that Councilmember Herrera said earlier are there ways we can start looking at this while still being responsible finding ways to get more money for our current-year deficit which is something that we talk less and less about, for our current-year deficit to keep our services going, and to keep our employees employed and to keep our residents served? And so I think going forward that's -- I'm not going to dispute the nature of the problem but I will continue to ask questions about how we address the problem. Because it's great to do all these fiscally sound measures, but it's knot -- the balance, if the balance is that we continue to have our crime rate skyrocket or if we have services that are cut dramatically out in the community I don't think that's a fair decision for us to make and put our residents in peril. Thank you. [applause]

>> Mayor Reed: Councilmember Campos.

>> Councilmember Campos: Thank you, mayor. I'll be brief. I won't repeat questions that were asked, but I will start off with, you know, we started this session with the statement that council gave direction to staff to come back with fiscal reform solutions. And I wholeheartedly agree with Councilmember Rocha, in that all we've gotten was one solution. And really, that's misleading. Well, I won't say it's misleading but it doesn't give us options. You're basically telling us you've got to go with this, or else. And I would be much more comfortable being able to have real options. Something that we could decide on that yes, this might -- this might not solve everything in one year. But you know what? This will preserve services. And still, get us to a path where we are creating fiscal reforms over the long period. That's what would I like to see, and that's what I was hoping that, as we started talking about this three months ago, that we would have received by now. Councilmember Rocha had asked for this study session two or three months ago, and we're having this, you know, two weeks or a week before, you know, we have a significant presentation on reforms, and, you know, a month from when we have to decide on our budget. I think that's pinning us into a corner and it doesn't feel good. So that's my statement. [applause]

>> Councilmember Kalra: But do I have a question regarding the -- and this would be a question to Rick. What would be the legal implications of some of the -- or the challenges that we might have on the retirement plans?

>> City Attorney Doyle: Well, I think the presentation noted that there are significant legal issues and risks. And in many ways the council has been advised of those, in a confidential way. I think that is something that I'm -- may be discussed today at Rules and we would come back next week to have further discussion about the specifics. But I think you know we're well aware of them. I'm going to have to respect the confidentiality of those opinions at this point unless the council directs me otherwise.

>> Councilmember Campos: Okay, thank you. I do have a follow-up question on the smoothing. So you stated that you had requested the actuaries to allow us to increase the smoothing period. Why did they not want to do that?

>> Russell Crosby: Because five is really the standard. They've got to sign off, part of what goes on with an actuary is that they personally sign your evaluation, saying that they believe that these numbers are truly representative. Once you get away from the five-year smoothing, you're off into something that's nonstandard, and you're asking an actuary to step off a curb in a different kind of way. Neither of the two actuarial firms were willing to go there.

>> Councilmember Campos: Have we ever done anything beyond five years?

>> Russell Crosby: No.

>> Councilmember Campos: Never. So since you asked --

>> Russell Crosby: And I'm not aware of any other plan other than Cal PERS that runs itself separately and has its own in-house actuaries and it goes beyond five.

>> Councilmember Campos: What do you believe the results would have been if smoothing would have been accepted over a longer period of time?

>> Russell Crosby: Well, would it have lowered the contributions. Instead of recognizing the loss over a five-year period you would have recognized it over a seven-year period. Meaning that in Federated from where the loss occurred to where the last increment of it was amortized would have been 27 years -- excuse me, 25 years. So, well, in the case of you going to 27, it would have been 27 years, so now you're almost to 30. You end up shifting two decades out into the future.

>> Councilmember Campos: Okay. And then my last question would be, and this is on some of the colts that Councilmember Kalra had made regarding our ability to attract talented employees to come work for our city, and also, to retain them. What kind of plan do we have moving forward to make our city attractive, not just for someone that's looking for a job, but someone that is highly skilled, because I mean if you go into our elevator, each floor basically says these are very specialized roles that these departments play in our city. So what kind of plan do we have to attract that kind of talent and then to retain it. And my follow-up question to that would be, I mean are we prepared for a mass exodus of just losing talent because of some of the dramatic changes that we could be seeing?

>> City Manager Figone: Well, a few things. First of all, nothing's changed. What has changed is our ability to afford the employees that we have. And so we're cutting their jobs, unfortunately. In cutting their jobs, until things change, we'll be slowly rehiring into the existing system and they'll have the benefit of the system that we have until that changes. Clearly, no doubt, to the degree we continue to compare ourselves to PERS agencies, and other cities, I think San José will have a challenge. I think we're going to have to redefine what compensation looks like. Right now, the biggest challenge is the significant majority of the compensation pie is being eaten up by retirement. And this is going to be a very expensive place to work. To the degree that doesn't change, we're also understanding that in the next generation of workers, the retirement is going to be less important to them. Some of what Russell's commented on, we're hearing a lot about in terms of, again, that next generation. So clearly we're in a period of great change. And we, City of San José, are going to have to decide what we can afford, in terms of our workforce and how to redefine compensation that we can provide.

>> Councilmember Campos: But I think retirement's going to be less -- I mean that's historically it's less important to 20-year-olds or 25-year-olds because they're not thinking that far in advance. It starts to become real important once they hit their mid 30s and they really start thinking about that they have families and I just think that what we're doing is we're repeating what we saw in the late '90s when what I believe got us into this mess when we were really trying to compete with industry. And our tech companies, you know, I think that in order to get talent here we're going to have to entice talent to come here. It's not, as Councilmember Kalra had mentioned, you know, we're going to have a population of employees that I'm not going to say they're not going to care about their job. But they might not come to work for the city for the reasons that most of our employees are here. Because they want to give back to their community, they want to contribute somewhere. They want to create the relationships. And I think that's what's one of the things that's unique about our city and why we're always rated as one of the best places to live. Because interfaced with the government is pleasant. And I don't want to see that jeopardized and those are my comments. Thank you.

>> Mayor Reed: We will take up public comment in a moment but Councilmember Rocha had a couple of other comments.

>> Councilmember Rocha: Thank you, mayor. Again, a hypothetical, so let's just say we withheld $3 million to spend on homework centers, senior nutrition funding, extending library hours for our arc contribution. How does it get made up? Is it just the next year you add three million, or does it get smoothed out, just curious?

>> Russell Crosby: Unfunded liability, yeah, it would shift over to unfunded liability and would be amortized over either the 16 or the 20 years.

>> Councilmember Rocha: So then our next year's contribution that $3 million that would be spread over 16 years?

>> Russell Crosby: Well it's not just $3 million. It's 3 million plus whatever the earnings assumption is over that period, so it becomes a 30 year mortgage at 7.75%.

>> Councilmember Rocha: On $20 million?

>> Russell Crosby: That's right. What you don't end up paying today you end up paying significantly tomorrow.

>> Councilmember Rocha: True in life. My visa bill. If I'm struggling to pay my rent, I'm struggling to pay my heat, I'm struggling to feed my family, and I'm struggling do I choose to pay my visa bill in full entirety that year, or that month? Most folks would probably eat it for a little while and hope that things get a little bit better and not suffer as much. Since we moved to investing more in stocks, what's been the change in the return?

>> Russell Crosby: It went the other way. We're reducing the exposure to equities.

>> Councilmember Rocha: Okay. And how long has that trend been going?

>> Russell Crosby: Since I've been going here.

>> Councilmember Rocha: How long, I'm sorry?

>> Russell Crosby: Three years. And that's part of our significant out-performance against other plans in the state. And one of the reasons why these plans lost so much money was they had certainly in my opinion from the day I walked in the door here, way too much equity exposure. And that's what cost you the billion dollars during the --

>> Councilmember Rocha: And that was the investment in stock. I'm sorry, that's what I meant, so thank you.

>> Russell Crosby: Yeah, investment in stocks.

>> Councilmember Rocha: So in three years you've shifted. So what's the percentage in holdings?

>> Russell Crosby: Oh, right now, it's equities are, in Police and Fire, 40%, fixed income 25% and then alternatives, 35%. Federated is a little bit different. 49% equity, 20% fixed income, and then alternatives are 31%.

>> Councilmember Rocha: What are alternatives?

>> Russell Crosby: Things like real assets, commodities, real estate, hedge funds, other kinds of nontraditional asset classes.

>> Councilmember Rocha: Thank you. My last question to the City Manager to the earlier point whether we look at the MBA and the fiscal reform plan and addressing that I guess in a council meeting now separate from the budget process would it be acceptable if you had another system designed to look at just compare not for -- not a recommended, not a council adopted, not a suggested, just another one, to compare?

>> City Manager Figone: You know, I think what's being misunderstood and the answer is yes, but what I want to make sure the county understands, we just gave examples.

>> Councilmember Rocha: Uh-huh.

>> City Manager Figone: Those are not hard and fast any one option, two or 20. Those are just examples of the ranges within the probability assumptions that we've laid out for you. It's about two or three dimensional chess in a way. Because what I hear you saying councilmember is you'd like to know what a -- I'm just making this up -- a 2% at 65 might be, where there's a certain benefit at the end. But the other part of that question would be, under away assumptions, that way there we get at the cost to the employee, as well as the city, in, then, determining what the funding requirements would be. So there's the design, but then there's also the assumptions that go into that design. And that's why we keep raising one dimension with the other. So with that question answered, what level of risk do you want to take, then absolutely we can bring you back options that we've hammered out with our

employees, so that before you make that decision, you know what you're deciding and you know what it looks like to our employees. But there's really a couple of dimensions here.

>> Councilmember Rocha: Okay.

>> City Manager Figone: And I just want to make sure we understand that.

>> Councilmember Rocha: In what forum would I suggest that or offer that? Because bear with me a little bit, you have been on this dais longer than I have but so far in some cases I have a support of either supporting it in its entirety or not at all. The amendments or changes or small fixes within, are not always readily acceptable to the entire council. So when you talk about, well, we can mix and match here and in, but you know a document as thick as that, with that much material and that many different recommendations, little bit hard to get council unanimous approval to parcel out certain ones or look at two different options. So what form could I suggest or offer just an alternative for us to get the system designed and looked out to find out what that output looks like? A very simple, I'm not looking for complex.

>> City Manager Figone: Understood. Today is just a study session. Next Tuesday you're going to be debating this as a council and giving us direction. And I think it was coming through that direction, or perhaps through closed session meet-and-confer direction.

>> Councilmember Rocha: Thank you for your help. Thank you, mayor.

>> City Manager Figone: You're welcome.

>> Mayor Reed: Councilmember Herrera.

>> Councilmember Herrera: Hopefully a short question. Looking at slide 50, a fiscal reform plan retirement recommendation. And we're looking at the bottom there, a total savings of $216.6 million. And we have in there

several elements, so we're looking at something where I think the City Manager is just addressing how we have different components and this one SRBR retiree health care new employees, retiree, current employees. How much would we need, would this do it if this were implemented? Can you talk about it Alex?

>> Alex Gurza: Yes, Councilmember Herrera, the recommendations listed here meets the council's targets. There are risk limits here because we are recommending using the 50-50 range, so there is still some risk there but this would meet the council's target.

>> Councilmember Herrera: 50-50 that's in new employees, right?

>> Alex Gurza: No. I was referring to the assumptions we would use in looking at the benefits for current employees, for example, because for new employees we are recommending a hybrid plan. But short answer to your question is, if the council approved the fiscal year reform plan as proposed 50 City Manager it will meet the target.

>> City Manager Figone: Alex means the probability of the rate of return assumptions, councilmember. That's what he means 5050-50.

>> Alex Gurza: Yeah, the 50-50 you see there on the new employees account cost sharing, 50-50.

>> Councilmember Herrera: So that would presume a actuarial assumption of the current one or moving to a more -- were you talking about actuarial assumption?

>> Leslye Corsiglia: Yes.

>> Councilmember Herrera: 7.75 we only have a 25% chance. So you're talking about moving to a more conservative actuarial --

>> Alex Gurza: When we design the benefit, the earnings assumption that's chosen up to the boards is up to them. What might it cost us or what might it save, we are recommending at the very minimum, we use a 50-50 chance of achieving that cost.

>> Councilmember Herrera: That is actually more comforting. So this 216 is a 50-50 chance, although where do you think we're going to be when we add in the demographic changes, Russell, would we still get there with this?

>> Russell Crosby: No.

>> Councilmember Herrera: How much would we be off?

>> Russell Crosby: I don't know yet. I mean until the valuations get run we're not going to know. And this year is going to be one of those big years, with the extraordinary number of retirements.

>> Councilmember Herrera: So I think that you know, and I've asked, I'm one of those that has asked over and over again for different options to look at. Because I think we're dealing with a lot of variables as the City Manager said. I don't think it's that council doesn't want to make a decision or want to fix this. It is just that there's so many moving pieces and then adding to that the unknown of what the board is going to do with the actuarial assumption. So what would be a nightmare is somehow we get some implemented and it's completely off because you know, there's -- the ground changes underneath us from the board.

>> Russell Crosby: If anything, you're likely not to go far enough.

>> Councilmember Herrera: Which you mean you're not likely to go too far?

>> Russell Crosby: Too far.

>> Councilmember Herrera: This slide points out, we're looking at, I'm not saying it's right but I'm just point ugh out it does achieve this $216.6 million and it does look at everybody contributing. So it's looking at current employees, retirees, new employees, we're looking at retiree health care and then also SRBR. So it covers like all of a lot of different components that together, would get us there. It doesn't increase the age of retirement. It doesn't do that. There's a lot of things this doesn't do, right?

>> Alex Gurza: Well no, I think -- yes, no, it could. So in other words the -- if you looked at current employees, $166 million. Part of the thing that could be done there is to increase the age. So that could be a component of that.

>> Councilmember Herrera: But I'm saying it doesn't right now. It's just the cola. We're getting there without doing that. I'm pointing out we're not doing all these other things.

>> Russell Crosby: In this particular scenario that you see, all you're doing is changing the cola and reducing the benefit accrual in the future, it doesn't change the age.

>> Alex Gurza: Let me clarify. If you looked at the $166 million number there, there are various ways to achieve that. If you did not change the age, the accrual for future years of service would be so small, right, that we couldn't recommend it. So that we showed examples in our fiscal reform plan that would raise the age. But what it actually turns out to be again would be subject of those negotiations and you could model it okay if we went to this plan, we said if we raise the age by five years then the accrual could be this. If we change this, it could be that. If we know the five years chem once we know the residence we're headed there are the multiple dials that could you do to adjust it. We think without doing the age it would be very difficult to reach that 166 and give a --

>> Councilmember Herrera: So we're not getting it just for the cola reduction, then, this isn't accurate then?

>> Russell Crosby: You can, that's what Alex is trying to convey, is that you've got all these knobs on the machine. And when you tweak one of them, you can go farther on the other. So for example, if you reduce the

cola and reduce the benefit accrual down to a ridiculous number, then the problem goes away. Or you could keep a reasonable benefit accrual, or better than the first case, but then would you have to increase the age. So there are all these pieces, that if you increase the age, can you do a bigger benefit. If you -- the farther you reduce the cola the bigger the benefit. So there are variable in the fact that whatever you turn the one knob, the other one can have more to give, does that make sense?

>> Councilmember Herrera: It's hard to put an idea out here without having to have all these considered and I think we need input --

>> Russell Crosby: And ultimately it is a process of negotiation. My experience in the business is the plan sponsor can come up with whatever ideas they want to until the plan sponsor's negotiator interfaces with the unions and the unions come back with their view of the same problem, and maybe he set the dial to have a fairly decent benefit accrual but with an age 65, and a 0% cola. And what the unions come back with and say is well, we'd like an age 62 but with a little bit higher cola and a lower benefit based accrual. I mean you don't know the variability that's going to come out of the other side in negotiating. And so what Alex has to do I mean really needs from you guys is general direction, so that he knows how to interface with the union so that they, then, bounce the ball back across the tennis net that say, we don't like this, we don't like that, and what comes out of it is the meat grinder. You think you know what you're going in for, and what comes out will be different, will be entirely different than what you guys spell out up here on the dais, once he has to interface with the unions. Certainly that's my experience in 25 years is that the plan sponsor can decide general negotiating strategy. But until he sits, the negotiator sits down with the unions you don't know what comes out of the meat grinder.

>> Mayor Reed: Well, the general direction that you'd like, next week, 24th is we're going to attempt to do that. That's why it's on the agenda so we can begin to narrow down this multidimensional chess set, with not too few options but really too many options I think in front of us. But I would like to get out of here today. And I don't want to lose my quorum because I've got about 20 minutes of public testimony based on the cards, I want to make sure I get that done.

>> Councilmember Herrera: I hadn't finished my thought.

>> Mayor Reed: I know you hadn't. I want to encourage councilmembers to hang on, we have a quorum so we can finish the meeting.

>> Councilmember Herrera: I've listened to a lot of others speak.

>> Mayor Reed: I don't want any of you to leave while we're still speaking if we can help it.

>> Councilmember Herrera: And I don't have that much else to say. I think those are some of the ways that we need to work, and it is my hope that all of the bargaining units will be working with our team deliberately and in earnest to solve this crisis because it is a crisis. And I want to see it solved. I want to see our benefits maintained for our employees the best we can get. And keep our employees in San José. And we will be looking at this and making those decisions. They are tough decisions but we need to move forward, and acknowledge that this is real.

>> Mayor Reed: Okay, I think we should be done by about 12 can:30, hopefully councilmembers will be able to stay until then so we have a quorum. Take the public testimony now Allowing two minutes per speaker Nancy Ostrowsky, Jean Leonard, Kay Denise McKenzie.

>> Good afternoon, mayor and council, I'm Nancy Ostrowsky, Local 21, AEA and CAMP. I've been told by experts to keep repeating your message until it sinks in. So here I go again. Local 21 doesn't have its head in the sand and doesn't believe that these fiscal issues surrounding retirement benefits are imaginary. We have a track record of working with the city to preserve jobs and services. Our bargaining units have been waiting for the city administration to begin talking with us about retirement reform. What gives? When you voted in January to direct staff to work with us on retirement reform, staff never picked up the phone and never met and exchanged a single proposal. We exchanged, we presented proposals in bargaining. Of course you don't see a slide up there on costing that out. We do matter here. We're on the Federated retirement board and we gave you a proposal. City

administration committed to bring you actuarial sound options that met your goals after meeting with bargaining units. What got lost in the translation? Councilmember after councilmember asked city administration if they planned on meeting and working with employees on retirement reform. And you were told yes. It never happened. Now, some of you want to change the January direction. How fair is this? Just like SRBR yesterday, you are told that there will be outreach discussions and negotiations with the bargaining units. And it just hasn't happened. You want solutions? Please tell staff to work through on what they were directed to do. Thank you.

>> Mayor Reed: Jean Leonard. Kay Denise McKenzie and then Jerry Mungai.

>> Hi, I am a long time retiree. I retired when salaries were low and pensions were low and I'm really concerned about a statement that was made in your memo about that if the provisions became illegal, invalid or whatever, that any benefit enhancements or increases granted to retirees since the date of their retirement would be eliminated. And I wanted to know if that means it will go back to what we were getting the day we retired? And everything we've gotten since then would be wiped out. Because like Councilmember Oliverio, a lot of us aren't depending solely on our city retirement. We too have saved money that we live on. But not to a point where we could make-do if we had to go back to what we were getting when we retired.

>> Mayor Reed: Kay Denise McKenzie. Jerry Mungai, Steve Osten.

>> Good afternoon, honorable mayor and council, I'm Kay Denise McKenzie. CAMP president, CAMP IFPTE local 21 president. January, February, March and April have passed and it's now May. Months since you directed city administration to work on this, on retirement reform. There has been plenty of rhetoric in the newspaper and doom and gloom scenarios and now a declaration of a fiscal emergency, an emergency that won't be discussed for five more weeks? The same charts and financial projections used in January to justify that council direction are the same charts and financial projects used now to seek a change in that direction. Shouldn't you explore every avenue possible before going down the legally risky path of trying to take away constitutionally vested benefits from the very employees you say you value? Shouldn't you follow through on what you promised to do in January, before changing direction? Don't paint us with the same brush as some who think pension reform is not

necessary. We are ready to walk out of council chambers right now, and begin the discussion that was supposed to happen back in January. Thank you.

>> Mayor Reed: Jerry Mungai, Steve Osteen and Jim McMann.

>> Thank you, mayor. The winds of change associated with economic globalism that affected the private sector's compensation plans are now affecting those in the public sector, limit on or elimination of collective bargaining rights related to compensation are being considered in Ohio, Wisconsin, Indiana and New Jersey. Now even cities are addressing less sustainable compensation plans more reflective of a bygone era, I applaud Mayor Reed, Vice Mayor Nguyen and Councilmember Liccardo for showing strong leadership by proposing long overdue reforms in the City's pension plans. This plan represents a major step in helping to rein in pension cost, in order to end the cuts to services. I just hope it's not too little, too late. Thank you.

>> Mayor Reed: Steve Osteen, Jim McMann Roger store.

>> Thank you, city council, mayor and City Manager. I agree with several of you, that options are certainly in order. It's always been necessary to have more than one option to resolving a problem. And it is very limiting, as Mr. Chu and Mr. Rocha have indicated. Beyond that it used to be a handshake and your word was all you needed. We've gone to paper. It's a contract. I'm referring to the liability here of legal aspect, when there is actually contracts in place that were negotiated in good faith and determined by a third party arbitrator, all in good faith. Now, being attacked, if you will. There are firefighters, police officers, and I'm sure people from the other unions, that are living at the poverty level or below right now. Which would be significantly impacted by any cuts in this retirement. I personally would give up my SRBR to contribute to those people. Because I'm not living, thankfully at the poverty level. But there are many who are. One of your statements, mayor Figone was the fairness of this whole thing, I appreciate your thought process. What I do not see up there is the people we serve. We serve the citizens of San José. All of the city employees. From you, right on through everybody. They're not part of that equation. I don't see tax cost increases, and I'm not saying that they should bear the entire burden. But there certainly should be a responsibility to the taxpayer, to pay for the services

received. In my view. And I just think that's fair and good business. I want to do business with people who can keep their word, who I can trust. I want to work 35 years, but I wasn't able to. The city doctor says you can't stay so I'm gone. I think people would work longer if it was a happy work environment that they could trust the people that they work with.

>> Mayor Reed: Sorry your time is up.

>> Thank you sir.

>> Mayor Reed: Jim McMann Roger stores, Aurelia Sean San chez, Bob Leninger.

>> You have to excuse me, every time I come up here I have problems with the microphone.

>> Mayor Reed: I think it will work if you pick it up and ignore it.

>> Good afternoon, honorable mayor and council. My name is Roger stores, I'm a board member of the association of engineers and architects, IFPTE local 21. As was reiterated earlier my union engineers and architects we don't have our head in the sand, we don't believe that the problem is imaginary. We know there is a problem. But we are engineers and architects and we're trained to solve problems. And so previously, previous direction is that you ask for a plan that would be comparable in cost to Social Security. We went out, at our expense, hired an actuary, put together a plan present they'd during negotiations, we're told at the time that the city wasn't prepared to negotiate on that. And that we were asked to sign a side letter to keep negotiations going, to sign a side letter, to have the option later on to discuss this. And then all of a sudden, things changed. Now things come out, in memos and in the newspaper and we're kind of wondering what happened, we stand ready to negotiate and to talk about this issue and to approach it in a form of you know cooperative manner. But now, things are being more dictated to us than discussed with us. So, you know, we're ready. And we ask that, you know, that we work together in a spirit of cooperation because this is something that affects us all. It affects me as an employee. I'd like to retire. I'd like to have a retirement when the time comes. It affects me as a citizen, as a

resident, as a taxpayer. It affects our membership. So please, come talk to us, work with us. We stand ready. Thank you.

>> Mayor Reed: Aurelia Sanchez, Bob Leninger, Paul Solerno.

>> Hello. I have been before the council before so I'm going to repeat some of the statements I have said before. I'm a big believer that public money has to go to public services. Also, public lands need remain in public domain. I really feel that we do need reform, I understand that. But I also feel that politicians and big businesses have too much control. I think we also need to do reform, in the business sector. Governor Brown has gotten rid of redevelopment which means more money for the cities. I think that's a good thing. I'm sad that the workers lost their jobs but hopefully we can get them back. Governor Brown is also proposing that we get rid of the enterprise zone which really I think half the businesses downtown are being subsidized. If we got rid of the enterprise zone that would add money to the budget for city services. That, I think, is an option that no one here is talking about. I also feel that the auditor needs to be auditing the businesses that are downtown. You know what if they don't have business sense and they've been subsidized for more than four years they need to be out. I also feel the mayor needs to give back the money that was set aside for the stadium. I think Lew Wolff is very intelligent, I think he could raise the money with bonds or borrowing the money. Again, public money needs to be used for public services. I also feel that the American worker not just the city worker county worker is at a pearl and the reason is that politicians listen too much to businesses. Businesses got us into this trouble because politicians were not regulating them. The American worker has to work longer and harder than ever before. I recently went to the dentist and my dentist asked me how my son was doing, I'm -- I'm a grandmother now and I said you know, he asked me he goes is your son a good father and I said no. I go because he has to work long and hard just like a lot of us have to do nowadays.

>> Mayor Reed: Sorry your time is up.

>> Thank you.

>> Mayor Reed: Bob Leninger, Paul Solerno, followed by Yolanda Cruz.

>> Bob Leninger, representing the Federated retirees. Could the person put up number 50 for me, please? You know, we don't have as retirees, as we take a look at number 50, we don't have meet and confer rights but unfortunately I have to be here to make a few statements I have to make. But we have retirees who that worked under a city contract with benefits that were promised, paid in under the requirements and remind on it when they retired and this is an onerous burden on that cola. They've already been whacked on their Social Security which had a cola attached to it. You can already imagine the impact for survivors when the worker passes away with the reduction in the benefit. We support reform we know something has to be done. We don't have our head in the sand either but this kind of thing is just simply the wrong way to go and we're not going to stand idly by for the people least able to bear these kinds of burdens. We are willing to sit down and work and help you find ways to do it but this simply isn't the way. I appreciate the comments about options and our own frustration here and we're looking forward to something happening very quickly so we can put some numbers on this chart that make sense and do justice to the existing retirees. I'd like to commend Pierluigi Oliverio and the people that talked about recruitment. Just as an example, I've asked people not to sign cards, if I can get a couple of extra minutes. I asked five or six retirees not to put in cards because I know --

>> Mayor Reed: Sorry you're going to be out of time. You get your two.

>> Just take a couple of minutes. I don't want to have a wife or a grand kid in a four story building with an underpaid fireman who is 60 years of age who has to get up there and save that person. And I think that goes to the quality, just not the quantity of the workforce. And I think you can only go so far with this and you have to go to the public and political leadership and say you've gotten concessions of a substantial nature and now we have to share the burden out there with reasonable fees and taxes even if they're temporary. And I think that's the leadership you need to take. Don't take it out on the people that can't afford it and paid in and were promised. Go out there and take a leadership approach. [applause]

>> Mayor Reed: Paul Solerno.

>> Good afternoon. I'm Paul Solerno with the retirees association for the police and firefighters. Excuse me. I'll be brief which is unusual. That is, we all -- well let me back one statement up. I'm hearing a lot of willingness to work with you from all the active unions. And they're all saying the same thing, that you're just not working with me. And I hear -- I'm hearing a willingness to negotiate on their part. I'm here to represent the retirees or speak for them anyway. And the issue is, we had an agreement. You can't be like Lucy and the peanuts cartoon holding the football while those people there the Charlie browns spent 25 or 30 years running up to the football to kick it and you pull it away. You can't do some of these things. You can't take away the colas, there's dig fit, there's honor, we had a deal, we worked decades for. You need to please live up to those obligations. Thank you.

>> Mayor Reed: Yolanda Cruz.

>> My fame is Yolanda Cruz and I'm the president of AFSCME MEF. AFSCME's position has never, I repeat never been that there is no crisis. We are challenging the manner in which the City Manager and her staff want to address the issues. When we asked about the numbers, as Councilmember Kalra Rocha, Chu and Campos are doing, we got no answers. Hopefully they will be more successful. If the city does, as OER has said, by passing proposals back and forth, it will be as unsuccessful as the negotiations we have had thus far. If you do not work collaboratively with the unions you will have labor strife with the bargaining units and the employees of this city. Thank you.

>> Mayor Reed: That concludes the public testimony. That concludes our meeting. We're adjourned. Thank you all for staying past the appointed hour.