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>> Mayor Reed: Good morning, I'd like to call the city council back into session, less than 12 hours from when we adjourned last night. Time to start all over again. This is a continuation of our budget study sessions. The topics for today are fees and charges, and the retirement system projections revisit. Everything is a revisit. We do this every year, don't we? We're going to start with fees and charges, and I'm sure we'll get through all of this this morning. And we'll take up the capital budget items starting tomorrow morning. And I would like to first turn it over to the City Manager.

>> City Manager Figone: Thank you, Mr. Mayor. Just a couple of opening comments. Last light I was a little brain dead when you gave me the mic at the end of the evening. What I should have acknowledged is I have received a very thorough packet from working partnership. I received it on Monday, and I want to thank them for their community budget work. And Jennifer Maguire will be reaching out -- I think she always has -- to Bob Brownstein and will be sitting down and thoroughly reviewing the proposals and discussing them with them. We'll have recommendations for you. We are going to discuss fees and charges, and then also, Mayor, you had wanted a discussion of retirement systems' projections. So staff is prepared. There is no written report, but we have a very thorough PowerPoint slide to take you through, and so that is another part of our agenda today. And with that, I'll turn it over to Jennifer.

>> Jennifer Maguire: And actually, Margaret McCann is going to give the presentation.

>> Good morning, honorable Mayor and members of the city council. I'll be providing a brief overview of the 2009-2010 proposed fees and charges. We expect a little over $70 million from the fees presented in this document. Almost $62 million of that would be generated in the General Fund, and 8.5 million would be generated in other funds. For our category 1 fees, which are those that we have a goal of 100% cost recovery, we expect those to be 97% cost recovery in 2009-2010, which is up slightly from 96% in 2008-9. For our category 2 fees, which can be more than or less than cost recovery, we expect those to be 93% cost recovery, which is the same level as 2008-9. And I'll provide a brief overview of some of the highlights in the various departments. For our four development fees programs, Building, Planning, Fire and Public Works, there is no fee increases in three of those programs, and there's a fee restructuring in the fourth one. In the building programs there's no general fee increase but to close a 4.9 million gap in that program, there is the proposed elimination of just over 30 positions, and a mandatory 10% reduced work week and furlough for the inspection services staff. Which was able to preserve funding for five inspectors. In our fire fee program, there's also no general fee increase. To close a $736,000 gap in that program there is a net elimination of 1.9 positions. There's use of 729,000 from the fire development fee program reserve and there's also some one time additions for some I.T. staffing and a file net upgrade. In our planning program there is no general fee increase and there is some reallocation of existing staff. The actions taken at mid year during 2008-9 were sufficient to rebalance that program going into 2009-10. In our Public Works fee program, there is a fee restructuring in that area that is expected to generate 12.6% additional revenue, and there's an elimination of 9.63 positions to close a $2.1 million gap and bring that $5.4 million program into balance. In our Parks, Recreation, and Neighborhood Services department, we're implementing phase 1 of the PRNS pricing and revenue strategy. The fees proposed would be set by the City Manager or designee and shown on the PRNS Website by July 1 rather than itemized in the fees and charges document. The fees are to be set reasonably in response to community needs and market trends. There will be cost recovery goals set annually, and they're on page 77 of our fees and charges document this year. And the goals are linked to the level of benefits, and there's three levels. The public merit or private services, and to generate additional revenue and increase the cost recovery in this program, there are some new fees and adjustments to various fees. There is a new after-school level 2 fee of $7 per day per student that is expected to generate $567,000 in 2009-10. There's adjustments to other fees such as sports field rentals, parks fees, facility rentals and fee classes that are expected to generate another $500,000 in '9-10. In the City Clerk, there is a new $100 election commission complaint filing fee proposed. In Economic Development there's some changes to special events permit fees including the paseo plaza use permit fees, and private property use permit fees. Environmental services, there are new fees to cover cost of damaged or lost power meters that are rented out to the public through the libraries for the new Silicon Valley energy watch tool ending library program. In the finance department there is a new collection fee for delinquent accounts that are between 60 and 90 days overdue. In the general services department, there's proposed revisions to the City Hall event fees. The Mexican heritage plaza fees are now included in this document, and there are various adjustments to the animal care and services fees including increases to the animal licensing, spay and neuter, various permits and owner surrender fees. In the housing department there are two new fees. There's a $280 home buyer subordination fee, and a $1275 multifamily project owner transfer fee to

cover administrative costs. And in the library, there is the proposed doubling of the library fines from 25 cents per day with a $10 maximum to 50 cents per day with a $20 maximum. That's expected to generate $600,000 in revenue in 2009-10. In our Planning, Building, and Code Enforcement Department, in the nondevelopment areas, there is increases of just over 4% for both the solid waste enforcement fee and the multiple housing occupancy fee to bring those programs to 100% cost recovery. In the police department, the majority of these fees are 100% cost recovery. There are a few fees that are under cost recovery, and we're fazing in increases with a 20% increase proposed for '9-10, and that includes your taxicab permit fees and your towing permit fees. There is a modification to the false alarm fines that's not shown in this document. It's part of the administrative citation program. And a separate memo will be brought forward in June on that item. The modification would right now -- you can get two false alarms with no charge every 60 days, and then you pay a fine between $50 and $250. Under the proposed system, you would have one false alarm free every year, and then you would pay ranging from $150 to $300. There are some new fees in the police department. There is a police recruit academy fee of $3100, if other agencies would like to send recruits to our academy to recover a portion of that cost. There is also a new special events traffic enforcement unit fee to cover a portion of the cost of the traffic enforcement unit. And there's the elimination of the emergency communications system support fee, which has been replaced with a telephone line tax. And then, in transportation, there's a new fee structure for the sidewalk repair program where there's fees between $90 and $110, for the permit fee, and it replaces a $145 fee that's currently charged only when the city contractor performs the work. And then there's other adjustments to get those fee to cost recovery in that area. And there's increases to the parking citation fines that's not also shown in the fees and charges document. There will be a separate action that we're planning to bring forward in June on that. But there's a 27% average increase in those parking citations, and the increases range from $2 to $22 per citation. And with that, staff's available to answer any questions.

>> Mayor Reed: Thank you. I'm sure we'll have a few questions. We'll start with Councilmember Oliverio.

>> Councilmember Oliverio: Thank you, Mayor Reed. Thank you for the presentation. On general reservations permits, the outdoor ceremonies at the municipal rose garden, obviously if you were here last night you heard about how the park brings in revenue by hosting weddings and also school graduations. Those fees are nominal. I would really highly suggest that they be doubled. It's certainly not a lot of money to get married at the park for $500, considering other options are thousands of dollars. We currently charge $250. That revenue, although be it -- it would go to the general fund, it would be nice to see if it could stay and remain in the park so it could to continue to take it -- or sustain where it's been able to go. But that is a general viewpoint that that could be easily doubled and swallowed by the consumer and not lose any of the revenue, in fact, increase it. And even if you thought that someone may not get married in the garden, you would still have a gain, because it's an overall increase. So that would be one I would point out. And then, in addition, on -- we have an MOU going forward with the fire department and the jail. Also throw out there that if we're going to get unnecessary calls that don't necessitate the fire department showing up, that should be an area to consider as a policy level. But that I think will be a separate discussion. But I think for my main point is that we need to double those fees for outdoor ceremonies at the rose garden. Thank you.

>> Mayor Reed: Councilmember Kalra.

>> Councilmember Kalra: Thank you, mayor. In terms of the fees under the umbrella of the Parks, Recreation, and Neighborhood Services, some of the concerns certainly that I've heard especially from some of the seniors and so on, the raising of the fees, I think that adds to kind of the general stress over the fact that some centers are going to close and so on. And I just have a concern about, you know, heaping on burdens, all at one time, and so in terms of the fees being set reasonably, I'd really ask that that be taken into consideration. Especially if we know there are certain types of classes that are heavily being used by seniors or any other folks that might be really in an economically disadvantaged situation. So that's just a general comment. But I do have a question about the after school level 2 fee, $7 per day, and that is a new fee. And so what is that mean by after school level 2, what kind of programs are we talking about?

>> Councilmember Kalra, Julia Minsmades, assistant director, Parks, Recreation, and Neighborhood Services. The level 2 program are recreational programs provided after school at nine sites. We actually outline those sites for you on page 75 of the fees and charges book where in those nine sites we would add a new fee. Our outreach component is already underway with folks in these impacted areas. We have appointments with

each of the principals. We'll also be sending fliers home with participants and letting them know this is being considered a fee by the council. And then in the fall -- over the summer we'd let them know if it were to be adopted, that it would move forward and let them have advance notice that the fee would be implemented in the fall.

>> Councilmember Kalra: Okay, and again, it's just to go from zero to $7. $7 doesn't seem a lot, but if you have a couple of kids, that's approaching $300 a month if they're taking advantage of a program every day after school. I just wanted to put my two cents' on that. And then the City Clerk, the $100 election commission complaint filing fee, how many complaints -- Lee, how many complaints are there on a -- I mean, if you can even average, I know depending on an election cycle you're going to get more, obviously. But there are a lot of local, a lot of city council races going on at the same time, that would tend to have more. But how many complaints are filed anyway, in general?

>> Lee Price: Excuse me. Thank you, Councilmember Kalra, for the question. Lee Price, City Clerk. Five or six a year. Again, depending upon whether or not we have an election cycle or not. So in some years it's been more than that, and other years it may be less frequently. But five or six is probably a pretty good example -- or average.

>> Councilmember Kalra: And my concern, and I know that the mayor has scheduled discussions on broader issues, but that included kind of the election commission complaints and so on. My concern is $100, if somebody is -- in that there is someone has an ax to grind, and they hae deep pockets, 100 is not an issue. But 100 would be an issue of whether they're going to file something or not. And so that's my concern, if it's not really an area where we're getting a lot of complaints anyway. My fear would be to dissuade that lone citizen that has an issue with something that's happening in a campaign from filing something, and if they're not going to have any -- again, not going to have any impact on anyone that really has an ax to grind, that has the ability to raise funds, 100 bucks is not going to stop them. That's just a comment on that going forward. I don't have anything against the $100 fee. I just would be cautious if there may be a way that if someone could show, I don't know, if there's an economic scale, something else, just make sure it's open to everybody. Because it's certainly part of the democratic process, being able to file complaints as well as part of the democratic process, we're going through the elections, so that everybody has access. That's just one concern. I don't know if you have any thoughts on that.

>> Lee Price: Well, a little bit of background, if I might, Mr. Mayor. The elections commission meets this evening in their regular meeting, and they have two items on their agenda. One of which is to weigh in on the fee, the $100 fee. And the other is a discussion about whether or not the commission should continue to allow anonymous complaints. The proposal on the table relatively to anonymous complaints is that the commission consider no longer allowing them but providing for a method for which someone who really truly had good cause to file an anonymous complaint could do so, through a new process. Having said that, as the subcommittee on the commission has discussed this issue relative to the fee, if an individual were to file a complaint, and pay the $100 fee and then the commissions found that the respondent was, in fact, in violation of the City's ordinance or ordinances, and found a violation, and fined the respondent, then the complainant would get the $100 back. So that there would be an opportunity to receive that money back, if in fact there was a violation found. Obviously, we're not proposing that this is going to recover costs. Because it's expensive to investigate and evaluate a complaint to the elections commission. However, it might also prevent frivolous and anonymous complaints that really had no merit. Because there are some costs, even to determine that a complaint is frivolous.

>> Councilmember Kalra: Thank you. And the election commission will have an opportunity to chime in and I think they probably have -- their experience will have a better perspective. But I'm glad to hear that they're at least looking into kind of having a deposit refunded if there is something that's found so thank you.

>> Lee Price: You're welcome.

>> Councilmember Kalra: In regards to the police department, there was mention of a $3100 fee for the new police recruit academy fee for other police departments that use our facility to help train their officers. Now, and I believe you mention that it was a partial cost recovery. Is there a reason why we're not asking for the full cost recovery for other departments if they're using our academy?

>> Good morning, Mr. Mayor and council. Dave Cavalero, deputy chief, bureau of administration for the police department. There is a little bit of history here, Ash. Essentially what has happened is over the course of our bringing our academy back to San JosÈ as opposed to the South Bay Regional Academy, we initially were hiring only San JosÈ officers, and we had been requested by a number of agencies within the county to train their recruit officers, as well. So we initially didn't charge. We're currently charging $3100 as the fees and charges book says. And this is the second year that we have done that. Ultimately we want to go up to the rate that other academies are charging, and I believe currently South Bay charges $4800. But there's that cost-benefit analysis. We believe that by having these other officers from other agencies within the county, we build some synergy with them because we're going to be working with them. Crime doesn't have any boundaries between cities so we think it's a small price to pay and ultimately I think we'll get that price up to a more reasonable number so that it is full cost recovery.

>> Councilmember Kalra: Okay, thank you. Thank, I trust your judgment on that, and on the balance. Actually, one more question, Dave, before you head back up the steps. On the special events traffic unit enforcement unit fee, because I think many of us, especially those who have events downtown, have heard about the cost it takes to be able to do special events. So currently costs that are incorporated with special events do not have the traffic enforcement unit fee?

>> They do not.

>> Councilmember Kalra: Okay.

>> They're on-duty folks, and they're diverted from their normal traffic enforcement, say, at the major crash intersections, to do these special events when on they're on duty time.

>> Councilmember Kalra: And so what's the difference practically speaking in terms of costs, to enforce the traffic enforcement unit fees for these special events, as opposed to what's currently being charged to have officers at the event?

>> You know, I don't know what the fee proposed is. I think we're going to be working with the budget office to come up with a reasonable fee for them.

>> Jennifer Maguire: Jennifer Maguire, budget director. Per the fees and charges document, we would bill at top-step police officer salary plus overhead. So we would try to do full cost recovery to the extent the time is taken away from regular duties.

>> Councilmember Kalra: And how does that mix with the current policy, or the -- currently when they have special events and they have to get officers there is this an additional cost, then, or is it to supplant the officers that are there, and -- but rather have the traffic enforcement unit there? Am I making any sense?

>> Well, I think certain events require the specialty of traffic enforcement, versus other events such as music in the park where they don't, it's more of a crowd control issue. And so that's what we're talking about, those specific events that need that special skill set, the traffic enforcement skill set.

>> Councilmember Kalra: Okay, I see. So currently the events that would probably -- probably have a traffic enforcement unit don't necessarily have one.

>> Correct.

>> Councilmember Kalra: Versus having officers maybe doing overtime or what have you, pulled from other patrol units that are doing that service. So now, instead, for those events that are specific that will require that kind of unit, charge the full cost recovery for those units.

>> Correct.

>> Councilmember Kalra: Thank you.

>> Mayor Reed: Councilmember Constant.

>> Councilmember Constant: Thank you, mayor. Two comments, one on the fee that was just being talked about with the traffic enforcement officers. I think we need to make sure that it also has the 5% premium pay, not just top-step officer pay so that we don't lose out on 5% and then I wanted to echo Ash's concerns about the complaint fee for the ethics commission. I really -- I do think we need some reforms in the area of the anonymous complaints. But I don't necessarily agree with a fee for filing a complaint. I don't think we're going to see that much revenue, and I concur that I don't think it's going to deter a malicious complaint. But it may deter and average citizen complaint. And I just wouldn't want to see us start charging for complaints. Because then, before you know it, we're going to charge for complaints in other areas of the city, and I just think it's a bad policy for us to have.

>> Mayor Reed: Councilmember Pyle.

>> Councilmember Pyle: Thank you, mayor. I wanted to see if I understood this properly. Could the complainants not receive a nuisance fee if the complaint were strictly -- where did Lee go? I wanted to make sure I understood it properly. If they don't pay a fee up front could they then, all the people that are filing nuisance complaints or for lack of a better word, a complaint that's not viable, could they not pay a fee at that point? In other words, if they had to pay for a nuisance complaint, they're not going to be likely to file another one in a big hurry. So that, to me, seems like somewhat of an answer in that it puts the onus on people who are abusine the system.

>> Lee Price: I think that it's just similar to an appeal fee that an applicant, or any member of the public, for that matter, might file with the Planning Department if he or she was unhappy with a decision by the Planning Commission. So I think it's similar, you know, you pate up front you let it go through the process and then there's a decision based on the appeal. So that was, you know, the --

>> Councilmember Pyle: Intent?

>> Lee Price: The like thing to that is just to ensure that, by submitting a complaint that someone, you know, was serious and had given a lot of thought to filing the complaint. But I certainly, you know, I certainly understand the ambivalence about doing so.

>> Councilmember Pyle: Okay, thank you. I wanted to talk more on page 75 of our huge fee structure packet. In reference to sport field rentals, I'm not sure whom that would be. I guess Albert if he's here. I don't know how much of a higher fee that would be, is that something I can find out about? Because I've already received complaints from the coaches who are trying to do the coaching and raise money for whatever it is they have to do. Suzanne, you --

>> Councilmember Pyle, I can give the first level answer, and that is, per our sports field study, we are going to be utilizing a tiered system, in that where we have the regular fee, the high use fee and then the premium fee. The premium fee would be in alignment with the fees we charge at Leland where we're completely booked for an artificial turf, high-use field. We don't anticipate changing, as of July 1st, any specific fees in the sports field area other than adding these two new categories of high use and premium. Now, we will, over time, reevaluate the lower end fees. But after doing extensive outreach with our partners and engaging and letting them know and having plenty of advance notice. But nothing will happen July 1st.

>> Councilmember Pyle: Right, I took great comfort in that. I thought that was great, that people are going to have a little bit of time to get used to the idea, that things are going to change. So would it change during the summer months, then?

>> No, it would be -- stay in place over the summer months and then we would have an engagement process. The leagues also have an issue with advance notice, so that they can plan their fee structure.

>> Councilmember Pyle: Right.

>> So we recognize that and will work with them. We wouldn't anticipate changes in that particular area until the next season.

>> Councilmember Pyle: Okay, great, thanks. I'll make sure I get that word out, as well. And then I totally agree with Councilmember Oliverio, regarding the rose garden. But I think doubling this doubling the price is -- if we can just phase-in, perhaps.

>> Councilmember Oliverio: Yavol.

>> Councilmember Pyle: Yavol?

>> Mayor Reed: It's an auction.

>> Councilmember Pyle: Do I hear? Okay, so that's it for me. Thank you.

>> Mayor Reed: Councilmember Nguyen.

>> Councilmember Nguyen: Thank you. I just have a quick comment. In regards to the community room rental at the libraries. I think the proposed change in the fees is to charge $70 per use over four hours. I'm just requesting that staff reconsider this proposed change for the neighborhood associations and/or groups, because I think we had this discussion a couple of weeks ago. I just feel that most of these neighborhood associations are doing a lot of programs and services for the city, and when they rent these community rooms it is actually to carry out some of the things that they're doing for the city. So we can't -- I'm comfortable with the change, in charging $70 for over four hours for other community groups in our city. But in terms of the neighborhood association and/or groups, that we hope that it would maintain at $35.

>> Jane Light: Councilmember Nguyen, my staff agrees. They work so closely with those folks, and many of the programs are ones that are open to the whole community. So when the programs are open to the whole community, my staff has the option to co-sponsor the program and waive the fee.

>> Councilmember Nguyen: Great, that's good to hear, thank you, Jane.

>> Mayor Reed: Councilmember Campos.

>> Councilmember Campos: Thank you, mayor. My question is more of a general question. I think that yesterday's discussion, when Councilmember Chu brought up about whether we -- and it was during a council meeting, whether we had the ability if someone was late on their reports, had the ability to increase the fee. So my question is, in this document, where I -- you know, I kind of glanced through it briefly, and I didn't spend a whole lot of time going line item by line item. But in some of these, there are reports that are due for certain areas, and there is a fee that, if they're delinquent per day, and then there's other fees, where if they're late on maybe paying their bill, through this, do we have opportunities to look at those and increase those fees so that we're getting a little bit more revenue than we are in those areas? It is more of a general question. Could we go back through it and whether it's the council that does it or staff that does that, and pulls those particular items out.

>> Jennifer Maguire: Jennifer Maguire budget director. We have taken a look at some of our fine and fine categories and have proposed changes in them. I don't know if Scott Johnson of the finance department wants to talk about the collection fees and talk a little bit more specifically what you're doing in that area to give you a sense.

>> Scott Johnson: Thank you Mr. Mayor, members of the council, Scott Johnson director of finance. One of the new fees we are proposing is a collection fee for accounts that are 60 days or older. We're requesting that we implement a $25 fee that's based on cost recovery. And last year, council approved a similar fee for those accounts that we were assigning to collection agencies.

>> Councilmember Campos: So it's basically cost recovery?

>> Scott Johnson: Yes.

>> Councilmember Campos: So I know when Councilmember Chu asked, it was on a different item, you were here at council yesterday.

>> Scott Johnson: Uh-huh.

>> Councilmember Campos: And he proposed the question, and the City Attorney said that if it's reasonable, we could do more than cost recovery. Is this a particular area that we could do a little bit more than cost recovery so that we're generating a little more revenue to the General Fund?

>> Scott Johnson: Well we have -- so there's actually three categories related to delinquences, where in some cases we charge interest. Other cases we also charge a penalty. So we do have some fines and penalties, as well as interest, and then we also have collection fees. Depending on -- go ahead.

>> City Attorney Doyle: Go ahead, Scott.

>> Scott Johnson: It really depends what we're billing for. Whether or not we're allowed to only limit our fees related to cost recovery, versus if we have the flexibility to also charge interest, and charge penalties, on top of a collection fee.

>> Councilmember Campos: So Scott, you have a scale internally that tells you whether you can do a little bit more than cost recovery, or whether you have to stay at cost recovery?

>> Scott Johnson: Yes.

>> Councilmember Campos: So let me ask you a broader question. As we look at every department that probably has a scenario, you're able to judge across the board whether we could do more than cost recovery, or just cost recovery?

>> Scott Johnson: That's correct. We work with the City Attorney's Office. We look at the particular ordinance and the applicable law, whether or not we're allowed to go beyond cost recovery for fees.

>> Councilmember Campos: So in this, in the documents that we're looking at through this whole budget, you have identified every opportunity that can be a little bit more than cost recovery?

>> Scott Johnson: To the extent that we're allowed, we have -- every year we review that, and we look for those opportunities.

>> Councilmember Campos: Okay, just want to make sure that we've done everything to finds every opportunity to generate some funding. Thank you.

>> Scott Johnson: Okay. Thank you.

>> Mayor Reed: I have a question for Jennifer, probably. On page IV-9 of the big book, not the fees and charges book, the big book, which is the five year comparison of General Fund sources. For 2009 and 10, obviously for next year, where do the fees and charges show up in the list of general revenues? Is that split up among various categories there?

>> Jennifer Maguire: It is. It would be under the licenses and permits category and the departmental charges category, for the most part. Is there a little -- other revenue? Maybe one or two in other revenue, but primarily in departmental charges and licenses and permits. The things in licenses and permits would be like the fire department permits and things like that.

>> Mayor Reed: How much General Fund revenue -- I think you mentioned that in the beginning, I've forgotten -- in total revenue are we looking at from fees and charges?

>> Jennifer Maguire: Little over $70 million.

>> Mayor Reed: All right. Looking at that general revenue list, and then turning the page to look at the five-year comparison of General Fund uses. And looking at the proposed budget for next year, Public Safety department, $445 million for next year. That's actually up, it's the only one that's going up. So $445 million. And I take that number and come back to the General Fund revenues. Property tax, sales tax, youth tax are the three largest sources of revenues, plus the telephone tax, all combined, will not generate enough funds for Public Safety.

>> Jennifer Maguire: That would be correct.

>> Mayor Reed: So fees and charges look like kind of an important category, $70 million to pay for the rest of the enterprise.

>> Jennifer Maguire: Yes, and I do want to mention one other category, which is fines forfeitures and penalties so the library fines would also be included in that category.

>> Mayor Reed: You take the public safety money off of the top, $445 million out of the $685 million total, that leaves you at $240 million, out of those revenues. So the fees and charges are between a third and a fourth of the total revenues available for all of the other departments besides public safety.

>> Jennifer Maguire: That would be correct.

>> Mayor Reed: Okay, that's why we spend so much time on fees and charges trying to figure out how to squeeze them every little place. Because they do add up to some significant numbers when we get done. And I think I asked this earlier, the card club fees is not in the fees and charges, that is in another category?

>> Jennifer Maguire: That's right. The permit fees are in the fees and charges document but the actual card room tax is not.

>> Mayor Reed: Okay. And that's $13 million a year, the card room tax, okay. And that's in licenses and permits if I remember right. Okay. Councilmember Oliverio.

>> Councilmember Oliverio: One more back to the rose garden. We have multiple schools that graduate from the park which create a tremendous amount of park overtime. And the city makes $800 for those seven graduations which take up a lot of overtime. So I don't know what that fee should be. But it clearly should be somewhere closer to cost recovery, considering tall overtime in the park department.

>> Mayor Reed: Councilmember Pyle wants to second that. In fact she already did. Okay.

>> Councilmember Pyle: I have a quick question. And that's in reference to the after-school programs. How long do those usually last Julie?

>> It's an afternoon program, approximately three hours a day, five days a week.

>> Councilmember Pyle: So three hours, $7 divided by three hours, we're talking less than what you'd pay a babysitter.

>> Yes, and if you convert that to a monthly rate it's approximately $140 a month. Just to give you a benchmark analysis, the YMCA, for very similar programming, very similar hours, is charging $400-$500 a month.

>> Councilmember Pyle: Those are the little factoids that parents need to hear.

>> Yes.

>> Councilmember Pyle: And then the other thing is, I know that a lot of the private schools give a break to families that have several children. Is that something that is doable? I noticed in another page you talked about scholarships, that was on page 76.

>> Yes, our primary strategy would be utilize a scholarship program and make scholarships available for families up to $100 per child per year, and that would be over the calendar year. So in the school year they would actually have access up to $200.

>> Councilmember Pyle: Great, thank you very much.

>> Mayor Reed: Any other questions on fees and charges? If not, we'll move on to -- Councilmember Herrera.

>> Councilmember Herrera: Yeah, just to comment on PRNS. And obviously, these charges are very important in the contribution to helping us bring in enough money to close this gap. I was very impressed. I took a tour out there of the community center and library complex in Almaden and saw in action the Website that's been developed and how that's going to be very useful for our community. And I think that's going to help us reach out, and be able to provide service, and also be able to recover some more costs. And I just want to say I'm supportive mostly of the fees that PRNS has come up with. I think it's creative, I think it's looking at charging more for those customized kind of services and I like the fact that they are going to, you know, it's not just one set fee, they're going to take into consideration you know, who's using it and be able to recoup some of that. So I just wanted to support that. I had just kind of a question, and maybe an idea, in terms of building fees, development fees for our residents and folks that might be thinking of doing a project. Is there any way we can do anything to incent people to do something and in terms of maybe on a very large project, say, a homeowner wants to do remodel or wants to do something and it reaches a certain level, is had any way we could give back a little bit? I don't know what that amount would be, but just some sort of incentive to stimulate people to do some building or some projects.

>> Joe Horwedel: Thank you, Joe Horwedel, director of Planning, Building, and Code Enforcement. Our fee structure in development pretty much does that, because it recognizes the first increment of cost is the most expensive. And so the more you build your incremental per square foot, per dwelling unit, it drops. So the example it uses is for a remodel project, somebody who's doing a 200 square foot addition to their home and a thousand square foot addition to the house, our cost to deliver plan check and inspection services are not significantly higher for the larger. It cost us the same to drive out to that site, 20 minutes' travel time. Ten minutes to look at the plans, ten minutes to walk out to the site. I'm looking at smaller/larger addition. Our fees are based on that. Previously it used to be based, there was not -- it didn't reward larger projects, so it really recognizes that first square foot is expensive, but the 50th square foot is cheaper, and the 100th square foot is cheaper even stilll.

>> Councilmember Herrera: So if there's a size of project that yields us a better return, is there a some way -- I guess I'm asking two questions -- on those things can we do something that would stimulate people to do more, that I would assume that would be good for us. And on the smaller projects, is there some way we can -- I'm trying to think of some incentive to raising all these fees. I mean, if we don't -- nothing from nothing is nothing. If we don't have projects coming in, is there some way to stimulate more projects?

>> Paul Krutko: Thank you, councilmember. Paul Krutko, chief development officer. Councilmember, we are looking at some options that we aren't ready to bring forward at this time that would give us an opportunity maybe to position ourselves differently, look at how we are -- what kind of revenue that would generate from a project over a longer period of time, and would that give us any opportunities to maybe adjust the fee schedule or have a different payment schedule that would incent that. So we are looking at that. We recognize that any kind of positioning we can do at this time might really benefit us in getting more development, or developments that wouldn't occur. So we understand your comment. I know I've had -- I think I've had a conversation with you about it so Joe didn't, that's why I came up to the dais.

>> Councilmember Herrera: Thank you. Yes, I'm just trying to think, in these times if we can do something that's stimulative, let people know about it, market it, if that's our intention to try to get some more business, and projects working that we want to see happen.

>> Paul Krutko: One of the things that helped us in a very significant way and will be a tool that we'll use coming out of this recession was to really market our special tenant improvement program and our industrial tool program. We offered a much higher level of service in terms of for the money that the clients were spending, we were bringing the entire team together to quickly move them forward. And we've -- we at one point in that program, we were -- we had reduced taxes as a part of that approach. And had an extended payment schedule. Last year, when the economy had gotten better, we took those incentives down. The clients were really responding just to the increased level of service, and didn't appear to us that they needed the incentive. But we've used that tactic in the past, particularly coming out of recessions to capture early business. The first few people making decisions to occupy space in the valley, we want to be as competitive as we possibly can.

>> Councilmember Herrera: And I don't know about remodels. I don't know the whole business of remodels, but I imagine there's some folks that may not be planning to be moving any time soon, may be wanting to do some remodels, might push them over the edge if we had some incentives. Any of these projects put people back to work, and our construction industry has got a huge unemployment rate, greater than the 12% that San JosÈ is unfortunately having right now. I think it's 18%, might even be more. So any way we can increase opportunities for people to get back to work would be good, too.

>> Joe Horwedel: Yeah. The only challenge with the incentive piece is in the fee program, I'm not allowed to run a profit, and I can't run a loss, and I can't subsidize between customers. So literally it is a model of you pay for what you use. And so we do have programs we've built to try as an incentive from a service delivery side to help with that but even those are at a cost recovery basis. So we're trying to make sure we've reduced the barriers for people to come in through the permitting process and make sure that our service delivery matches what they're trying to get done. So if they're trying to do a small project, we've got teams that are worked around that. We've looked at how to drive down our costs for that so that we reduce to the maximum extent possible. But really, the only other options that I have available are to ask for General Fund money or to do things like waiving taxes, which have consequences to the capital budget, and we'll talk about tomorrow, or I guess on Friday.

>> Councilmember Herrera: And finally, I guess what I'm suggesting is something more temporary during this down time, some ways to move things forward that might not have happened.

>> Mayor Reed: Any other questions on fees and charges? Okay, I think we're done on that. We'll move next into the retirement system projections. We'll swap out a few staff, move people around here for a minute. Councilmember Kalra.

>> Councilmember Kalra: Thank you Mayor. While we're waiting for staff to switch out I just want people to know that I went to the airport this morning to check out the new ticketing area of terminal A and it's very impressive, and although sparsely populated right now, I'm hoping that it is -- air travel picks up. I'm certain there are going to be a lot of people surprised today that are flying out of San JosÈ, that aren't aware that these terminals were being made or they weren't aware they're open. And so I look forward to the rest of the airport being built. It was nice to see the first piece of the puzzle completed. So I've met with David Vossbrink and he wanted me to extend an invitation to all of you whenever you've had had the opportunity to head on over there and check it out.

>> Mayor Reed: Thank you. Ready to go. City Manager.

>> City Manager Figone: Yes, thank you Mr. Mayor, members of the council. The presentation you're about to receive is the result of a request of the mayor to help the council, our employees and the public, understand what we're facing in terms of the potential pension costs. And so what we're going to do is take you through what is really some pretty technical information but I think it's important to take you through the presentation as the staff has planned it, so you really understand the underpinnings of what is driving the various issues that we will have to confront as we move forbid. So with that I'll turn it over to Alex and he'll get us started.

>> Alex Gurza: Good morning, mayor, members of the city council, Alex Gurza, director of employee relations. With me this morning is Russell Crosby, director of retirement services, and deputy director of retirement services Carmen Rossi Choy. In November of last year and in April of this year, the city manager provided the council information regarding the investment performance of the retirement plans in light of the

significant market decline. The retirement plans have experienced over a $1 billion decline in assets in a relatively short period of time as a result of the market's downturn. Although this is clearly cause for concern, we want to emphasize that this is not an issue of the plan not having enough money to pay benefits. Retirees will continues to receive their pensions. The issue is, the impact of the investment losses, on the City's contribution rates, and how much more money will need to be put into the retirement system in order to ensure that the retirement plans continue to be actuarially sound. This of course has an impact on the city's budget. For sense of perspective, in 2008-9, this current fiscal year, the city contributed approximately $125 million into the two city pension plans. This is before any impact of the market decline. Agencies throughout the state and the country have experienced similar decline in plan assets. The headline of a recent associated press story was this: $1 trillion hit to pensions could cost taxpayers and workers. So in that sense we are not alone in the situation of the decline in assets and impact on pensions, both in the public and private sector. The principle that we have compensation and benefits is that we try to pay, set aside sufficient money, when services are rendered to the public, to have sufficient money to pay benefits that are received in the future. So for example, if we have a retirement plan, we try to set aside enough money today so that there will be sufficient enough money to pay that benefit in the future. Not doing that causes what's called an intergenerational transfer where future taxpayers are paying benefits for services that they in fact did not receive, that were received many years earlier. So that's why we try as hard as we can to ensure that there is a sufficient money put in the plan when the services are rendered. Although we are not alone in this issue, as we learned, in addressing the retiree health care challenge, not every agency is in the same boat. The unfunded liabilities are different for different agencies, and can be affected by the level benefits, so what benefits are promised to retirees, investment performance, and many other factors. We do hope, however, that we can learn from the best practices and the expertise of the trustees of the two plans, and our Department of Retirement services. The information we have provided to the council as the City Manager indicated has prompted several questions from councilmembers related to the impact of the decline in assets. The projections that the police and fire retirement board actuary provided clearly caused alarm, but they are just that. They are projections. And we're going to go through and Carmen and Russell are going to go through the presentation and talk a little bit about those projections. Although we do not know at this point what exact impact there will be on the city's contribution rate, we do not believe there is a question that the City's contribution rate will increase. The issue yet to be determined is by how much. So we will begin the presentation today by providing an overview of the pension benefits very quickly, and then move and turn it over to Russell and Carmen to talk about some of the technical issues. Again our principle is to ensure that our retirement plans are well funded and actuarially sound and that we take the appropriate steps to keep our plans in that status. So we'll begin the presentation, I'll go through it, try to go through things as quickly as possible. But please feel free to answer questions, and I'm going to go through my section as expeditiously and we can. So we're going to start talking about pension benefits, about the recent investment performance, talk about what are key factors that impact contribution rates, and talk a little bit about those projections that are what had caused some concern, and then very quickly go through best practices. In this presentation, Carmen and Russell can probably do it -- it takes several days to do everything there is to know about pension plans, so we are going to, in a short period of time, give you a lot of information. We have two retirement systems, as you know. The federated city employees retirement system, the effective date of that system was 1975. It has been in place for many years. And the formula has not changed in all those years. It is a maximum of 75% of an employee's final average salary that is reached after 30 years of service. An employee receives 2.5% of their final average salary for every year. This type of benefit is what is called a defined benefit program. So the retiree receives a benefit based on a formula. There is no relationship between what the employee has contributed or what the city has contributed on what the employee actually receives. So that's an important difference between our 457 plan, which is our version of a 401(k) plan, what you get is what you contribute and how investments are. Despite investments whether they gain or lose, the employee still receives the benefits under a formula like this. Our police retirement formula has changed over the years. You can see in 1970, it was 75%, and the formula was the same as our current federated system still is. And then there have been several increases. So for 26 years it remained unchanged and then it started increasing in 1996, again in 2000, and again in 2006. So that we currently have a benefit that is a maximum of 90% of an employee's final average salary after 30 years. Fire has a very similar history, and from 1970 to 1996, it did not change and then several changes to the formula, again raising it to 90%. And although both police and fire at 90%, the formula is different for police and for fire. There are additional benefits that are received by eligible retirees beyond the pension benefit itself. There is what is referred to as the 13th paycheck, and the term SRVR is supplemental retiree benefit reserve. Another important component of our retirement package is retiree health benefits, where the retiree receives 100% of the lowest price plan. An important point to point out about retiree health care is it is funded different. That is, where employees in the city contribute 50% of

the cost to set aside the money othat benefit is there. This presentation is going to focus on pension however, not on retiree health care. We also have a benefit of reciprocity. We are independence, an independent retirement plan not part of PERS. But there are some benefits for people who move between a PERS agency and San JosÈ, and vice versa. Lastly, a very important component of a pension plan is what cost of living increases are received. Many cost of living increases in pension plans are actually tied to the CPI. Ours is a 3% cost of living fixed. So every year the pension increases by 3% regardless of what CPI increases. Briefly talk about now how is money set aside to pay for these retirement benefits? There is a split, and on the pension side there is what is called normal cost, an Carmen is going to later talk about what normal cost is. But there is a ratio that's specified in the city charter that is 8 to 3. What that means is that for every $8 the employee puts in, the employee puts in 3. There's another important component of the cost which are called prior service costs or unfunded liabilities, again, something Carmen later in the presentation will go over. That is 100% paid by the city for pension on a prior service cost. That is set forth in the municipal code. The little asterisk is important, which says that the city bears all risks, including investment and mortality risks. Meaning that if investments do not perform as well as the actuary predicts that they will, the city bears that risk. This very quickly shows you the current city contribution rates. Now, a lot of numbers on this slide. But if we just focus on the bottom total. In the federated plan, combined currently for pension and health care, the city contributes 23.5% of payroll. So what that means is on top of an employee's base pay, the city puts in 23.5% into the retirement system. The employee puts in 8.93%. Also, an important thing to keep in mind is that we are not members of the Social Security system. So our pension plan is in lieu of Social Security. On the police side, the contribution rate total is 25.8. Employees contribute approximately 12%. And fire is 28.3, and the employees contribute 12.4% of payroll. Is okay, so with that I'm going to turn it over to Carmen who's going to go over the recent retirement performance.

>> You've received from Mr. Russell Crosby in the fourth quarter of last year an update that showed that the decline in asset value on the investment portfolios was really approximately $950 million. As of March 31st, 2009, the number had decreased to $1.2 billion. That's where the decline in asset value stands. There are various measures to measure the health of a pension plan. One of the most common ones is called the funding ratio. The funding ratio is very simply the ratio of the assets divided by the liabilities. So for illustration purposes, if the funding ratio is 100%, this is equivalent to having $1 of assets for every dollar of liability. As you can see, the funding ratios for both planned are projected to decline. This is not surprising, given the level of losses that have been incurred to date. Just as an explanation, the police and fire projected funding ratio of 76% really means that for every $3 in assets, we have $4 in liabilities. Was the cost of pension benefits? The cost of pension benefits is really made up of two pieces. The normal cost and the unfunded liability amortization. The way to think about it is that the normal cost is for future service, so if an employee starts today, the normal cost would be the cost for the next year of service for that employee. The unfunded liability amortization stems from two possibilities. One is benefit enhancements or assumptions, actuarial assumptions not working out. You can consider the unfunded liability amortization similar to a mortgage. These are the two pieces of the cost. The key factors that impact the City's contribution rates clearly benefit enhancements, actuarial assumptions, the main ones being the mortality rates, and the assumed investment rate of return. The asset smoothing methodology could also have a very big impact. You've probably heard from -- or read from the memo that I mentioned earlier, about the investment assumption made by the actuary. On police and fire, that assumption is 8% net. On federated it is 8.25. Now, this is the number that the actuary believes he needs to fund benefits. So in order to earn 8% net, we, or the investment function, needs to earn 8.9 gross. The difference of 0.9% pays for investment manager fees, administrative expenses of the plan, as well as benefits not observed by the actuary such as the supplemental retiree benefit reserve transfers. Now, what I'd like to invite you to look at is the last column of the table in front of you, which shows our investment consultant's median rate of return. The investment consultants obviously understand our investment strategies. The rate that they believe will be realized by the investment portfolio on police and fire is 7.5 gross. So this compares to the 8.9 and on federated it is 7.25. Again, this is a gross number so it is comparable to the 9.15. Now, what is the impact of having a gap between the investment rate that is realized and the actuarial rate of return? Fundamentally this will result in an unfunded liability, and the city is responsible for 100% of the unfunded liability payment. Asset smoothing methodology, why do we have an asset smoothing methodology? It is a mechanism to control the contribution rate volatility, the city has a five-year smoothing period, and that's the most common smoothing period. The major of plans, of pension plans have a five-year smoothing period. Next, I will be talking about the corridor. The police and fire pension plan has a specific feature in its asset-smoothing methodology. The corridor fundamentally stops smoothing of gains and losses, and what this means is that it will increase the contribution rate volatility. Just to give an illustration, given the gains and losses that have been incurred on the plan as of fiscal year ending 2008, we can own infer 9% in

losses for this year. So all the losses that have been realized on police and fire that are in excess of minus 9% could not be deferred to future years as would normally be the case in the five-year smoothing. I will talk a little bit more about the impact of the corridor when we mention the projections. Some pros and cons of changing the asset smoothing amortization period. Obviously, if we extend the period, this would decrease the City's contribution. The disadvantage of extending the period is the fact that we'd be shifting cost further out to the future, to future generations, and the second disadvantage is that we'd be stepping outside of normal actuarial practice. We have heard comments about Cal PERS having an asset smoothing amortization period of 15 years. This is actually quite aggressive, because this means that they only realize the gains or the losses after 15 years. And at that point in time they have a 30-year amortization period. So current costs could, in fact, be deferred to up to 45 years. So that is quite an aggressive assumption.

>> Alex Gurza: Before Carmen gets into the scenarios and the projections, we just wanted to give you a sense of scope in terms of the increases in contribution rates. So if the city's contribution rate goes up 1%, which means if it's currently 24% of payroll, and it goes to 25% of payroll, this is what the cost is. So for police and fire it would be $2.4 million, and federated $3 million. So approximately $5.5 million for every 1% that the City's contribution rate goes up. And you can see in some of these projections it is many, many percentage points. But even if it were to go up by 1%, it is $5.5 million.

>> Thank you. You've already received the Segal projections. Clearly these are only projections. One thing we do know is that given the losses that have occurred, the City's contribution rates will go up. I would like to invite you to look at the baseline scenario. The baseline scenario fundamentally assumes no changes in methodology and no changes in assumptions and reflects the investment return that has been earned on the investment portfolios up until the end of February 2009. What I would like to point out is the impact of the corridor and the police and fire's smoothing methods. If you look at fiscal year '10-11 you can see that the contribution rate increases from 22.5 to 45%, roughly. If the corridor was to be removed, meaning if the losses were to be smoothed over five years as they normally would, that number would change to something just under 30%. So the corridor and the smoothing methodology does have an impact on the short-term rate. I would like to point -- to bring to your attention the fiscal year '14-15 numbers, which shows the City's contribution at 61%. Now we've received feedback that some of these scenarios were too pessimistic. And so what I'd like to share with you is the results of an optimistic scenario. The optimistic scenario is based on the same methodologies and assumptions as the baseline. It also reflects the losses that have occurred to the end of February. However, we are assuming we are going to earn 20% return next year, and the year after. After -- clearly this is an optimistic scenario. You can see why. What I'd like to bring to your attention is, even if we assume we're earning significant returns, 20%, in fiscal years 10-11 and 11-12, in fiscal year 10-11 the contribution rate would remain constant at 45%, no change from the baseline. The ultimate contribution rate, fiscal year 14-15, changes to 50%. This is the optimistic scenario.

>> This slide shows the results of best practices in institutional investing. These are the results for the top performing clients of New England pension consultants, probably the best pension investment consultant in the U.S. right now. NEPC was hired by the police and fire plan midway through last year. For NEPC's top corporate clients the average performance for 2008 was negative 7%. That compares to negative 27% for San JosÈ police and fire. Late yesterday, we received information that 40% of NEPC's more or less hundred corporate accounts had performance that was either positive or at least better than negative 10%, for the year ended April 30th. This compares to negative 24.8% for the police and fire for that same year ended April 30th. Next slide. The single biggest difference in investment strategy is those top performing plans have professional staff and trustees who focus on eliminating risk rather than shooting for arbitrary return targets. In each of those top performing plans the actuarial assumed rate of return is based on the investment consultant's capital market expectations. In slide 17, Carmen has already demonstrated the disconnect between the work of the investment consultants and the actuaries here in San JosÈ. Regardless of asset -- regarding asset smoothing five-year smoothing is the norm. But there's been discussion of using longer smoothing periods. That discussion ignores the fact that both the accounting profession and the actuarial profession are moving towards shorter smoothing periods rather than longer. Many corporate plans are already essentially mark to market rather than using accounting gimmicks such as smoothing to hide performance problems. This last slide offers a time line on when the actual contribution rate increases will be known. As you see, we've got an RFP for actuarial consultants out on the street right now. We anticipate selecting consultants to perform the work within the next month or two. It will take six to eight months for the actuaries to actually do their work. With the approval of contribution rates sometime in spring of 2010, then the retirement contribution rates become effective July 2010.

>> Alex Gurza: So that concludes our presentation, and we are happy to answer any questions you may have.

>> Mayor Reed: Thank you. I reckon we'll have a few questions on this. I'd like to start this. I asked to have this presented. And I think one of the assignments I'd like for you to do, as we get into the budgeting part of this, the budget process, not this year's budget because we're talking about next year. But I think we need to know, before we have to bite the bullet next year with these kinds of numbers or even the optimistic scenario numbers, what are the things that we have the power to do? Because some of these issues are vested and they are what they are. But some of them are not. And we need to have that menu of things, not that we can necessarily accomplish them, but we at least have to start with, these are in our power to have some effect on. I don't know exactly when you can get that back, but before next year's budget process we certainly want to have that. For example: On slide number 8, cost of retirement benefits. Where we have the cost split and the source, the pension normal costs is in the city charter. So we have some ability to change the city charter. Not a lot, but some. Pension prior service cost is in the municipal code. So we have some ability to change the municipal code. I understand that a lot of this is subject to meet and confer and bargaining and all that but it is something that is within our power to have an impact on. So my first question is, what's the difference between what's in the city charter and what's in the municipal code, and is it just the location or is there some reason, one or the other?

>> City Attorney Doyle: Well, I think Alex and I can tag-team on this. Because I can tell you, if it's in the charter, it requires voter approval. It may require meet and confer as well. If it's in the municipal code it requires meet and confer, in all likelihood, I wouldn't say in every case, but we will have to look at it on a case by case. The council then has the ability to change the municipal code without a vote of the people.

>> Mayor Reed: On that topic of who pays for the unfunded liability, us, as the representatives of the taxpayers, not the employees, I'm concerned that the structure creates an incentive to be overly optimistic about the scenarios the rate of return. We have I think a majority of both boards who are members of the plan and also employees. So if you have a very optimistic assumption about rate of return, that decreases the contribution. And then every few years you have to come back in and make up the difference, but that comes from a different pot. That comes from the taxpayers. So I think that one goes into the sort of looking at the structure of the boards on a long term basis that I know you've got on your work plan. But in terms of the things that we can change, perhaps more quickly, the retirement formula account 90% numbers, for example, are there things that we could change that people use to gross up their numbers? For example, I know that if you retire on the appropriate date, you can get a 3% cost of living increase the next day, effectively retiring at 93% of something. And then I understand that if you gross up your benefit -- your pay in the last year, by saving vacation or -- I don't know what it is, but if there are things like that, that could affect these numbers, and help us bring down the cost, you know, we should know those. Understand everything may be subject to meet and confer and contracts. But at least we ought to know what the opportunities are. The 13th paycheck, SRBR, I was here when we approved one of them, I think federated had it before I got onto council and police and fire got it later. Is that something that is vested in the way that other pension benefits are vested? If it is not it could be something we could do something about.

>> City Attorney Doyle: That is something we would have to get back to you on. I sent an e-mail to my staff to follow up on. I know that's an open issue and part of this budget process we'll be getting -- we'll be doing that probably in the form of an MBA.

>> Mayor Reed: On slide 17 you had the actuarial rate of return, net and gross and investment consultant rate of return. Is it the conclusion to draw from that is that we have overly optimistic assumptions about rate of return that when you try to look at the real world, which is the investment consultant's job that they're saying that it's not going to be that good?

>> That's correct.

>> Mayor Reed: Okay. That is something the board will consider in setting the rate of return projections, just one of the pieces of advice from our investment consultants, but the board's not bound by that? The board can ultimately pick any number the board decides is appropriate?

>> That's correct.

>> Mayor Reed: On chart 11 or page 11 you talked about PERS assumptions being aggressive. Is aggressive polite talk, in actuarial terms, for way out there?

>> That is correct, actually. Pushing current costs 45 years into the future is not a good financial practice.

>> Mayor Reed: But these are the things that the state of California does on a routine basis. And if I remember not long ago, PERS was urging or telling local agencies that they could grant enhanced retirement benefits at no cost. That the return was so good, that it would be at no cost, right? Okay. I don't think I put PERS in the best practices category when I'm looking at best practices. They're probably not on this list of best practices that you have here, I don't suppose. As a member of the VTA board, I asked the board to do some best practices comparisons of VTA and other funds. And included in that analysis was a comparison to our funds, and VTA did over any period better than what we've done over, like, a ten-year period, a couple of percentage points difference. What's the impact of a couple of percentage points difference in actual performance over some period of time? Does that translate into a couple of percentage points less that we have to put in to fund?

>> Actually, if you change the interest rate assumption by 1%, it has an impact of changing your contribution rate by roughly 18%. It's quite significant.

>> Mayor Reed: You would say so. Okay, that's a big number. And then I want to go --

>> Councilmember Liccardo: Sorry to interrupt, Mayor. Carmen, could you repeat that just so we understand it again? It seemed like a very important point, and I didn't quite get it.

>> Sure. Actually, the -- we didn't show the original Segal projections, but based on memory, the comparison between the first scenario that we ran in the Segal projections was what would happen if we dropped the interest rate assumptions by half a percentage point. And the answer was, in every year thereafter, the city's contribution rate would increase by approximately 9%. This is where I'm coming with the estimate of 18%. So a 1 percentage point drop would result in an 18 point -- 18 percentage point increase in the City's contribution.

>> Councilmember Liccardo: Thank you. I'm sorry to interrupt.

>> Mayor Reed: That's okay. That's an important point. Then I think my last question is on your slides 23 and 24, which are the contribution rate, 1% is worth 5 and a half million bucks. And the optimistic scenario has a rate projection going from 23% to 45%. So that's a 22% difference. Does that mean I multiply 22% times 5 and a half million bucks to turn it into actual dollars that we have to write a check for?

>> Alex Gurza: Yes, that's correct.

>> Mayor Reed: I was afraid that's what that meant.

>> And it's important to note that's only the starting point. Your terminal rate is three years out, and that would hit 50%, or in the baseline scenario, somewhere 61%.

>> Mayor Reed: How optimistic a scenario do we have to have in order to avoid that? You've got a pretty optimistic scenario with 20% rate of returns.

>> We -- go ahead.

>> Well, this scenario was really designed by me to say, okay, the plan's best year was 2006. And you did 19% in police and fire and 16% in federated. Let's just round that up to 20%, give yourself two years of that outrageous assumption. There's not anybody in the investment world that would assume anything like that as potential returns over the next two years. But even using that outrageous assumption, you still end up with a 50% contribution rate after three years.

>> Mayor Reed: What if we doubled the value?

>> Well, basically to avoid a contribution rate increase you have to have something close to 100% return over the next 45 days.

>> Mayor Reed: Okay, now we know what to shoot for. [Laughter]

>> Mayor Reed: Thank you, that's the end of my questions. City Manager.

>> City Manager Figone: Staff, could you clarify, do the actuarial assumptions assume that this is for the existing workforce, or are we making assumptions about new employees coming into this plan?

>> No assumptions are made with respect to new employees. So this is -- these projections were based on the June 30, 2007 membership. We have not assumed any additional membership since.

>> City Manager Figone: And because we're a vested plan, a new hire coming into this system, as well as us very lucky existing employees to be part of this great system, but those benefits, then, are guaranteed for the remainder of their life, correct, once they vest in terms of the five-year period?

>> Alex Gurza: Yes. On the pension benefit itself, I mean I think those are clearly vested and cannot be changed. There are certain features of the plan that the mayor has pointed out that we need to work with the city attorney's office to determine whether they're in that same vested category or not. But clearly, for new employees, there could be different benefits that could apply to people who are not members of the system yet.

>> Mayor Reed: Councilmember Constant.

>> Councilmember Constant: Thank you, mayor. I think one of the things that's going to be really important for the council to understand as we go forward is the relationship between, and the differences between, the city council and the individual Board of Trustees. In other words, where the power lies and who makes the decisions. For example, in actuarial studies, there's probably what, two dozen or so assumptions that are made in order to come up with that valuation, and what the contribution rates are. But that decision rests solely on the Board of Trustees, and there's no power whatsoever on the council. And I think getting an explanatory memo to the council that really shows what decisions are made, on a daily or monthly basis, by boards of trustees, how those affect or could affect the plan, and what, if any, roles those of us who are not on the Board of Trustees have. And I think it's also important that we clearly delineate between the two funds how -- not necessarily how they're similar but how they're different. For example, I think I understand that how you calculate final average salary is different between the two plans. In fact my understanding with federated is, it's not what you made, but it's what you could have made. Things like that, I think, are important for the council to really understand, as we go forward, because the retirement systems, because of the economic environment, are going to have, as we've seen over the last 18 months, a lot more scrutiny going forward. And I don't know if everyone's completely clear on that. And I want to make sure that everyone understands what happened in San Diego, where there was conclusion over assumption rates, and what were the results of that. And how any attempts to manipulate assumptions to predetermine an outcome, whether it's to benefit the General Fund or to benefit employees, what the pitfalls of that are. Because as I've learned in far more depth than I ever thought I wanted to know about this retirement stuff, it's quite a complex field, and the liability issues beyond the civil liability, with the criminal liability issues, can be fairly significant. And I think it's something that we need to make sure that everybody on the council understands. And that also, the trustees, I think the trustees are pretty aware of it. But anything that's given to us would be good to give to them, as well. Because the decisions that are made in the next several months are going to have huge impacts. Whether the assumptions are overstated, or understated, whether it's just the rate of return or the mortality or any of those other things are going to have some huge implications for both employees and for the City of San JosÈ's taxpayers, via the General Fund. So I know that's a lot of information. I'm not sure how would be best to approach it. But I think it's really important for two reasons. Just one, because we all need to know, because this is so important. But also, so nobody steps outside of those bounds and we find our cells in some of the problems that the City of San Diego had with their trustees.

>> Alex Gurza: Councilmember Constant, if I can respond briefly to that, those are excellent points. Clearly we've been following the other pension plans, including San Diego, and the challenges they faced. If you simply

look at this slide, there is a natural tendency to say, what can we do to make those numbers go down. And I think speaking on behalf of the administration, we want to be extremely carefully about anything that makes those go down. Are they actuarially sound decisions, or are they pushing the cost to future generations. And I can speak for the City Manager that we will be very cautious in not suggesting or doing anything that implies that we simply wants to push those costs out. We want to make actuarially sound decisions.

>> Councilmember Constant: Thank you. And I think the discussion of the intergenerational equity is important. Because we see what's happening with the health care liability and what contribution rates need to be now, because we weren't prefunding for a long time. And even though we don't have agreements with all of our unions yet, I'm sure we will soon. But the longer you do that or the more you compound things, the more the next generation of employees and the following generation of employees are really going to pay. And quite frankly, also those next generations of taxpayers, our children and our grandchildren will be paying a whole lot more money towards those if we make mistakes along the way. Thank you.

>> Mayor Reed: Councilmember Liccardo.

>> Councilmember Liccardo: Thanks, mayor. I wanted to thank Russell and your team, Carmen and everybody on your team. I really appreciate you coming on board last year as you did. It was a breath of fresh air, I think. I never realized the depth of the problems until I just came on the board this year. And I think only began to appreciate just how badly this ship needed redirection. And I also wanted to thank Councilmember Constant for your leadership on this. I know we don't agree on a lot, but I appreciate your courage to come out and speak out on this. Because this is a ticking time bomb. And I think we've only recently started to get a sense of all that. What number I was hoping we might have in our minds, because I know we have it on the medical retiree side, what is the total unfunded liability? The total was somewhere around $1.14 billion between June of '08 and the end of March. But I'm assuming our unfunded liability's a bit larger than that. Is that a fair assumption?

>> That's a fair assumption. Just off, I don't have the exact numbers in front of me. But from the funding ratios, you could tell that we're roughly around 75% funded. What that really means is, as of June 30, we'll probably be looking at approximately $3 billion in unfunded liability.

>> Councilmember Liccardo: Approximately $3 billion?

>> Yes.

>> Alex Gurza: Councilmember Liccardo, if I can add, just make sure we clarify. Since the presentation is about pensions, I want to point out a key difference on the retiree health care side. The costs are shared with the employees for medical 50-50. The agreement that Councilmember Constant mentioned with eight of our 10 bargaining units, are actually sharing the unfunded liability. It's going to take us quite a while to get there but that's very different than the way the unfunded liabilities are on the pension side which are 100% paid by the city.

>> Councilmember Liccardo: Thank you, Alex, I appreciate that reminder. And I'm certainly mindful of the fact that the General Fund, and ultimately the taxpayer, picks of the tab on pension end of things. Carmen, when you say $3 billion, I suspect you were answering the question assuming I was asking about medical and pensioned combined, is that right, or are you saying just the pension liability alone is $3 billion? Okay that is very sobering.

>> Mayor Reed: Could we get that again?

>> Just pension liability. The unfunded liability that is expected as of June 30, 2009 is approximately $3 billion between the two plans.

>> Mayor Reed: Okay, plus the health care one.

>> Councilmember Liccardo: Right, Plus 1.6 or something slightly less. Is there a lottery out there that pays out $4.5 billion that we could -- [Laughter]

>> Councilmember Liccardo: I think an important issue too, is looking at slide 17, understanding the source of this problem, the difference between what the consultant is saying our estimated rate of return or assumed rate of return ought to be, a gross of 7.5% and what assumptions we've been using which are close to 9%, it seems to me that even prior to the market fallout of last year, we were essentially locked into a structure that was destined to fail, with overly rosy assumptions about what our rates of return would be that were not commensurate with reality. Do you have any rough sense of the $3 billion hole that we're in now, roughly how much is attributable to the historic challenges we've had in making accurate assumptions based on reasonable rates of return?

>> These are rough numbers, but approximately the impact of the losses that you saw of $1.2 billion, this is going to result in a $1.5 billion unfunded liability just because the actuaries assume you're going to earn, as you saw, 9%. So when you underperform, when your assets decline by 1.2, you really have an unfunded liability of 1.5. So roughly 50% of the number is due to the decline in the markets, and 50% to the discrepancies between the forward-looking investment provided by the investment consultants and the rate assumed.

>> Councilmember Liccardo: Thank you, Carmen. Question arose, Russell, during your discussion of NEPC, and the New England Pension Consultants, who you described as sort of being the gold standard for consultants in the country. You indicated that our P and F fund last year fired them?

>> Hired them midway through the year.

>> Councilmember Liccardo: Hired them, okay, good, whew.

>> They had previously declined to bid for San Jose's business, but we reopened an RFP that was outstanding and were able to get them in here.

>> Councilmember Liccardo: Do you have any idea why they declined to bid previously?

>> They didn't think there would be any change here. They don't -- they choose their customers very carefully.

>> Councilmember Liccardo: And regarding number -- slide number 24, on the contribution rate projections, under both baseline and optimistic, I see an assumed rate of investment return of 8% per year. My concern is comparing that to slide 17, isn't 8% higher than we believe is actuarially sound?

>> That's correct. It is higher than what we believe is actuarially sound. However, it is the current assumption adopted by the boards and the trustees.

>> Councilmember Liccardo: Should our Board of Trustees have the wisdom to adopt an assumption, an actuarially sound assumption, fair to say that contribution rate increases?

>> That's correct.

>> Councilmember Liccardo: Do you have any idea what the magnitude of that increase would be?

>> An increase of -- a decrease in the rate of 1% would increase the facility's contribution by 18%.

>> Councilmember Liccardo: Okay, that's where the number was, okay, thank you. Now I think I fully understand that. So I think this goes back to Councilmember Constant's point, we really do need real reform in the board structure. This is a real problem, when we continue to believe against all facts and all probability that things will be different when we continue to make assumptions that are completely unrealistic. I'm concerned, in my very short time on the board, and what I've seen that we have, based on historic practice, and this is prior to your time coming on, Russell, but excessive number of fund managers, and excessive amount of, for lack of better term, churning, of overmanagement of the funds. I'm concerned about relationships in the past between trustees and fund managers and insurers. I'm concerned about the lack of professional membership on the board. I think we've got real problems that are costing our taxpayers real dollars now and for many, many generations in the future. And not just our taxpayers, if that's not bad enough, but in fact our future retirees. I think Councilmember Constant pointed to the intergenerational equity problem. The reality is that we are making choices that are

cheating future retirees. Because we're undermining the soundness of the system. So it seems to me, this really isn't an issue about the city versus labor or anything like that. And if you believe in protecting retirees and you protect, you want to protect those who are doing the good work that they're doing today for our city, then we need serious reform here. And so I hope certainly we can do whatever it takes to get there.

>> Mayor Reed: Councilmember Oliverio.

>> Councilmember Oliverio: Thank you, mayor. One word: Unsustainable. That's it. I mean, you show us the numbers, the numbers are what they are, they're the facts. And at this point, you know, we can continue as we're doing, and then just lay off every other employee and cut every other city service because we won't have the money. If you picture the pie graph, the portion that's going to pension contributions, number one, is doubled in the last seven years and continued with the further losses in the market, and what you're showing us today will continue to grow. That means I have no choice than to cut a library a day, and lay off MEF staff. I have no choice to not hire officers, et cetera, et cetera. So I think, you know, we deal with past decisions here. And now, it's up to us to deal with it. We can yawn, and leave, and be done with this meeting. Or you can seriously say that if a new employee starts working for the city, that they have to have new benefits that are lower. Because I can't sustain it. I need benefits I can afford versus benefits that make me take away city services from our residents. I really want to see a vote on this sooner versus later. I'd like this to come to the city council where we can vote on having new benefits for new employees, not yet hired. It's not for your co-worker. It's not for you. It's for people that haven't started working in the city. It's really simple. Ask your friends that have 401(k)s. Ask them how much they're matched. I've worked for multiple companies. It's always been a zero. Some people work for companies that get 6%, 10%, pretty generous. We're matching it 200%. If you were to put this on the ballot on the charter change and say that should the city of San Jose reduce its contribution from 200-plus percent to 100%, that would pass in an instant. And 100% is still incredibly generous. So we -- the numbers are here, the facts are the facts. I mean, what else can you say? I mean, everywhere you go, everywhere you turn on this thing, via an optimistic scenario that's not going to happen to the pessimistic scenarios, and it's your view on the economy. A lot of people view that we're going to have -- we've reached a point where we've produced all these goods, we can only consume so much, and that we're going to have just flat growth for the next 10 to 12 years. Because you know what? The only way you get stocks to rise is through earnings. And if people aren't buying, and margins of companies are lower, you're not going to have that. And that's what -- you know, a good portion of our portfolios are in equities. So whether it's your retirement or ours, et cetera. So I've said it, I'll stress it: We need to have new benefits, new employees not yet hired as soon as possible. I know there's people that are fearful of this. But I can't sustain it. And if you're telling me you want me to keep it this way, then I have no choice than to continue to lay off people and cut city services. You know, we have a hard time making decisions and we always want to kick the can forward. Not saying us, I'm saying all elected officials have this issue. So we got to just you know suck it up and make a choice. And I think this is the where we have to go. Its painful but it shouldn't be. Because you're really talking about sustaining the city. Thank you, mayor.

>> Mayor Reed: Councilmember Pyle.

>> Councilmember Pyle: Thank you, mayor. Boy, do I have a question! First of all, I heard on the television this morning as I was getting dressed the fact that the Social Security system is very, very badly running amok. And that by 2037, they expected that they weren't going to be able to sustain the program anymore. And so I got thinking about the fact that we were going to get together today, and I thought we need changes everywhere, because what we're doing is continuing to pay for Mercedes Benz when we can only afford a Volkswagen. So there are several questions I wanted to ask. Clearly our system is broken and clearly we need to get it fixed. How many retirements do we anticipate in the next five years? Or would we have any idea? Maybe two years would be a pairer question.

>> Alex Gurza: It's hard to estimate, Councilmember Pyle. Although we do have many -- a high percentage of our employees becoming eligible to retire. We have the baby boomer generation moving into retirement. So approximately a third of our workforce is going to be eligible to retire in the next five years. That doesn't mean they all will retire. But we do expect because of the aging of the workforce an increasing number of people in the retirement system, and so that means that there's a -- that that shift into receiving the benefits. And so we do expect that number to increase, but we don't have an exact number.

>> Councilmember Pyle: Well, clearly education is needed here. Because I think when everyone is aware of just how dire this is, it would make a difference. Because it's dire nationally, there is a higher likelihood that some major changes are going to be taking place. And I wondered if you had heard of anything of -- anything astir nationally in reference to this outside of a national health care system, which is going to be -- require a few miracles as well. No? Okay. It's a little early for that. Well, let me move on a bit here. First of all, I think we need to change our whole thinking about retirement. I tried it once. I hated it. I -- you know I just couldn't handle it. So here I am. Trying to make waves. We do need to take a look at the age. Is there some reason why we can't change the age, for example, of police retirement?

>> Alex Gurza: Clearly, those are issues that fall into --

>> Councilmember Pyle: I know that's meet and confer.

>> Alex Gurza: Beyond that it is one of the vested benefits things. It is one of the things that we can't even negotiate because they're vested benefits. That goes back to an issue of a new tier. That is something that pension plans are looking at going back to your earlier question, Councilmember Pyle, which is a second tier that increases the age requirements, for whether it be for public safety or civilian employees. It is raising it from the 55, for example, for civilians to hire, that's an option but it would be something that would have to apply to new employees.

>> Councilmember Pyle: Right. And there are some cities that have done that successfully.

>> Alex Gurza: Yes.

>> Councilmember Pyle: The other thing is obviously, when we talk about tier 2, kind of makes me laugh a little bit because we are not hiring and we probably are not going hiring for quite some time. So that is not any kind of a -- even an immediate -- certainly not an immediate answer, and I don't know how many years it's going to be before we do any hiring. So we've got to look a little more outside the box.

>> Alex Gurza: Although if I can add to that, there clearly is a -- there's a dichotomy now, because unfortunately, we are facing the situation of eliminating positions. But I think the city will still need to be hiring. If you think about police officers retiring, needing to replace them, or firefighters or anybody. So there still will be some hiring. If any agency is looking for a second tier, the sooner that started you look backwards at the last three, five years, all of a sudden you have an increasing percentage of people in that second tier.

>> Councilmember Pyle: Okay. So to even start thinking more in terms of next career opportunity, that kind of thing, for all employees, I think is a good thing. It really does extend the life, because you're not home thinking about what's wrong with you or -- well, I've seen too many of my friends come into all kinds of health problems and I think it's mostly because they're not engaged. So couple of other questions. Is there some reason why we have to have two accounts? I don't know how that started. I don't know the history of it. I don't know why we have one for federated, one for police and fire. It just doesn't make sense to me.

>> Not -- I believe the benefits are different. I don't -- this is more a legal question, I think.

>> Councilmember Pyle: Okay.

>> What -- not too sure why 20 years or so I go, the decision was made to split the plan. But fundamentally at this stage you're looking at very different benefits.

>> Councilmember Pyle: And see, that's part of what we have to break through. We've inherited years and years and years of something that's gone on. And we, as Councilmember Oliverio said, it's not sustainable. So we have to kind of break out of the shell. And that's going to be pretty tough. Let's see, what else? Other cities, have you gotten any information about what other cities might be doing about their retirement programs or how -- how innovative they've been?

>> Alex Gurza: I think that as we mentioned earlier I think everybody's grappling with this issue similar to retiree health care, the City of San JosÈ is leading the way on retiree health care. I think similarly we can be on the same position on pension side. But I think people again are looking at the contribution rate increases and what can they do. And because of the investment benefit issue it does limit the options. And so that's why many agencies look at a second tier, because it isn't possible to moderate the benefit for everyone. So the second tier really is a logical or one of the few steps that agencies can look at to reduce the long term costs.

>> Mayor Reed: The City Manager had an add-on to that.

>> City Manager Figone: If I could add onto that. I think it's safe to say the majority of cities are in the Cal PERS system in California. City Managers are forming a coalition to take a look at the problem within Cal PERS and to may be the ones to provide some leadership on how to affect that.

>> Councilmember Pyle: Okay. And then, I think you might have said this Carmen, you said the current cost could be deferred 45 years. I didn't hear that right, did I?

>> This was my comment relating to Cal PERS.

>> Councilmember Pyle: Oh yeah.

>> They have a 15 year asset smoothing method, which means they could defer -- they don't recognize losses and gains until 15 years after the fact. And at that point in time they actually start paying for them. And it takes 30 years for them to fully amortize whether a loss or a gain. So in total, current costs could be deferred for up to 45 years.

>> Councilmember Pyle: Wow! Do you recommend that?

>> Absolutely not.

>> Councilmember Pyle: Yeah, it didn't make sense to me. Okay, so the other question is: How did it come to be that there was a expectation of 9% a year, was it police and fire? I don't know how that -- where does that come from? I mean that's --

>> It's been in place for a very long time. Certainly predates me.

>> Councilmember Pyle: That sounds like somebody got ripped off by madoff because you expected 30% per year. It's not reasonable. Do you think that's the primary reason why there was -- that we're in the mess we're in or that -- well, I don't know. Is it in case of one fund causing more problems than the other or is it just all over the place?

>> That's -- I would say it's about a 50-50 share of the problem. Meaning the recent market events are probably responsible for 50% of the mess. The other 50%, though, is that gap in interest rates that we brought to your attention. And that percentage will continue to increase, meaning if nothing is done about it, in five years, the problem would have increased, and the percentage that is related to that gap in interest rate will also increase. It's something that's there and will continue to increase unless it's dealt with.

>> Councilmember Pyle: Got it. And then, as a last question, let's see, I covered everything, well I just wanted to sum up and say, all of us in this room are helping paying for this. Everybody we represent is paying for this. And so when we say the city, we mean to say the taxpayers. And I think that's been stated multiple times. We need not to cheat ourselves. That's basically what's going to be happening over the years. So thank you. I appreciate all your expertise and your patience. And I know Carmen and I have had a pretty elongated conversation with you before. I really appreciate that tremendously. Keep us informed.

>> Mayor Reed: Councilmember Herrera.

>> Councilmember Herrera: Thank you, mayor. So I'm one of the privileged, I guess, to be sitting on the police and fire retirement board, along with Councilmember Liccardo. I take this really seriously, for all the reasons everyone's mentioned, and also because those of us who serve on these boards have a personal liability, fiduciary responsibility. It is a very sobering experience to sit there and go through these meetings and learn about this and try to make the best decisions we can make. I wanted to say a few things I consider good news, as daunting as it has been, I haven't had the extensive training, I have to commend Councilmember Constant, he was one of the people that gave me the introduction when I first started on this and he has attended many, many trainings and has a lot of expertise in this area, and I think we're lucky to have him with that expertise. It's -- it was reassuring when I met Russell Crosby and the staff that we have on the retirement board. And I think that is one of the good news things out of this scenario. We have some really good experts helping us get through this. And I wondered, Russell, can you or one of your staff here just kind of list some of the positive things that have happened since your tenure began, and the new consultant was hired, investment group was hired, just kind of list some of those things? I just want people to know that we are working diligently, and there have been some positive things that were done.

>> For police and fire, probably the biggest single thing was the hiring of New England pension, and then embarking on a course of diversification of the portfolios. Both portfolios have been essentially 60-40 plans, meaning 60% equities, 40% fixed income. In the industry, that's recognized as just about the riskiest portfolio that you can have. And by diversifying into noncorrelated asset classes, meaning asset classes that move opposite equities or move opposite bonds, you begin to dampen out the risk of a catastrophic event either in equities or in fixed income. That process is still underway today. We now have an RFP out on the street for an investment consultant for federated. We're looking at the RFP that's out on the street for both the actuaries for the police and fire and federated. And we would hope to be able to retain, call it firms with greater depth than either of the current firms. Building a staff, being able to hire people like Carmen, we have -- she's hired a support staff, Dr. Ali Ameri, who is a research director with one of the consulting firms. In our budget for this year we have additional three very senior positions that we will be recruiting for to look at each of the asset class as well as risk management within the trust. Our intent is to move more toward a corporate model with risk controls and an emphasis on risk rather than shooting for some, call it unattainable return estimate or return assumption. Both Carmen and I come from the corporate world and we're used to seeing assumed rates of return in the 7 to 7.5% range. Certainly I've never in my career seen anything like an 8 or an 8.25% return assumption. That's part of the whole strategy of moving these plans onto a more solid footing.

>> Councilmember Herrera: Thank you for that. Looking at the unfunded retirement liability of $3 billion, I'm sure that was enough to sober anybody up here who wasn't already feeling that way. What is the -- how does that, going forward, how do we see that unfunded liability being taken care of? And kind of I'm thinking about the health -- the other good news I want to say is health care, the fact that we are leading the way on that. So on the health care side we are doing a lot of really good things. Our employees are stepping up. I do think we need to tell the good and the challenged here. You can compare that to the pension side the unfunded liability and what do you think is the best strategy or talk about the strategy you've already mentioned and how that's going to take care of that?

>> The unfunded liability, once it's created on the federated plan will be amortized over 30 years. It's very similar to a mortgage concept. So let's say the right number as of June 30, 2009 is $3 billion for the pension plans. For the federated plan it will take 30 years to pay it off. For the police and fire, I believe it's a 16-year period. Typically, you would start by phasing in over five years, meaning you start recognizing -- you don't recognize 100% of the gain or loss up until the end of the fifth year, and from that point in time, on the federated plan, it takes 30 years. On police and fire it takes 16 years. Clearly, the city will be responsible on the pension plan for the amortization of the unfunded liability. On the health -- on the health plans, the unfunded liability is shared 50-50 between the city and the employees. So it's definitely a very different structure. And because the structure is different, it gives the trustees the goal of trying to manage risk, which right now is not there on the pension side. And that risk management is what has resulted in the list that -- the slide that Russell basically spoke briefly about, which showed that a list of the 12 corporate clients, having had the best having had a positive 15% return, and maybe the average having had a positive 4% return, for the year ending December 2008. So does that answer your question?

>> Councilmember Herrera: So if we were to have had different actuarial assumptions, if we were to have been a little more conservative and have investments more diversified and not so equity-focused, our rates we could have assumed to be similar to the other funds you were mentioning there?

>> That's correct. You can tell your investment consultant, implement strategies that minimize the unfunded liabilities. This is what these companies have done and that's why they have better rates.

>> Councilmember Herrera: And so the good news is going forward we will be doing that as long as the board makes those decisions, right? Our board will be responsible for making determinations in terms of actuarial assumptions and all those things and as long as we are making those kinds of decisions we should begin to see improvement going forward?

>> Correct, assuming the board makes those decisions.

>> Councilmember Herrera: So I want to say the police and fire retirement board meetings, it is not a secret club, it's public. We would invite, the public can come to these meetings. And the next meeting is I think June 4th but you guys probably have that -- is it? Yeah, 8:30 in the morning. I think we should let people know they can come to the meetings, they can see our board in operation. This is public money. And you know, our main focus here is to make sure that our retirees who have worked really hard, you know, folks who work hard for this city, we manage those funds so that we have retirement. And we also -- are also at the same time have to make sure that we minimize our city contributions. Those are the two major things that we, as board members, have to do. So I just want to invite the public to come see us at work and you know, see how we are progressing on these goals. Thank you.

>> Mayor Reed: Councilmember Nguyen.

>> Councilmember Nguyen: Thank you. Thank you for the presentation. It's very informative. I hear what Councilmember Oliverio is saying in terms of our ability to -- not being able to sustain with the current state of unpredictability and working with actuaries' baseline assumptions. But we also have to be very cautious. Before we jump on that band wagon of seriously looking at tier 2, let's also look at the past recessions and evaluate recovery periods immediately following those recessions and see how that affects the average return on the plan assets. We don't really know. And we haven't -- at least I don't know and I haven't got any information about that. And I wanted to make reference to a memo that Councilmember Kalra and I distributed on April 13th, 2009, and to this day we haven't received any answers to those questions. And I think that before I can make any decisions in terms of where we go, I need to know what happened in the past. And so we can get those answers to those questions on the memo, as soon as possible, we can have a more productive discussion.

>> The short answer is that it's irrelevant. Unless you have in the next 45 days very close to 100% return in these plans, you're going to have a contribution rate increase. There's -- it's the math. It doesn't matter what happened in past recessions. It's irrelevant. It simply is irrelevant. What we've done is create an assumption that is so far optimistic that no investment consultant anywhere would be willing to sign on to an investment of 20% return this year and 20% the following year even given those outrageous, outrageous assumptions, you still have a 50% contribution rate in the future years. It doesn't matter what happened in past recessions. That's a red herring. That's something that, you know, is being offered up as a way to not have to face the problem. It simply doesn't matter.

>> Councilmember Nguyen: Right, at this -- thank you, Russell, for that, but at the same time potentially what staff is asking us to do is really looking at a totally different model. And you know, when we talk about seriously looking at tier 2, we're also looking about changing the morality among the workforce, among city employees. That would take a toll on people. I think that, you know, for me on a personal level, if we are going to go into this route which, you know, I think is feasible, I need to understand, have a more thorough understanding of what we're getting ourselves into, as well. And I don't think that -- I don't think we're asking too much. You know, I just wanted to understand the historic analysis of prior recessions, the recovery periods following that, and how that, you know, and the returns on those funds' assets. And if once I see those numbers and I think it's irrelevant as you stated it's a lot easier for us to make those kinds of decisions. But this is something that is completely different. I just don't feel comfortable moving forward if I don't have those answers.

>> City Manager Figone: Yes, clearly before anybody signs up for a second tier, we need to do our homework. So we will be answering the question. I'm hot sure, I personally lost track of that memo. But second tier is on the structural deficit elimination plan list. There is a lot of concern about it, I acknowledge that, and I do think that this needs to be an important part of the council discussion moving forward.

>> Alex Gurza: If I can add to that, there actually is, I mean, there's no requirement to do a second tier. What these numbers reflect is not changing the benefits. So if the city decided not to change any of the benefits for police and fire and federated this shows you the police and fire rates. And I just think it becomes an issue of affordability. If the current benefits and costs are football to the city then there is no need to look at a second tier.

>> Councilmember Nguyen: Okay, thank you. Again, the city's manager says she lost this memo. This is a very important memo that we put out, and somewhere lost along the way so we need to get those answers back.

>> Alex Gurza: Actually, we did, the three of us did design the presentation around the memo in an attempt to try to find a broader framework around it. And again there was no intent not to answer those specific questions, hopefully to give the broader viewpoint of that issue. And so we have the memo right here. And again, we can go through the questions now, and have -- I mean don't have the numbers of the past recessions but again, our attempt was to try to in the presentation, embed the answers to the questions. And so any of the questions you want to go through we'd be happy to go through them in detail today and follow up --

>> Councilmember Nguyen: Yeah, well, Alex, you don't have to answer these questions today. I think it would be good if you could just answer these questions in the form of a memo and distribute it to all the councilmembers. If I would have a copy, that would be great.

>> Alex Gurza: Yeah, and I think some of them are very easy. For example, number 3 says, is there a legal reason why the city has to eliminate an unfunded accrued liability in a single year? I hope we answered that question. No, there is not. The way the unfunded liabilities are paid off 100% by the city, and they're amortized, they're smoothed, and then amortized over either 30 years or 16 years. So in no case is the unfunded liability being paid off in one year. In fact we couldn't. Because you're talking $3 billion or on a retiree health care in excess of $1 billion. So absolutely, I don't know if any reason why that was ever -- I don't believe it was ever contemplated. So that we hope was answered in the presentation itself. Number 4, is it accurate to interpret the Segal documents, assuming there will be no recovery from the recession. I think that you may want to expand and answer that question number 4.

>> The intent of the Segal projections was not to provide a forecast for what would happen. The intent was to send a message that, given the losses that have happened, and we reflected losses 'til the end of February, the city can expect a contribution rate increase. So we assumed beyond once the losses was reflected, we assumed no further declines or no further increases to try and stay within the scope of what we were trying to do.

>> Alex Gurza: And Carmen, you may want to answer number 5, let me read number 5. If the economy improves significantly in fiscal year '10-11 or '11-12, and the Dow average returns to 11,000 or 12,000, wouldn't the unfunded accrued liability in the plans be much less than it is today? That was, Carmen, correct me if I'm wrong, the point of the optimistic scenario.

>> That's exactly correct. So the unfunded accrued liability, the loss of 1.2 billion that you saw, would be augmented again by the fact that the actuaries assume a positive 9% return. So really, you'd end up roughly with $1.5 billion loss. Based, assuming a five-year smoothing you would recognize that loss fully in five years, then start amortizing the unfunded actuarial liability. And so it takes quite a while for the loss to go into the system. And once you recognize, given the magnitude of the loss, the city will be paying for it for potentially the next 30, 35 years.

>> Alex Gurza: So Councilmember Nguyen and Councilmember Kalra in your memo, that leaves the question 1 and 2 that are related to past recessions, I think we can try to follow up on that. I think one important thing that it -- I would imagine would have an impact is if you look back many years ago at a recession, the benefits that are provided today are much, much different. If you think about the earlier slides where we talked about now 90%

benefits, those are relatively new. So the cost of the benefit I would imagine has a big impact, and Carmen would love to comment on that.

>> Absolutely. The benefits that were being provided 20 years ago are significantly lower than the current benefits. So trying to take past recessions and to somehow come up with a meaningful answer to the question is actually quite difficult. The reason is, if you go back in time, then you need to -- what is it that we need to look at? Is it past pensions as they were 20 years ago? Or the existing benefit structure?

>> Councilmember Nguyen: I'm actually looking at periods of recession where we faced something similar to a current state of the economy at this point. And you know, and the reason why I ask this is not to be difficult, but I think it's important that we have these answers so that when we meet with representatives from different unions that we can explain to them why we're moving forward and why you know, the possibility of looking at tier 2 is feasible. I don't have any answers to that. And for me, to ask me to support that or not support that, I don't have any justification. And so I think when we put out questions in this memo we just wanted to get some explanation so that it is you know easier to communicate with our union representatives.

>> I think the best way that we can address this question is to say, given the level of losses that had happened at the end of February, fundamentally we needed to make 100% return between March 1st and June 30th of 2009 in order to avoid a contribution rate increase. So this is what's going to fix the problem now. And the reason I'm hesitant, looking back at history, as I'm sure you know, we're experiencing a recession that is only second to the great depression. So I'm not sure how, looking back at historical rerecessions is going to help guide current.

>> Mayor Reed: It is beyond just the actuarial stuff. I get it. It's about making a decision about the future with, you know, new employees and I think it's a factor in that. But so we don't have to have it today. But as we move forward, with decision making, I think we're going to need to have more specific answers to that.

>> Councilmember Nguyen: Thank you.

>> Mayor Reed: And I will have some suggestions when we get done about moving forward. I do have some requests from the public to speak but -- so before I go through the council again, there are still a couple of councilmembers who haven't had a chance to speak at all. That would include Councilmember Kalra who does serve on one of the boards.

>> Councilmember Kalra: Thank you, mayor and thank you for the presentation, very informative and clearly tells us the important and difficult decisions that we'll have to make but we certainly have to make some serious movement in regard to our pensions. And one question I have is in regards to the New England pension consultants. I was in the back, I think I heard right when you were answering a question from Councilmember Liccardo that they initially didn't want to work with our fund, but then they changed their mind? What are some of the factors or what are the factors they look at, that make them -- you know, what are the factors they look at and why did they change their mind? What was it that allowed them to change their mind?

>> I had been a client of theirs in the past, in past lives. They felt that with the change in management here in the retirement services department, that there would be change, and that it would be worthwhile for them to bid on the account and come in here. They select their clients very carefully. They have long waiting lists for people who would like to have them as a consultant. They don't just accept engagements without understanding who the client is and the likelihood of having some success with the portfolio.

>> Councilmember Kalra: And when -- does that -- does that imply that they want to make sure that their suggestions will be heeded or there -- you know, that there will be begin some flexibility so that the way that they customarily handle plans can be followed through on so it's not just their name on the surface --

>> Correct.

>> Councilmember Kalra: They want to be sure that the way they fundamentally do business is taken into account and incorporated into the funds?

>> That's correct.

>> Councilmember Kalra: Okay. And how long have they been on board?

>> Well, we use finished the contract with them but they just started work for us at the end of April of last year.

>> Councilmember Kalra: Okay. So some of the analysis, they're on the -- they're consultants, but are they consulting strictly on the fund allocations or also in regards to some of the numbers we're seeing here today, as far as the looking forward, looking out forward, you know, the different options we have?

>> That's a major piece of what they do, is the -- to look forward if you will. The capital market assumptions are developed by them in conjunction with the staff, and then presented to the trustees. And then the next step is once you have those individual capital market assumptions for somewhere between 15 and 20 asset classes they then work up the proposed asset allocation between each one of those asset classes.

>> Councilmember Kalra: Okay, thank you. And then the last thing is also in regards to the memo that Councilmember Nguyen and I put out, that, you know, the questions being asked again are not a way to find reasons not to make change. It's quite the contrary. The questions being asked are to get more information, so that we have a better understanding, but also so that we can explain better to those that may be affected. Because these are questions that you're going to end up getting anyway. And I think if there are written responses to them in advance, it's kind of like yesterday, where we discussed some of the budget issues and the mayor right off the top before the public comment, to have the staff discuss some questions that had come up routinely, just to get them out of the way early on so that they were answered by staff. It's something similar to that because it is important that we can explain, you know, why it is we're doing what we're doing. It is important, but regardless of whether it's your opinion that it's a red herring, or that it's not relevant, we need to give more than that. And the reality is that it is important to me that the morale of our employees are taken into account. It doesn't mean that we're not making serious changes, we're not going to make serious changes. But if they ask a question, and that they're expecting an answer to, we can answer them, and we can say as part of that answer you know, what, really, it's irrelevant because A, B, C, and D. That's fine. And I think we're starting to get some of the answers here. But as the mayor was saying, there's still time for us to get a memo response to respond to those questions, and I think it will make it -- and that's just one of many, many elements of what we need to look at and consider and think about going forward. I really do appreciate the work you've done in the presentation as well.

>> Mayor Reed: Okay, I'd like to take public testimony now before we go back to additional council questions. I have three cards so please come on down. Susan Bailey, Jerry Mungai and Ross Signorino. Ross, you want to go first? You're closest, go ahead. Come on, we're burning daylight, Ross.

>> Yes, my name is Susan Bailey, and there seems to be a prevailing misconception that government can do it all. There is not enough money on the face of the earth to make that come true. Just look at all of our governments, at every level. They're all in deficit. We need to make major changes in the way government business is conducted. As far as what we're talking about this morning, the public sector works for the private sector individuals that are paying the taxes. And we pay their salaries. Not the unions. The only way I can see that there is going to be a way out of the financial crisis, since the budget is two-thirds compensation and pension and health care, is to eliminate the labor union representation and their mandated salaries. I don't recall voting. I understand the state mandates that we have to have union representation. I don't remember ever voting on that. I think it should be brought up for a vote. I think the people that work for the city, their pay should be on par with the private sector. They should have 401(k)s which they fund and they should be on Social Security, requirement, if it's good enough for us, it should be good enough for the government workers. I did have a question. There is the projected 1.146 billion in losses. What is the total amount in the retirement fund?

>> Mayor Reed: I'm sorry, your time is up but we can get that question answered, current balance in the retirement fund.

>> I'm sorry, I didn't know how many minutes we had.

>> Mayor Reed: Two minutes, I'm sorry.

>> We only had one last night.

>> Mayor Reed: We have a little more time to work with today, and a lot less people, and we'll do the regular two-minute rule. Does staff has the current estimate of the current valuation of the plans to the nearest billion?

>> Roughly 3.1 billion combined for the two.

>> Mayor Reed: 3.1 billion combined between the two plans current asset value, okay. Jerry Mungai, then Ross Signorino.

>> Good morning. Couple of facts. Nancy Pyle has mentioned that we're pretty much broke nationwide and we certainly are. But the public sector as recently as 2007, studies show that the public sector total compensation is '40s% greater than that in the private sector. And that may be a reason why the union membership in the public sector is increasing at a rapid rate while it's decreasing in the private sector. Although that may change with the card shift tax if that goes through. Nancy also mentioned that Social Security is going to go broke in 2037. Well, Medicare is going broke in 2017. If they're saying 2017 today, next year is going to be even closer, I'm sure. I just want you people to know that we in the private sector are suffering losses in our 401(k)s we're losing jobs we're taking pay cuts in order to survive a global economy but the public sector is living in a world totally immune to all this. It's only going to get worse for our taxpayers because now we have to make up unfunded liabilities for the state fund, the Cal PERS is also having problems. So Mrs. Bailey said, you got to go to a 401(k) plan for new employees and we also have to have changes in the existing contracts. If we can make changes in contract law, where the federal government forces bond holders at Chrysler to take a secondary position to the auto workers union and the ownership of the new company, we got to take the lead and do that. We got to think out of the box. Thank you.

>> Mayor Reed: Ross Signorino.

>> Ross Signorino: Thank you, Mr. Mayor and members of the council. I come up here with no answers whatsoever. I don't even have good questions. In regards to all this what's going on right now, this was all based one time on the private sector. Let's hire these people, let's pay them because if we don't pay them what the private sector was paying them and give them pensions what the private sector was giving them then we'd lose all those good employees. So we shouldn't admire the private sector all that much too, because we thought the good times would never end. Maybe we should try to think in regards to buyouts, what the automobile companies are doing with their pension people, just buy them out, so they can get out from under this. And that's part -- I don't know if that's a solution but it's just one way of thinking. And then Councilwoman Pyle asked, what have other cities done or tried to do? I think Vallejo went into bankruptcy. Maybe we should think of bankruptcy and then councilman Liccardo, is it a ticking time bomb? That's true too. Then you have Oliverio, councilman Oliverio says it's going to get bigger and bigger and bigger. I think he was referring to a fungus of some sort in this regard. But you had problems here, no question about it in what to do. I hope we stop one way or another, stop the private sector as a model. That's how we got into the problem in the first place. Oh if we don't pay these people such and such, the private sector, you gobble them up. You have head hunters, you don't have that anymore, there used to be a time you had head hunters. Like the song that goes, the bills are all due and the baby needs shoes, and I'm busted.

>> Mayor Reed: That concludes the public testimony for this morning. We have some additional council comments and questions. Councilmember Constant.

>> Councilmember Constant: Thank you. And thanks, Ross, although you didn't quote me, I'm a little hurt, but that's okay. A few comments that I missed earlier because I had the notes on another page. First, I want to say that I'm just happy that the council is taking the time to spend so much time discussing these things. Because I know the mayor and I had just about two years ago discussions on about -- about all these issues, and where I thought they would be going in the next couple of years, which brought us to today, and he shared a lot of my concerns. And this is the third or fourth time we've had council discussions and I think it's a good thing, and I think it's something we need to continue to do. Because we spent a lot of time talking about things that have very little

impact. And this is something that has a huge impact to our employees, a huge impact to our taxpayers. And obviously a huge impact to our General Fund. So I'm just glad that we're having these discussions. I had two questions for staff. Russell, what would the impact be of us going to annual actuarial evaluations, versus biannual, and is that something -- is that a decision made by each of the boards individually?

>> Yes, it is a decision made by the boards. That would bring you closer to normal business practice, which is annual evaluation. Historically City of San JosÈ has done biannual.

>> Councilmember Constant: Okay. And then we briefly touched on it when someone asked the question about the two different boards and why we have two funds versus one. And I know you and I have discussed this, but what about the possibility of having the boards having some fairly regular, joint board meetings, so that matters of administrative nature, like direction to you and your staff, could be streamlined so you're not doing the same thing two different ways to serve two of your three bosses, and would that be potentially an avenue for the boards to really come together on actuarial assumptions, and things that might help us, at least get them both going in the right direction?

>> Potentially. I mean, it would be up to the two boards, and whether they wanted to do it. And then, once they're in joint session, who's in charge, how does it work? I mean, there are a lot of questions around that. But --

>> Councilmember Constant: I just think it's something that we should consider. Because there's so much of what we do as boards that's administrative. I know we cause a lot of extra work for you buys goo because I see what you're doing for both boards and I think it would also help the council. Because I think I know quite a bit about the retirement funds, but I didn't know the difference between the 16 year and the 30 year amortization on the unfunded liability. So there's just so many moving parts and when they're not in sync it's just difficult for us. It's something to keep in mind and maybe I can help spearhead that at least through the federated side. And then an editorial comment, we've had a lot of comments about the stock market and the recession. I just want to reemphasize again that stock market performance is one factor of a gazillion factors. More important than what the stock market does is really the asset allocation of the plan. Because the -- I forget the exact number, is it 96 or 98% of return due to asset allocation, not individual performance.

>> Rule of thumb is roughly 90% of return comes from asset allocation. Less than 10% is manager selection.

>> Councilmember Constant: And that is just so important for everybody involved to understand. Whether it's the boards or the unions or the individual employees or the taxpayers or the councilmembers, it is those fundamental decisions that are being made by the boards in how they manage the plan, that have a greater impact than what happens to the Dow. Really, if the Dow returned to 12,000 tomorrow, it still wouldn't fix a lot of the issues that we see here. We'd still have problems because there's the governance issues, the assumptions issues, the expense issues, the benefit issues, the unfunded prior service cost issues, plus the unfunded liability issues for performance. There's just all these things that stack on top of each other, and the stock market is just a sliver. It's an important sliver, but it's still just a sliver. And then the last comment, and I know I think it's tomorrow we have our board meeting for the federated retirement system. We're going to be talking about the furloughs. And I just want to make sure that everybody who's listening understands that furloughs do save the city money, but they also cost our retirement systems. Because they increase that unfunded liability. So as we're going forward, and we're talking about ways to deal with our General Fund deficit, we have to be conscious, very, very conscious of what we do to the two retirement systems. Because we already have the issues that we've been talking about today that need a lot of attention. The last thing we need to do, as unions and as a council together, is compound that problem. So I just want to make sure that that discussion is very deep, and very thorough, and that everybody is thinking about that unfunded liability as we look at those. And there are ways to calculate what we're going to be -- what harm we're causing to the fund. And I just want to make sure that everyone keeps in mind that part of the calculation, if we think we're going to save $200,000, maybe we should count on saving 160 and making sure that money goes into the retirement system. I don't want to make decisions in isolation and forget about these two trust funds that already have problems. I don't want to see those numbers going to 50% funded or 40% funded or any of those things. And then my final comment is just echoing what people have said. I think that the differences in the retirement plan since Russell arrived is pretty striking. Just watching the orientation that the new councilmember trustees went through that I got to sit in on and the information that was provided to the three new board members in contrast to what -- how I was indoctrinated into the system was a world of difference, and I

think you guys got a great head-start on what has happened compared to what has happened with trustees in the past. Not to mention, the level of competency has just incredibly risen with Carmen and Ali there. I know I tell them to their face, but I just want to say it publicly. Russell, we know you do a good job, but everybody needs to know that the two of them are really huge, huge improvements to the system. And it's a direct reflection because we picked the right person for the job. So thank you.

>> Mayor Reed: Councilmember Liccardo.

>> Councilmember Liccardo: Thanks, mayor. I just wanted to follow up on information we do have that might at least take a cut at trying to answer the question that was raised by Councilmember Nguyen and Councilmember Kalra about past recessions just to see what information we do have. Russell, when you were talking about past returns, and you comprised the overoptimistic scenario of two years, a consecutive 20% return, in the past history, in recessions and recoveries, have you ever seen a scenario in which we've had back to back years of 20% returns?

>> No. And even in the good years, the -- what I did was take the high year of 2006, which risky portfolios, market going essentially straight up, and said okay, let's round that up to the next increment which is 20%. Because the plans actually performed, police and fire in 2006, was 19%. And federated was 16%. So let's give you the best years that have ever occurred. And let's do it twice in a row. And that was the basis for the optimistic assumption is that you're going to have two of the very best years that have ever occurred in the history of the market. And you're going to do it back to back. And that's unreasonable. No investment advisor would advise anything like an assumption like that. But to set an outer bound of, okay, even given that, you still have a contribution rate that more than doubles over the next three years.

>> Councilmember Liccardo: Okay, thank you, that's helpful context. In terms of that 19% return, that was obtained in 2006. You said that was with a risky allocation strategy. That presumably we wouldn't repeat today, right? We would be in a more risk-averse posture, wouldn't be getting us those kinds of returns in the good years so we could avoid what just happened. Is that right?

>> What would happen is we would be reducing the risk in these portfolios in the next three to five years and getting them to a much lower equity position, much more broadly diversified across other asset classes.

>> Councilmember Liccardo: Okay.

>> The risk is in equities. Well, there are three components to risk. Equities, interest rates, and then inflation over time.

>> Councilmember Liccardo: Right.

>> And those three risks are totally unaccounted for in these plans at this point.

>> Councilmember Liccardo: And one side issue, and I see our auditor is here. Since they spent some time looking at trustee travel, one issue that I don't think that the council heard but it did come up during a prior board meeting. Because I understand some trustees are pushing to travel once again for due diligence in far flung places which has me puzzled. My question I want to pose to you, Russell, and then Carmen, too, in all your experience with public pension funds, have you experienced trustees doing due diligence travel to interview fund managers?

>> By and large it's very limited. I have checked with other plans and particularly in California, occasionally one trustee may go with staff after a manager is hired, at the first year or some kind of annual review mark. But it is extraordinarily rare that trustees would travel to do due diligence. Because it really comes back to 90% of your return comes from asset allocation. Manager selection provides less than 10% of the return, yet these boards and generally nonprofessional boards tend to focus very heavily on managers. And individual manager performance, and individual manager selection, it's an irrelevancy. They need to focus on the asset allocation and make sure that within the general pockets of 15 to 20 asset classes, you are allocated appropriately across those asset

classes. Often the decision of how to fill in the blanks with particular managers within an asset class is simply left up to the staff.

>> Councilmember Liccardo: So in terms of how we judge past practice, and as well as what may be future practice, depending on what the board decides, the money that we're spending at retirees' expense for trustees to go and travel to these places is really having very, very little impact at best on return, because those interviews of fund managers aren't making the impact that the basic asset allocation policy is?

>> That's correct.

>> Councilmember Liccardo: And that travel itself, if it should be happening at all, should be extraordinarily rare and not routinely as it's been happening every year here in San JosÈ?

>> That is the norm in both public plans and corporate plans.

>> Councilmember Liccardo: Okay, thank you, Russell.

>> Mayor Reed: Councilmember Pyle.

>> Councilmember Pyle: Thank you. I just wanted to ask a couple of things. For my assessment, and what I've been reading, and I've been reading a lot lately, in order for us to truly recover, we have to get to the point that the rest of the world recovers as well, because that's who we sell to. In other words, we are, because we are a global economy, that, to me, would be the basic difference between the 1939 depression and this. We weren't as globally connected at that time. Now, we are. So what I'm hearing is that we're looking at at least five years for this to truly become healed. So I just wanted to check with your thinking.

>> Well, those are the kinds of assumptions certainly that the investment community is working off of. That this is not a quick down and up, as some past recessions were.

>> Councilmember Pyle: Right.

>> That this is going to take somewhere in the five to ten-year range to work itself out.

>> Councilmember Pyle: Okay. And then the other thing lest we --

>> One more.

>> We actually ran a scenario where we said how many years does it take to actually, begin the increases that you're seeing, to go back for the City's contribution, to go back to the 22.5% level of fiscal year '09-10, and we found that we needed 8 consecutive 20% return, on the pension plan, in order for the city's contributions to go back to 22.5%, and clearly during those eight years, you're paying significantly higher levels.

>> Councilmember Pyle: Yeah, any of the scenarios are not very likely are they?

>> That's correct.

>> Councilmember Pyle: Okay. And I also wanted to say lest we say it's all government's fault, it's all somebody else's fault, I would like to remind us all that we can't say the business plan is the one to follow. Wasn't it the real estate market that got carried away with incredible greed and the banks never checked the assets, they never looked at the packages that were put together and stamped AAA and let's not forget the stock market and then there's the car industry. I'm sorry, I don't think the business plan and the by industry has the answers either, thank you.

>> Mayor Reed: Councilmember Herrera.

>> Councilmember Herrera: Thank you, mayor. Just to follow up on Councilmember Liccardo's question, line of questioning. In terms of a board member traveling to select a fund manager, that kind of expertise, you can describe the kind of expertise one would need in order to make an assessment on a fund manager?

>> This is very significant expertise that's needed. My background was in investment consulting, where I consulted for ten different plans. With Mercer investment consulting, we as consultants although quite knowledgeable were not allowed to go on due diligence trips. We had a staff worldwide of 100 people, fundamentally all what these hundred people did was go on due diligence trips. The reason for that is, until you've seen 30 fixed income products that are quite similar, you can't really tell who's good, who's doing best practices, and who's not. So the keep is to have deep expertise in that area. That's how you generate results. And that's why a lot of the investment consultants have very specialized staff doing it and that's why we hired Dr. Ali Amiri who complements my expertise and who has been doing the job of director of research for an investment consulting company.

>> And Carmen's experience with Mercer is similar to the structure at NEPC, New England Pension, is there is a specialized, very large research staff headquartered in Boston, and within that research class it's not like those people just do due diligence. They do due diligence within asset classes. There is a cadre of people who only review fixed income managers, who only review equity managers, who only review private equity managers, who only review commodity managers and so on. Each one of those is very specialized, and they don't do crossover. So that if you're a fixed income manager-reviewer, you're not out there doing equity managers, and you're not doing private equity managers, and you're not doing commodities. It's very narrow-focused and very deep with lots of experience. Usually people have undergraduate degree, and some relevant field, a master's degree, usually an MBA or some other kind of technical field, might even be something like physics or economics, and then most of them also have a very specialized designation called a CFA and that requires three additional years and several exams in order to get the CFA designation. And then if you're doing alternative assets you've probably got a further designation as a certified alternative investment analysis. And we're fortunate enough, Carmen is actually a CIA, CAIA designee as well. But that doesn't mean that she's prepared to go out and do due diligence on a particular manager. We would use our specialist, Dr. Amiri, and then the specialized staff out of New England pension to go out and do the due diligence.

>> Councilmember Herrera: So again, the board member, the important decision we would make would be the diversification, the classification, the allocation of the assets is the important thing we would make. So not taking anything away from any of our board members but if this is -- you know, if you're you talking about specialized expertise needed, the kind of which I'm doubting any of our board members possesses, then what would be the pitfall in having someone who doesn't possess that go out and do that kind of interviewing of fund managers?

>> One of the biggest concerns in the business quite honestly, is contact between money managers and trustees. Often, money managers have a variety of blandishments, anything from golf games to dinners to whatever. And they develop -- the whole purpose of part of the marketing aspect of money management is they develop personal relationships with trustees that will then carry the money management firm through bad periods of performance. Where a staff, professional staff, would look at that manager and say, you're underperforming, you're out of here, we need to terminate you immediately. A less professional, particularly trustees develop personal relationships with the money managers and it becomes very difficult to terminate the money manager.

>> Councilmember Herrera: That's kind of what, if I'm hearing this right, kind of a sales situation in a way.

>> It is exactly a sales situation. It becomes -- it moves away from a technical analysis of the underlying capabilities of the manager, the process they have in place, the controls they have in place, the risk controls in particular that are needed within any money management firm. And you take it out of that realm and into a personal relationship selling.

>> Councilmember Herrera: Thank you.

>> I would also add that in addition, it really undermines the technical staff. Because typically, in that type of an interview, the investment manager is trying to tell you, absolutely nothing. The technical staff are asking technical questions and probing deeper and deeper with each question, to try and understand the risks and the investment

strategies of that investment manager. To the expense that that process is interrupted by questions that may not be relevant. It basically may not allow a proper assessment to happen. So it is quite disruptive.

>> Councilmember Herrera: Thank you. And then last, I wanted you to maybe reiterate for us, what are the most important actions we can take to move this forward to reduce contributions by the city to help our fund be right -- be squared away with assets and liabilities?

>> Mayor Reed: Legality me suggest we have them come back with that. Because I'd like to talk with what we do going forward and I think that's precisely the question that we need to give them the chance to think about, rather than just what comes off here. So if there are any other council questions, I think we're just about done. I had a couple of comments and some suggestions to follow up on what Councilmember Herrera said. First I want to thank Russell and Carmen for doing such a great job. I feel so much better about the direction we're going. Although I'm distressed to hear about the travel issue. Apparently some people didn't learn anything from the travel audit. They apparently didn't take heart from the questions that council asked when we made recent appointments and I think that's a problem for all the reasons that have been outlined and so I'm really disappointed that people are still carrying on the way they did in the past. So I'd like to get more sunshine on the operations of the boards. I'd like to get them into the council committee meeting rooms for their meetings, that can be televised, that way anybody who wants to can watch what's going on, sunshine's always a good thing, I think. That would be one thing I would like to have happen. The second is, I'd like to have the staff think about the answer to Councilmember Herrera's question about what we can do, and more specifically, what we can do and when we need to do it. Because we have this RFP out for actuaries, they're going to do their evaluation reports. If there are things that we could do, that would affect the evaluation reports, we should do that, on a timetable or at least get it to the council for a decision on a timetable that could be effective. And so I would suggest that we ask the staff to bring that to the Rules Committee and we'll look at the council's schedule and the work plan and try to figure out how to bring these things to the council for some sort of a decision making process. I think we could get some of those decisions in front of us before the actuaries need to make their decisions. And then, as part of that process I want to get a more refined answer to the questions that the Councilmember Kalra and Nguyen asked in their memo to make sure we've covered that. And then finally, I really want to thank my council colleagues who have taken the time to serve on those boards. I know it's a heavy burden. There's a lot of work but I think we can all see how incredibly important those assignments are here as we try to recover, and fix these problems for very long into the future. Really important numbers, really important work. So thank you very much, and I want to thank the auditor, Sharon Erickson for her travel audit. And it appears we're going to need your services again in this area. [Laughter]

>> Mayor Reed: We'll take that up at the Rules Committee when we talk about your work plan, as well. So any other referrals to staff that we need to, out of this study session? And again, this really doesn't affect our decisions in the budget this year. Except knowing that next year's probably going to be worse. I think we are done, then. We are going to adjourn, until our next meeting, which is tomorrow, great. Tomorrow morning we'll be taking up, I've already forgotten what the topic is, capital budget, starting at 9:00 tomorrow. So we're adjourned.