

December 18, 2012

Vera Todorov
President
Association of Legal Professionals (ALP)
c/o City Attorney's Office
200 E. Santa Clara Street
San Jose, CA 95113

RE: Retiree Healthcare Proposal

Dear Vera:

In August 2012, we sent the bargaining units representing employees in the Federated City Employees' Retirement System letters requesting to meet with the bargaining units to discuss potential options regarding retiree healthcare. As we indicated in this letter, the City recognizes the concern employees have expressed regarding the substantial increase in retiree healthcare contributions that are expected to take effect in July 2013.

Based on projections the Boards' actuary provided in February 2012, which were based on June 30, 2011 data, they expected that the contributions would increase from 15.17% in Fiscal Year 2012-2013 to 32.34% in Fiscal Year 2013-2014. As the cost of retiree medical is borne equally between the City and employees, this meant a projected increase in the employee contribution from 7.26% to 15.50%.

We very much appreciate ALP's willingness to discuss options and solutions with the City during your current negotiations over a successor agreement. It was and still is our hope that we can reach an agreement on how to address the retiree healthcare challenge.

Attached is the City's first written proposal to the bargaining units on retiree healthcare. In developing the City's proposal, we have considered the various interests and issues regarding this matter. They include the following:

- Consideration for City employees in the Federated retiree healthcare benefit program who are understandably concerned about the expected dramatic increase in contributions effective July 2013, and the need to quickly reach an agreement so that we can help alleviate this concern.

- Ensuring that the City and the bargaining units have an opportunity to continue to work together towards solutions that reduce the cost of the retiree healthcare benefit, including options for employees in the current retiree healthcare program.
- Providing a way to allow new employees to not be in the current retiree healthcare benefit program. This is important since new employees are in the Tier 2 defined benefit program and have a higher retirement age which means they would receive less advantages of the retiree healthcare program, particularly considering the cost of the benefit.

In summary, the City's proposal achieves the following:

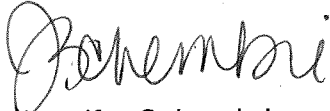
- Avoids the significant increase in employee contributions towards retiree healthcare that was anticipated to occur in July 2013.
- The phase in to paying the Annual Required Contribution for retiree healthcare will continue with the current maximum increase of 0.75% per year.
- Provides a cap on employee and City contributions for retiree healthcare that doesn't currently exist for employees in Federated. The caps are similar to those in place for members of the Police and Fire Department Retirement Plan.
- Provides for an opportunity to meet and confer at any time upon request of the City or the bargaining units to discuss solutions that could reduce costs for both the City and employees.
- If contributions reach the cap, the City and the bargaining units will meet and confer over how the full Annual Required Contribution is paid. Hopefully, before the cap is reached the City and the bargaining units will have had the time to work on solutions to reduce the cost of the retiree healthcare benefit.
- Provides an opportunity to continue exploring retiree healthcare benefit options for current employees. Although we would like to provide options for current employees immediately, there are IRS issues we need to continue to work through.
- Provides new employees with a benefit in lieu of the retiree healthcare defined benefit program. New employees would be eligible for a defined contribution match of up to 1% as long as the City contributions for Tier 2 do not exceed a total of 9%.
- Effective January 2014, the City will institute a four tier rate program for both active employees and retirees. This means that all plans will have single, single plus spouse, single plus child(ren) and family rates.
- Employee contributions will start going into the 115 Trust in time to avoid any potential of reaching the IRS limits on the current medical benefits account.

Please refer to our proposal for details and specific provisions.

This proposal avoids the dramatic increase in employee contributions that were expected to occur in July 2013 and provides some security to employees about increases in future years. We are committed to continuing to work with you to develop solutions to the very high cost of retiree healthcare benefits.

We look forward to discussing this proposal further with you.

Sincerely,

A handwritten signature in cursive script, appearing to read "Jennifer Schembri".

Jennifer Schembri
Assistant to the City Manager

Enclosure

CITY PROPOSAL – RETIREE HEALTHCARE

Proposed Language:

RETIREE HEALTHCARE FUNDING AND BENEFITS

The City and employees represented by the Association began to transition from the current partial pre-funding of retiree medical and dental healthcare benefits (referred to as the “policy method”) to pre-funding of the full Annual Required Contribution (ARC) for the retiree healthcare plan (“Plan”). The transition began on June 28, 2009. The Plan’s initial unfunded retiree healthcare liability shall be fully amortized over a thirty year period so that it shall be paid by June 30, 2039 (closed amortization). Amortization of changes in the unfunded retiree healthcare liability other than the initial retiree healthcare liability (e.g. gains, losses, changes in actuarial assumptions, etc.) shall be determined by the Plan’s actuary. The City and Plan members (active employees) shall contribute to funding the ARC in the ratio currently provided under Section 3.28.380 (C) (1) and (3) of the San Jose Municipal Code. Specifically, contributions for retiree medical benefits shall be made by the City and members in the ratio of one-to-one. Contributions for retiree dental benefits shall be made by the City and members in the ratio of eight-to-three. When determining the contribution rates for the Plan, the Plan actuary shall continue to use the Entry Age Normal (EAN) actuarial cost method and a discount rate consistent with the pre-funding policy for the Plan as outlined in this section.

The City and the Association agree that the Municipal Code and/or applicable plan documents shall be amended to the extent necessary in accordance with this agreement and that the Association will support such amendments.

The phase-in to the ARC shall be effective on the first pay period of the City’s fiscal year in each succeeding year, the first increment which was effective on June 28, 2009. It is understood that because of changes resulting from future actuarial valuations, the amount of the ARC may vary upward or downward. The City and the Association agree that the Plan member cash contribution rate shall not have an incremental increase of more than .75% of pensionable pay in each fiscal year and the City cash contribution rate shall not have an incremental increase of more than .75% of pensionable pay in each fiscal year. For example, if the members’ contribution rate is 4% of pensionable pay, the subsequent fiscal year’s contribution rate for retiree healthcare cannot exceed 4.75% of pensionable pay

If, at any time the calculated Plan member cash retiree healthcare contributions exceed 10% of pensionable pay or the calculated City cash retiree healthcare contributions exceed 10% of pensionable pay for the City (excluding implicit subsidy), the parties shall meet and confer on how to address any retiree healthcare contributions above 10% of pensionable pay for Plan members and/or the City in order to fund the full ARC. Such discussions shall include alternatives to reduce retiree healthcare costs. If the parties are unable to agree on the manner in which to fully fund the retiree healthcare

ARC (contributions exceeding 10% of pensionable pay for Plan members and/or the City, excluding implicit subsidy), applicable impasse dispute resolution procedures shall apply.

The City has established a qualified 115 trust ("Trust"). Employee contributions will begin going into the Trust in time to avoid any potential of reaching IRS limits on the existing medical benefits account or whenever the City receives advice of Tax Counsel or ruling from the IRS that the contributions can be treated as pre-tax, whichever occurs first.

It is the objective of the parties that the Trust created pursuant to this agreement shall become the sole funding vehicle for Federated retiree healthcare benefits, subject to any legal restrictions under the current plan, or other applicable law.

Employees hired into full-time benefited positions on or after the first payperiod following the effective date of the ordinance implementing this provision ("Effective Date") will not participate in or be eligible for the defined benefit retiree healthcare program. Employees hired on or after the Effective Date will receive up to a 1% match into a defined contribution plan that is established by the City in accordance with IRS regulations, as long as the total City contribution in addition to the retirement benefit contribution does not exceed 9%. If the City's contribution reaches 9%, the amount contributed by the City into a defined contribution plan will automatically be reduced. Employees will be eligible for a maximum of a 1% City contribution only if the Employee contributes at least 1% of their salary into the defined contribution program.

HEALTHCARE COST MITIGATION

Notwithstanding any other provision of this Agreement, the parties agree to meet and confer over retiree healthcare benefits and funding upon request of either party. This may include but is not limited to alternatives to reduce the cost of retiree healthcare benefits and options for current employees that comply with IRS regulations.

Negotiations between the City and the Association shall commence within 14 days upon notice of either party. The City and the Association shall negotiate in good faith in an effort to reach a mutual agreement. Applicable impasse dispute resolution procedures shall apply.

(This language shall be added as a section to any agreement on a Memorandum of Agreement between the City and ALP under the article entitled "Agreement Conditions.")

HEALTH INSURANCE

Effective January 1, 2014, all available plans will have a 4-tier rate structure (Employee, Employee plus spouse, Employee plus Child(ren) and Family). The premiums will be adjusted effective the first payperiod in payroll calendar year 2014, which starts December 22, 2013.

(This language shall be added as a section to any agreement on a Memorandum of Agreement between the City and ALP under the article entitled "Health Insurance.")