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December 12, 2012

Bill Pope
Business Representative
International Union of Operating Engineers, Local #3 (OE#3)
1654 The Alameda, Suite 110
San Jose, CA 95126

RE: Retiree Healthcare Proposal

Dear Bill:

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 and solutions 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 OE#3's engaging with the City in discussing options and solutions over the last three months. As we indicated at the bargaining table, 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 we have discussed during our meetings. 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:

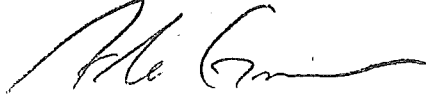
- Avoids the significant increase in employee contributions towards retiree healthcare that was anticipated to occur in July 2013.
- The phase in to paying the Annual Required Contribution for retiree healthcare will continue with the current maximum increase of 0.75% per year.
- Provides a cap on employee 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 begin going into the 115 Trust in time to avoid any potential of reaching the 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.

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 black ink, appearing to read "Alex Gurza", written in a cursive style.

Alex Gurza
Deputy City Manager

Enclosure

CITY PROPOSAL – RETIREE HEALTHCARE

Proposed Language:

ARTICLE 27 RETIREE HEALTHCARE FUNDING AND BENEFITS

- 27.1 Effective June 28, 2009, the City and the Union began transitioning 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 shall be accomplished by phasing into fully funding the ARC over a period of five (5) years ~~beginning~~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 Article.
- 27.2 The Municipal Code and/or applicable plan documents shall be amended to the extent necessary in accordance with this agreement above.
- 27.3 The phase-in to the ARC shall be divided in five steps (using a straight line method), each to be effective on the first pay period of the City’s fiscal year in each succeeding year. The first increment of the phase in shall be which was effective on June 28, 2009. It is understood that because of changes resulting from future actuarial valuations, the amount of each ~~increase~~the ARC may vary upward or downward. 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. ~~Notwithstanding the limitations on the incremental increases, by the end of the five year phase in, the City and plan members shall be contributing the full Annual Required Contribution in the ratio currently provided under Section 3.28.380 (C) (1) and (3) of the San Jose Municipal Code.~~

27.4 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.

27.5 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 IRS that the contributions can be treated as pre-tax, whichever occurs first.

~~27.4~~ Until such time as a Trust is established, the City and employee contributions shall be made into the existing Medical Benefits Account for as long as the contributions can be made into the Medical Benefits Account in accordance with IRS limitations. If the Trust is not established prior to reaching the IRS limitation, the parties will meet to discuss alternative funding vehicles.

~~27.5~~ 27.6 It is the objective of the parties that the Trust created pursuant to the above shall become the sole funding vehicle for Federated retiree healthcare benefits, subject to any legal restrictions under the current plan, or other applicable law.

27.7 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.

ARTICLE 9 FULL UNDERSTANDING, MODIFICATION AND WAIVER

9.1 This Agreement sets forth the full and entire understanding of the parties regarding the matters set forth herein, and any and all prior or existing

Memorandums of Agreement, understandings and agreements, whether formal or informal, are hereby superseded and terminated in their entirety.

- 9.2 Existing benefits provided by ordinance or resolution of the City Council or as provided in the San Jose Municipal Code and which are referenced in the Agreement shall be provided in accordance with the terms of the Agreement.
- 9.3 It is the intent of the parties that ordinances, resolutions, rules and regulations enacted pursuant to this Memorandum of Agreement be administered and observed in good faith.
- 9.4 Although nothing in this Agreement shall preclude the parties from mutually agreeing to meet and confer on any subject within the scope of representation during the term of this Agreement, it is understood and agreed that neither party may require the other party to meet and confer on any subject matter covered herein or with respect to any other matter within the scope of representation during the term of this agreement.

9.5 Healthcare Cost Mitigation.

9.5.1 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.

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

5.5 Health Insurance

5.5.1 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.