CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Manager
EMPLOYEE RELATIONS

April 24, 2009

Randy Sekany
President
San Jose Fire Fighters, IAFF, Local 230
425 E. Santa Clara Street, Suite 300
San Jose, CA 95113

Re: Response to One Year Proposal

Dear Randy:

We sincerely appreciate Local 230's commitment, expressed in your March 27, 2009 letter, to leading the way in assisting the City with the challenges created by present economic circumstances. As you know, the City's fiscal situation has continued to worsen. Most recently, we have learned that the shortfall in the coming fiscal year has increased by $14 million as a result of declining property tax revenues. This increases the City's budget deficit in 2009-2010 to an estimated $77 million. The City has also received information about potentially significant increases in pension contribution rates beginning in 2010. (Please see attached memos.)

On April 9, you presented your complete one year proposal. As we discussed during our meeting of April 23, 2009, while we can accept Local 230's proposal of a one year wage freeze, we are not able to accept Local 230's one year package proposal because of additional items included in the April 9 proposal, and, equally important, because some key items are not included in the offer.

One issue of particular concern is that Local 230's one year proposal does not address the critical issue of retiree healthcare. As you know, the City and employees have a significant unfunded retiree healthcare liability. Eight out of the City's ten unions have now agreed to fully pre-funding retiree healthcare beginning in July 2009, and an agreement on this issue is essential to the continued viability of the City's retiree healthcare benefits. Any agreement for a new contract with Local 230 must include full pre-funding of retiree healthcare. At our meeting of April 23rd, we provided you with the agreement we reached with the San Jose Police Officer's Association, which is the language we are seeking for Local 230.

Below is a brief discussion of the other major issues.

Wages

Local 230's one year proposal includes no base wage increase for fiscal year 2009-2010. However, as clarified in Local 230's April 9 proposal, the wage freeze offer does not contemplate freezing employee step increases. As you know, employees' pay goes up not only through negotiated general wage increases, but also through 5% automatic "step" increases that generally occur annually until an employee reaches the top of the pay scale. The City is interested in a wage freeze for 2009-2010 that includes freezing step increases.

48/96 Shift Schedule

Local 230's one year proposal includes a change to the existing work schedule for Fire employees who currently work 24-hour shifts. The current schedule worked by San Jose Fire Fighters is a very common schedule among Fire Departments in other cities. The schedule proposed by Local 230 would require employees to work a continuous 48-hour shift, with 4 days (96 hours) off in between the 48-hour shifts.

As the City demonstrated in the last interest arbitration, there are significant problems with a schedule that requires employees to regularly work 48 straight hours. The concerns with scheduling firefighters to work 48 hour shifts as their regular schedule include the effects of fatigue, which could lead to increased accidents, injuries and impaired judgment and decision-making when responding to 9-1-1 calls. The proposed schedule would decrease the number of shifts per month from 10 to 5. We are not aware of evidence that a schedule in which firefighters work 48 straight hours would benefit the Fire services delivered to the residents of San Jose.

Taxes Paid by Employees Receiving Supplemental Workers Compensation Income

As you know, San Jose Fire Fighters receive compensation in addition to regular Workers' Compensation benefits. Under the provisions of the current contract, a Fire Fighter who is eligible for Workers' Compensation temporary disability payments receives a supplement to the state mandated amount of Workers' Compensation payments so that Fire Fighters receive 100% of their pay for up to one year while on temporary disability.

Local 230's one year package proposal asks the City Council to adopt an ordinance with the intent of classifying the supplemental Workers' Compensation benefits in a manner that would make them exempt from income taxation.

Work-related injuries and disabilities, as well as the benefits for injured and disabled employees are very important and complex issues. As you know, the City Auditor's Office recently issued an audit on the City's workers compensation program, which includes recommendations to address the findings of the audit. We are more than willing to engage in a discussion regarding changes in disability benefits, but given the complexity of these issues, we do not believe that this discussion is suited to a simple one year agreement. If we cannot reach a quick agreement on a one year contract, we can certainly discuss this proposal in more detail, along with City proposals regarding disability benefits.

Firefighters Bill of Rights—California Assembly Bill 220

Local 230's one year proposal also includes a provision to incorporate the Firefighter Bill of Rights into the union contract. As you know, the Firefighter Bill of Rights is a state law contained in the California Government Code that primarily is related to the rights of fire fighters who are being investigated for misconduct. For the City, complying with all of the various legal protections that apply to employees and specifically those that apply to government employees is a priority. Although we do not include all of the many laws and legal protections that apply to employees in the union contracts, we look forward to continuing to work with Local 230 on the issues raised by the Firefighters Bill of Rights for the City of San Jose. Our understanding is that Local 230 recently filed a court action against the City related to the Firefighters Bill of Rights. Hopefully, the various issues relating to this new law will be resolved and clarified through our attorneys.

Discussion on Fire Companies and Stations

In proposing no general wage increase in 2009-2010, Local 230 indicates that it is doing so in order to assist the City in maintaining all current fire companies and stations. Given the City's fiscal situation, many difficult decisions must be made. Unfortunately, these decisions will include elimination of City jobs across the many City departments and a corresponding reduction in services to our community. The City welcomes Local 230's leadership in assisting the City to lessen the reduction in services to our community by helping us to address the growth in our personnel costs.

You indicated that you will be out of town from April 29th until May 6th and consequently Local 230 will not be able to meet with us again until at least May 7, 2009. We would appreciate hearing back from you before you leave on April 29th as to whether or not Local 230 would be open to a one year agreement with the terms outlined in this letter and discussed at our meeting on April 23rd.

We hope that we can reach a quick agreement. However, if we cannot reach an agreement quickly on the terms of one year agreement, we would like to begin scheduling frequent and regular negotiations sessions so that we can begin making proposals on the various items on both the City's and Local 230's list of issues.

Once again, we appreciate Local 230's one year proposal and look forward to hearing back from you.

Sincerely,

Alex Gurza
Director of Employee Relations

Enclosures

c: Jeff Welch, Local 230 Vice President
Darryl Von Raesfeld, Fire Chief
Teresa Reed, Assistant Fire Chief

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: DEBRA FIGONE

SUBJECT: **2009-2010 PROPERTY TAX UPDATE**

DATE: April 3, 2009

INFORMATION MEMO

Staff received information today from Santa Clara County Assessor Larry Stone on the current status of the property tax roll for 2009-2010. The news is far worse than we had anticipated, and will result in a significant increase to the General Fund shortfall. Based on this new information, it is estimated that the General Fund revenue estimate for 2009-2010 will need to be adjusted downwards by at least $14.3 million.

I called a special meeting today to share this information with Senior Staff. All departments, including public safety, are being directed to propose further reductions in the development of the 2009-2010 Proposed Operating Budget. As you know, the challenges we have been facing in the current budget cycle were already severe. The impact of an additional $14 million to our General Fund deficit will require very difficult choices and significant service reductions will be unavoidable.

The Assessor's Office estimates that the assessment roll for Santa Clara County may fall by as much as 2% in 2009-2010, which is a significant reversal from the County-wide growth of 7% in 2008-2009. This performance is also one of the worst in the County's history. "To put this in perspective, in the past 75 years, the Santa Clara County assessment roll was negative only four times: immediately following Proposition 13 in 1978, and in 1932, 1933, and 1936, during the Great Depression," said the Assessor. The assessment roll decline is being driven by the reassessment of properties that are valued at less than their purchase price.

For San José, the property assessment decline for 2009-2010 is even higher than the County-wide figure. As of April 1, 2009, the 2009-2010 real property assessment roll for San José (excluding the Redevelopment Agency) is down by 5.1% from the 2008-2009 level. It is anticipated that this figure will drop further as the assessment roll is finalized. Based on this latest information, a downward revision to the Secured Property Tax estimate from a minimal 1% growth to a 6.5% decline will be brought forward in the 2009-2010 Proposed Budget. This will increase the 2009-2010 General Fund deficit by $14.3 million. That is in addition to the approximately $63 million General Fund shortfall (February Forecast adjusted for the recent Sales Tax decline and other base budget adjustments) for a total shortfall of $77 million.

Attached is a press release from the County Assessor's Office with details on the latest assessments. Please contact Jennifer Maguire, Budget Director, at 535-8144 if there are any questions about these Property Tax results.

Debra Figone
City Manager

Attachment

MEDIA RELEASE

County of Santa Clara
Office of the County Assessor
County Government Center, East Wing
70 West Hedding Street
San Jose, California 95110-1770
1-408-299-5500 FAX 1-408-297-9526
E-Mail: david.ginsborg@asr.sccgov.org
Web Site: http://www.sccassessor.org/

Lawrence E. Stone, Assessor

For Release:
April 3, 2009

Contact: David Ginsborg
(408) 299-5572

Assessor notifies schools and cities of preliminary assessment information

"Worse than expected," says Assessor

Earlier today the Santa Clara County Assessor notified the finance directors of every city, redevelopment agency and school district in Santa Clara County with the preliminary results of extensive reductions in the assessed values of 90,000 residential properties, and the potential impact on the 2009-2010 assessment roll. "It is far more pervasive than I expected, and these preliminary numbers are far from final. "While incomplete, this data is valuable to cities and schools as they plan their budgets, said Assessor Larry Stone."

The Assessor's "Proposition 8" analysis identified over 90,000 properties, primarily homes and condominiums, that will be valued less than their purchase price therefore, qualifying for a reduction in the property's assessment. The total number of properties is more than double over the previous year. The market value as of January 1, 2009, of approximately 20 percent of all single family homes and one-third of all condominiums have declined below their purchase price. To date, the aggregate reduction exceeds $18 billion, by far the largest decrease in county history. The average reduction for a home increased from $78,000 last year to $181,000. Additional reductions are anticipated between now and July 1, 2009, when the assessment roll is officially completed.

Lower assessments will result in negative growth of the county's assessment roll, something that has happened only once since the "Great Depression," Stone said. It is estimated that the assessment roll for Santa Clara County may fall by as much as 2 percent, a far cry from last years modest growth of 6.98 percent. In Gilroy and San Jose the decline may exceed 11 percent and 4 percent respectively.

The annual change in the assessment roll is a combination of a number of factors including: changes in ownership in a declining market, new construction and the 2 percent California CPI limit allowed by Proposition 13. It also includes of the values of business personal property, including machinery, equipment, computers and fixtures. "While Proposition 8 reductions in the assessment of residential property are an important component of the overall assessment roll, many other factors remain to be assessed before of the assessment roll is closed. However, the trend is not encouraging," said Stone.

In most years, substantial roll growth is derived from changes in ownership at higher prices and new construction. This year, many of the changes in ownership are home foreclosures or distressed sales. The result is that instead of a property with an old, very low assessment base transferring to a new, much higher base, the assessment of properties are going from a high base to a lower base as a direct

result of the unprecedented number of foreclosures at substantially reduced prices. In 2008, the number of foreclosures jumped four fold to 6,200 homes.

This perilous decline is especially remarkable when you consider that Proposition 13 provides for an automatic two percent increase in the assessed value for all real property that did not change ownership or complete new construction during the prior calendar year.

"To put this in perspective, in the past 75 years, the Santa Clara County assessment roll was negative only four times: immediately following Proposition 13 in 1978, and in 1932, 1933, and 1936, during the Great Depression," said the Assessor.

Last year, the assessment roll was negative in neighboring Stanislaus, San Benito, San Joaquin and Solano Counties, where both the residential and commercial sectors were in financial turmoil. Numerous other counties also experienced steep declines including Fresno, Contra Costa, Sacramento and Riverside Counties. For the first time in decades, total revenue from property taxes in California is projected to fall 10 percent over the next three years, further reducing property tax revenue and exacerbating the state budget crisis.

Local government (schools, cities, the county, RDA's, community colleges, and special districts) will experience significant decline in services to the public. Even schools backfilled from the State, will feel the impact as bonds and special assessments predicated upon real growth in property taxes will have to be reevaluated.

While property owners are eager to learn if they will receive a reduction, they are urged to wait until the Assessor's Office completes the full review in late June, and property owners receive the notification cards mailed to all 460,000 property owners. Santa Clara County is one of only nine California counties that notify property owners of their assessed value, before their tax bill is received in mid September.

The Assessor also cautioned taxpayers to be wary of solicitations promising reduced assessed values in exchange for a fee. "It is outrageous. There's simply no reason for a property owner to pay a fee to a private company for a service taxpayers receive from the Assessor's Office without charge. Thousands of property owners are being inundated by these questionable operators who are feeding upon the increased fears of homeowners stressed by a declining real estate market and the loss of equity," said Stone. By soliciting taxpayers before the Assessor's notification card is mailed, these companies are encouraging homeowners to pay a fee to apply for a reduction in their assessment that they are likely to receive automatically from the Assessor's Office in late June.

Between January and June, the Assessor's Office is reviewing assessed values of nearly 200,000 residential properties to determine if the market value, as of January 1, has fallen below the original assessed value (typically, the purchase price). "While homeowners are certainly anxious to know their assessed value, we urge everyone to wait until they receive their notification cards in late June. Otherwise, staff will be responding to phone calls instead of reducing values," said Stone.

Once all properties are assessed, the Assessor's Office will mail an assessment notification card to every property owner. This year, that notice is expected to arrive during the last week of June. If a property owner believes the market value of their property is less than the assessed value printed on the notification card, they are encouraged to contact the Assessor's Office to request a review. A

simple interactive form is available on the Assessor's website http://www.sccassessor.org/prop8. Requests for review can also be made by phone, fax, mail, e-mail or in person.

If a value reduction is appropriate, as determined by the Assessor prior to August 15, 2009, the assessed value will be changed, and the revised assessment will be reflected on the September property tax bill. The first installment is delinquent if not paid by December 10th.

Any reductions agreed upon after August 15, will be processed through an assessment roll correction. Since an assessment roll changes involve a more complex, time-consuming administrative process, it is unlikely that a corrected tax bill can be processed prior to the December 10th delinquency date. To avoid late penalties, property owners are required to pay the first installment by December 10th, even if the Assessor's Office has agreed to a reduction. If a reduction is subsequently enrolled, the property owner will receive a refund from the County. (By the State Constitution, the Assessor's Office is completely separate from the Tax Collector's Office, which is overseen by the Board of Supervisors. The assessor is independently elected every four years.)

In addition, Stone encourages property owners who have requested a review, but have not received a written response by August 15, to consider filing a formal assessment appeal by the September 15 deadline. Appeals are heard, within two years, by an independent, quasi-judicial board comprised of appraisers and real estate professionals appointed by the Board of Supervisors. "If you disagree with the assessed value, please do not wait for the tax bill, mailed in mid-September after the assessment appeal filing deadline. More information is available from the Clerk of the Board by calling (408) 299-5001 or going to their website, http://www.sccgov/portal/site/cob.

--end—

Distributed on:

SENT TO COUNCIL: APR - 3 2009

by City Manager's Office

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: **Police & Fire Pension Contribution Rate Projections**

DATE: 04-03-09

INFORMATION

On November 14, 2008, I distributed an Information Memorandum to the City Council forwarding information from the Department of Retirement Services regarding the investment performance of our retirement funds in light of the significant market decline (Attachment 1). As of the information available at that time, the retirement funds had experienced a decline of nearly **$1 billion** in assets. As noted in my memorandum, the decline in assets will lead, in the absence of a financial market recovery by the end of the current fiscal year, to higher City contribution rates in the future. The extent of the impact on the contribution rates was not known at that time.

Following-up on my memorandum, the Department of Retirement Services provided additional information regarding the financial status of the retirement plans. A memo dated December 18, 2008, was heard by the City Council at the January 13, 2009, City Council meeting (Attachment 2).

The Segal Company, the actuary for the Police and Fire Department Retirement Plan, recently provided a report to the Department of Retirement Services that contains projected contribution rates for the City and sworn Police and Fire employees under different scenarios that take into account the decline in assets as of February 2009 (Attachment 3). This report was initially presented to the Police & Fire Retirement Board yesterday, April 2, 2009. The Board has not had an opportunity to fully consider the report, and it will be discussed more fully at the May Board meeting.

It is important to note that this report contains **projections only** and not any final determinations of pension contribution rates. As the report states:

> Projections by their nature are not a guarantee of future results. The modeling projections are intended to serve as illustrations of future financial outcomes that are based on information available to us at the time the modeling is undertaken and completed, and the agreed-upon assumptions and methodologies described herein. Emerging results may differ significantly if the actual experience proves to be different from these assumptions or if alternative methodologies are used. Actual experience may differ due to such variables as demographic experience, the economy, stock market performance and the regulatory environment.

Although the attached report contains only projected contribution rates that include variables and assumptions that may change, I believe it is important to share this report with the City Council immediately.

Please note Exhibit 1 of The Segal Company report. The baseline City pension contribution rate is shown as 22.5% in "plan year" 2008-2009 and 2009-2010. The projected contribution rates begin in plan year 2010-2011.

Under the scenarios examined, the City's contribution rate for Police and Fire is projected to increase from 22.5% to the range of 35.3%-57.8% for 2010-2011 and to the range of 54.2%-70.1% for 2013-2014. It is important to note that these projections are for Police and Fire pension benefits only and do **not** include retiree healthcare contribution rates.

For reference, Scenario 2 would result in additional costs to the City for Police and Fire pension of approximately $31 million in 2010-11, $24 million in 2011-12, $22 million in 2012-13 and $24 million in 2013-14, for a total additional cost of $101 million.

A representative from my office was present at the Police and Fire Department Retirement Plan Board meeting on April 2nd and indicated to the Board the City Administration's desire and intent to stay engaged with the Retirement Board on this issue, including the various decisions the Board will be making regarding actuarial assumptions and methodologies.

The projected contribution rates for the current pension benefits are very significant, particularly considering the City's fiscal situation. However, we must continue to ensure that the City's pension plans are actuarially sound and funded appropriately.

We do not yet have similar projections for the Federated City Employees Retirement System, but my understanding is that those projections are being developed. I will forward that information to the City Council as soon as it is available.

Debra Figone
City Manager

For questions please contact Russell Crosby, Director of Retirement Services, at (408) 794-1000.

Attachments
1 – Retirement Fund Investment Performance (November 14, 2008)
2 – Financial Status of the Retirement Plans (December 18, 2008)
3 – Projection of Contribution Rates Under Different Scenarios (March 25, 2009)

ATTACHMENT I

Distributed on:

SENT TO COUNCIL: NOV 14 2008

by City Manager's Office

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Debra Figone

SUBJECT: **Retirement Fund Investment Performance**

DATE: November 14, 2008

INFORMATION

Attached for your information are two memos recently released by the Department of Retirement Services regarding the soundness of the Police and Fire Department Retirement Plan and the Federated City Employees' Retirement System. As the memos indicate, most retirement systems are exposed to general market risks, and the City's pension plans are no exception.

The total market value of the assets in the two retirement plans has declined by approximately $950 million since the beginning of the fiscal year. The following chart summarizes the performance of the Plan's investment portfolio in the current fiscal year.

	Police & Fire Department Retirement Plan		Federated City Employees' Retirement System	
	Market Value	Rate of Return	Market Value	Rate of Return
June 30, 2008	$2.561 Billion	-24.8%*	$1.774 Billion	-17.8%*
October 2008	$1.926 Billion*		$1.459 Billion*	
Total Decline in Market Value Return	**$635 Million***		**$315 Million***	
Grand Total	**$950 Million***			

*unaudited data as of 10/27/2008 P&F and 10/31/2008 (Federated)

The Police and Fire Department Retirement Plan assumes an 8% rate of return and the Federated City Employees' Retirement System assumes an 8.25% return. As shown above, these recent returns are far less than the long-term assumptions.

Although pension plans operate under a long-term investment strategy, this recent significant decline of nearly **$1 billion** in assets of the City's pension plans is certainly a concern. Although employees and retirees should **not** be concerned about retirement benefits being paid, the decline in assets will lead, in the absence of a financial market recovery by the end of the current fiscal year, to higher City contribution rates in the future. The extent of the impact on the contribution rates is not known at this time.

Future actuarial valuations performed by both Retirement Boards will incorporate pension fund performance, among other factors. It is these actuarial valuations that result in the contribution rates that the City and employees pay into the pension plans. The Boards currently perform actuarial valuations every two years. Performing annual actuarial valuations, rather than

biannual, would lead to a lower volatility in both the City's and the employee contribution rates. I will be requesting that the Boards consider performing annual actuarial valuations rather than biannual.

For your information, the current retirement contribution rates are as follows:

	City	Employees
Federated	22.68%	8.93%
Police	24.94%	11.96%
Fire	27.37%	12.40%

The contribution rates listed above include only the current partial pre-funding of retiree healthcare benefits. For the entire 2008-2009 fiscal year, the City has contributed approximately $120 million into the retirement plans.

We will continue to be in contact with the Department of Retirement Services and both Retirement Boards and will provide updated information.

DEBRA FIGONE
City Manager

Attachments

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: Police & Fire Department Retirement Plan Board of Administration

FROM: Ronald R. Kumar

SUBJECT: Soundness of the Plan

DATE: October 28, 2008

Approved

Date 10/28/08

INFORMATIONAL

BACKGROUND

At the October 3, 2008 meeting of the Board of Administration (the "Board") of the Police & Fire Department Retirement Plan (the "Plan"), the Trustees requested a summary of the Plan's asset balance and exposure to the AIG, Lehman Brothers, and Merrill Lynch.

ANALYSIS

The following chart illustrates the fluctuation of the Plan's assets over the past calendar year:

Balance as of:		Market Value
12/31/2007		$ 2,776,959,000
6/30/2008		$ 2,561,590,000
9/26/2008*	Friday prior to the proposed Financial Bailout Plan	$ 2,449,512,000
9/29/2008*	Monday: Financial Bailout Failure	$ 2,356,872,000
9/30/2008		$ 2,348,046,000
*10/27/2008**		***$ 1,926,656,000***

*-30.6% decline since Calendar Year End 12/31/2007**
*-3.8% decline due to the Financial Bailout Failure***
-8.1% decline in the 3rd Quarter (-8.4% for S&P 500)*
*-24.8% decline from 6/30/2008 thru 10/27/2008**

Current Exposure to:	Market Value*	Percent of Plan
AIG	$ 1,078,506	0.06%
Lehman Brothers	2,317,203	0.12%
Merrill Lynch	5,944,783	0.30%
Total Exposure:	$ 9,340,492	0.48%

** unaudited data as of 10/27/2008*
*** estimated data as of the end of the business day*

As is the case with most retirement systems, the Plan is exposed to general market risk. In a pension plan context, the market risk is the risk that the rate of return earned on the pension plan

assets could be below the long term rate of return assumed for the Plan, which is 8.0%. This general market risk is reflected in asset valuations fluctuating with market volatility. Any impact from market volatility on the Plan depends in large measure on how deep the market downturn is, how long it lasts, and how it fits within fiscal year reporting periods.

Market risk could impact the financial condition of the Plan and the City's required contribution to the Plan. However, it should be noted that the Plan takes a long term view and invest for the long term benefits. Market gains and losses are factored into the contribution rates through biennial actuarial calculations and "smoothed" or averaged over five years. This smoothing methodology has the effect of minimizing the possibility of large fluctuations in the contribution rates.

Employees and retirees should be assured over the City's ability to make retirement benefit payments either today or in the future. The City has a legal obligation to make these payments, and the Plans have investment strategies in place which take into account long-term market perspectives and methods are in place to periodically evaluate the various assumptions and make adjustments in the contribution rates through the biennial actuarial evaluation process.

Ronald R. Kumar
Financial Analyst

QC: Ceara O'Fallon
Analyst II

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: Federated City Employees' Retirement System Board of Administration

FROM: Ronald R. Kumar

SUBJECT: Soundness of the Plan

DATE: November 3, 2008

Approved

Date 11/3/08

INFORMATIONAL

BACKGROUND

At the October 9, 2008 meeting of the Board of Administration (the "Board") of the Federated City Employees' Retirement System (the "Plan"), the Trustees requested a summary of the Plan's asset balance and exposure to the AIG, Lehman Brothers, and Merrill Lynch.

ANALYSIS

The following chart illustrates the fluctuation of the Plan's assets over the past calendar year:

Balance as of:		Market Value
12/31/2007		$ 1,884,199,000
6/30/2008		$ 1,774,276,000
9/26/2008*	Friday prior to the proposed Financial Bailout Plan**	$ 1,709,940,000
9/29/2008*	Monday: Financial Bailout Failure**	$ 1,646,525,244
9/30/2008		$ 1,654,258,000
*10/31/2008**		*$ 1,459,203,000*

*-22.6% decline since Calendar Year End 12/31/2007**
*-3.8% decline due to the Financial Bailout Failure***
-6.8% decline in the 3rd Quarter (-8.4% for S&P 500)*
*-17.8% decline from 6/30/2008 thru 10/31/2008**

Current Exposure to:	Market Value*	Percent of Plan
AIG	$ 916,949	0.06%
Lehman Brothers	358,669	0.03%
Merrill Lynch	904,619	0.06%
Total Exposure:	$ 2,180,237	0.15%

** unaudited data as of 10/31/2008*
*** estimated data as of the end of the business day*

As is the case with most retirement systems, the Plan is exposed to general market risk. In a pension plan context, the market risk is the risk that the rate of return earned on the pension plan

assets could be below the long term rate of return assumed for the Plan, which is 8.25%. This general market risk is reflected in asset valuations fluctuating with market volatility. Any impact from market volatility on the Plan depends in large measure on how deep the market downturn is, how long it lasts, and how it fits within fiscal year reporting periods.

Market risk could impact the financial condition of the Plan and the City's required contribution to the Plan. However, it should be noted that the Plan takes a long term view and invests for the long term benefits. Market gains and losses are factored into the contribution rates through biennial actuarial calculations and "smoothed" or averaged over five years. This smoothing methodology has the effect of minimizing the possibility of large fluctuations in the contribution rates.

Employees and retirees should be assured over the City's ability to make retirement benefit payments either today or in the future. The City has a legal obligation to make these payments, and the Plans have investment strategies in place which take into account long-term market perspectives and methods are in place to periodically evaluate the various assumptions and make adjustments in the contribution rates through the biennial actuarial evaluation process.

Ronald R. Kumar
Financial Analyst

QC: Ceara O'Fallon
Analyst II

ATTACHMENT 2

COUNCIL AGENDA: 1-13-09
ITEM: 3.4

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Russell U. Crosby

SUBJECT: FINANCIAL STATUS OF THE RETIREMENT PLANS

DATE: December 18, 2008

Approved Christine F. Shippey Date 12/19/08

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

Accept report on staff's response to questions raised by the Rules and Open Government Committee on December 10, 2008 related to the financial status of the retirement plans.

OUTCOME

Present the financial status of both the Federated City Employees' Retirement System and the Police & Fire Department Retirement Plan.

BACKGROUND

A recent report by the City Manager indicated that the total market value of assets in the two retirement Plans had declined by approximately $950 million since the beginning of the fiscal year due to current economic conditions. Regardless of the long-term investment strategy of the plans, the decline of nearly $1 billion is of great concern.

At the December 10, 2008, the Rules and Open Government Committee, Mayor Reed requested that staff prepare a report for the January 13, 2009 City Council meeting regarding the status of the City of San Jose's ("City") two Retirement Plans to include:

a) The amount of investment losses in 2008;
b) Report on the impact of the City's required contribution to make up for the losses;
c) Benchmark comparisons to performance of other retirement plans, public and private, over the last five to ten years; and
d) Identify any best practices that might be considered to improve the Plans' investment performance and to protect the City's General Fund from additional losses.

This memorandum has been prepared in response to that request.

ANALYSIS

a) Performance

The following table illustrates the Federated City Employees' Retirement System's ("Federated System") and the Police & Fire Department Retirement Plan's ("Police & Fire Plan"), collectively referred to as "the Plans," performance.

	Oct-08*	YTD*	3rd Qtr. 2008**	ICC Rank	TUCS Rank	One Year**	ICC Rank	TUCS Rank	Three Years**	ICC Rank	TUCS Rank	Five Years**	ICC Rank	TUCS Rank
Federated System	-11.7%	-23.7%	-9.1%	61	57	-14.0%	39	31	2.7%	40	47	6.8%	42	47
Policy Index~FED	*-11.9%*	*-22.4%*	*-7.0%*	*16*	*12*	*-12.1%*	*14*	*15*	*3.3%*	*25*	*28*	*6.9%*	*40*	*40*
Police & Fire Plan	-13.2%	-27.2%	-9.6%	79	68	-16.5%	81	79	3.0%	39	34	7.3%	19	33
Policy Index~P&F	*-12.9%*	*-26.0%*	*-8.8%*	*60*	*45*	*-15.3%*	*62*	*58*	*3.6%*	*23*	*23*	*7.4%*	*17*	*32*
Public Funds^	-	-	-8.0%	-	-	-14.2%	-	-	2.7%	-	-	6.5%	-	-
Corporate Funds^	-	-	-8.2%	-	-	-14.4%	-	-	2.4%	-	-	6.7%	-	-
S&P 500	-16.8%	-32.8%	-8.4%	46	-	-22.0%	57	-	0.2%	53	-	5.2%	77	-
MSCI EAFE (Intn'l Equity)	-20.2%	-43.5%	-20.6%	62	-	-30.5%	73	-	1.1%	82	-	9.7%	84	-
Barclays Capital Aggregate+	-4.5%	-1.7%	-0.5%	15	-	3.7%	22	-	4.2%	31	-	3.8%	39	-
NCREIF Real Estate Index	0.6%	2.0%	-0.2%	67	-	5.3%	28	-	13.2%	38	-	14.2%	42	-

** as of 10/31/2008 ** as of 9/30/2008 + Formerly Lehman Brothers Aggregate Bond Index*
^ Median Data Source: ICC & TUCS (not available for 10/31/2008)
The Independent Consultants Cooperative ("ICC") uses systems supported by State Street Bank to deliver detailed performance and asset allocation rankings. The Wilshire's Trust Universe Comparison Service ("TUCS") is a collaborative effort between Wilshire Associates and custodian banks to provide comprehensive information on the effects of risk, allocation, and style.

The Federated System has consistently ranked in the second and third quartiles of the ICC and TUCS universes. A more diversified portfolio including alternative investments would have improved the Federated System's quartile ranking. The Policy Index return is the return that the asset allocation would have achieved with passive managers who attempt to replicate and not outperform their benchmarks. For all time periods considered, except the month of October, the Federated System underperformed its Policy Index. In other words, active management has consistently detracted value.

The Police & Fire Plan has ranked in different quartiles in the various time periods considered. The reason for the volatility of returns is a heavy allocation to equity investments. A more diversified portfolio including alternative investments would have improved the Plan's quartile ranking. For all time periods considered, the Police & Fire Plan underperformed its Policy Index. Again, active management has consistently detracted value.

More important than performance against other plans, however are the Plans' progress towards full funding. Progress towards full funding is achieved by performing at least as well as the actuarial assumptions. The following discussion will explain the potential impact of falling short of the actuarial assumptions.

The following table illustrates the Plans' balances as of recent dates and a year-to-date percent change, which is calculated without accounting for cash flows:

	Nov. 30, 2008*	Oct. 31, 2008	Sept. 30, 2008	Jun. 30, 2008	Dec. 31, 2007
Federated System	$1,398,610,000	$1,457,774,000	$1,654,258,000	$1,774,276,000	$1,884,199,000
YTD $ Loss	($485,589,000)	($426,425,000)	($229,941,000)	($109,923,000)	-
YTD % Loss	*-25.8%*	*-22.6%*	*-12.2%*	*-5.8%*	-
Police & Fire Plan	$1,992,396,000	$2,031,499,000	$2,348,046,000	$2,561,590,000	$2,776,959,000
YTD $ Loss	($784,563,000)	($745,460,000)	($428,913,000)	($215,369,000)	-
YTD % Loss	*-28.3%*	*-26.8%*	*-15.4%*	*-7.8%*	-

** unaudited data*

As illustrated above, as of November 30, 2008, the market values of the Federated System and Police & Fire Plan have declined 25.8% and 28.3%, respectively, since the beginning of the calendar year. The decline in the third quarter is slightly understated due to the City's prepayment of the retirement contributions for fiscal year 2008-09.

b) The impact of the Plans' investment losses on the City of San Jose

The impact of the Plans' investment losses on the City's contribution rate will be determined through an actuarial valuation. The City's required pension contribution, determined as a percentage of payroll, is based on an actuarial valuation report that is currently performed on a biennial basis for both Plans. The current pension contribution rates are based on the June 30, 2007 actuarial valuation and will be effective through June 30, 2010, unless the Retirement Boards modify the current biennial valuation process.

The following table illustrates the two Plans' normal valuation schedule:

FUNDS' CONTRIBUTION SETTING PROCESS		
Actuarial Valuation	**Date rates adopted by the Board**	**Rates Effective**
6/30/2007	June 2008	Fiscal Year 2008-09 Fiscal Year 2009-10
6/30/2009	June 2010	Fiscal Year 2010-11 Fiscal Year 2011-12

Given the current process, new rates based on the June 30, 2009 actuarial valuation will be implemented beginning July 1, 2010. These rates will reflect the largely smoothed actuarial investment losses incurred to the valuation date. The Police & Fire Plan has a "corridor" trigger, which ceases smoothing of losses when the losses exceed certain levels. Retirement Services has requested additional information from the actuary relating to the level at which the "corridor" trigger stops the smoothing of losses.

The actuarial loss or experience loss due to investment performance is defined as the difference between the "expected investment income" that the actuarial valuation assumed would be earned on the Plan's assets, based on an 8.75% gross rate of return assumption for Police & Fire (8.00%

net) and 9.00% gross rate of return for Federated (8.25% net), and the realized investment income. Actuarial losses are smoothed over five years except when losses exceed the "corridor" trigger for the Police & Fire Plan.

The current pension funding arrangement provides for the following cost sharing of benefits:

1. The current service cost or Normal Cost is the cost of funding an additional year of service for all the current active participants. Current service rate cost sharing is eight-to-three between the city and the employees. This year the City's portion of the normal cost was paid in full at the beginning of the fiscal year; whereas, members pay through payroll deductions during the year; and

2. The current service and past service deficiency cost is the cost of funding the Unfunded Actuarial Liability ("UAL"), which is the difference between the Plans' assets and liabilities. Current service deficiency cost refers to service accrued by members on and after July 1, 1975 while the past service deficiency cost refers to service prior to July 1, 1975. In other words, this deficiency cost pays for experience gains or losses relative to the assumptions in the actuarial valuation. Deficiency cost is amortized over 30 years, similar to a 30-year mortgage, and for pension benefits, entirely paid for by the City.

Contributions for retiree medical benefits are made by the City and employees in the ratio of one-to-one for both Plans. Contributions for retiree dental benefits are made by the City and employees in the ratio of three-to-one in the Police and Fire Plan and in the ratio of eight-to-three in the Federated System.

The following table illustrates the two Plans' Schedule of Funding Progress as of the most recent actuarial valuation.

Schedule of Funding Progress

HEALTHCARE	Valuation Date	Actuarial Value of Assets*	Liabilities	Actuarial Unfunded Liability	Funded Ratio
Federated	6/30/2006	$ 81,288,000	$ 702,939,000	$ 621,651,000	12.0%
P&F	6/30/2006	38,381,000	851,217,000	812,836,000	5.0%
Total		**$ 119,669,000**	**$ 1,554,156,000**	**$ 1,434,487,000**	**8.0%**
PENSION	**Valuation Date**	**Actuarial Value of Assets***	**Liabilities**	**Actuarial Unfunded Liability**	**Funded Ratio**
Federated	6/30/2007	$ 1,622,851,000	$ 1,960,943,000	$ 338,092,000	82.8%
P&F	6/30/2007	2,365,790,000	2,372,386,000	6,596,000	99.7%
Total		**$ 3,988,641,000**	**$ 4,333,329,000**	**$ 344,688,000**	**92.0%**

** Includes gain/loss smoothing, if any.*

Source: P&F Healthcare: CAFR 2006-07, Segal Report 2/21/2007; P&F Pension: Segal Actuarial Valuation 1/31/2008
Federated Healthcare: CAFR 2006-07, GRS Report 2/28/2007; Federated Pension: GRS Actuarial Valuation 1/2/2008

While all actuarial assumptions could generate deficiencies, the two actuarial assumptions that typically generate the most significant deficiencies are:

1. Investment risk, which is the risk that the plan will not achieve its stated rate of return assumption, 8.75% gross rate of return assumption for the Police & Fire Plan and 9.00% gross rate of return for the Federated System;

2. Mortality risk, which is the risk that retired members survive and receive pensions for longer than anticipated by the actuary.

Deficiency cost is amortized over 30 years, similar to a 30-year mortgage, and for pension benefits, paid entirely by the City. The following paragraphs illustrate how the deficiency cost could affect the City's contribution level. Admittedly the following is an oversimplification of actuarial methodology and calculations; however, the illustration is valid.

For the last ten years ending September 30, 2008, combined, the Plans underperformed the actuarially assumed rates of return by roughly $1.7 billion, of which roughly $0.7 billion predate the stock market crash of the third quarter of 2008. Normally, large underperformance over periods such as ten years or longer is an indication that the actuarial assumption, in this case the rates of return, 8.75% gross rate of return assumption for Police & Fire Plan and 9.00% gross rate of return for the Federated System, are inappropriately high.

An UAL relating to the actuarial rate of return assumption of roughly $1.7 billion would be created once all the investment losses are smoothed in; the total UAL consists of surpluses or deficiencies relating to all assumptions. The City will be responsible for making annual payments sufficient to pay interest on the UAL and to amortize the UAL over approximately 30 years.

The adoption of a more conservative investment return assumption will increase Normal Cost of the Plans, but decrease the total cost of the Plans and reduce the potential for additional increases in the UAL.

c) Discussion on Best Practices

Academic studies show that pension plans that follow best practices deliver the promised benefits at a lower cost. On a typical pension plan, an industry rule of thumb is that if the annual investment rate of return can be increased by 0.1%, the plan's liability decreases by roughly $100 million for plans with total liability of approximately $5.0 billion. Using this rule of thumb, the City's contribution rate would drop by about 1.0% of payroll, and the employees' contribution rate would drop by roughly 0.2%.

Pension plan best practices fall into the following three categories: governance, investments, and administration.

1. Governance is by far the most important area to focus a study of best practices since it directly impacts both investments and administration.

Technical skills are required to understand the complex issues that are present in the governance of the Plans. The combination of highly technical rules for pension administration and the need to understand the use of actuarial science in the measurement of present and future pension plan liabilities requires an experienced and highly trained Board member to effectively govern the plan.

While some may argue that the purpose of the Board is to set policy and that technical aspects are handled by trained professionals, a lack of understanding of the finer points of governance, administration, or investments means that a Board member may not be able to ask meaningful questions or fully understand the implications of a recommended course of action. Consequently, ineffective policies and inferior plan governance result. Inferior plan governance always leads to suboptimal decisions and higher costs for the City.

Recent court cases also highlight problems with the current construct of the Plans' Board membership. The ongoing Lexin (San Diego) case involves a Board with composition similar to the existing Police & Fire and Federated Boards and demonstrates issues that arise with Boards whose membership have potential conflicts of interest. Issues of potential conflict of interest can be resolved through changes to Board membership and improved internal Board governance procedures.

Over the years, there have been numerous conflicts between the Boards and City Administration that highlight the perception that the Board membership represents various constituencies rather than plan participants as a whole. Board members are currently perceived as being "representative" of a particular nominating group, even though each trustee must act as a fiduciary on behalf of all participants and beneficiaries rather than a "representative" of a particular nominating group. In addition, requirements for Trustees to be a "member" of the nominating group rather than "nominated by" the underlying group leads to potential conflicts of interest and limits the expertise and quality of trustees to individuals in the member pools who are willing to serve on the Boards.

One example of governance leading to suboptimal decisions and higher costs for the City is the issue of active money manager performance. This memo has pointed out in the performance section that active managers have detracted from the Plans' performance. Typically investment consultants are reluctant to recommend the termination of an active manager without making the same recommendation to all clients, which often implies that the consultant will allow the manager to underperform for a length of time. Knowledgeable Trustees can provide direction to the consultant on this issue to ensure no underperforming manager is retained for an excessive period of time.

Since proper governance is the key that leads to professionalism and excellence in all areas of practice, a consultant who has seen the governance structures of many different plans is in the best position to advise the City as the plan sponsor regarding the necessary governance changes.

2. The two retirement plans have made a number of changes toward best practices in their investment programs during the past year. The Federated System expanded the contract with its investment consultant to include full service consulting and adopted a new asset allocation in January 2008. The new allocation increases the allocation to alternative investments.

   The Police & Fire Plan replaced their investment consultant in April 2008 and adopted a new asset allocation in June 2008. The new asset allocation increases the allocation to alternative investments, and includes absolute return, real assets, private equity, and opportunistic strategies.

   - Had the Plans previously diversified their asset allocations to include alternative investments their rankings would very likely have been top quartile across the time periods considered. For example, the San Bernardino County Employees' Retirement Association ("SBCERA"), which began implementing an alternative investments strategy in 2003, outperformed its Policy Index by 1.9% and ranked in the 18th percentile at one-year, 2.0% at three-years (ranked in the 3rd percentile), and 0.9% at five-years (ranked in the 3rd percentile). SBCERA's nine-member Board consists of the County Treasurer (ex officio member), four members appointed by the San Bernardino County Board of Supervisors, two members elected by "General" members, one member elected by the "Safety" members (along with an Alternate), and a member elected by "Retired" members. SBCERA outperformed the San Jose Plans' returns by significant margins. Best practices do in fact translate into higher investment returns and lower contributions for all parties.

   During the year, the San Jose Plans hired a Chief Investment Officer, an Investment Officer, and a Senior Accountant. The Chief Investment Officer is an actuary and a former investment consultant. The Investment Officer is a Ph.D. and a former Director of Research for an investment consulting firm. The Senior Accountant is a former accounting manager of a private equity-owned firm.

3. Recent administrative best practices include the retention of the Segal Company in April 2008 to perform a review of Retirement Services administrative practices and HIPAA compliance; an ongoing audit of City payroll contributions to the retirement plans by the Plans' independent auditor, Macias Gini & O'Connell, LLP; approval of a staff request to conduct a review and develop a request for proposals to determine whether the Pension Gold processing software used by the Retirement Services Department is the best and lowest cost solution going forward; and a review of all insurance coverage for the Plans and their assets. Additionally, there has been renewed emphasis on ensuring that all calculations and procedures are in compliance with the Municipal Code. This lead to the recalculation of the Federated Supplemental Retirement Benefit Reserve ("SRBR") to at least 2005 and possibly further back in time to account for excessive transfers and potential overpayments in prior years.

As noted above, best practices in plan governance will yield the greatest benefits. Governance impacts all aspects of pension plan operations and leads to professionalism, excellence, and ultimately increased returns for the Plans.

EVALUATION AND FOLLOW-UP

This memorandum is provided as an informational item and may be updated upon the City Council's request.

PUBLIC OUTREACH/INTEREST *(Not Applicable)*

- ☐ **Criterion 1:** Requires Council action on the use of public funds equal to $1 million or greater. **(Required: Website Posting)**
- ☐ **Criterion 2:** Adoption of a new or revised policy that may have implications for public health, safety, quality of life, or financial/economic vitality of the City. **(Required: E-mail and Website Posting)**
- ☐ **Criterion 3:** Consideration of proposed changes to service delivery, programs, staffing that may have impacts to community services and have been identified by staff, Council or a Community group that requires special outreach. **(Required: E-mail, Website Posting, Community Meetings, Notice in appropriate newspapers)**

COORDINATION

This memorandum has been coordinated with the City Manager's Office, the City Auditor's Office, the City Attorney's Office, the Office of Employee Relations, and Human Resources.

CEQA

Not a project.

Russell U. Crosby, DIRECTOR
Retirement Services

For questions please contact Ronald R. Kumar, Financial Analyst, at (408) 392-6708.

ATTACHMENT 3

SEGAL

THE SEGAL COMPANY
120 Montgomery Street Suite 500 San Francisco, CA 94104-4308
T 415.263.8200 F 415.263.8290 www.segalco.com

March 25, 2009

Mr. Russell Crosby
Director
City of San Jose Police and Fire Department Retirement Plan
1737 North First Street, Suite 580
San Jose, CA 95112-4505

Re: Projection of Contribution Rates Under Different Scenarios (Retirement Plan Only)

Dear Russell:

As requested by your office, we have projected the employer and the employee's contribution rates under different future market rates of return as well as different investment return assumptions for the Retirement Plan. The projected contribution rates under the Baseline scenario (discussed below) for the Retiree Health Plan are provided in a separate report.

Description of the Scenarios Studied

In order to have level and predictable plan costs from one year to the next, the Board of Retirement has approved an asset valuation method that gradually adjusts to market value. Under this valuation method, any market value returns that are either below or above the assumed rate of investment return (currently 8% per year) are recognized over five years and as a result, the asset value and the resulting contribution rates are more stable. In addition, to avoid the smoothed Actuarial Value of Assets (AVA) from getting too far away from the Market Value of Assets (MVA), there is a market value corridor that limits the AVA to be no greater than 120% and no less than 80% of the MVA.

In this report, we have analyzed the impact of: (1) increasing contribution rate requirements brought about by unfavorable past and hypothetical future market rates of return since the last valuation date as of June 30, 2007; (2) increasing contribution rate requirements that would result if the current 8% assumed rate of investment return assumption used in the June 30, 2007 valuation were to be changed to 7.5% starting with the June 30, 2009 valuation; and (3) eliminating the 80% to 120% market value corridor starting with the June 30, 2009 valuation.

A description of the scenarios studied is summarized in the chart below.

	Rate of Investment Return Assumed in Valuation	Net Rate of Return (Plan Year)				MVA Corridor Applied
		07/08	08/09	09/10	10/11 and thereafter	
Baseline	8.00%	-5.89%(1)	-30.00%(2)	8.00%(3)	8.00%	Yes
Scenario 1	7.50%	-5.89%	-30.00%	7.50%	7.50%	Yes
Scenario 2	7.50%	-5.89%	-30.00%	7.50%	7.50%	No
Scenario 3	7.50%	-5.89%	-35.00%	0.00%	7.50%	Yes
Scenario 4	7.50%	-5.89%	-35.00%	0.00%	7.50%	No

(1) This was the net rate of return for plan year 07/08 as provided by the Retirement Department and used by Segal without review. According to the Retirement Department, it was calculated by taking the -5.10% gross rate of return, reduced by 0.55% in administrative and investment expenses and by 0.24% in benefit related payments from the Supplemental Retiree Benefit Reserve (SRBR).

(2) This was the net rate of return from July 1, 2008 through February 28, 2009 as provided by the Retirement Department and used by Segal without review. According to the Retirement Department, it was calculated by taking the -29.31% gross rate of return for the first eight months of plan year 08/09, reduced by 0.55% in administrative and investment expenses and by 0.14% in benefit related payments from the SRBR. Implicit in the -30.00% net rate of return assumption was that the market return would be flat (i.e., 0%) for the last four months of plan year 08/09.

(3) According to the Retirement Department, the Plan has to earn an 8.90% gross rate of return in order to yield an 8.00% net rate of return because the 8.90% gross return has to be reduced by 0.60% in administrative and investment expenses and by 0.30% in benefit related payments from the SRBR.

Actuarial Assumptions Used in the Projection

Other than the investment return assumptions described above, it is assumed that all future actuarial experience would match the assumptions adopted by the Board of Retirement for the June 30, 2007 retirement plan valuations. For the purpose of the projection, we have also made a simplifying assumption that an annual (rather than the current biennial) actuarial valuation

would be performed effective with the June 30, 2009 valuation and that the valuation would establish the contribution rate requirements for the plan year that begins 12 months following the date of the valuation.

Results

For the Baseline and each of the four scenarios, we have provided the following results:

- Projection of the employer rates from the June 30, 2007 to the June 30, 2027 actuarial valuations. The results are separated into two exhibits based on the rate of return used under each scenario for plan year 08/09. Exhibit 2a includes the results for the Baseline and Scenarios 1 and 2 (assuming a net rate of return of -30% for plan year 08/09), and Exhibit 2b includes the results for Scenarios 3 and 4 (assuming a net rate of return of -35% for plan year 08/09).

- Projection of the Unfunded Actuarial Accrued Liability (UAAL) for the retirement plan from the June 30, 2007 to the June 30, 2027 actuarial valuations. These results are displayed separately in Exhibit 3a for the Baseline and Scenarios 1 and 2 and in Exhibit 3b for Scenarios 3 and 4. In each year, any additional UAAL as a result of the unfavorable investment return experience has been amortized over the Board of Retirement's current policy of 16 years.

- Projection of the funded percentage for the retirement plan from the June 30, 2007 to the June 30, 2027 actuarial valuations. These results are displayed separately in Exhibit 4a for the Baseline and Scenarios 1 and 2 and in Exhibit 4b for Scenarios 3 and 4.

Exhibit 1 provides a consolidated summary of the projected results for the current and the next five years. This summary shows the employer rate, the UAAL and the funded percentage listed above for the baseline and the four scenarios. We have also included the employee's contribution rates for the next five years, as well as the ratio of AVA to MVA. This last ratio is used to show the effect of the market value corridor.

Below is a summary of the key results from the projections:

1. Under the Baseline scenario, it is anticipated that the AVA would be limited to 120% of the market value corridor in the June 30, 2009 valuation. This means that any market losses after the AVA exceeds 120% of the MVA would have to be fully recognized in developing the employer's contribution rate as of the June 30, 2009 valuation.

2. Under the Baseline scenario, the employer contribution rate for the retirement plan is expected to almost double from 22.5% of payroll developed in the June 30, 2007 valuation to 44.6% developed in the June 30, 2009 valuation for an increase of 22.1% of payroll.

   Please note that in projecting the contribution rates for the employer, we have not taken into account a provision in the Municipal Code that would allow the transfers of up to 5% of the accrued principal balance of the SRBR to buydown one-tenth of the increase in the City's contribution rate caused by poor market/investment return of the Fund. Those transfers would have a negligible impact on the results of this study.

3. Under Scenario 1, if the Board of Retirement were to decrease the 8.0% assumed rate of investment return assumption used in the June 30, 2007 valuation to 7.5% effective with the June 30, 2009 valuation, there would be an immediate increase in the employer and the employee contribution rates of 8.2% and 1.1% of payroll, respectively.

   The Scenario 1 contribution rates are expected to be higher in the short-term when compared to the Baseline. However, in the long term, the contribution rates under Scenario 1 are about the same as those under the Baseline, in spite of the assumption under Scenario 1 that the Plan would earn an annual market return of 7.5% effective 09/10 and is 0.5% less than that assumed under the Baseline.

4. Under Scenario 2, we have removed the 80-120% market value corridor that we have applied in determining the maximum amount that the AVA is allowed to deviate from the MVA in Scenario 1. Note that, relative to Scenario 1, the June 30, 2009 contribution rate is smaller by 17.5% of payroll. However, in the long term, the contribution rates under Scenario 2 will end up higher than those of Scenario 1 to recover the market losses as well as to make up for the time value of money due to the delay in contributions.

5. Under Scenario 3, the contribution rates will be higher than those under Scenario 1 because of the more unfavorable market rates of return assumed for plan years 08/09 and 09/10 assumed for Scenario 3.

6. Under Scenario 4, the MVA corridor has been removed. Note that, relative to Scenario 3, the June 30, 2009 contribution rate is smaller by 21.6% of payroll. However, in the long term the contribution rates under Scenario 4 will be higher than those under Scenario 3 for the same reasons stated in item 4.

   Note that we include results under Scenarios 2 and 4 with no MVA corridor to illustrate the impact of the MVA corridor, and not because removing the MVA corridor is necessarily a viable policy option.

Market Value Corridor and the Actuarial Standard of Practice

In 2007, the Actuarial Standards Board adopted Actuarial Standard of Practice (ASOP) No. 44. That standard requires that the "actuary should select an asset valuation method that is designed to produce actuarial values of assets that bear a reasonable relationship to the corresponding market values."

In particular, the ASOP goes on to say that the qualities of an asset valuation method should include the following:

> "3.3(b) The asset valuation method is likely to produce actuarial values of assets that, in the actuary's professional judgment, satisfy both of the following:
>
> 1. The asset values fall within a reasonable range around the corresponding market values. For example, there might be a corridor centered at market value, outside of which the actuarial value of assets may not fall, in order to assure that the difference from market value is not greater than the actuary deems reasonable.
>
> 2. Any differences between the actuarial value of assets and the market value are recognized within a reasonable period of time. For example, the actuary might use a method where the actuarial value of assets converges toward market value at a pace that the actuary deems reasonable, if the investment return assumption is realized in future periods.
>
> In lieu of satisfying both (1) and (2) above, an asset valuation method could satisfy section 3.3(b) if, in the actuary's professional judgment, the asset valuation method either (i) produces values within a sufficiently narrow range around market value or (ii) recognizes differences from market value in a sufficiently short period."

The application of this standard in relation to recent market events is still under review and discussion.

Other Considerations

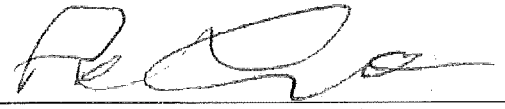
As the Retirement Department is aware, even though removing the Market Value Corridor would reduce contribution rate volatility for the next couple of the plan years, a change in the asset smoothing method (or any other funding methodology change) will not have a long-term impact on Plan costs (except for the time value of money effect noted above). The Plan's ultimate costs are determined by the benefits and expenses paid less actual investment income. Since an asset smoothing method affects neither benefits nor expenses, it will not reduce the Plan's true costs. The table of projected contribution rates shows that any short term current contribution savings will have to be made up in the future, plus interest.

Finally, we emphasize that projections, by their nature, are not a guarantee of future results. The modeling projections are intended to serve as illustrations of future financial outcomes that are based on the information available to us at the time the modeling is undertaken and completed, and the agreed-upon assumptions and methodologies described herein. Emerging results may differ significantly if the actual experience proves to be different from these assumptions or if alternative methodologies are used. Actual experience may differ due to such variables as demographic experience, the economy, stock market performance and the regulatory environment.

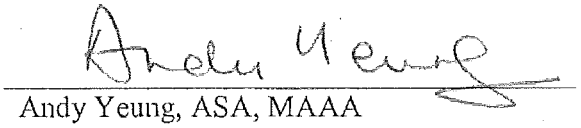
Except as noted, all the calculations are based on the June 30, 2007 actuarial valuation results including the participant data and actuarial assumptions on which that valuation was based. The valuation and these projections were completed under the supervision of Andy Yeung, ASA, MAAA.

Please let us know if you have any question regarding this letter and/or the enclosures.

Sincerely,



Paul Angelo, FSA, MAAA, FCA
Senior Vice President & Actuary



Andy Yeung, ASA, MAAA
Vice President & Associate Actuary

/bqb
Enclosures

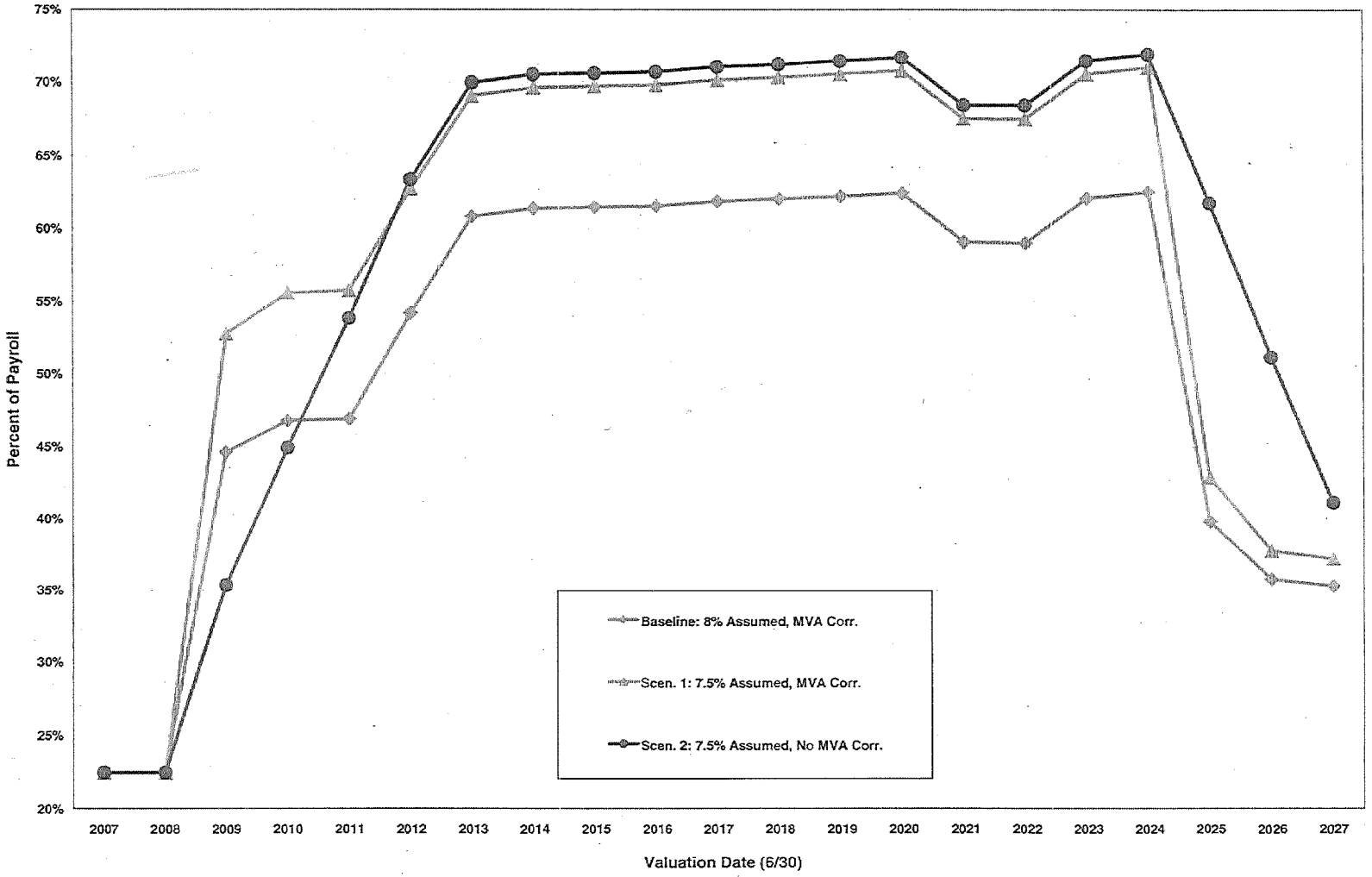
Exhibit 1: Summary of Projected Results for Next 5 Years

($ in millions)

Valuation Date (6/30)	2007	2008	2009	2010	2011	2012
Plan Year	08/09	09/10	10/11	11/12	12/13	13/14
Baseline: Assumed Rate of Investment Return at 8% per year, 120% MVA corrider applied						
Net Rate of Return at -5.89% for plan year 2007/2008, -30% for 2008/2009, and 8% per year thereafter						
Employer Rate	22.5%	22.5%*	44.6%	46.8%	46.9%	54.2%
Employee Rate	8.3%	8.3%*	8.3%	8.3%	8.3%	8.3%
UAAL	$ 7	$ (64)	$ 642	$ 699	$ 694	$ 917
Funded Percentage	100%	103%	76%	75%	77%	71%
Ratio of AVA to MVA (before corridor)	89%	104%	150%	136%	123%	109%
Scenario 1: Assumed Rate of Investment Return at 7.5% per year, 120% MVA corrider applied						
Net Rate of Return at -5.89% for plan year 2007/2008, -30% for 2008/2009, and 7.50% per year thereafter						
Employer Rate	22.5%	22.5%*	52.8%	55.6%	55.8%	62.8%
Employee Rate	8.3%	8.3%*	9.4%	9.4%	9.4%	9.4%
UAAL	$ 7	$ (64)	$ 820	$ 897	$ 888	$ 1,105
Funded Percentage	100%	103%	71%	70%	72%	68%
Ratio of AVA to MVA (before corridor)	89%	104%	150%	137%	123%	109%
Scenario 2: Assumed Rate of Investment Return at 7.5% per year, no MVA corrider						
Net Rate of Return at -5.89% for plan year 2007/2008, -30% for 2008/2009, and 7.50% per year thereafter						
Employer Rate	22.5%	22.5%*	35.3%	44.9%	53.8%	63.4%
Employee Rate	8.3%	8.3%*	9.4%	9.4%	9.4%	9.4%
UAAL	$ 7	$ (64)	$ 302	$ 593	$ 872	$ 1,177
Funded Percentage	100%	103%	89%	80%	73%	66%
Ratio of AVA to MVA	89%	104%	150%	137%	123%	109%
Scenario 3: Assumed Rate of Investment Return at 7.5% per year, 120% MVA corrider applied						
Net Rate of Return at -5.89% for plan year 2007/2008, -35% for 2008/2009, 0% for 2009/2010, and 7.50% per year thereafter						
Employer Rate	22.5%	22.5%*	57.8%	65.6%	66.1%	69.3%
Employee Rate	8.3%	8.3%*	9.4%	9.4%	9.4%	9.4%
UAAL	$ 7	$ (64)	$ 969	$ 1,198	$ 1,196	$ 1,282
Funded Percentage	100%	103%	66%	61%	63%	63%
Ratio of AVA to MVA (before corridor)	89%	104%	160%	153%	134%	114%
Scenario 4: Assumed Rate of Investment Return at 7.5% per year, no MVA corridor						
Net Rate of Return at -5.89% for plan year 2007/2008, -35% for 2008/2009, 0% for 2009/2010, and 7.50% per year thereafter						
Employer Rate	22.5%	22.5%*	36.2%	47.6%	58.6%	70.1%
Employee Rate	8.3%	8.3%*	9.4%	9.4%	9.4%	9.4%
UAAL	$ 7	$ (64)	$ 326	$ 676	$ 1,020	$ 1,387
Funded Percentage	100%	103%	89%	78%	68%	59%
Ratio of AVA to MVA	89%	104%	160%	153%	134%	114%

*Contribution rate calculated in the June 30, 2007 valuation.

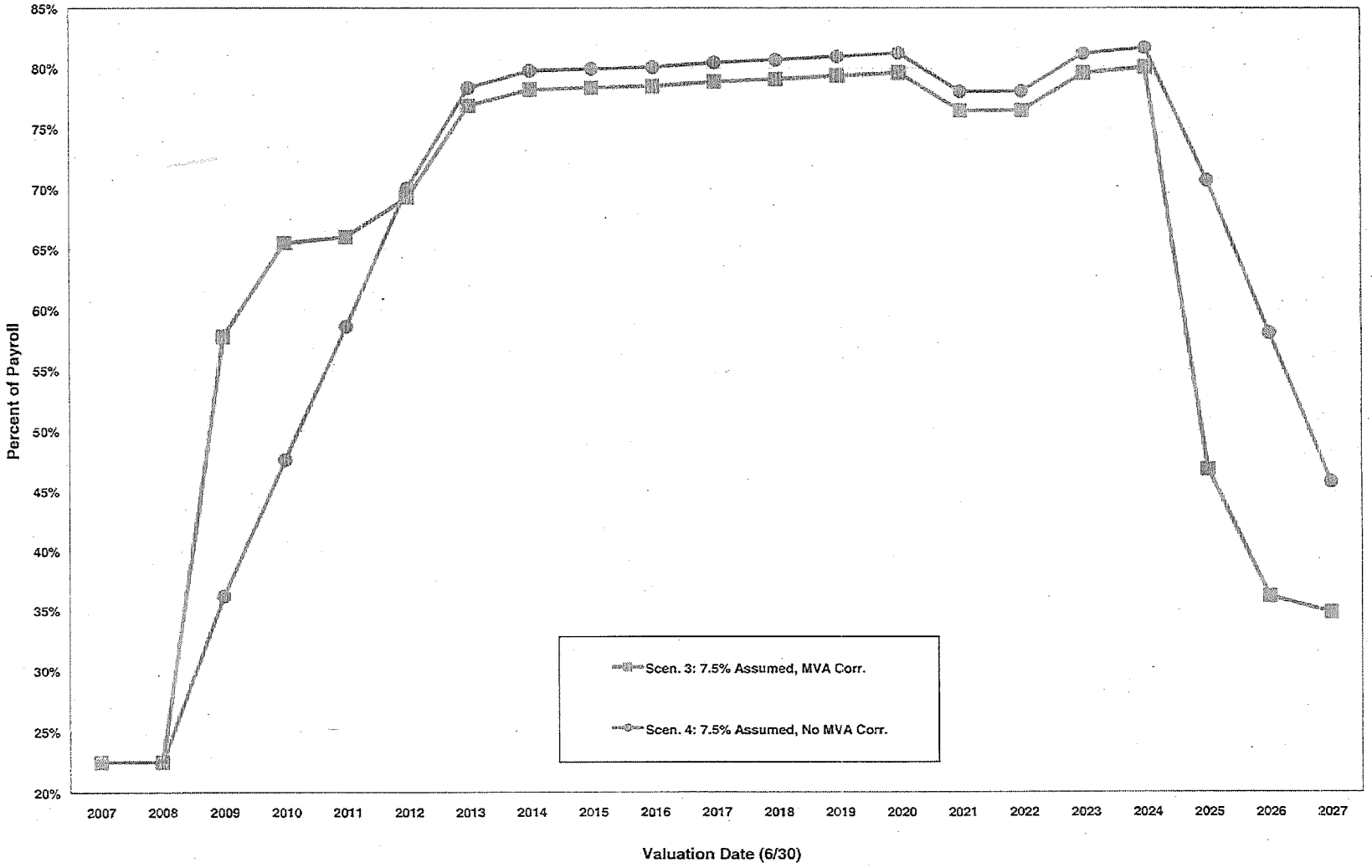
Exhibit 2a: Projected Employer Rates



Valuation Date (06/30)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Baseline: 8% Assumed, MVA Corr.	22.5%	22.5%	44.6%	46.8%	46.9%	54.2%	60.9%	61.4%	61.5%	61.6%	61.9%	62.1%	62.3%	62.5%	59.1%	59.0%	62.1%	62.6%	39.8%	35.8%	35.3%
Scen. 1: 7.5% Assumed, MVA Corr.	22.5%	22.5%	52.8%	55.6%	55.8%	62.8%	69.1%	69.7%	69.8%	69.8%	70.2%	70.4%	70.6%	70.8%	67.6%	67.6%	70.6%	71.0%	42.9%	37.8%	37.2%
Scen. 2: 7.5% Assumed, No MVA Corr.	22.5%	22.5%	35.3%	44.9%	53.8%	63.4%	70.0%	70.5%	70.6%	70.7%	71.1%	71.2%	71.5%	71.7%	68.5%	68.5%	71.5%	71.9%	61.8%	51.2%	41.1%

Baseline: Net market rate of return: -5.89% (07/08), -30% (08/09), and 8% per year thereafter.
Scenario 1: Net market rate of return: -5.89% (07/08), -30% (08/09), and 7.50% per year thereafter.
Scenario 2: Net market rate of return: -5.89% (07/08), -30% (08/09), and 7.50% per year thereafter.

Exhibit 2b: Projected Employer Rates



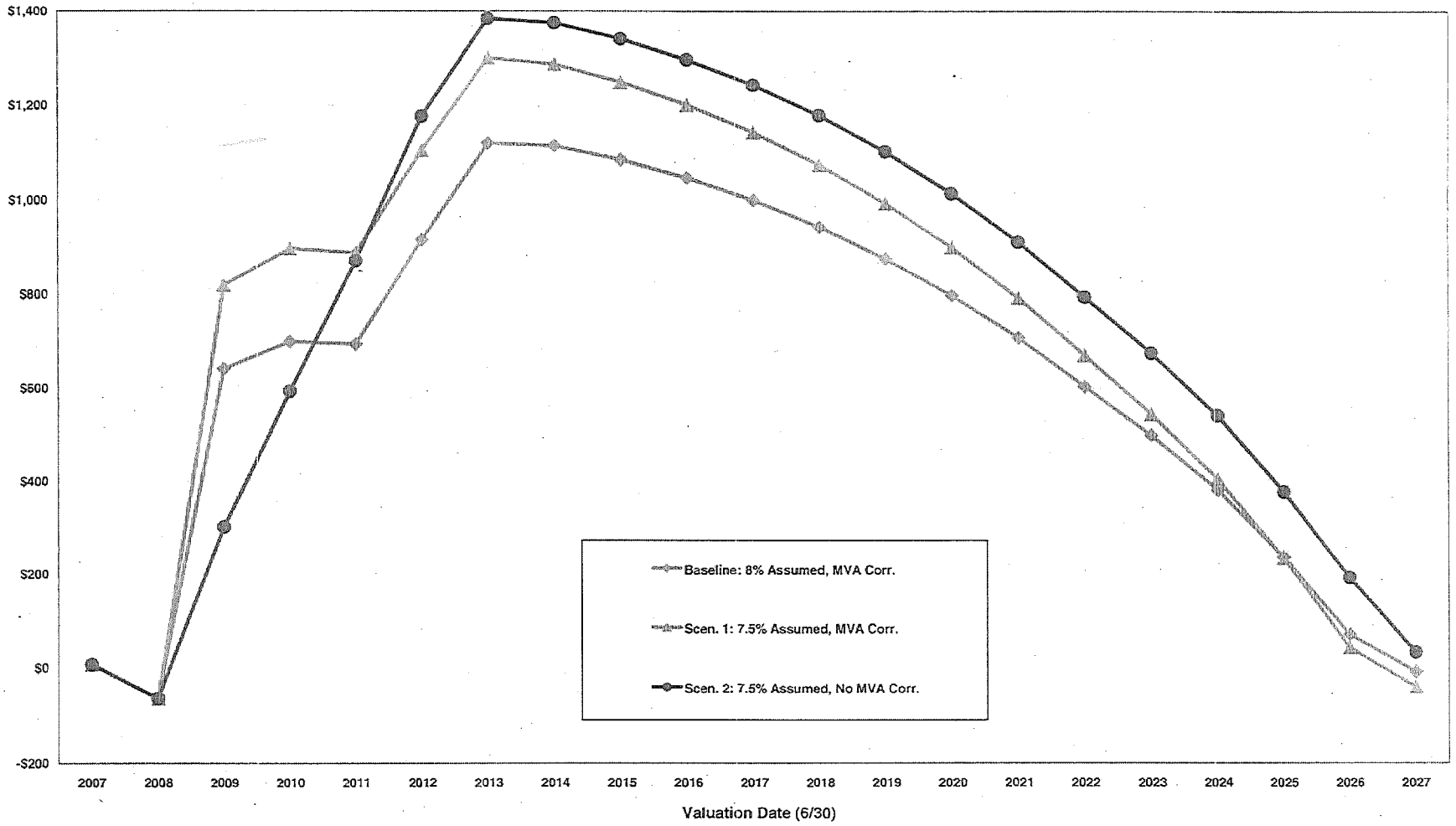
Valuation Date (06/30)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Scen. 3: 7.5% Assumed, MVA Corr.	22.5%	22.5%	57.8%	65.6%	66.1%	69.3%	76.9%	78.3%	78.4%	78.6%	78.9%	79.1%	79.4%	79.7%	76.5%	76.5%	79.6%	80.1%	46.8%	36.2%	34.8%
Scen. 4: 7.5% Assumed, No MVA Corr.	22.5%	22.5%	36.2%	47.6%	58.6%	70.1%	78.4%	79.8%	79.9%	80.1%	80.4%	80.6%	80.9%	81.2%	78.1%	78.1%	81.2%	81.7%	70.7%	58.1%	45.8%

Scenario 3: Net market rate of return: -5.89% (07/08), -35% (08/09), 0% (09/10), and 7.50% per year thereafter.

Scenario 4: Net market rate of return: -5.89% (07/08), -35% (08/09), 0% (09/10), and 7.50% per year thereafter.

Exhibit 3a: Projected UAAL

($ in millions)

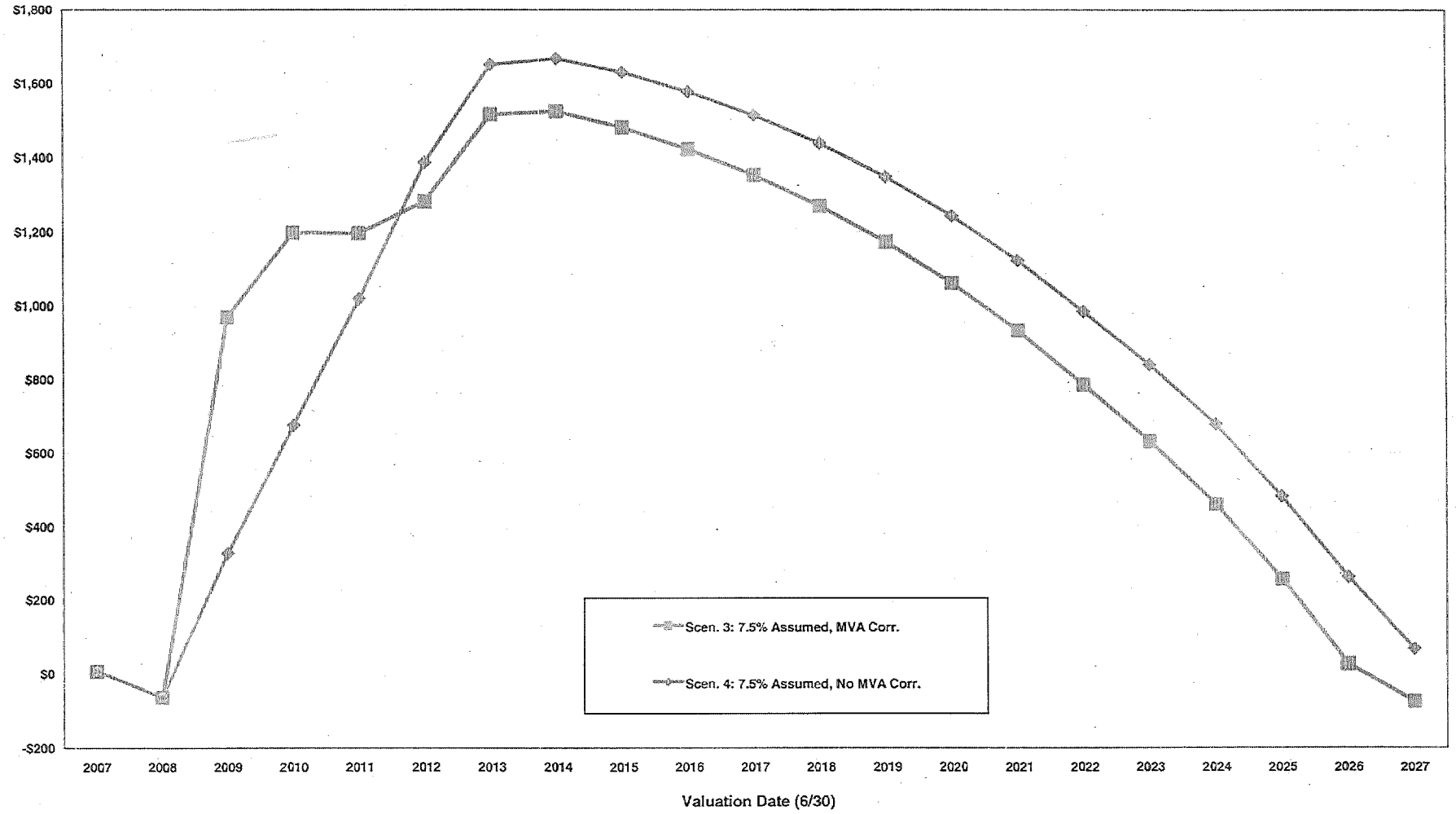


Valuation Date (06/30)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Baseline: 8% Assumed, MVA Corr.	7	(64)	642	699	694	917	1,121	1,116	1,086	1,048	1,000	944	877	799	708	604	499	382	236	71	(8)
Scen. 1: 7.5% Assumed, MVA Corr.	7	(64)	820	897	888	1,105	1,301	1,288	1,250	1,201	1,143	1,074	993	900	792	670	544	404	235	43	(39)
Scen. 2: 7.5% Assumed, No MVA Corr.	7	(64)	302	593	872	1,177	1,384	1,375	1,341	1,297	1,243	1,179	1,102	1,014	912	795	675	541	378	193	33

Baseline: Net market rate of return: -5.89% (07/08), -30% (08/09), and 8% per year thereafter.
Scenario 1: Net market rate of return: -5.89% (07/08), -30% (08/09), and 7.50% per year thereafter.
Scenario 2: Net market rate of return: -5.89% (07/08), -30% (08/09), and 7.50% per year thereafter.

Exhibit 3b: Projected UAAL

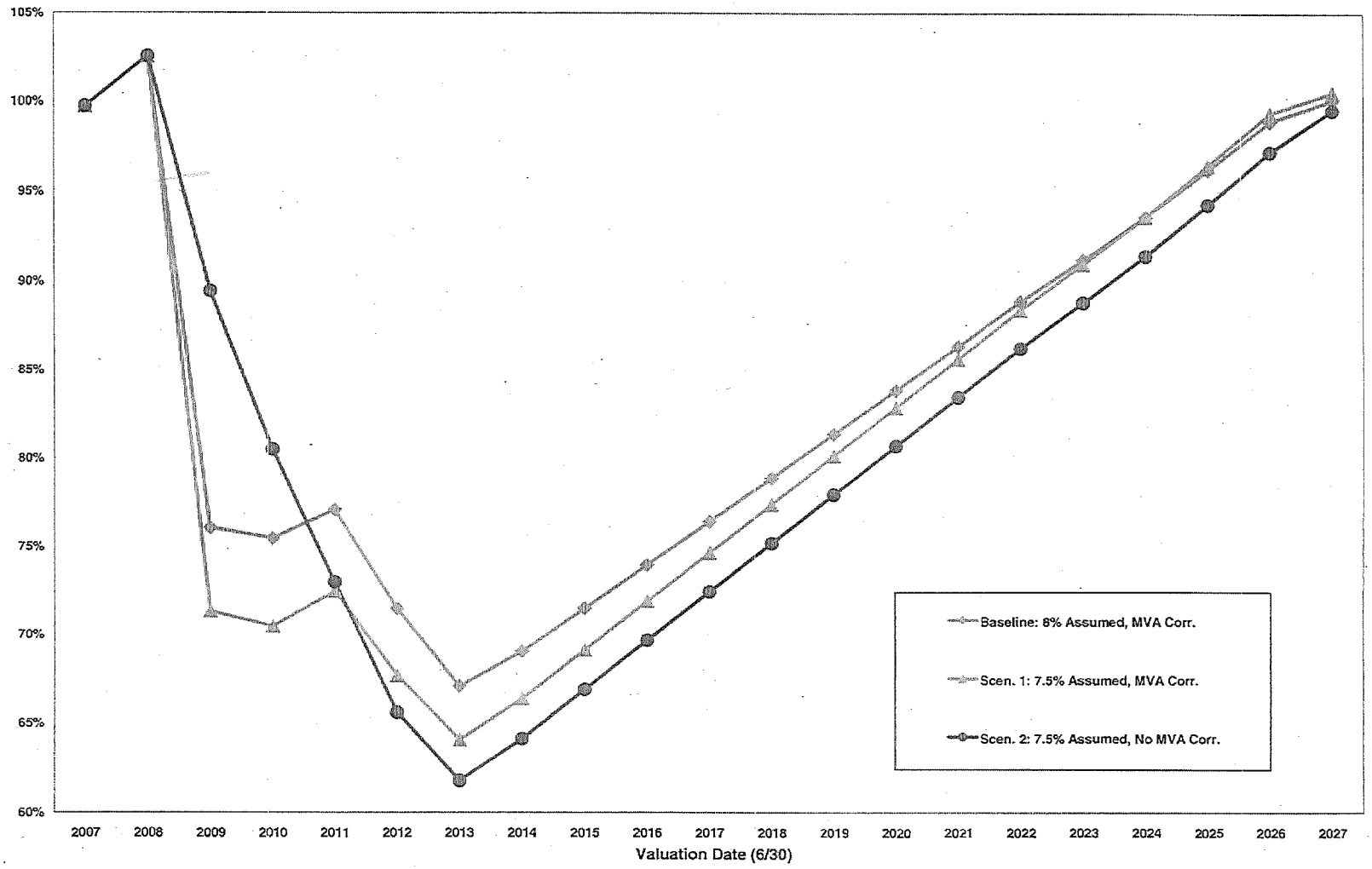
($ in millions)



Valuation Date (06/30)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Scen. 3: 7.5% Assumed, MVA Corr.	7	(64)	969	1,198	1,196	1,282	1,517	1,526	1,482	1,423	1,354	1,271	1,174	1,062	933	786	633	462	258	27	(75)
Scen. 4: 7.5% Assumed, No MVA Corr.	7	(64)	326	676	1,020	1,387	1,651	1,667	1,629	1,577	1,514	1,439	1,349	1,244	1,124	985	841	679	483	262	66

Scenario 3: Net market rate of return: -5.89% (07/08), -35% (08/09), 0% (09/10), and 7.50% per year thereafter.
Scenario 4: Net market rate of return: -5.89% (07/08), -35% (08/09), 0% (09/10), and 7.50% per year thereafter.

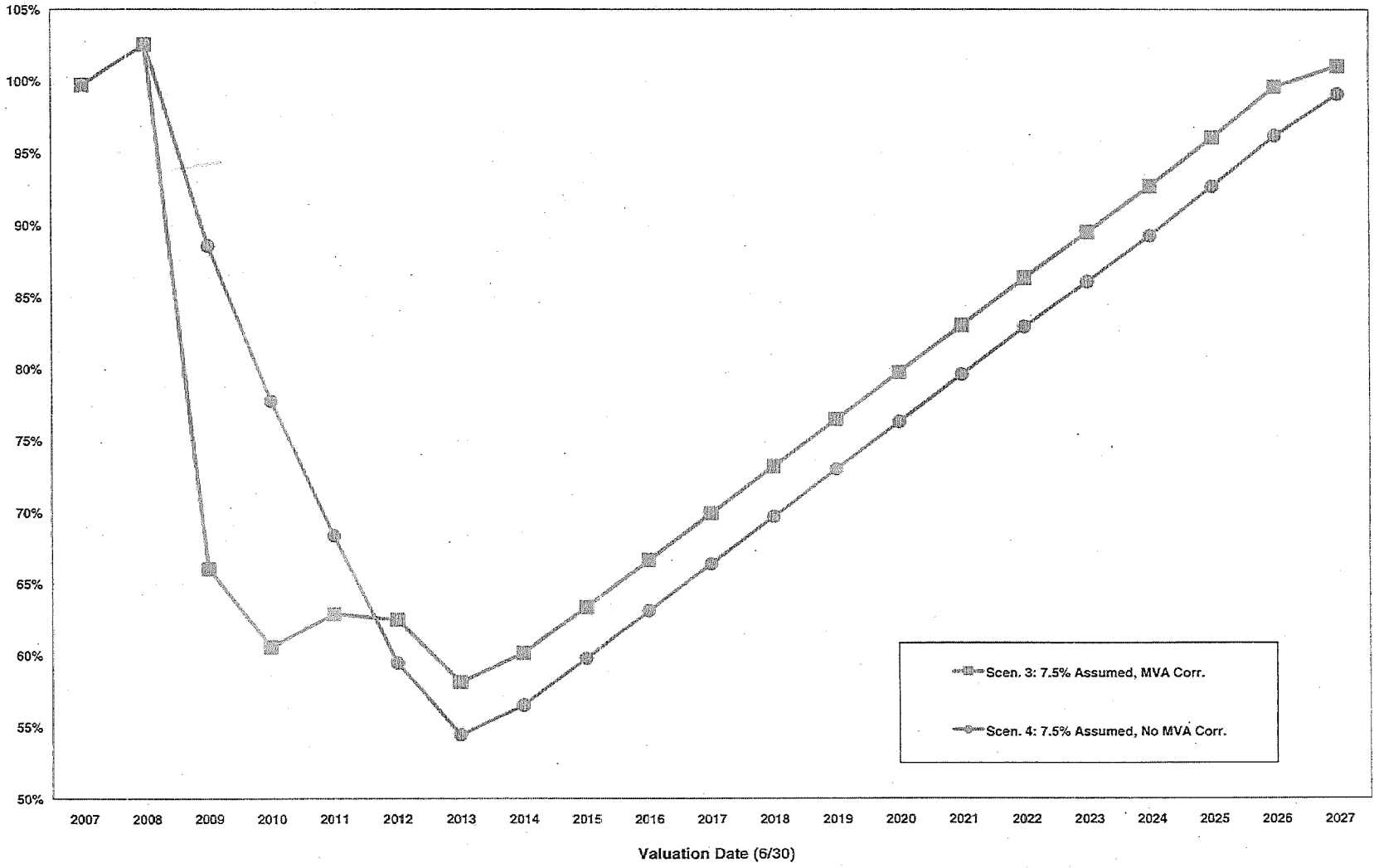
Exhibit 4a: Projected Funded Percentage



Valuation Date (06/30)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Baseline: 8% Assumed, MVA Corr.	100%	103%	76%	75%	77%	71%	67%	69%	71%	74%	76%	79%	81%	84%	86%	89%	91%	94%	96%	99%	100%
Scen. 1: 7.5% Assumed, MVA Corr.	100%	103%	71%	70%	72%	68%	64%	66%	69%	72%	75%	77%	80%	83%	86%	88%	91%	94%	96%	99%	101%
Scen. 2: 7.5% Assumed, No MVA Corr.	100%	103%	89%	80%	73%	66%	62%	64%	67%	70%	72%	75%	78%	81%	83%	86%	89%	91%	94%	97%	100%

Baseline: Net market rate of return: -5.89% (07/08), -30% (08/09), and 8% per year thereafter.
Scenario 1: Net market rate of return: -5.89% (07/08), -30% (08/09), and 7.50% per year thereafter.
Scenario 2: Net market rate of return: -5.89% (07/08), -30% (08/09), and 7.50% per year thereafter.

Exhibit 4b: Projected Funded Percentage



Valuation Date (06/30)	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027
Scen. 3: 7.5% Assumed, MVA Corr.	100%	103%	66%	61%	63%	63%	58%	60%	63%	67%	70%	73%	77%	80%	83%	86%	90%	93%	96%	100%	101%
Scen. 4: 7.5% Assumed, No MVA Corr.	100%	103%	89%	78%	68%	59%	54%	56%	60%	63%	66%	70%	73%	76%	80%	83%	86%	89%	93%	96%	99%

Scenario 3: Net market rate of return: -5.89% (07/08), -35% (08/09), 0% (09/10), and 7.50% per year thereafter.
Scenario 4: Net market rate of return: -5.89% (07/08), -35% (08/09), 0% (09/10), and 7.50% per year thereafter.