CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Office of the City Attorney
RICHARD DOYLE, CITY ATTORNEY

September 19, 2019

The Honorable Deborah A. Ryan
Presiding Judge
Santa Clara County Superior Court
191 North First Street
San Jose, CA 95113

(ENDORSED)
FILED
SEP 23 2019
Clerk of the Court
Superior Court of CA County of Santa Clara
BY Brittney Huelbig DEPUTY

Re: Grand Jury Report

Dear Judge Ryan:

Pursuant to California Penal Code section 933, et seq., please accept the City's response to the 2018-2019 Santa Clara County Civil Grand Jury Report, "San José's Unfunded Pension Liability: A Growing Concern." The City Council approved the City's response to the Grand Jury Report on September 17, 2019. The approved City response and the Grand Jury's Report are enclosed for your review. The Retirement Boards will send their response under separate cover.

Please feel free to contact me if you have any questions. Thank you for your consideration.

Very truly yours,

RICHARD DOYLE
City Attorney

Enclosures

cc: Mayor Sam Liccardo
David Sykes, City Manager
Roberto Pena, Director of Retirement Services
Jennifer Schembri, Director of Employee Relations

COUNCIL AGENDA: 09/17/19
FILE: 19-792
ITEM: 3.5

CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND CITY COUNCIL

FROM: Jennifer Schembri

SUBJECT: **SANTA CLARA COUNTY CIVIL GRAND JURY REPORT – UNFUNDED PENSION LIABILITIES**

DATE: September 5, 2019

Approved Jennifer A. Maguire Date 9-5-19

RECOMMENDATION

Accept staff's response to the June 18, 2019, 2018-2019 Santa Clara County Civil Grand Jury Report entitled "San Jose – Unfunded Pension Liabilities: A Growing Concern."

OUTCOME

Approval of this response will satisfy the requirements of Penal Code Section 933(c), which requires the City Council to respond to Civil Grand Jury reports to the presiding judge of the Superior Court.

BACKGROUND

The Santa Clara County Civil Grand Jury (Grand Jury) initiated an investigation into the City of San Jose's two independent retirements systems, the Police and Fire Department Retirement Plan and the Federated City Employees' Retirement System, on November 6, 2018. In the report, the Grand Jury explains that the City used $335 million of the General Fund in the Fiscal Year 2018-2019 budget to pay for pension costs. General Fund monies are also used for services such as police and fire, street repairs, parks, and libraries. The Grand Jury concludes that if changes are not made to the way the City's retirement systems are funded and managed, then the City will have to continually increase the amount it contributes toward pension and other post-employment benefits costs. The potential impact on City services concerned the Civil Grand Jury, which precipitated their investigation.

The Grand Jury report states that their investigation focused on "the structure of the two Board and the Office of Retirement Services." In addition, their investigation considered the efficiency and effectiveness of the Boards' administrative duties and the investment profiles of the two retirement systems.

The Grand Jury provided the City of San Jose with its final report entitled, "San Jose – Unfunded Pension Liabilities: A Growing Concern." The Grand Jury requested that responses to its findings and recommendations be provided the Grand Jury's presiding Judge of the Superior Court in accordance with the California Penal Code.

ANALYSIS

The report contained six (6) findings with applicable recommendations to either the City of San Jose or the boards of the two retirement systems. The City was requested to respond to Findings and Recommendations #3, 4, 5, and 6. There are two findings and recommendations, numbers 3 and 4, that require responses from both the City and the boards of the two retirement systems. California Penal Code Section 933.05 states that the responding person or entity shall provide certain basic information in the response to each finding and recommendation. With regard to the findings, the respondent(s) must indicate whether they agree, disagree partially, or disagree wholly. When disagreeing, the respondent(s) must state which portion is disputed and why. With regard to the recommendations, the respondent(s) must state whether it has been implemented, will be implemented (with a time frame), requires further analysis (with an explanation), or will not be implemented (with an explanation). What follows are the Grand Jury's findings and recommendations and the associated responses.

FINDING 3
The City of San José's mandatory required contributions to pension plans are putting an ever increasing burden on the City's General Fund, which impedes the ability of the City to provide essential services to its residents.
AGREE
The City agrees with this finding. The City of San Jose is committed to providing its residents and customers with essential services, and has taken several steps to address the high cost of retirement benefits for City employees. This includes the Alternative Pension Reform Framework Agreements with the City's eleven bargaining units, which contained several cost saving measures and protections against further benefit enhancements without a vote of the electorate. (Attachment A and Attachment B). *For example, the City and the bargaining units agreed that employees in Tier 2 would share the cost of pension benefits 50/50 with the City. The City also agreed to close the defined benefit retiree healthcare plan for Tier 2 Police and Fire employees, as the Federated defined benefit plan had been previously closed to Tier 2 employees in 2013.*

Additionally, the voters approved Measure F on November 8, 2016. Measure F amended the City Charter so that any future benefit enhancement to the retirement plans would need to be approved by the voters. Measure F also contained a provision that prohibited any retroactive defined retirement benefit enhancements. These were important cost containing measures for future benefits. (Attachment C).

The City is continuing to monitor and review the cost of retirement benefits. As approved by the City Council in March 2019, the Mayor's March Budget Message directed the City Manager to provide support to the Retirement Stakeholder Solutions Working Group meetings in the coming months. This Working Group has a goal of convening key stakeholders to address the current challenges of the City's retirement systems in a collaborative and transparent manner, and making recommendations for City Council consideration. This Working Group is tentatively scheduled to begin in October 2019. (Attachment D).

RECOMMENDATION 3

The City of San José should work collaboratively with the 11 bargaining units to find ways to reduce this burden and make the findings public no later than June 2020.

AGREE

The City agrees with the recommendation to work collaboratively with bargaining units. As stated above, the Retirement Stakeholder Solutions Working Group is tentatively scheduled to commence meetings in October 2019. The anticipated outcome of the Working Group is that a list of recommendations will be developed. The timing of the recommendations may not coincide with making the findings public by June 2020.

With respect to the benefits agreed to in the Alternative Pension Reform Framework Agreements, those benefits set forth in the City Charter and Municipal Code are to be memorialized in a retirement memorandum of agreement (MOA) between the City and the bargaining units. The retirement MOAs will also include summaries of the benefits for Tier 1 employees. The retirement MOAs have a term of ten years, both expiring on June 30, 2025. The City and the bargaining units are subject to the terms of the retirement MOAs until the expiration date.

FINDING 4

Maintaining two separate pension Boards has resulted in inefficiencies including duplication of various tasks and responsibilities.

AGREE

The City agrees with this finding in general. While the two Boards maintain a shared administrative staff and typically engage the same professionals to advise them on investment, actuarial, and legal matters, it appears that there is some inherent duplication of effort and expenses that need to be explored further.

RECOMMENDATION 4A

The City of San José should examine the current Board models, consider opportunities for streamlining, and identify areas of administrative cost reduction. This investigation should include evaluating one board for both plans but structured to prevent the proportional dilution of members' representation. This recommendation does not include the combining or commingling of plans funds. The results of these actions should be made public by June 30, 2020.

RECOMMENDATION REQUIRES FURTHER ANALYSIS

The recommendation requires further analysis. One of the goals of the Retirement Stakeholder Solutions Working Group is to examine the issues and challenges surrounding the retirement systems. Several issues will be reviewed and researched by the Working Group, and the Working Group could address the different opportunities to streamline the administration of the Boards.

FINDING 5

The expertise of the public members of the Boards of Administration is heavily weighted toward investment professionals. Other more successful pension funds, such as LACERS, have boards that have a much wider range of expertise.

PARTIALLY DISAGREE

The City partially disagrees with this finding.

The City agrees that the expertise of the current public Board members is heavily weighted toward investment professionals. The City made significant changes to the composition of the retirement boards in 2010. These changes were based on recommendations from a consultant's review of the retirement board structure. The consultant, Cortex Applied Research (Cortex), recommended that each retirement board should have four (4) public, independent members selected by the City Council, and that those members should "possesses strong knowledge, expertise, and experience relevant to the administration of public retirement plans." These recommendations applied to both the Federated Retirement Board and the Police and Fire Retirement Board.

Based on the recommendations by Cortex, stakeholder outreach, and a review of other public pension plans, the City recommended changes to the qualifications for the public members of the board to include a minimum of fifteen years' experience in pension administration, pension actuarial practice, institutional investment management, employee benefits/investment law, banking, asset/liability management for an insurance company, or university or college professor with a focus on fiduciary or trust fund law or a quantitative background in financial theory or actuarial math. These qualifications were approved and are now included in the City's Municipal Code sections related to the administration of the Boards.

The changes made to the required qualifications for the public Board members were meant to help select individuals who had relevant expertise to understand the complex issues that occur in the administration of defined benefit retirement plans. The City disagrees that broadening *the qualifications for the public members of the Boards beyond the qualifications enumerated above would necessarily make the pension systems more successful without further analysis.*

RECOMMENDATION 5

The City of San José should broaden the backgrounds of the public Board members beyond the present focus on investment strategy beginning with the next Board member appointment.

RECOMMENDATION WILL BE IMPLEMENTED

The recommendation has not yet been implemented, but will be implemented as Board members' terms expire.

Recently, the Clerk's Office, in conjunction with the Office of Retirement Service, began outreach to several different websites and forums to be more inclusive of the other possible professions and backgrounds that qualify for the public seats pursuant to the Municipal Code. The City will continue to work with its stakeholders to better advertise the vacancies to a wide range of professionals who may have the requisite experience to effectively administer the retirement systems.

The process for filling vacancies on the Boards begins with the City Clerk posting the vacancy on the City Clerk's website. Possible applicants can apply via the Clerk's website, and are then reviewed to ensure that the applicants meet the minimum qualifications.

The Municipal Code provides that the public members of the boards shall possess a baccalaureate degree from an accredited college or university in finance, actuarial science, law, economics, business or other relevant field of study. An advanced degree in a relevant field of study or professional certification is desirable but not required.

Moreover, each public member of the boards shall possess a high level of knowledge and expertise, and at least twelve years of experience, relevant to the administration of a public retirement plan. Knowledge and expertise relevant to the administration of a public pension system may include but is not limited to experience in: a senior executive position in pension administration; pension actuarial practice; institutional investment management; auditing; accounting; legal; health and welfare and/or employee benefits management; investment management; banking; asset/liability management for an insurance company; college or university professor with a focus on fiduciary or trust fund law or a quantitative background in financial theory or actuarial math.

FINDING 6

The 3% COLA for Tier 1 retirees has a major impact on the unfunded liability, increasing the burden on the City's General Fund and further impeding the ability of the City of San José to provide essential services to its residents.

AGREE

The City agrees with this finding. The City recognizes that the 3% COLA has an impact on the cost of pension benefits for Tier 1 employees. To contain costs related to post-retirement *benefits, the City and the bargaining units agreed to a lesser level of benefits for Tier 2 when compared to Tier 1 pension benefits in recognition of the unsustainable retirement costs. As stated in the Grand Jury's report, the Tier 2 COLA benefits are tied with the Consumer Price Index (CPI) and capped at a maximum of 2%.*

RECOMMENDATION 6

The City of San José should examine ways in which the 3% COLA liability can be reduced fairly as many other public entities have done by considering options such as reducing COLAs in exchange for lump sum buyouts, etc. This examination should be completed and made public by June 2020.

DISAGREE WHOLLY

The City disagrees with this recommendation. The City is currently in a closed retirement MOA with its bargaining units through June 30, 2025, as stated above. Tier 1 retirement benefits contained in the MOA are subject to the terms of the MOA until it expires. This includes the 3% COLA for Tier 1 employees.

Moreover, there are legal issues relating to changes to the current Tier 1 COLA structure. The City's prior attempt to modify Tier 1 COLAs was found invalid by a County Superior Court in the Measure B litigation.

EVALUATION AND FOLLOW-UP

There is no anticipated follow-up with the City Council at this time.

PUBLIC OUTREACH

This response will be posted on the City's web site for the September 17, 2019 Council Agenda.

COORDINATION

This memorandum has been coordinated with the City Attorney's Office and the Office of Retirement Services.

COMMISSION RECOMMENDATION/INPUT

This item does not have any input from any board or commission.

CEQA

Not a Project. File No., PP17-010, City Organizational and Administrative Activities resulting in no changes to the physical environment.

/s/
JENNIFER SCHEMBRI
Director of Employee Relations
Director of Human Resources

For additional information on this report, contact Jennifer Schembri at (408) 535-8154.

Attachment A – Police and Fire Alternative Pension Reform Framework Agreement[1]
Attachment B – Federated Alternative Pension Reform Framework Agreement[2]
Attachment C – Measure F (Santa Clara County List of Local Measures November 8, 2016)[3]
Attachment D – Mayor's March Budget Message – Fiscal Year 2019-2020[4]

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[1] http://www.sanjoseca.gov/DocumentCenter/View/45132

[2] http://www.sanjoseca.gov/DocumentCenter/View/48240

[3] https://www.sccgov.org/sites/rov/Info/Nov2016Info/Documents/E110%20List%20of%20local%20measures.pdf

[4] https://gcc01.safelinks.protection.outlook.com/?url=https%3A%2F%2Furldefense.proofpoint.com%2Fv2%2Furl%3Fu%3Dhttps-3A__sanjose.legistar.com_View.ashx-3FM-3DF-26ID-3D7082148-26GUID-3D6370C1D4-2DC207-2D4E3B-2DA174-2DACCC0D37C482%26d%3DDwMFAw%26c%3DY6lK3sQOQe5gkvL3EqgybQ%26r%3DcIvO38fEEu2xNDuOe75njhioTuL7wSN6KhqGMmblIPY%26m%3DvqiRw03vmyqCoPb5LXbFqQkYKBoIN0Lv85uowI_BCxM%26s%3DWd9EJeF1eSaPUbjZz-mgfc3DGG_Bbp9oQbouvnqA7YM%26e%3D&data=02%7C01%7CChloe.Meyere%40sanjoseca.gov%7Cf3ef81b10f524e9bf60008d6a4e15172%7C0fe33be061424f969b8d7817d5c26139%7C0%7C0%7C636877684987724653&sdata=Lz2Synbk%2F1nn1fzlbv334bBmqPItl2JwhJmQRCPDlCs%3D&reserved=0

ALTERNATIVE PENSION REFORM SETTLEMENT FRAMEWORK

(Evidence Code Section 1152)

Settlement Discussion Framework Language

The City of San Jose, the San Jose Fire Fighters, IAFF Local 230, and the San Jose Police Officers' Association have engaged in settlement discussions concerning litigation arising out of a voter-approved ballot measure, known as Measure B. The parties have reached the below framework for a tentative settlement of San Jose Police Officers' Association v. City of San Jose, Santa Clara Superior Court, No. 1-12-CV-22926, Sapien, et. Al. v. City of San Jose, et. al., Santa Clara County Superior Court, No. 1-13-CV-225928 (and associated actions), The People of the State of California ex rel. San Jose Police Officers' Association v. City of San Jose, Santa Clara County Superior Court, No. 1-13-CV245503 (quo warranto proceedings), International Association of Firefighters, Local 230 vs. City of San Jose, Public Employment Relations Board Unfair Practice No. SF-CE-969-M, and various other actions, including grievances. This settlement framework shall be presented for approval by the City Council and the respective Union Board of Directors.

It is understood that this settlement framework is subject to a final overall global settlement. In the event the settlement framework is not accepted, all parties reserve the right to modify, amend and/or add proposals. Each individual item contained herein is contingent on an overall global settlement/agreement being reached on all terms, by all parties/litigants (including the retirees), and ratified by union membership and approved by the City Council.

MARCH 11th LETTER

In accordance with Mayor Sam Liccardo's letter on behalf of the City Council to all bargaining units dated March 11, 2015, inclusive of the direction from Councilmember Don Rocha's March 6, 2015, memorandum, the City Council is willing to pursue settlement of Measure B litigation through a quo warranto process in 2015, contingent on the Council's satisfaction that the following conditions have been met before the quo warranto process begins:

1. *Agreement on an alternative strategy to implement pension reform and replace Measure B. Such agreement must achieve all reform objectives that the Council deems necessary to the public interest, including improved city services, and the sustainability of our retirement plans.*
2. *The quo warranto strategy is legally viable and can be carried out on a timeline that would allow the Council sufficient time to pursue a 2016 ballot measure should a quo warranto strategy fail.*
3. *All bargaining units have agreed to pursue the quo warranto strategy.*
4. *The Council is satisfied that the quo warranto strategy does not impair the public interest.*

If agreements are not reached to end litigation with all plaintiffs in Measure B litigation, or if the process of quo warranto does not permit the replacement of Measure B with this or any other agreement, the City Council, Local 230 and the POA shall request a stay of all Measure B litigation to which they are involved in to permit this agreement to appear on a 2016 ballot as a measure to replace Measure B in its entirety with respect to police and fire participants of the Police & Fire Retirement Plan. If this ballot measure is enacted, all Measure B litigation involving Local 230, the POA and the City would be terminated and dismissed.

Retirement Memorandum of Agreement

1. The parties (The City of San Jose, San Jose Police Officers' Association and San Jose Fire Fighters, IAFF Local 230) shall enter into a Tripartite Memorandum of Agreement to memorialize all agreements related to retirement. The Tripartite MOA shall expire June 30, 2025.
2. The Tripartite MOA will be a binding agreement describing the terms of the final agreement between the parties and will be subject to any agreed-upon reopeners herein.

The current Tier 2 retirement plans for Police and Fire employees will be modified as follows:

1. Pension benefit based upon a back-loaded accrual rate as follows:
   a. For each year from years 1-20: 2.4% per year
   b. For each year from years 21-25: 3.0% per year
   c. For each year 26 and above: 3.4% per year
2. Retirement Age
   a. The eligible age for an unreduced pension benefit will be age 57
   b. The eligible age for a reduced pension benefit will be age 50. The reduction for retirement before age 57 will be 7.0% per year, prorated to the closest month.
3. 80% cap
   a. The maximum pension benefit will be 80% of an employee's final average salary
4. Three-year final average salary
5. A member is vested after 5 years of service
6. No retroactive pension increases or decreases

a. Any such changes in retirement benefits will only be applied on a prospective basis.

7. No pension contribution holiday
8. Pensionable pay will include base pay, holiday in lieu pay, EMT pay, anti-terrorism training pay, POST pay, and base FLSA pay as per Tier 1 members.
9. Current Tier 2 sworn employees will retroactively be moved to the new Tier 2 retirement benefit plan except as provided in Paragraph 16a (returning Tier 1).
   a. Any costs, including any unfunded liability, associated with transitioning current Tier 2 employees into the restructured Tier 2 benefit will be amortized as a separate liability over a minimum of 16 years and split between the employee and the City 50/50. This will be calculated as a separate unfunded liability and not subject to the ramp up increments of other unfunded liability.
10. Removal of language limiting vesting of benefits from City Charter (Section 1508-A (h))
11. Tier 2 cost sharing
    a. Employees and the City will split the cost of Tier 2 including normal cost and unfunded liabilities on a 50/50 basis
    b. In the event an unfunded liability is determined to exist for the Police and Fire Tier 2 retirement plans, Tier 2 employees will contribute (the "Ramp Up") toward the unfunded liability in increments of 0.33% per year until such time that the unfunded liability is shared 50/50 between employee and employer
    c. Until such time that the unfunded liability is shared 50/50, the City will pay the balance of the unfunded liability
12. Cost of Living Adjustment (COLA)

a. Tier 2 retirees will receive an annual cost of living adjustment based on the Consumer Price Index – Urban Consumers (San Francisco-Oakland-San Jose, December to December) or 2.0%, whichever is lower
b. In the first year of pension benefits, the COLA will be pro-rated based on the date of retirement

13. Disability Benefit (Tier 2)
    a. A Tier 2 member who is approved by the independent medical review panel for a service-connected disability retirement is entitled to a monthly allowance equal to the greater of:
        i. 50% of final compensation;
        ii. A service retirement allowance, if he or she qualified for such;
        iii. An actuarially reduced factor, as determined by the plan's actuary, for each quarter year that his or her service age is less than 50 years, multiplied by the number of years of safety service subject to the applicable formula, if not qualified for a service retirement.
    b. A Tier 2 member who is approved by the independent medical review panel for a non-service connected disability is entitled to a monthly allowance equal to:
        i. If less than age 50: 1.8% per year of service; or
        ii. If older than age 50: The amount of service pension benefit as calculated based upon the service pension formula.
14. If there is any Tier 1 or Tier 2 benefit not mentioned in this framework, the parties agree to meet to discuss whether or not that benefit should be included in the Tier 2 benefit.
15. Tier 2 members will be provided with 50% Joint and Survivor benefits, which provide 50% of the retiree's pension to the retiree's surviving

spouse or domestic partner in the event of the retiree's death after retirement.

a. Tier 2 members will be provided with survivor benefits in the event of death before retirement. These benefits will be the same as Tier 1 members but reduced to reflect the new 80% pension cap versus the current 90% pension cap.

16. "Classic" Lateral will become Tier 1, including former San Jose Fire Department /San Jose Police Department sworn employees

a. Former Tier 1 sworn City employees who have been rehired since the implementation of Tier 2 or rehired after the effective date of a tentative agreement based on this framework will be placed in Tier 1

b. Any costs, including any unfunded liability, associated with transitioning current Tier 2 employees who were former Tier 1 sworn City employees who have since been rehired will be amortized as a separate liability over a minimum of 16 years and split between the employee and the City 50/50. This will be calculated as a separate unfunded liability and as Tier 1 employees these members are not subject to a ramp up in unfunded liability.

c. Any lateral hire from any other pension system who transfers as a "Classic" employee under PEPRA, regardless of tier, will be placed in Tier 1.

d. Any lateral hire from any other pension system who transfers as a "new" employee under PEPRA will be placed in Tier 2.

17. Tier 2 members will be provided the same service repurchase options as Tier 1 members (excluding purchases of service credit related to disciplinary suspensions) so long as all costs for the repurchase are paid for by the employee.

18. The City and the Unions agree to work with their actuaries to jointly request that the Police and Fire Retirement Board of Administration and its actuary carefully consider retirement rate actuarial assumptions with regard to the new Tier 2 plan. Specifically, the parties will request that the Board and its actuary incorporate retirement rate assumptions similar to the CalPERS retirement rates of the similarly designed CalPERS PEPRA plan rather than that of the existing San Jose Police and Fire Tier 1 plan.

Retiree Healthcare - All provisions below are contingent on final costing by the City's Actuary and review for legal and/or tax issues

1. Close the current defined benefit retiree healthcare program to new employees and current Tier 2 employees

2. The parties will implement a defined contribution healthcare benefit in the form of a Voluntary Employee Beneficiary Association (VEBA). The plans would not provide any defined benefit, would not obligate the City to provide any specific benefit upon member retirement, and therefore create no unfunded liability. This agreement does not require the City to contribute any future funds to an employee's VEBA, nor does it preclude an agreement to allow future City contributions

3. New lowest cost medical plan
   a. Kaiser NCAL 4307 Plan (305/$3,000 HSA-Qualified Deductible HMO Plan) will be adopted as the new lowest cost healthcare plan, for active and retired members

b. The City will continue the cost sharing arrangement for active employees of 85% of the lowest cost non-deductible HMO plan

c. The "lowest cost plan" for any current or future retiree in the defined benefit retirement healthcare plan shall be set that it may not be lower than the "silver" level as specified by the current Affordable Care Act in effect at the time of this agreement. This specifically includes the provision that the healthcare plan must be estimated to provide at least 70% of healthcare expenses as per the current ACA "silver" definition.

4. Potential Tier 1 opt-out

a. So long as it is legally permitted, Tier 1 employees may make a one-time election to opt-out of the defined benefit retiree healthcare plan into an appropriate vehicle for the funds, i.e. a Voluntary Employee Beneficiary Association (VEBA). Members of the current defined benefit plans will be provided with one irrevocable opportunity to voluntarily "opt out" of the current retiree medical plan. Those members who "opt out," and are thus not covered by the City defined benefit retiree medical plan, will be mandated to join the VEBA plan.

5. Enrollment in Medicare Parts A and B as required by any applicable federal regulations or by insurance providers

6. The current defined benefit retiree healthcare plan is modified to enable retired members to select an "in lieu" premium credit option. At the beginning of each plan year, retirees can choose to receive a credit for 25% (twenty-five percent) of the monthly premium of the lowest priced healthcare and dental plan as a credit toward future member healthcare premiums in lieu of receiving healthcare coverage. On an annual basis,

or upon qualifying events described in the "special enrollment" provisions of the Health Insurance Portability and Accountability Act of 1996, retirees and their spouses/dependents can elect to enroll in a healthcare plan or continue to receive an "in lieu" premium credit. Enrollees receiving in lieu credit at any tier other than retiree only must verify annually that they are still eligible for the tier for which they are receiving the in lieu credit. If a member selects the "in-lieu" premium credit, but the member, their survivor or beneficiaries never uses their accumulated premium credit, the accumulated credit is forfeited. At no time can a member or survivor/beneficiary take the credit in cash or any form of taxable compensation. There is no cap on the size of the accumulated credit.

7. Members of the VEBA and their spouses/dependents, during retirement, may also elect to enter or exit coverage on an annual basis or upon a qualifying event (however, members in the VEBA will not receive an "in lieu" benefit).
8. The VEBA contribution rate for all new hires and Tier 2 members will be 4.0% of base pay. The VEBA contribution rate for all members who opt out of the defined benefit plan and are mandated to join the VEBA plan will be 5.0% of base pay.
9. Members who remain in the Defined Benefit retirement healthcare plan will contribute 8.0% of their pensionable payroll into the plan. The City will contribute the additional amount necessary to ensure the Defined Benefit retirement healthcare plan receives its full Annual Required Contribution each year. If the City's portion of the Annual Required Contribution reaches 11% of payroll, the City may decide to contribute a maximum of 11%.

10. The parties have been advised that the difference between the defined benefit contribution rate (8.0%) and the VEBA opt-out contribution rate (5.0%) will be taxable income.

11. Upon making such an irrevocable election to opt-out of the defined benefit retiree healthcare plan, an amount estimated to equal the member's prior retiree healthcare contribution, with no interest included, will be contributed by the City to the member's VEBA plan account (pending costing and tax counsel advice). In making these contributions, the City may transfer funds from the 115 Trust to the members' VEBA plan account to the extent permitted by federal tax law and subject to receipt of a favorable private letter ruling. If it is determined by the IRS that the funds may not come out of the 115 trust, the parties will meet and confer regarding the opt-out and whether or not it can be implemented through other means. In addition, if the amount needed based on the number of employees who chose to opt out is more than the funds in 115 trust, the parties will also meet and confer. Members will be provided with individual, independent financial counseling to assist them with any decisions to remain in or "opt out" of the defined benefit retiree medical plan.

12. Pending legal review by tax counsel, deferred-vested Tier 1 members who return to San José will be given a one-time irrevocable option to "opt out" of the defined benefit retirement healthcare option. Upon choosing to "opt out", they will become a member of the VEBA and their VEBA account will be credited for their prior contributions. If they choose not to "opt out", they will return to the Defined Benefit retirement healthcare plan.

13. Catastrophic Disability Healthcare Program –Members of the VEBA who receive service-connected disability retirements will be eligible for 100% of the single premium for the lowest cost plan until the member and is eligible for Medicare (usually age 65).
    a. Qualifications - The member must not be eligible for an unreduced service retirement.
    b. The member must exhaust any funds in their VEBA account prior to becoming eligible for the Catastrophic Disability Healthcare Program.
    c. Upon reaching Medicare eligibility, the benefit will cease
    d. Any retiree who qualifies must submit on an annual basis an affidavit verifying that they have no other employment which provides healthcare coverage.
    e. If a retiree is found to have other employment which provides healthcare coverage, their eligibility to participate in the Catastrophic Disability Healthcare Program will automatically cease, subject to re-enrollment if they subsequently lose said employment-provided healthcare coverage.

Disability Definition and Process

1. Reinstate the previous City definition for disability for all sworn employees
2. Applications for disability must be filed within one month of separation from City service subject to the exceptions reflected in Municipal Code § 3.36.920 A (4).
3. All applicants must submit medical paperwork indicating the initial nature of their disability including the affected body part if applicable, the current level of disability, and current treatments underway. Such medical paperwork must be filed within one year of separation unless

the independent medical review panel grants a longer deadline due to extenuating circumstances.

4. Applications for disability may not be deferred by the applicant past four (4) years of the date of application submittal, unless the independent medical review panel grants a longer deadline due to extenuating circumstances.
5. The member and the City may have legal representation at hearings
6. Independent panel of experts appointed by 6 of 9 retirement board members will evaluate and approve or deny disability retirement applications
    a. Using the established Request for Proposal process, the retirement boards will recruit potential members of the independent medical panel
    b. Each member shall have a four-year term and meet the following minimum qualifications
        i. 10 years of practice after completion of residency
        ii. Practicing or retired Board Certified physician
        iii. Not a prior or current City employee
        iv. No experience providing the City or retirement boards with medical services, except for prior service on medical panel
        v. No experience as a Qualified Medical Evaluator or Agreed Medical Evaluator
        vi. Varying medical experience
    c. A panel of three independent medical experts will decide whether to grant or deny all disability applications, whether service or non-service connected. The panel's decision will be made by majority vote.
    d. Upon its own motion or request, the independent medical panel may determine the status of a disability retirement recipient to

confirm that the member is still incapacitated or if the member has the ability to return to work

7. Administrative law judge
    a. A decision to grant or deny the disability retirement made by the independent medical panel may be appealed to an administrative law judge.
    b. Applicant or City has forty-five (45) days to appeal a decision made by the independent medical panel. The appeal hearing must commence within ninety (90) days of the notice of appeal, unless a later date is mutually agreed to by the parties.
    c. The decision rendered by the administrative law judge is to be based on the record of the matter before the independent medical review panel.
    d. The decision of the administrative law judge will be a final administrative decision within the meaning of Section 1094.5 of the California Code of Civil Procedure.
8. Modified Duty (POA – Article 39)
    a. The City and the POA will continue to discuss the modified duty positions during collective bargaining
    b. While these discussions take place, the number of modified duty positions will be increased to 30
    c. The independent medical review panel will evaluate the status of the employees in the modified duty program on a yearly basis until the program is modified through bargaining
9. Worker's Compensation Reform
    a. For Tier 2 participants, the workers' compensation offset currently in place for Federated Plan participants will apply to a maximum aggregate total of $10,000.00 per Tier 2 employee in workers'

compensation cash disability benefit awards only using the same pension benefit offset formula.

b. In an effort to streamline the workers' compensation process, reduce costs, decrease the number of work related injuries through prevention and expedite the return to work of those injured or ill, the parties agree to convene a Public Safety Wellness Improvement Committee to discuss modifications to, or creation of, wellness and/or workers' compensation policies, procedures and protocols.

Supplement Retiree Benefit Reserve (SRBR)

1. Continue elimination of SRBR
   a. The funds credited to the SRBR will continue to be credited to the Police and Fire Department Retirement Plan to pay for pension benefits
2. City will replace SRBR with guaranteed purchasing power (GPP) provision for all Tier 1 retirees, prospectively. The GPP is intended to maintain the monthly allowance for Tier 1 retirees at 75% of purchasing power effective with the date of the retiree's retirement
   a. Beginning January 2016 and each January thereafter, a retiree's pension benefit will be recalculated annually to determine whether the benefit level (including any increases due to cost of living adjustments) has kept up with inflation as measured by the CPI-U (San Francisco-Oakland-San Jose). The actual benefit level will be compared to what would have been required to maintain the same purchasing power as the retiree had at the time of retirement, with a CPI-based increase.

b. Those Tier 1 retirees whose benefit falls below 75% of purchasing power will receive a supplemental payment that shall make up the difference between their current benefit level and the benefit level required to meet the 75% GPP.

c. The supplemental GPP payment to qualifying retirees will be paid annually in a separate check, beginning February 2016, and each February thereafter.

d. The number of Tier 1 retirees whose benefit level was below 75% GPP at the time of costing was approximately 55.

e. In the event of litigation by a retired member or members of POA and/or IAFF Local 230 challenging this provision of the Settlement Agreement against POA and/or IAFF Local 230, the Unions will have a right to tender the defense of the litigation to the City. City will accept the defense of the litigation and will defend POA and/or IAFF Local 230 with counsel of City's choice, including the City Attorney's Office. If the City is also named defendant in any such suit, Unions will not claim that joint representation of either or both of them and the City constitutes a legal conflict for the attorney(s) defending the suit. This defense obligation will not apply to lawsuits challenging or in any way relating to this provision filed more than five years after the effective date of this agreement.

Memoranda of Agreement (MOA)

1. This agreement is contingent upon reaching a successor MOA agreement with the POA.

Attorney's Fees

1. $1.5 million within 30 days of settlement framework being approved by Council in open session
2. The parties agree to final and binding arbitration to resolve additional claims over attorneys' fees and expenses related to the litigation and resolution of Measure B
3. The arbitration will be before a JAMS judge formerly of San Francisco or Alameda County
4. The City shall pay the arbitrator's fees and costs, including court reporter
5. The parties agree that the issue presented shall be: Whether the Unions are entitled, under any statutory or common law basis, to additional attorneys' fees and/or expenses related to litigation (including administrative proceedings) and resolution of Measure B? If so, in what amounts?

Implementation Timeline

1. Each party will receive approval of this settlement framework from their respective principals (for the City, this means the City Council; for the Unions, this means their respective Boards of Directors) by August 4th, 2015.

This settlement framework is an outline of the agreement reached by the parties that will need to be implemented through various means, such as ordinances. Successful implementation of this agreement will satisfy and terminate the "Retirement (Pension and Retiree Healthcare) Reopener" agreed upon by SJFF Local 230 or SJPOA. If this agreement is implemented through the quo warranto process, the parties agree to discuss provisions for voter approval of benefits and actuarial soundness for consideration of a 2016 ballot measure to put those provisions into the City Charter.

7/15/15

7/15/15

7/15/15 9pm

7/15/15

7/15/15 @ 9pm

ALTERNATIVE PENSION REFORM SETTLEMENT FRAMEWORK

(Evidence Code Section 1152)

Settlement Discussion Framework Language

The City of San Jose, AFSCME, Local 101 (on behalf of its chapters, the Municipal Employees' Federation, the Confidential Employees' Organization), the Association of Engineers and Architects, the Association of Maintenance Supervisory Personnel, the City Association of Management Personnel, and the Operating Engineers, Local 3 ("the Litigants") have engaged in settlement discussions concerning litigation arising out of a voter-approved ballot measure, known as Measure B. The Litigants have reached the below framework for a tentative settlement of American Federation of State, County, and Municipal Employees v. City of San Jose, Santa Clara Superior Court, No. 1-12-CV-227864, Harris, et. Al. v. City of San Jose, et. al., Santa Clara County Superior Court, No. 1-12-CV-226570, Mukhar, et. Al. v. City of San Jose, Santa Clara County Superior Court, No. 1-12-CV-226574), International Federation of Professional and Technical Engineers vs. City of San Jose, Public Employment Relations Board Unfair Practice No. SF-CE-996-M, American Federation of State, County and Municipal Employees vs. City of San Jose, Public Employment Relations Board Unfair Practice No. SF-CE-924-M, Operating Engineers, Local 3 vs. City of San Jose, Public Employment Relations Board Unfair Practice No. SF-CE-900-M, and various other actions, including grievances. This settlement framework shall be presented for approval by the City Council and the respective Union Board of Directors.

Although the Association of Legal Professionals, the Association of Building, Mechanical, and Electrical Inspectors, and the International Brotherhood of Electrical Workers ("Non-Litigants") are not plaintiffs in a legal challenge to Measure B, these bargaining units also agree to the settlement framework as listed below and will present this framework to their members for approval. Litigants and Non-Litigants will be referred to collectively as "The Parties"

It is understood that this settlement framework is subject to a final overall global settlement. In the event the settlement framework is not accepted, all Parties reserve the right to modify, amend and/or add proposals. Each individual item contained herein is contingent on an overall global settlement/agreement being reached on all terms, by all Parties and other litigants (including the retirees), and ratified by union membership and approved by the City Council.

Retirement Memorandum of Agreement

1. The Parties (the City of San Jose, the Association of Building, Mechanical, and Electrical Inspectors (ABMEI), the Association of Engineers and Architects (AEA), the Association of Legal Professionals (ALP), the Association of Maintenance Supervisory Personnel (AMSP), the City Association of Management Personnel (CAMP), the Confidential Employees' Organization (CEO), the International Brotherhood of Electrical Workers (IBEW), the Municipal Employees' Federation (MEF), and the Operating Engineers, Local 3 (OE#3)) shall enter into a Retirement Memorandum of Agreement to memorialize all agreements related to retirement. The Retirement MOA shall expire June 30, 2025.
2. The Retirement MOA will be a binding agreement describing the terms of the final agreement between the parties (ABMEI, AEA, ALP, AMSP, CAMP,

CEO, IBEW, MEF and OE#3) and will be subject to any agreed-upon reopeners herein.

The current Tier 2 retirement plans for Federated employees will be modified as follows:

1. Pension benefit will be 2.0% per year of service
2. One year of service will be 2080 hours. Pensionable pay will be the same as Tier 1 employees.
3. Retirement Age
    a. The eligible age for an unreduced pension benefit will be age 62
    b. The eligible age for a reduced pension benefit will be age 55. The reduction for retirement before age 62 will be 5% per year, prorated to the closest month.
4. 70% cap
    a. The maximum pension benefit will be 70% of an employee's final average salary
5. Three-year final average salary
6. A member is vested after 5 years of service
7. No retroactive defined benefit pension increases or decreases
    a. Any such changes in retirement benefits will only be applied on a prospective basis.
8. No pension contribution holiday for the City or the employee
9. Final compensation means base pay actually paid to a member and shall not include premium pay or any other forms of additional compensation
10. Current Tier 2 Federated employees will retroactively be moved to the new Tier 2 retirement benefit plan except as provided in Paragraph 18 (returning Tier 1).

a. Any costs, including any unfunded liability, associated with transitioning current Tier 2 employees into the restructured Tier 2 benefit will be amortized as a separate liability over a minimum of 20 years and split between the employee and the City 50/50. This will be calculated as a separate unfunded liability and not subject to the ramp up increments of other unfunded liability.

11. Removal of language limiting vesting of benefits from City Charter (Section 1508-A (h))
12. Tier 2 cost sharing
    a. Employees and the City will split the cost of Tier 2 including normal cost and unfunded liabilities on a 50/50 basis
    b. In the event an unfunded liability is determined to exist for the Federated Tier 2 retirement plan, Tier 2 employees will contribute toward the unfunded liability in increments of 0.33% per year until such time that the unfunded liability is shared 50/50 between the employee and the employer.
    c. Until such time that the unfunded liability is shared 50/50, the City will pay the balance of the unfunded liability.
13. Cost of Living Adjustment (COLA)
    a. Tier 2 retirees will receive an annual cost of living adjustment based on the Consumer Price Index – Urban Consumers (San Francisco-Oakland-San Jose, December to December) ("CPI") or a back-loaded 2.0% COLA (as described below), whichever is lower. The back-loaded COLA shall be calculated as follows:
        i. Service at retirement of 1-10 years: 1.25% per year
        ii. Service at retirement of 11-20 years: 1.5% per year
        iii. Service at retirement of 21-25 years: 1.75% per year
        iv. Service at retirement of 26 years and above: 2.0% per year

b. In the first year of pension benefits, the COLA will be pro-rated based on the date of retirement

c. Current Tier 2 employees as of the date of this agreement will receive an annual cost of living adjustment of the lower of CPI (as defined above) or 1.5% per year for service at retirement of 1-10 years. After 10 years of service, employees will receive an annual cost of living adjustment in retirement pursuant to Section 13(a) above.

14. Disability Benefit (Tier 2)
    a. A Tier 2 member who is approved by the independent medical review panel for a service-connected disability retirement is entitled to a monthly allowance equal to:
        i. 2% x Years of Service x Final Compensation, with a minimum of 40% and a maximum of 70% of Final Compensation.
    b. A Tier 2 member who is approved by the independent medical review panel for a non-service connected disability is entitled to a monthly allowance equal to:
        i. 2% x Years of Service x Final Compensation, with a minimum of 20% and a maximum of 70% of Final Compensation.
15. If there is any Tier 1 or Tier 2 benefit not mentioned in this framework, the parties agree to meet to discuss whether or not that benefit should be included in the Tier 2 benefit.
16. Tier 2 members eligible for retirement will be provided with 50% Joint and Survivor benefits, which provide 50% of the retiree's pension to the retiree's surviving spouse or domestic partner in the event of the retiree's death after retirement.
    a. Tier 2 members eligible for retirement will be provided with survivor benefits in the event of death before retirement. These benefits will

be the same as Tier 1 members but reduced to reflect the new 70% pension cap versus the current 75% pension cap.

17. Tier 2 members not eligible for retirement at the time of death will be provided with survivor benefits of a return of employee contributions, plus interest in the event of death before retirement
18. Former Tier 1 Federated City employees who have been rehired since the implementation of Tier 2 or rehired after the effective date of a tentative agreement based on this framework will be placed in Tier 1
    a. Any costs, including any unfunded liability, associated with transitioning current Tier 2 employees who were former Tier 1 City employees who have since been rehired will be amortized as a separate liability over a minimum of 20 years and split between the employee and the City 50/50. This will be calculated as a separate unfunded liability and as Tier 1 employees these members are not subject to a ramp up in unfunded liability.
    b. Any lateral hire from any other pension system who transfers as a "Classic" employee under PEPRA, regardless of tier, will be placed in Tier 1.
    c. Any lateral hire from any other pension system who transfers as a "new" employee under PEPRA will be placed in Tier 2.
19. Tier 2 members will be provided the same service repurchase options as Tier 1 members (excluding purchases of service credit related to disciplinary suspensions) so long as all costs for the repurchase are paid for by the employee.

Retiree Healthcare - All provisions below are contingent on final costing by the City's Actuary and review for legal and/or tax issues

1. The parties will implement a defined contribution healthcare benefit in the form of a Voluntary Employee Beneficiary Association (VEBA). The plans would not provide any defined benefit, would not obligate the City to provide any specific benefit upon member retirement, and therefore create no unfunded liability. This agreement does not require the City to contribute any future funds to an employee's VEBA, nor does it preclude an agreement to allow future City contributions
2. New lowest cost medical plan
    a. Kaiser NCAL 4307 Plan (305/$3,000 HSA-Qualified Deductible HMO Plan) will be adopted as the new lowest cost healthcare plan, for active and retired members
    b. The City will continue the cost sharing arrangement for active employees of 85% of the lowest cost non-deductible HMO plan
    c. "Floor": The "lowest cost plan" for any current or future retiree in the defined benefit retirement healthcare plan shall be set that it may not be lower than the "silver" level as specified by the current Affordable Care Act in effect at the time of this agreement. This "Floor" specifically includes the provision that the healthcare plan must be estimated to provide at least 70% of healthcare expenses as per the current ACA "silver" definition.
    d. Any changes to the "Floor" shall be by mutual agreement only.
3. Potential Tier 1 opt-out
    a. So long as it is legally permitted, Tier 1 employees may make a one-time election to opt-out of the defined benefit retiree healthcare

plan into an appropriate vehicle for the funds, i.e. a Voluntary Employee Beneficiary Association (VEBA). Members of the current defined benefit plans will be provided with one irrevocable opportunity to voluntarily "opt out" of the current retiree medical plan. Those members who "opt out," and are thus not covered by the City defined benefit retiree medical plan, will be mandated to join the VEBA plan.

4. Continue enrollment in Medicare Parts A and B as required by any applicable federal regulations or by insurance providers. The enrollment period for Medicare Parts A and B shall begin three months before the retiree's 65th birthday, continue through the month of birth, and conclude three months after the retiree's 65th birthday.

5. The current defined benefit retiree healthcare plan is modified to enable retired members to select an "in lieu" premium credit option. At the beginning of each plan year, retirees can choose to receive a credit for 25% (twenty-five percent) of the monthly premium of the lowest priced healthcare and dental plan as a credit toward future member healthcare premiums in lieu of receiving healthcare coverage. On an annual basis, or upon qualifying events described in the "special enrollment" provisions of the Health Insurance Portability and Accountability Act of 1996, retirees and their spouses/dependents can elect to enroll in a healthcare plan or continue to receive an "in lieu" premium credit. Enrollees receiving in lieu credit at any tier other than retiree only must verify annually that they are still eligible for the tier for which they are receiving the in lieu credit. If a member selects the "in-lieu" premium credit, but the member, their survivor or beneficiaries never uses their accumulated premium credit, the accumulated credit is forfeited. At no time can a member or

survivor/beneficiary take the credit in cash or any form of taxable compensation. There is no cap on the size of the accumulated credit.

6. Members of the VEBA and their spouses/dependents, during retirement, may also elect to enter or exit unsubsidized coverage on an annual basis or upon a qualifying event (however, members in the VEBA will not receive an "in lieu" benefit).
7. The VEBA contribution rate for all members who opt out of the defined benefit plan and are mandated to join the VEBA plan will be 4.5% of base pay.
8. Any former Tier 1 employee who was rehired into Tier 2 will be treated as Tier 1 for pension and Tier 2 for retiree healthcare.
9. All Tier 2A employees (except those represented by OE#3) will mandatorily be removed from the Defined Benefit retirement healthcare plan and will be mandated to contribute 2% of base pay to the VEBA. ***This will occur as soon as practical from implementation of the agreement and does not need to wait for implementation of any other retiree healthcare provision.*** The City may transfer funds from the 115 Trust to the members' VEBA plan account to the extent permitted by federal tax law and subject to receipt of a favorable private letter ruling. If this occurs, an amount estimated to equal the member's prior retiree healthcare contribution, with no interest included, will be contributed to the VEBA.
10. Tier 2A employees represented by OE#3, so long as it is legally permitted, may make a one-time election to opt-out of the defined benefit retiree healthcare plan into an appropriate vehicle for the funds, i.e. a Voluntary Employee Beneficiary Association (VEBA). Members of the current defined benefit plans will be provided with one irrevocable opportunity to voluntarily "opt out" of the current retiree medical plan. Those members who "opt out," and are thus not covered by the City defined

benefit retiree medical plan, will be mandated to join the VEBA plan. Tier 2A employees represented by OE#3 who remain in the Defined Benefit retirement healthcare plan will contribute 7.5% of their pensionable payroll into the plan. The VEBA contribution rate for all Tier 2A employees represented by OE#3 who opt out of the defined benefit plan and are mandated to join the VEBA plan will be 4.5% of base pay.

11. All Tier 2B employees will be mandated to contribute 2% of base pay to the VEBA.
12. All Tier 2C employees will be automatically removed from the dental benefit plan and will be mandated to contribute 2% of base pay to the VEBA. ***This will occur as soon as practical from implementation of the agreement and does not need to wait for implementation of any other retiree healthcare provision.*** The City may transfer funds from the 115 Trust to the members' VEBA plan account to the extent permitted by federal tax law and subject to receipt of a favorable private letter ruling. If this occurs, an amount estimated to equal the member's prior retiree healthcare contribution, with no interest included, will be contributed to the VEBA.
13. Members who remain in the Defined Benefit retirement healthcare plan will contribute 7.5% of their pensionable payroll into the plan. The City will contribute the additional amount necessary to ensure the Defined Benefit retirement healthcare plan receives its full Annual Required Contribution each year. If the City's portion of the Annual Required Contribution reaches 14% of payroll, the City may decide to contribute a maximum of 14%.
14. The parties have been advised that the difference between the defined benefit contribution rate (7.5%) and the VEBA opt-out contribution rate (4.5%) will be taxable income.

15. Upon making such an irrevocable election to opt-out of the defined benefit retiree healthcare plan, an amount estimated to equal the member's prior retiree healthcare contribution, with no interest included, will be contributed by the City to the member's VEBA plan account (pending costing and tax counsel advice). In making these contributions, the City may transfer funds from the 115 Trust to the members' VEBA plan account to the extent permitted by federal tax law and subject to receipt of a favorable private letter ruling. If it is determined by the IRS that the funds may not come out of the 115 trust, the parties will meet and confer regarding the opt-out and whether or not it can be implemented through other means. In addition, if the amount needed based on the number of employees who chose to opt out is more than the funds in 115 trust, the parties will also meet and confer. Members will be provided with individual, independent financial counseling to assist them with any decisions to remain in or "opt out" of the defined benefit retiree medical plan.
16. Pending legal review by tax counsel, deferred-vested Tier 1 members who return to San José will be given a one-time irrevocable option to "opt out" of the defined benefit retirement healthcare option. Upon choosing to "opt out", they will become a member of the VEBA and their VEBA account will be credited for an amount estimated to equal the member's prior retiree healthcare contribution, with no interest included. If they choose not to "opt out", they will return to the Defined Benefit retirement healthcare plan.
17. Catastrophic Disability Healthcare Program –Members of the VEBA who receive service-connected disability retirements will be eligible for 100% of the single premium for the lowest cost plan until the member is eligible for Medicare (usually age 65).

a. Qualifications - The member must not be eligible for an unreduced service retirement.
b. The member must exhaust any funds in their VEBA account prior to becoming eligible for the Catastrophic Disability Healthcare Program.
c. Upon reaching Medicare eligibility, the benefit will cease
d. Any retiree who qualifies must submit on an annual basis an affidavit verifying that they have no other employment which provides healthcare coverage.
e. If a retiree is found to have other employment which provides healthcare coverage, their eligibility to participate in the Catastrophic Disability Healthcare Program will automatically cease, subject to re-enrollment if they subsequently lose said employment-provided healthcare coverage.

Disability Definition and Process

1. Reinstate the previous City definition for disability for all Federated employees.
2. Applications for disability must be filed within one month of separation from City service subject to the exceptions reflected in Municipal Code §3.28.1240
3. All applicants must submit medical paperwork indicating the initial nature of their disability including the affected body part if applicable, the current level of disability, and current treatments underway. Such medical paperwork must be filed within one year of separation unless the independent medical review panel grants a longer deadline due to extenuating circumstances.

4. Applications for disability may not be deferred by the applicant past four (4) years of the date of application submittal, unless the independent medical review panel grants a longer deadline due to extenuating circumstances.
5. The member and the City may have legal representation at hearings.
6. Independent panel of experts appointed by 4 of 7 retirement board members will evaluate and approve or deny disability retirement applications
   a. Using the established Request for Proposal process, the retirement boards will recruit potential members of the independent medical panel.
   b. Each member shall have a four-year term and meet the following minimum qualifications:
      i. 10 years of practice after completion of residency
      ii. Practicing or retired Board Certified physician
      iii. Not a prior or current City employee
      iv. No experience providing the City or retirement boards with medical services, except for prior service on medical panel
      v. No experience as a Qualified Medical Evaluator or Agreed Medical Evaluator
      vi. Varying medical experience
   c. A panel of three independent medical experts will decide whether to grant or deny all disability applications, whether service or non-service connected. The panel's decision will be made by majority vote.
   d. Upon its own motion or request, the independent medical panel may determine the status of a disability retirement recipient to

confirm that the member is still incapacitated or if the member has the ability to return to work.

7. Administrative law judge
    a. A decision to grant or deny the disability retirement made by the independent medical panel may be appealed to an administrative law judge.
    b. Applicant or City has forty-five (45) days to appeal a decision made by the independent medical panel. The appeal hearing must commence within ninety (90) days of the notice of appeal, unless a later date is mutually agreed to by the parties.
    c. The decision rendered by the administrative law judge is to be based on the record of the matter before the independent medical review panel.
    d. The decision of the administrative law judge will be a final administrative decision within the meaning of Section 1094.5 of the California Code of Civil Procedure.
8. Workers' Compensation Offset
    a. The workers' compensation offset currently in place for Federated Plan participants will continue for Tier 1 and Tier 2.

Supplement Retiree Benefit Reserve (SRBR)

1. Continue elimination of SRBR
    a. The funds credited to the SRBR will continue to be credited to the Federated City Employees' Retirement System to pay for pension benefits
2. City will replace SRBR with guaranteed purchasing power (GPP) provision for all Tier 1 retirees, prospectively. The GPP is intended to

maintain the monthly allowance for Tier 1 retirees at 75% of purchasing power effective with the date of the retiree's retirement

a. Beginning January 2016 and each January thereafter, a retiree's pension benefit will be recalculated annually to determine whether the benefit level (including any increases due to cost of living adjustments) has kept up with inflation as measured by the CPI-U (San Francisco-Oakland-San Jose). The actual benefit level will be compared to what would have been required to maintain the same purchasing power as the retiree had at the time of retirement, with a CPI-based increase.
b. Those Tier 1 retirees whose benefit falls below 75% of purchasing power will receive a supplemental payment that shall make up the difference between their current benefit level and the benefit level required to meet the 75% GPP.
c. The supplemental GPP payment to qualifying retirees will be paid annually in a separate check, beginning February 2016, and each February thereafter.
d. The number of Tier 1 retirees whose benefit level was below 75% GPP at the time of costing was approximately 68.
e. In the event of litigation by a retired member or members of the Federated bargaining units challenging this provision of the Settlement Agreement against a Federated bargaining unit, the Unions will have a right to tender the defense of the litigation to the City. City will accept the defense of the litigation and will defend the Federated bargaining unit with counsel of City's choice, including the City Attorney's Office. If the City is also named defendant in any such suit, Unions will not claim that joint representation of either or both of them and the City constitutes a legal conflict for the

attorney(s) defending the suit. This defense obligation will not apply to lawsuits challenging or in any way relating to this provision filed more than five years after the effective date of this agreement.

Attorney's Fees

1. $1.257 million to the litigants (AFSCME-MEF and CEO; IFPTE Local 21-AEA, AMSP and CAMP; and OE#3) within 30 days of the settlement framework being approved by Council in open session.
   a. AFSCME (MEF and CEO) shall not be entitled to any more in Attorneys' Fees and expenses related to the litigation and resolution of Measure B, and are not entitled to final and binding arbitration regarding Attorney's Fees.
   b. The City and IFPTE Local 21 (AEA, AMSP and CAMP) and OE#3 agree to final and binding arbitration to resolve additional claims over attorneys' fees and expenses related to the litigation and resolution of Measure B.
      i. The arbitration will be before a JAMS judge formerly of San Francisco or Alameda County
      ii. The City shall pay the arbitrator's fees and costs, including court reporter
      iii. The parties agree that the issue presented shall be: Whether IFPTE Local 21 (AEA, AMSP and CAMP) and OE#3 are entitled, under binding statutory or common law basis, to additional attorneys' fees and/or expenses related to litigation and resolution of Measure B? If so, in what amounts?

Quo Warranto/Ballot Measure Implementation Plan

1. The Federated bargaining units (ABMEI, AEA, ALP, AMSP, CAMP, CEO, IBEW, MEF and OE#3) agree to work collaboratively with the City to develop a ballot measure, which, if the quo warranto process (as defined in the Settlement Framework and Proposed Quo Warranto Implementation Plan) succeeds, will supersede Measure B with the following (1) a provision requiring voter approval of defined benefit pension enhancements, (2) a provision requiring actuarial soundness, (3) a provision prohibiting retroactivity of defined benefit pension enhancements, and (4) any other provisions contained in the Settlement Framework that the parties mutually agree to, for inclusion in a 2016 ballot measure that will incorporate any such provisions into the City Charter. Once the parties mutually agree to the language, all the Federated bargaining units shall endorse the ballot measure.
2. As agreed upon by the City and the Federated bargaining units (ABMEI, AEA, ALP, AMSP, CAMP, CEO, IBEW, MEF and OE#3), the proposed quo warranto implementation plan shall be followed by the parties in the manner described below.

Step	Time	Action
1.	Immediately upon signature of the Framework by the litigants	Parties ask for a stay in appellate proceedings (Lucas ruling). AFSCME (MEF and CEO), IFPTE (AEA, AMSP and CAMP), and OE#3 will also ask for a stay in the PERB proceedings until March 31, 2016. So long as the quo warranto process is still ongoing, the stay will be continued on a quarterly basis until the conclusion of the quo warranto process.
2.	*Upon ratification of Federated/Retirees Deal*	*Global Settlement Addendum Agreement on quo warranto process:* • Global settlement involving all litigants (including retirees) and bargaining unit representatives • Entered into for purposes of settlement

		• Except as otherwise provided in the stipulated order and judgment described below no admission of wrongdoing, including no admission that the City acted in bad faith • Non-precedential for any purpose
3.	Immediately after #2	Begin drafting ordinances. Begin identifying ordinances implemented as a result of Measure B.
5.	Immediately after #2	Parties negotiate charter language, pursuant to Section 1 above under "Quo Warranto/Ballot Measure Implementation Plan," simultaneous with agreement on stipulated facts, order and judgment.
6.	Simultaneous with #5	Although the Federated Bargaining Units are not parties to the pending litigation in Santa Clara Superior Court Case No. 1-13-CV-245503 ("Quo Warranto Case"), the Federated Bargaining Units will support the City and SJPOA's Proposed Stipulated Facts, Order and Proposed Stipulated Judgment in the Quo Warranto Case (for purposes of settlement only). Outline of stipulated facts and findings: • history of negotiations including agreement on impasse as of 10/31, number of negotiation sessions, and use of mediation; • changes to the proposed ballot language, including post-impasse changes; • tension between City's powers and MMBA and effort to harmonize through Seal Beach negotiations—as described on pages 3-4 of Attorney General opinion No. 12-605. • language from AG decision to grant QW based on the question of whether impasse had been broken by post-impasse ballot changes made by City and whether City Council needed to negotiate further (the inherent powers vs. MMBA issue); • the cost and time and risks of litigating QW, including appeals and the issue of whether a decision in QW case would be universally applicable; • the desirability of finding a solution that is collaborative • financial challenges facing City and retirement funds - desire on part of employees, retirees and City to make benefits sustainable; • Stipulated Order that City should have engaged in further negotiation of final language before putting on ballot to comply with MMBA obligations and failure to do so was a procedural defect significant enough to declare null and void Resolution placing Measure B on ballot; This order will not include a finding that the City acted in bad faith.

		• Any additional language required by the court to allow the Court to approve the parties' Stipulated Order and Judgment. The Court order must be factually accurate. • Agreement that Resolution No. 76158 shall be null and void. • Overriding public interest in expedited resolution of quo warranto proceedings and implementation of Settlement Framework to restore and improve city services and sustainability of retirement plans. Stipulated Judgment shall reflect that Measure B shall be invalidated
7.	Upon completion of #5 and #6	• Submission of Stipulated Order and Stipulated Judgment to quo warranto judge, which may require coordination with the Attorney General.
8.	Upon entry of judgment in quo warranto case	• Formally adopt ordinances to implement Settlement Framework and replace Measure B. • At such time as the judgment becomes final and the Quo Warranto issues, or the voters pass a substitute measure supported by the Parties, all parties dismiss/withdraw all complaints, unfair practice charges, etc.
9.	January 2016	• Begin discussions over including any other provisions in Settlement Framework in ballot measure (per Section 1 above under "Quo Warranto/Ballot Measure Implementation Plan) to be completed by July 2016
10.	Third Party Litigation	All Federated bargaining units (except ALP) agree to oppose any third party litigation challenging the invalidation of Measure B through the quo warranto process either by joining the litigation or by petitioning to file an Amicus Brief.
11.	Immediately upon: (1) retirees not settling their litigation; or (2) quo warranto process not succeeding in invalidating Measure B	Craft ballot measure to implement all aspects of Settlement Framework agreed to by the Federated bargaining units for placement on the ballot in November 2016. The Parties will begin this process immediately in January 2016 if either the retirees have not settled or the quo warranto process has not been completed.

This settlement framework is an outline of the agreement reached by the parties that will need to be implemented through various means, such as ordinances. Successful implementation of this agreement will satisfy and terminate the "Retirement (Pension and Retiree Healthcare) Reopener" agreed upon by the Federated bargaining units.

The Federated Bargaining Units and the City shall in good faith work toward implementing this agreement, and neither party shall take any action to undermine or subvert the terms and benefits provided by this agreement.

11/23/15

MB 11/23/15

11/23/15

JWJ 11/23/15

11/23/15

yae 11/23/15

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11-23-15

Mario Mercado for JS 11/23/15

FJC 12-3-15

MM 11/23/15

12-3-15

LC 11/23/15

12/4/15

12/4/15

PCF 12/14/15 ABMEI

LIST OF LOCAL MEASURES
PRESIDENTIAL GENERAL ELECTION
November 8, 2016

County of Santa Clara
2/3 Vote

A To provide affordable local housing for vulnerable populations including veterans, seniors, the disabled, low and moderate income individuals or families, foster youth, victims of abuse, the homeless and individuals suffering from mental health or substance abuse illnesses, which housing may include supportive mental health and substance abuse services, shall the County of Santa Clara issue up to $950 million in general obligation bonds to acquire or improve real property subject to independent citizen oversight and regular audits?

Bonds Yes
Bonds No

Santa Clara Valley Transportation Authority
2/3 Vote

B To relieve traffic, repair potholes; shall VTA enact a 30-year half-cent sales tax to:

- Repair streets, fix potholes in all 15 cities;
- Finish BART extension to downtown San Jose, Santa Clara;
- Improve bicycle/pedestrian safety, especially near schools;
- Increase Caltrain capacity, easing highway congestion, improving safety at crossings;
- Relieve traffic on all 9 expressways, key highway interchanges;
- Enhance transit for seniors, students, disabled;

Mandating annual audits by independent citizens watchdog committee to ensure accountability.

Yes
No

City of Cupertino
Majority Vote

C Shall an initiative ordinance be adopted amending Cupertino's General Plan to limit redevelopment of the Vallco Shopping District, limit building heights along major mixed-use corridors, increase to 45 feet the maximum building height in the Neighborhoods, limit lot coverages for large projects, establish new setbacks and building planes on major thoroughfares, and require voter approval for any changes to these provisions?

Yes
No

City of Cupertino
Majority Vote

D Shall an initiative be adopted enacting the Vallco Town Center Specific Plan for the 58-acre Vallco Shopping District Special Area requiring residential (approximately 389-800 units, including approximately 20% senior housing), office (2,000,000 sf), commercial (640,000 sf), hotel, park, civic/educational uses; requiring funding/community benefits for transportation (approximately $30,000,000), schools (approximately $40,000,000), green roof (approximately 30 acres), recycled water; granting initial entitlements; establishing development standards and limited future approval process; and making related Cupertino General Plan and Municipal Code amendments?

Yes
No

City of San Jose
Majority Vote

E Opportunity to Work Ordinance

Shall an ordinance be adopted amending the San Jose Municipal Code to require employers of 36 or more employees to offer additional work hours to existing qualified part-time employees before hiring new employees or contractors, unless waived through a collective bargaining agreement or a welfare to work program; and, authorize the City to enforce, and grant hardship exemptions from, the offer of work requirement?

Yes
No

City of San Jose
Majority Vote

F PENSION MODIFICATION: Shall the Charter be amended to adopt an agreement between the City and police officers, firefighters and City employee bargaining groups that would, among other things, stop funding retiree healthcare for new employees, potentially reduce costs of supplemental pension payments, reinstate disability retirement provisions for injured police officers, firefighters and other City employees, change criteria for determining actuarial soundness, and continue to require voter approval for benefit increases?

Yes
No

City of San Jose
Majority

G Business Tax Modernization

Shall an ordinance be adopted modernizing San Jose's 1986 business tax to fund essential services – such as police, emergency response, and pothole repair – with approximately $12 million in additional annual revenue by raising the base tax from $150 to $195; increasing rates incrementally for larger businesses, as provided in the ordinance at http://sanjoseca.gov/businesstax2016; adjusting for inflation; expanding exemptions for small businesses and financial hardship; and allowing online registration and payment?

Yes
No

City of Gilroy
Majority Vote

H Shall an ordinance be adopted to amend the Gilroy General Plan to add an Urban Growth Boundary line (UGB) to the General Plan Land Use Plan Map, designate lands outside the UGB as Open Space and prohibit urban development on such lands, and provide that (with limited exceptions) such restrictions may not be amended or repealed until December 31, 2040 without a vote of the people?"

Yes
No

City of Milpitas
Majority Vote

I Shall an ordinance that amends the Milpitas General Plan Land Use Element to extend until December 31, 2038 an Urban Growth Boundary near the base of the Milpitas foothills, that would limit development within Milpitas to the valley floor and the base of the foothills by prohibiting Milpitas from providing city services to new land use developments in the hillside area, be adopted?

Yes
No

City of Milpitas
Majority Vote

J Shall an ordinance, requiring until December 31, 2038, any amendments to the existing "Hillside Combining District" Ordinance and any amendments to the general plan land use designation for lands currently designated as "Hillside" property be approved by the voters before becoming effective, be adopted?

Yes
No

City of Milpitas
Majority Vote

K Shall an ordinance amending the City of Milpitas General Plan be adopted to mandate that any attempt to rezone parks, parklands or open space to residential, commercial or industrial, or any proposal for residential, commercial or industrial development in parks, parkland or open space, must be placed before Milpitas voters and secure two-thirds support in the City's next general election?

Yes
No

City of Milpitas
Majority Vote

L Shall Resolution No. 8532 authorizing an Exclusive Franchise Agreement with Waste Management, Inc. for Solid Waste Disposal Services, which was approved by the Milpitas City Council on March 15, 2016 but suspended by referendum petition on April 14, 2016, be adopted?

Yes
No

City of Sunnyvale
Majority Vote

M Shall an ordinance be adopted to require the City to conduct a citywide special or general election requesting approval from a majority of voters for any sale, lease, lease extension, lease renewal, land swap, or transfer of any property, facility, or land that the City owns, leases, or uses for government administration, recreation, public park, or similar community purposes?

Yes
No

City of Sunnyvale
Majority Vote

N SUNNYVALE ESSENTIAL SERVICES PROTECTION MEASURE. To maintain Sunnyvale's financial stability without increasing the existing 2% tax rate, and fund essential City services including police, fire and 911 emergency response, and pothole, street, sidewalk, and neighborhood park maintenance/repairs, shall Sunnyvale modernize its existing utility users tax to treat telecommunication taxpayers equally regardless of technology used, providing approximately $1,500,000 annually on an ongoing basis, until ended by voters, with independent audits, and all funds used locally?

Yes
No

City of Santa Clara
Majority Vote

O SETTING OF SALARIES FOR MAYOR AND CITY COUNCIL. Shall section 702 of the Santa Clara City Charter be amended to set the salaries of the Mayor at $2500 per month and City Council at $2000 per month, and to create a Salary Setting Commission to review and adjust those salaries every two years?

Yes
No

City of Santa Clara
Majority Vote

P MAYOR AND CITY COUNCIL TERM LIMITS. Shall Sections 701 and 704.1 of the Santa Clara City Charter be amended to limit the Mayor and members of the City Council to no more than two full terms for each office, and to define a partial term in excess of two years as a full term?

Yes
No

City of Santa Clara
Majority Vote

Q FILLING VACANCIES IN CITY ELECTED OFFICES. Shall Section 703 of the Santa Clara City Charter be amended to provide that vacancies in any elective office of the City be filled by a four-fifths (4/5) vote of the City Council and to require that persons appointed to fill vacancies occurring in the first half of a term of office shall hold office until the next general municipal election?

Yes
No

City of Santa Clara
Majority Vote

R PROTECTION OF PARKLAND AND OPEN SPACE. Shall Section 714.1 of the Santa Clara City Charter be added to provide that no City owned land used for park or recreational purposes, including the Ulistac Natural Area and the Santa Clara Soccer Park, shall be sold or disposed of by the City without being authorized by a two-thirds (2/3) majority vote and that development upon such property shall be subject to referendum?

Yes
No

City of Morgan Hill
Majority Vote

S Shall a measure be adopted to amend the Morgan Hill General Plan and Municipal Code to update the City's voter-approved Residential Development Control System (RDCS) to extend it to 2035, establish a population ceiling of 58,200, with a slower rate of growth than currently exists, and improve policies to maintain neighborhood character, encourage more efficient land use, conserve water, and preserve open space?

Yes
No

Town of Los Gatos
Majority Vote

T To maintain quality of life and small town character in Los Gatos by enhancing traffic safety and flow; maintaining 911 response, police services, parks, trails, creeks, playground equipment and restrooms; repairing potholes and Town facilities; beautifying Downtown; providing general services, shall Los Gatos increase by 2% the short-term rental tax paid only by hotel/lodging guests, raising approximately $350,000 to $400,000 per year with published annual audits, fiscal oversight, and all funds spent locally for Los Gatos?

Yes
No

San Benito High School District
55% Vote

U To improve the quality of local high school education by upgrading science labs and classrooms to help prepare students for college and careers; continue improving school access for students with disabilities; adding classrooms and school facilities to reduce overcrowding; upgrading aging student facilities; and improving school and earthquake safety, shall the San Benito High School District issue $60 million in bonds, with citizen oversight, annual audits and with NO money for administrator salaries?

Bonds Yes
Bonds No

City of Mountain View
Majority Vote

V Shall a Rent Stabilization CITY CHARTER AMENDMENT be adopted enacting rent regulation and prohibiting amendments except by Citywide election, with annual rent increases limited to the Consumer Price Index (minimum 2%, maximum 5%) for most multifamily rental units built before February 1, 1995; prohibiting evictions without just cause for rental units built before this measure becomes effective; creating a Rental Housing Committee authorized to enact regulations, hire staff, expend funds, and charge landlords fees to implement this amendment?

Yes
No

City of Mountain View
Majority Vote

W Shall a RENT STABILIZATION ORDINANCE be adopted requiring a tenant-landlord dispute resolution program and binding arbitration for rent increase disputes exceeding 5% of base rent per 12-month period and service reductions for most multifamily rental units with a certificate of occupancy before February 1, 1995; prohibiting eviction of tenants without just cause or relocation assistance; prohibiting substantive changes for two years, and requiring a super majority City Council vote for substantive changes thereafter?

Yes
No

San Jose-Evergreen Community College District
55% Vote

X To repair/ upgrade classrooms to prepare students/ veterans for jobs/ university transfer by repairing/ building nursing, engineering, vocational, technology, science/ job training classrooms, improving campus, earthquake safety/ disabled access, remove asbestos/ lead paint, acquiring, constructing, repairing sites, facilities/ equipment, shall San Jose-Evergreen Community College District issue $748,000,000 in bonds at legal rates, no money for administrators' salaries/ pensions, requiring citizen oversight, independent audits, all funds used locally?

Bonds Yes
Bonds No

San Jose Unified School District
2/3 Vote

Y To improve education in local neighborhood schools by supporting core academic programs in reading, writing, math, the arts and science, preparing students for college and careers and attracting and retaining high performing teachers and educational staff, shall San Jose Unified School District authorize an annual $72 school parcel tax for 8 years, raising approximately $5 million annually, with independent citizen oversight, no funds for district office administrators' salaries, a senior citizen exemption and all funds benefiting local neighborhood schools?

Yes
No

East Side Union High School District
55% Vote

Z To upgrade/construct science, technology and engineering classrooms; remove hazardous materials from school grounds; upgrade fire/security systems; and replace deteriorating roofs at Andrew Hill, Calero, Evergreen Valley, Foothill, Independence, James Lick, Mt. Pleasant, Oak Grove, Piedmont Hills, Santa Teresa, Silver Creek, Yerba Buena, W.C. Overfelt, alternative, adult and district charter schools, shall East Side Union High School District issue $510 million of bonds with independent citizen oversight, interest rates below legal limits, and no funds for administrators' salaries?

Bonds Yes
Bonds No

Campbell Union High School District
55% Vote

AA To improve local highs schools to better prepare students for 21st century careers, by modernizing classrooms, labs, and technology for career education in engineering, science, advanced math, coding and computer skills; repairing aging facilities, including leaky roofs, floors, electrical systems, and restrooms; making seismic upgrades, removing hazardous asbestos, and adding classrooms/school facilities to prevent overcrowding, shall the Campbell Union High School District issue $275 million in bonds, within legal rates, with annual financial audits and independent citizen's oversight?

Bonds Yes
Bonds No

Sunnyvale School District
2/3 Vote

BB To renew the Sunnyvale School District parcel tax to support classroom programs including math, English, science and technology; to attract and retain quality teachers and keep class size small; shall Sunnyvale School District be authorized to renew its existing $59 per parcel tax providing $1 million annually for seven years beginning July 1, 2018, with exemptions for senior citizens and all expenditures audited and reviewed by a citizens' oversight committee with no funds spent on administrators?

Yes
No

Campbell Union School District
55% Vote

CC To continue providing high-quality education and to ensure equal access to a 21st-century education for all local students by repairing leaky roofs; upgrading fire alarms and security systems; upgrading science equipment and laboratories; providing access for students and teachers with disabilities; constructing new classrooms and facilities and modernizing old classrooms, shall Campbell Union Elementary School District issue $72 million in bonds at legal interest rates, with citizens' oversight and financial audits with no funds for administrator salaries?

Bonds Yes
Bonds No

Oak Grove School District
2/3 Vote

EE To improve education and student achievement in neighborhood schools by maintaining small class sizes; hiring, retaining and training quality teachers; expanding science, technology, engineering, math, language, art, and music education; improving health, safety, security, and maintenance services; and providing before-/after-school programs; shall Oak Grove Elementary School District levy a parcel tax of $132 per parcel for nine years providing $3.1 million annually, exempting seniors, with annual audits, citizens' oversight, and all funds used locally?

Yes
No

Los Altos School District
2/3 Vote

GG To continue excellent education for all local public elementary and junior high school students; maintain outstanding core academics, innovative science, technology, engineering and math programs; and attract and retain highly qualified teachers; shall Los Altos School District renew its expiring annual education parcel tax at $223 per parcel for eight years, providing approximately $2.8 million annually for local schools, with independent oversight, no funds for administrators' salaries, exemptions for seniors, and all funds benefitting local public schools?

Yes
No

Franklin-McKinley School District
2/3 Vote

HH Local Elementary School District Achievement Measure. To improve the quality of education and enhance student achievement, by expanding counseling and tutoring programs for at-risk students; maintaining small class sizes in kindergarten through third grade; enhancing reading, science/math programs; retaining teachers; expanding student access to after school programs, shall Franklin-McKinley School District renew without increasing its expiring parcel tax at $72 annually for 9 years, with citizen oversight, audits and an exemption for senior citizen homeowners?

Yes
No

City Council Agenda:
Item: 3.3

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: CITY COUNCIL

FROM: Mayor Sam Liccardo

SUBJECT: **MARCH BUDGET MESSAGE FOR FISCAL YEAR 2019-2020**

DATE: March 8, 2019

Approved:

Date: 3/8/19

RECOMMENDATION

Direct the City Manager to submit a balanced budget for Fiscal Year 2019-2020, guided by the policy direction and framework of priorities outlined in this March Budget Message.

* * *

In accordance with Section 1204 of the San José City Charter, I present my Fiscal Year 2019-2020 March Budget Message for consideration by the City Council, and the residents of San José. With Council approval, this initial framework provides the City Manager with direction to prepare proposals for the Council's budget deliberations in May, and to formulate the Fiscal Year 2019-2020 Proposed Budget.

OVERVIEW

Budgetary Resilience: A Strategy for Spending in Uncertain Times

We will sit at the zenith of the longest economic climb in our nation's modern history, having benefitted from continuous job growth each year since 2010.

History teaches—too well—what comes after the summit.

We have succeeded in many ways in the last four years in our efforts to "right the ship" fiscally with belt-tightening, focused spending, strategic investments, and restoration of key services. We can celebrate a modest, $3.5 million surplus in the coming year, spurred by a uniquely helpful confluence of fiscal news, including record revenues in several key categories, the passage of several ballot measures, and relatively buoyant financial markets. In the fiscal terrain of big U.S. cities, surpluses are species rarely sighted, and even more elusive to corral for any length of time.

Yet the recent release of the City's five-year general fund forecast shows sources of strain, with combined deficits of approximately $16 million in the half-decade ahead. While small, those projections do not account for variables not captured by standard fiscal modeling, such as inevitable recessions, implicit wage increases within tight labor and housing markets, and accelerated growth in retirement costs with declining discount rate assumptions or bear markets.

For all of these reasons, this Budget Message triggers the foghorn to prepare for the dangers in the misty months ahead. Above all, it emphasizes savings. Savings can take two forms: building reserves, and paying down debt that will sap the General Fund with future interest expense. Where the Council chooses to spend, we must invest strategically so as to provide long term cost-savings, efficiency improvements, and the highest-priority services to our residents. Expanding our efforts to leverage external resources—such as with State grants, private-sector partnerships, philanthropic commitments, or volunteer energy—will enable us to stretch our limited dollars the farthest, and should inform our budgetary choices. To the extent possible we must also limit expenditures within the General Fund to one-time sources of funding that will not require ongoing, multiple-year obligations that cannot be credibly sustained. Adhering to these principles will enable our City to remain resilient through tough times.

Through this Budget Message, I seek my colleagues' support for a strategy emphasizing what I call five basic principles of budgetary resilience:

1. **SAVE**: as the clouds emerge, prepare for the storms by increasing reserves and paying down debt;
2. **ONLY MAKE COMMITMENTS WE CAN KEEP**: when a downturn is likely, either limit General Fund spending to one-time expenditures not requiring ongoing commitments or else find ongoing, stable sources outside of the General Fund;
3. **USE LEVERAGE**: maximize leverage of external resources, including private-public partnerships, philanthropy, and volunteer energy;
4. **SPEND ON SUSTAINABILITY**: invest in programs likely to provide countervailing long-term savings or greater efficiencies; and
5. **FOCUS**: scarce dollars should target on our residents' highest priorities.

I'll now identify the factors shaping the recommendations in this message.

Restoring Core City Services

Following a difficult decade punctuated by the Great Recession, we have continued to restore key core City services every year since my first Budget Message.

In our first Budget Message in Fiscal Year 2015-2016, the Council agreed to add firefighters, restore library hours to six days a week, enhance gang prevention, accelerate homeless rehousing, and combat illegal dumping. We then prepared and secured voter support for two measures on the 2016 ballots — a one-quarter cent sales tax (Measure B) in June and a modernization of the City's business tax (Measure G) in November—that together boosted revenues approximately $60 million annually. That year, we added 41 authorized sworn police officers, restored all "browned out" fire stations, added two-person "squad" cars to boost emergency medical response, invested in emergency vehicle signal preemption technology, bolstered our community service officer team to improve response to burglaries and neighborhood crime, expanded crime analysis capability at

SJPD, allocated $4 million to provide "rapid response" housing for homeless residents, and committed $17.7 million in long-overdue funding for street pavement.

Subsequent years have built on those investments, while securing wage contracts with our employees that boosted pay to improve employee morale, retention, and recruiting. In the last three years—and since the passage of Measure F and the City's new wage contract with our police—we've added more than 200 officers, net of retirements and departures, to our understaffed SJPD. Similarly, our recent agreement with the fire union will enable a raise for firefighters who had seen base pay rise by only 3% during a decade in which the cost of living increased by more than 25%. In addition to expanding staffing in public safety, we've managed to substantially reduce the roughly 900 vacancies that we faced only two years ago, to significantly improve all of our services to our residents.

For their ongoing commitment to providing the highest, most professional service to our residents, I have the deepest gratitude to our hardworking City workforce who have weathered many years of growing workloads without commensurate growth in staffing or support. I am also grateful to my City Council colleagues for their continued commitment to target our scarce resources to our residents' highest priorities.

Filling the Potholes: Restoring our Streets and Infrastructure

I'm especially proud of our important work together to secure ongoing funding that will finally enable us to provide the repaving and other basic maintenance required by our rapidly deteriorating streets and roads, and to rebuild much of our critical infrastructure.

Whether we're long-range commuters, devoted transit riders, or avid cyclists, every trip of ours begins—and depends upon—neighborhood streets. The condition of those streets and our main roads matters for our safety, for our fuel mileage, and for our pocketbooks. According to a recent study, roads in need of repair cost San José motorists more than $900 annually in the form of auto wear-and-tear, tire damage, and additional gas.

The current condition of our roads resulted from nearly two decades of underinvestment. In a typical year, City Hall spent only $20 or $25 million annually—but we would have needed to invest almost $93 million to keep our 2,400 miles of streets in a state of good repair. By 2015, San Joséans inherited more than a half-billion-dollar backlog of road maintenance and repair, with 400 miles of streets in "poor" condition, and plenty more posing less-than-safe conditions for motorists and pedestrians. Even worse, the costs escalated exponentially with neglect; a $1 investment today in preventative maintenance ("street sealing") saves more than $6 in more extensive repairs ("street resurfacing") a few years in the future.

In other words, there are no short-cuts here. There's no smartphone "app" to fix a road. It simply costs money to repair streets, and if we ignore the problem, it costs even more money.

Fortunately, the pieces have finally fallen into place for restoring our roads. This year, we'll pave more than 200 miles of streets for the first time since the turn of the century—and save our residents millions of dollars in tire and car repairs. We'll allocate $94 million for street repair this year, and more importantly, we have established a steady stream of dedicated funding for future years of sustained maintenance.

There are many people to thank for this turnaround. Our Department of Transportation has encouraged paving companies to use more cost-effective methods, such as cold-in-place-recycling of existing pavement, to help reduce costs by as much as 30%. Senator Jim Beall championed the passage of SB1, which has added another $19 million annually for local San José streets, and Silicon Valley Leadership Group CEO Carl Guardino led another countywide effort in 2016 for transportation funding.

But more than anyone, we need to thank our voting taxpayers, who have agreed to provide the federal and state funding that disappeared long ago:

- In the depths of the Great Recession in 2010, I worked with then-VTA official John Ristow—now San José's Acting Director of Transportation—to gather countywide support for the use of vehicle registration fees for street paving.
- VTA Measure B, which passed in November of 2016 with 70% of voter support countywide. I am grateful for Guardino's work in leading that initiative, and his partnership with me to raise the dollars needed for the campaign. Though it passed three years ago, we'll see the first dollars—some $42.8 million—from that measure only this year, with the dismissal of a frivolous lawsuit that stalled implementation.
- In November of 2018, voters defeated Proposition 6, and its proposed repeal of SB1.
- Finally, also last November, San Joseans passed the largest bond measure in our city's history, Measure T, with 71% support. In prior years, we lacked sufficient pavement funding to restore anything other than roads with high-frequency traffic, leaving neighborhood streets to continue deteriorating. Starting in 2020, however, Measure T funding will allow us to reach every neighborhood, with at least $300 million for the restoration of the 400 miles of residential streets in the worst condition. As we're paving, we'll also be improving roadway markings, installing bike lanes, and upgrading many curb ramps to enable full accessibility of our sidewalks.

Of course, in addition to all of the road work, the remainder of Measure T's $650 million in bonds will enable the City to acquire land and construct public improvements for public safety and disaster preparedness, as described more fully in Table 1.

Table 1. Proposed Measure T General Obligation Bond Project Categories

Bond Project List	Anticipated Dollar Amount	Description of Potential Projects[1] (final list will be pending environmental approval of individual projects)	Potential General Fund Impact[2]
Street Repair[3]	\$300,000,000	Repair/replacement of neighborhood streets in worst condition	Positive
Police/Fire/Emergency Operations Center4	\$175,000,000	Build new Fire Station 37	Negative
		Rebuild/relocate or build two Fire Stations, including property acquisition	Positive
		Rehabilitation of various stations	Positive
		Upgraded or new 911 and Emergency Operations Center (if new, assume built on existing City property)	Negative
		Public Safety Headquarters Infrastructure Needs	Positive
		New police training center (assume land acquisition and rehabilitation of an existing building)	Negative
		New police dept. Air Support Unit Hangar helicopter terminal on existing city property at Mineta SJIA	Positive
Environmental Protection Projects	\$50,000,000	Water supply, flood control, open space and environmental protection of lands such as Coyote Valley	Neutral
Storm System Conveyance & Flood Prevention Projects	\$35,000,000	Construction of a pump station at Charcot Avenue	Positive
Clean Water Projects	\$25,000,000	Priority projects would be partnerships to simultaneously provide clean water to our Bays and beautify existing City-owned open space.	To be determined
Bridges	\$20,000,000	Leverage up to or more than \$80 million in outside funds for bridge overpasses to be seismically retrofitted or repaired.	Positive
LED Lighting	\$20,000,000	Replacement of both streetlights and other outdoor lights in city facilities, such as the parks, libraries, community centers and corporation yards to reduce ongoing General Fund impacts.	Positive
Public safety parks/community center facility improvements	\$12,950,000	Upgrading community centers/emergency shelters and parks facilities to support public safety	Positive
Other Priority-Critical Infrastructure	\$5,000,000	Priority critical infrastructure repairs to reduce ongoing General Fund impacts	Positive
Total[5]	**\$642,950,000**		

1. Although not listed above as a separate category, the inclusion of smart infrastructures, such as broadband and fiber connectivity to enhance emergency response, will be evaluated as appropriate as part of the scope of work for the above projects.

2. The potential General Fund impact column is a conceptual estimate of whether the project(s) would have a positive, neutral or negative direct impact on the City's General Fund after implementation. This typically relates to the change in operating and maintenance costs associated with the facilities/projects. At this time there is not enough information available to estimate the potential impact of the Clean Water Projects, so this is listed as "to be determined."

3. The street repair allocation is a minimum amount. All other allocations are anticipated dollar amounts and subject to change as projects are further defined and scoped out.

4. If any savings result from this category the intent would be to place them in the "Other Priority Critical Infrastructure" category

5. The total does not equal \$650,000,000 as it takes into account approximately \$7,050,000 in necessary funds for bond issuance

Source: https://www.sanjoseca.gov/DocumentCenter/View/80283

Our Fiscal Outlook

The recently revised General Fund Forecast (Table 2) illustrates an uncertain fiscal future over the next few years, with projections ranging from a $15 million deficit to an $11 million surplus. This demonstrates the need for continued and intentional financial prudence. Fortunately, we have multiple cost-saving strategies available that should allow us to close these gaps without significant service cuts in the year ahead.

Table 2 – 2020-2024 General Fund Forecast Incremental General Fund Surplus / (Shortfall) $ in Millions

2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
$3.5 M	($15.6 M)	($13.7 M)	$11.4 M	($1.7 M)

Source: 2020-2024 Five-Year Forecast and Revenue Projections for the General Fund

Some important facts compel concern, however. First, we've benefitted from a dramatic overperformance of several revenue streams, most notably sales taxes, with the help of legal changes in the tax treatment of internet transactions. Second, the standard projections do not account for what any economist would expect soon after 127 consecutive months of expansion: a recession. That is, five more consecutive years of steadily growing revenues would defy the laws of gravity. For this reason, the City Manager prepared a "Recession Scenario," so that we can better understand the dramatic impact of a typical recession on our budgetary forecast: over five years, the string of deficits would exceed $150 million in deficits. Most importantly, though, the forecast projections do not account for likely changes in the City's annual obligations for its long-term retirement debt, as discussed below.

Legacy Unfunded Liabilities, and Lagging Retirement Fund Returns

Long-standing battles over pension and retirement health costs have beleaguered San Jose over the past decade. In a little more than a decade between 2001 and 2012, the City's contribution to the retirement funds quadrupled, while the Great Recession pulled the bottom out of revenues. The pension and retiree healthcare accounts accrued billions in unfunded liabilities. General Fund deficits ranged between $84 and $119 million for three consecutive years. Budgetary austerity resulted in the layoffs of hundreds of employees, severe service reductions, hiring freezes, pay reductions, and pension reform, ultimately cutting the City's workforce by one-third.

After divisive political campaigns and lengthy court battles, we brought all of the parties back to the table when I came into office in 2015. Eleven unions and the City together agreed on a framework for resolving these challenging and complex issues, and negotiated a solution that saved City taxpayers at a level similar to the original 2012 Measure B, by closing the retiree healthcare plan, eliminating supplemental pension payments, and reducing pension benefits for new hires. We took that plan to the voters in 2016 and secured the support of our 61% electorate to win passage of Measure F in November.

The good news: we have succeeded in slowing the cost impacts of unsustainable benefit structures, and we have created a sustainable set of pension and healthcare benefits for new employees. Specifically:

- The City's actuary estimated that Measure F will save our taxpayers some $3 billion over the next three decades, including $42 million annually in the years after Measure F's enactment.
- We have dramatically reduced future retiree healthcare cost increases by closing the retiree health plan to employees hired after 2012.
- We have created a sustainable, stable "second-tier" of pension benefits for those employees hired after 2012, where unfunded liabilities are shared equally between the City and employees.
- The light appears visible at the end of the tunnel: five-year projections show the retirement plans' costs slowing their ascent by FY2020-21, and moderating to more sustainable increases on the order of 2% to 3% annually thereafter until 2027, when they begin dropping substantially.

We have accomplished this collaboratively, through negotiation at the bargaining table, and with the approval of our residents at the ballot box.

But there's plenty of worrisome news as well.

First, we're already paying a lot for retirement costs. Next year, retiree pension and health care will consume more than ¼ of the City's entire General Fund, or $334.7 million, a share far higher than any other large California city. Since 2013-14, the City's annual costs for pension and retiree healthcare have increased $125 million, an amount that exceeds the annual expenditures of all but two City departments. From all of the City's fund sources, including the airport, sewage treatment plant, the General Fund, and the like, the total bill will exceed $429.7 million. The historic growth of these costs to the City appears markedly faster than our revenue growth, as displayed below.

Second, the costs of financing the City's retirement obligations—or more precisely, its *past* retirement obligations— will continue rising for several more years. Even if the current (relatively rosy) assumptions hold, the General Fund impacts of retirement costs will increase another $50 million to $366 million by FY 2021-22, as displayed below.

Table 3 – 2020-2024 City Retirement Budgeted Contribution Amounts General Fund ($ in Millions)*

Retirement Plan	2018-2019**	2019-2020	2020-2021	2021-2022	2022-2023	2023-2024
Federated Retirement Plan						
Tier 1 Pension (Normal Cost)	$19.6	$17.7	$15.9	$14.4	$13.1	$11.8
Tier 1 Pension (Normal Cost) Rate	*18.6%*	*19.3%*	*19.1%*	*19.0%*	*18.9%*	*18.7%*
Tier 2 Pension+	$8.8	$8.3	$9.3	$10.5	$11.5	$12.7
Tier 2 Pension Rate	*8.3%*	*8.3%*	*8.3%*	*8.3%*	*8.3%*	*8.3%*
Unfunded Actuarial Liability	$69.1	$78.8	$81.3	$85.4	$88.0	$90.9
Retiree Health Care	$13.5	$12.3	$12.2	$12.4	$12.6	$12.6
Total Federated Contributions	**$111.0**	**$117.1**	**$118.7**	**$122.7**	**$125.2**	**$128.0**
Police Retirement Plan						
Tier 1 Pension (Normal Cost)	$34.5	$31.3	$32.3	$29.8	$27.2	$24.7
Tier 1 Pension (Normal Cost) Rate	*30.1%*	*31.4%*	*31.7%*	*32.1%*	*32.7%*	*33.4%*
Tier 2 Pension+	$5.1	$9.6	$9.3	$11.3	$13.5	$15.7
Tier 2 Pension Rate	*13.7%*	*14.1%*	*14.1%*	*14.1%*	*14.1%*	*14.1%*
Unfunded Actuarial Liability	$61.2	$70.0	$75.8	$78.5	$68.3	$68.6
Retiree Health Care	$16.3	$14.5	$15.4	$16.4	$17.2	$17.9
Total Police Contributions	**$117.1**	**$125.4**	**$132.8**	**$136.0**	**$126.2**	**$126.9**
Fire Retirement Plan						
Tier 1 Pension (Normal Cost)	$25.1	$24.0	$23.7	$22.8	$21.7	$20.6
Tier 1 Pension (Normal Cost) Rate	*31.2%*	*32.3%*	*32.4%*	*32.6%*	*32.8%*	*33.1%*
Tier 2 Pension+	$1.5	$3.0	$3.5	$4.6	$5.7	$6.8
Tier 2 Pension Rate	*15.1%*	*15.4%*	*15.5%*	*15.4%*	*15.4%*	*15.4%*
Unfunded Actuarial Liability	$49.5	$55.0	$62.0	$67.0	$66.8	$70.9
Retiree Health Care	$9.6	$9.4	$10.0	$10.6	$11.1	$11.6
Total Fire Contributions	**$85.7**	**$91.4**	**$99.2**	**$105.0**	**$105.3**	**$109.9**
Other Retirement Contributions	**$1.0**	**$0.8**	**$0.8**	**$0.9**	**$0.9**	**$0.9**
Total General Fund	**$314.8**	**$334.7**	**$351.5**	**$364.6**	**$357.6**	**$365.7**
Total All Funds	$405.6	$429.7	$448.0	$464.3	$459.4	$469.7

+Though Tier 2 contributions are overwhelmingly comprised of normal costs, these figures do contain a very small component of UAL related to the Tier 2 program. For Tier 2, UAL is evenly split between the City and employees.

* City budgetary amounts differ from the Federated and Police and Fire Retirement Boards approved amounts due to the budgetary spread of retirement contributions across vacant, as well as filled positions. Cheiron, the Boards' actuary, applies retirement contributions to an assumed level of filled positions.

** Contributions in 2018-2019 associated with the UAL and retiree healthcare were paid at the beginning of the year, resulting in a slight discount in the contribution amount/rate. With the changing economic environment, all contributions in 2019-2020 will be spread throughout the year.

Source: Cheiron Letters dated January 9, 2019 (Federated) and January 30, 2019 (Police and Fire) and Cheiron presentation slides dated February 7, 2019 (Police and Fire).

It's critically important to look carefully at each of the components to understand why those costs are rising.

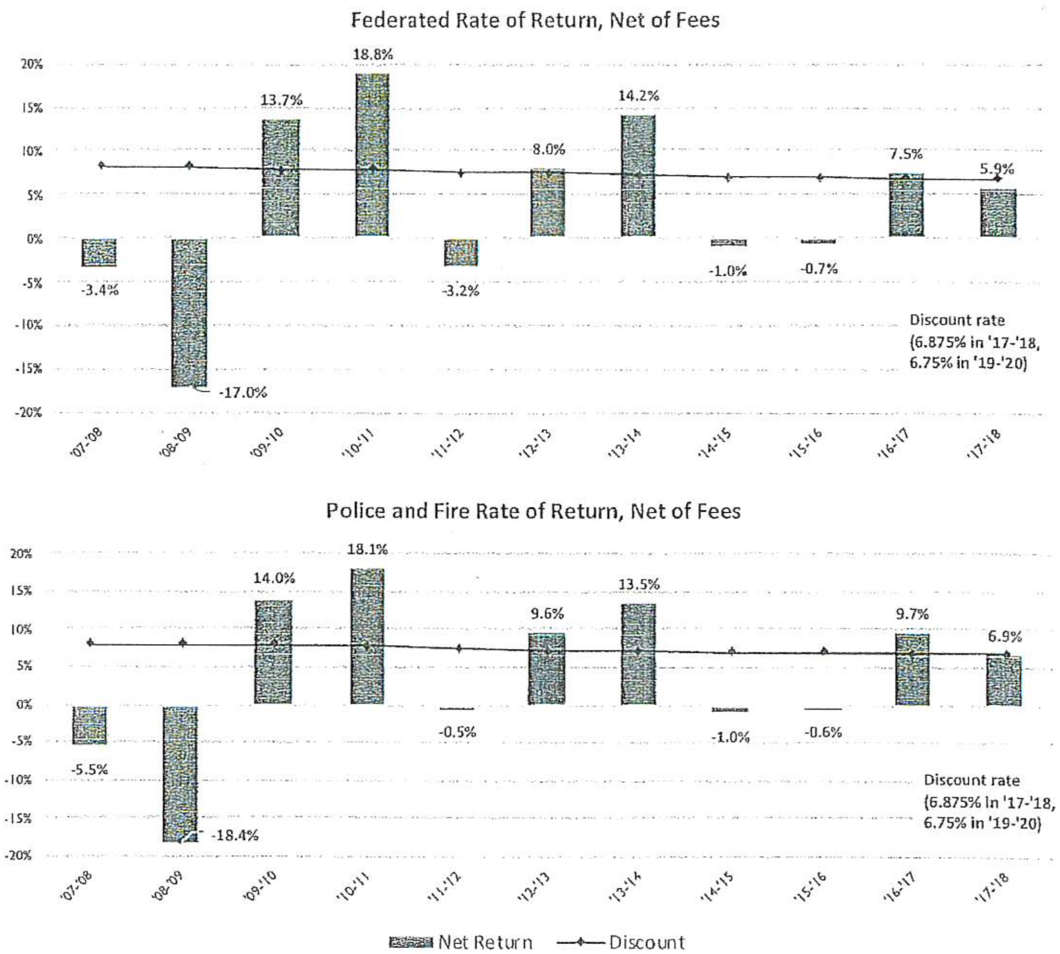
Specifically, with Measure F, we've successfully constrained what actuaries call the "normal" cost of pension and retiree healthcare obligations—the ongoing cost incurred today by current employees. As the figures for the Federated, Police, and Fire Plans show, current employees in Tier 1 and Tier 2 have very manageable pension and retiree healthcare costs projected over the next half-decade. The pension costs of Tier 1 employees decline in every plan as older employees retire from the workforce. Tier 2 employee pension costs remain relatively constant as a percentage of total employee compensation, increasing at a rate commensurate with headcount and salary gains. Retiree healthcare grows at a slow clip across the three plans, from an aggregate of $39.4 million to $42.1 million, or an increase of about 1% annually. In other words, Measure F is working.

The problem is that Measure F did not—and under California law, could not—retroactively constrain the cost of financing the "unfunded actuarial liability" —essentially the excess costs of the City's obligations to employees hired before 2012. That is, the "California Rule" generally precludes jurisdictions from reducing or limiting costs of benefits already promised and earned, even where those costs exceed the retirement plan's assets and projected earnings. The cost of financing unfunded liability rises in the aggregate by 28%, or more than $50 million over five years, and will continue rising until approximately 2027.

Third, projections understate the seriousness of the problem. Actuaries necessarily base their cost projections on relatively fixed assumptions, necessitating a static view of the universe. Given what we know today, "status quo" is unrealistically optimistic, for two interrelated reasons: inadequate investment returns, and changing assumptions.

As displayed below, our retirement plans have generally produced returns below the expected "discount rate" for their investments in recent years. In any year in which the investment returns fail to meet the discount rate, the unfunded liability of the funds—now reaching $4 billion—grows.

Figure 1. Retirement Plan Rates of Return, Net of Fees, Over the Past 10 Years



Source: Police and Fire Department Retirement Plan and Federated City Employees' Retirement System, Comprehensive Annual Financial Reports. Recreated from City Auditor Report 18-09.

There appear to be several factors causing these poor returns, independent of the larger market. They include some causes—such as the conservative (low-yield, low-risk) investment strategy embraced by the boards—that appear both deliberate and defensible. That is, given the highly vulnerable fiscal structure of a plan that has more retirees receiving benefits than workers paying in, a conservative approach that avoid large losses appears sensible.

Other factors appear more troubling, however. For example, until a few months ago, outsized portions of the plan assets sat in cash, seemingly a result of both board indecision and of lengthy delays in hiring a chief investment officer. Fortunately, a new CIO has now taken over, and those cash holdings appear to be getting reinvested. Also troubling has been the tendency for the boards and Retirement Services staff to favor investment in high-fee, management-intensive alternative investments such as private equity, real assets, private debt, and hedge funds. Monday-morning quarterbacking suggests that superior risk-adjusted returns, and greater transparency, could have been achieved from a combination of indexed, low-fee equity and bond funds. While the boards' approach appears by no means unusual, some experts have more successfully charted a different course toward more passive investments, such as the Nevada state pension system[1]. Academics have long speculated about the likelihood of a widespread bias in the industry to prefer higher fee, active investment approaches despite the evidence of inferior outcomes[2], perhaps because decision-makers tend to share the same education, career paths, and social circles as those directing actively managed funds. Time will tell whether decisions to allocate our fund assets to such high-cost investments appears justified. I've expressed concerns repeatedly in the past, however, that existing strategies maximize financial benefit to asset managers, at the cost to the City and our plan members.

The retirement boards' decisions to change the assumptions that actuaries use to calculate the assets, liabilities, and contribution rates of the funds also have profound impacts on the annual cost to the City, and have driven much of the aggregate cost increase since 2013. Those assumptions include demographic projections—such as retirees' life expectancy, health needs, and the like—as well as economic variables, regarding such variables as future inflation, wage increases, and most importantly, fund investment returns. I commend the boards for their courageous willingness to make adjustments as new data reveals the need to pivot toward reality. Indeed, it has been the historic failure of the Boards prior to 2008 (and of many other public pension fund boards nationally) that has irresponsibly created false optimism about the financial status of pension funds that obscured billions in unfunded liabilities.

The most important of those varying assumptions involves the "discount rate," which describes the expected investment returns of the funds. By choosing an optimistic discount rate, such as 10%, one can make unfunded liabilities disappear—on paper, at least. Eventually, of course, reality comes crashing in, as it did in 2008, when we saw steeply negative actual returns creating huge claims on the City treasury while our City's retirement funds kept discount rates of 8.25% (Federated) and 8.0% (Police & Fire). Since that time, we have learned our lesson, and the retirement boards have ratcheted return assumptions downward, to 6.75%. While we should commend them for demonstrating the fortitude and transparency to reduce the discount rate below that of nearly any public agency in the state, every reduction of the discount rate ratchets the required General Fund contribution upward. That is, this is tough medicine of fiscal discipline: we will be forced to pay more now for a more responsible and transparent estimate of the costs of paying for retirement costs over the long run.

Here's the challenge: this will get worse. Retirement board experts have—with good reason—continued to advise the boards to reduce their discount rates even further. Resulting board action will drive up annual retirement costs to the city by several tens of millions of dollars, cutting spending on everything from police to parks and potholes. Moreover, a historically long bull market run leaves many expecting a substantial correction, and other asset classes will get pulled down with declines in equities. Investment losses will require still higher General Fund contributions in the following half-decade.

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[1] Martin, Timothy W., "What Does Nevada's $35 Billion Fund Manager Do All Day? Nothing", Wall Street Journal, 2016.
[2] Bird, Ron et al., "Why Do Investors Favor Active Management...To the Extent They Do?", Rotman International Journal of Pension Management, Volume 6-Issue2, Fall 2013.

All of this will happen despite the best of intentions: Unions and city management worked responsibly reduce Tier 2 benefits to sustainable levels, and the retirement boards have been honest brokers with discount rate assumptions. Nonetheless, absent corrective action, we will again see retirement costs undermine our collective efforts to serve our residents.

Discerning Our Residents' Priorities

Given these dark clouds on the horizon, any spending decisions should be made with only the very highest priorities of our residents in mind. Here's the problem: no one other than a Delphic oracle can claim to know our residents' spending priorities with precision. The best we can do is to ask our residents directly, which we've attempted through various surveys over the years. Although an imperfect means of identifying clear spending priorities, we do know that public safety comprises the highest priority of our residents—routinely ranking as the highest priority of our residents in nearly every poll. The City Auditor's Annual Report on City Services 2017-18 (Report 18-09), relates the results of the annual community survey in San Jose, and again, the "overall feeling of safety" ranked highest among resident priorities, as "essential" or "very important" by more than 90% of residents. When the same survey residents to rate their community characteristics, San Jose's Achilles' heel came into full view: more than 90% of residents rated as "poor" or "fair" our city's "cost of living" and "availability of affordable quality housing"—the two poorest-rated elements of our quality of life, and close behind was the "availability of affordable child care." Among the other areas of great concern involved our city's aesthetics: more than three-quarters of our residents ranked the cleanliness and overall appearance of the city as "fair" or "poor."

The Mayor's Office continues to explore new means to engage the community in prioritizing budgetary needs. This year, we have refined the online use of the "Balancing Act" software to allow us to see how residents would allocate dollars within a constrained fiscal outlook. We introduced this tool to our residents at our Community Budget Town Hall in mid-February, and in several meetings since, and we have translated it into three languages: English, Spanish, and Vietnamese. Residents can continue to provide budgetary feedback through the use of the online tool through the end of April. We'll report those results to the Council during the budget process, along with resident feedback from our low-tech communication tool known as "community meetings"— to inform our budget discussion.

RECOMMENDATIONS:

As we look to the future, the many issues highlighted above inform my recommendations for budgetary spending and savings. I make these recommendations mindful of the five principles of budgetary resilience that I described in the introductory section, above, namely the admonition to save, avoid unsustainable commitments, leverage external resources, prioritize investments that boost sustainability, and focus on residents' very highest priorities. Using those principles, my budgetary recommendations can be categorized in the following areas:

1. Saving
2. Public Safety
3. Confronting the High Cost of Housing and Living

4. Homelessness
5. Combatting Blight
6. Environment

1. SAVING

Surplus: Given the projected deficits ahead—which will likely grow in coming years— the entire ongoing surplus—with one exception—should be saved in reserve, to offset the shortfalls expected in future years. The exception: an ongoing allocation of $300,000 to bolster the rapid-response team's capacity to respond to illegal dumping and abate trash, as more fully described below. The City Manager is directed to allocate the ongoing $3.2 million surplus to a Future Deficit Reserve for 2020-2021, thereby delivering a "double benefit" of reducing the projected deficit in the following year by the same amount.

One-Time Funds: The City benefits uniquely this year from one-time sources of revenue, such as the City's portion of the sale proceeds of the SARA- owned land to Google, and the sale of various City-owned sites, such as the former FMC plant and Hayes Mansion. Even better, many of these transactions—such as on FMC and Hayes— have also reduced ongoing debt service obligations of the City. Since these one-time sources will not provide sustainable streams of revenue in future years, we should use them strategically to (a) pay down debt, such as on our City golf courses, that create ongoing drag on the General Fund, and (b) fund critical one-time needs, as more fully described in this memorandum, and (c) establish reserves sufficient to boost our fiscal resilience in tough times. The City Manager is directed to employ these strategies with one-time funding sources, and return to Council with an analysis of potential ongoing savings.

Paying Down Debts: City staff and the Council have diligently reduced debt citywide in recent years, by paying down outstanding general obligation bonds, refinancing redevelopment debt, and paying off obligations on City investments in real estate such as the Hayes Mansion and the FMC site. All of those efforts will reduce the drag of annual debt service on the General Fund, freeing dollars for services. The General Fund remains beholden to several smaller obligations yet, however, including legacy obligations on two golf courses, and an energy services company debt that financed LED light conversions. The City Manager is directed to pay down those debts, targeting an amount of up to $5 million, to free General Fund dollars for ongoing services.

Reserves: Insufficient reserves make existing City services vulnerable under fiscal strain, resulting in the too-familiar (but painful) whipsaw effects on our residents and employees, who reasonably expect stable service provision. A City audit in March 2015 (Report 15-03) revealed that the City does not sufficiently fund its reserves, as benchmarked against best practices by the Government Finance Officers Association (GFOA). The audit recommended a "safety net" reserve target in the range of 10 percent—the minimum among benchmarked California cities—to 16.6 percent of expenditures, which comprises the GFOA-recommended best practice. As of this fiscal year, those reserves appear to hover around 6%, or roughly three weeks of operating costs. Although we have made progress since the 2015 audit—boosting this percentage from the 4%, current levels remain insufficient against our future fiscal challenges. We need to prioritize funding to boost those reserves most critical to our City's resilience and core services, particularly the Budget Stabilization Reserve and Future Deficit Reserve. The City Manager is further directed to reassess reserve target levels in light of our own current operational needs to develop baseline, desired, and optimal reserve targets that protect recently-restored services, and to report those reserve targets to Council. Council and staff will then identify strategies for achieving more satisfactory reserve levels.

- **Budget Stabilization Reserve:** To protect residents and employees from the severe cuts that characterized the last two economic cycles, we must boost the Budget Stabilization Reserve. The City Manager is directed to contribute any one-time funds not otherwise prioritized to the Budget Stabilization Reserve, at a minimum amount of $10 million.

- **Future Deficit Reserve:** After this year's surplus, the City Manager's General Fund Forecast suggests we'll be grappling with deficits for several years. To preserve recently restored services, we must prepare prudently. The City Manager is directed to: 1) allocate $3.2 million of the current-year surplus to one-time needs to preserve the ongoing funding to address a portion of the FY 2019-20 projected shortfall, reducing that shortfall from $15.6 million to $12.4 million; and 2) carry over $12.4 million of the 2019-2020 Future Deficit Reserve to the 2020-2021 Future Deficit Reserve to address the remaining projected shortfall in that year. The City Manager is further directed to return to Council with proactive options for ongoing cost savings and efficiencies that will address the remaining ongoing gap of $12.4 million, that, if left unchecked will almost double the deficit projections for FY 2021-22.

- **Essential Services Reserve:** The City Manager is directed to set aside $4 million in one-time funds that may be used to support services that are of essential importance to our residents. Services deemed essential by the City Council may be funded with the use of these one-time funds.

- **IT Sinking Fund Reserve:** Investment in information technology can dramatically improve the productivity of our understaffed workforce, after years of underfunding our IT have forced much of our workforce to work harder with fewer results. IT Director Rob Lloyd came into office two years ago confronting tens of millions in "tech debt," with mismatched and poorly functioning software platforms, vulnerabilities in cybersecurity, and staff time wasted on patching holes in outdated, legacy software systems. Since that time, Lloyd has admirably improved IT, and the City has made critical investments, but the City has no "sinking fund" for critical replacement and repair of aging systems. The City Manager is directed to allocate at least $2 million in one-time funds for IT capital repair and replacement, independent of any allocations needed for 2019-2020 IT priorities.

Convening Stakeholders to Address Retirement Fund Resilience: As I've extensively described in the "Overview" portion of this memorandum, our retirement funds face serious challenges, with fast-growing contribution rates that will undermine the General Fund's capacity to pay and employ employees and deliver basic services to our residents. This is certainly not the fault of any employees or retirees who earned the benefits they were promised, nor of the unions nor Council who negotiated a sustainable solution for ongoing benefits, nor of the voters who approved Measure F that will save taxpayers $3 billion, nor of the retirement boards that have selected more realistic economic assumptions for investment. Every key stakeholder has acted in good faith, and has sought to make decisions in the long-term best interest of the community.

Nonetheless, we still collectively face a daunting challenge, and we need to explore options, such as around reducing "fee drag" on investment returns, altering amortization schedules to finance the $4 billion legacy pension debt that we inherited, and any other worthy ideas that stakeholders may bring forward.

In the past downturn, severe shortfalls created an intensely contentious atmosphere in City Hall that precluded constructive dialogue about solutions. Now is the time to convene key stakeholders—including our City unions, management, retirement board members and staff, with the help of experts—to calmly explore options that will both protect the benefits that our employees have earned, and protect the City's ability to provide basic services through the next recession. This convening should, at a minimum, ensure a full vetting and scrubbing of the numbers to enable a clear, shared understanding of the challenges of the fiscal landscape, and to educate the Council, our workforce, and the public. These public meetings will not constitute—nor substitute for—negotiations with our bargaining units. Rather, they will provide everyone with a clear view of the challenge ahead, and an opportunity to evaluate options. The City Manager is directed to provide staff support for such meetings in the coming months.

2. PUBLIC SAFETY

Police Hire-Ahead Program: As of late December, the Police Department had 1,098 filled sworn officers, and a budget to employ 1,110 officers. By July, our authorized sworn positions will increase to 1,151, enabling us to continue hiring. SJPD has consistently run full academies to bring new recruits into the fold, while several former SJPD officers continue to return home. Although police recruiting and hiring continues its successful run, the aging demographics of our force mean that we will face high rates of retirements that will prevent us from reaching our authorized sworn levels if we do not continue to hire aggressively. A Hire-Ahead Program enables SJPD to hire and train personnel in the Academy at a rate that anticipates future vacancies to provide street-ready officers available to fill them. The City Manager is directed to identify one-time funding required to maintain ongoing academies for the next two fiscal years, until FY 2020-21, in order to fill anticipated vacancies. In an acknowledgment of the need, the City Manager is further directed to develop a staffing plan that describes how an incremental increase in sworn officers would be prioritized, should any additional resources become available in the future.

South Police Substation Activation: Assuming that we can successfully maintain our current staffing projections, and with the passage of Measure T enabling construction of a new police training facility, we finally have an opportunity to utilize the South Substation for its intended purpose. The City Manager is directed to identify permanent sites for a police training facility, and make preparations to begin the transition of the South Substation from a training facility to fully activated substation.

Downtown Foot Patrol: Ongoing concern about the sense of safety of residents, workers, and visitors in our Downtown compels us to continue to fund the $600,000 Downtown Foot Patrol Program, using one-time funding to get more police officers into visible locations of our core.

Fire Department Call Volume: As we have invested in additional staffing and new technology, Chief Robert Sapien and the SJFD have done a tremendous job in restoring emergency response.

After years "browned-out" stations and post-recession struggles, we have now exceeded our emergency medical response standards for ten consecutive months, for example.

Yet our ability to sustain that response appears at risk. We've seen rapid increases in 911 call volume to our Fire Department, at rates far higher than population growth, from roughly 68,000 annual calls in 2012 to more than 93,000 today. There are many causes of this growth, including a fast-expanding elderly population that demands greater medical attention, and emergency medical calls now comprise 62% of all emergency calls for service to the Department. The explosion of homelessness over the last decade has generated more calls for everything from drug overdoses to encampment fires. While we are adding new fire stations and planning for additional line staff to fill those stations, fiscal constraints will not enable us to expand capacity at the same rate as demand growth. We must look critically at our capacity to determine whether the Fire Department should be responding in the same way to non-emergency calls, or whether we could achieve better efficiencies with alternative responses from other service providers.

Specifically, low-priority, non-emergency medical calls, jail transports, and interfacility transports comprise a substantial share of SJFD's call volume. According to the department's March 8, 2016 Fire Department Organizational Review memorandum, low-priority, non-emergency medical ("alpha") calls comprised 13% of total SJFD responses in 2014-15, for symptoms that included earaches, toothaches, hemorrhoids, diarrhea, sunburn, and sore throat. In many if not most cases, a Lyft or Uber ride to the County clinic will save both dollars and precious SJFD time. Similarly, the County contracts with a private ambulance provider to transport County patients under treatment for routine medical treatment, and ambulance delays often cause the County to call SJFD for transport from one County building to another—often literally across the street— even though the patient is rarely in critical condition. These and other calls represent an irrational expenditure of public resources that can distract and delay our SJFD firefighters from their life-saving mission.

The City Manager is directed to conduct an internal review of opportunities to triage rising call volumes and maximize our scarce SJFD resources on life-saving and fire mitigation. That report should be provided to the Council prior to our next budget cycle, and should inform the City in its upcoming negotiations with the County over the provision of medical transport services. The City Manager is further directed to engage in discussions with VTA and BART regarding financial responsibility for the increases in anticipated call volume resulting from the opening of the Berryessa-North San Jose BART Station, and whether 2008 Measure B should fund additional response.

3. CONFRONTING THE HIGH COST OF HOUSING AND LIVING

Child Care Workforce Development and Facilities: The lack of access to affordable childcare comprises a major barrier to securing and maintaining stable work for many families, and the second-greatest drain—after housing—on their budgets. Today, our families with infants, toddlers, and preschoolers need 17,000 more child care slots than currently exist. Families inhabiting fourteen San Jose zip codes dwell in child care "deserts," where at least 300 children lack the child care they need. The lack of quality child care also has huge impacts on the future prospects of our children. More than 70% of San José's 27,000 preschoolers enter kindergarten without the necessary skills and/or socio-emotional competencies. Students who are kinder-ready are 4 to 5 times more likely to pass 3rd grade standardized English literacy and mathematics tests—itself a powerful predictor of academic and life success.

Two of the main challenges driving the deficit in child care services are insufficient facilities and shortages in a trained workforce. Regarding facilities, leasing and upgrade costs inhibit many providers, yet San Jose has ample vacant retail spaces and several new developments that could potentially address this demand. Prior to the Great Recession, child care provider training once comprised a task of our own Library Department, enabling hundreds of parents—primarily immigrants of modest means— to generate additional income and start their own businesses.

The City Manager is directed to (1) allocate one-time funding to address the Council-approved priority of incentivizing construction of on-site child care facilities within new and existing developments, and identifying public facilities for child care; (2) request that the work2future board include childcare providers within its priority career pathway initiative, and include funding for certification training through our community colleges and other institutions; (3) allocate up to $250,000 to the Library Department to evaluate, design, and launch a child care provider training program, utilizing our prior experience and current best practices; and (4) should the Governor's $490 million budget proposal obtain legislative approval, apply for funding for childcare provider training, focusing on at-home, license-exempt providers.

Leveraging State Dollars for "Missing Middle" Affordable Housing: The Bay Area's housing crisis continues to afflict residents across the income spectrum, from homeless to housed. The Governor's January Proposed Budget calls for an investment of $500 million for the development of housing for "missing middle" workers, through the California Housing Finance Agency's expansion of its Mixed-Income Loan Program (MILP). The MILP finances housing for families earning between 60% and 80% of average median income, doing so with less subsidy than traditional programs.

The Housing Department has already been exploring innovative financing approaches to support housing development for the "missing middle," including the potential creation of a private-public investment fund for this purpose. A City commitment that aligns with the Governor's program could make our affordable housing projects more competitive in securing funding through the Governor's proposed mechanism, enabling San Jose to build more housing for workers of modest incomes. The City Manager is directed to identify $10 million in the Multi-Source Housing Fund for this purpose, should the legislature approve the Governor's direction. The City Manager is further directed to return during the budget process with a cost estimate for the creation of an affordable housing fund leveraging private investment, including costs associated with legal fees, structuring, planning, and execution.

San Jose College Promise: Due to the collaborative efforts of San Jose-Evergreen Community College District, West Valley College, the Library Department, the San Jose Library Foundation, and my office, this year we will enable more than 1,500 low-income students to attend community college without paying for books, fees, or tuition. The Governor recently announced his intention to make community college free for two years, essentially filling the need addressed by the College Promise. My office has communicated with several local companies about expanding our College Promise program to four-year institutions such as San Jose State University. If the legislature approves the Governor's proposal, the City Manager is directed to work with the Mayor's Office and local stakeholders to evaluate an expansion of the San Jose College Promise to four-year institutions, with philanthropic support.

Expedited Housing Development: Last year, the Council approved $144,000 for a dedicated staff person in the Department of Planning, Building, and Code Enforcement to provide service to expedite processing of housing projects. The City Manager is directed to adjust PBCE fees to fund this position, and to make this position permanent and ongoing. The City Manager is further directed, within his legal authority, to immediately enable off-hours fire inspection services to address the chokepoint of development processing with fire inspections.

Parcel-Mapping For Housing and City-wide Data Projects: In last year's Budget Message, I called for, and the Council approved, funding for a city-wide data strategy. Focusing on the most pressing issues for our residents, the strategy specifically mentioned: "adopting an early use case for a robustly layered, GIS-based map that will allow housing developers, real estate professionals, and housing advocates to have accurate, parcel-level, and spatial data about opportunity sites for housing development that could speed development of much needed-housing in the city." It appears that this direction has not yet been fully implemented, so the City Manager is directed to identify one-time funding sufficient to enable this specific priority to move forward as a demonstration project, and to report to the Smart City Committee about the program's progress and outcomes.

Additionally, as our City embraces the use of data to improve service delivery, we must improve data governance, open data, and data analytics policies and programs for our City. This takes on additional importance as we seek designation a "What Works" city—a Bloomberg Philanthropy designation for "best in class" cities that use data to inform policy decisions. In addition to improving the efficiency and efficacy of our own decisionmaking, sharpening our data saw will better position San Jose to attract substantial new external resources for evidence-based policy-making across our City. The City Manager is directed to allocate one-time funding to enable data analytics, visualization, and management across City departments, with an emphasis on Housing, PRNS, and SJPD, for a two-year period.

Alquist Building Redevelopment: Our State delegation, led by Senator Jim Beall and Assemblymember Ash Kalra, will seek funding to begin planning for the redevelopment of the Alquist Building on 2nd and San Carlos for housing—particularly for SJSU educators and staff—and other uses. The City Manager is directed to work collaboratively with State officials to enable the development of that site to maximize affordable housing potential, activate the ground-floor streetscape, and preserve public parking to support nearby arts venues and restaurants.

4. HOMELESSNESS

Transitional Jobs Program: Five months ago, we launched the Transitional Jobs Pilot Program to employ homeless residents to clean litter and trash in dozens of citywide "hot spots," with one-time funding that expires June 2019. This partnership with Downtown Streets Team and Goodwill helps homeless get back on their feet, and provides badly-needed cleaning of our streetscape. Most importantly, the program has begun to change the narrative around blight and homelessness in our City, from pointing fingers at homeless residents as "the problem," to including homeless individuals who want to be part of "the solution." Last week, a Goodwill manager informed me that of the dozen or so clients participating in his portion of the program, three have already secured jobs from other employers, and several more have moved on to recycling and other more steady work within Goodwill, plainly demonstrating the early success of this program. Yets dozens of their clients remain on a wait list—ready to work, but unable to do so. The City Manager is directed to use one-time dollars to double the capacity of the program, both to expand work opportunities for our homeless neighbors, and to improve the cleaning of our streets, creeks, and prominent public spaces. To make this more fiscally sustainable, staff is directed to review other potential sources of funding outside the General Fund. The City Manager is further directed to allocate no more than $100,000 for the purchase of trucks and other capital equipment needed to expand the program, to be coordinated with the Mayor's Office's corporate & philanthropic fundraising strategy.

"Cash-for-Trash": Continuing the theme of transforming "homeless as the problem" to "homeless with solutions," we have often heard from encampment residents that they would willingly clean their surrounding area if provided with trash bags and hauling service. In small pilots, we've seen experimentation with paying homeless individuals a few dollars for a bag of garbage, with positive effects. Of course, we should approach carefully: what economists refer to as "moral hazard" could undermine a poorly administered cash-for-trash program, and incentivize counterproductive behavior. The City Manager is directed to explore how to address this "moral hazard" risk, and to administer a modest pilot cash-for-trash program, with $50,000 in one-time funds.

Homeless Students: We're learning that statewide, college students are not immune to hunger and homelessness; locally, our university and community college partners work daily to address these problems. The City Manager is directed to explore partnerships with San Jose State University and our San Jose City and Evergreen Valley community colleges to address this challenge, with a particular focus on enhancing cash assistance funding for students needing emergency options. The City should provide a matching commitment for those schools that choose to increase their own contributions to help their students.

Navigation Center: The Governor has committed to supplement one-time Homeless Emergency Aid Program (HEAP) funding with another $500 million in this budget cycle. In our ongoing advocacy with the Big 13 city mayors, we have reason to believe that we could secure at least as large—if not a larger—allocation from this year's state surplus. We remain committed to a strategy that focuses on the ongoing, urgent, and critical need for permanent housing for the homeless. However, we also critically need to identify locations and structures that can address the acute needs of homeless willing to get off the street. The City Manager is directed to identify a location for a "navigation center," continue discussions with the County regarding sharing the burden, and return to Council in June with a proposal that will enable us to carve out specific one-time HEAP funding for land/building acquisition, or a long-term lease, that purpose.

Ballot Measure: I have been working with key stakeholders to assess whether we should return to the ballot in 2020 to seek voter approval for an affordable housing bond or other funding measure. Additionally, staff has continued to explore measures that might support other critical needs, such as rebuilding and restoring our parks, and expanding our public safety workforce. The City Manager is directed to allocate one-time funds to enable polling for these purposes.

5. BLIGHT

Beautify San Jose: Now in its second year, the Beautify SJ program has accelerated, leveraging the energy of more than 50,000 volunteers for community clean-ups, triple the number of volunteers two years ago. More than 48,000 residents now use our My San Jose reporting app, more than 70 neighborhood groups have collaborated in volunteer-led beautification projects with BeautifySJ grants, our illegal dumping abatement activity has doubled, and the volume of free unlimited junk pickup service has doubled to 496 tons collected per month. A cursory visual inspection of our city reveals, however, that all of these efforts have not lessened the blight problem; more than 80% of our residents in our 2018 community survey rated our city's cleanliness only "fair" or "poor." Through targeted one-time investments, we can leverage the growing community passion that supports our beautification efforts. Specifically:

- **Removing And Preventing Illegal Dumping (RAPID) Program:** The Environmental Services Department's Removing And Preventing Illegal Dumping (RAPID) team responds to illegal dumping service requests on public property and proactively sweeps dumping "hot spots." This hard-working crew removes 25 tons of dumped materials per week on average from City streets and public areas, and in a short time, this program has clearly demonstrated success. The rising demand for illegal dumping services—from 592 monthly requests to 1,226 monthly requests in two years—has strained RAPID's resources. The program now often exceeds its 4-5 day targeted response time, and response exceeds 10 days during busy summer months. The City Manager is directed to allocate $300,000 in ongoing funds for three maintenance worker positions to continue the progress we've seen. Further, the City Manager is directed to continue and expand their enterprise work—which should include ESD, DOT, SJPD, PRNS, and the CMO's data team—to study proactive, comprehensive strategies that better address dumping, and to improve enforcement. As a part of its study, the working group should consider opportunities for inter-departmental collaboration, multiple funding sources, and external partnerships with the San Jose Conservation Corps, Caltrans, VTA, and others.

- **Transitional Jobs, and Cash-for-Trash:** The City Manager is directed to ensure smooth cross-departmental collaboration on the expansion of models for cleaning our city by empowering homeless residents through work-first approaches to self-sufficiency, which was fully described in Section 4, above.

- **Proactive Legal Enforcement of Blighted and Nuisance Properties:** In struggling neighborhoods, blighted properties and empty parcels plant the seeds of decay, providing a sense of disorder to neighbors that invites crime and additional vandalism. Our understaffed code enforcement team assesses fines and other city sanctions, but some of the more neglectful landlords and property owners remain intransigent. The City has largely lacked any robust or consistent legal enforcement of those sanctions, due to staffing shortages in the City Attorney's Office. The City Manager is directed to allocate $400,000 in one-time funds to enable the City Attorney to hire a dedicated Deputy City Attorney for the purpose of litigating these matters for two years, and any fee recoveries, settlements, or money judgments shall fund the continued sustenance of this position.

- **Dumpster and Beautification Days:** In my prior Budget Messages, we directed the City Manager to allocate $18,000 to each Council Office for ongoing funding for Council Office- and neighborhood-led dumpster and beautification days. We neglected to include my own office. The Mayor's Office supports all of these cleanup efforts, with the help of three hard-working staff members and several interns. I direct the City Manager to allocate $36,000 in one-time funding for the Mayor's Office to support of dumpster and beautification days in each Council district.

- **BeautifySJ Capital Needs:** The Environmental Services Department currently has trash compactor equipment that appears inadequate in capacity and breaks down frequently. Moreover, the City needs more trucks to transport equipment to volunteer events. It seems reasonable to expect that the same truck could serve the Transitional Jobs Program during the week, and BeautifySJ volunteer events on the weekend. The City Manager is directed to allocate $300,000 in one-time resources from an appropriate funding source to purchase additional trash compactor equipment and trucks to meet the need, but to ensure that such purchases are not duplicative with equipment purchases for other programs.

- **BeautifySJ Grant Program:** More than 70 neighborhood organizations have received BeautifySJ grants in each year since the program's introduction, leveraging the power of volunteer energy and community pride. Neighborhoods have shown how they can multiply the force of small grants—never exceeding $5,000–to convene community members for neighborhood cleanups, tree plantings, mural-painting, and many other tasks to beautify their corner of San Jose. I direct the City Manager to allocate $200,000 in one-time funds to the BeautifySJ Grant program to continue this momentum.

- **Median Island Landscape Maintenance:** Previous funding of this program allowed us to increase weed abatement, trash cleanup, and other maintenance along major streets and at key gateway locations from once every 18 months to once every four months. The one-time funding for the program expires in June 2019, with initial funding in Fiscal Year 2017-2018 indicating a cost of $1 million. Staff is directed to return to Council to (1) identify the extent to which the Transitional Jobs Program or similar initiative could perform these tasks at a lower cost and with greater social impact, (2) assess alternative sources of funds, including SB1 revenues, to continue this program while limiting impact to the General Fund.

Freeway Trash and Debris: After several years of inaction in response to the poor freeway maintenance, we've seen significant improvement CalTrans response in recent months \under the leadership of their new District Director, Tony Tavares. City-brokered partnerships with the San Jose Conservation Corps and others are starting to gain traction. The City Manager is directed to report to Council on the status of ongoing efforts to encourage and support better CalTrans maintenance of our freeway.

Turning the Lights On in Empty Storefronts: High operating costs, combined with the "Amazon effect" on brick-and-mortar retail has left San Jose with too many empty storefronts. Empty, dark commercial spaces exacerbate blight, and undermines our efforts to activate streetscapes, and maintain an overall sense of safety. Of course, fiscal benefits accrue to the public as well: retail sales tax comprises the second-largest source of General Fund revenue, and retail provides our residents with a major source of employment and entrepreneurial opportunity. Brick-and-mortar retail also provides residents with better quality of life through access to convenient good and services, and provides public space for social convening and activation of our streetscape. The ongoing retail "leakage" in San Jose means that our residents continue to disproportionately send millions of our retail dollars to other communities.

- **Storefront Activation Grant Program:** We piloted the Storefront Activation Grant Program during my years as a Councilmember in District Three, and we've continued to see success in transforming empty spaces to vibrant retail by helping entrepreneurs reduce the burden of City fees for tenant improvements and permits, to get up and running. The City Manager is directed to allocate one-time funding to continue this program.

- **Retail Activation Program:** The Office of Economic Development (OED) recently completed work on Citywide, North San Jose, and Downtown retail strategies, and each point to the need to proactively facilitate retail growth across the City to achieve success. The existing efforts on retail attraction currently consume about 5% of OED time; however, this activity yields a 4:1 ratio of tax revenues (e.g., sales and business taxes, excluding property taxes) generated by companies assisted by the OED team. As such, the City Manager is directed to allocate $375,000 in one-time dollars, spread over two years, to create a Citywide Retail Attraction Program, that will research and market San Jose submarkets and prime opportunity sites, provide outreach to a broad range of retailers, assist small business owners seeking retail sites, and support property owners and developers in facilitating the leasing of available retail spaces. The City Manager is further directed to consider drawing some portion of these dollars from the General Purpose Parking Fund (for Downtown retail) or other sources to minimize burdens on unconstrained General Fund dollars.

6. ENVIRONMENT

Coyote Valley: With the voters' strong approval of Measure T, we have a once-and-only-once opportunity to preserve Coyote Valley from development, thereby protecting our drinking water from contamination risk, reducing downstream flooding, mitigating wildfire vulnerabilities, expanding recreational and trail opportunities, and securing key wildlife corridors. The City Manager is directed to dedicate staff resources to negotiate a favorable price for the purchase of parcels in Coyote Valley, so that the Council can vote in the months ahead to secure this gift for future generations.

Climate Smart San Jose: Environmental Services staff, working in collaboration with the Mayor's Office, have successfully secured grant funding to support the San Jose Climate Smart Program, including grants and other resources from PG &E, BAAQMD, and Microsoft. With our more recent success in the American Cities Climate Challenge, providing $2.5 million in assistance from Bloomberg Philanthropies, San Jose has the opportunity to pilot and demonstrate greenhouse gas-reducing strategies on a national stage. Our successful launch of San Jose Clean Energy will generate dollars to support our Climate Smart San Jose initiatives within 18-24 months, but several initiatives lack the data analysts and other staff needed for implementation and success, as defined by meeting our commitments to Bloomberg and other funders. The City Manager is directed to allocate $700,000 in one-time dollars from the General Fund and appropriate Environmental Services funding sources to enable implementation of Climate Smart San Jose. These dollars shall be spread over two years, to provide "bridge' funding until SJCE's operations provide stable net revenues needed to support the program, and to better position San Jose for similar grant funding opportunities in the future.

CONCLUSION

Prior One-Time Funded Items: The City Manager is directed to evaluate programs funded on a one-time basis in Fiscal Year 2018-2019 for continuation in Fiscal Year 2019-2020.

Budget Balancing Strategy Guidelines: In addition to the five principles I've articulated in this Budget Message, the City Manager is directed to use the familiar FY 2019-2020 Budget Balancing Strategy Guidelines as detailed in Appendix A to develop a balanced budget for the fiscal year ahead.

I respectfully request the support of my colleagues for this March Budget Message. This memorandum has been coordinated with the City Manager and City Attorney.

For more information on this memorandum, please contact Nicholas Almeida, Budget Director, at 408-535-4811.

ATTACHMENTS

Appendix A – FY 2019-2020 Budget Balancing Strategy Guidelines

APPENDIX A

2019-2020 Budget Balancing Strategy Guidelines

1. Develop a budget that balances the City's delivery of the most essential services to the community with the resources available. Consider current needs in the context of long-term service delivery priorities.
2. Balance ongoing expenditures with ongoing revenues to maximize service delivery within existing resources, to ensure no negative impact on future budgets, and to maintain the City's high standards of fiscal integrity and financial management.
3. To the extent possible, establish a Future Deficit Reserve in the General Fund to cover any projected budgetary shortfall in the following year as a stopgap measure.
4. When bringing forward any position reductions, make every effort to eliminate vacant positions rather than filled positions, if operationally feasible, to minimize the number of employees displaced by reductions with the goal of no significant employee impacts.
5. Evaluate program-level budgets and determine if there are opportunities to shift resources or reconfigure operations to close service delivery gaps, generate new revenues, address truly significant community or organizational risks, fund programs added on a one-time basis in 2018-2019, and/or respond to City Council direction and organizational risks. Factor in performance measure data in the development of proposals.
6. Focus on business process redesign to improve employee productivity and the quality, flexibility, and cost-effectiveness of service delivery (e.g., streamlining, simplifying, reorganizing functions, and reallocating resources).
7. Explore alternative service delivery models (e.g., partnerships with non-profit, public, or private sector for out- or in-sourcing services) to ensure no service overlap, reduce and/or share costs, and use City resources more efficiently and effectively.
8. Identify City policy changes that would enable/facilitate service delivery changes or other budget balancing strategies.
9. Analyze non-personal/equipment/other costs, including contractual services, for cost savings opportunities. Contracts should be evaluated for their necessity to support City operations and to identify negotiation options to lower costs.
10. Explore expanding existing revenue sources and/or adding new revenue sources.
11. Establish a fees, charges and rates structure designed to fully recover operating costs, while considering the impacts on fee and rate payers, and explore opportunities to establish new fees and charges for services, where appropriate.
12. Focus any available one-time resources on investments that 1) address the City's unmet or deferred infrastructure needs; 2) leverage resources to or improve efficiency/effectiveness through technology and equipment or other one-time additions; 3) continue high-priority programs funded on a one-time basis in 2018-2019 for which ongoing funding is not available; and/or 4) increase budget stabilization reserves to address future budget uncertainty.
13. Engage employees in department budget proposal idea development.
14. Continue a community-based budget process where the City's residents and businesses are educated and engaged, as well as have the opportunity to provide feedback regarding the City's annual budget.
15. Use the General Plan as a primary long-term fiscal planning tool and link ability to provide City services to development policy decisions.

SAN JOSÉ - UNFUNDED PENSION LIABILITIES
A GROWING CONCERN

2018-2019 Civil Grand Jury
of Santa Clara County

June 19, 2019

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GLOSSARY AND ABBREVIATIONS

Benchmark	A set of data that is used as a measure of comparison against another set of data
BPS	Basis points - 100th of one percent (1/100 of 1%; 0.01%)
CAFR	Comprehensive Annual Financial Report
CEO	Chief Executive Office
CIO	Chief Investment Officer
City	City of San José
City Council	City of San José City Council
COLA	Cost of living adjustment
COLI	Cost of living index
Discount Rate	The assumed rate of return on pension plan assets that an actuary uses to determine employer and employee annual contribution to a plan in order to meet City's future obligations to its pensioners.
Federated	San José Federated City Employees' Retirement System
General Fund	The primary operating fund used to account for all the revenues and expenditures of the City that are not related to special or capital funds. Most day-to-day operations, including any shortfalls in the pension plans, are paid out of the General Fund.
K	Thousand (e.g., $5K is 5 thousand dollars)
LAFPP	Los Angeles Fire and Police Pensions
LACERS	Los Angeles City Employees' Retirement System
LACERA	Los Angeles County Employees Retirement Association
Mature	A mature pension plan is one in which there are an equal number or more retiree beneficiaries than active employees paying into the plan.
ORS	San José Office of Retirement Services

Pension plan/fund	Pension plans/funds are an employment benefit designed to provide employees with a source of income during their retirement years. The terms fund and plan are used inter-changeably in this report.
Percentile/Centile	A number that represents a percentage position in a list of data. For example, if the performance of an entity is at the 43rd percentile, then it performs better than 42 percent of all entities within its group.
Police and Fire	San José Police and Fire Department Retirement Plan
Plans	Both the Federated and Police and Fire Plans, collectively
Policy Benchmark	A standard designed to gauge the performance of a pension plan, investment manager, asset or other financial entity. It is calculated as the weighted average of returns of multiple indices selected to represent the asset classes and allocation percentages of, in the case of this report, a pension fund.
Quartile	One of the three points that divide a range of data or population into four equal parts. The first quartile (also called the lower quartile) is the number below which lies 25% of the bottom data. The second quartile (the median) divides the range in the middle and has 50% of the data below it. The third quartile (also called the upper quartile) has 75% of the data below it and the top 25% of the data above it.
Sharpe ratio	This is a measure that provides the average return of an asset minus the risk-free return of that asset divided by the standard deviation of the return on that asset. In other words, the ratio indicates how much excess return received for the extra volatility you experience for holding an asset with relatively higher risk.
SIEPR	Stanford Institute for Economic Policy Research
Standard Deviation	A measure of the historical volatility of an asset. For example, the higher the standard deviation the more volatile the asset.
Trailing returns	Returns for past specific periods
UAL	Unfunded accrued/actuarial liabilities are the calculated cost of promised benefits that is greater than the current value of a fund's assets.

SUMMARY

It has been recently reported that the City of San José's share of pension costs in fiscal year 2019 spiraled to nearly 28% of the General Fund, at approximately $335 million, and are estimated to continue to climb. This $335 million from the General Fund, which is the primary operating fund used to account for all the revenues and expenditures of the City of San José (City) that are not related to special or capital funds, would otherwise have been available for essential City services such as police and fire, street repairs, parks and libraries.

The City's two pension plans will need to distribute $4.3 billion to retirees between 2020 and 2029 according to the San José Office of Retirement Services (ORS). As originally conceived, these pension plans were supposed to be self-sufficient, without requiring annual cash infusions from the City's General Fund. The ORS estimates that the pension funds will pay out $1.3 billion between 2020 and 2029. This means that the City will have to provide at least $3 billion over the same timeframe.

The reasons for the pension plans' shortfalls include: (1) insufficient employer/employee contributions; (2) investment earnings that have fallen short of expectations; (3) annual mandatory retiree COLAs; and (4) high overhead. Verus Investments, a consultant to ORS, has estimated that for FY2020, the portion of the General Fund used for pension costs will increase to approximately 31%.

If changes are not made to the way in which the public pension plans are funded and managed, the City will likely be forced to continually increase its share of the required cash payouts and liabilities.

The City, Federated and the Police and Fire pension plans and the bargaining units are urged to find common ground on which to create strategies that will enable the City to reduce its annual cash obligations to cover the underfunding for the pension plans so that the City may deliver necessary services to its residents.

BACKGROUND

A pension plan is a benefit funded by an employer on behalf of its employees. Pension plans are designed to provide employees with a source of income for the remainder of their lives once they retire and meet certain criteria, such as length of time with that employer. Employees typically contribute a percentage of their pay into the plan as well. The San José Police and Fire Retirement Plan (Police and Fire) and the Federated City Employees' Retirement System (Federated) are examples of pension plans. These plans are "defined benefit plans" wherein the level of payments is set at the time of retirement and does not change based on the plan's investment performance. Almost all San José City employees are covered by one of these plans. In this report, the terms plan and fund are used inter-changeably, as in pension fund or pension plan.

As of June 30, 2018, among the 39 public pension plans in the state of California surveyed by Cheiron, the actuarial consultant contracted by each of the San José pension plans, Federated had the lowest funded status of all 39 plans. Its 50% unfunded actuarial liability (UAL) means it currently has half the assets necessary to meet the future obligations to its pensioners. Police and Fire, with stronger investment returns and higher City contributions, is better positioned for its future obligations, being funded at 74%. Table 1 below presents market value and actuarial liability for both Plans as of June 30, 2018.

Table 1 - Pension Fund Assets FY18

Plan/Fund	Market Value	Actuarial Liability
Federated Plan	$2.1 billion	$4.1 billion
Police and Fire Plan	$3.5 billion	$4.7 billion
Total	$5.6 billion	$8.8 billion

For fiscal year (FY) 2019, retirement costs will require a $334.7 million contribution from the General Fund, an increase of $15.6 million from the FY2018 contribution of $319.1 million. The FY2019 costs represent 27.8% of the total General Fund base expenditure budget with committed additions and reflect the Federated Retirement System and Police and Fire Department Retirement Boards' approved economic and demographic assumptions. The forecast for the City's FY2020 retirement contribution is $352 million, representing a 5% increase over its FY2019 contribution.

Many public and private organizations have changed from pension plans to 401(k) defined contribution plans. The primary reason for the change is that many of those pension plans have become increasingly burdensome to the organization due to underfunding. That is, the amount of funds paid into a plan and the amount of income generated by the assets are insufficient to cover the long-term costs. That shortfall necessitates the need for employers to cover those obligations through such mechanisms as borrowing, which also increases costs due to interest payments. In the case of San José, shortfalls are covered by using General Fund monies.

Police and Fire and Federated plans are governed by two separate boards of administration as authorized by Chapter 3 of the Santa Clara County Ordinance Code[1]. These two Boards are comprised of current employee plan members, plan member retirees and appointed members of the public from the financial and investment industry.

Police and Fire is a defined benefit retirement plan operating under the Municipal Code Chapter 3.32 and is managed and administered by the Police and Fire Board. The duties of the Board include administration and investment of funds, and retirement requests, membership and benefits. The Board has the authority to administer the Plans and to enter into agreements on behalf of the City for Plan administration. Board meetings are held monthly, except for July, at the San José City Hall.

The Police and Fire Board consists of nine members who serve four-year terms. Board members include one employee each from the Fire Department and Police Department and one each from their respective retired members. The active and retiree members are elected by their membership. In addition, four members of the public are appointed by the City of San José City Council (City Council) and one public member is selected by the Board. Public members must live within 50 miles of the San José City Hall and have a degree in finance, actuarial science, law, economics, business or other related field from an accredited university. Public members must also have at least twelve years of relevant experience.

Federated is a defined benefit retirement plan operating under the San José Municipal Code Chapter 3.28. Federated operates in much the same way as Police and Fire. The Federated Board consists of seven members, each of whom serves a four-year term. Board membership includes two employee members, who are members of two of the eleven labor unions, each of them from a different City department. One board member must be a retiree member of Federated. Three members are appointed from the general public by the City Council. One public member is selected by the Board.

Measure G amended the City Charter in regards to governance of the retirement Boards. The measure allowed the City Council to establish one or more retirement Boards, specified the hiring authority of the retirement services chief executive, excluded certain future retirement services employees from the classified civil service and established the process for setting stipends paid to non-employee retirement board members.[2]

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[1] Chapter 3.28.100 - 1975 Federated Employees Retirement Plan

[2] ("City of San Jose Retirement Board Governance, Measure G," 2014)

The San José Office of Retirement Services (ORS) administers both the Police and Fire Plan (and fund) and the Federated Plan (and funds) on behalf of the two Boards. In November 2016, following the passage of Measure G, the Boards were given direct authority to hire and appoint a Chief Executive Officer (CEO) and a Chief Investment Officer (CIO) who report directly to the two Boards. There are approximately 13,400 active, vested-but-not-receiving-benefits, retired and survivor participants who are served by the ORS.

The 2011–2012 Santa Clara County Civil Grand Jury likewise concluded that mounting retirement obligations were a direct cause of the need to scale back government services. In a 2012 report on the pension systems of the county and all the cities and towns therein, the Grand Jury asserted:

> "The [2011-2012] Grand Jury concludes that until significant modifications are enacted, there is no doubt that the escalating cost of providing Benefits at the current level is interfering with the delivery of essential City services and the ultimate cost to the taxpayers is an unbearable burden. These costs are already impacting delivery of essential services such as demonstrated by San José reducing police and fire department staffing levels, closing libraries or not opening those newly built, curtailing hours of community centers, and not repairing pot-holed city streets."[3]

The 2018-2019 Civil Grand Jury (Grand Jury) finds this situation continues today.

[3] (2011-2012, 2012, p. 25)

METHODOLOGY

The Grand Jury began an investigation of the San José Police and Fire Retirement Plan and the Federated City Employees' Retirement System on November 6, 2018. The investigation focused on the structure of the two Boards and the ORS. The Grand Jury considered the efficiency and effectiveness of their administrative duties, investment profile of the underfunded pensions, along with the challenges these issues bring to members and taxpayers.

The Grand Jury also investigated public pension funding of other public entities' plans.

The Grand Jury conducted visits to San José City Hall, Stanford University Law School, Stanford University Institute for Economic Policy Research (SIEPR), the ORS, and San José Pension Fund workshops hosted by the City.

Fifteen interviews were conducted with twelve individuals. Interviewees included members of the San José City Council, employees of the ORS, Board members of the two San José pension funds, and an out of state pension fund manager. Interviews also included attorneys who advise on public policy and/or represent pension fund trustees and investors of a few of the largest national pension funds.

The Grand Jury attempted to obtain the perspective of the membership of the bargaining units and so invited representatives of the 11 unions whose members participate in the Plans to appear before the Grand Jury. The Grand Jury is disappointed that the bargaining units chose not to avail themselves of the opportunity. It was a missed opportunity for the membership of those units to provide valuable insight into how they view the serious issues confronting the pension funds and the City.

Reports specific to San José pensions were reviewed including the 2011-2012 Grand Jury reports and responses. The San José Municipal Code, Chapter 2, Parts 10 and 12, Section 2.08.1200 and Section 2.08.1000 were studied. Measure G of the City of San José was reviewed. A study of the San José public pension plans that was conducted by the SIEPR was reviewed and is referenced in this report. Other resources are listed in the Reference section of this report. Other sources of data include a significant amount of City and ORS information that was obtained from their websites.

The Grand Jury reviewed retirement plans and fund data for Los Angeles County, City of Los Angeles, Atlanta, Illinois Public Safety Officers, New York City, Palm Beach, Austin, Orange County Cities, New Jersey Public Safety Officers, the State of Nevada, among others, and a report from the California Policy Center by Robert Fellner of April 25, 2014.[4] The Grand Jury looked in-depth at the board structures of both the City and County of Los Angeles. Information from the California Policy Center was reviewed. Pension plan specifics for San José, the City of Los Angeles[5] and the County of Los Angeles[6] have in some cases been taken directly from their websites.

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[4] Fellner, R. (2014). Evaluating Public Safety Pensions in California. Retrieved from California Policy Center website: https://californiapolicycenter.org/evaluating-public-safety-pensions-in-california/

[5] (LACERS, 2019)

[6] (LACERA, 2019)

DISCUSSION

San José ORS: Organization, Budget and Operations

The ORS currently reports to the two separate pension fund Boards. The ORS CEO oversees the general activities of all the services that the ORS provides including its budget for services that ranges from $10 to $12 million per year (see Table 2 below comparing FY19 and FY20 costs). The CEO and CIO are City employees and report to both Boards.

Table 2 - Office of Retirement Services Administrative Costs, 2018-2020

Expense Category	2018-2019 Adopted (A)	2018-2019 Forecast (B)	2019-2020 Proposed (C)	% Increase (Decrease) (A to C)	% Increase (Decrease) (B to C)
Personnel Services	$7,118,000	$6,201,733	$7,387,000	3.8%	19.1%
Non-personnel / Equipment	$2,624,000	$2,283,328	$2,816,000	7.3%	23.3%
Professional Services	$1,878,000	$1,413,270	$1,607,000	(14.4%)	13.7%
Medical Services	$438,000	$336,270	$355,000	(18.9%)	5.6%
TOTAL	**$12,058,000**	**$10,234,601**	**$12,165,000**	**0.9%**	**18.9%**

The CIO receives direction from both the CEO of ORS and the Board. The CIO is responsible for recommending investment policies and strategies to the Boards for both Police and Fire and Federated.

Both Plans earned negative returns in 2015 and 2016. Based in part on these poor returns, in March of 2017, the Mayor of San José requested and the City Council approved a review of the investment portfolios of the City's retirement plans by the City Auditor.[7] The City Auditor selected the SIEPR to conduct the analysis.

On October 12, 2017, the City Auditor (Auditor) published a report on the ORS' administrative and investment operations.[8] The Auditor found that the costs for administering these plans, from an operations standpoint, ranked in the middle and not significantly higher or lower than the peer benchmark jurisdictions assessed.

The SIEPR report[9], published on November 20, 2017, noted that using 2016 data, the San José Plans underperformed peer plans in net returns, although in terms of risk-adjusted return (Sharpe

[7] (Diamond, 2017)
[8] (Erickson, 2017a)
[9] (Nation, Tulloch, & Lipshitz, 2017)

Ratio), Police and Fire was ranked 5 and Federated was 8 out of 10 peers. The ORS later responded that 1-year data was inadequate to draw meaningful conclusions.

The SIEPR report also focused on the ineffectiveness of the prior investment management team, citing the investment funds selected and the generally high expenses associated with such management. Figures 13 and 14 on pages 22 and 23 of the report demonstrate that the total expenses of the San José Plans had increased from 2014 forward. The increased costs have placed San José among the costliest of managed plans among the peer group that SIEPR selected.[10] The report also cited the high number of investment staff for the San José Plans compared to peers.

The City of San José did not concur with those observations, arguing that circumstances warranted the costs. The City cited the pension portfolio's diversity of complex investments and the administrative effort required to manage that portfolio. In addition, the ORS took the position that San José pension administration overhead included staffing costs that peer groups did not report.

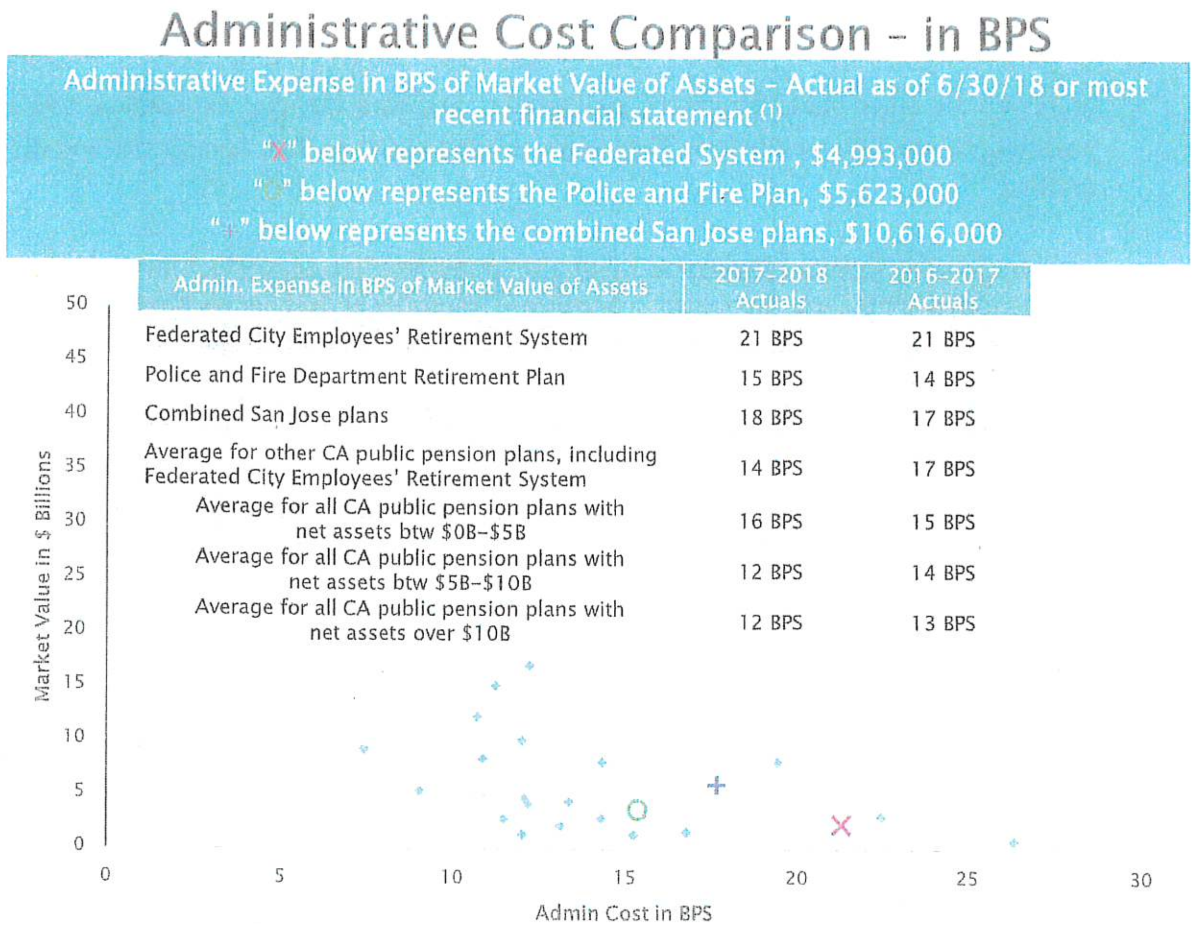
Board Structure and Expenses

Measure G, approved by the voters in November 2016, authorizes the establishment of one or more retirement boards to administer the retirement plans. A subsequent analysis by the City Attorney found that the City Council has the authority to establish "one" or "more" retirement boards.[11]

The Grand Jury reviewed the administration of the ORS in its relationship to the Boards in order to determine if there were improvements and/or cost benefits that could be achieved. The Grand Jury also reviewed the profiles of members of the Boards, and compared the member qualifications and experiences to other boards overseeing public pension funds in other jurisdictions.

In terms of administrative costs, Federated costs are the one of highest among all classes of public pension plans in California. California public pension plans, with net assets under $5 billion, had an average of $4.1 million in administrative costs. Both San José Plans have administrative costs in excess of this average.[12] Refer to Table 1 for the net asset values for the Plans and to Figure 1 that presents the San José funds' administrative costs in Basis Points (BPS) relative to other California public pension plans. Basis points (BPS) are used chiefly in expressing differences in interest rates and investment fees.

[10] (Nation et al., 2017, p. 24)
[11] (Erickson, 2017a)
[12] (Peña, 2019)



[1] *Retirement Services gathered and compiled most recent financial information from 23 public pension plans' CAFRs*

Figure 1 - Administrative Cost Comparison for Police and Fire, and Federated[13]

The Nevada Public Employees Retirement System presents an example of a pension fund that is managed cost efficiently with above-average returns. In an article in the Wall Street Journal titled, "What does Nevada's $35 Billion Fund Manager Do All Day? - Nothing", the author describes the Nevada pension fund as focused on minimizing investment fees and administrative overhead by investing pension assets into low cost passive index funds.[14] As of March 2019, the Nevada Public Employees Retirement System had assets with a market value of over $45 billion with 85% invested in low cost index funds managed by only 10 investment managers. By contrast, the City of San José's two pension plans with assets slightly above $6 billion utilize more than 70 investment managers and have less than 50% of assets in a passive index strategy. With investment fees about one-seventh the average public pension, the Nevada Public Employees Retirement System provides a compelling strategy of reducing investment costs to increase investment returns.

[13] (Peña, 2019)

[14] (Martin, 2016)

Examples of Board Structures, Member Profiles and Experience

In review of other board structures and profiles of board member experience, two relevant jurisdictions are discussed below. They were selected based on their complexity and diversified profiles.

The Los Angeles County Employees' Retirement Association (LACERA), for example, has safety and non-safety employees combined in one plan. The profile of the board is broad and diverse with the labor representatives including a public defender, retired sheriff, county assistant treasurer, deputy head of tax collection and assistant chief counsel. The public representatives include a real estate developer, two attorneys, an underwriter, the Chief Financial Officer of the Los Angeles County Department of Public Works Building and Safety, and a pension plan consultant. Safety and general employee members are represented together under one board of directors, however, there is a separate "Board of Retirement" and "Board of Investments" providing oversight for these plans.[15]

The LACERA "Board of Retirement" is responsible for the administration of the retirement system, the retiree healthcare program and review and processing of disability retirement applications. The board is composed of eleven members: six members are elected; two are active general members; two are retired members; and two are safety members. Four of its members are appointed by the Los Angeles County Board of Supervisors. The law requires the County Treasurer and Tax Collector to serve as ex-officio and alternate ex-officio members.

The LACERA "Board of Investments" is responsible for establishing the investment policy and objectives, as well as exercising authority and control over the investment management of the Plan. The Board is composed of nine members. Four members are elected: two are elected by active general members; retired members elect one member; and safety members elect one member. Four of its members are appointed by the Los Angeles County Board of Supervisors. The same law applies regarding the Tax Collector and Treasurer of the County. There is some overlap of individuals who serve on both boards.

The Los Angeles City Employees' Retirement System, (LACERS) [16] is a department of the City of Los Angeles, established by City Charter in 1937, to provide retirement benefits to the civilian employees of the City of Los Angeles, representing three-fifths of the city's workforce. The Los Angeles city profile is different than the county boards in that the City of Los Angeles has three separate groupings of labor members. In addition to the civilian employees noted above, the

[15] LACERA Los Angeles County Website: https://www.lacera.com/home/index.html
[16] LACERS website: https://lacers.org/aboutlacers/about-us.html

remaining two-fifths of the city workforce has retirement benefits through the Department of Water and Power Employees Retirement System, or the Los Angeles Police and Fire System.

Currently LACERS provides services to 24,000 active employees, and provides benefits to nearly 17,500 retirees and their beneficiaries. LACERS administers the benefits approved by the City of Los Angeles, the "plan sponsor", and includes pension benefits, administration of retiree health care premiums, and management of the pension fund portfolio to offset payment of these obligations.[17]

The Board of Fire and Police Pension Commissioners administers the Los Angeles Fire and Police Pensions (LAFPP) System in accordance with the City Charter, the City Administrative Code and the State Constitution. The Board consists of nine commissioners – five appointed by the Mayor of Los Angeles and confirmed by the City Council, and four elected by members. The five appointed members include a doctor of medicine, attorney, philanthropist and two investment managers. The diversity of the Public Board members for Los Angeles' three plans has a similar makeup to that of Los Angeles County, where it is not all comprised of investment financial professionals.

In reviewing the composition of each of the San José Boards of Administration the expertise of the members is heavily weighted toward investment professionals. Other more successful pension funds, such as LACERS, have boards that have a much wider range of expertise.

Oversight of the San José ORS' CEO and CIO

The Grand Jury discovered that the CEO and CIO of the ORS do not have an annual performance review that included predetermined measurable goals. The Grand Jury did not find evidence that the Boards evaluate performance based on metrics other than periodic evaluation of investment portfolios, although the Grand Jury learned that the need to determine metrics has been discussed.

Because the CEO and CIO of ORS report to two different boards, their efficiency and measurement of effectiveness is difficult to assess without established and measurable goals. For example, the complexity of Police and Fire benefit requirements and the financial difficulties of Federated may cause ORS to focus on varied priorities simultaneously.

The joint council personnel committee[18] of the Boards conducts performance evaluations. The Grand Jury found that there is currently no measurement of work effectiveness or performance of ORS personnel. A robust measurement of ORS staff might expose the inefficiencies caused by

[17] https://www.lacers.org/aboutlacers/about-us.html
[18] A committee consisting of members from each Board.

any duplication of efforts in serving two entities. Without such an analysis the City, Board and ORS are unable to address these management issues.

Consideration for Improving Effectiveness of the Boards

Both Boards appear to be strong and understand their fiduciary responsibilities. Members generally were found to be both engaged and comprehend the issues required to making informed decisions. The Grand Jury was advised that the Police and Fire Board tends to manage much more complex pension issues. As confirmation of this, on a statewide basis in California, Police and Fire employees make up 15% of California's total state and local government workforce but represent 25% of pension costs with different benefit needs.[19]

The Grand Jury discovered that the ORS administration and investment team members are subjected to unnecessary duplication of efforts. This duplication increases the amount of time spent on administration of activities, board meeting preparation and attendance, workshops and related work effort. The Grand Jury found that members of ORS participate in nearly three times the number of meetings than peer jurisdictions of similar size. In some instances, there are conflicts of priority that go along with a duplication of efforts resulting in less time being spent on value-added duties.

The Grand Jury learned that the City of San José has periodically considered the benefit of combining the two Boards partly for reasons described above, and there is currently a willingness from some interviewees to combine the Federated and Police and Fire Boards. The combining of the two boards would reduce redundancy and provide more time to focus on investment performance and serving the members.

There are already certain committees that report to both Boards, whose recommendations and actions are for both member populations, therefore suggesting that one board could serve all members of both Plans. Any such change should ensure that member representation on the Board not be diluted nor that they lose visibility.

Other pension plan boards have benefited from a broad range of backgrounds beyond an investment focus. San José should consider the benefits of this improvement in its public members.

[19] Fellner, R. (2014). Evaluating Public Safety Pensions in California. Retrieved from California Policy Center website: https://californiapolicycenter.org/evaluating-public-safety-pensions-in-california/(Fellner, 2014)

Other Areas of Possible Cost Reductions

Pension Plan Investment Management Fees

For calendar year 2017, the combined investment fees paid by Federated and Police and Fire exceeded $70 million.[20]

Management fees are fees charged by fund managers to invest and manage assets. Incentive fees are performance-based fees. That is, fees are based on the ability of the fund manager to meet or exceed an agreed upon level of return and are only applicable to certain types of investments. Operating expenses include overhead related to managing a fund; these expenses are indirectly borne by investors, and include professional, administration, research, tax, legal, custodial and audit expenses for a fund. Trading expenses such as broker commissions are not included in this discussion of fees. Other expenses excluded are institutional services such as custodial services (State Street Bank) and the cost of plan consultants who include the general investment consultant (Meketa Investment Group), the risk consultant (Verus Investments) and the absolute return consultant (Albourne America).

According to information received from ORS, for fiscal year 2017, the three plan consultants received total payments of approximately $1.5 million, broken down as follows: Meketa Investment Group Investment Group received $608K; Albourne America received $480K; and Verus Investments received $299K.

The Mayor and City Council have become more keenly focused on the impact of investment fees on investment performance. In the Mayor's budget message of March 9, 2019, he devoted a significant portion of his message to retirement contribution liabilities and the impact of underperforming assets in the pension funds.[21]

In this budget message, the Mayor stated, "Also troubling has been the tendency for the boards and Retirement Services staff to favor investment in high-fee, management-intensive alternative investments such as private equity, real assets, private debt, and hedge funds. Academics have long speculated about the likelihood of a widespread bias in the industry to prefer higher fee [these can include "carried interest" that is profit sharing between plans and managers] active investment approaches despite the evidence of inferior outcomes, perhaps because decision-makers tend to share the same education, career paths, and social circles as those directing actively managed funds. I've expressed concerns repeatedly in the past, however, that existing strategies maximize financial benefit to asset managers, at the cost to the City and our plan members."[21]

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[20] (Peña, 2017)
[21] (Liccardo, 2019)

Per the Plan's actuarial consultant, Cheiron, for every $1 million reduction in investment fees, the City contributions would decrease by approximately $20,000.

The Federated and Police and Fire Plans' overall expense ratio, sum of management, incentive and administrative fees, of 1.29% (129 basis points) is driven primarily by the higher fees associated with alternate investments. This fact is supported by the CEO's preliminary report on investment fee analysis dated March 12, 2019[22], that reveals multiple hedge investments in its global equity, private equity, real estate and absolute return allocations with expense ratios ranging from 3.29% to 5.35% (329 to 535 basis points).

The Impact of COLAs on Pension Liabilities

The growth in the City's unfunded liabilities has many causes, including the financial downturn after 2008. But the primary cause is a massive increase in retirement benefits. The 3% cost-of-living adjustments (COLA) awarded to all Tier 1 San José employees when they retire and all current Tier 1 retirees who retire after April 1, 2006 is one such generous benefit. Note that Tier 1 refers to retired and active plan members hired prior to the passage of Measure G. Tier 2 are all other employees.[23]

San José Tier 1 retiree plans include a mandated 3% COLA that compounds annually. Tier 2 employee plans support a COLA based on cost of living index values for the preceding year but cap at a maximum of 2%.

Based on estimated pension payouts and the mandated annual COLA increases, San José retirement plans in the next 10 years will need to payout approximately $4.3 billion, of which $1.8 billion is needed for Police and Fire retirees and the remainder for Federated retirees. ORS has estimated that the City will cover $3.0 billion of this expense and the retirement plans must cover the rest ($1.3 billion). To-date, the City has transferred over $30 million per year to cover retiree COLA expenses and will need to continue to do so; retiree COLA payouts are estimated to increase through at least year 2034. The Grand Jury has evaluated and annualized current City contributions including COLA payments, and determined the estimate of the City's contribution to be closer to $3.4 billion for the 10-year commitment.

A basic shortfall results as the City continues to contribute additional funds to cover costs and amortization of the unfunded liabilities. These sums are large and, as noted above, take funding away from other essential and desired services the City otherwise could provide its citizens.

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[22] "March Budget Message for Fiscal Year 2019-2020" memorandum from Mayor Liccardo to City Council, March 8, 2019, page 11

[23] Per San José Municipal Code sections 3.44.160 and 3.28.1910

To put part of the shortfall in context, a retiree's pension will double in 24 years when the guaranteed 3% COLA is applied (e.g., with an initial pension of $50K, payments in year 24 would equal $100K and in year 30, the same initial pension of $50K would payout $119.4K and so forth). See Table 2 below. These payout rates mean that the City and retirement plans must find increasing funds to cover the mandated pension obligations.

Table 2 - Pension Growth Based on COLAs

Pension at Retirement	COLA	Pension Pay Out at Year			Notes
		24	30	36	
$50,000	3%	$100,000	$119,400	$142,580	
$85,000	3%	$170,000	$202,990	$242,380	
$100,000	3%	$200,000	$238,810	$285,150	
$100,000	2%	-	-	$200,000	For comparison

Since 2009, at least 29 states have attempted to pare pension costs by reducing, suspending or eliminating post-employment COLAs, and some have implemented various mechanisms to help reduce the unfunded liability risk. Many of the COLA changes have taken place in states that had guaranteed a fixed percentage pension COLA, regardless of inflation. The financial pressures of the Great Recession of 2008, combined with a relatively low-inflation environment, made reducing or eliminating these guaranteed rates, or shifting to a different type of formula, attractive to states such as Colorado, Hawaii, Florida, Kansas, Illinois, Minnesota, Montana, New Mexico, Ohio and South Dakota.[24]

During this same period some states, including Kentucky, Minnesota, Montana, New Jersey and Wyoming, tied their COLAs to pension plan funding levels, while others, such as Colorado, tied COLAs to investment performance. Other types of cuts have involved skipping or delaying COLAs so that they apply only after a worker has been retired for a certain length of time or reached a certain age. Some states, including Rhode Island and Louisiana, have developed complex COLA arrangements that combine several of these features. Many state and local government pension COLA approaches fluctuate with inflation, based on consumer price indices (CPIs) published by the U.S. Bureau of Labor Statistics. These approaches are worthy of consideration. See also National Association of State Retirement Administrators (NASRA) 2018 papers on this subject with each state's current adjustments outlined in some detail.[25]

Illinois defined a 3-part pension solution of which an optional COLA buy-out was provided. In this program, Tier 1 members (that is, the older members who still have guaranteed 3% compounding cost-of-living adjustments) can accept a reduction in their COLA from 3% to 1.5%

[24] (Petrini, 2015)
[25] (NASRA, 2018)

in exchange for a lump sum benefit of 70% of the present value of the amount of future COLA reduction. This is projected to save the state $381.9 million of their $203 billion unfunded liability. Other states have delayed COLA payments for a time after retirement or until a certain age is achieved.

The Grand Jury acknowledges that reducing any part of an agreed upon pension benefit is complex, requires careful legal review and must thoroughly consider the impact on retirees, and active members who will retire in the future. However, there is room to develop creative and supportive solutions that address the ever-growing liability associated with pension costs.

An Example of How One County is Solving its Pension Liability Problems

Other public pension plans are continuing to address existing and growing unfunded liabilities. One example that bears consideration by San José is San Mateo County. San Mateo County pension plans support about 12,000 employees, retirees and vested-but-not-receiving-benefits members, which is comparable to San José's 10,600 members. San Mateo County has actively reduced its discount rate as has San José; San Mateo reduced those rates from 8.0% in 2004 to 6.75% in fiscal year 2018. Finally, San Mateo is an independently managed pension plan as is San José; neither is part of CalPERS.

Where San Mateo County and San José differ is in employee contribution rates and pension plan actual returns. San Mateo County employees contribute 13% (pro rata) to their pensions and the County's pension plan actual returns averaged 9.2% over the last five years, significantly higher than San José's. Although there are differences between San José and San Mateo County pension plan attributes, some of the County's approaches are worthy of consideration.

Among other solutions designed to address the growing UAL, San Mateo County in 2012-2013 decided to make payments over and above the annual required contribution, or supplemental payments, towards reducing the unfunded liability to zero within 10 years. They are on track to accomplish this goal. The benefits of these supplemental payments include:

a. Reducing current interest payments on the unfunded liability balance - San Mateo County expects to save almost 40% of its UAL in reduced interest costs over the 10-year time period; and
b. Reducing ongoing principal and interest costs in the years following when the UAL is fully paid off - San Mateo County estimates this to be about 14% of its costs.

San Mateo County and the Grand Jury acknowledge that this program is not without risk. Economic factors can lead to reduced revenues and hence limit the ability to make supplemental payments. Rates of return and asset allocations need to be managed to ensure effective returns.

However, an engaged and proactive administration and oversight team should be able to manage such challenges.

Pension Plans' Performance

The Grand Jury examined the investment performance of the San José Plans. The SIEPR report showed that the San José Plans were mature -- with more retirees and beneficiaries than the active members. To be self-sustaining pension plans generally need a ratio of active members to retirees of 2.0 or greater. The Grand Jury noted that at the end of FY18, the ratio of retiree/beneficiaries to active members in Federated was 1.19, and 1.37 in Police and Fire. This is a similar ratio to the 2016 numbers published in the SIEPR report. The ORS explained that maturity was the main reason for the San José Plans to take more risk-averse investment strategies and thus accept lower returns.

The Grand Jury used the annualized returns to examine the performance of the San José Plans. The data was obtained from the pension performance reports as of June 30, 2018.[26] The average annualized returns of the trailing 1-, 3-, 5-, and 10-year periods are presented in Appendix A together with the returns of the InvestorForce[27] Public defined benefit plan peers having assets of more than $1 billion.

The data shows that over the last 10 years, the San José Plans' returns were consistently lower than 99% of its peers. Police and Fire did slightly better in 2018, at 91% lower than its peers. Over the last 10 years, the investment policy benchmarks generally ranked in the lowest quartile, reflecting the risk-averse approach of plan investment. The data also show that the San José Plans consistently underperform their investment policy benchmarks. This indicates that the active management of funds did not serve its purpose of outperforming the market.

The Grand Jury found that the concern about actively managed portfolios to be a common issue. For example, the State of Pennsylvania Public Pension Management and Asset Investment Review Commission conducted a review of its two largest public pension plans, for public school employees and state employees. In 2018, the Commission made its final report[28], recommending "moving to fully index all public market investments in both equities and fixed income at both retirement systems". It stated that the Commission heard compelling evidence demonstrating that active management of public securities underperforms, net of costs, in all sectors over the long term when compared to the appropriate risk adjusted index benchmark, and that there is no

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[26] Meketa. (2018). San José Federated City Employees' Retirement System Quarterly Review June 30, 2018. Retrieved from https://www.sjretirement.com/Uploads/Fed/2Q18%20SJFED%20Review_Revised%2006.30.2018.pdf

[27] InvestorForce is a company that does investment analytics and reporting solutions for the global investment industry. One data group is the public defined benefit plans, each of which has assets of more than $1B.

[28] (Tobash, 2018)

persistence of manager outperformance or reliable way to select outperforming managers in advance.

Because of the City's risk-averse approach, the Grand Jury also examined the investment performance using the risk-adjusted return (Sharpe Ratio) as a metric. The data are shown in Table 3 below.

Using the Sharpe Ratio, Police and Fire performance ranking improved, especially in the last five years, moving out of the last quartile of the peers. Federated performance ranking stayed in the bottom 10%. Both plans still underperform their policy benchmark. The benchmark selection appeared to have improved in the last 3 years, with benchmark performance ranking in the second and third quartiles among peers.

The effect of the lower than benchmark performance may be illustrated by looking at Federated's 2018 returns. At the 5.9% net return rate, the investment income paid for 60% of the Federated retirees' pension benefit. Had the investment return been at the policy benchmark level of 7.4%, it would have been able to pay for 75% of the retiree benefits. In addition, by following the public market index funds, the reduced investment manager fees further help the City reduce the unfunded liability, which Federated needs to be funded at 51% as of June 30, 2018.

Table 3 - Risk-Adjusted Return (Sharpe Ratio) Performance

Sharpe Ratio	Police and Fire Department Retirement Plan				Federated City Employees Retirement System			
	Trailing 1 year	Trailing 3-year	Trailing 5-year	Trailing 10-year	Trailing 1 year	Trailing 3-year	Trailing 5-year	Trailing 10-year
Total Fund % (percentile)	1.4 (63rd)	1.0 (54th)	1.1 (78th)	0.5 (96th)	1.2 (91st)	0.8 (94th)	1.0 (93rd)	0.4 (99th)
Policy Benchmark % (percentile)	1.4 (58th)	1.0 (40th)	1.2 (69th)	0.5 (75th)	1.5 (43rd)	0.9 (73rd)	1.0 (99th)	0.5 (91th)
Top 5% IFPDB Plans	2.3	1.5	1.7	0.8	2.3	1.5	1.7	0.8
25% IFPDB Plans	1.7	1.1	1.4	0.7	1.7	1.1	1.4	0.7
Median IFPDB Plans	1.5	1.0	1.2	0.6	1.5	1.0	1.2	0.6
75% IFPDB Plans	1.3	0.9	1.1	0.5	1.3	0.9	1.1	0.5
95% IFPDB Plans	1.1	0.8	1.0	0.5	1.1	0.8	1.0	0.5

The demographic maturity of the San José pension plans prompted the investment staff to take a more risk-averse approach to portfolio allocation and expected lower returns as a result. However, the lower investment return also requires the City and employees to contribute more to maintain unfunded liability. The Grand Jury appreciates the difficult situation the City is facing and wants to find ways to support the City. The following are observations from the Grand Jury's investigation that will hopefully trigger innovative ideas:

- CalPERS removed hedge funds from its portfolio in 2015 for its high fees and not having a significant material impact.[29]

- Over the last 10 years, Federated investment returns have always been lower than peer portfolios having similar or less standard deviation, as shown on pp. 48-49 of the pension performance report as of June 30, 2018 and reproduced in Table 3 of this report. Other

[29] Farmer, L. (2015). As Retirees Outnumber Employees, Pensions Seek Saviors. Retrieved from https://www.governing.com/topics/finance/gov-pension-hedge-funds-investments.html

city, county and state plans have achieved higher returns with lower risks; this should be investigated.[30]

- According to the Center for State and Local Government Excellence, most public pension plans have outperformed their blended portfolio benchmark over the long term.[31]

- Public pension plans that underperform their benchmarks more often pay higher fees across all major asset classes, particularly for such alternatives as private equity and hedge funds, as mentioned in reports from the Center for State and Local Government Excellence and the Boston College Center for Retirement Research.[32]

The Grand Jury suggests that the allocations to alternative asset classes should be reviewed to ensure that this is being done in the most optimal way.[33]

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[30] (Meketa, 2018)
[31] (Aubry & Crawford, 2018)
[32] (Cypen, 2018)
[33] (Erickson, 2017b)

CONCLUSIONS

The ORS estimates that, over the period of 2020 through 2029, the City of San José will need to pay between $3 billion and $3.3 billion dollars from the General Fund to cover pension obligations. For 2020, the estimated cost amount is 31% of the City budget, monies that would otherwise be available for essential City services.

Some of the factors contributing to the underfunding of the pension plans are:

- Unrealistic projections of investment earnings (the funds have continually earned less than projected and have earned far less than comparable pension funds);
- Insufficient contributions by both the employer (the City) and the employee members of the 11 bargaining units (two for Police and Fire and nine for Federated). The insufficient contributions were largely based on unrealistically high earnings projections;
- The mandatory 3% annual COLA for Tier 1 retirees that doubles retiree pensions in 24 years as compared to the CalPERS COLA of the actual cost of living index with a 2% cap; and
- Two independent Boards of Administration (one board for Police and Fire and a second for Federated) result in duplication of management structures, redundant outside contractors and consultants fees and costs.

Among public pension plan peers, Federated has consistently been ranked at the bottom, while Police and Fire falls in the last 10^{th} percentile. The demographic maturity of the plans appears to have been the primary reason why portfolio allocations changed to more risk-averse investment options. In recent years, even controlling for risk adjustment, Federated's return (Sharpe Ratio) still ranks in the lowest 10%, while Police and Fire ranks in the 50-75 percentile.

The Grand Jury recommends that the City, the 11 bargaining units, the two Boards of Administration and the ORS work collaboratively to address these issues.

FINDINGS AND RECOMMENDATIONS

Finding 1

Moving the City of San José mature pension plan to a more risk-averse investment portfolio has contributed, in part, to poor investment returns.

Recommendation 1

The two Boards of Administration should conduct a comprehensive review of the investment portfolios that should be made public by June 30, 2020. The review should consider investment strategies used by other state and government pension organizations, particularly assessing portfolios of other pension plans with similar risk profiles that had higher returns.

Finding 2

The City of San José pension plans are overburdened with a large number of investment managers and excessive investment management fees.

Recommendation 2

The two Boards of Administration should study ways in which to reduce the number and the cost of investment managers and make their findings public by June 2020.

Finding 3

The City of San José's mandatory required contributions to pension plans are putting an ever-increasing burden on the City's General Fund, which impedes the ability of the City to provide essential services to its residents.

Recommendation 3

The City of San José should work collaboratively with the 11 bargaining units to find ways to reduce this burden and make the findings public no later than June 2020.

Finding 4

Maintaining two separate pension Boards has resulted in inefficiencies including duplication of various tasks and responsibilities.

Recommendation 4a

The City of San José should examine the current Board models, consider opportunities for streamlining, and identify areas of administrative cost reduction. This investigation should include evaluating one board for both plans but structured to prevent the proportional dilution of members' representation. This recommendation does not include the combining or commingling of plans funds. The results of these actions should be made public by June 30, 2020.

Recommendation 4b

The Boards of Administration should implement employee reviews based on measurable goals and performance metrics for the CEO and CIO. The goals and performance metrics should be completed and made public by December 31, 2019.

Finding 5

The expertise of the public members of the Boards of Administration is heavily weighted toward investment professionals. Other more successful pension funds, such as LACERS, have boards that have a much wider range of expertise.

Recommendation 5

The City of San José should broaden the backgrounds of the public Board members beyond the present focus on investment strategy beginning with the next Board member appointment.

Finding 6

The 3% COLA for Tier 1 retirees has a major impact on the unfunded liability, increasing the burden on the City's General Fund and further impeding the ability of the City of San José to provide essential services to its residents.

Recommendation 6

The City of San José should examine ways in which the 3% COLA liability can be reduced fairly as many other public entities have done by considering options such as reducing COLAs in exchange for lump sum buyouts, etc. This examination should be completed and made public by June 2020.

REQUIRED RESPONSES

Pursuant to Penal Code sections 933 and 933.05, the Grand Gury requests responses as follows:

From the following governing bodies:

Responding Agency	**Finding**	**Recommendation**
The City of San José	3, 4, 5 and 6	3, 4a, 5 and 6
Police and Fire Board of Administration	1, 2, 3 and 4	1, 2, 3 and 4b
Federated Board of Administration	1, 2, 3 and 4	1, 2, 3 and 4b

APPENDIX A – Aggregate Annual Return Performance

This appendix presents trailing years performance returns and benchmarks.

Table A1 -- San José Plans Performance as of June 30, 2018

Annual Return (%)	Police and Fire Department Retirement Plan				Federated City Employees Retirement System			
	Trailing 1-year	Trailing 3-year	Trailing 5-year	Trailing 10-year	Trailing 1-year	Trailing 3-year	Trailing 5-year	Trailing 10-year
Total Fund Return % (percentile)	6.9 (91st)	5.2 (99th)	5.6 (99th)	4.6 (98th)	5.9 (99th)	4.2 (99th)	5.0 (99th)	4.1 (99th)
Policy Benchmark % (percentile)	7.6 (68th)	6.0 (86th)	6.2 (95th)	4.9 (96th)	7.4 (74th)	5.6 (99th)	5.9 (98th)	5.0 (95th)
Top 5% IFPDB Plans	10.5	8.1	9.3	7.5	10.5	8.1	9.3	7.5
25% IFPDB Plans	8.8	7.2	8.3	6.7	8.8	7.2	8.3	6.7
Median IFPDB Plans	8.0	6.7	7.5	6.1	8.0	6.7	7.5	6.1
75% IFPDB Plans	7.3	6.2	7.0	5.6	7.3	6.2	7.0	5.6
95% IFPDB Plans	6.5	5.8	6.2	4.9	6.5	5.8	6.2	4.9

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Note: All links verified June 10, 2019

This report was **ADOPTED** by the 2018-2019 Santa Clara County Civil Grand Jury on this 19th day of June 2019.

John Pedersen
Foreperson