

RECEIVED

MAR 22 2017

CIVIL GRAND JURY
Office of the City Attorney
RICHARD DOYLE, CITY ATTORNEY

March 22, 2017

Santa Clara County Civil Grand Jury
Superior Court
Attn: Tamara Davis, Deputy Manager of Jury Services
191 North First Street
San Jose, CA 95113

Re: Grand Jury Report entitled "An Analysis of Pension and Other Post Employment Benefits"

Dear Ms. Davis:

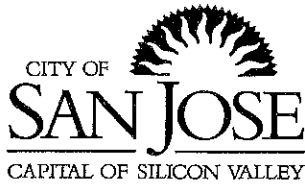
Pursuant to the request of the Grand Jury, please find attached the City's follow-up response to the report "An Analysis of Pension and Other Post Employment Benefits."

Very truly yours,



RICHARD DOYLE
City Attorney

Encl.



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Jennifer Schembri

SUBJECT: SEE BELOW

DATE: March 16, 2017

Approved

Date

3/17/17

SUBJECT: SANTA CLARA COUNTY CIVIL GRAND JURY REPORT – AN ANALYSIS OF PENSION AND OTHER POST EMPLOYMENT BENEFITS

RECOMMENDATION

It is recommended that the Mayor and City Council approve this updated response to the 2011-2012 Santa Clara County Civil Grand Jury Report entitled “An Analysis of Pension and Other Post-Employment Benefits.”

OUTCOME

Approval of this report 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

Grand Jury Report

The Santa Clara County Civil Grand Jury conducted an analysis of the Comprehensive Annual Financial Reports of all fifteen (15) cities and town located within Santa Clara County, which was passed and adopted on May 17, 2012. As such, the Grand Jury provided the City with its final report, including findings and recommendations, entitled “An Analysis of Pension and Other Post Employment Benefits.” The Grand Jury report requested answer based on the City’s two independent retirement plans: The Federated City Employees’ Retirement System and

the Police and Fire Department Retirement Plan. (Please see Attachment A) According to the report:

(T)he Grand Jury sought to answer the following question: "Is the cost of providing pension and other post employment benefits interfering with the delivery of essential City services and is the ultimate cost to the taxpayers a bearable burden"?

The report contained seven (7) findings with applicable recommendations to all cities in Santa Clara County including recommendations made for San Jose. The City responded to each of those findings and recommendations in accordance with California Penal Code Section 933.05, which states that the responding person or entity shall indicate one of the following with respect to each finding and recommendation:

Finding:

1. The respondent agrees with the finding.
2. The respondent disagrees wholly or partially with the finding, in which case the response shall specify the portion of the finding that is disputed and shall include an explanation of the reasons thereafter.

Recommendation:

1. The recommendation has been implemented, with a summary regarding the implemented action.
2. The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.
3. The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This timeframe shall not exceed six months from the date of publication of the grand jury report.
4. The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.

In August 2012, the City responded to the Santa Clara County Civil Grand Jury's report based on the passage of the "The Sustainable Retirement Benefits and Compensation Act," (Measure B). The City Council approved this response on August 28, 2012. Measure B was intended to provide the City with long-term savings through cost containment strategies related to pension benefits, including providing maximums for the retirement benefit for new employees and

requiring voter approval for increases in retirement benefits. (Please refer to Attachment A for the City's previous response to the Grand Jury Report and Findings.)

After the issuance of the City's response to the Civil Grand Jury, a second tier of pension benefits for new employees in the Federated City Employees' Retirement System (Federated System) and the Police and Fire Department Retirement Plan (Police and Fire Plan) was implemented for eligible employees. The Federated second tier of retirement benefits (Tier 2) was put into place on September 30, 2012. After entering arbitration with the San Jose Police Officers' Association (SJPOA), the City and the SJPOA came to a Joint Stipulated Award regarding the Tier 2 pension benefits. Police Tier 2 became effective on August 4, 2013. The City and the San Jose Firefighters (IAFF, Local 230) went to arbitration over the implementation of Tier 2. The arbitration panel selected the City's position to implement Tier 2 for sworn Fire employees, and it was implemented on January 2, 2015.

The City enacted other changes that were part of the City's retirement reform efforts. Among these changes were the elimination of the Supplemental Retiree Benefit Reserve (SRBR) or the "13th" check, and the implementation of a new lowest cost healthcare plan. The Measure B and retirement reform changes resulted in savings of approximately \$41.8 million in Fiscal Year 2016-2017.

Since the City's response to the Civil Grand Jury was issued in August 2012, several of the employee groups and the Federated Retirees' Association filed litigation over Measure B and the retirement reforms. The City was also experiencing significant challenges in recruitment and retention. For example, there have been a total of approximately 300 resignations and 217 retirements since 2012 in the Police Department alone. In an effort to settle litigation for budget stability and to provide certainty to the City's workforce, the City Council directed the City Administration to make any and all reasonable efforts to reach and implement a settlement for the litigation related to Measure B.

In August 2015, the City Council formally approved an Alternative Pension Reform Settlement Framework Agreement with the SJPOA and Local 230 ("Public Safety Settlement Framework").

Subsequently, in December 2015 and January 2016, the City and the nine bargaining units with members in the Federated Plan agreed to an Alternative Pension Reform Settlement Framework Agreement related to Measure B ("Federated Settlement Framework"). 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, as well as the three bargaining units that were not litigants in these lawsuits, agreed to the Federated Settlement Framework. Please refer to Attachments B and C for the Public Safety Settlement Framework and Federated Settlement Framework, respectively.

The terms of both the Public Safety and Federated Settlement Frameworks ("Settlement Frameworks") included changes to both Retirement Plans, as described below:

- Modifies Tier 2 pension benefits for sworn and non-sworn employees to levels similar to other San Francisco Bay Area agencies to attract and retain employees;
- Allows Tier 1 employees who terminated employment with the City and either subsequently returned or who return in the future to return as members of Tier 1;
- Allows employees who are considered CalPERS "Classic" members to become members of Tier 1;
- Preserves 50/50 risk sharing with employees in Tier 2 through the cost sharing of a 50/50 *split in Normal Costs and any future unfunded liability associated with the Tier 2 benefit* subject to a ramp up of 0.33% increments per year for employee contributions towards unfunded liability costs until the costs are shared 50/50;
- Closes the defined benefit retiree healthcare plan to new and existing Tier 2 employees, and allows an opt-out for Tier 1 employees and Tier 2 employees in the OE#3 and ABMEI bargaining units who are contributing to the defined benefit retiree healthcare plan into a defined contribution Voluntary Employee Beneficiary Association ("VEBA") subject to legal and IRS approval;
- New and current Tier 2 employees (except those represented by OE#3 and ABMEI who are making contributions into the defined benefit retiree healthcare plan) will be automatically placed into a defined contribution VEBA;
- Implements a new lowest cost healthcare plan in order to reduce retiree healthcare costs;
- Continues the elimination of the SRBR, and, in lieu of the SRBR, establishes a "Guaranteed Purchasing Power" provision, to apply prospectively, in order to maintain the monthly allowance for current and future Tier 1 retirees at 75% of the purchasing power in effect as of the date of retirement;
- Reinstates the previous definition of disability for both Retirement Plans, which is comparable to other agencies; and creates an Independent Medical Panel to be appointed by each Retirement Board, which will determine disability eligibility instead of the applicable Retirement Board;
- COLAs to pensions allowances to be equal to the Consumer Price Index (San José- San Francisco-Oakland U.S. Bureau of Labor Statistics Index, CPI-Urban Consumers, December to December) or 2% cap, whichever is lower, for the Police and Fire Plan. The COLA is equal to the CPI, or, subject to a graduating cap based on years of service with a maximum of 2%, whichever is lower, for the Federated Plan.

It is important to note that the provisions of the Settlement Frameworks also apply to unrepresented Executive Management and Professional Employees.

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As part of the Frameworks, the parties agreed to "Seal Beach" bargaining over the language of a ballot measure that would implement the aspects of the Framework and supersede the language of Measure B. The Alternative Pension Reform Act or "Measure F" was approved by the voters in November 2016. Measure F, in addition to superseding the provisions implemented by Measure B, amends the Charter to, among other things, prohibit any enhancements to defined retirement benefits without voter approval; codify the revised Tier 2 pension benefit contemplated by the Settlement Frameworks; specify the closure of the defined benefit retiree healthcare plan to new employees as had been previously implemented by the City Council; and to prohibit retroactive defined benefit retirement benefit enhancements. Please refer to Attachment D for a copy of Measure F.

In early November 2016, the City and the San Jose Retired Employees Association ("SJREA") developed a term sheet outlining the proposed terms for settlement of the SJREA's litigation and appeals of the Measure B litigation. The membership of the SJREA approved the terms of the settlement in February 2017 and it will be placed on a future City Council agenda for the City Council's consideration.

The settlement term sheet includes provisions that would make the following changes, among others, to the Federated Plan:

- Implements a new lowest cost healthcare plan in order to reduce retiree healthcare costs and establishes a minimum threshold for the lowest cost healthcare plans that may be implemented in the future. This is the same lowest cost healthcare plan as in the active employees' Measure B Settlement Frameworks;
- Continues the elimination of the SRBR and, in lieu of the SRBR, establishes a "Guaranteed Purchasing Power" provision, to apply prospectively, in order to maintain the monthly allowance for current and future Tier 1 retirees at 75% of the purchasing power in effect as of the date of retirement, the same as what was agreed to with the bargaining units in the Settlement Frameworks;
- Creates a health-in-lieu premium credit option so that retirees can choose to receive twenty-five percent of the monthly premium of the lowest priced healthcare and dental plan (that cannot be taken in cash) in lieu of receiving healthcare coverage, the same as what was agreed to with the bargaining units in the Settlement Frameworks;
- Ends both parties' appeals of the Measure B litigation; and
- Reimburses specific retirees (i.e., those earning a pension of \$54,000 or less, and who were enrolled in pre-Medicare health plan between 1/1/13 and 12/31/16) for a portion of their additional contributions towards retiree medical premiums up to a maximum total amount of \$1.25 million.

Over the next 30-plus years, there will be a savings to the City of San Jose taxpayers of an estimated \$3.12 billion. This amount is based on the savings from the elimination of the SRBR,

the revised Tier 2 pension benefit, and changes to the defined benefit retiree healthcare system. These savings are in comparison to what the total costs would be if the City had never put into place Measure B or the retirement reforms.

The City's response to the Civil Grand Jury's response is based on the terms of the Settlement Frameworks, Measure F, and the terms of the settlement with the SJREA.

GRAND JURY FINDINGS, RECOMMENDATIONS AND CITY'S UPDATED RESPONSE

Grand Jury Finding 1

Public sector employees are eligible for retirement at least 10 years earlier than is common for private sector employees.

City Response to Finding 1

The City agrees with this finding. The City of San Jose is committed to providing its residents and customers with essential services, and a goal of the global settlement negotiations with the bargaining units was to preserve the cost savings that were accomplished through Measure B and the accompanying retirement reforms, while recognizing the need to be a competitive employer for recruitment and retention purposes. The City's pension plans have provisions that allow employees to retire with an unreduced benefit if they retire as of a certain age. As part of the negotiated Alternative Pension Reform Framework Agreements, the retirement age was reduced for Tier 2 employees from 65 to 57 with five (5) years of service in the Police and Fire Plan and from 65 to 62 with five (5) years of service in the Federated Plan. For Tier 2 employees in the Police and Fire Plan, retirees must take a 7% reduction factor for each year they retire before age 57. In the Federated System, Tier 2 members must take a 5% reduction factor for each year they retire before age 62. The Police and Fire ordinance that amends the Municipal Code to implement this change will become effective on March 31, 2017. The City and the Federated bargaining units are still discussing the language in the ordinance. It is expected that the Federated ordinances will become effective in mid-2017.

Although the age for Tier 2 employees to retire is lower than previously implemented, the age Tier 2 employees can retire is later than for Tier 1 employees. In Tier 1, employees in the City's Federated City Employees' Retirement System are generally eligible to retire at age 55 with 5 years of service or at any age with 30 years of service, while sworn employees in the Police & Fire Department Retirement Plan are generally eligible to retire at age 50 with 25 years of service, age 55 with 20 years of service, or at any age with 30 years of service. It is recognized that allowing employees to retire at such an early age significantly adds to the cost of the pension and retiree healthcare benefits.

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Grand Jury Recommendation 1

The Cities should adopt pension plans to extend the retirement age beyond current retirement plan ages.

City Response to Recommendation 1

The City has implemented this recommendation. As stated above, the terms of the Settlement Frameworks allow for Tier 2 retirees to retire at 57 for Police and Fire Plan members and 62 for Federated System members. This is seven years later than the current Tier 1 retirement ages for both plans.

Grand Jury Finding 2

Campbell, Gilroy, Los Altos Hills, Los Gatos, Milpitas and Palo Alto have adopted second tier plans that offer reduced Benefits, which help reduce future costs, but further changes are needed to address today's unfunded liability. Santa Clara County and the cities Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga, and Sunnyvale have not adopted second tier plans.

City Response to Finding 2

The City agrees with this finding. As stated previously, the City implemented a second tier of retirement benefits in accordance with the parameters established by Measure B. The Federated Tier 2 was effective on September 30, 2012. The Police Tier 2 was effective on August 4, 2013, while the Fire Tier 2 was effective on January 2, 2015. In order to settle significant litigation with the City's bargaining units, the City and the eleven bargaining units agreed to a revised Tier 2 benefit. Please refer to Attachments B and C for further details on the revised Tier 2 benefits.

Grand Jury Recommendation 2A

Santa Clara County and the Cities of Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga, and Sunnyvale should work to implement second tier plans.

City Response to Recommendation 2

The recommendation has been implemented. There is currently a Tier 2 in place for the Federated System and Police and Fire Plan. As noted above, the City will be implementing revised Tier 2 pension benefits for eligible employees. Please refer to Attachments B and C for further details on the revised Tier 2 benefits.

Grand Jury Recommendation 2B

For Gilroy, Los Gatos, Milpitas, and Palo Alto, which have not implemented second tier plans for MISC and Public Safety second tier plans should be implemented for both plans.

City Response to Recommendation 2B

The recommendation will not be implemented because it is not warranted or is not reasonable in that this recommendation appears to address an issue specific to another agency.

Grand Jury Recommendation 2C

All Cities' new tier of plans should close the unfunded liability burden they have pushed to future generations. The new tier should include raising the retirement age, increasing employee contributions, and adopting pension plan caps that ensure pensions do not exceed salary at retirement.

City Response to Recommendation 2C

The recommendation has been implemented. Under the Settlement Frameworks for the revised Tier 2 pension benefits, the retirement age remains higher for Tier 2 than Tier 1, Tier 2 employees will be sharing the cost of any pension costs on a 50/50 basis, including unfunded liability on an incremental basis of 0.33% per year until such time as 50% of the unfunded liability is paid by employees. In addition, the pension benefit has maximum caps of 80% for the Police and Fire Plan and 70% for the Federated Plan. Please refer to Attachments B and C for further information.

Grand Jury Finding 3

Retroactive Benefit enhancements were enacted by Cities using overly optimistic ROI and actuarial assumptions without adequate funding in place to pay for them.

City Response to Finding 3

The City agrees with this finding. With previous retirement benefit enhancements, arbitrators awarded enhanced retroactive pension benefits that unduly burdened the City with significant increases to the unfunded liabilities of the pension plans. The voters passed Measure V in 2010, which prohibited an arbitrator, where applicable, to render a decision or award that retroactively increases or enhances pension or retiree healthcare benefits or additional unfunded liability that the City would be obligated to pay for through increased contribution rates.

The Settlement Frameworks enact retroactive enhancements for those who are currently Tier 2 employees, rehired Tier 1 employees, and CalPERS "Classic" members. The costs

of these retroactive benefits will split 50/50 between the City and employees. Any of the revisions to the Tier 2 benefit in the Settlement Framework were subject to an actuarial study conducted by the City's actuary, Bartel Associates, LLC. It is important to note that the retirement boards' actuary will determine any final costs. The Framework Agreements and Measure F also contain provisions that there will be no retroactive defined benefit enhancements adopted on or after January 1, 2017.

Additionally, in the past several years, the Retirement Boards of the Federated System and the Police and Fire Plan have incrementally lowered the discount rate of both plans to where it stands today at 6.875%. The lower discount rate assumes a more realistic view of the expected investment returns of the plans.

Grand Jury Recommendation 3

The Cities should adopt policies that do not permit Benefit enhancement unless sufficient monies are deposited, such as in an irrevocable trust, concurrent with enacting the enhancement, to prevent an increase in unfunded liability.

City Response to Recommendation 3

The recommendation has been implemented. While the Alternative Frameworks establish a revised Tier 2 pension benefit for employees and allows rehired Tier 1 employees back into Tier 1, any costs associated with the enhanced benefits to be received by the employees is to split 50/50 between the City and affected employees. In addition, the Framework Agreements and Measure F contain provisions that there will be no retroactive defined benefit enhancements adopted on or after January 1, 2017. Please refer to Attachments B and C for further information.

Grand Jury Finding 4

The Cities are making an overly generous contribution toward the cost of providing benefits.

City Response to Finding 4

The City partially agrees with this finding. To contain costs related to post-retirement benefits, the City and the bargaining units agreed to a lesser level of benefits when compared to Tier 1 pension benefits in recognition of the unsustainable retirement costs. In addition, the parties agreed to close the defined benefit retiree healthcare plan due to the costs to both the City and employees. While these costs in the past were can be considered "overly generous", the benefit reductions agreed to by the parties were made with the intention of providing reasonable post-retirement benefits at a significantly reduced cost. Additionally, the revised Tier 2 includes a provision that employees will split the costs of pension benefits on a 50/50 basis, including the incremental phase-in to paying 50% of the unfunded liability, as noted above.

Grand Jury Recommendation 4A

The Cities should require all employees to pay the maximum contribution rate of a given plan.

City Response to Recommendation 4A

The recommendation will not be implemented because it is not warranted or is not reasonable. This recommendation appears to apply to those agencies that are in CalPERS and pick up the employee portion of costs. As the City discussed in its August 2012 response, under the Sections §1504 and §1505 of the City Charter, the City shares the actuarially defined normal cost of the retirement benefit with active employees in a ratio of 8:3, meaning that for every \$8 the City contributes for retirement benefits allocated to an employee's current year of service, that active employee contributes \$3. Both the City and its employees currently and will continue to pay their respective contributions under the terms of the City Charter. However, it is worth noting that any unfunded liability associated with Tier 1 pension costs is solely funded by the City, except as provided for in the Framework Agreements.

According to the Tier 2 parameters of Settlement Frameworks, the City and Tier 2 employees will continue share all costs associated with the Tier 2 plan 50/50, including contribution increments of 0.33% per year until such time that the unfunded liability is shared 50/50 between the City and employees.

Grand Jury Recommendation 4B

The Cities should require employees to pay some portion of the Past Service Cost associated with the unfunded liability, in proportion to the Benefits being offered.

City Response to Recommendation 4B

The recommendation has been implemented. Under the parameters of the Measure B Tier 2 benefit for employees in the Federated System and the Police and Fire Plan, all costs associated with the pension benefit were split 50/50 between the City and employees. For example, if the total contribution rate associated with the Tier 2 plan was 20% of annual payroll, the employee would be responsible for paying 10%.

The Tier 2 negotiated under the Alternative Pension Reform Framework also has a provision that the City and the employees will split the cost of the pension benefit 50/50. However, 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 City and employees. Please note that this is above and beyond the CalPERS requirement that "PEPRA" employees share 50/50 in the normal cost.

It should be noted that Tier 1 employees in the Police and Fire Department Retirement Plan currently pay a small portion of the unfunded liability for a benefit enhancement.

Additionally, the City and the POA agreed that Tier 1 employees represented by the POA would pay a portion of the unfunded liability that resulted from the delay in the implementation of a separate benefit enhancement.

Grand Jury Finding 5

The Cities are not fully funding OPEB benefits as evidenced by large unfunded liabilities.

City Response to Finding 5

The City agrees with the finding. The City and employees are currently paying fixed contribution amounts that were negotiated based on a five-year phase-in to fully fund the Annual Required Contribution (ARC). At the end of the five-year period, the City and the Federated bargaining units agreed to cap the contribution rates in order to address the long-term costs of the retiree healthcare plan in a stakeholder solutions working group. The parties also agreed to close the Federated retiree healthcare plan to employees in Tier 2 hired on or after September 27, 2013. To ensure that sufficient funds would go into the defined benefit retiree healthcare plan, the City agreed to pay the portion of the unfunded liability that the City and the Tier 2 employees would have otherwise paid. The Police and Fire retiree healthcare rates were also capped based on the retiree healthcare funding agreements with the SJPOA and IAFF, Local 230.

Under the Frameworks, the City and the bargaining units agreed to close the defined benefit retiree healthcare plan to new employees in the Federated System and Tier 2 employees in the Police and Fire Plan in the Settlement Frameworks.

All Tier 1 employees and Tier 2A employees represented by the Operating Engineers, Local 3 (OE#3) and the Association of Building, Mechanical and Electrical Inspectors (ABMEI) will have the opportunity to irrevocably elect to opt out of the defined benefit plan into the VEBA. If the City's portion of the ARC reaches 11% for Police and Fire Plan or 14% for the Federated System, the City may decide to contribute up to those maximums.

The City will also implement a new lowest cost healthcare plan. In the past, implementing a new lowest cost plan has resulted in significant reductions to the unfunded liability because the City's defined benefit plan is based on 100% of the premium cost of the lowest priced plan available to active employees.

The City actuary's analysis of the Settlement Frameworks indicated that the changes to the lowest cost healthcare plan and the opt-out may result in a reduction of \$114.1 million to the actuarial liability of the Police and Fire OPEB Plan and a reduction of \$105.2 million to the actuarial liability of the Federated OPEB Plan. In total, the changes to retiree healthcare from the Settlement Frameworks have an estimated cost savings of \$493.9 million over the next 30 or more years based on an analysis by the City actuary.

The numbers are subject to change based on actual opt-out rates and analysis by the Board's actuary.

Grand Jury Recommendation 5

The Cities, should immediately work toward implementing policy changes and adopting measures aimed at making full OPEB ARC payments as soon as possible.

City Response to Recommendation 5

The recommendation has not yet been fully implemented. The City and the bargaining units agreed to close the defined benefit retiree healthcare plan to new employees in the Federated System and Police and Fire Tier 2 employees in the Settlement Frameworks. It is important to note that the defined benefit retiree healthcare plan was already closed for Tier 2 employees in the Federated System. In addition, the City will create a defined contribution Voluntary Employees' Beneficiary Association (VEBA) for new and Tier 2 employees. All Tier 1 employees and Tier 2A employees represented by the Operating Engineers, Local 3 (OE#3) and the Association of Building, Mechanical and Electrical Inspectors (ABMEI) will have the opportunity to irrevocably elect to opt out of the defined benefit plan into the VEBA.

If an eligible employee chooses to stay in the defined benefit plan, their contribution rate will be 8% for employees in the Police and Fire Plan and 7.5% for employees in the Federated Plan. The City has agreed to pay the additional amount necessary to ensure the defined benefit plan receives its full Annual Required Contribution (ARC). If the City's portion of the ARC reaches 11% for Police and Fire Plan or 14% for the Federated System, the City may decide to contribute up to those maximums. The irrevocable opt-out will be implemented in the calendar year after the City receives approval from the IRS indicating that option to leave the defined benefit plan is allowable under the Internal Revenue Code.

Grand Jury Finding 6

The City of San Jose permits the transfer of pension trust fund money, when ROI exceeds expectations, to the SRBR, despite the fact that the pension trust funds are underfunded.

City Response to Finding 6

The City agrees with this finding. The SRBR was a "13th check" for retirees payable under certain circumstances in addition their regular monthly pension checks. When the retirement plans investment income exceeds their expected returns, 10% of those "excess" earnings are credited to the SRBR. Under the current definition, "excess" earnings can be declared and transferred to the SRBR even if other actuarial assumptions have not been met and even if the plans are significantly underfunded The City

acknowledged its commitment to fiscal stability by eliminating the Supplemental Retiree Benefit Reserve (SRBR) as part of the retirement reform efforts.

With the voter's approval of Measure F, the SRBR will remain discontinued. The SRBR functioned as a "bonus" check to retirees payable under certain circumstances. The elimination of the SRBR saved approximately \$17.8 million in Fiscal Year 2016-2017.

Grand Jury Recommendation 6

The City of San Jose should eliminate the SRBR program or amend the SRBR program to prevent withdrawal of pension trust money whenever the pension-funded ratio is less than 100%.

City Response to Recommendation 6

The recommendation has been implemented. After the passage of Measure B, an ordinance implementing this change was approved by the City Council in December 2012. The Alternative Pension Reform Framework Agreements, settlement terms with the SJREA, and the passage of Measure F continue the elimination of the SRBR.

Grand Jury Finding 7

The Cities' defined benefit pension plan costs are volatile. Defined contribution plan costs are predictable and therefore manageable by the Cities.

City Response to Finding 7

The City agrees with this finding. The City implemented a 401(a) defined contribution plan (Tier 3) for unrepresented Executive Management and Professional Staff. These unrepresented employees have an irrevocable option of entering the Tier 2 defined benefit plan or the Tier 3 defined contribution plan if they have never been a participant in one of the City's defined benefit retirement plan upon hire.

Grand Jury Recommendation 7

The Cities should transition from defined benefit plans to defined contribution plans as the new tier plans are implemented.

March 16, 2017

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City Response to Recommendation 7

The recommendation has been implemented. As noted above, the City has implemented a defined contribution plan for unrepresented employees Executive Management and Professional Staff. In addition, the Alternative Pension Reform Frameworks have a provision that new and Tier 2 employees will be placed into a Voluntary Employees' Beneficiary Association (VEBA) for retiree healthcare benefits, and the current defined benefit retiree healthcare plan will be closed. Current Tier 1 employees will be offered a one-time irrevocable opt-out into the VEBA after the receipt of approval from the IRS.

PUBLIC OUTREACH/INTEREST

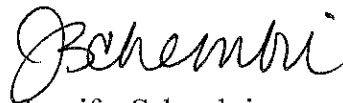
By the very nature of the Grand Jury's report and its release, public outreach requirements have been met. Additionally, upon approval of this memorandum by Council, the City Attorney will submit the memorandum to the presiding judge of the Superior Court, as required under Penal Code Section 933(c).

COORDINATION

This memorandum was coordinated with the City Attorney's Office.

CEQA

Not a project, File No.PP10-069(a) (Staff Reports/Assessments/Annual Reports/Information Memos. City Manager's Office)



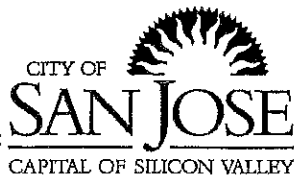
Jennifer Schembri
Director of Employee Relations

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

Attachment A – City Response to Civil Grand Jury dated August 2012
Attachment B – Police and Fire Alternative Pension Reform Framework Agreement
Attachment C – Federated Alternative Pension Reform Framework Agreement
Attachment D – Measure F

COUNCIL AGENDA: 08/28/12

ITEM:



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Alex Gurza

SUBJECT: SEE BELOW

DATE: August 14, 2012

Approved

Date

8/14/12

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2. The recommendation has not yet been implemented, but will be implemented in the future, with a time frame for implementation.
3. The recommendation requires further analysis, with an explanation and the scope and parameters of an analysis or study, and a time frame for the matter to be prepared for discussion by the officer or head of the agency or department being investigated or reviewed, including the governing body of the public agency when applicable. This timeframe shall not exceed six months from the date of publication of the grand jury report.
4. The recommendation will not be implemented because it is not warranted or is not reasonable, with an explanation therefor.

The conclusions of the report indicate "that until significant modifications are enacted, there is no doubt that the escalating cost of providing (employee pensions and other post employment 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 as demonstrated by San Jose reducing police and fire department staffing levels, closing libraries or not opening those newly built, curtailing hours of community centers, and not repairing pot-hold city streets." The report further concludes that other cities in Santa Clara County "are likely to face similar challenges as long as high cost benefit plans face an underfunding liability."

The focus of the Grand Jury's finding and recommendations includes maintaining an actuarially sound retirement benefit for employees while adjusting the level of benefits offered to newly hired employees. The City of San Jose recognizes the need for reducing retirement costs and

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recently had a ballot measure before the San Jose voters on June 5, 2012; "The Sustainable Retirement Benefits and Compensation Act," (Measure B). Measure B is intended to provide the City with long-term savings through cost containment strategies related to post-employment benefits, including providing maximums for the retirement benefit for new employees and requiring voter approval for increases in retirement benefits. Further, a second tier for new employees in the Federated City Employees' Retirement System is currently in the process of being implemented. A second tier for employees in the Police and Fire Department Retirement Plan will be subject to binding interest arbitration.

GRAND JURY FINDINGS, RECOMMENDATIONS AND CITY'S RESPONSE

Grand Jury Finding 1

Public sector employees are eligible for retirement at least 10 years earlier than is common for private sector employees.

City Response to Finding 1

The City agrees with this finding. The City of San Jose is committed to providing its residents and customers with essential services. As a service organization, the vast majority of the City's costs are personnel costs for the employees who provide those services. However, the City's rising personnel expenditures have been significantly affected by the rising costs of pension and other post employment benefits. Despite major sacrifices from both the community the City serves and the City's employees to address these ever escalating costs, significant concerns remain which need to be considered, especially related to escalating retirement costs. To that end, Measure B is intended to provide the City with long-term savings.

Currently, employees in the City's Federated City Employees' Retirement System are generally eligible to retire at age 55 with 5 years of service or at any age with 30 years of service, while sworn employees in the Police & Fire Department Retirement Plan are generally eligible to retire at age 50 with 25 years of service, age 55 with 20 years of service, or at any age with 30 years of service. It is recognized that allowing employees to retire at such an early age significantly adds to the cost of the pension and retiree healthcare benefits.

On June 5, 2012, the citizens of the City who through taxes and fees fund these benefits, voted to approve Measure B by 69.02%. Measure B, among other things, provides for maximums for a new tier of retirement benefits for new employees. This includes language that, within the defined benefit program, the retirement age should be no less than 65 for employees in the Federated City Employees' Retirement System and age 60 in the Police & Fire Department Retirement Plan, thereby raising the eligibility age for retirement. In addition, Measure B creates a Voluntary Election Program (VEP) whereby current employees who are members of the existing retirement programs may choose to

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enroll in an alternate retirement program with reduced benefits, while maintaining the benefit accrual rate for years of service already rendered. The VEP is subject to IRS approval due to the tax implications of creating an option for retirement benefits. This Voluntary Election Program (VEP) also raises the age at which someone can retire by six (6) months every year, until the retirement age is age 62 for employees in the Federated City Employees' Retirement System and age 57 in the Police and Fire Department Retirement Plan.

Grand Jury Recommendation 1

The Cities should adopt pension plans to extend the retirement age beyond current retirement plan ages.

City Response to Recommendation 1

The City has not yet implemented this recommendation, but it will be implemented in the future. Under the parameters set forth in Measure B, the City will extend the retirement age under the Voluntary Election Program, subject to IRS approval, and the second tier as soon as possible. Specifically, for those current employees who choose to enroll in the Voluntary Election Program, the retirement eligibility will be changed to age 57 for employees in the Police and Fire Department Retirement Plan, and to age 62 for employees in the Federated City Employees' Retirement System over a period of 14 years. Employees in the second tier retirement benefit (Tier 2) in the Federated City Employees' Retirement System will be eligible for retirement at age 65 with at least 5 years of City service. In addition, the eligibility to retire with 30 years of service shall be increased by 6 months annually on July 1 of each year, starting with July 1, 2017. Subject to arbitration, sworn Police and Fire employees would be eligible to retire at age 60 with 10 years of service credit. The second tier for employees in the Federated City Employees' Retirement System is estimated to be in place by the Fall of 2012.

Grand Jury Finding 2

Campbell, Gilroy, Los Altos Hills, Los Gatos, Milpitas and Palo Alto have adopted second tier plans that offer reduced Benefits, which help reduce future costs, but further changes are needed to address today's unfunded liability. Santa Clara County and the cities Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga, and Sunnyvale have not adopted second tier plans.

City Response to Finding 2

The City agrees with this finding. As stated previously, the City plans to implement a second tier retirement benefit for new hires. Voters overwhelmingly approved Measure W in 2010, which allowed the City to create a new retirement benefit tier for newly hired

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or re-hired employees. As a result, Measure B was designed to provide parameters for a new tier of retirement benefits. The City Council voted to approve a Tier 2 for new non-sworn employees on or about June 12, 2012. The City is currently in the process of implementing this second tier for new employees in the Federated City Employees' Retirement System and it is estimated to be in place by the Fall of 2012. The second tier for new employees in the Police and Fire Department Retirement Plan are subject to binding interest arbitration with the San Jose Police Officers' Association (POA) and San Jose Fire Fighters, IAFF Local 230, (IAFF Local 230).

Grand Jury Recommendation 2A

Santa Clara County and the Cities of Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga, and Sunnyvale should work to implement second tier plans.

City Response to Recommendation 2

The recommendation has not yet been implemented but will be implemented in the future. As noted above, on or about June 12, 2012, the City Council approved a second tier retirement benefit for new, rehired or reinstated non-sworn employees within the parameters set forth in Measure B. The City is currently working on the administrative necessities to put this program in place, including any ordinances, resolutions, etc., that are required to effectuate the second tier retirement benefit for new non-sworn employees. It is expected that this be in place by the Fall of 2012. The City is also pursuing a second tier retirement benefit for new sworn Police and Fire employees consistent with the parameters set forth in Measure B and will be proceeding to binding interest arbitration with the affected unions.

Grand Jury Recommendation 2B

For Gilroy, Los Gatos, Milpitas, and Palo Alto, which have not implemented second tier plans for MISC and Public Safety second tier plans should be implemented for both plans.

City Response to Recommendation 2B

The recommendation will not be implemented because it is not warranted or is not reasonable in that this recommendation appears to address an issue specific to another agency.

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Grand Jury Recommendation 2C

All Cities' new tier of plans should close the unfunded liability burden they have pushed to future generations. The new tier should include raising the retirement age, increasing employee contributions, and adopting pension plan caps that ensure pensions do not exceed salary at retirement.

City Response to Recommendation 2C

The recommendation has not yet been implemented but will be implemented in the future. The City recognizes the financial burden placed on current and future taxpayers as a result of the escalating retirement costs and as such determined the necessity to address the unfunded liability. While both the City and its employees will be significantly affected by the financial burden of retirement costs, Measure B is intended to assist the City and its employees manage the financial gap in the years to come. As noted above, on or about June 12, 2012, the City Council approved a second tier retirement benefit for new or rehired non-sworn employees within the parameters set forth in Measure B. By implementing Tier 2 for newly hired and re-hired employees, the City expects to realize cost savings over time. It is expected that this be in place by the Fall of 2012.

In addition, the City is also pursuing a second tier retirement benefit for new sworn Police and Fire employees consistent with the parameters set forth in Measure B and the impasse procedures applicable to sworn Police and Fire employees, which is binding interest arbitration.

The second tier parameters in Measure B raise the retirement age, require new employees to pay fifty (50) percent of the total cost of the retirement benefit, and ensure that the retirement benefit payment is based on the highest three consecutive years of earned base pay only.

Grand Jury Finding 3

Retroactive Benefit enhancements were enacted by Cities using overly optimistic ROI and actuarial assumptions without adequate funding in place to pay for them.

City Response to Finding 3

The City agrees with this finding. In 2010, the citizens of the City approved Measure V, which was passed by voters in 2010, prohibits an arbitrator, where applicable, to render a decision or award that retroactively increases or enhances pension and retiree healthcare benefits, or that creates a new or additional unfunded liability the City would be obligated to pay for. It should be noted that whereas arbitrators previously issued decisions in binding interest arbitration granting retroactive benefit enhancements to employees, creating new unfunded liabilities that the City was solely responsible for and that were

not previously funded, Measure V prohibits these types of decisions in the future. In addition, the voters also passed Measure W in 2010 allowing for the establishment of a new tier of retirement benefits and that the any such plan must be actuarially sound. In 2012, the voters passed Measure B which takes steps to ensure the actuarial soundness of future retirement benefits and expense decisions.

Grand Jury Recommendation 3

The Cities should adopt policies that do not permit Benefit enhancement unless sufficient monies are deposited, such as in an irrevocable trust, concurrent with enacting the enhancement, to prevent an increase in unfunded liability.

City Response to Recommendation 3

The recommendation has not yet been implemented but will be implemented in the future. The passage of Measure B included language that requires the actuarial soundness of the retirement benefit plans. The language of Measure B also includes language that prevents the Retirement Board from paying a benefit or expense that has not been actuarially funded. In addition, Measure B reserves the right for voters to modify any retirement benefit, including pension and other post employment benefits, and any such increases are subject to future approval by the voters. In addition and as noted above, the voters passed Measure V in 2010 which prohibits an arbitrator, where applicable, to render a decision or award that retroactively increases or enhances pension and retiree healthcare benefits, or that creates a new or additional unfunded liability the City would be obligated to pay for. It should be noted that arbitrators previously issued decisions in binding interest arbitration granting retroactive benefit enhancements to employees, creating new unfunded liabilities that the City was solely responsible for and that were not previously funded; Measure V prohibits these types of decisions in the future.

Grand Jury Finding 4

The Cities are making an overly generous contribution toward the cost of providing benefits.

City Response to Finding 4

The City agrees with this finding. Recognizing the need for a fiscally responsible and actuarially sound pension program, the City acted with the intention of curtailing unsustainable retirement costs by pursuing the changes to retirement benefits in Measure B. Employees who choose to remain in the current retirement benefit tier instead of opting into the Voluntary Election Program will be required to pay for a portion of the unfunded liability costs of the retirement system.

Grand Jury Recommendation 4A

The Cities should require all employees to pay the maximum contribution rate of a given plan.

City Response to Recommendation 4A

The recommendation will not be implemented because it is not warranted or is not reasonable. This recommendation appears to apply to those agencies that are in CalPERS and pick up the employee portion of costs. The City of San Jose operates two (2) independent retirement systems (the Federated City Employees' Retirement System, and the Police & Fire Department Retirement Plan) independent of CalPERS. Under the Sections §1504 and §1505 of the City Charter, the City shares the actuarially defined normal cost of the retirement benefit with active employees in a ratio of 8:3, meaning that for every \$8 the City contributes for retirement benefits allocated to an employee's current year of service, that active employee contributes \$3. Both the City and its employees currently and will continue to pay their respective contributions under the terms of the City Charter. However, it is worth noting that any unfunded liability associated with pension costs is currently solely funded by the City.

According to the Tier 2 parameters of Measure B, the City and Tier 2 employees are expected to share all costs associated with the Tier 2 plan 50/50. However, Measure B will require employees who choose to remain in the current retirement benefit tier instead of opting into the Voluntary Election Program to pay for a portion of their costs. Furthermore, it is worth noting that the costs associated with retiree medical care are equally borne by both the City and current employees, including any unfunded liability associated with retiree healthcare.

Grand Jury Recommendation 4B

The Cities should require employees to pay some portion of the Past Service Cost associated with the unfunded liability, in proportion to the Benefits being offered.

City Response to Recommendation 4B

The recommendation has not yet been implemented but will be implemented in the future. Under Measure B, active employees who choose to stay in the current level of benefits will be required to contribute additional amounts associated with the unfunded liability of the retirement benefit and thus will share the costs of the unfunded liability with the City. It should be noted that current employees in the Police and Fire Department Retirement Plan currently pay a small portion of the unfunded liability.

Grand Jury Finding 5

The Cities are not fully funding OPEB benefits as evidenced by large unfunded liabilities.

City Response to Finding 5

The City agrees with the finding. The City and employees are currently in a transition phase-in strategy to contribute the full Annual Required Contribution (ARC) for retiree healthcare benefits. As noted previously, active employees currently pay at least fifty percent (50%) of the retiree healthcare cost, which includes normal costs and unfunded liability costs. The transition to contribute the ARC began in 2009 for most bargaining units with a five-year phase in strategy. However, it should be noted that, for employees represented by the POA and IAFF Local 230, the contribution amount cannot exceed an incremental increase of 1.25% of pensionable pay when compared to the previous year. When the retiree healthcare ARC contribution rate exceeds 10% of pensionable pay, the POA and IAFF Local 230 will enter discussions with the City to address the contributions to contribute the full ARC and alternatives to lower retiree healthcare costs.

Grand Jury Recommendation 5

The Cities, should immediately work toward implementing policy changes and adopting measures aimed at making full OPEB ARC payments as soon as possible.

City Response to Recommendation 5

The recommendation has not yet been fully implemented. As noted above, the City has partially implemented the Grand Jury's recommendation to make full OPEB ARC payments. The transition to contribute the full ARC began in 2009 for most bargaining units with a phase in strategy. For employees represented by the POA and IAFF Local 230, both bargaining units will enter discussions with the City to address the contributions to contribute the fully fund the ARC and alternatives to lower retiree healthcare costs, should the retiree healthcare ARC contribution rate exceed 10% of pensionable pay.

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Grand Jury Finding 6

The City of San Jose permits the transfer of pension trust fund money, when ROI exceeds expectations, to the SRBR, despite the fact that the pension trust funds are underfunded.

City Response to Finding 6

The City agrees with this finding. The City acknowledged its commitment to fiscal stability by proposing to eliminate the Supplemental Retiree Benefit Reserve (SRBR) in Measure B. The SRBR provided cash payments to retirees, payable under certain circumstances, in addition to their regularly allocated retirement system benefit payments. Accordingly, with the approval of Measure B and once the implementation of Measure B is completed, the assets set aside for the SRBR will be transferred back into the appropriate retirement trust fund. It should be noted that the City Council adopted consecutive resolutions to suspend disbursements from the SRBR in Fiscal Year 2010-2011, and continuing through Fiscal Year 2012-2013, pending the Measure B effective date.

Grand Jury Recommendation 6

The City of San Jose should eliminate the SRBR program or amend the SRBR program to prevent withdrawal of pension trust money whenever the pension-funded ratio is less than 100%.

City Response to Recommendation 6

The recommendation has not yet been implemented but will be implemented in the future. As noted above, the passage of Measure B eliminates the SRBR once implemented. In addition, City Council has previously placed a moratorium on disbursements from the SRBR through Fiscal Year 2012-2013.

Grand Jury Finding 7

The Cities' defined benefit pension plan costs are volatile. Defined contribution plan costs are predictable and therefore manageable by the Cities.

City Response to Finding 7

The City agrees with this finding. While considering the appropriate paths to financial solvency, the City discussed wholly funding Tier 2 employees' retirement benefit through a 401(k)-style defined contribution plan. The parameters set forth in Measure B allowed for a defined contribution plan, however, at this time, the City Council approved a lower defined benefit plan for new employees in the Federated City Employees' Retirement System, and the City anticipates proceeding to binding interest arbitration over a second

HONORABLE MAYOR AND CITY COUNCIL

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tier with the POA and IAFF Local 230. Further analysis will be necessary to determine the appropriate defined contribution style plan should the City Council decide to pursue this option in the future.

Grand Jury Recommendation 7

The Cities should transition from defined benefit plans to defined contribution plans as the new tier plans are implemented.

City Response to Recommendation 7

The recommendation requires further analysis. As noted above, the City has not implemented a defined contribution plan but, under Measure B, parameters were set that allowed for a hybrid defined benefit/defined contribution retirement benefit for new hires in Tier 2. Ultimately, the City Council approved a lower defined benefit plan for new employees in the Federated City Employees' Retirement System, and the City anticipates proceeding to binding interest arbitration over a second tier with the POA and IAFF Local 230. Should the City Council decide to pursue this available option in the future, further analysis will be necessary regarding the most viable defined contribution plan option.

PUBLIC OUTREACH/INTEREST

By the very nature of the Grand Jury's report and its release, public outreach requirements have been met. Additionally, upon approval of this memorandum by Council, the City Attorney will submit the memorandum to the presiding judge of the Superior Court, as required under Penal Code Section 933(c).

COORDINATION

This memorandum was coordinated with the City Attorney's Office.

HONORABLE MAYOR AND CITY COUNCIL

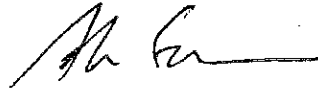
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CEQA

Not a project, File No.PP10-069(a) (Staff Reports/Assessments/Annual Reports/Information
Memos. City Manager's Office)



Alex Gurza
Deputy City Manager

*For additional information on this report, contact Alex Gurza,
Deputy City Manager, at 535-8150.*

GRAND JURY
SANTA CLARA COUNTY



June 7, 2012

Honorable Chuck Reed
Mayor
City of San Jose
200 East Santa Clara Street
San Jose, CA 95113

Dear Mayor Reed and Members of the City Council:

Pursuant to Penal Code § 933.05(f), the 2011-2012 Santa Clara County Civil Grand Jury is transmitting to you its Final Report, **An Analysis of Pension and Other Post Employment Benefits.**

Penal Code § 933.05(f)

A grand jury shall provide to the affected agency a copy of the portion of the grand jury report relating to that person or entity two working days prior to its public release and after the approval of the presiding judge. No officer, agency, department or governing body of a public agency shall disclose any contents of the report prior to the public release of the final report. Leg. H. 1996 ch. 1170, 1997 ch. 443.

This report will be made public and released to the media on **Wednesday, June 13, 2012, at 1 P.M.** If you have any questions please contact Gloria Alicia Chacón at 408-882-2721.

Sincerely,

A handwritten signature in black ink, appearing to read "Kathryn G. Janoff". The signature is written in a cursive, flowing style.

KATHRYN G. JANOFF
Foreperson
2011-2012 Civil Grand Jury

KGJ:dsa
Enclosure

cc: Ms. Debra Figone, City Manager, City of San Jose



2011-2012 SANTA CLARA COUNTY CIVIL GRAND JURY REPORT

AN ANALYSIS OF PENSION AND OTHER POST EMPLOYMENT BENEFITS

Issue

After reviewing the Comprehensive Annual Financial Reports (CAFRs) of all cities, towns and the County of Santa Clara (hereafter referred to as City or Cities¹), the Grand Jury was struck by the extent that the pensions and Other Post Employment Benefits (OPEB) (collectively "Benefits") were underfunded. Subsequently, the Grand Jury sought to answer the following question: "Is the cost of providing pension and other post employment benefits interfering with the delivery of essential City services and is the ultimate cost to the taxpayers a bearable burden?"

Introduction

The Grand Jury developed a survey to gather information from the Cities and the County. The Survey and responses are important to this report and the Grand Jury encourages readers to read the Survey questionnaire provided in Appendix A before continuing. Due to the technical complexity of this report, the Grand Jury has provided a glossary of the terminology used throughout this report (Appendix B). Acronyms are also included in the glossary.

CalPERS² requires Cities to contribute sufficient funds, held in trust, to pay for pension benefits as they are earned. This helps to ensure sufficient funding is in place to provide the promised pension benefits. This trust money is invested and expected to return a long-range investment return as high as 7.50%³ (after expenses). It is these investment earnings that are expected to pay for as much as 70%⁴ of the cost of pension benefits.

¹ Cities as defined in this report include: Santa Clara County; the cities of Campbell, Cupertino, Gilroy, Los Altos, Milpitas, Monte Sereno, Morgan Hill, Mountain View, Palo Alto, San Jose, Santa Clara, Saratoga, Sunnyvale; and the towns of Los Altos Hills and Los Gatos.

² The California Public Employees' Retirement System (CalPERS) is an agency in the California executive branch that manages pension and health benefits for California public employees, retirees, and their families.¹

³ CalPERS recently reduced this rate from 7.75%.

⁴ Expected to decline as investment yield declines.

According to interviews, historically high investment earnings in the early 1990s spawned the belief that expensive pension enhancements could be granted and paid for by the excess investment earnings without compromising the Cities' ability to afford other services. Once these pension enhancements are granted to an employee, they generally cannot be retracted unless a substantially comparable replacement is offered, a concept referred to as vested rights. Cities reported that they felt compelled to enhance benefits to attract and retain the best work force possible.

In addition to pensions, employers provide OPEB consisting primarily of health care benefits. Unlike pension funding requirements, there is no requirement for Cities to pre-fund the cost of OPEB benefits. As a result, most Cities have not funded OPEB benefits and have accrued large OPEB debts. Escalating health care costs, the largest component of OPEB, compound this debt problem.

As a result of an economic downturn, the average investment rate of return (investment earnings) for the last ten years is considerably below what experts and Cities agree is the still optimistic assumed rate of 7.5%. This return on investment (ROI) leads to an increase in the Cities' annual payment into the pension fund to make up the difference.

The rising costs of pension and OPEB (collectively hereinafter referred to as Benefits), combined with the downturn of the economy have resulted in very large budget shortfalls. These must be paid by current and future tax revenue, which is limited. Thus, according to interviews, paying for these rising costs will come at the expense of other City services.

With this in mind, the Grand Jury assessed the viability and sustainability of Cities' public employee Benefits. This assessment sought to answer the following questions:

- What are the costs of public employee Benefits and who pays for them?
- Will Cities' projected revenues keep up with projected expense of Benefits?
- What is being done and what can be done to control Benefit costs?
- Why are public employee Benefits different from those in the private sector?

Background

Several cities have declared bankruptcy. While the reasons for bankruptcy vary from one municipality to another, and include lower tax revenues and decreased home values, one common reason cited is large unfunded liability associated with providing pension and healthcare benefits to its public employees. Locally, the City of Vallejo declared bankruptcy in 2009 after failing to negotiate pay cuts in the face of \$195 million in unfunded pension obligations. Stockton is falling into bankruptcy with less than 70

cents set aside for every dollar of pension benefits its workers are owed⁵. A recent Stanford University study regarding public pension funds statewide emphasizes this predicament: "public pension shortfalls of \$379 billion or \$30,500 per household" exist statewide⁶ contributing to the downgrading of California's bond rating. San Jose is proposing pension reform and considering higher taxes resulting from ten consecutive years of budget shortfalls. The full effect of these unsustainable costs is yet to come.

Methodology

The scope of the Grand Jury's investigation was limited to the Cities. Special districts and other agencies were excluded from this investigation. The following resources were used to gather and evaluate the data contained in this report:

- City CAFRs; particularly notes to financial statements concerning Benefits (see Appendix A)
- Results obtained from a survey created by the Grand Jury and distributed to the Cities (see Appendix B for the complete survey)
- Interviews conducted with one or more of the following persons from the Cities: Financial Manager, Chief Finance Officer, City Manager, Retirements Service Director, and Human Resource Manager. All interviews were conducted following receipt and evaluation of a survey, affording the opportunity to seek clarification and elaboration on survey responses as necessary.
- Interviews with CalPERS actuaries and CalPERS consultants
- Other documents listed in Appendix A.

Report Conventions

The Grand Jury did not extrapolate, derivate or convert the data provided by the Cities in response to the survey. When the Grand Jury had questions, or found inconsistencies in the data provided, every effort was made to resolve the issues through interviews, email and phone conversations.

All dollar figures are expressed in actuarial valuation units,⁷ not market value, unless otherwise stated. The glossary in Appendix C provides definitions of the terminology used throughout this report. Acronyms are also included in the glossary.

⁵ "Untouchable pensions may be tested in California," Mary Williams Walsh, New York Times, March 16, 2012.

⁶ <http://slepr.stanford.edu/system/files/shared/Nation%20Statewide%20Report%20v081.pdf>

⁷ See Appendix C Glossary for definition.

Discussion

This discussion consists of three primary sections:

- **Understanding CalPERS** presents and discusses the basic concepts of CalPERS public pension benefits to lay a foundation for a more detailed look at City-provided Benefits.
- **Key Survey Results** discusses those survey results found to be most relevant to answering the Grand Jury questions.
- **San Jose's Plan** is discussed separately because San Jose is the only city to not use CalPERS.

Understanding CalPERS

Because all Cities except San Jose⁸ participate in CalPERS for pension and many use CalPERS for OPEB as well, it is vital to understand the following key concepts:

- Basic Pension Plan Formulas
- Annual Required Contribution (ARC)
- CalPERS Menu Options
- Assumed or expected Return on Investment (ROI)
- Unfunded Liability.

Basic Pension Plan Formulas

Employees belong to one of two different groups: Miscellaneous (MISC) or Public Safety,⁹ each having defined plans. Table 1 lists all first tier¹⁰ CalPERS plans utilized by Cities. Note that the plan names include the pension earned per year and the retirement age at which full benefits are received.

⁸ Excluding the San Jose Mayor and Council Member plan.

⁹ Police and Fire personnel.

¹⁰ See Appendix C Glossary for definition.

Table 1: First Tier CalPERS Plans Used by the Cities

Miscellaneous Plans		Public Safety Plans	
Plan Name	Number of Cities Participating	Plan Name	Number of Cities Participating
2.0%@55	4	3.0%@50	11 ¹¹
2.5%@55	5	3.0%@55	1
2.7%@55	7		

For all plans the pension benefit formula contains the same three primary components multiplied together as shown here:

$$\text{Pension} = \text{Earned Benefit Rate} \times \text{Years of Service} \times \text{Salary}$$

Earned Benefit Rate: This is the percent of salary earned per year of service as indicated by the plan name. Retirement before age 55 for MISC employees and before age 50 for most Public Safety employees results in the Earned Benefit Rate being reduced (per CalPERS' table). For example, a MISC employee in the 2.0%@55 plan who retires at age 50 gets an earned benefit rate of 1.426¹² per year of service rather than 2.0. Similarly, participants of the 2.5%@55 plan as well as the 2.7%@55 plan receive an earned benefit rate of 2.0 at age 50. Interestingly, the earned benefit rate for members of the 2.0%@55 plan continue to rise until the age 63 where it plateaus at 2.418¹³ percent per year of service. This contrasts with the other two MISC plans that plateau at age 55 at 2.5% and 2.7% respectively. (For a more detailed delineation of earned benefit rates, see www.calpers.ca.gov).

Years of Service: This is self explanatory except to point out CalPERS supports reciprocity, which means that employees can transfer from one CalPERS-covered agency (City) or any other public agency that has established reciprocity with CalPERS, to another such agency without forfeiture of earned pension (as is usually the case in the private sector).¹⁴ Thus, an employee may work 10 years each for three different cities and earn the same pension benefits as otherwise would have been earned if they had worked for 30 years at a single city. But because each of the three cities pays only its one-third share of the earned pension, statistically, this employee appears as three employees earning a more modest pension from each city.

¹¹ Some Cities contract for police and fire, Gilroy police and fire belong to separate Public Safety plans.

¹² From CalPERS Benefit Factors Table, page 22, Local Miscellaneous Benefits

¹³ From CalPERS Benefit Factors Table, page 22, Local Miscellaneous Benefits

¹⁴ Reciprocity agreements may also exist between other pension plan providers.

Salary: CalPERS has guidelines defining what wages and reimbursements qualify for the purposes of determining pension. For a detailed discussion, go to www.calpers.ca.gov. Generally, salary can either be the average highest salary over a three-year period, or a highest single 12-month salary can be used, depending on the plan adopted by the City. Using the highest 12-month salary (rather than highest 36-month average salary in the pension formula shown above) is an example of what is known as a "Class 1" benefit enhancement that is more expensive to provide.

It is noted here that Public Safety plan participants have a 90% maximum salary cap that can be earned at onset of retirement. There is no corresponding limit placed on plan participants. In both cases however, the Grand Jury learned that large pensions (expressed as a percent of salary) serve as a deterrent to prolonging employment because one can retire at close to full pay. Subsequent discussions on Employer Paid Member Contribution (EPMC) and Cost-of-Living Allowances (COLA) will show how pensions can actually exceed salary, leading to the paradox of employees losing income if they continue to work as a public employee rather than retire.

ARC: What is it and How is it Determined?

The ARC is the annual actuarially determined amount that must be paid to ensure there will be enough money to pay for all promised Benefits. As shown below, the pension ARC consists of three principle components added together:

$$\text{ARC} = \text{Employee Contribution} + \text{Normal Cost} + \text{Past Service Cost}$$

It should be noted that generally the Normal Cost and Past Service Cost, in accordance with labor contracts, are paid for by the Cities—through tax revenue—and sometimes are supplemented by an employee contribution.

Employee Contribution: From the perspective of CalPERS, this is a fixed percent and, as the name would suggest, was intended to be paid by the employees in much the same way as most private workers pay a portion of their own Social Security benefits. For all City employees, the Employee Contribution is either 7%, 8% or 9% of an employee's salary, depending in which plan the employee participates. It is important to note, however, that in practice, most Cities pay some portion of this cost on behalf of the employees.

Normal Cost: Less the employee contribution, if made, this is the amount required to pay for the benefits that were earned in the prior year for the (expected) life of the employee in retirement. This is determined through rigorous actuarial valuations taking many variables into account, including retirement age, life expectancy, and probability of disability. Normal Cost tracks very closely with the degree of Benefits being offered. That is to say, discrete cost increases occur to this component of the ARC with each benefit enhancement proportional to the cost of the benefit. Without benefit enhancements, Normal Cost remains relatively flat over time.

Past Service Cost: Whenever the plan assets (all previously paid ARCs), including ROI, become insufficient to pay the actuarial accrued cost of benefits, an unfunded liability¹⁶ exists. This deficit must be made up in the form of Past Service Cost. This component of the ARC is largely proportional to unfunded liability, increasing as the unfunded liability goes up to begin paying down the debt. For many Cities surveyed, Past Service Cost is approaching and in some cases already exceeds Normal Cost. Later, this report will discuss the three most often cited reasons for unfunded liability: market losses (ROI lower than the assumed rate), retroactive benefit enhancements, and other accumulated actuarial assumption changes (e.g., longer life expectancy, demographic changes).

CalPERS Menu Options

Each CalPERS plan has numerous benefits that are inherent to the plan itself.¹⁶ In addition to these benefits, CalPERS offers a wide range of menu options that can be thought of as upgrades or enhancements to the base plan. They are too numerous to list but include the following:

- Annual cost-of-living allowance (COLA) increase
- Employer-paid member contribution (EMPC)
- Credit for unused sick leave
- Improved industrial and non-industrial disability
- Special death benefits
- Survivor benefits
- Various military and public service credits.

Each enhancement selected results in quantifiably larger ARC payments. One cannot conclude from the plan name that it is necessarily more or less generous than another plan of a different name. For this reason, the Grand Jury's investigation concerned itself not with the issue of what specific Benefits were being provided but rather what was the total cost of providing the Benefits expressed as a percent of payroll. Cities and CalPERS experts agreed this is a sound methodology for comparing cities of different sizes.

¹⁶ See Appendix C Glossary for definition.

¹⁸ For a more detailed discussion of menu options, go to www.calpers.ca.gov.

Sensitivity to Expected ROI

All Cities and all CalPERS representatives interviewed consistently told us that somewhere between 65% and 70% of the money to pay for Benefits comes from the ROI of previously accumulated ARC payments. This cannot be emphasized enough. The Cities spoke to their burden in struggling to meet ARC obligations in light of budget constraints, but these ARC payments cover only about 30% of the amount necessary to cover the cost of providing these Benefits. A critical actuarial assumption is the expected ROI, which is currently assumed to be 7.50% after expenses for pension. The actual average ROI over the last ten years has been 6.1% as depicted in Figure 1. The result of this underperformance is higher unfunded liabilities, lower funded ratios, and larger ARC payments (in particular, the Past Service Cost component of the ARC as discussed above). Discussion of San Jose's ROI included in this figure is deferred until later.

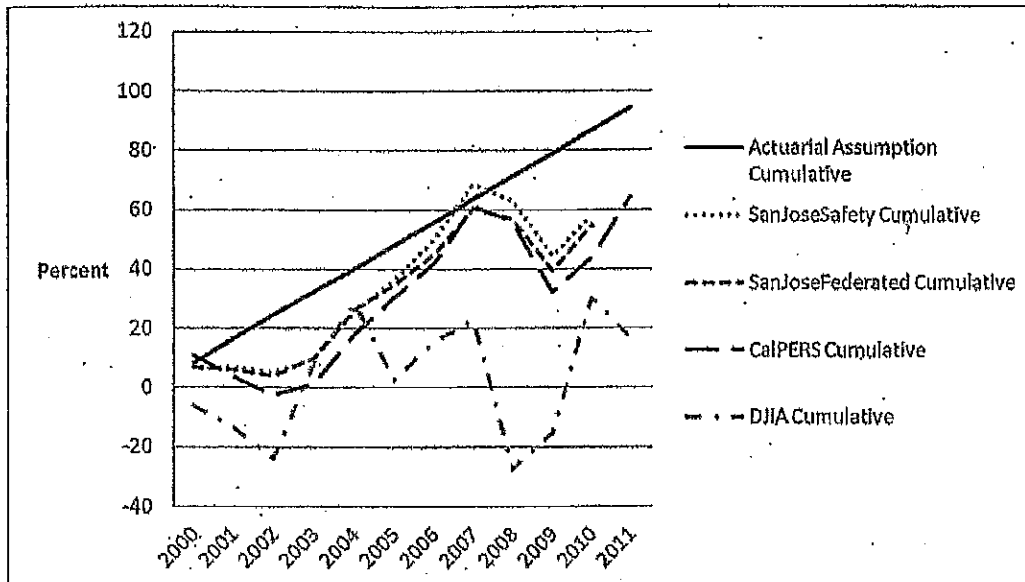


Figure 1: Actual Return on Investment Compared to Assumed and Dow Jones¹⁷

CalPERS lowered the assumed ROI from 7.75% to 7.5% at a March 14, 2012 meeting. Last year this same recommendation was rejected. This year, a 0.5% change was recommended and only a 0.25% change was approved. Table 2 below is excerpted from "Pension Math: How California's Retirement Spending is Squeezing the State Budget" written by Joe Naton from Stanford Institute for Economic Policy Research.

¹⁷ DJIA is calendar year and other data are fiscal year

Table 2: CalPERS Return on Investment Analysis

Investment rate	Probability of meeting or exceeding rate	CalPERS funded ratio
9.5%	21.7%	95.1%
7.75%	42.1%	73.5%
7.1%	50.7%	66.7%
6.2%	62.6%	58.3%
4.5%	80.9%	45.1%

Two key points in Table 2 are:

- According to this analysis, there is only a 42.1% chance of meeting or exceeding an assumed investment rate of 7.75% as highlighted in the table. It should be noted that the ROI assumption was recently reduced to 7.5%.
- Dropping down to a more conservative 6.2% investment rate (still higher than the 6.1% average for the last ten years) is recommended by many leading economists and recognized financial experts. The corresponding funded ratio reduction would result in increases to unfunded liabilities and significantly higher ARC costs.

Sunnyvale projects this modest CalPERS-approved reduction of 0.25% in assumed ROI will increase its ARC by 2.3% of payroll for MISC employees and 3.8% of payroll for Public Safety employees, totaling nearly a \$3M increase per year in ARC payments. As shown in Table 3, Sunnyvale's pension cost was just over \$25M. So, a \$3M increase represents a 12% increase. CalPERS and pension experts we spoke with asserted that the cost of each additional 0.25% reduction in assumed ROI is not linear and warned extrapolating this cost increase would result in underestimating the total cost impact.

Unfunded Liability & Funded Ratio

Unfunded Liability is the unfunded obligation for prior benefits, measured as the difference between the accrued liability and plan assets. When using the actuarial value of plan assets, it is also referred to as the Unfunded Actuarial Accrued Liability (UAAL). In everyday language, it is the difference between the cost of the benefits already earned and the amount currently paid; it is the amount due.

¹⁸ As of June 30, 2011

Table 3: Unfunded liability for pension and OPEB for all large cities shows the total for these nine cities is nearly \$7B

FY 2010 Unfunded Liabilities (Not in Risk Pool) ¹⁹				Debt per Resident
City	Pension	OPEB	Total	
Santa Clara County	\$1,455,835,322	\$1,300,000,000	\$2,755,835,322	\$1,547
Cupertino	\$18,581,728	\$18,069,366	\$36,651,094	\$629
Gilroy	\$35,100,000	\$4,900,000	\$40,000,000	\$819
Milpitas	\$70,166,975	\$31,230,798	\$101,397,773	\$1,518
Mountain View	\$104,121,296	\$29,396,467	\$133,517,763	\$1,803
Palo Alto	\$153,941,000	\$105,045,000	\$258,986,000	\$4,021
San José ²⁰	\$1,434,696,471	\$1,706,081,881	\$3,140,778,352	\$3,320
Santa Clara	\$223,867,947	\$23,855,000	\$247,522,947	\$2,125
Sunnyvale	\$149,300,000	\$92,800,000	\$242,100,000	\$1,728
Total	\$3,645,410,739	\$3,311,378,512	\$6,956,789,251	

The Funded ratio is the market value of assets at a specified date, over the accrued actuarial liability as of the same date. While technically accurate, these definitions provide no insight into the causes of what have become large unfunded liabilities and correspondingly low-funded ratios. The Grand Jury learned from CalPERS that the three primary reasons for unfunded liabilities are the following:

- 70% of the unfunded liabilities is attributable to market performance
- 15% of the unfunded liabilities is attributable to retroactive benefit enhancements
- 15% of the unfunded liabilities is attributable to other actuarial assumption changes.

The percentages shown above are "rule of thumb" values according to the CalPERS representatives; individual City percentages will vary.

Key Survey Results

With the basic concepts of public pension benefits understood, the Grand Jury prepared a survey to gather information from the Cities. Survey responses and all supplemental data provided by the Cities were analyzed to answer the following questions:

¹⁹ Numbers reflect data provided in survey responses.

²⁰ Excluding Mayor and Council Member Plan.

- What is the total amount of unfunded liabilities?
- What is the total cost each year to provide Benefits and at what rate is the cost going up per year?
- Why are OPEB funded ratios so low?
- When were Benefit enhancements enacted and how do they impact unfunded liability?
- What progress is being made to control escalating costs?
- Why are public Benefits so different from private sector Benefits?
- Do vacation, holiday and sick leave policies in the public sector differ from those that are commonly found in the private sector?

Unfunded Liability (Large Debts)

Table 3 tabulates the unfunded liability for both pension and OPEB for all large cities not belonging to a risk pool and shows the total unfunded liability for these nine cities is nearly \$7B. Cities having fewer than 100 employees in a given pension plan (Campbell, Los Altos, Los Altos Hills, Los Gatos, Monte Sereno, Morgan Hill, and Saratoga) are not included because they belong either entirely or in part to a risk pool. CalPERS currently does not provide this information to the Cities in the risk pool. Los Gatos and Morgan Hill, for instance, do not know their portion of a \$3,515,314,403 unfunded liability associated with the Public Safety risk pool to which they belong. While Monte Sereno and Los Altos Hills did offer an approximation of their portion of the risk pool liability, CalPERS representatives recommended against using the estimation and as a result are not included in Table 3. The Grand Jury has learned the Government Accounting Standard Board (GASB) is considering a policy change to require the Cities in the risk pool²¹ to report individual unfunded liability. Many Cities surveyed focused primarily on minimizing the ARC payments, the short-term cost due, as opposed to addressing the larger, endemic problem of its unfunded liability. This is problematic because minimizing ARC payments today at the expense of addressing the growing unfunded liability means shifting the costs to the future, hoping market improvements will solve the problem. If the market does not improve, taxpayers may face increased taxes or reduced services in the future.

Using 2010 census data obtained from <http://www.sccgov.org> together with the data in Table 3, it is possible to estimate the amount owed by each resident to pay down current Benefit debts in the Cities. For example, each resident of San Jose owes \$3,320 to the city. As residents of the County, they also owe an additional \$1,547 to the

²¹ See Appendix C Glossary for definition.

County.²² But while this would pay down the current debt and significantly reduce ARC payments, it does not guarantee staying out of debt going forward.

High Cost of Benefits (ARC) . . . and Getting Higher

The accumulated City cost of providing annual Benefits in FY2010 was \$667,215,205 as shown in Table 4. While it is useful to know the annual cost of providing Benefits it is not possible to judge whether or not any City is paying a disproportionate cost due to the size variance of the Cities (large Cities are expected to pay more because they have more employees). For this reason, the Grand Jury chose to compare the Cities by expressing the ARC as a percent of payroll. Cities and pension experts agreed the Grand Jury's method of making this calculation was correct. That said, the same values shown in Table 4 are also shown in Figure 2 expressed as percent of payroll separating pension, OPEB and Social Security as applicable.

Table 4: Countywide total cost of providing annual Benefits in FY2010 is \$667,215,205

City	Pension Cost ²³	OPEB Cost ²⁴	Social Security Cost ²⁵	Total
Santa Clara County	\$235,630,042	\$90,000,000	\$65,136,430	\$390,766,472
Campbell	\$2,728,302	\$206,220		\$2,934,522
Cupertino	\$1,841,350	\$7,616,760		\$9,458,110
Gilroy	\$4,900,000	\$186,334		\$5,086,334
Los Altos	\$1,842,949	\$19,505		\$1,862,454
Los Altos Hills	\$190,021	\$203,000		\$393,021
Los Gatos	\$2,958,209	\$949,845		\$3,908,054
Milpitas	\$7,164,473	\$3,356,836		\$10,521,309
Monte Sereno	\$125,713	\$0	\$37,863	\$163,576
Morgan Hill	\$2,763,818	\$15,119		\$2,778,937
Mountain View	\$8,929,685	\$4,376,387		\$13,306,072
Palo Alto	\$19,964,080	\$9,019,000		\$28,983,080
San Jose	\$106,881,000	\$34,147,000		\$141,028,000
Santa Clara	\$20,257,754	\$2,115,643	\$3,494,639	\$25,868,036
Saratoga	\$917,228	NA		\$917,228
Sunnyvale	\$25,300,000	\$3,940,000		\$29,240,000
Total	\$442,394,624	\$156,151,649	\$68,668,932	\$667,215,205

²² Note these figures are per resident, not per household, and exclude an additional state pension liability all California residents bear, which is outside the scope of this report.

²³ Many Cities, but not all, provided separable "sidefund" expenditures from ARC.

²⁴ May include money spent over and above ARC payment.

²⁵ Only MISC employees in Santa Clara County, Monte Sereno and Santa Clara participate in Social Security.

As shown in Figure 2, the cities of Campbell, Los Altos, Monte Sereno, Morgan Hill and Saratoga pay less than 20% of payroll towards Benefits while the remaining cities pay more than 20%. Cupertino, Palo Alto and Sunnyvale pay in excess of 30% of payroll towards Benefits. The survey results further indicated that Mountain View is noteworthy because it offers similar plans as Cupertino, Palo Alto and Sunnyvale but at lower cost to the city through cost sharing with employees who pay the entire employee contribution (8% for MISC and 9% for Public Safety) plus some negotiated portion of that city's cost in the range of 1.5% to 6.8% depending on job type. Cupertino, Palo Alto and Sunnyvale in contrast to Mountain View, pay some portion of the employee contribution with Sunnyvale contributing the most (7% of the required 8% for MISC employees and 8% of the 9% for Public Safety employees).

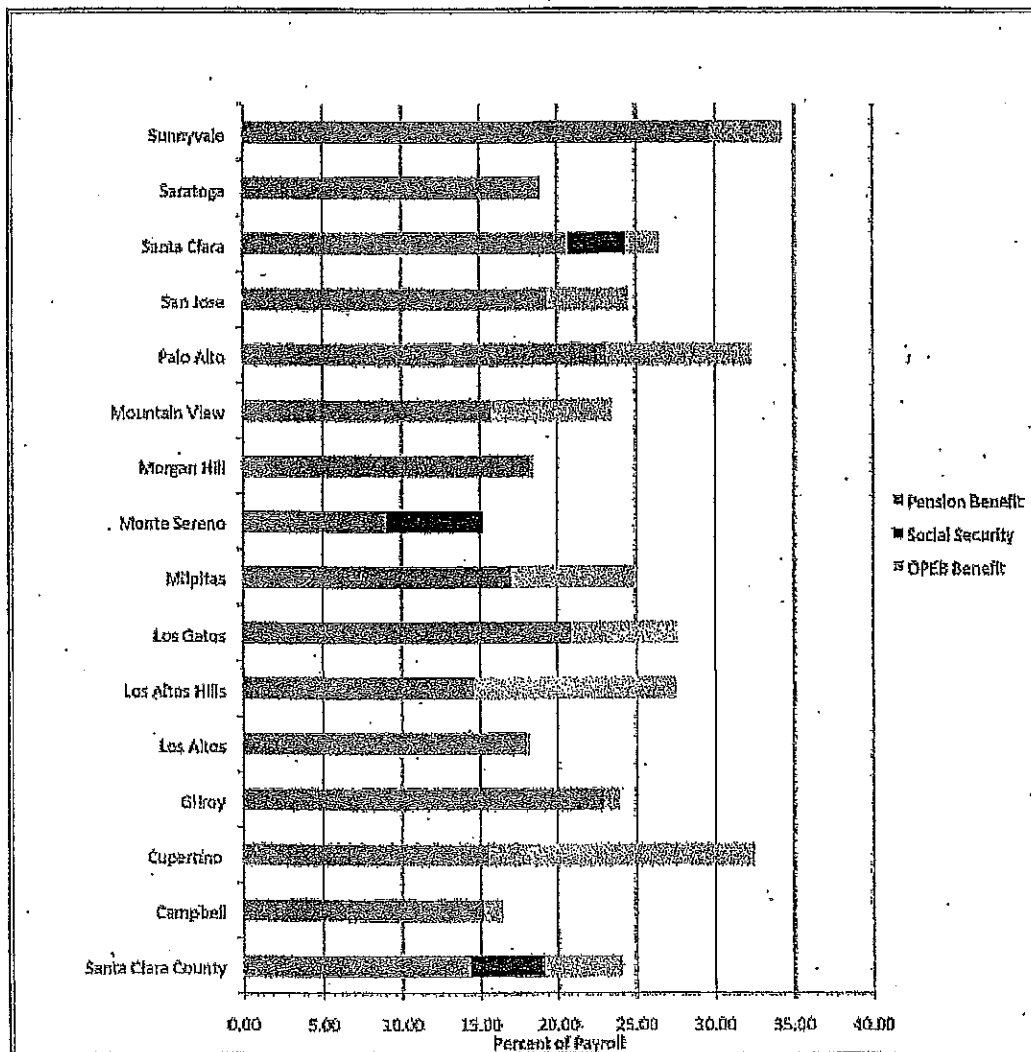


Figure 2: FY 2010 Benefit Ranking by Percent of Payroll

Comparing the Sunnyvale pension costs expressed in percent of payroll to Mountain View (same plans) demonstrates that employee contributions toward the cost of pensions is just as effective at keeping the cost under control as curtailing the level of pension benefits being offered. Mountain View actually compares favorably to other cities offering lower benefits. Table 5 summarizes the Cities' plan(s) and the amount contributed by employees.

For those Cities that elected to participate in Social Security (MISC employees in the City of Santa Clara, Santa Clara County and Monte Sereno), the cost to the city has been added to reflect the total amount the city is paying toward employee Benefits.

The survey responses conveyed how much pension and OPEB were expected to rise during the next five to ten years. Most Cities' responded using projections from the latest actuarial valuations, which estimate contributions as a percentage of payroll rather than in dollars. In the case of pension, these valuations are performed by CalPERS and in the case of OPEB, the valuations are performed by an actuary firm under contract to the City. All Cities' Benefits costs are trending up, in spite of optimistic assumptions regarding the ROI that has been shown to be of paramount importance. Projected San Jose cost increases are discussed separately in subsequent sections.

Unfunded Retroactive Pension Benefit Enhancements

When a City amends its contract with labor unions to increase the pension formula (e.g., 2% @ 55 to 2.5% @ 55) the increased benefits apply retroactively to all prior years of service. The retroactive application of the increase results in an increase in the unfunded liability and requires an increase in ARC payments by the City. The reason for the increase in ARC payments can be illustrated by this example:

Assume an employee has worked for twenty-five years and has paid into the system all those years. The City leaders now approve a retroactive benefit enhancement without funding the retroactive period. Immediately the employee and employer have effectively underpaid for the enhanced unfunded benefits portion for the previous twenty-five years. The difference between what was actually paid and what should have been paid to provide the enhanced benefit adds to unfunded liability, which increases ARC payments. This is now a new liability to the taxpayer.

In question three of the Grand Jury questionnaire (Appendix B), Cities were asked to list any significant pension benefit changes that have been made over the past ten years. Table 5 summarizes the responses received by the Grand Jury. As the table shows, most Cities have increased pension benefits within the last ten years. When asked how much these benefit increases changed Unfunded Liability, most cities provided the CalPERS provided answer of 15%. However, Cupertino stated that benefit changes are responsible for 26% of their Unfunded Liability and the City of Santa Clara cited 24.6%.

Table 5: Pension Benefit Plan Changes

Name of City/County	Year of Increase	1st Tier Plan			2nd Tier Plan		
		Original Plan	Benefit Increase	Employee Paid Contribution FY 2011 (Per Survey Responses)	Plan Name	Year Adopted	Employee Paid Contribution
County of Santa Clara	2007	MISC 2%@55	MISC to 2.5%@55	3.931 to 5%	None		
County of Santa Clara	2001	Public Safety 2%@50	Public Safety to 3%@50	0.5 to 9%	None		
Campbell	2002	MISC 2%@55	MISC to 2.5%@55	7%	MISC 2%@60	2011	7%
Campbell	2001	Public Safety 2%@50	Public Safety to 3%@50	8%	Public Safety 2%@50	2010	9%
Cupertino	2007	MISC 2%@55	MISC to 2.7%@55	2%	None		
Gilroy	2006	MISC 2%@55	MISC to 2.5%@55	8%	None		
Gilroy	2002	Police 2%@50	Police to 3%@50	9%	Police 2%@50	2011	9%
Gilroy	2007	Fire 2%@50	Fire to 3%@55	9%	Fire 2%@55	2011	7%
Los Altos	2004	MISC 2%@55	MISC to 2.7%@55	1%	None		
Los Altos	2003	Public Safety 2%@50	Public Safety to 3%@50	1%	None		
Los Altos Hills*		MISC 2%@55	None	0%	MISC 2%@60	2011	7%
Los Gatos	2008	MISC 2%@55	MISC to 2.5%@55	8%	2%@60	2012	7%
Los Gatos	2001	Public Safety 2.5%@55	Public Safety to 3%@60	9%	None		
Milpitas	2002	MISC 2%@55	MISC to 2.7%@55	8%	2%@60	2011	9%
Milpitas	2000	Public Safety 2%@50	Public Safety to 3%@50	9%	None		
Monte Sereno*		MISC 2%@55	No pension benefit changes	0%	None		
Morgan Hill	2006	MISC 2%@55	MISC to 2.5%@55	1-8%	None		
Morgan Hill	2002	Public Safety 2%@50	Public Safety Increase to 3%@50	9%	None		
Mountain View	2007	MISC 2%@55	MISC Increase to 2.7%@55	8%+	None		
Mountain View	2001	Public Safety 2%@50	Public Safety Increase to 3%@50	9%+	None		
Palo Alto	2007	MISC 2%@55	MISC Increase to 2.7%@55	2%-5.7%	2%@60	2010	2%
Palo Alto	2002	Public Safety 2%@50	Public Safety Increase to 3%@50	0%-9%	None		
San Jose		Federated 2.5%@55		4.68%	None		
San Jose		Public Safety 3%@50		10.50%	None		
Santa Clara	2006	MISC 2%@55	MISC Increase to 2.7%@55	8%	None		
Santa Clara	2000	Public Safety 2%@50	Public Safety to 3%@50	9%-11.25%	None		
Saratoga*		2%@55	No pension benefit changes	7%	None		
Sunnyvale	2007	MISC 2%@55	MISC Increase to 2.7%@55	3%	None		
Sunnyvale	2001	Public Safety 2%@50	Public Safety Increase to 3%@50	1%-3%	None		

* These cities contract out for public safety services, avoiding a direct benefit liability.

Cities told the Grand Jury that as recently as 2003, and in 2007 for Campbell and Los Altos Hills, their plans were over funded. Assuming this trend would continue, Cities thought they could enhance Benefits without significantly increasing their costs. Analysis was performed to prove the enhancements could be funded. In hindsight, this did not prove to be the case because the analysis assumed the optimistic ROI would be achieved.

The County and a few of the cities attempted to recover some of the increased cost by increasing the employee paid contributions and by eliminating previously enhanced menu options. The Grand Jury learned that in some cases adequate funding was not in place to pay for the enhanced pension benefits at the time they were granted. Without solid plans to fund increases in pension benefit plans, Cities pushed the impact of these increases to future generations of taxpayers.

Nearly every City demonstrated an historical pattern of granting unfunded benefit enhancements as discussed here. This practice is beginning to change with the adoption by a few cities of second tier²⁶ plans that extend retirement age and reduce Benefit costs.

Table 5 shows that eight cities have adopted second tier plans. Other Cities may be in the process of adopting second tier plans but cannot report this fact because of ongoing union negotiations. Note that all new second tier plans continue to be the defined benefit type; none have adopted any form of defined contribution elements. While the creation of second tier plans will reduce the cost of providing pension benefits,²⁷ these savings will not materialize for many years. All risks associated with market losses remain with the Cities, and ultimately the taxpayers. Increasing employee contribution rates, subject to labor agreements, is the most effective method of controlling cost in the shortest amount of time.

Low OPEB Funded Ratios

As shown in Table 6, OPEB-funded ratios are low. These OPEB low-funded ratios and corresponding high unfunded liabilities are of concern to the Grand Jury. Cities are required to "pay forward"²⁸ for pensions, but not for OPEB. As a result, many cities only pay the minimum required to cover the current annual OPEB cost; no extra is paid to defray the cost of all current employees when they retire. The Cities referred to this as the "pay-as-you-go" strategy and results in very low-funded ratios—even zero percent. This strategy has resulted in San Jose's OPEB being \$1,706,081,881 underfunded (refer back to Figure 2 for a comparison of San Jose's underfunded status relative to other cities and the County)

²⁶ See Appendix C Glossary for definition.

²⁷ At the time of this report, the Grand Jury is not aware that Cities are considering OPEB changes in second tier plans.

²⁸ See Appendix C Glossary for definition.

Table 6: OPEB Funded Ratio

City	FY 2010 OPEB Funded Ratio ²⁹
Santa Clara County	10.10%
Campbell	4.00%
Cupertino ³⁰	0%
Gilroy	0%
Los Altos	0%
Los Altos Hills	23.40%
Los Gatos	2.70%
Milpitas	24.13%
Monte Sereno	0%
Morgan Hill	0%
Mountain View	55.90%
Palo Alto	19.00%
San Jose ³¹	12.00%/6.00%
Santa Clara	22.80%
Saratoga	N/A
Sunnyvale ³²	0%

Mountain View, Sunnyvale and Cupertino are commended for having begun to implement a "pay forward" strategy, which demonstrates fiscal responsibility. One San Jose public official interviewed stated that the reason San Jose was not fully funding OPEB is that it could not be done without significant curtailment of services, effectively shifting the burden of payment to future generations.

Public Benefit Comparison to Private Sector Benefits

To put public employee Benefits into perspective, consider the average pension for Public Safety employees in Palo Alto retiring between the ages of 51 and 54 with 30 years of service is \$108,000. In Sunnyvale, the same employee receives almost \$102,000 per year. The most common pension plans offered to public employees who spend their entire career in the public sector not only discourage employees from

²⁹ Some 2010 data is derived from 2009-Actuarial Valuations

³⁰ In 2010 and 2011 the city made payments of nearly \$6.5M in excess of ARC to bring this up to 35.6%

³¹ San Jose has separate OPEB funds for its employees

³² In 2011 the city paid \$32M in excess of ARC but impact on funded ratio has not yet been determined via actuarial evaluation

continuing to work beyond the age of 50 or 55, they penalize them for doing so. The CalPERS reported average pension of under \$30,000 per year is misleading because it fails to recognize persons who receive multiple pensions. The Grand Jury learned that some employees actually earn more in retirement than they did while employed. Further, the ratio of active employees to retirees was found to be three to two.³³ With budget constraints leading to staffing reductions and as the baby boom generation approaches retirement age, this ratio is expected to continue downward, placing additional financial burdens on the Cities.

Public benefits are overwhelmingly of the defined benefit type (refer to Appendix C for the differences between defined benefits and defined contributions). While some private sector companies continue to offer defined benefits, the clear trend in the private sector is to transition away from defined benefits in favor of defined contributions, thereby transferring the risks associated with market performance from the employer to the employee. An additional advantage of the defined contribution is that it leads to less volatile City budgets over time because the cost of providing benefits is constant, not varying over time to compensate for market performance.

Determining in any meaningful way what might be considered "standard" private sector benefits for the purposes of comparing to public sector was clearly outside the scope of this investigation. That said, Bureau of Labor Statistics surveys show the majority of private pensions include participation in Social Security and a defined contribution plan such as a 401k. The employee and employer each contribute 6.2% of salary (currently up to \$110,100 in salary) per year, to pay for Social Security benefits.

While the particulars of 401k plans vary widely, the surveys show that the majority of employees receive some form of matched savings plan described as follows. For every dollar the employee contributes to their own 401k, the employer will contribute some amount: 50 cents or less for most employees. Employees may be limited to the amount they can contribute and employers limit the amount they contribute by specifying that employer contributions cannot exceed a set percent of salary: four percent or less for most employees. As described, the majority of private sector employees contribute more than 50% of the total cost toward their own pensions (exactly 50% in the case of Social Security and greater than 50% of the 401k since an employer only contributes a portion of every dollar the employee contributes). Using 65 as a traditional retirement age, the differences between public and private benefits are summarized in Table 7.

The Grand Jury reviewed the survey results and observed the following for all first tier plan employees:

- All Public Safety employees, except Gilroy fire,³⁴ qualify for full retirement benefits no later than age fifty (assuming at least five years of service)

³³ Half the Cities surveyed currently have more retirees than employees.

³⁴ Gilroy fire receives the same at age fifty-five rather than age fifty.

- All Public Safety employees, except Gilroy fire,³⁵ with thirty years of service credit receive no less than 90% of their salary in retirement, not considering annual COLA increases.
- All MISC employees qualify for retirement benefits no later than age fifty-five (assuming at least five years of service)

Table 7: Sample comparison of MISC Public versus Private Benefits³⁶

Attributes	Public ³⁷	Private ³⁸
Percent of salary contributed by employee toward Benefits	7 - 8%	14 - 16%
Age pension may be drawn without an age-related reduction in eligible amount	55	65
Employee contribution for every dollar of employer contribution	50¢ ³⁹	\$1.40 ⁴⁰
Retirement income expressed as a percent of salary (assuming the retiree reaches full plan benefit age and works 35 or 45 years, respectively)	87.5%	66% ⁴¹
Who bears the risk if market underperforms?	Taxpayer	Employee
Is subsidized retiree healthcare available?	Generally Yes	Generally No

- The majority⁴² of MISC employees who work 35 years receive 87.5% of their salary in retirement before annual COLA increases.

³⁵ Gilroy fire receives the same benefits at thirty-five years service rather than thirty years.

³⁶ The table is intended for comparison; it is not representative of all situations.

³⁷ Represented by participant in 2.5%@55.

³⁸ Represented by participant in Social Security and 401k Savings plan where employee contributes 8% salary and employer matches 50 cents per dollar.

³⁹ Based on CalPERS data for 2011. Actual varies by city; can be as high as 50¢ or as low as 5¢.

⁴⁰ Based on the Bureau of Labor statistics.

⁴¹ This number assumes a \$750K in retirement savings.

⁴² Los Altos Hills, Monte Sereno and Saratoga are exceptions receiving 70% of salary.

In consideration of these statistics, and as shown in Table 7, the Grand Jury concludes:

- Full pension is attained at an earlier age in the public sector than in the private sector – some by ten years or more
- Pension earned, expressed as a percentage of salary, is greater in the public sector than in the private sector even after adjustment to account for non-participation in Social Security
- Employees in the public sector contribute less towards their pension plans than their private-sector counterparts
- Taxpayers in the public sector bear the risk of ROI and actuarial assumptions associated with the pension plan; whereas employees in the private sector bear the risk of market performance.

The Grand Jury acknowledges wages and salaries are a large portion of Cities' budgets, and when salaries escalate this further exacerbates budget shortfalls. It may be asserted that public sector salaries are lower than their private sector counterparts, thus, justifying more generous public benefits. Readers can explore whether this assertion is true by accessing publically available salary data.

Accrued Sick Leave Can Be Reimbursed

In general, the survey revealed no significant differences between the Cities in regard to holiday, vacation and sick leave policies. However, it is noted that all Cities surveyed except Gilroy, Monte Sereno, and Sunnyvale either reimburse for accrued unused sick time or permit it to be converted into service time for purposes of determining pension. Often reimbursement is at discounted rates and other times the amount of sick time that can be accrued is capped. Gilroy, Monte Sereno and Sunnyvale responded "No" to the survey question asking if accrued sick time is paid upon retirement, without proffering whether or not it could be converted into service time. However, the Grand Jury learned that sick time conversion to service credit is a common CalPERS benefit for all members of risk pools.

The survey revealed that the City of Santa Clara grants fire personnel on 24-hour shifts 288 hours of sick leave per year. Up to 96 hours per year can be accrued and paid (discounted to 75% of their hourly wage equivalent) for employees with 25 or more years of service.

San Jose's Plan

San Jose is the only city that does not use CalPERS to provide pension benefits (with the exception of the Mayor and Council members who get benefits in accordance with CalPERS 2%@55 plan). San Jose public employees have two independent plans: Federated and Public Safety. Federated Plan members are equivalent to those in a CalPERS Miscellaneous Plan. Public Safety members (police and fire) in San Jose are

identical to Public Safety members in other Cities. The San Jose Federated and Public Safety plans share commonality with CalPERS 2.5%@55 and 3.0%@50 respectively with the following key differences:

- COLA is a guaranteed 3% compared to CalPERS' not-to-exceed 2%
- Employee-to-employer contribution ratio of three to eight (3:8)
- Money is invested and managed by the two governing Boards (the Federated Plan Retirement Board and the Public Safety Retirement Board) rather than by CalPERS, and San Jose performs its actuarial valuations independent of CalPERS
- San Jose participates in a Supplemental Retiree Benefit Reserve (SRBR) program.

Each of the major differences cited above is discussed in more detail below.

3% Guaranteed COLA

San Jose provides a guaranteed 3% COLA increase every year compared to a CalPERS base COLA which is "not to exceed an accumulated 2% per year".⁴³ The Grand Jury is unable to quantify the additional cost of increasing COLA. As mentioned previously, CalPERS does provide menu options for increased COLA (including 3%), but no other Cities have opted for this increase, citing cost as a reason.

Three-to-Eight (3:8) Employee Contribution Ratio

For every eight dollars San Jose spends on the Normal Cost of providing benefits (excluding the Past Service Cost portion of benefits that the employer pays entirely⁴⁴) employees contribute \$3-dollars. This differs substantially from CalPERS, which sets employee contribution as a percent of salary between 7% and 9% depending on the plan. As noted in Table 5, many Cities pay much of the employee contribution on behalf of the employees, further complicating any comparison. As noted in *Methodology*, the Grand Jury is reluctant to interpolate the data provided. The San Jose survey response shows that Federated employees pay 4.68% (of payroll) toward pension, which compares to CalPERS' MISC plan at 8%. San Jose's Public Safety employees pay approximately 10.5% (of payroll) toward pension, which compares to CalPERS' Public Safety plan at 9%.

⁴³ As a function of inflation, CalPERS COLA has a clause protecting retirees from losing more than 20% of their buying power in retirement which could result in increases greater than 2%. When CPI is less than the 2% promised, CalPERS COLA also entails "banking" of COLA as unneeded credits that can be applied when CPI is greater than 2%. This results in annual COLA increase in excess of 2% when the CPI exceeds 2%.

⁴⁴ The ratio of Past Service Cost to Normal Cost (expressed in Percent Payroll) for Federated and Public Safety are: 15.58/12.76 and 22/27 respectively

From a cost perspective, there is insufficient data to determine if the 3:8 ratio results in net savings or increased cost to San Jose, compared to the CalPERS plan. However, excluding Past Service Cost from any form of employee cost sharing does result in San Jose paying a higher portion of the cost of providing Benefits.

Self-Managed Investing

The Federated and Public Safety Boards independently manage approximately \$2B in assets each (approximately \$4B total). Both currently assume a 7.5% ROI, similar to the recently adopted CalPERS ROI. As with CalPERS, these investment returns are expected to pay the majority of the costs for providing benefits. It is critical, therefore, to compare the actual investment performance to what is actuarially assumed, and it is useful to compare San Jose's investment performance to CalPERS.

As was shown in Figure 1, both Federated and Public Safety ROI for the last ten years has been below the actuarial assumptions but slightly better than what CalPERS did in the same time period. San Jose did not provide ROI data for 2011. The DJIA is shown in the figure for comparison purposes and is intended to show that both San Jose and CalPERS outperformed the general market (represented by DJIA) by a wide margin, yet still fell below the optimistic actuarial assumptions so critical to economic viability.

The largest advantage of managing one's own plans would seem to be the added flexibility it affords the city in tailoring retirement formulas to meet the needs and means of the city. Although there is little evidence the city is using this advantage in the current first tier plans (as noted, San Jose plans are both very similar to CalPERS plans offered), this advantage may be utilized if and when second tier plans are developed.

Supplemental Retiree Benefit Reserve (SRBR)

Recall from Table 3 that the combined pension unfunded liability for both the Federated Plan and the Public Safety Plan is \$1,434,696,471. As has already been discussed and demonstrated, the largest single contributor to this is when the achieved ROI falls short of the actuarially assumed ROI. With this in mind, it is difficult to comprehend how responsible financial management would allow withdrawal of any portion of excess ROI whenever the market actually does out-perform the expected rate to be used to pay dividends in the form of an additional "thirteenth check"⁴⁶ to retirees. But this is exactly what the SRBR does. In the case of the Federated Plan, the market must only exceed the expected rate in a single year to permit withdrawal of a portion of the excess ROI for that year. For the same thing to happen in the Public Safety plan, the running five-year average must exceed the expected return rate to permit withdrawal.

⁴⁶ Generally, a windfall dividend payment.

It should be noted that San Jose has temporarily suspended the SRBR payouts. Although San Jose has suspended payouts, the funds remain in the account and San Jose has not used the payout to pay down its underfunded liability. In fact, the suspension merely delays eventual payment to retirees in the form of even larger "thirteenth checks." A better use for these excess funds might be to retain them to pay down the underfunded Benefits, as long as an underfunded liability exists.

Why Such Variance with Estimated Future Benefit Costs?

Much has been written regarding the predicted ARC cost for San Jose in FY 2015/2016. Published estimates vary in the range of \$400M to as much as \$650M. The latter figure represents a more than doubling of the current ARC of \$245M per year—a rate of increase not seen in any of the other Cities.

The Grand Jury interviewed several key personnel associated closely with these predictions to determine why there is so much variability in the estimates. In particular, the Grand Jury wanted to answer the following questions:

- Were these predictions based on sound, factual data?
- Does \$650M represent a worst case number or could it be higher?

The Grand Jury learned that a large set of assumptions factor into any actuarial valuation and many of these assumptions have complex interdependencies with one another. The actuarial valuation itself is a rigorous, precise mathematical calculation based upon these assumptions.

The ARC value can vary, from 400M to \$650M or higher, when assumptions are adjusted. Just two of those actuarial assumption changes, by themselves, account for \$120M of the \$250M difference between the high and low estimate. These two assumption changes are:

- Longer life expectancy of Public Safety employees⁴⁶ than previously assumed
- Lower ROI rate.

Key personnel associated with making actuarial predictions gave an example where increasing the life expectancy of police and fire to be closer to the life expectancy of miscellaneous employees would increase the cost by approximately \$40M. This is a reasonable assumption change to consider since it reflects demographic changes that CalPERS also has begun to reflect. In another assumption query, if the ROI were

⁴⁶ CalPERS has been recognizing this trend and several Cities cited this as being a contributor to unfunded liability

lowered by a whole percentage point to 6.5%, more in line with actual ROI for the last ten years, this would contribute an additional \$80M to the cost of ARC. Importantly, the rationale for exploring a lower ROI was not to bring it into agreement with recent earnings history, but to move San Jose's portfolio from one of high risk and high volatility to a position of low risk and low volatility.

The \$650M per year cost estimate is not a worst case number. Pension experts the Grand Jury interviewed stated that other actuarial assumption changes, within reason and easily justified, would result in ARC costs even higher than \$650M per year. The Grand Jury understands that exploring these actuarial assumptions is justified. They help bring attention to the severity of the Benefits crisis and abate the trend of pushing financial problems to future generations of taxpayers.

Conclusions

Very optimistic actuarial assumptions result in lower ARC costs, leading to insufficient funding and causing unfunded liabilities. The most critical of these is the ROI, which is generally assumed to be 7.5%⁴⁷. The actual ROI for the last ten years has been 6.1%. This underperformance is the largest contributor to the Cities' combined unfunded liability of over \$7B. Future taxpayers are responsible for paying benefits that are being earned and collected today. Lowering the expected ROI—as recommended by leading economists and recognized financial experts—significantly increases ARC and further exacerbates attainment of balanced budgets. Public employee Benefits, especially after being enhanced retroactively, have been shown to be more generous than those found in the private sector and at an earlier retirement age. The amount a public employee contributes toward benefits is shown to generally be less than an employee in the private sector. As a result of lower public employee contribution rates toward their retirement, increasingly large ARC costs must be funded by taxpayer dollars. Ignoring this largesse will result in increased taxes combined with reduced services.

Average pensions are often cited in the range of \$30,000, but these statistics can be misleading. For instance, they include persons whose careers lasted five years or part-time employees with longer service periods. Likewise, it can include employees who work an entire career in the public sector but for different public entities over the course of their careers. Each city that the employee worked for pays only its pro-rated portion of the retirees pension. Thus, the employee's actual pension is larger than the portion attributable to each public entity.

Tier 2 plans that Cities are implementing offer a modest reduction to the future liability, but do not significantly impact the unfunded liability in the short term. To address the short-term cost of the public Benefit crisis, possible solutions may be found in two

⁴⁷ Some OPEB ROI are at lower values.

elements of private sector benefits. The first is the need to reduce the level of benefits to be more comparable to those found in the private sector, inclusive of extending retirement age. Second, public employees must contribute a greater share towards their Benefits, particularly those employees who receive enhanced Benefits. Such solutions will reduce the burden the unfunded Benefits have placed upon current and future taxpayers.

As to the question of defined benefits versus defined contributions, public Benefits continue to be based on a defined benefit model versus the defined contribution model that private industry has moved toward. The defined contribution model works well in the public sector. It offers a working solution to the public sector as a means of reducing the risk of high-cost defined benefit plans. Benefit plans are heavily subsidized by public sector employers compared to the contributions of private sector employers.

The 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 as demonstrated by San Jose 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. Other cities in the County are likely to face similar challenges as long as high cost benefit plans face an underfunding liability. Understanding how Cities created this problem through unfunded retroactive benefit enhancements, compounded by poor ROI, helps taxpayers understand that the problem will not go away on its own.

Findings and Recommendations

When the term Cities is used below, it includes the following: Santa Clara County, the cities of Campbell, Cupertino, Gilroy, Los Altos, Milpitas, Monte Sereno, Morgan Hill, Mountain View, Palo Alto, San Jose, Santa Clara, Saratoga, Sunnyvale; and the towns of Los Altos Hills and Los Gatos.

Finding 1

Public sector employees are eligible for retirement at least 10 years earlier than is common for private sector employees.

Recommendation 1

The Cities should adopt pension plans to extend the retirement age beyond current retirement plan ages.

Finding 2

Campbell, Gilroy, Los Altos Hills, Los Gatos, Milpitas and Palo Alto have adopted second tier plans that offer reduced Benefits, which help reduce future costs, but further changes are needed to address today's unfunded liability. Santa Clara County and the cities of Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga and Sunnyvale have not adopted second tier plans.

Recommendation 2A

Santa Clara County and the cities of Cupertino, Los Altos, Monte Sereno, Morgan Hill, Mountain View, San Jose, Santa Clara, Saratoga and Sunnyvale should work to implement second tier plans.

Recommendation 2B

For Gilroy, Los Gatos, Milpitas and Palo Alto, which have not implemented second tier plans for MISC and Public Safety second tier plans should be implemented for both plans.

Recommendation 2C

All Cities' new tier of plans should close the unfunded liability burden they have pushed to future generations. The new tier should include raising the retirement age, increasing employee contributions, and adopting pension plan caps that ensure pensions do not exceed salary at retirement.

Finding 3

Retroactive Benefit enhancements were enacted by Cities using overly optimistic ROI and actuarial assumptions without adequate funding in place to pay for them.

Recommendation 3

The Cities should adopt policies that do not permit Benefit enhancements unless sufficient monies are deposited, such as in an irrevocable trust, concurrent with enacting the enhancement, to prevent an increase in unfunded liability.

Finding 4

The Cities are making an overly generous contribution toward the cost of providing Benefits.

Recommendation 4A

The Cities should require all employees to pay the maximum employee contribution rate of a given plan.

Recommendation 4B

The Cities should require employees to pay some portion of the Past Service Cost associated with the unfunded liability, in proportion to the Benefits being offered.

Finding 5

The Cities are not fully funding OPEB benefits as evidenced by large unfunded liabilities and small funded ratios.

Recommendation 5

The Cities, should immediately work toward implementing policy changes and adopting measures aimed at making full OPEB ARC payments as soon as possible.

Finding 6

The City of San Jose permits the transfer of pension trust fund money, when ROI exceeds expectations, to the SRBR, despite the fact that the pension trust funds are underfunded.

Recommendation 6.

The City of San Jose should eliminate the SRBR program or amend the SRBR program to prevent withdrawal of pension trust money whenever the pension-funded ratio is less than 100%.

Finding 7

The Cities' defined benefit pension plan costs are volatile. Defined contribution plan costs are predictable and therefore more manageable by the Cities.

Recommendation 7

The Cities should transition from defined benefit plans to defined contribution plans as the new tier plans are implemented.

Appendix A: Documents Reviewed

Report Name	Report Date	Document Source
Santa Clara County Comprehensive Annual Financial Report (CAFR)	30-Jun-10	www.sccgov.org/
Santa Clara County Comprehensive Annual Financial Report (CAFR)	30-Jun-11	www.sccgov.org/
City of Campbell CAFR	30-Jun-10	www.ci.campbell.ca.us/
City of Campbell CAFR	30-Jun-11	www.ci.campbell.ca.us/
City of Cupertino CAFR	30-Jun-10	www.cupertino.org/
City of Cupertino CAFR	30-Jun-11	www.cupertino.org/
City of Gilroy CAFR	30-Jun-10	www.cityofgilroy.org/
City of Gilroy CAFR	30-Jun-11	www.cityofgilroy.org/
City of Los Altos CAFR	30-Jun-10	www.ci.los-altos.ca.us/
City of Los Altos CAFR	30-Jun-11	www.ci.los-altos.ca.us/
Town of Los Altos Hills CAFR	30-Jun-10	www.losaltoshills.ca.gov/
Town of Los Gatos CAFR	30-Jun-10	www.town.los-gatos.ca.us/
City of Milpitas CAFR	30-Jun-10	www.ci.milpitas.ca.gov/
City of Monte Sereno CAFR	30-Jun-10	Monte Sereno city hall
City of Morgan Hill CAFR	30-Jun-10	www.morgan-hill.ca.gov/
City of Morgan Hill CAFR	30-Jun-11	www.morgan-hill.ca.gov/
City of Mountain View CAFR	30-Jun-10	www.ci.mtnview.ca.us/
City of Mountain View CAFR	30-Jun-11	www.ci.mtnview.ca.us/
City of Palo Alto CAFR (Revised December 21, 2010)	30-Jun-10	www.cityofpaloalto.org/
City of San Jose CAFR	30-Jun-10	www.sanjoseca.gov/
City of Santa Clara CAFR	30-Jun-10	www.santacruzca.gov/
City of Saratoga CAFR	30-Jun-10	www.saratoga.ca.us/
City of Sunnyvale CAFR	30-Jun-10	www.sunnyvale.ca.gov/
Pension Sustainability: Rising Pension Costs Threaten the City's Ability to Maintain Service Levels - Alternatives For A Sustainable Future	29-Sep-10	www.sanjoseca.gov/auditor
Cities Must Rein In Unsustainable Employee Costs (Santa Clara County Grand Jury Report)	30-Jun-10	http://www.sccourt.org/court_divisions/civil/cg/grand_jury.shtml
Running on Empty (San Mateo County Grand Jury Report)	30-Jun-11	www.sanmateocourt.org/court_divisions/grand_jury/
National Compensation Survey: Employee Benefits in Private Industry in the United States, 2005	1-May-07	www.bls.gov/ncs/home.htm
A Preliminary Analysis of Governor Brown's Twelve Point Pension Reform Plan (Prepared by CalPERS)	30-Nov-11	www.calpers.ca.gov/eip-docs/preliminary-analysis.pdf
CalPERS Pension Benefit Primer	1-Oct-09	www.calpersresponds.com/downloads/Pension_Primer.pdf
More Pension Math: Funded Status, Benefits, and Spending Trends for California's Largest Independent Public Employee Pension Systems	21-Feb-12	www.cacs.org/images/dynamic/articleAttachments/7.pdf
Statement No. 45 of the Governmental Accounting Standards Board	30-Jun-04	Santa Clara County Finance Agency

Appendix B: Grand Jury Survey

Instructions: Please complete the questions below. The questionnaire consists of three sections: Section 1 covers questions regarding Pension Benefits, Section 2 covers questions regarding Other Post Employment Benefits and Section 3 covers questions regarding vacation and sick leave payout policy at time of retirement. Insert your responses directly into this file and return it in your email reply.

Please respond by Dec 19th to this questionnaire for both the fiscal year ending 6-30-2010 and the fiscal year ending 6-30-2011. If you have questions or require additional time, please reply via email as quickly as possible to allow sufficient time to resolve issues. Thank you.

Section 1: PENSION

1. How many defined pension plans do you have? Please identify them by name and answer all subsequent questions for each identified plan name.
2. Does CalPERS administer your pension fund? If not, please identify and describe the manner in which the pension plan is being administered.
3. Please provide a description of each defined pension plan that you provide to your employees.
 - At what age is an employee eligible for a pension?
 - How many years must an employee work to be vested for a pension?
 - Are employees required to make contributions to their own accounts? If so, what percent of their salary is paid toward their pension? Is there any annual or lifetime employee contribution cap?
 - Does the plan include cost-of-living allowance increases post retirement?
4. For each identified plan, what percent of an employee's income is earned toward retirement each year of employment?
 - For each identified plan, is there an identified maximum salary percent cap that can be earned in retirement?
5. Do plan participants contribute to Social Security?
6. For each identified plan, describe the formula for determining final compensation used in factoring a retiree's pension. Include number of months that income is averaged, whether or not overtime is included or excluded from this calculation, and whether or not any other form of employee payments other than base salary are included in the formula (awards, bonuses, travel compensation, etc.).
7. How much money was contributed in each of the last two fiscal years toward pensions (not including employee contributions)?
 - What percent was this of total payroll?
8. How much pension money was paid out in each of the last two fiscal years to retirees?
 - How many retired employees are currently collecting benefits?
 - How many active employees are there currently?
 - How many employees are within five years of being eligible for retirement?
9. For each plan, please identify and quantify all significant actuarial assumptions used in evaluation of ARC to include:
 - a) Amortization period
 - b) Investment rate of return
 - c) Projected salary increases
 - d) Overall payroll growth
 - e) Inflation factor
 - f) Smoothing duration
 - g) Other, if applicable
10. What is the unfunded liability of each identified plan for the fiscal years 2010 and 2011?
11. Please indicate the major reasons for the unfunded liability. For each reason provided, indicate the approximate percentage of contribution to total unfunded liability.
12. What is the funded ratio of each identified plan for the fiscal years 2010 and 2011?
13. When was the last time the funds have been funded at the level of 100% or higher?
14. Have pension contributions ever been reduced from calculated ARC payments?
 - What year was the last time this happened?
15. Please summarize any significant changes to pension benefits over the last ten years for each plan.
 - For each, indicate if this was a pension benefit enhancement or reduction.
16. Please provide any evidence that indicates how projected pension costs are expected to change in the next 5 to 10 years. (Page referencing within an included URL or separate attachment with appropriate material is an acceptable response.)

Appendix B: Grand Jury Survey - continued

17. Please provide any evidence of the strategies that are in work to reduce the rate of pension escalation. (Page referencing within an included URL or separate attachment with appropriate material is an acceptable response.)
18. For each plan, please provide evidence as to how pension fund past performance is doing relative to assumed performance for the last ten years. (Page referencing within an included URL or separate attachment with appropriate material is an acceptable response.)

Section 2: OTHER POST EMPLOYMENT BENEFITS

1. How many defined benefit plans do you have? Please identify them by name and answer all subsequent questions for each identified plan name.
2. Does CalPERS administer your OPEB fund? If not, please identify and describe the nature of the OPEB benefit plan being used.
3. Please provide a description of the OPEB benefits to include:
 - At what age is an employee eligible for a OPEB benefits?
 - How many years must an employee work to be vested for a OPEB benefits?
 - Are employees required to make contributions to their own OPEB benefits? If so, how much?
 - Are OPEB benefits limited to employees only or do they include additional family members? Identify any additional family members qualifying for OPEB benefits.
4. Is OPEB generally offering health care benefits (defined benefit) or is it making contributions (defined contribution) toward health care?
 - Are there caps in what is paid?
 - Who is at risk for escalating health costs; the employee or the employer?
5. How much money was contributed in each of the last two fiscal years to OPEB (not including any employee contribution)?
 - What percent of total payroll cost was this?
6. How much money was paid out in each of the last two fiscal years in OPEB benefits?
 - How many retired employees are currently collecting OPEB benefits?
 - How many current employees are there? (If the number of current employees is different here than provided above, please explain the difference.)
7. Please identify and quantify all significant actuarial assumptions used in evaluation of ARC to include:
 - a) Amortization period
 - b) Investment rate of return
 - c) Projected health care increases
 - d) Inflation factor
 - e) Smoothing duration
 - f) Other, if applicable
8. What is the OPEB unfunded liability of each identified plan for the fiscal years 2010 and 2011?
9. Please indicate the major reasons for the unfunded liability. For each reason provided, indicate the approximate percentage of contribution to total unfunded liability.
10. What is the funded ratio of each identified OPEB plan for the fiscal years 2010 and 2011?
11. When was the last time the funds have been funded at the level of 100% or higher?
12. Have OPEB contributions ever been reduced from calculated ARC payments?
 - What year was the last time this happened?
13. Please summarize any significant changes to OPEB benefits over the last ten years. For each, indicate if this was a benefit enhancement or reduction.
14. Please provide any evidence that indicates how much OPEB benefit costs are expected to rise in the next 5 to 10 years. (Page referencing within an included URL or separate attachment with appropriate material is an acceptable response.)
15. Please provide any evidence of plans that are in work to reduce future OPEB costs? (Page referencing within an included URL or separate attachment with appropriate material is an acceptable response.)
16. Please provide any evidence as to how OPEB fund past performance is doing relative to assumed performance? (Page referencing within an included URL or separate attachment with appropriate material is an acceptable response.)

Appendix B: Grand Jury Survey - continued

Section 3: VACATION AND SICK LEAVE ACCRUAL POLICIES

1. Please describe vacation policy to include:
 - How many vacation days are granted at what seniority levels?
 - Is there any limit to the amount of vacation time that can be accrued?
 - Is unused vacation paid upon retirement?
2. Please describe sick leave policy to include:
 - Is there any limit to the number of sick days allowed per year?
 - Is there any limit to the amount of sick days that can be accrued?
 - Are unused sick days paid upon retirement?

Appendix C: Glossary of Terms & Acronyms

Actuarial Assumptions: Assumptions representing expectations about future events (e.g. expected investment returns on plan assets, member retirement and mortality rates, future salary increases, or inflation) which are used by actuaries to calculate pension liabilities and contribution rates.

Actuarial Valuation: Technical reports conducted by actuaries that measure retirement plans' assets and liabilities to determine funding progress. They also measure current costs and contribution requirements to determine how much employers and employees should contribute to maintain appropriate benefit funding progress.

Actuary: Professionals who analyze the financial consequences of risk by using mathematics, statistics, and financial theory to study uncertain future events, particularly those of concern to insurance and pension programs. Pension actuaries analyze probabilities related to the demographics of the members in a pension plan (e.g., the likelihood of retirement, disability, and death) and economic factors that may affect the value of benefits or the value of assets held in a pension plan's trust (e.g., investment return rate, inflation rate, rate of salary increases).

Actuarial Accrued Liability (AAL): The value of benefits promised to employees and retirees for services already provided. This concept applies to both the pension liability and retiree health care liabilities.

Annual Required Contribution (ARC): The amount of money that actuaries calculate the employer needs to contribute to the retirement plan during the current year for benefits to be fully funded over time. Generally CalPERS uses a 30 year period.

CAFR: Acronym for Comprehensive Annual Financial Report

CalPERS: Acronym for California Public Employees' Retirement System

Defined Benefit: Promised fixed sum paid or service rendered. The assets in a defined benefit plan are held by the employer who incurs all investments risks. See also defined contribution.

Defined Contribution: Contributions made by an employer to an individual employees investment account such as a 401k. All investment gains or losses are those of the employee, not the employer. See also defined benefit.

Employer Paid Member Contribution (EPMC): A program whereby the city pays employee contribution in a manner in which the amount paid is considered income for the purposes of determining pension. As exemplified by one city, "For example, an employee with a \$100K income and a 7% EPMC retires using a salary of \$107K per year rather than \$100K per year."

Experience Gains/Losses: Gains or losses that arise from the difference between actuarial assumptions about the future and actual outcomes in an organization's pension plan.

First tier (1st tier) plans: Benefits promised to all employees prior to the implementation of a second tier plan. First tier plans have generally been enhanced, contributing to the cost escalation. See also "second tier" in the Glossary.

Appendix C: Glossary of Terms & Acronyms - continued

Funded Ratio: The market value of assets divided by the accrued liability. Funded ratio is a measure of the economic soundness of a fund.

Market Gains/Losses: Gains or losses that arise from an increase or decrease in the market value of a plan's assets, including stock, real property, and investments.

Miscellaneous (MISC) employee/plan: Public employees who are not sworn police or fire. The term MISC generally is used to describe a pension plan. The city of San Jose refers to these employees as belonging to a Federated plan rather than a MISC plan.

Normal Cost: That portion of the ARC (see above) which is based solely on the value of the benefits being offered.

OPEB: Acronym for Other Post Employment Benefits. OPEB benefits are primarily health care benefits but can include other benefits such as life insurance.

Opt In Plan: Term used to designate an employee elective benefit plan; employees choose between maintaining current benefits but at an increased employee contribution rate or elect to receive lower benefits and avoid increases to employee contribution rates.

Risk Pool: In 2005 CalPERS created risk pools to aggregate small cities (generally defined as having less than 100 employees) into large pools to eliminate statistical anomalies associated with small sample sizes and gain reporting efficiencies.

ROI: Acronym for Return on Investment. See also Market Gains/Losses.

Public Safety Employees: Most police and fire personnel. Other public employees are generally referred to as miscellaneous employees (see above) and may include some members of police and fire departments.

Second tier (2nd tier) plans: Benefits promised to all employees hired after the date of implementing a plan with reduced benefits. Second tier plans generally have reduced benefits and lower costs. See also "first tier" in the Glossary.

Sidefund: Generally the unfunded liability that existed prior to entering a risk pool. A city is responsible for their entire sidefund plus their portion of the risk pool. Sidefund repayment can be accelerated. Some cities did not separate sidefund monies from ARC while others did.

Smoothing of Gains/Losses: Actuarial method of spreading, or smoothing, market gains and losses over a period of time. The purpose of smoothing is to minimize short-term, year-to-year contribution rate fluctuations which may result from market swings. The smoothed asset value is also known as the actuarial value of assets.

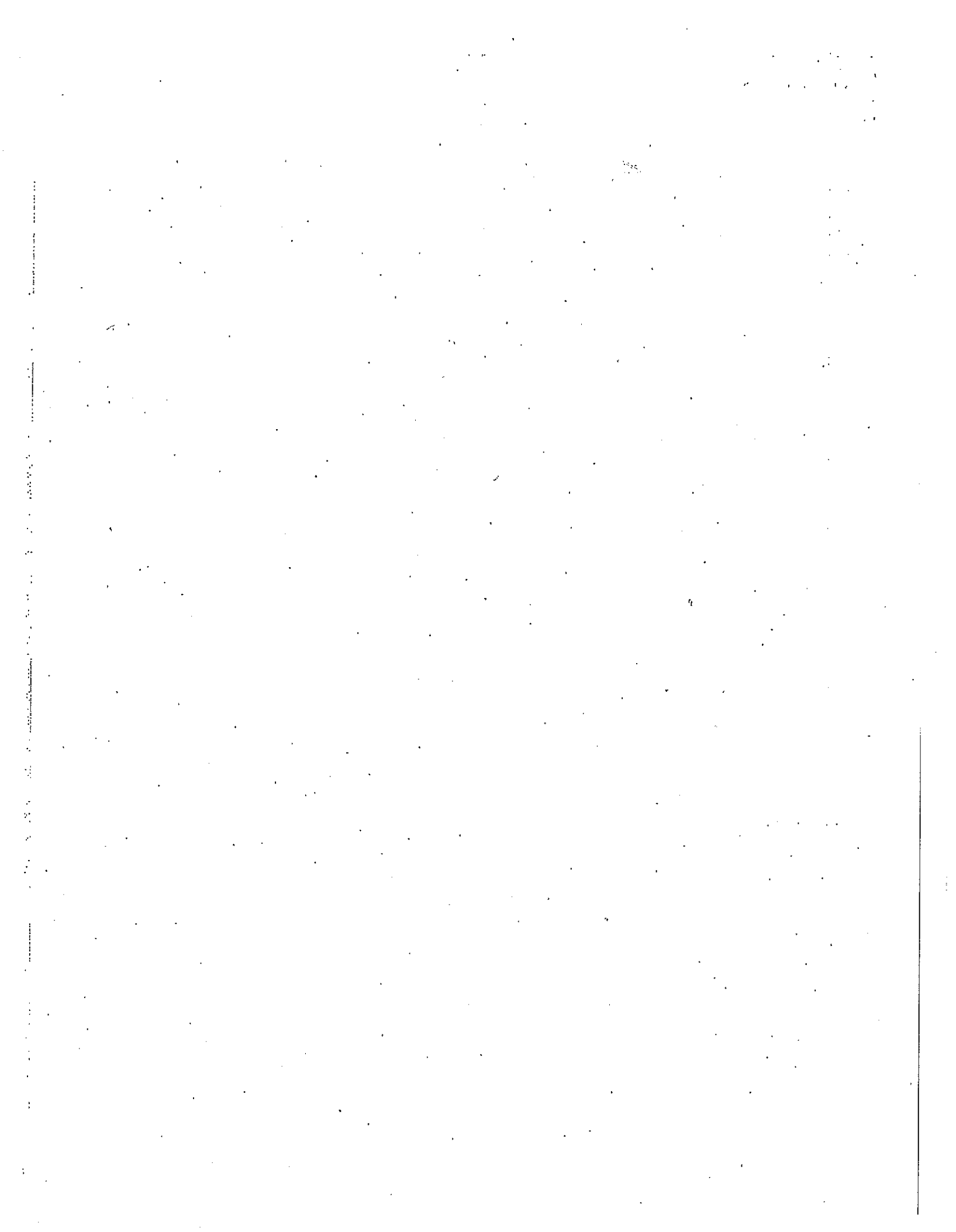
Unfunded Liability: This is the unfunded obligation for prior benefit costs, measured as the difference between the accrued liability and plan assets. When using the actuarial value of plan assets, it is also referred to as the Unfunded Actuarial Accrued Liability (UAAL).

This report was **PASSED** and **ADOPTED** with a concurrence of at least 12 grand jurors on this 17th day of May, 2012.

Kathryn G. Janoff
Foreperson

Alfred P. Bicho
Foreperson pro tem

James T. Messano
Secretary



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.

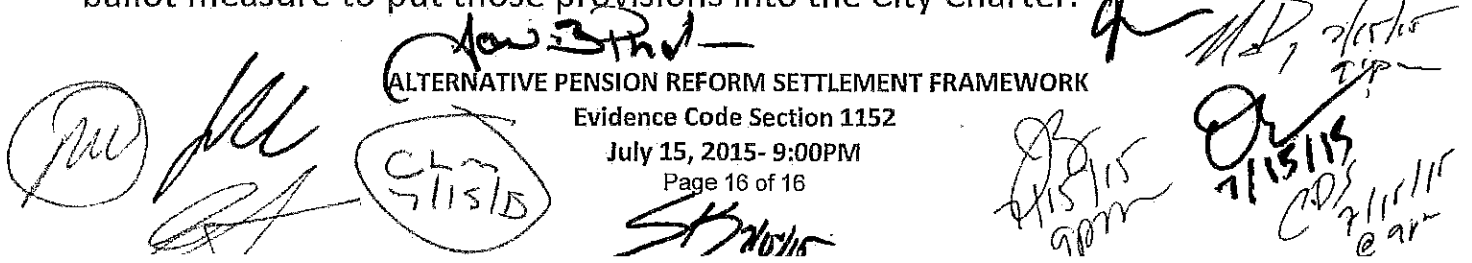
Attorney's Fees

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.



 ALTERNATIVE PENSION REFORM SETTLEMENT FRAMEWORK
 Evidence Code Section 1152
 July 15, 2015- 9:00PM
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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. $2\% \times \text{Years of Service} \times \text{Final Compensation}$, 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. $2\% \times \text{Years of Service} \times \text{Final Compensation}$, 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 PEPR, 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 PEPR 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), IEPTE (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: <ul style="list-style-type: none"> • Global settlement involving all litigants (including retirees) and bargaining unit representatives • Entered into for purposes of settlement

		<ul style="list-style-type: none"> • 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	<p>Although the Federated Bargaining Units are not parties to the pending litigation in Santa Clara Superior Court Case No. 1-13-CV-245508 ("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)</p> <p>Outline of stipulated facts and findings:</p> <ul style="list-style-type: none"> • 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.

ALTERNATIVE PENSION REFORM SETTLEMENT FRAMEWORK

Evidence Code Section 1152

November 23, 2015

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		<ul style="list-style-type: none"> 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. <p>Stipulated Judgment shall reflect that Measure B shall be invalidated.</p>
7	Upon completion of #5 and #6	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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.

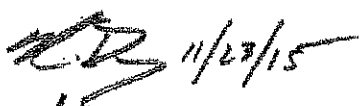

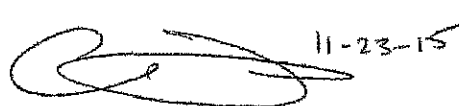

ALTERNATIVE PENSION REFORM SETTLEMENT FRAMEWORK

Evidence Code Section 1152

November 23, 2015

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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
	MB 11/23/15
QEM 11/23/15	JWT 11/23/15
CS 11/23/15	yae 11/23/15
	 11-23-15
Mano Murado for JS 11/23/15	JLC 12-3-15
MM 11/23/15	VMT 12-3-15
LC 11/23/15	SV 12/4/15
 12/4/15	TCF 12/14/15 ABMEI

SIDE LETTER AGREEMENT

Between

The City of San Jose

And

The Association of Building, Mechanical and Electrical Inspectors (ABMEI)
The Association of Engineers and Architects, IFPTE Local 21 (AEA)
The Association of Legal Professionals (ALP)
The Association of Maintenance Supervisory Personnel, IFPTE Local 21 (AMSP)
The City Association of Management Personnel, IFPTE Local 21 (CAMP)
The Confidential Employees' Organization, AFCME Local 101 (CEO)
The San Jose Fire Fighters, IAFF Local 230 (IAFF)
The International Brotherhood of Electrical Workers, Local No. 332 (IBEW)
The Municipal Employees' Federation, AFSCME Local 101 (MEF)
The International Union of Operating Engineers, Local No. 3 (OE#3)
and
The San Jose Police Officers' Association (POA)

Alternative Pension Reform Act

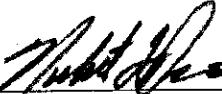
The parties agree to the terms of the attached ballot measure, entitled the "Alternative Pension Reform Act" (hereafter, "Act"), for consideration by City Council to be placed before the voters of the City of San Jose on the November 2016 ballot.

The parties agree that they have met and conferred in good faith, and that this agreement fulfills the City's Seal Beach bargaining obligations related to the Act.

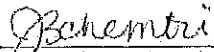
The Unions shall endorse the Ballot Measure.

This agreement shall become effective when signed by all parties below and adopted by City Council.

For the City:



Norberto Dueñas
City Manager
Date 7/22/16




Jennifer Schembri
Director of Employee Relations
Date 7/22/16



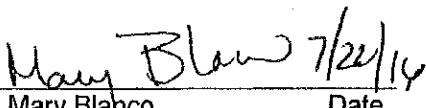
Charles Sakai
Labor Consultant
Date 7/22/16

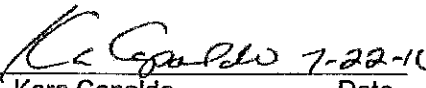
Side Letter Agreement – "Alternative Pension Reform Act" Ballot Measure Language
July 21, 2016
Page 2 of 2

For the Unions:

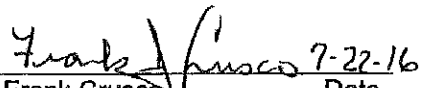
 8/2/16
Date
Gregg Adam
Legal Counsel, POA

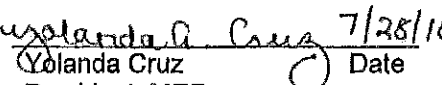
 7-26-16
Date
Charles Allen
AFSCME Local 101


 7/22/16
Date
Mary Blanco
OE#3

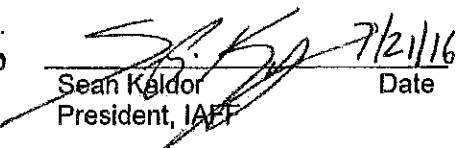
 7-22-16
Date
Kara Capaldo
President, CAMP

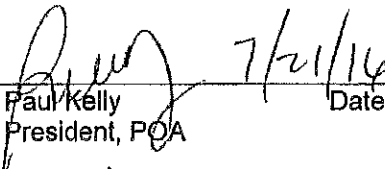
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Date
Steve Contreras
President, AMSP

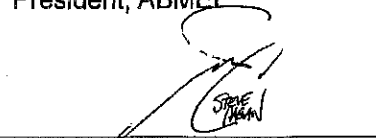
 7-22-16
Date
Frank Crusco
Chief Steward, IBEW

 7/25/16
Date
Yolanda Cruz
President, MEF


 7/21/16
Date
Peter Fenerin
President, ABMEI


 7/21/16
Date
Sean Keldor
President, IAFF


 7/21/16
Date
Paul Kelly
President, POA

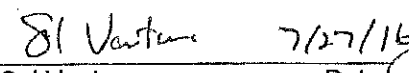

Date
Steve Pagan
AEA


 7/28/16
Date
Christopher Platten
Legal Counsel

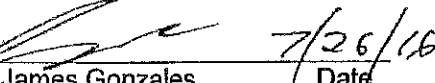
 7.27.16
Date
Tom Saggau
Labor Consultant

 7/22/16
Date
Sean Stalbaum
IFPTE Local 21

 7/22/16
Date
Vera Todobrov
ALP

 7/27/16
Date
Sal Ventura
IBEW

 7/26/16
Date
LaVerge Washington
President, CEO

 7/26/16
Date
James Gonzales
Vice President, POA

ALTERNATIVE PENSION REFORM ACT

The Citizens of the City of San Jose do hereby enact the following amendments to the City Charter which may be referred to as: "*Alternative Pension Reform Act*."

Section 1501-A: Intent

The City of San Jose's financial ability to provide basic services is essential to the health, safety, quality of life and well-being of its residents. This Act is intended to strengthen the City's financial ability to ensure the City can provide reasonable and sustainable post-employment benefits while at the same time delivering essential city services to the residents of San Jose. This Act is further designed to ensure that no future defined retirement benefit increases occur without voter approval.

Section 1502-A. Act Supersedes All Conflicting Provisions

The Sections of Article XV-A enacted by the voters pursuant to the ballot measure known as Measure B in 2012 are hereby replaced in their entirety by the following provisions. The provisions of this Act shall prevail over all other conflicting or inconsistent wage, pension, or postemployment benefit provisions in the Charter, ordinances, resolutions, or other enactments.

Notwithstanding any other provisions of this Article, the City Council may, by ordinance, and subject to the provisions of California Government Code Section 3500 et seq., provide for the conformance of any retirement plan or plans established and maintained by the City of San José to Section 415 of the United States Internal Revenue Code or other applicable provisions of the laws of the United States or the State of California.

Section 1503-A. Reservation of Voter Authority

- (a) There shall be no enhancements to defined retirement benefits in effect as of January 1, 2017, without voter approval. A defined retirement benefit is any defined post-employment benefit program, including defined benefit pension plans and defined benefit retiree healthcare benefits. An enhancement is any change to defined retirement benefits, including any change to pension or retiree healthcare benefits or retirement formula that increases the total aggregate cost of the benefit in terms of normal cost and unfunded liability as determined by the Retirement Board's actuary. This does not include other changes which do not directly modify specific defined retirement benefits, including but not limited to any medical plan design changes, subsequent compensation increases which may increase an employee's final compensation, or any assumption changes as determined by the Retirement Board.
- (b) If the State Legislature or the voters of the State of California enact a requirement of voter approval for the continuation of defined pension benefits, the voters of the City of San Jose hereby approve the continuation of the pension benefits in existence at the time of passage of the State measure including those established by this measure.

Section 1504-A: Retirement Benefits – Tier 2

The Tier 2 retirement plan shall include the following benefits listed below. This retirement program shall be referred to as "Tier 2" and shall be effective for employees hired on or after the following dates except as otherwise provided in this section: (1) Sworn Police Officers: August 4, 2013; (2) Sworn Firefighters: January 2, 2015 and (3) Federated: September 30, 2012. Employees initially hired before the effective date of Tier 2 shall be Tier 1 employees, even if subsequently rehired. Employees who qualify as "classic" lateral employees

under the Public Employees' Pension Reform Act and are initially hired by the City of San Jose on or after January 1, 2013, are considered Tier 1 employees.

- (a) **Cost Sharing.** The City's cost for the Tier 2 defined benefit plan shall not exceed 50% of the total cost of the Tier 2 defined benefit plan (both normal cost and unfunded liabilities), except as provided herein. Normal cost shall always be split 50/50. In the event an unfunded liability is determined to exist, employees will contribute toward the unfunded liability in increasing increments of 0.33% per year, with the City paying the balance of the unfunded liability, until such time that the unfunded liability is shared 50/50 between the employer and employee.
- (b) **Age.** The age of eligibility for service retirement shall be 57 for employees in the Police and Fire Retirement Plans and 62 for employees in the Federated Retirement System. Earlier Retirement may be permitted with a reduction in pension benefit by a factor of 7% per year for employees in the Police and Fire Retirement Plan and a reduction in pension benefit by a factor of 5% per year for employees in the Federated Retirement System. An employee is not eligible for a service retirement earlier than the age of 50 for employees in the Police and Fire Retirement Plan or age 56 for employees in the Federated Retirement System. Tier 2 employees shall be eligible for a service retirement after earning five years of retirement service credit.
- (c) **COLA.** Cost of living adjustments, or COLA, shall be equal to the increase in the Consumer Price Index (CPI), defined as San Jose – San Francisco – Oakland U.S. Bureau of Labor Statistics index, CPI-Urban Consumers, December to December, with the following limitations:
 - 1. For Police and Fire Retirement Plan members, cost of living adjustments applicable to the retirement allowance shall be the lesser of the Consumer Price Index (CPI), or 2.0%.
 - 2. For Federated Retirement System members, cost of living adjustments applicable to the retirement allowance shall be the lesser of CPI or:
 - a. 1-10 total years of City service and hired after the effective date of the implementing ordinances of the revised Tier 2: 1.25%
 - b. 1-10 years total years of City service and hired before the effective date of the implementing ordinances of the revised Tier 2: 1.5%
 - c. 11-20 total years of City service: 1.5%
 - d. 21-25 total years of City service: 1.75%
 - e. 26 or more total years of City service: 2.0%
 - 3. The first COLA adjustment will be prorated based on the number of months retired in the first calendar year of retirement.
- (d) **Final Compensation.** "Final compensation" shall mean the average annual earned pay of the highest three consecutive years of service. Final compensation shall be base pay only, excluding premium pays or other additional compensation, except members of the Police and Fire Plan whose pay shall include the same premium pays as Tier 1 members.
- (e) **Maximum Allowance and Accrual Rate.** For Police and Fire Plan members, service retirement benefits shall be capped at a maximum of 80% of final compensation for an employee who has 30 or more years of service at the accrual rate contained in the Alternative Pension Reform Settlement Framework approved by City Council on August 25, 2015. For Federated Retirement System members, service retirement benefits shall be capped at a maximum of 70% of final compensation for an employee who has 35 or more years of service at the accrual rate contained in the Alternative Pension Reform Settlement Framework approved by City Council on December 15, 2015, and January 12, 2016.

- (f) **Year of Service.** An employee will be eligible for a full year of service credit upon reaching 2080 hours of regular time worked (including paid leave, but not including overtime).

Section 1505-A: Disability Retirements

- (a) The definition of "disability" shall be that as contained in the San Jose Municipal Code in Sections 3.36.900 and 3.28.1210 as of the date of this measure.
- (b) Each plan member seeking a disability retirement shall have their disability determined by a panel of medical experts appointed by the Retirement Boards.
- (c) The independent panel of medical experts will make their determination based upon majority vote, which may be appealed to an administrative law judge.

Section 1506-A: Supplemental Payments to Retirees

The Supplemental Retiree Benefit Reserve ("SRBR") has been discontinued, and the assets returned to the appropriate retirement trust fund. In the event assets are required to be retained in the SRBR, no supplemental payments shall be permitted from that fund without voter approval.

The SRBR will be replaced with a Guaranteed Purchasing Power (GPP) benefit for all Tier 1 retirees. The GPP is intended to maintain the monthly allowance for Tier 1 retirees at 75% of purchasing power of their original pension benefit effective with the date of the retiree's retirement. The GPP will apply in limited circumstances (for example, when inflation exceeds the COLA for Tier 1 retirees for an extended period of time). Any calculated benefit will be paid annually in February.

Section 1507-A: Retiree Healthcare

The defined benefit retiree healthcare plan will be closed to new employees as defined by the San Jose Municipal Code in Chapter 3.36, Part 1 and Chapter 3.28, Part 1.

Section 1508-A: Actuarial Soundness (for both pension and retiree healthcare plans)

- (a) In recognition of the interests of the taxpayers and the responsibilities to the plan beneficiaries, all pension and retiree healthcare plans shall be operated in conformance with Article XVI, Section 17 of the California Constitution. This includes but is not limited to:
1. All plans and their trustees shall assure prompt delivery of benefits and related services to participants and their beneficiaries;
 2. All plans shall be subject to an annual actuarial analysis that is publicly disclosed in order to assure the plan has sufficient assets;
 3. All plan trustees shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system;
 4. All plan trustees shall diversify the investments of the system so as to minimize the risk of loss and maximize the rate of return, unless under the circumstances it is not prudent to do so;
 5. Determine contribution rates on a stated contribution policy, developed by the retirement system boards and;

6. When investing the assets of the plans, the objective of all plan trustees shall be to maximize the rate of return without undue risk of loss while having proper regard to the funding objectives of the plans and the volatility of the plans' contributions as a percentage of payroll.

Section 1509-A: Retirement Contributions

There shall be no offset to normal cost contribution rates in the event plan funding exceeds 100%. Both the City and employees shall always make the full annual required plan contributions as calculated by the Retirement Board actuaries which will be in compliance with applicable laws and will ensure the qualified status under the Internal Revenue Code.

Section 1510-A: No Retroactive Defined Retirement Benefit Enhancements

- (a) Any enhancement to a member's defined retirement benefit adopted on or after January 1, 2017, shall apply only to service performed on or after the operative date of the enhancement and shall not be applied to any service performed prior to the operative date of the enhancement.
- (b) If a change to a member's retirement membership classification or a change in employment results in an enhancement in the retirement formula or defined retirement benefits applicable to that member, except as otherwise provided under the plans as of [effective date of ordinance], that enhancement shall apply only to service performed on or after the effective date of the change and shall not be applied to any service performed prior to the effective date of the change.
- (c) "Operative date" would be the date that any resolution or ordinance implementing the enhancement to a member's defined retirement formula or defined retirement benefit adopted by the City Council becomes effective.

Section 1511-A: Severability

This Act shall be interpreted so as to be consistent with all federal and state laws, rules and regulations. The provisions of this Act are severable. If any section, sub-section, sentence or clause ("portion") of this Act is held to be invalid or unconstitutional by a final judgment of a court, such decision shall not affect the validity of the remaining portions of this amendment. The voters hereby declare that this Act, and each portion, would have been adopted irrespective of whether any one or more portions of the Act are found invalid. If any portion of this Act is held invalid as applied to any person or circumstance, such invalidity shall not affect any application of this Act which can be given effect.