

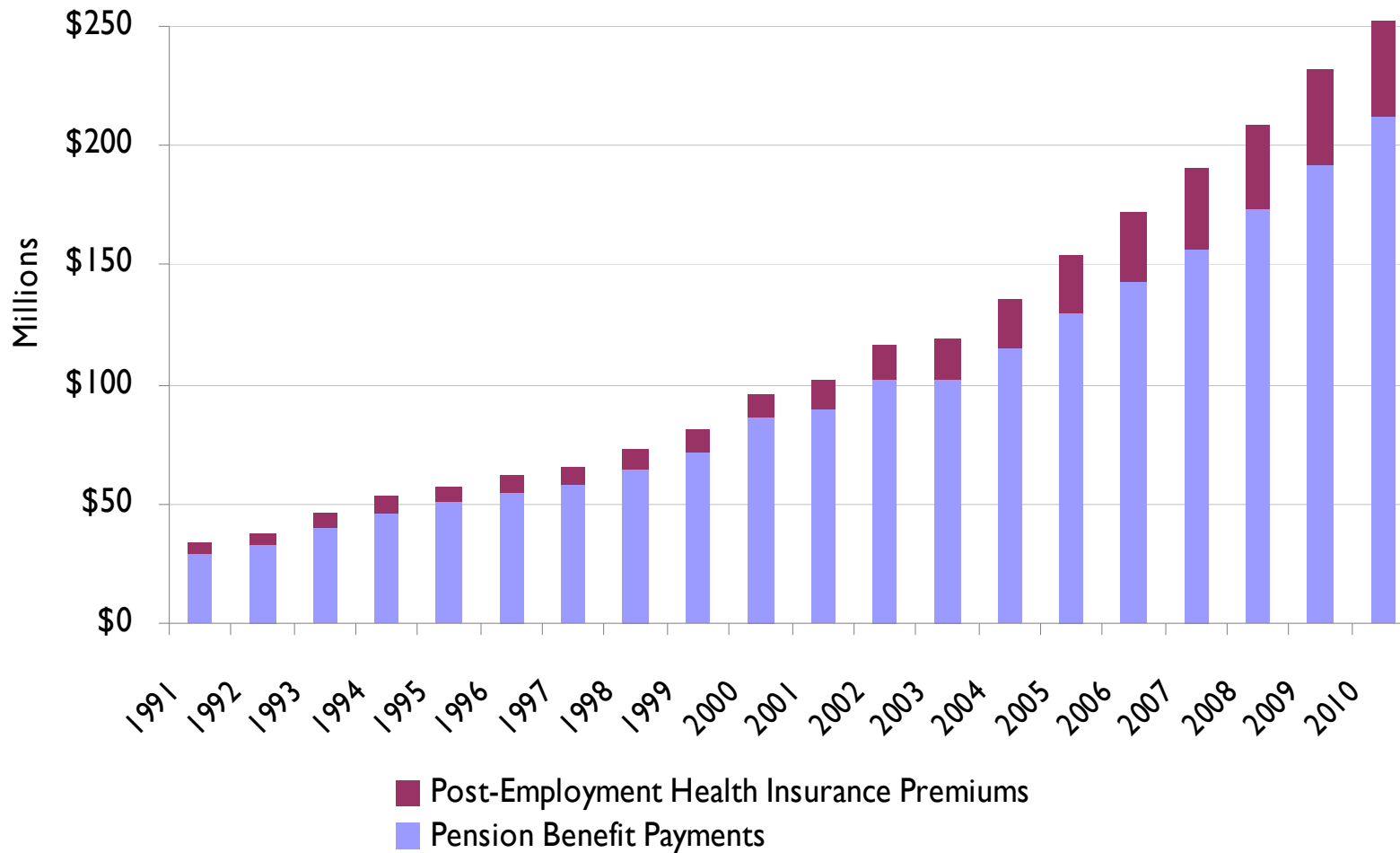
Pension Sustainability

Rising Pension Costs Threaten the City's Ability to Maintain Service Levels— Alternatives for a Sustainable Future

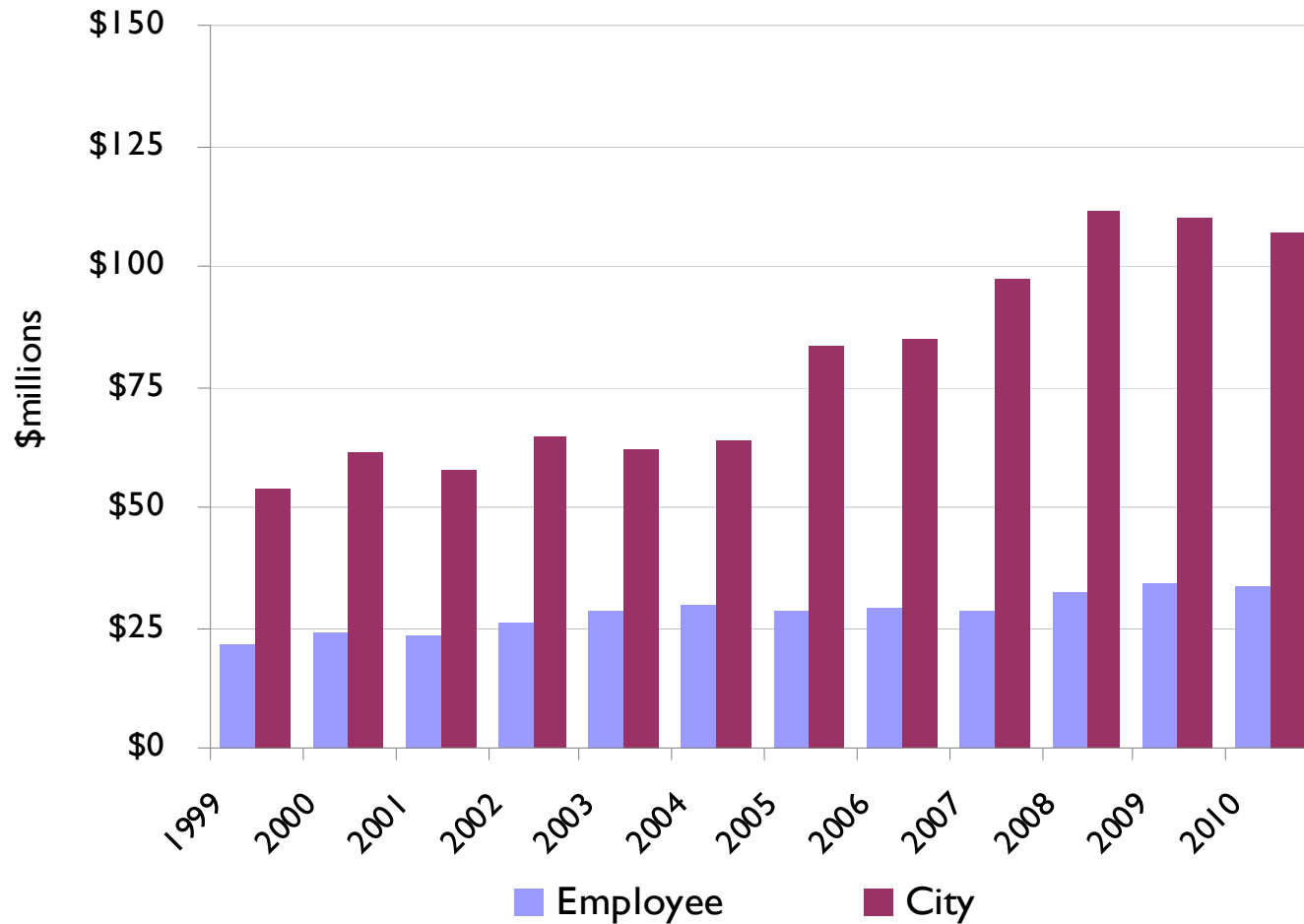
*A Report from the City Auditor
Issued September 2010*

How did we get here?

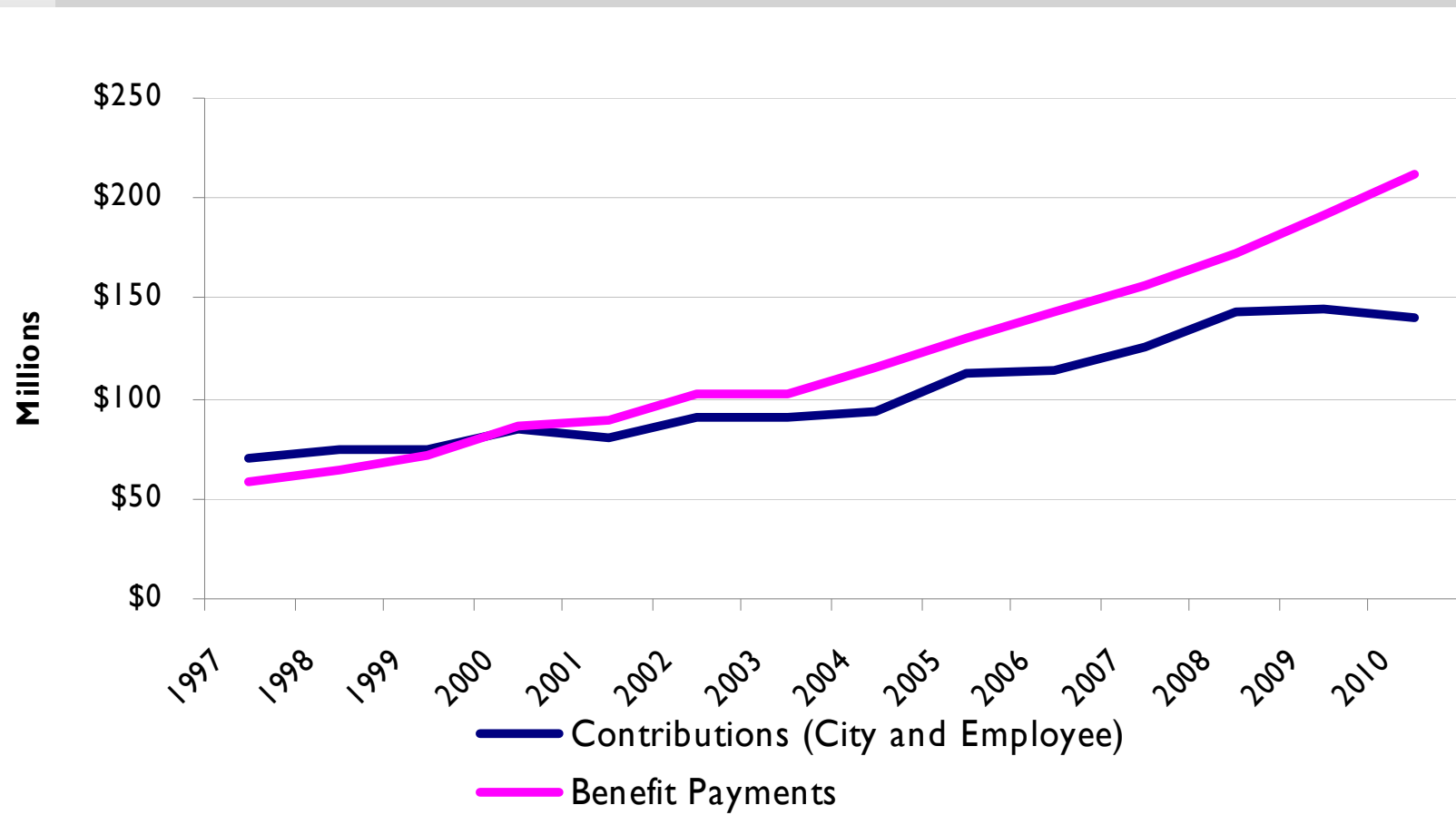
Benefit Payments Grew Seven Fold Over 20 Years



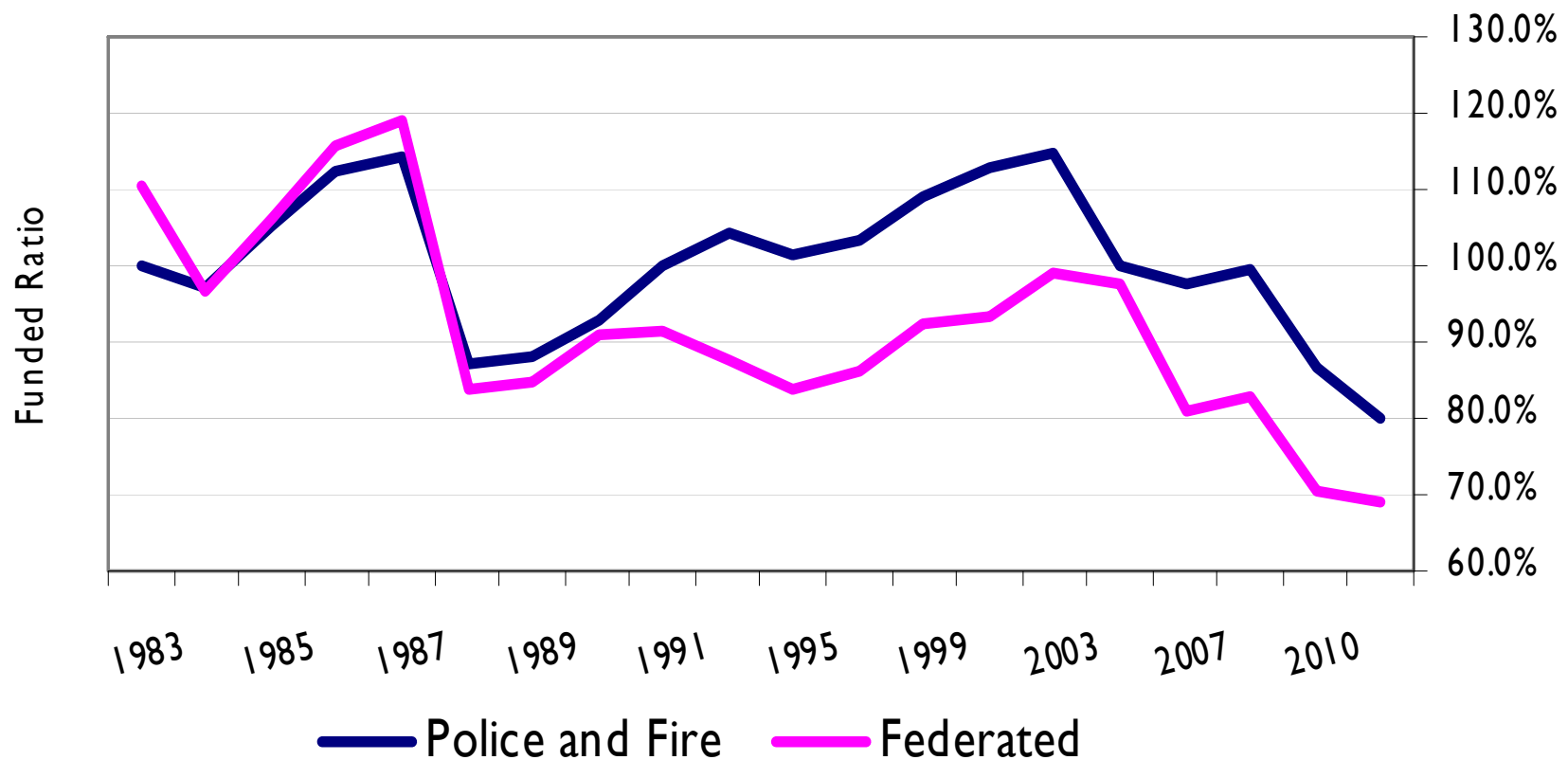
City and Employee Contributions Up Significantly Over the Past Decade



Pension Benefit Payments Have Exceeded Contributions Since 2001



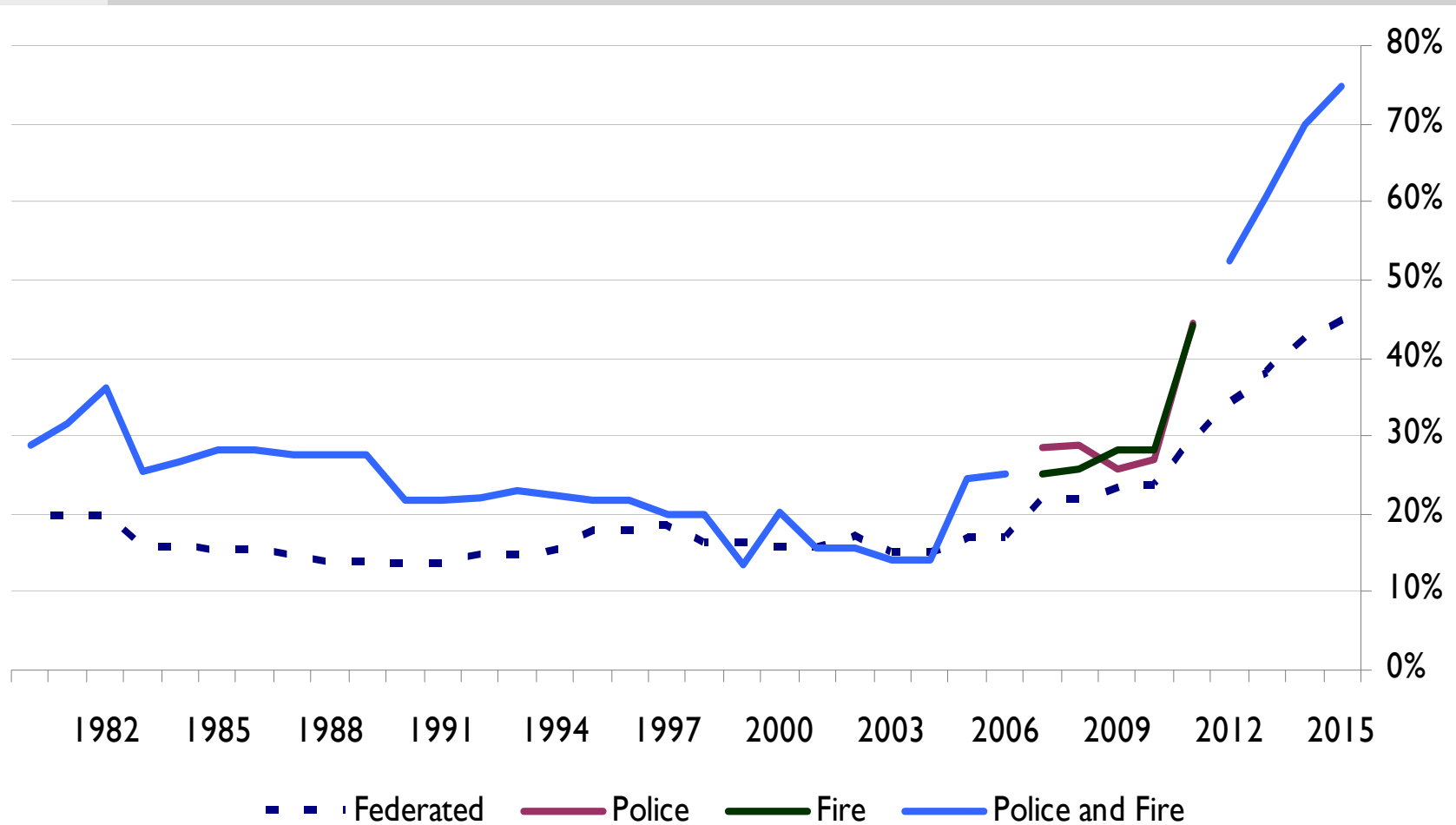
Funded Ratios Have Fallen



Most Current Estimate of the Pension Liability is \$5.7 Billion

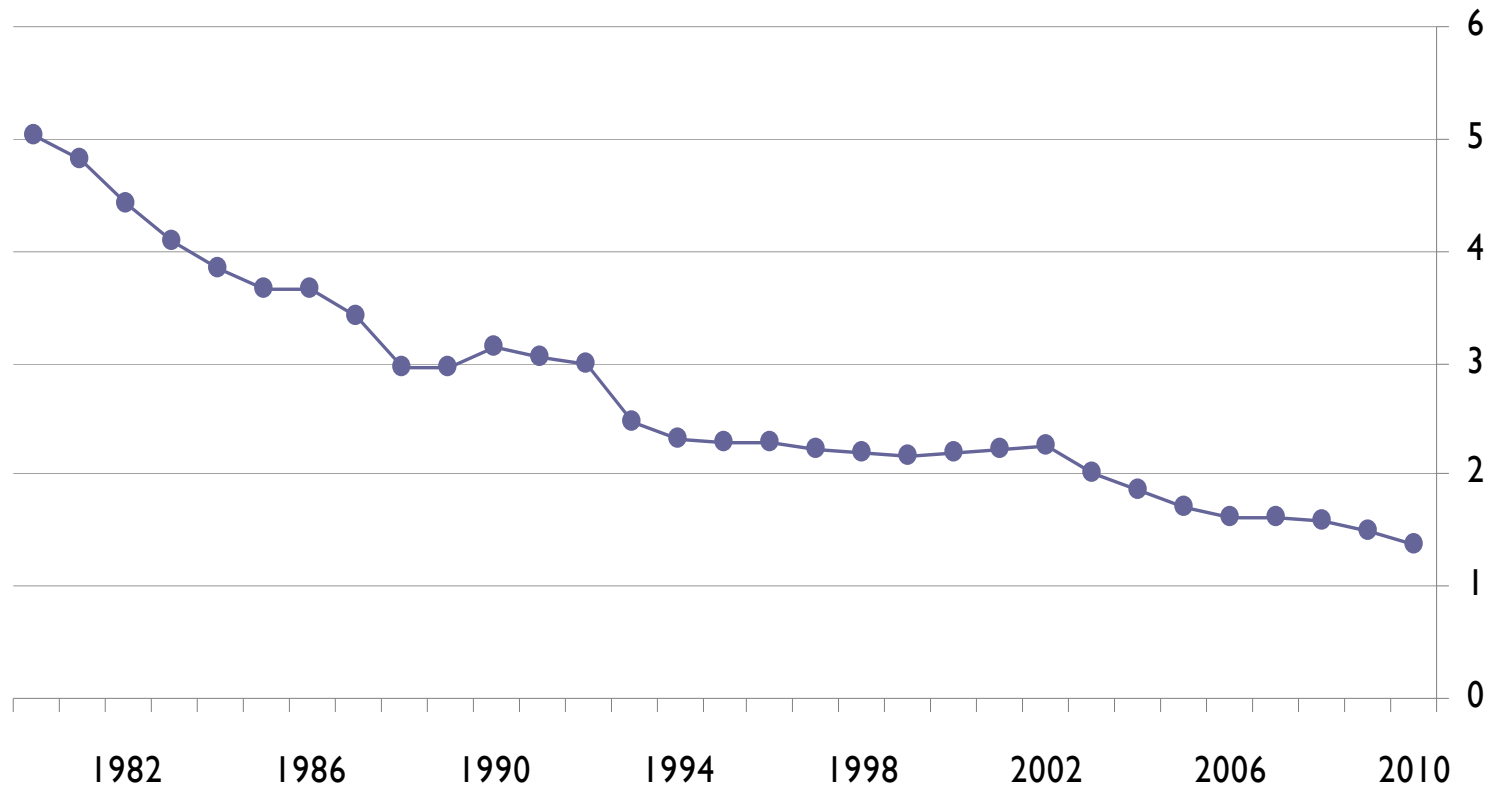
- As of June 30, 2010
 - \$3.7 billion in assets (market value)
 - \$2 billion unfunded liability (market value)
 - In addition, a \$1.7 billion unfunded retiree healthcare liability

The City's Contribution Rates for Pension and Retiree Healthcare Are Projected To Rise Dramatically



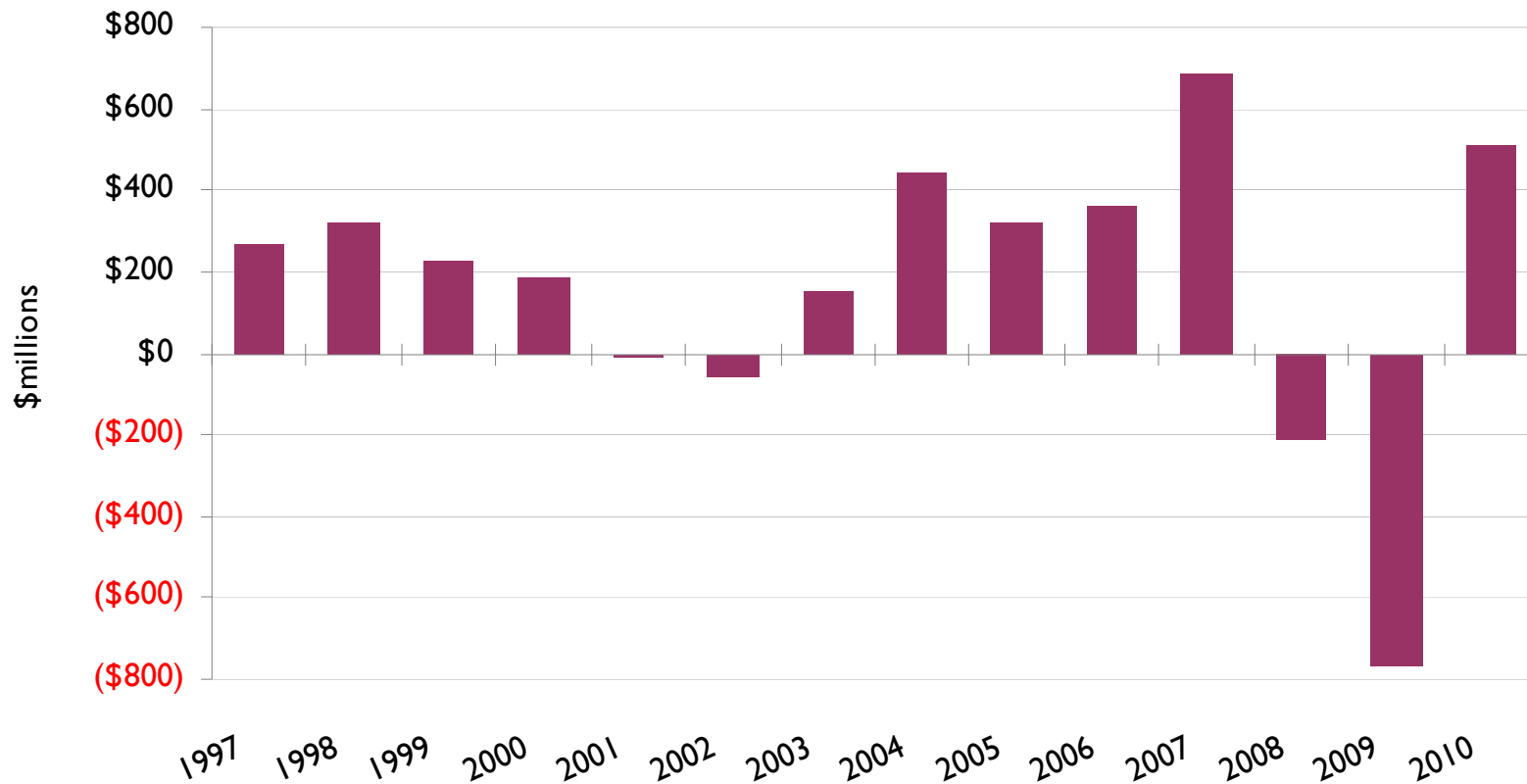
What happened?

Declining Ratio of Employees to Retirees and Beneficiaries Creates a Risk of Even Higher Future Contribution Rates

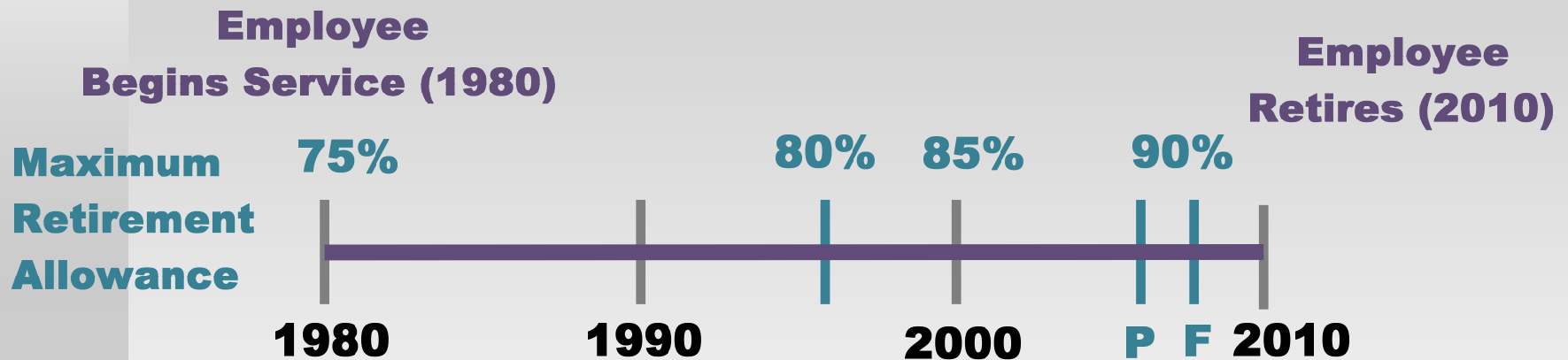


No Guarantees that Even a Fully Funded Plan will Stay That Way

Retirement Plans' Investment Gains and Losses



Retroactive Pension Benefit Enhancements Added to the Unfunded Liability



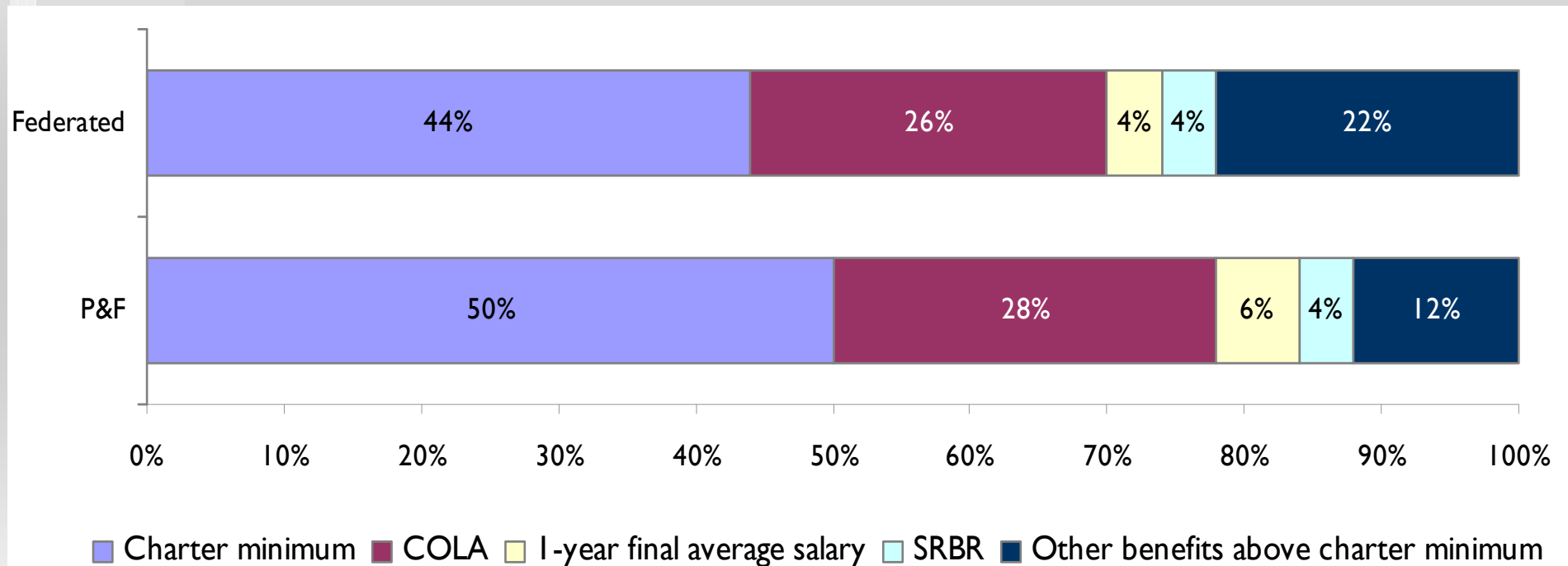
- Other changes
 - benefit formulas
 - retirement age
 - definition final compensation
 - survivorship benefits
 - guaranteed 3% COLA
 - supplemental retiree benefit

Actuarial Forecasts did not Hold True

- The Retirement Board's actuaries build models to estimate liabilities and determine contribution rates
- \$750 million added to the unfunded liability as of June 30, 2009
 - Assumed investment rate of return
 - Longer lives
 - Earlier and more retirements

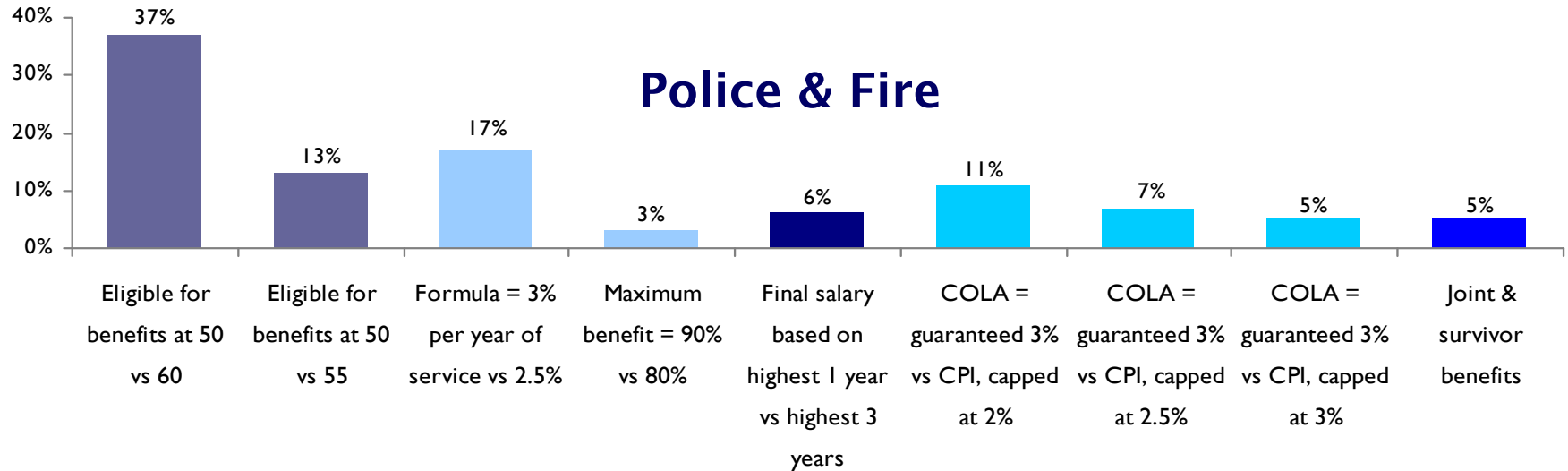
*What are the major drivers of
pension costs?*

Cost Components of the Current Plans

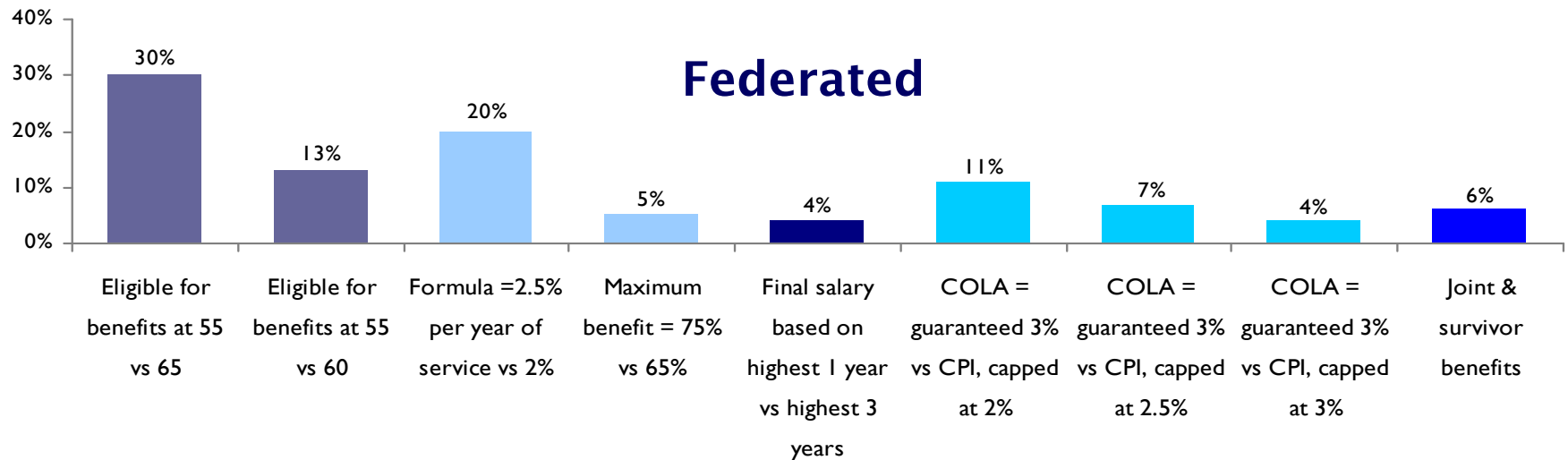


Estimated Costs Attributable to Various Benefits

Police & Fire



Federated



*What are the consequences of
inaction?*

Rising Pension Costs Threaten the City's Ability to Maintain Service Levels

- FY 2010-11 budget deficit of \$118.5 million
 - About \$52 million attributable to retirement costs
 - Cuts to services, lay offs, pay and other employee concessions
- FY 2011-12 budget deficit of \$115.4 million
 - Estimated increased retirement costs: \$60.9 million
 - Police: \$26.7 million
 - Fire: \$18.7 million
 - Federated: \$15.5 million

Projected City Retirement Contributions Exceed \$1.7 Billion Over Next Five Years (All Funds)

Retirement Plan	FY 11-12	FY 12-13	FY 13-14	FY 14-15	FY 15-16
Federated	\$112.6M	\$133.6M	\$158.6M	\$171.2M	\$176.2M
Police	\$89.7M	\$110.6M	\$126.1M	\$136.2M	\$140.4M
Fire	\$53.9M	\$66.3M	\$75.5M	\$81.5M	\$84.1M
TOTAL	\$256.2M	\$310.5M	\$360.2M	\$388.9M	\$400.7M
% Increase		21.19%	16.01%	7.97%	3.03%

Note: Does not include the City's pre-payment discount

What are the options and policy considerations?

Options and Policy Considerations

- Reducing costs of the current plan
 - Maneuverability to change plans for current employees is limited under current law
 - Pensions already earned versus going forward
 - Additional cost sharing
- Second tier for new employees
 - Redesigned defined benefit plan
 - Hybrid plan or Social Security
- Different perspectives on the purpose of the plan

Audit Recommendations

- Explore prohibiting pension benefit enhancements without voter approval, and retroactive pension benefit enhancements that create unfunded liabilities
- Pursue one or a combination of pension cost-containment strategies:
 - Additional cost sharing
 - Eliminating or limiting SRBR transfers/distributions
 - Negotiate prospective changes for existing employees
 - Establish a second tier for new employees
 - Consider joining CalPERS to reduce administrative costs

Audit Recommendations

- Actuarial audits every five years to ensure reasonableness of assumptions
- Propose ongoing budget for actuarial services
- Provide annual updates to the City Council on the status of the plans and forecasts of pension costs
- Distribute annual summary of the plans' financial condition to all plan members

Conclusion

- Considerable risks from rising pension costs for years to come
- Rising pension costs threaten the City's ability to maintain service levels
 - Understanding how we got here
 - Identifying major cost drivers
 - Initial assessment of alternatives

Questions/Discussion