

**2003-2004 SANTA CLARA COUNTY CIVIL GRAND JURY**

**INQUIRY INTO THE FINANCIAL IMPACT OF RETIREMENT  
PROGRAMS ON SANTA CLARA COUNTY AND THE CITY OF  
SAN JOSE**

**Summary**

The Santa Clara County Civil Grand Jury (Grand Jury) has examined the financial impact of defined-benefit retirement plans on County of Santa Clara (County) and City of San Jose (San Jose) budgets. The trend in recent years has been to enhance government pension benefits. Meanwhile, the private sector has been moving towards defined-contribution programs (such as 401k plans) and away from defined-benefit (traditional) retirement plans. Current County and San Jose budget shortfalls are made worse by required increases in contributions to the retirement systems, but potentially more serious problems loom in the future that may burden local government with very high fixed costs, requiring increased revenue or reduced services.

This report is intended to inform the citizens of the County, San Jose and, by analogy, other cities in the County of the increasing liabilities and risks of retirement programs provided to local government employees.

**Background**

The County has contracted with the California Public Employees' Retirement System (CalPERS) for administering its retirement system since 1953. Over the past 50 years, the County has amended the agreement to add certain options such as basing the pension on the single highest income month or year and providing for a one-half pension survivor continuance.

The basic retirement benefit for County non-safety employees (working at least half-time) is 2% for each year of service, payable at retirement starting at age 55, and 3% per year at age 50 for public safety employees. The maximum benefit is for 30 years of service times 2% per year (60%) for non-public-safety employees and times 3% (90%) for public-safety employees. All are vested at 5 years of service. The County pays 100% of the employee share in most cases and 100% of the employer share. As a percent of salaries paid, the contributions have increased from 8% to 9.3% from fiscal year 2001-2002 to the present. The County's cost for funding retirement plans has increased almost 50%, from \$66 million to a projected \$95 million over the same period.

San Jose is not part of CalPERS; rather, it operates and finances its own retirement plans. San Jose non-public-safety employees covered by the Federated City Employees Retirement System are eligible for a pension at age 55 with 5 years of service or 30 years service at any age. The pension accrues at 2.5% times the number of years of service (up to a 75% maximum) multiplied by the highest average monthly salary, including overtime pay, during the highest 12 consecutive months.

San Jose police officers and firefighters are covered by a separate plan, the Police and Fire Retirement System. They are eligible to retire with an 85% pension after 30 years of service, ranging from \$77,202 to \$125,013 for life. Currently, there are 2170 active police and fire employees in the pension system and 1300 drawing retirement benefits. To compensate for poor investment returns as well as an increased payroll, retirement costs for police officers and firefighters will increase from \$28 million annually to \$76 million over the next three years, contributing to projected city budget deficits.

The San Jose safety officers are now seeking a pension increase from 85% to 90% of salary, comparable to the County CalPERS plans, which would mean an increased pension of \$5,000 to \$7,000 annually. Mercer Human Resource Consulting prepared an actuarial valuation for San Jose should they choose to enhance the public safety personnel pensions to mirror the CalPERS 3%-per-year-at-age-50 model. Enhancing the pension benefit from an 85% maximum to 90% would cost \$235 million for vested liabilities. Amortized over the next 14 years, this would add \$24 million to a current budget line of \$50 million. The yearly adder can be reduced to \$16 million if it is spread over the next 30 years instead.

## **Discussion**

Defined-benefit pension plans promise a future fixed monthly payment to an employee, paid for by current government and employee contributions, investment gains, and future undetermined government payments to make up for any investment shortfall from projections. For the past few years, investment gains have been below the forecasts made in previous years, and now increased payments to the pension funds are required to keep them from being under-funded compared to their promises. Defined-contribution pension plans (such as 401k programs) return a future lump sum to an employee of a variable amount based on the contributions and the investment returns on the contributions (which then can be invested to provide a fixed monthly payment), but with no requirement for the employer to make up for any investment shortfall.

In the past, a generous pension was a benefit governments used to compensate for lower salaries compared to the private sector. Considering that government salaries and other benefits, such as days off, are now comparable to the rest of the employment market, pension programs that are much better than the market standard should no longer be required. Each year, fewer private sector employers offer guaranteed pensions comparable to those of government workers. Moreover, a pension providing 85% of salary already ranks among the most generous in the nation.

According to the president of San Jose Firefighters Local 230, the city risks losing some of its highly qualified firefighters and future recruits if it does not make its retirement packages equal to those of other jurisdictions. The difficulty arises when all government jurisdictions respond similarly by making sure their own pension benefits are equal to or above average, causing the new average for surrounding jurisdictions to spiral ever higher.

The rising costs of funding retirement programs to the County and to San Jose will impact already stretched budgets and makes the delivery of essential public services to communities more expensive. It is incumbent upon elected officials in the County to balance the benefits provided to government employees against the funding of essential public services. This is especially important now when revenues from local and state sources are strained.

## **Finding I**

The San Jose and County governments have negotiated generous pension programs that have an increasingly large negative impact on their budgets. These defined-benefit programs rely on future increases in the financial markets to pay pension benefits. The government is responsible for any shortages in fund performance.

## **Recommendation I-A**

The San Jose and County governments should not further increase the defined-benefit pension benefits of existing employees and, instead, work with unions to limit the costs of employee pension programs.

## **Recommendation I-B**

To reduce the financial risk, San Jose and County governments should explore changing to defined-contribution pension programs for new employees, retirement programs that are comparable to the private sector.

**PASSED** and **ADOPTED** by the Santa Clara County Civil Grand Jury on this 25<sup>th</sup> day of May 2004.

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Richard H. Woodward  
Foreperson

## References

CalPERS Amendment to Contract - Between the Board of Administration, CalPERS, and the Board of Directors, Santa Clara County Central Fire Protection District.

City of San Jose, Federated City Employees Retirement System (FCERS), Benefits Fact Sheet.

City of San Jose, Police & Fire Department Retirement Plan, Benefits Fact Sheet.

County of Santa Clara, Basic Benefit Programs, Coded Employees.

County of Santa Clara, Central Fire Protection District, Administration, "Resolution of Intention to Add 3% @ 50 Option to Fire District's CalPERS Contract for Safety Members," March 19, 2002.

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MERCER letter to Retirement Administrator, San Jose Police and Fire Department, "Retirement Benefit Study Under the CalPERS 3% at 50 Formula," January 27, 2004.

San Jose Federated City Employee's Retirement System, *Comprehensive Annual Financial Report 2002-03*, Schedule of Employer Contributions, Defined Benefit Pension Plan.

San Jose Police and Fire Department Retirement Plan, *Comprehensive Annual Financial Report 2002-03*, Schedule of Employer Contributions, Defined Benefit Pension Plan.