File No. 110671

Committee Item No. 9
Board Item No. 12

COMMITTEE/BOARD OF SUPERVISORS

AGENDA PACKET CONTENTS LIST

Committee: Budget and Finance FULL-Committee **Date:** June 15, 2011

Board of Supervisors Meeting Date June 21, 2011

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Completed by: Victor Young **Date:** June 10, 2011
Completed by: Victor Young **Date:** 6-16-11

An asterisked item represents the cover sheet to a document that exceeds 25 pages. The complete document is in the file.

[Extension of Deferred Retirement Option Program]

Motion extending the Deferred Retirement Option Program.

WHEREAS, Proposition B was passed by the voters on February 5, 2008, directing the San Francisco Employee's Retirement System (SFERS) to implement a Deferred Retirement Option Program (DROP) for an initial period of three years beginning July 1, 2008, and ending June 30, 2011; and

WHEREAS, Proposition B provides that "[n]ot later than April 15, in the third year after the effective date of the DROP, a joint report prepared by the Controller of the City and the consulting actuary of the Retirement System documenting the net cost effect of the Program shall be submitted to the Board of Supervisors, and the Board shall determine by majority vote whether, on the basis of said report, the Program shall be renewed for an additional period of time as specified by the Board, but in no event beyond an additional three years." Charter section A8.909(b); and

WHEREAS, A joint report was prepared, as required under Charter section A8.909(b), by the Controller, SFERS, and the Police Department which was submitted on April 15, 2011, to the Board of Supervisors, on file with the Clerk of the Board of Supervisors in File No. 110671, which is hereby declared to be a part of this motion as if set forth fully herein; and

WHEREAS, The Board has considered evidence in addition to the joint report described above and finds that the City should not incur any net increase in cost due to the continuation of DROP for the additional period approved by this motion; now, therefore, be it

MOVED, That the Board of Supervisors hereby extends DROP to ______________ (a period not to exceed three years).

CITY AND COUNTY OF SAN FRANCISCO

DENNIS J. HERRERA
City Attorney

OFFICE OF THE CITY ATTORNEY

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RECEIVED
BOARD OF SUPERVISORS
SAN FRANCISCO
2011 MAY 13 AM 8:03

MEMORANDUM

TO: HONORABLE DAVID CHIU
Board of Supervisors

FROM: JESSE CAPIN SMITH
Chief Assistant City Attorney

CARYN BORTNICK
Deputy City Attorney

COPIES: ANGELA CALVILLO
Clerk of the Board of Supervisors

DATE: May 12, 2011

RE: Deferred Retirement Option Program

At your request, we write to confirm and explain our advice that the Board of Supervisors (the "Board") must, by June 30, 2011, vote on a motion to extend the Deferred Retirement Option Program (the "DROP").

In February 2008, the voters approved Proposition B, a Charter amendment placed on the ballot by initiative petition creating the DROP for eligible police officers. Police officers who participate in the DROP continue working for a specified period and continue to receive their regular salary. At the same time, DROP participants begin accumulating retirement allowances, which are placed in a tax-deferred DROP account maintained by the Retirement System. At the end of the DROP period, the officers leave City service and begin receiving their regular monthly retirement allowance, as well as the benefits that accumulated in their DROP account.

Proposition B provides the operation of the DROP should be cost neutral to the City; "The implementation of the DROP shall not result in any net increase in cost to the City." (Charter section A8.909(a).) The Charter requires the City to offer the program for an initial three-year period, subject to a process for periodic review of the costs of the DROP and possible renewal of the program. (Charter section A8.909(b).)

In particular, in describing the periodic review process, the Charter provides:

> Not later than April 15, in the third year after the effective date of the DROP, a joint report prepared by the Controller of the City and the consulting actuary of the Retirement System documenting the net cost effect of the Program shall be submitted to the Board of Supervisors and the Board *shall determine by majority vote* whether, on the basis of said report, the program shall be renewed for an additional period of time as specified by the Board, but in no event beyond an additional three years.

(Charter section A8.909(b).) (Emphasis added).

Similarly, the findings adopted by the voters as part of the Charter amendment approving the DROP state:

> [I]n order that the cost impact of the DROP may be assessed, this measure additionally provides that at the end of the third year after implementation of the Program, the Board of Supervisors, pursuant to data provided by the Police Department along with an analysis by the Controller of the City and County and the consulting actuary of the Retirement Board, *shall determine* whether the Program has been cost-neutral, and whether in light of its achievement of the goals of the measure, it should be continued for an additional three year term, and thereafter, subject to similar evaluations.

(Charter section A8.900(e).) (Emphasis added).

The initial three-year period for the DROP expires on June 30, 2011. On April 25, 2011, the Controller submitted a report to the Mayor and the Board analyzing the DROP's cost neutrality and achievement of the program's goals, together with the required analysis by the Retirement System's consulting actuary. (For a copy of the report, see http://sfcontroller.org/Modules/ShowDocument.aspx?documentid=1982.) Following delivery of that report, a question has been raised whether the Board of Supervisors must consider the report as a body and vote to extend the DROP, or whether the DROP would automatically terminate at the end of the initial three-year period if the Board takes no action. We have advised that the Board must vote on whether to extend the DROP. A summary of our analysis supporting this conclusion follows.

In construing the Charter, we rely on principles of statutory construction established by the courts. (*Alesi v. Board of Retirement* (2000) 84 Cal.App.4th 597, 601.) Courts begin by looking at the plain language of a statute. "If the language of a statute is unambiguous, the plain meaning governs and it is unnecessary to resort to extrinsic sources to determine the legislative or voters' intent." (*Bostick v. Flex Equipment Company, Inc.* (2007) 147 Cal. App. 4th 80, 107 (Citations and quotation marks omitted).) But if the meaning of the language is not clear, courts examine other evidence to ascertain the intent of the law. "([A] court may consider extrinsic indicia of intent, including . . the analysis and arguments contained in the official ballot pamphlet of a statute enacted by voter initiative, and the historical circumstance of the statute's enactment." (*Id.*)) For ballot measures, the official ballot pamphlet distributed to the voters is the primary and often the only source of legislative history that courts will consult. (*Robert L. v. Superior Court* (2003) 30 Cal. 4th 894, 903-905.)

Here, consistent with these principles, we begin by examining the plain language of the key Charter provisions and attempt to ascertain the intent of the voters, who adopted them. (*Id. at* 901 (Court's task in construing a voter initiative is to effectuate the intent of the electorate).) Under the Charter, the DROP terminates unless the Board acts to extend the program. (Charter section A8.900(e).) As mentioned above, the question is whether the Board is required to act. The phrase "shall determine" in both Charter Sections A8.909(b) and (e) imposes on the Board a duty to decide whether to renew the DROP. When used in statutes, the word "shall" generally means compelled, with the force of "must." (*Common Cause v. Board of Supervisors* (1989) 49 Cal. 3d 432, 443 ("Under well-settled rules of statutory construction, the word "shall" is ordinarily construed as mandatory").)

But even if the word "shall" were susceptible to another meaning (such as "may") and if the question of whether the Board were under a compulsion to act were not evident from the Charter language itself, the ballot digest resolves any doubt. The digest states: "The Board *must consider* the report *and vote whether DROP should be renewed* for any period of time . . ."

(Emphasis added). The description in the digest seems clear that the voters intended the Board as a body to have a duty to both consider the report and vote on whether to renew the DROP.

Accordingly, based on the plain language of the Charter and the intent of the voters as expressed in the ballot digest, we conclude the Board must consider the joint report and vote on whether, based on the report, the DROP should be renewed for a period of up to three years.

As to the process for voting on whether to renew the DROP, the Charter requires the Board to calendar and vote on a motion to extend the DROP, taking into account the joint report. We enclose a proposed motion for your consideration. The Charter does not require the Board to consider a separate motion terminating the DROP, though the Board could choose to do so as a policy matter. If the Board votes on a motion to extend the DROP and does not have at least six votes to approve the motion, then the program will terminate automatically on its expiration date, June 30, 2011. If the Board wishes to continue the program, then the Board should have evidence in the record supporting a finding that the program will be cost neutral.

We hope this information is helpful. If we can provide you with further information or assistance, please do not hesitate to call us.

Creating a New Deferred Retirement Option Program for Members of the San Francisco Police Department

B

PROPOSITION B

Shall the City allow certain retirement-eligible police officers to continue working for up to three additional years while accumulating their regular retirement benefits in tax deferred retirement accounts?

YES
NO

Digest

by the Ballot Simplification Committee

THE WAY IT IS NOW: Under the City Charter, police officers are eligible for retirement benefits based on their compensation, age and length of service. The Charter does not allow City employees, including police officers, to continue working fulltime for the City after retirement. However, retired City employees may be reemployed for a limited number of hours while collecting retirement benefits.

THE PROPOSAL: Proposition B is a Charter Amendment that would establish a "Deferred Retirement Option Program" (DROP) for eligible police officers. Any eligible police officer who participates in DROP would continue working as a police officer for a specified period of time, not longer than three years. Police officers participating in DROP would continue to receive their regular pay and benefits but would not accrue any retirement benefits. DROP participants would begin accumulating their regular retirement payments, frozen at the level that the officer had earned upon entry into DROP. These payments would be placed in a tax deferred DROP account maintained by the City's retirement system. At the end of the DROP period, officers would begin receiving their regular monthly retirement payment, as well as their retirement benefits that had accumulated in their DROP account.

To be eligible to participate in DROP, a police officer must have at least 25 years of service as a sworn member of the Police Department, be at least 50 years of age, be a full-duty officer and agree to retire at the conclusion of his or her service in DROP.

Proposition B provides that the City should not incur any overall cost increase due to the creation and operation of DROP. The Charter amendment requires periodic evaluation by the City of the costs of the program:

- The City's Controller and the Retirement System must prepare a joint report for the Board of Supervisors (Board) in the third year of the program documenting any overall cost to the City of DROP;
- The Board must review whether the program is cost-neutral at the end of every extension of the DROP program; and
- The Board must consider this report and vote whether DROP should be renewed for any period of time, not to exceed three years.

A "YES" VOTE MEANS: If you vote "yes," you want to amend the Charter to establish a "Deferred Retirement Option Program" (DROP) for eligible police officers.

A "NO" VOTE MEANS: If you vote "no," you do not want to adopt this program.

Notice to Voters:
The "Controller's Statement" and "How 'B' Got on the Ballot" information on this measure appear on the opposite (facing) page.

THIS MEASURE REQUIRES 50%+1 AFFIRMATIVE VOTES TO PASS.

ARGUMENTS FOR AND AGAINST THIS MEASURE IMMEDIATELY FOLLOW THIS PAGE. THE FULL TEXT BEGINS ON PAGE 89.
SOME OF THE WORDS USED IN THE BALLOT DIGEST ARE EXPLAINED ON PAGE 61.

B Creating a New Deferred Retirement Option Program for Members of the San Francisco Police Department

Controller's Statement on "B"

City Controller Edward Harrington has issued the following statement on the fiscal impact of Proposition B:

Should the proposed charter amendment be approved by the voters, in my opinion, it is probable that the program will meet its goal of being cost-neutral to the City and may even provide some positive benefits, however, since it is a voluntary program, it is not possible to know the actual savings or cost until police officers actually enroll in the program.

The charter amendment authorizes the Board of Supervisors to create a Deferred Retirement Option Plan (DROP) for San Francisco police officers. A DROP allows officers to formally retire, put their retirement earnings into a tax-deferred account and continue to work for normal wages and benefits for a period of up to three years. As a result, the City retains a qualified officer for that period of time and delays the cost of recruitment and training incurred in replacing a retiring officer. DROP programs can be useful during times of staff shortages to encourage experienced officers to work for the City past normal retirement age. The San Francisco Employees' Retirement System would have new and complex responsibilities for administering the DROP program which could cost in the range of $500,000 or more annually.

The Charter amendment states that the program is intended to be cost neutral and provides that costs will be evaluated in fiscal year 2010-2011 when the City has three years of actual experience. At that time, the Board of Supervisors could end or extend the program, however, individuals who had entered it would continue to earn DROP benefits for up to three years.

Approximately 600 police personnel in ranks from Police Officer to Police Captain would be eligible for the DROP program over the next three years. Current actuarial projections are that the City is likely to achieve the cost-neutral intent of the amendment. However, because the eligible individuals have varying ages, years of service and pay rates, participation in the program is voluntary, and because new recruits would have been paid at lower rates than experienced officers, the program may or may not be cost neutral.

How "B" Got on the Ballot

On September 18, 2007 the Department of Elections certified that the initiative petition, calling for Proposition B to be placed on the ballot, had qualified for the ballot.

41,672 signatures were required to place an initiative Charter Amendment on the ballot. This number is equal to 10% of the registered voters at the time the petition was first filed with the Department of Elections.

A random check of the signatures submitted by the proponents of the initiative petition prior to the October 8, 2007 submission deadline showed that more than the required number of signatures was valid.

THIS MEASURE REQUIRES 50%+1 AFFIRMATIVE VOTES TO PASS.

ARGUMENTS FOR AND AGAINST THIS MEASURE IMMEDIATELY FOLLOW THE FACING PAGE. THE FULL TEXT BEGINS ON PAGE 89.
SOME OF THE WORDS USED IN THE BALLOT DIGEST ARE EXPLAINED ON PAGE 61.

Joy, POB, help page

City and County of San Francisco

Edwin M. Lee
Mayor

Department of Human Resources

Micki Callahan
Human Resources Director

MEMORANDUM

DATE: May 11, 2011

TO: Honorable Members of the Board of Supervisors

THROUGH: Angela Calvillo, Clerk of the Board

FROM: Micki Callahan, Human Resources Director Micki Call

COPY: San Francisco Police Chief Greg Suhr

RE: **Response to Inquiries from Members of the Board of Supervisors regarding Personnel Matters in the San Francisco Police Department**

This memorandum is in response to inquiries by Members of the Board of Supervisors regarding various personnel matters in the San Francisco Police Department ("SFPD"). Specifically, the Department of Human Resources was asked to provide information on whether the SFPD is "top heavy" as compared to other police departments, what the participation levels have been in the Deferred Retirement Option Program ("DROP"), whether there are retention issues in the SFPD, and whether disciplinary issues are keeping police officers off the streets.

1) Is the SFPD "top heavy" as compared to other police departments in the Bay Area?

Although DHR has not conducted any surveys on staffing levels in other police departments, we note that SFPD records reflect that there were 639 supervisory officers (Command Staff, Captain, Lieutenant, Inspector and Sergeant) and 1,580 police officers in the SFPD as of last month. However, it is our understanding that the newly appointed Police Chief, Chief Greg Suhr, has made or intends to make a number of staffing changes which will impact supervisory staffing levels in the SFPD, including a reduction in the number of Assistant Chiefs.

2) What are the statistics on officer participation in the DROP?

According to our records, there were 113 officers enrolled in the DROP from July 1, 2008 through December 31, 2010. Please see the attached document with an analysis of DROP participation. The Controller's Office also conducted an extensive analysis on demographics and retirement behavior under the DROP (the Controller's report is attached for your ease of reference).

3) Are there retention issues in the SFPD?

I believe that the primary focus of this question is on whether the SFPD is at risk for mass retirements in the near future, resulting in vacancies that it will be unable to fill.

There are currently 2,204 police officers on the SFPD's active payroll. The average age of those officers is 43.9 years, and they have on average 16.1 years of service. The average age of retirement for police officers in the SFPD is 56.3 years, and the average number of years of service at retirement is 30.7 years. Our records indicate that there are 305 police officers who are at or above the age of 55; and of those 305 officers, 165 have 30 or more years of service, and 267 have between 20 and 25 years of service. From July 2008 to December 2010, there were on average, 72 retirements per year in the SFPD, and we expect to see the same retirement trends of about 70 to 100 retirements in the SFPD for the foreseeable future.

Although these retirements will result in police officer vacancies, it is important to note that the SFPD has indicated that it is depending on those retirements as a means of achieving cost savings in its budget next year (a little over $7 million in savings).

Regarding the question of whether the SFPD will have the ability to fill the number of vacancies that it wishes to fill, it will depend on the availability of funding for future academy classes. The approximate cost of an 8-month academy class of 50 new recruits is $5 million; however, the Civil Service Commission has approved the lateral hire of police officers from other jurisdictions. Lateral hires require a much shorter academy course of only 6 to 8 weeks, which not only results in reduced costs for those abbreviated academy classes, but also means that field training officers and the new lateral hires are available for deployment in the field sooner. Given the fact that the City now pays a competitive salary in the Bay Area, and in light of recent police officers layoffs in surrounding jurisdictions, we believe that the City will be able to hire new and lateral officers over the next few years to fill the vacancies for which it has funding, depending on the City's willingness to fund academy classes.

4) Are disciplinary issues keeping police officers off the streets?

Disciplinary matters are handled within the SFPD; and as such, DHR does not have any information regarding the status of pending disciplinary matters. However, according to the SFPD, only 2 police officers are currently out due to administrative suspension, and 33 are on disciplinary assignment—not significant numbers given the 2,200+ number of police officers in the SFPD.

I hope you found this information helpful. Please do not hesitate to contact me at (415) 557-4845 or Micki.Callahan@sfgov.org if I can be of further assistance.

Attachments
DHR Analysis Sheet of the DROP Program
Controller's Office Analysis of the DROP Program

City and County of San Francisco

Department of Human Resources
Classification and Compensation

Deferred Retirement Option Plan (DROP)
April 2011 Renewal Analysis

- Active Demographics: *2,282 Police Officers (Units P-1 and P-2A); January 2011*
    - 165 Police Officers age 55+ with 30+ years of service.
    - 267 Police Officers age 50-55 with 25+ years of service.

- DROP Enrollment: *July 1, 2008 through December 31, 2010*

Rank	Enrolled	Length of Eligibility	Avg. Time Enrolled
Q2-Q4 Police Officer	64	36 months	12.5 months
Q50-Q52 Sergeant	18	24 months	12.8 months
0380-0382 Inspector	22	24 months	11.1 months
Q60-62 Lieutenant	5	12 months	9.7 months
Q80-Q82 Captain	4	12 months	11.3 months
Total	113 (avg. 45 a year)		

   - Average Age: 56.3 years
   - Average Years of Service: 31.6 years

- Retirements: *July 1, 2008 through December 31, 2010*
    - Retirements: 180 (9 of which were disability retirements) (avg. 72 a year)
    - Average Age: 55.6 years
        - Percent under age 55: 32.7% *(excluding disability retirement)*
    - Average Years of Service: 30.7 years
        - Percent under 30 years of Service: 40.6%
        - Percent under 25 years of Service: 20.2%
    - Wellness Sick Leave Payouts Upon Retirement: Maintain through FY12-13 so no spike in retirements to avoid losing as took place with miscellaneous employees at the end of FY09-10 such that this recent retirement history should be a good indicator of the rate of retirements in the near future.

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CITY AND COUNTY OF SAN FRANCISCO

OFFICE OF THE CONTROLLER

Ben Rosenfield
Controller

Monique Zmuda
Deputy Controller

RECEIVED
BOARD OF SUPERVISORS
SAN FRANCISCO
2011 MAY 10 AM 10: 50
BY

MEMORANDUM

TO: Mayor Edwin Lee
Members of the Board of Supervisors

FROM: Ben Rosenfield, Controller

DATE: April 15, 2011

SUBJECT: Analysis of the Deferred Retirement Option Program's Cost Neutrality and Achievement of the Program's Goals

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I am providing with this memo background information and findings concerning the City's Deferred Retirement Option Program (DROP or the Program). The memo provides the Controller's Office analysis of the Program and includes an attached report with actuarial and analytical work as required on this subject from Cheiron, Inc., the Retirement System's consulting actuary.

In 2008 voters approved Proposition B, which created a voluntary Deferred Retirement Option Program for an initial three-year period. The DROP is intended to provide incentives to encourage Police Officers to continue working beyond the date they would have retired and thereby reduce the need to recruit, hire and train new officers to meet staffing requirements. The Program is intended to be "cost neutral" to the City. To this end, the Controller's Office and the San Francisco Retirement System's (SFERS) consulting actuary are required to report on the cost effects of the Program. On the basis of these reports, the Board of Supervisors may act to continue the Program for an additional period of time, but in no event beyond an additional three years, or the Board may let the program sunset on June 30, 2011.

Summary Findings

In summary, Cheiron's actuarial work and our analysis show that:

- The net increase or decrease in City costs attributable to the DROP over its first three years is difficult to state with certainty. This is due largely to difficulty in quantifying DROP's impact, in isolation from all other changes, on police officers' retirement behavior.

- Although only a limited number of people have been eligible, and retirement decisions are influenced by a myriad of factors, since DROP was instituted an officer is likely to enter DROP earlier than they would have otherwise retired;

- Overall, the Retirement System's accrued liability has likely increased under the DROP because of this change in retirement behavior;

- In particular, Cheiron forecast the current observed retirement rates and existing conditions of the DROP and found that if the Program is continued under current conditions, the City would expect a resulting accrued liability of $52 million in retirement costs. Amortizing this liability over 20 years as is SFERS' current practice for benefit changes would add approximately 0.25 percent of payroll (or approximately $6 million annually) to the current employer contribution rate;

- While the City does save some operating costs by not having to replace an officer during their DROP period, those savings are less than the change in the expected value of that officer's retirement benefits and the overall cost to SFERS.

Description of the DROP

The Program became available to San Francisco police officers on July 1, 2008. To be eligible to participate in DROP, a police officer must have at least 25 years of service as a sworn member of the Police Department, be at least 50 years of age, be a full-duty officer and agree to retire at the conclusion of his or her service in DROP.

Participants in DROP:

- Continue working for a specified period of time, not longer than three years;
- May elect to leave the Program at any time prior to end of their eligibility period;
- Continue to receive their regular pay and benefits;
- Continue to make contributions to the Retirement System from their regular pay;
- Do not directly receive retirement pay and benefits. Retirement benefits are "frozen" at the level that the officer had earned upon entry into DROP;
- The officer's retirement payments, with cost of living adjustments, are placed in a tax- deferred account maintained by the SFERS with a set four percent interest rate;
- At the end of the DROP period, officers retire, leave service, stop receiving regular pay and benefits and begin receiving their regular retirement payments;
- At the end of the DROP period, officers receive a lump sum payment of the retirement benefits, plus interest, accumulated in their DROP account.

Savings and Costs with the DROP

Overall, the Program could save the City money if the officer had planned to retire and the DROP causes that officer to work more years than originally intended. Conversely, the Program could cost the City money if the officer does not work past their planned retirement date, or retires earlier than they would have otherwise.

Savings could come in three primary ways—avoided retiree health benefit costs, recruitment and training costs, and savings in the retirement trust fund.

A working DROP officer means that instead of the City paying for health benefits for two individuals (a retiree and a replacement hire), the City only has to pay for the DROP Officer during that period. In particular, the period of time between an individual's retirement and their eligibility for Medicare at age 65 is the highest cost period for City retiree health benefits and savings per person during those years could be significant.

Second, during the DROP period, the City can defer the cost of recruiting, hiring and training an additional officer.

Finally, under the City's Program design, while an officer is enrolled in the DROP they continue to make a required contribution of 7.5 percent of pay to the Retirement System, but do not accrue additional retirement benefits.

To illustrate, the DROP would save money if the officer intended to retire at age 55 but instead joined the DROP at age 55 and worked another three years to age 58. Conversely, the DROP costs money if the officer joins the Program at age 52 and then retires at age 55 when they had planned to retire anyway. In that instance, they are effectively taking a cash payout with their DROP account instead of a somewhat increased retirement payment under the City's defined benefit formula that would have accrued during those DROP years. They are not working any longer than originally anticipated; there is no offset from saved health insurance premiums or deferred training costs. Instead, there are increased costs to the Retirement System due to their beginning to draw benefits sooner and reduced retirement contributions, on a net basis, with the four percent that they earn on retirement payments to their DROP account.

Demographics and Retirement Behavior under the DROP

The data provided by Cheiron and SFERS shows that relative to retirement experience prior to DROP, the actual DROP entry date is not the date at which officers would likely have retired if DROP had not existed (See Table 1).

Over a long period of time, the demographics of SFERS' Police members show that prior to DROP, approximately 12 percent of officers age 55 with 25 or more years of service would have been expected to retire. Since DROP, 33 percent of these officers have elected to retire or enter DROP. With an adjustment for the initial rush of entrants at the beginning of DROP, in summer of 2008, 21 percent of these officers have elected to retire or enter DROP.

Some members who enter DROP earlier than they planned to retire may work for the City longer than they planned to before DROP was offered, but others may be retiring from DROP exactly as they would have if there had been no DROP. It appears from the data that most members enter DROP before they would have retired if no DROP existed. As these members continue to work through their period in DROP they may exit DROP after they would have otherwise retired. There are too few members who have retired from DROP to determine the additional service due to the Program.

Table 1: Retirement Rates for Police Officers age 55 with 25 or more years of Service	
Pre-DROP	12%
Since-DROP	33%
Since-DROP (adjusting for initial rush)	21%
Source: Cheiron Report	

For the period July 1, 2008 to January 1, 2010, the most recent period for which complete data exists, 252 officers retired based on their service (disability retirements also occur but are not included here). Of these, 169 (67 percent) participated in DROP and 83 (33 percent) chose to retire without participating.

The 169 officers who participated in DROP represent 27% of all officers who were eligible to retire via DROP during the period. Of the officers who have elected to retire during the period, Group 2, Inspectors and Sergeants, have the highest DROP enrollment rate at 74 percent, Group 3, Lieutenants and Captains, have the lowest enrollment rate at 53 percent and Group 1, Police Officers, are in the middle at 66 percent. Overall, 67 percent of all officers who retired elected to take advantage of DROP and all Groups have over a 50 percent election rate. (See Table 2)

Table 2. DROP Enrollment vs. Retirement without DROP July 1, 2008 to January 1, 2011

Rank	Total Eligible to Retire through DROP	Eligible but has not elected to Retire	Retired by Entering DROP	Retired without DROP	Retired for Disability
Group 1: Police Officers	278	149	82	43	4
Group 2: Inspectors and Sergeants	235	139	70	25	1
Group3: Lieutenants and Captains	102	69	17	15	1
TOTAL	**615 (100%)**	**357 (58%)**	**169 (27%)**	**83 (13%)**	**6 (>1%)**
Source: Retirement System Data					

In the period from July 1, 2008 to January 1, 2011, 169 officers have enrolled in DROP, 114 are currently enrolled and 55 have since retired, either because their eligibility expired or because they left voluntarily.

Group 1—the 82 individuals with the rank of Police Officer that represent approximately 50 percent of total enrollment, are eligible to enroll for up to three years. Eighty percent of these officers are currently enrolled. Group 2—the 70 Inspectors and Sergeants, represent approximately 40 percent of total enrollment and are eligible to enroll for up to two years. Of these 70 participants, 40 are currently enrolled and 30 have retired, of these 30 retirees 11 or 37 percent used over 95 percent of their eligibility prior to retiring. Group 3—the 17 Lieutenants and Captains, represent 10 percent of total enrollment and are eligible to enroll for one year. Of the nine Group 3 participants that have retired, seven or 78 percent used over 95 percent of their eligibility prior to retiring (one used 94 percent and the other used 34 percent) (See Table 3).

Through January 1, 2011, Captains and Lieutenants that entered the Program almost always use their full year of eligibility, Inspectors and Sergeants are much less likely to have used their full two-year term—only 15 percent of these officers have used over 95 percent of their eligibility; however 57 percent are currently enrolled and may still maximize their eligibility. Eighty percent of Group 1 Police Officers who have enrolled are still enrolled and are on track to maximize their three-year eligibility. It is unclear what caused 37 officers (67 percent of all exits to date) to enroll for less than the maximum term—in general it is beneficial to both the member and the System to maximize eligibility.

Table 3. DROP Enrollment
July 1, 2008 to January 1, 2011

Rank	Length of Eligibility	Entered DROP	% Total Enrollment	Currently Enrolled	% Currently Enrolled	Since Retired	Median % Eligibility Used by Retired	% Retiring after using at least 95% of Eligibility
Group 1: Police Officers	3 years	82	**49%**	66	**80%**	16	**37%**	**0%**
Group 2: Inspectors and Sergeants	2 years	70	**41%**	40	**57%**	30	**52%**	**37%**
Group3: Lieutenants and Captains	1 year	17	**10%**	8	**47%**	9	**100%**	**78%**
TOTAL		**169**	**100%**	**114**		**55**		

Source: Retirement System Data

Cost Neutrality Considerations and Findings

The Charter requires the Controller and the consulting actuary of the Retirement System to analyze whether the Program has been cost-neutral and whether, in consideration of its achievement of its goals, it should be continued for an additional period of time as specified by the Board of Supervisors, but in no event beyond an additional three years. In fulfillment of this requirement, the Controller considered savings and costs to both SFERS and the City.

As noted above, the net increase or decrease in City costs attributable to the DROP over its first three years is difficult to state with certainty. In large part this is due to the difficulty of quantifying the impact that DROP, in isolation from all other changes within the Police Department, the City and the overall economy, has had on police officers' retirement behavior and on the City and the Police Department's hiring decisions. In other words: if DROP had not existed what would have happened?

Retirement System Trust Fund Cost/Savings

We asked the actuary to analyze three scenarios. Scenario 1 shows the range of possible net savings and net costs using actual data through January 1, 2011, the latest period for which complete data exists. Scenario 2 shows the range of possible costs expected if DROP sunsets and all 357 officers that are eligible as of January 1, 2011 enroll. Scenario 3 is a projection of what the Program would cost in retirement benefits, or overall liability to the Retirement System, if it were continued for three years with the current DROP design and with the current behavior as experienced to date.

For Scenario 1, DROP enrollment is frozen as of January 1, 2011. Under this Scenario Cheiron calculates the present value of benefits[1] for the 114 active DROP participants and 55 DROP retirees[2] as of January 1, 2011 to be $300.5 million—that is the net amount the Retirement System Trust Fund (Trust) would be expected to pay these Officers during their DROP enrollment and retirement. Within this Scenario, Cheiron tested two assumptions. Assumption 1 is that Officers would have retired when they entered DROP, (i.e. DROP extended their service), and under that assumption DROP has saved the Trust $5 million. Assumption 2 is that Officers would have retired when they exited DROP (i.e. DROP did not extended their service), and under that assumption DROP has cost the Trust $29.5 million.

For Scenario 2, DROP sunsets as of June 30, 2011 and all eligible members enter the program. Using the same assumptions as above to test what would have occurred if DROP did not exist, Cheiron found that under this Scenario DROP's net cost impact to the Trust would range from net savings of $47.1 to net costs of $47 million.

Table 4. Present Value of Benefits Due to DROP Participants

	(Actual) DROP Participants	Assumption 1: Retire DROP Entry	Assumption 2: Retire DROP Exit
Scenario 1: DROP enrollment frozen as of 1/1/11	$300.5 million	$305.5 million	$271 million
Scenario 1: (Costs)/Saving		**$5 million**	**($29.5 million)**
Scenario 2: DROP Sunsets at 6/30/11 all eligible Officers join	$838.5 million	$885.6 million	$808.1 million
Scenario 2: (Costs)/Savings		**$47.1 million**	**($47 million[3])**

Source: Cheiron Report

These valuation results, taken together with the actual demographic findings discussed above, present a likelihood that DROP has increased the City's retirement costs because a significant portion of eligible individuals did enter DROP earlier than they would have retired under previous conditions.

[1] Present Value of Benefits is roughly equal to: (monthly pension benefits payments while in DROP+ monthly pension benefits due during retirement) - pension contributions while in DROP.

[2] Officers who have enrolled in DROP and exited either voluntarily or because they have reached their maximum allowable participation.

[3] $47 million assumes eligible Officers that would be made worse off by joining DROP do not join. If these Officers elect to join DROP, even though this is against their own financial interest, the City's projected costs are reduced to approximately $30.4 million.

For Scenario 3, Cheiron modeled the cost to extend DROP as allowed in the Charter under current conditions and with current demographics and behavior. The change in the overall actuarial liability to the Trust under this scenario would be approximately $52 million. Citywide, the employer contribution would need to increase by 0.25 percent of payroll to amortize the $52 million in costs over 20 years and accrue for expected future service DROP costs. Expressed in terms of the FY11-12 budget, that change would mean approximately $6 million in increased retirement contributions required from the City.

Table 5 shows this change in payroll contribution rates not on the citywide basis, but for Police only. If the Police Department alone was required to fund the increased costs, the Department's net employer contribution rate would increase from 28.17 percent of Police payroll to 30.36 percent of Police payroll, an increase of 2.19 percent of payroll.

Table 5. Impact on Employer Contribution Rate for Police (as a Percent of Payroll)

	2010 Valuation without DROP	2010 Valuation with DROP	Change Due to DROP
Employer Normal Cost Rate	18.57%	19.28%	0.71%
Amortization of NET UAL	9.15%	10.63%	1.48%
Expenses	0.45%	0.45%	0.00%
Net Employer Contribution Rate	**28.17%**	**30.36%**	**2.19%**

Source: Cheiron Report

City and Police Department Operating Costs/Savings

Officers who enter the DROP program effectively allow the San Francisco Police Department (SFPD) to avoid the cost of recruiting, hiring and training a replacement. The salary and fringe benefit cost for a cadet in training at the Police Academy is approximately $98,000. Cost savings from keeping a senior officer at the top of their pay band instead of hiring a new officer have not been included in this analysis.

There have been administrative and operating costs associated with the DROP program as well. The Retirement System estimated it cost approximately $700,000 to set up and administer the DROP through January 1, 2011. In addition, the Police Department, the Department of Human Resources and the Controller's Office have used staff time for this Program, however those costs are considered here as part of the City's operations and not material to this analysis.

As discussed above, if the DROP encourages officers to work longer than they would have without DROP, then the Program's potential for deferred costs are realized. For each entrant to DROP, costs can be deferred for a maximum of three years since they may participate in the Program for a range of only 12 months (Lieutenants and Captains) to 36 months (Police Officers).

Averaged over the aggregate cost of the hiring and training program, the City's costs for a new recruit, outside of the recruit's salary and benefits, include:

•	$4,700	Premium pay to trainers
•	$3,200	Uniform and equipment costs
•	$27,600	Background investigation: third party medical, poly and psych costs
•	$11,600	Background investigations: research by former sworn officers
•	$8,000	Health benefit savings ($15,000 for retiree vs. $7,000 for active employee)
	$55,100	**Minimum Costs Avoided or Delayed per Recruit**

During the first 30 months, 169 officers enrolled in DROP. On average these officers enrolled in DROP for 12 months. On a yearly basis this equates to approximately 68 officers retained due to DROP. If the 169 individuals retired one year later than they would have absent the Program, the City would have deferred operating costs of approximately $3.75 million ($55,100 in deferred costs for 68 officers) during the initial three year pilot period of the Program.

If the Program is extended, the likely increase in employer-paid retirement contributions will exceed these deferred cost savings, even assuming that officers retire later than they actually have during the pilot period.

In summary, the impact to the City's operating budget from the Program to date ranges from incurred costs of $700,000 to potential savings or deferred costs of $3.75 million. With this range, under any scenario, the City's possible savings are exceeded by the Retirement System's liability costs.

With its current design, and with the demographics and behavior of the eligible members to date, it appears that the DROP program represents a net increase in the City's liability and is not cost-neutral. We note that there are other considerations, both programmatic and financial, that may affect the City's review of the Program.

The Controller's Office is available to answer your questions on this analysis and to work with the Retirement System and the consulting actuary as appropriate.

cc: Department Heads
Labor Organizations

City and County of San Francisco Employees' Retirement System

Deferred Retirement Option Program Analysis

Produced by Cheiron

April 2011

CHEIRON Classic Values, Innovative Advice

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April 15, 2011

Mr. Gary Amelio
Executive Director
City and County of San Francisco Employees' Retirement System
30 Van Ness Avenue, Suite 3000
San Francisco, CA 94102

Re: ***Deferred Retirement Option Program Analysis***

Dear Mr. Amelio:

As requested, we have analyzed the cost impact of the Deferred Retirement Option Program (DROP) on the City and County of San Francisco Employees' Retirement System (SFERS) as the actuary's portion of the cost impact study being prepared by the City Controller's office. It is our understanding that the Charter requires a cost analysis (joint report from the Controller and the SFERS actuary) no later than April 15, 2011. This report represents Cheiron's response to that requirement.

We have analyzed the cost impact under three different scenarios as requested by the City Controller:

1. The DROP program sunsets on June 30, 2011, and there are no new DROP participants after December 31, 2010.
2. The DROP program sunsets on June 30, 2011, and all eligible members enter DROP before it sunsets.
3. The DROP program is made permanent (ongoing 3-year renewals), and funding for DROP is anticipated in the annual actuarial valuation.

The cost impact of these scenarios depend on the retirement decisions of members assuming there was no DROP provision compared to their decisions with the DROP. Because we cannot know what retirement decisions members would have made if there had been no DROP we have developed a range for the cost impact.

This report was prepared exclusively for the City and County of San Francisco for a specific and limited purpose. It is not for the use or benefit of any third party for any purpose. Any third party recipient of Cheiron's work product who desires professional guidance should not rely upon Cheiron's work product, but should engage qualified professionals for advice appropriate to its own specific needs.

This report does not address any contractual or legal issues. We are not attorneys and our firm does not provide any legal services or advice. In preparing our report, we relied, without audit, on information supplied by SFERS' staff. This information includes, but is not limited to, plan provisions, employee data, and financial information.

1750 Tysons Boulevard, Suite 1100, McLean, VA 22102 Tel: 703.893.1456 Fax: 703.893.2006 www.cheiron.us

We hereby certify that, to the best of our knowledge, this report and its contents, which are work products of Cheiron, Inc., are complete and accurate and have been prepared in accordance with generally recognized and accepted actuarial principles and practices which are consistent with the Code of Professional Conduct and applicable Actuarial Standards of Practice set out by the Actuarial Standards Board. Furthermore, as credentialed actuaries, we meet the Qualification Standards of the American Academy of Actuaries to render the opinion contained in this report.

Sincerely,
Cheiron

William R. Hallmark, ASA, FCA, EA, MAAA	Kenneth Kent, FSA, FCA, EA, MAAA
Consulting Actuary	Principal Consulting Actuary

EXECUTIVE SUMMARY

Assessing the impact on City contributions to the City and County of San Francisco Employees' Retirement System (SFERS) of the adoption of the Deferred Retirement Option Program (DROP) effective July 1, 2008 requires some judgment. We know what members elected DROP and what their benefits cost under DROP, but there is no way to know for sure when these same members would have retired had there been no DROP available to them.

It is reasonable to assume that without DROP, members would have retired somewhere between the time they entered DROP and the time they exited DROP and began receiving benefits. Consequently, our analysis determines a range of cost impacts based on the two ends of this spectrum of member retirement decisions if there had been no DROP.

The table below summarizes the range of the cost impact for DROP since its effective date using both members who had entered DROP by December 31, 2010 and assuming all members eligible for DROP enter the program before June 30, 2011. These estimates assume DROP sunsets on June 30, 2011.

Net (Cost) or Savings if DROP Sunsets June 30, 2011		
	Retire on DROP Entry Date	**Retire on DROP Exit Date**
DROP enrollment frozen as of 1/1/2011	$ 5.0	$ (29.5)
DROP Sunsets at 6/30/11: all eligible enter DROP	$ 47.1	$ (30.4)

Dollar amounts in millions

The breadth of the cost impact range shown in the table is substantial, but doesn't capture the highest cost scenario. The highest cost scenario assumes that all eligible members who are financially advantaged enter DROP before it sunsets. Under this scenario, the cost impact would be a net cost of approximately $47 million.

As of July 1, 2011, the estimated range of the impact on City contribution rates is shown in the table below.

Amortization of Net (Cost) or Savings if DROP Sunsets June 30, 2011		
	Retire on DROP Entry Date	**Retire on DROP Exit Date**
DROP enrollment frozen as of 1/1/2011	(0.02)%	0.10%
DROP Sunsets at 6/30/11 all eligible enter DROP	(0.16)%	0.10%

If DROP is renewed and becomes a permanent part of SFERS, the expected cost of DROP would become embedded in the cost of SFERS. The data gathered after just two and one half years of experience is not sufficient to determine long-term changes in retirement behavior due to DROP with a high degree of certainty. Nevertheless, we would need to make an initial estimate, and we would update our assumptions with each experience study to refine the initial estimate. Based on the current data available, our estimate indicates an increase in the net employer contribution rate for Police of about 2.19% of payroll. On a composite basis (including Miscellaneous and Fire), the increase is about 0.25% of payroll.

EXECUTIVE SUMMARY

The experience data indicates that most members who enter DROP have reached the maximum percentage of final compensation they can receive from SFERS. Whether or not DROP is cost neutral with respect to SFERS depends on whether these members would have retired immediately if DROP did not exist or if they would have continued working and DROP provides an option for them to maximize their benefits. It appears from the data that most enter DROP before they would have retired if no DROP had existed. However, as these members continue to work through their period in DROP, on average, we expect that they will exit DROP after they would have otherwise retired. There are too few members who have retired from DROP for us to determine the additional service due to DROP.

INTRODUCTION

To address recruitment and retention, a Deferred Retirement Option Program (DROP) was established under the City Charter for Police members of the City and County of San Francisco Employees' Retirement System (SFERS) effective July 1, 2008. The Charter provision specifically stated that the intent was for the DROP to be "cost neutral" to the City. The Charter established an automatic sunset for the DROP as of June 30, 2011, a requirement for a cost analysis, and an option for the Board of Supervisors to renew the program for another three years. This process could be repeated every three years.

The determination of cost neutrality is defined in the Charter to *"take into account the costs associated with payroll, the expenditures associated with the recruitment and training of Police Officers, the costs of conducting academies for such recruits and trainees, the Field Training Officer costs, the retirement contributions made by members participating in the DROP, and the City, and the City's share of the return on the investment of the DROP funds, along with any other cost or savings elements related to the implementation of the Program."* Much of this analysis must be performed by the City Controller. This report only addresses the cost impact on City contributions to SFERS.

The cost impact of DROP depends in part on whether members who are eligible for the program actually elect to participate. When the DROP became effective on July 1, 2008, a number of members elected to participate in the program within the first month having anticipated the option to join. After the first month, the rate of participation dropped significantly. If DROP is allowed to sunset on June 30, 2011, there may be a similar surge in participation before the program ends. However, if DROP is renewed well in advance of the sunset date, we would not expect a similar surge in participation.

Consequently, this report analyzes the cost impact using actual DROP participation through December 31, 2010 (the latest date for which data was available) assuming both no new DROP participation and all eligible members elect to participate in DROP by June 30, 2011. These two scenarios provide the potential range of costs if the DROP program is not renewed.

Under the current actuarial valuation, no explicit adjustment has been made to the assumptions for the DROP. As we noted in the recent demographic experience study, with the combination of limited data and a sunset date, we recommended deferring the adoption of specific DROP assumptions unless the program was renewed by the Board of Supervisors. If DROP becomes permanent (renewed every three years), assumptions will need to be considered for the annual actuarial valuation, and these assumptions will be revisited with each demographic experience study to ensure that the costs of the DROP program are funded in advance. For this report, we used a set of DROP assumptions, to evaluate the cost impact of making DROP permanent, which are described at the end of this report.

ANALYSIS RESULTS

This section provides the full analysis for each of these three scenarios:

1. DROP sunsets -- No new DROP participants,
2. DROP sunsets -- All eligible members enter DROP, and
3. DROP is renewed every three years.

DROP Sunsets -- No New DROP Participants

Under this scenario, the DROP program is not renewed and there are no new DROP participants after December 31, 2010. Consequently, the cost of the DROP program is based on those members who entered DROP between July 1, 2008 and January 1, 2011.

The cost impact of DROP is equal to the difference between the present value of benefits in DROP and the present value of benefits assuming there was no DROP program. To estimate the benefits assuming there was no DROP program, however, requires an assumption as to when members would have retired if there had been no DROP program. We have calculated the value of the benefits under two assumptions that represent the range of likely behavior and the range of the cost impact: (1) assuming the member would have actually retired when they chose to enter DROP and (2) assuming the member would have actually retired when they exited DROP (or are anticipated to exit DROP). The table below summarizes these calculations.

DROP Members as of January 1, 2011 Present Value of Benefits				
		DROP	Assuming No DROP	
Status	Count	Current Participant	Retire on DROP Entry Date	Retire on DROP Exit Date
Active	114	$ 197.8	$ 200.3	$ 172.1
Retired	55	102.7	105.2	98.9
Total	**169**	**$ 300.5**	**$ 305.5**	**$ 271.0**
Difference (Cost)/Savings			$ 5.0	$ (29.5)

Dollar amounts in millions

The potential cost impact for this scenario ranges from a **net savings of $5.0 million to a net cost of $29.5 million** before consideration of any of the City and County cost savings outside SFERS. This difference would have been recognized as an experience gain or loss in the July 1, 2009, July 1, 2010, and July 1, 2011 actuarial valuations. The estimated impact on City contribution rates in each of those valuations is shown in the table below.

Estimated Impact on City Contribution Rates		
Actuarial Valuation Date	Retire on DROP Entry Date	Retire on DROP Exit Date
July 1, 2009	(0.01)%	0.03%
July 1, 2010	(0.02)%	0.10%
July 1, 2011	(0.02)%	0.10%

ANALYSIS RESULTS

The increase in contribution rate as of the July 1, 2011 actuarial valuation is expected to decrease as a percentage of pay over time following the rolling 15-year amortization method for actuarial gains and losses.

Explanation

The present value of benefits for members who participated in DROP, but are now retired is equal to the accumulated value of all benefits paid prior to January 1, 2011 (including the DROP account balance) plus the present value of all benefits expected to be paid in the future less the accumulated value of any employee contributions paid while the member was in DROP.

For DROP members who are still active employees, the present value of benefits equals the present value of all benefits expected to be paid on or after January 1, 2011 (including the DROP account balance) less the accumulated value of employee contributions paid while the member was in DROP prior to January 1, 2011 and less the present value of expected future employee contributions while in DROP. For DROP members who are still active employees, it is assumed that they will remain active employees until the maximum DROP period expires.

For the assumption that members would have retired when they entered DROP, the present value of benefits is calculated based upon the retirement benefit commencing immediately upon entering DROP. In addition, there is an offset for the accrual of benefits of a replacement employee during the DROP period. This amount is calculated as the employer normal cost rate multiplied by the member's pay during the period the member was in DROP.

For the assumption that members would have retired when they exited DROP, the member's pay and service and age specific benefit accrual during their DROP participation is used to calculate what their benefit would have been had they actually retired at the later date. Then, the present value of benefits is calculated as before using the hypothetical benefit amounts and commencement date.

DROP Sunsets – All Eligible Members Enter DROP

Under this scenario, the DROP is not renewed, and all eligible members enter DROP before it sunsets. Again we have calculated the value of the benefits under two assumptions that represent the range of likely behavior and the range of the cost impact: (1) assuming the member would have actually retired when they chose to enter DROP and (2) assuming the member would have actually retired when they exited DROP (or are anticipated to exit DROP). The table below summarizes these calculations.

ANALYSIS RESULTS

DROP Members as of January 1, 2011 Present Value of Benefits				
		DROP	Assuming No DROP	
Status	Count	Current Participant	Retire on DROP Entry Date	Retire on DROP Exit Date
Eligible	357	$ 538.0	$ 580.1	$ 537.1
Active	114	197.8	200.3	172.1
Retired	55	102.7	105.2	98.9
Total	**526**	**$ 838.5**	**$ 885.6**	**$ 808.1**
Difference (Cost)/Savings			**$ 47.1**	**$ (30.4)**

Dollar amounts in millions

The potential cost impact for this scenario ranges from a **net savings of $47.1 million to a net cost of $30.4 million** before consideration of any of the City and County cost savings outside SFERS. This difference would have been recognized as an experience gain or loss in the July 1, 2009, July 1, 2010, and July 1, 2011 actuarial valuations. The estimated impact on City contribution rates in each of those valuations is shown in the table below.

Estimated Impact on City Contribution Rates		
Actuarial Valuation Date	Retire on DROP Entry Date	Retire on DROP Exit Date
July 1, 2009	(0.01)%	0.03%
July 1, 2010	(0.02)%	0.10%
July 1, 2011	(0.16)%	0.10%

The increase in contribution rate as of the July 1, 2011 actuarial valuation is expected to decrease as a percentage of pay over time following the rolling 15-year amortization method for actuarial gains and losses.

However, it should be noted that some members who are eligible for DROP are not advantaged by entering DROP by June 30, 2011 even if they were planning to retire by the time they would have to exit DROP. The value of additional accruals for these members is greater than the value of accumulating a year of pension payments in a DROP account. If these members did not elect DROP, but all others did (i.e., assume the maximum impact of what is referred to as anti-selection), the cost of DROP assuming DROP members would have retired on their DROP exit date would increase by approximately $17 million, increasing the City contribution rate to SFERS in the July 1, 2011 valuation by an additional 0.06% (0.16% total increase).

Explanation

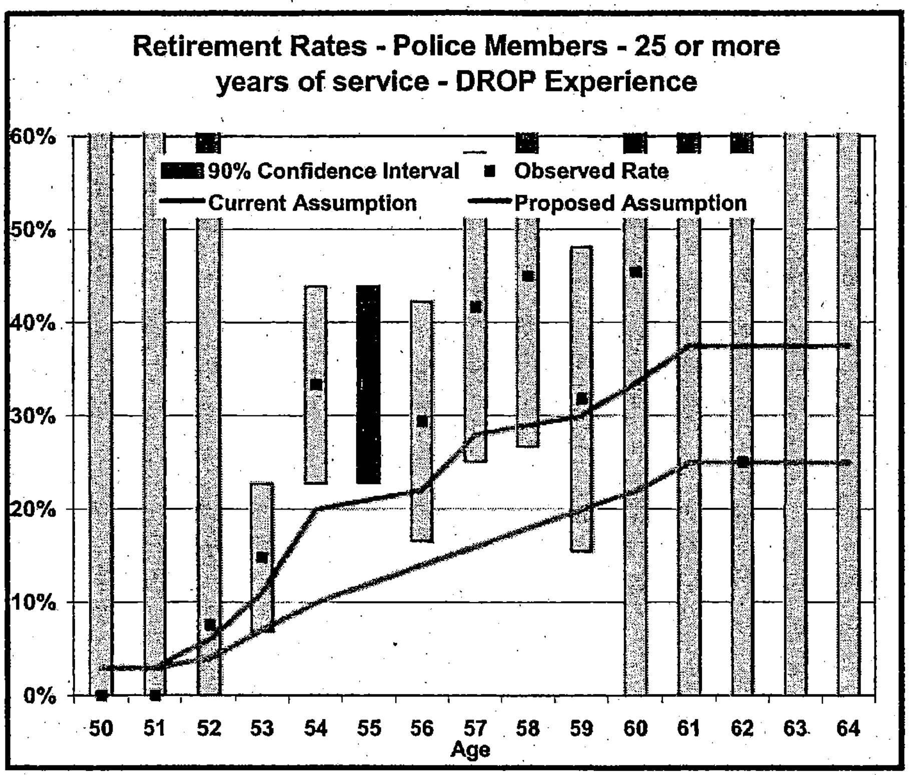
For members who are eligible, but have not entered DROP yet, we assumed that they all entered on June 30, 2011 and remained in DROP for the maximum period permitted. The present value of benefits for these members equals the present value of all benefits expected to be paid on or after July 1, 2011 (including the projected DROP account balance) less the present value of expected future employee contributions while projected to be in DROP.

ANALYSIS RESULTS

DROP is Renewed Every Three Years

Under the current actuarial valuation, no adjustment has been made to the assumptions for the DROP program. As noted in the recent demographic experience study, with the combination of limited data and a sunset date, we recommended deferring the adoption of specific DROP assumptions unless the program was renewed by the Board of Supervisors. If DROP becomes permanent (renewed every three years), assumptions will need to be incorporated into the annual actuarial valuation, and these assumptions will be revisited with each demographic experience study to ensure that the costs of the DROP program are funded in advance.

To develop initial DROP assumptions, we examined the rates of retirement or entry into DROP for those members eligible to enter DROP since July 1, 2008. The chart below summarizes the data and the proposed assumption. The current assumption is the retirement assumption used in the July 1, 2010 actuarial valuation.



Age	Current	Proposed
50	3.00%	3.00%
51	3.00%	3.00%
52	4.00%	6.00%
53	7.00%	11.00%
54	10.00%	20.00%
55	12.00%	21.00%
56	14.00%	22.00%
57	16.00%	28.00%
58	18.00%	29.00%
59	20.00%	30.00%
60	22.00%	33.50%
61	25.00%	37.50%
62	25.00%	37.50%
63	25.00%	37.50%
64	25.00%	37.50%

Current A/E Ratio: 2.262 Proposed A/E Ratio: 1.398

The black squares represent the observed rate of retirement or DROP entry during the period, and the gray bars represent the 90% confidence interval around the observed rate. The larger confidence intervals indicate that there is less data so there is less credibility in predicting the long-term rate.

ANALYSIS RESULTS

The relatively large gray bars indicate that the amount of data after just two and one half years of experience is not sufficient to discern behavior changes with a high degree of confidence. But clearly, the retirement rates are higher with the DROP than without it. However, some of this difference is due to the relatively large proportion of DROP retirements in the first month after DROP became effective. Consequently, the proposed assumption adjusts for the higher rates in the first month. Because the data is limited, it should be anticipated that additional adjustments to this assumption will be needed over time as more data on rates of retirement and DROP entry become available. Such adjustment will modify the implications of cost neutrality of the DROP as it relates to SFERS component of the program impact. It is also important to note that before these retirement rates could be used in an actuarial valuation, they would need to be presented to the Retirement Board and adopted.

The table below shows the impact on the July 1, 2010 valuation results of applying the proposed retirement rates above to Police members.

Impact on Employer Contribution Rate for Police

	2010 Valuation w/o DROP	2010 Valuation w/ DROP	Change Due to DROP
Employer Normal Cost Rate	18.57%	19.28%	0.71%
Amortization of Net UAL	9.15%	10.63%	1.48%
Expenses	0.45%	0.45%	0.00%
Net Employer Contribution Rate	**28.17%**	**30.36%**	**2.19%**

The change in the composite employer contribution rate (includes Miscellaneous and Fire) would be approximately 0.25% of payroll. The change in actuarial liability under this scenario would be approximately $52 million and the rates shown above assume the change is treated as a plan change and amortized over 20 years.

In addition to adjusting the retirement rates, the impact on employer contribution rates shown above includes an adjustment for the continued employee contributions while in DROP and for the difference between crediting the DROP account with 4.0% interest and the discount rate of 7.75%.

MEMBER DATA

The following tables summarize key aspects of the census data for members who have participated in DROP or are currently eligible for DROP.

DROP Participation		
Year	Entered DROP	Exited DROP
7/1/2008 – 6/30/2009	59	3
7/1/2009 – 6/30/2010	92	26
7/1/2010 – 12/31/2010	18	26

DROP Membership Statistics		
	Active DROP	Retired DROP
Count	114	55
Averages		
Age at DROP Entry	57.3	56.5
Service at DROP Entry	31.2	30.6
Months in DROP as of 1/1/2011	12	13
DROP Account Balance	$ 118,711	$ 124,616
Monthly Benefit as of 1/1/2011	$ 9,544	$ 9,520

The maximum benefit payable to a police officer is 90% of final compensation. While final compensation may continue to increase with additional service, the 90% limit is reached with 30 years of service at age 55 or older. This limit corresponds fairly close with the average age and service for members entering DROP as shown in the tables above.

Whether or not DROP is cost neutral with respect to the pension plan largely depends on whether these members who had reached the 90% limit would have retired immediately if DROP did not exist or if they would have continued working and DROP provides an option for them to maximize their benefits. Based on retirement experience prior to the effective date of DROP, approximately 12% of police members age 55 with 25 or more years of service retired. After the effective date of DROP, the observed experience (including entry into DROP) for police members age 55 with 25 or more years of service was 33% and after adjusting for the initial rush of DROP members, the proposed assumption was 21%. This experience indicates that a significant portion of the members entering DROP probably would not have retired at that date if DROP didn't exist. Some of these DROP members may exit DROP after they would have otherwise retired, but others may exit DROP at the same time they would have otherwise retired. However, given the short period of experience, other factors could also play a role in the change in retirement rates.

ADDITIONAL CONSIDERATION

The estimates provided in this report reflect the range of cost impacts on the retirement system of the DROP, and do not include any cost impact such as training or recruitment costs that are outside of the retirement system.

In examining the cost impact of the first three years of the DROP, we have only identified a range because it is uncertain what the long term retirement behavior would have been had there been no DROP.

In determining the cost if the DROP becomes permanent, we have estimated the change in retirement behavior based on a comparison of retirement behavior since DROP became effective to retirement behavior for similar employees prior to DROP becoming effective. These initial estimates of retirement rates are likely to change as a longer period of data becomes available.

The retirement behavior over the short period since the DROP was available has been influenced by pent up demand, concern of future availability given the sunset provisions as well as a challenging economic environment. As cost/saving in terms of SFERS is associated primarily with the change in retirement behavior, the value of the DROP to the City and County of San Francisco should be anticipated to change over time if the DROP is continued.

APPENDIX A
AGE-SERVICE EXHIBITS

Age – Service Distribution – Retired DROP Members				
	Service			
Age	25 – 29	30 – 34	35 +	Total
50 – 54	1	0	0	1
55 – 59	8	31	1	40
60 – 64	4	5	3	12
65 +	0	0	2	2
Total	13	36	6	55

Age – Service Distribution – Active DROP Members				
	Service			
Age	25 – 29	30 – 34	35 +	Total
50 – 54	2	3	0	5
55 – 59	14	60	4	78
60 – 64	7	13	6	26
65 +	0	2	3	5
Total	23	78	13	114

Age – Service Distribution – Active Members Eligible for DROP				
	Service			
Age	25 – 29	30 – 34	35 +	Total
50 – 54	120	106	0	226
55 – 59	46	54	4	104
60 – 64	9	8	8	25
65 +	0	0	2	2
Total	175	168	14	357

APPENDIX B
SUMMARY OF DROP PLAN PROVISIONS

Effective Date – July 1, 2008 through June 30, 2011

Section A8.900 – effective July 1, 2008 through June 30, 2011. DROP sunsets on June 30, 2011 unless the Board of Supervisors votes to renew for up to three more years.

1. Membership Requirement

Active, full duty sworn officers occupying one of the eligible ranks; Police Officer, Sergeant, Inspector, Lieutenant, or Captain.

2. Eligibility

Age 50 with 25 years of credited service as a sworn member, including any service as a member of the San Francisco Airport Police. To participate, the member must agree to terminate employment through retirement at the end of their participation in DROP. No member shall be eligible for a promotion during their participant in DROP.

3. Length of DROP period

Once a member enters DROP, participation continues until either termination of employment or the maximum DROP participation period has been reached.

Rank	Maximum DROP Period
Police Officer	36 months
Sergeant/Inspector	24 months
Lieutenant/Captain	12 months

4. DROP Benefit

DROP Account Balance
The service pension, which is calculated based on age, compensation and length of service as of their date of entry into the Program, is credited monthly into a DROP Account including any Basic or Supplemental Cost of Living Adjustments. The DROP Account is also credited on a monthly basis with interest at an annual effective rate of 4% throughout the member's DROP period.

Retirement Benefit
At the end of the DROP period, a lump sum distribution of the DROP Account Balance will be made and monthly retirement benefits will commence based on the initial DROP benefit calculated based on age, compensation and service at the date of entry into DROP including any cost of living adjustments to which the member would otherwise be entitled.

APPENDIX B
SUMMARY OF DROP PLAN PROVISIONS

5. Employee Contributions while in DROP

The member still makes employee contributions into the retirement system which are deemed contributions to the general assets of SFERS, and shall not be part of the member's DROP Account.

6. Effect of Disability on DROP participation

Duty Related Disability
The Member will receive an industrial disability benefit as though the participant was never enrolled in DROP. Service, compensation, and age at the time of disability will be used to calculate the disability benefit. The DROP Account will be waived.

Non-Duty Related Disability
Member will terminate participation in DROP and is paid the balance in their DROP Account. They will begin receiving a monthly payment equal to the service retirement benefit determined as of the DROP entry date including any cost of living adjustments to which the member would otherwise be entitled.

7. Effect of Member Death on DROP participation

Duty Related Death
The member's qualified surviving spouse, domestic partner or other qualified dependent will receive a death allowance as though the participant was never enrolled in DROP. Service, compensation, and age at the time of death will be used to calculate the benefit. The DROP Account will be waived. The qualified spouse, domestic partner or qualified dependent may elect to receive a non-work related death benefit specific below instead.

Non-Duty Related Death
Participation in DROP is terminated and the balance in the Member's DROP Account is paid to the Member's beneficiary. In addition, any qualified survivor will begin receiving a post-retirement continuation allowance determined on the basis of beneficiary elections made by the member at the time of entry into DROP including any cost of living adjustments to which the Member would otherwise be entitled.

APPENDIX C
SUMMARY OF STUDY ASSUMPTIONS AND METHODS

The assumptions and methods used in this study are identical to those used in the July 1, 2010 actuarial valuation issued in January, 2011, except as noted below.

1. Active Members Eligible for DROP

    - Assumed members' pay would increase annually by 5.5% (4.0% + 1.5%) for FYE 6/30/12, 6/30/13, and 6/30/14.
    - Future COLA's on benefits will be 2% for new police and 4% for old police.
    - Miscellaneous benefits were not included in this analysis.
    - Maximum length in DROP based on Job code was assumed.
    - Pay as of 1/28/2011 provided in data was annualized for FYE 6/30/2011.

2. Active Members In DROP

    - Assumed members' pay would increase annually by 5.5% (4.0% + 1.5%) for FYE 6/30/12, 6/30/13, and 6/30/14.
    - Pay as of 1/28/2011 provided in data was annualized for FYE 6/30/2011.
    - Future COLA's on benefits will be 2% for new police and 4% for old police.
    - Miscellaneous benefits were included in this analysis.
    - Assumed that actual DROP exit is equal to expected DROP exit date provided in the data.
    - The DROP Account Balance given as of 1/31/2011 was adjusted to 1/1/2011.
    - Assumed retirement benefits accumulated are equal to the DROP Account Balances provided in the data adjusted for the difference between the 7.75% discount rate and the 4.0% DROP crediting rate.
    - The recently granted Supplemental COLA was added to the benefit amounts provided in the data.

3. Retired Members Who Participated in DROP

    - Future COLA's on benefits will be 2% for new police and 4% for old police.
    - Miscellaneous benefits were included in this analysis.
    - No adjustment was made for the recently granted Supplemental COLA as it would have an identical impact on all scenarios studied.