File No. 101131

Committee Item No. 2
Board Item No. 12

COMMITTEE/BOARD OF SUPERVISORS

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Completed by: LaTonia Stokes Date September 10, 2010
Completed by: LaTonia Stokes Date September 22, 2010

An asterisked item represents the cover sheet to a document that exceeds 20 pages. The complete document is in the file.

[Board Response to the 2009-2010 Civil Grand Jury Report Entitled "Pension Tsunami: The Billion Dollar Bubble"]

Resolution responding to the Presiding Judge of the Superior Court on the findings and recommendations contained in the 2009-2010 Civil Grand Jury Report entitled "Pension Tsunami: The Billion Dollar Bubble" and urging the Mayor to cause the implementation of accepted findings and recommendations through the department heads and through the development of the annual budget.

WHEREAS, Under California Penal Code Section 933 et seq., the Board of Supervisors must respond, within 90 days of receipt, to the Presiding Judge of the Superior Court on the findings and recommendations contained in Civil Grand Jury Reports; and,

WHEREAS, In accordance with Penal Code Section 933.05(c), if a finding or recommendation of the Civil Grand Jury addresses budgetary or personnel matters of a county agency or a department headed by an elected officer, the agency or department head and the Board of Supervisors shall respond if requested by the Civil Grand Jury, but the response of the Board of Supervisors shall address only budgetary or personnel matters over which it has some decision making authority; and,

WHEREAS, The 2009-2010 Civil Grand Jury Report Entitled "Pension Tsunami: The Billion Dollar Bubble" is on file with the Clerk of the Board of Supervisors in File No. <file number>, which is hereby declared to be a part of this resolution as if set forth fully herein; and,

WHEREAS, The Civil Grand Jury has requested that the Board of Supervisors respond to Findings A1, A2, B1, B2, B3, C1, C2, D1, E1, F1, and F2 as well as Recommendations A1, B1, B2, B3, C1, C2, D1, and E1 contained in the subject Civil Grand Jury report; and,

WHEREAS, Finding A1 states: "San Francisco's Defined Benefit Plan retirement benefits are financially unsustainable without significant cutbacks in jobs and city services."; and,

WHEREAS, Recommendation A1 states: "The San Francisco City Charter should be amended, as follows: For new employees, the pension multiplier should be set at a level to provide fiscally sound future pensions – fair to employees and taxpayers alike. For new Miscellaneous employees, the retirement age to receive full benefits should be comparable to that of Social Security and/or private sector recipients, and be fair to employees and taxpayers alike. The Jury recommends that City officials consider a hybrid retirement plan with components of both Defined Benefit and Defined Contribution, 401(k)-type, in the next negotiated contract in 2012. No cost-of-living or other increase should be awarded to retirees unless the pension fund is found through a multi-year analysis to be actuarially sound and fully funded. SFERS and actuaries for the City should research other public and private sector data to determine fair pension benefits and the results should be reported at SFERS board meetings and to the Board of Supervisors to lead to a sustainable plan."; and,

WHEREAS, Finding A2 states: "For current employees and retirees, pension benefits are guaranteed by City Charter and protected by Federal and State constitutional provisions prohibiting impairment of contract."; and,

WHEREAS, Finding B1 states: "The City's pension and health benefit costs are expected to increase from approximately $400 million for the current fiscal year to nearly $1 billion in five years, a billion-dollar bubble that the City cannot realistically afford. Current pension rules are producing an ever-increasing employer contribution rate, from 0% in 2004, to 9.49% in 2010 and to 30% by 2015. This will impact the General Fund, and could make it very difficult for the City to sustain funding for police and fire, public health, human services,

cultural and artistic programs. It will disproportionately affect the poor and the needy, and tax the middle class."; and,

WHEREAS, Recommendation B1 states: "The Mayor and the Board of Supervisors should prepare a plan within the next year to fund the projected $1 billion in pension costs."; and,

WHEREAS, Finding B2 states: "The Department of Human Resources and SEIU Local 1021 entered into an agreement that Miscellaneous employees would pay their own 7.5% contribution, and, in return, the base wages were increased by 6%, effective July 1, 2010. There was no actuarial valuation to estimate the resulting pension liability for the City. This agreement resulted in a substantial increase in pension obligations for the City without voter approval."; and,

WHEREAS, Recommendation B2 states: "The Department of Human Resources (DHR) should not enter into agreements with the employee unions which increase the City's future pension obligations without voter approval. DHR should engage the City's professional Actuary to investigate any increase in pensionable compensation."; and,

WHEREAS, Finding B3 states: "2,384 retirees receive pensions greater than $75,000."; and,

WHEREAS, Recommendation B3 states: "DHR should compare the retirement benefits in other California cities to determine whether the pension benefits are excessive. The results should be reported to the Mayor and Board of Supervisors."; and,

WHEREAS, Finding C1 states: "Proposition H, passed by voters in 2002, requires that if the City's contribution rate to the pension fund exceeds 0%, then the City and the Safety employee unions must "meet and confer" to implement a "cost-sharing" arrangement to reduce the cost impact of the employer's contributions on the City's General Fund. The City's contribution rate has exceeded 0% for fiscal 2004-05 to the present. The City and County of

San Francisco is not in compliance with the requirements of the City Charter resulting from the passage of Proposition H. There have been no "meet and confer" sessions to establish a "cost-sharing" arrangement. The City Attorney has not mandated that the SFERS Board comply with these requirements of the Charter Amendment resulting from Proposition H."; and,

WHEREAS, Recommendation C1 states: "The City Attorney should initiate legal action against the SFERS Board to enforce the requirements of the Charter amendment to "meet and confer" and "cost-sharing" provisions of Proposition H, as stipulated in Charter § A8.595-11 (e). The Jury recommends that the City Attorney and/or his representatives present to the Board of Supervisors and SFERS Board the following documents regarding § A8.595-11 (e) of the City Charter:

1. A legal opinion on the charter section.
2. Documentation regarding the dates and times that the City and the Police and Firefighters unions met to confer and to implement a cost-sharing arrangement as required in the section.
3. A legal opinion regarding fiduciary duties of the SFERS Board to comply with it.
4. A legal opinion regarding SFERS duty to revise the Safety employee contribution rate to comply with the Charter section.
5. A legal opinion regarding possible remedies to enforce compliance."; and,

WHEREAS, Finding C2 states: "The unfunded pension liability for Proposition H as of July 1, 2009, was approximately $276 million, amortized over thirteen years to about $26 million annually. "; and,

WHEREAS, Recommendation C2 states: "The City and Safety employees should establish an arrangement to share the annual $26 million cost as required by the City Charter."; and,

WHEREAS, Finding D1 states: "The soon-to-be retired have been able to increase final pensionable compensation to inflate retirement benefits. The Jury found instances of nursing supervisors being allowed to have two concurrent jobs and earn pensions on both, sometimes referred to as pension-pyramiding. "; and,

WHEREAS, Recommendation D1 states: "San Francisco should take steps to curb abuses from pension spiking by limiting the final pensionable income an employee can claim at retirement and from pension-pyramiding. The Jury suggests the following:

- Use a three-year average to determine pensionable income, similar to Federal rules.
- Limit final pensionable compensation to 120% of the rank pay rate as determined by Civil Service job classification.
- The Controller should perform an independent review of pensions to determine whether the practice of pension spiking is ongoing.
- Disallow employees from drawing pensions from two simultaneous City jobs.
- Pensionable compensation should not include pay for two separate pay types, known as pension-pyramiding."; and,

WHEREAS, Finding E1 states: "For current employees and retirees, health benefits are "vested" after 10 years. Unlike pensions, health benefits for most City workers are not pre-funded, but are paid directly out of the City's General Fund. In 2001, the City expended $17 million on retiree health care. By 2007, that amount had grown to $130 million and continues to rise. Mercer Consulting reported on June 30, 2008, that the City's unfunded liability for retiree health benefits was $4 billion."; and,

WHEREAS, Recommendation E1 states: "Department of Human Resources and collective bargaining units should meet and confer to determine a cost-sharing arrangement to pre-fund the $4 billion unfunded liability for retiree health care obligations."; and,

WHEREAS, Finding F1 states: "There are seven SFERS board members: three are elected by the members; three are appointed by the Mayor; and the seventh Commissioner comes from the ranks of the Board of Supervisors. One of the three public members has not been appointed for at least six months. "; and,

WHEREAS, Finding F2 states: "Minutes of the SFERS board meetings record attendance of the board members. When the members representing the public are absent, the interest of the public is eroded."; and,

WHEREAS, in accordance with Penal Code Section 933.05(c), the Board of Supervisors must respond, within 90 days of receipt, to the Presiding Judge of the Superior Court on Findings A1, A2, B1, B2, B3, C1, C2, D1, E1, F1, and F2 as well as Recommendations A1, B1, B2, B3, C1, C2, D1, and E1 contained in the subject Civil Grand Jury report; now, therefore, be it

RESOLVED, That the Board of Supervisors reports to the Presiding Judge of the Superior Court that it partially agrees with Finding A1 of the 2009-2010 Civil Grand Jury Report Entitled "Pension Tsunami: The Billion Dollar Bubble" because, although prior voter approved propositions have impacted future pension liabilities, additional solutions will be required in the future to avoid significant trade offs in the City's budget; and, be it

FURTHER RESOLVED, That the Board of Supervisors agrees with Finding A2; and, be it

FURTHER RESOLVED, That the Board of Supervisors, partially agrees with Finding B1 because while the Civil Grand Jury correctly reports that the San Francisco Employee Retirement System's actuary projects employer contribution rates of 30 percent in 2015, such a projection is only one of many projected contribution scenarios provided by the actuary ranging from 21 percent to 33 percent employer contribution in 2015; and, be it

FURTHER RESOLVED, That the Board of Supervisors incorporates and adopts as its own the response of the Mayor on Finding B2; and, be it

FURTHER RESOLVED, That the Board of Supervisors agrees with Finding B3; and, be it

FURTHER RESOLVED, That the Board of Supervisors incorporates and adopts as its own the response of the Mayor and the Department of Human Resources on Finding C1; and, be it

FURTHER RESOLVED, That the Board of Supervisors agrees with Finding C2; and, be it

FURTHER RESOLVED, That the Board of Supervisors incorporates and adopts as its own the response of the Mayor on Finding D1; and, be it

FURTHER RESOLVED, That the Board of Supervisors incorporates and adopts as its own the response of the Mayor and the Department of Human Resources on Finding E1; and, be it

FURTHER RESOLVED, That the Board of Supervisors agrees with Findings F1 and F2 and, be it.

FURTHER RESOLVED, That the Board of Supervisors incorporates and adopts as its own the response of the Mayor on Recommendation A1, except for the third paragraph of the Mayor's response regarding hybrid pension models because the Board of Supervisors considers the hybrid pension model worthy of further consideration; and, be it

FURTHER RESOLVED, That the Board of Supervisors agrees with Recommendation B1; and, be it.

FURTHER RESOLVED, That the Board of Supervisors disagrees with Recommendation B2 and incorporates and adopts the response of the Department of Human Resources; and, be it

FURTHER RESOLVED, That the Board of Supervisors agrees with Recommendation B3; and, be it

FURTHER RESOLVED, That the Board of Supervisors disagrees with Recommendation C1 and incorporates and adopts as its own ~~and~~ the response of the City Attorney ~~on~~; and, be it

FURTHER RESOLVED, That the Board of Supervisors agrees with Recommendation C2 and incorporates and adopts as its own the responses of the City Attorney and the Department of Human Resources; and, be it

FURTHER RESOLVED, That the Board of Supervisors finds that Recommendation D1 requires further analysis; and, be it

FURTHER RESOLVED, That the Board of Supervisors agrees with Recommendation E1; and, be it

FURTHER RESOLVED, That the Board of Supervisors urges the Mayor to cause the implementation of accepted findings and recommendations through his/her department heads and through the development of the annual budget.

2009-2010 Civil Grand Jury

City and County of San Francisco

PENSION TSUNAMI
The Billion Dollar Bubble

Report Released: JUNE 2010

Office of the Mayor
City & County of San Francisco

Gavin Newsom

August 23, 2010

The Honorable James J. McBride
Presiding Judge
Superior Court of California, County of San Francisco
400 McAllister Street
San Francisco, CA 94102

Dear Judge McBride:

The following is in response to the 2009-2010 Civil Grand Jury report, "Pension Tsunami: The Billion Dollar Bubble."

As you know, San Francisco has been at the forefront both in providing universal access to health care and managing our retirement obligations in a partnership with workers. I'm proud to have worked together with city workers to pass Proposition D, which increased employee pension contributions and protected the security of our retirement system. San Francisco has led the way in insuring basic health access is a right, while working in collaboration with all of the stakeholders to address the real cost challenges associated with our health and retirement systems. Efforts to turn back the clock on health care are shortsighted and will end up costing us all more in the long run.

Increased pension costs are a very real concern as we plan for the future financial health of our city. Like other local and state pension systems across the country, San Francisco's pension system has been impacted by the economic downturn. Over the past several years, my administration has worked actively with city departments, labor organizations, and a wide range of stakeholders to develop and implement initiatives to address projected growth in the cost of pensions and other employee benefits. In June of 2010, the voters of San Francisco overwhelming passed Proposition D, which changed the way the City calculates retirement benefits, increased the employee pension contribution amount for new safety employees, and required that any savings realized from reduced employer contributions to the San Francisco Employees' Retirement System (SFERS) be used to pay for future benefit liabilities.

Since Proposition D, the City has continued to pursue pension and benefits reform. These efforts are important to control cost increases that, if left unaddressed, could have a very real impact on the City's long-term ability to support important programs and provide critical services. The continuing dedication of my office, the SFERS staff and the Department of Human Resources (DHR) underscores our belief in the importance of pension reform to our city's future.

The Civil Grand Jury findings and recommendations on Proposition H warrant a brief discussion. Proposition H, approved by voters in 2002, requires the City and the safety employee unions to meet and confer when the City's retirement contribution rate exceeds zero percent, in order to implement a cost-sharing arrangement. The Civil Grand Jury asserts that the City has not complied with portions of the

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City Charter established by Proposition H. However, the City has met with the Police and Fire unions and these meetings have resulted in significant reductions to the cost impact of employer contributions to our General Fund. Furthermore, as DHR explains in its response, these reductions have also almost completely covered the increased costs under Proposition H.

As our negotiations with the public safety unions have demonstrated, we must work collaboratively with labor to address this issue. When labor contracts come up for renewal, the City will continue to consider the impact these contracts will have on any future pension obligations.

The Mayor's Office response to the Civil Grand Jury's findings is as follows:

Finding A1: San Francisco's Defined Benefit Plan retirement benefits are financially unsustainable without significant cutbacks in jobs and city services.

Response: Disagree. San Francisco's Defined Benefit Plan is one of the most soundly funded and managed public retirement systems in the United States; the system itself is sustainable, despite the impact of the severe economic downturn. The City has faced economic downturns before, and, as it has in the past, our system will recover and remain financially sound.

Finding A2: For current employees and retirees, pension benefits are guaranteed by City Charter and protected by Federal and State constitutional provisions prohibiting impairment of contract.

Response: Agree.

Finding B1: The City's pension and health benefit costs are expected to increase from approximately $400 million for the current Fiscal Year to nearly $1 billion in five years, a billion-dollar bubble that the City cannot realistically afford.

Current pension rules are producing an ever-increasing employer contribution rate, from 0% in 2004, to 9.49% in 2010 and to 30% by 2015. This will impact the General Fund, and could make it very difficult for the City to sustain funding for police and fire, public health, human services, cultural and artistic programs. It will disproportionately affect the poor and the needy, and tax the middle class.

Response: Partially Disagree. Although the City's pensions and health benefit costs are expected to increase significantly over the next several years, the City is working to reduce the impact that these increases will have on important programs and critical services. As the Controller and the SFERS state in their respective responses, the 30% employer contribution rate referenced by the Civil Grand Jury is a projection provided by the SFERS' actuary based on a worst-case scenario where the SFERS Trust would earn only 4.5% on investments for the period covering Fiscal Year 2009-2010 through Fiscal Year 2013-14 rather than its assumed 7.75% return. In fact, the SFERS Trust earned over 12% investment returns for Fiscal Year 2009-2010, well in excess of the worst-case scenario assumed in the SFERS projection. Please see the Controller's response and the SFERS' response.

Finding B2: The Department of Human Resources and SEIU Local 1021 entered into an agreement that Miscellaneous employees would pay their own 7.5% contribution, and, in return, the base wages were increased by 6% effective July 1, 2010.[1] There was no actuarial valuation to estimate the resulting

[1] This "swap" will occur on July 1, 2011 and not July 1, 2010.

pension liability for the City. This agreement resulted in a substantial increase in pension obligations for the City without voter approval.

Response: Partially Disagree. Although the City did not undertake an actuarial valuation to estimate the resulting pension liability, the Civil Grand Jury's statement that the agreement with SEIU resulted in a substantial increase in pension obligations for the City is incorrect. The City's obligation to obtain an actuarial valuation does not arise in a situation such as this where DHR is negotiating wages.

First, as DHR notes in its response, the City agreed to begin paying the employee pension contribution for most unions in 1995 (not in 2002 as indicated in the Civil Grand Jury report), in lieu of providing wage increases. Therefore, if the City had not paid the employee contribution and instead given employee wage increases at that time, there would have been pension cost increases dating back to 1995.

Second, while it is true that SEIU Miscellaneous (non-MTA) employees will receive a base wage increase on July 1, 2011 in exchange for resuming the payment of the employee pension contribution, it will in fact be on a cost-neutral basis to the City. Although it is also true that any increase in pensionable compensation results in a corresponding increase in employer contributions to retirement, the increase is significant only if it occurs at the end of one's career. However, most SEIU employees will continue working for years after the "swap" takes effect.

More importantly, the SFERS pension fund has been funded assuming 4.5% annual wage increases for miscellaneous employees, increases that the City's miscellaneous unions did not receive and are not scheduled to receive, thereby offsetting the impact on pension costs. Please see SFERS' response for more information. Therefore, the increase in benefit liability as of July 1, 2011 as a result of the 6% wage increase is not significant.

See DHR's and SFERS' responses to this finding for additional information and further clarification.

Finding B3: 2,384 retirees receive pensions greater than $75,000.

Response: Agree.

Finding C1: Proposition H, passed by voters in 2002, requires that if the City's contribution rate to the pension fund exceeds 0% then the City and the Safety employees unions must "meet and confer" to implement a "cost-sharing" arrangement to reduce the cost impact of the employer's contributions on the City's General Fund. The City's contribution rate has exceeded 0% for fiscal 2004-05 to the present.

The City and County of San Francisco is not in compliance with the requirements of the City Charter resulting from the passage of Proposition H. There have been no "meet and confer" sessions to establish a "cost-sharing" arrangement.

The City Attorney has not mandated that the SFERS Board comply with these requirements of the Charter Amendment resulting from Proposition H.

Response: Partially Disagree. The first statement and the third statement are correct. However, I disagree with the second statement. The City has worked with its Police and Fire labor organizations to

negotiate provisions in their respective collective bargaining agreements to address Charter obligations regarding cost-sharing, and has set pension contributions for those organizations at the maximum limit allowed by the Charter. Please see DHR's response and the City Attorney's response for more information and further clarification.

Finding C2: The unfunded pension liability for Proposition H as of July 1, 2009, was approximately $276 million, amortized over thirteen years to about $26 million annually.

Response: Agree. According to the SFERS, the annual amortization payment for Fiscal Year 2010-2011 is approximately $26 million.

Finding D1: The soon-to-be retired have been able to increase final pensionable compensation to inflate retirement benefits.

The Jury found instances of nursing supervisors being allowed to have two concurrent jobs and earn pensions on both, sometimes referred to as pension-pyramiding.

Response: Partially Disagree. I agree that practices such as "pension spiking" and "pension-pyramiding" undermine the credibility of the pension system and that the City should prevent such practices.

However, while there are some controls on assignments, pay and retirement calculations that minimizes the risk of these practices, DHR recently completed an audit and found that there are indeed a handful of instances in which employees at the Department of Public Health (DPH) have been earning pensionable income on multiple appointments. DHR is working with DPH to implement a mechanism in the system to prohibit these anomalies from occurring in the future.

The SFERS has also successfully defended against all attempts to "spike" pensions illegally through inclusion of non-wage compensation in pension calculations. Please see the SFERS' response, the Controller's response, and the San Francisco Fire Department's response for more details.

Finding E1: For current employees and retirees, health benefits are "vested" after 10 years.

Unlike pensions, health benefits for most city workers are not pre-funded, but are paid directly out of the City's General Fund. In 2001, the City expended $17 million on retiree health care. By 2007, that amount had grown to $130 million and continues to rise. Mercer Consulting reported on June 30, 2008, that the City's unfunded liability for retiree health benefits was $4 billion.

Response: Partially Disagree. Current employees who were hired prior to January 10, 2009 receive full employer health care coverage after five years of city service. Although retiree health benefits have not been pre-funded, the Controller's Office has been analyzing the City's unfunded retiree health benefit liability and exploring funding options to address this issue.

Furthermore, San Francisco voters approved Proposition B in 2008, which established a Retiree Health Care Trust Fund and created a graduated health benefit vesting schedule for employees hired on or after January 10, 2009. Pursuant to Proposition B, all employees hired on or after January 10, 2009 must

contribute 2% of their salary into the City's Retiree Health Care Trust Fund. The City contributes an additional 1% for each corresponding 2% employee contribution. These contributions offset retiree health liability.

Nevertheless, retiree health benefits have not historically been pre-funded, and the City has a substantial, unfunded retiree health liability. DHR and the City have taken steps, and will continue to takes steps, to address this issue. Please see DHR's response to this Finding and Recommendation E1 for additional information.

Finding F1: There are seven SFERS board members: three are elected by the members; three are appointed by the Mayor; and the seventh Commissioner comes from the ranks of the Board of Supervisors. One of the three public members has not been appointed for at least six months.

Response: Agree. Please note that since the issuance of this report, I have filled the vacancy.

Finding F2: Minutes of the SFERS board meetings record attendance of the board members. When the members representing the public are absent, the interest of the public is eroded.

Response: Agree. It is important for members of all commissions and boards to attend meetings.

The Mayor's Office response to the Civil Grand Jury's recommendations is as follows:

Recommendation A1: The San Francisco City Charter should be amended, as follows:

For new employees, the pension multiplier should be set at a level to provide fiscally sound future pensions – fair to employees and taxpayers alike.

For new Miscellaneous employees, the retirement age to receive full benefits should be comparable to that of Social Security and/or private sector recipients, and be fair to employees and taxpayers alike.

The Jury recommends that City officials consider a hybrid retirement plan with components of both Defined Benefit and Defined Contribution, 401(K)-type, in the next negotiated contract in 2012.

No cost-of-living or other increase should be awarded to retirees unless the pension fund is found through a multi-year analysis to be actuarially sound and fully funded.

SFERS and actuaries for the City should research other public and private sector data to determine fair pension benefits and the results should be reported at SFERS board meetings and to the Board of Supervisors to lead a sustainable plan.

Response: Recommendation Requires Further Analysis. While we have taken a number of important and significant steps toward pension reform, there is still more that can be done.

In response to the recommendation that the City increase the retirement age for new miscellaneous employees to receive full benefits, I note that the retirement age at which miscellaneous employees receive maximum benefits was recently increased to age 62. This is among the highest in California (the maximum benefit age in a majority of the other jurisdictions is between age 55 and 60).

I do not believe the City should create a hybrid system that combines elements of a Defined Benefit Plan and a Defined Contribution Plan at this time. Defined Contribution Plans carry risks that have led to negative unanticipated consequences for many private sector employees, and it would be imprudent to switch to any new model that has not proven to be dependable over the long run. However, I agree that we should continue to review other models and structures that could be appropriate for the City.

The Civil Grand Jury recommends that no cost-of-living or other increase be awarded unless the pension fund is sound and fully funded. While it is true that cost of living adjustments (COLA) are awarded regardless of the financial stability of the pension fund, the additional supplemental COLA amount of up to 3.5% is only awarded if there are sufficient excess investment earnings. The cost-of-living adjustments provided under the SFERS plans have been approved by city voters. It would be a violation of the Charter for the City or SFERS to withhold payments to retirees and beneficiaries to which they are entitled under the Charter. Nevertheless, I agree that we should further evaluate whether it is beneficial as a matter of policy to award a COLA when the retirement system's investment earnings are flat.

I agree that the City should continue to examine benefits offered to ensure that benefits provided by the City are appropriate and commensurate with other comparable plans. DHR currently conducts this research periodically. The latest survey data is included in the DHR response. Nonetheless, the City pension benefits are consistent with or better than those of many cities and counties. I disagree with the assertion by the Civil Grand Jury that our system is unsustainable and therefore requires these changes.

Recommendation B1: The Mayor and the Board of Supervisors should prepare a plan within the next year to fund the projected $1 billion in pension costs.

Response: Agree; Already Implemented. My office, in conjunction with city departments, continues to work to address the projected $1 billion pension cost. Over the past several years, I have held regular meetings with city departments, labor representatives and other stakeholders to explore and develop options for long-term pension and benefits reforms. These efforts led to Proposition D, approved by voters on the June 2010 ballot, which will limit pension costs.

In addition, two years ago I directed the Controller to undertake the Budget Improvement Project, an effort to examine long-term financial issues and develop reforms to the City's budget process and financial planning. I worked with the Board of Supervisors to turn the results of that process into Proposition A, which was approved by voters in November of 2009. Under Proposition A, the City is now developing two year budgets, financial policies, and a five-year financial plan to address major financial issues including pension and other benefit costs.

In addition to these financial planning efforts, my office continues to work actively with a broad range of stakeholders to develop practical initiatives to address pension costs. I am committed to continuing these efforts and working with the Board of Supervisors to address these issues.

Recommendation B2: The Department of Human Resources (DHR) should not enter into agreements with the employee unions which increase the City's future pension obligations without voter approval.

DHR should engage the City's professional Actuary to investigate any increase in pensionable compensation.

Response: Disagree; Will Not be Implemented. As part of the collective bargaining process, DHR relies on data furnished by the SFERS and the Controller's Office to evaluate cost increases associated with pensionable compensation. Requiring voter approval of any employee wage increases that would result in an increase in pensions would likely violate both the Charter and State law on collective bargaining.

The Civil Grand Jury recommendation fails to recognize that all increases in pension obligations were voter-approved. Without voter approval, DHR cannot change employee retirement plans. DHR has the responsibility to negotiate wages and benefits with labor organizations in accordance with the Charter, and this responsibility cannot be delegated to the voters. Please see DHR's response and the City Attorney's response for more information and further clarification.

Recommendation B3: DHR should compare the retirement benefits in other California cities to determine whether the pension benefits are excessive. The results should be reported to the Mayor and the Board of Supervisors.

Response: Agree; Already Implemented. San Francisco's retirement benefits are lower than those of most other cities in California. Please see DHR's response for more information.

Recommendation C1: The City Attorney should initiate legal action against the SFERS Board to enforce the requirements of the Charter amendment to "meet and confer" and "cost-sharing" provisions of Proposition H, as stipulated in Charter § A8.595-11(e).

The Jury recommends that the City Attorney and/or his representatives present to the Board of Supervisors and SFERS Board the following documents regarding § A8.595-11(e) of the City Charter:

1. A legal opinion of the charter section.
2. Documentation regarding the dates and times that the City and the Police and Firefighters unions met to confer and to implement a cost-sharing arrangement as required in the section.
3. A legal opinion regarding fiduciary duties of the SFERS Board to comply with it.
4. A legal opinion regarding SFERS duty to revise the Safety employee contribution rate to comply with the Charter section.
5. A legal opinion regarding possible remedies to enforce compliance.

Response: Disagree. City Charter §A8.595-11(e) does not require the SFERS to enter into a meet and confer with the City's safety employee unions. Therefore, the City Attorney cannot initiate legal proceedings to require such action. As the City Attorney's response notes, the City has complied with the cost-sharing provisions of Proposition H and the Civil Grand Jury is mistaken about the appropriate role of the SFERS Board in this matter. Please see the City Attorney's response.

Recommendation C2: The City and Safety employees should establish an arrangement to share the annual $26 million cost as required by the City Charter. Please refer to DHR's and the City Attorney's responses.

Response: Agree; Already Implemented. Where the City Charter requires the City and its public safety unions to share costs, the City has and will continue to work with the unions as required under the Charter.

Recommendation D1: San Francisco should take steps to curb abuses from pension spiking by limiting the final pensionable income an employee can claim at retirement and from pension-pyramiding. The Jury suggests the following:

- Use a three-year average to determine pensionable income, similar to Federal rules.
- Limit final pensionable compensation to 120% of the rank pay rate as determined by Civil Service job classification.
- The Controller should perform an independent review of pensions to determine whether the practice of pension spiking is ongoing.
- Disallow employees from drawing pensions from two simultaneous City jobs.
- Pensionable compensation should not include pay for two separate pay types, know as pension-pyramiding.

Response:

- Use a three-year average to determine pensionable income, similar to Federal rules.

Agree; Already Partially Implemented. As a reminder, Supervisor Sean Elsbernd and I introduced a Charter amendment to the Board of Supervisors in 2008, which would have required a three-year average to determine pensionable income. The Board of Supervisors voted to reduce that time to two years. The measure, Proposition D on the June 2010 ballot, was passed by an overwhelming majority of the voters (nearly 79%), and it will require a two-year average to avoid spiking in the final year.

- Limit final pensionable compensation to 120% of the rank pay rate as determined by Civil Service job classification.
- The Controller should perform an independent review of pensions to determine whether the practice of pension spiking is ongoing.

Although pensionable income is determined by Charter, I will work with DHR, SFERS, and the Controller's Office to limit final pensionable compensation to the extent possible under the Charter and collective bargaining agreements.

- Disallow employees from drawing pensions from two simultaneous City jobs.
- Pensionable compensation should not include pay for two separate pay types, known as pension-pyramiding.

I agree with the Civil Grand Jury that employees should not draw from two simultaneous city jobs and that pensionable compensation should not include pay for two separate pay types. As stated earlier, my office and DHR are working together to ensure that there are systematic controls in place to eliminate this practice where it exists.

Recommendation E1: Department of Human Resources and collective bargaining units should meet and confer to determine a cost-sharing arrangement to pre-fund the $4 billion unfunded liability for retiree health care obligations.

Response: Agree; Already Implemented. The City does have a large unfunded liability for retiree health care obligations. Through past voter-approved propositions, the City has begun to address this

issue by requiring the City and its employees to contribute to the Retiree Health Trust Fund. I will continue to work with the Controller's Office and DHR to address this liability. Please see DHR's response for additional information.

Recommendation F1 : The Mayor needs to appoint two Commissioners to represent the public's interest.

Response: Disagree; Will Not be Implemented. I agree that commissioners need to be appointed, and I have already made these appointments. Upon appointment, all commissioners are required to discharge faithfully the duties of the particular commission or board to which they are appointed. In the case of the SFERS, the duty of the commissioners appointed to the SFERS is to represent the interest of the members and their beneficiaries, not only the public at large. All seven SFERS Commissioners share the same fiduciary duty, not just those appointed by the Mayor.

Recommendation F2 : It is important for the public Commissioners appointed by the Mayor to attend the Board meetings. They should attend regular monthly Board meetings or resign.

Response: Agree; Already Implemented. I agree that all Commissioners appointed to the SFERS should attend regular monthly Board meetings. As the SFERS Board states in its response, the Board also has a committee structure that allows its members to discharge its duties even if a member is not able to make every Board meeting. Please see the SFERS' Board response.

Sincerely,

Gavin Newsom
Mayor

ATTACHMENT

City and County of San Francisco

Gavin Newsom
Mayor

Department of Human Resources

Micki Callahan
Human Resources Director

DEPARTMENT OF HUMAN RESOURCES' RESPONSE ON THE 2009-2010 GRAND JURY REPORT – PENSION TSUNAMI: THE BILLION DOLLAR BUBBLE

RESPONSES TO FINDINGS:

C. Proposition H (Police and Firefighter Retirement Plan)
C1. Proposition H, passed by voters in 2002, requires that if the City's contribution rate to the pension fund exceeds 0% then the City and the Safety employees unions must "meet and confer" to implement a "cost-sharing" arrangement to reduce the cost impact of the employer's contributions on the City's General Fund. The City's contribution rate has exceeded 0% for fiscal 2004-05 to the present. The City and County of San Francisco is not in compliance with the requirements of the City Charter resulting from the passage of Proposition H. There have been no "meet and confer" sessions to establish a "cost-sharing" arrangement. The City Attorney has not mandated that the SFERS Board comply with these requirements of the Charter Amendment resulting from Proposition H.

Disagree. Charter §A8.595-11(e) (Proposition H) states that in "[a]ny year in which, based upon the Retirement Systems annual actuarial valuation, the employer contribution rate exceeds 0%, the employee organizations representing safety members shall jointly meet and confer with City representatives to implement a cost sharing arrangement between the City and employee organizations." The Grand Jury notes that since Fiscal Year 2004-05, the employer contribution has exceeded 0%. Further, the Grand Jury holds that the City has not been in compliance with this Charter section as there have been no "meet and confer" sessions to establish a "cost-sharing" agreement.

DHR disagrees that the City is not in compliance with Proposition H mandates. The City met and conferred with the Police and Fire groups in the spring of 2003, during the first round of labor negotiations following passage of Proposition H, and negotiated provisions in the collective bargaining agreements covering police officers and firefighters to address Charter obligations as to cost-sharing. At that time, both the Police and Fire unions agreed to pay the maximum employee pension contribution allowed under the Charter (7.0%, old plan; or 7.5%, new plan). These agreements were reached in recognition of the parties' cost-sharing obligations, the fact that the City's pension costs were projected to increase above 0%, and to facilitate balancing the City's budget. Proposition H specifically provides that, "Such cost sharing arrangement shall not require an employee contribution in excess of the limits set elsewhere in this Charter." The Charter specifically provides that employee contributions are limited to 7.5% for new plan members. As a result of the agreements reached during these meet-and-confer sessions, Police and Fire employees pay the maximum employee pension contribution.

By way of background, the City and virtually all of its labor organizations had negotiated an Employer-Paid Member Contribution (EPMC) during the 1990's, under which the City "picks up" the employee pension contribution. During the early 2000's, the City negotiated a temporary elimination of the EPMC for its unions,

to achieve budget savings during a recessionary period. By July 2006, the City's miscellaneous employee unions had had the EPMC restored, or received a wage increase in lieu of that restoration. However, the police and fire labor agreements did not include a restoration of the EPMC, nor did they provide for a wage increase in lieu thereof. Instead, their labor agreements provided that the obligation to pay the employee pension contribution would continue, in recognition of the Charter's cost-sharing obligations as indicated above. As reflected in both the Police and Fire collective bargaining agreements (located on the Department of Human Resources' website at www.sfgov.org/DHR):

> ***San Francisco Firefighters Union, Local 798 (Section 11):***
> *Employees shall pay their own employee retirement contributions in an amount equal to 7.0% (old plan) or 7.5% (new plan) of covered gross salary. The parties acknowledge that said contributions satisfy the requirements of Charter Sections A8.596-11(e) and A8.598-11(d).*
>
> ***San Francisco Police Officers' Association (Section 9):***
> *For the duration of this Agreement, employees shall pay their own retirement contributions. Tier 1 employees will contribute an amount equal to 7% of covered gross salary; Tier 2 employees and Harbor Police Officers will contribute an amount equal to 7.5% of covered gross salary. The parties acknowledge that said contributions satisfy the requirements of Charter Sections A8.595-11(d) and A8.597-11(d) for the duration of this Agreement.*

(Please also see the City Attorney's response for more information on negotiations with Police and Fire since the passage of Proposition H.)

Not only have these contributions had "a material reduction of the cost impact of employer contributions on the City's general fund" as required by Proposition H, they have actually almost completely covered the increased costs under Proposition H.

According to the San Francisco Employee Retirement System's estimations, increased costs since Fiscal Year 2004-2005 (the year that the City's rate first exceeded 0%) attributable to the Police and Fire pension improvements under Proposition H amount to $205,693,993. However, the retirement contributions by Police and Fire since 2003 amount to approximately $202,042,321. See the chart below for further details.

	Approximate Retirement Contributions by Police and Fire			**Prop H**
Fiscal Year	**Police**	**Fire**	**Total for Police and Fire**	**Increased Costs**
FY03-04	$13,275,000.00	$ 9,750,000.00	$ 23,025,000.00	
FY04-05	$14,043,750.00	$10,200,000.00	$ 24,243,750.00	$30,792,593
FY05-06	$14,798,407.35	$11,025,221.85	$ 25,823,629.20	$32,418,548
FY06-07	$16,580,467.65	$12,021,110.78	$ 28,601,578.43	$35,643,372
FY07-08	$16,871,911.20	$12,542,837.10	$ 29,414,748.30	$35,920,662
FY08-09	$20,805,085.50	$14,382,645.60	$ 35,187,731.10	$37,467,254
FY09-10	$21,655,563.30	$14,090,321.25	$ 35,745,884.55	$33,451,564
FY10-11	$21,391,609.80	$14,271,636.08		
		Totals	**$ 202,042,321.58**	**$205,693,993**

* Notes:
- The Prop H figures are based on information provided by SFERS.
- The Prop H increased cost in Fiscal Year 2009-10 is an estimate.
- The retirement contribution amounts for Fiscal Years 2002-03, 2003-04 and 2004-05 are estimates, since DHR does not have payroll data for those years at this time.
- The retirement contribution rates for Fiscal Years 2005-06 to 2010-11 are estimates based on the Controller's Office payroll data.
- Contribution rates are calculated based on adjusted base and premiums.

(It should be noted that the 7.5% amount of the Police and Fire pension contribution during Fiscal Year 2011-12 will be $35,663,245. Extrapolating from the downward trend in increased costs under Proposition H, we assume that the 7.5% employee pension contribution will actually exceed the cost of Proposition H pension improvements for Police and Fire in that period).

Further, in addition to their agreement to pay the employee retirement contributions in recognition of their cost-sharing Charter obligations, Police and Fire also agreed additional give-backs. It is important to note that, as these agreements reduce pensionable income, the City's pension costs are also reduced.

- In negotiations, consistent with the Charter, the City includes pension costs as an element of total employee compensation, and adjusts its economic positions accordingly. City strategies to address increases in pension costs have also taken the form of reducing wages or other economic benefits. To illustrate:
  - For Fiscal Years 2004-05 and 2005-06, Fire agreed to partially defer wage increases they were entitled to pursuant to their parity relationship with Police.
  - Beginning in Fiscal Year 2004-05, Fire agreed to:
    - increase their average work week from 48 hours to 48.7 hours;
    - work the first 5 hours of overtime at straight-time;
    - exclude sick pay and use of compensatory time from weekly overtime calculations.
  - Beginning in Fiscal Year 2007-08, Fire agreed to work the first 106 hours per pay period at straight-time; the average work schedule per pay period for fire is 97.4 hours.
- In addition, the City was able to renegotiate provisions of closed labor contracts with Police and Fire unions, which achieve additional savings in the Fiscal Years 2008-09 through 2011-12. For example:
  - Beginning in Fiscal Year 2008-09 through Fiscal Year 2010-11, Fire agreed to temporarily reduce their Holiday Pay premium that they receive in lieu of paid holidays.
  - In the Spring of 2009, Police and Fire agreed to defer 2% of their 4% wage increase from July 1, 2009 to January 8, 2011.
  - In the Spring of 2010:
    - Police agreed to a temporary wage reduction, the value of 6 unpaid days, in Fiscal Year 2010-11 and the value of 4 unpaid days in Fiscal Year 2011-12 and agreed to move their 2% wage increase from January 8, 2011 to January 7, 2012.
    - Fire agreed to move their 4% wage increase from July 1, 2010 to July 1,2011 and to move their 3-5% survey based wage increase from July 1, 2011 to July 1, 2012.

  Labor concessions this fiscal year alone amount to $18 million from Police and $11.5 million from Fire. See the chart on the following page for additional information.

Additional Give-Backs from Closed Contracts			
Fiscal Year	**Police**	**Fire**	**Total for Police and Fire**
FY08-09	-	$ 4,000,000	$ 4,000,000
FY09-10	$ 10,000,000	$ 7,000,000	$ 17,000,000
FY10-11	$ 18,000,000	$ 11,500,000	$ 29,500,000
FY11-12	$ 9,500,000	$ 7,000,000	$ 16,500,000
Totals	$ 37,500,000	$ 29,500,000	**$ 67,000,000**

* Note: Again, these figures are estimations based on payroll data from the Controller's Office.

Lastly, it is important to note that while our Police Officer wages are at or slightly above market for the region (less than 0.5% above market, actually), our retirement benefit is much lower than that of other jurisdictions. Safety employees throughout California receive a "3% at 50" benefit, while San Francisco's safety members receive "3% at 55."

Jurisdictions	*Age at Which 3% Benefit is Received for Safety Employees*
San Francisco	55
State of California	50
Alameda County	50
Contra Costa County	50
Marin County	50
Sacramento County	50
San Mateo County	50
Santa Clara County	50
Solano County	50
Sonoma County	50
Oakland	50
San Jose	50

Although the City Attorney opines that the City has met the requirement that it negotiate with representatives of police officers and firefighters to effect a material reduction in General Fund costs in years in which it faces a positive contribution to the Retirement System, we are amenable to his recommendation that the process be undertaken on an annual basis and that it be made more transparent to the public.

C2. The unfunded pension liability for Proposition H as of July 1, 2009 was approximately $276 million, amortized over thirteen years to about $26 million annually.

Disagree. Negotiated employee contributions to fund the pension improvement have actually almost completely covered the increased costs under Proposition H. DHR will continue to negotiate with Police and Fire as necessary to ensure compliance with the cost-sharing obligations under Proposition H.

While DHR cannot comment on amortization rates, we note that the 7.5% amount of the Police and Fire pension contribution during Fiscal Year 2011-12 will be $35,663,245. Extrapolating from the downward trend

in increased costs under Proposition H, we assume that the 7.5% employee pension contribution will actually exceed the cost of Proposition H pension improvements for Police and Fire in that period. Again, Proposition H does not require Police and Fire to cover the entire increased costs; rather, it requires that their contributions have a "material reduction" on those increased costs.

E. Health Benefits

E1. For current employees and retirees, health benefits are "vested" after 10 years.

Disagree.

Current employees who were hired prior to January 10, 2009 "vest" after 5 years of City service; and pursuant to Proposition B (passed by the voters in June 2008), employees hired on or after January 10, 2009 vest for retiree health insurance based on the following years of service:

- 5 years – access to City Health Plans
- 10 years – access to City Health Plans with 50% of City Contribution
- 15 years – access to City Health Plans with 75% of City Contribution
- 20 years – access to City Health Plans with 100% of City Contribution

We also note that pursuant to Proposition B, employees hired on or after January 10, 2009 must effectuate retirement within 180 days of separation from the City to maintain the eligibility for retiree health insurance. Prior to Proposition B, an employee could separate upon vesting and effectuate a retirement decades later and receive retiree health.

E1. Unlike pensions, health benefits for most City workers are not pre-funded, but are paid directly out of the City's General Fund. In 2001, the City expended $17 million on retiree health care. By 2007, that amount had grown to $130 million and continues to rise. Mercer Consulting reported on June 30, 2008, that the City's unfunded liability for retiree health benefits was $4 billion.

Partially agree.

Retiree healthcare is not paid solely out of the General Fund, as 40% is paid by self-supported department funds. The largest element of this increase was the voter-approved expansion of spousal health benefits.

Nevertheless, DHR concurs that retiree health benefits have not historically been pre-funded, and that the City has a substantial, unfunded retiree health liability. DHR and the City have taken steps to address this issue as indicated in our response to Recommendation E1 below.

RESPONSES TO RECOMMENDATIONS:

B. Pension Costs

B2. The Department of Human Resources should not enter into agreements with the employee unions which increase the City's future pension obligations without voter approval.

This recommendation has already been implemented in part, and cannot be implemented in remainder.

At the outset, we would like to respond to the Civil Grand Jury's findings upon which this recommendation is based.

The Civil Grand Jury's Finding B states: The Department of Human Resources and SEIU Local 1021 entered into an agreement that Miscellaneous employees would pay their own 7.5% contribution, and, in return, the base wages were increased by 6% effective July 1, 2010. There was no actuarial valuation to estimate the resulting pension liability for the City. This agreement resulted in a substantial increase in pension obligations for the City without voter approval. DHR disagrees with several aspects of this finding.

First, the effective date of the "swap"for SEIU Miscellaneous (non-MTA) employees is on July 1, 2011, not July 1, 2010. DHR specifically delayed the implementation of this "swap" to prevent enticing the 1,000+ SEIU Miscellaneous employees that were likely to retire in Fiscal Year 2009-2010 from delaying their retirement. There was a large number of employees planning to retire this year, as they sought to obtain sick pay cash-outs under the Wellness Program before it expired on June 30, 2010. Those employees not retiring this fiscal year likely felt that the benefits of the Wellness Program did not outweigh the benefits of continued employment, which means they will likely work for many more years. The impact of this is that they will be earning and contributing to retirement based on this new wage for a number of years prior to their retirement.

Second, the Civil Grand Jury's statement that the agreement with SEIU resulted in a "substantial increase" in pension obligations for the City is incorrect.

The City agreed to pick-up the employee pension contribution for most unions in 1995 (not in 2002 as indicated in the Civil Grand Jury report) in lieu of wage increases. Therefore, if the City had not paid the employee contribution and instead given employee wage increases at that time, there would have been pension cost increases dating back to 1995.

While it is true that SEIU Miscellaneous (non-MTA) employees will receive a base wage increase on July 1, 2011 in exchange for resuming the employee pension contribution, it will in fact be on a cost-neutral basis to the City. In calculating the base wage increase that could be provided in exchange for employees agreeing to pay their own retirement contribution, costs such as contributions to retirement and social security are taken into account. This is why only a 6% wage increase was provided in exchange for employee payment of the 7.5% member contribution. As this increase is across the board (i.e., provided to all covered employees regardless of the number of years of service), there should not be disproportionate increase in employer contributions to retirement. Although an increase in pensionable compensation will result in a corresponding increase in employer contributions to retirement, it is only if a significant increase is made to pensionable income solely at the end of one's career that there is a significant financial impact on the City's future pension obligations; however, most SEIU employees will

continue working (and contributing to the retirement fund) for years after the "swap" takes effect.

The Civil Grand Jury estimates that, "the swap arrangement between the City and [it's unions] will result in approximately $136 million in unfunded pension obligations." Although the Civil Grand Jury does not cite the source of this data, this assertion is a gross overestimation if it based this number on the example of the SEIU employee the Civil Grand Jury proffers. The Civil Grand Jury asserts that, "The 6% increase in wages would provide a comparable 6% increase in pension; therefore, an SEIU employee who would have retired with, say, a $20,000 annual pension would realize an additional $1,200 annual lifetime benefit…[and that] the present value of this benefit would be $13,784." This estimate is based on the Civil Grand Jury's incorrect assumption that there is a 100% benefit formula for SEIU members, when by Charter the maximum contribution is limited to 75%, which would require nearly 33 years of service at age 62. However, the average age and service of the Miscellaneous Plan retirees is 62+ and 25.8 for Fiscal Year 2009-10. This calculates to an average benefit formula percentage of 59.34%, far below the 100% cited in the report.

More importantly, the SFERS pension fund has been funded assuming 4.5% annual wage increases for miscellaneous employees—increases that the City's miscellaneous unions did not receive and are not scheduled to receive—thereby offsetting the impact on pension costs. Please see the SFERS response for more information. Therefore, the increase in benefit liability as a result of the swap is not an "unfunded" liability.

As to the recommendation that DHR not enter into agreements with the employee unions which increase the City's future pension obligations without voter approval, we note again that under Charter §A8.409, the City is obligated to bargain with recognized employee organizations over wages and benefits. Any increase in pensionable compensation necessarily results in a corresponding increase in employer contributions to retirement. It also increases the amount that the employee is required to contribute, since the employee's contribution is based on a set percentage rate of salary by Charter mandate.

Pursuant to the City's Charter, DHR has no ability to change employee retirement plans, as all such changes must be approved by the voters. Accordingly, all of the retirement enhancements that are noted in the Grand Jury's report were approved by the voters.

B2. DHR should engage the City's professional Actuary to investigate any increase in pensionable compensation.

This recommendation will not be implemented.

During collective bargaining, DHR already engages SFERS and the Controller's Office to evaluate cost increases to any pensionable compensation. Both of these agencies employ actuaries on which DHR relies. It would not be practical—nor cost-effective—for the City to engage an actuary in every discussion with the City's 48 labor groups over possible wage increases and the corresponding impact on pensions. Moreover, we note that the Charter does not specifically include impact on employer pension costs as a factor that must be determined by an arbitrator in determining wage increases.

B3. DHR should compare the retirement benefits in other California cities to determine whether the pension benefits are excessive. The results should be reported to the Mayor and the Board of Supervisors.

This recommendation has been implemented.

DHR has compared the retirement benefits provided by the City to those of other cities and counties in California and has determined that our retirements plans for both miscellaneous and safety are on the lower end of those provided across California (see below). This information was shared with both the Mayor's Office and the Board of Supervisors pursuant to the formulation of Proposition B in the winter and spring of 2008.

	Miscellaneous		Safety
	Benefit at Age	*Benefit at Age*	*Age Receive*
Jurisdictions	*60*	*65*	*3% Benefit*
San Francisco	2.10%	2.30%	55
State of California	2.26%	2.42%	50
Alameda County	2.34%	2.62%	50
Contra Costa County	2.26%	2.42%	50
Marin County	2.26%	2.42%	50
Sacramento County	2.44%	2.61%	50
San Mateo County	3%	3%	50
Santa Clara County	2.50%	2.50%	50
Solano County	2.70%	2.70%	50
Sonoma County	3%	3%	50
Oakland	2.70%	2.70%	50
San Jose	2.50%	2.50%	50

C. Proposition H (Police and Firefighter Retirement Plan)

C1. The Grand Jury recommends that the City Attorney and/or his representatives present to the Board of Supervisors and SFERS Board the following documents regarding §A8.595(e) of the City Charter:

1. **A legal opinion on the Charter**
2. **Documentation regarding the dates and times that the City and Police and Firefighters union met to confer and to implement a cost-sharing arrangement as required in this section.**
3. **A legal opinion regarding fiduciary duties of the SFERS Board to comply with it.**
4. **A legal opinion regarding SFERS duty to revise the Safety employee contribution rate to comply with the Charter section.**
5. **A legal opinion regarding possible remedies to enforce compliance.**

This recommendation cannot be implemented by DHR, as this is recommendation is directed to the City Attorney's Office. Accordingly, we defer to the City Attorney's Office for response to these recommendations.

However, regarding documentation of the implementation of cost-sharing arrangements pursuant to the applicable Charter sections, DHR points the Grand Jury to the list of agreements in DHR's response to Finding C1 above.

C2. The City and Safety employees should establish an arrangement to share the annual $26 million cost as required by the Charter.

This recommendation has already been implemented – the parties have met Charter obligations for Proposition H. Please see DHR's response to Finding C1. DHR will continue to negotiate with Police and Fire to ensure compliance with the cost-sharing obligations under Proposition H.

To the extent that the Civil Gran Jury is recommending that Safety employees contribute more than otherwise required under Proposition H, we defer to the City's policy makers for direction. As detailed in the City Attorney's response to the Civil Grand Jury Report, the Charter vests in the Mayor, acting through the Director of Human Resources, and in consultation with the Board of Supervisors, the exclusive responsibility of meeting and conferring with all employee representatives about the terms of the labor agreements (see Charter Section 11.100 and 11.101).

D. Pension Spiking

D1. San Francisco should take steps to curb abuses from pension spiking by limiting the final pensionable income an employee can claim at retirement and from pension-pyramiding.

The Jury suggests the following:

- **Use a three-year average to determine pensionable income, similar to Federal rules.**
- **Limit final pensionable compensation to 120% of the rank pay rate as determined by the Civil Service job classification.**
- **The Controller should perform an independent review of pensions to determine whether the practice of pension spiking is ongoing.**
- **Disallow employees from drawing pensions from two simultaneous City jobs.**
- **Pensionable compensation should not include pay for two separate pay types, known as pension-pyramiding.**

DHR's responses to the Grand Jury's suggestions:

- DHR cannot implement this recommendation. The Mayor and Supervisor Elsbernd proposed 3 years, but this was reduced by the Board of Supervisors to 2 years. Pursuant to Proposition B on the June 2010 ballot, the voters approved moving from a formula based on the single highest year of earnings to the average of 2 highest years.
- DHR cannot implement this recommendation, as this would require a Charter amendment.
- As the third recommendation is directed to the Controller's Office, DHR cannot implement this recommendation. However, DHR welcomes any analysis of whether there is any pension spiking occurring and how it can be prevented.
- The fourth bullet-point recommendation requires further analysis, but will be implemented if possible. DHR recently completed an audit and determined that there are a few instances in which employees at the Department of Public Health (DPH) are earning more than 2088 hours in pensionable compensation because of multiple appointments. DHR is working with DPH to implement a mechanism in the system to prohibit these anomalies from occurring in the future.
- As to the fifth bullet point, changes in the definition of pensionable compensation can only be effectuated by changes in the Charter, state law or ruling by a court of competent jurisdiction. DHR therefore cannot implement this recommendation.

E. Health Benefits

E1. Department of Human Resources and collective bargaining units should meet and confer to determine a cost-sharing arrangement to pre-fund the $4 billion unfunded liability for retiree health care obligations.

This recommendation has been partially implemented.

Pursuant to Proposition B (June 2008 Ballot), all employees hired on or after January 10, 2009 must contribute 2% of their salary into the City's Retiree Health Care Trust Fund Contribution, and the City contributes an additional 1% for each corresponding 2% contribution. Approximately 10% of the City's workforce is making this mandatory contribution. This amount serves to entirely prefunds those new employees' retiree health benefits and a portion of the City's unfunded liability for retiree health benefits for employees who were hired prior to January 10, 2009.

Further, DHR has, and will continue to seek contributions to the Retiree Health Care Trust Fund from non-contributing employees through the collective bargaining process. DHR proposed contributions for active employees during the last two rounds of labor negotiations and was able to successfully negotiate it for one of the City's labor unions.

CITY AND COUNTY OF SAN FRANCISCO

TO: Honorable Judge James J. McBride
Presiding Judge of the Superior Court

FROM: Gary Amelio, Employee Retirement System Director
Joanne Hayes-White, Fire Chief
Ben Rosenfield, Controller

DATE: August 23, 2010

SUBJECT: CITY RESPONSE TO 2009-2010 CIVIL GRAND JURY REPORT: "PENSION TSUNAMI The Billion Dollar Bubble"

In accordance with California Penal Code Section 933.05, the City submits its consolidated response to the above-referenced Civil Grand Jury Report as well as the attached individual responses to each finding and recommendation from the designated City entities and departments. The consolidated response does not include the City Attorney's response or the Department of Human Resources' response, which are submitted separately.

The Civil Grand Jury Report presents findings and recommendations in six areas related to the City's employee pension program: 1) Pension Plan; 2) Pension Costs; 3) Prop H (Police & Fire); 4) Pension Spiking; 5) Health Benefits; and 6) SFERS Board Meetings.

Pension Plan. The Civil Grand Jury Report finds that "San Francisco's Defined Benefit Plan retirement benefits are financially unsustainable without significant cutbacks in jobs and city services." The Report recommends that "the City should research other public and private sector data to determine fair pension benefits... to lead to a sustainable plan" and proposes specific amendments to pension benefits and eligibility requirements contained in City's Charter.

The City does not agree that retirement benefits are financially unsustainable. The Retirement System is 97% funded (actuarial value), well above the 80% funding ratio recommended by the Government Accountability Office (GAO). The current required employer contribution rate of 13.56% (up from 9.49% in the prior fiscal year) is lower than most other California public plans. The benefits provided by San Francisco's Employee Retirement System (SFERS), including pension benefits terms and conditions, are established in the City Charter and require voter approval to amend. Also, as the Civil Grand Jury correctly stated, pension benefits for current employees and retirees are guaranteed and protected under the constitutions of the United States and California, changes to these benefits may not be possible.

Notwithstanding the foregoing, the Mayor and Board of Supervisors may make proposals regarding retirement benefits within the current system to put before the voters; any proposals will be informed by many sources, including the findings of the Civil Grand Jury, information and analysis from City departments, third party analysis and data, and discussions with union and City leaders. The Department of Human Resources has compared the retirement benefits provided by the City to those of other cities and counties in California and has determined that our retirements plans for both miscellaneous and safety are on the lower end of those provided across California. It is important to note that the question of what is "fair" is not for the City to determine, it is for the voters to determine.

Pension Costs. The Civil Grand Jury concludes that current pension rules are producing ever-increasing employer contributions, crowding out General Fund spending, which disproportionately affects the poor and needy, and taxes the middle class. The Civil Grand Jury correctly finds that the required employer pension plan contribution rate has increased from 0% in 2004 to 9.49% in FY 09-10. The Civil Grand Jury finding that the City's pension **and** health care benefit costs are expected to be nearly $1 billion dollars in five years, an increase from the projected FY 09-10 cost of $412 million includes conclusions based on worst case rates presented by the SFERS actuary, and should be understood as a possibility in a range of cost scenarios.

The City agrees that the pension costs will increase in the near term as investment losses are realized; in the longer term varying investment returns and benefit payouts will have a significant impact on the pattern and magnitude of actuarially computed employer contribution rates. Under any reasonable economic scenario employer pension contribution rates are expected to increase significantly over the next several years. However, the Jury's finding that the City's contribution rate will be 30% in 2015 is not necessarily correct; the 30% employer contribution rate is a projection, not a certainty, based on assumptions provided by SFERS' actuary. By 2015, while the projected employer contribution rate may be as low as 21% or as high as 33%, the median rate is projected at 25%.

City leadership will consider how to manage retirement costs and benefits as part of its overall financial planning, and, as mentioned previously, the Mayor and Board of Supervisors may make proposals regarding retirement benefits within the current system to put before the voters. Benefits, terms and conditions of SFERS are set in the Charter, and changes to them are a matter for voter approval; the Charter also requires that each year's budget be balanced. Balancing future budgets will require some combination of expenditure reductions and/or additional revenues. Proposition A mandated changes (a two-year budget and a five-year financial plan which forecasts revenues and expenses and summarizes expected public service levels and funding requirements for that period) to the City's budget and financial processes which are likely to stabilize spending through requiring multi-year budgeting and financial planning.

The City Civil Grand Jury issued a specific finding that the Department of Human Resources and Service Employees International Union (SEIU) Local 1021 entered into an agreement that miscellaneous employees would pay their own 7.5% contribution and in return base wages were increased by 6%, effective July 1, 2010. The City agrees with this aspect of the finding. The Report goes on to state that there was no actuarial valuation to estimate the resulting pension liability for the City and therefore this agreement resulted in a substantial increase in pension obligations for the City without voter approval. The City disagrees with this aspect of the finding as it can be interpreted to mean that due to the lack of an actuarial valuation the resulting increase in the City's pension liability was unknown at the time of the agreement—this is not correct. In this case, as with all labor agreements, the fringe benefit costs, including the City retirement contribution cost of the higher wage level and the savings due to the employee pension contribution, were reported in the Controller's estimate and in Department of Human Resource's presentation of the agreements to the Board of Supervisors for their approval. Further, the City (DHR's) has the authority to negotiate labor agreements, including wages and benefits. Voter approval is required for changes to retirement conditions—defined benefits, eligibility, and service requirements.

Prop H (Police & Fire). The Civil Grand Jury found that the "The City and County of San Francisco is not in compliance with the requirements of the City Charter resulting from the passage of Proposition H. There have been no "meet and confer" sessions to establish a "cost-sharing" arrangement." The City disagrees with the Civil Grand Jury's finding and directs the Jury to the City Attorney's letter of August 10, 2010 and the Department of Human Resources cost sharing agreements with safety departments dating back to FY03-04. The Department has successfully negotiated the maximum employee contribution allowed under the City's current cost-sharing arrangements.

The Jury also finds that the current unfunded pension liability for Proposition H as of July 1, 2009 was approximately $276 million and recommends that City and safety employees should establish an arrangement to share the annual $26 million cost to amortize this liability. The City agrees with that there is currently a $276 million liability, which the City will continue to address as part of its ongoing negotiations with labor.

Pension Spiking. The City does not agree with the Civil Grand Jury finding that the soon-to-be retired have been able to increase final pensionable compensation to inflate retirement benefits. There are appropriate controls on assignments, on pay, as well as on retirement calculations to insure that City employees are appropriately compensated and their pensions are determined in accordance with all applicable City Codes and the Charter. SFERS has actively and successfully litigated all cases of attempted pension spiking activities, including class action lawsuits brought on behalf of active and retired Miscellaneous, Police and Fire Plan members and individual members who sued SFERS to allow inclusion of additional components of pay in the calculation of final compensation.

The City agrees that "pension spiking' and "pension-pyramiding" are unfair and costly practices and should be prevented, as noted previously, we are confident that we have appropriate controls and audit programs in place to insure that pensions are determined in accordance with applicable pay practices and procedures. In calculating a SFERS retirement benefit, SFERS staff confirms that all elements of pay included in the calculation of SFERS pensions are paid as provided by City Charter and Memoranda of Understanding (MOUs).

Health Benefits. The City agrees with the Civil Grand Jury finding that the City's retiree annual health care benefit expense has grown significantly in recent years while the City's unfunded liability for retiree health benefits increased to $4 billion as of June 30, 2006. The City acknowledges that is a large and growing liability, which the City has taken steps to address and will continue to address within the voter approved framework.

The City desires to clarify the Jury's finding that for current employees health benefits are "vested" after 10 years. In June 2008, the voters of San Francisco passed Proposition B, the Retiree Health Charter amendment. This measure created a graduated health benefit vesting schedule for employees hired after January 10, 2009 and established a separate Retiree Health Trust Fund in order to pay for future costs related to retiree health care. Employees hired on or after January 10, 2009, contribute up to 2% of their pre-tax pay and the City contributes 1% to the Trust Fund. Employees hired on or after January 10, 2009 vest for retiree health insurance based on the years of service and only after 20 years do employees fully vest with a 100% city contribution. Further, employees must effectuate retirement within 180 days of separation from the City to maintain eligibility for retiree health insurance. Prior to Prop. B, an employee could separate upon vesting and effectuate a retirement decades later and receive retiree health. Prospectively these changes will significantly reduce the City's unfunded liability.

SFERS Board Meetings. The Civil Grand Jury finds that certain members of the SFERS board had poor attendance records and that there are currently vacant Board positions and concludes that the people are not being heard. The City agrees that pursuant to the members' interest as well as the Board's policy all Commissioners appointed to the SFERS Board should attend regular monthly Board meetings and notes that the vacant Board positions have since been filled.

The City disagrees with the Civil Grand Jury's finding that the people are not being heard. First, this finding ignores the Board's statutory role: all seven SFERS Board members bear the fiduciary duty to act solely in the interests of the Plan members and beneficiaries. There are no public representative board positions. Second, this finding fails to recognize that Board members participate in public session at Board meetings and Committee meetings as well. Indeed, the report noted that one Commissioner had 53% attendance at the monthly Board meetings for FY2009-10, but failed to acknowledge that the same Commissioner attended 12 of 14 Committee meeting (86%) for the same period of time.

Respectfully submitted,

OFFICE OF THE CONTROLLER

Ben Rosenfield, Controller

SAN FRANCISCO FIRE DEPARTMENT

Joanne Hayes-White, Fire Chief

SAN FRANCISCO EMPLOYEES' RETIREMENT SYSTEM

Gary Amelio, Executive Director

Response to the 2009-10 Civil Grand Jury Report
"PENSION TSUNAMI The Billion Dollar Bubble"

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CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2010 Response Text
2009-10	Pension Tsunami The Billion Dollar Bubble	F.A1	San Francisco's Defined Benefit Plan retirement benefits are financially unsustainable without significant cutbacks in jobs and city services	BOS, Mayor	This item is a finding - there will be no action plan in response.	MYR: Disagree. San Francisco's Defined Benefit Plan is one of the most soundly-funded public retirement systems in the United States; the system itself is sustainable, despite the impact of the severe economic downturn. The City has faced similar situations before with other economic downturns and our system will continue to remain financially sound.
2009-10	Pension Tsunami The Billion Dollar Bubble	F.A2	For current employees and retirees, pension benefits are guaranteed by City Charter and protected by Federal and State constitutional provisions prohibiting impairment of contract.	BOS, Mayor	This item is a finding - there will be no action plan in response.	MYR: Agree.
2009-10	Pension Tsunami The Billion Dollar Bubble	R.A1	The San Francisco City Charter should be amended, as follows: For new employees, the pension multiplier should be set at a level to provide fiscally sound future pensions – fair to employees and taxpayers alike. For new Miscellaneous employees, the retirement age to receive full benefits should be comparable to that of Social Security and/or private sector recipients, and be fair to employees and taxpayers alike. The Jury recommends that City officials consider a hybrid retirement plan with components of both Defined Benefit and Defined Contribution, 401(K)-type, in the next negotiated contract in 2012. No cost-of-living or other increase should be awarded to retirees unless the pension fund is found through a multi-year analysis to be actuarially sound and fully funded. SFERS and actuaries for the City should research other public and private sector data to determine fair pension benefits and the results should be reported at SFERS board meetings and to the Board of Supervisors to lead a sustainable plan.	BOS, Mayor	3	MYR:Recommendation Requires Further Analysis. As I have stated, I agree that increased pension cost is a very real concern we face as we not only continue to grapple with the adverse effects of the continuing economic downturn, but as we plan for the future fiscal health of our city. While we have taken a number of important and significant steps toward pension reform, there is still more that can be done. As to the recommendation that the City increase the retirement age for new miscellaneous employees to receive full benefits, I note that the retirement age at which miscellaneous employees receive maximum benefits was recently increased to age 62, which is among the highest in California (the maximum benefit age in a majority of the other jurisdictions is between age 55 and 60). I do not think the City should create a hybrid system that combines elements of a Defined Benefit Plan and a Defined Contribution Plan at this time. Defined Benefit Plans carry certain risks that we have seen too often in the private sector, and it would be imprudent to switch to any new model that is not proven to be dependable in the long run. However, I agree that we should continue to review other models and structures that could be appropriate for the City. As to the Civil Grand Jury's recommendation that no cost-of-living or other increase be awarded unless the pension fund is sound and fully funded—while it is true that cost of living adjustments (COLA) are awarded regardless of the financial stability of the pension fund, the additional supplemental COLA amount of up to 3.5% is only awarded if there is enough excess investment earnings. The cost-of-living adjustments provided under the SFERS plans have been approved by the voters and it would be a violation of the Charter for the City or SFERS to withhold such payments to retirees and beneficiaries entitled to them under the Charter. Nevertheless, I agree that we should further evaluate whether it makes sense to award a COLA in times when the retirement system's investment earnings are flat and the City is required to contribute to the retirement fund in a time of economic downturn. Although I disagree that the SFERS' role is to research data in the public and private sector, I agree that the City should take a look at other pension benefits offered so that we can ensure that those benefits provided by the City are commensurate and appropriate with other comparable plans. Nonetheless, compared to the public sector, the City is consistent, if not better, than other cities and counties. I disagree with any assertion by the Civil Grand Jury that our system is unsustainable and therefore requires these types of changes.

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2009-10	Pension Tsunami The Billion Dollar Bubble	F.B1	The City's pension and health benefit costs are expected to increase from approximately $400 million for the current fiscal year to nearly $1 billion in five years, a billion-dollar bubble that the City cannot realistically afford. Current pension rules are producing an ever-increasing employer contribution rate, from 0% in 2004, to 9.49% in 2010 and to 30% by 2015. This will impact the General Fund, and could make it very difficult for the City to sustain funding for police and fire, public health, human services, cultural and artistic programs. It will disproportionately affect the poor and the needy, and tax the middle class.	BOS, Mayor, Controller, SFERS	This item is a finding - there will be no action plan in response.	MYR: Partially Disagree. Although I agree that the City's pensions and health benefit costs will significantly increase over the next several years, the City is working to reduce the impact that these increases will have on important programs and critical services. As the Controller and the SFERS state in their respective responses, the 30% employer contribution rate referenced by the Civil Grand Jury is a projection provided by the SFERS' actuary based on the scenario that the SFERS Trust would earn only 4.5% on investments for the period fiscal year 2009-2010 through fiscal year 2013-14. In fact, the SFERS Trust earned over 12% investment return for fiscal year 2009-2010, well in excess of the assumed 4.5% for this projection and lessening the likelihood that employer contribution rates will climb to the 30% level projected in the scenario selected by the Civil Grand Jury. Please see the Controller's response and the SFERS response. CON: The 30% employer contribution rate is a projection, not a certainty, based on assumptions provided by SFERS' actuary Cheiron (2/9/10 "Negative 5-Yr Moderate" Scenario). Under any reasonable economic scenario employer pension contribution rates are expected to increase significantly over the next several years. By 2015, while the projected employer contribution rate may be as low as 21% or as high as 33%, the median rate is projected at 25%. In addition, varying investment returns will have a significant impact on the pattern and magnitude of actuarially computed employer contribution rates. SFERS: Partially Disagree. SFERS neither determines pension benefits or benefit levels nor determines the City's funding methods or payment sources. SFERS has no involvement with City health benefits. SFERS administers the City's defined benefit pension and 457 plans. Pursuant to this duty, SFERS engages a consulting actuary to annually determine required employer contributions to maintain the financial soundness of the SFERS pension. The 30% employer contribution rate referenced in the report is merely an estimate - one of various projected future contribution rates based on varied investment return scenarios provided to the SFERS by its consulting actuary.
2009-10	Pension Tsunami The Billion Dollar Bubble	F.B2	The Department of Human Resources and SEIU Local 1021 entered into an agreement that Miscellaneous employees would pay their own 7.5% contribution, and, in return, the base wages were increased by 6%, effective July 1, 2010. There was no actuarial valuation to estimate the resulting pension liability for the City. This agreement resulted in a substantial increase in pension obligations for the City without voter approval.	BOS, Mayor, Controller, SFERS	This item is a finding - there will be no action plan in response.	MYR: Partially Disagree. Although the City did not undertake an actuarial valuation to estimate the resulting pension liability, the Civil Grand Jury's statement that the agreement with SEIU resulted in a substantial increase in pension obligations for the City is incorrect. First, as DHR notes in its response, the City agreed to begin paying the employee pension contribution for most unions in 1995 (not in 2002 as indicated in the Civil Grand Jury report), in lieu of providing wage increases. Therefore, if the City had not paid the employee contribution and instead given employee wage increases at that time, there would have been pension cost increases dating back to 1995. Second, while it is true that SEIU Miscellaneous (non-MTA) employees will receive a base wage increase on July 1, 2011 in exchange for resuming the payment of the employee pension contribution, it will in fact be on a cost-neutral basis to the City. Although it is also true that any increase in pensionable compensation results in a corresponding increase in employer contributions to retirement, the increase is significant only if it occurs at the end of one's career—most SEIU employees will continue working for years after the "swap" takes effect. More importantly, the SFERS pension fund has been funded assuming 4.5% annual wage increases for miscellaneous employees—increases that the City's miscellaneous unions did not receive and are not scheduled to receive—thereby offsetting the impact on pension costs. Please see the SFERS response for more information. Therefore, the increase in benefit liability as a result of the "swap" is not an "unfunded" liability. See DHR's and SFERS' responses to this finding for additional information and further clarification. CON: As required under ordinance 92-94, the Controller's Office estimates the cost of labor agreements as they are being negotiated, and reports the costs to the Board of Supervisors when the agreement is submitted for approval. In this case, as with all labor agreements, the fringe benefit costs, including the City retirement contribution cost of the higher wage level and the savings due to the employee pension contribution, were both reported in the Controller's estimate and in DHR's presentation of the agreements to the Board of Supervisors. SFERS: Partially Disagree. The negotiated change to having Miscellaneous employees pay their own SFERS employee contributions is "cost neutral" to the Plan. Pensionable income for impacted SFERS members is unchanged regardless of whether the City pays the employee contributions on behalf of the employee or such contributions are paid directly by the employee through payroll deduction. The negotiated 6% wage increase effective July 1, 2011 does not result in a "substantial increase in pension obligations for the City". Based on the actuarial methods and assumptions recommended by the SFERS consulting actuary and approved by the SFERS Board, the annual actuarial valuation of "pension obligation" anticipates wage increases each year which are on average 6% or more (4.5% wage inflation plus merit-based wage adjustments based on years of service). Considering that there are no negotiated wage increases for the two years immediately preceding the July 1, 2011 six percent wage increase, it is in fact likely that the City's pension obligations for these SEIU employees will be less than that anticipated by the SFERS consulting actuary based on the SFERS actuarial assumptions.

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2009-10	Pension Tsunami The Billion Dollar Bubble	F.B3	2,384 retirees receive pensions greater than $75,000.	BOS, Mayor, Controller, SFERS	This item is a finding - there will be no action plan in response.	MYR: Agree. CON: No response necessary. SFERS: Agree
2009-10	Pension Tsunami The Billion Dollar Bubble	R.B1	The Mayor and the Board of Supervisors should prepare a plan within the next year to fund the projected $1 billion in pension costs.	BOS, Mayor, Controller	1	MYR: Agreed; Already implemented. My office, in conjunction with other city departments, continues to work to address the projected $1 billion pension costs. In addition to the normal budget process, the City is now required to create a two-year budget as well as a five-year financial plan that will address the funding requirements for future years. I am committed to doing more to address our pension costs and I will continue to work with the Board of Supervisors to monitor this issue. CON: City leadership may consider how to manage retirement costs and benefits as part of its overall financial planning, and the Mayor and Board of Supervisors may make proposals regarding retirement benefits within the current system to put before the voters. These considerations already occur through the City leadership's and managers' review of pension costs and contribution rates and their financial impacts in the budget process and in other settings. Benefits, terms and conditions of SFERS are set in the Charter, and changes to them are a matter for voter approval; the Charter also requires that each year's budget be balanced. Balancing future budgets will require some combination of expenditure reductions and/or additional revenues. The Controller is working with City leadership to enact Proposition A mandated changes (a two-year (biennial) budget and a five-year financial plan which forecasts revenues and expenses and summarizes expected public service levels and funding requirements for that period) to the City's budget and financial processes, which are likely to stabilize spending through requiring multi-year budgeting and financial planning. Also, per San Francisco Administrative Code Section 3.6, the Controller, the Mayor's Budget Director, and the Budget Analyst for the Board of Supervisors will issue a three-year budget report.
2009-10	Pension Tsunami The Billion Dollar Bubble	R.B2	The Department of Human Resources (DHR) should not enter into agreements with the employee unions which increase the City's future pension obligations without voter approval. DHR should engage the City's Actuary to investigate any increase in pensionable compensation.	BOS, Mayor, Controller, Human Resources, SFERS	4	MYR: Disagree; Will Not be Implemented. DHR ensures that as it enters into collective bargaining with the City's labor groups, it relies on data furnished by the SFERS and the Controller's Office, which evaluate cost increases to any pensionable compensation. Requiring voter approval of any employee wage increases that would result in an increase in pensions would likely violate both the Charter and State law with regard to collective bargaining. The Civil Grand Jury recommendation fails to recognize that all increases in pension obligations were voter-approved. Without voter approval, DHR cannot change employee retirement plans. DHR has the responsibility to negotiate wages and benefits with the labor groups in accordance with the Charter, and this responsibility cannot be the responsibility of the voters. Please see DHR's response for more information and further clarification. CON: Labor agreements legitimately address wages and benefits and are appropriately and efficiently within the City's (DHR's) authority to negotiate. A wide variety of factors including wage levels, hiring and staffing, attrition, management decisions, and many others, affect the total amount of pensionable compensation and the City's obligations. These factors do not however change the retirement elements that require voter approval such as changes to defined benefits, eligibility, and service requirements. The City, through DHR and the Controller's Office, projects the current and future costs of wage increases and of pensionable compensation as part of its negotiations and budget processes. Actuarial services are not indicated for this purpose. Actuarial analysis is done as part of the annual valuation and contribution rate-setting process at SFERS, and whenever a change to retirement conditions and requirements is proposed. SFERS: The SFERS Board has no role or responsibility in the management of labor, meet and confer, or the City's determination of benefit funding methods or payment sources. SFERS provides data and information to the Mayor's Office and the Department of Human Resources related to the cost impact of any proposed changes to pensionable income that may arise during the City's collective bargaining activities. Each year the SFERS consulting actuary considers plan changes approved by voters as well as changes in pensionable compensation that may have been negotiated by the City through its collective bargaining process in preparing the annual valuation as well as recommending actuarial methods and assumptions to the SFERS Board. The SFERS consulting actuary's role does not include "investigation" of any increase in pensionable compensation negotiated between the City and employee representative organizations. SFERS is not familiar with the report's reference to "the City's professional Actuary". Moreover, the consulting actuary is engaged by SFERS, not the City, and is responsible to SFERS, not the City.

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2009-10	Pension Tsunami The Billion Dollar Bubble	R.B3	DHR should compare the retirement benefits in other California cities to determine whether the pension benefits are excessive. The results should be reported to the Mayor and the Board of Supervisors.	BOS, MYR, Human Resources	1	MYR: Agree; Already Implemented.
2009-10	Pension Tsunami The Billion Dollar Bubble	F.C1	C1. Proposition H, passed by voters in 2002, requires that if the City's contribution rate to the pension fund exceeds 0%, then the City and the Safety employee unions must "meet and confer" to implement a "cost-sharing" arrangement to reduce the cost impact of the employer's contributions on the City's General Fund. The City's contribution rate has exceeded 0% for fiscal 2004-05 to the present. The City and County of San Francisco is not in compliance with the requirements of the City Charter resulting from the passage of Proposition H. There have been no "meet and confer" sessions to establish a "cost-sharing" arrangement. The City Attorney has not mandated that the SFERS Board comply with these requirements of the Charter Amendment resulting from Proposition H.	BOS, Mayor, City Attorney, Controller, Human Resources, SFERS Board	This item is a finding - there will be no action plan in response.	MYR: Disagree. The City has worked with its Police and Fire labor groups to negotiate provisions in their respective collective bargaining agreements to address Charter obligations as to cost-sharing, and has set their pension contributions at the maximum limit allowed by the Charter. Please see DHR's response and the City Attorney's response for more information and further clarification. CON: Please see the Department of Human Resources' response on this item. SFERS Board: Partially Agree. The SFERS Board has no role or responsibility in the management of labor, meet and confer, or the City's determination of benefit funding methods or payment sources.
2009-10	Pension Tsunami The Billion Dollar Bubble	F.C2	C2. The unfunded pension liability for Proposition H as of July 1, 2009 was approximately $276 million, amortized over thirteen years to about $26 million annually.	BOS, Mayor, City Attorney, Controller, Human Resources, SFERS Board	This item is a finding - there will be no action plan in response.	MYR: Agree. According to the SFERS, the annual amortization payment for fiscal year 2010-2011 is about $26 million. CON: Confirms that the unfunded pension liability for Proposition H as of July 1, 2009 was approximately $276 million. SFERS Board: Agree. The unfunded pension liability for Proposition H as of July 1, 2009 was approximately $276 million and the annual amortization payment for fiscal year 2010-2011 is approximately $26 million.

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2009-10	Pension Tsunami The Billion Dollar Bubble	R.C1	The City Attorney should initiate legal action against the SFERS Board to enforce the requirements of the Charter amendment to "meet and confer" and "cost-sharing" provisions of Proposition H, as stipulated in Charter § A8.595-11(e). The Jury recommends that the City Attorney and/or his representatives present to the Board of Supervisors and SFERS Board the following documents regarding § A8.595-11(e) of the City Charter: 1) A legal opinion on the charter section; 2) Documentation regarding the dates and times that the City and the Police and Firefighters unions met to confer and to implement a cost-sharing arrangement as required in the section; 3) A legal opinion regarding fiduciary duties of the SFERS Board to comply with it; 4) A legal opinion regarding SFERS duty to revise the Safety employee contribution rate to comply with the Charter section; and 5) A legal opinion regarding possible remedies to enforce compliance.	BOS, Mayor, City Attorney, Human Resources, SFERS Board	4	MYR: Disagree; Will Not be Implemented. City Charter §A8.595-11(e) does not require the SFERS to enter into a meet and confer with the City's safety employee unions. Therefore, I believe the City Attorney cannot initiate such legal proceedings to require such action. As the City Attorney's response notes, the City has complied with the cost-sharing provisions of Proposition H and the Civil Grand Jury is mistaken about the role of the SFERS Board in this matter. Please see the City Attorney's response. **SFERS Board:** The SFERS Board has no role, duty or responsibility in the management of labor, meet and confer, or the City's determination of benefit policy or funding methods. Further, the SFERS Board has no role, duty or responsibility in "enforcing" the "meet and confer" and "cost sharing" provisions of Proposition H.
2009-10	Pension Tsunami The Billion Dollar Bubble	R.C2	The City and Safety employees should establish an arrangement to share the annual $26 million cost as required by the City Charter.	BOS, Mayor, City Attorney, Human Resources, SFERS Board	4	MYR: Agree; Already Implemented. Where the City Charter requires the City and its public safety unions to share costs, the City has and will continue to work with the unions on this matter. **SFERS Board:** The SFERS Board has no role or responsibility in the management of labor, meet and confer, or the City's determination of benefit policy or funding methods.
2009-10	Pension Tsunami The Billion Dollar Bubble	F.D1	D1. The soon-to-be retired have been able to increase final pensionable compensation to inflate retirement benefits. The Jury founds instances of nursing supervisors being allowed to have two concurrent jobs and earn pensions on both, sometimes referred to as pension-pyramiding.	BOS, Mayor, SFERS, SFERS Board, SFFD	This item is a finding - there will be no action plan in response.	MYR: Partially Disagree. I agree that practices such as "pension spiking" and "pension-pyramiding" are practices that undermine the credibility of the pension system and the City should prevent such practices. However, while there are some controls on assignments, and on pay and retirement calculations that minimizes the risk of these practices, DHR recently completed an audit and found that there are indeed a handful of instances in which employees at the Department of Public Health (DPH) have been earning pensionable income on multiple appointments. DHR is working with DPH to implement a mechanism in the system to prohibit these anomalies from occurring in the future.The SFERS has also successfully litigated all instances where these practices might have occurred. Please see the SFERS' response, the Controller's response, and the San Francisco Fire Department's response. **SFERS and SFERS Board:** Partially Disagree. SFERS has no role or responsibility in the management of labor, meet and confer, or the City's employment policies and practices. SFERS has actively and successfully litigated all cases where SFERS members have attempted to include non-pensionable compensation in the calculation of SFERS benefits. In calculating a SFERS retirement benefit, SFERS staff confirms that all elements of pay included in the calculation of SFERS pensions are paid as provided by City Charter and Memoranda of Understanding (MOUs). The voters have prohibited a retired SFERS member from "pyramiding" a second SFERS pension after retirement. **SFFD:** Any increases to final pensionable compensation of a retiree in the Fire Department are legitimate and in accordance with established Citywide pay practices and procedures, including applicable MOU provisions and Merit System principles. Increases can be attributed to negotiated contract enhancements (pre- or post-retirement) or promotion in rank pre-retirement through the following MOU or DHR and Civil Service-approved appointment methods: Like Work-Like Pay, Acting Assignment, Provisional or Exempt Appointment, or Permanent Appointment from an eligible list. Increases to final pensionable compensation do not occur for the purpose of inflating or "spiking" retirement benefits.

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For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2010 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2010 Response Text
2009-10	Pension Tsunami The Billion Dollar Bubble	R,D1	D1. San Francisco should take steps to curb abuses from pension spiking by limiting the final pensionable income an employee can claim at retirement and from pension-pyramiding. The Jury suggests the following: - Use a three-year average to determine pensionable income, similar to Federal rules. - Limit final pensionable compensation to 120% of the rank pay rate as determined by the Civil Service job classification. - The Controller should perform an independent review of pensions to determine whether the practice of pension spiking is ongoing. - Disallow employees from drawing pensions from two simultaneous City jobs. - Pensionable compensation should not include pay for two separate pay types, known as pension-pyramiding.	BOS, Mayor, Controller, Human Resources, SFFD	1, 2, 3	MYR: Final year averages • Already implemented. As a reminder, Supervisor Sean Elsbernd and I introduced a Charter amendment to the Board of Supervisors in 2008, which would have required a three-year average to determine pensionable income; unfortunately, however, the Board of Supervisors voted to reduce that time to two years. The measure, Proposition B on the June 2008 ballot, was passed by an overwhelming majority of the voters (74%). • The Controller should perform an independent review of pensions to determine whether the practice of pension spiking is ongoing. • Recommendation Requires Further Analysis. Although pensionable income is determined by Charter, I will work with DHR, SFERS, and the Controller's Office to limit final pensionable compensation to the extent possible under the Charter and the collective bargaining agreement.• Disallow employees from drawing pensions from two simultaneous City jobs. • Recommendation Requires Further Analysis. I agree with the Civil Grand Jury that employees should not draw from two simultaneous public service jobs and that pensionable compensation should not include pay for two separate pay types. As stated earlier, my office and DHR are working together to ensure that there are systematic controls in place for this purpose. CON: The Controller's Office agrees that "pension spiking' and "pension-pyramiding" are unfair and costly practices and should be prevented. We note that CGJ recommendations 1. and 2. require voter approval and that recommendations 4. and 5. are addressed as part of the Controller's Office's payroll audit program (as well as other City programs), which audits controls on assignments, on pay and on retirement calculations to control the risk of "spiking" and "pyramiding" and insure that City employees are appropriately compensated and their pensions are determined in accordance with all applicable codes. In response to recommendation 3., the Controller's Office includes SFERS as part of its annual risk assessment and considers whether to schedule internal audit(s) for that agency as it does for any city department. SFERS has systems for quality control and audit testing, is relatively lower in risk order than many other city functions, and is not scheduled for an audit in FY10-11 at this time. An internal audit for the Department could be scheduled in FY11-12 or even later in FY10-11; however that will be determined during our workplan and risk assessment process in the spring of 2011, and ongoing prioritization of resources during current FY10-11. SFFD: See prior responses-the City and the Fire Department have controls in place to ensure that pension levels are earned and paid in accordance with the Charter and all codes.
2009-10	Pension Tsunami The Billion Dollar Bubble	F, E1	E1. For current employees and retirees, health benefits are "vested" after 10 years. Unlike pensions, health benefits for most City workers are not pre-funded, but are paid directly out of the City's General Fund. In 2001, the City expended $17 million on retiree health care. By 2007, that amount had grown to $130 million and continues to rise. Mercer Consulting reported on June 30, 2008, that the City's unfunded liability for retiree health benefits was $4 billion.	BOS, Mayor, Controller, Human Resources, SFERS	This item is a finding - there will be no action plan in response.	MYR: Partially Disagree. Current employees who were hired prior to January 10, 2009 receive full employer health care coverage after only five years of City services. Although retiree health benefits have not been pre-funded, the Controller's Office analyzes the City's unfunded retiree health benefit liability and explores funding options to address this issue. Further, the voters have responded to this issuing by passing Proposition B in 2008, which established a Retiree Health Care Trust Fund and created a graduated health benefit vesting schedule for employees hired on or after January 10, 2009. Pursuant to Proposition B, all employees hired on or after January 10, 2009 must contribute 2% of their salary into the City's Retiree Health Care Trust Fund Contribution, and the City contributes an additional 1% for each corresponding 2% contribution. This amount serves to prefunds said employees' retiree health benefits. Nevertheless, I agree that retiree health benefits have not historically been pre-funded, and that the City has a substantial, unfunded retiree health liability. DHR and the City have taken steps, and will continue to takes steps, to address this issue. Please see DHR's response to this Finding and Recommendation E1 for additional information. CON: Through work led by the Controller's Office, the City has been diligent in estimating and reporting its unfunded retiree health benefit liability and exploring funding solutions to replace the pay-as-you-go burden. Some progress has been made in addressing the liability. In June 2008, the voters of San Francisco passed Proposition B, the Retiree Health Charter amendment. This measure created a graduated health benefit vesting schedule for employees hired after January 10, 2009 and established a separate Retiree Health Trust Fund in order to pay for future costs related to retiree health care. Employees hired on or after January 10, 2009, contribute up to 2% of their pre-tax pay and the City contributes 1%. The Controller's Office, with other City leadership, continues to work steadily on this issue. SFERS: SFERS has no role, duty or responsibility in the City's health benefit area.
2009-10	Pension Tsunami The Billion Dollar Bubble	R. E1	E1. Department of Human Resources and collective bargaining units should meet and confer to determine a cost-sharing arrangement to pre-fund the $4 billion unfunded liability for retiree health care obligations.	BOS, Mayor, City Attorney, Controller, Human Resources	4	MYR: Agree; Already Implemented. The City does acknowledge that it has a large unfunded liability for retiree health care obligations. With past propositions, the City has begun to address this issue by requiring the City and its employees to contribute to the Retiree Health Trust Fund. I will continue to work with the Controller's Office and DHR to address this liability. Please see DHR's response for additional information. CON: Please see the Controller's Office response to R.B1 and F.E1.

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Response to the 2009-10 Civil Grand Jury Report
"PENSION TSUNAMI The Billion Dollar Bubble"

California Penal Code Sections 933.05(a) and (b) requires the responding party to report for each recommendation of the Civil Grand Jury one of the following actions:

1. Recommendation implemented - Date Implemented - Summary of Implemented Action	2. Will Be Implemented in the Future - Anticipated Timeframe for Implementation	3. Requires Further Analysis - Explanation - Timeframe (Not to exceed six months from date of publication of grand jury report)	4. Will Not Be Implemented: Not Warranted or Not Reasonable - Explanation

For each recommendation below, indicate one of the four actions you have taken or plan to take in the "Action Plan" column and provide the required explanation in the "2010 Response Text" column.

CGJ Year	Report Title	Recommendation or Finding Number	Recommendation or Finding Text	Response Required From	Action Plan	2010 Response Text
2009-10	Pension Tsunami The Billion Dollar Bubble	F.F1	There are seven SFERS board members: three are elected by the members; three are appointed by the Mayor; and the seventh Commissioner comes from the ranks of the Board of Supervisors. One of the three public members has not been appointed for at least six months.	BOS, Mayor, SFERS Board	This item is a finding - there will be no action plan in response.	MYR: Agree. Please note that since the issuance of this report, I have filled my vacant appointment. **SFERS Board:** Agree.
2009-10	Pension Tsunami The Billion Dollar Bubble	F.F2	Minutes of the SFERS board meetings record attendance of the board members. When the members representing the public are absent, the interest of the public is eroded.	BOS, Mayor, SFERS Board	This item is a finding - there will be no action plan in response.	MYR: Agree. It is important for members of all commissions and boards to attend meetings. **SFERS Board:** The report ignores the Board's statutory role. All seven SFERS Board members bear the fiduciary duty to act solely in the interests of the Plan members and beneficiaries. There are no public representative board positions.
2009-10	Pension Tsunami The Billion Dollar Bubble	R.F1	The Mayor needs to appoint two Commissioners to represent the public's interest.	Mayor	4	MYR: Disagree; Will Not be implemented. Upon appointment, all commissioners are required to discharge faithfully the duties of the particular commission or board to which they are appointed. In the case of the SFERS, the duty of the commissioners appointed to the SFERS is to represent the interest of the members and their beneficiaries. All seven SFERS Commissioners share the same fiduciary duty, not just those appointed by the Mayor.
2009-10	Pension Tsunami The Billion Dollar Bubble	R.F2	It is important for the public Commissioners appointed by the Mayor to attend the Board meetings. They should attend regular monthly Board meetings or resign.	Mayor, SFERS Board	1	MYR: Agree; Already implemented. I agree that all Commissioners appointed to the SFERS should attend regular monthly Board meetings. As the SFERS Board states in its response, the Board also has a committee structure that allows its members to discharge its duties even if a member is not able to make every Board meeting. Please see the SFERS' Board response. **SFERS Board:** Board members participate in public session, at not only Board meetings, but Committee meetings as well. The report failed to recognize the existence of the latter. Indeed, the report noted that one Commissioner had 53% attendance at the monthly Board meetings for FY2009-10, but failed to acknowledge that the same Commissioner attended 12 of 14 Committee meeting (86%) for the same period of time. Moreover, the report references "public Commissioners", a reference to those Commissioners appointed by the Mayor. As noted in the response to Finding F.2 above, all seven Commissioners bear the same statutory duty - to act in the sole interest of the Plan members and beneficiaries. There are no "public Commissioners." SFERS agrees that Commissioner attendance at public meetings is encouraged pursuant to the member's interest as well as the Board's policy.

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CITY AND COUNTY OF SAN FRANCISCO

OFFICE OF THE CITY ATTORNEY

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August 10, 2010

Hon. Katherine Feinstein
Presiding Judge
San Francisco Superior Court
400 McAllister Street, Room 008
San Francisco, CA 94102

Re: City Attorney Office's Response To The June 24, 2010 Civil Grand Jury Report Entitled "Pension Tsunami – The Billion Dollar Bubble"

Dear Judge Feinstein:

Under Penal Code Sections 933 and 933.05, the City Attorney's Office submits the following response to the Civil Grand Jury Report entitled "Pension Tsunami – The Billion Dollar Bubble" and issued on June 24, 2010. The Grand Jury requested that this Office respond to the report.

For each Civil Grand Jury finding for which you ask a response from the City Attorney's Office, you asked that we either:

1. agree with the finding; or
2. disagree with it, wholly or partially, and explain why.

For each Civil Grand Jury recommendation for which you ask a response from the City Attorney's Office, you asked that we report one of the following:

1. that the recommendation has been implemented, with a summary explanation of how it was implemented;
2. that the recommendation has not been implemented, but will be implemented in the future, with a time frame for the implementation;
3. that the recommendation requires further analysis, with an explanation of the scope of that analysis and a time frame for the officer or agency head to be prepared to discuss it (less than six months from the release of the report); or
4. that the recommendation will not be implemented because it is not warranted or reasonable, with an explanation of why that is. (California Penal Code §§933, 933.05)

Of the ten findings and corresponding recommendations in the Civil Grand Jury Report, the City Attorney's Office has been asked to respond to the Findings and Recommendations listed below.

Finding C1.

Proposition H, passed by voters in 2002, requires that if the City's contribution rate to the pension fund exceeds 0%, then the City and the Safety employee unions must "meet and confer" to implement a "cost-sharing" arrangement to reduce the cost impact of the employer's

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contributions on the City's General Fund. The City's contribution rate has exceeded 0% for fiscal 2004-05 to the present.

The City and County of San Francisco is not in compliance with the requirements of the City Charter resulting from the passage of Proposition H. There have been no "meet and confer" sessions to establish a "cost-sharing" arrangement.

The City Attorney has not mandated that the SFERS Board comply with these requirements of the Charter Amendment resulting from Proposition H.

City Attorney's Office Response to Finding C1.

Partially disagree. The San Francisco Employees' Retirement System (the "Retirement System") has confirmed to us that, as the Grand Jury Report states, the City's contribution rate to the Retirement System has exceeded 0% for every fiscal year since the fiscal year beginning July 1, 2004. Accordingly, we agree that the meet and confer and cost-sharing provisions in Charter Sections A8.595-11(e) and A8.596-11(e) (Proposition H November 2002) were first triggered in July 2004 and have continued to be triggered since then. (We note that while the Civil Grand Jury Report refers to the meet and confer and cost-sharing language in Charter Section A8.595-11(e), which governs the police plan, it omitted reference to the identical language in Charter Section A8.596-11(e), which applies to the firefighter plan. References to "Proposition H" here include both of these Charter provisions.)

But we disagree that the City has not complied with Proposition H. The conclusion of the Civil Grand Jury Report that there have been no meet and confer sessions to establish a cost-sharing arrangement appears to be based on incorrect facts and on a misinterpretation of the law.[1] For the reasons we explain below, the City has met the requirement that it negotiate with representatives of police officers and firefighters to effect a material reduction in General Fund costs in years in which it faces a positive contribution to the Retirement System. But, as we describe further in this response, the City can and should do a better job of implementing Proposition H by conducting the process annually and making the process more transparent to the public. And the Civil Grand Jury Report touches upon serious policy questions about whether the City needs to take other actions to ensure the long-term viability of its Retirement and Health Systems and protect its General Fund. As described below in our response to Recommendation C2, we are prepared to provide legal advice to the City policy-makers should they wish to examine taking such actions.

Before analyzing the City's legal compliance with the cost-sharing provisions of Proposition H, we first explain how these Charter provisions fit into the City's collective bargaining process, and the context of the collective bargaining agreements at the time the voters approved Proposition H in 2002.

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[1] In this regard, as expressed in the City Attorney's June 14, 2010 letter to Presiding Judge McBride, we are concerned that there is at least an appearance that the author of the Civil Grand Jury Report might have reached a policy decision that drove the conclusions in the report, without regard to an objective analysis of the facts or the law. The author of the report was listed as a co-sponsor of a proposed initiative measure to amend the Charter to address funding City employee pension and health benefits. That measure includes an express finding that the City "has failed to achieve a material reduction of the cost impact of employer contributions to the City's general fund as required by the 2002 Charter Amendment [Proposition H]." The sponsors circulated that measure for signature and submitted it before the Grand Jury issued its report.

Overview Of The City's Collective Bargaining Process

Generally, the City and the unions representing its employees agree on the salary, benefits and the terms of employment through a labor negotiation process. The City's Charter and the California Meyers-Milias-Brown Act ("MMBA") (Gov. Code §§3500 et seq.) govern that process. The MMBA's purpose is to "promote full communication between public employers and their employees by providing a reasonable method of resolving disputes regarding wages, hours and other terms and conditions of employment . . . ," as well as to promote good employer-employee relations. (Gov. Code §3500.)

The focus of the labor negotiation process is collective bargaining to reach an agreement embodied in a Memorandum of Understanding ("MOU"), between the City and the unions representing City employees. Under the Charter, the City and a representative of its safety employees must "negotiate in good faith" to agree upon the terms of an MOU. (Charter §§A8.409-3 (non-safety employees), A8.590-4 (safety employees).) This Charter requirement complies with the City's obligation under the MMBA to "meet and confer in good faith regarding wages, hours and other terms and conditions of employment." (Gov. Code §3505.) Typically, MOUs are lengthy documents covering a variety of topics and are the product of substantial give and take on numerous points. The current MOUs between the City and representatives of its safety employees are posted online by the Department of Human Resources ("DHR"). (See http://www.sfdhr.org.)

The Charter vests in the Mayor, acting through the Director of Human Resources, and in consultation with the Board of Supervisors, the exclusive responsibility for meeting and conferring with all employee representatives about the terms of its MOUs. (*See* Charter §§11.100 and 11.101.) More particularly, DHR develops, in conjunction with other City agencies such as the Controller's Office, the economic and wage data used in the collective bargaining process. Under the City Charter, the Mayor's Office and DHR determine the City's negotiating position and attempt to reach agreement with the unions over wages, hours and other terms and conditions of employment as part of the collective bargaining process.

If the negotiators for the City and the union reach agreement, DHR prepares the MOU reflecting the terms of that proposed agreement. If instead the City and a union cannot agree on all terms of an MOU, an arbitration panel decides disputed terms through binding interest arbitration. (Charter §§A8.409-4 (non-safety employees), A8.590-5 (safety employees).) Once the terms of the MOU are decided, whether by agreement or by arbitration, DHR submits the proposed MOUs to the Board of Supervisors for its approval by ordinance. Once ratified by the union membership and approved by Board ordinance, the MOUs become binding agreements.

Like other contracts, our Office approves those final MOUs as to form. (Charter §6.102(6).) Approval as to form, as mandated by the City's Charter, reflects the City Attorney's determination that the contract is in an acceptable legal form and contains the provisions required under the Charter and Municipal Codes, and that there is a legal basis for the City to enter into and perform the contract and for the City to realize the basic benefits of its bargain. But approval as to form does not extend to making any judgment about how good a bargain the City has struck – the Charter vests the responsibility for making that determination in the City's policy-makers.

Historical Context, Including Post-Proposition H Negotiations With Public Safety Employee Representatives

Labor negotiations are complex and take into account many economic factors that may not appear in the text of MOUs. For that reason, one must also examine Proposition H in its historical context. When the Board of Supervisors unanimously approved placing on the ballot the measure enhancing police and fire employee retirement benefits that became Proposition H and when the voters approved that measure, the City Retirement System had a surplus. The City was not making any employer contribution to the Retirement System, and the Controller and the Retirement System determined that it was unlikely that the City would be required to do so for at least the next ten years. An underlying premise of Proposition H was that the surplus would cover the City's share of the cost of the enhanced benefits. Unfortunately, these predictions proved to be incorrect and, within two years after the passage of Proposition H, the Retirement System informed the City that it would need to make contributions to the Retirement System. This turn of events triggered the cost-sharing provisions of Proposition H.

When the City's Retirement System had a surplus, the City had agreed, through negotiated MOUs, to pay, or "pick up," the employees' full share of their retirement contributions, in lieu of other economic concessions, such as wage increases. DHR informs us that in 2003, in the face of the need to achieve budget savings in a recessionary period and in anticipation for the first time after the adoption of Proposition H that the City would have to make an employer contribution to the Retirement System, the safety employee organizations entered into an agreement with the City to eliminate this benefit for the duration of the MOUs.

The MOU covering police employees for the period July 1, 2003 through June 30, 2007 stated that the employees' agreement to pay their retirement contributions satisfied the cost-sharing requirements of Proposition H. The MOU covering firefighters for the period July 1, 2003 through June 30, 2005 provided that the City pick up would be eliminated only until June 30, 2004, when the parties would return to the "status quo ante," and the City would resume the pick up. But the parties amended the firefighters' MOU to continue elimination of the City pick up, omit the language that the parties would ever return to the status quo ante, to extend the term of the MOU to June 30, 2007, and acknowledge that the firefighters' payment of their own retirement contributions satisfied the cost-sharing requirements of Proposition H.

Thus, the safety employees resumed paying their employee contributions to the Retirement System. During this period, other non-safety employees agreed in their MOUs to forego the City's pick up of their retirement contributions temporarily, but the City agreed with those other employees to resume the pick up after a specified period of time, depending on the specific MOU. As to these non-safety employees, when the City became obligated to resume the employee pick up, in negotiations the City offered non-safety employee unions the choice to have the City continue the pick up or to receive a wage increase in lieu of the City's resumption of the pick up. Many of these unions selected the wage increase, which was reflected in City MOUs as a wage increase in recognition of the employees' agreement to continue paying the employee retirement contribution. But, we understand that the City did not offer to police or firefighters this wage increase in recognition of continued payment of the employee retirement contribution.

As the City and unions representing safety employees negotiated new or amended MOUs for the fiscal years beginning July 1, 2008 and after, the safety employees agreed to continue this concession. The DHR informs us that since the safety employees' agreement in 2003, they have continued to pay the full employee contribution. The MOUs that the City negotiated for safety

employees expressly state that the parties intended this concession to satisfy the cost-sharing requirements in Charter Sections A8.595-11(e) and A8.596-11(e). Also, DHR informs us that the safety employees agreed to additional wage concessions, beyond the payment of the employee contribution, in Fiscal Years 2008-2009, 2009-2010, and the fiscal year that began July 1, 2010, that resulted in substantial General Fund savings.

With that background we turn back to the findings in the Grand Jury Report that the City has not complied with the meet and confer and cost-sharing requirements of Proposition H.

Analysis Of City's Compliance With Meet And Confer And Cost-Sharing Requirements

First, as indicated above, we understand that meet and confer negotiations took place in the context of bargaining over the terms of MOUs established during the relevant period. Those negotiations resulted in safety employees agreeing to MOUs that would require employees to pay their full retirement contribution, which the City had been paying in full before Fiscal Year 2003-2004. And we further understand from DHR that meet and confer sessions also resulted in further wage concessions by the safety employees. The MOUs between the safety employee unions and the City state that the employment concessions met the requirements of Charter Sections A8.595-11(e) and A8.596-11(e). (We note that the MOU with the Police Officers Association includes a misreference to Section A8.595-11(d) instead of A8.595-11(e), but from the context it is clear that this reference was a typographical error and the intended reference was to cost-sharing provisions of subsection e.)

While specific sessions to negotiate cost-sharing did not occur in each year since the City first faced a positive retirement contribution in Fiscal Year 2004-2005, in fact, the City and the safety employees maintained cost-sharing arrangements, reflected in the negotiated MOUs, which cover every fiscal year in which a cost-sharing arrangement was required. We conclude that Proposition H allows the City to enter into multi-year agreements providing for cost-sharing arrangements in each year of the term of such agreements where the City faces a positive contribution rate. Such multi-year arrangements comply with Proposition H. They also operate in conjunction with the City's obligations under collective bargaining laws and avoid the uncertainty that year-to-year negotiations in changing economic times would inject into the City's budgetary process.

Second, we understand from information that DHR has recently made public in the memorandum from DHR entitled "City Response: Inquiry on Prop H Obligations" (a copy of which is attached as Attachment A to this response) that these cost-sharing arrangements resulted in a material reduction in General Fund costs. In particular, DHR estimates that the total dollar amount of the savings to the City's General Fund under the MOUs requiring public safety employees to assume responsibility for paying their contribution rate is substantial. The savings from that agreement alone nearly equals the increases to the City for the police and fire enhanced pension benefits arising under Proposition H for the relevant period, Fiscal Year 2004-2005 to the present. The reported wage concessions resulted in additional savings to the General Fund.

Some have argued that the City and the unions may not agree that General Fund savings resulting from the public safety employees' resuming to pay their contribution rate to the Retirement System and from the later wage concessions satisfy the cost-sharing provisions of Proposition H because the concessions were driven by the need to achieve budget savings due to the economic recession. But under the circumstances described above, we disagree. As previously mentioned, labor negotiations involve a wide range of matters, and it is difficult to disaggregate the causes of various concessions and benefits. As described in our response to

Recommendation C2 below, we have concluded that going forward the City could improve the Proposition H implementation process so that MOUs more clearly tie General Fund savings to the cost-sharing requirements. Still, it is beyond doubt that the various MOU concessions that DHR has identified from Fiscal Year 2004-2005 to the present have resulted in substantial General Fund savings. Also, as mentioned above, the MOUs themselves specify that the City agreed that the public safety employees' resuming payment of their contributions to the Retirement System satisfied the Proposition H cost-sharing obligation.

Importantly, from a legal standpoint the plain language of Proposition H does not mandate a dollar-for-dollar offset to the General Fund; it requires negotiations to implement a "cost-sharing" arrangement" that effects a "material" reduction in General Fund costs. Nor does Proposition H define what is cost-sharing or what is material. The common definition of "share" is to divide or parcel out in shares or apportion. The word suggests that both sides contribute a share. Also, under the common law, the term "material" does not import a rigorous standard. Generally the word "material," when used in connection with contracts and or other monetary terms, means something of significant value. Nevertheless, the figures provided by the DHR in Attachment A show that the concessions that the police and firefighters agreed to were of significant value, *nearly equaling* the cost to the City of providing the enhanced retirement benefits over the relevant period.

When the plain meaning of a Charter provision is not clear, courts examine its legislative history to interpret the measure. Here, the legislative history of Proposition H's cost-sharing provision does not particularly illuminate what the voters intended through the materiality requirement. The digest in the ballot pamphlet for Proposition H did not even mention the cost-sharing provisions. The Controller's Statement in the ballot pamphlet for Proposition H characterized the cost-sharing concept as an obligation to "negotiate a cost-sharing agreement with the police officers and firefighters to cover *all or part* of the cost of providing the additional retirement benefits through employee contributions." (Emphasis added.) In fact, as described above, that sharing agreement is just what occurred when the police and firefighters' agreed to amend their MOUs to pay their retirement contribution. And, also as described above, that agreement differs significantly from MOUs with other City employees in which those employees agreed to continue paying their retirement contribution in exchange for a wage increase. Police officers and firefighters agreed to pay their own retirement contributions as a concession without requiring the City to give them an alternative benefit in exchange.

The cost-sharing requirements of Proposition H stand in contrast to other Charter provisions. For instance, in March 2004 the voters approved Proposition B, a Charter amendment that authorized the City to contract with the California Public Retirement System ("CALPERS") for increased retirement benefits for District Attorneys, Public Defenders and Public Defender Investigators but only if there is no change in costs to the City. Charter Section A8.506-5, added by Proposition B, states that "The power to enter into a contract . . . [with CALPERS] shall be limited to a contract that is *cost-neutral to the City*." (Emphasis added.) So, under this provision the City may not even agree to provide the increased benefits unless it first achieves cost-neutrality. Proposition H does not require cost-neutrality.

Finally, we disagree with the assertion that the City Attorney has not mandated the Retirement Board to comply with Proposition H. As noted below in our response to Recommendation C1, the Retirement Board must determine and inform City policy-makers each fiscal year about whether the City will have a positive contribution rate to the Retirement System. Retirement System staff inform us it did so. But the Retirement Board does not have any responsibility or authority under the Charter to determine how to allocate the burden of that

contribution between the City and its employees, much less to negotiate a cost-sharing arrangement.

In sum, the City has satisfied the materiality standard of Proposition H's cost-sharing provisions. Whether the City can or should do more to achieve further concessions from its public safety employees, or take other steps to help ensure the long-term viability of its pension or health systems, are other, more difficult policy questions. As mentioned in our response to Recommendation C2, we are prepared to provide legal advice to the City policy-makers about options should they wish to pursue them.

Finding C2.

The unfunded pension liability for Proposition H as of July 1, 2009 was approximately $276 million, amortized over thirteen years to about $26 million annually.

City Attorney's Office Response to Finding C2.

The City Attorney's Office is unable to agree or disagree with this Finding because the subject matter does not present a legal issue. We defer to the Retirement System and the Controller's Office for a response.

Recommendation C1.

The City Attorney should initiate legal action against the SFERS Board to enforce the requirements of the Charter amendment to "meet and confer" and "cost-sharing" provisions of Proposition H, as stipulated in Charter §A8.595-11(e).

The Jury recommends that the City Attorney and/or his representatives present to the Board of Supervisors and SFERS Board the following documents regarding §A8.595-11(e) of the City Charter:

1. A legal opinion on the charter section.
2. Documentation regarding the dates and times that the City and the Police and Firefighters unions met to confer and to implement a cost-sharing arrangement as required in the section.
3. A legal opinion regarding fiduciary duties of the SFERS Board to comply with it.
4. A legal opinion regarding SFERS duty to revise the Safety employee contribution rate to comply with the Charter section.
5. A legal opinion regarding possible remedies to enforce compliance.

City Attorney's Office Response to Recommendation C1.

Recommendation to sue the Retirement Board:

The City Attorney's Office will not initiate legal action against the Retirement Board for two reasons. First, as described above, the City has complied with the cost-sharing provisions of Proposition H. Second, the Grand Jury Report recommendation miscomprehends the role of the Retirement Board in this area. The cost-sharing provisions under Charter Sections A8.595-11(e) and A8.596-11(e) impose no duty on the Retirement Board to implement the meet and confer requirements; that is a City responsibility. The Retirement Board's responsibility is limited to informing the City of the amount of the employer contribution that the City must pay to keep the

Retirement System funded and of the cost to the City of providing the enhanced benefits to the police and fire employees under Proposition H. The Charter specifies contribution obligations of employees as percentages (depending on the plan) of pay. The City pays the balance. The extent to which the City may agree to pay all or part of the employees' contributions is a matter of negotiation between the City and representatives of employees, through the collective bargaining process. As described in our response to Finding C1, the Retirement Board has no authority and plays no direct role in this collective bargaining process.

Legal opinion on the Charter section (Proposition H cost-sharing provisions):

Please refer back to our response to Civil Grand Jury Finding C1, above, in this letter.

Documentation regarding meet and confer:

The City Attorney's Office does not maintain records pertaining to the dates and times that the City and the safety employee unions met and conferred to negotiate a cost-sharing arrangement under Charter Sections A8.595-11(e) and A8.596-11(e). Accordingly, we are not in a position to implement that recommendation. But, as stated above and evidenced by the express statement in the MOUs, DHR informs us that negotiations did take place resulting in economic concessions that the City and representatives of the police officers and firefighters agreed to for the purpose of satisfying the Charter's cost-sharing requirements.

Legal opinion regarding fiduciary duties of the Retirement System under Proposition H:

Please refer to our response above regarding the recommendation to sue the Retirement Board. As stated above, the Retirement System's duties under the cost-sharing provisions of Proposition H are limited.

Legal opinion regarding the Retirement System's obligation to revise contribution rates:

Since, as described above, the City has complied with Proposition H, the factual premise of this opinion request does not exist. We recognize that arguments have been raised that the City has the authority to increase the current employee contribution rates above 7.5%, to as high as 10%. DHR's position has been that the Charter limits employee contribution rates to 7.5%. For purposes of analyzing the City's legal compliance with Proposition H, we need not resolve the issue of whether the City could further increase employee contribution rates because the cost-sharing arrangements to date have met the materiality threshold.

Legal opinion regarding remedies:

Because, as described above, the City has complied with Proposition H, the factual premise of this opinion request does not exist.

Finally, we note that it is for the City's policy-makers in labor negotiations (i.e., DHR, the Mayor and the Board of Supervisors) to decide how cost-sharing should best be achieved so long as that arrangement at least meets the Charter's materiality standard. This Office does not play a policy-making role in that process. But, in our capacity as legal advisor to the City, we offer suggestions to improve transparency of the cost-sharing agreement process in the future and, as discussed in our response to Recommendation C2 below, we will consider providing a confidential written opinion to the Mayor, the Board of Supervisors, the Retirement Board and

the Director of Human Resources about the legal issues and options associated with further possible cost-sharing arrangements, as appropriate.

Recommendation C2.

The City and Safety employees should establish an arrangement to share the annual $26 million cost as required by the City Charter.

City Attorney's Office Response to Recommendation C2.

As discussed above, the MOUs with the City's safety employees do establish a cost-sharing arrangement that has satisfied the requirements of Proposition H. If through this recommendation the Grand Jury intends to mean that going forward the City should secure greater cost-sharing concessions from its employees, then that recommendation raises policy issues for the City agencies and officials vested with authority in the City's labor negotiation processes to address. As legal advisors to the City we are not in a position to respond to that recommendation.

But, the City Attorney's Office intends to continue advising the City's policy-makers of their legal obligations in the context of their consideration of any specific negotiation proposal and, if the policy-makers wish to pursue other options regarding additional concessions, of any significant legal issues that those options present. Likewise, in anticipation of the City's possible consideration of such options, the City Attorney's Office will consider addressing in a confidential memorandum the legal issues that this Recommendation C2 generally poses, if such a confidential memorandum is appropriate. (Here we note that while we often give public legal advice to the City's policy-makers, this Office sometimes must give confidential legal advice, which is protected by the attorney-client privilege, on matters that could compromise the City's negotiating strategy or could expose the City to possible litigation.)

Also, the City Attorney's Office recommends that DHR improve its implementation of the cost-sharing provisions of Proposition H. Even though we conclude that the City has satisfied those provisions through its collective bargaining process, we recommend that the City's labor negotiators meet and confer annually over cost-sharing with the unions representing the public safety employees. DHR should document those meetings and should issue a public report that includes:

- estimates from the Retirement System of the City's contribution to the Retirement System for the upcoming fiscal year and the projected costs of providing the enhanced benefits under Proposition H for that year;
- a specific statement in the MOUs about how the City is effecting the cost-sharing obligation for the applicable year;
- if the parties determine that they do not need to amend the MOU provisions regarding cost sharing for that fiscal year, a statement about why that is the case; and
- an estimate of the total dollar amount in General Fund savings that the City is allocating for that fiscal year to the cost-sharing provisions of Proposition H.

Recommendation E1.

Department of Human Resources and collective bargaining units should meet and confer to determine a cost-sharing arrangement to pre-fund the $4 billion unfunded liability for retiree health care obligations.

City Attorney's Office Response to Recommendation E1.

The City has taken steps to implement this recommendation. Proposition B, a Charter amendment that the Board of Supervisors placed on the ballot and that the San Francisco electorate approved in June 2008, requires all newly hired employees to contribute 2% of compensation to defray retiree health care costs. DHR informs us that approximately 10% of the current workforce is making that contribution. Over time that percentage will grow until 100% of the City's workforce is contributing toward retiree health care costs. The City Charter now also requires that the City contribute annually to the Retiree Health Care Trust Fund 1% of payroll for newly hired employees. Eventually that contribution should also cover all of the City's workforce. DHR informs us that the City's authorized representatives continue to engage in discussions with all of the employee unions to pursue contributions to the Retiree Health Care Trust Fund from the remainder of the workforce.

We hope this information is helpful.

Very truly yours,

Dennis J. Herrera
City Attorney

cc: Mayor Gavin Newsom
Angela Calvillo, Clerk of the Board of Supervisors
Members of the Retirement Board, San Francisco Employees' Retirement System
Gary Amelio, Executive Director, San Francisco Employees' Retirement System
Micki Callahan, Director of Human Resources
Controller Ben Rosenfield

ATTACHMENT A

City and County of San Francisco

Gavin Newsom
Mayor

Department of Human Resources

Micki Callahan
Human Resources Director

City Response: Inquiry on Prop H Obligations

The City met with the Police and Fire groups in the spring of 2003, during the first round of labor negotiations following passage of Proposition H, and negotiated provisions in the collective bargaining agreements covering police officers and firefighters to address Charter obligations as to cost-sharing. At that time both the Police and Fire unions agreed to pay the maximum employee pension contribution allowed under the Charter (7.0% (old plan) or 7.5% (new plan)). These agreements were reached in recognition of the parties' cost-sharing obligations, the fact that the City's pension costs were projected to increase above 0%, and to facilitate balancing the City's budget. Proposition H specifically provides that, "Such cost sharing arrangement shall not require an employee contribution in excess of the limits set elsewhere in this Charter." The Charter specifically provides that employee contributions are limited to 7.5% for new plan members.

During the 1990's, the City and virtually all of its labor organizations had negotiated an Employer-Paid Member Contribution (EPMC), under which the City "picks up" the employee pension contribution. During the early 2000's, the City negotiated a temporary elimination of the EPMC for its unions, to achieve budget savings during a recessionary period. By July 2006, the City's miscellaneous employee unions had had the EPMC restored, or received a wage increase in lieu of that restoration. However, the police and fire labor agreements did not include a restoration of the EPMC, nor did they provide for a wage increase in lieu thereof. Instead, their labor agreements provided that the obligation to pay the employee pension contribution would continue, in recognition of the Charter's cost-sharing obligations. As reflected in both the Police and Fire collective bargaining agreements (located on the Department of Human Resources' website at www.sfgov.org/DHR):

> ***San Francisco Firefighters Union, Local 798 (Section 11):***
> *Employees shall pay their own employee retirement contributions in an amount equal to 7.0% (old plan) or 7.5% (new plan) of covered gross salary. The parties acknowledge that said contributions satisfy the requirements of Charter Sections A8.596-11(e) and A8.598-11(d).*
>
> ***San Francisco Police Officers' Association (Section 9):***
> *For the duration of this Agreement, employees shall pay their own retirement contributions. Tier 1 employees will contribute an amount equal to 7% of covered gross salary; Tier 2 employees and Harbor Police Officers will contribute an amount equal to 7.5% of covered gross salary. The parties acknowledge that said contributions satisfy the requirements of Charter Sections A8.595-11(d) and A8.597-11(d) for the duration of this Agreement.*

Not only have these contributions had "a material reduction of the cost impact of employer contributions on the City's general fund" as required by Prop H, they have actually almost completely covered the increased costs under Prop H.

According to the San Francisco Employee Retirement System's estimations, increased costs since Fiscal Year 2004-2005 (the year that the City's rate first exceeded 0%) attributable to the Police and Fire pension improvements under Proposition H amount to $205,693,993. However, the retirement contributions by Police and Fire (7.5% for new plan members, 7.0% for old plan members) during the period since 2003 amount to approximately $202,042,321. See the chart below for further details.

	Approximate Retirement Contributions by Police and Fire			Prop H Increased Costs
Fiscal Year	Police	Fire	Total for Police and Fire	
FY03-04	$13,275,000.00	$ 9,750,000.00	$ 23,025,000.00	
FY04-05	$14,043,750.00	$10,200,000.00	$ 24,243,750.00	$30,792,593
FY05-06	$14,798,407.35	$11,025,221.85	$ 25,823,629.20	$32,418,548
FY06-07	$16,580,467.65	$12,021,110.78	$ 28,601,578.43	$35,643,372
FY07-08	$16,871,911.20	$12,542,837.10	$ 29,414,748.30	$35,920,662
FY08-09	$20,805,085.50	$14,382,645.60	$ 35,187,731.10	$37,467,254
FY09-10	$21,655,563.30	$14,090,321.25	$ 35,745,884.55	$33,451,564
FY10-11	$21,391,609.80	$14,271,636.08		
		Totals	$ 202,042,321.58	$205,693,993

(See notes on following page.)

* Notes:
- The Prop H figures are based on information provided by SFERS.
- The Prop H increased cost in FY09-10 is an estimate.
- The retirement contribution amounts for FY02-03, FY03-04 and FY04-05 are estimates, since DHR does not have payroll data for those years at this time.
- The retirement contribution rates for FY05-06 to FY10-11 are estimates based on the Controller's Office payroll data.
- Contribution rates are calculated based on adjusted base and premiums.

(FYI- the 7.5% amount of the Police and Fire pension contribution during FY 2011-12 will be $35,663,245. Extrapolating from the downward trend in increased costs under Prop H, we assume that the 7.5% employee pension contribution will actually exceed the cost of Prop H pension improvements for Police and Fire in that period).

In addition, the City was able to renegotiate provisions of closed labor contracts with Police and Fire unions which achieve additional savings in the fiscal years 2008-09 through 20012-13. As these agreements reduce pensionable income, the City's pension costs also reduce during the period. Labor concessions this fiscal year alone amount to $18 million from Police and $11.5 million from Fire.

Additional Give-Backs from Closed Contracts			
Fiscal Year	**Police**	**Fire**	**Total for Police and Fire**
FY08-09	-	$ 4,000,000	$ 4,000,000
FY09-10	$ 10,000,000	$ 7,000,000	$ 17,000,000
FY10-11	$ 18,000,000	$ 11,500,000	$ 29,500,000
Totals	$ 28,000,000	$ 22,500,000	**$ 50,500,000**

Finally, while our Police Officer wages are at or slightly above market for the region, (less than 0.5% above market, actually), our retirement benefit is much lower than that of other jurisdictions. Safety employees throughout California receive a "3% at 50" benefit, while San Francisco's safety members receive "3% at 55."

Jurisdictions	Safety *Age at Which 3% Benefit is Received*
San Francisco	55
State of California	50
Alameda County	50
Contra Costa County	50
Marin County	50
Sacramento County	50
San Mateo County	50
Santa Clara County	50
Solano County	50
Sonoma County	50
Oakland	50
San Jose	50