



Good Neighbors

San Diego
Housing Commission

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REPORT

DATE ISSUED: January 28, 2005

ITEM 104

REPORT NO: HCR-05-15
For the Agenda of February 4, 2005

**SUBJECT: RECOMMENDATION(S) OF AD HOC COMMITTEE
CONCERNING SAN DIEGO HOUSING COMMISSION
RETIREMENT PLAN**

SUMMARY

Issue 1: Should the San Diego Housing Commission recommend to the Housing Authority of the City of San Diego that actions necessary and appropriate to join the CALPERS 2% @ 60 Defined Benefit Plan be taken?

Issue 2: Should the San Diego Housing Commission authorize the Ad Hoc Retirement Committee, with the aid and assistance of Mr. Bob Bell of Heller, Ehrmann, White and McAuliff and General Counsel open labor discussions with representatives of Service Employees International Union, Local 535 (the "Union") with recommendations concerning the same to be referred back to the full Board?

Recommendation 1: The Ad Hoc Retirement Committee recommends that the Board of Commissioners of the San Diego Housing Commission not recommend the implementation of any changes to the Defined Contribution Plan and that any further action on this matter, if any, be tabled for a period of no less than two (2) years.

Recommendation 2: That the Ad Hoc Committee, with the aid and assistance of special and general counsel open labor negotiations with the Union in accordance with the Union's prior written request and the Ad Hoc Committee report back to the full Board with its recommendations.

BACKGROUND

The Current Pension Plan and Establishment of the Ad Hoc Committee.

In 1979, the Housing Commission established a Defined Contribution Pension Plan (Money Purchase Pension Plan), to provide tax-deferred retirement benefits to covered employees. All permanent Housing Commission employees are covered by the Defined Contribution Pension Plan. The Housing Commission makes an annual contribution to the Defined Contribution Pension Plan on behalf of covered employees. Over the years the amount of the Housing Commission's annual contribution to the Defined Contribution Pension Plan has varied. However, since June 1997, the Housing Commission has made an annual contribution to the Defined Contribution Pension Plan on behalf of each covered employee in an amount equal to 14% of each covered employee's annual salary.

The Ad Hoc Retirement Committee of the San Diego Housing Commission Board was established by the San Diego Housing Commission Board on October 8, 2004, to independently study and evaluate whether the Housing Commission replace the current Defined Contribution Pension Plan with a Defined Benefit Pension Plan.

Defined Benefit vs. Defined Contribution Pension Plans.

As previously stated the Housing Commission currently provides a Defined Contribution Pension Plan for its permanent employees. Under Defined Contribution Pension Plans, the employer [and in some cases the employee (voluntarily)] makes a contribution to the Plan for the benefit of each covered employee, including represented, non represented and management employees. The money in each employee's account is not subject to income taxation until the funds are withdrawn by the employee. Upon retirement the employee is entitled to whatever amount is in his or her account.

Defined Benefit Pension Plans are fundamentally different from Defined Contribution Pension Plans. Under a Defined Benefit Pension Plan, at retirement the employee is entitled to receive an amount equal to a certain percentage of his or her salary for his or her lifetime. Under a Defined Benefit Pension Plan the employer contributes an amount annually that is an actuarially calculated approximation of the amount needed to provide a certain predetermined and prescribed retirement benefit to the employee. The actuary determines the amount of the contribution using complicated formulas which include the ages, life expectancy and salaries of the employees, the expected return on investments, the expected inflation rate and other factors. The amount of the employer's contribution is recalculated annually and is increased or decreased based upon the actual experience of the plan.

Under Defined Contribution Pension Plans the risk is primarily assumed by the employee (the employee is entitled to whatever amount is in his or her account). On the other hand, under Defined Benefit Pension Plans, the risk is primarily assumed by the employer; the employee is assured of a lifetime benefit and the employer assumes all of the risk of providing the benefit.

Union Request to Reopen Negotiations.

In June 2004, Service Employees International Union, Local 535 (the "Union") entered into a Memorandum of Understanding (the "MOU"). The Union represents approximately 147 Housing Commission employees. The Union has the right under the Letter of Understanding to reopen salary negotiations in the event efforts to gain participation into CalPERS are unsuccessful. The Union requested the reopening of negotiations by letter to the Housing Commission dated August 27, 2004. The reopening of those discussions has been placed on hold pending the determination of the Commission, and if necessary, the Authority as to whether a defined benefit plan would be adopted.

The City of San Diego Retirement System.

The City of San Diego City Charter established the City's Defined Benefit Pension Plan. The City's Defined Benefit Pension Plan is formally called the San Diego City Employees Retirement System (SDCERS). SDCERS has various categories of members, including general members, legislative members and safety members (fire and police). Each category of members is entitled to different benefits. The majority of City employees are "general members" and the benefits applicable to the "general members" will be discussed here. Under SDCERS "general members" are entitled to a benefit equal to 2.5% of the employee's final salary for each year of employment, with normal retirement (eligibility to received benefits) at age 55. For example, if someone is hired by the City at age 25 and works for the City for 30 years, at age 55 that employee will be eligible to retire and receive an annual pension benefit equal to 75% (2.5% x 30 years) of such employee's final salary. This amount is adjusted annually for inflation.

The City of San Diego Pension Reform Committee Final Report made 17 recommended reforms to the City Council with respect to SDCERS, including recommendations to reduce member benefits by 20% and to increase the normal retirement age by 7 years. If adopted, the benefit for "general members" would decrease from 2.5% at age 55, to 2.0% at age 62.

California Public Employees Retirement System.

The State of California established the California Public Employees Retirement System (CalPERS). Over 2,500 public agencies and over 1,400,000 members participate in CalPERS. CalPERS offers numerous benefit options. The Ad Hoc Committee studied a basic plan offered by CALPERS, called a 2% @60 Plan, with no health benefits provided. Basically the plan would allow the potential retiree to collect 2% of its annual salary based upon the average of his or her highest three (3) years qualifying compensation during its employment with the Commission. Simply stated, a 25 year employee would receive a pension equal to 50% of his or her highest three (3) years qualifying compensation salary, as referenced above. The benefits included a limited 2% cost of living increase over the years from retirement to the termination of the benefit. The plan that was studied was the most basic and least expensive CalPERS Plan that is offered.

WORK OF THE AD HOC COMMITTEE

As referenced above, on October 8, 2004 an Ad Hoc Committee of three (3) Commissioners was established by the Board. The members of the Ad Hoc Committee are Commissioners Alice Tuminia, Jennifer Adams-Brooks and Tony Yip. The Ad Hoc Committee was charged with studying the existing defined contribution pension plan and the proposed CALPERS 2% @60 Plan, as referenced above, and making recommendations to the full Board on whether or not a change from a defined contribution plan to a defined benefit plan should be recommended to the Housing Authority of the City of San Diego. As referenced above and as detailed below, the Ad Hoc Committee is recommending that no change in the defined contribution retirement plan be recommended to the Housing Authority of the City of San Diego at this time or in the foreseeable future.

In October of 2004, the Ad Hoc Committee met in the offices of Christensen Schwerdtfeger & Spath LLP and established a schedule of work to be accomplished by the Ad Hoc Committee and its retained experts. The Ad Hoc Committee requested that a public workshop discussing the differences between the defined contribution and defined benefit plans be held and that this workshop be open to all of the public.

On October 22, 2004, the Commission held the public workshop and testimony was taken by members of the public as well as actuarial experts and representatives of the defined contribution and defined benefit plans.

Thereafter, independent experts for the Commission, including the actuarial firm of Epler & Company, a retirement attorney, Mr. Rob Butterfield and Mr. Robert Bell of the firm of Heller Ehrman White & McAuliffe LLP, a labor attorney, were consulted by the Ad Hoc Committee.

Written reports by both the Epler Company and Mr. Butterfield were prepared. Those reports are attached, in their entirety to this report, as Attachments A and B.

The Ad Hoc Committee met four (4) times to study this matter, including the workshop mentioned above. The first meeting, in October of 2004, was organizational and was held for the purpose of determining the scope of the inquiry. A public workshop was held on October 22, 2004, as referenced above. One meeting was held with Mr. Butterfield and Ms. Jane Barry of the Epler Company to discuss the progress of their investigations of the CalPERS Proposed Plan. This meeting was held in late November of 2004. Finally, on December 28, 2004, the Ad Hoc Committee met with General Counsel to discuss and to formulate the recommendations of the Ad Hoc Committee. These recommendations have been formulated without employee input, except public testimony during the workshop, in accordance with the prior conflict opinion of General Counsel attached to the October 8, 2004 Board report dealing with the creation of the Ad Hoc Committee. That opinion is incorporated herein by reference, but is not attached. The establishment of the Ad Hoc Committee was proposed to avoid any conflict or appearance of conflict of interest in studying the retirement plan options. No employee of the San Diego Housing Commission has participated in the preparation of this report.

On December 28, 2004, the Ad Hoc Committee gave instructions to General Counsel on the preparation of the report and on its recommendations. The Ad Hoc Committee directed that its recommendations be discussed and considered at the February 4, 2005 San Diego Housing Commission meeting. This report was finalized on January 28, 2005 after final input from members of the Ad Hoc Committee. This is the report of the Ad Hoc Committee.

REPORTS FROM EXPERTS

As referenced above, written reports were prepared by both the Epler Company, discussing the results of their actuarial studies, and by Mr. Butterfield, dealing with legal and other issues concerning the potential adoption of a defined benefit plan. Those reports are attached as Attachments A and B, in their entirety. The highlights of the reports are summarized in bullet form, in this section:

EPLER REPORT DECEMBER 2004

- SDHC has approximately 234 employees that could participate in the retirement plan
- The current SDHC plan is a defined contribution plan
- Current employer contributions are 14% of annual compensation for each SDHC employee
- This 14% rate has been in force since 1997
- Employees may also voluntarily contribute to the defined contribution plan
- The “Proposed Plan” is the CalPERS 2% @60 Defined Benefit Plan that was studied
- Under a Defined Benefit Plan the employer promises to pay a defined benefit for each covered employee at retirement
- The employer assumes the risk that sufficient assets are available to pay the promised benefits when the employee retires
- SDHC could elect to become a contracting agency and participate in the CalPERS system
- Epler was retained to provide an analysis of the risks and costs to the SDHC if the Proposed Plan were to be adopted
- Proposed Plan provisions are contained within Section II of the Epler Report (“the Report”)
- Valuation assumptions and methods are contained within Section III of the Report
- Summary of valuation data is contained within Section IV of the Report
- Section V of the Report contains a comparison of the actuarial study by CalPERS and to the study done by Epler
- Section V also contains a separate risk analysis study to evaluate the impact of various risk factors on the actuarial results
- Section VI provides an analysis of the number of employees that would be immediately benefited by the change vs. those that would not be immediately benefited

- Epler validated the actuarial analysis performed by CalPERS as being approximately 12% of salary based upon the stated assumptions
- Section V-B shows the reduction of employer cost could be realized through the use of a three year average of compensation instead of the highest year of compensation used by CalPERS. Using the three year average the employer cost would be reduced to approximately 11%
- If the Proposed Plan were adopted each of the employees would have to contribute 7% of their salary in addition to the employer contributions
- A majority of public entities use the three year average compensation plans
- A one percent (1%) decrease in earnings on the total contributions from 7.75% assumed by CalPERS to 6.75% would increase the required employer contribution to 19% from 12%
- A one percent (1%) increase in earnings from 7.75% assumed to 8.75% would reduce the required employer contribution from 12% to 7%
- 35 employees would benefit immediately from the change to the Proposed Plan
- If only those 35 employees opted into the Proposed Plan the cost to the SDHC would increase from 12% to 16%
- An additional 67 employees would be likely to ultimately benefit from the Proposed Plan
- If only the 102 employees that immediately or ultimately would benefit from the Proposed Plan opted into the plan, the cost of the Proposed Plan would increase from 12% to 15%
- 132 employees are unlikely to ever benefit from the Proposed Plan
- Plan termination liability, calculated the day after the Proposed Plan was adopted would be \$4.2 Million
- Converting to a defined benefit plan would shift the risk of providing a retirement benefit from the employee, under the current plan, to the SDHC under the Proposed Plan
- If the Proposed Plan is adopted, but the monies set aside annually are not sufficient to generate the required retirement benefit, the SDHC must increase its contribution rate
- Defined benefit plans are subject to demographic risks such as employees living longer than their life expectancies
- Participation pools being initiated by CalPERS in July of 2005 may smooth out the fluctuations in contribution rates, but to join such a pool would require adopting plan attributes richer than those contemplated in the Proposed Plan or, the SDHC would have to pay a surcharge
- Once in the pool a public entity may not move out of the pool
- Only Plans with less than 100 employees must participate in a pool, participation for plans with more than 100 employees is optional
- If the SDHC is not able to sustain the ongoing costs of the Proposed Plan, it could terminate its contract with CalPERS, after five (5) years of existence but the SDHC would be required to fund any unfunded liability at the time of termination
- At CalPERS discretion, this unfunded liability could be financed over time

- Historical rates of return for CalPERS are shown in Appendix A to the report
- The Plan Termination Summary is discussed in Appendix C to the report

BUTTERFIELD REPORT JANUARY 6, 2005

- The proposed effective date of the transfer to the Proposed Plan should be July 1, 2005 due to “anti cutback” rules, since the defined contribution year end is June 30, 2005
- Other available Plan options are discussed
- Conversion to a Defined Benefit Plan is a major organizational decision
- Trend of public agencies is to go to defined contribution plans not visa versa
- Added costs of Risk Pools are approximately 50 basis points higher than the estimated costs for the SDHC because of added benefits necessary to be admitted to the Risk Pools
- CalPERS administration is effective and investment counseling is available
- SDHC could consider creating its own plan where other benefit structures, such as a 1.8% @ 62 benefit formula could be explored, however the cost of administration for an independent plan is higher than with CalPERS
- Risks are outlined in PROS and CONS section of the Butterfield Report
- Younger employees are normally better off with a Defined Contribution Plan
- Anti-Selection, which is defined a decision by an employee not to join the Proposed Plan, is discussed
- The generic concept of a pay raise vs. pay decrease is discussed at conversion
- Recommends using the three year average if move to Defined Benefit Plan is adopted
- Procedure for adoption of new plan under Government Code requires two votes by secret ballot
- Disclosure of potential pluses and minuses of conversion would need to be given to employees before the votes
- Fully informed decision of each employee would be required prior to implementation and voting
- Employees should consult their individual advisors before voting
- Disclosure package would have to be prepared
- Attorney General advice would be needed regarding whether “conditional approval” of conversion could be allowed, i.e., conversion to CalPERS would only be effective if greater than X% of employees elect to join CalPERS. It is not specifically authorized statutorily.
- Once the Proposed Plan is adopted it cannot be terminated for five (5) years. Thereafter, it can be terminated upon fully funding all deficits, if any, in the plan
- Termination of the Proposed Plan could be legally problematic and potentially expensive
- Should the Board determine to recommend adoption of the Proposed Plan to the Housing Authority additional work by the labor lawyer would be necessary to fully address the right to terminate the plan prospectively

- The ability to earn 8% return over the next 10 to 15 years is uncertain
- Legislation may be forthcoming to address and/or limit the ability of public agencies to implement and/or maintain defined benefit plans
- Careful consideration of all of the ramifications of proceeding from a defined contribution plan to a defined benefit plan is urged

DISCUSSION

The Ad Hoc Committee has carefully studied all of the information and reports available to it. The Ad Hoc Committee is extremely concerned by the uncertainty created by the potential anti selection referenced above. This is exacerbated by the potential volatility of the plan contributions once a defined benefit plan is adopted, even a basic one, such as the Proposed Plan. There would be an unfunded liability upon the adoption of the plan of potentially \$7 Million Dollars, depending upon which employees elect to join CalPERS, which can be paid off over an extended period of time. Once paid off, which is expected to be 13 to 14 years after implementation of the Proposed Plan, the normal cost for the Proposed Plan would be approximately six percent (6%) of the compensation base, which is almost 8% less than the current contribution to the defined contribution plan, which would be a savings to the SDHC.

The Ad Hoc Committee is concerned however, with the potential increase of 7% in the SDHC's required annual contributions for each 1% decrease in the assumed investment return rate of 7.75%, as referenced above. While CalPERS has historically done better than the 7.75% CalPERS assumed rate of return rate, there is uncertainty in the future. Past earnings are not a valid indicator of future returns.

The Ad Hoc Committee is also concerned with the Epler Company's determination that only 102 of the Housing Commission employees are likely to benefit from the Proposed Plan, while 132 employees are not likely to benefit from the Proposed Plan. Also, the Epler Company's determination that the impact of the employees that are unlikely to benefit from the Proposed Plan electing not to join the Proposed Plan will cause the Housing Commission's initial contribution rate to increase from approximately 12% to 15% or 16%, and would result in the Proposed Plan being unaffordable to the Housing Commission at this time.

There is a growing trend away from public involvement in defined benefit plans, with proposals being suggested to ban or eliminate them in favor of 401 (k) type programs.

Weighing all of the factors, the Ad Hoc Committee has voted unanimously to not recommend going forward with any defined benefit plan. To give the employees some certainty concerning this matter, it has been recommended that this proposal be tabled for at least a two (2) year period before it is again considered, if it is considered at all.

The Ad Hoc Committee also recommends that the labor negotiations be reopened on the limited issues of compensation as requested by the Union and that, for potential conflict reasons, the Ad Hoc Committee, or a member or members of the Committee, with the assistance of Special Counsel and General Counsel participate in those negotiations.

POTENTIAL CHANGES TO CalPERS SYSTEM

Numerous articles have been published recently concerning potential changes to the CalPERS system that may be forthcoming in the near future that could affect a decision to join that system as well as commenting upon defined benefit plans in general. The following are a sampling of two (2) written on the issue:

Excerpt from San Diego Union Tribune article dated 12/4/04: A member of the state Assembly plans to introduce a bill that would begin the process of closing California's giant public pension funds to new employees, and giving public workers the type of benefit known as a 401(k) plan in the future. Thousands of companies have replaced their traditional, defined-benefit pension plans with 401(k) plans over the last two decades.

Many local governments in California were having so much trouble making their required contributions to the central funds in Sacramento that they were issuing bonds to produce the cash. That left them responsible not only for pension contributions in subsequent years, but also for the interest on the bonds – at an additional cost of about \$800 million a year.

The proposed bill would not cancel any existing pensions or eject public employees from CalPERS or any of the other state and local pension funds in California. Workers who are in such pension plans would have the option of staying until retirement or switching to the new 401(k) plan for the remainder of their careers. Only new public employees would be required to join the 401(k) plan.

Excerpt from San Diego Union Tribune article dated 12/7/04 – Pension solution: An assemblyman introduced a measure that would require most state and local government workers hired after July 1, 2007, to join 401(k) plans. Existing defined benefit plans for public employees throughout California, including the \$178 billion CalPERS system, would be slowly phased out of existence as currently covered workers are no longer covered by the plans due to death.

The private sector long ago shifted from defined benefit plans to 401(k) plans because the risks of promising specified monthly payments for workers were great. Under defined benefit plans, employers assume the risk, including declines in the value of stock portfolios. Under a 401(k), the employer's risk is eliminated and the worker receives whatever contributions were made to his/her account, plus earnings.

It should be noted that there is no assurance that any measure to limit CalPERS or to change to 401(k) type plans will be successful or that the CalPERS Plan will change in any way in the future.

RECOMMENDATION

The Ad Hoc Committee recommends that the existing defined contribution plan be retained and that the current proposal to switch to a defined benefit plan be tabled for a period of not less than two (2) years and that the current proposal not be forwarded to the Housing Authority.

The Ad Hoc Committee also recommends that Mr. Robert Bell in collaboration with General Counsel and the Ad Hoc Committee, and/or any representative of the Committee, open discussions with the Union concerning their request to reopen salary negotiations, as requested in August of 2004 and deferred pending the outcome of this investigation. It is further recommended that the Ad Hoc Committee report back to the full Board concerning its progress with the discussions.

ALTERNATIVE(S)

Continue to study the CalPERS Plan and attempt to obtain an Attorney General Opinion as to whether a conditional approval to join CalPERS based upon a specified percentage of employees electing to join the Proposed Plan and that percentage of employees actually joining the Proposed Plan is legally permissible. Addressing this issue, however, does not resolve the other risks and uncertainty with going to a defined benefit plan. This alternative is not recommended by the Ad Hoc Committee.

Recommend adoption of the defined benefit plan to the Housing Authority. This is not recommended by the Ad Hoc Committee due to the risk and financial uncertainty involved.

Respectively submitted,

Tony Yip
Signed electronically by Tony Yip
Ad Hoc Committee Member

Jennifer Adams-Brooks
Signed electronically by Jennifer Adams-Brooks
Ad Hoc Committee Member

Alice Tumminia
Signed electronically by Alice Tumminia
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Attachments: Attachments A and B

Attachment A

**SAN DIEGO HOUSING COMMISSION
ACTUARIAL STUDY**

October 31, 2004

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December 2004

SAN DIEGO HOUSING COMMISSION

Table of Contents

SECTION I	
Executive Summary	1
SECTION II	
Proposed Plan Provisions.....	5
SECTION III	
Valuation Methods and Actuarial Assumptions	9
SECTION IV	
Valuation Data	14
SECTION V	
Valuation Results	15
SECTION VI	
Advantaged/Disadvantaged Analysis	21
APPENDIX A	
CalPERS Historical Investment Returns	23
APPENDIX B	
Risk Pooling Summary	24
APPENDIX C	
Plan Termination Summary	26

SECTION I
SAN DIEGO HOUSING COMMISSION
Executive Summary

BACKGROUND

The San Diego Housing Commission (“SDHC”) is a state agency formed by local ordinance of the City of San Diego. Policy decisions concerning the SDHC are made by the Housing Authority of the City of San Diego also a state agency under state law.

The SDHC has approximately 230 employees including members of the SEIU Union and management employees. All permanent SDHC employees are currently covered under a money purchase defined contribution retirement plan (“Current Plan”) to which the SDHC makes an annual contribution on behalf of each eligible employee. A money purchase defined contribution plan provides a fixed (as a percent of payroll) employer contribution. The ultimate retirement benefit paid by a defined contribution plan depends on the contributions and investment earnings at an employee’s retirement. Since June 1997, the annual employer contribution amount has been 14 percent of each eligible employee’s annual salary. Employees can also elect to contribute a percent of salary but are not required to.

Recently the SDHC Board set up an Ad Hoc Retirement Committee (“Committee”) to study retirement options available to the SDHC and its employees. The Committee has reviewed the Current Plan and other retirement plan alternatives including a defined benefit plan proposed by CalPERS (“Proposed Plan”). Under a defined benefit plan the employer promises to pay a defined benefit (typically the benefit is defined as a percent of pay for each year of credited service) at retirement. The employer assumes the risk that sufficient assets are available to pay the promised benefits when the employee retires. The SDHC, a public employer, is not required to participate in CalPERS but can elect to become a “contracting agency” and participate in CalPERS (The California Public Employees Retirement System). The Committee has retained the Epler Company to provide an independent actuarial study to review the proposed CalPERS plan including analysis of the risk and cost to the SDHC, if this plan is adopted.

PURPOSE OF THE REPORT

The primary purpose of this report is to validate the actuarial results including the employer contribution rates provided by CalPERS for the Proposed Plan. The Proposed Plan is a defined benefit plan providing employees with a targeted retirement benefit equal to 2% of salary for each year of service at age 60 (“2% at 60 Plan”). A detailed summary of the proposed plan provisions can be found in Section II of this report. The actuarial valuation methods and assumptions used to validate the actuarial results were set to be equivalent to (or interpolated close to) those used by the CalPERS actuary. A detailed summary of the valuation methods and assumptions can be found in Section III of this report. The demographic and asset (employee account balance) information upon which the actuarial results were based were furnished by SDHC. A summary of the valuation data can be found in Section IV of this report. Section V of this reports provides a comparison of the results of our actuarial study to the results provided by the CalPERS actuary including the impact of an alternative CalPERS plan design. In addition, this section provides the results of a separate risk analysis study that we performed to identify the impact (particularly on the employer contribution rate) of various risk factors on the actuarial results. Finally, Section VI provides a commentary analysis of participants who are advantaged (immediately benefit or in the future benefit) versus those who are disadvantaged under the Proposed Plan.

SUMMARY OF FINDINGS

As noted above, Section V presents the major findings of our actuarial study. Section V-A provides a comparison of our results with those provided by the CalPERS action. Our results validate the CalPERS calculation of the employer contribution rate of 12% of payroll. Section V-B provides the results of implementing a 2% at 60 Plan using salary based on the average highest 3 consecutive years. V-C provides a comparison of the 2% at 60 Plan using salary based on the average highest 3 consecutive years vs. using salary based on the highest 1 year. Final 1-year salary plans are rarely seen in the private sector and there is a movement to final 3-years of salary plans in the public sector. In 2001, a study by NASRA on 76 retirement systems for state and school employees showed that the vast majority (89%) of public retirement plans are based on either the final 3-years (74%) or final-5 years (15%) of salary. Implementing a final 3-years of salary plan would reduce the employer contribution rate to about 11% of payroll.

Section V-D provides the impact of several risk factors associated with implementing the CalPERS defined benefit plan. The employer contribution rate of the Proposed Plan is affected by a number of factors including the plan provisions, the investment earnings, the actuarial methods and assumptions used in the valuation and the demographics of the employee population. Significant changes in any of these areas can result in a different employer contribution rate upon implementation as well as differing future employer contribution rates. Below are the components of the estimated impact on the employer contribution rate for the identified risk factors.

Risk Factor	Impact on Employer Contribution Rate
1% Decrease in Investment Earnings	Increase from 12% to 19%
1% Increase in Investment Earnings	Decrease from 12% to 7%
Choice of Funding Method (Allocation of cost to past service, current service and future service)	EAN Funding Method results in higher rate in early years vs. PUC Funding Method. (See chart on page 18)
<p>Anti-selection Against Proposed Plan (See Section VI)</p> <p>1) 35 employees who immediately benefit under the Proposed Plan elect the Proposed Plan</p> <p>2) 102 employees who immediately or ultimately benefit under the Proposed Plan elect the Proposed Plan</p>	<p>Increase from 12% to 16%</p> <p>Increase from 12% to 15%</p>
Plan Termination Liability	CalPERS would require payment of unfunded accrued liability on plan termination basis. Estimated to be approximately \$4.2 million on plan termination basis.

ADDITIONAL COMMENTARY

Implementation of a defined benefit plan in place of a defined contribution plan will shift the risk associated with providing retirement benefits from the employee to the employer. Under a defined benefit plan, the employer must fund the benefits promised. If the money set aside for these benefits does not generate sufficient interest, the employer must increase its funding. In general, defined benefit plans typically earn a higher earnings rate than defined contribution plans due primarily to the use of professional investment advisors. However, more and more defined contribution plans are implementing access to professionally managed accounts for their employees. The historical investment earnings for CalPERS can be found in Appendix A.

In addition to investment risks, a defined benefit plan is subject to demographic risks such as participants living longer than expected and receiving higher benefits than expected. CalPERS has established risk pooling for smaller employer groups to help smooth out the fluctuation in the employer contribution rate due to demographic risks. Participation in the risk pool will not lower the employer contribution rate in the first year but over time may help to smooth fluctuations due to demographic risks. If an employer remains an ongoing plan this may lower ultimate plan cost. Risk pooling is required for plans with less than 100 participants and is voluntary for other smaller plans. A summary on risk pooling can be found in Appendix B.

Ultimately if a plan is unable to sustain the ongoing cost of the defined benefit plan, a plan could terminate its contract with CalPERS. The plan would be required to fund any unfunded termination liability. A summary on the termination of a contract with CalPERS can be found in Appendix C. In order to ensure adequate termination funding, a plan can regularly monitor the funded status of its plan on a plan termination basis.

SECTION II
SAN DIEGO HOUSING COMMISSION
Proposed Plan Provisions

PLAN EFFECTIVE DATE

October 31, 2004.

ELIGIBILITY

All full-time employees shall be eligible to join the Plan on the first day of any month, provided they have completed one year of continuous service and agreed to make the mandatory employee contributions. Elective officials are also eligible to join the Plan.

MANDATORY EMPLOYEE CONTRIBUTIONS

Each employee shall be required to contribute 7% of his monthly earnings in order to participate in this Plan.

Such contributions shall, at all times, be fully vested in the participant and shall be credited with interest at the rate of 6%, compounded annually.

NORMAL RETIREMENT DATE

The first day of the month coinciding with or next following the attainment of age 60.

EARLY RETIREMENT DATE

A participant may elect Early Retirement, provided he has attained age 50, with at least five years of credited service.

DELAYED RETIREMENT DATE

The first day of any month after Normal Retirement Date. Benefits do not begin until actual retirement occurs. Benefits continue to accrue until actual retirement.

YEARS OF CREDITED SERVICE

The participant's years of employment with the Employer calculated in completed years and months. Part-time employee hours are calculated by dividing hours worked by 1,720.

AMOUNT OF NORMAL RETIREMENT PENSION

The monthly amount of pension payable to a participant at the Normal Retirement Date shall be equal to the larger of (a) or (b):

- a. The product of 2.0% of the participant's Final Average Monthly Earnings (FAME) and Years of Credited Service.
- b. The benefit due to accumulated contributions including contributions from the prior plan.

FAME is defined as the average of the participant's highest 12 consecutive months' full-time equivalent monthly pay, excluding overtime.

AMOUNT OF EARLY OR LATE RETIREMENT PENSION

The monthly benefit payable at Early Retirement Date or Delayed Retirement Date shall be equal to the larger of (a) or (b):

- a. The product of the following benefit rate times the participant's Final Average Monthly Earnings (FAME) and Years of Credited Service

<u>Age at Retirement</u>	<u>Benefit Rate</u>	<u>Age at Retirement</u>	<u>Benefit Rate</u>
50	1.092%	57	1.650%
51	1.156%	58	1.758%
52	1.224%	59	1.874%
53	1.296%	60	2.000%
54	1.376%	61	2.134%
55	1.460%	62	2.272%
56	1.552%	63 & older	2.418%

- b. The benefit due to accumulated contributions including contributions from the prior plan.

NORMAL FORM OF PENSION

Life Annuity with Modified Cash Refund.

OPTIONAL FORM OF PENSION

The following options are available for Normal, Early or Delayed Retirement:

Joint and Survivor Annuity (either 50%, 75% or 100% continuation) or any other form permitted by PERS Board.

COST-OF-LIVING ADJUSTMENT

Provided the Plan has not terminated, a participant whose pension is being paid shall have his pension subject to a cost-of-living adjustment of 2% compounded annually each year, beginning with the second calendar year after the year of retirement. The cumulative adjustment may not exceed the cumulative change in the Consumer Price Index since retirement.

DEATH BENEFIT

Before Retirement. In the event of death after termination of employment with all CALPERS employers, the sole benefit payable to the participant's designated beneficiary shall be the return of the participant's accumulated Employee Contributions with interest at 6%. In the event of a participant's death while employed with any CALPERS Employer, his beneficiary may choose one of the following benefits:

- a. *Basic Death Benefit* – The beneficiary (or the estate) shall be entitled to receive, a lump sum in the amount of the participant's accumulated Employee Contributions with interest at 7.75% plus a lump sum of one month's salary for each completed year of credited service (to a maximum of 6 years). The salary rate is the average monthly full-time rate of compensation during the 12 months preceding death.
- b. *1957 Survivor Benefit* – The eligible survivor (the spouse if married for at least one year, or, if no spouse, the unmarried children under age 18) of an employee who had attained age 50 and has at least five Years of Credited Service is entitled to receive one-half of the unmodified service allowance. The benefit ends at remarriage or the children's attainment of age 18. The spouse may elect a reduced amount that does not end at remarriage. The total amount paid must be at least equal to the basic Death Benefit.
- c. *Special Death Benefit* - The eligible survivor (the spouse, or, if no spouse, the unmarried children under age 22) of an employee of the San Diego Housing Commission whose death is job-related is entitled to receive 50% of final monthly compensation. The benefit increases at the same rate salary increases for that job classification until the employee would have attained age 50. The benefit ends at the death of the surviving spouse, then continues to any unmarried children's attainment until age 22. If the member's death is the result of accident or injury caused by external violence incurred in the performance of the member's duty, and there are eligible surviving children (unmarried and under age 22) in addition to an

eligible spouse, then an additional monthly allowance is paid equal to the following:

1 eligible child	12.5% of final monthly compensation
2 eligible children	20.0% of final monthly compensation
3 or more eligible children	25.0% of final monthly compensation

The total amount paid must be at least equal to the basic Death Benefit.

After Retirement. A one-time payment of \$500 plus the survivor portion if a Joint and Survivor Annuity was elected at retirement.

TERMINATION BENEFIT

In the event a participant's employment with the Employer is terminated prior to his eligibility for Normal Retirement or Early Retirement for any reason other than his death or disability and he leaves his contributions on deposit, he will receive the vested percentage of his accrued benefit, based on the following schedule:

<u>Completed Years of Credited Service</u>	<u>Percentage Vested</u>
Less than 5	0%
5 or more years	100%

A participant may receive a refund of his Employee Contributions plus accumulated interest in lieu of any other benefit.

DISABILITY BENEFIT

Upon a participant's termination of employment as a result of disability and after completing five years of service, he shall be entitled to the largest of (a), (b) or (c):

- a. The product of 1.8% of the participant's Final Average Monthly Earnings (FAME) and Years of Disability Service. Years of Disability Service equals Years of Credited Service plus the additional number of years that the member would have worked until age 60, not to exceed a total of 18.518 years. For members with less than 10 or more than 18.518 Years of Credited Service, Years of Disability Service equals Years of Credited Service
- b. The benefit due to accumulated contributions including contributions from the prior plan.
- c. Retirement benefit accrued to date of disability.

SECTION III

SAN DIEGO HOUSING COMMISSION

Valuation Methods and Actuarial Assumptions

Actuarial Cost Method

The actuarial cost method used in this actuarial valuation is the Entry Age Normal Actuarial Cost Method (Level Percent of Pay). Under this method, the actuarial present value of projected benefits of each individual included in the actuarial valuation, is allocated on a level basis over the earnings of the individual between entry age and assumed date of termination due to death, disability, turnover and retirement. The portion of this actuarial present value allocated to a valuation year is called the Normal Cost. The portion of this actuarial present value not provided for at the valuation date by the present value of future normal costs is called the Actuarial Accrued Liability. Under this method, actuarial gains (losses), as they occur, reduce (increase) the Unfunded Actuarial Accrued Liability.

Any changes in liability due to plan amendments, changes in assumptions, or methodology are amortized separately over a 20-year period. Experience gains and losses are accumulated and 10% of the net unamortized gain or loss is amortized each year. If the Actuarial Accrued Liability exceeds the actuarial value of assets, the annual contribution with respect to the total unfunded liability may not be less than the amount produced by a 30-year amortization of the Unfunded Actuarial Accrued Liability.

Valuation of Assets

The transferred account balances (net of voluntary employee contributions) at August 30, 2004, with expected interest to October 31, 2004 were used as the assets of the Plan for cost purposes.

The Expected Value of Assets is the prior year Actuarial Value of Assets brought forward with contributions received, benefits paid, and expected interest. The Actuarial Value of Assets is the Expected Value of Assets plus one-third of the difference between the actual market value of assets and the Expected Value of Assets at the valuation date. The actuarial value of the Plan's assets will be adjusted so as not to be less than 90% nor more than 110% of the actual market value of the Plan's assets as of the current valuation date.

Actuarial Assumptions

The following actuarial assumptions were used in performing the valuation:

Mortality - In accordance of the following tables:

<u>Age</u>	<u>Pre-Retirement Mortality</u>		<u>Job-Related Mortality</u>
	<u>Male</u>	<u>Female</u>	<u>Male and Female</u>
20	0.00019	0.00009	0.00003
25	0.00027	0.00014	0.00007
30	0.00038	0.00021	0.00010
35	0.00054	0.00031	0.00013
40	0.00077	0.00046	0.00017
45	0.00110	0.00068	0.00020
50	0.00156	0.00102	0.00023
55	0.00221	0.00151	0.00027
60	0.00314	0.00226	0.00030

Post-Retirement Mortality

<u>Age</u>	<u>Healthy Recipients</u>		<u>After Disablement</u>	
	<u>Male</u>	<u>Female</u>	<u>Male</u>	<u>Female</u>
50	0.00245	0.00136	0.01459	0.01129
55	0.00429	0.00253	0.02115	0.01481
60	0.00721	0.00442	0.02870	0.01884
65	0.01302	0.00795	0.03617	0.02356
70	0.02135	0.01276	0.04673	0.03020
75	0.03716	0.02156	0.06552	0.04298
80	0.06256	0.03883	0.09481	0.06514
85	0.10195	0.07219	0.14041	0.10269
90	0.17379	0.12592	0.20793	0.16189
95	0.25917	0.21773	0.30792	0.25522
100	0.34724	0.32036	0.45599	0.40236

Termination of Employment – In accordance with the following tables:

Duration of Service	<u>Termination and Refund of Employee Contributions</u>					
	Entry Age	Entry Age	Entry Age	Entry Age	Entry Age	Entry Age
	<u>20</u>	<u>25</u>	<u>30</u>	<u>35</u>	<u>40</u>	<u>45</u>
0	0.1760	0.1691	0.1622	0.1553	0.1483	0.1414
1	0.1561	0.1492	0.1423	0.1353	0.1284	0.1215
2	0.1362	0.1293	0.1224	0.1154	0.1085	0.1016
3	0.1163	0.1094	0.1025	0.0955	0.0886	0.0817
4	0.0964	0.0895	0.0826	0.0756	0.0687	0.0618
5	0.0283	0.0257	0.0232	0.0206	0.0181	0.0155
10	0.0184	0.0161	0.0139	0.0117	0.0095	0.0073
15	0.0120	0.0102	0.0083	0.0064	0.0046	0.0027
20	0.0073	0.0057	0.0041	0.0025	0.0009	0.0002
25	0.0034	0.0022	0.0009	0.0002	0.0002	0.0002
30	0.0010	0.0002	0.0002	0.0002	0.0002	0.0002

Duration of Service	<u>Termination - Employee Contributions Left on Deposit</u>				
	Entry Age	Entry Age	Entry Age	Entry Age	Entry Age
	<u>20</u>	<u>25</u>	<u>30</u>	<u>35</u>	<u>40</u>
5	0.0482	0.0439	0.0395	0.0351	0.0307
10	0.0390	0.0343	0.0296	0.0249	0.0000
15	0.0326	0.0274	0.0224	0.0000	0.0000
20	0.0245	0.0192	0.0000	0.0000	0.0000
25	0.0156	0.0000	0.0000	0.0000	0.0000
30	0.0000	0.0000	0.0000	0.0000	0.0000

Disablement

<u>Age</u>	<u>Male</u>	<u>Female</u>
20	0.0001	0.0001
25	0.0002	0.0002
30	0.0002	0.0004
35	0.0008	0.0010
40	0.0015	0.0016
45	0.0024	0.0023
50	0.0037	0.0035
55	0.0049	0.0041
60	0.0055	0.0039

<u>Age</u>	<u>Retirement Rates</u>					
	<u>5 Years</u>	<u>10 Years</u>	<u>15 Years</u>	<u>20 Years</u>	<u>25 Years</u>	<u>30 Years</u>
50	0.0085	0.0120	0.0146	0.0165	0.0184	0.0206
51	0.0059	0.0082	0.0100	0.0113	0.0126	0.0142
52	0.0092	0.0129	0.0157	0.0178	0.0198	0.0222
53	0.0104	0.0146	0.0177	0.0200	0.0224	0.0251
54	0.0109	0.0154	0.0187	0.0211	0.0236	0.0264
55	0.0198	0.0279	0.0339	0.0383	0.0427	0.0479
56	0.0181	0.0254	0.0308	0.0348	0.0389	0.0436
57	0.0208	0.0292	0.0354	0.0400	0.0447	0.0501
58	0.0262	0.0368	0.0447	0.0505	0.0564	0.0632
59	0.0335	0.0471	0.0572	0.0646	0.0721	0.0809
60	0.0615	0.0865	0.1051	0.1187	0.1325	0.1485
61	0.0628	0.0883	0.1073	0.1212	0.1353	0.1517
62	0.1258	0.1767	0.2147	0.2426	0.2708	0.3036
63	0.1263	0.1775	0.2156	0.2436	0.2720	0.3049
64	0.0972	0.1366	0.1659	0.1875	0.2093	0.2346
65	0.1731	0.2432	0.2955	0.3339	0.3727	0.4178
66	0.0946	0.1330	0.1616	0.1825	0.2038	0.2284
67	0.1272	0.1787	0.2171	0.2453	0.2738	0.3069
68						
69						
70						

Interest to be Earned on the Fund – 7.75% per annum, compounded annually, net of expenses.

Compensation Increases – For purposes of the unfunded liability, compensation is projected at 3.25% for all participants. Salary for the Plan Year is assumed to be the salary during the Plan Year ending on the valuation date increased with salary scale for one year. For other purposes, assumed future salary increases are in accordance with the following table (numbers interpolated for years not shown).

<u>Public Agency Miscellaneous</u>			
<u>Duration of Service</u>	<u>Entry Age 20</u>	<u>Entry Age 30</u>	<u>Entry Age 40</u>
0	0.1445	0.1265	0.1005
1	0.1215	0.1075	0.0875
2	0.1035	0.0935	0.0775
3	0.0905	0.0825	0.0695
4	0.0805	0.0735	0.0635
5	0.0725	0.0675	0.0585
10	0.0505	0.0485	0.0435
15	0.0455	0.0435	0.0385
20	0.0415	0.0395	0.0355
25	0.0365	0.0365	0.0345
30	0.0325	0.0325	0.0325

Social Security - The employees are not covered by Social Security.

Benefit Limitations and Inflation - Future increases in statutory benefit amounts and Plan compensation limits are projected at 3% per year.

Retirement - Participants were assumed to refund immediately if non-vested, retire immediately if eligible or retire at earliest retirement age if not eligible.

Marital Status - 85% of the participants are assumed to be married; female spouses are assumed to be three years younger than the male spouses.

Cost-of-Living Adjustments – 2% per year.

Expenses - Current year administrative and investment expenses are assumed to be ½ of 1% of the asset balance on the valuation date.

Valuation Date – October 31, 2004

Entry Age - For purposes of calculating the entry age normal accrued liability, entry age is assumed to be the hire age.

Inflation – 3%

SECTION IV
SAN DIEGO HOUSING COMMISSION
Valuation Data

The valuation was performed on the basis of the employee data including accumulated assets (employer contributions) for each participant furnished by SDHC. The following table shows the composition of the employee group and accumulated assets used in the valuation:

Active participants:	234
Terminated participants with deferred vested benefits:	
Retired participants:	
Total participants included in valuation:	234
Total assets (accumulated employer contributions) assumed transferred:	\$19,107,480

SECTION V
SAN DIEGO HOUSING COMMISSION

Valuation Results

A. **Preliminary Study Results:** Below are the results of the actuarial valuation of the Proposed Plan (2% at 60 benefit) based on the plan provisions outlined in Section II, Proposed Plan Provisions and determined using the valuation methods and actuarial assumptions outlined in Section III. A comparison to the results of the CalPERS valuation is also shown below.

	<u>Epler</u>	<u>CalPERS</u>	<u>Variance > 1%</u>
Members Included in Valuation			
- Active Members	234	234	
- Transfers	0	0	
- Vested Terminations		0	
- Receiving Payments	<u>0</u>	<u>0</u>	
- Total	234	234	
Annual Covered Payroll	\$11,403,295	\$11,403,295	
Average Annual Pay	\$48,732	\$48,732	
Average Attained/Entry Age for Actives	45.74/35.82	45.77/35.62	
Present Value of Projected Benefits	\$38,606,352	\$38,974,724	
Development of Unfunded Actuarial Accrued Liability			
Entry Age Normal Accrued Liability	\$26,080,740	\$25,859,943	
Actuarial Value of Assets	<u>\$19,107,480</u>	<u>\$19,107,480</u>	
Unfunded Actuarial Accrued Liability (UAL)	\$ 6,973,260	\$6,752,463	\$ 220,797/+3.3%
Employer Contribution Required (in projected dollars)			
- Payment for Normal Cost	\$ 701,054	\$ 700,961	
- Amortization of UAL	<u>\$ 696,549</u>	<u>\$ 687,658</u>	\$8,891/+1.3%
- Total	1,397,603	\$1,388,619	
Employer Contribution Required (as percent of projected payroll)			
- Payment for Normal Cost	6.15%	6.15%	
- Amortization of UAL	<u>6.11%</u>	<u>6.03%</u>	
- Total	12.26%	12.18%	

Note: UAL is amortized over the future working lifetime of the SDHC active employees.

B. **Alternative Plan Design:** Below are the results of the actuarial valuation of an alternative CalPERS plan design (“Alternative Plan”) using Final Average Monthly Earnings (FAME) equal to the average final highest 36 months (“FAME – 3 Years”). These results are also based on the valuation methods and actuarial assumptions outlined in Section III.

	<u>Alternative Plan FAME – 3 Years</u>
Members Included in Valuation	
- Active Members	234
- Transfers	0
- Vested Terminations	0
- Receiving Payments	<u>0</u>
- Total	234
Annual Covered Payroll	\$11,403,295
Average Annual Pay	\$48,732
Average Attained/Entry Age for Actives	45.74/35.82
Present Value of Projected Benefits	\$37,361,560
Development of Unfunded Actuarial Accrued Liability	
Entry Age Normal Accrued Liability	\$25,230,116
Actuarial Value of Assets	<u>\$19,107,480</u>
Unfunded Actuarial Accrued Liability (UAL)	\$ 6,122,636
Employer Contribution Required (in projected dollars)	
- Payment for Normal Cost	\$ 651,344
- Amortization of UAL	<u>\$ 611,581</u>
- Total	\$1,262,925
Employer Contribution Required (as percent of projected payroll)	
- Payment for Normal Cost	5.71%
- Amortization of UAL	<u>5.37%</u>
- Total	11.08%

Note: UAL is amortized over the future working lifetime of the SDHC active employees.

C. Proposed Plan vs. Alternative Plan: Below is a comparison of the employer contribution rate for providing benefits under the Alternative Plan: FAME – 3 Years versus the Proposed Plan: FAME - 1 Year.

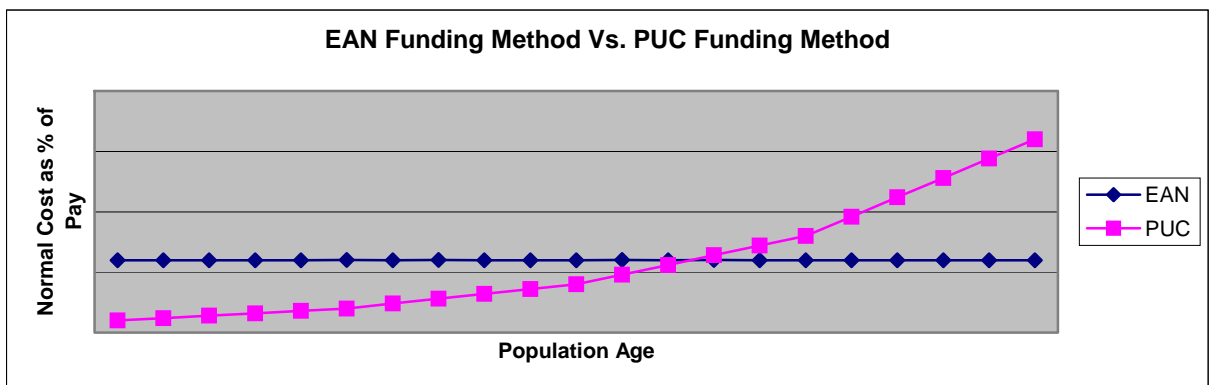
	<u>Proposed Plan</u> <u>FAME – 1 Year</u>	<u>Alternative Plan</u> <u>FAME – 3 Years</u>	<u>Decrease</u>
Normal Cost (Dollar Amount/Percent of Payroll)	\$ 701,054 6.15%	\$ 651,344 5.71%	\$ (49,710) (0.44%)
Amortization of Unfunded Accrued Liability (Dollar Amount/Percent of Payroll)	\$ 696,549 6.11%	\$ 611,581 5.37%	\$ (84,968) (0.74%)
Total Employer Contribution (Dollar Amount/Percent of Payroll)	\$1,397,603 12.26%	\$1,262,925 11.08%	\$(134,678) (1.18%)

D. Risk Analysis: The employer contribution rates of the Proposed Plan are affected by a number of factors including the plan provisions, the investment earnings, the actuarial methods and assumptions used in the valuation and the demographics of the employee population. Significant changes in any of these areas can result in a different employer contribution rate upon implementation as well as differing future employer contribution rates. In addition, if employees have the option to remain in the Current Plan, employees may select against the Proposed Plan (i.e. the employees will select that plan that is most advantageous to them and usually more costly to the employer). This anti-selection can result in employer contribution rates different than those presented above. Finally, if the Proposed Plan were to terminate, the SDHC would need to satisfy the entire unfunded plan liability at termination. The determination of this amount would be based on what is typically referred to as the plan termination liability. The plan termination liability would be equal to the present value of accrued benefits based on a participants credited service and salary at the plan termination date. The unfunded amount would be equal to the plan termination liability less the market value of assets at the plan termination date. This amount can differ substantially from the unfunded accrued liability determined for funding (establishment of employer contribution rate) purposes. Provided below are the components of the estimated impact on the employer contribution rate for the identified factors.

1) 1% Change in Investment Earnings: CalPERS currently uses a 7.75% investment earnings assumption to determine the employer contribution rate for the Proposed Plan. The impact on the employer contribution rate upon implementation of the Proposed Plan of a 1% decrease and a 1% increase in the investment earnings rate is shown below.

	<u>1% Decrease</u>	<u>1% Increase</u>
Normal Cost (Dollar Amount/Percent of Payroll)	\$ 351,629/+3.08%	(\$274,440)/-2.41%
Amortization of Unfunded Accrued Liability (Dollar Amount/Percent of Payroll)	\$ 379,726/+3.33%	(\$321,919)/-2.82%
Total Employer Contribution (Dollar Amount/Percent of Payroll)	\$ 731,355/ +6.41%	(\$596,359)/-5.23%

2) Choice of Funding Method: The total cost of the Proposed Plan under the valuation methods and assumptions in Section III is measured by the present value of projected benefit. The choice of funding method used determines how much of the total cost is allocated to the past (referred to as the actuarial accrued liability), how much is allocated to the current year (referred to as the normal cost) and how much is left to be funded by future normal costs. The unfunded accrued liability represents the amount of the actuarial accrued liability that has not been funded for (actuarial accrued liability less market value of assets). CalPERS uses the Entry Age Normal (EAN) funding method which allocates the present value of benefits as a percent of payroll. This funding method typically provides a more stable normal cost (as a percent of payroll) as a group ages than other funding methods. The graph below shows a comparison of the EAN to an alternative funding method the Projected Unit Credit (PUC). The PUC funding method begins at a lower rate but increases over time as a population ages. Alternative funding methods would be available to the SDHC under an individually designed and administered plan.



3) Anti-Selection Against the Proposed Plan Offering: The impact on the employer contribution rate if there is selection against the Proposed Plan is shown below assuming the 14% employer contribution under the Current Plan continues and assuming the employer contribution is decreased under the Current Plan to 12%.

a. The results below assume that 35 employees (See Section VI) who immediately benefit under the Proposed Plan elect to participate in that plan:

	14% <u>Contribution</u>	12% <u>Contribution</u>
Normal Cost (For 35 Employees) Under Proposed Plan	\$ 175,800	\$ 175,800
Amortization of Unfunded Accrued Liability (For 35 Employees) Under Proposed Plan	\$ 335,087	\$ 335,087
Employer Contribution (For 199 Employees) Under Current Plan (Based on \$9,171,401 Payroll)	\$1,283,996	\$1,100,568
Total Employer Contribution	\$1,794,883	\$1,611,455
Total Payroll	\$11,403,295	\$11,403,295
Resulting Increase (Dollar Amount/Percent of Total Payroll)	\$397,280/ +3.5%	\$213,852/ +1.9%

b. The results below assume that 102 employees (See Section VI) who immediately or ultimately benefit under the Proposed Plan elect to participate in that plan:

	14% <u>Contribution</u>	12% <u>Contribution</u>
Normal Cost (For 102 Employees) Under Proposed Plan	\$ 379,293	\$ 379,293
Amortization of Unfunded Accrued Liability (For 102 Employees) Under Proposed Plan	\$ 415,085	\$ 415,085
Employer Contribution (For 132 Employees) Under Current Plan (Based on \$6,489,205)	\$ 908,489	\$ 778,705
Total Employer Contribution	\$1,702,867	\$1,573,083
Total Payroll	\$11,403,295	\$11,403,295
Resulting Increase (Dollar Amount/Percent of Total Payroll)	\$305,264/ +2.7%	\$175,480/ +1.5%

Note: The unfunded accrued liability is amortized over the average working lifetime of the entire employee group.

4) Plan Termination Liability: Below is a determination of the present value of the accrued benefit valued compared to the market value of assets (account balances under the Current Plan transferred to the Proposed Plan) as of the implementation date. The amount shown below does not include any contingency loads that CalPERS may require and is determined based on the plan provisions and valuation methods and actuarial assumptions in Section II and III.

Plan Termination Liability (Present Value of Accrued Benefit):	\$23,246,436
Market Value of Assets:	<u>\$19,107,480</u>
Unfunded Plan Termination Liability:	\$ 4,138,956

SECTION VI
SAN DIEGO HOUSING COMMISSION
Advantaged/Disadvantaged Analysis

Upon implementation of the Proposed Plan, the employer account balance for each participant under the Current Plan would be transferred to CalPERS. Each employee would be eligible to receive a return of these monies plus future employee contribution with interest in the event of their termination of employment prior to receipt of benefits. Depending on the age, service, and salary of each employee, the present value of the benefits provided under the Proposed Plan upon implementation may be larger than the account balance transferred for the employee. Employees whose present value of benefits under the Proposed Plan is greater than their account balance transferred under the Current Plan will immediately benefit under the Proposed Plan. Employees whose present value of benefits under the Proposed Plan is less than their account balance transferred under the Current Plan will not immediately benefit under the Proposed Plan. Some of these employees may ultimately benefit under the Proposed Plan (as they earn more service and salary credits).

An analysis was performed to determine the participants who are advantaged under the Proposed Plan based on the employee's current age, service, salary and account balance and based on their service, salary and account balances projected to an assumed retirement age of 60. The Proposed Plan accrued and projected benefits were based on the actuarial assumptions outlined in Section III. The Current Plan accrued benefit is based on the participant's current (as of 10/31/2004) account balance and the projected benefit is based on the assumption that the future employer contribution would be 12% of salary (a decrease from the past 14%), that the employee would contribute 7% of salary & the investment earnings would average 7.75% annually. We have analyzed the data and the following bullets provide information on how many participants who are advantaged (immediately benefit or in the future benefit) versus those who are disadvantaged under the Proposed Plan.

- 35 employees will immediately benefit from the Proposed Plan. Their present value of accrued benefit under the Proposed Plan is greater than their current account balance under the Current Plan. In general, these are older, longer service & higher paid employees.

- Of these 35 employees, 15 would continue to benefit under the New Plan based on their projected benefit payable at age 60 or older. The remaining 20 would ultimately benefit more from the Current Plan based on their projected benefit payable at age 60 or older.
- 187 employees will not immediately benefit from the Proposed Plan (their present value of accrued benefit under this plan is less than their current account balance under the Current Plan). In general, these are younger, shorter service and lower paid employees.
- Of these 187, 132 would continue to not benefit under the Proposed Plan based on their projected benefit payable at age 60 or older. The remaining 55 would ultimately benefit under the Proposed Plan.
- The above numbers exclude 12 new employees who currently have no account balance or service. In general, younger new employees will benefit under the Current Plan and older new employees will benefit under the Proposed Plan.

APPENDIX A

SAN DIEGO HOUSING COMMISSION

CalPERS Historical Investment Returns

2004	– 16.7%
2003	– 3.9%
2002	– (5.9%)
2001	– (7.2%)
2000	– 10.5%
1999	– 12.5%
1998	– 19.5%
1997	– 20.1%
1996	– 15.3%
1995	– 16.3%
1994	– 2.0%
1993	– 14.5%
1992	– 12.5%
1991	– 6.5%
1990	– 9.7%
1989	– 15.7%
1988	– 3.9%
1987	– 13.8%
1986	– 24.6%
1985	– 35.4%
1984	– (3.1%)
Average	– 11.3% (arithmetic); – 10.8% (geometric)

APPENDIX B

SAN DIEGO HOUSING COMMISSION

Risk Pooling Summary

CalPERS is implementing risk pools effective July 1, 2005 to mitigate the risks associated with providing defined benefit pension benefits. The purpose of risk pooling is to smooth out the employer contribution rate. Risk pooling will be required for plans with less than 100 active participants and is voluntary for other plans. Non-mandated plans will be allowed to join on a voluntary basis unless it would be harmful to the risk pool as determined by the CalPERS actuary. Once in a risk pool, a plan cannot leave the risk pool structure but can move from one pool to another depending on the benefits offered.

The risk pools are established based on the benefits provided (e.g. 2% of pay at 60 vs. 2% of pay at 55, etc.). Certain benefits are mandated for plans participating in a risk pool. These benefits will become effective on July 1, 2005, the day the first pooled contribution rates are applicable. The mandated benefits include spousal benefits, conversion of unused sick leave, employee paid credits for prior military and public service and death benefit based on local system service. All optional benefits will still be available to plans participating in the risk pools but a plan contracting for a more expensive optional benefit will be required to pay a surcharge in addition to the pool's rate. The amount of the surcharge will vary depending on the optional benefits provided by the participating plan. Optional benefits include use of 1-Year FAME, 3% COLA, 5% COLA and Post-retirement Survivor Allowance.

The implementation of the risk pools is done in a way that minimizes the impact on the employer contribution rates. The difference between the risk pool's normal cost and the individual plan's normal cost is phased in over a period of five years beginning in the second year. During the first year, the employer contribution rate will be almost identical to the non-pooled rate except for the impact, if any, of the required mandated benefits.

In addition, a side fund is established for each plan as it enters a pool. That side fund takes into account the assets and liabilities of the plan. The side fund is set equal to the surplus or unfunded liability of the stand alone employer plan at the time of joining a risk pool. All investment gains and losses on the side fund that exceed or fall below the assumed investment return shall be attributed to the risk pool. The side funds are amortized over time and either add to (if unfunded accrued liability) or subtract (if surplus assets) from the plan's employer contribution rate.

As risk pooling is currently under development at CalPERS, it is unclear what long term advantage there is to participating in a risk pool. If an employer remains under contract with CalPERS, the employer may experience smoothing of its annual cost and possibly lower its ultimate cost. However, if an employer were to terminate their contract with CalPERS, it is likely that they would be responsible for any underfunding specific to their own employees. CalPERS has not addressed the termination of pooled plans but indicated that terminating pooled plans would be treated the same as non-pooled plans.

An additional study would be necessary to determine the actual impact on the employer contribution rate if SDHC were to join a risk pool.

APPENDIX C

SAN DIEGO HOUSING COMMISSION

Plan Termination Summary

A participating employer can terminate its contract with CalPERS after 5 years in the CalPERS system. They must provide at least a one-year notice. A resolution giving notice of intention to terminate must be adopted by affirmative vote of two-thirds of the members of the governing body (either the Housing Authority or the Housing Commission Board, if Housing Authority delegates its sole discretion). Once an agency terminates the contract, the agency may not re-contract with CalPERS for 3 years.

Upon contract termination, CalPERS will determine if the participating employer is in an underfunded status versus an overfunded status. This calculation is not based on the actuarial liability determined under the funding method used for determining the employer contribution rate but is based on the present value of all accrued benefits at the time of termination. The present value is determined based on the assumed valuation interest rate at the time of termination. The accrued benefit is based on an employee's service and salary at date of termination (credit for unused sick leave – if provided as a benefit – only used if retirement effective no later than four months after the contract termination date). In addition, the accrued liability is loaded (currently around 7% according to the CalPERS actuary) to provide for any contingencies. This contingency load would include a contingency for future investment earnings.

Note: The employer can elect to have the benefit based on a higher pay rate if a participant later works for another CalPERS employer or reciprocal system.

If the plan is in an underfunded status (present value of accrued benefits is less than the market value of assets) at the time of the contract termination, the employer is required to pay the underfunded amount. The CalPERS actuary indicated that the underfunded amount could (depending on the facts and circumstances and subject to approval by CalPERS) be spread over a fixed number of years (recommended by the actuary and also subject to approval by CalPERS) but there would be an interest adjustment using the assumed valuation interest rate to the amount required.

When the plan terminates, participants not in receipt of benefits can withdraw accumulated employee contributions with interest but then forfeit other benefits under the plan - similar to what occurs when a participant terminates employment and elects to withdraw funds on deposit. For participants in receipt of benefits, the annual cost of living increase factor is frozen at the percentage applicable on the date of the contract termination. Current and future retirees will not be entitled to additional increases provided by legislation.

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January 6, 2005

To: Ad-Hoc Retirement Benefit Committee
San Diego Housing Commission

From: Robert K. Butterfield
Butterfield Schechter, LLP

Re: Decisions on Retirement Plan Choices

The Committee is weighing options on the choice between continuing its current Defined Contribution Plan at a 14% level vs. abandoning that Plan for new hires and “electing current Plan participants” in favor of becoming a CALPERS Member Agency at a “2%/60 level”.

RECOMMENDATION ON TIMING

The proposed effective date of any change - if the SDHC decides on a change - should be July 1, 2005. Why? The existing Defined Contribution Plan Year ends June 30, 2005. For technical reasons having to do with “anti-cutback” rules, and contractual benefit issues, the SDHC is committed to a 14% of compensation contribution for eligible participants through June 30, 2005. A prospective termination of that obligation could occur on July 1, 2005, “labor counsel permitting” (whenever I refer to “labor counsel permitting” I refer to labor/meet and confer issues outside the scope of my engagement).

The three alternatives under consideration as part of discussions with employees about benefits are as follows:

1. Continue with existing Plan post June 30, 2005.
2. Convert Existing Plan to CALPERS Program or your own self-created program - offering each existing participant a one-time irrevocable option to transfer existing account balance to CALPERS - to become the beginning balance in his/her CALPERS employee account. Past service for SDHC would be credited for CALPERS purposes. Those who

January 6, 2005
Page 2

elect not to convert to CALPERS would remain in the 14% DC Plan (and not join CALPERS).

3. Not convert existing Plan to CALPERS - freeze it for all who elect to join CALPERS - and those who join PERS have no "past service".

GENERAL OVERALL COMMENT

A conversion to a Defined Benefit Plan is about as major a decision as an organization can make in the area of providing retirement benefits. It is momentous and fraught with risks: monetary, political and conflict of interest. There are significant pros and cons - also other considerations I discuss below. I can, upon request, provide a supplemental attachment with a sampling of recent articles and editorials discussing public agency retirement benefit issues. The trend in the press and the public is toward converting defined benefit plans to defined contribution plans - and SDHC is considering the reverse.

I served as a member of the City of San Diego Pension Reform Committee - and we did explore the potential of recommending a Defined Contribution Plan to new hires. That was not our recommendation for a variety of reasons, but there was virtually no chance we would have recommended going from a Defined Contribution option to a Defined Benefit Plan.

COMMENT ON CALPERS vs. SELF-CREATED PROGRAM

A Defined Benefit Plan option could proceed with two choices (I assumed the SDCERS option was off the table):

1. CALPERS - this involves the 2%/60 option with the "Social Security Substitute". It is an all or nothing choice - no option for 1.8%/62 option. CALPERS has a limited menu of choices. CALPERS would place SDHC in its own risk pool - so the overall assets of other member agencies are not available to share risks. CALPERS has created a concept "risk pools" under which SDHC could elect to join a designated pool to share "actuarial risks" (turnover, mortality, etc.) but not investment risks. Added benefits enhancements are mandatory under this approach - with an associated cost exceeding 50 basis points.

Comment - A CALPERS' "risk pool" decision can be made at a later date. There does not appear to be any compelling reason to join a risk pool upon entering CALPERS and there is a measurable cost in doing so.

January 6, 2005
Page 3

Joining CALPERS allows piggy-backing on CALPERS' existing administration organization and investment counsel/approach. Joining CALPERS also facilitates reciprocity with other systems in recruitment (although this can work against SDHC in loss of employees taking CALPERS service to other agencies).

2. Create Your Own Plan - SDHC has a sufficient number of employees and funds involved to create its own Defined Benefit Plan. This could allow a 1.8%/62 benefit structure and provide more flexibility in funding - with this new Plan not bound to all of CALPERS actuarial assumptions. "Cons" include SDHC's increased involvement in investment decisions or hiring managers (it has none under DC Plan or CALPERS), risk that investments will underperform CALPERS return (could be better though), potentially greater administrative costs relative to CALPERS (as the Plan would have its own actuary, administrator and investment counsel), importantly the perceived popularity of CALPERS vs. a self-created plan with SDHC personnel, and lack of reciprocity options.

January 6, 2005
 Page 4

PROS AND CONS OF CHOICES

	<u>Defined Benefit Plan</u>	<u>Defined Contribution Plan</u>
Investment Risk and Benefit	100% on SDHC - Assumption of 7.75% interest on a go-forward is aggressive even with past PERS performance.	100% on Employees.
Contribution Percentage	7% employee <u>(after-tax) fixed</u> . 12/13% SDHC initially - increases or decreases in SDHC based on investment performance relative to CALPERS actuarial assumption (7.75%). Epler Company illustrates a potential 6%+- increase in contributions for every 1% <u>less</u> than 7.75% PERS yields.	14% fixed - 0% employee contribution (employees can save 7% extra on their own).
Employee Anti-Selection	Younger employees tend to be better off with DC Option - 14% SDHC <u>plus</u> 7% employee is favorable until an "age break point" (determinable by Epler Company). DB Plans accrue benefits at an accelerated rate in excess of 21% per year (if converted to annual accrual) after that "age break point."	Favors Younger Personnel.

January 6, 2005
Page 5

Employee
Anti-Selection

Participants with poor DC investment performance to-date will benefit by converting to PERS relative to those with above average performance. This can result in adverse selection - as those with above average performance may decide not to convert - depriving plan of actuarial surplus. Conversion bails out poor performance with no penalty. Conversion potentially penalizes above average performance.

Distribution Options

No lump sum option of all benefits -only amounts in employee contribution account - and participant walks away from post 7-1-2005 "SDHC funded" benefits (usually a foolish move).

100% of Plan account convertible to lump sum IRA rollover upon retirement.

Death Benefit

Death Benefit limited to CAL PERS benefit structure - if no spouse then the death benefit is only return of employee's account - no assurance participant's death benefits will equal "value" of total employee and SDHC contributions

100% of account balance (including SDHC contributions) goes to beneficiary

January 6, 2005
Page 6

Pay Raise	Results in immediate benefit increase - calculated on a present value lump sum basis-for number of employees - this "pay raise" should be considered in the decision process. There also is a potential pay <u>decrease</u> for younger employees who would normally be better off with a 14% DC contribution.	No hidden pay increase or decrease.
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Comment - A DC Plan works to the benefit of younger employees below a "calculable age." Workers younger than that age are usually better off with a DC Plan and workers over that age are better off with DB. Epler Company can comment on that age.

COMMENT ON AVERAGE COMPENSATION

The initial proposal envisioned use of "high one year compensation". This raises three concerns:

1. Pension "spiking" - One issue of note in public pension plans has been potential manipulation of pay to create a disproportionate one year high to artificially create a higher benefit. This issue is currently under investigation within the California Highway Patrol.

2. Cost Factors - Epler Company has determined costs are materially higher with "one year" vs. "three years".

3. Pension Reform Committee - The City Pension Reform Committee examined one year vs. three years and recommended "three years". Three years was determined to be the appropriate measure for the SDCERS - especially given no known major private sector plans use a one year average. The City Council has endorsed that recommendation for new hires. Adopting a PERS option with a one year option is contrary to the City's new direction with SDCERS and could entail political considerations.

Comments - A three year high average is consistent with the latest City Council policy.

January 6, 2005
Page 7

IMPLEMENTATION

The implementation procedures for a conversion for a change involve labor issues outside of my scope. Assuming labor negotiations result in conversion, the Government Code prescribes procedures for two Board votes with an intervening secret ballot election for employees. The Government Code prescribes issuing a summary of each plan as part of the ballot measure. We believe financial and other disclosures of the pros and cons of a selection are necessary to minimize the risk of later litigation over the decisions. A fully informed decision is important, along with advice for the individual employee to seek individualized advice relating to his/her decision. I envision a disclosure package with summaries of both plans, pros and cons along the lines of what I write about herein, and generalized financial information about the potential impact of a conversion on employees within specified age brackets with sample current DC account balances.

POTENTIAL CONDITIONAL IMPLEMENTATION

We have not been able to determine whether the Government Code allows the SDHC to approve a conversion conditioned on a specified sample group of employees opting to convert.

Epler Company has determined there is a cost of "adverse selection" if, the significant portion identified "as not likely to benefit from" in a conversion opt to stay with the DC Plan. Attorney General advice, informal or otherwise, could be sought as to whether SDHC can conditionally approve a conversion.

TERMINATION OF CALPERS

The Government Code also provides a mechanism to exit PERS. This potentially allows the SDHC a mechanism to convert back to a DC Plan. The mechanism does require SDHC to fully fund any deficit in past service and current funding, and realistically the "past service liability" upon inception of the conversion will still be significant at the end of an initial 5 year period (the past service liability is amortized over a longer period - more than 10 years). It is not realistic to expect the ability to exit after 5 years with a conversion back to a 14% DC option because the past service liability remains and is thereafter funded solely by SDHC without assistance from a 7% employee contribution. Epler Company can provide financial impact advice.

The exit allowed under the Government Code is tempered by significant concerns raised by existing case law with respect to the contractual origin of State employee

January 6, 2005
Page 8

retirement rights: SDHC employees are not state employees, but it is a state agency. The most prominent case in this area is "Legislature vs. March Fong Eu" Supreme Court of California. The Court ruled there was a contractual basis for maintaining Legislators who were in office upon passage of Proposition 140 as participants in the Retirement Plan for the balance of their legislative service. The Court indicated this contractual right extended to State employees in general.

Comment - There is a misconception among many State employees that the right is contained within the California State Constitution or Government Code. I could not find any evidence of this.

Comment 2 - It's rare in the private sector for the finding of a contractual basis of a right to remain a retirement plan throughout employment. Private sector employers are universally, except with labor agreements, allowed to reduce or terminate benefits on a prospective basis. Legislature vs. Eu held California law provides a contractual basis for a newly hired State employee's right to remain in CALPERS (or a comparable plan - whatever that is) for the balance of his/her career!

I have discussed the Legislature vs. Eu case with Robert Bell. The scope of the contractual right evidenced by the Eu case and defensive strategies to avert future contractual rights issues upon potential conversion from CALPERS back to a Defined Contribution Plan is within the purview of Robert Bell. I am unable to opine the SDHC can safely convert from CALPERS to a DC Plan without exposure under a contractual rights "Eu case" theory. Mr. Bell can counsel the SDHC on that issue and provide guidance as to the disclosures to employees and contractual provisions in employment contracts and labor agreements that can help preserve SDHC's option to convert out of CALPERS in the future.

ACTUARIAL STUDY

Epler Company has provided extensive actuarial analysis of the SDHC's options.

FUTURE LABOR NEGOTIATIONS

One could reasonably anticipate periodic attempts by employees or labor negotiators to increase benefits.

January 6, 2005
Page 9

CONCLUSION

A decision to convert from the current Defined Contribution Plan to CALPERS is a major one, shifting 100% of risk from the employees to the SDHC. All at a time when many respected investment advisors are skeptical of a diversified portfolio's ability to earn 8% plus annually over the next 10-15 years. This decision is also coming at a time when the concept of defined benefit plans for public employees is becoming more controversial as a result of public opinion, and because of concern over existing and projected deficits in pension funding.

It is likely a Proposition will make the ballot at a near future election to call for mandating use of DC Plans for new public sector employees. The popularity of this measure is unknown.

All of the pros and cons must be considered to help avert unforeseen surprises later.