



Memorandum

TO: BOARD OF ADMINISTRATION,
POLICE AND FIRE DEPARTMENT
RETIREMENT PLAN

FROM: Jennifer A. Maguire

SUBJECT: SEE BELOW

DATE: March 13, 2025

SUBJECT: LUMP SUM PAYMENT OF EMPLOYER PENSION AND OPEB CONTRIBUTIONS AND ESTABLISHMENT OF THE PREPAYMENT AMOUNT FOR FISCAL YEAR 2025-2026

RECOMMENDATION

The City elects to make a single lump-sum contribution towards the Police and Fire Department Retirement Plan (Plan) Tier 1 pension and Postemployment Healthcare Plan (OPEB) for Fiscal Year 2025-2026 on July 1, 2025. The City asks the Board of Administration (Board) request the Plan's actuary to calculate discounted contribution amounts using the current assumed rates of returns for Tier 1 pension payments and OPEB.

Additionally, the City requests the Board provide estimated Tier 1 pension and OPEB contribution amounts for FY 2026-2027 through and including FY 2029-2030, assuming the City will prepay either a single lump-sum contribution or a semi-annual contribution at the beginning of the period for future planning purposes.

BACKGROUND

Prior to fiscal year 2008-2009, the City made biweekly contributions to the Plan in conjunction with each payroll distribution. In some years after, the City has elected to pre-fund employer retirement contributions at the beginning of the fiscal year and has indicated the City's intent to make future lump-sum contributions as resources permit.

In September 2014, the Chief Investment Officer (CIO) for Retirement Services expressed concerns on behalf of the Boards' Investment Committees, to City staff, of potential investment risks associated with the prefunding, and created a framework for the retirement plans to

“incentivize the City to prefund contributions when market valuations are low and the economic cycle is in the early stages of expansion and create a disincentive for the City to prefund contributions when market valuations and/or economic expansions are beyond historic norms.”

March 13, 2025

Subject: Lump-Sum Payment of Employer Pension Contributions

Page 2

The Plan's legal counsel opined that, while Municipal Code Section 3.36.1590(C) allowed the City to elect the lump sum contribution option, the Board decides how to determine what is "actuarially equivalent" to the monthly or biweekly payment that would otherwise have been required. Subsequently, the Board adopted an incremental approach to reduce the discount rate by 15% to 45% to determine the actuarially equivalent on the basis of market valuation and the stage of economic cycle. The incremental approach was updated in February 2022 to include a third metric, Cyclically Adjusted Price/Earnings (CAPE) ratio.

ANALYSIS

Based on the Board's action on March 6, the City expects the Board to approve the City to pre-pay based on a discount of 5.631% for Tier 1 pension contribution (6.625% with 15% haircut) and 5.10% for OPEB contribution (6.00% discount with 15% haircut). Adjusted for an average life of one-half year, the prepayment values are discounted approximately by 2.815% on Tier 1 contributions (based on the current Discount Rate of 6.625% minus a 15% haircut) and 2.55% on OPEB contributions (based on the current Discount Rate of 6.00% minus a 15% haircut). Receipt of the contribution letters will allow the City to proceed with available funds for the timely prepayment on July 1, 2025.

In order to assess potential risks and continued prefunding financial feasibility and to manage investment liquidity for potential future prepayment dates, the City further requests a multi-year actuarial calculation, comparing regular contributions throughout the year and prefunding options of pension and OPEB for FY 2026-2027 through and including FY 2029-2030.

CONCLUSION

As stated in Section 3.28.940 of the San José Municipal Code, as amended by Ordinance No. 28332, the City Manager may opt to select the periodic basis on which City contributions to the retirement funds will be paid. A notice of intent to exercise this option, including the periodic basis selected and the payment date(s), is required to be provided to the Board on or before April 30 of the fiscal year prior to the fiscal year in which the City wishes to exercise the option. This memorandum serves as the City's "notice of intent" to pay a lump-sum contribution towards the Tier 1 Pension and OPEB costs for FY 2025-2026 on July 1, 2025. The City requests this be placed on the next available Board agenda.



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City Manager

For questions, please contact Qianyu Sun, Deputy Director of Finance, Debt & Treasury Management at (408) 535-7832.