

DATE ISSUED: January 21, 2005

REPORT NO. 05-023

ATTENTION: Honorable Mayor and City Council
Docket of January 25, 2005

SUBJECT: Payment of the Fiscal Year 2005 Retiree Health Care Balance

REFERENCE: Manager's Report No. 04-218, September 30, 2004

SUMMARY

Issue –

1. Should the Appropriation Ordinance be amended to increase General Fund and Non-General Fund appropriations to provide funding for the payment of the remaining Fiscal Year 2005 retiree health care balance?
2. Should the Mayor and City Council approve the payment of the remaining Fiscal Year 2005 retiree health care balance by City Departments proportionally based upon the number of eligible employees?

Manager's Recommendations –

1. Amend the Appropriation Ordinance to increase General Fund and Non-General Fund appropriations to provide funding for the payment of the remaining Fiscal Year 2005 retiree health care balance.
2. Approve the payment of the remaining Fiscal Year 2005 retiree health care balance by City Departments proportionally based upon the number of eligible employees. Increase the General Fund Revenue appropriation by \$4.1 million to budget for the payment of the General Fund's share of the Fiscal Year 2005 retiree health care balance.

Estimated Fiscal Impact: The fiscal impact of the City Manager's recommendation to pay the Fiscal Year 2005 retiree health care balance is estimated to be \$6.5 million, of which approximately \$4.1 million is from General Fund departments and approximately \$2.4 million is from Non-General Fund departments. The exact amount will be determined at the end of the fiscal year based upon actual retiree health premiums.

BACKGROUND

In the City Manager's Report 04-218, dated September 30, 2004, the City Manager discussed support of the recommendation from the Pension Reform Committee that retiree health care benefits no longer be funded in a manner that reduces assets of the retirement fund. Based upon current projections of monthly health care insurance premiums, the cost of retiree health care is estimated to be \$14.4 million for Fiscal Year 2005. The balance remaining in the 401(h) health care trust fund is approximately \$7.9 million, which will be exhausted mid-January 2005, leaving an estimated \$6.5 million to be covered by other sources for retiree health care costs. It is recommended that this amount be paid by city departments proportionally based upon the number of eligible employees.

Estimated Fiscal Year 2005 Retiree Health Care Cost Data

Fiscal Year 2005 retiree health care cost	\$14.4 million
Retiree health care trust fund 401(h) amount	\$ 7.9 million
Remaining FY 2005 retiree health care balance	<u>\$ 6.5 million</u>

Remaining balance breakdown by fund

General Fund	\$4.1 million
Non - General Funds	<u>\$2.4 million</u>
	\$6.5 million

Major Non – General Funds' share of remaining balance

Development Services	\$323,515
Environmental Services	\$206,604
General Services	\$340,836
Metropolitan Wastewater	\$575,895
Water	\$512,800
Other Non – General Fund Departments	<u>\$440,350</u>
Total	\$2,400,000

DISCUSSION

The Municipal Code currently provides that in years when San Diego City Employees' Retirement System (SDCERS) realized earnings are sufficient, a portion of the City's Employer Contributions be deposited into the 401(h) health care trust established to be used exclusively for eligible retiree's health care benefits. While this long term practice has been determined legal, in compliance with Internal Revenue Code, and one that is done in other governmental plans, the City Council directed the City Manager to recommend an alternative to this practice.

New contributions into the 401(h) have not occurred since Fiscal Year 2003 as earnings were not sufficient. As part of the settlement in City of San Diego vs. Gleason, \$130 million was paid

directly into the employer's reserve. The current Municipal Code states that retiree health care benefits will be paid from the 401(h) Fund until exhausted and then from the City directly from any source available.

By allocating the unfunded retire health care expenses proportionally by the number of eligible employees, the General Fund would pay approximately \$4.1 million and Non-General Fund departments would pay approximately \$2.4 million. This allocation methodology is the most reasonable approach for the city to share the cost for retiree health care as the current employee population carries the burden of funding the Retirement System. Additionally, city departments with the greatest number of budgeted staff will most likely have a greater number of retired employees. Conversely, spreading the cost proportionally by total department salary may not be as equitable as retiree health costs are not directly tied to departments' personnel expense or total department budgets.

The General Fund portion of approximately \$4.1 million could be paid using surplus General Fund revenues. As San Diego's economy continues to outperform both the State and national economies, due to the strength of the local economy, major General Fund revenues are projected to be over-budget by the end of the fiscal year. The projected surplus from these revenues will be sufficient to cover the General Fund's share of retiree health costs. The Non-General Fund portion of approximately \$2.4 million would be allocated to the respective departments and be paid using fund balances or reprioritizing appropriations. This action would authorize fund transfers via an amendment to the annual appropriations ordinance.

CONCLUSION

The total retiree health cost for Fiscal Year 2005 is approximately \$14.4 million. Of that amount, \$7.9 million will be paid from the retiree health care trust fund. The City Manager recommends the Mayor and City Council approve the estimated payment of the remaining Fiscal Year 2005 retiree health care balance of \$6.5 million be paid directly from City departments. The General Fund portion of the remaining retiree health care balance is approximately \$4.1 million and will be mitigated primarily by the use of over-budget Sales Tax proceeds. The estimated \$2.4 million Non-General Fund amount will be shared proportionally based on the number of eligible employees by Non-General Fund departments.

ALTERNATIVE

Do not accept the City Manager's recommendation to use over-budget revenue, expenditure savings or fund balances to fund the pension health care liability.

Respectfully submitted,

Mary Vattimo
Financial Management Director

APPROVED: P. Lamont Ewell
City Manager

LI/dmd