OFFICE OF COUNCILMEMBER TODD GLORIA
CITY OF SAN DIEGO

M E M O R A N D U M

DATE: September 12, 2012

TO: City Council

FROM: Councilmember Todd Gloria, Chair, Budget and Finance Committee Todd Gloria

SUBJECT: Letter from SDCERS

You recently received a letter dated September 7, 2012 from Mark Hovey, Chief Executive Officer of the San Diego City Employees' Retirement System (SDCERS). A copy of the letter is attached for your reference.

The content of Mr. Hovey's letter is critical for the financial health of the City of San Diego. Based on lower than anticipated investment returns and the impacts of Prop B, which was approved by voters in June 2012, the City's Annual Required Contribution (ARC) to SDCERS in Fiscal Year 2014 is estimated to be as much as $37 million higher than previously anticipated. The payment may be approximately $273.2 million.

As the Chair of the Budget and Finance Committee, I have worked diligently with my council colleagues, Mayor Sanders, and City staff to stabilize and strengthen San Diego's finances. Since 2008, our budget has gone from a deficit of more than $200 million to a surplus for Fiscal Year 2013. After years of budget cuts, our reform efforts, compensation agreements with City employees, managed competition savings, and the global economic recovery combined this year to make restoration of necessary services possible. It is imperative that we consider how this unanticipated expense may impact City services. Options for how to move forward must be considered carefully to ensure our hard work to balance the City's budget is not compromised.

The attached letter will be released to the general public as part of the September 26 Budget and Finance Committee agenda. Your comments, questions, and suggestions are welcome. Should more detailed information be requested, I will work with Mr. Hovey to schedule a presentation in October.

I look forward to working with you all to address this newest challenge proactively, intelligently, and efficiently. If you have any questions about this Budget and Finance Committee item, please contact Pam Ison, pison@sandiego.gov or x67787.

cc: Mayor Jerry Sanders
Mark Hovey, CEO, SDCERS

SDCERS
San Diego City Employees' Retirement System

Mark A. Hovey
Chief Executive Officer

September 7, 2012

Councilmember Todd Gloria
Chair, Budget and Finance Committee
City Council of the City of San Diego
202 C Street, MS #10A
San Diego, CA 92101

Reference: SDCERS FY 2012 Investment Returns and Implications to City FY 2014 ARC

Dear Councilmember Gloria:

You asked that I present the FY 12 SDCERS investment performance to the Budget and Finance Committee and the potential effect on the City's 2014 ARC payment. Both the Committee's schedule and my plans to be out of town at the end of the month are proving to be a challenge for me to present in person. So that you receive timely the information you need, I am sending you this letter with the information requested.

SDCERS recorded preliminary investment returns of 0.3% for the fiscal year ending June 30, 2012. Final investment returns will be available soon, but are not expected to change appreciably. Last month, SDCERS Chief Investment Officer Liza Crisafi sent you a letter with further details on the FY 2012 performance, and a copy of that letter is attached for your reference. As Liza noted, I would draw your attention to the positive track record at SDCERS regarding long-term investment performance. SDCERS ranks in the top 8% of public pension plans in investment performance according Hewitt EnnisKnupp's most recent fund performance report. SDCERS' long-term rates of return on an annualized basis over 10 years and 20+ years are 7.2%, and 8.9%, respectively.

SDCERS' actuary (Cheiron) most recently estimated the City's FY 2014 Annual Required Contribution (ARC) at $236.2 million, as reported in the June 30, 2011 actuarial valuation. The actuarial valuation for the year ending June 30, 2012 will be available in January 2013. Cheiron and I will be presenting the results to the City Council after the report has been approved by the SDCERS Board.

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Holding all other actuarial assumptions at their expected rates, the 0.3% return will result in an increase to the City's ARC of \$5 - \$10 million in FY 2014. Note that the actuarial valuation will address the actual versus expected experience of all assumptions, not just investment returns, and that the final ARC may be further increased or decreased based upon the complete results.

Cheiron will also take into account the passage of Prop B in the actuarial assumptions incorporated into the June 30, 2012 valuation. As documented in a letter from Cheiron to Independent Budget Analyst Andrea Tevlin in March 2012, the projected increase in FY 2014 ARC costs associated with the partially closed defined benefit plan are approximately \$27 million. This increase is in addition to an estimated increase in the ARC due to the investment performance discussed above.

I would be happy to address any further questions you may have regarding the City's ARC in FY 2014 and beyond, but the best opportunity for the Committee to receive a complete picture of the FY 14 ARC will be after the January 2013 timeframe when the actuary completes his valuation and projections.

Sincerely,

Mark A. Hovey

MAH/cj

Enclosure: August 16, 2012 Memo from Liza Crisafi to Plan Sponsors re: 2012 Investment Results

cc: Members of the City Council
Jay Goldstone, Chief Operating Officer
Mary Lewis, SDCERS Chief Financial Officer
Andrea Tevlin, Independent Budget Analyst
SDCERS Board of Administration

SDCERS

San Diego City Employees' Retirement System

DATE: August 16, 2012

TO: Plan Sponsors

FROM: Liza Crisafi, Chief Investment Officer Liza Crisafi

SUBJECT: SDCERS' Investment Report for the Year ended June 30, 2012

For the fiscal year ended June 30, 2012, SDCERS reported a preliminary return of 0.3%. The figure will be updated following the receipt of private market performance data for the system's real estate and private equity holdings.

The results were driven by volatile market conditions due to concerns of an economic slowdown in the U.S., uncertainty over the next presidential election, and a worsening European debt crisis.

While U.S. equity returns were positive, SDCERS' bias towards small capitalization stocks restrained returns as investors fled towards large capitalization stocks. Small cap stocks underperformed large cap stocks by nearly 7%. In addition, while SDCERS has transitioned nearly 50% of its equity exposure to passively managed index funds, the remaining active managers underperformed during the year. These factors were largely responsible for the underperformance of the portfolio versus the benchmark. As expected, international equities were the worst performing asset class; posting a one year return of -13.8%.

Stronger returns were realized in other asset classes. U.S. Fixed Income holdings were up 7.1%, Emerging Market Debt returns were up 5.6%, and preliminary real estate returns were 6.4%. Private Equity returns, when finalized, are also expected to be positive for the year.

Longer term performance continues to be strong with annualized returns of 7.2% for 10 years and 8.9% over 20+ years.

Attached is the investment report from Hewitt EnnisKnupp.