Summary and Answers to Frequently-Asked Questions about the June 30, 2008 Actuarial Valuation for the City of San Diego

SUMMARY

The June 30, 2008 Actuarial Valuation for the City of San Diego (the "2008 Valuation") incorporates the same methodology changes that were first reflected in the City's June 30, 2007 actuarial valuation, including the following:

(1) The use of the Entry Age Normal (EAN) actuarial funding method;

(2) A 20-year amortization period (19 years left) for the pay down of the City's June 30, 2007 Unfunded Actuarial Liability ("UAL");

(3) Full payment of the interest on the UAL to avoid any "negative amortization" of the UAL; and

(4) The use of the Expected Value of Assets asset smoothing method.

The 2008 Valuation also incorporates a number of new actuarial assumptions that were approved by the SDCERS Board of Administration in September 2008 that were based on an experience study completed by Cheiron in July 2008. These include the following:

(1) The assumed rates of retirement were increased and changed to be based on service as opposed to the age of a member;

(2) Rates of termination from employment were increased;

(3) Disability rates were decreased;

(4) The mortality rates for General and Safety members were increased;

(5) The investment return assumption was lowered from 8.00% to 7.75%; and

(6) The inflation assumption was lowered from 4.25% to 4.00%.

These are all important and positive changes. Taken together with the changes that were implemented in the City's June 30, 2006 Valuation (e.g., apportionment of assets based on individual cash flows attributable to each plan sponsor; recognition of "contingent" liabilities; proper treatment of disability payment liabilities; and removal of active members' future liabilities for payments projected to be in excess of IRC Section 415 limits), SDCERS has completed the transition to using the most widely-accepted, industry-standard actuarial methods used by public pension plans.

FREQUENTLY ASKED QUESTIONS

1. Based on the June 30, 2008 Actuarial Valuation for the City of San Diego (the "2008 Valuation") what is the City's 2008 Unfunded Actuarial Liability (UAL)?

Using the Entry Age Normal ("EAN") funding method, the City's UAL as of June 30, 2008 was $1,303.2 million. The UAL is split into several tiers comprised of: (1) the $1,205.9 million remaining balance of the City's June 30, 2007 UAL; (2) the $83.8 million UAL due to the impact of changes in actuarial assumptions; and (3) the $13.5 million UAL due to FY 2008 experience losses. *[See the 2008 Valuation at page 21.]*

2. How does the 2008 UAL compare to the 2007 UAL?

It is $119.0 million, or 10.0%, higher. The UAL at June 30, 2007 was $1,184.2 million *[See the 2008 Valuation Letter of Transmittal and the 2008 Valuation at page 3.]*

3. Why did the 2008 UAL increase?

The primary cause of the increase was the change in actuarial assumptions adopted by the SDCERS Board in July 2008. Theses changes included a decrease in the investment return assumption from 8.00% to 7.75%, a decrease in the inflation rate assumption from 4.25% to 4.00%, and other changes to the assumptions regarding membership turnover, retirement, disability, mortality and salary increases. FY 2008 actuarial investment losses were largely offset by gains in liability experience and member contributions. *[See the 2008 Valuation Letter of Transmittal and the 2008 Valuation at page 4.]*

4. What is the City's 2008 funding ratio?

As of June 30, 2008, the City's funding ratio, which is the ratio of the actuarial value of assets (after smoothing) over total actuarial liabilities, was 78.1%. *[See the 2008 Valuation Letter of Transmittal and the 2008 Valuation at page 3.]*

5. How does this compare to the City's 2007 funding ratio?

It is slightly lower. As of June 30, 2007, the City's funding ratio was 78.8%. *[See the 2008 Valuation Letter of Transmittal and the 2008 Valuation at page 3.]*

6. What is the City's Annual Required Contribution (ARC) for FY 2010? (The ARC is the amount the City will have to contribute to SDCERS on or after July 1, 2009.)

If paid in full in July 2009 as expected, the City's ARC for FY 2010 will be $154.2 million (approximately 26.7% of payroll). If the City pays the ARC evenly throughout FY 2010, the contribution will be $160.1 million (approximately 27.7% of payroll). *[See the 2008 Valuation Letter of Transmittal and the 2008 Valuation at page 5.]*

7. What was the City's ARC payment for FY 2009?

The City's FY 2009 ARC was $161.7 million, and it was paid in full on July 1, 2008. *[See the 2008 Valuation Letter of Transmittal and the 2008 Valuation at page 5.]*

8. Why did the FY 2010 ARC decrease but the UAL increase?

The City's FY 2010 ARC was reduced by $7.5 million, or 4.6%. While the UAL increase did cause a increase in the ARC payment ($7.3 million), it was offset by reductions to both the normal cost ($8.1 million) and the payment necessary to avoid any negative amortization ($6.7 million). *[See the 2008 Valuation at page 5.]*

9. How is the City's FY 2010 ARC calculated?

The City's employer contributions are composed of two components: the Normal Cost contribution and the UAL contribution.

Normal Cost represents, for each active City employee, the present value as of June 30, 2008 of the portion of the employee's projected retirement benefit assigned to FY 2010. By paying the Normal Cost, the City pays a level percentage of permissible salary to fund for the value of benefits over each participant's career. If paid at the beginning of FY 2010, the City's Normal Cost is $60.5 million.

The UAL portion of the employer contribution is an amount the City pays each year to pay down any unfunded liabilities accrued over past years. The UAL is paid-off ("amortized") over a period of years. The City's June 30, 2008 UAL of $1,303.2 million is split into several tiers, each using a different amortization period. These tiers are comprised of:

1. the $1,205.9 million remaining balance of the City's June 30, 2007 UAL now amortized over 19 years ($85.1 million of the FY 2010 ARC);

2. the $83.8 million UAL due to the impact of changes in actuarial assumptions that is amortized over 30 years ($4.8 million of the FY 2010 ARC); and

3. the $13.5 million UAL due to the FY 2008 experience loss that is amortized over 15 years ($1.2 million of the FY 2010 ARC). In addition, there is a $2.6 million payment included in the City's FY 2010 ARC to avoid any negative amortization of the June 30, 2008 UAL.

Adding the amortization amounts of each tier together and including the $2.6 million payment to avoid any negative amortization results in an FY 2010 UAL amortization payment of $93.7 million. *[See the 2008 Valuation at pages 1, 5, and 24.]*

10. What was the market value of SDCERS' Trust Fund on June 30, 2008, and what was the City's portion of this amount?

The market value of the assets in SDCERS' Trust Fund on June 30, 2008 was $4.697 billion. The City's portion of this amount was $4.409 billion. *[See the 2008 Valuation at page 15.]*

11. How does this compare to the June 30, 2007 market values?

They are 5% lower. The June 30, 2007 market value for the SDCERS Trust Fund was $4.953 billion, and the City's portion of the Trust Fund was $4.657 billion. *[See the 2008 Valuation at page 15.]*

12. Why did the market value of the City's portion of the Trust Fund decrease?

In FY 2008, the market value of the City's portion of Trust Fund assets decreased by $248 million. This decrease is almost entirely due to the decline in the market value of investments, net of investment income, of $236 million. This reflects an investment return of -4.66% for the year. *[See the 2008 Valuation at page 17.]*

Contributions from the City and from members totaled $233 million, largely offsetting payments made for benefits and administration that totaled $262 million.

The City's FY 2009 ARC payment of $161.7 million that was contributed in July 2008 will be reflected in the June 30, 2009 Valuation. *[See the 2008 Valuation at page 5.]*

13. What is the actuary's assumed investment return for the SDCERS Trust Fund?

For the 2008 Valuation, SDCERS' actuary assumes a long-term average investment return of 7.75% for Trust Fund assets. *[See the 2008 Valuation at page 43.]*

14. What were the annualized investment returns of Trust Fund assets?

SDCERS' annualized investment returns at market value for the one, three, five and ten-year periods ended June 30, 2008, as reported by Callan Associates, SDCERS' Investment Consultant, were -4.66%, 7.78%, 10.77% and 7.96%, respectively. Annualized investment returns are different from the actuarial rate of return calculated by the actuary (e.g., 6.24% for the year ending June 30, 2008) because the actuary computes the actuarial return using the Expected Value of Assets smoothing method. *[See the 2008 Valuation at pages 16 and 17.]*

15. Are the City's retiree health care expenses included in the 2008 Valuation?

No. Health care expenses are a separate obligation of the City, and they are not paid from retirement assets in the SDCERS Trust Fund.

16. What will the City's June 30, 2009 Valuation look like?

It is too early to tell.

Obviously, the current turmoil in the global financial markets has impacted SDCERS' investments just as it has every other institutional and individual investor. However, to keep current events in proper perspective, it is the fiscal year's final investment return as of June 30, 2009 that SDCERS' actuary will use to determine the City's Annually Required Contribution (ARC) for FY 2011, payable on or after July 1, 2010. Therefore, the market downturn since July 1, 2008 reflects only about half of SDCERS' fiscal 2009 year. Only when the fiscal year is concluded on June 30, 2009 and the ARC payment calculated, will the impact of the current market condition be known.