



# *Memorandum*

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**TO:** HONORABLE MAYOR  
AND CITY COUNCIL,  
FEDERATED BOARD AND  
POLICE AND FIRE BOARD

**FROM:** Jennifer A. Maguire  
Roberto L. Peña

**SUBJECT:** SEE BELOW

**DATE:** September 25, 2021

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**SUBJECT: JOINT STUDY SESSION: PENSION OBLIGATION FINANCING -  
RESPECTIVE ROLES AND RESPONSIBILITIES FOR  
POLICY DEVELOPMENT**

## **PURPOSE OF STUDY SESSION**

The purpose of this joint study session is to present and discuss the respective roles and responsibilities of the City Council and Retirement Plan Boards in policy development as the City Council evaluates issuing Pension Obligation Bonds (“POBs”) as an option to reduce the unfunded actuarial liabilities (“UAL”) in the Plans. The Study Session is intended to provide preparatory work that will enable the City Council and Retirement Plan Boards to make informed decisions about the policies they will formulate and adopt, should the City choose to issue POBs, and align all parties’ understanding of their respective roles to improve the funded status of the Plans.

## **DESIRED OUTCOME OF STUDY SESSION**

The City Council, Retirement Plan Boards, Administration, and stakeholders will begin an important dialogue among themselves and come away from this first meeting with a shared understanding of:

- (a) why addressing the UAL and its budgetary impact on the City and its two retirement plans remains an important shared objective of the City and the Retirement Boards;
- (b) the distinct respective roles of each of the parties;
- (c) the key considerations that each party will make that will impact the decisions of the other party and how those decisions can be adopted in policies; and
- (d) the workplan and timeline required for achieving key milestones.

## **BACKGROUND**

The City has been exploring options for controlling retirement costs including issuing POBs since at least 2007. In October 2007, Mayor Reed formed the Budget Shortfall Advisory Group (“BSAG”), and, in March 2008, the City Manager formed the General Fund Structural Deficit Task Force to support the work of BSAG. In November 2008, the City Manager released a report entitled “General Fund Structural Elimination Plan” which included a summary of strategies to eliminate the General Fund structural deficit. One of those potential strategies was the issuance of POBs. In March 2010 in the Mayor’s Budget Message, as approved by the City Council, the City Manager was directed to identify the potential benefits and drawbacks of POBs. In May 2010, the City Manager reported to the Council the conclusion of staff’s analysis:

- POBs were not a viable tool to address the 2010-2011 shortfall.
- If the Council wanted to assume the risk of financial loss from POBs, the general stock market conditions were not favorable.
- 6- to 12-month court validation action would have to be undertaken in 2010.
- It was imperative for Council to understand the market-volatility risks of POBs and potential financial losses to the City over the long term.
- These risks existed even with optimistic assumptions about the future average spread between bond interest costs and pension plan earnings.

Nine years later, Mayor Liccardo, as part of his March 2019 Budget Message for FY 2019-20 as approved by the City Council, recommended convening what became the Retirement Stakeholder Solutions Working Group (“RSSWG”) to address retirement fund resilience and explore options that would protect both employee benefits and the City’s ability to provide basic services through the next recession.

Between November 2019 and February 2021, the RSSWG met nine times. At the October 13, 2020 meeting, the Finance Department provided a presentation on POBs which included discussion of some of the important developments and changes in POB issuance since the City Council previously considered the option. On October 16, 2020 at the Joint meeting of the City Council and Retirement Boards, the Budget and Finance Departments provided a similar presentation on POBs.

On December 1, 2020 the City Council received a further presentation on POBs and directed the Administration to initiate the process for possible POB issuance by securing needed legal and advisory services and to conduct other preparatory work to enable the City Council to make a full informed decision in 2021, including a public Study Session, which was subsequently scheduled to occur in April.

The final report of the RSSWG was issued on April 2, 2021<sup>1</sup> which included exploration of various avenues to reduce the City’s unfunded pension liability; one option explored was POBs. The RSSWG’s conclusions were that POBs Feasibility was “Achievable”, Cost would be

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<sup>1</sup> <https://www.sanjoseca.gov/home/showpublisheddocument?id=71005>

“Determined over time”, Risk was “High”, and Difficulty was “Moderate”. Other than dedicating new taxes or existing revenues to pay retirement costs, (which were judged to be “unlikely” to be feasible and highly difficult), the POBs were the only other option deemed by the RSSWG to have a “Significant” Impact on the UAL.

On April 23, 2021, the City Council conducted a 4-hour Study Session on funding pension obligations, including hearing from various external experts and market participants. Following the Study Session, the Council met on May 11<sup>th</sup> and directed staff to begin the legal process for judicially validating POBs which could make the POBs an option for the City, if approved, but which does not commit the City to actual issuance of such bonds.

During the summer months, the Retirement Boards held several meetings that explored POBs. City staff returned to each Board and provided a presentation titled, *“Discussion of City staff’s objectives and approach to potential issuance of Pension Obligation Bonds”* in August and September respectively, in anticipation of this meeting.

Following this Study Session, the City Council will consider whether to file a judicial validation action in Santa Clara Superior Court to confirm that the City has authority to issue POBs to satisfy an obligation under law to fund the pension plan. A favorable judgment is required for the necessary opinions required for bond issuance. The court validation process can be lengthy, and the timing is not certain due to COVID and the potential that the complaint will be answered by a party or an appeal if litigated. The process could take more than 6 months. Given the uncertainty of what investment and bond market conditions may be that far in advance, staff would return to the City Council with detailed analysis of the proposed financing plan and issuance of POBs which may be issued in pieces or all at once. No bonds can be issued until the City Council has specifically reviewed and approved the offering document for such bonds known as an “Official Statement”. If bond or investment market conditions are not conducive to such a bond sale following final favorable judgment, staff would wait for improved market conditions before returning to the City Council for consideration of issuance.

While the validation is in process, staff intends to develop proposed pension funding policies for the City Council’s consideration. The proposed policies may include a combination of new policies and revisions to existing policies. Staff’s purpose in having such policies in place before issuance is to provide clarity to the Retirement Boards and other stakeholders of the City approach to pension funding and POBs.

### **SELECT RECENT MEETING HISTORY ON POBs**

- October 16, 2020<sup>2</sup> - Joint meeting of the City Council and Retirement Boards - Implications of COVID-19 on the City’s budget, including a presentation on POBs as an important strategy to mitigate the impact of the retirement plans’ UAL on the resources available to fund City services.

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<sup>2</sup> <https://sanjose.legistar.com/LegislationDetail.aspx?ID=4662155&GUID=3CFC3D1C-872D-409C-927B-D50DE113D1F4&Options=&Search=>

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- December 1, 2020<sup>3</sup> - City Council Direction to Study POBs
- April 23, 2021<sup>4</sup> – City Council Study Session – POB Financing Options
- May 11, 2021<sup>5</sup> - City Council Direction to Draft Validation Documents
- August 19, 2021<sup>6</sup> - City staff Meets with Federated Board
- September 9, 2021<sup>7</sup> - City staff Meets with Police & Fire Board
- September 15, the Rules Committee set a Joint Study Session with the City Council and two Retirement Boards entitled *Pension Obligation Financing – Respective Roles and Responsibilities for Policy Development* for Thursday, September 30, 2021 from 1:30 p.m. - 4:30 p.m.

## **AGENDA**

The Study Session agenda will include presentations from staff from the Finance Department, City Manager's Budget Office, City Manager's Office of Employee Relations, the Boards' Actuary, and the City's POB municipal advisor. It will also include public comment, followed by a question-and-answer session for Council and Board Member discussion. City staff anticipates an in-depth discussion on the merits and risks of POBs, roles and responsibilities of the City and Boards. No action by Council (or the Boards) will occur at the Study Session. City staff will provide concluding remarks and potential next steps for Council to consider in the future.

Study Session Agenda Topics will include:

- **City Manager's Introductions/Opening Comments**
- **Framing the Study Session** – City staff will provide background on how we got here, including past efforts by the City to provide funding solutions and where we need to go from here.
- **Roles and Responsibilities of the City** – Why is the City considering issuing POBs?
- **Roles and Responsibilities of the Retirement Boards** – Differences between the two Plans; Investment Strategy; Amortization Strategy and Existing Policies.
- **The Retirement Boards' Consultants (Cheiron)** – Analysis of Actuarial impacts.
- **The City's Consultants (Urban Futures Inc.)** – The City's POB municipal advisor will provide their analysis on potential POB issuance.

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<sup>3</sup> <https://sanjose.legistar.com/LegislationDetail.aspx?ID=4697795&GUID=DE8D3A1B-B870-4572-888B-7FCD2C3F3ACB&Options=&Search=>

<sup>4</sup> <https://sanjose.legistar.com/LegislationDetail.aspx?ID=4917259&GUID=94AF889E-2B80-4EEB-9B8C-0572D1679144&Options=&Search=>

<sup>5</sup> <https://sanjose.legistar.com/LegislationDetail.aspx?ID=4924655&GUID=D19F00AE-4AF8-4E36-9AE3-3B8BC09E0FFB&Options=&Search=>

<sup>6</sup> <https://sjrs.legistar.com/LegislationDetail.aspx?ID=5078681&GUID=B45F2546-F5BA-45E1-9572-658EEAF41857&Options=&Search=>

<sup>7</sup> <https://sjrs.legistar.com/LegislationDetail.aspx?ID=5117178&GUID=C063512F-E9F3-4FEB-A87C-9414F7DB5A88&Options=&Search=>

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- **Public Comment**
- **City Council and Retirement Board Member Dialogue** – An opportunity to ask questions and provide City Council and Retirement Boards input.
- **Wrap-up and Next Steps** - City staff will provide concluding remarks and provide potential next steps for the City Council to consider.
- **Adjourn**

The presentation will be posted to the Council Agenda website the week of September 27 in advance of the Study Session.

## **ANALYSIS**

The City has considered many options to address the UAL obligations of the City's two retirement systems. While the City has explored and implemented many options over the years to reduce retirement costs, POBs are being explored in the Study Session, at the Council's direction, as the last best option for making a significant impact on the City's large, multi-billion UAL. The goal is to begin an important dialogue among the City Council, Retirement Plan Boards, Administration, and stakeholders and to come away with a basis for making future decisions.

## **EVALUATION AND FOLLOW-UP**

Staff will return to the City Council on October 5, 2021 for City Council consideration of whether to initiate the judicial validation process. While the City awaits the outcome of the court validation process, ongoing dialogue between the City and Retirement Plans will occur along with examination of current policies of the City and Boards and development of a City Pension Funding Policy. If the City receives a favorable judgment, staff will return to Council for approval to issue, including a specific bond financing plans and offering document for potential investors.

## **PUBLIC OUTREACH**

This memorandum will be posted on the City Council Agenda website for the September 30, 2021 City Council Study Session.

HONORABLE MAYOR AND CITY COUNCIL, FEDERATED BOARD, POLICE AND FIRE BOARD

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**COORDINATION**

This memorandum was coordinated with the City Attorney's Office, City Manager's Budget Office, and the City Manager's Office of Employee Relations.



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City Manager

/s/

ROBERTO L. PEÑA  
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For questions, please contact Julia H. Cooper, Director of Finance, at (408) 535-7011 or via email at [julia.cooper@sanjoseca.gov](mailto:julia.cooper@sanjoseca.gov), or Roberto L. Peña, Director of Retirement Services, at (408) 794-1050 or via email at [roberto.pena@sanjoseca.gov](mailto:roberto.pena@sanjoseca.gov).

# JOINT STUDY SESSION PRE-READING AND REFERENCE MATERIAL

September 30, 2021

1. **Council Memo: Actions Related to Pension Obligation Bonds Issuance and Court Validation Proceedings, dated September 1, 2021**, City Council Meeting, October 5, 2021, item 3.4  
<https://sanjose.legistar.com/View.ashx?M=F&ID=9826679&GUID=352E78CF-9AF5-495C-97E2-70063C488CCE>
2. **Council Memo and Presentation: Actions Related to Continued Exploration of Pension Obligation Funding Strategies, dated April 29, 2021**, City Council Meeting, May 11, 2021, item 3.4  
<https://sanjose.legistar.com/View.ashx?M=F&ID=9354313&GUID=8A5EFC8A-6840-4DE4-B5E2-8321D45351EE>  
<https://sanjose.legistar.com/View.ashx?M=F&ID=9385353&GUID=572D951B-32AF-4697-B6B6-609711F940FE>
3. **City Council Study Session Pension Obligation Financing, April 23, 2021**
  - **Council Memorandum: Council Study Session Pension Obligation Financing, dated April 16, 2021**  
<https://sanjose.legistar.com/View.ashx?M=F&ID=9322490&GUID=542625AE-EA45-401A-9FFA-88D970068BE1>
  - **Municipal Advisors Report: Pension Obligation Financing Options, Urban Futures Inc., April 23, 2021**  
<https://sanjose.legistar.com/View.ashx?M=F&ID=9322486&GUID=77E68C41-4A38-44F0-B739-0D25CD7501E2>
  - **Presentation: City Council Study Session (Pension Obligation Financing), April 23, 2021**  
<https://sanjose.legistar.com/View.ashx?M=F&ID=9335109&GUID=F789CA8D-A106-44BD-B104-6B27F846206D>

*The following items were presented at the respective Federated and Police & Fire Board meetings in August and September 2021*

## **Federated Board**

4. **Presentation by Bill Hallmark from Cheiron on amortization policy**, September 23, 2021 Board Meeting, Item #4c  
<http://sjrs.legistar.com/gateway.aspx?M=F&ID=d5657f4c-d466-46f6-8f72-322f291c6667.pdf>
5. **Discussion on Pension Obligation Bonds by CIO Palani, Meketa Investment Group, & Verus Investments**, August 19, 2021 Board Meeting, Item 3b  
Meketa - <http://sjrs.legistar.com/gateway.aspx?M=F&ID=411bf5ce-cc6a-4bf4-9031-12878670b87e.pdf>  
Verus - <http://sjrs.legistar.com/gateway.aspx?M=F&ID=3801bff4-fa22-4677-9875-980aa38ee8bb.pdf>

6. **Actuarial presentation by Cheiron on updated Pension Projections on preliminary investment returns as of June 30, 2021**, August 19, 2021 Board Meeting, Item 4c  
<http://sjrs.legistar.com/gateway.aspx?M=F&ID=ceabf6ce-4dac-4e15-9a78-6497c2871927.pdf>
7. **Discussion of City staff's objectives and approach to potential issuance of Pension Obligation Bonds (POBs)**, August 19, 2021 Board Meeting, Item 4d  
<http://sjrs.legistar.com/gateway.aspx?M=F&ID=d4fb8569-c6a8-441c-b281-ca90140ab5c4.pdf>

**Police and Fire Board**

8. **Presentation by Bill Hallmark from Cheiron on amortization policy**, September 9, 2021 Board Meeting, Item 4c  
<http://sjrs.legistar.com/gateway.aspx?M=F&ID=f0229c5d-26c2-4064-9020-664cdd88eaec.pdf>
9. **Discussion of City staff's objectives and approach to potential issuance of Pension Obligation Bonds (POBs)**, September 9, 2021 Board Meeting, Item 4d  
<http://sjrs.legistar.com/gateway.aspx?M=F&ID=0c72c69c-bf4b-427a-9add-7d42b28abffa.pdf>
10. **Chairman's thoughts on Pension Obligation Bonds (POB's)**, September 9, 2021 Board Meeting, Item 4f  
<http://sjrs.legistar.com/gateway.aspx?M=F&ID=f267d734-b4ab-4218-b3a3-63bd3db7d2a6.pdf>  
<http://sjrs.legistar.com/gateway.aspx?M=F&ID=14d44397-4713-4ddd-acc6-7fb70819abc0.pdf>
11. **Discussion on Pension Obligation Bonds by CIO Palani, Meketa Investment Group, & Verus Investments**, August 5, 2021 Board Meeting, Item 2b  
<http://sjrs.legistar.com/gateway.aspx?M=F&ID=3d721634-d3ad-462e-a43e-0d34c560df8d.pdf>
12. **Actuarial presentation by Cheiron on updated Pension Projections on preliminary investment returns as of June 30, 2021**, August 5, 2021 Board Meeting, Item 4d  
<http://sjrs.legistar.com/gateway.aspx?M=F&ID=56e58bb2-3f37-4dd7-b051-73b91ffedc94.pdf>

*The following items were part of the Recommended Pre-Study Session Reading Materials for the April 23, 2021 City Council Study Session*

13. **Information Memorandum to the City of San José City Council: Final Report of the Retirement Stakeholder Solutions Working Group Final Report, April 2, 2021**  
<https://www.sanjoseca.gov/home/showpublisheddocument?id=71005>
14. **Mayor's Memo on Pension Obligation Bonds, October 15, 2020**  
<https://sanjose.legistar.com/View.ashx?M=F&ID=8856564&GUID=A70433AD-39C2-40BE-8124-E8A3A39281EE>
15. **Administration Memo and Presentation on Pension Obligation Bonds, November 23, 2020**  
<https://sanjose.legistar.com/View.ashx?M=F&ID=8939982&GUID=6DCC6CFC-CA97-48E0-B587-3FAAA1979182>



16. **Government Finance Officers Association (GFOA) News Release “State and Local Governments Should Not Issue Pension Obligation Bonds”, February 2021**  
<https://www.gfoa.org/materials/pension-obligation-bonds-february-release>  
<https://www.gfoa.org/materials/pension-obligation-bonds>
17. **Governing Magazine, “Can Fiscal Alchemy Bolster Public Pension Funds?”, by Girard Miller (governing.com), March 16, 2021**  
<https://www.governing.com/finance/Can-Fiscal-Alchemy-Bolster-Public-Pension-Funds.html>
18. **Government Finance Review, “Point/Counterpoint: Pension Obligation Bonds: Yes or No?”, featuring Girard Miller, June 2020**  
[https://gfoaorg.cdn.prismic.io/gfoaorg/7b397130-6318-4e16-993b-b8a478d81733\\_GFR\\_04-2020-POB.pdf](https://gfoaorg.cdn.prismic.io/gfoaorg/7b397130-6318-4e16-993b-b8a478d81733_GFR_04-2020-POB.pdf)
19. **Commentary: The time is ripe for public pension obligation bonds, by Girard Miller, March 25, 2020**  
<https://www.pionline.com/industry-voices/commentary-time-ripe-public-pension-obligation-bonds>
20. **National Conference on Public Employee Retirement Systems, “Ten Ways to Close Public Pension Gaps”, September 2020**  
[https://www.ncpers.org/files/NCPERS%20Research%20Paper\\_September\\_Close%20Public%20Pension%20Funding%20Gaps\\_Web.pdf](https://www.ncpers.org/files/NCPERS%20Research%20Paper_September_Close%20Public%20Pension%20Funding%20Gaps_Web.pdf)
21. **Orrick Green Book Series on Municipal Finance “An Introduction to Pension Obligation Bonds and Other Post-Employment Benefits, Third Edition”, 2006**  
<https://www.orrick.com/en/Insights/2006/09/An-Introduction-to-Pension-Obligation-Bonds-and-Other-Post-Employment-Benefits>
22. **Center for Retirement Research at Boston College, “An Update on Pension Obligation Bonds” July 2014**  
[https://crr.bc.edu/wp-content/uploads/2014/07/slp\\_40.pdf](https://crr.bc.edu/wp-content/uploads/2014/07/slp_40.pdf)
23. **City of San José Federated City Employees’ Retirement System Actuarial Valuation Report as of June 30, 2020, produced by Cheiron December 2020**  
[Actuarial Valuation for period ending June 30th, 2020](#)
24. **City of San José Federated Postemployment Healthcare Plan Actuarial Valuation Funding Report as of June 30, 2020, produced by Cheiron January 2021**  
[Actuarial OPEB Valuation for period ending June 30th, 2020](#)
25. **City of San José Police and Fire Department Retirement Plan Actuarial Valuation Report as of June 30, 2020, produced by Cheiron December 2020**  
[Actuarial Valuation for period ending June 30th, 2020](#)
26. **City of San José Police and Fire Department Postemployment Healthcare Plan Actuarial Valuation Funding Report as of June 30, 2020, produced by Cheiron January 2021**  
[Actuarial OPEB Valuation Report for period ending June 30th 2020](#)