SAN DIEGO CITY ATTORNEY

REPORT TO THE PEOPLE OF SAN DIEGO

REGARDING THE

SAN DIEGO CITY

EMPLOYEES'

RETIREMENT SYSTEM

20 December 2007

I.
INTRODUCTION

San Diego taxpayers have a right to know about the financial crisis they face. The liability for future pension benefits at the San Diego City Employees' Retirement System (SDCERS) is nearly $6.5 billion. Several hundred million dollars of the underlying pension benefits were not paid for or earned. This report is written to make certain that San Diegans understand the harsh financial reality they face, with the hope that they will support effective action to reduce their looming debt burden.

The current financial problems at SDCERS began in 1996, when City and pension officials agreed to increase benefits in exchange for decreasing the contributions below the level set by the SDCERS' actuary.

City officials have not only committed taxpayers to pay $6.4 billion for employee pension benefits, they have diverted hundreds of millions of dollars that could have been spent on essential services vital to the operation of a city. These mounting contributions, however, have not kept pace with the pension obligations made in the name of taxpayers by City officials.

II.
BACKGROUND

The City of San Diego created a pension system in 1946. The San Diego City Charter established the program and stated, "The Council of the City is hereby authorized and empowered by ordinance to establish a retirement system and to provide for death benefits for compensated public officers and employees…"

The City created the San Diego City Employees' Retirement System to administer the retirement plan per the rules approved and established by the San Diego City Council. The plan is currently structured as a defined benefit plan, which means that employee benefits are calculated based on a formula, using factors such as salary history and duration of employment.

The City and the employee pay into the system. Earnings are collected on those funds before the employee retires. The employee's and the employer's monies over time accrue with the hope that it will be enough to pay the employee's retirement for life.

In order to calculate an individual's pension payment, the system uses a formula in which the employee's number of years worked is multiplied by the employee's one year highest salary. The product of these two is then multiplied using the City's "multiplier," a percentage negotiated by the City and its municipal unions. A visual representation of the formula is:

(Years Worked X High Salary) X Multiplier = Pension Payment

For example, to determine the monthly pension payment for a City employee who worked for 20 years, whose one-year high salary is $100,000, and whose multiplier is 2.5 percent. The calculation appears:

20 years X $100,000 X 2.5 percent = $50,000 per year pension payment.

Using the formula, a City employee who has worked for 20 years with a one-year high salary of $100,000 will earn $50,000 per year in retirement. It is worth noting that the multiplier is different for public safety, general service, and elected officials.

The City has created a series of retroactive benefits for City employees:

1. The first of these increases was approved as part of a deal between the San Diego City Council and the board of the San Diego City Employees' Retirement System. The deal, approved in 1996 and commonly referred to as Manager's Proposal I increased the multiplier for City employees; created a plan to allow employees to buy years of service; and implemented the Deferred Retirement Option Plan, which allowed City employees to receive their paychecks and their retirement payments from the retirement system at the same time.

2. The second retroactive increase was approved by the City Council as part of a settlement commonly referred to as the Corbett settlement. By agreeing to the settlement, the City Council and SDCERS substantially increased pension benefits.

3. The third retroactive pension enhancement for employees came as a result of a deal between the City Council and SDCERS called Manager's Proposal II (MPII) in 2002. This deal gave employees another increase in the multiplier.

A retroactive benefit increase means that the benefit increase is made back to the employee's start on the job. This causes an instant debt for a retirement system. This is because the employee makes his weekly contributions to the pension based on his salary, years worked, and multiplier, as discussed above. A retroactive increase in the multiplier, for example, would create a benefit that is not funded, since neither the City nor the employee had been contributing funds for this benefit in the past.

III.
DISCUSSION

A. The Amount of Pension Benefits

The amount to be paid to retirees is staggering when looked at in the context of comparison to the finances of the City. The City of San Diego, like all other retirement

systems, measures the total amounts due to each City employee and retiree by measuring the "present value of future benefits." This is a term used by actuaries – the financial experts paid to monitor and make financial projections – to detail the fiscal health of pensions. The present value of future benefits represents the total dollar amount in today's dollars of all benefits the pension plan will pay to current retirees through their expected life spans; plus all benefits the plan will have to pay to people who are eligible for retirement benefits but not yet retired. The present value of future benefits at June 30, 2006, is nearly $6.5 billion.

A look at the present value of future benefits owed to high-paid City officials is illustrative of the imbalance of executive level pensions at the City. For instance, the present value of benefits for just one current retiree is $2.3 million. The actual total payout that the City owes this one individual is much more than $2.3 million over the course of that individual's retirement. It must be emphasized that more than 417 current and retired employees have pension benefits with a present value greater than $1 million. If these 417 individuals received their benefits in a lump sum today, the payout to each of them would exceed $1 million. Table 1 illustrates the size of the present value of benefits for 20 of these 417 retirees:

Table 1 - Examples of Lump Sum Benefits

Retiree No.	PV Benefit Lump Sum
City Retiree 1	$2,354,565
City Retiree 2	$2,150,878
City Retiree 3	$1,982,747
City Retiree 4	$1,922,354
City Retiree 5	$1,907,539
City Retiree 6	$1,900,539
City Retiree 7	$1,894,243
City Retiree 8	$1,892,588
City Retiree 9	$1,842,264
City Retiree 10	$1,821,462
City Retiree 11	$1,821,316
City Retiree 12	$1,815,019
City Retiree 13	$1,813,178
City Retiree 14	$1,811,114
City Retiree 15	$1,792,430
City Retiree 16	$1,785,099
City Retiree 17	$1,766,511
City Retiree 18	$1,754,014
City Retiree 19	$1,750,614
City Retiree 20	$1,748,823

To put Table 1 in perspective, Table 2, below, details the annual amounts the City and SDCERS will pay 20 current retirees annually for the remainder of their lives.

Table 2 - Examples of Annual Pension Benefits

Retiree No.	Total Annual Benefit
City Retiree 1	$ 148,335
City Retiree 2	$ 147,942
City Retiree 3	$ 147,749
City Retiree 4	$ 141,282
City Retiree 5	$ 134,637
City Retiree 6	$ 134,421
City Retiree 7	$ 133,833
City Retiree 8	$ 133,460
City Retiree 9	$ 129,918
City Retiree 10	$ 126,190
City Retiree 11	$ 125,942
City Retiree 12	$ 124,866
City Retiree 13	$ 124,205
City Retiree 14	$ 123,323
City Retiree 15	$ 121,281
City Retiree 16	$ 118,064
City Retiree 17	$ 117,575
City Retiree 18	$ 114,969
City Retiree 19	$ 114,114
City Retiree 20	$ 113,736

Standing behind the 417 retirees holding benefits with present values above $1 million, are 11,246 current and former employees who will get pensions when they retire over the next several years. Taxpayers are facing a $1.2 billion debt for past unpaid pension bills and $1.5 billion of future unpaid benefits. Table 3 lists the different categories of those who have retired and are receiving benefits and those who will be retiring and receiving benefits.

Table 3 - Breakdown of Plan Participants

City Employee Status	Number	Present Value of Future Benefits by Category
Current Employees *	8,887	$3,463,425,413
Terminated Vested Employees *	2,359	$189,840,833
Disabled **	1,237	$371,327,233
Retirees **	4,118***	$2,335,419,143
Beneficiaries **	1,046	$115,456,455
Total	**17,647**	**$6,475,469,077**

* Not yet receiving benefits. ** Receive benefits *** 959 in DROP

The rate that City employees are moving into retirement raises concerns about the growth of the pension system's liabilities. Last year, the number of employees that entered retirement grew by 390, marking an increase from 3,728 retirees in 2005 to 4,118 retirees in

2006. This growing stock of new retirees is causing a rapid growth in pension liabilities to SDCERS and the City. Specifically, pension liabilities increased from $5.958 billion in 2005 to $6.475 billion in 2006 – an increase of more than $500 million.

Unless certain benefits that were improperly given in the name of San Diego taxpayers are rescinded, the people of San Diego will be burdened with billions of dollars of debt that will hinder the City's ability to provide the basic safety and services needed to keep it in sound condition.

B. Present Value of Future Benefits

The present value of future pension benefits is growing at a substantial rate. The "present value of future benefits" (PVFB) measures the total amount of money owed to all active employees and retirees who have worked long enough to receive a pension. The present value of future benefits has increased by more than 65 percent since 2000 to about $6.5 billion, according to SDCERS' actuary.

Five specific benefits given to employees without funding have driven PVFB growth. The five unpaid for benefits are (1) retroactive benefits, (2) service years, (3) the DROP benefit, (4) the supplemental benefit (13th check) and (5) the supplemental cost of living benefit. The City's current plan is to transfer the burden of paying these benefits to the next generation.

The present value of benefits increased from $3.7 billion in 2000 to nearly $6.5 billion in 2006 – a jump of more of more than 65 percent. Table 4 and Charts 1 and 2, below, document the rapid growth in the PVFB. They also show that while payroll went up 19 percent and active and retired employees increased by 4 percent between 2000 and 2006, pension benefits increased by more than 65 percent.

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Table 4 - Growth in Present Value of Future Benefits 2000-2006

Year	Number of SDCERS Active and Retired Participants	Present Value of Future Benefits*	Payroll	% Increase In Present Value of Future Benefit	% Increase In Payroll
2000	14,702	$3,681,800,000	$448,501,827		
2001	14,904	$3,890,000,000	$481,863,318	6%	7%
2002	15,552	$4,382,900,000	$535,156,545	13%	11%
2003	15,567	$4,941,000,000	$533,595,405	13%	0
2004	15,472	$5,467,447,943	$540,180,941	11%	1%
2005	15,431	$5,957,900,719	$557,630,735	9%	3%
2006	15,288	$6,475,469,077	$534,102,801	9%	-4%

*****2000-2004 do not include the present value of Corbett, the 13th check, DROP, Supplemental COLA or adjustment for benefit in excess Internal Revenue Code 415 limits.

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Chart 1 - Increase in Present Value of Future Benefits 2000-2006

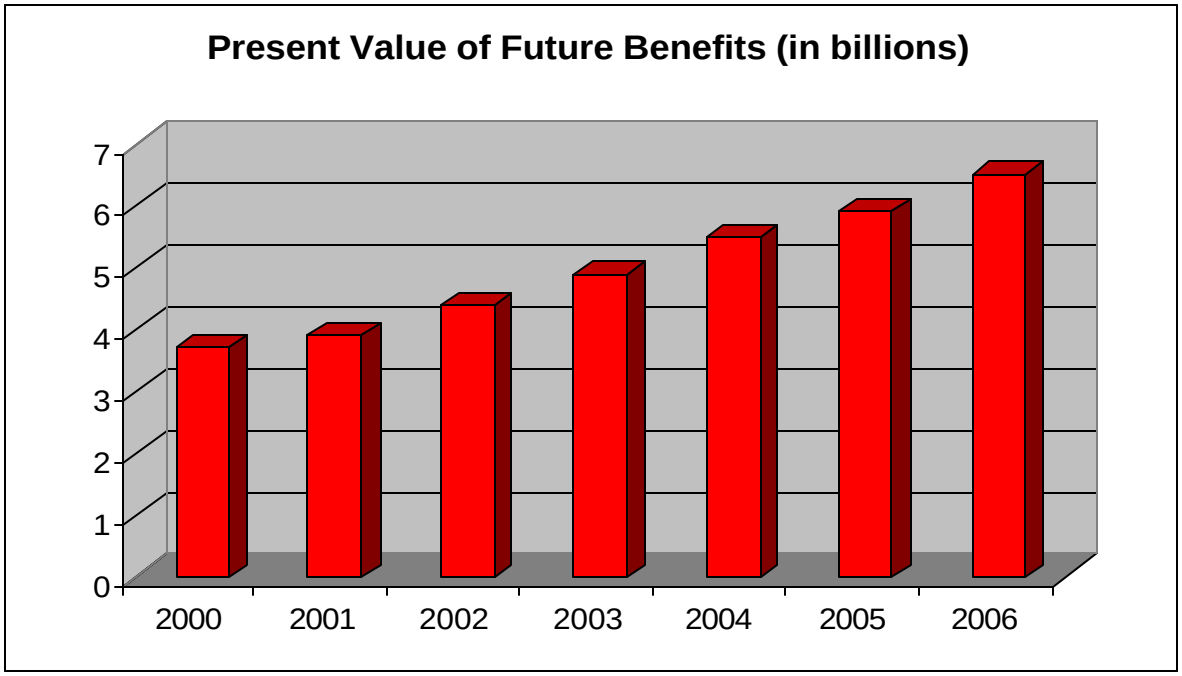
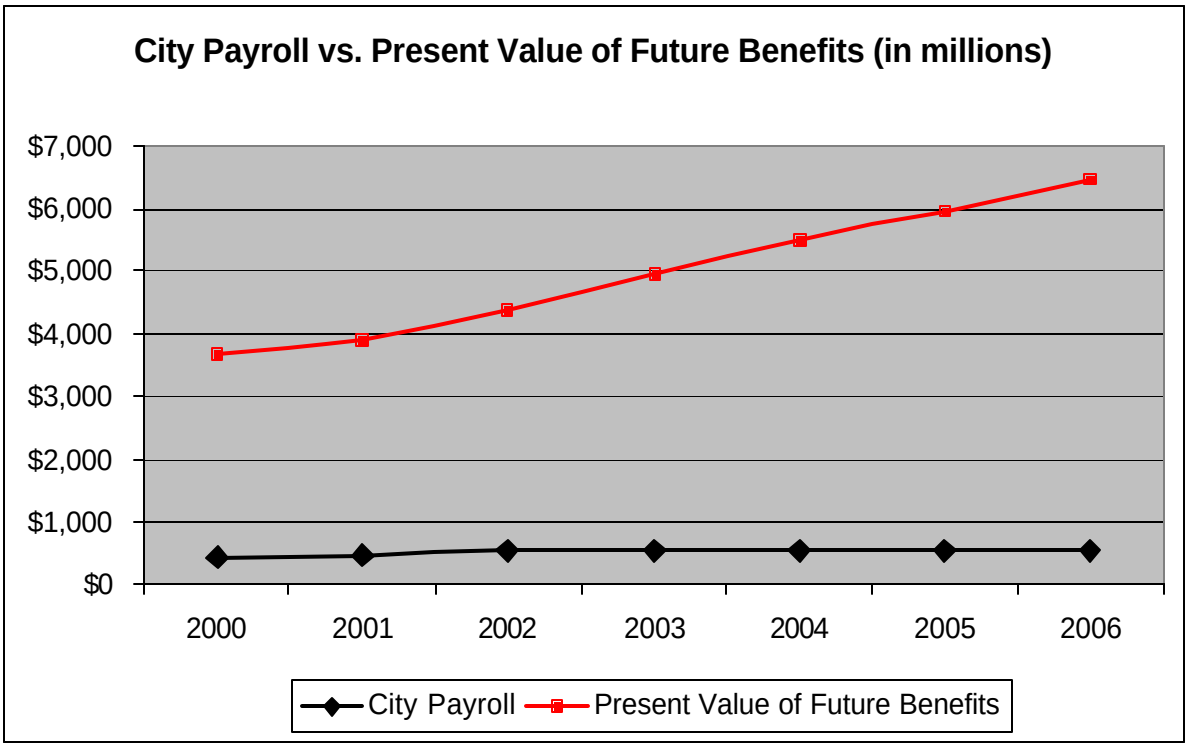


Chart 2 - Comparison of Payroll to Present Value of Future Benefits 2000-2006



As a result of the increase in the future value of benefits, the City will be faced with increasing annual payments to the pension system from its General Fund. This will result in less money available for City services.

C. Unpaid Service Years

One of the most disconcerting components of the City's current $1.2 billion deficit, under the EAN funding method, is the fact that a large portion of the debt was unearned or unpaid by City employees.

As part of Manager's Proposal I in 1996, City employees were given the opportunity to buy service years to boost their retirement calculation. An employee who works for the City for 20 years was permitted to increase his or her years worked by buying five years of service. The pension would then be based upon 25 years. The service years were not priced at actual cost, as was required under the law. Employees were supposed to pay full costs. SDCERS officials knowingly priced the service years below actual cost and the current board has refused to charge the actual price required.

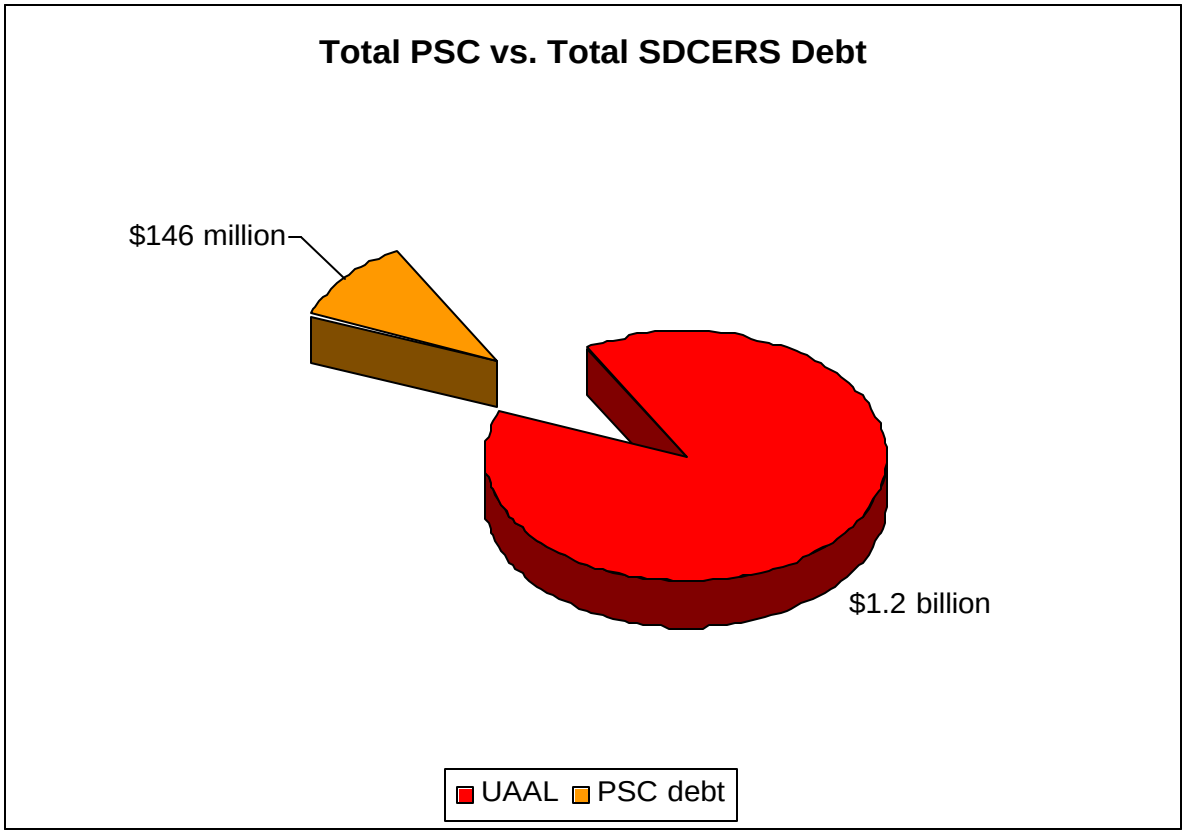
Unless a way is found to enforce the law requiring actual cost pricing, taxpayers will now have to pay at least $146 million for the 8,268 service years given away. Table 5 and Chart 3 show when the 8,268 unpaid years were given away. Table 5 shows the average unpaid service credit benefit received by those who did not earn or pay for the 8,268 service credits:

Table 5 - Itemization of Unpaid Service Years

Date Range	Total Service Credits Sold	Service Credits Not Paid For	Years Not Paid For	Number of Contracts	Average Unpaid Service Credit
Pre-2000	$32,817,001	$20,000,000	1,031	447	$19,399
7/1/2000 through 6/30/2002	$120,254,728	$63,000,000	3,157	1578	$19,956
7/1/2002 through 8/15/2003	$72,091,615	$29,000,000	1,674	1186	$17,324
8/16/2003 through 10/31/2003	$112,129,360	$34,000,000	2,374	2392	$14,322
11/1/2003 through 6/30/2006	$12,524,368	$425,000	32	372	$13,281
TOTAL	$340,817,073	$146,000,000	8,268	5975	$17,658

In order to understand the magnitude of how much money has been given away at the expense of taxpayers, the chart below illustrates the debt caused by the under-pricing of the purchase service credits as a portion of the total unfunded actuarially accrued liability ("UAAL") of the pension system, currently is $1.2 billion.

Chart 3 - Unpaid Service Credits compared to Unfunded Liability



The above graph makes clear that the size of the pension debt could be drastically reduced if the City were to require that the years of service be re-calculated using the true cost of the service years purchased.

On 16 November 2007 the SDCERS declined to charge the correct amount for the services years given away. Instead, the SDCERS board voted to transfer the $146 million cost to San Diego City taxpayers.

D. DROP NOT COST NEUTRAL AS REQUIRED

Another benefit causing the pension to be in deficit is the Deferred Retirement Option Program ("DROP"). Under the terms of DROP, employees receive their retirement allowance while they continue to work for the City for up to five additional years. DROP was implemented to keep experienced employees at the City after they reached retirement age for up to five additional years. DROP was supposed to be cost neutral but several actuarial reports have found it operates at a significant cost to taxpayers by as much as $400 million.

SDCERS maintains a DROP reserve account to pay for the retirement benefits of DROP members. The amount in this DROP reserve has increased 491percent and the average amount attributable to each participant has increased 155 percent since 2000. There are currently 1,575 participants in DROP, 995 active service employees and 580 retirees. The total DROP liability is $282,259,890. There are also 8,500-plus active employees still eligible to participate in DROP. The cost of DROP will continue to rise.

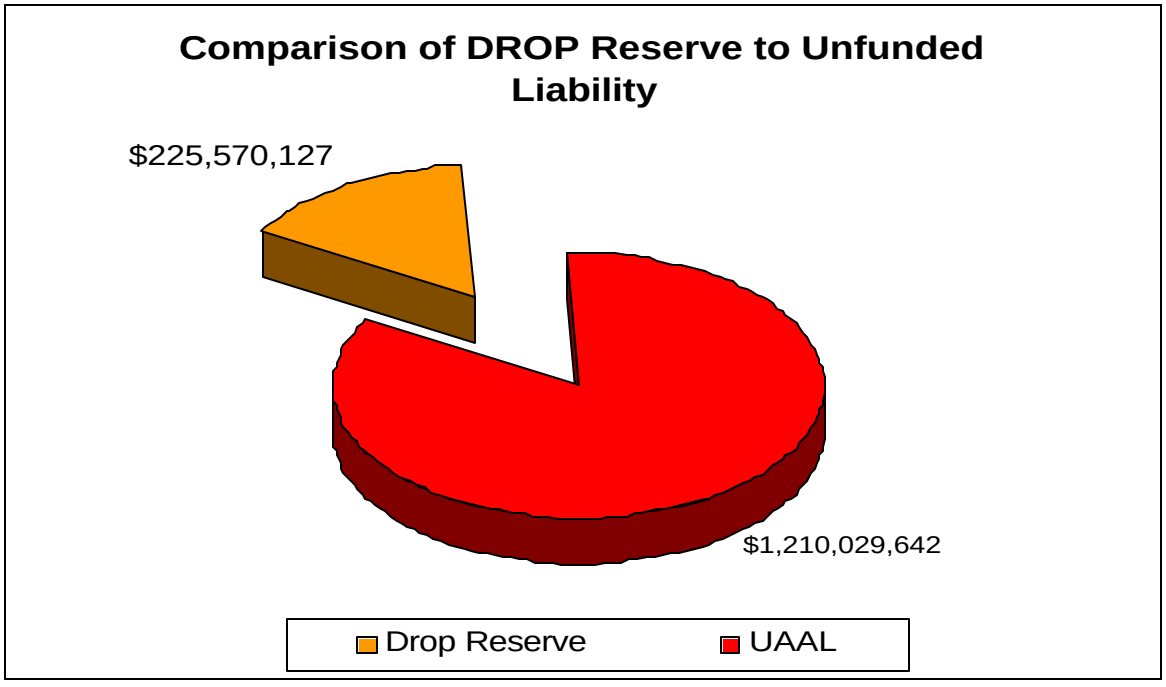
Table 6 and Chart 4 show the growth in the funds transferred to the DROP reserve account, which is used to pay the DROP benefit.

Table 6 - Growth in DROP Reserve Account

Year	DROP Reserve Account	DROP Participants	Average Per DROP Participant
2000	$38,187,621	414	$92,241
2001	$66,373,564	547	$121,341
2002	$97,430,035	522	$186,648
2003	$134,169,637	732	$183,292
2004	$185,107,857	781	$237,014
2005	$228,514,263	838	$272,690
2006	$225,570,127	959	$235,214

The following table illustrates the growth of the reserve for DROP participants. Despite clear evidence suggesting DROP has not been administered as a cost-neutral benefit the City has so far taken no corrective action.

Chart 4 - Growth in DROP Reserve



It is easy to see the substantial growth in the amount of money that must be set aside each year for DROP. On top of the basic DROP payments to its participants, the City is also responsible for paying into each DROP account 8 percent interest, compounded quarterly. Thus, during their participation in DROP, each DROP member receives:

1. normal salary;
2. a monthly retirement benefit with a guaranteed 8 percent interest compounded quarterly;
3. a 3.025 percent matching City contribution; and
4. the 13th check.

DROP accounts for nearly $200 million of the pension's $1.2 billion deficit. DROP employees are estimated to be up to $200 million expensive than replacement employees, according to the City's actuary. Thus, DROP is estimated to cost City taxpayers up to $400 million (a $200 million increase in the pension deficit and $200 million in higher payroll costs).

E. Retroactive Benefits

City officials awarded employees retroactive pension benefit increases in 1996, 2000 and 2002. These new benefits increased the pension multiplier, the yearly percentage used to determine pension benefits, from less than 2 percent to 2.5 percent for general employees and to 3 percent for public safety employees. For example, for every year of service a safety employee works or purchases, he or she will receive a pension benefit equal to 3 percent of his or her highest one-year salary times the total number of years of service.

The pension increases granted in 1996, 2000 and 2002 were made retroactive to each employee's start date. In other words, as the pension multiplier was increased from 1996 to 2002, each employee's total pension benefit was increased using the higher multiplier for all years worked. This occurred even though these employees had already been paid for the work performed and had only contributed to the pension based on a lower pension multiplier. So, even though prior to 1996, employees contributed to the pension fund based on the assumption that their pension multiplier was less than 2 percent, by 2002, their multiplier was 2.5%, thus creating an instantaneous shortfall.

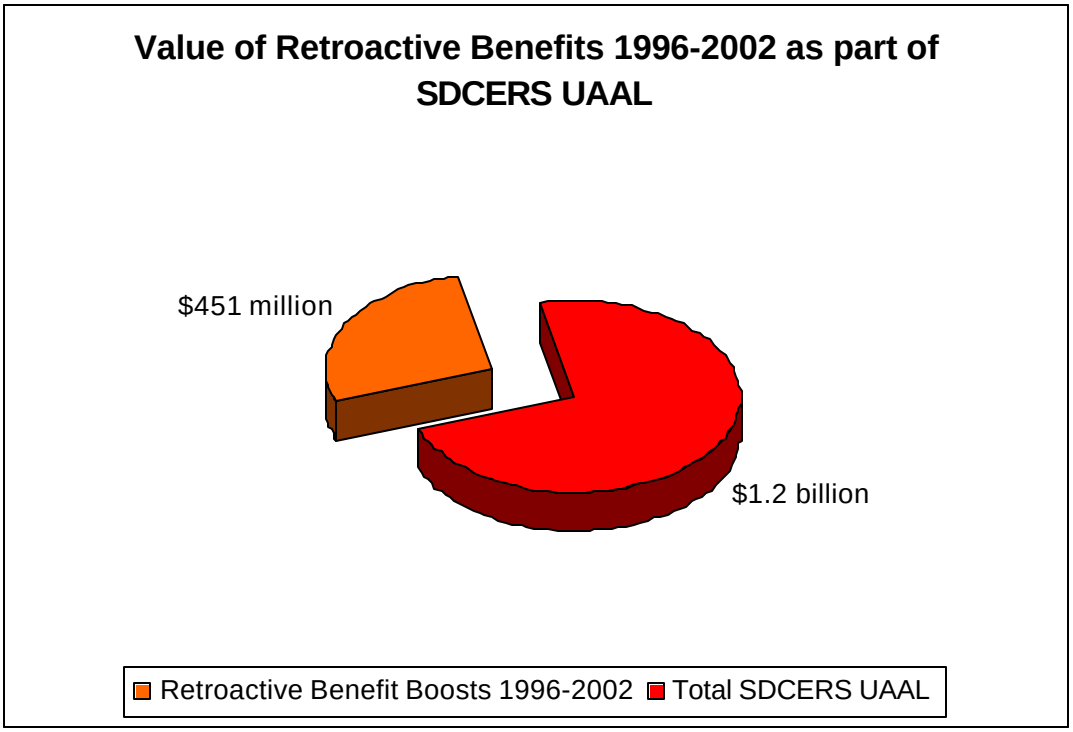
The employees were not made to contribute any additional funds to pay for this increased benefit. Nor has the City provided funding to pay for these substantial increases in pension benefits, other than increasing its annual amortization contribution. Therefore, the current and future taxpayers of the City of San Diego are now liable for these costs. Table 7 and Chart 5 show the amount of the current under-funding attributable to the granting of these retroactive benefit increases.

Table 7 - Retroactive Benefits

Year – Benefit Increase Source	Retroactive Benefits
1996 - MP-1	$159,000,000
2000 - Corbett	$115,000,000
2002 - MP-2	$177,000,000
Total	$451,000,000

The retroactive benefit enhancements approved and granted by the Mayor and City Councils between 1996 and 2002 have resulted in a $451 million debt to the City and its taxpayers. This amount represents nearly 40 percent of the current pension deficit. These benefits were not funded when these benefit increases were granted and no future funding source has ever been identified to pay these benefits.

Chart 5 - Retroactive Benefit Debt as part of Pension Deficit



F. Excess Benefits

Since 2000 SDCERS officials have made $2.8 million in payments above the limits of Internal Revenue Code ("IRC") Section 415. This code was created and is enforced by the Internal Revenue Service ("IRS"). IRC Section 415 places an upper limit on the amount a retiree may annually receive in order to prevent people from receiving preferential tax benefits for monies received in retirement. The number of retirees to whom excess payments were made has increased from 12 in 2000 to 58 in 2007. Table 8 and Chart 6 provide details about these excessive payments. [1]

Table 8 - Excess Benefit Payments

415 Limit Year	Persons in Year	415 Testing Benefit	Adjusted 415 Limit	Amount Overpaid	Overpayments Rolled Forward to 6/30/07
2000	12	$ 1,020,156	$ 1,043,222	$ 84,853	$ 145,424
2001	15	$ 1,316,911	$ 1,233,572	$ 150,301	$ 238,510
2002	18	$ 1,544,697	$ 1,617,640	$ 168,962	$ 248,261
2003	23	$ 2,068,641	$ 2,173,698	$ 223,764	$ 304,431
2004	29	$ 2,485,186	$ 2,761,943	$ 252,334	$ 316,626
2005	40	$ 3,378,272	$ 3,617,051	$ 397,661	$ 463,399
2006	56	$ 4,752,430	$ 4,962,075	$ 665,880	$ 719,126
2007	58	$ 5,856,269	$ 5,401,703	$ 862,581	$ 862,583
Total		**$ 22,422,562**	**$ 22,810,904**	**$ 2,806,336**	**$ 3,298,360**

The alarming trend in Table 8 is the increase of new retirees receiving benefits in excess of IRC 415 limits. Twelve retirees received excess benefits in 2000. This number grew to 58 in 2007. The corresponding cost climbed dramatically from $84,853 in 2000 to $862,581 in 2007. Chart 6 shows the increase.

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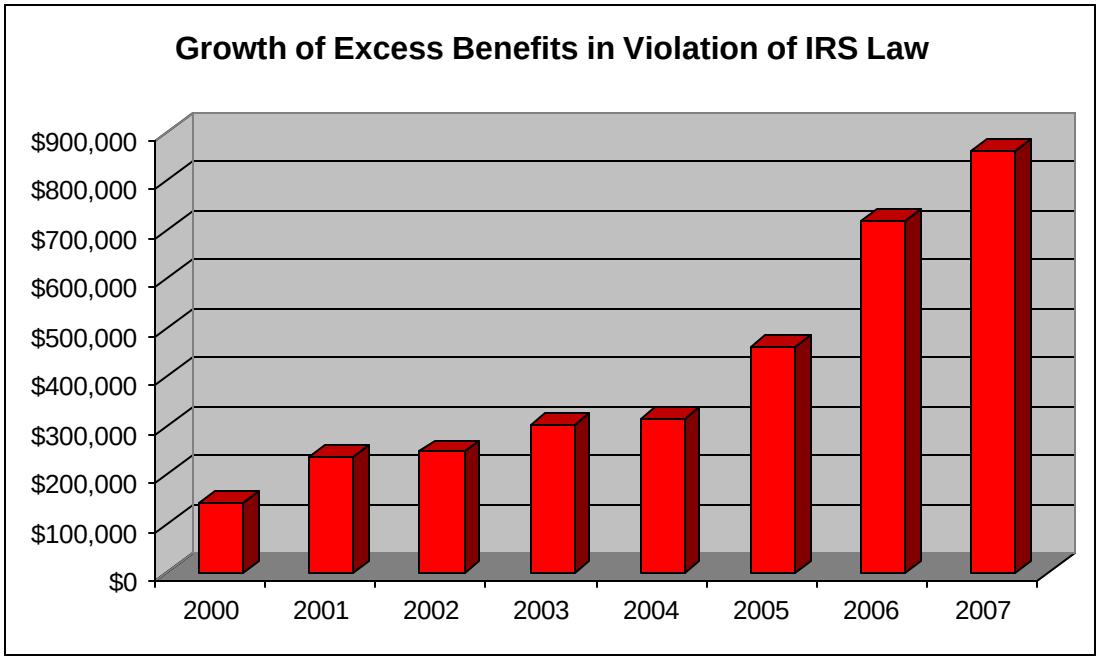
[1] On 13 December 2007 SDCERS submitted this Excess Benefit IRC 415 Report to the Internal Revenue Service, reducing the number of excess benefit recipients from 102 to 58 and reducing the total amount of excess from over $8 million in payments to $3,779, 221.

Chart 6 - Growth in Excessive Benefits



SDCERS has not disclosed the potential City liability for future excess benefits.

G. Unfunded Liability

The 8,268 years of unpaid service credits, the deficit at which DROP operates, certain retroactive benefits given without funding, actuarial mistakes, and intentional under-funding have led to a 1,600 percent increase in the deficit between pension assets and pension liabilities in just six short years.

The total unfunded actuarially accrued liability in 2000 was $68.9 million and it has grown to $1.2 billion in 2006. Table 9 and Chart 7 show the dramatic growth in the unfunded liability:

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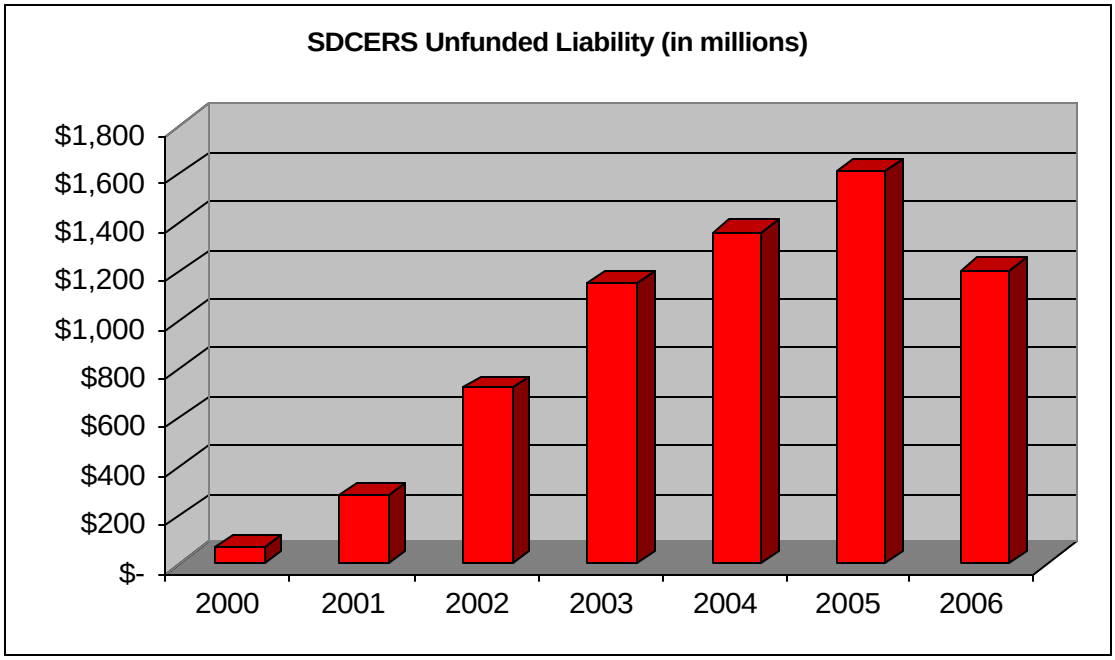
Table 9 - Growth in Unfunded Liability

YEAR	Unfunded Liability *
2000	$68,959,000
2001	$283,893,000
2002	$720,713,000
2003	$1,157,194,000
2004	$1,368,648,000
2005	$1,618,961,916
2006	$1,210,029,642

*** 2000-2004 based on PUC funding, 2005-2006 based on EAN funding**

Chart 7 - Growth in Unfunded Liability



The unfunded liability decreased from $1.6 billion to $1.2 billion between 2005 and 2006, based on EAN funding. In his 2006 valuation, the SDCERS actuary has conceded that the unfunded liability is likely to go up in the near term: "it is anticipated that the UAL will increase in the early years then decrease in the later years." The dip in unfunded liability between 2005 and 2006 is primarily attributable to a one time infusion of $108 million by the City and a change in the method used by SDCERS to measure its investment returns. The unfunded liability is unlikely to go down unless the City continues to significantly increase its yearly contributions.

H. "Contingent" Benefits: The 13th Check and Supplemental COLA

With a $1.2 billion deficit, the SDCERS board had to decide what bills to pay and what bills not to pay. SDCERS has used creative accounting practices to solve its problem. At the heart of those creative accounting practices are the "waterfall" and "surplus undistributed earnings."

SDCERS used fictional surplus earnings to create a fictional "waterfall" of funds. The waterfall was used to pay a 13th check benefit and a supplemental cost of living benefit (supplemental COLA). In doing so, SDCERS increased its deficit by the amount paid for these two contingent benefits. Surplus earnings were also used to pay other SDCERS bills. Surplus earnings are not really surplus and add to SDCERS' funding deficit.

SDCERS and City officials have found surplus earnings in all but one year since 2000. During this same period, SDCERS' funding deficit increased 1,600 percent, from $68.9 million to $1.2 billion. Any cash returned on investments was needed to reduce the SDCERS' deficit.

As noted by the City's outside counsel Vinson & Elkins, City officials falsely represented in public disclosures that the cost of the 1996 benefit increases was covered in reserves established from surplus earnings. As further noted by Vinson & Elkins:

> The surplus earnings concept ignores this long-term dynamic of actuarial projections. It evaluates returns on a year-by-year basis and treats all cash generated by system assets (beyond assumed rates of return) as free money. This, of course, flies in the face of the basic premise of actuarially assumed returns: they are rarely met for any individual year, but are expected to average out over time to approximate the projections. Therefore, the concept of "surplus earnings" is a misnomer. Unless and until it can be demonstrated that the actuary's projections are unrealistically conservative, *all* earnings are necessary to support the long-term viability of the system – none are truly "surplus" or "excess."

Table 10, Table 11 and Chart 8 show amounts expended for the 13th check and supplemental COLA. They also show earnings declared to be surplus, while the pension deficit grew. Taxpayers under the existing terms of the pension plan are required to pay the deficit shortfall caused by improper surplus funding practices.

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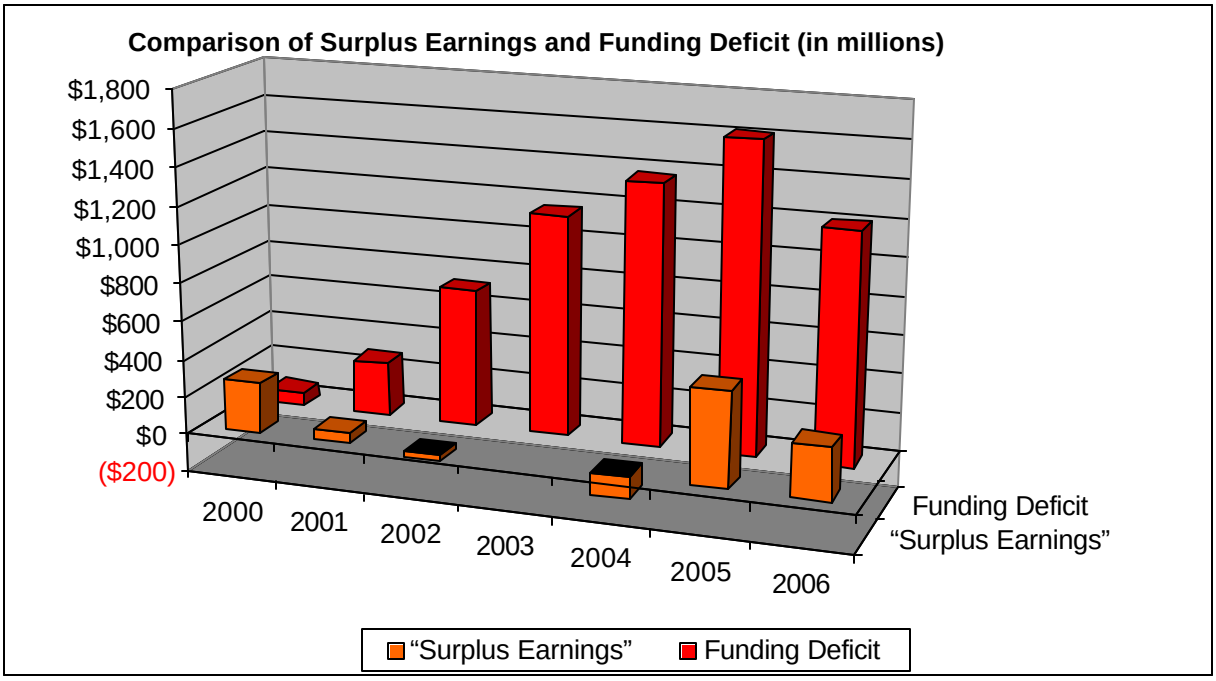
Table 10 - 13th Check and Supplemental Cola

Year	13th Check	Supp. COLA
2000	$3,427,519	$3,678,210
2001	$3,540,643	$4,161,525
2002	$3,627,495	$4,434,946
2003	Not Available	Not Available
2004	$14,374	$3,986,604
2005	$4,139,464	$3,899,449
2006	$4,206,260	$3,685,076

Table 11 - Comparison of Surplus Earnings to Funding Deficit

Year	"Surplus Earnings"	Funding Deficit
2000	$270,930,906	$68,959,000
2001	$58,565,610	$283,893,000
2002	($38,305,977)	$720,713,000
2003	Not Available	$1,157,194,000
2004	($113,021,789)	$1,368,648,000
2005	$495,592,461	$1,618,961,000
2006	$270,819,587	$1,210,029,642

Chart 8 - Comparison of Surplus Earnings to Funding Deficit



I. Contributions

The pension system is funded by contributions from both the employee and the City. Between 2000 and 2006 the City increased its pension contributions to the pension plan by 807 percent. In 2007 the City lowered its contribution from $271 million to $165 million. The increase in the City's contribution in 2006 was a one-time event connected to the settlement of litigation. The City's contribution increased from $29 million in 2000 to $271 million in 2006. However, the City also paid a part of the employee's contributions between 2000 and 2007.

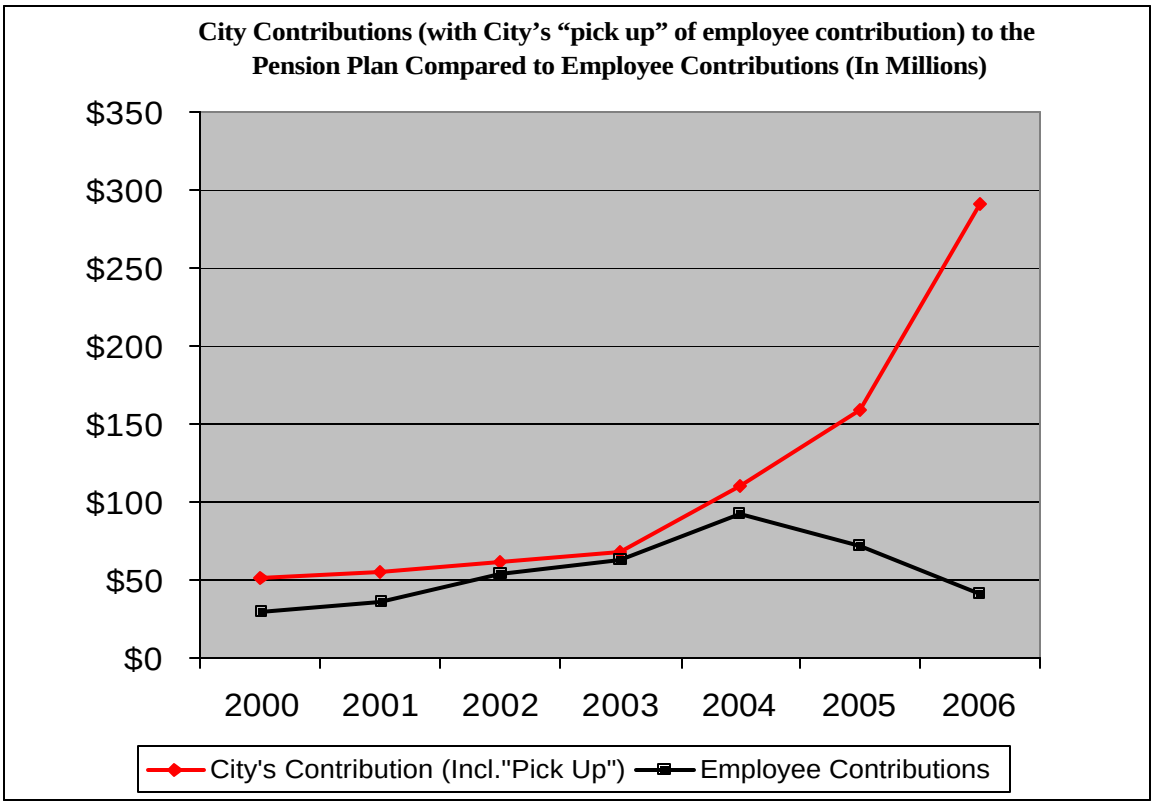
The opportunity cost of the funds diverted to pension contributions for unearned or unpaid benefits are essentially a trade-off for city services such as street repairs and park maintenance. Table 12 and Chart 9 show the growth in the City's contributions to the pension system and provide a comparison to the employees' contributions.

Table 12 - Growth of the City's Contributions to the Pension Plan

Year	City Contribution Amount	City "pick up" of Employee Contribution	Total City Contribution	Employee Contributions	Total Contributions
2000	$29,908,000	$21,986,996	$51,894,996	$29,533,246	$81,428,242
2001	$31,426,737	$23,896,431	$55,323,168	$36,360,970	$90,058,836
2002	$35,254,746	$25,896,431	$61,151,177	$54,640,917	$115,792,094
2003*	$39,988,927	$28,573,503	$68,562,430	$62,712,108	$131,274,538
2004	$80,937,000	$30,204,840	$111,141,840	$92,886,011	$204,027,851
2005	$130,000,000	$29,893,945	$159,893,945	$71,661,307	$231,555,252
2006	$271,298,430	$19,261,595	$290,560,025	$41,662,341	$332,222,366
2007	$165,000,000	Not available	Not available	Not available	Not available

*Employee DROP contribution estimated

Chart 9 - City Contributions (with City's "pick up" of employee contribution) to the Pension Plan Compared to Employee Contributions



The City's contributions to the pension plan, as discussed above, are taking a toll on the City's budget priorities. For example, the City has failed to maintain its roads, so that 70 percent are now in a condition below national standards.

Citizen concerns are legitimized when one looks at contributions in relation to the City's general fund. Chart 10 illustrates the point:

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Chart 10 - City Contribution (with City employee pick up) to Pension vs. General Fund

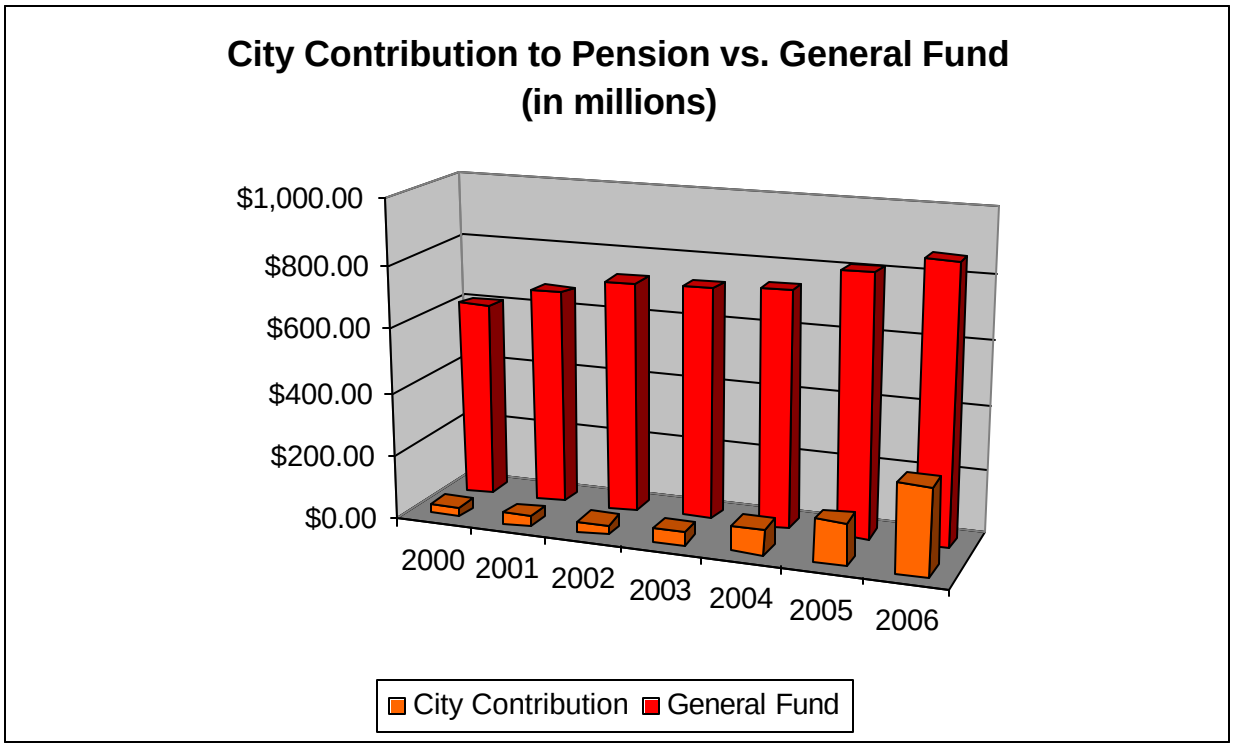


Chart 10 illustrates the alarming growth of the City's contribution to the pension system, as represented by the light bars. One can see the upward growth of the General Fund, as represented by the dark bars, as it is not increasing at the same pace. The practical effect of this disparity of growth will be the continued cuts to funding of City services and the erosion of the quality of these services. In other words, there will be a significant reduction of the quality of life for San Diego residents.

J. Deductions Compared to Contributions

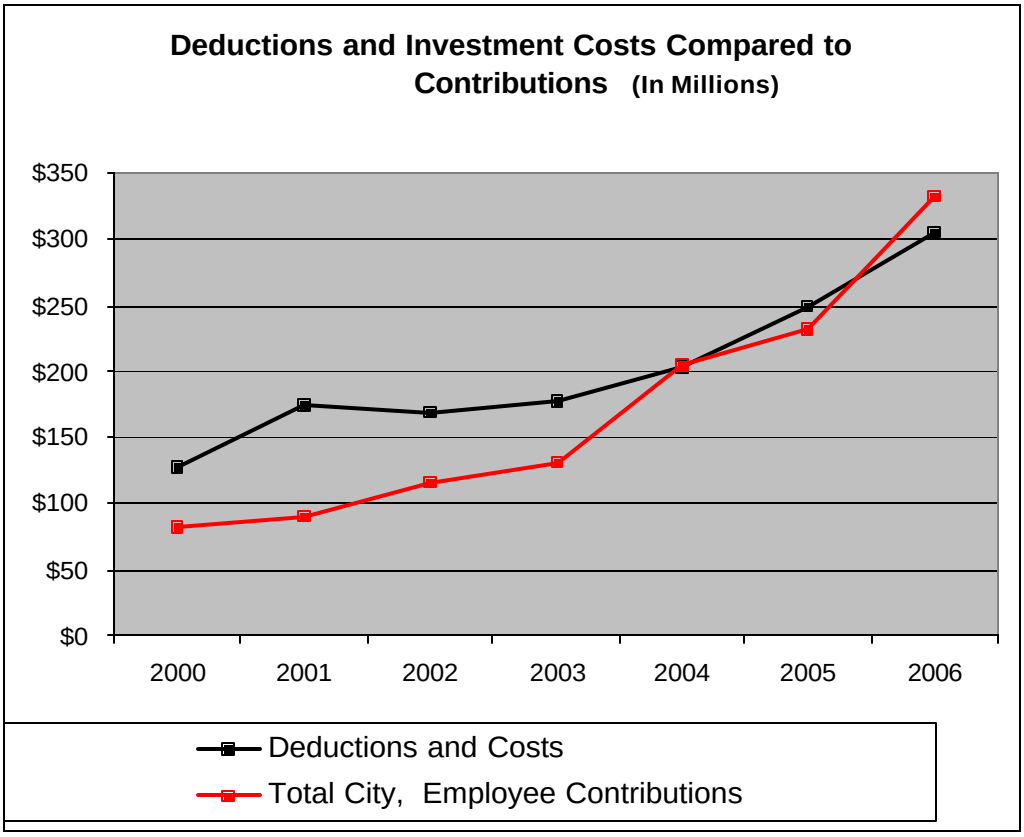
The money being spent by SDCERS on benefits and costs reduces pension fund principal and results in smaller earnings. Contributions in several years have been below SDCERS' deductions and costs of operations. Therefore, the pension fund is growing only by investment earnings, with no new principal in most years. The City reduced its base contribution from $271 million to $165 million in 2007 that resulted in deductions and costs being substantially higher than contributions. Table 13 and Chart 11 illustrate these points.

Table 13 - Deductions and Investment Costs Growth Compared to Contributions

Year	Deductions	Investment Costs	Total Deductions Invest Costs	Total City Employee Contributions
2000	$117,678,839	$9,561,581	$127,240,420	$81,428,242
2001	$162,336,721	$11,212,248	$173,542,969	$90,058,836
2002	$158,541,303	$11,273,944	$169,815,247	$115,792,094
2003	$164,948,329	$11,956,062	$176,904,391	$131,274,538
2004	$187,885,446	$14,781,389	$202,666,835	$204,027,851
2005	$232,302,504	$16,330,752	$248,633,256	$231,555,252
2006	$290,261,712	$15,000,000*	$305,261,712	$332,222,366
2007	$300,000,000*	$15,000,000*	$315,000,000*	Not available

*estimate

Chart 11 - Deductions and Investment Costs Compared to Contributions



K. Market Value of Pension Assets

One way to avoid having current and future taxpayers bear the burden of the pension's under-funding is to increase pension assets through investment income. However, SDCERS' data shows that the growth of the market value of the pension plan's assets has not kept pace with the growth of the pension plan's liabilities. The market value of pension assets in 2006 was $3.9 billion. The present value of future benefits for 2006 was $6.4 billion. Table 14

illustrates the growth (and decline) in the market value of pension assets since 2000 and the relationship to present value of future benefits.

Table 14 - Growth (and Decline) in Market Value of Pension Assets

Year	Market Value of Assets	Present Value of Future Benefits
2000	$2,999,010,145	$3,681,800,000
2001	$2,807,446,618	$3,890,000,000
2002	$2,609,623,272	$4,382,900,000
2003	$2,780,080,397	$4,941,000,000
2004	$3,368,239,286	$5,467,447,943
2005	$3,210,721,975	$3,471,603,833
2006	$3,981,931,694	$6,475,469,077

L. Actuarial Gains and Losses

The pension plan operates based upon actuarial assumptions. In four of the seven years between 2000 and 2006, the pension plan lost money as the market value of its assets declined. In other words, during those years, the pension plan was more expensive to operate than projected by the plan actuary.

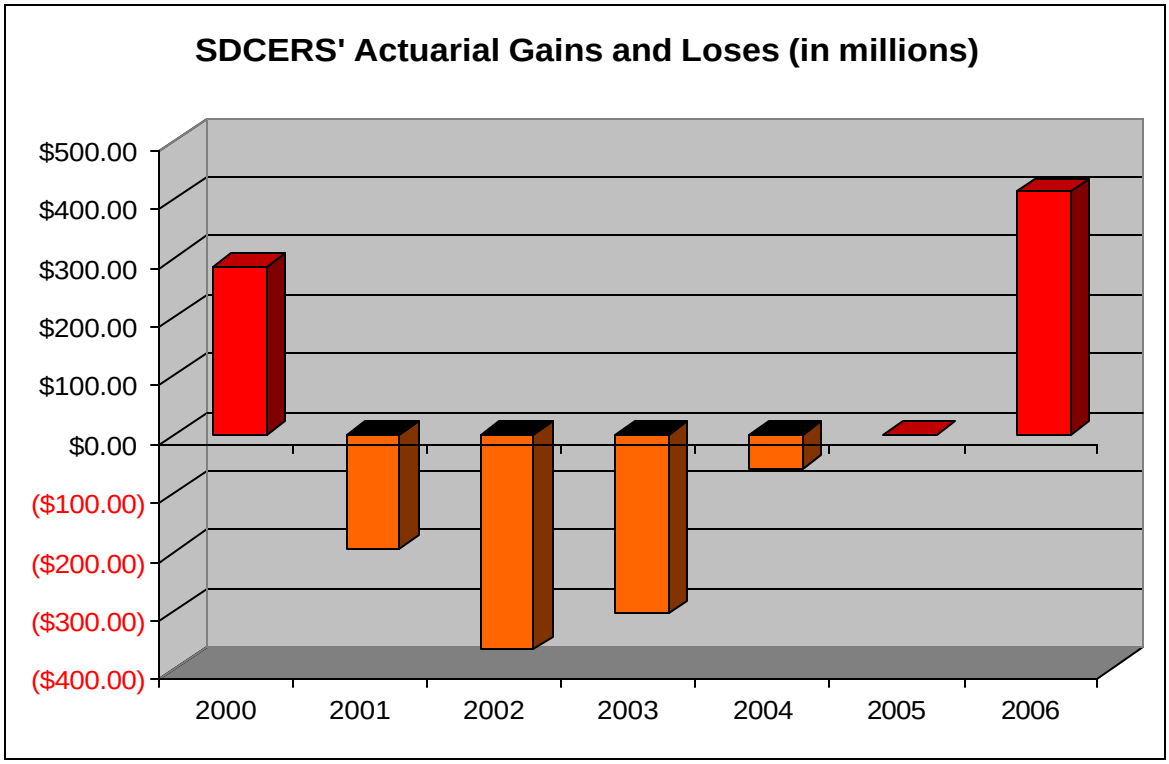
Beyond actual gains and losses, another factor that can result in a gain or loss to the pension system is the effect of assumed investment returns. SDCERS' actuary assumes an 8 percent return on investment on a yearly basis. If returns exceed the assumed rate of 8 percent, the plan shows a gain; if returns are less than 8 percent, the plan shows a loss. Additionally, other factors affecting gains or losses involve assumptions such as the mortality rate, increases in payroll levels and the age at which one retires.

Table 14 and Chart 13 show that pension actuarial losses for the period 2000 to 2006 exceed gains by $217 million:

Table 15 - Pension Plan Actuarial Gains and Losses

Year	Gain or (Loss)
2000	$286,639,160
2001	($193,168,984)
2002	($364,815,155)
2003	($303,699,305)
2004	($58,123,874)
2005	$923,388
2006	$414,639,048

Chart 13 - Actuarial Gains or Losses



M. Analysis of Trends

Assets of the pension plan are not keeping pace with the pension plan's liabilities and expenditures. The present value of pension benefits has increased 65 percent since 2000. Deductions from the plan have increased 140 percent. Even though the City's contributions since 2000 have increased 807 percent, the unfunded liability during the same period has increased 1,600 percent. In other words, taxpayers are worse off today than they were in 2000.

The City has no funds available to pay down this debt. The City's 2005 financial statement shows that the City has negative current assets of $215 million - i.e., no available funds. The Mayor and City Council must address and resolve the City's underlying financial problems if the City is to again enter the financial market. The pension debt is massive and growing, affecting the City's ability to repay other debts.

IV.
CONCLUSION

San Diego City taxpayers have a right to know about the financial burdens they are facing. If the granting of unfunded benefits is allowed to go uncorrected it will result in further deterioration of the City's financial condition.

As stated above, SDCERS unpaid bill for past benefits is $1.2 billion. Future benefits will cost taxpayers nearly $1.4 billion, for a total of almost $2.6 billion. SDCERS most recent actuarial study shows it has enough assets to pay only 41 percent of the future benefits. Ridding taxpayers of unearned and unpaid pension benefits is imperative to the City's financial recovery.

Michael J. Aguirre

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CITY OF SAN DIEGO