

# EXHIBIT 5

FEB 12 2003 #2

## SAN DIEGO CITY EMPLOYEES RETIREMENT SYSTEM

Date Issued: February 5, 2003

Attention: City Council Committee on Rules, Finance and Intergovernmental Relations

Subject: Response to the Blue Ribbon Committee Report on City Finances dated February 2002 Regarding Pension and Health Insurance Funding

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THIS IS AN INFORMATION ITEM ONLY. NO ACTION IS REQUIRED ON THE PART OF THE COMMITTEE OR THE CITY COUNCIL.

### Background

In February 2002, the Mayor's Blue Ribbon Committee on City Finances issued its report. Among the recommendations were two related to the City's funding of its pension and health insurance obligations for retired City employees. The City Manager has asked the San Diego City Employees Retirement System (SDCERS) to review the Blue Ribbon Committee's Report and recommendations, and comment on projected pension expenses, revenue sources and the current present value of retiree health benefits.

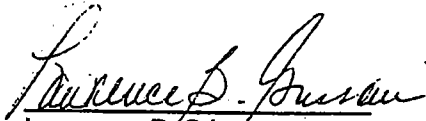
The Board of Administration of SDCERS has been studying these issues with its actuary for the past several months. The declining investment market over the past three years, along with changes in benefits such as the addition of the Corbett settlement liability, have dramatically impacted the funding level of the Retirement Fund. In addition, since 1996, the City has been making its contributions to the Retirement Fund under a negotiated agreement known as the Manager's Proposal. The Proposal allows the City to make its required annual contribution to the Fund at a rate less than the rate calculated by the actuary. As a result of these factors, the Retirement Fund is at its lowest funded ratio (assets to liabilities) in well over a decade, and the compounding effect of a less than full-actuarial contribution policy has impacted the current and future strength of the City's Retirement Fund.

Conclusion

Future scenarios are difficult to predict, and it's important to remember that the City's Retirement Fund is \$2.5 billion dollars strong and will continue to provide monthly retirement benefits to current retirees and to current City employees when they retire. The performance of the investment markets over the past three years has definitely impacted the earnings of the Fund, and consequently impacted the Fund's ability to pay contingent benefits. The investment decline has also been the primary contributor to the Fund's declining funding ratio in recent years. However, under Manager's Proposal II, the City is committed to achieving the full PUC actuarial rate contribution by 2009 and moving quickly to funding at the EAN actuarial rate thereafter. These steps will eventually improve the Retirement Fund's funding ratio. While the short-term horizon may continue to bring "weak" investment returns, it's important to remember that the Retirement Fund's 10-year average annual return for the period ending June 2002 was 9.26%. This is well above the actuarially assumed rate over this same time period of 8%. The projections in this report have assumed that investment returns may not be sufficient to pay some or all of the various contingent benefits between now and 2009. If this projection holds true, then the City will have to assess whether or not it wishes to fund these benefits from other sources and pay the contingent benefit that continues to accrue (the Corbett payment) from increased contributions.

With regard to health insurance, the current "pay-as-you-go" approach will almost certainly require either a change in this benefit or funding from sources other than the Retirement Fund and its reserves in the not too distant future. Given the dramatic rise in health insurance costs predicted by the experts, the City of San Diego might want to consider beginning to fund the future liability of health insurance for current retirees and future retirees as part of its annual employer contribution to the Retirement Fund.

Respectively Submitted,

  
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