The Report of the Actuarial Valuation of the San Jose

Federated City Employees' Retirement System

as of June 30, 2005

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GRS

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February 1, 2006

Board of Administration
Federated City Employees' Retirement System
1737 N First Street
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Dear Members of the Board:

We are pleased to present the report of the actuarial valuation of the Federated City Employees' Retirement System of the City of San Jose ("System") as of June 30, 2005.

This valuation provides information on the funding status of the System. In addition, it includes a determination of the actuarially calculated contribution levels for the 2007 fiscal year (beginning July 1, 2006) and the 2008 fiscal year.

This valuation is based on the provisions of the System in effect as of the valuation date, data on the System membership and information on the asset value of the trust fund as of that date. All member data and asset information were provided by System staff. While certain checks for reasonableness were performed, the data used was unaudited.

The actuarial assumptions and cost method are identical to those used in the prior actuarial valuation of the System, except that, a revised asset valuation method was used in this valuation.

To the best of our knowledge, this actuarial statement is complete and accurate, and has been prepared in accordance with generally accepted actuarial principles and practice.

Respectfully submitted,

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Report Highlights

Report Highlights

The following is a set of key results for the prior valuation and for the current year:

	June 30, 2003	June 30, 2005	Percent Change
I. Total Membership			
A. Active Members	4,479	4,148	(7.4)%
B. Pensioners	2,172	2,426	11.7%
C. Inactive	373	438	17.4%
II. Valuation Compensation as of June 30			
A. Total Annual Payroll	$292,961,371	$286,445,861	(2.2)%
B. Average Annual Compensation	$65,408	$69,056	5.6%
III. Benefits to Current Pensioners and Beneficiaries			
A. Total Annual Benefits	$54,687,033	$69,465,541	27.0%
B. Average Annual Benefit	$25,178	$28,634	13.7%
IV. Total System Assets			
A. Actuarial Value (net of excludables)	$1,355,987,000	$1,461,444,000	7.8%
1. Retirement Assets	1,280,719,000	1,384,454,000	8.1%
2. Health Assets	75,268,000	76,990,000	2.3%
B. Market Value	$1,217,789,000	$1,512,163,000	24.2%
V. Unfunded Actuarial Accrued Liability/(Surplus)			
A. Retirement Benefits	$30,971,610	$326,915,830	955.5%
B. Health and Dental Benefits	$145,048,399	$235,659,694	62.5%
VI. Budget Items	*FYE 2005, 2006*	*FYE 2007, 2008*	
A. Employer Cost (% of pay)			
1. Retirement Benefits	14.96%	18.16%	21.4%
2. Health and Dental Benefits	2.16%	3.82%	76.9%
3. Total	17.12%	21.98%	28.4%
B. Employee Cost (% of pay)			
1. Retirement Benefits	4.26%	4.26%	0.0%
2. Health and Dental Benefits	1.80%	3.32%	84.4%
3. Total	6.06%	7.58%	25.1%
C. Total Contribution Rate (% of pay)	**23.18%**	**29.56%**	**27.5%**
VII. Funded Ratio			
(Based on Actuarial Value of Assets)			
A. Retirement Benefits	97.6%	80.9%	(17.1)%
B. Health Subsidy Benefits	34.2%	24.6%	(28.1)%
C. Total	88.5%	72.2%	(18.4)%
(Based on Market Value of Assets)			
D. Total	79.5%	74.7%	(6.0)%

Comments and Recommendations

Comments & Recommendations

COMMENT A: The contribution rate for the System increased significantly from 23.18% to 29.56%. Based on the provisions of the Ordinance this total rate is allocated as follows:

1) 21.98% to the City — current 17.12
2) 7.58% to the employees — 6.06

COMMENT B: The retirement benefit funded ratio decreased from 97.6% to 80.9%. The health benefit funded ratio also decreased from 34.2% to 24.6%. The overall funded ratio dropped from 88.5% to 72.2%.

COMMENT C: The principal reasons for the contribution rate increase and funded ratio decrease are as follows. Please refer to page 16 for additional details:

1) There was a $93.8 million loss on the actuarial value of assets. For this purpose, gains and losses are calculated relative to the 8.25% investment assumption NOT zero. Despite the healthy market returns since June 30, 2003, such losses reflect smoothing from the 2000-2002 bear market. On an actuarial basis, the City's investment return averaged 5.0% for the 2004 and 2005 fiscal years.

2) There were many more retirements at earlier ages than expected during July 1, 2003 and June 30, 2005. There were nearly 60% more new retirees in this time period than anticipated by the prior assumptions.

3) Significant retiree medical premiums increases and more retirees receiving medical benefits than expected. AVE YOS 2003 10.5 2005 11.4

4) There was an unexpected decrease in active member payroll. When a fixed liability is financed over smaller than expected payroll, a higher percentage rate of the unfunded actuarially accrued liability results, other factors equal.

COMMENT D: There is one element of good news in this valuation. Due to actuarial smoothing, the market value of assets is not directly used in calculating computed rates. Unexpected market fluctuations are spread over a 5-year time frame (see page 34). There is no longer a large deferred loss reflected in the actuarial value of assets but a deferred gain.

Comments & Recommendations

Using market value, the overall funded ratio is 74.7% compared to 72.2% using the actuarial value of assets. In the 2003 valuation, the overall funded ratio was 9% higher (88.5% versus 79.5%) using the actuarial value of assets than when using market value. Put another way, the funded ratio dropped by 16.3% using the actuarial value of assets but only by 4.8% using market value of assets. Thus, this valuation reflects the final adverse impact from the 2000-02 bear market.

Other factors equal, this deferred gain will provide some impetus for a slightly reduced 2007 contribute rate. An ongoing deferred loss has the opposite effect.

COMMENT E: Staff indicated concern with the marked increase in the unfunded accrued actuarial liability ("UAL") for retirement benefits – from $31 million to $327 million – close to a ten-fold increase. Changes of this magnitude for funds your size have been quite common recently. In addition to the experience losses, primarily for investments and greater retirements than anticipated, assumption changes were made to reflect longer life expectancies and earlier retirements. The net impact of all assumption changes was to increase the UAL by $82.7 million. Also, most large entities in California have annual valuations. This report reflects two years of updated activity instead of just one. Last, the percentage increase is so high due to the fact that the System was so close to being fully funded in 2003 – a small denominator means a much higher percentage increase. We believe it is more relevant to look at the change in the dollar amount of the UAL in this case.

COMMENT F: The SRBR reserve balance as of June 30, 2005 was $15,323,850 as reported to us by Staff. This is excluded from valuation assets.

COMMENT G: There were two interesting demographic developments. The number of active employees decreased by (7.4%) and the average age of an active member increased from 44.1 to 45.0 years.

COMMENT H: At the December Retirement Board meeting, we recommended that the 30-year amortization period commence to be reduced in future valuations as a "best practice." Two weeks ago, there was a suit filed against the San Diego County Employees' Retirement Association which alleges that their 20-year amortization period is "illegal" since there is negative principal amortization using level dollars for the next several years. However, there is "positive" amortization in context of assumed future inflation. We will keep the Board and staff up to date on such developments.

COMMENT I: The Retiree Medical contribution rate increased significantly from 3.96% to 7.14%. This was primarily due to a 50% increase in total premiums from June 30, 2003 to June 30, 2005 when only a 30% increase was projected.

Financial Principles and Operational Techniques

Financial Principles and Operational Techniques

Promises Made, and To Be Paid For. As each year is completed, the Retirement System in effect hands an "IOU" to each member then acquiring a year of service credit – the "IOU" says: "The San Jose Federated City Employees' Retirement System owes you one year's worth of retirement benefits, payments in cash commencing when you qualify for retirement."

The related key financial questions are:

Which generation of taxpayers contributes the money to cover the IOU?

> **The present taxpayers**, who receive the benefit of the member's present year of service; or
>
> **The future taxpayers**, who happen to be in San Jose at the time the IOU becomes a cash demand, years and decades later?

The principle of level percent of payroll financing intends that this year's taxpayers contribute the money to cover the IOUs being handed out this year. By following this principle, the employer contribution rate will remain approximately level from generation to generation (after funding of the system's initial unfunded liability is addressed) – our children and our grandchildren will contribute the same percents of active payroll we contribute now.

(There are systems which have a design for deferring contributions to future taxpayers, lured by a lower contribution rate now and putting aside the consequence that the contribution rate must then relentlessly grow much greater over decades of time.)

An inevitable by-product of the level-cost design is the accumulation of reserve assets, for decades, and income produced when the assets are invested. Invested assets are a by-product and not the objective. Investment income becomes, in effect, the 3rd contributor for benefits to employees, and is interlocked with the contribution amounts required from employees and employer.

Translated to actuarial terminology, this level-cost objective means that the contribution rates must total at least the following:

Current Cost (the cost of members' service being rendered this year) . . .

plus. . .

Interest on Unfunded Accrued Liability (UAL is the difference between (i) liabilities for service already rendered and (ii) the assets of the plan).

Computing Contributions To Support System Benefits. From a given schedule of benefits and from the employee data and asset data furnished, the actuary determines the contribution rates to support the benefits, by means of an actuarial valuation and a funding method.

An actuarial valuation has a number of ingredients such as: the rate of investment return which plan assets will earn; rates of withdrawal of active members who leave covered employment; rates of mortality; rates of disability; rates of pay increases; and the assumed age or ages at actual retirement. In an actuarial valuation, assumptions must be made as to what the above rates will be, for the next year and for decades in the future. Only the subsequent actual experience of the plan can indicate the degree of accuracy of the assumptions.

Reconciling Differences Between Assumed Experience and Actual Experience. Once actual experience has occurred and been observed, it will not coincide exactly with assumed experience, regardless of the wisdom behind the various financial assumptions or the skill of the actuary and the millions of calculations made. The future can be predicted with considerable but not complete precision, except for inflation which defies reliable prediction.

The System copes with these continually changing differences by having bi-annual actuarial valuations. Each actuarial valuation is a complete recalculation of assumed future experience, taking into account all past differences between assumed and actual experience. The result is continual adjustments in the computed contribution rates.

Financial Principles and Operational Techniques

THE ACTUARIAL VALUATION PROCESS

The financing diagram on the following page shows the relationship between the two fundamentally different philosophies of paying for retirement benefits: the method where contributions match cash benefit payments (or barely exceed cash benefit payments, as in the Federal Social Security program) which is an increasing contribution method; and the level contribution method which equalizes contributions between the generations.

The actuarial valuation is the mathematical process by which the level contribution rate is determined. The flow of activity constituting the valuation may be summarized as follows:

A. Covered people data, furnished by staff, including:

Retired members now receiving benefits

Former employees with vested benefits not yet payable

Active employees

B. + Asset data (cash & investments), furnished by staff

C. + Assumptions concerning future experience in various risk areas, which are established by the Board after consulting with the actuary

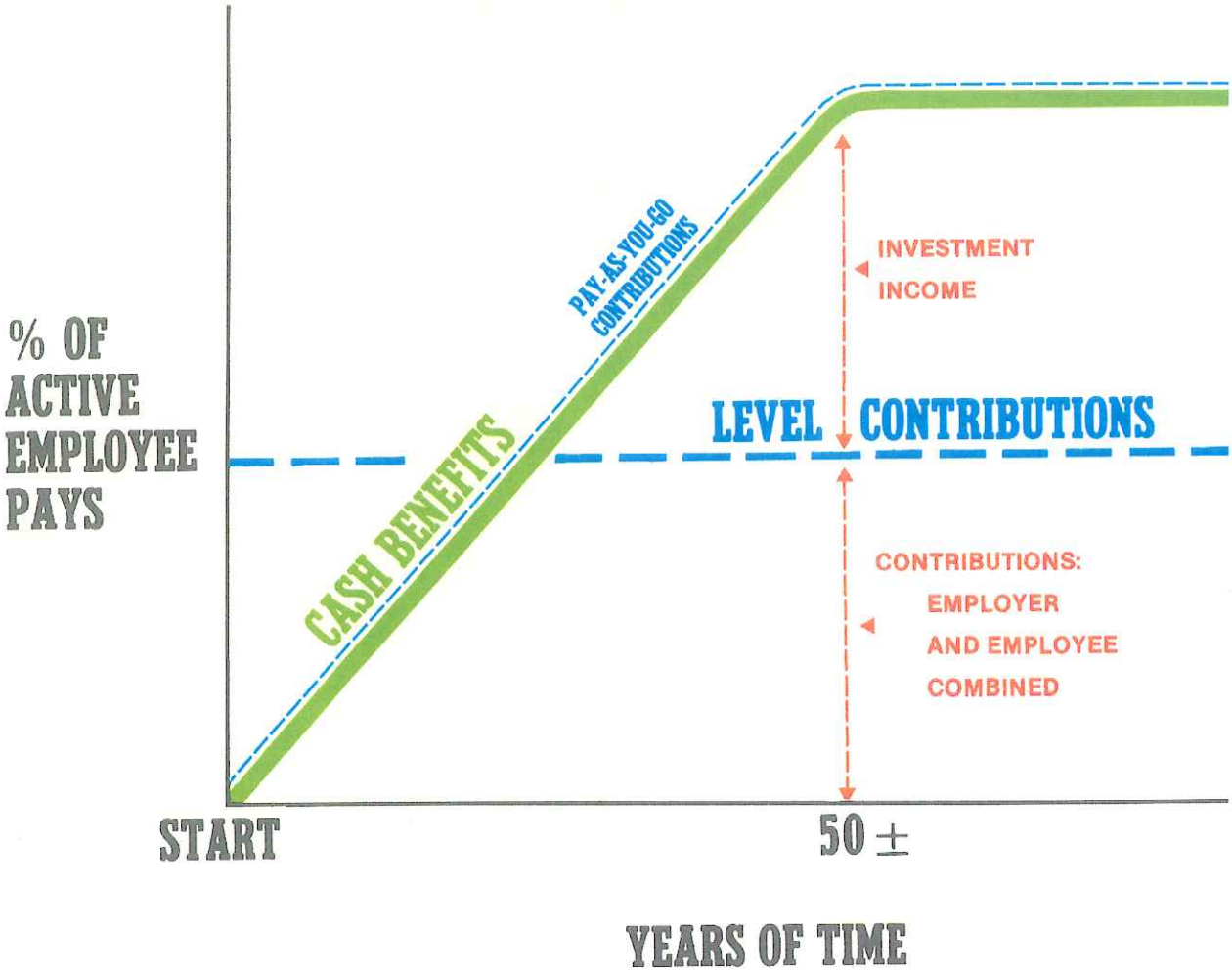
D. + The funding method for employer contributions (the long-term, planned pattern for employer contributions)

E. + Mathematically combining the assumptions, the funding method, and the data

F. = Determination of:

Plan Financial Position and/or

Employer's New Contribution Rate



CASH BENEFITS LINE. This relentlessly increasing line is the fundamental reality of retirement plan financing. It happens each time a new benefit is added for future retirements (and happens regardless of the design for contributing for benefits).

LEVEL CONTRIBUTION LINE. Determining the level contribution line requires detailed assumptions concerning a variety of experiences in future decades, including:

Economic Risk Areas

- Rates of investment return
- Rates of pay increase
- Changes in active member group size

Non-Economic Risk Areas

- Ages at actual retirement
- Rates of mortality
- Rates of withdrawal of active members (turnover)
- Rates of disability

Valuation Results

Valuation Results

Total Actuarial Contribution

The San Jose Municipal Code provides that the required annual contribution is allocated between the City and the members as follows:

- The **Current Service Rate (Normal Rate)** is the cost for funding liabilities for service after July 1, 1975. This cost is shared 8/3 between the City and the Members.
- The **Current Service Deficiency Rate** is the amortization of the funding deficiency for service after July 1, 1975 which is not covered by the Current Service Rate. The City bears this entire cost.
- The **Prior Service Rate** is the difference in costs between the current plan and the predecessor plan (the "1964 Plan') for service before July 1, 1975. The cost is shared 58/42 between the City and the Members. Additionally, the City's Prior Service Rate reflects the entire cost for any gains or losses associated with liabilities for service prior to July 1, 1975 (**Prior Service Deficiency Rate**).
- The **Golden Handshake Rate** is the cost for funding the additional benefits granted to certain retiring employees. The City bears this entire cost.
- The **Reciprocity Rate** represents prefunding of the liability associated with the adoption of reciprocal benefits with other public pension plans. The City bears this entire cost.

Under the Municipal Code, the contribution is allocated between the City and the members as follows:

- The **Health Insurance Rate** is the cost for funding, as a level percent of payroll, a 15-year projection of premiums. The cost is shared 50/50 between the City and the Members.
- The **Dental Insurance Rate** is the cost for funding, as a level percent of payroll, a 15-year projection of premiums. The cost is shared 8/3 between the City and the Members.

The contribution rates developed in this valuation are summarized as follows:

Recommended Contributions for Fiscal Years 2007 and 2008		
	Percentage of Salary	
	City	**Member**
Contribution for Retirement, Disability, and Death Benefits	18.16%	4.26%
Contribution for Health Subsidy Benefits	3.82%	3.32%
Total Contribution	21.98%	7.58%

Valuation Results

Explanation of Contribution Change Since the Last Valuation

The effect of experience on the System's total contribution rate is as follows:

June 30, 2003 Pension and Medical Contribution Rate		**23.18%**
Increase due to Investment Losses	1.77%	
Increase due to greater number of retirements than anticipated	1.45%	
Decrease due to Salary Gains	-0.72%	
Decrease due to Assumption Changes	-0.59%	
Increase due to Retiree Medical Premium increases and decreasing payroll	1.40%	
Increase in retiree medical rate due to funding method	1.43%	
Increase due to contribution timing lag	0.39%	
Decrease due to post-retirement mortality gains	-0.09%	
Impact of lower payroll on retirement benefit rate	0.07%	
Other miscellaneous factors	1.27%	
Total Change in Contribution Rate		**6.38%**
June 30, 2005 Pension and Medical Total Contribution Rate		**29.56%**

Computed Contribution Rates - Historic Comparison

Valuation Date	CITY Retirement	CITY Health	CITY Total	MEMBER	TOTAL	Valuation Payroll (thousands)
6/30/91	n/a	n/a	n/a	*n/a*	22.47%	n/a
6/30/93	n/a	n/a	n/a	*n/a*	26.13%	$145,781
6/30/95	n/a	n/a	n/a	*n/a*	26.65%	153,918
6/30/97	n/a	n/a	n/a	*n/a*	21.83%	176,284
6/30/99	15.33%	0.76%	16.09%	*4.76%*	20.85%	193,650
6/30/01	13.82%	1.38%	15.20%	*5.08%*	20.28%	252,696
6/30/03	14.96%	2.16%	17.12%	*6.06%*	23.18%	292,961
6/30/05	18.16%	3.82%	21.98%	*7.58%*	29.56%	286,446

Valuation Results

Recommended Contributions for Retirement Benefits
Fiscal Years 2007 and 2008

	City	Members
For Basic Retirement Benefits		
Current Service Normal Rate	8.75%	3.28%
Current Service Deficiency Rate	2.98%	n/a
Prior Service Normal Rate	0.01%	0.01%
Prior Service Deficiency Rate	1.53%	n/a
Retirement Golden Handshake Rate	0.31%	n/a
Reciprocity	0.40%	n/a
Total Contributions for Basic Retirement Benefits	*13.98%*	*3.29%*
For Cost-of-Living (COL) Retirement Benefits		
Current Service Normal Rate	2.60%	0.97%
Current Service Deficiency Rate	1.36%	n/a
Prior Service Normal Rate	0.01%	0.00%
Prior Service Deficiency Rate	0.00%	n/a
Retirement Golden Handshake Rate	0.09%	n/a
Reciprocity	0.12%	n/a
Total Contributions for COL Retirement Benefits	*4.18%*	*0.97%*
Total Contributions for Retirement Benefits	18.16%	4.26%

Valuation Results

Summary of Actuarial Values

($ in 000's)

			Entry Age Actuarial Values	
		Present Value of Projected Benefits	Actuarial Accrued Liability (AAL)	Normal Cost % of Pay
(1)	**Active Members**			
	a. Retirement	$1,004,977	$753,648	11.91%
	b. Termination	66,479	29,982	1.58%
	c. Death	22,084	12,490	0.45%
	d. Disability	59,520	31,392	1.34%
	e. Refunds	23,220	9,782	0.60%
	Total	$1,176,280	$837,294	15.88%
(2)	**Benefit Recipients**	$824,043	$824,043	0.00%
(3)	**Other Inactives**	50,033	50,033	0.00%
(4)	**Total Actuarial Values of Benefits**	$2,050,356	$1,711,370	15.88%
(5)	**Actuarial Value of Assets**		$1,384,454	
(6)	**Unfunded Actuarial Accrued Liability:** (4) – (5)		$326,916	
(7)	**Funding Ratio**		80.9%	

Valuation Results

Actuarial Balance Sheet – Retirement Benefits
As of June 30, 2005
($ in 000's)

PRESENT VALUE AND EXPECTED FUTURE RESOURCES

			Total
(1)	Actuarial Value of Assets		$1,384,454
(2)	Present Value of Future City Contributions		
	a. Normal Rate	251,151	
	b. Deficiency Rate	307,123	
	c. Golden Handshake	19,793	
	d. Unfunded Accrued Liability: (b) + (c)	326,916	
	e. Total		578,067
(3)	Present Value of Future Member Contributions		87,835
(4)	**Total Present and Expected Future Resources**		**$2,050,356**

PRESENT VALUE OF EXPECTED FUTURE BENEFIT PAYMENTS AND RESERVE

			Total
(1)	To Retirants and Beneficiaries		$824,043
(2)	To Vested Terminated and Inactive Members		50,033
(3)	To Active members		
	a. Allocated to service rendered prior to valuation date	837,294	
	b. Allocated to service expected to be rendered in the future	338,986	
	c. Total		1,176,280
(4)	**Total Present Value of Expected Future Benefit Payments**		**$2,050,356**

Valuation Results

Actuarial Balance Sheet – Health Subsidy Benefits
As of June 30, 2005

($ in 000's)

Assets

(1)	Current Assets Available for Benefits		$76,990
(2)	Present Value of Future Contributions		
	a. City	126,081	
	b. Members	109,579	
	c. Total		235,660
(3)	Total Assets		312,650

Liabilities

(4)	Present Value of Subsidies for the Next 15 Years	$312,650

Recommended Contributions for Health Subsidy Benefits
Fiscal Years 2005 and 2006

	City	Members
Medical Insurance Rate	3.03%	3.02%
Dental Insurance Rate	0.79%	0.30%
Total	**3.82%**	**3.32%**

Valuation Results

Unfunded Actuarial Accrued Liability for Retirement Benefits Only June 30, 2005

Derivation of Experience Gain (Loss)

Analysis of actuarial gains and losses in a pension benefit program is a review of the effects on actuarial results of actual experience that differs from assumed experience. If such a difference increases assets or reduces liabilities, there is an actuarial gain. The reverse is an actuarial loss.

(1) Unfunded Actuarial Accrued Liability (UAAL) as of June 30, 2003		$30,971,610
(2) Expected Change in UAAL during 2004-2005		
a. Normal Cost for 2004-2005	$106,379,171	
b. Contributions during 2004-2005	(105,873,000)	
c. Interest adjustments on 1, 2a, & 2b @ 8.25%	5,475,541	
d. Adjustment for timing lag of contributions	15,450,000	
e. Expected change in UAAL		$21,431,712
(3) Increase in UAAL due to Assumption Changes		$82,657,395
(4) Expected UAAL at the end of year [(1) + (2) + (3)]		$135,060,717
(5) Actual End of Year UAAL		$326,915,830
(6) Total Gain/(Loss)		$(191,855,113)
As a % of Accrued Liabilities at 6/30/03		(14.6)%

Note:

Asset (Loss)	(89,906,000)
- As a % of Accrued Liabilities at 6/30/03	(6.8)%
Liability (Loss)	(101,949,113)
- As a % of Accrued Liabilities at 6/30/03	(7.8)%

Funding Progress

Information for GASB No. 25 & 27

Funding Progress Indicators

June 30, 2005

There is no single all-encompassing indicator which measures a retirement system's funding progress and current funded status. A traditional measure has been the relationship of valuation assets to unfunded actuarial accrued liability -- a measure that is influenced by the choice of actuarial cost method.

We believe a better understanding of funding progress and status can be achieved using the following indicators which are independent of the actuarial cost method.

(1) The ratio of assets to the actuarial present value of credited projected benefits allocated in the proportion accrued service is to projected total service -- a plan continuation indicator. The ratio is expected to increase in the absence of benefit improvements or strengthening of actuarial assumptions.

(2) The ratio of the unfunded actuarial present value of credited projected benefits to member payroll - a plan continuation indicator. In a soundly financed retirement system, the amount of the unfunded actuarial present value of credited projected benefits will be controlled and prevented from increasing in the absence of benefit improvements or strengthening of actuarial assumptions. However, in an inflationary environment, it is seldom practical to impose this control on dollar amounts which are depreciating in value. The ratio is a relative index of condition where inflation is present in both items. The ratio is expected to decrease in the absence of benefit improvements or strengthening of actuarial assumptions.

Funding Progress

Schedule of Funding Status for Retirement Benefits
($ in 000's)

End of Year	Actuarial Value of Assets (a)	AAL (b)	UAAL (b-a)	Funding Ratio (a/b)	Payroll* (c)	UAAL as % of Payroll ((b-a)/c)
1993	489,865	583,119	93,254	84.0%	145,781	64.0%
1995	566,102	658,175	92,073	86.0%	153,918	59.8%
1997	678,954	735,772	56,818	92.3%	176,284	32.2%
1999	804,860	862,226	57,366	93.4%	193,650	29.6%
2001	1,060,144	1,072,333	12,189	98.9%	252,696	4.8%
2003	1,280,719	1,311,691	30,972	97.6%	292,961	10.6%
2005[1]	1,384,454	1,628,713	244,259	85.0%	286,446	85.3%
2005	1,384,454	1,711,370	326,916	80.9%	286,446	114.1%

[1] **Liabilities based on old assumptions**

Funding Progress

Schedule of Employer Contributions
Retirement Benefits Only

Fiscal Year	Annual Required Contribution	Percentage Contributed
1999/2000	15.37%	100%
2000/2001	15.33%	100%
2001/2002	15.33%	100%
2002/2003	13.82%	100%
2003/2004	13.82%	100%
2004/2005	14.96%	100%

Summary of Benefit Provisions

Summary of Retirement Benefit Provisions

1. Eligibility: Members are eligible on their first day of City employment.

2. Final Compensation: Highest 12-month average salary, if separation takes place on or after July 1, 2001.

Highest 36-month average salary, if separation takes place before July 1, 2001.

3. Service Retirement:

A) Eligibility: Age 55 with 5 years of service, or any age with 30 years of service.

B) Benefit: 2.5% of Final Compensation for each year of service. Maximum benefit is 75% of Final Compensation.

C) Form of Payment: Monthly benefit payable for the life of the member.

4. Disability Retirement:

A) Eligibility: Physically or mentally incapacitated so unable to perform duties of position. If disability is not service connected, then the member must have at least five years of City service.

B) Benefit: 2.5% of Final Compensation per year of service. The maximum benefit is 75% and the minimum benefit is 40% of Final Compensation. Any Workers' Compensation benefits are offset from the benefits under this system.

If the disability was non-service connected, then the benefit is reduced by .5% for every year under age 55.

For those members who are hired on or after September 1, 1998, the non-service connected benefit is as follows:

20% of Final Compensation for 6 years of service;
Plus 2% for each years of service in excess of 6, but less than 16;
Plus 2.5% for each year of service in excess of 16.

C) Form of Payment: Monthly benefit payable for the life of the member.

Summary of Retirement Benefit Provisions

(continued)

5. Deferred Service Retirement:

A) Eligibility: Five years of membership prior to termination of City service. Member must leave contributions on deposit until retirement.

B) Benefit: Same as Service Retirement, payable anytime after age 55.

C) Form of Payment: Same as Service Retirement.

6. Pre-Retirement Death Benefits:

A) Non-Service Connected with less than five years of service, or No Family Members Eligible for Allowance: Member's beneficiary or estate receives (i), and (ii) where:

(i) = Accumulated contributions with interest.

(ii) = Lump sum benefit of one month's salary for each year of service, up to six years.

B) Service-Connected, or Non-Service Connected with five years of service

Member's eligible survivor receives 2.5% of Final Compensation per years of service. The maximum benefit is 75% and the minimum benefit, if still an active employee at time of death, is 40% of Final Compensation, payable until the spouse remarries. If the Member was age 55 with 20 years of service at death, the benefit is payable for the lifetime of the Member's spouse.

7. Post-Retirement Death Benefits: Member's eligible survivor receives (i) and (ii), where:

(i) = 50% continuance to surviving eligible spouse; if there is no surviving spouse, certain benefits are paid to the children.

(ii) = $500 death benefit allowance for burial expenses at death of retired member.

Summary of Retirement Benefit Provisions

(continued)

8. Post-retirement Cost-of-Living Benefits:

Each April 1, the benefits are increased by the percentage increase in CPI (to a maximum of 3%). Increases in CPI above 3% are "banked" to apply in years when CPI increase is less than 3%.

The first cost-of-living adjustment is on the first day of the month following the one-year anniversary of retirement. The next adjustment will be prorated for the number of months remaining until the following April.

9. Employee Contributions:

The Members' contribution rates are recalculated on an actuarial basis at each actuarial study. Contributions are credited with 3% interest annually (the interest crediting provision was changed from 7.25% to 3% effective July 1, 2001).

All references to spouse also encompass registered domestic partners.

Summary of Health Subsidy Benefit Provisions

1.	**Eligibility:**	
	A) Medical	Fifteen years of service credit at retirement, or receiving an allowance of at least 37 1/2% of Final Compensation. Must be enrolled in a City medical insurance plan at retirement.
	B) Dental	Five years of service credit at retirement, or receiving an allowance of at least 37 1/2% of Final Compensation. Must be enrolled in a City dental insurance plan at retirement.
2.	**Benefit**	
	A) Medical	The Retirement System pays 100% of the premium for the lowest cost medical plan offered by the City for single and family coverage. Members and eligible survivors pay for the difference in the premium for their selected plan and the portion paid by the Retirement System for the lowest cost plan.
	B) Dental	The Retirement System pays the entire cost of dental insurance coverage.
3.	**Contributions**	Both the City and the Members contribute to the Retirement System fund for medical and dental insurance benefits.

NOTE: Please inform the actuary IMMEDIATELY if any of the retirement or health benefit provision summaries are incorrect.

Asset Information

Asset Information

Statement of Plan Net Assets
June 30, 2005
($ in 000's)

	Pension Benefits	Post-Employement Healthcare	Total
ASSETS			
Receivables			
Employee Contribution	403	171	574
Employer Contribution	1,418	205	1,623
Brokers and Others	41,204	2,300	43,504
Accrued Investment Income	5,901	330	6,231
	48,926	3,006	51,932
Investments			
Short Term Funds	28,041	1,536	29,577
Short Term Currency Investments	3,030	166	3,196
Government Debt Securities	328,153	17,977	346,130
Corporate Debt Securities	188,044	10,302	198,346
Equities	856,998	46,950	903,948
Real Estate	47,246	2,637	49,883
Securities Lending Pool	158,504	8,846	167,350
	1,610,016	88,414	1,698,430
Total Assets	**$1,658,942**	**$91,420**	**$1,750,362**
Liabilities			
Payable to Brokers	65,580	3,660	69,240
Securities Lending Collateral Due	158,504	8,846	167,350
Other Liabilities	1,530	79	1,609
Total Liabilities	**$225,614**	**$12,585**	**$238,199**
Net Assets Available For Benefits	**$1,433,328**	**$78,835**	**$1,512,163**

Asset Information

Statement of Changes in Plan Net Assets
For the Fiscal Year Ended June 30, 2005
($ in 000's)

	Pension Benefits	Post-Employement Healthcare	Total
ADDITIONS			
Contributions			
Employee Contribution	12,393	5,219	17,612
Employer Contribution	41,552	5,996	47,548
	53,945	11,215	65,160
Investment Income			
Net Appreciation	82,296	4,657	86,953
Dividends and Interest	29,326	1,658	30,984
Net Rental Income	8,086	458	8,544
Investment Expense	(4,293)	(245)	(4,538)
Net Securities Lending Income	203	11	214
	115,618	6,539	122,157
Total Additions	**169,563**	**17,754**	**187,317**
DEDUCTIONS			
Retirement Benefits	60,438	-	60,438
Health Insurance Premiums	-	13,393	13,393
Death Benefits	5,437	-	5,437
Refunds	927	-	927
Administrative Expenses	1,588	95	1,683
Total Deductions	**68,390**	**13,488**	**81,878**
NET ASSETS AVAILABLE FOR BENEFITS			
Beginning of Year	**1,332,155**	**74,569**	**1,406,724**
End of Year	**1,433,328**	**78,835**	**1,512,163**

Asset Information

Development of Actuarial Value of Assets
As of June 30, 2005
($ in 000's)

(1)	**Market Value of Assets**		**1,512,163**
(2)	Deferred Gains / (Losses)	Total	Deferred
	June 30, 2005 Gain (80% deferred)	6,778	5,422
	June 30, 2004 Gain (60% deferred)	103,558	62,135
	June 30, 2003 (Loss) (40% deferred)	(19,130)	(7,652)
	June 30, 2002 (Loss) (20% deferred)	(122,552)	(24,510)
	Total		35,395
(3)	Actuarial Value of Assets @ 6-30-2005 (1) - (2) (including excludable assets)		1,476,768
(4)	Allocation of Actuarial Value of Assets ("AVA")		
	a. Post-employment Health Care Fund		**76,990**
	b. Retirement Benefits		
	Remaining AVA	1,399,778	
	Contingency Reserve	-	
	SRBR Reserve	15,324	
	AVA for Retirement Benefits		**1,384,454**
(5)	**Final Actuarial Value of Assets for System**		**1,461,444**

Membership Data

Membership Data

Summary of Data Characteristics

	June 30, 2003	June 30, 2005	Percentage Change
Active Members*			
Number	4,479	4,148	-7.4%
Average Age	44.1	45.0	2.0%
Average Years of Service	10.5	11.4	8.6%
Total Annual Compensation	292,961,371	286,445,861	-2.2%
Average Annual Compensation	65,408	69,056	5.6%
Retirees & Disabled Members			
Number	1,833	2,078	13.4%
Average Age	68.3	68.1	-0.3%
Total Annual Allowance	49,766,886	63,998,727	28.6%
Average Annual Benefit	27,151	30,798	13.4%
Beneficiaries			
Number	339	348	2.7%
Average Age	70.6	72.4	2.5%
Total Annual Allowance	4,920,147	5,466,814	11.1%
Average Annual Benefit	14,514	15,709	8.2%
Benefit Recipients - Total			
Number	2,172	2,426	11.7%
Average Age	68.7	68.7	0.0%
Total Annual Allowance	54,687,033	69,465,541	27.0%
Average Annual Benefit	25,178	28,634	13.7%
Inactive Members			
Number	373	438	17.4%
Average Age	45.3	45.7	0.9%
Total Annual Allowance	4,499,141	5,714,166	27.0%
Average Annual Benefit	12,062	13,046	8.2%

* Includes those on Leave of Absense

Membership Data

Distribution of Active Members and Average Pay by Age and Years of Service as of June 30, 2005

Age	Years of Service								Totals
	Under 1	1-4	5-9	10-14	15-19	20-24	25-29	30 & Over	
Under 20	1	-	-	-	-	-	-	-	1
	$34,424	-	-	-	-	-	-	-	$34,424
20-24	5	23	2	-	-	-	-	-	30
	$33,937	$43,792	$48,610	-	-	-	-	-	42,471
25-29	27	166	51	1	-	-	-	-	245
	$50,573	$54,744	$58,375	$87,412	-	-	-	-	55,174
30-34	33	211	200	20	-	-	-	-	464
	$49,777	$60,081	$66,734	$68,013	-	-	-	-	62,558
35-39	18	171	212	92	54	1	-	-	548
	$59,118	$61,678	$65,520	$68,530	$67,981	$83,054	-	-	64,891
40-44	12	109	190	98	201	46	1	-	657
	$62,628	$66,493	$68,721	$77,701	$72,570	$69,017	$54,870	-	70,757
45-49	11	101	140	104	204	107	58	1	726
	$53,756	$68,245	$69,217	$77,386	$73,899	$75,898	$72,756	$64,844	72,595
50-54	8	94	136	81	185	115	95	8	722
	$69,221	$73,945	$70,716	$71,159	$75,399	$76,171	$73,644	$77,960	73,704
55-59	9	53	98	69	132	64	48	14	487
	$63,400	$66,926	$71,463	$76,533	$76,011	$78,612	$73,755	$83,538	74,284
60-64	3	27	52	20	42	32	14	7	197
	$47,057	$74,868	$66,514	$61,058	$71,932	$80,571	$71,735	$74,987	70,919
65&Over	1	4	21	17	12	9	6	1	71
	$13,566	$54,455	$63,945	$59,351	$63,007	$67,695	$65,614	$137,883	63,100
Totals	128	959	1,102	502	830	374	222	31	4,148
	$53,893	$62,770	$67,587	$73,088	$73,605	$75,822	$73,014	$81,318	$69,056

Actuarial Methods and Assumptions

Actuarial Methods

Actuarial Valuation Cost Method. The Entry Age Normal Cost Methods is used for the retirement benefits of the System.

The concept of this method is that funding of benefits for each employee should be effected as a, theoretically, level contribution (as a percentage of pay) from entry into the System to termination of active status.

The Normal Cost (NC) for a fiscal year under this method is determined as described in the prior paragraph for each employee. The NC for the year is the total of individual normal costs determined for each active employee.

The Actuarial Accrued Liability (AAL) under this method is the theoretical asset balance such normal costs would have accumulated to date based on current assumptions. To the extent that the assets of the fund are insufficient to cover the AAL, an Unfunded Actuarial Accrued Liability (UAAL) develops.

The actuarially calculated contribution for a year is the NC for that year plus an amount to amortize the UAAL over 30 years as a level percentage of pay. GRS has recommended that the amortization period start to decline in future valuations.

A 15-year projection of premiums as a level percent of payroll is used to determine the Medical Insurance Contribution Rates.

Financing of Unfunded Actuarial Accrued Liability. The balance of unfunded actuarial accrued liabilities was amortized by level (principal & interest combined) percent of payroll contributions over a 30-year period.

Active member payroll in aggregate was assumed to increase 4.0% (4.5% per year in the previous valuation) a year for the purpose of determining the level percent contributions, although individual annual compensation increase rates will increase by at least 4.25% per year for the purpose of projecting individual benefits.

Asset Valuation Method. The Actuarial Value of Assets recognizes 20% of total return in excess of (or less than) the investment return assumption for each of the last five years. This method has the effect of smoothing volatility in investment returns.

Actuarial Assumptions Used for the June 30, 2005 Valuation

The contribution requirements and benefit values of the Fund are calculated by applying actuarial assumptions to the benefit provisions and member information furnished, using the actuarial cost methods described on the previous page.

The principal areas of financial risk which require assumptions about future experiences are:

(i) long-term rates of investment return to be generated by the assets of the Fund.

(ii) patterns of pay increases to members.

(iii) rates of mortality among members, retirants, and beneficiaries.

(iv) rates of withdrawal of active members (without entitlement to a retirement benefit).

(v) rates of disability among members.

(vi) the age patterns of actual retirements.

In making a valuation, the monetary effect of each assumption is calculated for as long as a present covered person survives -- a period of time which can be as long as a century.

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Actual experience of the system will not coincide exactly with assumed experience, regardless of the choice of the assumptions, the skill of the actuary and the precision of the many calculations made. Each valuation provides a complete recalculation of assumed future experience and takes into account all past differences between assumed and actual experience. The result is a continual series of adjustments to the computed contribution rate. From time to time it becomes appropriate to modify one or more of the assumptions, to reflect experience trends (but not random year-to-year fluctuations).

Actuarial Assumptions Used for the June 30, 2005 Valuation

The Investment Return Rate used for the actuarial valuation calculations was 8.25% a year, net of administrative expenses, compounded annually. This assumption is used to equate the value of payments due at different points in time. The rate is comprised of two elements:

Inflation	4.00% (4.5% in previous valuation)
Real Rate of Return	4.25% (3.75% in previous valuation)
Total	8.25%

The Inflation Rate used for the actuarial valuation calculations was 4.00% per year compounded annually (compared to 4.5% used in the previous valuation). It represents the difference between the investment return rate and the assumed real rate of return. Inflation actually experienced, as measured by the Consumer Price Index for urban wage earners, has been as follows:

Consumer Price Index
Urban Wage Earner and Clerical Workers Before 1978
All Urban Consumers After 1977
10 Year Moving Averages

June 30, 1965	1.7%
June 30, 1975	5.4%
June 30, 1985	7.2%
June 30, 1995	3.6%
June 30, 2005	2.5%
50-Year Average	**4.1%**

Salary Increase Rates used to project current pays to those upon which a benefit will be based are represented by the following table. Rates do not vary by age, but do reflect an added merit component, for those with 0-4 years of service at the valuation date.

New Assumptions

Base Annual Rate of Salary Increase

Inflation	4.00%
Merit and Longevity	0.25%
Total	4.25%

Additional merit component

Years of Service at Valuation Date	Merit/ Longevity
0	5.50%
1	3.50%
2	2.00%
3	1.50%
4	0.75%

Actuarial Assumptions Used for the June 30, 2005 Valuation

Old Assumptions

Age	Annual Salary Increase
25	8.0%
30	7.5%
35	7.0%
40	6.5%
45	6.0%
50	5.5%
55+	5.0%

Interest credited to member contributions is 3.0%, compounded annually.

Comparison of Selected Actuarial Assumptions To Actual Experience

The salary increase assumptions project annual increases in total member payroll of 4.0%, the inflation portion of the individual pay increase assumptions. In effect, this assumes no change in the number of active members. Changes actually experienced in areas related to these assumptions have been as follows:

	Year Ended			3-year
	6/30/05	6/30/04	6/30/03	Average
Inflation[1]	2.0%	1.2%	1.8%	1.7%
Assumed	4.5%	4.5%	4.5%	4.5%
Average Pay Increase	2.8%	2.8%	7.5%	4.3%
Assumed	4.5%	4.5%	4.5%	4.5%
Merit & Longevity Increase	0.8%	1.6%	5.7%	2.7%
Assumed	Varies By Age			N/A
Total Payroll	(1.1)%	(1.1)%	7.7%	1.8%
Assumed	4.5%	4.5%	4.5%	4.5%
Investment Return Rate[2]	6.4%	3.6%	3.6%	4.5%
Assumed	8.25%	8.25%	8.25%	8.25%
Real Rate of Investment Return	4.4%	2.4%	1.8%	2.9%
Assumed	3.75%	3.75%	3.75%	3.75%
Administrative Expenses[3] (Percentage of total assets)	0.1%	0.1%	0.1%	0.1%
Assumed	0.0%	0.0%	0.0%	0.0%

[1]Based on Annual Consumer Price Index for San Francisco-Oakland-San Jose, CA, All Items, 1982-84=100.

[2]Based on actuarial value of assets NOT market value or book value.

[3]Excluding Investment Fees

Actuarial Assumptions Used for the June 30, 2005 Valuation

Rates of separation from active membership are shown below (rates do not include separation on account of retirement or death). This assumption measures the probabilities of members remaining in employment.

% of Active Members Separating Within Next Year

Sample Ages	*Disability*[1] Old Assumption Male	Old Assumption Female	New Assumption	*Withdrawal* Old Assumption Male	Old Assumption Female	New Assumption	*Vested Termination*[2] Old Assumption Male	Old Assumption Female	New Assumption
20	.05%	.03%	.04%	6.60%	8.20%	11.00%	1.50%	1.50%	---%
25	.07	.05	.06	4.80	5.80	7.00	2.43	2.10	3.00
30	.08	.06	.07	3.30	3.80	5.00	2.19	2.46	3.00
35	.11	.06	.09	1.80	2.24	2.50	1.87	2.47	2.75
40	.14	.07	.15	1.24	1.59	1.50	1.03	2.37	2.00
45	.18	.08	.25	0.90	1.25	1.25	0.91	1.11	2.00
50	.31	.14	.40	0.61	0.87	1.25	0.65	1.35	1.50
55	.79	.44	.50	0.50	0.84	1.00	0.00	0.50	0.00
60	1.89	1.19	1.00	0.00	0.00	1.00	0.00	0.00	0.00
65	4.20	3.00	2.00	0.00	0.00	0.00	0.00	0.00	0.00
70	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

[1] 50% of the disabilities are assumed to be duty-related and 50% are assumed to be non-duty related.

[2] 30% of terminating employees who leave their contributions in the Plan, with 5+ years of service, are assumed to subsequently work for a reciprocal employer and receive 4.0% pay increases per year. (previous valuation not explicitly valued)

For inactive members, the assumed age at retirement is age 58 (previous assumption was 60).

If an inactive member is not vested, the liability valued is their employee contributions with interest.

Actuarial Assumptions Used for the June 30, 2005 Valuation

The post-retirement mortality table used for healthy retirees and beneficiaries was the 1994 Group Annuity Mortality Table (sex distinct). (The previous valuation used the 1983 Group Annuity Mortality Table for males with a one-year setback, and for females, with a one-year set forward). The disabled mortality table used was the 1981 Disability Mortality Table. This assumption is used to measure the probabilities of members dying after retirement and the probabilities of each benefit payment being made after retirement. Related values are shown below.

	Future Life Expectancy (Years)			% of Benefit Recipients Dying Each Year		
	Retired			Retired		
Sample Ages	Men	Women	Disabled	Men	Women	Disabled
45	35.4	39.7	23.6	0.16%	0.10%	2.08%
50	30.7	34.9	21.1	0.26	0.14	2.44
55	26.2	30.2	18.7	0.44	0.23	2.84
60	21.8	25.6	16.4	0.80	0.44	3.30
65	17.8	21.3	14.1	1.45	0.86	3.79
70	14.3	17.3	11.7	2.37	1.37	4.37
75	11.1	13.6	9.2	3.72	2.27	5.53
80	8.4	10.3	7.0	6.20	3.94	8.74

The active member mortality assumption measures the probability of mortality before retirement. The new rates include probability of ordinary death, service death, and death while eligible for retirement or disability.

% of Active Members Dying Each Year

	Old Assumptions				New Assumptions	
	Not Eligible to Retire		Eligible to Retire			
Sample Ages	Men	Women	Men	Women	Men	Women
30	.04%	.02%	-	-	.06%	.05%
35	.05	.03	-	-	.06	.05
40	.06	.04	-	-	.07	.06
45	.08	.06	-	-	.09	.08
50	.10	.08	.21%	.12%	.16	.13
55	.15	.09	.31	.18	.26	.20
60	.19	.12	.43	.28	.38	.30
65	.24	.15	.58	.38	.53	.44

Actuarial Assumptions Used for the June 30, 2005 Valuation

The rates of retirement used to measure the probability of eligible active members retiring during the next year.

Percent of Active Members Retiring Within the Next Year

Retirement Ages	*Old Assumptions*		*New Assumptions*[1]
	Male	Female	
50	1.0%	0.25%	---%
51	0.5	0.25	---%
52	0.5	0.25	---%
53	0.5	0.50	---%
54	1.0	0.50	---%
55	17.0%	10.0%	15.0%
56	8.0	4.0	7.5
57	8.0	6.0	7.5
58	8.0	6.0	7.5
59	8.0	6.0	7.5
60	10.0%	7.0%	7.5%
61	13.0	8.0	7.5
62	20.0	15.0	20.0
63	17.0	7.5	10.0
64	22.0	7.5	10.0
65	25.0%	25.0%	25.0%
66	40.0	25.0	25.0
67	40.0	35.0	25.0
68	45.0	35.0	25.0
69	50.0	40.0	25.0
70	100.0	100.0	100.0

[1]Superceded by 50% retirement probability each year after completion of 30 years of service and attainment of age 50.

Actuarial Assumptions Used for the June 30, 2005 Valuation

Disability Benefit Offset. Workers' Compensation Benefits are assumed to not be an offset.

Survivor Benefits. Marital status and spouses' census data were imputed with respect to active and deferred members.

Marital Status: 75% of men (85% in the previous valuation) and 55% of women (60% in the previous valuation) were assumed married at retirement.

Spouse Census: Women were assumed to be 3 years younger than men.

"Spouse" is assumed to encompass a registered domestic partner.

HEALTH SUBSIDY BENEFITS

Increase in Retiree Population:	The covered Retiree population is assumed to increase 6.10% per year.
Covered Payroll Increase:	4.0% per year. (4.5% previous valuation)
Medical and Dental Trend Rate:	7.50%

DEFINITIONS OF TECHNICAL TERMS

Actuarial Accrued Liability. The difference between the actuarial present value of system benefits and the actuarial value of future normal costs. Also referred to as "accrued liability" or "actuarial liability".

Actuarial Assumptions. Estimates of future experience with respect to rates of mortality, disability, turnover, retirement, rate or rates of investment income and salary increases. Actuarial assumptions (rates of mortality, disability, turnover and retirement) are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (salary increases and investment income) consist of an underlying rate in an inflation-free environment plus a provision for a long-term average rate of inflation.

Accrued Service. Service credited under the system which was rendered before the date of the actuarial valuation.

Actuarial Equivalent. A single amount or series of amounts of equal actuarial value to another single amount or series of amounts, computed on the basis of appropriate actuarial assumptions.

Actuarial Cost Method. A mathematical budgeting procedure for allocating the dollar amount of the actuarial present value of retirement system benefits between future normal cost and actuarial accrued liability. Sometimes referred to as the "actuarial funding method".

Actuarial Gain (Loss). The difference between actual experience and actuarial assumption anticipated experience during the period between two actuarial valuation dates.

Actuarial Present Value. The amount of funds currently required to provide a payment or series of payments in the future. It is determined by discounting future payments at predetermined rates of interest, and by probabilities of payment.

DEFINITIONS OF TECHNICAL TERMS

Amortization. Paying off an interest-discounted amount with periodic payments of interest and principal -- as opposed to paying off with lump sum payment.

Normal Cost. The actuarial present value of retirement system benefits allocated to the current year by the actuarial cost method.

Unfunded Actuarial Accrued Liability. The difference between actuarial accrued liability and valuation assets. Sometimes referred to as "unfunded actuarial liability" or "unfunded accrued liability".

Most retirement systems have unfunded actuarial accrued liability. They arise each time new benefits are added and each time an actuarial loss is realized.

The existence of unfunded actuarial accrued liability is not in itself bad, any more than a mortgage on a house is bad. Unfunded actuarial accrued liability does not represent a debt that is payable today. What is important is the ability to amortize the unfunded actuarial accrued liability and the trend in its amount (after due allowance for devaluation of the dollar). Unfunded actuarial accrued liability should be controlled.

San Jose Federated City Employees' Retirement System
Unfunded Accrued Liability - Retirement Benefits Only
(in thousands)

	2003	2005	% Change
(1) Actuarial Value of Assets [Retirement benefits only]	$1,280,719	$1,384,454	8%
(2) Accrued Liability	1,311,691	1,711,370	30%
(3) Unfunded Accrued Liability using Actuarial Value of Assets [(2) - (1)]	30,972	326,916	956%
(4) Funded Ratio using Actuarial Value of Assets [(1) / (2)]	98%	81%	-17%
(5) Market Value of Assets [Retirement benefits only]	$1,149,873	$1,433,328	25%
(6) Unfunded Accrued Liability using Market Value of Assets [(2) - (5)]	161,818	278,042	72%
(7) Funded Ratio using Market Value of Assets [(5) / (2)]	88%	84%	-5%

The 956% is highly leveraged because the unfunded accrued liability as of June 30, 2003 was so small.

The funded ratios, using market value of assets, did not change nearly as much in the last two valuations as the funded ratios using actuarial value of assets.