2. Deferred Compensation Plan, 2014

Proposed Plan and Executive Budget Review

2. Deferred Compensation Plan

I. EXECUTIVE SUMMARY.

Table 2.1. Statement of Changes in Operating Budget, 2013 to 2014.

2012 Actual Expenditures	$1,258,354
2013 Adopted Budget	$1,505,558
Personnel Costs	
Salaries & Wages	$0
Fringe Benefits	($1,283)
Total Changes	($1,283)
Operating Expenses	$128,160
Equipment Purchases	$0
Special Funds	$0
Total Changes	$126,877
2014 Proposed Budget	$1,632,435

1. <u>Plan asset value increases.</u> The value of the entire Plan increased from $624 million at year's end in 2011 to $677 million at year's end in 2012. As of June 30, 2013, the valuation increased further to $705 million.

2. <u>Contributions decrease while distributions increase.</u> Employee contributions decreased from $37.1 million at year-end 2009 to $32.3 million at year-end 2011, with a slight increase to $32.7 million at year-end 2012. Distributions to participants increased from $23.8 million at year-end 2009 to $33.4 million at year-end 2010, down to $33.1 million at year-end 2011 and up to $38.2 million at year-end 2012.

3. <u>Participation decreases.</u> As of June 30, 2013, there were a total of 7,451 participants in the Plan; 4,455 were active participants. The number of participants decreased by 69 over the last year, and the number of active participants fell by 96.

4. <u>Plan performance positive.</u> One-year performance as of 6/30/13 of accounts ranged from a low of +1.2% for the Stable Value Account to a high of +21.3% for the Passively Managed Income Account. The most successful model portfolio was the Aggressive Model Portfolio at +14.2%.

5. <u>Hardship withdrawals remain high.</u> Hardship withdrawals remain high with 40 in 1st quarter 2013 and 39 in 2nd quarter 2013.

6. <u>Department budget increases 8.4%.</u> Personnel costs decrease by 0.7% due to lower fringe benefit costs for healthcare. Professional Services costs increase primarily due to costs for a new consultant for the Stable Value account.

II. INITIATIVES AND PROGRAMS.

1. Plan Overview.

The Deferred Compensation Plan allows all City employees to invest a portion of their income before federal and state taxes are withheld. In addition, in late 2011, the plan also began allowing for after-tax contributions.

The Plan currently offers 11 investment options: 6 directed accounts, a self-directed account and 4 model portfolios. The directed account options include a Stable Value Account, an Active Equity Account, a U.S. Passive Equity Account, an International Passive Equity Account, an Actively Managed Income Account and a Socially Conscious Balanced Account. A fund-of-funds investment approach is utilized, whereby participant selection of an account option actually results in investment among multiple funds with similar goals. The self-directed option is a Charles Schwab & Co.-administered Personal Choice Retirement Account (PCRA). The self-directed account provides participants with greater investment flexibility and options. The new 4 model portfolios are risk-based and consist of various mixes of the Plan's investment options.

2. Plan Valuation and Performance.

Table 2.2. Participants, Fund Valuation and Percent of Total Assets by Fund.

Name of Fund	Number of Participants (as of 6/30/12)	2013 Valuation (in millions as of 6/30/13)	Percent of Total Assets
Stable Value Account	4,431	$229.2	32.5%
Actively Managed Income Account	2,458	$54.3	7.7%
Socially Conscious Balanced Account	1,750	$25.6	3.6%
Actively Managed Equity Account	4,608	$178.2	25.3%
Passively Managed U.S. Account	3,684	$114.6	16.3%
Passively Managed International Account	3,196	$47.5	6.8%
Schwab PCRA	357	$37.4	5.4%
American United Life (old, no new investments allowed)	74	$1.2	0.2%
Conservative Portfolio	75	$5.3	0.8%
Accumulator Portfolio	84	$5.2	0.8%
Wealth Builder Portfolio	117	$3.4	0.5%
Aggressive Portfolio	144	$3.1	0.5%

The value of the entire Plan increased from $624 million at year's end in 2011 to $677 million at year's end in 2012. As of June 30, 2013, the valuation was up to $705 million. Valuation and participation by account can be found in Table 2.2. The participation in model portfolios more than tripled, increasing from 126 to 420.

The increased asset values reflect the improved market conditions since 2008. The history of performance by account can be found in Table 2.3 (presented in increasing order of risk return). The Plan's investment manager no longer reports performance year-to-date; therefore, performance for 2012 and 2013 is provided as a "one-year" value which is the performance for the prior 12 months to the date.

The Plan's average net expense ratio of 0.50 basis points (as of 6/30/13) remained well below the peer group's average of 0.72 basis points listed in the Deloitte Consulting 2009 Annual 401(k) Benchmarking Survey.

Table 2.3. Plan Performance by Investment Option, 2007—2011 & One Year as of 6/30/12 and 6/30/13.

Name of Account	2007	2008	2009	2010	2011	One Year (6/30/12)	One Year (6/30/13)
Stable Value Account	4.7%	+4.3%	+3.0%	+2.4%	+1.8%	+1.7%	+1.2%
Actively Managed Income Account	6.7%	-8.1%	+17.4%	+8.6%	+4.5%	+4.5%	+2.1%
Socially Conscious Balanced Account	3.5%	-24.3%	+21.2%	+12.0%	+2.3%	+1.4%	+15.5%
Actively Managed Equity Account	8.6%	-40.6%	+35.2%	+15.4%	-4.7%	-1.8%	+2.2%
Passively Managed U.S. Account	5.6%	-37.3%	+29.3%	+17.6%	+0.5%	+3.8%	+21.4%
Passively Managed International Account	15.4%	-44%	+38.7%	+11.7%	-14.3%	-14.8%	+13.3%
Conservative Model Portfolio	NA	NA	NA	NA	NA	+2.2%	+5.4%
Accumulator Model Portfolio	NA	NA	NA	NA	NA	+1.7%	+10.5%
Wealth Builder Model Portfolio	NA	NA	NA	NA	NA	+1.3%	+12.8%
Aggressive Model Portfolio	NA	NA	NA	NA	NA	+1.2%	+14.3%

3. Plan Participation.

As of June 30, 2013, there were a total of 7,451 participants in the Plan; 4,455 were active participants. The total number of participants decreased by 69 over the last year, and the number of active participants fell by 96. The decreases in participation reflect the aging of City employees and the number of retirements occurring.

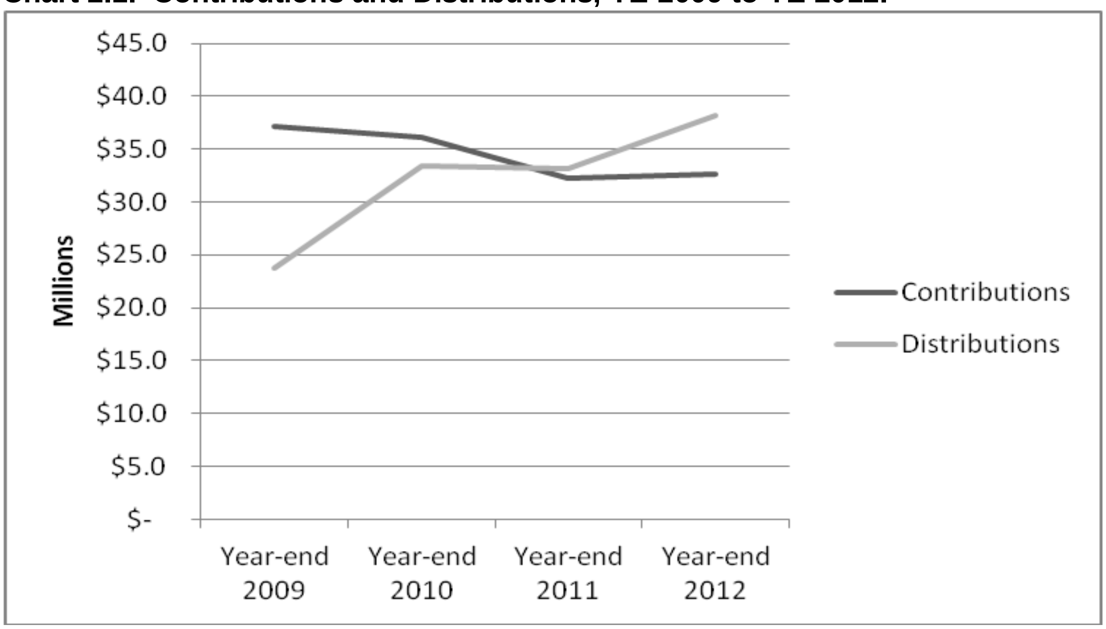
The average monthly cash deferral per-participant remains flat after years of decreases. At year-end 2012, the average monthly cash deferral was $429. The average for year-end 2011 was $428 per month. The goal for 2014 is to maintain the average monthly cash deferral.
The participation rate of current eligible employees has recently dipped as low as 65% and is presently approximately 68%, steady from 68% at the end of 2012, but down from 70% at the end of 2011 and 72% at the end of 2010. Table 2.2 shows the number of participants, valuation and percent of total assets for each of the Plan's options as of June 30, 2013. The goal for 2014 is to maintain participation at 68%

4. Asset Preservation.

Asset preservation and growth is a primary goal of the Plan. Because of the Plan's asset size, participants save money by investing in institutional-class mutual funds which are offered at reduced costs. In addition, the Plan's fees will decline over time as a percentage of the account balance because the Plan's account balances are growing faster than the Plan's fee increases.

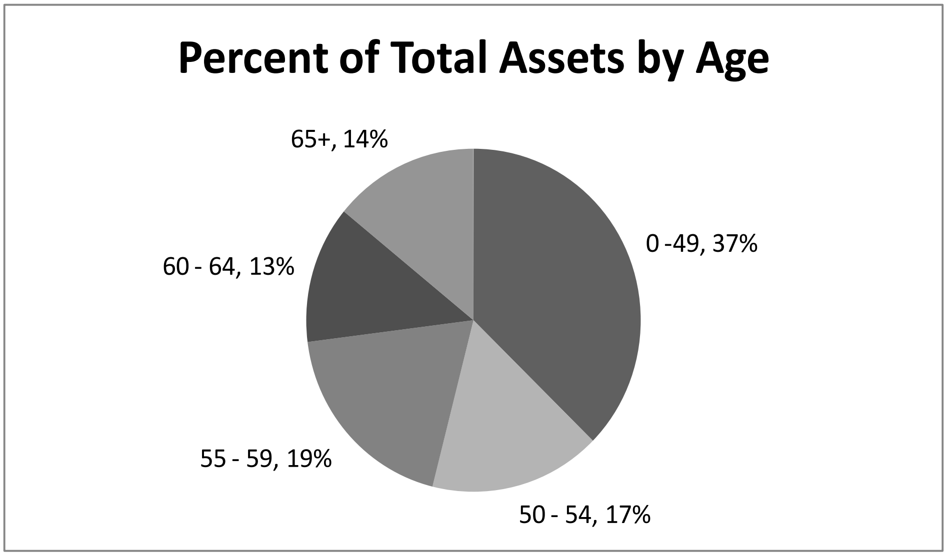
Employee contributions decreased from $37.1 million at year-end 2009 to $32.7 million at year-end 2012. Distributions to participants increased from $23.8 million at year-end 2009 to $38.2 million at year-end 2012. A comparison of contributions and distributions from year-end 2009 to 2012 can be found in Chart 2.1.

Chart 2.1. Contributions and Distributions, YE 2009 to YE 2012.



As can be found in Chart 2.2, as of June 30, 2013, 63% of the Plan's assets were held by 49% of participants who were 50 years of age or older. As participants retire and begin to withdraw funds and fewer City employees contribute to the Plan, the asset balance of the Plan is challenged.

Chart 2.2. Percentage of Assets Held by Age Group, June 30, 2013.



5. Plan Marketing.

In 2013, representatives from the Plan will continue to attend new employee orientations and meet with employees of departments granting permission to the Plan to give presentations. The Plan will be using PeopleSoft queries to identify and reach the employees that are not enrolled in the Plan.

To further address the growing number of retirees, in addition to all participants, the Plan last year introduced automated model portfolios. There has been an increase in participation since inception.

The Plan is also offering participants, at the least on a quarterly basis, the customized workshops of "Countdown To Your Retirement" and "3 Steps to Plan Your Retirement Income." The "Countdown To Your Retirement" workshop is tailored to meet the needs of those participants that are one to 10 years away from retirement and the "3 Steps to Plan Your Retirement Income" is tailored to meet the needs of those participants that are within one year of retirement. In 2012, the Plan also added two new workshops: "Managing Personal Finances" and "Women in Investing."

6. Hardship Withdrawals.

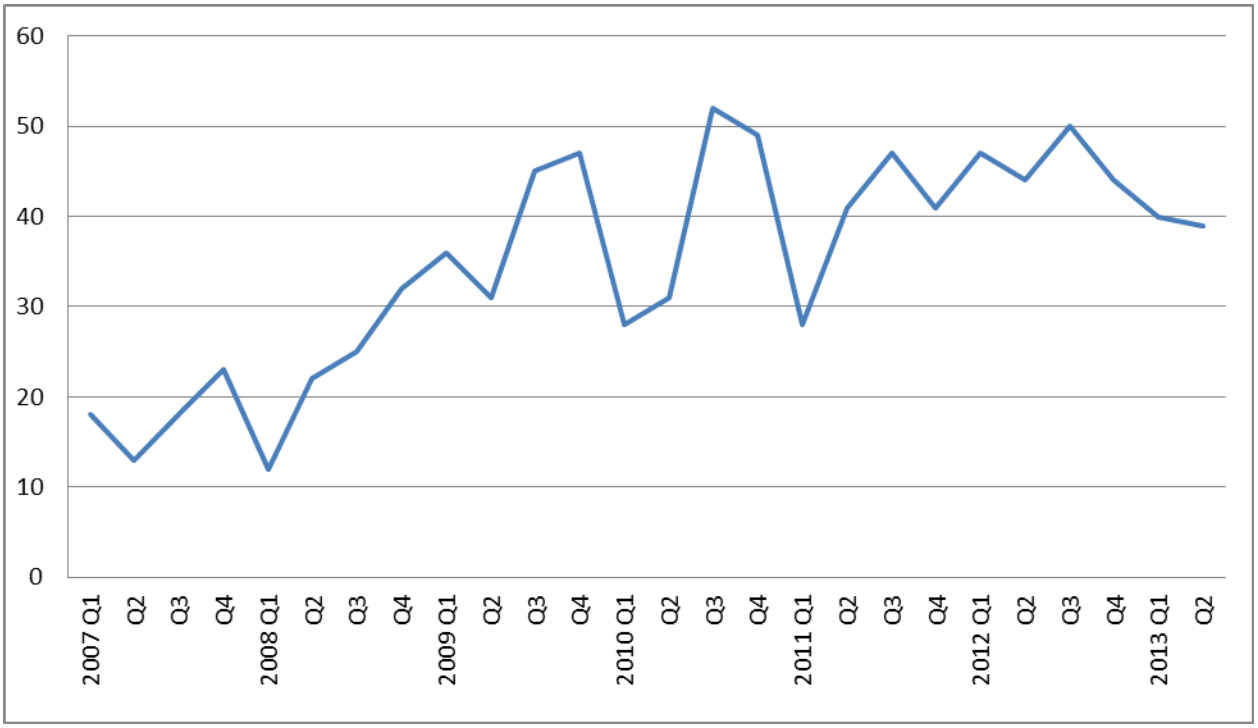
Hardship withdrawals are regulated by section 457 of the Internal Revenue Code. To receive a hardship withdrawal, a participant must demonstrate one of the following:

1. A sudden and unexpected illness or accident of the participant, his or her spouse or dependent.

2. Loss of a participant's property due to casualty that are not covered by insurance.
3. Foreclosure of a primary residence.
4. Any extraordinary and unforeseeable circumstance as a result of events beyond the control of the participant.

The Plan saw a low of 12 hardship withdrawals in 1st quarter 2008 to a high of 52 in 3rd quarter 2010, many due to foreclosures and evictions. The trend in hardship withdrawals can be found in Chart 2.3.

Chart 2.3. Quarterly Change in Number of Hardship Withdrawals, Q1 2007 to Q2 2013.



7. New Initiatives and Programs.

The Plan has recently taken care of Plan fundamentals by having extended contracts with the Plan's record keeper (Nationwide), Investment Manager (Cleary) and custodian (US Bank). In addition, the Plan is in the process of negotiating contract terms with the finalist of a Request-for-Proposal process for a new plan consultant.

Earlier in 2013, the Plan implemented alternative payee distributions which allow distributions to former spouses of Plan participants. Plans for late 2013 include a loan program and In-Plan Roth conversion feature. The loan program would allow participants to borrow money from the Plan using parts of their account balances as collateral for the loans. The In-Plan Roth conversion feature would allow participants to convert portions, or all, of their account balances from a pre-tax status to an after-tax status in a Roth IRA.

III. EXPENDITURES.

Table 2.5. Changes in Expenditure Amounts by Account.

Expenditure Account	2012 Actual	2013 Adopted Budget	% Chng.	2014 Proposed Budget	% Chng.
Salaries and Wages	$128,042	$128,235	0.2%	$128,235	0%
Fringe Benefits	$58,938	$61,553	1.5%	$60,270	(2.1%)
Operating Expenditures	$1,071,374	$1,240,770	15.8%	$1,368,930	10.3%
Equipment Purchases	$0	$0	0%	$0	0%
Special Funds	$75,000	$75,000	0%	$75,000	0%
Total Operating Budget	$1,258,354	$1,505,558	19.6%	$1,632,435	8.4%

1. Budget Summary.

The total 2014 Proposed Budget is $1,632,435, an increase of $126,877 (8.4%) from the 2013 Adopted Budget amount of $1,505,558.

2. Personnel Costs.

Personnel costs in the 2014 Proposed Budget are $188,505, a decrease of $1,283, (-.7%). Salaries and wages remain unchanged at $128,235. Fringe benefits decrease $1,283 (-2.1%).

3. Operating Expenditures.

Operating Expenditures in the 2014 Proposed Budget are $1,368,930, an increase of $128,160 (10.3%) from the 2013 Adopted Budget amount of $1,240,770. The changes can be attributed to an increase in Professional Services costs for a new consultant for the Stable Value account.

4. Equipment Purchases.

Equipment purchases in the 2014 Proposed Budget are $0, the same as provided in the 2013 Adopted Budget.

5. Special Funds.

The 2014 Proposed Budget provides $75,000 in special funds, the same as in the 2013 Adopted Budget.

The Plan has a Contingent Fund of $75,000 that is the same as in 2013. The purpose of the fund is to provide contingent expenditure authority that can be repaid by participant charges. The Deferred Compensation Plan budget is offset by revenue collected from member fees.

Because government accounting regulations do not allow the City to "net budget" if the Plan underestimates its costs, the Contingent Fund is the only source of additional revenue. If no additional funding (over budget) is required, members will not be charged any additional fee.

IV. PERSONNEL.

Table 2.6. Changes in Full-Time Equivalent (FTE) and Authorized Positions.

Position Category	2010 Actual	2011 Adopted Budget	Change	2012 Proposed Budget	Change
O&M FTEs	2.0	2.0	0	2.0	0
Non-O&M FTEs	0	0	0	0	0
Total Authorized Positions	2	2	0	2	0

1. Personnel Changes.

The total number of authorized positions in the department under the 2014 Proposed Budget remains the same as in the 2013 Adopted Budget.

2. Vacancies.

None.

V. SPECIAL PURPOSE ACCOUNTS (SPA).

None.

VI. REVENUES.

All expenditures are recovered through charges for service to Plan participants. Therefore, estimated total revenues for 2014 of $1,632,435 equal the amount of total expenditures, which is an increase of 8.4% from the 2013 Adopted Budget.

The Deferred Compensation department budget has no tax levy impact.

VII. CAPITAL PROJECTS.

None.

VIII. ISSUES TO CONSIDER.

1. Long-term Viability of Plan.

As of June 30, 2013, 33% of the Plan's participants were 50 years of age or older, holding 63% of the Plan's assets. The long-term viability of the Plan in light of the aging of the participant population needs to be examined.

2. Impact of Adverse Economic Environment.

More employees are paying a percentage of their incomes for pension contributions, and all are contributing more towards health insurance with no salary increases, except for protected services, for 4 to 5 years. Ways of maintaining Plan participation in such an adverse economic environment need to be investigated.

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