THE CITY OF OAKLAND

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OFFICE OF THE CITY CLERK
OAKLAND

AGENDA REPORT

2011 JUN 30 PM 3:46

TO: Office of the City Administrator/ Agency Administrator
Executive Director of the Oakland Joint Powers Financing Authority
ATTN: P. Lamont Ewell, Interim City Administrator
FROM: Finance and Management Agency
DATE: July 12, 2011

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF OAKLAND AUTHORIZING AND APPROVING THE OPTION TO FUND THE POLICE AND FIRE RETIREMENT SYSTEM UNFUNDED ACCRUED ACTUARIAL LIABILITY THROUGH A COMBINATION OF PAY-AS-YOU-GO METHOD AND THE USE OF PENSION OBLIGATION BONDS; DIRECTING THE CITY ADMINISTRATOR TO NEGOTIATE THE TERMS AND CONDITIONS OF THE FUNDING OPTION(S) APPROVED BY CITY COUNCIL FOR THE SYSTEM AND ENTER INTO AN AGREEMENT WITH THE POLICE AND FIRE RETIREMENT BOARD;

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF OAKLAND AUTHORIZING AND APPROVING THE TERMINATION OF THE SWAP AGREEMENT RELATED TO THE OAKLAND JOINT POWERS FINANCING AUTHORITY, LEASE REVENUE BONDS, 1998 SERIES A1/A2

SUMMARY

The Police and Fire Retirement System ("PFRS") provides pension, disability and beneficiary payments to retired Police and Fire sworn officers and under Article XXVI of the City's Charter, the City is obligated to make these payments to PFRS until 2026. PFRS is currently funded at only 37.6% (actuarial value of assets/actuarial liabilities). Given the low funding level, a one-time or ongoing investment into the system has become a matter of fiscal urgency. Moreover, a payment holiday that the City negotiated with PFRS will expire in July 2011. Based on actuarial computafions, the City will be required to deposit to PFRS approximately $45.6 million beginning FY 2011-12.

Resuming the annual required contributions combined with PFRS existing debt obligations, will require funding above the available resources dedicated to PFRS, (Override Tax approved by voters in 1976 and 1988 and a New York Life Insurance Annuity purchased for the system in 1985). As a resuh, payments in excess of the system's revenue will be paid from the General Fund. Faced with multiple year deficits and declining revenues, the City's General Fund will not be able to absorb significant annual contributions without serious reduction in core service levels. Currently, the City has excess tax override revenues that may be used to offset these payments in the near term, but to address PFRS long-term funding, including increasing the funding levels, the City needs to issue pension bonds as a way to protect further deterioration of the General Fund and increase the funding levels of PFRS. Therefore, staff recommends a

hybrid funding option: combining a pay-as you –go method with reduced payments and a one-time deposit of pension bond proceeds into the System.
In addition, a mechanism would be put in place to monitor the PFRS funding level and alert the City if the funding level declines to a certain pre-determined funded ratio. The City would then be required to take action to increase the System's funding level up to the required funded ratio.

Over the past several months, City staff has been actively exploring options to address the PFRS unfunded liability. In addition, staff has been in conversations with the actuary, Bartel & Associates, LLC to review and possibly revise the current actuarial assumptions which may have a signiticant impact on lowering the unfunded liability and the annual required contribution. The proposed resolutions have been prepared which seeks approval from City Council to:

(1) Authorize and approve the option to fund PFRS through a combination of pay-as-you-go method and the use of pension obligation bonds;

(2) Direct the City Administrator to negotiate the terms and conditions of the funding option(s) approved by City Council and enter into an agreement with the PFRS Board; and

(3) Authorize the termination of the swap agreement in connection with the issuance of Oakland Joint Powers Financing Authority, Lease Revenue Bonds, and 1998 Series A1/A2.

Lastly, issuing pension debt does have associated risks and benefits that have to be taken into consideration before issuance: The following are some benetits and risks associated with Pension Bonds issuance:

<u>Benefits</u>

- No annual required contributions from General Fund for a negotiated period
- Increase funding level
- Increase in investment returns with greater asset base
- Reduce annual required contributions after the negotiated period

<u>Risks</u>

- Investment risk, poor performance will cause the market value of asset to decline
- Incorrect actuarial assumptions could result in a further decline in funded ratios
- Decline in assessed values resulting in decline in tax override revenues
- Increase in benetits resulting in increased in liabilities

FISCAL IMPACT

The debt service for the Pension Obligation Bonds (the "2011 POBs") will be payable from excess tax override revenues.

Faced with the current projected budget deficit, resuming annual General Fund contributions of $45.6 million would put more stress on the General Fund. Without PFRS contributions, the City cannot balance the budget without major reductions to core services. By issuing 2011 POBs, the City can minimize General Fund contributions when discretionary funds are scarce and resume contributions when the General Fund can support additional contributions in later years when other non-pension related debt supported by the General Fund matures. Therefore, staff recommends the issuance of 2011 POBs in order to manage this Charter mandated obligation.

BACKGROUND

PFRS is established pursuant to the Retirement Law and is a defined benefit pension system for the members of the City of Oakland (the "City") Police and Fire Department hired prior to July 1, 1976. PFRS is now a closed plan and no new members can join the plan. PFRS provides for the payment of retirement allowances, disability and death benetits to its members and their beneficiaries. As of June 30, 2010, PFRS covered one active employee and 1,152 retired employees. The City Charter dictates how PFRS is managed; the City is required to fund all liabilities for future benetits for all members by June 30, 2026.

Participant Profile		
	July 1, 2010	***Average Age***
Actives	1	*71.7*
Service Retirees	531	*72.2*
Disability Retirees	287	*70.5*
Beneficiaries	334	*80.0*
Total	**1,153**	**N/A**
Actuarial Liabilities	**$792,202,000**	**N/A**
Avg. Liability/Participant	**687,079**	**N/A**

Tax Override Revenues

The City is authorized to levy the Tax Override on all taxable property within the City pursuant to Measure R. State legislation enacted in 1985 limits the rate of the levy of the Tax Override to the rate levied by the City in Fiscal Year 1983 or 1984, which was 0.1575% of the assessed value of taxable property within the City. The City has levied the Tax Override at this 0.1575% rate since 1983. The City is authorized pursuant to Measure O to levy the Tax Override through

Fiscal Year 2025-26. The "Tax Override Revenues" are revenues generated and collected by the City in each Fiscal Year as proceeds of its annual tax levy goes to fund PFRS obligations.

In 1997, the City issued Taxable Pension Obligation Bonds ("POBs") of approximately $436 million to fund a portion of the current balance of the City's unfunded liability for retirement benefits for the members of PFRS. These bonds were subsequently restructured in 2001 in a manner which extended their debt service payments through fiscal year 2023 in order to lower the annual debt service payments for the City. As a resuh of the restructuring and subsequent property tax growth, the City's Tax Override Revenues have exceeded annual debt service. In addition, there will be three years of unencumbered revenue stream from 2023 through 2026.

The proceeds of the POBs provided a lump-sum payment equal to the present value of payments the City would otherwise be required to make to amortize the unfunded liability calculated at that point in time through June 30, 2011. As a result, the City received a "holiday" from making payments into the Retirement System until June 30, 2011, and instead covenanted to make debt service payments on the POBs through that date. Funding for the debt service of the POBs is allowed under Measure R and Measure O.

New York Life Annuity and Associated POBs

In 1985, the Redevelopment Agency of the City of Oakland, (the "Agency") issued Certificates of Participation, 1985 Series A (the "1985 COPs") to provide financing for a portion of PFRS. The City entered into an Annuity Deposit Agreement with PFRS and purchased an annuity with New York Life (the "Annuity") to be used to pay a portion of the City's obligation to retired City employees, as set forth in Article XXVI of the City Charter.

In 1988, the City and PFRS amended the Annuity Deposit Agreement and pledged and assigned Pension Credits to the payment of principal of and interest the City of Oakland Special Refunding Revenue Bonds (Pension Financing) 1988 Series A (the "1988 Series A Bonds"), which refunded the 1985 COPs. The City restructured these bonds three more times in 1998, 2005 and 2008 (the latter being the "2008 Bonds"). The Annuity is currently being used to repay the 2008 Bonds which mature in 2017, after which the remaining Amuity proceeds will go to offset the payments of PFRS unfunded liability.

Swap Payments

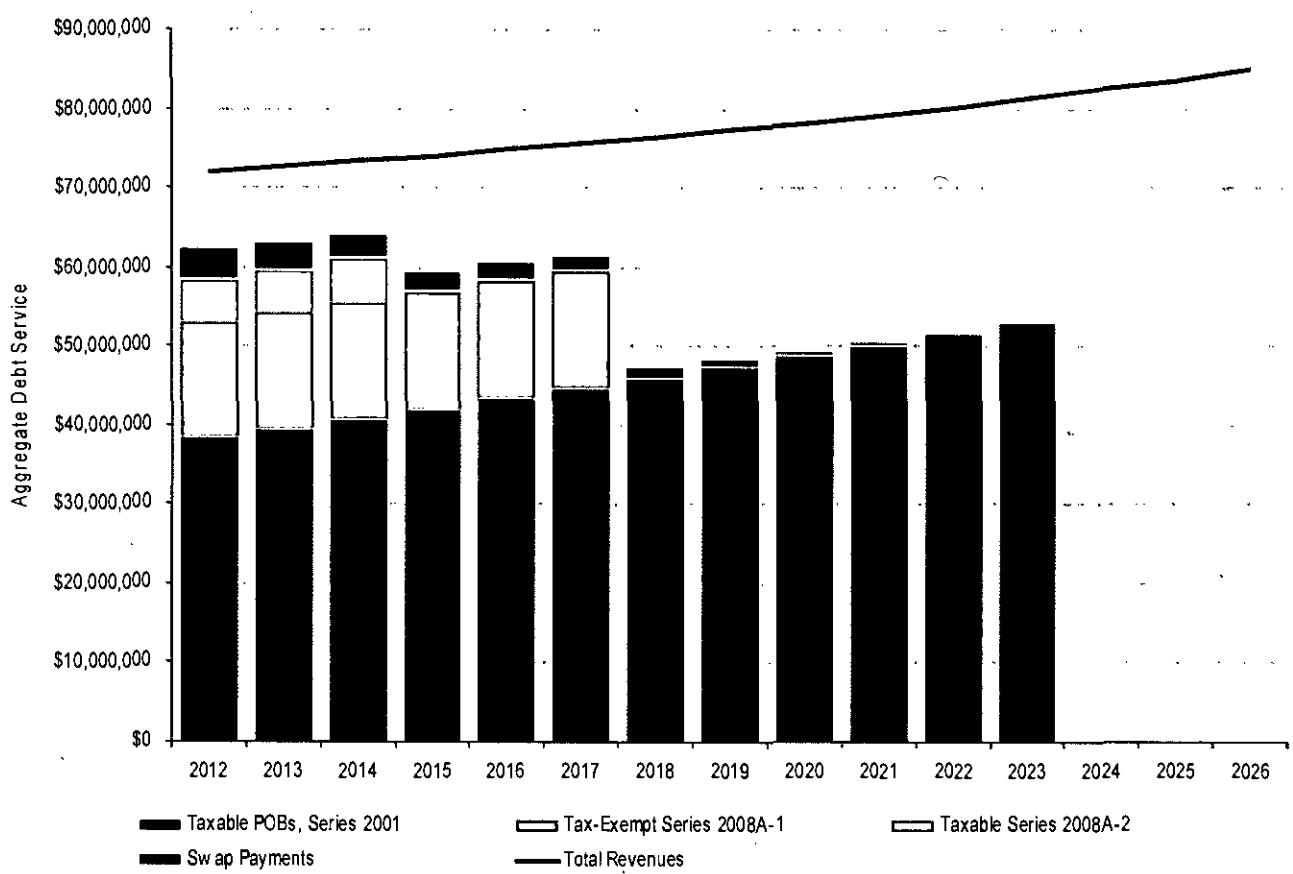
When the City restructured the 1988 Series A Bonds in 1998, it entered into a forward-starting synthetic fixed rate swap agreement (the "Swap") with Goldman Sachs Mitsui Marine Derivatives Products, U.S., L.P. (the "Counterparty") in connection with the issuance of Oakland Joint Powers Financing Authority (the "Authority") Lease Revenue Bonds, 1998 Series A1/A2 (the "JPFA Bonds"). Because the original series of bonds tied to the Swap were fixed in 2008, the Swap no longer serves its original purpose, which was to mitigate interest rate risk. As of January 30, 2011, the notional amount on the swap is $76.8 million and the swap does not expire until 2021. Due to changes in interest rates since the execution of the Swap, as of June 22, 2011, the Swap had a negative market value of approximately $16.5 million. Therefore, staff is recommending terminating the Swap using the excess tax override revenue reserve. With an estimated annual interest rate swap payments of $3.8 million. By terminating the Swap today, the City can generate cash flow savings.

KEY ISSUES AND IMPACTS

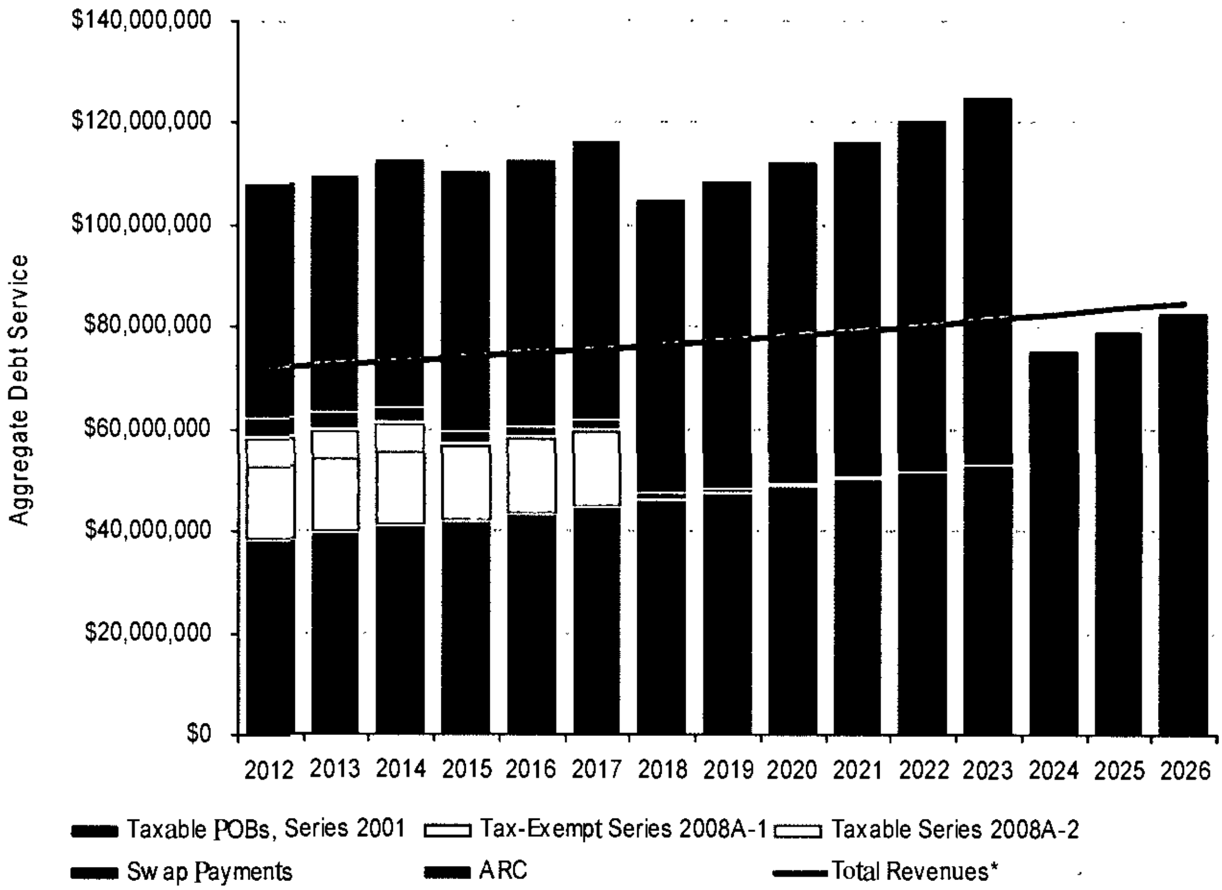
Currently, PFRS has an unfunded liability of $494.4 mifiion with a funding level of 37.6%. Given this low funding level, a one-time revenue source or ongoing investment into the system is critical. Also, staff has been in conversations with the actuary, Bartel and Associates, LLC to review and possibly revise the current actuarial assumptions which include discount rate, mortality and salary (cost of living) rates, which could have a significant impact in lowering the unfunded liability and the annual required contribution.

Funded Ratio	
	July 1, 2010
Actuarial Value of Plan Assets	297,829,000
YOY Change in Plan Assets	*-14.22%*
Actuarial Liability	792,202,000
Unfunded Actuarial Liability	494,373,000
Funded Ratio	37.6%

Also, the "holiday" is set to expire on June 30, 2011, and the City will be required to contribute to PFRS to fund its Unfunded Actuarial Accrued Liability ("UAAL"), which is estimated to be $45.6 million on July 1, 2011. In addition to the UAAL, the City will pay debt service on PFRS pension-related bonds in an amount equal to $62.4 million, which includes the swap payment. Currently, the revenues from the tax override and the annuity are sufficient to pay the debt service payments on the outstanding bonds with some excess residual afterward as depicted in the chart below.



In FY 2011/12, the City's total obligation on the PFRS unfunded liability as well as bond debt service payments will total approximately $108 million. The available revenues from the tax override revenues as well as the annuity are being used to pay debt service payments on the outstanding debt with very littie flexibility to cover the annual required contribution to PFRS. The annual required contribution combined with the existing General Fund supported debt service cannot be fully supported by the available revenues as shown in the chart below.



* Total revenues currently exceeds PFRS total debt service without the UAAL

Payments in excess of the available revenues will be paid from the General Fund. The City will use some of the reserve money to offset the payments in fiscal year 2011-12. A summary of the total obligations of debt service, unfunded liability and shortfall of the expected receipt of tax override revenues are shown in the table below. The City may be able to use the excess reserve to offset these shortfalls but only for a short period of time until it's exhausted.

Fiscal Year (June 30)	Total Funding Available for PFRS	Outstanding Debt Service Obligations	Annual Recommended Contribution (ARC)	General Fund Support Required
2012	72,010,614	62,365,892	45,634,000	(35,989,278)
2013	72,685,525	63,184,045	46,500,000	(36,998,520)
2014	73,377,704	64,038,301	48,800,000	(39,460,597)
2015	74,093,747	59,522,606	50,800,000	(36,228,859)
2016	74,840,423	60,541,072	52,500,000	(38,200,649)
2017	75,623,861	61,491,000	55,000,000	(40,867,139)
2018	76,449,484	47,357,932	57,600,000	(28,508,448)
2019	77,322,283	48,366,922	60,300,000	(31,344,639)
2020	78,246,143	49,410,912	63,100,000	(34,264,769)
2021	79,223,748	50,495,456	66,000,000	(37,271,708)
2022	80,257,072	51,620,000	69,100,000	(40,462,928)
2023	81,347,308	53,130,000	72,300,000	(44,082,692)
2024	82,494,925	-	75,700,000	6,794,925
2025	83,699,767	-	79,300,000	4,399,767
2026	84,961,261	-	83,100,000	1,861,261
	1,166,633,865	671,524,138	925,734,000	(430,624,273)

Given the current economic circumstances and the City's budget deficit, resuming the annual required contributions will be an additional stress on the General Fund. Staff recommends that the City negotiate and execute an agreement with the PFRS Board for a payment holiday for a negotiated period of time. The City could resume the annual required contribution in five to six years when other non-pension related debt service begins to decline and supporting revenues increase. The City could avoid the extreme measures that would be required to fund this obligation in the next several years.

Issuing 2011 POBs and Pay-As-You-Go Contribution

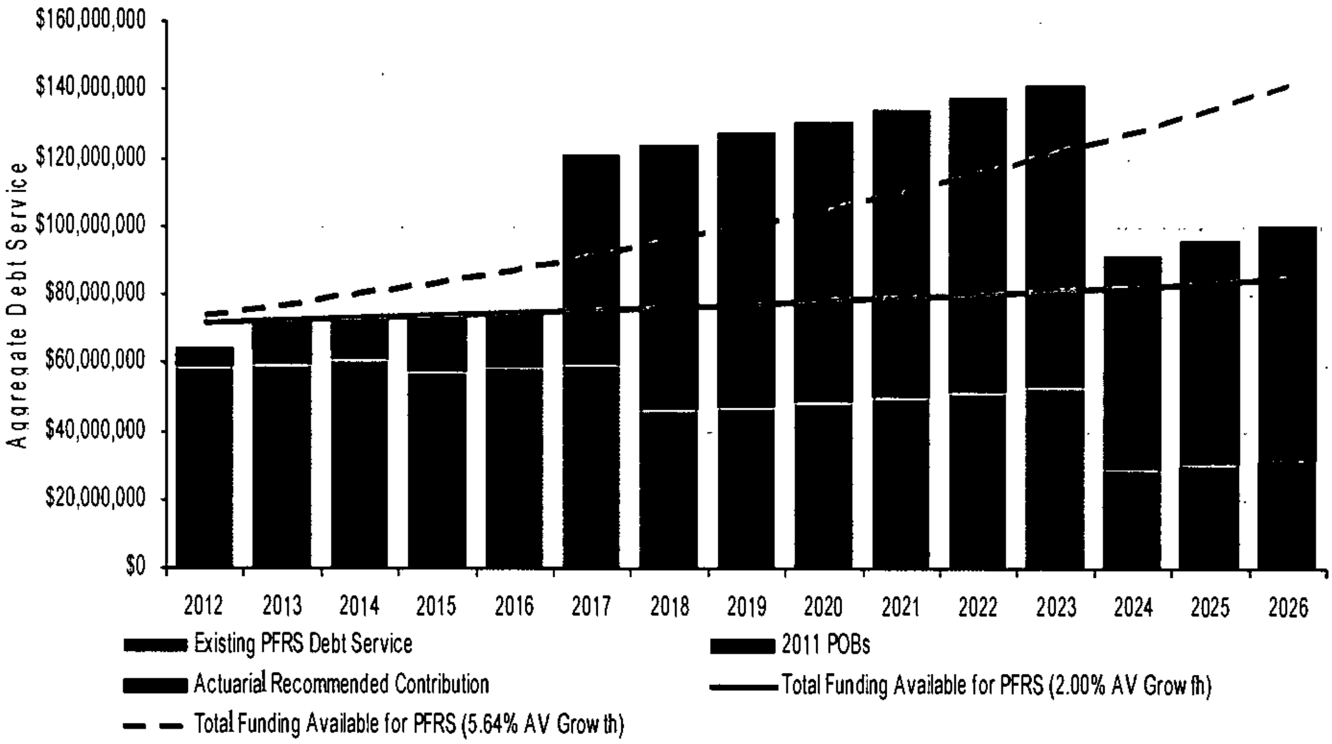
Issuing additional pension obligation bonds supported by excess tax override, negotiating the terms and conditions of the funding option (s) approved by Council and entering into an agreement with the PFRS Board will relieve the General Fund from paying into the PFRS system for a period of time and increase the funding level close to 70%.

The 2011 POBs would be structured to match the available Tax Override Revenues through FY 2025-26, and the annual required contributions will resume after the negotiated period ends when the City can support addhional contributions due to the declining debt starting in FY 2015-16. In the later years, other non-POBs related debt will mature (i.e., museum, convention center, and master leases) thus reducing the General Fund debt obligations resulting in declining debt.

In conjunction with issuing 2011 POBs, the City will make $5 million contribution from FY 2012-13 through FY 2016-17, which will lower the annual net General Fund payments from FY 2016-17 through FY 2025-26 and lower total General Fund debt service payments. The chart below shows the estimated debt issuance effective December 2011.

Fiscal Year Ending	Actuarial Recommended Contributions (ARC)	Less: Minimum Contribution	Net Actuarial Recommended Contributions (ARC)	Discounted Amount at 7.00%	Recommended Contribution
2012	$45,634,000		$45,634,000	$43,632,158	
2013	46,500,000	(5,000,000)	41,500,000	37,083,650	
2014	48,800,000	(5,000,000)	43,800,000	36,578,400	$221,773,954
2015	50,800,000	(5,000,000)	45,800,000	35,746,399	5 Year Contribution
2016	52,500,000	(5,000,000)	47,500,000	34,647,879	
2017	55,000,000	(5,000,000)	50,000,000	34,085,469	
2018	57,600,000		57,600,000	36,697,626	
2019	60,300,000		60,300,000	35,904,511	
2020	63,100,000		63,100,000	35,113,756	
2021	66,000,000		66,000,000	34,324,806	
2022	69,100,000		69,100,000	33,586,011	
2023	72,300,000		72,300,000	32,842,401	
2024	75,700,000		75,700,000	32,137,249	
2025	79,300,000		79,300,000	31,463,152	
2026	83,100,000		83,100,000	30,813,873	

The 2011 POBs will provide an amount sufficient to fund five years of required contribution to the System with a debt service pattern that would keep all debt payment to remain below the revenues pledge to PFRS.



In addition, a mechanism would be put in place to monitor the PFRS funding level and alert the City if the funding ratio declines below a certain pre-determined threshold level. This would be a funding trigger requiring the City to explore alternatives to increase funding level.

Associated Benefits /Risks of Issuing Pension Bonds

Staff would like to note that there are associated benefits and risks involved in issuing pension obligation bonds which must be taken into consideration before any approvals. Some of the risks benefits are summarized below:

BENEFITS	RISKS
• Protect the General Fund from making <u>any</u> Annual Required Contributions for five years • Fund up the System to a funded ratio close to 70% • Increase absolute investment returns based on a greater asset base • Reduce Amual Required Contributions after the holiday period	• Investment performance is poor and market value of assets declines • Actuarial assumptions are incorrect and further contributions are needed • Future decline in Assessed Values cause the primary funding source, tax override revenues, to decline • Further benefit increases cause the projected liabilities to increase

SUSTAINABLE OPPORTUNITIES

There is no impact to economic, environmental or social equity opportunities following actions under this report.

DISABILITY AND SENIOR CITIZEN ACCESS

There is no impact to disability or senior citizen access following actions under this report.

RECOMMENDATION(S) AND RATIONALE

Due to the City's fiscal situation, staff recommends moving forward with utilizing Pension Obligation Bonds combined with Pay-As-You-Go to manage this mandated debt.

Staff further recommends that Council approve this resolution and direct the City Administrator to negotiate the terms and conditions with PFRS Board for paying into the system, for a period of time based on a lump sum payment into PFRS by the City and financed through the issuance of the 2011 POBs. In addition, staff recommends that Council authorize the termination of the swap agreement.

ACTION REQUESTED OF THE CITY COUNCIL

Staff requests that the City Council approve the resolution and authorize the following actions:

(1) Authorize and approve the option to fund PFRS through a combination of pay-as-you-go method and the use of pension obligation bonds;

(2) Direct the City Administrator to negotiate the terms and conditions of the funding option(s) approved by City Council and enter into an agreement with the PFRS Board; and

(3) Authorize the termination of the swap agreement in connection with the issuance of Oakland Joint Powers Financing Authority, Lease Revenue Bonds, 1998 Series A1/A2.

Respectfully submitted,

JOSEPH T. YEW JR.
Director, Finance and Management Agency

Prepared by:
Katano Kasaine, Treasury Manager
Treasury Department

APPROVED AND FORWARDED TO THE
FINANCE AND MANAGEMENT COMMITTEE:

Office of the City Administrator/
Acting Agency Administrator

FILED
OFFICE OF THE CITY CLERK
OAKLAND

2011 JUN 30 PM 3:46

Approved as to Form and Legality

Oakland City Attorney's Office

OAKLAND CITY COUNCIL

RESOLUTION NO. ______________ C.M.S.

Introduced by Councilmember ______________

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF OAKLAND AUTHORIZING AND APPROVING THE OPTION TO FUND THE POLICE AND FIRE RETIREMENT SYSTEM UNFUNDED ACCRUED ACTUARIAL LIABILITY THROUGH A COMBINATION OF THE PAY-AS-YOU-GO METHOD AND THE USE OF PENSION OBLIGATION BONDS; AND DIRECTING THE CITY ADMINISTRATOR TO NEGOTIATE THE TERMS AND CONDITIONS OF THE FUNDING OPTION(S) APPROVED BY CITY COUNCIL FOR THE SYSTEM AND ENTER INTO AN AGREEMENT WITH THE POLICE AND FIRE RETIREMENT BOARD

WHEREAS, the Police and Fire Rethement System ("PFRS") is established pursuant to the Retirement Law and is a defmed benefit pension system for the members of the City of Oakland (the "City") Police and Fire Departments hired prior to July 1, 1976; and

WHEREAS, Article XXVI of the City Charter provides the City shall make such contributions to the System periodically during the year that, when added to the contributions of System members, will actuarially fund all liabilities for all System members by July 1, 2026; and

WHEREAS, the most recent adopted actuarial study of the PFRS, dated July 1, 2010 (the "Actuarial Study"), determined that the actuarial present value of future employer normal cost ("Employer Liability") is $792 million; and

WHEREAS, the "holiday" that the City negotiated with the PFRS system will expire on June 30, 2011, and the City is required to contribute approximately $45.6 million annually to PFRS to fund its unfunded accrued actuarial liability (UAAL) beginning July 1, 2011; and

WHEREAS, the City Council desires to authorize and approve the option of pension obligation bonds in conjunction with an aimual contribution of approximately $5,000,000 for the period July 1, 2012 through June 30, 2017 to fund PFRS; and

WHEREAS, it is in the best interest of the City that Council authorize the City Administrator to negotiate the terms and conditions of the funding option(s) approved by City Council for the System and enter into an agreement with the PFRS, which would relieve the general fund from payments into the system for a negotiated period of time; and

RESOLVED, that to meet the City's obligations to the PFRS under Article XXVI of the City Charter to fund the system, the City Council hereby authorizes the City Administrator to move forward with the option of issuing Pension Obligation Bonds and an annual contribution of approximately $5,000,000 for the period of July 1, 2012 through June 30, 2017, and be it

FURTHER RESOLVED, that the City Council authorize the City Administrator to negotiate the terms and conditions of the funding option(s) approved by City Council for the System and enter into agreement with the PFRS Board for a negotiated period of time based upon a lump sum payments into PFRS by the City financed through the issuance of additional Pension Obligation Bonds and thereafter resume the annual required contribution on July 1, 2017 which is determined by an actuarial; and be it

FURTHER RESOLVED, that this Resolution shall take effect immediately upon its passage.

IN COUNCIL, OAKLAND, CALIFORNIA, ______________________, 20______

PASSED BY THE FOLLOWING VOTE:

AYES - BROOKS, BRUNNER, DE LA FUENTE, KAPLAN, KERNIHGAN, NADEL, QUAN, and PRESIDENT REID

NOES -

ABSENT -

ABSTENTION -

ATTEST: ______________________

LaTonda Simmons
City Clerk and Clerk of the Council
of the City of Oakland, California

Approved as to Form and Legality

Oakland City Attorney's Office

OAKLAND CITY COUNCIL

RESOLUTION NO.______________C.M.S.

Introduced by Councilmember ______________

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF OAKLAND AUTHORIZING AND APPROVING THE TERMINATION OF THE SWAP AGREEMENT RELATED TO THE OAKLAND JOINT POWERS FINANCING AUTHORITY, LEASE REVENUE BONDS, 1998 SERIES A1/A2

WHEREAS, the City entered into a forward-starting synthetic fixed rate swap agreement (the "Swap Agreement") with Goldman Sachs Mitsui Marine Derivatives Products, U.S., L.P. in the comection with the issuance of Oakland Joint Powers Financing Authority, Lease Revenue Bonds, 1998 Series A1/A2; and

WHEREAS, the Swap Agreement no longer serves its original purpose to mitigate interest rate risks because the interest rates on the original series of bonds tied to the Swap were restructured to fixed rates in 2008, the City Council finds that termination of the Swap Agreement in the best interest of the City; now therefore be it

RESOLVED, that the City Coumcil authorizes the termination of the swap agreement in the connection with the issuance of Oakland Joint Powers Financing Authority, Lease Revenue Bonds, 1998 Series A1/A2; and be it

FURTHER RESOLVED, that this Resolution shall take effect immediately upon its passage.

IN COUNCIL, OAKLAND, CALIFORNIA, ______________________, 20______

PASSED BY THE FOLLOWING VOTE:

AYES - BROOKS, BRUNNER, DE LA FUENTE, KAPLAN, KERNIHGAN, NADEL, QUAN, and PRESIDENT REID

NOES -

ABSENT -

ABSTENTION -

ATTEST: ______________________

LaTonda Simmons
City Clerk and Clerk of the Council
of the City of Oakland, California