City of Oakland
Police and Fire Retirement System

Plan Funding Analysis – Pension Obligation Bonds

Prepared by Aon Hewitt
Retirement Consulting

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Agenda Slide

Section 1: Purpose of the Report

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Purpose of the Report

- Engaged by the City Auditor conduct an analysis of the PFRS plan funding options
  - Provide context and background to stakeholders
  - Describe various uses for POBs
  - Examine past decision to issue POBs
  - Illustrate various select funding options including issuing new POBs
  - Examine broad range of potential outcomes
  - Benchmark current PFRS situation to peer group

- Objective is not to
  - State an opinion on the use of POBs
  - Steer the City in any one direction with respect to plan funding

Section 2: Current Situation

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Current Situation

- Current funding position (based on draft 2010 valuation report provided by Bartel & Associates)
  - Liability: $790M
  - Market Value of Assets: $290M
  - Unfunded Liability: $500M

- Plan is “closed” to new entrants
  - All but one plan participant as of July 1, 2010 is receiving benefit payments
- Only growth in benefits due to negotiated cost of living increases
- Plan expected to pay $67M in benefits to pensioners for FYE 2011
  - Paid out of the pension trust
  - Roughly ¼ of total assets
- Plan required to be fully funded by 2026 according to the City Charter

Section 3: Background on POBs

Background on POBs

- Pension Obligation Bonds ("POBs") are bonds issued by a state or local government as a means to meet its obligation to fund a pension system that benefits its employees.

- First POBs ever issued were by the City of Oakland in 1985
  - Over 300 since then including 100 in California

- Potential Advantages - Reasons to Issue POBs
  - Budget Relief
  - Investment Return
  - Negotiated Discounts

- Potential Disadvantages
  - Investment Return
  - Deferring the Inevitable
  - Bond Issuance Costs

Section 4: Analysis of 1997 Bond Issuance

Background on 1997 Bond Issuance

- In 1997 the City issued approximately $435 million in Pension Obligation Bonds
- Proceeds were deposited into the plan trust in exchange for a contribution holiday until the 2011/2012 fiscal year
- The debt was initially scheduled to be fully paid off in 2010 but was restructured in 2001
  - Restructured debt scheduled to be fully paid off in 2023
- $710 million left to be repaid, PV of approx $510 million at 6.50%

Expected vs. Actual Investment Returns

	Return on Market Value of Assets												
	1997-1998	1999-2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Cumulative Annual Return
Expected	3.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	7.50%	7.00%	7.92%
Actual	12.60%	8.80%	-0.20%	-2.63%	4.01%	13.44%	7.96%	7.20%	13.70%	-6.10%	-20.70%	16.50%	4.31%

- Cumulative returns over the contribution holiday period were below expected returns resulting in actuarial losses over that period

- In addition, the interest rates charged to service the debt range from approximately 6.1% to 7.3% per year. Since these rates are higher than the cumulative annual return on the pension trust the amount of money that the City has paid (and is scheduled to pay) to service the debt has to date outweighed the amount these funds have earned in the pension trust.

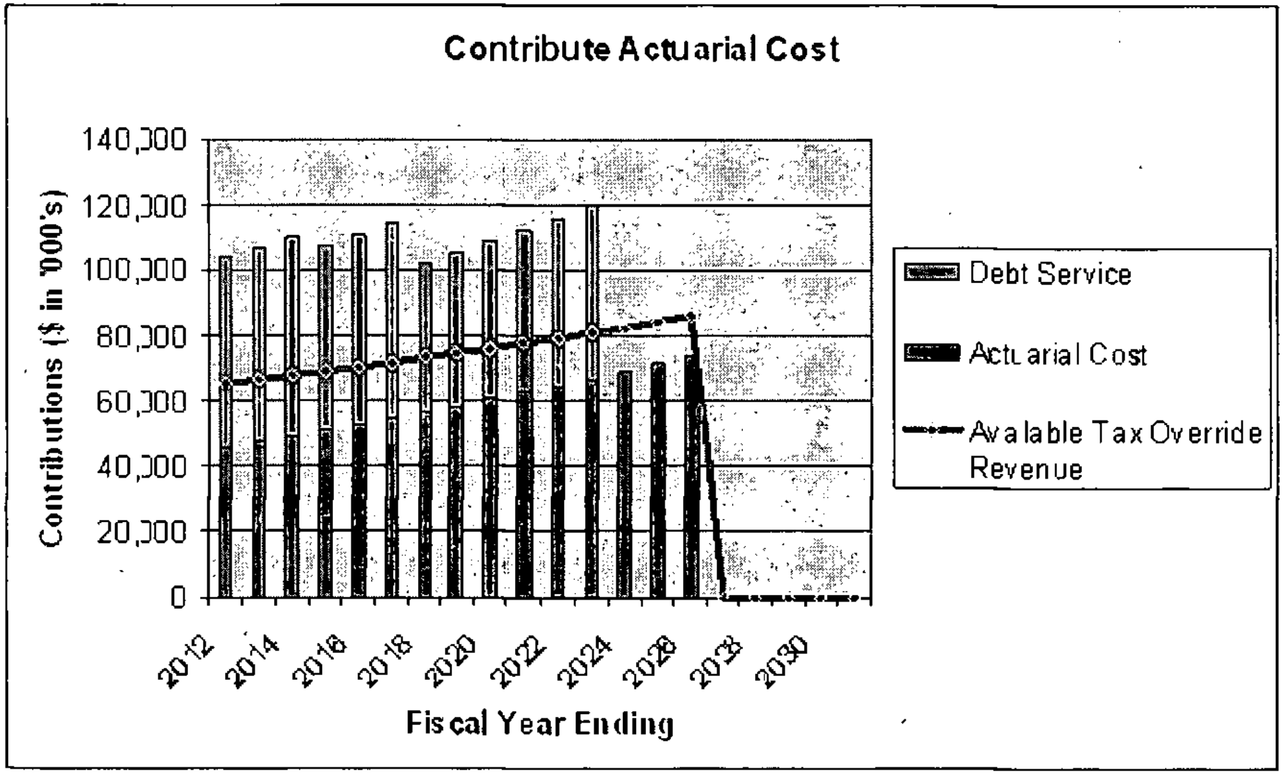
Hypothetical Comparison

Contribution to Pension Trust ($ in '000s)	As of June 30, 2010 Market Value of Assets (a)	Unfunded Liability (b)	Outstanding Debt (c)	Total Amount Owed (b) + (c)
Actual - Payments to POB Debt	290,000	500,000	510,000	**1,010,000**
Hypothetical - Payments to the Pension Trust	30,000	760,000	0	**760,000**

- Actual Scenario – 1997 Bonds issued, City contributions during holiday period used to service debt
- Hypothetical Scenario – 1997 Bonds are not issued, City contributions are instead paid into the plan trust
- Both scenarios have assume identical City cash flow equal to the amount of the "actual" debt service payments
    - Contributions under hypothetical scenario not made according to actuarially recommended cost
    - Allows for apples to apples comparison
  - Outstanding debt column is the present value of all debt service payments remaining according to Attachment A of the May 11, 2010 Finance and Management Agency Agenda Report
    - 6.5% discount rate assumed

Section 4: Potential POB Program for 2011

Baseline Situation – Contribute Actuarially Recommended Cost



- No additional bonds issued
- Contribute cost recommended by actuary every year until full funding in 2026
- Large contributions in excess of tax override revenue required until current debt service payments expire 2024

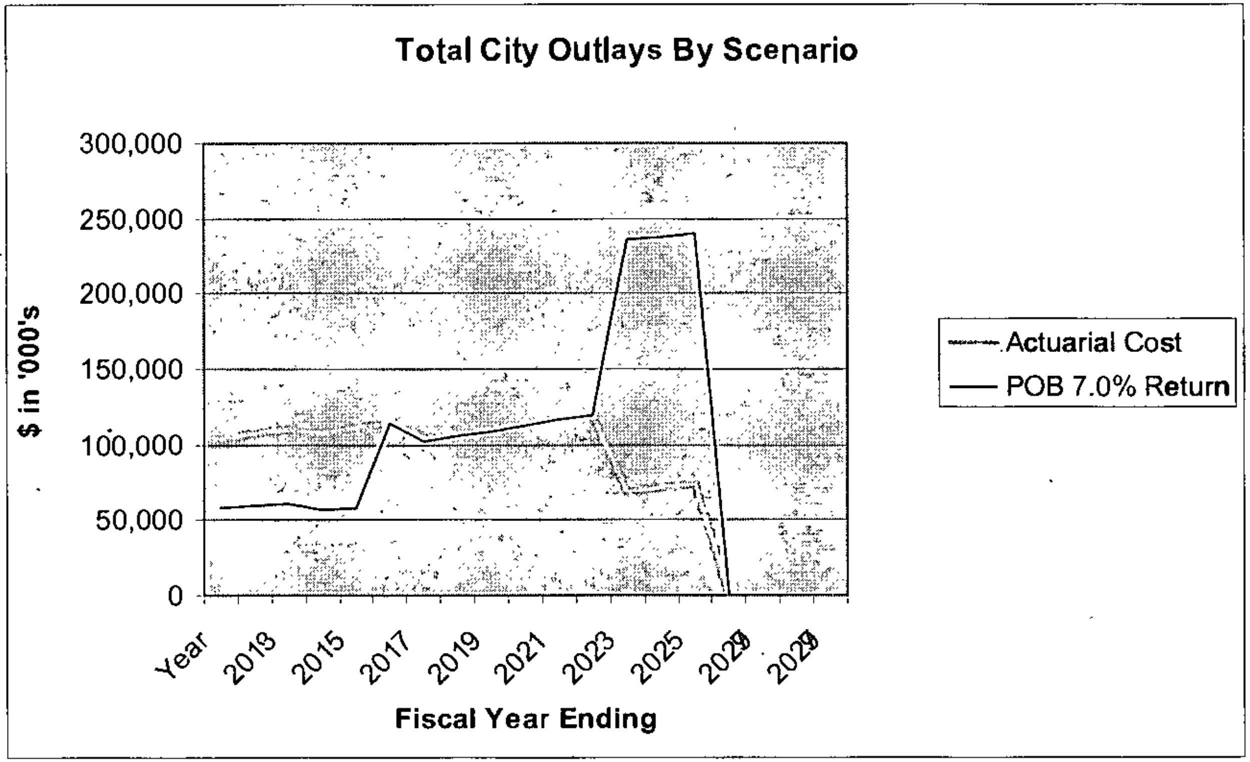
General Program Framework

- Issue POBs during 2011 in exchange for a five year contribution holiday
  - Amount of POBs issued equal to the present value of the five years of actuarially recommended contributions
    - $214 million based on the draft July 1, 2010 valuation report provided by Bartel & Associates

- Repay all of the debt over a three year period 2024-2026
  - Current Debt Service Payments scheduled to expire in 2024
  - Frees up Tax Override Revenue to use to finance debt
  - City Charter states plan must be fully funded by 2026

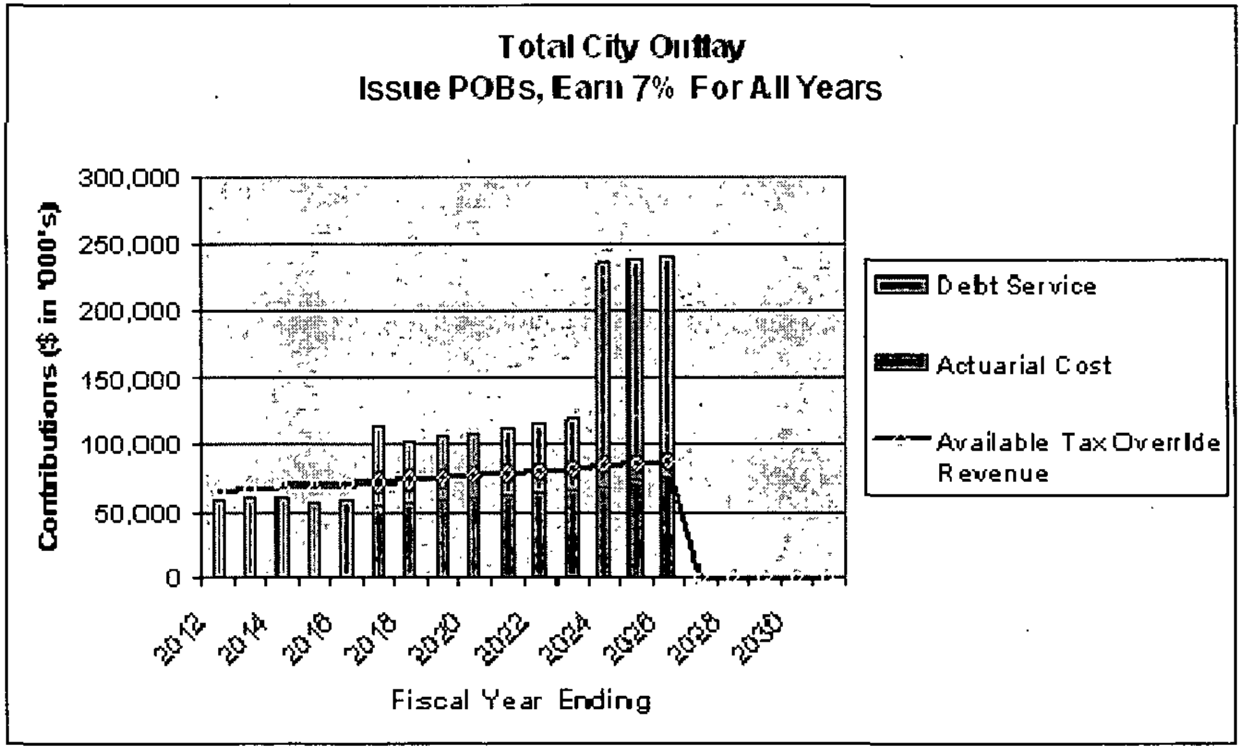
- This is a hypothetical scenario based on what a new POB program might possibly look like and does not reflect any final stages of planning by the City with respect to a new POB program

City Cash Flow Pattern



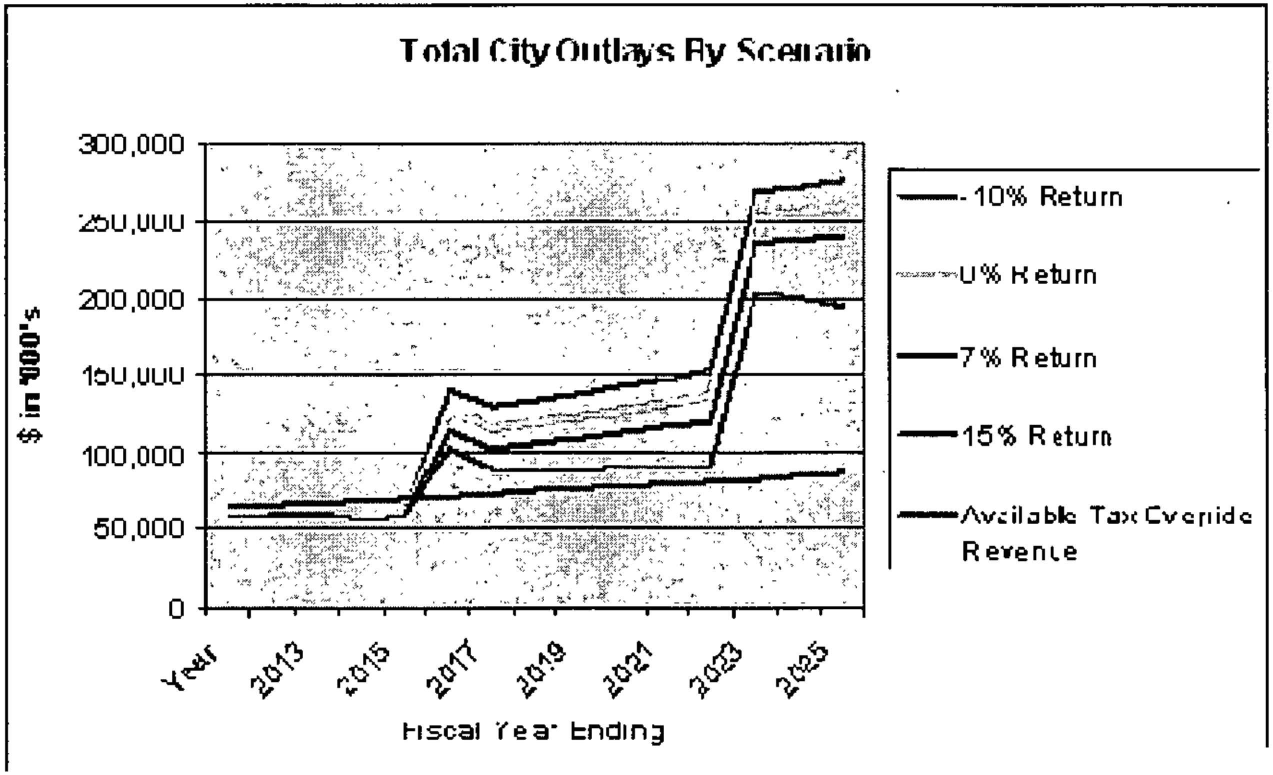
- Program represents deferral of costs
- Sample program had five years of contributions “borrowed” and paid back over three years

Potential Financial Outcome – Trust Earns 7% Per Year During Holiday Period



- "Expected Scenario"
  - Asset returns exactly equal to actuarial assumption of 7%
- Short term savings cash savings versus baseline
- Spike in Contributions when new POBs are repaid in 2024-2026
- Approximately $20M in savings versus baseline

Potential Financial Outcome – Varying Investment Returns



- Total outlays sensitive to investment return in the trust
- Even if strong investment returns are realized, sizeable contributions will be due 2024-2026