THE CITY OF OAKLAND

AGENDA REPORT

TO: Office of the City Administrator/ Agency Administrator
Executive Director of the Oakland Joint Powers Financing Authority
ATTN: Dan Lindheim
FROM: Finance and Management Agency
DATE: February 22, 2011

RE: **A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF OAKLAND AUTHORIZING THE AVAILABLE OPTION(S) AND TERMS FOR FUNDING THE POLICE AND FIRE RETIREMENT SYSTEM UNFUNDED ACCRUED ACTUARIAL LIABILITY, 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 members who were hired prior to 1976. Since that time all retired sworn staff have been covered under the PERS retirement system. Under Article XXVI of the City's Charter, the City is obligated to fund these retirement benefits until 2026. PFRS is currently funded at only 37.6% (actuarial value of assets/actuarial liabilities) or unfunded by $494 million. The unfunded liability is a factor of actuarial assumptions which can either increase or decrease the liability. Such assumptions include cost of living increases that are tied to increases provided to active employees. If the assumptions are inflated, they can substantially increase the liability.

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. The City will be required to deposit to PFRS beginning FY 2011-12 an annual contribution of approximately $45.6 million, an amount based on actuarial computations.

Resuming annual contributions of this magnitude to PFRS would place extreme pressure on the City's General Fund. After evaluating all available options to fund PFRS, staff is recommending the issuance of Pension Obligation Bonds (the "2011 POBs") to take advantage of excess tax override revenue already pledged to PFRS. Utilizing the tax override revenues, which are revenues generated and collected by the City on its annual tax levy authorized by Measure R and Measure O, to meet this financial obligation will alleviate the General Fund contribution to the system in July 2011 and for a number of fiscal years thereafter.

Pension obligation bonds are a financing vehicle for the City to manage the mandated obligation to PFRS. Staff has included in this report various scenarios utilizing pension obligation bonds and General Fund support to ensure an uninterrupted and secure level of funding until the system meets all of its obligations to the retirees and their dependents. Staff has been actively exploring options to meet the City's obligations to the PFRS under Article XXVI of the City Charter to fund the system. These options are:

Option 1: Pay-As-You Go Method

In addition to the amount paid out of the excess Tax Override Revenues and Annuity, this option would require annual General Fund contributions beginning in FY 2012-13 that range from $18.7 million to $40.5 million as presented in Table 2 of the report

Option 2: Issue Pension Obligation Bonds ("2011 POBs")

Issuing additional pension obligation bonds supported by excess tax override revenues and negotiating a "holiday" period will relieve the General Fund from paying into the PFRS system and increase the funding level to above 75%.

The 2011 POBs would be structured to match the available Tax Override Revenues through FY 2025-26, and General Fund contributions would resume after the five-year "holiday" when it can support additional contributions due to the declining General Fund-supported debt. In the later years, other non-POB related debt will mature (i.e., museum, convention center, and master leases) thus reducing the magnitude of General Fund debt obligations.

In addition, a mechanism would be put in place to monitor the PFRS funding level and alert the City if the funding level declined 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.

Option 3: Combination of Issuing 2011 POBs and General Fund Pay-As-You-Go

If the City can afford to make modest annual General Fund payments – e.g., $5 million from FY 2011-12 through FY 2015-16, Staff is recommending this option because it would also require lower annual net General Fund payments from FY 2016-17 through FY 2025-26 and lower total General Fund payments than under Option 2.

Voluntary Buy-out Program

Once the 2011 POBs have been issued, the City could explore the potential option of using a portion of the 2011 POB proceeds to buy out some members by offering upfront cash payments.

Option 3 provides the lowest overall cost to the City. However, all scenarios above will be exposed to investment risk and any other changes to the actuarial assumptions used to calculate the UAAL. For example, if the 2011 POBs proceeds and/or PFRS holiday contribution do not meet the 7% investment rate the City's UAAL will increase.

Rebuttal to City Auditor's Report

- Contrary to the Auditor's report, the City does not have the option not to fund PFRS because it is a Charter mandated obligation.
- Even if the hypothetical figures in the Auditor's report are assumed correct, a $30 million PFRS asset value of as of June 30, 2010, would have been depleted by July 2010 leaving the City with approximately $130 million annual payments to PFRS at a time when the City was laying off safety employees and reducing other core services to balance the City's budget.
- Faced with ongoing General Fund deficits and the $45.6 million annual PFRS payment, the City's best viable option absent a change to the Charter (to relieve the City of its pension obligafions), is to issue pension debt to fund the PFRS mandated obligation.

Finally, staff is seeking City Council authority to terminate the swap agreement in connection with the issuance of Oakland Joint Powers Financing Authority, Lease Revenue Bonds, and 1998 Series A1/A2. As of January 30, 2011, the notional amount on the swap is $76.8 million and the swap does not expire until 2021. The estimated termination cost of the swap as of January 30, 2011 is approximately $17 million. With an estimated amual interest rate swap payment of $5 million, the City would realize cash flow savings after three and a half years by terminating the swap now.

FISCAL IMPACT

The debt service for 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 be impossible, as even without this obligation the FY 2011/12 budget will require major reductions to core services to achieve balance budget. 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 contribufions due to the declining debt in later years when other non-pension debt supported by the General Fund matures. Therefore, staff recommends the issuance of 2011 POBs in order to manage this Charter mandated obligation, which will allow the City to better manage its annual General Fund obligations.

BACKGROUND

Overview of the Retirement System

The Police and Fire Retirement System was originally established in 1951 by Article XXVI of the City of Oakland Charter (the "Retirement Law") and is a defined benefit pension system for the sworn members of the City's Police and Fire Departments. The System has been closed to new members since July 1, 1976. Pursuant to the Retirement Law, the City is obligated to provide for the payment of retirement allowances and disability and death benefits to its members and their beneficiaries. As of June 30, 2010, PFRS covered one active employee and 1,152 retired employees. The System is governed by a seven-member Police and Fire Refirement Board, which controls the operation, investment and disbursement of the System's funds. The Retirement Board has discretion to invest plan assets under the prudent person standard of the City Charter Article XXVI section 2619, the California Constitution and other applicable law. The City Charter dictates how PFRS is managed and requires that the City fund all liabilities for future benefits for all members by June 30, 2026. PFRS is currently funded at 37.6% of actuarial liability, representing a decline from the 44.4% funding level in July 2009. Beginning July 2011, the City will be required to deposit annual contributions of approximately $45.6 million.

PFRS Expenditure History

PFRS is a defined benefit plan that provides its members a prescribed retirement pension based on the plan formula. As stated in the City Charter, the PFRS plan formula is based on "compensation attached to the average rank held." The City Charter defines this term as the compensation attached to the lowest rank held during the three years immediately preceding retirement. As a result, the PFRS plan pays its members a percentage of the compensation currently paid to active sworn personnel who hold the rank the retired member held prior to retirement. For example, if a PFRS member retired as a Police Sergeant, they would continue to receive a percentage of the pay of an active Oakland Pohce Sergeant. The active pay elements currently deemed attached to the rank include (1) Base Pay/ Cost of Living Adjustment ("COLA") (2) Holiday Pay, (3) Uniform Allowance, (4) Shift Differential, (5) Longevity Pay and (6) FLSA. Any changes to these pay elements changes the pay that the PFRS members receive.

Below is a historical summary of the average monthly retirement benefits paid to PFRS participants. Changes in actuarial assumptions such as salary increases, investment returns, and mortality impact the benefit payment. The City has experienced a rising trend in benefit payments primarily due to salary increases.

Period	Annual Payment	Average Monthly Payment	Number of Participants
1997	$56,619,290	$4,718,274	1,491
1998	$54,133,824	$4,511,152	1,495
1999	$54,910,015	$4,575,834	1,484
2000	$61,119,186	$5,093,265	1,495
2001	$63,314,000	$5,276,167	1,492
2002	$66,179,000	$5,514,917	1,513
2003	$67,411,000	$5,617,583	1,479
2004	$70,334,000	$5,861,167	1,448
2005	$70,960,842	$5,913,404	1,403
2006	$71,352,000	$5,946,000	1,311
2007	$71,404,000	$5,950,333	1,328
2008	$74,980,000	$6,248,333	1,238
2009	$72,658,000	$6,054,833	1,194
2010	$69,757,000	$5,813,083	1,152

Tax Override Revenues

The "Tax Override Revenues" are revenues generated and collected by the City in each Fiscal Year ("FY") from an ad valorem annual tax levy authorized by Measure R, adopted by the voters of the City on June 8, 1976 ("Measure R"), which requires the City to amortize the unfunded liability of the City to PFRS by FY 2015-16, as described in ***Attachment A***. On June 7, 1988, the voters of the City adopted Measure O (the "Measure O") by a 71% vote, extending the period for amortizing the unfunded liability by 10 years, to FY 2025-26, as described in Resolution No. 65264 C.M.S.

The City is authorized to levy the Tax Override on all taxable property within the City pursuant to Measure R. Beginning in 1981, the City Council levied the Tax Override to fund the unfunded liability. State legislation enacted in 1985 limits the rate of the Tax Override levy to 0.1575%. The Tax Override has been levied at 0.1575% since 1983. The City is authorized pursuant to Measure O to levy the Tax Override through FY 2025-26.

1997 Pension Obligation Bonds

On February 1, 1997, the City issued Taxable Pension Obligation Bonds ("1997 POBs") of approximately $436 million to fund (1) a portion of the current balance of the City's unfunded actuarial accrued liability ("UAAL") for retirement benefits for the members of PFRS and (2) a lump-sum payment in the amount of $417,173,300 to PFRS, which equals the present value of the payments the City would otherwise have been required to make to amortize the current balance of the City's UAAL through June 30, 2011. As a result, the City received a "holiday" from making payments related to its unfunded liability into the System until June 30, 2011 and instead covenanted to make debt service payments on the POBs through that date. Funding for the POB debt service comes from the Tax Override Revenues, as allowed under Measure R and Measure O.

At the time, staff recommended – and City Council approved – the bond issuance based on an assumption that depositing the bond proceeds with the PFRS system would earn 8% in annual interest. The City's intent was to pre-fund some of the long-term liability and generate greater returns by investing the bond proceeds, thereby reducing the City's UAAL over the long term. The recent actual investment earnings have been in double digits: during fiscal year 2009-2010, PFRS realized a 15% return on its assets, and during the first quarter in 2010-2011, returns have been at nearly 10%. The negative returns in 2008 and 2009 (of -5.8% and -18.2%, respectively) were in years when most if not all retirement systems and other major investors nationwide lost money. The 1997 POBs will not mature unfil 2022, which means there are twelve more years to generate additional returns. Therefore, it would be premature to determine what investment rate the POB proceeds earned over the life of the bond issue.

2001 Pension Obligation Bonds

On October 17, 2001, the City issued $195.6 million of Taxable Pension Obligation Bonds ("2001 POBs"). The 2001 POBs refunded the 1997 POBs in order to reduce average annual debt service payments to a level at or below the anticipated Tax Override Revenues received by the City and to minimize the need for the City to use other revenues besides the Tax Override Revenues to pay for such debt service. The restructuring extended the final maturity of the POBs from 2010 to 2023, resulting in reduced annual debt service payments. As a result of the restructuring and subsequent property tax growth, the City's Tax Override Revenues have exceeded annual debt service. As of January 2011, the City has accumulated $76.7 million of reserves from these excess Tax Override Revenues.

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 and interest on 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 Annuity proceeds will become part of the City's General Fund. The Annuity consists of a series of monthly payments to the City; however, payments from the Armuity are dependent on retiree mortality and will therefore decline over time. The City is projected to receive approximately $10.7 million for FY 2010-11, which is less than the debt service due on the 2008 POBs for that fiscal year. The shortfall will be paid by the Tax Override Revenues.

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 connecfion with the issuance of Oakland Joint Powers Financing Authority (the "Authority") Lease Revenue Bonds, 1998 Series A1/A2 (the "JPFA Bonds"). Under the swap agreement, which effecfively changed the City's variable interest rate on the bonds to a synthetic fixed rate, the City would pay the Counterparty a fixed rate of 5.6775% through the end of the swap agreement in 2021 and receive a variable rate based on 1-month LIBOR. The City received a $15 million upfront payment from the restructuring at the time it entered into the Swap.

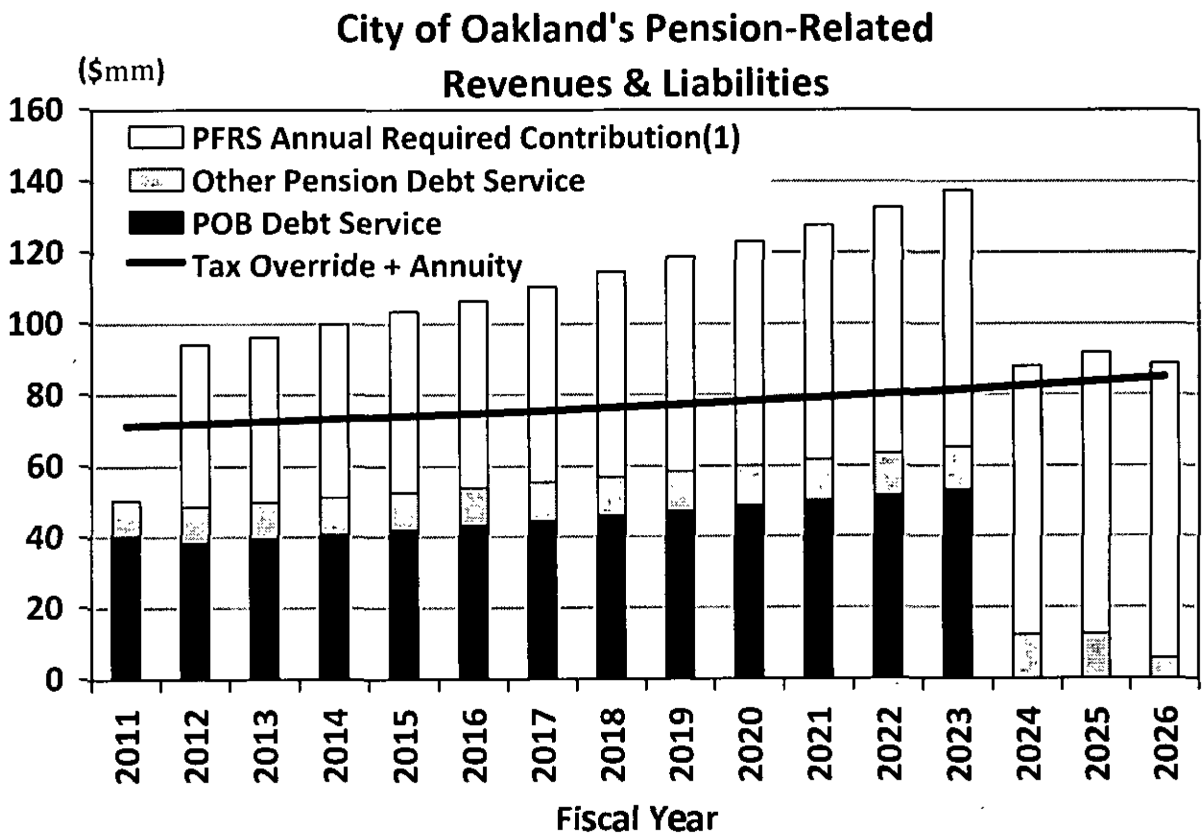
Due to changes in interest rates since the execution of the Swap, as of January 30, 2011, the Swap had a negative market value of approximately $17 million. Because the original series of bonds tied to the Swap were fixed in 2008, the Swap no longer serves its original purpose, which was to mifigate interest rate risk. Therefore, Staff is recommending terminating the Swap using a portion of the excess tax override reserve. By terminating the swap today, the City can generate cash flow savings that allows for a more cost-effective POB structure.

Attachment A presents the revenues and expenses associated with PFRS, as well as, the excess Tax Override Revenues.

KEY ISSUES AND IMPACTS

PFRS provides death, disability and service retirement benefits to sworn members and their beneficiaries. The City is required under Article XXVI of the City's Charter to fund all liabilities for future benefits for all members by June 30, 2026. The PFRS plan has paid its members a percentage of the compensation currently paid to active sworn personnel who hold the rank the retired member held prior to retirement, which has been costly to the City because as active employees continued to receive COLA and other salary increases, the retirement benefit costs continued to escalate as well. Given the low funding level of 37.6%, a one-time revenue source or ongoing investment into the system is critical. In addition, the "holiday" is set to expire on June 30, 2011, and the City will be required to contribute to PFRS to fund its UAAL, which is estimated to be $45.6 million on July 1, 2011.

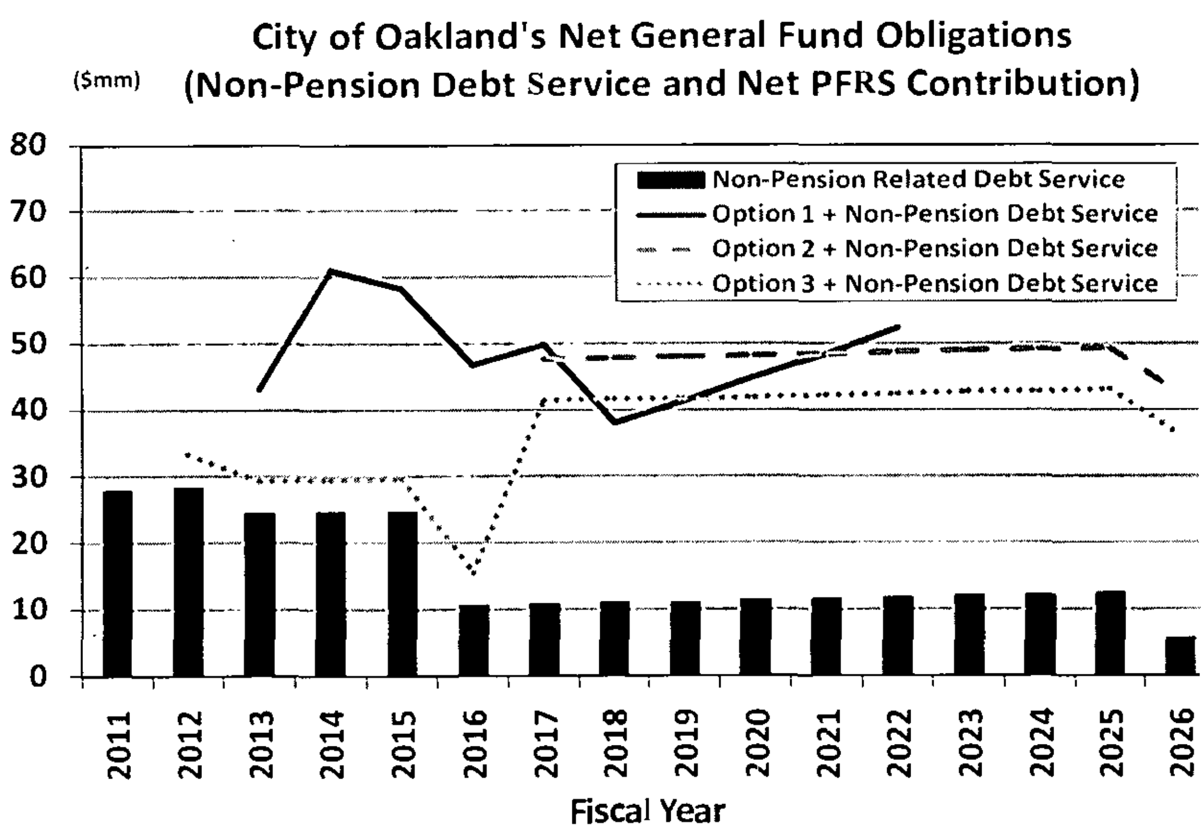
In addition to the UAAL, the City will pay debt service on PFRS pension-related bonds in an amount equal to $63.5 million, which includes the swap payment. In FY 2011/12, the City's total obligation on the PFRS unfunded liability as well as bond debt service payments will total approximately $109.1 million 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 in ***Attachment A*** herein.


City of Oakland's Pension-Related
Revenues & Liabilities
($mm)
PFRS Annual Required Contribution(1)
Other Pension Debt Service
POB Debt Service
Tax Override + Annuity
160
140
120
100
80
60
40
20
0
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025
2026
Fiscal Year

CURRENT FUNDING STATUS AND OPTIONS

Why issue Pension Obligation Bonds?

Given the current economic circumstances, with a continued decline of City revenues and the severe constraints on additional General Fund expenditures, resuming annual contributions of approximately $45.6 million is impossible. In addition, the City's current General Fund supported debt service, depicted in the chart below, will not start to decline until FY 2015-16, thus creating an opportunity to fund additional General Fund payments. If the City were able to execute a plan that would enable it to take a total or at least a partial payment holiday from the PFRS obligation, and resume General Fund support in FY 2016-17 when other, non-pension-related debt service begins to decline, it could avoid the extreme measures that would be required to fund this obligation in the next several years.



Staff evaluated a range of available options to fund the PFRS system in order to ensure continuous payment of retiree and beneficiary benefits and to minimize the net payments from the General Fund. **All of the options analyzed assume full funding of PFRS by FY 2025-26, assuming all of the actuarial assumptions are realized, and the termination of the swap.** These options are discussed below.

TABLE 2 – Summary of Options
Net General Fund Payments

	Option 1			Option 2			Option 3		
Fiscal Year	Total Obligations Payments(1) (A)	Total Revenues & Fund Balances(2) (B)	Required General Fund Contribution (C = A - B)	Total Obligations Payments(1) (A)	Total Revenues & Fund Balances(2) (B)	Required General Fund Contribution (C = A - B)	Total Obligations Payments(1) (A)	Total Revenues & Fund Balances(2) (B)	Required General Fund Contribution (C = A - B)
2012	104,173	109,173	-	72,011	72,011	-	77,011	72,011	5,000
2013	106,285	87,554	18,731	72,686	72,686	-	77,686	72,686	5,000
2014	109,856	73,378	36,478	73,378	73,378	-	78,378	73,378	5,000
2015	107,746	74,094	33,652	74,094	74,094	-	79,094	74,094	5,000
2016	110,858	74,840	36,018	74,840	74,840	-	79,840	74,840	5,000
2017	114,686	75,624	39,062	112,467	75,624	36,843	106,252	75,624	30,628
2018	103,525	76,449	27,076	113,293	76,449	36,843	107,077	76,449	30,628
2019	107,595	77,322	30,273	114,166	77,322	36,843	107,950	77,322	30,628
2020	111,800	78,246	33,554	115,090	78,246	36,843	108,874	78,246	30,628
2021	116,140	79,224	36,916	116,067	79,224	36,843	109,852	79,224	30,628
2022	120,720	80,257	40,463	117,100	80,257	36,843	110,885	80,257	30,628
2023	125,430	128,251	-	118,191	81,347	36,843	111,975	81,347	30,628
2024	75,700	82,495	-	119,338	82,495	36,843	113,123	82,495	30,628
2025	79,300	83,700	-	120,543	83,700	36,843	114,328	83,700	30,628
2026	83,100	84,961	-	168,708	131,865	36,843	162,493	131,865	30,628
Total >>	1,576,914	1,265,569	332,222	1,581,972	1,213,537	368,434	1,544,816	1,213,537	331,279
PV of Total(	969,800	766,686	214,240	899,643	715,142	184,501	889,019	715,142	173,877

(1) Estimated based on PFRS actuarial report for 6/30/2009. Includes contributions to fund remaining UAAL net of POB contribution (if any) and debt service on existing and new POBs.
(2) Includes Measure O tax override revenues at assumed growth rate of 2%, New York Life annuity receipts and release of fund balances. Excludes fund balances transferred in FY2010 as part of POB financing or to terminate outstanding swap.
(3) Discounted at 7%.

Option 1: Pay-As-You Go Method

An alternative to funding the approximately $45.6 million PFRS FY 2011-12 annual contribution from the General Fund is to use excess Tax Override Revenues, on a pay-as-you-go basis. The City could use the approximately $52 million of the projected excess Tax Override Revenues (after the termination of the Swap) at the end of FY 2010-11 to make the annual PFRS contributions for FY 2011-12 as well as approximately 50% of the FY 2012-13 payment. This would also provide for the retention of a liquidity reserve from additional existing excess Tax Override Revenues to meet annual debt service payments. The future unfunded liabilities would have to be met by the General Fund because the City Charter requires PFRS to be fully funded (i.e. at 100%) by June 30, 2026 as depicted in Attachment A. After the depletion of the current balance of excess Tax Override Revenues, this option would require annual General Fund contributions beginning in FY 2012-13 that range from $18.7 million to $40.5 million and would necessitate cuts to the General Fund budget of the equal amount in addition to any existing budget shortfalls.

Option 2: Issue Pension Obligation Bonds ("2011 POBs")

Issuing 2011 POBs allows the City to leverage its excess Tax Override Revenues as shown on Table 1. In addition, the Annuity will continue to contribute revenues to meet debt service on the 2008 Bonds, 1997 POBs and 2001 POBs. Issuing 2011 POBs supported by this excess Tax Override and negotiating a "holiday" period will relieve the General Fund from paying into the PFRS system. Further, the proceeds of the 2011 Bonds, as well as all or some of the existing excess Tax Override Revenues would be deposited into PFRS, increasing the funding level to approximately 75%. Under Option 2, the 2011 POBs would be structured to match available Tax Override Revenues through FY 2025-26, and General Fund contributions would resume after the five-year "holiday" and continue until the PFRS system fully satisfies its retirement and beneficiary obligations. From an affordability perspective, this option works better with the City's declining debt service pattern as presented on the previous page than Option 1.

In addition, a mechanism would be put in place to monitor the PFRS funding level and alert the City if the funding level reached a certain pre-determined funded ratio. This would trigger the City to explore alternatives to address any new unfunded liabilities and to bring the funding level up immediately, thus preventing any additional funding considerations to go unaddressed.

Option 3: Combination of Issuing 2011 POBs and General Fund Pay-As-You-Go

This alternative combines the issuance of 2011 POBs with limited General Fund annual contributions to pay down the PFRS UAAL and reduce the long-term General Fund funding requirements. Under this scenario, the City would issue 2011 POBs as in Scenario 2, depositing the net proceeds as well as a portion of the excess Tax Override Revenues into PFRS to raise the funded level to approximately 77%. In addition, the City would make modest – e.g., $5 million – annual payments for 2011 POB interest and PFRS, thus resulting in only a partial payment holiday for five years, followed by higher annual contributions through FY 2026. From an affordability perspective, this option also works better with the City's declining debt service pattern as presented on the previous page than Option 1. In addition, if the City can afford these modest annual General Fund payments from FY 2011-12 through FY 2015-16, Staff is recommending this option because it would also have lower annual net General Fund payments from FY 2016-17 through FY 2025-26 and lower total General Fund debt service payments than under Option 2, due to the ability to issue all current interest 2011 POBs under current market conditions.

In addition, a mechanism would be put in place to monitor the PFRS funding level and alert the City if the funding level declined 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.

Additional Alternative

If legally viable and economically beneficial, the City can explore an alternative of using a portion of the 2011 POB proceeds to buy out some members by offering upfront cash payments,. The economics of this scenario will depend on the terms negotiated for the buy-outs which will require extensive research and analysis.

REBUTTAL TO CITY AUDITOR'S REPORT

Charter-Mandated Obligation

Contrary to the Auditor's report, the City does not have the option not to fund PFRS. As previously stated, under Article XXVI of the City's Charter, the City is obligated to make payments to PFRS for these retirement benefits. Absent issuance of 2011 POBs or some other one-time source of funding, the City will be mandated to begin making an annual contribution to PFRS estimated at $45.6 million from the General Fund beginning July 2011. This is to ensure Charter-mandated funding for the PFRS system through 2026.

Use Up Existing PFRS Assets

Contrary to the suggestion made in the City Auditor's report, the existing assets are simply not sufficient to continue funding the required annual benefit level. As of the July 2010 Actuarial Report, the PFRS system currently has $297 million in assets, while the PFRS annual benefit payment is $70 million. The existing assets are, therefore, only sufficient for a little over four years of benefit payments. To complicate the matter, the City Charter requires PFRS to be fully funded (i.e. at 100%) by June 2026, so any scenario which considers payments into PFRS beyond FY 2026 (i.e., the "No Contributions to the Fund" scenario on page 6 of the Auditor's report) is simply not possible without an amendment to the City's Charter.

Auditor's Retrospective Analysis of the 1997 POBs

Without the detailed analysis behind the hypothetical "cash flow" scenario against which the Pension Obligation Bonds are being compared, the City cannot opine on the validity of the Auditor's results. Even if the hypothetical figures are assumed correct, a $30 million asset value as of June 30, 2010, would have been depleted by July 2010 leaving the City with a Charter mandated obligation of approximately $130 million annually. Given the City's financial position at the time, the City would have had to drastically cut its Police and Fire personnel and other critical City services in order to meet the retiree mandated pension obligation. With the declining revenue base and rising expenditures, the City cannot sustain such costs.

In addition, calculating an average return on the City's 1997 POB investment at 4.31% - as the City Auditor's report does – is extremely premature, given that: (a) public pension systems earn on average 9.3% over a 25-year period, as the Auditor's report itself acknowledges, and (b) the 1997 POBs will not mature until 2022, which means there are twelve more years to generate additional returns.

Are Pension Obligation Bonds the right solution to tlte PFRS System?

Bonds are typically used as a vehicle to manage debt when the pay-as-you-go method is not an option. Faced with ongoing general fund deficits and the $45.6 million annual PFRS payment, the City's best and most viable option, absent a change in the Charter (to relieve the City of its pension obligations), is to issue pension debt to fund the PFRS mandated obligation. The 2011 POBs will be paid by the already voter-approved tax override revenues which are pledged to PFRS obligations though 2026. Utilizing 2011 POBs to fund PFRS has its associated risks and costs; however, not funding the plan is not an option at this time. Furthermore, depleting the plan assets will lead to much higher annual costs that cannot be supported by the General Fimd.

More importantly, issuing 2011 POBs allows the City to utilize the Tax Override Revenues that can be used to pay pension-related bonds. Currently, the City has excess Tax Override Revenues to secure additional bonding. Issuing 2011 POBs supported by excess Tax Override Revenues and negotiating a "holiday" period will relieve the General Fund from paying into the PFRS system and increase the funding level to above 70%. Unlike the Auditor's examples, the 2011

POBs will be structured to spread the Tax Override Revenues over the years, until the PFRS system fully satisfies its retirement and beneficiary obligations.

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 financial position and limited discretionary general funds, staff recommends issuing Pension Obligation Bonds to manage this mandated obligation.

Staff further recommends that Council approve this resolution and authorize staff to move forward with options 3(a combination of 2011 POBs and Pay-As-You-Go) and to explore an alternative of using a portion of the 2011 POB proceeds to buy out some members by offering upfront cash payments. 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 staff to proceed with executing a financing option for funding the PFRS UAAL a combination of 2011 POBs and Pay-As-You-Go and explore an altemative of using a portion of the 2011 POB proceeds to buy out some members by offering upfront cash payments; and

(2) Terminate the Swap Agreement associated with the Oakland Joint Powers Financing Authority Lease Revenue Bonds.

Respectfully submitted,

JOSEPH T. YEW, JR.
Finance Director/ Treasurer

Prepared by:
Katano Kasaine, Treasury Manager
Treasury Department

APPROVED AND FORWARDED
TO THE FINANCE AND
MANAGEMENT COMMITTEE

Office of the City Administrator/
Agency Administrator

Oakland Joint Power Financing Authority
Projected Excess Tax Override Revenues

Fiscal Year (June 30)	New York Life Annuity	Tax-Exempt Series 2008A-1	Taxable Series 2008A-2	Remaining Balance of NYL Annuity Excess/(Deficit)	Tax Override Revenues	Net Tax Override Revenues	Taxable POBs, Series 1997	Taxable POBs, Series 2001	Total Debt Service	Annual Excess Tax Override Revenues	PFRS Unfunded Liabilities [1]	Net Tax Override Revenues Excess/(Deficit)
Excess Reserve Balance (July 1, 2010)												55,000,000
2011	10,733,754	14,479,650	2,530,483	(6,276,379)	60,612,521	54,336,142	40,305,000		40,305,000	14,031,142	-	52,031,142 [2]
2012	10,185,843	14,571,300	5,592,886	(9,978,343)	61,824,771	51,846,428		38,375,000	38,375,000	13,471,428	45,634,000	19,868,570
2013	9,624,258	14,697,750	5,532,247	(10,605,739)	63,061,266	52,455,528		39,555,000	39,555,000	12,900,528	46,500,000	(13,730,902)
2014	9,055,212	14,820,750	5,470,053	(11,235,591)	64,322,492	53,086,901		40,765,000	40,765,000	12,321,901	48,800,000	(36,478,099)
2015	8,484,805	14,935,550	-	(6,450,745)	65,608,941	59,158,196		42,010,000	42,010,000	17,148,196	50,800,000	(33,651,804)
2016	7,919,302	15,073,350	-	(7,154,048)	66,921,120	59,767,072		43,285,000	43,285,000	16,482,072	52,500,000	(36,017,928)
2017	7,364,318	15,095,950	-	(7,731,632)	68,259,543	60,527,911		44,590,000	44,590,000	15,937,911	55,000,000	(39,062,089)
2018	6,824,750	-	-	6,824,750	69,624,734	76,449,484		45,925,000	45,925,000	30,524,484	57,600,000	(27,075,516)
2019	6,305,054	-	-	6,305,054	71,017,228	77,322,282		47,295,000	47,295,000	30,027,282	60,300,000	(30,272,718)
2020	5,808,570	-	-	5,808,570	72,437,573	78,246,143		48,700,000	48,700,000	29,546,143	63,100,000	(33,553,857)
2021	5,337,423	-	-	5,337,423	73,886,324	79,223,747		50,140,000	50,140,000	29,083,747	66,000,000	(36,916,253)
2022	4,893,021	-	-	4,893,021	75,364,051	80,257,072		51,620,000	51,620,000	28,637,072	69,100,000	(40,462,928)
2023	4,475,976	-	-	4,475,976	76,871,332	81,347,308		53,130,000	53,130,000	28,217,308	72,300,000	(44,082,692)
2024	4,086,166	-	-	4,086,166	78,408,758	82,494,924			-	82,494,924	75,700,000	6,794,924
2025	3,722,833	-	-	3,722,833	79,976,934	83,699,767			-	83,699,767	79,300,000	4,399,767
2026	3,384,788	-	-	3,384,788	81,576,472	84,961,260			-	84,961,260	83,100,000	1,861,260
	108206073	103,674,300	19,125,668		1,129,774,060	1,115,180,165	40,305,000	545,390,000	585,695,000	529,485,165	925,734,000	(286,349,123)

[1] Actuary projection as of July 1, 2010
[2] Includes Swap Termination of $17 million

Approved as to Form and Legality

DRAFT
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 THE AVAILABLE OPTION(S) AND TERMS FOR FUNDING THE POLICE AND FIRE RETIREMENT SYSTEM UNFUNDED ACCRUED ACTUARIAL LIABILITY, 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 Police and Fire Retirement System ("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 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 the various funding options to fund PFRS such as 1) Pay-As-You-Go, 2) issuance of 2011 POBs, 3) a combination of 2011 POBs and pay-as-you-go and 4) issuance of 2011 POBs and to explore a buy-out option; and

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 connection with the issuance of Oakland Joint Powers Financing Authority, Lease Revenue Bonds, 1998 Series A1/A2; and

RESOLVED, that to meet the City's obligations to the PFRS under Article XXVI of the City Charter to fimd the system, the City Council hereby authorizes Treasury Staff to move forward with option 3 (a combination of 2011 POBs issuance and pay-as-you-go) and to explore a buy-out option; and be it

FURTHER RESOLVED, that the City Council authorize the termination of the swap agreement in the comection 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, KERNIGHAN, NADEL, SCHAAF AND PRESIDENT REID

NOES -

ABSENT -

ABSTENTION -

ATTEST: ____________________

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