CITY OF OAKLAND

AGENDA REPORT

TO: DEANNA J. SANTANA
CITY ADMINISTRATOR

FROM: Katano Kasaine

SUBJECT: Pension Obligation Bonds
Series 2012

DATE: April 25, 2012

City Administrator Approval	Scott P. Johnson	Date	4/27/12

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

Staff recommends that the City Council adopt an Ordinance Authorizing the Issuance and Sale of City of Oakland (the "City"), California Taxable Pension Obligation Bonds, Series 2012 and Approving Certain Related Matters, the proceeds of which will be used to fund the Police and Fire Retirement System (the "PFRS"), in a not-to-exceed amount of $250 million.

EXECUTIVE SUMMARY

An ordinance has been prepared authorizing the issuance and sale of the Taxable Pension Obligation Bonds, Series 2012 (the "2012 POBs") in a not-to-exceed amount of $250 million in one or more series, and to authorize the execution and delivery of related documents. In addition, staff will be returning to Council in June 2012 with a resolution seeking approval of the issuance and sale of the 2012 POBs. The debt service on the 2012 POBs will be payable from Tax Override Revenues.

Under Article XXVI of the City's Charter, the City is obligated to make pension, disability and beneficiary payments to retired Police and Fire sworn officers and fully fund pension obligations by 2026. Since the end of the suspension period in June 2011, the City has been funding PFRS on a pay-as-you-go basis with monthly payments of approximately $3.8 million from the excess reserve Tax Override Revenues.

However, based on the preliminary July 1, 2011 actuarial report, the City will be required to deposit to PFRS approximately $38.5 million beginning FY 2012-13 or continue on a pay-as-you go basis of approximately $3.2 million per month.

Absent a pension obligation bond issue for the purpose of pre-funding PFRS for a period of time, resuming the Actuarially Recommended Contribution ("ARC") payments, when combined with

PFRS existing debt obligations, would require funding at levels above the available resources dedicated to PFRS. As a result, payments in excess of the system's revenue would otherwise be paid from the General Fund. Faced with multiple year deficits, declining revenues and dissolution of the Redevelopment Agency, the City's General Fund will not be able to absorb significant annual contributions without serious reductions in core service levels.

Currently, the City has excess Tax Override Revenues that may be used to offset these payments in the near term. However, to address PFRS' long-term funding requirements, Staff recommends that the City issue pension obligation bonds in order to guard against further deterioration of the General Fund and increase the funding levels of PFRS, which is currently funded at only 37.5% (actuarial value of assets/actuarial liabilities) as of June 2011. Staff recommends a one-time deposit of approximately $210 million which will improve the funded ratio to approximately 70%.

In addition, as part of the long-term financial plan, a trigger mechanism can be put in place at the City's discretion to monitor the PFRS funding level and alert the City if the funding level declines below a certain pre-determined funded ratio. The City would then be required to take appropriate action to increase the System's funding level above this pre-determined level.

Lastly, issuing pension debt does have associated risks and benefits that have to be taken into consideration before issuance of bonds, which are outlined in the Analysis section of this report.

OUTCOME

Approval of this recommendation will result in authorizing the issuance of the 2012 POBs in an amount not-to-exceed $250 million in a single series. The maximum interest rates for the Series 2012 POB shall not exceed an overall average rate of 6.5%. Based on the current market rates, estimated contribution amount of approximately $210 million will reduce the Unfunded Actuarial Accrued Liability ("UAAL") from $426.8 million (as of July 1, 2011) to approximately $215.0 million and improve the funded ratio from 37.5% to an estimated ratio of 70%. Additionally, pre-funding some of the long-term liability will enable the fund to generate greater returns and will thereby further reduce the City's UAAL over the long-term.

BACKGROUND/LEGISLATIVE HISTORY

PFRS is established pursuant to the Retirement Law and is a defined benefit pension system for the members of the City of Oakland 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 benefits to its members and their beneficiaries. As of June 30, 2011, PFRS covered one active employee and 1,106 retired employees (629 retired police and 477 retired Fire). Under Article XXVI of the City's Charter, the City is required to fully fund all liabilities for future benefits for all members by June 30, 2026.

Tax Override Revenues

On June 8, 1976, the voters of the City approved "Measure R", amending the City Charter and establishing the amortization of the City's unfunded accrued actuarial liability to the Police and Fire Retirement System. To fund the voter approved indebtedness to PFRS, the City Council authorized the levy of the Tax Override pursuant to Resolution No. 59916 C.M.S., which was upheld by the Court of Appeal in Valentine v. City of Oakland. 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. On June 7, 1988 the voters approved Measure O, which extended the amortization period of the City's unfunded accrued actuarial liability to the System from July 1, 2016 until July 1, 2026. The "Tax Override Revenues" are revenues generated and collected by the City in each Fiscal Year as proceeds of its annual tax levy goes towards funding PFRS obligations.

1997 Pension Obligations Bonds

On February 1, 1997, the City issued Taxable Pension Obligation Bonds (" 1997 POBs") 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. In conjunction with this deposit to PFRS, the City negotiated a suspension period with the Retirement System, whereby Actuarial Recommended Payments into the Retirement System were suspended from February 25, 1997 to June 30, 2011. In lieu of those payments, the City covenanted to make debt service payments on the POBs through maturity. The debt service payments were payable from the Tax Override Revenues. The 1997 POBs has matured in December 2010.

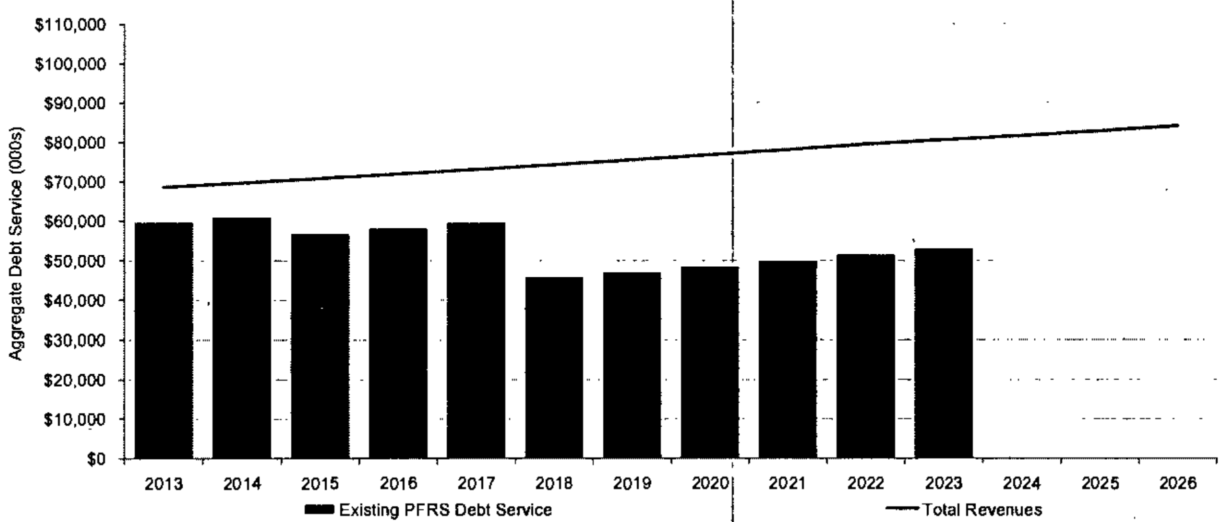
2001 Pension Obligations Bonds

On October 17, 2001, the City issued $195.6 million of Taxable Pension Obligation Bonds ("2001 POBs"). The 2001 POBs refunded a portion of 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 beside 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.

ANALYSIS

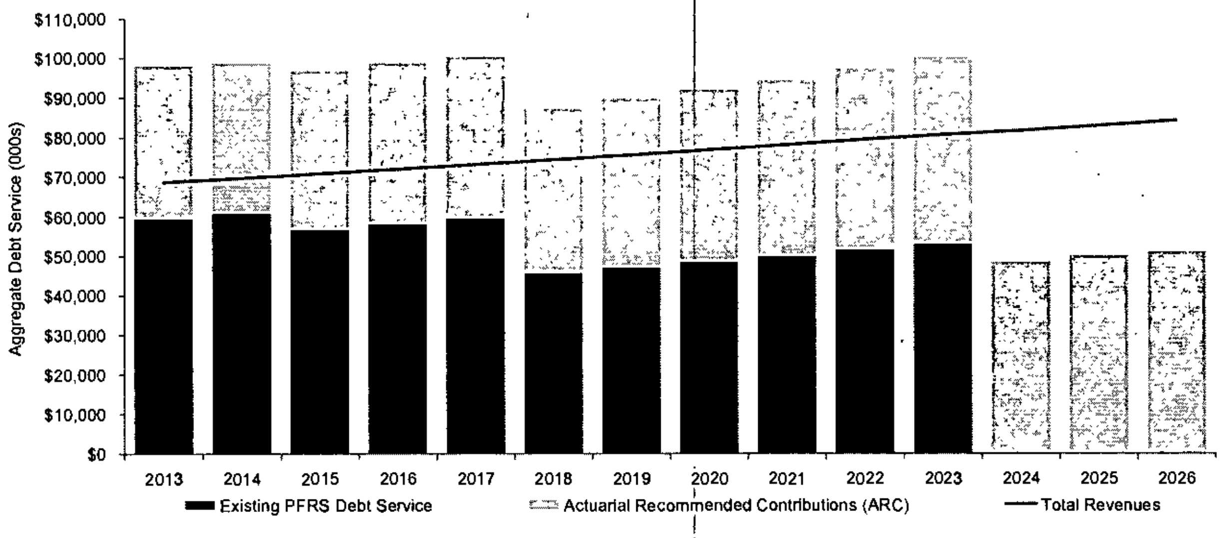
As of the July 1, 2011 actuarial report, PFRS has an unfunded liability of $426.8 million with a funding ratio of 37.5%, which is the ratio of the plan's assets to its liabilities. Given this low funding ratio, a one-time deposit to the System to increase plan assets is recommended. Also, since the end of the "suspension payment period" of June 30, 2011, the City has made monthly payments of approximately $3.8 million on a pay-as-you-go basis for FY 2011-12 from the excess Tax Override Revenues.

Beginning FY 2012-13, the City will be required to contribute to PFRS to fund its UAAL, which is estimated to be $38.5 million. In addition to the UAAL, the City will pay debt service on PFRS pension-related bonds in an amount equal to $59.8 million. Currently, the revenues from the Tax Override and the annuity are sufficient to pay the debt service payments on the PFRS' outstanding bonds, with some residual revenue as depicted in the chart below.



** The revenues are projected at a conservative 2% percent growth rate.*

In FY 2012-13, the City's obligation on the PFRS unfunded liability plus bond debt service payments will total approximately $98.3 million. The available revenues from the Tax Override Revenues and the annuity are being used to pay debt service on the PFRS' outstanding debt, however, residual revenues depicted in the chart above is insufficient to cover the estimated annual ARC payments to PFRS. Therefore, the sum of the annual ARC payments and the existing PFRS' pension debt service cannot be fully supported by the available revenues, as shown in the chart below.



* *Total revenues currently exceed PFRS total debt service without the ARC. The revenues are projected at a conservative 2% percent growth rate.*

Since there are no other dedicated revenues to fund PFRS, payments in excess of the available revenues (tax override and annuity) will be payable from the General Fund. The City is applying some of the excess Tax Override Revenue to offset the ARC payments in FY 2011-12. The following table shows the estimated General Fund support that would be required to fund the shortfall between the currently available PFRS funding and the sum of outstanding debt service obligations and ARC payments. The City may be able to use the excess Tax Override Revenues to offset these shortfalls but only for a short period of time.

Fiscal Year Ending	Estimated Net Funding Available for PFRS	Outstanding Debt Service Obligations	Actuarial Racqmmended Contributions (ARC)	General Fund Support Required
2013	$68,648,071	$59,784,997	$38,500,000	($29,636,925)
2014	69,744,032	61,055,803	37,700,000	(29,011,770)
2015	70,852,494	56,945,550	39,900,000	(25,993,056)
2016	71,980,220	58,358,350	40,400,000	(26,778,130)
2017	73,127,781	59,685,950	40,800,000	(27,358,169)
2018	74,311,701	45,925,000	41,400,000	(13,013,299)
2019	75,531,412	47,295,000	42,400,000	(14,163,588)
2020	76,801,904	48,700,000	43,300,000	(15,198,096)
2021	78,120,298	50,140,000	44,200,000	(16,219,702)
2022	79,494,119	51,620,000	45,700,000	(17,825,881)
2023	80,569,096	53,130,000	47,100,000	(19,660,904)
2024	81,701,148		48,600,000	33,101,148
2025	82,890,115		50,100,000	32,790,115
2026	84,135,415		51,100,000	33,035,415
Total	$1,067,907,804	$592,640,649	$611,200,000	($135,932,845)
			Present Value @ 6.75%	($135,503,123)

Issuing 2012 POBs

Given the current economic circumstances and the City's budget deficit, resuming the ARC payments will place an unsustainable burden on the General Fund. Therefore, the issuance of the 2012 POBs is the best option to finance the prepayment of the ARC in an amount of approximately $210 million to reduce the UAAL and improve the hunded ratio. In return for this significant contribution and the resulting liability to be incurred from the sale of these bonds, the City will request a suspension of ARC payments for approximately six years. In lieu of paying the full annual ARC, during that agreed upon period, the City could do the following:

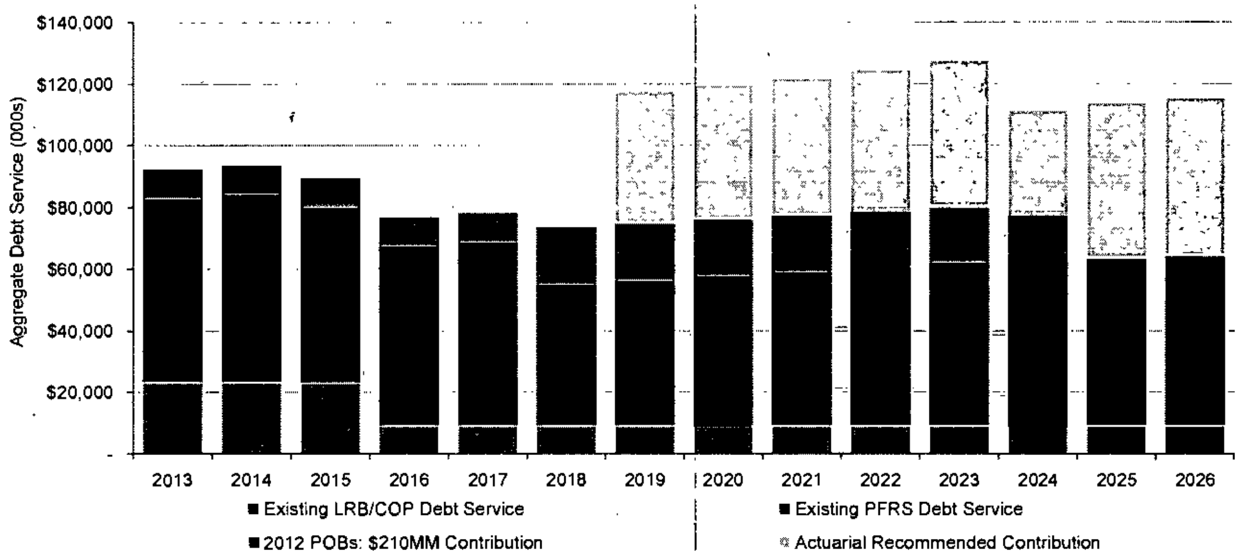
1) Make an inhial prepayment contribution amount of approximately $170 million (which is equivalent to the ARC payments from FY 2013 through FY 2018), PFRS's UAAL will be reduced from $426.8 million (as of July 1, 20111) to approximately $256.8 million and improve the funded ratio from 37.5% to an estimated ratio of 62%. In addition, the City will make annual contribution of $5 million from FY 2014 through FY 2018 for a total of $25 million, or

2) make a one-time deposit of approximately $210 million in July, 2012 which will reduce the UAAL to $216.8 million and increase the funded ratio from 37.5% to an estimated ratio of 70%.

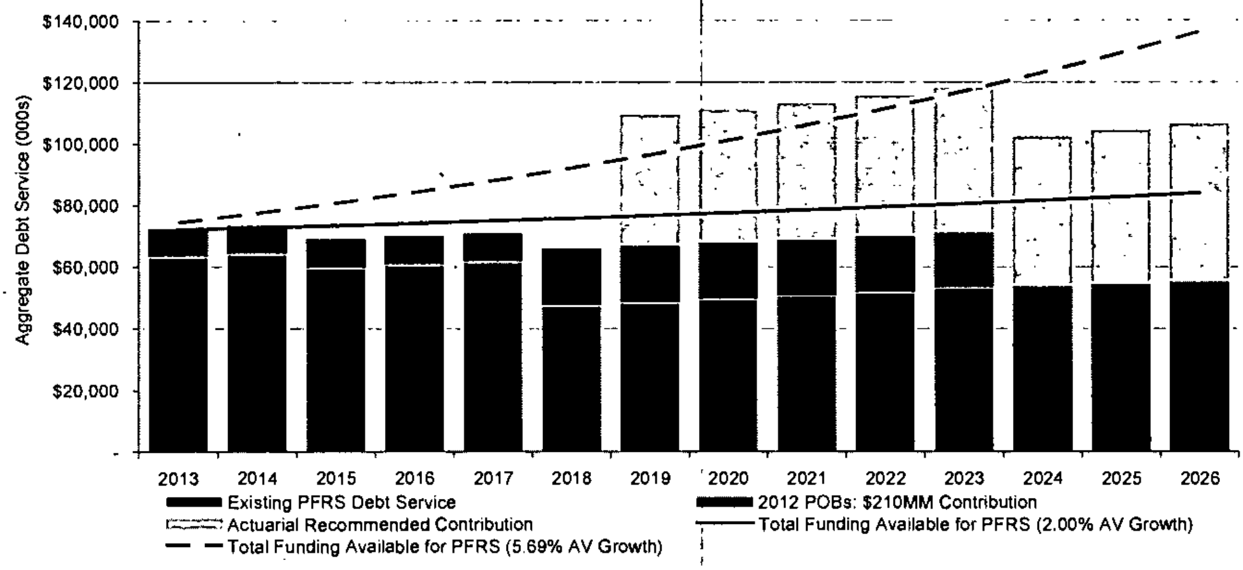
Staff recommends option two because this will improve the funded ratio to approximately 70% and lower the UAAL to $216.8 million.

The City would expect to resume making the ARC payments in FY 2019, following this prepayment period, when other non-pension related, General Fund supported debt service begins to decline and supporting revenues increase. The City could thereby avoid the extreme measures that would be required to fund this obligation from the General Fund in the next several years. The table below presents the recommended contribution amount of deposits for the respective prepayment years for the 2012 POBs.

The proposed issuance and sale of the 2012 POBs in an amount not to exceed $250 million, at an average interest rate not to exceed 6.5%, in one or more series is expected to price in June 2012. The 2012 POBs debt service schedule would be structured to match the available Tax Override Revenues through FY 2025-26. After the prepayment period ends, either the annual ARC payments will resume or the City will explore other options when the City can support additional General Fund contributions due to the declining debt service starting no earlier than FY 2015-16. In the later years, other non-POB related debt will mature (i.e., Convention Center and Master Leases) thus reducing the General Fund debt obligations further.



The 2012 POBs will provide an amount sufficient to pre-fund at least six years of ARC payments to the System, with a debt service schedule that allows all pension debt payments to remain substantially below the projected level of revenues pledged to PFRS as shown in the chart below. The revenue assumptions are based on an assumed conservative 2% annual growth in the tax override revenues for the solid line and a 5.69% assumed annual growth rate (based on the historical growth rate on the average of the past 25 years) for the dotted line.



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 any Annual Required Contributions for six years ▪ Increased the funding ratio ▪ Increase absolute investment returns based on a greater asset base ▪ Reduce Annual Required Contributions after the holiday period	▪ Investment performance is poor and market value of assets declines (which could disproportionately impact System asset value if declines happen shortly after lump sum deposits from pension bond proceeds are made) ▪ Actuarial assumptions are incorrect and further contributions are needed ▪ Future decline in Assessed Values cause the primary finding source, Tax Override Revenues, to decline ▪ Further benefit increases cause the projected liabilities to increase

Trigger Mechanism

At the City's discretion, a trigger mechanism would be put in place to monitor the PFRS funding level and alert the City when 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 promptly, thus avoiding any additional funding considerations to go unaddressed.

Staff will be returning to Council in June 2012 with a resolution seeking approval for the sale of the 2012 POBs and approving all bond documents necessary for the issuance including the Funding Agreement.

PUBLIC OUTREACH/INTEREST

This item did not require any additional public outreach other than the required posting on the City's website.

COORDINATION

This report has been prepared by the Treasury Division in coordination with City Attorney's Office, and Budget Office.

COST SUMMARY/IMPLICATIONS

The 2012 POBs debt service payments and other negotiated payments will be payable from Tax Override Revenues.

SUSTAINABLE OPPORTUNITIES

Economic: There are no environmental opportunities associated with this report.

Environmental: There are no environmental opportunities associated with this report.

Social Equity: There is no social equity opportunities associated with this report.

CEQA

This report is not a project under CEQA.

For questions regarding this report, please contact Katano Kasaine, Treasury Manager, at (510) 238-2989.

Respectfully submitted,

Katano Kasaine

KATANO KASAINE
Assistant City Administrator

Prepared by:
Dawn Hort, Financial Analyst
Treasury Division

FILED
OFFICE OF THE CITY CLERK
OAKLAND

2012 APR 27 AM 10: 42

Approved as to Form and Legality

City Attorney

OAKLAND CITY COUNCIL

ORDINANCE NO. ________ C.M.S.

ORDINANCE AUTHORIZING THE ISSUANCE AND SALE OF CITY OF OAKLAND, CALIFORNIA TAXABLE PENSION OBLIGATION BONDS, SERIES 2012 IN AN AMOUNT NOT TO EXCEED $250,000,000 AND APPROVING CERTAIN RELATED MATTERS

WHEREAS, in 1997, the City of Oakland (the "City"), in accordance with the City Charter, enacted Chapter 4.44 of the Municipal Code of the Chy of Oakland (the "Financing Program") to establish a program for the financing and refinancing of the City's obligations to hs Police and Fire Retirement System (the "System"); and

WHEREAS, the City by execution and delivery of a Master Trust Agreement dated as of February 1, 1997 (the "Master Trust Agreement"), as supplemented by a First Supplemental Trust Agreement dated as of February 1, 1997 (the "First Supplemental Trust Agreement") by and between the City and The Bank of New York Mellon Trust Company, N.A. (the "Trustee") as successor trustee to The Chase Manhattan Bank, Houston, Texas, successor trustee to Texas Commerce Bank National Association, pursuant to the provisions of the Financing Program, issued its $436,289,659.15 City of Oakland, California Taxable Pension Obligation Bonds, Series 1997, Sub-series A and Sub-series B (the "1997 Bonds"); and

WHEREAS, the City by execution and delivery of a Second Supplemental Trust Agreement dated as of September 1, 2001 (collectively with the Master Trust Agreement and the First Supplemental Trust Agreement, the "Trust Agreement") by and between the City and the Trustee, issued $195,636,449.10 City of Oakland, California Taxable Pension Obligation Bonds, Series 2001 (collectively with the 1997 Bonds, the "Prior Bonds"); and

WHEREAS, the City desires to evidence its obligation to pay all or a portion of its unfunded accrued actuarial liability by issuing a debenture (the "Pension Obligation Debenture") to the System; and

WHEREAS, the City wishes to authorize the issuance of additional bonds (the "Series 2012 Bonds"), and the Trust Agreement provides for the issuance of additional bonds, for the purpose of refunding the Pension Obligation Debenture; and

WHEREAS, on June 8, 1976, the voters of the City approved "Measure R", and on June 7, 1988 approved "Measure O," which amended various sections of the City Charter relating to the amortization of the City's unfunded accrued actuarial liability to the System; and

WHEREAS, the City has levied a tax override to pay certain amounts due from time to time with respect to the Prior Bonds and is authorized by the terms of the Trust Agreement to apply the proceeds of the tax override to pay any additional bonds issued pursuant to the Program in the future from time to time, including the Series 2012 Bonds approved for issuance hereby; and

WHEREAS, the 1997 Bonds, the Trust Agreement, and additional series of bonds, among other things, were validated pursuant to the laws of the State of California by a default judgment rendered on January 3, 1997, by the Superior Court of the County of Alameda in the action entitled City of Oakland v. All Persons, Case No. 772719-7; and now therefore

THE COUNCIL OF THE CITY OF OAKLAND DOES ORDAIN AS FOLLOWS:

Section 1. Recitals True and Correct. All of the recitals set forth above are true and correct, and the Council so finds and determines.

Section 2. Authorization of Series 2012 Bonds. This Council hereby authorizes and approves the issuance of the Series 2012 Bonds in an aggregate principal amount not to exceed $250,000,000 and hereby authorizes and directs the City Administrator to execute (by manual or facsimile signature) the Series 2012 Bonds, and the City Clerk to affix and attest the seal of the City and to cause the Series 2012 Bonds to be authenticated and delivered in accordance with the Trust Agreement. The proceeds of the Series 2012 Bonds shall be applied to refund the Pension Obligation Debenture and to pay costs of issuance of the Series 2012 Bonds. The Series 2012 Bonds may be issued in a single series or in two or more series. The true interest cost for the Series 2012 Bonds shall not exceed 6.5% per annum and the final maturity date or dates of the Series 2012 Bonds shall be not later than December 15, 2025. The Series 2012 Bonds shall be in substantially the form set forth in a supplemental trust agreement, with such changes therein, deletions therefrom and additions thereto as the City Administrator or the Assistant City Administrator, or a designee of either such official, and the City Attorney, shall approve, such approval to be conclusively evidenced by the execution and delivery of the Series 2012 Bonds.

Section 3. Sale of Series 2012 Bonds; Ancillary Agreements. (a) The agreements relating to the issuance and sale of the Series 2012 Bonds, including but not limited to a Third Supplemental Trust Agreement, Funding Agreement, Pension Obligation Debenture, Continuing Disclosure Certificate, Official Statement and Bond Purchase Contract, shall be approved by resolution of the Council.

(b) The City Administrator or the Assistant City Administrator, or a designee of either such official, is hereby authorized and directed, for and in the name and on behalf of the City, to do any and all things and take any and all actions and execute and deliver any and all certificates, agreements and other documents without returning to Council, whether before or after the issuance of the Series 2012 Bonds, including but not limited to those described in the

Trust Agreement, which they may deem necessary or advisable in order to consummate the lawful issuance and delivery of the Series 2012 Bonds.

Section **4.** Effective Date. This Ordinance shall be effective immediately, if passed by the affirmative vote of at least six City Council members; if this ordinance is passed by the affirmative vote of five City Councilmembers it will be effective seven days after final passage.

IN COUNCIL, OAKLAND, CALIFORNIA, ______________, 2012

PASSED BY THE FOLLOWING VOTE:

AYES - BROOKS, BRUNNER, DE LA FUENTE, KERNIGHAN, NADEL, SCHAAF, and PRESIDENT REID

NOES -

ABSENT -

ABSTENTION -

ATTEST: ______________________________
LaTonda Simmons
City Clerk and Clerk of the
Council of the City of Oakland

$\$$__________

CITY OF OAKLAND, CALIFORNIA
TAXABLE PENSION OBLIGATION BONDS, SERIES 2012

Certified Copy of the Ordinance
Adopted on ________, 2012

I, LaTonda Simmons, hereby certify that I am the City Clerk of the City of Oakland, California (the "City"), a political subdivision organized and existing under and by virtue of the laws of the State of California and that as such I am authorized to execute this Certificate on behalf of the City.

I hereby further certify that attached hereto is a true, correct and complete copy of an ordinance which was duly adopted by the City Council of the City at a meeting thereof which was duly called and held on _________ 2012, and at such meeting a quorum was present and acting throughout, and that said Ordinance No. ________ C.M.S. has not been modified, amended, rescinded or revoked since the date of adoption and is now in full force and effect.

Dated: _________, 2012.

CITY OF OAKLAND, CALIFORNIA

By: ________________________________
LaTonda Simmons, City Clerk and
Clerk of the Council of the
City of Oakland