CITY OF OAKLAND

AGENDA REPORT

TO: DEANNA J. SANTANA
CITY ADMINISTRATOR

FROM: Katano Kasaine

SUBJECT: Supplemental Report
Authorizing the Issuance and Sale of
Pension Obligation Bonds to Fund PFRS

DATE: May 17, 2012

City Administrator Approval [signature] Date 5/18/12

COUNCIL DISTRICT: City-Wide

RECOMMENDATION

Staff recommends that the City Council;

1. Adopt an Ordinance Authorizing the Issuance and Sale of City of Oakland (the "City"), California Taxable Pension Obligation Bonds, Series 2012 (the "2012 POBs") in the not-to-exceed amount of $250 million to fund the Police and Fire Retirement System (the "PFRS")and Approving Certain Related Matters, and

2. Adopt a Resolution Approving the Issuance and Sale of the 2012 POBs in a not-to-exceed amount of $250 million; and Authorizing Necessary Actions Related Thereto to fund the Police and Fire Retirement System (the "PFRS") and increase the funding ratio closer to 70%.

OUTCOME

Approval of this recommendation will result in authorizing the issuance and sale of the 2012 POBs to fund the City's Police and Fire Retirement System (the "PFRS") 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 6.0%. It should be noted that interest rates are at historical lows and based on current market conditions, staff estimates the average interest rate on the bonds will be approximately 4.75%. The 2012 POB proceeds will finance the contribution amount to PFRS, which will reduce the Unfunded Actuarial Accrued Liability ("UAAL") and improve the System's funded ratio. 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.

REASON FOR SUPPLEMENTAL

At the May 8, 2012 meeting, the Finance and Management Committee asked staff to provide additional information associated with the options to fund PFRS from the proceeds of the issuance and sale of the 2012 POBs.

ANALYSIS

The following analysis provides the basis for staff s recommendation. Staff recommends that the Council; (1) authorize the issuance and sale of pension obligation bonds (POBs) to pre-fund the City of Oakland's Police and Fire Retirement System (PFRS) as outlined by Option 3 in this report, (2) approve establishing a reserve of no less than $25 million from the existing balance in the tax override fund, (3) approve the establishment of predetermined triggers to mitigate market and funding risk, and (4)designate and commit funds for the sole purpose to fund PFRS from resources that will become available beginning in FY 2015-16 due to declining general fund and tax override fund debt service payments.

As of the July 1, 2011 actuarial report, The Actuarial Value of Plan Assets for PFRS was $256.4 million with an unfunded Actuarial Liability of $426.8 million, resulting in 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 PFRS 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 method 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.

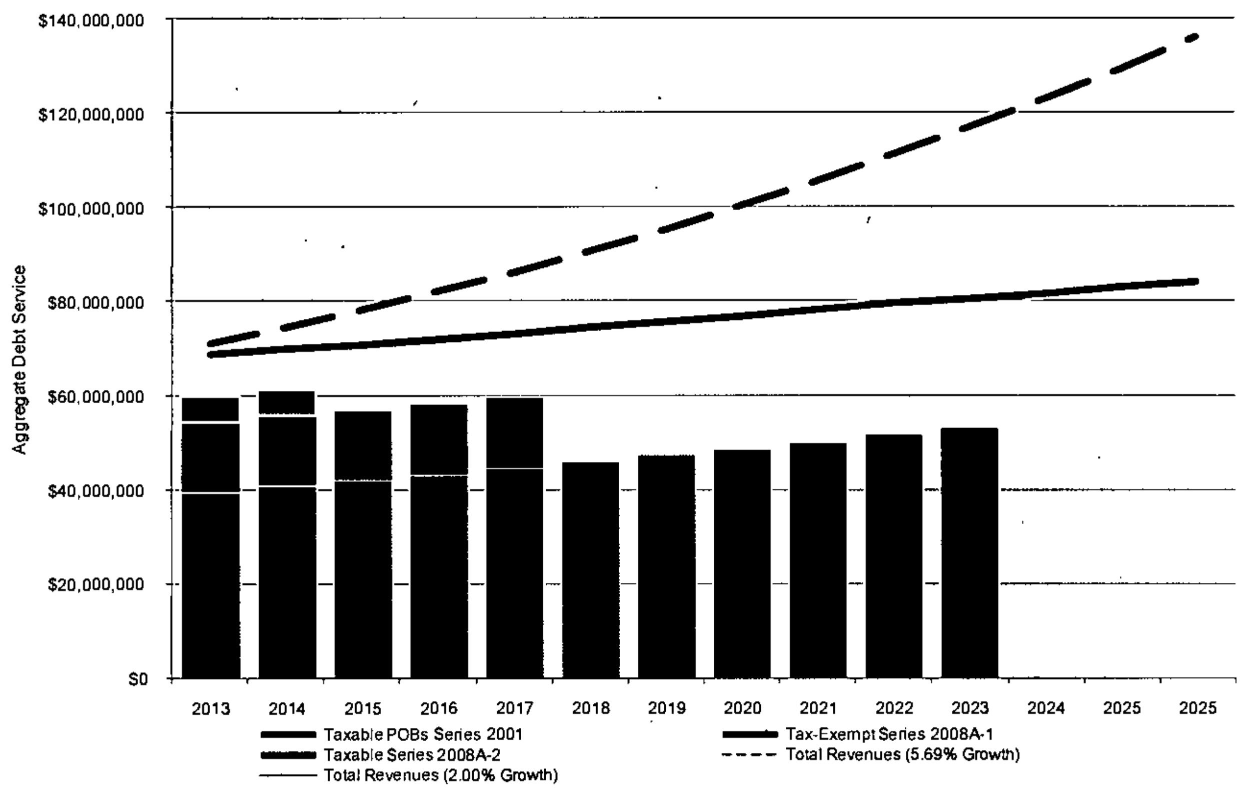
Fund Sources

There are two primary funding sources that are used to fund PFRS' obligations. Tax Override Revenues which is an override tax levied at 0.1575% on all properties within the City and the receipts from an annuity that was purchased in 1985. Although the City has experienced a moderate decline in assessed values in the past two years due to the national housing downturn, over the past 25 years, assessed values have increased on an average of 5.69% annually. The table below summarizes the total revenues available to fund PFRS, which include the annuity receipts and projections of the tax override revenues at a conservative 2% average annual growth rate and the historical 25 year average annual growth rate of 5.69%.

Fiscal Year (June 30)	Tax Override Revenues	Net New York Life Annuity Receipts	Total Funding (2.00% Growth)	Total Funding (5.69% Growth)
2013	$62,422,861	$6,225,210	$68,648,071	$70,906,310
2014	63,671,318	6,072,714	69,744,032	74,434,169
2015	64,944,745	5,907,749	70,852,494	78,158,970
2016	66,243,640	5,736,580	71,980,220	82,098,896
2017	67,568,513	5,559,268	73,127,781	86,266,600
2018	68,919,883	5,391,818	74,311,701	90,691,397
2019	70,298,280	5,233,132	75,531,412	95,386,257
2020	71,704,246	5,097,658	76,801,904	100,380,496
2021	73,138,331	4,981,967	78,120,298	105,686,398
2022	74,601,098	4,893,021	79,494,119	111,327,534
2023	76,093,120	4,475,976	80,569,096	116,966,613
2024	77,614,982	4,086,166	81,701,148	122,977,520
2025	79,167,282	3,722,833	82,890,115	129,379,105
2026	80,750,627	3,384,788	84,135,415	136,190,902

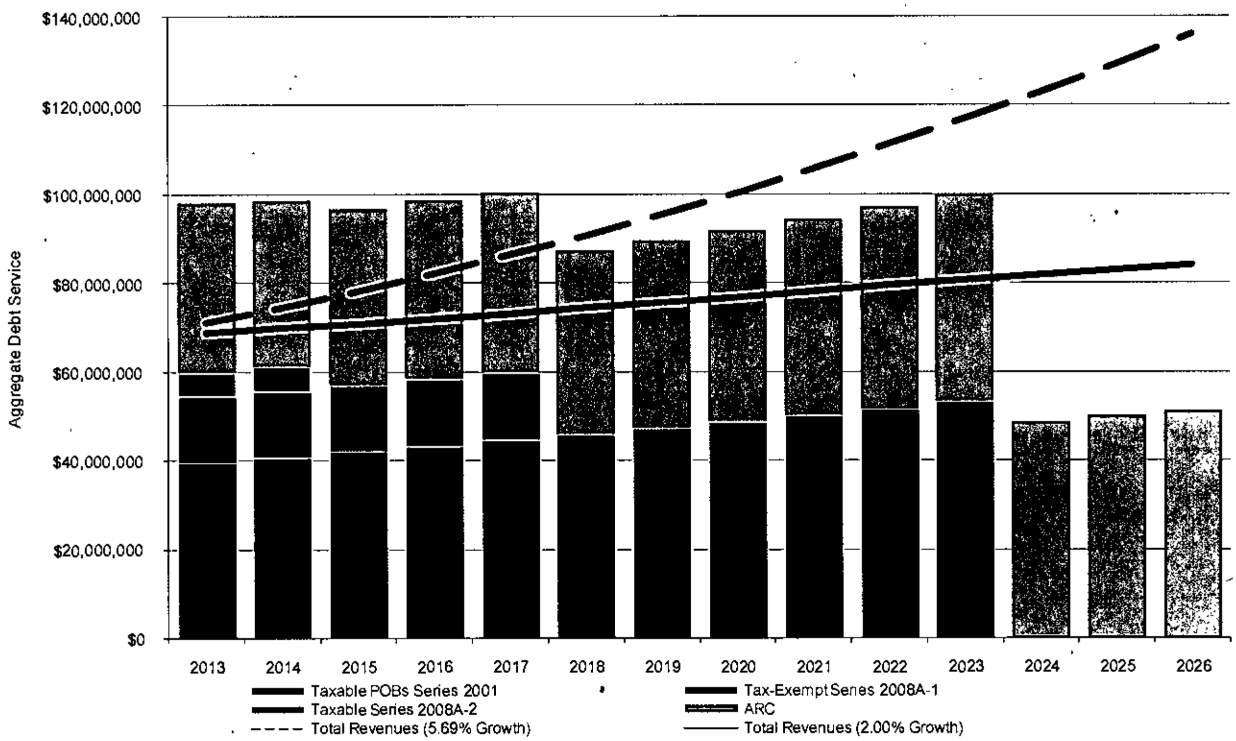
Summary of Outstanding Debt

The City has issued pension debt in the past to fund PFRS. Those outstanding obligations are being supported by the tax override and annuity revenues. Debt service (principal and interest) on existing PFRS pension-related bonds for FY 2012-13 totals $59.8 million. The revenues the City receives from the Tax Override and the annuity are sufficient to pay the debt service payments on the existing PFRS' outstanding bonds, with some residual revenue as depicted in the chart below.



* *Total revenues currently exceed PFRS total debt service.*

Based on the latest actuary study as of July 1, 2011, the City's obligation for the PFRS actuarially required contribution (ARC) for FY 2012-13 is $38.5 million. Combining the ARC plus the existing bond's debt seryice payments of $59.8 million (for FY2012-13), the total FY 2012-13 obligation is approximately $98.3 million. The available revenues from the Tax Override and the annuity are being used to pay debt service on PFRS' outstanding debt. However, residual revenues depicted in the chart above are insufficient to also 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.*

*Insufficient PFRS Revenues to Fund Existing Debt Service **and** ARC in the Near Term*

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 resumed paying the ARC in July 2011 with monthly payments of approximately $3.8 million. The City is applying some of the accumulated excess Tax Override Revenue to fund the ARC payments in FY 2011-12. However, there are insufficient balances in the fund to sustain these payments for a long duration. 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 combined with the ARC payments beginning in FY 2012-13. The City may be able to use the excess Tax Override balance to offset these shortfalls, but only for a short period of time. Staff suggests that such a strategy would not be a prudent use of such limited resources and recommends that the majority of the balance in the fund be set aside as a reserve as discussed below.

General Fund Impact - Without Sale of Pension Obligation Bonds

Fiscal Year Ending	Total Funding Available for PFRS	Outstanding Debt Service Obligations	Actuarial Recommended 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)

Issuing 2012 POBs

Staff has evaluated a number of options to fund the PFRS system in order to ensure continuous payment of retiree and beneficiary benefits. Given the current economic environment and the City's need to maintain a balanced budget, covering the ARC payments from the general fund is unsustainable and would, in all cases, require serious cuts to other essential City services. Therefore, the issuance of the 2012 POBs to fund PFRS, and increase the funded ratio, in conjunction with an understanding with the PFRS Board to suspend the ARC payments over the next five to six years is the only real viable approach. This improved funding level will result in lower ARC payments in the future. In return for this significant contribution and the resulting liability to be incurred by the City from the sale of these bonds, the City will request a suspension of the ARC payments for approximately five to six years and resume paying the full ARC after the suspension period ends.

POB Options

Below are three POB options staff analyzed. In lieu of paying the annual ARC, during that agreed upon period, the City could do the following:

Option 1: Make an initial contribufion amount to PFRSof approximately $197 million (which is equivalent to discounted ARC payments from FY 2013 through FY 2018), PFRS's UAAL will be reduced from $426.8 million (as of July 1, 2011) to approximately $229.8 million and improve the funded ratio from 37.5% to an estimated ratio of 66.4%. In addition, the City would make annual contributions of $5 million from FY 2014 through FY 2018 for a total of $25 million, or

Option 2: Make a one-time deposit of approximately $210 million in July, 2012 for a **six year** suspension period, resuming the full ARC payments in FY 2018-19, which will reduce the UAAL to $216.8 million and increase the funded ratio from 37.5% to an estimated ratio of 68.3%, <u>or</u>

Option3: Make a one-time deposit of approximately $210 million in July, 2012 for a **five year** suspension period, resuming paying the ARC in FY 2017-2018, which will reduce the UAAL to $216.8 million and increase the funded ratio from 37.5% to an estimated ratio of 68.3%.

The lump-sum deposit of the three options described above will result in an increase in the asset base, thus reducing the unfunded liability and increasing the funded ratio as shown in the table below.

Estimated Funded Ratio

Improvement in Funding Ratios	July 1, 2011	Option 1	Option 2	Option 3
Recommended Contribution		$ 197,000,000	$ 210,000,000	$ 210,000,000
Actuarial Value of Plan Assets	256,394,000	453,394,000	466,394,000	466,394,000
Actuarial Liability	683,162,000	683,162,000	683,162,000	683,162,000
Unfunded Actuarial Liability	426,768,000	229,768,000	216,768,000	216,768,000
Funded Ratio	37.5%	66.4%	68.3%	68.3%

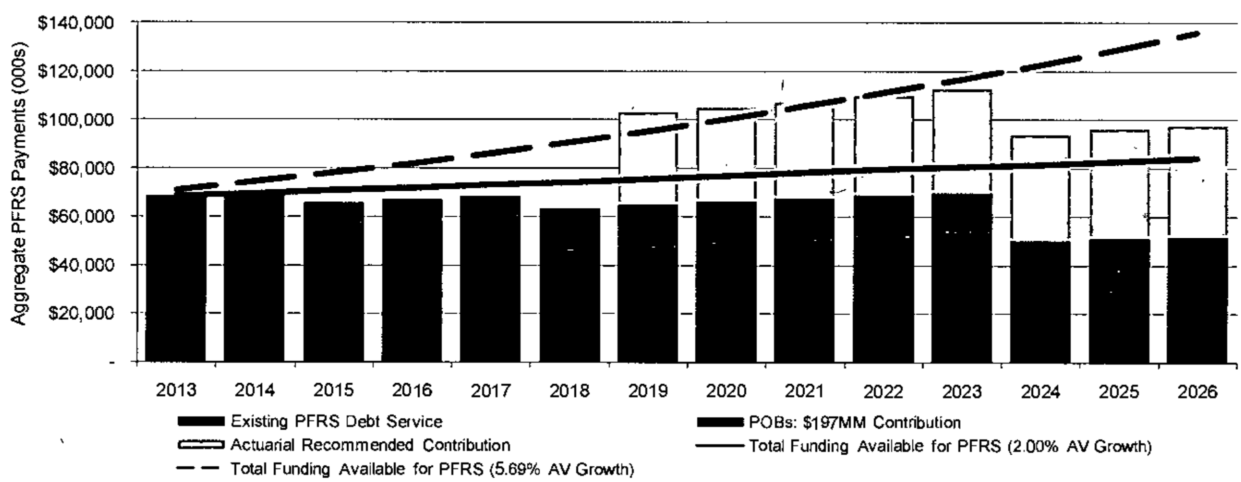
In addition, these options will reduce future ARC payments as shown in the table below:

Original ARC		Contribution Option - 1		Contribution Option - 2		Contribution Option - 3	
Fiscal Year Ending	Actuarial Recommended Contributions (ARC)	Deposit to PFRS	Resume Recommended Contributions	Deposit to PFRS	Resume Recommended Contributions	Deposit to PFRS	Resume Recommended Contributions
2013	$38,500,000	$197,000,000		$210,000,000		$210,000,000	
2014	37,700,000	5,000,000					
2015	39,900,000	5,000,000					
2016	40,400,000	5,000,000					
2017	40,800,000	5,000,000					
2018	41,400,000	5,000,000					34,200,000
2019	42,400,000		38,600,000		40,100,000		36,000,000
2020	43,300,000		39,300,000		40,900,000		35,600,000
2021	44,200,000		40,200,000		41,800,000		36,400,000
2022	45,700,000		41,500,000		43,100,000		37,500,000
2023	47,100,000		42,800,000		44,500,000		38,700,000
2024	48,600,000		44,100,000		45,900,000		39,800,000
2025	50,100,000		45,400,000		47,300,000		41,000,000
2026	51,100,000		46,300,000		48,200,000		41,700,000
Total	$611,200,000	$222,000,000	$338,200,000	$210,000,000	$351,800,000	$210,000,000	339,900,000

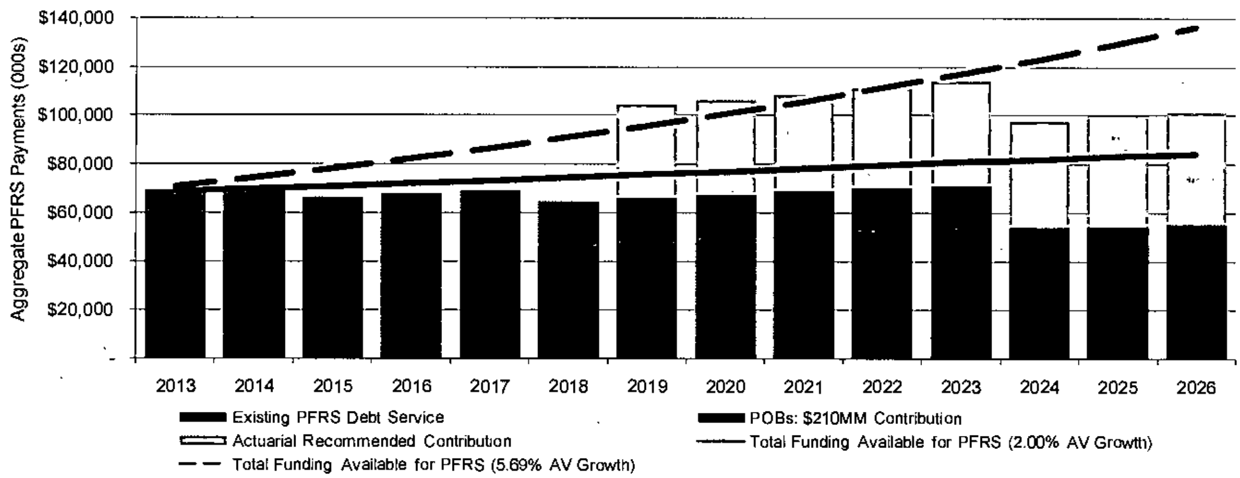
Illustration of the three POB options

The following charts provide a graphical illustration of each of the POB options noted above. The 2012 POBs will provide an amount sufficient to pre-fund at least five to sixyears of ARC payments to PFRS, 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 charts below. The revenue assumptions are based on two scenarios; (1) an assumed conservative 2% annual growth in the tax override revenues, represented by the solid line, and (2) the 25 year historical average annual growth rate of 5.69%, represented by the dotted line.

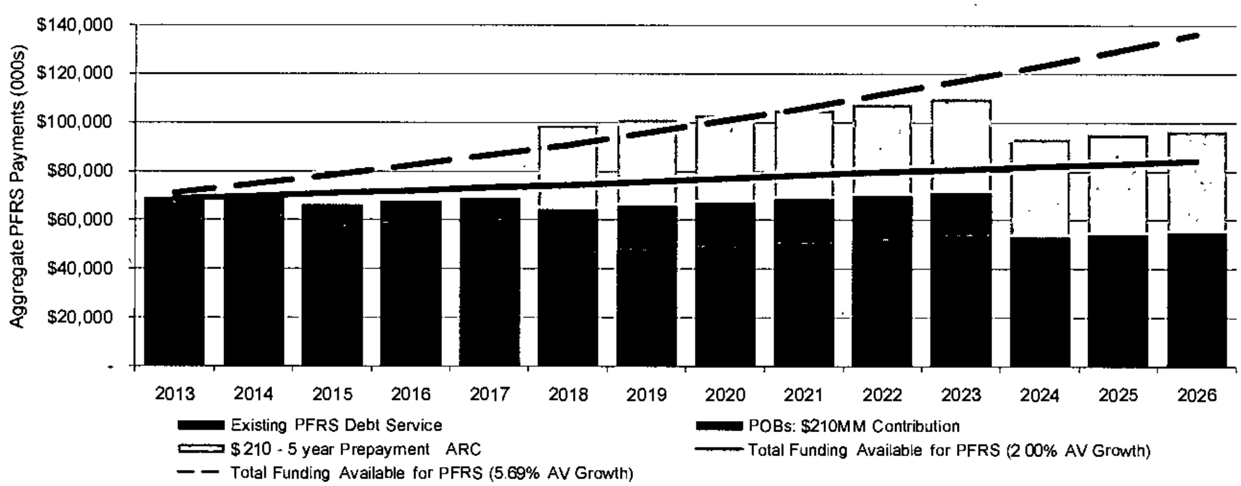
Option 1: Deposit $197 million with $5 million Annual Contribution for Five Years



Option 2: Deposit $210 million with $0 Annual Contribution for Five Years



Option 3: Deposit $210 million with $0 Contribution for Four Years



Bartel Associates LLC recommendation

Bartel Associates LLC (PFRS Actuary) provided the City with the following statement: "Bartel Associates is comfortable telling the PFRS Board that a $197 million July 2012 pre-payment, followed by no City contributions for the next four fiscal years (2013/14 through 2016/17) and a resumption of regular City actuarially determined contributions (beginning with the 2017/18 fiscal year) would provide the system with a reasonable degree of confidence the Plan would be at least as well funded when regular contributions resume as compared to the City making no pre-payment. While there is no certainty this will be the case, we believe the confidence level is sufficient for us to recommend this pre-payment approach to the Board. We support an increase in the initial pre-payment amount (for example $210 million) as it would increase the confidence level."

Staff's recommendation –Option 3

Staff recommends Option 3 as outlined above with a prepayment contribution amount of $210 million. The proposed issuance and sale of the 2012 POBs would be in an amount not to exceed $250 million, at an average interest rate estimated at approximately 4.75% based on current market conditions, in one or more series, expected to be priced in June 2012. The 2012 POBs debt service schedule would be structured to match the available Tax Override Revenues through FY 2025-26.

Establishing a Reserve to Mitigate Market Risk and Funding Ratio Risk

Staff recommends the establishment of a reserve of approximately $25 million to be funded from the current balance of the tax override fund for the purpose of mitigating market risk to the PFRS funds from the deposit of the POB proceeds and/or if the funding ratio reaches a level below a predetermined benchmark during the suspension period. In addition, staff also recommends that any excess tax override funds received during any given year above the Proposition XIII 2% property tax growth rate (after all other debt obligations are satisfied) be deposited into the reserve of the tax override fund for the purpose of mitigating market risk and funding ratio reaching a predetermined benchmark level during the duration of the suspension period.

Trigger Mechanism

At the City's discretion, a trigger mechanism could be put in place to monitor the PFRS funding level and alert the City when the funding levels deteriorate below a certain pre-determined level. At that time the City could explore alternative approaches to address this event, given the facts in place at that time.

Long-Term Responsible Funding Solution – designate and commit PFRS funding

Staff is recommending a responsible long-term funding solution by securitizing available tax override funds to facilitate a POB issue in 2012 supported by the tax override revenues, thus allowing a prepayment into the system in which annual contributions would be suspended for a period of time, approximately five years. During the suspension period, the annual payments on the 2012 POBs debt service would be lower than the annual required contributions that the City would otherwise be required to pay to fund PFRS if we did not issue the POBs.

The long term funding strategy aligns the City's funding of PFRS at times when the general fund will be in a better position to support the PFRS obligations. Beginning in FY 2015-16, general fund related debt will mature (i.e., Convention Center and Master Leases). In addition, one of the POB related debt obligations will mature in 2017-18 (i.e., 2008 JPFA Refunding Bonds). As a result, the City will realize a total annual savings of approximately $35.5 million from these debt maturities (fiscal years 2015-16 to 2017-18). Therefore, after the prepayment period ends for this POB, either the annual ARC payments can resume or the City can 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. Staff is recommending that the Council designate and commit these funds for the sole purpose to fund PFRS.

Associated 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 carefully considered. Some of the benefits and risks inherent in a sale pension obligation bonds are summarized:

BENEFITS	RISKS
▪ Protection of the General Fund in the next five to six years, ensuring that system obligations can be fully covered by dedicated revenues ▪ Increased funding ratio ▪ Increase absolute investment returns based on a greater asset base ▪ Reduce Annual Required Contributions after the prepayment period	▪ Investment performance is poor and and results in a decline in the market value of assets ▪ Actuarial assumptions are incorrect resulting in an increase in the unfunded liability ▪ Future decline in Assessed Values cause the primary funding source, Tax Override Revenues, to decline ▪ Further benefit increases or actuarial assumptions employed cause the projected liabilities to increase

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 economic, environmental or social equity opportunities associated with this report.

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

Respectfully submitted,

Katano Kasaine

KATANO KASAINE
Treasury Manager

Prepared by:
Dawn Hort, Financial Analyst
Treasury Division