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**CITY OF OAKLAND  
AGENDA REPORT**

2011 FEB 10 PM 6:36

**TO:** Office of the City Administrator  
**ATTN:** Dan Lindheim  
**FROM:** Department of Human Resources Management  
**DATE:** February 22, 2011

**RE:** Informational Report on the Financial and Membership Status of the Police and Fire Retirement System (PFRS) as of December 31, 2010

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### **SUMMARY**

The purpose of this informational report is to summarize the current membership status, actuarial value and investment performance of the Police and Fire Retirement System (PFRS) fund for the period ending December 31, 2010. This report provides the most recent funding status data and key activities and actions taken by the PFRS Board since the last update as of September 30, 2009.

### **FISCAL IMPACT**

This report is informational only. Based on the most recent Actuarial Study dated July 1, 2010, the PFRS Fund is 37.6% funded. The next contribution from the City to PFRS is due July 1, 2011 and is \$45.6 million.

A report detailing possible funding options will be presented by the Finance and Management Agency.

### **BACKGROUND**

The Police and Fire Retirement System (PFRS) is a closed defined benefit plan, which was created pursuant to Article XXVI of the City Charter. The Plan was closed to new members on June 30, 1976. There is only one remaining active member; all other members are retirees and beneficiaries.

Pursuant to Article XXVI of the Oakland City Charter, the PFRS Board has exclusive control of the administration and investment of the PFRS Fund. The Board is charged with the maintenance and operation of the System and is required to formulate all Board rules and regulations.

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## KEY ISSUES AND IMPACTS

PFRS is a closed defined benefit plan. Its purpose is to provide a sound and efficient retirement system to ensure payment and continuity of members' retirement benefits.

In March 1997, the City issued Pension Obligation Bonds (POBs) in the amount of \$417 million to pay the City's contributions to the System through June 2011. In accordance with an agreement entered into at the time the POBs were issued in 1997, the City was not required to contribute until FY 2011/2012. The City's contribution to PFRS is set to resume July 1, 2011 at an annual amount of \$45.6 million.

## PROGRAM DESCRIPTION

### PFRS Membership

The City Charter establishes plan membership, contribution, and benefit provisions. The System serves the City's sworn employees hired prior to July 1, 1976 who have not transferred to the California Public Employees' Retirement System (CalPERS). The System provides that any member who completes at least 25 years of service, regardless of age, or completes 20 years of service and attains age 55, or has attained age 65, is eligible for retirement benefits. The System provides a maximum service retirement rate of 67.67%. The System also provides for various death, disability and survivors' benefits. After retirement, benefits change according to the corresponding rank of active sworn personnel. Upon a retiree's death, benefits are continued to an eligible surviving spouse at a two-thirds level for service and non-duty disabled retirees and at a 100% level for retirements for duty related deaths. Currently all of the System's members are retired with the exception of one.

The current PFRS membership is 1,125, which includes 1 active employee, 806 retirees and 319 beneficiaries. Table 1 shows additional detail regarding the PFRS membership.

<b>Membership</b>	<b>POLICE</b>	<b>FIRE</b>	<b>TOTAL</b>
Retiree	470	336	806
Beneficiary	167	152	319
<b>Total Membership</b>	<b>637</b>	<b>488</b>	<b>1,125</b>

Pursuant to the Oakland City Charter, the PFRS retirees are paid a fixed percentage of "compensation attached to the average rank held" at the time of retirement. This means that a PFRS

retiree's pension payment is determined by a percentage of the compensation paid to current active sworn personnel who hold the same rank that the member held prior to retirement. The active pay elements currently deemed attached to the rank include (1) Base Pay (2) Holiday Pay, (3) Uniform Pay, (4) Shift Differential (5) Longevity Pay and (6) FLSA. Any changes to these active sworn pay elements will change the pay that the PFRS members receive. The annual payroll to PFRS members and beneficiaries for FY 2010 was approximately \$70 million.

PFRS Investment Portfolio

Pursuant to the City Charter the System's investments are controlled by the PFRS Board. The Board sets an investment policy that authorizes investment in a variety of equity and fixed income securifies. The System's portfolio is currently managed by nine external investment managers and the majority of the portfolio is held in a Trust at The Bank of New York-Mellon.

The System investments are also restricted by the City Charter. In November 2006, City voters passed Measure M amending the City Charter to allow the System's Board to invest in non-dividend paying stocks and to change the asset allocation structure from 50% equities and 50% fixed income to the Prudent Person Standard as defined by the California Consfitution. As of October 2007, the Plan's investment portfolio has had an allocation of approximately 70% equity (stocks) and 30% fixed income (bonds).

Similar to many pension funds, the Oakland Police and Fire Retirement System saw significant reductions in the Plan's investment portfolio associated with a downturn in the U.S. financial markets during the economic recession. The System's net investment losses for the year ended June 30, 2009 was \$91,791,021, or an actual annual return of -18.2%. The System's Portfolio has had some recovery. As of the fiscal year ended June 30, 2010, the portfolio had a net investment income of \$43,556,150, or an annual portfolio return of 15.0%.

As of December 31, 2010, the total PFRS investment portfolio value was \$308.2 million. During the past sixteen (16) months, the portfolio decreased by \$16.0 million from the September 30, 2009 value of \$292.2 million. This reduction includes approximately \$92.8 million in withdrawals to pay retiree benefit payments. Table 2 shows the PFRS Investment Portfolio as of December 31, 2010.

Table 2	
INVESTMENTS AT FAIR VALUE	
December 31, 2010	
Investment Type	Fair Value
Cash	\$3,917,450
Domestic Equity (stocks)	172,183,843
Intemational Equity (stocks)	52,064,045
Fixed Income (bonds)	80,001,366
Real Estate	40,391
<b>Total Portfolio</b>	<b>\$308,207,095</b>

Table 3 below illustrates the 1-year, 3-year and 5-year portfolio performance relative to the actuarial expected rate of return.

	Total Returns %		
	1 Year	3 Year	5 Year
Total Fund	14.5%	1.1%	4.1%
Actuarial Expected Rate of Return	8.0%	8.0%	8.0%
Excess Returns	6.5%	-6.9%	-3.9%

- During the most recent 12-month period, the PFRS Portfolio outperformed its actuarial rate of return by 6.5%, gross of fees. This placed the PFRS portfolio in the top quartile of investment returns among the Mellon Total Public Fund Universe.
- The PFRS Portfolio trailed its actuarial rate over the latest 3-year time period. Underperformance over this longer time period can be attributed to severe market corrections in the second half of 2008. However, due to a strong 2009-2010, longer-term performance has improved significantly resulting in positive absolute returns.
- During the latest 5-year period, the PFRS portfolio trailed that of its actuarial assumptions with an annualized return of 4.1%. Underperformance during this time period can be attributed to the global financial crisis of 2008-2009.

**PFRS Actuarial Valuation and Funding Status**

Article XXVI, Section 2602(b) of the City Charter requires that the PFRS plan be actuarially valued at intervals not to exceed three years. The latest actuarial valuation as of July 1, 2010 was performed by actuary, Bartel Associates. As of this report, the PFRS Funded Ratio (assets divided by present value of future benefits) is 37.6% and a contribution of \$45.6 million is required for FY 2011/12.

**PFRS Actuarial Assumptions**

The PFRS Actuarial Assumptions are recommended by the Actuary through an Experienced Study and are approved by the PFRS Board. The following are the significant assumptions used to compute contribution requirements:

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- 7.00% investment rate of return
- 3.25% inflation rate, US
- 3.50% inflation rate, Bay Area
- 4.50% post-retirement benefit increases
- Based on the current Sworn Memorandum of Understandings, Police are assumed to receive no increases until a 4% increase on January 1, 2013. Fire receives no increases until July 1, 2011. At that point Fire is assumed to receive annual increases of 3.5% from July 1, 2011, changing to annual increases of 4.5% beginning July 1, 2016.

Note: The Fire MOU does not specify the 3.5% increase effective July 1, 2011. However, the MOU states that the contract may be reopened to negotiate salary increases in the final year. The 3.5% assumption was based on the actuary's long-term assumption for increases in the Bay Area CPI. The 4.5% increase is based on the 3.5% Bay Area CPI assumption increased by 1% to reflect pay increases in excess of inflation. Historical differences between average national wages and the CPI for the 10, 25, and 50 year periods ending in 2008 were 0.8%, 0.9%, and 0.8%. Differences since 1998 between Oakland Police and Fire pay increases and the Bay Area CPI, taking into account the current MOU's were 0.7% and 0.9% for Police and Fire respectively. Through 2010 they were 1.3% and 1.2% respectively.

Actuarial results for the Oakland Police and Fire Plan are as follows.

Valuation date 1-Jul	Actuarial Accrued Liability	Actuarial Value of Assets	Unfunded Liability	Funded Status
2005 (a)	\$883.6	\$614.9	\$268.7	69.60%
2007 (b)	888.1	566.0	322.1	63.70%
2009 (b)	782.5	347.2	435.3	44.40%
2010 (b)	792.2	297.8	494.4	37.60%

(a) Actuary valuation studies by Milliman Actuaries  
(b) Actuary valuation study performed by Bartel Associates

The City Charter requires that the PFRS plan be fully funded by July 1, 2026. As mentioned, the City's annual contribution is set to resume July 1, 2011. Thereafter, the City must contribute, at a minimum, such amounts as are necessary on an actuarial basis to provide assets sufficient to meet benefits to be paid to plan members. Once the Unfunded Actuarial Liability has been calculated, the actuarial cost method defines the pattern of future contributions to pay off that liability. For example, contributions may be designed to be the same dollar amount each year, or they may be

designed to be lower initially and increase in dollar amount as payroll increases. If the latter method is used, contributions will remain a level percentage of payroll in the future if all actuarial assumptions are met. Contributions to PFRS have historically been calculated using this method.

Police and Fire Retirement Board

The System is governed by a board of seven trustees; the Mayor or his designate, three Mayoral appointees approved by the City Council, an elected active or retired member of the Police Department, an elected active or retired member from the Fire Department, and an elected member position which alternates between the Police Department and Fire Department membership. Trustees receive no compensation. The PFRS Board currently meets on the last Wednesday of each month at Oakland City Hall.

PFRS Board Members

Robert (Bob) P. Crawford, President – Elected	Steven J. Bernard – Elected
Jaime Godfrey, Vice President – Appointed (Bank Rep)	John Speakman – Elected
Walter Johnson – Appointed (Community Rep)	Ken Bullock – Appointed (Insurance Rep)
Joe Yew – Appointed (Mayoral Rep)	

Staff Liaison

Yvonne S. Hudson-Harmon  
Manager, Retirement and Benefits  
Department of Human Resources Management

Legal Advisor

Tracy Chriss (City Attorneys office)  
Deputy City Attorney  
  
Olson Hagei and (Outside Legal Counsel)  
Sacramento, CA

Investment Consultant

Pension Consulting Alliance, Inc.  
Portland, Oregon

Actuary

Bartel Associates, LLC  
San Mateo, CA

Key Board Activities and Actions (October 1, 2009 – December 31, 2010)

- PFRS hired Northern Trust Global Investments to manage their Passive Large Cap Core Portfolio of approximately \$81 million.
- PFRS hired Lord Abbett to manage a Small Cap Growth portfolio of approximately \$9 million.
- Termination of New Star Institutional Managers (International equities; \$20 million) due to poor performance.
- Hired Olsen Hagei & Fishburn LLC as Outside Legal Counsel to PFRS Board.
- Extended contract for Bartel Associates as PFRS Actuary.
- John Speakman elected to second term as 5-year tire member representative on PFRS board.

- Hired T. Rowe Price to manage their Fixed Core Portfolio of approximately \$45 million.
- Steven J. Bernard elected to PFRS Board as a tire member to replaced James Cooper, police member, as the 3-year alternating Board member.
- Hired Fisher Investments to manage a Non-US Equity of approximately \$20 million.

### SUSTAINABLE OPPORTUNITIES

There are no economic, environmental or social equity opportunities represented in this report.

### DISABILITY AND SENIOR CITIZEN ACCESS

There are no disability or senior citizen access issues associated with this report.

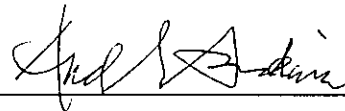
### RECOMMENDATION(S) AND RATIONALE

Staff recommends that the Council accept this informational report pursuant to the Oakland City Charter for the Police and Fire Retirement System.

### ACTION REQUESTED OF THE CITY COUNCIL

Staff requests that the Council accept this informational report.

Respectfully submitted,



Andrea R. Gourdine, Director  
Department of Human Resources Management

Reviewed by:  
Yvonne Hudson  
Human Resources Manager

Prepared by:  
Téir Jenkins,  
Retirement Systems Accountant

FORWARDED TO THE  
FINANCE AND MANAGEMENT COMTE:

  
Office of the City Administrator

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