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CITY OF OAKLAND

AGENDA REPORT

TO:	Sabrina B. Landreth City Administrator	**FROM:**	Katano Kasaine Director of Finance
SUBJECT:	Status of the City's Unfunded Liabilities	**DATE:**	April 3, 2017

City Administrator Approval Date: 4/12/17

RECOMMENDATION

Staff Recommends the City Council Receive An Informational Report On The Status Of The City of Oakland's Unfunded Actuarial Accrued Liability (UAAL).

EXECUTIVE SUMMARY

The purpose of this informational report is to provide an update on the City of Oakland's unfunded liabilities, which include California Public Employee Retirement System (CalPERS), Police and Fire Retirement System (PFRS), and Other Post-Employment Benefits (OPEB), which are currently estimated to total approximately $2.46 billion. Table 1 below provides a summary of the City's pension plans (CalPERS and PRFS).

Table 1
Summary of Pension Plans (CalPERS and PFRS)

Plan	Accrued Liability	Assets	Unfunded Liability	Funded Ratio	Normal Cost Rate(1)	UAL Amount Contribution(1)	Total Employer Contribution	Valuation Date
PFRS	$672,916,000	$363,550,000	$309,366,000	53.70%	N/A	N/A	$44,860,000	7/1/2016
PERS--Public Safety	1,754,078,714	1,179,020,200	575,058,514	67.20%	18.29%	32,173,315	58,573,865	6/30/2015
Miscellaneous	2,409,031,753	1,691,228,930	717,802,823	70.20%	11.08%	55,380,769	79,667,751	6/30/2015

(1) CalPERS has change the w ay it calcuate the Required Employer Contribution, the amount comprise of the Normal Cost as a % and the UAL as a fixed dollar amount. Rates and Employer Contribution is for Fiscal Year 2017-2018

In addition, the City has three programs in place to pay the partial costs of health insurance premiums for certain classes of retirees. Based on the recent valuation as of July 1, 2015 prepared by Cherion, the City's OPEB liability is currently computed at $862.9 million and the net OPEB obligation is $305 million as shown in Table 2. For fiscal year 2016, the City's annual required contribution (ARC) is $74.1 million and the City anticipates paying $25.4 million on a pay-as-you-go basis for retirees in a City-sponsored CalPERS health benefit plan.

Table 2
Summary of OPEB

Valuation Date	Accrued Liability	Actuarial Value of Assets	Unfunded Liability	Required Contribution	Employer Contribution	Net OPEB Obligation
7/1/2015	$862,891,642	$2,901,346	$859,990,296	$74,094,179	$25,359,800	$305,024,063

ANALYSIS

PENSION PLANS

California Public Employees Retirement System (CalPERS)

Table 3
Summary of CalPERS
(Miscellaneous and Safety Plan)

Plan	Accrued Liability	Assets	Unfunded Liability	Funded Ratio	Normal Cost Rate[1]	UAL Amount Contribution[1]	Total Employer Contribution	Valuation Date
PERS--Public Safety	1,754,078,714	1,179,020,200	575,058,514	67.20%	18.29%	32,173,315	58,573,865	6/30/2015
PERS--Miscellaneous	2,409,031,753	1,691,228,930	717,802,823	70.20%	11.08%	55,380,769	79,667,751	6/30/2015

(1) CalPERS has change the way it calcuate the Required Employer Contribution, the amount comprise of the Normal Cost as a % and the UAL as a fixed dollar amount. Rates and Employer Contribution is for Fiscal Year 2017-2018

CalPERS is a defined-benefit plan administered by the State that covers all non-uniformed employees hired after September 1, 1970 and uniformed employees hired after June 30, 1976, as well as certain former members of PFRS and OMERS. Employees covered under CalPERS are classified as either miscellaneous employees or safety employees (police and fire). The contribution requirements of the plan participants and the City are established by and may be amended by CalPERS toward the objective of fully funding the plans.

Beginning with Fiscal Year 2017-18, CalPERS will collect minimum required employer contributions equal to the sum of the Plan's Employer Normal Cost Rate (expressed as a percentage of payroll) plus the Employer Unfunded Accrued Liability Contribution Amount (billed monthly in a fixed dollar amount). In prior fiscal years, the Employer Unfunded Accrued Liability Contribution Amount was a percentage contribution rate.

As percentages of projected annual covered payroll, the total required employer contribution rates for Fiscal Year 2017-18 are estimated to be 36.35% for miscellaneous employees and 40.58% for safety employees (police and fire employees). Table 4 sets forth the City's employer contribution rates as determined by CalPERS for Fiscal Years 2016-17 and 2017-18, and CalPERS' projections for Fiscal Years 2018-19 and 2022-23. The Total Required Employer Contribution is the sum of the Plan's Employer Normal Cost Rate (expressed as a percentage of payroll) plus the Employer Unfunded Accrued Liability Contribution Amount.

Table 4
California Public Employees' Retirement System Contribution Rates
Fiscal Years 2016-18 and Projected Fiscal Years 2018-19 and 2022-23

	2016-17	2017-18[1]	2018-19 (Projected)[2]	2022-23 (Projected)[2]
Miscellaneous Plan				
Total Required Employer Contribution (% of payroll)	34.23%	36.35%[3]	N/A[4]	N/A[4]
Employer Normal Cost Rate (% of payroll)	11.32%	11.08%	11.10%	11.10%
Employer Unfunded Accrued Liability Contribution Amount	$48,748,259	$55,380,769	$64,395,246	$90,359,211
Safety Plan				
Total Required Employer Contribution (% of payroll)	40.67%	40.58%[3]	N/A[4]	N/A[4]
Employer Normal Cost Rate (% of payroll)	19.17%	18.29%	18.30%	18.30%
Employer Unfunded Accrued Liability Contribution Amount	$27,369,357	$32,173,315	$38,667,195	$57,660,374

(1) Beginning with Fiscal Year 2017-18, CalPERS will collect employer contributions toward the plan's unfunded liability as dollar amounts instead of the prior method of a contribution rate.
(2) Based on various assumptions, including 0.0 percent investment return for 2015-16 and 7.50 percent every fiscal year thereafter. On December 21, 2016, the CalPERS Board of Administration voted to lower the discount rate to 7.00% over the next three fiscal years. Such reduction will increase the required unfunded accrued liability contribution amounts.
(3) Estimated.
(4) Not provided by CalPERS.
Source: CalPERS Annual Valuation Reports as of June 30, 2015.

CalPERS uses an actuarial method that takes into account those benefits that are expected to be earned in the future as well as those already accrued. CalPERS also uses the level percentage of payroll method to amortize any unfunded actuarial liabilities. Major actuarial assumptions included a 3.00% inflation rate and a 7.75% investment return until the June 30, 2012 valuation. For its June 30, 2012 valuation, CalPERS revised the assumptions to a 2.75% inflation rate and a 7.50% investment return.

After the June 30, 2012 valuation, CalPERS made additional changes to its actuarial assumptions and method. Additionally, Public Employees' Pension Reform Act (PEPRA) was implemented and the City adopted Tier 3. Currently, the City has a three tiered system as summarized in the Table 5. In addition, under current bargaining agreements, all City participants, other than Tier 3 employees, are required to contribute a percentage of their annual covered salary to CalPERS as shown in Table 6. The contribution requirements of the plan members are established by State statute and the employer contributions are established, and may be amended, by CalPERS toward the objective of fully funding the plans.

Table 5
City of Oakland
Tiered Pension Plans

Employee Organization	Tier One (Classic Members)	Tier Two (Miscellaneous new hires after June 8, 2012, Safety new hires after February 8, 2012)	Tier Three: AB 340 (New hires on or after January 1, 2013)
Safety	Receive 3% at age 50 Pension benefits are based on the highest paid twelve (12) consecutive months	Receive 3% at age 55 Pension benefits are based on the final average salary of 3 years under the Government Code 20037	Basic: 2% at age 57 Option 1: 2.5% at age 57 Option 2: 2.7% at age 57 Pension benefits are based on the final average salary of 3 years subject to established cap
Miscellaneous	Receive 2.7% at age 55 Final compensation is based on the twelve (12) highest paid consecutive months.	Receive 2.5% at 55 Final compensation is based on the highest paid three (3) consecutive years' average	2% at age 62 Pension benefits are based on the final average salary of 3 years subject to established cap

Table 6
Employees' Contribution Rate to CalPERS

Employee Organization	Tier One (Classic Members)	Tier Two (Miscellaneous new hires after June 8, 2012, Safety new hires after February 8, 2012)	Tier Three: AB 340 (New hires on or after January 1, 2013)
Safety	12% for Police and 13% for Fire of annual covered salary	12% for Police and 13% for Fire of annual covered salary	50% of normal cost (currently, 11.5% for police and 12.5% for fire)
Miscellaneous	8% of annual covered salary	8% of annual covered salary	50% of normal cost (currently, 6.75%)

On April 17, 2013, the CalPERS Board of Administration (the "CalPERS Board") approved to change the CalPERS amortization and rate smoothing policies. Beginning with the June 30, 2013 valuations that set the 2015-16 rates, CalPERS no longer uses an actuarial value of assets and will employ an amortization and smoothing policy that will pay for all gains and losses over a fixed 30-year period with the increases or decreases in the rate spread directly over a 5-year period.

In 2014 CalPERS completed a 2-year asset liability management study incorporating actuarial assumptions and strategic asset allocation. On February 19, 2014, the CalPERS Board adopted relatively modest changes to the current asset allocation that will reduce the expected volatility of returns. The adopted asset allocation is expected to have a long-term blended return that continues to support a discount rate assumption of 7.50 percent. The Board also approved several changes to the demographic assumptions that more closely align with actual experience. The most significant of these is mortality improvement to acknowledge the greater life expectancies seen in CalPERS's membership and expected continued improvements. The new actuarial assumptions have been used to set the Fiscal Year 2016-17 contribution rates for public agency employers. The increase in liability due to new actuarial assumptions have been calculated in the 2014 actuarial valuation and will be amortized over a 20-year period with a 5-year ramp-up/ramp-down in accordance with Board policy.

On December 21, 2016, the CalPERS Board voted to further lower the assumed investment rate of return to 7.00% over the next three fiscal years. CalPERS announced that such reduction will result in average employer rate increases of about one percent to three percent of normal cost as a percent of payroll for most miscellaneous retirement plans, and two percent to five percent increase for most safety plans. Increased payments will be made to amortize unfunded liabilities over 20 years to bring CalPERS's fund to a fully funded status over the long-term. This new change will be implemented in the July 1, 2018.

The phase-in of the discount rate change approved by the Board for the next three fiscal years is as follows:

Table 6
Three Year Phase-In of Discount Rate

Valuation Date	FY for Required Contribution	Discount Rate
June 30, 2016	2018-19	7.375%
June 30, 2017	2019-20	7.250%
June 30, 2018	2020-21	7.000%

The lowered discount rate will increase both the normal costs (the cost of pension benefits accruing in one year for active members) and the accrued liabilities for the City. These increases will result in higher required employer contributions. In addition, active members hired after January 1, 2013, under the PEPRA may also see their contribution rates rise. There can be no assurance that CalPERS will not again lower its investment assumptions thus increasing the City's contribution obligations.

The benefits of reducing the discount rate include:

- Strengthening long-term sustainability of the fund
- Reducing negative cash flows; additional contributions will help to offset the cost to pay pensions
- Reducing the long-term probability of funded ratios falling below undesirable levels
- Improving the likelihood of CalPERS investments earning our assumed rate of return
- Reducing the risk of contribution increases in the future from volatile investment markets

Based on updated information from CalPERS, employer contribution increases as a result of the discount rate changes are estimated below by Normal Cost and required Unfunded Accrued Liability (UAL) payment.

Table 7
Estimated Increases to Normal Cost and UAL Payments

		Normal Cost		UAL Payments	
Valuation Date	**Fiscal Year Impact**	**Misc. Plans**	**Safety Plans**	**Misc. Plans**	**Safety Plans**
6/30/2016	2018-19	0.25% - 0.75%	0.5% - 1.25%	2% - 3%	2% - 3%
6/30/2017	2019-20	0.5% - 1.5%	1.0% - 2.5%	4% - 6%	4% - 6%
6/30/2018	2020-21	1.0% - 3.0%	2.0% - 5.0%	10% - 15%	10% - 15%
6/30/2019	2021-22	1.0% - 3.0%	2.0% - 5.0%	15% - 20%	15% - 20%
6/30/2020	2022-23	1.0% - 3.0%	2.0% - 5.0%	20% - 25%	20% - 25%
6/30/2021	2023-24	1.0% - 3.0%	2.0% - 5.0%	25% - 30%	25% - 30%
6/30/2022	2024-25	1.0% - 3.0%	2.0% - 5.0%	30% - 40%	30% - 40%

Police and Fire Retirement System

Table 8
Summary of the Police and Fire Retirement System

Plan	Actuarial Liability	Actuarial Value of Assets	Unfunded Liability	Funded Ratio	Employer Contribution	Valuation Date
PFRS	$672,916,000	$363,550,000	$309,366,000	53.70%	$44,860,000	7/1/2016

The Police and Fire Retirement System (PFRS) is a closed pension system that provides pension, disability and beneficiary payments to retired Police and Fire sworn officers hired prior to July 1, 1976. As of July 1, 2016, PFRS covered no active employees and 929 retired employees and beneficiaries. An actuarial valuation of PFRS is conducted at least every two years; the most recent valuation was based on data as of July 1, 2016.

The City's pre- payment period, which the City deposited $210 million to the PFRS fund is set to expire on June 30, 2017, at which time the City will be required to contribute an estimated $44.9M to fund PFRS UAAL beginning July 1, 2017. Payments in excess of the available revenues (tax override) will be payable from the General Fund.

Tax Override Revenues

To support funding PFRS, in June 1976, Oakland voters approved Measure R, amortizing over 40 years the City's obligations to the Police and Fire Retirement System (PFRS). On March 2, 1982, City Council Resolution No. 60474 created a Pension Liability Fund and authorized collection an annual property tax levy to fund the Police and Fire Retirement System. The "tax override" is comprised of proceeds of this annual tax levy. The 1985 State legislation limited the Tax Override rate to 0.1575%, and the City has levied the 0.1575% rate since 1983. On June 7, 1988, the voters of the City adopted Measure O (Measure O) by a 71% vote extending the period for amortizing the unfunded liability by 10 years, to 2026, as described in Resolution No. 65264 C.M.S. Funding for the debt service of the pension bonds obligations is allowed under Measure R and Measure O. In addition, the City purchased an annuity with New York Life (the "Annuity") in 1985 to be used to pay a portion of the City's obligation to PFRS.

To increase funding to PFRS, the City issued a series of debt to support the unfunded liability as shown in the Table 9 and 10. Currently, the Tax Override and the Annuity are used to pay debt service on PFRS related bonds. ***The debt service on PFRS related bonds is structured in a manner that it could be fully covered from the tax override revenues as shown in the Table 11 and Table 12.*** Please note that a conservative growth rate assumption of 3.00% is used for the tax override revenue in Table 11. In comparison, the City experienced a historical average growth of 5.24% over the last 25 years, which is used in Table 12. Also, shown in the chart below is the tax override revenue at 3.00% (solid line) and 5.24% (dotted line).

Table 9
Summary of PFRS Debt Obligations
Outstanding as of April 1, 2017

Issue Name	Issue Date	Final Maturity Date	Original Par Amount	Outstanding Par Amount	Interest Rate
Taxable POBs Series 2001	10/17/2001	12/15/2022	$195,636,449	$174,776,566	6.09% - 6.89%
Taxable POBs Series 2012	7/12/2012	12/15/2025	212,540,000	212,540,000	2.37% - 4.68%
Tax-Exempt Series 2008A-1	4/16/2008	1/1/2017	107,630,000	-	3.00% - 5.25%

Table 10
Summary of PFRS Debt Service

Fiscal Year (June 30)	2012 POBs	Taxable POBs Series 2001	Tax-Exempt Series 2008A-1 [1]	Total Obligations
2017	8,961,220	44,590,000	17,134,173	$57,515,643
2018	18,511,496	45,925,000	1,654,991	$66,093,505
2019	18,413,468	47,295,000	1,280,276	$66,990,763
2020	18,326,222	48,700,000	911,239	$67,939,481
2021	18,241,900	50,140,000	545,040	$68,928,961
2022	18,140,385	51,620,000	181,680	$69,944,087
2023	17,894,170	53,130,000		$71,026,193
2024	53,273,555			$53,275,579
2025	54,079,805			$54,081,830
2026	54,858,285			$54,860,311
Total	**$280,700,506**	**$341,400,000**	**$21,707,399**	**$630,656,353**

[1] Includes swap payments

Table 11
TOR at 3.00% Growth

Tax Override Revenues Projections - 3.00% AV Growth in 2018

Fiscal Year Ending	Total Funding Available for PFRS	Outstanding Debt Service Obligations	Net of PFRS Obligations	Actuarial Recommended Contributions (ARC)	General Fund Support Required	Net Using TOR Reserve
Excess Reserve Balance[1]						56,600,000
2017	87,659,051	57,515,643	30,143,409	-	30,143,409	86,743,409
2018	89,528,325	66,091,487	23,436,838	44,900,000	(21,463,162)	65,280,247
2019	91,489,736	66,988,744	24,500,992	46,400,000	(21,899,008)	43,381,239
2020	93,548,793	67,937,461	25,611,332	47,900,000	(22,288,668)	21,092,571
2021	95,709,853	68,926,940	26,782,913	49,500,000	(22,717,087)	(1,624,516)
2022	97,976,624	69,942,065	28,034,559	51,100,000	(23,065,441)	
2023	100,352,087	71,024,170	29,327,917	52,800,000	(23,472,083)	
2024	102,838,560	53,273,555	49,565,005	54,600,000	(5,034,995)	
2025	105,437,799	54,079,805 [1]	51,357,994	56,400,000	(5,042,006)	
2026	108,151,203	1,307,066 [1]	106,844,137	58,400,000	48,444,137	
Total	**$972,692,030**	**$577,086,936**	**$395,605,094**	**$462,000,000**		

[1] Net of one year of debt service for the pension bonds.

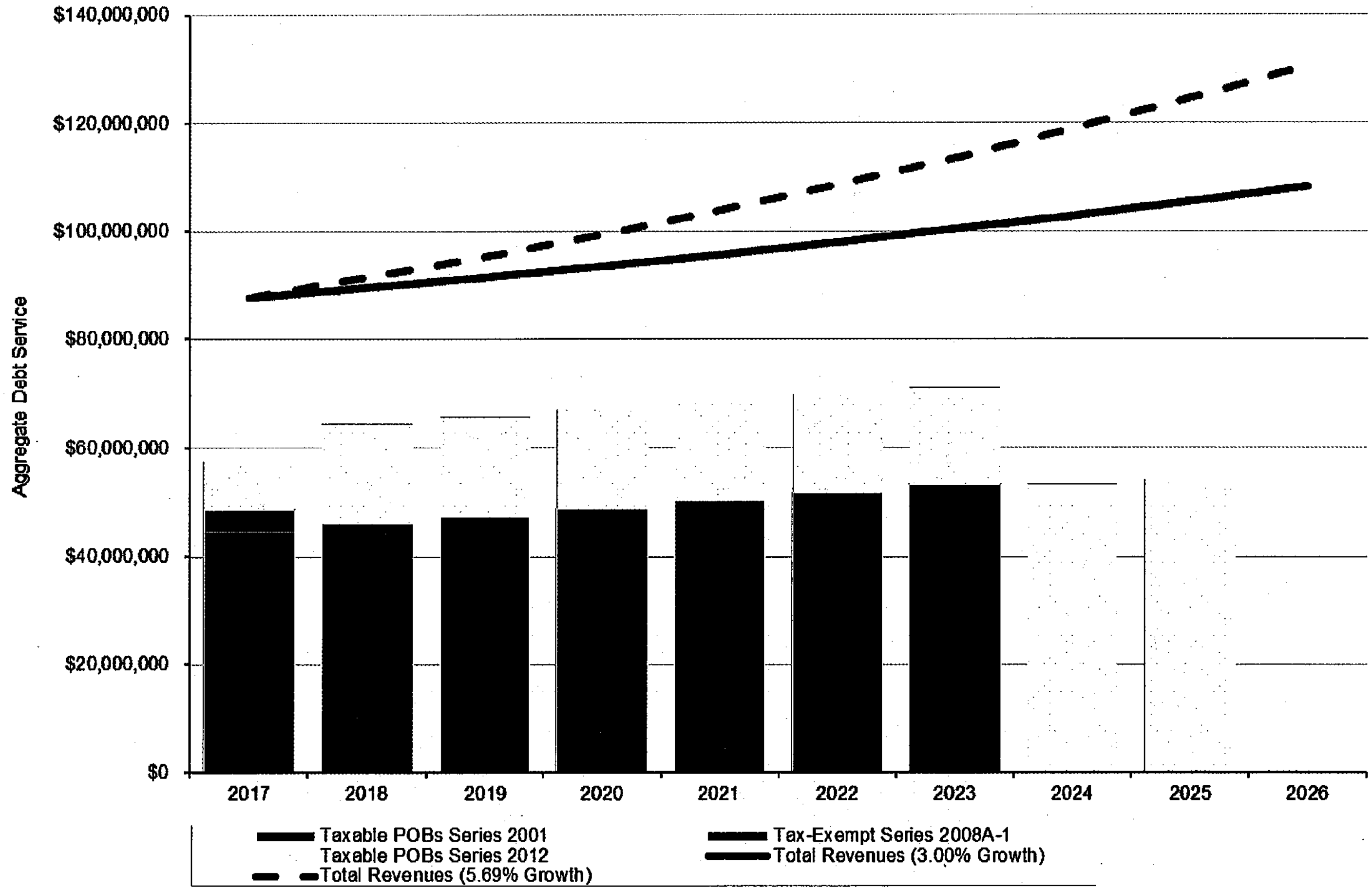
Table 12
TOR at 5.24% Growth (historical 25 year average)

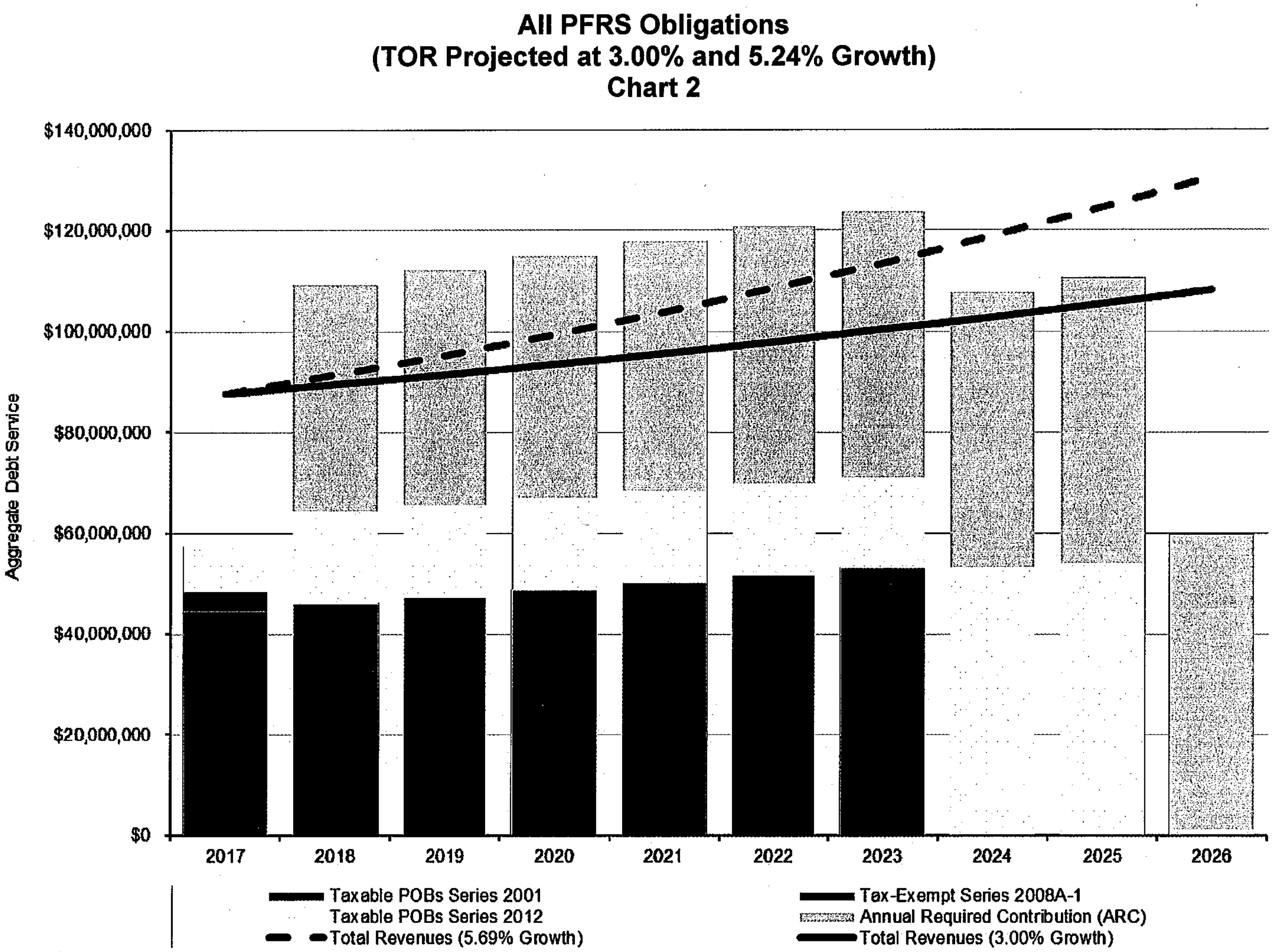
Tax Override Revenues Projections - 5.24% AV Growth in 2018

Fiscal Year Ending	Total Funding Available for PFRS	Outstanding Debt Service Obligations	Net of PFRS Obligations	Actuarial Recommended Contributions (ARC)	General Fund Support Required	Net Using TOR Reserve
Excess Reserve Balance[1]						56,600,000
2017	87,659,051	57,515,643	30,143,409	-	30,143,409	86,743,409
2018	91,326,927	66,091,487	25,235,440	44,900,000	(19,664,560)	67,078,849
2019	95,235,145	66,988,744	28,246,401	46,400,000	(18,153,599)	48,925,250
2020	99,398,598	67,937,461	31,461,137	47,900,000	(16,438,863)	32,486,387
2021	103,831,569	68,926,940	34,904,629	49,500,000	(14,595,371)	17,891,016
2022	108,548,260	69,942,065	38,606,195	51,100,000	(12,493,805)	5,397,211
2023	113,562,749	71,024,170	42,538,579	52,800,000	(10,261,421)	(4,864,210)
2024	118,889,086	53,273,555	65,615,531	54,600,000	11,015,531	
2025	124,541,426	54,079,805	70,461,621	56,400,000	14,061,621	
2026	130,534,276	1,307,066 (1)	129,227,210	58,400,000	70,827,210	
Total	**$1,073,527,088**	**$577,086,936**	**$496,440,152**	**$462,000,000**		

(1) Net of one year of debt service for the pension bonds.

TOR Sufficiently Covers All PFRS Debt Service
(TOR Projected at 3.00% and 5.24% Growth)
Chart 1





Post-Employment Benefits Other than Pension (OPEB)

The City pays the partial costs of health insurance premiums for certain classes of retirees from City employment. Retirees meeting certain requirements relating to age and years of service are eligible for health benefits. The health benefits are extended to retirees pursuant to labor agreements between the City and certain of its employee labor unions and in resolutions adopted by the City. In addition to making annual payments on a pay-as-you go basis, the City has begun investing into the California Employer's Retiree Benefit Trust (CERBT), an agent multi-employer defined benefit post-employment healthcare funding plan administered by CalPERS. As of December 1, 2016, the City has deposited approximately $4.07 million into CERBT for its

OPEB obligations. The City plans to continue to contribute approximately $665,000 annually until June 30, 2022.

Based on the most recent actuarial report prepared by Cheiron, as of July 1, 2015, the OPEB Unfunded Actuarial Liability (UAL) is approximately $862.9. Assuming a 4.00% interest earnings and recognizing implicit subsidy for the first time, the City's projected net OPEB obligation (defined, in terms of balance sheet liability, as the cumulative difference between the annual OPEB cost, on an actuarial basis and the City's actual contribution to the OPEB plan since 2008) will be approximately $305.0 million. The ARC for the fiscal year ending June 30, 2016 is approximately $74.1 million and the City anticipates paying approximately $25.4 million on a pay-as-you-go basis to CalPERS for retirees.

Table 13 sets forth certain information with respect to the City's OPEB obligations:

Table 13
Summary of the Post-Employment Benefits Other than Pension

Actuarial Valuation Date	Actuarial Accrued Liability	Asset	Unfunded Actuarial Liability	Annual Required Contribution	Employer Contribution	Net OPEB Obligation
7/1/2010	$520,882,498	$0	$520,882,498	$46,657,000	$15,710,000	$156,978,000
7/1/2012	$553,530,074	$0	$553,530,074	$46,596,504	$17,622,496	$215,252,287
7/1/2013	$463,850,944	$0	$463,850,944	$39,418,149	$20,632,950	$235,094,821
7/1/2015	$862,891,642	$2,901,346	$859,990,296	$74,094,179	$25,359,800	$305,024,063

In the past five years, there has been much concentration on addressing the concerns of the CalPERS' unfunded liability with CalPERS implemented reforms to reduce the City's long-term pension liability. These changes are intended to protect beneficiaries and reduce the long-term cost of benefits for all in addition to meeting the pension obligations of current and future public employees. The various changes from CalPERS and realizing savings from the multiple tiered pension system, the pension plans will be funded at a healthy level long-term. However, CalPERS' reform will have a short-term impact on the City's budget. As for PFRS, the tax override revenues will support the current debt obligations. The challenge will be after 2026 when PFRS is fully funded and there are remaining retirees left in the system.

A major challenge for the City that needs to be addressed is OPEB. As of July 1, 2015, the UAL is approximately $862.9 million. The City is partially funded with CERBT with an asset of only $4 million as of December 2016. Currently, the City is making payment on a pay-as-you-go and not meeting the annual required contribution. Therefore, the City's net OPEB obligation has totaled to $305 million and growing as shown Table 13.

COORDINATION

This report was prepared by the Finance Department.

ACTION REQUESTED OF THE CITY COUNCIL

Staff Recommends the City Council Receive An Informational Report On The Status Of The City of Oakland's Unfunded Actuarial Accrued Liabilities.

For questions, please contact Katano Kasaine, Director of Finance, at (510) 238-2989.

Respectfully submitted,

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