DISTRIBUTION DATE: ______2/27/13______

CITY OF OAKLAND

MEMORANDUM

TO: HONORABLE MAYOR & CITY COUNCIL

FROM: Katano Kasaine

SUBJECT: SEE BELOW

DATE: February 26, 2013

City Administrator Approval **/s/ Scott P. Johnson**

Date **2/26/13**

INFORMATION

SUBJECT: City of Oakland's Credit Ratings, PFRS Debt Obligations and Unfunded Actuarial Accrued Liabilities

The purpose of this memorandum is to provide information regarding the City's credit ratings, the debt obligations of the Police and Fire Retirement System (PFRS) and the City's unfunded actuarial accrued liabilities (UAAL) for the City's pension and retiree health benefits.

CREDIT RATINGS

The City's current ratings from the national rating agencies are as follows:

	Moody's	S&P	Fitch
Underlying Rating	Aa2/Stable	AA-/Stable	A+/Stable
GO Bonds (Measure DD)	Aa2/Stable	AA-/Stable	A+/Stable
Pension Obligation Bonds	Aa3:A1/Stable	A+/Stable	A/Stable

A credit rating is a value assigned by one or more of the recognized rating agencies that "grade" a jurisdiction's credit, or financial trustworthiness. The three primary rating agencies are Moody's Investors Service ("Moody's"), Standard & Poor's Rating Services ("S&P"), and Fitch Ratings ("Fitch"). These rating agencies serve as independent assessors of municipal and corporate credit strength. Investors rely on their opinions to make investment decisions. The higher the grade the City receives, the stronger the credit. Rating agencies generally focus on four major areas when assigning credit ratings: finances, management, economy and outstanding debt.

Importance of credit ratings to the City

A credit rating is important to the City for the following reasons:

- Ensures low interest cost to the City
- Demonstrates strong financial management and condition to potential investors
- Ability to attract potential investors
- Ability to sell bonds
- Yields savings on debt service

THE POLICE AND FIRE RETIREMENT SYSTEM DEBT OBLIGATIONS

The Police and Fire Retirement System ("PFRS System") 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, 2011, PFRS covered one active employee and 1,081 retired employees and/or their 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, 2011. 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. However, the City is the process of obtaining a new valuation since the City had made a deposit of $210 million into the PFRS System in July 2012 (as a result of the City issuing PFRS pension obligation bonds – see below), which increased PFRS System's asset to approximately $466.4 and the funded ratio to approximately 68.3% while decreasing the UAAL to an estimated amount $216.8 million. Please note that no actuarial report has been issued since the issuance of the bonds in July 2012.

2012 Pension Obligations Bonds

On July 12, 2012, the City issued Taxable Pension Obligation Bonds, Series 2012 ("2012 POBs") of approximately $212.5 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 $210,000,000 to PRFS, which equals the present value of the payments the City would otherwise be required to make to amortize the current balance of the City's UAAL through June 30, 2017. As a result, the City will not be required to make any further periodic payments to the Retirement System through June 30, 2017, thereby providing temporary relief to the City's general fund.

By issuing the 2012 POBs and making a one-time deposit of approximately $210 million, the City reduced the PFRS' UAAL from $426.8 million to $216.8 million and increased the funded ratio from 37.5% to an estimated ratio of 68.3%, thus reducing the City's annual required contribution. Additionally, pre-funding some of the long-term liability will enable the fund the opportunity to generate greater returns and will thereby further reduce the City's UAAL over the long-term.

In fiscal year 2012, the general fund paid approximately $46.5 million to PFRS for pension, disability and beneficiary payments and would have continued to pay a net estimate of $30 million for fiscal year 2013 if the City did not issue the 2012 POBs. Given the current economic environment and the City's need to maintain a balanced budget, the general fund would not support the payments to PFRS without major reductions to core services.

Most importantly, the 2012 POBs allow the City to structure the payment obligations for PFRS with the available dedicated revenue sources for PFRS, thus mitigating the fiscal impact on the City's general fund. PFRS has a dedicated revenue source, the Tax Override Revenues (TOR) in which Oakland property owners are assessed a special tax to fund PFRS obligations. The TOR is outside of the general fund, and is pledged to the bonds, unlike other pension obligation bond structures which generally do not have a dedicated revenue source to fund the debt payments. The 2012 POBs are structured to match the available TOR with the PFRS obligations, through maturity (2026).

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 beside the Tax Override Revenues to pay for such debt service. It was restructured in a manner, which extended the final maturity date from 2010 to 2023, resulting in reducing the annual debt service payments for the City. Given that in some past years the tax override revenue exceeded the debt service obligation due to the restructuring, resulted in excess tax override revenue of approximately $67.5 million.

Series 2008 Bonds

The 2008 Bonds were issued to refund and defease all of the outstanding JPFA's Refunding Revenue Bonds, 2005 Series A and B, which refunded the outstanding Lease Revenue Bonds, 1998 Series A that refunded the original bonds, Special Refunding Revenue Bonds, (Pension Financing) 1988 Series A, which was issued by the City to fund a portion of the City's obligation under its Charter to make payments to its PFRS System in order to fund retirement benefits accruing to the members of the PFRS System.

To support funding the PFRS System, in 1976 Oakland voters approved a property tax add-on ("Tax Override") known as Measure R. 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 (the "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. Funding for the debt service of the pension bonds are 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 retiree. Currently, the Tax Override and the Annuity are used to pay debt service on PFRS related bonds as shown in the table 1. ***The debt service on PFRS related bonds are structured in a manner that they could be fully covered from the tax override revenues as shown in the table 2 and table 3.*** Please note that a conservative growth rate assumption of 2% is used for the tax override revenue in table 2. In comparison, the City experienced a historical average growth of 5.69% the last 25 years, which is used in table 3. Also, shown in the chart below is the tax override revenue at 2% (solid line) and 5.69% (dotted line).

Summary of PFRS Debt Obligations
Table 1

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	64,865,000	3.00% - 5.25%
Taxable Series 2008A-2	4/16/2008	1/1/2014	20,330,000	10,285,000	3.45% - 4.69%

PFRS Debt Service
TOR[1] at 2% Growth
Table 2

Fiscal Year (June 30)	Taxable POBs Series 2001	Taxable POBs Series 2012	Tax-Exempt Series 2008A-1	Taxable Series 2008A-2	Total Outstanding Debt Service	Total Revenues (2.00% Growth)	Excess TOR
2013	$39,555,000	$7,841,067	$14,697,750	$5,532,247	$67,626,064	$68,648,071	$1,022,007
2014	40,765,000	8,961,220	14,820,750	5,470,053	70,017,023	72,726,530	2,709,508
2015	42,010,000	8,961,220	14,935,550		65,906,770	73,429,550	7,522,780
2016	43,285,000	8,961,220	15,073,350		67,319,570	74,162,942	6,843,372
2017	44,590,000	8,961,220	15,095,950		68,647,170	74,932,831	6,285,661
2018	45,925,000	18,511,496			64,436,496	75,744,633	11,308,137
2019	47,295,000	18,413,458			65,708,458	76,603,334	10,894,876
2020	48,700,000	18,326,222			67,026,222	77,512,816	10,486,594
2021	50,140,000	18,241,900			68,381,900	78,475,754	10,093,854
2022	51,620,000	18,140,385			69,760,385	79,494,119	9,733,734
2023	53,130,000	17,894,170			71,024,170	80,569,096	9,544,926
2024		53,273,555			53,273,555	81,701,148	28,427,593
2025		54,079,805			54,079,805	82,890,115	28,810,310
2026		54,858,285			54,858,285	84,135,415	29,277,130
Total	**$507,015,000**	**$315,425,223**	**$74,623,350**	**$11,002,300**	**$908,065,873**	**$1,081,026,352**	**$172,960,480**

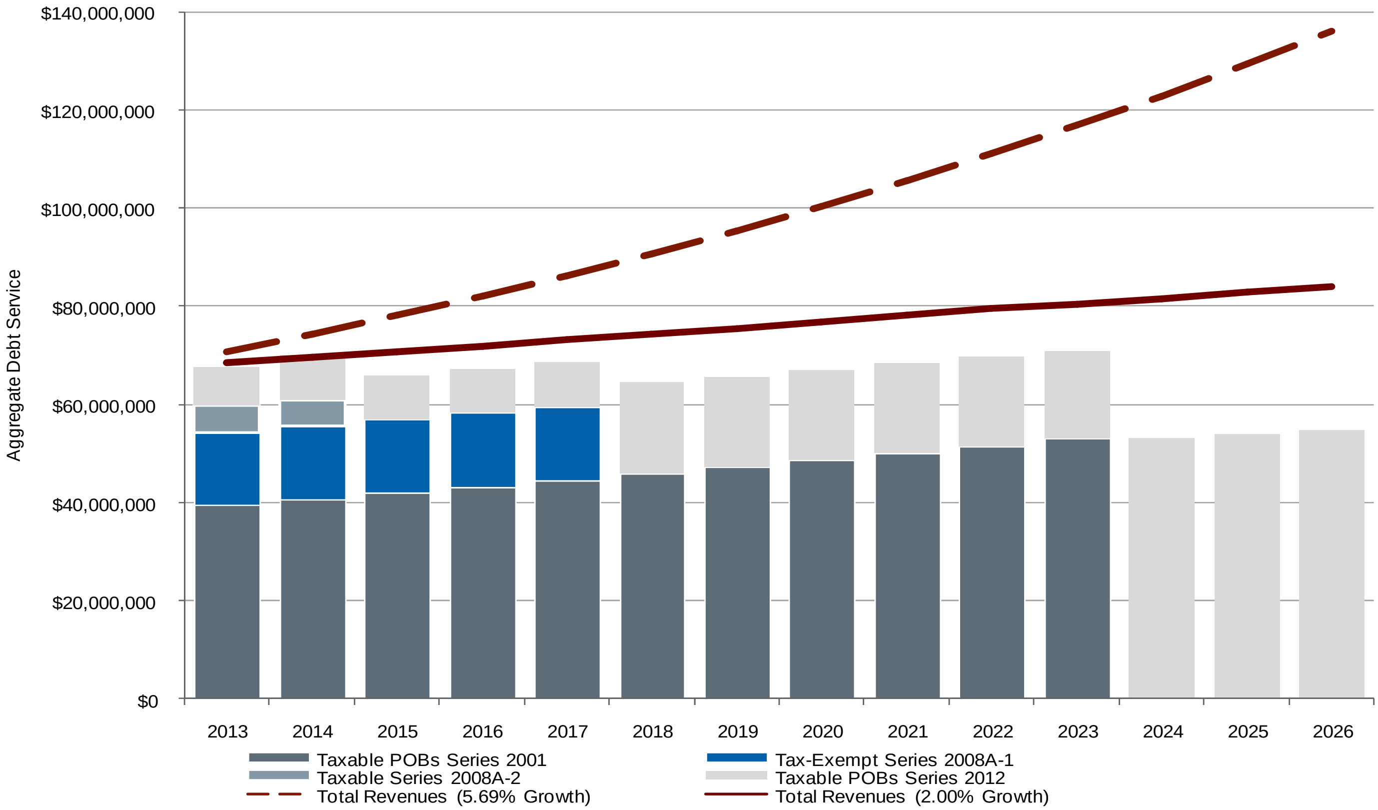
[1] **Tax Override Revenues (TOR)**

PFRS Debt Service
TOR[1] at 5.69% Growth (historical 25 year average)
Table 3

Fiscal Year (June 30)	Taxable POBs Series 2001	Taxable POBs Series 2012	Tax-Exempt Series 2008A-1	Taxable Series 2008A-2	Total Outstanding Debt Service	Total Revenues (5.69% Growth)	Excess TOR
2013	$39,555,000	$7,841,067	$14,697,750	$5,532,247	$67,626,064	$70,906,310	$3,280,246
2014	40,765,000	8,961,220	14,820,750	5,470,053	70,017,023	77,416,667	7,399,644
2015	42,010,000	8,961,220	14,935,550		65,906,770	80,736,026	14,829,256
2016	43,285,000	8,961,220	15,073,350		67,319,570	84,281,618	16,962,048
2017	44,590,000	8,961,220	15,095,950		68,647,170	88,071,650	19,424,480
2018	45,925,000	18,511,496			64,436,496	92,124,329	27,687,833
2019	47,295,000	18,413,458			65,708,458	96,458,179	30,749,721
2020	48,700,000	18,326,222			67,026,222	101,091,408	34,065,186
2021	50,140,000	18,241,900			68,381,900	106,041,854	37,659,954
2022	51,620,000	18,140,385			69,760,385	111,327,534	41,567,149
2023	53,130,000	17,894,170			71,024,170	116,966,613	45,942,443
2024		53,273,555			53,273,555	122,977,520	69,703,965
2025		54,079,805			54,079,805	129,379,105	75,299,300
2026		54,858,285			54,858,285	136,190,902	81,332,617
Total	**$507,015,000**	**$315,425,223**	**$74,623,350**	**$11,002,300**	**$908,065,873**	**$1,413,969,715**	**$505,903,843**

[1] **Tax Override Revenues (TOR)**

TOR[1] Sufficiently Covers All PFRS Obligations
(TOR[1] Projected at 2% and 5.69% Growth)
Chart 1



[1] **Tax Override Revenues (TOR)**

PENSION PLANS AND UNFUNDED ACTUARIAL ACCRUED LIABILITY

The City maintains two closed pension systems, the PFRS and the Oakland Municipal Employees Retirement System ("OMERS"). In addition, the City is a member of the California Public Employees' Retirement System ("CalPERS"), a multiple-employer pension system that provides a contributory defined-benefit pension for most current employees. ***Currently, there are no bond financings associated with OMERS, CalPERS and retirement programs.***

Plan	Accrued Liability	Assets	Unfunded Liability	Funded Ratio	Employer Rate[1]	Employer Contribution[1]	Valuation Date
OMERS	$5,471,000	$4,728,000	$743,000	86.40%	N/A	$0	7/1/2010
PERS--Public Safety	1,357,816,142	1,023,866,075	333,950,067	75.40%	33.35%	47,562,695	7/1/2011
PERS--Miscellaneous	2,025,140,791	1,615,939,765	409,201,026	79.80%	27.30%	57,898,591	7/1/2011

(1) Rates and Employer Contribution is for Fiscal Year 2013-2014

Oakland Municipal Employees Retirement System. OMERS is the second closed pension system, which covers active non-uniformed employees hired prior to September 1, 1970 who have not transferred to CalPERS. The program covers no active employees and 37 retired employees as of July 1, 2011. OMERS is administered by a seven-member Board of Administration. An actuarial valuation of OMERS is conducted every three years; the most recent complete valuation was for the period ended July 1, 2010 prepared by Bartel Associates, LLC. Significant actuarial assumptions used to compute the contribution requirement include a 6.5% investment rate of return, inflation rate of 3.25%, future benefit increase of 3% and mortality rates. Based on the actuarial report, the plan is 86.4% funded due to losses in the market value of asset. As shown above, the plan had assets of $4.7 million and liabilities of $5.5 million.

California Public Employees Retirement System. CalPERS is a defined-benefit plan administered by the State and covers all uniformed employees hired after June 30, 1976 and all non-uniformed employees hired after September 1, 1970 as well as certain former members of PFRS and OMERS. CalPERS acts as a common investment and administrative agent for public entities participating with the State of California. CalPERS is a contributory plan deriving funds from employee contributions as well as employer contributions and earnings from investments. A menu of benefit provisions is established by State statutes within the Public Employees' Retirement Law. The City selects its optional benefit provisions, subject to collective bargaining with the City's employee labor groups, from the benefit menu by contract with CalPERS. For more information: www.calpers.ca.gov.

Post-Employment Benefits Other than Pensions (OPEB)

FY Ended	Accrued Liability	Unfunded Liability	Annual Required Contribution	Employer Contribution	Net OPEB Obligation
6/30/2012	$520,882,498	$520,882,498	$46,401,000	$16,795,999	$186,583,000

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. Approximately $16.8 million was paid on behalf of retirees under these programs for the year ended June 30, 2012.

The City implemented GASB 45 in fiscal year 2008, which addresses how state and local governments should account for and report the annual OPEB cost. GASB 45 generally requires that employers account for and report the annual cost of OPEB and the outstanding obligations and commitments related to OPEB in essentially the same manner as they currently do for pensions. As of July 1, 2010, the Actuarial Accrued Liability (the "AAL"), which is equal to that portion of the Actuarial Present Value of Benefits deemed to have been earned to date, was $520.9 million (the chart above shows as of 6/30/12). As of June 30, 2012, assuming 4.00% interest earnings, 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 $186.6 million after a pay-as-you-go amount of $16.8 million.

Tier Pension Plans

In July 2011, the City approved two-tiered pension plans for all labor unions, one benefit plan for existing employees (classic member), and a less expensive plan for new employees hired after June 9, 2011 to reduce the City's costs overtime. The two-tiered pension plans were approved through collective bargaining agreements between the City and labor organizations representing Miscellaneous and Safety employees. The City implemented the two-tiered pension plan for the Safety group on February 9, 2012, pursuant to Ordinance No. 13106 C.M.S., and on June 8, 2012 for the Miscellaneous Group, pursuant to Ordinance No. 13119 C.M.S. The level of benefits under the second tier is described in Table 1 below.

In September 2012, Governor Brown signed Assembly Bill 340, known as PEPRA, which reforms all state and local public retirement systems and their participating employers with the exception of charter cities or counties that operate an independent retirement system (not governed by the 37 Act) that took effect on and after January 1, 2013. PEPRA limits the pension benefits offered to new employees and increases flexibility for employee and employer cost sharing for current employees. **The most significant savings will be realized only as new members are hired in the future, short-term savings will be minimal.** Table 1 below provides information on the amount of benefits for Tier Three. The only mechanism to realize greater short-term savings is through greater employee cost sharing, subject to collective bargaining with the City's employee labor bargaining groups.

The table below summarizes the key differences in the three tiers of the PERS pension plan the City participates in.

Table 1
Tier Pension Plans

Employee Organization	Tier One (Classic Members)	Tier Two (New Hires as of June 9, 2011)	Tier Three: AB 340 (January 1, 2013)
Safety	Receive 3% at age 50 Pension benefits are based on the one year of highest salary	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 average annual compensation of the three consecutive years	2% at age 62 Pension benefits are based on the final average salary of 3 years subject to established cap

Additional information on PEPRA can be found at the Official California Legislative Information website: http://www.leginfo.ca.gov/.

For questions, please contact Katano Kasaine, Treasurer, at (510) 238-2989.

Respectfully submitted,

/s/

KATANO KASAINE
Treasurer