City of Sacramento
City Council

915 I Street, Sacramento, CA, 95814
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Meeting Date: **1/8/2013**

Report Type: Staff/Discussion

Title: City of Sacramento Long-Term Liabilities Report and Presentation

Report ID: 2013-00021

Location: Citywide

Recommendation: Receive and file.

Contact: Russell Fehr, City Treasurer, (916) 808-5832, Office of the City Treasurer

Presenter: Russell Fehr, City Treasurer, Office of the City Treasurer, (916) 808-5832

Department: City Treasurer
Division: City Treasurer
Dept ID: 05001011

Attachments:

1-Description/Analysis
2-Background Report Regarding the Long-Term Financial Liabilities of the City
3-Presentation to the City Council

City Attorney Review
Approved as to Form
Grace Arupo
1/3/2013 8:54:16 AM

City Treasurer Review
Reviewed for Impact on Cash and Debt
Russell Fehr
1/2/2013 11:55:01 AM

Approvals/Acknowledgements

Department Director or Designee: Russell Fehr - 1/3/2013 8:46:37 AM

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Description/Analysis

Issue: The City has nearly $2 billion in long-term financial liabilities. These liabilities have not previously been presented to the City Council as a unit. Long-term financial issues and trends are being integrated into the on-going budget and financial planning process.

Policy Considerations: Long-term financial information will be integrated into the development of City fiscal policies where appropriate.

Economic Impacts: None

Environmental Considerations: None

Sustainability: Development long-term sustainable budgets requires consideration of long-term financial issues and trends

Commission/Committee Action: None

Rationale for Recommendation: The information presented will be further used in financial planning and the budget process

Financial Considerations: The long-term liabilities which are the subject of this report and presentation are financial obligation of the City which must be paid, with interest, over the next 30 years. The nature of these liabilities, trends in their reduction or growth, and other issues association with those liabilities constitute critical information necessary for the sound financial management of the City

Emerging Small Business Development (ESBD): Not applicable

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Background

The Long-Term Financial Liabilities

of the City of Sacramento

Russell Fehr
City Treasurer

Along with the severe short-term fiscal challenges brought on by the deep and prolonged recession, the City also faces long-term financial issues. In developing the immediate and shorter term budgetary plans it is important also consider and plan for the long-term financial issues.

This is a report and a presentation regarding long-term financial liabilities of the City of Sacramento. Specifically, the report and presentation focus on those long-term liabilities which will be paid from future revenues, also referred to as “unfunded liabilities.”

These long-term liabilities for which the City has not currently set aside funding total nearly $2 billion. In the standard summary financial presentations of the Annual Budget and Annual Financial Report (CAFR) the long-term liabilities are not presented together as a unit; they are, rather, found scattered in the presentation. The City Manager requested the City Treasurer prepare the report and presentation focusing on the long-term liabilities of the City. The goals of this report are:

1. Present the different types and values of long-term liabilities together;
2. Identify trends; and
3. Discuss prominent policy issues.

Long-term liabilities

A long-term liability is a financial obligation arising from past events or transactions and payable more than one year in the future. This can take the form of future payments to individuals or organizations, the future provision of services, or future transfer of assets. Examples of City of Sacramento long-term liabilities include outstanding principal debt balances, future costs of remediation of toxics at city land fill sites, and future pension payments to retirees and current employees. A critical point is that though the payments are made or service rendered in the future, the obligations for which those payments are made have been incurred in the past up to the immediate present. The current level of long-term liabilities does not include any obligation incurred in the future.

The City of Sacramento has currently unfunded long-term liabilities in excess of $1.9 billion. The major categories of unfunded long-term liabilities include debt, post-retirement benefits, and other future costs. The follow table gives the values of the City’s unfunded long-term liabilities:

City of Sacramento Long-Term Liabilities

Liability	Value
Debt	$ 823 million
Benefits	$ 950 million
Other Future Costs	$ 167 million
Total	$ 1,940 million

Funding Long-Term Liabilities

Long-term liabilities, by their very nature, are paid in the future. Depending upon the type of liability and discretionary decisions made by financial entity (the City), long-term liabilities are funded in different ways. There are two broad categories: (1) payment of the long-term liabilities out of future budgets with future revenues; and (2) setting aside funds at the time the long-term liabilities are being incurred. The first method is typically used to pay debt, and the second is used to fund and pay employee benefits. These two categories, however, are not mutually exclusive.

An example of the future payment category is debt and debt service. A long-term liability is established when bonds are issued and funds are borrowed. The long-term liability is the value of the outstanding principal on the debt. The payments of principal and interest over time are included in annual budgets. The debt service payments are funded with revenues collected the future. This payment in the future is the plan when the funds are borrowed.

An example of setting aside funds while liabilities are being incurred is the actuarial funding of pensions. In theory, an employee and the employer would annually contribute sufficient funds into a pension plan so that those funds plus future investment income on those funds would be sufficient to make pension payments to the employee after retirement.

Again, the two general methods are not mutually exclusive. Funds to make future debt service payments may be set aside early and invested so that investment income would be available to make future debt service payments. Conversely, some employee benefit programs which could be funded on an actuarial set aside basis are not. Payments are made out of future budgets funded with future revenues.

The City of Sacramento funding of its long-term liabilities is discussed in detail in this report. The reality is that the City will have to pay down these long-term liabilities

DEBT

The City borrows funds for capital projects and other capital needs such as acquiring land, building and restoring facilities, and acquiring equipment. The long-term liability for debt is the outstanding principal balance of the debt. Even though interest payments will also be made in the future, the value of those interest payments is not included in the long-term liability.

The City's debt is in three forms:

1. Bonded debt -- A security issued (sold) by the City paying principal and interest at regular intervals over time in exchange for up front funding. Bonds are negotiable, being traded on secondary markets
2. Leases -- Short term borrowing used for equipment. The equipment is leased over a fixed period. At the end of the lease the City typically owns the equipment. Leases typically have a term of five years or less.
3. Loans -- Funds borrowed from other governmental entities or financial institutions. Payment of principal and interest is specified in the terms of the loan.
4. Swap – This is associated with the Kings loan and associated debt issue. If the loan is prepaid, then the interest rate swap in place must be paid off. The June 30, 2012 value was $ 14 million. This would be an obligation of the team.

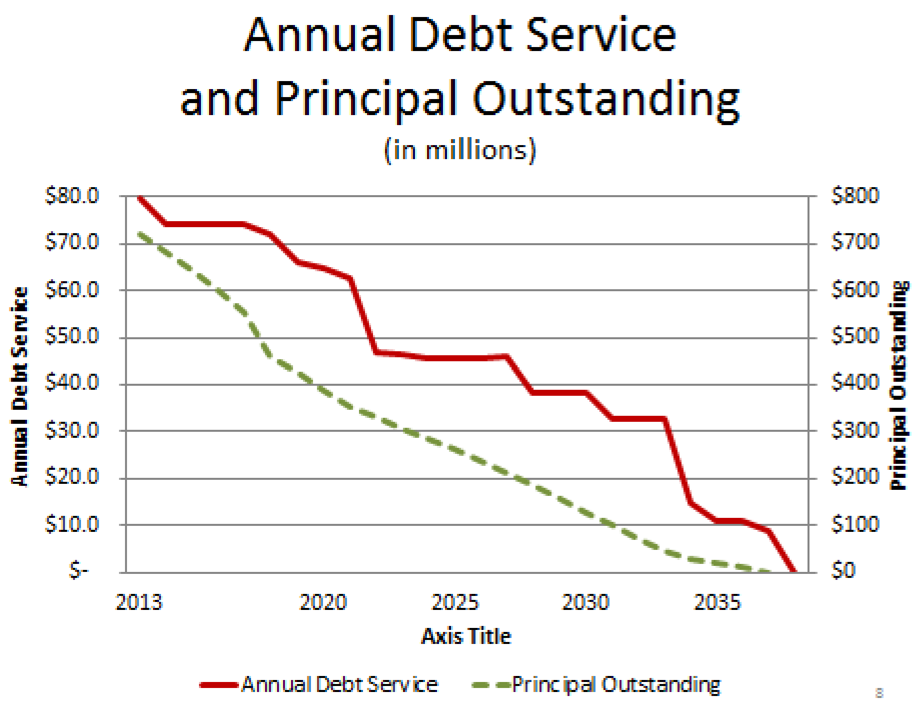
The outstanding leases are through banks or specialized lease providers. The outstanding loans are with state agencies.

The following graph illustrates the levels of outstanding City debt. The total debt was approximately $823 million as of June 30, 2012.

The total City debt not does include the debt of the former redevelopment agencies for which the City elected to become the successor agency. This debt is paid from a dedicated property tax allocation and is not a liability of the City.

Reduction of Long-Term Liabilities

The annual debt service payments made on City debt issues, the loans, and the equipment leases included principal and interest components. The long-term liabilities are reduced as the payments are made. If the City were to borrow no new funds, then all debt would be paid off by 2035 with the final payments on the 2006 debt issue. Current leases will be paid off in five years. The reduction in debt service payments does not exactly match the reduction in the long-term liabilities. Budgetary reduction comes when debt issues and individual loans or leases are paid off. The reduction of principal and debt service is illustrated in the following graph.



Shift of Debt Burden Away From General Fund

All of the outstanding City bond issues are in the form of lease revenue bonds, where the City has entered into a long term lease relationship with debt service taking the form of lease payments. Debt security is City owned land and facilities. All the outstanding bond issues are directly or indirectly backed by the General Fund.

With the changes since 2008, this type of financing is not favored by investors. While there have been very few actual debt defaults, there is a concern that the security is weak and that the commitment to make payments is weakening. Though municipal facilities are pledged as security, investors believe that many facilities have no real market value. While there may be buyers for parking garages and office buildings, there may not be buyers for parks, theaters, community centers, libraries, even water plants.

In this context, the City's plans to issue debt mesh well with market changes. The City plans to issue revenue bonds for water and wastewater infrastructure. Security for the debt is the revenue stream and not the facilities financed. Debt in this form and for essential infrastructure projects is favored in the financial markets meaning the City would pay lower interest rates.

OTHER FUTURE COSTS

There are a series of there future costs classified as long-term liabilities which are neither debt nor employee benefits. The long-term liabilities in this general category total $167 million. These include:

1. Landfill Post-Closure Costs ($23 million) – there are long-term costs associated with the closed city refuse disposals sites. A long-term liability is recorded while the actual costs are paid year to year.
2. Risk Claims ($59 million) – Claims are paid by the City in the future for events which have already happened. Long-term liabilities are estimated and recorded. Reserves have been established to fund future claims payments
3. Development Impact Fee Credits ($43 million) – A long-term liability is recorded with the credit is granted.

Funding of these separate liabilities is mixed.   Costs associated with the closed landfill sites are funded from the solid waste fund, and some reserves have been established. For liability claims, departments are assessed in the budget process, and reserves are established in the City Liability Fund. These reserves appear to be sufficient to meet known and anticipated claims over the next several years.

POST EMPLOYMENT BENEFITS

The City has $950 million in unfunded long-term liabilities for post-employment benefits to be paid to those who worked for the City and their survivors. These benefits included pensions, the retiree medical benefit, and payoff of leave balances upon retirement. In very round numbers, and expressed in an actuarial basis, the long-term liability for these benefits is approximately $3 billion but only $2 billion has been set aside to fund those benefits. In actuarial terms the retiree medical benefit is unfunded.   The following table summarizes the funding status of the long-term benefit liabilities.

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Actuarial Liabilities and Assets

Plan	Actuarial Liabilities	Actuarial Assets	Unfunded Liability	Funding Ratio
PERS Safety	$1,249 m	$1,035 m	$214 m	83 %
PERS Misc	$819 m	$660 m	$160 m	81 %
SCERS	$389 m	$294 m	$95 m	76 %
Retiree Medical	$440 m	$0 m	$440 m	0 %
Comp Absences	$41 m	$0 m	$41 m	0%
Total	$2,938 m	$1,989 m	$950 m	68 %

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Funds are currently set aside only for the pension plans. The retiree medical benefit is funded on a current basis; payments are made to retirees out of the annual budget. The compensated absences are recorded as liabilities, yet are paid out every year as employees retiree. If a reserve were established, funds would be placed in the reserve and withdrawn every year. The financial gain to the City would be a higher cash balance.

The Pension Plans

City employees and retirees participate in one of three pension plans:

1. PERS Safety – Members of this plan receive the higher, and more costly, safety retirement benefit.
2. PERS Miscellaneous – Members of this plan receive a lower, and less costly, benefit.
3. SCERS – This was the pension plan for city employees until 1978 when the City entered CalPERS. All employees hired after this date became members on a PERS plan. During the 1980s, active safety members of SCERS migrated to the PERS safety plan funded with a transfer of assets. SCERS provides both a safety and miscellaneous benefit.

Normal Costs and Unfunded Liabilities

Payment to the pension plans are in two types. Payments according to the actuarial assumptions are normal costs. These, in effect, keep the pension plans current. The normal costs are shared by the City and most employees. An employee share is calculated. Payments against any unfunded liabilities are made by the City only.

Unfunded Liabilities

The pension plans have a collective unfunded long-term liability of $469 million, and the unfunded long-term liabilities have grown significantly in recent years:

Valuation Date **June 30th**	**PERS Safety**	**PERS Misc**	**SCERS**	**Total**
2005	$93 m	$71 m	($3 m)	$161 m
2006	$121 m	$89 m	$30 m	$240 m
2007	$118 m	$92 m	$30 m	$240 m
2008	$140 m	$107 m	$32 m	$279 m
2009	$189 m	$140 m	$84 m	$413 m
2010	$196 m	$144 m	$98 m	$438 m
2011	$214 m	$160 m	$100 m	$474 m
			$95 m	$469 m
Dollar Change	$121 m	$89 m	$98 M	$308 m

Since the conclusion of the 2004-05 Fiscal Year, the unfunded long-term liabilities in the pension plans have grown by $308 million, from $161 million to $469 million. This is a debt the City, as the employer, owes to the three pension plans. And like the bonded debt, these long-term liabilities are payable with interest at the pension plan discount rate.

Why There Are Unfunded Liabilities

The obvious reason for unfunded liabilities would be the weak performance of investment markets in recent years. There are actually four fundamental reasons for unfunded liabilities in the pension plans:

1. In half the years since 2000 investment returns have fallen below assumptions. The aggregate return in the period is below the assumption. The result in 2008/09 was particularly bad. As a point of reference, the S&P 500 stock index is still below 2000 levels.
2. There has been a recognition that people live longer after retirement. This increases the long-term benefit payment assumptions
3. Both PERS and SCERS had employer contribution "holidays," depriving the funds of assets.
4. Employee benefit levels were enhanced without an increase in assets or contributions.

Financial markets have been volatile in the past decade, after a decade of steady growth. The PERS pension plan investment income has failed to meet the target level in 6 of past 12 years due to these market conditions. In four years the plans actually experienced net asset losses; in two years the gain was less than the discount rate.

There have been significant adjustments to retiree longevity assumptions which have resulted in increases to both normal costs and unfunded liabilities. The pension payments out to retirees have turned out to be made over a longer period than previously assumed. This results in a unfunded liability for retirees and for active employees and an increase in normal costs prospectively.

The impact of the investment performance in the past decade has been made worse by prior use of "surplus" funding contrary to sound actuarial and long-term budgetary practice. Pension plan trustees actively advocated for these actions. There were "rate holidays", or years where the City did not contribute to the pension plans or contributed less than the normal cost. This deprived the pension plans of assets. There were also enhancements to the pension benefits for active employees and retirees without any increase in assets or in rates. Plan trustees lost their way and rather than protecting the integrity of the pension plans fell for arguments that plan assets were available for the use by employers and employees.

PERS Rates

Payments to the two active PERS pension plans are determined by applying rates to salary. The rates are broken into components are shown in the following table giving the rates to be used for the Fiscal Year 2013/14:

Office of the City Treasurer

Components of PERS Rates FY 2013/14

Rate Component	Safety Plan	Miscellaneous Plan
City Normal	17.324 %	7.676 %
Employee Normal	9.000 %	7.000 %
Total Normal Cost	**26.324 %**	**** 14.496 %**
City Unfunded Liability Cost	12.133 %	6.487 %
Total Rate	**38.457 %**	**20.983 %**
Total Employee Share	9.000%	7.000 %
Total City Share	29.457 %	14.163 %

** Actuarial total from PERS study

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For both the PERS Safety and Miscellaneous Pension Plans, nearly one-third of the of the total pension rates go to paying down the unfunded liabilities. The employer rate to pay off the unfunded liability in the Safety Plan is over 12 % of salaries. The employer rate for unfunded liabilities for the Miscellaneous Plan is approximately 6.5 % of salary.

The pension rates have grown significantly in recent years as the unfunded liabilities have grown. City rates have increased significantly since Fiscal Year 2008/09 as is illustrated in the following two table how a history of the Safety and Miscellaneous Rates. Fiscal Year 2008/09 was when the City began making budget and staffing reductions in the General Fund. There also has been a significant overall decline in tax revenue in the period represented in the tables.

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Recent History of Safety Rate

Fiscal Year	Normal Rate	Unfunde55d Rate	Total Rate
2008/2009	24.794 %	7.601 %	32.395 %
2009/2010	24.813 %	6.771 %	31.584 %
2010/2011	24.829 %	7.358 %	32.187 %
2011/2012	24.861 %	10.669 %	36.530 %
2012/2013	25.933 %	10.848 %	36.781 %
2013/2014	26.324 %	12.133 %	38.457 %
6 Year Rate Change	1.530 %	4.532 %	6.062 %
6 Year % Change	5 %	60 %	19 %

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Recent History of Miscellaneous Rate

Fiscal Year	Normal Rate	Unfunded Rate	Total Rate
2008/2009	14.792 %	3.660 %	18.452 %
2009/2010	14.740 %	3.302 %	18.042 %
2010/2011	14.767 %	3.780 %	18.547 %
2011/2012	14.337 %	5.142 %	19.479 %
2012/2013	14.253 %	5.411 %	19.664 %
2013/2014	14.496 %	6.487 %	20.983 %
6 Year Rate Change	(0.296%)	2.827%	2.531 %
6 Year % Change	(2%)	77 %	14%

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The Safety rate has increased by 6 percent. The unfunded portion of the rate has grown by 4.5 percent of salary. All the growth in the Miscellaneous Rate is due to the unfunded portion.

The growth in pension rates has posed a budget challenge since Fiscal Year 2011/12. With no growth in revenue and no one-time funding available, in the General Fund, the increase in pension rates was financed by reduction of positions, including layoffs.

Future Pension Rates

City contribution rates will continue to increase for the next several years. PERS earned 1 percent in Fiscal Year 2011/12, well below the 7.5 percent discount rate, which will begin to be reflect in the 2014/15 rates. The very low interest rate environment continues. The impacts to the pension changes enacted last summer and effective at the start of this calendar year will take years to have impact.

There is a debate regarding the level of the discount rate, or long-term earnings assumption. Those advocating lowering the discount rate point to the failure to meet investment targets in half of the past 12 years and an increasingly volatile economy. Lowering the discount rate would increase unfunded liabilities and increase the need for contributions.

Retiree Medical Benefit

The City provides medical benefits to retired employees. Retirees have access to the group medical plans. In addition, retirees meeting certain service thresholds are eligible to receive monthly payments to offset medical insurance costs. One-half the benefit is earned after 10 years of service, and the full benefit is earned after 20 years of service. The benefit is pro-rated for retirees between 10 and 20 years of service.

This benefit is paid from the budget to retirees; it is not actuarially funded. Even though the benefit is funded on this pay-as-you-go basis, financial standards require the City to account for the benefit as if it were actuarially funded. This results in an unfunded liability currently of $440 million and which has grown by $60 million since Fiscal Year 2007/08. A portion of this liability is on the balance sheet; the remainder is a note.

The City has an actuarial study of the retiree medical benefit performed every other year; the last was completed during the current fiscal year. The following table sets forth how the benefit would be funded actuarially and changes since the 2007/08 study:

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Retiree Medical Plan
Calculated Actuarial Funding

	FY 2007/08	FY 2012/13	Change
Liability	**$380 m**	**$440 m**	**$60 m**
Payments			
Normal Cost	$16.4 m	$18.9 m	$2.5 m
Unfunded	$15.1 m	$23.9 m	$8.8 m
Total	$31.5 m	$42.8 m	$11.3 m
Rates			
Normal	6.1 %	7.2 %	0.9 %
Unfunded	5.7 %	9.1 %	3.6 %
Total	11.8 %	16.3 %	4.5 %

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Total payments into the trust fund in the current year would be $43 million with $19 million being the normal cost proactively funding the benefit for the remaining career of active employees and $24 million paying down the $440 million unfunded liability. Benefit payments would be made from the trust fund. In time, as the balance in the trust and investment income accumulated, then contributions would drop significantly.

This payment is far greater than the current $11 million under the pay-as-you-go method. In the short run the current method is less expensive. But under the current method benefit payments are always made from principal, never with investment income. In the longer run, the actuarial method of funding the benefit is less expensive due to investment income.

The practical problem is that it is clearly beyond the budgetary capacity of the City to absorb an increase to the budget of over $30 million, the difference from the current payment level to full actuarial funding.

Where the growing unfunded liability for the retiree medical benefit is an immediate problem for the City is in debt issuance, credit rating and investor evaluation. The credit rating agencies are taking note of the growing unfunded liability, but this has not been the immediate cause of a rating downgrade. The institutional investors who hold City bonds and are the potential purchasers of future City debt issues are also interested in the funding status of this benefit.

From long-term fiscal perspective, the status quo for the retiree medical benefit is not sustainable. Costs will grow, and the City's failure make a change the benefit will become a credit rating problem. Two not mutually exclusive options are suggested:

1. Alter the benefit
2. Establish a trust fund and begin to make contributions from employer and employees.

COMMENTS

Sound financial management and planning integrates the short-term, immediate needs with a long-term perspective. The City Manager has asked that this information be brought forward at the start of the Fiscal Year 2013/2014 budget process. This is an example of the sound fiscal management of the City. The short-term budget financial planning will consider that the General Fund has very little debt capacity, that financial markets are changing, that pension rates continue to rise, and that the retiree medical benefit presents a financial challenge. Difficult issues will be addressed rather than deferred or ignored.

The payment of long-term liabilities is by definition long-term. Payment of liabilities incurred in the past and the present will be passed off to the next generation, to future residents of the City. This poses the policy issue and concern of inter-generational equity. People pay taxes and fees in return for services and infrastructure. The City will soon issue water revenue bonds to be repaid over 30 years. The major project will be rehabilitation of the Sacramento River Water Treatment Plant. PERS is spreading 2008/09 investment losses over 30 years. In looking at inter-generational equity, the benefit to the future resident of clean, safe water from the Treatment Plant is clear; however, the benefit of paying on other liabilities is difficult to establish. Payments on some liabilities were purposely pushed into the future to avoid the impact of paying in the present. When better economic times return it would be appropriate to reconsider some of those decisions.

The Long-Term Liabilities of The City of Sacramento

Presentation to

Sacramento City Council

January 8, 2013

Long-Term Liabilities

- Financial obligations
  - Incurred in the past up to the present
  - Payable in the future
- Focus on long-term liabilities which will be paid from future revenues, **“unfunded”**
  - Payments involve contractual obligations
  - Impact future budgets, constraining future choices
- Inter-generational equity – Who pays?

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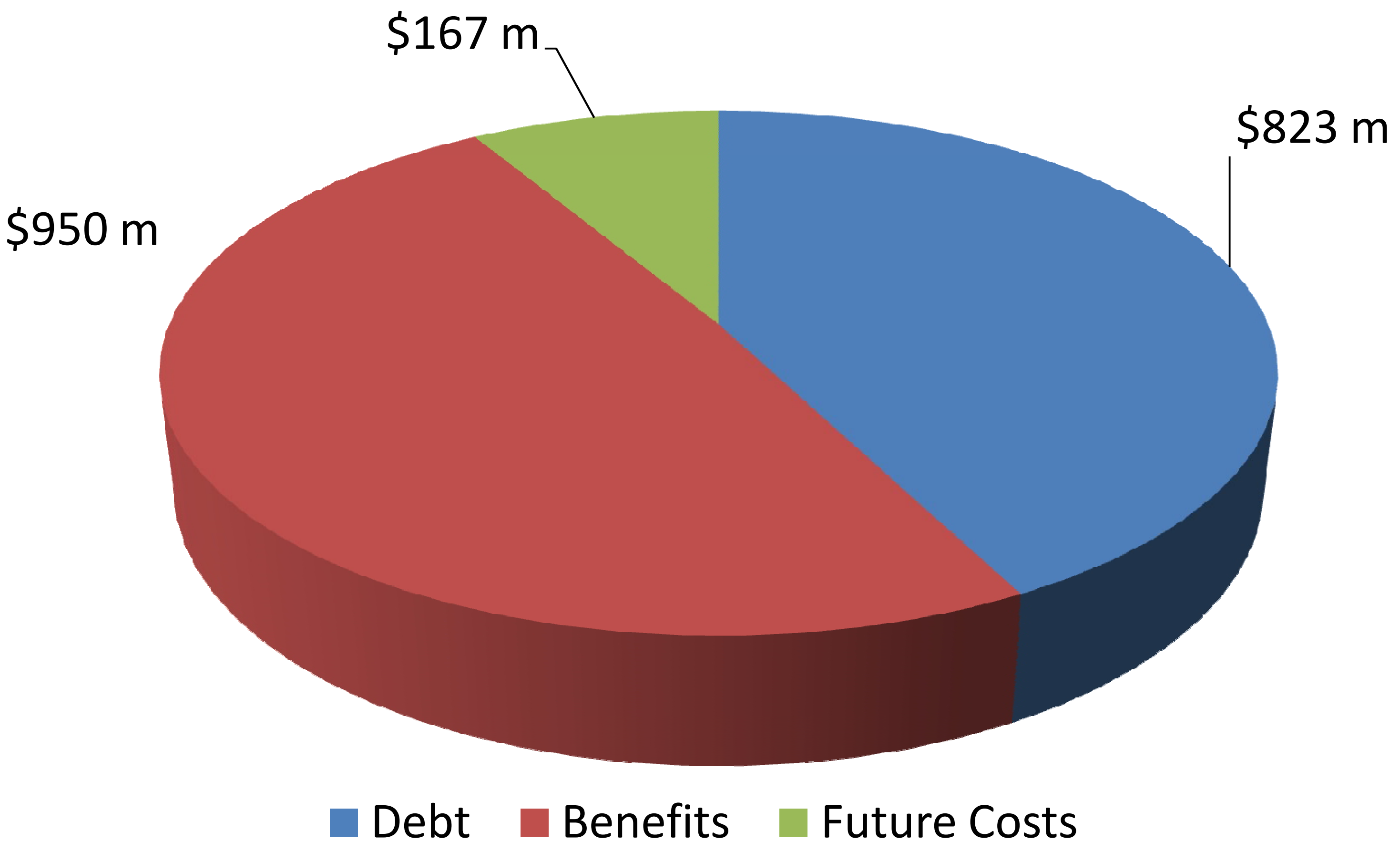
City Long-Term Liabilities
$1.94 Billion



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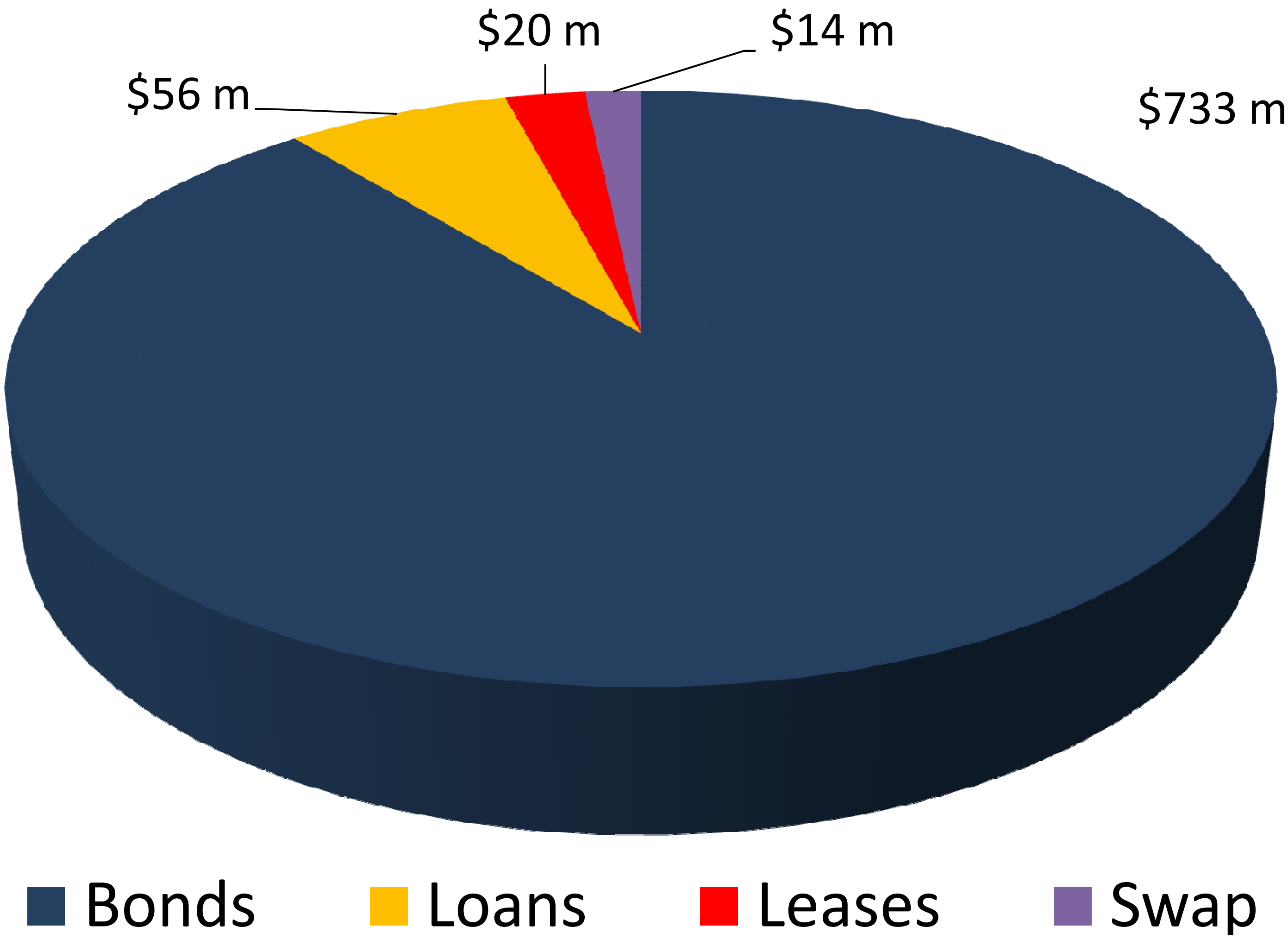
Debt

- City borrows money for capital needs
  - Land acquisition
  - Facility construction and rehabilitation
  - Equipment
- The cost of high value assets is spread out over time
- Liability equals the outstanding principal balance of debt
- Interest payments also made in the future

Types of City Debt

- Bonds
  - A security issued (sold) by the City paying principal and interest at regular intervals. Bonds are negotiable, being traded on secondary markets
- Leases
  - Short term borrowing for equipment. Equipment is leased over a fixed period. City owns equipment at end of lease
- Loans
  - Funds borrowed from other governmental entities or financial institutions. Payment of principal and interest is specified in the terms of the loan.

City Debt
$823 million



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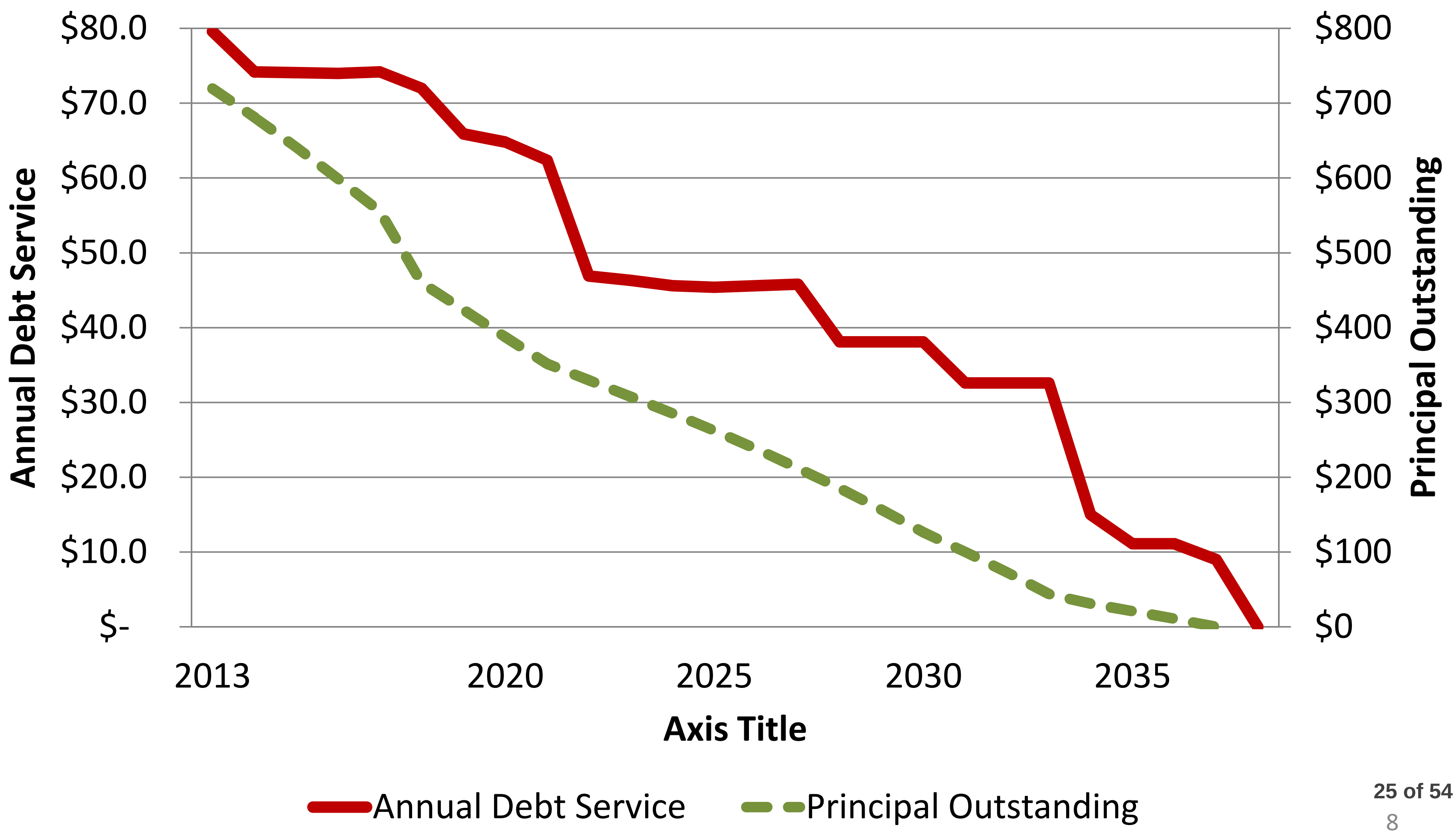
Debt Reduction

- Debt reduction & interest payments
  - Principal & interest payments on every debt issue every year reducing the long-term liability
    - $35 m in bond principal paid in FY 2011/12
    - $146 m in bond principal paid since FY 2007/08
    - Total payments, including interest, on $733 m in bonded debt principal will be $1.17 billion
  - Debt service reduction & budget reduction comes in steps when entire debt issues are paid off.
  - Some debt issues can be “called” or prepaid, others cannot

Annual Debt Service and Principal Outstanding

(in millions)



New Debt

- Water & Wastewater Revenue Bonds
  - Multi-year planning & public process by Utilities Department
  - Rate increases approved
  - Rated separately
- Community Center Theater
  - Report back requested
- Redevelopment replacement

Other Future Costs
$167 Million

- Landfill post-closure ($23 million)
  - Included in Solid Waste long-term planning
- Risk claims ($59 million)
  - Reserves established
- Development Impact Fee Credits ($43 million)

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Employee Benefits Post Retirement

- Employee benefits as long-term financial liabilities
  - Earned during a career
  - Payable in the future and over time, after retirement
  - May (should) be funded on an actuarial basis
- Benefits which are long-term liabilities
  - Pensions $469 million
  - Retiree medical benefit $440 million
  - Compensated absences $41 million

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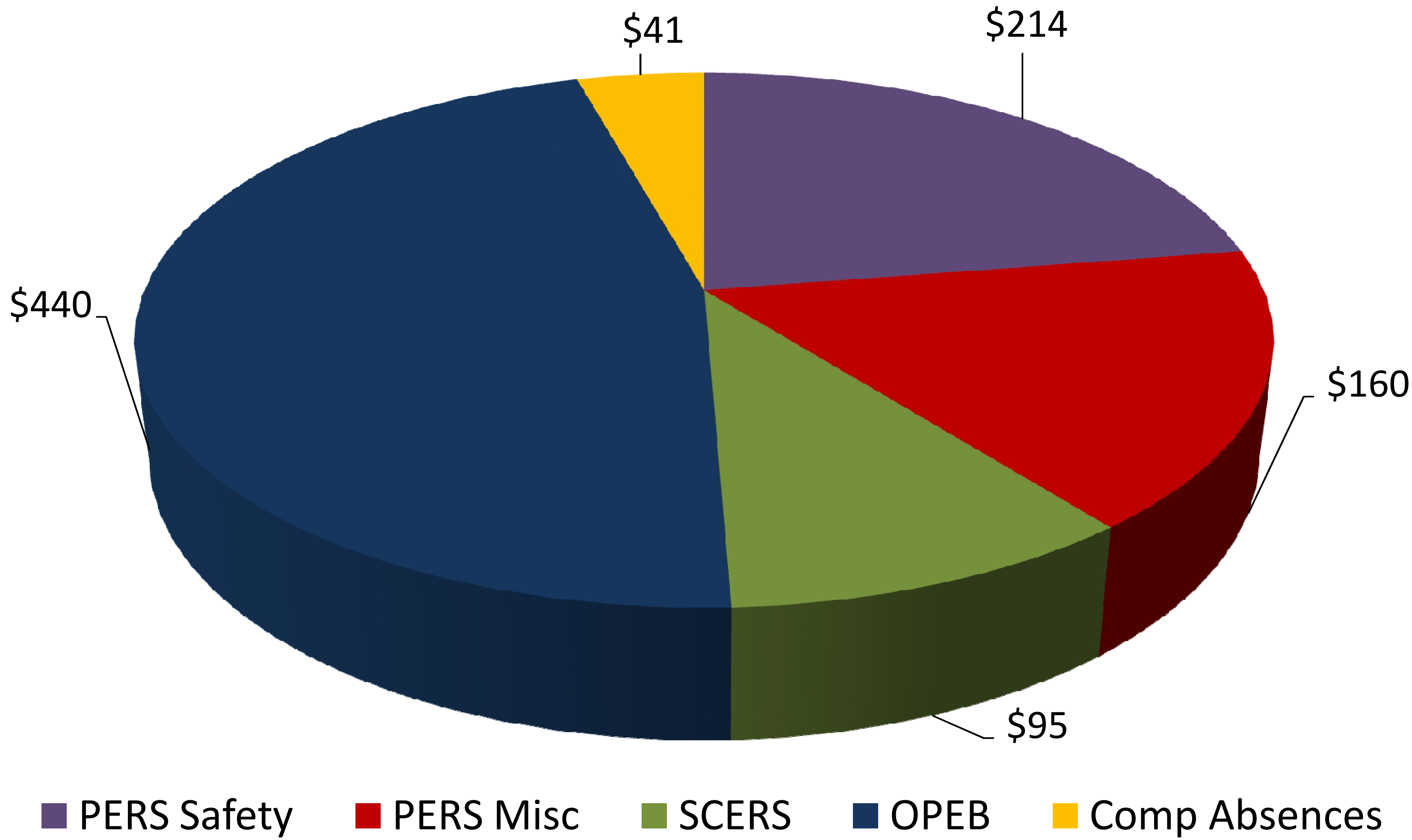
Benefit Unfunded Liabilities
$950 Million



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Actuarial Funding

- Accepted method for funding of pensions & retiree medical benefit
- Based on funding future cost of retirement benefit during the career of an employee, not after retirement
- At retirement, funds are available in a trust fund to make pension payments
- Alignment of long-term funding plan with long-term liability

Basis of Actuarial Funding

- Calculation of what must be set aside to make benefit payments through a combination of:
  - During career of employee
    - Contributions of employee
    - Contributions of City
  - Investment income on contributions
- Normal costs – current within assumptions
- Unfunded liability –debt to pension plan

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Components of PERS Rates FY 2013/14

Rate Component	Safety Plan	Miscellaneous Plan
City Normal	17.324 %	7.676 %
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Total Normal Cost	**26.324 %**	** **14.496 %**
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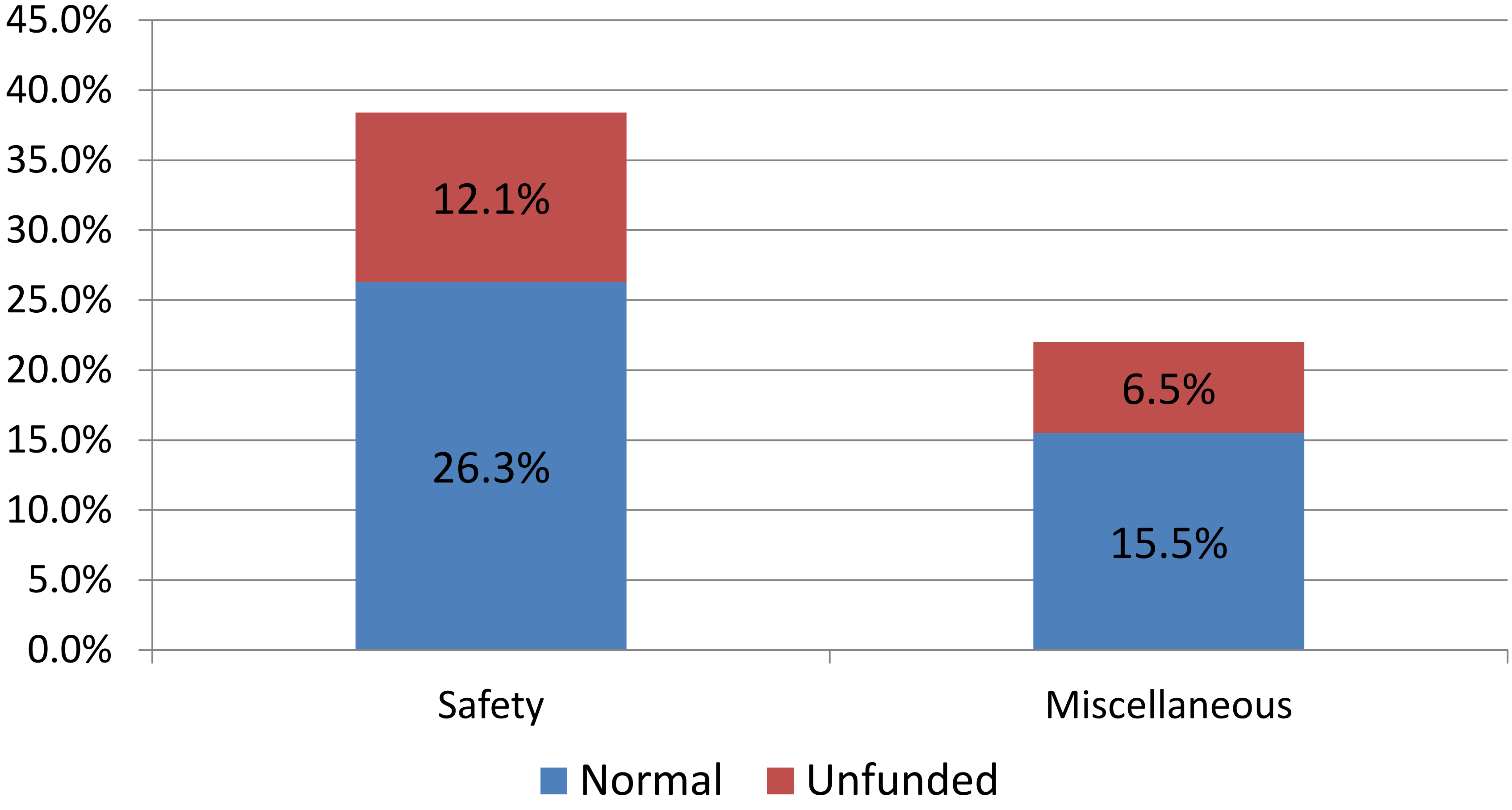
** Actuarial total from PERS study

2013/14 PERS RATES



Investment Income

- Investment income makes up the greatest share of pension payments to retirees
- The long-term investment return, or discount rate, is a **critical assumption**
- Small changes in the discount rate have significant impacts
  - Funding status of a retirement plan
  - Future contributions of City

City Risk

- Funds must be available to provide the defined benefit
- Long-term funding gaps may develop
  - Investment income falls short of assumed levels
  - Actuarial changes to long-term cost of benefit
  - Pension plan assets are used contrary to actuarial assumptions
- More funds are required. These funds come from increased City contributions

Unfunded Liability

- The actuarial determination of any gap between the funds needed & funds available
- Under actuarial funding plans, any unfunded liability must be paid down over time with interest at the discount rate
- Paying down the unfunded liability is the responsibility of the City
- **Unfunded liabilities moving from notes to balance sheet in CAFR**

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Actuarial Liabilities and Assets

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Reasons for Pension Plan Unfunded Liabilities

- Investment performance under discount rate since 2000 – 2008/09 far below assumptions
- Non-economic assumption changes -- longevity
- Use of investment earnings contrary to fundamental actuarial logic & financial responsibility
  - City contribution rate “holidays” – normal costs should have always been paid
  - Unfunded employee benefit enhancements
- Plan trustees lost sight of fiduciary responsibilities

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Growth in Unfunded Liabilities for Pension Plans

Valuation Date June 30th	PERS Safety	PERS Misc	SCERS	Total
2005	$93 m	$71 m	($3 m)	$161 m
2006	$121 m	$89 m	$30 m	$240 m
2007	$118 m	$92 m	$30 m	$240 m
2008	$140 m	$107 m	$32 m	$279 m
2009	$189 m	$140 m	$84 m	$413 m
2010	$196 m	$144 m	$98 m	$438 m
2011	$214 m	$160 m	$100 m	$474 m
2012			$95 m	$469 m
Dollar Change	$121 m	$89 m	$98 M	$308 m
Percent Change	130 %	125 %		191 %

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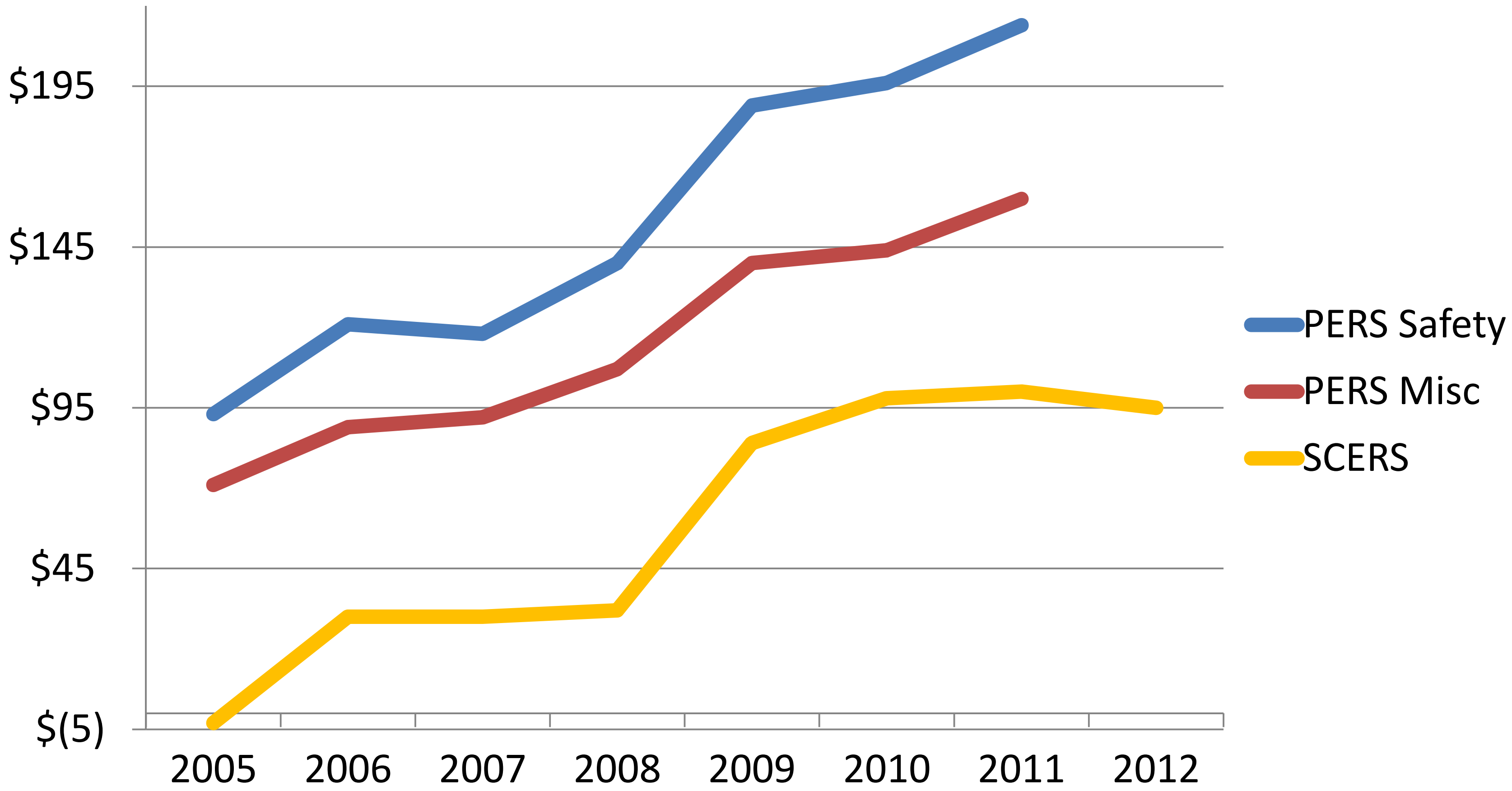
Pension Unfunded Liabilities

(in millions)



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Recent History of Safety Rate

Fiscal Year	Normal Rate	Unfunde55d Rate	Total Rate
2008/2009	24.794 %	7.601 %	32.395 %
2009/2010	24.813 %	6.771 %	31.584 %
2010/2011	24.829 %	7.358 %	32.187 %
2011/2012	24.861 %	10.669 %	36.530 %
2012/2013	25.933 %	10.848 %	36.781 %
2013/2014	26.324 %	12.133 %	38.457 %
6 Year Rate Change	1.530 %	4.532 %	6.062 %
6 Year % Change	5 %	60 %	19 %

Recent History of Miscellaneous Rate

Fiscal Year	Normal Rate	Unfunded Rate	Total Rate
2008/2009	14.792 %	3.660 %	18.452 %
2009/2010	14.740 %	3.302 %	18.042 %
2010/2011	14.767 %	3.780 %	18.547 %
2011/2012	14.337 %	5.142 %	19.479 %
2012/2013	14.253 %	5.411 %	19.664 %
2013/2014	14.496 %	6.487 %	20.983 %
6 Year Rate Change	(0.296%)	2.827%	2.531 %
6 Year % Change	(2%)	77 %	14%

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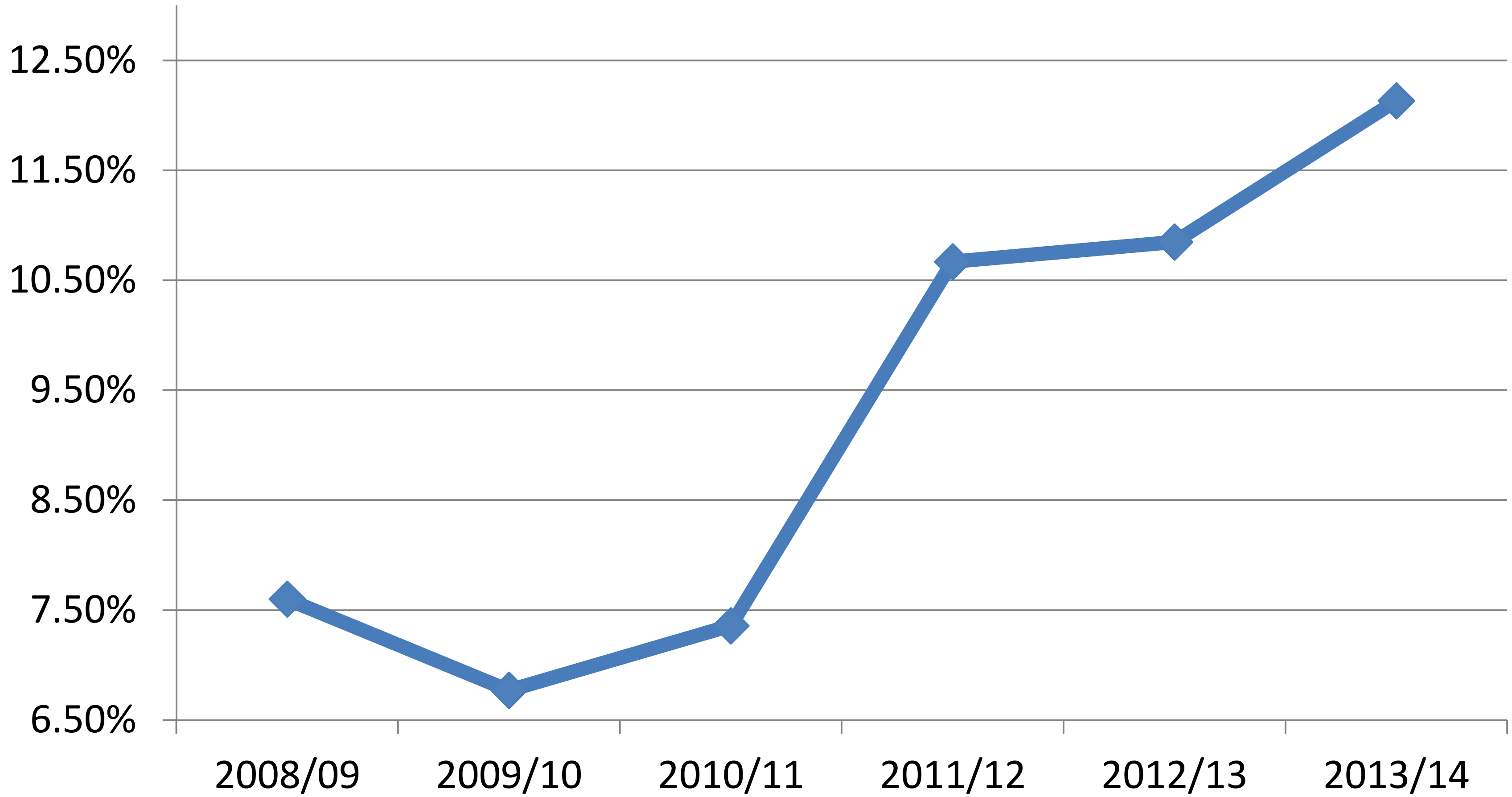
Safety Rate
Unfunded Liabilities



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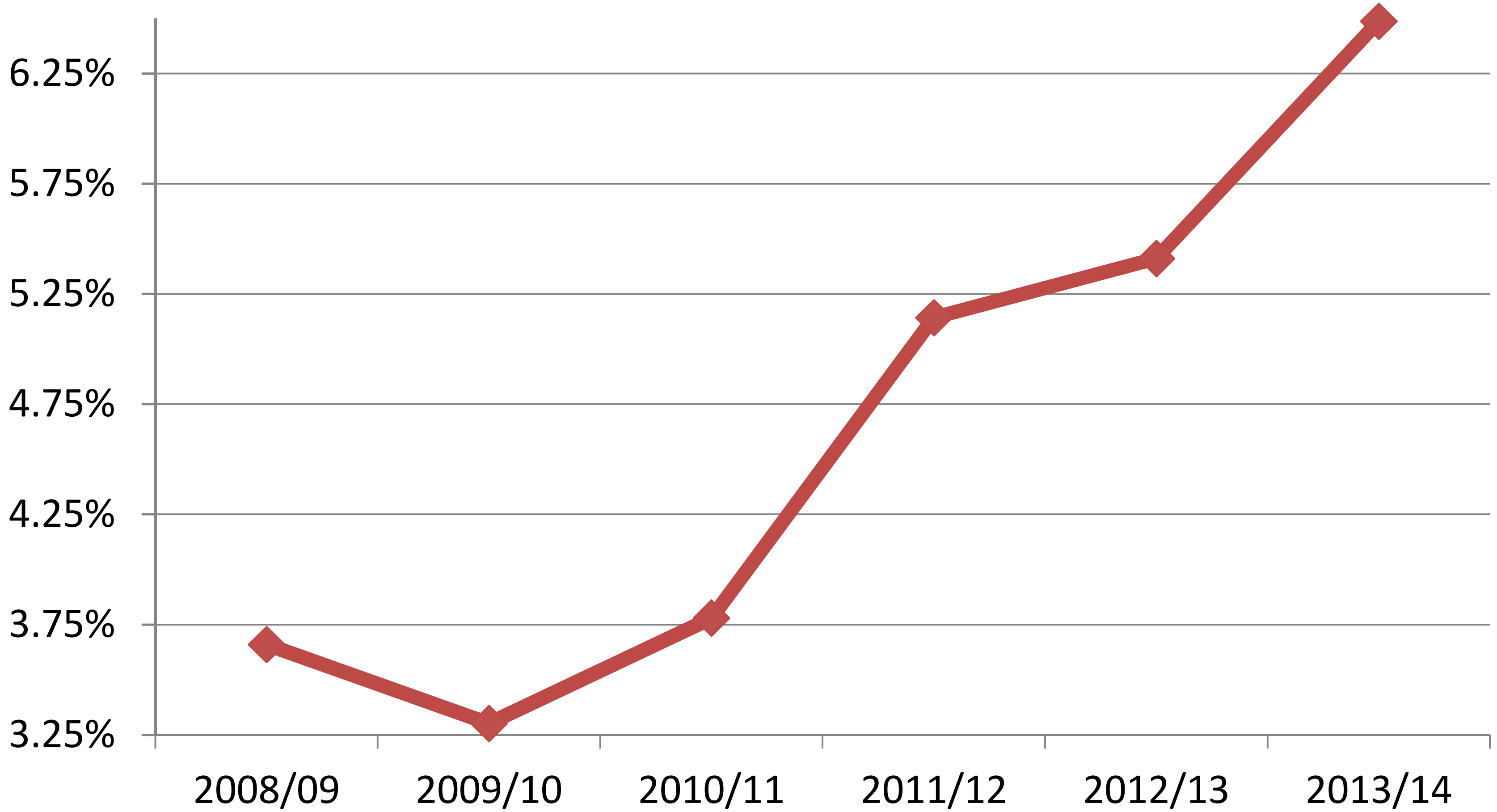
Miscellaneous Rate Unfunded Liabilities



Future Pension Costs

- City can expect continuing PERS rate increases for next several years
  - 1 % return in FY 2011/12
  - Unrealized losses
  - Low interest rate environment
- Discount rate assumption
- “Pension Reform” impacts decades out
- Proposed ballot measures

Retiree Medical Benefit

- The Retiree Medical benefit supplements pensions
  - Half benefit earned after 10 years of service
  - Full benefit earned after 20 years of service
- Retirees are in the same insurance pool as active employees
  - Non-Medicare retirees pay active rates rather than actual costs
  - Active employee & employer premiums subsidize retiree costs

Benefit Funding

- Pay as you go funding – annual payments to retirees from annual budget
- If the benefit were funded like a pension
  - $440 million trust fund
  - Significant portion of benefit payments would come from investment income
- Accounting standards require City to account for benefit as if it were actuarially funded creating a large unfunded liability

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Retiree Medical Plan Calculated Actuarial Funding

	FY 2007/08	FY 2012/13	Change
Liability	**$380 m**	**$440 m**	**$60 m**
Payments			
Normal Cost	$16.4 m	$18.9 m	$2.5 m
Unfunded	$15.1 m	$23.9 m	$8.8 m
Total	$31.5 m	$42.8 m	$11.3 m
Rates			
Normal	6.1 %	7.2 %	0.9 %
Unfunded	5.7 %	9.1 %	3.6 %
Total	11.8 %	16.3 %	4.5 %

Funding Retiree Medical

- $43 m per year to fund the benefit & pay down the unfunded liability is well beyond current capacity of City
- Growing liability becoming a credit rating & investor evaluation problem
- Payments all principal, no investment income
- In long run, status quo more expensive
- Impact of national healthcare changes not knowable at this point in time

Comments

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Debt

- Prudent use of debt in future
- General Fund debt capacity
  - General Fund debt service over 6% of revenue, high
  - Extensive borrowing 1999 – 2006 in era of significant revenue growth, revenue decline since 2006
  - No debt issue redemption until 2019
  - Limited addition capacity when revenues grow

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Debt

- Debt Changes
  - All outstanding City debt is in the form of General Fund back lease revenue bonds
  - Security is pool of City facilities
  - Falling is disfavor with investors. Municipal facilities have little market value
  - California bankruptcies
- Market favors revenue bonds
  - Security is revenue
  - Water & Wastewater debt City is planning to issue

Benefits

- Pension costs will rise over next several years
- Discount rate assumption
- Recent pension changes will not impact budget for over a decade
- Retiree medical status quo not sustainable long term
  - Liabilities will continue to grow, financially & reputationally
  - Establish a trust
  - Change the benefit

"Inter-Generational Equity"

- Issue of what liabilities are passed to future residents for payment
- Issue of association of benefit with payment
  - Residents receive services in return for taxes & fees
- Should future residents pay only if benefit is received ?
  - Future benefit from a rehabilitated & enhanced water treatment plant
  - Future residents may not perceive benefit from paying on other long-term liabilities