City Pension Program

UPDATED PROJECTIONS AND COST SAVINGS ALTERNATIVES

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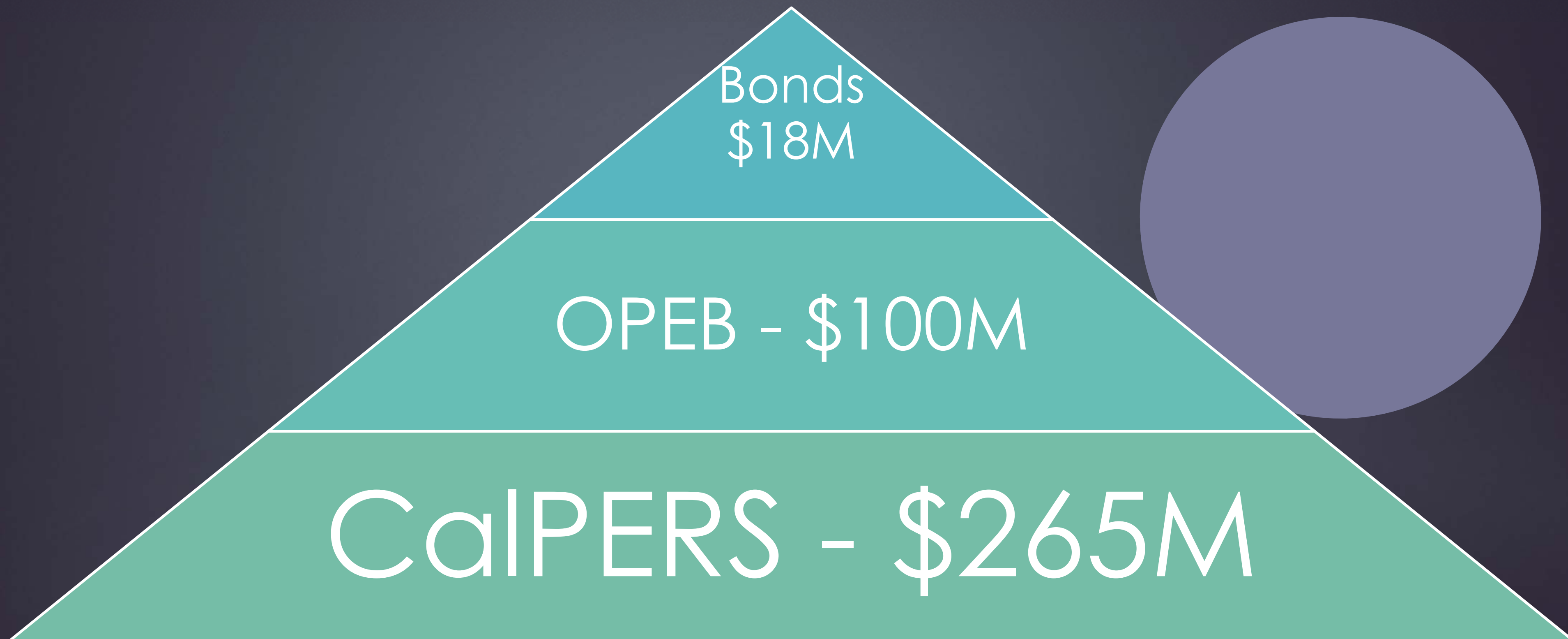
Primary General Fund Financial Liabilities



Safety OPEB - Overview

- 2011: Benefit Changes (Safety) – **0% Funded**
- 2012: OPEB Task Force created
- FY 2015/16 Safety Contracts (through December 2021)
  - City contributed $5.0M + $250K/year
  - Employees contributions go to 4%
- 2015 Budget Surplus $3.0M
- June 2017: OPEB/Pension Policy
  - One-half of each fiscal year's General Fund surplus over the 25% available fund balance shall be put towards Pension or OPEB
  - $100,000 minimum annual contribution

OPEB - Contributions

- September 2017: $10.6M current balance → **9.4% Funded**
  - $676K – Employee contributions
- Estimated $512,000 per year employee contributions

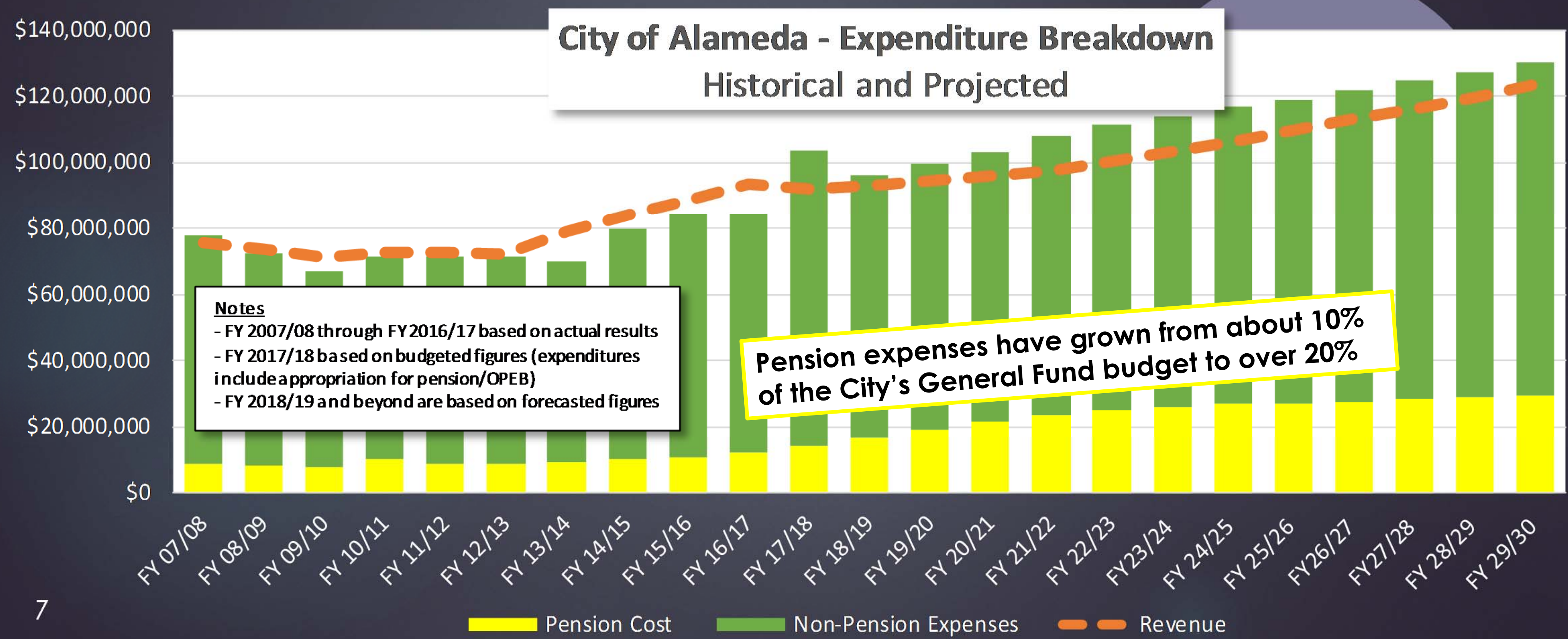
City of Alameda
PARS OPEB Trust Contributions Inception-to-9/30/2017

City Contributions (direct)	$	8,825,000
City Contributions (via payroll)		676,000
Investment Earnings, net of expenses		1,100,000
Total	$	10,601,000
OPEB Liability as of 1/1/2015	$	113,165,000
Funding status		9.4%

Background - Pension

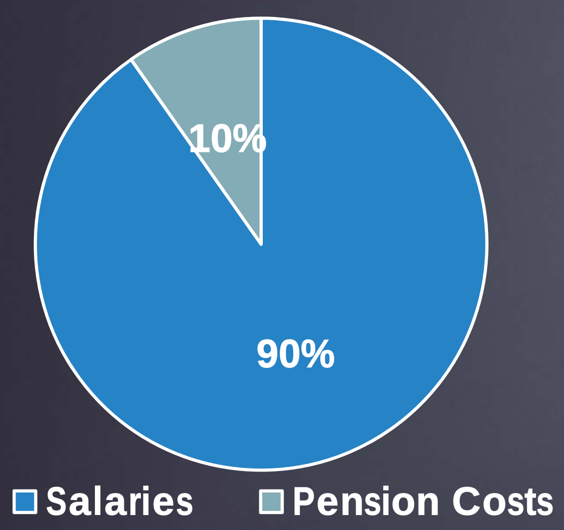
- May 17, 2017 – Budget Workshop, including CalPERS discussion by NHA Advisors
  - NHA provided historical cost trends, recent developments, and estimated projections
- What has happened since that time?
  - NHA refined initial cost estimates
    - Reduced Miscellaneous Plan expenses given that 50% covered by non-General Fund sources
    - Included increased employee share of Normal Cost (6% for Safety and 1.868% for Miscellaneous)
      - Note: Employees were given a raise to cover their increased pension costs
  - CalPERS released new actuarial reports in August 2017
    - Report confirmed Spring projections
- City faces increasing structural deficit and is taking proactive steps to develop solutions
- City has set aside $8M of existing reserves to apply towards pension liabilities
  - $3.0M from FY 2015 Budget surplus and $5.0M from FY 2016 & FY 2017 Budget surplus

Pension Expenditures Crowding Out Budget

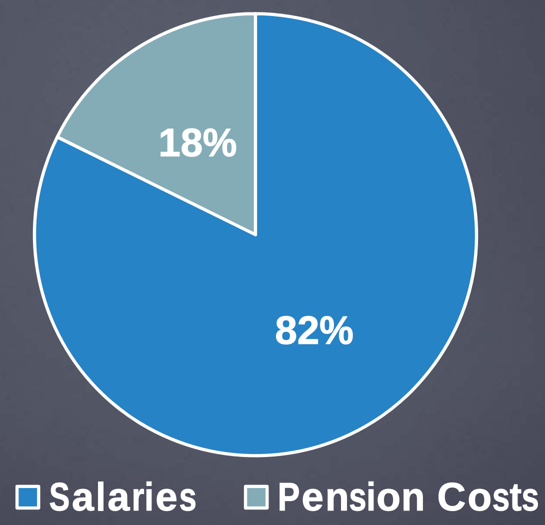


Pension Costs vs. Salaries – *Miscellaneous Plan*

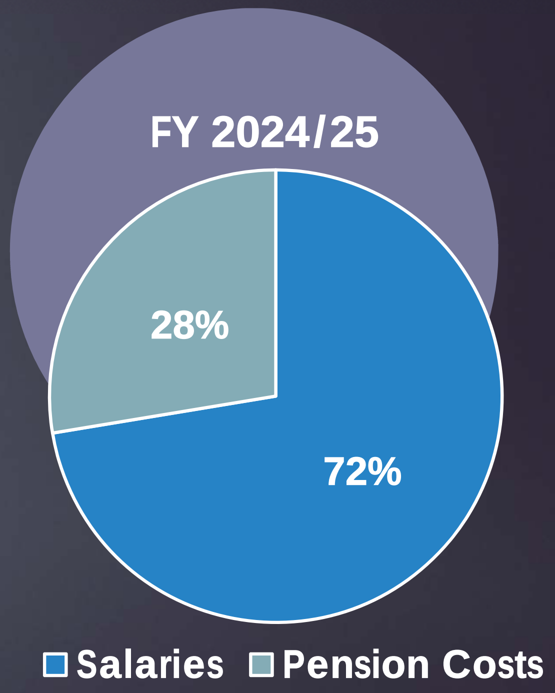
FY 2010/11



FY 2017/18

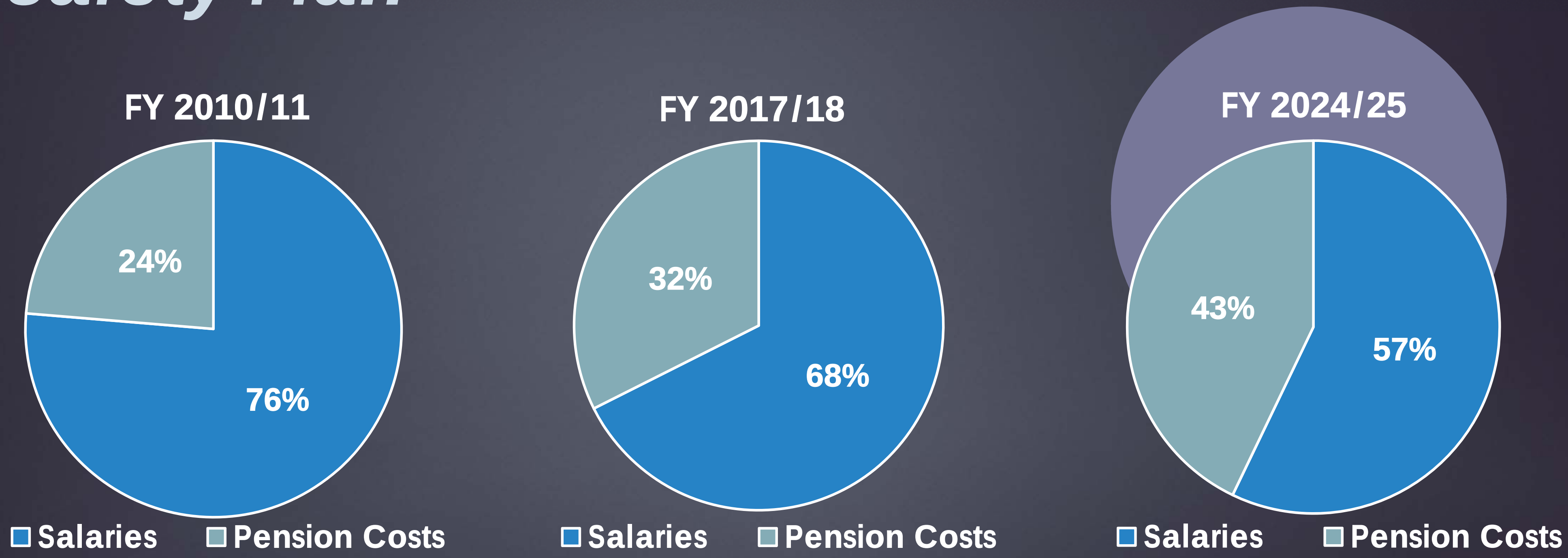


FY 2024/25



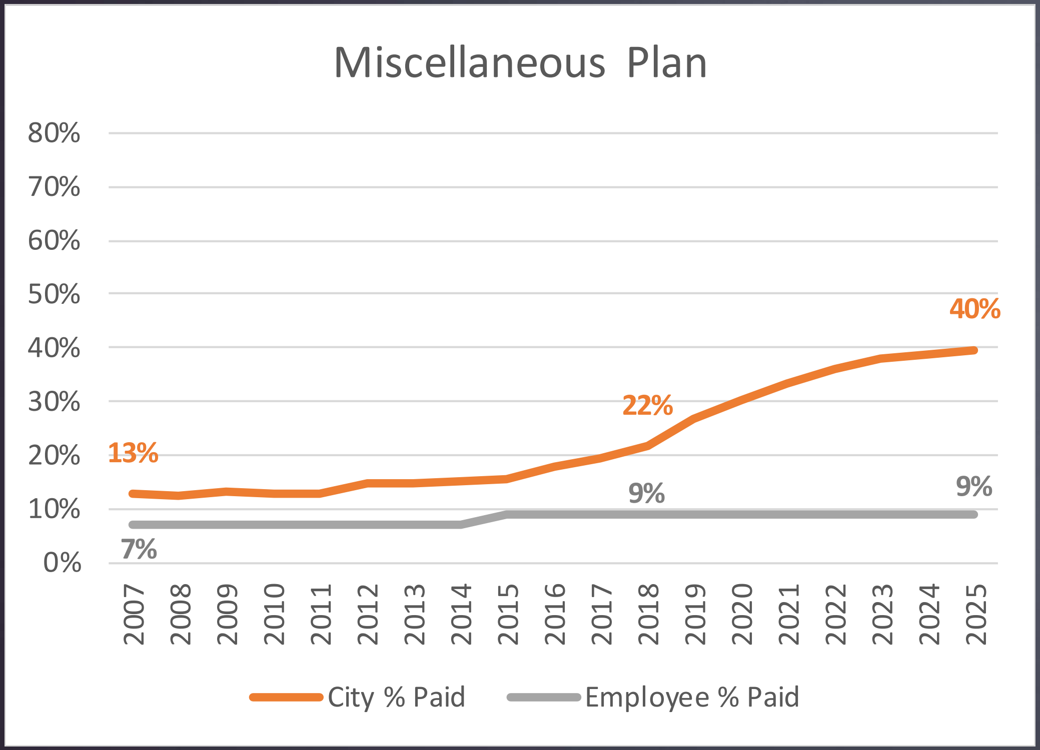
Pie charts reflect % of total combined payroll and pension costs

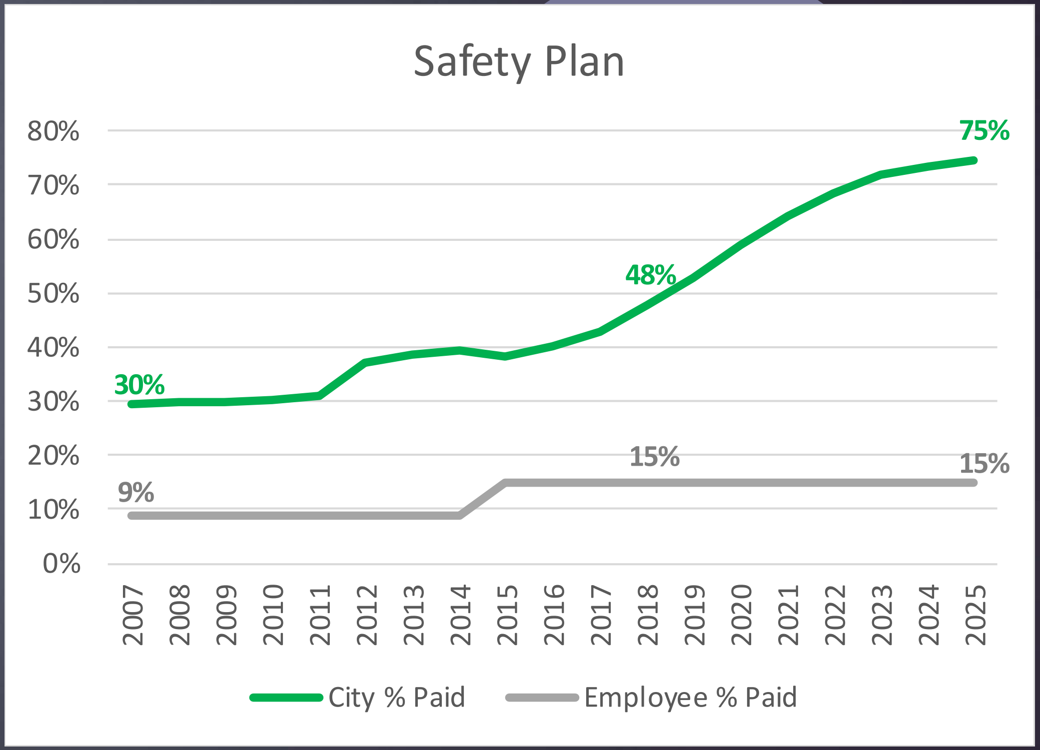
Pension Costs vs. Salaries – *Safety Plan*



Pie charts reflect % of total combined payroll and pension costs

Share (% payroll) of PERS Costs – *City vs. Employee*





Recent Developments - Update

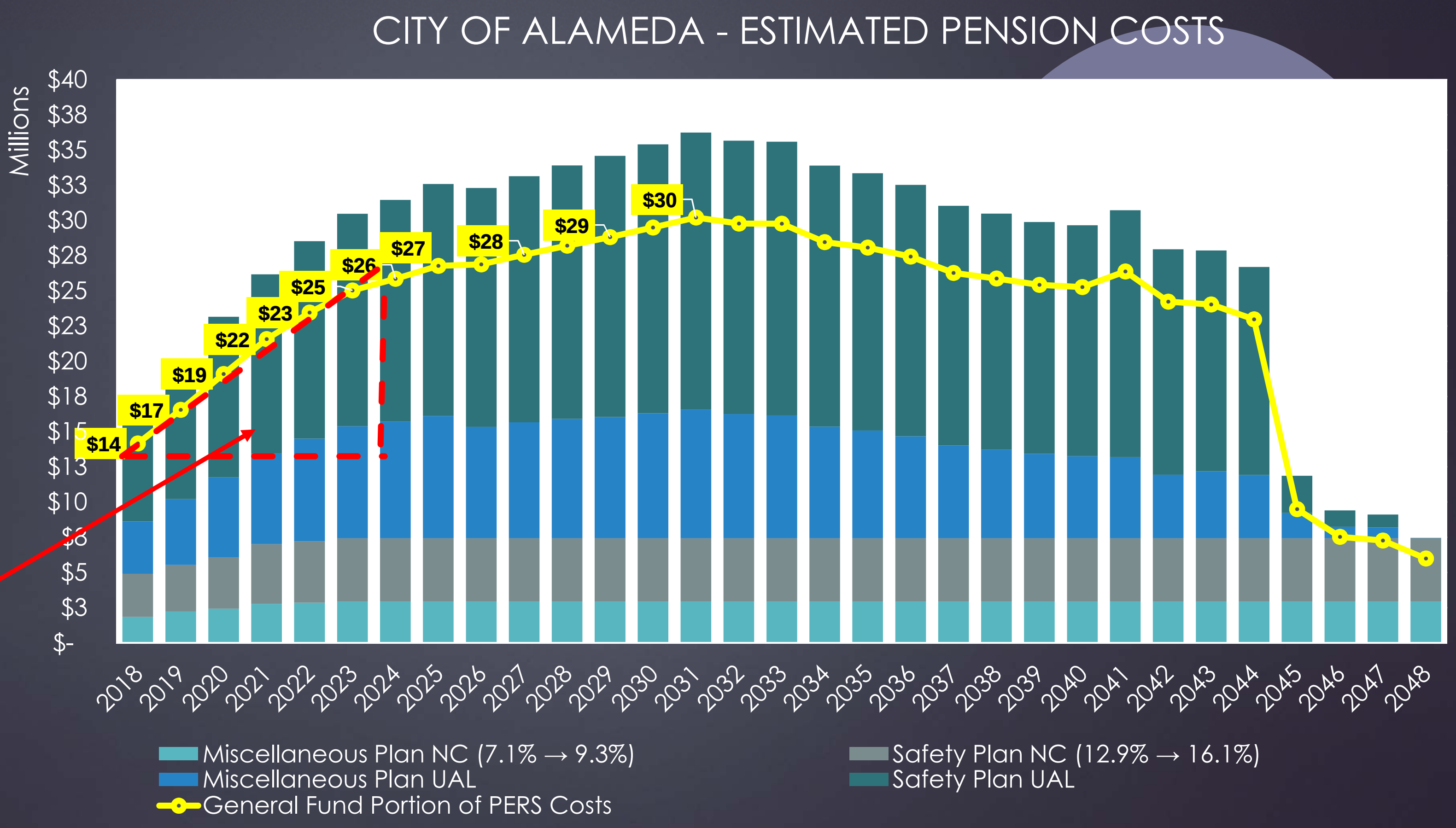
Historical PERS Returns
5-Year: 8.8%
10-Year: 4.4%
20-Year: 6.6%

- Recent Developments
  - CalPERS is reducing their expected returns (discount rate) to 7.0% (phased in over 3 years)
  - Actual CalPERS Returns Impacting Unfunded Accrued Liability (UAL)
    - 2015/16: **0.6%**
    - 2016/17: **11.2%**
- Based on latest CalPERS report, City's UAL increased to $265M (from $215M last year)
  - $84M for Miscellaneous and $181M for Safety
  - Funded Ratio decrease from last year: 77% → 71% (Miscellaneous) and 63% → 58% (Safety)
- NHA estimates that UAL will slightly increase (< 5%) again after Phase 2 and 3 discount rate reductions, and the 2016/17 returns of 11.2%, are implemented

Note: NHA Advisors, LLC is not a registered actuary and therefore all projections are "best estimates."

Estimated Annual Cost Projections

- Annual CalPERS contribution from General Fund increasing to $23M in 2021/22
- Projected annual increase to $30M by 2031
- **Over next five years (2019 thru 2023), the cumulative amount of cost increases above 2017/18 levels are $35M (for GF only)**



Proactive Steps to Address Rising Pension Costs

- Alameda Pension Reform - Increased employee contributions
  - Public Safety extra 6% (for total of 15%)
  - Miscellaneous extra 1.868% (for total of 8.868%)
- California Public Employees' Pension Reform Act of 2013 (PEPRA)
  - New employees pick up greater share of Normal Cost; should reduce Normal Costs over longer term
- Newly Adopted – Pension and OPEB Policy
  - Excess dollars from closed pension plans goes to Pension Liability
  - One-half of each fiscal year's General Fund surplus over the 25% available fund balance shall be put towards Pension or OPEB
  - $250,000 minimum annual contribution
- **$8M has been set aside from recent budget surpluses to contribute towards pension costs**

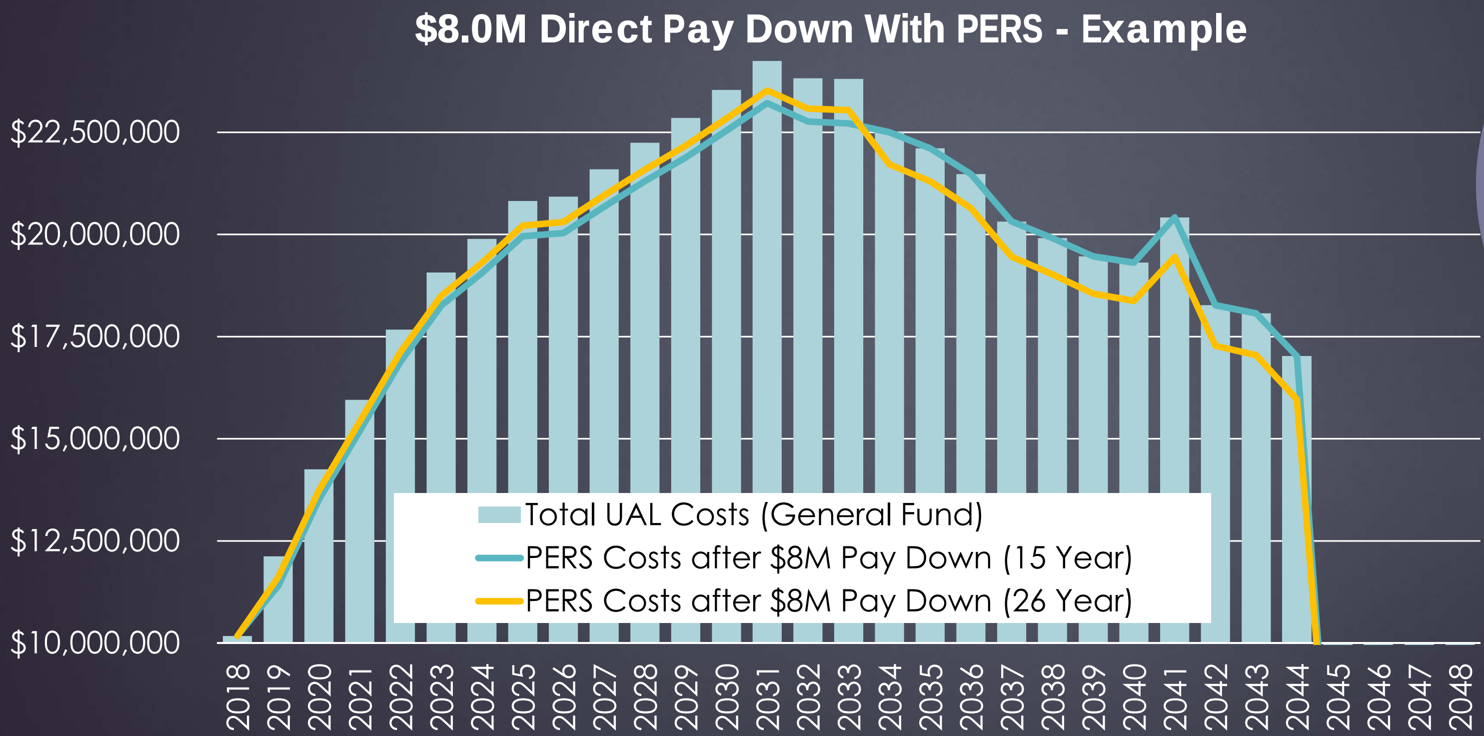
Primary Alternatives for $8M of Reserves

- Do Nothing - Continue to keep in low yielding, conservative and liquid investment to pay CalPERS bills over next few years
- Invest money more aggressively
  - **Option 1 – CalPERS Direct Pay Down** – Money is given to CalPERS and is credited against UAL, directly reducing liability and removing payments associated with that portion paid off (assumes earnings rate of 7.25%)
  - **Option 2 - Section 115 Trust** – Money is given to PARS/Highmark capital to invest
    - Does not directly reduce CalPERS UAL, but will serve as offsetting asset on City's balance sheet
    - Available to offset annual required contributions (ARC) and/or make additional contributions above what is required
    - 0.60% annual management fee
- Both options should increase investment return on committed reserve dollars

CalPERS Direct Pay-Down vs. Section 115 Trust

OPTION	Direct UAL Pay Down with CalPERS	Section 115 Trust
Reduced UAL with CalPERS	Yes	No
Reduced Pension Liability in CAFR	Yes	No (but will be off-setting asset on balance sheet)
Control of Investment Strategy	No	Yes
Funds Managed By	CalPERS	PARS/Highmark Capital (0.60% management fee)
Flexibility in Uses	No	Yes (annual required expenses or additional UAL pay down)
Savings	Immediate; Length of Time Varies Based on Which Amortization Component is Paid Off	Varies; Depends on When City Utilizes Funds to Pay Liabilities
Enhanced Budgetary Flexibility	No	Yes

Option 1 – Direct Pay Down with CalPERS



- A direct pay down with CalPERS "removes" a portion of the UAL and the payments associated with it
- Can choose any amortization base (varying maturities)
  - The longer the amortization base, the more cumulative savings, but less on an annual basis
- Overall UAL will continue to fluctuate based on CalPERS returns with impacts (positive or negative) added annually– and amortized over 30-year period

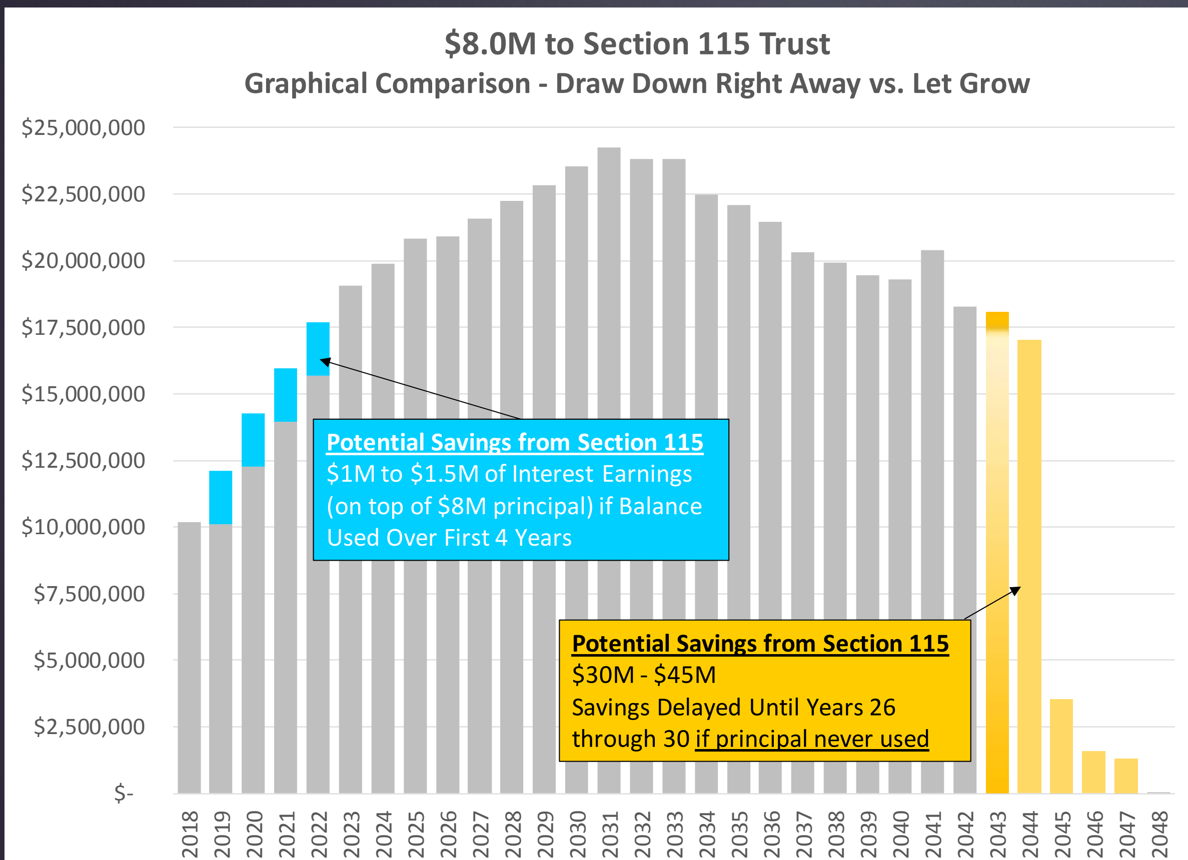
Option 1 - $8M Direct Pay Down – 15 vs. 26 Year

- Based on current shape of City's UAL payments, we looked at paying down a long-term base (26 years) and a medium-term base (15 years)
- 15-Year: 13.4M savings over 15 years
  - **$900K annual average**; ranging from $722K in Year 1 to $1.1M in Year 15
- 26-Year: 19.5M savings over 26 years
  - **$750K annual average**; ranging from $505K in Year 1 to $1.1M in Year 26
- NHA would recommend paying off an amortization base closer to the 15-year maturity in order to maximize cash flow savings in the near term

Amount	$8 Million	$8 Million
Amortization Base	**15 Year**	**26 Year**
Year 1 Savings	721,957	504,694
Year 2 Savings	743,616	519,835
Year 3 Savings	765,924	535,430
Year 4 Savings	788,902	551,493
Year 5 Savings	812,569	568,037
Cumulative 5-Year Savings	3,832,968	2,679,488
Cumulative 10 Year Savings	8,276,429	5,785,750
Cumulative 15 Year Savings	**13,427,617**	9,386,758
Cumulative 26 Year Savings	N/A	**19,457,485**
Less Intial Pay Down	(8,000,000)	(8,000,000)
Actual Total Savings	5,427,617	11,457,485

** All savings estimates assume CalPERS earns their projected rate of return in future years*

Option 2 – Section 115 Trust



- Section 115 savings are difficult to forecast - can't compare "apples to apples" to a direct pay-down
  - Based on future investment returns (conservative, moderate or aggressive portfolio?)
  - Depends on <u>how</u> and <u>when</u> City uses the money
    - Use to pay ARC, or additional UAL?
- Two primary strategies:
  - Invest long-term; don't need immediate flexibility (Aggressive Investment Objective)
  - Use for near-term budgetary flexibility and uncertainty (Investment Objective: Conservative to Moderate)
- **Primary benefit is <u>flexibility</u>**
  - Based on the City's likely needs for the money and flexibility in the near term, this money would likely be invested much more conservatively than the CalPERS portfolio

Factors to Consider

Flexibility

- If the City desires full flexibility for this money, it should use a Section 115 Trust.
- Trust proceeds can be used to defray annual pension costs during difficult budget years.
- If direct pay-down executed with CalPERS, the money is gone, and there is no added budgetary flexibility (except for the reduced payments from the pay-down)

Timing

- When the City will need the money will impact the recommendation
- If not needed until years 10 to 15 and beyond, a Section 115 could be more effective
- If savings desired immediately and spread out, a direct pay down may be better option

Investment Risk

- Both options have investment risk. A near term downturn will impact the City more in a Section 115 trust, since it will directly impact the principal. PERS would phase in impacts of a downturn over a longer period of time. Thus, if the City **will need this money in the near term**, it should invest more conservatively

Diversification / Customization

- Though PARS (managed by Highmark) and CalPERS will invest in similar market instruments, a Section 115 is the only pension specific investment alternative to CalPERS
- Portfolios can be customized as well (unlike CalPERS) to be as conservative, moderate, or aggressive as desired

Balance Sheet

- If concerned about reducing UAL with CalPERS and the Pension Liability in CAFR, a direct pay down would be the best option
- However, the ability to show the Section 115 as an off-setting asset on general balance sheet is a positive, and likely viewed by bond credit rating agencies as just as strong as a direct pay down

Political

- For any number of reasons, if the City does not want to give money to CalPERS at this time, it should utilize a Section 115

Continued Monitoring

- A Section 115 will require annual (or intermittent) monitoring by the City to determine if, when and how money will be applied towards pension liabilities

City Objectives

Near Term Budgetary Flexibility (at least $2M)

- PARS Section 115

Immediate Savings and Through Next 15 Years

- CalPERS Pay Down

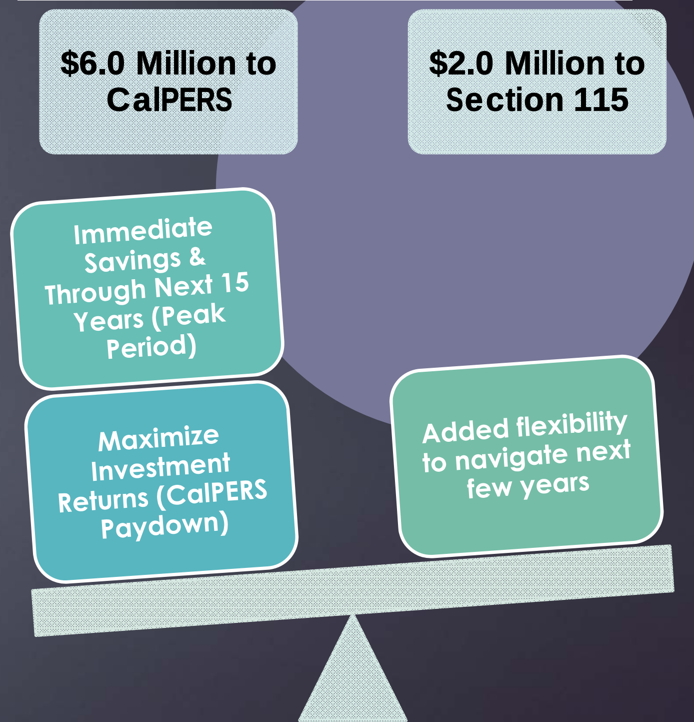
Maximize Investment Returns

- CalPERS Pay Down

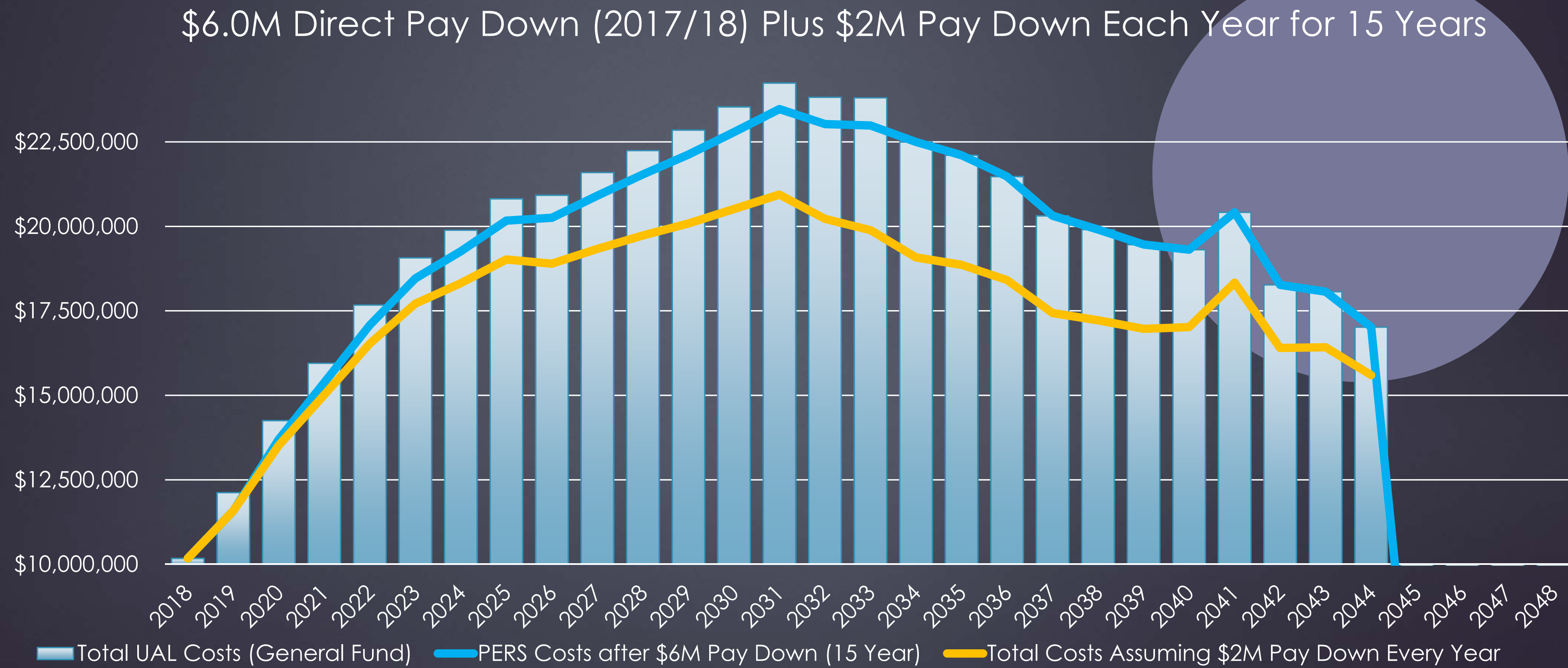
Preliminary Options

1. All $8M to CalPERS
2. All $8M to Section 115
3. 50/50 Hybrid - $4M to each
   1. $350K to $550K annual savings from pay down + FLEX to use $4M in Section 115
4. **Recommended – 75/25 Split**
   - ❑ $6M to CalPERS and $2M to PARS
     - $550K to $825K in annual savings from pay down ($10M over 15 years) + FLEX to use $2M in Section 115
   - \+ Continue investment every year going forward ('Snowball effect' – see chart on next slide)

RECOMMENDED – 75/25 SPLIT



Recommended $6M Pay Down + $2M Annual Ongoing Pay Down



Summary

- To date, the City has either invested or set-aside $18.5M for both OPEB and Pensions (above and beyond annual required contribution); $676K of which is from employee contributions
- All options being considered by the City demonstrate a pro-active willingness to address rising pension costs
  - Credit positive by bond rating agencies and investors
  - Potential for increased investment earnings than previously possible
- Flexibility and timing are most important factors to consider for City
- $8M pension savings strategy is an important, yet small piece of the overall budget deficit solution
  - ≈ <10% of solution
  - Other expense reductions and/or revenue enhancements must be considered to develop holistic solution
- City should commit to invest and buy-down as much as possible every year

	OPEB	Pension	Total
Contributed To-Date (9/30/17):			
City share	$ 8,825,000	$ -	$ 8,825,000
City payroll	676,000	-	676,000
Investment Income, net	1,100,000	-	1,100,000
Subtotal	10,601,000	-	10,601,000
Projected through 6/30/18:			
City share	250,000	8,393,000	8,643,000
City payroll	383,000	-	383,000
Investment Income, net	238,000	707,000	945,000
Total	$ 11,472,000	$ 9,100,000	$ 20,572,000