

Mendocino County's Unfunded Pension Obligations

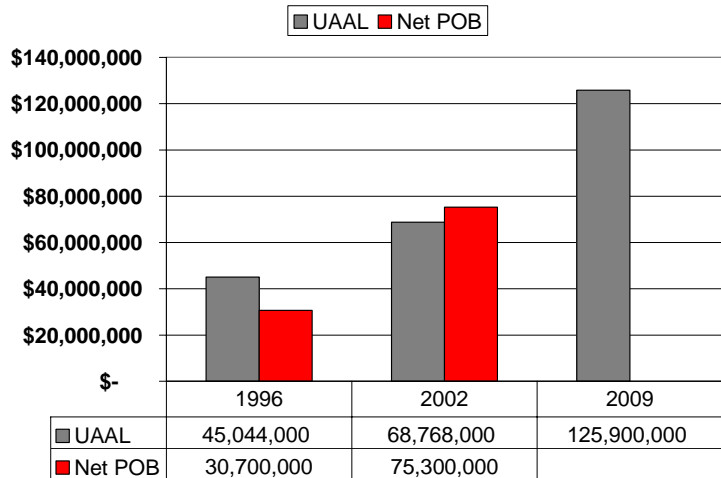
Situation - April 30, 2009

On Tuesday April 28, 2009 the Mendocino County Board of Supervisors held a joint meeting with the Mendocino County Employees Retirement Association (MCERA). MCERA is the County's Pension Fund; it is managed by an independent Retirement Board. At that meeting a representative of MCERA's Actuary - Buck Consultants - presented their projections of the County's Unfunded Pension Liability and County payments to MCERA for the next several years. Buck projects MCERA's investment losses this year will be about \$100 million. The projections below are taken directly from slides used by the Buck representative at the meeting. This historical numbers come from County or MCERA financial reports and/or budgets.

This graph shows two things:

- Mendocino County's Unfunded Pension Liability (UAAL) as of June 30 of each year shown. ¹
- Pension Obligation Bond (POB) borrowing in December of 1996 and 2002. ²

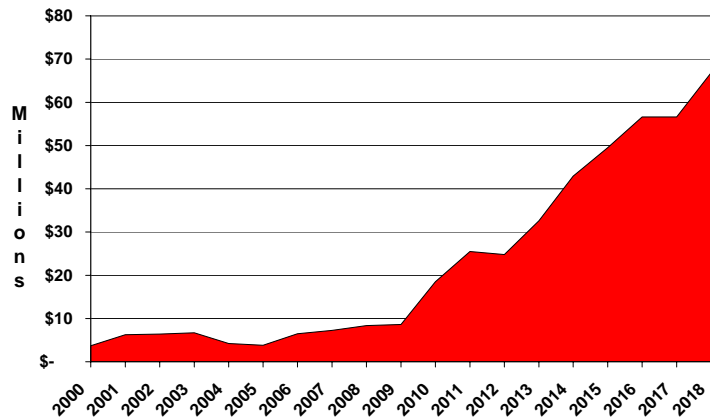
Unfunded Pension Obligations and Pension Obligation Bonds
Mendocino County



Given the policies currently in place, this graph shows payments from Mendocino County to MCERA to fulfill its pension obligations:

- Actual payments reported in MCERA financial statements through 2007
- My estimates for 2008 and 2009
- Projections by Buck for 2001 through 2018

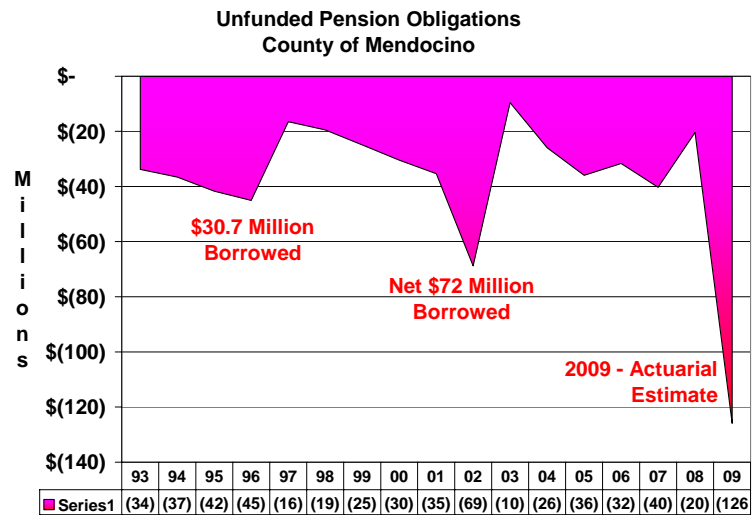
Actual and Projected County Pension Contributions



¹ The 2009 UPO is the projection by the Actuary hired by the Mendocino County Employees Retirement Association (MCERA). "UAAL" = Unfunded Actuarially Accrued Liability, in this case, Unfunded Pension Liability.

² Some of the 2002 POB was used to "debase" - essential refund part of the earlier POB. The value shown here is the net increase in debt caused by the 2002 POB.

This graph shows the UAL since 1993. During that entire time - nearly 20 years - the Pension Fund has always had a deficit. It appears Mendocino County's Pension Fund has never been fully funded.



The County Owes Over \$200 Million in Pension Debt

First - some simple definitions:

- Asset Value Today's value of the Pension Fund's assets calculated by the Actuary.
- Accrued Liability This is how much money should be in the Pension Fund today to be able to pay the amount of future pensions that have already been earned by current and former employees.
- Unfunded Accrued Liability (or UAAL or UPL) If there isn't enough money in the fund today to pay future pensions that have already been earned, the Pension Fund is "Underfunded". The County owes this entire amount to the Pension Fund - none is owed by current employees or retirees.
- "Interest Rate" - "Target Rate of Return": This is a percentage rate of investment return the Retirement Association tells the Actuary to assume the Association will earn in the future on its investments. This has been 8% for decades.

The "Accrued Liability" is the total pension debt. But since the County and its employees have set aside substantial funds to pay that total debt, only the deficit - the Unfunded Liability - is considered a debt still owed by the County.

During the 4/28/09 joint meeting the Retirement Association's Actuary and Administrator praised the Board of Supervisors for doing a very good job of funding MCERA up until the recent national financial crisis. As proof they presented the Retirement Fund's situation as of last year - June 2008:

Funding Position of MCERA

June 2008 - \$Millions

Asset Value	\$353.4
Accrued Liability	(373.8)
Unfunded Pension Liability	(\$20.4)
 MCERA Funded Ratio	 95%

But that's the Retirement Association's situation, not the County's. When the County borrowed money by selling the Pension Bonds it used the proceeds to pay down the Unfunded Pension Liability. But it still owed the money - all it did was change the form of the debt to Pension Bonds. The balance still due on the Pension Bonds is also part of the County's Pension Debt - and since it hasn't yet been paid, it is still "unfunded". Here's the additional calculation for the County:

Funding Position of Mendocino County - Pension Debt

June 2008 - \$Millions

Asset Value	\$353.4
Accrued Liability	<u>(373.8)</u>
Unfunded Pension Liability	(20.4)
Balance of POB	<u>(92.0)</u>
Net County Pension Debt	(\$112.4)
County Funded Ratio	71%

Now compare the situations of MCERA and the County as of June 2009. These numbers are from County or Retirement Association documents:

Funding Position - MCERA and Mendocino County - Unfunded Pension Debt

June 2009 - \$Millions

Asset Value	\$267.2
Accrued Liability	<u>(393.1)</u>
Unfunded Pension Liability	(125.9)
MCERA Funded Ratio	68%
Balance of POB	<u>(89.3)</u>
Net County Pension Debt	(\$215.2)
County Funded Ratio	45%

Sixty eight percent is pretty bad - but 45% is far worse. Here's the kicker:

The County's Pension Debt is more than half the total of pensions owed to current and former employees. Today the best estimate is the County owes well over \$200 million in Unfunded Pensions and Pension Obligation Bonds.

The Wolf at the Door

The County must pay down the Unfunded Pension Liability. The County essentially has two options:

1. Pay down the Unfunded Pension Liability in a certain number of years.
2. Sell more Pension Obligation Bonds to obtain a lower interest rate.

Option One - Pay It Down On Its Own

The Retirement Association assumes it will earn 8% a year on its investments. But if the Pension Fund is underfunded it can't earn 8% on the amount of money that isn't there. When the Unfunded Pension Liability goes over a certain level - 10% - the County is forced to pay an annual "interest" charge equal to the Association's target rate of return. In addition, it will have to pay down the Unfunded Liability just as if it were a home mortgage.

Option Two - Borrow Pension Obligation Bonds

As stated earlier, Pension Obligation Bonds are simply a restructuring of Unfunded Pension Debt. The reason the County borrowed POBs in the past is that it could borrow at an interest rate substantially lower than the Association's assume rate of return, say 4.5% instead of the target return on 8%.

How do these options compare? Assume the County will pay down \$125 million over 20 years. In the first case it will have to pay 8% interest on the balance of Unfunded Pension Liabilities each year. In the second case assume a 4.5% interest rate.

Option 1 - Pay It Down On Its Own	\$12.7 million/year
Option 2 - Borrow Pension Bonds	\$9.6 million/year

The big unknown here is how long it will take for the Retirement Association to recover its investment losses. If it could do so in 5 years the County would not have to make further payments under option one. But if it exercised option two - the Pension Bonds - it will still have to pay the full Bond debt. However, even then it could receive credits for "prepayment" from the Association so that it could reduce its yearly pension payments.

But the County will probably need to make these payments for the few years in any case.

The County's Deficit Just Doubled!

County officials have been saying the County faces an \$8 to \$10 million deficit next year. We still don't know if there was any allowance for increased payments because of these Unfunded Pension Liabilities were included in that projection. We're inclined to think not - or certainly no where near as much as we now know will be required.

The County should tell its citizens the truth about this situation - but we believe we can assume that the County's deficit just doubled overnight.