THE 800 POUND GORILLA IN MENDOCINO COUNTY'S BUDGET
UNFUNDED OBLIGATIONS GROW 8% A YEAR
ONE PAGE SUMMARY - AUGUST 27, 2009

Mendocino County's Pension Fund has never had enough money to pay all the pensions it owes in the future. But now the Fund earned $130 million less than it needed in the past 2 years[1]. It's "**Unfunded Pension Obligation**" is the **biggest it's ever been** - by far. Both employees and the County contribute each year to pay for the pensions employees are earning that year. But only the County has to pay to eliminate these "Unfunded Obligations". There are **two ways to calculate this "deficit"**:

	Market Value	Actuarial Value
Pension Fund Assets	$274 million	$329 million
Less Total Obligations	- 387 million	- 387 million
Unfunded Pension Obligations	($113 million)	($58 million)

The **Market Value** of Assets is **what the Fund is really worth**. It's based on the real value of its investments. It's the actual dollars the Fund has to invest and pay pensions. But Market Value can change rapidly because of the stock market's volatility. County payments to the Fund would careen up and down making it hard to plan year to year.

That's where the **Actuarial Value** of Assets comes in. A formula **slows down** changes in value caused by the **stock market's volatility**. This prevents extreme year to year changes in the County's Unfunded Obligation payments.

But many County and Retirement Association officials are making a **huge and dangerous error**. They're **acting as if the Actuarial Value is the Real Value**. But the Actuarial Value overstates the real value of Assets by $55 million.

<u>Here's the problem</u> - the Pension Fund's financing plan requires it to earn 8% on its assets each year, and it needs to be fully funded. But it's really $113 million short. **<u>It can't earn investment returns on money it doesn't have</u>**. Even if it earns 8% on the $274 million it has, total earnings will be $9 million below what they need (8% of the $113 million deficit).

The **economic reality** is that the $113 million **Unfunded Obligation will grow at 8% a year unless it is eliminated**. There are basically only two ways it can be eliminated:

- **The County pays it off**
- **High Pension Fund Investment Profits**

Many County officials appear inclined to adopt the **strategy below**:

- **Reduce annual Unfunded Obligation Payments** to help the County through its current budget crisis
- **Rely on high Pension Fund profits** to eliminate the Unfunded Obligation

They are ignoring the 800 pound gorilla - **<u>the effective 8% interest expense</u> on Unfunded Obligations.** Further, **<u>Pension Fund investment profits won't eliminate the deficit</u>**. It would have to earn 15% yearly for 8 years. Its long-term average is less than half - 6.3%. Since the Fund has 1/3 of its investments in safe bonds that pay, say, 2.5%, it would have to earn 17% on the rest of its investments. No credible economist or investment analyst believes the market will grow that much.

<u>Most likely result</u>: **1) <u>$152 million payments</u> over the next 8 years, 3 times more** than the last 8. Even with these payments **2) <u>Unfunded Obligations will double</u>**. **Total <u>County debt</u>** would be about **<u>$1/2 billion</u>**.

There are **<u>no good choices.</u>** The **least bad choice** would be to **borrow money at a lower interest rate** to eliminate the Unfunded Obligation. But this would be the **3rd time in 13 years** the County was forced to borrow money to eliminate Unfunded Pension Obligations. Something is terribly wrong, but the County isn't trying to figure it out.

The **<u>citizens should not allow more debt</u>** until the County makes very **basic changes in its financial management.** **Visit YourPublicMoney.Com** to read all about Mendocino County's debt.

[1] Fiscal Years ending June 30, based on Actuarial estimates - final numbers not yet available.

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