CITY OF BREA - UNFUNDED LIABILITY ANALYSIS

INTRODUCTION

Since the economy hit the skids in 2008, California cities' revenues have tanked as sales tax revenue dropped, housing values crashed and unemployment increased.

At the same time CalPERS investment returns dropped drastically resulting in the need for cities to increase their pension contributions for current and future retirees.

Stockton, Vallejo and recently San Bernardino have declared bankruptcy. Vallejo's General Fund budget was 80% labor and benefits.

The Orange County Register has written many articles on state, county and city unfunded liabilities during this period most cities, including Brea, have made adjustments to their pension formulas.

Because of all the attention being given to unfunded liabilities I became concerned for Brea's future finances. I requested the city manager to ask the mayor and mayor pro tem to have staff prepare a comprehensive analysis of Brea's unfunded liabilities and present it at a future City Council Study Session.

My request was denied but it was suggested that I could meet with staff and generate my own presentation. I have met with staff several times and what I learned follows.

This is not meant to be an exposé, only a report on Brea's unfunded liabilities. Brea is in good financial condition at this time.

DEFINITIONS

Unfunded Liabilities

Liabilities that do not have savings or investments set aside to pay for them.

Under Funded Liabilities

When sufficient contributions have not been set aside to fund present and future liabilities of promised benefits.

CalPERS criteria: underfunded if less than 80% is set aside.

Defined Benefit Plan

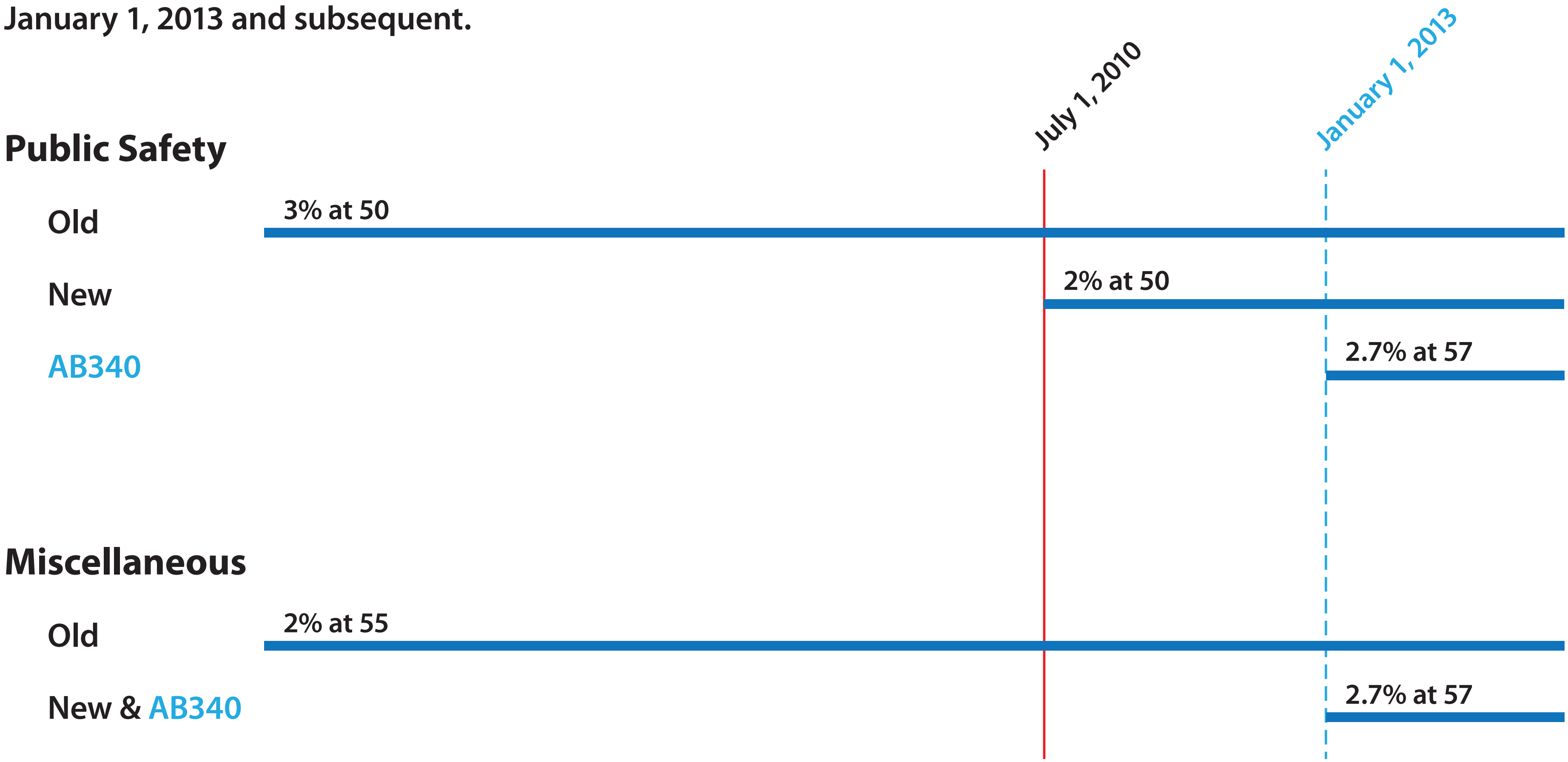
A guaranteed monthly pension check for life per formula. (i.e. 3% at age 50).

Defined Contribution Plan

401K individual investment plan. Employees contribute, employer may match a certain percentage, invested for employee's retirement. No additional employer liability.

PENSION FORMULAS

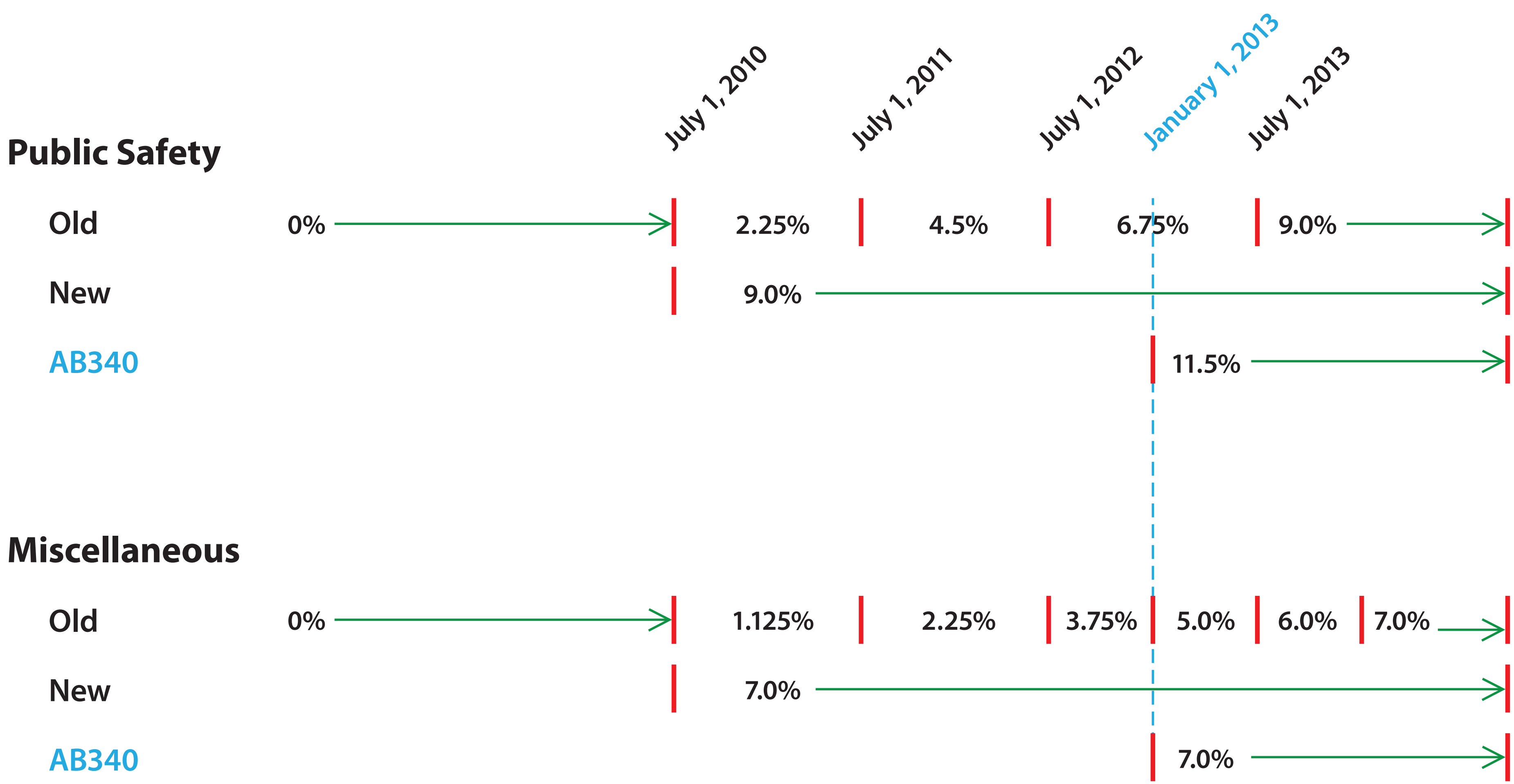
The pension formula time lines below show formula revisions by date and employee classification. "Old" indicates employees hired prior to July 1, 2010. "New" indicates new employees hired July 1, 2010 to December 31, 2012. AB340 was passed by the State effective for new employees hired January 1, 2013 and subsequent.

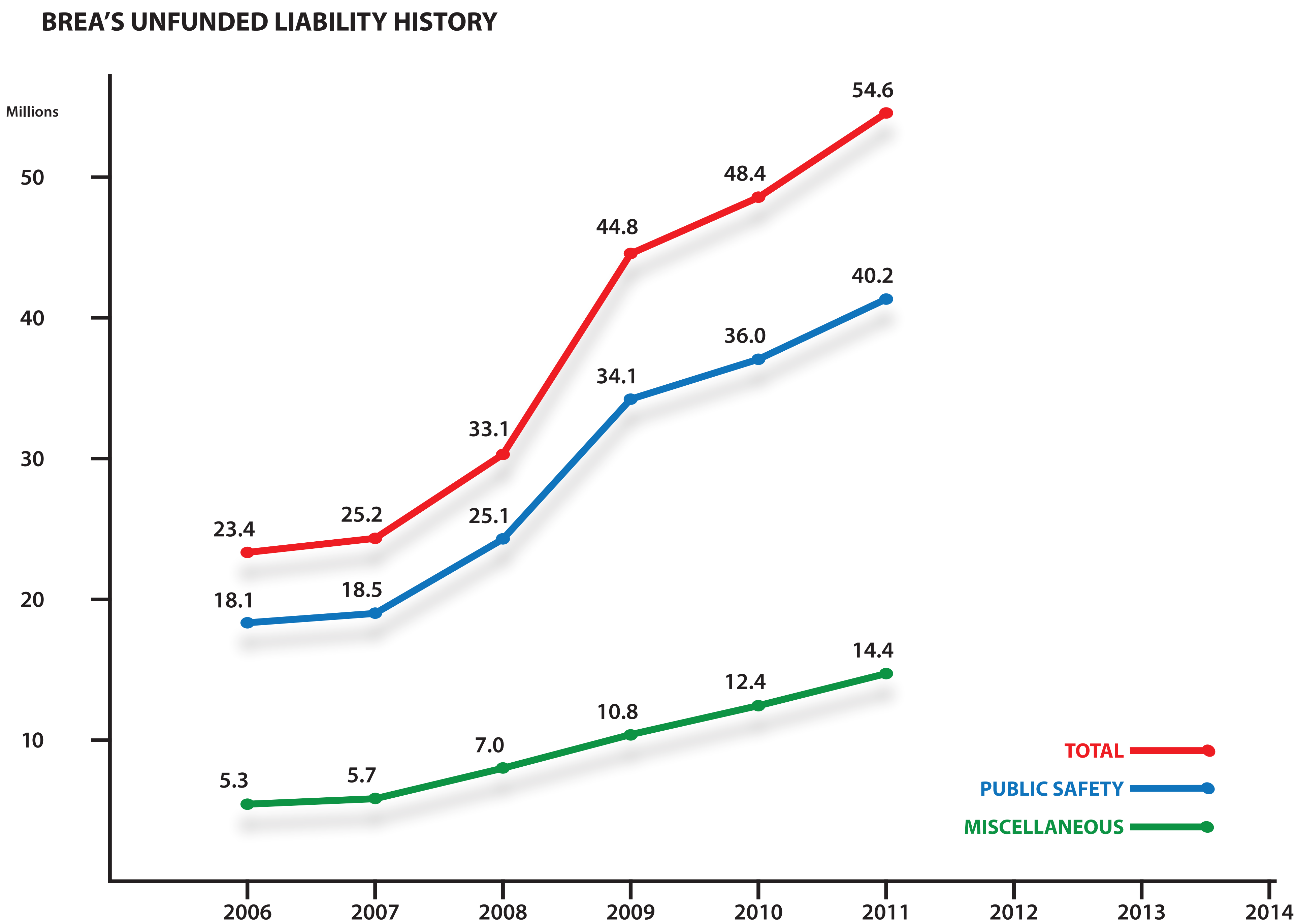


3% at 50
- Employee accumulates 3% of salary for every year worked, retires at age 50.
- A 30 year employee will receive 90% of their salary in retirement.

EMPLOYEE CONTRIBUTIONS

Employees made zero percent contribution to their pensions prior to July 1, 2010. At that time forward the employee associations agreed to contribute as shown in the time lines below.




BREA'S UNFUNDED LIABILITY HISTORY
Millions
50
40
30
20
10
54.6
48.4
44.8
33.1
25.2
23.4
40.2
36.0
34.1
25.1
18.5
18.1
14.4
12.4
10.8
7.0
5.7
5.3
TOTAL
PUBLIC SAFETY
MISCELLANEOUS
2006
2007
2008
2009
2010
2011
2012
2013
2014

CITY OF BREA - UNFUNDED LIABILITY ANALYSIS

BREA'S FUNDED LIABILITIES

Funded liabilities are the total dollars in Brea's CalPERS account on a specific date to cover the City's pension obligations.

It is estimated that the City contributes 21%, the employee 13% and CalPERS investment income provides 66%

As of June 30, 2011 Brea's funded assets (in million dollars) are as follows...

Public Safety Employees:

Funded	Unfunded	Total	%
$129.9	$40.2	$170.1	76.4

Miscellaneous Employees:

Funded	Unfunded	Total	%
$74.1	$14.4	$88.5	83.4

Total:

Funded	Unfunded	Total	%
$204.0	$54.6	$258.6	78.9

CalPERS believes if the City is 80% funded its pensions are adequately protected.

CalPERS invests the funded dollars and currently projects a 7.5% return on the investments. If the market crashes so does Brea's funded liability fund. This could result in an increase in the City's future contributions.

Retirement Unfunded Medical Liaibilities

These are funded on a pay-as-you-go basis. These unfunded liabilities have remained steady at about $17.0 million for the past six years.

POSSIBLE SOLUTIONS

Although Brea's unfunded liabilities are significant and seem to be increasing, at this time they don't seem to be creating a crisis. However, if the market turns bad for a significant period severe adjustments will need to be made. Possible solutions are:

1. **Change pensions to defined contribution plans**
2. **Extend retirement ages**
3. **Cap pensions at 66% of final pay**
4. **Layoff employees**
5. **Reduce salaries**
6. **Lower benefit formulas**
7. **Eliminate pension cost of living adjustment**
8. **Raise taxes**

CITY OF BREA - UNFUNDED LIABILITY ANALYSIS

CONCLUSIONS

1. Brea's unfunded liabilities as of June 30, 2011 are:

Pensions	$54.6 million
Medical	$17.1 million
Total	$71.7 million

2. Pension unfunded liabilities have increased annually from 2006 to 2011, from $22.4 million to $54.6 million.

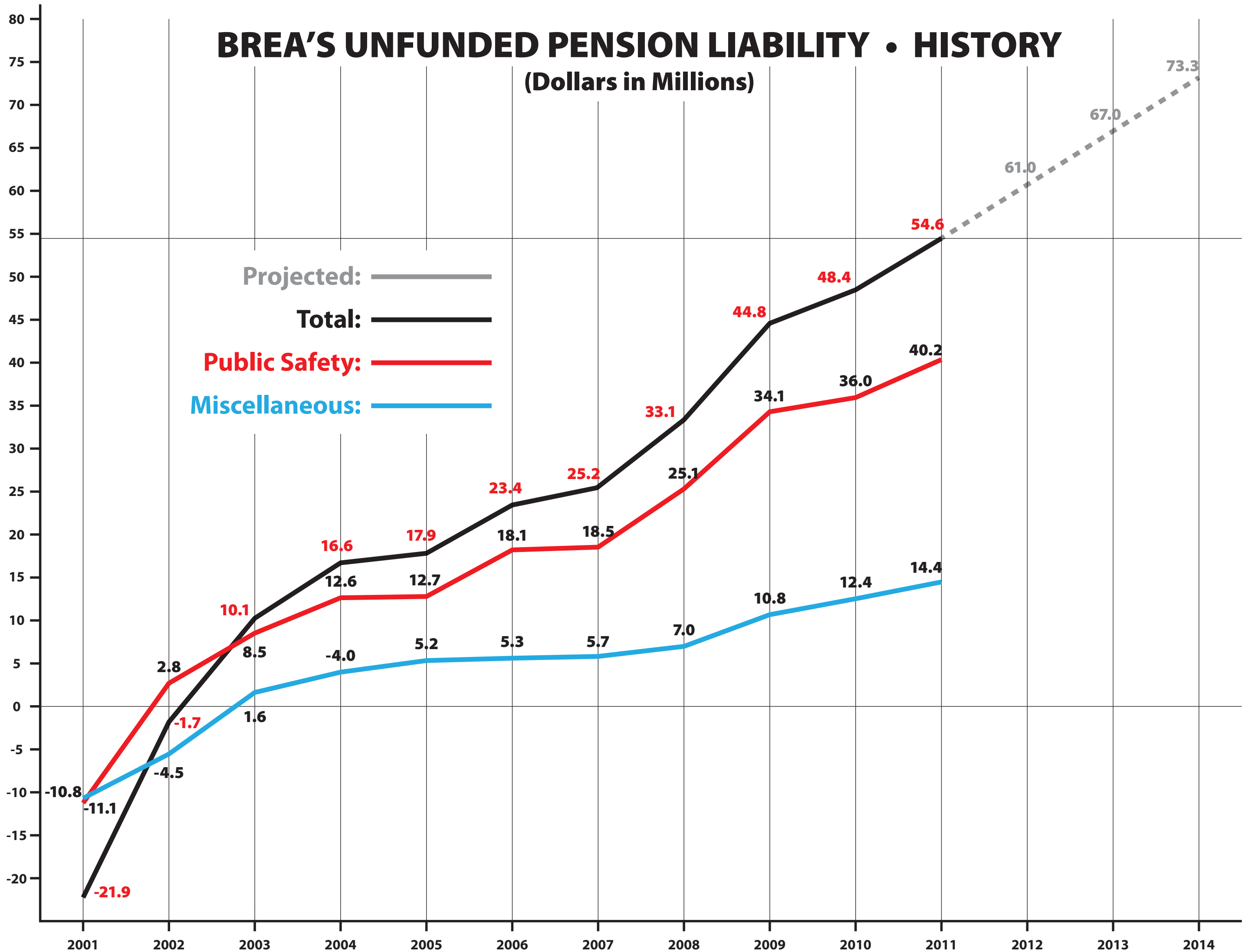
3. Brea has implemented some pension reforms. These should show up in the June 30, 2012 data. It is expected to slow down the annual rate of increase in the unfunded liabilities but the increasing trend line is expected to continue upward.

4. Unfunded liabilities will not go away and most likely will increase.

5. It is likely that CalPERS will not meet its 7.5% return on investment

6. Brea is currently in a strong financial condition with balanced budgets and a growing General Fund reserve.

7. Brea's unfunded liabilities are not creating any near term crisis, however, current trends are indicative of potential long term negative consequences and should be addressed. Brea's City Council should take prudent steps now to develop contingent resolutions to our potential future unfunded liability vulnerability. To ignore today might lead to tomorrow's disaster.


BREA'S UNFUNDED PENSION LIABILITY • HISTORY
(Dollars in Millions)
Projected:
Total:
Public Safety:
Miscellaneous:
80
75
70
65
60
55
50
45
40
35
30
25
20
15
10
5
0
-5
-10
-15
-20
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
-21.9
-1.7
10.1
16.6
17.9
23.4
25.2
33.1
44.8
48.4
54.6
61.0
67.0
73.3
-11.1
2.8
8.5
12.6
12.7
18.1
18.5
25.1
34.1
36.0
40.2
-10.8
-4.5
1.6
-4.0
5.2
5.3
5.7
7.0
10.8
12.4
14.4