Association of Bay Area Governments (ABAG)

Discussion of Budget Challenges
ABAG Executive Board
October 28, 2022

Association of Bay Area Governments

Serving the counties, cities and towns of the Bay Area since 1961

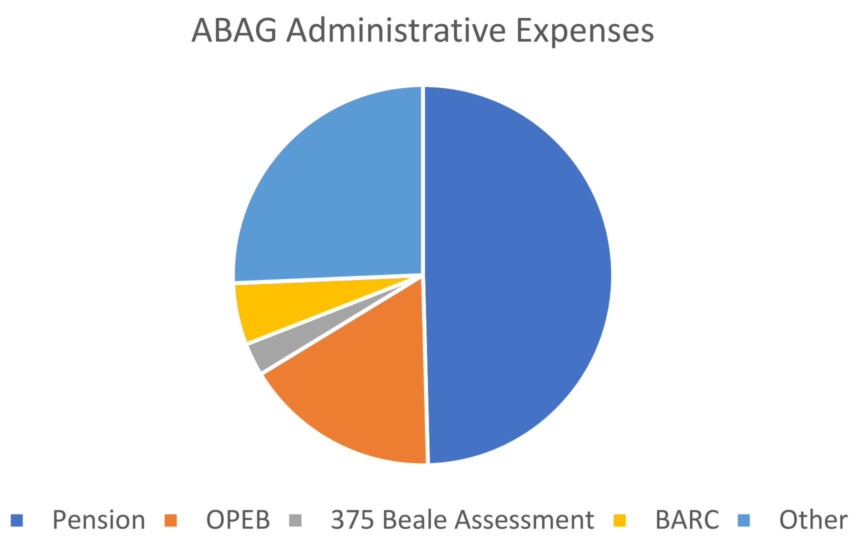
Level Setting

- Much discussion over past several years about the ABAG "Structural Deficit"
- What is a Structural Deficit
  - A fundamental and continuing mismatch between governmental revenues and governmental expenditures
- Major driver of ABAG structural deficit is amortization of unfunded pension liabilities
- Current budgetary practices obscure the size of this challenge
- ABAG should establish reserves for operational flexibility and any legal exposure

The ABAG Budget (the headline)

- In considering the ABAG structural deficit, it is important to start with the Administration Budget (BayREN and SFEP are intended to be self-supporting)
- The FY 2022-23 Administration Budget is balanced as adopted:

Revenue		
Membership Dues	$	2,592
Other	$	587
Transfers	$	372
Total Revenue and Transfers	$	3,551
Expenses & Transfers		
Pension	$	1,744
OPEB	$	587
375 Beale Assessment	$	98
BARC	$	185
Other	$	903
Total Expenses & Transfers	$	3,517



The ABAG Budget (behind the scenes)

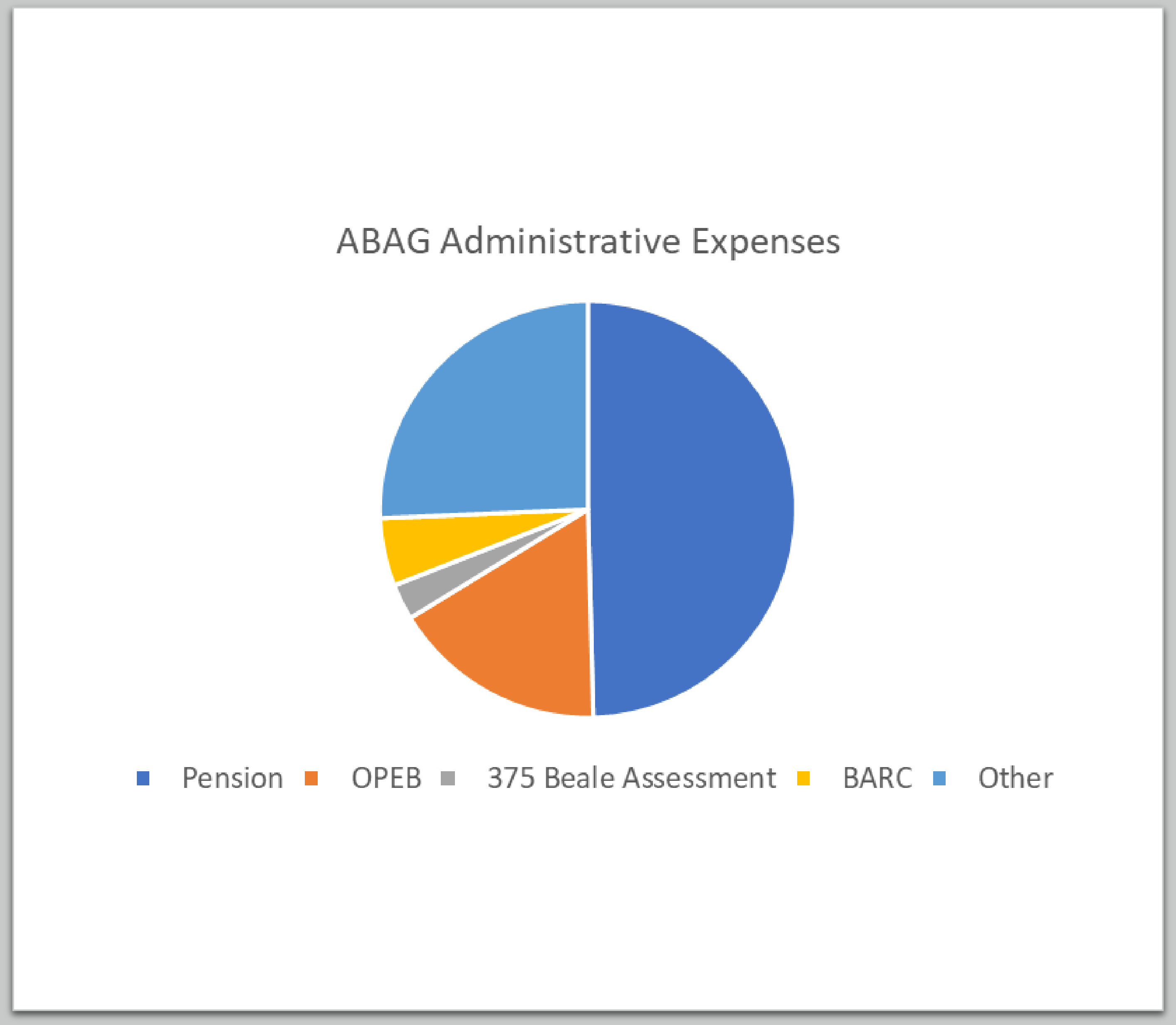
- No staff or overhead cost is billed to the ABAG Administration budget
  - Staff and overhead costs are charged to the various programs, but do not represent full cost of services provided to ABAG across the breadth of its programs
- Many staff who provide substantial direct service to ABAG are charged to the larger MTC overhead budget
- Portions of MTC allocated overhead charges are being retained within ABAG to balance Administration budget and the SFEP Conference program
- Assessment of appropriate charges for shared services needs to be revisited, consistent with provisions of the 375 Condo CC&Rs
- “True” Administration budget deficit likely around $175,000, not adjusted for other items above, with another $180,000 of MTC overhead funds supporting the SFEP conference

Unfundeded Pension Liabilities are the Primary Driver of the Structural Deficit

- While all current ABAG staff are MTC employees (and therefore part of the MTC CalPERS plan), ABAG has obligations with respect to the closed ABAG plan

- This plan has a substantial unfunded liability, the amortization of which demands substantial annual funding

- FY2023 amortization is approximately 50% of the overall ABAG Administration budget, and about two-thirds of member dues



Questions and Discussion

The Underfunded Pension Plan

- ABAG has a “closed” CalPERS retirement plan for former employees who retired prior to the ABAG/MTC merger
- As of June 30, 2021, the ABAG pension plan was underfunded by approximately $11.8 million
- Since the 2021 valuation, ABAG has made two payments, totaling approximately $3.3 million
- Unfortunately, in FY2022, the CalPERS performance was substantially below the discount rate assumed for calculating payments (-6.1% vs. +6.8% assumed)
- While not yet disclosed, it is likely that the 1st quarter of FY2023 has continued to produce negative returns for the pension plan
- These negative returns more than offset the last two payments made by ABAG

Pension Math (Figures as of 6/30/21)

1.	Plan's Accrued Liability	$54,476,815
2.	Projected UAL balance at 6/30/2021	16,070,729
3.	Pool's Accrued Liability[1]	20,794,529,023
4.	Sum of Pool's Individual Plan UAL Balances at 6/30/2021[1]	4,597,734,264
5.	Pool's 2020/21 Investment (Gain)/Loss[1]	(2,338,185,055)
6.	Pool's 2020/21 Non-Investment (Gain)/Loss[1]	(84,077,623)
7.	Plan's Share of Pool's Investment (Gain)/Loss: [(1) - (2)] ÷ [(3) - (4)] × (5)	(5,544,340)
8.	Plan's Share of Pool's Non-Investment (Gain)/Loss: (1) ÷ (3) × (6)	(220,264)
9.	Plan's New (Gain)/Loss as of 6/30/2021: (7) + (8)	(5,764,604)
10.	Increase in Pool's Accrued Liability due to Change in Assumptions[1]	60,407,898
11.	Plan's Share of Pool's Change in Assumptions: (1) ÷ (3) × (10)	158,255
12.	Increase in Pool's Accrued Liability due to Funding Risk Mitigation[1]	495,172,731
13.	Plan's Share of Pool's Change due to Funding Risk Mitigation: (1) ÷ (3) × (12)	1,297,237
14.	Offset due to Funding Risk Mitigation	(1,297,237)
15.	Plan's Net Investment (Gain): (7) – (14)	(4,247,103)

[1] Does not include plans that transferred to Pool on the valuation date.

Development of the Plan's Share of Pool's Market Value of Assets

16.	Plan's UAL: (2) + (9) + (11) + (13)	$11,761,617
17.	Plan's Share of Pool's MVA: (1) - (16)	$42,715,198

More Pension Math (Figures as of 6/30/21)

Assumed Annual Return FY 2021-22 through 2040-41	Projected Employer Contributions				
	2024-25	2025-26	2026-27	2027-28	2028-29
3.0% (5th percentile)					
Normal Cost Rate	0.0%	0.0%	0.0%	0.0%	0.0%
UAL Contribution	$1,410,000	$1,671,000	$1,960,000	$2,281,000	$2,647,000
10.8% (95th percentile)					
Normal Cost Rate	0.0%	0.0%	0.0%	0.0%	0.0%
UAL Contribution	$971,000	$726,000	$427,000	$60,000	$0

Assumed Annual Return for Fiscal Year 2021-22	Required Employer Contributions	Projected Employer Contributions
	2023-24	2024-25
(17.2)% (2 standard deviation loss)		
Normal Cost Rate	0.00%	0.0%
UAL Contribution	$1,173,327	$2,671,000
(5.2)% (1 standard deviation loss)		
Normal Cost Rate	0.00%	0.0%
UAL Contribution	$1,173,327	$1,922,000

And the last bit (Figures as of 6/30/21)

Sensitivity to the Real Rate of Return Assumption

As of June 30, 2021	1% Lower Real Return Rate	Current Assumptions	1% Higher Real Return Rate
Discount Rate	**5.8%**	**6.8%**	**7.8%**
Inflation	2.3%	2.3%	2.3%
Real Rate of Return	**3.5%**	**4.5%**	**5.5%**
a) Total Normal Cost	0.00%	0.00%	0.00%
b) Accrued Liability	$61,429,036	$54,476,815	$48,787,147
c) Market Value of Assets	$42,715,198	$42,715,198	$42,715,198
d) Unfunded Liability/(Surplus) [(b) - (c)]	$18,713,838	$11,761,617	$6,071,949
e) Funded Ratio	69.5%	78.4%	87.6%

Sensitivity to the Price Inflation Assumption

As of June 30, 2021	1% Lower Inflation Rate	Current Assumptions	1% Higher Inflation Rate
Discount Rate	**5.8%**	**6.8%**	**7.8%**
Inflation	**1.3%**	**2.3%**	**3.3%**
Real Rate of Return	4.5%	4.5%	4.5%
a) Total Normal Cost	0.00%	0.00%	0.00%
b) Accrued Liability	$56,387,659	$54,476,815	$50,134,741
c) Market Value of Assets	$42,715,198	$42,715,198	$42,715,198
d) Unfunded Liability/(Surplus) [(b) - (c)]	$13,672,461	$11,761,617	$7,419,543
e) Funded Ratio	75.8%	78.4%	85.2%

Questions

Addressing the Challenges

- Need to develop full cost for providing service to ABAG
  - Proper allocation of staff to support activities (as opposed to project staff)
  - Full reimbursement to MTC for overhead costs
  - Appropriate costing for shared services
- Staff is addressing this need and will return with more information at a later date
- Need to consider strategies to:
  - Create greater cost stability with respect to pension
  - Address need for reserves
  - Develop approach to fully funding these needs

Addressing the Pension

There are several options for addressing the issue of the underfunded pension:

- Modified “Do Nothing”
  - Leave current CalPERS plan in place, with its unknown volatility. Provide separate calculation of dues requirements necessary to fund the Required Employer Contribution
- Pension Obligation Financing (current CalPERS plan) - taxable loan to fund part/all of current unfunded accrued liability (funds provided to and invested by CalPERS)
  - Can create greater (though not complete) stability in payments associated with the pension
  - May provide the ability to “arbitrage” spread between borrowing rate and CalPERS returns
  - ABAG still subject to CalPERS returns and pension plan experience – negative changes could require additional funding

Addressing the Pension (continued)

- Pension Obligation Financing (current CalPERS plan plus Section 115 Trust) - taxable loan to fund part/all of current unfunded accrued liability (funds provided to and invested by CalPERS plus funding to a 115 Trust)
  - Can create greater (though not complete) stability in payments associated with the pension
  - May provide the ability to "arbitrage" spread between borrowing rate and CalPERS returns and 115 Trust earnings
  - 115 Trust funds could be used, at ABAG's discretion, to meet some or all of additional Required Employer Contribution, mitigating immediate impact on budget requirements
- Pension Obligation Financing (terminate plan) – taxable loan to fund termination of CalPERS plan
  - Termination calculated at substantially reduced discount rate, which thus requires termination payment substantially higher than currently recognized unfunded liability
  - Termination would retire all responsibility of ABAG for future payments to CalPERS
  - ABAG payments would be limited to debt service on the taxable financing

375 Condominium Interest

- As a means of funding some portion of the currently unfunded pension liabilities, ABAG could consider the sale of some or all of its condominium interest in the Bay Area Metro Center
- Current interest is 19,091 square feet (17,687 sf on 7^{th} floor, 1,404 sf on 1^{st} floor)
- Such a sale would also provide a basis for reducing condominium assessments on a proportional basis
- Sale proceeds could also be used to establish important working capital and legal reserves

Funding the Challenges

- The 6% increase in member dues for FY2023 represents a good step in the right direction toward funding the challenges
- While this is a good step, it is insufficient given the scale of the challenges
- Sale of all or a portion of the condominium interest would help address (but not solve) the current fiscal need and would reduce ongoing costs associated with condominium ownership
- Apart from member dues, there is no currently identifiable source of ongoing funding to address these challenges
- Staff recommends a specific “carve-out” to identify the portion of dues related to retirement of the pension obligation (whether current amortization or debt service)
- This would allow members to also see the “true cost” of ABAG’s continuing operations and understand the value of such operations relative to the cost of supporting them through that portion of dues

Questions and Discussion