Shari [redacted]

From: Shari Freidenrich [redacted]
Sent: Tuesday, June 18, 2013 10:01 PM
To: 'Lindholm, Wayne'
Subject: RE: Let's talk

[redacted]

Dear Wayne:

Thanks for sending this draft. I appreciate your consideration.

As I mentioned to Tom today, I had planned on asking for this item to be reconsidered so that I can get the benefit of having the charts in front of me, so I can see the impact of the proposed changes to the prior amortization and get the additional questions on the prior amortization that I had answered. In addition, I know that Andy had some comments on the prior amortization, and I was unable to hear them clearly. I thought he said that we should not be changing the prior amortization, which is one of the reasons that I didn't support it yesterday along with not having the detailed charts, but I understand that actually, he stated the opposite, that he was okay with us changing the prior amortization now. For me, that was a change from the prior meeting where initially Paul Angelo had really discouraged us from making changes to the prior year and then provided some details on shortening and lengthening the change. Can you confirm what he stated? I also wanted to ask what Andy the impact that the phase-in of the lowered discount rate over the 2 years would have on the prior amortization of the $935M, when it would go into effect and what would be the percentage in each of the two years. The chart only had it shown as it was going into effect in one year and I don't think that is correct. Since it is phased in, shouldn't the full $935M be split into 2 years?

I was not comfortable with voting on the prior amortization without the charts and details in front of me as I had several questions that I needed answered before I finalized my decision. Since it was a part of both of the motions brought forth, that impacted my votes. In hindsite, I should have just left the call when I had to go outside the building and got all my questions answered at the next meeting in July.

As I mentioned, without having access to the presentation for over an hour of the discussion and the votes, and having to step out again to make a presentation to the conference in the middle, I was definitely at a disadvantage. In addition, it sounded like there was other material that may have been sent to the iPad that I did not get. You indicated that it was possibly included with a future item on the agenda so I am not sure if it would have mattered or not, but it is always good to be seeing the same information as the rest of the Board.

I will be contacting Steve tomorrow, as I first wanted Tom as Chair to know my plan to request it be reconsidered. Thanks again for reaching out to me tonight.

Talk to you tomorrow,

Shari

From: Lindholm, Wayne [mailto:WLindholm@henselphelps.com]
Sent: Tuesday, June 18, 2013 8:20 PM
To: [redacted]
Subject: Let's talk

OUCH!

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TREASURER'S VOTE COSTS $1 BILLION TO ORANGE COUNTY TAX PAYERS

It's unfortunate for our sons and daughters in Orange County as the looming Pension Crisis gets "Kicked Down The Road" or as the Wall Street Journal says, "Generational Theft"! At issue was a vote on Monday, June 17, at the monthly board meeting of the Orange County Employee Retirement System, (OCERS), on how to handle a portion of the $5.7 Billion Unfunded Liability, specifically $935 Million that was added due to an assumption rate change. Treasurer Shari Freidenrich joined with the union vote to not only "Kick the Can" but delay any reduction of the $935Million for 19 years!

Where did the $935Million come from? Earlier this year the board agreed to reduce the assumption rate for returns from 7.75% to 7.25% which added $935Million to the Unfunded Liability, (UAAL)! The vote passed 5-4 with Shari joining the appointees. The union representatives had pushed to lower the rate ¼ point to 7.5% but the nine year average return since Segal, (OCERS Actuarial Consultant), started with the county is 6.28%! Does this mean a lower rate adjustment is in our future?

So how did Shari help "Kick the Can"? In 2004, when Segal came on, there was a vote to amortize assumption rate changes over 30 years. The problem arises when you look at the amortization method called "Level Percent of Pay" which takes into account an assumed payroll increase, in this case 3.75%. The actual increase, again over the 9 years Segal has been here, is 2.9% so the charts are overly optimistic by .85%! In essence think of your house mortgage, a lot of us have 30 year loans but in this case the payments for a 30 year amortization do not even cover the principle, ($935Million), it is a negative amortizing loan so you actually owe more than that for a full 19 years as you wait for pay increases to catch up and you finally pay off the liability in the last 11 years. This DELAYS payments to another generation thereby kicking the can down the road.

Now why would we want to shorten the amortization period? First bear in mind the Average Remaining Service Life, (ARSL). Of Orange County Employees is about 11 years. The appointed board members wanted to move the amortization to 18 or 20 years which still exceeds the remaining service life by 7 to 9 years but it at least tries to associate payments with those receiving the benefits! These 11 year ARSL employees will be long gone at 30 year amortization that actually pays less than the principle for 19 years, the younger employees and tax payers are left holding the bag!

Now where does the $1Billion come from? By stretching out and negatively amortizing the $935 Million the interest paid is about $1.86 Billion. A 20 year amortization would cost us $25 Million more each year but the net interest would be $1.02 Billion a difference in just interest of $840 Million. A 15 year amortization, still more than the service life of 11, would cost $705,925,000 or a savings of $1.15 Billion. The appointees pushed for a 20 year amortization, Shari voted for 30!

We should mention that several cities came to the board and urged the 30 year amortization to prevent financial hardship or even possible bankruptcy. The board understands the dire situation, they don't define the benefits but do have a fiduciary duty to properly invest and provide a benefit to the retirees. What is a concern is why there wasn't a line of retirees coming to the podium asking for the shorter amortization so that more dollars go into the system that is now only 63% funded, a crisis is looming if UAAL continues to climb like it has the last 12 years! Let's deal with the problem and stop "KICKING THE CAN"!