Orange County Fire Authority

AGENDA STAFF REPORT

Budget and Finance Committee Meeting | **Agenda Item No. 3B**
January 14, 2015 | **Consent Calendar**

Quarterly Status Update
Orange County Employees' Retirement System

Contact(s) for Further Information

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Summary

This agenda item is a routine quarterly transmittal to the Committee to provide a report on actions taken by the Orange County Employees' Retirement System's (OCERS) to improve its financial policies, procedures, and business practices.

Prior Board/Committee Action

Not Applicable.

Recommended Action(s)

Receive and file the report.

Impact to Cities/County

Not Applicable.

Fiscal Impact

Not Applicable.

Background

Actions Taken/Financial Policies & Practices October –December 2014

<u>OCERS BOARD OF RETIREMENT MEETING December 15, 2014:</u>

OCERS PLAN SPONSOR REVIEW

This item was informational only. Mr. David James, OCERS Director of Internal Audit, presented a report that provides a deeper background on the various plan sponsors who participate in OCERS, with detail on their funding sources, and touching on the topic of contract cities and how they interact with the Orange County Fire Authority and the Orange County Sheriff's Department. Mr. James stated that the creditworthiness of the plan sponsors seems sound and the risk of default is low. None of the plan sponsors have ever missed a payment to OCERS, not even after the Orange County Bankruptcy. At the Board's request, Mr. James will include a section summarizing his conclusions and bring back a revised version of the report for the Board's approval in January (Attachment 1).

LESSONS FROM THE CITY OF STOCKTON BANKRUPTCY CASE

OCERS Fiduciary Counsel, Harvey Leiderman of ReedSmith LLP, gave a presentation on the City of Stockton and its Chapter 9 bankruptcy plan (Attachment 2).

<u>OCERS INVESTMENT COMMITTEE MEETING October 29, 2014:</u>

DIRECT LENDING

The Committee approved an additional investment of up to $60 million in the OCP Asia's Orchard Landmark direct lending fund, subject to completion of due diligence, contract reviews, fee negotiations and related terms as presented and discussed by the CIO. In November 2013 the Committee approved an investment of $60 million in the OCP Asia's Orchard Landmark direct lending fund, upon recommendation of the staff and NEPC. Onsite due diligence was conducted by the CIO in their Hong Kong and Singapore offices. Fee terms for that subscription were especially favorable under a NEPC client club pricing arrangement. OCERS' investment is subject to a rolling 3-year lockup, at which point the funds can be redeemed. In June 2014, OCP Asia was reviewed by the OCERS' Manager Monitoring Subcommittee and no issues were noted (Attachment 3).

The Committee approved a staff recommendation to place PIMCO on watch as a result of personnel and organizational changes (including the resignation of founder and Chief Investment Officer Bill Gross in September 2014). PIMCO presently manages $1.2 billion for OCERS in six different investment mandates and has been a portfolio manager for OCERS for 32 years.

In a related action, the Committee voted to resume the exploratory search for a "core plus" domestic fixed income manager; this due diligence search may or may not result in a replacement manager or a finalists' competition, as it represents an open-minded exploratory market scan without prejudice to PIMCO's incumbent management team - which will be evaluated and considered on their comparative merits, experience, processes and performance record in juxtaposition with competing firms.

OCFA staff will continue to monitor actions taken by OCERS to improve its financial policies and practices, and will report back in April regarding progress made during the next quarter.

Attachment(s)

1. OCERS Plan Sponsor Review December 2, 2014
2. Presentation by ReedSmith LLP, A Tale of Two Rulings: The City of Stockton and Chapter 9, December 15, 2014
3. Memo from OCERS' Chief Investment Officer on OCP Asia - Review of Additional Investment October 29, 2014

OCERS Plan Sponsor Review

Report Date: December 2, 2014

Internal Audit Division
Director of Internal Audit: David James, CPA, MBA
Internal Auditor: Mark Adviento, CPA

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Purpose of this Review

The Board of Retirement approved OCERS Internal Audit to prepare a report on key financial information on OCERS' plan sponsors at the May 19, 2014 Regular Board meeting. As such, this report is a compilation of key historical financial information on OCERS' plan sponsors such as revenue sources and net positions for a five-year period beginning with fiscal year July 1, 2008 – June 30, 2009 through fiscal year July 1, 2012 – June 30, 2013.

Scope

This report includes financial information on all fifteen OCERS plan sponsors for the five-year period mentioned above. Although this report includes financial information on the Orange County Fire Authority and the Orange County Sheriff's Department, it does not include financial information of the cities that contract with the Orange County Fire Authority (OCFA) and the Orange County Sheriff's Department. Fees received from contract cities represent the second highest source of revenues for the OCFA and the Orange County Sheriff's Department.

Background

According to the County Employees Retirement Law of 1937, plan sponsors are obligated to make annual payments to the pension system. Upon withdrawal from the retirement system, a plan sponsor is liable for its share of any unfunded actuarial liability:

> *"§31564.2. Liability of district upon termination of participation*
>
> *(a) If a district's participation in the retirement system is terminated pursuant to the provisions of Section 31564, the district shall remain liable to the retirement system for the district's share of any unfunded actuarial liability of the system which is attributable to the officers and employees of the district who either have retired or will retire under the retirement system."*

There were 21,368 active members within OCERS' fifteen plan sponsors as of December 31, 2013. Plan sponsors contributed $427 million in employer contributions and $209 million in employee contributions for total contributions of $636 million to the OCERS plan during fiscal year ended December 31, 2013. See the chart below for plan sponsors, contributions, active member counts, and Unfunded Actuarial Accrued Liability (UAAL) as of December 31, 2013.

2013 Contributions to OCERS (in 000's)	Employer	Employee	Total	Percentage	Active Members	Percentage	12/31/13 UAAL**	Percentage
Orange County	$302,680	$162,675	$465,355	73.123%	16,281	76.193%	4,036,362	75.194%
OCFA	56,014	13,093	69,107	10.859%	1,185	5.546%	449,861	8.381%
Superior Court	27,090	16,301	43,391	6.818%	1,492	6.982%	388,668	7.241%
OCTA	19,181	7,913	27,094	4.257%	1,519	7.109%	219,042	4.081%
Sanitation District	16,558	6,645	23,203	3.646%	587	2.747%	204,965	3.818%
San Juan Capistrano	1,794	732	2,526	0.397%	81	0.379%	23,952	0.446%
OCERS	1,468	859	2,327	0.366%	65	0.304%	20,794	0.387%
Toll Roads	1,173	580	1,753	0.276%	77	0.360%	11,222	0.209%
Law Library	269	169	438	0.069%	17	0.080%	3,908	0.073%
Children & Families	297	115	412	0.065%	11	0.051%	3,897	0.073%
Cemetery District	202	97	299	0.047%	21	0.098%	1,721	0.032%
In-Home Support Services	126	66	192	0.030%	18	0.084%	1,265	0.024%
UCI	155	29	184	0.029%	11	0.051%	1,199	0.022%
LAFCO	74	26	100	0.016%	3	0.014%	975	0.018%
Dept of Education	13	1	14	0.002%	-	0.000%	88	0.002%
Total (net of prepaid discount):	**$427,095**	**$209,301**	**$636,396**	**100%**	**21,368**	**100%**	**5,367,917**	**100%**

**12/31/13 UAAL per plan sponsor are estimates, pending Segal's final calculation for GASB 67/68 purposes. OCFA, OCTA, Toll Roads, and Cemetery District each had their own rate group on the 12/31/13 valuation. Others are combinations of rate groups.

Primary Revenue Sources for OCERS' Top 5 Plan Sponsors – Year Ended June 30, 2013

Revenue Category	County*	OCFA	Superior Court **	OCTA	OCSD
Intergovernmental	51%	7%	98%	25%	-
Property Taxes	23%	59%	-	2%	21%
Sales Taxes	-	-	-	57%	-
Service Charges	18%	33%	-	12%	79%
% of Total Revenues	92%	99%	98%	96%	100%
	$3.4 billion	$308 million	$182 million	$766 million	$383 million

* Excludes CalOptima revenues
**Year ended June 30, 2014 numbers available from Superior Court

County of Orange

The County of Orange (the County) was incorporated in 1889 and is one of the major metropolitan areas in the state of California (the State) and nation. The County occupies a land area of 798 square miles with a coastline of 42 miles serving a population of over 3 million. It represents the third most populous county in the state, and ranks sixth in the nation. The County is governed by a five-member Board of Supervisors (the Board), who each serve four-year terms, and annually elect a Chairman and Vice-Chairman. The supervisors represent districts that are each approximately equal in population. A County Executive Officer, who reports to the Board, oversees nineteen County departments, and elected department heads oversee seven county departments.

The County of Orange is OCERS' largest plan sponsor, with approximately 76.2% of OCERS' active members with 16,281 active members as of December, 31 2013. The County made $465.3 million in employee and employer contributions to OCERS, which represents 73.1% of OCERS' total contributions as of December, 31 2013.

As of County Fiscal Year 6/30/13

Total Assets	$7.2 billion ($2.2 billion in cash and cash equivalents)
Total Liabilities	$2.1 billion (excludes contributions to OCERS)
Net Position	$5.1 billion ($532 million in Unrestricted funds)

As of OCERS Fiscal Year 12/31/13

Share of OCERS' Total UAAL	$4 billion
Total Pension Contributions	$465 million

Revenues

The County's total revenues were $5.2 billion for the year ending June 30, 2013.

The County's total government fund revenues were $3.5 billion for the year ended June 30, 2013. The County's key sources of government fund revenue were intergovernmental revenues (received from outside agencies), taxes, and charges for services. This excludes revenues of $1.5 billion for CalOptima, Orange County's health plan for low-income families, children, seniors, and persons with disabilities. CalOptima is a legally, discrete unit of the County because the County Board has no control over the revenues, budgets, staff, or funding decisions made by CalOptima.

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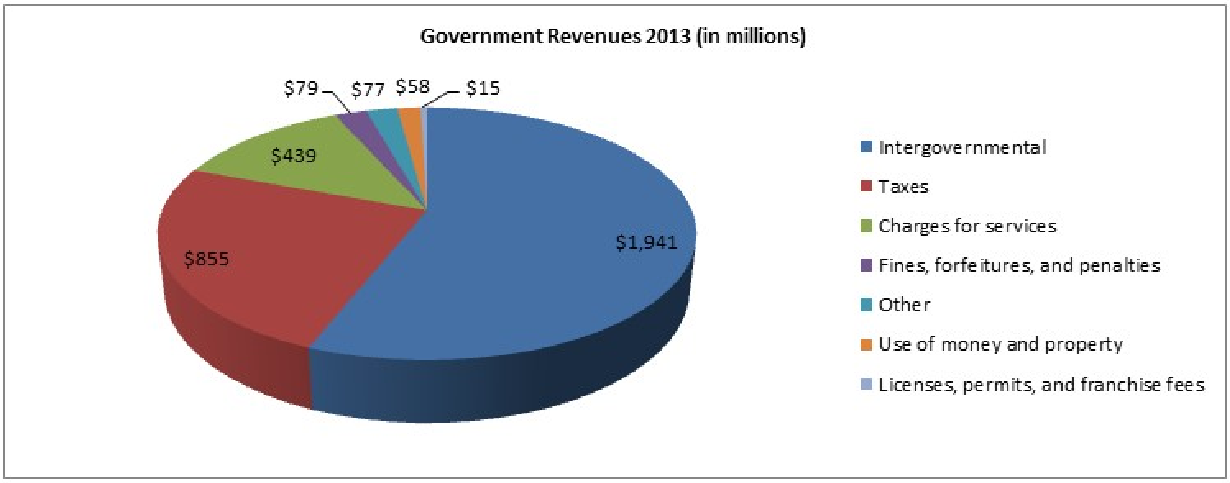


Intergovernmental revenues were $1.9 billion. This revenue is primarily an allocation of State and Federal revenues to the County and are restricted for the purpose of running various public assistance and health care programs, some of which were previously operated by the State. Of the county's 16,100 employees, approximately 2,200 employees work in the County's Health Care Agency and 3,900 employees work for the County's Social Services Agency. This revenue source does not have any impact on the County's ability to meet its pension payment obligations as they are restricted to funding specific programs.

The County collected taxes of $855 million in 2013. These included property taxes levied for the General Fund. The 1% tax rate is the levy for property tax based on assessed property values. From the 1% property tax collected, the County receives 6% for its General Fund operations. Taxes received to the General Fund were $313 million. The County received Property Taxes In-Lieu of Motor Vehicle License Fees of $310 million from the State in fiscal year 2013. As a part of the State Budget Act of 2004, the Legislature cut the backfill to cities and counties for reductions in the Vehicle License Fee and in return gave cities and counties additional property tax revenue. The remaining $232 million were taxes levied for parks, libraries, flood control, and other taxes.

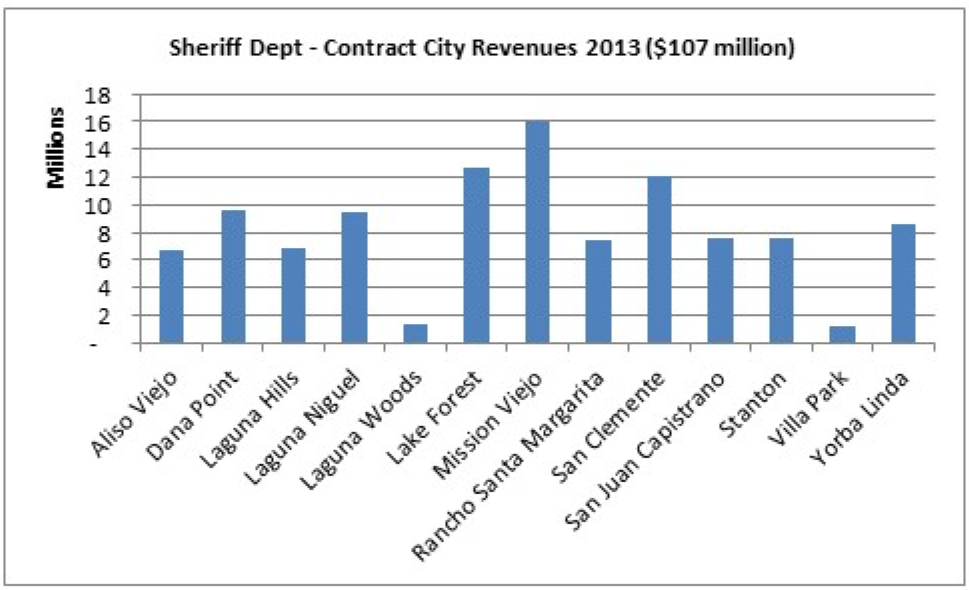
Tax revenues for the County will be affected in the future due to a 2013 Court ruling which required the County to pay $150 million, payable through 2019, to refund the state of California for property taxes previously withheld by the County. Payments to the state would start at $5 million this fiscal year, and in the following years will be $15 million, $25 million, $50 million, and $55 million. In addition, the County will lose approximately $50 million annually in SB 8 property tax revenues beginning in 2013 and will instead receive $53 million in VLFAA (vehicle license fee adjustment amount) revenues plus growth.

Charges for Services were $439 million.

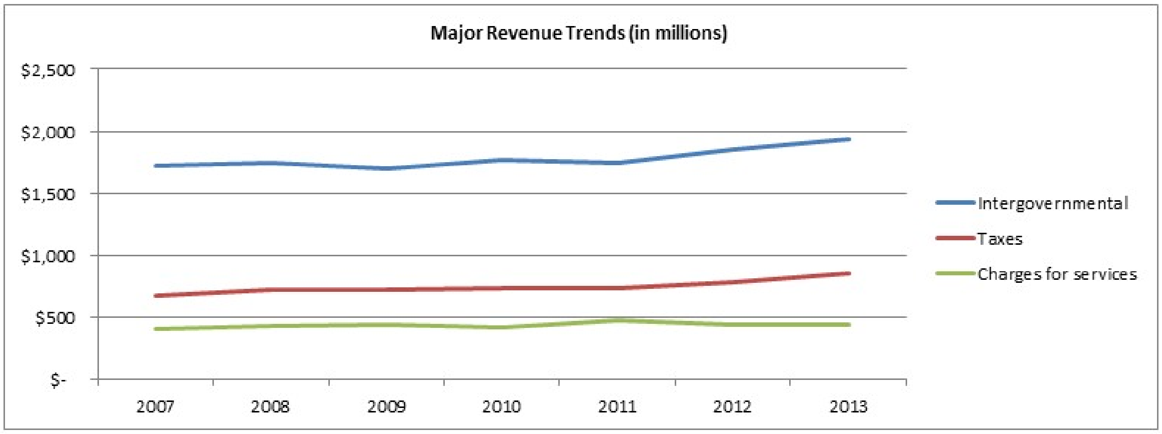
Sherriff's Department

A large component of service charges for government services was public safety provided by the Orange County Sherriff's Department to 13 contract cities, unincorporated areas of the County, and John Wayne Airport. The Orange County Sheriff-Coroner Department has approximately 3,000 sworn and professional staff members in addition to reserve personnel. The Department receives financial support from the Proposition 172 Public Safety ½ Cent Sales Tax which provided approximately $274 million. For fiscal 2013-14, 13 contract cities also paid approximately $107 million to obtain the services of the Sheriff's Department to recoup the cost of services. Rates for contract cities are budgeted to increase by an average of 5.78% for fiscal 2014-2015. These funds are in part used for pension contributions to OCERS.

Contracts between contract cities and the County with Orange County Sheriff's Department are one year long, and either party can terminate the agreement with 180 days written notice. All cities currently under contract with the Orange County Sheriff's Department also contract with the Orange County Fire Authority for fire and emergency services.



County Revenue Past Trends



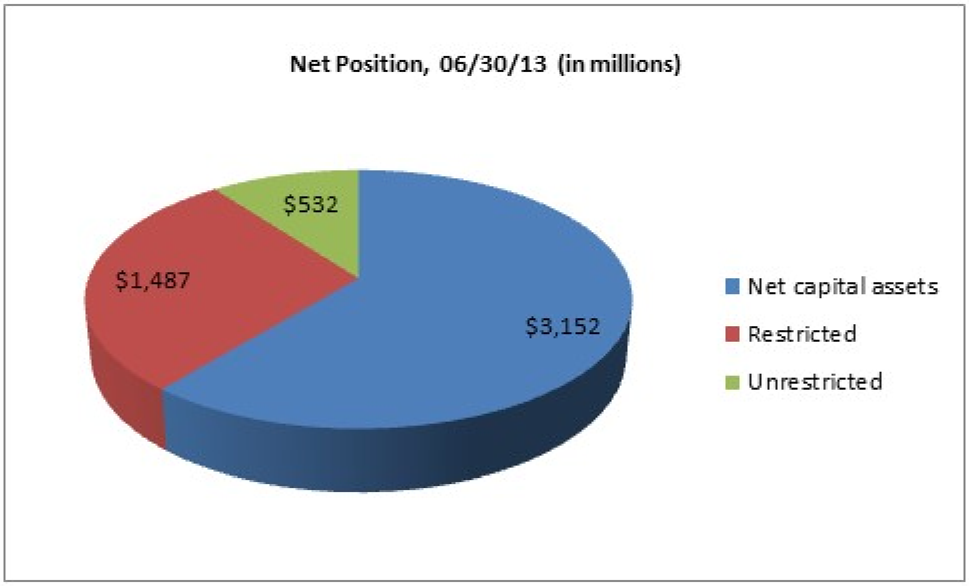
Orange County's total operating revenues for enterprise funds were $221 million in 2013. Enterprise funds are separately stated from government funds to emphasis the business-like nature of enterprise funds versus governmental operations. The County's enterprise revenues come from sources such as the John Wayne airport and the County's waste management facilities. The Airport's revenue was $114 million and Waste Management was $107 million during the year. Enterprise employee payments to pensions are paid from enterprise funds. The County pays its employer pension obligations using OCERS' prepayment program. The source of County payments is pension obligation bonds. True-up payments are made later in the year to make the 100% payment, including employer pickups.

Net Position as of June 30, 2013

The total assets of the County exceeded its total liabilities at June 30, 2013 by $5.1 billion. Of this amount, $532 million is unrestricted and may be used to meet the County's ongoing obligations to citizens and creditors. Total liabilities exclude employer contributions to OCERS, which were paid from pension bond proceeds.

The County's Net Position was comprised of the following:

- **Net Investments in capital assets** of $3.2 billion includes buildings, equipment, land, construction in progress, structures, equipment, software, and infrastructure.
- **Restricted** was $1.5 billion, which combined amounts constrained to specific purposes by their providers (such as grantors, bondholders and higher levels of government) through constitutional provisions or by enabling legislation and was primarily for social services/welfare grants, pension obligation bonds, future capital projects, and the County's debt service.
- **Unrestricted** was $532 million. These are available for any purpose approved by the Board of Supervisors.



Budgeting and Forecasting by the County

The County Executive Office prepared the fiscal year 2014-15 Recommended Budget for approval by the Board of Supervisors. The "2013 Strategic Financial Plan" includes their forecast and what key indicators they use. The Strategic Financial Plan is influenced by several economic factors, measuring Orange County against the nation and other counties and against its own past performance:

- Comparative employment statistics against other Southern California counties
- Orange County's year-over-year property tax and general purpose revenue growth
- Comparison of Orange County's Fund Balance against other Southern California counties
- Comparative housing analysis of median home price, unit sales, and median family incomes against other Southern California counties
- Trends in taxable sales year-over-year
- Orange County's Sources and Uses for the County's discretionary General Purpose Revenue
- Additional funding or augmentations requests from the County General Fund and Reserve available to the General Fund
- Orange County's Capital Improvement Plan
- Orange County's Strategic Priorities for major projects/initiative and requested funding from the County General Fund.

The County uses the Anderson Forecast, which makes quarterly economic forecasts for Southern California, the State, and the United States. The Forecast reports consist of national and state level data and commentary including interest rates, real estate analysis, government revenues, online services, exports and imports, employment, financial activity, demographics, personal income, online services, and consumer spending.

The County also uses the Congressional Budget Office (CBO) Monthly Budget Review-Summary for forecasts of Gross Domestic Product, Consumer Price Index, unemployment, Treasury bill rates, and the federal deficit. The County uses the Legislative Analyst's Office revenue forecasts for the State. The County also uses the Chapman University forecast for economic and employment growth. Chapman also tracks and forecasts Permits for Dwelling Units and Resale Homes Index for Single Units. Both UCLA and Chapman have state forecasts of CPI, Taxable Sales, Personal Income, and Payroll Employment. The County tracks taxable sales and other economic data from various sources that help the County to forecast revenues.

Long-Term Debt and Bond Ratings (Non-OCERS' UAAL)

Standard & Poor's Rating Services has rated Orange County bonds AA, and its long-term rating and underlying rating on the County's lease revenue bonds, recovery bonds, and pension obligation bonds A+. S&P assigned AA- rating to the county's 2014-2015 pension obligation note. S&P's outlook on all ratings is stable.

The ratings reflect S&P's assessment of the following factors for the county:

- S&P considers the county's economy to be very strong, with projected per capita effective buying income at 122.3% of the U.S. and per capita market value of $144,921. Assessed valuation reached $443 billion for fiscal 2014, up 3.4% from the prior year. The county unemployment rate for calendar year 2012 was below 7.6%.
- S&P considers the County's budgetary performance factor to be adequate. The general fund and total governmental funds net adjusted results include a surplus of less than 1% for total governmental funds (before transfers) for fiscal 2012 and 2.9% for the general fund. General fund results were projected to be positive.
- S&P considers the liquidity of the County's finances to be very strong, with total government cash and investments (maturity of less than one year) equal to 28% of total governmental funds expenditures and 661% of total governmental funds debt service. S&P believes the county has exceptional access to external liquidity. The County currently has no variable-rate debt.
- S&P considers the County's management conditions as very strong with strong financial practices. Highlights include a five-year financial forecast and capital improvement plan, and the County provides quarterly budget reports to elected officials. The County sets a reserve target for the upcoming budget year in its strategic plan. In S&P's opinion, the County's debt and contingent liabilities profile is strong, with total governmental fund debt service as a percentage of total governmental fund expenditures at 4.3%, net direct debt (including tax increment bonds) as a percentage of total governmental fund revenue at 22.8%, and overall net debt less than 3% of market value. S&P considers the County's

pension obligation to be large, with a pension annual required contribution plus other postemployment benefits contribution at 11% of expenditures.

Moody's Investor Service rates the County Aa1.

County Long-Term Obligations

In its CAFR, the County specifies revenues it plans to use to pay long-term debt. The amount of general obligation bonded indebtedness the County can incur is limited by law to 1.25% of the last equalized assessment property tax roll. At June 30, 2013, the County had no net general obligation bonded debt. The County's legal debt limit for the year was $5.4 billion. In order for the County to issue general obligation bonds secured by ad valorem taxes on real property, California Constitution Article XIIIA, Section 1 requires the approval of 2/3 of the voters voting on the proposition.

Long-Term Debt as of June 30, 2013 was:

- Refunding Recovery Bonds (2005) had an outstanding principal balance of $37.4 million and interest of $2.6 million.
- Lease Revenue Refunding Bonds Series (2005) had an outstanding principal balance of $114.1 million and interest of $12.4 million. These are secured by lease payments made by the County.
- Refunding Certificates of Participation (1991) had an outstanding principal balance of $2.8 million and interest of $12.8 million. These are also secured by lease payments made by the County.
- Juvenile Justice Center Facility Lease Revenue Refunding Bonds (2012) had an outstanding principal balance of $32.7 million and interest of $4.5 million. These are also secured by lease payments made by the County.
- Lease Revenue Bonds (2006) had an outstanding principal balance of $19.8 million and interest of $2.8 million. These are also secured by lease payments made by the County.
- Series 1996A and 1997A Pension Obligation Bonds had outstanding principal balances of $16.4 million and $21.5 million, respectively.
- Airport Revenue Refunding Bonds (2003) had an outstanding principal balance of $23.7 million and interest of $0.6 million. These are secured by John Wayne Airport revenues.
- Airport Revenue Bonds, Series 2009A and 2009B had outstanding principal balances of $64.1 million and $152.7 million, respectively, and outstanding interest were $51.9 million and $90.2 million, respectively. These are secured by John Wayne Airport revenues.
- Waste Management System Refunding Revenue Bonds (1997) had an outstanding principal balance of $7.0 million and interest of $0.2 million. These are secured by Waste Management revenues.
- Tax exempt Teeter Plan Notes had an outstanding principal balance of $43.4 million.

Past Ten-Year Trends

The County of Orange CAFR also publishes a statistical section with information regarding financial trends, revenue capacity, and debt capacity for the past ten years. The net position for government and business type activities has for the most part steadily improved for the past ten years. Even the financial crisis of 2008 seems to have had a limited effect on the County net position, causing a relatively small decline only for two years before surpassing previous levels. The net change was negative only in 2008-09, and in 2011.

The assessed value of taxable property in Orange County declined in 2009-10, but by 2012-13, the value reached $428 billion, surpassing the high of 2008-2009.

Total County debt has declined steadily in the past ten years from $1.5 billion in 2003-04 to $700 million in 2012-13. The percentage of debt to personal income in this period went from 1.18% to 0.41%. Certificates of participation declined significantly. Redevelopment bonds and Teeter Plan revenue bonds have been retired. Airport revenue bonds have increased significantly in the period.

Orange County Fire Authority (OCFA)

The OCFA was formed on March 1, 1995, transitioning from the Orange County Fire Department to a Joint Powers Authority (JPA). The OCFA is an independent special district that services twenty-three member cities and the unincorporated areas of Orange County. A twenty-five member Board of Directors governs the OCFA. This Board includes an elected official from each of the twenty-three member cities and two representatives from the County Board of Supervisors. The OCFA is managed by an appointed Fire Chief who reports to the Board of Directors. Emergency response services are provided to 1.7 million residents in a 571 square mile area of Orange County. The OCFA's authorized staffing level (including all frozen/unfunded positions) was 1,343 full-time positions for fiscal year 2012-13.

As of OCFA Fiscal Year 6/30/13

Total Assets	$394 million ($157 million Cash and Investments)
Total Liabilities	$136 million (excludes contributions to OCERS)
Net Position	$258 million (Unrestricted - $75 million)

As of OCERS Fiscal Year 12/31/13

Share of OCERS' Total UAAL	$450 million
Total Pension Contributions	$69 million

OCFA is OCERS' second largest plan sponsor, making approximately 10.9%, or $69.1 million, of OCERS' contributions. It has 1,185 active members, or 5.5% of OCERS' active membership.

Through quarter ended March 2014 (75% of the year), OCFA's General Fund revenues are 67.3% of budget at a YTD total of $205 million and General Fund expenditures are 70.8% at a YTD total of $216 million. OCFA prepays its annual employer contributions to OCERS, and its total liabilities of $136 million does not include its employer contribution.

Revenues

OCFA's total revenues were $311 million for the year ending June 30, 2013.

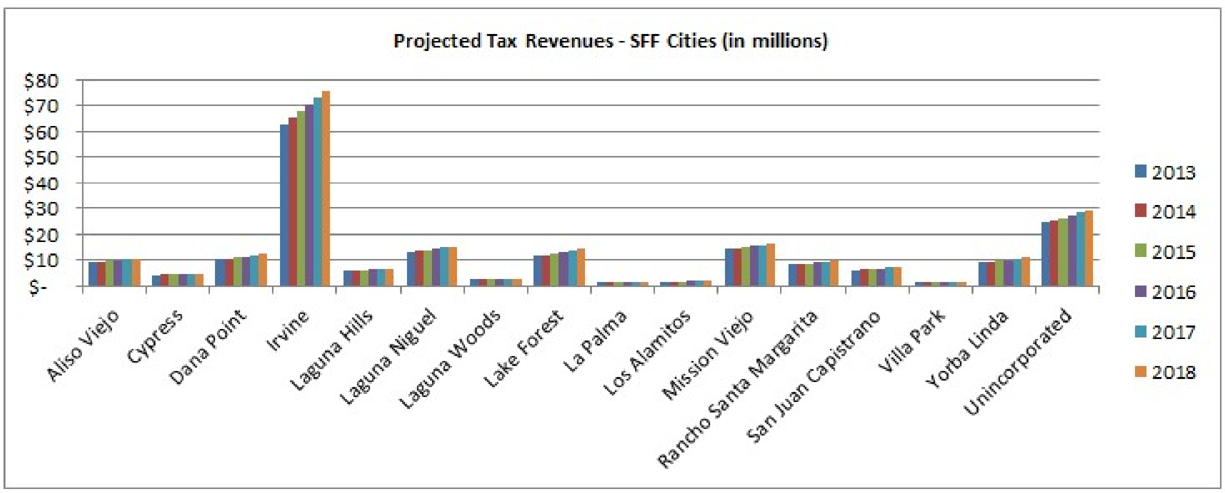
Two primary sources of OCFA revenue come from contract cities and the Structural Fire Fund as outlined in the Joint Powers Agreement for the OCFA. The majority of revenues came from property taxes ($182 million) from the Structural Fire Fund (SFF) and charges for services ($103 million) mostly paid by contract cities. Property tax is 63% of their budgeted revenues. OCFA also received $22 million in operating grants and capital grants from other governmental agencies. Miscellaneous revenues of $4 million consisted mostly of $3.3 million in contributions to the Firefighter Medical Trust Agreement and $0.7 million in other revenues.

Structural Fire Funds (SFF)

The County of Orange remits a portion of property taxes collected from SFF cities to OCFA in accordance with the County's tax apportionment procedures and schedules (i.e. a percentage of property tax revenues collected from the SFF cities and unincorporated areas of the County). In fiscal year 2012-2013, 11.56% of the county's collected property tax was allocated to OCFA for SFF.

SFF members currently include Aliso Viejo, Cypress, Dana Point, Irvine, Laguna Hills, Laguna Niguel, Laguna Woods, Lake Forest, La Palma, Los Alamitos, Mission Viejo, Rancho Santa Margarita, San Juan Capistrano, Villa Park, Yorba Linda, and unincorporated areas of the County. For SFF members, the current 20-year term began on July 1, 2010 and ends on June 30, 2030. Approximately 47% of property tax revenues allocated to OCFA are generated from the City of Irvine and the County's unincorporated territory.

Below is OCFA's projected five-year trend of forecasted property tax revenues for each of the SFF members, according to their consultant for forecasting, RSG. OCFA expects an average of 3.57% increase in property tax revenues over the next five years.

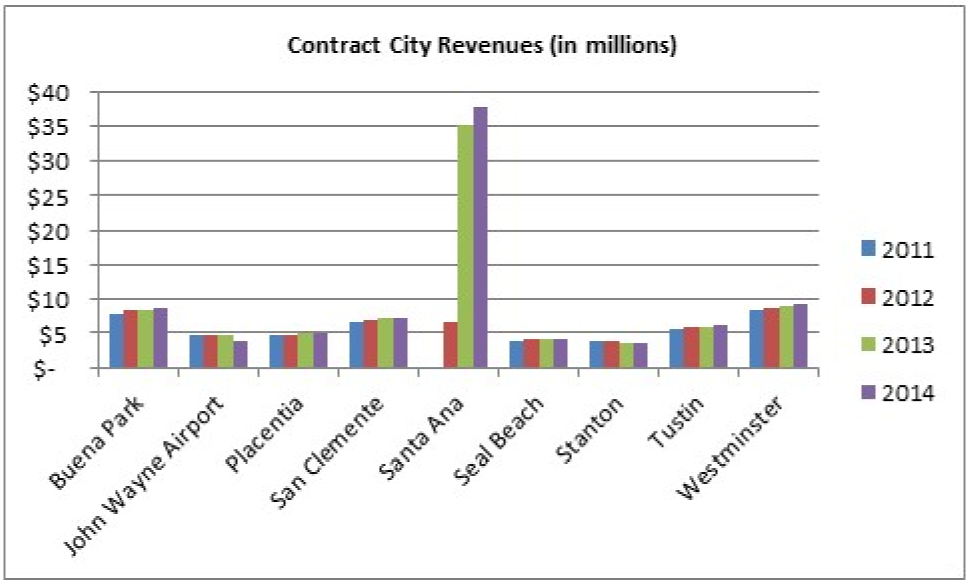


Contract Cities

Contract cities pay the OCFA for fire services out of their respective general funds. Contract cities currently include Buena Park, Placentia, San Clemente, Santa Ana, Seal Beach, Stanton, Tustin, Westminster and John Wayne Airport. There is also a contract with the state department of forestry that renews every three years. Contract cities are members of the OCFA for a current 20-year term that began on July 1, 2010 with the option of dropping out after 10 years.

Annually, OCFA calculates the total fire service charges for each contract city. The charge includes a base service charge, a shortfall catch up payment, vehicle replacement costs, and station maintenance costs. The base service charge is the sum of the prior year total service charge plus cost increases capped at no more than 4.5%. Generally, salary and benefits historically account for more than 90% of the base service charge. Thus, increases in salary and benefits have been the general drivers of the annual increase in base service charges. The shortfall catch up is a 10-year amortized payment of the difference between a contract city's 2009-2010 actual service charge and the contract city's service charge had there been no contractual caps of service charges for the 10 years prior to 2009-2010. Each city also pays into the vehicle replacement cost fund to recover depreciation expense for equipment assigned to that city. Finally, each contract cities contributes $15,000 per fire station in their boundaries to replenish the maintenance fund.

Every five years, OCFA compares actual operational costs for the fiscal year against the annual service charge of each contract city. Depending on the size of the difference between those two, the contract city may potentially end up paying to OCFA the entire difference in the current year or amortizing payment over the subsequent five years.



OCFA's Long-Term Liabilities (Non-OCERS' UAAL)

OCFA's long-term liabilities as of June 30, 2013 were $116 million composed of the following: $49 million in accrued workers' compensation claims, $38 million in other post-employment benefits (OPEB), $16 million in compensated balances for vacation and sick pay, and $13 million in capital lease obligations for helicopters.

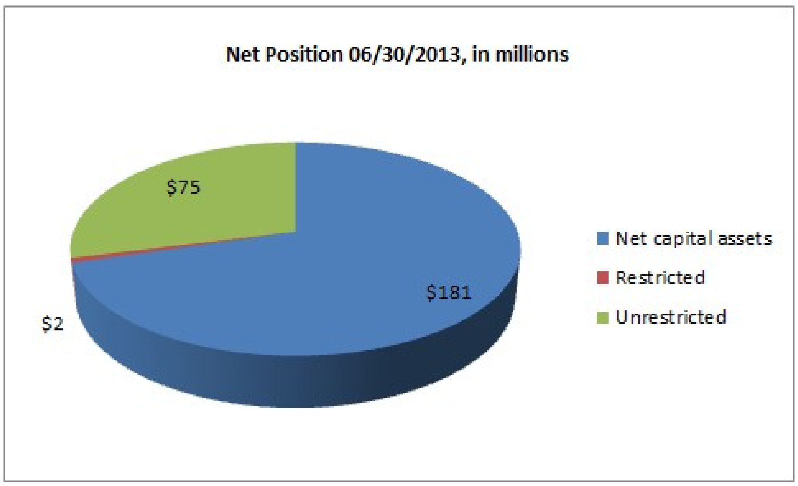
OCFA's Expedited UAAL Payment Plan

OCFA's total UAAL was $550 million as of December 31, 2013. In September 2013, the OCFA Board of Directors approved an "Expedited Pension UAAL Payment Plan" with an expected payment of the entire UAAL balance over 13 years. During FY 2013-14, OCFA made a total of $5.2 million in additional payments to OCERS to help pay down its share of the UAAL. Also, on July 2014, OCFA made an additional $18.3 million payment to help pay down the UAAL balance as required under OCFA's Memorandum of Understanding (MOU) with the Orange County Professional Firefighters Association.

Net Position as of June 30, 2013

The total assets of OCFA exceeded its total liabilities at June 30, 2013 by $258 million. Of this amount, $75 million is unrestricted and may be used to meet OCFA's ongoing obligations to citizens and creditors.

The OCFA's Net Position was classified as follows:



- **Net Investments in capital assets** of $181 million includes buildings, equipment, and vehicles.
- **Restricted** was $2 million, which mostly includes external contract revenues that are legally restricted for new fire station development or improvements to existing fire stations.
- **Unrestricted** was $75 million. These are available for any purpose approved by the Board of Directors.

City of Irvine and Payment Amendment to Joint Powers Agreement

Nearly 34%, or about $62 million, of 2013 SFF revenues were derived from the City of Irvine, more than any other city, or about 20% of total 2013 revenues. Beginning in fiscal year 2013-14, the OCFA amended its Joint Powers Agreement with SFF cities and the County to adjust revenues received from SFF members. OCFA agreed to pay “overfunded” SFF members a Jurisdictional Equity Adjustment Payment (JEAP). “Overfunded” means a SFF revenue rate greater than the average SFF revenue rate for all SFF members. The City of Irvine was entitled to receive its JEAP payment in fiscal year 2013-14. However, the County of Orange contested the JEAP amendment in Superior Court, and on August 4, 2014, the judge invalidated the JEAP amendment to the plan. This decision is under appeal as filed by attorneys for OCFA.

Contract Cities Agreements and UAAL

Neither the original March 1995 OCFA Joint Powers Authority Agreement, nor the March 2000 amendment, nor the July 2010 amendment renewing the OCFA membership of contract cities, structural fire fund cities, and the County, explicitly mention any requirement for a member city to pay a portion of OCFA’s unfunded actuarial accrued liability to OCERS upon leaving OCFA. However, the March 2012 “Fire Services and Medical Services Agreement” between the City of Santa Ana and OCFA states:

> “Upon termination or expiration of this Agreement or other cessation of city’s membership in OCFA, city agrees to pay OCFA the amount of the unfunded pension liability that had accrued during the term of this Agreement for the number of OCFA employees serving the city. In the event of any dispute regarding the amount of the unfunded pension liability at that time, the parties agree that the amount shall be determined by an independent actuary selected either by mutual agreement of the parties, or failing that, by the actuary used by the Orange County Employees Retirement System (OCERS).”

Leaving the JPA

Under the JPA, both SFF and Contract Cities shall be members of the Authority for a 20-year term commencing July 1, 2010. Twenty-year membership terms automatically renew in 2030. However, any city except the City of Irvine may give written notice of withdrawal prior to July 1 of the second to last year of every ten-year interval of a twenty-year term (e.g., for the first ten-year interval, notice must be given by July 1, 2018 to withdraw by June 30, 2020). However, the City of Irvine can leave the OCFA in 2020 if OCFA fails to make JEAP payments to Irvine, due to the Court decision.

Orange County Superior Court

The State of California has 58 superior courts—one in each of the state's 58 counties. Based on the number of authorized judicial officers, the Superior Court of Orange County is the third largest of the 58 courts. The Court has 124 Superior Court Judges and 20 Superior Court Commissioner positions. The Orange County Superior Court was part of the County of Orange until 1999 when it transitioned to the State of California and became a plan sponsor for OCERS.

As of OCERS Fiscal Year 12/31/13

Share of OCERS' Total UAAL	$389 million
Total Pension Contributions	$43 million

Superior Court is OCERS' third largest plan sponsor, making approximately 6.8%, or $43 million, of OCERS' contributions in OCERS' fiscal year 2013. It has 1,492 active members, or 7.0% of OCERS' active membership, as of OCERS' fiscal year 2013.

Trial courts in California are predominantly state-funded entities, whose funding appropriations are included in the State of California Budget under the Trial Court Trust Fund. Thus, the Judicial Branch is subject to the level of funding that is negotiated between the Governor and the state Legislature. Since the recession of 2008, the Judicial Branch has seen funding reductions. Over the past five years, the state of California has reduced State General Fund support for the Judicial Branch by nearly $1 billion. The Superior Court had their fiscal year 2013-14 base allocation distributed by the Judicial Council at $129.8 million.

Orange County Superior Court does not have audited financial statements solely for its entity. Financial information of Orange County Superior Court is included along with the other 57 superior courts in the audited financial statements for the state of California.

Revenue Allocation from California

For Fiscal Year 2012-13 the state budget for all funds was $142.5 billion and out of that the Judicial Branch budget was allocated 2.1 percent, or $2.95 billion. Out of this $2.95 billion, 78% ($2.3 billion) was allocated to the State's 58 trial courts, including the Superior Court of Orange County.

In 2012, the Governor and Legislature tasked the Judicial Branch with developing a new funding methodology to more equitably distribute funding to the 58 trial courts. In 2013, the new methodology named the Workload-Based Allocation and Funding Methodology (WAFM) establishes a baseline funding formula for each court using data such as total court filings, filing-driven costs, and U.S. Bureau of Labor Statistics (BLS) labor cost data. Adjustments are taken to account for the ratio of simple and complex cases for each of the 58 trial courts. The WAFM result for each court will be updated annually and will vary year-to-year depending on actual filing trends, workload costs, and other various adjustments. The new methodology will be phased in over a period of five years accordingly (see table below “Revenues 2009-2014”). The Orange County Superior Court’s calculated share of revenues allocated by the State for Superior Courts was 8.23% last year and reduced to 7.26% for the current year. The experience of the last few fiscal years is that the amount of money available to the Court is declining.

Use of Reserves

During the past five years, the Court has been able to use its financial reserves to make up for budget shortfalls. The reserve balances were $62.5 million at the conclusion of FY 2010-11. The court has used most of its reserves to replace an old case management system for family law and juvenile cases. To make its budget for 2013-14, the Court used $23.5 million from reserves. The use of reserves has been an important resource for the court system to make up for budget shortfalls. However, beginning June 30, 2014, the Governor is limiting the courts to carry a reserve balance of no more than 1% of the prior year’s operating budget plus restricted funds, which for the Court means an allowable reserve balance of just over $2 million for the next fiscal year. In the past, the Legislature has used funds from construction fund balances generated from fine revenues to make up for budget shortfalls, but it is unclear whether this will continue.

Revenues

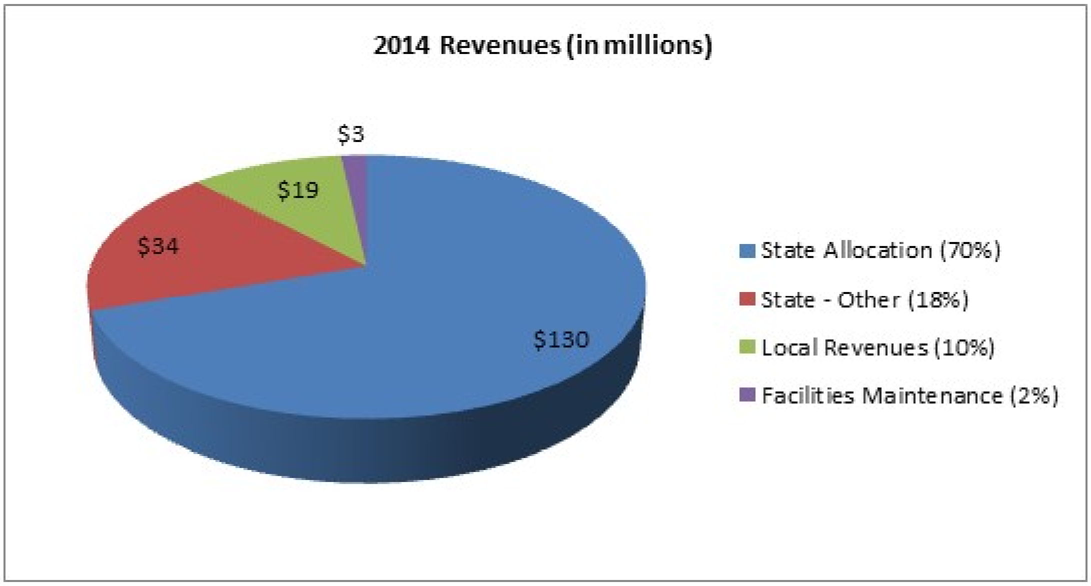
Superior Court’s total revenues were $186 million for the year ending June 30, 2014.

State Allocation of revenues to the Court was $130 million for fiscal year ended June 30, 2014 as discussed above.

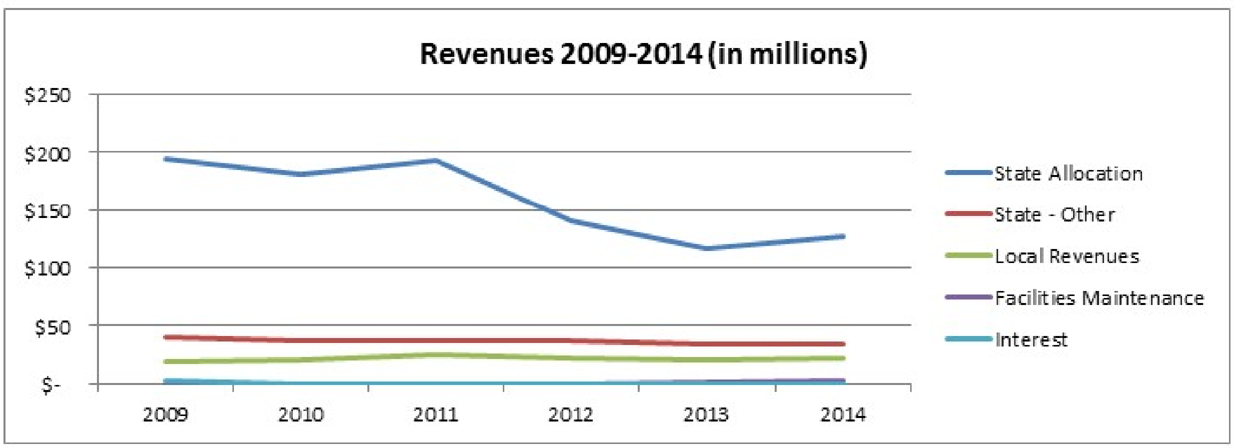
“State Other Revenue” was $34 million that includes state grants and dollar for dollar reimbursements of expenditures for language interpreters, jury pay expenditures, complex case programs, and self-help programs.

Local Revenues were $19 million and includes donations, reimbursements for services provided to the County, and cost recovery for the Enhanced Collections program and local fees, for example for copies of documents. Typically, local revenues remain consistent and do not fluctuate much from year to year. These are dollar in – dollar out reimbursement of expenses.

Facilities Maintenance was $3 million and is a three-year pilot program in which the court gets reimbursed for facility maintenance and modifications, also a dollar in/dollar out arrangement.



Superior Court's Past Revenue Trend



Orange County Transportation Authority (OCTA)

OCTA was established by state law on June 20, 1991. OCTA is governed by an 18-member Board of Directors (Board) that includes of five members of the Orange County Board of Supervisors, ten city representatives, two public members selected by the OCTA Board, and a non-voting representative appointed by the Governor of California. A Chief Executive Officer manages OCTA and acts in accordance with the directions, goals, and policies approved by the Board. OCTA serves Orange County residents and commuters by providing countywide bus and paratransit service, Metrolink commuter rail service, freeway improvements, street and road improvements, the 91 Express Lanes, motorist aid services, and taxi program regulation.

OCTA is OCERS' fourth largest plan sponsor, making approximately 4.3%, or $27.1 million, of OCERS' contributions in fiscal year 2013. It has 1,519 active members, or 7.1% of OCERS' active membership, as of 2013 year-end.

For OCTA Fiscal Year Ended 6/30/13

Total Assets	$2,012 million ($155 million Cash and Cash Equivalents)
Total Liabilities	$736 million (excludes contributions to OCERS)
Net Position	$1,276 million (Unrestricted - $525 million)

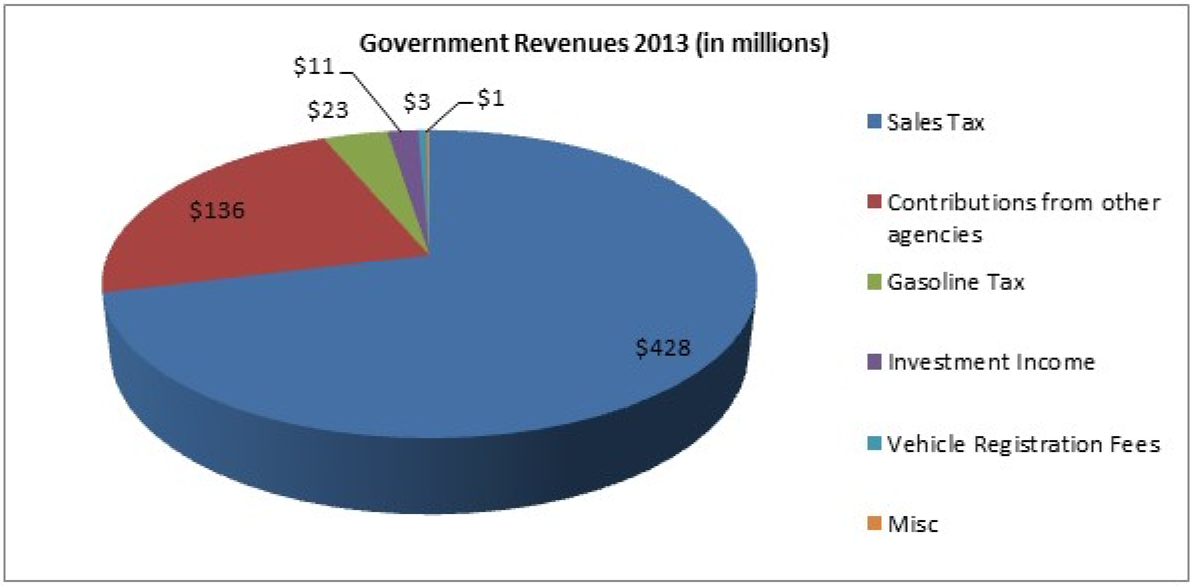
For OCERS Fiscal Year Ended 12/30/13

Share of OCERS' Total UAAL	$219 million
Total Pension Contributions	$27 million

OCTA's total revenues were $798 million for the year ending June 30, 2013.

2013 Revenues – Government Funds

OCTA's total government fund revenues were $602 million for the year ended June 30, 2013. OCTA's key sources of revenue were Measure M sales taxes, state sales tax, and contributions from other agencies.

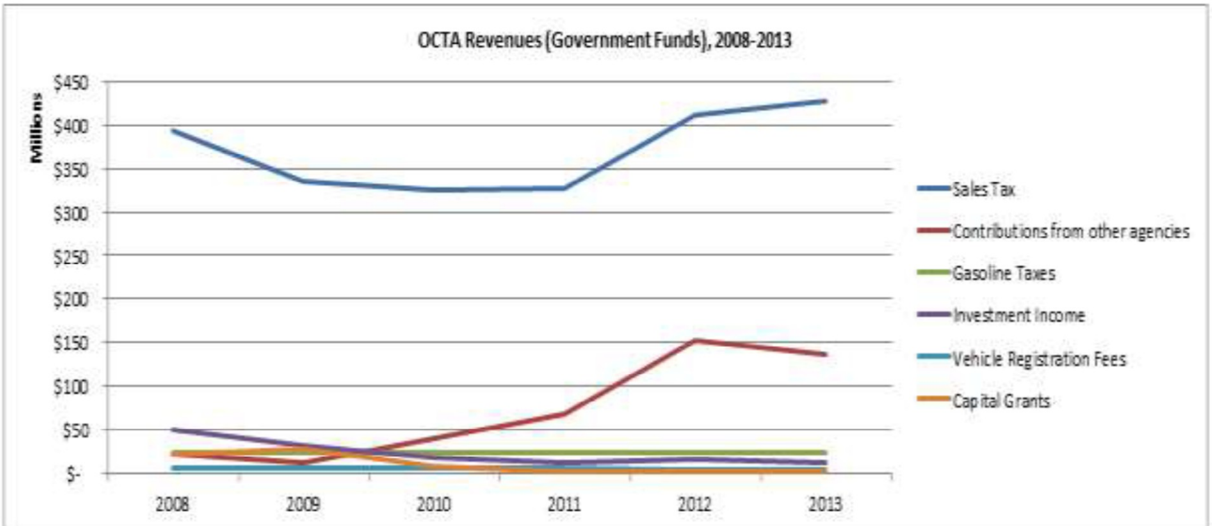


Sales Taxes of $428 million were comprised of Orange County's Measure M, California's Transportation Development Act, and State Transit Assistance programs:

- $265 million - Measure M ½ cent local sales tax - In 2006, Orange County voters renewed the M2 ½-cent sales tax for an additional 30 years. Allocation of M2 funds remains the same as the original M1 with 43% slated for freeway improvements, 32% for streets and roads, and 25% for transit projects and programs.
- $142 million – California's Transportation Development Act (TDA) ¼ cent state sales tax - TDA provides funding for public transportation via the Local Transportation Fund (LTF). This fund is for the development and support of public transportation needs that exist in California and are allocated to areas of each county based on population, taxable sales, and transit performance.
- $21 million - State Transit Assistance (STA) revenue is generated by the state sales tax on diesel fuel as specified under the gas tax swap enacted in March 2010. STA revenues are then distributed based on several demographic factors.

Contributions from other agencies ($136 million) include $69 million in Federal Operating Assistance Grants, $57 million in Federal Capital Assistance Grants, and $10 million in other federal or state grants. These funds are available for para-transit operating assistance, preventive maintenance, capital cost of contracting, demonstration projects, transportation planning, and acquisition and construction of facilities, transit vehicles and related support equipment. Federal grant funds are allocated on a formula and competitive basis for capital projects. Federal revenues are legally restricted to their intended purposes and cannot be used to pay pension costs.

OCTA'S Past Revenue Trends (Government Funds)



In addition to government fund revenues above, OCTA also had 2013 total proprietary (enterprise) operating revenues of $93 million and non-operating revenues of $103 million from the 91 Freeway Express Lanes (owned and operated by OCTA) and the Orange County Transit District (OCTA's predecessor agency which is now managed by OCTA). Enterprise funds are separately stated from government funds to emphasis the business-like nature of enterprise funds versus governmental operations. Operating revenues include cost recovery revenues for the 91 Freeway Express Lanes and OCTD. The 91 Express Lanes collected operating revenues of $39 million. The OCTD's operating revenues (farebox revenues) were $54 million. The OCTD's non-operating revenues mostly consisted of $60 million in Federal operating grants, $23 million in gas taxes, and $14 million in County property taxes during 2013.

Net Position as of June 30, 2013

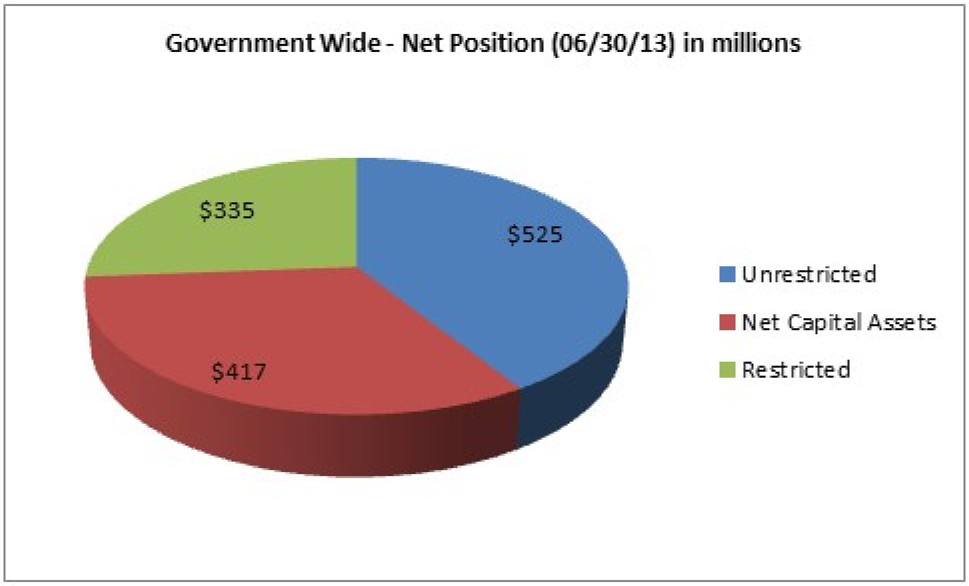
The total assets of OCTA exceeded its total liabilities at June 30, 2013 by $1.3 billion. Of this amount, $525 million is unrestricted and may be used to meet OCTA's ongoing obligations to citizens and creditors. OCTA prepays its annual employer contributions to OCERS, and its total liabilities do not include its employer contribution.

The OCTA's Net Position was assigned or restricted to the funds listed below:

- **Net Investments in capital assets** of $417 million includes buildings and improvements, machinery, equipment, furniture, transit vehicles, and transponders.
- **Restricted** was $335 million, represents net position that is not accessible for general use because their use is subject to restrictions enforceable by third parties. This is mostly

comprised of $290 million of net assets restricted by Measure M2 legislation for transportation programs and motorist services.

- **Unrestricted** was $525 million. These are available for any purpose approved by the Board of Directors.



Budgeting and Forecasting by OCTA

According to OCTA's CAFR, in 2005 when Measure M (M2) was being developed, the revenue forecast at that time assumed M2 would generate $24.3 billion during the 30 year program. With the economic downturn at the lowest point the forecast had dropped to $13.7 billion. This represents a 44% drop in anticipated revenue. Over the last 4 years, sales tax receipts have improved significantly, and the current forecast as of March 2014 is showing revenue at $15.5 billion over the life of the program. The impact of the overall reduction in funds for Measure M2 has also been aided by a favorable bidding environment with bids coming in below engineer's estimates.

Also according to OCTA' approved budget, the estimated taxable sales growth rate for FY 2014-15 is 6.7%. This blended rate is based on forecasts from Chapman University, California State University, Fullerton, and University of California, Los Angeles.

Long-Term Obligations and Bond Ratings (Non-OCERS' UAAL)

In 2008, OCTA issued $100 million in par value worth of commercial paper. The outstanding amount as of June 30, 2013 was $25 million. M2 sales tax revenues are the revenue source assigned to pay down this debt. Currently, bond rating agencies have assigned A-1 ratings for these bonds. The maturity date for this debt is October 2014.

In 2010, OCTA issued $293.5 million in par value worth of bonds. The outstanding amount as of June 30, 2013 was also $293.5 million. M2 sales tax revenues are the revenue source assigned to pay down this debt. Currently, bond rating agencies have assigned AA+ ratings for these bonds. The maturity date for this debt is February 2041.

Also in 2010, OCTA issued $59 million in par value worth of bonds. The outstanding amount as of June 30, 2013 was $46 million. M2 sales tax revenues are the revenue source assigned to pay down this debt. Currently, bond rating agencies have assigned AA+ ratings for these bonds. The maturity date for this debt is February 2020.

The above debt issuances financed the M2 program which has a spending allocation of 43% for freeway projects, 32% for street projects, and 25% for transit projects.

In 2013, OCTA issued $124 million in par value worth of bonds. The outstanding amount as of June 30, 2013 was also $124 million. 91 Express Lane toll revenue is the revenue source assigned to pay down this debt. Currently, bond rating agencies have assigned AA- ratings for these bonds. The maturity date for this debt is December 2030. This was issued to help OCTA finance the purchase of the 91 Express Toll lanes.

Past Trends

The CAFR also publishes a statistical section with information regarding financial trends, revenue capacity, and debt capacity for the past ten years. The net position for government and business type activities combined dropped by 24% during 2008 (due to the completion of the SR-22 project that transferred from OCTA's books to Caltrans) but has mostly remained steady since then.

Over the last four years, Orange County sales tax receipts have improved significantly, and the current forecast as of March 2014 is showing Measure M revenues at $15.5 billion over the life of the program.

Total OCTA debt had been steadily declining from 2004 until 2010. However, the issuance of $352 million of bonds in 2010, and $124 million in bonds in 2013, reversed this trend.

Orange County Sanitation District

The Sanitation District is a special district established by the California State legislature and governed by a 25-member board of directors. The directors are comprised of elected representatives for each of the sewer agencies or cities within OCSD's 479 square mile service area.

The Sanitation District owns and operates certain wastewater facilities in order to provide regional wastewater collection, treatment, and disposal services to approximately 2.5 million people in the northern and central portion of the County – 200 million gallons of daily wastewater. It is managed by an administrative organization comprised of directors appointed by the agencies and cities which are serviced by the Sanitation District.

The Sanitation District is OCERS' fifth largest plan sponsor, making approximately 3.7%, or $23.2 million, of OCERS' contributions in 2013. It has 587 active members, or 2.7% of OCERS' active membership, as of 2013 year end.

For OCSD Fiscal Year Ended 6/30/13

Total Assets	$3,145 million ($208 million Cash and Cash Equivalents)
Total Liabilities	$1,444 million (excludes contributions to OCERS)
Net Position	$1,701 million (Unrestricted - $520 million)

For OCERS Fiscal Year Ended 12/30/13

Share of OCERS' Total UAAL	$205 million
Total Pension Contributions	$23.2 million

Revenues

Sanitation District's total revenues were $383.6 million for the year ending June 30, 2013.

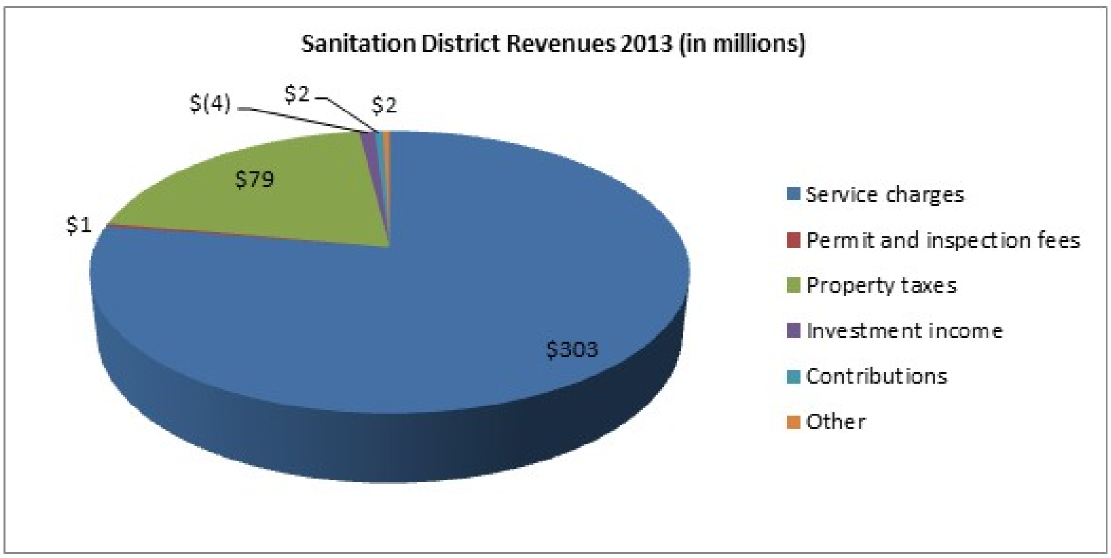
Service Charges were $303.4 million: user fees are ongoing fees for service paid by customers connected to the sewer system. A property owner, or user, does not pay user fees until connected to the sewer system and receiving services. Once connected, a user is responsible for his share of the system's costs, both fixed and variable, in proportion to his demand on the system. These fees are for both single family residences and multiple family residences. The 2013-14 single family residential rate, the underlying basis for all sewer rates, is $308. Rates for commercial and residential use are modified upward for the additional water flow that comes from these types of structures.

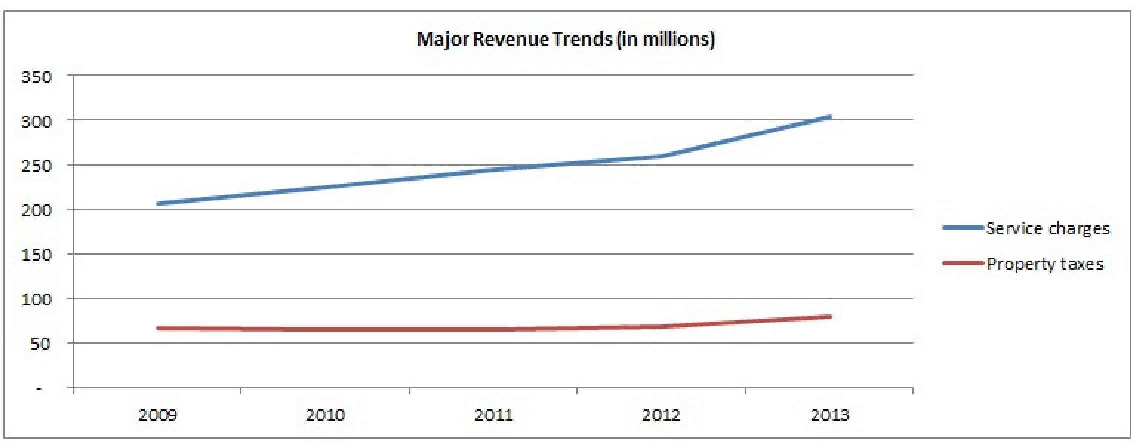
Property taxes were $79.2 million: the County is permitted by State law (Proposition 13) to levy taxes at 1 percent of full market value (at time of purchase) and can increase the assessed value no more than 2 percent per year. The District receives a share of the basic levy proportionate to what was received from 1976 to 1978. The District's share of this revenue is dedicated for the payment of debt service.

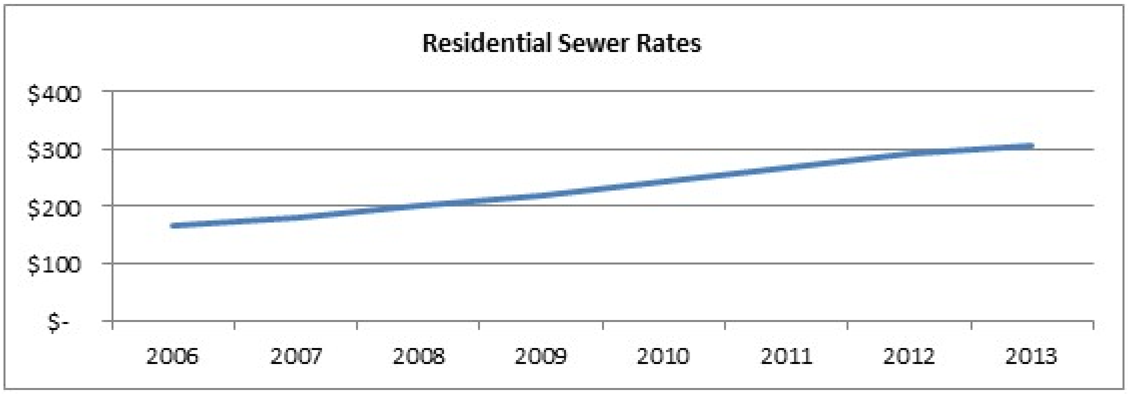
Contributions from other government were $2.0 million: this represents service charges to the Irvine Ranch Water District for its use of the Sanitation Districts' collection, treatment, and disposal system.

Permit and inspection fees were $1.2 million: large industrial and commercial properties that discharge high volumes or high strength wastewater are required to obtain a discharge permit and pay extra fees. These fees are for the owner's share of the system's costs, both fixed and variable, in proportion to the demand placed on the system.

Investment Losses of $3.9 million and Other Income of $1.7 million were also part of 2013 revenues.





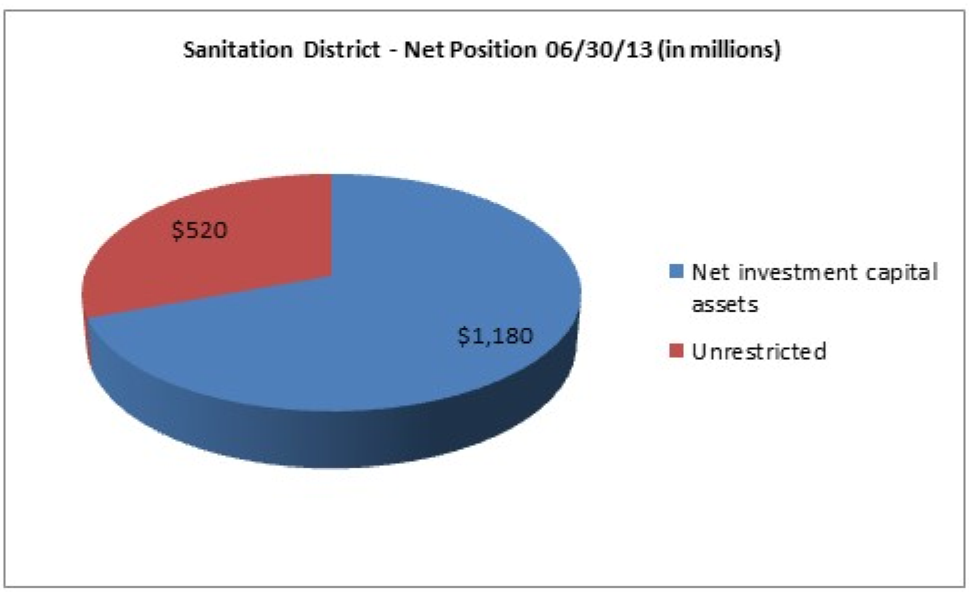


Net Position as of June 30, 2013

The total assets of the Sanitation District exceeded its total liabilities at June 30, 2013 by $1.7 billion. Of this amount, $520 million is unrestricted and may be used to meet the Sanitation District's ongoing obligations to citizens and creditors.

The County's Net Position was assigned or restricted to the funds listed below:

- Net investment in capital assets – $1.2 billion:
  - Collection system - $508.9 million
  - Treatment and disposal (land) $4.5 million
  - Treatment and disposal (equipment) $1.9 billion
  - (Less: debt of $1.2 billion)
- Unrestricted – $520 million: These are available for any purpose approved by the Board of Directors.



Long-Term Obligations and Bond Ratings (Non-OCERS' UAAL)

All of the outstanding debt of OCSD ($1.2 billion as of June 30, 2013) has rate covenants that require a minimum coverage ratio of 1.25. The minimum coverage ratio is the ratio of net annual revenues available for debt service requirements to total annual debt service requirements. As of June 30, 2013, the coverage ratio for senior lien debt was 3.01.

Both Standard and Poor's Corporation and Fitch Ratings reaffirmed their AAA rating of the Orange County District in the past fiscal year.

City of San Juan Capistrano

The City of San Juan Capistrano is OCERS' sixth largest plan sponsor, making approximately 0.4%, or $2.5 million, of OCERS' contributions in 2013. It has 81 active members, or 0.4% of OCERS' active membership, as of December 31, 2013. The City's Unfunded Actuarially Accrued Liability was estimated at $24 million as of December 2013.

The City has grown from a small community of approximately 10,000 persons in 1974 to a developed city of 34,593 in 2011. The City government is staffed by 81 employees plus seasonal and temporary workers and is governed by a City Council of five people elected to four year overlapping terms. San Juan Capistrano joined OCERS as a plan sponsor in 1975 and most current city employees are part of OCERS' Plan S (2.0% @ 57) or Plan J (2.7% at 55).

Revenues

The City's total revenues were $54 million for the year ending June 30, 2013.

The City's total governmental revenues were $32 million for the year ending June 30, 2013 and are broken down as follows:

Property Tax of $11.5 million was allocated from county property taxes for properties within the City boundaries. The base property tax rate is 1%, and the City is entitled to 11% of this property tax; the other 89% is allocated to other entities by the County. Also included are additional property taxes from the state in lieu of vehicle license fees historically allocated to the City, indicating an expected increase of property taxes collected. Included in these property tax receipts, the City is receiving property taxes from the state in lieu of a portion of the sales tax historically allocated to the City.

Four major factors affecting property tax revenue include the property turnover rate, pricing, new construction activity, and Proposition 13's 2% inflation cap. The City also expects the construction of an additional 2 million square feet of non-residential real estate and over 2,000 residential units over the next eight years.

Sales Tax of $8.1 million came from local sales tax charges. Sales tax is levied on all tangible retail goods sold within the San Juan Capistrano City limits. An 8% tax is levied at the site where the sale is made. One percent is remitted back to the City of San Juan Capistrano by the state of California.

The City categorizes its sales tax into six categories in descending order of historical receipts: 1) transportation (auto sales), 2) general retail, 3) food products, 4) construction, 5) business-to-business, and 6) miscellaneous. Currently there are eight auto dealerships in the city that generate a substantial portion of sales tax revenue for the City.

Franchise Tax of $0.3 million comes from taxes on franchise operations in the City including electric, gas, cable TV, waste management. For electric and gas companies, the City collects 2%

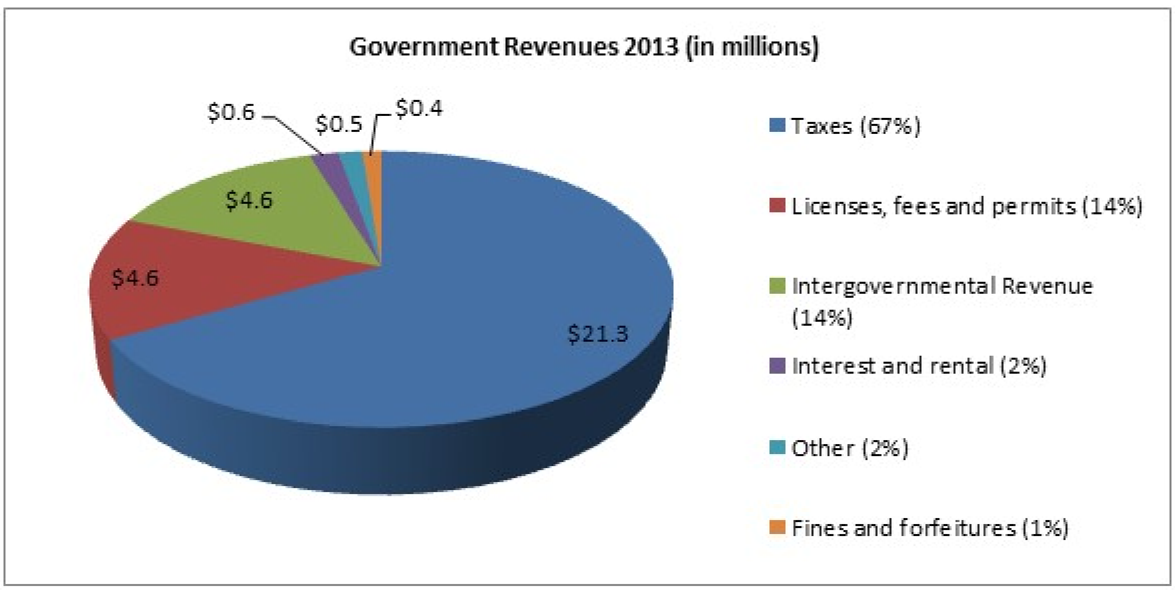
of gross revenues generated in the City. For cable TV, the rate is 5% for revenues generated in the City.

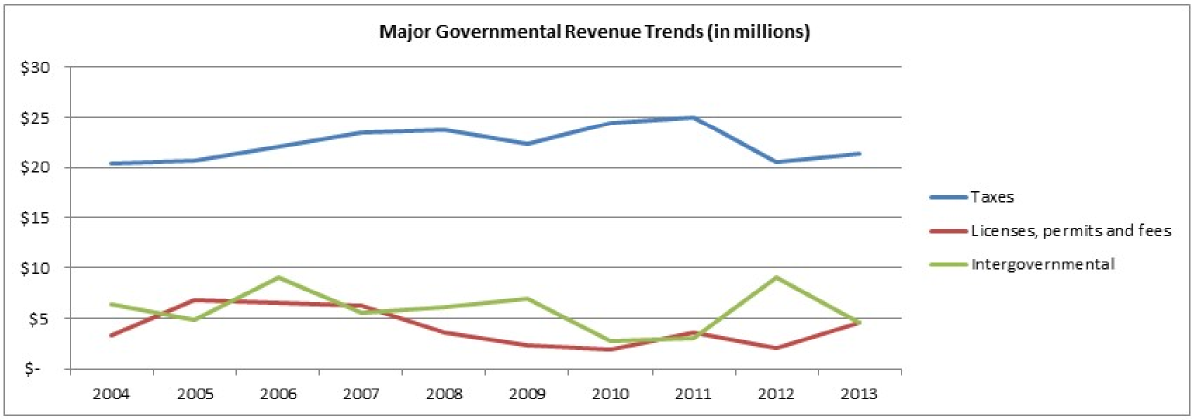
Other Taxes of $1.4 million include real property transfer taxes when property is sold and is based on the value of the property sold; hotel occupancy taxes, which have a 10% charge to total collected for hotel stays; and business license taxes.

License, fees, and permits were $4.6 million and consist largely of charges to process building permits and engineering and planning division reviews of building development related projects. Currently there are homebuilding developments that are expected to build over 2,000 residential units within the City.

Intergovernmental Revenue were $4.6 million and is mostly derived from highway and road constructions grants from both Federal and State sources, Measure M funds from the County of Orange, state gasoline tax revenue grants, and parks and recreation revenues.

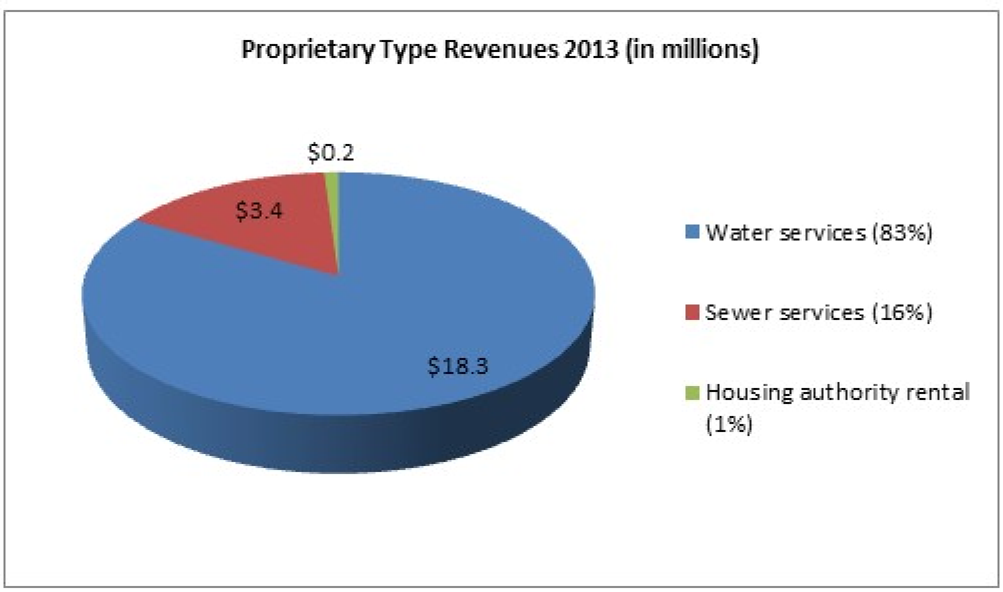
Other Revenues such as fines, forfeitures, interest income totaled $1.5 million.





The City's total proprietary fund operating revenues were $22 million for the year ended June 30, 2013. Proprietary funds are separately stated from government funds to emphasis the business-like nature of proprietary funds versus governmental operations.

Charges for water services and municipal sewer were 98% of operating revenues. Water service rates and municipal sewer rates are set by the City Council, primarily for cost recovery purposes. The remainder of service charges was comprised of rental income from low income housing projects within the City. Proprietary employee payments to pensions are paid from proprietary funds.

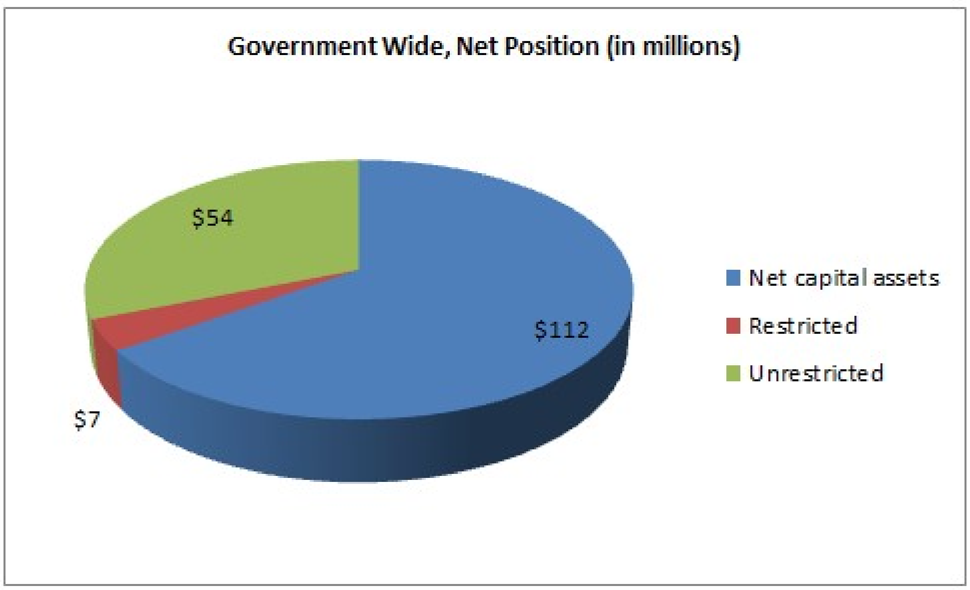


Net Position as of June 30, 2013

The total assets of the City of San Juan Capistrano exceeded its total liabilities at June 30, 2013 by $173 million. Of this amount, $54 million is unrestricted and may be used to meet the City's ongoing obligations to citizens and creditors.

The City' Net Position was assigned or restricted to the funds listed below:

- **Net Investments in capital assets** of $112 million includes buildings, equipment, and land and also included construction in progress, structures, equipment, software, and infrastructure.
- **Restricted** was $7 million, which combined amounts constrained to specific purposes by their providers (such as grantors, bondholders and higher levels of government) through constitutional provisions or by enabling legislation. These funds are restricted to various public and development works projects and for the water rate stabilization project.
- **Unrestricted** was $54 million. These are available for any purpose approved by the City Council.



Orange County Employees Retirement System (OCERS)

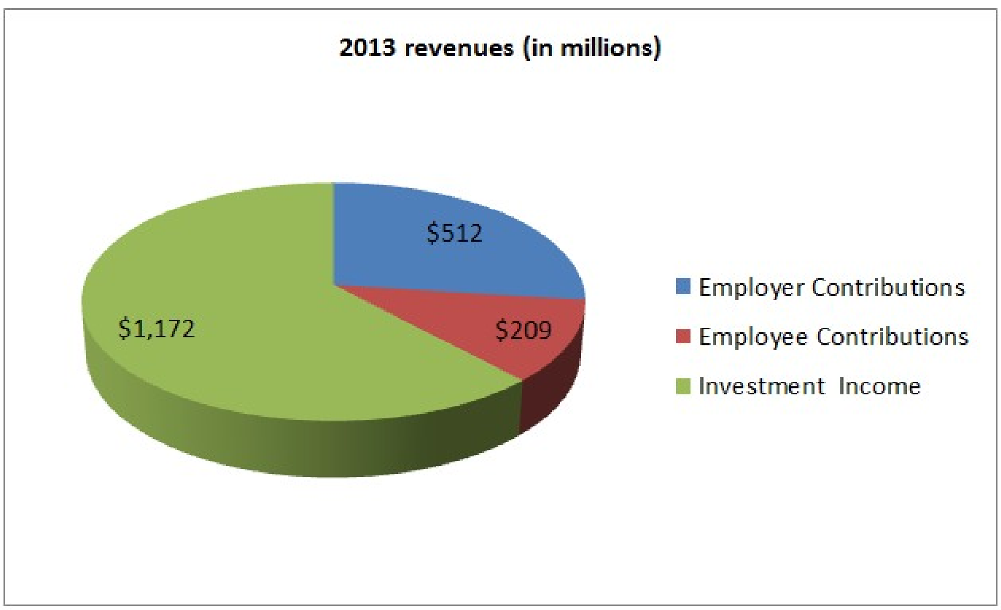
OCERS operates as a cost sharing multi-employer defined benefit pension plan for the County of Orange, the City of San Juan Capistrano, and 13 other special districts as described elsewhere in this report. As of December 31, 2013 the OCERS plan has approximately 26,000 active and deferred members and over 14,000 retired members. It is governed by a nine member Retirement Board with one alternate. OCERS also serves as the trustee for the County of Orange and OCFA other postemployment (OPEB) health care plan trusts.

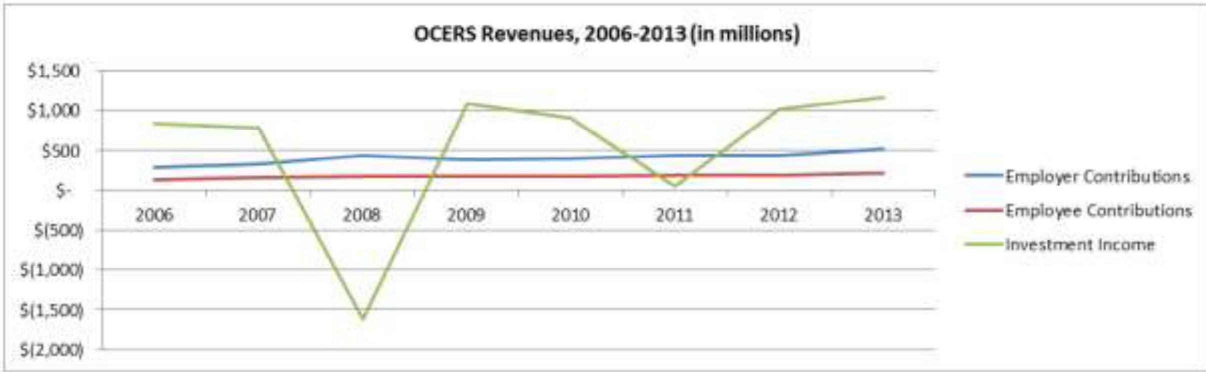
OCERS is also its seventh largest plan sponsor, making approximately 0.4%, or $2.3 million, of OCERS' contributions in 2013. It has 65 active members, or 0.3% of the OCERS plan's active membership, as of December 31, 2013. The Unfunded Actuarially Accrued Liability of OCERS as a plan sponsor was estimated at $21 million as of December 2013. Its 65 active members include 43 County of Orange employees assigned to work at OCERS and 22 employees who are directly employed by OCERS.

The revenues and net position reported below are held in trust for the benefit of all its plan sponsors, the OPEB plans for the County and OCFA, and to pay for the administration expenses of the OCERS plan.

Revenues

OCERS' total revenues were $1.9 billion for the year ending June 30, 2013.





Net Position as of December 31, 2013

The total assets of OCERS exceeded its total liabilities at December 31, 2013 by $11 billion. The entire amount is restricted for the benefit of all its plan sponsors, the OPEB plans for the County and OCFA, and to pay for the administrative expenses of the OCERS plan.

Transportation Corridor Agencies

The Transportation Corridor Agencies (TCA), or The Toll Roads, is OCERS' eighth largest plan sponsor, making approximately 0.3%, or $1.8 million, of OCERS' contributions for the year ended December 31, 2013. It had 77 active members, or 0.4% of OCERS' active membership, as of December 31, 2013. TCA's Unfunded Actuarially Accrued Liability was $11.2 million as of December 31, 2013.

TCA is comprised of the two joint-powers agencies -- the San Joaquin Hills Transportation Corridor Agency (SJHTCA) and the Foothill/Eastern Transportation Corridor Agency (FETCA) -- formed in 1986 to manage the planning, financing, construction and operation of State Routes 73, 133, 241 and 261. TCA's Board of Directors is composed of elected officials from 18 cities and three members of the Orange County Board of Supervisors.

The San Joaquin Hills Transportation Corridor, commonly known as the 73 Toll Road, opened to traffic in 1996. At June 30, 2014 approximately 83,000 transactions were recorded on the 73 Toll Road every weekday, serving as an alternative route to the 405 and 5 Freeways.

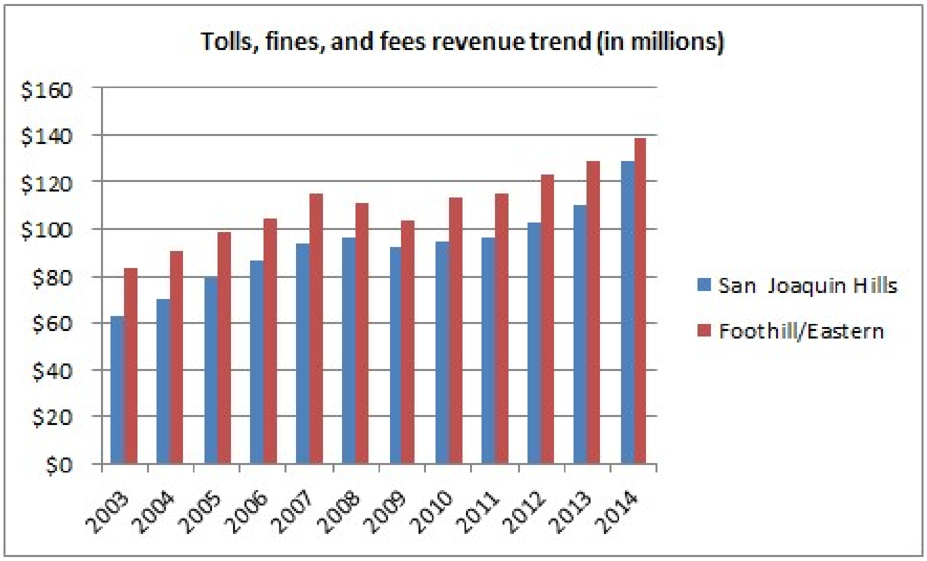
The Foothill/Eastern Transportation Corridor consists of the 241, 261, and 133 Toll Roads and first opened to traffic in 1993. As of June 30, 2014, approximately 177,000 transactions were recorded every weekday, serving as an alternative to local freeways and arterial roads.

Revenues

TCA' total revenues (SJHTCA and FETCA combined) were $292 million for the year ending June 30, 2014.

San Joaquin Hills Transportation Corridor Agency earned $129 million in tolls, fees, and fines during the year ended June 30, 2014. Foothill/Eastern Transportation Corridor Agency earned $139 million in tolls, fees, and fines during the year ended June 30, 2014.

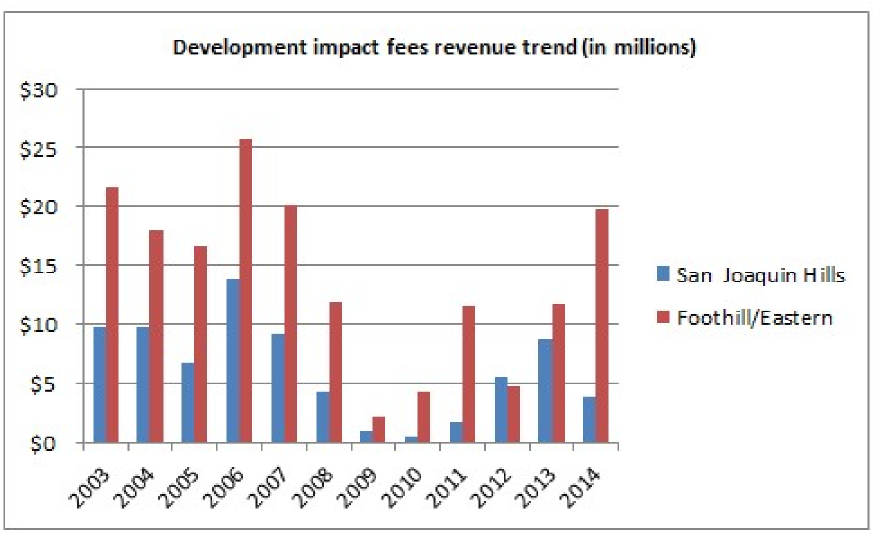
The bonds that financed the construction of the San Joaquin Hills toll road were restructured in 2011; in connection with this restructuring, toll rates were required to be adjusted annually to levels determined by an outside traffic consultant that would maximize toll revenue. However, during November 2014, SJHTCA completed a transaction that provided for refinancing $1.4 billion of its senior lien debt and removal of the requirement that toll rates be maximized. As is the case for the FETCA, toll rates for the San Joaquin Hills toll road will be determined and approved by the Board of Directors, with the assistance of a traffic consultant, at levels intended to meet debt covenant requirements and increase use of the toll road.

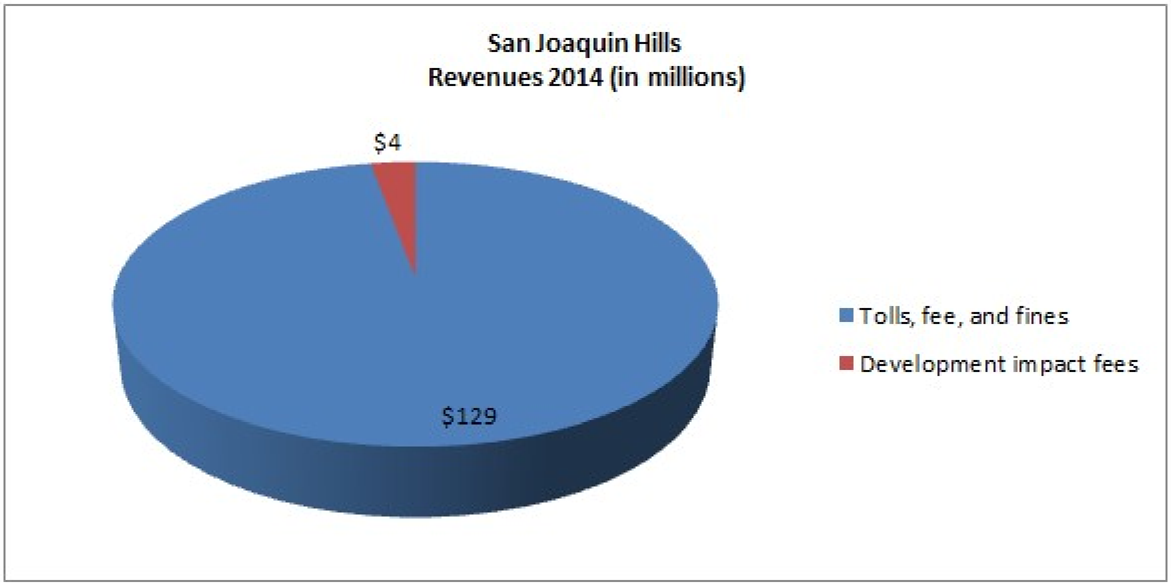


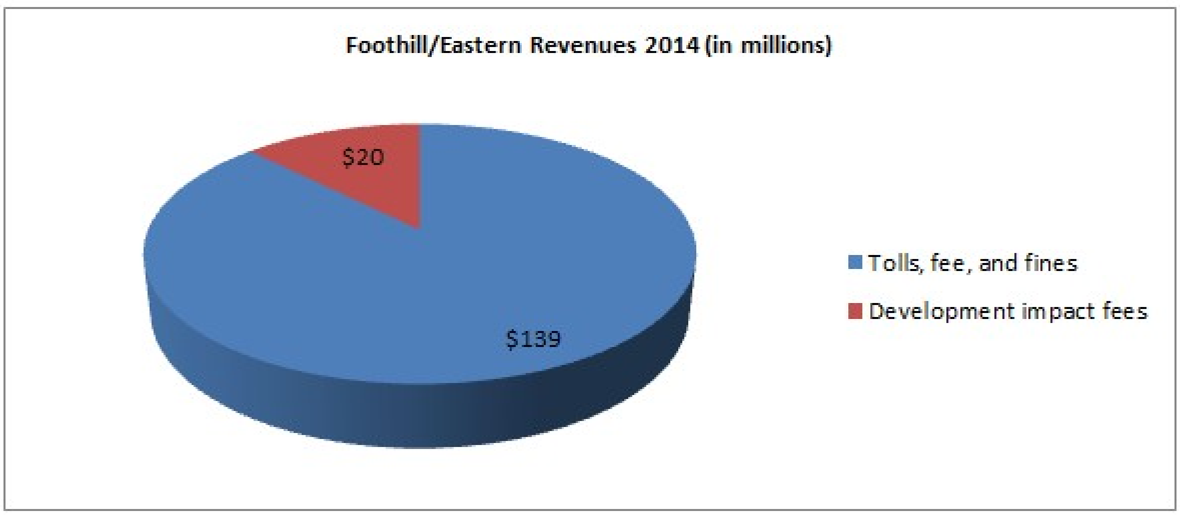
Development impact fees during the year ended June 30, 2014:

- San Joaquin Hills Transportation Corridor Agency earned $4 million in development impact fees during the year ended June 30, 2014.
- Foothill/Eastern Transportation Corridor Agency earned $20 million in development impact fees during the year ended June 30, 2014.

Development impact fees are fees charged for new residential units and new commercial square footage developed in certain cities that surround and benefit from the Toll Roads. The cities collect these fees from property developers and remit them directly to the Toll Roads. Of the $24 million development impact fees noted above, the City of Irvine was the largest city to remit funds and remitted $14 million collected from the developers during the year ending June 30, 2014.







Long-Term Debt

Out of SJHTCA's long-term debt of $2.2 billion as of June 30, 2014, approximately $1.4 billion has maturities extending up to 2050. Approximately $2.2 billion of FETCA's $2.4 billion in long-term debt as of June 30, 2014 has maturities between 2020 and 2053. According to the JPA, SJHTCA's and FETCA's existence as independent agencies collecting tolls is to "sunset," or cease, upon the payment in full of its respective debts. However, as has been done in the past, refinancing of debt can push back the "sunset" provision beyond the years 2050 and 2053, respectively, as noted above.

As rated by S&P, Fitch, and Moody's, the bonds of SJHTCA and FETCA have ratings that fall in the BB (speculative grade) and BBB (good credit quality/investment grade) categories.

Net Position as of June 30, 2014

- **Restricted –** $346 million and $436 million, respectively, for SJHTCA and FETCA. This portion of Net Position is subject to externally imposed conditions that can be fulfilled by the actions of the agency or by the passage of time, and is related primarily to restricted bond proceeds and certain revenues collected.

- **Unrestricted –** $23 million and $126 million, respectively, for SJHTCA and FETCA. These amounts are available for any purpose approved by the Board of Directors.

- **Capital Assets –** Negative $2,142 million and negative $2,016 million, respectively, for SJHTCA and FETCA. The portion of Net Position related to investment in capital assets is actually a negative balance because ownership of the toll roads and related rights-of-way has been transferred to the State of California's Department of Transportation and these assets are not presented within each agency's financial statements. Thus, the balances presented include only certain other capital assets, offset by the debt that financed construction of the toll roads.

Orange County Public Law Library

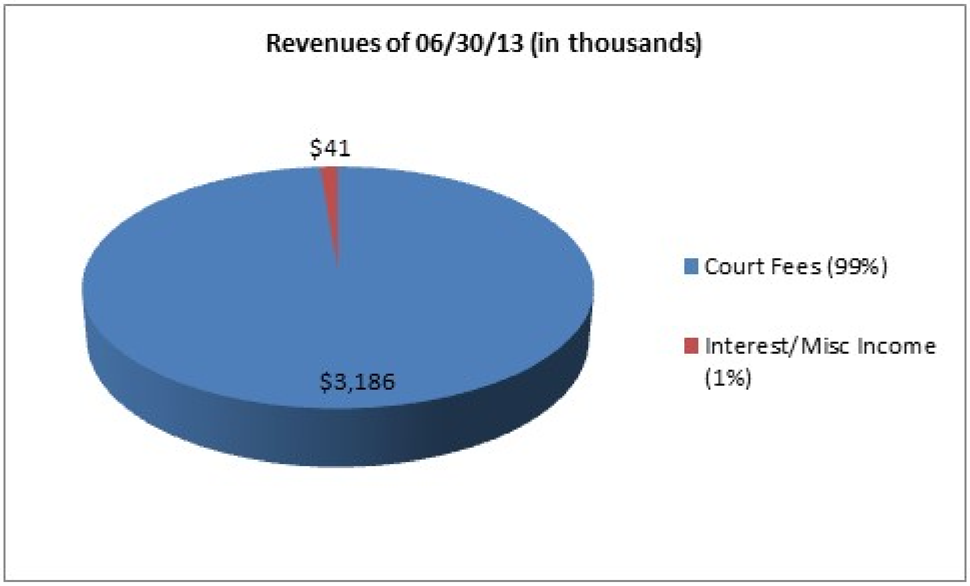
The Orange County Law Library is OCERS' ninth largest plan sponsor, making approximately 0.07%, or $0.44 million, of OCERS' contributions in 2013. It has 17 active members, or 0.08% of OCERS' active membership, as of December 31, 2013. The Law Library's Unfunded Actuarially Accrued Liability was estimated at $4 million as of December 2013.

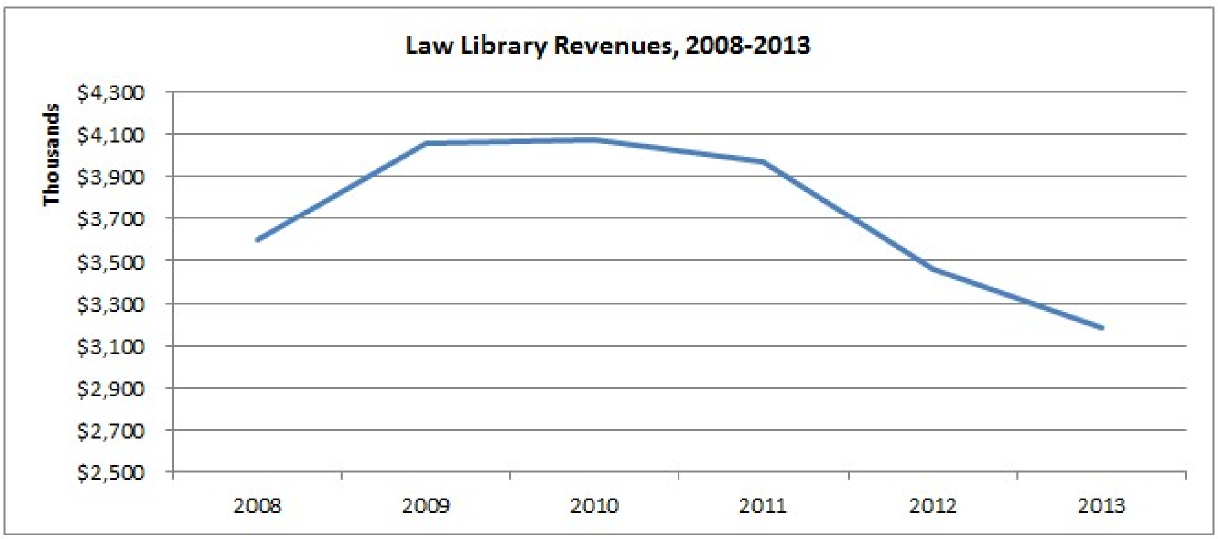
Founded in 1891, the Orange County Law Library's mission statement states, "The Orange County Public Law Library is a state chartered comprehensive public library, the purpose of which is to provide reference materials and research services on state, federal and international statutes, case law and supporting materials to the general public and legal community of Orange County, California." The library's Board of Trustees is composed of five judges chosen by the Orange County Superior Court and two attorneys chosen by the Orange County Board of Supervisors. The library has a collection of over 150,000 pieces in the main library and served over 45,000 visitors in 2013, in addition to providing services to inmates of Orange County jails.

Revenues

The Law Library's total revenues were $3.2 million for the year ending June 30, 2013.

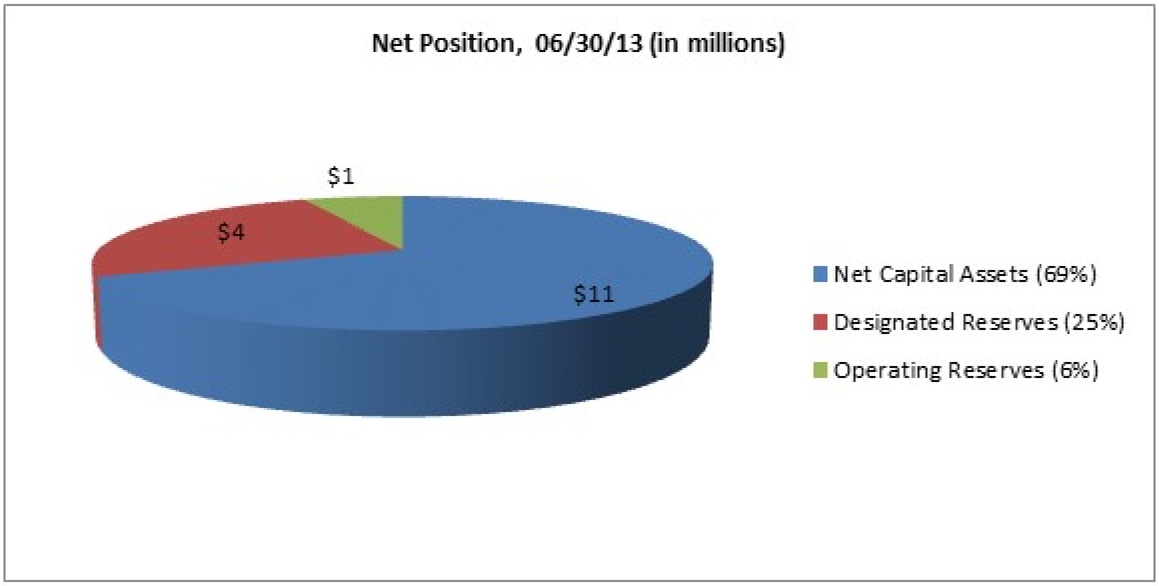
Filing Fees received by the Library accounted for 99% of total revenues for the year. The remaining 1% of revenues consisted of investment income and miscellaneous income. The library's court filing fees are derived from a filing fee paid for every civil action filed in Orange County Superior Court. The filing fee of $35 ($2 for small claims cases) is set statutorily by California and this rate has been stable for several years. However, the number of civil cases filed in court has declined – an 8% decline in 2013 preceded by a 13% decline in 2012 - leading to decreased court filing fee revenues for the library. Fee waivers granted by the court for civil cases also have a negative impact on revenues. Accordingly, the law library has no control over the number of civil filings nor the filing fee rate set by the state of California.





Net Position as of June 30, 2013

- **Net Investments in capital assets** of $11 million comprised of facility, books and equipment.
- **Designated Reserves** of $4 million, assets set aside by the Board of Trustees for replacement of equipment, future expansion of the existing facility, a self-insurance fund for protecting against earthquake damage, and other future capital requirements of the library.
- **Operating Reserves** of $1 million – Net assets subject available for the general use of the library.


Net Position, 06/30/13 (in millions)
$1
$4
$11
Net Capital Assets (69%)
Designated Reserves (25%)
Operating Reserves (6%)

Children and Families Commission

The Children and Families Commission is OCERS' tenth largest plan sponsor, making approximately 0.07%, or $0.41 million, of OCERS' contributions in 2013. It has 11 active members, or 0.05% of OCERS' active membership, as of December 31, 2013. The Children and Families Commission's Unfunded Actuarially Accrued Liability was estimated at $4 million as of December 2013.

The Children and Families Commission of Orange County was created as a result of Proposition 10, the California Children and Families Act of 1998. The proposition added a 50-cent sales tax on tobacco products sold in California and requires that funds raised be used to support education, health and child development programs for children from the prenatal stage through age five. The State Commission, or First 5 California, receives 20 percent of Proposition 10 funds for state-wide programs and public outreach. The remaining 80 percent of funds are allocated to commissions in each of California's 58 counties by birth rate. Only Los Angeles and San Diego counties surpassed Orange County in terms of birth rate totals for 2011 in the state of California.

The commission is governed by a nine member board consisting of the County's Health Care Agency director, the County's Social Services Agency Director, one member of the County's Board of Supervisors, and six members from the public appointed by the Board of Supervisors.

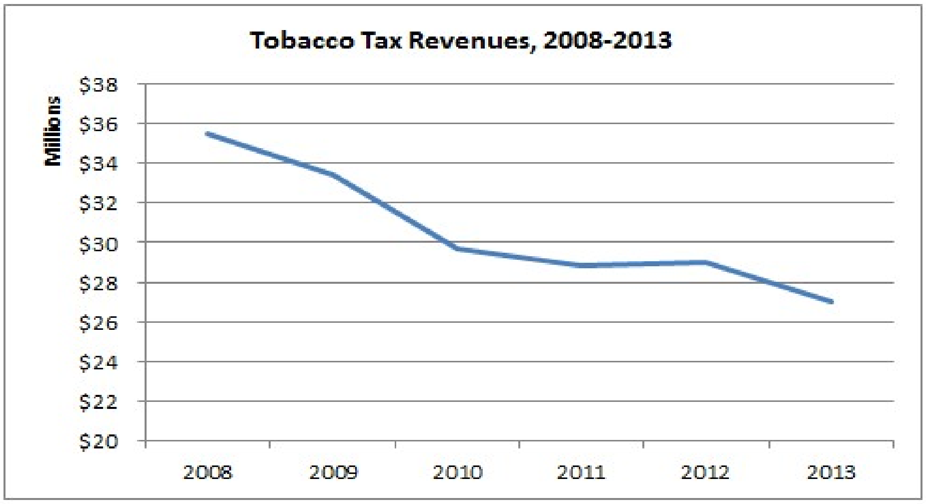
Revenues

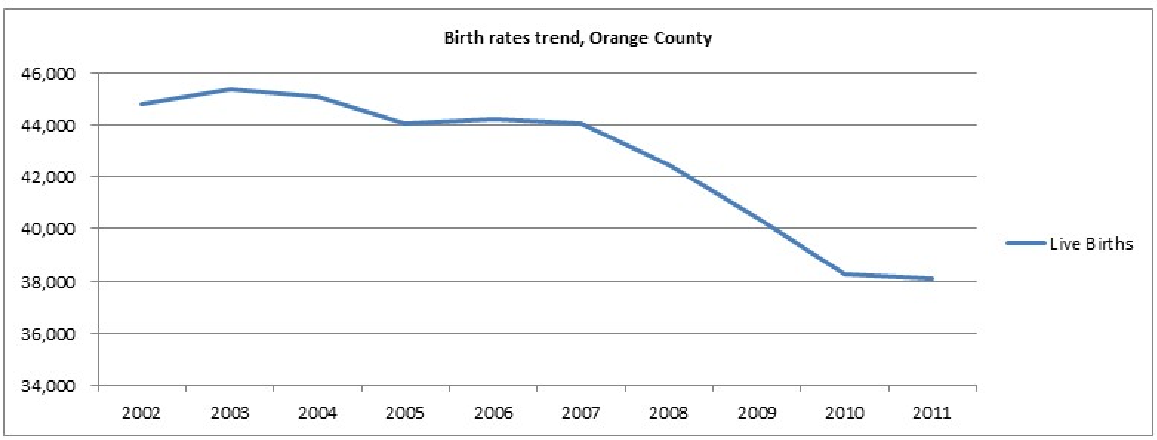
OC Children and Families Commission's total revenues were $28.2 million for the year ending June 30, 2013.

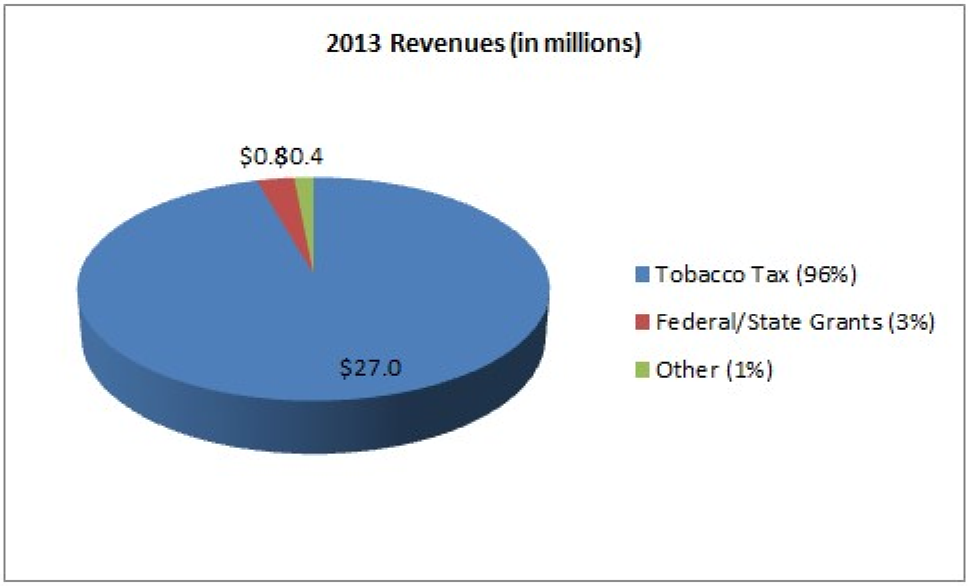
Tobacco Tax revenues received by the commission in 2013 amounted to $27 million, or 96%, of total revenues for the year. The major purpose of the Tobacco Tax is to reduce smoking in California and accordingly tobacco tax revenues have declined by 33% since 2005; declining county birth rates of 15% over a similar period have also contributed to lower tax revenues. The commission budgets an annual decrease of 3% in tobacco tax revenues. Revenues of $800,000, or 3%, were for from various State and Federal grants for children programs such as the state's Child Signature Program and the federal American Recovery and Reinvestment Act (ARRA) Health Research grant. The remaining revenues of $400,000, or 1%, included investment income and other revenues.

Net Position as of June 30, 2013

The total assets of the Children and Families Commission exceeded its total liabilities at June 30, 2013 by $72 million. The entire amount is unrestricted and may be used to meet the Commission's ongoing obligations to citizens and creditors as directed by its Board of Commissioners.






2013 Revenues (in millions)
$0.8
$0.4
$27.0
Tobacco Tax (96%)
Federal/State Grants (3%)
Other (1%)

Orange County Cemetery District

The Orange County Cemetery District is OCERS' eleventh largest plan sponsor, making approximately 0.05%, or $0.30 million, of OCERS' contributions in 2013. It has 21 active members, or 0.1% of OCERS' active membership, as of 2013 year end. The Cemetery District's Unfunded Actuarially Accrued Liability was $1.7 million as of December 2013.

In early 2014, the Cemetery District became the only current OCERS plan sponsor to pay off its entire unfunded actuarially accrued liability. It paid its full share of $1.7 million.

The Orange County Cemetery District is an independent special district governed by an appointed Board of Trustees who serve four-year terms. The three cemeteries owned and operated by the District are among the County's oldest with each having recorded burials prior to 1900.

Although privately owned in the beginning, the cemeteries were formed into separate independent districts in 1926. In 1985 the districts were consolidated under one governing board to create the Orange County Cemetery District. The district has three cemetery locations in Anaheim, Lake Forest and Santa Ana. The district typically averages between 800 to 900 lot sales per year.

Restricted funds have been set aside to fund the perpetual maintenance and care of cemeteries in accordance with the provisions of the Health and Safety Code, which will require continued staffing. The Orange County Cemetery District has also committed $2.5 million for future land acquisitions.

Revenues

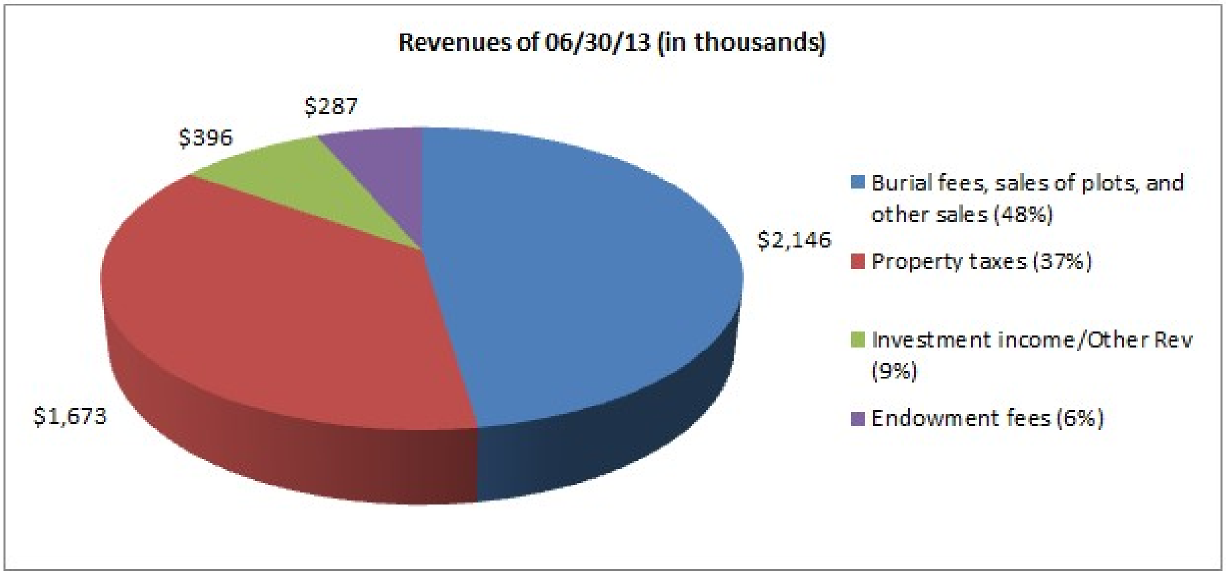
OC Cemetery District's total revenues were $4.5 million for the year ending June 30, 2013.

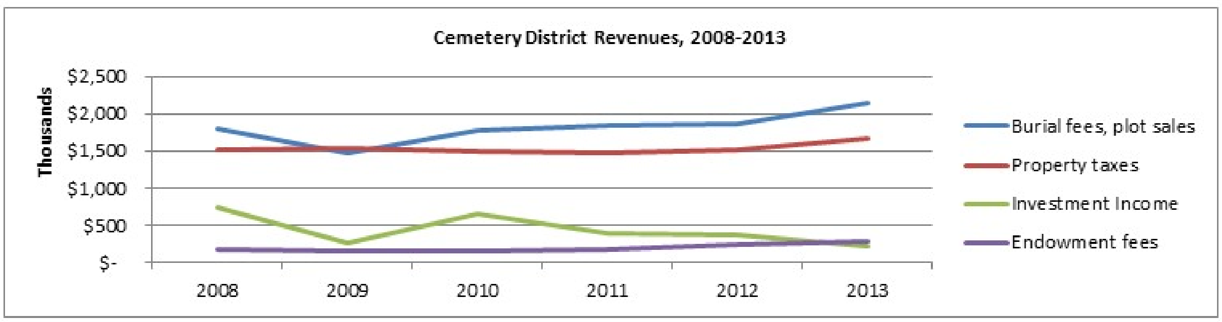
Burial fees, sales of plots, and other sales were $2.1 million, which represents 48% of revenues received by the district in 2013. Since the district is a government agency, general burial and cremation costs are meant to help recover costs, keeping in line with price inflation and the district's expected share of property tax revenues.

Property taxes were $1.7 million, or 37% of revenues, and were allocated to the district in 2013 from their minor share of County property tax revenues. Since county property tax revenue is allocated to the district to help keep burial costs lower, non-county residents must pay an extra fee to be buried at a district cemetery.

Investment Income and Other Revenues were $396 thousand, or 9% of revenues.

Endowment fees were $287 thousand, or 6% of revenues. Endowment fees of $200-$400 per regular burial/cremation are collected and placed into an endowment principal fund established to provide for the maintenance and care of all three cemeteries in accordance with the provisions of the County's Health and Safety Code.



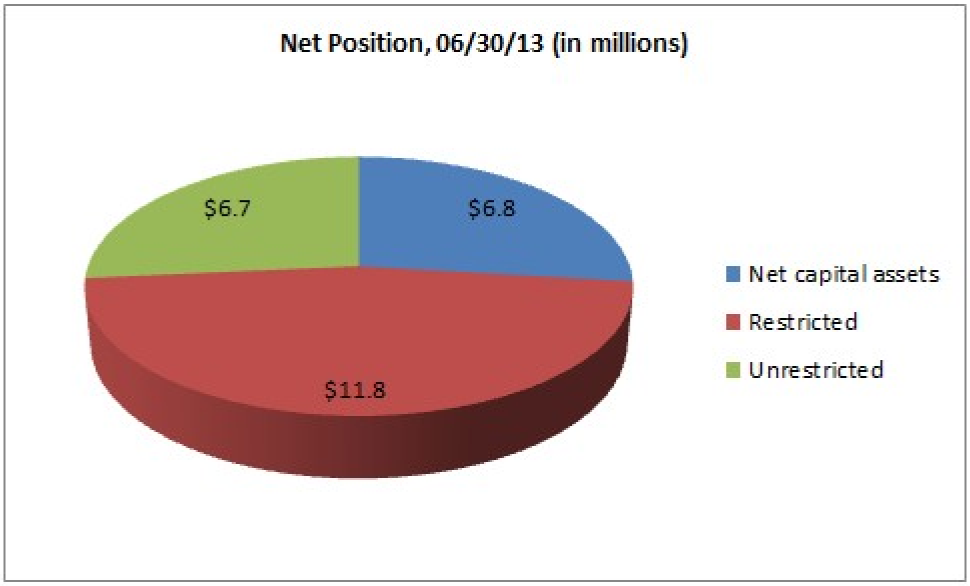


Net Position as of June 30, 2013

The total assets of the Cemetery District exceeded its total liabilities at June 30, 2013 by $25.3 million. Of this amount, $6.7 million is unrestricted and may be used to meet the Cemetery's ongoing obligations to citizens and creditors.

The Cemetery's Net Position was assigned or restricted to the funds listed below:

- **Net Investments in capital assets** of $6.8, invested in capital assets (e.g., land, structures and improvements, and furniture and equipment) that are used to provide services to citizens; consequently.
- **Restricted** was $11.8 million, restricted for the perpetual care of the cemetery grounds. These funds are invested and will continue to earn interest income which will eventually be used for the maintenance and operation of the District's cemeteries.
- **Unrestricted** was $6.7 million. These are available for any purpose approved by the Board of Trustees.


Net Position, 06/30/13 (in millions)
$6.7
$6.8
$11.8
Net capital assets
Restricted
Unrestricted

OC In-Home Supportive Services Public Authority

The Orange County In-Home Supportive Services Public Authority is OCERS' twelfth largest plan sponsor, making approximately 0.03%, or $0.2 million, of OCERS' contributions in 2013. It has 18 active members, or 0.1% of OCERS' active membership, as of 2013 year end. Its Unfunded Actuarially Accrued Liability was estimated at $1.3 million as of December 2013. The financial statements of Orange County In-Home Supportive Services are blended with other government fund units in the CAFR for the County of Orange.

UC Irvine – Medical Center and Campus

The UC Irvine Medical Center and Campus is OCERS' thirteenth largest plan sponsor, making approximately 0.03%, or $0.2 million, of OCERS' contributions in 2013. It has 11 active members, or 0.05% of OCERS' active membership, as of 2013 year end. Its Unfunded Actuarially Accrued Liability was estimated at $1.2 million as of December 2013. Both UC Irvine and the County of Orange evenly split the payment of UC Irvine's employer contributions to OCERS.

Orange County Local Agency Formation Commission (LAFCO)

The LAFCO is OCERS' fourteenth largest plan sponsor, making approximately 0.02%, or $0.1 million, of OCERS' contributions in 2013. It had only three active members as of 2013 year end. LAFCO's Unfunded Actuarially Accrued Liability was estimated at $0.9 million as of December 2013.

In 1963, the California state legislature formed Local Agency Formation Commissions for each of the 58 counties located in the state. These Commissions are primary responsible for monitoring the boundaries of cities and special districts with the goal of ensuring municipal service are allocated efficiently and cost-effectively. This process includes the review and approval of incorporating cities within the county, annexing unincorporated areas to cities and special districts, and forming special districts among other actions. An example of a recent project includes the annexation of approximately 15,000 acres of land located in the City of Anaheim, Irvine Ranch Water District, and Yorba Linda Water District to the Orange County Water District.

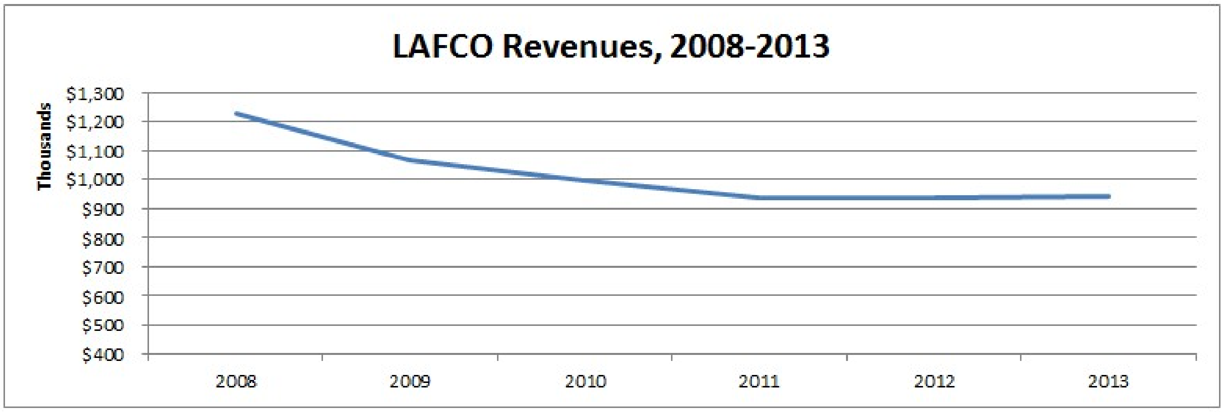
The appointed Board of Commissioners consists of two commissioners representing the County, two commissioners representing cities; two represent special districts; and one commissioner representing the public. An alternate also exists for each of these positions.

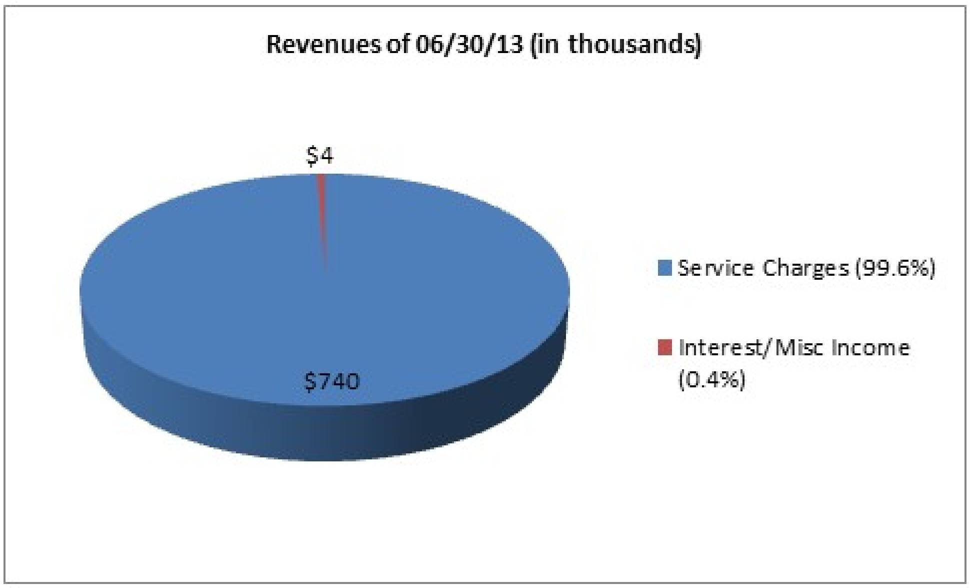
2013 Revenues

LAFCO's total revenues were $940,000 for the year ending June 30, 2014.

Total Service Charges received by the Commission in 2013 amounted to $940,000 and accounted for 99% of total revenues for the year. However, the Commission made a one-time refund of $200,000 to its funding agencies, which include 34 cities, 27 special districts, and the County of Orange, for the year.

The Commission's Service Charge revenue is comprised of funding apportionments allocated among the Commission's funding agencies. One-third is paid by the County of Orange. One-third is paid collectively by the 34 cities within Orange County. The final one-third is paid by special districts, such as the Orange County Water District, that operate in the County. Revenues are set annually by the Commissioners to fully recover the costs of operating the Commission which is staffed currently by four employees. Forecasted revenues over the next three years include an average 7% increase in service charges.



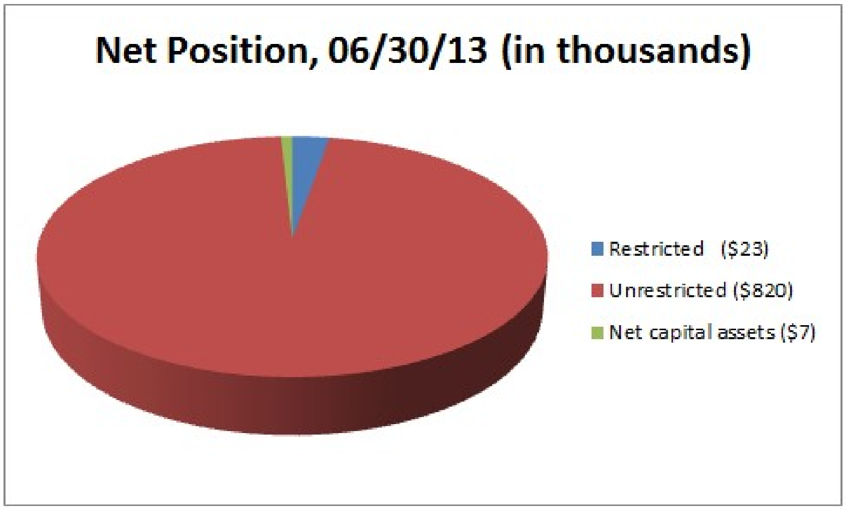


Net Position as of June 30, 2013

The total assets of LAFCO exceeded its total liabilities at June 30, 2013 by $850,000. Of this amount, $820,000 is unrestricted and may be used to meet LAFCO's ongoing obligations to citizens and creditors.

LAFCO's Net Position was assigned or restricted to the funds listed below:

- **Net Investments in capital assets** of $7,000, consists of capital assets, net of accumulated depreciation and reduced by any outstanding debt outstanding against the acquisition, construction or improvement of those assets.
- **Restricted** was $23,000, consists of constraints placed on net position use through external constraints imposed by creditors, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted** was $820,000. These are available for any purpose approved by the Board of Commissioners.


Net Position, 06/30/13 (in thousands)
Restricted ($23)
Unrestricted ($820)
Net capital assets ($7)

Department of Education

The Department of Education is OCERS' smallest plan sponsor, making approximately $14,000 of OCERS' contributions in 2013. However, it has no current active members as of 2013 year-end. Its Unfunded Actuarially Accrued Liability was estimated at $0.09 million as of December 2013.

ReedSmith

The business of relationships.℠

A TALE OF TWO RULINGS: The City of Stockton and Chapter 9

Board of Retirement
Orange County Employees' Retirement System
December 15, 2014

Harvey L. Leiderman

Attachment 2

THE UNIQUE CHARACTERISTICS OF CHAPTER 9

- Just for municipalities
- Adjustment of debts
- Constitutional balance of federalism and states' rights
  - Uniform bankruptcy laws
  - Supremacy clause
  - 10th Amendment – powers reserved to states

ReedSmith

THE FEDERAL - STATE BALANCE

- Not all Bankruptcy Code provisions apply
- State control over municipality's political and governmental powers continues - §903
- The Court cannot interfere with municipality's political or governmental powers - §904
- Only the municipality can propose a plan
- Same reason why OCERS is non-ERISA

ReedSmith

WHO MAY FILE CHAPTER 9?

Federal law requirements:

- A "municipality." Includes a political subdivision, public agency <u>or</u> instrumentality of a state. Counties, cities and districts are; the State is not
- Authorized under state law to be a debtor under federal bankruptcy law (CA Govt. Code §53760)
- Insolvent – unable to, or not paying debts when due (cash flow test, not balance sheet)
- Desires to effect a plan to adjust its debts
- Negotiations with creditors and bargaining units are at impasse or futile

ReedSmith

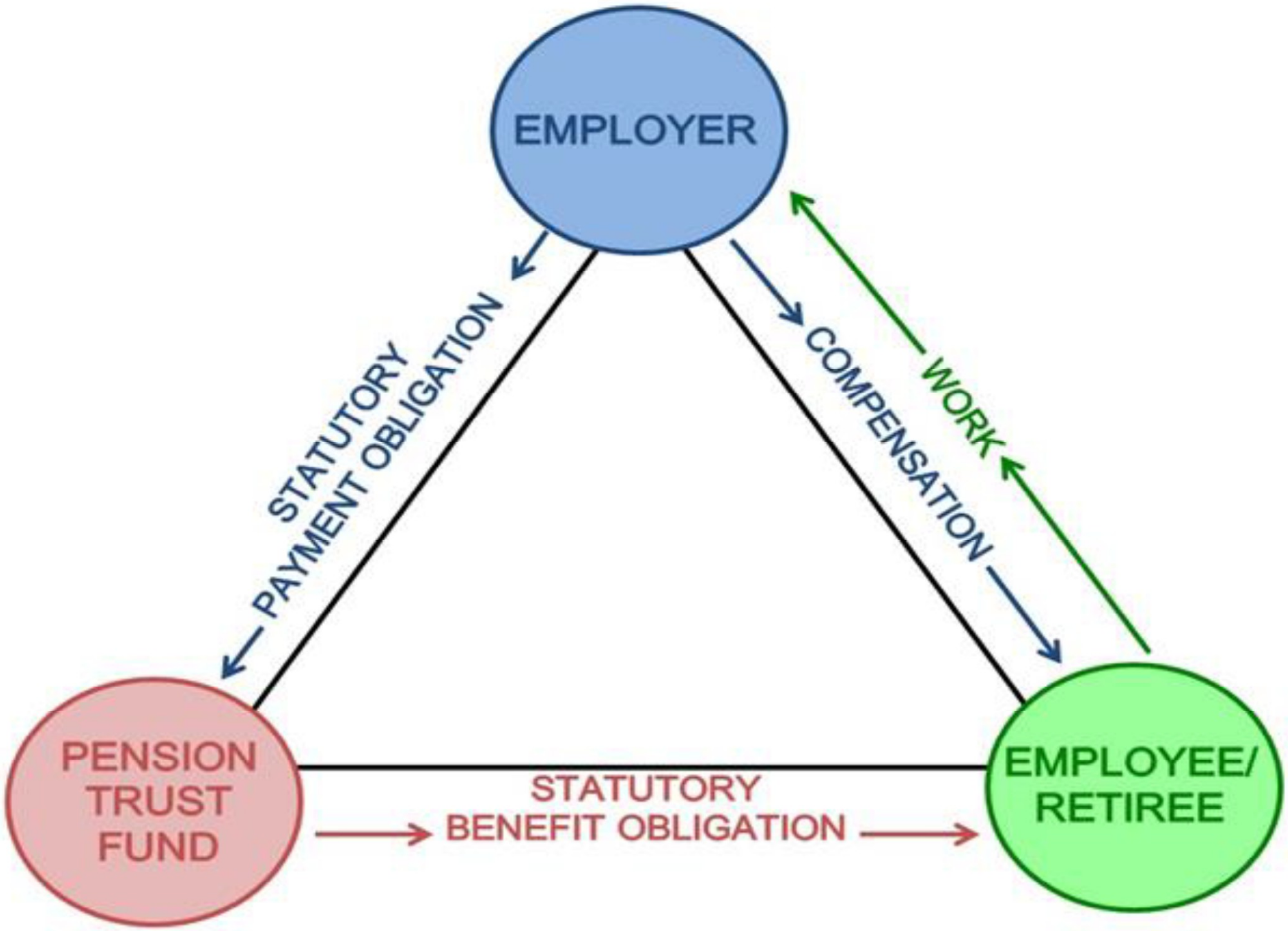
CITY OF STOCKTON - BACKGROUND

- Victim of Great Recession
- Negotiated with creditors and bargaining units for over a year (unlike San Bernardino)
- Filed Ch. 9 when negotiations grew futile
- Kept CalPERS current during Ch. 9
- Proposed Plan of Adjustment – new tax, new labor contracts, pay creditors cents-on-dollar, CalPERS unimpaired
- One under-secured creditor opposes Plan

STOCKTON & CALPERS:
A UNIQUE RELATIONSHIP

- PERS benefits elected by City, not mandatory
- Stockton is a "contracting agency"
- Contract triggers all applicable PERS statutes
- Funding obligation is statutory
- Contract termination is permitted, but triggers UAAL funding on a "risk-free" basis
- Failure to pay full termination amount could trigger retiree benefit reductions

UNDERSTANDING PENSION OBLIGATIONS UNDER CALIFORNIA LAW



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JUDGE KLEIN'S
OCTOBER 1 RULING – THE THEORY

- Hearing on Plan confirmation
- Considering the CalPERS obligation because of Franklin's objection to Plan
- Stockton's obligations are contractual
- Bankruptcy courts alter contracts. Bk. §365
- CA can control gateway to Ch. 9, but not the municipality's conduct once in Ch. 9. PERL §20487 is invalid

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JUDGE KLEIN'S
OCTOBER 1 RULING – THE THEORY

- Real creditors are retirees and employees; CalPERS is just a collection agency. So no state power being impaired if contract were rejected
- Pensions are a municipality's commercial, proprietary function, not a governmental function. Bk. §903 restraints do not apply
- Stockton should have considered pension alternatives – own plan, other gov't plans, private plans (the "art of the possible")

JUDGE KLEIN'S OCTOBER 1 RULING – THE THEORY

- "Why haven't you been talking settlement?"
- The ghost of *Vallejo*
- Decision on Plan confirmation postponed to October 30
- If Plan confirmed as City proposes, this ruling would be irrelevant ("All talk, no hat!")

ReedSmith

DID THE COURT GET IT RIGHT?

- **Exercise due federal judicial restraint? Tenth Amendment and Bk. § § 903, 904**
- **Are employee pensions a *commercial* enterprise, not a core governmental activity?**
- **Is CalPERS just a collection agency, not a trust?**
- **Forgot that only *executory* contracts may be rejected? Is there anything left for retirees to perform?**
- **Is UAAL even a "debt" that can be "adjusted"? Not under CA law!**

ReedSmith

JUDGE KLEIN'S OCTOBER 30 RULING – THE REALITY

- **Plan in best interests of creditors, feasible and proposed in good faith, meets all requirements**
- **Culmination of two years of negotiation, compromise, sacrifice, reduced employee pay and benefits, voter-approved tax hike. No viable alternatives and too late to start over**
- **Retirees already sharing the pain**
- **Poison pill: Impairing CalPERS and retirees would create huge unsecured claims and prevent any plan confirmation**

ReedSmith

TAKE THIS AWAY

- Legal reasoning still to be addressed by a higher authority – here or elsewhere
- Pension impairment is likely a hollow threat:
  - Municipalities are reluctant to deeply harm their employees
  - Rejecting pensions will tank any Plan proposal
  - Too costly to contest
  - Expect legislation to close the gateway further

ORANGE COUNTY EMPLOYEES RETIREMENT SYSTEM

MEMORANDUM

DATE: October 29, 2014

TO: Members of the Investment Committee

FROM: Girard Miller CFA, Chief Investment Officer

SUBJECT: OCP Asia – Review of Additional Investment

Recommendation:

Approve an additional investment of up to $60 million in the OCP Asia's Orchard Landmark direct lending fund, subject to completion of due diligence, contract reviews, fee negotiations and related terms as presented and discussed by the CIO.

Background:

In November 2013 the Committee approved an investment of $60 million in the OCP Asia's Orchard Landmark direct lending fund, upon recommendation of the staff and NEPC. Onsite due diligence was conducted by the CIO in their Hong Kong and Singapore offices. Fee terms for that subscription were especially favorable under a NEPC client club pricing arrangement. As a reminder, OCERS' investment is subject to a rolling 3-year lockup, at which point the funds can be redeemed.

In June 2014, OCP Asia was reviewed by the OCERS' Manager Monitoring Subcommittee and no issues were noted.

OCP Asia has now completed its initial funding round, and has made commitments against approximately $300 million of capital, with the majority of that amount now deployed. The investment returns have been quite favorable in the early stages, with the current portfolio yielding low double digits on a cash basis and high double digits on an aggregate yield basis which includes the value of "sweeteners" that OCP secures for its clients through warrants and other equity kickers. The firm has additional attractive lending opportunities in its underwriting pipeline, and approached the CIO last month to see if OCERS would have an interest in additional investments at this time. Our response was that we would require favorable fee arrangements to consider them further, and they replied with a willingness to negotiate certain fee concessions for us as a founding-round investor if we were to supplement our mandate by $40 to $60 million.

On October 21, the staff conducted and satisfactorily completed a review of the current portfolio and additional due diligence by teleconference. NEPC has prepared its independent report which is included in the Committee materials and supports an additional investment as recommended here.

Several rounds of fee negotiations have been completed through triangulation between the firm, the CIO and NEPC. Advantageous NEPC club deal terms included a potential management fee discount from their now standard rate, for new investments of $50 million, and an expense cap on ancillary costs. In addition, the CIO has negotiated separately for a highly advantageous "semi-soft" performance hurdle of 10% which will be implemented through a special Rebate Share class in which OCERS receives a rebate of the entire OCP performance fee (15% now) at the third anniversary of new investments if our annualized return on those shares net of fees is less than 10%. This special arrangement applies only to OCERS as a lead/anchor investor with $100 million in aggregate investment. This accomplishes a powerful alignment of interests and a strong statement by the manager that OCP continues to expect to deliver double digit net returns, as they are putting more than half their compensation at risk at this above-market level. Given the level of cash yields, the 10% IRR threshold provides a very strong incentive to OCP to avert and mitigate defaults of principal, which is our foremost concern in this strategy.

Analysis:

Asian lending has proven to offer the highest risk-adjusted return-on-capital opportunities anywhere in the world this year. OCP has exceeded its original expectations for portfolio yields in assembling the current portfolio, and OCERS' supplemental capital investments immediately would enjoy those returns in parity with the founding investors with very little J-curve effect. We are now dealing with a known quantity.

This is not a grab for yield. As CIO, I continue to encourage realistic expectations in this space that would be lower than those presented in the NEPC memo. It is inevitable that there will ultimately arise a default by one or more of these borrowers which could easily reduce our ultimate IRR from the current lofty first-year pro-forma yields. Accordingly the staff continues to view this strategy as most likely to produce low-teen returns over longer periods of time including recessions.

Despite what I would characterize as a higher risk lending portfolio on its face, we have more downside protection against global economic and geopolitical forces in this fund than anywhere else in the OCERS' portfolio. Downside macro risk on this fund is hedged extensively by equity index puts, as the manager will explain. OCP typically spends roughly 1% of its nominal returns to provide its clients with peace of mind on the downside, and to position itself to negotiate very favorable terms in adverse periods by having supplemental capital available when its borrowers and competitors will be facing liquidity crises. Previously they have used this position of strength to optimize their returns by bargaining harder for clients in systemic default periods.

By making a second investment to be funded in 2014-15 (which will probably be phased in over several months as they increase their AUM, to avoid over-concentration), OCERS will benefit from having staggered redemption periods -- which is mutually beneficial to us, the manager and the fund as this will reduce redemption cash flow issues on their end as the fund grows in size.

Ideally, in my view, OCP would double the fund's total size in the next 12-18 months, through additional incremental investments, as long as those can be thoughtfully and prudently deployed in similar secured loans of high quality.

Looking longer-term, if OCP successfully navigates individual loan defaults and adverse industry or economic downturns to our satisfaction in the next year or two, this investment strategy and product structure could be a worthwhile candidate to serve as an "income-producing surrogate parking lot" for undeployed private equity investments, given its return profile and the staggered maturities that we will be building here. Instead of over-allocating to public market equities as a surrogate for undeployed private equity commitments, this fund may provide superior return-risk characteristics. But that remains to be proven through actual experience during an incident or period of adversity. In the meantime, we will continue to monitor OCP's performance and default management, and work with them to keep our preferential future investment term options open as appropriate to both parties.

Prepared by:

OCERS G.M.- Approved

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