| To: | Board of Supervisors |
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From: David Twa, County Administrator

Date: May 4, 2010

Subject: Other Post Employment Benefit Funding Update



Contra Costa County

RECOMMENDATION(S):

- 1. ACCEPT this report documenting the significant and continual progress made towards funding the County's Other Post Employment Benefit liability;
- 2. ACKNOWLEDGE Grand Jury reports on the County's Other Post Employment Benefit (OPEB) liability:
 - a. No. 0606, entitled "County Ignores Retiree Health Cost: The Financial Tidal Wave";
 - b. No. 0708, entitled "Mayday, Mayday, Mayday! The County Drifts Ever Closer to the 'OPEB' Rocks";
 - c. No. 0805, entitled "The Supervisors Chip Away at the County's Mountain of Health Benefit Debt"; and

| APPROVE RECOMMENDATION OF BOARD COMMITTEE | | | | |
|--|---|--|--|--|
| RECOMMENDATION OF CNTY ADMINISTRATOR OTHER | | | | |
| Action of Board On: 05/11/2010 APPROVED AS RECOMMENDED | OTHER | | | |
| Clerks Notes: | | | | |
| VOTE OF SUPERVISORS | I hereby certify that this is a true and correct copy of an action taken and entered on the minutes of the Board of Supervisors on the date | | | |
| AYES 5 NOES | shown. ATTESTED: May 11, | | | |
| ABSENT ABSTAIN | 2010 David J. Twa, County | | | |
| RECUSE | Administrator and Clerk of the Board of | | | |
| Contact: Lisa Driscoll, County Finance Director (925) 335-1023 | Supervisors | | | |

By: June McHuen, Deputy

cc: Lisa Driscoll, County Finance Director, Stephen Ybarra, County Audtior-Controller, William Pollacek, Treasurer-Tax Collector, Patrick Godley, Chief Financial Officer/Health Services

RECOMMENDATION(S): (CONT'D)

- d. No. 0907, entitled "Retiree Healthcare Benefits Leave County Taxpayers on the Hook";
- 3. ACKNOWLEDGE that the Board of Supervisors takes very seriously their responsibility to resolve the County's OPEB liability and thanks the Grand Jury for their work over the years in helping to identify issues and potential solutions;
- 4. ACKNOWLEDGE that the Board of Supervisors has continually emphasized the need to focus on implementing sustainable strategies to reduce retiree healthcare costs through the creation and implementation of a strategic plan;
- 5. ACKNOWLEDGE the Board of Supervisors' has exercised steadfast diligence in following their strategic plan to address the County's OPEB liability by reducing retiree healthcare costs rather than attempting to fund the original liability;
- 6. ACKNOWLEDGE the Board of Supervisors' continual progress in addressing its original 2006 OPEB liability, as summarized by the following highlights:
 - a. the County's Unfunded Actuarial Accrued Liability (UAAL) has declined by 60.3% (from \$2.57 billion to \$1.02 billion);
 - b. the normal cost has declined 78% (from \$130.6 million to \$29.2 million);
 - c. the Annually Required Contribution (ARC) has declined by 70.7% (from \$216.3 million to \$63.3 million);
 - d. the results reflect negotiated changes to the health care plans, caps on the County's contributions and the cooperation of the County's bargaining units;
 - e. the original funding target of 100% of the potential liability for the retiree population was 40% of the total liability in 2007 and is 54% today; and
 - f. the County has also pre-funded 2% of its OPEB obligation by depositing funds in an irrevocable trust fund.

FISCAL IMPACT:

The report presents an update of progress made in addressing the County's OPEB liability and has no specific fiscal impact on its own. The Board of Supervisors' leadership in creating and implementing the County's strategic management plan to reduce the liability has had and will continue to have significant future impact on the County's overall fiscal stability and ability to deliver services to County residents and taxpayers.

BACKGROUND:

On April 13, 2010 the Board of Supervisors was presented with the County's '2010 Other Post Employment Benefits (OPEB) Valuation Report as of January 1, 2010 and Annual Required Contributions for the Fiscal Year Ending June, 30, 2010'. The report describes the County's OPEB liability per Government Accounting Standards Board Statement 45 and projects the County's liability based upon those specific accounting rules.

The purpose of this report is to describe and document the County's progress todate in meeting Board established funding goals.

History

On May 16, 2006, the Board of Supervisors accepted a report from Buck Consultants concerning a preliminary actuarial analysis of the County's liability for retiree healthcare and other post-employment benefits. This report estimated the County's then current OPEB liability at \$2.6 billion. The report concluded by recommending that staff:

- 1. Prepare an analysis of OPEB liability reductions that could be produced through changes to healthcare benefits
- 2. Prepare an analysis of the cost associated with funding varying levels of the liability and make recommendations concerning the portion of the liability that should be pre-funded
- 3. Investigate unresolved questions concerning State and Federal reimbursement for pre-funding OPEB costs, establishment of an irrevocable trust for the accumulation of pre-funding assets, and options for investment of such assets
- 4. Work with California State Association of Counties (CSAC) and other public sector partners to gather data and develop statewide strategies for managing this issue

In the fall of 2006, the County Administrator established an OPEB Task Force to bring together the breadth of expertise available within the County and through professional contracts in each of the following areas: financial, audit, budgetary, personnel, labor relations, benefits, and legal. The importance of incorporating into the ongoing

process the perspective of all stakeholders was also emphasized. The first direction to the Task Force was the development of a strategic plan to address the County's OPEB liability.

In March 2007, the Task Force presented a report to the Board that detailed the OPEB challenge, the consequences of inaction, strategies to deal with the issue, and described where the County was in relation to other governmental entities. The report quoted Ken Kurtz of Moody's Investor Services who said "If you decide you want to continue Retiree Health Benefits as a priority then make a plan and fund it. If you decide that Retiree Health Benefits are not a priority, then don't make a plan, and you don't have to fund it. But don't maintain Retiree Health Benefits with no plan and no funding."

In June 2007, the OPEB Task Force presented an OPEB Update Report to the Board of Supervisors. The result of the Task Force report was that the Board of Supervisors:

- established goals to guide the Task Force's work: 1) Fully comply with Governmental Accounting Standards Board (GASB) Statement 45; and 2) Adopt an OPEB financing plan, which balances our requirement to provide public services with competitive health care benefits for our employees (now and when they retire);
- adopted an OPEB funding target of 100% of the potential liability for the retiree population (at that point approximately 40% of the total liability);
- adopted a specific allocation of resources to be directed towards the OPEB liability; and
- directed the County Administrator to begin pre-negotiation meetings with County labor representatives regarding the development of possible plans and models for benefit reform.

The Update Report declared that "the scope of the issue is—as has been noted many times by many individuals—huge, not only for Contra Costa County, but for the nation; however, it is not insurmountable. Contra Costa will address this issue successfully as it does with every challenge. A sound long-term strategy is of uppermost importance. The primary issue is that Contra Costa County has a very large potential OPEB liability that is the result of 46 years of retiree health benefit accumulation, combined with the positive demographic of longer life expectancy, and the less positive reality of rapidly increasing health care costs. Preparing to pre-fund this liability will take a multi-decade effort, but can and will be achieved through a combination of revenue redirection, benefit plan changes, and as a last resort, service delivery reductions". The Board of Supervisors accepted this report and directed the County Administration and staff to begin implementation of its recommendations.

Present Day

Four years after the initial report regarding the County's OPEB liability, the Board of Supervisors has achieved unprecedented results. Continual implementation of the strategic recommendations has allowed the Board of Supervisors to meet or exceed all of their goals.

The County's Unfunded Actuarial Accrued Liability (UAAL) has declined by 60.3% (from \$2.57 billion to \$1.02 billion); the normal cost has declined 78% (from \$130.6 million to \$29.2 million); the Annually Required Contribution (ARC) has declined by 70.7% (from \$216.3 million to \$63.3 million); the results reflect negotiated changes to the health care plans, caps on the County's contributions and the cooperation of the County's bargaining units; and the County has also pre-funded 2% of its OPEB obligation by depositing funds in an irrevocable trust fund.

Allocation of Resources

A major component of the County's original strategic plan was addressing funding scenarios which would have a direct impact on the County's resources and ability to provide services. The challenge was addressed through a combination of three basic mechanisms:

- 1. identifying resources available for transfer without reducing benefits or service levels;
- 2. reducing and/or changing benefits and changing cost sharing; and
- 3. reducing service levels and program cuts.

The OPEB Task Force analyzed future eligible resources to meet the requirements for OPEB funding. As was reported to the Board in the March 2007 OPEB Report, the majority of the County's reimbursement rates are capped; therefore, the County could not expect to fund the OPEB liability through increased State and Federal revenues. Consequently, the challenge was to identify resources not already allocated that could be used to fund retiree health care costs. The Task Force recommended and the Board of Supervisors adopted the following annual resources (in millions):

| Resource | Beginning FY | Amount |
|----------|--------------|--------|
|----------|--------------|--------|

| Redirect Workers Compensation | 2008/09 | \$10 |
|--|---------------|-------|
| Redirect UAAL Rate Adjustment | 2009/10 | \$10 |
| Redirect POB Bond payments | 2014/15 | \$33 |
| Redirect POB Bond payments | 2022/23 | \$47 |
| Total Annual Future Resource Redirection | 2024 - onward | \$100 |

The original March 2007 report warned that, the redirection of POB payments to OPEB rather than CCCERA was 'contingent upon CCCERA continuing to meet its assumed rate of investment—among other things and that all of these resources are contingent upon them not being targeted for other increased costs of doing business and/or increasing service levels/programs'. The report projected that if these resources were been put aside beginning in fiscal year 2008/09, there would be \$588 million (plus interest) reserved at the end of fiscal year 2022/23 and \$100 million would be available to be added annually thereafter.

As has been well documented, the Board of Supervisors actually began partially pre-funding the OPEB liability in FY 2008/09 with \$20 million rather than the originally planned \$10 million.

Future Funding

If we project that the Board adopts the remaining resource redirection into the future we can predict that the County will exceed its OPEB goals. Because the original ARC was \$216.3 million, it made sense to allocate \$100 million annually towards an OPEB Trust Fund. The present ARC of \$63.3 million does not support that recommendation. However, the ARC calculation anticipates full funding of the annual pay-go costs. Even after the significant efforts of the majority of our bargaining groups to reduce the County's cost of health care, pay-go costs will increase over the next 30 years to over \$111 million annually. Therefore, the funding level scenarios presented take into account that the additional future contributions will offset annual increases in the pay-go cost from current year levels. This means that some monies will be paid out of the OPEB Trust to cover the increase in pay-go cost levels; however the bulk of the contribution still goes to the Trust. The following projections prepared by the County and verified by its Actuary support the Board's accomplishment:

- If the Board of Supervisors were to continue with the original funding plan adopted in 2007 (modified by \$10 million in FY 2008/09) the liability will be 40% funded in 2026 and fully funded in 2041 (The County Administrator's Office and OPEB Task Force would not recommend such a funding level, as was described in the OPEB report of June 26, 2007.)
- If the Board of Supervisors were to change the resource allocation policy with the goal of reaching a 40% funded target in 30 years, that goal would require an average of \$29 million additional dollars each year over and above current pay-go AND the \$20 million partial pre-pay each year beginning in 2011 and finishing in 2040
- If the Board of Supervisors were to change the resource allocation policy with the goal of reaching a 54% funded target in 30 years, it would take an average of \$39 million additional dollars each year over and above current pay-go AND the \$20 million partial pre-pay each year beginning in 2011 and finishing in 2040

Conclusion

The County's Other Post Employment Benefit liability issue is complex. No entity should expect to reach a point where OPEB is 'solved' and further review is no longer necessary. The original liability grew over a period of almost fifty years with little or no attention to funding. The Board of Supervisors' original policy was sound and its goals are being achieved. As was noted above, the Board may wish to review its original policy and further refine it over the next few years. As was the purpose of GASB 45, the County Administrator's Office will continue to monitor and report to the Board on this issue on an on-going basis as it does for pension costs.

All OPEB reports and materials are available on the County's internet site at http://ca-contracostacounty.civicplus.com/index.aspx?nid=1318.