Agenda Date: 3/21/2018
Agenda Placement: 8B

Napa Sanitation District
Board Agenda Letter

TO:	Honorable Board of Directors
FROM:	Jeff Tucker - Director of Administrative Services/CFO NS-Administration
REPORT BY:	Jeff Tucker, Director of Administrative Services/CFO - 707-258-6000
SUBJECT:	Receive Presentation on Long-Term Pension and OPEB Liabilities, and Provide Direction to Staff

RECOMMENDATION

Receive presentation on pension and OPEB liabilities, and provide direction to staff.

EXECUTIVE SUMMARY

Staff will provide information to the Board on the current status of CalPERS pension unfunded liability status, NapaSan's current and projected pension liability and costs, and potential options for lowering both the liability and the costs, without making changes to the benefits provided to employees. Staff is asking for direction from the Board regarding various funding options, for inclusion in the proposed FY 2018/19 budget and ten-year financial forecast.

Status of Pension Liability

CalPERS has made several changes in the last few years to address its pension funding status, currently at about 70%. These changes have included changes to amortization policy, updating mortality tables, adopted a Risk Mitigation policy for investment returns, and reducing the discount rate. The expected results of these changes is to increase the contributions required by member agencies for both the normal cost calculations and the unfunded actuarial liability amortization.

NapaSan has three different tiers of CalPERS plan. The Tier 2 plan was put into place in September 2009 to reduce employee benefit levels and reduce costs. In January 2013, changes to the statewide system were implemented, called PEPRA. These statewide changes were also designed to reduce employee benefits and limit the financial exposure to the state and member agencies for future retirement costs.

NapaSan's normal cost for the three plans has been relatively stable for the past five years. However, with changes made by CalPERS, it is expected that the normal cost paid by NapaSan will increase each year for the next decade or longer. Expected increase is1% to 3% of salary, or between 3% and 8% increase in annual pension costs.

In FY 2019/20, NapaSan will make its final payment into a "side fund" that is associated with increased benefits provided to employees two decades ago. The annual payment to this side fund is approximately $500,000. This equates to a direct reduction in CalPERS contributions by that same amount, but annual increases will continue. For example, between 2019 and 2032, the expected annual increase in payments would have been on average about 4% per year. With the drop in annual payments in 2020, the annual average increase is about 2%.

Options to Address Unfunded Actuarial Liability

The annual amortization costs associated with NapaSan' unfunded liability is the main reason for the projected annual increases in payments to CalPERS. However, NapaSan can take actions now that would result in moderating the projected annual increases. Much like making extra payments on a home mortgage can lower the overall amount of interest that is paid and shorten the length of the loan, NapaSan can make additional payments (either directly to CalPERS or into a Trust account) to reduce future required annual payments.

Staff has identified several different "funding policies" that could be adopted by the Board to make additional contributions toward the pension liability:

1. Pay-Go (continuing to pay the minimum, as determined by CalPERS)
2. Make payments from one-time salary savings derived from position vacancies
3. Make additional payments when the side fund expires in 2020
4. Make additional payments from savings derived from recent debt refinancing
5. Adopt a 15-Year amortization schedule, to replace the current CalPERS 30-Year schedule

During the Board meeting, staff will discuss each of these options in detail with the Board.

Use of IRC Section 115 Trust Fund for Pension Liability

If the Board decides that it wants to adopt a funding policy for pension liabilities and includes making payments in excess of the annual minimum required by CalPERS, an additional question will be whether to make those payments directly to CalPERS or into a trust account. The Internal Revenue Service, under Internal Revenue Code Section 115, allows organizations to establish trust accounts that inure to the benefit of retiree pensions. By establishing a Trust, the proceeds can be invested in equities and other instruments, and with liquidities, that would otherwise not be available to the local government (and with it comes the associated risk of investment loss).

- Making those payments directly to CalPERS would have the advantage of directly reducing NapaSan's unfunded liability amounts and will directly result in lower annual required contributions. However, once made, NapaSan does not have access to those contributions but instead become the assets of the CalPERS system.
- Making those payments into a Trust Account would not directly reduce the unfunded liability (this determination has been made under GASB accounting rules), but it would still be held in trust and would only be available to NapaSan to apply toward future pension costs. This is similar to setting up a savings account, investing the cash in the account, and then using the investment earnings toward future expenses.

A decision whether to pay CalPERS directly or establish a trust account will be further evaluated and brought to the Finance Committee and Board at a future date, depending on the policy direction provided on the funding policy.

Update on CERBT Trust Fund for OPEB Liability

Staff will provide an update on the Section 115 trust that was established for OPEB liabilities in 2010. In summary, the trust fund has returned about $1 million in proceeds from investment earnings since inception seven years ago, with a total amount of $3.5 million held in trust. Changes in GASB reporting and Actuarial Standards of Practice (ASOP) have resulted in an increase in the Total OPEB Liability from $7.1 million in 2015 to $10.7 million in 2017. About half of this increase is due to projected benefits costs, with the other half due to including the implicit rate subsidy in the liability calculation, as required in ASOP number 6 ($1.8 million).

FISCAL IMPACT

Is there a Fiscal Impact? No

ENVIRONMENTAL IMPACT

ENVIRONMENTAL DETERMINATION: The proposed action is not a project as defined by 14 California Code of Regulations 15378 (State CEQA Guidelines) and therefore CEQA is not applicable.

BACKGROUND AND DISCUSSION

In May 2017, the Board updated its Strategic Plan to include Objective 2B: Evaluate long-term liabilities, including pension liability and OPEB liability, and develop policy options for Board consideration.

Definition of Terms

Normal Cost - the cost for benefits provided in retirement attributable to the current year of service.

Unfunded Actuarial Liability (UAL) - The difference between the actuarial values of assets in the retire plan and the total actuarial accrued liabilities of a plan. Essentially, the UAL is the amount of retirement that is owed to an employee in future years that exceed current assets and their projected growth.

Implicit Rate Subsidy - The implicit rate is an inherent subsidy of retiree healthcare costs by active employee healthcare costs when healthcare premiums paid by retirees and actives are the same. The true healthcare costs for retirees are, on average, greater than active employees' healthcare costs. Thus, if both subgroups pay the same per-capita premium for their benefits, retirees are paying less than they would if their premiums were calculated solely based on retiree-only expected healthcare costs. With an implicit rate subsidy, the active employee premiums are subsidizing the retiree premiums, and that subsidization creates a liability.

OPEB - Other Post-Employment Benefits - for NapaSan, these would include health insurance, vision insurance, and life insurance provided to the employee after retirement.

SUPPORTING DOCUMENTS

A . Presentation

Napa Sanitation District: Approve

Reviewed By: Jeff Tucker