Agenda Date: 11/14/2006
Agenda Placement: 8C
Set Time: 10:30 AM
Estimated Report Time: 1 Hour

NAPA COUNTY BOARD OF SUPERVISORS
Board Agenda Letter

TO:	Board of Supervisors
FROM:	Britt Ferguson for Nancy Watt - County Executive Officer County Executive Office
REPORT BY:	Helene Franchi, Senior Management Analyst, 253-4820
SUBJECT:	Discussion of OPEB Liability

RECOMMENDATION

County Executive Officer to make a presentation on the draft actuarial valuations of Other Post Employment Benefits (OPEB) liability.

EXECUTIVE SUMMARY

The Government Accounting Standards Board (GASB) issued "Statement 45", which requires states and local governments to report the unfunded accrued liability of non-pension retiree benefits – called Other Post Employment Benefits (OPEB) - on those governments' financial statements. Prior to the adoption of this rule, state and local governments typically accounted for OPEB costs on a pay-as-you-go basis. Governments are not obligated to pre-fund these liabilities, but only to report them on their financial statements. John Bartel of Bartel & Associates, LLC will present a draft actuarial report regarding the County's OPEB liability and will discuss with the Board of Supervisors the assumptions used in the creation of the report and options for dealing with the County's OPEB liability. The Executive Summary of that report is attached, and shows that Napa County's unfunded OPEB liability is between $37 million and $51 million. Of Mr. Bartel's 48 public agency clients with Miscellaneous membership, Napa County's unfunded actuarial liability ranks in the bottom 26th percentile for that category. Staff will be returning to the Board at a later date with recommendations concerning the funding of the County's unfunded liability.

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

The Governmental Accounting Standards Board (GASB) has established standards for the measurement, recognition, and reporting of costs associated with Other (than pensions) Post Employment Benefits (OPEB) which are offered by many state and local government employers as part of a total compensation package for employees. OPEB includes retiree healthcare benefits, as well as other forms of post employment benefits such as life insurance, dental insurance, and optical coverage. The GASB standards address financial statement and disclosure requirements for reporting OPEB expenses and related accrued liabilities.

OPEB expenses are considered part of the overall salary and benefit package because the expenses constitute compensation for employee services. In the past, governments have typically accounted for this obligation using a "pay-as-you-go" methodology. Under GASB 45 the County and all other public employers are required to recognize and report in financial statements the value of the benefits.

Under the "pay-as-you-go" methodology costs are reported on a cash basis only after an employee retires as part of the normal operating expenses in a given year. GASB 45 requires the accrual and reporting of the estimated cost of the benefits in financial statements each year during the years that employees are providing services to the County. By identifying the accrued liability associated with these benefits the amount of any unfunded liability can be calculated. Recognizing and reporting this unfunded liability more accurately reflects the true cost of the services the County provides to its constituents.

GASB 45 does not require the County to pre-fund any of the unfunded liability associated with these retirement benefits. However, pre-funding these anticipated future benefit costs is a central policy decision relative to the long term management of these costs. The only real requirement of GASB 45 is that the unfunded OPEB liability be reported on the County's financial statements starting in Fiscal Year 2007-08.

It is important to understand the concept of pre-funding under GASB 45. To consider a retiree healthcare plan pre-funded for GASB 45 purposes, assets must be set aside in an irrevocable trust that cannot, legally, be used for any purpose other than to pay retiree healthcare benefits. This is similar to the situation that currently exists with regard to PERS pension benefits. A plan with assets not set aside in an irrevocable trust is not a pre-funded plan under GASB 45. This has significant implications on the discount rate assumptions used to calculate plan liabilities. Finding present values of future benefits (or discounting, as it is commonly called) is simply the reverse of compounding. The discount rate is the "interest rate" used to make the present value calculation of future liabilities. The higher the discount rate, the lower the present value of liabilities. Pre-funded plans with contributions made to an irrevocable trust with diversified assets (such as CalPERS) will likely achieve a rate of return much higher than with a plan with no pre-funding and benefits paid from the County's general fund following a "pay-as-you-go" strategy. This will be discussed in more detail below.

There are advantages and disadvantages to pre-funding the OPEB liability. The main disadvantages of pre-funding are higher employer contributions in the near term and the loss of access to the pre-funding moneys paid to an irrevocable trust. There are some significant advantages to pre-funding this liability. Some of the advantages to pre-funding pointed out by CalPERS in the September 2006 circular letter are:

- By not pre-funding, the employer's credit rating might be affected, making it difficult or more expensive to issue bonds;
- Earnings on assets reduce employer contributions significantly;

- Investment return assumption (discount rate assumptions) will be higher, making annual expense and the unfunded liability lower;
- Prevents net OPEB obligation from becoming a significant liability on balance sheet; and
- Enhanced security for members.

The advantage of continuing a “pay-as-you-go” approach is that the near term costs will be less per year than when following a pre-funding strategy. However, a disadvantage is that the future costs of continuing the benefit may exceed the County’s ability to pay for those benefits in the future.

In December of 2005 the Board approved a contract with Bartel & Associates, LLC to provide an actuarial valuation of the County’s OPEB liability. A draft actuarial report prepared by Bartel & Associates is attached. Mr. Bartel will be at the Board of Supervisors’ Meeting on November 14, 2006 to make a presentation of his analysis and report. While no effort will be made here to review in detail all of the facets of Mr. Bartel’s technical analysis and report, there are several key points that need to be mentioned that will help set the stage for Mr. Bartel’s presentation.

The County has historically accounted for retiree healthcare benefits as they were paid. In FY 2006-07, the value of paid benefits was approximately $1.5 million. GASB 45 will require the County to account for these benefits on an accrual basis (as benefits are earned). As of January 1, 2006, the County had an Unfunded Actuarial Liability (UAL) for retiree healthcare benefits of between approximately $37 million and $51 million dollars depending on the interest rate that was used in calculating this liability. In Fiscal Year 2006-07, the County established a designation of $4.1 million for purposes of the OPEB liability.

In addition to the UAL, each year additional benefit liabilities accrue as employees work. This cost is known as the Normal Cost (NC) which is the value of benefits that are accrued during a given year. For Napa County, the NC of these additional benefits for Miscellaneous employees is between approximately $2.1 million and $3.5 million dollars per year depending on the interest rate used in the calculation. When comparing this with 48 other public agency clients of Bartel & Associates, the County’s NC falls in the bottom 26th percentile for its Miscellaneous membership. This means that of Mr. Bartel’s clients, 26% have a NC of retirement benefits lower and 74% have a NC higher than Napa County.

GASB 45 does not require an agency to make up any of the shortfall (UAL). An agency’s Annual Required Contribution (ARC) is nothing more than the current employer NC, plus the amortized UAL. The ARC ranges from $4.8 million to $6.4 million based on the NC and 20-year amortization of the UAL. This would range from 6.0% to 8.0% of FY 2006-07 payroll.

The plan’s funded status is equal to the Actuarial Liability less plan assets. The Actuarial Liability of the plan represents the present value of benefits accrued through the valuation date. In fiscal year 2006-07, the County has designated $4.1 million dollars for the purpose of the OPEB liability. The discount rate plays heavily in calculating a plan’s Actuarial Liability. The higher the discount rate the lower the UAL and the lower the ARC. Higher rates of return and hence, discount rates, can be achieved by putting plan assets and contributions into an irrevocable trust with diversified assets. This would be considered pre-funding under GASB 45. The long-term rate of return assumption for pre-funded plans in Mr. Bartel’s report is 7.0%. For plans with no pre-funding (assets held in the general fund and not in trust) the long-term rate of return assumption was only 4.25%.

There are a number of policy decisions that the Board will need to make in the coming months. The first policy decision will be whether to pre-fund the retiree healthcare benefits in an irrevocable trust. In addition, if it is decided to pre-fund, the Board would need to make a decision on the period of time to amortize the current unfunded liability for retiree benefits and rate of return assumptions. The actuarial report prepared by Bartel & Associates is the first step in that process. Staff will return to the Board, after researching various funding options, with a recommendation regarding the implementation of either pre-funding the OPEB liability or continuing on a “pay-as-you-go” basis.

SUPPORTING DOCUMENTS

A . Retiree Healthcare Plan Jan. 1, 2006 Actuarial Study Executive Summary

CEO Recommendation: Approve

Reviewed By: Helene Franchi