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NAPA COUNTY BOARD OF SUPERVISORS
Board Agenda Letter

TO:	Board of Supervisors
FROM:	Britt Ferguson for Watt, Nancy - County Executive Officer County Executive Office
REPORT BY:	Helene Franchi, Principal Management Analyst - 253-4820
SUBJECT:	Agreement with PERS regarding OPEB obligation

RECOMMENDATION

County Executive Officer and Auditor-Controller to discuss status of prefunding the County's Other Post Employment Benefits through the California Employer's Retiree Benefit Trust Program and request approval of and authorization for the Chair to sign the following documents upon conclusion of negotiations with CalPERS:

1. An agreement with California Public Employees' Retirement System (CalPERS) for a maximum contribution of $5,900,000 for Fiscal Year 2007-08 which includes current year premium payments; and
2. Delegation of Authority to Request Disbursements.

EXECUTIVE SUMMARY

In November 2006, John Bartel of Bartel Associates, LLC presented the Board with a draft actuarial report regarding the County's Other Post Employment Benefits (OPEB) liability. The report identified the County's unfunded liability at between $37 million and $51 million. At that time, of Mr. Bartel's public agency clients, Napa County's unfunded liability ranked in the bottom 26th percentile. In April 2007, Mr. Bartel identified the cost of fully funding that unfunded liability under different amortization schedules.

At the meeting in April, the Board was presented with the following alternatives:

- Continue funding retiree health insurance costs on a pay-as-you-go basis, or;
- Pre-fund, that is pay down the unfunded liability through contributions to an irrevocable trust. If pre-funding was selected the period of time to fully fund (or amortize) the County's unfunded liability needed to be determined.

The Board determined that pre-funding the County's OPEB unfunded liability over 14 years with an option to change to either a 20 or 30 year amortization schedule if necessary, would be desirable and directed staff to enter into an agreement with CalPERS to that end. Since that direction, staff has reviewed other funding vehicles, met with representatives of PARS (a private corporation that has engaged Union Bank of California to provide investment and trust services), and entered into discussions with representatives from CalPERS regarding its California Employer's Retiree Benefit Trust Program (CERBT). While staff continues to recommend participation in the CERBT, there are elements of the current Agreement which are under consideration by CalPERS and are yet to be resolved. Today's recommendation is to direct staff to continue negotiations with CalPERS and authorizes the Chair to sign the necessary documentation upon conclusion of those negotiations.

Procedural Requirements

1. Chair announces the agenda item.
2. Staff reports on the item.
3. Questions by the Board.
4. Chair invites public comments.
5. Member makes a motion.
6. Different member seconds the motion.
7. Board discussion and debate on the motion.
8. Chair calls for the vote.
9. If roll call vote requested by member, Clerk calls the roll.
10. Chair announces the result of the vote.

FISCAL IMPACT

Is there a Fiscal Impact?	Yes
Is it currently budgeted?	Yes
Where is it budgeted?	Funding is available in the recommended budget for FY 07-08. The cost is approximately $5.9 million which is comprised of $3.9 million towards the unfunded liability (UAAL) and $2.0 million for the Normal Cost. The total contribution is $4.1 million more than the pay-as-you-go cost. (Note: Normal Cost is the value of benefits being earned by active employees while pay-as-you-go costs are benefits being paid to retirees.)
Is it Mandatory or Discretionary?	Discretionary
Discretionary Justification:	Benefits of pre-funding the County's OPEB obligation occur only when the money is set aside in an irrevocable trust. Due to CalPERS' expertise and investment track record, approval of an agreement is recommended. However, the agreement as currently proposed includes a restriction on moving funds within the first three years. Staff is working with representatives from CalPERS and is hopeful that the restriction may be modified for smaller investors. If the restriction remains, it is possible (although unlikely) that actions taken by the Legislature during the first three years of the agreement may impose some negative fiscal impact on the County.
Is the general fund affected?	Yes
Future fiscal impact:	Annual pre-funding will be included in recommended budgets. Based on the January 1, 2006 Actuarial Study, costs in future years will range between $6 million in FY 08-09 and $9 million in FY 20-21 at which time the unfunded

	liability will be paid in full. These costs assume the County continues to amortize the cost on a 14 year schedule, however, the Board may request a change to either a 20 or 30 amortization schedule depending on fiscal impacts. The Five Year Forecast supports the ability of the General Fund to sustain this schedule for the next five years.
Consequences if not approved:	Options available to the County include investing in different funding vehicles such as those identified on the attached table. For example, if the Board determines CalPERS is not a viable option, staff could continue discussions with PARS or one of the other trust vehicles. If those options are not considered, the County would not be able to pre-fund its OPEB obligation and would continue on a pay-as-you-go basis. Failure to pre-fund, as well as not paying 100% of the Annual Required Contribution, could adversely impact the County's bond rating and cost of borrowing. Alternatively, the Board could request staff returns with a different amortization schedule.
Additional Information:	

ENVIRONMENTAL IMPACT

There is no Environmental Impact for this item.

BACKGROUND AND DISCUSSION

As previously reported to the Board, 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.

Because OPEB expenses constitute compensation for employee services, they are considered part of the overall salary and benefit package. In the past the County, as is typical for local and state agencies, has accounted for this obligation using a "pay-as-you-go" methodology. However, in April of this year, the Board directed that the County begin pre-funding its OPEB liability and amortize it over a 14 year period. For Fiscal Year 2007-08, $5.9 million was budgeted for this purpose. 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.

<u>OPEB Funding Vehicles</u>

While GASB 45 is relatively new, there are nevertheless a number of different funding vehicles available that the County may consider in its establishment of an irrevocable trust. Mr. Bartel has created a chart comparing five such entities: CalPERS (CERBT), International City/County Managers Association (ICMA), Public Agencies Retirement Services (PARS) - a private for-profit corporation, CalVEBA, and RCM Capital Management LLC (RCM). The types of tax exempt trusts available to government entities include that used by CalPERS and PARS (a Section

115 Trust), an Integral Part Trust (used by ICMA), and a Voluntary Employee Benefit Association (a 501(c) (9) trust) used by CalVEBA. The later is the most problematic because administration of the plan can be more cumbersome and ownership of the funds is complicated. The attached table compares the different trust options based on a number of different factors, with the more significant of those discussed below.

- Local Control of Investments – Only the CERBT manages the portfolio with no local control. All of the other trust options would require at least some involvement by County staff in terms of the types of investments made by the trust and in some cases require that County staff be completely responsible for managing investments. Involvement ranges from local control of investment portfolios to discretionary options which could include moderate or aggressive portfolio options to that of the CERBT which completely manages the portfolio on behalf of its members. Providing for local control means that the County would have the ability to craft an investment portfolio that meets our more customized needs and reflects our specific risk tolerance. On the other hand, it would require the County to invest staff time and resources into evaluating different investment options. If the County chooses an option with some level of local control, Mr. Bartel recommends that an independent investment advisor be consulted which will result in additional expenses ranging from $30,000 to $45,000 annually.

- Fiduciary Responsibility – Fiduciary responsibility is defined as a relationship imposed by law where an agency or person has voluntarily agreed to act in the capacity of “caretaker” of another’s rights, assets and/or well being. Essentially, in this case, the party with fiduciary responsibility is legally liable for actions related to the care and investment of funds in the OPEB trust. As you can see from the attached table, only CalPERS completely assumes fiduciary responsibility for its trust. In all of the other options, fiduciary responsibility would remain with the County. If the County were to assume this responsibility, its liability will be increased. To mitigate this liability, and as a matter of due diligence, the County would likely need to devote additional staff time and hire independent investment advisors as described above. This would have a cost which could, effectively reduce the overall rate of return to the County.

- IRS Rulings – There are two types of rulings made by the IRS upon request from the investment agent, one is a “determination letter”, the other a “private letter ruling”. Both are regularly used in the private sector and neither is required by the IRS. The IRS may issue a “determination letter” which acts as an insurance policy and confirms that the IRS recognizes the entire plan as tax exempt. A “private letter ruling” is not as extensive and relates to a specific set of circumstances at a point in time. A private letter ruling can be used to increase confidence in the trust design. CalPERS and PARS have established IRC Section 115 trusts. Under IRS Revenue Rule 90-74, a Section 115 Trust is tax exempt if funded by political subdivisions to pool their “risks in lieu of purchasing insurance to cover their public liability, workers’ compensation, or employees’ health obligations.” As noted on the attached table, CalPERS has said their internal and external legal counsel believe the Trust is in full compliance with IRS rules. They have not sought nor have they received an IRS determination. PARS does have a private letter ruling for its Plan documents and CalVEBA and RCM, which are not Section 115 trusts have determination letters. If the IRS were to determine, at some future date, that the CalPERS' Section 115 trust is no longer tax exempt it is likely that CalPERS’ errors and omissions insurance policy would contribute towards any liability but it is unclear whether member agencies would be required to fund any resultant penalties.

- Estimated Net Rate of Return – The attached table shows various rates of return as determined for the different options, as estimated by Bartel Associates based on investment mix and estimated expenses. You will note each vehicle has different fees associated with the administration of its trust. These have been incorporated into the estimated net rate of return, however, this does not include the cost of an investment advisor as recommended above. As you can see, the CalPERS’ rate of return at 7.75% is generally equal to or higher than the other vehicles, with only the CalVEBA trust reaching 7.75% in its aggressive pool. It is important to note that while all of these are estimates it is likely that the non-CalPERS funds will have a higher percentage invested in equities which means that their investment mix will be more volatile and thus the CalPERS estimated rate of return is more reliable than the others. Generally, the CalPERS investment return is higher because their expenses (investment and administrative) are lower. For all of the considered trusts, rates of return are based on annual averages and may fluctuate significantly either higher or lower from year to year.

Analysis and Funding Recommendation

There are potential advantages and disadvantages of each of the different trust options that have been identified. And, given how new OPEB trusts are, there is a certain amount of uncertainty and risk associated with all options. After careful review, staff has concluded that funding through CalPERS is the best option for the County. This recommendation is based on the following:

- As noted above, CalPERS estimated net rate of return is equal to or greater than all of the other trust options (where the agency does not fully design its own investment strategy), and the volatility of CalPERS' investment mix is less. It is possible that the County, working with investment advisors, could craft a "local control" investment strategy that would exceed the 7.75% annual return level. However, CalPERS has a seasoned investment staff and a long history of securing significant investment returns on the pension side and staff is skeptical that the County could do better on a consistent basis at a lower cost.

- With the CalPERS option the County does not retain "local control" and fiduciary responsibility. Avoiding fiduciary responsibility limits the County's legal liabilities. Not having local control and fiduciary responsibility also will likely keep the County's investment cost down, since we will not have to hire outside investment advisors. Finally, as indicated above, unlike CalPERS, County staff does not have experience in the sorts of equity investments that would be needed to achieve a significant rate of return.

- Given its history, staff is relatively confident that CalPERS has relied on well qualified legal experts in establishing its OPEB trust and thus the trust is qualified under Section 115. While it is noted that private sector investment agents such as PARS and ICMA have requested and received private letter rulings these are specific rulings on circumstances at the present time. A determination letter while desired is not generally requested by public sector agencies such as CalPERS.

- As indicated, CalVEBA is a 501 (c) (9) trust, which is more cumbersome and therefore more problematic. The ICMA trust has not yet established a discretionary investment option, which staff believes makes the most sense for Napa County if the County did not select the CalPERS trust.

To date, approximately 25 agencies have contracted with CalPERS to participate in the California Employers Retiree Benefit Trust Fund (CERBT); among those are the counties of Nevada, Placer and Riverside. For comparison purposes, PARS has approximately 22 agencies the majority of which are school districts.

The current Agreement as drafted by CalPERS, includes an initial three year commitment on the part of the County after which time the County could terminate its participation in the CERBT and transfer its funds to another trustee. Staff is currently negotiating with CalPERS to remove this restriction. The stated intent by CalPERS representatives for the restriction is to allow rebalancing of the portfolio if a large billion dollar investor was to transfer out of the CERBT. CalPERS is considering modifying that term for smaller investors, allowing more flexibility. However, if CalPERS determines that this flexibility is not in the best interest of the CERBT and insists on the initial three year restriction, staff believes that contracting with CalPERS is still the most viable option for the County and, if the Board approves today's recommended action, would proceed to finalize an agreement in any case.

Today's action will allow staff to continue its conversations with representatives from CalPERS and upon conclusion of those conversations, establish an Employer Prefunding Account within the CERBT Prefunding Plan (the Plan). The Plan is a trust fund that consists of an aggregation of single-employer plans, with pooled administrative and investment functions. Contributions will be made annually with the first contribution consisting of approximately $5.9 million. Each year thereafter, contributions will be at least $5,000 or equal to the County's Annual Required Contribution as noted in the Actuarial Study prepared every two years. The Actuarial Study indicates annual payments ranging from $6 million to $9 million over the next 14 years. It is important to note that money set aside in the Plan, which is an irrevocable trust, cannot be used to meet any other County needs that may arise (including disasters or other emergencies). It is possible, though not likely, that the County's irrevocable trust could become super-funded (that is, have more assets than needed to cover the County's OPEB liabilities). If that were to occur, CalPERS may return such excess to the County.

Today's action reflects a contribution commitment based on a 14 year amortization schedule. The Board may wish to consider at some time in the future, changing to a longer (i.e. 20 or 30 year) amortization. If that becomes desirable, a contract amendment will need to be executed with CalPERS. For example, by utilizing a 20 year amortization schedule rather than a 14 year schedule, the County could reduce the average annual cost in the early years by approximately $500,000 (in non-present valued dollars). If a 30 year amortization is used, the average annual cost in the early years could be reduced by approximately $1 million (again, non-present valued) compared to the 14 year amortization schedule. In all cases, these amortization schedules would result in fully funding, or eliminating, the County's unfunded liability by the end of the amortization period.

SUPPORTING DOCUMENTS

A . Trust Comparison

CEO Recommendation: Approve

Reviewed By: Helene Franchi