

**Meeting Date:** 12/8/2015

**Report Type:** Staff/Discussion

**Report ID:** 2015-00852

**Title:** Strategies to Address the City's Other Post-Employment Benefits (OPEB) Unfunded Liability

**Location:** Citywide

**Recommendation:** Pass a Motion 1) endorsing one of the recommended strategies in this report for reducing the City's OPEB liability; and 2) directing the City Manager to prioritize the endorsed strategy when negotiating future City employee labor contracts.

**Contact:** Dennis Kauffman, Operations Manager, (916) 808-5843; Leyne Milstein, Director, (916) 808-8491, Department of Finance

**Presenter:** Dennis Kauffman, Operations Manager, (916) 808-5843, Department of Finance

**Department:** Finance

**Division:** Finance

**Dept ID:** 06001011

**Attachments:**

- 1-Description/Analysis
- 2-Background
- 3-Excerpt
- 4-Sac OPEB Options

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**City Attorney Review**

Approved as to Form  
Steve Itagaki  
11/10/2015 11:07:29 AM

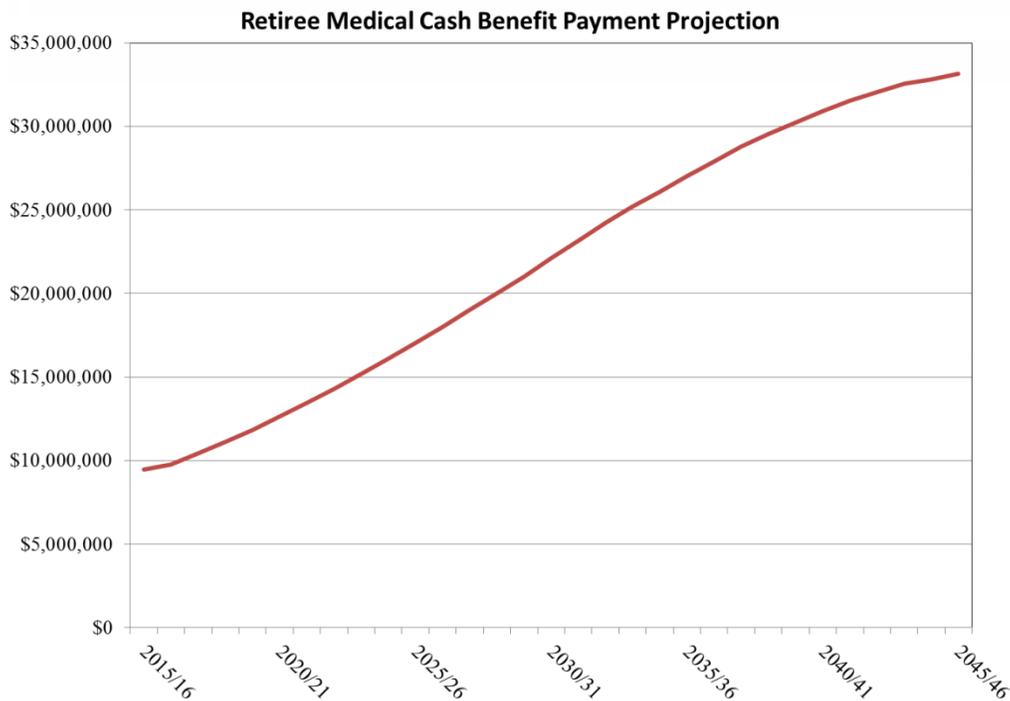
**Approvals/Acknowledgements**

Department Director or Designee: Leyne Milstein - 11/3/2015 12:35:46 PM

## Description/Analysis

**Issue Detail:** As part of the Fiscal Year (FY) 2015/16 budget development process, staff provided the Budget and Audit Committee a briefing on the City's challenges related to the provision of post-retirement health benefits (referred to as OPEB) over the long-term. The Budget and Audit Committee asked staff to identify ways the City might address its long-term liabilities while striving to maintain program and service levels to the extent possible. Staff contracted with Bartel Associates to quantify several options the Council can consider in addressing the City's OPEB liabilities and costs (Attachment 1).

The City's current unfunded liability for OPEB benefits is \$452 million. The City's OPEB costs, unlike pensions, are not offset by significant investments. The FY2015/16 pay-as-you-go (pay-go) cost of these benefits is approximately \$10 million (\$9 million in the General Fund). If the City does not replace the current plan of pay-go combined with minimal contributions to the City's relatively new OPEB trust fund, the City's pay-go obligation will continue to grow, consuming resources that would otherwise pay for vital programs and services as depicted in the illustration below:



The Government Finance Officers' Association recommends that an appropriate funding approach include prefunding of the OPEB obligation. By prefunding, employers who make long-term investments to cover these obligations will experience a lower total cost for providing these benefits.

Given the magnitude of the City's existing unfunded liability, the cost difference between the current pay-go funding of OPEB benefits and full prefunding is substantial. If the City were prefunding OPEB on an actuarially-responsible basis, the City's FY2015/16 Annual Required Contribution (ARC)<sup>1</sup> would

<sup>1</sup> The ARC, as determined by the City's OPEB actuary, is comprised of:

- Normal Cost – the current year cost of the program to provide the benefit for current employees in the future, is \$17 million or 6.2% of total payroll.
- Amortization of the unfunded liability is \$29.5 million or 10.7% of total payroll.

be \$46.5 million, \$37 million of which is from the General Fund. This is a difference of \$28 million annually over the current budgeted General Fund pay-go cost.

Analysis of the City’s comparison agencies (see table below) reveals that the City of Sacramento has the second highest OPEB liability as a percentage of its General Fund budget and one of the lowest funded statuses. OPEB and ARC reduction strategies employed by some of these agencies include the following: The City of San Jose is 15% funded, has negotiated significant employee contributions to fund its OPEB benefits and has plans to ramp up to fully fund its ARC. The City of Roseville is 22% funded, has adopted a five-year ramp-up funding plan, and has established new tiers with the newest tier employees contributing to retirement health savings accounts (RHSAs). The City of Oakland started funding its OPEB trust fund in FY2013/14 with significant one-time and ongoing contributions. The City of San Francisco started funding its OPEB Trust in FY2008/09 with contributions from the City and employees hired after January 2009, and will require contributions from all employees effective July 2016.

### Comparison City OPEB Survey

Agency	Unfunded Liability as a % of FY15/16 General Fund Budget	Funded Status Based on Most Recent Actuarial Valuation	Funding Strategy
San Jose	129%	15%	Significant employee contributions; ramping up to full ARC
Sacramento	107%	0%	Pay-go, plus one-time deposits and \$1 million annual appropriation
Roseville	102%	22%	Five-year funding plan; 3 tiers; new tier contributes to RHSA
Oakland	88%	0%	Started funding in FY13/14 with one-time and ongoing appropriations
San Francisco	87%	0%	Started funding in FY09/10 with City and employee contributions
State of California	66%	0%	Pay-go
Fresno	49%	0%	Pay-go
Long Beach	33%	0%	Unfunded liability attributable to subsidized premiums for retirees
Bakersfield	31%	42%	No benefits to employees hired after 2006
Sacramento County	5%	0%	Benefits nearly eliminated
Stockton	1%	0%	Benefits nearly eliminated

Note: The City’s current funded status is approximately 1% as of November 2015.

Since full prefunding of the current OPEB benefit is not a realistic option given current budget constraints, the significant unfunded liability remains a negative in reports from credit rating agencies, and the City’s unfunded liability is significant in relation to our comparison agencies, the Budget and Audit Committee tasked staff with evaluating potential mechanisms for future labor negotiations to reduce both the City’s OPEB liability and ARC. The following strategies quantified by Bartel would provide significant and immediate OPEB liability reduction and long-term cost savings:

### City Savings (\$ in millions)

Strategy	Description	Liability Reduction	ARC Savings
1	Eliminate OPEB Benefit for Current Employees	269	31.1
2	Replace OPEB Benefit for Current Employees with RHSA Funding	202	26.8
3	Eliminate OPEB Benefit for Certain Current Employees and Cap Local 522 OPEB Benefit	150+	20+
4	Reduce OPEB Benefit by 50% at Medicare eligibility for Current Employees and Match Employee Contributions to OPEB Trust Fund	52+ 2.8 per 1% of payroll	6.7+ 2.8 per 1% of payroll

Note: All 4 strategies include a 10-year phase-in to full ARC funding in light of the City’s current budget constraints.

### Strategy 1 - \$269 million liability reduction

- **Eliminate OPEB benefit for current employees**
- **Phase-in to full funding of ARC for retired employees over 10 years**

Elimination of OPEB benefits for current employees with a 10-year phase-in to full ARC prefunding would reduce the unfunded OPEB liability by \$269 million and reduce the ARC by \$31 million.

### Strategy 2 - \$140 million to \$200+ million liability reduction

- **Replace current OPEB benefit for current employees with funding for RHSAs at retirement based on years of service**
- **Phase-in to full funding of ARC over 10 years**

Replacing the current OPEB benefit for current employees with a contribution to a Retirement Health Savings Account (RHSA) at retirement of \$1,000 per year of City service would reduce the unfunded OPEB liability and ARC substantially:

City Savings (\$ in millions)

Strategy	Description	Unfunded Liability	ARC
3a	Replace OPEB Benefit for Current Employees with RHSA Funding. RHSA retirees participate in City health plans.	140.8	19.2
3b	Replace OPEB Benefit for Current Employees with RHSA Funding. RHSA retirees do not participate in City health plans.	201.8	26.8

RHSA retirees could obtain insurance through the State exchange or private exchanges if they are not allowed to participate in City health plans.

### Strategy 3 - \$150+ million liability reduction

- **Eliminate OPEB benefit for current employees with a sum of age and years of City service less than 60**
- **Reduce OPEB benefit by 50 percent for employees with a sum of age and years of City service between 60 and 65**
- **Cap Local 522 Firefighters OPEB benefits**
- **Reduce OPEB benefit by 50% at Medicare eligibility for all current employees**
- **Phase-in to full funding of ARC over 10 years**

Eliminating the OPEB benefit for current employees with a sum of age and years of City service less than 60 and reducing the benefit by 50 percent for employees with a sum of age and years of City service between 60 and 65, would reduce the unfunded OPEB liability by more than \$100 million and the ARC by more than \$15 million.

The retiree medical benefit for most of the Local 522 (firefighters, engineers, captains, and battalion chiefs) membership is tied to medical costs, as opposed to a fixed benefit as with all other City employees. As a result, the retirement medical benefits that will be paid to Local 522 members constitute about 45 percent of the City's unfunded liability in the General Fund. Reducing the OPEB benefit amount for all current Local 522 employees to an amount consistent with that of all other bargaining units would reduce the City's unfunded OPEB liability by \$49 million and the ARC by \$7 million.

Reducing the OPEB benefit by 50% at Medicare eligibility (currently at age 65) for all current employees will reduce the unfunded OPEB liability by \$52 million and the ARC by \$6.7 million.

Eliminating the OPEB benefit for a significant number of current employees, combined with capping the Local 522 benefit and adopting a 10-year phase-in to full funding of the remaining ARC, will reduce the OPEB liability by more than \$150 million.

**Strategy 4 - \$52 million liability reduction plus up to \$14 million (5% of payroll) annually from employee contributions (Actual savings depend on investment assumptions)**

- **Reduce OPEB benefit by 50% at Medicare eligibility for current employees only**
- **Employees contribute to OPEB trust fund – 1% of pay will reduce OPEB liability and ARC by \$2.8 million annually**
- **Phase-in to full funding of ARC over 10 years**

As stated above, reducing the OPEB benefit by 50% at Medicare eligibility (currently at age 65) for current employees would reduce the unfunded OPEB liability by \$52 million and the ARC by \$6.7 million.

Without other significant changes to the City's OPEB benefits, the only way to sustain the plan over the long-term is with additional employee and City contributions. This strategy calls for employees to match City contributions, ramping up from 1% of pay to between 3% (\$8.4 million) and 5% (\$14 million) of pay, until the remaining ARC is fully funded over a 10-year phase-in. As contributions from employees and the City ramp up over time, the assets accumulating in the OPEB Trust will generate investment earnings to help pay for the OPEB benefit and result in a lower ARC.

**Policy Considerations:** The strategies outlined in this report are consistent with the Mayor and Council's budget priority to adopt financially sound policies and procedures that are prudent and take into account long-term liabilities. A sustainable budget must be evaluated in a long-term rather than a short-term context.

**Economic Impacts:** None.

**Environmental Considerations:** This action is not a project that is subject to CEQA because it is an administrative activity and relates to government fiscal activities that do not involve any commitment to any specific project that may result in a potentially significant physical impact on the environment. (CEQA Guidelines § 15378(b)(2) and (b)(4).)

**Sustainability:** None.

**Commission/Committee Action:** Options to address the City's OPEB unfunded liability were presented to the Budget and Audit Committee on April 7, 2015 (Attachments 2 and 3). The Committee requested that the options be quantified, asked for information about how the City's comparison agencies are addressing OPEB, and approved a Motion to forward the options to the City Council for further consideration.

**Rationale for Recommendation:** This staff report provides the City Council with strategies to reduce the unfunded liability of the City's OPEB plan, as well as a recommended phase-in strategy to fund the City's remaining liability. Establishing consistent bargaining practices incorporating one or more of the above strategies will reduce the City's unfunded OPEB liability and move the City closer to a sustainable OPEB plan.

**Financial Considerations:** The City's pay-go funding policy for its OPEB plan is not financially sustainable. Strategies to reduce or eliminate the unfunded liability of the OPEB plan should be implemented as soon as possible to avoid City programs being crowded out by increasing OPEB costs. A phase-in to full funding of a reduced ARC should be adopted to achieve a financially responsible OPEB plan that reflects Council's priorities to maintain programs and services while addressing the City's long-term liabilities.

**Local Business Enterprise (LBE):** Not applicable.

## Background

The City provides OPEB benefits to active employees hired before specific dates. For police and miscellaneous employees, the cash benefit amount is \$300 per month for retirees only and \$365 per month for retirees with dependents. Police employees hired after September 3, 2013, and miscellaneous employees hired after June 30, 2012, are not eligible for post-employment health benefits. For Local 522 employees hired before January 14, 2015, the cash benefit amount is equal to the lowest cost medical plan premium plus the highest benefit dental plan premium plus \$25, a total of \$774.28 per month currently. Local 522 employees hired on or after January 14, 2015, are eligible for a cash benefit amount up to \$774 monthly from the date of retirement until the retiree reaches Medicare eligibility age, and up to \$387 monthly from the date the retiree reaches Medicare eligibility. Current employees pay \$45 per month, with a City match of \$45 per month, which goes into a separate trust fund to pay for that benefit.

The City's current OPEB benefit is prorated based on years of service – 50% for employees with ten to fifteen years of service, 75% for employees with fifteen to twenty years of service, and 100% for employees with twenty years of service or more.

Currently, the City has \$452 million in unfunded long-term liabilities associated with retiree medical benefits from all funding sources, \$385 million attributable to the General Fund. While the benefit is currently funded on a pay-go basis, paying only the actual cost of the benefit to retirees in the current fiscal year, financial accounting standards require the City to account for the benefit as if it were actuarially funded, which accounts for benefits earned by employees this year but paid to them after they retire. The General Fund pay-go amount included in the FY2015/16 budget is \$9 million (\$10.7 million for all funds), an increase of 4.9% over the prior fiscal year.

Consistent with best practices, Council authorized the establishment of an irrevocable trust in January 2013 with an initial General Fund investment of \$2 million. Another \$2 million was contributed to the trust in FY2013/14. The FY2014/15 and FY2015/16 approved budgets each included a \$1 million contribution to the trust, bringing the total funding for the trust to \$6 million. The approved FY2014/15 and FY2015/16 Budget Resolutions also included authority to direct any available budgetary resources in the PERS budgetary accounts at the end of the fiscal year, as a result of vacancies, to be appropriated to the OPEB Trust.

**RETIREE HEALTHCARE PLAN**

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June 30, 2013 GASB 45 Actuarial Valuation  
Alternative Benefits Study

**Bartel Associates, LLC**

John E. Bartel, President

Catherine Wandro, Assistant Vice President & Actuary

Daniel Park, Actuarial Analyst

June 10, 2015

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**BENEFIT SUMMARY – ALTERNATIVE BENEFITS**

<b>Fire, Police, and Miscellaneous</b>	
<b>Alternative 1</b>	<ul style="list-style-type: none"> <li>■ Require Employee Contributions to an OPEB Trust (no refunds):</li> <li style="padding-left: 20px;">#1a – Employees contribute 1% of pay</li> <li style="padding-left: 20px;">#1b – Employees contribute \$50/month</li> </ul>
<b>Alternative 2</b>	<ul style="list-style-type: none"> <li>■ Eliminate OPEB Benefit for certain employees:</li> <li style="padding-left: 20px;">#2a – Current employees with less than 20 years of service now are ineligible for city paid health benefits at retirement</li> <li style="padding-left: 20px;">#2b – Current employees with sum of age plus service less than 65 now are ineligible for city paid health benefits at retirement</li> <li style="padding-left: 20px;">#2c – Same as #2a but service eligibility applied at retirement</li> <li style="padding-left: 20px;">#2d – Same as #2b but age plus service eligibility applied at retirement</li> </ul>
<b>Alternative 3</b>	<ul style="list-style-type: none"> <li>■ Establish RHTSA<sup>2</sup> and eliminate OPEB benefit for all actives. City contributes \$1,000 per year of service at retirement directly from City.</li> <li style="padding-left: 20px;">#3a – Allow RHTSA retirees to participate in City health plans</li> <li style="padding-left: 20px;">#3b – Don't allow RHTSA retirees to participate in City health plans</li> </ul>

<sup>2</sup> Retiree Health Savings Account.



June 10, 2015



**BENEFIT SUMMARY – ALTERNATIVE BENEFITS**

<b>Fire, Police, and Miscellaneous</b>	
<b>Alternative 4</b>	<ul style="list-style-type: none"> <li>■ Change Cap on Fire benefits (no change to Misc &amp; Police Caps):</li> <li style="padding-left: 20px;">#4a – Fire Actives benefit capped at current Miscellaneous level</li> <li style="padding-left: 20px;">#4b – Fire Actives and retiree benefit cap frozen at current premium</li> </ul>
<b>Alternative 5</b>	<ul style="list-style-type: none"> <li>■ Separate the Retirees from Actives in the Health Insurance Pool:</li> <li style="padding-left: 20px;">#5a – No change to Fire benefit (but cap uses higher retiree premium)</li> <li style="padding-left: 20px;">#5b – Fire cap changed to Miscellaneous level</li> </ul>
<b>Alternative 6</b>	<ul style="list-style-type: none"> <li>■ Phase into full ARC pre-funding: 5-year and 10-year phase in for the following scenarios:</li> <li style="padding-left: 20px;">#6a – 5-Year phase in with current benefit</li> <li style="padding-left: 20px;">#6b – 10-Year phase in with current benefit</li> <li style="padding-left: 20px;">#6c – 5-Year phase in and eliminate benefit for actives</li> <li style="padding-left: 20px;">#6d – 10-Year phase in and eliminate benefit for actives</li> </ul>
<b>Alternative 7</b>	<ul style="list-style-type: none"> <li>■ Reduce OPEB benefit by 50% at Medicare eligibility:</li> <li style="padding-left: 20px;">#7a – For all actives and retirees with enhanced retirement benefit<sup>3</sup></li> <li style="padding-left: 20px;">#7b – For actives only</li> </ul>

<sup>3</sup> Miscellaneous with 2%@55 benefit, Police with 3%@50 benefit, and Fire with 3%@55 benefit.



June 10, 2015



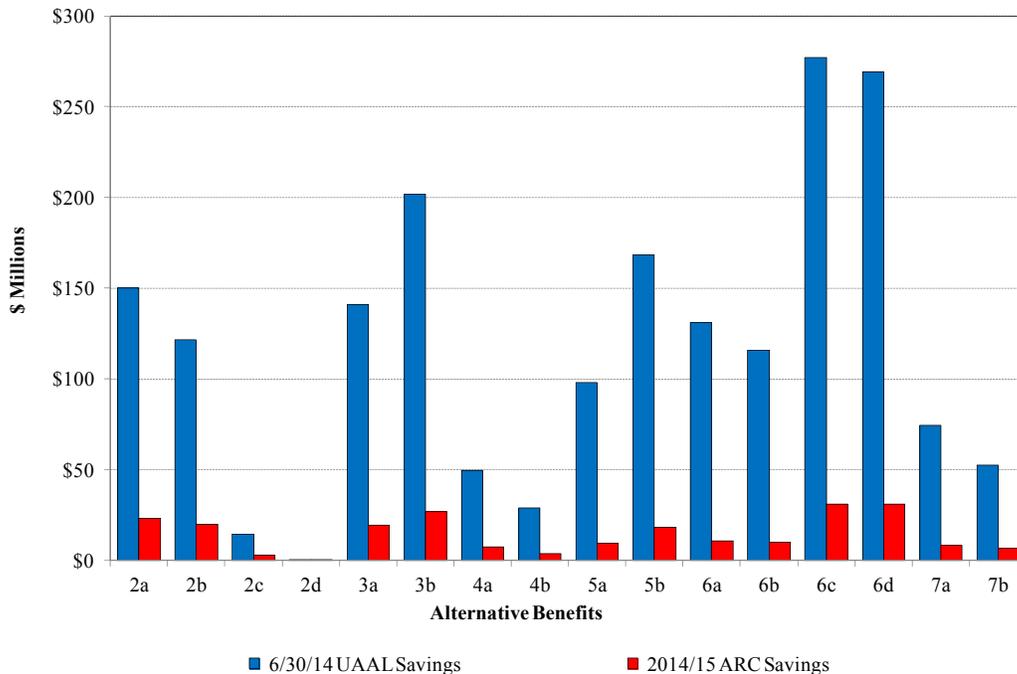
**RESULTS – SUMMARY**

**Summary of City Savings by Alternative Benefit**

	City Savings (\$millions)	
	6/30/14 UAAL	2014/15 ARC
■ Alt #1a – Employees contribute 1% of Pay	See slides 9 and 10	
■ Alt #1b – Employees contribute \$50/mo	See slides 11 and 12	
■ Alt #2a – Eliminate Benefit for Actives < 20 Years Service	\$ 150.0	\$ 23.1
■ Alt #2b – Eliminate Benefit for Actives Age + Service<65	121.5	19.6
■ Alt #2c – No Benefit for Actives < 20 Years Service at Ret.	14.6	2.6
■ Alt #2d – No Benefit for Actives Age + Service<65 at Ret.	0.0	0.0
■ Alt #3a – \$1,000 x Service into RHSA – in City Plans	140.8	19.2
■ Alt #3b – \$1,000 x Service into RHSA – Not in City Plans	201.8	26.8
■ Alt #4a – Fire Cap changed to Misc Cap for Current Actives	49.7	7.2
■ Alt #4b – Fire Cap frozen at Current Level for Act + Rets	29.0	3.7
■ Alt #5a – Split Active/Retiree Pool – No change to Fire	97.9	9.3
■ Alt #5b – Split Active/Retiree Pool – Fire Cap = Misc Cap	168.3	18.2
■ Alt #6a – 5-Year ARC Phase-In with current benefit	131.0	10.6
■ Alt #6b – 10-Year ARC Phase-In with current benefit	115.7	10.0
■ Alt #6c – 5-Year Phase-In and eliminate benefit for actives	277.0	31.1
■ Alt #6d – 10-Year Phase-In and eliminate benefit for actives	269.2	31.1
■ Alt #7a – 50% Reduction at Medicare Eligibility – Act+Ret	74.6	8.0
■ Alt #7b – 50% Reduction at Medicare Eligibility – Act only	52.6	6.7

**RESULTS – SUMMARY**

**Summary of City Savings by Alternative Benefit**



**RESULTS – ALTERNATIVE BENEFITS**

**Alternative #1a**  
**Employees Contribute 1% of Pay into OPEB Trust<sup>4</sup>**  
**10-Year Unfunded Liability Projection**  
**4.5% Discount Rate**  
**(Amounts in \$000's)**

FYE June 30,	6/30/13 Valuation			Alt. #1a			Cumulative UAAL Impact
	BOY AAL	Assets	BOY UAAL	BOY AAL	Assets	BOY UAAL	
2015	\$456,370	\$4,143	\$452,227	\$456,370	\$ 4,143	\$452,227	\$ -
2016	479,852	5,467	474,385	479,852	8,222	471,630	(2,755)
2017	503,422	5,884	497,538	503,422	11,683	491,738	(5,800)
2018	527,054	6,328	520,726	527,054	15,485	511,569	(9,157)
2019	550,574	6,802	543,772	550,574	19,655	530,919	(12,853)
2020	573,942	7,308	566,634	573,942	24,224	549,718	(16,916)
2021	597,230	7,849	589,381	597,230	29,224	568,005	(21,376)
2022	620,054	8,427	611,627	620,054	34,690	585,364	(26,263)
2023	642,583	9,046	633,537	642,583	40,660	601,923	(31,614)
2024	664,667	9,709	654,958	664,667	47,173	617,494	(37,464)

<sup>4</sup> Assumes no refunds of employee contributions.



June 10, 2015

**RESULTS – ALTERNATIVE BENEFITS**

**Alternative #1a**  
**Employees Contribute 1% of Pay into OPEB Trust<sup>5</sup>**  
**10-Year ARC Projection**  
**4.5% Discount Rate**  
**(Amounts in \$000's)**

FYE June 30,	6/30/13 Valuation			Alt. #1a			Annual ER ARC Impact
	Total ARC	EE Cont.	ER ARC	Total ARC	EE Cont.	ER ARC	
2015	\$43,383	\$ -	\$43,383	\$43,383	\$2,755	\$40,628	\$(2,755)
2016	46,480	-	46,480	46,480	2,845	43,635	(2,845)
2017	49,900	-	49,900	49,900	2,937	46,963	(2,937)
2018	53,590	-	53,590	53,590	3,032	50,558	(3,032)
2019	57,569	-	57,569	57,569	3,131	54,438	(3,131)
2020	61,899	-	61,899	61,899	3,233	58,666	(3,233)
2021	66,620	-	66,620	66,620	3,338	63,282	(3,338)
2022	71,776	-	71,776	71,776	3,446	68,330	(3,446)
2023	77,436	-	77,436	77,436	3,558	73,878	(3,558)
2024	83,648	-	83,648	83,648	3,674	79,974	(3,674)

<sup>5</sup> Assumes no refunds of employee contributions.



June 10, 2015

**Meeting Date:** 4/7/2015

**Report Type:** Staff/Discussion

**Report ID:** 2015-00357

**Title:** Options to Address the City's Other Post-employment Benefits (OPEB) Unfunded Liability

**Location:** Citywide

**Recommendation:** Pass a Motion considering options to address the City's Other Post-employment Benefits (OPEB) unfunded liability for further action to be taken by the City Council in June, as part of the budget approval.

**Contact:** Dennis Kauffman, Operations Manager, (916) 808-5843; Leyne Milstein, Director, (916) 808-8491, Department of Finance

**Presenter:** None

**Department:** Finance

**Division:** Finance

**Dept ID:** 06001011

**Attachments:**

1-Description/Analysis

2-Background

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### **City Attorney Review**

Approved as to Form  
Joseph Cerullo  
4/1/2015 6:43:46 PM

### **Approvals/Acknowledgements**

Department Director or Designee: Leyne Milstein - 4/1/2015 11:30:41 AM

## Description/Analysis

**Issue Detail:** The Mayor and City Council have asked staff to identify ways the City can address its long-term liabilities to ensure that program and service levels are maintained. This report identifies several options the City Council may consider in addressing the City's Other Post-employment Benefits (OPEB) (i.e. retiree medical benefits) costs and liabilities.

The City's current unfunded long-term liability associated with retiree medical benefits is \$452 million from all funding sources, with \$385 million attributable to the General Fund. The benefit is currently funded on a pay-as-you-go (pay-go) basis, meaning the City pays only the actual cost of the benefit in the current fiscal year and does not pay any portion of the of the Annual Required Contribution (ARC) costs related to funding the benefit for current employees when they retire nor any portion of the unfunded liability. While the City has taken steps to limit the growth of the liability, including the elimination of the benefit for most new employees, the current unfunded liability will remain and continue to grow if the City relies only on the continuation of the practice of pay-go. That means the annual pay-go amount will continue to increase year after year.

The Government Finance Officers' Association recommends that governments develop a plan to address these outstanding long-term liabilities and ensure the sustainability of the benefits currently offered to employees. This includes determining an appropriate funding approach including prefunding of the OPEB obligation. By prefunding, employers who make long-term investments to cover these obligations will experience a lower total cost for providing these benefits.

The cost difference between pay-go and switching to full prefunding is substantial. The City's fiscal year (FY) 2014/15 pay-go cost is \$10.2 million (\$8.6 million General Fund), while the City's FY2015/16 prefunding ARC<sup>1</sup> would be \$46.5 million (\$37.0 million General Fund), a difference of \$28.4 million over the budgeted General Fund pay-go cost. Since full prefunding is not a realistic option given current budget constraints, the City Council should consider the following strategies to reduce the City's OPEB ARC and unfunded liability:

### **1. Require Employee Contributions to OPEB Trust**

The City could consider requiring employee contributions to the City's OPEB trust. Employee contributions could take the form of a flat dollar amount per pay period or a percentage of pay. Employee contributions will lower the City's OPEB unfunded liability without affecting the benefit.

### **2. Eliminate/Reduce OPEB Benefit for Current Employees**

Although retirees make up about half of the City's unfunded OPEB liability, eliminating or reducing benefits owed to them should be a strategy of last resort because they retired from the City based on an assumed benefit. In order to achieve significant cost savings and reduction of the unfunded OPEB liability, the City could consider reducing or eliminating the benefit for active employees. Since the benefit increases with years of service, the benefit could be reduced or eliminated based on years of service. For example, the benefit could be eliminated for employees who

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<sup>1</sup> The ARC, as determined by the City's OPEB actuary, is composed of the following:

- Normal Cost – the current year cost of the program to provide the benefit for current employees in the future, which is \$17.0 million, or 6.2% of total payroll.
- Amortization of the Unfunded Liability, which is \$29.5 million, or 10.7% of total payroll.

haven't yet earned the full benefit or who have less than 20 years of service. Similarly, the benefit could be reduced permanently for employees with less than 20 years of service.

### **3. Establish Retirement Health Savings Account (RHSA)**

RHSAs serve like a 401(k) defined contribution plan for retiree health savings. A RHSA can complement or replace the City's current OPEB plan for active employees. In the City's most-recent negotiated agreement with Local 522, the City agreed to meet and discuss the establishment of RHSAs. The City also agreed with Plumbers and Pipefitters Local 447 to establish RHSAs no later than September 1, 2015, for those employees contributing \$10 per pay period to the RHSA.

The City could consider elimination or reduction of current OPEB benefits for active employees in exchange for establishing RHSAs. A variation on this option would be to reduce or eliminate the benefit for employees with 20 or less years of service. Presumably, they would have more years to set aside funds for retirement health-care costs. Employees and the City could contribute to RHSAs.

### **4. Cap Local 522 OPEB Benefits for Current Employees and Existing Retirees at Same Level as All Other City Retirees**

While the City was successful recently in negotiating with Local 522 (fire fighters, engineers, captains, and battalion chiefs) for contributions to help offset the OPEB costs for new employees, benefits for existing retirees and employees hired before the current contract are tied to health insurance premium amounts. The result is that these retirees receive more than twice the benefit of all other City employees and constitute 45% of the City's unfunded liability in the General Fund.

Reducing the OPEB benefit amount for fire employees to that of all other units would substantially reduce both current General Fund costs and the overall OPEB liability.

### **5. Separate Retirees from Current Employees in Health Insurance Pool**

Approximately one fourth of the City's unfunded OPEB liability is caused by the "implied subsidy" created by pooling the City's retired and active employees in the same group for health care premium determination. The "implied subsidy" is the difference between the actual cost of retiree health benefits and the retiree premiums subsidized by active-employee premiums. Separating the retirees from the active employees would result in higher premiums for retirees and lower premiums for active employees.

With the exception of Local 522 members whose OPEB benefits are tied to health insurance premium amounts, separating the retirees from active employees in the health insurance pool would reduce the City's OPEB unfunded liability. If this strategy were pursued without a negotiated cap on Local 522 benefit amounts, additional actuarial analysis would be necessary to determine the costs and the benefits of this strategy. Coupled with a Local 522 capped benefit, this strategy would result in a significant reduction in OPEB costs and unfunded liability.

### **Phase-in Funding Policy**

The City should consider adopting a policy to phase-in the funding necessary, in conjunction with cost reduction strategies identified above, to achieve a financially sustainable OPEB plan. After one or

more of the aforementioned strategies have been implemented to stabilize or reduce the ARC, the City should determine a period of time over which to ramp up funding to reach the ARC amount. A phased-in funding approach has been employed by many governments that could not afford to fund the full ARC. A typical phase-in period would be 5-10 years; however, a longer period may be necessary depending on the size of the ARC.

**Policy Considerations:** The strategies outlined in this report are consistent with the Mayor and Council's budget priority to adopt financially sound policies and procedures that are prudent and take into account long-term liabilities. A sustainable budget must be evaluated in a long-term rather than a short-term context.

**Economic Impacts:** None.

**Environmental Considerations:** None.

**Sustainability:** None.

**Commission/Committee Action:** None.

**Rationale for Recommendation:** This staff report provides the City Council with strategies to reduce the unfunded liability of the City's OPEB plan, as well as a recommended phase-in strategy to fund the City's remaining liability. Implementation of one or more of the above strategies will reduce the City's unfunded OPEB liability and move the City closer to a sustainable financial future.

**Financial Considerations:** The City's pay-go funding policy for its OPEB plan is not financially sustainable or responsible in the long run. Strategies to reduce or eliminate the unfunded liability of the OPEB plan should be implemented. A phase-in to full funding of a reduced ARC should be adopted to achieve a financially sustainable OPEB plan.

**Local Business Enterprise (LBE):** No goods or services are being purchased as a result of this report.

## Background

The City provides OPEB benefits to active employees hired before specific dates. For police and miscellaneous employees, the cash-benefit amount is \$300 per month for retirees only and \$365 per month for retirees with dependents. Police employees hired after September 3, 2013, and miscellaneous employees hired after June 30, 2012, are not eligible for post-employment health benefits. For fire employees hired before January 14, 2015, the cash-benefit amount is equal to the lowest-cost medical-plan premium plus the highest-benefit dental-plan premium plus \$25, a total of \$774.28 each month currently. Fire employees hired on or after January 14, 2015, are eligible for a cash-benefit amount up to \$774 monthly from the date of retirement until the retiree reaches Medicare eligibility, and up to \$387 monthly from the date the retiree reaches Medicare eligibility.

The City's OPEB benefit is prorated based on years of service — 50% for employees with ten to fifteen years of service, 75% for employees with fifteen to twenty years of service, and 100% for employees with twenty years of service or more.

Currently, the City has \$452 million in unfunded long-term liabilities associated with retiree medical benefits from all funding sources, \$385 million attributable to the General Fund. While the benefit is currently funded on a pay-go basis, paying only the actual cost of the benefit in the current fiscal year, financial-accounting standards require the City to account for the benefit as if it were actuarially funded.

Consistent with best practices, the City Council authorized the establishment of an irrevocable trust in January 2013 with an initial General Fund investment of \$2 million. Another \$2 million was contributed to the trust in FY2013/14. The FY2014/15 approved budget included a \$1 million contribution to the trust, bringing the total funding for the trust to \$5 million. The approved FY2014/15 Budget Resolution also includes authority to direct any available budgetary resources in the PERS budget accounts at the end of the fiscal year as a result of vacancies to be appropriated to the OPEB Trust. In addition, as part of its adopted priorities for development of the FY2015/16 budget, the City Council has asked that \$1 million be contributed to the OPEB Trust. The General Fund pay-go amount included in the FY2014/15 budget is \$8.6 million (\$10.2 million for all funds), an increase of 6.2% over the prior fiscal year.