San Joaquin Delta Community College District

District Approach to Funding OPEB Obligation

Other Post Employment Benefits (OPEB)

Response to May 2012 Actuarial Study
February 2013

The granting of post-employment retirement benefits, especially "life-time benefits" was very popular in the 70's and 80's. At that time employers did not understand the cost implications of these programs and, as such, did not make any special provision for their funding. When there became a greater awareness of the true costs of providing these benefits, a number of years had passed with districts having done nothing to set aside funds for these programs. Districts began paying more attention to this issue. Some moved to close off eligibility for such benefits. Actuarial studies became common place even before districts were mandated to do so. The studies told us not only how much the whole program should cost, but also how much we should already have saved for future costs. That is good information but didn't change the reality faced by the districts.

In 2006, the Governmental Accounting Standards Board (GASB) instituted a reporting requirement for all public agencies regarding the costs and liabilities associated with other post-employment benefits (OPEB). The only retiree benefit that exists for the District, other than pension benefits, is health insurance. The District's first OPEB actuarial report was obtained in 2008 and was updated in May 2012. As additional studies are completed the typical results of each succeeding report reflects how much the debt has grown and how much further behind the district has fallen in terms of addressing this obligation.

There are multiple obstacles facing the District as it tries to respond to the actuarial assessment. The goal of this analysis is to provide some context and options for action that are in fact possible.

<u>The Dynamics of OPEB Health Plans</u>

The general tendency is for the total cost of OPEB to increase over time. The explanation for this trend has multiple components.

- The first element is the actual premium costs for health insurance. The actuaries guess at this but in reality it is hard to predict the rate of increase with accuracy over a period of years. It means then that each subsequent study must be recalibrated and it further suggests that as the district anticipates costs in the near term it has to examine closely the previous actuarial assumptions in light of current costs. Budgeting for a new year needs to take into account prior year actual costs as compared to the actuarially anticipated costs for the next budget year.
- The second component has to do with how many employees are retired, projecting when more employees will retire and when retirees will die. It is here where the actuaries are

much better in making projections. What can be a problem however is the type of benefit afforded dependents and their eligibility upon death of the covered retiree.

- The third component is related to the second and that is whether or not the plan is closed off to new hires or if they continue to qualify for this benefit. To the extent new employees qualify the life of the program is extended making the calculations of cost more difficult. This component is addressed more fully below.
- The fourth component is the assumption by the actuaries on the interest rate earned on district funds set aside for the purpose of funding the current, as well as future benefit. The rates typically used in the actuarial studies are, in today's environment, difficult to achieve. However, if the district does not have much money set aside to fund the obligation, the rate of return is not a significant issue.

For the District, the latest actuarial report dated May 10, 2012 indicates the total program liability is $122 million. The report states that, had the District begun accruing retiree health benefits at the time each employee eligible for retiree health benefits was hired, the District would have accumulated $104 million by now. For those remaining eligible employees with years of employment left prior to retirement, the district should be adding another $3.2 million a year.

Clearly this has not happened.

<u>What Has the District Done or Not Done?</u>

The District is like many community college districts in the state in terms of its actions regarding OPEB. There are some districts who have done better and a large number who are in much the same boat as the District.

The District has done and is doing the following:

- Negotiated changes with its employee groups, including moving from a defined benefit to a defined contribution, and eliminating retiree health benefits for new hires after May 31, 2007
- Did set aside approximately $4.7 million toward its long term OPEB obligation
- Pays health premiums on a "pay-as-you-go" basis for current retirees
- Initiated tighter controls over monitoring status of qualifying retirees and dependents

The District has not:

- Developed a specific plan to address the long term debt created by this benefit
- Committed additional funds to the retiree health benefits fund beyond the $4.7 million

After analysis of the May 2012 actuarial study the administration anticipates bringing forward a recommendation to address what has not been done. Clearly the District cannot provide $104 million today as identified in the actuarial study but there are concrete steps which will bring the program under control over time.

Strategies to Address OPEB Obligation

The District requested from the actuary a table which listed by year the expected "pay-as-you-go" costs for retiree health benefits. From that table, we determined what year the program peaks and what the cost would be at that time. Using this table we were able to prepare a graph of costs over time. This provided a framework for the development of a funding strategy.

The basic premise is that the District will have to continue the "pay-as-you-go" approach but if by making additional contributions to the retiree health benefit fund could put an end to the increases. This would flatten out the annual District cost which would be in the District's best interests to do so.

For this strategy to work there needs to be enough time to accrue funds, there must be a commitment to the strategy, careful monitoring of assumptions and a level of financial investment that is reasonable and affordable for the district.

The administration believes that one of the plans that follow meets those conditions.

Recommendation Regarding OPEB Funding (Plan A)

Key actuarial data points affecting the recommendation:

1. By 2025 the annual cost of actual benefits is estimated to be $7,218,446
2. In 2035 the program costs peak at $8,834,782 and starting in 2036 will begin to decline
3. In 2044 the annual cost of actual benefits is estimated to be $7,304,624
4. By 2099 the program will end

Objective

Establish a point in time to flatten out the annual additional contribution for retiree benefits so that the District no longer experiences added budget costs to fund this program.

By 2025, accrue enough money to cover the cost increases above $7,218,446 until 2044 when the annual cost will decline again to the $7.2 million level.

The amount the District needs to accrue to keep the annual operating budget contribution at $7.2 million from 2025 through 2044 is $21.1 million. In other words – the District can begin to accrue now to fund the 19-year bridge between years 2025 and 2044 to maintain the annual budget contribution at $7.2 million, as demonstrated below.

Presently there is $4.7 million in the retiree health benefit fund.

Actions

Starting in 2013, budget from the unrestricted general fund a $250,000 contribution to the retiree fund. Each year thereafter through 2025 increase the preceding year's contribution by $150,000.

To illustrate this the first few years would appear as follows;

2013-14	$250,000
2014-15	$400,000
2015-16	$550,000

By the end of 2025 the District would have on hand approximately $21.1 million. This would be close enough to address the $21.15 million to bridge the 20 years from 2025 to 2045. As the opportunities occur the District should consider one-time additions to the retiree health fund as well. The one-time additional funding can help expedite the accumulation of funds and ensure the objective is met.

This strategy is better illustrated visually. Attached is a graph depicting the elements of Plan A.

Recommendation Regarding OPEB Funding (Plan B)

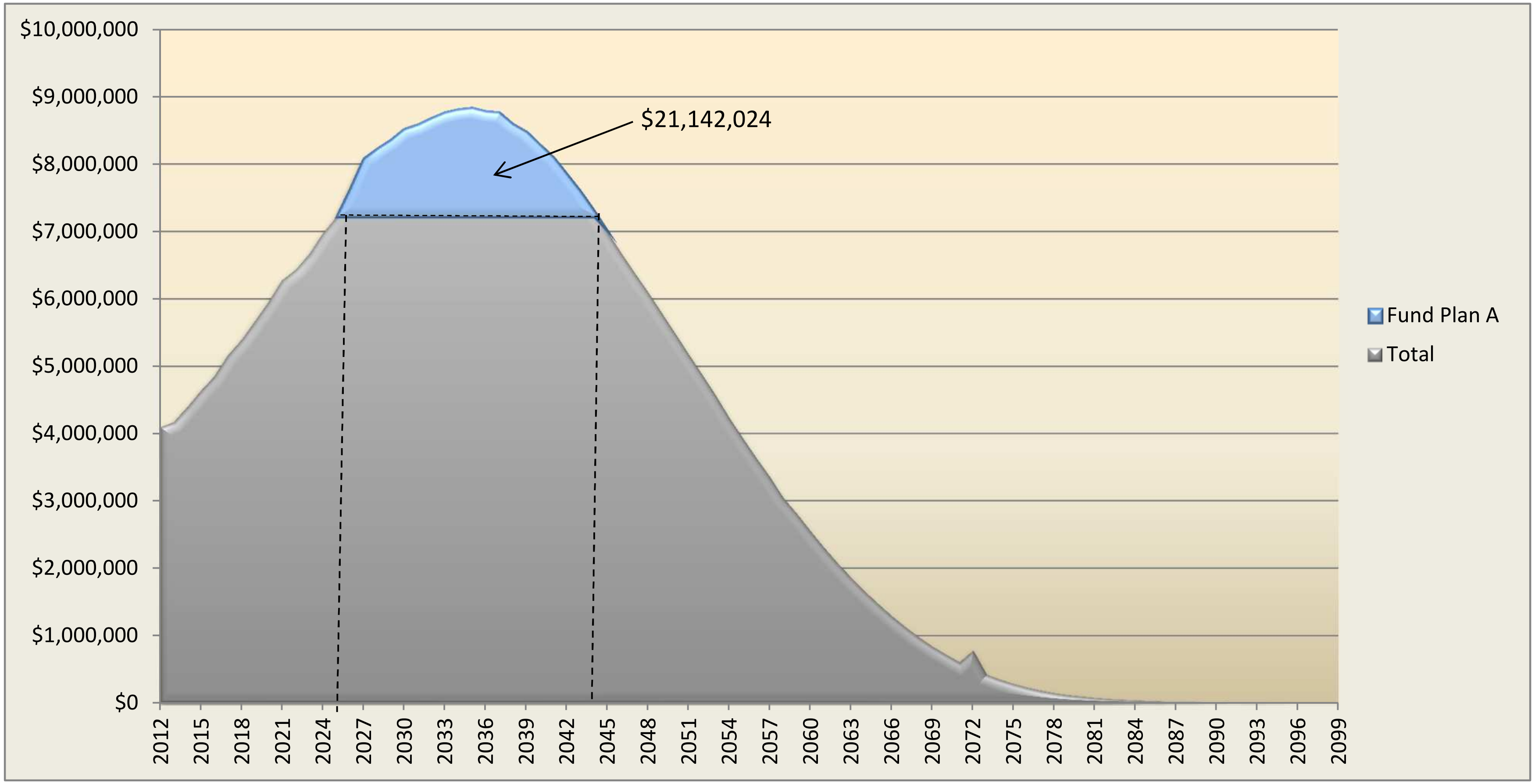
Plan B looks at the possibility of achieving a stable funding level earlier in 2020. Please note that a five year acceleration increases the amount needed from $21.1 million to $51.5 million. It would require a contribution for the next 8 years of $5.5 million each year. The reason is that funds have to be accrued faster, 8 years instead of 13 and last 8 years longer. Attached is a second graph depicting the elements of Plan B. As you can see an acceleration of just five years from Plan A to Plan B is materially different in its impact upon the District's resources.

Summary

The question about how the District is addressing this long term debt comes up in the accreditation process, during audits and as part of bond rating discussions. It is an issue for many employers. To be able to indicate that the district has a workable plan to address this debt and can have it covered within the next 13 years or less is very desirable. It will also relieve pressure on the on-going district budget by that time.

There are other options possible. The two above provide contrast as to how small changes in the variables have a big impact on the outcome. There are other possibilities but not many that meet the criteria of financial investment that is reasonable and affordable. One other notable option is to do nothing other than continue the pay-as-you-go without any additional action. This approach means the costs will continue to increase until 2035. Instead of an annual operating budget cost of $7.2 million, doing nothing will cause the annual cost to rise to $8.8 million. This option would be the passive approach to the problem. It can work. The down side is that it will continue to draw upon future resources and pass on costs to those who will not benefit from the program.

SAN JOAQUIN DELTA COMMUNITY COLLEGE DISTRICT
RETIREMENT HEALTH BENEFITS
"PAY-AS-YOU GO" ACTUARIAL ESTIMATES PLAN "A"
2012-2099



Plan A Details
- Generate $21.1 Million between 2013 - 2025.
- By 2025 if plan is followed, District will be able to stop annual increase of premiums for retirees.
- By 2044 annual costs will start to decline from the 2025 cost of $7.2 Million.