

Chabot-Las Positas  
Community College District



Other Post-Employment Benefits (OPEB)  
Impact on District's Budget

*Presented by: Lorenzo Legaspi*  
*Vice Chancellor, Business Services*

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**Background**

# Background

## This presentation is intended to address how OPEB costs will impact the District's budget

- ◆ Onset of GASB 45 requires District and all other governmental agencies to account for the cost of OPEB liabilities beginning in FY 2007-08
- ◆ GASB 45 did not “cause” these liabilities, but rather has caused agencies to quantify the costs
- ◆ The District has a large liability (\$82,222,004)
  - Actuarial study shows that the District should be setting aside \$7,195,292 per year
  - District is not setting aside the dollars yearly. Instead, the District is operating on a “Pay-As-You-Go” basis. The District currently pays \$2,693,226 on a Pay-As-You-Go basis
  - Regardless of GASB 45, the District faces an \$82 million liability that will continue to grow as long as the District provides retiree health benefits
- ◆ The District must develop a funding strategy in the context of total employee compensation

***Prefunding OPEB is no different than how the District has been paying PERS and STRS for years***

1. “OPEB” means “Other Post-Employment Benefits.”



# A Look Back

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## Fiscal Challenges Facing the District

- ◆ Structural Deficit – Expenses greater than Revenues
- ◆ Budget Reductions (\$2.6 million in FY 2006-07)
- ◆ Negotiations-Salary Formula
- ◆ Rising Medical and Dental Costs
- ◆ Unfunded Liability (\$78 million) in FY 2005-06
- ◆ Measure B Cash Flow Needs



# We Are Not Alone

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## The 72 California Community College Districts were surveyed regarding their OPEB “retiree benefits” liabilities

- ◆ 71 of the 72 districts have OPEB liabilities
- ◆ 15 of the 72 districts have not completed an actuarial study and therefore, their unfunded liability is undetermined
- ◆ Total dollar amount for the community colleges is estimated at \$3.1 billion
- ◆ Lowest is \$640,000 (West Hills) and highest is \$623 million (Los Angeles)



# OPEB Liabilities Is A Rising Concern

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## **This issue of ever-increasing liabilities for OPEB is now in the forefront of many state leaders**

- ◆ Governor's Commission – The Governor issued an executive order in December 2006 creating a commission to address the issue of unfunded liabilities, mainly retiree health benefits
  - Estimate for all California Public Agencies is \$200 billion (to put things into perspective, the entire budget for the State of California for FY 2007-08 is \$131 billion)
  
- ◆ SB 1729 - This bill grants the CalPERS Board of Administration authority to allow public entities, as specified to contract with CalPERS system in order to pre-fund retiree health care benefits and other post-employment benefits
  - This bill would allow an employer to voluntarily participate in the pre-funding of health care coverage and OPEBs
  - CalPERS determines the contribution rate for that employer
  - This bill was recently vetoed
  
- ◆ SB 840 (Soto) - This bill proposed a single-payer health insurance bill for California
  - This bill was recently vetoed



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**How Did We Incur This Liability**



# How Did We Incur This Liability

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- ◆ Post-employment benefits are part of the compensation for services rendered by employees
- ◆ Benefits are “earned” and obligations accrue during employment, but benefits are not taken until after employment
- ◆ However, the District chose not to fund it concurrently
- ◆ In contrast, the District has been paying its full amortization to PERS and STRS
- ◆ On average, a District employee “earns” an additional \$5,623 per year



# How Did We Incur This Liability (cont'd)

◆ Retiree Benefits is part of Employee Compensation

Salary	Paid within the year
STRS	Paid and sent to STRS (dollars set aside)
Medicare	Paid within the year
Unemployment Insurance	Paid within the year
Retiree Benefits	Earned, but paid at retirement (no dollars set aside)

◆ The actuarial study shows that on average, the District should set aside \$5,623 per year per employee



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## **Impact on the District's Budget**

# Retiree Medical Costs

## Historical Retiree Medical Costs

Year	Amount
1997 – 98	\$790,152
1998 – 99	\$827,331
1999 – 00	\$826,559
2000 – 01	\$1,083,961
2001 – 02	\$1,199,584
2002 – 03	\$1,392,620
2003 – 04	\$1,916,069
2004 – 05	\$2,300,159
2005 – 06	\$2,629,110
2006 – 07 (est.)	\$2.7 million

## The RUMBLE Fund

- ◆ Every year the District transfers funds from the General Fund into the RUMBLE to pay for Retiree Medical Premiums

Year	Amount	Difference from 2006 – 07
2006 – 07	\$2.7 million	N/A
2015 – 16	\$5.2 million	\$2.5 million
2034 – 35	\$8.0 million	\$5.3 million

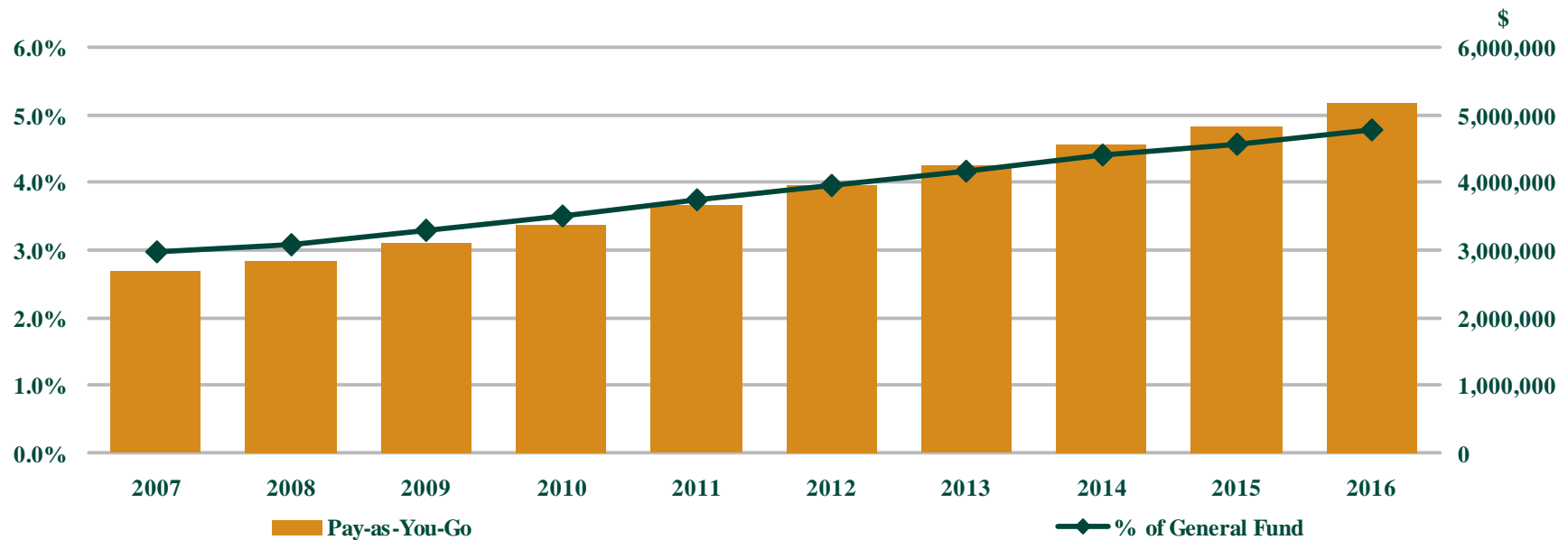
- ◆ The increases in cost will eventually require budget cuts from the General Fund



# Impact on General Fund Revenue

- ◆ Pay-as-you-go retiree health costs are expected to consume a greater percentage of the General Fund Budget
  - Pay-as-you-go is expected to increase from \$2.7 million or 2.97% of the General Fund in 2007 to \$5.2 million or 4.78% of the General Fund in 2016, even when assuming a 2% annual growth in General Fund revenues

**Pay-Go versus Pay-Go as a Percentage of General Fund Revenues**



\* These estimates are only for the current workforce. Actual pay-go is likely to be considerably higher as new employees come on line



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## **Alternative Solutions to the Problem**

# Funding Solutions for OPEB Liabilities

The National 2nd Annual OPEB Liability Conference lists the following as alternative solutions

**Alternative 1**

◆ Pay As You Go

**Alternative 2**

◆ Amortized Contribution

**Alternative 3**

◆ Asset Sales

**Alternative 4**

◆ OPEB Obligation Bonds



# Pros and Cons of Four Alternatives

## Pay As You Go

### Pros

- ◆ We are already doing it
- ◆ We take the amount necessary “off the top” of the budget

### Cons

- ◆ Amount increases to unmanageable levels
- ◆ Will require budget cuts/no funding programs
- ◆ Short-term solution for a long-term problem





# Pros and Cons of Four Alternatives (cont'd)

## Amortized Contribution

### Pros

- ◆ Dollars are set aside each year for each employee from time of hire to retirement date
- ◆ Works like pension benefits (STRS and PERS)

### Cons

- ◆ Cost prohibitive – the cost to prefund retiree benefits plus the unfunded accrued liability totals \$7.2 million per year

### To put things into Perspective . . .

- The District set aside **\$2.1 million** last year for STRS
- The District set aside **\$1.7 million** last year for PERS
- The District's Annual Required Contribution for OPEB is roughly **\$7.2 million** per year



# Pros and Cons of Four Alternatives (cont'd)

## Asset Sales

### Pros

- ◆ Proceeds can be used to fund liability with certain restrictions
- ◆ No debt incurred

### Cons

- ◆ District has no surplus assets to sell



# Pros and Cons of Four Alternatives (cont'd)

## OPEB Obligation Bonds: Why OPEB and Why Now

### Pros

- ◆ Solution in context of District's macro-financial picture
- ◆ Manage the liability, the District will have equal annual payments
- ◆ When invested, can earn higher interest which, in and of itself, can reduce the liability
- ◆ Long-term solution to a long-term problem
- ◆ Imposes budget discipline
- ◆ Spreads the pain – Does not over burden future employees and decision makers
- ◆ Take advantage of low interest rate environment and statutory investment authority
- ◆ Provides benefit security for current and future retirees
- ◆ Be responsive to credit rating and accreditation guidelines

### Cons

- ◆ Investment earnings may fall below expectations



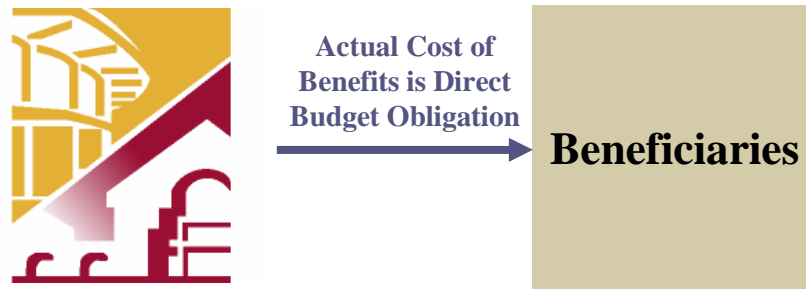
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## **OPEB Financing Solution**

# Current OPEB Funding Method

- ◆ Currently, the District funds its OPEB benefits on a pay-as-you-go basis; the District pays the actual cost of contractually obligated benefits directly to Beneficiaries
- ◆ No Trust Fund or investment vehicle stands between the District and the Beneficiaries
  - No earnings offset the District's future budget obligation

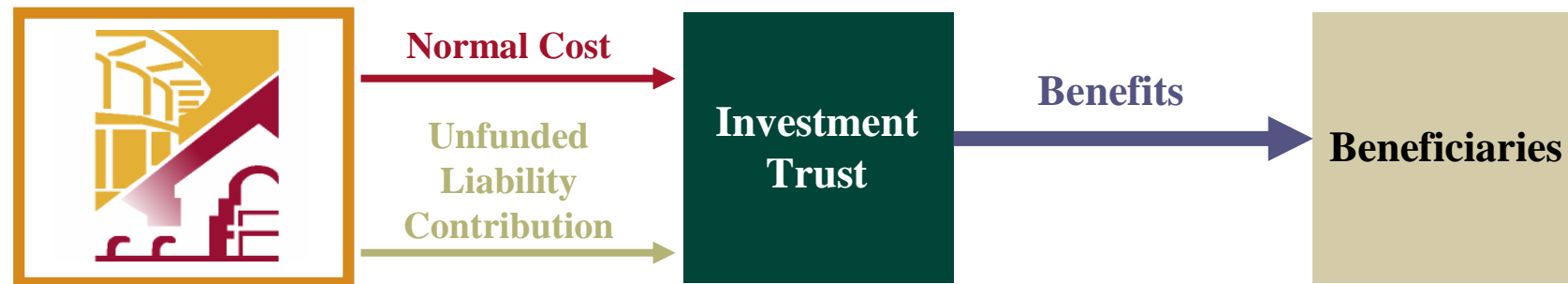
## OPEB Benefit Payments Under Current Method



# Adopting a Funded Plan Approach

- ◆ A funded plan approach would be similar to pension funding
- ◆ Like saving for College Tuition, the sooner the District establishes an OPEB savings account (Trust Fund), the better off it will be in the long-term since accumulated investment income will offset costs

## OPEB Benefit Payments Under Funded Plan Approach



- ◆ Periodic future valuations will reflect additions/deletions to employee base

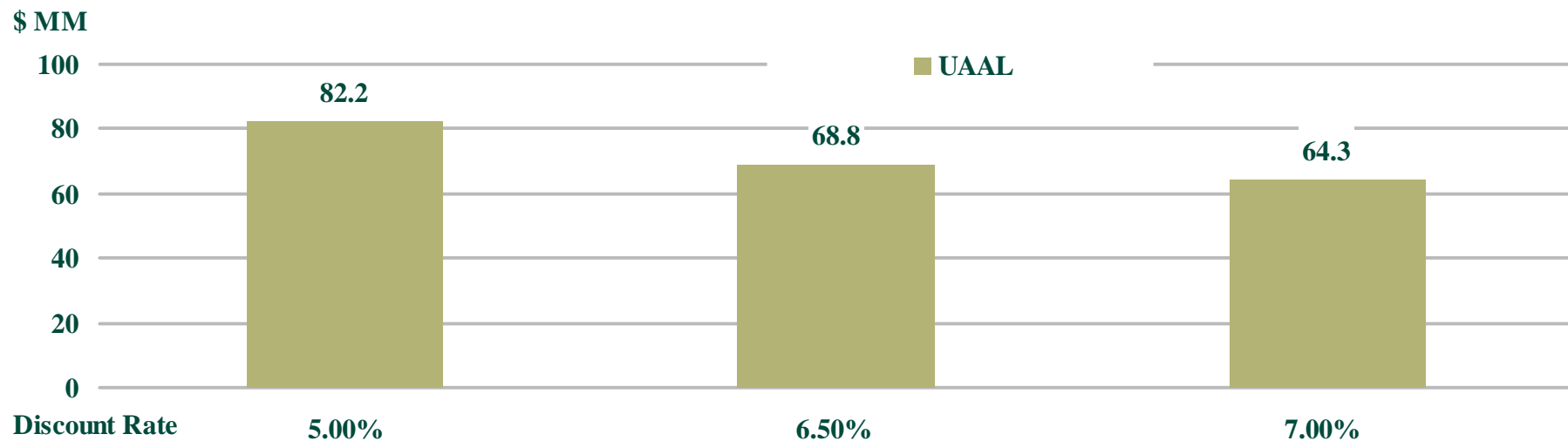


# OPEB Bonds Can Facilitate a Transition to Funding

## Committing to prefunding will reduce the District's Unfunded Liability significantly

- ◆ The District's OPEB Unfunded Liability is \$82,222,004 assuming a 5% discount rate
- ◆ Given the statutory authority to invest a dedicated OPEB trust fund in both fixed income and equities, a higher discount rate which matches the expected life of the liability is reasonable
  - CalPERS' assumed rate of return is now 7.75%
  - CalPERS' return in 2006 was 15.4%
- ◆ Assuming a higher discount rate would reduce the District's Unfunded Liability
- ◆ Using a conservative discount rate of 6.5%, the Unfunded Liability is reduced to \$68.8 million

### Prefunding Leads to High Earning Potential and Lower Unfunded Liability



# OPEB Bonds Can Facilitate a Transition to Funding (cont'd)

- ◆ Pre-funding allows the District to use a higher discount rate which, in and of itself, can reduce the Unfunded Liability and Annual Required Contribution payments dramatically

	5.00%	6.50%	7.00%
Unfunded Liability	\$82,222,004	\$68,797,642	\$64,295,666
Annual Required Contribution	\$7,195,292	\$6,002,697	\$5,696,415

- ◆ OPEB Bonds allow the District to reshape the amortization of its Unfunded Liability to better fit its ability to pay
- ◆ Currently, the District could refinance/restructure its OPEB Unfunded Liability at  $\approx 5.85\%$





# Bonds Can Be Structured with a Safety Valve

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- ◆ To protect the District against uncertainties related to future national healthcare policy, actual healthcare costs, investment performance, mortality, etc. the bonds could be structured to incorporate a “safety valve”
  
- ◆ The safety valve would allow for redemption of bonds prior to maturity
  - All or a portion of the bonds could be made callable
  - The bonds could be sold with either a “make whole” call or a standard muni bond call
  
- ◆ A make whole call option is priced without upfront yield penalty, but if exercised, the District would pay investors the greater of par or the present value of debt service payments discounted at the then-current applicable Treasury rate plus a spread, usually 12.5 basis points
  
- ◆ Additionally, for a small increase in cost, the District could incorporate a 10-year par call on some designated portion of the bonds
  - For example, some of the District’s 2006 General Obligation Refunding Bonds was non-callable while some of those bonds featured a 10-year par call

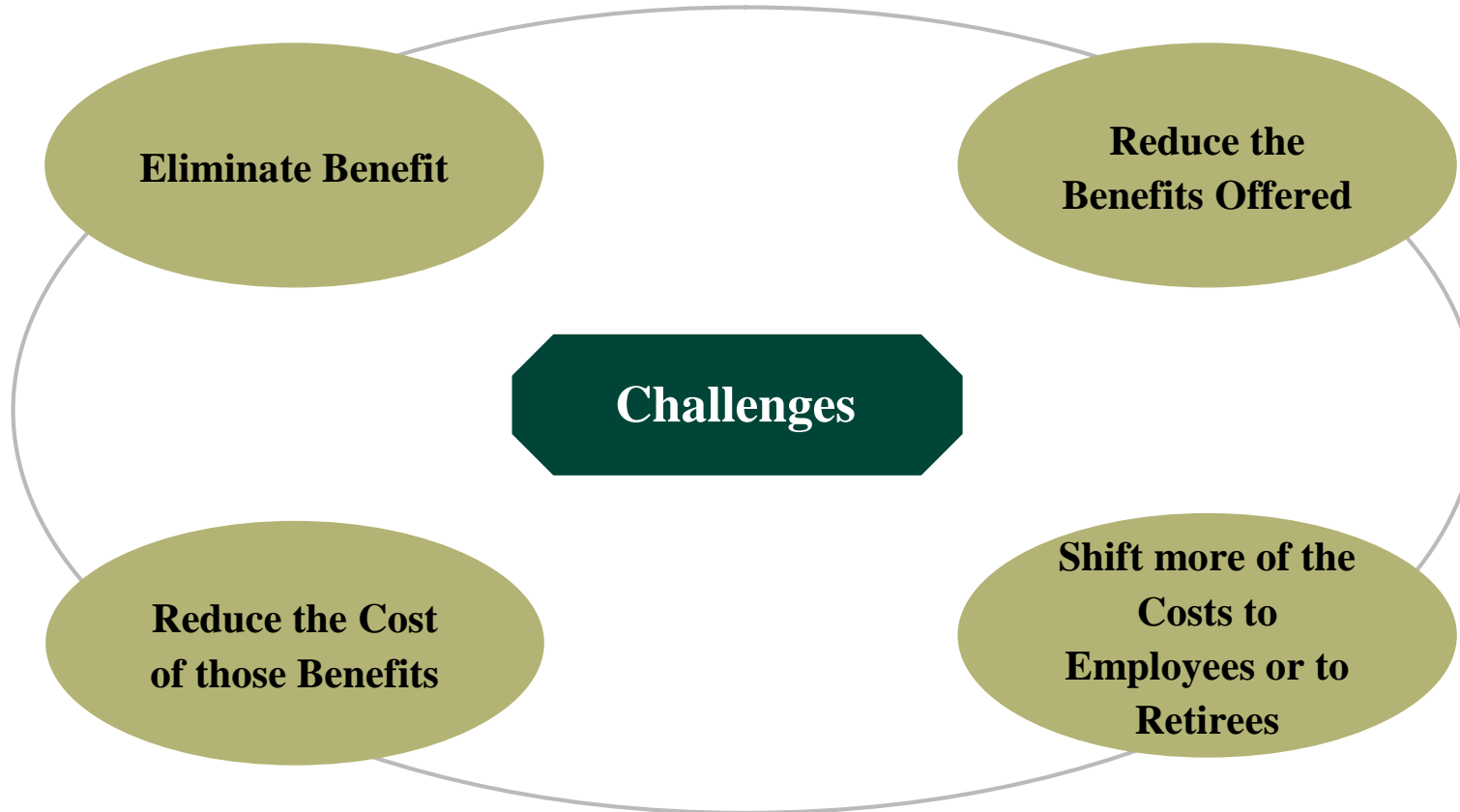


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## Why OPEB and Why Now

# The Challenge

The challenge is that there really is only one choice – **REDUCE** the liabilities: many options, but no single panacea



*Even if the District eliminated retiree health benefits today, it would still have an unfunded OPEB liability of \$82 million that it would still need to address*



# Conclusion

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- ◆ Retiree medical benefits are expected to consume a growing share of the General Fund Budget and will eventually require budget cuts in the future
- ◆ Even if the District were to cutoff retiree medical benefits today, it would still face an unfunded liability of \$82 million
- ◆ OPEB Bonds are the most attractive and feasible option for CLPCCD in addressing its unfunded OPEB liability



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## **Financing Team Qualification**

# Financing Team

## The District has assembled an experienced and capable team

- ◆ Both Lehman Brothers and Dale Scott & Company are recognized nationally as leaders in the subject

