City of Brisbane
Agenda Report

To: City Council via City Manager

From: Stuart Schillinger, Administrative Services Director

Subject: Work with Public Agency Retirment System (PARS) to Develop a Funding Mechanism for the City's Other Post Employment Benefits (OPEB)

Date: December 18, 2014

Purpose:

To ensure the City's maintains long-term financial viability while maintaining a capable and motivated workforce.

Recommendation:

Direct staff to work with Public Agency Retirement System to set-up a trust fund for the City's Other Post Employment Benefit (OPEB) costs.

Background:

Governmental Accounting Standards Board number 45 created the need for governmental agencies to state within their financial statements what the accrued liability of all future obligations owed their employees. Since governments were already doing this for pension benefits this was called Other Post-Employment Benefits. The City has two different OBEB requirements. One is the PERs health insurance requires the City to pay the same amount for retiree health as it pays for active (current) employee health. The City pays the minimum required by PERS which is currently $122 a year. The second benefit is a supplemental stipend which is indexed to the Kaiser Health rate less what is paid for retiree medical insurance (defined benefit program). We have different tiers of this benefit based on which bargaining group an employee retires from. The City, through negotiations, eliminated this benefit for all new employees hired after July 1, 2008. Also at that time we allowed existing employees to opt out of the supplemental stipend program and opt into a defined contribution program instead. About 10 employees opted into this program.

A requirement of GASB 45 is to do an actuarial study concerning the OPEB program every two years. The first time we did this we used John Bartel's actuarial firm. We brought the information back to City Council and staff recommended not to fund the program at that time in order to give employees a chance to shift from the defined benefit program to the defined contribution program. Since that time we have done two other studies using the actuarial firm of Milliman. They offer a do it yourself actuarial study. By having our Deputy Finance Director do this in-house we have saved over $50,000 based on the cost charged by John Bartel's firm. However, the Milliman study is limited to 100 employees and we are reaching that limit.

Our current unfunded liability is between $6,000,000 and $8,500,000 depending on the discount rate used and our normal cost is about $300,000. Each of these concepts will be explained below.

We currently pay about $250,000 on a pay as you go basis. This amount will increase over time as more employees retire and the cost for the program increases.

As stated above the City currently has an unfunded liability between $6,000,000 and $8,500,000, depending on the discount rate used. The unfunded liability is the amount we should have accumulated to date to pay for the benefits which have been accrued to date. This is for both the current retirees and current employees. The difference in the amount is based on the discount rate or the amount we can anticipate earning on our investments. The higher the discount rate the lower the unfunded liability. For a pay-as-you-go method the amount of interest allowed is 4.25%. If we were to invest the full amount in an account dedicated for this purpose we could invest in broad array of market products and earn a higher interest rate. Currently PERS uses a 7.25% interest rate which produces the lower end of the scale.

The City has a number of ways of paying for this unfunded liability. One method would be to take the full amount out of reserves and invest it. A second method would be to pay what is called the Actuarially Required Contribution (ARC). The ARC is made up of both the normal cost (explained later) and a portion of the Accrued Liability. The Accrued Liability is paid off over a period of time. The cost to fund the ARC is $764,701 a year. The ARC payment is made up of $311,313 of Normal Cost and $453,388 of Amortization Payment (current portion of unfunded liability). A third method would be to do a combination of both.

The Normal Cost is the amount of new liability created each year for existing employees. In theory if the City was able to earn its anticipated interest rate and all other actuarial assumptions held then this is the amount the City would need to put aside to fund the benefit in the future.

The budget subcommittee has met three times since November 2013 to discuss this issue and develop a strategy which would ensure the long-term financial health of the City while ensuring the intergrity of the contracts it has signed with its employees.

The subcommittee first determined it would be better to begin paying down the liability now instead of letting it grow over time and become a larger portion of the City's budget. The committee then studied various ways of paying down the unfunded liability portion. The subcommittee determined using a portion of the savings from the previous year would assist the City in keeping its long-term costs under control while at the same time still providing a level of community benefit which the City Council determined to be appropriate.

The second item the committee looked at was the method of funding going forward. Then finally, it reviewed who would be the best provider of the trust.

<u>Discussion:</u>

<u>Amount to Fund from the Reserves:</u>

The City based its 2014/15 budget based on July 1, 2014 General Fund Fund Balance of $10,627,000. The City actually began FY 2014/15 with $12,063,000 in reserves. The difference was based on expenditures being lower than anticipated and revenues being higher than anticipated. Of the $12,063,000 in beginning fund balance the City will need to recommit about $120,000 for the General Plan update and the History Book completion. This means FY 2014/15 started with about about $1,900,000 more than expected. The committee recommends that $500,000 of this amount be committeed towards the City's outstanding OPEB liability. The committee will also be studying setting aside funds for equipment replacement, and determining a more refined policy for General Fund reserves over the next six to twelve months.

Method for Funding OPEB Costs Going Forward:

The committee reviewed the idea of using the *expected rate of return* (anticipated interest earned each year) for the *actuarial rate of return* (anticipated rate of return used to determine necessary funding amount) compared to using a lower actuarial rate of return than the expected rate of return on investments. The expected rate of return is what the City can anticipate receiving give a certain mix of investments. This means 50% of the time the City would anticipate earning more than the expected rate of return and 50% of the time less than expected. Over a long period of time the City would anticipate receiving the expected rate of return. The committee discussed this and requested staff to develop a more conservative model for investing. Staff recommended and the committee agreed to fund the Trust using an actuarial rate of return lower than the antipicated rate of return. This provides a financial cushion for the City if it does not receive the expected each year. For example if the City used an actuarial rate of return of 6% and an expected rate of return of 7% it would be anticipated that 50% of the time we would earn less than 6% and 50% of the time we would earn more than 6%. However, from an actual funding perspective we would exceed 5% (the rate of return we would use for funding purposes) more than 50% of the time thus making it more likely that the cost to the City for funding this benefit could decrease over time.

Provider of the OPEB Trust:

The subcommittee looked at two different firms for providing Trust services to the City. Public Agency Retirement System (PARs) and CalPER's Trust system. The two services were similar in costs and structure. The committee is recommending the City work with PARs for the following reasons: first, it has been in the business of providing OPEB style Trusts longer than PERs has. PERS started after GASB handed down GASB 45, while PARs had been in the business prior to this; second, PARs offered a broader array of investment options than PERS does, third the City already uses PARs for its supplemental retirement program for the City Manager and has been extremely satisfied with the service it receives, and finally it provides the City greater diversity than having all of our retirement funds handled through one entity. The cost of the PARS option is about .005% of our invested funds for the first $10,000,000 invested on an annual basis.

Investment Strategy:

PARS offers five different investment strategies for its investments. These strategies are called Conservative, Moderately Conservative, Moderate, Balanced, and Capital Appreciation. The expected rates of return based on their investment strategy and the long-term return on equity and fixed income investments are 5.54%, 6.26%, 7.23%, 7.71%, and 8.43% respectively. The City uses the Moderate strategy for its investment for the City Manager's supplemental retirement. The subcommittee recommends a similar strategy for the OPEB Trust. This provides for a middle of the road approach during what could become difficult economic times. Also, the committee recommends funding the program based on the Moderately Conservative rate of return of 6.26%. This will mean we will need to fund the Trust with a slightly higher amount at the beginning of the process but we would anticipate the amount needed would be reduced as the reserves builds up quicker than anticipated.

Conclusion:

The subcommittee recommends the Council direct staff to work with PARS to develop an OPEB Trust which uses the Moderate investment strategy for investments and bring back the appropriate staff reports and resolutions to enact this policy.

Fiscal Impact:

If the City decides to fund its ARC, additional funding will need to be set aside during the budget process each year to make this payment. However, if the City does not set aside funding each year the annual cost of the program will exceed what the City needs to pay for its Annual Required Contribution.

Measure of Success

The City's OPEB Trust becomes fully funded over the next 20 – 30 years.

Attachments:

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