Retiree Healthcare

SECTION IV
PROJECTION RESULTS

Projection Assumptions and Methods

Key Assumptions

- 7.0% investment return on the Market Value of Assets in all future years
- The Actuarial Value of Assets reflects the deferred gains and losses generated by the smoothing method
- Actuarial assumptions and methods as described in Section VIII. All future demographic experience is assumed to be exactly realized.
- The Annual OPEB Cost (AOC) is contributed each year, beginning in fiscal year 2012
- Projections assume a 0% increase in the total active member population. All new future members are expected to enter the plan upon date of hire.
- New plan design giving an account of $2,500 / year of service will apply only to new members who are in Non-Union, AFSCME and AAPOA starting for fiscal year 2012. The impact of this change on the future liability and normal cost can be seen in the tables below:

FYE June 30	AAL - W/ Change	AAL - No Change	$ Difference	% Difference
2011	241,122,000	241,122,000	-	0.0%
2021	325,340,000	345,340,000	20,000,000	6.1%
2031	359,161,000	461,711,000	102,550,000	28.6%
2041	358,752,000	621,575,000	262,823,000	73.3%

FYE June 30	AOC - W/ Change	AOC - No Change	$ Difference	% Difference
2011	14,533,000	14,533,000	-	0.0%
2021	13,374,000	16,784,000	3,410,000	25.5%
2031	15,374,000	23,208,000	7,834,000	51.0%
2041	18,609,000	31,649,000	13,040,000	70.1%

Table of Projected Actuarial Results*
Financial Projection($'s in 000's)

Investment return 7.00%

	Valuation Amounts on June 30							Flow amount during next 12 months					
	Actuarial	Accrued Liability				Funding	Surplus	Annual	Employer	Benefit	Expected	Recognized Asset	Ending Actuarial
Year	Asset	General	Police	Fire	Total	Ratio	(Deficit)	OPEB Cost	Contribs	Payments	Return	Gain/(loss)	Asset
2011	82,416	141,064	59,310	40,748	241,122	34.18%	(158,706)	15,006	14,859	10,665	5,916	(1,765)	90,762
2012	90,762	146,964	62,090	42,227	251,281	36.12%	(160,519)	12,527	12,527	11,590	6,386	165	98,250
2013	98,250	152,654	64,802	43,747	261,203	37.61%	(162,953)	12,671	12,671	12,544	6,882	3,509	108,767
2014	108,767	158,087	67,482	45,277	270,846	40.16%	(162,079)	12,639	12,639	13,585	7,581	2,877	118,279
2015	118,279	163,176	70,039	46,888	280,103	42.23%	(161,824)	12,641	12,641	14,659	8,209	288	124,759
2016	124,759	167,832	72,499	48,579	288,910	43.18%	(164,151)	12,758	12,758	15,692	8,630	238	130,694
2017	130,694	172,093	74,808	50,357	297,258	43.97%	(166,564)	12,876	12,876	16,847	9,010	155	135,887
2018	135,887	175,852	76,980	52,143	304,975	44.56%	(169,088)	13,040	13,040	17,972	9,340	67	140,362
2019	140,362	179,158	78,952	53,985	312,095	44.97%	(171,733)	13,207	13,207	18,771	9,631	21	144,450
2020	144,450	182,302	80,703	55,903	318,908	45.30%	(174,458)	13,374	13,374	19,618	9,893	12	148,111
2021	148,111	185,164	82,220	57,956	325,340	45.52%	(177,229)	13,526	13,526	20,695	10,117	6	151,065
2022	151,065	187,570	83,417	60,119	331,106	45.62%	(180,041)	13,702	13,702	21,687	10,295	2	153,377
2023	153,377	189,675	84,179	62,417	336,271	45.61%	(182,894)	13,890	13,890	22,609	10,431	1	155,090
2024	155,090	191,493	84,552	64,831	340,876	45.50%	(185,786)	14,089	14,089	23,356	10,532	0	156,355
2025	156,355	192,930	84,625	67,521	345,076	45.31%	(188,721)	14,300	14,300	24,102	10,602	0	157,154
2026	157,154	194,077	84,410	70,362	348,849	45.05%	(191,695)	14,498	14,498	24,915	10,636	0	157,374
2027	157,374	194,812	83,874	73,405	352,091	44.70%	(194,717)	14,695	14,695	25,680	10,632	0	157,021
2028	157,021	195,205	83,049	76,520	354,774	44.26%	(197,753)	14,927	14,927	26,543	10,585	0	155,990
2029	155,990	195,006	81,924	79,873	356,803	43.72%	(200,813)	15,153	15,153	27,225	10,497	0	154,414
2030	154,414	194,333	80,624	83,361	358,318	43.09%	(203,904)	15,374	15,374	28,021	10,366	0	152,134
2031	152,134	193,196	79,084	86,881	359,161	42.36%	(207,027)	15,611	15,611	28,439	10,200	0	149,507
2032	149,507	191,602	77,348	90,739	359,689	41.57%	(210,182)	15,837	15,837	28,907	10,008	0	146,445
2033	146,445	189,447	75,519	94,820	359,786	40.70%	(213,341)	16,096	16,096	29,142	9,795	0	143,194
2034	143,194	186,945	73,667	99,098	359,710	39.81%	(216,516)	16,391	16,391	29,581	9,562	0	139,565
2035	139,565	184,049	71,623	103,608	359,280	38.85%	(219,715)	16,707	16,707	29,460	9,323	0	136,135
2036	136,135	180,878	69,826	108,372	359,076	37.91%	(222,941)	17,044	17,044	29,540	9,092	0	132,731
2037	132,731	177,473	67,999	113,459	358,931	36.98%	(226,200)	17,388	17,388	29,642	8,862	0	129,340
2038	129,340	173,713	66,203	118,910	358,826	36.05%	(229,486)	17,769	17,769	29,908	8,629	0	125,829
2039	125,829	169,621	64,362	124,656	358,639	35.09%	(232,810)	18,181	18,181	30,042	8,393	0	122,361
2040	122,361	165,344	62,563	130,640	358,547	34.13%	(236,186)	18,609	18,609	30,003	8,166	0	119,133

*Forecast based on the present employees with assumption about replacement employees

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TO:	Council Budget Committee
CC:	Steve Powers, City Administrator
FROM:	Tom Crawford
DATE:	February 6, 2012
SUBJECT:	VEBA Funding and Allocations

At the Committee's December meeting, staff was asked to provide a memo describing the retiree healthcare allocation methodology change. Since that time, the City has received the VEBA (Voluntary Employee Beneficiary Association) actuarial report as of June 30, 2011. The receipt of this report has raised an additional policy issue for discussion. Following is a brief summary of the two issues which I will be available to discuss in greater detail at the February 13th Council working session.

Issue #1-Funding Level

<u>Background:</u> The City charges the various city service units for retiree healthcare claims as well as contributions to pre-fund the VEBA. These amount are determined by the actuaries on an annual basis and is called the Actuarial OPEB (Other Post-Employment Benefits) Cost (AOC). The most recent actuarial report determined the City's AOC is now approx. $12.4 mil. The City's planned cost for FY13 was $15.3 mil.

The reduction is primarily due to:

- High investment return (28% last year) – the VEBA system assumes a 7% return so anything above that is beneficial. High investment returns reduce the plan's unfunded liabilities.
- Ordinance changes (Plan design) – recent collective bargaining agreements and ordinance changes reflect a plan design with lower City costs for active employees. These reduced costs also affect projected retiree healthcare costs for these active employees. In addition, employees hired after 7/1/11 have an access-only retiree healthcare plan which is a significant cost savings for the city compared with the traditional plan. These Plan changes reduce the city's normal cost going forward. The normal cost represents the portion of the AOC that is attributable to the future benefit cost that an active employee earns in exchange for a year's worth of service to the city.
- Lower claims experience – the city's claims experience has declined from previous levels. Lower claims reduce both actuarial unfunded liabilities and normal costs.

Staff Recommendation: Take $2.5 mil. of the $2.9 mil. city-wide savings and continue to contribute it to the VEBA to pay down the unfunded liability and reduce future expenditures.

Reasoning:
1. The $2.9 mil. savings derives from the favorable convergence of the above three factors; however, they are volatile and could reverse in the future resulting in higher costs.
2. This is a unique opportunity given recent investment performance. If utilized to reduce future costs, it will contribute to creating a financially sustainable city organization.
3. Due to a settlement with the IRS regarding previous funding, the city will end up with a $12 mil. OPEB obligation. Contributing the $2.5 mil. to the VEBA will help address the OPEB obligation and hopefully pay it off in 5 years.
4. Historically the city's contribution to the VEBA has been substantially more than the retiree health benefit costs. The excess over the cost of claims contributes to pre-funding future benefits. Due to an increased number of retirees and the higher cost of medical care, the benefit expense is expected to exceed the AOC in the next couple of years. As this occurs the city will face a greater reliance on achieving the actuarial assumptions or face greater volatility in annual expenditures.
5. If the city had a VEBA funding policy that directed future city contributions would be based on the FY2012 level adjusted up/down for the percentage change in total General Fund revenues, the General Fund would achieve greater stability in financial planning and investing thereby reducing future volatility in expenditures.

Policy Highlights:
- Recognize the city has been collecting sufficient funds from the organization to pay the full AOC.
- Recognize the IRS settlement has resulted in repayment to the pension system, which in turn has created an OPEB obligation.
- Recognize a greater risk of volatility in the AOC expense due to the benefit costs exceeding the AOC.
- Recommend the city continue to collect sufficient funds from the organization to pay a minimum of the AOC based on the FY2012 budget level adjusted up/down for the annual percentage change in total General Fund revenue.
- Recommend the policy be re-visited in 3-5 years since investment and claims experience create volatility.

The second issue relates to how the organization collects the costs from each service unit. This process is driven by the methodology for retiree healthcare allocation.

Issue #2-Allocation Method for Retiree Healthcare

Background:
Initially the city, like most other communities, paid for retiree healthcare benefits with a pay-as-you-go method. This means that as claims came in for existing retirees in any given year, the claims were paid from that year's budget. For the past decade, the city has had an actuarial report prepared which determines the amount of funding needed to both pay for

existing claims as well as set aside funds in the VEBA to pay for future claims from all employees. In 2008, the city started consistently collecting sufficient funding to pay the AOC.

In 2010, the City settled an issue with the IRS that resulted in an OPEB obligation being created (estimated $12 mil.). This obligation is over and above the city's typical Actuarial Required Contribution and needs to be paid-off.

The city collects funds to pay its AOC by charging each service unit for retiree healthcare. Historically this charge had two components: retiree healthcare claims expense (73% of AOC) and pre-funding (27% of AOC). Because the city knows which service unit each retiree worked in, each service unit was charged a per retiree cost to cover the claims expense. In addition, the pre-funding amount determined by the actuary was charged for all active employees.

This method worked well for the city until the plan design changed in 2011 so that all new hires after 7/1/11 have an access-only plan. This plan is much less expensive for the city. In trying to budget for the implementation of the new plan, the disadvantages of the existing method of allocation were highlighted (described more fully below under "Reasons for New Methodology").

<u>Staff Recommendation:</u> Adopt a new retiree healthcare allocation methodology that allocates the costs based on where the liability is generated. The breakdown is as follows:

1. The liability for future benefits for active employees because they worked in the service of the city for the past year (27% of AOC)
2. The unfunded liability for active employees who worked prior years but for which there are no funds previously set aside (16% of AOC)
3. The unfunded liability related to the future cost of benefits for existing retirees (40% of AOC)
4. The repayment of the Net OPEB obligation (17% of AOC)

<u>Reason for New Methodology:</u> With the changing environment, there are now several reasons why the city should consider changing its retiree healthcare methodology.

1. Individual service units would not see the cost savings in their service unit for employees hired under the new ordinance under the existing methodology, but service units will with the new methodology.
2. The city could adopt a true pre-funding methodology which is consistent with best practice funding principles instead of its recent modified pay-as-you-go funding method.
3. The recommended methodology aligns the cost of the benefit to where the liability is generated.

These are complicated topics that I'll be available to discuss further at the working session, but if you have questions in advance, please let me know so I can address them.

	FY 2013 Projection-Before Allocation Change			FY 2013 Budget-Recommended			
Fund	4239-Retiree Health Care	4238-VEBA Funding	2013 Budget Total	Revised Retiree Amount (a)	Revised Active Employee Amount (b)	2013 Revised Plan Total	Cost (Savings)
0003-DDA	27,400	12,749	40,149	14,592	28,588	43,180	3,031
0010-General	7,295,250	2,304,991	9,600,241	3,885,110	$ 4,699,539	8,584,649	(1,015,592)
0011-Central Stores	68,500	18,053	86,553	36,480	30,589	67,069	(19,484)
0012-Fleet	164,400	77,764	242,164	87,552	185,677	273,229	31,065
0014- Information Technology	123,300	149,411	272,711	65,664	263,722	329,386	56,675
0016-CTN	13,700	55,002	68,702	7,296	150,086	157,382	88,680
0018-Parks Millage		1,596	1,596	-	5,003	5,003	3,407
0021-Major Streets	520,600	148,426	669,026	277,247	303,602	580,849	(88,177)
0022-Local Streets	27,400	42,579	69,979	14,592	96,055	110,647	40,668
0024-Park Acquistion		2,874	2,874	-	3,573	3,573	699
0026-Construction Code	253,450	84,716	338,166	134,976	179,531	314,507	(23,659)
0034-Parks Memorials		376	376	-	715	715	339
0042-Water	945,300	332,367	1,277,667	503,423	752,286	1,255,709	(21,958)
0043-Sewer	602,800	314,852	917,652	321,023	674,385	995,408	77,756
0046-Market		4,678	4,678	-	16,152	16,152	11,474
0047-Golf	54,800	24,668	79,468	29,184	61,321	90,505	11,037
0048-Airport	95,900	15,523	111,423	51,072	12,150	63,222	(48,201)
0049-Project Management	191,800	165,404	357,204	102,144	286,735	388,879	31,675
0057-Insurance	54,800	22,610	77,410	29,184	54,317	83,501	6,091
0058-Wheeler Center		2,306	2,306	-	3,573	3,573	1,267
0059-Retirement System	41,100	15,388	56,488	21,888	23,585	45,473	(11,015)
0061-Alternative Transportation		6,325	6,325	-	10,720	10,720	4,395
0063-DDA Parking System		12,748	12,748	-	28,588	28,588	15,840
0069-Stormwater	41,100	115,778	156,878	21,888	238,708	260,596	103,718
0071-Parks Maintenance & Capital	137,000	121,909	258,909	72,960	250,000	322,960	64,051
0072-Solid Waste	424,700	138,705	563,405	226,175	290,023	516,198	(47,207)
00MG-Major Grants		4,354	4,354	-	-	-	(4,354)
Total (excl. Housing Commission)	$ 11,083,300	$ 4,196,152	$ 15,279,452	$ 5,902,448	$ 8,649,222	$ 14,551,670	$ (727,782)
	73%	27%	100%	40%	60%	100%	

Notes:

(a) Retiree amount is reflective of the Unfunded Retiree Health Care Cost and is no longer based on the pay-as-you-go rate.

(b) Employee amount is reflective of three components: the normal cost of funding retiree health care for actives, the unfunded portion of retiree health care for actives, and an additional amount to pay down the OPEB obligation.

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