TO: James L. App, City Manager

FROM: Mike Compton, Director of Administrative Service

SUBJECT: Presentation of "Other Post Employment Benefits" Actuarial Study

DATE: January 16, 2007

NEEDS: Present actuarial report and related findings for Other Post Employment Benefits (OPEB) to the City Council by the actuary, Demsey, Filliger & Associates.

FACTS:

1. GASB Statements 43 and 45 require public agencies to report in their liability for OPEB. OPEB include compensation received after employment ends in exchange for employees' current service. City payments made to retired employees for health insurance coverage qualifies as an OPEB.

2. GASB Statement 43 & 45 requires agencies to establish uniform financial reporting standards for OPEB Plans and include instructions for calculating expenses, liabilities, and supplementary information schedules (e.g. funding progress).

3. The City is required to implement said accounting changes and uniform financial reporting requirements by fiscal year beginning July 1, 2007.

4. Actuarial services are required to implement GASB 43 and 45. The City distributed a Request for Proposal (RFP) to fifteen firms and received seven responses. The firm of Filliger & Associates was awarded the project by the Council at their September 16, 2006 meeting.

5. Demsey, Filliger & Associates, headquartered in Chatsworth, California, specializes in the group actuarial services, with a concentration of clients in the public sector. The firm has provided actuarial services in California for more than 30 years.

6. Demsey, Filliger & Associates has completed the actuarial study and is prepared to present the findings to Council (copy enclosed).

ANALYSIS & CONCLUSION:

The new GASB standards require the City to measure and disclose the annual OPEB cost on the accrual basis of accounting. The annual cost is equal to the City's annual required contribution plus an amount to amortize the total (future) unfunded actuarial accrued liability over a period not exceeding 30 years. Actuarial evaluations are required at least every two years for employers with 200 or more employees or every three years if less than 200 employees.

Depending upon year of retirement, eligible retirees receive a monthly benefit of $50 to $500 to offset the cost of health insurance premiums and/or out of pocket costs. This benefit qualifies as an OPEB.

The results of the study indicate an actuarial liability for current and future retirees as of July 1, 2006 is $6,953,464 on a present value basis. This is the amount if deposited into a special fund earning a 6% return annually and all actuarial assumptions were exactly met, the fund would accumulate sufficient resources to pay all expected benefits to current and future retirees.

It is not expected that the City will fund the actuarial liability in lump sum but will make annul contributions to a special fund until fully funded. The City has been funding the annual obligation as calculated on a cash basis since fiscal year 2005. The current Two Year Budget/Four Financial Plan provides for annual contributions including $288,000 in fiscal year 2008. The fund currently has $260,000 in cash resources. The actuary has identified four funding options:

1. Pay-as-you-go
2. Level Contribution for 20 years
3. Level % of Unfunded Liability
4. Constant % Increase

Through the budge approval process, the City has already made the decision to fund the total unfunded actuarial accrued liability. Fully funding the OPEB liability is consistent with current policy that provides for full funding of the City's PERS retirement liability (on an amortized basis) and set-asides for equipment replacement. Advantages of funding the liability include:

1. Added security that the City will be able to pay its contractual obligation going forward; and
2. Ability to use higher discount rate to value liabilities will result in lower actuarial liability and expense calculations.

While staff prefers options #2 and 3 because either option fully funds the outstanding actuarial liability within 20 years, final decision by Council will be made during preparation and adoption of the next two year budget/four year financial plan.

FISCAL IMPACT:

City Council approved the current Two Year Budget/Four Financial Plan which provides for annual cash contributions to the OPEB special fund. As noted above, the contribution for fiscal year 2008 is $288,000. This level of funding is only $84,700 short of the contribution identified in option #4 for fiscal year beginning 2006 or $189,400 short of the option #2. Enterprise funds will make appropriate contributions for their individual obligations.

OPTIONS:

a. Receive and file; or

b. Amend, modify or reject above option.

Demsey Filliger
+ ASSOCIATES

December 22, 2006

Mr. Michael J. Compton
Director of Administrative Services
City of El Paso de Robles
1000 Spring Street
Paso Robles, CA 93446

Re: City of El Paso de Robles ("City") - GASB 45 Valuation as of July 1, 2006

Dear Mr. Compton:

This report sets forth the results of our GASB 45 actuarial valuation for the City of El Paso de Robles' retiree health insurance program as of July 1, 2006.

The Government Accounting Standards Board (GASB) has recently issued its final accrual accounting standards for retiree healthcare benefits, GASB 43 and GASB 45. GASB 43/45 will require public employers such as the City to perform periodic actuarial valuations to measure and disclose their retiree healthcare liabilities for the financial statements of both the employer and the trust, if any, set aside to pre-fund these benefits. The City requires an estimate of the liabilities and disclosure requirements of its retiree health insurance program under the new standards.

To accomplish these objectives, the City selected Demsey, Filliger and Associates ("DF&A") to perform an actuarial valuation of the retiree health insurance program as of July 1, 2006. We have set forth the results of the valuation in this report, and are available to answer any questions the City may have concerning the report.

Financial Results

We have determined that the amount of actuarial liability for current and future retirees, as of July 1, 2006, is $6,953,464. This represents the present value of all benefits expected to be paid by the City for its current and future retirees. If the City were to place this amount in a fund earning interest at the rate of 6.0% per year, and all other actuarial assumptions were exactly met, the fund would have exactly enough to pay all expected benefits.

This includes benefits for 30 retirees and 169 active employees expected to retire and receive benefits in the future. It does not include employees hired after the valuation date.

If the above amount is apportioned into past service and future service components, under the projected unit credit cost method, the past service liability (or "Accrued Liability") component is $4,935,458 as of July 1, 2006. This represents the present value of all benefits earned to date assuming that an employee earns retiree medical benefits ratably over his or her career. The $4,935,458 is comprised of liabilities of $3,129,475 for active employees and $1,805,983 for retirees. As of July 1, 2006, the City held a reserve of $260,000 for the pre-funding of retiree healthcare benefits, so the Unfunded Accrued Liability (called the UAL, equal to the AL less Assets) is $4,675,458. (Please see the next section of the report for an important caveat regarding this number.)

Governmental employers are not yet required by the Government Accounting Standards Board (GASB) to adopt accrual accounting standards for retiree medical benefits, but this will happen in the near future. The new GASB standard, GASB 45, was published in June, 2004. The scheduled implementation date for GASB 45 is 2007, or possibly later, depending on the City's annual revenues. The standard encourages early compliance, however.

We have determined that the annual expense for the fiscal year 2006-7 under accrual accounting would be $630,022. This amount is referred to as the "Annual Required Contributions", or "ARC", under GASB 45. The $630,022 is comprised of the present value of benefits accruing in the current year (called the "Service Cost") and a 30-year amortization of the Unfunded Accrued Liability. Because the City is expected to pay $129,082 for the 2006-7 fiscal year in healthcare premiums on behalf of its retirees, the <u>change</u> to accrual accounting would represent an increase in annual expense of $500,940.

The above numbers are summarized in the table on the following page. The valuation covered a total of 30 retirees and 169 active employees.

Estimated Annual Liabilities and Expense Under
GASB 45 Accrual Accounting Standard
Projected Unit Credit Cost Method

Item	Amounts for Fiscal 2006-7
Present Value of Future Benefits (PVFB):	
Active	$5,147,481
Retired	1,805,983
Total: PVFB	**$6,953,464**
Accrued Liability (AL)	
Actives	$3,129,475
Retired	1,805,983
Total: AL	**$4,935,458**
Assets	(260,000)
Total: Unfunded AL	**$4,675,458**
Annual Required Contributions (ARC)	
Service Cost At Year-End	$290,355
30-year Amortization of Unfunded AL	339,667
Total: ARC	**$630,022**

We are presenting this information to help the City understand the long-term nature of these liabilities and the expected impact of the numbers at some point in the future. We wish to emphasize that it is not necessary to reflect any of these numbers in the City's financial statements at present.

All numbers set forth in the above table, as well as elsewhere in this report, are net of expected future retiree contributions, except where otherwise indicated.

GASB 43 and GASB 45 Compliance Issues

There are two considerations regarding GASB 43 and GASB 45 that we would like to mention at this point:

(1) Both statements specify that in order for a retiree fund to be counted as "assets" for purposes of the statements, the fund must be set aside in a separate, irrevocable trust, that may not be used for any purpose besides the payment of plan benefits to retirees, and is beyond the reach of creditors of both the employer and/or the plan administrator, if any. For example, an earmarked reserve within the General Fund is not expected to meet this definition of "assets". We recommend that the City consider taking steps to establish a retiree fund that meets the GASB requirements, as soon as practicable. **The UAL and ARC shown in the table on page 3 assume that the City's retiree fund will be made to meet the GASB requirements between now and the implementation date of GASB 43/45. If not, they will be higher.**

(2) There was initially some confusion among public agencies throughout California over what GASB 45 does and does not require. Specifically, many agencies believed that GASB 45 required pre-funding of retiree healthcare plans. This is not the case - the standard applies only to the expense to be charged to the agencies' income statement. Contributing to the confusion is the terminology used in both GASB 43 and GASB 45 for the annual expense - it's called the "Annual Required Contributions", even though it's neither required nor (necessarily) contributed.

We do not believe that it is necessary or even desirable for an agency to contribute the full ARC on a cash basis each year. The reasons for this are a bit complex and beyond the scope of this report, but the important thing to understand is that GASB 45 pertains to the income statement, and funding pertains to cash flow, and there is no need for the two to be directly linked, at least for now.

Funding Schedules

There are many ways to approach the pre-funding of retiree healthcare benefits. In the *Financial Results* section, we determined the annual expense for all City-paid benefits. The expense is an orderly methodology, developed by the GASB, to account for retiree healthcare benefits. This amount will fluctuate from year to year based on the asset performance and as the population matures. It will eventually reach zero when the last eligible retiree dies. The GASB 45 expense has no direct relation to amounts the City may set aside to pre-fund healthcare benefits.

The table on the next page provides the City with three alternative schedules for funding (as contrasted with expensing) retiree healthcare benefits. The schedules all assume that the retiree fund earns 5.0% per annum on its investments, and that contributions and benefits are paid mid-year. All numbers are net of expected retiree contributions. A starting balance of $260,000 as of July 1, 2006 was assumed for all three schedules.

The schedules are:

1. A level contribution amount for the next 20 years.
2. A level percentage of the Unfunded Accrued Liability (UAL).
3. A constant percentage (3%) increase in contribution each year for the next 20 years.

We provide these funding schedules to give the City a sense of the various alternatives available to it to pre-fund its retiree healthcare obligation. The three funding schedules are simply three different examples of how the City may choose to spread its costs.

By comparing the schedules, you can see the effect that early pre-funding has on the amount the City will eventually have to pay. Because of investment earnings on fund assets, the earlier contributions are made, the less the City will have to pay in the long run. Of course, the advantages of pre-funding will have to be weighed against other uses of the money.

The table on the next page shows the required annual outlay by the City under the pay-as-you-go method and each of the above schedules. The three funding schedules include the "pay-as-you-go" costs; therefore, the amount of pre-funding is the excess over the "pay-as-you-go" amount.

City of El Paso de Robles

Sample Funding Schedules (Closed Group)

Starting Fund Value of $260,000 as of July 1, 2006

Fiscal Year Beginning	Pay-as-you-go	Level Contribution for 20 years	Level % of Unfunded Liability	Constant Percentage Increase
2006	$129,082	$477,400	$716,058	$372,672
2007	150,501	477,400	632,393	383,852
2008	173,784	477,400	562,745	395,368
2009	203,712	477,400	505,032	407,229
2010	236,533	477,400	457,697	419,446
2011	263,568	477,400	419,183	432,029
2012	291,970	477,400	387,746	444,990
2013	323,878	477,400	362,255	458,340
2014	356,039	477,400	341,822	472,090
2015	385,961	477,400	325,524	486,253
2016	415,811	477,400	312,473	500,840
2017	446,215	477,400	302,003	515,866
2018	472,380	477,400	293,563	531,342
2019	490,309	477,400	286,508	547,282
2020	502,237	477,400	280,179	563,700
2021	512,372	477,400	274,143	580,611
2022	519,971	477,400	268,199	598,030
2023	524,351	477,400	262,166	615,971
2024	525,860	477,400	255,885	634,450
2025	523,997	477,400	249,250	653,483
2026	519,094	0	242,181	0
2027	512,314	0	234,636	0
2028	503,473	0	226,629	0
2029	492,352	0	218,179	0
2030	479,649	0	209,313	0
2031	465,589	0	200,084	0
2032	450,414	0	190,551	0
2033	434,099	0	180,779	0
2034	416,513	0	170,831	0
2035	397,743	0	160,769	0
2040	294,797	0	111,040	0
2045	191,036	0	64,910	0
2050	106,197	0	34,239	0
2055	50,046	0	17,685	0
2060	20,198	0	8,848	0

Actuarial Assumptions

In order to perform the valuation, it is necessary for the actuary to make certain assumptions regarding such items as rates of employee turnover, retirement, and mortality, as well as economic assumptions regarding healthcare inflation and interest rates. Our assumptions are based on a standard set of assumptions we have used for similar valuations, modified as appropriate for the City. For example, turnover rates were taken from a standard actuarial table, T-5, then increased by 100% at all ages, to match historical City turnover experience.

The City's actual pattern of early retirements, a key element in the valuation, was used to develop the retirement rates shown on page 13. This assumption is important because lifetime benefits are available after age 50 upon completion of required service, and our review of the City's retirement data showed a significant number of retirements at ages below 55.

The discount rate of 6.0% is based on our best estimate of expected long-term plan experience and is in accordance with our understanding of the guidelines for selection of these rates under GASB 45. The healthcare inflation rates are based on our knowledge of the general healthcare environment and the specific coverages offered by the City.

Please see the "Actuarial Assumptions" section of the report for further details.

Cash Flow

As part of the valuation, we prepared a projection of the expected annual costs to the City to pay benefits on behalf of its retirees on a pay-as-you-go basis. These numbers are on a closed group basis. Projected pay-as-you-go costs for selected future years are as follows:

Year Beginning	*Pay-as-you-go* *
2006	$129,082
2007	150,501
2008	173,784
2009	203,712
2010	236,533
2015	385,961
2020	502,237
2025	523,997
2030	479,649
2035	397,743
2040	294,797
2045	191,036
2050	106,197
2055	50,046

* These numbers decrease and eventually reach zero by the year 2090 because the group is valued on a closed basis (does not consider future hires).

Breakdown By Age At Which Benefits Payable

Pursuant to the City's request, we have included Exhibit I at the end of this report, providing a breakdown of benefits by age at which they are payable. This approach splits the cash flow for each expected retiree into two parts, under age 65 vs. age 65+, and discounts the resulting splits. For example, a retiree (or active employee) who is currently age 53 as of the valuation date would contribute some liability to both the under-age 65 and age 65+ columns.

In performing the valuation, we assumed that retirees over age 65 covered by non-City health plans will be able to provide support documentation for full reimbursements of their City-paid benefits ($500/month for future retirees.) An unmarried, Medicare-eligible retiree may not generate quite this much monthly healthcare expense, at least not for the next several years, so to the extent the City is diligent about requiring documentation for reimbursement from outside plans, it may be able to limit its plan costs somewhat.

To estimate the sensitivity of the valuation results to our assumption of 100% reimbursement, we re-ran the valuation using estimated Medicare Supplement premiums together with a 50% married assumption, and valued the lesser of the actual cost or the City's $500/month benefit. The Accrued Liability was found to decrease about 3% as a result of this modification - in our opinion, not a sufficiently significant change to merit further fine-tuning of this assumption in the present valuation.

Certification

The actuarial certification, including a caveat regarding limitations of scope, if any, is contained in "Actuarial Certification" section at the end of the report.

We have enjoyed working with the City on this report, and are available to answer any questions you may have concerning any information contained herein.

Sincerely,
DEMSEY, FILLIGER AND ASSOCIATES

T. Louis Filliger, FSA, EA, MAAA
Partner & Actuary

Benefit Plan Provisions

This valuation analyzes the health and welfare benefit plans of the City including medical, prescription drug, dental and vision benefits. The medical plan is the Blue Cross PPO One Plan, dental benefits are provided through Standard Dental, and vision benefits through Vision Service Plan (separate rates apply for SEIU employees/retirees and all other groups.)

City employees who have attained age 50, have completed 10 years of City service will be eligible to receive a City contribution towards healthcare premiums for the remainder of their lifetimes. Prior to age 65, retirees have the option of remaining on the City plan, or being reimbursed for premiums they pay for outside healthcare coverage. Retirees may no longer remain on the City plan after age 65, and must request reimbursement for outside coverage in order to continue to receive City-paid benefits.

The City's maximum monthly contribution has increased by $50 for each year of retirement since 1996, reaching its current level of $500 per month for retirements in fiscal 2005 or thereafter. A retiree's maximum dollar amount of reimbursement is fixed in his or her year of retirement and remains at that dollar amount for the retiree's further lifetime.

The $500 benefit level has been assumed in our valuation to remain level for all future retirements. If the $500 cap is in fact increased, any such increase would generate actuarial losses to be reflected in future actuarial valuations. Furthermore, the assumption of a level future cap used in this initial valuation would become subject to possible revision if it became evident that the City had a de facto policy of periodically increasing the cap. These guidelines are described in some detail in GASB 43/45 and the implementation guide for those statements.

The City's medical plan uses the same tiered premium structure for its active employees and its retirees. These rates are significantly lower than the actuarial cost of claims for the current non-Medicare-eligible retiree group. This arrangement gives rise to an "implicit subsidy" in the retiree coverage which provides a significant economic benefit to a retiree even in the case where there are no employer contributions towards the plan. This subsidy has been included in the liabilities set forth in this actuarial report, as required by GASB 45.

There does not appear to be any mention of Medicare Parts A and B in the City's MOUs. We recommend that the City require enrollment in Medicare once a retiree reaches age 65 (provided that retiree is eligible based on quarters of coverage), and request proof of such coverage in order to obtain reimbursement from the City for their healthcare premiums. This recommendation is based on what is generally considered to be sound plan design, since there is no point in the City paying for benefits that are duplicative with benefits provided by Medicare.

Benefit Plan Provisions

The MOUs make no mention of survivor benefits after the death of the City retiree. We have followed a strict interpretation of the MOUs on this point. If the City, over time, adopts an administrative practice of extending retiree healthcare benefits to future surviving spouses, the GASB 45 liabilities could increase on the order of 15%-20% as a result of the change.

The following healthcare premiums were in effect as of the valuation date (premiums renew each October 1):

Plan	*Blue Cross PPO One*	*Standard Dental*	*Vision Service Plan (SEIU)*	*Vision Service Plan (Others)*
Active	$307.64	$32.96	$16.06	$26.73
2-Party	646.01	82.14	16.06	26.73
Family	922.86	82.14	16.06	26.73
Retiree*	$307.64	32.96	16.06	26.73
Retiree 2P*	646.01	82.14	16.06	26.73
Family*	922.86	82.14	16.06	26.73

*Applies to retirees under age 65 only. Retirees age 65 and over must obtain coverage in an outside healthcare plan in order to be eligible for continued City-paid benefits. The valuation assumes that retirees over age 65 will request and obtain reimbursement for 100% of all City-paid benefits for which they become eligible.

Valuation Data

Age/Years of Service Distribution of Active Employees

Years →	0-4	5-9	10-14	15-19	20-24	25-29	30+	Total
AGE								
20-24	7							7
25-29	6	3						9
30-34	10	6	1					17
35-39	13	7	3	2				25
40-44	9	5	1	3	2	1		21
45-49	12	3	5	7	8	2		37
50-54	9	3	3	5	7	2	1	30
55-59	6	1	2	2	3	1	3	18
60-64	3	1	0	0	0	0	0	4
65+	0	0	0	0	1	0	0	1
All Ages	75	29	15	19	21	6	4	169

Average Age: 43.93
Average Service: 9.25

Age Distribution of City-paid Retired Participants & Surviving Spouses

Age	Total
Under 50	2
50-54	6
55-59	7
60-64	9
65+	6
All Ages	30

Average Age: 58.9

Actuarial Assumptions

The liabilities set forth in this report are based on the actuarial assumptions described in this section.

Valuation Date: July 1, 2006

Discount Rate: 6.0% per annum

Return on Assets: 5.0% per annum

Pre-retirement Turnover: According to Crocker-Sarason Table T-5 less mortality, loaded by 100%. Sample rates are as follows:

Age	*Turnover (%)*
25	15.4%
30	14.4
35	12.5
40	10.4
45	8.0
50	5.2
55	1.9

Pre-retirement Mortality: 1994 Group Annuity Mortality, Male and Female tables. Sample deaths per 1,000 employees are as follows:

Age	*Males*	*Females*
25	0.71	0.31
30	0.86	0.38
35	0.92	0.51
40	1.15	0.76
45	1.70	1.05
50	2.77	1.54
55	4.76	2.47
60	8.58	4.77

Post-retirement Mortality: 1994 Group Annuity Mortality, Male and Female tables. Sample deaths per 1,000 retirees are as follows:

Age	*Males*	*Females*
65	15.63	9.29
70	25.52	14.73
75	40.01	24.39
80	66.70	42.36
85	104.56	72.84
90	164.44	125.02

Actuarial Assumptions

Retirement Rates:

Age	*Percent Retiring**
50-51	5.0%
52-54	15.0
55	5.0
56	3.0
57	8.0
58	8.0
59	20.0
60	25.0
61-62	15.0
63	25.0
64	40.0
65	100.0

* Of those having met eligibility to receive City-paid benefits. The percentage refers to the probability that an active employee who has reached the stated age will retire within the following year.

Trend Rate:

Year	*Medical/Rx*	*Dental/Vision*
2006	10.0%	4.0%
2007	9.0	4.0
2008	8.0	4.0
2009	7.0	4.0
2010	6.0	4.0
2011+	5.0	4.0

Claim Cost per Retiree/Spouse:

Age	*Medical/Rx*	*Dental/Vision*
50	$4,300	$606
55	4,984	606
60	5,778	606
64	6,504	606
65	2,974	606
70	3,204	606
75	3,452	606

Percent of Retirees with Spouses:

Future Retirees: 50% assumed to have spouses. Female spouses assumed three years younger than male spouses.

Current Retirees: Actual dependent data used.

Participation Rates: Medical - 100%; Dental - 57%; Vision - 40%

Dependent Coverage: All assumed to be retiree-paid, without subsidy.

Actuarial Certification

The liabilities set forth in this study are based on our actuarial valuation of City of El Paso de Robles retiree health insurance program as of July 1, 2006.

The valuation was performed in accordance with generally accepted actuarial principles and practices. We relied on census data for active employees and retirees provided to us by the City in October, 2006. We also made use of claims, premium, expense, and enrollment data, and copies of relevant sections of healthcare documents provided to us by the City and made available on the City's website.

The assumptions used in performing the valuation, as summarized in this report, and the results based thereupon, represent our best estimate of the actuarial costs of the program under GASB 43 and GASB 45, and the existing and proposed Actuarial Standards of Practice for measuring post-retirement healthcare benefits.

Throughout the report, we have used unrounded numbers, because rounding and the reconciliation of the rounded results would add an additional, and in our opinion unnecessary, layer of complexity to the valuation process. By our publishing of unrounded results, no implication is made as to the degree of precision inherent in those results. Clients and their auditors should use their own judgment as to the desirability of rounding when transferring the results of this valuation report to the clients' financial statements.

Certified by:

T. Louis Filliger, FSA, EA, MAAA Date: 12/22/06
Partner & Actuary

Estimated Annual Liabilities and Expense Under GASB 45 Accrual Accounting Standard

Projected Unit Credit Cost Method

Broken Down by Benefits Payable Under Age 65 vs. Age 65 and over

Item	Benefits Payable before Age 65	Benefits Payable at Ages 65+	Total All Benefits
Present Value of Future Benefits (PVFB):			
Active	$2,850,802	$2,296,679	$5,147,481
Retired	993,747	812,236	1,805,983
Total: PVFB	**$3,844,549**	**$3,108,915**	**$6,953,464**
Accrued Liability (AL)			
Actives	$1,723,329	$1,406,146	$3,129,475
Retired	993,747	812,236	1,805,983
Total: AL	**$2,717,076**	**$2,218,382**	**$4,935,458**
Assets	(143,000)	(117,000)	(260,000)
Total: Unfunded AL (UAL)	**$2,574,076**	**$2,101,382**	**$4,675,458**
Annual Required Contributions (ARC)			
Service Cost At Year-End	$153,377	$136,978	$290,355
30-year Amortization of UAL	187,003	152,664	339,667
Total: ARC	**$340,380**	**$289,642**	**$630,022**

Assets allocated to UAL in proportion to AL for each column; for illustrative purposes only. There is no authority in GASB 45 for this allocation method.