

**ITEM NO. 6A1 OPEB ACTUARIAL VALUATION
REPORT UPDATE
ATTACHMENT A
STAFF PRESENTATION – ADDITIONAL MATERIALS RECEIVED**

Other Post-Employment Benefits Actuarial Valuation Report Update

Item No. 6A1
OPEB Actuarial Valuation Report Update
Additional Materials Received
November 9, 2023



**Finance
Committee**

November 9, 2023



Background

- The City provides eligible retirees and surviving spouses with certain retiree medical benefits, also known as other post-employment benefits (OPEB).
- Benefits vary by hire date, employment status and classification. Benefits generally fall into the following categories:
 - **Legacy Defined Benefit Plan** – up to \$450 per month is provided for eligible healthcare expenses. The legacy plan is a closed plan, which generally includes employees and retirees who were active and enrolled in the defined benefit plan as of 12/31/2005.
 - **Defined Contribution Retiree Health Savings Plan** – employee and employer contributions are required to be made to the employee’s Retiree Health Savings (RHS) account, which generally includes new hires on or after 1/1/2006. The City has no further funding obligation to the RHS plan once the City has made the required contributions.
 - **CalPERS Minimum Required Contribution (MRC)** – agencies that contract with CalPERS for health insurance coverage are required under the Public Employees’ Medical and Hospital Care Act (PEMHCA) to contribute a minimum amount for retiree health insurance (\$151/month in 2023).



Implicit Rate Subsidy

- A portion of the City's OPEB liability is in the form of an implicit rate subsidy, which results from the pooling of non-Medicare retirees and active employees for premium purposes.
- Although retirees are solely responsible for the cost of their health insurance, retirees receive the benefit of a lower rate. The difference between these amounts is the implicit rate subsidy.
- The accounting standards require that the value of the implicit subsidy be included in the City's OPEB liability, even though these costs will be paid on a pay-as-you-go basis in the future in the form of higher premiums for active employees.
- However, the cost associated with the implicit subsidy is covered by the City's cafeteria plan contribution and is paid from the City's operating budget. Therefore, the targeted funding level is based on the value of the explicit subsidy associated with the legacy defined benefit plan and the CalPERS MRC.



2023 Actuarial Valuation Report



2023 Actuarial Valuation Report

- An actuarial valuation is completed once every two years. The most recent actuarial valuation was completed in 2022, which had a measurement date of June 30, 2021.
- An interim actuarial report is updated between valuations. In 2023 an interim valuation report with a measurement date of June 30, 2022 was completed for inclusion in the City's financial statements for the fiscal year ending June 30, 2023.
- The City has set-aside funds in an OPEB trust with the California Employers' Retiree Benefit Trust (CERBT), which is managed by CalPERS. The OPEB Trust is invested in CERBT Strategy 1.
 - In 2022 CalPERS updated its Capital Market Assumptions for CERBT Strategy 1, which has a long-term expected rate of return of 6.0% whereas in 2018 the expected return was 6.50%.
- The interim actuarial valuation report reflects a decrease in the discount rate from 6.50% to 6.00% based on the revised expected return.



Summary of Valuation Results

- The City’s total OPEB liability increased by \$2.6 million, which is largely due to the impact from the decrease in the discount rate and an increase in health insurance premiums, which increased at a rate that was higher than projected.
- Assets on hand with CERBT as of the measurement date of June 30, 2023 relates to balances as of June 30, 2022, which were \$3.4 million lower due to a \$4.8 million unrealized loss on investments (14%), which was partially offset with a \$1.4 million City contribution to the Trust.

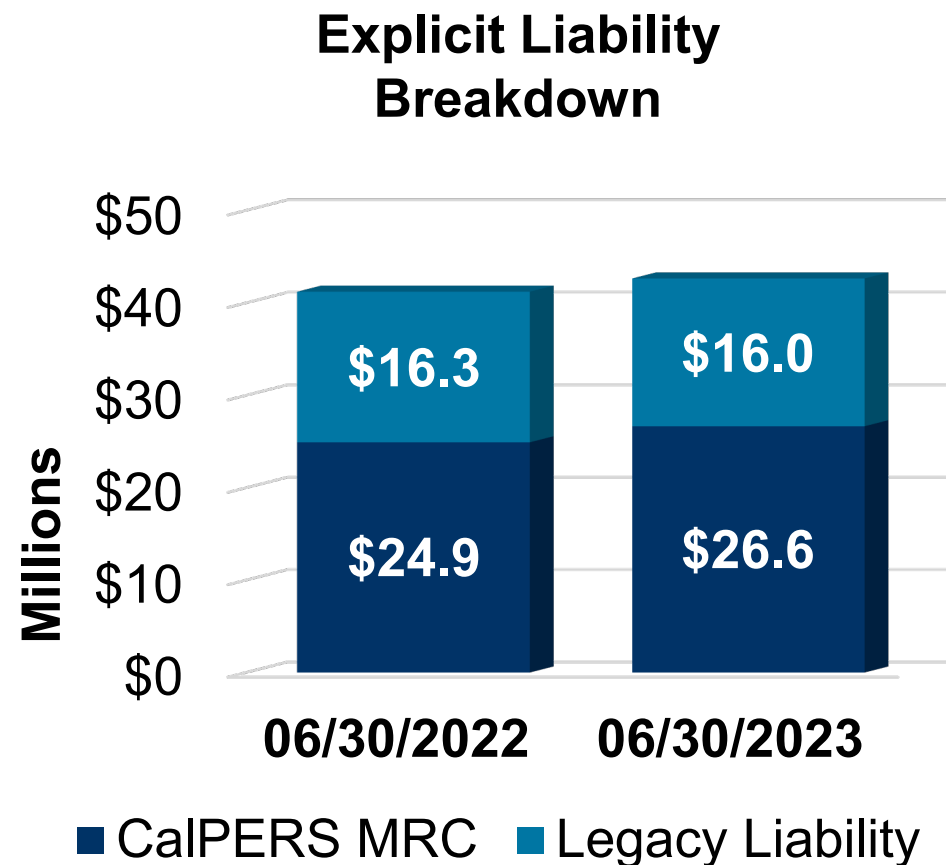
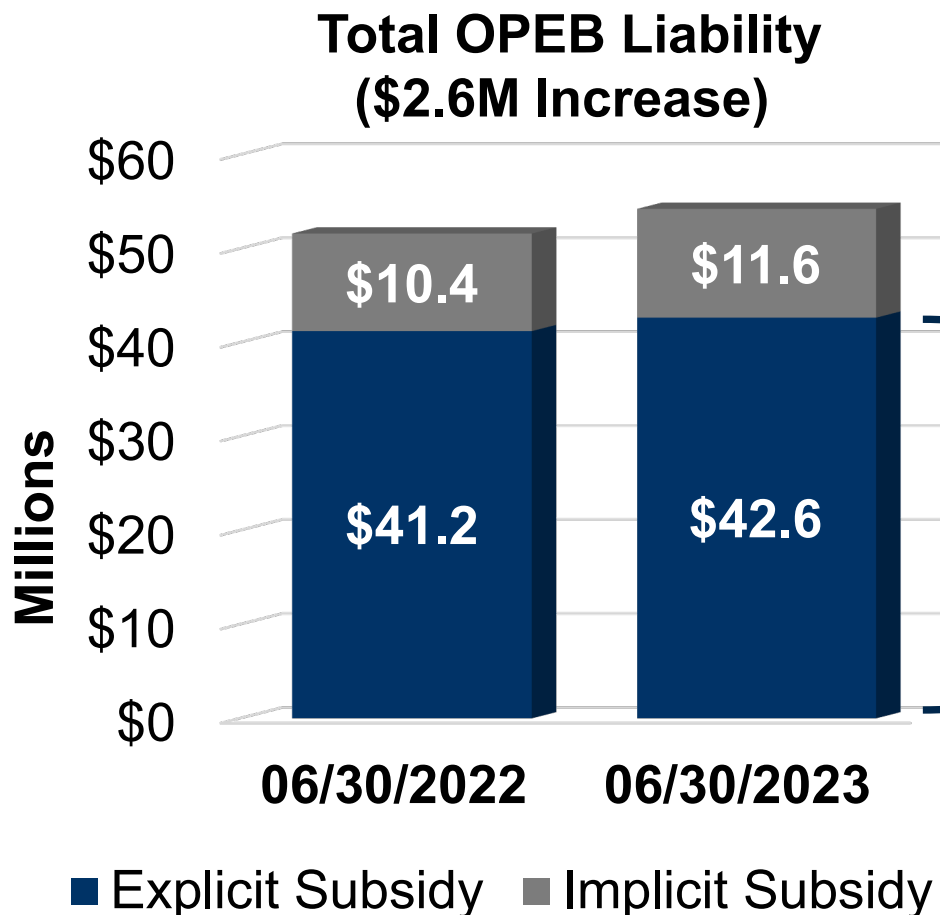
	June 30, 2022 ¹	June 30, 2023 ²
Total OPEB Liability	\$ 51,603,833	\$ 54,234,204
Trust Assets	<u>(\$ 34,969,715)</u>	<u>(\$ 31,569,252)</u>
Net OPEB Liability	\$ 16,634,118	\$ 22,664,952
Funded Percentage	67.8%	58.2%

¹ June 30, 2021 measurement date for inclusion in the Financial Statements for the Fiscal Year Ending June 30, 2022.

² June 30, 2022 measurement date for inclusion in the Financial Statements for the Fiscal Year Ending June 30, 2023.



Changes in the OPEB Liability





Targeted Funding Level

- City Council Policy F-2 (Reserve Policy) requires the “new plan” be 100% funded and that the explicit portion of the “old plan” be funded over a 20-year amortization period (or less) based on the annual required contribution determined by a biennial actuarial review. Council Policy F-2 does not directly address whether funds should be set-aside for the implicit subsidy.
- Since the cost associated with the implicit subsidy is covered by the City’s cafeteria plan contribution and is paid from the City’s operating budget, the targeted funding level has been based on the value of the explicit subsidy associated with the legacy defined benefit plan and the CalPERS MRC.
- In October 2023, the City Council approved allocating \$5.8 million of the General Fund’s operating surplus for Fiscal Year 2022-23 towards paying down the City’s OPEB liability.
- The explicit subsidy is projected to be 98% funded as of June 30, 2024, which includes the \$5.8 million contribution from the FY 2022-23 operating surplus and an annual contribution to the Trust based on the annual required contribution determined by the actuarial review.
- The explicit subsidy is projected to be 100% funded in Fiscal Year 2024-25.



Overview of the CERBT Trust



CERBT Overview

- CERBT has three investment strategies that provide for three alternative levels of tolerance for investment volatility risk.
- CERBT investments are managed by State Street Global Advisors in lieu of CalPERS investment staff with investment criteria dictated by an investment policy adopted by the CalPERS Board.
- Participating agencies own units of the portfolio rather than having direct ownership of securities.
- All-inclusive charge of 10 basis points for administrative, custodial, and investment fees.

Asset Class	Strategy 1	Strategy 2	Strategy 3
Global Equity	49%	34%	23%
Fixed Income	23%	41%	51%
Global Real Estate	20%	17%	14%
Treasury Inflation Protected Securities	5%	5%	9%
Commodities	3%	3%	3%



2022 Capital Market Assumptions

- In March 2022, CalPERS approved changes to the asset class allocations for the OPEB Pre-Funding Candidate Portfolios based on the 2022 Capital Market Assumptions.
- The changes to the Strategy 1 Candidate Portfolio resulted in a shift from global equities to global real estate to provide for diversification. However, it resulted in lower returns (7.59% to 6.0%) that are expected over the long-term and an increase in volatility (11.8% to 12.1%).

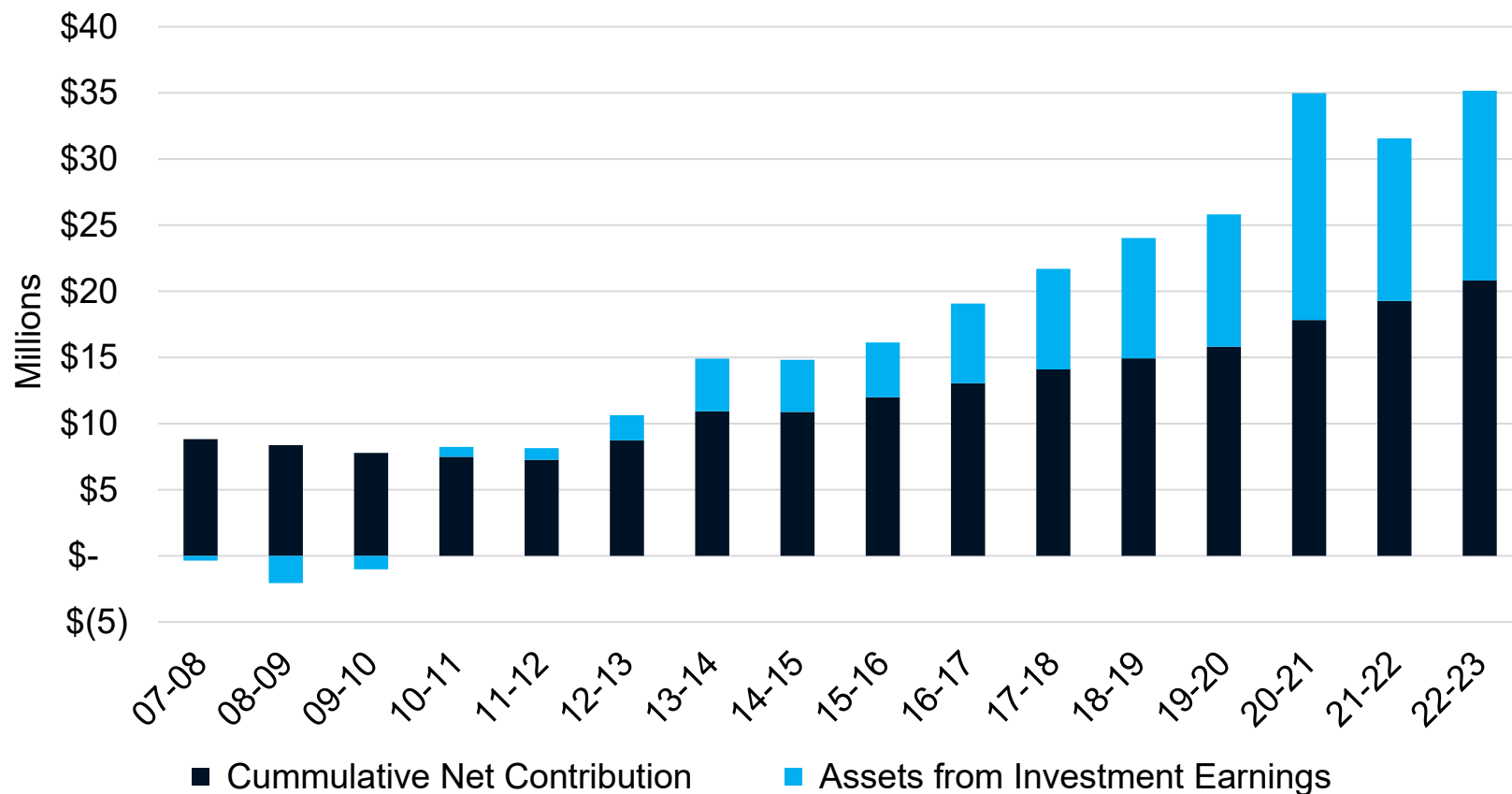
Strategy 1 Portfolio Asset Allocation, Volatility and Expected Returns

Asset Class	2018	2022
Global Equity	59%	49%
Fixed Income	25%	23%
Global Real Estate	8%	20%
Treasury Inflation Protected Securities	5%	5%
Commodities	3%	3%
Volatility	11.8%	12.1%
Expected Return, Net of Fees	7.59%	6.0%



Historical Performance of the City's Trust Account

- Total contributions in excess of withdrawals of \$20.8 million
- Total investment earnings (net of fees) of \$14.4 million
- Total assets of \$35.2 million at 6/30/23
- Annualized net rate of return of 5.52% from 2008-2023





Public Agency Retirement Services

- Approximately 500 public agencies prefund pension and other post-employment benefits through trusts administered by Public Agency Retirement Services (PARS).
- PARS has five investment strategies that provide for alternative levels of tolerance for investment volatility risk. PARS also allows agencies to create a customized investment strategy, which allows for greater investment flexibility and risk diversification.
- HighMark Capital Management provides investment advisory and management services.
- Participating agencies have direct ownership of securities, which are held in individual custodial accounts with US Bank.
- The administrative, trustee and investment management fees are assessed based on the value of assets held in the Trust. The fee structure decreases as the asset balances increase. For example, total fees equate to 29 basis points for a Trust with \$35 million in assets whereas the fees equate to 25 basis points for a Trust with \$50 million in assets.



PARS Compared to CERBT

- The PARS moderate and custom strategies provide for investment returns (net of fees) that are comparable to CERBT. However, the PARS strategies have less volatility than CERBT.

Asset Class	CERBT Strategy 1	PARS Moderate Strategy	PARS Custom Strategy
Global Equity	49%	50%	55%
Fixed Income	23%	45%	40%
Global Real Estate	20%	0%	0%
Treasury Inflation Protected Securities	5%	0%	0%
Commodities	3%	0%	0%
Cash	0%	5%	5%
Volatility	12.1%	8.75%	9.43%
Expected Return, Net of Fees	6.0%	5.87%	6.07%



Summary

- It is recommended that the city continue with the current paydown strategy, which is projected to result in fully paying down the explicit subsidy in Fiscal Year 2024-25.
- Staff is seeking input from the Finance Committee on whether all or a portion of the OPEB Trust assets should be transferred from CERBT to PARS, which would allow for greater investment flexibility and risk diversification.



Questions?