City of La Palma  
*Agenda Item No. 5*

**MEETING DATE:** October 1, 2013  
**TO:** CITY COUNCIL  
**FROM:** CITY MANAGER  
**SUBMITTED BY:** Michael Solorza, Finance Director  
**AGENDA TITLE:** Establishment of Irrevocable Trust with California Employers’ Retiree Benefit Trust (CERBT)

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**PURPOSE:**

To request City Council approval of the required legal documents, delegation of authority forms, and related agreements formally establishing an irrevocable trust with the California Employers’ Retiree Benefit Trust (CERBT) to reduce and fund the City’s Other Post Employment Benefit (OPEB) liabilities.

**BACKGROUND:**

The City has a post-employment, retiree health benefit program in place (i.e., "other post employment benefits" [OPEB] plan). Eligibility is based on retirement from the City of La Palma with eligibility for a California Public Employees’ Retirement System (CalPERS) pension and enrollment in a CalPERS retiree health plan. The benefits are only available to employees who retire from the City of La Palma on or after age 50 and meet CalPERS pension eligibility requirements. The paragraphs below provide an overview of the current benefit structure as well as a discussion of the benefits of establishing an irrevocable trust.

*Current Retiree Health Program Status*

The City of La Palma contracts with CalPERS for employee health benefits. Current (active) employees and retirees are provided health benefits through CalPERS. Specifically, the Public Employees’ Medical and Hospital Care Act (PEMHCA) governs the level of benefits provided since La Palma contracts with CalPERS for health insurance.

PEMHCA sets a minimum monthly amount employers contribute towards employee health benefits. In addition, this amount is adjusted annually (January of each year). Currently, for calendar year 2013, the minimum amount is $115 per month. Per PEMHCA, retirees cannot receive less than the amount provided to active employees. Current employees receive a cafeteria benefit in addition to the PEMHCA minimum health benefit. Because this additional amount is not considered a health benefit, it does not apply to retirees and retirees do not receive the additional amount.
Non-safety retirees who meet the eligibility requirements (described above) and retire from the City of La Palma receive only the PEMHCA minimum amount – currently $115 per month. This benefit amount is capped and only increases to match the annually updated PEMHCA minimum. Safety employees hired before July 1, 2011, and who retire from the City of La Palma receive a higher negotiated monthly amount: $416.49. This amount is capped and can only increase through labor negotiations. In addition, for any safety employee hired on or after July 1, 2011, the retiree monthly amount is pegged to the PEMHCA minimum. In other words, future safety employees hired on or after July 1, 2011, who retire from the City of La Palma will receive a much lower retiree health benefit.

The City has taken steps such as this to minimize its future retiree health liabilities by only providing the PEMHCA minimum amount for non-safety employees, capping the monthly amount for safety retirees hired before July 1, 2011, and lowering the amount provided to safety employees who are hired on or after July 1, 2011. These actions will reap positive benefits over the long term since the retiree health benefits are capped and – for new safety hires – decreased to match that of non-safety employees.

Currently the City meets the obligations for retiree medical costs on a “pay as you go” basis. The paragraphs below explain in greater detail the benefits of establishing a trust and moving beyond “pay as you go.”

**Benefits of a Trust**

An alternative to the “pay as you go” method is to establish a trust, whereby the City puts enough money aside to not only pay current obligations (i.e., the cost of current retirees) but also to fund the costs of future retirees (normal cost, or the actuarial assumed amount for current employees). By establishing an irrevocable trust, the City positions itself to meet current obligations while setting aside funds to meet future obligations.

In addition, those funds on deposit with the trust, as invested and managed by an independent entity, accrue interest earnings. The entire pot of money, as it grows with annual contributions plus the dividends from interest earnings, helps to defer the total cost of the retiree medical program. Also, the actuarial and accounting treatment is more favorable, since there are assets which can be valued and used to offset the unfunded liability that has accrued over the life of the retiree medical program.

In effect, as the trust amount grows, the City receives credit towards its unfunded liability since more assets would be available – and set aside in a trust – to be used exclusively for Other Post Employment Benefit (OPEB) expenses. The bottom line, positive impact of having an irrevocable OPEB trust is to reduce liabilities over the long-term while helping ensure adequate funding is available for future retirees.

**Recent Actions and Next Steps**

On February 5, 2013, Staff presented information to the City Council concerning the options available for addressing – and reducing – its OPEB liability. One of the options presented was establishment of an irrevocable trust. Subsequently, on April 16, 2013, the City Council directed Staff to proceed with establishing an irrevocable trust with CalPERS’ California Employers’ Retiree Benefit Trust (CERBT) program. Furthermore, Staff was instructed to assume that an amount not to exceed $1.5 million would be utilized to “pre-fund” this trust (i.e., a portion of General Fund
reserves). This pre-funding amount is utilized in developing the actuarial valuation that is required as part of the trust establishment process.

Since April, Staff has worked with CalPERS and Total Compensation Specialists (TCS) in order to request and prepare the required actuarial reports and agreements in order to formally establish the trust. This agenda report presents an overview of the next steps required to formally establish and pre-fund the trust. Attachments 1, 2, and 3 (with Exhibits A and B) are required CalPERS/CERBT documents which establish the trust, provide for pre-funding, delegate management authority and amend the Fiscal Year 2013-14 budget. The required actuarial valuation (i.e., GASB 45 actuarial report) has been attached as well (Attachment 4) for City Council review. City Council agenda items from the February 5 and April 16 meetings are provided for reference (Attachments 5 and 6). Finally, Attachment 7 provides an overview of the CERBT investment strategy.

SUMMARY:

As noted above, the City Council has previously approved establishing a trust with CERBT, with further direction of utilizing an amount not to exceed $1.5 million in available reserves to pre-fund the trust. This agenda report and recommended actions are the next – and final – steps required to formally establish and pre-fund the trust.

Establishment and pre-funding the trust immediately reduces the City’s OPEB unfunded actuarial accrued liability. A prior GASB 45 actuarial report dated February 21, 2012, indicated an unfunded actuarial accrued liability (i.e., UAAL) of approximately $3.312 million. The August 7, 2013, GASB 45 report indicates a UAAL of approximately $1.893 million.

This updated – and lower – unfunded actuarial accrued liability amount was derived utilizing numerous assumptions. All of these assumptions are explained in greater detail in the GASB 45 report, Appendix C, page 17 (Attachment 4). However, the two primary and most positively impactful assumptions which reduced the UAAL are the following:

- $1.5 million in CERBT trust assets
- A discount rate (i.e., rate of return) of 7.25%

The discount rate of 7.25% is slightly lower than the recommended trust investment strategy discount rate of 7.61%. The actuary preparing the valuation report reduced the rate of return to reflect changes to long-term inflation assumptions as well as netting out plan expenses.

Even with the reduced UAAL, La Palma will continue to make annual payments to the trust. However, for the first time ever, La Palma will be meeting its actuarial required contribution (ARC), and not just the “pay as you go” amount. This is a significant change in funding philosophy and overall management of the OPEB program.

Specifically, this positive change means that La Palma will be putting funds in the trust sufficient to not only pay the costs of current retirees (“pay as you go”), but also making contributions to offset actuarial assumed costs of potential future retirees (normal cost). That is, prior to establishing a trust, the City was only paying the minimum required amount to meet the annual costs of current retirees and was not “putting money away” for current or future employees who might be eligible for the retiree medical program at some point in the future. While the City was dutifully meeting its current obligations, the future liability was growing since no funds were
being committed for that purpose. Furthermore, the annual required contribution (pay as you go amount + normal cost) is lower and more predictable and stable than the “pay as you go” amount.

As per direction received on April 16, Staff has assumed a pre-funding amount of $1.5 million. Therefore, the CERBT agreements and GASB 45 actuarial valuation have been completed as such. These funds would be disbursed to CERBT during the course of the 2013-14 fiscal year in a methodical and level manner in order to reduce cash flow impact while taking advantage of the “dollar cost averaging” method of investing.

Utilizing this method, by June 30, 2014, there will be $1.5 million in assets invested with CERBT, credited to the City of La Palma and accessible only by the City, and utilizing investment Strategy 1 as described in Attachment 7. This investment strategy is the most popular of the 376 agencies which are part of CERBT. Strategy 1 is utilized by 310 local agencies, or 82%.

Once the trust is established and funds have been deposited, CERBT will provide quarterly reports on plan activity. Staff will provide these reports to the City Council on a quarterly basis in order to provide information on the plan’s performance. The City Council will have the opportunity to determine any additional contributions to the trust which are above the annual required contribution (ARC) amount as part of future budget adoption processes.

**ALTERNATIVES:**

On April 16 the City Council directed Staff to make the necessary arrangements to establish an irrevocable trust with CERBT. In addition, direction was provided to pre-fund the trust in an amount not to exceed $1.5 million, utilizing available General Fund reserves. At this point, City Council could direct Staff to pre-fund the trust at an amount other than $1.5 million.

Any amount less than $1.5 million would increase the City’s UAAL, while an amount greater than $1.5 million would further decrease the City’s unfunded liability. The exact impact would need to be calculated by TCS. Should the City Council decide on an amount other than $1.5 million, the trust can still be established by passage of the required resolution (Attachment 1, Exhibits A and B) at tonight’s meeting. Staff would then work with TCS to update the actuarial valuation report to reflect the pre-funding amount and the new actuarial report would be utilized.

The City Council could also decide not to change its current practice of “pay as you go” and not establish or fund a trust for these liabilities.

**FISCAL IMPACT:**

The City's available General Fund reserves would be impacted by the pre-funding of the CERBT trust by being reduced by $1.5 million. These funds are available without impacting the reserves policy amount. Additionally, future fiscal years would benefit from lower ongoing retiree health care program costs. Under the “pay as you go” process, annual contributions for current retirees were approximately $120,000, and growing. As the June 30, 2013, actuarial report indicates, the annual required contribution (ARC) amount is approximately $68,600. By establishing this trust, the City accomplishes two important goals:
• Lowering the annual, ongoing operating cost of its retiree medical program

• Contributing – for the first time – the full actuarial required contribution (ARC) amount (pay as you go + normal cost)

The positive fiscal impact of the second point above is extremely important. Prior to establishment of the trust, La Palma was not committing any funds towards paying the actuarial assumed future liability of current employees who might qualify for the retiree medical health program. This potential liability was not being addressed and subsequent actuarial reports would indicate a growing liability related to current and future employees. In fact, as page 13 of the GASB 45 actuarial report indicates (Attachment 4), the pay as you go amount would continue to grow annually.

Establishing and pre-funding an OPEB trust helps address the total liability of the City’s retiree medical health program, not just the annual cost of current retirees. This action is forward looking and proactive and sets in motion the long-term reduction of the City’s unfunded liability. Furthermore, this action allows for lower, predictable, and stable retiree health program costs for the current and foreseeable future fiscal years. These are extremely important factors that directly benefit the City’s overall fiscal health over the long-term.

It should also be noted that the City has taken steps in the past to cap retiree health benefit amounts. Future options to reduce liabilities are extremely limited. Any changes which could be done as part of upcoming labor negotiations would be reflected in subsequent GASB 45 required valuation reports (i.e., those done as of June 20, 2015 or later). The potential for future – as yet to be determined – changes to retiree medical benefits does not impact the need for the initial $1.5 million pre-funding amount being requested as part of this agenda item.

**RECOMMENDED ACTION:**

It is recommended that the City Council:

a) Adopt a Resolution approving the “CERBT Agreement and Election to Prefund OPEB Through CalPERS” (Attachment 1, Exhibit A) and the “Delegation of Authority Form” (Attachment 1, Exhibit B).

b) Adopt a Resolution amending the Fiscal Year 2013-14 General Fund budget by increasing appropriations by $1,500,000 to be utilized for pre-funding the CERBT trust (Attachment 2).

**APPROVED:**

[Signatures]

Department Director
Finance
City Manager

Attachment: 1. Resolution Approving CERBT Agreement and Election to Prefund OPEB Through CalPERS (Attachment 1, Exhibit A) and Delegation of Authority
to Request Disbursements from the CERBT Trust (Attachment 1, Exhibit B)

2. Resolution Amending the Fiscal Year 2013-14 General Fund and Employee Benefits Internal Service Fund

3. Certification of OPEB Funding Policy and GASB 43/45 Reporting Compliance

4. GASB 45 Valuation Report as of June 30, 2013

5. February 5, 2013 City Council Agenda Report

6. April 16, 2013 City Council Agenda Report

7. CalPERS CERBT Investment Strategy Overview
RESOLUTION NO. 2013-__

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF LA PALMA APPROVING AN AGREEMENT AND ELECTING TO PREFUND OTHER POST EMPLOYMENT BENEFITS (OPEB) THROUGH CALPERS THROUGH ESTABLISHMENT OF AN IRREVOCABLE TRUST THROUGH THE CALIFORNIA EMPLOYERS’ RETIREE BENEFIT TRUST PROGRAM (CERBT)

WHEREAS, the City of La Palma provides a retiree medical health program for retired employees that meets certain, specific eligibility requirements; and

WHEREAS, this retiree medical health program, also commonly and generically referred to as an Other Post Employment Benefits (OPEB) program, has certain ongoing and actuarial estimated future costs associated with its administration and maintenance; and

WHEREAS, the City of La Palma wishes to reduce the unfunded actuarial accrued liability (UAAL) of its OPEB program as determined in an actuarial report of June 30, 2013; and

WHEREAS, on February 5 and April 16, 2013, the City Council received information concerning various methods for reducing the City’s UAAL and subsequently provided direction to establish an irrevocable trust with the CalPERS sponsored and managed California Employers’ Retiree Benefit Trust Program (CERBT); and

WHEREAS, the City Council on April 16, 2013, provided direction that establishment of the trust with CERBT would include pre-funding the trust by utilizing $1,500,000 in available General Fund reserves; and

WHEREAS, the final pre-funding amount will be revised so as to reflect each and all of the modifications of the pre-funding amount which the City Council, up to the time of adoption of this resolution, believes should be transmitted to CERBT during the course of the 2013-14 Fiscal Year.

NOW, THEREFORE, the City Council of the City of La Palma hereby makes the following representation and warranty and agrees to the terms and conditions contained in Exhibit A to this Resolution, also referred to as the “California Employers’ Retiree Benefit Trust Program Agreement and Election of the City of La Palma to Prefund Other Post Employment Benefits Through CalPERS” and delegates authority to request disbursements from the CERBT as outlined in the Exhibit B, “Delegation of Authority to Request Disbursements.”

APPROVED AND ADOPTED by the City Council of the City of La Palma at a regular meeting held on the 1st day of October 2013.
I, LAURIE A. MURRAY, City Clerk of the City of La Palma, California, DO HEREBY CERTIFY that the foregoing resolution was adopted by the City Council of said City at a regular meeting of said City Council held on the 1st day of October 2013, and that it was so adopted by called vote as follows:

AYES:

NOES:

Laurie A. Murray, City Clerk
CALIFORNIA EMPLOYERS’ RETIREE BENEFIT TRUST PROGRAM ("CERBT")

AGREEMENT AND ELECTION
OF
City of La Palma

(NAME OF EMPLOYER)

TO PREFUND OTHER POST EMPLOYMENT BENEFITS THROUGH CalPERS

WHEREAS (1) Government Code Section 22940 establishes in the State Treasury the Annuitants' Health Care Coverage Fund for the prefunding of health care coverage for annuitants (Prefunding Plan); and

WHEREAS (2) The California Public Employees' Retirement System (CalPERS) Board of Administration (Board) has sole and exclusive control and power over the administration and investment of the Prefunding Plan (sometimes also referred to as CERBT), the purposes of which include, but are not limited to (i) receiving contributions from participating employers and establishing separate Employer Prefunding Accounts in the Prefunding Plan for the performance of an essential governmental function (ii) investing contributed amounts and income thereon, if any, in order to receive yield on the funds and (iii) disbursing contributed amounts and income thereon, if any, to pay for costs of administration of the Prefunding Plan and to pay for health care costs or other post employment benefits in accordance with the terms of participating employers' plans; and

WHEREAS (3) City of La Palma (Employer) desires to participate in the Prefunding Plan upon the terms and conditions set by the Board and as set forth herein; and

WHEREAS (4) Employer may participate in the Prefunding Plan upon (i) approval by the Board and (ii) filing a duly adopted and executed Agreement and Election to Prefund Other Post Employment Benefits (Agreement) as provided in the terms and conditions of the Agreement; and

WHEREAS (5) The Prefunding Plan is a trust fund that is intended to perform an essential governmental function within the meaning of Section 115 of the Internal Revenue Code as an agent multiple-employer plan as defined in Governmental Accounting Standards Board (GASB) Statement No. 43 consisting of an aggregation of single-employer plans, with pooled administrative and investment functions;
NOW, THEREFORE, BE IT RESOLVED THAT EMPLOYER HEREBY MAKES THE FOLLOWING REPRESENTATION AND WARRANTY AND THAT THE BOARD AND EMPLOYER AGREE TO THE FOLLOWING TERMS AND CONDITIONS:

A. Representation and Warranty

Employer represents and warrants that it is a political subdivision of the State of California or an entity whose income is excluded from gross income under Section 115 (1) of the Internal Revenue Code.

B. Adoption and Approval of the Agreement; Effective Date; Amendment

(1) Employer's governing body shall elect to participate in the Prefunding Plan by adopting this Agreement and filing with the CalPERS Board a true and correct original or certified copy of this Agreement as follows:

Filing by mail, send to:
CalPERS
Affiliate Program Services Division
CERBT (OPEB)
P.O. Box 1494
Sacramento, CA 95812-1494

Filing in person, deliver to:
CalPERS Mailroom
Affiliate Program Services Division
CERBT (OPEB)
400 Q Street
Sacramento, CA  95811

(2) Upon receipt of the executed Agreement, and after approval by the Board, the Board shall fix an effective date and shall promptly notify Employer of the effective date of the Agreement.

(3) The terms of this Agreement may be amended only in writing upon the agreement of both CalPERS and Employer, except as otherwise provided herein. Any such amendment or modification to this Agreement shall be adopted and executed in the same manner as required for the Agreement. Upon receipt of the executed amendment or modification, the Board shall fix the effective date of the amendment or modification.

(4) The Board shall institute such procedures and processes as it deems necessary to administer the Prefunding Plan, to carry out the purposes of this Agreement, and to maintain the tax exempt status of the Prefunding Plan. Employer agrees to follow such procedures and processes.
C. Other Post Employment Benefits (OPEB) Cost Reports and Employer Contributions

(1) Employer shall provide to the Board an OPEB cost report on the basis of the actuarial assumptions and methods prescribed by the Board. Such report shall be for the Board's use in financial reporting, and shall be prepared at least as often as the minimum frequency required by GASB 43. This OPEB cost report may be prepared as an actuarial valuation report or, if the employer is qualified under GASB 45 and 57, may be prepared as an Alternative Measurement Method (AMM) report.

(a) Unless qualified under GASB 45 and 57 to provide an AMM report, Employer shall provide to the Board an actuarial valuation report. Such report shall be for the Board's use in financial reporting, and shall be prepared at least as often as the minimum frequency required by GASB 43 and 57, and shall be:

1) prepared and signed by a Fellow or Associate of the Society of Actuaries who is also a Member of the American Academy of Actuaries or a person with equivalent qualifications acceptable to the Board;

2) prepared in accordance with generally accepted actuarial practice and GASB 43, 45 and 57; and,

3) provided to the Board prior to the Board's acceptance of contributions for the valuation period or as otherwise required by the Board.

(b) If qualified under GASB 45 and 57, Employer may provide to the Board an AMM report. Such report shall be for the Board's use in financial reporting, shall be prepared at least as often as the minimum frequency required by GASB 43 and 57, and shall be:

1) affirmed by Employer’s external auditor, or by a Fellow or Associate of the Society of Actuaries who is also a Member of the American Academy of Actuaries or a person with equivalent qualifications acceptable to the Board, to be consistent with the AMM process described in GASB 45;

2) prepared in accordance with GASB 43, 45, and 57; and,

3) provided to the Board prior to the Board's acceptance of contributions for the valuation period or as otherwise required by the Board.

(2) The Board may reject any OPEB cost report submitted to it, but shall not unreasonably do so. In the event that the Board determines, in its sole discretion, that the OPEB cost report is not suitable for use in the Board's financial statements or if Employer fails to provide a required OPEB cost report, the Board may obtain, at
Employer’s expense, an OPEB cost report that meets the Board’s financial reporting needs. The Board may recover from Employer the cost of obtaining such OPEB cost report by billing and collecting from Employer or by deducting the amount from Employer’s account in the Prefunding Plan.

(3) Employer shall notify the Board of the amount and time of contributions which contributions shall be made in the manner established by the Board.

(4) Employer contributions to the Prefunding Plan may be limited to the amount necessary to fully fund Employer's actuarial present value of total projected benefits, as supported by the OPEB cost report acceptable to the Board. As used throughout this document, the meaning of the term "actuarial present value of total projected benefits" is as defined in GASB Statement No. 45. If Employer’s contribution causes its assets in the Prefunding Plan to exceed the amount required to fully fund the actuarial present value of total projected benefits, the Board may refuse to accept the contribution.

(5) No contributions are required. If an employer elects to contribute then the contribution amount should not be less than $5000 or the employer’s annual required contribution (ARC), whichever amount is lower. Contributions can be made at any time following the seventh day after the effective date of the Agreement provided that Employer has first complied with the requirements of Paragraph C.

D. Administration of Accounts, Investments, Allocation of Income

(1) The Board has established the Prefunding Plan as an agent plan consisting of an aggregation of single-employer plans, with pooled administrative and investment functions, under the terms of which separate accounts will be maintained for each employer so that Employer’s assets will provide benefits only under employer's plan.

(2) All Employer contributions and assets attributable to Employer contributions shall be separately accounted for in the Prefunding Plan (Employer’s Prefunding Account).

(3) Employer’s Prefunding Account assets may be aggregated with prefunding account assets of other employers and may be co-invested by the Board in any asset classes appropriate for a Section 115 Trust.

(4) The Board may deduct the costs of administration of the Prefunding Plan from the investment income or Employer’s Prefunding Account in a manner determined by the Board.

(5) Investment income shall be allocated among employers and posted to Employer’s Prefunding Account as determined by the Board but no less frequently than annually.

(6) If Employer's assets in the Prefunding Plan exceed the amount required to fully fund the actuarial present value of total projected benefits, the Board, in compliance with applicable accounting and legal requirements, may return such excess to Employer.
E. Reports and Statements

(1) Employer shall submit with each contribution a contribution report in the form and containing the information prescribed by the Board.

(2) The Board shall prepare and provide a statement of Employer's Prefunding Account at least annually reflecting the balance in Employer's Prefunding Account, contributions made during the period and income allocated during the period, and such other information as the Board determines.

F. Disbursements

(1) Employer may receive disbursements not to exceed the annual premium and other costs of post employment healthcare benefits and other post employment benefits as defined in GASB 43.

(2) Employer shall notify CalPERS in writing in the manner specified by CalPERS of the persons authorized to request disbursements from the Prefunding Plan on behalf of Employer.

(3) Employer's request for disbursement shall be in writing signed by Employer's authorized representative, in accordance with procedures established by the Board. The Board may require that Employer certify or otherwise establish that the monies will be used for the purposes of the Prefunding Plan.

(4) Requests for disbursements that satisfy the requirements of paragraphs (2) and (3) will be processed monthly.

(5) CalPERS shall not be liable for amounts disbursed in error if it has acted upon the written instruction of an individual authorized by Employer to request disbursements. In the event of any other erroneous disbursement, the extent of CalPERS' liability shall be the actual dollar amount of the disbursement, plus interest at the actual earnings rate but not less than zero.

(6) No disbursement shall be made from the Prefunding Plan which exceeds the balance in Employer's Prefunding Account.

G. Costs of Administration

Employer shall pay its share of the costs of administration of the Prefunding Plan, as determined by the Board.

H. Termination of Employer Participation in Prefunding Plan

(1) The Board may terminate Employer's participation in the Prefunding Plan if:
(a) Employer gives written notice to the Board of its election to terminate;

(b) The Board finds that Employer fails to satisfy the terms and conditions of this Agreement or of the Board's rules or regulations.

(2) If Employer's participation in the Prefunding Plan terminates for any of the foregoing reasons, all assets in Employer’s Prefunding Account shall remain in the Prefunding Plan, except as otherwise provided below, and shall continue to be invested and accrue income as provided in Paragraph D.

(3) After Employer’s participation in the Prefunding Plan terminates, Employer may not make contributions to the Prefunding Plan.

(4) After Employer’s participation in the Prefunding Plan terminates, disbursements from Employer’s Prefunding Account may continue upon Employer’s instruction or otherwise in accordance with the terms of this Agreement.

(5) After the Employer’s participation in the Prefunding Plan terminates, the governing body of the Employer may request either:

(a) A trustee to trustee transfer of the assets in Employer’s Prefunding Account; provided that the Board shall have no obligation to make such transfer unless the Board determines that the transfer will satisfy applicable requirements of the Internal Revenue Code, other law and accounting standards, and the Board’s fiduciary duties. If the Board determines that the transfer will satisfy these requirements, the Board shall then have one hundred fifty (150) days from the date of such determination to effect the transfer. The amount to be transferred shall be the amount in the Employer’s Prefunding Account as of the date of the transfer (the “transfer date”) and shall include investment earnings up to an investment earnings allocation date preceding the transfer date. In no event shall the investment earnings allocation date precede the transfer date by more than 150 days.

(b) A disbursement of the assets in Employer’s Prefunding Account; provided that the Board shall have no obligation to make such disbursement unless the Board determines that, in compliance with the Internal Revenue Code, other law and accounting standards, and the Board’s fiduciary duties, all of Employer’s obligations for payment of post-employment health care benefits and other post-employment benefits and reasonable administrative costs of the Board have been satisfied. If the Board determines that the disbursement will satisfy these requirements, the Board shall then have one hundred fifty (150) days from the date of such determination to effect the disbursement. The amount to be disbursed shall be the amount in the Employer’s Prefunding Account as of the date of the disbursement (the “disbursement date”) and shall include investment earnings up to an investment earnings allocation date
preceding the disbursement date. In no event shall the investment earnings allocation date precede the disbursement date by more than 150 days.

(6) After Employer’s participation in the Prefunding Plan terminates and at such time that no assets remain in Employer’s Prefunding Account, this Agreement shall terminate.

(7) If, for any reason, the Board terminates the Prefunding Plan, the assets in Employer’s Prefunding Account shall be paid to Employer after retention of (i) amounts sufficient to pay post employment health care benefits and other post employment benefits to annuitants for current and future annuitants described by the employer’s current substantive plan (as defined in GASB 43), and (ii) amounts sufficient to pay reasonable administrative costs of the Board.

(8) If Employer ceases to exist but Employer’s Prefunding Plan continues to exist and if no provision has been made by Employer for ongoing payments to pay post employment health care benefits and other post employment benefits to annuitants for current and future annuitants, the Board is authorized to and shall appoint a third party administrator to carry out Employer’s Prefunding Plan. Any and all costs associated with such appointment shall be paid from the assets attributable to contributions by Employer.

(9) If Employer should breach the representation and warranty set forth in Paragraph A., the Board shall take whatever action it deems necessary to preserve the tax-exempt status of the Prefunding Plan.

I. General Provisions

(1) Books and Records.

Employer shall keep accurate books and records connected with the performance of this Agreement. Employer shall ensure that books and records of subcontractors, suppliers, and other providers shall also be accurately maintained. Such books and records shall be kept in a secure location at the Employer's office(s) and shall be available for inspection and copying by CalPERS and its representatives.

(2) Audit.

(a) During and for three years after the term of this Agreement, Employer shall permit the Bureau of State Audits, CalPERS, and its authorized representatives, and such consultants and specialists as needed, at all reasonable times during normal business hours to inspect and copy, at the expense of CalPERS, books and records of Employer relating to its performance of this Agreement.

(b) Employer shall be subject to examination and audit by the Bureau of State Audits, CalPERS, and its authorized representatives, and such
consultants and specialists as needed, during the term of this Agreement and for three years after final payment under this Agreement. Any examination or audit shall be confined to those matters connected with the performance of this Agreement, including, but not limited to, the costs of administering this Agreement. Employer shall cooperate fully with the Bureau of State Audits, CalPERS, and its authorized representatives, and such consultants and specialists as needed, in connection with any examination or audit. All adjustments, payments, and/or reimbursements determined to be necessary by any examination or audit shall be made promptly by the appropriate party.

(3) Notice.

(a) Any notice, approval, or other communication required or permitted under this Agreement will be given in the English language and will be deemed received as follows:

1. Personal delivery. When personally delivered to the recipient. Notice is effective on delivery.

2. First Class Mail. When mailed first class to the last address of the recipient known to the party giving notice. Notice is effective three delivery days after deposit in a United States Postal Service office or mailbox.

3. Certified mail. When mailed certified mail, return receipt requested. Notice is effective on receipt, if delivery is confirmed by a return receipt.

4. Overnight Delivery. When delivered by an overnight delivery service, charges prepaid or charged to the sender's account, Notice is effective on delivery, if delivery is confirmed by the delivery service.

5. Telex or Facsimile Transmission. When sent by telex or fax to the last telex or fax number of the recipient known to the party giving notice. Notice is effective on receipt, provided that (i) a duplicate copy of the notice is promptly given by first-class or certified mail or by overnight delivery, or (ii) the receiving party delivers a written confirmation of receipt. Any notice given by telex or fax shall be deemed received on the next business day if it is received after 5:00 p.m. (recipient's time) or on a nonbusiness day.

6. E-mail transmission. When sent by e-mail using software that provides unmodifiable proof (i) that the message was sent, (ii) that the message was delivered to the recipient's information processing system, and (iii) of the time and date the message was delivered to
the recipient along with a verifiable electronic record of the exact content of the message sent.

Addresses for the purpose of giving notice are as shown in Paragraph B.(1) of this Agreement.

(b) Any correctly addressed notice that is refused, unclaimed, or undeliverable because of an act or omission of the party to be notified shall be deemed effective as of the first date that said notice was refused, unclaimed, or deemed undeliverable by the postal authorities, messenger or overnight delivery service.

(c) Any party may change its address, telex, fax number, or e-mail address by giving the other party notice of the change in any manner permitted by this Agreement.

(d) All notices, requests, demands, amendments, modifications or other communications under this Agreement shall be in writing. Notice shall be sufficient for all such purposes if personally delivered, sent by first class, registered or certified mail, return receipt requested, delivery by courier with receipt of delivery, facsimile transmission with written confirmation of receipt by recipient, or e-mail delivery with verifiable and unmodifiable proof of content and time and date of sending by sender and delivery to recipient. Notice is effective on confirmed receipt by recipient or 3 business days after sending, whichever is sooner.

(4) Modification

This Agreement may be supplemented, amended, or modified only by the mutual agreement of the parties. No supplement, amendment, or modification of this Agreement shall be binding unless it is in writing and signed by the party to be charged.

(5) Survival

All representations, warranties, and covenants contained in this Agreement, or in any instrument, certificate, exhibit, or other writing intended by the parties to be a part of their Agreement shall survive the termination of this Agreement until such time as all amounts in Employer's Prefunding Account have been disbursed.

(6) Waiver

No waiver of a breach, failure of any condition, or any right or remedy contained in or granted by the provisions of this Agreement shall be effective unless it is in writing and signed by the party waiving the breach, failure, right, or remedy. No waiver of any breach, failure, right, or remedy shall be deemed a waiver of any other breach, failure, right, or remedy, whether or not similar, nor shall any waiver constitute a continuing waiver unless the writing so specifies.
(7) Necessary Acts, Further Assurances

The parties shall at their own cost and expense execute and deliver such further documents and instruments and shall take such other actions as may be reasonably required or appropriate to evidence or carry out the intent and purposes of this Agreement.

A majority vote of Employer’s Governing Body at a public meeting held on the ___1st___ day of the month of ___October___ in the year ___2013___, authorized entering into this Agreement.

Signature of the Presiding Officer: __________________________________________

Printed Name of the Presiding Officer:  Steven Hwangbo, Mayor

Name of Governing Body:  City Council of the City of La Palma

Name of Employer:  City of La Palma

Date: _______________________________

BOARD OF ADMINISTRATION
CALIFORNIA PUBLIC EMPLOYEES’ RETIREMENT SYSTEM

BY____________________________________
RAND ANDERSON
AFFILIATE PROGRAM SERVICES DIVISION
CALIFORNIA PUBLIC EMPLOYEES’ RETIREMENT SYSTEM

To be completed by CalPERS

The effective date of this Agreement is: ___________________________
DELEGATION OF AUTHORITY
TO REQUEST DISBURSEMENTS

RESOLUTION
OF THE
City Council of the City of La Palma
(GOVERNING BODY)

OF THE
City of La Palma
(NAME OF EMPLOYER)

The __________ City Council of the City of La Palma ________ delegates to the incumbents
(GOVERNING BODY)
in the positions of ______________ Finance Director _______________ and
(TITLE)

________________________ City Manager
(TITLE)

________________________ Accountant
(TITLE)

authority to request on
behalf of the Employer disbursements from the Other Post Employment Prefunding
Plan and to certify as to the purpose for which the disbursed funds will be used.

By __________________________

Title __________________________

Witness __________________________

Date __________________________

OPEB Delegation of Authority (1/13)
RESOLUTION NO. 2013-__

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF LA PALMA AMENDING THE FISCAL YEAR 2013-14 BUDGET FOR THE PURPOSE OF PRE-FUNDING AN IRREVOCABLE TRUST ESTABLISHED WITH THE CALIFORNIA EMPLOYERS’ RETIREE BENEFIT TRUST PROGRAM (CERBT)

WHEREAS, the City of La Palma has established a trust through separate action and resolution with the California Employers’ Retiree Benefit Trust (CERBT) program; and

WHEREAS, the City Council of the City of La Palma has directed that the CERBT trust be pre-funded by utilizing available General Fund reserves in order to further and immediately reduce the City’s unfunded liability associated with its Other Post Employment Benefits (OPEB) program; and

WHEREAS, the City of La Palma retains sufficient reserves to effectuate the pre-funding of the trust and the transfer of said funds to CERBT during the course of Fiscal Year 2013-14; and

WHEREAS, the pre-funding and transfer of funds to CERBT requires amending the Fiscal Year 2013-14 budget by appropriating funds from available General Fund unassigned fund balance.

NOW, THEREFORE, the City Council of the City of La Palma hereby amends the Fiscal Year 2013-14 budget accordingly:

SECTION 1: Appropriate funds from the General Fund unassigned fund balance by amending the General Fund Transfers Out account (001-995-990.000) in the amount of $1,500,000

SECTION 2: Amend the Employee Benefits Internal Service Fund Transfer In account (061-000-495.100) in the amount of $1,500,000

SECTION 3: Amend the Employee Benefits Internal Service Fund account (061-610-550.100) in the amount of $1,500,000, which will be the account utilized to make the expenditure and transfer of funds to CERBT during the course of the 2013-14 fiscal year.

APPROVED AND ADOPTED by the City Council of the City of La Palma at a regular meeting held on the 1st day of October 2013.
ATTEST:

______________________________
Laurie A. Murray, CMC
City Clerk

STATE OF CALIFORNIA  )
COUNTY OF ORANGE   )   SS
CITY OF LA PALMA   )

I, LAURIE A. MURRAY, City Clerk of the City of La Palma, California, DO HEREBY CERTIFY that the foregoing resolution was adopted by the City Council of said City at a regular meeting of said City Council held on the 1st day of October 2013, and that it was so adopted by called vote as follows:

AYES:

NOES:

______________________________
Laurie A. Murray, City Clerk
SECTION I: Asset Allocation Strategy and Discount Rate Selection

I certify that
1. My agency chooses the following asset allocation strategy
   Select one Asset Allocation Strategy and the corresponding Discount Rate

<table>
<thead>
<tr>
<th>Asset Allocation Strategy</th>
<th>Discount Rate with NO MFAD adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>X  Strategy 1</td>
<td>7.61%</td>
</tr>
<tr>
<td>□  Strategy 2</td>
<td>7.06%</td>
</tr>
<tr>
<td>□  Strategy 3</td>
<td>6.39%</td>
</tr>
</tbody>
</table>

2. My agency elects to use a Margin for Adverse Deviation (MFAD)
   □  No
   □  Yes

   * If “Yes”, then identify that MFAD percentage here: 0._____%

3. The discount rate net of MFAD is _______%

SECTION II: ARC Funding

As the employer, I certify that our funding policy is to contribute consistently an amount that is equal to (select one):

 Voll ARC Funding:
   □  100 % of the ARC as determined in our OPEB valuation (or AMM) dated ________, 20______, which used an average actuarial Discount Rate of ____.____%.

Partial ARC Funding:
   □  _________% of the ARC as determined in our OPEB valuation (or AMM if it applies) dated ________, 20______ which used a blended actuarial Discount Rate of _______% where the base short-term investment Discount Rate is _______%.
We will contribute to the trust using an approach not directly related to the ARC. (In the space provided below, please describe your funding approach and how the approach relates to the average discount rate assumption made by your actuary in the OPEB valuation (or AMM if it applies) dated June 30, 2013, which used a blended actuarial Discount Rate of 7.25% where the base short-term investment Discoun...)

Planning to make lump sum payment of $1.5 million during the 2013-14 fiscal year with plans to fully fund 100% of the ARC on an annual basis.

SECTION III: ARC Contribution Method

We plan to contribute toward the ARC in the following manner (select one):

☐ Contribute our full ARC payments to the trust and seek reimbursements for Pay-go costs

☐ Contribute our ARC payments to the trust net of Pay-go costs and not seek reimbursements (ARC minus Pay-go = Trust Contribution)

☒ Other (Please describe):

Planning to make lump sum payment of $1.5 million during the 2013-14 fiscal year with plans to fully fund 100% of the ARC on an annual basis.

SECTION IV: Years of ARC Coverage

This OPEB valuation provides ARC amounts for the following periods:

(AARC dates should correspond with Item No. 10.0 in Summary of Actuarial Information)

First Year: From July 1, 2013 through June 30, 2014.
Second Year: From July 1, 2014 through June 30, 2015.

The California Employers' Retiree Benefit Trust (CERBT) fund plan includes more than 200 members. We understand that, under GASB 43, paragraph 33, as an employer participating in the CalPERS CERBT, we must obtain an actuarial valuation (or AMM if it applies) on at least a biennial basis.
We understand that we will be asked to provide accounting information to CalPERS as required in order to facilitate CalPERS compliance with GASB 43 reporting requirements, and we agree to make any information requested available to CalPERS on a timely basis. Our contact information is noted below.

We understand that CalPERS will provide us with our Statement of Plan Net Assets and our Statement of Changes in Plan Net Assets, which can be used to prepare our GASB 45 reporting. CalPERS will report aggregated GASB 43 information pertaining to the Funded Status and Funding Progress.

June 30, 2013
Date of OPEB Valuation (or AMM if it applies)

City of La Palma
Name of Employer

Michael Solorza, Finance Director
Printed Name and Title of Person Signing the Form

Signature ___________________________ Date __________

Michael Solorza
Designated Employer Contact Name for GASB Reporting
714-690-3323  michaels@cityoflapalma.org
Phone #  Email Address

Instructions to complete the form
SECTION I: Asset allocation Strategy and Discount Rate Selection

Check the box next to the Asset Allocation Strategy on which you have based your OPEB actuarial valuation or Alternative Measurement Method (AMM) cost report. Each strategy has a different assumed Discount Rate and risk profile. Your CERBT assets will be invested using the Asset Allocation Strategy indicated here.

Check the box to show whether your actuary applied a Margin for Adverse Deviation the expected assumed discount rate for your portfolio. If reducing the expected rate of return for a Margin for Adverse Deviation please indicate the percentage adjustment for the Margin for Adverse Deviation in the location indicated and then indicate the appropriate net rate of return resulting when the full rate of return has been reduced by a selected by your consulting actuary.

*The choices you check off on this form should match those used by your actuary in the OPEB valuation.*

SECTION II: ARC Funding

- If you are fully funding, check the first box indicating the 100% funding, the applicable Discount Rate, and the valuation date.
- If you are funding at less than 100%, check the second box to indicate the percentage of funding [trust contributions plus paygo (and Implicit Rate Subsidy if applicable) divided by ARC], the valuation date, the Discount Rate, and the Base rate used to blend.
- If you are funding at less than 100% and your contributions are not tied specifically to the ARC, then indicate how you expect to contribute. For example, if you intend to make unreimbursed pay-go payments plus a fixed dollar amount to the trust, then describe this in the space provided.

SECTION III: ARC Contribution Method

Here we ask you to indicate how you expect to make contributions to the trust: Full ARC with reimbursements, ARC net of paygo, or something else (please describe).

SECTION IV: Years of ARC Coverage

Generally, your OPEB valuation will provide two years of ARC coverage. Please identify the specific periods to which the ARC applies.
City of La Palma
Actuarial Study of
Retiree Health Liabilities
As of June 30, 2013

Prepared by:
Total Compensation Systems, Inc.

Date: September 19, 2013
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PART I: EXECUTIVE SUMMARY

A. Introduction

City of La Palma engaged Total Compensation Systems, Inc. (TCS) to analyze liabilities associated with its current retiree health program as of June 30, 2013 (the valuation date). The numbers in this report are based on the assumption that they will first be used to determine accounting entries for the fiscal year ending June 30, 2014. If the report will first be used for a different fiscal year, the numbers will need to be adjusted accordingly.

This report does not reflect any cash benefits paid unless the retiree is required to provide proof that the cash benefits are used to reimburse the retiree’s cost of health benefits. Costs and liabilities attributable to cash benefits paid to retirees are reportable under Governmental Accounting Standards Board (GASB) Standards 25/27.

This actuarial study is intended to serve the following purposes:

- To provide information to enable La Palma to manage the costs and liabilities associated with its retiree health benefits.
- To provide information to enable La Palma to communicate the financial implications of retiree health benefits to internal financial staff, the Council, employee groups and other affected parties.
- To provide information needed to comply with Governmental Accounting Standards Board Accounting Standards 43 and 45 related to "other postemployment benefits" (OPEB's).

Because this report was prepared in compliance with GASB 43 and 45, as appropriate, La Palma should not use this report for any other purpose without discussion with TCS. This means that any discussions with employee groups, governing Boards, etc. should be restricted to the implications of GASB 43 and 45 compliance.

This actuarial report includes several estimates for La Palma’s retiree health program. In addition to the tables included in this report, we also performed cash flow adequacy tests as required under Actuarial Standard of Practice 6 (ASOP 6). Our cash flow adequacy testing covers a twenty-year period. We would be happy to make this cash flow adequacy test available to La Palma in spreadsheet format upon request.

We calculated the following estimates separately for active employees and retirees. As requested, we also separated results by the following employee classifications: General Employees, Management, Police Officers and Professional Employees. We estimated the following:

- the total liability created. (The actuarial present value of total projected benefits or APVTPB)
- the ten year "pay-as-you-go" cost to provide these benefits.
- the "actuarial accrued liability (AAL)." (The AAL is the portion of the APVTPB attributable to employees’ service prior to the valuation date.)
- the amount necessary to amortize the UAAL over a period of 30 years.
the annual contribution required to fund retiree benefits over the working lifetime of eligible employees (the "normal cost").

The Annual Required Contribution (ARC) which is the basis of calculating the annual OPEB cost and net OPEB obligation under GASB 43 and 45.

We summarized the data used to perform this study in Appendix A. No effort was made to verify this information beyond brief tests for reasonableness and consistency.

All cost and liability figures contained in this study are estimates of future results. Future results can vary dramatically and the accuracy of estimates contained in this report depends on the actuarial assumptions used. Normal costs and liabilities could easily vary by 10 - 20% or more from estimates contained in this report.

B. General Findings

We estimate the "pay-as-you-go" cost of providing retiree health benefits in the year beginning July 1, 2013 to be $120,878 (see Section IV.A.). The “pay-as-you-go” cost is the cost of benefits for current retirees.

For current employees, the value of benefits "accrued" in the year beginning July 1, 2013 (the normal cost) is $28,715. This normal cost would increase each year based on covered payroll. Had La Palma begun accruing retiree health benefits when each current employee and retiree was hired, a substantial liability would have accumulated. We estimate the amount that would have accumulated to be $1,893,010. This amount is called the "actuarial accrued liability" (AAL). The remaining unamortized balance of the initial unfunded AAL (UAAL) is $2,493,669. This leaves a “residual” AAL of negative $600,659.

La Palma has established a GASB 43 trust for future OPEB benefits. The actuarial value of plan assets at June 30, 2013 was $1,500,000. This leaves a residual unfunded actuarial accrued liability (UAAL) of negative $2,100,659. We used a 7.25% discount rate. We used an open 30 year amortization period. The current year cost to amortize the residual unfunded actuarial accrued liability is negative $127,141.

Combining the normal cost with both the initial and residual UAAL amortization costs produces an annual required contribution (ARC) of $68,584. The ARC is used as the basis for determining expenses and liabilities under GASB 43/45. The ARC is used in lieu of (rather than in addition to) the “pay-as-you-go” cost.

We based all of the above estimates on employees as of June, 2013. Over time, liabilities and cash flow will vary based on the number and demographic characteristics of employees and retirees.

C. Description of Retiree Benefits

Following is a description of the current retiree benefit plan:
D. Recommendations

It is outside the scope of this report to make specific recommendations of actions La Palma should take to manage the substantial liability created by the current retiree health program. Total Compensation Systems, Inc. can assist in identifying and evaluating options once this report has been studied. The following recommendations are intended only to allow the City to get more information from this and future studies. Because we have not conducted a comprehensive administrative audit of La Palma’s practices, it is possible that La Palma is already complying with some or all of our recommendations.

- We recommend that La Palma inventory all benefits and services provided to retirees – whether contractually or not and whether retiree-paid or not. For each, La Palma should determine whether the benefit is material and subject to GASB 43 and/or 45.

- We recommend that La Palma conduct a study whenever events or contemplated actions significantly affect present or future liabilities, but no less frequently than every two years, as required under GASB 43/45.

- We recommend that the City communicate the magnitude of these costs to employees and include employees in discussions of options to control the costs.

- Under GASB 45, it is important to isolate the cost of retiree health benefits. La Palma should have all premiums, claims and expenses for retirees separated from active employee premiums, claims, expenses, etc. To the extent any retiree benefits are made available to retirees over the age of 65 – even on a retiree-pay-all basis – all premiums, claims and expenses for post-65 retiree coverage should be segregated from those for pre-65 coverage. Furthermore, La Palma should arrange for the rates or prices of all retiree benefits to be set on what is expected to be a self-sustaining basis.

- La Palma should establish a way of designating employees as eligible or ineligible for future OPEB benefits. Ineligible employees can include those in ineligible job classes; those hired after a designated date restricting eligibility; those who, due to their age at hire cannot qualify for City-paid OPEB benefits; employees who exceed the termination age for OPEB benefits, etc.

- Several assumptions were made in estimating costs and liabilities under La Palma’s retiree health program. Further studies may be desired to validate any assumptions where there is any doubt that the assumption is appropriate. (See Appendices B and C for a list of

*18 months at full single premium
Total Compensation Systems, Inc.

assumptions and concerns.) For example, La Palma should maintain a retiree database that includes – in addition to date of birth, gender and employee classification – retirement date and (if applicable) dependent date of birth, relationship and gender. It will also be helpful for La Palma to maintain employment termination information – namely, the number of OPEB-eligible employees in each employee class that terminate employment each year for reasons other than death, disability or retirement.

Respectfully submitted,

Geoffrey L. Kischuk, FSA, MAAA, FCA
Consultant
Total Compensation Systems, Inc.
(805) 496-1700
PART II: BACKGROUND

A. Summary

Accounting principles provide that the cost of retiree benefits should be “accrued” over employees' working lifetime. For this reason, the Governmental Accounting Standards Board (GASB) issued in 2004 Accounting Standards 43 and 45 for retiree health benefits. These standards apply to all public employers that pay any part of the cost of retiree health benefits for current or future retirees (including early retirees).

B. Actuarial Accrual

To actuarially accrue retiree health benefits requires determining the amount to expense each year so that the liability accumulated at retirement is, on average, sufficient (with interest) to cover all retiree health expenditures without the need for additional expenses. There are many different ways to determine the annual accrual amount. The calculation method used is called an “actuarial cost method.”

Under most actuarial cost methods, there are two components of actuarial cost - a “normal cost” and amortization of something called the “unfunded actuarial accrued liability.” Both accounting standards and actuarial standards usually address these two components separately (though alternative terminology is sometimes used).

The normal cost can be thought of as the value of the benefit earned each year if benefits are accrued during the working lifetime of employees. This report will not discuss differences between actuarial cost methods or their application. Instead, following is a description of a commonly used, generally accepted actuarial cost method that will be permitted under GASB 43 and 45. This actuarial cost method is called the “entry age normal” method.

Under the entry age normal cost method, the actuary determines the annual amount needing to be expensed from hire until retirement to fully accrue the cost of retiree health benefits. This amount is the normal cost. Under GASB 43 and 45, normal cost can be expressed either as a level dollar amount or a level percentage of payroll.

The normal cost is determined using several key assumptions:

- The current cost of retiree health benefits (often varying by age, Medicare status and/or dependent coverage). The higher the current cost of retiree benefits, the higher the normal cost.

- The “trend” rate at which retiree health benefits are expected to increase over time. A higher trend rate increases the normal cost. A “cap” on City contributions can reduce trend to zero once the cap is reached thereby dramatically reducing normal costs.

- Mortality rates varying by age and sex. (Unisex mortality rates are not often used as individual OPEB benefits do not depend on the mortality table used.) If employees die prior to retirement, past contributions are available to fund benefits for employees who live to retirement. After retirement, death results in benefit termination or reduction. Although higher mortality rates reduce normal costs, the mortality assumption is not likely to vary from employer to employer.

- Employment termination rates have the same effect as mortality inasmuch as higher termination rates reduce normal costs. Employment termination can vary considerably between public agencies.

- The service requirement reflects years of service required to earn full or partial retiree benefits.
While a longer service requirement reduces costs, cost reductions are not usually substantial unless the service period exceeds 20 years of service.

- **Retirement rates** determine what proportion of employees retire at each age (assuming employees reach the requisite length of service). Retirement rates often vary by employee classification and implicitly reflect the minimum retirement age required for eligibility. Retirement rates also depend on the amount of pension benefits available. Higher retirement rates increase normal costs but, except for differences in minimum retirement age, retirement rates tend to be consistent between public agencies for each employee type.

- **Participation rates** indicate what proportion of retirees are expected to elect retiree health benefits if a significant retiree contribution is required. Higher participation rates increase costs.

- The **discount rate** estimates investment earnings for assets earmarked to cover retiree health benefit liabilities. The discount rate depends on the nature of underlying assets. For example, employer funds earning money market rates in the county treasury are likely to earn far less than an irrevocable trust containing a diversified asset portfolio including stocks, bonds, etc. A higher discount rate can dramatically lower normal costs. GASB 43 and 45 require the interest assumption to reflect likely long term investment return.

The assumptions listed above are not exhaustive, but are the most common assumptions used in actuarial cost calculations. The actuary selects the assumptions which - taken together - will yield reasonable results. It's not necessary (or even possible) to predict individual assumptions with complete accuracy.

If all actuarial assumptions are exactly met and an employer expensed the normal cost every year for all past and current employees and retirees, a sizeable liability would have accumulated (after adding interest and subtracting retiree benefit costs). The liability that would have accumulated is called the actuarial accrued liability or AAL. The excess of AAL over the actuarial value of plan assets is called the unfunded actuarial accrued liability (or UAAL). Under GASB 43 and 45, in order for assets to count toward offsetting the AAL, the assets have to be held in an irrevocable trust that is safe from creditors and can only be used to provide OPEB benefits to eligible participants.

The actuarial accrued liability (AAL) can arise in several ways. At inception of GASB 43 and 45, there is usually a substantial UAAL. Some portion of this amount can be established as the "transition obligation" subject to certain constraints. UAAL can also increase as the result of operation of a retiree health plan - e.g., as a result of plan changes or changes in actuarial assumptions. Finally, AAL can arise from actuarial gains and losses. Actuarial gains and losses result from differences between actuarial assumptions and actual plan experience.

Under GASB 43 and 45, employers have several options on how the UAAL can be amortized as follows:

- The employer can select an amortization period of 1 to 30 years. (For certain situations that result in a reduction of the AAL, the amortization period must be at least 10 years.)

- The employer may apply the same amortization period to the total combined UAAL or can apply different periods to different components of the UAAL.

- The employer may elect a “closed” or “open” amortization period.

- The employer may choose to amortize on a level dollar or level percentage of payroll method.
PART III: LIABILITIES AND COSTS FOR RETIREE BENEFITS

A. Introduction

We calculated the actuarial present value of projected benefits (APVPB) separately for each employee. We determined eligibility for retiree benefits based on information supplied by La Palma. We then selected assumptions for the factors discussed in the above Section that, based on plan experience and our training and experience, represent our best prediction of future plan experience. For each employee, we applied the appropriate factors based on the employee's age, sex and length of service.

We summarized actuarial assumptions used for this study in Appendix C.

B. Medicare

The extent of Medicare coverage can affect projections of retiree health costs. The method of coordinating Medicare benefits with the retiree health plan's benefits can have a substantial impact on retiree health costs. We will be happy to provide more information about Medicare integration methods if requested.

C. Liability for Retiree Benefits.

For each employee, we projected future premium costs using an assumed trend rate (see Appendix C). To the extent La Palma uses contribution caps, the influence of the trend factor is further reduced.

We multiplied each year's projected cost by the probability that premium will be paid; i.e. based on the probability that the employee is living, has not terminated employment and has retired. The probability that premium will be paid is zero if the employee is not eligible. The employee is not eligible if s/he has not met minimum service, minimum age or, if applicable, maximum age requirements.

The product of each year's premium cost and the probability that premium will be paid equals the expected cost for that year. We discounted the expected cost for each year to the valuation date June 30, 2013 at 7.25% interest.

Finally, we multiplied the above discounted expected cost figures by the probability that the retiree would elect coverage. A retiree may not elect to be covered if retiree health coverage is available less expensively from another source (e.g. Medicare risk contract) or the retiree is covered under a spouse's plan.

For any current retirees, the approach used was similar. The major difference is that the probability of payment for current retirees depends only on mortality and age restrictions (i.e. for retired employees the probability of being retired and of not being terminated are always both 1.0000).

We added the APVPB for all employees to get the actuarial present value of total projected benefits (APVTBP). The APVTBP is the estimated present value of all future retiree health benefits for all current employees and retirees. The APVTBP is the amount on June 30, 2013 that, if all actuarial assumptions are exactly right, would be sufficient to expense all promised benefits until the last current employee or retiree dies or reaches the maximum eligibility age.
Total Compensation Systems, Inc.

Actuarial Present Value of Total Projected Benefits at June 30, 2013

<table>
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<th></th>
<th>Total</th>
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<td>$453,130</td>
<td>$107,527</td>
<td>$26,637</td>
<td>$279,883</td>
<td>$39,083</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>$828,444</td>
<td>$155,170</td>
<td>$34,968</td>
<td>$579,423</td>
<td>$58,883</td>
</tr>
<tr>
<td>Retiree: Pre-65</td>
<td>$291,422</td>
<td>$33,088</td>
<td>$8,706</td>
<td>$249,628</td>
<td>$0</td>
</tr>
<tr>
<td>Post-65</td>
<td>$1,010,329</td>
<td>$62,917</td>
<td>$30,578</td>
<td>$916,834</td>
<td>$0</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td>$1,301,751</td>
<td>$96,005</td>
<td>$39,284</td>
<td>$1,166,462</td>
<td>$0</td>
</tr>
<tr>
<td><strong>Grand Total</strong></td>
<td>$2,130,195</td>
<td>$251,175</td>
<td>$74,252</td>
<td>$1,745,885</td>
<td>$58,883</td>
</tr>
<tr>
<td>Subtotal Pre-65</td>
<td>$666,736</td>
<td>$80,731</td>
<td>$17,037</td>
<td>$549,168</td>
<td>$19,800</td>
</tr>
<tr>
<td>Subtotal Post-65</td>
<td>$1,463,459</td>
<td>$170,444</td>
<td>$57,215</td>
<td>$1,196,717</td>
<td>$39,083</td>
</tr>
</tbody>
</table>

The APVTPB should be accrued over the working lifetime of employees. At any time much of it has not been “earned” by employees. The APVTPB is used to develop expense and liability figures. To do so, the APVTB is divided into two parts: the portions attributable to service rendered prior to the valuation date (the past service liability or actuarial accrued liability under GASB 43 and 45) and to service after the valuation date but prior to retirement (the future service liability).

The past service and future service liabilities are each funded in a different way. We will start with the future service liability which is funded by the normal cost.

**D. Cost to Prefund Retiree Benefits**

1. **Normal Cost**

   The average hire age for eligible employees is 33. To accrue the liability by retirement, the City would accrue the retiree liability over a period of about 24 years (assuming an average retirement age of 57). We applied an "entry age normal" actuarial cost method to determine funding rates for active employees. The table below summarizes the calculated normal cost.

**Normal Cost Year Beginning June 30, 2013**

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>General Employees</th>
<th>Management</th>
<th>Police Officers</th>
<th>Professional Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td># of Employees</td>
<td>55</td>
<td>16</td>
<td>4</td>
<td>29</td>
<td>6</td>
</tr>
<tr>
<td><strong>Per Capita Normal Cost</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-65 Benefit</td>
<td>N/A</td>
<td>$107</td>
<td>$214</td>
<td>$270</td>
<td>$70</td>
</tr>
<tr>
<td>Post-65 Benefit</td>
<td>N/A</td>
<td>$294</td>
<td>$736</td>
<td>$311</td>
<td>$205</td>
</tr>
<tr>
<td><strong>First Year Normal Cost</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pre-65 Benefit</td>
<td>$10,818</td>
<td>$1,712</td>
<td>$856</td>
<td>$7,830</td>
<td>$420</td>
</tr>
<tr>
<td>Post-65 Benefit</td>
<td>$17,897</td>
<td>$4,704</td>
<td>$2,944</td>
<td>$9,019</td>
<td>$1,230</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$28,715</td>
<td>$6,416</td>
<td>$3,800</td>
<td>$16,849</td>
<td>$1,650</td>
</tr>
</tbody>
</table>

Accruing retiree health benefit costs using normal costs levels out the cost of retiree health benefits over time and more fairly reflects the value of benefits "earned" each year by employees. This normal cost would increase each year based on covered payroll.
2. Amortization of Unfunded Actuarial Accrued Liability (UAAL)

If actuarial assumptions are borne out by experience, the City will fully accrue retiree benefits by expensing an amount each year that equals the normal cost. If no accruals had taken place in the past, there would be a shortfall of many years’ accruals, accumulated interest and forfeitures for terminated or deceased employees. This shortfall is called the actuarial accrued liability (AAL). We calculated the AAL as the APVTPB minus the present value of future normal costs.

The initial UAAL was amortized using a closed amortization period of 30 years. The City can amortize the remaining or residual UAAL over many years. The table below shows the annual amount necessary to amortize the UAAL over a period of 30 years at 7.25% interest. (Thirty years is the longest amortization period allowable under GASB 43 and 45.) GASB 43 and 45 will allow amortizing the UAAL using either payments that stay the same as a dollar amount, or payments that are a flat percentage of covered payroll over time. The figures below reflect the level percentage of payroll method.

### Actuarial Accrued Liability as of June 30, 2013

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>General Employees</th>
<th>Management</th>
<th>Police Officers</th>
<th>Professional Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active: Pre-65</td>
<td>$283,648</td>
<td>$33,586</td>
<td>$3,904</td>
<td>$230,510</td>
<td>$15,648</td>
</tr>
<tr>
<td>Post-65</td>
<td>$307,610</td>
<td>$68,904</td>
<td>$11,410</td>
<td>$200,371</td>
<td>$26,925</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$591,258</td>
<td>$102,490</td>
<td>$15,314</td>
<td>$430,881</td>
<td>$42,573</td>
</tr>
<tr>
<td>Retiree: Pre-65</td>
<td>$291,422</td>
<td>$33,088</td>
<td>$8,706</td>
<td>$249,628</td>
<td>$0</td>
</tr>
<tr>
<td>Post-65</td>
<td>$1,010,329</td>
<td>$62,917</td>
<td>$30,578</td>
<td>$916,834</td>
<td>$0</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$1,301,751</td>
<td>$96,005</td>
<td>$39,284</td>
<td>$1,166,462</td>
<td>$0</td>
</tr>
<tr>
<td>Subtot Pre-65</td>
<td>$575,070</td>
<td>$66,674</td>
<td>$12,610</td>
<td>$480,138</td>
<td>$15,648</td>
</tr>
<tr>
<td>Subtot Post-65</td>
<td>$1,317,939</td>
<td>$131,821</td>
<td>$41,988</td>
<td>$1,117,205</td>
<td>$26,925</td>
</tr>
<tr>
<td>Grand Total</td>
<td>$1,893,010</td>
<td>$198,496</td>
<td>$54,598</td>
<td>$1,597,343</td>
<td>$42,573</td>
</tr>
<tr>
<td>Unamortized Initial UAAL</td>
<td>$2,493,669</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plan assets at 6/30/13</td>
<td>$1,500,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residual UAAL</td>
<td>($2,100,659)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residual UAAL Amortization at 7.25% over 30 Years</td>
<td>($127,141)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. Annual Required Contributions (ARC)

If the City determines retiree health plan expenses in accordance with GASB 43 and 45, costs will include both normal cost and one or more components of UAAL amortization costs. The sum of normal cost and UAAL amortization costs is called the Annual Required Contribution (ARC) and is shown below.
### Annual Required Contribution (ARC) Year Beginning July 1, 2013

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normal Cost</td>
<td>$28,715</td>
</tr>
<tr>
<td>Initial UAAL Amortization</td>
<td>$167,010</td>
</tr>
<tr>
<td>Residual UAAL Amortization</td>
<td>($127,141)</td>
</tr>
<tr>
<td><strong>ARC</strong></td>
<td><strong>$68,584</strong></td>
</tr>
</tbody>
</table>

The normal cost remains as long as there are active employees who may some day qualify for City-paid retiree health benefits. This normal cost would increase each year based on covered payroll.

#### 4. Other Components of Annual OPEB Cost (AOC)

Expense and liability amounts may include more components of cost than the normal cost plus amortization of the UAAL. This will apply to employers that don’t fully fund the Annual Required Cost (ARC) through an irrevocable trust.

- The annual OPEB cost (AOC) will include assumed interest on the net OPEB obligation (NOO). The annual OPEB cost will also include an amortization adjustment for the net OPEB obligation. (It should be noted that there is no NOO if the ARC is fully funded through a qualifying “plan”.)

- The net OPEB obligation will equal the accumulated differences between the (AOC) and qualifying “plan” contributions.
PART IV: "PAY AS YOU GO" FUNDING OF RETIREE BENEFITS

We used the actuarial assumptions shown in Appendix C to project ten year cash flow under the retiree health program. Because these cash flow estimates reflect average assumptions applied to a relatively small number of employees, estimates for individual years are certain to be inaccurate. However, these estimates show the size of cash outflow.

The following table shows a projection of annual amounts needed to pay the City share of retiree health premiums.

<table>
<thead>
<tr>
<th>Year Beginning July 1</th>
<th>Total</th>
<th>General Employees</th>
<th>Management</th>
<th>Police Officers</th>
<th>Professional Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>$120,878</td>
<td>$5,808</td>
<td>$2,820</td>
<td>$112,250</td>
<td>$0</td>
</tr>
<tr>
<td>2014</td>
<td>$122,936</td>
<td>$6,283</td>
<td>$2,945</td>
<td>$113,708</td>
<td>$0</td>
</tr>
<tr>
<td>2015</td>
<td>$127,678</td>
<td>$7,135</td>
<td>$3,157</td>
<td>$117,314</td>
<td>$72</td>
</tr>
<tr>
<td>2016</td>
<td>$131,897</td>
<td>$8,018</td>
<td>$3,391</td>
<td>$120,352</td>
<td>$136</td>
</tr>
<tr>
<td>2017</td>
<td>$135,714</td>
<td>$8,815</td>
<td>$3,854</td>
<td>$122,840</td>
<td>$205</td>
</tr>
<tr>
<td>2018</td>
<td>$139,103</td>
<td>$9,721</td>
<td>$4,131</td>
<td>$124,879</td>
<td>$372</td>
</tr>
<tr>
<td>2019</td>
<td>$143,012</td>
<td>$10,820</td>
<td>$4,416</td>
<td>$127,198</td>
<td>$578</td>
</tr>
<tr>
<td>2020</td>
<td>$149,118</td>
<td>$11,958</td>
<td>$4,679</td>
<td>$131,570</td>
<td>$911</td>
</tr>
<tr>
<td>2021</td>
<td>$153,067</td>
<td>$13,033</td>
<td>$4,984</td>
<td>$133,878</td>
<td>$1,172</td>
</tr>
<tr>
<td>2022</td>
<td>$157,003</td>
<td>$14,174</td>
<td>$5,239</td>
<td>$136,051</td>
<td>$1,539</td>
</tr>
</tbody>
</table>
PART V: RECOMMENDATIONS FOR FUTURE VALUATIONS

To effectively manage benefit costs, an employer must periodically examine the existing liability for retiree benefits as well as future annual expected premium costs. GASB 43/45 require biennial valuations. In addition, a valuation should be conducted whenever plan changes, changes in actuarial assumptions or other employer actions are likely to cause a material change in accrual costs and/or liabilities.

Following are examples of actions that could trigger a new valuation.

➢ An employer should perform a valuation whenever the employer considers or puts in place an early retirement incentive program.

➢ An employer should perform a valuation whenever the employer adopts a retiree benefit plan for some or all employees.

➢ An employer should perform a valuation whenever the employer considers or implements changes to retiree benefit provisions or eligibility requirements.

➢ An employer should perform a valuation whenever the employer introduces or changes retiree contributions.

We recommend La Palma take the following actions to ease future valuations.

➢ We have used our training, experience and information available to us to establish the actuarial assumptions used in this valuation. We have no information to indicate that any of the assumptions do not reasonably reflect future plan experience. However, the City should review the actuarial assumptions in Appendix C carefully. If the City has any reason to believe that any of these assumptions do not reasonably represent the expected future experience of the retiree health plan, the City should engage in discussions or perform analyses to determine the best estimate of the assumption in question.
PART VI: APPENDICES

APPENDIX A: MATERIALS USED FOR THIS STUDY

We relied on the following materials to complete this study.

- We used paper reports and digital files containing employee demographic data from the City personnel records.
- We used relevant sections of collective bargaining agreements provided by the City.
APPENDIX B: EFFECT OF ASSUMPTIONS USED IN CALCULATIONS

While we believe the estimates in this study are reasonable overall, it was necessary for us to use assumptions which inevitably introduce errors. We believe that the errors caused by our assumptions will not materially affect study results. If the City wants more refined estimates for decision-making, we recommend additional investigation. Following is a brief summary of the impact of some of the more critical assumptions.

1. Where actuarial assumptions differ from expected experience, our estimates could be overstated or understated. One of the most critical assumptions is the medical trend rate. The City may want to commission further study to assess the sensitivity of liability estimates to our medical trend assumptions. For example, it may be helpful to know how liabilities would be affected by using a trend factor 1% higher than what was used in this study. There is an additional fee required to calculate the impact of alternative trend assumptions.

2. We used an "entry age normal" actuarial cost method to estimate the actuarial accrued liability and normal cost. GASB allows this as one of several permissible methods under GASB45. Using a different cost method could result in a somewhat different recognition pattern of costs and liabilities.
APPENDIX C: ACTUARIAL ASSUMPTIONS AND METHODS

Following is a summary of actuarial assumptions and methods used in this study. The City should carefully review these assumptions and methods to make sure they reflect the City's assessment of its underlying experience. It is important for La Palma to understand that the appropriateness of all selected actuarial assumptions and methods are La Palma’s responsibility. Unless otherwise disclosed in this report, TCS believes that all methods and assumptions are within a reasonable range based on the provisions of GASB 43 and 45, applicable actuarial standards of practice, La Palma’s actual historical experience, and TCS’s judgment based on experience and training.

ACTUARIAL METHODS AND ASSUMPTIONS:

**ACTUARIAL COST METHOD:** Entry age normal. The allocation of OPEB cost is based on years of service. We used the level percentage of payroll method to allocate OPEB cost over years of service.

Entry age is based on the age at hire for eligible employees. The attribution period is determined as the difference between the expected retirement age and the age at hire. The present value of future benefits and present value of future normal costs are determined on an employee by employee basis and then aggregated.

To the extent that different benefit formulas apply to different employees of the same class, the normal cost is based on the benefit plan applicable to the most recently hired employees (including future hires if a new benefit formula has been agreed to and communicated to employees).

**AMORTIZATION METHODS:** We used a level percent, closed 30 year amortization period for the initial UAAL. We used a level percent, open 30 year amortization period for any residual UAAL.

**SUBSTANTIVE PLAN:** As required under GASB 43 and 45, we based the valuation on the substantive plan. The formulation of the substantive plan was based on a review of written plan documents as well as historical information provided by La Palma regarding practices with respect to employer and employee contributions and other relevant factors.
ECONOMIC ASSUMPTIONS:

Economic assumptions are set under the guidance of Actuarial Standard of Practice 27 (ASOP 27). Among other things, ASOP 27 provides that economic assumptions should reflect a consistent underlying rate of general inflation. For that reason, we show our assumed long-term inflation rate below.

**INFLATION:** We assumed 2.75% per year.

**INVESTMENT RETURN / DISCOUNT RATE:** We assumed 7.25% per year. This is based on assumed long-term return on plan assets assuming 100% funding through CERBT. We used the “Building Block Method” as described in ASOP 27 Paragraph 3.6.2.

**TREND:** We assumed 4% per year. Our long-term trend assumption is based on the conclusion that, while medical trend will continue to be cyclical, the average increase over time cannot continue to outstrip general inflation by a wide margin. Trend increases in excess of general inflation result in dramatic increases in unemployment, the number of uninsured and the number of underinsured. These effects are nearing a tipping point which will inevitably result in fundamental changes in health care finance and/or delivery which will bring increases in health care costs more closely in line with general inflation. We do not believe it is reasonable to project historical trend vs. inflation differences several decades into the future.

**PAYROLL INCREASE:** We assumed 2.75% per year. This assumption applies only to the extent that either or both of the normal cost and/or UAAL amortization use the level percentage of payroll method. For purposes of applying the level percentage of payroll method, payroll increase must not assume any increases in staff or merit increases.

**ACTUARIAL VALUE OF PLAN ASSETS (AVA):** Because plan assets are primarily short term, we did not use a smoothing formula.
NON-ECONOMIC ASSUMPTIONS:

Economic assumptions are set under the guidance of Actuarial Standard of Practice 35 (ASOP 35).

MORTALITY

<table>
<thead>
<tr>
<th>Employee Type</th>
<th>Mortality Tables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miscellaneous</td>
<td>2009 CalPERS Mortality for Miscellaneous Employees</td>
</tr>
<tr>
<td>Police Officers</td>
<td>2009 CalPERS Mortality for Safety Employees</td>
</tr>
</tbody>
</table>

RETIREMENT RATES

<table>
<thead>
<tr>
<th>Employee Type</th>
<th>Retirement Rate Tables</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Employees</td>
<td>2009 CalPERS 2.7%@55 Rates for Miscellaneous Employees or</td>
</tr>
<tr>
<td></td>
<td>2009 CalPERS 2.7%@55 Rates for Miscellaneous Employees</td>
</tr>
<tr>
<td>Management</td>
<td>2009 CalPERS 2.7%@55 Rates for Miscellaneous Employees or</td>
</tr>
<tr>
<td></td>
<td>2009 CalPERS 2.7%@55 Rates for Miscellaneous Employees</td>
</tr>
<tr>
<td>Professional</td>
<td>2009 CalPERS 2.7%@55 Rates for Miscellaneous Employees or</td>
</tr>
<tr>
<td>Employees</td>
<td>2009 CalPERS 2.7%@55 Rates for Miscellaneous Employees</td>
</tr>
<tr>
<td>Police Officers</td>
<td>2009 CalPERS 3%@50 Rates for Miscellaneous Employees or</td>
</tr>
<tr>
<td></td>
<td>2009 CalPERS 3%@55 Rates for Police depending on hire date</td>
</tr>
</tbody>
</table>

VESTING RATES

<table>
<thead>
<tr>
<th>Employee Type</th>
<th>Vesting Rate Tables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miscellaneous</td>
<td>100% at 5 Years of Service</td>
</tr>
<tr>
<td>Police</td>
<td>100% at 5 Years of Service</td>
</tr>
</tbody>
</table>

COSTS FOR RETIREE COVERAGE

Retiree liabilities are based on actual retiree costs. Liabilities for active participants are based on the first year costs shown below. Subsequent years’ costs are based on first year costs adjusted for trend and limited by any City contribution caps.

<table>
<thead>
<tr>
<th>Employee Type</th>
<th>Future Retirees Pre-65</th>
<th>Future Retirees Post-65</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Employees</td>
<td>$1,380</td>
<td>$1,380</td>
</tr>
<tr>
<td>Management</td>
<td>$1,380</td>
<td>$1,380</td>
</tr>
<tr>
<td>Police Officers</td>
<td>$4,998</td>
<td>$4,998</td>
</tr>
<tr>
<td>Professional</td>
<td>$1,380</td>
<td>$1,380</td>
</tr>
</tbody>
</table>

PARTICIPATION RATES

<table>
<thead>
<tr>
<th>Employee Type</th>
<th>&lt;65 Non-Medicare Participation %</th>
<th>65+ Medicare Participation %</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Employees</td>
<td>80%</td>
<td>80%</td>
</tr>
<tr>
<td>Management</td>
<td>100%</td>
<td>80%</td>
</tr>
<tr>
<td>Professional</td>
<td>80%</td>
<td>80%</td>
</tr>
<tr>
<td>Police Officers</td>
<td>95%</td>
<td>95%</td>
</tr>
</tbody>
</table>

TURNOVER

<table>
<thead>
<tr>
<th>Employee Type</th>
<th>Turnover Rate Tables</th>
</tr>
</thead>
<tbody>
<tr>
<td>Miscellaneous</td>
<td>2009 CalPERS Turnover for Miscellaneous Employees</td>
</tr>
<tr>
<td>Police Officers</td>
<td>Non-sworn: 2009 CalPERS Turnover for Miscellaneous Employees</td>
</tr>
<tr>
<td></td>
<td>Sworn 2009 CalPERS Rates for Sworn Police</td>
</tr>
</tbody>
</table>
SPOUSE PREVALENCE
To the extent not provided and when needed to calculate benefit liabilities, 80% of retirees assumed to be married at retirement. After retirement, the percentage married is adjusted to reflect mortality.

SPOUSE AGES
To the extent spouse dates of birth are not provided and when needed to calculate benefit liabilities, female spouse assumed to be three years younger than male.

AGING FACTORS

<table>
<thead>
<tr>
<th>Attained Age</th>
<th>Medical Annual Increases</th>
</tr>
</thead>
<tbody>
<tr>
<td>50-64</td>
<td>3.5%</td>
</tr>
<tr>
<td>65-69</td>
<td>3.0%</td>
</tr>
<tr>
<td>70-74</td>
<td>2.5%</td>
</tr>
<tr>
<td>75-79</td>
<td>1.5%</td>
</tr>
<tr>
<td>80-84</td>
<td>0.5%</td>
</tr>
<tr>
<td>85+</td>
<td>0.0%</td>
</tr>
</tbody>
</table>
## APPENDIX D: DISTRIBUTION OF ELIGIBLE PARTICIPANTS BY AGE

### ELIGIBLE ACTIVE EMPLOYEES

<table>
<thead>
<tr>
<th>Age</th>
<th>Total</th>
<th>General Employees</th>
<th>Management</th>
<th>Police Officers</th>
<th>Professional Employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 25</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>25-29</td>
<td>7</td>
<td>1</td>
<td>0</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>30-34</td>
<td>8</td>
<td>1</td>
<td>0</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>35-39</td>
<td>6</td>
<td>2</td>
<td>0</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>40-44</td>
<td>10</td>
<td>4</td>
<td>1</td>
<td>4</td>
<td>1</td>
</tr>
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### ELIGIBLE RETIREES

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APPENDIX E: CALCULATION OF GASB 43/45 ACCOUNTING ENTRIES

This report is to be used to calculate accounting entries rather than to provide the dollar amount of accounting entries. How the report is to be used to calculate accounting entries depends on several factors. Among them are:

1) The amount of prior accounting entries;
2) Whether individual components of the ARC are calculated as a level dollar amount or as a level percentage of payroll;
3) Whether the employer using a level percentage of payroll method elects to use for this purpose projected payroll, budgeted payroll or actual payroll;
4) Whether the employer chooses to adjust the numbers in the report to reflect the difference between the valuation date and the first fiscal year for which the numbers will be used.

To the extent the level percentage of payroll method is used, the employer should adjust the numbers in this report as appropriate to reflect the change in OPEB covered payroll. It should be noted that OPEB covered payroll should only reflect types of pay generating pension credits for plan participants. Please note that plan participants do not necessarily include all active employees eligible for health benefits for several reasons. Following are examples.

1) The number of hours worked or other eligibility criteria may differ for OPEB compared to active health benefits;
2) There may be active employees over the maximum age OPEB are paid through. For example, if an OPEB plan pays benefits only to Medicare age, any active employees currently over Medicare age are not plan participants;
3) Employees hired at an age where they will exceed the maximum age for benefits when the service requirement is met are also not plan participants.

Finally, GASB 43 and 45 require reporting covered payroll in RSI schedules regardless of whether any ARC component is based on the level percentage of payroll method. This report does not provide, nor should the actuary be relied on to report covered payroll.

GASB 45 Paragraph 26 specifies that the items presented as RSI "should be calculated in accordance with the parameters." The RSI items refer to Paragraph 25.c which includes annual covered payroll. Footnote 3 provides that when the ARC is based on covered payroll, the payroll measure may be the projected payroll, budgeted payroll or actual payroll. Footnote 3 further provides that comparisons between the ARC and contributions should be based on the same measure of covered payroll.

At the time the valuation is being done, the actuary may not know which payroll method will be used for reporting purposes. The actuary may not even know for which period the valuation will be used to determine the ARC. Furthermore, the actuary doesn’t know if the client will make adjustments to the ARC in order to use it for the first year of the biennial or triennial period. (GASB 45 is silent on this.) Even if the actuary were to know all of these things, it would be a rare situation that would result in me knowing the appropriate covered payroll
number to report. For example, if the employer uses actual payroll, that number would not be known at the time the valuation is done.

As a result, we believe the proper approach is to report the ARC components as a dollar amount. It is the client's responsibility to turn this number into a percentage of payroll factor by using the dollar amount of the ARC (adjusted, if desired) as a numerator and then calculating the appropriate amount of the denominator based on the payroll determination method elected by the client for the appropriate fiscal year.

If we have been provided with payroll information, we are happy to use that information to help the employer develop an estimate of covered payroll for reporting purposes. However, the validity of the covered payroll remains the employer’s responsibility even if TCS assists the employer in calculating it.
APPENDIX F: GLOSSARY OF RETIREE HEALTH VALUATION TERMS

Note: The following definitions are intended to help a non-actuary understand concepts related to retiree health valuations. Therefore, the definitions may not be actuarially accurate.

**Actuarial Accrued Liability:** The amount of the actuarial present value of total projected benefits attributable to employees’ past service based on the actuarial cost method used.

**Actuarial Cost Method:** A mathematical model for allocating OPEB costs by year of service.

**Actuarial Present Value of Total Projected Benefits:** The projected amount of all OPEB benefits to be paid to current and future retirees discounted back to the valuation date.

**Actuarial Value of Assets:** Market-related value of assets which may include an unbiased formula for smoothing cyclical fluctuations in asset values.

**Annual OPEB Cost:** This is the amount employers must recognize as an expense each year. The annual OPEB expense is equal to the Annual Required Contribution plus interest on the Net OPEB obligation minus an adjustment to reflect the amortization of the net OPEB obligation.

**Annual Required Contribution:** The sum of the normal cost and an amount to amortize the unfunded actuarial accrued liability. This is the basis of the annual OPEB cost and net OPEB obligation.

**Closed Amortization Period:** An amortization approach where the original ending date for the amortization period remains the same. This would be similar to a conventional, 30-year mortgage, for example.

**Discount Rate:** Assumed investment return net of all investment expenses. Generally, a higher assumed interest rate leads to lower normal costs and actuarial accrued liability.

**Implicit Rate Subsidy:** The estimated amount by which retiree rates are understated in situations where, for rating purposes, retirees are combined with active employees.

**Mortality Rate:** Assumed proportion of people who die each year. Mortality rates always vary by age and often by sex. A mortality table should always be selected that is based on a similar “population” to the one being studied.

**Net OPEB Obligation:** The accumulated difference between the annual OPEB cost and amounts contributed to an irrevocable trust exclusively providing retiree OPEB benefits and protected from creditors.

**Normal Cost:** The dollar value of the “earned” portion of retiree health benefits if retiree health benefits are to be fully accrued at retirement.
**Total Compensation Systems, Inc.**

<table>
<thead>
<tr>
<th><strong>OPEB Benefits:</strong></th>
<th>Other PostEmployment Benefits. Generally medical, dental, prescription drug, life, long-term care or other postemployment benefits that are not pension benefits.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Open Amortization Period:</strong></td>
<td>Under an open amortization period, the remaining unamortized balance is subject to a new amortization schedule each valuation. This would be similar, for example, to a homeowner refinancing a mortgage with a new 30-year conventional mortgage every two or three years.</td>
</tr>
<tr>
<td><strong>Participation Rate:</strong></td>
<td>The proportion of retirees who elect to receive retiree benefits. A lower participation rate results in lower normal cost and actuarial accrued liability. The participation rate often is related to retiree contributions.</td>
</tr>
<tr>
<td><strong>Retirement Rate:</strong></td>
<td>The proportion of active employees who retire each year. Retirement rates are usually based on age and/or length of service. (Retirement rates can be used in conjunction with vesting rates to reflect both age and length of service). The more likely employees are to retire early, the higher normal costs and actuarial accrued liability will be.</td>
</tr>
<tr>
<td><strong>Transition Obligation:</strong></td>
<td>The amount of the unfunded actuarial accrued liability at the time actuarial accrual begins in accordance with an applicable accounting standard.</td>
</tr>
<tr>
<td><strong>Trend Rate:</strong></td>
<td>The rate at which the cost of retiree benefits is expected to increase over time. The trend rate usually varies by type of benefit (e.g. medical, dental, vision, etc.) and may vary over time. A higher trend rate results in higher normal costs and actuarial accrued liability.</td>
</tr>
<tr>
<td><strong>Turnover Rate:</strong></td>
<td>The rate at which employees cease employment due to reasons other than death, disability or retirement. Turnover rates usually vary based on length of service and may vary by other factors. Higher turnover rates reduce normal costs and actuarial accrued liability.</td>
</tr>
<tr>
<td><strong>Unfunded Actuarial Accrued Liability:</strong></td>
<td>This is the excess of the actuarial accrued liability over assets irrevocably committed to provide retiree health benefits.</td>
</tr>
<tr>
<td><strong>Valuation Date:</strong></td>
<td>The date as of which the OPEB obligation is determined. Under GASB 43 and 45, the valuation date does not have to coincide with the statement date.</td>
</tr>
<tr>
<td><strong>Vesting Rate:</strong></td>
<td>The proportion of retiree benefits earned, based on length of service and, sometimes, age. (Vesting rates are often set in conjunction with retirement rates.) More rapid vesting increases normal costs and actuarial accrued liability.</td>
</tr>
</tbody>
</table>
AGENDA ITEM

TO:        CITY COUNCIL
FROM:  CITY MANAGER
Submitted By:  Michael Solorza
Finance Director

Meeting Date:  February 5, 2013
Subject:  Options for Addressing the City’s Other Post Employment Benefit (OPEB) Liability

RECOMMENDATION:

It is recommended that the City Council review the options presented in this report on how best to address the City’s Other Post Employment Benefits (OPEB) liability and:

a) Approve the Staff recommended method as outlined in the Conclusions to this agenda report; or,

b) Provide alternative directions to Staff based on a different option not presented in this report

SUMMARY:

The City has a post-employment, retiree health benefit program in place (i.e., “other post employment benefits” [OPEB] plan). Eligibility is based on retirement from City of La Palma (on or after age 50) with a minimum of five years of service and have eligibility for a PERS pension and are enrolled in a CalPERS retiree health plan. The benefits are only available to employees who retire from the City of La Palma and the benefit differs between Safety and Miscellaneous employees and between the different retirement tiers. Eligible Tier 1 Safety retirees receive a $416.49 monthly health benefit. All other retirees receive the State-mandated Public Employees Medical and Hospital Care Act (PEMHCA) monthly benefit of $116 (adjusted annually by the State). Currently, the City meets the obligations for retiree medical costs on a “pay as you go” basis. That is, the city has not established a trust nor has it "pre-funded" the annual or expected costs of the retiree medical program.

The pay as you go method is common and is one of several approaches municipal agencies take in addressing retiree medical benefit costs. The City annually meets its obligations to this program and will continue to do so as needed and required through the monthly medical insurance payments it makes to PERS.
This report presents four options for City Council consideration in addressing the OPEB liability, each one having a different impact on annual costs and General Fund reserves.

BACKGROUND:

As required by Government Accounting Standards Board Statement Number 45 (GASB 45), the City must have an actuarial valuation completed of its OPEB plan every three years. The latest GASB 45 report was completed in April, 2012 (Attachment 1). Based on that valuation report and the actuarial assumptions therein, the City’s current unfunded actuarial accrued liability (UAAL) is approximately $3.3 million.

In the past year, staff has researched various options for establishing an "irrevocable trust" as an alternative method of funding its current and future OPEB obligations. Staff has met with representatives from CalPERS, PARS, and PFM Asset Management to discuss the particulars of establishing a trust. Each of those entities offers a basic trust mechanism that can be utilized for funding OPEB obligations, and each entity has its pros and cons, with cost being a major consideration. For the purposes of this report, information received from CalPERS will be utilized since they offer the largest OPEB trust program in the State (over 351 members with $2.4 billion in assets deposited), have been operating since 2008, and are the cheapest in terms of administrative fees.

The City currently meets its retiree medical costs on a pay as you go basis. Essentially, the City pays retiree medical bills as invoiced. An alternative to this method is to establish a trust, whereby the City would put enough money aside to not only pay current obligations (i.e., the cost of current retirees) but also to help fund the costs of future retirees (normal cost, or the actuarial assumed amount for current employees). By establishing an irrevocable trust, the City positions itself to meet current obligations while setting aside funds to meet future obligations.

In addition, those funds on deposit with the trust, as invested and managed by an independent entity, would accrue interest earnings. The entire pot of money, as it grows with annual contributions plus the dividends from interest earnings, helps to defer the total cost of the retiree medical program. Also, the actuarial and accounting treatment is more favorable, since there are assets which can be valued and used to offset any unfunded liability that has accrued over the life of the retiree medical program. In effect, as the trust amount grows, the City would get credit towards its unfunded liability since more assets would be available – and set aside in a trust – to be used exclusively for OPEB expenses.

In an effort to address the City Council’s 2013 goal of receiving OPEB funding information, Staff is providing four options for addressing the City’s unfunded OPEB liability. Staff is requesting direction by City Council on which one of the following recommendations should be pursued.

**Option #1: Continue the “pay as you go” Method**

This option presents no change from the current approach. The City fully meets its annual OPEB obligations and will continue to do so. However, as medical costs increase each year, the City
will see its annual OPEB cost increase. With no assets “on deposit” to grow or to be used in future actuarial valuations, the City would have to put aside greater amounts of funds each year as medical costs grow.

Currently, the City’s Employee Benefits internal service fund is where these charges are expensed. Since the City contracts with PERS for health insurance – for current employees as well as retirees – the monthly expense is charged to the Employee Benefits internal service fund. The total annual amount of health insurance costs, as budgeted, is then allocated to each department/program as part of the annual budget development process.

Through this method, any annual increases to health insurance costs are borne by each department through the cost allocation process. Since the majority of personnel are charged to the General Fund, one can see how increased health insurance costs translate into increased General Fund obligations. Therefore, pay as you go method cannot anticipate future health care costs. Furthermore, the city is not putting aside funds in anticipation of having to pay increased retiree health care costs in the future – either for current or potential new retirees.

While pay as you go does not allow for funds to be set aside to be available for future (increased) health care costs, it is an acceptable method. The City has had no problem meeting its obligations as health costs have increased. However, in light of recent budget trends, the City should explore alternative ways to meet its retiree health care costs that could help reduce the impact on the General Fund, as well as provide a better basis for future actuarial valuations.

**Option #2: Designate a Portion of General Fund Reserves as “Committed” for OPEB Liabilities**

Governmental Accounting Standards Board Statement 54 (GASB 54) allows various levels of fund balance designations, each having more or less flexibility in terms of availability to spend. For example, the City currently utilizes three GASB 54 categories for its General Fund reserves: unspendable, assigned, and unassigned. The unassigned amount is utilized to meet the City Council’s 100% reserve goal.

That is, each year, as part of the annual audit, an amount of General Fund reserves is designated as unassigned that is equal to 100% of General Fund expenditures. For the fiscal year ending June 30, 2012, this amount was $9,289,212. The assigned amount is then calculated as the remaining amount, net of any unspendable amounts. As of June 30, 2012, the assigned amount was $4,541,983. This amount fluctuates annually depending on the net amount available. Therefore, as General Fund expenditures change, the unassigned amount, so long as City Council maintains its 100% reserve policy, will always be equal to General Fund expenditures. The assigned amount therefore can fluctuate, depending on how much total fund balance is available, how large the nonspendable amount is, and finally what the unassigned amount must be.

A more restrictive level of fund balance designation is the “commitment,” which the City currently does not utilize in classifying its General Fund reserves. Available (i.e., “spendable”) fund balance can be “committed” by the passage of a resolution by the City Council. Option #2 would
have the City Council pass a resolution committing fund balance equal to the amount of the Unfunded Actuarial Accrued Liability (UAAL) of approximately $3.3 million (per the latest actuarial valuation).

In essence, this amount of fund balance would be “set aside” and could not be used for any other purpose unless a new resolution was passed by the City Council. That is the power of the GASB 54 “commitment” designation, reserving funds that can only be spent for the purpose for which they were committed. It then takes another resolution to change the purpose of the commitment. The intent of utilizing Option #2 would be to place a “marker” on an amount equal to the UAAL, but still maintain them within the City’s control. This approach would indicate that the City Council recognizes the amount of UAAL and seeks to sequester that amount from other spendable portions of fund balance. However, the City would still be pursuing pay as you go for retiree medical costs, and not setting aside funds in an irrevocable trust which could then be used as assets for future actuarial valuation purposes.

Despite the continuation of the pay as you go method, using the GASB 54 commitment designation would be one step beyond the current method of not formally setting aside any available fund balance towards the OPEB UAAL. In addition, in future fund balance presentations as part of the City’s financial statements, the committed amount would be “off the table” in terms of its availability for any one-time use other than that spelled out in the commitment resolution.

Option #3: Designate a Portion of General Fund Reserves as “Committed” for OPEB liabilities AND Use that Committed Amount to Pay Annual Retiree Medical Costs

This option differs slightly from Option #2. Option #3 would still require the City Council to pass a resolution committing a portion of General Fund reserves towards the OPEB UAAL ($3.3 million). Once this was done, as in Option #2, only a subsequent resolution passed by the City Council could “de-commit” all or a portion of those funds to be used for other purposes.

Where this option differs from Option #2 is that the City would shift payment of annual retiree medical costs from the General Fund, and use the committed reserve amount to pay the annual costs. In effect, the City would be drawing down fund balance (up to the committed amount of $3.3 million) each year, depending on annual actual retiree medical costs (i.e., invoices). Assuming our current retiree medical costs average $200,000 per year, this amount would get us about 15 years of payments. (For FY 2011-12, our actual retiree medical costs were $150,000.)

However, Option #3 is still a “pay as you go” process, and the City would still have an unfunded liability since we would not be putting money aside in an irrevocable trust so that assets grow. The benefit of this option is that General Fund expenditures would decrease, since annual retiree medical charges would be made using the reserve funds. The drawback to this option is reserves would be used, and without having funds in an irrevocable trust earning interest dividends, our unfunded liability would not decrease. Furthermore, once the committed amount was “used up,” the City would need to find another option for paying retiree medical costs (e.g., going back to pay as you go, or some other alternative). Like Option #2, this option is not a sustainable, long-term solution.
Option #4: Establish an irrevocable trust

This option presents the most actuarial favorable approach for several reasons: it reduces UAAL, helps guarantee funding would be available for future retirees, and eventually lowers the annual cost of the OPEB program. In fact, establishing an irrevocable trust is the only method recognized by credit rating agencies as adequately addressing an agency’s OPEB UAAL.

This approach would require the City to fund the actuarial required contribution (ARC) at 100%. Per the April 2012 valuation report this is approximately $276,000, higher than the current annual pay as you go amount.

By establishing a trust, the City could set aside considerable funds by sending them to be deposited in the trust. For example, depending on City Council goals and directions as part of the budget development process, a significant amount of available General Fund reserves could be utilized for this purpose (e.g., $2.0 million of the available $13.3 million as of June 30, 2012). These funds would help “seed” the trust and would be considered assets that would be used in the next actuarial valuation of the retiree health plan. Having assets on hand, earning higher rates of return, would lower the ARC and ultimately lead to a lower annual cost to the City. In addition, using a trust administered by a third party, a higher discount rate would be used on future actuarial valuations, further reducing the UAAL over a 20-30 year amortization period.

In the near-term, annual costs would increase, since the City would have to begin fully funding the ARC (in the pay as you go method, the normal cost portion of the ARC is not funded). However, depending on how much money is deposited “up-front” in the trust, the treatment of assets assuming a higher rate of return, and other favorable actuarial calculations, the annual ARC amount would soon be less than the pay as you go amount (estimated at 10-15 years from establishment of the trust). Establishing a trust allows for future retiree health commitments to be paid from the trust assets. Therefore, as assets grow (based on fully funding the ARC annually as well as the accumulation of interest earnings), more funds are available in the trust to meet ongoing (and future) obligations.

CONCLUSIONS:

Therefore, Staff recommends City Council approve a two-step process in addressing the City’s OPEB liabilities:

1. As part of the FY 2013-14 budget adoption process, adopt a resolution “committing” fund balance (per GASB 54 guidelines) equal to the UAAL amount indicated in the April, 2012 OPEB valuation report (approximately $3.3 million).

2. Direct Staff to begin discussions with a third party agency that would offer the most cost effective alternative to the pay as you go method in order to establish an irrevocable OPEB trust by June 30, 2014.
If so directed, Staff would include language in the FY 2013-14 Budget adoption resolution to commit General Fund reserves (per Step #1). Furthermore, if the above two-step process is approved by City Council, Staff would work to establish the trust as soon as practicable, returning with a work plan once additional discussions with third party trust providers were pursued and concluded.

**FISCAL IMPACT:**

At this point, the fiscal impact would depend on the options approved by the City Council.

**Attachments:** 1. OPEB Actuarial Valuation, April 2012
City of La Palma
Actuarial Study of
Retiree Health Liabilities
As of February 1, 2012

Prepared by:
Total Compensation Systems, Inc.

Date: April 5, 2012
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A. Introduction

City of La Palma engaged Total Compensation Systems, Inc. (TCS) to analyze liabilities associated with its current retiree health program as of February 1, 2012 (the valuation date). The numbers in this report are based on the assumption that they will first be used to determine accounting entries for the fiscal year ending June 30, 2012. If the report will first be used for a different fiscal year, the numbers will need to be adjusted accordingly.

This report does not reflect any cash benefits paid unless the retiree is required to provide proof that the cash benefits are used to reimburse the retiree’s cost of health benefits. Costs and liabilities attributable to cash benefits paid to retirees are reportable under Governmental Accounting Standards Board (GASB) Standards 25/27.

This actuarial study is intended to serve the following purposes:

- To provide information to enable City of La Palma to manage the costs and liabilities associated with its retiree health benefits.
- To provide information to enable City of La Palma to communicate the financial implications of retiree health benefits to internal financial staff, the Board, employee groups and other affected parties.
- To provide information needed to comply with Governmental Accounting Standards Board Accounting Standards 43 and 45 related to "other postemployment benefits" (OPEB’s).

Because this report was prepared in compliance with GASB 43 and 45, as appropriate, City of La Palma should not use this report for any other purpose without discussion with TCS. This means that any discussions with employee groups, governing Boards, etc. should be restricted to the implications of GASB 43 and 45 compliance.

This actuarial report includes several estimates for City of La Palma's retiree health program. In addition to the tables included in this report, we also performed cash flow adequacy tests as required under Actuarial Standard of Practice 6 (ASOP 6). Our cash flow adequacy testing covers a twenty-year period. We would be happy to make this cash flow adequacy test available to City of La Palma in spreadsheet format upon request.

We calculated the following estimates separately for active employees and retirees. As requested, we also separated results by the following employee classifications: LPGEA, Management, LPPA, LPPEA and 0. We estimated the following:

- The total liability created. (The actuarial present value of total projected benefits or APVTPB)
- The ten year "pay-as-you-go" cost to provide these benefits.
- The "actuarial accrued liability (AAL)." (The AAL is the portion of the APVTPB attributable to employees’ service prior to the valuation date.)
- The amount necessary to amortize the UAAL over a period of 30 years.
the annual contribution required to fund retiree benefits over the working lifetime of eligible employees (the "normal cost").

- The Annual Required Contribution (ARC) which is the basis of calculating the annual OPEB cost and net OPEB obligation under GASB 43 and 45.

We summarized the data used to perform this study in Appendix A. No effort was made to verify this information beyond brief tests for reasonableness and consistency.

All cost and liability figures contained in this study are estimates of future results. Future results can vary dramatically and the accuracy of estimates contained in this report depends on the actuarial assumptions used. Normal costs and liabilities could easily vary by 10 - 20% or more from estimates contained in this report.

B. General Findings

We estimate the "pay-as-you-go" cost of providing retiree health benefits in the year beginning February 1, 2012 to be $123,933 (see Section IV.A.). The “pay-as-you-go” cost is the cost of benefits for current retirees.

For current employees, the value of benefits "accrued" in the year beginning February 1, 2012 (the normal cost) is $117,305. This normal cost would increase each year based on covered payroll. Had City of La Palma begun accruing retiree health benefits when each current employee and retiree was hired, a substantial liability would have accumulated. We estimate the amount that would have accumulated to be $3,312,376. This amount is called the "actuarial accrued liability" (AAL). The remaining unamortized balance of the initial unfunded AAL (UAAL) is $3,498,553. This leaves a “residual” AAL of negative $186,177.

We calculated the annual cost to amortize the residual unfunded actuarial accrued liability using a 5% discount rate. We used an open 30 year amortization period. The current year cost to amortize the residual unfunded actuarial accrued liability is negative $8,246.

Combining the normal cost and UAAL amortization costs in the first year produces a total first year annual required contribution (ARC) of $276,069. The ARC is used as the basis for determining expenses and liabilities under GASB 43/45. The ARC is used in lieu of (rather than in addition to) the “pay-as-you-go” cost.

We based all of the above estimates on employees as of January, 2012. Over time, liabilities and cash flow will vary based on the number and demographic characteristics of employees and retirees.

C. Description of Retiree Benefits

Following is a description of the current retiree benefit plan:
D. Recommendations

It is outside the scope of this report to make specific recommendations of actions City of La Palma should take to manage the substantial liability created by the current retiree health program. Total Compensation Systems, Inc. can assist in identifying and evaluating options once this report has been studied. The following recommendations are intended only to allow the City to get more information from this and future studies. Because we have not conducted a comprehensive administrative audit of City of La Palma’s practices, it is possible that City of La Palma is already complying with some or all of our recommendations.

- We recommend that City of La Palma inventory all benefits and services provided to retirees – whether contractually or not and whether retiree-paid or not. For each, City of La Palma should determine whether the benefit is material and subject to GASB 43 and/or 45.

- We recommend that City of La Palma conduct a study whenever events or contemplated actions significantly affect present or future liabilities, but no less frequently than every two or three years, as required under GASB 43/45.

- We recommend that the City communicate the magnitude of these costs to employees and include employees in discussions of options to control the costs.

- Under GASB 45, it is important to isolate the cost of retiree health benefits. City of La Palma should have all premiums, claims and expenses for retirees separated from active employee premiums, claims, expenses, etc. To the extent any retiree benefits are made available to retirees over the age of 65 – even on a retiree-pay-all basis – all premiums, claims and expenses for post-65 retiree coverage should be segregated from those for pre-65 coverage. Furthermore, City of La Palma should arrange for the rates or prices of all retiree benefits to be set on what is expected to be a self-sustaining basis.

- City of La Palma should establish a way of designating employees as eligible or ineligible for future OPEB benefits. Ineligible employees can include those in ineligible job classes; those hired after a designated date restricting eligibility; those who, due to their age at hire cannot qualify for City-paid OPEB benefits; employees who exceed the termination age for OPEB benefits, etc.

- Several assumptions were made in estimating costs and liabilities under City of La Palma's retiree health program. Further studies may be desired to validate any assumptions where

*18 months at full single premium
there is any doubt that the assumption is appropriate. (See Appendices B and C for a list of assumptions and concerns.) For example, City of La Palma should maintain a retiree database that includes – in addition to date of birth, gender and employee classification – retirement date and (if applicable) dependent date of birth, relationship and gender. It will also be helpful for City of La Palma to maintain employment termination information – namely, the number of OPEB-eligible employees in each employee class that terminate employment each year for reasons other than death, disability or retirement.

Respectfully submitted,

Geoffrey L. Kischuk, FSA, MAAA, FCA
Consultant
Total Compensation Systems, Inc.
(805) 496-1700
PART II: BACKGROUND

A. Summary

Accounting principles provide that the cost of retiree benefits should be “accrued” over employees' working lifetime. For this reason, the Governmental Accounting Standards Board (GASB) issued in 2004 Accounting Standards 43 and 45 for retiree health benefits. These standards apply to all public employers that pay any part of the cost of retiree health benefits for current or future retirees (including early retirees).

B. Actuarial Accrual

To actuarially accrue retiree health benefits requires determining the amount to expense each year so that the liability accumulated at retirement is, on average, sufficient (with interest) to cover all retiree health expenditures without the need for additional expenses. There are many different ways to determine the annual accrual amount. The calculation method used is called an “actuarial cost method.”

Under most actuarial cost methods, there are two components of actuarial cost - a “normal cost” and amortization of something called the “unfunded actuarial accrued liability.” Both accounting standards and actuarial standards usually address these two components separately (though alternative terminology is sometimes used).

The normal cost can be thought of as the value of the benefit earned each year if benefits are accrued during the working lifetime of employees. This report will not discuss differences between actuarial cost methods or their application. Instead, following is a description of a commonly used, generally accepted actuarial cost method that will be permitted under GASB 43 and 45. This actuarial cost method is called the “entry age normal” method.

Under the entry age normal cost method, the actuary determines the annual amount needing to be expensed from hire until retirement to fully accrue the cost of retiree health benefits. This amount is the normal cost. Under GASB 43 and 45, normal cost can be expressed either as a level dollar amount or a level percentage of payroll.

The normal cost is determined using several key assumptions:

- The current cost of retiree health benefits (often varying by age, Medicare status and/or dependent coverage). The higher the current cost of retiree benefits, the higher the normal cost.

- The “trend” rate at which retiree health benefits are expected to increase over time. A higher trend rate increases the normal cost. A “cap” on City contributions can reduce trend to zero once the cap is reached thereby dramatically reducing normal costs.

- Mortality rates varying by age and sex. (Unisex mortality rates are not often used as individual OPEB benefits do not depend on the mortality table used.) If employees die prior to retirement, past contributions are available to fund benefits for employees who live to retirement. After retirement, death results in benefit termination or reduction. Although higher mortality rates reduce normal costs, the mortality assumption is not likely to vary from employer to employer.

- Employment termination rates have the same effect as mortality inasmuch as higher termination rates reduce normal costs. Employment termination can vary considerably between public agencies.

- The service requirement reflects years of service required to earn full or partial retiree benefits.
While a longer service requirement reduces costs, cost reductions are not usually substantial unless the service period exceeds 20 years of service.

- **Retirement rates** determine what proportion of employees retire at each age (assuming employees reach the requisite length of service). Retirement rates often vary by employee classification and implicitly reflect the minimum retirement age required for eligibility. Retirement rates also depend on the amount of pension benefits available. Higher retirement rates increase normal costs but, except for differences in minimum retirement age, retirement rates tend to be consistent between public agencies for each employee type.

- **Participation rates** indicate what proportion of retirees are expected to elect retiree health benefits if a significant retiree contribution is required. Higher participation rates increase costs.

- The **discount rate** estimates investment earnings for assets earmarked to cover retiree health benefit liabilities. The discount rate depends on the nature of underlying assets. For example, employer funds earning money market rates in the county treasury are likely to earn far less than an irrevocable trust containing a diversified asset portfolio including stocks, bonds, etc. A higher discount rate can dramatically lower normal costs. GASB 43 and 45 require the interest assumption to reflect likely *long term* investment return.

The assumptions listed above are not exhaustive, but are the most common assumptions used in actuarial cost calculations. The actuary selects the assumptions which - taken together - will yield reasonable results. It's not necessary (or even possible) to predict individual assumptions with complete accuracy.

If all actuarial assumptions are exactly met and an employer expensed the normal cost every year for all past and current employees and retirees, a sizeable liability would have accumulated (after adding interest and subtracting retiree benefit costs). The liability that would have accumulated is called the actuarial accrued liability or AAL. The excess of AAL over the *actuarial value of plan assets* is called the unfunded actuarial accrued liability (or UAAL). Under GASB 43 and 45, in order for assets to count toward offsetting the AAL, the assets have to be held in an irrevocable trust that is safe from creditors and can only be used to provide OPEB benefits to eligible participants.

The actuarial accrued liability (AAL) can arise in several ways. At inception of GASB 43 and 45, there is usually a substantial UAAL. Some portion of this amount can be established as the "transition obligation" subject to certain constraints. UAAL can also increase as the result of operation of a retiree health plan - e.g., as a result of plan changes or changes in actuarial assumptions. Finally, AAL can arise from actuarial gains and losses. Actuarial gains and losses result from differences between actuarial assumptions and actual plan experience.

Under GASB 43 and 45, employers have several options on how the UAAL can be amortized as follows:

- The employer can select an amortization period of 1 to 30 years. (For certain situations that result in a reduction of the AAL, the amortization period must be at least 10 years.)

- The employer may apply the same amortization period to the total combined UAAL or can apply different periods to different components of the UAAL.

- The employer may elect a “closed” or “open” amortization period.

- The employer may choose to amortize on a level dollar or level percentage of payroll method.
PART III: LIABILITIES AND COSTS FOR RETIREE BENEFITS

A. Introduction.

We calculated the actuarial present value of projected benefits (APVPB) separately for each employee. We determined eligibility for retiree benefits based on information supplied by City of La Palma. We then selected assumptions for the factors discussed in the above Section that, based on plan experience and our training and experience, represent our best prediction of future plan experience. For each employee, we applied the appropriate factors based on the employee's age, sex and length of service.

We summarized actuarial assumptions used for this study in Appendix C.

B. Medicare

The extent of Medicare coverage can affect projections of retiree health costs. The method of coordinating Medicare benefits with the retiree health plan's benefits can have a substantial impact on retiree health costs. We will be happy to provide more information about Medicare integration methods if requested.

C. Liability for Retiree Benefits.

For each employee, we projected future premium costs using an assumed trend rate (see Appendix C). To the extent City of La Palma uses contribution caps, the influence of the trend factor is further reduced.

We multiplied each year's projected cost by the probability that premium will be paid; i.e. based on the probability that the employee is living, has not terminated employment and has retired. The probability that premium will be paid is zero if the employee is not eligible. The employee is not eligible if s/he has not met minimum service, minimum age or, if applicable, maximum age requirements.

The product of each year's premium cost and the probability that premium will be paid equals the expected cost for that year. We discounted the expected cost for each year to the valuation date February 1, 2012 at 5% interest.

Finally, we multiplied the above discounted expected cost figures by the probability that the retiree would elect coverage. A retiree may not elect to be covered if retiree health coverage is available less expensively from another source (e.g. Medicare risk contract) or the retiree is covered under a spouse's plan.

For any current retirees, the approach used was similar. The major difference is that the probability of payment for current retirees depends only on mortality and age restrictions (i.e. for retired employees the probability of being retired and of not being terminated are always both 1.0000).

We added the APVPB for all employees to get the actuarial present value of total projected benefits (APVTPB). The APVTPB is the estimated present value of all future retiree health benefits for all current employees and retirees. The APVTPB is the amount on February 1, 2012 that, if all actuarial assumptions are exactly right, would be sufficient to expense all promised benefits until the last current employee or retiree dies or reaches the maximum eligibility age.
The APVTPB should be accrued over the working lifetime of employees. At any time much of it has not been "earned" by employees. The APVTPB is used to develop expense and liability figures. To do so, the APVTFB is divided into two parts: the portions attributable to service rendered prior to the valuation date (the past service liability or actuarial accrued liability under GASB 43 and 45) and to service after the valuation date but prior to retirement (the future service liability).

The past service and future service liabilities are each funded in a different way. We will start with the future service liability which is funded by the normal cost.

D. Cost to Prefund Retiree Benefits

1. Normal Cost

The average hire age for eligible employees is 32. To accrue the liability by retirement, the City would accrue the retiree liability over a period of about 26 years (assuming an average retirement age of 58). We applied an "entry age normal" actuarial cost method to determine funding rates for active employees. The table below summarizes the calculated normal cost.

<table>
<thead>
<tr>
<th># of Employees</th>
<th>Total</th>
<th>LPGEA</th>
<th>Management</th>
<th>LPPA</th>
<th>LPPEA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pre-65 Benefit</td>
<td>N/A</td>
<td>$157</td>
<td>$179</td>
<td>$1,191</td>
<td>$133</td>
</tr>
<tr>
<td>Post-65 Benefit</td>
<td>N/A</td>
<td>$570</td>
<td>$649</td>
<td>$2,389</td>
<td>$437</td>
</tr>
<tr>
<td>Pre-65 Benefit</td>
<td>$36,268</td>
<td>$3,297</td>
<td>$1,074</td>
<td>$30,966</td>
<td>$931</td>
</tr>
<tr>
<td>Post-65 Benefit</td>
<td>$81,037</td>
<td>$11,970</td>
<td>$3,894</td>
<td>$62,114</td>
<td>$3,059</td>
</tr>
<tr>
<td>Total</td>
<td>$117,305</td>
<td>$15,267</td>
<td>$4,968</td>
<td>$93,080</td>
<td>$3,990</td>
</tr>
</tbody>
</table>

Accruing retiree health benefit costs using normal costs levels out the cost of retiree health benefits over...
time and more fairly reflects the value of benefits "earned" each year by employees. This normal cost would increase each year based on covered payroll.

2. Amortization of Unfunded Actuarial Accrued Liability (UAAL)

If actuarial assumptions are borne out by experience, the City will fully accrue retiree benefits by expensing an amount each year that equals the normal cost. If no accruals had taken place in the past, there would be a shortfall of many years’ accruals, accumulated interest and forfeitures for terminated or deceased employees. This shortfall is called the actuarial accrued liability (AAL). We calculated the AAL as the APVTPB minus the present value of future normal costs.

The initial UAAL was amortized using a closed amortization period of 30 years. The City can amortize the remaining or residual UAAL over many years. The table below shows the annual amount necessary to amortize the UAAL over a period of 30 years at 5% interest. (Thirty years is the longest amortization period allowable under GASB 43 and 45.) GASB 43 and 45 will allow amortizing the UAAL using either payments that stay the same as a dollar amount, or payments that are a flat percentage of covered payroll over time. The figures below reflect the level percentage of payroll method. This amortization payment would increase each year based on covered payroll.

### Actuarial Accrued Liability as of February 1, 2012

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>LPGA</th>
<th>Management</th>
<th>LPPA</th>
<th>LPPEA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active: Pre-65</td>
<td>$521,892</td>
<td>$59,391</td>
<td>$78,584</td>
<td>$360,478</td>
<td>$23,439</td>
</tr>
<tr>
<td>Post-65</td>
<td>$685,391</td>
<td>$148,248</td>
<td>$164,279</td>
<td>$332,066</td>
<td>$40,798</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$1,207,283</td>
<td>$207,639</td>
<td>$242,863</td>
<td>$692,544</td>
<td>$64,237</td>
</tr>
<tr>
<td>Retiree: Pre-65</td>
<td>$338,557</td>
<td>$10,163</td>
<td>$63,107</td>
<td>$265,287</td>
<td>$0</td>
</tr>
<tr>
<td>Post-65</td>
<td>$1,766,537</td>
<td>$63,305</td>
<td>$396,510</td>
<td>$1,306,722</td>
<td>$0</td>
</tr>
<tr>
<td>Subtotal</td>
<td>$2,105,094</td>
<td>$73,468</td>
<td>$459,617</td>
<td>$1,572,009</td>
<td>$0</td>
</tr>
<tr>
<td>Subtot Pre-65</td>
<td>$860,449</td>
<td>$69,554</td>
<td>$141,691</td>
<td>$625,765</td>
<td>$23,439</td>
</tr>
<tr>
<td>Subtot Post-65</td>
<td>$2,451,928</td>
<td>$211,553</td>
<td>$560,789</td>
<td>$1,638,788</td>
<td>$40,798</td>
</tr>
<tr>
<td>Grand Total</td>
<td>$3,312,376</td>
<td>$281,107</td>
<td>$702,480</td>
<td>$2,264,552</td>
<td>$64,237</td>
</tr>
<tr>
<td>Unamortized Initial UAAL</td>
<td>$3,498,553</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residual AAL</td>
<td>$(186,177)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Residual UAAL Amortization at 5.0% over 30 Years</td>
<td>$(8,246)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. Annual Required Contributions (ARC)

If the City determines retiree health plan expenses in accordance with GASB 43 and 45, costs will include both normal cost and one or more components of UAAL amortization costs. The sum of normal cost and UAAL amortization costs is called the Annual Required Contribution (ARC) and is shown below.
Total Compensation Systems, Inc.

Annual Required Contribution (ARC) Year Beginning
February 1, 2012

<table>
<thead>
<tr>
<th>Description</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normal Cost</td>
<td>$117,305</td>
</tr>
<tr>
<td>Initial UAAL Amortization</td>
<td>$167,010</td>
</tr>
<tr>
<td>Residual UAAL Amortization</td>
<td>$(8,246)</td>
</tr>
<tr>
<td><strong>ARC</strong></td>
<td><strong>$276,069</strong></td>
</tr>
</tbody>
</table>

The normal cost remains as long as there are active employees who may some day qualify for City-paid retiree health benefits. This normal cost would increase each year based on covered payroll.

4. Other Components of Annual OPEB Cost (AOC)

Expense and liability amounts may include more components of cost than the normal cost plus amortization of the UAAL. This will apply to employers that don’t fully fund the Annual Required Cost (ARC) through an irrevocable trust.

- The annual OPEB cost (AOC) will include assumed interest on the net OPEB obligation (NOO). The annual OPEB cost will also include an amortization adjustment for the net OPEB obligation. (It should be noted that there is no NOO if the ARC is fully funded through a qualifying “plan”.)
- The net OPEB obligation will equal the accumulated differences between the (AOC) and qualifying “plan” contributions.
PART IV: "PAY AS YOU GO" FUNDING OF RETIREE BENEFITS

We used the actuarial assumptions shown in Appendix C to project ten year cash flow under the retiree health program. Because these cash flow estimates reflect average assumptions applied to a relatively small number of employees, estimates for individual years are certain to be inaccurate. However, these estimates show the size of cash outflow.

The following table shows a projection of annual amounts needed to pay the City share of retiree health premiums.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>LPGEA</th>
<th>Management</th>
<th>LPPA</th>
<th>LPPEA</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>$123,933</td>
<td>$4,484</td>
<td>$33,541</td>
<td>$85,908</td>
<td>$0</td>
</tr>
<tr>
<td>2013</td>
<td>$124,475</td>
<td>$5,045</td>
<td>$30,205</td>
<td>$89,225</td>
<td>$0</td>
</tr>
<tr>
<td>2014</td>
<td>$132,240</td>
<td>$5,930</td>
<td>$32,790</td>
<td>$93,520</td>
<td>$0</td>
</tr>
<tr>
<td>2015</td>
<td>$139,772</td>
<td>$6,940</td>
<td>$35,060</td>
<td>$97,772</td>
<td>$0</td>
</tr>
<tr>
<td>2016</td>
<td>$148,258</td>
<td>$8,050</td>
<td>$37,143</td>
<td>$102,961</td>
<td>$104</td>
</tr>
<tr>
<td>2017</td>
<td>$156,927</td>
<td>$9,128</td>
<td>$39,485</td>
<td>$108,136</td>
<td>$178</td>
</tr>
<tr>
<td>2018</td>
<td>$164,847</td>
<td>$10,224</td>
<td>$41,351</td>
<td>$112,917</td>
<td>$355</td>
</tr>
<tr>
<td>2019</td>
<td>$173,969</td>
<td>$11,368</td>
<td>$43,428</td>
<td>$118,620</td>
<td>$553</td>
</tr>
<tr>
<td>2020</td>
<td>$183,524</td>
<td>$12,815</td>
<td>$45,645</td>
<td>$124,222</td>
<td>$842</td>
</tr>
<tr>
<td>2021</td>
<td>$194,296</td>
<td>$14,207</td>
<td>$47,617</td>
<td>$131,265</td>
<td>$1,207</td>
</tr>
</tbody>
</table>
PART V: RECOMMENDATIONS FOR FUTURE VALUATIONS

To effectively manage benefit costs, an employer must periodically examine the existing liability for retiree benefits as well as future annual expected premium costs. GASB 43/45 require biennial or triennial valuations. In addition, a valuation should be conducted whenever plan changes, changes in actuarial assumptions or other employer actions are likely to cause a material change in accrual costs and/or liabilities.

Following are examples of actions that could trigger a new valuation.

- An employer should perform a valuation whenever the employer considers or puts in place an early retirement incentive program.
- An employer should perform a valuation whenever the employer adopts a retiree benefit plan for some or all employees.
- An employer should perform a valuation whenever the employer considers or implements changes to retiree benefit provisions or eligibility requirements.
- An employer should perform a valuation whenever the employer introduces or changes retiree contributions.

We recommend City of La Palma take the following actions to ease future valuations.

- We have used our training, experience and information available to us to establish the actuarial assumptions used in this valuation. We have no information to indicate that any of the assumptions do not reasonably reflect future plan experience. However, the City should review the actuarial assumptions in Appendix C carefully. If the City has any reason to believe that any of these assumptions do not reasonably represent the expected future experience of the retiree health plan, the City should engage in discussions or perform analyses to determine the best estimate of the assumption in question.
PART VI: APPENDICES

APPENDIX A: MATERIALS USED FOR THIS STUDY

We relied on the following materials to complete this study.

- We used paper reports and digital files containing employee demographic data from the City personnel records.
- We used relevant sections of collective bargaining agreements provided by the City.
APPENDIX B: EFFECT OF ASSUMPTIONS USED IN CALCULATIONS

While we believe the estimates in this study are reasonable overall, it was necessary for us to use assumptions which inevitably introduce errors. We believe that the errors caused by our assumptions will not materially affect study results. If the City wants more refined estimates for decision-making, we recommend additional investigation. Following is a brief summary of the impact of some of the more critical assumptions.

1. Where actuarial assumptions differ from expected experience, our estimates could be overstated or understated. One of the most critical assumptions is the medical trend rate. The City may want to commission further study to assess the sensitivity of liability estimates to our medical trend assumptions. For example, it may be helpful to know how liabilities would be affected by using a trend factor 1% higher than what was used in this study. There is an additional fee required to calculate the impact of alternative trend assumptions.

2. We used an "entry age normal" actuarial cost method to estimate the actuarial accrued liability and normal cost. GASB will allow this as one of several permissible methods under its upcoming accounting standard. Using a different cost method could result in a somewhat different recognition pattern of costs and liabilities.
APPENDIX C: ACTUARIAL ASSUMPTIONS AND METHODS

Following is a summary of actuarial assumptions and methods used in this study. The City should carefully review these assumptions and methods to make sure they reflect the City’s assessment of its underlying experience. It is important for City of La Palma to understand that the appropriateness of all selected actuarial assumptions and methods are City of La Palma’s responsibility. Unless otherwise disclosed in this report, TCS believes that all methods and assumptions are within a reasonable range based on the provisions of GASB 43 and 45, applicable actuarial standards of practice, City of La Palma’s actual historical experience, and TCS’s judgment based on experience and training.

ACTUARIAL METHODS AND ASSUMPTIONS:

**ACTUARIAL COST METHOD:**  Entry age normal. The allocation of OPEB cost is based on years of service. We used the level percentage of payroll method to allocate OPEB cost over years of service.

Entry age is based on the age at hire for eligible employees. The attribution period is determined as the difference between the expected retirement age and the age at hire. The present value of future benefits and present value of future normal costs are determined on an employee by employee basis and then aggregated.

To the extent that different benefit formulas apply to different employees of the same class, the normal cost is based on the benefit plan applicable to the most recently hired employees (including future hires if a new benefit formula has been agreed to and communicated to employees).

**AMORTIZATION METHODS:** We used the level percentage of payroll method to allocate amortization cost by year. We used a closed 30 year amortization period for the initial UAAL. We used an open 30 year amortization period for any residual UAAL.

**SUBSTANTIVE PLAN:** As required under GASB 43 and 45, we based the valuation on the substantive plan. The formulation of the substantive plan was based on a review of written plan documents as well as historical information provided by City of La Palma regarding practices with respect to employer and employee contributions and other relevant factors.
ECONOMIC ASSUMPTIONS:

Economic assumptions are set under the guidance of Actuarial Standard of Practice 27 (ASOP 27). Among other things, ASOP 27 provides that economic assumptions should reflect a consistent underlying rate of general inflation. For that reason, we show our assumed long-term inflation rate below.

**INFLATION:** We assumed 3% per year.

**INVESTMENT RETURN / DISCOUNT RATE:** We assumed 5% per year. This is based on assumed long-term return on employer assets. We used the “Building Block Method” as described in ASOP 27 Paragraph 3.6.2. Our assessment of long-term returns for employer assets is based on long-term historical returns for surplus funds invested pursuant to California Government Code Sections 53601 et seq.

**TREND:** We assumed 4% per year. Our long-term trend assumption is based on the conclusion that, while medical trend will continue to be cyclical, the average increase over time cannot continue to outstrip general inflation by a wide margin. Trend increases in excess of general inflation result in dramatic increases in unemployment, the number of uninsured and the number of underinsured. These effects are nearing a tipping point which will inevitably result in fundamental changes in health care finance and/or delivery which will bring increases in health care costs more closely in line with general inflation. We do not believe it is reasonable to project historical trend vs. inflation differences several decades into the future.

**PAYROLL INCREASE:** We assumed 3% per year. This assumption applies only to the extent that either or both of the normal cost and/or UAAL amortization use the level percentage of payroll method. For purposes of applying the level percentage of payroll method, payroll increase must not assume any increases in staff or merit increases.

**ACTUARIAL ASSET VALUATION:** There were no plan assets on the valuation date.
NON-ECONOMIC ASSUMPTIONS:

Economic assumptions are set under the guidance of Actuarial Standard of Practice 35 (ASOP 35).

**MORTALITY:** CalPERS mortality for Sworn employees used for Sworn employees
CalPERS mortality for Miscellaneous employees for other employees.

**RETIREMENT RATES:** CalPERS retirement rates for the 3 % @ 50 police pension formula for sworn police.
CalPERS retirement rates for the 2.7 % @ 55 pension formula for other employees.

**VESTING RATES:**

<table>
<thead>
<tr>
<th>Vesting Percentage</th>
<th>LPGEA</th>
<th>Management</th>
<th>LPPA</th>
<th>LPPEA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vesting Period</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>5 years</td>
<td>5 years</td>
<td>5 years</td>
<td>5 years</td>
</tr>
</tbody>
</table>

**COSTS FOR RETIREE COVERAGE:**

There was not sufficient information available to determine whether there is an implicit subsidy for retiree health costs. Based on ASOP 6, there can be justification for using “community-rated” premiums as the basis for the valuation where the insurer is committed to continuing rating practices. This is especially true where sufficient information is not available to determine the magnitude of the subsidy. However, City of La Palma should recognize that costs and liabilities in this report could change significantly if either the current insurer changes rating practices or if City of La Palma changes insurers.

First Year costs are as shown below. Subsequent years’ costs are based on first year costs adjusted for trend and limited by any City contribution caps.

<table>
<thead>
<tr>
<th>Current Retirees: based on actual costs</th>
<th>LPGEA</th>
<th>Management</th>
<th>LPPA</th>
<th>LPPEA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Plan:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Future Retirees Pre-65</td>
<td>$1,344</td>
<td>$1,344</td>
<td>$4,998</td>
<td>$1,344</td>
</tr>
<tr>
<td>Future Retirees Post-65</td>
<td>$1,344</td>
<td>$1,344</td>
<td>$4,998</td>
<td>$1,344</td>
</tr>
</tbody>
</table>

**PARTICIPATION RATES:** 100%

**TURNOVER:** CalPERS turnover for Police used for Sworn police.
CalPERS turnover for Miscellaneous employees for other employees.

**SPOUSE PREVALENCE:** To the extent not provided and when needed to calculate benefit liabilities, 80% of retirees assumed to be married at retirement. After retirement, the percentage married is adjusted to reflect mortality.

**SPOUSE AGES:** To the extent spouse dates of birth are not provided and when needed to calculate benefit liabilities, female spouse assumed to be three years younger than male.
**AGING FACTORS:**

<table>
<thead>
<tr>
<th>Attained Age</th>
<th>Medical Annual Increases</th>
</tr>
</thead>
<tbody>
<tr>
<td>50-64</td>
<td>3.5%</td>
</tr>
<tr>
<td>65-69</td>
<td>3.0</td>
</tr>
<tr>
<td>70-74</td>
<td>2.5</td>
</tr>
<tr>
<td>75-79</td>
<td>1.5</td>
</tr>
<tr>
<td>80-84</td>
<td>0.5</td>
</tr>
<tr>
<td>85+</td>
<td>0.0</td>
</tr>
</tbody>
</table>
APPENDIX D: DISTRIBUTION OF ELIGIBLE PARTICIPANTS BY AGE

ELIGIBLE ACTIVE EMPLOYEES:

<table>
<thead>
<tr>
<th>Age</th>
<th>Total</th>
<th>LPGEA</th>
<th>Management</th>
<th>LPPA</th>
<th>LPPEA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 25</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>25-29</td>
<td>8</td>
<td>4</td>
<td>0</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>30-34</td>
<td>12</td>
<td>2</td>
<td>0</td>
<td>8</td>
<td>2</td>
</tr>
<tr>
<td>35-39</td>
<td>6</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>40-44</td>
<td>11</td>
<td>4</td>
<td>1</td>
<td>5</td>
<td>1</td>
</tr>
<tr>
<td>45-49</td>
<td>9</td>
<td>3</td>
<td>1</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>50-54</td>
<td>10</td>
<td>5</td>
<td>2</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>55-59</td>
<td>2</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>60-64</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>65 and older</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>60</td>
<td>21</td>
<td>6</td>
<td>26</td>
<td>7</td>
</tr>
</tbody>
</table>

ELIGIBLE RETIREES:

<table>
<thead>
<tr>
<th>Age</th>
<th>Total</th>
<th>LPGEA</th>
<th>Management</th>
<th>LPPA</th>
<th>LPPEA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under 50</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>50-54</td>
<td>2</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>55-59</td>
<td>7</td>
<td>1</td>
<td>1</td>
<td>5</td>
<td>0</td>
</tr>
<tr>
<td>60-64</td>
<td>5</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>65-69</td>
<td>5</td>
<td>1</td>
<td>1</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>70-74</td>
<td>6</td>
<td>0</td>
<td>2</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>75-79</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>80-84</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>85-89</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>90 and older</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>26</td>
<td>3</td>
<td>6</td>
<td>17</td>
<td>0</td>
</tr>
</tbody>
</table>
APPENDIX E: CALCULATION OF GASB 43/45 ACCOUNTING ENTRIES

This report is to be used to calculate accounting entries rather than to provide the dollar amount of accounting entries. How the report is to be used to calculate accounting entries depends on several factors. Among them are:

1) The amount of prior accounting entries;

2) Whether individual components of the ARC are calculated as a level dollar amount or as a level percentage of payroll;

3) Whether the employer using a level percentage of payroll method elects to use for this purpose projected payroll, budgeted payroll or actual payroll;

4) Whether the employer chooses to adjust the numbers in the report to reflect the difference between the valuation date and the first fiscal year for which the numbers will be used.

To the extent the level percentage of payroll method is used, the employer should adjust the numbers in this report as appropriate to reflect the change in OPEB covered payroll. It should be noted that OPEB covered payroll should only reflect types of pay generating pension credits for plan participants. Please note that plan participants do not necessarily include all active employees eligible for health benefits for several reasons. Following are examples.

1) The number of hours worked or other eligibility criteria may differ for OPEB compared to active health benefits;

2) There may be active employees over the maximum age OPEB are paid through. For example, if an OPEB plan pays benefits only to Medicare age, any active employees currently over Medicare age are not plan participants;

3) Employees hired at an age where they will exceed the maximum age for benefits when the service requirement is met are also not plan participants.

Finally, GASB 43 and 45 require reporting covered payroll in RSI schedules regardless of whether any ARC component is based on the level percentage of payroll method. This report does not provide, nor should the actuary be relied on to report covered payroll.

GASB 45 Paragraph 26 specifies that the items presented as RSI "should be calculated in accordance with the parameters." The RSI items refer to Paragraph 25.c which includes annual covered payroll. Footnote 3 provides that when the ARC is based on covered payroll, the payroll measure may be the projected payroll, budgeted payroll or actual payroll. Footnote 3 further provides that comparisons between the ARC and contributions should be based on the same measure of covered payroll.

At the time the valuation is being done, the actuary may not know which payroll method will be used for reporting purposes. The actuary may not even know for which period the valuation will be used to determine the ARC. Furthermore, the actuary doesn’t know if the client will make adjustments to the ARC in order to use it for the first year of the biennial or triennial period. (GASB 45 is silent on this.) Even if the actuary were to know all of these things, it would be a rare situation that would result in me knowing the appropriate covered payroll.
number to report. For example, if the employer uses actual payroll, that number would not be known at the time
the valuation is done.

As a result, we believe the proper approach is to report the ARC components as a dollar amount. It is the client's
responsibility to turn this number into a percentage of payroll factor by using the dollar amount of the ARC
(adjusted, if desired) as a numerator and then calculating the appropriate amount of the denominator based on the
payroll determination method elected by the client for the appropriate fiscal year.

If we have been provided with payroll information, we are happy to use that information to help the employer
develop an estimate of covered payroll for reporting purposes. However, the validity of the covered payroll
remains the employer's responsibility even if TCS assists the employer in calculating it.
APPENDIX F: GLOSSARY OF RETIREE HEALTH VALUATION TERMS

Note: The following definitions are intended to help a non-actuary understand concepts related to retiree health valuations. Therefore, the definitions may not be actuarially accurate.

- **Actuarial Accrued Liability:** The amount of the actuarial present value of total projected benefits attributable to employees’ past service based on the actuarial cost method used.

- **Actuarial Cost Method:** A mathematical model for allocating OPEB costs by year of service.

- **Actuarial Present Value of Total Projected Benefits:** The projected amount of all OPEB benefits to be paid to current and future retirees discounted back to the valuation date.

- **Actuarial Value of Assets:** Market-related value of assets which may include an unbiased formula for smoothing cyclical fluctuations in asset values.

- **Annual OPEB Cost:** This is the amount employers must recognize as an expense each year. The annual OPEB expense is equal to the Annual Required Contribution plus interest on the Net OPEB obligation minus an adjustment to reflect the amortization of the net OPEB obligation.

- **Annual Required Contribution:** The sum of the normal cost and an amount to amortize the unfunded actuarial accrued liability. This is the basis of the annual OPEB cost and net OPEB obligation.

- **Closed Amortization Period:** An amortization approach where the original ending date for the amortization period remains the same. This would be similar to a conventional, 30-year mortgage, for example.

- **Discount Rate:** Assumed investment return net of all investment expenses. Generally, a higher assumed interest rate leads to lower normal costs and actuarial accrued liability.

- **Implicit Rate Subsidy:** The estimated amount by which retiree rates are understated in situations where, for rating purposes, retirees are combined with active employees.

- **Mortality Rate:** Assumed proportion of people who die each year. Mortality rates always vary by age and often by sex. A mortality table should always be selected that is based on a similar “population” to the one being studied.

- **Net OPEB Obligation:** The accumulated difference between the annual OPEB cost and amounts contributed to an irrevocable trust exclusively providing retiree OPEB benefits and protected from creditors.

- **Normal Cost:** The dollar value of the “earned” portion of retiree health benefits if retiree health benefits are to be fully accrued at retirement.
<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>OPEB Benefits:</strong></td>
<td>Other PostEmployment Benefits. Generally medical, dental, prescription drug, life, long-term care or other postemployment benefits that are not pension benefits.</td>
</tr>
<tr>
<td><strong>Open Amortization Period:</strong></td>
<td>Under an open amortization period, the remaining unamortized balance is subject to a new amortization schedule each valuation. This would be similar, for example, to a homeowner refinancing a mortgage with a new 30-year conventional mortgage every two or three years.</td>
</tr>
<tr>
<td><strong>Participation Rate:</strong></td>
<td>The proportion of retirees who elect to receive retiree benefits. A lower participation rate results in lower normal cost and actuarial accrued liability. The participation rate often is related to retiree contributions.</td>
</tr>
<tr>
<td><strong>Retirement Rate:</strong></td>
<td>The proportion of active employees who retire each year. Retirement rates are usually based on age and/or length of service. (Retirement rates can be used in conjunction with vesting rates to reflect both age and length of service). The more likely employees are to retire early, the higher normal costs and actuarial accrued liability will be.</td>
</tr>
<tr>
<td><strong>Transition Obligation:</strong></td>
<td>The amount of the unfunded actuarial accrued liability at the time actuarial accrual begins in accordance with an applicable accounting standard.</td>
</tr>
<tr>
<td><strong>Trend Rate:</strong></td>
<td>The rate at which the cost of retiree benefits is expected to increase over time. The trend rate usually varies by type of benefit (e.g. medical, dental, vision, etc.) and may vary over time. A higher trend rate results in higher normal costs and actuarial accrued liability.</td>
</tr>
<tr>
<td><strong>Turnover Rate:</strong></td>
<td>The rate at which employees cease employment due to reasons other than death, disability or retirement. Turnover rates usually vary based on length of service and may vary by other factors. Higher turnover rates reduce normal costs and actuarial accrued liability.</td>
</tr>
<tr>
<td><strong>Unfunded Actuarial Accrued Liability:</strong></td>
<td>This is the excess of the actuarial accrued liability over assets irrevocably committed to provide retiree health benefits.</td>
</tr>
<tr>
<td><strong>Valuation Date:</strong></td>
<td>The date as of which the OPEB obligation is determined. Under GASB 43 and 45, the valuation date does not have to coincide with the statement date.</td>
</tr>
<tr>
<td><strong>Vesting Rate:</strong></td>
<td>The proportion of retiree benefits earned, based on length of service and, sometimes, age. (Vesting rates are often set in conjunction with retirement rates.) More rapid vesting increases normal costs and actuarial accrued liability.</td>
</tr>
</tbody>
</table>
AGENDA ITEM

TO:        CITY COUNCIL
FROM:  CITY MANAGER

Meeting Date: April 16, 2013

Subject: Recommendation for Establishing an Irrevocable Trust to Address the City’s Other Post Employment Benefit (OPEB) Liabilities

RECOMMENDATION:

It is recommended that the City Council review the Staff recommendations presented in this report relative to establishing an irrevocable trust to address the liabilities related to Other Post Employment Benefits (OPEB):

   a) Direct Staff to begin the process of establishing an irrevocable trust with CalPERS California Employers’ Retiree Benefit Trust (CERBT) with formal action coming at a subsequent City Council meeting; and

   b) Approve the use of an estimated amount not to exceed $1,500,000 in Unassigned General Fund reserves as an initial deposit into the irrevocable trust, once established; and

SUMMARY:

On February 5, 2013, the City Council was presented with four options for addressing its Other Post Employment Benefits (OPEB) unfunded liability and indicated support for the option to establish an irrevocable trust. This action responds directly to one of the City Council’s goals for 2013.

This option presents the most financially and actuarial favorable approach for several reasons:

• Immediate and significant reduction of the City’s unfunded actuarial accrued liability (UAAL)
• Helps ensure adequate funding will be available for future retirees
• Over the long-term, lowers the annual, ongoing operating cost of the retiree medical health program
allows the General Fund to realize one-time, operational savings in Fiscal Year 2013-14, which will help close the anticipated gap between revenue and expenditures.

By establishing a trust, the City would permanently set aside funds for the sole purpose of funding the Other Post Employment Benefits (OPEB) liability. Part of the recommended action, is to utilize a portion of Unassigned General Fund reserves as an initial deposit in establishing the trust (also known as pre-funding). These funds would help “seed” the trust and would be considered assets on deposit when the required actuarial valuation of the retiree health plan is conducted.

Having assets on hand, earning higher rates of return, lowers the annual cost of the retiree health benefit program. This lower cost would positively impact the General Fund. In addition, using a trust administered by a third party allows for the use of a higher discount rate (i.e., rate of return) in the required actuarial valuations, further reducing the UAAL. Finally, establishing a trust allows for retiree health care commitments to be paid from the trust assets. Therefore, as assets grow (based on fully funding the actuarial required contribution [ARC] annually as well as the accumulation of interest earnings), more funds are available in the trust to meet ongoing (and future) obligations.

As directed at the February 5, 2013, City Council meeting, Staff has returned prior to the end of the 2012-13 fiscal year with a recommendation on which agency with which to establish the trust as well as an estimated “seed” amount to pre-fund the trust. Based on direction received, Staff will commission a required actuarial valuation report (as of June 30, 2013) as well as put together all contractual and legal documentation requiring City Council approval to formally establish the trust. It is estimated that Staff can return shortly after the beginning of the 2013-14 fiscal year with an action item to establish the trust as well as a detailed plan outlining the pre-funding process (i.e., depositing an amount not to exceed $1.5 million in the trust over the course of the fiscal year).

Based on Staff research, it is recommended that a trust be established with CalPERS through their California Employers’ Retiree Benefit Trust (CERBT) program. Furthermore, Staff is recommending a pre-funding level in an amount not to exceed $1.5 million. At this stage in the process, this recommended pre-funding amount is an estimate. The required actuarial valuation, once completed, will provide a clearer picture of exactly how much should be utilized as an initial deposit. However, based on Staff’s numerous conversations with the City’s actuary, the $1.5 million amount is a reasonable estimate and would provide numerous, immediate benefits to the City, on top of the longer-term benefits realized from establishing a trust.

The following pages present a detailed analysis of this recommendation, as well as the steps to be taken in the next few months to formally establish an irrevocable trust.

BACKGROUND:

Staff has met with representatives from CalPERS, PARS and PFM Asset Management, LLC to review their OPEB trust offerings. For numerous reasons, Staff is recommending the CalPERS California Employers’ Retiree Benefit Trust (CERBT) program.
The advantages of CERBT include:

- Single point of contact for all trust management issues (administration, investment and disbursement of funds)
- Low administrative cost (low overhead)
- Ability to have seamless transition for current retirees (no impact on retirees and their health benefits)
- Simple process for initial trust set-up (sooner vs. later)

Staff considered these and other aspects in recommending CERBT. Of significant importance in the decision making process was the overall cost of establishing and administering a trust. The overall cost consideration included direct cost to the City (as a percentage of assets) as well as indirect costs of City Staff time necessary to set-up and manage the trust.

Each of the three agencies reviewed base their management fees as a percentage (i.e., number of basis points) of assets on hand. The CERBT offers the most competitive rate and rate structure, approximately 16 basis points (0.16%), regardless of the amount of assets on hand. Attachment 2 provides a comparison of these administrative costs between CERBT, PARS, and PFM Asset Management.

Another important consideration is ease of administration. Given the limited number of dedicated treasury and payroll staff in the Finance Department and benefits staff in Administration, it is imperative that the trust be relatively simple to administer. CERBT is a better fit for an organization the size of La Palma, having only a small amount of active retirees (currently twenty-eight).

Another benefit in choosing CERBT is not having to establish a separate “trustee” or “custodian” banking relationship for the deposit, management and investment of funds. With CERBT, all annual payments, as well as the initial pre-funding amount, can be sent directly to the CalPERS CERBT office. There is no need to establish a trustee account with another bank or financial institute, thus saving initial set-up time, streamlining long-term administration, and saving money.

It should be noted that, for PARS and PFM, a portion of the additional management costs are directly related to having multiple “partners” handling the trustee and investment functions. For example, for plans with less than $5 million in assets, the PARS administration fee is 55 basis points: 35 basis points are related to trustee/investment management. PFM Asset Management assess a 45 basis point fee for deposits less than $10 million. CERBT does not have these additional trustee/investment management partners and therefore does not assess related fees since these functions are handled in-house.

Finally, all three agencies offer at least three different investment strategies. While PFM and PARS admittedly offer a much wider variety of investments and investment strategies, Staff believes the three strategies provided by CERBT (available since FY 2011-12) are sufficient for La Palma’s needs. Given the relatively small asset amount that La Palma will be investing, the
CERBT investment allocations and strategies will provide more than enough financial stability and returns in order to reach the primary goal of establishing a trust, which is lowering the City’s unfunded liability. Attachment 3 provides an overview of the three CERBT investment strategies and their underlying asset allocation.

**ANALYSIS:**

As required by Government Accounting Standards Board Statement Number 45 (GASB 45), the City must have an actuarial valuation completed of its OPEB plan every three years. (This requirement changes to every two years once an irrevocable trust is established, since GASB 43 rules would then apply.) The latest GASB 45 report for the City of La Palma was completed in April, 2012 by Total Compensation Specialists (Attachment 4). Based on that valuation report and the actuarial assumptions therein, the City’s current unfunded actuarial accrued liability (UAAL) for its retiree medical program is approximately $3.312 million.

In establishing a trust, a new valuation report is required, using a fiscal year ending date of June 30, 2013. (In addition, the valuation report must be completed before a trust can be formally established.) This new valuation report will utilize a host of new assumptions, which will have positive impacts for the City. Of primary importance is the positive effect which the new assumptions will have on the City’s unfunded liability (UAAL).

By establishing a trust, La Palma’s unfunded liability will be immediately reduced by two primary means:

- The required actuarial valuation report will utilize a higher discount rate (i.e., rate of return on investments)
- The City will have assets on hand which will be counted in the required actuarial valuation report

These – and other – beneficial impacts will be reflected in the Fiscal Year 2012-13 Certified Annual Financial Report (CAFR). The following paragraphs provide a fuller explanation of the immediate positive impacts that establishing a trust will have on the City’s financial position.

**Discount Rate Assumption**

The last OPEB actuarial valuation (April, 2012) utilized a 5% discount rate assumption. This is a standard rate used for “pay as you go” plans such as La Palma’s. One of the immediate benefits of joining a trust is that the required initial actuarial valuation – and all subsequent valuations – can utilize the discount rate of the participating trust.

Since the recommendation is to join the CERBT, this analysis focuses on the discount rate strategies used by CalPERS. Their CERBT has three strategies (available as of FY 2011-12), each varies based on the underlying asset allocation. Much as one’s personal retirement account works (i.e., 401(k)), depending on the way deposits are invested, one can have a higher or lower assumed rate of return. The CERBT strategies have discount rates of 6.39%, 7.06% or 7.61%.
Even the lowest rate of return is 28% higher than the 5% assumption used in the April, 2012 valuation report.

The use of a higher discount rate (e.g. CERBT Strategy 1, 7.61%) in the required June 30, 2013 actuarial valuation would lower the City’s OPEB unfunded liability to approximately $2.5 million (from $3.312 million). Subsequent City Council action, as recommended in this report, will provide additional detail on a suggested investment strategy. Attachment 3 provides a summary of each CERBT investment strategy and the underlining asset classifications for each.

**Assets on Hand**

One of the most important decisions in moving to establish a trust is determining the proper pre-funding amount. La Palma is fortunate to have considerable Unassigned General Fund reserves that could be used for this purpose. Another of the many benefits of establishing a trust is the positive effect which assets have on the actuarial valuation.

Currently, since the City does not have a trust, there are no assets which can be “counted” when completing the required GASB 45 actuarial report. However, this situation would change immediately with the pre-funding of a trust and the required June 30, 2013 actuarial valuation would show assets utilized for paying OPEB liabilities. The recommendation in this report assumes a use of an amount not to exceed $1.5 million in Unassigned General Fund reserves as a pre-funding amount. Subsequent discussions will sharpen this estimate and the next action brought forth to the City Council will have an exact amount and a funding plan. However, based on the numerous discussions with the City’s actuary and other professionals who have been through this process, Staff feels confident in recommending the $1.5 million pre-funding amount.

Pre-funding has the benefit of positively impacting the UAAL (by reducing it) as well as lowering the annual, ongoing operating expenses of having a retiree medical program. Once the required actuarial valuation is completed, a clearer picture of the benefits of pre-funding can be presented.

**Additional (Non-UAAL Related) Benefits**

In addition to the immediate benefits of reducing the City’s unfunded liability, the establishment of a trust has several long-term benefits. One of the most important long-term benefits is the reduction in annual ongoing costs. Currently, under the “pay as you go” model, the City spends approximately $120,000 annually for retiree medical benefits, about $91,000 of which is from the general fund. This amount only pays for those expenses in the current year – expenses of current retirees. By establishing a trust, the City is not only continuing to pay current retiree medical expenses, but is also putting enough funding away annually to cover projected, future retiree medical costs.

The “pay as you go” amount is only one component of the total cost of having a retiree medical program. Adding the amount needed to cover projected future retiree medical costs to the “pay as you go amount” produces the “actuarial required contribution” (ARC) figure. One goal of establishing a trust is to reduce the ARC to an amount that is less than the “pay as you go” amount.
As a rule of thumb, for every $500,000 deposited in a trust up front, a component of the ARC drops by 20%. This is an important effect since one of the benefits of pre-funding is to not increase the annual, ongoing operating expenses of the City’s retiree health program. Therefore, by pre-funding the trust with $1.5 million in assets, the annual amount required to fully fund the total, ongoing liability would be close to that $120,000 amount. Hence, the City can fully fund its ARC for close to the amount currently spent to only fund current retirees.

The benefit of pre-funding is that the point at which the ARC is equal to or less than the normal cost is much sooner than if no funds were initially deposited. Using the Staff recommendation of $1.5 million in pre-funding, the ARC would immediately be close to, if not equal to, the current “pay as you go” amount. Under the “pay as you go” method, the City would never be able to reduce its ARC.

An important auxiliary benefit of pre-funding is the positive impact on the FY 2013-14 budget. The City will realize approximately $91,000 in one-time General Fund savings in employee benefit costs through the establishment of the trust. Due to actuarial and accounting rules, the pre-funding amount (approximately $1.5 million as being recommended here) will cover the first year’s ARC in addition to serving as “assets on hand” used in the required valuation report. This one-time General Fund savings is merely another positive ancillary benefit of joining the CERBT and is a standard accounting practice which other agencies have benefited from. This $91,000 in one-time General Fund savings will help further close the FY 2013-14 budget gap.

CONCLUSIONS:

Staff recommends City Council approve the following actions allowing for the establishment of an irrevocable trust to address OPEB liabilities:

1. Approve Staff recommendation to prepare the necessary trust documents with CalPERS CERBT, with a subsequent City Council action item to formally adopt the trust documents.

2. Approve Staff recommendation to pre-fund the trust by an amount not to exceed $1.5 million; subsequent discussions with CalPERS staff and the City’s actuary will provide an exact amount once the required actuarial valuation is completed.

In addition, Staff will work with Total Compensation Specialists (TCS) to update the OPEB actuarial valuation (GASB 45) report using a June 30, 2013 date with the additional assumptions of pre-funding and a higher discount rate. Staff will also work closely to communicate with its current retirees about the establishment of the trust, in order to answer any questions which might arise. However, our retirees will see no change in their benefits or the administration of their benefits with the establishment of the trust.
FISCAL IMPACT:

The fiscal impacts of establishing a trust are many. From an operating standpoint, the proposed FY 2013-14 General Fund budget would see an estimated $91,000 in one-time savings due to the timing and nature of pre-funding the trust. In addition, the City’s June 30, 2013 financial statements will show a much lower unfunded liability once the CAFR is published. Finally, Unassigned General Fund reserves will be reduced by an amount not to exceed $1.5 million; with the exact amount to be determined after the completion of the required actuarial valuation and formal approval to use the funds by the City Council. Unassigned Reserves, above the amount established by Council policy, are available for this purpose.

In addition, there are long-term benefits which will be realized over the life of the OPEB amortization period. As the trust assets grow, the City’s unfunded liability as well as the annual amount required to be paid (the ARC) will continue to decrease.

Attachments:

1. February 5, 2013 City Council OPEB Options Agenda Item
2. Comparison of CalPERS CERBT, PARS, and PFM Asset Management OPEB Trust Administrative and Investment Costs
3. CalPERS CERBT Investment Strategies Overview
4. GASB 45 Report, April 2012
Objective
The objective of the CERBT Strategy 1 portfolio is to seek favorable returns that reflect the broad investment performance of the financial markets through capital appreciation and through investment income. There is no guarantee that the portfolio will achieve its investment objectives.

Strategy
The CERBT Strategy 1 portfolio is invested in various asset classes in percentages approved by the CalPERS Board. The specific percentages of portfolio assets allocated to each asset class are shown under “Composition”. Generally, equities are intended to help build the value of the employer’s portfolio over the long term while bonds are intended to help provide income and stability of principal. Also, strategies invested in a higher percentage of equities seek higher investment returns (but assume more risk) compared with strategies invested in a higher percentage of bonds.

Compared with other asset allocation strategies, this portfolio consists of a higher percentage of equities to bonds and other assets. Historically, equities have displayed greater price volatility and therefore this portfolio may experience greater fluctuation of value. Employers that seek higher investment returns, and are able to accept greater risk and tolerate more fluctuation in returns, may wish to consider this portfolio.

Information Provided in Lieu of Prospectus
The CERBT Strategy 1 portfolio consists of assets managed internally by CalPERS. Because it is not a mutual fund, a prospectus is not available. This summary is designed to provide descriptive information.

Assets Under Management
As of February 28, 2013, the aggregate total of assets under management for all CERBT Strategies was $2,503,582,328.

Composition
Asset Class Allocations and Benchmarks
The CERBT Strategy 1 portfolio may consist of the following asset class target allocations and corresponding benchmarks:

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Equity</td>
<td>MSCI All Country World Index IMI (net)</td>
</tr>
<tr>
<td>U.S. Fixed Income</td>
<td>Barclays Capital Long Liability Index</td>
</tr>
<tr>
<td>Treasury Inflation-Protected Securities (TIPS)</td>
<td>Barclays Capital Global Real: US TIPS Index</td>
</tr>
<tr>
<td>Real Estate Investment Trusts (REITs)</td>
<td>FTSE EPRA/NAREIT Developed Liquid Index (net)</td>
</tr>
<tr>
<td>Commodities</td>
<td>S&amp;P GSCI Total Return Index</td>
</tr>
</tbody>
</table>

Portfolio Benchmark
The CERBT Strategy 1 benchmark is a composite of underlying asset class market indexes, each assigned the target weight for the asset class it represents.

Target vs. Actual Asset Class Allocations
The following chart shows policy target allocations compared with actual asset allocations as of February 28, 2013. CalPERS may overweight or underweight an allocation to a particular asset class based on market, economic, or CalPERS policy considerations.

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Target</th>
<th>Actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Equity</td>
<td>60%</td>
<td>60%</td>
</tr>
<tr>
<td>U.S. Fixed Income</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>TIPS</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>REITs</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Commodities</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Cash</td>
<td>10%</td>
<td>10%</td>
</tr>
</tbody>
</table>

CERBT Strategy 1 Performance as of February 28, 2013

<table>
<thead>
<tr>
<th></th>
<th>1 Month</th>
<th>3 Months</th>
<th>Fiscal YTD</th>
<th>1 Year</th>
<th>3 Years*</th>
<th>5 Years*</th>
<th>Since Inception* (June 1, 2007)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Returns before expenses</td>
<td>0.13</td>
<td>4.96</td>
<td>12.10</td>
<td>9.98</td>
<td>10.73</td>
<td>4.19</td>
<td>2.93</td>
</tr>
<tr>
<td>CERBT Strategy 1 Benchmark</td>
<td>0.11</td>
<td>4.99</td>
<td>12.03</td>
<td>9.96</td>
<td>10.85</td>
<td>4.37</td>
<td>2.46</td>
</tr>
</tbody>
</table>

*Returns for periods greater than one year are annualized.
1See the “Expenses” section of this document.
Performance data shown represents past investment performance and is no guarantee of future results. The investment return and principal value of the portfolio will fluctuate so that an employers’ account balance in the portfolio may be worth more or less than the amount invested. Current performance may be lower or higher than the performance data shown above.
General Information

What Employers Own
Each employer owns a percentage of the CERBT Strategy 1 portfolio, which invests in pooled asset classes managed by CalPERS. Employers do not have direct ownership of the securities in the portfolio.

Information Accessibility
Since the portfolio is not a mutual fund, information is not available from a newspaper source. Instead, CalPERS provides a quarterly statement of the employer's account. For current performance information, including performance to the most recent month-end, investment policy, and detailed asset allocation, please visit our website at: www.calpers.ca.gov.

Price
The value of the portfolio changes daily, based upon the market value of the underlying securities. Just as prices of individual securities fluctuate, the portfolio’s value changes with market conditions.

Expenses
CERBT is a self-funded trust in which participating employers pay for all administrative and investment expenses. Expenses reduce the gross investment return by the fee amount. The larger the fee, the greater the reduction of investment return. Currently, CERBT expenses are accrued at an annual rate of 0.15% and charged daily to employer accounts. CERBT’s actual expenses may differ from the amount currently being accrued due to factors such as changes in average fund assets or actual expenses. The expense accrual rate may change without notice in order to reflect changes in average portfolio assets or in expense amounts. The CalPERS Board annually reviews the operating expenses and changes may be made as appropriate. Even if the portfolio loses money during a period, the fee is still charged.

Portfolio Manager Information
The portfolio is managed by CalPERS Investment Office staff as directed by the CalPERS Investment Committee and Board of Administration.

Principal Risks of the Portfolio
An investment in the portfolio is not a bank deposit, and it is not insured nor guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency. It is possible to lose money by investing in this portfolio. The portfolio’s risk depends in part on the portfolio’s asset class allocations and the selection, weighting and risks of the underlying investments. Some major risks associated with investing in equities, fixed income and other assets include:

- Allocation Risk: The portfolio’s ability to achieve its investment objectives depends in part on the managers’ skill in determining the portfolios’ sector allocations and in selecting and weighting the underlying investments. The managers’ evaluations and assumptions regarding asset classes and underlying investments may differ from actual market conditions.
- Market Risk: The value of the portfolio will go up and down based on the performance of the underlying investments in which it invests. The value of the underlying investments will, in turn, fluctuate based on the performance of the securities owned and other factors generally affecting the securities market.
- Interest Rate Risk: Generally, when interest rates rise, the value of an underlying investment’s fixed income securities will decline. The opposite is true when interest rates decline.
- Credit Risk: The value of an underlying investment’s fixed income securities will be adversely affected by any erosion in the ability of issuers of these securities to make timely interest and principal payments.
- Foreign Risk: Some of the underlying investments are in foreign securities, which are generally riskier than U.S. securities. As a result, the portfolio is subject to foreign risk, meaning that political events (such as civil unrest, national elections, and imposition of exchange controls), social and economic events (such as labor strikes and rising inflation), and natural disasters occurring in a country where the portfolio invests could cause the portfolio’s investments in that country to experience losses.
- Principal Loss: Employers own a percentage of the CERBT Strategy 1 portfolio (expressed as “units”). At any given time, the value of an employer’s units may be worth less than the price paid for them.

CERBT Strategy Risk Levels
CalPERS offers employers the choice of one of three investment strategies. Risk levels among strategies vary, depending upon the target asset class allocations. Generally, equities carry more risk than fixed income securities.

<table>
<thead>
<tr>
<th>Asset Class Target Allocations</th>
<th>Strategy 1</th>
<th>Strategy 2</th>
<th>Strategy 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Equity</td>
<td>66%</td>
<td>50%</td>
<td>32%</td>
</tr>
<tr>
<td>U.S Fixed Income</td>
<td>18%</td>
<td>24%</td>
<td>42%</td>
</tr>
<tr>
<td>TIPS</td>
<td>5%</td>
<td>15%</td>
<td>15%</td>
</tr>
<tr>
<td>REITs</td>
<td>8%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Commodities</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
</tr>
</tbody>
</table>