

OPEB Trust Fund



April 4, 2017



Definitions

- OPEB: Other (than pension) Post Employment Benefits: Medical benefits paid to retirees
- Normal Cost (NC): value of benefits to be earned by employees in the coming year
- Actuarial Accrued Liability (AAL): value of benefits earned to date
- Unfunded Actuarial Accrued Liability:
AAL minus Assets
- Discount Rate (DR): Rate used to calculate present value of future benefits. Higher rate => lower present value

Current Investment Policy

- In accordance with Government Code Sections 53620-53622, assets of the City of Berkeley retiree medical plan trusts may be invested in any form or type of investments deemed prudent by the City Council.
- Current investments \$39.3 million
 - Fixed income
 - Highly rated, low risk
 - Study assumes long term return on current assets = 4% per year



Recommended Investment Policy

- Change investment allocation to produce higher long-term average future returns
 - Use outside investment manager
 - Study includes 6% average annual future return assuming recommendation accepted



Investment Policy Rationale

■ Long Term Investment Horizon

- Benefits will be paid over 30 years or more
- Annual cash requirements for benefit payments are relatively small compared to total fund
- Fund has time to make up for periodic losses expected with riskier asset allocation
 - If additional risk is accompanied by higher expected long term returns

Investment Policy Rationale

$$\begin{aligned} \text{Contributions + Investment Earnings} \\ = \\ \text{Benefits + Expenses} \end{aligned}$$

- Example: CalPERS
 - 65% of every pension dollar from investment earnings
- Results of Recommended Policy:
 - Larger portion of benefits paid by investment earnings
 - Lower contributions and actuarial liabilities

OPEB Funding

- **Miscellaneous Employees**
- **Police**
- **Fire**
- **“PERIP”**



April 4, 2017



Definitions

- Normal Cost (NC): value of benefits to be earned by employees in the coming year
- Unfunded Actuarial Accrued Liability:
AAL minus Assets
- ARC or Actuarially Determined Contribution (ADC):
Full Prefunding:
 - Normal Cost plus
 - Amortization (payment over time) of UAAL
- “Pay as you Go” or “Pay-Go”: Benefits are paid as they come due. No fund is built up.

OPEB Funding Study Assumptions

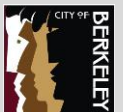
- Projection assumptions for study
 - Recommended investment policy: 6%/yr future returns
 - Current investment policy: 4%/yr future returns
 - Full prefunding = normal cost + 20 year amortization of unfunded actuarial accrued liability
 - No change in number of active employees

OPEB Funding

■ Miscellaneous Employees



April 4, 2017



OPEB - Miscellaneous

■ Benefit

- City pays retiree premium up to a cap and subject to benefit percentage schedule
 - 100% after 20 years
- Cap varies by bargaining group, medical coverage and retirement date
- Cap increases by Kaiser premium %, up to 4.5%/year

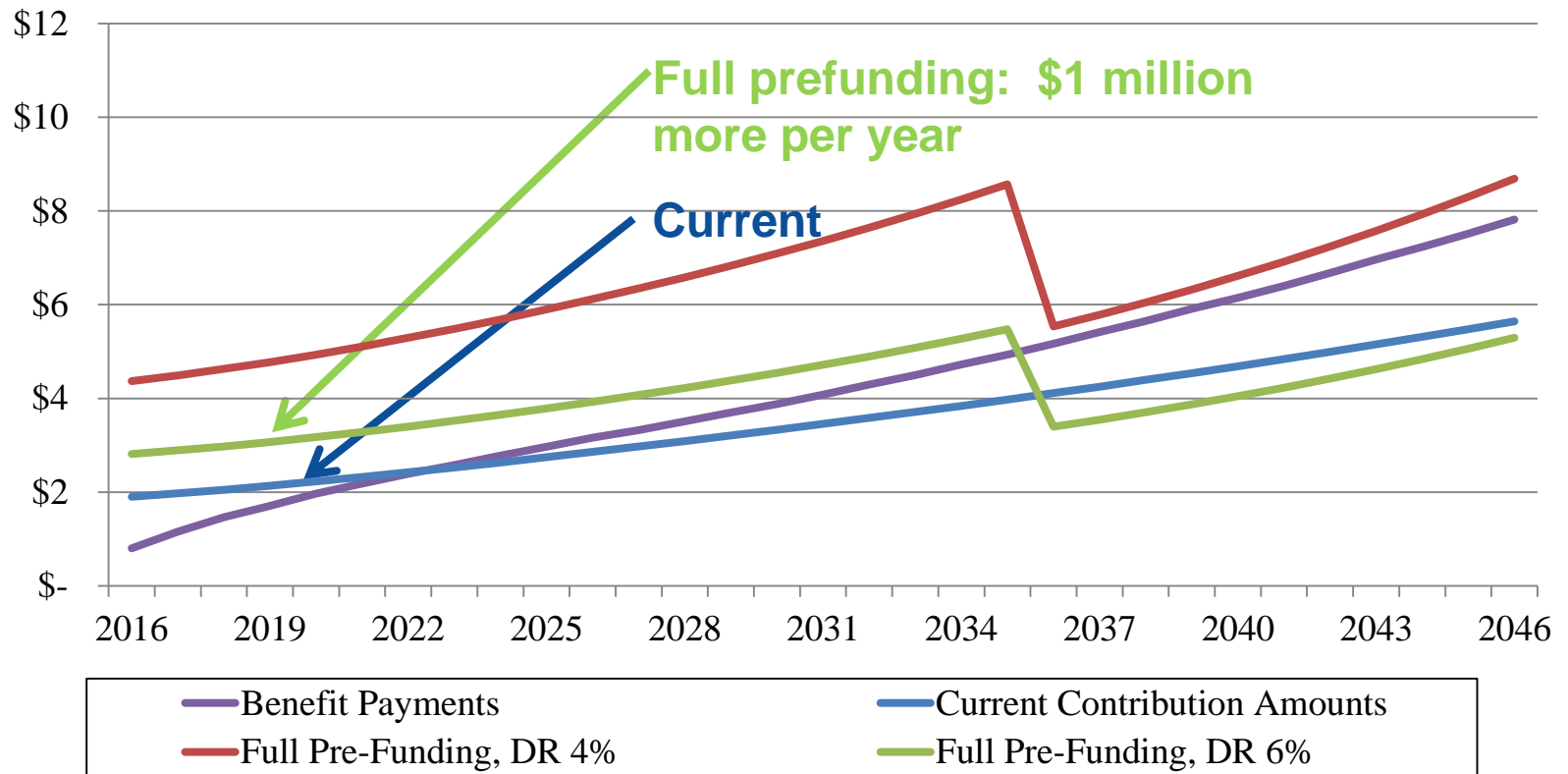
■ Current funding policy: Percent of payroll specified in MOUs



OPEB - Miscellaneous

Contribution

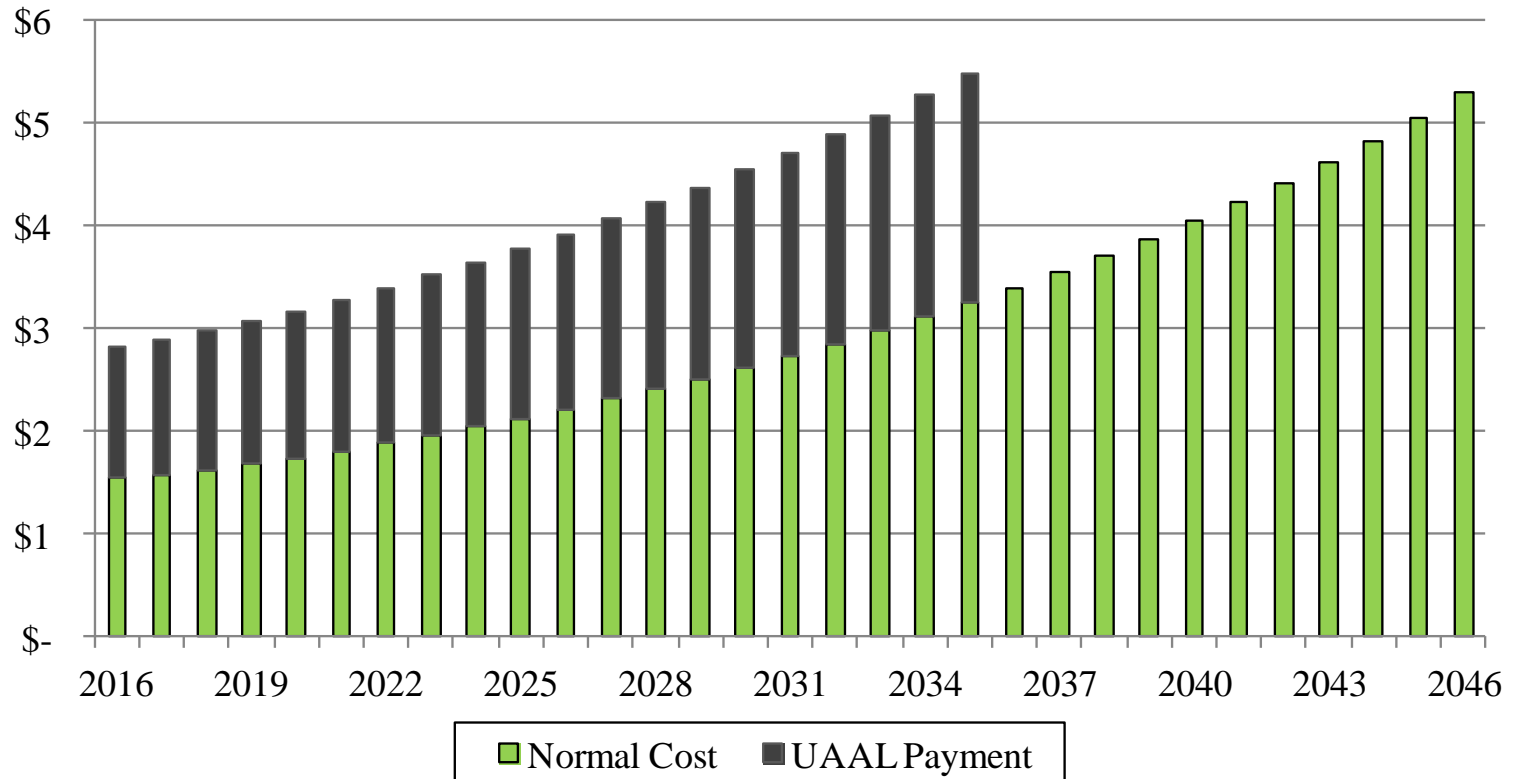
(Amounts in millions)



OPEB - Miscellaneous

Full Pre-Funding, Discount Rate 6.0%

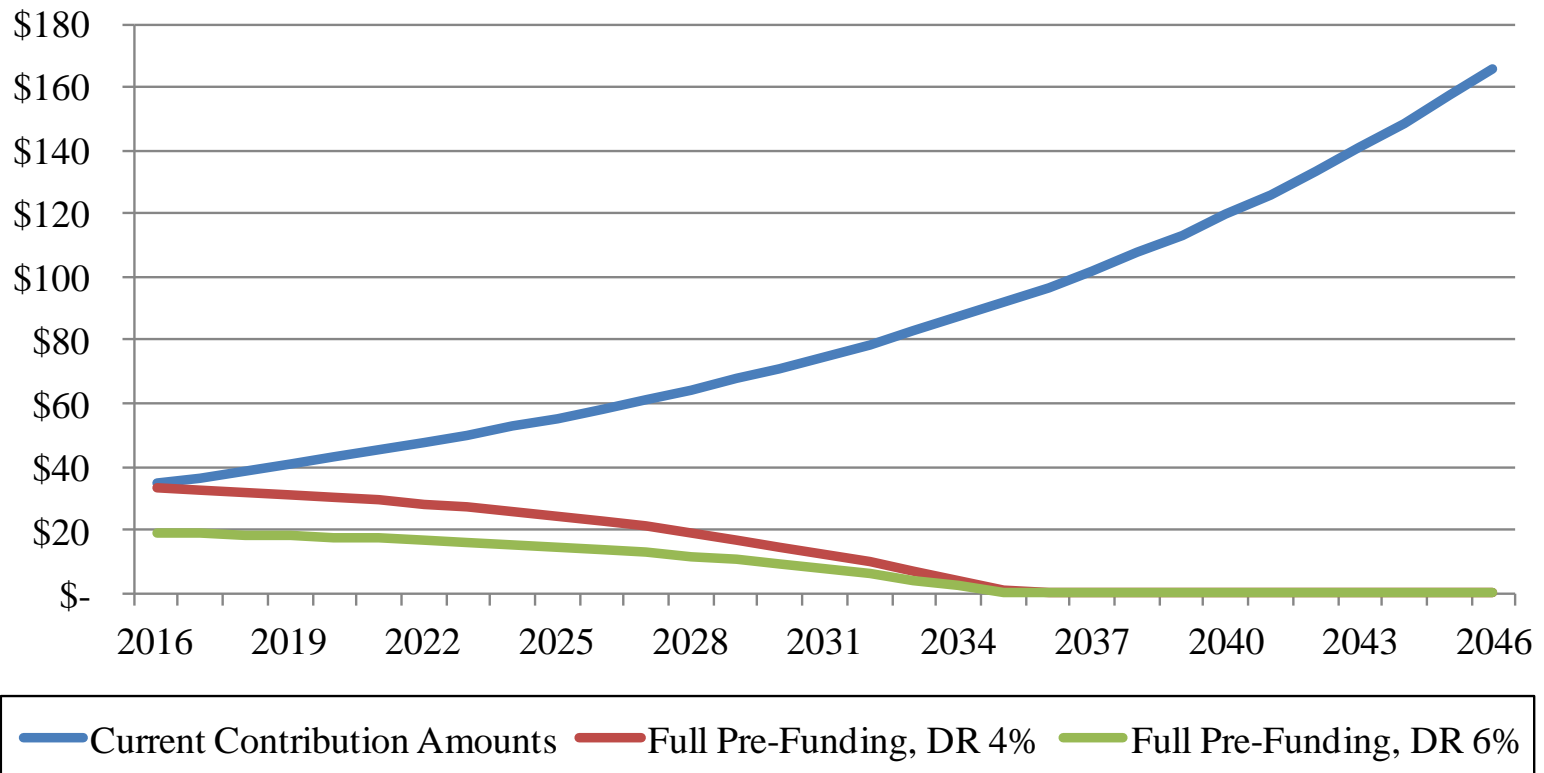
(Amounts in millions)



OPEB - Miscellaneous

Unfunded Actuarial Accrued Liability

(Amounts in millions)



OPEB – Miscellaneous Funding Recommendation

■ Recommendation

- Full prefunding of actuarially determined contribution
- Approximately \$1 million per year increase over current contribution amounts
 - \$1 million is total for all bargaining units

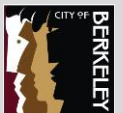


OPEB Funding

■ Police



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OPEB - Police

■ Benefit

- City pays retiree premium up to a cap and subject to benefit percentage schedule
 - 100% after 20 years
- Cap increases annually by the percentage increase of Kaiser premium up to 6%
- Retirees after September 2012 only

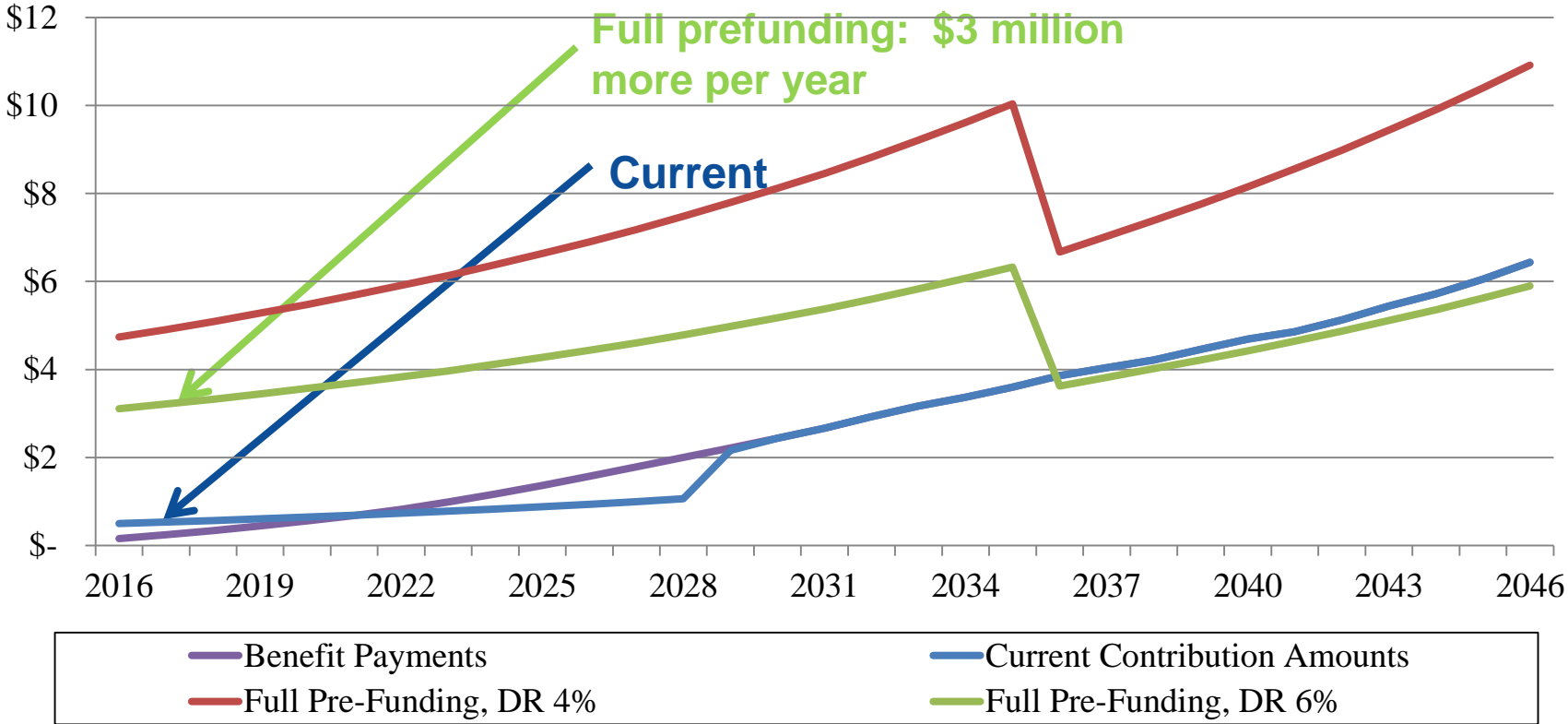
■ Current contribution amounts: approximately 10% of actuarially determined contribution



OPEB - Police

Contribution

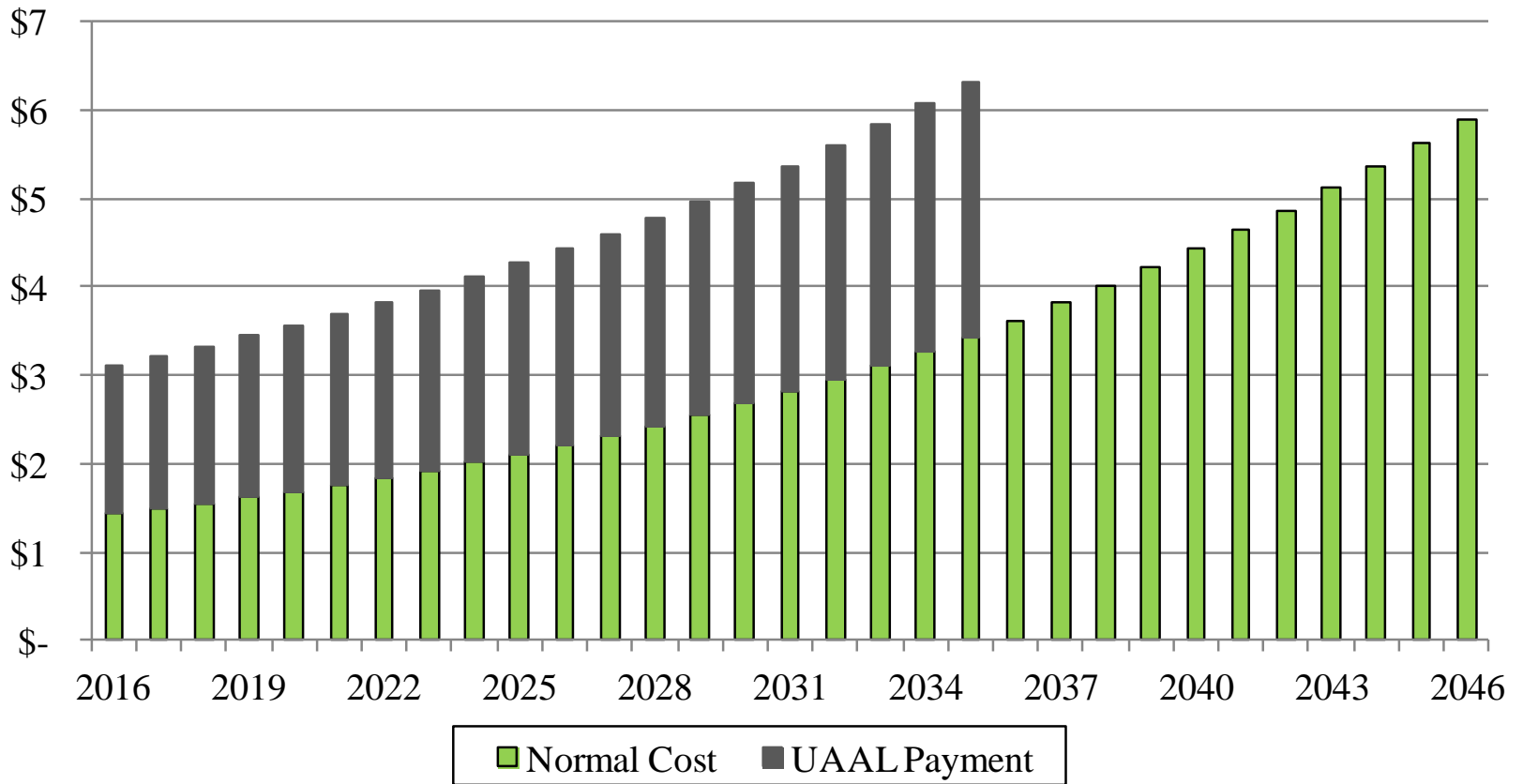
(Amounts in millions)



OPEB - Police

Full Pre-Funding, Discount Rate 6.0%

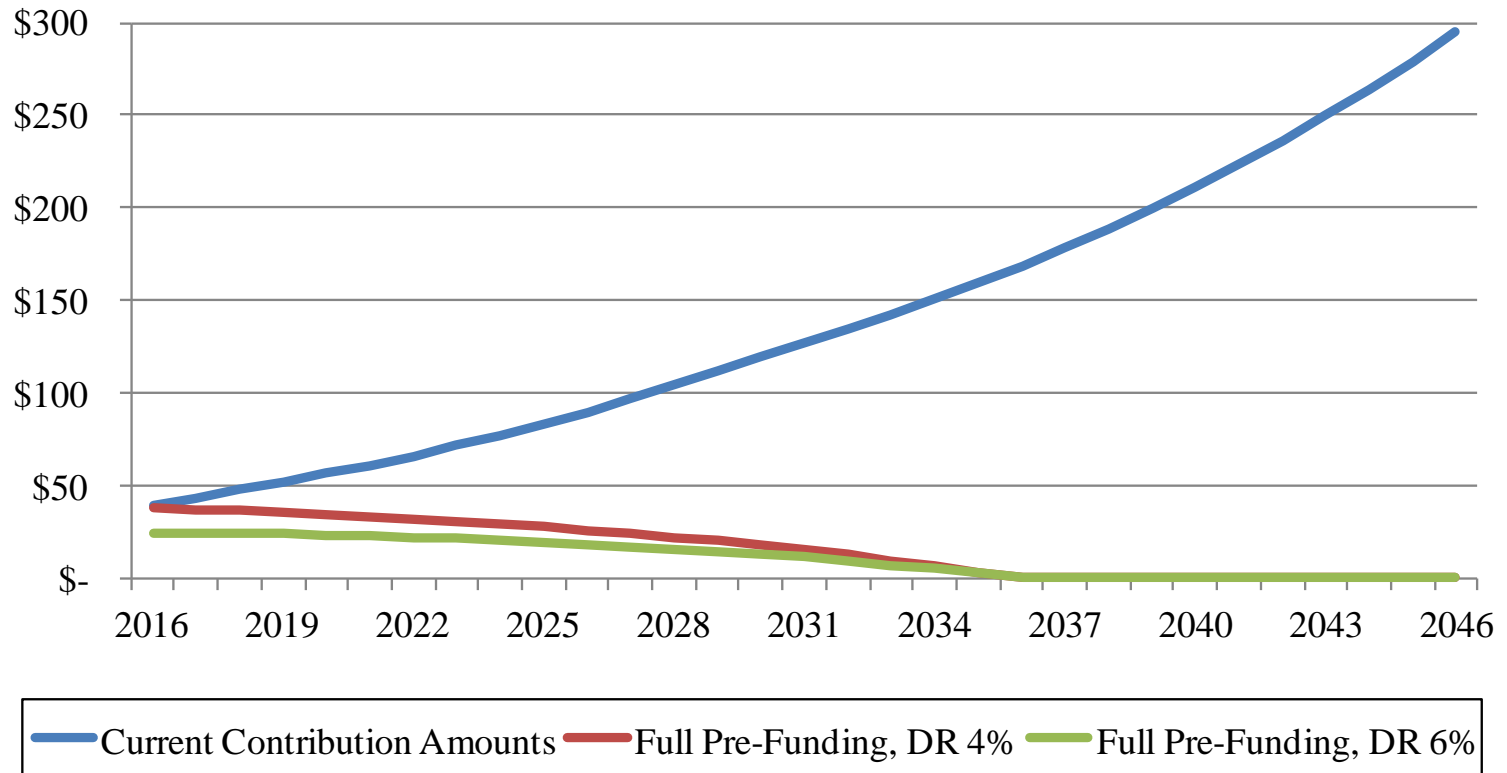
(Amounts in millions)



OPEB - Police

Unfunded Actuarial Accrued Liability

(Amounts in millions)



OPEB – Police

Funding Recommendation

■ Recommendation

- Full prefunding of actuarially determined contribution
- Approximately \$3 million per year increase over current contribution amounts



OPEB Funding

■ Fire



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OPEB - Fire

■ Benefit

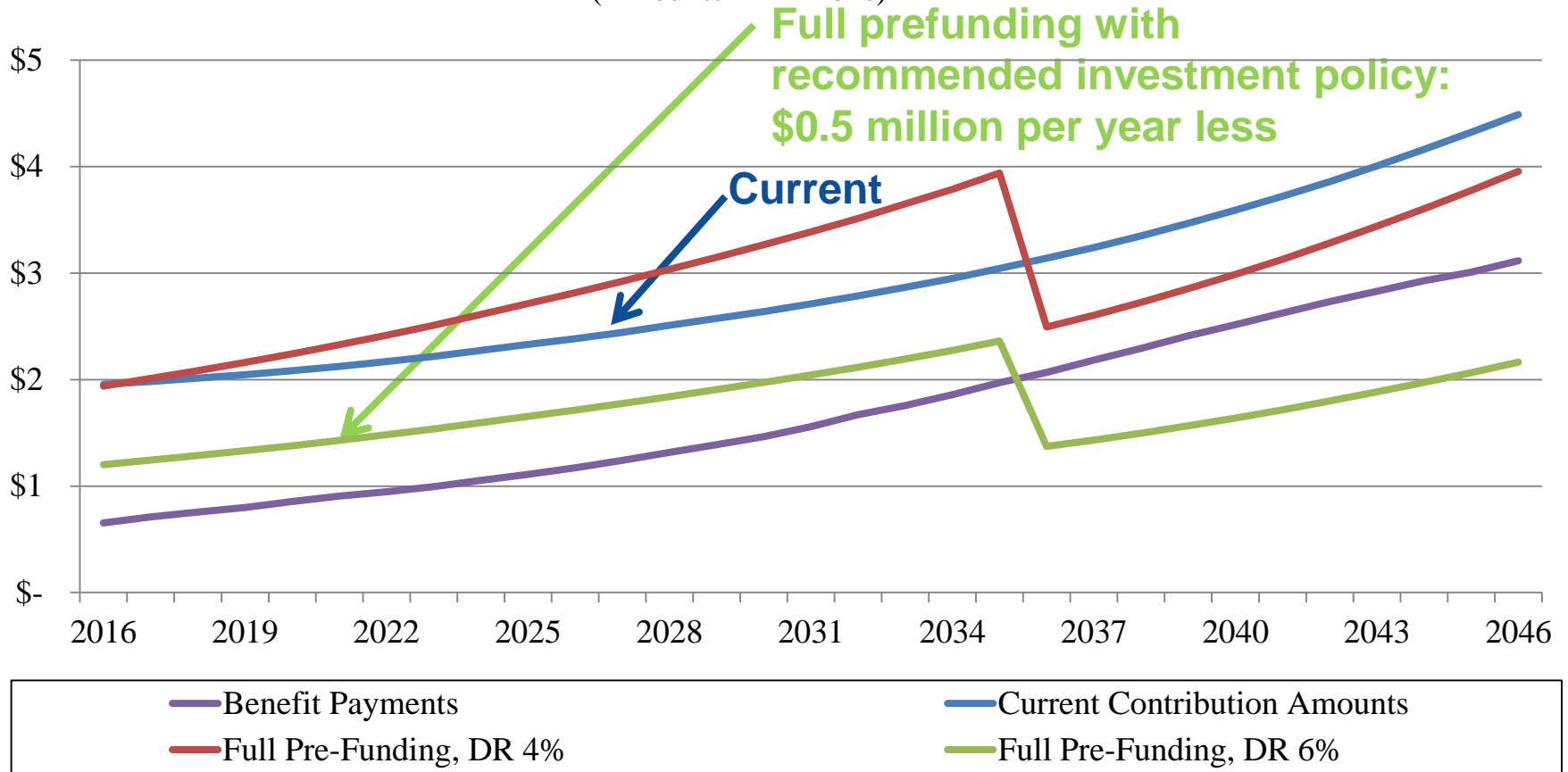
- City pays retiree premium up to a cap and subject to benefit percentage schedule
 - 100% after 25 years
- Cap increases annually by 4.5%
- Retirees after July 1997 only

- ## ■ Current contribution amounts: Full prefunding of actuarially recommended contribution, 4% discount rate, 30 year rolling amortization

OPEB - Fire

Contribution

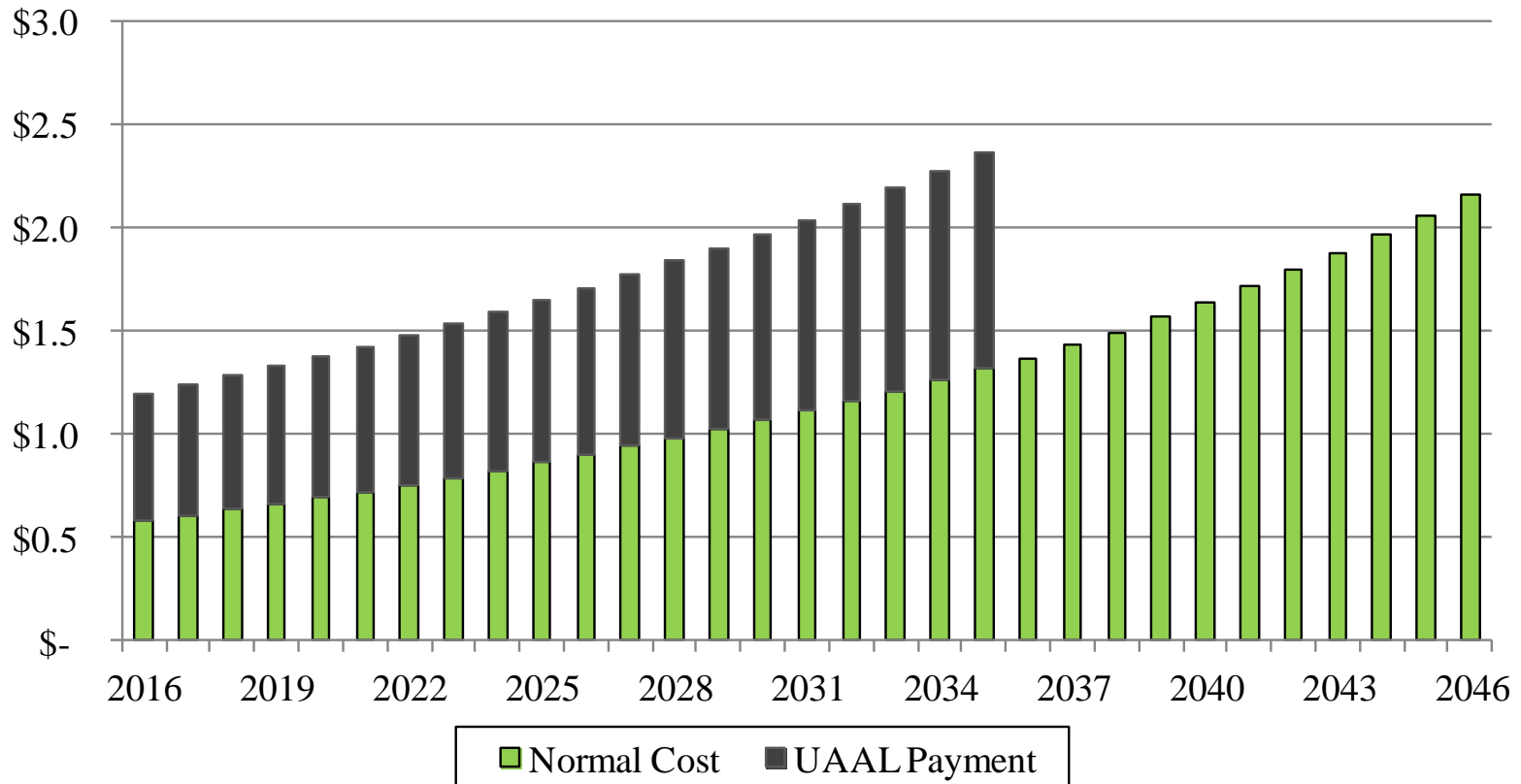
(Amounts in millions)



OPEB - Fire

Full Pre-Funding, Discount Rate 6.0%

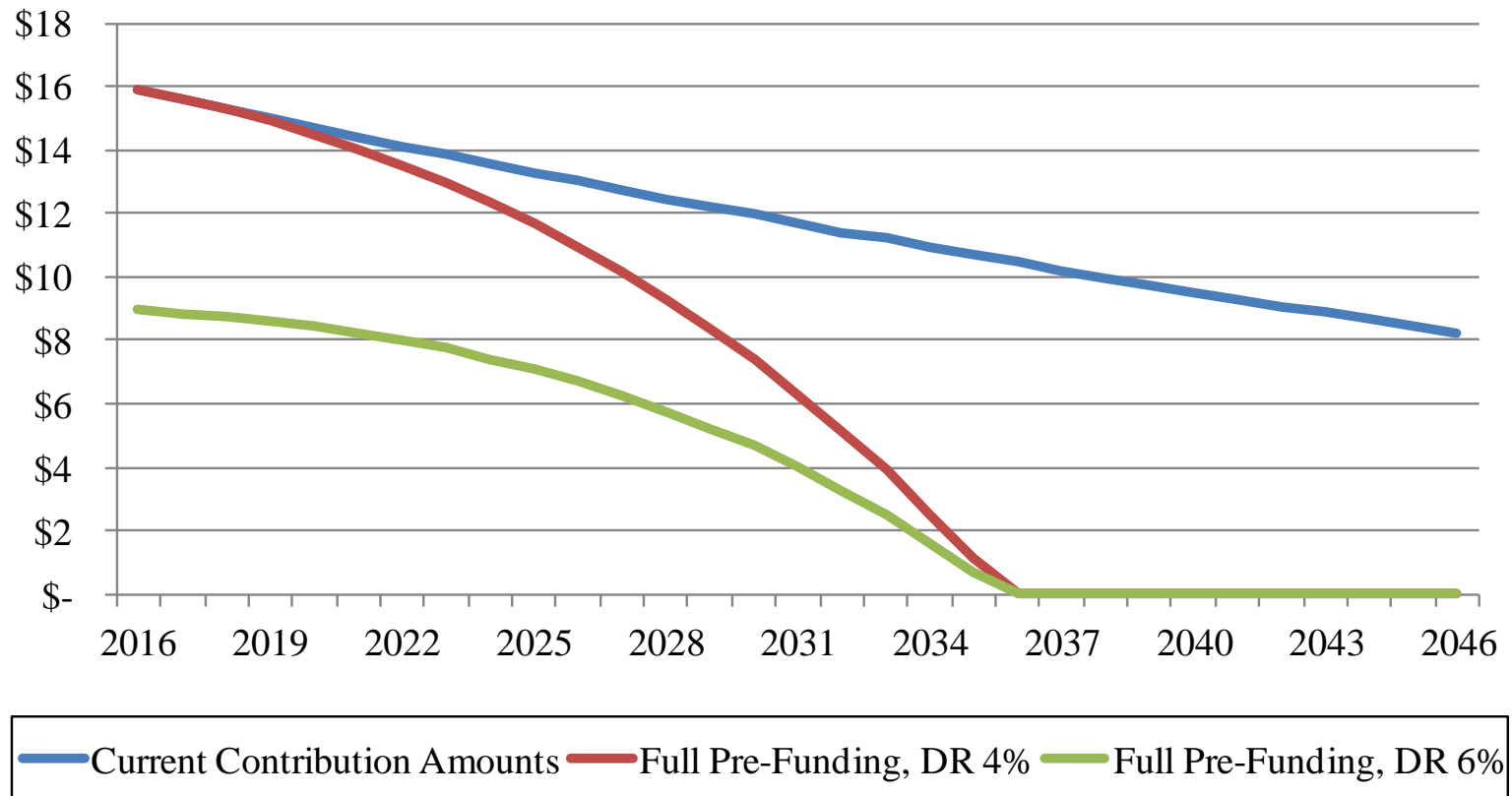
(Amounts in millions)



OPEB - Fire

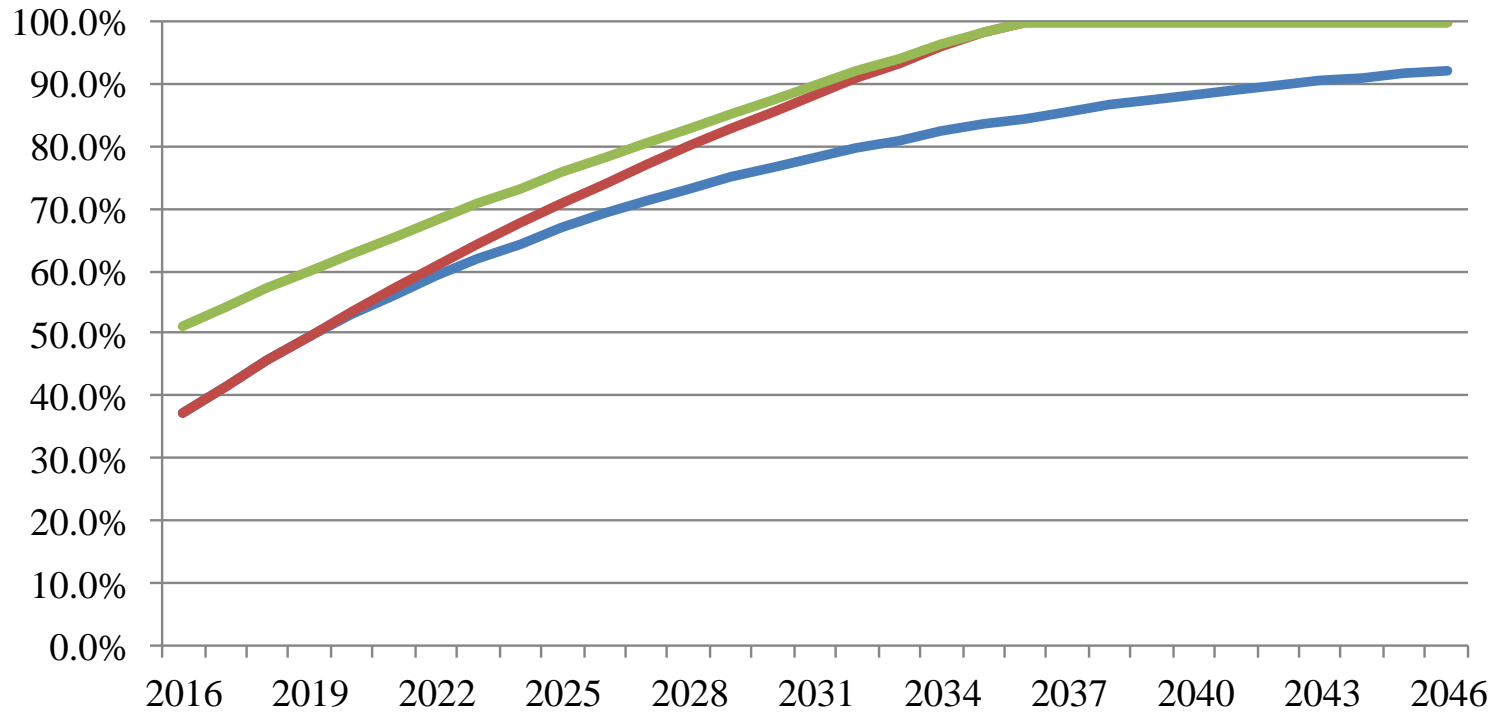
Unfunded Actuarial Accrued Liability

(Amounts in millions)



OPEB - Fire

Funding of Liability for Past Service



— Current Contribution Amounts — Full Pre-Funding, DR 4% — Full Pre-Funding, DR 6%



OPEB – Fire

Funding Recommendation

■ Recommendation

- Recommended asset allocation reduces actuarial liabilities
- Reduced actuarially determined contribution
 - Amortization period shortened to 20 years
 - Approximately \$500,000 per year reduced contribution

OPEB Funding

- “PERIP”



Police Retirement Income Plan (Closed; Intended for Retiree Medical)

■ Benefit

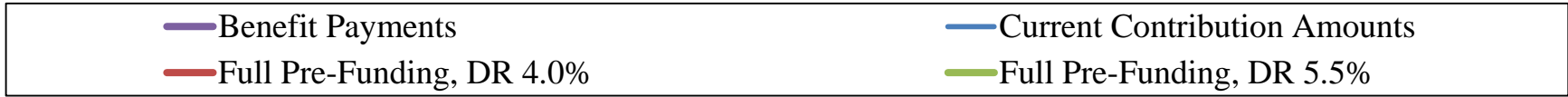
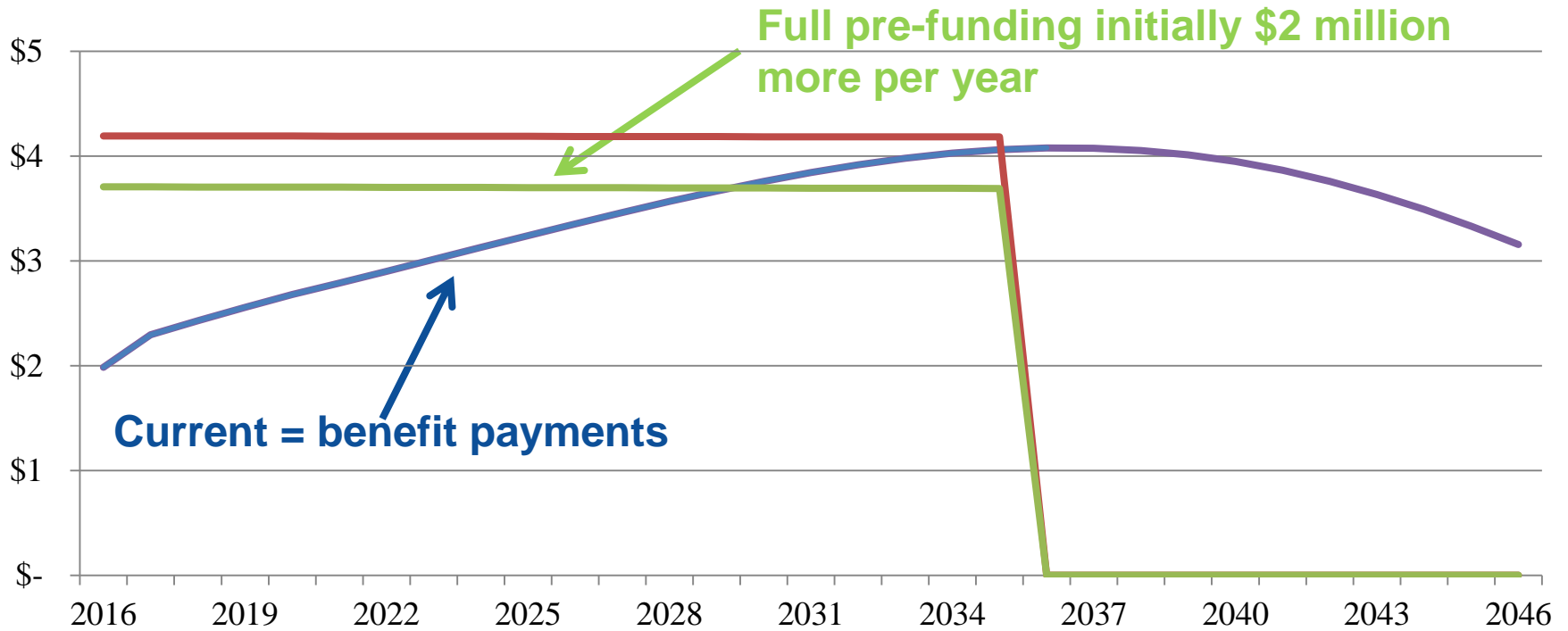
- City pays Kaiser 2-party premium subject to benefit percentage schedule
 - 100% after 25 years
- Retirees before September 2012 only

■ Current contribution amounts: benefit payments only (“pay-go”)



Police Retirement Income Plan

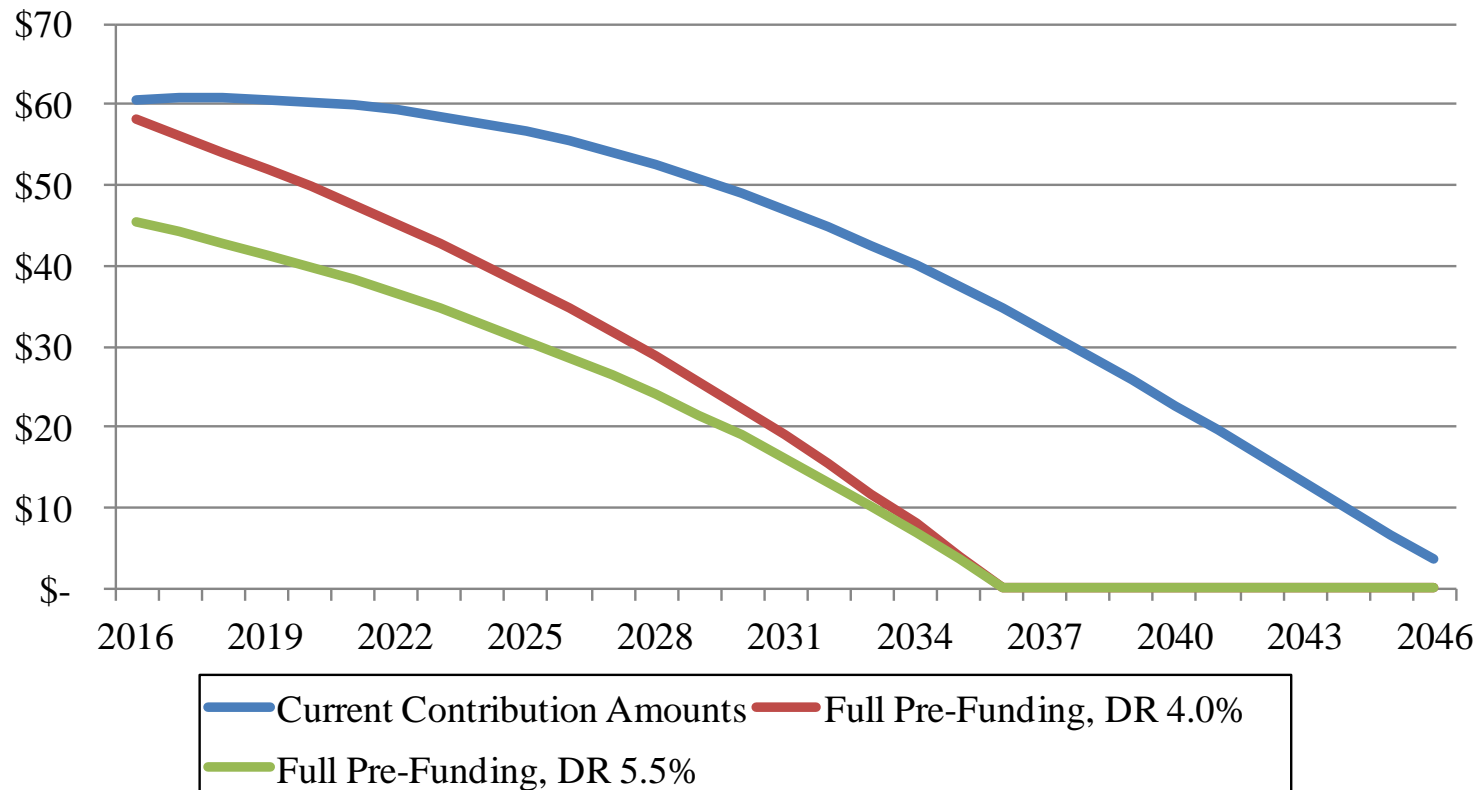
Contribution (Amounts in millions)



Police Retirement Income Plan

Unfunded Actuarial Accrued Liability

(Amounts in millions)



Police Retirement Income Plan Funding Recommendation

■ Recommendation

- Recommend full prefunding
 - Assumed slightly more conservative investments over time so 5.5% discount rate
 - \$1.7 M higher contribution in initial year than current

■ Comments

- Closed plan
- Unfunded liabilities decrease slowly under current contribution amounts (no prefunding)

OPEB Funding

■ Total



Total of All OPEB Plans

■ Summary of Recommendation

(\$ Millions)

Plan	Current Contribution Amounts	Increase	Full Pre-Funding ADC (DR 6%)
Miscellaneous	\$1.9	\$0.9	\$2.8
Police	0.5	2.6	3.1
Fire	2.0	(0.7)	1.2
PERIP	<u>2.0</u>	<u>1.7</u>	<u>3.7</u>
Total	\$6.3	\$4.5	\$10.8

CalPERS Rate Projections



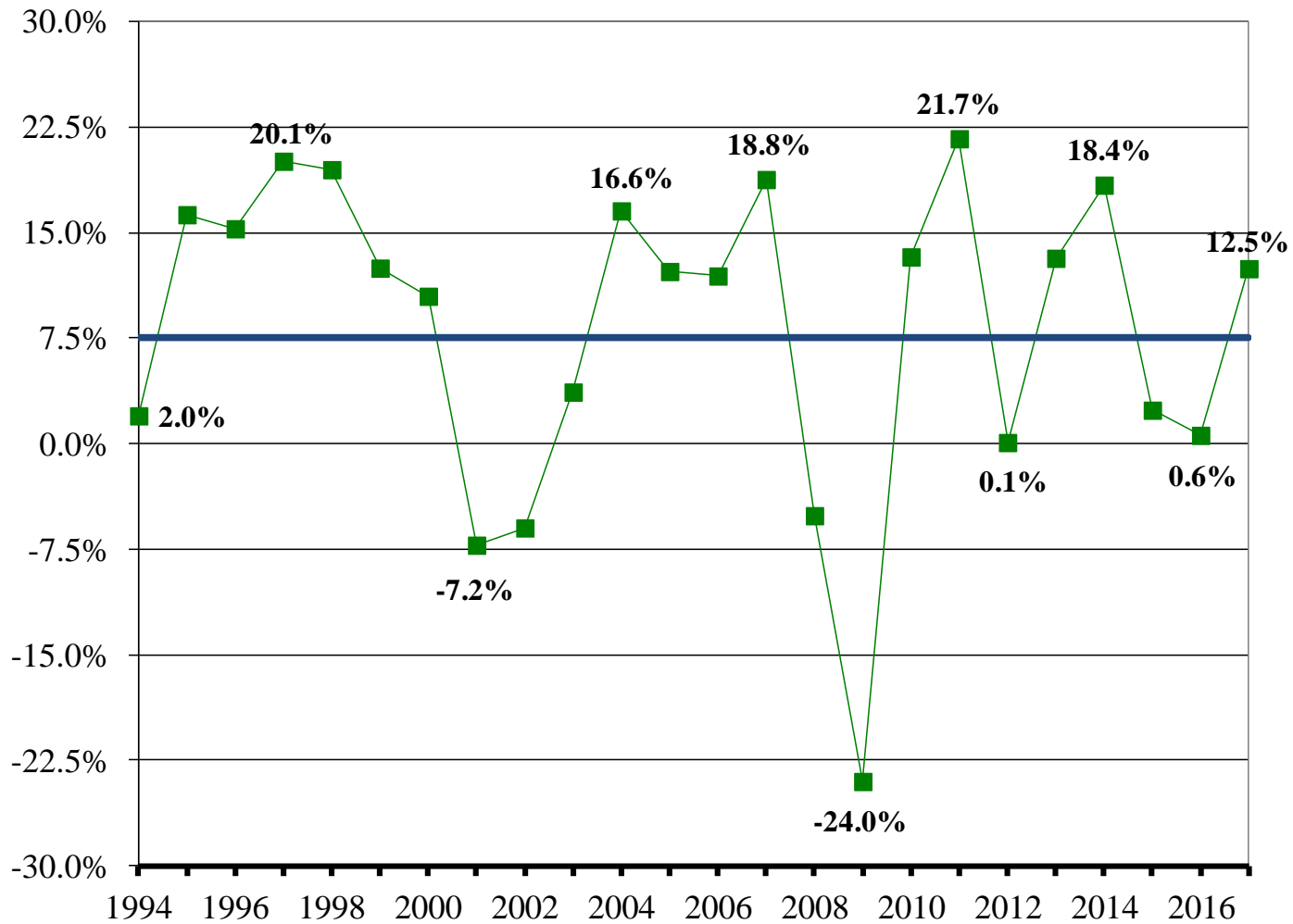
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How Did We Get Here?

- Investment Losses
- Enhanced Benefits
- CalPERS Contribution Policy
- Demographics
- PEPPRA

Historical Investment Returns



Estimated June 30, 2017 based on CalPERS actual return through 1/31/17 and assumed returns for 5 months.



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Enhanced Benefits

- At CalPERS, enhanced benefits implemented using all (future & prior) service
 - Miscellaneous 2.7% @ 55
 - Safety 3% @ 50
- Typically not negotiated with cost sharing

CalPERS Old Policy

- Effective with 2003 valuations:
 - Slow (15 year) recognition of investment losses into funded status
 - Rolling 30 year amortization of all (primarily investment) losses
- Designed to:
 - First smooth rates
 - Second pay off UAL and
- Mitigated contribution volatility



Demographics

- Around the State
 - Large retiree liability compared to actives
 - Declining active population
- Commonly 60% - 65% of liability is for retirees
 - City of Berkeley
 - Miscellaneous: 57%
 - Police & Fire: 70%

PEPRA

- Public Employees Pension Reform Act
 - Effective for new hires on and after 1/1/2013
 - Not for “laterals” from another public plan
- New employees have lower benefits and pay more
 - Will reduce employer contribution for future hires
 - Does not impact current unfunded liabilities
 - Slow to impact total employer pension cost

Where Are Rates Going?

- CalPERS Changes
- CalPERS Rate Projections



Contribution Policy Changes

- Rate increases ramp up FY 2016 thru 2020
- Designed to:
 - First pay off UAL and
 - Second smooth rates
- No asset smoothing
- 5-year ramp up for amortization bases
- All amortization bases have fixed periods
 - No rolling amortization

Assumption Changes

- Rate increases ramp up FY 2017 thru 2021
- Mainly anticipate future mortality improvement



Discount Rate

- CalPERS Board was told at end of 2016:
 - Long term return on current asset mix expected to average 7%
 - Returns over next 10 years average under 7%
- Board lowered discount rate
 - 3 year phase-in, each with 5-year ramp-up

	<u>Rate</u>	<u>Initial Year</u>	<u>Full Year</u>
● 6/30/16 val.	7.375%	18/19	22/23
● 6/30/17 val.	7.25%	19/20	23/24
● 6/30/18 val.	7.00%	20/21	24/25

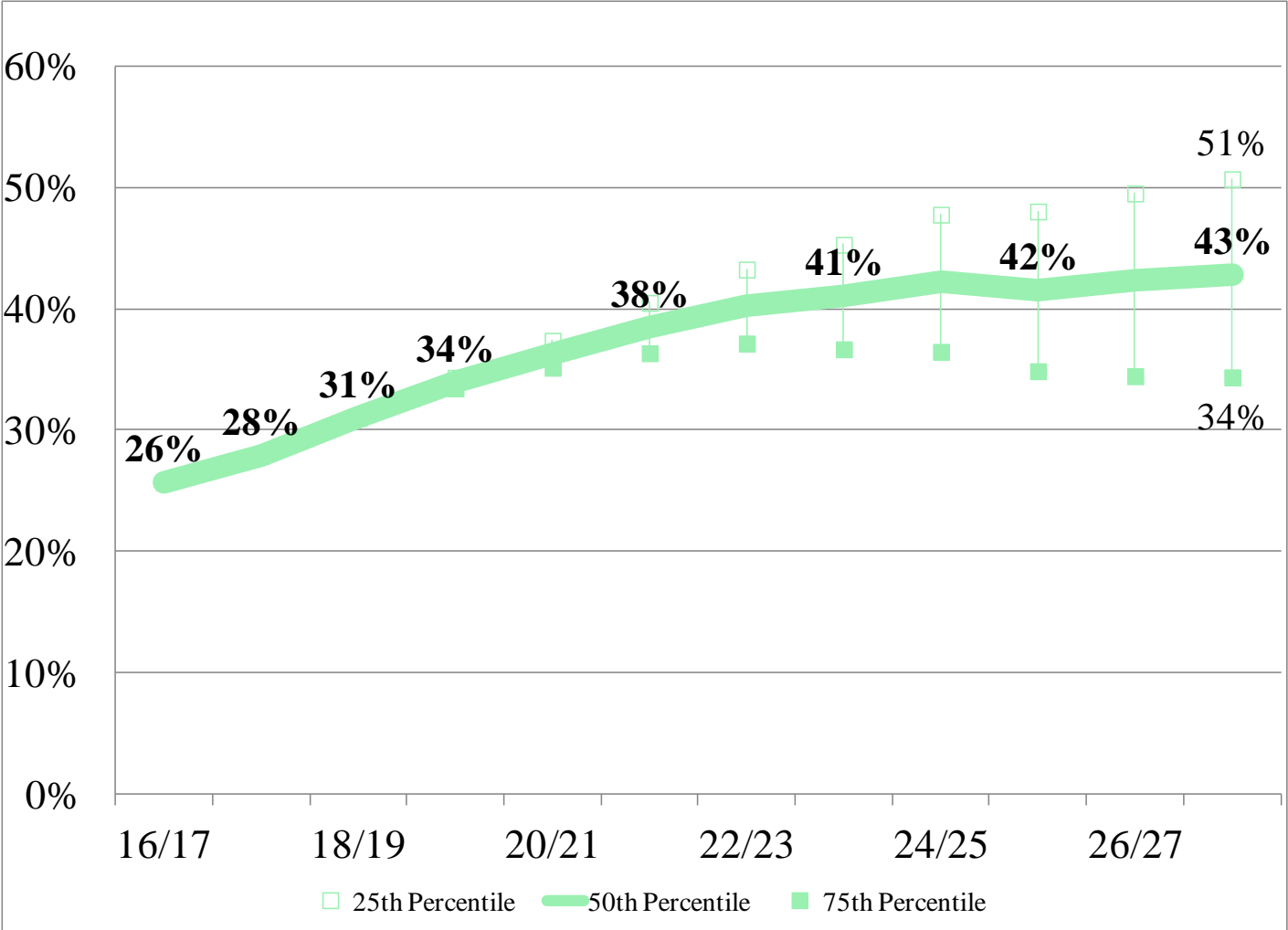
Risk Mitigation Strategy

- Move to more conservative investments over time
 - Years when investment return is 2%+ above expected
 - Essentially use $\approx 50\%$ of investment gains to pay for cost increases
- Lower discount rate in concert with investment mix changes
 - Likely reduces discount rate from 7% to 6% over ≈ 20 years

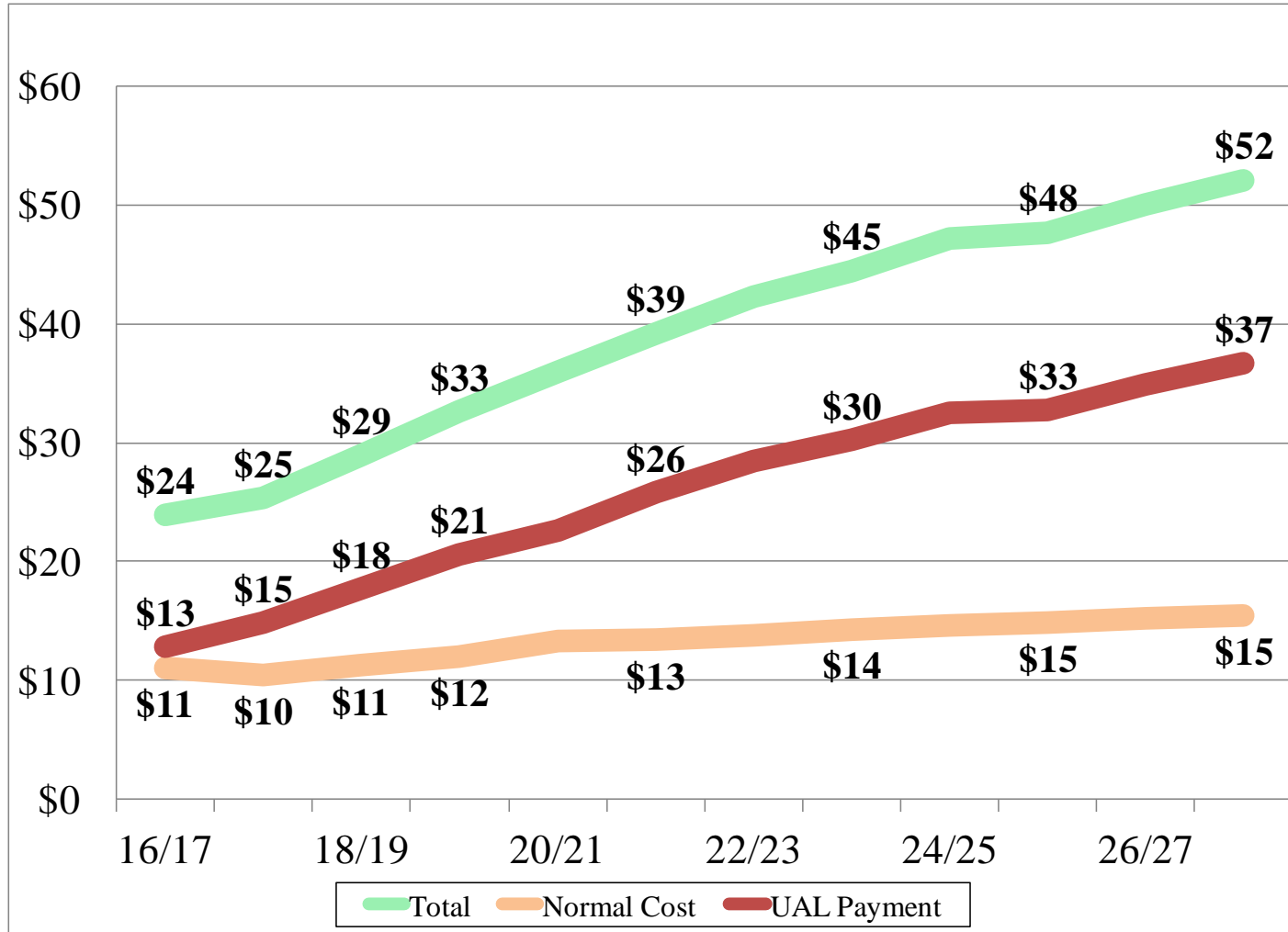
Other Factors

- New Tier 2 and PEPRAs reduce costs
- Projected return for FY 2017 = 12.5%
 - Based on returns through 12/31/16
- Projections reflect lower than 7.0% expected returns in next 10 years (expect average 6.5%)
- Modeling shows most likely contribution level and 25th & 75th percentiles

Miscellaneous–CalPERS Rates (% Payroll)



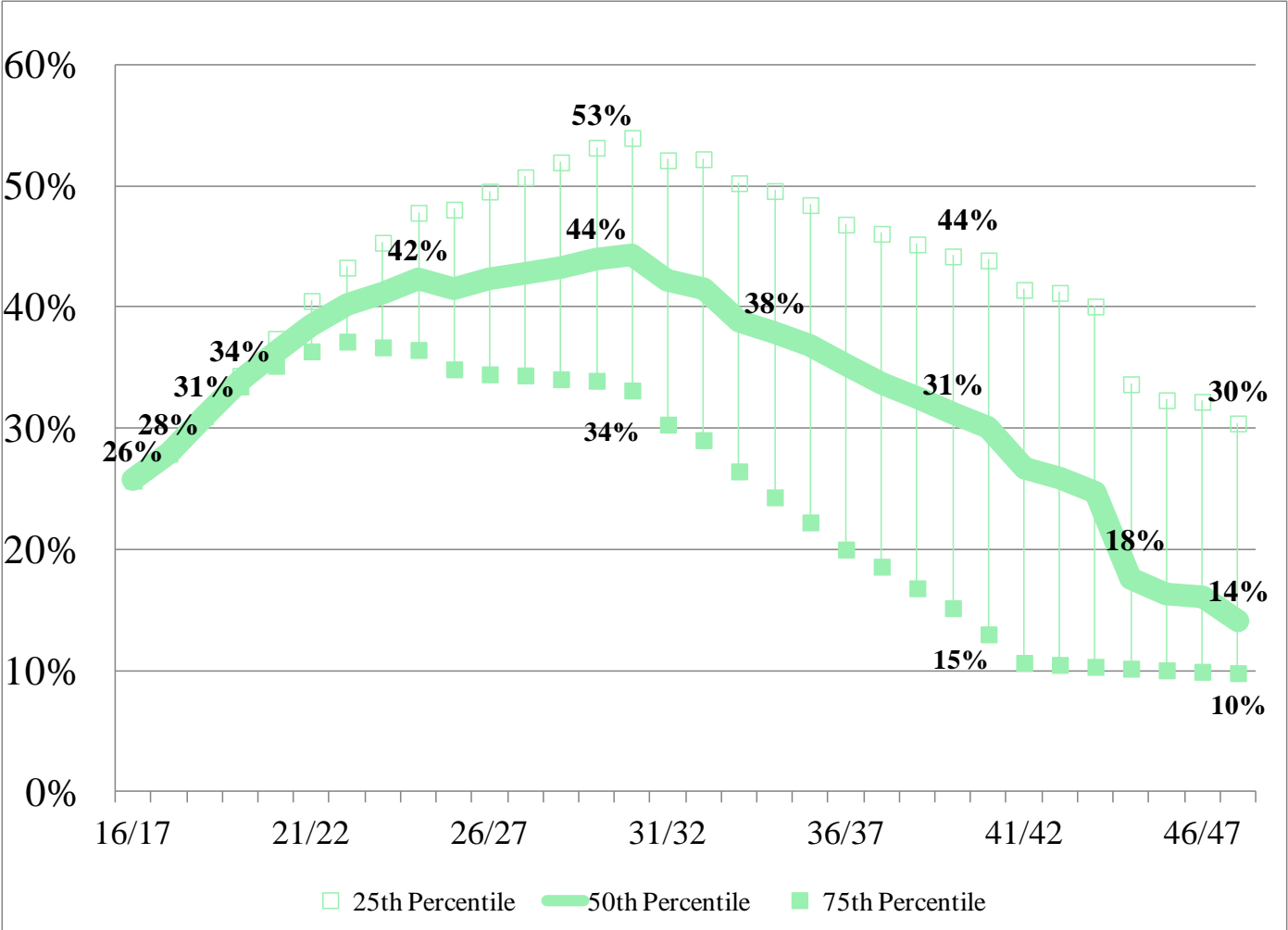
Miscellaneous–CalPERS Rates (\$millions)



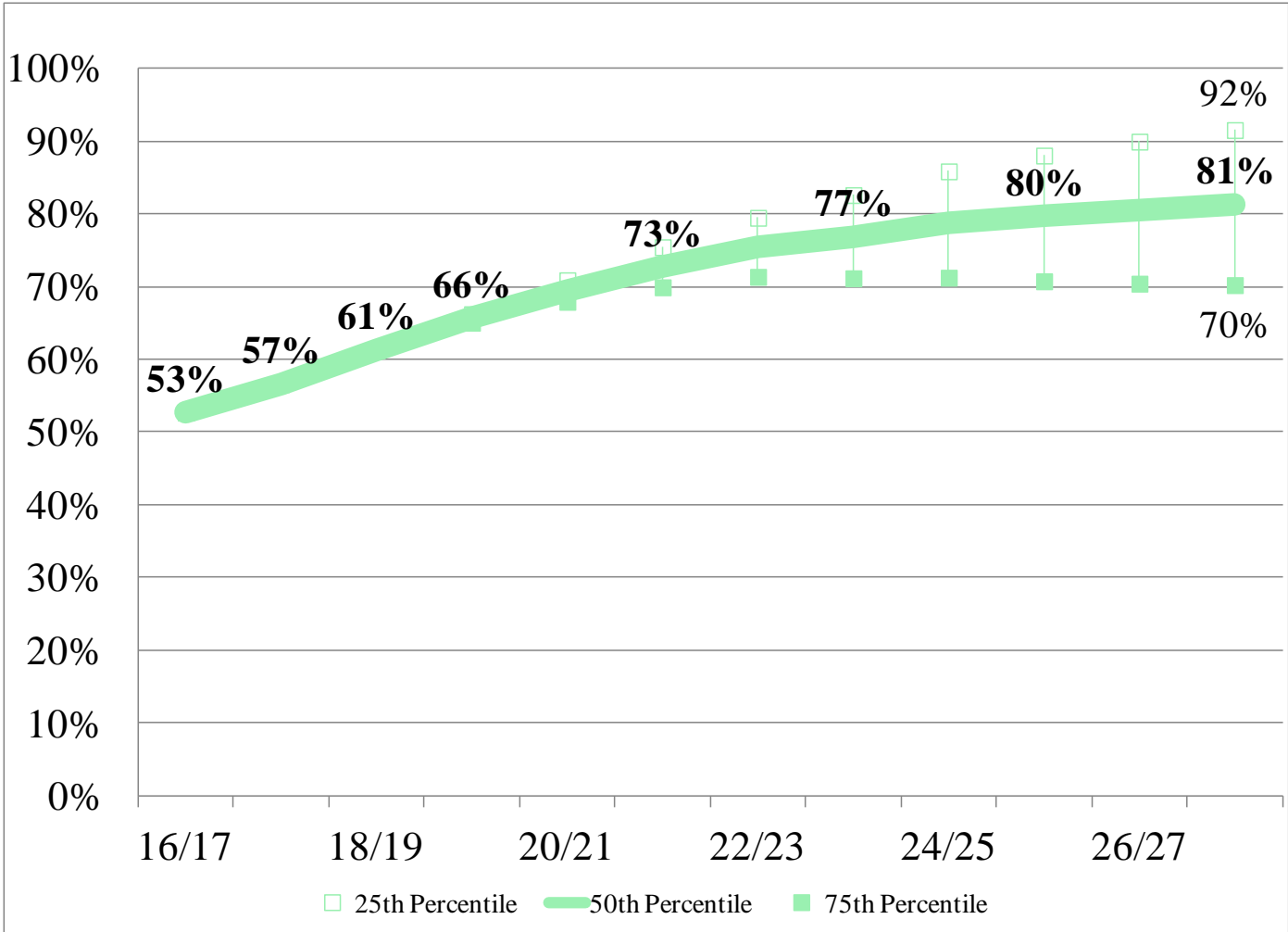
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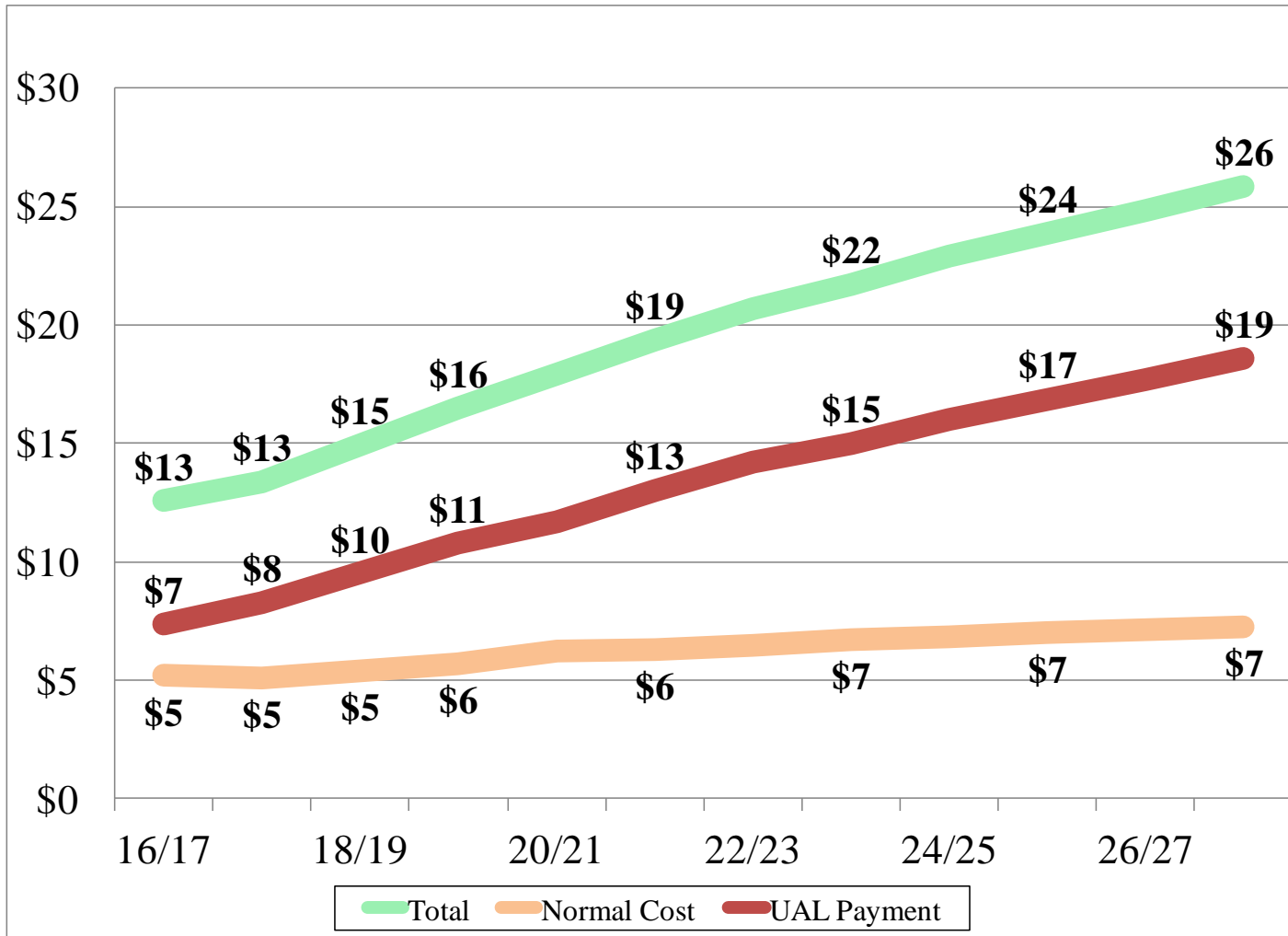
Miscellaneous—CalPERS Rates (% Payroll)



Police – CalPERS Rates (% of Payroll)



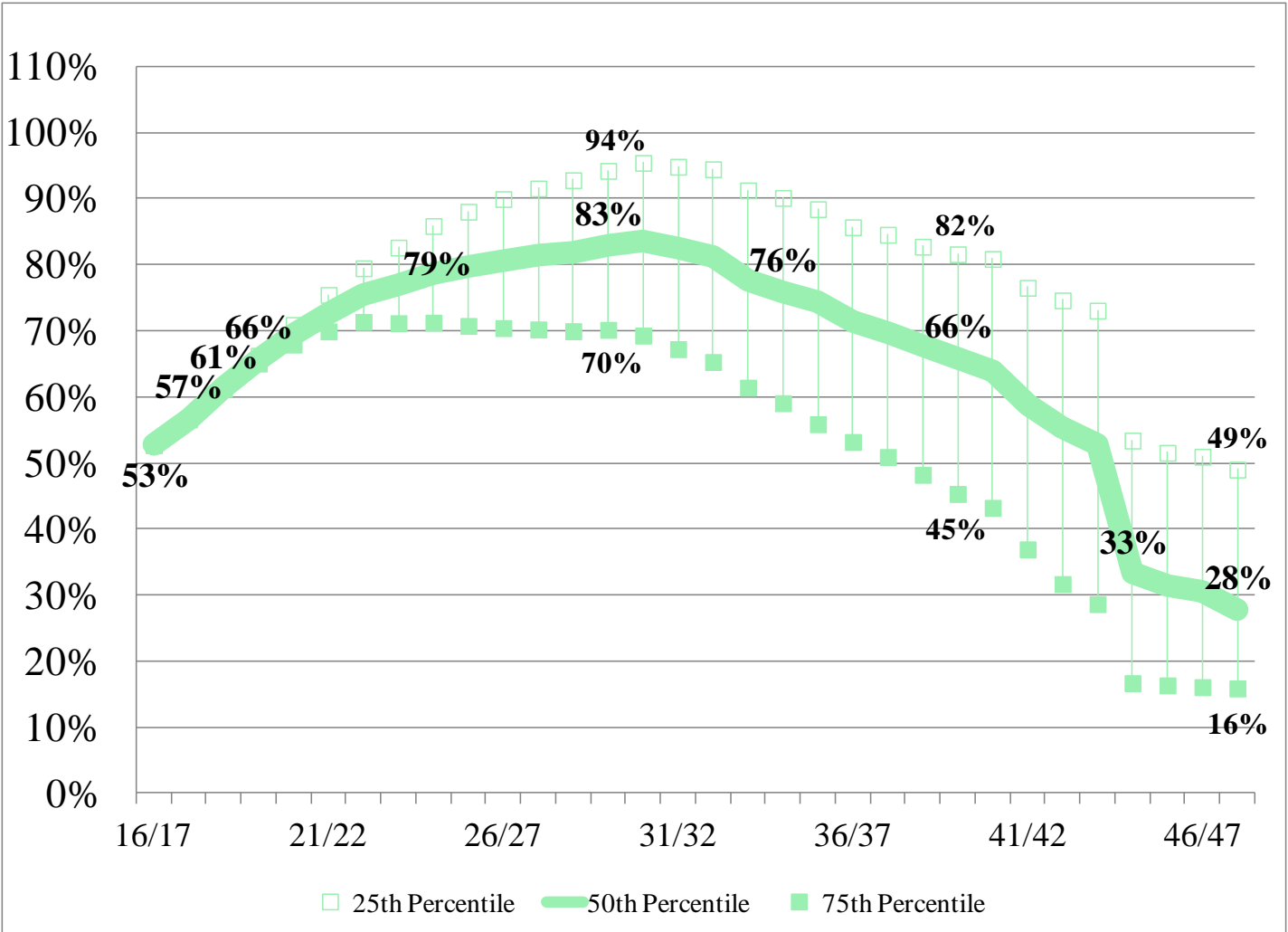
Police – CalPERS Rates (\$millions)



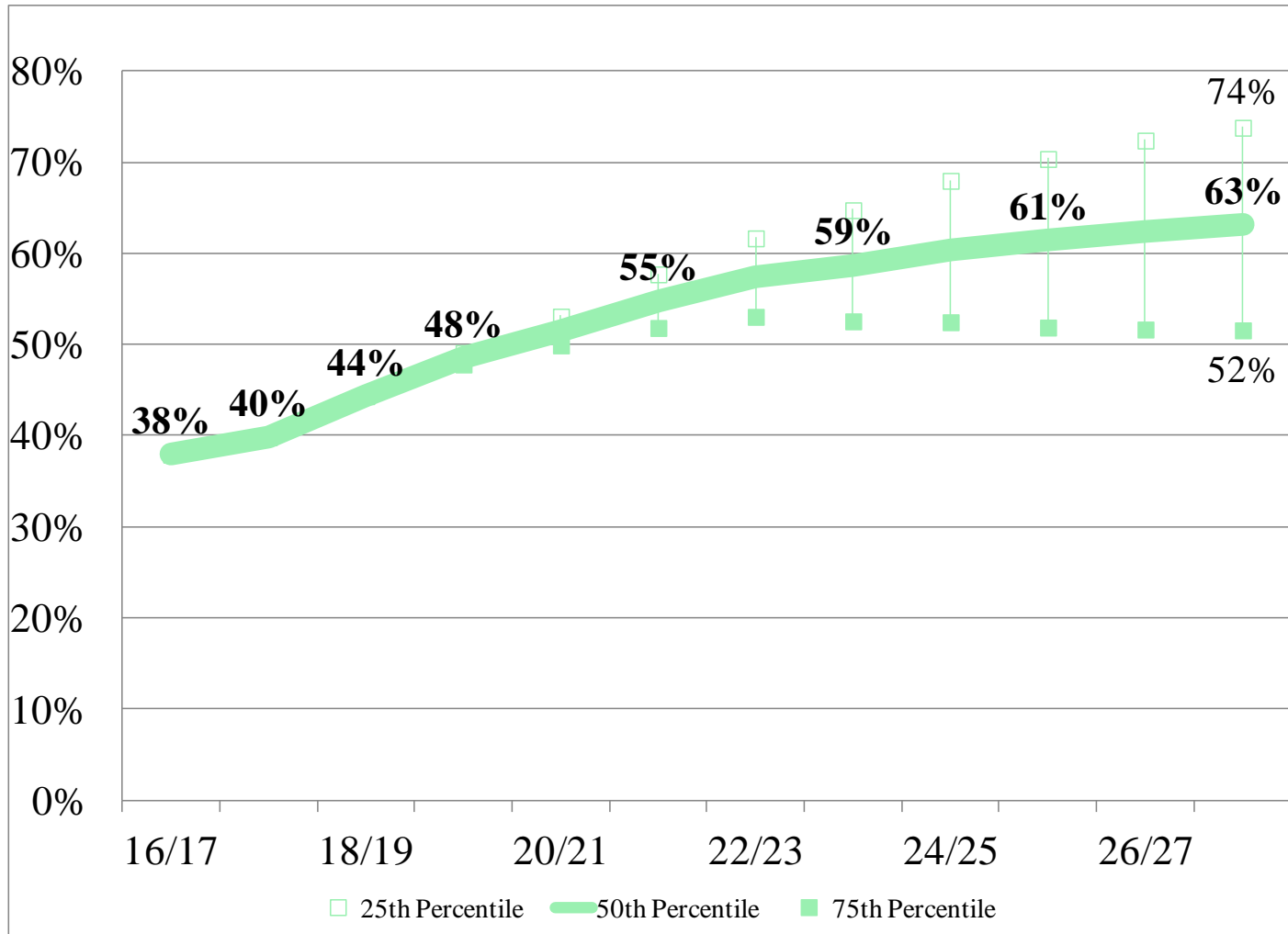
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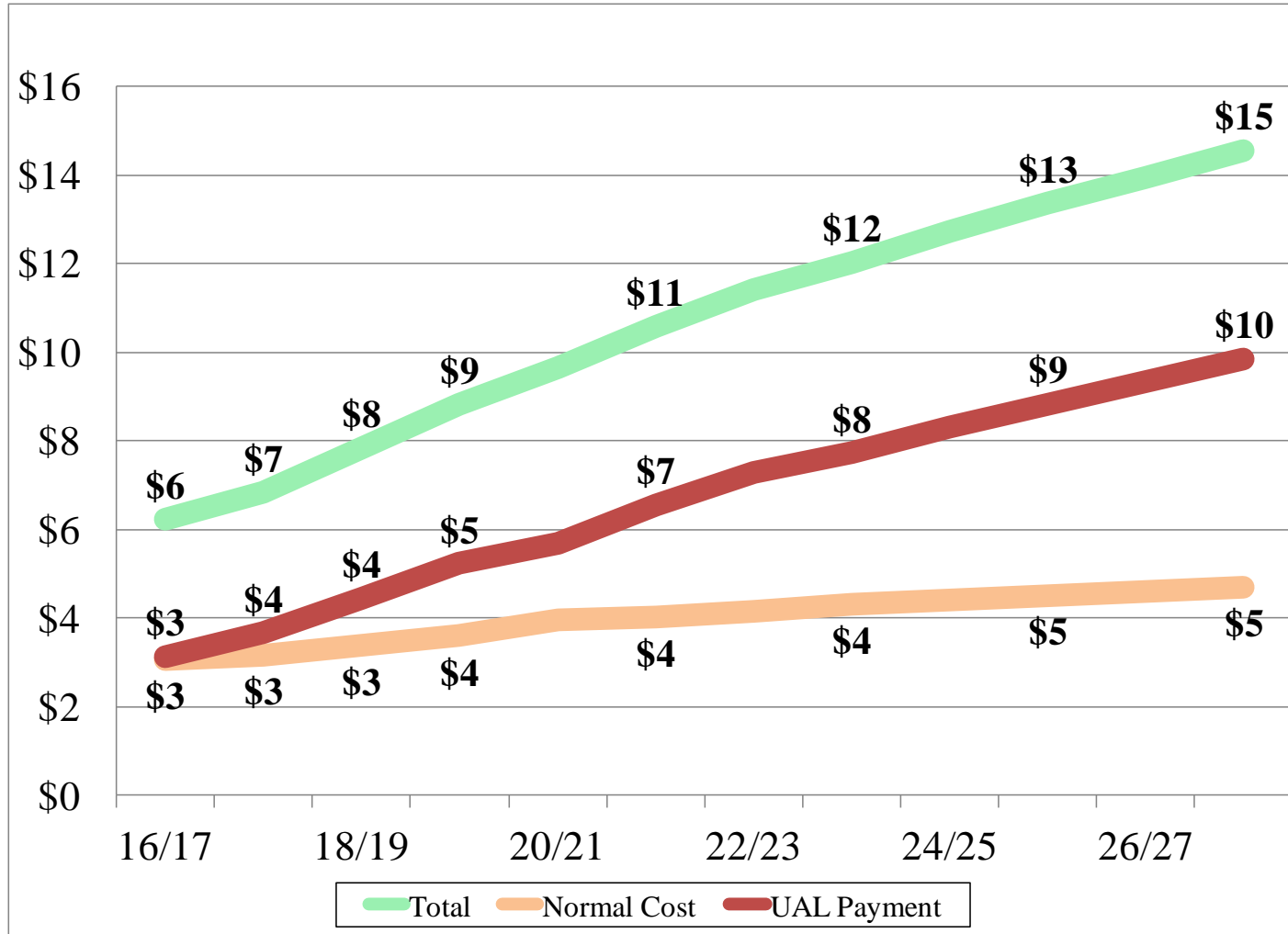
Police – CalPERS Rates (% of Payroll)



Fire – CalPERS Rates (% of Payroll)



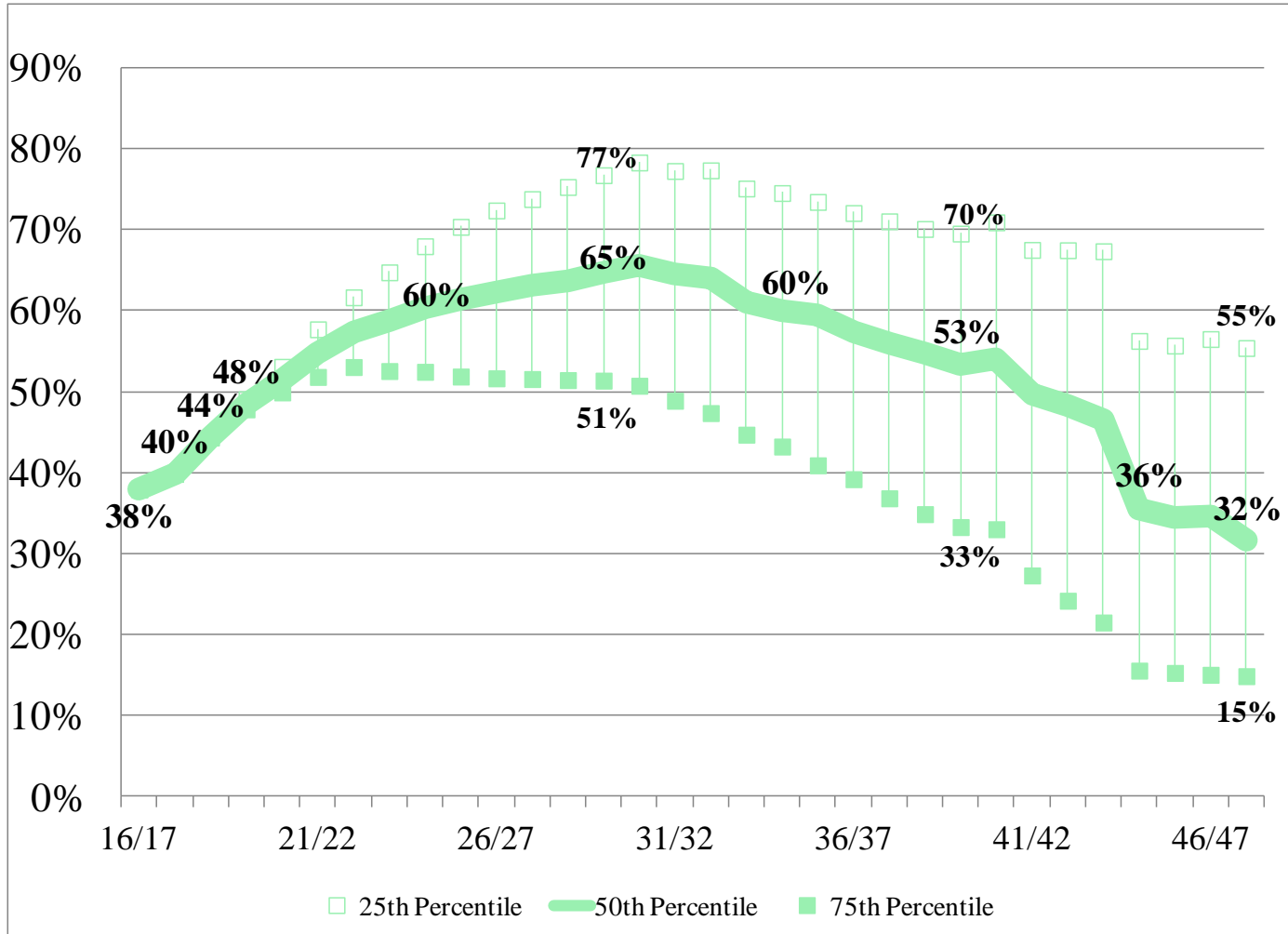
Fire – CalPERS Rates (\$millions)



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Fire – CalPERS Rates (% of Payroll)



Summary 10th-Year Impact (% of Payroll)

	FY 2017-18	FY 2027-2028
Miscellaneous	27.9%	42.8%
Police	56.6%	81.3%
Fire	39.9%	63.1%
Overall	34.6%	52.4%

Summary 10th-Year Impact (\$millions)

	FY 2017-18	FY 2027-2028
Miscellaneous	\$25.3	\$52.2
Police	\$13.4	\$25.8
Fire	\$6.8	\$14.6
Overall	\$45.5	\$92.6

CalPERS Funding



April 4, 2017



Pay Down Unfunded Liability

- The City is already paying the full actuarially determined contribution for its CalPERS plans
- The City's funded status is similar to other CalPERS public agencies
- Most ideas to pay down the unfunded liability ahead of schedule are not recommended
 - Pension Obligation Bond (POB) is interest arbitrage
 - Success not guaranteed

Irrevocable Supplemental (§115) Trust

- Can only be used to:
 - Reimburse City for CalPERS contributions
 - Make payments directly to CalPERS
 - Nothing else
- Investments significantly less restricted than City investment funds
 - Designed for long term returns
 - Likely much higher (5% - 7%) investment return

Irrevocable Supplemental (§115) Trust

- Over 70 trusts already established
 - PARS, PFM, Keenan, Other
- Likely will not “count” for GASB accounting
 - Will not reduce net pension liability



Irrevocable Supplemental (§115) Trust

■ Best use: Rate Stabilization

- “Seed” trust with initial deposit
- Determine “target” CalPERS contribution
- If CalPERS required contribution is below target => pay difference into trust
- If CalPERS required contribution is above target => trust pays difference to CalPERS



CalPERS Funding Recommendation

- Establish irrevocable supplemental (Section 115) pension Trusts
- \$3 Million initial “seed” deposit
 - \$3 million is total for Miscellaneous, Police and Fire
 - Additional Trust “start up” contributions:
 - 3% payroll in year 1 (\$4 million)
 - 4% payroll in year 2 (\$5.5 million)

Summary



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Summary of Recommendations

- OPEB Trust Fund:
 - Invest for the long term to generate more earnings
- OPEB Funding (Misc, Police, Fire, “PERIP”)
 - Full pre-funding; will increase annual contribution
 - Total \$4.5 million additional per year
- CalPERS
 - Establish Supplemental Trust
 - \$3 million initial, \$4 million year 1, \$5.5 million year 2

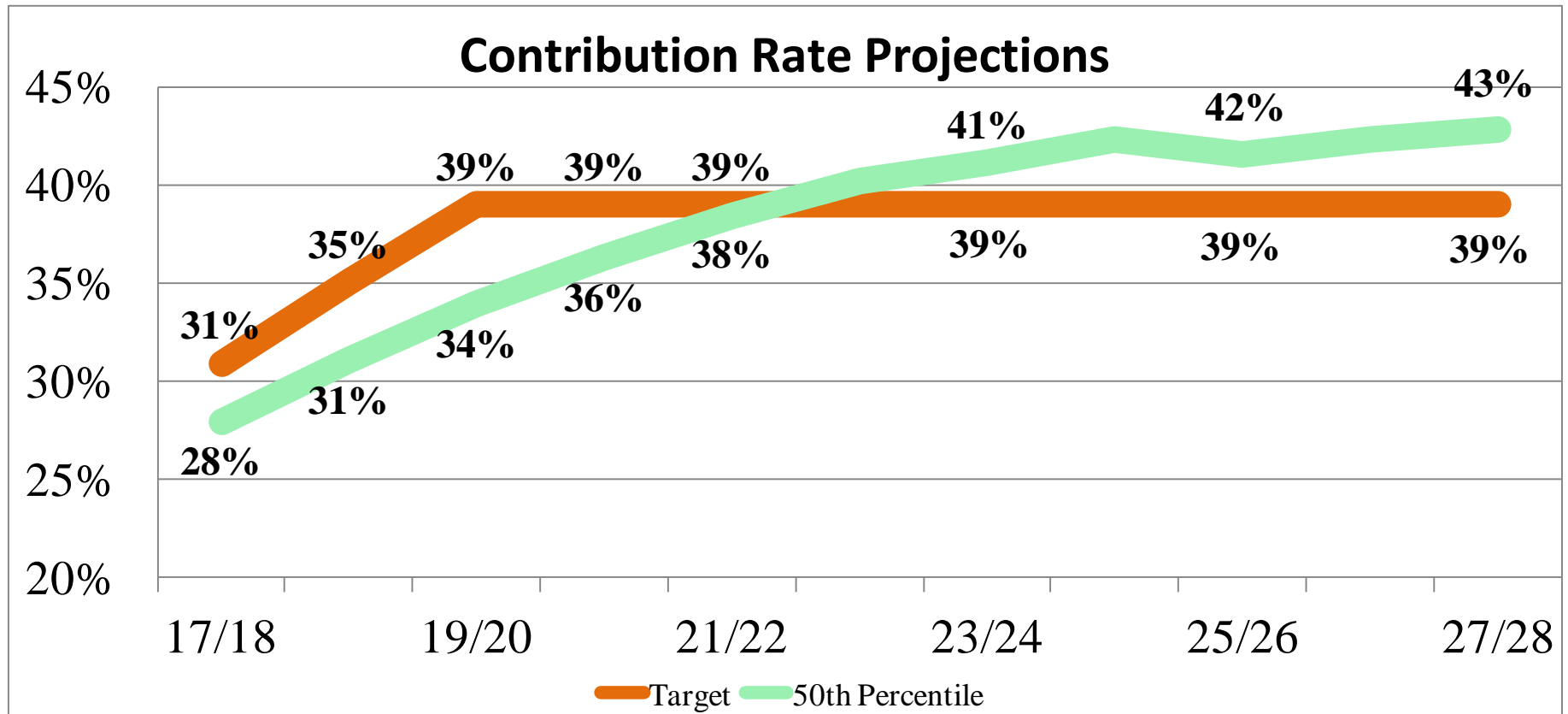
Thank You



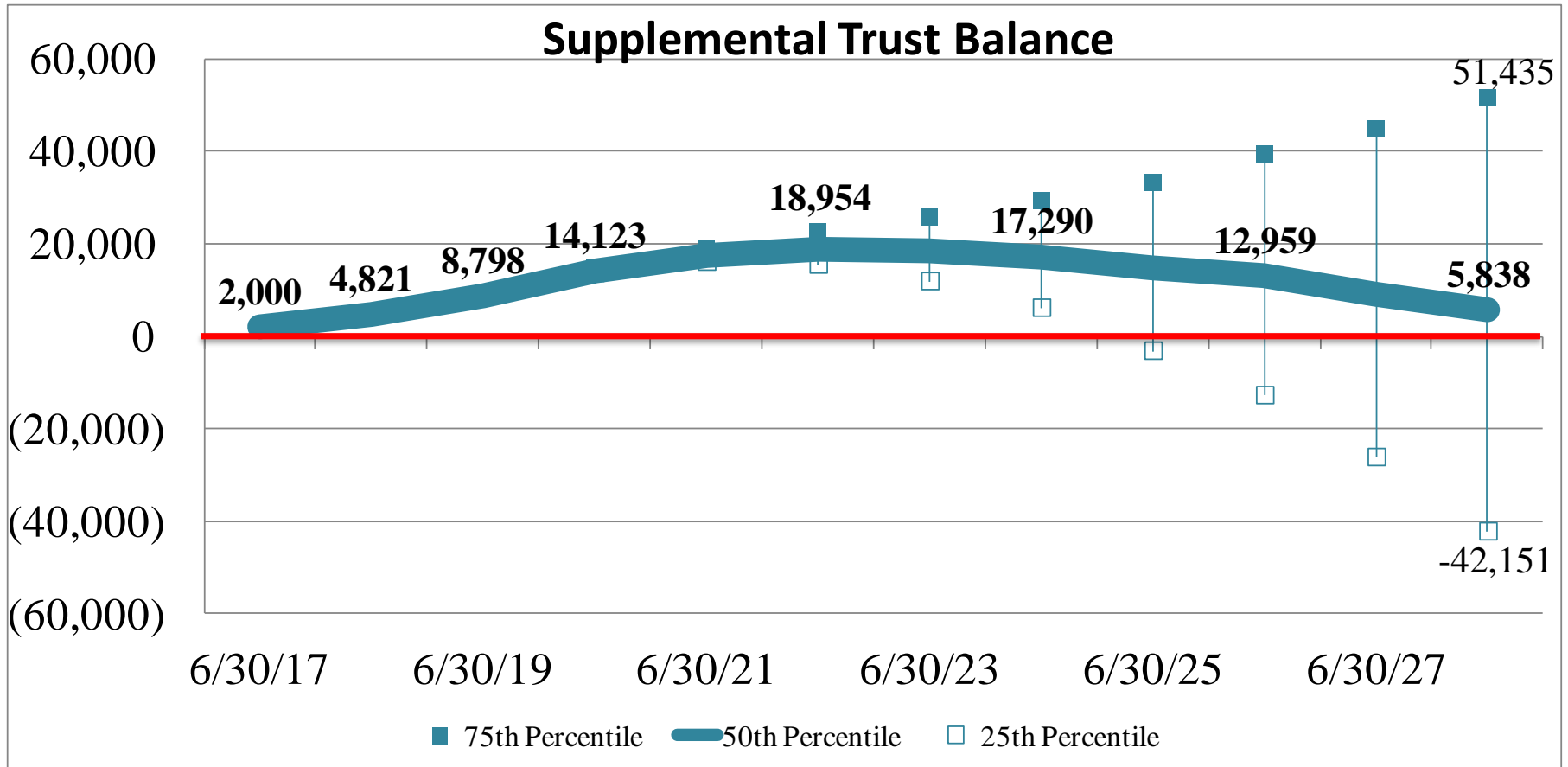
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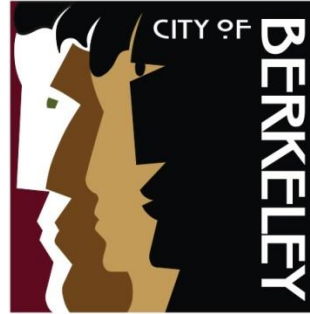


Supplemental Trust: Miscellaneous



Supplemental Trust: Miscellaneous





City of Berkeley

BARTEL
ASSOCIATES, LLC

Pension and OPEB Funding Study

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Bianca Lin, Assistant Vice President

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