City of Stockton

Retiree Healthcare Plan
June 30, 2007 Actuarial Valuation
Executive Summary

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On June 21, 2004, the Governmental Accounting Standards Board approved Statement No. 45 (GASB 45), Accounting Standards for *Other* (than pensions) *Post Employment Benefits* (OPEB). This report is based on the financial reporting standards established under GASB 45. We understand the City is required to implement GASB 45 for its 2007/08 fiscal year[1]. Historically the City has accounted for retiree healthcare benefits as they were paid, with approximately $7.2 million paid for 2005/06. GASB 45 will require the City account for this promise on an accrual basis (as benefits are earned).

STUDY RESULTS

Funded Status: The plan funded status is equal to the Actuarial Liability (see definitions and assumptions section below) less plan assets. When assets equal liabilities, a plan is considered on track for funding.

To consider a retiree healthcare plan funded for GASB 45 purposes, assets must be set aside in a trust that cannot legally be used for any purpose other than to pay retiree healthcare benefits. The City's retiree healthcare plan is not currently funded. This has important implications on the discount rate assumption used to calculate plan liabilities (see definitions and assumptions section below). We have prepared valuation results under 2 scenarios:

- No Pre-Funding – Benefits are paid from the City’s general fund which is assumed to earn a 4.5% long-term rate of return.
- Pre-Funding – Contributions are made to an irrevocable trust with diversified assets which are assumed to earn a 7% long-term return. Ultimately, the long-term return assumption will be based on the plan’s actual investment mix.

The following table summarizes the plan’s June 30, 2007 funded status (000s omitted):

	No Pre-Funding 4.5%	Pre-Funding 7%
■ Actuarial Liability (AL)		
• Actives	$ 204,794	$ 143,294
• Retirees	183,509	140,820
• Total	$ 388,303	$ 284,115
■ Plan Assets	0	0
■ Unfunded AL (UAL)	$ 388,303	$ 284,115
■ Reserve (Net OPEB Obligation)	0	0
■ Unreserved and Unfunded Actuarial Liability	$ 388,303	$ 284,115

1 Assumes the City was a Phase I GASB 34 implementer.

Annual Required Contribution (ARC): GASB 45 doesn't require an agency make up any shortfall (unfunded liability) immediately, nor does it allow an immediate credit for any excess assets. Instead, the difference is amortized over time. An agency's Annual Required Contribution is nothing more than the current employer Normal Cost, plus the amortized unfunded liability or less the amortized excess assets. Simply put, this contribution is the value of benefits earned during the year plus something to move the plan toward being on track for funding. For the City's valuation we calculated the ARC as the Normal Cost plus a 30-year amortization (as a level percent of pay amortization) of the Unfunded Actuarial Liability (000s omitted):

	No Pre-Funding 4.5%	Pre-Funding 7%
■ Normal Cost	$ 17,784	$ 10,573
■ UAL Amortization	16,017	16,215
■ 2007/08 Annual Required Contribution	$ 33,801	$ 26,788
■ Annual Required Contribution as a percentage of estimated 2007/08 payroll	34.4%	27.2%

Net OPEB Obligation (NOO): An agency's Net OPEB Obligation is the historical (from implementation)[2] difference between actual contributions made and the Annual Required Contributions[3]. If an agency has always contributed the required contribution, then the Net OPEB Obligation equals zero. However, an agency has not "made" the contribution unless it has been set aside <u>and</u> cannot legally be used for any other purpose.

Annual OPEB Cost (AOC): GASB 45 requires the Annual OPEB Cost equal the Annual Required Contribution, except when an agency has a Net OPEB Obligation at the beginning of the year. When that happens an agency's Annual OPEB Cost will equal the ARC, adjusted for expected interest on the Net OPEB Obligation and reduced by an amortization of the Net OPEB Obligation (000s omitted):

	No Pre-Funding 4.5%	Pre-Funding 7%
■ 2007/08 Annual Required Contribution	$ 33,801	$ 26,788
■ Interest on Net OPEB Obligation	0	0
■ Amortization of Net OPEB Obligation	0	0
■ Total 2007/08 Annual OPEB Cost	$ 33,801	$ 26,788

2 GASB 45 specifies the initial Net OPEB Obligation (at implementation) be set to zero.
3 Benefits paid for current retirees are considered contributions.

The following illustrates the City's June 30, 2008 Net OPEB Obligation if the City adopts GASB 45 for the 2007/08 fiscal year (000s omitted):

	No Pre-Funding 4.5%	**Pre-Funding 7%**
■ June 30, 2007 Net OPEB Obligation	$ 0	$ 0
■ 2007/08 Annual OPEB Cost	$ 33,801	$ 26,788
■ 2007/08 Contributions	(10,492)[4]	(26,788)[5]
■ June 30, 2008 Net OPEB Obligation	$ 23,309	$ 0

The City's actual June 30, 2008 Net OPEB Obligation will differ slightly from the above because actual benefit payments will be different from estimated.

Pre-Funding: The following table compares the Pay-As-You-Go Cost (expected benefit payments) to Full ARC Pre-Funding and a phase-in of the ARC funding over 5, 10, and 12 year periods (000's omitted) starting with the 2008/09 fiscal year. For example, the 2008/09 contribution for the 5-year phase-in method is the PayGo cost plus 20% of the difference between the full ARC and the PayGo cost for that year.

Fiscal Year	**Pay-Go**	**5-Year Phase-In**	**10-Year Phase-In**	**12-Year Phase-In**	**Full ARC Pre-Funding**
2007/08	$10,492	$10,492	$10,492	$10,492	$26,788
2008/09	11,973	15,295	13,634	13,357	27,658
2009/10	13,653	20,313	17,003	16,447	28,557
2010/11	15,413	25,302	20,450	19,624	29,485
2011/12	17,254	30,122	23,943	22,864	30,443
2012/13	19,253	34,627	27,486	26,192	31,433
2013/14	21,297	35,753	30,969	29,502	32,454
2014/15	23,305	36,915	34,337	32,742	33,509
2015/16	25,360	38,114	37,601	35,940	34,598
2016/17	27,501	39,353	40,730	39,085	35,723
2017/18	29,564	40,632	43,680	42,115	36,884
2018/19	31,563	41,952	45,100	45,042	38,082
2019/20	33,875	43,316	46,565	47,868	39,320

4 Estimated 2007/08 benefit payments.
5 Assumes full ARC is contributed.

Sensitivity: The above results are based on a 30-year amortization of the unfunded liability. Following illustrates the impact of changing the amortization period to 20 years (000s omitted):

	No Pre-Funding 4.5%	Pre-Funding 7%
■ 30-year amortization		
• Total ARC $	$ 33,801	$ 26,788
• Total ARC %	34.4%	27.2%
■ 20-year amortization		
• Total ARC $	$ 40,475	$ 31,461
• Total ARC %	41.1%	32.0%

BASIC DEFINITIONS AND ASSUMPTIONS

Present Value of Benefits: When an actuary prepares an actuarial valuation, (s)he first gathers participant data (including active employees, former employees not in payment status, participants and beneficiaries in payment status) at the valuation date (for example June 30, 2007). Using this data and actuarial assumptions, (s)he projects future benefit payments. (The assumptions predict, among other things, when people will retire, terminate, die or become disabled, as well as what salary increases, general (and healthcare) inflation and investment return might be.) Those future benefit payments are discounted, using expected future investment return, back to the valuation date. This discounted present value is the plan's present value of benefits. It represents the amount the plan needs as of the valuation date to pay all future benefits – if all assumptions are met and no future contributions (employee or employer) are made. The City's June 30, 2007 retiree healthcare Present Value of Benefits is $592 million using a 4.5% discount rate ($382 million using a 7% discount rate), with $184 million of this for former employees who have already retired ($141 million using a 7% discount rate).

Actuarial Liability: This represents the portion of the present value of benefits that participants have earned (on an actuarial, not actual, basis) through the valuation date. The City's June 30, 2007 retiree healthcare Actuarial Liability is $388 million using a 4.5% discount rate ($284 million using a 7% discount rate), with $184 million of this for former employees who have already retired ($141 million using a 7% discount rate).

Normal Cost: The Normal Cost represents the portion of the present value of benefits expected to be earned (on an actuarial, not actual, basis) in the coming year. The City's June 30, 2007 retiree healthcare Normal Cost is $17.8 millions (18.1% of payroll) using a 4.5% discount rate and $10.6 million using a 7% discount rate (10.8% of payroll).

Actuarial Cost Method: This determines the method in which benefits are actuarially earned (allocated) to each year of service. It has no effect on the Present Value of Benefits, but has significant effect on the Actuarial Liability and Normal Cost. The City's June 30, 2007 retiree healthcare valuation was prepared using the Entry Age Normal cost method.

Actuarial Assumptions: Under GASB 45, an actuary must follow current actuarial standards of practice, which generally call for explicit assumptions - meaning each individual assumption represents the actuary's best estimate.

GASB 45 requires that the discount rate is based on the source of funds used to pay benefits. This means the underlying expected long-term rate of return on plan assets for funded plans. Furthermore, since the source of funds for an unfunded plan is usually the general fund and California law restricts agencies' investment vehicles, this valuation uses a relatively low, 4.5%, discount rate. If the City sets up a separate Trust (that could only be used to pay plan benefits), and diversifies Trust assets, then the discount rate would be based on the Trust's expected long-term investment return. This might result in a higher (such as a 7%) discount rate. However, the appropriate discount rate will be determined based on the plan's actual asset diversification.

Another key assumption is future healthcare inflation rates. The inflation rate for non-Medicare eligible benefits starts at 11.3% (the increase in 2008 over 2007) and grades down to 4.5% (2017 over 2016) and remains at 4.5% into the future. The inflation rate for Medicare eligible benefits starts at 11.7% (the increase in 2008 over 2007) and grades down to 4.5% (2017 over 2016) and remains at 4.5% into the future. This assumption means healthcare is assumed to increase, on the average, about 8% a year for the next 10 years. Furthermore, since the valuation's general inflation assumption is 3%, it also means healthcare is assumed to level off at about 1.5% over general inflation.

BENEFIT PROMISE

The following table summarizes medical benefits:

■ Eligibility	• Service retirement: ➢ Age 50 and 5 years CalPERS service ➢ Age 50 and 15 years City service for SCEA, Trades & Maintenance • Disability retirement: ➢ 5 years CalPERS service ➢ Immediate for Safety for Industrial (in service) disability ➢ No disability healthcare benefit for Trades & Maintenance • Retire directly from City

■ Medical Benefit	• Non-Medicare eligible: ➢ City pays for retiree plus 1 dependent • Medicare eligible: ➢ City pays for retiree plus 1 dependent (spouse for Firefighters and Trades & Maintenance) ➢ City Medicare eligible contribution for retirements on or after: ▪ 1/1/85 for Mgt & Confid, Mid-Mgt & Super, Law Dept ▪ 1/1/90 for Police Mgt ▪ 1/1/96 for Fire ▪ 1/1/97 for Fire Mgt, SCEA, Trades & Maintenance ▪ 8/1/98 for Police • Dependent coverage for 15 years maximum • Retiree pays monthly contribution for additional dependents: ➢ 1/1/08 proposed: $121 per additional dependent • Disability retiree pays monthly contribution for years < 65 and greater than 15 years payments ➢ 1/1/08 proposed: $259 single, $453 2-party, & $574 family
■ Medical Benefit (Continued)	• Trades & Maintenance can participate in OEHWT (pre-Medicare only) with City contribution equal to average cost per enrollee (actives & retirees) • Police & Police Management hired > 7/1/07 in pooled defined contribution plan
■ Dental Benefit	• City-paid for City Manager, Unrepresented Department Heads, and Executive Plan Law Department employees and spouses, each to age 65
■ Vision & Life Benefits	• None for retiree or surviving spouse of retiree
■ Surviving Spouse Benefit	• Active Death: Medical benefit for surviving spouse of active employee eligible to retiree, to age 65. Also dental and vision for Mid-Management & Supervisory. • Active Safety Death: Medical, dental, vision benefits for surviving spouse and children of active employee who dies in line of duty, to age 65, paid by City, reimbursed by State • Retiree Death: Medical for surviving spouse of retiree, to age 65, paid by spouse, for those without lifetime benefits