Presentation to:

County of Contra Costa

Other Post Employment Benefits Challenge

OPEB Task Force

March 1, 2007

"If you decide you want to continue Retiree Health Benefits as a priority, then make a plan and fund it. If you decide that Retiree Health Benefits are not a priority, then don't make a plan, and you don't have to fund it. But don't maintain Retiree Health Benefits with no plan and no funding."

Ken Kurtz, Moody's Investor Services

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The County’s OPEB Challenge

Background

This presentation is intended to address how OPEB costs will impact the County's budget, employee benefit programs and reduction strategies; its emphasize is not the effects of GASB 45 reporting

- Impending onset of GASB 45 has prompted an independent actuarial valuation of the County's existing commitments to provide retiree healthcare (OPEB[1])
- County is required to account for the cost of OPEB liabilities beginning in FY 2007-08
- GASB 45 did not "cause" these liabilities, but rather has caused governments at all levels to fully quantify the lifecycle costs of previous benefit decisions / existing promises
- The County has a very large liability ($2.57 billion)
  - Actuarial study shows County should be setting aside $227 million per year
  - County is not setting aside anything, instead, County is operating on a "Pay-go" basis, just incurring current cost
  - Regardless of GASB 45, the County faces a tripling of its $33 million annual retiree health care costs over the next decade
- County currently pays $33.1 million on a pay-as-you-go basis and should be paying an annual contribution of $227 million
- The County must develop a funding strategy as well as a labor negotiation strategy

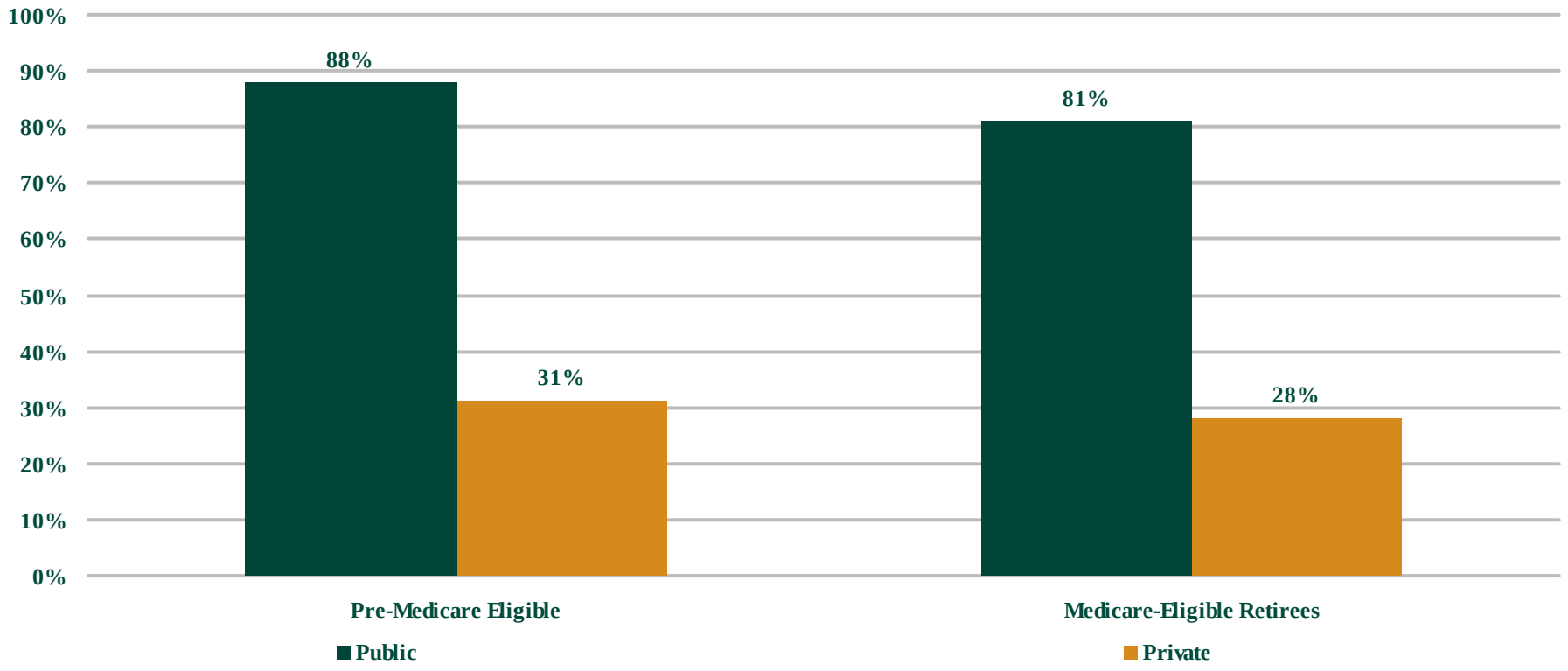
The Cost of the County's retiree health care benefits is unsustainable

1. *"OPEB" means "Other Post-Employment Benefits."*

The County is Not Alone in Offering OPEB

In California, the public sector offers retirees medical coverage at almost three times the rate in the private sector, whether or not they are eligible for Medicare

Public vs. Private Sector OPEB



- Retiree health plans vary greatly in terms of scope of coverage and funded status

Source: Mercer National Survey of Employer-Sponsored Health Plans, 2005.

County's Benefit Package is Very Costly

- The County had 8,428 active employees, 4,856 retirees and 360 surviving spouses as of 1/1/2006

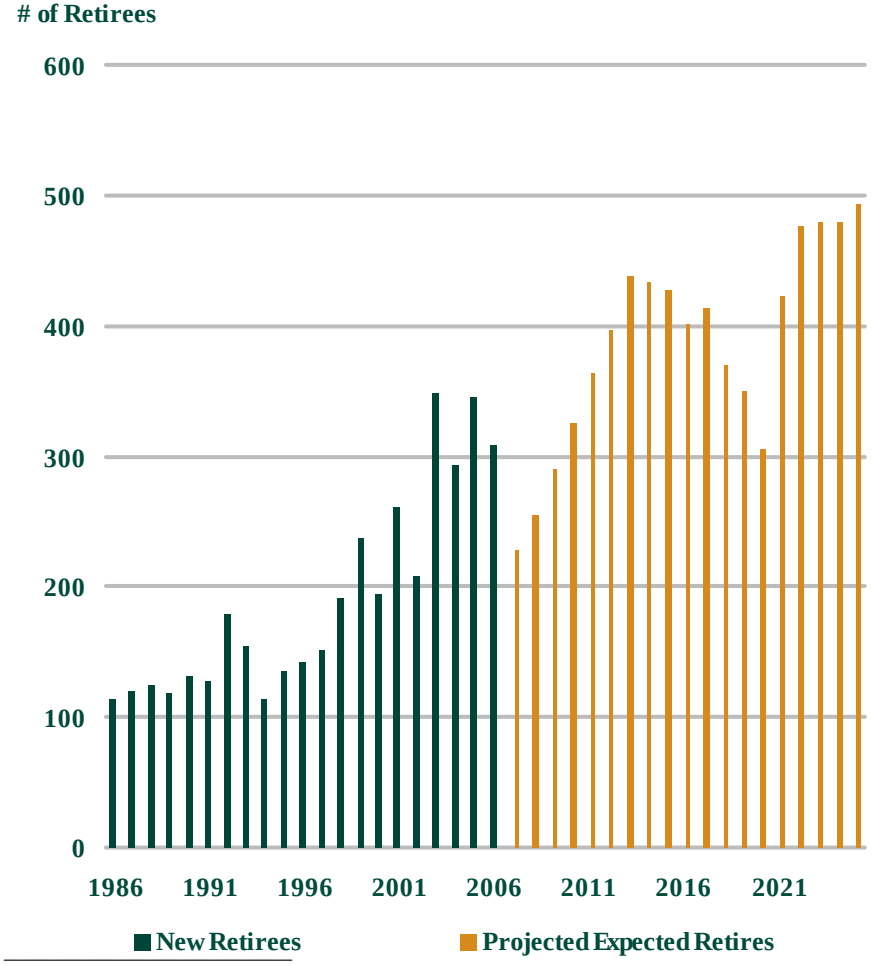
- ***The County contributes 80% of retiree health plan cost*** for most plan options and adds an amount equal to the Medicare Part B rate to this contribution
  - In many cases, this means the retiree's contribution is nominal
    - 60% of retirees are over age 65 and pay 1 cent a month
    - 40% of retirees are under age 65 and pay 20%; the County pays the remaining 80% of the cost

- Eligibility for County retiree health coverage only requires that the participant be eligible for a County pension benefit
  - Full benefits are available after 10 years of service and attainment of age 50
  - Hires made after December 31, 2006 are required to have a minimum of 15 years of service at the County
  - ***Service at many other non-County government organizations can be combined with County service to meet the requirements (for pre 12/31/06 hires only)***

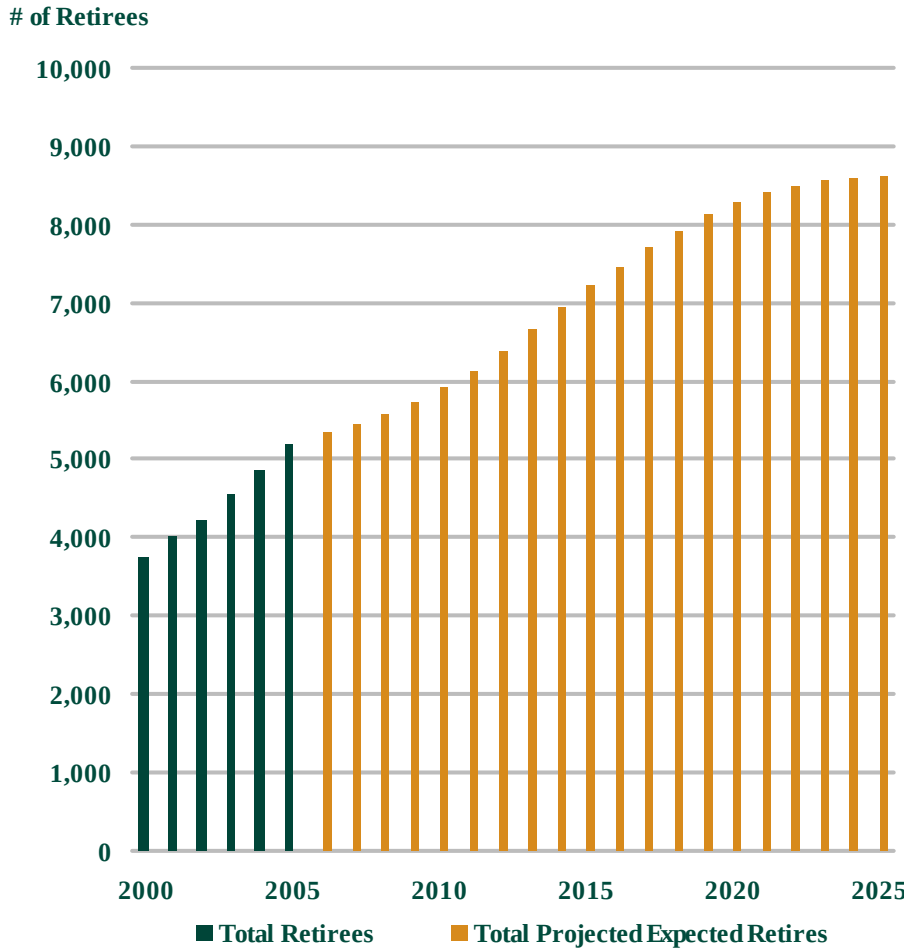
Demographics Drive the County's OPEB Exposure

Reflecting average workforce age of 46, employees who will be retiring over the next 20 years far exceeds historical retirement rate

Annual Number of County Retirees – Historical & Projected



Cumulative Number of County Retirees – Historical & Projected



Source: Buck Consultants.

County Faces an Enormous UAAL

OPEB UAAL Dwarfs County's Debt

Contra Costa County's Outstanding Liabilities ($000s)

Sources: Public Debt data from FY2006 CAFR, Pension UAAL data from The Segal Company (CCCERA's Actuary) as of December 31, 2005 and OPEB UAAL data from Buck Consultants.

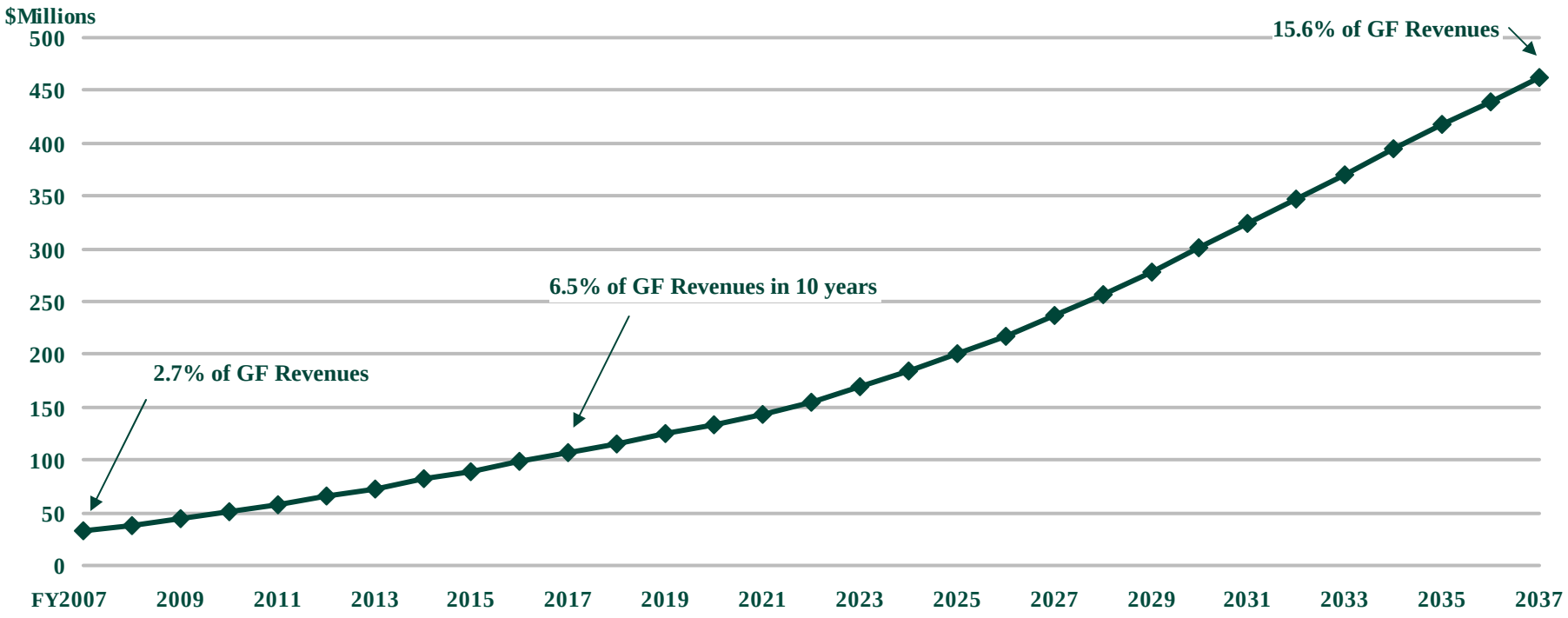
** The County blends the active and pre- and post- 65 retiree rates which results in subsidy of the retiree costs by the active population*

- Retiree Health Subsidy is responsible for $424,583,000 of the total $2,571,650,000 OPEB UAAL

Defining the County's OPEB Funding Challenge

Given scope of benefits and retirement rates, OPEB costs will continue to grow and represent an ever-increasing percentage of the County's annual budget

Projected Pay-Go Cost[1]



- ***Pay-Go expense will nearly triple in 10 years***

1. Pay-Go cashflow from Buck Consultants. General Fund Revenue, p.15 of County's 2007 Budget. Assumed General Fund annual growth rate of 3.0%

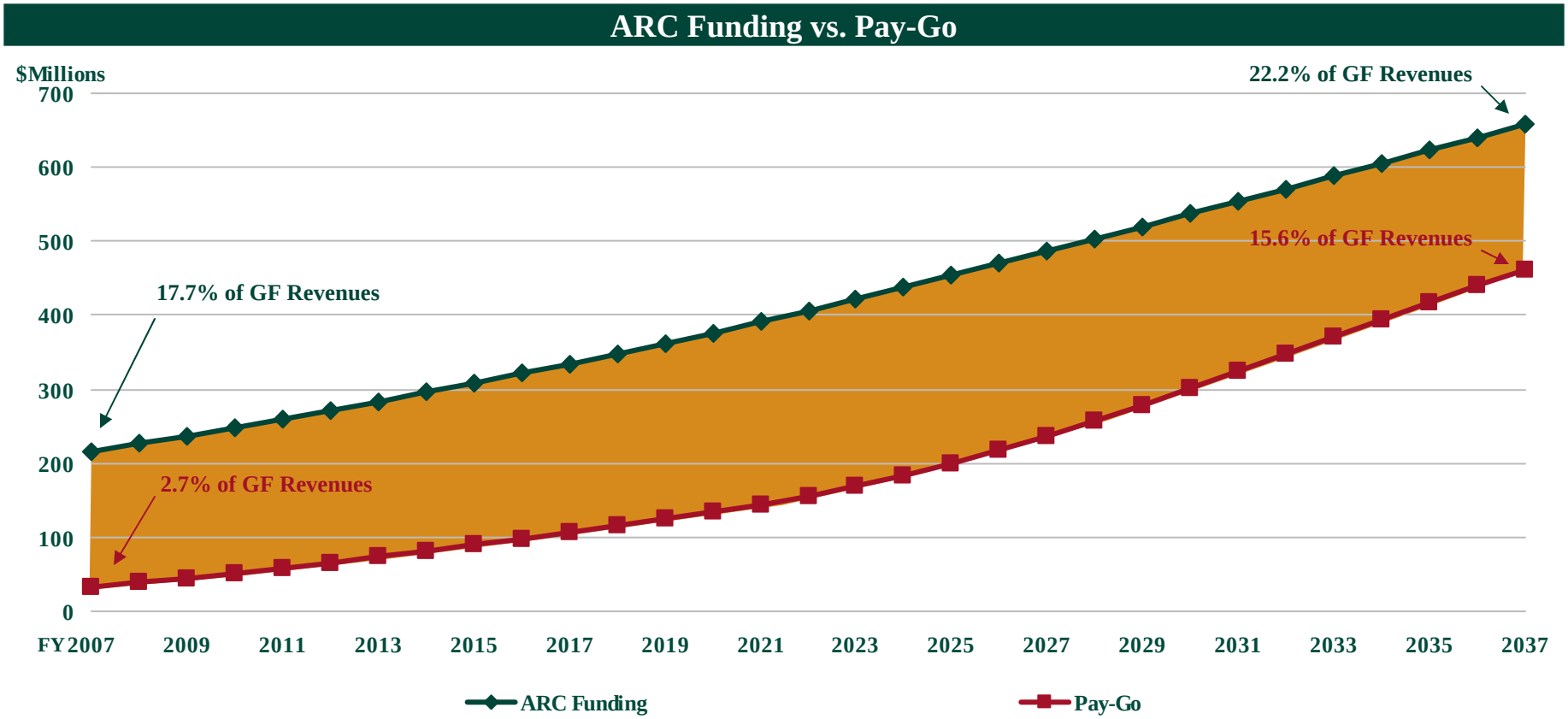
Majority of County's Reimbursement Rates are Capped

- Reimbursement rates vary by program and service, but 60-80% are capped at absolute dollar levels.
  - HSD is 90-95% capped
  - EHS is 80% capped
- Reimbursements are subject to change by the State and federal governments, depending on their budget circumstances
- The proportion of capped reimbursable departments suggests the County cannot expect to pay off its OPEB costs

Consequences of Inaction

Pay-go Doesn't Cut it

ARC (Annual Required Contribution) represents the actuarially appropriate funding of benefits as they are incurred

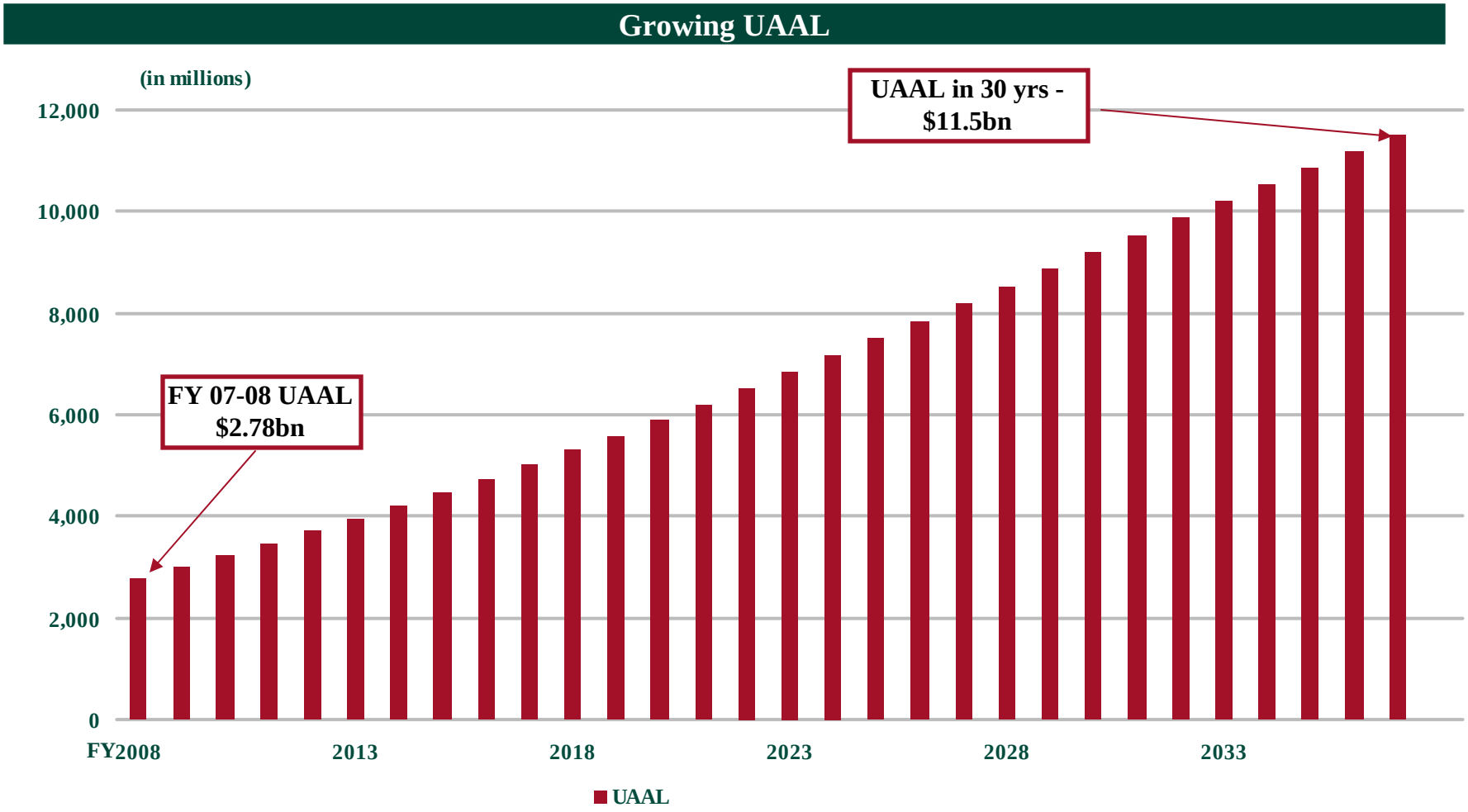


Annual Required Contribution (ARC) = Normal Cost + Amortization of Unfunded Liability (UAAL)

1. ARC cashflow from Buck Consultants. General Fund Revenue, p.15 of County's 2007 Adopted Budget. Assumed General Fund annual growth rate of 3.0%

Budgeting Less than the ARC Causes a Massive Fiscal Hole

If the County continues on a pay-as-you-go basis, its unfunded OPEB liability will continue to grow and the cost of "catching up" will skyrocket

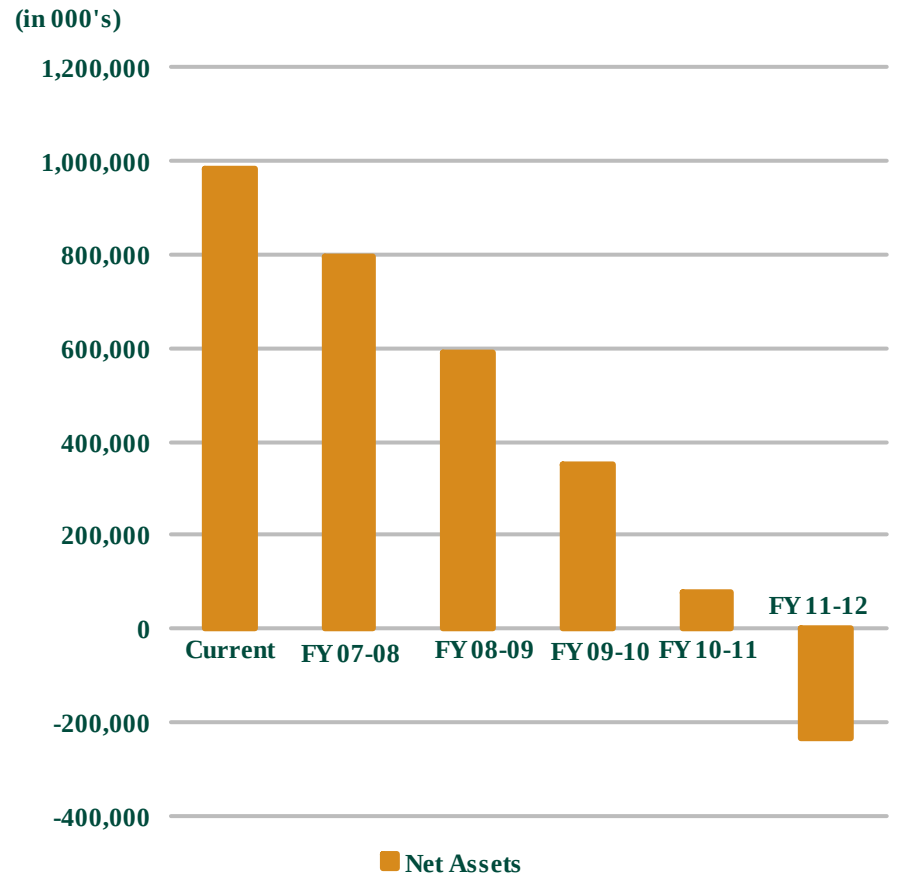


Urgency of Strategy/Decisions

For every dollar of underfunding, the County will have to book a "Net OPEB Obligation" on its balance sheet

- Budget decisions for FY 2007-08 will affect the County's financial statements published in the fall of 2008
  - Budgeting less than the annually required contribution ("ARC") ($227 million[1] - the equivalent of 1,981 FTE) for FY 2007-08 will result in a "net OPEB obligation" of approximately $188 million on the balance sheet
  - Failure to budget the ARC will wipe out the County's net assets and by FY2012, the County will be technically insolvent
  - Underfunding the ARC has a particularly critical impact on the Hospital Enterprise Fund and County Health Plan
    - State license at risk once Enterprise Fund Balance Sheet goes negative

County Net Assets reduced by Net OPEB Obligation Balance



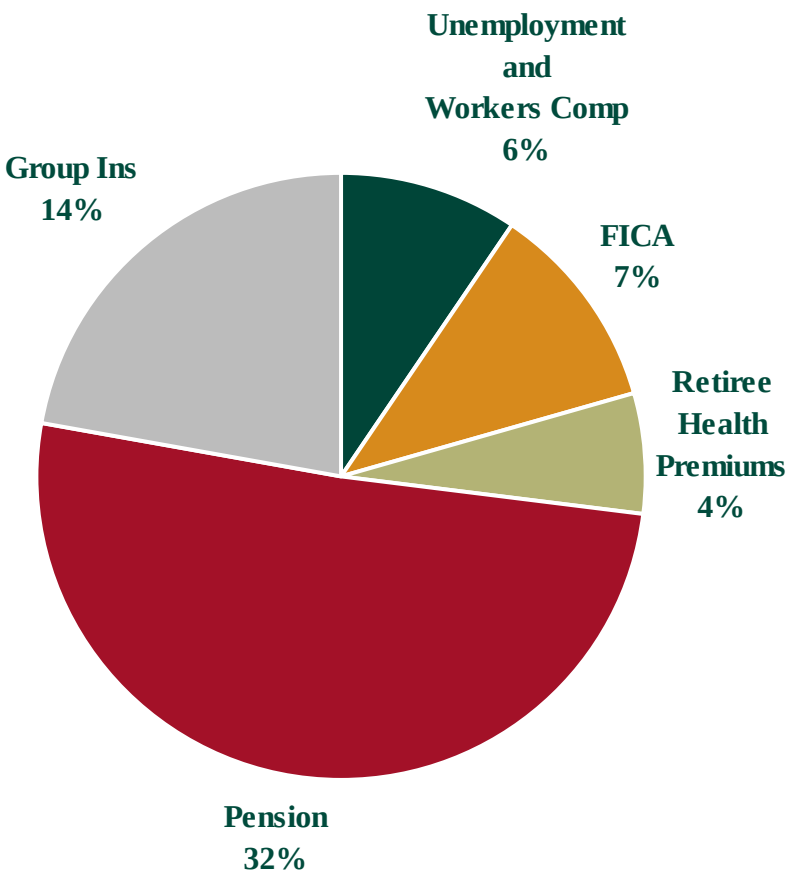
1. *Assumes County's net assets are grown at 4% per annum.*

Within Health Budget, Employee Benefit Rate will Rise to 95% of Wages

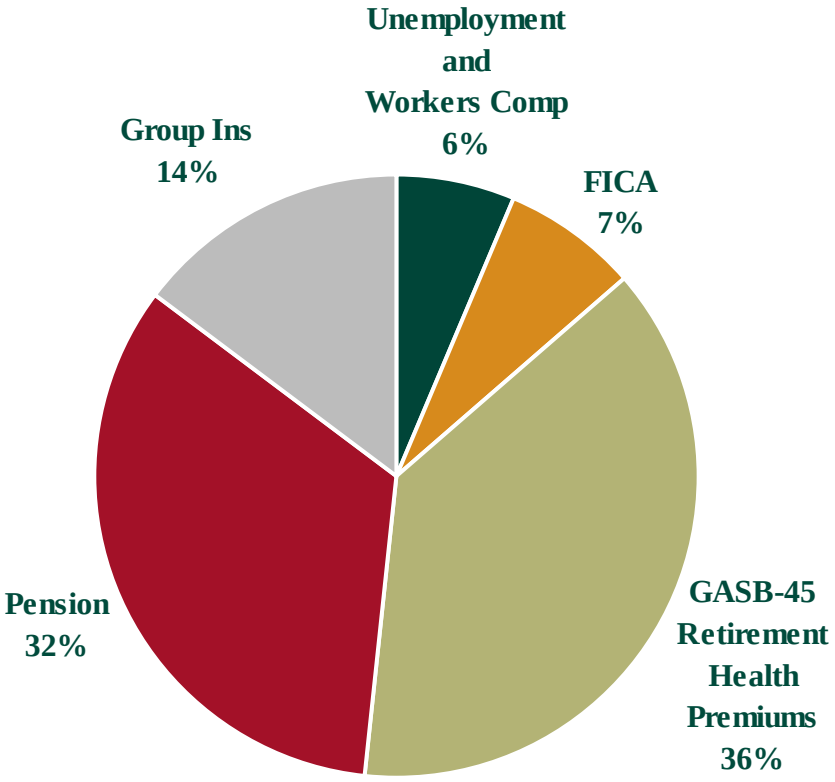
Presenter: Pat Godley

Contra Costa County
Contra Costa Regional Medical Center
Employee Benefits as a % of Wages

Pre GASB-45 Benefits (63% of Wages)



Post GASB-45 Benefits (95% of Wages)



Health Services Department Reimbursement Summary

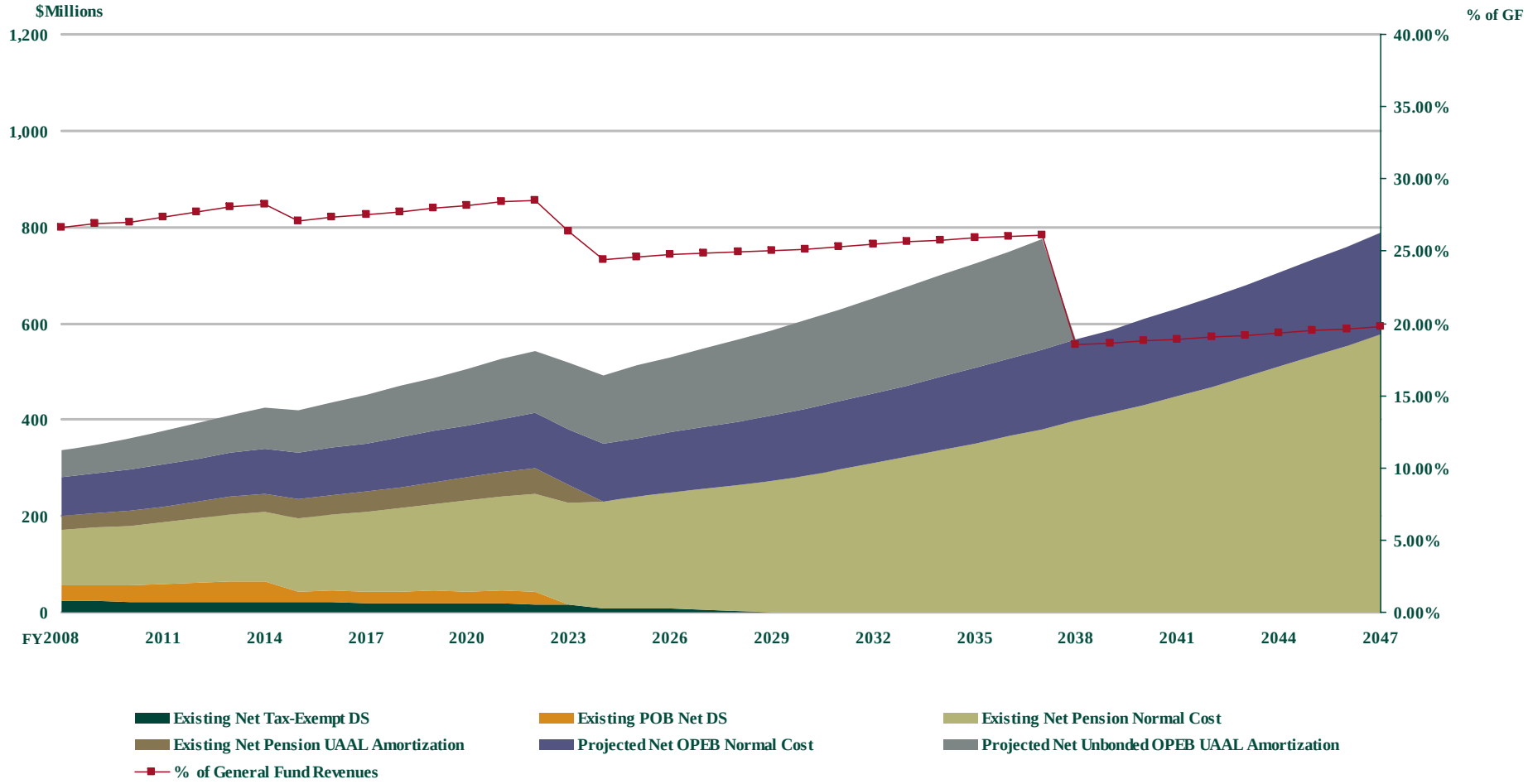
Health Services Department Revenue Offsets to GASB-45 Costs

Division	Major Revenue Items	Reimbursed On Cost	Manner of Payment
Hospital and Clinics	Inpatient Medicare	No	Fixed Diagnosis Related Group (DRG) payment per discharge
	Outpatient Medicare	No	Fixed Average Payment Category (APC) payment per visit
	Inpatient Medi-Cal	Yes*	Certified Public Expenditures (CPE), subject to maximum limit; limit is maximized
	Outpatient Medi-Cal	No	Fixed Federally Qualified Health Center (FQHC) payment per visit
	Private Ins. & private pay	No	Collections on charges billed
	Realignment	No	Fixed percent of Vehicle License Fee collections
Health Plan	County employee premium	Yes	Rates charged to County based on costs
	All other enrollee premiums	No	Fixed monthly payment per enrollee per month
	Master Tobacco Settlement	No	Fixed percent of State settlement distribution
Mental Health	Inpatient Medicare	No	Fixed Diagnosis Related Group (DRG) payment per discharge
	Inpatient Medi-Cal	Yes*	Cost, subject to Schedule of Maximum Allowances (SMA) limitation; limit is maximized
	Outpatient Medi-Cal	Yes*	Cost, subject to Schedule of Maximum Allowances (SMA) limitation; limit is maximized
	Private Ins. & private pay	No	Collection on charges billed
	Realignment	No	Fixed % of Vehicle License Fee Sales Tax collections
	State & Federal funds	No	Fixed allocation and grant amounts
Alcohol & Drugs	Medi-Cal	Yes*	Cost, subject to Schedule of Maximum Allowances (SMA) limitation; limit is maximized
	Federal funding	No	Fixed allocation and grant amounts
	State funding	No	Fixed allocation and grant amounts
Public Health	State funding	No	Fixed allocation and grant amounts
	Federal funding	No	Fixed allocation and grant amounts
Environmental Health	Fees	Yes	Fees charged to businesses based on Board set rates
Ca Childrens Services	State funding	Yes	Cost reimbursed at 50%
Homeless Programs	Federal funding	No	Fixed allocation and grant amounts
	State funding	No	Fixed allocation and grant amounts

** Cost is reimbursed but is set at a cap*

Evaluating OPEB Costs in the Context of the Whole Budget

Net County Debt Service + Benefits Cost[1]

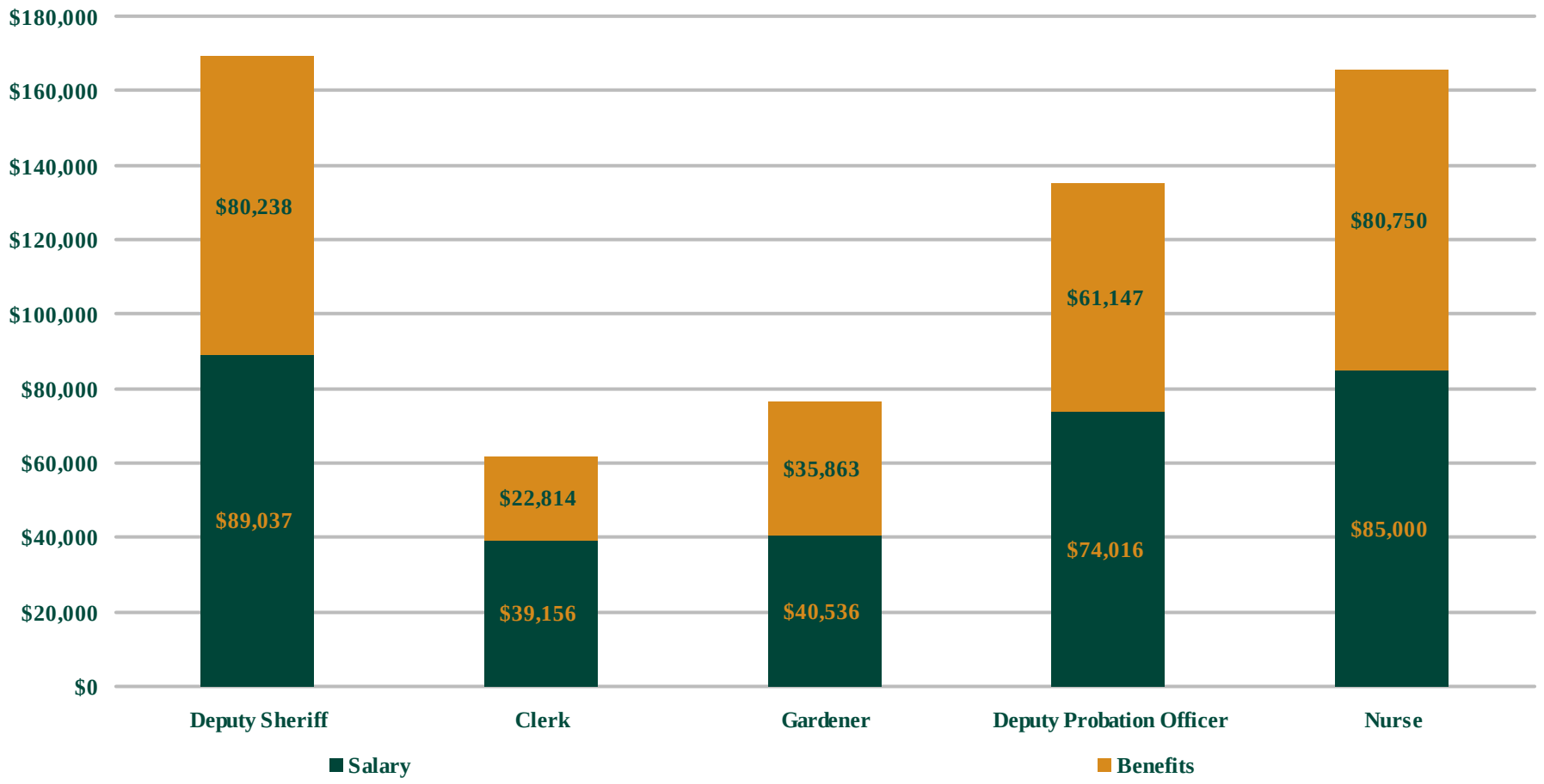


1. *Assumes 40% Reimbursement.*
2. *OPEB Normal Cost and UAAL amortization from Buck Consultants.*

Across the Entire County Workforce, Benefits Threaten to Crowd Out Service Delivery

Presenter: Pat Godley

Current Employees Cost Comparison*



1. *Excludes approximately $15,000 per year pay-go retiree health costs*

What Do the Rating Agencies and Other Credit Arbiters Say?

Presenter: Lisa Driscoll

- Rating agencies are very focused on OPEB, because of the demographic tsunami facing federal, state and local government agencies
- Although they are unlikely to unleash wholesale ratings downgrades at this time, they have incorporated a review of all issuers' OPEB and Pension funding status and indicated they will take issuers' funding plans into account when determining credit ratings
  - The County's large UAALs have been noted
  - A negative net worth is likely to be the catalyst for negative rating action
- Bond insurers seem to be incorporating UAAL data into their ratio analysis as valuations become available
- Institutional investors are acutely aware of the retirement benefit risks, having been badly burned on many corporate credits
- It is critical for the County's future market access that the County develop a viable funding plan/benefit management strategy

"You can't ignore the problem. You can't let the OPEB number grow to infinity over time. You need to develop a feasible plan to address the liability. Arguing that you only need to continue with the PAY-GO and failure to address the OPEB liability is unacceptable."

Parry Young, Standard & Poor's

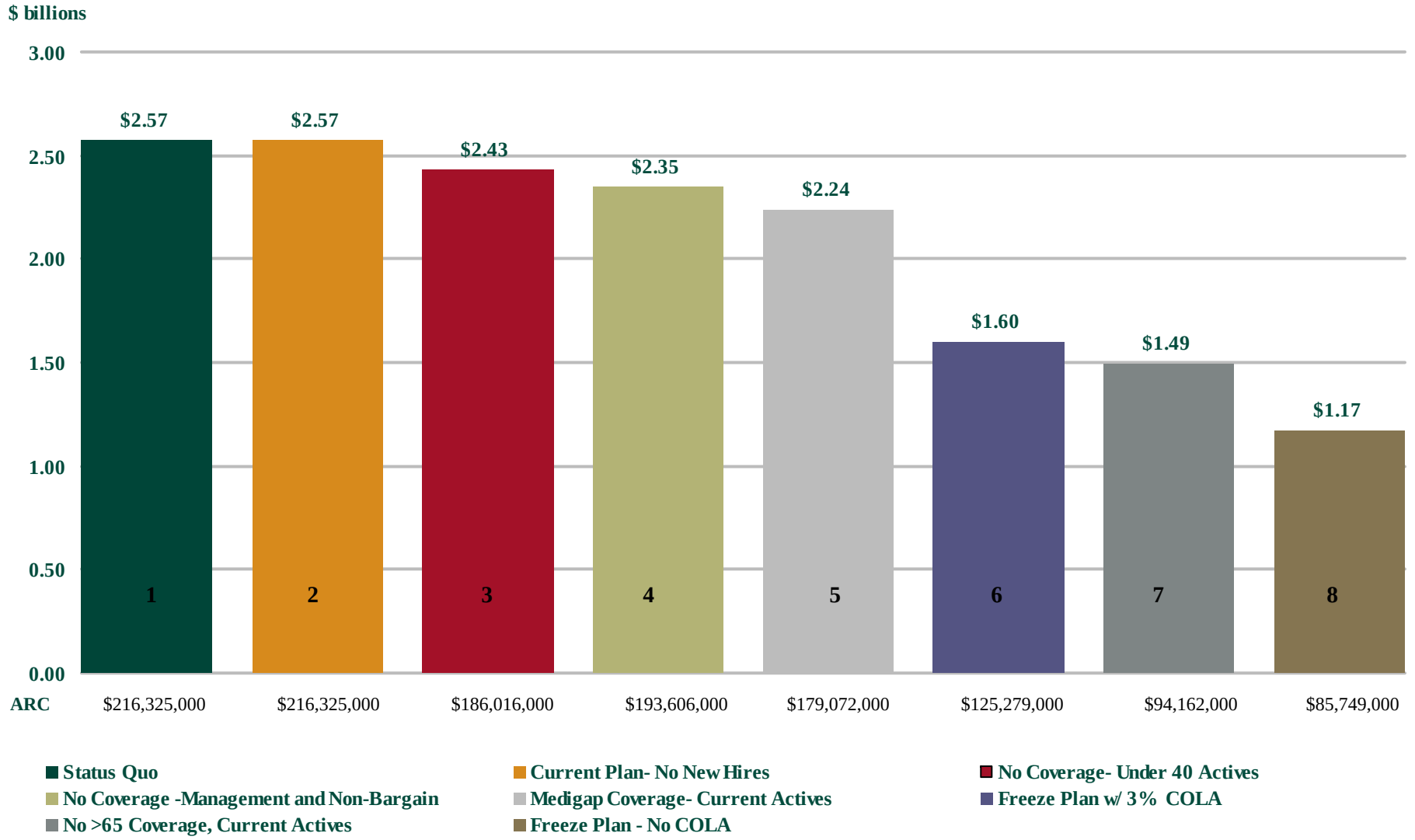
"The County's unfunded post-retirement benefits are yet another potentially very large burden on its finances...The County's strategy to address its onerous OPEB exposure will be an important consideration in our analysis of the County's rating, going forward. It is possible that in order to maintain financial health, while addressing the financial burden of its OPEB liability, the County will be forced to implement significant expenditure reductions. "

Kevork Khrimian, Moody's (2-20-07 Credit Rating Release)

Strategies to Deal with OPEB

High Level Perspective on Impact of Various Plan Designs

County's OPEB UAAL Under Different Contribution Options



Freezing Existing Actual Dollar Benefit Would Cut UAAL in Half

Presenter: Christine Penkala

- Rising health care inflation drives up total County outlay each year
- County could freeze actual dollar benefit today, and reduce its UAAL to $1.2 billion
  - Inflation will no longer affect total County outlay

Liability Change

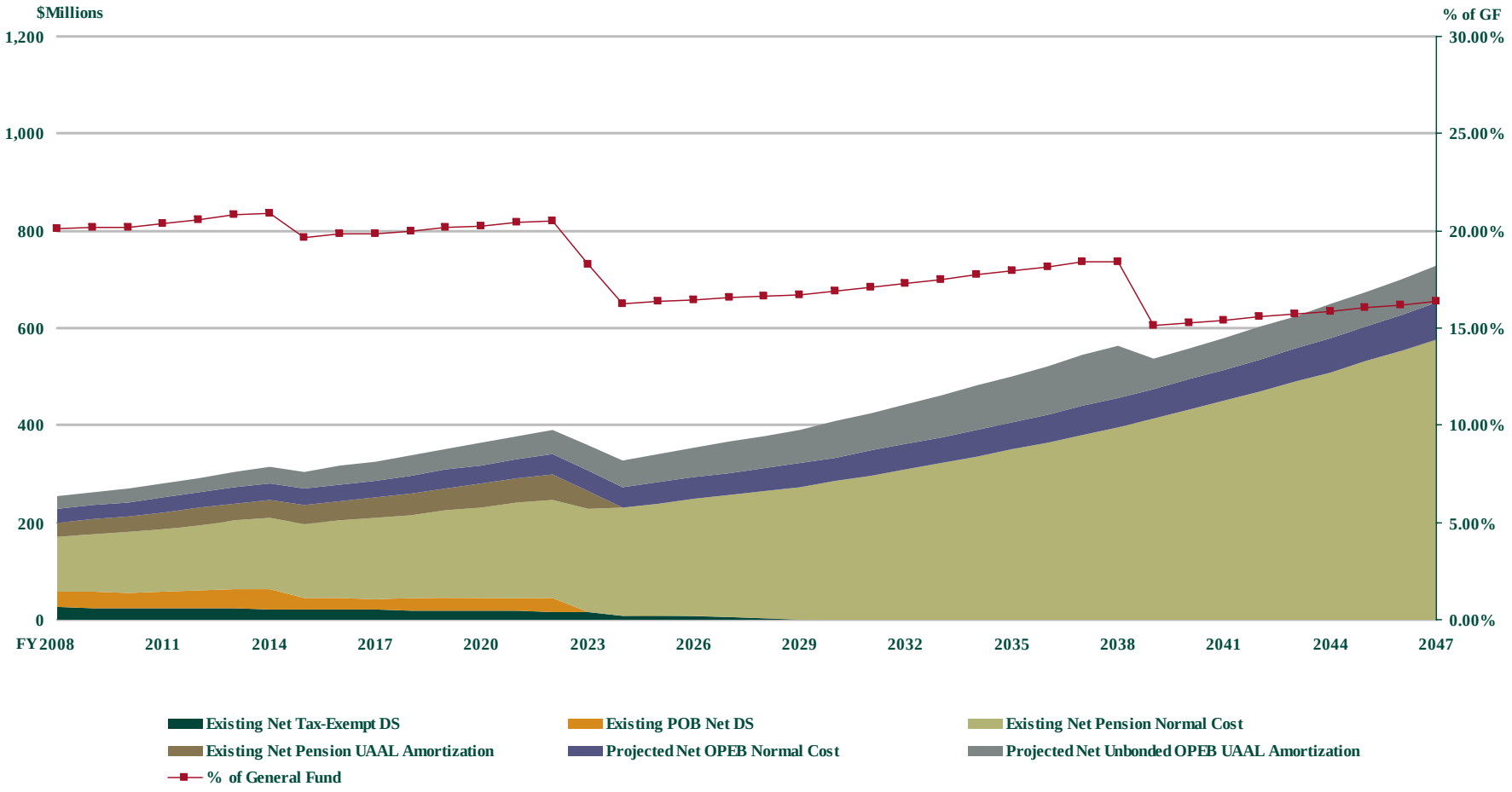
	1	2	3	4	5	6	7	8
	Current Plan No Changes	**Current Plan No New Hires**	**No Coverage under 40 Actives**	**No Coverage Mgmt & Non-Barg**	**Medigap Cov Current Actives**	**Freeze Plan w/ 3% COLA**	**No > 65 Cov Current Actives**	**Freeze Plan No COLA**
Total APBO	$2,571,650,000	$2,571,650,000	$2,431,155,000	$2,348,329,000	$2,238,727,000	$1,600,603,000	$1,490,775,000	$1,172,938,000
Assets	0	0	0	0	0	0	0	0
UAAL	$2,571,650,000	$2,571,650,000	$2,431,155,000	$2,348,329,000	$2,238,727,000	$1,600,603,000	$1,490,775,000	$1,172,938,000
Annual Required Contribution								
Normal Cost	130,604,000	130,604,000	104,977,000	115,328,000	104,448,000	71,926,000	44,469,000	46,651,000
30 Year Amort of UAAL	85,721,000	85,721,000	81,039,000	78,278,000	74,624,000	53,353,000	49,693,000	39,098,000
ARC	$216,325,000	$216,325,000	$186,016,000	$193,606,000	$179,072,000	$125,279,000	$94,162,000	$85,749,000

1. No changes to current plan, 4.5% discount rate used for all scenarios. Subsidy of retiree rates by actives remains in effect for all scenarios.
2. Close current plan to all future hires, results in no change to current closed-group valuation liability.
3. Active employees under age 40 do not receive postretirement medical benefit, actives over age 40 retire under current plan.
4. Management and non-represented units do not receive postretirement medical coverage, current actives only, no change for current retirees.
5. Current actives retire under current plan but with Medigap coverage only once they turn age 65, no change for current retirees.
6. Freeze plan at current employer contribution levels, increase each future year benefit level with a 3% COLA.
7. Coverage ends at age 65 for all future retirees, no change for current retirees.
8. Freeze employer contributions for retiree coverage at current levels, both over and under age 65, no COLA.

Freezing Benefits at Current Level Helps Bring County's Costs into Better Alignment with Resources

Presenter: Jean Buckley

Net County Debt Service + Benefits Cost[1]



1. *Assumes 40% Reimbursement.*
2. *OPEB Normal Cost and UAAL amortization from Buck Consultants.*

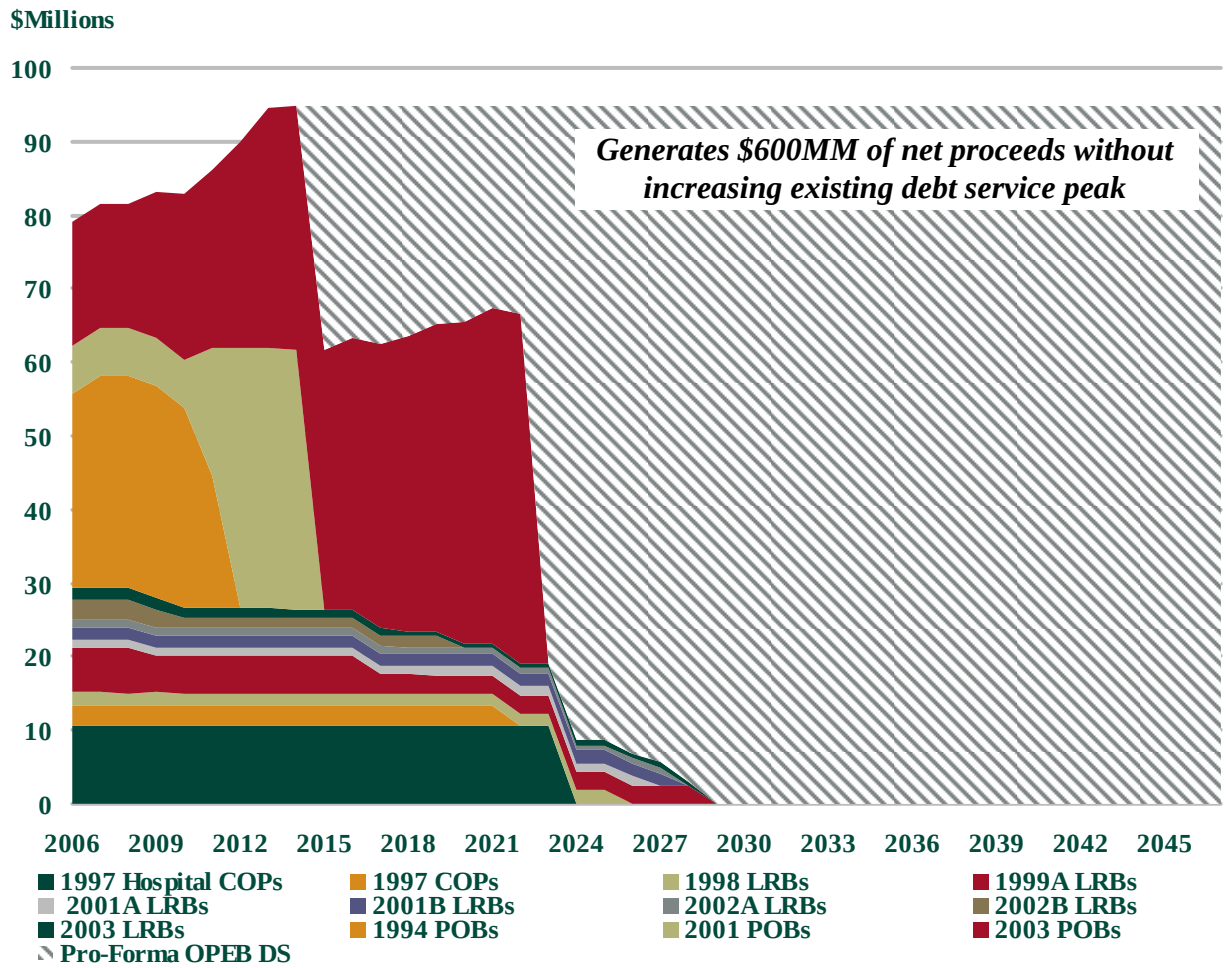
Prefunding May Help Reduce Long-Term Cost

Presenter: Jean Buckley

County could issue OPEB Bonds that enable it to make a substantial down payment towards its UAAL, without increasing existing debt service peak

- By prefunding a portion of its OPEB UAAL, the County would reduce its ARC
- Does not eliminate the UAAL; instead, converts UAAL into debt
- Combined with a Plan Freeze, this bond solution would bring the County to a funding ratio of 50%
- Exposes County to investment risk
- Exposes County to risk of pre-funding what later may no longer be an obligation

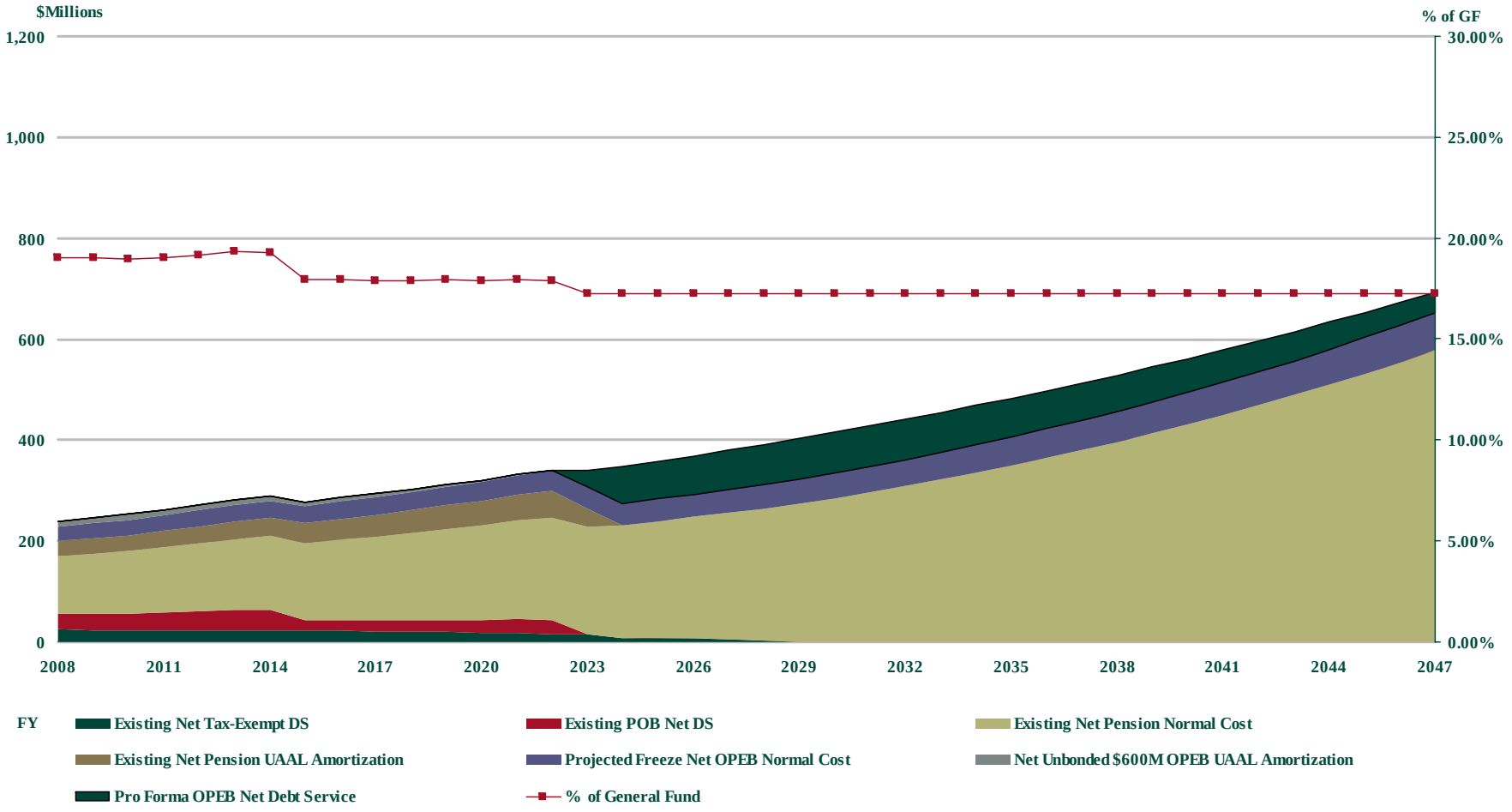
Wrapping OPEB Bonds Around Existing Debt Service



Freeze + Partial Bonding Brings OPEB Cost to Manageable Level

Presenter: Jean Buckley

Net County Debt Service + Benefits Cost[1]



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2. *OPEB Normal Cost and UAAL amortization from Buck Consultants.*

What are Other Counties Doing?

What Are Other Counties Doing?

County	Size of General Fund ($000s)[1]	OPEB AAL[2]	OPEB AAL as a % of GF	Status/Comments
Alameda	◆ 1,770,647	◆ $613.5M	◆ 34%	◆ Of total AAL, approximately $70M results from implicit rate subsidy, leaving net AAL of $544M. Retirement System (ACERA) holds $450M of net assets for OPEB, leaving net UAAL of $94M. ACERA pays for OPEB from a designated portion of the County's retirement contribution (modified defined contribution). Because benefit is paid by ACERA and is contingent upon earnings, ACERA/County believe there is no UAAL under GASB.
Contra Costa	◆ 1,194,048	◆ $2.57 Bn	◆ 215%	◆ OPEB Taskforce is reviewing options.
Los Angeles	◆ 12,331,217	◆ Valuation In Process	◆ Not Applicable	◆ Planning to create trust. County subsidizes retiree health benefits based on years of service: 4% of "Benchmark Plan" (Blue Cross) per year of service, subject to a minimum of 10 years. After 25 years of service, 100% coverage.
Marin[3]	◆ 369,103	◆ Valuation In Process	◆ Not Applicable	◆ N/A
Orange	◆ 2,290,663	◆ $598M	◆ 26%	◆ UAAL reduced from $1.4 bn by a) splitting benefit pool, b) capping growth at 3% c) requiring Medicare integration, and d) linking benefit to retirement age.

1 6/30/06 CAFR, unless otherwise noted
2. OPEB UAAL at Pay-Go discount factor
3. 6/30/06 Unaudited CAFR

What Are Other Counties Doing?

County	Size of General Fund ($000s)[1]	OPEB AAL[2]	OPEB AAL as a % of GF	Status/Comments
Riverside	◆ 1,993,863	◆ $257M	◆ 13%	◆ $178M of UAAL is attributable to subsidy. In process of establishing trust; to contribute $10M initially.
Sacramento	◆ 1,900,238	◆ UAAL estimated at $300-500M, Valuation just commissioned, due June 2007	◆ 16% – 26%	◆ County has annually appropriated subsidy (max is $244/month) since 1993, initially from Retirement System's "excess earnings", which have been depleted. FY07 general fund cost of $14.3M. Board voted 5-0 to defer decision on proposal to end subsidy for retirees who retired after June 29, 2003 when pension benefits were enhanced. Proposal also entailed County creating HSAs and funding at $650/year per employee.
San Bernardino	◆ 1,915,550	◆ $0	◆ 0%	◆ No vested benefit. Prior Retirement System "excess earnings" were deposited in separate account, being used to fund annual subsidy (currently, about $14M/year). When fund exhausted, subsidy ends. ($180M initial balance, depleted to $126M).
San Diego	◆ 2,548,000	◆ $640M	◆ 25%	◆ Retirement benefit of up to $400/month provided since 1974 by Retirement Association (SDCERA) from "excess earnings". County counsel has opined that benefit is not vested and is not an obligation of the County. In December, County Board voted to request SDCERA to reduce the subsidy. SDCERA has responded that County lacks jurisdiction.

1 6/30/06 CAFR, unless otherwise noted
2. OPEB UAAL at Pay-Go discount factor
3. 6/30/05 CAFR, 2006 CAFR not completed.

What Are Other Counties Doing?

County	Size of General Fund ($000s)[1]	OPEB AAL[2]	OPEB AAL as a % of GF	Status/Comments
San Francisco	◆ 2,473,839	◆ $4.9BN	◆ 200%	◆ MOU with labor unions call for Citywide Committee to develop recommendations on how to fund OPEB.
San Mateo	◆ 799,360	◆ $70M	◆ 9%	◆ County has already set aside $29M and plans to budget $50-60M in FY07 to wipe out UAAL.
Santa Clara	◆ 1,931,266	◆ $1.2BN	◆ 62%	◆ OPEB liability is 30% funded. County began funding UAAL after sponsoring legislation (10+ years ago) allowing it to invest in a diversified asset mix, including equities. County also has Pre-Proposition 13 property tax override that is uses for OPEB.
Sonoma	◆ 464,109	◆ $577M	◆ 124%	◆ County is reviewing its options.
Solano	◆ 187,208	◆ Valuation in Process	◆ Not Applicable	◆ County does not provide OPEB. County pays PERS health administrative cost of $64.60 per employee. FY06 expenditure was $224,000.
San Joaquin	◆ 591,190[3]	◆ $13.8M	◆ 0.23%	◆ Prior to recent negotiations, County maintained a "sick leave bank" but otherwise provided no OPEB. UAAL to be amortized over 10 years (FY08 cost is $4.3M). Beginning July 2007, County will offer a defined Post Employment Health Benefit Contribution. FY08 cost will be $910K.

1 6/30/06 CAFR, unless otherwise noted
2. OPEB UAAL at Pay-Go discount factor
3. 6/30/05 CAFR, 2006 CAFR not completed.

The Governor's Pension Commission

- In late December 2006, Governor Arnold Schwarzenegger established the Public Employee Post-Employment Benefit Commission to:
  - Identify the full amount of retirement health and dental benefits for which California governments are liable but which remain unfunded
  - Evaluate and compare the various approaches for addressing governments' unfunded retirement health care and pension obligations

- The 12 members of the Commission are: Gerald Parsky, *Chair*, Matthew Barger, Paul Cappitelli, John Cogan, Connie Conway, Ronald Cottingham, Dr. Teresa Ghilarducci, Jim Hard, Leonard Lee Lipps, Dave Low, Curt Pringle and Robert Walton

- The first meeting of the Commission is scheduled for March 9, 2007

- The Commission is to report back by January 1, 2008

Proposals emanating from the Commission will not reduce the County's net OPEB costs

Summary

Summary

Presenter: Lisa Driscoll

- The County cannot afford future costs of current Benefit Plans and maintain service levels
- The County's OPEB UAAL is not going away
- Absent action to reduce the County's net contributions, OPEB costs will consume an ever-increasing share of the County's expenditures, crowding out other programs which will quickly and adversely impact the County's net assets
- Failure to fund the ARC (or reduce it) will affect the County's financials, leading to negative net assets in 5 years or FY 2011-2012
- Prudent fiscal management requires action
- Staff requests direction to:
  - Develop cost reduction strategy for new hires, current employees, and current retirees; and
  - Develop a simple presentation with options and impacts for public education with our work force in 2007; develop our labor strategy for 2008; and initiate benefit reductions and cost containment actions now where legally feasible