

# RSCCD Board Fiscal/Audit Committee

Other Post Employment Benefits (OPEB)  
Unfunded Liability

Contingency (Minimum Required)  
Reserves – Board Policy/Budget  
Assumptions

November 20, 2018

# Agenda

- Retiree Health Benefits Liability – OPEB
- Board Policy Contingency/Reserves
- Recommendations

# Retiree Health Benefits Liability – Other Post Employment Benefits (OPEB)

# OPEB Retiree Health Benefits

- RSCCD provides full time employees with two forms of Retiree Health Benefits at retirement
  - Lifetime Health Benefits – F/T employees hired prior to 1986/87 after 15 years of service
  - Up to age 70 Health Benefits – F/T employees hired after 1986/87 after 15 years of service
- RSCCD pays annual retiree health premiums out of general fund
  - Approximately \$8 million per year for 2018/19
- Contractual Obligation to pay per CBA's
- Increasing annual cost of premiums for retiree health benefits
- Creates a huge unfunded liability to district's year to year budget as limited funding is set aside for this future obligation
  - None currently in an Irrevocable Trust
- Annual health premiums increase an average of 5% per year
- Future annual premium costs?
  - Larger and larger financial burden on General Fund

# OPEB Retiree Health Benefits

- New GASB 75 valuation presented by Actuary to Board of Trustees on July 16th
  - GASB 43/45 prior pronouncements
- OPEB Liability now ~\$167.3 Million
  - Was \$82.1 million in 2014 and \$129.6 million in 2016
- Growing Unfunded Liability estimates are now more volatile under GASB 75
- RSCCD has contributed full Annual Required Contribution (ARC) since 2012
  - Prior Budget Assumptions ARC contribution policy was 1% of total salaries plus \$500,000
    - Not sufficient to keep up with rising ARC calculations and annual premium increases
    - At times used one time funds to increase contributions to ARC
- 2016 ARC - \$12 million
  - \$8 million goes to pay annual health care premiums for retirees (pay-as-you-go)
  - \$4 million contribution to Retiree Health Benefits Fund
- Contributions left over after annual premiums paid deposited into Retiree Health Benefits Fund
  - Current cash fund balance approximately \$60 million
- A major influencer of unfunded liability calculation is interest earnings on deposited funds
  - “Discount Factor”
- Had been earning approximately 1% interest in the County Treasury
  - Actuary using 3.5% since current funds are not considered Irrevocable Trust Plan Assets
  - If idle funds earned higher interest earnings, would lower ARC obligation

# Irrevocable Trust

- In order to manage increasing liability one mechanism to assist on the interest earnings calculations is to use an Irrevocable Trust
  - Higher interest earnings due to expanded ability for investments for a legal trust
  - Not constrained by Government Code 53600 et al
- Plan Assets (irrevocable trust) vs Health Benefits Fund (revocable by Board action)
- Legally establish an independent Irrevocable Trust Plan
- Interestingly, GASB doesn't require districts to fund the calculated unfunded liability – just requires acknowledgement of liability on financials and a plan to fund
- However:
  1. Prudent to plan and fund identified obligations of district
  2. Accreditation Standard III D-12 requirements
  3. Bond Financing/credit ratings requirements
  4. Increasing cost pressure on district's annual budget

# Irrevocable Trust

## Benefits of an Irrevocable Trust

- Increase earnings if have Irrevocable Trust (up to 7%)
- Counts as Plan Assets and reduces the OPEB liability
- Employees can feel comfortable that funds are “locked away” for their future retiree benefits
- Reduce costs and strain to General Fund
- Potential credit rating increase
- Accreditation Standard

## Drawbacks of an Irrevocable Trust

- Less Board flexibility as it cannot be tapped for other needs
- Once deposited to trust it cannot be removed
- Need to set careful rules for investment options as we don't want to bet on stock market volatility (investment risk assessment)

# OPEB Retiree Health Benefits

- Available Resources:

○ Retiree Benefits Fund	\$60,000,000
○ Potential additional from Self Insurance Funds	<u>\$10,000,000</u>
Total available	\$70,000,000

- Other Needs to Consider:

- Ability/flexibility to borrow from these funds for projects?
- Ability to borrow from these funds for cash flow?
- Ability to use funds for financial crisis?



# OPEB Retiree Health Benefits

- Irrevocable Trust – invest \$30 - \$40 million?
- Retiree Health Benefits Fund – maintain \$30 million in revocable?
- Future ARC contributions options:
  - Remaining balance of ARC after premiums paid deposited to Irrevocable?
  - Remaining balance of ARC after premiums paid split between Irrevocable trust and Retiree Health Benefits Fund?
  - Remaining balance of ARC after premiums paid deposited to Retiree Health Benefits Fund

# OPEB Retiree Health Benefits

## Establishment of an Irrevocable Trust

- Tentative Timeline:
  - Discussion with Board Fiscal Audit Committee November 20, 2018
  - Board of Trustees Presentation December/January
  - Discussion with the County of Orange January, 2019
  - RFP Process for an OPEB Trust Provider Jan – April, 2019
  - Legal Review/Board Approval May, 2019
  - Establish Irrevocable Trust and Transfer Funds June, 2019

# Staff Recommendation

- Recommend the Board Fiscal Audit Committee Consider:
  - Comfort level for a transfer to establish an Irrevocable Trust for a portion of monies set aside for Retiree Health Benefits
    - Transition to a hybrid plan
      - Part irrevocable trust
      - Part “revocable”
  - Discuss distribution of yearly ARC contributions
  - Request for Proposal (RFP) for OPEB Managed Trust Services

# Reserves

## RSCCD Board Policy on Contingency Reserves

# Board Policy Contingency Reserves

- Current Board Policy Contingency is at “no less than 5%” (BP 6250)
  - ~\$9.3 million
  - State recommended “prudent reserves”
  - Chancellor’s Office encouraging districts to review their reserve policies because of new funding formula
- RSCCD monthly expenses average ~\$20 million
- Payroll and benefits costs alone averages over \$15 million a month, meaning the current reserve level could not even cover a single month of payroll in an emergency
- We are now in the tenth year of recovery since the Great Recession
- When will the next downturn hit and will we be best positioned to weather the storm?

# Board Policy Contingency

- Other Factors to Consider:
  - New Student Centered Funding Formula with added Supplemental and Student Success performance based data elements adds significant funding variability and uncertainty
  - Multi-year projections of revenue will be much more difficult to model and predict
  - Our FTES has remained relatively flat in last several years (flat funding with increasing costs)
  - Although the new Funding Formula allocates funds on more than just the numbers of students, we still need to grow our student population over time
  - Increasing automatic annual costs such as PERS and STRS, step/column movements, health benefits increases and inflation add to budget uncertainty
  - Anticipated that all districts will quickly improve their data accuracy and increase student success, thereby creating large apportionment deficits statewide due to limitations in funding from Proposition 98 minimum funding guarantee
  - ACCJC Accreditation – working on strengthening financial stability standards
  - Bond Credit Ratings – Credit agencies look for liquidity and financial security

# Board Policy Contingency

- Government Finance Officers Association (GFOA)
  - National organization for support of governmental agencies and advisories on Generally Accepted Accounting Principles (GAAP)
  - Recommended Best Practice for General Fund Reserves (balances)
- “GFOA recommends, at a minimum, that general-purpose governments, regardless of size, maintain unrestricted budgetary fund balance in their general fund of no less than two months of regular general fund operating revenues or regular general fund operating expenditures.”
  - RSCCD – two months = \$20 million
  - Current RSCCD Policy – 5% = \$9 million

# Board Policy Contingency

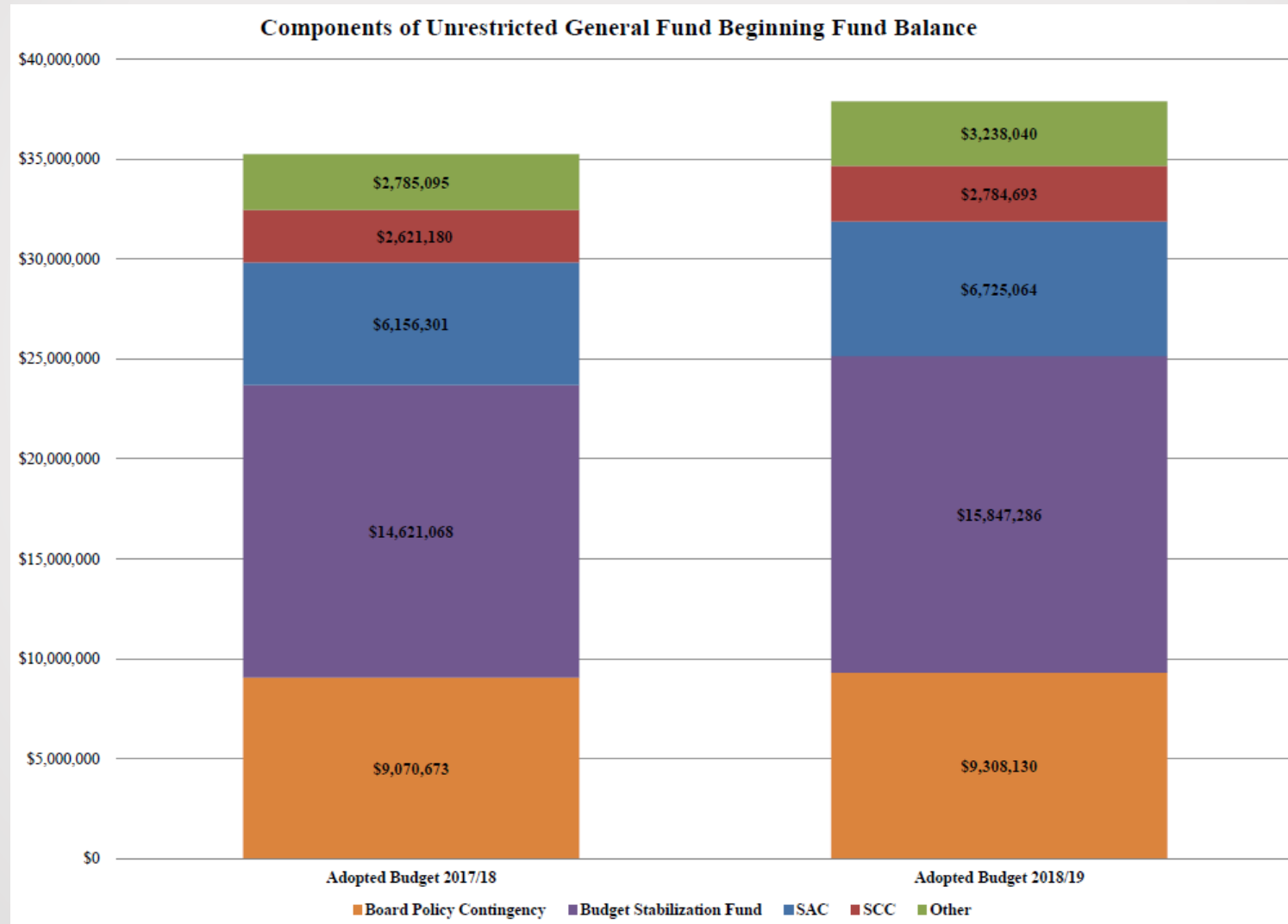
- Several other neighboring community college districts have recognized the need to increase reserves through Board Policy changes:
  - Coast, South Orange, Chaffey, Mt. SAC, Compton, Mira Costa, Hartnell, Copper Mtn all have increased reserves between 7% - 20%
- Schools Services Update on July 13, 2018 discusses these same issues and the need to be thoughtful of cash balances and reserve levels in the wake of the new Student Centered Funding Formula
- Schools Services Update on November 16, 2018 now recommends Community College Districts keep a minimum reserve of 10% due to the new SCFF
- GFOA January 2015 “Best Practices” report recommends no less than a 10% reserve
- Fiscal Self-Assessment Checklist/Chancellor’s Office Watch List is returning and will strongly encourage higher reserves for districts due to funding vulnerability of SCFF



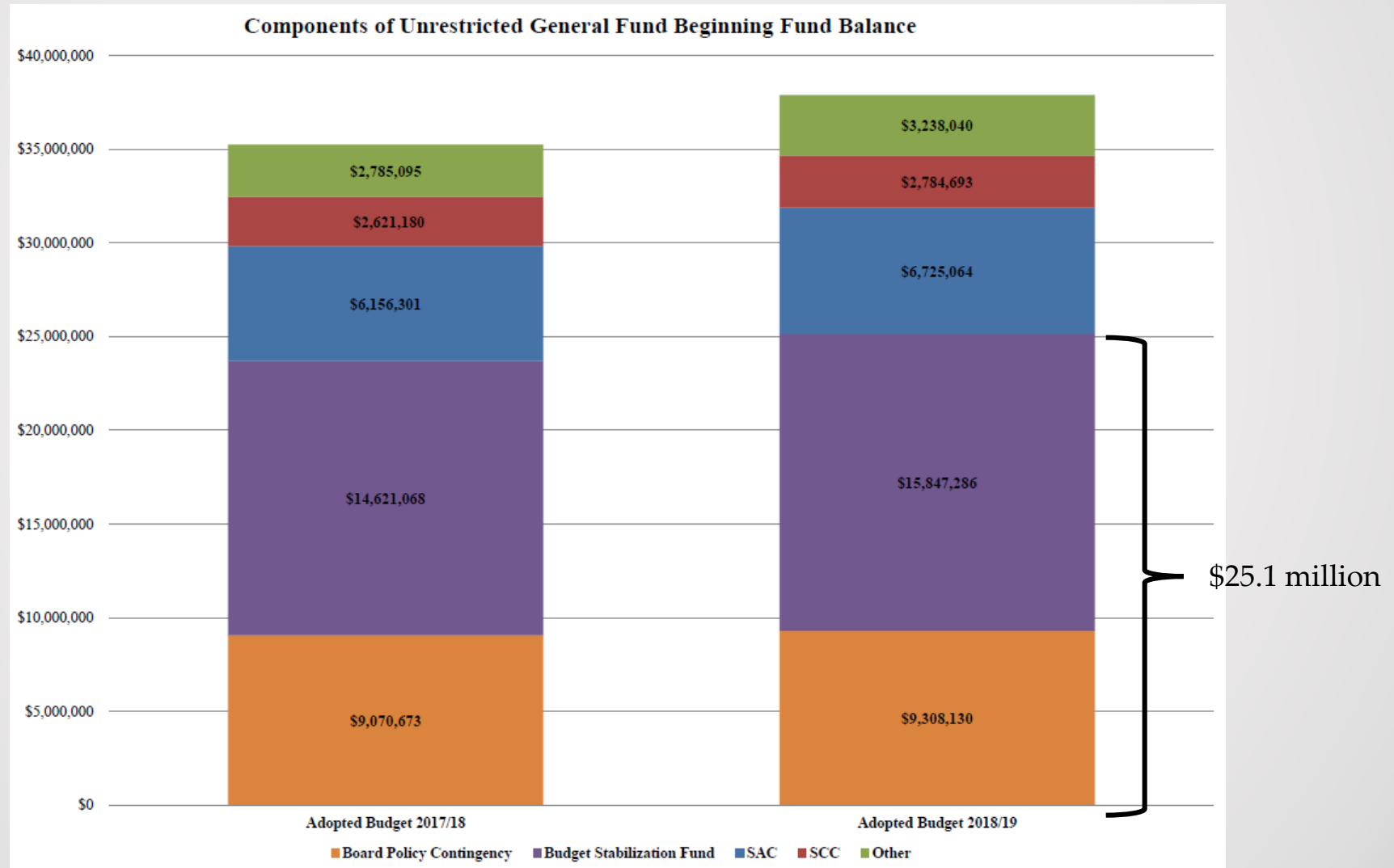
# Board Policy Contingency

- No new cost to currently increase policy on reserves from 5% to 10%
  - Additional reserves currently in Budget Stabilization Fund
- Now is the time with the new SCFF and before next economic downturn
- Budget Stabilization Fund established in 2012/13 and maintained at current balances
- Board approved annual Budget Assumptions include a balanced budget
  - Not deficit spending with utilization of BSF reserves
- Before spend down of Budget Stabilization Fund
  - Now is the time to convert BSF reserves to Board Policy reserves to fund from 5% to 10%
- Will still maintain Budget Stabilization funds and Campus reserves in excess of Board Policy Reserve

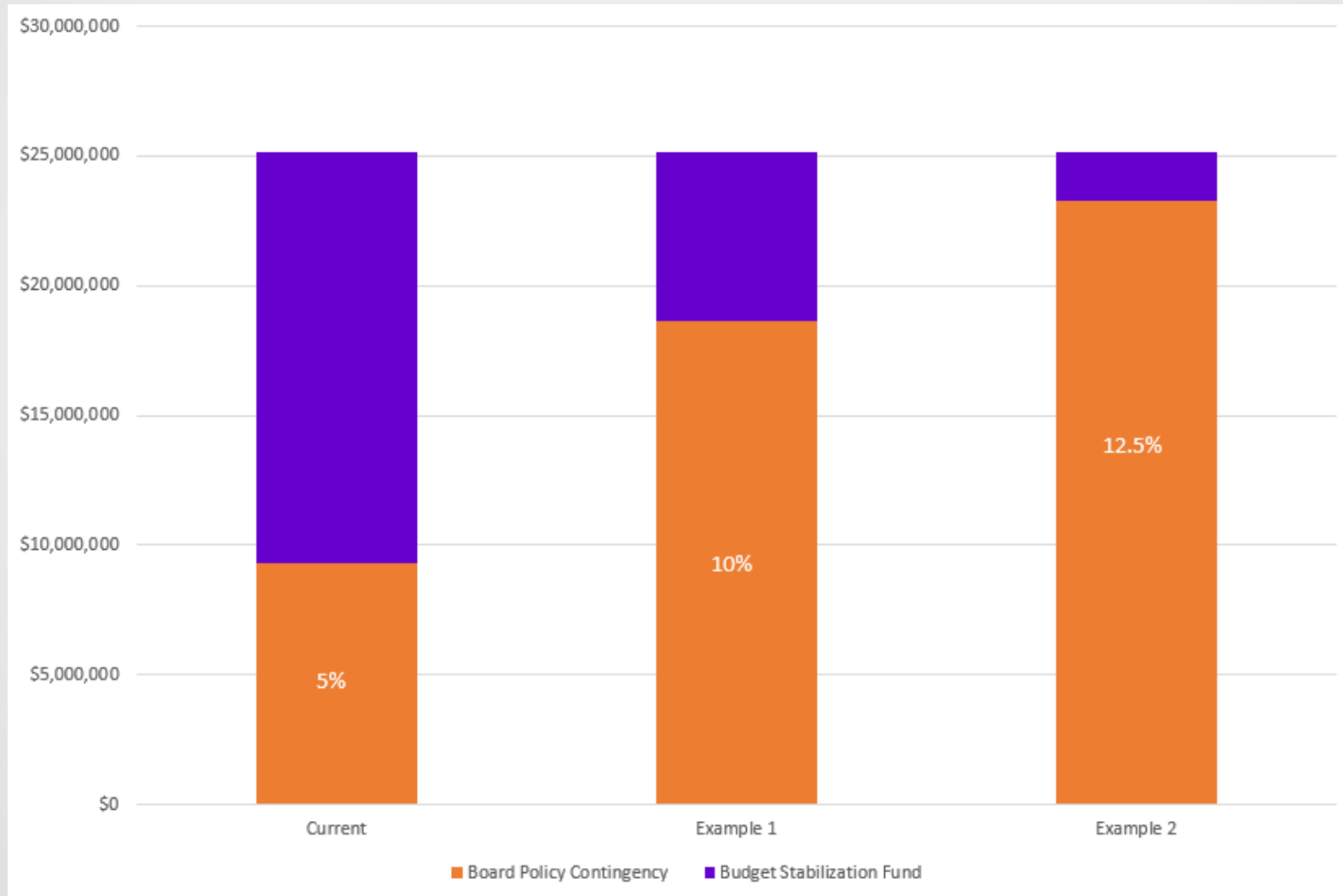
# Board Policy Contingency



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# Board Policy Contingency



# Staff Recommendation

- Recommend Board Policy change to BP 6250 and AR 6305
- Increasing the Board Policy Contingency from 5% to 10%
- Annual Budget Assumptions will follow new Board Policy

# Recommendations - Summary

# Final Recap of Recommendations

- Recommend establishment of an Irrevocable Trust for OPED liabilities
  - Transfer amount to establish an Irrevocable Trust for a portion of monies set aside for Retiree Health Benefits
  - Flexibility of yearly ARC contributions
- Recommend Board Policy reserve increase from 5% to 10%