

Retiree Health Care: A Growing Cost for Government



**Legislative Analyst's Office
California Legislature**

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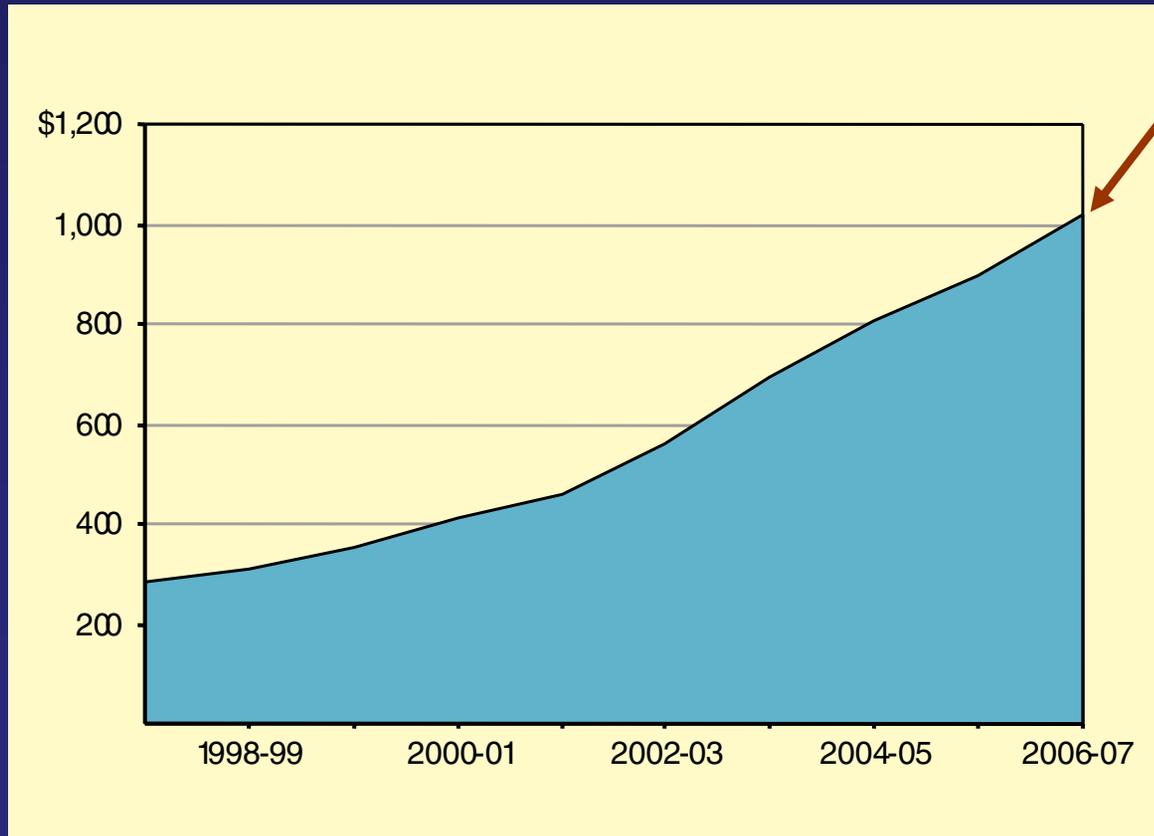
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State Retiree Health Costs Are Growing Rapidly

Dollars in Millions



Costs for Retired State and CSU Employees: *Up 14 Percent from 2005-06*

State Retiree Health Costs Are Growing Rapidly

(Continued)

- **Between 2003-04 and now, retiree health has been the fastest growing employee compensation item in the state budget.**
 - Retiree health costs: up 47 percent
 - State employee salaries: up 15 percent
 - State employee pension costs: up 21 percent
 - Total salary costs, California Department of Corrections and Rehabilitation: up 33 percent

State Retiree Health Costs Are Growing Rapidly

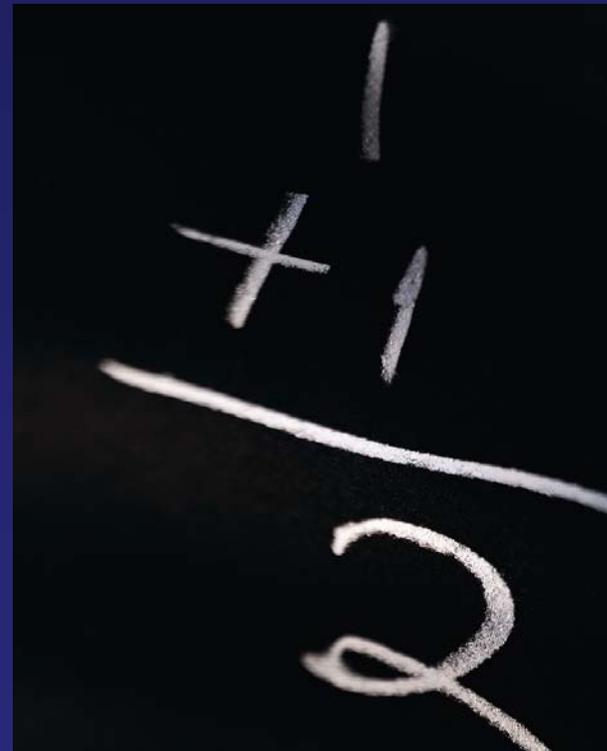
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- **Public agencies receiving funding from the state also have rapidly growing retiree health costs, now totaling in the hundreds of millions of dollars per year.**
- **Examples include:**
 - School districts
 - Community college districts
 - University of California
 - County governments

State Retiree Health Costs Are Growing Rapidly

(Continued)

- **School district employee and retiree health costs sometimes are so large that they may lead to requests for additional state support.**
 - **Los Angeles Unified School District: \$10 billion retiree health liability**



State Retiree Health Costs Are Growing Rapidly

(Continued)

- Continued, rapid growth of retiree health costs may result in fewer funds being available for other state services.



State Retiree Health Costs Are Growing Rapidly

(Continued)

- **These costs contribute to the state's structural budget deficit.**
- **General Fund operating shortfalls of \$4.5 billion to \$5 billion are forecast for 2007-08 and 2008-09.**



California State Capitol

2006: A Year of Increasing Awareness

- ✓ Prior to 2006, few California public entities focused on the retiree health (OPEB) issue.
- ✓ Now, with the upcoming deadlines of GASB 45, *most* California governments—including the state government—have begun gathering **information**.
- ✓ Only a small percentage of California governments have taken **action** to begin addressing OPEB liabilities.

2006: A Year of Increasing Awareness

(Continued)



- ✓ **The February 2006 LAO Report, *Retiree Health Care: A Growing Cost for Government*, estimated state government's OPEB liabilities at \$40 billion to \$70 billion or perhaps more.**

LAO's Key Findings and Recommendations to the Legislature

- ✓ **Begin to prefund state retiree health benefits.**
 - Ramp up to increased state contribution over several years after receiving OPEB valuation
 - May cost *much* more in the short term...but should reduce growth of costs *substantially* over the long term
- ✓ **Require disclosure and encourage planning by thousands of other California public entities.**
 - University of California
 - Cities and counties
 - School districts and community college districts
 - Special districts

2006 Legislative Actions: Retiree Health Care



- ✓ **Approved Controller's request for \$252,000 to:**
 - **Pay for OPEB actuarial valuation**
 - **Fund other actions to ensure state's compliance with GASB 45**

2006 Legislative Actions: Retiree Health Care

(Continued)

- ✓ **Approved \$2.9 million for Public Employees' Retirement System (CalPERS) to:**
 - **Extract data**
 - **Develop actuarial model**
 - **Study helping local agencies with GASB 45 compliance**



2006 Legislative Actions: Retiree Health Care

(Continued)



- ✓ **Deferred decision on how to use state's Medicare Part D employer subsidies.**
 - Around \$38 million per year
 - CalPERS directed in the budget to deposit subsidies in special account for future legislative determination

2006 Legislative Actions: Retiree Health Care

(Continued)

- ✓ **Approved funding for school districts.**
 - **\$10 million for districts to create fiscal solvency plans**
 - **Districts can use a part of their \$133 million share of a one-time block grant to reduce outstanding fiscal obligations**



2006 Legislative Measures Awaiting Gubernatorial Action *(as of 9/14/06)*



- ✓ **Senate Bill 1729 (Soto).**
 - Would allow CalPERS to establish investment fund under Section 115 of the Internal Revenue Code
 - Fund would receive moneys from governments that choose to prefund OPEB benefits

2006 Legislative Measures Awaiting Gubernatorial Action *(as of 9/14/06)*

(Continued)



✓ **Assembly Bill 2863 (Karnette).**

- **Would allow public entities to establish OPEB trust accounts with one of the 20 retirement systems established under the County Employees Retirement Law of 1937**

Actions of Other California Governments

(Continued)

- ✓ **Santa Clara County.**
 - Began prefunding in 1984
 - OPEB benefits are 44 percent funded (\$310 million of assets and \$387 million of unfunded liabilities)
 - 2004: Reduced prefunding to only the normal cost due to budget shortfall



Actions of Other California Governments

(Continued)

✓ Los Angeles.

- Began prefunding in 1987 for employees with ten or more years of service
- Recently began to prefund for all city employees
- \$1.5 billion set aside for city, police, and fire
- \$1.5 billion unfunded liability



Actions of Other California Governments

(Continued)

- ✓ **Community College Districts.**
 - Have formed joint powers agency to help districts comply with GASB 45
 - Plan to have agency help districts team together to develop prefunding plans



Actions of Other California Governments

(Continued)

- ✓ **Other California Governments.**
 - Retiree health now is a major issue in many negotiations with employee groups



Actions of Other California Governments

(Continued)

✓ Orange County.

- Board of Supervisors recently approved agreement with large union that will reduce county retiree health costs substantially
- Legal action by retirees is possible in response to this action



Actions of Other California Governments

(Continued)

✓ Peralta Community College District.

- \$154 million bond issue to address OPEB liabilities
 - Final bond maturity date: August 5, 2049
- Unions agreed to end post-65 health benefits for new employees



Legislature's Options to Reduce Future Retiree Health Costs

- ✓ **For current and past State of California employees.**
 - Options may be limited
 - Some believe that certain aspects of current health benefits are obligatory under contract law
 - How a court would react to changes is unknown



California State Senate Chamber

Legislature's Options to Reduce Future Retiree Health Costs *(Continued)*

- ✓ **For future employees, extensive options.**
 - Changing payment formula
 - Increasing share of costs paid by employees and retirees
 - Changing eligibility requirements
 - Establishing defined contribution health program



California State Assembly Chamber

Legislature's Options to Reduce Future Retiree Health Costs *(Continued)*

- ✓ **Whether the Legislature would want to pursue these options depends on a variety of factors, such as:**
 - **The desired level of state employee compensation**
 - **The amount of the unfunded liability to be identified in 2007**
 - **Other funding priorities**
- ✓ **Consequently, LAO makes no recommendations as to these options.**

For Additional Information

- ✓ ***Retiree Health Care: A Growing Cost for Government***
 - http://www.lao.ca.gov/2006/ret_hlthcare/retiree_healthcare_021706.pdf
- ✓ ***Analysis of the 2006-07 Budget Bill (School District Financial Condition)***
 - http://www.lao.ca.gov/analysis_2006/education/ed_anl06.pdf#page=56