Health and Welfare Costs and Liabilities

Independent Analysis Unit

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Agenda

- What is the problem?
- How do we address the problem?
  - Pay-as-you-go
  - Pre-funding
  - Cost reduction strategies
  - Hybrid cost/pre-funding strategies
- What are the tradeoffs?

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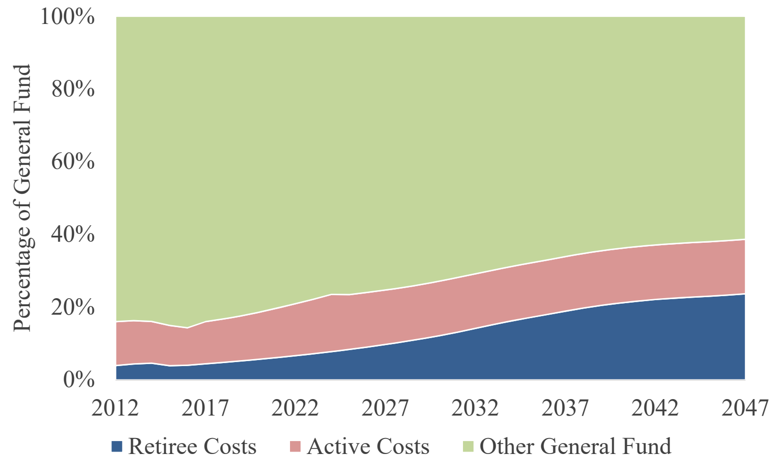
Health and Welfare costs are growing and crowding out other priorities



Source: 2010-2015 Actuals and 2015-2016 3rd Interim Report

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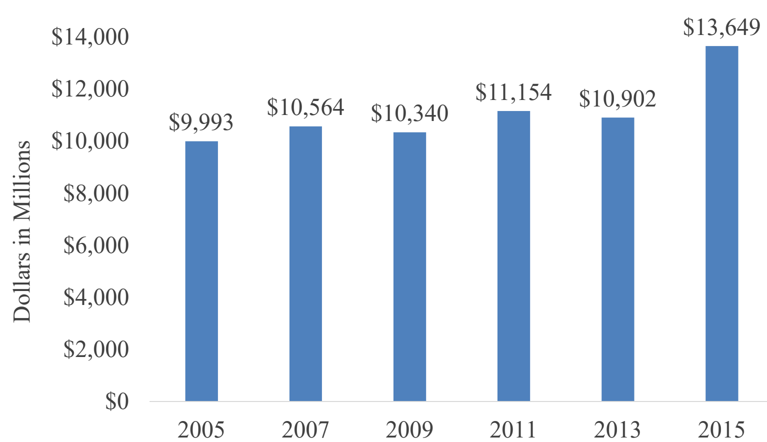
Other Postemployment Benefit (OPEB) accrued liability is growing



Sources: CAFR 2005-2006, 2011-2012, 2015-2016

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Core model: L.A. Unified uses money to compensate adults for educating children

- Educating children must be done in the present.
  - A first-grader cannot wait ten years for us to provide a quality first-grade classroom.
- Compensating adults includes both present and future obligations.
  - Salary and health benefits in the present
  - Pensions and Other Post-employment Benefits (OPEB) in the future
- Finding the right balance of present and future compensation is a central challenge of this model.

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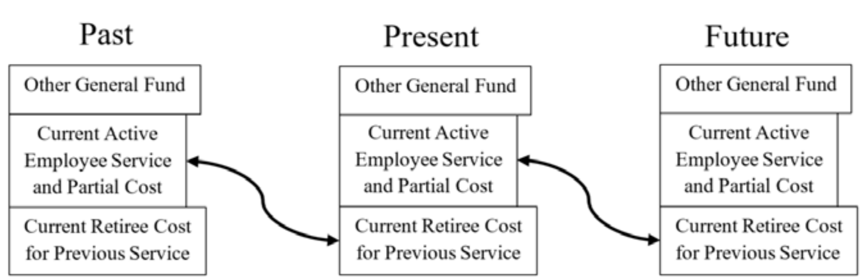
Pay-as-you-go functions as a subsidy across time



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Pay-as-you-go pro and con

- PRO

  Does not tie up money that could be used for educating children today

- CON

  Ties up *more* money in the future that could be used for educating children then

  Does not reduce cost of retiree health benefits

  Does not mitigate growth of OPEB liability

  Does not help District's standing with oversight bodies and credit rating agencies

Pre-funding pro and con (1)

PRO

Reduces *unfunded* liability over time

Frees up funds that could be used for educating children in the future

Consistent pre-funding can help credit ratings and thus lower interest rates on other debt

$100 million/year for 30 years will end up funding the equivalent of $1,591 million in today's liability*

* Present value at assumed discount rate 4.7% as used by actuary

Pre-funding pro and con (2)

CON

- Ties up money that could be used for educating children today
- Does not reduce cost of retiree health benefits
- Does not mitigate growth of OPEB liability
- Pre-funding is not currently obligatory except to improve standing with oversight bodies – there is little experience over time with OPEB liabilities and no recognized standard for what percent should be pre-funded

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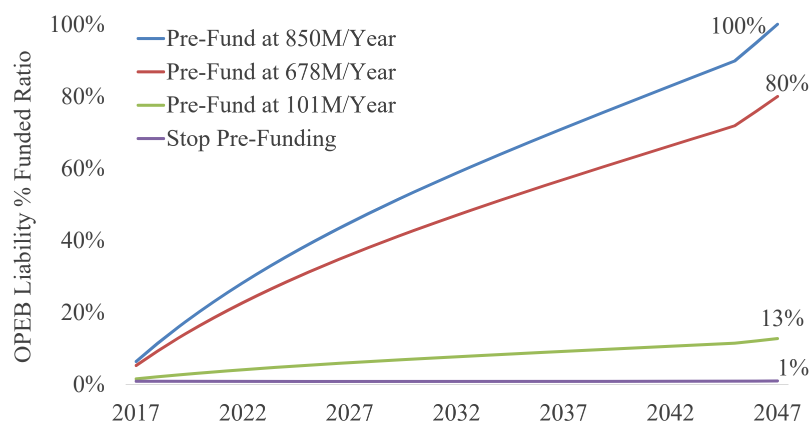
Any consistent pre-funding helps but current level is quite small



Sources: CAFR 2015-2016 and IAU projections

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Cost reductions – like cost increases – exhibit a leverage effect

- Relatively small increases in retiree health and welfare costs lead to relatively much larger increases in the OPEB liability.

  This is a large part of why we are where we are now.
- Similarly, relatively small decreases in retiree health and welfare costs lead to relatively much larger decreases in the OPEB liability.

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Cost reduction pro and con (1)

PRO

Reduces OPEB liability instantly

$100 million/year cut eliminates $1,591 million of the current liability*

Mitigates growth of liability

Frees up funds in the present

- Use to prefund remaining liability
- Use to cut structural deficit
- Use for offsetting compensation

May involve a variety of partial strategies instead of a single fix

* Present value at assumed discount rate 4.7% as used by actuary

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Cost reduction pro and con (2)

CON

Depending on methods of cost reduction:

- May reduce existing benefits for retirees
- May reduce total compensation of current employees unless offset with savings

Not a negative, but a shared challenge:

Depending on methods of cost reduction, may need to be addressed through collective bargaining

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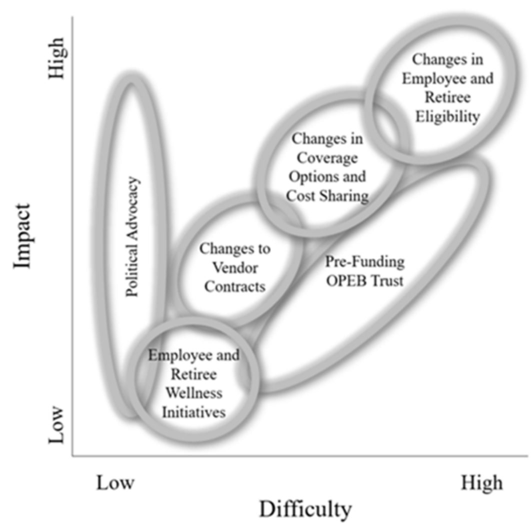
Strategies to contain costs have tradeoffs between impact and difficulty



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A hybrid cost-saving/pre-funding strategy offers high impact on liability

- By reducing retiree health and welfare costs and shifting savings to the OPEB Trust, the District can both increase its funded ratio and decrease its OPEB liability.
- Saving $100 million/year in costs and placing that in trust reduces the OPEB liability by $1,591 million right away and also pre-funds the liability by $1,591 million over time, for a combined effect of $3,182 million.

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Conclusions (1)

- Pay-as-you-go is an unsustainable option.
- Pre-funding 80% or 100% of OPEB liabilities is unnecessary and undesirable; it ties up cash that could be used for other priorities.

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Conclusions (2)

- There is a wide variety of actions that could reduce OPEB costs now or in the future, with varying degrees of impact and difficulty.
- Any action that reduces annual benefit costs for retirees and projected costs for active employees when they retire will:
  - instantly reduce OPEB liability by a factor of about 16:1,
  - and save funds that can be used for additional pre-funding or for offsetting compensation.
- A combination of strategies may be optimal.

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Caveats

- The projections used in this report are based upon relatively imprecise (but conservative) assumptions; additional study would be required to provide more precise projections for the board.
- The Actuarial Report is due this month and will provide updated information that the IAU could use in further analyses.

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