

To Fund or Not: That is the Question! OPEB Bonds = the Answer?

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Discussion Topics

- Concept of OPEB Bonds
- Financial Issues
- Legal Issues
- Other Considerations
- OPEB Axiom

What is an OPEB Bond?

- Borrow money to cover all or a portion of your total “UAAL” (unfunded actuarially accrued liability)
- Invest bond funds in a GASB-Compliant Fund
- Fund makes payments to retiree health benefit plan pursuant to district plan
- UAAL is now AAL - “funded”, not “unfunded”
- District makes annual debt service payments, instead of annual payments toward the UAAL.
- Taxable interest rates = not subject to arbitrage rebate
- Repayment structure not tied to 30 year actuarial assumption and does not have to be level

GASB-Compliant Trust

- More liberal investment options for restricted funds or irrevocable trusts than other school district funds (Govt. Code 53620-22)
 - Prudent Person rules
- Reduces total OPEB liability by allowing actuary to use higher interest earning assumptions to calculate UAAL.
- Independent irrevocable trust required if issuing bonds

Does a District Have to Pre-Fund the UAAL?

- GASB 45 does ***NOT*** require that the OPEB be funded, only *calculated*. However, funding a restricted or unrestricted plan will offset the UAAL on your balance sheet.
- Rating agencies are concerned with how well the District is managing the obligation – “a long-term plan”
 - An OPEB Bond will not necessarily add to credit quality; more debt, but the OPEB contractual liability funded
- Proposed legislation - A.B.2793, S.B.1457, S.B.1514 - is State mandate of funding next?

OPEB Bonds – Basic Question

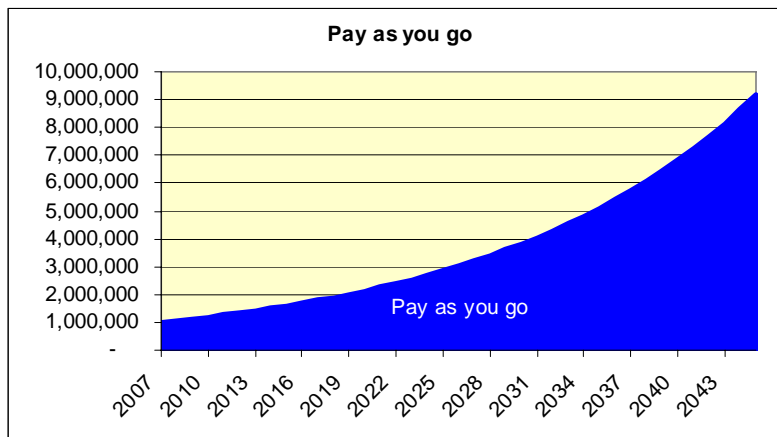
- Is the payment to be made to bondholders better than an annual payment toward UAAL under GASB 45?
- ARC is revised every two-three years (with updated actuarial study); bond payment remains fixed.
- Are there other lower cost solutions providing similar actuarial/financial benefits?
- Other advantages besides numbers?



Financial Analysis

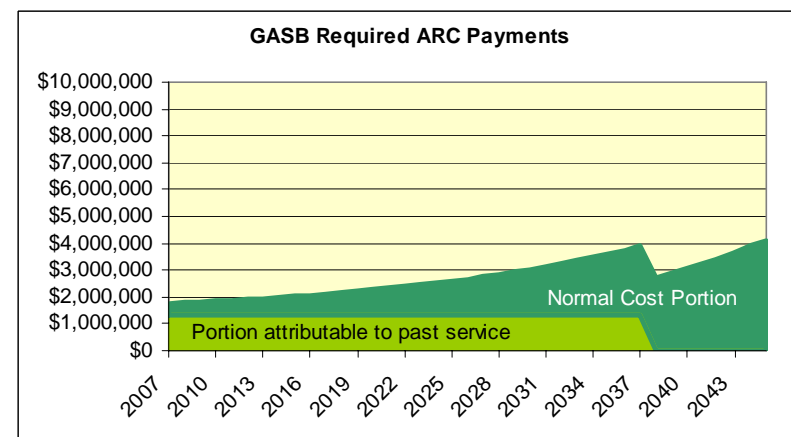
■ Pay as you go:

- Escalating payments due to health costs increasing and number of retirees receiving benefit increasing
- No funds set aside for future payments.



■ GASB-45 Pay as you go:

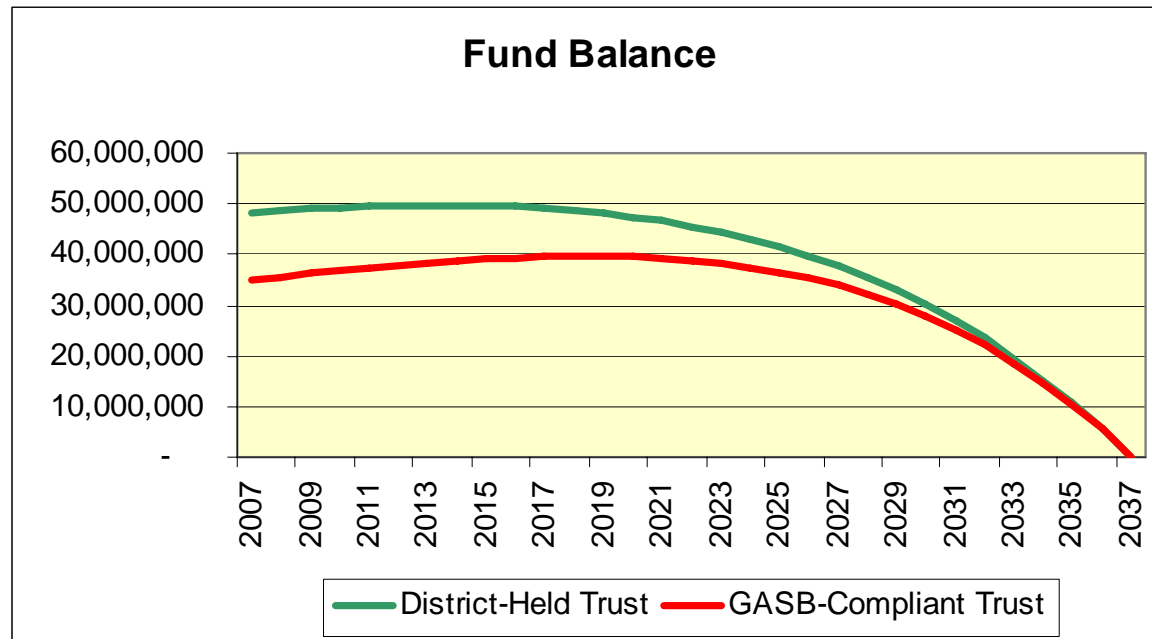
- Normal costs escalate due to health costs increasing
- UAAL amortizes the benefits of prior retirees not covered by normal costs
- Funds set aside for to pay future benefits.



Assumptions: 6% compound growth annually of Pay as you go requirement.

Financial Analysis, cont.

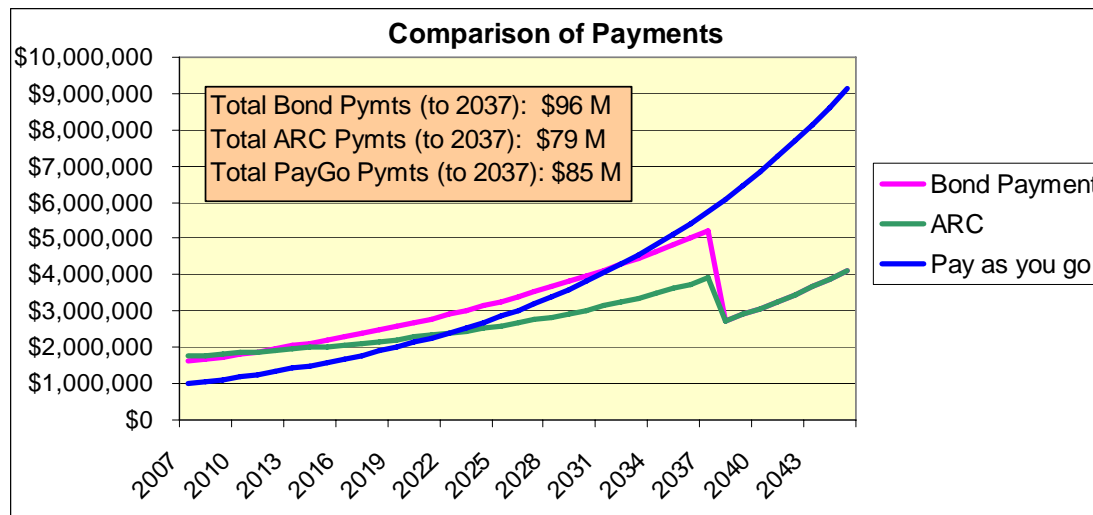
- Total OPEB liability, net present value (NPV):
 - If invested in GASB-Compliant Trust \$34 Million
 - If invested in District-held Trust \$48 Million



Assumptions: OPEB-Eligible Trust earns 5% interest; District-held Trust earns 3% interest.

Bond Payments vs. ARC Payments

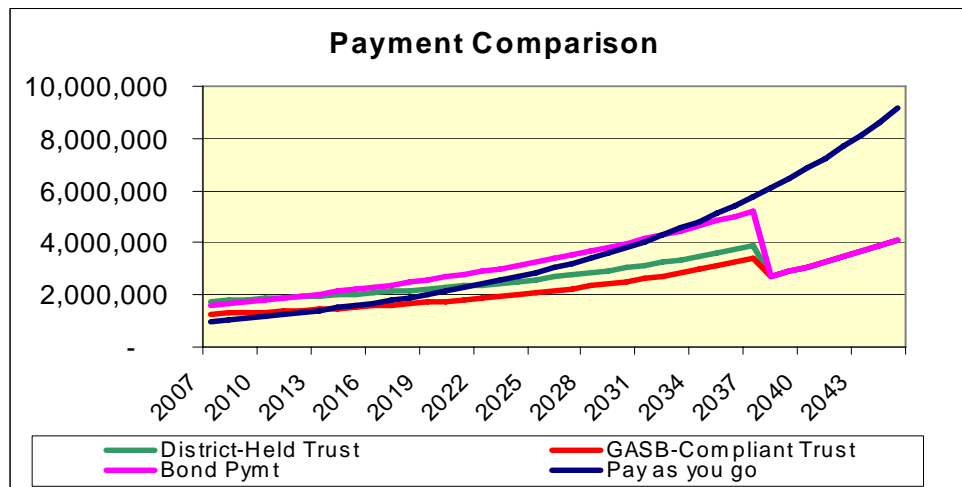
- It's all in the assumptions:
 - Increase in cost of benefits
 - Interest rate to be paid on Bonds
 - Interest rate on invested Trust Funds (bond proceeds) not necessarily “locked in” – risk of insufficient earnings



Assumptions: Bond interest payments at 6%, interest earnings on Bond proceeds, 5%.

ARC Payment Comparison

Payment thru 2037 to...	Annual Payment	Total Payments
District-held Trust	\$1.8 – 3.9 MM	\$78.9 MM
GASB-Compliant Trust	\$1.6 – 3.7 MM	\$73.4 MM
Bondholders	\$1.3 – 5.2 MM	\$95.7 MM



Assumptions: District-Held Trust earns 3%; OPEB-Eligible Trust earns 5%; OPEB Bond payments at 6%, proceeds earn 5%.

Comparison of Options

Option	Access to Funds (for other than health benefits)	PV Rate (to determine UAAL) *	Fund Earning Rate	Interest Payment Rate	
Pay as you go	Yes	3%		0%	
District Reserve Fund	Yes	3%	LAIF/Co Pool	3%	
GASB Trust - internal	No	5%	"Prudent Person" **	5%	
GASB Trust - external	No	5%	"Prudent Person" **	5%	
GASB Trust - prefunded (OPEB)	No	5%	"Prudent Person" **	5%	6%

* Determined by actuary, based on actual investment earnings and inflation rate assumptions.

** Prudent Person per Government Code 53620-22.

Legal Analysis

- Is this debt? And if so, how can a District issue without voter approval?
 - *Obligation Imposed by Law or Court Order*
 - *Peralta CCD OPEB bond issue: Govt. Code 53570 & 53584 provide legal authority to “refund/refinance” existing contractual obligations to provide retiree health benefits*
- Requires careful legal review of contracts and OPEB commitments
- Not subject to Constitutional debt restriction on non-voter approved debt
- Validation process recommended

Future Unknowns

- Actuarially determined ARC relies on certain assumptions; what if those assumptions don't hold up and the true liability is much less?
 - District is locked into OPEB Bond payments, regardless of decreases in liability
- What if the liability is much more?
 - District must pay debt service (from OPEB bonds) + new OPEB UAAL
- What about unforeseen future benefit enhancements, benefit reductions, higher than estimated inflation in health costs?

Interest Rate Considerations

- Bond interest rate environment
 - OPEB bonds are “taxable” - higher rate than other district debt.
 - May be issued variable or fixed rate.
- Investment interest rate environment
 - Key is to lock in interest rates higher than the bond rates.
 - What if interest rates go up after locking in?
 - More liberal investment options for restricted funds or irrevocable trusts than other school district funds (Govt. Code 53620-22)

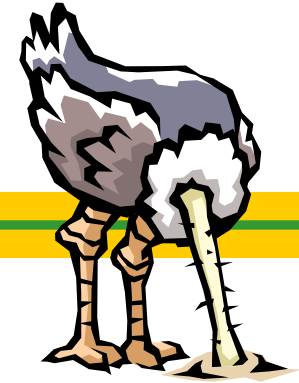
Indirect Costs

- Costs of issuance is added to amount borrowed, but won't go into trust account.
- Converting a “soft” liability to a “hard” liability
 - Ensures that District is making some effort to fund UAAL;
 - Reduces availability of those funds (and flexibility) for other uses.
- Does not necessarily improve credit rating – it makes the total unfunded liability an actual liability for credit rating formulas, rather than just a UAAL.
- Uses up a portion of your credit enhancement (and debt issuance) capabilities

Recommendations

- First, determine your actual liabilities.
- Second, stop the bleeding.
- Third, figure out what can you afford to put toward OPEB.
- Then, and only then consider whether to bond, fund irrevocable trust or district-held fund.
- Have someone review all aspects - to make sure all pieces fit together (actuarial, acct'g, financial obligations, budget)
- Monitor annually the investments and investment rates to avoid earning shortfalls.

OUR OPEB AXIOM



- DON'T IGNORE IT!
 - It will only continue to grow
 - Auditors will require actuarial study
 - Rating agencies will likely expect long-term financial plan to cover the UAAL
 - Bonds - one of several options; area likely to see more activity - obtain independent advice!
 - Consultants, underwriters & financial companies all pushing products - evaluate carefully!
- ***Caveat emptor***