

Managing OPEB Costs and other Liabilities in a Tumultuous Fiscal Environment

May 25, 2023

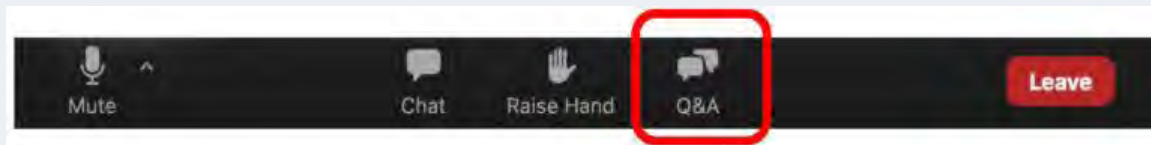


Today's Presenters

- Presenters:
 - **Dennis Meyers**, Assistant Executive Director, Governmental Relations - CSBA
 - **Rachael Sanders**, Vice President - PARS
- Moderator:
 - **James Collins**, Senior Director Business Development - CSBA

Housekeeping

- At the end of the presentation, we will have a Question-and-Answer segment where we will try our best to answer your questions
- Please, use the Q & A feature of Zoom to type your questions. This is located on ribbon below the speaker.



- Your questions will be answered either in the Q & A panel or live by our presenters
- All attendees will receive a link to the **video** of this webinar as well as **the slide deck**



May Revision Overview

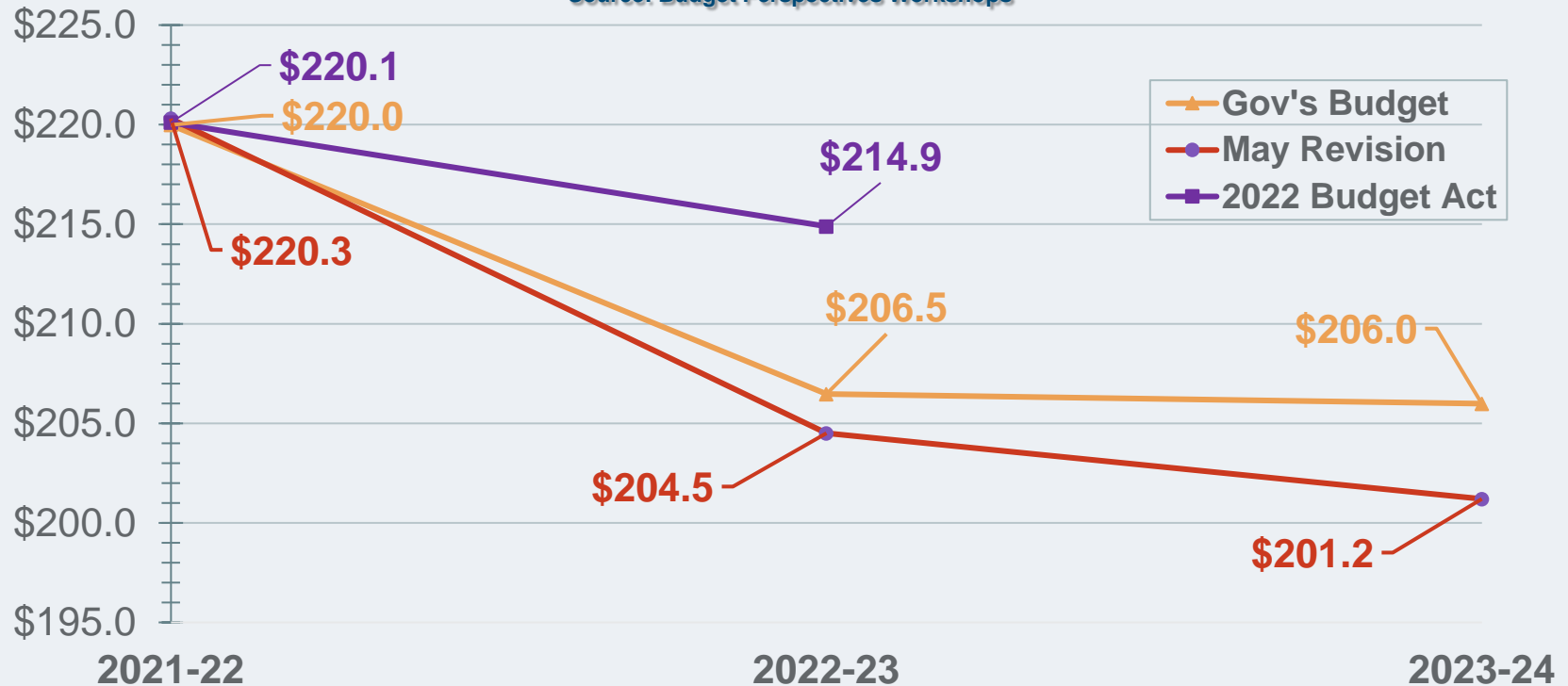
Overall Budget

- Projected budget deficit in the January Budget was estimated to be \$22.5 billion.
- May Revision projects a growth in the deficit by \$9.5 billion, increasing to an overall deficit of \$31.5 billion.
- Factors of concern impacting the state budget:
 - Federal Debt Ceiling Impasse – Federal Government estimated to hit the debt ceiling June 1st
 - Delayed Tax Filing Deadline of October 15th
 - Interest rate increases and their impact on the financial sector
 - Possible recession incoming



Overall Budget

Source: Budget Perspectives Workshops



Proposition 98 Overview

- Prop 98 remains in Test 1.
- Share of General Fund increases from 38.3 percent to 38.5 percent in May Revision.
- Due to the decrease in overall General Fund revenues, Prop 98 guarantee decreases from \$108.8 billion in the Governor's January Budget to \$106.8 billion in the May revision, a decrease of \$2 billion.
- 3-year total decrease in Prop 98 of \$3.8 billion.
- \$23,706 per pupil* funding ALL SOURCES
- \$17,444 per pupil* funding PROP 98

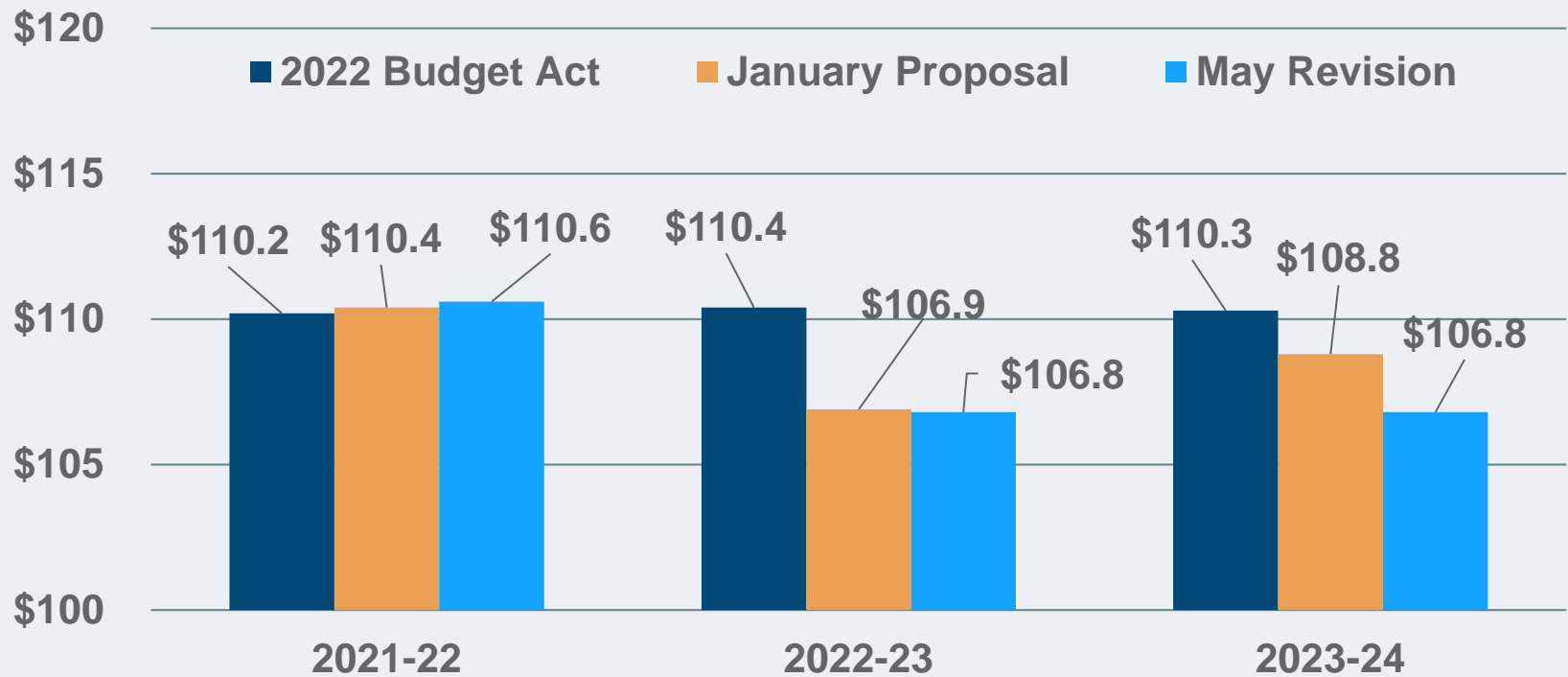
* Note that not all LEAs will receive these amounts.

Prop 98	2021/22	2022/23	2023/24
K-14	\$110.6	\$106.8	\$106.8
K-12	\$98.5	\$95.12	\$95.12



Proposition 98 Overview

Source: Budget Perspectives Workshops



Cost of Living Adjustment (COLA)

The May revision honors increase in statutory COLA from 8.13% to 8.22% for all programs:

- \$3.4 billion for LCFF.
- 8.22% COLA applies to County Offices of Education and all categorical programs that receive statutory COLA, including Special Education.



Cost of Living Adjustment (COLA)

Proposed for Ongoing Funding (no COLA)

- ▶ After School Education & Safety Program (\$794.6 million)
- ▶ Career Technical Education Incentive Grant (\$300 million)
- ▶ K-12 Strong Workforce Program (\$163.5 million)
- ▶ State Assessment Program (\$98.5 million + \$26.6 million federal)
- ▶ California Partnership Academies (\$21.4 million)
- ▶ County Office Fiscal Oversight (\$7.5 million)
- ▶ College Planning and Preparation Website (\$26 million)
- ▶ California School Information Services (\$8.6 million)
- ▶ Specialized Secondary Education Grants (\$4.9 million)
- ▶ Agricultural Education Incentive Program (\$6.1 million)
- ▶ Teacher Dismissal (\$300,000)

Proposed for Ongoing Funding (8.22% COLA)

- ▶ Special Education: (\$5.4 billion + \$1.37 billion federal)
- ▶ Child Nutrition (\$1.8 billion + \$3.5 billion federal)
- ▶ Adult Education Block Grant (\$651.1 million + \$106.4 million federal)
- ▶ Mandate Block Grant: (\$260 million)
- ▶ Foster Youth Programs: (\$32 million)
- ▶ American Indian Education Centers (\$5.2 million)
- ▶ American Indian Early Childhood Education Program (\$696,000)
- ▶ HOME TO SCHOOL TRANSPORTATION Approved Costs

Source: Budget Perspectives Workshops



Public School System Stabilization Account Prop 98 Reserve

- Share of General Fund revenues due to capital gains has increased, thus increasing deposits into the Prop 98 Reserve to an estimated total of \$10.7 billion; an increase of \$2.2 billion over January Budget.
- Prop 98 Reserve at its max in 2023-24

School district reserve cap STILL triggered in 2023-24.

- Local reserve cap triggered when PSSSA balance is at least 3% of the K-12 share of Prop 98.
- Medium and large districts will generally need to limit their reserves to no more than 10% of annual expenditures – applies only to assigned and unassigned funds. Does not apply to committed funds
- Small and basic aid districts are exempt.



School Employer Pension Costs

Source: Budget Perspectives Workshops

May Revision budget does not include any relief for school employers in 2023-24

► CalSTRS

Fiscal Year	Contribution Rate**
2022-23	19.1%
2023-24	19.1%
2024-25	19.1%*
2025-26	19.1%*

► CalPERS

Fiscal Year	Contribution Rate
2022-23	25.37%
2023-24	26.68%
2024-25	27.7%*
2025-26	28.3%*

* Latest rates based on most recent projections

** CalSTRS Board now allowed to adjust employer contribution rate up or down by up to 1% each year, but no higher than 20.25% and no lower than 8.25%



Governor's Budget Proposals



Increased Funding for Juvenile Court and County Community Schools and Differentiated Assistance

- A **big win** for CSBA advocacy alongside our co-sponsors, the California County Superintendents and the Los Angeles County Office of Education.
- CSBA co-sponsored AB 906 (Gipson) and an associated budget request to provided needed funding support for juvenile court schools and county community schools.
- The May Revision proposes an additional \$80 million in ongoing Proposition 98 funding to support these county office of education-operated schools.
- Also proposes to increase the COE base grant by 50 percent to further support the differentiated assistance they provide to member school districts in their counties.



Substantial Cuts to Arts, Music and Instructional Materials Discretionary & Learning Recovery Emergency Block Grants

- Reduces one-time Proposition 98 General Fund provided for the Arts, Music & Instructional Materials Block Grant (AMIM Grant) by an additional \$607 million.
 - The January Budget reduced the funding for the AMIM by \$1.2 billion to \$2.3 billion; this additional reduction will bring the total cut to \$1.8 billion – a 50% reduction.
- Proposes a \$2.5 billion decrease in one-time Proposition 98 General Fund for the Learning Recovery Emergency Block Grant, taking support for the Block Grant from \$7.9 billion in January to \$5.4 billion in the May Revision – a 30% reduction.
- These reductions are being used to fund LCFF COLA and increased deposits into the rainy-day fund.



Universal Transitional Kindergarten

- Continues the state's commitment to fully implement universal transitional kindergarten (UTK), including re-benching Proposition 98 to reflect enrollment growth, but with reductions based upon revised enrollment estimates:
 - Reduces the first-year costs for the initial expansion of TK eligibility from December 2nd to February 2nd from \$604 million to \$357 million. This includes an associated reduction in Proposition 98 General Funding for schools to add one additional certificated or classified staff person to each TK class from \$337 million to \$283 million.
 - Reduces the second-year costs for TK eligibility from February 2nd to April 2nd, the for the coming 2023-23 school year from \$690 million to \$597 million.
- Does not trigger the statutory language requiring the lowering of the TK teacher to student ratio from 1:12 to 1:10. The 1:12 ratio is proposed to remain for the 2023-24 school year.



Special Education

No major changes to the Governor's January Budget

- COLA is now 8.22%.
- January Budget included:
 - Limits the amount of additional funding that SELPAs are allowed to retain for non-direct student services before allocating to LEAs.
 - Extends the moratorium on new single-district SELPAs by two years from June 30, 2024, to June 30, 2026.
 - Requires the California Department of Education to post on its website each SELPA's annual local plan, including their governance, budget and service plans to increase fiscal transparency.



Added Funding for Universal School Meals

- The Governor's January Budget included approximately \$1.5 billion in ongoing Proposition 98 General Fund to support the Universal School Meals program which provides public K-12 students with access to two free meals per school day.
- Due to greater demand for meals, the May Revision includes an additional \$110 million in one-time Proposition 98 General Fund and approximately \$191 million ongoing Proposition 98 General Fund to fully fund the program in the 2022-23 and 2023-24 fiscal years.



LCFF Equity Multiplier Remains

- \$300 million ongoing Prop 98 to establish an Equity Multiplier as an LCFF Add-On.
- Intended to accelerate learning gains and close opportunity gaps.
- Allocated based on school-site free meal (reduced price not included) eligibility to support the highest need students.
 - Elementary: 90%, High School 85%
- Includes LCAP amendments to ensure significant student groups are identified and addressed effectively.
- Follow up to the agreement with the Legislature regarding AB 2774 (Weber) from the 2021-22 Legislative Session.



New Investments in Literacy & Dyslexia Screening

- Continues prioritization of identification and intervention to improve literacy rates for students, including those with dyslexia.
- The May Revision proposes to require LEAs to begin screening pupils in K-2 for risk of reading difficulties, including dyslexia, by the 2025-26 school year.
- \$1 million one-time Proposition 98 General Fund to support the convening of an independent panel of experts to approve a list of screening instruments for these assessments.
- For students identified as at risk of reading difficulties, including dyslexia, LEAs would be required to provide supports and services.
- Greater detail will be provided in trailer bill language, but this proposal is built upon language contained in Senate Bill 691 (Portantino, D-Burbank).



Modest Adjustments to Investments in Teacher Recruitment and Retention Programs

- Increases the Teacher and School Counselor Residency Program grants and allows candidates to complete their service requirements in eight years instead of five years.
- Permits teachers who were unable to meet their Teaching Performance Assessments through a Commission on Teacher Credentialing (CTC) approved induction program or through two years of satisfactory teacher evaluations.
- Permits the CTC to issue a credential to any US military servicemember or their spouse who has a valid credential from another state who is relocated to California on military orders.
- Requires the CTC to review how transcript reviews can be used in lieu of requiring teaching candidates to take state-mandated exams to demonstrate competence.





Latest Trends & Best Practices for Addressing OPEB and Pension Liabilities

Rachael Sanders
Vice President
PARS

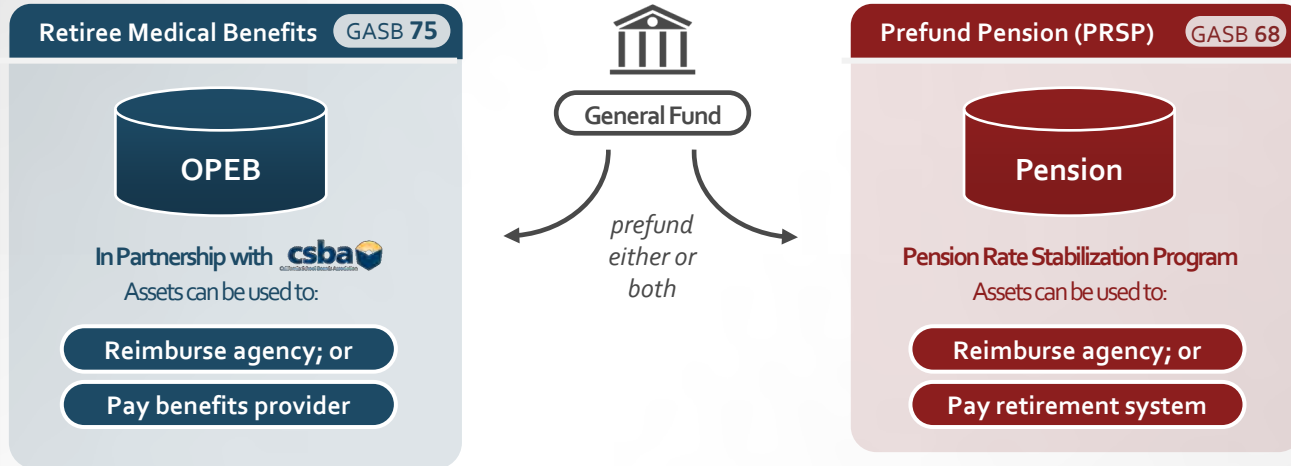
OPEB/GASB 75

- **Other Postemployment Benefits (OPEB)** are benefits (other than pensions) that state and local governments provide to retired employees
- **GASB 75 is the required national standard** for retiree healthcare accounting and financial reporting set by the Governmental Accounting Standards Board (GASB)

Latest Trends in OPEB

- Currently, school districts have several options for dealing with their unfunded obligations:
 - 1) Pay-As-You-Go
 - 2) Set aside funds in a general reserve fund
 - 3) **Trust Funding (Prefunding)** into a separate trust
 - Address unfunded OPEB obligations by prefunding a Section 115 Trust

Using the 115 Trust for a “Rainy Day”



Subaccounts

OPEB and pension assets are individually sub-accounted, and can be divided by dept., bargaining group, or cost center.



Anytime Access

Trust funds are available anytime; OPEB for OPEB and pension for pension.



Financial Stability

Assets in a Section 115 Combination Trust can be used to address unfunded liabilities.



Economies-of-Scale

OPEB and pension assets aggregate and reach lower fees on tiered schedule sooner—saving money!



Flexible

Allows separate investment strategies for OPEB and pension subaccounts.

Pay-as-You-Go vs. OPEB Prefunding

Sample District	July 1, 2011 Valuation 3.00% Discount Rate Pay-as-you-go	July 1, 2021 Valuation Discount Rate: 5.00% Prefunding
Actuarial Accrued Liability (AAL)	\$16,695,000	\$6,711,695
Actuarial Value of Assets	\$0	\$5,931,443
Net OPEB Liability (NOL) Unfunded Actuarial Accrued Liability (UAAL)	\$16,695,000	\$780,252
Funded Ratio (%)	0%	88.4%
Annual Benefit Payments (Pay-as-you-Go)	\$652,000	\$440,642 for FY 2021-22

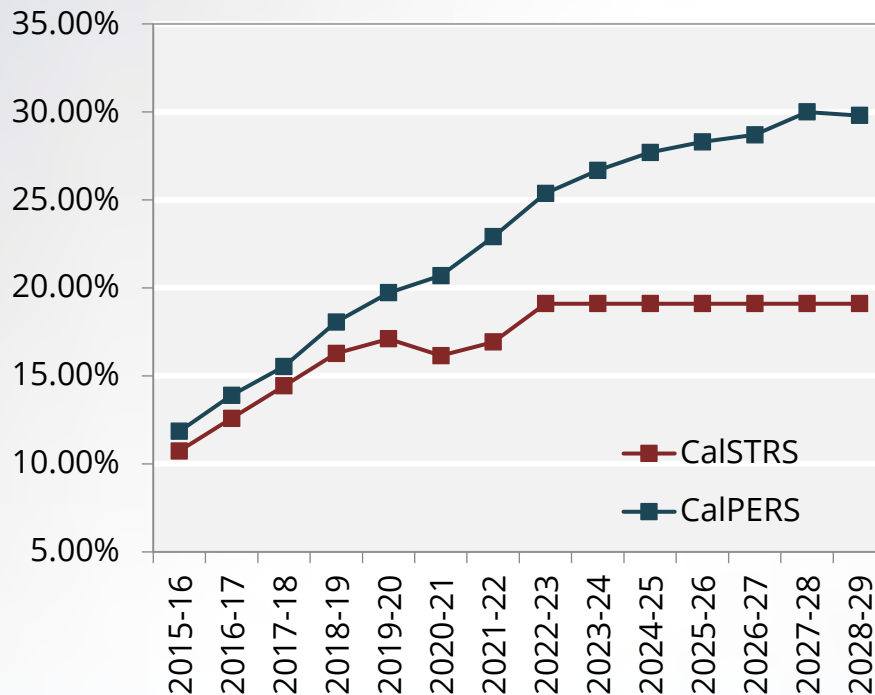
Rule of thumb: For every one percent increase in the discount rate, the unfunded liability is lowered by 10-12%.

Misconceptions About Trust OPEB Prefunding

- 1) I can lower my liability by putting money in the general fund
- 2) If I set up a prefunding trust, I am obligated to make regular contributions
- 3) If I set up a prefunding trust, the money will be stuck there even if I eliminate OPEB benefits

How Much Have Pension Costs Grown?

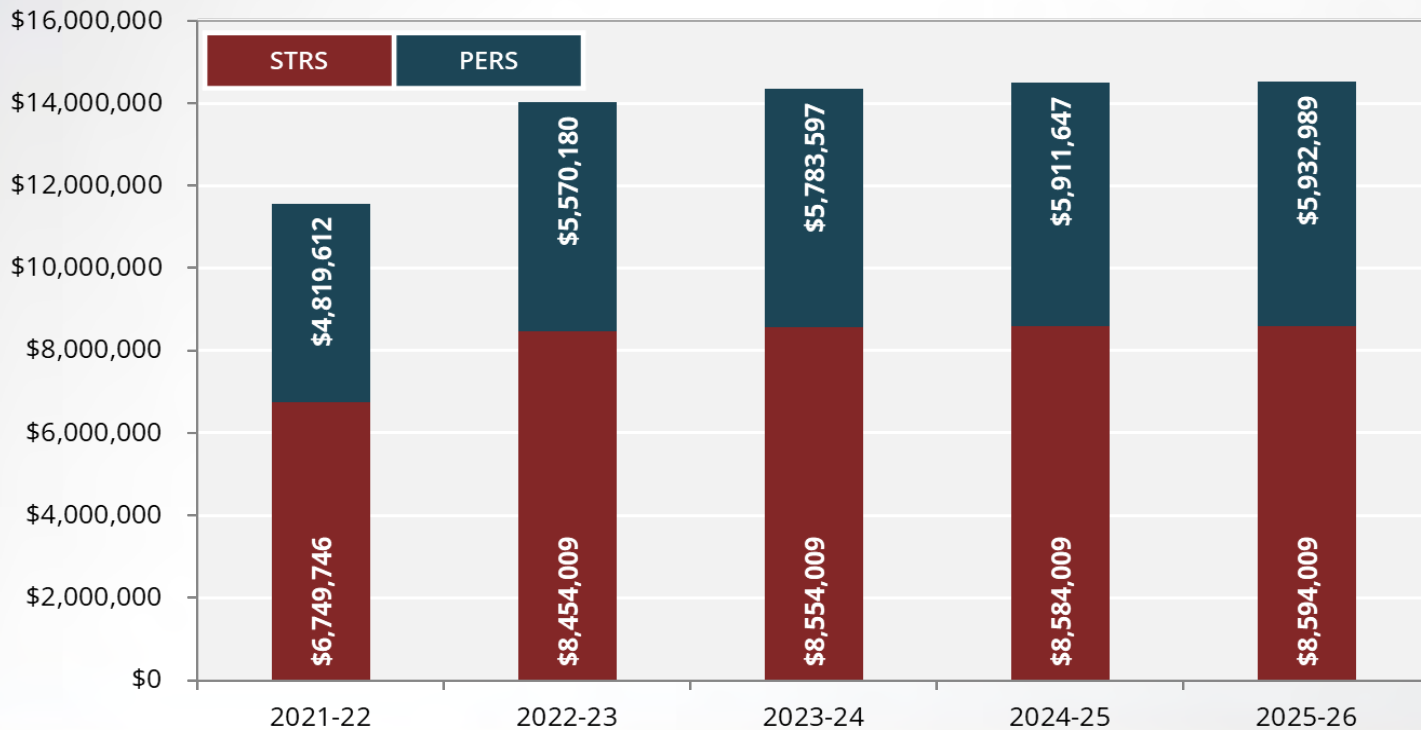
CalSTRS/CalPERS rate increases through 2028-29:



Fiscal Year	CalSTRS	CalPERS
2015-2016	10.73%	11.85%
2016-2017	12.58%	13.89%
2017-2018	14.43%	15.53%
2018-2019	16.28%	18.06%
2019-2020	17.10%	19.72%
2020-2021	16.15%	20.70%
2021-2022	16.92%	22.91%
2022-2023	19.10%	25.37%
2023-2024	19.10%	26.68%
2024-2025	19.10%	27.70%
2025-2026	19.10%	28.30%
2026-2027	19.10%	28.70%
2027-2028	19.10%	30.00%
2028-2029	19.10%	29.80%

Sample Agency Contribution Increases

Annual pension costs increase from \$11.6 million to \$14.7 million in 2025-26



Why Prefund Liabilities?

1

Create a Rainy-Day Fund

Assets can be used as an emergency source of funds for either OPEB or pension-related costs when District revenues are impaired based on economic or other conditions

2

Address Long-term Costs

OPEB and/or STRS/PERS costs are a long-term burden; prudent diversified investment planning is important to current and future management of obligations

3

Address Liabilities

Contributions placed into an exclusive benefit trust are assets which address the district's ongoing OPEB and/or pension liabilities

4

Stabilize Costs

When pension contribution rates or OPEB costs increase, assets can be transferred from the Trust program directly to CalPERS/CalSTRS or OPEB provider, which can help to pay large contribution increases

Why Prefund Liabilities (cont.)?

6

Chance to Retain Retiree Benefits (OPEB)

Districts with lower liabilities have a better chance to retain some level of retiree medical benefits

7

Achieve Better Returns

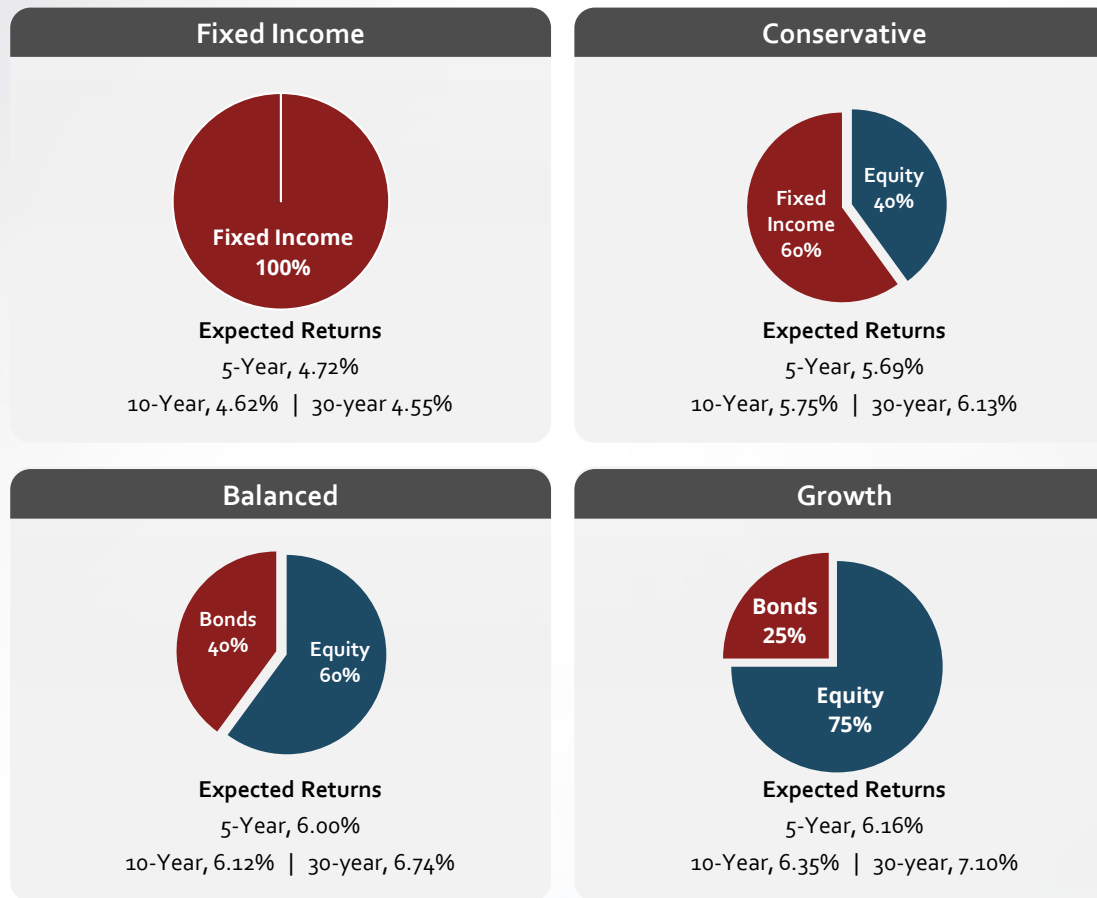
Prefunding with in 115 Trust enables diversified investing that may achieve greater returns than County Treasury Pools

8

Strengthen Credit Rating

Credit rating agencies may look more favorably upon districts who take steps to reduce liabilities

Vanguard Investment Options



Expected Returns from Vanguard's Capital Markets Model (VCMM) as of December 31, 2022

Sample Pension Funding Policies

1. Contribute predetermined percentage each fiscal year based on certain budget, unrestricted fund balance, or reserve thresholds
2. Contribute full amount of annual employer STRS and/or PERS contributions, allowing anytime access to trust assets
3. Contribute funds to stabilize contribution through FY 25-26
4. Annually identify any one-time general purpose funds appropriated to district through the state budget, and recommend portion to be allocated to trust

Sample Pension Funding Policies (cont.)

5. OPEB Account shall maintain an equal share of assets to liabilities based on latest Actuarial Valuation; if condition met, District will contribute remaining unrestricted fund balance (exceeding mandated 8%) to pension prefunding account
6. Contribute one-time revenue source and set forth policy to draw down only on investment earnings in short term time horizon, preserving principal
7. Commit funds in adherence with Reserve Cap of 10% on surplus funds (effective FYE 22-23)

Remember: Benefits of Prefunding!

- Assets can be **accessed at any time** for OPEB or Pension expenses
- **Address your liabilities** by creating an asset and potential greater return
- **Save for a rainy day!**



SRP – Supplementary Retirement Plan

Early Retirement Incentives

OPEB solutions
program

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Cost Cutting vs. Cost Saving

Layoffs

Reorganization, Reassignment

Furloughs

Step and Column Freezes

Position Elimination

Salary Schedule Reductions

Increased Class Size

**SRPs offer districts possibility of “cost savings” approach, intended to be a “win-win.”*

Why Consider a SRP?

- Financial incentive to encourage employees to retire from service earlier than normal to achieve fiscal savings for the district
- Savings created by:
 - Accelerating rate of natural retirement attrition
 - Replacing the departing employee with lower salaried employees
 - Eliminating higher salaried employees to reduce the number of positions otherwise needed to achieve savings
- SRP normally offered to a group of employees deemed eligible based on a set of criteria during a short period of time or “window” period

****PARS offers a complimentary analysis to assess the fiscal/operational feasibility of a SRP***



Questions?

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Would you like to learn more?

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Thank you



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