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THE SUPERVISORS CHIP AWAY AT THE COUNTY'S MOUNTAIN OF HEALTH BENEFIT DEBT

The Next Critical Step Will Require the Supervisors to Take and Hold Tough Negotiating Positions with Labor Unions

SUMMARY

Contra Costa County has reached a critical juncture regarding its escalating retiree health care benefit costs. The unfunded financial liability is now estimated to be approximately $1.74 billion. That figure is more than Contra Costa County's total annual operating budget, and nearly equal to the unfunded liabilities for Alameda, Orange, and San Diego Counties combined.

The latest estimate is lower than the $2.57 billion calculated two years ago. The reduction results primarily from the use of new actuarial assumptions, and secondarily, from recent board of supervisors' action to modify the health care benefits for unrepresented county employees.

The liability is still staggering, because the board of supervisors has yet to make any meaningful changes to the generous health care benefit plans available to county employees and retirees covered by union contracts, despite three opportunities to do so in the past several months.

The county's predicament did not develop overnight. It has been nurtured for decades by past boards that repeatedly agreed to increasingly expensive health care benefits in a labor-friendly environment, without any consideration of future costs. But in light of today's clear understanding of the crushing impact that the obligation will have on the county's ability to provide services, it is worrisome to see the current board appears to be continuing this trend.

Most of the county's 39 union contracts expire in September of 2008. In the past several months, three new labor contracts have been approved. None includes changes to health care benefit plans that would begin to seriously address the county's imminent financial crisis. This does not bode well for the outcome of future negotiations unless the supervisors take as realistic and tough a position with labor unions as it has with the County's unrepresented employees.

If the Board of Supervisors either collectively, or any of its members individually, squander this opportunity to substantially improve the county's financial situation in the name of political expediency or labor peace, out-of-control retiree health care costs will surely and painfully impact the county's ability to deliver basic services to its more than one million citizens.

The complete report is available on the Contra Costa County Grand Jury web site: www.cc-courts.org/grandjury

CONTRA COSTA COUNTY GRAND JURY REPORT 0805

THE SUPERVISORS CHIP AWAY AT THE COUNTY'S MOUNTAIN OF HEALTH BENEFIT DEBT

The Next Critical Step Will Require the Supervisors to Take and Hold Tough Negotiating Positions with Labor Unions

TO: Contra Costa County Board of Supervisors

BACKGROUND

Contra Costa County (County) provides its retirees and eligible dependents with medical and dental care benefits. These benefits flow from labor agreements with employee organizations, since retirees and their dependents receive the same health care benefits as active employees and their dependents.

The County has paid its share of health insurance premiums from its annual operating budget on a cash basis, also known as pay-as-you-go. Retiree health care benefits are referred to as Other Post Employment Benefits (OPEB) to distinguish them from pension obligations.

In compliance with Government Accounting Standards Board Statement Number 45 (GASB 45), the estimated future accumulated OPEB costs must be reported in the County's Comprehensive Annual Financial Report. An independent actuarial consultant estimated that, as of January 1, 2006, the County's unfunded OPEB liability over the next 30 years was approximately $2.57 billion. In March 2008, the actuary reported that the County's unfunded liability, as of January 1, 2008, now totals an estimated $1.74 billion. The reduction results primarily from the use of new actuarial assumptions, and secondarily, from recent Board of Supervisors' (Supervisors) action to modify the health care benefits available to county employees that are not covered by a union contract.

Various demographic trends, such as earlier employee retirements and longer life spans, have swelled the ranks of County retirees. These trends have been compounded by dramatic increases in medical care and health insurance costs that have far outpaced overall inflation. All these factors have contributed to the County's staggering unfunded OPEB liability, the liability with the County's historically generous health care benefits as its foundation.

The County's unfunded OPEB liability has been the subject of Grand Jury reports in each of the last four years, but little significant progress has been made during that period to address the problem. During that time, the Supervisors have failed to negotiate changes to the health benefits that will do anything to reduce the County's growing liability. In 2008, most of the County's union contracts will be renegotiated. This will be the opportunity for the Supervisors to make changes in health care benefits that will significantly reduce the OPEB liability.

Adopting the most effective option in the upcoming labor negotiations is essential if the County is truly committed to containing its unfunded OPEB liability. Unless the Supervisors restructure the County's health care benefits for all its employees and retirees, they will be forced to reduce programs and services. This will have a devastating effect on employees, taxpayers, and residents, especially those dependent on County services.

FINDINGS

A. Defining the OPEB Problem

1. Governmental Accounting Standards Board Statement Number 45 ("GASB 45"), "Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions" (OPEB) sets an accounting standard analogous to the governmental pension accounting standard. This standard requires the calculation and disclosure of an unfunded liability for government employee retiree health care benefits similar to the method already in place for recognizing the cost of government employee pensions. Contra Costa County (County) has elected to embrace this standard.

2. As of January 1, 2006, County's unfunded OPEB liability for the cost of providing health care benefits to its current and future retirees and their dependents over the course of their lifetimes was estimated by an independent actuarial consultant hired by the Board of Supervisors (Supervisors) to be $2.57 billion.

3. The 2006 actuarial study indicated that the structure and costs of the County's retiree health care benefits were not sustainable.

4. According to a March 1, 2007 County OPEB Task Force report, as of January 1, 2006, the estimated unfunded OPEB liabilities for Alameda, Orange, Riverside, San Diego, and San Mateo counties were $613 million, $598 million, $257 million, $640 million, and $70 million respectively. These five counties have a combined OPEB liability of approximately $2.17 billion, which is less than the $2.57 billion estimate for Contra Costa alone.

5. In 2008, the actuarial consultant updated the estimated unfunded OPEB liability. As of January 1, the revised estimate was $1.74 billion. The reduction results primarily from the use of new actuarial assumptions, and secondarily, from Supervisor action on May 6, 2008 to modify the health care benefits available to County employees that are not covered by a union labor contract; i.e., unrepresented employees. The $1.74 billion figure is more than the County's total annual operating budget of approximately $1.2 billion for fiscal year 2007-08, and is still nearly equal to the combined health care benefit liabilities for Alameda, Orange, and San Diego Counties.

6. According to County officials, the growth in the cost of health care benefits has and will continue to compromise the County's ability to provide public services since County general funds earmarked for services will have to be used to pay for increasingly costly employee and retiree health care benefits.

7. As early as 1994, the Supervisors were briefed by administrative staff about the pending OPEB crisis, but took no action for more than a decade.

8. The OPEB liability results primarily from labor agreements in which retirees and their dependents receive the same increasingly costly health care benefits as active employees and their dependents. Other factors that contribute to the OPEB liability include longer life spans, earlier retirement ages, as well as medical costs and health insurance premiums that have escalated dramatically compared to overall inflation.

9. The Supervisors have the authority and responsibility to establish the labor negotiation policy, to explain it clearly to the County's negotiating team, and to ensure that the negotiating team carries it out.

10. There have been occasions in the past in which individual supervisors have had conversations with union leaders about matters being negotiated. Reportedly, these conversations have on occasion undermined the Supervisors' labor negotiation policy, causing a weakening of that body's resolve, resulting in labor contracts that were not fiscally prudent.

11. The subject of the County's unfunded OPEB liability has been the topic of four previous Contra Costa County Grand Jury reports:

    - 2004: "Take Action Now to Reduce Costs of Retiree Health Insurance."
    - 2005: "Code Blue: County Health Care Costs."
    - 2006: "County Ignores Retiree Health Care Costs: The Financial Tidal Wave."
    - 2007: "Mayday, Mayday, Mayday! The County Drifts Ever Closer to the OPEB Rocks."

12. The Governmental Accounting Standards Board recommends public agencies account for unfunded OPEB costs over the active service life of benefiting employees, rather than reporting current year OPEB costs for existing retirees.

13. Currently, there is no universal County requirement for eligible retirees to enroll in Medicare Parts A (hospital coverage) and B (physician and ancillary medical coverage), and assign benefits to County sponsored health insurance carriers. When Medicare benefits are assigned to the County's health insurance carriers by retirees by means of a carrier-provided form, Medicare becomes the primary payer, leaving the County responsible only as a secondary payer. Currently, Medicare health benefits are not uniformly assigned to the County's health insurance carriers to help pay for the

participants' medical care. This results in higher insurance premium costs for the County**.**

14. The County provides combined medical and dental benefits to approximately 8600 active employees, 5800 retirees, plus dependents and surviving spouses of retirees. Approximately 7400 (86%) of the active employees are represented by labor unions. The remaining 1200 (14%) are unrepresented.

15. The County's $1.2 billion, fiscal year 2007-08 budget includes $130 million, 10.7% of the total budget, to pay health premium costs on a pay-as-you-go plan ($36 million for retirees and $94 million for active employees).

B. Addressing the OPEB Problem

16. On September 25, 2007, the Supervisors adopted a plan to finally begin addressing the County's unfunded OPEB liability. It included the following:

    - A Strategic Plan and timetable addressing the OPEB problem.
    - An Irrevocable Trust Account for pre-funding a portion of the County's OPEB liability.
    - An initial goal to pre-fund, i.e., deposit into the trust, 40% of the total OPEB liability over the course of the next 30 years. This amount represents only the costs of current retirees' health care costs during that period, not future retirees.
    - A pledge to deposit $588 million between fiscal years 2008-09 and 2022-23, 15 years, into the Irrevocable Trust Account.

17. Effective January 1, 2007, the County increased the eligibility requirement for retiree health care benefits. Since then, employees, other than deputy sheriffs and firefighters, must work for the County for 15 years. Previously, some new employees had become eligible for retiree health benefits after as little as one day on the job.

18. On January 15, 2008, the Supervisors established an Irrevocable Trust Account, under the provisions of Internal Revenue Code Section 115, to deposit future OPEB funds. The funds in such accounts may not be used for any other purpose than as directed in the trust document. The trustees are: the County's Administrator, Auditor-Controller, Treasurer-Tax Collector, Director of Finance, and Health Services Department's Chief Financial Officer.

19. The County Administrator has conducted information sessions covering the County's OPEB liability problems during which he answered employee and public questions.

20. On January 23, 2008, the County Administrator presented a report to the County Health Care Coalition, a group that includes representatives of the various labor organizations. This report contained several benefit design change options that, if adopted, would have varying impacts on reducing the County's OPEB liability. The pros and cons, as well as

the fiscal impact on the County's unfunded OPEB liability, were presented for each of the options.

21. The January 23, 2008 report proposed changes to the health benefits available to retired unrepresented employees and their dependents. On May 6, 2008, the Supervisors approved the following changes for retired unrepresented employees and their dependants:

    - Limit coverage to one County health plan for retired employees, and their dependents, regardless of a spouse or partner's County employee status; i.e., no dual County health coverage.
    - Require retirees who become 65 on or after January 1, 2009 to enroll in Medicare Parts A&B.
    - Beginning January 1, 2010, set the County health care insurance premium subsidy at the 2009 premium level.

22. The January 23, 2008 report proposed the establishment of a second benefit tier for newly hired unrepresented employees intended to limit the County's costs of providing health plan benefits to future retirees. On May 6, 2008, the Supervisors approved the following changes for unrepresented employees hired after January 1, 2009:

    - Limit coverage to one County health plan for active or retired employees, and their dependents, regardless of spouse or partner County employee status; no dual County health coverage.
    - Establish separate insurance rating pools for active and retired employees to allow for more accurate cost calculations for each group.
    - Provide that upon retirement: a) the County would not contribute toward the cost of health care for employees that retire before the age of 65; and, b) the County would permit retirees to enroll in County health plans at their own expense until age 65, when employees are eligible to enroll in Medicare Parts A&B.

23. The January 23, 2008 report proposed the establishment of a Benefit Design Task Force to develop a new health benefit program for the County. On May 6, 2008, the Supervisors approved:

    - The establishment of a task force to deal with health care benefits for unrepresented employees. Members of the task force would include unrepresented employees and retirees, County subject matter experts, independent benefit design, actuary, and tax consultants.
    - Setting specific achievement goals and parameters to recommend options for sound health care benefits within the County's budgetary limits.
    - Setting specific target dates for completion of any re-design recommendations before 2010.
    - Pursuing the means to assure portability of employee health coverage and access to health savings mechanisms for unrepresented County employees, retirees, and their dependents.

24. The County Administrator implemented a hiring freeze effective February 1, 2008, subject to case-by-case exceptions only he and his chief deputies have the authority to grant.

25. On May 6, 2008, the Supervisors approved a fiscal year 2008-09 budget that directs $20 million to the OPEB trust.

26. The County has 39 labor contracts with 17 different employee organizations. Most of the contracts expire on September 30, 2008.

27. The County Human Resources Department's labor relations services unit coordinates the activities of both in-house staff and contracted labor consultants.

C. The OPEB Problem Continues

28. In October 2007, the Supervisors approved a new contract with the United Professional Firefighters, Local 1230 that did not include any changes in health benefits.

29. In December 2007, the Supervisors approved a new contract with the Costa County Deputy District Attorneys Association that did not include substantive changes in health benefits.

30. In April 2008, the Supervisors approved a new contract with the California Nurses Association that did not include substantive changes in health benefits.

31. Based on 2008 estimates from the independent actuary hired by the Supervisors, the County will need to set aside $130 million per year, for 30 years, to pay down 40% of the OPEB liability. The Supervisor-approved 40% target level represents the estimated cost of the County's current retiree health care benefits, not the total amount required to also cover the health care benefit costs for all future retirees. Recent steps by the Supervisors, including the May 6, 2008 approval of the fiscal year 2008-09 budget, will reduce the liability over time. However, in the absence of any further action by the Supervisors to increase the target level, the gap between the required and planned contributions is estimated to be $54 million per year.

CONCLUSIONS

A number of factors have contributed to Contra Costa County's current retiree health benefits cost crisis. But there is a primary factor that could have mitigated this crisis years ago, and which, even now, is contributing to making the situation worse. That primary cause was the inability of elected County Board of Supervisors to develop a fiscally prudent and tough negotiating position with the labor unions that represent County employees, and then stick to it.

This fiscal problem has been before the Supervisors for many years, and only recently have they begun to take steps to address the situation. Thus far, those steps have been limited to making health benefit changes that will affect only unrepresented employees, approximately 14% of the County's workforce. This is the fifth consecutive year that the Grand Jury has been one of the voices forcefully bringing this matter to the attention of the Supervisors and the public. The Supervisors consistently approved labor contracts covering the remaining 86% of the workforce that obligate the County to expenses that are not sustainable, and budgets that do not provide funds to pay down this obligation over time.

The pattern has continued this year. Supervisors have said that they have learned their lesson, that they will do better, and that they are on the road to fiscal sanity. Their record says otherwise. In the past few months, three labor contracts have come up for approval, and in each case, the Supervisors as a group have failed to take any meaningful steps to address out-of-control health benefit costs, attributable largely to the generous union agreements.

The Supervisors have been unable to maintain a united front because some supervisors have gone outside the "meet and confer" process, communicating directly with union leaders about matters that are being negotiated by the County's negotiating team. In fairness, not all supervisors are so beholden to organized labor. But those that have the best interests of County taxpayers in mind are powerless to accomplish the necessary tasks when other supervisors seem more interested in union political support and its impact on the next election.

It is imperative that the Supervisors take additional meaningful steps to get the County on a fiscally sound footing. The next key step involves establishing and holding tough negotiating positions with the unions that represent County employees. To do so will require a majority of supervisors who take seriously their duties to all, not just some, County taxpayers.

RECOMMENDATIONS

The 2007-08 Contra Costa County Grand Jury recommends that:

1. The Supervisors establish the County's labor negotiation policy, explain it clearly to its negotiating team, and see that the negotiating team carries it out.

2. The Supervisors refrain from individually communicating with labor leaders regarding any contract item being negotiated.

3. The Supervisors only approve labor contracts that are fiscally prudent and that reduce the County's unfunded OPEB liability.

4. The Supervisors develop and implement a new health benefit program for County employees and retirees that will reduce the OPEB liability.

5. All Medicare eligible employees, retirees, and their dependants receiving health care benefits from the County be required to enroll in Medicare Parts A and B, and to assign their Medicare benefits to the County's authorized health insurance carriers.

6. The Supervisors approve only County budgets that incorporate features of the approved OPEB funding strategy. These must include reductions and/or containment of employee and retiree health plan costs, program and service reductions, and redirecting funds into the OPEB irrevocable trust.

7. Within six months of this report, the Supervisors develop a plan to incrementally increase the OPEB Irrevocable Trust funding from the current 40% target level to 85% over the course of the next 30 years.

REQUIRED RESPONSES

Findings:

Contra Costa Board of Supervisors: 1 through 31

REQUIRED RESPONSES

Recommendations:

Contra Costa Board of Supervisors: 1 through 7