



# A 360 View of OPEB Trusts and Why They Work

## **Presented by:**

**Mary Beth Redding, FSA**

Vice President, Bartel Associates LLC

**Ellen Clark**

Director, PFM Asset Management LLC

**Dennis Kauffman**

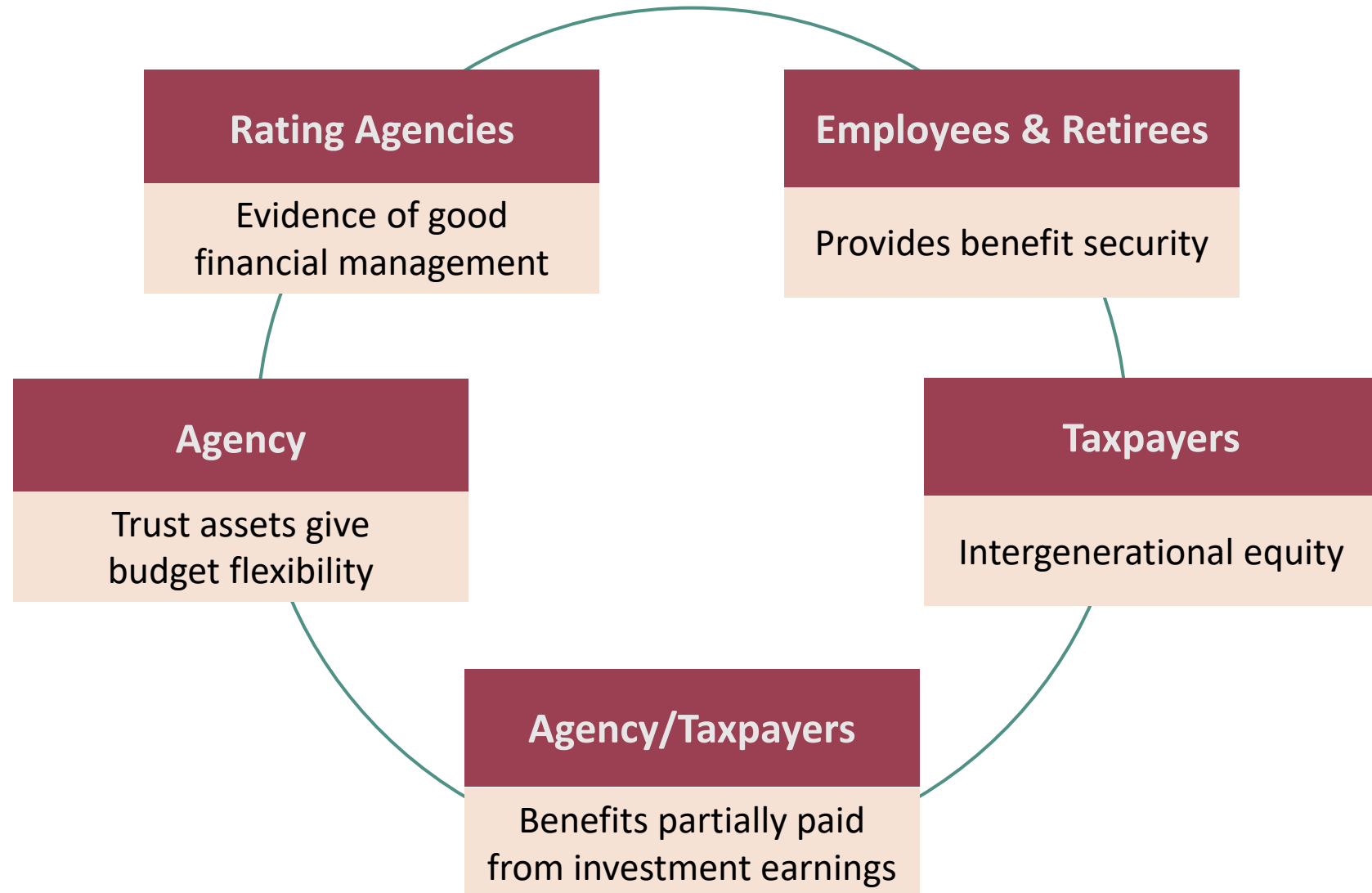
Assistant City Manager, Chief Financial Officer  
City of Roseville

# Funding an OPEB Trust – An Actuarial Perspective

Mary Beth Redding, FSA  
Vice President  
Bartel Associates, LLC



# Why Prefund OPEB Liabilities?



# GASB Statement 75

- Net OPEB liability on the balance sheet
  - Previously: difference between “ARC” and contributions/benefits paid
  - GASB says the future obligation is real
- How funding in a Trust helps
  - Net OPEB liability is smaller
  - Total OPEB liability is lower
    - Example

	No Trust	Sample Trust 1	Sample Trust 2
Expected Trust return	N/A	6.0%	5.0%
Discount rate	2.2%	6.0%	5.0%
Total OPEB liability	\$65,000	\$35,000	\$40,000



# Prefunding Savings

	No Trust	Sample Trust 1	Sample Trust 2
<b>Expected Trust return</b>	N/A	6.0%	5.0%
<b>Discount rate</b>	2.2%	6.0%	5.0%
<b>Total OPEB liability</b>	\$65,000	\$35,000	\$40,000
<b>Expected Agency payments for accrued benefits</b>	\$185,000 (Pay-Go over 90 years)	\$60,000 (20-year level payment)	\$65,000 (20-year level payment)
<b>Benefits paid from investment earnings (unadjusted for time value of money)</b>	\$0 (0%)	\$125,000 (68%)	\$120,000 (65%)

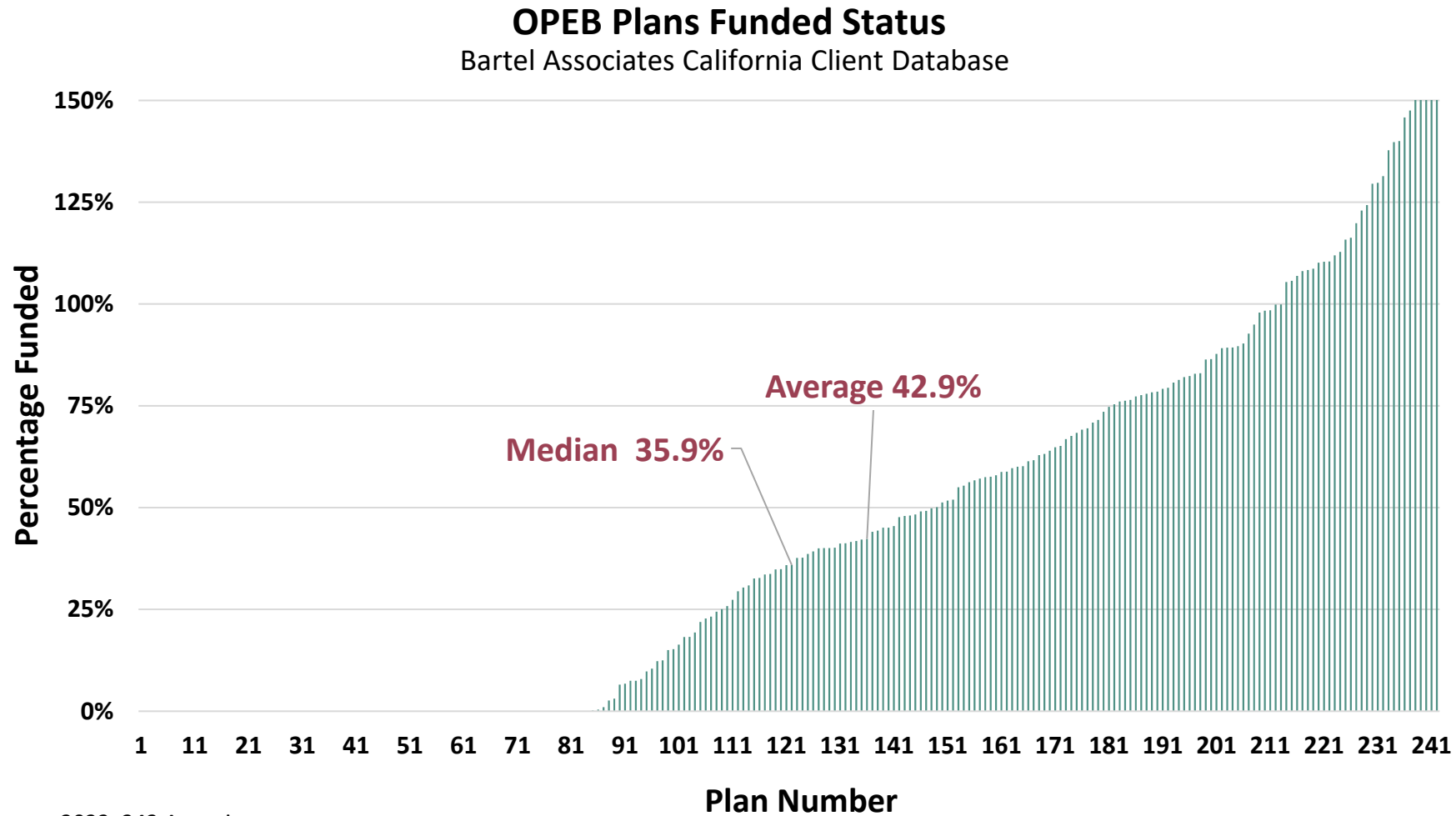


# GASB Statement 75 Discount Rate

- Set by “Crossover” test
  - Current assets
  - Expected future return on assets
  - Future benefit payments
  - Future contributions => employer funding policy
- Discount rate somewhere between
  - Municipal bond rate
  - Expected future asset return



# How many agencies are prefunding OPEB?



January 2022 242 Agencies



# How to Manage Your OPEB Liabilities: My Opinions

- Almost all plans should be pre-funding
  - If you can't afford to prefund OPEB, you can't afford the benefits and need to address that challenge
  - Exceptions where pre-funding may not be recommended
- Where you are headed is more important than where you are right now
  - Do you have a funding strategy and are you following it?
- Avoid excessive overfunding
  - Assets can't be withdrawn from the Trust until all benefits owed have been paid
  - Unlike pensions, OPEB benefits can (usually) be reduced
    - By employer/negotiations, CalPERS or other plan design, U.S. government (e.g., Medicare expansion), and others



# What is a Good OPEB Funded Level?

- What is a good level?
  - Keep 100% target in mind
    - Gives a cushion for asset losses
  - I think 80 – 90% is good, to guard against overfunding
    - At 80%, re-evaluate budget needs, current health care environment, investments, other
- Should you fund the implied subsidy liability?
  - Generally, yes
  - Implied subsidy liability = cost of benefits if you left CalPERS and paid an unblended healthcare premium
  - Improves funded status/discount rate for GASB Statement 75 reporting
  - Reimburse implied subsidy payments from trust assets



# What to Do With a Well-Funded Plan?

- Opportunity to reduce investment risk
  - Consider what actions could reduce likelihood of future losses
- Redirect budget funds
  - Pause OPEB contributions to focus on other needs (pension?)
- Reimburse OPEB payments from the trust
  - Premium and implied subsidy benefit payments, allowable administrative expenses
  - Prevent/limit overfunding
  - Remember, the trust's purpose is to pay benefits



# Investing an OPEB Trust – A Current Market Perspective

Ellen Clark  
Director  
PFM Asset Management LLC

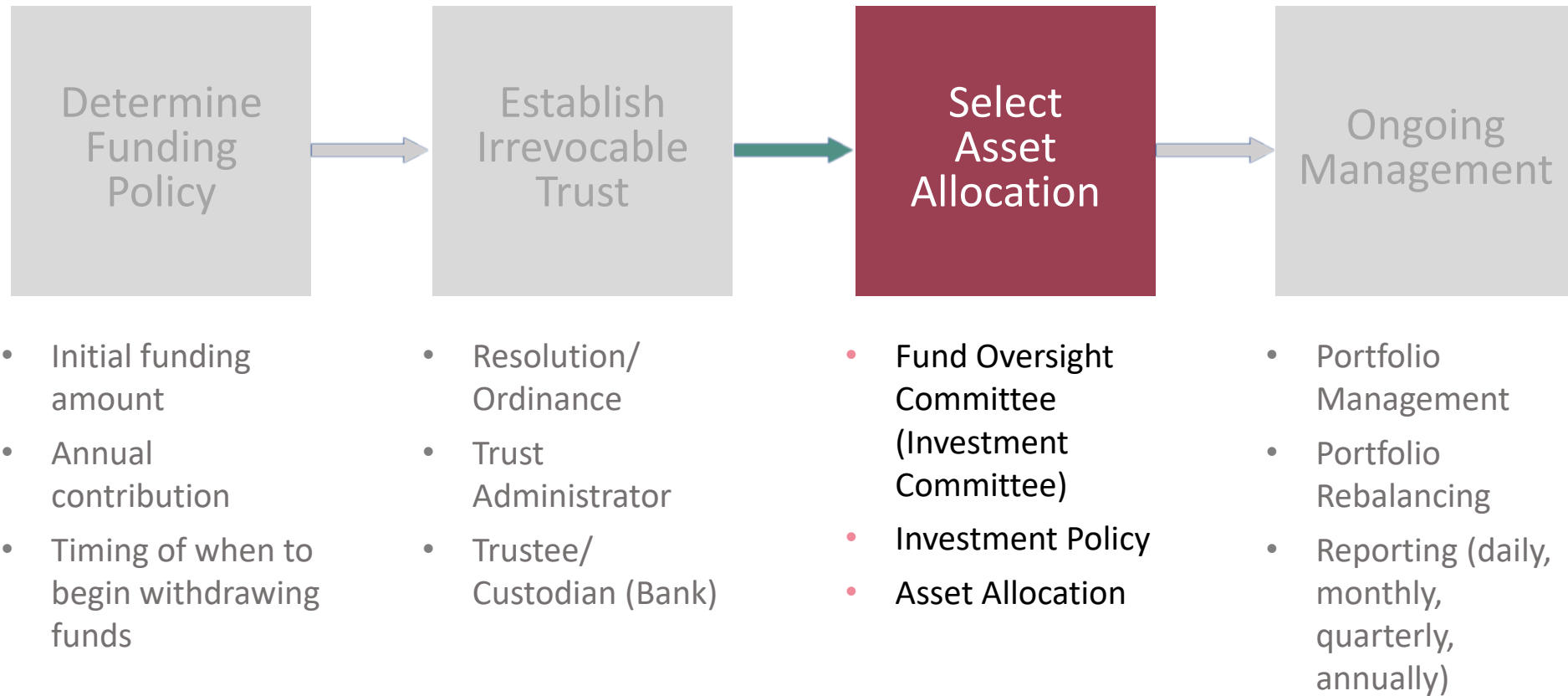


*PFM Asset Management LLC*

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# Establish Broad Market Access During the Setup Process



# Establishing a Trust Expands Your Investment Universe

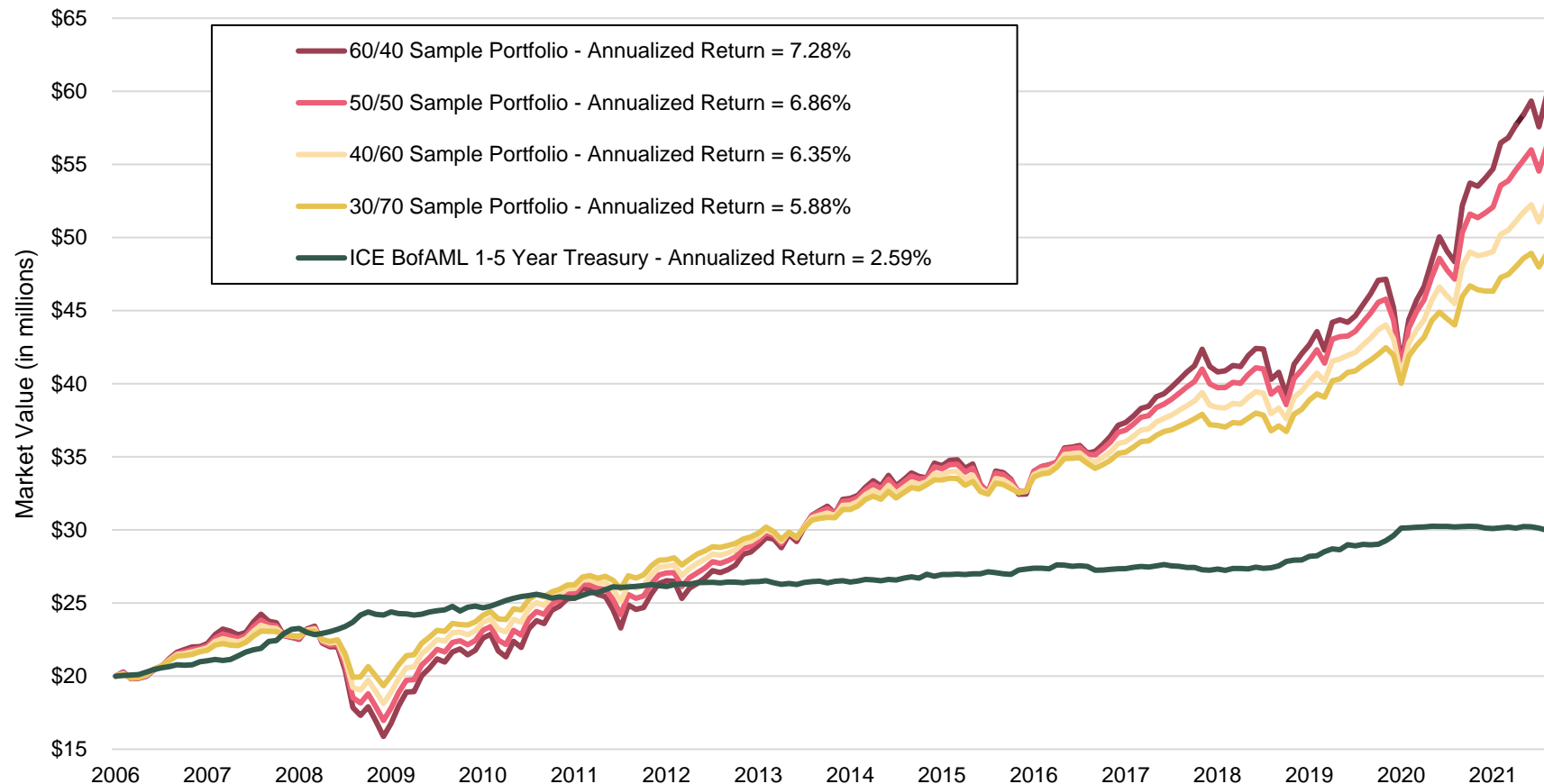
Asset Class	Types of Investments	Investment Authority
<b>"Conventional" Fixed-Income</b>	U.S. Treasuries Federal Agencies Municipal Securities Negotiable Certificates of Deposit Prime Commercial Paper Bankers' Acceptances Medium-Term Corporate Bonds ("A" or Better) Asset-Backed Securities (ABS) Supranationals ("AA" or better) Repurchase Agreements Money Market Funds Local Government Investment Pools	CA Government Code
<b>Broader Fixed-Income</b>	Foreign Sovereign/Agencies Non-Agency MBS BBB and High-Yield Private Placements Convertibles Emerging Markets Debt Non-U.S. Dollar Investment Grade Bank Loans	Section 115 OPEB Trust
<b>Equities</b>	Domestic Equities (Large Cap, Mid-Cap, Small Cap) International Equities (Large Cap, Mid-Cap, Small Cap) Emerging Markets Preferred Stock Equity Mutual Funds and ETFs	
<b>Alternatives</b>	Commodities Real Estate Hedge Funds Private Equity	

Source: California Government Code Section 53601



# Comparing Investment Strategies

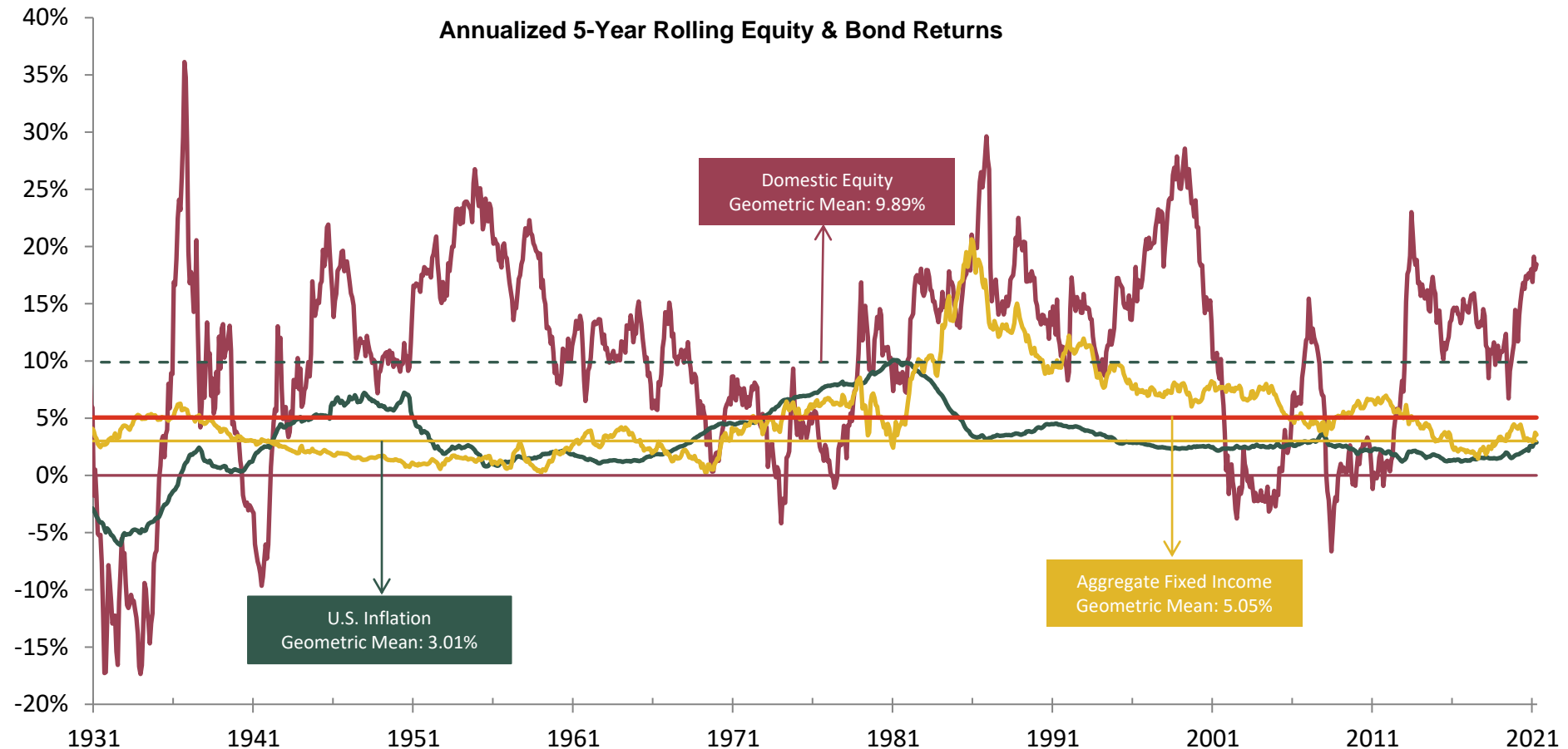
**Growth of \$20 Million**  
March 31, 2006 – December 31, 2021



Source: Investment Metrics. Sample portfolios consist of a weighted average of the following: US Equity - Russell 3000, Non-US Equity - MSCI ACWI ex US (net) and Fixed Income - Bloomberg Barclays Aggregate indices.



# Long-Term Equity/Bond Returns Outpace Inflation



Source: Morningstar as of 12/31/21



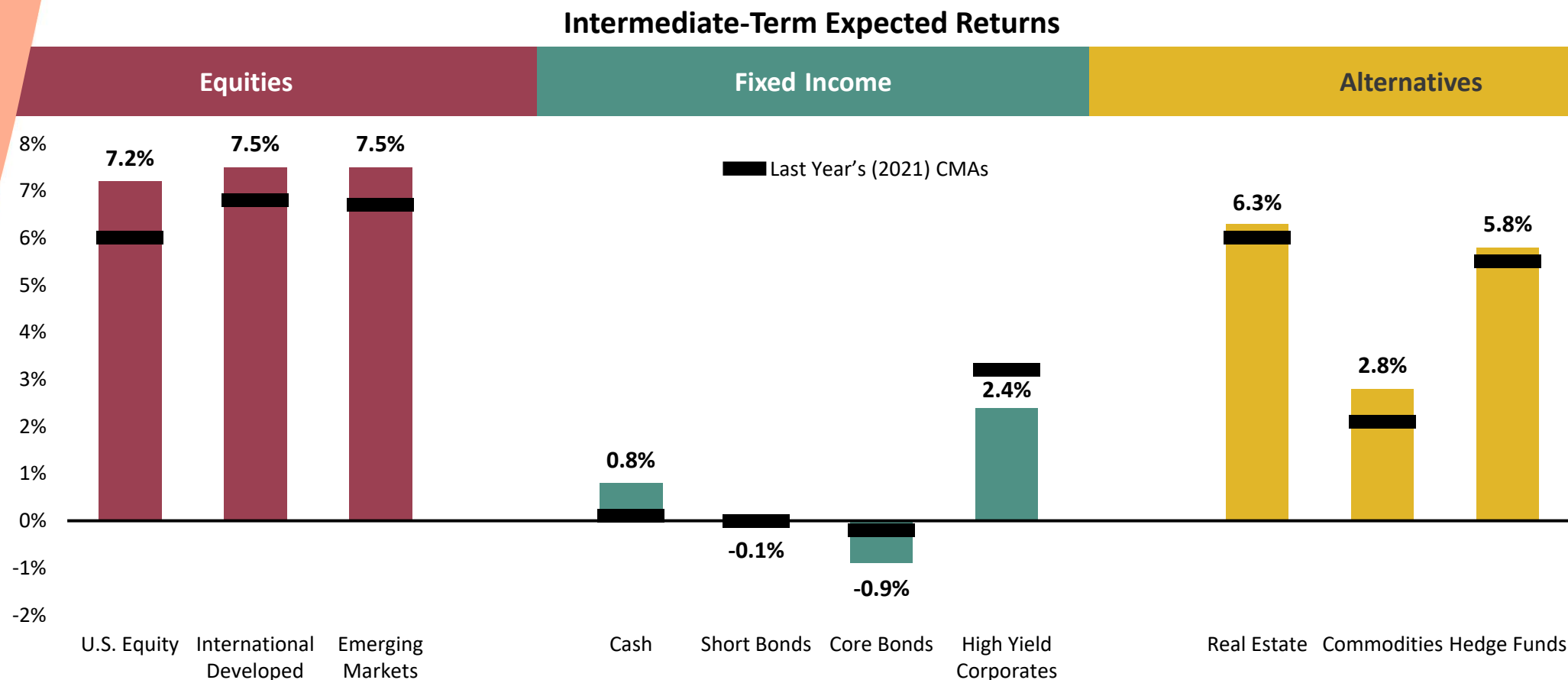
# Fixed Income: 30 Years of Declining Rates



Source: St. Louis Federal Reserve as of 12/31/2021



# Select PFMAM 2022 Capital Market Assumptions



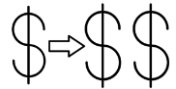
Source: PFMAM 2022 Capital Market Assumptions and Overview of Economic Fundamentals. Full PFMAM 2022 Capital Market Assumption Report available upon request. Please refer to PFMAM's 2022 Capital Market Assumptions for a complete description of the methodology used to develop these assumptions and important disclosures. The return data is hypothetical in nature and should not be relied upon as independently verifiable information. There is no guarantee that the projected returns can or will be achieved. Results may vary with each use and over time. This material does not purport to contain all of the information that a prospective investor may wish to consider and is not to be relied upon or used in substitution for the exercise of independent judgment. Past performance is not a guarantee of future results. Prior to investing, you should consult your accounting, tax, and legal advisors to understand the implications of such investment.



# Current Market Themes



- **COVID-19** cases at record high due to Omicron



- Risk of persistently elevated **inflation** is weighing on consumer sentiment



- Federal Reserve is accelerating pace of **tapering** and expect to raise rates three to four times in 2022

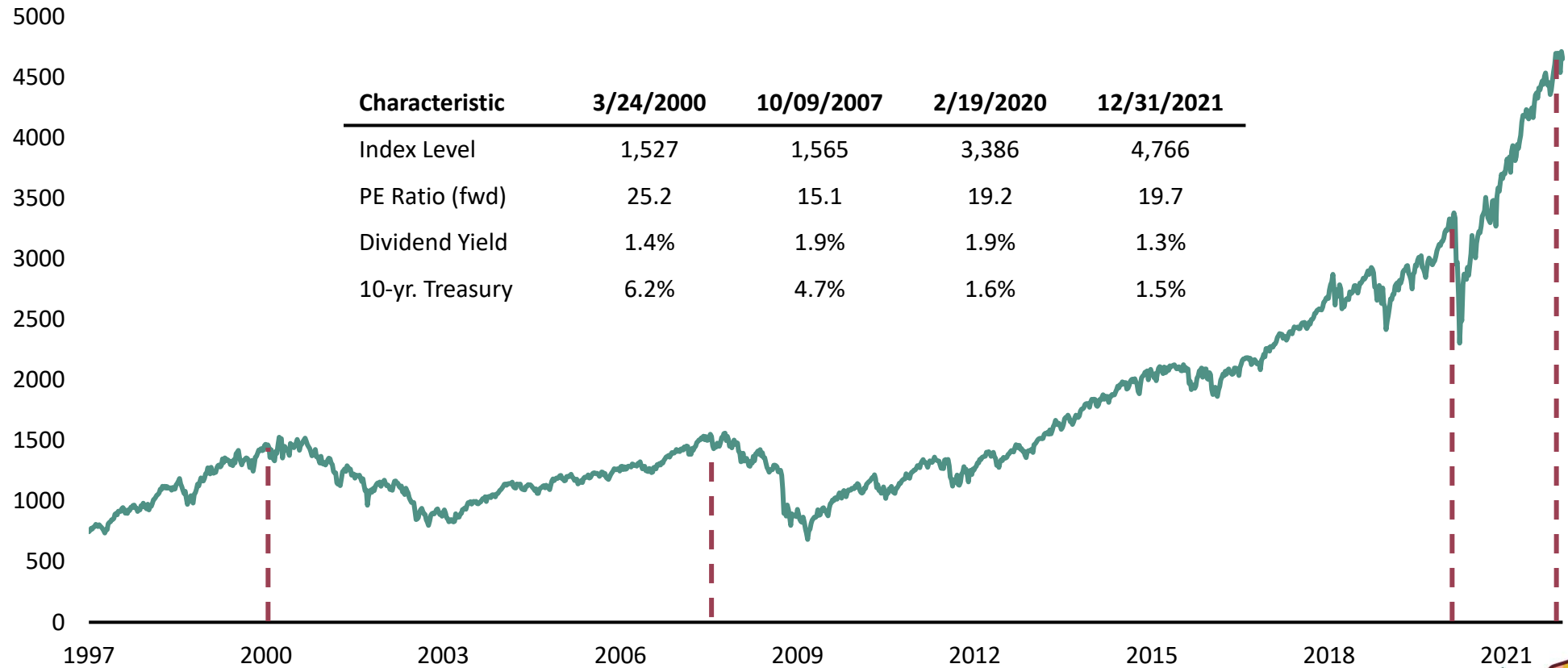


- Equity and fixed income valuations remain **expensive**



# Where is the U.S. Equity Market Today?

S&P 500 Index

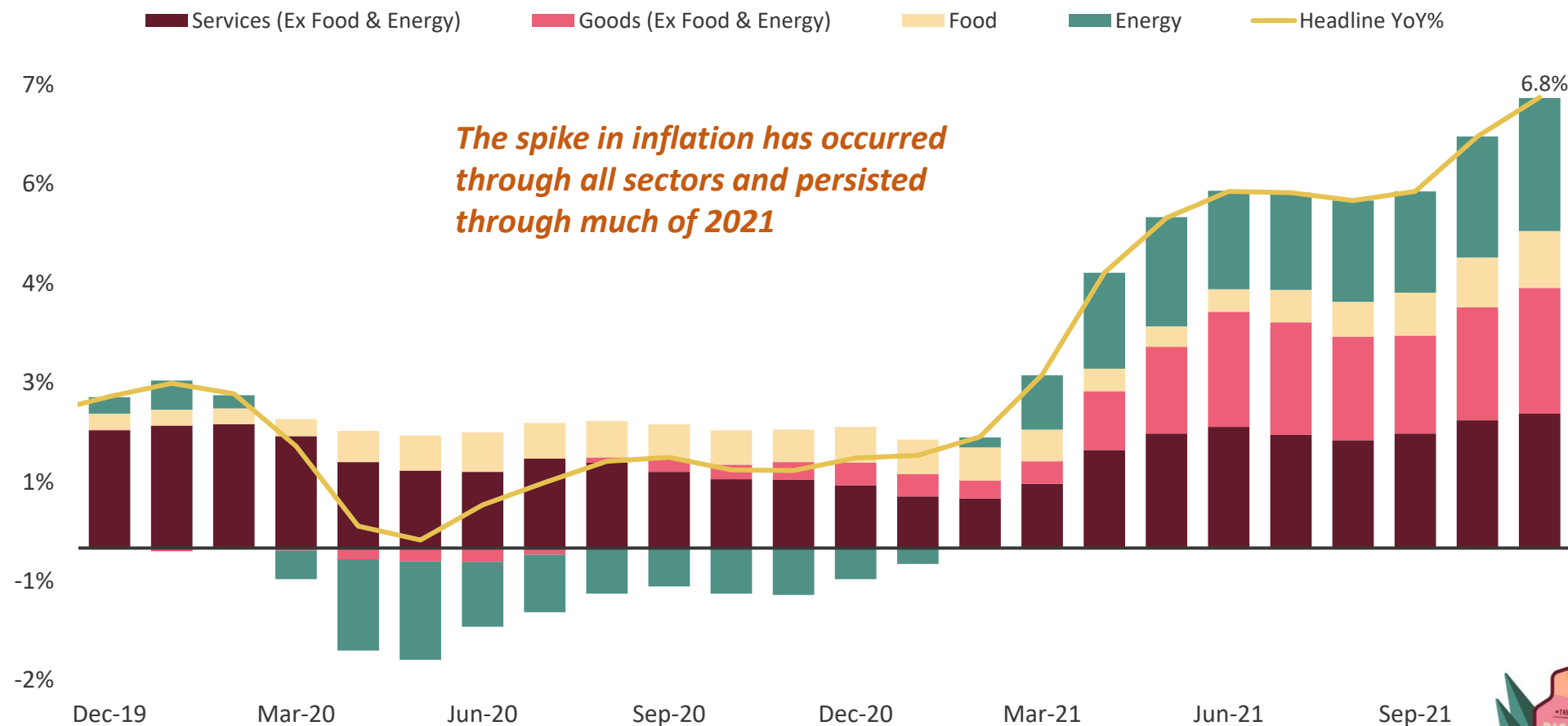


Source: Bloomberg.



# Inflation - Here to Stay?

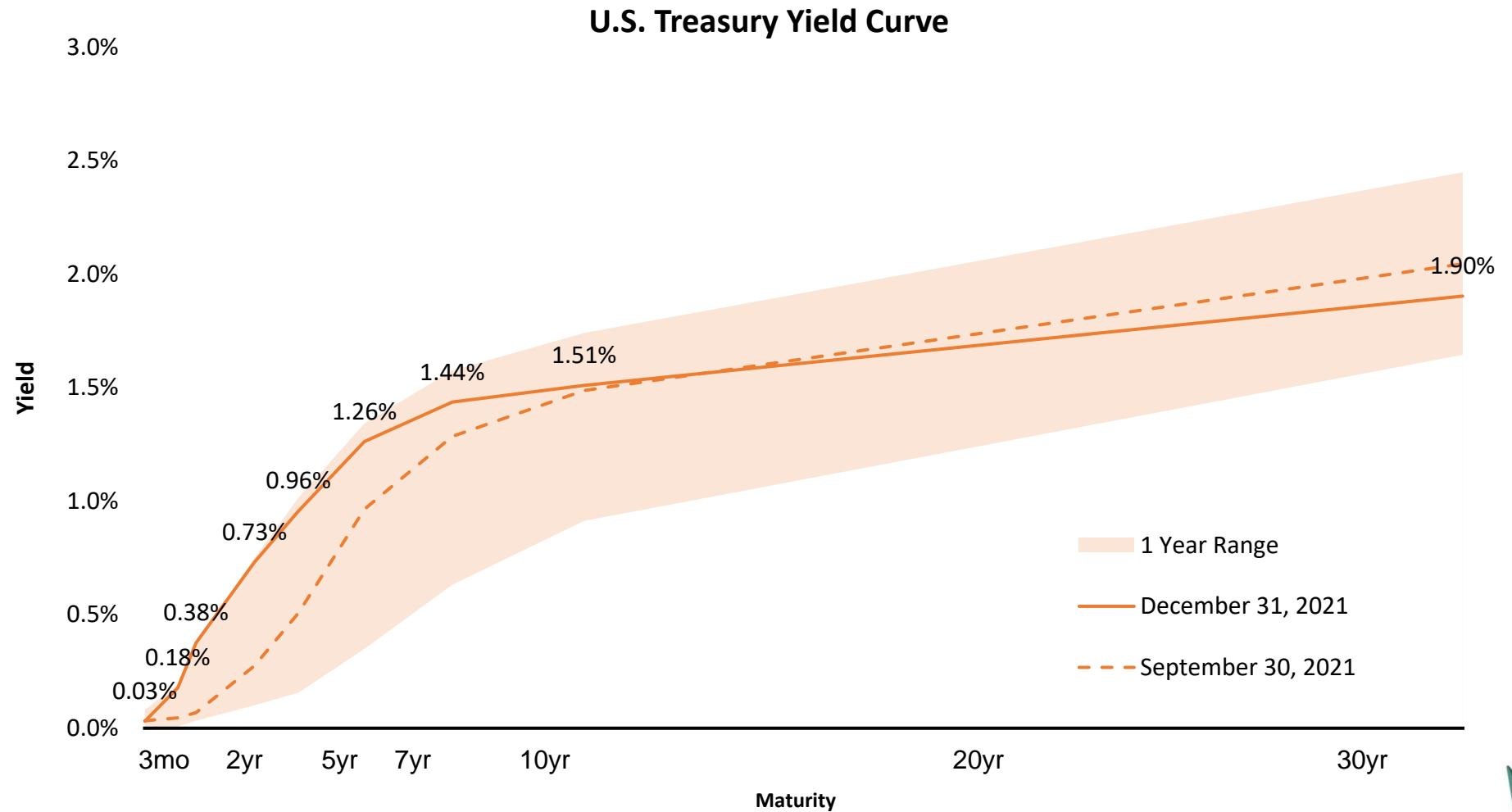
Top-Line Contributions and CPI YoY



Source: Bloomberg, as of November 2021.



# Current Yield Curve



Source: Bloomberg as of 12/31/2021.



# Market Performance

Index Performance as of December 31, 2021						
	4 <sup>th</sup> Quarter	Year to Date	1 Year	3 Years	5 Years	10 Years
<b>Domestic Equity</b>						
<i>S&amp;P 500</i>	9.75%	28.68%	28.68%	26.03%	18.45%	16.53%
<i>Russell 3000 Index</i>	8.00%	25.64%	25.64%	25.75%	17.94%	16.28%
<i>Russell Midcap Index</i>	6.44%	22.58%	22.58%	23.26%	15.09%	14.89%
<i>Russell 2000 Index (small cap)</i>	2.12%	14.78%	14.78%	19.97%	11.99%	13.21%
<b>International Equity</b>						
<i>MSCI AC World ex USA (Net)</i>	2.44%	7.82%	7.82%	13.17%	9.60%	7.28%
<i>MSCI Emerging Markets Index</i>	-0.80%	-2.54%	-2.54%	10.93%	9.87%	5.48%
<b>Fixed Income</b>						
<i>Bloomberg Barclays U.S. Aggregate</i>	-0.27%	-1.54%	-1.54%	4.79%	3.57%	2.90%
<i>Bloomberg Barclays U.S. Gov't/Credit</i>	0.18%	-1.75%	-1.75%	5.49%	3.99%	3.13%
<i>Bloomberg Barclays U.S. 1-3 Year Treasury</i>	-0.58%	-0.60%	-0.60%	2.03%	1.61%	1.09%
<i>Bloomberg Barclays U.S. High Yield Cor</i>	0.71%	5.28%	5.28%	8.83%	6.29%	6.82%
<b>Alternatives</b>						
<i>FTSE NAREIT Equity REIT Index</i>	14.67%	41.30%	41.30%	19.91%	12.45%	11.37%
<i>Bloomberg Commodity Index Total Return</i>	-1.73%	27.11%	27.11%	9.86%	3.66%	-3.43%

Source: Investment Metrics, data as of 12/31/2021.



# Establishing an OPEB Trust – A Finance Officers Perspective

Dennis Kauffman  
Assistant City Manager, Chief Financial Officer  
City of Roseville



# Funding Policy

- Purpose/goals
- Background section
- Actuarial valuations
  - Discount rate
- Actuarially Determined Contributions
  - Roseville's funding strategy
- One-time funding
- Policy updates



# City of Roseville OPEB Funding Policy

## Introduction

The purpose of this Funding Policy is to state the overall funding goals for the City of Roseville OPEB Trust. The objective is to accumulate sufficient assets to fully finance the retiree healthcare benefits that the retired employees receive throughout retirement. In meeting this objective, the City will strive to meet the following funding goals:



# Investing

- Asset allocation
- Risk tolerance
- Long-term plan
- Investment portfolio management
- Oversight committee



# City of Roseville OPEB Trust

As of June 30, 2021

## Performance (%)

	1 <sup>st</sup> Quarter	Year to Date	Jul-2020 to June- 2021	1 Year	3 Years	5 Years	7 Years	Since Inception	Inception Date
City of Roseville OPEB Trust	5.33	8.19	25.52	25.52	12.41	11.31	8.79	9.09	03/1/2011
Blended Policy Benchmark	5.09	6.99	23.22	23.22	11.77	10.07	8.08	8.17	03/1/2011

Source: City of Roseville Other-Post Employment Benefits Quarterly Performance Report, June 30, 2021.



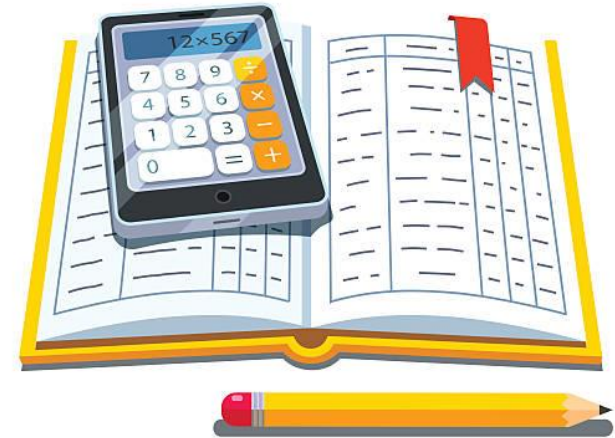
# Budgeting

- Annual budget
  - Paygo
  - Contributions to trust
- Long-term forecasting
  - General Fund
  - Other funds



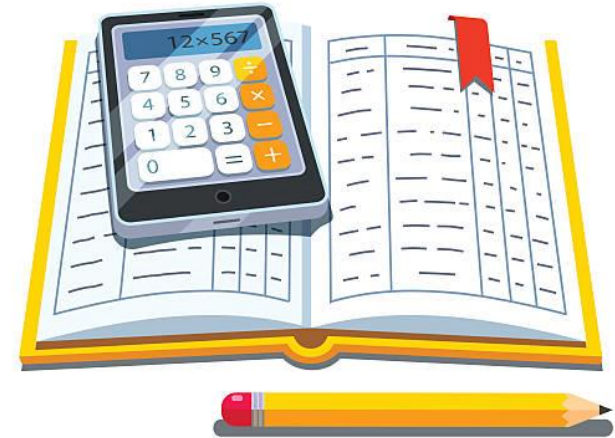
# Accounting/Financial Reporting

- Impact on financial statements
- Allocation to funds
- RSI schedules
- Statistical section
- Stakeholders
  - Governing body, constituents, employees, retirees
  - Rating agencies



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# City of Roseville OPEB Note Disclosure

## Changes In Net OPEB Liability

	<u>Total OPEB Liability</u>	<u>Fiduciary Net Position</u>	<u>Net OPEB Liability</u>
Balances as of June 30, 2020 (Measurement Date)	<u>\$ 225,754,000</u>	<u>\$ 109,681,210</u>	<u>\$ 116,072,790</u>
Service cost	5,414,588	-	5,414,588
Interest on total pension liability	14,125,117	-	14,125,117
Changes in assumptions	7,744,727	-	7,744,727
Contribution - employer*	-	15,353,152	(15,353,152)
Net investment income	-	28,457,424	(28,457,424)
Benefit payments	(10,333,464)	(10,333,464)	-
Administrative expenses	-	(81,197)	81,197
Net changes	<u>16,950,968</u>	<u>33,395,915</u>	<u>(16,444,947)</u>
Balances as of June 30, 2021 (Measurement Date)	<u>\$ 242,704,968</u>	<u>\$ 143,077,125</u>	<u>\$ 99,627,843</u>

Source: City of Roseville Comprehensive Annual Financial Report, June 30, 2021.



# City of Roseville OPEB Note Disclosure

## Net OPEB Liability of The City

The components of the net OPEB liability of the City at June 30, 2021, were as follows:

Total OPEB Liability	\$ 242,704,968
Plan Fiduciary Net Position	<u>143,077,125</u>
City's Net OPEB Liability	<u>\$ 99,627,843</u>

Plan Fiduciary Net Position as a Percentage of the Total OPEB Liability	58.95%
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Source: City of Roseville Comprehensive Annual Financial Report, June 30, 2021.



# City of Roseville Statistical Section

	2018	2019	2020	2021
Measurement Date	June 30, 2018	June 30, 2019	June 30, 2020	June 30, 2021
Net OPEB Liability/(Assets) - ending (a) - (b)	\$142,788,360	\$140,710,594	\$116,072,790	\$99,627,843
Plan fiduciary net position as a percentage of the total OPEB liability	37.07%	41.04%	48.58%	58.95%

Source: City of Roseville Comprehensive Annual Financial Report, June 30, 2021.



# When to Fund a Trust?

## ASAP

*Remember this is part of your long-term financial strategy*

- Reduces liabilities
- Improves balance sheet
- Broader investment opportunity
- Viewed positively by rating agencies, creditors, public



# QUESTIONS?



# PFMAM 2022 Capital Market Assumptions

	Intermediate: Next 5 Years		Long Term Projections	
	Expected Return	Expected Risk	Expected Return	Expected Risk
<b>US Equity</b>	7.2%	16%	7.6%	16%
<b>U.S. Small-Cap</b>	8.8%	19%	8.0%	19%
<b>Int'l Developed Equity</b>	7.5%	17%	7.3%	17%
<b>EM Equity</b>	7.5%	20%	7.7%	20%
<b>Non-US Small-Cap</b>	8.1%	20%	7.6%	20%
<b>Short-Term Bonds</b>	-0.1%	3%	3.0%	3%
<b>Core Bonds</b>	-0.9%	5%	3.9%	5%
<b>Global Core</b>	-1.8%	5%	3.2%	5%
<b>Int. IG Corp</b>	0.1%	7%	3.9%	7%
<b>Long IG Corp</b>	-4.2%	8%	4.4%	8%
<b>EM Debt</b>	2.5%	10%	4.9%	10%
<b>High Yield</b>	2.4%	9%	5.0%	9%
<b>Bank Loans</b>	4.2%	6%	4.7%	6%
<b>Private Debt</b>	6.7%	13%	6.8%	13%
<b>REITs</b>	6.3%	12%	6.6%	12%
<b>Private Real Estate</b>	7.0%	15%	7.9%	15%
<b>Infrastructure</b>	7.1%	18%	8.0%	18%
<b>Commodities</b>	2.8%	16%	4.2%	16%
<b>Hedge Funds</b>	5.8%	15%	6.3%	15%
<b>Private Equity</b>	10.1%	25%	9.2%	25%
<b>Cash</b>	0.8%	1%	2.2%	1%

For the intermediate term (up to 5 years), our capital market assumptions derive from our assessment of current economic conditions, including corporate profits, balance sheets, etc., and current valuations for various asset classes. Our long-term assumptions are derived using an economic building block approach that projects economic and corporate profit growth and takes into consideration the fundamental factors driving long-term real economic growth, our expectation for inflation, productivity and labor force growth.



# PFMAM 2022 Capital Market Assumptions

	U.S. Equity	U.S. Small- Cap	Int'l Developed Equity	EM Equity	Non-US Small-Cap	Short Bonds	Core Bonds	Global Core	Intermediate IG Corp	Long IG Corp	EM Debt	High Yield	Bank Loans	Private Debt	REITs	PE RE	Infrastructure	Commodities	Hedge Funds	Private Equity	Cash
U.S. Equity	1.0																				
U.S. Small- Cap	0.9	1.0																			
Int'l Developed Equity	0.8	0.8	1.0																		
EM Equity	0.7	0.7	0.7	1.0																	
Non-US Small-Cap	0.8	0.8	0.9	0.8	1.0																
Short Bonds	0.2	0.2	0.1	0.1	0.1	1.0															
Core Bonds	0.3	0.3	0.2	0.2	0.2	0.5	1.0														
Global Core	0.2	0.2	0.2	0.2	0.2	0.4	0.4	1.0													
Intermediate IG Corp	0.3	0.3	0.2	0.2	0.2	0.7	0.9	0.9	1.0												
Long IG Corp	0.3	0.3	0.2	0.2	0.2	0.7	0.9	0.9	0.9	1.0											
EM Debt	0.5	0.5	0.5	0.5	0.5	0.3	0.4	0.4	0.4	0.4	1.0										
High Yield	0.7	0.7	0.5	0.5	0.5	0.3	0.4	0.4	0.4	0.4	0.4	1.0									
Bank Loans	0.4	0.4	0.3	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.7	0.7	1.0								
Private Debt	0.6	0.6	0.4	0.4	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.8	0.7	1.0							
REITs	0.5	0.5	0.4	0.4	0.4	0.2	0.3	0.3	0.3	0.3	0.3	0.4	0.4	0.4	1.0						
PE RE	0.4	0.4	0.3	0.3	0.3	0.2	0.3	0.3	0.3	0.2	0.2	0.4	0.2	0.4	0.8	1.0					
Infrastructure	0.3	0.3	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.3	0.2	0.3	0.4	0.5	1.0				
Commodities	0.1	0.1	0.1	0.2	0.1	0.4	0.2	0.2	0.2	0.2	0.3	0.2	0.2	0.2	0.1	0.1	0.1	1.0			
Hedge Funds	0.6	0.6	0.5	0.5	0.5	0.3	0.4	0.4	0.4	0.3	0.3	0.4	0.4	0.4	0.4	0.3	0.3	0.2	1.0		
Private Equity	0.7	0.7	0.6	0.6	0.6	0.2	0.3	0.3	0.3	0.3	0.3	0.5	0.2	0.5	0.4	0.4	0.4	0.1	0.5	1.0	
Cash	0.1	0.1	0.1	0.1	0.1	0.5	0.2	0.2	0.2	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	1.0

Full PFMAM 2022 Capital Market Assumption Report available upon request.



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