



# NOVATO SANITARY DISTRICT

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August 14, 2013

The Honorable Judge James Ritchie  
Marin County Superior Court  
PO Box 4988  
San Rafael, CA 94913-4988

Rich Treadgold, Foreperson  
Marin County Grand Jury  
3501 Civic Center Drive, Room #275  
San Rafael, CA 94903

Subject: Grand Jury Report Response: "Marin's Retirement Health Care Benefits: The Money Isn't There"

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The 2012/2013 Marin County Civil Grand Jury released a report on June 3, 2013, "*Marin's Retirement Health Care Benefits: The Money Isn't There*" (Report). Novato Sanitary District discussed the report in the following publicly noticed meetings in accordance with the notice, agenda, and open meeting requirements of the Ralph M. Brown Act:

- June 10, 2013, Board of Directors Meeting;
- July 16, 2013, Finance Committee Meeting;
- August 12, 2013, Board of Directors Meeting.

The Report noted that Novato Sanitary District has the highest number of current retirees relative to active employees. (Page 8) This is due to two factors. First, the wastewater requirements increased significantly in 1972 with the passage of the Clean Water Act, which resulted in a large influx of workers into the field who are now reaching retirement age. Second, the District significantly reduced staff through partnering with Veolia for treatment plant operation resulting in substantial savings to the ratepayers, as well as a reduction in OPEB liability.

The Novato Sanitary District was listed as having an unfunded OPEB liability of \$6.1 million. This is based on the 2011 Actuarial study. The unfunded OPEB liability as of April 2013 is

\$5,347,276. The reduction is due to a reduction in the number of retirees as well as some employees leaving the District without applying for retiree medical. The District has been steadily reducing its OPEB liability since first becoming aware of the issue in 2005. The current liability is less than half the liability identified in 2005.

Novato Sanitary District uses a very conservative 4.0% discount rate, which makes their liability look significantly higher than agencies using the 7.5% discount rate. It is not possible to accurately compare the "unfunded liability" from different agencies without correcting for the different actuarial assumptions.

## FINDINGS

*F1. We find that many of Marin's local governments and special districts are failing to pre-fund future costs for retired employees by making investments to cover promised benefits for active employees. This jeopardizes the certainty that retiree health care benefits promised to current employees will be paid.*

***Novato Sanitary District partially disagrees.***

**Novato Sanitary District is pre-funding a portion of its retiree medical obligation through a Health & Welfare Trust Fund that was put into place in July 2008. All employees hired since July 1, 2008 are placed into the medical-after-retirement plan and the District contributes 1.5% of their salary to the plan. The District does have an unfunded liability for employees hired prior to July 1, 2008.**

F2. The failure of the majority of entities studied in this investigation to begin an investment program to provide a portion of the needed funds to pay for retiree health care benefits leads to generation shifting of the payment responsibility. Thus it appears to be, at the least unethical, and even a breach of fiduciary responsibility.

***Novato Sanitary District partially disagrees:***

**There are two reasons to set up a trust to fund the OPEB liability: 1. To recognize the expense as it is incurred, and 2. To use the increases from the invested money to offset the cost. Investment returns for the very conservative investments suitable for the District have not even kept up with inflation negating reason number two. District Counsel has advised that setting up a trust would reduce the District's flexibility to make any changes to the program such as trimming benefits or sharing costs with employees. The District is fully aware of its fiduciary responsibility and has been proactive in identifying and reducing its OPEB liability. The liability is clearly identified in its financial reports as required by GASB 45.**

F3. The extreme 30-year amortization period used by most entities minimizes the annual cost of funding the liability gap and further defers to future generations the

compensation owed to present employees who provide services to present taxpayers and customers. Shorter amortization periods should be required for reasons of equity and to ensure that the promised benefits will be provided.

***Novato Sanitary District disagrees:***

**GASB 45 requires that the cost of the OPEB be recognized in a systematic manner over the working careers of employees. Novato Sanitary District has elected to use the Entry Age Normal actuarial funding method with a closed 30-year level dollar amortization of the unfunded actuarial accrued liability to determine what the annual operating expense will be.**

- F4. By capping retiree health care benefits, the City of San Rafael has reasonable certainty as to what those costs are. Other entities studied here that promise to pay for future retiree health care with uncertain and likely rapidly increasing costs are accepting an unknown and potentially very costly risk.

***Novato Sanitary District agrees:***

**Novato Sanitary District recognized this risk earlier than most public agencies and took a number of steps to reduce the risk as early as 2008. The result was to halve the unfunded liability for OPEB and by reducing benefits for current employees and going to a defined contribution program for new hires.**

- F5. Because a few Marin County cities and other entities studied provide very limited benefits yet still appear able to meet community service needs, and because providing such benefits is increasingly rare in the private sector, such benefits appear to be unnecessary for attracting and retaining employees. Accordingly, for active and newly hired employees, the benefits should be trimmed and costs should be shared between the employees and their employer.

***Novato Sanitary District partially disagrees:***

**Novato Sanitary District's total retirement benefits, including pension and OPEB, are lower than those of similar agencies in the area. Unlike many local agencies, Novato Sanitary District never implemented the higher pension formulas. The high standards that must be maintained to protect the environment and public health require a well-trained and experienced workforce.**

- F6. Marin entities using "Pay-Go" funding are paying only the current year health care benefits of those already retired. This ignores the reasonably known rising costs to cover future retirees who are already heading for retirement. Some actuarial valuation reports the Grand Jury studied provide those future "Pay-Go" estimates year-by-year, so they should be readily available from the actuary's valuations. Estimates of those annual costs for each of the next 10 years should be provided to

the public so that those who will incur the costs can know those costs.

***Novato Sanitary District agrees:***

**Novato Sanitary District currently provides a five-year projection of OPEB costs to the public.**

- F7. Employers studied for this report should include an age-60, or even later, date for retiree health care benefits to commence in future negotiations with employees and their representatives.

***Novato Sanitary District agrees:***

**Novato Sanitary District currently requires employees that potentially qualify for retiree health care to be at least 55 and have 25 years of service or 60 and 15 years at the District to qualify for employee and spouse retiree health care coverage.**

- F8. The results of retiree health care actuarial cost analyses are summarized, if at all, only in obscure notes to annual financial statements. The public is entitled to more readily accessible explanation of these costs because the public will bear those costs.

***Novato Sanitary District agrees:***

**Novato Sanitary District posts biannual actuarial studies on its web site and the studies are discussed in open and noticed board meetings.**

- F9. There is a wide range of retiree health care benefits offered among the entities studied in this investigation. No clear explanation for the range from minimal to extremely generous is readily available. Those entities that are promising relatively generous benefits should provide clear justifications to their citizens and customers.

***Novato Sanitary District agrees:***

**Novato Sanitary District supports full disclosure of all financial information.**

- F10. Most of the entities the Grand Jury investigated are using fairly reasonable discount rates of 4% - 5% per year to bring back to today in actuarial valuations the future annual costs of retiree health care benefits. However, some are using higher and highly questionable rate assumptions that are not justified by the investments (if any) that they have made to grow and fund the future benefits. The result is to understate the total funding needed today and in future years, to pay for those future benefits.

***Novato Sanitary District agrees:***

**Novato Sanitary District uses the most conservative discount rate: 4%.**

## RECOMMENDATIONS

The Grand Jury recommends that each Marin County local government, special district and school district:

- R1. Begin setting aside in separate investment accounts, if it is not already doing so, each year's funds for amortizing its retiree health care benefits' UAAL, in addition to its "Pay-Go" funding of those benefits for present retirees.

### *Implemented*

**Novato Sanitary District has included funds to set up an OPEB account in the 2013-14 and 2014-15 budgets and will consult with legal and financial advisors as to the advisability of setting up a separate account.**

- R2. Begin a program to lower the amortization period for funding its retiree health care benefits UAAL from as much as 30 years presently, to approach (within 10 years), the commonly used 17-year amortization period for retiree pension funding.

### *Requires further analysis*

**Novato Sanitary District will consult with its financial advisors with regard to the amortization period for the next biannual actuarial evaluation.**

- R3. Negotiate caps on the amounts it commits to pay existing and new employees for retiree health care benefits.

### *Implemented*

**Novato Sanitary District has already negotiated reduced OPEB benefits for employees hired before July 1, 2008. Employees hired since July 1, 2008 are in a defined benefit plan for OPEB. OPEB continues to be a subject of negotiations.**

- R4. Negotiate a higher retirement age than the currently applicable age for the commencement of retiree health care benefits.

### *Implemented*

**Novato Sanitary District negotiated an increase from age 50 to 55 and 60 for commencement of retirement benefits in 2008.**

- R5. Require active employees to make a contribution towards the cost of their retiree health care benefit.

### *Requires further analysis*

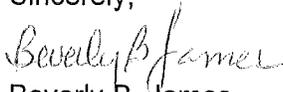
**The District will take this under consideration in future negotiations.**

- R6. Place a link on its website to provide the latest actuarial valuation of its AAL, its UAAL, its consequent percent funded, its discount rate (annual percentage) used to determine these values, and a projection of outlays ("Pay-Go") for retiree health care benefits for each of the current and subsequent 10 years.

***Implemented***

**Novato Sanitary District posts the current OPEB actuarial valuation prepared in May 2013 on our website.**

Sincerely,



Beverly B. James  
Manager-Engineer