A MONTHLY REPORT FROM STATE CONTROLLER BETTY T. YEE

California Fiscal Focus

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CA Controller Reports State Revenues Top January Projections

California revenues of $15.04 billion for January beat projections in the proposed 2017-18 budget Governor Jerry Brown introduced last month by $884.4 million, or 6.2 percent, State Controller Betty T. Yee reported.

In December, the “big three” sources of California general fund dollars—personal income taxes, corporation taxes, and retail sales and use taxes—all fell short of monthly and fiscal year-to-date budget estimates. For January, all three outpaced 2016-17 Budget Act assumptions and projections in the governor’s proposed 2017-18 budget.

For the first seven months of the fiscal year that began in July, total revenues of $66.76 billion are now $392.5 million below last summer’s budget estimates, and just $115.5 million short of January’s revised fiscal year-to-date predictions, or 0.2 percent.

January PIT of $13.27 billion topped projections in the governor’s proposed budget by $237.2 million, or 1.8 percent. In the current fiscal year, California has collected total PIT receipts of $47.85 billion, just 1.0 percent shy of January’s revised estimate.

Corporation tax receipts of $420.5 million for January were nearly double the assumption of $213.8 million laid out in the proposed 2017-18 budget. Fiscal year-to-date corporation tax receipts of $3.65 billion are $211.5 million above projections in the proposed 2017-18 budget, or 6.1 percent.

January retail sales and use tax receipts of $1.17 billion for January outpaced expectations in the governor’s proposed 2017-18 budget by $376.8 million, or 47.4 percent. For the fiscal year to date, sales tax receipts of $13.23 billion are $96.7 million above the revised estimates released in January, or 0.7 percent.

The state ended January with unused borrowable resources of $28.38 billion, which was $3.80 billion more than predicted in the governor’s proposed budget, or 15.4 percent. Outstanding loans of $11.70 billion were $83.6 million higher than projected in early January. This loan balance consists of borrowing from the state’s internal special funds.

For more details, read the monthly cash report.

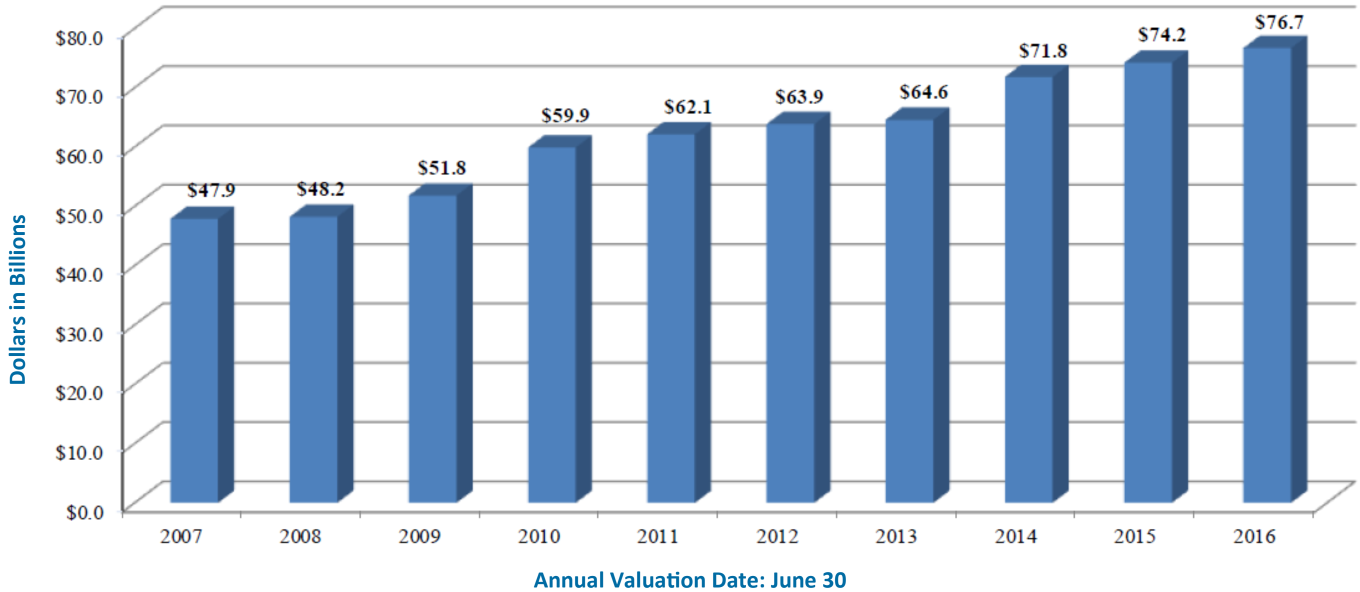
Inside this issue

New Accounting Standards for Retiree Health Costs

Figure 1

California's 10-year Retiree Health Care Unfunded Liability Growth

Source: Gabriel Roeder Smith & Company, Consultants & Actuaries (December 12, 2016)



For the last 10 years, the California State Controller's Office (SCO) has reported actuarially accrued liabilities for public sector retirees' health care expenses known as other post-employment benefits, or OPEB. On January 25, SCO issued its latest valuation using Governmental Accounting Standards Board (GASB) rules to show accumulated debts for future retiree health coverage.

This report complies with several changing federal standards intended to enhance accounting and financial reporting for all post-employment benefits (pensions and OPEB), improve transparency and accountability regarding the state's long-term debts, and support better decision-making to address them. As a consequence, California is starting to make significant progress from only paying for current-year costs to saving for future obligations.

The state's 2016 Comprehensive Annual Financial Report (to be published in March) will show a debt of $26 billion for accrued obligations to current public employees and retirees. In Fiscal Year 2017-18, a new GASB standard will require the state to report OPEB obligations on its balance sheet, accounting for actuarial liabilities for all future employees and retirees for the next 30 years. Using the new rule, the SCO actuarial valuation reports this debt to be $76.68 billion in 2016, up from $74 billion in the prior year.

OPEB obligations usually reflect health care benefits pledged to retirees, but they may also include benefits such as long-term care or life insurance. The SCO actuarial liabilities only account for those obligations funded by the state, excluding employee contributions paid as premiums or co-insurance, in addition to other benefits offered completely at employee expense.

In keeping with older cash-based reporting obligations, the state's

(See OPEB, page 4)

Retiree Health Valuation Shows Savings from Benefit Design

The latest SCO actuarial valuation shows an unfunded liability of $76.68 billion for California's future retirees' health care costs. The state's obligation for future retirees is reported at net present value based on anticipated health care cost trends, retirement rates, and future retiree life spans.

In addition to demographic changes, longer survival rates, and increasing health care costs, strategies to improve health care delivery and reduce claims are major factors used to measure the state's long-term debt for retiree health care. In fact, in the latest SCO actuarial valuation, demographics and cost trends increased. At the same time, design changes and other improvements in claims experience reduced the growth of debt by almost $1.5 billion.

Some of these improvements reflect strategies by CalPERS to manage the cost of covering more than 800,000 state workers, retirees, and their dependents. These workers comprise a majority of the more than 1.4 million covered lives in CalPERS' health care coverage pool. One notable step reflected in the recent SCO valuation was a decision by the CalPERS Board of Administration to streamline, which was estimated to save $24 million per year when it was adopted in the spring of 2015.

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Other factors that affect the state's long-term liability for retiree health care include changes in Medicare payment rules and employee premium contributions. Concurrently, CalPERS has initiated cost-savings strategies over the years, including integrated health care delivery models, reference pricing for expensive hip and knee replacements, and prescription benefit strategies to encourage use of the lowest-cost medicines.

In January, as part of several newly anticipated initiatives, the CalPERS Board discussed a new concept known as value-based insurance design, focused on promoting preventative care and incentives for using only high-value services. They are contemplating adjusting co-pays and deductibles to encourage preventative care and earlier treatment for costly ailments such as diabetes, hypertension, and pulmonary disease.

These initiatives complement other "value-to-volume" strategies used by large employers and emphasized through the Affordable Care Act and Medicare to save costs.

Many details remain to be developed. However, this is one example where health care delivery design changes have shown cost savings in current years and bent the cost curve for long-term retiree health costs.

(OPEB, continued from page 2)

retiree health care obligations have continued to be covered on a pay-as-you-go basis, as each year's costs must be paid. This has been the practice even as an older GASB accrual standard shows mounting obligations for future costs for current workers and retirees. The new GASB standard accounts for anticipated costs for future benefits for future workers and retirees using anticipated health care cost trends, retirement rates, and future life spans to report the amount the state must pledge in the current year to meet all eventual obligations.

The pledge, or annual required contribution, is calculated as the net present value of these anticipated future benefit payments, with interest costs amortized over 30 years. Any current assets pledged for future obligations are subtracted. With the pay-as-you-go approach, few assets for future liabilities accumulate to offset the growing unfunded liability. Even as the state contributed $2.1 billion in the last fiscal year to meet these obligations, the annual required contributions to fully cover them are estimated to reach $5.77 billion by the end of this fiscal year.

To cover this mounting debt, the state has slowly begun to build up assets, a change that has increased significantly in the last two years. In his January 2015 budget proposal, Governor Brown suggested funding the actuarial liability with equal contributions from the state and its employees, to be negotiated through the collective bargaining process. At the end of last fiscal year, five of the state's 21 collective bargaining agreements provided contributions, meeting two-tenths of one percent of what the state needed to save in that year to cover these obligations.

As reported last month in the governor's FY 2017-18 budget proposal, the administration has reached agreements with all but one of the state's bargaining units, including an agreement with the nine bargaining units represented by the Service Employees International Union, Local 1000—the state's largest public employee union.

As savings accumulate, they can be invested in the same manner as pension funds with anticipated earnings to meet future obligations. The California Public Employees' Retirement System (CalPERS) already has approximately $400 million set aside in the California Employers' Retiree Benefit Trust Fund. By the end of FY 2017-18, the state's trust fund balance is anticipated to more than double to $1 billion in assets.

As with a pension plan, when accumulated assets earnings contribute significantly to building up funds needed to cover future obligations, the state's OPEB obligations will provide for a discount rate to account for these earnings. By using the new GASB standards, the state will not only be able to identify all of its debt, but also track its strategy to fund it over time.

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