

CITY OF GAINESVILLE
RETIREE HEALTH CARE PLAN

2003 ACTUARIAL VALUATION
INCLUDING IMPACT OF REVISED
PLAN PROVISIONS EFFECTIVE
JANUARY 1, 2004

JANUARY 2005

Actuarial Concepts

Management Advisors

Benefit Specialists

January 21, 2005

Mr. Mark S. Benton
Finance Director
City of Gainesville
P. O. Box 490
Gainesville, Florida 32602

Dear Mr. Benton:

This report presents the results of the October 1, 2003, actuarial valuation of the City of Gainesville Retiree Health Care Plan incorporating revisions to Plan provisions effective January 1, 2004, and current actuarial assumptions. Actuarial Concepts was retained by the City to perform the actuarial valuation and prepare this report.

The major purpose of the valuation is to determine the liabilities and related annual funding for the Retiree Health Care Plan. A summary of results is provided in Section 1. The methodology involved in the valuation process is summarized in Section 2. The recommended contributions to the Plan effective for the 2005-2006 fiscal year are presented in Section 3.

A review of the valuation methodology is important in interpreting the welfare plan expense estimate, as well as in judging its limitations. The valuation is based on employer reimbursement of a certain percentage of average medical premiums, subject to such percentage being earned by a participant based on age at benefit commencement and number of years employed by the City.

The actuarial computations and report have been prepared in accordance with generally accepted actuarial principles and practices, with full reliance on the accuracy and completeness of the information provided for this purpose. The use of the valuation results for financial or administrative purposes, other than those outlined in the report, is not recommended without an advance review by Actuarial Concepts of the appropriateness of such application.

Mr. Mark S. Benton
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We would be pleased to discuss the results of the 2003 valuation and to provide any additional information that may be desired.

Very truly yours,

ACTUARIAL CONCEPTS

By: 
Michael J. Tierney
ASA, MAAA, FCA, EA #02-1337

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SECTION 1

KEY VALUATION RESULTS SUMMARY

The 2003 actuarial valuation of the City of Gainesville Retiree Health Care Plan presents a statement of the financial status of the Plan as of October 1, 2003. This report establishes the contribution recommendation for the 2005-2006 fiscal year.

Key Results Synopsis

The major conclusions of the report are:

- The Plan experienced an overall actuarial loss over the last 36 months of approximately \$9.3 million due to adverse retiree medical claim experience. Offsetting this increase were reductions in future expected premiums due to the Plan restructuring, creating a decrease in unfunded liabilities of about \$2.5 million.
- The City and Member contribution rates have significantly increased since the last valuation, due to necessary increases in the retiree medical premium structure. Total City recommended contributions for the 2005-2006 fiscal year are \$4,654,523 or 4.69% of anticipated active member payroll.

Changes Since Last Valuation

There have been no changes to the actuarial assumptions or actuarial cost method since the last valuation.

The valuation is based on revised plan provisions effective January 1, 2004.

The per capita cost structure and premium trend rates are discussed in Section 2, and valuation results are presented in Section 3. Summary of plan provisions is contained in Appendix A and actuarial assumptions and cost method are described in Appendix B.

SECTION 2

VALUATION METHODOLOGY

Date and Basis of Valuation

Actuarial present values (APVs) of projected medical benefits to be provided by the Retiree Medical Insurance Plan have been estimated as of October 1, 2003, based upon:

1. the revised provisions of the Plan effective January 1, 2004, as summarized in Appendix A;
2. the actuarial assumptions and actuarial cost method, as summarized in Appendix B; and
3. the participant data provided by the City and Blue Cross Blue Shield of Florida (BCBSF), as summarized in Appendix C.

The employee data has been supplied by the City and BCBSF and provided as accurate for the current active and retiree group. While the employee information was reviewed for overall reasonableness, Actuarial Concepts has relied on the City and BCBSF for this information and does not assume responsibility for either its accuracy or completeness.

The 2003 actuarial valuation presents a statement of the financial status of the Plan as of October 1, 2003. Information in the report provides a basis for determining funding for the retiree medical plan. Results are presented in Section 3.

Per Capita Cost Structure

The methodology underlying the 2003 APV determinations of the Plan involves determining the discounted present value of a series of future health benefit premiums payable over each current and expected retiree's future remaining lifetime.

Current Plan

In 1995, the City instituted cost-sharing with the retired employees for individual coverage only, based on a formula taking into account age and service at time of retirement. That is, the City pays up to 50% of the individual premium for each insured according to the age/service formula factor of the retiree, i.e., the retiree's benefit accrual rate. Spouses and other dependents are still eligible for coverage, but the employee is responsible for the entire cost; there is no direct City subsidy.

Specifically, the following benefit accrual formula is applied to the individual premium:

- 2% per year for the first 10 years of service
- 3% per year for the next 10 years of service
- 2% per year for each year of service thereafter
- 2% increase for each year older than age 65 at coverage commencement
- 2% reduction for each year younger than age 65 at coverage commencement

The above components combined are limited to 50% (i.e., the City will provide no more than a 50% subsidy).

Premiums for individual coverage for the Plan the Retirees are assumed to elect (Preferred Patient Care with current deductible of \$300) are anticipated to be \$233.72 per month effective January 1, 2003.

For example, an employee who retires with at least 20 years of service at age 65 would have a subsidy rate of 50%. Under current premium costs, this would mean that the City would pay \$116.86 and the employee would be responsible for paying the remaining \$116.86 of the total \$233.72 premium.

Transition Plan

Every current retiree and current active employee with more than 10 years of service as of April 1, 1995, is eligible for a plan of "transition benefits" that provide increased subsidies over those of the "ultimate" Retiree Health Care Plan.

Assumed Future Cost Escalation and Sharing

The valuation assumes that the City will be responsible for its proportionate percentage share of the future health premiums. The valuation also assumes current premium costs will escalate 7% per year. This premium cost escalation would be assigned pro rata to the City and retiree. For a transition employee who retires, for example, at age 65 with 20 years of service, the cost at normal retirement date is split 80%/20%, with the City paying \$186.98. Ten years from now, the \$233.72 total premium is assumed to escalate to \$459.76. The City would be responsible for 80% of this amount, or \$367.81.

Assumed behavior regarding the future increases in the retiree-paid premium is significant in the estimation of future costs. As indicated above, this valuation analysis assumes that the percentage of current total costs that the current retiree premium represents would continue to exist in the future as costs (and related premiums) are increased. If total medical costs were to increase 15%, this valuation projection assumes that the retiree portion would also be increased by 15%, thus keeping the employer portion of the total cost intact.

It should be kept in mind that actual cost estimates for the retiree participant are expected to be higher than costs for active employees. However, since medical costs are averaged for all groups combined, the resultant average premium reflects a rate that is less than the actual retiree expected costs, but more than the expected active participant costs. Note that these average premiums are used to project future health premiums for currently active employees but to be applicable only after retirement.

Premium Trend Rate

The premium trend rate is assumed to be 7% per year. The premium cost trend rate is an assumption about the annual rate of change in the per capita cost of health care benefits provided by the Plan. It implicitly considers estimates of medical cost inflation, changes in utilization and technological improvements.

In determining an appropriate medical cost inflation rate, the medical care component of the Consumer Price Index for Urban Consumers (CPI-U) was analyzed. The following table shows the levels of the CPI-U indices for "all items" and "medical care" only during December for the most recent 10 years:

CPI-U (1967=100) (Unadjusted)	All Items	% Change	Medical Care	% Change
December 1994	448.4		764.3	
December 1995	459.9	2.6%	794.1	3.9%
December 1996	475.0	3.3%	817.9	3.0%
December 1997	483.2	1.7%	840.8	2.8%
December 1998	491.0	1.6%	869.4	3.4%
December 1999	504.1	2.7%	901.6	3.7%
December 2000	521.1	3.4%	939.5	4.2%
December 2001	529.2	1.6%	983.6	4.7%
December 2002	541.9	2.4%	1032.8	5.0%
December 2003	552.1	1.9%	1071.0	3.7%

The increases in these indices from December 1994 to December 2003 were 23.1% (2.1% per year) for "all items" and 40.1% (3.4% per year) for "medical care" items. Therefore, during this period, the increase in costs for medical care is 163.2% of the CPI taken as a whole.

While this comparison is one measure of the increase in the cost of medical care, it is probably not a good measure of the cost increase experienced by group health plans. The medical care component of the CPI reflects how individuals spend their health care dollars, including the retiree payment of health insurance. Not reflected in this component is the amount of employer contributions nor the effect of increased use of health facilities. Neither does this component reflect the leveraged effect of employer-absorbed increases in total costs.

In addition to increasing prices, there are other factors affecting the costs of group health plans that result in cost increases exceeding the medical care component of the CPI:

1. Increased utilization, both in the frequency of services and in the scope or intensity of those services.
2. Cost shifting, resulting from the lack of full reimbursement to providers by Medicare and Medicaid.

3. Cost leveraging where, due to annual deductibles and coinsurance provisions, Plan costs increase more than medical expenses increase (e.g., if deductibles and coinsurance limits are frozen, a 10% increase in medical expenses might lead to a 15% increase in Plan costs).

Most group health plans recently have experienced cost increases of approximately 15-20% per year as medical expenses have increased more rapidly than before, and consolidation in health providers has resulted in a somewhat less competitive market. Many group health insurers continue to anticipate cost trends in excess of the medical component of the CPI.

The premium structure to be applicable starting January 1, 2004, provides for notable decreases over the assumed medical trend premium. Based on the assumed medical trend, the October 1, 2003, medical premium was projected at \$243.07 and the premium now applicable is \$233.72.

Over the last 10 years, the average rate of increase of the medical component of the CPI was 163% of the CPI as a whole. For valuation purposes, we have assumed the health care cost trend rate ultimately settles at 175% of a 4% long-term rate of inflation or 7%.

SECTION 3

RECOMMENDED FUNDING

Funding Approach

The Individual Entry Age Actuarial Cost Method was used. This method assigns total projected costs as a level percent of pay over each employee's anticipated work years. The funding arrangement consists of two components: one, an ongoing cost (called normal cost), and the other, a temporary cost to provide for payment of costs assigned to prior years but not funded during those years (called amortization payment).

Valuation Components

Actuarial Present Value (APV) of Future Benefits

The APV of future benefits is determined by first measuring what future subsidy would be available for each employee at various future dates (assuming future service credits earned and expected age at retirement) upon retirement or disablement. Then the future value of those benefit entitlements is determined by multiplying the various subsidy amounts by the then current value of the annuities associated with those amounts. Finally, the APV of those future benefit values is determined by applying discounts to recognize the time value of money and probabilities of death, withdrawal, termination of employment, etc.

APV of Total Future Normal Costs

The APV of future normal costs is that portion of the total APV of future benefits, as described above, that is assigned to future plan years by the Individual Entry Age Actuarial Cost Method (described in Appendix B).

Actuarial Accrued Liability (AAL) and Unfunded Actuarial Accrued Liability (UAAL)

The AAL and the UAAL (the AAL less the actuarial value of assets) are actuarial values generated under the Individual Entry Age Actuarial Cost Method, as described in Appendix B. These liability amounts are not the APV of benefits accrued to date by employees. They are actuarially determined amounts based on the accrual of Individual Entry Age normal cost amounts due prior to the valuation date.

Normal Cost

The normal cost represents the ongoing long-term estimate of costs for the proposed schedule of City subsidies. It has been derived as a level percentage of each year's anticipated payroll. As determined by the Individual Entry Age Actuarial Cost Method, it represents the current year's allocation of the APV of total future normal costs. In the absence of actuarial gains or losses, charges to the Plan or changes in the characteristics of the participating group, the normal cost percentage is expected to remain level over time, and the normal cost amount is expected to increase as payroll increases.

Amortization Payment

The amortization payment is a temporary payment that will disappear at the end of the amortization period. It represents the funding of normal costs assigned to past periods. Once the past normal costs have been funded, amortization payments stop. The UAAL is being amortized over a period of 20 years from October 1, 1994. The amortization incorporates the assumption that Plan payroll will grow at the rate of 4% per year over the 20-year period. Starting from October 1, 2004, the changes in the UAAL due to plan changes, assumption changes or plan experience will be amortized over 10 years from inception.

Recommended City Contribution

The recommended funding of the City's Retiree Health Care Plan consists of the ongoing normal cost plus the amortization payment associated with the 20-year funding of the UAAL. The contributions provided are effective for fiscal year 2005-2006, and include adjustments to reflect delay in amortization of the new UAAL experience loss and growth in valuation payroll from the valuation date to date of payment.

Plan Experience

Adverse claims experience has served to increase significantly the Plan liabilities over that previously expected. The actual costs charged to the retiree medical fund were substantially in excess of the premiums allocated to the City and retirees. This as well as other adverse demographic plan experience has resulted in a \$7.5 million actuarial loss. (Additional losses of \$1.8 million occurred due to investment earnings less than assumed.)

CITY OF GAINESVILLE RETIREE HEALTH CARE PLAN

Valuation Financial Values

	10/1/2000	10/1/2003
1. Actuarial Present Value (APV) of Future Benefits		
(a) Active Employees with less than 10 Years of Service	\$ 2,780,452	\$ 3,464,867
(b) Active Employees with between 10 and 20 Years of Service	6,997,561	5,930,755
(c) Active Employees with at least 20 Years of Service	7,750,088	7,508,061
(d) Current Retirees and Disableds	15,900,455	26,533,286
(e) Total	<u>\$ 33,428,556</u>	<u>\$ 43,436,969</u>
2. APV of Future Normal Costs	3,617,460	3,827,275
3. Actuarial Accrued Liability [(1)-(2)]		
(a) Active Employees with less than 10 Years of Service	947,734	1,128,234
(b) Active Employees with between 10 and 20 Years of Service	5,600,569	4,802,588
(c) Active Employees with at least 20 Years of Service	7,362,338	7,145,586
(d) Current Retirees and Disableds	15,900,455	26,533,286
(e) Total	<u>\$ 29,811,096</u>	<u>\$ 39,609,694</u>
4. Actuarial Value of Assets	4,674,726	8,974,921
Unfunded Actuarial Accrued Liability [(3)-(4)]		
(a) Active Employees with less than 10 Years of Service	947,734	1,128,234
(b) Active Employees with between 10 and 20 Years of Service	5,600,569	4,802,588
(c) Active Employees with at least 20 Years of Service	7,362,338	7,145,586
(d) Current Retirees and Disableds	11,225,729	17,558,365
(e) Total	<u>\$ 25,136,370</u>	<u>\$ 30,634,773</u>
6. Normal Cost*	455,427	495,773
Normal Cost Rate	0.59%	0.50%
7. UAAL Amortization Payment*	\$ 2,554,789	\$ 4,158,750
UAAL Amortization Payment Rate	3.30%	4.19%
8. Total Recommended Contribution [(6)+(7)]*	\$ 3,010,216	\$ 4,654,523
Percentage of Payroll	3.89%	4.69%

* Payments start 2 years from valuation date;
includes a payroll growth rate of 4% per year.

Development of Unfunded Actuarial Accrued Liability (UAAL)

1.	UAAL as of 9/30/2000	\$ 25,136,370
2.	Normal Cost	455,427
3.	Interest on (1) to 9/30/2001	2,262,273
4.	Contributions	2,370,021
5.	Interest on (4) to 9/30/2001	106,651
6.	Expected UAAL as of 9/30/2001 [(1)+(2)+(3)-(4)-(5)]	<u>\$ 25,377,399</u>
7.	Normal Cost	473,644
8.	Interest on (6) to 9/30/2002	2,283,966
9.	Contributions	3,285,900
10.	Interest on (9) to 9/30/2002	147,866
11.	Expected UAAL as of 9/30/2002 [(6)+(7)+(8)-(9)-(10)]	<u>\$ 24,701,244</u>
12.	Normal Cost	492,590
13.	Interest on (11) to 9/30/2003	2,223,112
14.	Contributions	3,380,217
15.	Interest on (14) to 9/30/2003	152,110
16.	Expected UAAL as of 9/30/2003 [(11)+(12)+(13)-(14)-(15)]	<u>\$ 23,884,619</u>
17.	Changes in UAAL due to:	
	(a) Premium Update	(2,531,822)
	(b) Assumptions Changes	-
	(c) Actuarial (Gain)/Loss	9,281,975
18.	UAAL as of 10/01/2003 [(11)+(12a)+(12b)+(12c)]	<u>\$ 30,634,773</u>