

R E C E I V E D

Town of Acton
OPEB Working Group

APR 3 2013

TOWN CLERK, ACTON

Date: Wednesday, October 3, 2012 7:00p.m.

Place: Superintendent's Conference Room

RJ Grey Junior High

Attendees: D Clough, D Bruce, D Aicardi, S Barrett, R

Evans, S Noone

Public: A Nitschelm

Organizational Items

a. Election of Chair

Steve Noone was elected Chair

b. Schedule of Meetings

It was agreed that we try to meet every two weeks

c. Decision Process (Consensus vs. Votes)

It was agreed that decisions would be made by consensus

2 Discussion of the group's objectives and timetable as indicated by the Acton Leadership Group

It was agreed that we would do our best to recommend a number for budget planning to ALG by mid- December, however the key deliverable of the group would be a funding policy, which would not be completed by that time

3 Review work done by Finance Committee's OPEB subcommittee

The group discussed many questions, thoughts and ideas about OPEB. The chair asked each member to submit their ideas in writing

4 Next Steps

S Barrett and D Aicardi agreed to conduct a review of less than full time employees

S Barrett, D Aicardi, and S Noone would have a conference call with Segal & Company to obtain answers to questions the group had on the actuarial study

Meeting was adjourned

DRAFT FOR COMMENT

OPEB Addendum Sept 2012

During the summer of 2011 a subcommittee of the Finance Committee undertook a project to write a white paper on the topic of Other Post Employment Benefits or OPEB. Recent changes in accounting rules by the Government Accounting Standards Board (GASB) require calculation and disclosure of liabilities that had not previously been recognized on the financial statements of public entities.

Drawing on a variety of source material including an actuarial report prepared by The Segal Company the subcommittee reported that as of December, 2010 the total unfunded liability was as follows;

| | <u>Acton</u> | <u>ABRSD</u> | <u>Total</u> |
|------|--------------|--------------|---------------|
| 2010 | \$57,330,858 | \$43,598,441 | \$100,929,299 |

While there is not now a GASB requirement to fund the liability, the expectation is clear that it should be funded. Without funding or other mitigation, the total liability continues to grow potentially reaching \$400 million by 2038 for the combined Town and the Acton portion of the regional school district's responsibilities.

To put the obligation in perspective, as of July 30 2010, the Net Assets (Assets less Liabilities) of the Town and Regional School District were \$165.1 million and \$38.9 million respectively.

Those numbers do not reflect the whole OPEB liability but only the portion that represents the difference between what was paid and the Annual Required Cost or (ARC) from 2009 and 2010, which is what the accounting standard requires

The terminology of funding is as follows:

Normal Cost
Amortization of Unfunded Liability
Annual Required Cost (ARC)

The Normal Cost covers current year payments and an actuarially determined amount for future costs attributable to current year service. The Amortization of Unfunded Liability amortizes that amount by one of two approved methods. The Annual Required Cost or ARC is the sum of the first two.

Acton and the ABRSD use "pay as you go." That means that although we are paying the current year premiums, we have not set aside funds to pay for the cost of;

- providing healthcare to our retirees
- providing healthcare to our current employees when they retire

In essence by statute, we have made promises to pay in the future for services provided but have not put any funds aside to pay for it.

The amount of OPEB liability reflected in the 2010 Financial Statements is \$5.6 million for the Town and \$5.0 Million for the District and these numbers are each growing at a rate of about \$5.0 million per year.

The OPEB issue is what that significantly impacts every level of government both within Massachusetts and the nation.

After reviewing the requirements of the GASB and looking at what other municipalities were doing the subcommittee recommended

Establish an OPEB Trust

The Trust should be set up to qualify for the higher investment returns, but it should contain language such that the funds cannot be used to fund current year employee benefit costs, until and unless the liability for post-employment benefits is either eliminated by legislation or assumed by some other governmental entity

Begin to fund some amount in recognition of the liability that we have.

Partial funding of the ARC should be made into that irrevocable trust to gain full advantage of more favorable discount rates in calculating the unfunded liability. Given the degree of uncertainty around the issue a conservative contribution is appropriate. There could well be changes on the state and national level that would impact the measurement of the liability and the funding requirements

Such funding should be subject to a vote at the Annual Town Meeting.

Funding recommendation for the first year was \$2,200,000, which is approximately equal to the unused portion of last year's FY12 Appropriated budgets and assessments. It also represents approximately 46% of the Annual Required Cost or ARC

Consider potential changes that can be implemented locally, or that may be enabled by future legislative changes, to modify the measurement of the liability such as.

- Increases in deductibles and co-pays
- Proration of health insurance benefit based on hours worked
- Restricted availability
 - Must retire from the town with at least X years of service
 - If less than Y years of service with town, then a higher coshare by the retiree

A majority of the Finance Committee supported the recommendations to set up trusts and begin to fund the OPEB Liability. However the majority did not support the \$2,200,000 amount and instead opted for an amount of \$500,000. That amount was ratified by the Acton Leadership Group.

In the spring of 2012, Both the Acton Boxborough Regional School Committee and the Acton Town Meeting voted to establish the trusts and fund their proportionate shares of \$500,000 amount.

During the same period, negotiations concerning healthcare plan design occurred between the Town, Schools, and a coalition of representatives of collective bargaining units. These negotiations resulted in changes to the cost sharing formula and plan design that reduced the calculated OPEB liability by \$13.6 million.

Subsequent to the 2012 Annual Town meeting the Acton Leadership Group agreed to establish an OPEB Working Group consisting of a member from the Board of Selectman, the School Committee, Finance Committee, Health Insurance Trust, and town staff and school staff. The group is tasked with developing solutions including funding recommendations to assist the ALG in planning for FY14.

To expedite efforts of the OPEB Working Group the OPEB subcommittee resumed meeting monthly in June 2012 continuing over the summer to discuss and quantify various solutions.

Defining potential solutions for OPEB is a difficult task at best. It is complicated by the fact that the size of the problem has changed and will continue to change over the years due to shifts in actuarial assumptions as well as healthcare plan design and demographics. Also the underlying legal framework of Massachusetts General Laws and collective bargaining agreements may be altered as municipalities in other states have been declaring bankruptcy, citing OPEB as a contributing cause.

Any local solution to the OPEB issue needs to be part of a comprehensive long range financial plan; the amounts are too large to be dealt with in isolation.

For now, we can work with what we know. The OPEB contribution required to put the town and schools us on track to solve the problem called the Annual Required Contribution (ARC) is approximately \$5 million per year. The numbers that we are dealing with are based on a single set of assumptions and as such will always be subject to doubt.

For example, other actuaries provide a sensitivity analysis on key assumptions in their reports. In a report for the Town of Canton, Stone Consulting stated that a 1% increase in the assumption on health care cost trend would increase the total liability by 19% and the ARC by 26%. On the other hand a 1% decrease would reduce the total liability by 14% and the ARC by 19%

We have by no means exhausted the entire spectrum of health insurance plan design changes for Acton's employees, but assuming no further changes, the issue as it stands today can be put into perspective.

The following six scenarios quantify the impact of getting our annual OPEB contribution equal to the ARC. The scenarios have been evaluated using the Finance Committee Long Range Planning Model favorable case.

In these scenarios it is assumed for purposes of illustration, that we fund OPEB as follows FY14 \$1,000,000, FY15 \$2,000,000, FY16 \$3,500,000, and FY17 \$5,000,000. All other assumptions in the model including reserve use remain the same. Each scenario suggests a funding mechanism.

Scenario 1 Assumption is funding by recurring property tax overrides. Increase taxes by a total of 5% per year, the normal 2.5% plus an override of 2.5%

Scenario 2 Assumption is that the State funds the ARC by increasing State Aid 14% per year, every year

Scenario 3 Assumption is all salaries of current employees are frozen for FY14 and FY15, followed by a 0.5% increase in FY16 and a 1.5% increase in FY17

Scenario 4 Assumption is that the current employer cost share of health insurance of 75% be dropped to 50% and assumed by current employees.

Scenario 5 Assumption is that funding comes from a single Operating or debt exclusion override of 7.5% which when coupled with the normal 2.5% would mean a 10% tax increase in FY14.

Scenario 6 Assumption is for an across the board decrease in salary cost of 9% for current employees in FY14 either through reduction in salaries or reductions in FTE's

The following table shows the Net Position that results from each of these scenarios. The first line shows the current projected net position from the Finance Committee Long Range Plan, Favorable Case, adjusted for the higher OPEB contributions mentioned above. These contribution amounts and solution scenarios are offered as illustrations only and should not be construed as recommendations.

| | Net Position \$000 | | | | |
|---|-----------------------|-------|-------|-------|------------|
| | FY14 | FY15 | FY16 | FY17 | Cumulative |
| Favorable Case excluding OPEB | 350 | -481 | -1167 | -2286 | -3584 |
| OPEB contribution equal to ARC in FY17 | 1000 | 2000 | 3500 | 5000 | 11500 |
| Favorable Case Incr. OPEB | -650 | -2481 | -4667 | -7286 | -15084 |
| Scenario 1 Taxation recurring overrides | 1026 | 1007 | 779 | 270 | 3082 |
| Scenario 2 State Aid | 755 | 560 | 277 | -138 | 1454 |
| Scenario 3 Salary Freeze | 980 | 836 | 148 | -1408 | 556 |
| Scenario 4 Cost Share to 50% | 3081 | 1511 | -396 | -2715 | 1481 |
| Scenario 5 Single Override | 4379 | 2673 | 616 | -1871 | 5797 |
| Scenario 6 Wage and Salary reduction | 2423 | 3796 | 1820 | -580 | 7459 |

There are many other scenarios that can be conceived of and indeed the solution may very well be a combination of several of these approaches.

What is clear from this illustration is any solution will represent significant change. The scenarios that use reductions in personnel cost and benefits cannot be implemented without the agreement of the employees. Furthermore none of these scenarios actually represent a long term solution since the net position is negative in FY17 in scenarios 2-6 and will be negative for FY18 in scenario 1.

Many of the unknowns of 2011 are still unknown in 2012, namely the accuracy of the prescribed calculation method, the potential for change in the underlying mandates, and the potential for change in healthcare delivery and cost

However it is important to note that solutions to the OPEB issue can come about from other means.

Further changes to eligibility and plan design are possible and should be studied and evaluated.

Eligibility

Currently, an employee must work 20 hours a week for 10 years to qualify for post- retirement health coverage. Also state law mandates that spouses be covered as well as the employee

The Massachusetts Department of Revenue suggests all municipalities review all positions that are eligible for health benefits, considering the long term impact of providing health insurance to employees not working full time in the service of government. DOR also suggests that it is valuable for all municipalities to evaluate current business practices and policies with an eye for long range fiscal feasibility.

Some states have voter to amend current statutes and change ongoing municipal responsibilities. For example West Virginia recently ended retirement health insurance subsidies for new employees.

Plan Design

The plan design changes that were agreed to by the employee unions and the Town and School District had a significant impact on the OPEB liability calculation. Further changes may well be needed in the future.

One consideration is that the State and many municipalities have unilateral control of plan design by virtue of participation in the Group Insurance Commission (GIC) health plans. Acton is not a member of the GIC and has not adopted Chapter 69, so any proposed changes to plan design will be subject to negotiation and or collective bargaining with the unions.

Next Steps

To bring forth a comprehensive solution more work is needed. Before deciding on the amount and source of funding we need to do the following to change some of the unknowns into knowns;

1. Conduct a review of all part time positions eligible for health insurance
2. Further develop the actuarial information to ascertain the sensitivity of the liability to changes in assumptions;
 - a. Medical cost inflation
 - b. Investment returns

- c. Changes in eligibility
 - d. Changes in plan design
3. Ask our legislators what help will be forthcoming from the State or Federal Government.

With all that information in hand as well as the results of a long range financial plan, we will be able to determine a funding policy for OPEB liabilities.

However when all is known that can be known, the amount required to fund OPEB may be beyond our reach. That is, we may be unwilling to tax ourselves or cut our services to the degree necessary to fund OPEB fully. That would not just be an issue specific to Acton or any other single municipality and the inability or unwillingness to fund now for past and future OPEB responsibilities may precipitate significant changes in public employee compensation practices or public service delivery methods.

In the long run conversion from Defined Benefit Plans to Defined Contribution Plans might be the answer, but that is not within the purview of a single municipality to implement.

Finally, given that the lifetime cost of a municipal employee is far greater than a private sector employee who is not offered a defined benefit pension and post- retirement healthcare coverage; consideration must be given to outsourcing non critical functions to the private sector.