TOWN OF SUDBURY

Final Report of the Strategic Financial Planning Committee for OPEB (Other Post-Employment Benefits) Liabilities

January 6, 2015

I. Introduction

On October 1, 2013, the Sudbury Board of Selectmen voted to establish an ad-hoc committee to begin developing strategies and options for dealing with the unfunded OPEB[1] liabilities facing the Town of Sudbury, including the Sudbury Public Schools and L-S Regional High School. The Committee's membership was drawn from elected and appointed members of four standing committees: the Board of Selectmen, the Sudbury Public School Committee, the Lincoln-Sudbury Regional High School Committee and the Finance Committee. Additionally, staff from the Town, SPS and L-S was included on the committee. Although a seat was reserved for a citizen at-large with specific expertise to join the committee, no resident volunteered to join the committee. The Committee's mission statement was later amended in May 2014 to extend the time for its work as the Committee was not able to begin its work until the conclusion of the 2014 Annual Town Meeting. The charge of the Committee was to create and submit to the Selectmen a report that the Board, Finance Committee and School Committees can use to make OPEB related decisions over the next 15 years. Attachment A is the Committee's mission statement.

The Board voted to create a committee for this purpose after the April 4, 2013 release of the ***Sudbury Strategic Financial Planning Report***. This report was cooperatively prepared by staff from the Town of Sudbury, Sudbury Public School and Lincoln-Sudbury Regional High School. One of the three topics addressed in that report is the challenge of developing a plan for funding the OPEB obligations facing all three entities. Attachment B to this report is a copy of the section of the Strategic Financial Planning Report dealing with OPEB obligations.

As a result of that report, the Sudbury Board of Selectmen formed a new advisory committee, the Strategic Financial Planning Committee for OPEB. The Committee met a number of times between July and December 2014, and minutes of those meetings are included as Attachment C to this report.

The Committee members met many times over the summer and fall of 2014, working toward fully understanding the complex issues regarding OPEB obligations, and studying options to address this strategic issue. This report is the result of our Committee efforts, and is respectfully submitted to the Sudbury Board of Selectmen, Sudbury Finance Committee, the Sudbury Public School Committee and the Lincoln-Sudbury Regional High School Committee.

A list of the committee members is included at the end of the report.

[1] OPEB is defined as Other Post-Employment Benefits (other than pensions, typically retiree health insurance)

II. Background on OPEB[i2]

For those that who may not be familiar with this topic, other post-employment benefits refer to benefits other than pension that employees receive after they retire. By far, the most significant of these is health insurance, but may also include life insurance, dental or other benefits paid after an employee's retirement. In 2004, the Governmental Accounting Standards Board (GASB) issued directives concerning how these liabilities must be presented in a municipality's financial statements going forward (Pronouncements 43 and 45).

Similar to an employee's pension benefits, OPEB are earned during the employee's active working career, but are not actually paid until after the employee retires. GASB directed that these future costs no longer be accounted for on a pay-as-you-go basis, but rather these liabilities must be recognized as they are earned or accrued. In other words, employees earn the right to receive health insurance and other benefits upon retirement incrementally over their active working career. Therefore, on an accrual basis, the annual cost of an employee's health insurance includes both the municipal share of the actual premium paid on the employee's behalf plus a portion of the projected post-retirement benefit earned in the current accounting period.

These projections are done by actuaries who look at several variables to estimate these future costs. These variables include a projected rate of inflation for future medical costs, assumptions about employee turnover, age at retirement, Medicare eligibility, premiums for various plans at retirement, and mortality. Factored in as well are the respective cost sharing agreements for splitting benefit costs between the municipality and retirees. To attribute these future costs to current accounting periods, it is necessary to calculate a present value of these future benefits using a discount rate. As we will discuss later, the discount rate has a tremendous impact on the calculation of OPEB liabilities.

The important estimates that emerge from an actuarial analysis include the total present value of future OPEB benefits and the required contribution that must be appropriated or otherwise set aside annually to address this liability over multiple years. The projected cost of future benefits discounted to a present value is referred to as the Actuarial Accrued Liability (AAL). This amount is then attributed to the current and prior fiscal years based on when these benefits were earned. The amount of the AAL is reduced in cases where there are OPEB reserves set aside. The Annual Required Contribution (ARC) is the portion of projected benefits earned in or attributable to the current fiscal year (normal cost), plus an additional amount necessary to

[2] Most of the background discussion is excerpted from an article by Rick Kingsley, Bureau Chief, Department of Revenue, published in the *City and Town* newsletter. The article is included as Attachment D of this report.

amortize the unfunded actuarial accrued liability for prior years. The amortization period cannot be more than 30 years.

Although GASB has not mandated a funding requirement for OPEB liabilities, it is important for municipalities to start saving for these costs as soon as possible. Through the adoption of MGL c.32B, s.20, a community can establish an OPEB trust. Even if a community is not in the position to contribute the full ARC each year, modest and manageable contributions are better than nothing. Strategies to set aside one-time revenues, appropriation balances or other available funds and appropriate them to the trust as available or identifying a recurring revenue stream over time can make a significant difference.

III. Town of Sudbury and Lincoln-Sudbury OPEB Actuarial Valuations as of July 1, 2013

Both the Town of Sudbury and the Lincoln-Sudbury Regional High School had actuarial valuations provided as of July 1, 2013. These valuation reports were prepared by Linda L. Bournival from KMS Actuaries, LLC as were previous valuations. Both are attached as Attachments E and F and readers are encouraged to review those valuations in detail.

Table 1 below is similar to Table 1 from the April 4, 2013 Strategic Financial Planning Report. That chart in the prior report used valuations as of July 1, 2011, so the numbers in the table below have been updated for 7/1/13.

Table 1

Total Unfunded Liability for Town/SPS (K-8) and Lincoln Sudbury Regional High School as of 7/1/13					
As of 7/1/13					
	Lincoln Sudbury Regional High School			**Town and SPS**	
	Pay-as-you-go (3.5% interest rate)	**Pre-funded** (7.5% interest rate)		**Pay-as-you-go** (3.5% interest rate)	**Pre-funded** (7.5% interest rate)
Active Employees:	$15,433,007	$6,646,994		$18,564,696	$8,046,224
Retirees:	$11,801,216	$8,010,551		$17,440,087	$11,349,163
Total Actuarial Accrued Liability:	$27,234,223	$14,657,545		$36,004,783	$19,395,387
ARC (Annual Required Contribution:	$2,527,989	$1,626,307		$3,359,128	$2,148,099
FY 15 Contribution Towards Retirees:	$758,966	$758,966		$1,069,290	$1,069,290
FY15 Difference*:	$1,769,023	$867,341		$2,289,838	$1,078,809
*Additional amount needed to fully fund the Pay-as-you-go or Pre-funded ARC.					

Table 2 shows the changes between the valuations since 2011.

Table 2

FY13 to FY15 Difference in Amount Contributed towards Retirees' Benefits as Compared to ARC					
	Lincoln Sudbury Regional High School			**Town and SPS**	
	Pay-as-you-go (3.5% interest rate)	**Pre-funded** (7.5% interest rate)		**Pay-as-you-go** (3.5% interest rate)	**Pre-funded** (7.5% interest rate)
FY15 Difference*:	$1,769,023	$867,341		$2,289,838	$1,078,809
FY13 Difference*:	$3,638,997	$1,777,107		$2,758,802	$1,211,772
Difference since FY13:	-$1,869,974	-$909,766		-$468,964	-$132,963

*Additional amount needed to fully fund the Pay-as-you-go or Pre-funded ARC.

IV. Steps Already Taken by Town/SPS and L-S to Address OPEB Obligations

Both the Town of Sudbury and the Lincoln-Sudbury Regional High School have been actively taking steps to address these unfunded obligations. Both cooperatively retained a consultant to prepare the actuarial analysis applying similar reporting assumptions, to facilitate comparisons and understanding. Both have made significant changes to the health insurance benefits offered to their employees. The Town/SPS negotiated lower contribution rates for all employees, and even lower rates for new hires. Following this, the Town Board of Selectmen voted to enroll their employees and retirees in the Group Insurance Commission (GIC). L-S employees accepted plan design changes and contribution rate changes for new enrollees.

The Town/SPS received approval through a Special Act of the state legislature in 2006 to establish a Town/SPS Liability Trust Fund for OPEB obligations, and the Town/SPS have accumulated $181,000 thus far in the Fund by appropriating funds for retiree health insurance directly into the Fund, then paying the retiree benefits out of the Fund. Money not needed at the end of the year has remained in the Fund, instead of closing out to Free Cash. This residual balance albeit small counts towards funding for our OPEB obligations.

V. Recommendations addressing the OPEB obligations

Recommendation One – Immediately Create/Formalize Liability Trust Funds

The Town of Sudbury should complete the work of establishing a formal trust, known as an Other Post-Employment Benefits Liability Trust Fund, as a vehicle to receive irrevocable contributions for the cost of benefits for the eligible retirees of the Town of Sudbury and Sudbury Public Schools. L-S Regional High School should establish a formal trust, known as an Other Post-Employment Benefits Liability Trust Fund, as a vehicle under Chapter 32B:20 to receive irrevocable contributions for the cost of benefits for the eligible retirees of the Lincoln-Sudbury Regional High School. The assets of these two separate liability trusts shall be dedicated to providing benefits to the retirees of the entity and shall be legally protected from creditors of the employer. Trust assets shall be used to build more assets through careful investments.

The Town of Sudbury currently has such a Liability Trust, established under a special act of the Legislature in 2006, but needs certain actions to complete the work of establishment of the Trust, primarily finalization of a Trust document. The Trust has a balance of $181,000.

The L-S School Committee established an OPEB Trust per the provisions of MGL Chapter 32B Section 20 in November 2014. This paves the way for future contributions to the trust.

Recommendation Two – For FY16, Begin Funding the Annual "Normal" Costs

That in FY16 the three cost centers begin to include in their operating budgets the Normal costs for future health insurance for their current employees. Normal costs are the present value of the future benefit attributed to services rendered by the active employees eligible for this benefit in the current year. Basically, it is the cost of offering this benefit this year to active employees. It can be thought of as part of the compensation for working this year, along with an employee's salary and current benefits. Focusing the initial budget impact on the Normal cost should not be confused with the cost of "catching up" and paying the price of not funding this benefit in the past. The OPEB Committee feels that as a goal each cost center's Normal Cost should be recognized annually and fully incorporated at a 100% level (into the operating budgets) by FY18 and further that intermediate steps should be taken between now and FY18 to begin moving toward accomplishment of that goal.

NOTE: for L-S, implementation of this recommendation for FY16 would depend on a match from the Town of Lincoln toward these Normal costs. If Lincoln is not in a position to contribute a match to these funds in FY16, the committee recommends that the L-S School Committee and the Sudbury and Lincoln Finance Committees begin discussions to develop a plan for L-S to meet this goal in the FY17 and FY18 budgets.

Having said this, the OPEB Committee feels that would be a significant challenge for the cost centers to accomplish as part of the FY16 budget under the 2% and 2.5% budget development guidelines issued by the Finance Committee. Therefore, the Committee is suggesting that the three cost centers prepare a supplemental budget request asking for $675 per eligible employee for FY16, toward funding a percentage of the Normal Cost as shown in Table 3 below. If each cost center voted to develop and submit such a supplemental budget request, the total request would be approximately $496,800. This supplemental budget request would only be for this purpose, and these funds, if approved by the Finance Committee and voted by Town Meeting; would only be used for this purpose and would immediately be placed into OPEB Liability Trusts.

The OPEB Committee members from the cost centers felt it was critical that the Finance Committee be aware that this recommendation to begin funding a portion of Normal Cost in FY16 is contingent on a supplemental funding basis, above or in addition to the 2% and 2.5% budget guidelines already determined by the Finance Committee. It appears that the Finance Committee suggested in their budget development guidance letter that they recognized that some steps need to be taken to address the OPEB liabilities and that there are additional non-override revenues (up to 3.56% over FY15) which may be taken under consideration for this purpose (see attachment G, FinCom budget memo). The OPEB Committee along with representatives from the cost centers agree that supplemental funding in FY16 would help the Town, SPS and L-S begin working towards funding a portion of Normal Costs that otherwise cannot be met under current FY16 budget guidelines

$675 per eligible employee will not achieve full funding for Normal Cost for any of the employee groups, but it does take some closer than others. Table 3 below shows how those funds would be allocated among the cost centers/eligible groups. As can be seen from this table, Normal cost for the eligible employees of each cost center varies. Factors that impact the normal cost include, but are not limited to, plan design, contribution rates, age, retirement date and profession. For instance, the average normal cost per employee for the Town/SPS valuation is $890.43. The average normal cost per employee for the L-S valuation is $1,733. This cost can be further broken down by looking at the make-up of the full normal cost. Our actuary has recommended that when looking at "Town", we should break out Public Safety (Group 4) employees separately, as these employees are generally more costly than the Non-Public Safety Town employees since they can retire earlier than Group 1 employees. The Normal cost for SPS eligible employees under a fully funding scenario is $812, Public Safety is $1,460 and Town Non-Public Safety is $760[3].

Table 3

	# of eligible employees	Normal Costs as of 7.1.2013 valuation	Supplemental Budget Request at $675/eligible	Percent of Normal Cost Requested for FY16
Town Non-Public Safety	98	$ 74,471	$ 66,150	88.83%
Town- Public Safety	72	$ 105,088	$ 48,600	46.25%
SPS	359	$ 291,477	$ 242,325	83.14%
L-SRHS	207	$ 358,707	$ 139,725	38.95%
Total	736	$ 829,743	$ 496,800	

[3] Please note that while the information contrasting Town Public Safety, Non Public Safety and SPS employees are shown for informational purposes, funds put in the OPEB Liability Trust are not allocated toward any particular group but will be used to pay all Town/SPS retiree health insurance obligations.

The Normal cost for eligible L-S employees is higher than the Town (both Public Safety and Non-Public Safety) and SPS primarily due to the fact that L-S pays a higher amount of retiree healthcare benefits than the Town and SPS, which pay the minimum of 50%. L-S will have more catching up to do to get to fully funded status between FY16 and FY18.

Recommendation Three – Steps to Address the AAL To Be Taken in FY16

The Committee has developed recommendations that could start the process of putting funds into Liability Trusts to reduce the Actuarial Accrued Liability (AAL) that has accumulated over many years. The AAL are the costs attributable to past service. The amount of the AAL depends based on assumptions about how aggressively an entity is paying off the accrued liability, but it is clear that if the three cost centers do not start setting aside funds for this liability, it will continue to grow. Putting aside funds into the Trust for the AAL (that is, over and above what is needed for the annual Normal Costs) will also provide the opportunity to invest trust assets over time, thus reducing future costs substantially. For example, if the Town/SPS were able to fully set aside not only the annual Normal Cost but also the amortized amount each year ($1,527,196), the total amount needed to cover the entire liability over a 30 year period would be reduced from a present day $36,004,783 liability to a present day $19,395,387 liability, a savings of $16,609,396.

<u>Specific action steps recommended for the 2015 Annual Town Meeting</u>.

1. For the Town/SPS ask Sudbury Town Meeting to appropriate all but $150,000 of the remaining balance of the now closed Health Claims Trust Fund into the Other Post-Employment Benefits Liability Trust Fund. These funds exist for several reasons: (a) the Town had to leave funds in the Trust after it closed to pay run out claims after the Town converted to the GIC (Group Insurance Commission); (b) deposit funds were returned to the Town by Blue Cross/Blue Shield and Fallon Community Health Care from the deposits that were held by the insurance companies and (3) Reinsurance payments were paid to the Town's Health Claims Trust Fund to reimburse the Town for high claims that exceeded the stop loss threshold per claim the Town chose to self-insure for. Approximately $1.3 million was received in FY12 and FY13, after the conversion to the GIC. Over the life of Trust (established in 1994) more than $5 million was received in Reinsurance money. *(NOTE 1: The amount due to the employees and retirees for their share of the trust fund has already been paid to them. NOTE 2: The Town would have paid the same amounts each year on a self-funded basis as on a fully insured basis, as the actuarial risk for coverage was the same given our risk profile. However, we would not have received back the amounts listed above. All of those amounts would have been kept by the insurance companies as their requirements for assuming the risk of covering Sudbury employees and retirees).*

2. Begin allocating a percentage of Free Cash to the AAL for the three cost centers in FY16. The Town has not always had Free Cash. As recently as FY08 Free Cash was $15,235. But when the Town does have substantial certified Free Cash, the Committee recommends that adding to the Liability Trust Funds of the Town/SPS and L-S to reduce the OPEB AAL liability be very high on the list for potential uses of that Free Cash. NOTE: for L-S, implementation of this recommendation for FY16

would depend on a match from the Town of Lincoln toward this AAL liability. If Lincoln is not in a position to contribute a match to these funds in FY16, the committee recommends that some funds be kept in Free Cash until Lincoln is in a place to make this match.

3. As a revenue source to address the AAL for the Town/SPS and L-S, consider dedicating one specific revenue source. One potential revenue source is the local option Room Tax and the Local Option Meals Tax. The Town began collecting these taxes in FY12. In FY14 these new local options taxes generated $329,464. To dedicate these funds ***in perpetuity*** directly to the Trust Funds would take a Special Act of the state legislature. The benefit of this action would be to build in discipline to annually put some funds toward paying down the AAL. The down side would be this would reduce the amount of Local Receipts available to support operating budgets.

Specific action steps that could be studied and potentially implemented at a future date

1. One funding source for the AAL will hopefully arise in 2036, when the Town/SPS will have made the last payment to Middlesex Retirement System for unfunded pension liabilities. If the current schedule is adhered to, Sudbury (and L-S) may have funds freed up that can be redirected from pension funding to OPEB funding.
2. Under Chapter MGL 32B, section 9A1/2 municipalities can bill other municipalities for the portion of the premium contributions that corresponds to the percentage of the retiree's creditable service that is attributable to each governmental unit. The problem at this time is that there is no enforcement mechanism and no oversight agency built into the policing this so communities are ignoring bills they receive. The MMA's bill, H2429 that was filed to clarify this stature and put some teeth in it was referred to a study committee in June 2014.
3. State law related to earning the post-retirement health insurance benefit could change in the future, and although these changes have not been implemented yet, the state legislature will likely take up this issue again in the near future. If these charges are local option items, the Town and L-S should study them carefully.

Recommendation Four – Future Actions

At this time, Committee members do not recommend taking steps such as Wellesley took, where Town leaders, with the legal authority of a Special Act of the State legislature, received support of voters for a 10 year operating override to fund OPEB liability. Nor are we recommending that the Town begin to fund the full annual ARC amounts for the Town/SPS and L-S (beyond budgeting for pay-as-you-go for current retirees). We believe the approach we are suggesting – fully funding the Normal Cost within operating budgets by FY18, and then addressing the AAL by taking advantage of opportunities to use one-time funds such as Free Cash and the close out of the Town's Health Insurance Trust Fund, along with dedicating the Local Options Meals and Hotel taxes – will make significant strides toward addressing these obligations.

However, the Committee respectfully suggest that the Board of Selectmen create a similar advisory committee in two years to review the status of the OPEB unfunded liability for the Town and SPS when the actuarial valuation of July 1, 2015 will be complete. That advisory committee can evaluate the results of the actions taken thus far, assuming that at least some of our recommendations are acted on, and make further recommendations for the future.

VI. Final Thoughts

The Committee recommends that it be disbanded after the Board of Selectmen, which created this Advisory Committee, receives our report and all questions on the report have been addressed from all the relevant Town and School Committees. We believe that our advisory task will be completed, and that the work of acting on our recommendations, or developing alternative ones that hopefully will also address the growing OPEB liability, will fall on the standing boards working with their staff.

As a cautionary note, we would like readers to be aware that the numbers in all of the valuation reports are based on many assumptions about health care trends, how we provide the benefits, the level of benefits provided, the number of covered employees, and the state laws that guide who qualifies for benefits and how much the benefit might be. This makes the AAL and the Normal Cost amounts moving targets that need to be reassessed at least every two years. Further, if the next Advisory Committee feels that not enough progress has been made toward reducing our OPEB liabilities, they can and should recommend further actions to address the problem.

And we remind readers that while our recommendations for L-S are essentially the same as for the Town/SPS, L-S is a separate governmental entity working with two Towns to support the costs of their OPEB liabilities. Furthermore, the High School has a different retiree benefit structure than the Town/SPS. Those levels of benefits translate into higher Normal Costs and higher AAL cost. One solution will not fit all.

Larry O'Brien, Committee Chair – Sudbury Board of Selectmen
Chuck Woodard – Sudbury Board of Selectmen
Lucie St. George – Sudbury Public School Committee
William Kneeland – Sudbury Finance Committee
Mark Minassian – Sudbury Finance Committee
Kevin Matthews – Lincoln Sudbury Regional School Committee
Maureen Valente – Sudbury Town Manager
Maryanne Bilodeau – Sudbury Assistant Town Manager/HR Director
Andrea Terkelsen – Sudbury Finance Director/Treasurer-Collector
Mary Will – Finance Director, Sudbury Public Schools.
Bella Wong – Superintendent/Principal, Lincoln-Sudbury Regional High School
Patrick Collins – Director of Finance and Operations, Lincoln-Sudbury Regional High School

VII. Attachments:

A. Mission statement
B. Strategic Planning Report Chapter on OPEB
C. Minutes of Committee meetings
D. DOR article cited in Section II
E. Actuarial Valuation for Town of Sudbury, as of July 1, 2013
F. Actuarial Valuation for Lincoln-Sudbury Regional High School, as of July 1, 2013
G. Memorandum from Sudbury Finance Committee, dated October 23, 2014.