

TOWNSHIP OF LOWER MERION
Finance Committee
Issue Briefing

Topic: Postretirement Benefits Plan – 1/1/2017 GASB 45 Valuation

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I. Action To Be Considered By The Board:

N/A

II. Why This Issue Requires Board Consideration:

The Board of Commissioners should remain informed of the Township's Postretirement Benefits Plan and its impacts especially in light of upcoming accounting changes to be implemented in the coming years.

III. Current Policy Or Practice (If Applicable):

The Township received its Postretirement Benefits Plan Actuarial Valuation as of January 1, 2017 which was completed by the Township Actuary (Conrad Siegel). This report is typically completed biannually and places an actuarial value on the long-term costs of all Other Post-Employment Benefits (OPEB) the Township offers its former employees. The report is typically referred to as an "OPEB Valuation" and covers any employment benefits provided after retirement other than pensions. While the Township does offer a modest life insurance benefit to retired employees, the vast majority of the Township's liability and costs for OPEB are related to medical benefits provided to retirees.

The previous OPEB valuation was completed as of January 1, 2015 and contained a total unfunded accrued liability of \$34.76 million. The January 1, 2017 valuation contained a total unfunded accrued liability of just over \$26.3 million, a decrease of nearly \$8.46 million or 24%. This significant decrease is primarily due to the Township's ability to control and reduce the cost of healthcare. The Township's healthcare premium increases were far below the actuarially assumed 6% annual growth. The Township's transition to a high-deductible health plan has provided further cost-containment which should continue to reduce the accrued liability over time.

In addition, as a result of the most recent labor negotiations future Township retirees will follow active employees in terms of retiree healthcare plans. This should also help reduce the cost of this benefit over time since older more expensive medical plans will not have to be kept in place for only a few retirees. One other secondary factor in the decrease in the OPEB liability was changes to some of the actuarial assumptions used in the valuation. The most significant of these is an increase in the number of retirees that selected an opt-out reimbursement in lieu of retiree health

coverage. This is likely part of a larger demographic trend that reflects spouses working longer (and therefore Township retirees having access to non-Township provided healthcare benefits). The chart below shows Unfunded Accrued Liability by the Township's various employee groups.

**Unfunded Accrued Liability by Employee Group
As of January 1, 2017**

	Management	Non-Union Non-Management	Workers Association	Fraternal Order of Police	Total
Actuarial Present Value of Total Projected Benefits ¹					
Active Participants	\$3,051,327	\$1,228,819	\$12,455,997	\$18,992,312	\$35,728,455
Retired Participants	720,617	59,398	660,034	6,733,369	8,173,418
Total Actuarial Present Value of Projected Benefits	<u>\$3,771,944</u>	<u>\$1,288,217</u>	<u>\$13,116,031</u>	<u>\$25,725,681</u>	<u>\$43,901,873</u>
Accrued Liability					
Active Participants	\$1,911,961	\$821,786	\$6,763,643	\$8,629,518	\$18,126,908
Retired Participants	720,617	59,398	660,034	6,733,369	8,173,418
Total Accrued Liability	<u>\$2,632,578</u>	<u>\$881,184</u>	<u>\$7,423,677</u>	<u>\$15,362,887</u>	<u>\$26,300,326</u>
Unfunded Accrued Liability					
Accrued Liability	\$2,632,578	\$881,184	\$7,423,677	\$15,362,887	\$26,300,326
Less: Actuarial Value of Assets	0	0	0	0	0
Unfunded Accrued Liability	<u>\$2,632,578</u>	<u>\$881,184</u>	<u>\$7,423,677</u>	<u>\$15,362,887</u>	<u>\$26,300,326</u>

The following chart shows demographic information related to the Township's employee groups.

**Summary of Demographic Information by Employee Group
As of January 1, 2017**

Demographic Information	Management	Non-Union Non-Management	Workers Association	Fraternal Order of Police	Total
Active Participants	43	25	208	121	397
Vested Former Participants	0	0	0	0	0
Retired Participants	29	8	83	96	216
Total	<u>72</u>	<u>33</u>	<u>291</u>	<u>217</u>	<u>613*</u>
Annual Payroll of Active Participants	\$4,465,805	\$1,830,879	\$12,793,416	\$12,267,682	\$31,357,782

The table below provides further detail on the Township's overall OPEB liability. The Annual Required Contribution (ARC) represents the projected amount needed to fund 1) the cost of the OPEB benefits attributable to the current year (Normal Cost), and 2) an amortized portion of the unfunded liability. These two components serve as a basis for determining the financial costs of OPEB. The ARC is further adjusted by interest on the OPEB Obligation and adjusted for actual contributions and benefit payments throughout the year. When the adjustments are factored into the ARC the result is the Annual OPEB Cost.

Next, the Annual OPEB Cost is reduced by the annual Township payments. If the amount paid by the Township for OPEB benefits during the year is less than the Annual OPEB Cost then the difference is added to the previous year's Net OPEB Obligation to determine the total Net OPEB Obligation at year-end. This information is currently disclosed annually in the required notes to the audited financial statements (CAFR). The table below shows this calculation over the past five years. It is worth noting that the 2017 increase in the Net OPEB Obligation is smallest in the past five years.

**Summary of ARC, Annual OPEB Cost and Net OPEB Obligation
2013-2017**

	2013	2014	2015	2016	2017
Total Normal Costs as of January 1	1,482,666	1,482,666	1,835,894	1,835,894	1,471,788
Amortization of Unfunded Accrued Liability	1,946,053	1,946,053	2,133,969	2,133,969	1,614,617
Annual Required Contribution (ARC)	3,428,719	3,428,719	3,969,863	3,969,863	3,086,405
Adjustments to ARC	(146,425)	(175,808)	(202,254)	(235,956)	(266,642)
Annual OPEB Cost	3,282,294	3,252,911	3,767,609	3,733,907	2,819,763
Contributions Made	(1,489,725)	(1,639,511)	(1,711,565)	(1,861,866)	(1,322,891)
Increase in Net OPEB Obligation	1,792,569	1,613,400	2,056,044	1,872,041	1,496,872
Net OPEB Obligation - Beginning of Year	8,932,983	10,725,552	12,338,952	14,394,996	16,267,037
Net OPEB Obligation - End of Year	10,725,552	12,338,952	14,394,996	16,267,037	17,763,909

IV. Other Relevant Background Information:

The information contained within this Issue Briefing is under the guidance of Governmental Accounting Standards Board (GASB) Statement Number 45. GASB 45 is the current standard but will be replaced by GASB 75 which serves the same purpose—to value an entity’s OPEB liability. GASB 75 will be fully implemented in the Township’s 2018 CAFR (to be released in Summer 2019). Both GASB standards require a calculation of a present liability for future non-pension benefits for employees and retirees, also known as the “Actuarial Accrued Liability” in GASB 45 and the “Total OPEB Liability” in GASB 75. The two standards differ in how and where the liability is disclosed on financial statements.

The current standard GASB 45 recognizes the liability within a footnote in the financial statements while GASB 75 requires the full liability to be recognized immediately on the balance sheet. There are other differences between GASB 45 and GASB 75 including changes to the discount rate which will likely increase liabilities, as well as the schedule by which actuarial valuations must be completed. The Township will now be required to have annual valuations completed.

It is prudent to ask what bond rating agencies’ reaction has been and will be to these OPEB liabilities and any potential impacts on bond ratings. Bond rating agencies have been looking at municipal OPEB liabilities for years and staff does not anticipate the Township’s current OPEB liability or any impact from upcoming changes to accounting standards to materially change how bond rating agencies view municipal credits (including the Township’s). Furthermore, rating agencies typically view OPEB liabilities in conjunction with pension liabilities. Thus, the Township’s well-funded pension plans constrain any potential negative OPEB impacts.

Overall the Township’s OPEB liability is considered average given the size of the workforce and the unfunded accrued liability as a percentage of covered payroll. Many other governmental entities face much higher relative liabilities due to extending coverage to dependents and/or providing coverage after Medicare eligibility. The Township does not cover dependents and ends healthcare coverage once the retiree becomes Medicare eligible which helps to limit its OPEB liability. The Township pays for retiree OPEB benefits on a pay as you go basis, budgeting for

and paying the annual premium costs. As discussed earlier, the Township's recent changes to healthcare benefits should continue to put downward pressure on its OPEB liability.

Other ways to reduce this liability over time would include further restructuring benefits which would need to be bargained with the Township's labor organizations. Another option to address the OPEB liability is for the Township to begin to put money into an OPEB Trust to build assets similar to its pension plans to fund the future OPEB liabilities. This option has begun to be used by some municipalities in recent years and there are service providers that administer multi-jurisdictional OPEB trusts that local governments can join. The benefit of this structure is it eliminates the costs of setting up a trust and can allow a government to benefit from lower administrative costs due to the pooled nature of the trusts. This option would come at a financial cost to the Township because the Board of Commissioners would need to allocate additional funds annually for OPEB benefits above and beyond what the current pay as you go premium payments require. This may be an option to exercise if the impact of OPEB liabilities begins to affect bond ratings.

V. Impact On Township Finances:

There is no financial impact of this report and the future changes due to GASB 75 will not have a direct financial impact on the Township operating budget only on the Township's balance sheet. The Township should remain committed to reducing the overall growth in healthcare costs which will help curtail this liability moving forward.

VI. Staff Recommendation:

N/A