ED COMMITTEE #1&2
May 2, 2016
Worksession

MEMORANDUM

April 29, 2016

TO: Education Committee

FROM: Essie McGuire, Senior Legislative Analyst

SUBJECT: **Worksession – FY17 Operating Budget, Montgomery County Public Schools, *continued, and* MCPS Technology Modernization CIP Project**

Today the Education Committee will continue its review of the FY17 Operating Budget for the Montgomery County Public Schools (MCPS), addressing expenditures related to group insurance benefits and retirement benefits for employees. The Committee will also review the Technology Modernization project in the Capital Improvements Program (CIP).

In October and April of each year, the Board transmits a letter to the Council providing detailed information on the group insurance and pension fund expenditures within State Category 12, Fixed Charges. The Board's March 31 letter is attached on circles 1-9. Sections I and II of the packet below highlight key changes in the funds as well as the major budget implications for FY17.

I. HEALTH BENEFITS FOR ACTIVE AND RETIRED EMPLOYEES, AND OTHER POST EMPLOYMENT BENEFITS (OPEB)

For FY17, the Board's budget request included a total of $312.4 million for health benefits for active and retired employees, an increase of $62.7 million over the FY16 budget level. MCPS maintains separate fund accounts for active and retired employees. Of the $312.4 million in the Board's budget, $275.3 million is attributed to active employees and $37.1 million is attributed to retired employees.

On April 8, the Superintendent provided an update to the Council (letter attached on circles 10-11) that indicated that the requested appropriation for health benefits in FY17 could be reduced by $10 million. The letter outlines recent plan experience changes that have resulted in higher than expected prescription rebate revenue that ultimately allows for this expenditure reduction in FY17. Recognizing this reduction would result in an FY17 total contribution of $302.4 million for health benefits for active and retired employees.

For active employees, the Board's budget request reflects no changes to group insurance benefits in FY17. It does reflect the full implementation of changes to cost share for active employees phased in over FY15 and FY16. MCPS' increases in total group insurance costs for FY17 reflect a projected 7.1% increase in claims expenses and additional funds needed to restore the active employee group insurance fund back to a zero fund balance.

MCPS' full implementation of cost share changes includes credits of 1% each for completing a biometric screening and a health risk assessment and a cost share penalty of 3% for tobacco users. As of March 1, 2016, MCPS reports that approximately 60% of enrollees are receiving the biometric screening credit, 35% are receiving the health risk assessment credit, and about 15% of enrollees are paying the tobacco user penalty.

Group Insurance Fund Deficit

MCPS ended FY15 with a $4.7 million deficit in its group insurance fund for active employees; or -1.6% of expenditures. MCPS currently projects an FY16 year-end fund deficit of $13.1 million (or -4.2%) due to higher than anticipated claims expenditures, particularly for prescriptions. MCPS ended FY14 with a $4.2 million deficit in its group insurance fund for retired employees; or -4.5% of expenditures. MCPS currently projects an FY16 year-end fund balance of $2.0 million (or 2%).

As outlined on circle 10, this results in a projected fund deficit across both funds of $11 million. The Board intends to request that the Council approve a categorical transfer of $4 million at the end of FY16 to help reduce the negative fund balance to a deficit of $7 million. This transfer is currently anticipated in the financial report as a deficit in Category 12, and reduces the amount of fund balance available at the end of FY16 for reappropriation as a resource for FY17.

As the Committee discussed, the current projected year-end fund balance for FY16 is $500,000 less than the amount assumed by the Board and the Executive for FY17. **Council staff supports assuming the same amount of fund balance for FY17 as assumed by the Board. Council staff also supports the Board's proposal to transfer $4 million, if possible, to the group insurance fund at the end of FY16 to address the deficit.** Council staff's view is that it is possible that additional savings will accrue during the remainder of the year to address both funding issues; and if not, that it is possible to transfer less if necessary to the group insurance fund and continue to monitor that fund through FY17.

MCPS FY16 Approved and FY17 CE Recommended Retiree Pay-As-You-Go Funding

In FY15, the Council reduced MCPS' tax supported retiree health pay-as-you go funding by $27.2 million, MCPS used its internal OPEB Trust to fund that portion of pay-as-you-go expenditures, and the Council added $27.2 million to MCPS' portion of the Consolidated OPEB Trust to hold MCPS OPEB spending harmless. In FY16, the Council approved the County Executive's recommendation to provide MCPS $51.2 million in total retiree pay-as-you-go funding, with $24.0 million from the MCPS internal OPEB Trust and $27.2 million from the Consolidated OPEB Trust. Unlike the Council's actions in FY15, the budget actions in FY16 did not replace the expenditures in either trust.

MCPS pay-as-you-go: In FY17, the Board of Education proposed and the County Executive recommended $64.3 million in total retiree pay-as-you-go funding through $37.1 million in tax supported funding and using $27.2 million from MCPS' portion of the Consolidated OPEB Trust. The tax supported funding includes $24.0 million to replace the funds from the MCPS internal trust (which has now been zeroed out) and $13.1 million in additional spending for projected claims increases. The Executive's proposed budget does not replace the $27.2 million in expenditures from the Consolidated Trust.

FY16 Approved		**FY17 BOE Request/CE Recommendation**	
• County funding	$0	• County funding	$37.1 million
• Consolidated OPEB Trust	$27.2 million	• Consolidated OPEB Trust	$27.2 million
• MCPS OPEB Trust	$24.0 million	• MCPS OPEB Trust	n/a
Total Pay-As-You-Go Funding:	$51.2 million	**Total Pay-As-You-go Funding:**	$64.3 million

MCPS OPEB Pre-Funding: While the Executive's recommended budget proposes to fully fund MCPS' OPEB pre-funding requirement of $63.1 million, it also proposes to use $27.2 million in assets from MCPS' portion of the Consolidated OPEB Trust to pay current year claims. As a result, the net effect of the Executive's proposal is to increase MCPS' OPEB Trust balance (excluding any investment earnings) by $35.9 million in FY17 instead of $63.1 million.

The Executive recommended and the Council approved a similar approach last year, except with a greater reduction in Trust assets ($51.2 million). At that time, the Council's actuarial adviser, Bolton Partners, noted that some other jurisdictions have taken this approach – for example, Baltimore, Calvert, and Howard Counties in Maryland – but that it should be used sparingly. Bolton Partners also noted that this action will likely: 1) decrease MCPS' projected OPEB funded ratio; and 2) increase MCPS' required pre-funding amount in future years to make up for the net reduction in contributions.

II. PENSION FUND

MCPS makes an annual contribution to its pension fund to pay for cost of: (1) the "core" pension benefit offered employees who do not participate in the State-run pension plan; and (2) the "supplemental" benefit for all permanent employees. The amount of the annual contribution is determined by the Board based on an actuarial assessment of plan assets and liabilities. **For FY17, MCPS is expected to pay $66.8 million into its pension fund.** This is a decrease from the FY16 contribution amount of $74.7 million.

Rating agencies consider a pension fund's "funded ratio" (among other factors) in determining the bond ratings for local governments. The term "funded ratio" refers to the percentage of the plan's liabilities covered by the current actuarial value of the plan's assets. At that start of FY03, the MCPS pension fund held assets that were <u>greater</u> than its liabilities, that is, the funding ratio exceeded 100%. By FY10, the MCPS pension funded ratio had dropped to below 70%. Two primary factors contributed to the sharp decline. First, in 2006, the Board of Education approved two pension plan enhancements that significantly raised the plan's unfunded liability. Second, the MCPS pension fund incurred a combined investment loss of more than $265 million during FY08 and FY09.

The MCPS pension fund experienced gradual improvement in recent years attaining a funded ratio of 81.5% as of July 1, 2014.[1] As with most pension funds, the improvement in the MCPS funded ratio was a function of strong investment returns. More recently, however, the MCPS funded ratio declined to 79.2% as of July 1, 2015. In other words, the MCPS pension fund had only 79.2 cents of assets for every dollar of liability.

In a March 31 letter to the Council President, Board President Durso cautioned that recent investment pension fund investment performance has fallen below expectations. Should investment returns continue to fall below actuarial assumptions, the MCPS pension fund would experience a decline in its funding ratio which could raise future year pension costs. As stated by Mr. Durso:

> *"During FY 2015, the pension fund experienced positive returns of 2 percent, but did not meet the actuarially assumed return. FY 2016 has, to date, been a difficult investment market, and the fund to date has not met the actuarially assumed return."*

III. TECHNOLOGY MODERNIZATION

The Board of Education requested an increase of $17.1 million over the six-year period FY17-22 for the Technology Modernization project:

	FY17	FY18	FY19	FY20	FY21	FY22
BOE Rqst	27,399	26,010	22,875	25,366	25,484	25,143
Approved	21,358	21,998	20,728	20,798	n/a	n/a
Increase	6,041	4,012	2,147	4,568		

The PDF is attached on circle 12. At this juncture, the Board's request for this project is reflected in the Council's preliminary reconciliation assumptions.

Below is a breakdown of the requested FY17 expenditures:

Finance payments for purchased hardware	$13.5 million
Licensing maintenance payments for major software	$2.4 million
CIP funded staff related to Technology Modernization	$3.6 million
16 positions shifted from operating budget	$2.2 million
New desktops, laptops, and required operating licenses, includes next phase of Chromebooks	$3.7 million
Modernization of infrastructure and program	$1.5 million
Extended parts and service warranty: printers, scanners, mobile devices	$0.7 million
Total	$27.4 million

[1] The funded ratios cited in this section are calculated based on the "market value of assets (MVA)." The MVA method values a fund's assets based on the amount of money the fund would receive if it sold all its investments. The MVA method produces funded ratios that are highly sensitive to fluctuations in the investment market.

Erate

E-rate Federal reimbursement funding is another resource for the Technology Modernization project that is appropriated each year by the Council as a supplemental appropriation once the funding amount is more certain. In recent years, the Council has appropriated the E-rate funding as additive to the County funding to get the total Tech Mod appropriation closer to the Board's requested funding level. For FY16, MCPS estimates that the E-rate reimbursement amount will be $2.1 million. In budget discussions last spring, the Council assumed that the FY16 funding would be added to the approved $25.5 million level when it was received and requested by the Board. The Council has not yet received the appropriation request for the FY16 amount.

Chromebooks

A key element of the Board's technology modernization strategy is the implementation of Chromebooks for student and staff use in the classroom. This began in the 2014-2015 school year with implementation in Grades 3, 5, 6, and high school social studies classes. The Board and the Education Committee have heard directly from students, teachers, and parents the benefits of using the Chromebooks for class instruction and the innovative learning initiatives that the devices support.

This school year was originally planned to be the second of three rollout years for the Chromebook initiative. The Board reduced funding for the initiative as part of the significant overall budget reductions that were required in the FY16 Operating Budget. In order to maintain continuity with the initiative, MCPS reprioritized already approved funds in the Technology Modernization project. The revised plan for the current school year is to implement Chromebooks in Grade 4 and in approximately 150 middle school classrooms.

The FY17 Tech Mod request would continue funding for Chromebooks on a revised rollout schedule. The FY17 funds would support implementation in the remainder of 7th grade, half of 8th grade, and one high school content area. The revised schedule would continue expansion of Chromebooks into all grades by FY20, as outlined below. Chromebook replacement would then start in FY20 as needed, starting with the oldest devices.

- FY17: Remainder of 7th grade, one HS content area, and half of 8th grade
- FY18: Remainder of 8th grade, all of 2nd grade, and one HS content area
- FY19: Fourth HS content area and part of Grade 1
- FY20: Remainder of Grade 1

Regular replacement cycle: As noted, MCPS prioritized the modified rollout of Chromebooks in the current school year by delaying the regular replacement of hardware and software that was scheduled for the current school year. The funding requested in FY17 would resume that replacement schedule, one year behind.

Board's additional request: The Board of Education's amendments to the Superintendent's operating budget included $3 million identified for Chromebooks. Council staff understands that if these additional funds are ultimately approved, they would support increased implementation of the Chromebook rollout schedule and some critical elements of the deferred replacement schedule.

Staffing

The Tech mod project includes funds for two groups of staff. First, staff associated with the technology replacement and other technology infrastructure work have long been funded through this project, and currently account for approximately $3.6 million in the project. The second group includes 16 positions that were previously funded in the operating budget and were shifted to the Technology Modernization project as part of overall funding constraints in FY16. This group accounts for approximately $2.2 million.

It is not necessarily a problem to have $5.8 million of technology staffing in the CIP if the base funding level is sufficient to incorporate this level of committed cost. One advantage is that it is not within the Maintenance of Effort (MOE) calculation; this may be relevant this year given the Board's and Executive's recommendations to exceed MOE by a large amount.

Council staff recommendation

Council staff supports funding the Board's full request for Tech Mod, if possible within affordability constraints. While the Council has increased available funding in this project in recent years, it has not generally been able to fully meet the Board's requests for this project. The technology project is important to both maintain the technology infrastructure and to implement learning initiatives. The Chromebook initiative has widespread support and Councilmembers have heard about its impact in the classroom.

In Council staff's view, any funding for additional Chromebooks or technology replacement, as proposed by the Board above the CIP request, should be funded in the CIP and not in the operating budget.

One possible source for the requested additional technology funds is the Federal E-rate reimbursement, which has been approximately $2 million in recent years. If this is presumed to be added again in FY17, that would provide possibly two-thirds of the increase the Board requested in the operating budget. Council staff recommends this approach to provide additional technology resources in FY17.

If the full amount of the Board's request cannot ultimately be funded as part of the Council's final reconciliation, then Council staff supports the recent practice of adding E-rate funding to the County funding as a means to approach the level requested by the Board for Tech Mod.

Council staff recommends approval of the FY16 E-rate reimbursement revenue, when the request is received from the Board of Education, in addition to the FY16 approved funding level, consistent with the Council's policy direction last spring.

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MONTGOMERY COUNTY BOARD OF EDUCATION
850 Hungerford Drive ♦ Room 123 ♦ Rockville, Maryland 20850

Malcolm Baldrige National Quality Award 2010 Award Recipient

March 31, 2016

The Honorable Nancy Floreen, President
Montgomery County Council
Stella B. Werner Council Office Building
100 Maryland Avenue
Rockville, Maryland 20850

Dear Ms. Floreen:

As requested in then-Council President Roger Berliner's memorandum of January 18, 2012, this letter provides the information regarding State Expenditure Category 12. The Board of Education's Fiscal Management Committee closely monitors the expenditures in this category as we do with all expenditures. I look forward to working with you, councilmembers, Board members, and the interim superintendent of schools to continue to address the fiscal challenges we face.

1. **Estimates of the amount of the annual employer contributions to the Montgomery County Public Schools (MCPS) Pension fund for the next five fiscal years:**

   The Fiscal Year (FY) 2017 Operating Budget assumes that funding will be at the actuarially required level of 4.18 percent. The estimated annual required contributions are expected to be the following amounts:

	Amount	Current Percentages
FY 2016	$74.7 million	5.01
FY 2017	$66.8 million	4.18
FY 2018	$67.2million	4.08
FY 2019	$68.6 million	4.14
FY 2020	$71.3 million	4.29
FY 2021	$74.8 million	4.36
FY 2022	$77.9 million	4.33

   The FY 2017 Operating Budget assumes that funding will be at the actuarially required level of 4.18 percent.

2. **A description of the major factors (e.g., salary adjustments, changes in workforce size, investment performance, plan modifications, actuarial assumptions) that affect estimated pension fund contributions over the next five years:**

   The calculation of the annual employer contribution is based on actuarial work performed by the MCPS actuary, AON Hewitt, and submitted to Mrs. Susanne G. DeGraba, chief financial officer, on February 18, 2016 (Enclosure A). The estimate is based on the updated market value

Phone 301-279-3617 ♦ Fax 301-279-3860 ♦ boe@mcpsmd.org ♦ www.montgomeryschoolsmd.org

of the plan as of January 31, 2016. The actuary's estimate of the percentage of salary that is required to be contributed each year is applied to the anticipated salaries to be paid from the MCPS operating budget. The percentage contribution is based on actuarial assumptions as follows:

- **Salary adjustments**: Aggregate salaries for continuing employees will increase 2 percent overall during the next three years.
- **Changes in workforce size**: The number of employees will increase by 1 percent each year with salaries adjusted to 0.57 percent to reflect the lower salaries paid to new employees.
- **Investment Performance**: MCPS will achieve its actuarial assumed rate of return on its pension fund of 7.5 percent in all future years. Pension fund investment performance is included through January 31, 2016.
- **Plan Modifications**: The pension plan changes effective July 1, 2011, are amortized over a 30-year closed period, the same method used to incorporate the impact of the July 1, 2006, changes.
- **Actuarial Assumptions**: MCPS' actuary completed an experience study during 2015. Experience studies typically are done every five years. MCPS last had an experience study in 2010. Findings from this study included retirees living longer, employees retiring later, and inflation that has been lower than earlier periods during the past decade. MCPS adopted the revised assumptions for the FY 2015 actuarial valuation.

3. **A written summary of the Board's current strategy to achieve a desired pension funding level ("funded ratio") and the short- and long-term effects of this strategy on the Category 12 budget:**

As described in the letter of April 4, 2012, to then-Council President Roger Berliner from then-Board President Shirley Brandman and in the letter of March 26, 2013, to then-Council President Nancy Navarro from then-Board President Christopher S. Barclay, the Board's Fiscal Management Committee discussed strategies to improve the fund's status in light of the current fiscal environment. A decision was made that it would be appropriate to recommend maintaining the contribution percentage to achieve an 80 percent funding level beginning with the FY 2016 budget. This action was approved by the Board on January 14, 2014; however, due to budgetary constraints, it has not been possible to fund this strategy.

The investment performance of the fund during the past three years has helped to maintain the funded status even as financial markets did not provide hoped for investment returns. The investment portfolio of low-cost index funds, along with an allocation to alternative strategies, and the continued use of the cash overlay strategy have enabled investment returns to maintain the fund's status despite market volatility over the past 18 months.

During FY 2014, the pension fund gained 15.2 percent. During FY 2015, the pension fund experienced positive returns of 2 percent, but did not meet the actuarially assumed return. FY 2016 has, to date, been a difficult investment market, and the fund to date has not met the actuarially assumed return. The value of the pension fund is $1.365 billion as of January 31, 2016.

4. A comparison of current fiscal year budgeted versus actual revenues and expenditures to date for the Active Employee and Retiree Group Insurance Funds:

Comparisons for active employees and retirees are enclosed (Enclosures B and C, respectively).

5. The projected year-end balance for the Active Employee and Retiree Group Insurance Funds: This should include an accompanying explanation of the factors causing the variation (e.g., claims experience, plan enrollment) if the projected balance in either fund differs from what was assumed at the beginning of the fiscal year.

These figures are based on revenues and expenses as of February 29, 2016.

Active employees	
Beginning fund balance	$(4.7) million
Anticipated change to fund balance	(8.4) million
Projected ending fund balance	$(13.1) million

Retirees	
Beginning fund balance	$(4.2) million
Anticipated change to fund balance	6.2 million
Projected ending fund balance	$ 2.0 million

The active employee fund balance became negative late in FY 2015 due to increased claims, primarily for prescriptions. The use of fund balance to fund expenses has created a situation where there is no remaining reserve to absorb any unanticipated increases in expenses or decreases in revenue. While a negative fund balance is not prohibited, it does create the potential for a need to request further appropriation authority to ensure all claims may be paid by the plan. As a result, the Board intends to transfer an additional $4.0 million to the fund in FY 2016 and request that the Council approves a categorical transfer of $4.0 million from other categories. The fund is projected to have expenses exceed revenues in FY 2016 by $8.4 million, ending with a negative fund balance of $13.1 million prior to the transfer of $4.0 million.

In the current year, prescription drug costs have exceeded the budgeted amount, reflecting continued growth in specialty prescription drug use and cost as well as large prescription drug claims. In particular, plans have seen continued high expenses from specialty drugs, such as those used for treating hepatitis C, rheumatoid arthritis, and other biologics. Another result of the rising costs of prescriptions are increased prescription drug rebates which have tempered the rate of increase. These rebates are expected to continue at this level for the next two to three years.

Effective January 1, 2015, employees experienced an increase in their premiums from the previous 5 percent Health Maintenance Organization (HMO) plans only and 10 percent Point of Service plans, prescription, dental, and vision to 8 percent (HMO) and 13 percent (all other). Effective January 1, 2016, the employee cost share increased again to 12 percent (HMO) and 17 percent (all others) with an ability to reduce this by up to 2 percent by participating in wellness incentives beginning in FY 2016. Smoker rates for employees (FY 2016) and their spouses (FY 2017) have been added to the plans. Tobacco users pay an additional 3 percent of the cost of their health care. Based on open enrollment results, 17.6 percent of employees are being charged the tobacco surcharge.

The retiree fund balance is projected to increase by $6.2 million, improving the balance to a positive fund balance of $2.0 million. Retiree prescription coverage was moved to Medicare Part D with a wrap-around program for retirees on January 1, 2015. Savings from this program continue. In FY 2016, MCPS received a one-time payment related to the previous Medicare program of $4,469,000 which helped the plan return to a positive fund balance. The retiree trust also benefited from increased prescription rebates.

The members of the Board of Education, the interim superintendent of schools, and MCPS staff are prepared to work with the County Council and Council staff to provide additional clarifications as needed.

Sincerely,

Michael A. Durso
President

MAD:sgd

Enclosures

Copy to:
Members of the Montgomery County Council
Members of the Board of Education
Mr. Bowers
Dr. Zuckerman
Mrs. DeGraba
Mr. Klausing
Mr. Ikheloa

Enclosure A

AON
Empower Results®

February 18, 2016

Ms. Susanne DeGraba
Chief Financial Officer
Montgomery County Public Schools
850 Hungerford Drive
Rockville, MD 20850-1747

Re: Six-Year Projection of Board Contributions to MCPS's Pension Plans – Projected Unit Credit

Dear Sue:

We estimated Board contributions to the Montgomery County Public Schools Employees' Retirement and Pension Systems (the "Plan") for the next six years under the investment return/contribution assumptions used for the July 1, 2015 valuation. As a reminder, this assumes the December 31, 2015 assets will earn annually 7.5% *gross* (before investment expenses are subtracted). The actual contribution percentage will vary and may vary significantly from the results of this projection due to actuarial gains/losses and demographic changes.

The results are summarized in the table below assuming no minimum contribution rate of 5.73% until the plan becomes 80% funded under an actuarial value basis.

Valuation Date	Fiscal Year (FY) Ending	Board Contribution as % of Payroll	% Funded AVA Basis	% Funded MVA Basis
July 1, 2015	June 30, 2017	**4.18%**	79.22%	79.45%
July 1, 2016	June 30, 2018	**4.10%**	80.07%	76.81%
July 1, 2017	June 30, 2019	**4.08%**	80.88%	77.83%
July 1, 2018	June 30, 2020	**4.14%**	81.13%	78.80%
July 1, 2019	June 30, 2021	**4.29%**	80.56%	79.79%
July 1, 2020	June 30, 2022	**4.36%**	80.84%	80.84%
July 1, 2021	June 30, 2023	**4.33%**	82.04%	82.04%

The contribution increases for several years due to recognizing anticipated 2016 asset losses, offset in part by the savings over time as more and more participants are covered by the new plan features.

Aon Hewitt | Retirement & Investment Consulting
555 East Lancaster Avenue, Suite 300 | P.O. Box 7300 | Radnor, PA 19087-7300
t +1.610.834.2100 | f +1.610.834.2176 | aonhewitt.com

For a historical perspective, the table below shows the Board contributions from July 1, 1994 until now.

Valuation Date	Fiscal Year Ending	Board Contribution as % of Payroll
July 1, 1994	June 30, 1996	2.92
July 1, 1995	June 30, 1997	3.30
July 1, 1996	June 30, 1998	2.83
July 1, 1997	June 30, 1999	2.53
July 1, 1998	June 30, 2000	2.11
July 1, 1999	June 30, 2001	1.98
July 1, 2000	June 30, 2002	1.89
July 1, 2001	June 30, 2003	1.86
July 1, 2002	June 30, 2004	2.06
July 1, 2003	June 30, 2005	2.74
July 1, 2004	June 30, 2006	3.30
July 1, 2005	June 30, 2007	4.85
July 1, 2006	June 30, 2008	4.59
July 1, 2007	June 30, 2009	4.53
July 1, 2008	June 30, 2010	4.53 *
July 1, 2009	June 30, 2011	4.67
July 1, 2010	June 30, 2012	5.12 +
July 1, 2011	June 30, 2013	5.42
July 1, 2012	June 30, 2014	5.74
July 1, 2013	June 30, 2015	5.73
July 1, 2014	June 30, 2016	5.01
July 1, 2015	June 30, 2017	4.18

* The valuation resulted in a 4.37% Board contribution rate in 2008, but MCPS continued with the same contribution rate as the previous valuation to avoid a larger increase from fiscal year 2010 to fiscal year 2011.

\+ Beginning with the July 1, 2010 valuation report, the contribution was increased with interest from July 1 to October 1 based on expected timing of the actual contribution. The FY 2012 Board contribution was later revised to 5.12%, as described in Mercer's May 13, 2011 letter, to reflect the Plan changes effective July 1, 2011. Prior to reflecting the Plan changes, the Board contribution would have been 5.57% of pay.

The last half of the 1990s was characterized by high asset returns, allowing a drop in the Board contributions. The challenging market environment during 2001–2003 caused Board contributions to increase. The Plan amendment associated with House Bill 1737 caused the spike in Board contribution for the fiscal year ending June 30, 2007. All increases in cost sharing from the amendment (i.e. phased increase in employee contributions) were reflected fully in the contribution for the fiscal year ending June 30, 2009. MCPS's favorable returns on assets during 2004–2007 helped to lower contributions in FY 2008 and 2009. It is expected that there will be approximately sixty million of unrecognized asset losses as of July 1, 2016.

There has been a great deal of volatility in the contribution rate in the past, and the causes of this volatility will continue into the future. One of the main causes of this volatility is the asset returns the fund generates. To calculate contributions, MCPS uses an actuarial value of assets which smoothes market returns over a 5-year period, but even with this smoothing technique, contributions and funded ratios can be volatile. The following table illustrates a distribution of financial outcomes over the course of a one-year time period including the potential change in the Plan's funded status and the corresponding impact on the contribution required for the fiscal year ending in 2018 assuming that all actuarial assumptions are met. Please note, the average expected return below is base on average market returns using the board's investment policy, which is lower than the boards long term rate of 7.50% investment return.

Fiscal Year (FY) Ending	Percentile	Expected Return	Board Contribution as % of Payroll	% Funded AVA Basis	% Funded MVA Basis
June 30, 2018	5th	**(11.0%)**	**4.20%**	78.68%	69.89%
June 30, 2018	35th	**1.9%**	**4.13%**	79.66%	74.77%
June 30, 2018	50th	**6.2%**	**4.10%**	79.97%	76.34%
June 30, 2018	65th	**10.7%**	**4.08%**	80.29%	77.93%
June 30, 2018	95th	**26.7%**	**4.00%**	81.38%	83.39%

The following statement can be used to interpret the first row of this chart: there is a 5% chance (or 1 chance in 20) that asset returns will be bad enough to result in a funded status of 78.68% *or lower,* and a Board contribution of 4.20% of payroll or higher. Similarly, there is a possibility that higher than expected returns will actually decrease the future board contributions needed to fund the Plan. These percentages assume a normal distribution of returns around the mean. There is a school of thought that a normal distribution understates the portion of returns in the tails (i.e. below 10% of above 90%) of the curve. In determining the returns, we did not take into consideration the return from July 1, 2015 to the present. The normal distribution of return is based on a short term period of 1 year.

In order to complete this 6 year projection, we used the following methods and assumptions:

- All exits are replaced by new employees based on average new hire demographic information in the July 1, 2015 valuation data.
- The funding method of Projected Unit Credit.
- Total expenses are assumed to be 0.60% of beginning of year market value of assets.
- We amortize unrecognized gains and losses over an open 15-year period.
- For the contribution volatility exhibit, we have relied on portfolio volatility based on Aon Hewitt Investment Consulting's one-year time horizon projection.
- Unless otherwise noted, we used the same assumptions and Plan provisions as for the 2015 valuation. We assumed there will be no changes to the valuation assumptions or provisions in the future.

Please give us a call if you have any questions.

Sincerely,

Thomas Vicente

Tom Vicente, FSA, EA, MAAA

TV/jss
Enclosure

MCPS Employee Benefit Trust Fund
Schedule of FY 2016 Budgetary Expenditures for the Active Employee Trust Account
As of June 30, 2016 (Actual Through February 29, 2016)

	FY16 Budget/Projection	YTD actual	Projected Remaining	Total	Variance Fav - (Unfav)
Revenue Receipts:					
County Appropriation	238,496,208	233,546,208	4,950,000	238,496,208	-
Enterprise Funds	9,033,833	5,292,804	3,796,272	9,089,076	55,243
Capital Projects	1,072,319	673,759	399,843	1,073,602	1,283
Supported Programs	8,236,809	4,584,736	3,518,100	8,102,837	(133,972)
Employee Payments	42,270,355	21,398,622	17,021,853	38,420,474	(3,849,881)
Optional Life	635,000	351,948	259,412	611,361	(23,639)
Investment Earnings	20,000	12,211	7,871	20,082	82
Rebates/ Recoveries/Other	5,764,000	3,259,360	1,881,640	5,141,000	(623,001)
Total Revenue	305,528,524	269,119,648	31,834,992	300,954,639	(4,573,885)
Expenditures:					
Premiums:					
VOYA Life	3,396,000	2,234,409	1,145,036	3,379,445	16,555
Dental	1,833,000	1,120,594	594,832	1,715,426	117,574
Kaiser Permanent Health Plan	41,574,600	27,657,034	13,881,520	41,538,554	36,046
All Other	7,557,600	4,020,903.63	2,528,112.00	6,549,016	1,008,584
Claims:					
Dental	13,995,500	9,387,225	4,851,300	14,238,525	(243,025)
Health	173,416,500	113,379,574	58,991,100	172,370,674	1,045,826
Prescription	64,963,600	43,151,905	22,667,900	65,819,805	(856,205)
Vision	304,600	203,535	101,600	305,135	(535)
Administrative Expenses:	3,177,858	2,835,988	561,667	3,397,655	(219,797)
Total Expenditures	310,219,258	203,991,168	105,323,067	309,314,235	905,023
	(4,690,734)	65,128,479	(73,488,075)	(8,359,596)	(3,668,862)

MCPS Employee Benefit Trust Fund
Schedule of FY 2016 Budgetary Expenditures for the Retired Employee Trust Account
As of June 30, 2016 (Actual Through February 29, 2016)

	FY16 Budget/Projection	YTD actual	Projected Remaining	Total	Variance Fav - (Unfav)
Revenue Receipts:					
County Appropriation	3,353,736	3,353,736	-	3,353,736	0
Retiree Payments	34,694,496	22,300,276	11,783,162	34,083,437	(611,059)
Investment Earnings	-	2,692	(484)	2,208	2,208
Rebates/ Recoveries/Other	2,978,900	1,183,933	2,298,563	3,482,496	503,596
Medicare Part D Reimbursements	12,354,000	4,151,675	8,300,325	12,452,000	98,000
OPEB Shift to Trust Fund	51,150,000	35,945,918	15,200,000	51,145,918	(4,082)
Total Revenue	104,531,132	66,938,230	37,581,566	104,519,796	(11,337)
Expenditures:					
Premiums:					
Prudential Life	3,322,800	2,219,997	1,110,160	3,330,157	(7,357)
Aetna	448,800	256,467	153,560	410,027	38,773
Kaiser Permanente Health Plan	8,105,400	5,524,270	2,718,920	8,243,190	(137,790)
All Other	4,177,800	2,251,509	1,293,336	3,544,845	632,955
Claims:					
Dental	5,523,000	3,300,074	1,810,100	5,110,174	412,826
Health	38,428,300	22,922,603	11,756,000	34,678,603	3,749,697
Prescription	41,691,500	28,039,892	14,594,700	42,634,592	(943,092)
Vision	41,400	31,749	18,400	50,149	(8,749)
Administrative Expenses:	303,635	248,468	61,756	310,224	(6,589)
	102,042,635	64,795,026	33,516,932	98,311,958	3,730,677
Total Expenditures	2,488,497	2,143,203	4,064,634	6,207,837	3,719,340

MCPS MONTGOMERY COUNTY PUBLIC SCHOOLS
www.montgomeryschoolsmd.org MARYLAND

Malcolm Baldrige National Quality Award
2010 Award Recipient

April 8, 2016

The Honorable Nancy Floreen, President
The Honorable Craig Rice, Chair, Education Committee
Montgomery County Council
Stella B. Werner Council Office Building
100 Maryland Avenue
Rockville, Maryland 20850

Dear Ms. Floreen and Mr. Rice:

This letter provides an update on the projected fund balance of the Employee Benefit Plan (EBP) as of June 30, 2016, and the projected expenses and revenues for Fiscal Year (FY) 2017. This information was provided to the Board of Education on April 6, 2016.

For several years, Montgomery County Public Schools (MCPS) and other employers have experienced significant increases for medical costs, especially for prescription drugs. Trends in medical and prescription expenses are expected to continue to be well above the rate of inflation. The prescription costs have been driven primarily by new specialty drugs.

In addition to increases in prescription costs, there has been a recent dramatic increase in prescription rebates. Under our current agreement with Caremark, our prescription plan provider, MCPS shares in the rebates from drug manufacturers that Caremark negotiates on behalf of the plan as do all participating Montgomery County agencies. In FY 2017, the prescription rebates are expected to increase by $9.0 million more for MCPS than had been anticipated when the budget was approved in February 2016. Under a contract proposal currently being reviewed, these rebates would remain guaranteed at the higher levels for three years.

Beginning in FY 2014, a decision was made to use the fund balance in the Employee Benefit Trust to fund current year benefit costs, thus reducing the amount of the fund balance. Since that time, the entire fund balance has been eliminated. At the end of FY 2015, even with a categorical transfer of $3.5 million into the EBP funds, the active employee fund balance ended with a deficit of $4.6 million and the retiree fund had a $4.2 million deficit for a total deficit of $8.8 million. Continued increased expenses during FY 2016 have been mitigated somewhat by increased rebates; however, by the end of the fiscal year, the two accounts are projected to have a deficit of $11.0 million. We are planning to request a $4.0 million categorical transfer at year-end, which will bring the fund balance to a deficit of $7.0 million.

Office of the Superintendent of Schools
850 Hungerford Drive, Room 122 ♦ Rockville, Maryland 20850 ♦ 301-279-3381

As a result of the increased rebate revenue for prescriptions in FY 2017, the requested appropriation for health benefits in the FY 2017 Operating Budget can be reduced by $10.0 million. It is important to remember that the funding we have requested for active and retiree health benefits for FY 2017 includes an additional $10.0 million to offset the FY 2016 deficit, as well as funds to cover the increases in medical and prescription costs projected for the year. It is hoped that beyond FY 2017, cost increase trends will ease, and along with our continued wellness efforts will, in turn, result in smaller increases in employee benefit costs. Depending on the extent to which costs increase, the funds used in FY 2017 to support the fund balance may be available to offset increases in EBP costs or for other structural deficits in the FY 2018 Operating Budget.

The Board of Education members and I are prepared to provide additional clarification as needed.

Sincerely,

Larry C Bowers

Larry A. Bowers
Interim Superintendent of Schools

LAB:AMZ:san

Copy to:
Members of the Montgomery County Council
Members of the Board of Education
Dr. Navarro
Dr. Statham
Dr. Zuckerman
Mr. Edwards
Mrs. DeGraba
Mr. Ikheloa

BOARD REQUEST

Technology Modernization (P036510)

Category	Montgomery County Public Schools		Date Last Modified	11/17/14
Sub Category	Countywide		Required Adequate Public Facility	No
Administering Agency	Public Schools (AAGE18)		Relocation Impact	None
Planning Area	Countywide		Status	Ongoing

	Total	Thru FY15	Est FY16	Total 6 Years	FY 17	FY 18	FY 19	FY 20	FY 21	FY 22	Beyond 6 Yrs
EXPENDITURE SCHEDULE ($000s)											
Planning, Design and Supervision	363,610	185,795	25,538	152,277	27,399	26,010	22,875	25,366	25,484	25,143	0
Land	0	0	0	0	0	0	0	0	0	0	0
Site Improvements and Utilities	0	0	0	0	0	0	0	0	0	0	0
Construction	0	0	0	0	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0	0	0	0	0
Total	363,610	185,795	25,538	152,277	27,399	26,010	22,875	25,366	25,484	25,143	0
FUNDING SCHEDULE ($000s)											
Current Revenue: General	208,995	58,588	2,332	148,075	26,319	24,930	21,936	24,263	25,484	25,143	0
Current Revenue: Recordation Tax	143,907	116,499	23,206	4,202	1,080	1,080	939	1,103	0	0	0
Federal Aid	10,708	10,708	0	0	0	0	0	0	0	0	0
Total	363,610	185,795	25,538	152,277	27,399	26,010	22,875	25,366	25,484	25,143	0

APPROPRIATION AND EXPENDITURE DATA (000s)

Appropriation Request	FY 17	27,399
Appropriation Request Est.	FY 18	26,010
Supplemental Appropriation Request		0
Transfer		0
Cumulative Appropriation		211,333
Expenditure / Encumbrances		185,795
Unencumbered Balance		25,538

Date First Appropriation FY 03	
First Cost Estimate	
Current Scope	0
Last FY's Cost Estimate	294,215

Description

The Technology Modernization (Tech Mod) project is a key component of the MCPS strategic technology plan, Educational Technology for 21st Century Learning. This plan builds upon the following four goals: students will use technology to become actively engaged in learning, schools will address the digital divide through equitable access to technology, staff will improve technology skills through professional development, and staff will use technology to improve productivity and results. The funding source for the initiative is anticipated to be Federal e-rate funds. The Federal e-rate funds programmed in this PDF consist of available unspent e-rate balance: $1.8M in FY 2010, $1.8M in FY 2011, and $327K in FY 2012. In addition, MCPS projects future e-rate funding of $1.6M each year (FY 2010-2012) that may be used to support the payment obligation pending receipt and appropriation. No county funds may be spent for the initiative payment obligation in FY 2010-2012 without prior Council approval. During the County Council's reconciliation of the amended FY 2011-2016 CIP, the Board of Education's requested FY 2012 appropriation was reduced by $3.023 million due to a shortfall in Recordation Tax revenue. An FY 2012 supplemental appropriation of $1.339 million in federal e-rate funds was approved; however, during the County Council action, $1.339 million in current revenue was removed from this project resulting in no additional dollars for this project in FY 2012. An FY 2013 appropriation was requested to continue the technology modernization project and return to a four-year replacement cycle starting in FY 2013; however, the County Council, in the adopted FY 2013-2018 CIP reduced the request and therefore, the replacement cycle will remain on a five-year schedule. An FY 2013 supplemental appropriation in the amount of $2.042 million was approved in federal e-rate funds to roll out Promethean interactive technology across all elementary schools and to implement wireless networks across all schools. An FY 2014 appropriation was approved to continue this project. An FY 2015 appropriation was approved to continue the technology modernization program which will enable MCPS to provide mobile (laptop and tablet) devices in the classrooms. The County Council adopted FY 2015-2020 CIP is approximately $21 million less than the Board's request over the six year period. However, e-rate funding anticipated for FY 2015 and FY 2016 will bring expenditures in those two years up to the Board's request to begin the new initiative to provide mobile devices for students and teachers in the classroom. The County Council, during the review of the amended FY 2015-2020 CIP, programmed an additional $2 million in FY 2016 for this project. A supplemental appropriation was approved to have the $2 million appropriated to MCPS. An FY 2016 appropriation was approved to continue the technology modernization program. An FY 2017 appropriation is requested to continue the technology modernization program as well as fund 16 information technology system specialist positions being reallocated from the operating budget to the capital budget.

Coordination

FY 2017 – Salaries and Wages: $4.819M, Fringe Benefits: $893K, Workyears: 36.5 FY 2018-2022 – Salaries and Wages $24.782M, Fringe Benefits $4.604M, Workyears: 219