FY 24 Operating Budget Public Hearing
April 13, 2023 at 1:30pm

Testimony of Montgomery County Retired Employees Association (MCREA)

I'm Sara Harris, President, Montgomery County Retired Employees Association, and I'm here today to submit testimony concerning OPEB (Other Post Employment Benefits).

MCREA's 17 Board members represent 7500+ Retirees and dependents, who depend on well managed and financed trust funds for their pension and health care benefits.

Given the importance of OPEB benefits, MCREA established a 4-member Work Group to review the FY 24 Operating Budget, the GO Committee packet, and the GO Committee March 7 letter to the County Executive. (A copy of our Work Group report is submitted with this testimony.)

The indisputable point made by the GO Committee is that "An updated OPEB funding policy is key to ensuring the long-term viability of the OPEB Trust, controlling costs over the long term, and creating a clear and defined path to begin using Trust assets."

It is essential for the Council and Executive to work on narrowing the differences and securing agreement on a long term OPEB policy during this budget cycle.

To quote from the MCREA OPEB Work Group report:

"While the Executive and his staff raise some important issues, in our view the approach taken by the GO Committee represents the correct starting point and the best path forward. It is principled, responsible, and realistic, and it is a better fit for the gyrations in investment returns of recent, and likely coming years. It is consistent with MCREA's historical position on OPEB funding policy."

MCREA urges Councilmembers to continue to fully fund the OPEB Trust Fund to protect future retiree health benefits.

March 20, 2023

Sara Harris, President
Montgomery County Retired Employees' Association (MCREA)

Dear Sara,

On March 9 you asked us to assess two approaches to funding OPEB (Other Post Employment Benefits, chiefly health benefits) for retirees of Montgomery County Government:

1. The approach taken by the Government Operations and Fiscal Policy Committee, as reflected in its attached March 7 letter to the County Executive. The Committee drew on the comprehensive analysis prepared by Council staff in the link below:
https://www.montgomerycountymd.gov/council/Resources/Files/agenda/cm/2023/20230302/20230302_GO1.pdf

2. The approach taken by the Executive, as reflected in his FY24 recommended operating budget. See the section on the Consolidated Retiree Health Benefits Trust in the link below.
https://apps.montgomerycountymd.gov/BASISOPERATING/Common/Chapter.aspx?ID=WORKFORCE

The central point of disagreement is the appropriate level of funding as it relates to the Actuarially Determined Contribution (ADC).[1]

OPEB funding policy has long been a priority concern for MCREA. Given the importance of reliable OPEB funding for both current County retirees and dependents, who number nearly 7,500, and future retirees and dependents, this makes good sense. Over the years, MCREA has consistently and effectively defended the integrity of the County's pension and OPEB Trusts. Last year, when the Executive wanted to utilize $20 million from the OPEB Trust to fund other parts of the FY23 budget, MCREA strongly supported the Council's decision to reject that proposal. In the FY24 budget, OPEB funding policy is once again the locus of different approaches.

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[1] The ADC is the sum of the annual pay-as-you-go and the pre-funding amount. Pay-as-you-go refers to the annual cost of group insurance benefits for current retirees and their dependents, including the cost for both retirees and the County. (The County's share in FY23 was $49 million.) Pre-funding refers to assets set aside in an OPEB Trust to cover obligations that will be paid in the future. The advantages of pre-funding include lowering long-term costs by 25-40%, protecting the County's AAA bond rating, and ensuring the long-term sustainability of retiree health benefits.

The GO Committee's Approach

On March 2 the GO Committee reviewed OPEB funding policy with Council and Executive Branch staff and the County's actuarial consultant, Bolton Partners. In its March 7 letter to the Executive, the Committee wrote:

In summary, the Committee supported the updated OPEB funding policy proposed by Council staff as a preliminary policy – with the understanding that additional work by staff and the actuarial consultant is needed on select policy elements (such as investment rate of return) that could lead to some modest adjustments during the budget review process. Key elements of a preliminary policy supported by the Committee include:

- *Changing from an open to closed amortization schedule;*
- *Adopting an initial funded ratio target goal of 85%;*
- *Adopting a 15-year target to reach the funded ratio target goal; and*
- *A provision to allow the Council and Executive to jointly agree to deviate from policy guidelines during a period of fiscal distress.*

The Committee's letter is carefully calibrated. The Committee did not address the Council staff's recommendation to lower the investment rate of return from 7.5% to 6.5%. The Committee noted that the preliminary policy it supports -- if it were to include this change -- would require up to $20 million in additional OPEB pre-funding contributions in year 1 and asked the Executive to include this funding in his FY24 recommended budget.[2]

In our view, changing from an open to closed amortization schedule is an essential element of an updated OPEB funding policy. (The current 30-year open amortization schedule restarts the process annually and defers attainment of the target. Closed amortization does not.) The Government Finance Officers Association (GFOA) calls this a best practice for OPEB pre-funding. Other elements, including an initial funded ratio target goal of 85% and a 15-year target to reach that goal (the GFOA recommends a range of 15 to 20 years), represent what Bolton consultant Tom Vicente on March 2 called "a very good start," but they can and will be adjusted as the policy is refined.

The crucial point made by the GO Committee is indisputable:

An updated OPEB funding policy is key to ensuring the long-term viability of the OPEB Trust, controlling costs over the long term, and creating a clear and defined path to begin using Trust assets.

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[2] The policy would require smaller additional contributions, declining to about $1 million in year 8, before the County could start withdrawing funds from the OPEB Trust to help pay current year pay-as-you-go costs, starting at about $0.5 million in year 9. This amount would rise to about $6.7 million in year 15, and then to the entire annual pay-as-you-go cost, starting with an estimated $65 million in year 16. In the early years this approach would clearly impose additional costs. Thereafter it would provide secure funding and would free up substantial amounts for other operating budget priorities.

The County Executive's Approach

Far from adding up to $20 million to OPEB funding in FY24 as requested by the GO Committee, the Executive reconfirmed his support for a very different updated OPEB funding policy. The Executive believes that he legitimately could have utilized $17.4 million in Trust assets to fund other parts of the FY24 budget -- just as he proposed in the FY23 budget to utilize $20 million in Trust assets -- but chose not to actually do so. The budget document states:

In planning for FY24, actuarial analysis assumed a utilization of $17.4 million in Trust assets, as the pay-as-you-go amount was again determined to be higher than the ADC. The FY24 budget again includes funding in excess of the ADC by $17.4 million (County General Fund) to fully fund the pay-as-you-go amount, and no prefunding amount is required for Montgomery County Government.

The budget document further states:

The County Executive has determined that the magnitude of the assets in the OPEB Trust requires a shift from the policy of paying the full amount of the ADC each year, to a policy that utilizes the Trust in a fiscally responsible and sustainable manner to pay a portion of the retiree health benefits while maintaining the assets necessary to support continued growth and long-term fulfillment of its purpose through sustained investment growth and contributions as required.

On pages 10-12 of the Council staff report, Executive Branch staff articulated this position in greater detail.[3]

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[3] "Executive Branch staff feel it is premature to pass a funding policy for the OPEB Trust. The proposal and options discussed within this packet constitute as being mid-way through a process, but not a completed process that has undergone thorough review and updating of assumptions, options, and outcomes....

"The current funding policy (requiring annual funding at the level of the Actuarially Determined Contribution, which is consistent with GFOA best practice principles) did not contemplate that the calculation for the ADC could result in a value lower than the annual pay-as-you-go cost. This scenario has been in play for the FY22 and FY23 ADC calculations. In these scenarios, adhering to the funding policy by funding at the level of ADC would inherently assume funding at a level below the total pay-as-you-go estimated cost. This would mean using OPEB Trust Fund assets to fund the remaining portion of the pay-as-you-go costs in an amount that is consistent with the actuarially calculated ADC, representing that difference between the ADC and pay-as-you-go cost, consistent with the results of the actuarial valuation.

"The Bolton analysis served to provide the working group with information and context about the potential impacts of various assumptions. The scenarios presented were selected to provide the working group with information from which to develop a full policy, but not to be reflective of "completed analysis."....

"Executive Branch staff therefore recommend letting the working group continue and complete its efforts to develop the revised long-term funding policy, and requests that this committee session serve to allow

The sharply different perspectives of the GO Committee and Council staff, on the one hand, and the Executive and Executive Branch staff, on the other, explain why agreement on an updated OPEB funding policy has not been reached in the last year, or for that matter in the last several years. While hope was expressed at the March 2 GO Committee meeting that agreement is possible before the FY24 budget process ends in two months, this seems unlikely. In any event, it is essential for work on narrowing differences and securing agreement to continue.

While the Executive and his staff raise some important issues, in our view the approach taken by the GO Committee represents the right starting point and the best path forward. It is principled, responsible, and realistic, and it is a better fit for the gyrations in investment returns of recent, and likely coming, years. It is consistent with MCREA's historical position on OPEB funding policy. We recommend that MCREA strongly support it.

Sincerely,

Steve Farber Linda Herman Linda McMillan Art Spengler

Council to affirm the direction of the policy development rather than adoption of an underdeveloped policy."

MONTGOMERY COUNTY COUNCIL
ROCKVILLE, MARYLAND

March 7, 2023

Marc Elrich
Montgomery County Executive
101 Monroe Street
Rockville, MD 20850

Dear County Executive Elrich:

On March 2, the Government Operations and Fiscal Policy (GO) Committee held a worksession to discuss potential updates to the County's OPEB funding policy. This worksession followed-up on the Committee's prior review of OLO Report 2019-11, where need for an updated OPEB funding framework was first discussed, and the Council's request during the FY23 budget process for staff to review and prepare potential updates to the long-term funding policy.

The Committee had a robust and productive discussion with Executive Branch staff, the County's actuarial consultant Bolton Partners, and Council staff. The Committee appreciates the ongoing work of Executive Branch staff on this issue.

In summary, the Committee supported the updated OPEB funding policy proposed by Council staff as a preliminary policy – with the understanding that additional work by staff and the actuarial consultant is needed on select policy elements (such as investment rate of return) that could lead to some modest adjustments during the budget review process. Key elements of a preliminary policy supported by the Committee include:

- Changing from an open to closed amortization schedule;
- Adopting an initial funded ratio target goal of 85%;
- Adopting a 15-year target to reach the funded ratio target goal; and
- A provision to allow the Council and Executive to jointly agree to deviate from policy guidelines during a period of fiscal distress.

As detailed in the actuarial analysis prepared by Bolton, the preliminary policy supported by the Committee will require up to $20 million in additional OPEB pre-funding contributions in FY24. **As a result, the GO Committee requests that you include this additional funding as part of your FY24 recommended budget consistent with this preliminary policy recommendation.**

An updated OPEB funding policy is key to ensuring the long-term viability of the OPEB Trust, controlling costs over the long-term, and creating a clear and defined path to begin using Trust assets.

We look forward to your continued collaboration on fiscal policy issues.

Sincerely,

Kate Stewart, Chair | Andrew Friedson | Sidney Katz