Odyssey Advisors

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November 11, 2016

Personal and Confidential

Ms. Debra Morin
Treasurer/Collector
Town of Avon
65 E Main Street
Avon, MA 02322

Re: GASB 74 and 75 – Summary of Results

Dear Ms. Morin:

The purpose of this letter is to summarize our actuarial valuation of the Town of Avon Other Postemployment Benefits Plan (the "Plan") for the fiscal year ending June 30, 2017 with a valuation date of June 30, 2016 and a measurement date of June 30, 2016 in accordance with Statement Nos. 74 and 75 of the Governmental Accounting Standards Board ("GASB 74/75").

GASB 74 and 75 Impact

The Town has adopted GASB 74 and 75 for its Fiscal Year ending June 30, 2017. The adoption of GASB 74/75 introduces a new actuarial cost method and discount rate as well as new disclosures and methodologies for reporting plan liabilities and OPEB expenses. Significant changes have been made to the recognition of OPEB expenses, making the comparison of Net OPEB Expense in the current valuation to the expenses reported under GASB 45 misleading. The liability reported on the Town's balance sheet will increase dramatically as GASB 74/75 require the recognition of liabilities immediately rather than recognizing liabilities (Net OPEB Obligation) over a 30 year period as GASB 45 allowed. Please keep these changes in mind when considering any comparison to previously reported liabilities and expenses. If you or your auditors have questions on this, feel free to give us a call.

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What caused plan liabilities to change from FY 15 to FY 17?

Plan experience was less favorable than expected - for the year ending on the reporting date of June 30, 2017, the Plan saw an experience loss of $2,724,265 or 25.14%. This was mainly due an increase in the number of active participants in the plan. This was somewhat offset by premiums for Medicare integrated plans increasing by less than the expected 10% increase. The actuarial experience loss is amortized into the net OPEB expense over time until fully recognized. The net impact of plan experience is an increase in the net OPEB expense.

Over the two year period, the Total OPEB Liability ("TOL") went from $13,375,933 as of July 1, 2014 to $14,269,140 as of June 30, 2016 for an increase of $893,207. During that same period the Town's Net OPEB Liability ("NOL") increased from $12,849,080 as of June 30, 2015 to $13,559,407 as of June 30, 2017 for a total change of $710,327. For a 30-year projection of future costs and liabilities refer to Exhibit C of our GASB 75 report.

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Key Drivers of Plan Liabilities

A key driver of plan costs and liabilities is post-age 65 (Medicare Integrated) Plan costs. In the current valuation post-age 65 liabilities represent 67% of the total plan liabilities. Consequently, plan design changes that affect post-65 plan costs will have the most impact on future liabilities.

The age at which participants retire and the percentage of participants who elect coverage for themselves and/or a spouse are also drivers of plan liabilities. Unlike a pension plan where a participant receives a reduced benefit for early retirement, a participant in a retiree welfare plan will receive a higher benefit by retiring early (more years of benefits to be received plus more years before Medicare). A key issue to keep in mind is that participant behavior (as far as retirement is concerned) is affected by many factors including the economy, personal health and work satisfaction.

Future Healthcare Cost Inflation

The future healthcare cost inflation assumption has a significant impact on plan liabilities. In our report we use a long term 5.00% inflation assumption for healthcare costs. This is based on a 2.75% general inflation assumption plus an additional 2.25% inflation assumption due to increased healthcare utilization. The Town's ability to manage future increases in healthcare costs will be a major driver of future plan performance. In the event that healthcare trend rates were 1% higher than forecast and employee contributions were to increase at the forecast rates, the Total OPEB Liability would increase to $17,038,226 or by 19.4% and the corresponding Service Cost would increase to $555,591 or by 40.9%. If such healthcare trend rates were 1% less than forecast and employee contributions were to increase at the forecast rate, the Total OPEB Liability would decrease to $11,061,885 or by 22.5% and the corresponding Service Cost would decrease to $236,440 or by 40.0%.

Assumptions

The assumptions used in the GASB 74 and 75 report for mortality rates, termination rates, and retirement rates mirror the assumptions used by PERAC. The long term healthcare inflation trend assumption is 5.00% as described in the previous paragraph.

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What are some key plan metrics?

While an actuarial valuation under GASB 74/75 can be very complex with many variables, we find it helpful to look at several key metrics shown below to better allow you to manage your plan.

Representative Plan Statistics

	June 30, 2016	July 1, 2014
Total OPEB Liability	14,269,140	13,375,933
Per Eligible Active Plan Participant	29,517	32,146
Per Retiree/Spouse Plan Participant	59,130	56,823
Total Annual Service Cost (annual benefit accrual)	394,207	523,844
Per Eligible Active Plan Participant	1,752	2,894
Expected Employer Share of Retiree Costs	701,682	602,151
Per Retiree/Spouse Plan Participant	5,439	4,527
Net OPEB Liability as a % of Payroll	121.30%	127.10%
Average Annual Medical Plan Premium (Single Coverage)	8,079	7,664
Average Annual Medical Plan Premium (Family Coverage)	27,306	24,724
2018 Excise Tax Thresholds		
Annual Medical Plan Premium (Single Coverage)	10,200	
Annual Medical Plan Premium (Family Coverage)	27,500	

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Impact of Patient Protection and Affordable Care Act ("PPACA") Excise Tax

Under the Patient Protection and Affordable Care Act ("PPACA"), an excise tax will be imposed for tax years beginning after December 31, 2019 (formerly December 31, 2017, but amended by Consolidated Appropriations Act) for high cost employer sponsored health coverage. The law specifies a 40% excise tax, to be paid by the provider of such coverage, of the excess value beyond a basic dollar amount plus an additional "kicker" for qualified retirees or those engaged in a high risk profession. The threshold amounts for 2018 (original legislation) were $10,200 for single coverage and $27,500 for family coverage and a "kicker" amount of $1,650 for single coverage and $3,450 for family coverage. These threshold and kicker amounts are expected to be updated because of the Consolidated Appropriations Act before the tax takes effect in 2020, but currently the updated amounts have not been released.

The excise tax liability will vary significantly over time as it is highly leveraged with the basic threshold amount increased with general CPI and medical costs increasing with medical trend (generally higher). For purposes of the fiscal year ending June 30, 2017, the TOL for the excise tax is $600,134 and the increase in OPEB Expense is $77,308. Given your premiums through the 2017 fiscal year and the excise tax threshold, your average single premiums are $2,121 below the excise tax threshold and your average family premiums are $194 below the excise tax threshold. As more regulatory guidance becomes available, the calculation of the excise tax liability will evolve.

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Liabilities & Benefit Payments in today's dollars

With the growth of medical care costs over time, the nominal accrued liabilities ("TOL") and benefit payments can appear daunting. However, it is important to remember that a dollar paid in the future is worth less than a dollar paid today. As such, another way to view the projected liabilities and benefit payments is in 2017 dollars so you can compare them to your current budget and ability to pay. As part of our analysis, we have developed projections of plan liabilities & expenses over the next 40 years assuming that the Town's benefit eligible active population remains constant (i.e., employees who terminate or retire are replaced). While the full 40 year projection in 2017 dollars in shown in the report, below are some selected years:

Fiscal Year	Number of Retirees, Spouses & Surviving Spouses	Present Value at 2.75% of Total OPEB Liability	Present Value at 2.75% of Employer Share of Premiums / Claims including "implicit cost"
2017	129	14,269,140	701,682
2022	153	15,215,718	847,207
2027	171	15,971,366	887,421
2032	179	16,734,180	904,603
2037	177	17,549,402	884,808
2042	169	18,394,705	874,637
2047	159	19,858,584	834,984

Looking at these liabilities and expenses over the next 40 years, we would offer the following highlights/observations:

- ✓ The present value of the Plan's TOL will reach its maximum in 2056 at $22.0 million ($63.5 million in 2056 dollars).
- ✓ The present value of the Plan's benefit payments will reach a peak of $926 thousand in 2034 ($1.47 million in 2034 dollars).
- ✓ The Plan will see the number of retirees & beneficiaries receiving benefits increase from 129 to a maximum of 179 in 2032 before beginning to decline.

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We have an "unfunded liability". How do we fund it? Can we fund it?

The Plan currently has an unfunded liability of approximately $13,559,407 and this amount is expected to grow over time in the foreseeable future. While some municipal entities across America have chosen to fund this liability, over 95% are not currently dedicating funding to it. The State of Massachusetts has passed legislation allowing municipal entities to establish a Trust for Other Postemployment Benefits ("OPEB") under M.G.L. Chapter 32B, Section 20 for purposes of accumulating assets to pre-fund the liabilities under GASB 75. This legislation was amended effective November 9, 2016 to clarify who may adopt such a Trust and provide guidance on the ongoing operation of such a Trust. To the best of our knowledge, the Town of Avon has established an irrevocable trust for the purposes of prefunding liabilities under GASB 74/75.

GASB 74 and 75 at a glance

The Governmental Accounting Standards Board ("GASB") issued GASB 74 and 75 "*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*" on June 2, 2015 which is effective for your fiscal year and beyond. This standard largely mirrors the GASB 67 and 68 standards for pension plans. The new standards require increased disclosure and tie interest rates used in the valuation to the plan's underlying investment and funding policy. This may increase the pressure on many entities to begin funding their OPEB liabilities.

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On October 18, 2016 GASB released the implementation guide for GASB 74. This report reflects our current understanding of the implementation guide. As more guidance becomes available the methodologies in our report may evolve.

If you or your auditors have questions on this, feel free to give us a call.

Sincerely,

Parker E. Elmore, ASA, EA, FCA, MAAA
President, CEO & Actuary