Revenue and Expenditure Task Force
Thursday, January 28, 2021 5:30PM
WebEx Virtual Meeting

I. Call to Order

Chair Vaill called the meeting of the Revenue and Expenditure Task Force (RETF) to order at 5:31PM and initiated roll call. Present by video conferencing were Tim Vaill-Y, Joe Guilmartin-Y (arrived late), Melissa Danisch-Y, Paul MacKay, Tom Hartwell-Y and Kevin Connors-Y. Also present was Patrick Lawlor, Assistant Town Manager, Finance Director Donna Walsh, Hayley Green, Town Accountant/Assistant Finance Director, Finance Committee Liaison Linn Anderson, as well as School Liaison Shannon Scully. The meeting was taped and live cablecast.

II. Approval of Minutes – December 10, 2020

Upon motion duly made by Mr. MacKay and seconded by Ms. Danisch, it was unanimously voted to approve above minutes. Tim Vaill-Y, Joe Guilmartin-Y, Melissa Danisch-Y, Paul MacKay, Tom Hartwell-Y and Kevin Connors-Y. Motion passed 6-0.

III. Presentation of Pension Obligation Bonds – Pension Reform – Mr. Hartwell

Mr. Hartwell gave his presentation on the Pension Obligation Bonds and Pension Reform (see attached PowerPoint presentation.)

Mr. Hartwell reported that the Town Manager gave his presentation this morning to the Retirement Board on the Integrated Financial Plan including Pension Obligation Bonds and he encouraged members to view the videotape of that presentation.

He stated that the Town Manager's plan is a solid one to address the pension unfunded liability, but it is Mr. Hartwell's conviction that the plan needs to be accompanied by pension reform. This reform would not put an undue burden on the taxpayers and would ensure basic benefit promises to current employees and retirees are kept.

The town's actuarial accrued liability has been growing at an annual rate of 6.70% and not keeping pace with the market value of the assets. The reasons are threefold: a) increase in benefits to employees and retirees; b) changes in actuarial assumptions; and c) adding new employees to the plan. In some ways growth has been slowed by the change made in lowering the discount rate from 7.0% to 6.25%, but unless pension reform is instituted growth will continue to outpace assets. The present accrued liability is $326M.

Mr. Hartwell then reviewed the annual employer normal cost set aside for pension, payment of unfunded actuarial accrued liability, actuarially determined contribution, the actual pension expense reflected on the town's audited financial statements and the projected annual payroll (see PowerPoint presentation attached.)

The four recommended reforms are: a) form an investment advisory committee; b) change pension eligibility from part-time to full-time for new employees; c) new part-time employees will not be allowed to buy back past service rendered with the town upon becoming full-time; and d) offer retirement options to new full-time employees. Mr. Hartwell noted that recommendation a) is within the authority of the Town Manager and he is collaborating with the Retirement Board to set up this advisory committee. Recommendations b) and c) are within the authority of the Retirement Board to effectuate and are currently being considered and d) would require legislative approval. None of the above reforms will have any impact on the town's existing unfunded pension liabilities but will slow down the growth.

If the town goes forward with pension obligation bonds, the Retirement Board will have $345M+ in investable assets. While the Retirement Board has the ultimate fiduciary responsibility over the investment process, management of pension fund assets will be critical to dovetail with a successful pension obligation bond program.

Mr. Hartwell suggests consideration of some of the following roles of the Investment Committee comprised of experienced residents with relevant expertise appointed by the Town Manager: a) set the strategic asset allocation ranges; b) performance monitoring; c) establish investment objectives and guidelines; d) direct the investment consultant on investment decisions; e) stress test and risk constraints; and f) set the annual long term rate of return/discount rate used for the actuarial report. There is value in doing an actuarial report on a yearly basis to keep accurate track of the state of assets. Bids are currently out seeking both annual estimates and bi-annual estimates for this service.

Mr. Hartwell then reviewed changing eligibility from part-time (20 hours/week) to full-time. He also reviewed the policies of neighboring communities requiring a 30-hour/week. He is recommending the town contribute 3% for new part-time employees into the 457 plan with ICMA-RC. This would minimally save 6% and likely significantly more as the town no longer has any market risk. He believes contributing 3% would make this attractive in hiring qualified staff.

Changing the eligibility for participation in the retirement plan also affects participation in OPEB. By limiting the eligibility to 35 hours/week, the town's full funding schedule for OPEB would be reduced from 45 years 38 years and from $302.2M to $271.9M.

In terms of eligibility the Retirement Board has the authority to set policy on whether or not employees can purchase past service rendered. However, state law does not allow the Retirement Board to prohibit employees from purchasing past service rendered at another governmental unit within the Commonwealth.

Mr. Hartwell also reviewed his proposed defined contribution plan in lieu of the current defined benefit plan. New employees will be given the option of joining the current defined benefit or defined contribution. This plan has been instituted in other states. Employees will contribute 7.50% and the town match with 7.50%. This reform would require state approval. Mr. Lawlor pointed out that not only state approval would be needed, but legislative change would be needed as well by filing home rule petition, positive results of which would be highly unlikely.

Recruitment practices for government positions among younger job seekers were also discussed and the difficulties thereof in competition with the private sector.

Discussion ensued on the current number of part-time employees broken down by school and town with the majority on the school side. Ms. Scully noted that part-time jobs cannot easily be combined into one full-time position at the school level. Categories in the largest number are instructional assistants that may be moved to an FTE1.0. One major concern is if reduction in benefits are instituted, operating budgets may see an increase in the salary line that would need to be increased in order to offset that delta. Not to be overlooked is the value of the person performing part-time duties, like vital crossing guards, cafeteria workers, classroom assistants, etc. Mr. Hartwell pointed out that fiduciary responsibility is owed to the current employees and retirees, and plans offered to new incoming employees that will enable that commitment.

Integrated Financial Plan – West El/Shawsheen Preschool, Pension Obligation Bonds, OPEB and Andover High School – Mr. Lawlor

Mr. Lawlor presented the Town Manager's Integrated Financial Plan (see PowerPoint presentation attached.)

1. Unfunded Pension Liability. The actual amount fluctuates between $165-$185M. The pension liability is required by Massachusetts General Laws (MGL) to be fully funded by 2040. At the present time our funding schedule is set by the Retirement Board and on schedule for 2037. The actual benefit structure of municipal pensions is identified by MGL, (age, percentage of pay received in retirement) are all set by statute, and only the legislature can make changes. This unfunded liability presents the greatest threat to service levels and bond ratings in order to maintain AAA rating. He added that the Retirement Board's efforts at pension reform is limited to eligibility only. The town's required contribution this year is $13M and could increase to $42M if funded by 2037, or $50M+ if funded by 2040.

2. West El/Shawsheen Preschool. This project replaces two schools built on one campus with many shared systems. MSBA reimburses the town $333/sq/ft but present construction costs are higher. With a projected cost of $148M and Town's share of $114M a net reimbursement of 23% is expected from MSBA. This project would alleviate overcrowding in other schools.

3. Other Post Employment Benefits (OPEB) in Retirement. Unlike the pension obligation liability, there is currently no required funding amount or mandatory funding dates, but rating agencies have made it clear they want to see a plan of how it is going to be fully funded. Andover has aggressively been contributing to this fund, significantly more than other communities' contributions, and is expected to be funded by 2062. The integrated financial plan will provide us an option to accelerate this payment.

4. Andover High School. This is a large project that can take a number of various forms - new high school, renovations, additions, etc. The project has to proceed to full design to get a better idea of cost. MSBA is delayed in responding to a filed statement of interest

submitted due to COVID. There is a current warrant article that would reauthorize remaining debt service of Bancroft in order to fund the feasibility study.

Tenets of the Plan: The Town Manager is proposing a $290M debt exclusion to fully fund the unfunded pension liability and the school building project: $175M to fund a pension obligation bond over a 17-year term and $115M to fund the construction of the two new schools. The plan identifies a $10M general fund mitigating factor (GFMF) to offset tax impacts as a debt exclusion applied to the total cost of the debt, which directly mitigates the tax impacts of the two large projects and gives the opportunity to retire the debt exclusion in year 18 and repurpose GFMF to offset West El and another obligation such as OPEB. Part of the program would be to reauthorize the Bancroft School debt of $1.5M to contribute to the AHS project and not create any tax impact for the design.

The Financing Plan Calculation = POB Debt Service + West El/Shawsheen Debt Service – GF Mitigating Factor ($10M) = Amount to be raised outside of the levy

Mr. Lawlor then compared the existing unfunded pension liability from 2023 extrapolated out to 2040 to the below scenarios of the integrated plan.

Scenario A: Integrated Financing Plan
Scenario B: Pension Operating Override and West Elem & Shawsheen School Debt Exclusion
Scenario C: Pension Operating Override Only
Scenario D: West Elementary and Shawsheen School Only

Mr. Lawlor then reviewed the impact to the average tax bill from the point of view of level principal from 2022 to 2040. The first amount to be borrowed in 2022 would be for the school project with an increase to the average tax bill of $262. The following year 2023 there would be no increase to the average tax bill. In 2024 there would be an increase of $259 attributable to the integrated financing plan, and in 2025 an increase of $360 also attributable to the plan. At the highest point in the tax bill the taxpayer would be paying $876, which decreases each year to 2040. From 2041 to 2053 the payment would be just for the school project as the pension obligation has been funded. The options for that time period would be to end the school project exemption and assume debt service for another school without impact. From the point of view of level debt the highest year of the tax impact would be $783.

Comparison of Pension Funding and Override History of other Comparable AAA Rated Communities: Many of the communities passed overrides on a fairly regular basis to fully fund their pension plan (see attached PowerPoint presentation.) Andover is the only AAA rated community in Massachusetts that is less than 50% funded and the only community which has never had an override to fund the pension. At this point Mr. Lawlor explained how, through the Integrated Financial Plan, Andover would stay "in the middle of the pack" and maintain its competitive place in which to live and be 100% funded in its pension obligation and school debt.

Mr. Lawlor then reviewed the impact of a yes/no vote on the proposed financial plan. A 'yes' vote on both projects would have no service impacts, whereas a 'no' vote would have major impact on reduction of services. A 'yes' vote on building and 'no' on pension obligation bonds would also have major impacts on services; whereas a 'yes' vote on pension obligation bond and 'no' on the school, the service impacts would be unknown. The amount needed to fully fund the pension liability would remain approximately $427M, which would be $185M more than the pension obligation option and $70.5M more than the integrated plan. The total amount of reduction in services would be approximately $16M, and Mr. Lawlor outlined the potential positions that may need to be reduced.

Discussion ensued on the year service reductions would need to be made. Mr. Lawlor stated that the breaking point year would be 2023 with a projection over a five year period. Also discussed was the process that went into deciding on analysis of positions in each department. Mr. Lawlor stated that this "pencil sharpening" analysis is done every year in the budgeting process at the time of resignations, retirements, etc. in light of determining efficiencies and decisions made on refilling, eliminating or repurposing the position among departments.

Mr. Lawlor stated that a reserve fund has been established for direct contributions from active town employees, the first municipality in the Commonwealth whose employees voluntarily contribute 1% of their salary to offset losses and/or reconcile unfunded liability. Approximately 87% of active employees will contribute between $475-$2,100 annually to the reserve fund and total approximately $5.7M over the life of the pension obligation debt schedule.

Understanding the Risks: Mr. Lawlor reviewed the mitigation measures that would be taken if the return on assets does not exceed the borrowing rate or if the legislature extends funding requirements beyond 2040. Andover's long term rate of return is approximately 6.25% (discount rate) and the current bond market expectation is 1.43-1.84% as of January 26th. However, projections in the proposed plan assume 3.5%, creating a buffer from the expected bond market. He also added that since 1950 the 20-year return on a pension obligation issuance has never been below 5.59%: and since 1900 there have only been four 10-year periods where returns were negative (the great depression and great recession.)

Next steps include a) appointing an investment committee; b) public outreach; c) borrowing authorizations for both school project and pension obligation bonds will require Town Meeting approval on June 5th; and both the school project and pension bonds will require debt exclusion votes on June 15th.

Next Steps of the Revenue and Expenditure Task Force

Mr. Lawlor reviewed next steps (see attached chart):

- Monthly meetings
- Informal Working Groups can work individually between meetings to develop focus area (see more detailed descriptions attached)
- Task Force Milestones in a Normal Year
- June–September: research and study sessions
- September-October: revenue recommendations prior to CIP release

- November-December: short report on task force positions
- March-May: public information function

Discussion ensued on investigating pension reform in conjunction with the pension obligation bond. The Chair reiterated his commitment to pursue the important areas of focus and he will be conferring with Task Force members on their priorities as to these areas of focus.

<u>Next Meeting</u>
Thursday, February 18 @ 5:30PM

<u>Adjournment</u>
Upon motion duly made by Mr. MacKay and seconded by Mr. Connors, it was unanimously voted to adjourn. Tim Vaill-Y, Joe Guilmartin-Y, Melissa Danisch-Y, Paul MacKay-Y, Mr. Hartwell-Y, Mr. Guilmartin-Y and Kevin Connors-Y. Motion passed 6-0. Meeting adjourned at 7:02PM.

Respectfully submitted,

Christine Martin Barraford
Recording Clerk

Attachments:

Presentation Pension Reform and Pension Obligation Bonds – Mr. Hartwell
Town Manager's Presentation on Integrated Financial Plan and Pension Obligation Bonds