May 23, 2016

Personal and Confidential

Mr. Jeffrey Sands
Assistant Superintendent for Finance and Administration
Hamilton-Wenham Regional School District
5 School Street
Wenham, MA 01984

Re: GASB 45 – Summary of Results

Dear Mr. Sands:

The purpose of this letter is to summarize our actuarial valuation of the Hamilton-Wenham Regional School District Other Postemployment Benefits Plan (the "Plan") for the fiscal year ending June 30, 2016 in accordance with Statement No. 45 of the Governmental Accounting Standards Board ("GASB 45").

What caused plan liabilities to change from FY 13 to FY 16?

Plan experience was more favorable than expected. This was mainly due to premiums for Medicare integrated plans decreasing vs. an expected 11% increase as well as a decrease in average service. This was somewhat offset by the preparations for GASB 75 including the introduction of a new Actuarial Cost Method and a decrease in the discount rate from 4% to 3.5% (increasing disclosed liabilities by $1.7 million and $1.8 million respectively), a more conservative mortality table as recommended by PERAC, and the ACA excise tax. The actuarial experience gain is amortized into the annual OPEB costs over a 30-year period. The net impact of plan experience is a decrease in the annual OPEB cost. Please note there was a change in methodology to include spouses of retirees in the count.

Over the three year period, the Actuarial Accrued Liability ("AAL") went from $24,075,216 as of July 1, 2012 to $25,337,907 as of July 1, 2015 for an increase of $1,262,691. During that same period the Annual OPEB Cost went from $2,495,422 to $2,427,496 for a decrease of $67,926. As you continue to recognize more of the AAL at the time of adoption of GASB 45 onto your financial statements and factor in plan experience you can expect your OPEB obligation to increase. The District's OPEB obligation increased from $12,171,846 as of June 30, 2013 to $17,530,238 as of June 30, 2016 for a total change of $5,358,392. For a 30-year projection of future plan costs and liabilities refer to GASB 45 report, exhibit C.

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 87% of the total plan liabilities. Consequently, plan design changes that affect post-65 plan costs will have the most impact of future plan 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 liabilities. Unlike a pension plan where a participant receives a reduced benefit for early retirement, a participant in a retiree welfare plan will actually 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.

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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 District'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 Actuarial Accrued Liability would increase to $33,634,262 or by 32.7% and the corresponding Normal Cost would increase to $1,923,792 or by 57.5%. If such healthcare trend rates were 1% less than forecast and employee contributions were to increase at the forecast rate, the Actuarial Accrued Liability would decrease to $18,948,251 or by 25.2% and the corresponding Normal Cost would decrease to $732,425 or by 40.0%.

Assumptions

The assumptions used in the GASB 45 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 45 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

	July 1, 2015	July 1, 2012
Total Accumulated Postretirement Benefit Obligation	25,337,907	24,075,216
Per Eligible Active Plan Participant	43,383	41,088
Per Retiree/Spouse Plan Participant	61,822	60,609
Total Annual Normal Cost (annual benefit accrual)	1,221,307	1,187,163
Per Eligible Active Plan Participant	3,829	3,757
Expected Employer Share of Retiree Costs	694,549	896,395
Per Retiree/Spouse Plan Participant	3,734	4,898
Unfunded Actuarial Liability as a % of Payroll	137.10%	138.60%
Average Annual Medical Plan Premium (Single Coverage)	5,962	6,090
Average Annual Medical Plan Premium (Family Coverage)	22,674	21,455
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, 2016, the AAL for the excise tax is $357,856 and the increase in annual OPEB Cost is $64,756. Given your premiums through the 2017 fiscal year and the excise tax threshold, your single premiums are within 71.08% of the excise tax and your family premiums are within 21.28% of the excise tax. As more regulatory guidance becomes available, the calculation of the excise tax liability will evolve.

Liabilities & Benefit Payments in today's dollars

With the growth of medical care costs over time, the nominal accrued liabilities ("AAL") 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 2016 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 District's benefit eligible active population remains constant (i.e., employees who terminate or retire are replaced). While the full 40 year projection in 2016 dollars in shown in the report, below are some selected years:

Fiscal Year	Number of Retirees, Spouses & Surviving Spouses	Present Value of Total Accumulated Postretirement Benefit Obligation ("APBO")	Present Value of Employer Share of Premiums / Claims including "implicit cost"
2016	186	25,337,907	694,549
2021	210	28,122,036	761,098
2026	233	31,093,210	889,494
2031	250	33,963,450	993,689
2036	258	36,918,602	1,063,887
2041	258	40,231,350	1,116,224
2046	258	43,956,453	1,144,406

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 AAL will reach their maximum in 2055 at $51.9 million ($198 million in 2055 dollars).
- ✓ The present value of the Plan's benefit payments will reach a peak of $1.29 million in 2055 ($4.96 million in 2055 dollars).
- ✓ The Plan will see the number of retirees & beneficiaries receiving benefits increase from 186 to a maximum of 266 in 2055.

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

The Plan currently has an unfunded liability of approximately $25,337,907 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 recently 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 45. To the best of our knowledge, Hamilton-Wenham Regional School District has not established an irrevocable trust for the purposes of prefunding liabilities under GASB 45.

Pre-Funding – if you were to elect to "pre-fund" the OPEB expenses each year by contributing the entire Annual Required Contribution, you would be allowed to use a long-term interest rate based on your underlying investment policy. Assuming a balanced portfolio (50% equities & 50% fixed-income), you could use a 7.00% discount rate vs. the 3.50% used in our analysis. The impact of such funding would be to reduce disclosed plan liabilities to $15,591,240 and the annual OPEB Cost to $1,746,266. This would require additional funding of $764,800 in the first year which will increase by 0.00% per year until the plan reaches full funding. While this does not impact the ultimate cost of the plan, it would reduce disclosed liabilities and expenses.

In the report we have outlined several options for pre-funding (including pay-as-you-go, funding over 30 years and funding the annual normal cost):

- Pay-as-you-go – pay annual retiree premiums as they come due with little to no funding set aside in a trust.
- 30 year funding – the concept is to contribute to achieve full funding over a 30 year period.
- Funding annual normal cost – the concept is to fund the excess of the normal cost over current year benefit payments. This approach prevents the liability from growing in current dollars.

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Please be aware the options presented represent a sampling of your options. The ultimate choice to fund, not to fund or the level of funding will depend on your circumstances. Should you decide that pre-funding is an appropriate option for you we would be happy to help you design a funding schedule that best fits your needs.

Upcoming Changes

The Governmental Accounting Standards Board ("GASB") issued GASB 75 "*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions"* on June 2, 2015 which will become effective for your 2018 fiscal year. This standard will largely mirror the GASB 68 standard for pension plans. The new standards will require increased disclosure and will 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. For more information, please review our white papers at www.GASB75.com or on our website.

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