ORANGE WATER AND SEWER AUTHORITY

A public, non-profit agency providing water, sewer and reclaimed water services to the Carrboro-Chapel Hill community.

TO: **Human Resource Committee**
Barbara Foushee, Chair
Yinka Ayankoya
Jeff Danner
John Young
Robert Morgan, Ex-Officio

THROUGH: Ed Kerwin

FROM: Stephanie S. Glasgow

DATE: June 22, 2018

SUBJECT: **Human Resource (HR) Committee Meeting**
Monday, June 25, 2018, 5:00 pm, OWASA Boardroom

Agenda

1) **Retiree Health Benefits for New Hires**
   Evaluate information and options for the health benefits provided to retirees (attached).
2) **Deferred Compensation (457) Plan**
   Discuss information and options for the deferred compensation benefits (attached).

Stephanie S. Glasgow, MESH, MPM, PHR, SHRM-CP
Director of Human Resources and Safety

Background

In 2014, consultants analyzing OWASA's compensation and benefits programs determined that our benefits plans are not in sync with the employment market. In summary: our 457 benefits plan is below market, whereas our retiree health benefit plan is above market. Based on recommendations in the report, the Board considered changes to our retiree health benefit and deferred compensation (457) plans for new hires. The Board ultimately decided to defer action and directed the Human Resource Committee to work with staff to consider options, and to make a recommendation to the Board of Directors.

Retiree Health Benefit Plan

The HR Committee has discussed OWASA's retiree health benefit plan and has expressed a goal of keeping the benefit competitive with other local governments. Information about the benefit offered by other local entities is presented in Appendix A.

In the current retiree health insurance plan, OWASA pays a percentage of the health insurance premiums for pre-65-year-old retirees and provides a Medicare Supplement for post-65-year-old retirees. An employee's age and years of service determine the percentage of premium paid by OWASA.

Years of Service	Age	Percentage of Premium (Pre-65) or Supplement (Post-65) Paid by OWASA
10 years	60	50%
15 years	60	75%
20 years	60	100%
30 years	Any age	100%

Pre-65-year-old retirees stay on OWASA's group health plan. The Fiscal Year 2018 monthly premium is $1,097 per individual.

Post-65-year-old retirees receive a Medicare Supplement where costs vary based on the plan chosen by the retiree. These decisions are private with OWASA having no influence. The average cost for Medicare Supplement plans and Part D prescription coverage is $183 and $124, respectively, bringing our average monthly cost per post-65-year-old retiree to $307.

457 Plan

The 2014 consultant's report noted that OWASA's 457 plan was not competitive in the employment marketplace. Information about the benefit offered by other local entities is presented in Appendix B.

In previous discussions, the Human Resource Committee set the following goals for OWASA's 457 plan:

- No reduction in the amount of benefit currently provided to employees.
- Expand the benefit to include employees with six-months to less than four years of service.

- Improve the competitiveness of OWASA's Plan (benefit not to be less than 4% of wages).
- Implement an employer matching contribution whereby OWASA will match an employee's voluntary contribution.

The benefit provided by OWASA's current 457 plan includes:

OWASA's Contribution to Employees' 457 Accounts (amount)					
	Employee's Tenure				
	0 to < 4 Years	4 to 9 Years	10-14 years	15-19 Years	20+ Years
Bi-weekly	$0	$40	$60	$80	$100
Annual	$0	$1,040	$1,560	$2,080	$2,600

Since this benefit is a fixed amount, the annual percentage of this benefit depends on the amount of an employee's salary. Below are three examples:

OWASA's Contribution to Employees' 457 Accounts (percentage)					
	Employee's Tenure				
	0 to < 4 Years	4 to 9 Years	10-14 years	15-19 Years	20+ Years
$34,000	0%	3.1%	4.6%	6.1%	7.6%
$70,000	0%	1.5%	2.2%	3.0%	3.7%
$100,000	0%	1.0%	1.6%	2.1%	2.6%

Purpose

OWASA's Board of Directors is considering making changes to our deferred compensation (457) and retiree health benefit plans for new hires. At its meeting on May 9, 2018, the Board's Human Resource Committee asked staff to develop an alternate combined 457/retiree health benefit package option.

The new option would be effective for all employees hired after a certain, to-be-determined date. Employees hired prior to this date would be able to choose between plan options; these employees would be able to switch to the new option at any time. However, no one would be permitted to switch from the new option back to the current package. (Throughout the rest of this memo, the current 457/retiree health benefit package is referred to as Option 1, the new offering is Option 2.) Each of the plan options would be a package of 457 and retiree health benefits; employees would not be able to choose, for example, the Option 1 457 plan and the Option 2 retiree health benefit plan.

Benefit	Option 1 (Current)	Option 2
457 Deferred Compensation Plan	OWASA makes a fixed monthly contribution to employees' plans. Employees may, but are not required to, contribute. Employer contribution amounts are based on tenure and have not been adjusted since 2001.	OWASA makes a "percentage of salary" contribution of 4%. OWASA contribution may, or may not be contingent on employee matching contribution. (Peer organizations contribute 3% to 5% and do not require an employee contribution.)

Retiree Health Insurance	OWASA pays 50% to 100% of retiree's health insurance cost (percentage based tenure). Retirees remain on the same policy that covers active employees until age 65. At age 65 retirees are covered under a Medicare supplement plan and OWASA continues to pay for premiums at the same 50% to 100% rate.	Mandatory employee participation in a Retirement Health Savings plan by contributing 2% each pay period up to $1,000 per plan year. OWASA contributes $35 per pay period with a maximum of $910 per year. The total annual RHS contribution will not exceed $1,910 for the plan year. The plan may include a vesting schedule for employer contributions. (Contribution percentages, fixed amounts and limits are determined by OWASA. Those shown here are comparable to OWASA peer organizations; they are included for illustration and to estimate cost.)

Cost Analysis

The cost of the current 457 plan is about $168,000 per year. Determining the cost of the 457 plan in Option 2 and comparing it to the 457 plan in Option 1 is fairly straight-forward. Depending on the Board's preference for OWASA's percentage contribution to the Option 2 457 plan, OWASA's contribution would be approximately $250,000 to $410,000 per year. This assumes that all employees receive the employer contribution. If an employee contribution is required in order to receive employer match, the amount of OWASA's contribution could be less because fewer employees may choose to make the matching contribution.

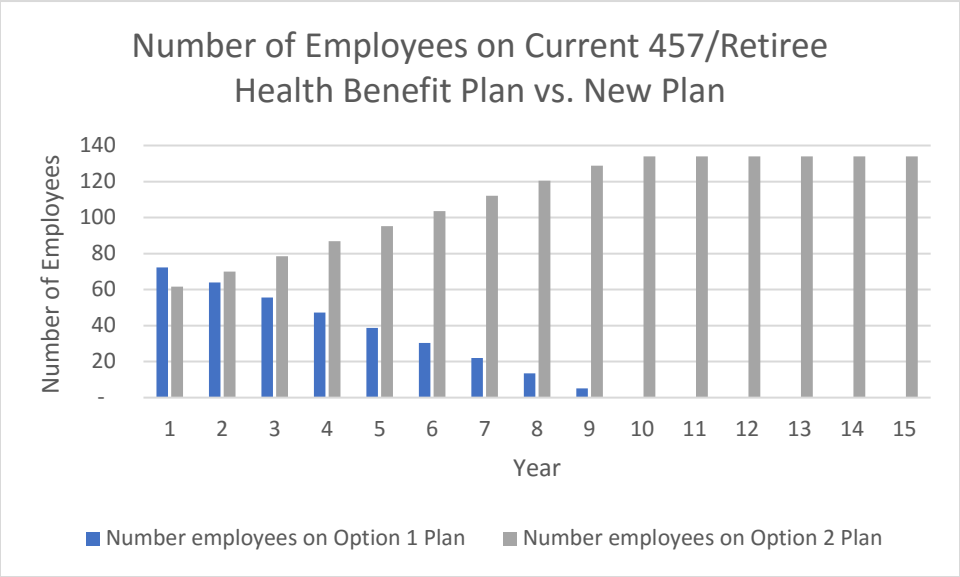
This analysis for the retiree health benefits is not as straight-forward.

For the retiree health benefit, the costs we are incurring for the Option 1 benefit consists of the health insurance premiums OWASA pays to provide coverage for retired employees. We will continue to incur these costs until there are no longer retirees receiving the benefit. For example, an employee hired at a young age today could retire 30 years from now and receive benefits for many years after retiring.

The retiree health benefit costs for Option 2 begin when an employee is hired or when a current employee selects Option 2 benefits. This means we will begin to incur costs for Option 2 benefits immediately, many years before we cease to incur costs for Option 1 benefits.

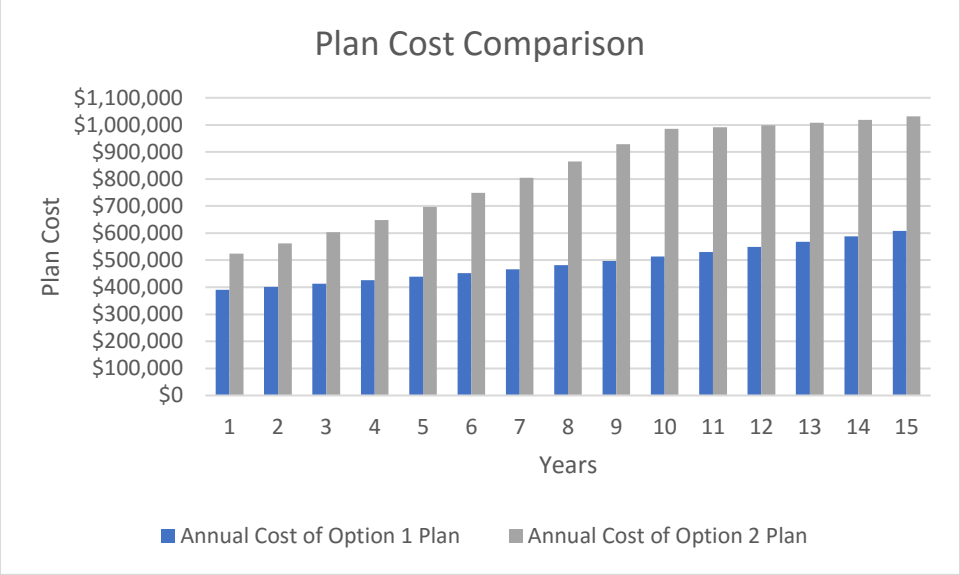
In order to estimate and compare costs of the two options, we made a number of assumptions. Our assumptions are included after the graphs shown below. The costs are based on the plans as defined on page one of this memo.

Graph 1 shows the estimated number of employees that will be covered under each plan Option over the next 15 years.



Graph 1

For the first nine years, we would have employees covered under both plan Options. Over time, as current employees leave or retire, participation would decrease for Option 1 and increase for Option 2.



Graph 2

In Graph 2, the blue bars represent the estimated annual costs to OWASA if no changes are made to the 457 or retiree health insurance plans. The gray bars represent an estimate of the costs of implementing Option 2.

The following are assumptions used in estimating these costs:

1	Total number of employees	134
2	Base year average salary	$61,088
3	Annual salary increase	4%
4	Annual average number of new hires (based on experience of last five years)	14
5	Estimate of the percentage of current employees who will choose Option 2 in Year 1 because the value of the new 457-benefit exceeds the value of the Option 1 retiree health insurance benefit	40%
6	Subsequent to Year 1, estimate of the annual percentage of "grandfathered" employees on Option 1 who will choose to transition to Option 2	10%
7	Estimate of the percentage of annual new hires who will replace employees hired prior to plan transition date, (e.g. employees still on Option 1) vs. more recent hires who would be on Option 2 (used to help estimate how many employees will remain on Option 1 plan)	60%
8	Number of retired employees receiving Option 1 retiree health insurance benefit based on average of previous 5-years, reduced by 10% per year beginning in Year 11	Pre-age-65 – 14 Post-age-65 – 18
9	Beginning in Year 11, annual percent reduction in the number of retired employees receiving Option 1 benefits	10%
10	Base year for determining OWASA's annual cost of Option 1 retiree health insurance benefit	FY 2018. Year 1 reflects FY 2019 reduction in premiums of 7.4%
11	Annual cost inflation adjustment for Option 1 retiree health insurance premiums	5%
12	Base year per-employee annual OWASA contribution to Option 2 retiree health benefit	$910
13	Annual cost inflation adjustment for Option 2 retiree health benefit	3%
14	Annual contribution to Option 1 457 plan	$168,000
15	Annual cost inflation adjustment for Option 1 457 plan	0%
16	OWASA contribution percentage to Option 2 457 plan	4%
17	Newly hired employees would be eligible for Option 2 retiree health and 457 plan benefits after 30 days.	
18	Number of existing employees who will initially choose to remain on Option 1 plan because the current 457-benefit is greater than Option 2 benefit. Average tenure of this group is 25 years.	19

These assumptions are intended to be somewhat optimistic about how quickly participation will shift from Option 1 to Option 2. This results in lower overall costs.

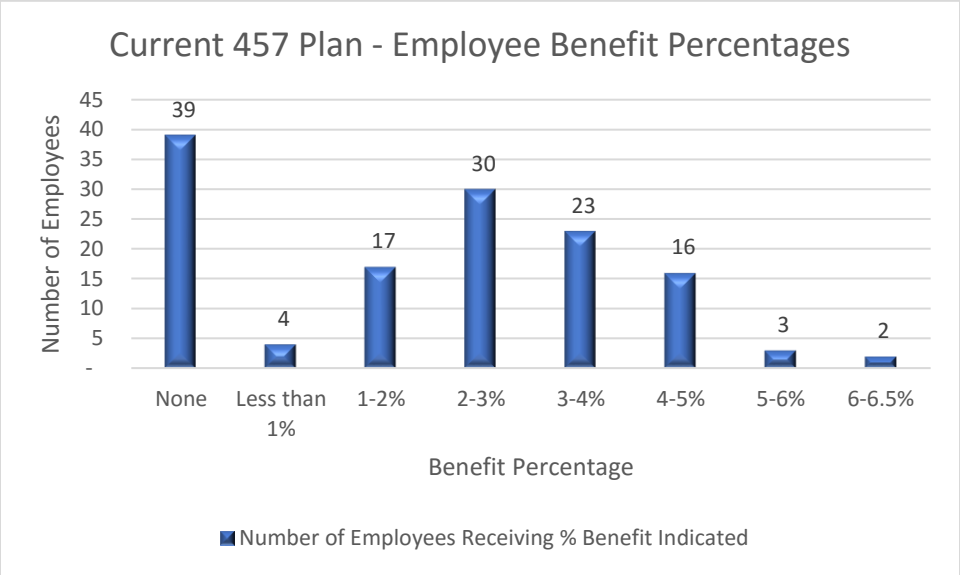
For example, we are estimating that upon offering Option 2, 40% of current employees will choose to switch from Option 1 to Option 2. If the actual number of employees who switch plans is less, participation in Option 1 will likely be extended further into the future and result in higher life-time Option 2 costs. Because an employee's decision may be based on a variety of factors, some which may not be strictly financial, it is difficult to predict how many will switch plans.

From Employees' Point of View

457 Plan

The benefit of the current, Option 1, 457 plan increases with employee longevity. Because the contribution amounts are fixed, the benefit is greater at lower salaries. Graph 3 shows the employee benefit of the current 457 plan.

As you can see, 39 current employees receive no 457 plan benefit because employees receive the 457 benefit only after they have been employed at OWASA for four years. An additional 51 employees receive a benefit of 3% or less. Only 44, or about 33% of OWASA's current workforce receives a 457 plan benefit of more than 3%.



Graph 3

Retiree Health Benefit Plan

As mentioned, an employee's choice between Options 1 and 2 may not be entirely based on financial considerations. One's plans for tenure at OWASA, one's tolerance for risk, and how one feels about the

future of healthcare in the U.S., could all play a role in the decision. But obviously, financial implications matter.

After 30 years of participating in the Option 2 retiree health benefit plan, the annual employee contribution of $1,000 combined with OWASA's annual contribution of $910 could total as much as $185,000, depending on assumptions about rate of return, etc.

To determine the amount of the Option 1 benefit to the employee, we need to estimate the cost of health insurance 30 years into the future. In today's dollars, if the employee retired at age 60 and lived to 79 (the current life expectancy in the U.S.), the benefit would be approximately $104,300. Adjusted for inflation at a rate of 3%, this benefit would equate to a little over $250,000 in 30 years ($450,000 if costs escalate annually at 5% rather than 3%).

Staff Observations

- Savings from phasing out the current (Option 1) retiree health benefit will not be realized for many years while the additional costs of Option 2's 457 and retiree health benefit plans will begin to be incurred immediately.
- Employees have been kept aware of the Board's work on the 457 plan benefit to be more competitive in the employment marketplace. Offering a new, more competitive 457 plan but requiring employees to give up their current retiree health insurance benefit to receive it could be viewed as taking away a current benefit.
- Many of our peer organizations have terminated retiree health insurance benefit plans like OWASA's, instead offering a retiree health savings account (for employees hired after a certain date, grandfathering existing employees). This approach ends the accumulation of the liability for future retiree health benefit costs because no new employees will be added to the plan after a certain date. Additionally, these costs will phase-out over time as retired grandfathered employees transition off our health insurance policy.
- A retiree health saving account has the advantage of providing funds for future healthcare costs that are portable (go with the employee even if they leave employment at OWASA).
- The outlook for U.S. healthcare is uncertain; employees may value the benefit of having funds in a savings account more than the promise to pay their future health insurance premiums when the market for the latter could be far different when they retire.
- OWASA's current 457 plan does not require employees to make a contribution. Peer organizations with 457 plans contribute 3% to 5% without requiring an employee matching contribution. Requiring an employee match could adversely impact participation in the plan, especially for those with limited discretionary income.
- A 457 plan with a percentage-based employer contribution of 3% to 5% is costlier than OWASA's current plan. Assuming 100% employee participation, the increase in the annual cost over the annual cost of our current plan is:

Contribution %	Increase in Costs
3%	$57,000
4%	$160,000
5%	$240,000

- There are numerous employer contribution and employee matching alternatives the Board could consider.

The 2014 compensation study identified our retiree health (above market) and 457 (below market) benefit plans as benefits that are not in sync with the employment market. Employees are aware and appreciative of the Board's efforts to address these issues as well as the work the Board has done on compensation and health insurance.

Recommendation

Staff recommends the following:

- Retiree health
    - Eliminate the current retiree health insurance benefit for employees hired after a to-be-determined date. Our plan is above what other employers offer and creates a long-term liability.
    - For new hires, offer a retiree health savings account plan. It is competitive in the marketplace and provides a portable benefit to employees.
    - Current employees remain on the current plan.
- 457 plan
    - Allow employees to become eligible to receive the benefit after successful completion of their six-month probation period.
    - Offer a 457 plan that includes employer contributions that are based on a percentage of an employee's salary in the 2.5% to 5% range without requiring an employee matching contribution. All organizations we researched offer an employer contribution with no matching requirement. This would bring our 457 benefit in-line with peer organizations and provide a more valuable benefit to employees.
        - If the Board wants to require employees to make a contribution in order to receive an employer contribution, staff recommends splitting the matching requirement whereby the employee receives a contribution without making a contribution and has the option to receive an employer match by making an additional contribution (similar to the benefit offered by Cape Fear PUA shown in Appendix B).
    - Give existing employees the option of remaining on OWASA's current 457 plan or switching to the new plan. Staff recommends giving employees a few weeks or months to make the decision rather than leaving the time-frame open-ended. This avoids taking a benefit away from current employees whose current 457 benefit is greater than the new offering.

Action Requested

Review information and provide guidance to staff.

Appendix A
Retiree Health Benefit Comparative Information

<table>
<tr><th>Entity</th><th>Retiree Benefits</th></tr>
<tr><td>Cape Fear Public Utility Authority</td><td>Cape Fear Public Utility Authority formed in July 2008 from a merger of the City of Wilmington and New Hanover County. Existing employees hired prior to July 2008 are eligible for individual health polices until age 65. If hired after July 2008, no retiree benefits available.</td></tr>
<tr><td>City of Durham</td><td>Employees hired prior to July 1, 2008 are eligible to participate in the medical benefits up to age 65. Those hired after July 1, 2008 must participate in a Retirement Health Savings (RHS) plan by contributing 2% each pay period up to $1,000 per plan year. The City of Durham contributes $35.00 per pay period with a maximum of $910 per year. The total annual RHS contribution will not exceed $1,910 for the plan year. The plan includes a vesting schedule for employer contributions.
<table>
<tr><th>Hire Date</th><th>10 Years of Service</th><th>15 Years of Service</th><th>20+ Years of Service</th></tr>
<tr><td>Prior July 2008</td><td>Active Employee Cost + 50% of City Cost</td><td>Active Employee Cost + 25% of City Cost</td><td>Pays Active Employee Cost</td></tr>
<tr><td>After July 2008</td><td>50% Vested</td><td>75% Vested</td><td>100% Vested</td></tr>
</table></td></tr>
<tr><td>Greenville Utilities Commission</td><td>Retirees remain on the group plan until age 65 and may participate in Medicare Supplemental Plan and Medicare Part-D at the same percentage based on the eligibility schedule below.
<table>
<tr><th>Years of Service</th><th>Base Plan Contribution Percentage Age 55 - 59</th><th>Base Plan Contribution Percentage Age 60 - 64</th></tr>
<tr><td>20 – 24 Years</td><td>50% for retiree</td><td>65% for retiree</td></tr>
<tr><td>25 Years or more</td><td>75% for retiree</td><td>95% for retiree</td></tr>
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<table>
<tr><th>Entity</th><th>Retiree Benefits</th></tr>
<tr><td>Orange County</td><td>
If hired on or before June 30, 2012 retirees must have worked 10 years as permanent employees for Orange County. If hired after, retirees must have worked 20 years as permanent employees. After age 65, Orange County pays for Medicare Supplement Plan and Part D at same percentage.
<table>
<tr><th>Hire Date</th><th colspan="2">Before* - 6/30/2012</th><th colspan="2">7/1/2012 and later</th></tr>
<tr><td>Age</td><td>Under age 65</td><td>65 or older</td><td>Under age 65</td><td>65 or older</td></tr>
<tr><td>Years of Service (Minimum)</td><td>10</td><td>10</td><td>20</td><td>20</td></tr>
<tr><td>Retiree Coverage</td><td>100%</td><td>100%</td><td>100%</td><td>100%</td></tr>
<tr><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Age</td><td>Under age 65</td><td>65 or older</td><td>Under age 65</td><td>65 or older</td></tr>
<tr><td>Years of Service (Minimum)</td><td>n/a</td><td>5</td><td>n/a</td><td>10</td></tr>
<tr><td>Retiree Coverage</td><td>n/a</td><td>50%</td><td>n/a</td><td>50%</td></tr>
</table>
*Prior to 7/1/2008, County subsidized the cost of retiree dependent health premiums.
</td></tr>
<tr><td>Town of Carrboro</td><td>
If hired before July 1, 2007 the retiree may remain on the group health plan until age 65 at which time they participate in a Medicare Supplement Plan based on the same eligibility schedule. If hired after July 1, 2007 the same schedule applies but retiree receives a monetary stipend for their own plan. The stipend amount is based on the current active employee individual premium rate.
<table>
<tr><th>Years of Service</th><th>Percentage
Insurance Premium or Stipend Amount</th></tr>
<tr><td>10 – 14 Years</td><td>50%</td></tr>
<tr><td>15 – 19 Years</td><td>75%</td></tr>
<tr><td>20 or more Years</td><td>100%</td></tr>
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<table>
<tr><th>Entity</th><th>Retiree Benefits</th></tr>
<tr><td>Town of Cary</td><td>Retirees with 15 years of service are eligible for the Town to subsidize 50% of the individual rate. Each additional year of service beyond 15 years increases the percentage of the subsidy by 5%, with a maximum subsidy of 100% for 25 years of service. When the retiree is no longer covered by the group health insurance plan due to coverage under Medicare or some other form of a Federal Government-sponsored health insurance program, the Town will continue to provide a subsidy to the retiree to be applied to the cost of the retiree's Medicare supplemental plan, Part D prescription drug plan, Town-sponsored group vision plan, and Town sponsored group dental plan, or any other applicable health-related supplemental plan. The amount of the subsidy applied toward these plans shall not exceed 100% of the amount due each month to keep these plans in force, will not change more than once each fiscal year, and will never exceed the amount of the subsidy provided to the retiree still active on the Town's group health insurance plan. The retiree is responsible for paying any balance due after the Town's subsidy (if applicable) has been applied. Current, monthly subsidy amount is $718.</td></tr>
<tr><td>Town of Chapel Hill</td><td>Retirees hired prior to July 1, 2010 receive health insurance or Medicare Supplement premiums paid by employer on a vested schedule based on their time in service. If hired after July 2010, enrollment is mandatory in a Retirement Health Savings (RHS) plan with employee contributions of 1% of compensation, and the Town contributes $35 each pay date (26 pay periods). The plan includes a vesting schedule for employer contributions.
<table>
<tr><th>Hire Date</th><th>5 Years of Service</th><th>10 Years of Service</th><th>15 Years of Service</th><th>20+ Years of Service</th></tr>
<tr><td>Prior July 2010</td><td>25% of Premiums Paid by Town</td><td>50% of Premiums Paid by Town</td><td>75% of Premiums Paid by Town</td><td>100% of Premiums Paid by Town</td></tr>
<tr><td>After July 2010</td><td>25% Vested</td><td>50% Vested</td><td>75% Vested</td><td>100% Vested</td></tr>
</table></td></tr>
<tr><td>Town of Hillsborough</td><td>The retiree may continue to receive health insurance coverage comparable to that being provided for regular employees without cost either for the life of the retiree or until eligible for Medicare. No post-65 benefits available.
<table>
<tr><th>Hire Date</th><th>Minimum Age</th><th>Continuous service with Town</th></tr>
<tr><td>Before Feb. 2009</td><td>55</td><td>20</td></tr>
<tr><td>After Feb. 2009</td><td>60</td><td>30</td></tr>
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Appendix B
Deferred Compensation (457) Plan Information

Organization	Deferred Compensation	Effective	Employee Contribution	Last Update
Town of Chapel Hill	401K - employer 5% contribution	At hire	Not Required	Not sure of exact date but 18+ years ago
Town of Hillsborough	401K - employer 5% contribution	At hire	Not Required	Employer reported "Unknown"
Town of Carrboro	401K - employer 3% contribution	At hire	Not Required	July 1, 2013
Greenville Utilities Commission	401K - employer contributes flat amount $40 per pay period ($1,040 annually)	At hire	Not Required	Employer reported "Unknown"
Cape Fear Public Utility Authority	401K and 457 offered; employer 2% contribution, plus another 2% match if the employee contributes 2% or greater	First of the month following employment	Not Required to receive employer contribution; matching option available	January 1, 2018
Town of Cary	401K and 457/401a plan offered; employer will contribute 5% to employee's choice of 401K or 401a	At hire	Not Required	Not sure of exact date 17+ years ago
City of Durham	401K and 457 offered; employer contributes 5% to 401K	At hire	Not Required	Unknown

Organization	Deferred Compensation	Effective	Employee Contribution	Last Update
Orange County	401K and 457 offered; employer contributes $715 per year; if an employee contributes employer will matches up to $63 each pay period for a matching total of $1,512 per year; employee can choice either 401K or 457 for the employer contribution/matching option	At Hire	Not Required to receive employer contribution; matching option available	July 1, 2014