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TO: Joshua D. Shapiro, Chair
Leslie S. Richards, Vice Chair
Bruce L. Castor, Jr., Commissioner
Lauren Lambrugo, COO

RE: Fiscal Update

Date: September 12, 2013

A number of events have occurred over the last few weeks which have fiscal impacts on the County for the current year, as well as impacting the 2014 Budget, which is now being formulated. The County is also preparing to roll-out its open enrollment period for health benefits for 2014, and will need to budget for cost increases and plan changes.

Moody's Outlook Change

On August 16, 2013, Moody's released a report on the County's financial outlook. The report affirmed the County's rating of Aa1, reflecting County management's efforts over the past year to grow recurring revenues, control costs and improve long-term budgeting procedures, the County's large and diverse tax base, and below average debt burden.

At the same time, the rating agency revised the outlook for the County from stable to negative for one primary reason – the spending down of the County's reserves by nearly 80% over four years. Significant operating deficits in fiscal years 2008 through 2012 reduced the fund balance from over $95 million to less than $20 million. Moody's outlook revision focused on this weak financial position, with reserves equivalent to only 5.8% of revenues as opposed to the recommended 10% level.

In the short term, this change should have little direct impact on County finances. The County has no plans to issue debt, and our variable rate debt continues to trade at levels similar to those of AAA rated entities. However, Moody's action should serve as a reminder that though the financial situation is stabilizing, we continue to dig out of a tremendous hole that was left behind.

The County does not, and should not, make its budgeting decisions in response to Moody's; the point of the Zero-Based Budget process we utilize is to establish the spending levels the County needs to achieve its mission. That is the primary motivating factor in evaluating spending decisions. However, the report correctly points outs fiscal deficiencies of the County - the fund balance is too narrow, providing little financial flexibility and requiring that the County issue short term Tax Revenue Anticipation Notes each of the last two years to ensure adequate cash flow. Even though these borrowings were done as economically as possible, they have cost the County approximately $60,000 a year; money which could have been put to better use.

The 2013 Budget currently projects to have a year-end operating surplus. While this is a healthy sign for annual operations, the projected surplus of $3 million would increase the reserves to $21 million, still $20 million short of the amount required to achieve a healthy 10% fund balance level. Similarly in the case of our Pension obligations, while the County has rightly been applauded for making its first pension payments in five years, this year's payment represents one third of the amount determined adequate by the Pension Fund's actuarial consultant.

As we continue to monitor 2013 revenue and expenditure levels, and prepare the 2014 Budget, all County officials and Department leaders must recognize that even if they are performing well relative to their own budget line, we ultimately move forward as a County. There is no "extra money" when the County functions without a sufficient reserve or has a budget which does not include its full pension payment.

Legacy Economic Development Debt Obligations

The County's budget is further challenged by the reckoning coming due for several past economic development decisions which have failed to produce the revenues promised when they were authorized.

Logan Square

The issues concerning Logan Square have been well documented, and were outlined in detail in a memo dated May 13, 2013, including the decision by the Senior Lender to foreclose on the property on May 3.

Among the $24.5 million in County grants, loans, and loan guarantees for the project, was a loan guarantee for $6.2 million guaranteed revenue bonds issued in 2010. The project is not producing income to cover its debt, including the debt service requirements for this loan.

The Board of the Montgomery County Redevelopment Authority (RDA), the agency which issued these bonds on behalf of the County, agreed to make the September 1, 2013 payment of $363,362.50, which was the first loan payment due since the foreclosure proceedings. Beginning in 2014, in accordance with the loan guarantee provided in 2010, the County will begin assuming the debt payments on these bonds. The 2014 payments will total $528,200, and the remaining obligation for the County will be approximately $9.4 million through 2030.

Norristown Sewer Relocation Project

In 2010, the County guaranteed a loan from the Pennsylvania Infrastructure Investment Authority (Pennvest), in the amount of $1.9 million, acquiring properties on East Washington Street for the purpose of the Norristown Sewer Relocation Project. That project also failed to realize its promised economic benefits, and is not producing revenues, resulting in a requirement that the County honor its loan guarantee and begin making debt service payments, including a first payment of $8,882.96 on September 3, 2013.

County and RDA staff are in discussions with Pennvest to defer some monthly payments while the loan is formally closed. However, should the County be required to make all payments on this loan in 2014, those payments will total approximately $110,000.

Federal Sequester Impacts

As the Federal government nears the close of its fiscal year, the County is beginning to experience additional fiscal impacts, beyond those identified in March when the Sequester first went into effect. In 2010, the County issued certain debt under the Build America Bonds, which included a rebate of some of the interest costs of the County. While the first two rebate payments were made in full, the August payment was reduced by $24,785. One more payment for the year could be impacted as well, with a loss to the County of nearly $31,000.

Federal support for Drug and Alcohol programs was recently cut by $64,301, which will likely result in shortening of residential stays and/or reducing the number of placements. Program staff is continuing to evaluate how to best absorb the cuts while minimizing the impact on the provision of services.

These cuts are in addition to previously highlighted impacts including:

- A reduction in Title IV- Part B funding for Children and Youth in the amount of $14,613. This cut was offset in part by an increase in Act 148 funding from the Commonwealth, and an increase in the local share provided by the County.
- The Department of Aging had a Sequester related cut which was offset by an increase in funding by the Commonwealth Department of Aging.
- A reduction in Workforce Investment Board funding across all programs by $103,000, resulting in reduced opportunities across various programs.

Strict Scrutiny Hiring Standard in Effect

Although the County continues to project an overall surplus for 2013, as indicated above the County is still short of its ultimate goals of making its full pension payment and achieving a sufficient level of cash reserves. Additionally, the 2014 County Budget is still being formulated, with additional challenges and difficult funding decisions still to be addressed. The County cannot take on new staff, and does not wish to hire individuals for positions which may be eliminated as part of the 2014 budget.

As a result, the County is implementing hiring restrictions with a strict scrutiny standard being applied to all requests for new position postings and hiring. New position requests will be evaluated by the County Chief Operating Officer and Chief Financial Officer to determine if they meet a need for emergency services delivery, public safety, or regulatory/statutory requirements. All other position requests will be held at least until a 2014 budget has been adopted.

Employee Health Care Benefit Costs for 2014

The County has been working with its health care consultants to project the costs for employee health care for 2014, and prepare for the next health care open enrollment period, scheduled to begin the first week in October.

Last year, in preparation for 2013, the County used an RFP process to select a new health care consultant (Marsh & McLennan Agency) at a lower cost than the outgoing broker. Originally the County was projecting health care cost increases of over 8%, consistent with the national projections. Marsh McLennan eliminated certain hidden fees, negotiated better rates relative to our prescription plan, and renewed our basic medical plans with limited increases. As a result, the County was able to take a projected $2.6 million increase, and instead realize $1.8 million in savings - $600,000 (or one-third) of which was shared with the employees through increased benefits such as reduced co-pays, lower cost emergency room stays, and women's preventive healthcare coverage.

Currently, the County covers nearly 90% of the over $33 million in health care costs related to employee benefits. According to the Kaiser Family Foundation annual survey of health care benefits for 2013, employers for covered workers contribute on average 82% of the premium for single coverage and 71% of the premium for family coverage. A similar survey found that large government entities contribute on average 85% of the premium for single coverage and 78% of the premium for family coverage.

In terms of dollars, County employees currently pay from $234 to $1,105 annually for the Flex HMO Plan depending on income level and the number of covered family members. According to the Kaiser Foundation report, workers nationally pay $4,565 annually toward the cost of their coverage. The survey of large government entities revealed that workers on average pay $2,444 annually toward the cost of their coverage.

For 2014, the industry is projecting increased health care cost increases of over 10%; approximately 1.5% of this increase is due to fees associated with the Affordable Healthcare Act. After working with Marsh & McLennan, the County was able to reduce its projected increase to about 8.9%, which translates into a $2.93 million increase. A Philadelphia Inquirer article (August 21, 2013) noted that employers are reducing the projected impact to between 4 and 5 percent by increasing plan costs to employees and reducing benefits.

Based on individual discussions with each of the Commissioners and among the senior staff of the County, it was determined not to reduce employee benefits, and for the County to continue it approach of covering nearly 90% of the costs of the health care benefit increase. As a result, the County is planning to absorb $2.6 million of the increase, while passing along $260,000 in increased costs to the employees. For most employees, this will result in an increase of about $4 per pay period. A detailed chart of the increased costs by plan is attached to this report and presented on the accompanying PowerPoint.

In order to improve choices for employees, the County will also be introducing a new low-cost Alternative HMO option. This option will provide a more basic coverage level at a lower cost to employees. Per-pay costs for this plan for employees will range from as low as $5 to a high of $20; details are attached to this report and appear in the accompanying PowerPoint. Though this option will not be the best approach for all employees, it does diversify the options available to employees so they can identify which makes the most sense for their individual situation.

In light of the addition of a new health plan option, the County will be utilizing a more personalized one-on-one open enrollment process, designed to help employees identify the best health care option for the employee and their families.

The County has also reviewed its Voluntary Benefit offerings, which in the past consisted of three vendors offering an overlapping and complex array of products and plans. This approach was more administratively complex and expensive, had benefit crossover within products, and was leading to over-insurance and overpayment by employees. The County will consolidate its Voluntary Benefit offerings with one vendor, allowing employees to better evaluate which products make sense for their individual needs, and tailor policies to align with County benefits to avoid over-insurance and overpayment by employees.

Fiscal Update

September 12, 2013

Moody's Report

On August 16, Moody's released a report on the County's Financial Outlook

- Affirmed County rating of Aa1:
  - Management efforts to grow revenues, control costs, and improve budgeting procedures.
  - Large and diverse tax base
  - Below average debt burden

On August 16, Moody's released a report on the County's Financial Outlook

- Revised outlook from "stable" to "negative"
  - Primary reason – the spending down of the County's reserves by nearly 80% over four years. Narrow financial position following years of operating deficits.
  - Depleted liquidity due to drop in fund balance from $95 million in 2008, to less than $20 million in 2012.
  - Reserves equal to only 5.8% of revenues (10% recommended level)

Moody's Report

Logan Square

- County guarantee on $6.2 million revenue bond
- Project in foreclosure – not producing any revenues to make debt payments
- RDA Board voted to make September 2013 payment of $363,362
- County will need to budget for annual debt payments beginning in 2014
  - 2014 payment: $528,200
- The total obligation for the County from 2014 through retirement of the bonds in 2030 will be approximately $9.4 million.

Legacy Economic Debt Obligations

Norristown Sewer Relocation Project

- County guarantee on $1.9 million Pennvest Loan
- Project failed to realize economic benefits and not producing revenues
- County and Pennvest Staff negotiating on formally closing loan and possibly deferring payments.
- County made September monthly payment of $8,883.
- County will need to budget for annual debt payments beginning in 2014
  - 2014 payment: $110,000

Legacy Economic Debt Obligations

- Interest rebates related to 2010 Build America Bonds reduced by $24,785
  - Another $31,000 at risk in 2013
- Federal support for Drug and Alcohol programs reduced by $64,301
  - Still evaluating how best to absorb cuts while minimizing service impacts

Federal Sequester Impacts

- Although the County continues to project an overall surplus for 2013, the County remains short of its ultimate goals of making its full pension payment and achieving a sufficient level of cash reserves.

- The 2014 County Budget is still being formulated, with additional challenges and difficult funding decisions still to be addressed.

- The County cannot take on new staff, and does not wish to hire individuals for positions which may be eliminated as part of the 2014 budget.

- As a result, the County is implementing hiring restrictions with a strict scrutiny standard being applied to all requests for new position postings and hiring.

- New position requests will be evaluated by the County Chief Operating Officer and Chief Financial Officer to determine if they meet a need for emergency services delivery, public safety, or regulatory/statutory requirements. All other position requests will be held at least until a 2014 budget has been adopted.

Strict Scrutiny Hiring Standard in Effect

- In 2013, the County was projecting health care cost increases of over 8%, consistent with the national projections.

- New broker eliminated certain hidden fees, negotiated better rates relative to our prescription plan, and renewed our basic medical plans with limited increases.

- The County was able to take a projected $2.6 million increase, and instead realize $1.8 million in savings - $600,000 (or one-third) of which was shared with the employees through increased benefits such as:
  - Reduced co-pays
  - Lower cost emergency room stays
  - Women's preventive healthcare coverage.

Employee Health Benefit Costs

Employee Health Benefit Costs

- Currently, the County covers nearly 90% of the over $33 million in health care costs related to employee benefits.

- According to the Kaiser Family Foundation annual survey of health care benefits for 2013, employers for covered workers contribute on average 82% of the premium for single coverage and 71% of the premium for family coverage.

- Large government employers contribute an average of 85% of the premium for single coverage and 78% of the premium for family coverage.

- In terms of dollars, County employees currently pay from $234 to $1,105 annually for the Flex HMO Plan depending on income level and the number of covered family members.

- According to the Kaiser Foundation report, workers nationally pay $4,565 annually toward the cost of their coverage.

- Workers in large government entities on average pay $2,444 annually toward the cost of their coverage.

- For 2014, the industry is projecting increased health care cost increases of over 10%; approximately 1.5% of this increase is due to fees associated with the Affordable Healthcare Act.
- After working with broker, the County was able to reduce its projected increase to about 8.9%, which translates into $2.93 million.
- A Philadelphia Inquirer article (August 21, 2013) noted that employers are reducing the projected impact to between 4 and 5 percent by increasing plan costs to employees and reducing benefits.
- County choosing to maintain employee benefit levels and continue to cover nearly 90% of the costs of the health care benefit increase, consistent with the current approach.
- As a result, the County is planning to absorb $2.6 million of the increase, while passing along $260,000 in increased costs to the employees.
- For most employees, this will result in an increase of about $4 per pay period. Plan-by-plan details follow on the next two slides:

Employee Health Benefit Costs

	2013				2014			Employee Per pay change from 2013 to 2014	County Per pay change from 2013 to 2014
	Per Pay (Bi-Weekly)				Per Pay (Bi-Weekly)				
	Total Rate	EE Contrib	County Cost		Total Rate	EE Contrib	County Cost		
Keystone Flex HMO									
A.E Under $30,000									
Single	$258.39	$9.00	$249.39		$281.33	$11.25	$270.08	**$2.25**	**$20.69**
Ee + 1 Dep	$461.19	$17.00	$444.19		$502.14	$20.09	$482.06	**$3.09**	**$37.87**
Family	$730.41	$28.00	$702.41		$795.28	$31.81	$763.46	**$3.81**	**$61.05**
A.E $30,001 - $40,000									
Single	$258.39	$11.00	$247.39		$281.33	$14.07	$267.27	**$3.07**	**$19.88**
Ee + 1 Dep	$461.19	$21.00	$440.19		$502.14	$25.11	$477.04	**$4.11**	**$36.85**
Family	$730.41	$34.00	$696.41		$795.28	$39.76	$755.51	**$5.76**	**$59.10**
A.E $40,001 - $55,000									
Single	$258.39	$12.50	$245.89		$281.33	$14.07	$267.27	**$1.57**	**$21.38**
Ee + 1 Dep	$461.19	$23.50	$437.69		$502.14	$30.13	$472.01	**$6.63**	**$34.33**
Family	$730.41	$39.00	$691.41		$795.28	$47.72	$747.56	**$8.72**	**$56.15**
A.E Over $55,000									
Single	$258.39	$14.00	$244.39		$281.33	$16.88	$264.45	**$2.88**	**$20.07**
Ee + 1 Dep	$461.19	$26.00	$435.19		$502.14	$30.13	$472.01	**$4.13**	**$36.83**
Family	$730.41	$42.50	$687.91		$795.28	$47.72	$747.56	**$5.22**	**$59.65**

Flex HMO Plan

	2013 Per Pay (Bi-Weekly)			2014 Per Pay (Bi-Weekly)			Employee Per pay change from 2013 to 2014	County Per pay change from 2013 to 2014
Keystone HMO 10	Total Rate	EE Contrib	County Cost	Total Rate	EE Contrib	County Cost		
Single	$283.55	$77.45	$206.10	$308.73	$86.44	$222.29	**$8.99**	**$16.19**
Ee + 1 Dep	$508.01	$140.16	$367.85	$553.12	$154.87	$398.25	**$14.71**	**$30.40**
Family	$803.69	$221.08	$582.61	$875.06	$245.02	$630.04	**$23.94**	**$47.43**
Personal Choice POS								
Single	$341.97	$136.33	$205.64	$372.34	$148.93	$223.40	**$12.60**	**$17.76**
Ee + 1 Dep	$623.69	$256.83	$366.86	$679.07	$285.21	$393.86	**$28.38**	**$27.01**
Family	$982.92	$401.74	$581.18	$1,070.21	$438.79	$631.42	**$37.05**	**$50.24**

HMO 10 and POS Plan

Alternative HMO Option

		2014		
		Per Pay (Bi-Weekly)		
		Total Rate	EE Contrib	County Cost
A.E Under $30,000				
Single		$262.12	**$5.00**	$257.12
Ee + 1 Dep		$467.85	**$9.00**	$458.85
Family		$740.96	**$14.00**	$726.96
A.E $30,001 - $40,000				
Single		$262.12	**$5.50**	$256.62
Ee + 1 Dep		$467.85	**$10.00**	$457.85
Family		$740.96	**$15.50**	$725.46
A.E $40,001 - $55,000				
Single		$262.12	**$6.00**	$256.12
Ee + 1 Dep		$467.85	**$11.00**	$456.85
Family		$740.96	**$17.00**	$723.96
A.E Over $55,000				
Single		$262.12	**$7.00**	$255.12
Ee + 1 Dep		$467.85	**$13.00**	$454.85
Family		$740.96	**$20.00**	$720.96

Voluntary Benefit Offerings

- The County reviewed its Voluntary Benefit offerings, which in the past consisted of three vendors offering an overlapping and complex array of products and plans.
  - This approach was more administratively complex and expensive, had benefit crossover within products, and was leading to over-insurance and overpayment by employees.
- The County will consolidate its Voluntary Benefit offerings with one vendor, allowing employees to better evaluate which products make sense for their individual needs, and tailor policies to align with County benefits to avoid over-insurance and overpayment by employees.