THE TOWN OF NARRAGANSETT'S FINANCIAL CONDITION
AUGUST, 2014

The Citizen's Finance Advisory Committee, in its role as advisor to the Town Council on financial matters, has prepared this report for the Town Council, on behalf of Town residents, on the state of the Town of Narragansett's financial condition. The Town Council ***does not*** necessarily endorse the Citizen's Advisory Finance Committee's opinions or recommendations contained in this report.

It is important for all residents to understand where your tax dollars go, and what are the challenges in maintaining a reasonable and affordable property tax rate. It is also important for residents to provide their questions, input and opinions to the Town Council.

At First Glance

At first glance it would appear that the Town's financial situation is in a relatively sound condition. The Town is projected to have an unrestricted general fund surplus of $5 million at the end of the most recent fiscal year ended June 30, 2014. This surplus, which essentially represents the cumulative amounts of annual revenues over annual expenses, represents approximately 10% of total general fund operating expenses. This percentage is at the low end of what independent rating agencies like to see a municipality have. The Town's annual bond debt obligation payments (principle and interest) have remained relatively stable since 2011, and total bond debt outstanding ($26 million at June 30, 2013) is well within state and Town policy guidelines. The average property tax levy increase over the last five years has been 2.88% exceeding the annual increase in inflation (2.07% over last five years per US Bureau of Labor).

Looming over this apparent relatively sound financial condition, however, is Narragansett's struggle to understand and plan for liabilities related to Pensions and Other Post Employment Benefits (OPEB), collectively referred to in this document as ***post-retirement benefits***. Having previously failed to act on its pension and OPEB liabilities, Narragansett is now at the point where future pension and health insurance expenses have become so large that they have begun to overwhelm other budget priorities and have a detrimental impact on municipal services. This can best be presented in the chart below which shows what each dollar of Town revenue (primarily your property tax dollars) pays for:

What Each Dollar of Revenue Pays For

	Last Year	This Year
Education	45₵	45₵
Town Services	33₵	32₵
Post-retirement	11₵	13₵
Debt Service	4₵	5₵
Capital Improvements	6₵	2₵
Other	1₵	3₵
Total	$1.00	$1.00

An Introduction to Pension and OPEBs

For those who may not be familiar with this topic, pensions and other post-employment benefits (OPEBs) refer to benefits that employees receive after they retire. By far, the most significant of OPEBs is health insurance, but may also include life insurance, dental or other benefits paid after an employee's retirement.

An employee's pension and OPEB benefits are earned during the employee's active working career, but are not actually paid until after the employee retires. The Governmental Accounting Standards Board, or GASB, which is the organization that sets accounting standards for municipalities, directed that these future employee benefits costs no longer be accounted for on a pay-as-you-go basis. Rather these costs, and the resulting liabilities, must be recognized as they are earned by employees. In other words, employees earn the right to receive pension and health insurance and other benefits upon retirement incrementally over their active working career. Therefore, on an accrual basis, the annual cost of a municipal's pension and health insurance includes both the municipal share of the actual premium paid on the employee's behalf plus a portion of the projected post-retirement benefit earned in the current accounting period.

The projected post-retirement benefits are calculated by actuaries who look at several variables to estimate these future costs. These variables include a projected rate of inflation for future medical costs, assumptions about employee turnover, age at retirement, Medicare eligibility, election rates for various plans at retirement, and mortality. Factored in as well are the respective cost sharing agreements for splitting benefit costs between the municipality and retirees. To attribute these future costs to current accounting periods, it is necessary to calculate a present value of these future benefits using a discount rate. The interest rate used to discount the projected benefits also has a tremendous impact on the calculation of post-retirement costs and liabilities.

The important estimates that emerge from an actuarial analysis include the total present value of future pension and OPEB benefits and the required contribution that must be appropriated by the Town annually to fund this liability over multiple years. The projected cost of future benefits discounted to a present value is referred to as the Actuarial Accrued Liability (AAL). This amount is then attributed to the current and prior fiscal years based on when these benefits were earned. The amount of the AAL is reduced in cases where there are pension and OPEB reserves (or assets) set aside to fund true AAL. The Annual Required Contribution (ARC) is the portion of projected benefits earned in or attributable to the current fiscal year (normal cost), plus an additional amount necessary to amortize the unfunded AAL for prior years. The amortization period cannot be more than 30 years.

Narragansett's Post-retirement Benefits

Narragansett funds its post-retirement liabilities through annual contributions budgeted from its general fund. These annual contributions, which should be equal to the ARCs, are made to the Town's Pension and OPEB trust funds. The trust funds' assets are invested and earn income in order to pay out annual benefits to retirees. The trust funds' net assets should theoretically be equal to the post-retirement accrued liabilities. Due to several factors, which are discussed below, the Town's post-retirement benefits are severely underfunded (Pension is 43% unfunded and OPEB is 98% unfunded at the end of June 2013).

There are several contributing causes to the underfunding of Narragansett's post-retirement benefits. Beginning in 2001, and for years thereafter, significant changes to employees' benefit plans were approved by the then Town Councils. These changes included: high annually compounded cost-of-living adjustments ("COLAs"); enhanced retirement age eligibility; not requiring retirees to enter Medicare when eligible, and; offering expensive health plan options. These benefit changes have resulted in what now are very costly and, in the view of the Citizen's Finance Advisory Committee, unsustainable pension and OPEB benefits. Also contributing to the underfunding are the facts that individuals are retiring earlier and living longer, the impact of the recent economic recession and, most importantly, the failure of the Town to fully fund the annual required contributions.

To demonstrate the unsustainable nature of these costs, a hypothetical example was created for a public safety employee who retired in 2010 at the age of 47 (as allowed for under the then negotiated union contract), with a pension benefit of $42,000 upon retirement, and assuming the employee lives until the age of 80. As shown below, ***the net cost of post-retirement benefits to the Town over the life expectancy for just this one employee would be over $3 million:***

Pension Costs	$2,160,000
Health Insurance	$1,031,000
Other Benefits (Dental, Life Ins.)	$ 51,230
Total Cost to Town	$3,247,230
Less Employee Contributions and Interest During Active Employment	($ 149,000)
Net Cost to Town	$3,098,230

Assumptions used in determining costs to the Town are consistent with actual plan benefits that existed in 2010, including: annual 3% COLA adjustment, compounded, and paid annual health insurance premium from retirement and past medicare age.

(source: Town finance department)

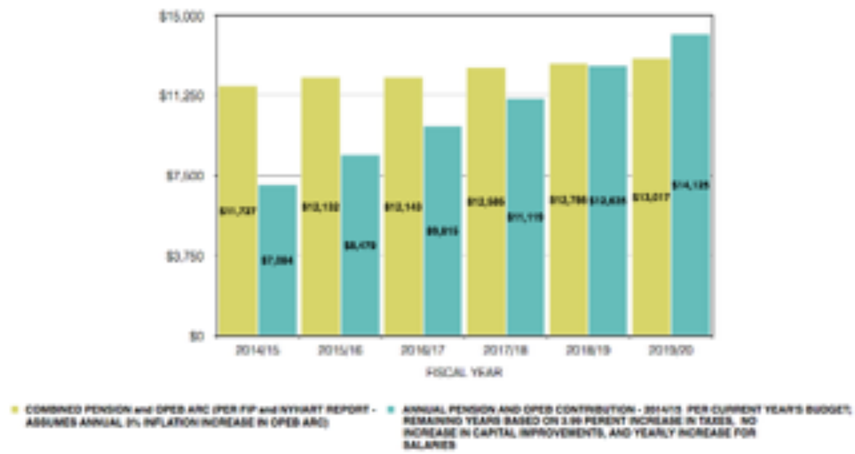
Although this is a hypothetical example, there are actual retirees analogous to the hypothetical example, and for which the Town is paying unsustainable retirement benefits.

The Town of Narragansett has accumulated a post-retirement (pension and OPEB) unfunded accrued liability of $106 million as of June 30, 2013. The $106 million unfunded accrued liability should be viewed as a long-term liability of the Town - an amount that it ultimately owes. Adding this amount to the Town's other long-term liabilities - these being bond debt obligations - of $26 million dollars at June 30, 2013 results in total long-term liabilities outstanding of $132 million, well above the Town's internal debt limit policy, which does not consider amounts for post-retirement liabilities. And, when you include $20 million of additional or proposed bond offerings over the next two years, the Town of Narragansett could accumulate long-term liabilities, or owe, up to as much as $152 million. To put this amount in a different perspective, each Narragansett resident's share (adults and children) of the Town's total long-term liabilities would amount to $9,579 (based on 2010 census of 15,868 residents). Without the post-retirement long-term liabilities, the per capita amount would be $2,899, or 70% less.

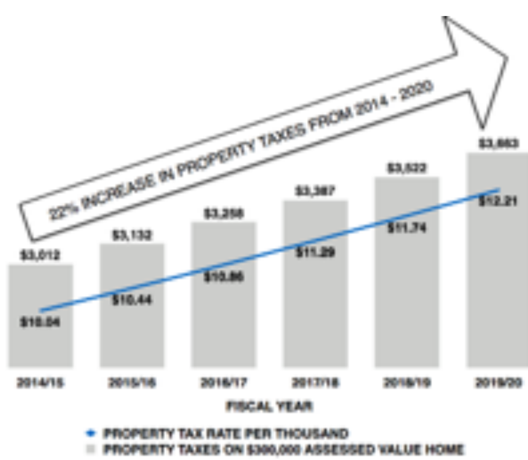
In order to pay the Town's post-retirement long-term liabilities , a payment of $11.2 million would have been required for fiscal year 2014. Instead, the Town contributed only $6.2 million, because contributing the entire amount would have meant a significant decrease in other Town services.

In the 2014/15 adopted budget, the Town Council has increased the funding of the pension contribution to comply with a "funding improvement plan" filed with the state. As noted in the chart on page 1, this increase has resulted in a significant decline in capital improvement expenditures and a decline in other services from last fiscal year.

As shown in the chart below, to fully fund the annual post-retirement benefits costs (as calculated by the Town's independent actuaries as of June 30, 2013) will require annual property tax increases of 3.99% over the next 4-5 years (3.99% being the maximum increase allowed by state law). There would almost certainly be a negative impact on Town services, through a reduction in Town expenses, such as annual capital improvements which would likely see no increase over the next five years from that amount in the 2014/15 budget).



Furthermore, an annual property tax increase of 3.99% for the next 4-5 years would result in an increase of 22% in property taxes for a resident with a home having a $300,000 assessed value, as shown in the chart below.



The growing significance of pension and OPEB payments has been acknowledged by the recent Town Council and unions representing Town employees, and some actions have been taken to change the plans benefits during recent contract negotiations (e.g., suspension of COLA for a period of time). These changes will have an impact on lowering the post-retirement debt, but not to the point where such costs are sustainable, in part because not all who receive post-retirement benefits are impacted by the current negotiations. Retirees, who are not part of contract negotiations, continue to receive benefits whose costs and funding remain unsustainable.

What Needs to be Done

There are actions that can be taken which could reduce the Town's post-retirement benefits long-term liabilities and related annual costs. These include:

- Address the mounting post-retirement long-term liabilities and the related unsustainable annual benefits of ***all*** parties, including retirees.
- Provide post-retirement benefits to Town employees whose annual costs are considered sustainable. The Citizen's Finance Advisory committee in March 2013 presented several recommendations to the Town Council as to what could be done to to reduce these annual costs The presentation can be found on the Town's website at www.narragansettri.gov. The Committee recognizes that some of its recommendations have been included and accepted in the recent negotiations between the Town andPublic Safety employees unions.
- Consider total long-term liabilities to include outstanding bond debt obligations ***plus*** those amounts related to post- retirement benefits. In doing so will, hopefully, impact Town Council decisions on whether to add to total long-term liabilities by issuing new bonds or enhancing post- retirement benefits.

We again encourage all taxpayers to better understand these issues and voice their views.

Town of Narragansett Citizen's Finance Advisory Committee
August 2014