Supplemental Report on Health Benefits

New Jersey Pension and Health Benefit Study Commission

February 11, 2016

LETTER FROM THE COMMISSION

The people of New Jersey need to face five hard truths:

1. The State's current public employee pension system is broken and needs to be fixed now to protect current retirees;

2. The State cannot afford to continue to provide employees with pension and health benefits far greater than those enjoyed in the private sector;

3. If pension and health benefits costs exceed ~15% of the State's annual budget, the State will be in financial jeopardy and New Jersey's credit ratings will continue to decline;

4. Any attempt to fully fund the existing pension benefits, whether under the terms of the proposed pension funding amendment or any other schedule, will inevitably force cuts in essential services such as education, infrastructure and public safety; and

5. The tax increases which have been discussed to date as the answer to the funding crisis would only raise a small percentage of the revenue needed.

To head off this crisis, the nonpartisan New Jersey Pension and Health Benefit Study Commission[1] outlined in its 2015 Report[2] a comprehensive package of reforms to public employee pension and health benefits. At that time we estimated that **the State could save over $2 billion in health benefits spending annually and use those savings to preserve pension benefits earned to date.** This Report confirms that the necessary savings can be achieved. Indeed, the new analysis shows this can be done with less impact to employees and retirees health benefits than envisioned in our 2015 Report.

Although health benefits are the specific focus of this Report, a part of the Commission's charge is to aid the Legislature's consideration of necessary reforms and advise the taxpayers on the risks and benefits of options under consideration.[3] One of these options is the proposed pension funding amendment which in January received the first of the two legislative approvals necessary for it to appear on the ballot in November.[4] That amendment would irrevocably lock in the existing pension plans for all employees but recent hires, and mandate full funding of all benefits claimed by those employees under the plans, even benefits not yet earned. It would do so without regard to cost or the resulting impairment of the State's ability to protect the health, safety and welfare of its citizens. Because it would impose a significant, irrevocable burden on the State without specifying how that obligation would be paid for, the Commission believes that the Legislature and the public as a whole should approach the proposed amendment with extreme caution, as its risks appear to far outweigh its benefits.

These risks may not be fully appreciated, as arguments have been made in the press[5] assuring the public that the amendment will have no effect on them,[6] as all the funding needed to make the payments will come from "revenue growth" and new taxes affecting only millionaires. In contrast, the Commission estimates that even with a millionaires' tax, steady annual growth in existing revenues of over 3% and other optimistic assumptions, at least $2.8 billion in new annual taxes[7] would be needed by 2022 on citizens other than millionaires. The following factors make it difficult to envision any reasonable scenario, absent reductions in State-paid health benefits far greater than the Commission proposes, in which the amendment would not result in substantial, broad-based tax increases on New Jersey's already hard-pressed taxpayers,[8] or draconian service cuts or, most likely, both.

- As Moody's recently observed, fully-funding the current pension program would require sustained revenue growth higher than the State has experienced recently.[9] Moody's also observed that this would require that any growth in the other costs of government – in other words, essential services such as hospitals, courts, nursing homes, prisons, the Department of Children and Families, Law and Public Safety and higher education – be kept below the inflation rate, an exercise Moody's charitably described as "challenging."[10]

- Even if the money could be found, by 2022 the current pension and health benefits would consume 27% of the budget,[11] almost twice the current percentage.[12] A budget so overwhelmingly dominated by employee benefits would hurt the State's credit ratings,[13] as it would deprive the State of the flexibility needed to respond to emerging public needs and weather economic downturns. Furthermore, under the proposed amendment, pension funding would take priority over State aid used to balance school district and municipal budgets, whose credit ratings would also suffer. Rating agencies would also likely take into account the potentially cataclysmic consequences of honoring the funding mandate in bad times. Just two years of flat growth, let alone an actual recession, would increase the need for new taxes to almost $4 billion a year.[14]

- Mandated pension funding poses risks beyond bad credit ratings. The precedent of the State of Illinois, which is now facing a fiscal crisis due to its inability to make payments mandated by its constitution, is just one illustration of how such a constitutional mandate can backfire.[15] Austerity measures imposed by pension funding mandates can also have unintended and unfortunate consequences.[16]

- Finally, the extreme preference given to pension funding under the amendment appears at odds with basic principles of public policy. The premise of the amendment is that funding employee benefits – not protecting the health, safety and welfare of the public – should have the first call on the State's funds. New Jersey expressly rejected giving such preferential treatment to public employee benefits when it adopted its 1947 Constitution.[17] Pension funding mandates have also proven problematic in Illinois and Michigan, two of the small minority of states[18] which have included such provisions in their constitutions.

These are not new issues. The Commission considered them a year ago when, reluctantly, it concluded full funding of all the benefits claimed under the current pension plans was no longer within the State's means. This is not only because of the dollar amount of funding required, but also because a State budget so burdened by employee benefits would not be able to weather a recession or permit the State to do what is necessary to promote the general welfare of its citizens. Nothing has occurred since our 2015 Report to change this conclusion. Instead, a year of inaction has simply made the problem worse.

To provide the needed flexibility**, the Commission believes the cost of public employee benefits must be kept below 15% of the budget.** Additional revenue is not a realistic solution to the problem of having such a high percentage of the budget devoted to benefits and "crowding out" funding for essential government services. For example, the proposed millionaires' tax would only reduce benefits' share of the budget from 27.3% to 26.8%.[19] Any increase in investment income from proposed quarterly pension funding[20] - a widely-promoted element of the proposed amendment - would make even less of a difference.

The question the State must face now is which benefits to preserve? The answer is complicated by the fact that both taxpayers and public employees have cause to feel aggrieved, since for decades elected officials promised public employees more than they were willing to ask taxpayers to pay for.[21] As a matter of fairness, the Commission believes pension benefits earned through service to date should be protected, even if this means burdening future generations of taxpayers who had no role in causing the problem.[22] Fairness, however, also demands that this intergenerational burden be capped by ending the grant of new benefits to current employees under existing terms, while putting in place new means of providing for employees' retirement.[23]

With pension reforms limited to changing the terms under which new benefits are earned, health benefits reforms – the focus of this Report – assume added importance. The current health benefits – at platinum-plus levels[24] rarely found in the private sector – are exceedingly costly[25] and have contributed to crippling the system by consuming revenue which otherwise would have been available for pensions.[26] In a tight budget, every dollar needs to be spent wisely. Currently, this is not the case with health benefits. The Commission's focus on health benefits as a key element of comprehensive reform minimizes the impact of reform on employees and retirees while generating substantial savings dedicated to funding a new and less costly retirement system and retiring the pension deficit.

In contrast to the problems inherent in any approach which seeks to fund all current pension benefits without specifying a funding source or also requiring health benefits reform, the Commission's proposal offers a viable way forward. As Moody's recently reported, "[i]f the commission's reforms are implemented as proposed, the state would have the budgetary flexibility to make *larger* pension contributions *and* resolve a significant portion of New Jersey's long-standing structural imbalance."[27] Fitch reached a similar conclusion, observing that "if implemented in their current form, Fitch believes the reforms could provide notable annual state cost savings and thus improve prospects for future budget sustainability."[28]

Rating agencies have noted that the Commission's approach could provide notable annual cost savings and thus improve prospects for future budget sustainability.

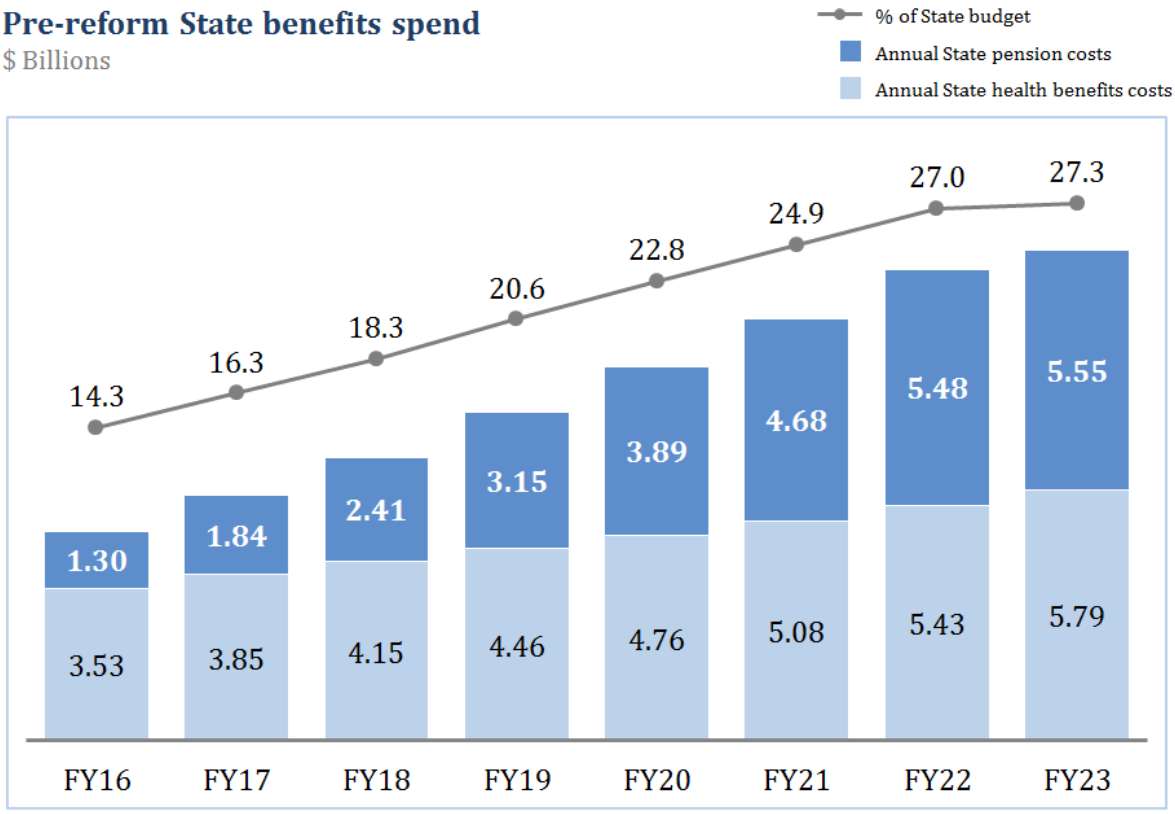
It is time for fair, realistic reform. With our pension debt increasing by $ 10 million every day,[29] the greatest threat is inaction. It is with this imperative in mind that the Commission urges that the health benefit reforms proposed below be considered for immediate action by the people of the State of New Jersey.

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

One of the key insights of our 2015 Report is that pension and health benefits for State, school district and local employees and retirees must be viewed in light of their combined cost to New Jersey taxpayers. As Exhibit 1 shows, absent comprehensive reform, pension and health benefits costs would exceed 27% of the state's budget by 2023.[30]

Exhibit 1[31]



The reforms proposed by the Commission* would reduce the State's health benefits spending to a sustainable level and permit the resulting savings to be used to bolster pension funding. Together, the proposed reforms would reduce the State's projected health benefits costs by over 50%, resulting in over $2 billion in annual savings.

In formulating the proposed reforms, the Commission has consulted with numerous stakeholders, and Aon Hewitt, the State's health benefits consultant. In addition, the effort to synthesize this input has benefitted greatly from the

* The reforms discussed in our 2015 Report included the potential transfer of the existing pension and new retirement plans to employee entities, and reform of locally-funded PERS and PFRS pensions. The transfer to employee entities is an option contingent on legal feasibility and stakeholder willingness that is separate from the financing of the Commission's proposal. Similarly, while reform of local health benefits is essential, subsequent discussions have highlighted reform of local-funded pensions as an issue for further consideration and stakeholder input.

analytic support and fact-based analysis, including health benefits related cost estimates, provided by the Commission's own advisor, McKinsey & Co. The result of this process is a forward-looking report which, for purposes of illustration, shows the full impact of the proposed reforms on 2016 costs. As some of the proposed changes are transformational, however, it is important to note that not all savings will be immediate. Implementation will take time, and require an ongoing process of oversight, assessment and adjustment based on experience. As a hedge against the uncertain timing of certain savings, where appropriate, conservative assumptions have been made. The result of this process is a comprehensive approach to health benefits reform which would preserve a high level of benefits while generating substantial savings. These reforms are outlined in Exhibit 2 below and described in greater detail in the discussion of "Segment-Specific Recommendations" beginning on page 10.

Exhibit 2

Estimated Savings from Reform (2016 Costs)

Segment	Reform Highlights	Base-Level Savings $ millions
State Active Employees	▪ Gold Plan benchmarked to private sector equivalent ▪ Employee premium contributions reduced ~30% ▪ Optimized network – will include major providers ▪ Primary Care Medical Home ▪ Out-of-network reform (also applicable to retirees)	$510
State-Paid Early Retirees	▪ Private exchange-based coverage with multiple plan options ▪ Retiree Reimbursement Account funded to Gold Plan premium level	$310
State-Paid Retirees	▪ Private exchange-based coverage with multiple plan options ▪ Retiree Reimbursement Account funded to cover Medicare Advantage Prescription Drug Plan and average out-of-pocket costs	$590
	Total before "shift":	$1.42 billion
Education Retirees & Early Retirees	▪ Shift benefit costs going forward to their local employers ▪ Parallel health benefit reforms at local district and municipal level fully offset increased costs to local taxpayers	$810
	Total:	**$2.23 billion**

In summary, the Commission proposes narrowing the current extreme difference in health benefits between public and private sector employees by implementing some needed structural reforms and moving employees to the same gold level standard under the ACA which serves as the benchmark for high quality plans in the private sector.

For early retirees – by far the most expensive segment to cover on a per-capita basis – the Commission proposes to continue the current practice of providing the same level of benefits employees have without any premium contribution requirement not already mandated by existing law.[32] This coverage, however, would be purchased by retirees through a private exchange with funds provided through a Reimbursement Retirement Account (RRA), an annual funding allotment provided to retirees to purchase

Most of the changes would remove costs from the system, not merely shift them to employees.

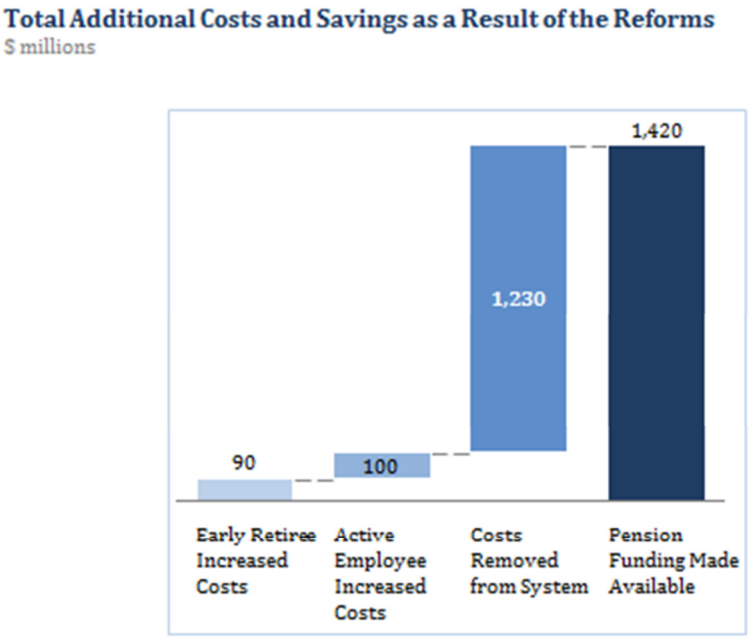
coverage through the exchange. This funding would be benchmarked to the cost of a gold plan or the applicable ACA Cadillac Tax threshold, whichever is less.

Finally, Medicare-eligible retirees, for whom the State currently pays a disproportionately high marginal cost to cover residual expenses not covered by Medicare, would also be provided RRA funding to purchase coverage through a private exchange. RRA funding for Medicare-eligible retirees would be benchmarked to cover the cost of a high-quality Medicare Advantage Prescription Drug (MAPD) plan and the average out-of-pocket medical and prescription drug expenses for subscribers electing that coverage.

Because most of these reforms would remove costs from the system, not merely shift them to employees and retirees, the proposed reforms would generate almost $8 in pension funding for each $1 in increased health benefits costs to subscribers. Stated another way, as illustrated in Exhibit 3, while the proposed reforms to the health benefit plans would result in $190 million in increased costs paid by State employees and retirees, these same reforms would make available $1.42 billion a year for reallocation to pension funding. In addition, the change in responsibility for paying certain teacher retirement expenses, discussed in Part III and Appendix I of this Report, would save the State another $810 million without causing any increase in property taxes.

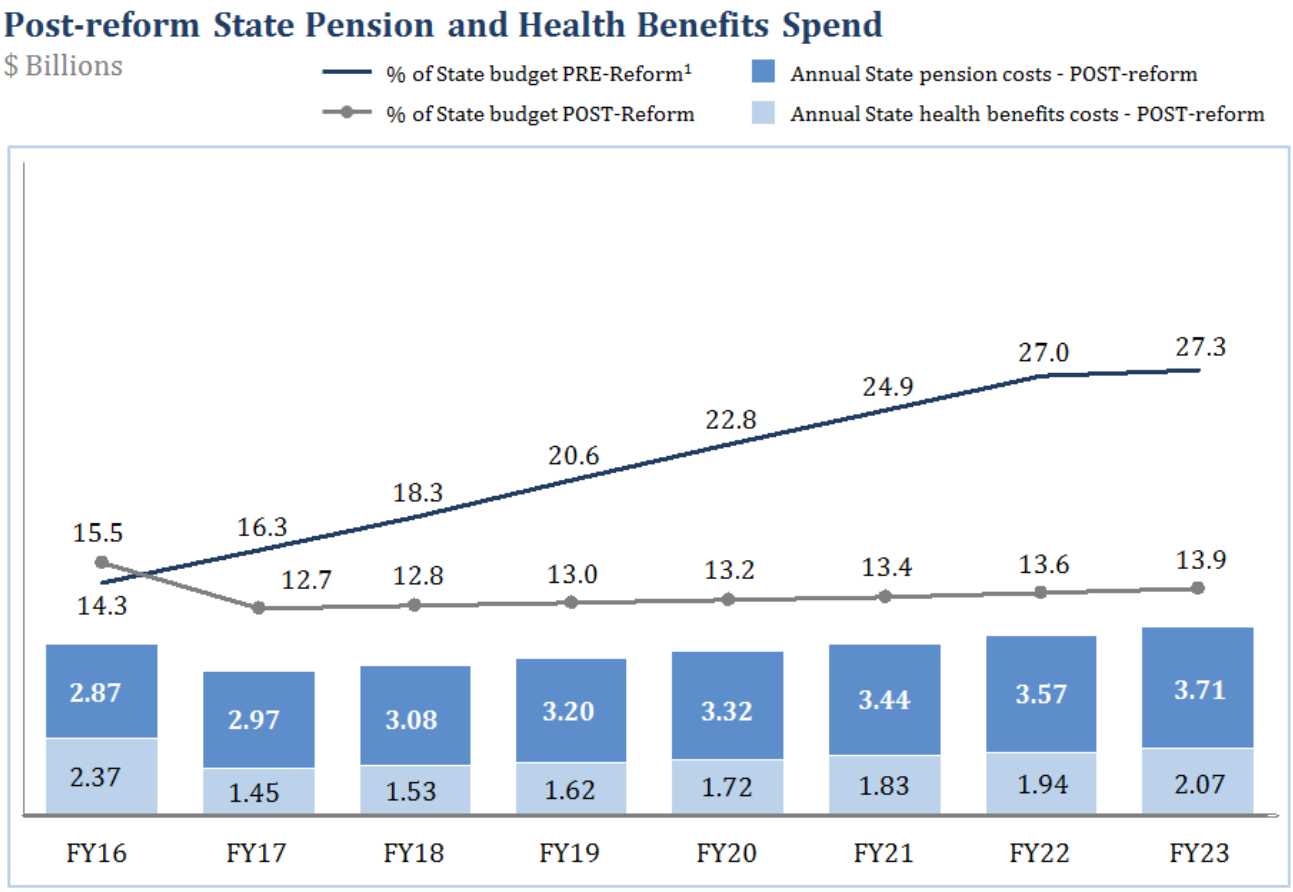
> The goal is not to reduce what the State currently spends on benefits, but to spend that money more wisely.

Exhibit 3



As shown in Exhibit 4, these health benefit reforms, combined with the proposed pension reforms discussed in our 2015 Report, should achieve the goal set in that Report of providing attractive benefits while reducing the costs of those benefits to a sustainable share of ~15% of the State's budget.

Exhibit 4[33]



Inevitably, there will be resistance to change, particularly in an area as sensitive as health benefits. But that resistance carries a steep price compounded by the cost of delay. With the fiscal health of the State at stake, the Commission strongly urges that the process of implementing comprehensive reform begin now.

II. HEALTH BENEFITS REFORM PROPOSALS

Guiding Principles

It is possible, with modest impact to subscribers, to reallocate to pension funding over $2 billion a year currently spent by the State on employee and retiree health benefits. In identifying and prioritizing the reforms to accomplish this goal, the Commission has worked with certain guiding principles in mind:

Achieve long-term sustainability – Reforms should be systemic (versus one-off) and reduce the State's combined cost of pension/retirement and health benefits to a sustainable level of ∽15% or less of the State budget.

Use available funds in the most efficient way – The funds available for benefits are finite and need to be spent wisely. Plans should encourage the most efficient means of accessing the health care system including, where appropriate, utilization of private exchanges and options such as RRAs to provide pre-tax funding for retirees to purchase coverage through exchanges. Similarly, the State should never offer coverage subject to liability for the Cadillac Tax imposed on high-costs plans by the ACA.[34] Giving money away to the federal government is the least beneficial use of available funds.

Align benefits more closely to private sector employer standards and new market developments – One reason New Jersey's public employee health benefits costs are so high is that the State is years – if not decades – behind private sector employers in confronting the reality of escalating healthcare costs. While relevant differences between public and private sector employment should be reflected in related coverage terms, in general the State should follow the best practices which have evolved elsewhere to minimize costs while providing quality health benefits.

Minimize impact on employees and retirees in a manner consistent with achieving necessary savings – Given that the current level of benefits is part of the problem, some impact on beneficiaries is inevitable. To minimize this impact, however, reforms should preserve access to quality care and emphasize improvements which take more costs out of the system than are shifted to employees.

To minimize the impact of reforms, this proposal emphasizes improvements which would take more costs out of the system than are shifted to beneficiaries.

Do not adversely affect property taxes – The Commission has always been clear that any proposal to reallocate funding responsibility for teachers' retiree benefits must be cost-neutral to the local tax base and limited to the amount of savings available from reforming active teacher and local employee and retiree health benefits.

Application of Guiding Principles in the Context of Reform

The Commission's proposal gives effect to these principles by balancing the three basic "inputs" affecting health benefits costs: total cost, actuarial value and employee premium contribution percentage. For health benefits, "total cost" refers to the total cost of providing the benefits covered by a policy. The 2016 average total cost for family health benefits coverage for a State employee has been estimated to be $30,322.

"Actuarial value" is the percentage of average total cost covered by the policy. A bronze level plan under the ACA with an actuarial value of 60% would cover 60% of average total costs. State employees are covered by policies with an

average actuarial value of 96%, meaning the policies cover 96% of estimated total costs which, for family coverage in 2016, is $29,109. This is also, essentially, the total premium. One of the reasons the State's health benefits costs are so high is the extremely high actuarial value of the policies in the State health plans.

Conversely, "out-of-pocket" costs are the portion of total costs not covered by the health benefits plan. If total costs are $30,322, average out-of-pocket costs for a plan with an actuarial value of 96% would be $1,213 ($30,322 - $29,109). Finally, in addition to out-of-pocket costs, while almost all current retirees pay no contribution towards the cost of their coverage (this will change as current employees subject to a post-employment premium contribution requirements retire), employees now make a premium contribution under an income-driven schedule ranging from 3% to 35% of the total premium, with an average of 17.7%. An employee with family coverage making this average premium contribution would pay a premium contribution of $5,152. Combined with the average out-of-pocket costs of $1,213, this employee would pay a total of $6,365 against total costs of $30,322, with the State paying $23,957.

Exhibit 5

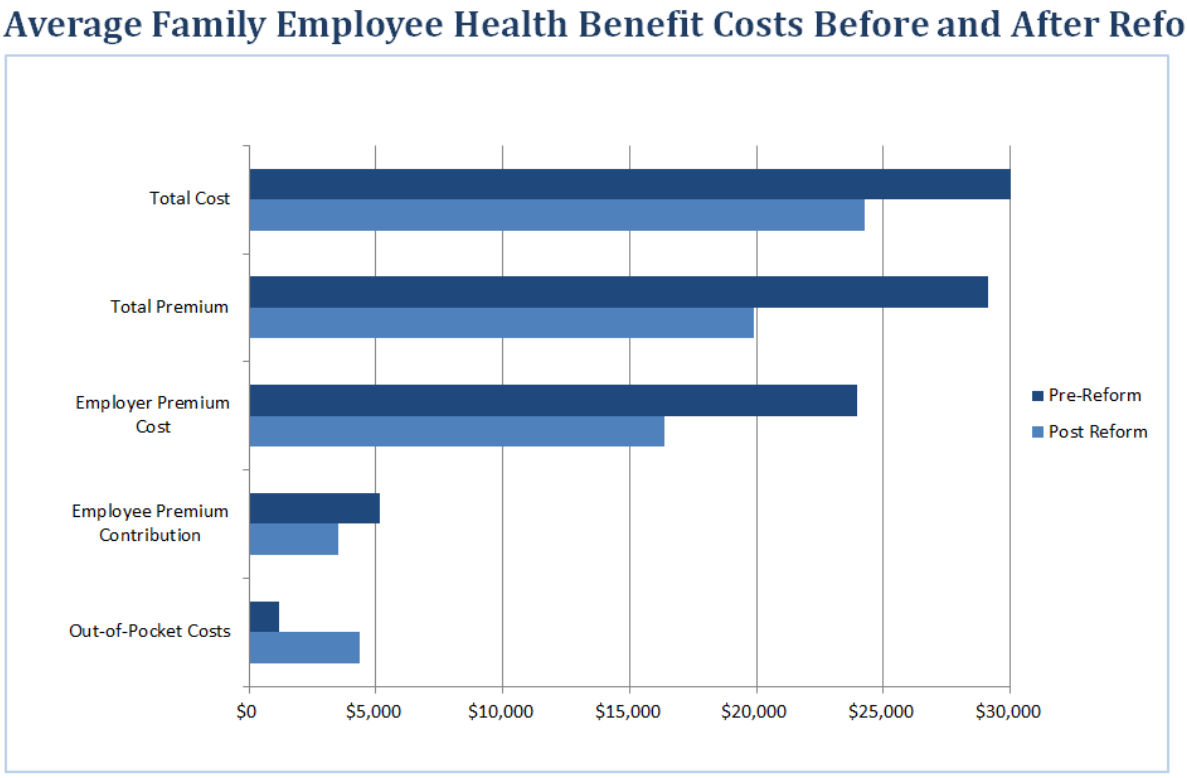


Exhibit 5 shows how the Commission's balance of these "inputs" achieves significant yet equitable savings in health benefit costs. Reforms affecting total cost yield the greatest "bang for the buck" since they reduce the bottom line and therefore result in cost savings to both employers and employees. For this reason, the Commission's proposed reforms, whenever possible, embrace reforms which reduce total costs.

The second input is actuarial value. A plan covering a lower percentage of total costs has a lower premium, which results in a lower employer cost and a lower employee premium contribution. The decrease in employee premium contribution, however, is offset by an increase in out-of-pocket expenses, although employees with lower-than-average out of pocket costs in a given year may see a net benefit. An additional factor to consider, however, is that the

health care industry is not immune to the laws of economics. Changes in actuarial value can reduce total costs because employees paying a greater share of total costs tend to be educated consumers. Because changes in actuarial value produce immediate, certain savings that are shared by employers and employees, and have some impact on total costs, they play an important part in the Commission's proposed reforms.

Reforms affecting total costs and actuarial value result in shared savings in premium costs for employers and employees.

The third input is the percentage of employee premium contribution. Changes in this input result in a zero-sum gain which merely shifts costs from employer to employee. For this reason, the Commission has elected not to change premium contribution percentages, even though the current Chapter 78 grid results in average premium contributions significantly below what is prevalent in the private sector. By keeping the grid in place, employees continue to enjoy a health benefits package better than that in the private sector, while the reforms affecting total cost and actuarial value will result in a reduction of premium costs for all employees.

While the illustration above concerned active employees, the Commission has followed the same approach to the same three basic inputs for early retirees and Medicare-eligible retirees. For all segments, the Commission has stressed reforms which reduce total costs and avoided reforms which would merely shift costs. The result is a package of reforms in which the increased costs to employees are far outweighed by overall savings in health benefits costs that can provide desperately needed additional funding to bolster public sector pensions.

NEW JERSEY'S UNIQUE OUT-OF-NETWORK REIMBURSEMENT ENVIRONMENT

Broadly speaking, in-network care, where providers have a contractual agreement to provide care at a set, often discounted rate, is typically more cost effective. In certain involuntary cases including emergent care, referrals to out-of-network providers or care provided by an out-of-network provider at an in-network facility, members may not have a choice or even realize they are receiving care from a higher-cost out-of-network provider.

While federal legislation prohibits plans from requiring greater co-pays or deductibles for out-of-network emergency services, it does not prohibit a provider from "balance billing" the plan member for the difference between its charges and what the plan pays. Thirteen states, including New Jersey, place some limits on this practice. Some states do this through payment benchmarks setting a maximum fee. Others use an arbitration process. New Jersey, however, requires plans to hold members harmless for balance billing by paying whatever the provider charges.

This combination of rules creates an incentive for providers to not join networks, and is a major driver of extremely high emergent care and healthcare prices in New Jersey. While this problem plagues both public and private sector plans, correcting it will be a key element of any effort at public sector health benefits reform not only for the direct savings, but also because it enables other reform options to generate greater savings. For example, the benefits of an optimized network of high-quality, cost-effective providers are undermined if providers have a financial incentive to remain out-of-network and there is no disincentive to subscribers to use out-of-network providers. Similarly, the New Jersey MAPD market would likely become more attractive to hospitals and insurers, leading to a more competitive market and better pricing for retirees.

Timing of Implementation

As discussed above, the Commission's health benefits reforms can be divided between systemic reforms affecting total cost, and those resulting from a reduction of actuarial value. These types of reforms differ in two important ways. First, reforms reducing total cost[35] result in savings without any additional cost to subscribers or employers.[36] Changes in actuarial value, however, reduce subscribers' premium contributions but increase their out-of-pocket expenses. Conversely, while changes in actuarial value are immediate, many of the systemic reforms take time to yield maximum savings due to the need to pass out-of-network reform legislation, establish optimized networks and, in many cases, alter provider and subscriber behavior. As set forth in Exhibit 6, the "no-cost" components of the Commission's proposal would save an estimated $864 million in their first fiscal year of full implementation. Due to health benefit plan years beginning in the middle of fiscal years, roughly half of these savings could be available in the first fiscal year of implementation.

Exhibit 6

Commission Proposal Elements With No Added Costs to Subscribers

Segment	Reform Highlights	Base-Level Savings $ millions
State Active Employees	• Optimized network – will include major providers • Primary Care Medical Home • Out-of-network reform (also applicable to retirees)	$164
State-Paid Early Retirees	• Private exchange-based coverage with multiple plan options • Retiree Reimbursement Account funded to current plan level	$110
State-Paid Retirees	• Private exchange-based coverage with multiple plan options • Retiree Reimbursement Account funded to cover Medicare Advantage • Prescription Drug Plan and average out-of-pocket costs	$590
	Total:	$864 billion

From a logistical standpoint, an argument can be made for giving the structural reforms a head start by enacting them first. The practical downside of this approach, however, is the risk political will for further reform will evaporate once the no-cost reforms are implemented. The Commission's commitment to comprehensive reform stems from the fact that since the funding gap is too large to fill with any one initiative, only a package of reforms can generate sufficient savings. Not every reform produces "win-win" results when viewed in isolation. Carving out the $864 million in annual savings with no additional costs could be an attractive initial step. This step, however, should only be taken with the understanding that an additional $1.4 billion in reforms would be needed before the State could enter into a fiscally responsible constitutional pension funding mandate.

Overview of New Jersey's Public Employer Health Benefits System

The public employee health benefits system[37] covers active employees, early retirees (typically retired employees under the age of 65) and retirees eligible for Medicare (65 years and older). As shown in Exhibit 7:

- **The State** pays for and administers coverage for its own employees and retirees through the State Health Benefits Program ("SHBP"), and for retired school district employees (early retirees and Medicare-eligible retirees) through the School Employees Health Benefit Program ("SEHBP").
- **School districts** pay for coverage for their own active employees, either through the State-administered SEHBP or through privately-placed coverage.
- **Municipalities** and other local entities pay for coverage of their active employees and retirees through the SHBP or through privately-placed coverage.[38] Employers who elect coverage through the SHBP or SEHBP are participants in the "State-run" plans. Those who secure coverage privately are referred to as "opt-out employers."

Exhibit 7[39]

Types of Coverage Offerings for Employees and Retirees

	State agencies	Education employers		Non-education local employers	
	Offer State plan	Offer State plan	Offer private plan	Offer State plan	Offer private plan
Medicare-eligible retirees	Subscribers: 34K Members: 46K $0.4B	Subscribers: 83K Members: 117K $0.8B	N/A	Subscribers: 19K Members: 26K $0.2B	Subscribers: 44K Members:60K $0.4B
Early retirees	Subscribers: 15K Members: 36K $0.4B	Subscribers: 20K Members: 40K $0.6B	N/A	Subscribers:10K Members: 28K $0.3B	Subscribers: 24K Members:66K $0.7B
Active employees	Subscribers:93K Members: 229K $1.5B	Subscribers: 90K Members: 227K $1.5B	Subscribers: 58K Members: 145K $1.0B	Subscribers: 46K Members: 121K $0.8B	Subscribers: 180K Members: 470K $3.2B

State plan is offered and funded by the State: $3.7 billion

State plan is offered, but funded by local education and municipal employers: $2.8 billion

State plan is not offered; benefits funded by local education and municipal employers: $5.3 billion

(Members refers to total covered lives, including subscribers, spouses and dependents)

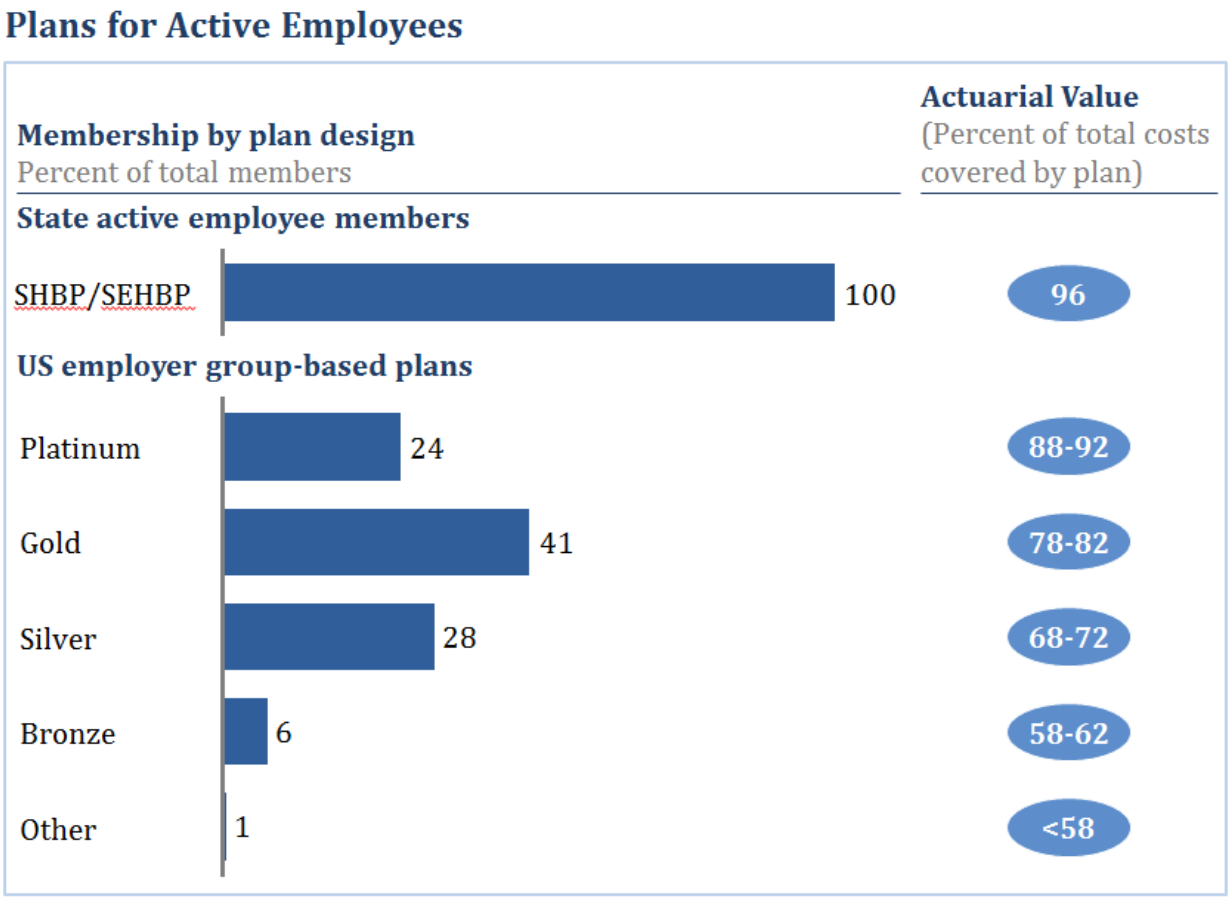
The total health benefits costs for New Jersey public employees for plan year (PY) 2016 are expected to be ~$ 11.8 billion, of which ~$3.7 billion would be spent by the State and ~$8.1 billion by local governments.

Segment-specific Recommendations

Active Employees

Active employees are the largest segment funded directly by the State and, as shown in Exhibit 8, are almost invariably enrolled in plans with among the highest actuarial values in the nation. In contrast, premium contributions are, on average, a relatively low 17.7%[40], compared to a nationwide private sector average of 25%.[41]

Exhibit 8[42]



For active employees, the Commission recommends that the State implement a set of care delivery reforms combined with a high gold level actuarial value plan. The care delivery reforms include implementing an optimized network that focuses on high-value providers, an expansion of the Primary Care Medical Home (PCMH) pilot that is currently in place, and reform to the statutes and regulations that currently govern out-of-network provider reimbursement.

While our 2015 Report had projected an increase in the average employee premium contributions under the Ch. 78 grid, further analysis suggests that increase is unnecessary. Preserving the current below-average employee contribution grid ensures public employees will continue to enjoy better than private sector health benefits, since they will continue to make below average premium contributions while receiving high private sector gold level health benefits.[43] The dollar value of employee premium contributions will actually go down, although out-of-pocket expenses, on average, would increase.

These reforms will narrow the current extreme gap between the level of benefits in the public and private sector as part of a coordinated approach to increase efficiency in use of the healthcare system. Out-of-network reform, optimized networks and greater physician coordination of care all encourage subscribers to get the most value possible from their health benefits. This network construct places the State in a position as more of a price maker than a price taker, enabling the State to leverage its size and purchasing power to command more attractive rates, both in- and out-of-network.

Plans with the same actuarial value can vary significantly in their individual terms. For example, among gold plans on the NJ public exchange, the deductible for a single person ranges from $1,000 - $1,800 and the out-of-pocket maximum ranges from $2,000 - $5,000.[44] Exhibit 9 below outlines selected provisions of different notional gold level plans. The table illustrates the options and trade-offs in plan terms which can yield the 82% actuarial value the Commission has used for cost and savings projections in this Report. Within the constraints set by actuarial value, the Commission sees the selection of the mix of terms which best meet employees' needs as a matter for stakeholder input in the implementation process.

Exhibit 9[45]

Illustrative Gold Level Plan Designs

Plan attribute	Gold option #1	Gold option #2	Gold option #3	Gold option #4
AV	▪ Low 80s	▪ Low 80s	▪ Low 80s	▪ Low 80s
Preventive Care / Preventive Rx	▪ 100%	▪ 100%	▪ 100%	▪ 100%
Deductible (In-network)	▪ Single: $0 ▪ Family: $0	▪ Single: $500 ▪ Family: $1,000	▪ Single: $1,000 ▪ Family: $2,000	▪ Single: $1,250 ▪ Family: $2,500
Co-insurance	▪ In-network: 30% ▪ Out-of-network: 60%	▪ In-network: 20% ▪ Out-of-network: 40%	▪ In-network: 10% ▪ Out-of-network: 20%	▪ In-network: 10% ▪ Out-of-network: 20%
Co-pay	▪ Primary care: $50 ▪ Specialist care: $100 ▪ ER: $300	▪ Primary care: $25 ▪ Specialist care: $50 ▪ ER: $200	▪ Primary care: $25 ▪ Specialist care: $50 ▪ ER: $200	▪ Primary care: $25 ▪ Specialist care: $50 ▪ ER: $200
OOP maximum (In-network)	▪ Single: $5,000 ▪ Family: $10,000	▪ Single: $5,000 ▪ Family: $10,000	▪ Single: $2,500 ▪ Family: $5,000	▪ Single: $2,500 ▪ Family: $5,000
Retail Rx	▪ Generic: 10 % / max $10 ▪ Preferred: 20% / max $30 ▪ Branded: 40% / max $60	▪ Generic: 10 % / max $10 ▪ Preferred: 20% / max $30 ▪ Branded: 40% / max $60	▪ Generic: $5 ▪ Preferred: 20% / max $30 ▪ Branded: 40% / max $60	▪ Generic: $5 ▪ Preferred: 20% / max $30 ▪ Branded: 40% / max $60

Employees will see a ~30% reduction in their premium contributions

For a variety of reasons, any statement of employee impact involves some degree of generalization. Premium contributions vary based on income and family status, the specific plans in which employees are currently enrolled have somewhat different terms, and there is natural variation in out-of-pocket expenses from year-to-year and person-to-person based on individual claims experience. By way of illustration, however, for a single employee making $33,000 annually enrolled in the NJ Direct 15 plan, the proposed reforms would reduce premium contributions from a current $1,043 per year to $711 annually. An employee making $72,000 enrolled in the NJ15 family plan currently paying $6,404 per year would see their premium contribution reduced to $4,366.[46] Just as the proposed reforms would result in over a 30% reduction in the State's average cost to provide coverage to active employees, employees would see the same reduction in their premium contributions.

The increase in an individual subscriber's out-of-pocket costs is particularly difficult to quantify, as it varies depending on a subscriber's use of medical services in a given year and the degree to which the subscriber utilizes in-network services. The current average annual out-of-pocket expense for a single person enrolled in NJ Direct 15 is approximately $435.[47] Under the proposed gold plan, the average out-of-pocket cost is projected to increase to $1,561.[48] Taking into account the reduction in premium contribution, the total annual cost of a single employee making $33,000 would be $2,272 ($711 premium contribution + $1,561 out-of-pocket expenses), $794 more than what the current cost would be under NJ Direct 15, but still significantly less than what an employee required to make the private-sector average premium contribution would pay for the same coverage.[49]

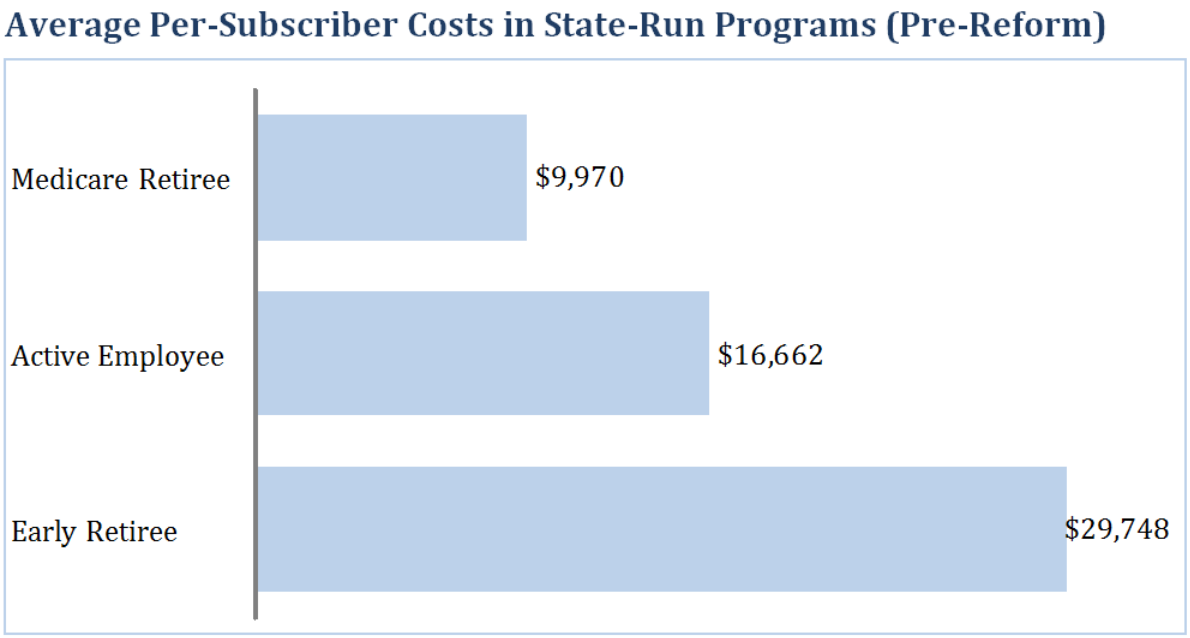
For an employee making $72,000 enrolled in the NJ15 family plan, average out-of-pocket expenses are projected to increase from $1,213 to $4,356.[50] Taking into account the reduction in premium contributions, the total annual cost for an average employee with family coverage earning $72,000 would be $8,722 ($4,366 premium contribution + $4,356 out-of-pocket expenses). This is $1,105 more than the $7,617 current cost under NJ Direct 15, but, again, less than an employee required to make the private-sector average premium contribution would pay for the same coverage.[51]

Finally, while not an express element of the reforms reflected in the cost projections of this Report, the Commission believes worthy of consideration the option of creating Health Reimbursement Accounts (HRA) for employees. In a HRA, the employer provides employees a set amount of annual funding (for example $250 or $500) that can be used to offset out-of-pocket expenses. Use of this device would further offset some of the increase in out-of-pocket expenses, particularly for lower-salaried employees.

Any increase in cost to employees, however, must be weighed against the fact that it is an element of an overall strategy which relies far more heavily on efficiency improvements than cost shifts to drive over $510 million in savings in providing health benefits to State employees. The employees themselves are the beneficiaries of these savings, as they will be dedicated to bolstering pension funding.

Early Retirees

Exhibit 10[52]



As shown in Exhibit 10, early retirees are the costliest segment on a per capita basis, comprising 11% of subscribers but 21% of costs.[53] This high cost is due to the fact that early retirees receive the same coverage as active employees but are more expensive to insure due to their age and health status. Current retirees receive retiree health benefits without any premium contribution requirement.[54] Because of these high costs, the current early retiree coverage would likely be subject to substantial Cadillac taxes as soon as that tax goes into effect.

Health coverage for early retirees under any terms is rare and getting rarer nationwide. Only 41% of large employers offer early retiree health benefits; of these employers, 46% do not provide these benefits for new hires.[55] Of the employers that do offer early retiree benefits, most do not fully fund premiums. For instance, 85% of government employers and 89% of private employers require member premium contributions.[56] Looking ahead, many employers anticipate making changes in early retiree benefit levels. In the near term, 29% of employers favor lowering costs through plan design, 22% favor shifting to exchange-based coverage, and 13% favor eliminating coverage.[57]

To preserve the current broad availability of early retirement, the way health benefits are provided to this population needs to change.

As set forth in our 2015 Report, early retirement has spread beyond its origins in the unique career demands of police and firefighters. To preserve the current broad availability of early retirement in the New Jersey public sector, the way health benefits are provided to this population needs to change.

PRIVATE EXCHANGE-BASED COVERAGE FOR EARLY RETIREES[58]

The State can offer early retirees health benefits coverage through a private exchange including access to the New Jersey public exchange. This approach delivers all of the benefits of public exchange-based coverage (lower, subsidized premiums for older populations and federal premium subsidies), while providing tailored decision support and guidance for the State's retirees.

Private exchanges supplement the advantages of the public exchanges under the ACA by providing additional support for private exchange members. In the public exchanges, individuals under age 65 and small businesses may purchase coverage in a state-specific virtual marketplace administered for New Jersey by the Federal government. The New Jersey individual health insurance market includes over 350,000 lives. Current participants in New Jersey's public exchange include AmeriHealth, Health Republic of New Jersey, Horizon Blue Cross Blue Shield, Oscar Health Insurance, and United Healthcare. The exchange includes a variety of plan types (e.g., HMO, PPO) across platinum, gold, silver and bronze tiers.

Only plans that meet certain standards (e.g., no discrimination by pre-existing condition) are permitted. Furthermore, rates must be set in a manner that the ratio between premiums for 64 year olds and premiums for 21 year olds does not exceed 3:1. In addition, the Federal government provides premium subsidies for individuals with income at or below four times the Federal poverty level. Funding retiree participation in the exchange through an RRA set at levels below Cadillac tax thresholds can also remove any potential exposure to that tax.

Private exchanges are virtual marketplaces operated by private third parties rather than the government. A private exchange can offer individual plans, coverage that is sold directly to individual members via public exchange or other direct to consumer channels and is subject to the 3:1 age rating limitation. Unlike public exchanges, these exchanges provide a concierge-type service to assist individuals in making major coverage decisions.

One final caveat in discussing an exchange approach is that because the exchanges are new, it is unclear how premiums will evolve over time. While premiums were stable between 2014 and 2015, some states have seen premium increases for 2016.

To make the most efficient use of available resources and take full advantage of opportunities to access federal funds, the Commission proposes that early retirees receive coverage through a private exchange. The State would provide funding through a RRA. This funding would be set at a level sufficient to enable early retirees to purchase through the exchange a gold level plan comparable to the one provided to active employees. Going forward, RRA funding would be subject to the limit that it not exceed any applicable Cadillac tax threshold. If they so desired, early retirees would be able to purchase more extensive coverage at their own expense. This approach would generate significant savings without changing contributions by retirees. Use of this model also enables early retirees choices in selecting coverage and will permit them to access favorably priced plans on the exchange, as the ACA regulates the amount that an insurer can charge someone based on their age.

As for projected out-of-pocket expenses, for an individual early retiree, average out-of-pocket expenses in the NJ15 plan of ~$579 in 2016 would increase to ~$1,979 under the proposed reforms. For a family, current average out-of-pocket expenses in the NJ15 plan would increase from ~$1,321 in 2016 to ~$4,515 under the proposed reforms.

While these increases are somewhat higher than those for active employees, this is because there are no offsetting premium contribution savings since current early retirees' premium contributions are *already* at $0. The average annual cost to an early retiree with family coverage would still be over $4,200 less than the overall cost to the active employee with family coverage discussed above. This is a relevant point of comparison given the frequency with which early retirees now continue to work after retirement and/or have spouses who continue to work in the public sector.

Overall, the proposed approach for continuing coverage to early retirees would generate $310 million in savings while member costs would rise by only $90 million.

Medicare-eligible Retirees

For Medicare-eligible retirees, for whom ~80% of medical costs on average are paid by Medicare, the State offers a supplemental plan that covers virtually all other remaining costs. The current marginal cost of providing this additional 20% of coverage is very high, roughly $5,700 a year per person.

The practice of employers providing any level of supplemental health benefits for Medicare-eligible retirees is in decline—in 2014, only 25% of large employers offered this benefit, compared to 35% in 2004.[59] In addition, most employers who do offer Medicare-eligible retiree health benefits do not fully fund premiums. Even across public employers, only 8% of plans are fully funded by the employer, while 48% of plans require the subscriber to pay the entire premium. Across all employers, 91% of plans require retiree premium contributions from Medicare-eligible retirees.[60]

Employers offering Medicare-eligible retiree health benefits are also increasingly looking to alternative models such as private exchanges. In fact, 11% of government employers already provide retirees with a subsidy to fund exchange-based coverage.[61] In both the public and private sectors, 1.4 million lives (retiree and dependents) are now covered via large private retiree exchanges.[62]

RRA funding for Medicare-eligible retirees would cover the cost of gold level equivalent MAPD coverage ***and*** average out-of-pocket costs.

Similar to the approach proposed for early retirees, coverage for Medicare-eligible retirees would be provided through a private exchange with Medicare retirees receiving funding through an RRA and having the option to purchase more extensive coverage at additional cost. The amount of RRA funding would be set at a level that would cover the cost of a gold equivalent MAPD plan and the average out-of-pocket medical *and* prescription drug costs associated with such a plan. In other words, the proposed reform would result in a ***net savings*** for average Medicare-eligible retirees.

MAPD plans are highly cost-effective as they are a form of managed care, incorporating elements of the PCMH approach proposed for active employees. Insurers receive a fixed Federal subsidy per enrolled member and work with physicians and members to provide efficient care. The resulting savings are substantial. In the New Jersey individual marketplace, Horizon Blue Cross Blue Shield offers a Medicare Advantage plan with prescription drug

benefits plan for less than ~$80/month, compared to $475/month for a single SHBP NJ Direct 15 plan for a Medicare-eligible retiree. Federal subsidies are adjusted based on demographic cost factors (e.g., age, gender) and risk (e.g., disease, condition). As such, any additional demographic risk is borne by Medicare, not the State.

Exhibit 11

Estimated Health Benefits Savings to State

Segment	Base-Level Savings $ millions
State Active Employees	$510
State-Paid Early Retirees	$310
State-Paid Retirees	$590
Total before shift:	$1.42 billion
Shift of Education Retirees & Early Retirees	$810
Total:	**$2.23 billion**

The current average out-of-pocket cost for a Medicare-eligible retiree in the State plan is projected to be $220 in 2016. This cost, currently borne by retirees, would be included in the RRA funding. In addition, participants in MAPD programs are not required to enroll in Medicare Part B. Moving to a RRA funded MAPD model eliminates the need for the State to spend ~$200 million a year on reimbursement of Medicare Part B premiums and would result in additional savings for those retirees who currently pay a portion of their Medicare Part B premiums. In aggregate, the State will save $590 million from these reforms.

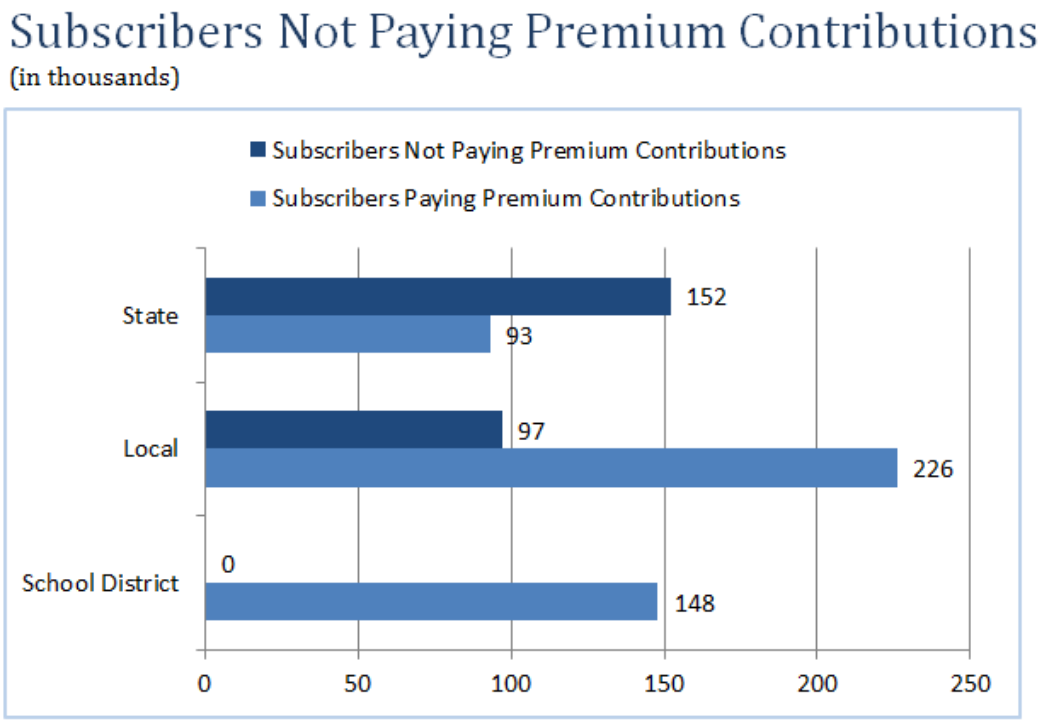
Combined Impact Across All Three Segments

Taken together, the Commission's reforms largely eliminate rather than shift costs. Most importantly, employees and retirees are the sole beneficiaries of these cost reductions. As shown in Exhibit 11, the full $1.42 billion reduction in health benefits spending for State employees and retirees, and the $810 million in savings from school districts assuming responsibility for their retirees' health benefits, will be allocated to pension funding.

III. THE SHIFT IN RESPONSIBILITY FOR FUNDING TEACHERS' RETIREMENT BENEFITS

Our 2015 Report concluded the State cannot continue to fund all of what has become a $4.6 billion annual obligation for teachers' pension and health benefits.[63] As shown in Exhibit 12, this results in the State funding health benefits for over 150,000 retirees[64] who do not make premium contributions, compared to only 93,000 employees who do. No other public employer in the State has this kind of an upside-down contribution ratio.

Exhibit 12



Even after the proposed reforms, teachers' retiree health benefits would cost $810 million for 2016,[65] and the proposed cash balance retirement plan for teachers would cost $402 million more.[66] This $1.22 billion needs to be paid by someone. Given the added burdens of increased pension funding, continued State funding would push benefit costs over the threshold of 15% of the budget at which benefits crowd out funding for essential State functions.[67] If funding responsibility is shifted to the local level, however, these obligations could be funded with savings from equally-needed reform of school district and municipal health benefits. Other options considered by the Commission all have significant and obvious drawbacks. Those options include:

- Reducing State-paid health benefits for retired teachers and State employees and State retirees to bronze level;[68]
- Requiring current retirees to begin to make significant health benefits premium contributions; or
- Repurposing State funding currently used for property tax relief programs directed at homeowners, or the Consolidated Municipal Property Tax Relief Aid to municipalities,[69] to pay the health benefits of these local employees.

Given the options, the Commission believes local funding of some teachers' retirement benefits is preferable. As a general rule, requiring employers to pay for their employees' benefits should not be controversial. The unique circumstances of teachers' retirement benefits, however, arguably support a compromise in which the State continues to fund teachers' retirement benefits earned prior to the proposed pension freeze and school districts' employer contributions to Social Security, a total of about $2.4 billion for 2016. The local tax base, combined, would fund teachers' retiree health benefits and the employers' contributions to the teachers' new cash balance retirement plan, a total estimated at about $1.22 billion Statewide for 2016. To protect local taxpayers, a condition of this change would be that the costs shifted not exceed what individual school districts and municipalities sharing the same property tax base would save by applying the reforms discussed in this Report to local health benefits, with the State retaining responsibility for the balance.[70]

The proposed shift would save the State an amount comparable to the current cost of Consolidated Municipal Property Tax Relief Aid.

Historically, the level of cooperation between State and local government entities and, in many communities, between school districts and municipalities, is not what it could be. Reflecting this reality, the proposed shift does not require any cooperation between school districts and municipalities. The school district's share of a homeowner's property tax bill would increase as a result of the shifted expenses, while the municipal share would decrease as a result of its health benefit savings. Since, except in rare situations, the decrease should be more than the increase, the net result, given no other spending changes, would be a property tax decrease, without any need for a mechanism to transfer savings from the account of one local entity to another.[71] All that is necessary for the shift to work is for the school districts and municipalities to implement the necessary health benefit reforms. While this should happen as a matter of course, there are a variety of means, involving varying degrees of statutory compulsion, to ensure that taxpayers are protected.[72]

As long as the necessary health benefit reforms are implemented, the proposed shift does not require any cooperation between school districts and municipalities to be effective.

It goes without saying that the viability of this approach is premised on the availability of at least $1.22 billion in local health savings. Taking the State as an aggregate, there is no question that this is the case, as district employee and local employee and retiree health benefits suffer from the same problems as those at the State level.

Local public sector employees and retirees can be divided between those whose employers provide health benefits through the two State-run health programs (the SEHBP for school districts and the SHBP for other public employers) and those who have "opted-out" of the State-run plans and secured coverage independently. As set forth in Exhibit 13, reforming the benefits of only the roughly one-third of local subscribers in the State-run plans would, by itself, produce three-quarters of the $1.22 billion in savings necessary to make the shift cost-neutral.[73] There is every reason to believe applying the same reforms to the two-thirds of local subscribers not enrolled in the State-run plans would provide more than enough total savings to offset the cost of the shifted teachers' retiree benefits.

Exhibit 13

Local Health Benefits Savings

Employer	Subscribers	Savings
Local-Paid in State-Run Plans	163,000	$0.94 billion
Local-Paid Outside State-Run Plans	306,000	$1.80 billion
Total Local	**469,000**	**$2.74 billion**

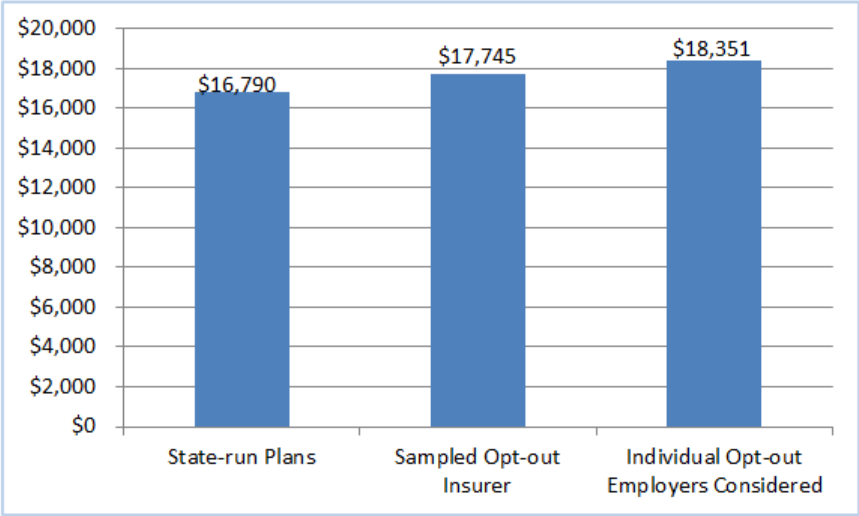
Total Local Savings Needed: $1.22 Billion

The Commission's confidence that there would be enough local health benefits savings for the shift to be cost-neutral is bolstered by the fact that opt-out costs do not appear to differ substantially from costs in the State-run plans. The Commission obtained data from one insurer providing coverage to approximately 75,000 employees of opt-out school districts and municipalities. As shown in Exhibit 14, the average employer cost per employee for this insurer's opt-out employees, $17,745, is actually somewhat higher than the average cost for school district and municipal employers in the State-run plans.[74]

Statewide, the Commission's proposal would permit a ***reduction*** of property taxes by over $1 billion Statewide.

Exhibit 14

Current Average Per-Employee Local Employer Cost



Similarly, as discussed in greater detail in the Appendix, the Commission also looked in detail at the health benefits costs of a broad cross-section of ten communities whose school districts (and in most cases municipalities) had opted out of the State-run plans. As also shown in Exhibit 14, the average per-employer costs for these opt-out employers were also higher than the average per-employee cost for school district and municipal employers in the State-run plans.

As the State could only shift expenses to the extent offset by local savings, under no circumstances could the shift increase property taxes. Every community the Commission considered would experience a net savings.

More importantly, the Commission modeled the impact of the proposed shift in each of these ten communities and confirmed that, in each community, the shift would be better than cost-neutral. On average, it would produce net savings of ~$2 million per community. Given the number and variety of the State's municipalities and school districts, it is possible the shift might not be cost-neutral in a specific community, but the data the Commission has reviewed suggest that this will be the case absent extraordinary circumstances. As set forth in the Commission's 2015 Report, however, if such extraordinary circumstances do exist in a community, the Commission believes the State should be limited to shifting only those expenses which can be offset by local savings, with any excess remaining the responsibility of the State to ensure that this reform does not result in increasing property taxes.

IV. CONCLUSION

Because elected officials overpromised and underfunded for over two decades, the painful reality is that the benefits currently provided to public employees are beyond the State's means. These obligations are growing by millions of dollars a day, and if the State's inaction continues, the problem will expand beyond the scope of any palatable remedy. The pension plans will run out of money and health benefits alone will grow to consume an unsustainable share of tax revenues. Credit ratings will slip and the State will become a less attractive place to live, work and do business.

What is needed is comprehensive reform. The Commission's proposal would preserve public employees' and retirees' health benefit packages at levels above those prevalent in the private sector, permit the reallocation to pension funding of over $2 billion a year in health benefits savings, and fully-fund pension benefits earned to date while insuring that benefits earned in the future remain within the State's means. The Commission's fervent hope is that the people of the State take full advantage of this opportunity as quickly as possible.

APPENDIX – SPECIFIC COMMUNITY CASE STUDY

State-wide, reforming municipal and school district health benefits would yield over $1 billion in savings above and beyond what would be necessary to offset the cost of school district retiree health benefits and the teachers' new cash balance plan.[75] Some school district and local employers, however, have expressed concerns that, as applied to their particular school district/ municipality combination, the shift would not be cost-neutral, either because they have secured favorable terms from insurers and/or do not provide certain kinds of costly coverage (some municipalities do not provide retiree health benefits). The Commission has given considerable attention to this issue and believes that, absent extraordinary circumstances, there would be sufficient savings to permit homeowners to see a net reduction in property taxes as a result of this proposal.

> Absent extraordinary circumstances in an individual community, this proposal, standing alone, should result in a net reduction of property taxes.

To test this assumption, the Commission modeled the shift on a cross-section of ten communities with a range of average household incomes and from different regions of the State as shown in Exhibit 15. All of the school districts have opted out of the SEHBP, and eight of the ten municipalities associated with those school districts have opted out of the SHBP. To ensure that all costs were contained in a common tax base, only non-Abbott K-12 districts drawing essentially all their students from one municipality were considered.[76]

Exhibit 15[77]

Communities Studied

Community	County	District Enrollment	Population	Household Income
Brick	Ocean	9,144	75,072	$65,129
Burlington Twp.	Burlington	3,987	22,594	$85,007
Dover	Morris	3,185	18,157	$59,454
Hamilton	Mercer	11,783	88,464	$71,724
Hillside	Union	3,085	21,404	$55,520
Glassboro	Gloucester	2,126	18,579	$54,795
Montclair	Essex	6,613	37,669	$95,656
Pennsauken	Camden	4,923	35,885	$57,241
Randolph	Morris	4,819	25,734	$123,041
Sparta	Sussex	3,290	19,722	$112,699

As Exhibit 16 illustrates, current costs for opt-out employers vary greatly.[78] Several factors contribute to this variation. The most significant appears to be that employers with a higher percentage of subscribers electing single coverage (the least expensive option) tend to have lower average costs than employers with higher percentages of subscribers electing more costly family coverage.[79] In addition, while, in general, premiums for opt-out employers do not differ greatly from their counterparts in the State-run plans, Montclair, to cite one example, recently secured

particularly advantageous initial terms from a new insurer.[80] Employers which restrict the availability of retiree health benefits in general or early retiree health benefits in particular will also have lower costs.[81]

Exhibit 16[82]

Variance in Employer Costs by Community

Community	Municipal Active Current Average Cost	District Active Current Average Cost	Municipal Blended Retiree Current Average Cost
Brick	$16,892	$21,596	$20,545
Burlington Twp.	$19,777	$22,551	$24,017
Dover	$18,219	$17,177	$24,396
Glassboro	$18,864	$20,792	$17,408
Hamilton	$15,422	$15,776	$19,375
Hillside	$14,671	$16,489	$13,879
Montclair	$14,356	$14,308	$11,030
Pennsauken	$19,880	$25,058	$21,682
Randolph	$18,505	$21,258	$18,955
Sparta	$20,394	$18,921	$15,726
Weighted Average	$16,842	$18,808	$18,783
State Plan Average	$17,732	$16,303	$17,864

There is no reason to believe that any of the factors resulting in differences in costs between and among opt-out and State plan participants would materially affect whether the shift would be cost neutral.

The average costs for employers who have opted out of the SHBP and SEHBP are close to the average costs of local employers participating in the State-run plans.

The shift is premised on the assumption that, for a school district and municipality sharing the same tax base, the combined savings resulting from reforming the school district's employee health benefits and the municipality's employee and retiree health benefits[83] would more than offset the combined cost of the teachers' new cash balance plan (4% of payroll)[84] and teachers' retiree health benefits. Using the cost and headcount data reported by the school districts and local employers themselves, in all ten instances considered, the school district and local health benefit savings would more than offset the teacher retirement costs to be shifted, usually producing a significant surplus.

Exhibit 17[85]

Projected Results of Shift in Communities Studied

	Total Savings	Total Shifted Costs	Net Savings
Brick	$13,092,938	$6,866,132	$6,226,806
Burlington Twp.	$3,931,350	$1,964,224	$1,967,126
Dover	$3,089,620	$2,014,104	$1,075,516
Glassboro	$3,087,052	$1,766,240	$1,320,812
Hamilton	$14,244,286	$9,406,085	$4,838,201
Hillside	$3,603,270	$1,710,317	$1,892,954
Montclair	$4,515,442	$4,220,926	$294,515
Pennsauken	$8,240,540	$4,037,193	$4,203,347
Randolph	$5,436,623	$3,477,349	$1,959,274
Sparta	$3,567,894	$2,426,682	$1,141,212

Significantly, the shift still produces net savings even in Montclair, the toughest case for the study, in that it has the lowest school district and municipal health benefit costs of any of the communities considered and provides minimal retiree health benefits, limiting the potential for savings from reforming these benefits.

New Jersey has 565 municipalities and ~600 school districts. Despite this diversity, the data suggests the proposed shift would be cost-neutral absent extraordinary circumstances in a particular community. Moreover, if such extraordinary circumstances do exist in a community, under the Commission's proposal, the State would be limited to shifting only those expenses which could be offset by local savings, with the State retaining responsibility for any excess. Under no circumstances would the Commission's proposed reallocation of funding responsibility result in an increase in property taxes.

END NOTES

[1] Commission Members Ethan Kra and Lawrence Sher are pension actuaries serving on the Commission as concerned citizens. They were not involved in preparing and are not responsible as actuaries for the health benefits-related cost projections set forth in this Report.

[2] *A Roadmap to Resolution*, New Jersey Pension and Health Benefits Commission (Feb. 24, 2015) (hereafter "2015 Report").

[3] Executive Order No. 161 (August 1, 2014).

[4] Under Article I Sec. 1 of the New Jersey Constitution, amendments must be approved by a majority of voters at a general election after being approved by a three-fifths majority of both houses of the Legislature in one session or by a simple majority in two consecutive sessions. The proposed amendment, introduced into the Senate as SCR 184 and in the Assembly as ACR 3, passed both houses on the last day of the 2015-16 Legislative session, but did not receive a supermajority. The amendment has been reintroduced in the 2016-17 Legislative Session as SCR 2 in the Senate and ACR 109 in the Assembly.

[5] http://www.nj.com/opinion/index.ssf/2016/01/the_truth_about_njs_pension_crisis_and_how_to_fix.html.

[6] The argument the public is not affected by the amendment is premised on the contention that reforming pension benefits is not an option and the public is limited to the Hobson's choice of prefunding benefits now or paying them out of current revenue on a pay-as-you-go basis later. This contention is in turn based on the claim courts have already ruled the State must pay all of the benefits current employees have earned to date as well as those they claim the right to earn in the future. The Statement accompanying the proposed constitutional amendment, however, expressly states that this is an open question which has *not* yet been resolved by the courts. http://www.njleg.state.nj.us/2014/Bills/SCR/184_I1.PDF The Supreme Court of New Jersey has never held that the existing "non-forfeitable rights" statute is constitutional, or that it grants such broad and absolute protection to benefits, particularly to benefits not yet earned. The sole purpose of section b of the proposed amendment is to concede this point to public employees prior to judicial resolution and take away any right the State might have to adjust pension benefits for employees hired before mid-2010.

[7] A factor frequently overlooked in projections which attempt to close the pension funding gap by attributing all revenue growth and new income taxes to pension funding is that the State budget contains a number of provisions linking certain revenue sources to specific mandated appropriations, such as the dedication of income tax revenues to property tax relief. Strictly speaking, growth in these revenues would not be available for increased benefits funding. In addition, some appropriations – debt service, Abbott school funding and Medicaid – in law or fact could not be reduced to augment pension funding even under the proposed amendment. In its 2015 Report, p. 8, n. 36, the Commission estimated the "off-limits" portion of State revenues to be as high as 87%. Ironically, much of what the public would consider essential – courts, prisons, colleges, police, Child and Family services, nursing homes, hospitals and economic development aid, etc., is technically discretionary, and therefore most susceptible to being crowded out

by mandated pension funding. Even with optimistic assumptions that the off-limits portion of State revenues is only 60%, and that there would be steady 3.34% annual growth in the State's revenues ($33.79 billion in FY 2016), and that a $650 million a year millionaires' tax would be added to those revenues beginning in FY 2018 and the State's existing pension assets would earn a steady 7.9% rate of return, there would appear to be a need for additional tax revenue as early as FY 2018, climbing to an additional $2.84 billion a year in additional taxes by FY 2022:

(in $ Billions)	2016	2018	2022
Pensions	$1.30	$2.41	$5.48
Health Benefits	$3.53	$4.15	$5.43
Other (60% of Growth)	$28.96	$30.73	$33.82
Total Costs with Current Benefits	$33.79	$37.29	$44.73
Projected Revenue, $3.34% Growth + $650 million $ MM Tax	$33.79	$36.73	$41.89
Additional Revenue Needed	$0.00	$0.56	$2.84

[8] New Jersey has, again, ranked 50th in the Tax Foundation's comparison of combined tax burden. http://taxfoundation.org/article/2016-state-business-tax-climate-index

[9] Even with respect to the less demanding seven year ramp-up to full funding discussed in the State's FY 2016 budget, Moody's observed that "funding the 10% pension contribution schedule and other budget growth would require 3.5% to 4.5% average revenue growth through fiscal 2023, compared to a 3.4% average since 2010." https://www.moodys.com/research/State-of-New-Jersey-Pension-and-Transportation-Decisions-Loom-as-Issuer-In-Depth--PBM_1011277 p. 5 (Jan. 20, 2016).

[10] Noting that "[t]he range of necessary revenue growth will depend on the state's ability to keep average operating cost growth below the projected inflation rate, which will be challenging over time." https://www.moodys.com/research/State-of-New-Jersey-Pension-and-Transportation-Decisions-Loom-as-Issuer-In-Depth--PBM_1011277 p. 7 (Jan. 20, 2016).

[11] Budget percentages here based on assumed constant 3% annual increase of FY 2016 budget of $33.79 billion.

[12] For FY 2016, State-paid pension and health benefits accounted for 14.3% of the State budget.

[13] Among the practical problems rating agencies would likely consider is that it is not apparent how the amendment's nominal preference for general obligation debt over pension funding could be given full effect when it is likely that three-quarters of pension payments would have already been made before end-of-fiscal-year general obligation payments become due.

[14] Using the same assumptions set forth in Note 7 but assuming flat growth in FY 2019-20, revenues in FY 2022 would be only $39.22 billion, increasing the need for additional annual revenue to fund existing benefits from $2.84 billion to $3.91 billion.

[15] https://www.illinoispolicy.org/flint-offers-grim-look-at-the-future-of-illinois-pension-crisis.

[16] State constitutional constraints restricting reform of pension and retiree health benefits, and the growth of those benefits to consume ~30% of the city budget, have been cited as factors contributing to the austerity measures which led to the water crisis in Flint, Michigan. *See* http://www.barrons.com/articles/flints-problem-was-money-not-water-1454131669.

[17] This issue was the subject of a formal proposal considered and rejected by the Convention's Committee on Rights, Privileges, Amendments and Miscellaneous Provisions. See N.J. Constitutional Convention: Vol. 3, Page 192 (vote rejecting proposal). The Convention's thinking with respect to constitutionalizing employee benefits was made clear by a member of the Convention in arguing that even judicial pensions should not be constitutionalized:

> The matter of pensions should certainly be left to the Legislature and not frozen in the Constitution. The fallacy of putting such matters as salary and pension in our Constitution has been very apparent and has been carefully avoided by this Convention, which has removed the salaries of legislators, for instance, therefrom and have refused to incorporate in their proposal for a new Constitution certain proposals to freeze into this Constitution the matter of pension rights of teachers, policemen and firemen. These are legislative matters and should be left to the legislators[.]

N.J. Constitutional Convention: Vol. 1, Page 490 (Statement of Delegate Dixon);

[18] Only seven states, Alaska, Arizona, Hawaii, Illinois, Louisiana, Michigan and New York, extend constitutional protection to pension benefits. http://crr.bc.edu/wp-content/uploads/2012/08/slp_25.pdf.

[19] Assuming 3% growth in State revenues, a $650 million annual millionaires' tax beginning in FY 2018 would reduce benefits share of the budget in 2023 from 27.3% to 26.8%.

[20] Increased revenue from quarterly payments depends on the difference between the State's cost of borrowing and the rate of return earned on pension fund assets. This impact has been estimated as $8 billion over 30 years assuming a 7.9% rate of return. http://www.njspotlight.com/stories/16/01/25/explainer-the-split-over-making-quarterly-payments-to-employee-pension-system/;http://www.njspotlight.com/stories/15/12/09/sweeney-seeks-constitutional-amendment-to-fully-fund-public-worker-pensions/. Relatively little of this additional revenue would be realized in the first ten years.

[21] This mindset persists to the present day. A recent poll found that a majority of people surveyed would favor a constitutional amendment mandating pension funding – ***if*** this could be accomplished without increasing taxes or reducing government services. http://view2.fdu.edu/publicmind/2016/160121/.

[22] In contrast to health benefits, the problem with pension funding is primarily a function of decades of underfunding rather than the level of benefits themselves. It is possible to take this distinction too far, however, particularly with respect to the benefit enhancement granted by L. 2001, c. 133. That statute, among other benefit enhancements, set PERS and TPAF pensions at 1/55 of final average salary for each year of service, compared to the prior 1/60 formula. This change, subsequently rescinded for new employees in 2010, was passed in conjunction with statutory provisions excusing non-funding of both the new enhanced and preexisting benefits for a number of years. The burden of this instant retroactive increase in the State's pension obligations, combined with an extended pension-funding holiday, has been a key contributing factor to the current crisis. Despite the tainted pedigree of this enhancement, a provision

of the proposed pension funding amendment seeks to write it into the Constitution, protecting not only benefits earned to date under those terms but also the right of currently vested employees to continue to earn new benefits under this enhanced formula for the remainder of their careers. In passing, it should be noted that one frequently-cited report has claimed that New Jersey's pensions are among the least generous in the nation. http://njpp.org/assets/reports/NJPPPensionBenefitsDecember2014.pdf. That report, however, rests on a non-quantitative survey that only looked at categories of elements of a pension plan (such as whether it currently has a COLA) without any consideration of the actual dollar value of benefits provided. It also scored New Jersey on the basis of the 1/60 formula used for roughly 24,000 new employees, not the 1/55 formula applicable to approximately 198,000 currently vested employees. 2015 Report, pp. 25-26.

[23] While sometimes mischaracterized as "like a 401(k)," cash balance plans are defined benefit plans with substantial advantages and safeguards lacking in defined contribution 401(k) plans. They also do not represent a "one-size-fits all" approach, as, for example, contributions would be adjusted for employees not enrolled in Social Security and for mid-career employees who might otherwise be disproportionately impacted by the transition between systems. *See* http://www.nj.com/opinion/index.ssf/2015/10/pension_commissions_cash_balance_plan_offers_more.html.

[24] Ironically, the high premium costs of the 96% actuarial value, platinum-plus plans provided to employees, combined with the highly progressive income-driven premium contribution grid defined by L. 2011, Ch. 78 ("Chapter 78") have led some employees to complain that their benefits are too costly. *See* http://www.njspotlight.com/stories/14/11/18/analysis-nj-public-employees-pay-high-percentage-of-healthcare-costs/. The solution to this problem preferred by employees – reducing or eliminating premium contributions – would simply add another $270 million a year to the State's costs. Initially, the Commission had proposed increasing the average premium contribution without changing the range of the Chapter 78 grid. By careful structuring of the reforms, however, the Commission's current proposal avoids any change to the grid or in the average premium contribution percentage. It was not, however, possible to find a reasonable way to decrease the premium contribution grid. The change to a less expensive gold level plan, however, will significantly reduce the dollar amount of premium contributions, particularly for employees with higher required premium contribution percentages.

[25] The Pew Charitable Trusts, *State Employee Health Spending*, 2014, http://www.pewtrusts.org/~/media/assets/2014/08/stateemployeehealthcarereportseptemberupdate.pdf.

[26] The State has the second highest per-capita unfunded liability for retiree health benefits in the nation. http://www.nasra.org/Files/Topical%20Reports/OPEB/SandP%20State%20OPEB%20report%2011-17-14.pdf.

[27] https://www.moodys.com/research/State-of-New-Jersey-Pension-and-Transportation-Decisions-Loom-as-Issuer-In-Depth--PBM_1011277 (Jan. 20, 2016) (emphasis added).

[28] https://www.fitchratings.com/site/fitch-home/pressrelease?id=989633.

[29] The $10 million a day estimate is based on the assumption that the State is currently paying little more than the normal cost (the amount necessary to keep even with new pension obligations) and not reducing the current ~$40 billion unfunded liability figure as determined by the statute defining the State's annual required pension contribution. It also reflects the 7.9% rate of return which the State would need to earn if the plans were fully-funded

to cover its existing pension obligations. It should be noted the $10 million a day estimate is conservative, since it is based on the ~$40 billion statutory unfunded liability figure. The statutory figure is less than half of the $82 billion unfunded liability as determined under current Government Accounting Standards Board (GASB) methodology.

[30] Projecting full annual required contributions ("ARC") to the State pension plans for future years is complicated by the fact that the amount of the ARC in a future year depends on the amount of payments made in prior years. Varying ramp-up assumptions will result in different ARCs in different years. The Office of Legislative Services has estimated a full statutory ARC for FY 2017 would be ~$4.59 billion (based on the assumption that $1.836 billion pension payment scheduled for FY 2017 would be 4/10 of the full statutory ARC). *See* Senate Budget and Appropriations Committee Statement on SCR 184, available at: http://www.njleg.state.nj.us/2014/Bills/SCR/184_S1.PDF. Exhibit 1 depicts an ongoing scenario in which the 10% annual ramp-up to a full ARC payment referenced in the FY 2016 Budget gives way in FY 2018 to the scheduled ramp-up in the constitutional amendment proposed in ARC 3 as estimated by the Office of Legislative Services. http://www.njleg.state.nj.us/2014/Bills/ACR/3_E1.HTM.

[31] Exhibit 1 assumes ~6% annual growth in health benefits expenses, but also reflects additional year-over-year changes due to demographic changes in membership of the State plans as the workforce ages and the percentage of retirees compared to active employees increases. To be conservative in measuring potential future savings, projections of future costs in this Report exclude any projected Cadillac taxes under the ACA. As originally enacted, under the ACA the federal government would have imposed an excise tax on health plans with total 2018 annual premiums (including both employer and member contributions) that exceed $10,200 for individuals and $27,500 for family coverage for active employees and $11,850 for individuals and $30,950 for family coverage for early retiree and high-risk segments. If, as originally envisioned, the Cadillac tax would have gone into effect in 2018, over half of the State's current plans would have already had premiums above the tax threshold for that year, resulting in an added cost to the State of approximately $300 million the first year and $3 billion over the first seven years, with local governments seeing added costs of similar magnitude.

[32] Under Chapter 78, current retirees and active employees who had 25 or more years of service credit as of the effective date of Chapter 78 are grandfathered from any post-employment premium contribution requirement. Employees with 20 or more years of service credit as of the effective date of Chapter 78 are also grandfathered at a contribution requirement of 1.5% of their monthly retirement allowance, but must still attain 25 years of service credit prior to retirement to qualify for retiree health benefits coverage. Employees who are not grandfathered, who do not fall within the above provisions, and who become eligible for employer-paid post-retirement benefits after 25 years of service, will be subject to a contribution toward post-retirement medical coverage based on the applicable percentage of premium as determined by the annual retirement allowance, including any cost-of-living adjustments. A minimum contribution of 1.5% of the monthly retirement allowance is required.

[33] Exhibit 4 assumes full implementation of the reforms outlined in Exhibit 2 would result in an overall reduction of ~38% in State health benefits costs. Exhibit 4, like Exhibit 1, also assumes ~6% annual growth in health benefits expenses exclusive of any future Cadillac tax. The post-reform pension costs are projections based on the assumptions in our 2015 Report. For a variety of reasons, including the time necessary to begin implementation of reforms and the fact that changes to the pension system are likely to be implemented on a fiscal-year basis (beginning July 1) while changes to the health benefits system are likely to be implemented on a calendar-year basis (beginning

January 1), the first year of implementation would be a transition year in any reform scenario. The transition issue, resulting in the first fiscal year of reforms likely only reflecting a half-year of health benefits savings, combined with the fact one goal of the reforms is to *increase* pension funding above current levels, is why the post-reform cost for FY 2016 shown on Exhibit 4 as an illustrative transition year, are slightly higher than the pre-reform cost for that year.

[34] According to the Kaiser Family Foundation, the tax was established to serve as disincentive for overly rich health benefits. While the tax thresholds will increase over time, the rate of increase is based upon CPI, a rate that has historically been below medical premium inflation rates (~7% for group-sponsored plans).

[35] "Consumerism" is the reduction in total cost due to subscribers being more cost-conscious as they bear a greater share of costs. While there are elements of consumerism in several of the total cost reforms, consumerism is also inter-related with the increase in out-of-pocket costs resulting from a change in actuarial value. To be conservative, the Commission has omitted all consumerism savings from its estimate of the "no cost" scenario discussed in this Report.

[36] Assuming appropriate utilization of in-network providers and services.

[37] Individual employees and retirees enrolled in these plans are sometimes referred to as "subscribers," while "members" refers to lives covered and includes subscribers, as well as their spouses/partners and dependents.

[38] See Appendix A of *2008 State Health Benefits Program Annual Report* for history of State health benefits legislation http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=1&cad=rja&uact=8&ved=0ahUKEwjL84K3tYTKAhVL4SYKHfq4ByMQFgggMAA&url=http%3A%2F%2Fwww.state.nj.us%2Ftreasury%2Fpensions%2F2008_fund_reports%2Fshbp-2008.pdf&usg=AFQjCNGFMQR0QGjm8rRFCEpHl1rhzEn2fg.

[39] State plan premium and membership data has been projected based on PY 2015 member experience and estimated segment growth rates. Private plan premiums based on analysis of publicly available data.

[40] The average premium contribution under the Chapter 78 grid is 17.7%, with a range of 5% to 35%. The grid is highly progressive and, for any given income, families pay a lower percentage than single employees up to the 35% cap. Roughly 85% of subscribers' premium contributions are less than the private sector average of 25%. For families, the income level at which this point is reached is ~$85,000.

[41] "State Trends in the Cost of Employer Health Insurance Coverage, 2003 – 2013," Cathy Schoen, David Radley, and Sara R. Collins; *The Commonwealth Fund* (Jan. 2015).

[42] New Jersey public plan data based on SHBP/SEHBP plan handbooks, enrollment data; Health Affairs (May 2012). National data based on survey of 2,046 public and private employers, with metal levels defined by target AV as set by ACA guidelines.

[43] The projections assume the impact of reforms such as optimized network, utilization management, PCMH, increased consumerism, etc. would result in a ~19% total cost reduction which, when combined with changing the actuarial value of the plan from ~96% to ~82%, would reduce total premium (employer + employee shares) by ~33%.

[44] https://www.healthcare.gov/see-plans/#/plan/results (New Jersey plans).

[45] Source: Towers Watson One Exchange, NJ Public Exchange.

[46] Premium calculations reflect the same employee premium contribution for that income level under the Chapter 78 grid applied to the lower premium of an 82% AV gold plan.

[47] Out-of-pocket for 2016 estimated based on actual 2015 NJHBP claims data with 7% medical trend inflation.

[48] Out-of-pocket expense estimated based on a gold level plan with 82% actuarial value and including reforms proposed in this Report (e.g., optimized network, utilization management, etc.).

[49] Based on private sector average gold level plan and premium contribution level (Kaiser Family Foundation).

[50] Out-of-pocket expense estimated based on a gold level plan with 82% actuarial value and including reforms proposed in this Report (e.g., optimized network, utilization management, etc.).

[51] The cost impact on employers and employees is as follows:

	Premium Contribution		Average Out-of-Pocket Expenses		Total Employee Cost		Total Added Employee Cost
Single	Pre-Reform	Post-reform	Pre-Reform	Post-Reform	Pre-Reform	Post-Reform	
$ 33,000	$1,043.35	$ 711.23	$434.73	$1,561.25	$1,478.08	$ 2,272.48	$ 794.40
Family							
$ 72,000	$ 6,404.09	$4,365.55	$1,212.90	$4,355.87	$7,616.98	$ 8,721.42	$1,104.44

Employer Cost	Pre-Reform	Post-Reform
Single	$8,441.67	$5,754.53
Family	$22,705.39	$15,477.86

[52] Average costs of SHBP and SEHBP subscribers for 2016.

[53] *See* Exhibit 7.

[54] *See* Note 32.

[55] *National Survey of Employer-Sponsored Health Plans,* Mercer (2013).

[56] Ibid.

[57] *2013 Retiree Health Care Survey,* Aon Hewitt (2013).

[58] http://www.hhs.gov/healthcare/about-the-law/index.html;https://www.healthcare.gov/see-plans/#/plan/results

[59] *Employer Health Benefits 2014 Annual Survey,* The Kaiser Family Foundation and The Health Research & Educational Trust.

[60] *National Survey of Employer-Sponsored Health Plans,* Mercer (2013).

[61] *Employer Health Benefits 2014 Annual Survey,* The Kaiser Family Foundation and The Health Research & Educational Trust.

[62] Based on press search, earnings call transcripts, private exchange websites, Credit Suisse Jan. 2014 reports; totals include exchanges run by Aon Hewitt, Buck Consultants, Mercer, Towers Watson (including Liazon), Bloom Health, Aetna, TransitionAssist, Conexis, HealthPlanOne, and BCBS Michigan.

[63] These obligations consist of approximately $2.5 billion in teacher pension payments, $1.4 billion in teacher retiree health benefits costs, and $750 million in school districts' contributions towards Social Security.

[64] Roughly 49,000 State retirees and 103,000 retired teachers. *See* Exhibit 7.

[65] $810 million is the remaining projected 2016 post-reform costs for retired teachers (early retirees and Medicare retirees), down from $1.4 billion pre-reform.

[66] This figure reflects 4% of the TPAF pensionable salary of $10.05 billion.

[67] It is worth noting that school district retiree health benefits were originally intended to be funded at ***no*** cost to the State from excess income earned by Teachers' Pension and Annuity Fund's assets. The cost of this "no cost" obligation has now risen to ~$1.4 billion a year and continues to climb. 2015 Report, n. 22.

[68] In order to make up the projected $1.22 billion in savings, the actuarial value of the State-paid health benefits plans would need to drop from the proposed reform level of 82% (a gold level plan) to ~63-65% (bronze level plan). A bronze plan is significantly worse than the private sector benchmark.

[69] The FY 2016 budget includes property tax relief programs directed at individual homeowners totaling $1.08 billion, and $1.38 billion in Consolidated Municipal Property Tax Relief Aid.

[70] There may be a need for a *one-time* budget cap adjustment to reflect the restructured obligations.

[71] To illustrate how this would work, consider a hypothetical community with a total pre-reform property tax levy of ~$39 million.

Total Property Taxes Before Reform	Tax Levy

Municipality	$12 million
School District	$19 million
County	$8 million
Total Levy	$39 million

Reforms would reduce municipal employee health benefits costs from $3.5 million to $2.3 million, reducing the municipality's share of the overall tax levy by $1.2 million.

	Tax Levy Before Reform	Tax Levy After Reform
Municipality	$12 million	$10.8 million

A total cost of $2.1 million ($1.5 million for retiree health benefits and $600,000 for teachers' new cash balance plan) would be shifted to the school district, but this would to a large extent be offset by reforms which would reduce the district's employee health benefits costs from $5.5 million to $3.6 million.

	Tax Levy Before Reform	Tax Levy After Reform
School District	$19 million	$19.2 million

The decrease in the municipal levy is greater than the increase in the school district levy, resulting, assuming there are no other changes in municipal or district spending, in a net decrease in the community's total property tax levy:

Total Property Taxes	Tax Levy Before Reform	Tax Levy After Reform
Municipality	$12 million	$10.8 million
School District	$19 million	$19.2 million
County	$8 million	$8 million
Total Levy	$39 million	$38 million

Absent other changes to the district and municipal budgets, a homeowner paying the statewide average property tax of $8,353 http://www.nj.gov/dca/divisions/dlgs/resources/property_tax.html#1 before reforms would pay $8,139 post-reform, allocated as follows:

Homeowner Tax Bill	Pre-Reform	Post-Reform
Municipality	$2,571	$2,314
School District	$4,069	$4,112
County	$1,713	$1,713
Total Tax Bill	$8,353	$8,139

Since health benefits of county employees would also be reformed, there would be additional savings associated with this line item, but savings from county-level reforms have not been estimated for purposes of this illustration.

[72] An approach preserving a significant degree of local autonomy would be to cap permissible school district and municipal health benefit costs at what the post-reform costs for the employees and retirees covered by that employer would be if the employer enrolled in the applicable State-run plan. This would ensure a minimum level of savings while preserving an opportunity for these employers to opt out of the State-run plans if this would result in further savings.

[73] Currently, the State funds the health benefits for 245,000 subscribers in the State-run plans: 93,000 State employees, 49,000 State retirees, and 103,000 retired teachers, all through the State-run plans. The reforms proposed by the Commission would reduce the cost of providing coverage to 245,000 State-paid subscribers in the State-run plans by ~$1.4 billion.

[74] The 2016 average employer costs for school district and municipal employees in the State-run plans of $16,790 reflects an average of $16,303 for school district employees and $17,732 for other local employees. Even within the State-run plans, employers' average cost per subscriber will vary due to the mix of subscribers electing single or family coverage, or the mix of employers' early or Medicare-eligible retirees. Different salary levels (the lower an employer's average salary, the higher percentage of coverage it pays under the Chapter 78 grid) also can influence an employer's average costs.

[75] In June 2015, the New Jersey State League of Municipalities and the New Jersey School Boards Association released a study they had commissioned projecting the increase in local property taxes in each of the State's 565 municipalities attributable to the stand-alone cost of transferring to the local tax base the cost of the teachers' new cash balance plan. http://www.njslom.org/letters/LOM-SBA-PENSION-STUDY.pdf ("Caprio study"). Significantly, the Caprio study did not purport to model the Commission's proposal, as it made no attempt to quantify the health benefit savings which are an integral element of the proposed shift. It also did not attempt to estimate teachers' retiree health benefits costs, another integral element of the Commission's proposal. The Caprio study, however, in addition to providing a Statewide overview, also discusses, conceptually, the nuances of allocating costs of regional school districts and school districts involved in sending-receiving agreements. To eliminate this complication, the Commission's study focused on communities with stand-alone K-12 districts.

[76] The Pennsauken School District is concluding a sending-receiving relationship with Merchantville. Students from the small adjoining communities of Mine Hill and Victory Gardens attend Dover High School.

[77] Demographic data from: http://www.nj.gov/education/data/enr/enr15/district.htm and http://factfinder.census.gov/faces/nav/jsf/pages/community_facts.xhtml. According to Department of Education data, 117 of the 221 K-12 school districts in the state have total enrollments of 3,500 or less.

[78] After identifying the communities in question, the Commission then sought out health benefits cost data for these communities, as there is no state-wide compilation of health benefit costs for opt-out school districts or municipalities. Data on individual school district costs for providing health benefits to their active employees, however, is reported to the Department of Education. Data on individual municipal health benefits costs is available for municipalities which have submitted their "User-Friendly Budgets" to the Department of Community Affairs. The health benefit costs associated with a school district's retirees and the pensionable salaries of the districts can be determined from Department of Treasury data.

[79] The impact of the mix of single and family coverage elections on average costs is illustrated by the differences in retiree health benefits costs for the districts in question. As all teacher retiree health benefits are provided through the SEHBP and paid for by the State, any difference in average cost from one district to another is due to different districts' retirees having different mixes of single or family coverage:

	Average District Early Retiree Cost	Average District Medicare Retiree Cost
Brick	$21,041	$8,429
Burlington Twp.	$21,888	$8,343
Dover	$20,382	$8,837
Glassboro	$19,883	$7,920
Hamilton	$20,005	$7,820
Hillside	$22,724	$8,306
Montclair	$20,108	$8,243
Pennsauken	$21,442	$8,912
Randolph	$20,056	$8,654
Sparta	$22,102	$8,784
Weighted Average	$20,639	$8,330
State-Plan Average	$28,626	$10,011

[80] *See* http://www.northjersey.com/news/education/boe-goes-with-new-healthcare-coverage-1.1021828?page=all. It also appears that the Town of Montclair has a disproportionately low percentage of early retirees receiving family coverage, which would facilitate negotiating favorable rates.

[81] Contrary to the mandate of Chapter 78, some employers also may not be collecting required employee premium contributions.

[82] The User Friendly Budgets for Burlington Twp., Hamilton, Hillside and Sparta do not report employee premium contributions. To be conservative, the Commission's projections assume the reported costs are total costs towards which employees contribute, on average, 17.7% of premium costs. If the reported figures actually reflect the employer-only cost, the savings resulting from the shift for these communities would be even greater.

[83] Given available data, there are two ways to project a local public employer's post-reform health benefit costs. The first is to proportionately reduce the employer's current costs by the same percentage as the reforms reduce costs in the State-run plan. The result of this approach reflects cost differences caused by variations in different employers' mix of single and family coverage and early and Medicare retirees, but can produce lower costs than might be achievable for employers whose current costs are already below average. The second approach is to assume employers applying these reforms will be able to achieve the same average costs as the State plan. The results of this approach might not be achievable if an employer has a high mix of family compared to single coverage or early retirees compared to Medicare-eligible employees. To be conservative, the projections in this Report use the higher of a proportionate reduction in costs or the post-reform State plan costs, thereby yielding the highest post-reform costs and lowest resulting savings. Even following this convention, the shift results in significant savings for all the communities examined.

[84] As set forth above, the New Jersey State League of Municipalities and New Jersey School Boards Association's Caprio study included for each school district in the State a pensionable salary figure which would, in turn, determine the cost of the new cash balance plan for the teachers in that district. The data the Commission obtained on the ten districts it studied in all cases showed pensionable salary figures 2% to 6% *higher* than the pensionable salary figures for those districts reported in the Caprio study. Given the number of potential inconsistences (including districts possibly reporting data from different years to different sources) that can occur when different sources report data from over 600 school districts, such a difference is not surprising. Since a higher pensionable salary figure increases the amount of the costs shifted and reduces net savings, to be conservative, the Commission has used the higher pensionable salary figures reported by the districts.

[85] The projected added costs and savings for the communities considered are as follows:

	Savings from Municipal Actives	Savings from Municipal Retirees	Savings from District Actives	Shifted District Retiree HB Costs	New Cash Balance Cost	Net Savings
Brick	$1,995,705	$1,921,720	$9,175,513	$4,370,614	$2,495,517	$6,226,806
Burlington Twp.	$798,652	$362,971	$2,769,727	$964,151	$1,000,073	$1,967,126
Dover	$510,760	$767,298	$1,811,562	$1,238,537	$775,567	$1,075,516
Glassboro	$742,927	$519,070	$1,825,055	$1,140,347	$625,893	$1,320,812
Hamilton	$2,153,095	$3,268,424	$8,822,767	$6,178,171	$3,227,913	$4,838,201
Hillside	$556,538	$827,709	$2,219,023	$802,314	$908,003	$1,892,954
Montclair	$1,003,838	$378,461	$3,133,143	$2,068,873	$2,152,053	$294,515
Pennsauken	$1,181,043	$1,071,603	$5,987,894	$2,670,064	$1,367,129	$4,203,347
Randolph	$673,177	$797,499	$3,965,947	$2,031,465	$1,445,884	$1,959,274
Sparta	$612,593	$366,143	$2,589,158	$1,390,219	$1,036,463	$1,141,212