city of Norton Shores

Internal Memo

November 16, 2016

TO: Mayor and City Council

FROM: Mark C. Meyers, City Administrator MCM

SUBJECT: Managing Unfunded Accrued Liabilities

The purpose of this memo is to outline new strategies to manage unfunded accrued liabilities (UAL) for both the Municipal Employees Retirement System (MERS) pension program and other post-employment benefits (OPEB), or retiree health insurance.

Background

As the City Council is aware the most recent funding level of the MERS pension program stands at 47%. This leaves the City with an approximate $23.5 million in UAL. This is essentially due to three reasons: 1) the City did not make any pension payments for three consecutive fiscal years from 1992 to 1994 and the funding level plummeted from 100% to approximately 65%; 2) the recession caused the pension system to lose $4.2 million during fiscal years 2008 and 2009; and 3) in 2005 and through 2015 MERS reduced the amortization schedule for the pension program from 30 years to 23 years.

Unlike pension plans, OPEB, such as retiree health insurance, are not required to be prefunded. Historically, municipalities budgeted for the expense annually on a "pay as you go" basis. However, several years ago the Governmental Accounting Standards Board (GASB) changed the accounting principles and began requiring that UAL appear on municipal balance sheets. The current UAL for OPEB is $38 million.

The City has initiated a number of strategies to manage UALs dating back a dozen years. These include implementation of a reduced benefit pension plan, employee contributions toward pension, discontinuing cost of living increases for existing retirees, increased payments above the Actuarially Required Contribution (ARC), establishing an OPEB Trust Fund, implementing reduced benefit retiree health care stipends for new hires, employee health care premium co-pays, and high deductible health plans. Unfortunately, many of these strategies are long term and results are not yet being realized. In addition, UALs are a moving target due to MERS most recent change to more conservative assumptions including extended life expectancy , lower

investment returns, and a reduced amortization schedule down to 15 years. Therefore, more must be done to manage UALs.

Goal, Objectives, and Strategies

The overall goal for managing UALs is to ensure sustainable benefits for employees and retirees. The objectives are to: 1) lower costs; 2) increase funding; and 3) a new objective, to spread the costs over time. Specific strategies are summarized below.

Pension

Lower Costs

- **Consider closing the DB plan and opening a DC plan for new hires.**
  This was the basis of a 2010 plan to attain 80% funding which was required by MERS to close the existing DB plan. However, in September 2016 MERS removed that requirement and the City is now free to pursue this objective. Based on City Council's direction at the October 2016 work session staff has ordered a required actuarial study which is the first step in the process.

- **Manage compensation costs for existing employees.**
  Review adjustments to wage ranges. Review budget appropriations for performance based pay.

- **Review types of compensation that are reported to MERS for purposes of calculating final average compensation.**
  Perform a survey of comparable municipalities to determine if we are consistent with the market.

- **Review opportunities to lower personnel costs by contracting out, combining or maintaining vacancies in positions.**

Increase Funding

- **Budget for a pass-through of Tax Increment Financing Authority (TIFA) proceeds and increase funding above the ARC.**
  This would provide up to approximately $525,000 in additional annual revenue to appropriate toward UALs. The existing fund balance in the TIFA fund is sufficient for projects in the newly amended plan in the near future.

- **Implement and maintain an employee contribution toward the pension program for all employees.**

Currently there are 21 employees not required to contribute toward the pension program. This could provide $42,000 in additional funding.

- **Appropriate any revenue growth and identify budget cuts and increase funding toward the ARC.**

Spread Costs Over Time

- **Request MERS to extend the length of the amortization schedule.**
  There is a provision with MERS that allows a retirement program member to request that the amortization schedule be extended beyond the existing number of years. This would spread payments over time resulting in a decreased ARC.

- **Consider bonding for the UAL.**
  The State law allows municipalities to eliminate their UAL by borrowing money to spread payments over a longer period of time than the existing amortization schedule. This requires closing the current DB plan. The advantage to this alternative is lowering the annual ARC. However, the disadvantage is the payment of interest. For example: a West Michigan municipality whose pension plan was 66% funded recently eliminated their UAL by issuing a bond. Their annual ARC was reduced from $3.9 million per year to $2.2 million per year. However, the bond will cost them $7.5 million in interest.

OPEB

Lower Costs

- **Implement and maintain a uniform prescription drug and medical plan for all retirees based on the current employee plan.**
  The City is obligated to provide prescription drug and medical insurance to retirees based on pay plans and collective bargaining agreements. However, it is not obligated to a specific plan or amount of benefit. Estimated annual savings for putting current retirees on the BC/BS Simply Blue Plan is $134,000.

- **Maintain prescription drug and medical plans based on market change.**
  Survey comparable communities to determine market changes. Also, review annually and adjust as necessary based on State of Michigan Department of Treasury "Hard Cap" standards.

Increase Funding

- **Apply savings in health care plan changes toward the annual recommended contribution.**

- **Budget for a pass through of TIFA proceeds to increase funding toward annual recommended contributions.**
  Again, this would provide up to approximately $525,000 in additional revenue that could be appropriated toward UALs.

- **Appropriate any revenue growth and identify budget cuts from the annual budget to increase funding toward the recommended contribution.**

Timing

Implementing these strategies would occur over time. Regarding pension, the MERS actuarial for closing the DB plan and opening a DC plan has been ordered. If a DC plan is opened for new hires, it could be done in the short term with MPTC employees and over time with union employees as their collective bargaining agreements expire or, perhaps sooner, if contracts were reopened. Other strategies, including managing employee contributions toward pension programs, would be implemented when new pay plans and collective bargaining agreements are approved beginning July 1, 2017. Additional funding toward the pension ARC will be determined during the Fiscal Year 2018 budget process and become effective July 1, 2017.

Regarding OPEB, implementing a new health plan for retirees cannot be done until January 1, 2018 due to the provider's (Humana) rules and timing of the plan year. However, this will allow time to meet with retirees to explain the program changes and adjust to the new plan. In the meantime, the changes would have to be negotiated with unions based on the timing of their collective bargaining agreement terms or, perhaps sooner, if contracts are reopened. As with the pension ARC, increased funding toward OPEB will be determined during the Fiscal Year 2018 budget process and become effective July 1, 2017.

Should the City Council direct staff to pursue these strategies, meetings regarding unfunded liabilities and the related strategies to manage them would be discussed with each employee group, as well as with retirees so that everyone is well informed on the issue and has an opportunity to ask questions and provide input.

This topic will be discussed at the November 22, 2016 Work Session. In the meantime, please contact me with any questions you may have.

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