Unfunded Accrued Liability Plan

Updated July 27, 2018

Pension Unfunded Accrued Liability

BACKGROUND: The City participates in the Municipal Employees' Retirement System of Michigan (MERS), an agent multi-employer defined benefit pension plan. The System is administered by the MERS retirement board. Act No. 427 of the Public Acts of 1984, as amended, establishes and amends the benefit provisions of the participants in MERS.

For the year ended June 30, 2018, the City's annual pension cost of $954,744 for MERS was equal to the City's required and actual contributions. The required contribution was determined as part of the December 31, 2016 actuarial valuation using the entry age actuarial cost method. Employees are required to contribute to the Plan from 1.71% to 4.24% of covered payroll depending on the bargaining unit. The remaining amortization period at December 31, 2017, the date of the most recent actuarial valuation, was 9 years.

The amortization period is the length of time needed to eliminate a pension plan's unfunded liability. Since 2005, MERS has been gradually reducing the amortization period to ensure their obligation will be fully funded by the time the last employee on the plan retires (in theory). Beginning in 2016, MERS no longer re-amortizes the full liability each year and instead layers the increases/decreases to the unfunded liability with a separate amortization schedule.

Before the 12/13/2015 actuary report was calculated, MERS enacted various changes to their actuarial assumptions. The most impactful areas were changes to the mortality rates table and investment rate of return assumption. The experience study recently completed by MERS showed that defined benefit participants are living longer. In addition, MERS lowered our investment assumption from 8% to 7.75% to reflect their current judgment of what the City can earn on assets over the long run.

PREVIOUS ACTIONS TAKEN: Beginning July 1, 1995 through April 1, 2000 the plans were closed to new employees and a defined contribution plan was established. In addition to closing the defined benefit pension plan, existing employees on the defined benefit plan were incentivized to convert to the newly established defined contribution plan. As a result, only eleven current employees (out of a total of eighty three) are remaining on the defined benefit pension plan.

Pension Unfunded Accrued Liability (continued)

The following is a history of the actuary results for the year-ended:

Actuary Report Date:	12/31/2015	12/31/2016	12/31/2017
Actuarial Value of Assets:	$11,886,765	$11,745,834	$11,743,201
Actuarial Accrued Liability:	$20,067,716	$20,125,303	$19,983,349
Amortization period (years)	10	10	9
Unfunded Actuarial Accrued Liability (UAL):	$ 8,180,951	$ 8,379,469	$ 8,240,148
Funded Ratio Total:	**59%**	**58%**	**59%**

CONTINUED IMPLEMENTATION: The long-term impact of implementing a defined contribution plan is that it eliminates the future accrual of liabilities of those benefits since the defined contribution does not have liabilities associated with the benefits. Based on 2017 projections, the City ARC will significantly increase each year until 2026, reaching an ARC payment of $1,400,000 at that point there will be no unfunded liability and the cost will be minimal (only the normal cost of the pension plan – approximately $200,000).

Pension Unfunded Accrued Liability (continued)

ACTIONS EXPLORED:

With these mounting costs for the future, the City reviewed the following options:

1. Explored issuing a taxable Pension Obligation Bond (POB) to pay off the Unfunded Actuarial Accrued Liability (UAL). Pension obligation bonds are taxable bonds that some state and local governments have issued as part of an overall strategy to fund the unfunded portion of their pension liabilities by creating debt. The use of POBs rests on the assumption that the bond proceeds, when invested with pension assets in higher-yielding asset classes, will be able to achieve a rate of return that is greater than the interest rate owed over the term of the bonds. However, it was determined that the *speculative* risk of issuing these bonds outweighs the potential savings. The following are the risks:

    - Bonds are a hard cost and issuing POBs create a mandatory payment schedule for the City to repay the bonds. This eliminates flexibility for the City to temporarily delay contributions, if necessary.

    - Does not eliminate the possibility of a UAL payment in the future if investment earnings do not meet projections. Currently the assumptions are set at 7.75% investment return. If MERS is unable to meet the rate of returns over the period of the bond, the City would have additional payment to MERS in addition to the debt service payment.

    - If the rate of investment return is less than the bond interest costs (i.e. 4% taxable bond), the balance of the POBs would be greater than the value of the assets.

- POBs are frequently structured in a manner that defers the principal payments or extends repayment over a period longer than the actuarial amortization period, thereby increasing the overall costs.

2. Discussed the option with MERS to modify the amortization schedule to reduce the City's required payments. In 2012, MERS agreed to an alternative amortization schedule to keep payments manageable. In 2016, MERS allowed a five year phase in of the increased payments due to assumption changes. To keep making progress toward being fully funded, it was determined that the City would continue to make the payments as actuarially required by MERS.

Other Postemployment Benefits (OPEB) Unfunded Accrued Liability

BACKGROUND: The City administers a single-employer defined benefit health care plan (the Plan). The Plan provides health insurance benefits to eligible retirees and their spouses until Medicare coverage at age 65. Dependents are covered until age 26.

For the year ended June 30, 2018, the annual required contribution was $428,908 while the City contributed $144,700.83 to the Plan, which was the amount of direct expenses relating to the retirees included on the Plan.

An actuarial study was performed by a consultant for the year-ended:

Actuary Report Date:	06/30/2017
Actuarial Value of Assets:	$1,191,747
Actuarial Accrued Liability:	$4,021,713
Unfunded Actuarial Accrued Liability:	$2,829,966
Funded Ratio Total:	29.6%

ACTIONS TAKEN: The City established a retirement health savings vehicle (RHFV) with MERS effective June 22, 2009 and the City has contributed $719,421 to this trust, which does not include the additional amounts contributed for direct expenses paid. At June 30, 2018, the value of assets equals $1,281,385.23 due to net investment income earned.

In addition, benefits at the City have been limited to retirees and their spouses until Medicare coverage at age 65. The City has also limited the insurance cost to the hard cap insurance costs from Public Act 152 and has frozen the expense at time of retirement. Any amount of increase after retirement is paid by the retiree. Many municipalities pay the entire cost of insurance over the life of a retiree and spouse.

CONTINUED IMPLEMENTATION: The City plans to continue paying the direct expenses relating to retirees (and eligible dependents) as the benefit payments come due and to contribute to the RHFV when possible. The most recent contribution ($5,000) was made on July 20, 2018.

In closing, the City has sent aside a $1,281,385.23 balance reserved to pay these benefits. Due to making the benefit payments from current resources, the reserved balance has not been reduced to pay current benefits and continues to accrue investment income.