Unfunded Accrued Liability Plan

Updated November 1, 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 $1,204,584 for MERS was equal to the City's required and actual contributions. The required contribution was determined as part of the December 31, 2015 actuarial valuation using the entry age actuarial cost method. Employees are required to contribute to the Plan from 0% to 5% 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 7 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 December 31, 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 our assets over the long run.

PREVIOUS ACTIONS TAKEN: This plan was closed to new employees on July 1, 1999 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 five current employees (out of a total of sixty-six) are remaining on the defined benefit pension plan.

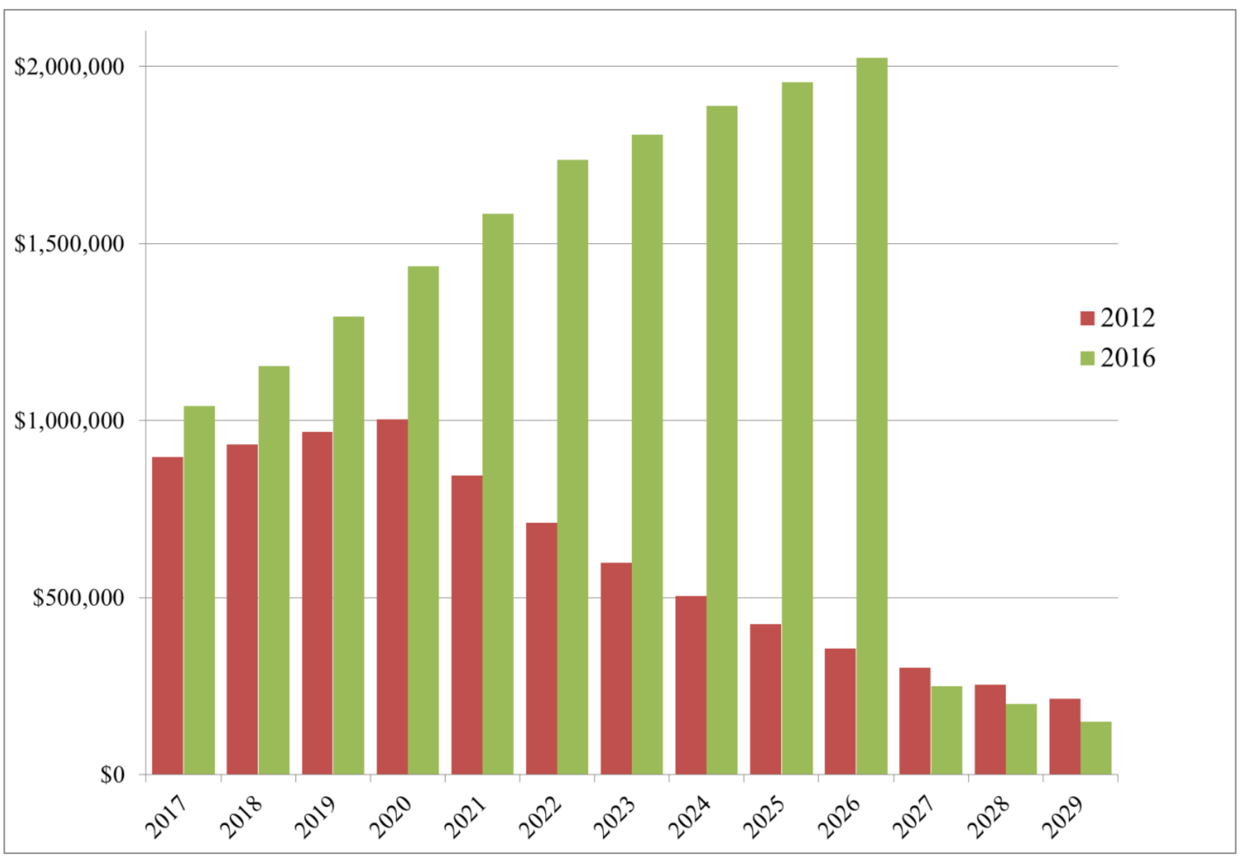
Pension Unfunded Accrued Liability (continued)

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:	$ 8,490,268	$ 8,735,603	$ 9,306,535
Actuarial Accrued Liability:	$18,797,241	$18,354,787	$18,518,876
Amortization period (years)	10	9	8
Unfunded Actuarial Accrued Liability (UAL):	$10,306,973	$ 9,619,184	$ 9,212,341
Funded Ratio Total:	**45%**	**48%**	**50%**

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 2012 projections, the City had previously projected an increase in yearly payments until 2020; at that point a *cliff* would be reached and the actuarially determined payments each year would begin to significantly decrease. MERS recalculated our projections in 2016 based on the new assumptions and the *cliff* was revised to 2026.

Although the 2016 projections from MERS are outdated (based on recent preliminary discussions from MERS on the likely change in assumptions), the following is a graph based on projections we received in 2012 and 2016 from MERS.



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 we are unable to meet the rate of returns over the period of the bond, we 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 our amortization schedule to reduce our 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 healthcare plan (the Plan). The Plan provides 100% of 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 $300,886 while the City contributed $226,255 to the Plan, which was the amount of direct expenses relating to the six retirees included on the Plan.

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

Actuary Report Date:	06/30/2016	06/30/2017	06/30/2018
Actuarial Value of Assets:	$1,215,967	$1,295,568	$1,344,341
Actuarial Accrued Liability:	$3,487,884	$3,264,267	$3,491,484
Unfunded Actuarial Accrued Liability:	$2,271,917	$1,968,699	$2,147,143
Funded Ratio Total:	35%	40%	39%

ACTIONS TAKEN: The City established a retirement health savings trust fund effective June 13, 2008 and the City has contributed $866,700 to this trust, which does not include the additional amounts contributed for direct expenses paid. At June 30, 2018, the value of assets equals $1,344,341 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. Many municipalities pay this benefit 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. While there is clearly a liability for future healthcare costs, the amount calculated in the actuarial report is a different outlook than the City's. In calculating the OPEB liability, an actuary looks at how many people work for the City and the benefits promised. Other critical inputs include the age of workers, when they are likely to retire, and how long the benefits will continue after retirement.

The actuarial accrued liability is also based on when those benefits have been earned and does not factor the expected cash flow of the benefit payments. Yearly benefit payments at the City are expected to remain manageable due to the following:

- Established employees are working longer under the defined contribution plan in order to build a larger retirement savings. This decreases the expected number of years employees will be included on the Plan.

- Newer hires are tending to move on and are not automatically retiring with the City due to the portability of the defined contribution plan.

Other Postemployment Benefits (OPEB) Unfunded Accrued Liability (continued)

- Some employees are coming in at the middle of their careers making it difficult to reach eligibility under the years of service requirement under the Plan.

- If after retirement a retiree were to seek employment that offered equal or better health coverage, that retiree and their dependents would be removed from the Plan.

- The City is self-insured and controls the cost and design of the Plan. We are not limited by rates set by an insurance carrier.

- Stop loss coverage (on the self-insured plan) kicks in at $50,000. It would be unlikely that more than one retiree (or dependent) would hit that limit in a year.

- The number of retirees on the Plan average between 5 – 10 per year plus spouse/dependents. Due to the 65 age limit, we are not expecting this to change significantly in the future.

Please note, the actuarial valuation does take in account some of the above statements in the study; but due to the unknown of many of those statements, the City feels the actuary report is a worst case situation.

In closing, the City has sent aside $1,344,341, a 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.