Responsible Retirement Reform for Local Government
Task Force

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REPORT OF FINDINGS AND RECOMMENDATIONS FOR ACTION

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Executive Summary

In his January 2017 State of the State address, Governor Rick Snyder announced the creation of a task force focused on addressing the unfunded pension and retiree health care liabilities of local governments in Michigan. Without intervention and a collaborative solution, this problem will only continue to grow - jeopardizing the quality of life and delivery of essential services in our communities while creating instability for the retirees and employees who depend on these benefits.

Of the approximately 1,800 local units in Michigan, roughly half provide post-retirement benefits. The problem – most of those communities have not saved enough over time to pay for those benefits promised to retirees. The total unfunded pension liability is estimated to be around $7.4 billion. The total unfunded liability for health care is estimated at $10 billion. Additionally, it is estimated that roughly 20 cents on the dollar for many Michigan cities goes to pay legacy costs instead of to provide current services. This number is growing faster and continues to be a bigger share of local budgets over time. Michigan is not alone in facing this growing crisis. Nationally, it is estimated that the more than 4,000 state and local pension systems in the U.S. owe an unfunded liability of more than $3 trillion, while the unfunded liability for health care is estimated at $862 billion.

The goal for the task force, named the Responsible Retirement Reform for Local Government Task Force, was to drive collaboration among legislators, state and local government officials, employee representatives, pension managers and insurance professionals, to ensure the financial stability and effective delivery of local government services, while meeting the commitments made to employees, in the coming decades. The Task Force consisted of 20 voting members and four ex-officio members. The Task Force was co-chaired by Ben Carter, Executive Vice President and Interim Leader of East Group Operations for Trinity Health, and David Breen, retired Managing Partner at PricewaterhouseCoopers LLP.

Governor Snyder directed the Task Force to provide recommendations on pension and retiree health care reforms by Spring 2017. Between February and May 2017, the Task Force met numerous times to discuss the size and scope of the problem and potential solutions to address this incredibly complex and growing issue.

In an effort to develop a comprehensive set of recommendations, the Task Force agreed on the following key understandings and concepts which were used as a filter during final recommendations deliberations:

- A serious problem exists and something must be done immediately to begin to fix it for the benefit of employees/retirees, our communities and the state.
- Solutions must ensure that this problem does not continue to grow in the future.
- As local units across our state are unique and diverse, there is not a one-size-fits-all solution to this problem – we must be flexible with our solutions.
- Attention should focus on the local units experiencing the worst fiscal stress.

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- It is understood that there are local units that simply cannot raise taxes or reduce liabilities enough to address their growing liabilities from agreements reached at the bargaining table years ago.
- The broader solution to the fiscal stability situation must include addressing long-term liabilities, effective provision of services, and local government revenue constraints, while considering intergenerational equity.

With these agreed upon understandings and concepts in mind, the Task Force agreed on four main recommendations:

- Greater reporting and transparency must be required of all local units to ensure a full understanding of the exact size and scope of the problem, and where the biggest challenges exist so that they can be addressed. This includes reporting based on a range of uniform assumptions.
- A fiscal stress test system for local governments should be created to be a system that would alert and assist local units in crafting solutions to best position them to continue to serve their residents, while funding their obligations and protecting benefits for employees and retirees. This system would identify and focus action on the local units experiencing the worst fiscal stress.
- This system, along with the creation of a new Municipal Stability Board (MSB), could assist in the review of a local unit's finances and the development of a corrective action plan. The Board could also provide research, training and technical assistance to those in need.
- Going forward, in addition to meeting the current constitutional requirement that they pay normal costs for pension, all local governments should meet minimum requirements to pay normal costs for OPEB for new hires (i.e., to prefund new active employee's current year obligation).

The Task Force worked diligently to find consensus where possible, however it must be noted that there were a few key issues for which there was fundamental disagreement:

- Some Task Force members were strongly opposed to the establishment of new funding requirements, concerned it would have too severe an impact on the local government's ability to provide current services. While they recognized these liabilities as important, they maintained that the focus should be on making benefits more affordable and having adequate cash flow to maintain current services.
- Some Task Force members were strongly opposed to the establishment of new plan design requirements for all local governments, believing that the local unit, through the collective bargaining process, should have the flexibility to agree upon what would work best within their communities.
- While the Task Force agreed to the concept of a MSB, it could not agree on the powers it would have. Some Task Force members thought the MSB should be able to unilaterally impose changes if the local unit was unable to successfully implement a corrective action plan, while others felt that the MSB's role should be limited to making recommendations and providing technical support.

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Additional recommendations that were discussed, but did not receive consensus, are noted further in the report.

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Overview of Local Government Pension and OPEB Systems[1] in Michigan

Michigan has slightly over 2,800 general and special purpose local government entities (Census Bureau, 2012). Of these, 1,856 are general purpose local governments (cities, villages, counties, townships) and about 1,000 are special purpose governments (school districts and other special districts).

2012 Census Governments	
General Purpose Governments	
Municipal	533
Town or Township	1,240
County	83
Total	1,856
Special Purpose Governments	
Special Districts	443
Independent School Districts	576
Total	1,019
Total	**2,875**

These governmental entities collect revenues, provide a wide variety of public services, and employ personnel to carry out these functions. As part of total compensation package for local government employees, deferred compensation in the form of retirement income (defined benefit or defined contribution) and access to retiree health care is often included - especially for larger government entities.

Deferred compensation can be paid for in two ways. The first way is called pay-as-you-go. This means that governments do not save today to pay for those benefits that have to be paid out in the future. Rather, they simply pay the liabilities as they come due in the future, even though the related services were performed long ago. The second way is called prefunding. Prefunding is based on setting aside money today, and earning interest or investment income, to build savings to pay for future payments.

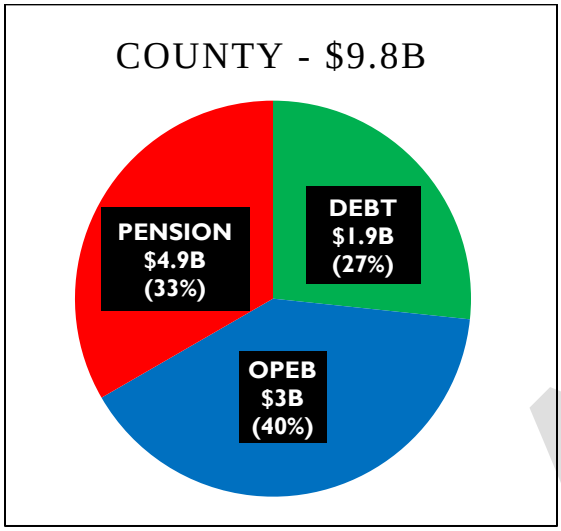
Governments that do not entirely and accurately prefund a deferred compensation benefit are required to account for it as a future liability. Over time, if prefunding is minimal or inaccurate, liabilities can grow to a large scale.

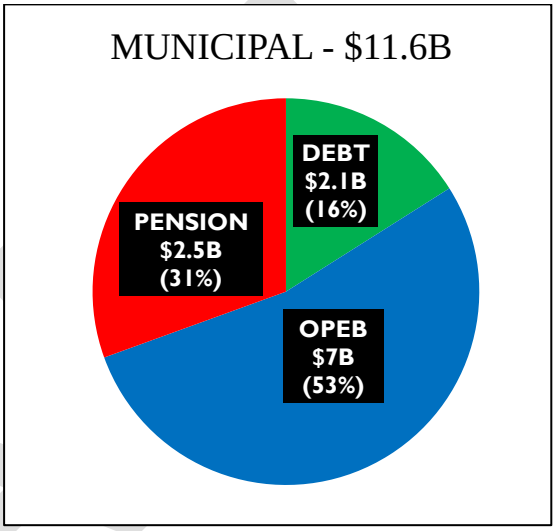
[1] Throughout this report, the terms OPEB system and retiree health care system are used interchangeably.

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What is the Current Situation?

In general, total local government liabilities can be broken down into three main categories: 1) bonded debt, 2) other post-employment net liabilities and 3) pension net liabilities.[2] The following chart provides a depiction of the total liabilities broken down into municipal governments (i.e., cities, townships, and villages) and county governments in Michigan. The liabilities are $10 billion in unfunded retiree health care, $7.4 billion in unfunded pension commitments and $4 billion in governmental activity debt.





Retiree health care is estimated to be the largest municipal and county liability as of this year. It is estimated that the total unfunded liability is approximately $10 billion for some 330 local units of governments in Michigan. Breaking that number down, we have roughly $3 billion in assets to cover $13 billion in total liabilities. The problem can be illustrated by looking at the top ten list for communities with the highest retiree health care liabilities.

Top 10 Local Government OPEB Unfunded Liabilities

Local Unit Name	OPEB UAAL
Lansing	$ 431,776,738
Warren	$ 275,148,754
Flint	$ 240,525,197
Taylor	$ 232,697,568
Pontiac	$ 231,427,530
Saginaw	$ 220,255,745
Kalamazoo	$ 187,860,805
Dearborn	$ 181,847,229
Southfield	$ 174,383,880
Ann Arbor	$ 162,100,000
Total:	**$ 2,338,023,446**

[2] These are not exhaustive of all potential government liabilities. Other categories are much smaller than the three main categories listed here.

Net pension liabilities are estimated to be the second largest category for local governments at roughly $7.4 billion. The best current estimates are that $28 billion in pension assets are held against $35.4 billion in total pension liabilities. These liabilities are not evenly distributed across all governments. This is demonstrated by reviewing the top ten list of net pension liability for Michigan.

Top 10 Highest Net Pension Liabilities in the State with Composite Average Funded Ratio		
City of Detroit	$2.8 billion	(64.5%)
Wayne County	$563 million	(58%)
City of Lansing	$305 million	(57.5%)
City of Warren	$278 million	(59%)
Genesee County	$185 million	(55%)
City of Saginaw	$182 million	(58.5%)
City of Grand Rapids	$141 million	(82%)
Ingham County	$112 million	(67%)
Washtenaw County	$102 million	(71%)
City of Ann Arbor	$89 million	(83%)

*In this table, cities with more than one pension are added together and funded ratio represents an average of the two systems. ($4.758 billion in total)

Administration of Local Plans

There are close to 600 local units of government in Michigan offering defined benefit pension plans. A single municipality might have several different retirement and health care agreements with numerous collective bargaining units representing their employees. The majority of these are administered by the Michigan Employees' Retirement System of Michigan (MERS)[3] under contracts entered between the local units and MERS. MERS membership includes just over 700 defined benefit pension plans. Approximately 130 independent plans are managed by the local unit of government. The pension assets managed by MERS equal approximately one third of the total pension assets in the state of Michigan.

Historically, MERS membership consisted of the smaller and mid-sized plans, but now also includes some larger local plans (such as Flint, Saginaw, Benton Harbor, and Ingham County). Many larger local governments, such as large and mid-sized cities and some counties in Michigan (for example Kalamazoo, Detroit, Pontiac, Lansing and Wayne County), maintain their own independent systems. As referenced previously, many local governments have more than one pension plan, for example there may be a general employee pension system and a police and fire pension system, which together may be referred to as a retirement system.

[3] MERS is an independent, professional retirement services company that administers retirement plans for participating Michigan local governments on a not-for-profit basis.

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It should also be noted that many of Michigan's local governments, general comprised of smaller townships, villages and small special purpose governments, do not offer retirement plans to their employees.

Approximately 330 general purpose local governments have other post-employment benefits (OPEB).[4] These retiree health liabilities tend to be owed by larger government entities such as cities, counties and charter townships.[5]

Current Financial Health Varies

Pension

As stated above, it is estimated that Michigan local government public pensions have a total unfunded liability of $7.4 billion, with an estimated $28 billion in pension assets held against $35.4 billion in total pension liabilities.

By some standards, including the credit rating industry, Michigan's average public pension plan is in the range of being adequately funded. Although the current average funding ratio of 78 percent is close to what many experts would say is adequate, there are some important caveats to this statement (NASRA, 2012). The current funded ratio is based on a set of assumptions that some experts challenge as being too optimistic or rosy. In particular, the discount rate, the rate at which it is assumed that pension assets will grow over time from investments, is too high they argue. Today, state and local governments are using on average a discount rate of 7.64 percent (Society of Actuaries, 2016). Economists, such as Joshua Rauh at Stanford, have argued that these discount rates are too high and should be brought down to a level coincident with U.S. treasuries which would currently be in the 2-3 percent range (Financial Times, 2016). The argument by Rauh and others is that a high discount rate is unrealistic given that

PENSION CASE STUDY - WARREN

In 2007, prior to the great recession, the City of Warren's Police and Fire Retirement System was 94.1% funded. The 2008-09 investment losses were phased into the asset levels over four years generating millions of additional unfunded liabilities. The unfunded liabilities are being amortized on an open basis over 25 years to help keep ARC payments low. When the new GASB accounting standard took effect for the City's 2015 CAFR, the pension plan projected to run out of funds in 2055; thus requiring that the pension obligation be valued using a reduced discount rate. In 2016, the Police and Fire Retirement System is projected to run out of funds in 2045, reducing the discount rate even further. The 2016 CAFR shows the system is only 58.15% funded.

[4] "Other post-employment benefits" (OPEB) is the term used to describe benefits promised to retirees and earned or guaranteed during their years of service. The most common benefit is health care for retiree and spouse. Some plans also include dental, life and other insurances. Though these benefits have been offered for decades, the majority of state and local governments did not report the respective liability until required to do so by accounting standards beginning in 2007.

[5] There are a small handful of OPEB Trusts that have been created by local governments to prefund benefits. Additionally, one hundred fifty-seven municipalities utilize the Retiree Health Funding Vehicle (OPEB Trust) administered by MERS to prefund their retiree health expenses.

most public pensions are a guaranteed benefit and should therefore be valued at a near guaranteed rate of return. U.S. treasuries, which yield typically far less than 7-8 percent, would be considered the closest possible approximation to a guaranteed rate of return.

A second caveat relates to the dispersion of funding levels across the population of public sector pension plans in Michigan. While the average funding level is 78 percent, there is a wide dispersion across the spectrum. Approximately 180 units of government have a funded ratio below 60 percent. This may be a warning sign that these systems do not currently have enough assets over time to meet ongoing liabilities and will need to assess and make plans. Another 130 units of governments have over 80 percent funded ratios. Thus, there is a dispersion of funding ratios with some well below the traditional 80 percent funding mark and with some above that mark. Serious consideration and planning will be necessary to ensure the long-term health of those pension systems below the mark.

PENSION CASE STUDY - LANSING

In 2007, the city of Lansing's general employees' retirement system had assets totaling $209 million and was 82% funded. By 2016, assets had declined to $164 million and was 50.5% funded, even though the city has contributed the ARC throughout this time period. Investment losses from the great recession of 2008/09, failure to modernize benefits and failure to amortize the UAAL using best practice have all resulted in the decline in the City's funding ratio. Further, the retirement system's ARC has almost doubled between 2007 and 2016. In 2007, the city's ARC was $5.2 million, reflecting 4.8% of general fund revenues, and by 2016 the ARC has grown to $10.2 million or 8.3% of general fund revenues.

Lowest Funded Ratios in the State	
Lincoln Park Police & Fire	22.0%
Lincoln Park General Employee	31.9%
Village of Capac	32.6%
City of Walled lake	35.7%
Arenac County Road Commission	37.0%
Village of Detour	37.9%
Benzie County Road Commission	40.0%
City of Burton	40.5%
Village of Breckenridge	41.7%
City of Jackson Police & Fire	42.7%

On an annual basis, Michigan local governments expend nearly 9.2 percent ($1 billion in 2015) of all government-wide revenues ($10.9 billion) to cover pension expenses. This annual expense can range from as low as one percent of government-wide revenues to well over 20 percent of government-wide revenues depending on the jurisdiction.

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OPEB

As stated above, on a long-term basis, it is estimated that Michigan local governments have over $10 billion in unfunded OPEB liabilities.[6] This equates to an estimated actuarially required contribution (ARC)[7] of $800 million annually. Of this amount, it is estimated that local governments are only contributing approximately $500 million. This leaves a current gap of $300 million between annual expenditures and the ARC, serving to increase the unfunded status of the local units' OPEB obligations.

OPEB CASE STUDY – GRAND RAPIDS

The city of Grand Rapids has greatly reduced its health care liability over the past several years. The city government (1) closed the defined benefit retiree health care system, (2) instituted premium sharing for retirees, (3) moved all non-vested employees to a defined contribution health care plan and (4) changed the funding discipline to a prefunding basis. These and other reforms have saved Grand Rapids a significant amount of money and have reduced its unfunded health care liability from $223 million in 2009 to $111 million in 2015.

It is possible to assess changes in the OPEB liability landscape between 2012 and the beginning of 2016 for the municipal sector. Over that period, the total statewide funding level went from 11 percent to 14 percent.[8] The total level of liabilities has generally been relatively flat over that period. In 2012, total OPEB liabilities were $8.5 billion and had fallen to $8.35 billion in 2015. This slight decrease is likely due to the forces of growing health care inflation being offset by other actions that reduced long-term liabilities (such as reduction in benefits for new hires and local government attempts to increase funding to reserve the funds necessary to cover long-term costs). The funding levels have also changed because of an increase in OPEB assets over that same period, growing from $800 million in 2012 to $1.3 billion in 2015. The growth in assets resulted from more local units beginning prefunding of their commitments and a few units issuing OPEB bonds, which resulted in increased OPEB assets. The difference between total OPEB liabilities and total OPEB assets is the unfunded liability; this is what determines the funding ratio. The current estimates are that in the municipal sector OPEB unfunded liabilities are $7 billion and the funded ratio is 14% in 2015.

OPEB CASE STUDY – KALAMAZOO

Kalamazoo *- The city of Kalamazoo has also reduced its unfunded retiree health care liability by a significant amount. Since 2009, the city government has cut its unfunded liability by almost $60 million. Additionally, since the 2015 audit, the city of Kalamazoo has taken even further steps to reduce health care spending. In spring 2015, the city retirees agreed to switch their primary medical insurance provider from the city to Medicare. This was expected to save the city $3.5 million over 30 years (Sundstrom, 2014). The city of Kalamazoo has sustained these changes in addition to the OPEB bonding approach.*

[6] The city of Detroit is not included in these figures. At the time of the bankruptcy, it is estimated that the city owed $6 billion in unfunded OPEB liabilities with no prefunding. These liabilities were largely eliminated in the bankruptcy but are not included here either before or after bankruptcy.

[7] Recommended employer annual payments to pension plans consisting of a payment for benefits being accrued in the current year (the "normal cost") and a payment for the amortized value of unfunded actuarial accrued liability (UAAL). The combination of these payments is the actuarially required contribution (ARC).

[8] Note that while this is an improvement, it is far from the generally established level of 80 percent that is recommended for prefunding.

Among individual municipalities in Michigan, this unfunded ratio varies from zero percent to 100 percent.

Municipal OPEB Funding Ratios		
Population Size	**2012**	**2015**
Less than 1,500	5.0%	7.0%
1,501 – 5,000	2.0%	9.0%
5,001 – 10,000	14.0%	13.0%
10,001 – 30,000	12.0%	14.0%
30,001 – 200,000	16.0%	22.0%
Total OPEB Assets	$ 810,080,965	$1,326,636,553
Total OPEB Liabilities	$8,570,242,386	$8,354,872,783
Overall Funding Level	11.0%	14.0%

County Sector – OPEB

The county sector can also be assessed in these same terms but only for 2015 (as data was not available from 2012). The total statewide county level OPEB liability is currently estimated to be $4.5 billion.[9] County level OPEB assets are estimated to be $1.4 billion.[10] The current estimates are that, in the county sector, OPEB unfunded liabilities are $3 billion and the average funded ratio is 34% in 2015. Like with municipal governments, there is a wide range of differences in funding levels among Michigan's 83 counties.

Prefunding of Pension Compared to OPEB

Prefunding of OPEB benefits is still a relatively new concept, primarily due to the lack of statutory and constitutional funding requirements. This is not the case for pensions. Article IX Section 24 of the Michigan Constitution guarantees the payment and prefunding of public pensions. "Accrued" pension benefits must be paid, however, future unaccrued benefits can be reduced so long as labor contracts are not breached. In practice, this means that any previously promised and currently earned benefits are constitutionally protected, but pension benefits and their calculations may be changed prospectively. These prospective

Pension and OPEB liabilities led, in part, to Detroit's historic bankruptcy and a requirement for a Consent Agreement between the state and Wayne County. As part of Detroit's bankruptcy settlement, members of the pension system took a cut in their pension, some members had cost-of-living adjustments removed and the memberships' health care benefits were cut. Wayne County's financial distress also resulted in some members receiving pension and health care cuts.

[9] These liability estimates will likely be altered as the Wayne County retiree health care changes reducing the OPEB liability come into full effect.

[10] It is estimated that Oakland County represents nearly $1.15 billion of these OPEB assets due to the issuance of OPEB bonds against the actuarial accrued liability of $900 million.

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changes may be made through the collective bargaining process for union employees and through local ordinance or charter amendment for non-union employees.

The prefunding mandate, found in the same constitutional section, has been interpreted by the Michigan Supreme Court to require local units to prefund accrued pension liability during the fiscal year for which corresponding services are rendered.[11] Assuming that the underlying assumptions used are realistic, payment of this "normal" cost will keep pension funds current in their funding. In addition, state law requires annual funding of an amortized portion of any unfunded pension liability.[12] A full actuarially determined contribution, therefore, is the payment of the constitutionally required normal cost plus the statutorily required unfunded portion.

Most local governments have chosen to pay OPEB on a pay-as-you-go basis, resulting in many OPEB systems being poorly funded. There are a number of reasons for this. First, local governments were not required by accounting standards to begin reporting OPEB liabilities until 2008. Thus, unlike for pension systems, there often was no commitment to prefund nor perhaps even awareness of the size of the unfunded obligation. Indeed, some local policy makers perhaps may not have been fully aware of these challenges until recently. Second, demographic forces are quickly increasing these retirement-based costs as the baby boom generation begins retiring in large numbers and people live longer. Third, the cost of health care has continued to increase faster than the general rate of inflation. Finally, revenue stagnation has limited the ability of local governments to find funding sources for the prefunding of retiree health care.

Legal Protections for Pension and OPEB Differ

In Michigan, legal protections for OPEB benefits differ from those protections covering pension benefits. In 2005, the Michigan Supreme Court held that OPEB was not a constitutionally protected "accrued financial benefit" in contrast to the conclusion reached regarding pensions.[13] In 2005, however, the court reversed itself[14] and since then courts have consistently held that OPEB is not protected by Article IX, Section 24. Without this constitutional guarantee, OPEB benefits are only owed if a public employer binds itself contractually to provide them. Only vested retirees are entitled to receive OPEB beyond the term of the contract which granted them. This is an important distinction, as non-vested retirees do not have any enforceable claim for health care, once their last collective bargaining agreement expires. Whether a benefit is "vested" is now being disputed in both federal and state courts.

The issue of whether a retiree is vested has been fertile ground for litigation. The old vesting standard was laid out in a 6th Circuit Court of Appeals decision[15] and held that lifetime OPEB

[11] *Studier v. Michigan Public School Employees' Retirement Bd*., 472 Mich. 642 (2005)
[12] See MCL 38.1140m
[13] *Musselman v. Governor*, 448 Mich. 503, (1995).
[14] *M & G Polymers USA, LLC v. Tackett*, 574 U.S. --, 135 S. Ct. 926 (2015)
[15] *UAW v. Yard-Man*, *Inc.*, 716 F.2d 1476 (1983)

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benefits were assumed for any retiree who retired under a collective bargaining agreement. This old standard was overruled by the U.S. Supreme Court in 2015, in M & G Polymers USA, LLC v. Tackett. Since Tackett, retirees are only vested with OPEB if their contract "explicitly" grants OPEB for "lifetime" or for another clearly defined period of time. Public sector benefits are regulated by state law and recent state court decisions.

Recent OPEB lawsuits have applied the *Tackett* standard and have found instances where retirees used to have lifetime OPEB under the old standard, but do not have any OPEB claim under the *Tackett* standard. For example, the City of Hamtramck reduced OPEB and was sued by retirees who pointed to CBA language which granted "Full benefits when the member or vested member has attained 25 years of service regardless of age . . ." The federal district court held[16] that this language was now insufficient to vest OPEB for life, and so the retirees lost.

If an OPEB claim is vested, any law which reduces it may violate the Contracts Clause of the federal or state constitution.[17] Courts have held that the Contracts Clause is not absolute, and that contracts can indeed be impaired by law if:

- The impairment is not substantial, or
- A three part test is passed:[18]

  (1) The impairment is substantial
  (2) The impairment is necessary for a compelling public interest, and
  (3) The terms of the impairment are reasonable (many courts have held that impairments must be temporary)

If either of these standards are met, then even vested OPEB benefits can be reduced or changed by enactment of a new law. Unvested retirees do not have a contractual claim to be impaired and so are not involved in Contract Clause analysis.

How Did We Get Here?

Past Government Practice

A combination of factors have collectively led to the underfunding of retiree liabilities within Michigan local governments. Utilization of deferred compensation and reluctance to adopt modern benefit packages, along with limited statutory requirements to prefund, allowed unfunded liabilities to continue to increase at a greater pace than many private pension and OPEB systems.

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[16] *Serafino v. City of Hamtramck*, Civil 14-14112 United States District Court, E.D. Michigan, Southern Division September 27, 2016
[17] Article I, §10 of both Federal and Michigan Constitutions
[18] *United States Trust Co. of New York v. New Jersey*, 97 S. Ct. 1505, 1518 (1977)

- Deferred Compensation: Historically, public employers have utilized deferred compensation, whereby the employee accepts reduced wages in exchange for a promise of greater defined benefits to be received upon retirement.

- Employer Risk Defined Benefit Plans: Many public employers and their employees through collective bargaining agreements were slower than private employers to move away from defined benefit pensions and OPEB toward cost-certain defined contribution benefits.

- Lack of Pre-funding: Best practice dictates that the ideal approach is to set money aside (both from the employer and employee) while the employee is working to ensure that adequate funds are available to meet commitments upon the employee's retirement. As funds are set aside, they can be invested and earn income over time. With a lack of required pre-funding, the long-term costs of the benefits to employers, employees and taxpayers increase. Services rendered today are paid in the future. With the pay-as-you-go approach, the employer may not be prepared for the significant cost increases as employees retire and the liabilities become annual cash outflows.

- Assumptions: Actuaries must estimate the long-term liabilities and costs based on a set of assumptions about the future. These assumptions include: 1) longevity, 2) age of retirement, 3) discount rate, 4) payroll growth, 5) annual employee income increases, 6) health care inflation, 7) investment income from prefunding, 8) mortality rates, and other factors. If these assumptions differ from future events, the long-term liability and cost estimates will vary and it is possible that government prefunding, if any, will not be as adequate as expected. Thus, for a variety of reasons, it can be very challenging for local governments to keep pace with long-term benefit commitments.

Outside of government, benefit offerings and practices have dramatically changed over time. Employer sponsorship of defined benefit programs in the private sector is rare today. While practices in the private sector were changing, some public employers made an affirmative decision to stay with defined benefit pensions and OPEB benefit plans based upon the belief that these systems and the benefits they provide are a better value to the local community and its public employees. In this way, public employers made significant post-retirement commitments at a rate generally greater than employers within the private sector.

Revenue Challenges

Michigan's local governments generate revenue from two main sources including property taxes and state revenue sharing. Both of these revenue sources have faced challenges and fluctuations over time. This has been contributing factor to the problems facing local government pension and retiree health care commitments.

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Property taxes remain the most important source of local own-source revenues in Michigan for cities, counties, villages, and townships, as well as many special district governments. Between 2000 and 2008, local governments saw a large increase in property tax revenues from $3.9 billion collected to $5.8 billion. This period of time corresponded to the U.S. housing bubble. The gains were not evenly distributed as townships saw growth of nearly 80 percent in property tax revenues collected and cities and counties grew in the 30 to 40 percent range. Over that same time period (2000-2008), state tax revenues only grew 14 percent.

There is a different story in the aftermath of the Great Recession. From 2008 through 2016, local property tax revenues have actually fallen from $5.8 billion to $5.7 billion. Cities, counties and villages have experienced, in aggregate, a loss of 5 to 19 percent of their property tax revenues collected. Townships have seen growth in property tax revenues of 15 percent in total. The state government total tax revenues have grown 7 percent. Thus, state tax revenues have grown less than township revenues but more than city, county and village revenues since 2008.

If the analysis is broken down on a geographic basis, the Citizens Research Council (CRC) reported that 248 local units of government in Michigan have a tax base in 2017 that is lower than where it was in 2000 (Citizens Research Council, 2017). For these governments, the only approach to raising revenue over this time frame would be significant increases in millage tax rates. These governments are located all over the state but are concentrated in southeast Michigan and the population centers of the state. For these 248 units of government, the coexistence of high legacy costs and a shrinking tax base would represent a significant risk of financial difficulties. Furthermore, according to CRC, Michigan's recovery in municipal general revenue has lagged behind that of other states. The chart below shows growth in municipal general revenues for Michigan compared to other states.

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State revenue sharing is another important piece of the local government financial picture. It generally accounts for about 25 percent of total government activity revenues, although that value varies quite a bit across types of local units of government. Currently, revenue sharing has four parts to it: 1) statutory municipal revenue sharing, 2) constitutional municipal revenue sharing, 3) statutory county revenue sharing and 4) statutory county incentive program (CIP). The largest portion is the constitutional municipal revenue sharing program which is based on a distribution of 15 percent of 4 percent of the sales tax rate and is distributed on a per capita basis. The second largest piece is the statutory municipal revenue sharing which is based on a set of criteria that must be met to receive the funding.

In 2001, revenue sharing was at $1.55 billion. In FY 2009-10, it had fallen to $994 million, and then rose again to $1.22 billion in 2017.[19] Therefore, revenue sharing is down about $300 million from where it was in 2011.

The Impact of the Great Recession

A benefit of prefunding is that plan assets under management can be invested and the earnings on these invested assets will reduce the total contributions of the local unit. However, with investing comes market risk. During the Great Recession of 2008-09, all major stock exchanges experienced dramatic shocks. During 2008, the Dow Jones Industrial Average declined 33.84% and pension and OPEB assets which were invested experienced similar losses. While the equity markets did recover and in 2013 actually surpassed the pre-recession values, not all funds recovered with the stock market.

[19] Revenue sharing in the state budget is a restricted fund for both constitutional and statutory portions. The figures reported here include both portions of state revenue sharing.

There are two principal reasons why some pension and OPEB investments followed the decline but not the recovery of the stock market. This is most apparent with respect to closed plans and poorly funded retirement systems because they had to liquidate significant holdings before the recovery in order to pay annual benefits to retirees. This essentially forced some systems to invest assets at high pre-recession values and sell at low recession prices. This effect also meant that fewer assets were invested when the markets recovered, diminishing the upswing in funding when it came.

Additionally, the ability of local governments to fund their respective pension and OPEB plans have been hindered because of the nature of Michigan's property tax system. The 2008-9 recession was caused by an unexpected decline in real estate values and the resulting collapse of securitized mortgage backed securities. When property values (and thus taxable values) fell during the great recession, many local units were deprived of the tax revenue necessary to prefund retiree liabilities. As an additional challenge, Article IX, Section 3[20] and statutory-implementing legislation of the section holds these taxable values low, only allowing them to increase at the lessor of inflation or 5 percent each year. Despite the general recovery of property values, many taxable values (and thus local government revenues) have not recovered to pre-recession values.

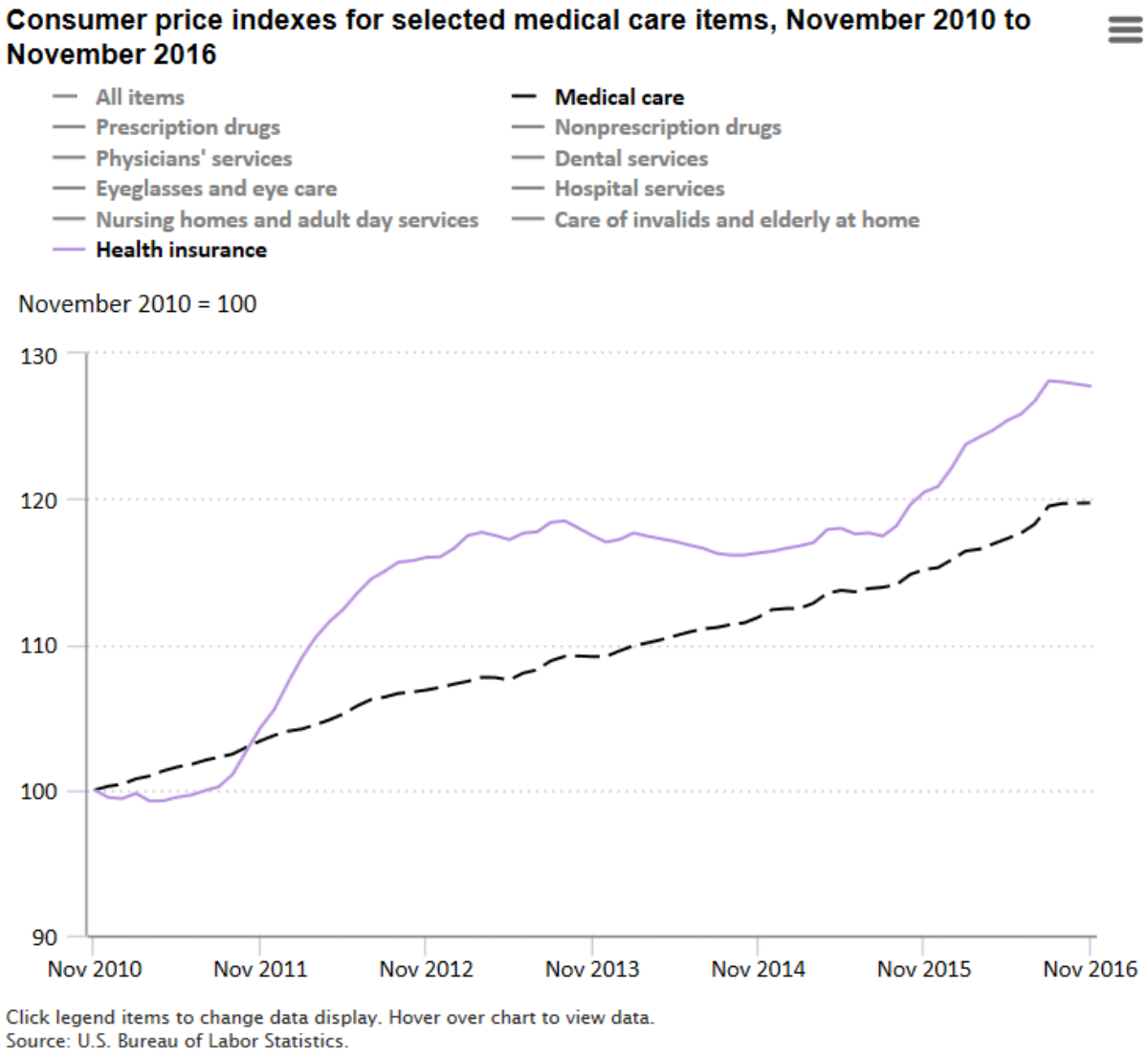
Finally, the demographics of plans that are closed to new entrants are, by definition, aging and have less time or opportunity to recover costs. That requires more conservative investments which generally tend to have lower returns. Further, the continued federal monetary policy of the federal government to maintain low bond rates means the safest investments (and the traditional safety net for investments during down markets) produce very low yields.

Rising Health Care Costs

An additional stressor for OPEB systems is that the cost of health insurance has increased at a rate which outpaces general inflation. For example, for the calendar year 2016, health insurance prices rose 6 percent while the general inflation rate was 1.7 percent. The chart below is a graphical illustration of health care pricing data from the Federal Bureau of Labor Statistics.

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[20] Enacted by Proposal A (1994)



Workforce Demographics

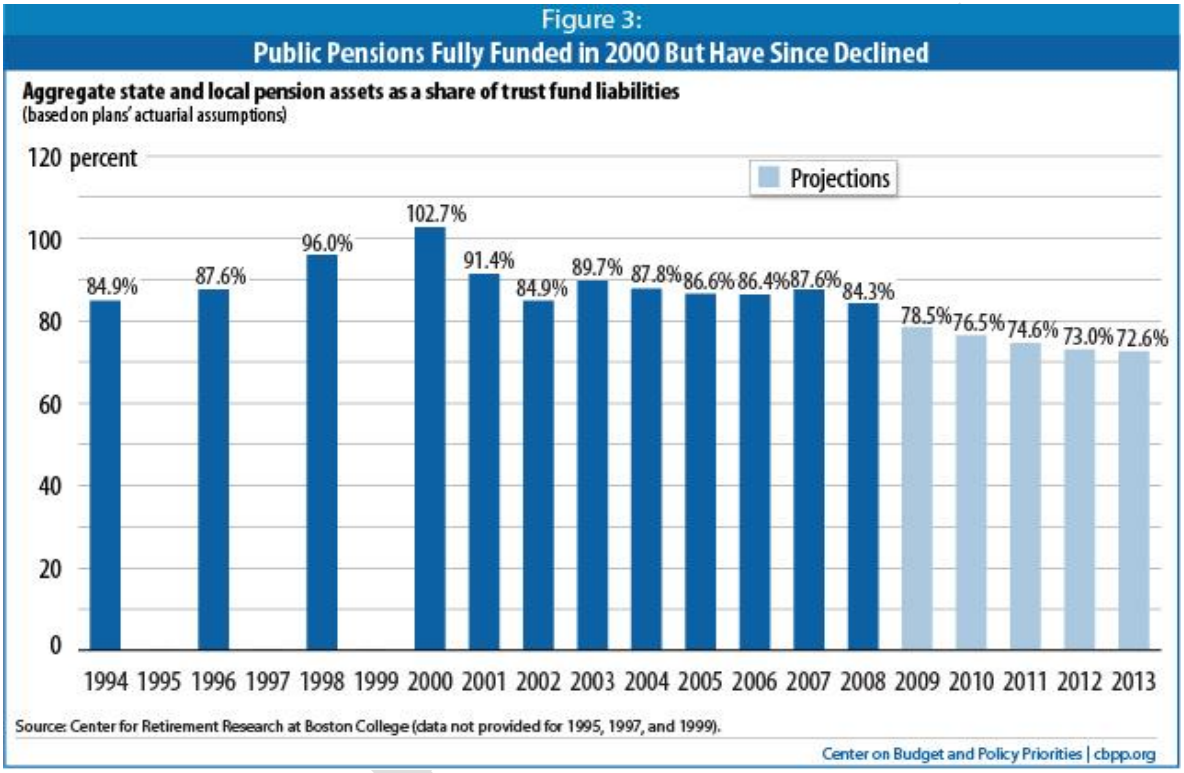
These deferred compensation systems impact both current employees and retirees. Based on the best data available, Michigan has approximately 250,000 local government full-time employees and another 130,000 part-time employees (Census Bureau, 2017). This equates to about 300,000 full-time equivalents (FTE). Of these, approximately 120,000 FTE work in general purpose local governments and non-school special districts. It is estimated that approximately 170,000 beneficiaries receive some form of deferred compensation retirement benefit from Michigan local pension systems.[21] This is a ratio of roughly one active employee for every one and a half retirees. The ratio is even bigger for some local governments, such as Flint, which has a ratio of one employee for every five retirees.

[21] This number does not reflect the number of beneficiaries of retiree health care from local governments. That number is likely smaller than the pension number but inclusive of it. This is because there are more pension systems than retire health care systems.

Is Michigan Unique?

Michigan is not alone in this challenge. It is a systemic problem facing the entire United States. On the pension side, state and local pensions have become increasingly less well-funded (see Figure 1).

Figure 1: State and Local Government Pension funding Trends



National Picture – Pensions

There are approximately 4,000 state and local pension systems in the United States covering over 20 million employees and retirees (Gale and Krupkin, 2016). These pension systems are estimated to owe an unfunded liability of over $3 trillion (Munnell and Aubry, 2016) and the overall average funding level has dropped to 80 percent which is considered to be just in the safe level. This overall increase in unfunded liabilities is likely due to less than expected investment returns and demographic changes in the country.

National Picture – OPEB

Although the retiree health care problem has only recently been fully recognized, the scale of the problem is rapidly approaching the same as the state and local pension situation. Though there is more uncertainty over the exact size of the national OPEB liability, the best estimates place the total unfunded liability at $862 billion (Munnell et al., 2016). Thus, at

the national level, pension unfunded liabilities exceed OPEB liabilities by a factor of three to one. It was also noted by Munnell et al. (2016) that the majority of OPEB unfunded liabilities, almost two-thirds, are located at the local level and are easier to address than pension problems due to legal differentials.

Michigan-National Comparison

Michigan, as noted previously, has a larger OPEB problem than a pension problem at the local level. This is in contrast to the national situation. This is perhaps due to Michigan local pension plans being better funded at the local level than their state and local national counterparts.

What is the Path Forward?

Summary of Key Understandings and Concepts

During this process, the Task Force agreed to a number of key understandings and concepts that were utilized during the development of recommendations.

- A serious problem exists and something must be done immediately to begin to fix it for the benefit of employees/retirees, our communities and the state.
- Solutions must ensure that this problem does not continue to grow in the future.
- As local units across our state are unique and diverse, there is not a one-size-fits-all solution to this problem – we must be flexible with our solutions.
- Attention should focus on the local units experiencing the worst fiscal stress.
- It is understood that there are local units that simply cannot raise taxes or reduce liabilities enough to address their growing liabilities.
- The broader solution to the fiscal stability situation must include addressing long-term liabilities, effective provision of services, and local government revenue constraints, while considering intergenerational equity.

Areas of Task Force Agreement

When developing an approach to address unfunded pension and retiree health care liabilities of local governments in Michigan, the Task Force agreed on four main recommendations:

(1) Greater reporting and transparency must be required of all local units to ensure a full understanding of the exact size and scope of the problem, and where the biggest challenges exist so that they can be addressed. This includes reporting based on a range of uniform assumptions.

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(2) A fiscal stress test system for local governments should be created to be a system that would alert and assist local units in crafting solutions to best position them to continue to serve their residents, while funding their obligations and protecting benefits for employees and retirees. This system would identify and focus action on the local units experiencing the worst fiscal stress

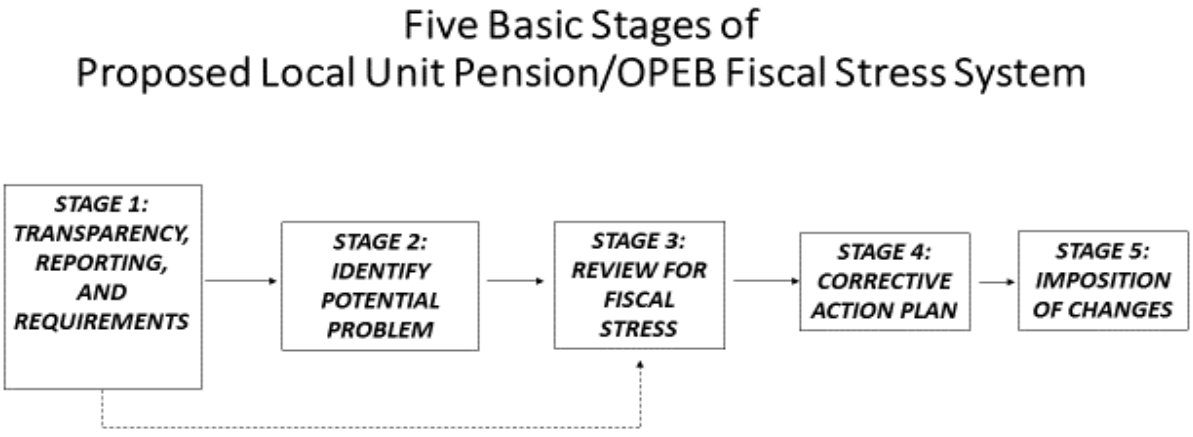
(3) This system, along with the creation of a new Municipal Stability Board, could assist in the review of a local unit's finances and the development of a corrective action plan. The Board could also provide research, training and technical assistance to those in need.

(4) Going forward, in addition to meeting the current constitutional requirement that they pay normal costs for pension, all local governments should meet minimum requirements to pay normal costs for OPEB for new hires (i.e., to prefund new active employee's current year obligation).

Overview of Pension and OPEB Fiscal Stress System

The Task Force agreed that the creation of an optimal system would enable decision-makers to have the data and transparency for a full understanding of the fiscal stability or stress of Michigan's local units, and enable the most fiscally stressed to receive attention and action. Although there was some disagreement on the component details, the Task Force envisioned this system would have five basic stages, as illustrated below.

High-level Flow Chart of Pension/OPEB Fiscal Stress System



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Stage 1: Transparency, Reporting, and Requirements

Stage 1 of the system involves Transparency, Reporting, and Requirements. For simplicity, this report considers Stage 1 is three parts: (1) Transparency and Reporting, (2) Uniform Reporting, and (3) Funding and Plan Design Requirements.

Transparency and Reporting within Stage 1

Throughout the Task Force's discussions, two themes continuously arose, the need for greater transparency and reporting and the need to ensure this problem does not grow any further. The Task Force agreed that pension and OPEB data should be reliably produced, collected in a central depository (Treasury) and widely available. Efforts to resolve the underfunding problems need to begin with a sound understanding of the current liabilities and funding situation. The collection of reliable data would allow policy and governance decisions to be based upon an analysis of where and how communities have successfully addressed these issues.

The Task Force came to a consensus that transparency and reporting by all local units to Treasury should be increased (Stage 1). The Task Force envisions that the data for Stage 1 will be collected electronically via Michigan Form F-65 ("Annual Local Unit Fiscal Report") which is required from all primary local units of government in the State of Michigan. The Task Force believes that current law regarding pension data is generally sufficient and that new legislation is needed for OPEB data, as specified in the paragraphs below.

NOTE ON CONSENSUS:
For Stage 1, there was consensus on the need for increased transparency and reporting, as well as uniform reporting. However, there was limited consensus on funding requirements and no consensus on plan design requirements.

Pension Data: For pensions, under Public Act 314 of 1965, current reporting requirements include an annual summary report. With minimal changes to this Act regarding timing of submissions, the Task Force agrees that sufficient reporting data is available.

OPEB Data: With respect to OPEB, the Task Force recommends new legislation be enacted to require annual valuations, reporting of actuarial assumptions (such as expected investment returns on plan assets, discount rates for ARC calculation, medical inflation and cost trends used, and amortization period for OPEB liability), and posting of annual reports on the local unit's website (as is now required for pension reports).

Uniform Reporting within Stage 1

The Task Force came to a consensus that, because comparing data across local units can be difficult due to the use of different assumptions, for reporting purposes only, all local units

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should recalculate its plans funded ratios using a range of assumptions set annually by Treasury. The uniform assumptions should include (1) a maximum assumed rate of return on plan assets, (2) a maximum discount rate for ARC calculation, (3) wage and health care inflation assumptions (4) and, perhaps, mortality tables.

Additionally, to improve the accuracy of estimating the liabilities, legislation is recommended to require local units conduct an actuarial experience study by the plan's actuary at least every five years. Also, a peer actuarial audit by an independent actuary should be conducted at least every eight years (or rotate actuaries at least every eight years). As in current law, exceptions would exist based upon the size of the local unit or plan.

Finally, with respect to transparency, to allow citizens, employees and state and local decision-makers to have easy access to this data, the Task Force recommends that Treasury be required to post reported data to the Local Government Dashboard (to be made available shortly).

Funding and Plan Design Requirements within Stage 1

The Task Force had limited consensus on new statutory funding requirements and no consensus on new plan design requirements that would be required of all local governments. When discussing the potential creation of statutory requirements, the Task Force considered pension and OPEB separately. When considering minimum funding requirements, some Task Force members felt that it may crowd out the ability of local governments to pay for other necessary services, while others felt it was the only way to stop the problem from getting worse. When considering potential plan design requirements, some felt that restrictions on plan designs were necessary to enable stable systems into the future, while others thought that while recommended best practices were useful, requirements would interfere with the rights of local governments and unions to negotiate contract terms.

<u>Pension:</u>

Potential New Funding Requirements:

> Given that the local government is already required by the Constitution and state law to pay its ARC, no new minimum funding legislation is recommended.

Potential New Plan Design Requirements:

1. Use of Final Average Compensation (FAC) standards to better reflect career compensation profile
2. Prohibition of "13th checks" (this is a process under which investment earnings that exceed a set amount are distributed via a formula to retirees)
3. Any benefit increases must be 100 percent funded and include notification to the public before such plan is considered
4. Implement a new hire maximum pension multiplier

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OPEB:

Potential new minimum funding requirements:

1. Payment of normal cost for new hires (this requirement had Task Force consensus)
2. Payment of normal cost for active employees
3. Payment of UAAL for active employees (i.e., prefund active employees)
4. Payment of retiree health care premiums (i.e., pay-as-you-go)

Potential New Plan Design Requirements:

1. Retiree health care plans must use Medicare as its primary insurance for Medicare-eligible retirees 65 and older
2. All retiree health care plans of the same local unit must mirror each other (generally this means that older retiree health care benefits would reflect newer plans being implemented under collective bargaining)
3. Any benefit increases must be 100 percent funded and include notification to the public before such plan is considered
4. Establish employee/employer cost sharing parameters
5. Close defined-benefit style retiree health for all new hires and offer stipends

For additional recommendations that were discussed, but did not receive consensus, please see the "Additional Recommendations" section.

Under the proposed fiscal stress system, a local government that does not meet any of these requirements would go directly to Stage 3 for an in-depth review by the Department of Treasury. The others would continue to Stage 2.

DIFFERING OPINIONS REGARDING REQUIREMENTS: Some Task Force members believed that focus should be on cash flow and annual budget rather than balance sheet and therefore opposed increasing minimum funding requirements beyond anything more than paying normal cost for new hires. They believed it was more important to focus on providing current residents the services they need rather than an accounting entry.

Other Task Force members believe choosing a plan design is a mandatory subject of bargaining and therefore should remain an item that is collectively bargained within each local unit. They opposed any plan design requirements, believing that freedom to select the plan design should stay within local choice and be negotiated to fit the needs of each community.

Stage 2: Identify Potential Problem

The Task Force agreed that a critical stage of this system is identifying where problems exist. As such, task force members came to the consensus that Stage 2 would include use of initial criteria to determine the general fiscal health of the local unit's pension and OPEB systems as well as the fiscal stress, if any, that may be put on the local unit's overall ability to provide services. A majority of local units should meet this criteria and therefore their participation in the process would end for the year.

In this stage, Treasury will perform calculations to compare each local unit's data again

criteria regarding funding ratios and ARC as a percent of government-wide operating revenue. These criteria were chosen, in part, based on a recent study published by the Rockefeller Institute in which researchers examined how demographic characteristics affect plan funding risk and contribution risk. They identified two key types of risks; extremely low funded ratios and extremely high employer contributions that could pose potential risk to pension plans and their beneficiaries (The Rockefeller Institute of Government, 2016).

While not necessarily a reflection of measures considered best practices, the following criteria would be used to initially identify communities that could be near financial distress and warrant a more in depth review.

Pension Criteria

Criteria #1: Pension funding level (assets/liabilities)
Less than 60 percent funded – This trigger is used because it indicates the long-term ability of the pension system to fully meet its commitments. A low value indicates that a system and the plan sponsor will need to engage in difficult decisions to meet the full funding level over time, which may include benefit changes, contribution increases or a speculative increase in investment income.

Criteria #2: Employer contribution (ARC) as a percent of government wide revenue
A value of 10 percent or greater- This trigger is based on a value considered to be significantly greater than the majority of local pension systems or outside of the normal range for the burden of annual pension costs on government revenues. A pension system that is consuming a large share of government revenues may place that government at a liquidity or insolvency risk in the base of a major fiscal shock.

When analyzing currently available pension data, criteria #1 would capture roughly 29% (151 of 519) of municipalities and criteria #2 would capture roughly 18% (95 of 519) of municipalities if these filters are applied.

NOTE ON CONSENSUS:
For Stage 2, there was consensus on the use of criteria that considered funded ratios and a measure of funding as a percentage of government-wide operating revenues. However, the Task Force recognized that further analysis may be needed to confirm the appropriate percentages to be used.

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OPEB Criteria

Given the complexities of OPEB[22], slightly different target percentages were selected. Like the pension filters, the following criteria may trigger the next step in the process to initially identify communities that could be near financial distress:

Criteria #1: OPEB funding level (assets/liabilities)
Less than 40 percent funded- This trigger is used because it indicates the long-run ability of the government to fully meet its OPEB commitments. A low value indicates that a system will need to engage in difficult decisions to meet the full funding level over time including benefit reductions, contribution increases or a speculative increase in contributions and investment income

Criteria #2: Employer contribution (ARC) as a percent of government wide revenue
A value of 12 percent or greater- This trigger is based on a value considered to be significantly greater than the majority of local governments or outside of the normal range for the burden of annual OPEB costs on government operating revenues. An OPEB liability that is consuming this large a share of government operating revenues places that government at a liquidity or insolvency risk in the event of a major fiscal downturn.

When analyzing currently available OPEB data, criteria #1 would capture roughly 81% (81 of 100) of municipalities and criteria #2 would capture roughly 17% (17 of 100) of municipalities when those filters are applied.

Stage 3: Review for Fiscal Stress

The Task Force came to a consensus that if a potential funding problem is determined for a local unit in Stage 2 Treasury should undertake a more individualized and comprehensive internal review of the local unit's pension or OPEB fund, discuss changes or reforms that have been made with the local unit's designated officials, and review actuarial projections, as described in greater detail below. The Task Force wanted to ensure that special attention is directed toward the increasing liabilities and costs in future years and the local unit's ability to afford its commitment. Additionally, all members agreed that analysis of trends and forecasting must be part of the review process.

If the local unit already has a plan in place for how they will continue to fund their retirement system over time to meet the criteria of Stage 1 and 2, it may file an application for waiver to Treasury. To ensure local support and commitment, the Task Force concluded that the waiver application and plan must have been approved by the local unit's administrative

[22] The extent and level of OPEB promises vary greatly among local government units. Similarly, the current level of funding related to the accrued liabilities for these OPEB benefits varies greatly as well. The recognition of the significance of these unfunded accrued liabilities has been a developing story over the last decade. Although communities may have recently addressed this issue in some manner (e.g., employer and/or employee funding benefit adjustments or terminations, etc.) complete updated data is not yet available (or required under existing law) to know to what extent local communities have sufficiently addressed the issue.

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officer and local legislative body. Once a full individualized review is complete, Treasury will determine if pension and/or OPEB plan(s) are address the underlying funding status, or if greater action is needed.

If the waiver is approved by Treasury, the local unit's participation in the process would end for the year.

If in Stage 3 a waiver is not requested or is requested but not approved, Treasury will confirm that a problem exists and that further action is needed. Communities which are determined to be sponsors of fiscally stressed retirement or OPEB systems will be subject to oversight by a statutorily created Municipal Stability Board (MSB) and will move to Stage 4.

Stage 4: Corrective Action Plan

The Task Force came to consensus that critical to this system is the creation and implementing of a plan by and for units that are under stress. During this stage, in order to develop a plan that meets the needs of the individual unit, a full review of all pension and OPEB contracts and financials must take place. The local unit will develop and submit a Corrective Action Plan to the proposed Municipal Stability Board (MSB) for review. The local unit and the Board must agree on a uniquely constructed plan that enables the local unit to work toward financial stability, while providing critical services to residents.

Municipal Stability Board

The Task Force agreed that this board would be comprised of appointed members representing state and local officials, as well as employee/retiree representative(s). Appointees must have strong technical knowledge of retirement systems, practices, policies and law.

The Task Force agreed that the MSB Board could develop a list of best practices and/or strategies that would assist local communities in developing their Corrective Action Plan. It is understood that best practices guidelines are developed in an ever-changing world and should not be seen as stagnant legislatively adopted guidelines which tend to become quickly outdated. The MSB Board should have resources made available to conduct studies of local government plans and research into alternative programs as adopted in other states and countries.

Corrective Action Plan Components

The Task Force unanimously agreed that because each local unit is unique, the components of the Corrective Action Plan will vary. The components will be determined by the local unit, approved by the local legislative body, and then must be agreed to by the MSB.

For pension, the components may include, but are not limited to, actions such as (1) closing the current defined benefit plan, (2) implementing a multiplier limit, (3) reducing or

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eliminating new accrued benefits, and (4) implementing FAC standards.

For OPEB, the components may include, but are not limited to, actions such as of (1) requiring cost sharing of premiums and sufficient copays, and (2) capping employer costs. The Task Force agreed that important to this process is involvement of the residents of the local unit. As such, the Task Force suggested that the Corrective Action Plan may also include a local ballot proposal to reduce unvested benefits, raise taxes, or both.

Once the Corrective Action Plan is approved by the MSB, the local unit attempts to implement the Corrective Action Plan. The fiscal instability is considered addressed once the local unit meets the requirements of Stage 1 and the criteria of Stage 2. If a Corrective Action Plan is unsuccessful, or if the MSB does not approve the local unit's Corrective Action Plan, then the local unit moves to Stage 5.

Stage 5: Imposition of Changes

The Task Force agreed that action must be taken in Stage 5 to assist the local unit in meeting the criteria of Stage 2 so that they become fiscally stable into the future. However, the Task Force did not come to a consensus on how this final stage would work. Furthermore, while the Task Force agreed that the role of the Municipal Stability Board is to work with the local government toward the development of an acceptable Corrective Action Plan, there was not consensus on which specific powers the MSB should have.

NOTE ON CONSENSUS:
For Stage 5, there was consensus that the goal of the Corrective Action Plan was to meet the Stage 2 criteria and that the timeline for its implementation should be determined on a case-by-case basis. Additionally, while there was consensus the Municipal Stability Board's role (to work with the local government toward an acceptable Corrective Action Plan) there was not consensus on the ability of the MSB to implement plan design changes.

The Task Force determined were three main options to address situations in which the Corrective Action Plan failed or was not implemented by the local unit.

OPTION 1: MSB CAN IMPLEMENT LIMITED DESIGN PLAN CHANGES

Under this option, the MSB would be statutorily authorized to implement certain benefit changes for future employees and cause any non-vested benefits paid to retirees of the local unit to be reduced through design plan changes, as enumerated in statute. Before this occurs, the MSB would solicit the local unit for an alternative benefit proposal and consider whether this proposed benefit level will achieve adequate liability reductions. A contract audit of existing pension and health care contracts would determine the required level of benefits to be provided. The MSB would have the authority to impose limited changes to benefits if an agreement between the parties cannot be reached.

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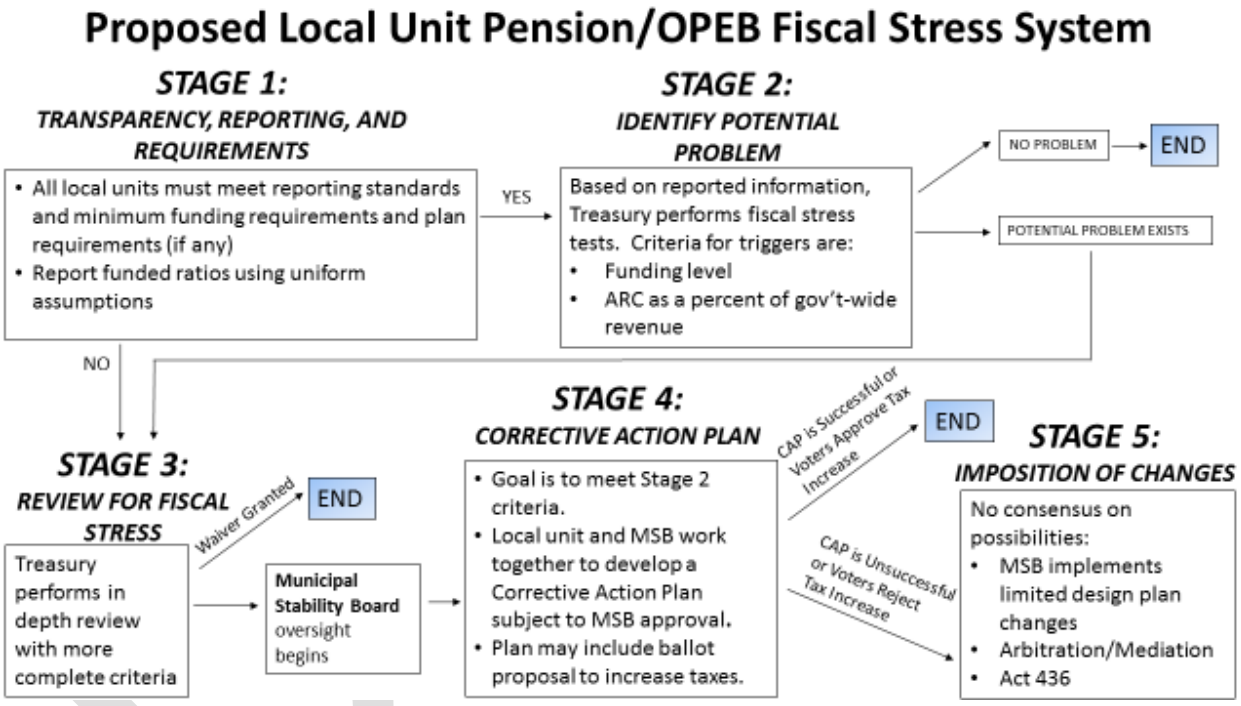
OPTION 2: MSB REQUIRES MEDIATION/ARBITRATION

Under this option, the MSB can require the local government and employee union groups to enter into mediation and utilize assistance of a neutral third party to assist in negotiations or into binding arbitration.

OPTION 3: MSB CAN RECOMMEND ACT 436

Under this option, the MSB can recommend to the State Treasurer the commencement of a preliminary review under the Local Financial Stability and Choice Act (PA 436 of 2012).

The chart below demonstrates the flow from one stage to the next within the proposed system.



A Note on Certain Local Units

The Task Force recognizes that there are currently a small number of local units that cannot raise taxes or reduce liabilities enough to fund their current commitments. The creation of this system will be unable to address the complexity that exists for those local units. Therefore, the Task Force recognizes that there is a potential need for further discussion on local revenue increases, potential statewide funding and/or other options.

Additional Recommendations:

The following recommendations were discussed by the Task Force but did not receive consensus.

General Recommendations

- Address local government revenue constraints.

- Expand bonding as a tool:

    (1) Expand the ability of local governments to borrow by lowering the minimum credit rating required under state statute and extending the sunset.
    (2) Structure a pooled borrowing that would give municipalities with lower credit ratings access to the public markets by either pooling them with higher rated municipalities or through a state guarantee.

- Expand Act 345 of 1937 to include general employees.

  Under this Act, with a vote of the people, a local unit may levy taxes in addition to and in excess of existing tax limits to fund police and fire retirement benefits. This act could be expanded to include funding retirement benefits for general employees.

- Consider implementation of CLEAR Hybrid Plan proposal.

- Allow the MSB to launch judgment levies to fund pension and OPEB.

- The Corrective Action Plan could also include a target affordability goal, e.g., that combined (pension and OPEB) legacy costs cannot exceed 10 percent of general-wide revenues.

- Reinstate PA 54 of 2011 (specifically reinstate Act 312 eligible groups as being subject to PA 54) to maintain motivation by both parties to bargain in good faith and a timely manner.

- Require minimum employee contributions.

- Changes to type of pension plan benefit offered must be determined by ability to fund plan type and following due diligence analysis of actuary projecting the short-term and long-term costs.

- Set statewide minimum retirement ages (except police/fire)

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Pension Recommendations

- Extension of amortization periods for unfunded pension liabilities.
- Create a "look-alike" Pension Benefit Guarantee Corporation.
- Implement new hire maximum pension multiplier for DB plans (plan type would remain at discretion of local unit).
- Prohibit employee's accumulated pension contributions from being withdrawn unless done so on a computed actuarially neutral basis.
- Prohibit early retirement incentives and prohibit universal service time purchases.
- Move pension board travel policies/practices under authorization & oversight of local unit governing boards.
- Require defined contribution plan for new hires.

OPEB Recommendations

- Close retiree health care to new hires.
- Systems must close off defined benefit style OPEB benefits for all new hires, stipends will be negotiated, and local governments have the option to move to a retiree health savings account for current employees with less than 10 years of service.
- Individuals should be required to use health plans of current employers if available, and spouses should utilize benefits from their employer, if available.
- Require health care benefits for retirees to mirror those offered to current employees.
- Eliminate the deferral of benefits and require that an employee be of "normal" retirement age and eligible for a full pension before qualifying for a health care benefit.
- Once a DB plan is closed for any bargaining unit, the future ability for it to be reopened or reoffered in any way should be eliminated.
- Codify Court Decisions to clarify legal authority to modify benefits for existing retirees (including definition of vested).

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Call to Action

As called for by Governor Rick Snyder's creation of the Responsible Retirement Reform Task Force for Local Governments, this report brings to light the complex issue of the growing unfunded pension and retiree health care liabilities affecting, and in some places crippling, our local governments. This issue was not created in one day, week or year, and will not be fixed in the same amount of time. It is a long-term issue that our employees/retirees, communities and state face. However, the Task Force unanimously agreed this issue must be dealt with immediately. Without prompt and meaningful action local units will struggle to provide services to residents, while following through on the commitments that have been made.

The Task Force recognizes that as we work to solve the growing liabilities problem facing our local units while meeting commitments made to our employees, we must continue the dialogue with stakeholders to address the impact that changing demographics, rising health care costs, and declining revenues have had on our communities.

This report is a solid first step in a long-term solution to improving the fiscal stability of local units in Michigan. With enactment of the items included in this report we will have the data we need to drive thoughtful decision-making and help provide tools and assistance to those local units greatest in need. The Task Force looks forward to continuing this discussion with the Governor, the Legislature and stakeholders.

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Glossary of Terms:

Actuarially Determined Contribution (ADC): A target or recommendation to a defined benefit pension plan for the reporting period, determined in conformity with Actuarial Standards of Practice based on the most recent measurement available when the contribution for the reporting period was adopted. This is the GASB's new definition for ARC (GASB Statement No. 67).

Annual Required Contribution (ARC): Recommended employer annual payments to pension and OPEB plans consisting of a payment for benefits being accrued in the current year (the "normal cost") and a payment for the amortized value of unfunded actuarial accrued liability (UAAL). The combination of these payments is the actuarially required contribution (ARC).

Actuarial Assumptions: These assumptions are estimates of future experience with respect to rates of mortality, disability, turnover, retirement, rate or rates of investment income and compensation increases. Actuarial assumptions are generally based on past experience, often modified for projected changes in conditions. Economic assumptions (compensation increases, payroll growth, inflation and investment return) consist of an underlying real rate of return plus an assumption for a long-term average rate of inflation.

Actuarial Valuation**:** The actuarial valuation report determines, as of the actuarial valuation date, the normal cost, total actuarial liability, and related actuarial present value of projected benefit payments for pension and OPEB plans.

Deferred Compensation: An arraignment in which a portion of an employee's income is paid out at a later date after which the income was earned.

Discount Rate: For GASB purposes, the discount rate is the single rate of return that results in the present value of all projected benefit payments to be equal to the sum of the funded and unfunded projected benefit payments, specifically:

1) The benefit payments to be made while the pension plans' fiduciary net position is projected to be greater than the benefit payments that are projected to be made in the period; and
2) The net present value of the benefit payments not in (a) above, discounted using the municipal bond rate.

Funded Ratio: The value of assets expressed as a percentage of the actuarial accrued liability.

Municipal Employee Retirement System (MERS): MERS is an independent, professional retirement services company that administers retirement plans for participating Michigan local governments on a not-for-profit basis.

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Net Pension Liability (NPL): The NPL is the liability of employers and non-employer contribution entities to plan members for benefits provided through a defined benefit pension plan.

Normal Cost: The actuarial present value of the pension trust benefits allocated to the current year by the actuarial cost method. Also known as service cost.

Other Post-Employment Benefits (OPEB): OPEB are the benefits that an employee will begin to receive at the start of retirement. This does not include pension benefits paid to retired employees.

Pay-As-You-Go Funding: A pension or OPEB funding scheme where plan contributions are generally made at the same time and in the same amount as retiree benefit payments and expenses come due. With pay-as-you-go funding, plan contributions are made as benefit payments become due and funds necessary for future liability are not accumulated. That is, contributions made are for current retirees only, causing the majority of retiree benefit liability to be considered unfunded.

Prefunding: The practice of funding a defined benefit during the course of an employees working lifetime.

State Revenue Sharing: In accordance with the State Constitution of 1963, Article IX, Section 10, as amended, constitutional revenue sharing payments are based on 15% of the 4% portion of Michigan's 6% sales tax collections. Distributions are made to all Michigan cities, villages, and townships on a population basis on the last business day of the even numbered months.

Unfunded Actuarial Accrued Liability (UAAL): The UAAL is the difference between actuarial accrued liability and valuation asset.

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