GRAND TRAVERSE COUNTY

REPORT ON UNFUNDED PENSION & RETIREE HEALTH CARE LIABILITIES

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EXECUTIVE SUMMARY

EXECUTIVE SUMMARY

INTRODUCTION

Over the last few years the Board of Commissioners has expressed increasing concerns regarding the overall long-term liabilities of the County's defined benefit (DB) pension plan and retiree health insurance. The attached report will examine the history of the funding status of the plans, the future obligations, and the options available to make short and long-term changes.

Based on the most recent annual valuation reports the County's unfunded accrued liability (UAL) for pension obligations ($45.8 million) and retiree health care obligations ($7.26 million) total $53.1. The funded status of the plans is 48% and 0% respectively. The County's UAL for pension obligations and retiree health care is expected to grow to $51.2 million and $7.7 million respectively by the end of 2016.

The County's pension plan has been administered by the Municipal Employees Retirement System (MERS) since 1967. The County offers a DB plan with multipliers ranging from 2.25% to 2.8%. In 2000 the County closed twelve of the fourteen divisions to new hires. Instead new hires were offered a Defined Contribution benefit. At the time the County's DB plan was about 63% funded and its UAL was $20.6 million.

In 2000 the county's unfunded accrued liability was based on a 30-year amortization period. When divisions are closed to new hires the municipality must pay off the UAL over a shorter period of time, thus increasing the County's UAL and annual cost. This was the first step in a long succession of decisions and events that lowered the County's funded status to 48% and increased its UAL to $45.8 million.

MERS has provided all municipalities with future projections of employer contributions based on changes to certain actuarial assumptions. Grand Traverse County received their projections on September 3, 2015, which is attached as Exhibit A. The changes included updated mortality rates to reflect longer life expectancy and a decrease in investment return assumptions from 8% to 7.75%. These experience changes will take effect in 2017 and will significantly increase the County's employer contribution and its UAL. Absent changes in the County's DB benefit plan the County's employer contribution will increase from $4.8 million in 2016 to $8.8 million in 2026.

As was mentioned previously the County's UAL for OPEB obligations total $7.2 million as of December 31, 2015. This liability reflects recent changes the County Board of Commissioners made last year, including the lowering of the County's cap on monthly premium contributions from $350 to $100 and the elimination of payment for the Medicare supplemental for employees and retirees not covered by a collective bargaining agreement (CBA). Without the change the County's UAL would have increased to $9.3 million.

While the County has set aside $250,000 in the 2016 budget as a contribution towards the OPEB UAL, the County has not yet established an irrevocable trust fund as required by the Government Accounting Standards Board. Therefore the County's funded status is established at 0%. Based on the 12/31/2015 valuation report the County would need to contribute almost $400,000 more per year in order to fund this obligation over a 30-year amortization period.

OVERALL COUNTY FINANCES

The County's overall 2016 budget totals $155.6 million and the general fund totals $37.8 million. The projected GF unobligated fund balance as of 12/31/2016 is $8.6 million. Please note that the pension and OPEB UALs ($58.9 million as of 12/31/2016) exceed the projected general fund unobligated fund balance by a ratio 6.8 to 1.

A recent analysis commissioned by the County projects that the County GF would need to address budget shortfalls over the next four years (2017-2020) ranging from $4.1 million in 2017 to $5.1 million in 2019. Please note that these shortfalls are not cumulative, so any structural shortfall that is not resolved will carry forward to the next year and increase that year's shortfall.

Increases in OPEB contributions and employer contributions to MERS directly contribute to these projected shortfalls. The County's 2016 budget includes $4.8 million for contributions to MERS that will increase by $400,000 each year or 35% over the next four years. On the other hand if you assume a 1.9% annual increase in payroll the employers contribution for the DC plan will increase from $1.6 million to $ 1.725 million, a $125,000 or a 7.8% increase over the next four years. Please note that DC plan covers over 300 employees while the DB plan covers over 400 participants. The 400 plus participants in the DB plan include 88 employees, 267 retirees, and 47 vested former employees.

Since 2004 the County's employer contribution to MERS has increased from $3.2 million to $4.8 million, a 50% increase. Over the next four years (2016-2020) the employer contribution will increase by $1.6 million, or 35%.

MUNICIPAL EMPLOYEES RETIREMENT SYSTEM

MERS is a non-profit organization that helped provide retirement plans for municipal employees for more than 70 years. MERS was created by the state legislature in 1945. In 1996 MERS was granted independence from the state.

MERS administers retirement plans for over 800 municipalities. They offer a variety of customizable plans including defined benefit (DB); defined contribution (DC); DB/DC hybrid pension plans; 457 plans; health care savings accounts; and group buying for life and disability as well as a Medicare Advantage plan.

In 2014 MERS administered defined benefit and hybrid plans for 728 municipalities, including 66 counties. Please refer to the chart below for further details.

Summary of Valuation Results for MERS as of December 31, 2014 for the 728 Defined Benefit Plan and Hybrid Municipalities:	
Number of Participating Municipalities	713
Number of Closed Municipalities	15
Total Defined Benefit & Hybrid Municipalities	728
Total Active Member Payroll (in millions)	$1,744
Assets at Market Value (in millions)	$8,057
Actuarial Accrued Liability (in millions)	$12,096
Average AAL Funded Percentage	78%
Average AAL Funded Percentage for all Counties	76%
Grand Traverse County AAL Funded Percentage	48%

MERS Summary Report of the 69th Annual Actuarial Valuations as of December 31, 2014
For the 728 Defined Benefit Plan & Hybrid Plan Municipalities

GRAND TRAVERSE COUNTY'S DB PLAN VERSUS OTHER MERS PLANS

Section V of the full report will provide detailed information regarding the benefits provided by the County's DB pension plan. It will include a summary of benefits by division, an explanation of those benefits, and compare this information to other MERS municipalities.

Select comparisons of Grand Traverse County versus other MERS municipalities:

- The average employee contribution to the MERS DB pension plan is between 5.5-6.5%. In 2014 only 9 of Grand Traverse County's active 88 MERS participants contribute to their pension, and even then the contribution rates were only .67% and 2%.
- Funded status of all DB plans administered by MERS is 78%. The funded status of all Counties in the MERS DB plan is 76%. Grand Traverse County's 48% funded status is the lowest of all counties in MERS.
- Grand Traverse County's benefit multipliers ranging from 2.25 to 2.8% are quite comparable to other municipalities in MERS.

PREFERRED OPTIONS TO ELIMINATE AND/OR REDUCE THE PENSION UAL

1. Pursue bridge benefit plan options with MERS. The idea would be to lower the multiplier going forward for the current employees enrolled in the DB plan. Please note that the current multipliers range from 2.25 to 2.8, with the vast majority of DB employees at 2.5.

Lowering the multiplier going forward could generate both short and long-term savings. In addition to creating savings, it would not affect any of the retirees, former vested employees and the current employees (300+) enrolled in the DC plan. On the negative side existing DB employees would have their future pensions reduced from the amounts they may have counted on.

There are numerous combinations of multipliers and final average compensation (FAC) options the County could pursue with MERS. At the request of the County, MERS issued a supplemental valuation in November 2015. The valuation examined the decrease in UAL and the annual employer's contribution if the multiplier for the DB Plans were to be reduced to 1.0 going forward.

Under a scenario with a 1.0 multiplier and a frozen FAC the UAL would decrease in the first year by $4.6 million and the employer's contribution by $750,000 a year.

Under a scenario with a 1.0 multiplier and a FAC based on termination the UAL would decrease in the first year by $1.35 million and the employer's contribution by $450,000.

2. Increase the employee's contribution—Currently most of the County's DB employees contribute nothing to their pension plan. The only exceptions are a 2% contribution for POAM Deputies Division and a .67% contribution for the TPOAM Division. Each 1% increase in the employee's contribution would save the County's budget about $45,000 per year. Similar to option # 1 this would generate savings and would not affect retirees, former vested employees, and the employees enrolled in the DC plan. An increase in the contribution rate would also be more consistent with other municipalities in the MERS DB plans whose employees contribute 5.5-6.5% of their income.

3. Increase the employer's contribution to MERS each year beyond that which is required by MERS. Each year MERS issues a valuation of the County's DB Plan that is based on the prior fiscal year and includes total assets, actuarial accrued liability, unfunded accrued liability, and employer's contribution for the upcoming fiscal year. For instance, the valuation for fiscal year ending 12/31/2015 will be used to determine the employer contribution for 2017. If the employer's contribution for 2017 is set at $5.24 million then the County could choose to contribute an additional $100,000, $500,000, $1 million or any amount each year. The result would be to decrease the County's long-term UAL. Any additional employer contributions would of course increase the projected shortfalls in future budgets.

PREFERRED OPTIONS TO REDUCE OPEB UAL

The County could implement one or more of the following options.

1. Close access to retiree health insurance for new hires. Implementation would result in long-term savings. Retirees and current employees would not be affected. This option could affect the County's ability to attract quality candidates for open positions.

2. Increase the retiree's and future retirees premium share for employees covered by a CBA. This option would result in short and long-term savings. The County implemented this option for employees not covered by a CBA in 2015.

3. Phase in an annual increase to the employer's ARC. The County will be almost $400,000 short of their ARC contribution in 2016. Over each of the next 4 years increase that contribution by $100,000. Alternatively the County could increase the 2017 ARC contribution by $400,000. Either alternative would result in long-term savings but it would also increase projected shortfalls in future budgets. Retirees and current employees would not be affected.

PENSION OBLIGATION BONDS

One of the options considered for reducing all or a portion of the UAL for OPEB and pensions is the issuance of municipal securities/pension obligation bond (POBs) as defined in Public Act 34 of 2001 as amended. This option was not considered a preferred option for the reasons stated below.

This option would reduce or eliminate the County's UAL, however, it would simply be trading one debt for another. There may be budget savings, but they are at the risk of a volatile stock market. In terms of the UAL pension obligations the County would issue the securities and send the dollars to MERS. In terms of the UAL for OPEB the county would issue the securities and deposit it into an irrevocable trust fund. The County would be responsible for repaying the securities out of the general fund. The County would no longer need to make a contribution towards OPEB or the UAL pension obligation. However, if the stock markets take a turn for the worse and the County or MERS do not make their investment targets then the County could once again begin paying for an UAL in the form of increased contributions for OPEB and to MERS. The new UAL payments would be on top of the debt payments for the securities.

It should be noted that few municipalities have pursued this option in Michigan. If this option is pursued without making some of the structural changes noted above the rating agencies may actually down grade the County's credit rating. And there would be no guarantee that the State of Michigan Treasury Department would approve the issuance of these securities, pursuant to the enabling statute. Please refer to Appendices B-D for further explanation.

GRAND TRAVERSE COUNTY

REPORT ON UNFUNDED PENSION & RETIREE HEALTH INSURANCE LIABILITIES

I. INTRODUCTION

Over the last few years the Board of Commissioners has expressed increasing concerns regarding the overall long-term liabilities of the County's defined benefit (DB) pension plan and retiree health insurance. This report will examine the history of the funding status of the plans, the future obligations, and the options available to make short and long-term changes.

Based on the most recent annual valuation reports the county's unfunded accrued liability (UAL) for pension obligations ($45.8 million) and retiree health care obligations ($7.26 million) total $53.1. The funded status of the plans is 48% and 0% respectively. The County's UAL for pension obligations and retiree health care is expected to grow to $51.2 and $7.7 million respectively by the end of 2016

A. DB PENSION

The County's pension plan has been administered by the Municipal Employees Retirement System (MERS) since 1967. The County offers a DB plan with multipliers ranging from 2.25% to 2.8%. In 2000 the County closed twelve of the fourteen divisions to new hires. Instead new hires were offered a Defined Contribution benefit. At the time the County's DB plan was about 63% funded and its UAL was $20.6 million.

In 2000 the county's unfunded accrued liability was based on a 30-year amortization period. When divisions are closed to new hires the municipality must pay off the UAL over a shorter period of time, thus increasing the County's UAL and annual cost. This was the first step in a long succession of decisions and events that lowered the County's funded status to 48% and increased its UAL to $45.8 million.

These decisions and events are detailed below:

- In 2000 the County closed twelve of fourteen DB divisions to new hires. This resulted in a shorter amortization period to pay off the UAL. Each year the amortization period was scheduled to decline by two years.

- In 2000 the County offered an early out incentive to their employees.

- In 2005 the County offered another early out. Neither of these early out incentives was built into the UAL prior to their implementation.

- MERS assumes an annual average investment return of 8%. MERS did not hit this target assumption during the 2000-2004 time period.

- The County requested and MERS approved a temporary freeze in the annual two-year reduction of the amortization period. The freeze took place three years in a row, 2009-2011.

- There were significant market losses in 2008-2009. Although MERS spreads losses and gains over a 10-year smoothing period it did result in system wide annual increases to municipalities UAL and employer contributions.

MERS has provided all municipalities with future projections of employer contributions based on changes to certain actuarial assumptions. The changes included updated mortality rates to reflect longer life expectancy and a decrease in investment return assumptions from 8% to 7.75%. These experience changes will take effect in 2017 and will significantly increase the County's employer contribution and its UAL. Absent changes in the County's DB benefit plan the County's employer contribution will increase from $4.8 million in 2016 to $8.8 million in 2026.

B. RETIREE HEALTH INSURANCE/OTHER POST EMPLOYMENT BENEFITS (OPEB)

As was mentioned previously the County's UAL for OPEB obligations total $7.2 million based on the 12/31/2015 valuation report. This liability reflects recent changes the County Board of Commissioners made last year, including the lowering of the County's cap on monthly premium contributions from $350 to $100 and the elimination of payment for the Medicare supplemental for non-union employees and retirees. Without the change the County's UAL would have increased to $9.3 million.

Similar to most state and local governments across the nation the County was simply paying as you go in terms of retiree health care for years. All of that changed when the Government Accounting Standards Board (GASB) issued GASB 43 and 45. These new standards required governments to provide actuarial valuation reports that estimated their UAL for OPEB obligations. It also required governments to reflect these obligations in their annual CAFR.

While the County has set aside $250,000 in the 2016 budget as a contribution towards the OPEB UAL, the County has not yet established an irrevocable trust fund as required by GASB. Therefore the County's funded status is established at 0%. Based on the 12/31/2015 valuation report the County would need to contribute almost $400,000 more per year in order to fund this obligation over a 30-year amortization period.

II. OVERALL COUNTY FINANCES

In order to put the overall finances of the County in perspective please refer to the following financial data. Please note that the County's long-term liabilities exceed the general fund reserves by a ratio of 6.8 to 1.

An Independent Financial Analysis was provided to the Board of Commissioners by a financial consulting firm, Rehmann Robson in November 2015. The report provided annual budget projections through 2030. The report also reflected the aforementioned annual contribution increases from pension and OPEB obligations. Absent significant policy changes and budget reductions the County general fund budget will need to address budget shortfalls over the next 4 years (2017-2020) ranging from $4.1 in 2017 to $5.1 million in 2020.

Budget	
2016 Total Budget	$155,600,269
2016 General Fund Budget	37,760,036
General Fund Reserves	
GF projection as of 12/31/2016	8,622,833
Long Term Liabilities	
Projected UAL by 12/31/2016	51,157,000
Projected OPEB UAL by 12/31/2016	7,704,335
Total Long-Term Liabilities	58,861,335

III. GRAND TRAVERSE COUNTY DEFINED BENEFIT PLAN (DB)

This section provides a history of the County's DB plan, the current status of the plan, and projections for future employer contributions. The County has participated in a DB Plan with the Municipal Employees Retirement System (MERS) since 1967. Participants in the plan include 88 active employees, 267 retirees, and 47 vested former employees. The plan includes fourteen different divisions. In 2000 twelve of the divisions became closed to new members when the County switched to a DB Plan for new hires. In December of 2015 there was an agreement to close the remaining two Circuit Court Divisions, and switch all of their new hires to the DC Plan.

When a DB plan is closed to new hires the unfunded accrued liability (UAL) will be paid off over a shorter number of years, thus increasing the County's contribution in the short run. For instance, for the valuation ending on December 31, 2014 the amortization period for the original twelve closed plans is thirteen years as opposed to twenty-four years for the open Circuit Court plans.

Subsections A-D detail the funded status of the plan, the employer contribution from 2004-2016, projected employer contribution from 2016-2020, and the employer contribution by division for the current year.

A. FINANCIAL STATUS OF PENSION PLAN BASED ON MERS 2015 EXPERIENCE STUDY PROJECTION

Total Liabilities	$ 96,085,000
Total Assets	44,928,000
Unfunded Accrued Liability (UAL)	51,157,000
Funded Status	47%

Source:
MERS Experience Study Projection for
Grand Traverse County, September 3, 2015, p. 19

B. MULTI-YEAR SUMMARY OF EMPLOYER CONTRIBUTIONS TO MERS

50% Increase from 2004-2016

YEAR ENDED	EMPLOYER CONTRIBUTIONS
2004	$3,188,538
2005	$2,744,813
2006	$3,023,727
2007	$3,275,854
2008	$3,441,339
2009	$3,572,015
2010	$3,960,432
2011	$3,962,869
2012	$3,879,285
2013	$3,964,682
2014	$4,258,800
2015	$4,466,904
2016	$4,782,300

Source:
MERS Annual Actuarial Valuation Report Dec. 31, 2014 for
Grand Traverse County, Spring 2015, p. 22

C. FIVE YEAR PROJECTION OF EMPLOYER CONTRIBUTIONS --STATUS QUO BENEFITS-BASED ON UPDATED EXPERIENCE FACTORS

The table below shows a projected increase in employer contributions of $1.67 million, or 35% over the next four years.

BUDGET YEAR	PROJECTED COUNTY CONTRIBUTIONS
2016	$4.81 Million
2017	$5.24 Million
2018	$5.65 Million
2019	$6.05 Million
2020	$6.48 Million

Source:
MERS Experience Study Projection for
Grand Traverse County, September 3, 2015, p. 19

D. EMPLOYER CONTRIBUTION BY DIVISION FOR THE 2016 FISCAL YEAR BASED ON THE DECEMBER 31, 2014 VALUATION

DIVISION	EMPLOYER CONTRIBUTION	TOTAL LIABILITIES	PARTICIPANTS*			PERCENT FUNDED
			A	V	R	
General Teamsters	$613,800	$12,160,082	8	10	68	51%
POAM Deputies	$675,672	$10,652,829	6	5	28	37%
Elected Employees	$386,184	$7,132,459	4	1	19	47%
General Non Contract	$168,660	$4,388,006	5	4	27	65%
AFSCME	$123,552	$2,384,378	3	2	5	54%
Circuit Court	$383,107	$8,566,719	32	6	19	65%
Health Department Union	$165,912	$4,796,527	6	9	23	69%
District Court Teamsters	$232,548	$4,405,308	2	3	13	46%
TPOAM Central Records	$77,328	$1,524,294	3	3	4	53%
Circuit Court Supervisors	$77,120	$1,353,047	2	0	3	30%
Exempt	$981,000	$16,727,760	9	4	33	42%
Teamsters Command	$595,332	$9,021,193	2	0	13	34%
Dispatch Unit	$2,832	$432,045	0	0	5	93%
COAM Sergeants	$299,256	$5,314,156	6	0	7	51%
Total	$4,782,303	$88,858,803	88	47	267	48.40%

*A=Active Employees, V=Former Vested Employees, R=Retirees

Source:
MERS Annual Actuarial Valuation Report Dec. 31, 2014 for
Grand Traverse County, Spring 2015, p. 22

MUNICIPAL EMPLOYEES RETIREMENT SYSTEM

A. MERS BACKGROUND

The Municipal Employees Retirement System (MERS) is a non-profit organization that helped provide retirement plans for municipal employees for more than 70 years. MERS was created by the state legislature in 1945. In 1996 MERS was granted independence from the state.

MERS administers retirement plans for over 800 municipalities. They offer a variety of customizable plans including defined benefit (DB); defined contribution (DC); DB/DC hybrid pension plans; 457 plans; health care savings accounts; and group buying for life and disability as well as a Medicare Advantage plan.

In 2014 MERS administered defined benefit and hybrid plans for 728 municipalities, including 66 counties. Please refer to the chart below for further details.

Summary of Valuation Results for MERS as of December 31, 2014 for the 728 Defined Benefit Plan and Hybrid Municipalities:	
Number of Participating Municipalities	713
Number of Closed Municipalities	15
Total Defined Benefit & Hybrid Municipalities	728
Number of Valuation Divisions	
Open to new hires	1,303
Closed to new hires	1,188
Closed municipalities	19
Total	2,510
Total Active Member Payroll (in millions)	$1,744
Assets at Market Value (in millions)	$8,057
Assets at Actuarial Value (in millions)	8,539
Actuarial Rate of Return	5.9%
Actuarial Accrued Liability (in millions)	$12,096
Average AAL Funded Percentage	78%
Grand Traverse County AAL Funded Percentage	48%

Source: MERS Summary Report of the 69th Annual Actuarial Valuation as of December 31, 2014 for the 728 Defined Benefit Plan & Hybrid Plan Municipalities

V. GRAND TRAVERSE COUNTY'S DB PLAN VERSUS OTHER MERS PLANS

As noted previously participants in the plan include 88 active employees, 267 retirees, and 47 vested former employees. This section of the report will provide detailed information regarding the benefits provided by the County's DB pension plan. It will include a summary of benefits by division, an explanation of those benefits, and compare this information to other MERS municipalities.

Select Comparisons of Grand Traverse County versus other MERS municipalities:

- The average employee contribution to the MERS DB pension plan is between 5.5-6.5%. Only 9 of Grand Traverse County's active 88 MERS participants contribute to their pension, and even then the contribution rates are only .67% and 2%.
- Funded status of all DB plans administered by MERS is 78%. The funded status of all Counties in the MERS DB plan is 76%. Grand Traverse County's 48% funded status is the lowest of all counties in MERS.
- Grand Traverse County's benefit multipliers ranging from 2.25 to 2.8% are quite comparable to other municipalities in MERS.

A. SUMMARY OF BENEFITS BY DIVISION

DIVISION NAME	MULTIPLIER	MAX % OF FAC	ELIGIBLE AGE TO RETIRE	ELIGIBLE AGE EARLY RETIRE	# OF YRS TO VEST	FAC
GENERAL TEAMSTERS	2.50%	80%	60	55/(25)	6	3
POAM DEPUTIES	2.80%	80%	60	50/(25	10	3
ELECTED EMPLOYEES	2.50%	80%	60	50/(25)	6	3
GENERAL NONCONTRACT	2.50%	80%	60	55/(25)	8	5
AFSCME	2.50%	80%	60	55/(25)	8	3
CIRCUIT COURT	2.50%	80%	60	55/(25	6	3
HEALTH DEPT. UNION	2.50%	80%	60	55/(25)	6	3
DISTRICT CT. TEAMSTERS	2.50%	80%	60	55/(25)	6	3
TPOAM CENTRAL RECORDS	2.50%	80%	60	55/(25)	8	5
CIRCUIT CT. SUPS	2.50%	80%	60	55/(25)	6	5
EXEMPT	2.50%	80%	60	55/(25)	8	3
TEAMSTERS COMMAND	2.80%	80%	60	25 & OUT	10	3
DISPATCH UNIT	2.80%	80%	60	25 & OUT	10	3
COAM SERGEANTS	2.25%	80%	60	50/(25)	10	5

Source:
MERS Annual Actuarial Valuation Report Dec. 31, 2015 for Grand Traverse County, Spring 2015

Explanation of column headings:

- Multiplier—The benefit multiplier is a specific percentage ranging from 2.25-2.8%. The multiplier is applied to years of service and FAC to determine annual pension payment.
- Maximum % of FAC---Each retiree's pension benefit is capped at 80% of their salary upon retirement.
- Eligible Age to Retire—Normal retirement age for all employees is 60.
- Eligible Age for Early Retirement—The first number is the early retirement age and the second number is the years of service required for eligibility.
- # of Years to Vest—The minimum number of years worked for eligibility to retire at age 60. A former employee with the required number of years of service to vest could begin to draw their pension benefit at age 60.
- FAC—Final Average Compensation is either the highest 3 or 5 years of compensation of an employee's service. It is applied against the multiplier to determine the annual pension benefit (i.e. 25 years of service X .025 X FAC).
- Example--Assume 25 years of service, 2.5 multiplier, and FAC of $50,000. The annual pension benefit would be 25 X .025=. 625 X $50,000 = $31,250.

B. BENEFIT FORMULA COMPARISON TO OTHER MERS MUNICIPALITIES

Grand Traverse County:

- **10 Divisions with a 2.5% Multiplier (80% Maximum)**
- 3 Divisions with a 2.8% Multiplier (80% Maximum)
- 1 Division with a 2.25% Multiplier (80% Maximum)

MERS DB Plans:

- 2,491 Divisions across 728 Municipalities
- 371 Divisions with a 2.0 Multiplier (No Maximum)
- 531 Divisions with a 2.25 Multiplier (80% Maximum)
- **909 Divisions with a 2.5 Multiplier (80% Maximum)**

C. FUNDED STATUS OF ALL DB PLANS ADMINISTERED BY MERS

- 115 Municipalities Under 60% Funded
- 307 Municipalities 60-80% Funded
- 203 Municipalities 80-100% Funded
- 88 Municipalities 100% + Funded

D. FUNDED STATUS OF COUNTY DB PLANS

- 1 County under 50% (Grand Traverse)
- 1 County between 50-59%
- 10 Counties between 60-69%
- 37 Counties between 70-79%
- 11 Counties between 80-89%
- 6 Counties between 90-100

Source Subsections A-D:
MERS Summary Report of the 69th Annual Actuarial valuations as of Dec. 31, 2014
for the 728 Defined Benefit Plan and Hybrid Plan Municipalities, Sept. 22, 2015.

VI. OPTIONS TO ELIMINATE AND/OR REDUCE UAL

A. PREFERRED OPTIONS

1. Pursue bridge benefit plan options with MERS. The idea would be to lower the multiplier going forward for the current employees enrolled in the DB plan. Please note that the current multipliers range from 2.25 to 2.8, with the vast majority of DB employees at 2.5.

Lowering the multiplier going forward could generate both short and long-term savings. In addition to creating savings, it would not affect any of the retirees, former vested employees and the current employees (300+) enrolled in the DC plan. On the negative side existing DB employees would have their future pensions reduced from the amounts they may have counted on.

There are numerous combinations of multipliers and FAC options the County could pursue with MERS. At the request of the County, MERS issued a supplemental valuation in November 2015. The valuation examined the decrease in UAL and the annual employer's contribution if the multiplier for the DB Plans were to be reduced to 1.0 going forward.

Under a scenario with a 1.0 multiplier and a frozen FAC the UAL would decrease in the first year by $4.6 million and the employer's contribution by $750,000 a year.

Under a scenario with a 1.0 multiplier and a FAC based on termination the UAL would decrease in the first year by $1.35 million and the employer's contribution by $450,000.

2. Increase the employee's contribution—Currently most of the County's DB employees contribute nothing to their pension plan. The only exceptions are a 2% contribution for POAM Deputies Division and a .67% contribution for the TPOAM Division. Each 1% increase in the employee's contribution would save the County's budget about $45,000 per year. Similar to option #1 this would generate savings and would not affect retirees, former vested employees, and the employees enrolled in the DC plan. An increase in the contribution rate would also be more consistent with other municipalities in the MERS DB plans whose employees contribute between 5.5-6.5% of their income.

3. Increase the employer's contribution to MERS each year beyond that which is required by MERS. Each year MERS issues a valuation of the County's DB Plan that is based on the prior fiscal year and includes total assets, actuarial accrued liability, unfunded accrued liability, and employer's contribution for the upcoming fiscal year. For instance the valuation for fiscal year ending 12/31/2015 will be used to determine the employer contribution for 2017. If the employer's contribution for 2017 is set at $5.24 million then the County could choose to contribute an additional $100,000, $500,000, $1 million or any amount each year. The result would be to decrease the County's long-term UAL. Any additional employer contributions would of course increase the projected shortfalls in future budgets.

B OTHER OPTIONS

4. Hybrid Plan Options—Hybrid plans are a combination of DB and DC options. MERS offers a variety of such plans. For instance, the County could pursue a Hybrid plan with a DB multiplier of 1.0 and an employer contribution to a DC plan of 2% of wages. The County could allow all current employees to enroll in a Hybrid plan or limit it to existing DB employees.

While this option if implemented correctly could provide long term savings it also raises several problematic issues. If it is opened to only current DB employees there would more than likely be long-term savings, but the short term costs could actually increase.
This option would result in even more divisions with MERS and muddy an already complex benefit structure. An argument could be made that if existing DC employees and new hires were allowed to enroll the County would be going backwards by opening up DB plan options.

5. Issue municipal securities (aka Pension Obligation Bonds) authorized pursuant to Public Act 34 of 2001 as amended. The County could issue municipal securities for all or a portion of the UAL currently estimated at over $58.9 million as of 12/31/2016.

This option would reduce or eliminate the County's UAL, however, it would simply be trading one debt for another. There may be budget savings, but they are at the risk of a volatile stock market. The County would borrow the UAL and transfer the funds to MERS. The County's annual contributions to MERS would be reduced significantly, but the County would be responsible for repaying the securities out of the general fund. If the stock markets take a turn for the worse and MERS does not make their investment targets then the County could once again begin paying for an UAL in the form of increased contributions to MERS.

It should be noted that few Michigan municipalities have pursued this option. If this option is pursued without making some of the structural changes noted above the rating agencies may actually down grade the County's credit rating. And there would be no guarantee that the State of Michigan Treasury Department would approve the issuance of these securities, pursuant to the enabling statute. Please refer to Appendices B-D for further explanation.

C. STEPS

- Options 1, 2, and 4 would require successful collective bargaining negotiations with labor unions. The County Board would ultimately have to approve the changes. The County would need to work with MERS to make sure the appropriate plan changes are made.

- Option 3 could be accomplished by building the increased employer contribution into the 2017 budget and beyond.

- Option 5—The first step would be to contact MERS and walk through the impact of various scenarios related to the amount of the borrowing. The next step would be for the County Administrator and County Treasurer to hire bond counsel. The County would need the approval of the State Department of Treasury before they could issue the municipal securities. The Board of Commissioners would need to approve the issuance of the municipal securities. The proceeds would be transferred to MERS. The annual debt service payments to repay the bonds would be paid for out of the general fund.

VII. OTHER POST EMPLOYMENT BENEFITS (OPEB)

A. CURRENT PLAN AND OPEB OBLIGATIONS

The County Board first adopted a Health Insurance Policy for employees and retirees in April of 1992. The plan was most recently amended in 2015. The plan provides non-contract employees, who are not yet eligible for Medicare, health care coverage up to age 65. The retiree must reimburse the County for the applicable premium amount. The County's premium share is capped at $100 per month and the retirees are eligible for the following premium coverage:

70 years (age & service) 30% premium
75 years (age & service) 40% premium
80 years (age & service) 50% premium
85 years (age & service) 60% premium
90 years (age & service) 70% premium

The impact of the change the County made in 2015 by reducing the cap on the County's monthly premium share from $350 to $100 per month is to basically nullify the aforementioned premium shares based on age and service years.

At age 65 the retirees are placed into the County Medicare Group. The County previously paid the full premium for Medicare supplemental insurance. The 2015 changes to the Health Insurance Policy eliminated the County's payment for supplemental insurance. The retiree can purchase the supplemental at the County's group rates.

The retiree may add coverage for their spouse by purchasing insurance through the County's group plan.

The coverage for union employees is spelled out in the individual labor agreements.

Based on the most recent actuarial valuation the plan had 44 retirees currently receiving benefits, 24 employees eligible to retire, and 193 employees not yet eligible to retire.

The UAL for the fiscal year ending December 31, 2015 was $7.3 million. The UAL should be paid off over a 30-year period. In order to meet the 30-year obligation the County should provide an Annual Required Contribution (ARC) of $640,000 in fiscal year 2016. Instead the County has budgeted only $250,000 toward the liability. Bottom line is that if the County wants to pay off the UAL over the next 30 years it should increase its OPEB contribution by almost $400,000 dollars per year.

B. OPTIONS TO REDUCE OPEB OBLIGATIONS

The County could implement one or more of the following options. The preferred options are 1-3.

1. Close access to retiree health insurance for new hires. Implementation would result in long-term savings. Retirees and current employees would not be affected. This option could affect the County's ability to attract quality candidates for open positions.

2. Increase the retiree's and future retirees premium share for union employees. This option would result in short and long-term savings. The County implemented this option for employees not covered by a CBA in 2015.

3. Phase in an annual increase to the employer's ARC. The County will be almost $400,000 short of their ARC contribution in 2016. Over each of the next 4 years increase that contribution by $100,000. Alternatively the County could increase the 2017 ARC contribution by $400,000. Either alternative would result in long-term savings but it would also increase projected shortfalls in future budgets. Retirees and current employees would not be affected.

4. Issue municipal securities/pension obligation bond (POBs) as defined in Public Act 34 of 2001 as amended, in order to pay off all or a portion of the $7.7 million UAL.

This option would reduce or eliminate the County's UAL, however, it would simply be trading one debt for another. Unlike public pensions OPEB is not guaranteed by the Michigan Constitution. Borrowing would create a "hard debt".

There may be budget savings, but they are at the risk of a volatile stock market. The County would borrow the UAL and deposit it into an irrevocable trust fund. The County would be responsible for repaying the securities out of the general fund. The County would no longer need to make a contribution towards OPEB. However, if the stock markets take a turn for the worse and the County does not make their investment targets then the County could once again begin paying for an UAL in the form of increased contributions for OPEB into the trust fund.

It should be noted that few municipalities have pursued this option. If this option is pursued without making some of the structural changes noted above the rating agencies may actually down grade the County's credit rating. And there would be no guarantee that the State of Michigan Treasury Department would approve the issuance of these securities, pursuant to the enabling statute. Please refer to Appendices B-D for further explanation.

C. STEPS

Options 1-2 would require approval by the Board of Commissioners to amend the County's Health Insurance Policy for nonunion employees. If the retiree health benefits were included in a labor agreement it would also require negotiations with the labor unions.

Option 3 could be implemented through the budget process.

Implementing option 4 could begin with the County Administrator working with the County Treasurer to hire bond counsel. Before issuing the municipal securities the County would need to obtain approval of the State Treasury Department. The Board of Commissioners would need to approve the issuance of the municipal securities. The proceeds should be deposited into a Trust Fund established for Retiree Health Insurance. The County Administrator and Treasurer should be appointed as Trustees for the Fund and hire an investment firm to invest the proceeds.

VIII CONCLUSION

This report has examined the history of the County's DB pension plan and retiree health care benefits. It also looked at the history of the funding status of both plans, as well as future projections. Several preferred options were outlined for the DB plan and OPEB. The report also looked into the potential risks and rewards of pursuing POBs.

The County must address the projected annual shortfalls in the near term. DB pension costs and OPEB obligation are direct contributors to these shortfalls. The County needs to act quickly to implement short and long-term solutions. Whatever options the County chooses to pursue must balance these changes with its ability to attract quality candidates for open positions.

The County would appear to have a much clearer path to resolving its OPEB long-term liabilities. The County should begin by pursuing negotiations with the labor unions that would include implementing the changes recently made for non-represented employees and retirees. If these changes are implemented for all retirees and employees it will significantly reduce OPEB's UAL. The County should also begin to increase their contribution to OPEB's ARC. It could be done in the 2017 budget by increasing the employer contribution by almost $400,000 or it could be phased in over a few years.

Absent significant changes to the County's DB plan the employer contribution will increase by $520,000 in 2017, another $410,000 in 2018, and every year after until the UAL tops out at $8.8 million in 2026. Several preferred options to reduce both the employer contribution and the UAL were identified in Section VI. These included pursuing a bridge benefit plan going forward, and increasing the employee's contribution. The County could also increase their own annual contribution but that would add to the projected shortfalls over the next few years. The County could pursue all of the aforementioned options at the same time.

Implementing most of these tough options would involve successful negotiations with labor unions through the collective bargaining process. This could take several years so the County needs to quickly identify alternative solutions for the 2017 budget.

SOURCES

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The Government Finance Officers Association Advisory in 2015 regarding Pension Obligation Bonds, http://www.gfoa.org/pension-obligation-bonds.

Gabriel Roeder Smith & Company (GRS), Pension Obligation Bonds: Risks and Rewards, July 10, 2014. http://www.gabrielroeder.com/wp-content/uploads/2014/07/RR-POB-Final.pdf

APPENDIX B
RISKS & REWARDS OF POBS

If the County is interested in pursuing the issuance of POBs for either or both the pension and OPEB shortfalls they need to carefully assess the risks and rewards. Borrowing an amount equal to the combined shortfall of $58.9 million would exceed the total of the County's 2016 general fund budget of $37.8 million, and would represent 38% of the County's total budget. The County should look to make changes in their pension and retiree health plans in order to reduce the long-term UAL, prior to pursuing POBs. Please also keep in mind that the issuance of a POB simply trades one debt for another. Below you can find several expert sources of information on the risks and rewards of POBs.

The Government Finance Officers Association issued an Advisory in 2015 regarding Pension Obligation Bonds (Exhibit x). http://www.gfoa.org/pension-obligation-bonds. Their recommendation is detailed below.

Recommendation

The Government Finance Officers Association (GFOA) recommends that state and local governments do not issue POBs for the following reasons:

1. The invested POB proceeds might fail to earn more than the interest rate owed over the terms of the bonds, leading to increased overall liabilities for the government.
2. POBs are complex instruments that carry considerable risk. POB structures may incorporate the use of guaranteed investment contracts, swaps, or derivatives, which must be intensively scrutinized as these embedded products can introduce counterparty risk, credit risk, and interest rate risk.
3. Issuing taxable debt to fund the pension liability increases the jurisdiction's bonded debt capacity that could be used for other purposes. In addition, taxable debt is typically issued without call options or with "make-whole" calls, which can make it more difficult and costly to refund or restructure than traditional tax-exempt debt.
4. POBs are frequently structured in a manner that defers the principal payments or extends repayment over a period longer than the actual amortization period, thereby increasing the sponsor's overall costs.
5. Rating agencies may not view the proposed issuance of POBs as credit positive, particularly if the issuance is not part of a more comprehensive plan to address pension-funding shortfalls.

An actuarial firm by the name of Gabriel Roeder Smith & Company (GRS) issued a more positive research report on July 10, 2014 entitled Pension Obligation Bonds: Risks and Rewards (Exhibit x). http://www.gabrielroeder.com/wp-content/uploads/2014/07/RR-POB-Final.pdf. As part of the background information in the report it states "...It is important to recognize that in order to achieve a net positive financial impact for the plan sponsor, the investment returns on the POB proceeds need to exceed the interest rate paid on the bonds over the life of the debt. It is also important to remember that the issuance of a POB itself does not reduce the total debt obligations of the sponsor. It does, however, convert the unfunded pension liability that is currently a "soft" debt of the plan sponsor and which can potentially be deferred into the future in difficult economic times, into a "hard" debt that must be paid to the bond holders even during the most trying economic times."

GRS modeled the long-term expected performance of a $6 billion and a $2 billion POB issue and associated pension plan. The report details all of the assumptions and showed the savings in employer contributions over 30 years with the POB and without the POB. "The simulation results indicate that…there is approximately a 70% probability that issuing a POB produces a savings in employer contributions (including debt service) over the life of the bond issue. The downside is that there is a 30% probability that issuing a POB produces an increase in employer contributions (including debt service) over the life of the bond issue."

The report also provides a rating agency view of POBs.

"According to Moody's Investors Service, the issuance of pension obligation bonds may be neutral or negative for an issuer's credit rating depending on the use of the proceeds, the relative size of the bond issue and associated debt service, the level of future budget savings assumed and the assumptions on which such savings are based.

However, Moody's points out that pension obligation bonds are often a red flag associated with greater rigidity of long-term obligations, failure to find sustainable solutions to pension funding and a pattern of pushing costs off into the future. For this reason Moody's indicates that most pension bonds have at best a neutral impact on the assessment of an issuer's credit quality.

Moody's cautions that if proceeds of POBs directly substitute for the issuer's pension contribution requirements, they would view the transaction as deficit financing and such transactions could have a material impact on credit quality. Moody's does offer that if the issuance of POBs is made as part of a broader effort aimed at restoring the balance between a plan's assets and liabilities and restoring affordability, the initiative would be considered as a credit positive effort."