Oakland County Michigan

BONDING FOR OPEB AND PENSION LIABILITIES – OAKLAND COUNTY EXPERIENCE

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OUTLINE - BUSINESS ISSUES AND PROPOSED RESOLUTIONS

- Unfunded pension and retirees' healthcare (OPEB) liabilities are substantial and growing in many local units. Local units are experiencing inability to fund these employee commitments earned by employees in prior years.

- Bonding as an alternative for the financing of unfunded actuarial accrued liabilities.

- Oakland County's experience with debt issues to cover unfunded liabilities for OPEB liabilities.

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UNFUNDED PENSION AND OPEB LIABILITIES

- Local examples of pension / OPEB commitments unable to be funded:
  - **Wayne** - $1.5 billion in unfunded OPEB liabilities. Wayne is struggling financially.
  - **Detroit** – emergency manager status. Unfunded pension and OPEB liabilities of $600 million in CAFR ($3.5 billion in "Orr Plan") and $6.0 billion, respectively. Unsecured obligation that may be negated in Chapter 9 – or, reduced to 10% of its current actuarial value.
  - **Flint** – pension and OPEB commitments are so great that if they were to fund these obligations on an actuarial basis, ***the payments would exceed the General Fund revenues for the next 30 years!*** Under an emergency manager.
  - **Pontiac** – under an emergency manger due to fiscal crisis. Unfunded OPEB liabilities are $380 million. General Fund revenues = $29 million. Actuarially required contributions would be 2/3rds of revenues for the next 30 years.
- Many more examples in varying degrees of distress could be provided.

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POTENTIAL OUTCOME / COURSES OF ACTION

- Fiscally-weaker local units are having trouble paying benefit commitments when due (e.g. 'pay-as-you-go'). OPEB payments (and to some extent even pension contributions are not being paid) will grow. Growth in these benefits will displace police, fire, EMS and similar services as local units struggle to fund.

- Alternative consequences of a fiscally distressed local unit, if federal inaction continues:

  - State governments *could* assume the obligations, but his highly unlikely as reduced federal support is coming.

  - Ultimately, federal government would be expected to assume the obligations to pay or will have to support seniors who have lost pension and retirees' healthcare benefits through a court bankruptcy. Orr's proposal is to partially fund and then rely on the federal government (Medicare and ACA) for rest of OPEB costs.

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BORROWING AS AN ALTERNATIVE COURSE OF ACTION

- The current interest rates would permit a borrowing of 2.7% to 4% on taxable bonds for federal purposes. Most pension plans assume a 7+% return on investments.

- Difference between interest paid and investment income earned helps fund pension and OPEB liabilities and would reduce future pension and OPEB costs.

- **If pension and OPEB plan administrators cannot achieve a rate of investment return (e.g. 7% plus) that covers bond interest costs (4% or less), nationally the governmental pension and OPEB plans are woefully under-water to the tune of trillions! And, the pension assumptions locally used are not valid.**

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BONDING FOR PENSION AND OPEB LIABILITIES

- Michigan recognized the potential of allowing local units to issue bonds and included preventative measures in legislation to thwart bargaining groups from seeking increases in benefits.

- Considerations for the use of Michigan's P.A. 329 of 2012 (copy attached):

  - Required the defined benefit plans to be closed (with the new hires covered by a defined contribution plan). Defined contribution plans must continue while the debt is outstanding.

  - Fiscal and program plan to be submitted to State Treasury for approval and required to demonstrate control over future pension and / or OPEB costs (could become a covenant to the bond issue).

  - Minimum bond rating required of AA.

  - Ability to issue pension and OPEB bonds ends on Dec. 31, 2014 (sunset date).

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- Pension plans:
  - Defined benefit plan (DB plan) closed on Dec. 31, 1994 to new hires. A fully-funded plan at the time of closing.
  - Defined contribution plan for new hires starting Jan. 1, 1995.
  - Periodic adjustments in employee benefits to control pension costs since 1994.
  - No contributions required for the DB plan since 1994 through 2012.
  - Essentially fully funded based upon current market values.

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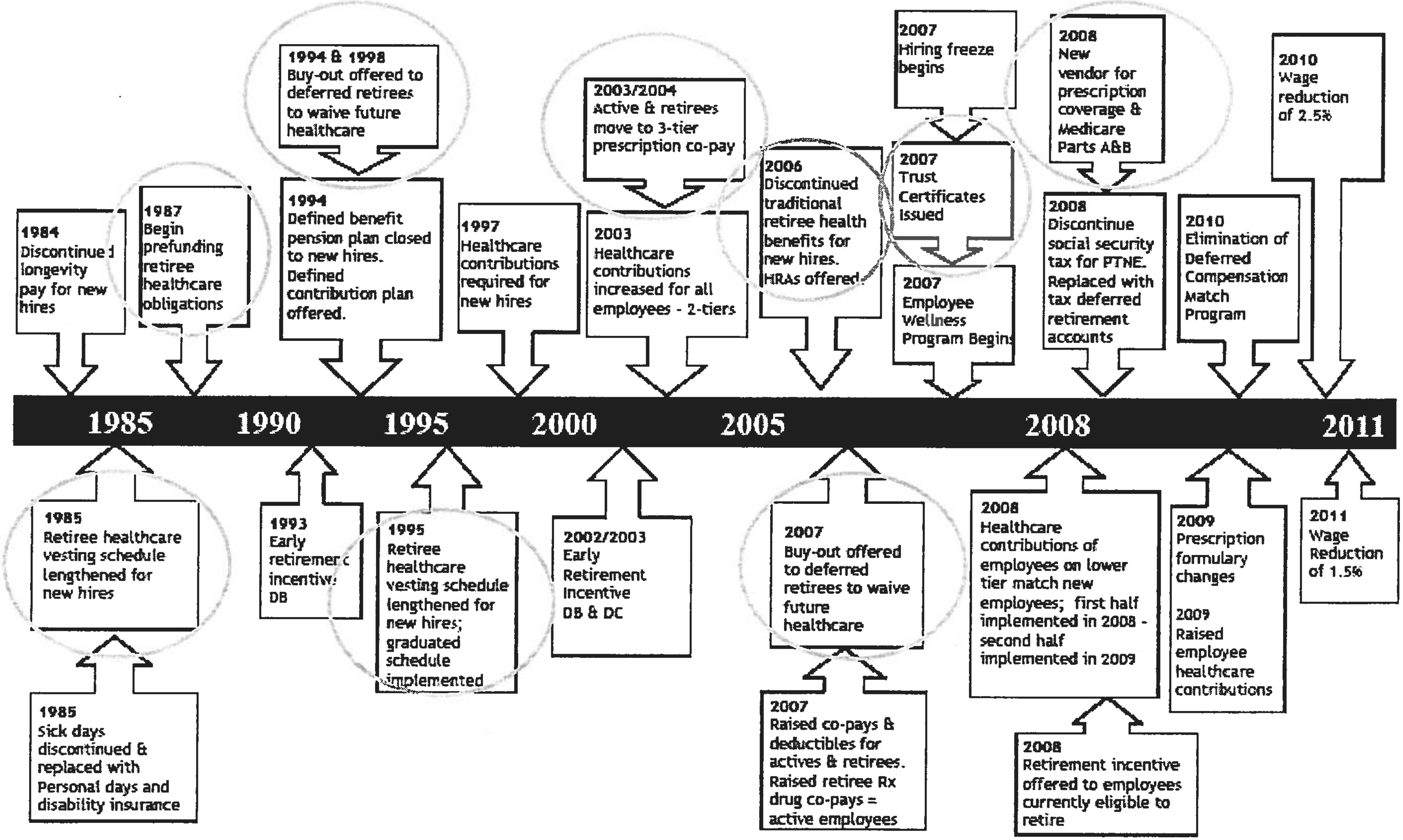
OAKLAND COUNTY EXPERIENCE (Cont.)

- Retirees' healthcare (OPEB):
  - OPEB (defined benefit) plan funded actuarially since 1987.
  - OPEB contributions began increasing at an alarming rate. In 2000, the required contribution was $12.2M, but by 2008 it was $60.2M (500% increase in 8 years).
  - Portions of the increase in OPEB contributions arose from the closing of the defined benefit healthcare plan and shortening the funding period assumption from 40-years to 30-years.
  - Even as the contributions were increasing, the County adjusted the OPEB benefits downward over the years. See actions on subsequent chart.
  - OPEB (defined benefit) plan closed effective Dec. 31, 2005 to most new hires, except Act 312 personnel until recently (labor agreement was in arbitration). OPEB defined contribution plan instituted. All new hires now under the OPEB defined contribution plan.

Major Changes in Benefits & Compensation



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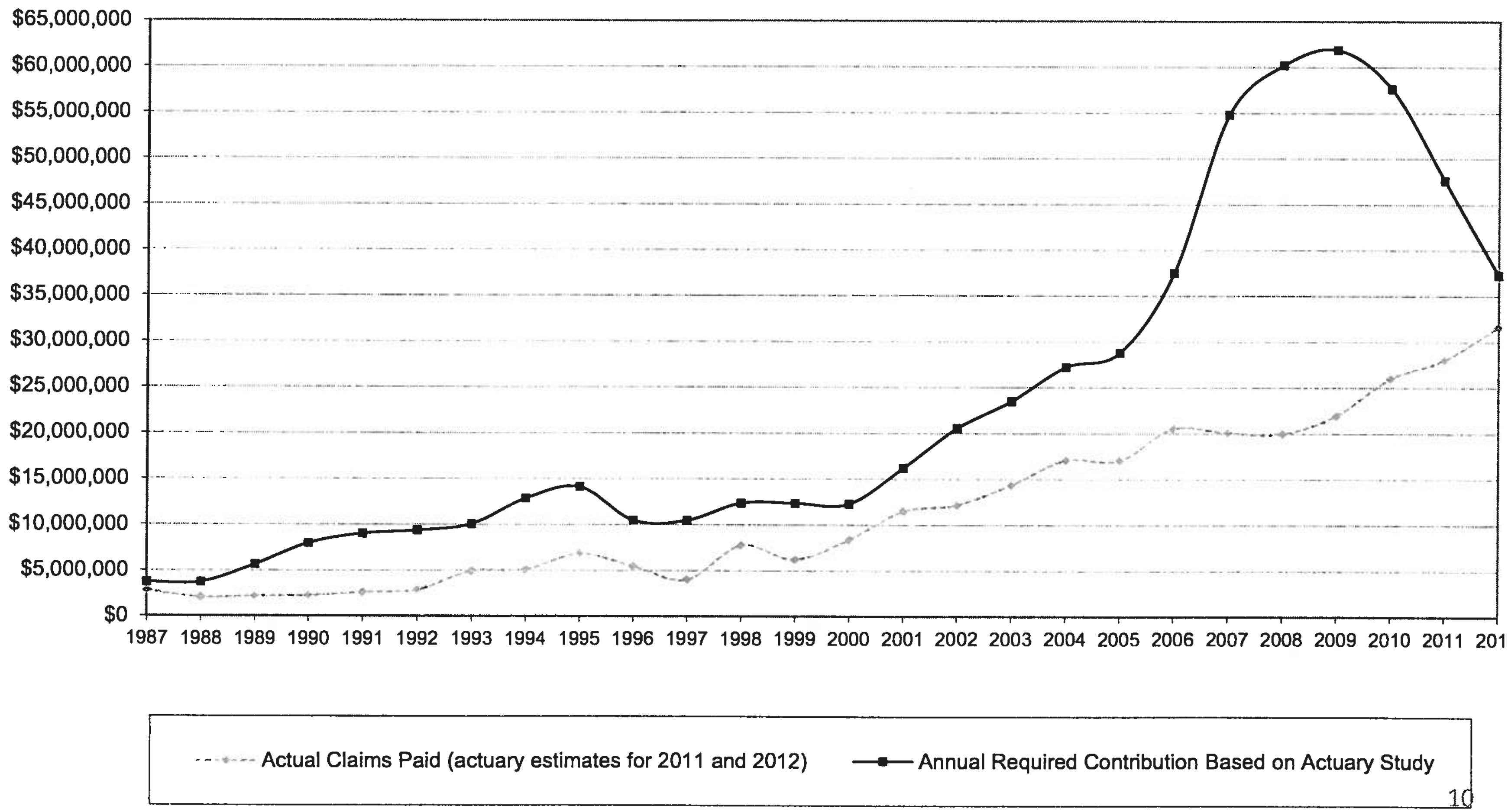
Retiree Health Care History
ARC Payment Compared to PAYGO Amount



OPEB Funding

- Issued certificates of participation on July 31, 2007.
- Sizing of the trust certificates (in millions):

– Actuarial accrued liabilities	$ 829.7	
– Actuarial assets	(303.1)	
Unfunded actuarial accrued liabilities	526.6	
– 2007 and 2008 ARC short-fall	25.9	(1)
– Issuance costs / prepaid interest	4.5	
Total amount borrowed	**$557.0**	

(1) Financial impact of actuarial assumptions arising from the closing of the OPEB plan to new hires effective Jan. 1, 2006.

(2) At the time of the trust certificate borrowing the County's OPEB plan was 100% funded between two trust funds.

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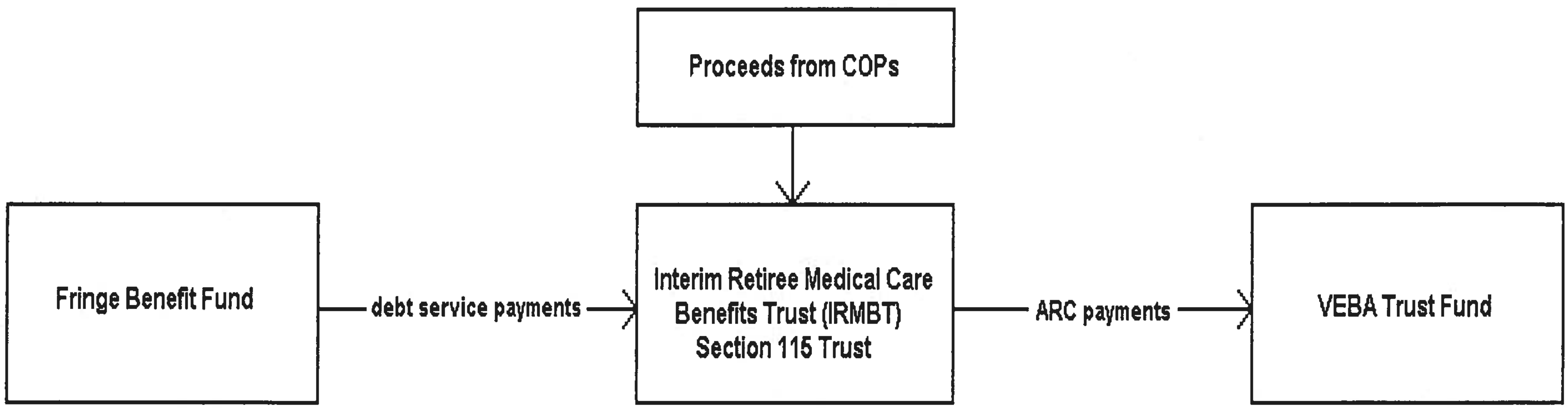
ORIGINAL OPEB SAVINGS (IN 2007)

- In 2007, $557 million of taxable Certificates of Participation (COPS) issued to be repaid over ***20 years***:
  - Annual debt service of approximately $48.5 million vs. $60.2 million ARC payment for 2008. ARC payment was still increasing.
  - Interest rate of 6.23% on COPS.
  - Callable after 7 years (April 1, 2014).
- Reduced funding period by 10 years (30 year amortization period to 20 years of debt service).
- **Net present value savings conservatively estimated to be in the range of $100 million to $150 million in large part due to the shortening of funding period.**

Trust Certificates of Participation



- Irrevocable IRMBT serves as an 'interim trust' fund used only to make payments to VEBA **or** to liquidate outstanding COPs

- Interim trust serves as a hedge against potential over-funding of VEBA **if** the national health care system and/or benefit limitations are ultimately imposed on employees/retirees

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CURRENT OPEB STATUS

As of March 31, 2013 (in millions):

VEBA market value of assets (1)	$ 726.3
IRMBT market value of assets (1)	338.8
Total assets at market value	1,065.1
Less – estimated actuarial accrued liabilities	
@ Sept. 30, 2012	(867.6)
Estimated ***excess of assets*** over liabilities	**$197.5**

(1) *Market value* of assets as of May 31, 2013 is different than *actuarial* value of assets (which are smoothed over a three-year period by formula).

(2) Almost six years later, the two trust funds are over-funded by 22.8%.

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FY-2013 DEBT REFINANCING

- COPS callable on April 1, 2014 at that time - $422 million.
- Will issue taxable bonds under new Michigan legislation (Act 329).
- Formal plan required by Michigan statutes to demonstrate control over future healthcare costs. Plan requires review and approval by State Treasurer.
- Some portion of excess assets over actuarial liabilities will be devoted to the reduction in new debt to be borrowed – estimated at $144.0M. Net borrowing estimated to be $280M to $300M.

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DEBT REFINANCING (Cont.)

- **Budgetary savings of *<u>no less than</u>* $14M annually over current debt service** using a 10-year term for bonds (as much as $20M per year using 13-year term):
  - Interest rates have fallen since the COPS were issued (should achieve 2.5% to 2.8% - taxable debt). <u>Interest rates at historic lows.</u>
  - May shorten remaining life of old debt from 2027 to 2024.
  - Bonds are better understood in the market than COPS.
  - Amount of the borrowing is reduced assuming a pay-off of perhaps $144M (using increases in market value of investments).

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CONSIDERATIONS / SUMMARY

- Involve actuary and financial advisors early in the bond discussions as the impact of the changes to the pension / OPEB plans will be substantial.

- AA bond requirement combined with long-range budgeting will be well accepted by the bond rating agencies.

- Substantial savings could be obtained from investment gains over bond interest payments; need to be careful in developing financial projections.

- If no funding has previously been provided towards pension / OPEB, it may be very difficult to justify the bonding unless the local unit is willing to accept additional costs.

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