

Financial Health Team City of Lansing, Michigan

December 13, 2017

Mayor Virg Bernero and Mayor-elect Andy Schor
City of Lansing
David C. Hollister City Hall
124 W. Michigan Avenue
Lansing, MI 48933

**RE: FHT Recommendations to the City of Lansing regarding Long-Term Pension
and OPEB Liabilities**

Dear Mayor Bernero and Mayor-elect Schor:

Per the direction and request of Mayor Bernero, the Lansing Financial Health Team (the “FHT”) has reviewed and analyzed reports prepared by Segal Consulting related to the City of Lansing’s Pension Plan (attached Exhibit A) and Retiree Health Plan (attached Exhibit B). Under direction from the FHT’s Long-Term Liability Subcommittee, the FHT hereby presents this letter, which is intended to describe the problem, present our key recommendations, and provide an overall summary for your consideration.

The FHT was originally formed by Mayor Bernero in 2012 to proactively provide guidance and direction to the Mayor and City of Lansing with respect to various financial matters. Over that time, countless hours have been spent by dozens of volunteer FHT members to work toward the common goal of ensuring long-term financial sustainability for the City.

The Problem

The City of Lansing has an unfunded actuarial accrued liability (“UAAL”) of approximately \$680 million, including both pension and retiree healthcare, also known as other post-employment benefits (“OPEB”). This means that the difference between the amount of money the City currently has invested to pay for the benefits retired and current City employees have earned and the present value of the additional amount the City needs to meet these future obligations is a shortfall of \$680 million. With that in mind, the Lansing Financial Health Team has been tasked with providing recommendations to the City to lessen this projected shortfall while minimizing the impact to current and former City employees.

While the \$680 million UAAL is not due in full at this time, the associated costs, combined with State-imposed constraints on revenue growth, result in unsustainable pressure on available resources in the context of community needs. In 2006, the amount that the City was paying annually toward pension and OPEB was **\$25 million** out of revenues of \$184 million, or 13.5% of total revenue. In 2017, these payments represent **\$44 million** of the City’s revenues of \$197 million, or 22.4% of total revenue, and this amount does not fully fund the City’s actuarially-calculated OPEB annual required contribution (“ARC”). The City is fully funding its pension ARC.

If nothing is done, this trend will continue and a larger and larger portion of the City’s resources will be going toward services already provided, rather than services expected and needed today. This is not a sustainable use of city tax revenues.

There are various reasons why Lansing and so many other Michigan municipalities are in this situation. These include, but are not limited to the following:

- People are living longer.
- The stock market, bond market and all pension investments have not experienced the returns that were originally assumed.
- The City has 2.3 retirees for every 1 active employee, due in part to the age of the City and responsible, necessary, and prudent budgetary decisions that reduced the City's workforce by 30% since 2006.
- Health care costs continue to rise at much faster rates than could have been predicted at the time those commitments were made.
- The City has limited options to increase revenue, and growth of existing revenue is constrained.
- The City has been significantly impacted by cuts to State revenue sharing (over \$6 million annually, totaling more than \$78 million) and State-imposed property tax limitations (see Charts 5-7 on pages 9-11 of Exhibit A, Segal Pension Plan Analysis).

With the above in mind, the focus of this document is not to look back and quibble over reasons as to why the City is in the situation it's in, or who is to blame. At this time, the answer to the question of "why does the City have the large unfunded liability?" is less important than the question of "what are we going to do to fully and sustainably fund it?" This is a forward looking document with a focus of providing recommendations on next steps. Unfortunately, there are no easy or painless solutions to this problem. These recommendations will be the "least worst" options to put the city on a more sustainable path for meeting its obligations to current and past city employees. The ultimate goal is that these difficult decisions can be made between the City and all affected parties, as opposed to having those decisions made for the City by a consent agreement, Emergency Manager, or bankruptcy judge. Not taking adequate and immediate steps at this time could result in the City and employees having these decisions made for them.

It also must be noted and applauded that significant accommodations and sacrifices have already been made by City employees, in an attempt to address these issues. It is estimated that these efforts have reduced future projected costs by over \$200 million over the next forty years. However, additional adjustments are necessary so as to ensure that the City will be able to sustainably fund all employee retirement commitments, and those sacrifices will need to be shared by all, including both active and retired City employees.

Finally, it must also be noted that there are many positive things happening in Lansing at this time. The city's decades-long population decline has been reversed, with population gains in each of the last three years; at 5.9%, the city's 2016 unemployment rate fell to its lowest level in 15 years; the City has seen billions of dollars in new private investment over the last decade with continued investment on the horizon, especially along the crucial Michigan Avenue Corridor; and, thanks to prudent financial management, the City has enjoyed a modest budget surplus in each of the last four fiscal years, allowing it to substantially improve its critically necessary reserves (i.e. "rainy day fund").

Despite all of these positive indicators, the City must remain focused on addressing the significant annual revenue demands its employee retirement obligations require in order to ensure that City services are still able to be provided and the growth that is occurring can continue.

The Recommendations

The Segal reports should be thoroughly studied by the reader, including all conclusions and recommendations. This letter will highlight how the FHT feels those recommendations should be prioritized, considering i) impact on addressing the liabilities, ii) impact on current and retired employees, and iii) likelihood of the recommendations successfully being implemented. It should be further recognized that not all of these recommendations can be acted upon by the City unilaterally; some will require collective bargaining while others may require voter approval. The following recommendations which pertain to OPEB liabilities and refer to "Exhibit B, Segal Health Plan Analysis" include projected potential UAAL dollar savings for those items.

1. Consider replacing group Medicare-eligible medical and drug coverage with a “defined dollar” Health Reimbursement Account (HRA) arrangement. This design can result in a “win-win” scenario for the City and its retirees, and would have the largest projected impact on the OPEB liability, potentially in the range of \$110 - \$160 million. See page 12 and Section 5 of Exhibit B, Segal Health Plan Analysis.
2. Conduct a thorough and systematic review of City-owned assets, starting with those assets with the highest potential market value. Analysis should include each asset’s net impact to the City’s budget, relative to its potential market value (i.e. even assets that produce a benefit to the budget should be considered; if those assets’ values are high enough the reduction in pension / OPEB payments could exceed the net annual financial benefit they provide). Consideration should be given to the sale (a one-time revenue source), monetization (e.g. bonding / financing particular assets), or transfer of those assets into the system(s).
3. Consider eliminating Medicare Part B reimbursement. See page 12 of Exhibit B, Segal Retiree Health Plan Analysis.
4. Consider eliminating subsidized dental and vision coverage. See page 12 of Exhibit B, Segal Retiree Health Plan Analysis.
5. Consider the addition and enforcement of the Michigan Public Act 152 hard cap for all groups. See page 12 of Exhibit B, Segal Retiree Health Plan Analysis.
6. It is recognized that the investment rate of return assumption has been reduced by the Pension Boards. The Pension Boards, the Mayor and City Council should monitor the investment return assumption, ensuring that actuarial assumptions being used are reasonable on a long-term basis. This recommendation will not reduce the liability, but will ensure an accurate liability is being calculated.
7. Continue to update the mortality assumptions over time to the most recent Society of Actuaries’ mortality assumptions. This recommendation will not reduce the liability, but will ensure an accurate liability is being calculated.
8. Consider pursuing a special millage allowed under Public Act 345 of 1937 for police and fire pensions (not available for other obligations other than police and fire pensions). The 12/31/2016 police and fire unfunded liability is \$130 million. It should be noted that this would require a vote of the people and needs to be considered with regards to the City’s current millage level. See item number 4 on page 38 of Exhibit A, Segal Pension Plan Analysis.
9. The Segal Consulting report recommends having the City give consideration to whether a pension obligation bond would be a means to finance the pension plans. However, the FHT is hesitant in endorsing this recommendation to the City, and provides a cautionary note with respect to this item. It should be noted that bonding for pension liabilities requires closing the pension fund. See item number 3 on page 38 of Exhibit A, Segal Pension Plan Analysis.

The Summary

The most fiscally irresponsible thing that could be done is to do nothing. To not take action is a conscious decision and will not lead to putting the City on a sustainable path to ensure current and past employees are supported in retirement and city residents continue to receive public services that support and enhance their day-to-day living in this exquisite capital city. Furthermore, the FHT believes that not taking action will increase the likelihood that the City and its employees may ultimately have these difficult decisions made for them.

It should be highlighted that the City is not alone in dealing with these challenges. Other municipalities throughout the Metro Lansing region and across the state are faced with the same issues as well. Collectively regional municipalities have close to \$1 billion in unfunded liabilities. Unique challenges require unique solutions. The FHT recommends the City of Lansing to fully expand collaborative regional efforts to evaluate what services could be provided regionally that would benefit the region, improve efficiencies and provide overall cost saving to taxpayers. Existing initiatives such as the Capitol Council of Governments can play an important role in convening regional partners. There are many examples of successes with regard to regional efforts, but there are additional and creative regional solutions that must be evaluated as well.

The FHT is appreciative of the proactive measures taken by the City to date. It should be the City's desire to continue working to establish a sustainable path going forward to address its own unfunded retirement liabilities. As the State capital, the FHT hopes the City will play a leadership role in having its solutions provide guidance to other municipalities throughout the state in developing their own fiscally sustainable plans.

Despite Lansing's efforts, no city can resolve this unfunded liability issue on its own. The State cannot limit itself to warnings and punitive actions alone. The State must instead take proactive action to provide the necessary tools to allow cities to address this problem in a meaningful and effective way.

The FHT's wish is for the City to reach its greatest potential as a safe, vibrant and diverse community, and a City that thrives economically and culturally. We desire a fiscally healthy City government that provides public services efficiently and effectively for all of us today and for our future generations.

Working together in the spirit of collaboration, these goals certainly can be achieved if our City's leadership continues to focus on securing the long-term stability and sustainability of its finances.

Respectfully submitted,

Financial Health Team
City of Lansing

cc: Governor Rick Snyder, State of Michigan
Treasurer Nick A. Khouri, State of Michigan