



Michigan's new local pension board offers no solutions

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Michigan's new Municipal Stability Board has given more than 100 local governments until the beginning of November to come up with a plan to tackle underfunded retirement plans.

What that plan needs to look like is the question these municipalities and market experts are asking now.

The board, put in place through legislation enacted in December, said at its first meeting earlier this month that corrective actions are needed because of underfunded pensions, retirement health care plans or both. The legislation, backed by Gov. Rick Snyder, is supposed to ensure that local governments start to adequately address billions in unfunded pension and health care liabilities.



Michigan's Municipal Stability Board hasn't offered governments tools to tackle pension underfunding, said James Hohman of the Mackinac Center for Public Policy.

Aside from alerting governments about the funding problem, the board has provided little else in terms of giving them tools to tackle the underfunding, said James Hohman, director of fiscal policy at the Mackinac Center for Public Policy, a think tank focused on Michigan issues.

"It's good that they are paying attention to them and they are finally getting some encouragement from the state to do more but these are tough problems to solve," said Hohman. "In the state we have constitutional protections on pension benefits. The only thing you can do is work with these going forward and try to find ways to shore up your funding for the benefits that have already been underfunded."

The stability board estimates total statewide unfunded pension liability at \$10.2 billion. The total retiree health care unfunded liability was estimated to be \$10.1 billion. The Michigan Department of Treasury said that more than 110 out of 490 local units of government have been identified as having an underfunded pension plan or retirement health care plan — or both.

Fixing the problem would require lowering investment return assumptions and acknowledging that the problems are "even larger than what we are willing to admit right now," Hohman said. "What they have to do is what these local governments have done and that is to find ways to cut expenses to put more money into pension systems."

The state in December enacted Act 202, which provides for thresholds on pensions and OPEB that all municipalities must meet in order to be considered funded at a viable level. For retiree health care, a plan is considered underfunded if its obligations are less than 40% funded and if its annual contribution is more than 12% of the unit's revenue. A pension plan is considered underfunded if it's below 60% funded and if the unit's annual contribution is more than 10% of its revenue.

Local units can pay for pensions and OPEB in two ways.

The first is called pay-as-you-go, which means that governments do not presently save, or separately fund, to pay for the benefits that will have to be paid out in the future. The second way is called prefunding, which is based on setting money aside at present, as services are performed, and earning interest or investment income, to build savings that will cover future payments. Governments that do not entirely and accurately prefund a pension or post-employment benefit are required to account for it as a liability.

The MSB was originally envisioned as holding broader powers to implement a plan of action but through the legislative process it was settled that the board would function more as an information gathering exercise that would request of local governments, if they are behind in funding, what sort of action they would take to address those, said Eric Luper, president of the Citizens Research Council of Michigan, an independent policy research organization.

"When the legislature tackled this issue and formed this board it really gave municipalities no more tools to address their municipal finance issues than they had yesterday," Lupher said. "Yes, we will understand better who has liabilities that are becoming overwhelming, and we will ask of those units what their plan to address those issues is, but there is nothing really being done to fix the problem."

In Michigan, each municipality negotiates labor deals on its own, sometimes with multiple collective bargaining units. The board, according to Lupher, has no authority to force the hands of collective bargaining "in coming to the table and trying to fix some of the wrongs in their pension systems, and nothing was done to change their underlying service delivery mechanisms."

The board will issue an annual best practice and strategies document to assist local governments in corrective action plans. The plans are due to the MSB within 180 days after a local unit receives a determination of underfunded status and should include the development and implementation of corrective options for the local unit of government to address its underfunded status. The MSB will review and vote to approve or reject corrective action plans submitted by the local unit of government within 45 days of submission and receipt on the agenda.

Snyder on April 26 announced the appointments to the Municipal Stability Board of Daryl Delabbio, a former county administrator for Kent County; Barry Howard, counsel to the law firm of Lipson, Neilson, Cole Seltzer & Garin, P.C.; and deputy treasurer Eric Scorsone.

Delabbio will serve an initial three-year term to expire May 1, 2021, Howard will serve an initial two-year term to expire May 1, 2020, and Scorsone will serve an initial four-year term to expire May 1, 2022. Members will serve four-year terms after their initial appointments.

Other organizations in the state have some ideas about how local governments could improve their funded ratios without steering funds away from services.

Mary Schulz, associate director for the Michigan State University Extension Center for Local Government Finance and Policy, said that the drumbeat is always more revenue sharing but one really interesting idea that municipalities could consider is an in-kind contribution of assets.

"So instead of selling the assets, why not use the assets to out fund your liabilities?" Schulz said.

The concept is to set up a trust for in-kind contributions of city owned assets. This is a way for the city to retain ownership of assets and unlock the fair market value of them.

The city would have an inventory of its capital assets -- land, buildings, airports, parking structures, equipment -- whatever it owns that is not necessary to deliver core public services. This inventory is then contributed to a trust for its pension systems. The unfunded liability could be addressed with this capital infusion. The ownership of the trust is divided with certificates of shares.

"This is not a simple 'accounting gimmick,'" Schulz said. "The city 'unlocks' the fair market value of the assets by transferring ownership to the trust. The new market value of these assets is given to the pension system [or municipalities]."

The new trust is then managed by a professional manager hired by the trust who is charged with maximizing the economic value of the assets in the trust.

Legislation may be needed to put the concept into action, and there is also the challenge of what to do with any legacy debt these enterprises may have on the books.

Another option Michigan could consider is giving municipalities access to bonding with a revenue sharing backstop.

Schulz said that the state did this type of bonding for the business sector when the unemployment insurance fund was underfunded in 2011. The state issued \$3.2 billion of bonds to cover its federal unemployment debt. The debt is secured by a first lien on a special tax assessment levied on all of the state's employers. Citi and Bank of America Merrill Lynch were the senior book-running managers on the deal.

"The same kind of concept could be applied to local governments," Schulz said, adding that the state could determine what sort of skin municipalities should have in the game and other behavioral changes they should enact before participating.

Schulz said there has been some rumbling in the legislature over changing state laws limiting pension obligation bond issuance.

Local government pension and OPEB bonds are permitted under 2012 revisions to the state's Municipal Finance Act, which added a section to allow pension and OPEB bonding by governments that have closed their defined-benefit plans. The legislation has since been extended twice. The law is scheduled to sunset in December 2018.

At present, only municipalities rated double-A or above can issue such bonds. Schulz said there is talk about eliminating the minimum rating requirement.

Lupher said that securitizing or bonding isn't the right solution because it doesn't address the underlying issues hobbling Michigan's municipal finance system.

"Michigan's municipal finance system is broken in a lot of ways and revenues do not recover from what they were before so changing the underfunded pension liability from a soft liability to hard liability doesn't create more revenue to pay the liability in whatever form it is," Lupher said. "Fix the property tax system and think about alternative revenue sources for local governments."



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