Police Pension Millage
Pension Fund Overview

Summary of Actions Taken

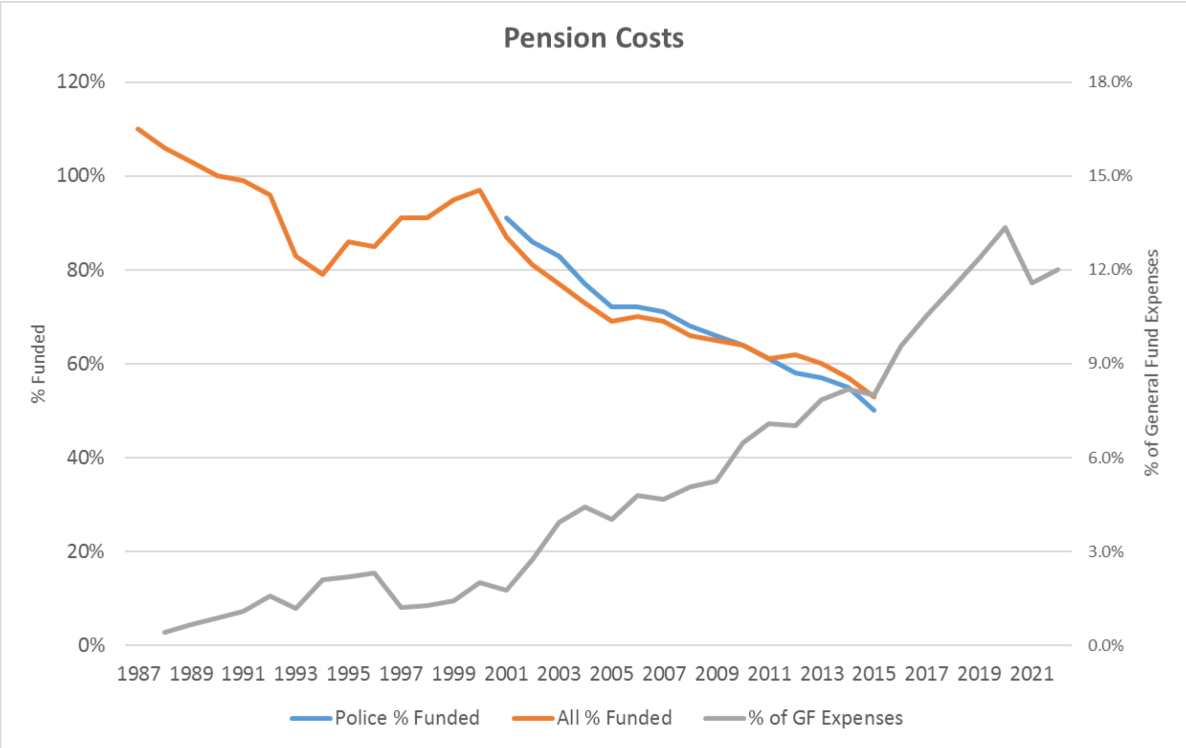
Following is a summary of actions taken by the City to address the unfunded liability issue:

- Defined benefit pension police group 02 and administrative group 10 were closed to new hires in 2011 and were replaced by new groups with lower benefit levels. The new groups are fully or nearly fully funded.
- City Manager pension group is closed. The current City Manager does not receive a pension.
- Police employee pension contribution increased from 0% to 2.5% in 2011. Administrative employee contribution increased from 0% to 3% in 2011.
- New police hires will receive a hybrid plan that has a small pension component combined with a defined contribution 401k-style plan.
- Retirement health care is no longer offered for any administrative employee hired after 2011 or police officer hired after 2017. Instead, employees have access to a Health Care Savings Plan that allows them to save for retirement health care costs with a small City match.

Pension Unfunded Liability and Cost Increase

The City has pension has steadily been becoming underfunded over the past 30 years, to the point where our police pension is just 48% funded in 2017. This is becoming an acute financial problem as the low pension funding level increases the amount that the City must contribute to the pension fund each year. The following Figure 1 summarizes the funding level of the City's total and police pension funds (left scale), along with the City's actual and projected pension funding cost as a percentage of general fund expenses.

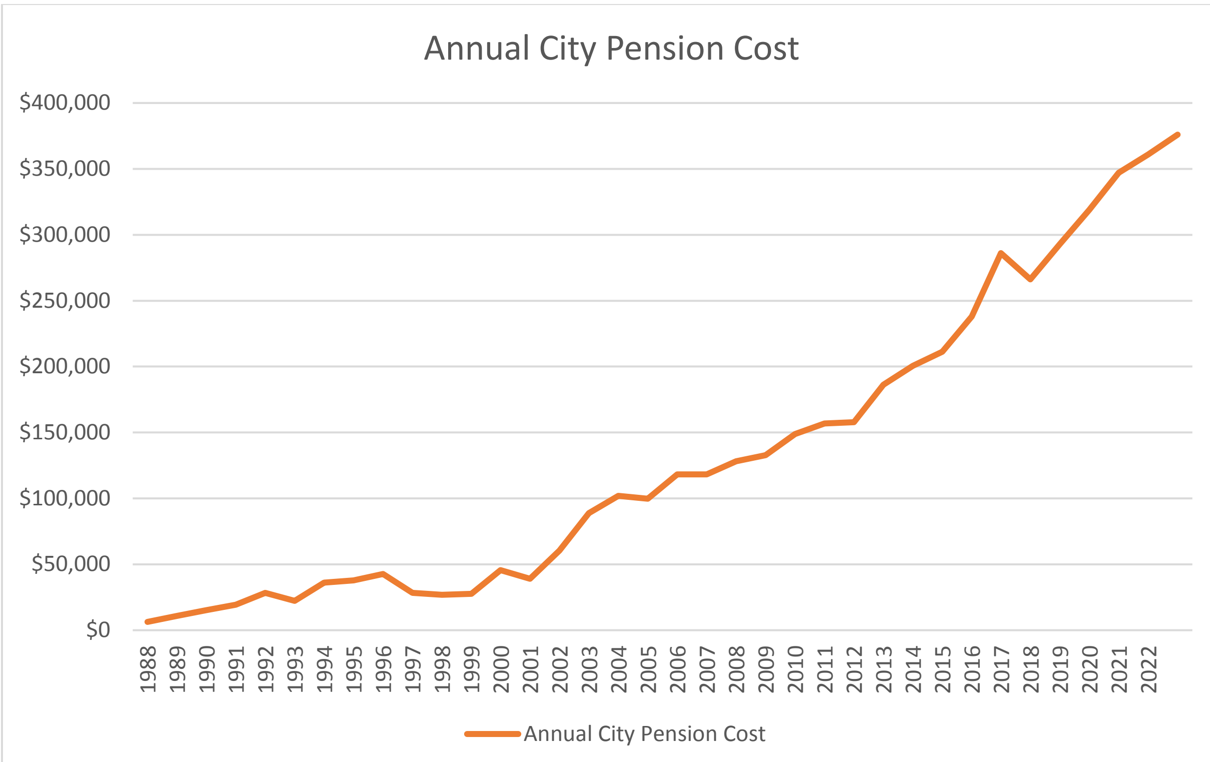
Figure 1. City Pension Funding Level and Expenses as a Percentage of General Fund Expenditures



The preceding Figure 1 shows that the City has experienced a decline from being 100% funded in the late 1980s to 48% funded in 2017. Over the same time period, pension costs have gone from 1.8% of general fund expenditures to 9.6% of general fund expenditures. By 2020, pension costs will represent 13.4% of general fund expenditures.

Please note that the police group funding level was not independently reported by MERS until 2001, which is why the blue line above only begins that year.

Figure 2. Annual Required City Pension Cost, 1988 - 2022



The above Figure 2 shows the City's annual required pension contribution. The required contribution is calculated each year by the Municipal Employees' Retirement System of Michigan (MERS), which is the City's pension system.

The reason for the jump in required contribution levels after 2001 were primarily due to the impact of increased benefit provisions, which is explored in more detail on the following pages. The reason for the large increases in required pension contributions after 2012 are due to a series of three primary reasons: 1) the stock market decline in 2008 lowered the value of the City's pension fund which was fully priced in to MERS' calculations in 2011, 2) MERS started requiring underfunded pension groups to contribute additional funding to amortize the City's unfunded liability, and 3) MERS completed an experience study in 2015 that changed the underlying assumptions about market return and life expectancy.

The changes from the experience study were a decrease in expected returns and an increase in life expectancy. Each of these changes individually would have caused the annual required contribution to increase, and in tandem, the effect was even more pronounced.

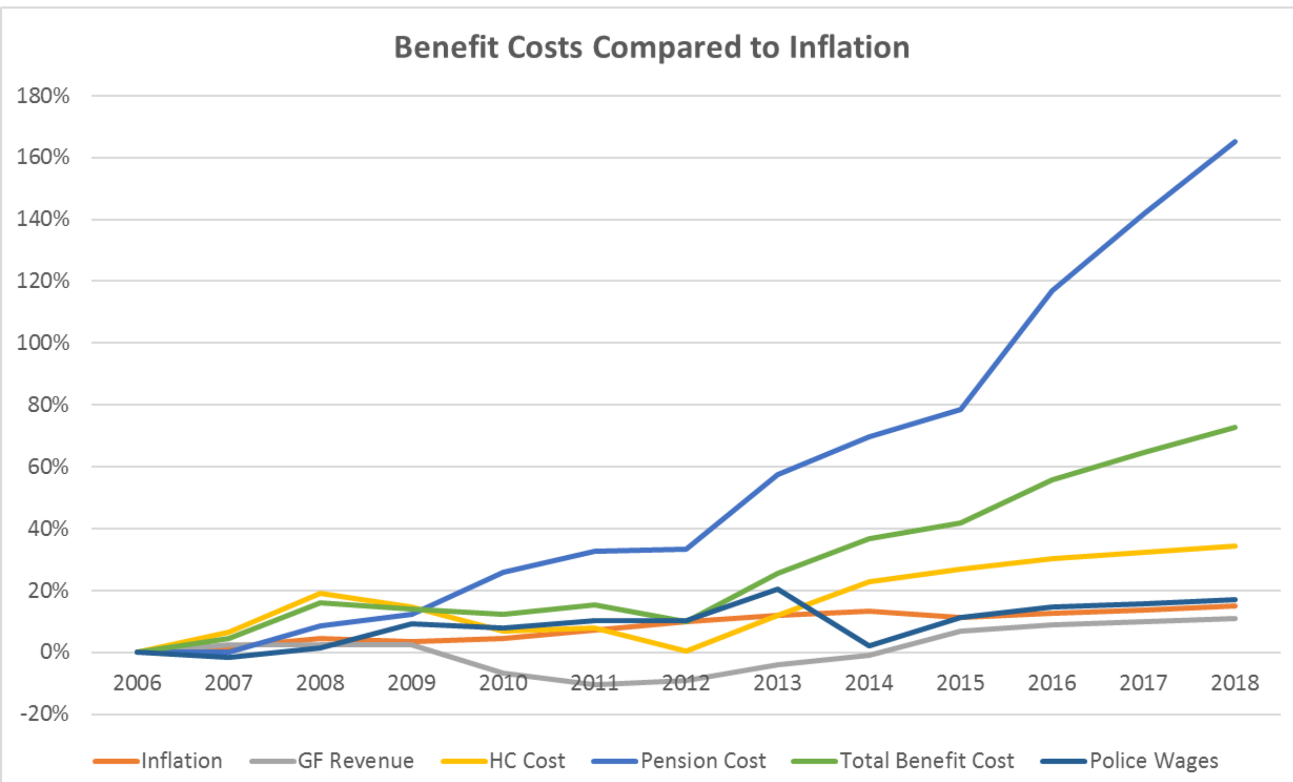
Benefit Costs Compared to Inflation

Another way of presenting costs is to benchmark them to inflation. The following chart shows how costs have increased using 2006 as a baseline. The chart shows that since 2006:

- Inflation has increased 13%
- General fund revenue has increased 9%[1]
- Pension costs have increased 120% (projected to increase by 165% by 2018)
- Total benefit costs have increased 56%
- Health care costs have increased 30%
- Police wages have increased 15%

This chart highlights how pension costs are increasing at a much, much higher rate than both revenues and other benefit and salary costs.

Figure 3. Benefit Costs Compared to Inflation, 2006 to 2018



While increasing health care costs are pressuring the City's budget, we have been able to make changes over the years to contain these costs. The most recent change was switching to a high-deductible plan in 2017.

[1] General fund revenue has increased at a rate lower than inflation due to the loss in property values during the recession and limits on subsequent taxable value growth

How Did the Pension Fund Become So Underfunded?

The City has never skipped or missed a required contribution to the pension fund. Today's underfunded pension problem is due primarily to decisions that were made between 1982 and 1998 to increase pension benefits, reduce employee contribution requirements without paying for those increases at the time. MERS also did not require the City to increase our annual pension contributions to pay for those past benefits increases until recently. Basically, what happened was that pension benefits were increased in the 80s and 90s, but weren't paid for until very recently.

The following table summarizes the pension benefit and employee contribution history for group 02, the police pension group for officers hired before 2011. New police officers hired after 2011 are in different groups with different retirement plans.

Table 1. Group 02 Police Pension Benefit Provision History, 1946 to Present

Year	02 - Police
1946	5% Contribution, 1.7% multiplier
1982	0% Contribution, 1.7% multiplier
1989	0% Contribution, 2.0% multiplier
1992	0% Contribution, 2.25% multiplier
1998	0% Contribution, 2.5% multiplier
2011	2.5% Contribution, 2.5% multiplier
2011	02 – Police group closed to new hires

The table shows that the trend from 1946 until 1998 was to increase benefits and to reduce employee contributions. Every change between 1946 and 1998 was to increase benefits, either through increased pension multipliers, or reduced employee contributions. In 1946, a patrol officer contributed 5% of their salary and received a 1.7% pension multiplier while a patrol officer hired before 2011 now contributes 2.5% of their salary and receives a 2.5% pension multiplier – a much richer benefit at a lower cost.

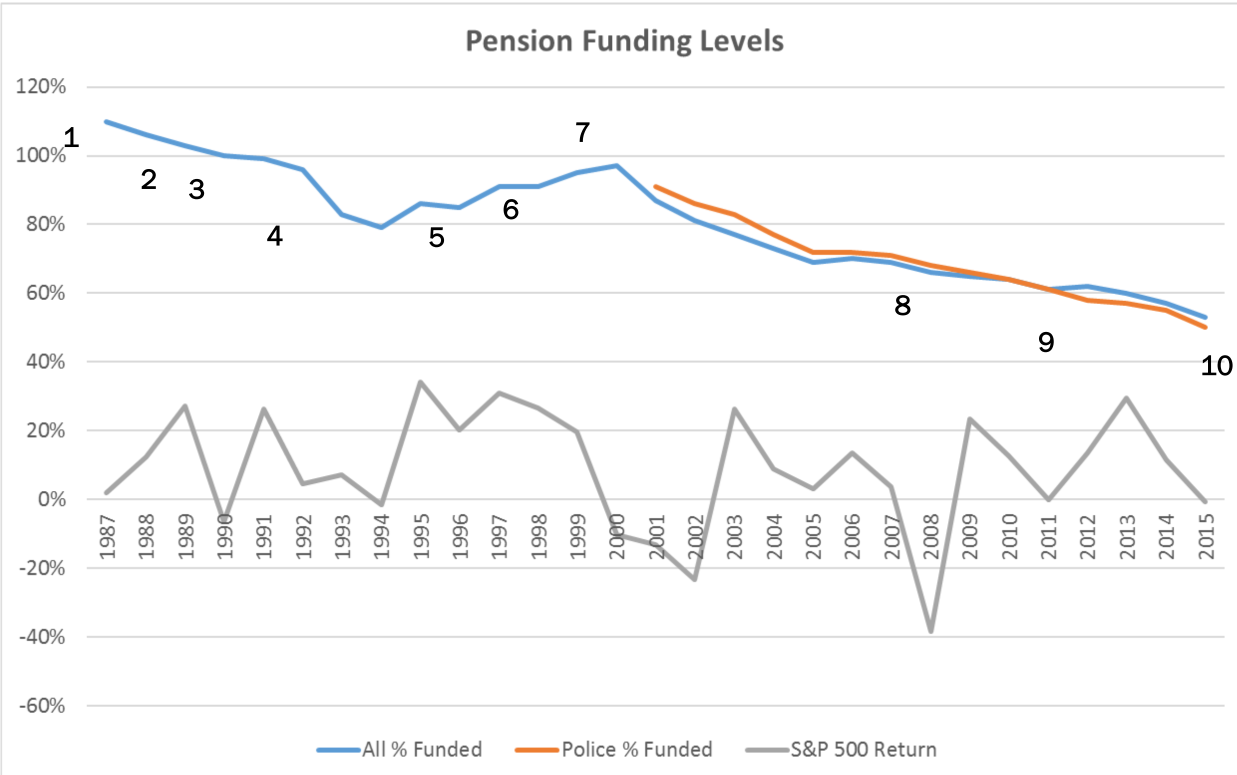
These changes are the primary cause of the situation we are now in. When an employee who contributed into the system for 20 years based on a 1.7% multiplier is bumped up to a 2.5% multiplier, it creates a shortfall that must be paid for eventually. The system only had enough money to pay out a benefit based on the 1.7% multiplier.

Alternately stated, an employee who contributed to the system based on a 1.7% multiplier would hypothetically need $100 in the system to pay their retirement benefit. If that employee was then changed to receive a 2.5% multiplier, there would need to be $250 in the system to pay their benefit. Yet, there was still only $100 in the system. The need for the extra $150 does not disappear, it must be paid by the City eventually.

The unsustainable nature of these benefit provisions led to the closing of these groups in 2011, and the creation of new pension groups with lower benefit levels for police and administrative employees hired after 2011.

Timeline of Pension Funded Percentage and Benefit Changes

The following chart and timeline show graphically the impact of the pension benefit decisions made during the 80s and 90s.



1. 1982 - The change from 5% employee contribution to a 0% employee contribution in 1982 started a downward trend in the percent funded for pensions.
2. 1989 - Police benefits increased from a 1.7% multiplier to a 2.0% multiplier. Funding level decrease continues.
3. 1990 – Administrative employees reduced from 5% to 0% contribution.
4. 1992 – Police benefits increased from 2.0% multiplier to 2.25% multiplier.
5. Booming stock market in the late 1990s generated abnormal gains in the pension fund, temporarily hiding the impacts of the past benefits increases/cost decreases.
6. 1998 – Police benefits increased from 2.25% multiplier to 2.5% multiplier.
7. 2000 – The tech bubble bursts, the early 2000s recession starts, and pension fund returns decrease back to “normal” historical levels.
8. 2001 to Present Day – Through the housing bubble in the stock market, the 2008 crash, or the market recovery to today, funding levels have continued to decline because benefits were increased for past employees above the level that the fund had been funded for, causing the fund to deplete over time.
9. 2011 - 2.5% Police pension group closed to new hires. New group created with 2.25% benefit level.
10. 2017 - 2.25% police pension group closed to new hires. New group created with a hybrid retirement plan that combines a 1.0% employer provided defined benefit with a 401k-style plan.

Actions Taken To-Date to Address Unfunded Liability

The 01, 02, 10, and 11 groups are now closed to new hires. Employees hired after 2011 are in different pension groups with lower benefit levels and higher employee contribution amounts. The pension groups for employees hired after 2011 – groups 12 and 20, are fully funded or nearly so.

The following table is reproduced from the City's most recent Annual Actuarial Valuation Report published by MERS shows accrued liabilities, assets, and funding levels for all the City's employee groups. The full document is available for review at: http://cityofpleasantridge.org/documents/budget/aav2016.pdf

Actuarial Accrued Liabilities and Valuation Assets As of December 31, 2016

Table 6

Division	Actuarial Accrued Liability	Valuation Assets[1]	Percent Funded	Unfunded (Overfunded) Accrued Liabilities
01 - Gnrl Oth				
Active Employees	$ 0	$ 0	0.0%	$ 0
Vested Former Employees	275,696	15,878	5.8%	259,818
Retirees And Beneficiaries	215,865	215,865	100.0%	0
Pending Refunds	0	0	0.0%	0
Total	**$ 491,561**	**$ 231,743**	**47.1%**	**$ 259,818**
02 - Police				
Active Employees	$ 1,054,481	$ 122,435	11.6%	$ 932,046
Vested Former Employees	52,322	0	0.0%	52,322
Retirees And Beneficiaries	2,218,596	1,493,245	67.3%	725,351
Pending Refunds	0	0	0.0%	0
Total	**$ 3,325,399**	**$ 1,615,680**	**48.6%**	**$ 1,709,719**
10 - NonUnion				
Active Employees	$ 735,830	$ 68,146	9.3%	$ 667,684
Vested Former Employees	94,962	94,962	100.0%	0
Retirees And Beneficiaries	684,140	684,140	100.0%	0
Pending Refunds	0	0	0.0%	0
Total	**$ 1,514,932**	**$ 847,248**	**55.9%**	**$ 667,684**
11 - City Mgr				
Active Employees	$ 0	$ 0	0.0%	$ 0
Vested Former Employees	0	0	0.0%	0
Retirees And Beneficiaries	693,891	470,734	67.8%	223,157
Pending Refunds	0	0	0.0%	0
Total	**$ 693,891**	**$ 470,734**	**67.8%**	**$ 223,157**
12 - Non-Union after 7/1/2011				
Active Employees	$ 24,908	$ 25,612	102.8%	$ (704)
Vested Former Employees	0	0	0.0%	0
Retirees And Beneficiaries	0	0	0.0%	0
Pending Refunds	2,263	2,263	100.0%	0
Total	**$ 27,171**	**$ 27,875**	**102.6%**	**$ (704)**
20 - Police as of 7/1/2011				
Active Employees	$ 41,093	$ 36,630	89.1%	$ 4,463
Vested Former Employees	0	0	0.0%	0
Retirees And Beneficiaries	0	0	0.0%	0
Pending Refunds	0	0	0.0%	0
Total	**$ 41,093**	**$ 36,630**	**89.1%**	**$ 4,463**

The City's total unfunded liability is $2,864,137, with nearly 60% of that unfunded liability being in the 02 – Police group. The 02- Police group includes all police officers hired before 2011. Also note that the City has closed group 20 (which was created in 2011) and creating a new hybrid plan for new police officers hired after July 1, 2017. The hybrid plan combines a defined benefit with a 401k-style defined contribution component as a way of further controlling the City's future pension liabilities.

Budget Impact

In 2014, when the City was asking the residents to approve a Headlee Override to increase the local property tax rate, our annual pension contribution was about $200,000. The residents approved the Headlee Override, which generated about $100,000 of net new revenue for the City's general fund to preserve valued City services.[2]

In 2017-18, the City's annual pension payment will be $285,000, by 2022 it will be $373,000, and by the mid 2020s it will be over $425,000. That will represent a **$225,000 increase** over pension expenses in 2014. The increasing pension contribution requirements will soon have consumed the increased operating funding approved by the voters in 2014, and further, the City must find another $73,000 in cuts.

So far we have absorbed the $95,000 annual increase in pension funding through cuts and efficiencies in the general fund while still balancing the budget and adding a little to fund balance every year. However, this year our budget is stretched to the limit to accommodate the pension payment increases.

	15-16	16-17	17-18	Increase 2015 to 2017
Total General Fund Revenue	$2,773,167	$2,679,162	$2,708,833	-2.3%
Total General Fund Expenditures	$2,719,248	$2,679,162	$2,696,404	-0.8%
Pension Expenditures	*$245,502*	*$238,010*	*$295,670*	20.4%
Non-Pension Expenditures	*$2,473,746*	*$2,441,152*	*$2,400,734*	-3.0%
Net Annual Revenue	$53,919	$0	$12,430	

The above table shows that non-pension spending in the general fund has decreased by 3% in the 2015 through 2017 period. Pension expenses, however, have increased by 20.4%, and represent all of the increase in total general fund expenses.

It is worth noting that if the City's millage rate had not been reduced by over 1 mill from 2015 to 2017, providing most residents a reduction in City taxes paid, the City would be collecting over $140,000 more in 2017 than it did in 2015. This additional funding would allow the City to cover the increased pension contributions and eliminate our unfunded liability over time without having to ask the voters to approve a supplemental millage. We anticipate that our millage rate will continue to be reduced in future years, so the supplemental millage request is designed to slow the rate at which taxes are reduced in future years, not raise taxes.

[2] It should be noted that MERS did not provide future pension cost estimates until their valuation report issued in June of 2015. When the City was asking for the Headlee override millage in November of 2014, we did not know what our pension funding requirements would be in future years. This impacted our financial planning ability at the time of the 2014 millage requests.

Now that MERS is providing funding requirements 5 years into the future, we know what our funding requirements are going to be and can plan for the impact of the increases.