MICHIGAN STATE UNIVERSITY | Extension

Legacy Costs Facing Michigan Municipalities

An Update to the 2013 MSU Report: Funding the Legacy – The Cost of Municipal Workers' Retirement Benefits to Michigan Communities [1]

Eric Scorsone, Ph.D.
Samantha Padilla, Ph.D.c.
Danielle Kamin, Ph.D.c.
Mary Doidge, Ph.D.c.

Center for Local Government Finance and Policy
Michigan State University (MSU) Extension and MSU Department of Agricultural, Food, and Resource Economics

[1] Special acknowledgement to our former research assistants Nickie Bateson, Amanda Wright and Traci Taylor for their hard work on these issues

1/8/2016

Table of Contents

Executive Summary

Recovering from the Great Recession of 2008-09, Michigan local governments face many fiscal challenges. The largest of these challenges is legacy costs – the cost burden of pensions and retiree health care. In the 2013 Michigan State University Extension report *Funding the Legacy: The Cost of Municipal Workers' Retirement Benefits to Michigan Communities*, authors Dr. Eric Scorsone and Nicolette Bateson (Scorsone & Bateson, 2013) stated that Michigan cities, villages and townships owed over $13 billion in unfunded legacy costs related to retiree health care and $2.5 billion in unfunded pension costs. These two costs were documented as the largest liabilities facing Michigan local governments. Since that report, the City of Detroit has undergone the largest municipal bankruptcy in U.S. history, and the City of Flint was forced into a state takeover. Both of these city governments managed to reduce their retiree health costs significantly. Even with these exceptional circumstances, the majority of Michigan local governments still owe a large unfunded liability related to health care at over $7 billion. Several policy solutions are being proposed including retiree health care bonding and unilateral changes to employee benefits. These ideas are assessed in this paper. Additionally, this report contains information on Michigan county governments not available in the 2013 report *Funding the Legacy*.

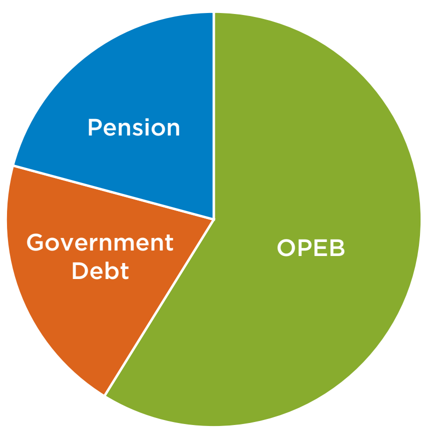
Produced by ANR Communications. 1P-01-2016-Web-PA/MR WCAG 2.0

The Current State of Michigan Local Government Liabilities and Legacy Costs

What are the current total liabilities of cities, villages and townships in Michigan?

As of 2014, the total amount owed by these jurisdictions in liabilities is $11.9 billion. Of this amount, almost $2.5 billion is traditional government debt and another $2.5 billion is unfunded pension liabilities. By far, unfunded liabilities from other postemployment benefits (OPEB) remain the biggest challenge facing these Michigan municipalities at just over $7 billion. The unfunded liabilities, both pension and OPEB, remain the overall greatest challenge into the future. The pie chart (Figure 1) below reveals the overall burden of each type of liability.

Figure 1: 2014 Total Liabilities for Cities, Villages and Townships (Pension, Debt and OPEB)



How have these liabilities changed since the 2013 report *Funding the Legacy*?

The 2013 report *Funding the Legacy* was based on 2011 data[2]. At that time, the biggest liability was still unfunded other postemployment benefits (OPEB) obligations. This new report uses data from 2014. The unfunded pension liability ($2.5 billion) has barely changed since 2011; the same is true of general governmental debt ($2.5 billion). Over the past three years, the overall unfunded OPEB liability has dropped nearly $750 million. However, that amount is based mostly on one jurisdiction, Flint. Therefore, many jurisdictions that owe the bulk of the liability remain at risk due to these liabilities. Even Flint, which has greatly reduced its unfunded liabilities, remains at risk due to the remaining amounts. The overall obligations stemming from unfunded pension liabilities and governmental debt have barely changed between 2011 and 2014.

What are legacy costs?

Legacy costs are based on accrued obligations or liabilities that an organization has due to past investments in labor and capital. These costs would include, for example, costs accrued as an employee works that he or she will earn at retirement. Generally, these legacy costs for governments relate to a pension or annual income payment. They also might relate to a retiree health care benefit also known as other postemployment benefits (OPEB)[3].

When do legacy costs or obligations present a problem?

Considered alone, legacy costs or obligations are not a problem. In fact, government employers use these benefits as a tool to attract a talented labor force. Problems arise when these obligations are not properly funded. To avoid future financial issues, government employers and employees should set aside funds as the employee works. Using this method, money will be available to pay for the benefits when the employee retires. This is known as prefunding. A problem with legacy costs occurs when either no money or an insufficient amount of money is set aside to cover these costs in the future. This is referred to as unfunded costs.

2 This report contains data on 283 cities, villages and townships in Michigan that have a recorded retiree health care plan and unfunded liability as reported in the 2013. This does not represent all local governments in Michigan, which number over 1,800. This does represent the vast majority of large local governments in the state.

3 Legacy costs can also include infrastructure; however, this study focuses on those legacy costs related to labor in the form of pension and retiree health care benefits.

What are other postemployment benefits or OPEB?

Other postemployment benefits (OPEB) may also be referred to as retiree health care. Primarily health care, these benefits may also include dental, vision or life insurance. Offering OPEB in the public sector began as a way to attract high-quality employees from the private sector to accept lesser paying jobs in the public sector in exchange for deferred compensation in the form of generous OPEB packages. In 2013, as stated earlier in this report, OPEB unfunded liabilities were by far the largest source of financial long-term stress facing many local governments in Michigan.

Has the unfunded OPEB situation for Michigan local governments improved or worsened since 2011?

In the 2013 report *Funding the Legacy*, the findings indicated that cities, villages and townships had accumulated an unfunded OPEB liability of approximately $7.9 billion.[4] The funding level of the overall OPEB liability was reported to be 6 percent in 2013. However, this 6 percent included figures from the City of Detroit, which given its size, is likely to skew the numbers. An adjusted non-Detroit funding level from 2013 would be approximately 9.5 percent. As of 2015, the overall funding level is now reported to be 14 percent. Thus, there has been some improvement in the overall funding level for cities, villages and townships in Michigan since the 2013 report (see Table 1). However, in general, the funding level available for retiree health care liabilities is very low compared to the 80 percent generally accepted as standard in the actuarial industry.

4 The figures from the 2013 report exclude the City of Detroit. In the city's historic 2013 bankruptcy filing, the vast majority of its OPEB liability was eliminated. Therefore, this report focuses on figures from the 2013 report *Funding the Legacy* regarding non-Detroit cities, villages and townships.

Table 1: OPEB Funding Level (2011 and 2014)

	2011	2014
less than 1,500	0.0%	1.3%
1,501-5,000	0.0%	5.6%
5,001 - 10,000	0.2%	9.5%
10,001 - 30,000	0.8%	8.3%
30,000 - 200,000	5.0%	16.6%
total OPEB Assets	810,080,965	1,107,303,880
total OPEB liabilties	8,570,508,617	7,915,452,477
overall funding level	9.5%	14.0%

What is the annual required payment for pensions and retiree health care in 2015?

Besides the overall long-term liability associated with legacy costs, an ongoing annual cost issue exists as well. Across all the municipalities in this report, the overall actuarial annual required contribution (ARC) for OPEB is $540 million and for pensions is $350 million. Thus at this time, the total ARC payment is nearly $900 million on an annual basis. This represents almost 20 percent of total government-wide revenues recorded at $4.5 billion. The largest government entities, greater than 10,000 in population, represent the jurisdictions where the legacy cost burden is the highest in aggregate on the budget at 19 percent. For smaller jurisdictions, the burden of legacy costs on the budget is slightly less – as low as 8 percent. However, this is an aggregate figure and individual jurisdictions may appear much worse in some cases across all size categories. (See Table 2.)

Table 2: Annual Required Contribution for Legacy Costs

	Number of Units	Government Wide Revenue	OPEB ARC	% of GW Revenue	Pension ARC		Total	
less than 1,500	11	24,044,364	1,014,266	4%	990,347	4%	2,004,613	8%
1,501-5,000	70	208,812,690	11,618,284	6%	13,515,096	6%	25,133,380	12%
5,001 - 10,000	56	349,866,714	30,361,103	9%	$27,280,394	8%	57,641,497	16%
10,001 - 30,000	88	1,074,714,714	126,319,962	12%	75,452,919	7%	201,772,881	19%
30,000 - 200,000	58	2,911,972,010	372,736,822	13%	230,361,930	8%	603,098,752	21%
total	283	4,569,410,492	542,050,437	12%	347,600,686	8%	889,651,123	19%

Municipal Responses to Legacy Costs

What have municipalities done in response to legacy cost liabilities?

In the face of untenable liabilities and fiscal crisis since the Great Recession of 2008-09, Michigan municipalities have generally used four strategies: (1) increase taxes, (2) decrease spending, (3) borrow to address unfunded liabilities or (4) reduce liabilities in the form of benefit reduction. While reducing benefits is politically unpopular, many municipalities cannot continue to increase taxes because these locations will risk further population decline and foreclosure; nor, can municipalities cut spending any further without substantially impairing or completely eliminating vital public services. As a result, municipalities have been making changes to public contracts to reduce health benefits and thus their overall liabilities. Municipalities are generally making changes to benefits to three areas: (1) the type of health benefit plan available, (2) the level of government contribution and (3) eligibility requirements.

Have any municipalities managed to reduce their OPEB liabilities?

Yes, many municipalities have reduced their OPEB liabilities. According to government financial statements, 146 of the 283 jurisdictions have reduced their OPEB liabilities since 2011. The total reduction amounts to a net dollar value of $750 million. It is net because some jurisdictions, more than half in fact, reported an increase in OPEB unfunded liabilities. For those that reduced their unfunded liabilities, the total dollar value was about $1 billion. To offset that, however, the other half of the jurisdictions saw a nearly $250 million increase in unfunded liabilities.

The following table (Table 3) presents some examples of cities, villages or townships that have reduced their liabilities.

Perhaps, the most notable is the City of Flint, which experienced a variety of fiscal difficulties since the early 2000s, requiring the appointments of a series of emergency managers from 2002 to 2004, and again from 2011 to 2015. During these later years, the emergency managers reduced the city's unfunded liabilities from over $800 million to approximately $260 million due to benefit changes for existing employees, retirees and new employees.

Table 3: Examples of Jurisdictions That Have Reduced OPEB Liabilities

Jurisidiction	County	2014 OPEB Liability	2010 OPEB Liability	% Change
Mackinaw City Village	Cheboygan	22,048	219,317	-90%
Algonac	St. Clair	147,387	1,046,006	-86%
Corunna	Shiawassee	282,261	1,639,187	-83%
Lowell	Kent	432,887	2,002,168	-78%
Keego Harbor	Oakland	4,332,348	6,899,218	-37%
Lowell	Kent	1,497,504	1,595,055	-6%
Flushing	Genesee	6,195,205	15,448,616	-60%
Flint	Genesee	240,525,197	862,302,934	-72%
Muskegon	Muskegon	2,841,000	10,764,000	-74%
Pontiac	Oakland	231,427,530	376,944,932	-39%
West Bloomfield Charter Township	Oakland	6,552,640	32,264,231	-80%
Kalamazoo	Kalamazoo	190,631,174	263,182,000	-28%
Novi	Oakland	3,895,716	10,845,195	-64%
Farmington Hills	Oakland	18,739,815	30,932,963	-39%
Total		707,522,712	1,616,085,822	0.56

Are there other examples of communities that have reduced their legacy cost liabilities?

A few cities have made major reductions in their unfunded health care liabilities.

The City of Grand Rapids has greatly reduced its health care liability over the past several years. The city government (1) closed the defined benefit retiree health care system, (2) instituted premium sharing for retirees and (3) moved all non-vested employees to a defined contribution health care plan. These and other reforms have saved Grand Rapids a significant amount of money and have reduced its unfunded health care liability from $223 million in 2011 to $135 million in 2014.

The City of Kalamazoo has also reduced its unfunded retiree health care liability by a significant amount. Since 2011, the city government cut its unfunded liability by almost $60 million. In addition, since the 2014 audit, the City of Kalamazoo has taken even further steps to reduce health care spending. In spring 2015, city retirees agreed to switch their primary medical insurance provider from the city to Medicare. This will save the city $3.5 million over 30 years (Sundstrom, 2014). The City of Kalamazoo has sustained these changes in addition to the OPEB bonding approach.

What are voluntary renegotiations to unfunded OPEB liabilities?

Voluntary renegotiations are agreed-to changes between the employer or municipality and the workers, retirees or unions. These changes are usually a result of mediation or some other structured negotiation process. Both sides agree to modify, reduce or restructure the type of health benefit plan available, the level of government contribution or the eligibility requirements to preserve the municipality's ability to fund or pay OPEB. A voluntary agreement is certainly a preferred option as both employer and employee will view the potential gains and losses as being mutually acceptable.

What are the negative aspects of voluntary renegotiations to OPEB liabilities?

There are some potential negative aspects to a voluntary reduction especially if a municipality is in a fiscal crisis or state of fiscal emergency. If a municipality attempts to renegotiate public employment contracts, it will likely face the risk that multiple groups of creditors will continue to demand or hold out for a better deal. Additionally, creditor groups, such as retirees, are often so numerous it may be impossible to bring all of these people to the bargaining table or to obtain the agreement of all persons affected by the changes. For these reasons, voluntary renegotiations of public employment contracts have generally not been successful. However, voluntary renegotiations may become more popular among creditors as they fear a pending municipal bankruptcy filing. Generally, a municipal bankruptcy filing would cost the municipality more in the long term, resulting in less available funds to pay for OPEB and thus, workers, retirees and unions may try to agree to changes outside of a bankruptcy proceeding.

What are unilateral reductions of OPEB liabilities?

In a unilateral reduction, one party makes a change to an agreed-upon contractual relationship. Generally, the idea behind the concept is a meeting of the minds between two parties and a shared understanding of a set of exchanges. A unilateral change can occur in a contractual relationship under certain conditions. In the case of retiree health care benefits, many nuances determine if a contractual relationship can be altered and much of it is based on specific conditions.

What legal challenges may face municipalities with unilateral changes?

When municipalities unilaterally alter public contracts, they usually face opposition in the form of legal challenges by unions and employees. Fighting these legal battles can consume money, time and resources. Municipalities facing financial emergencies generally may find it difficult to secure funding for ongoing legal challenges in multiple forums. Unilateral reductions of public employment contracts may also be viewed as counterproductive given that those resources could be used to pay off these liabilities instead of fighting the validity of the reduction. To further complicate this issue, public sector retiree healthcare benefits are not regulated on the federal level by the Employee Retirement Income Security Act of 1974 (ERISA), as are private sector retiree healthcare benefits. Thus, retiree healthcare benefit law varies significantly from jurisdiction to jurisdiction. Additionally, it varies significantly depending on the nature and terms of the contract involved. Because of differences in state law, it is difficult to know when a municipality has the authority to make unilateral modifications to these benefits. Conclusively, OPEB liability is generally regulated on the state level by constitutions or state law and more specifically a particular provision of a union contract and therefore it is difficult to draw any major general principles (Moran, 2010).

How does vesting give rise to a breach of contract claim?

When a municipality attempts to unilaterally modify the benefits provided for in a collective bargaining agreement (CBA) or other public employment contracts, employees, unions and retirees may bring typical breach of contract claims. In a breach of contract claim, one party alleges that another party violated the terms of an agreement. In the case of labor contracts and employee benefits, a key issue is whether benefits vest, which simply means that an employee has an unconditional right or ownership over those terms of employment. An unsettled issue in public sector benefits cases is whether or not retiree health care benefits vest in all cases. This issue is important because vesting determines the changes that can be made to current employee retiree benefits. It also influences whether retiree health care benefits can be altered for those employees who are already retired. Usually, if the benefits are vested then these benefits are protected by contract and not subject to reduction. However, if the benefits are not vested, the municipality can more easily make unilateral changes to the benefits.

When a court is presented with a breach of contract claim that causes it to decide whether or not particular benefits are vested, the court usually looks at the employer's or the government's intent: mainly, whether or not the employer intended the benefits to vest. Because there is little case law on the vesting of public sector benefits, courts generally look to the private sector for guidance. Unfortunately, the private sector is split as to whether or not these benefits vest, or if there should be an inference in favor of, or against, the vesting of retiree health care benefits.

In an important case, *UAW v. Yard-Man, Inc*. (1983), the sixth U.S. Circuit Court, the court stated that as long as a person remains classified as a retiree, it should be inferred that his benefits will continue without interruption. This view is commonly referred to as the "yard man inference." The view holds that the benefits have vested for retired employees, even if the contract under which they were promised has expired. As a U.S. Circuit court decision, this was not necessarily binding on the entire country.

Conversely, in *Bidlack v. Wheelabrator Corp*. (1993), the court rejected the yard man inference in favor of the presumption that "retiree benefits only last as long as the agreement under which they began." It is easy to understand why this interpretation is less protective of retiree health care benefits in the private sector than a court interpretation that chooses to follow the yard man inference. This interpretation allows employers to modify retiree benefits after the contract has expired and thus, provides little protection to those retirees whom the union no longer represents, and to which the employer may have no duty to bargain with.employees. Again, this was a U.S. Circuit court decision and not necessarily applicable to the entire country.

The U.S. Supreme Court has finally provided some clarification on the retiree health care issue in a recent ruling (*M & G Polymers v. Tackett*, 2015). In this important case, the U.S. Supreme Court ruled that retiree healthcare provisions in contracts must be assessed in terms of ordinary contractual principles and that the inference should not be automatically made that these benefits vest for life. This ruling is seen as overturning the principle established in 1983 in the Yard-Man case. In the M & G Polymers case, the U.S. Supreme Court laid out some key issues for future court revisions of this issue including supporting the "traditional principle that courts should not construe ambiguous writings to create lifetime purposes" (*M & G Polymers v. Tackett*, 2015).

Despite this Supreme Court decision, it remains unlikely or at least challenging as to whether municipalities can predict whether or not health care benefits vest in their states, and if they do vest, when the vesting occurs. In *Roth v. City of Glendale* (2000), the Supreme Court of Wisconsin held that benefits vest unless there is express language stating otherwise. Conversely, in *Davis v. Wilson County* (2002), the Supreme Court of Tennessee borrowed an analysis from the private sector and held that these benefits do not vest unless there is express language stating that the benefits will vest. These examples demonstrate the remaining challenges that will exist in addressing the retiree health care challenge at the state level in the public sector.

Has this issue of unilateral reduction and a breach of contract claim arisen in a specific context in Michigan?

This issue has arisen in the context of a specific Michigan situation in a partially resolved and pending case regarding retiree health care between the Harper Woods Retirees Association and the City of Harper Woods. The retirees of Harper Woods banded together via the retirees association and sued the city regarding what was deemed unilateral changes to health care benefits to retired employees. The retirees argued that the city could not unilaterally alter the benefits provided to them. The Michigan Court of Appeals (*Harper Woods Retirees Association v. City of Harper Woods*, 2015) ruled in this case that the trial court had improperly ruled on the case and that a fiscal crisis and rising medical costs could not justify unilateral contract changes.

However, while this part of the ruling can be seen as favorable to retirees, at the same time, another part of the decision may be seen as negative for retirees and retirees associations. Recognizing the recent M & G Polymers 2015 case, the Appeals Court stated that the trial court must determine if the plain language of the contract actually "vests" or confers lifetime retiree health care benefits. Thus, we see already the impact of this recent U.S. Supreme Court decision on a specific Michigan situation. It remains to be seen how the trial court will rule in this case.

Conclusively, this unsettled issue of vesting makes breach of contract claims difficult to predict and causes much uncertainty about the legality of unilateral modification of these benefits, especially as it applies to retirees.

What is a Contracts Clause challenge?

Another legal challenge facing municipalities that try to reduce benefits through unilateral modification is a Contracts Clause challenge through either the state or federal constitution. The Contracts Clause in the U.S. Constitution places a limit on the law-making function of the state or local government, preventing governments from interfering with valid contracts.

How has the Contracts Clause been interpreted in the case of a unilateral change to collective bargaining agreements?

The leading case on Contracts Clause violations based in the U.S. Constitution is *U.S. Trust Co. of New York v. New Jersey* (1977). The basic analytical framework of the U.S. Trust Co. case, considers three questions: (1) Is there a contract? (2) If so, has there been impairment? (3) If there has been impairment, does the reasoning behind the impairment fall within the public policy exception to the Contracts Clause?

However, it is important to note that states and lower courts vary significantly as to how they apply the reasoning articulated in the U.S. Trust Co. case to the unilateral modification of public employment contracts. It is also important to note that healthcare benefits will not always be found to be a contract right (some states have used promissory estoppel or a property theory of law to decide if a unilateral modification is valid), and thus, a different legal analysis may be applicable in that jurisdiction. Professor Stephen F. Befort, in a 2011 article in the *Buffalo Law Review*, discusses and lists the inconsistencies of lower courts in applying the U.S. Trust Co. case decision (Befort, 2011). This paper will not try to reproduce his work in full here, but rather provide a brief summary of his findings based on Befort's extensive analysis of case law.

First, Befort identifies the factual issues that the courts have most heavily relied upon in deciding the contracts clause issue. These factual issues are important because the facts will vary from case to case, and thus, show that the application of this analysis turns on a fact-specific inquiry. The facts, which Befort identifies, include:

1. The Severity of the Fiscal Emergency;
2. Foreseeability ("whether the government's economic problem was foreseeable");
3. The Substantiality of the Impairment ("the severity issue");
4. The Availability of Alternatives;
5. Timing (whether the actions taken by the state or local government are temporal in nature; and
6. Sharing the Pain (whether retirees and employees shared a "disproportionate share of the burden occasioned by the fiscal crisis").

Second, Befort identifies the "analytical shortcomings" or inconsistencies of the lower courts in deciding these cases. These inconsistencies include:

1. Varying level of deference given to the government by the courts in making policy decisions;
2. Distinctions between public sector CBAs and other contracts, or the belief that public sector contracts differ from "real" contracts simply because the employees contracted with the government; and
3. Distinctions between public sector workers and other employees, or the belief that public sector workers owe a duty of extra loyalty to government employers.

(Befort, 2011)

These inconsistencies also make it incredibly difficult to predict when a municipality will be found to be in violation of the Contracts Clause when the legislature attempts to impose unilateral modifications to public contracts.

Additionally, many states also have contracts clause provisions identical to the U.S. Constitution. For example, the Alaska Supreme Court has interpreted the Alaska Constitution as providing protection for retiree health care benefits. In *Duncan v. Retired Public Employees of Alaska, Inc*. (2003), the Alaska Supreme Court held that health insurance benefits were protected from diminishment or impairment by the Alaska Constitution. In contrast, the Michigan Supreme Court has interpreted a nearly identical constitutional provision as not extending protection to retiree health care. Article IX, Section 24 of the 1963 Michigan Constitution states: "The accrued financial benefits of each pension plan and retirement system of the state and its political subdivisions shall be a contractual obligation thereof which shall not be diminished or impaired thereby" (Michigan Constitution, 1963).

What communities in Michigan have used a bond funding strategy?

To date, seven Michigan communities have attempted to use bonds to fund unfunded liability costs to address their problems. In early 2015, Macomb County issued OPEB bonds totaling $263 million with an interest rate of 3.88 percent (Devitt, 2015b). The bonds were a general obligation limited tax issue and were rated Aa1 by Moody's (Moody's Investors Service, 2015). They were intended to pay off the unfunded retiree health care liability and provide financial stability to the county budget.

Saginaw County is another example of a jurisdiction that has attempted to use bonding to address an unfunded pension challenge. In January 2014, Saginaw County issued $52 million in bonds. Using the same structure as used in Macomb County, the strategy generated savings of $15 million over 15 years (Devitt, 2013; Tower, 2013). This was in response to the reality that Saginaw County participates in the Municipal Employees' Retirement System (MERS). MERS was requiring the county to increase its pension contributions substantially in accordance with widely accepted actuarial principles. Saginaw County can use the bond proceeds to pay MERS and stabilize pension payments instead of seeing a major increase. Saginaw County's bonds were issued with a 4.44 percent interest rate.

In September 2015, the City of Farmington received approval from the city council to go ahead with the issuance of OPEB bonds (Kolade, 2015). The council approved up to $8 million in bonds. Currently, the city pays nearly $700,000 a year out of its budget to address the OPEB cost issue.

In late 2014, the City of Kalamazoo issued a total of $90 million OPEB bonds that were rated AA- (Devitt, 2015a). The city's OPEB unfunded liability was initially projected to be $180 million but that was reduced to $130 million. This leaves about $30 million in unfunded liabilities remaining.

In total, seven municipal and county governments have engaged in legacy cost bonding. The total bonding was $823.8 million, occurring from 2013 through 2015. The biggest bonding jurisdictions were Oakland and Macomb counties in southeastern Michigan. (See Table 4.)

Table 4: Michigan Jurisdictions Issuing Legacy Cost Bonds

Jurisdiction	Dollar Value of Bonding	Type of Unfunded Liability
Macomb County	$263 mil.	Health care
City of Kalamazoo	$100 mil.	Health care
Saginaw County	$75 mil.	Health care
Oakland County	$350 mil.	Health care
Allegan County	$18.6 mil.	Pension
City of Farmington	$7.9 mil.	Health care
Charter Township of Shelby	$9.3 mil.	Pension
Total	**$823.8**	

Michigan County Governments and Legacy Costs

The 2013 report *Funding the Legacy* did not contain data regarding county governments in Michigan. This report *Legacy Costs Facing Michigan Municipalities* does discuss the OPEB and pension legacy cost issues facing Michigan's 83 county governments.

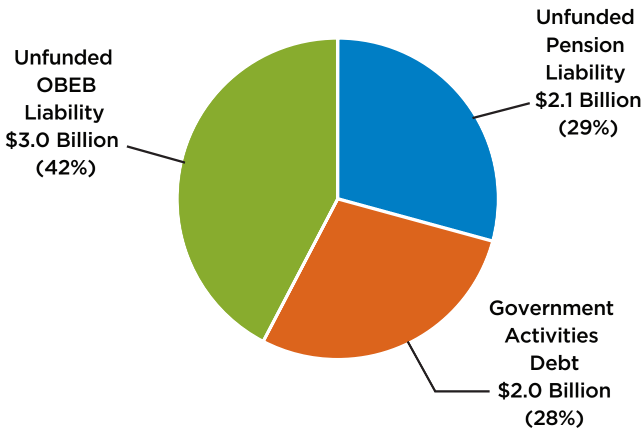
What are the basic financial facts of Michigan county governments?

The total government-wide revenues of the 83 county governments is $4.5 billion. These county governments provide services such as medical and public health services, drain control and environmental control, jail operations and police road patrol, tax collections and treasury, election oversight, and judicial and prosecutorial functions.

What are the unfunded legacy costs facing Michigan county governments?

In total, Michigan county governments owe approximately $3 billion in unfunded OPEB liabilities and $2.1 billion in unfunded pension liabilities. Nearly all of the counties (85 percent) offer a pension benefit and have a recorded set of pension assets and liabilities. A smaller number (about 65 percent) report having an other postemployment benefit and liability. Figure 2 reveals the total liabilities of Michigan counties broken down by governmental debt, unfunded OPEB liabilities and unfunded pension liabilities. Counties owe about $2 billion in general governmental debt.

Figure 2: Michigan County Long-Term Liabilities (2014)



What are the county funding levels for pension and OPEB legacy costs?

For pensions, Michigan county governments are funded at an average of 80 percent, across all size ranges. Considering all factors, this is a relatively healthy funding level.
For OPEB, however, the story is much less optimistic. Currently, the overall funding level is only 21 percent and, in fact, much lower for all county governments below the 200,000 size range. This means that county governments have a significant amount of work to address the OPEB-funding challenge. Counties have about $1.5 billion in assets of prefunding to cover nearly $4.5 billion in OPEB liabilities. This compares to $6.4 billion in assets to cover roughly $7.6 billion in pension liabilities. Table 5 provides the overall number of OPEB funding among the counties by size categories.

What are the annual budgetary impacts of the legacy costs on county budgets?

In terms of annual required payments, the counties owe $256 million for OPEB and $190 million for pensions, for a total of $446 million. Thus, approximately 10 percent of government-wide revenues should be devoted to annual required legacy cost contributions. OPEB represents a slightly larger challenge than pension costs. The overall legacy cost burden does vary depending on the population size of the county. Small counties (less than 15,000 people, which is 14 counties) and larger counties (greater than 65,0000, which is 27 counties) both face the largest burden of legacy costs on their government budgets at an average of 11 percent of government wide revenues. The middle-sized counties have a lower average at 6-7 percent of government wide revenues.

Generally, county governments are making equal to or more than their required annual contribution for pensions. On the other hand, they are not currently making the full annual required contribution for OPEB. Counties would need to pay an additional $100 million out of current revenues to make up the current difference between actual and required contributions for OPEB. This would mean additional cuts to county services at a time when county governments are still trying to recover from the Great Recession of 2008-09. Table 6 (on page 12) shows the annual payments that counties are making versus what they are required to make regarding their OPEB liabilities.

Table 5: OPEB Funding Levels for Michigan Counties (2014)

Population Category	Number of Units with Prefunding	OPEB Assets	OBEP Liabilities	Funded Status
Less than 15,000	1	436,354	27,497,934	0.02
15,001 - 25,000	1	437,412	11,918,097	0.04
25,001 - 35,000	3	5,931,152	60,323,096	0.10
35,001 - 65,000	3	6,031,613	50,241,042	0.12
65,001 - 115,000	5	50,312,364	261,211,710	0.19
Greater than 115,000	16	1,505,745,368	4,137,839,976	0.36
Total	**29**	**1,568,894,263**	**4,549,031,855**	**0.34**

Table 6: Michigan Counties OPEB and Pension Annual Payments, Actual and Required (2014)

	OPEB		Pension	
Local Unit Population	Annual Required Contribution (ARC)	Percent of ARC Funded	Annual Required Contribution (ARC)	Percent of ARC Funded
Less than 15,000	2,545,562	40%	5,536,720	100%
15,001 - 25,000	1,054,451	59%	8,384,396	112%
25,001 - 35,000	3,919,665	205%	11,178,554	101%
35,001 - 65,000	3,682,077	65%	12,811,980	125%
65,001 - 115,000	22,076,903	45%	29,610,909	123%
Greater than 115,000	223,409,244	56%	116,421,236	133%
	256,687,902	58%	183,943,795	127%

A comparison can also be made to assess all of county governmental obligations including OPEB, pension and debt. For counties, the unfunded OPEB liability is nearly $3 billion, while unfunded pensions liability is $1.2 billion and total governmental debt is $2 billion. As expected, OPEB unfunded liability is the single largest governmental obligation. The difference between OPEB unfunded liabilities, pension unfunded liabilities and governmental debt is not as great as it is in the city and township government area, yet OPEB unfunded liabilities still remain the single greatest risk to long-term county financial health on average.

What about county pension funding levels?

At this time, county pension systems are on average funded at the 80 percent generally recommended funding level. A few county pension systems are less well funded than this and may require careful oversight and consideration in the future. Table 7 shows the overall funding level of county pension systems by size category.

Table 7: Michigan County Pension System Funding Levels (2014)

Population Category	Number of Local Units with Pensions	Pension Assets	Pension Liability	Funded Status
Less than 15,000	14	111,359,884	147,348,864	0.755756651
15,001 - 25,000	13	171,754,751	221,111,217	0.776779909
25,001 - 35,000	12	274,658,890	364,223,690	0.754093975
35,001 - 65,000	15	321,265,287	407,388,141	0.788597543
65,001 - 115,000	12	939,387,469	1,131,441,703	0.830257066
Greater than 115,000	17	4,604,056,352	5,364,633,507	0.858223837
Total	83	6,422,482,633	7,636,147,122	0.841063239

Conclusion

With the end of the Great Recession of 2008-09 and a recovery in the general economy, Michigan local governments have weathered a difficult decade and a half. There are signs of fiscal stability returning in many parts of the state. However, Michigan cities, villages, townships and counties continue to face the long-term threat of legacy costs related to pensions and retiree health care. The 2013 Michigan State University Extension report *Funding the Legacy*, based on 2011 data, documented that the state's local governments faced a combined burden of $13 billion in retiree health care unfunded liabilities and over $4 billion in unfunded pension liabilities. Since that time, almost three years later (2014 data), the conditions have not changed dramatically. Two cities, Detroit and Flint, have dramatically reduced their retiree health care unfunded liabilities due to extraordinary fiscal emergencies and state intervention. Some other jurisdictions have reduced their overall unfunded liabilities, and others have actually seen an increase since the original report. The net effect is that Michigan local governments still owe nearly $10 billion in unfunded liabilities due to pension and retiree health commitments. These issues must be addressed so that cities can maintain a level of services and fiscal stability and so that employees and retirees can be assured that promised employee benefits can be maintained.

References

Befort, S. F. (2011). Unilateral alteration of public sector collective bargaining agreements and the contract clause. *Buffalo Law Review*, *59*(1), 1-55.

Bidlack v. Wheelabrator Corp., 993 F.2d 603, 608 (7th Cir. 1993).

Davis v. Wilson County, 70 S.W.3d 724, 728 (Tenn. 2002).

Devitt, C. (2013, April 2). Saginaw County is first in Michigan to bond for pension liability. *The Bond Buyer*.

Devitt, C. (2015a, January 5). Kalamazoo latest Michigan city to borrow for retirement debt. *The Bond Buyer*.

Devitt, C. (2015b, March 18). Michigan county reports 3.88% interest on OPEB bonds. *The Bond Buyer.*

Duncan v. Retired Public Employees of Alaska, Inc., 71 P.3d 882 (AK. 2003).

Harper Woods Retirees Association v. City of Harper Woods, Docket No. 318540. (Mich. Ct. App. 2015). Retrieved from http://www.michbar.org/file/opinions/appeals/2015/100115/60919.pdf .

Kolade, S. (2015, October 23). City Council OKs bonds for retiree health care costs. *Birmingham and Bloomfield Eagle*.

M & G Polymers v. Tackett, 135 S. Ct. 935 (2015).

Michigan Constitution. (1963). Article IX, Section 24.

Moody's Investors Service. (2015). *Moody's assigns Aa1 to Macomb County, MI's $263.8M GOLT OPEB bonds, Ser. 2015; outlook remains stable.* Retrieved from https://www.moodys.com/research/Moodys-assigns-Aa1-to-Macomb-County-MIs-2638M-GOLT-OPEB--PR_319265

Moran, J. A. (2010). The OPEB tsunami: Riding the wave of public sector postemployment health benefits. *Buffalo Law Review*, *58*(3), 677–716.

Roth v. City of Glendale, 614 N.W.2d 467, 474 (Wis. 2000).

Scorsone, E. A., & Bateson, N. N. (2013). *Funding the legacy: The cost of municipal workers' retirement benefits to Michigan communities*. East Lansing: Michigan State University Extension.

Sundstrom, G. (2014, April 8). Grand Rapids is addressing legacy costs. *Bridge Magazine*.

Tower, M. (2013, February 28). Saginaw County first in Michigan to bond out pension liability under new state law. *Saginaw News*.

UAW v. Yard-Man, Inc., 716 F.2d 1476 (6th Cir. 1983).

U.S. Trust Co. of New York v. New Jersey, 431 U.S. 1 (1977).