PENSION AND RETIREE HEALTH BENEFITS FUNDING POLICY AND ACTION PLAN

IN COMPLIANCE WITH PA 202 OF 2017

Village of
ST. CHARLES

2018

ADMINISTRATION:
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Deanna Koehler, Village Clerk
Marguerite Fowler, Village Treasurer
Vacant, DPW Superintendent
Vacant, Chief of Police

VILLAGE COUNCIL:
Marie Roe, Village President
Diane Dennis, President Pro-Tem
Diana Kutz, Trustee
James McPhail, Trustee
Christine Neumann, Trustee
Lois Theile, Trustee
Thomas White, Trustee

Prepared by: Matthew S. Lane, Village Manager
Approved by Village Council on April 11, 2018

INTRODUCTION/UNDERSTANDING

In December 2017, Governor Snyder signed into law Public Act 202 of 2017, also referred to as the *"protecting local government retirement and benefits act."* This new law requires all local governments to annually report its unfunded liabilities to the State and create a set of criteria to determine if a particular local government is in "underfunded" status. This legislation creates minimum funding requirements for both pension systems and retiree healthcare, also referred to as Other Post-Employment Benefits (OPEB). In addition it provides for standard actuarial assumptions for determining funding status which will be reviewed and published each year by the Michigan Department of Treasury.

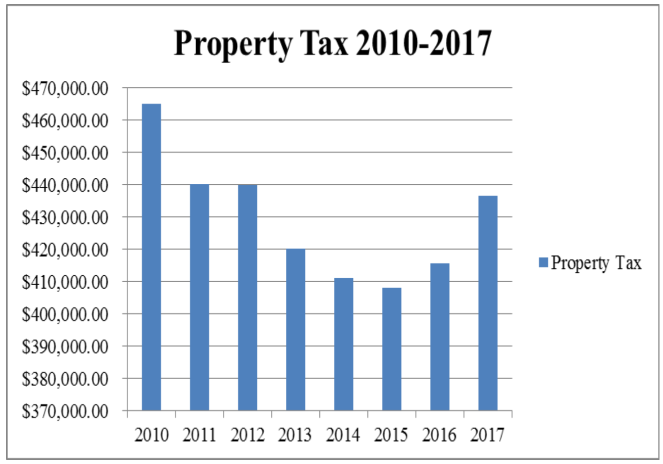
If a local unit of government is determined to be "underfunded" based on the calculations set out in the act, they are subject to review by a governor-appointed panel called the "municipal stability board." This panel is to have three members: one representing state officials, one representing local officials and one representing employees and retirees. The board will determine "best practices" to be used for pension and OPEB systems and will review the annual reports and corrective action plans of local units required to submit them. In addition, local units which fall into the category of "underfunded" may submit an application for a "waiver of underfunded status" to Treasury. This allows them the opportunity to take preemptive measures to address their funding status without triggering a full review.

To obtain a waiver, the application must be accompanied by a corrective action plan which details specific policies, and benefit provisions that either reduces liabilities and removes the system from underfunded status or that adequately funds the current liabilities over time. The specific items outlined in the plan are determined by the local unit preparing the plan. However, the adequacy of the plan is determined by Treasury. If a waiver is approved, the local unit will be required to make progress toward funded status. If the waiver is denied and the plan is not approved by Treasury, it will trigger an "individualized and comprehensive internal review…" of the local unit's retiree benefit systems.

The Village of St. Charles, like many communities across the state, anticipates a determination that at least one of our retiree benefit plans are in "underfunded status." Based on Generally Accepted Accounting Principles and Governmental Accounting Standard Board guidelines set forth in Act 202, our most recent audited financial statements place us within the trigger criteria for our MERS Pension System. However, as matter of policy, and consistency, we will address both components of our unfunded liability in this plan.

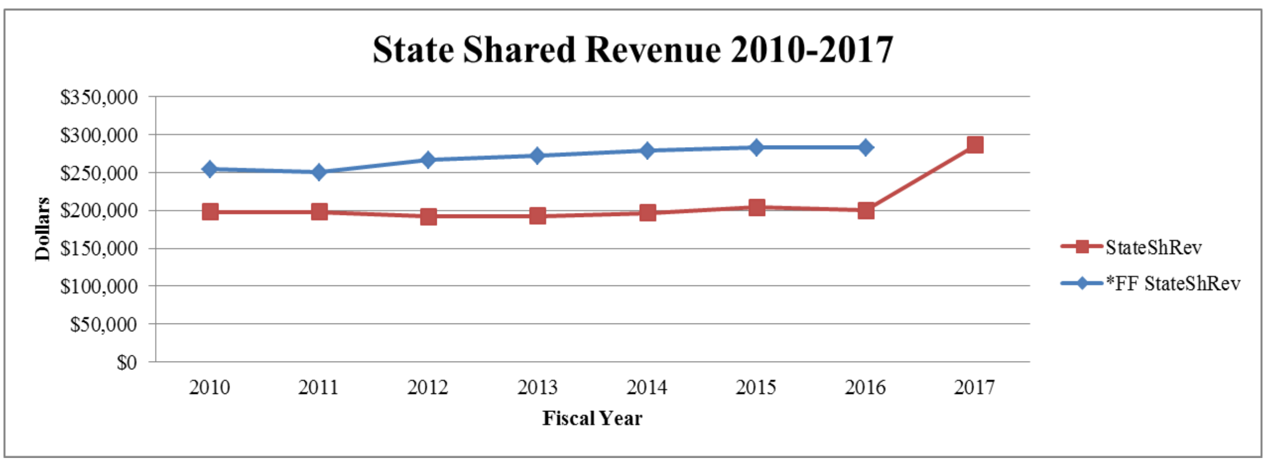
This document serves as the Village of St. Charles' corrective action plan. It will be revisited annually and amended as necessary based on updated actuarial information. It is intended not just for the Michigan Department of Treasury but will also serve as the ***Village of St. Charles Pension and Retiree Health Benefits Funding Policy.***

VILLAGE FINANCIAL CONDITIONS



Since 2003, the Village of St. Charles has seen a cumulative loss of state shared revenue of approximately $859,000. The time surrounding the great recession of 2008 to 2013, general fund revenue dropped over from $949,960 to $815,459. That is a drop over nearly $135,000 from all sources. In the time 2010 to 2015, property tax revenues dropped by 13 percent. This is partially due to the rise of personal property tax (PPT) exemptions. In 2016 and 2017, we saw some modest increases in real property tax revenue and additional revenue from PPT replacements through the Local Community Stabilization Authority. This funding source is not generally seen as stable, however, because of the complex nature of determining replacement payments. In other words, we do not assume we will get it because we do not understand how the payments are calculated.

During the period 2010 to 2016, our state shared revenue has remained relatively flat. As you can see from the chart below, our actual funding level represented by the red line, is consistently $50,000 or more less than what fully funded revenue sharing levels would be, which is represented by the blue line.



Our most recent audited financial statements show an increase in state shared revenue, which is encouraging, but by no means a silver bullet to financial stress. Fiscal years 2018 and 2019 are shaping up to be much better, financially. We anticipate modest increases for most revenue sources. However, the volatile nature of statutory revenue sharing is concerning. While it has been on the rise over the last two fiscal years, the will of the governor and the legislature determines how much statutory revenue local governments will receive. And though infrastructure funding is rising slightly through Public Act 51 and some one-time distributions from the State's General Fund, funding distributions are not adequate for large-scale projects and are simply making up gaps from previous losses.

MERS PENSION SYSTEM STATUS

The Village of St. Charles has been offering its employees defined benefit pensions since 1972. Currently, MERS manages the pension funds for our general employee group, which includes administrative employees, DPW workers and executive management for years prior to September 1, 2014, a police and fire group for employees hired before September 1, 2014 and a new division of all employees hired after September 1, 2014.

Benefit provisions for each group as of the date of our most recent actuarial report (12/31/2016) are outlined as follows:

General DB Division 01 – CLOSED	**TO NEW HIRES**
Benefit Multiplier:	2.5% (80%) Max
Retirement Age:	60 Years—Early 55/20— Early Reduced 50/25---55/15
Vesting:	6 Years
Final Average Compensation :	3 Years
COLA for Future Retirees	2.5% (Non-Compound)
Employee Contribution	0%
Act 88:	Yes (Adopted 12/14/1988)

The General Division currently has 13 plan participants and 5 retirees/beneficiaries.

Police DB Division 02 – CLOSED	**TO NEW HIRES**
Benefit Multiplier:	2.5% (80%) Max
Retirement Age:	60 Years—Early 55/20— Early Reduced 50/25---55/15
Vesting:	6 Years
Final Average Compensation :	3 Years
COLA for Future Retirees	2.5% (Non-Compound)
Employee Contribution	0%
Act 88:	Yes (Adopted 12/14/1988)

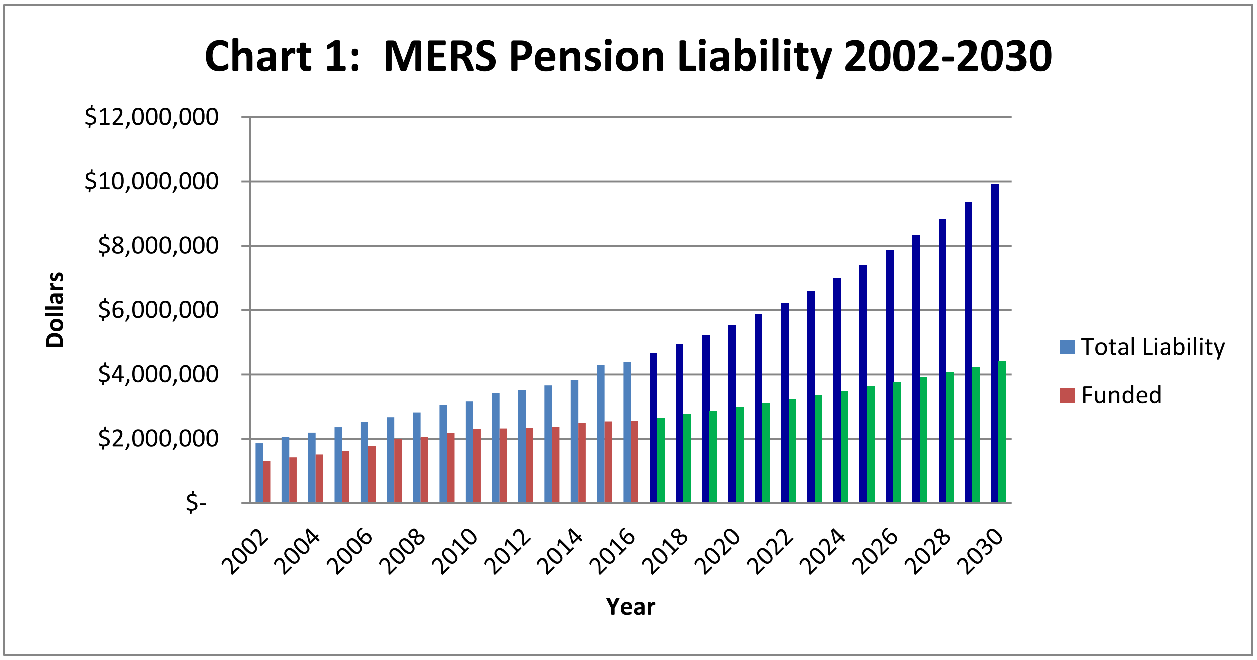
The Police Division has 8 participants, only two active employees and 6 retirees/beneficiaries.

ALL NEW FT DB Division 10	***Open To Those Hired After 09/01/2014***
Benefit Multiplier:	1.5% (No Max)
Retirement Age:	60 Years—Early 55/30— Early Reduced 50/25---55/15
Vesting:	10 Years
Final Average Compensation :	3 Years
COLA for Future Retirees	NONE
Employee Contribution	0%
Act 88:	Yes (Adopted 12/14/1988)

This new division has 1 active employee as of the most recent actuarial valuation and no retirees or beneficiaries. At April 1, 2018 this division will have 3 active employees and anticipates 2 additional to be added as vacant positions are filled.

Our current total MERS liability is $4,378,946. Our valued assets total $2,544,413, bringing our actuarial funding level to **58 percent**. The average increase in liability since 2002 is 6 percent while the average increase in valued assets has been about 4 percent.

That is not an adequate system for positive funding gains and as you can see from the following chart, assuming similar performance for the system, the unfunded status for our MERS Pension liability will grow. As shown by Chart 1 projections from 2017 to 2030 show funding status falling to 45 percent.



This is the complication in St. Charles. In addition to lackluster performance of investments, we have an unbalanced input/output scheme. We have been putting in less each year than it costs to pay out retirees. As of the most recent actuarial report, we also have more retirees than we have active employees. As of 2016, we have only been reducing our assets. As assumptions change, and the market fluctuates we expect our actuarial liability to continue to fluctuate as well. Though our best indication is that, if we do nothing, we only lose ground. That is why we have been formulating and executing a plan to address our status.

Most recent plan changes were adopted in 2014. Both general employee and police employee divisions were closed and a new division was created to house any newly hired employees. The Village reduced its plan multiplier from 2.5 to 1.5, increased the vesting period from 6 to 10 years and eliminated cost of living increases for retirees in the new division. These changes were intended to slow the growth of the long-term liabilities.

MERS FUNDING POLICY AND ACTION PLAN

In fiscal year 2016/2017, the Village of St. Charles began an internal review of unfunded liabilities and began discussing both problems and potential solutions with MERS for increasing our funding level and putting a plan in place to address the concerns we have as a community regarding pension benefits and the associated legacy costs. We have made a series of changes previously to capture the growth of the liability as outlined in the sections above. In our discussions with MERS, we have only a few actions left before our options are exhausted. The first option is to increase required contributions from employees. Currently, employees contribute nothing toward their pension benefits. We have not taken on that change as a policy decision to help maintain a competitive benefit package for recruitment purposes. The last option to capture liability would be to close the defined benefit system altogether and provide a defined contribution plan. This option has been discussed on multiple occasions and has been deemed not feasible for financial reasons. The amortization of the DB plan would accelerate, causing our annual required contribution to triple. This would cause a catastrophic hardship for the Village and prevent us from providing basic public services.

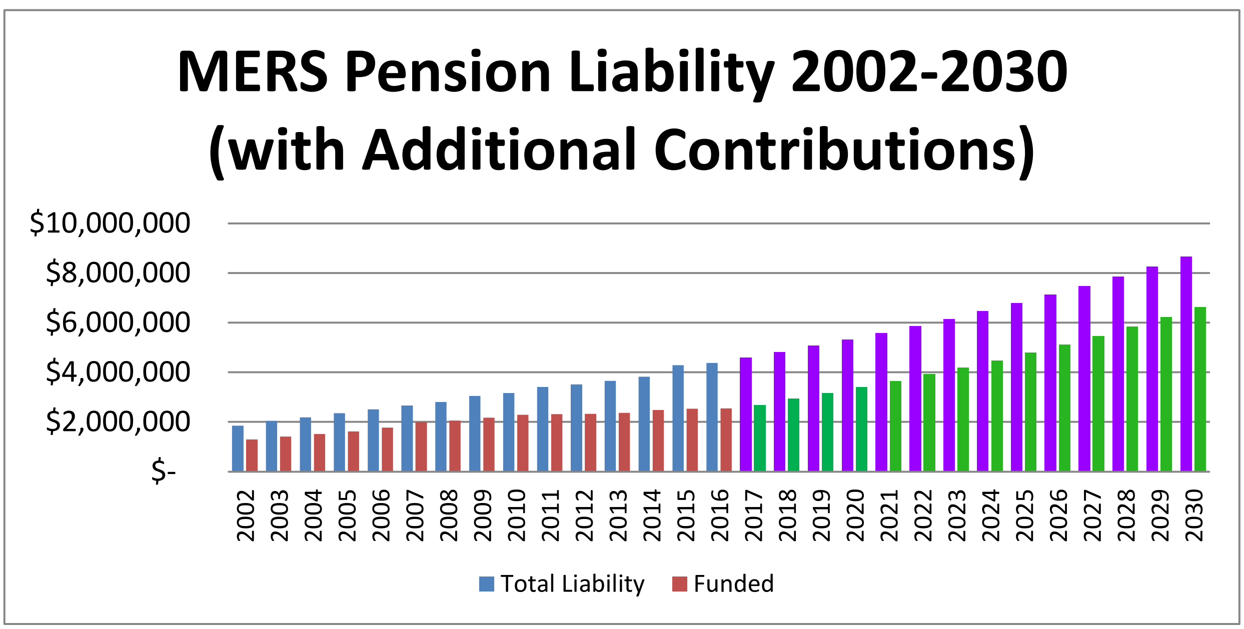
That being the case, the Village Council has made decisions over the last two fiscal years to annually review the financial capacity of the Village to make additional contributions to the MERS system in order to reduce the unfunded portion of the pension liability. This process began in 2016 when the Village began identifying strategic efficiencies in personnel assignments, capital expenditures and in daily operations. In FY 2016/2017, the Village of St. Charles made strategic investments in energy efficient street lighting, which reduced our annual energy bills by $15,000. We made strategic changes in employee allocations to more accurately reflect work experience, restructured employee compensation systems and reduced financial pressure on the general fund. We made investments in technology which save the Village time and money as well streamlined policies and procedures. We made plan changes in our healthcare insurances which reduced overall costs in all funds and began focusing on workplace safety, reducing workers compensation claims, and driving down insurance costs all-around.

The Village also realized large savings in FY 2017/2018 due to turnover in two of our highest paid department head positions. Strategic personnel restructuring along with the operational efficiencies listed above allowed for a large one-time commitment to the MERS DB unfunded liability of $137,400.

In the FY 2018/2019 Budget which was approved by the Village Council March 14, 2018 and commenced on April 1, 2018, the Village has allocated an additional $80,000 to the MERS DB unfunded liability. This is the first year of the Village's new additional funding policy.

The policy statement is this***: In consideration of the financial restrictions of the Village, operational needs to provide basic services to the Public, and economic conditions out of our control, the Village of St. Charles shall contribute an additional $80,000 per year to the MERS DB Pension Surplus Division 1 above the actuarially determined required contributions. This policy shall be reviewed annually to determine its feasibility and adequacy.***

As depicted in the graph below, based on historical liability patterns of our system, we will be 62% funded by 2019, taking into consideration our 2017 contribution of $137,400 and annual contributions thereafter of $80,000.



According to internal "ballpark" projections performed by MERS (attached) at the request of the Village Manager, based on this policy, accelerated funding status resulting in "overfunding" is expected by 2030. This analysis, however, did not take into account the 2017 additional contribution of $137,400 and projects 62% funding in 2022.

RETIREE HEALTHCARE (OPEB) POLICY AND ACTION PLAN

At present, the Village of St. Charles is 0% funded for its retiree healthcare liability, which was $1,299,434 as of our most recently audited financial statements for FY 2017. The policy of the Village of St. Charles, as with many communities, has been on of "pay-as-you-go." We currently pay 100% of the premiums for current retirees as the bills come due for single person health coverage.

As a matter of policy for future retirees, the Village has placed a $500 monthly cap for retiree health premiums for employees hired after April 8 of 2009. The Village would furnish the policy and the retiree would pay the difference in premiums. There are no retirees under this plan. The Village is considering a change to this policy, moving the $500 monthly premium cap to a $500 monthly deposit to a Health Savings Plan, which will allow the retiree to shop and customize their own healthcare solutions based on their individual needs.

The proposed policy statement is this***: In consideration of the service provided to the Village of St. Charles, employees hired after April 8, 2009 will receive $500 per month deposited into a Village sponsored Tax-Free Health Savings Plan Account, beginning the month after the employee retires. Retiree may use this stipend for medical expenses only, in accordance with the rules, regulations, and statutes governing the use of funds held in such accounts.***

This policy allows the Village to remove healthcare inflationary factors from is liability and creates a solid budgetary target for future fiscal years which may contain retirees from this class. The liability in this case would flatten out and be captured to a known variable for each retiree.

In order to address the current underfunded state of the retiree health liability, the Village has been encumbering $30,000 per year since 2017 in anticipation of forming a retiree health trust fund to protect the funds for OPEB liabilities. We anticipate an initial deposit of $90,000 followed by annual contributions of $30,000.

Recommended policy statement is this***: In order to reduce unfunded retiree healthcare liability, to pre-fund OPEB costs for future fiscal years, and consideration of the financial restrictions of the Village, operational needs to provide basic services to the Public, and economic conditions out of our control, the Village of St. Charles shall contribute $30,000 to a legally protected trust fund created solely for the purpose of funding Other Post-Employment Benefits (Retiree Healthcare).***

ADMINSTRATIVE APPROVAL AND ADOPTION BY RESOLUTION

This document was prepared, reviewed and approved by the Village Manager/Chief Administrative Officer of the Village of St. Charles. The policy statements identified in this document were created in conjunction with historical analyses presented herein, projections using the most accurate information available, with advice from experts from the Michigan Municipal Employee's Retirement System, most recently Audited Financial Statements, most recent Actuarial reports, and is feasible based upon the current financial condition of the Village. This policy shall be reviewed annually in conjunction with the each Fiscal Year's Budget process and amended as required to maintain a reasonable balance of funding statuses and adequate services to the public.

ADMINSTRATIVE APPROVAL:_____________________________ __________________

Matthew S. Lane, Village Manager Date

During the April 11, 2018 regular meeting of the St. Charles Village Council, resolution 18-8 was considered to officially adopt the policy statements contained herein. The signed resolution is attached to this document.

OTHER CONSIDERATIONS

As required in Public Act 202 of 2017, each local unit required to submit a report regarding their pension and OPEB systems filed a reporting template sheet which used a legislative formula to determine whether each system was considered "underfunded" or not. The Village was "flagged" as underfunded in our pension system based upon two basic questions outlined in the legislation:

1. Is the system less than 60% funded?
2. Does the Actuarially Determined Contribution (ADC) for the system exceed 10% of ***governmental*** fund revenue?

The answer to both of these questions, objectively, is "yes." However, PA 202 arbitrarily excluded revenue from enterprise funds in the calculation, which artificially inflates the ADC percentage for those who allocate employees to enterprise funds such as water and sewer, as we do.

We allocate roughly 19% of our total employee costs to water and sewer, including the pension liability associated with MERS. When you take this into consideration, PA 202 is adding $26,398 to the governmental funds' ADC that is actually allocated to the enterprise funds, which have revenue in excess of $900,000 to cover their portion of the ADC and unfunded liability additional payments. In fact, enterprise funds are required to account for pension liabilities under principles and guidelines of the Governmental Accounting Standards Board and Generally Accepted Accounting Principles.

Simply removing the 19% of the ADC associated with the enterprise funds' liability, we go from 11.4% of governmental funds revenue to 9.3%. That would remove us from underfunded status and allow us to operate our systems without a waiver or action plan. If we added the revenue from the enterprise funds, we drop to 6.6%. Both scenarios, keep us from having to file waivers and action plans.

Unfortunately, as long as this language remains in the legislation, or the reporting format does not change to accurately reflect allocations to enterprise funds, we will require a waiver each year when we report our numbers to treasury.