



COUNTY OF MILWAUKEE
INTEROFFICE COMMUNICATION

Office of the Comptroller

DATE: October 9, 2015
TO: Chairman Lipscomb, County Board of Supervisors
FROM: Scott B. Manske, Comptroller
SUBJECT: Request to Approve a Change in the Amortization Period of the Pension Fund and to Approve an Additional Payment to the Pension Fund for the Budget/Fiscal Year 2015

Issue

Last year, in its annual funding contribution request to the County Executive, the Pension Board requested a 2015 budget contribution of \$38.3 million. As a result of funding policy changes and the actuary's re-inclusion of cost of living (COLA) liabilities for certain retirees, the actual contribution requirement for 2015 has been determined to be \$57.9 million. This results in an underfunding of \$19.5 million which will be included in the amortization of the unfunded actuarial accrued liabilities (UAAL) as of 1/1/16.¹

The Comptroller seeks County Board approval of the attached resolution. The resolution includes approval of a twenty (20) year amortization period for the UAAL and approval of an additional \$10.0 million payment towards the 2015 pension contribution in order to save \$10.6 million in interest costs that would otherwise be incurred over the twenty year amortization period.

Amortization Period

The Pension Board has recommended that the County Board of Supervisors reduce the current 30-year amortization period for the Unfunded Actuarial Accrued Liability (UAAL) to 20 years. The Pension Board has also implemented other funding policy changes that do not require County Board approval. Those changes are as follows:

- Immediately recognizing expected administrative expenses for the coming year, rather than amortizing them over 10 years;
- Reducing future increases in amortization payments from the current policy (3.5% for ERS and 3.0% for OBRA) to 1.75% annually; and
- Updating the actuarial cost method from Aggregate Entry Age Normal to Individual Entry Age Normal.

¹ In this year's contribution requests, based on the actuarial valuation report, the funding policy changes and the re-inclusion of the COLA for certain retirees, the Pension Board requested a 2016 budget contribution of \$58.6 million. This request is a \$19.9 million increase over the requested 2015 budget contribution amount.

The Pension Board estimated that the amortization change as well as the funding policy changes already implemented increased the pension contribution by \$4.3 million in 2016.

Cost of Living Adjustments

The Pension Board has reported that additional funding would be required due to re-inclusion of COLAs for certain groups of retired individuals. The Pension Board stated that in June of 2015, the actuary reported that it had failed to include in its 1/1/13 and 1/1/14 valuation reports all of the previously included liabilities for COLA adjustments. Re-inclusion of those liabilities resulted in a further increase to the 2016 contribution by approximately \$16.7 million.

In each actuarial valuation, based upon the actual investment results and demographic experience of the pension system, the actuary calculates the actual required contribution for the completed year and compares that amount to the contribution that had previously been estimated and recommended as the budget contribution. The actuary will make a determination if the County underfunded or overfunded its 2015 contribution based on the final results. Based on the re-inclusion of the COLAs and funding policy changes, the County will have a significant underfunding of \$19.5 million for 2015 which will be amortized over 20 years (assuming the County Board of Supervisors implements a 20-year amortization period). The amortization of this \$19.5 million underfunding results in an estimated \$20.7 million in interest that will also be paid.

Analysis

Amortization Period

Industry practices suggest that amortization of the UAAL should 1) use fixed periods, 2) use a period that never exceeds 25 years, but ideally falls in the 15-20 year range, 3) uses a layered approach for the various components to be amortized, and 4) emerges as a percentage of member compensation. Because the County uses a tiered approach for its amortization schedule, contribution variances are amortized over a 5 year period; reimbursable expenses are amortized over a 10-year period; and all other expenses are amortized over a 30-year period. Because of this tiered approach, on average, the County's current amortization schedule is about 20 years. Therefore, it is an ideal time to change from a 30-year to 20-year amortization period to be in line with industry standards and to mitigate any cost increases due to the change.

Cost of Living Adjustment

The actual funding contribution for 2015, based on the results of the 1/1/2015 valuation, is \$57.9 million. Based on the 2015 Adopted Budget, the County will contribute \$38.3 million. This results in an underfunding of \$19.5 million which will be included in the amortization of the UAAL as of 1/1/2016.

Assuming that the 20-year amortization period is approved, the actuary will reestablish the amortization period for the UAAL over a 20-year period beginning with the 1/1/2016 valuation. Any variances that occur prior to the 1/1/2016 valuation will be reestablished as part of the new amortization schedule. Therefore, absent any other contributions, the County would pay \$20.7

million in interest over a 20-year period on an additional \$19.5 million in unfunded liabilities. In order to reduce these interest costs, the Comptroller is recommending that an additional \$10.0 million contribution be made to the Pension Fund in 2015. This additional contribution of \$10.0 million effectively reduces the total amount underfunded in 2015 by \$10.0 million from \$19.5 million to \$9.5 million. This results in interest savings over the 20-year period of \$10.6 million as total interest owed on the underfunding would drop from \$20.7 million to \$10.1 million.

Recommendation

Amortization Period

Based on industry practices and recommendations of the actuary, I recommend that the County Board approve the Pension Board's request to reduce the current 30-year amortization period for the UAAL to 20 years.

Cost of Living Adjustment

Due to significant savings in the County's healthcare expenditures, the County has a surplus of approximately \$15.0 million in healthcare costs. In addition to these savings, the County is projecting additional savings across the County which result in a total County surplus of approximately \$20.0 million. Therefore, to save approximately \$10.6 million in interest costs due to the underfunding of the pension contribution in 2015, I recommend that the County Board approve an additional contribution of \$10.0 million to the Pension Fund, resulting in a 2015 total contribution of \$48,305,000.



Scott B. Manske, Comptroller