# Financial Health Review Team

To: Members of the East Lansing City Council
From: Michael Moquin, Chair, Financial Health Team
Date: January 4, 2017

RE: Summary Report of Activities of Financial Health Review Team

On February 16, 2016, the East Lansing City Council created the 11-mmber Financial Health Review Team ("FHT"). The FHT was established to make recommendations to the City Council regarding the financial health of the City of East Lansing by December 15, 2016. I am pleased to report the FHT completed its work on December 12, 2016. The Office of the City Manager, Department heads and staff were always ready and able to help and support, in particular, detailed financial information. The help provided by the Assistant to the City Manager, and the Communications Coordinator, was invaluable. On behalf of my esteemed colleagues on the FHT - Jill Rhode, Vice-Chair, Douglas Jester, Aaron Harris, Ray Vlasin, Mary Schulz (succeeding Dr. Eric Scorsone in late September), Robert Kleine, Tricia Foster, Sue Haka, and Jeff Hicks - I submit this Report. The FHT was charged with the following mission:

BE IT FURTHER RESOLVED, that the committee shall review issues and gather information, including the use of outside consultants as needed, that is germane to the financial health of the City and shall, report and make recommendations including, but not limited to, the following:

- By July 31, 2016 report and recommend to the City Council means by which the City can address unfunded liabilities in the City's pension and other post-employment benefits;
- Whether, based on the current and projected valuation of real property in the City, the City should seek a Headlee override;
- What, if any, standards, appropriate to the circumstances of the City of East Lansing, should apply to the grant of development incentives;
- Determine short and long-term funding strategies for replacement and repair of City infrastructure, including but not limited to roads, sidewalks, public buildings, water and sewer lines, and trails and recreational amenities;
- What, if any, changes, enactment, or revisions are warranted to stabilize City finances and accomplish the above objectives, including but not limited to all current and potential sources of revenue such as license and permit fees; business and restaurant fees; fines and forfeitures; bonds; real property taxes; personal property taxes; income taxes; and, excise fees;
- What services the City should provide to its citizens, the sustainability of such services, the ability to change, reduce or replace such services and whether the City government is organized in a manner which efficiently and economically can provide such services …

The subjects above led the FHT to create Six Separate Work Groups, to gather information, hold meetings, prepare draft recommendations, vote at the Group level to approve recommendations (whether positive or negative), and then submit the Group Recommendations to the full FHT for review and approval.

The Groups formed were: Legacy Cost, Development Incentives, Real Property, Infrastructure, Revenue Options, and Citizen Services and Communications. Each FHT member chose the Work Group they wished to join, and each member was on at least two Work Groups. Each Group selected its own Chair. As FHT Chair, I decided to 'float' among all groups for purposes of coordinating and managing the collective efforts. All FHT meetings and Group meetings were held in public, and FHT meeting dates, agenda, reports and recommendations once approved, were placed on the FHT page of the City's website.

Beginning with its inaugural meeting on February 29, 2016, and through the final community forum on December 12, 2016, the FHT was very busy.

| | **Recommendations** | **Meetings Held** | **FHT approval date** |
|---|---|---|---|
| 1. | Pension Legacy Cost (Summary, and Recommendations) | 10 | July 20, 2016 |
| 2. | Real Property | 8 | September 26, 2016 |
| 3. | Development Incentives | 8 | November 14, 2016 |
| 4. | Citizen Communications and Services | 5 | November 14, 2016 |
| 5. | Revenue Options | 7 | November 14, 2016 |
| 6. | OPEB Legacy Cost (Other Post-Employment Benefits) | 6 | December 12, 2016 |
| 7. | Infrastructure | 11 | December 12, 2016 |

In terms of overall Financial Health Review Team activities, the first meeting was on February 29, 2016, and the last on December 12, 2016. The FHT met on 12 separate occasions. The Six Work Groups met 55 times. The Citizen Services and Communications Group hosted Six Community forums in the evening at Hannah Community Center: 6/15, 6/29, 10/13, 11/14, 11/28, and 12/12. The Chair presented at two neighborhood association meetings, and twice before City Council.

Overall, the Six Work Group, and FHT, approved seven separate sets of Recommendations. In the aggregate, the full Recommendations totaled 38 pages (excluding Attachments within individual Recommendations). Prominently, at FHT request and Council approval, two consultant reports were provided to FHT: <u>The Income Tax Feasibility Study</u> by Plante Moran (dated October 30, 2016), and <u>Uncompensated Cost of MSU to City of East Lansing's Public Safety and DPW Budgets</u> (dated October 31, 2016) by Great Lakes Economic Consultants, LLC.

In the following Forty-Two (42) Recommendations, only the formal Recommendation from each Report is stated (the full Reports are attached to this document). For convenience sake, the Recommendations appear in the chronologic order approved by the FHT, and to promote flow, all Recommendations are numbered sequentially. Beginning with the Real Property Recommendations following the Pension Recommendations, the original numbering of the Recommendation in the actual report is stated in brackets after the sequential number. To illustrate, Recommendation 15 is the Fifth Recommendation in the Real Property Report, and it appears as 15. [ bullet 5].

## 1. Pension Plan Recommendations (approved 7/20/16)

**1. Changes must be made in the City's pension plan.**

Changes must be made in the City's pension plan, given the fiscal impact of MERS contributions forecast for the next 5 fiscal years (FY 17—21, Summary @ 5). Prompt implementation of a combination of actions to reduce future unfunded liabilities through plan design changes, making additional employer pension contributions, bonding (to a degree consistent with the City's overall bonding authority limits, after considering other pressing needs), and possible income tax revenue. Creative financing mechanisms for police and fire services are available. As of 12/31/2015, police and fire unfunded liabilities comprise 62% (about $50 million) of the overall City's unfunded accrued liabilities of $81 million (Summary @ 4).

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**2. No Changes for current retirees under DB plan.**

FHT recommends no changes to benefits, in amount or in benefit provisions, received by current DB plan retirees (and deferred vested members.

**3. Increase Employee Contributions for DB covered employees**

As a matter of equity, bargain in the future to increase employee contributions to not less than 5.5% of pay for non-uniformed employees, and 11% for police and fire. Bargaining should take into consideration the funded level for the employee group (MERS Division), current contribution rate (if any), and the pattern of compensation increases or concession over the past few years.

**4. Revise the DB plan Final Average Compensation limit ('cap') on overtime and final payouts.**

The City is encouraged to continue to negotiate overtime and personal leave limits in FAC, and work towards a 240-hour (or less) maximum of final payouts in FAC. Doing so will ameliorate the 5% contributions 'load' and reduce future liabilities.

**5. Bridged Benefit: 2.25% Multiplier for future service in the four open-to-new hires DB police and fire divisions: #20, 22, 23, and 50.**

For three reasons, FHT does NOT recommend negotiating a Bridged Benefit. First, the MERS Supplemental Valuation indicates that the potential decrease in future liabilities results in lower immediate contributions—but unless a substantial amount is regularly paid as additional employer contributions, the funded level in 10 years will be largely the same as now. Secondly, considerable time and effort would be expended to implement the Bridged Benefit. Finally, and perhaps more significantly, bridging a defined benefit plan will not allow the City to bond unfunded pension liabilities under 2012 PA 329; see section 9 below.

**6. Close open DB Divisions, and place all current employees and new hires in a Hybrid Plan.**

It is not recommended that a plan-wide Hybrid enrollment for new hires and current employees be pursued.

- If pension bonding is to be employed, then the FHT does not recommend negotiating Hybrid for new hires in the four open DB divisions. DC must be adopted to bond.

- If pension bonding is not to be employed, and new revenue sources exist to pay down unfunded pension liabilities, then FHT recommends closing all open DB divisions and adopting Hybrid for new hires only. This is because current DB employees cannot be compelled to enroll in Hybrid, it is the individual employee's choice whether to convert to Hybrid. MERS Plan Document section 64(2). More fundamentally, the City is far short of meeting the requirement that the City be 80% actuarially funded plan-wide and in the specific employee division affected (the City has a 55% actuarial funded level as of 12/31/2015). MERS Plan Document section 64(1)(c).

**7. Close all DC and Hybrid divisions to new hires, with all New hires in DC**.

The City should engage expert municipal finance analysts and bond counsel to provide advice on this subject of long-term fiscal consequences of this critical matter, in conjunction with overall competing budgetary and revenue projections. Additionally, as the FHT is tasked by the City Council's Resolution of February 16, 2016 with forwarding Recommendations on all items under review by December 15, 2016, it is the Financial Health Team's' further advice that it is prudent to await review and consideration of the final recommendations before taking formal action on these pension recommendations.

**8. Close open DB and Hybrid Divisions, and Adopt DC plan for all Future service for current and new Employees.**

The FHT does NOT recommend this option for several reasons.

- Offering current employees in DB or Hybrid the opportunity to enroll in DC or not requires that the City be 80% actuarially funded (the City has a 55% actuarial funded level as of 12/31/2015). MERS Plan Document section 64(1)(c).

- It is not permissible to compel current employees to enroll in DC for future service; employees' possess the right to individually choose whether to enroll in DC or not. MERS Plan Document section 64(2).

- Recommendation 7 is relied upon.

**9. 2012 PA 329: Pension Bonding for Unfunded liabilities if All DB divisions and Hybrid divisions closed and DC adopted for all new hires.**

Consistent with Recommendation 7, the City should engage expert financial analysts and bond counsel to provide advice on this subject of long-term fiscal consequences of this critical matter, in conjunction with overall competing budgetary and revenue projections, after receipt of the final FHT recommendations

**10. Explore Financing mechanism for Police and Fire Services under 1988 PA 57.**

This item has been referred to the FHT's Revenue Options Group. As of December 31, 2015, the unfunded pension liabilities for the police and fire divisions was about $51 million (or about 63%) of the overall $81 million in unfunded liabilities (Division 14 excluded). It is recommended that PA 57 be considered as part of potential options, in combination with Recommendations 7 and 9.

## 2. Real Property (approved 9/26/16)

**11. [bullet one] Utilize Real Estate Asset Map and estimated market value of real estate assets to educate City staff, council, and public on difference between book value and market value**. Rationale: Book value is based on original acquisition value – a conservative value, while market value demonstrates current values.

**12. [bullet two] Utilize Real Estate Asset Map and market value of real estate assets to understand implications in monetization of assets (net proceeds, additions to tax base) for potential sale or sale/lease-back.** Rationale: Faced with a potential fiscal crisis, this would include assumption on whether monetization and sale would make sense.

**13. [bullet three]. Place on City website most recent Asset Map and estimated values.** Rationale: Educational & Transparency.

**14. [bullet four]. Annually update estate sales. market value of real estate assets annually, 4 to 6 months in advance of budget approval process.** Rationale: Market values change constantly, and annual update is common practice in real estate sales.

**15. [bullet five]. Determine operational expense containment and avoidance measure in relation to the City's real estate assets.** Rationale: Understand if the real estate assets containing buildings/operations are efficient – break-even or greater or net loss.

**16. [bullet six] Utilize DDA (Downtown Development Authority) district map to present a new development; whether inside the DDA district and subject to TIF (Tax Increment Financing*) plan, or outside the DDA district.**

* Tax Increment Financing is a public financing method that is used as a subsidy for redevelopment, infrastructure, and other community-improvement.

## 3. Development Incentives (approved 11/14/16)

**17. [1] Through City Development staff, utilize Real Estate Asset Map (link 1) (as annually updated by City Assessor), Interview answers (link 2), City and Group input, and market statistics to initially (and regularly) educate the City staff, council, and public on the impact of new development for the City.**

**18. [2] Utilize Real Estate Asset Map (link 1) and DDA boundary (link 3) to understand implications in approving projects in each geographic location and how economic incentives may differ by geography.**

**19. [3] Through outreach and professional organizations in which City staff participate (e.g., the Big 10 City Managers group), encourage best of class sharing of ideas with other like size and Big 10 University towns.**

**20. [4] Through a process created by City Development staff as approved by Council, establish and implement a plan to encourage long-term development within the City:**

- **Providing for flexibility with transparency in the process when considering incentives**
- **Improve number and quality of Developers through prequalification with high standards**
- **Empower and hold City employees accountable for the plan**

**21. [5] Through clear Guidelines recommended by Development staff, communicate process and steps leading to council approval, and streamline project approval process to assist in initial expense containment for the Developer.**

**22. [6] Have City Development staff target business, corporate, and institutional occupiers to determine if any City real estate assets (link 1) could and should be utilized to encourage economic development.**

**23. [7] Through direct collaborative meetings between the City and MSU Administration**

- **Identify complementary AND competing priorities held by the City and MSU**
- **Determine how MSU may play a greater role in improving economic development in the City**

## 4. Citizen Services and Communications (approved 11-14-16)

**24. [first bullet] Citizen Communications - to improve citizen communications, we recommend the city undertake a review of the accessibility of its website to community members (particularly considering potential reductions in citizen communications-see budget information).**

Citizens believe the website is not user friendly. The possibility of getting volunteer help to review and make recommendations to improve website communications capability (perhaps through a volunteer citizens group…see bullet point three 26] below) would yield benefits for the citizens and city staff.

**25. [second bullet] City Services** – City staff members were asked to provide proposed budget reductions at 5% (see attachment A) and 10% of city service personnel and programs to maintain the viability of the city budget moving forward. The City Manager's office, Police Department, Fire Department, General Finance, Library, Human Resources, General Fund, and Parks & Recreation all provided details regarding the impact of the two levels of reductions on city services and personnel. All components of the city must stand ready to contribute to the serious shortfall in City revenues. **Thus, we recommend a five percent budget cut managed by the city manager in consultation with the above units. We do not recommend 5% cuts across each unit, but suggest cuts be chosen to minimize the impact on East Lansing citizens and city staff.**

**26. [third bullet] Consultants – City will establish a volunteer network of East Lansing residents and other interested parties who can assist the city to find and implement creative cost savings using volunteers (see Attachment B for a proposal).**

## 5. Revenue Options (approved 11/14/16)

**27. [1] To maintain City services at the present level, IT IS RECOMMENDED that Council seek voter approval of a City Income Tax WITH millage reduction based upon the residential income tax estimated to be paid.**

**28. [2] As an alternative to Recommendation 1 [27], seek voter-approval of a Headlee Rollback to reinstate the City's 20 mills charter authority.**

**29. [3] Pension Legacy Cost Recommendation #10 [10], Explore Financing Mechanism for Police and Fire Services under 1988 PA 57, is incorporated, relied upon and specifically reaffirmed. In addition, FHT encourages the City Council to actively explore combination of services with neighboring communities, in the areas of public safety, the district court, and other service consolidations.**

**30. [4] The City Council is encouraged to continuously review fees for services and permits. The expense of providing a City service or amenity should include the actual cost to the City, including compensation and benefits.**

**31. [5] In the context of Revenue Options, the second Recommendation [25] of the Citizen Communications and Services Group, for a 5% budget reduction, is noted with approval and endorsed.**

## 6. Retiree Health Care (OPEB) Recommendations (approved 12/12/16)

**32. [1] For current employees in those divisions where the City will pay 100% or 97% of the cost once entitled to retiree health benefit coverage, bargain to implement a minimum of 10% retiree & spouse share of the cost.**

State of Michigan Civil Service employees and retirees pay 10% of the cost of retiree health care, until Medicare coverage begins, then the State pays the expense for a secondary-to-Medicare Part B and D plan.

**33. [2] Study moving Medicare-eligible retirees from the present Medicare Advantage Plan to a comparable Medigap plan.**

**34. [3] Study the feasibility of not requiring contributions from a retiree/spouse upon reaching age seventy-five.**

**35. [4] Establish and monitor a robust program for verifying beneficiary health care entitlement (must** be married at MERS retirement date); **and annual verification of no health coverage available at either the retiree's or spouse's current, post-retirement place of employment**.

Additionally, implement (if not in place a 'death check' program) using the Social Security database (perhaps MERS' database) to promptly remove a deceased retiree/spouse from health coverage.

**36. [5] Bonding for OPEB under 2012 PA 329 is NOT recommended.**

The Pension Plan Recommendations, #6, 7 and 9 discussed, and #9 [9] did recommend, that pension bonding be explored by the City. OPEB total liability is $54 million, with $13 million in assets, and unfunded liability of $41 million. In contrast, pension plan total liability is $182 million, with $100 million in plan assets, and unfunded liability of almost $82 million. The City has made considerable strides in revising retiree health care availability in many employee groups, increasing the retiree/spouse contributions, raising the earliest age for health care benefits to be provided, and a host of other actions. For all these reasons, all actions which can further decrease plan liabilities should be explored and taken and the impact assessed on OPEB liabilities, prior to serious consideration of future OPEB bonding.

**37. [6] The City is encouraged to redouble its cost containment initiatives with its Health Care Task Force, as it is clear that such efforts have a measurable positive impact in decreasing (or severely limiting any increase in) actuarial OPEB liabilities.**

Some areas to explore are: over the phone medical assistance, self-insured options, City directly employing physicians (as in a City-sponsored medical clinic), consumer cost comparison for costly services with a sharing of the savings going back to the user. Such actions open up possibilities for the adding of such 'savings' as RHFV contributions so that payment toward the unfunded liabilities may occur, the funded level increase, and required City contributions become more stable and level.

## 7. Infrastructure (approved 12/12/16)

**38. [1] Water and Sewer: We recommend that all necessary work and projects be financed by**

- **State Revolving Fund bonds for sewers, waste water recovery facilities, and water system improvements, and**
- **Increases in water and sewer rates.**

We endorse the November 21, 2016 Memorandum from the Director of Public Works, (Attachment 1, p 3) projecting water and sewer rate increases over 8 years, to finance completion of the required projects within 24 years.

**39. [2] Streets and Sidewalks: We recommend creation of a dedicated fund, with Voter approval. Dedicated revenue sources are not dependent on the City's General Fund on which there are multiple competing demands.**

A dedicated fund is essential for a disciplined and sustainable continuous schedule of street and sidewalk replacement, maintenance, repair and upkeep. We endorse Attachment 1, p 3, to finance street and sidewalk work on a 24-year cycle: with dedicated funding, annual (and variable) general fund financing of $1.8 million to $2.1 million projected over 8 years will not be required.

**40. [3] Parks and Recreation (including Hannah Community Center): We recommend creation of a dedicated fund, with voter approval. Dedicated revenue sources are not dependent on the City's General Fund on which there are multiple competing demands.**

A dedicated fund is essential for a disciplined and sustainable continuous schedule of ongoing necessary repairs to Parks and Recreation facilities. We endorse the November 22, 2016 Memorandum from Timothy McCaffrey, Director of Parks & Recreation, detailing Capital Reinvestment "Necessary" Needs for Facilities on a recommended 15-year cycle, and "Necessary" capital improvements replacement schedule on a the recommended 25-year cycle.

**41. [4] Dedicated funds to implement Recommendations 2 [39] and 3 [40] could be created as a component of a Headlee Rollback re-instating the City's 20 mill charter authority (from the present 17.5891 mills), with millage revenues generated by 2.4109 mills spread on an annual basis into separate funds:**

- **Streets and Sidewalks Fund, 1.6876 mills (about $1.8 million), and**
- **Parks and Recreation Fund, 0.7233 mills (about $633,000).**

This recommendation might mean that each year, transfer of about $267,000 from the general fund would be needed (difference between dedicated amounts in Recommendations 4 [41] and 5 [42]), after it has been determined that project efficiencies or other sources of funds are not available. This details Revenue Recommendation # 2 [28].

**42. [5] Dedicated funds to implement Recommendations 2[39] and 3[40] could be created as a component of a voter-approved City Income Tax (with, or without, a residential property tax millage reduction), with income tax revenues of $2.7 million spread on an annual basis into separate dedicated funds:**

- **Streets and Sidewalks Fund $1.9 million, and**
- **Parks and Recreation Fund, $800,000.**

This details Revenue Recommendation # 1 [27].

**End**