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Painful cures

Local governments are stretching to pay for previously unaccounted retiree health care benefits.

Time to check up on retirement savings

The U.S. Senate has proclaimed the week of Oct. 22-28, 2006, as National Save for Retirement Week, the first congressionally endorsed national campaign dedicated to promoting retirement saving and encouraging employees to save in their employer-sponsored plans. A Senate resolution passed on Sept. 13, 2006, cites the inadequate savings rate among all workers (e.g., half of all Americans report less than $25,000 in total savings and investments) and says the campaign is intended to raise "public awareness about the importance of adequate retirement savings and the availability of employer-sponsored retirement plans."

Many public sector workers have become complacent about retirement saving because they believe that their pension plans and Social Security benefits will provide adequate coverage. However, that is unlikely given longer life spans and rising health care costs. Statistics show that only 30 to 40 percent of government workers participate in employer savings plans, according to the Washington-based ICMA-RC.

The Lexington, Ky.-based National Association of Government Defined Contribution Administrators and ICMA-RC are promoting the week among public sector employers. ICMA-RC has created a Web site (www.icmarc.org/save4retirement) with resources cities and counties can use to help build interest in the program among their employees. The site includes sample announcement e-mails, articles for internal newsletters and handouts. It also links to a calendar of suggested events local governments can host for employees that mix fun activities, such as movie matinees and trivia challenges, and serious discussion about retirement. Other documents include flyers, paycheck stuffers and model press releases employers can use to gain exposure in the local media.

National Save 4 Retirement Week
Helping Workers Build Retirement Security

Fact: More than half of all workers report less than $25,000 in total savings and investments.* Forty-one percent of workers between the ages of 45-54 report the same amount.**

Fact: Four out of 10 people aged 55 or older, have less than $100,000 saved toward their retirement.**

Fact: Research indicates that workers may need 80 to 100 percent of their current income in retirement.***

Oakland County, Mich., has been funding the projected costs for its retired workers' health care benefits for more than 20 years. Even with impending changes in public sector accounting rules, the county believed it could cover the expenses.

But, when the county estimated the cost of actually paying for the promised health care benefits for the 2007 fiscal year, it found a 46 percent increase over the 2006 fiscal year. At that point, Doug Williams, the county's retirement administrator, decided it was time to explore other means to fund the soaring costs for retiree health care. "We had a plan ready to go," Williams says.

His idea was to fund the liability for retirement health care just like any other liability. To do that, the county borrowed money through a bond offering to cover the costs and pay it back over time, taking advantage of its pristine AAA credit rating and strong balance sheet.

Oakland County's approach to solving its retiree health care liability cost is just one of many options available to local governments as the deadline nears to implement the new rules from the Norwalk, Conn.-based Government Accounting Standards Board (GASB) for handling the promised benefits. The new standards will take effect after Dec. 15, 2006, for governments with gross receipts of more than $100 million. The first major year-end reporting date for employers on a July-June fiscal year is June 30, 2008.

Many cities and counties are waiting to follow the new rules, believing that ratings agencies will not immediately penalize those that do not address the liability. Other governments are actively preparing for what many believe will be a financial shake-up in the public sector.

Demanding new rules

The GASB rules, which were issued in 2004, force cities and counties to account for the estimated $1 trillion worth of liabilities that promise retiree health benefits. The rules cover all other post-employment benefits (OPEB) except pensions, but health care is the primary benefit affected.

Many local governments have not been accounting for the cost of retiree health benefits. But now, to stay in compliance with GASB standards, they are required to report annually both the accruing costs of retiree health benefits for active employees, and a portion of the unfunded liability accumulated from prior years. The good news, though, is that governments will be allowed to spread any unfunded liability over as many as 30 years.

Credit ratings agencies have stated that they will consider the retiree health care liabilities when they rate the credit worthiness of a government's bond issue. The ratings directly affect the interest rate that the government pays on bonds.

So, governments are left with a dilemma: Do they ignore the issue and wait to see the effect on their ratings? Or, do they create a tiered system, reducing the level of benefits (and liability) for new employees while deferring action on the accrued liabilities? Or, do they meet the issue head-on by changing the benefits and resolving the liabilities issue? Each approach has implications for employee relations as well as budgets because funding the long-term liability affects local services and employee wages.

A number of cities and counties have adopted creative strategies to meet the GASB rules. They vary in approach and the extent to which they will resolve the financial obligations. At a minimum, they show that some local leaders are beginning to confront the inevitable.

Selling bonds to cover costs

In Oakland County, the idea to sell bonds to cover the liability for retiree health care developed over time. The tipping point was when the county realized how much it needed to set aside for the current year to keep up with the estimated cost of the program.

Unlike many communities, Oakland County already had taken steps to control its retiree health care costs. Active employees must now wait longer to become vested in the benefits, while new hires receive only a defined contribution benefit. To pay for its vested retirees' benefits, the county began in 1988 setting aside an actuarially determined amount of $265 million, based on the actuarial method chosen and a 40-year amortization period. Because of a change in the county's 30-year amortization period and a necessary change to their accounting method, the county's total current accrued liability is $752 million.

To cover the remaining $487 million, the county annually pays what it needs to keep current to an irrevocable retiree health care trust. In 2005, that payment was $28 million, and in 2006, it was $37.5 million. The county calculated that $46 million would be sufficient to cover 2007's costs, but rising health care expenses and long life expectancies pushed the county's 2007 bill to $54.8 million.

The county plans to float a $500 million bond to cover the outstanding liability and provide a cushion for expenses. County officials figure they can sell the bond at a 5.5 percent interest rate and then invest the proceeds at 7.5 percent, as they do with their other defined benefit plans. The county will know exactly how much it owes each year, and the 2 percent increase will cover the 2007 shortfall and other future expenses — an estimated $145 million over the life of the 20-year bond.

However, because the county is investing the proceeds for extra income, which is not allowed on tax-free bonds, it must sell the bonds on a taxable basis. The county also needs the state legislature to change the law to allow it to sell bonds for retiree health care in the same way they are sold for pension obligations. Otherwise, the county will have to pay higher interest on less marketable securities. "Retiree health care is already a liability," Williams says. "Why not fund it every year like it is a liability?"

Monroeville, Pa., also is confronting its retiree health care costs by limiting the numbers of workers who can join the program. Through arbitration, the municipality also substituted its post-employment health care plan for a savings plan that places $1,000 per year into public employee accounts. The savings plan allows employees to invest in mutual funds like they would in deferred compensation plans. At retirement, employees can use the assets in their account for health care expenses.

The changes resulted from severe "sticker shock," says David Kucherer, a city councilman who is chair of the financial policy committee. Believing its balance sheet was under control, Monroeville leaders estimated a manageable liability of $12.5 million. So, they were stunned when the actuaries came back with a $28.2 million liability.

Monroeville had $6 million in a reserve fund that it shifted against the liability. The accounting maneuver decreased the liability to a more reasonable $22.2 million without forcing any tax increase. The municipality is considering how it will address the remaining liability. Kucherer says that the community does not have to report its liabilities under the GASB guidelines until December 2007. "We're way ahead of the game," he says.

As for the "sticker shock," Kucherer says he sees a positive side to the actuarial assessment. "I'm glad we found out about it," he says. "No one knew before. It was a wake-up call." ACC

Washington-based ICMA-RC contributed this article.

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