Legislative Analysis

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MUNICIPAL BONDS FOR RETIREE HEALTH CARE

House Bill 4074
Sponsor: Rep. Mary Valentine

House Bill 4075
Sponsor: Rep. Marc Corriveau

House Bill 4077
Sponsor: Rep. James Marleau

Committee: Judiciary

Complete to 2-10-09

A SUMMARY OF HOUSE BILLS 4074, 4075 AND 4077 AS INTRODUCED 1-22-09

The bills would amend the Revised Municipal Finance Act (MCL 141.2101 et seq.) to allow eligible counties, cities, villages, and townships to issue municipal securities (bonds) through September 30, 2010 to pay for the costs of unfunded accrued retiree health care benefits.

- House Bill 4075 would authorize eligible counties, cities, villages, and townships to issue municipal securities (bonds) to pay for the costs of unfunded accrued retiree health care benefits and set forth requirements and approval procedures for this type of bond issuance.

- House Bill 4074 specifies that the bonds issued would be secured by the general fund of the local unit and could include the phrase "general obligation limited tax" in the resolution authorizing the issuance. It also specifies that a local unit issuing securities without voter approval would not be authorized to levy any tax not authorized by law at the time of the issuance to pay for the municipal securities.

- House Bill 4077 would add definitions of "health care trust fund" and "unfunded accrued liability" to the act.

The three bills are tie-barred, meaning that none will go into effect unless all are enacted. Following is a more detailed description of each bill.

House Bill 4077 would add definitions of "health care trust fund" and "unfunded accrued liability" to Section 103 of the act:

- "**Health care trust fund**" would mean a trust or fund created in accordance with the state Public Employee Health Care Fund Investment Act, or other state or federal statute, and used exclusively to provide funding for post-employment health care benefits for public employee retirees. The term also would include the retiree health fund vehicle administered by the Municipal Employees Retirement System for a local unit of government that had adopted that system to provide funding for retiree health care benefits.

- "**Unfunded accrued liability**" would mean the difference between the assets and liabilities of a health care trust fund as determined by an actuarial study conducted under Governmental Accounting Standards Board Rule 43 or 45.

House Bill 4075 would add Section 518 to the act to allow eligible counties, cities, villages, and townships, through September 30, 2010, to issue municipal securities (bonds) to pay for the costs of their unfunded accrued retiree health care liabilities. Eligible counties would be those with a credit rating in "the category of A or higher."

Bond issuance not to be construed as contract. The bill states that issuance of bonds to help pay for retiree health care benefits does not necessarily mean that the municipality is obligated to pay the benefits or cannot reduce them. A bond issuance under this act would not constitute a contract to pay for such benefits.

Limited bond issuance authorized by resolution or ordinance without approval of local voters. A bond issuance under Section 518(1) would be authorized by adoption of a resolution or ordinance and would *not* require approval of local voters, provided the amount of taxes needed to pay the principal and interest, together with taxes levied for the same year, did not exceed the limit authorized by law. (In contrast, under Section 518(3) a local unit could issue municipal securities pledging its unlimited taxes to pay the costs of an unfunded accrued liability with a resolution *and* the approval of local electors.)

Public notice; petition for a referendum. Before issuing the municipal securities, a local unit would have to publish a notice of intent meeting the requirements of Section 517(2) (the section of the act generally setting forth requirements for the issuance of municipal securities for the payment of capital improvement items), except that voters would have 60 days, instead of 45 as in the case of capital improvement bonds, after the publication of the notice of intent to file a petition for a referendum. A petition would need the signatures of at least five percent of registered electors, or 10,000 registered electors, whichever was less (instead of at least at least 10 percent of registered electors, or 15,000 registered electors, whichever is less, as in the case of capital improvement bonds).

Use of proceeds; trust funds. The bill would permit the proceeds of the municipal security issuance to be used to pay the costs of the bond issuance. The proceeds of the bond issuance would have to be deposited in (1) a health care trust fund; (2) a trust fund which has as its beneficiary a health care trust fund; or (3) in the case of a county, city, village, or township, a restricted fund within a trust that would only be used to retire municipal retiree health care securities. A local unit could create a new trust which would be required to invest its funds in the same manner as a health care trust fund, use generally accepted accounting principles, and maintain tax exempt status under the Internal Revenue Code.

Comprehensive financial plan. Before issuing the municipal securities, a local unit would also have to prepare and make available to the public a comprehensive financial plan. Such a plan would have to include:

- Evidence that issuance of the securities, together with other funds, will be sufficient to eliminate the unfunded accrued liability.
- A debt service amortization schedule and a description of the actions required to satisfy the schedule.
- A certification by the person preparing the plan that the comprehensive financial plan is complete and accurate.
- Documentation that the issuance of the municipal securities will result in projected present value savings regarding the unfunded accrued liability.
- A plan in place from the county, city, village, or township to mitigate the increase in health care costs, which could include a wellness program.

Limit on outstanding securities as a percentage of local property values. The municipal securities issued and outstanding could not exceed five percent of the state equalized valuation of the property assessed in the county, city, village, or township issuing the securities.

Indentures and other agreements. A local unit issuing municipal securities to pay for retiree health care could enter into indentures or other agreements with trustees and escrow agents for the issuance, administration, or payment of the municipal securities.

Limit on cumulative outstanding securities as a percentage of unfunded accrued liabilities. Municipal securities could not on a cumulative basis exceed 75 percent of current unfunded accrued liabilities for retiree health care benefits owed to employees of the local unit existing on the bill's effective date.

Eligible local units. A county, city, village, or township could not issue a security under the bill unless it had been assigned a credit rating in the A category or higher by at least one nationally recognized rating agency.

Projected investment earnings would have to exceed projected interest rate by at least one percent. A municipality could not issue securities under the bills unless the projected difference between the assumed rate of return on the health care trust fund investments and the projected actual interest rate paid on the municipal securities is not less than 100 basis points. [Note: 100 basis points is the equivalent of one percent.]

Treasury Department approval. A county, city, village, or township would have to obtain the approval of the Department of Treasury before it offers securities under the bills. The Department of Treasury would have to review the proposed issuance, and if it verified that the local unit met specified requirements, the department would have to approve the issuance of the securities.

House Bill 4074 specifies that the securities issued would be secured by the general fund of the local unit and could include the phrase "general obligation limited tax" in the resolution authorizing the issuance. It also specifies that a local unit issuing securities without voter approval would not be authorized to levy any tax not authorized by law at the time of the issuance to pay for the municipal securities.

FISCAL IMPACT:

Potential Medicaid Impact. The bills may potentially increase the state's share of costs for the Medicaid program beginning in Fiscal Year 2011-12. In the prior legislative session, Department of Treasury staff testified on similar bills and the preliminary estimate was that the additional Medicaid costs for the State of Michigan would be approximately $11 million annually for 3 years.

The federal Medicaid match rate is established based on each state's per capita income as determined by the Bureau of Economic Analysis. Currently, the federal share of Michigan's Medicaid costs is 60.27 percent. An employer's pre-funding contribution to a pension or health insurance fund through bonding or other mechanisms could be enough to significantly affect the calculation of state's personal income, thereby also lowering the federal Medicaid match rate and increasing Michigan's share of program costs. A previous pension prefunding adjustment by General Motors for its employees and retirees reduced the Medicaid match rate by approximated 0.5 percent, which cost the state an estimated $40-$50 million annually in lost federal Medicaid revenues.

Because the Medicaid match rate is based on a three-year rolling average of per capita income comparisons with other states, the impact of a significant increase in personal income would occur over three consecutive years. Due to the time lag in finalizing personal income data for all states and establishing federal Medicaid match rates, the earliest that any changes would likely affect Medicaid funding in Michigan is Fiscal Year 2011-12.

At this time, it is uncertain whether large lump sum employer pension and insurance contributions will continue to be used in calculating each state's personal income levels as it relates to Medicaid.

Local Government Bonding Impact. The bills would have an indeterminate fiscal impact on local governmental units opting to issue municipal securities (bonds) as a means of fully funding their unfunded actuarially accrued liability for retiree medical benefits. It is not known which, if any, local units would choose to issue bonds. The general aim of the proposal would be to permit local governmental units to issue bonds and deposit the proceeds of the bond sale into a trust, which would be used to fund retiree health care costs. The revenue and expenditure impact on local units would depend on the structure of the bonds, the local unit's unfunded actuarially accrued liability, the local unit's current method of financing its unfunded actuarially accrued liability, the investment performance of the bond proceeds (market uncertainties), as well as a local unit's future health care policies and costs, none of which are known.

In June 2007, Oakland County issued $557 million in "certificates of participation" - another form of municipal debt - to fully fund its retiree medical benefits.[1] Debt service payments on the COP issue were about $46.4 million in 2008, compared to an actuarially determined annual required contribution (ARC) of $60.2 million. Washtenaw County is also in the process of issuing COPs to fully fund its retiree health care obligations.[2] Reportedly, a local unit's costs of issuing COPs (including direct issuance costs and interest costs) are higher than the costs of issuing a comparable amount in municipal bonds. To the extent that a local unit issues bonds, in lieu of COPs, the local unit could potentially realize some cost savings. The amount of unfunded actuarially accrued liabilities of Michigan local units of governments, on an individual or aggregate basis, is not immediately known.

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[1] See Dr. Paula Sanford, *The Implementation of GASB 45: Case Studies of 15 Counties*, 2007, University of Georgia, Carl Vinson Institute of Government, prepared for the National Association of Counties, [http://www.naco.org/Content/ContentGroups/Special/sp-2007-12-10-GASB-45.pdf]

[2] See the Washtenaw County Board of Commissioners, Ways and Means Committee, [http://www.ewashtenaw.org/government/boc/agenda/wm/year_2008/2008-07-02wm/2008-07-02wm14] and [http://www.ewashtenaw.org/government/boc/agenda/wm/year_2008/2008-07-02wm/Washtenaw%20-%20COPS%20Project.pdf].