Huntington West Virginia
Municipal Policeman's and Fireman's Pension
And Relief Funds:
An Analysis

Prepared for the
Huntington Area Chamber of Commerce

By
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October 17, 2012

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Overview

This analysis of the Huntington West Virginia Policemen's (Police Fund) and Firemen's (Fire Fund) Pension and Relief Funds was requested by the Huntington Area Chamber of Commerce (Chamber). The Chamber has not provided funding for the project or participated in anyway in developing the findings and conclusions which are contained in the report. Nor does it reflect the opinions or conclusions of the author's employer Marshall University or its Board of Governors. The responsibility for the content of the report is solely the author's.

The purposes of the report are to:

- Provide a summary of the current condition of the Police and Fire Funds along with forecasted performance as determined by the State's actuaries
- Explain how the Fund's operate and the Legislation which supports them
- Establish conclusions regarding the operation and solvency of the Funds
- Indicate possible areas where the operation and financing of the Funds could be strengthened.

Background

In response to the unsustainable costs of the police and fire pension plans faced by Huntington and almost all other West Virginia cities, the Legislature passed Senate Bill 407 in 2009. That legislation allowed cities, including Huntington, to alter the method then in place (Alternate Method)[1] for financing their pension programs and adopt a different method (Optional Method)[2] which was designed to reduce the annual payments from the cities into the funds over time and provide for full funding of the plans over a 40 year amortization period.

Specific provisions of the Optional Method included:

- Closing the existing plans to new employees
- Placing new employees under a new statewide plan: *Municipal Police Officers and Firefighters Retirement System*[3]
- Contributions to fund the closed Pension Fund were to come from:

[1] Under the Alternate Method adopted in 1991 cities had to contribute 107% of the previous year's contribution to the local pension funds.
[2] West Virginia Code 8-22-20 (e) (1)
[3] The new statewide plan is not covered in this report. See West Virginia Consolidated Public Retirement Board (n.d.) "Municipal police officer and firefighters retirement system".

- Employee contributions of 7.00% of pay for plan members hired prior to January 1, 2010[4] with employees hired after that date contributing 9.50% to the new statewide plan.
- Funds from the state insurance premium tax allocation (discussed later in this report)
- Employer contributions equal to the "normal cost"[5] of the closed plan

A Municipal Pensions Oversight Board (MPOB) was established with the duties discussed later in this report and to allocate to the local pension plans the funds collected from the insurance premium tax.

<u>Financial Condition of the Funds</u>

Under provisions of State Law[6] as revised in 2009, the newly established Municipal Pensions Oversight Board (MPOB) is to obtain for each municipal police and fire pension and relief fund an actuarial evaluation of the adequacy of each fund's funding policy[7]. The latest available reports cover the year beginning July 1, 2010 and were issued October 6, 2011[8]. Those reports prepared by the actuary revealed the following regarding the condition of the Huntington Funds.

- Both Funds are considered "solvent" meaning that their assets market value projected to be greater than zero (0) for the next 15 years.
- The Unfunded Liability of the Police Fund was $71,044,970 and for the Fire Fund $88,228,949
- The funding ratio for the Police Fund was 15.2% and for the Fire Fund 6.1%
- The actual assets of the Police Fund were $12,731,238 and the Fire Fund $5,708.591.
- Moneys received from the State Insurance Premium Tax were $971,129 for the Police Fund and $1,171,481 for the Fire Fund
- The investment return on the assets managed by the local Police Board of Trustees was 7.8 percent and for the Fire Board of Trustees 3.7%
- Under the existing plans for employees covered under the plans the unfunded liabilities are projected to increase in the first few years and then decline slowly until 2050 when the Funds will be fully funded (100%)
  - Contributions from the City were forecast as rising to $4,769,000 for the Police fund in 2013 and to $5,093,000 for the Fire Fund in 2014.
  - Both contributions would then slowly decline over the remaining period if the assumptions hold.

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[4] West Virginia Code 8-22-20 (c) (1) If adopted by the local Board of Trustees for each plan this can be increased from 7.0% by 2.50% to 9.5%. Neither Huntington plan has adopted this option.
[5] Normal cost is calculated as the amount needed to cover the cost of administration (benefits) and the amount to amortize the unfunded liability over a 40 year period less employee contributions and the state premium tax allocation West Virginia Code 8-22-20 (c)(1) and West Virginia Code 8-22-10.
[6] West Virginia Code 8-22-16-28 inclusive
[7] West Virginia Code 8-22-20
[8] Gabriel Roeder Smith & Company (GRS) (October 6, 2011) *City of Huntington West Virginia Policemen's Pension and Relief Fund Actuarial Valuation Report for the Year Beginning July 1, 2010.* and GRS (October 6, 2011) *City of Huntington, West Virginia Firemen's Pension and Relief Fund Actuarial Valuation Report for the Year beginning July 1, 2010.*

The contributions actually made by the City and the employees to the Police and Fire Funds are not determined from the actuarial reports which are estimates of what will be required. The City must file with the MPOB a "Worksheet for the Application for Initial Distributions and Certification of Municipal Contributions to the Closed Municipal Pensions and Protection Fund"[9]. Using the formulas on those worksheets, the actual amounts are determined. For FY 2012 the following contributions were to be made:

- From the City: $4,716,397 to the Police Fund and 4,387,923 for the Fire Fund
- From the employees: $364,286 to the Police Fund and $324,978 to the Fire Fund

The actual numbers may be greater or lesser than those projected by the actuary for any given fiscal year.

Assumptions behind the Numbers

The actuary points out that the projections are subject to and will probably change as they are based on assumptions which may either be revised based on experience, market conditions and alterations in funding policies by either the City or the State. Some of the assumptions upon which the projections are based included:

- Number of participants (retirees, surviving spouses, disabled members and deferred vested members)
- Level of employee contributions (currently 7.00% of pay)
- Retirement rates (anticipated that 45% will retire at age 50-51 and 100% by age 58)
- Mortality rates
- Disability rates
- Terminations
- General inflation of 3.00% per year
- Wage increases of 4.00% per year
- Investment performance of the Funds (currently expected at 5.00%)
- Increases in State contributions from the Insurance Premium Tax

If the anticipated results for any of these assumptions and the others included in the calculations do not hold true, then the projections will have to be altered to reflect those changes.

For an example of how the changes in assumptions can influence the projections, consider the changes made between the 2009 and 2010 reports.

- The Group Annuity Mortality Table was moved from the 1983 table to the 1994 table which anticipated longer life spans for retirees
- The interest rate used to discount liabilities was changed from 6.00% to 5.00% to reflect market conditions
- The City changed its funding policy from the Alternative Method to the Optional Method.

[9] For details see www.mpob.wv.gov/forms/Pages/Procedures.aspx

- Police Fund investment yield was 7.80% which was in excess of the 5.00% projected resulting in a reduction in the unfunded liability of their fund of $186,649. For the Fire Fund the yield was only 3.70% which increased their unfunded liability by $95,038.[10]

The result of these changes was to increase the actuarial unfunded liabilities of the Police Fund by $14,937,991 and of the Fire Fund by $16,392,207.

Future assumption changes and fund performance will increase or decrease the projected unfunded liabilities. Consequently the amount required from the City may fluctuate from the current amortization plan.

Determination of Benefits

Both the Police and Fire plans are "defined benefit plans" rather than "defined contribution" plans[11]. Under a defined benefit plan the member receives a specific amount determined by earnings, years of employment, age at retirement and other factors. The retiree receives the benefit plus any allowed cost of living increases for as long as they live. Their surviving spouse and children are also eligible for a percentage of those benefits. Disability benefits involve similar calculations. Benefits are guaranteed.

Defined contribution plans are where the employee contributes a portion of their salary which is usually matched by the employer. Individuals determine how the funds are to be invested. These contributions plus the investment earnings in each individual account are available to be paid at retirement to the beneficiary under a variety of provisions allowed under federal tax law. There is no guaranteed benefit.

The Fire and Police Plans for Huntington are defined benefit plans. The benefits to be paid to retirees, surviving spouses, disabled members and death benefits in West Virginia are determined by State law[12] and are not subject to alteration by the City. While a summary is provided here more detail can be found in Appendix A of this report.[13]

- Credited compensation at time of eligibility is limited to 120% of the Average Adjusted Compensation for the two previous years
- Retirees are eligible for benefits at age 50 with 20 years of service.
- Benefit for retirees are set at 60% of Average Adjusted Compensation. For service between 20-25 years benefits increase for each year of service by 2% and for years above 25, 1% per year with a 75% of Average Annual Compensation ceiling.
- Disability benefits are 60 percent of monthly salary with a $500 minimum. When added to workers compensation benefits the amount cannot exceed 100% of monthly salary

[10] The actuarial assumptions include an expected rate of return on the Fund's investments. For the year 2010 the projected yield was 5.00%. The investment policy of each fund is under the control of the local Board of Trustees. When the actual yield is above the projected the difference (gain) is subtracted from the unfunded liability. When the yield is less than anticipated the difference (loss) is added to the unfunded liability.

[11] U.S. Department of Labor (n.d.)"Retirement Plans, Benefits& Savings"

[12] West Virginia Code 8-22-7 through 8-22-28 inclusive.

[13] Benefits for police and fire members are similar so only one schedule is provided. The summary is from the GRS reports op.cit.

- Death benefits to a spouse are 60 percent of participants benefit until death or remarriage. For children the amount is 25% of participants benefit until age 18 or married.
- Cost-of-living adjustments are made to beneficiaries equal to the increase in the CPI with a 4 percent limit on the first $15,000 of benefits. This adjustment is cumulative and compounded.

The fiscal problems for state and local governments created by defined benefit plans for public employees have been documented.[14] 43 states between 2009 and 2011 enacted benefit cuts, increased employee contributions or both.[15] While West Virginia did make some changes in the benefits and funding for state employee pension plans, it did not substantially change the provisions for existing fire and police pensions. But it did enact a different pension and benefit program for new hires under the *Municipal Police Officers and Firefighters Retirement System*.

<u>Municipal Pension Oversight Board</u>

Under the Senate Bill a new entity, The West Virginia Municipal Pensions Oversight Board (MPOB) was created[16] with the purpose of" monitoring and improving" the performance of the funds and to "…assure prudent administration, investment and management" by the local boards of trustees. Specifically their duties include:

- Assisting the fund's boards of trustees in the performance of their duties
- Assuring local boards of trustees comply with applicable laws
- Providing for actuarial studies of the performance and condition of the funds
- Distribution of insurance tax proceeds to the funds as discussed later in the report
- Initiating or joining legal actions to protect the members of the fund's interests

Each year the MPOB is to have an actuarial valuation report on each local police and fire fund[17]. The contents of the report are spelled out in the statue[18]. The actuarial reports must be received by the local funds prior to any monies from the insurance tax being drawn dawn by the funds and are used to determine the eligibility of each fund to receive its distribution.

The MPOB also may establish minimum requirements for the training to be completed by all members of local boards of trustees.[19] This training is now available on line[20]. No data has been available on whether all trustees of the Huntington plans have completed the training.

Each year the MPOB is to report to the Legislature's Joint Committee on Government and Finance and the Joint Committee on Pensions and Retirement concerning the status of the local

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[14]Tysiac, K. (June 25, 2012) "GASB vote places unfunded pension liabilities on government balance sheets" *Journal of accountancy* http://journal of accountancy.com/News/20125927.htm?action=print. Accessed July 18, 2012.

[15] Keegan, B (June 18, 2012) "The widening gap update" Pew Center for the States www.pewstates.org/state-pension-update Accessed August 29, 2012.

[16] West Virginia Code 8-22-18a

[17] West Virginia Code 8-22-20(a)

[18] West Virginia Code 8-22-20(b)

[19] West Virginia Code 8-22-18j

[20] www.mpob.wv.gov

funds along with recommendations for strengthening the performance of the funds[21]. In performing that duty the MPOB is to present a detailed comparison of returns on long-term and short term investments held by the local boards with those of the West Virginia Investment Management Board and Board of Treasury Investments[22].

It is worth noting that the MPOB has only limited enforcement powers and cannot take actions to implement its recommendations or even to enforce compliance with State law other than withholding funds from the insurance premium tax until certain required reports are received.

Local Pension and Relief Fund Boards of Trustees

The key body in the administration of the funds is the local board of trustees[23] for each of the funds. The board "…shall have charge and administer the fund and shall order payments therefrom, and no money shall be paid out of the fund except upon order of the board."[24]
The boards consist of five members one of whom is the mayor and the other four are elected by the members of the fund[25]. The members constitute the majority of the local board.

There are reports which the local boards are to file with the MPOB to receive their allocation from the insurance premium tax.

- In order to receive its share of the insurance premium tax the local boards are to file an annual report with both the city and the MPOB[26]. This is a statistical form which is attached as Appendix B to this report. The required report for both Huntington funds was received on March 12, 2012. This will allow the City to draw down the insurance allocations from the MPOB.
- Another report[27] must also be submitted to the MPOB which details the number of members in the plan. This report is the basis for the allocations to each individual fund in the State.
- Another required report[28] is to contain the "…funds current rules, regulations and procedures" with the MPOB. Neither of the Huntington funds has filed this required report.
- There is a provision in Code[29] requiring the boards to provide the MPOB with the, "…pension and relief fund's investment policy". These were due on or before March 1, 2010. Any changes in the policy are to be sent forwarded to the MPOB within 30 days of their adoption. To date neither the Police Fund nor the Fire Fund has filed this report.
- That same section of Code requires that each pension fund, "…shall fully disclose all fees and costs of investing." The report is to come from the investment firm to the local board and the local board is to provide the report to the MPOB. To date these disclosures have not been made to the MPOB.

[21] West Virginia Code 8-22-18h
[22] West Virginia Code 8-22-18i
[23] West Virginia Code 8-22-4ff
[24] Ibid
[25] West Virginia Code 8-22-18
[26] West Virginia Code 8-22-29(d)(1)(B) and 8-22-23(a)
[27] West Virginia Code 33-3-14d(2)(b)(1)
[28] West Virginia Code 8-22-17(c)
[29] West Virginia Code 8-22-22(c)

Municipal Pensions Security Fund

The 2009 legislation provided for an additional premium tax of 1% on fire and casualty insurance policies.[30] Under the provisions for distribution of these funds the Teachers' Retirement System Reserve Fund receives 10% of the amount collected with the volunteer fire departments receiving 25%. This leaves 65% to be allocated to the newly created Municipal Pensions Security Fund.

The MPOB is responsible for distribution of the funds[31]. There are 31 police funds and 22 fire funds operating in the State that are eligible to receive money from the Municipal Pensions Security Fund. The money available is allocated to each of the police and fire funds based on plan enrollment. The allocations from the tax for each fund are made in September. After filing the required reports and receiving their actuarial report, the municipalities may begin to request to draw down their annual allocation.

But prior to the draw-down occurring the city must have made a payment into its municipal policemen's pension and relief fund or its municipal firemen's pension and relief fund as indicated in the required reports to the MPOB. While some cities make their annual payment in a lump sum, most make their payments monthly and receive their allocation on a monthly basis as required by law. Cities have 18 months from the date the monies become available to draw down their allocation. If any money is not drawn down in the time period, unclaimed money returns to the Municipal Pensions Security Fund to become part of the amount to be allocated the following year.

The amount of the allocation from the insurance premium tax and the amount contributed by the City are directly deposited into the local fund for investment or distribution. None of the distribution goes to the City general fund.

As of August 2012 the MPOB had allocated the entire 2011 amounts due Huntington to the Police Fund and the Fire Fund. The amount to the Police fund was $971,129.23 and the amount to the Fire Fund was $1,171,481.17. No money allocated to either of these Funds was "left on the table".[32]

Issues

Discussion has been made regarding actions which might be taken to reduce the burden of the unfunded liability of the Police and Fire Funds. Each of these is evaluated. **Note: the evaluation does not constitute advocacy by the author.**

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[30] West Virginia Code 33-3-14d. West Virginia Code 33-3-33 also levies a tax on insurance premiums but the entire amount goes to volunteer or part-time volunteer fire companies. None is allocate to municipal pension plans

[31] The following explanation was made available from Blair M. Taylor, Executive Director of the Municipal Pensions Oversight Board, July 12, 2012.

[32] Blair Taylor e-mail to author August 27, 2012

- Declare municipal bankruptcy. Municipal bankruptcy is covered under Chapter 9 of the federal bankruptcy code[33]. Under the federal code the municipality negotiates a plan for adjusting its debts while receiving protection from its creditors. The law does permit rejection of collective bargaining agreements and retiree benefit plans without using the procedures for Chapter 11 bankruptcy. Unlike Chapter 11 bankruptcy, the assets of the city cannot be liquidated to pay off creditors and the courts have much less authority with the bankruptcy process than under Chapter 11.

  But there are criteria which must be met before a municipality can go into bankruptcy:
  - There must be specific authorization in state law to allow a municipal bankruptcy. This author can find no such authorization in the West Virginia Code
  - The city must be insolvent. While the budget of Huntington is severely strained and the pension obligations reduce its ability to deal with other pressing concerns, the City has the capacity to pay its current bills. But if insolvent means "balance sheet insolvency" where its assets are less than its liabilities exclusive of equity capital, then the City can be so classified. There is a provision in State law which requires that a city must levy sufficient taxes to pay the pension costs and these payments take precedent over almost all other municipal obligations.[34]
  - The city must obtain agreement from the majority of its creditors, or negotiate in good faith with them or determine negotiation to be impracticable.

  There is also a stigma attached to a city going bankrupt[35] which may result in higher bond ratings and reduced ability for the city to obtain debt financing. But in light of the recent municipal bankruptcies there may be a reduction in the stigma[36].

- Switch to a defined contribution plan. While many states and cities have made this move in recent years, this option does not appear to have any viability under existing West Virginia law. State law has foreclosed the option of changing the benefits for those in the Optional Plan and established a statewide defined benefit plan for those employed after January 1, 2010.

  There is also a legal issue: Having made a commitment for a future benefit to a member at the time of employment or vesting, that member has received a "vested interest" or "contract right" in receiving that benefit which cannot later be altered or negated. Public pensions in most states are guaranteed by law, legal precedent, state constitutions or the "contract" and "takings" clauses of the U.S. Constitution[37]. This is the position of the West Virginia Supreme Court which has ruled that changing a pension creates a

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[33] "Municipal Bankruptcy" , http://www.uscourts.gov/federalcourts/bankruptcy/bankruptcybasics/Chapter9.aspx. Accessed June 18, 2012. From 1986-2011 there were 263 municipal bankruptcies.

[34] West Virginia Code 8-22-19 (a)(1) and 8-22-19 (a)(2)

[35] McConnell M (July 30, 2012) The growing shadow of municipal bankruptcy. http://sourcenewspapers.com/articles/2012/07/30/news/doc5016d7996eefd Accessed August 18, 2012

[36] Bloomberg News (nd) "California's Municipal bankruptcies sign of stigma waning" http://business week.com/news/2012-07-12/California-s-municipal-bankruptcies-sign-of-stigma-waning Accessed July 18, 2012

[37] Greenfield, D. and Lahne, S. (August 8, 2012) *In defense of state judicial decisions protecting public employees' pensions.* National Council of State Legislature Legislative Summit.

"substantial detriment" to the contract rights of eligible members.[38] It is instructive that in all the cases of municipal bankruptcy in the U.S. (at least through 2010) no city had failed to pay its pensions as promised[39].

- Obtain a higher contribution from plan members. Existing law requires a 7% contribution from plan members. Those hired after January 1, 2012 pay 9.5%. Local boards are authorized to increase the amount from 7 to 9.5%[40]. Neither of the two Huntington Boards has elected this option. Had the increase been in effect for 2010 the police contribution would have increased from $364,286 to $494,388 and the fire amount from $324,978 to $441,042.

- Seek approval to reduce the funding requirement from 100% to 80%. Although the suggestion has been opposed by the American Academy of Actuaries[41], other sources have postulated that 80% funding is an appropriate level.[42] Credit rating agencies also use a standard for funding that is less than 100%. Standard & Poor's uses 90 percent as "strong" and 80% as above average[43] while Fitch considers funding above 70% to be "adequate".[44] Part of the logic behind using the lower levels is the requirement that benefits paid to members must be as specified in the law. If the returns from the fund are inadequate to pay the benefits, then the city is obligated to make up whatever shortfall exists. This is a major difference between private and public pensions causing at least one expert to feel that municipal pension benefits are as safe as U.S. Treasury Bonds.[45]

- Consider investment through state agencies. Current law gives to the local boards almost unlimited investment authority over the funds[46]. While the boards of trustees may invest in the pools and funds managed by the West Virginia Investment Management Board or West Virginia Board of Treasury Investments they are not required to so do. The law reads "Within the limitations of the Uniform Prudent Investor Act, the board of trustees is

[38] Booth v. Simms 193 W.Va. 323,456 S.E. 2d. 167 (1995) "The pension rights of all current state pension plan members who have substantially relied to their detriment cannot be detrimentally altered at all, and any alterations to keep the trust fund solvent must be directed to the infusion of additional money"
[39] Biggs, A. (April 2010) "The market value of public sector pension deficits" American Enterprise Institute for Public Policy Research. Washington DC
[40] West Virginia Code 8-22-20(c)(1)
[41] American Academy of Actuaries, (July 2012) "The 80% pension funding standard myth" Issue Brief, Washington DC
[42] U.S. Government Accountability Office (September 2007) *State and local government retiree benefits—current status of benefit structures, protections, and fiscal outlook for funding future costs.* Http://www.gao.gov/assets/270/267150.pdf Pew Research Report (February 2010) *The trillion dollar gap-Underfunded state retirement systems and the roads to reform.* http://www.pew-states.org/uploadedFiles/PCS and Stanford Institute for Economic Policy Research, (February 21, 2012) *More pension math: Funded status, benefits, and spending trends for California's largest independent public employee pension systems.* http://www.cacs.org/images/dynamic/articleAttachments/7.pdf All accessed August 22, 2012
[43] Standard and Poor's (January 3, 2011) "U.S. State Ratings Methodology" Global Credit Portal http://www.standardandpoors.com/prof/ratings/articles/en/us/?artoc;eType=HTML Accessed august 24, 2012
[44] Fitch Ratings (February 17, 2011) "Enhancing the analysis of U.S. state and local government obligations" http://www.ncpers.org/Files/2011_enhancing_the_analysis_ of_state_and_local_ government_pension_obligations.pdf Accessed August 24, 2012
[45] Biggs, op.cit.
[46] West Virginia Code 8-22-22(a)

authorized in its sole discretion to invest and reinvest any funds received by it…" A later section[47] is the one requiring the boards to deliver a copy of their investment policy to the MPOB which has not been accomplished by either Huntington Board.

The local boards are to obtain an annual independent performance evaluation of the fund's comparative performance compared to other similar funds[48]. Each firm doing business with the funds is to provide on a quarterly basis a full disclosure of all fees and costs of investing to the trustees and to the MPOB.[49] These reports were not available at Huntington City Hall and had not been received by the MPOB.

Return on investment is the most crucial factor in determining the solvency of the funds[50]. Since benefits to members are guaranteed, the return on investment is of principal concern to the city. If the return on investment is comparatively[51] low, then the low return must be compensated by higher payments from the city. Investment returns for all municipal pension plans statewide average 8.9% for plan year ending June 30, 2010[52]. The returns for both Huntington plans were below that figure.

Suggestions have been made to deal with the issue of comparatively low returns.

- Require all funds to invest with one of the two state investment funds
- Require that funds which do not meet or exceed the returns from the state managed funds to invest with the state investment funds.

Implementation of either of these would require change in State law.

- Use bonding to cover pension obligations. There has been a trend for states and cities to use bonds to cover their pension liabilities.[53] The theory is that the interest cost of the bonds will be less than the investment earnings on the funds in the pension plans. So long as the returns received on the investments are greater than the interest paid on the bonds, this plan is successful. But if the reverse is true then the bonds actually increase the cost to the cities.

  This is not a new idea and has been employed by states and localities in the past. While some bond issues have worked for the ultimate benefit of the issuing government, this is

[47] West Virginia Code 8-22-22(c)
[48] West Virginia Code 8-22-22(8)(b)
[49] West Virginia Code 8-22-22(8)(c)
[50] U.S. Government Accountability Office op.cit., Hamacher, T (April 4, 2012) "Public pension pitfall: What municipal budget troubles mean for bond investors" Washington Post http:///www.brookings.edu/research/opinions/2012/04/06-pension-pitfall-pozen
[51] "comparatively low " returns could be defined as those below what is received by the State investment boards, all municipal pension plans or returns compared to a national index of investment returns for the type of securities allowed to be purchased or returns earned by other similar pension funds.
[52] Gabriel Roeder Smith & Company (January 9, 2012) *Municipal Policemen's and Firemen's Pension and Relief Funds of West Virginia: Consolidated actuarial valuation report for the year beginning July1, 2010.* p. 20
[53] Popper, N (March 26, 2012) "More municipalities betting on pension bonds to cover obligations" Los Angeles Times http://articles.latimes.com/print/2012/mar/26/business/la-fi-pension-bonds-2012037 accessed august 23, 2012

not always been the case.[54] There is considerable downside risk if the returns and values of stocks tumble as they did in 2002 and 2008. Advocates of this approach note that over a 30-40 year period returns on stocks and bonds have far exceeded the cost of municipal barrowing. In 2005 the voters of West Virginia by a 54-46 percent margin rejected a $5.5 billion proposal to use pension bonds to cover the unfunded liabilities of the teachers and other retiree's plans.[55]

- Adopt the "Conservation Method" of funding. Although Huntington chose not to use the Conservation Method, it was adopted by the City of Charleston as provided in State law.[56] This is essentially a pay-as-you-go system. The City is obligated to pay all the benefit and administrative costs each year from its general revenue, contributions of members and proceeds of the insurance tax. Each year 1 ½ % of the employees contributions is placed in a trust fund which cannot be used for any purpose until the fund is 100% funded. In addition whatever portion of the insurance premium tax that is needed, as determined by the actuary, to insure full funding must be deposited in the trust fund. Issues have been raised about the solvency of this approach as benefits increase as additional members retire and benefits to be paid out of general revenues increase while employee contributions decrease. For that reason it is not considered to be an actuarially sound approach. Since Huntington chose the Optional Method this approach is not available without a change in state law.

- Seek additional State funding. The Police and Fire Plans are state mandates allowing little discretion to the cities. The amount of State financial support is minimal consisting only of 0.65 % of the 1.00% additional insurance premium tax. Currently under the two insurance premium taxes, Volunteer and part time fire departments receive more funding than do full time municipal departments. Considering how tight the State budget is, an affirmative response is unlikely, but the situation needs to be a constant reminder for the relevant State officials.

Conclusions

- For the current fiscal year the contributions by the City to the Police and Fire Funds are approximately 23% of the General Fund Budget and are the largest single general fund expenditure.

- Current projections that the unfunded liabilities of the Fire and Police Funds will be eliminated by 2050 with costs to the City of Huntington gradually decreasing over time, must be viewed with caution. There are too many variables which will alter these outcomes for the predictions to be relied upon.

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[54] Walsh, M. (August 23, 2012) "Creditors of Stockton fight over pension funding while in bankruptcy *New York Times* http://nytimes.com/2012/08/24/business/creditors-of-stockton-figth-city-over-pension Accessed August 23, 2012

[55] *The State Journal* (June 25, 20o5) Voters reject bond amendment" http://www.statejournal.com?Global/storyasp?S=15772357 accessed August 23, 2012.

[56] West Virginia Code 8-22-20(c) (5)(f) (1-4)

- The benefits to be paid under the Police and Fire Plans are fixed by State law and are unlikely to change. Even if they did under the law and Constitution of the State, members in those plans would not be subject to alterations in their anticipated benefits.

- The relatively new Municipal Pensions Oversight Board lacks the statutory authority to adequately preform its mission. There are virtually no penalties which it has available for local plans which are non-compliant with certain provisions of the law.

- The cost of funding the police and fire plans accounted for 23 percent of the City budget. These costs are likely to force the City either to reduce employment or other benefits or reduce the quantity or quality of other services in order to make the needed payments.

- There are alternative ways of reducing the continuing impact of the unfunded liabilities but each has disadvantages which should be carefully considered prior to adoption. It is important to consider all the short and long run implications.

- The citizens of the City need to be fully informed about the cost of these programs and the activities of the local boards. All required reports should be timely filed. The current lack of transparency only increases public confusion.

- While only in existence for a year questions are already being raised about the future solvency of the new Municipal Police Officers and Fighters Retirement System under the Consolidated Public Retirement Board. This should be monitored closely.

- While not a part of this report, the problem of funding Other Post-Employment Benefits (OPEB) is predicted to be the fastest growing expense item for municipalities in the future. Of particular impact will be the rising cost of medical care for retirees. This will further strain all city budgets including Huntington's.

<u>About the author</u>

The author was formerly Business School Dean and a Vice President for Business and Economic Research at Marshall University. Since January 2012 he holds the Lewis Distinguished Chair in Business and Directs the BB&T Center for American Capitalism at the Marshall School of Business. He also is a Senior Fellow in Economics at the Center for Business and Economic Research at the Rahall Transportation Institute. He served for 11 years on the Huntington City Council. For nine of these years he chaired the Finance Committee. He has served on many state boards including being Vice Chair of Governor Underwood's Fair Tax Commission and

Chair of the Sub-Committee on Local Finance and Property Taxation of Governor Manchin's Tax Modernization Project. Currently he is a member of the West Virginia Property Valuation Commission.

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Appendix A

Summary of Principal Plan Provisions

Employee Eligibility—All compensated employees of the Fire Department hired before July 1, 2010 are eligible to participate in the Firemen's Pension and Relief Fund.

Average Annual Compensation — The average of any three twelve-consecutive-month periods of employment which produces the highest average annual compensation.

Each twelve-consecutive-month annual compensation is limited to 120% of the *Average Adjusted Salary* received by the member in the two consecutive twelve-consecutive-month periods immediately preceding the twelve-consecutive-month period used in determining benefits.

The *Average Adjusted Salary* is base salary (exclusive of all overtime and other pay) of the year used in determining benefits multiplied by the ratio of total salary (includes all overtime and other pay) to base salary from the respective preceding twelve-consecutive-month period.

Determining Years of Service Credit (Credited Service) — The number of years that the member has contributed to the employees retirement and benefit fund.

Prior Military Service — A city may provide that members who have been honorably discharged from the military shall receive up to two years prior service credit for military service prior to their employment with the city.

Current Military Service — Any current member who has been on qualified military service in the armed forces of the United States with an honorable discharge may, within six months from his or her date of discharge, be given credit for continuous service in the paid police or fire department.

Any member who has served in active duty with the armed forces of the United States, whether prior to or subsequent to becoming a member of a paid police or fire department, shall receive one additional percent for each year so served in active military duty, up to a maximum of four additional percent.

Absence from the service because of sickness or injury for a period of two years or less shall not be construed as time out of service.

Contributions — Participating employees contribute 7.0% of compensation. Participating employees hired on or after January 1, 2010 contribute 9.5% of pay. The municipality has elected to contribute the minimum employer contribution under the Optional Method.

Normal Retirement — Members are eligible at the earlier of age 50 with 20 years of credited service or age 65.

Benefit Commencement — Annual retirement pension benefits commence upon retirement or upon the member attaining age fifty, whichever is later, payable in twelve monthly installments.

City of Huntington Firemen's Pension and Relief Fund
Summary of Principal Plan Provisions
Actuarial Valuation as of July 1, 2010

Accrued Benefit — The annual retirement benefit equals 60% of average annual compensation, not less than $6,000, plus an additional percentage of average annual compensation for service over 20 years equal to 2% for each year of service between 20 and 25 and 1% for each year of service between 25 and 30 years. Employees serving in the military are eligible for an additional 1% of average annual compensation for each year of military service up to four years. The maximum benefit is limited to 75% of average annual compensation. Benefits continue for life.

Disability Retirement — Members are eligible after earning five years of service. No service requirement if disability is service related.

The monthly disability benefit equals the greater of 60% of monthly salary at disability or $500. Employees serving in the military are eligible for an additional benefit of 1% of monthly salary at disability for each year of military service up to four years. Disability benefits, when aggregated with monthly state workers compensation benefits, shall not exceed 100% of the member's monthly compensation at the time of disability. Benefits continue for life or until recovery.

Death Benefits— Members are eligible after earning five years of service. No service requirement if death is service related. Retirees and terminated vested participants are also eligible.

The benefit is equal to 60% of the participant's benefit, but not less than $300 per month, payable to the spouse until death or remarriage. Other dependents (children, parents, brothers, and sisters) are also eligible for death benefits. To each dependent child, twenty percent of the participant's benefit until the child attains eighteen or marries; to each dependent orphaned child, twenty-five percent of the participant's benefit until the child attains eighteen or marries; to each dependent parent, ten percent of the participant's benefit for life, and to each dependent brother or sister, the sum of fifty dollars per month (but a total not to exceed $100 per month) until such individual attains the age of eighteen years or marries.

In no case shall the payments to the surviving spouse and children be cut below sixty-five percent of the total amount paid to all dependents.

Supplemental Pension Benefits— All retirees, surviving beneficiaries and disability pensioners are eligible for automatic cost-of-living benefits commencing on the first day of July following two years of retirement. The benefits equal the percentage increase in the Consumer Price Index, limited to 4% (2% for some disability retirees), multiplied by the sum of the allowable amount which is the first $15,000 of the total annual benefits paid and the accumulated supplemental pension amounts for prior years.

Termination Benefits—Any member who terminates employment prior to retirement will be entitled to a refund of contributions without interest.

Refunds —Any member who is terminates from their department without receiving a retirement pension shall be refunded all deductions made from his salary, without interest. Any member who receives such a refund and subsequently wishes to reenter the department must repay to the pension fund all sums refunded with interest at the rate of eight percent annual.

Appendix B

Worksheet for the Application for Initial Distribution and Certification of Municipal Contributions to The Closed Municipal Pensions and Protection Plan

EXHIBIT III-F
PAGE 6 OF 6

FISCAL YEAR 2013
WORKSHEET FOR THE APPLICATION FOR INITIAL DISTRIBUTION AND CERTIFICATION OF MUNICIPAL CONTRIBUTIONS TO THE CLOSED MUNICIPAL PENSIONS AND PROTECTION FUND

Pension Fund	Pension & Relief Fund
Treasurer	Anybody
Municipality	Anytown

A. Contribution by Employees hired prior to 1/1/2010 Min. 7%-Max. 8.5% (FY2011-2012) 7.0%	$ 8,960.00		1. Payroll (FY2011-2012 Actual Payroll of Employees Hired prior to 1/1/2010) **AND**	$ 128,000.00
A1. Contribution by Employees hired on or after 1/1/2010 Min. 9.5%-Max. 12% (FY2011-2012) 9.5%	$ 427.50		1a. Payroll (FY2011-2012 Actual Payroll of Employees Hired on or after 1/1/2010)	$ 4,500.00
B. State Share (FY13)	$ 34,000.00		2. Normal Cost % **	27.00%
C. Municipal Obligation* (FY13)	$ 49,331.00		3. Normal Cost (Item 1 + Item 1.a) x (Item 2)	$ 35,775.00
D. TOTAL (A + A1 + B + C)	$ 92,718.50		4. Unfunded Liability Amortization Cost**	$ 47,556.00
			5. Funding Obligation for the Year Under the Optional funding Method (Item 3 + Item 4)	$ 83,331.00
			6. State Share	$ 34,000.00
			7. ***Municipal Share Under the Optional Funding Method (Item 5 - Item 6)	$ 49,331.00

** From the Actuary's Report

*** 8-22-20(c)(3) requires cities to contribute annually to the fund an amount, which may not be less than the normal cost, as determined by the actuary.

Notes: The "State Share" comes from the Insurance taxes collected by the Insurance commissioner during the 2011 calendar year.
Allocation of these funds by the Municipal Pensions Oversight Board is made on September 1, 2012.
Actuarial information is based on the GRS actuarial valuation as of July 1, 2011 as required by Chapter 8-22-20 and Chapter 8-22-26a (f).

DO NOT INCLUDE PAYROLL & EMPLOYEE CONTRIBUTION OF POLICE OFFICERS & FIREFIGHTERS PAYING IN THE WV MUNICIPAL POLICE OFFICERS & FIREFIGHTERS RETIREMENT SYSTEM