



Comments on Your Government

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RIPEC

Analysis of Rhode Island's Municipal Pension and OPEB Obligations and the Impact of the Proposed MAST Program

This RIPEC Comments presents information on the status of state and local pension and OPEB obligations as of June 30, 2010. In addition, the report examines the costs of these obligations relative to municipalities' ability to fund the expenditures. Finally, an overview of the proposed MAST program and its impact on municipal budgets is provided in order to put the program in context.

Introduction

There are a number of signs that the Rhode Island economy is beginning to recover. The impact of the economic downturn, however, will continue to affect state and local budgets as historic revenue declines are absorbed by governments. Moreover, the economic downturn has exposed how vulnerable some communities – and, by proxy, some municipal bond markets – are in the current fiscal environment. The challenges faced by municipalities are a combination of significant budget cuts at the state level and structural issues that continue to be unresolved.

One significant issue is the level of unstated debt in the form of long-term obligations such as pensions and other post-employment benefits (OPEB). Standard and Poor's, one of the country's three major credit rating agencies, notes that long-term liabilities differ from traditional debt in the sense that these liabilities are subject to variation based on a number of factors such as fund performance and the assumptions upon which the actuarial analysis is based. However, the long-term obligations represented by unfunded pension and OPEB liabilities pose significant risks to governments and, thus, taxpayers. Based on the most recent actuarial information, the combined state and

local pension and OPEB liability was \$11.4 billion as of June 30, 2010. This represents an increase of almost \$2.0 billion from RIPEC's 2010 report on state and local pension and OPEB liabilities.

Recently, experience studies, which compare "actual to expected" performance over the study period, were conducted for both the Employees' Retirement System of Rhode Island (ERSRI) and the Municipal Employees Retirement System (MERS). As a result of the study, the unfunded liability for the plans is projected to increase by over \$1.6 billion as plan assumptions are adjusted to reflect actual market returns, mortality and other factors upon which contributions are based. OPEB obligations also represent a large and growing cost for municipalities, although information on future costs is more difficult to obtain given the nature of the obligation. As these costs continue to rise, how municipal and state governments choose to fund them will have a significant impact on future budgets.

Pension and OPEB Overview

Pension and OPEB obligations represent a significant public commitment that, due to legal and constitutional protections, must be met by taxpayers unless statutory changes are made.

How governments fund these obligations – and the growing debt incurred by governments as a result of these liabilities – has become an increasingly pressing issue at the state and local level around the country.

There are over 150 pension plans in the state, as well as roughly 40 different OPEB plans. The combined liability of these plans represents a significant financial commitment on the part of taxpayers. RIPEC estimates that the combined state and local pension and OPEB obligation (excluding pensions for fire districts, lighting districts, housing authorities and quasi-publics) was \$11.4 billion in FY 2010. Notably, these estimates do not include the changes made to projected liabilities as a result of the recent experience study for state workers and teachers.

GASB

The Governmental Accounting Standards Board (GASB) is an independent, non-profit organization that establishes general accounting standards and reporting requirements for government entities. This organization is the official source for generally accepted accounting principles (GAAP) for governments. While GASB does not have authority to enforce the standards set out by the organization, many states require compliance with the standards as a part of the local audit process. Compliance with the standards is further reinforced by the bond market, which prefers financial statements that are prepared on a GAAP basis. Moreover, compliance with GASB standards may affect bond ratings as liabilities are disclosed, and by how governments fund their liabilities. The cost of borrowing may increase and bond ratings may be affected if liabilities are unfunded or strategies are not developed to manage costs.

Since 1997, governments have been required to measure, disclose and, ideally, fund pension obligations on an accrual basis of accounting (GASB 25 and 27). Financial statements are

required to provide descriptive information about the plan, three years of annual pension cost (APC) history, changes in the plan's net pension obligation (NPO) and funding progress for the last three actuarial valuations. Statement 50 further refines the reporting requirements set out in prior GASB statements, notably requiring governments to further disclose methodology and assumptions used in determining the actuarial value of assets.

Statement 45 requires disclosure of OPEB liabilities and costs in a manner similar to disclosure of pension liabilities. While GASB 45 does not require pre-funding of OPEB liabilities, the standard creates strong incentives to fund the obligations; employers who fund OPEB liabilities will generally be able to use more favorable accounting methods and a higher discount rate, both of which will result in lower OPEB costs. Implementation of GASB 45 was based on the size of a government's total annual revenues. The statement was phased-in over three years, from December 15, 2006 and December 15, 2008.

State and Local Liabilities

State Pension and OPEB

The State of Rhode Island administers defined benefit plans for general state employees and teachers (ERS), judges (JRBT), and the state police (SPRBT). Assets across all three plans are comingled for investment purposes, but are accounted for separately and are only used for the payment of benefits to members of that plan. As of June 30, 2010, the combined liability for all state employees and the state share of teacher retirement (40.0 percent of the total obligation) was \$3.0 billion. The funded ratio for state employees under ERS was 59.0 percent, while the teachers' share of ERS had a funded ratio of 58.1 percent. The plans for judges and state police had funded ratios of 88.3 percent and 79.8 percent, respectively. In FY 2010, the state made 100.0 percent of its ARC payment of \$199.6 million.

The recent ERSRI experience study for state employees and teachers increased the total unfunded liability for the two plans by \$1.4 billion, to \$4.4 billion, resulting in a projected increase in annual required contributions (ARC) of \$201.8 million in FY 2013. Of this amount, \$78.8 million reflects the increase in ARC payments for state employees. Of the remainder, \$78.9 million is the state's share of teacher retirement (40.0 percent of the total ARC for teachers). The experience study for judges and state police will be completed later this year.

The most recent actuarial valuation for the state's OPEB obligation, as of June 30, 2009,

showed an unfunded liability of \$774.7 million. Of this amount, \$673.6 million was for state general employees, \$13.5 million was for state teachers, \$67.1 million was for state police, \$8.7 million was for judges, and \$11.8 million was for legislators. As of the valuation date, the state had not started pre-funding its actuarial obligation and was paying benefits on a pay-go basis. Legislation enacted in 2008 required the state to fund OPEB liabilities on an actuarial basis and authorized the creation of a trust fund for retiree medical benefit liabilities; however, in 2009 the General Assembly delayed this funding requirement until FY 2011. As of the first pay period in FY 2011, the state has made payments into the OPEB trust fund based on the June 30, 2009 valuation.

Table 1
State/Local Pension and OPEB Liabilities
as of June 30, 2010 (\$ million)*

	ARC	Payments	% of ARC Contributed	Unfunded Liability
State				
<u>Pensions</u>				
State Employees	\$128.3	\$128.3	100.0%	\$1,836.2
Teachers-State Share	71.2	71.2	100.0%	1,156.8
<i>Subtotal Pensions</i>	<i>\$199.6</i>	<i>\$199.6</i>	<i>100.0%</i>	<i>\$2,993.0</i>
<u>OPEB**</u>	\$55.8	\$38.4	68.9%	\$774.7
Total State	\$255.3	\$238.0	-	\$3,767.7
Municipal Government				
<u>Pensions</u>				
MERS	\$26.8	\$26.9	100.4%	\$380.8
Locally-administered	162.9	133.3	81.8%	2,020.3
Teachers-Local Share	106.9	106.9	100.0%	1,735.2
<i>Subtotal Pensions</i>	<i>\$296.6</i>	<i>\$267.1</i>	<i>90.1%</i>	<i>\$4,136.3</i>
<u>OPEB</u>	\$238.5	\$116.8	49.0%	\$3,494.1
Total Municipal	\$535.1	\$383.9	-	\$7,630.5
Total State and Local	\$790.5	\$621.9	-	\$11,398.1

ARC= Annually required contribution

*Represents date of most recent Consolidated Annual Financial Report or valuation (MERS)

**Includes state employees, state teachers, state police, judges, and legislators

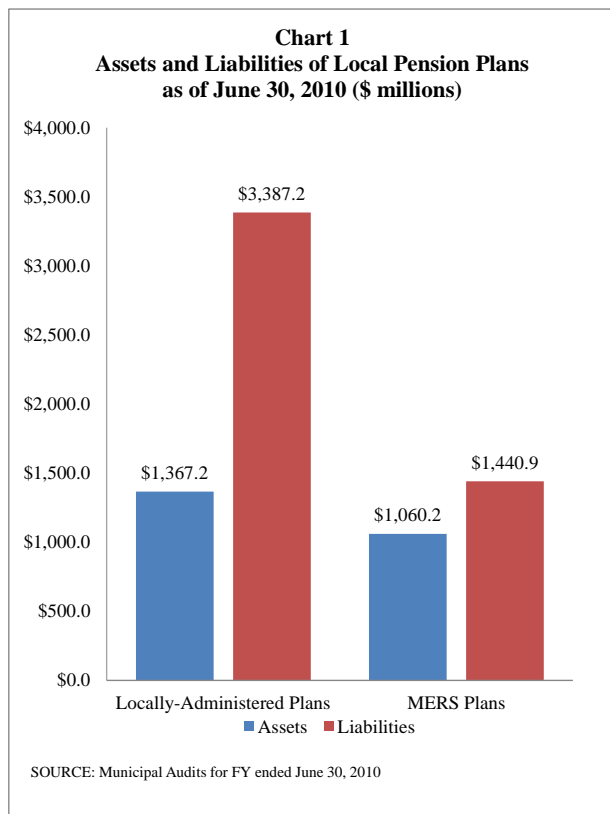
Sources: Comprehensive Annual Financial Report for FY Ended June 30, 2010; municipal financial reports for FY 2010 (except for Scituate and East Providence); Municipal Employees' Retirement System Actuarial Valuation Report as of June 30, 2010; State of Rhode Island Employees' Retirement System Fiscal Year Ended June 30, 2010; Rhode Island State Employees' and Electing Teachers OPEB Actuarial Valuation Report, June 30, 2009

Local Pension and OPEB

Currently, there are approximately 150 local pension plans in the State of Rhode Island. Of these plans, approximately 110 plans are administered by the state under the MERS plan for 30 communities. Assets in MERS are comingled with the other three state plans, but, as with the other state plans, they are accounted for separately and only used to pay benefits for members of that plan. In addition to MERS plans, there are an additional 36 locally-administered plans in 24 communities.

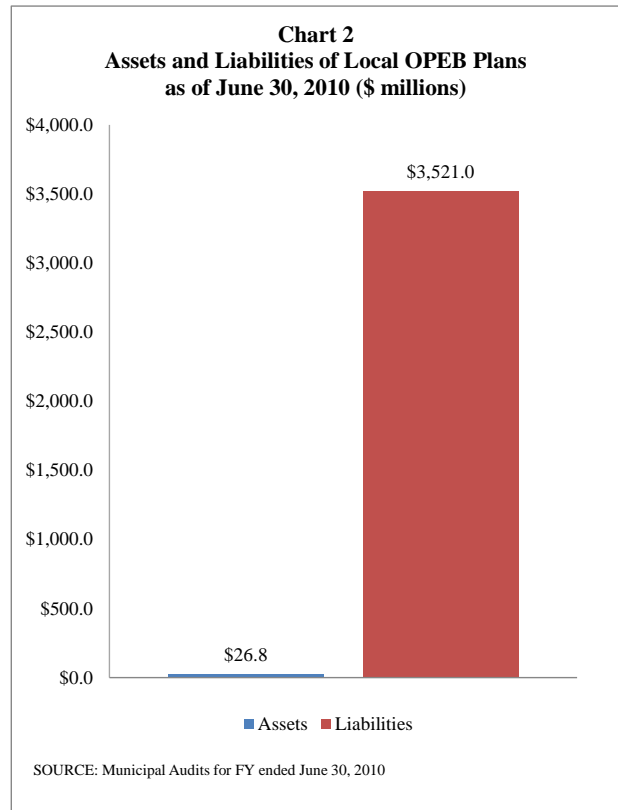
Based on the most recent valuations, the total unfunded pension liability for municipal governments, including the local share of teacher pensions, was \$4.1 billion. Less than 50.0 percent of this liability – \$2.0 billion – was for locally-administered plans. The unfunded liability for the local share of teacher retirement was

\$1.7 billion, while the unfunded liability for plans in the MERS system was \$380.8 million. In FY 2010, local ARCs amounted to \$296.6 million, while total payments totaled \$267.1 million (90.1 percent of the ARC). All MERS plans met 100.0 percent of their obligation, while locally-funded plans funded, on average, 81.8 percent of their ARC. As of June 30, 2010, locally-administered plans had a cumulative funding ratio of 40.4 percent, compared to a cumulative funding ratio of 73.6 percent for plans under MERS.



Based on municipal audits for the fiscal year ended June 30, 2010, the total local OPEB liabilities – including OPEB liabilities for the four regional school districts – totaled \$3.5 billion. Across the state, only 10 communities had started to pre-fund their OPEB obligations by the end of FY 2010. Plan assets across the state were \$26.8 million, resulting in an unfunded liability of \$3.5 billion and a statewide funding ratio of 0.8 percent. Municipalities paid \$116.8 million toward their

FY 2010 OPEB obligation, or 49.0 percent of the total ARC payment of \$238.5 million.



Municipal Pension and OPEB Obligations by Community

Of the total \$11.4 billion unfunded liability for state and local pensions and OPEB, 66.9 percent is related to unfunded local obligations. Funding these liabilities represents a significant – and growing – challenge to municipalities across the state. As market losses from the past few years are phased-in, and actuarial valuations are adjusted to reflect these changes, along with revised mortality, salary and other estimates, unfunded liabilities and, thus, payments, will continue to increase for most communities. This section examines pension and OPEB liabilities by community, as well as how communities have funded these liabilities. All data is from municipal audits, and state actuarial valuation reports, and represent the most recent, published information available.

Assets, Liabilities and Funding Ratios

Cumulatively, municipal pension plans (excluding the local share of teacher retirement) were 50.3 percent funded in FY 2010, while local OPEB plans were, cumulatively, 0.8 percent funded. However, pension and OPEB plan assets and liabilities vary significantly between communities. Based on the most recent valuation data, as shown in table 2, total pension obligation funding ratios (including municipal, public safety and other plans) ranged from a low of 20.1 percent in Coventry to a high of 89.9 percent in North Smithfield. (NOTE: municipal employees in Exeter participate in a 401(k)-style plan). On a disaggregated basis, the Central Falls “police and fire 1 percent plan” (prior to 7/1/72) had the lowest cumulative funding ratio at 8.8 percent while Scituate’s police pension plan was funded at almost seven times its actuarial liability. As with pension funding, outstanding OPEB obligations vary by community, although to a lesser extent as the majority of municipalities fund these obligations on a pay-go basis. Total OPEB cumulative funding ratios ranged from a low of 0.0 percent in 28 communities (excluding New Shoreham, who is not required to disclose their OPEB liability) to a high of 56.6 percent in Westerly.

**Table 2
Municipal Pension and OPEB Assets, Liabilities and Funding Ratios*
(\$ thousands)**

Municipalities	Pension			OPEB		
	Plan Assets	Liability	Funding Ratio	Plan Assets	Liability	Funding Ratio
Barrington	\$45,275.5	\$58,117.3	77.9%	\$3,513.8	\$21,471.7	16.4%
Bristol	30,926.4	48,131.8	64.3%	1,675.0	43,719.4	3.8%
Burrillville	31,008.6	35,308.2	87.8%	0.0	1,693.9	0.0%
Central Falls	12,944.9	62,034.6	20.9%	0.0	32,011.5	0.0%
Charlestown	10,522.4	16,907.3	62.2%	502.0	5,436.3	9.2%
Coventry	11,412.4	56,900.8	20.1%	0.0	12,835.0	0.0%
Cranston	220,508.3	511,089.6	43.1%	450.5	81,925.4	0.5%
Cumberland	33,573.9	55,804.3	60.2%	0.0	46,872.0	0.0%
East Greenwich	37,036.9	45,075.4	82.2%	0.0	13,840.8	0.0%
East Providence**	124,097.2	231,072.9	53.7%	0.0	106,001.5	0.0%
Exeter	0.0	0.0	N/A	0.0	1,937.7	0.0%
Foster	5,072.8	7,087.3	71.6%	0.0	1,874.8	0.0%
Glocester	10,988.6	15,436.6	71.2%	0.0	4,510.7	0.0%
Hopkinton	8,323.2	10,934.1	76.1%	0.0	610.6	0.0%
Jamestown	17,060.0	21,623.2	78.9%	0.0	15,814.3	0.0%
Johnston	64,299.7	162,453.7	39.6%	0.0	226,042.8	0.0%
Lincoln	18,072.1	25,953.8	69.6%	0.0	24,880.8	0.0%
Little Compton	4,990.6	7,757.6	64.3%	0.0	1,954.2	0.0%
Middletown	56,472.8	77,040.6	73.3%	2,500.3	32,388.0	7.7%
Narragansett	53,793.7	77,854.4	69.1%	0.0	72,792.5	0.0%
Newport	118,320.4	231,985.2	51.0%	8,486.7	125,947.1	6.7%
New Shoreham	5,615.7	7,734.8	72.6%	0.0	0.0	0.0%
North Kingstown	83,524.1	124,658.8	67.0%	0.0	34,510.7	0.0%
North Providence	74,216.0	92,161.5	80.5%	0.0	52,758.0	0.0%
North Smithfield	20,727.8	23,048.9	89.9%	0.0	5,796.7	0.0%
Pawtucket	144,182.1	311,165.1	46.3%	0.0	378,184.0	0.0%
Portsmouth	32,779.6	54,054.9	60.6%	0.0	17,541.2	0.0%
Providence	427,891.0	1,256,375.0	34.1%	1,040.0	1,498,491.0	0.1%
Richmond	2,302.3	3,107.3	74.1%	0.0	615.7	0.0%
Scituate***	11,800.4	23,459.9	50.3%	0.0	4,713.8	0.0%
Smithfield	44,182.6	75,077.5	58.8%	657.4	29,610.8	2.2%
South Kingstown	66,509.9	86,209.7	77.1%	0.0	18,700.0	0.0%
Tiverton	28,744.7	39,447.5	72.9%	0.0	36,172.9	0.0%
Warren	12,109.7	21,084.6	57.4%	700.0	20,024.2	3.5%
Warwick	313,214.7	549,837.5	57.0%	0.0	270,992.6	0.0%
Westerly	15,649.2	28,747.9	54.4%	7,301.1	12,896.2	56.6%
West Greenwich	4,913.3	7,894.3	62.2%	0.0	1,937.0	0.0%
West Warwick	35,588.0	119,658.0	29.7%	0.0	136,587.3	0.0%
Woonsocket	188,489.8	245,798.8	76.7%	0.0	126,879.9	0.0%
Total	\$2,427,141.2	\$4,828,090.8	50.3%	\$26,826.8	\$3,520,972.6	0.8%

* Pension totals exclude fire districts, housing authorities and lighting districts; OPEB totals include regional school districts; represents the most recent information available.

** East Providence fiscal year is Nov 1 to Oct 31

*** Scituate fiscal year is April 1 to March 31

SOURCE: Division of Municipal Finance; municipal financial reports for FY 2010 (except for Scituate and East Providence); Municipal Employees' Retirement System Actuarial Valuation Report as of June 30, 2010; Fiscal Year Ended June 30, 2010

Table 3
FY 2010 Pension and OPEB ARC Payments and Municipal Levies (\$ thousands)

	FY 2010 Levy	Total Pension*			ARC as % of FY 2010 Levy	Total Pension + OPEB			ARC as % of FY 2010 Levy
		ARC	Paid	%		ARC	Paid	%	
Barrington	\$51,856.5	\$3,166.5	\$3,166.5	100.0%	6.1%	\$5,763.6	\$4,693.0	81.4%	11.1%
Bristol	33,449.3	3,260.8	3,356.3	102.9%	9.7%	5,976.1	5,932.7	99.3%	17.9%
Burrillville	21,867.6	1,948.7	1,948.7	100.0%	8.9%	2,082.0	2,075.7	99.7%	9.5%
Central Falls	10,570.4	4,347.9	1,769.1	40.7%	41.1%	6,377.2	2,913.9	45.7%	60.3%
Charlestown	20,395.7	1,290.2	1,290.2	100.0%	6.3%	1,738.5	1,784.7	102.7%	8.5%
Coventry	59,014.1	8,068.7	7,001.9	86.8%	13.7%	9,268.7	7,860.9	84.8%	15.7%
Cranston	160,419.3	32,932.6	30,093.3	91.4%	20.5%	40,355.2	35,745.2	88.6%	25.2%
Cumberland	52,120.0	5,111.8	4,007.9	78.4%	9.8%	8,904.8	5,174.2	58.1%	17.1%
East Greenwich	41,524.3	2,265.5	2,265.5	100.0%	5.5%	4,009.3	2,694.3	67.2%	9.7%
East Providence**	87,805.6	12,938.4	8,249.1	63.8%	14.7%	19,890.0	14,207.8	71.4%	22.7%
Exeter	11,763.4	853.6	853.6	100.0%	7.3%	1,078.4	982.3	91.1%	9.2%
Foster	10,345.7	765.2	765.2	100.0%	7.4%	966.6	946.9	98.0%	9.3%
Glocester	20,380.9	1,639.2	1,639.2	100.0%	8.0%	2,101.6	2,047.0	97.4%	10.3%
Hopkinton	15,794.0	1,236.3	1,236.3	100.0%	7.8%	1,295.3	1,293.1	99.8%	8.2%
Jamestown	17,734.7	1,288.3	1,312.6	101.9%	7.3%	2,422.3	1,699.0	70.1%	13.7%
Johnston	63,658.4	10,707.6	10,032.6	93.7%	16.8%	29,888.0	14,505.3	48.5%	47.0%
Lincoln	50,599.5	3,866.1	3,824.3	98.9%	7.6%	5,858.9	4,709.7	80.4%	11.6%
Little Compton	9,441.5	802.3	718.8	89.6%	8.5%	1,027.2	837.8	81.6%	10.9%
Middletown	39,247.1	5,991.1	6,164.3	102.9%	15.3%	8,017.3	6,611.0	82.5%	20.4%
Narragansett	42,106.8	3,069.0	3,015.0	98.2%	7.3%	9,618.9	4,462.7	46.4%	22.8%
Newport	60,914.8	9,833.1	10,233.1	104.1%	16.1%	18,883.4	21,474.4	113.7%	31.0%
New Shoreham	7,529.9	734.9	734.9	100.0%	9.8%	734.9	734.9	100.0%	9.8%
North Kingstown	63,293.6	6,277.7	6,277.7	100.0%	9.9%	8,684.9	7,352.4	84.7%	13.7%
North Providence	60,468.7	4,869.3	4,086.1	83.9%	8.1%	9,158.3	6,031.1	65.9%	15.1%
North Smithfield	25,090.1	1,326.9	1,326.9	100.0%	5.3%	1,898.9	1,654.4	87.1%	7.6%
Pawtucket	88,299.4	17,530.0	17,111.1	97.6%	19.9%	40,411.7	28,527.5	70.6%	45.8%
Portsmouth	42,275.9	4,674.3	4,674.3	100.0%	11.1%	6,755.0	5,642.4	83.5%	16.0%
Providence	294,186.9	69,190.5	67,014.5	96.9%	23.5%	148,770.5	106,025.5	71.3%	50.6%
Richmond	14,376.8	1,156.3	1,156.3	100.0%	8.0%	1,215.8	1,213.6	99.8%	8.5%
Scituate***	24,570.7	2,457.1	2,230.6	90.8%	10.0%	2,986.8	2,409.0	80.7%	12.2%
Smithfield	46,156.6	4,295.9	4,461.7	103.9%	9.3%	6,603.4	5,819.8	88.1%	14.3%
South Kingstown	64,504.2	4,314.3	4,314.3	100.0%	6.7%	4,827.2	4,827.2	100.0%	7.5%
Tiverton	32,187.3	2,913.6	1,890.2	64.9%	9.1%	6,136.0	3,253.1	53.0%	19.1%
Warren	19,874.7	1,566.3	1,566.3	100.0%	7.9%	2,956.0	2,574.1	87.1%	14.9%
Warwick	204,173.3	29,971.0	36,397.7	121.4%	14.7%	54,468.3	46,228.9	84.9%	26.7%
Westerly	59,205.1	4,740.0	4,556.5	96.1%	8.0%	5,705.6	5,341.8	93.6%	9.6%
West Greenwich	16,850.5	1,095.5	1,095.5	100.0%	6.5%	1,352.8	1,256.7	92.9%	8.0%
West Warwick	51,701.0	8,674.4	5,375.3	62.0%	16.8%	18,001.9	8,948.7	49.7%	34.8%
Woonsocket	44,130.6	9,578.0	6,888.4	71.9%	21.7%	23,105.9	10,452.3	45.2%	52.4%
Total	\$2,039,884.5	\$290,748.9	\$274,101.8	94.3%	14.3%	\$529,297.4	\$390,944.8	73.9%	25.9%

* Totals exclude fire districts, housing authorities and lighting districts; includes school district ERSRI and private pension plans in MERS districts.

** East Providence fiscal year is Nov 1 to Oct 31

*** Scituate fiscal year is April 1 to March 31

SOURCE: Division of Municipal Finance; municipal financial reports for FY 2010 (except for Scituate and East Providence); Municipal Employees' Retirement System Actuarial Valuation Report as of June 30, 2010; Fiscal Year Ended June 30, 2010; Uniform Chart of Accounts, FY 2010

ARC Payments and Share of Levy

Table 3 shows the total ARC for pension (including the local share of teacher retirement) and OPEB in FY 2010. Statewide, the total ARC for pension payments was \$290.7 million, or 14.3 percent of the total FY 2010 levy. Communities funded 94.3 percent, or \$274.1 million, of this obligation. Central Falls had the lowest contribution ratio of 41.1 percent across their four plans, largely due to the fact that the city did not fund any of its \$2.6 million ARC payment for its local police and fire pension plan. Conversely, Warwick overpaid its ARC by 21.4 percent in FY 2010, largely due to additional payments made to its “local police and fire I plan” (city police officers appointed prior to 2/1/72 and fire department personnel appointed before 5/29/92). If communities had fully funded their ARC, contributions as a share of the municipal levy would have ranged from a low of 5.3 percent in North Smithfield to a high of 41.1 percent in Central Falls.

When OPEB is included, total payments increased to \$390.5 million, or 73.9 percent of the total \$528.6 million ARC. The FY 2010 pension and OPEB ARC represented 25.8 percent of the total FY 2010 levy. Payments as a share of the total ARC ranged from a low of 45.2 percent in Central Falls to a high of 113.7 percent in Newport, which contributed 124.2 percent of its OPEB ARC in FY 2010. Although Central Falls had the lowest contribution ratio when pension and OPEB liabilities are combined, Middletown had the lowest OPEB contribution ratio in FY 2010, contributing 22.0 percent of their ARC. Seventeen communities contributed less than 50.0 percent of their total ARC in FY 2010.

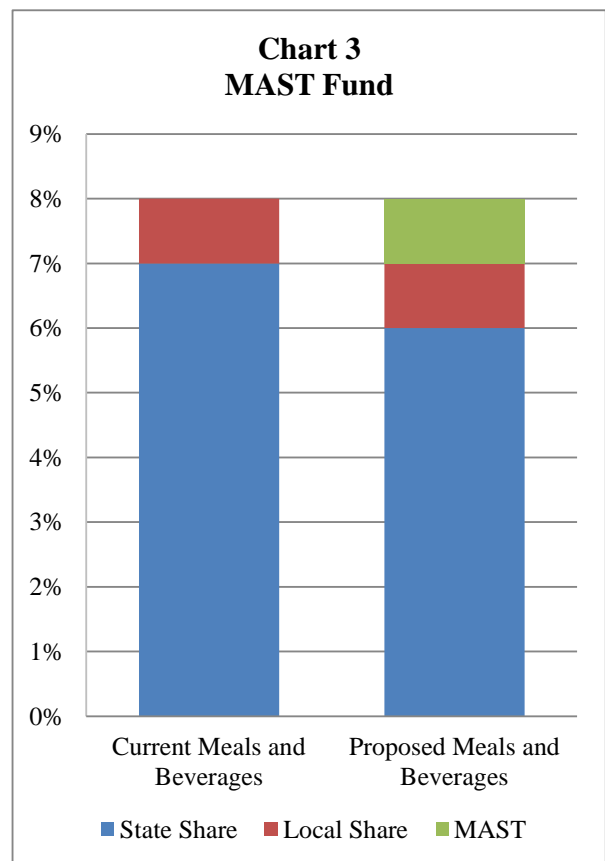
Municipal Accountability, Stability and Transparency Fund

Article 39 of Governor Chafee’s FY 2012 proposed budget creates the MAST Fund, a fiscal incentive plan to encourage communities to employ transparent and sustainable

budgeting practices. To receive the aid, municipalities must comply with mandates that focus on transparency of local budgets, long-term planning and reporting requirements, and sustainability of retirement benefit plans. Cities and towns are incentivized to comply with these requirements through the promise of state aid (the MAST fund). At the same time, there is also a penalty for non-compliance in the third year of the program.

MAST Funding and Requirements

Currently, there is a 7.0 percent state sales tax on food and beverages sold for immediate consumption and a 1.0 percent local meals and beverage tax. As part of Governor Chafee’s proposal to lower the sales rate from 7.0 to 6.0 percent, funding for MAST will come from the retention of the 8.0 percent total tax on meals and beverages. The 1.0 percent remainder from the sales tax rate reduction will go to a dedicated fund to support the MAST program.



In FY 2012, municipalities will be required to comply with the following practices:

- Development of two five-year forecasts, presented to the Department of Municipal Finance; a baseline forecast and a second forecast showing municipal and school district pensions and OPEB ARCs funded at 100 percent. The forecasts must show underlying actuarial assumptions;
- Provision of fiscal impact statements for changes in health care benefits, pension and OPEB, that reflect the effect of the changes on the unfunded liability and ARC;
- Timely reporting of quarterly financial reports, Annual Budget Survey, and Comprehensive Annual Financial Reports (CAFR); and
- Participation in electronic reporting and implementation of Municipal Uniform Chart of Accounts (UCOA) within six months of implementation of either initiative.

In FY 2013, municipalities will receive MAST funds if they:

- Comply with the practices started in FY 2012;
- Fund 100.0 percent of their pension ARC over a maximum of five years; and
- Make additional contributions equal to 10.0 percent over and above the actual contribution made in the prior fiscal year if the municipality's pension plan has a funded ratio below 50.0 percent. This additional contribution would continue until the municipality's funding ratio is 50.0 percent or higher.

Beginning in FY 2014 municipalities will need to comply with practices and pension requirements outlined for FY 2012 and FY 2013. Additionally, communities must:

- Fund 100.0 percent of their OPEB ARC over maximum 10 years; and

- Join a multiple employer health care trust once such a trust is established unless the municipality has already established a health care trust.

There is a penalty for non-compliance with the mandates beginning in FY 2014. Communities that do not adhere to the above practices will see a decrease of five percentage points per year in the state's contribution to teacher retirement (currently 40.0 percent).

MAST Fiscal Impact on Communities

In 2006, the Rhode Island General Assembly passed legislation, commonly referred to as "S3050", which limits property tax levy increases. Beginning in FY 2008, the maximum property tax levy increase was capped at 5.25 percent. The maximum increase was decreased by 0.25 percent per year to 4.0 percent in FY 2013. The property tax levy increase will be capped at 4.0 percent in subsequent years. Communities may qualify for an exemption if they meet a specified set of criteria: 1) a loss of non-property tax revenues, 2) in the event that growth in debt service exceeds the maximum allowable levy growth, and 3) if the community experiences significant growth in its tax base. These exemptions must be approved by a supermajority of the town council and by the Division of Municipal Finance. In addition, an exemption may be granted in the event of an emergency. This exemption must be certified by the Auditor General.

Table 4 shows the fiscal impacts of MAST mandates on Rhode Island communities for FY 2013 and 2014. Pension and OPEB ARC changes were calculated based on the community's fiscal disposition as of June 30, 2010. Communities with pension plans that were less than 50.0 percent funded in FY 2010 were subject to the 10.0 percent increase as outlined in the FY 2013 mandates. In addition, FY 2013 payments include the first of five years of making up the difference between their ARC and their contribution (assuming the gap was decreased by an equal amount each year).

Fiscal year 2014 data includes the additional amount communities would pay in order to fully fund their OPEB ARC as per the practices set out in the legislation. That is, the obligation represents one-tenth of the total gap between a community's ARC and actual payment. It should be noted that a community's funding strategy is subject to approval by, or agreement with the Division of Municipal Finance.

The middle column of the table, "maximum increase in levy", shows the maximum amount that a municipality could raise its property tax levy under S 3050. The final column calculates the percentage of the maximum levy increase that would be dedicated to meeting the enhanced pension and OPEB ARC requirements (NOTE: this analysis does not reflect any projected actuarial increases). Based on this analysis, 19 municipalities would not be subject to increased pension liabilities due to MAST mandates in FY 2013; however, by FY 2014 only three communities – Charlestown, New Shoreham and South Kingstown, two of which have fully funded their OPEB liability and one

**Table 4
Fiscal Impact of MAST Mandates, FY 2013 and FY 2014**

	Pension and OPEB ARC Change Due to MAST		Max Increase in Levy		% of Max Levy Increase	
	2013 (1)	2014 (2)	2013	2014	2013	2014
Barrington	\$0	\$107,062	\$2,247,572	\$2,337,475	0.0%	4.6%
Bristol	0	13,881	1,431,157	1,488,403	0.0%	0.9%
Burrillville (D)	0	624	981,914	1,021,191	0.0%	0.1%
Central Falls (D,S)	641,801	794,431	525,956	546,994	122.0%	145.2%
Charlestown	0	0	876,355	911,409	0.0%	0.0%
Coventry	495,829	579,512	2,483,770	2,583,121	20.0%	22.4%
Cranston	2,504,856	2,932,403	7,297,634	7,589,540	34.3%	38.6%
Cumberland	241,916	528,785	2,365,760	2,460,391	10.2%	21.5%
East Greenwich	0	131,501	1,799,162	1,871,128	0.0%	7.0%
East Providence (D,S)	937,857	1,037,151	3,980,232	4,139,441	23.6%	25.1%
Exeter	0	9,614	512,076	532,559	0.0%	1.8%
Foster	0	1,969	448,976	466,935	0.0%	0.4%
Glocester	0	5,455	874,048	909,010	0.0%	0.6%
Hopkinton	0	222	731,853	761,127	0.0%	0.0%
Jamestown	0	74,755	764,608	795,193	0.0%	9.4%
Johnston (S)	796,300	2,346,708	2,772,371	2,883,266	28.7%	81.4%
Lincoln	8,351	119,103	2,183,376	2,270,711	0.4%	5.2%
Little Compton	16,704	27,291	410,772	427,203	4.1%	6.4%
Middletown	0	157,951	1,674,244	1,741,214	0.0%	9.1%
Narragansett	31,439	542,864	1,833,930	1,907,287	1.7%	28.5%
Newport	398,126	437,938	2,540,104	2,641,708	15.7%	16.6%
New Shoreham	0	0	328,074	341,197	0.0%	0.0%
North Kingstown	0	133,252	2,742,470	2,852,169	0.0%	4.7%
North Providence (D,S)	156,640	391,040	2,723,488	2,832,427	5.8%	13.8%
North Smithfield	0	24,451	1,127,343	1,172,436	0.0%	2.1%
Pawtucket (D,S)	1,057,325	2,309,588	3,854,958	4,009,156	27.4%	57.6%
Portsmouth	0	111,263	1,842,097	1,915,781	0.0%	5.8%
Providence (D,S)	5,347,500	9,939,150	12,802,523	13,314,624	41.8%	74.6%
Richmond	0	224	628,585	653,728	0.0%	0.0%
Scituate	91,032	135,271	1,035,908	1,077,345	8.8%	12.6%
Smithfield	281,230	386,658	2,011,321	2,091,773	14.0%	18.5%
South Kingstown	0	0	2,731,326	2,840,579	0.0%	0.0%
Tiverton	204,672	411,096	1,447,144	1,505,029	14.1%	27.3%
Warren	0	38,186	882,267	917,558	0.0%	4.2%
Warwick (S)	2,597,893	4,324,289	8,711,046	9,059,488	29.8%	47.7%
Westerly	40,094	58,467	2,624,330	2,729,303	1.5%	2.1%
West Greenwich	0	9,611	734,292	763,663	0.0%	1.3%
West Warwick (D,S)	909,811	1,576,204	2,161,807	2,248,279	42.1%	70.1%
Woonsocket (D,S)	537,916	1,534,317	2,121,179	2,206,026	25.4%	69.6%
Total	\$17,297,291	\$31,232,285	\$89,246,027	\$92,815,868	19.4%	33.6%

(1) Represents one-fifth of the gap between the municipality's ARC and their contribution to the pension; the dollar amount includes the 10.0 percent penalty.

(2) Represents one-tenth of gap between OPEB ARC pension payment and contribution, includes penalty.

* Pension excludes fire, lighting, and housing authority districts; OPEB includes regional districts

D = Community receiving Distressed Communities Aid; S = Community was identified as fiscally stressed

SOURCE: Division of Municipal Finance; municipal financial reports for FY 2010 (except for Scituate and East

Providence); Municipal Employees' Retirement System Actuarial Valuation Report as of June 30, 2010; Fiscal Year Ended

June 30, 2010; Uniform Chart of Accounts, FY 2010; State budget documents; "Report to Measure the Fiscal Stress and

Financial Condition of Rhode Island Cities and Towns"; RIPEC calculations based on MAST documents

of which does not have any stated liability – would not see any increase in their retirement benefit payments due to MAST requirements.

Based on RIPEC calculations, statewide, the increased costs associated with MAST would account for 19.4 percent of the maximum allowable levy increase in FY 2013. In FY 2014, these expenditures would account for 33.6 percent of the statewide maximum levy increase. Not all communities would be affected equally; the increased pension costs would account for less than 1.0 percent of the maximum allowable levy increase in FY 2013 in 20 communities. However, this number drops to nine when communities must start working to fully fund their OPEB obligations in FY 2014.

Moreover, MAST requirements are projected to account for a significant share of levy increases – even if communities go to the cap each year – in a number of municipalities. Many of these communities have been designated by the state as fiscally stressed, determined by the Division of Municipal Finance’s January 28, 2010 “Report to Measure the Fiscal Stress and Financial Condition of Rhode Island Cities and Towns”. Similarly, a number of these municipalities receive Distressed Communities Aid in recognition of their high tax burden relative to their ability to pay.

If Central Falls, a community both designated as fiscally stressed and a recipient of Distressed Communities Aid, fully complied with the MAST Fund mandates, the town would need to contribute 122.0 percent of its maximum levy increase to pension payments in FY 2013. In 2014 this would increase 145.2 percent. Similarly, Johnston, which was designated as a fiscally-stressed community, would contribute an estimated additional \$796,300 to their pension payments, accounting for 28.7 percent of the increase in their total maximum levy that year. By FY 2014, the increase in their combined pension and OPEB payment will increase to \$2.3 million, while their levy increase would be capped at \$2.9 million. Johnston would need to allocate 81.4 percent of the levy increase to cover the increase in their

retirement benefit costs associated with the MAST program.

Comments

Unfunded pension and OPEB obligations represent a significant fiscal commitment on behalf of governments. In general, these costs account for a large share of budgets. If municipalities had fully funded their retirement benefit commitments in FY 2010, these payments would have accounted for approximately one-quarter of the total statewide levy. In addition, outstanding obligations and how communities choose to fund these costs have an effect on bond ratings and the ability of governments to borrow. The Governor’s proposed MAST program is an attempt to address the funding of these obligations, as well as to promote fiscal transparency at the local level and to support responsible budgeting and disclosure practices.

While the MAST program is a first step toward promoting sustainable local budgets, the requirements outlined in the MAST plan have the potential to put additional fiscal stress on already-strained communities. While there are funds attached to the program, they are not enough to offset the increase in costs for a number of municipalities. Notably, the cities and towns most impacted by the requirements under the proposal have been designated as fiscally-stressed by the state. Similarly, of the eight municipalities that receive Distressed Communities Aid, indicating a limited ability of their residents to support tax increases, six would see an increased ARC obligation equal to 25.0 percent or more of their maximum levy growth by FY 2014. Under the current proposal, the communities the most impacted are, in general, those least able to adhere to the requirements.

Local aid has declined \$246.0 million since its peak in FY 2008, due to the elimination of general revenue sharing and the reduction in the

motor vehicle excise tax reimbursement. Moreover, changes made at the state level to affect pension costs for teachers did not result in any cost-savings for municipalities as the state reduced education aid by an amount equal to the savings. The ability to control costs, particularly as they relate to cost drivers such as pension and OPEB liabilities, is essential if local governments are to be able to sustain basic services without undue pressure on local taxpayers. If the state is to require local governments to fully fund their pension and OPEB obligations, they must provide local governments with the ability to make fundamental changes to their cost structure, similar to the actions already taken by the state.

It should be noted that, while the long-term obligations are significant, they can be reduced through changes to the benefit structure. For example, the introduction of cost-sharing for retiree health could enable communities to significantly reduce their unfunded OPEB obligation. Other potential changes may include adjusting COLAs, modifying disability pensions or introducing alternate retirement benefit systems such as hybrid plans.

The General Assembly is considering several bills that would alter long-term funding requirements for retirement benefits that include:

- HB 5113 (sponsored by Rep. Gallison, Edwards, O'Grady, San Bento, and Azzinaro; introduced 1/25/2011) would authorize the general treasurer to deduct the amount owed by the municipality to the state for any purpose other than for education if the municipality has failed to contribute 100.0 percent of the annual required contribution to its pension plan(s);
- HB 5840 (sponsored by Rep. Menard, Malik, MacBeth, Schadone, Costa; introduced 3/8/2011) would eliminate the cost-of-living retirement adjustments for all teachers and state employees and

their surviving spouses or domestic partners. There is no impact on MERS or locally-administered plans; and

- SB 0896 (sponsored by Sen. Miller and Gallo; introduced 4/14/2011) would maintain previously negotiated retiree health benefits for current employees regardless of future employee contracts for new hires and would create a board to examine the feasibility of a uniform medical and prescription benefit plan for Rhode Island municipal employees.

Two bills, SB 0966 (sponsored by Sen. DaPonte; introduced 5/12/2011) and HB 5884 (sponsored by Rep. Brien, Trillo, Jackson and Malik; introduced 3/8/2011) would reduce the disability retirement allowance of municipal pension benefits for police or fire department employees except in the case of permanent and total disability, similar to changes made at the state level. In addition, the bills implement minimum retirement age requirements for non-vested employees participating in MERS plans, and stipulate that no municipal ordinance, collective bargaining agreement or arbitration award may require employee benefits that exceed the actuarial value of benefits afforded under state law for municipal employees participating in MERS for non-vested employees.

Additionally, HB 5137 and SB 0050 (sponsored by Rep. Gallison, Martin, San Bento, Blazejewski, O'Grady; introduced 1/25/2011; sponsored by Sen. DiPalma, DaPonte, Sheehan, Sosnowski, Lombardo; introduced 1/19/2011, respectively) would allow cities or towns and regional school districts to jointly establish a corporation to manage and operate OPEB trusts. These bills build upon previous legislation that allowed the creation of OPEB trusts.

House bills 6193 and 6209, (sponsored by Rep. Morgan, Chippendale; introduced 5/26/2011; sponsored by Rep. Brien, Jackson, Edwards,

Newberry; introduced 6/1/2011, respectively), require locally-administered and quasi-municipal plans to annually adjust disability pensions of pension beneficiaries according to compensation earned in alternate employment except in the case of total and permanent disabilities.

Changes to retiree benefit systems should be a part of a holistic approach to restructuring government at both the state and local level. In addition to ensuring sustainability, employee benefit packages should ensure that governments are able to attract and retain quality employees. The state has made a number of changes to its pension systems over the years, but still faces increasing costs that will be unsustainable in the near future, particularly as the state begins to fund its OPEB obligation. Municipal governments face similar, if not more severe, funding challenges with regard to their retirement benefit obligations, but, in most cases, lack the ability to affect the type of full-scale change that needs to occur to ensure that these plans both are sustainable and represent the long-term goals of employees, governments and taxpayers.