



Financial Services Audit Committee Communication

Date: June 19, 2020

To: Great Lakes Water Authority Audit Committee

From: Kim Garland, CPA, Reporting & Compliance Manager

Re: General Retirement System Financial Report and Annual Actuarial Valuation for Year End June 30, 2019 (City of Detroit Component II)

Background: The Great Lakes Water Authority (GLWA) assumed a portion of the legacy pension commitment assigned to the Detroit Water & Sewerage Department (DWSD) pursuant to the terms of the regional water and sewer system leases. For this reason, GLWA monitors activity related to the City of Detroit General Retirement System (GRS). While there are two plans managed by GRS, GLWA is impacted by only the Component II plan. Component II was closed as of June 30, 2014 under the City of Detroit bankruptcy plan of adjustment and is commonly referred to as the 'legacy plan'.

The following reports have been presented to the GRS Board and are attached.

1. Letter from the GRS external audit firm to those charged with governance for the General Retirement System of the City of Detroit for the year ending June 30, 2019
2. Audited Financial Report for the General Retirement System of the City of Detroit (dated November 26, 2019)
3. GASB Statement No. 67 and 68 Accounting and Financial Reporting of Financial Plans of Component II June 30, 2018 (dated November 8, 2019)
4. Annual Actuarial Valuation as of June 30, 2019 (dated February 26, 2020)

While the external auditor letter (#1 above) to those charged with governance did highlight some areas for improvement, the overall financial audit for the GRS combined plans received an unqualified opinion for the year ending June 30, 2019. This balance of this discussion will focus on the remaining reports: the results of the Audited Financial Report (#2 above) and GASB Statement No. 67 and 68 Report (#3 above) which are based on prior year actuarial results and serve as the basis for the DWSD and GLWA pension expense and liability to be reported in FY 2020,. Finally, we will address the most recent June 30, 2019 Actuarial Valuation Report (#4 above) which provide insight into future pension expense and liability expectations.

Analysis: As reported in the GASB Statement No. 67 and 68 Accounting and Financial Report, and shown below in Table 1, the June 30, 2019 Component II Net Pension Liability increased from \$832.7 million to \$934.7 million as of June 30, 2018 (approximately 12%).

Table 1: GASB Statement No. 67 and 68 Report - Executive Summary

Executive Summary as of June 30, 2019	
Actuarial Valuation Date	June 30, 2018
Measurement Date of the Net Pension Liability	June 30, 2019
Employer's Fiscal Year Ending Date (GASB No. 68 Reporting Date)	June 30, 2020
Membership	
Number of	
- Retirees and Beneficiaries	11,684
- Inactive, Nonretired Members	3,236
- Active Members	3,018
- Total	17,938
Covered Payroll	\$ 149,373,313
Net Pension Liability	
Total Pension Liability	\$ 2,733,602,681
Plan Fiduciary Net Position	1,798,906,827
Net Pension Liability	\$ 934,695,854
Plan Fiduciary Net Position as a Percentage of Total Pension Liability	65.81%
Net Pension Liability as a Percentage of Covered Payroll	625.74%
Development of the Single Discount Rate	
Single Discount Rate	7.38%
Long-Term Expected Rate of Investment Return	7.38%
Long-Term Municipal Bond Rate*	3.13%
Last year ending June 30 in the 2020 to 2119 projection period for which projected benefit payments are fully funded	2119
Total Pension Expense	\$ 122,330,696

Source: GASB Statement Nos. 67 and 68 Accounting and Financial Reporting for Pension Plans of Component II, June 30, 2019 (dated November 8, 2019), p 1.

The June 30, 2019 pension liability increase is largely attributed to the decline in actual net investment income of 2.64% as compared to June 30, 2018 of 8.64% and to the expected rate of return of 7.38%. Also, during the year ended June 30, 2019 other provisions such as the Annuity Saving Fund interest credits added approximately \$9.9 million to the liability for 2017 and 2018 fiscal year. This topic will be discussed in greater detail at a future Audit Committee meeting.

The GASB Statement No. 67 and 68 Accounting and Financial Report also provides a breakdown by unit as shown below in Table 2. The DWSD unit reflects the combined DWSD and GLWA pension obligation. On June 30, 2019 the DWSD Net Pension Liability increased from \$187.7 million to \$189.1 million at June 30, 2018 (approximately 0.7%). This increase is a result of benefit payments exceeding contributions and net investment income.

Table 2: GASB Statement No. 67 and 68 Report - DWSD Changes in Net Pension Liability

Schedule of Changes in Net Pension Liability and Related Ratios Current Period					
Fiscal Year Ended June 30, 2019*					
A. Total Pension Liability	General	DOT	DWSD	Library	Total
1. Service Cost	\$ -	\$ -	\$ -	\$ -	\$ -
2. Interest on the Total Pension Liability	106,206,939	30,424,159	52,205,387	6,653,158	195,489,643
3. Changes of benefit terms	-	-	-	-	-
4. Difference between expected and actual experience of the Total Pension Liability	10,605,505	(1,582,543)	4,924,609	(350,671)	13,596,900
5. Changes of assumptions	0	0	0	0	0
6. Benefit payments, including refunds of employee contributions ^	(138,650,989)	(36,531,401)	(66,156,352)	(7,451,273)	(248,790,015)
7. Net change in Total Pension Liability	\$ (21,838,545)	\$ (7,689,785)	\$ (9,026,356)	\$ (1,148,786)	\$ (39,703,472)
8. Total Pension Liability – Beginning	1,508,443,898	430,517,183	740,468,240	93,876,832	2,773,306,153
9. Total Pension Liability – Ending	<u>\$ 1,486,605,353</u>	<u>\$ 422,827,398</u>	<u>\$ 731,441,884</u>	<u>\$ 92,728,046</u>	<u>\$ 2,733,602,681</u>
B. Plan Fiduciary Net Position					
1. Contributions – employer	\$ 22,765,012	\$ 109,988	\$ 42,900,000	\$ 2,500,000	\$ 68,275,000
2. Contributions – employee	-	-	-	-	-
3. Net investment income	26,329,196	5,625,171	13,078,852	2,136,788	47,170,007
4. Benefit payments, including refunds of employee contributions	(138,650,989)	(36,531,401)	(66,156,352)	(7,451,273)	(248,790,015)
5. Pension Plan Administrative Expense	(2,566,338)	(326,107)	-	(131,498)	(3,023,943)
6. Other	(2,384,050)	(2,234,841)	(169,942)	(559,031)	(5,347,864)
7. Net change in Plan Fiduciary Net Position	\$ (94,507,169)	\$ (33,357,190)	\$ (10,347,442)	\$ (3,505,014)	\$ (141,716,815)
8. Plan Fiduciary Net Position – Beginning	1,094,225,823	209,280,239	552,728,316	84,389,264	1,940,623,642
9. Plan Fiduciary Net Position – Ending	<u>\$ 999,718,654</u>	<u>\$ 175,923,049</u>	<u>\$ 542,380,874</u>	<u>\$ 80,884,250</u>	<u>\$ 1,798,906,827</u>
C. Net Pension Liability	<u>\$ 486,886,699</u>	<u>\$ 246,904,349</u>	<u>\$ 189,061,010</u>	<u>\$ 11,843,796</u>	<u>\$ 934,695,854</u>
D. Plan Fiduciary Net Position as a percentage of the Total Pension Liability	67.25%	41.61%	74.15%	87.23%	65.81%
E. Covered-employee payroll	\$ 95,912,366	\$ 23,056,792	\$ 19,014,424	\$ 11,389,731	\$ 149,373,313
F. Net Pension Liability as a percentage of covered-employee payroll	507.64%	1070.85%	994.30%	103.99%	625.74%

*Totals may not add due to rounding.

On January 24, 2017, under a pension reporting agreement, the parties agreed that 70.3 percent of the liability allocated to the DWSD unit in the table above was attributable to GLWA regional operations and 29.7 percent to DWSD. This is the basis of allocation for future pension contributions with additional breakdowns within each entity between Water and Sewer funds summarized as follows and applied to the current June 30, 2019 liability.

Entity	Percent	Liability Allocation
DWSD - Water	17.8%	\$ 33,652,860
DWSD - Sewer	11.9%	\$ 47,643,374
GLWA - Water	25.2%	\$ 22,498,260
GLWA - Sewer	45.1%	\$ 85,266,515
	100.0%	\$ 189,061,008

Through June 30, 2023 as part of the City of Detroit bankruptcy plan of adjustment (POA), GLWA and DWSD contribute \$2.5 million annually towards administrative expenses for the combined plan. GRS allocates 60% of overall administrative expenses to Component II and 40% to Component I. A breakdown of overall pension administrative expense is provided in the GRS Annual Financial Report Statement of Changes in Fiduciary Net Position by Division shown in Table 3 below.

Table 3: Statement of Changes in Fiduciary Net Position by Division

Combined Plan for the General Retirement System of the City of Detroit							
Statement of Changes in Fiduciary Net Position by Division - Legacy Defined Benefit Plan							
For the Year Ended June 30, 2019							
	DWSD Subdivisions		General Retirement System - Divisions			Total - General Retirement System (all Divisions)	
	GLWA	DWSD-R	DWSD - Division Total (all DWSD Subdivisions)	General Division	DOT	Library	
Beginning Net Position - July 1, 2018	\$ 388,568,003	\$ 164,160,312	\$ 552,728,315	\$ 1,094,225,824	\$ 209,280,239	\$ 84,389,264	\$ 1,940,623,642
Additions:							
Investment income:							
Interest and dividends	6,642,004	2,806,081	9,448,085	19,307,301	4,420,066	1,619,795	34,795,247
Net increase in fair value of investments	4,441,159	1,876,279	6,317,438	12,217,909	2,096,851	899,554	21,531,752
Net unrealized gain on collateralized securities	2,745	1,160	3,905	7,550	1,296	556	13,307
Investment related expenses	(1,891,475)	(799,101)	(2,690,576)	(5,203,567)	(893,042)	(383,117)	(9,170,302)
Net investment income	9,194,433	3,884,419	13,078,852	26,329,193	5,625,171	2,136,788	47,170,004
Contributions:							
Employer contributions:							
Originating from DWSD:							
Regular pension contribution	30,158,700	12,741,300	42,900,000	-	-	-	42,900,000
Contribution for administrative expenses	1,757,500	742,500	2,500,000	-	-	-	2,500,000
DWSD transfer to General Division for administrative expenses	(1,757,500)	(742,500)	(2,500,000)	2,500,000	-	-	-
Total contributions originating from DWSD	30,158,700	12,741,300	42,900,000	2,500,000	-	-	45,400,000
Contributions from other divisions	-	-	-	20,000,000	-	2,500,000	22,500,000
Total employer contributions	30,158,700	12,741,300	42,900,000	22,500,000	-	2,500,000	67,900,000
Foundation for Detroit's Future	-	-	-	265,012	109,988	-	375,000
Total contributions	30,158,700	12,741,300	42,900,000	22,765,012	109,988	2,500,000	68,275,000
ASF recoupment interest	1,267,161	535,344	1,802,505	3,339,736	1,157,478	138,248	6,437,967
Other income	103,278	43,632	146,910	256,516	27,298	13,877	444,601
Total additions	40,723,572	17,204,695	57,928,267	52,690,457	6,919,935	4,788,913	122,327,572
Deductions:							
Member refunds and withdrawals	1,532,924	647,622	2,180,546	6,739,916	4,265,720	450,102	13,636,284
Retirees' pension and annuity benefits	44,974,991	19,000,814	63,975,805	131,911,076	32,265,881	7,001,171	235,153,733
General and administrative expenses	605,479	255,800	861,279	1,705,055	326,107	131,498	3,023,939
ASF Recoupment Write-off	603,798	255,090	858,888	1,442,867	854,064	58,935	3,214,754
Transfer of general and administrative expenses to General Division	(605,479)	(255,800)	(861,279)	861,279	-	-	-
Transfer to Component I (Transition Cost)	886,110	374,359	1,260,469	4,537,435	2,565,552	652,221	9,015,677
Total deductions	47,997,823	20,277,885	68,275,708	147,197,628	40,277,124	8,293,927	264,044,387
Net Increase (Decrease) in Net Position Held in Trust	(7,274,251)	(3,073,190)	(10,347,441)	(94,507,171)	(33,357,189)	(3,505,014)	(141,716,815)
End of Year Net Position Restricted for Pensions - June 30, 2019	\$ 381,293,752	\$ 161,087,122	\$ 542,380,874	\$ 999,718,653	\$ 175,923,050	\$ 80,884,250	\$ 1,798,906,827

Source: Audited Financial Report for the General Retirement System of the City of Detroit (dated November 26, 2019), p 40.

Of the \$2.5 million paid by GLWA and DWSD, \$861 thousand is attributable to the current year and is transferred to the General Division. The remainder is recorded as a prepaid toward future administrative expenses after June 30, 2024 summarized in Table 4 below.

Table 4: Schedule of DWSD/GLWA Contributions Toward Administrative Expenses

Combined Plan for the General Retirement System of the City of Detroit Schedule of DWSD/GLWA Contributions Toward Administrative Expenses as Compared to Actual DWSD/GLWA Allocable Administrative Expenses For the Year Ended June 30, 2019		
	DWSD Division Total GLWA DWSD-R	
Amount Paid in Excess of Administrative Expenses		
Otherwise Allocable - June 30, 2018	\$ 3,219,095	\$ 1,359,991
DWSD/GLWA contribution for administrative expenses in accordance with plan of adjustment and bankruptcy order	1,757,500	742,500
Administrative expenses otherwise allocable to DWSD/GLWA	(605,479)	(255,800)
Cumulative Amount Paid in Excess of Administrative Expenses		
Otherwise Allocable - June 30, 2019	\$ 4,371,116	\$ 1,846,691

Source: Audited Financial Report for the General Retirement System of the City of Detroit (dated November 26, 2019), p 41.

Under the POA, GLWA and DWSD make combined, Component II annual pension payments of \$45.4 million, of which \$2.5 million is specific to administrative expenses discussed previously. Shifting focus to the current June 30, 2019 Actuarial Valuation, those fixed payments are reduced after June 30, 2023 with a tail liability.

The actual amount of this remaining, unfunded liability will vary based upon plan performance and forecasts of the outstanding liability at that time. The June 30, 2019 Actuarial Report estimates the **total** Component II unfunded actuarial accrued liability (UAAL) for June 30, 2020 to be \$1,090.9 million with \$198.6 million for the DWSD-GLWA share.

Funded ratio is a metric used to measure a plan's ability to cover future obligations based on projected contributions. The Component II funded ratio for the period ending June 30, 2019 is 62.77% down from 66.25% the prior year with best practice benchmarks being a 75% minimum and 100% maximum funded ratio. This declining ratio implies investment earnings and contributions are not keeping pace with distributions.

As noted above, the POA established a funding policy for GLWA and DWSD. Adoption of a funding policy by the City of Detroit is necessary to reduce the UAAL moving forward. Two funding options available to the City are proposed in the Actuarial Report which ultimately impact the amount of the tail liability that GLWA and DWSD will be responsible for beginning

in FY 2024. Table 5 below summarizes this UAAL by unit and provides a range for annual contribution requirements beginning in FY 2024.

Table 5: Unfunded Actuarial Accrued Liability (UAAL)

Unfunded Actuarial Accrued Liability (UAAL)					
	(\$ Millions)				
	General City	D.O.T.	DWSD	Library	System Total
UAAL as of June 30, 2019	\$ 558.2	\$ 268.4	\$ 226.2	\$ 14.3	\$ 1,067.2
Anticipated POA Contribution (EOY)	2.8	0.1	42.9	2.5	48.3
Anticipated Expenses@	-	-	-	-	-
Interest at 6.75%	37.7	18.1	15.3	1.0	72.0
Projected UAAL as of June 30, 2020	\$ 593.1	\$ 286.4	\$ 198.6	\$ 12.8	\$ 1,090.9
Anticipated POA Contributions for FY2021	2.8	0.1	42.9	2.5	48.3
Estimated Employer Contributions for FY 2024 #!					
Alternate 1:Level Principal	\$ 71.9	\$ 35.1	\$ 10.5	\$ 0.8	\$ 118.2
Alternate 2:Level Dollar##	\$ 56.0	\$ 27.3	\$ 8.2	\$ 0.6	\$ 92.1

Totals may not add due to rounding.

@ In accordance with Plan Document, the mandated 6.75% rate of return is net of investment and administrative expenses.

Assuming the POA contributions through 2023 and a 30-year closed amortization thereafter. When determining the Fiscal Year 2024 illustrative amounts, only the total contributions and the DWSD contributions are stipulated in the POA. The remaining amounts were allocated to the other groups as described on page 2. A different allocation would result in different results by group.

! Total employer contributions, including amounts paid by employer but funded from other sources as required by POA.

Contributions at this level may not be sufficient to prevent fund depletion prior to satisfaction of all benefit payments. This scenario is included at System's request (see page 4).

Source: Annual Actuarial Valuation of Component II, June 30, 2019 (dated February 26, 2020), p 3.

Budget Impact: Based on the funding policy ultimately adopted by the City of Detroit, the annual contribution for GLWA and DWSD tail liability combined ranges from \$8.2 million to \$10.5 million. The prior year actuarial placed that range between \$5.7 and \$7.4 million for the fiscal years beginning July 1, 2023. Until that time, GLWA and DWSD will continue to make the combined \$42.9 million contribution per year plus an additional \$2.5 million per year in administrative expenses as stipulated in the POA and discussed in the analysis section of this report.

GLWA will continue to monitor and report on Component II activity, specifically as it relates to funding policy actions taken by the City of Detroit. GLWA has also engaged an independent actuarial firm to review the current valuation and the impacts of any funding policy actions taken by the City and GRS. The firm and GLWA staff will report to the GLWA Audit Committee

on these findings when they become available. In addition, GLWA staff continues to attend the monthly GRS Board meetings to monitor and report on the current events and impact on the Plan's investment assets.

Proposed Action: Receive and file this report.