



Financial Services Audit Committee Communication

Date: June 26, 2023

To: Great Lakes Water Authority Audit Committee

From: Kim Garland, CPA, Deputy Chief Financial Officer

Re: General Retirement System Financial Report and Annual Actuarial Valuation for Year End June 30, 2022 (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, 2022
2. Audited Financial Report for the General Retirement System of the City of Detroit (dated December 5, 2022)
3. GASB Statement No. 67 and 68 Accounting and Financial Reporting of Financial Plans of Component II June 30, 2022 (dated October 31, 2022)
4. *Draft* Annual Actuarial Valuation as of June 30, 2022 (dated January 5, 2023)*

While the external auditor letter (#1 above) to those charged with governance did highlight areas for improvement, the overall financial audit for the GRS combined plans received an unqualified opinion for the year ending June 30, 2022. The 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 2023. Finally, we will address the most recent June 30, 2022 Draft Actuarial Valuation Report (#4 above) which provides insight into future pension expense and liability expectations.

The GRS Actuarial Report remains in draft at this time due to pending litigation related to the Police & Fire Retirement System adoption of an amortization schedule not agreed to by the City of Detroit. At this time, we do not know the timeframe in which that case will be closed and the report finalized. Given the funding status at 86.6% of the DWSD/GLWA unit (as discussed later in this memo) this issue will have little impact on GLWA at this time. Therefore, we are presenting this annual communication utilizing the available, draft report to provide a timely update on the Authority's pension status.

Analysis: This report addresses five key areas.

1. Financial Position of the GRS as a Whole
2. Financial Position of the DWSD Unit with the GRS
3. Administrative Expenses
4. Planning for the Tail Liability (Unfunded Actuarial Accrued Liability - UAAL)
5. Impact on GLWA Financial Forecast

Financial Position of the GRS as a Whole

As reported in the GASB Statement No. 67 and 68 Accounting and Financial Report, and shown below in Table 1, the June 30, 2022 Component II Net Pension Liability is \$911.9 million as of June 30, 2022. This is an increase of approximately 3% from the prior year liability of \$885.5 million. The combined DWSD/GLWA unit makes up approximately \$89.9 million or 10% of that total and will be discussed further in the next section.

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

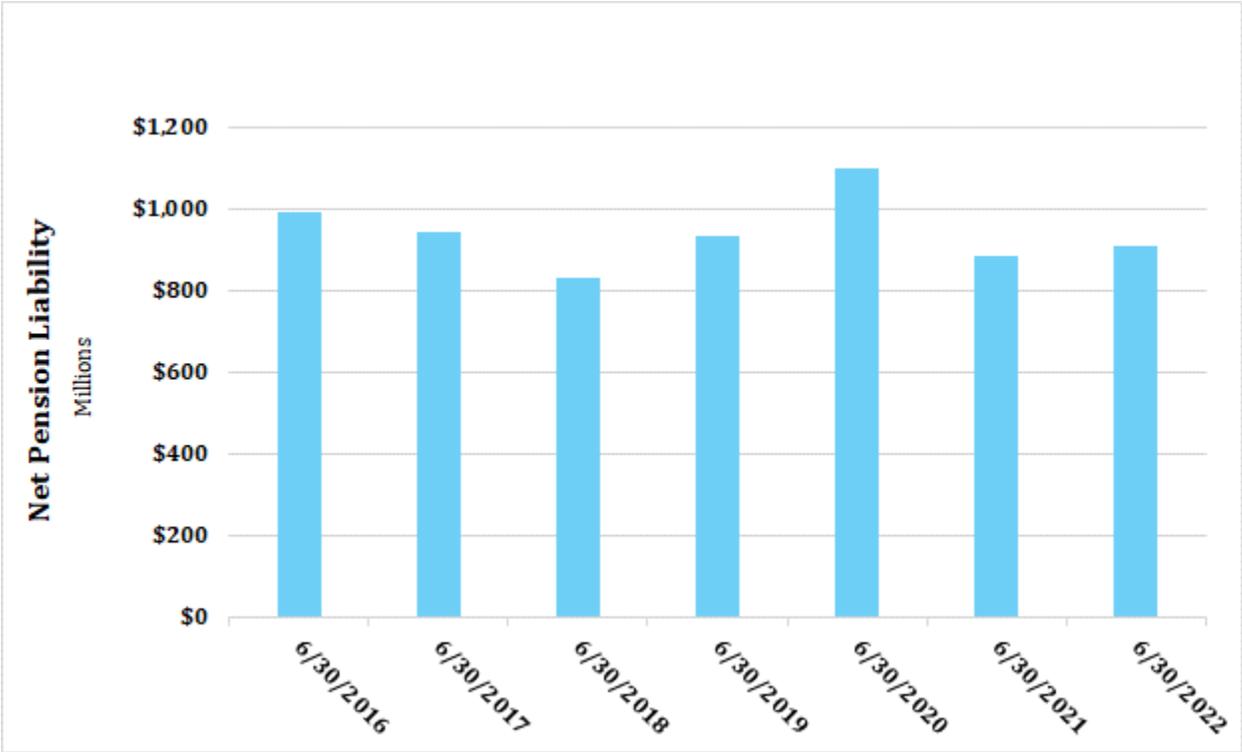
Executive Summary as of June 30, 2022

Actuarial Valuation Date	June 30, 2021
Measurement Date of the Net Pension Liability	June 30, 2022
Employer's Fiscal Year Ending Date (GASB No. 68 Reporting Date)	June 30, 2023
Membership	
Number of	
- Retirees and Beneficiaries	11,173
- Inactive, Nonretired Members	2,645
- Active Members	2,185
- Total	16,003
Covered Payroll	\$ 102,653,636
Net Pension Liability	
Total Pension Liability	\$ 2,441,710,745
Plan Fiduciary Net Position	1,529,846,295
Net Pension Liability	\$ 911,864,450
Plan Fiduciary Net Position as a Percentage of Total Pension Liability	62.65%
Net Pension Liability as a Percentage of Covered Payroll	888.29%
Development of the Single Discount Rate	
Single Discount Rate	6.75%
Long-Term Expected Rate of Investment Return	6.75%
Long-Term Municipal Bond Rate*	3.69%
Last year ending June 30 in the 2023 to 2122 projection period for which projected benefit payments are fully funded	2122
Total Pension Expense	\$ (116,831,901)

Source: GASB Statement Nos. 67 and 68 Accounting and Financial Reporting for Pension Plans of Component II, June 30, 2022 (dated October 31, 2022), p 1.

The June 30, 2022 actual total pension liability increase for GRS as a whole is largely attributed to a 7.27% decline in the actual net investment return as compared to the June 30, 2021 long-term expected rate of investment return of 6.75% and to the June 30, 2022 long-term expected rate of return of 6.50%. Chart 1 below highlights the overall net pension liability trend for the GRS since GLWA was formed in 2016.

Chart 1: Net Pension Liability Trend for GRS in Total



Source: GASB Statement Nos. 67 and 68 Accounting and Financial Reporting for Pension Plans of Component II. Multiple Years.

Financial Position of the DWSD Unit with the GRS

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. As of June 30, 2022, the DWSD Net Pension Liability is \$89.9 million. This is a decrease of 3.1% from \$92.8 million DWSD Net Pension Liability as of June 30, 2021 in contrast to the overall system increase of 3.0%. This decrease in the net pension liability is a result of actual net investment return exceeding the expected rate of investment return from previous year.



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, 2022***

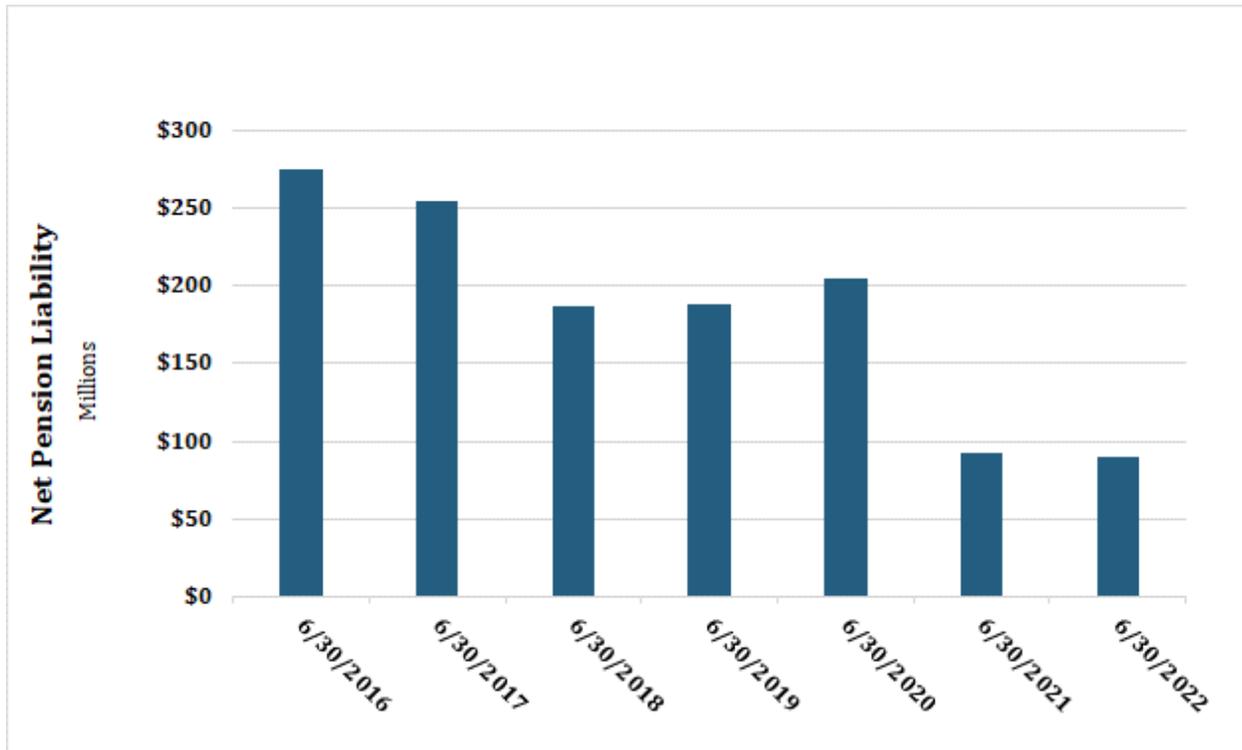
	General	DOT	DWSD	Library	Total
A. Total Pension Liability					
1. Service Cost	\$ -	\$ -	\$ -	\$ -	\$ -
2. Interest on the Total Pension Liability	90,815,782	26,191,783	45,271,791	5,799,838	168,079,194
3. Changes of benefit terms	-	-	-	-	-
4. Difference between expected and actual experience of the Total Pension Liability	(3,515,413)	(5,362,585)	(173,860)	(3,516,351)	(12,568,209)
5. Changes of assumptions	(104,147,584)	(28,216,051)	(40,756,353)	(8,237,536)	(181,357,524)
6. Benefit payments, including refunds of employee contributions	(129,402,174)	(36,240,358)	(64,116,971)	(6,793,446)	(236,552,949)
7. Net change in Total Pension Liability	\$ (146,249,389)	\$ (43,627,211)	\$ (59,775,393)	\$ (12,747,495)	\$ (262,399,488)
8. Total Pension Liability – Beginning	1,461,866,979	421,070,684	728,547,577	92,624,993	2,704,110,233
9. Total Pension Liability – Ending	\$ 1,315,617,590	\$ 377,443,473	\$ 668,772,184	\$ 79,877,498	\$ 2,441,710,745
B. Plan Fiduciary Net Position					
1. Contributions – employer	\$ 2,765,012	\$ 109,988	\$ 42,900,000	\$ 2,500,000	\$ 48,275,000
2. Contributions – employee	-	-	-	-	-
3. Net investment income	(53,975,928)	(6,823,068)	(37,094,627)	(4,896,407)	(102,790,030)
4. Benefit payments, including refunds of employee contributions	(129,402,174)	(36,240,358)	(64,116,971)	(6,793,446)	(236,552,949)
5. Pension Plan Administrative Expense	(2,225,371)	(190,555)	-	(125,154)	(2,541,080)
6. Other	2,357,356	981,295	1,447,612	19,793	4,806,056
7. Net change in Plan Fiduciary Net Position	\$ (180,481,105)	\$ (42,162,698)	\$ (56,863,986)	\$ (9,295,214)	\$ (288,803,003)
8. Plan Fiduciary Net Position – Beginning	956,924,896	136,380,233	635,771,862	89,572,307	1,818,649,298
9. Plan Fiduciary Net Position – Ending	\$ 776,443,791	\$ 94,217,535	\$ 578,907,876	\$ 80,277,093	\$ 1,529,846,295
C. Net Pension Liability	\$ 539,173,799	\$ 283,225,938	\$ 89,864,308	\$ (399,595)	\$ 911,864,450
D. Plan Fiduciary Net Position as a percentage of the Total Pension Liability	59.02%	24.96%	86.56%	100.50%	62.65%
E. Covered-employee payroll	\$ 68,028,797	\$ 13,547,705	\$ 12,777,868	\$ 8,299,266	\$ 102,653,636
F. Net Pension Liability as a percentage of covered-employee payroll	792.57%	2090.58%	703.28%	-4.81%	888.29%

*Totals may not add due to rounding.

Source: GASB Statement Nos. 67 and 68 Accounting and Financial Reporting for Pension Plans of Component II, June 30, 2022 (dated October 31, 2022), p 22.

Chart 2 below highlights the overall net pension liability trend for the DWSD unit since GLWA was formed in 2016.

Chart 2: Net Pension Liability Trend for DWSD Unit



Under a pension reporting agreement established on January 24, 2017, the parties of DWSD and GLWA 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 allocation within each entity between Water and Sewer funds. This is summarized in Table 3 below and applied to the current June 30, 2022 liability.

Table 3: Liability Allocation Between GLWA and DWSD as of June 30, 2022

Entity	Percent	Liability Allocation
DWSD - Water	17.80%	\$ 15,995,847
DWSD - Sewer	11.90%	10,693,853
GLWA - Water	25.20%	22,645,806
GLWA - Sewer	45.10%	40,528,803
	100.00%	\$ 89,864,308

Administrative Expenses

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. An allocation 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 4 below.

Table 4: Statement of Changes in Fiduciary Net Position by Division

	DWSD Subdivisions		General Retirement System - Divisions				Total - General Retirement System (all Divisions)	
	GLWA	DWSD-R	DWSD - Division Subdivisions		General Division	DOT		Library
			Total (all DWSD)					
Beginning Net Position - July 1, 2021	448,947,615	188,824,247	636,771,862	136,380,233	89,572,307	1,818,646,288		
Additions:								
Investment income (loss):								
Interest, dividends, and other income	9,370,637	3,958,861	13,329,498	19,404,483	2,437,982	36,833,902		
Net decrease in fair value of investments	(33,168,626)	(14,012,074)	(47,178,700)	(68,657,486)	(8,226,788)	(130,730,949)		
Net unrealized loss on collateralized securities	(32,617)	(13,780)	(46,397)	(6,521)	(6,127)	(128,563)		
Investment related expenses	(2,243,916)	(950,111)	(3,199,027)	(4,655,439)	(587,543)	(8,864,420)		
Net investment income	(28,077,522)	(11,017,104)	(37,094,626)	(63,975,930)	(6,823,087)	(102,780,030)		
Contributions:								
Employer contributions:								
Originating from DWSD:								
Regular pension contribution	30,168,700	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	30,168,700	12,741,300	42,900,000	2,500,000	-	45,400,000		
Contributions from other divisions	-	-	-	2,500,000	-	2,500,000		
Total employer contributions	30,168,700	12,741,300	42,900,000	2,500,000	-	47,900,000		
Foundation for Detroit's Future	-	-	-	285,012	109,988	375,000		
Total contributions	30,168,700	12,741,300	42,900,000	2,785,012	109,988	48,275,000		
ASF recoupment interest	1,143,861	483,168	1,626,929	2,980,845	1,045,283	5,775,503		
Other income	75,956	32,059	108,045	133,251	4,083	252,284		
Total additions - net	6,300,785	2,239,453	7,540,248	(48,096,822)	(5,663,703)	(48,487,243)		
Deductions:								
Member refunds and withdrawals	2,280,297	963,369	3,243,666	5,749,975	4,514,011	13,796,354		
Retirees' pension and annuity benefits	42,763,934	18,079,372	60,873,306	123,652,198	31,726,347	222,756,595		
General and administrative expenses	624,491	293,832	888,323	1,337,048	190,555	2,541,080		
ASF Recoupment Write-off	201,945	86,317	287,262	766,740	88,081	1,221,731		
Transfer of general and administrative expenses to General Division	(624,491)	(293,832)	(888,323)	888,323	-	-		
Total deductions	45,276,176	18,128,058	64,404,234	132,384,284	36,488,964	240,315,780		
Net Decrease in Net Position	(39,975,381)	(16,888,605)	(56,863,986)	(180,481,105)	(42,182,697)	(288,803,003)		
End of Year Net Position Restricted for Pensions - June 30, 2022	406,972,234	171,935,642	578,907,876	776,443,790	94,217,536	1,529,846,295		

Source: Audited Financial Report for the General Retirement System of the City of Detroit (dated December 5, 2022), p 49.

Of the \$2.5 million paid by GLWA and DWSD, \$888 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 5 below.

Table 5: Schedule of DWSD/GLWA Contributions Toward Administrative Expenses

Combined Plan for the General Retirement System of the City of Detroit		
<i>Schedule of DWSD/GLWA Contributions Toward Administrative Expenses as Compared to Actual DWSD/GLWA Allocable Administrative Expenses</i>		
For the Year Ended June 30, 2022		
	<u>DWSD Division Total</u>	
	<u>GLWA</u>	<u>DWSD-R</u>
Amount Paid in Excess of Administrative Expenses		
Otherwise Allocable - June 30, 2021	\$ 6,934,650	\$ 2,929,720
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	<u>(624,491)</u>	<u>(263,832)</u>
Cumulative Amount Paid in Excess of Administrative Expenses		
Otherwise Allocable - June 30, 2022	<u>\$ 8,067,659</u>	<u>\$ 3,408,388</u>

Source: Audited Financial Report for the General Retirement System of the City of Detroit (dated December 5, 2022), p 50.

Planning for the Tail Liability (UAAL)

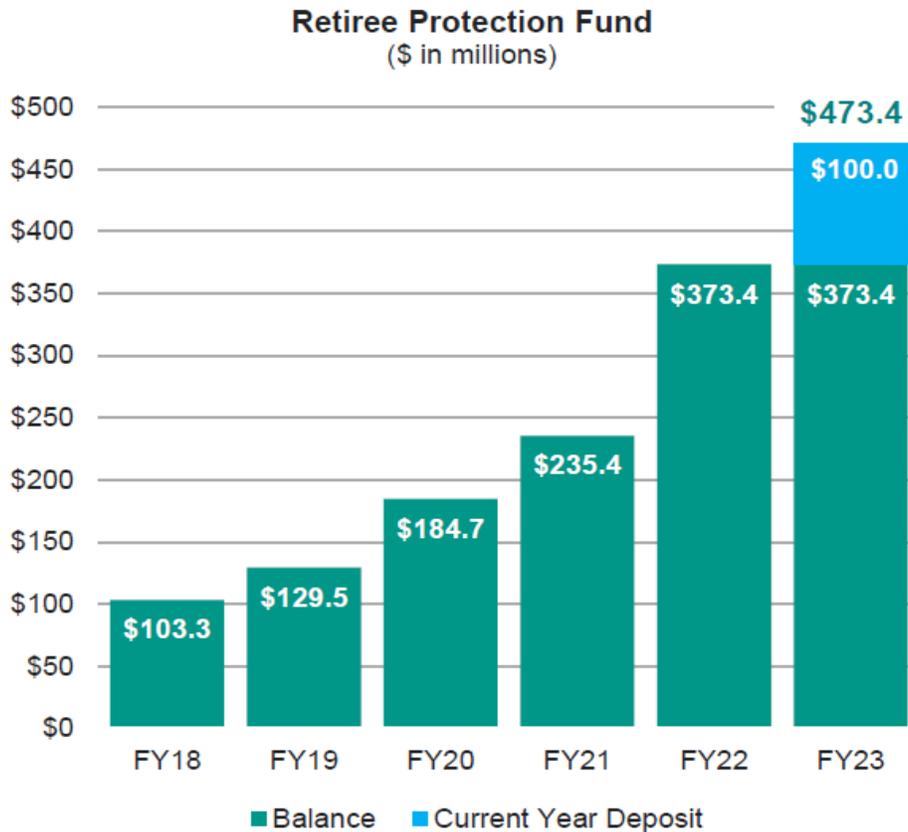
Under the POA, GLWA and DWSD make combined, Component II annual pension payments of \$45.4 million, of which \$2.5 million is specific to administrative expenses discussed above. Those fixed payments are reduced after June 30, 2023 based upon the terms of a pension agreement that addresses the tail liability. The actual amount of this remaining, unfunded liability will vary based upon plan performance and the outstanding liability at that time.

The June 30, 2022 *Draft* Actuarial Report estimates the total Component II unfunded actuarial accrued liability (UAAL) for the GRS as a whole to be \$773.0 million as of June 30, 2023, net of the DWSD-GLWA overfunded amount at \$10.1 million as the DWSD-GLWA unit share of that liability June 30, 2023.

The RPF is The City has been setting funds aside outside of the GRS in a “Retiree Protection Fund” (RPF) via an Internal Revenue Code Section 115 Trust. The balance in the RPF by year is shown in Chart 3 below. The chart was obtained from the FY 2023-2024 proposed budget presented by the Financial Review Commission and presents the current value of that fund as of June 30, 2022, as well as the FY 2023 budget projection. As noted in the City presentation, “Going beyond the POA requirements, the City has amassed over \$463 million

in the RPF” and has approved another \$10 million deposit for FY 2023 bringing the estimated FY 2023 yearend balance to \$473.4 million as shown in the FY 2023 column below.

Chart 3: City of Detroit Retiree Protection Fund



Source: [Mayor’s Proposed Budget \(detroitmi.gov\)](https://www.detroitmi.gov/mayors-proposed-budget)

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, 2022 is 62.7% (as shown in Table 1 on page 3 of this memo) down from 71.5% the prior year with best practice benchmarks being a 75% minimum and 100% maximum funded ratio. As stated previously, this decrease is largely attributed to the decline in the actual net investment return.

As noted above, the POA established a funding policy for GLWA and DWSD. However, fiscal year 2024 is the first year (post-bankruptcy) the City will be required to make actuarially determined employer contributions (ADEC) in accordance with the plan document. Three funding options available to the City are proposed in the June 30, 2022 *Draft Actuarial Report* which ultimately will impact the amount of the tail liability that GLWA and DWSD will be responsible for beginning in FY 2024 that could range from \$0.8 to \$1.0 decrease in the liability for the DWSD unit. Table 6 below summarizes this ADEC by unit and provides a range for annual contribution requirements beginning in FY 2024.

Consistent investment returns in FY 2023, a 30-year or 20-year amortization period and currently adopted interest rate of 6.75% result in a projected negative UAAL and no annual pension contributions for the DWSD pool. The report reflects a required contribution of \$0.7 million for the annual administrative expense, which needs to be reviewed as noted by the actuary based on the various agreements. The actual FY 2023 investment returns, and the actuarial assumptions adopted by the Board and Investment Committee will impact actual FY 2024 results.

Table 6: Projected Actuarially Determined Employer Contributions & UAAL/Tail Liability

Sample Actuarially Determined Employer Contributions (ADEC)

	(\$ Millions)				
	General City	D.O.T.	DWSD	Library	System Total
Actuarial Accrued Liability	\$ 1,317.6	\$ 376.9	\$ 663.3	\$ 80.7	\$ 2,438.6
Funding Value of Assets (FVA)	848.4	102.9	632.6	87.7	1,671.6
UAAL ¹ as of June 30, 2022	\$ 469.2	\$ 274.0	\$ 30.7	\$ (7.0)	\$ 767.0
Anticipated POA Contribution (EOY)	(2.7)	(0.1)	(42.9)	(2.5)	(48.3)
Anticipated Expenses ²	2.0	0.4	-	0.1	2.4
Interest at 6.75%	31.7	18.5	2.1	(0.5)	51.9
Projected UAAL as of June 30, 2023	\$ 500.2	\$ 292.7	\$ (10.1)	\$ (9.9)	\$ 773.0
Estimated Employer Contributions for FY 2024³					
Sample: 20-Year Level Dollar					
UAAL Contribution	\$ 46.3	\$ 27.1	\$ (0.9)	\$ (0.9)	\$ 71.6
\$0 Minimum UAAL Contribution	46.3	27.1	-	-	73.4
Administrative Expense Contribution ⁴	1.4	0.4	0.7	0.1	2.5
Total Contribution	\$ 47.7	\$ 27.5	\$ 0.7	\$ 0.1	\$ 75.9
Sample: 30-Year Level Principal (POA)					
UAAL Contribution	\$ 50.4	\$ 29.5	\$ (1.0)	\$ (1.0)	\$ 77.9
\$0 Minimum UAAL Contribution	50.4	29.5	-	-	79.9
Administrative Expense Contribution ⁴	1.4	0.4	0.7	0.1	2.5
Total Contribution	\$ 51.8	\$ 29.9	\$ 0.7	\$ 0.1	\$ 82.4
Sample: 30-Year Level Dollar⁵					
UAAL Contribution	\$ 39.3	\$ 23.0	\$ (0.8)	\$ (0.8)	\$ 60.7
\$0 Minimum UAAL Contribution	39.3	23.0	-	-	62.3
Administrative Expense Contribution ⁴	1.4	0.4	0.7	0.1	2.5
Total Contribution	\$ 40.7	\$ 23.4	\$ 0.7	\$ 0.1	\$ 64.8

Totals may not add due to rounding.

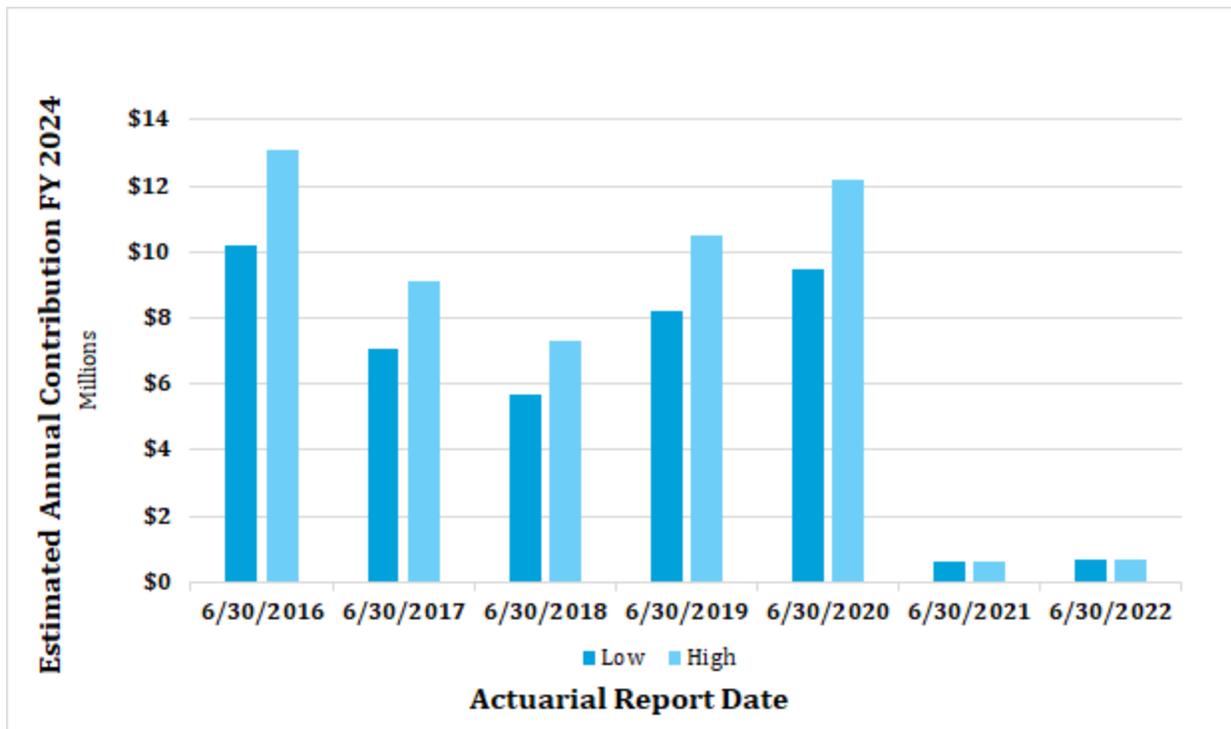
- ¹ Unfunded Actuarial Accrued Liability in accordance with the draft Funding Policy including the use of the Funding Value of Assets (FVA) shown in Section G.
- ² Administrative expenses for DWSD are paid by General City through 2023.
- ³ Total employer contributions, including amounts paid by the employer but funded from other sources as required by POA, if any. Employer contributions are assumed to be made at the end of the fiscal year.
- ⁴ FY 2024 and later administrative expenses were allocated (see Section D of the report) and anticipated to be paid by the individual units.
- ⁵ The use of a 30-year level dollar amortization significantly increases the risk of the Plan becoming insolvent (running out of money) compared to the use of a 20-year level dollar or 30-year level principal amortization. This scenario is included at Retirement System's request. Contributions based on the amortization method and period are significantly less than the contributions based on the amortization method and period contemplated in the POA (30-year level principal).

Source: Draft Annual Actuarial Valuation of Component II, June 30, 2022 (dated January 5, 2023), p 4.

Impact on GLWA Financial Forecast

Budget Impact: Based on the funding policy currently proposed to the City of Detroit for FY 2024, the annual contribution for GLWA and DWSD is \$0.7 million for administrative expense contribution only. The prior year actuarial placed that range as 0.6 million. The current annual estimated contribution based on the tail liability is summarized in Chart 4 below.

Chart 4: GLWA and DWSD Estimated Annual Contribution for FY 2024



Source: Draft Annual Actuarial Valuation of Component II, June 30, 2022 (dated January 5, 2023), p 4.

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 consultant to review the current valuation and the impacts of any funding policy actions taken by the City and GRS. The consultant and GLWA staff will report to the GLWA Audit Committee on these findings when they become available as well as the finalization of the June 30, 2022 actuarial report when the current Police & Fire Retirement System litigation is resolved. 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.