IMPROVEMENTS IN LONG-TERM LIABILITY MANAGEMENT

Office of General Treasurer Seth Magaziner

October 23, 2018

LOCAL PENSION REPORT CARD

CONTEXT

- The state's 2011 pension reform package that was secured by a 2015 settlement agreement did not include major reforms to Rhode Island's 34 locally administered pension plans.
- The 2011 reform created a temporary study commission, which produced a report in January 2015, recommending a series of options for improving local pension fiscal health. One of the ideas out of this study commission was a permanent oversight board.
- In 2016 the General Assembly established a permanent advisory council for the state's 34 locally administered pension plans, chaired by the Treasurer.
- Statute requires this council to produce an annual report that summarizes key information on the status and trends of each plan.
- In 2017, the "report" was a cover letter accompanying underlying data dashboards.

2018 REPORT CARD

- In 2018 the council, staffed by Treasury, produced a “report card” for each plan, outlining how the various plans perform across a variety of key metrics, including:
  - Funded status ratio & funded status ratio trend
  - Consistency of meeting annual required contributions
  - Amortization period for current unfunded liability
  - Negative amortization
  - Investment return assumption
  - Payroll growth assumption
  - Net cash flow
  - Active to retiree ratio

Appendix of the report also included self-reported fee data.

Providence

Key Facts

Market Value of Assets:	$333,287,000	**Number of Participants:**	2,889 Actives; 2,153 Retirees; 484 Disabled; 473 Terminated Vested and/or Inactive Lives; 548 Beneficiaries
Funded Status:	Critical	**Valuation Date:**	As of 7/1/16

Report Card

Factor	Value	Score
2016 Funded Status	26.2%	☆☆☆☆☆
Funded Status Percentage Point Change (FY2011-FY2016)	-5.7%	☆☆☆☆☆
Consistency of meeting 100% of ARC contributions over the past 4 years (FY14-FY17; number of times met)	4	★★★★★
Amortization period for the current unfunded liability based on the required contribution (time remaining in amortization period and/or single equivalent period)	24	★★★☆☆
Payroll growth assumption	3.50%	★★★☆☆
Does this plan have negative amortization?	Yes, less than 25	★★★☆☆
Current investment return assumption	8.0%	★☆☆☆☆
Net cash flow as a % of assets	-7.69%	★☆☆☆☆
Current active to retiree ratio	0.91/1	★☆☆☆☆

POSITIVE FINDINGS

- While the health of Rhode Island's locally administered pension plans varies by community, a few positive takeaways emerge:
  - Municipalities have improved responsiveness to council data requests relative to previous year.
  - The funded statuses for 17 plans have increased across the four years ending in FY 2016.
  - Most municipalities met or exceeded their required ARC payments over the past 4 years.
  - 12 plans have assumed rates of return at or below 7.0%, indicating that these plans have a strong funding policy and are less likely to face future unexpected shortfalls than plans with higher investment return assumptions.

NEGATIVE FINDINGS

- Despite these steps forward, significant challenges remain:
  - The 34 local plans reviewed carry a combined unfunded liability of over $2.4 billion, and over a third of plans are less than 60% funded, and therefore considered to be in critical status.
  - The funded statuses for 13 plans have decreased across the four years ending in FY 2016.
  - Many plans have investment return and payroll growth assumptions that may not be realistic.
  - Some communities have not consistently made the full actuarially required contributions to their pension plans over the past four years.
  - In more than a few cases, the share of the municipal ARC payment to a community's total tax levy is as high as 10-20%, suggesting that local pension liabilities are, or have the potential to, crowd out other necessary public investments.

OTHER LOCAL PENSION INITIATIVES

- In addition to reporting on the health of these plans, Treasurer Magaziner has introduced legislation over the past two cycles that would have made it easier for these local plans to join the state run Municipal Employees' Retirement System (MERS).
  - MERS plans are, on average, better funded and have historically stronger investment returns and lower costs than most smaller locally-managed plans.
  - Treasury intends to reintroduce this legislation again in January 2019.

- Further, for the 2019 iteration of the local pension scorecard, Treasury intends to run stress testing of these local plans' liabilities, to better understand how they fare under changing market conditions.

METHODOLOGY/SCORING

Metric	Scoring (Range 0-5)
Funded status ratio	Greater or equal to 100%=5; 80-99.9%=4; 60-79.9%=3; 50-59.9%=2; 40-49.9%=1; below 40%=0
Funded status ratio percentage point change	5=percentage point improvement of 10 or more; 4=percentage point improvement 9 or less; 3=percentage point improvement 7 or less; 2=percentage point improvement 5 or less; 1=percentage point improvement 3 or less; 0=decrease)
Consistency of meeting 100% of ARC Contributions over the past 4 years	Met payments for all 4 years and exceeded requirement for at least one year=5; Met all payments for 4 years or exceeded 3 payments and missed 1 payment=4; Met 3/4 payments=3; Met 2/4 payments=2; Met 1/4 payments=1; Met no payments=0
Amortization period for current unfunded liability	15 years or less=5; 16-20 years=4; 21-25=3; 26-30=2; above 30=1; plans with open amortization are reduced by 1 point

METHODOLOGY/SCORING

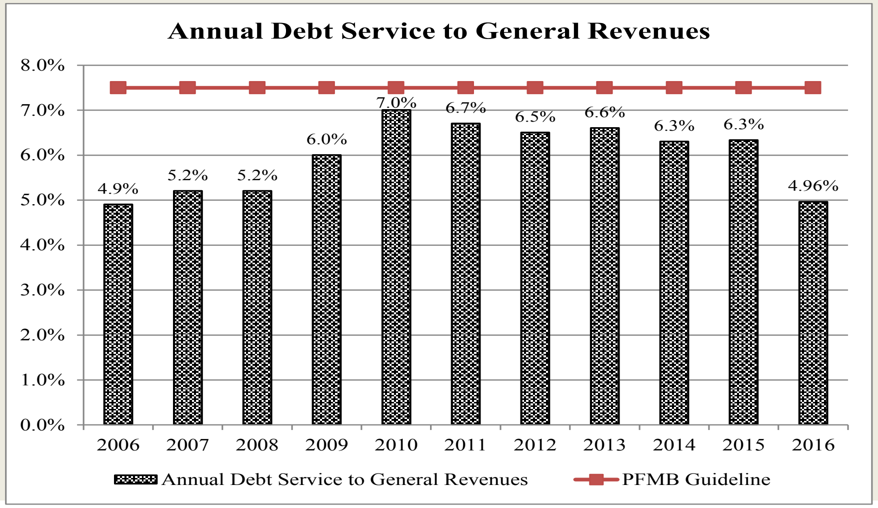
Negative amortization	5= No negative amortization; 3=Negative amortization, but less than 25 years; 1=Between 25-30 years negative amortization
Current investment return assumption	7% or below=5; 7.01-7.25%=4; 7.26-7.5%=3; 7.6-7.75%=2; 7.76-8%=1
Payroll growth assumption	3% or below=5; 3.01%-3.99%=3; 4% or above=1
Net cash flow as % of assets	Negative 3% or less=5; negative 3.01% to negative 4%=4; negative 4.01% to negative 5%=3; negative 5.01% to negative 6%= 2; worse than negative 6%=1
Current active to retiree ratio	Greater than 1.7/1=5; between 1.4 and 1.69/1=4; between 1.2 and 1.39/1=3; between 1.0 and 1.19/1=2; under 1.0/1=1

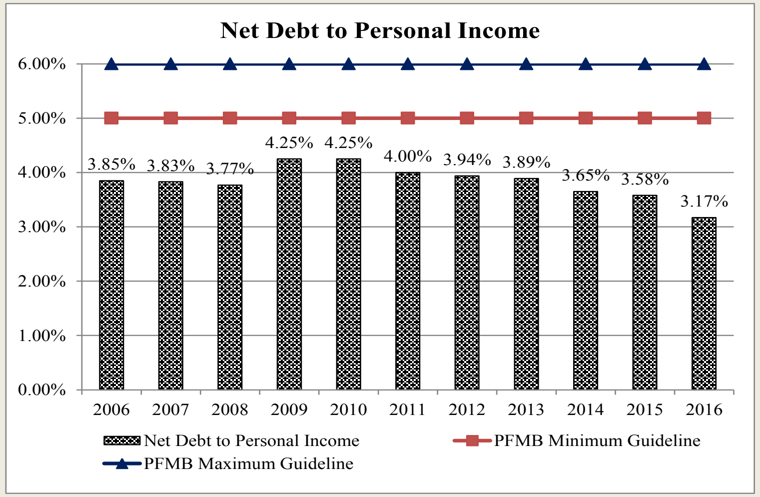
DEBT AFFORDABILITY ANALYSIS

CONTEXT

- In 1999, the Public Finance Management Board adopted guidelines for State tax-supported debt intended to be restrictive enough to maintain affordable debt levels, with enough flexibility to facilitate the funding of critical infrastructure needs. The 1999 guidelines were:
  - Tax-Supported Debt to not exceed the target range of 5.0% to 6.0% of personal income
  - Debt Service on Tax-Supported Debt to not exceed 7.5% of General Revenues

Rhode Island successfully remained within these targets, but had not updated the targets for almost two decades.



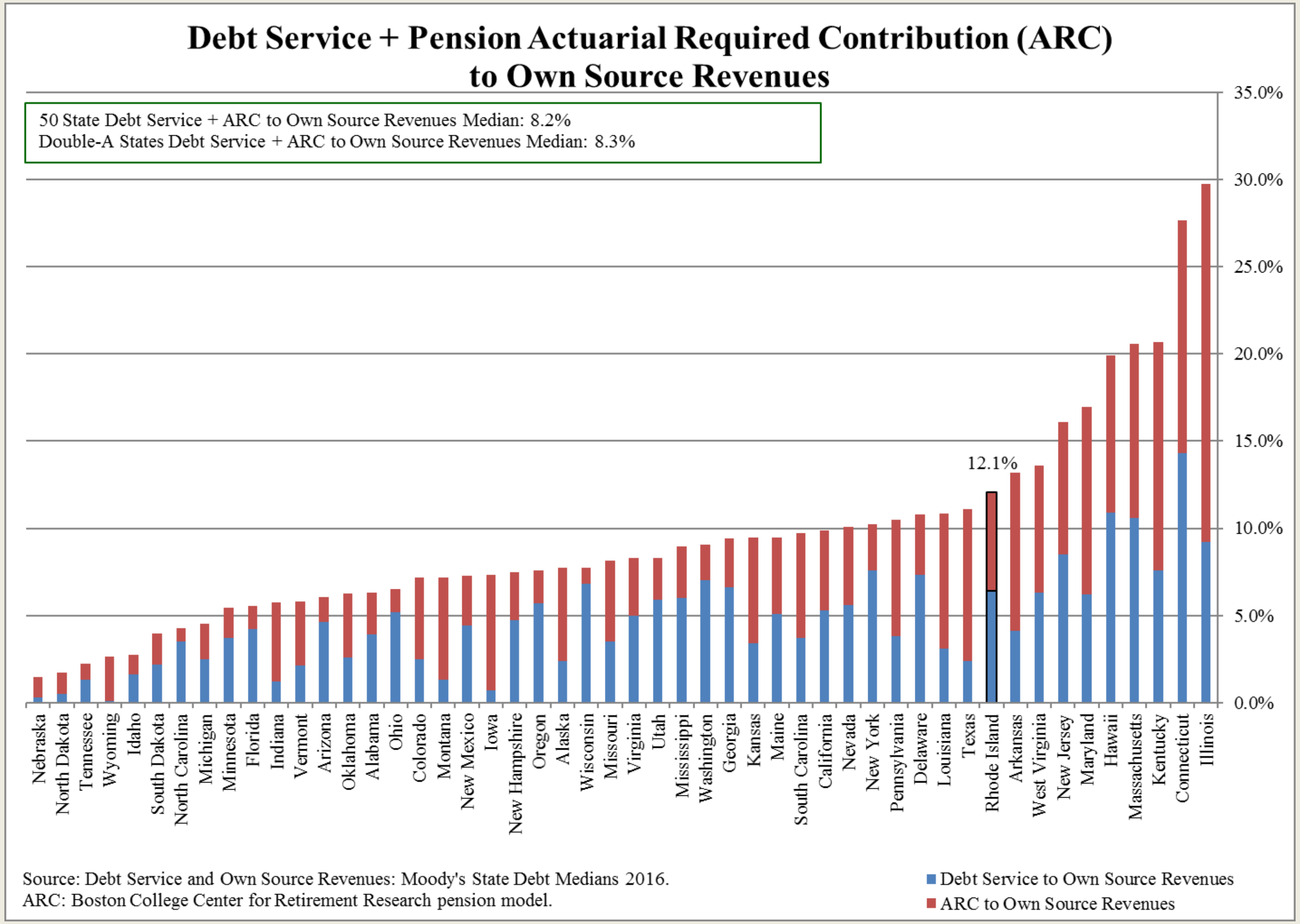


2017 DEBT AFFORDABILITY STUDY SUMMARY

- **Organization**
  - Part One: State tax-supported debt and long-term liabilities
  - Part Two: State-level agency, public and quasi-public corporation debt and long-term liabilities
  - Part Three: Municipalities, regional authorities, fire districts and other special districts debt and long-term liabilities

- **Scope of Liabilities**
  - Includes various types of debt, including gross direct debt and overlapping debt
  - Includes unfunded pension liabilities for the State and municipalities

2017 STATE COMPARISON



Comparative state pension liabilities are based on a model provided by the Boston College Center for Retirement Research, in which the pension liabilities for all states were adjusted to approximate the adoption of Rhode Island's discount rate and amortization period.

2017 STATE AFFORDABILITY RATIOS

Ratio	Current Level (FY2017)	Recommended Target
Debt Service on Tax-Supported Debt to General Revenues	6.1%	Not to exceed 7.5% within the next five years and 7.0% thereafter
Net Tax-Supported Debt as Percentage of Personal Income	3.4%	Not to exceed 4.0%
Net Tax-Supported Debt Service + Pension ARC as a Percentage of General Revenues	13.07%	Not to exceed 16%
Net Tax-Supported Debt + Pension Liability (UAAL) as a Percentage of Personal Income	8.5%	Not to exceed 8% beginning in 2021

QUASI-PUBLIC AGENCY AFFORDABILITY RATIOS

Borrowers	Affordability Metric	Current Level
Narragansett Bay Commission	1.3x debt service coverage for both Commission debt and RIIB loans	Debt Service Coverage 1.4x
Rhode Island Turnpike and Bridge Authority	1.7x debt service coverage	Debt Service Coverage 1.68x
Rhode Island Resource Recovery Corporation	PFMB recommends the Corporation refrain from any issuance of long-term debt until the future of the facility is more certain.	Debt Service Coverage 4.00x
Rhode Island Department of Transportation Grant Anticipation Revenue Bonds (GARVEEs)	4.5x debt service coverage	Debt Service Coverage 4.5x
Rhode Island Airport Corporation	1.5x debt service coverage when including the Coverage Account Ending Balance, and $100 debt per enplaned passenger	Debt Service Coverage 1.76x $137 per enplaned passenger
Rhode Island Health and Educational Building Corporation – University of Rhode Island	Total Debt to Cash Flow of less than 11.0x as a factor required for Additional Bonds.	7.0x Debt to Cash Flow
Rhode Island Housing and Mortgage Finance Corporation	Target minimum Program Asset to Debt Ratio (PADR) of 1.10x based on Moody's rating criteria for Aaa rating.	PADR of 1.19x (Single Family) PADR of 1.12x (Multi-Family)
Rhode Island Infrastructure Bank (Clean Water and Drinking Water Programs)	Maintain a minimum of 1.2x debt service coverage and Maintain asset to liabilities ratios at a minimum of 1.3x.	Debt service coverages: 1.3x for Clean Water and 1.5x for Drinking Water Asset to liabilities ratios: 1.5x for Clean Water and 1.6x for Drinking Water.
Rhode Island Student Loan Authority	Target minimum Parity Ratio of 110%	Parity Ratio of 120.97%

MUNICIPALITY FINDINGS

Ratio	Recommended Target
Net Direct Debt to Full Value	Less than 3%
Overall Net Debt to Full Value	Less than 4%
Overall Debt + Net Pension Liability to Full Value	Less than 6.3%
Overall Debt + Net Pension Liability to Personal Income	Less than 20%

Net Direct Debt- ***D***ebt of the municipality, typically paid for through the municipal budget with taxpayer funds. (Does not include revenue bonds that are supported by ratepayers, such as water and sewer bonds).

Overall Net Debt- Net direct debt (above) plus the direct debt of any overlapping taxing authority, but still not revenue bonds that are supported by ratepayer funds.

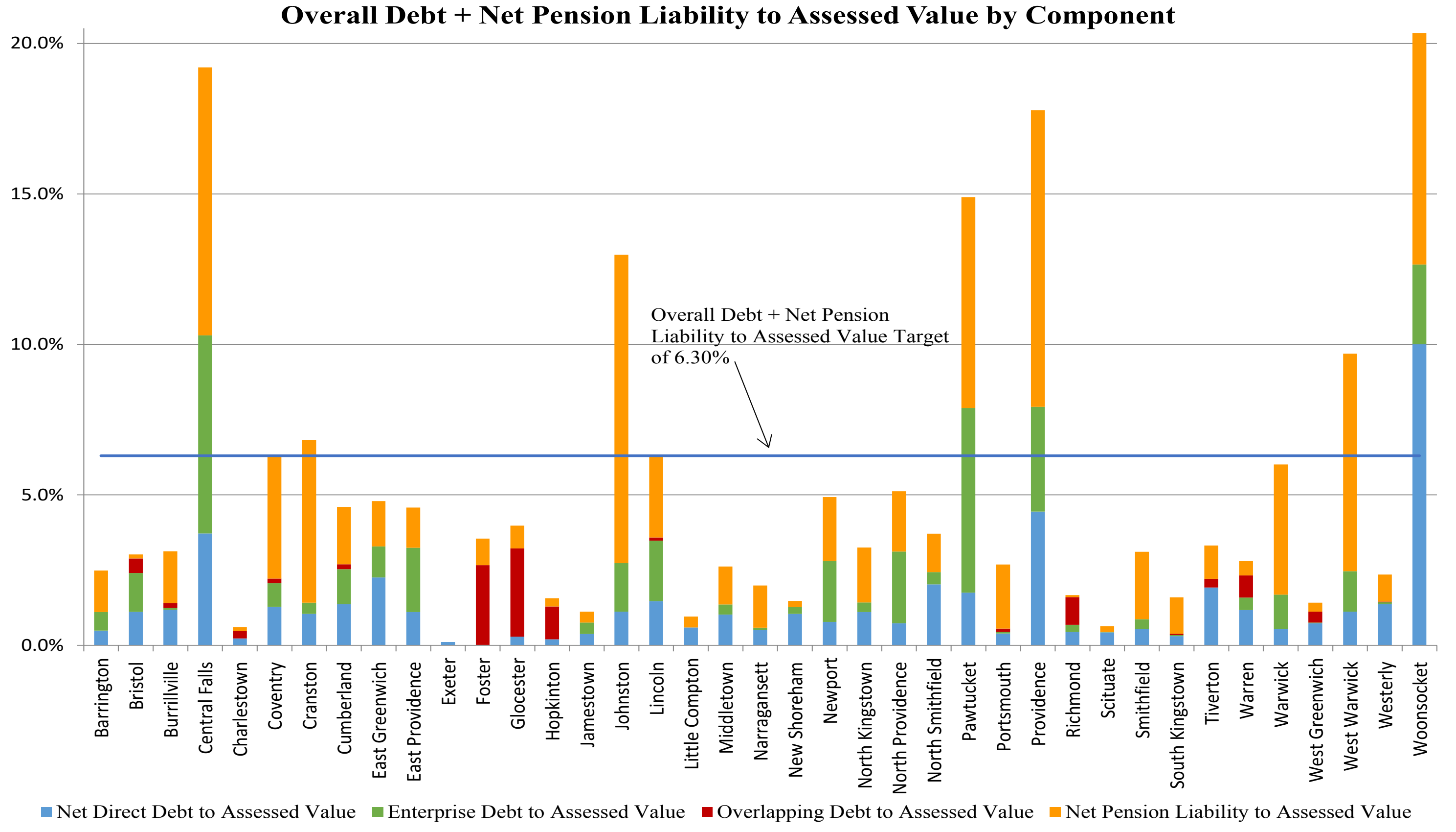
Overall Debt- Total debt of the municipality and all overlapping jurisdictions, including revenue bonds.

In selecting these recommended targets, the PFMB relied heavily on rating agency guidance, generally recommending a level equivalent to an 'A' rating for each ratio.

MUNICIPALITY FINDINGS

- The chart to the right reflects one of the Phase III ratios, overall debt and pension liabilities compared to assessed value.

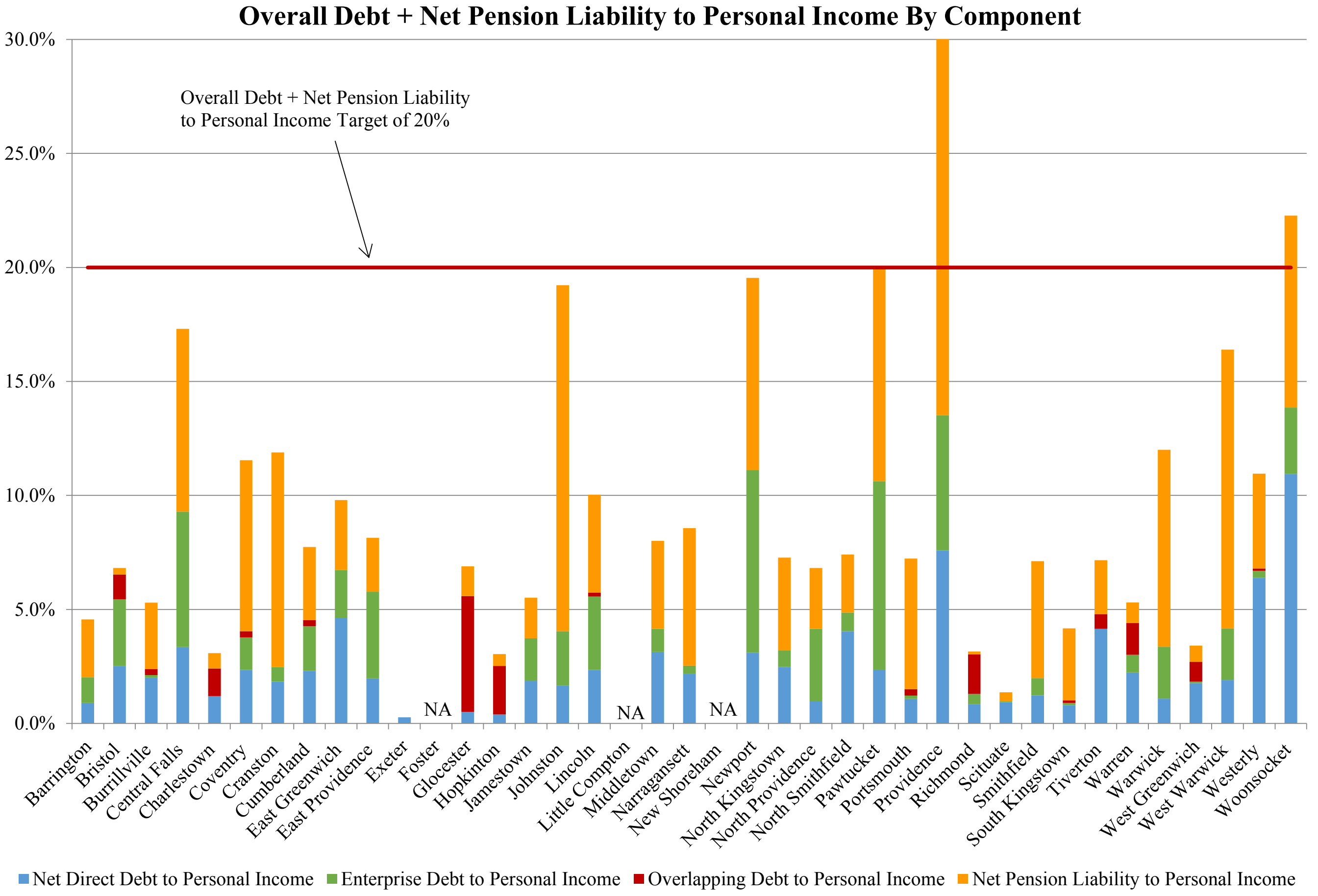
- Seven communities have exceeded the recommended target of 6.3%.



Overall Debt includes (1) Net Direct Debt: All debt of an issuer less self-supporting enterprise debt; (2) Enterprise Debt: Debt for essential service utilities that is self-supporting from user fees; (3) Overlapping debt: Issuer's proportionate share of the debt of other local governmental units that either overlap or underlie it.

MUNICIPALITY FINDINGS

- The chart to the right reflects the fourth ratio, overall debt and pension liabilities, as compared to personal income.
- Three communities have exceeded the recommended target of 20%.



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APPLICATION TO POLICYMAKING

- The 2017 study played an important role in assessing debt affordability as part of key public policy decisions over the past year, including, but not limited to:
  - The appropriate level of general obligation debt authorization to incorporate into the FY19 enacted budget
  - Appropriate levels of state and local debt that could be issued as part of a deal to construct a new PawSox minor league baseball stadium
  - Appropriate levels of debt to issue to make a generational investment in Rhode Island’s K-12 school facilities

2019 STUDY

- Treasury is in the process of developing the next iteration of this biannual study.

- Enhancements to previous version will include:
  - Inclusion of Other Post-Employment Benefit obligations for all issuers
  - Inclusion of any quasi-public agency pension liabilities
  - Data associated with quasi-public agency privately-placed debt

Q&A

Kelly Rogers
Deputy Treasurer for Policy & Public Finance
Office of the General Treasurer Seth Magaziner
Kelly.Rogers@treasury.ri.gov

Appendix

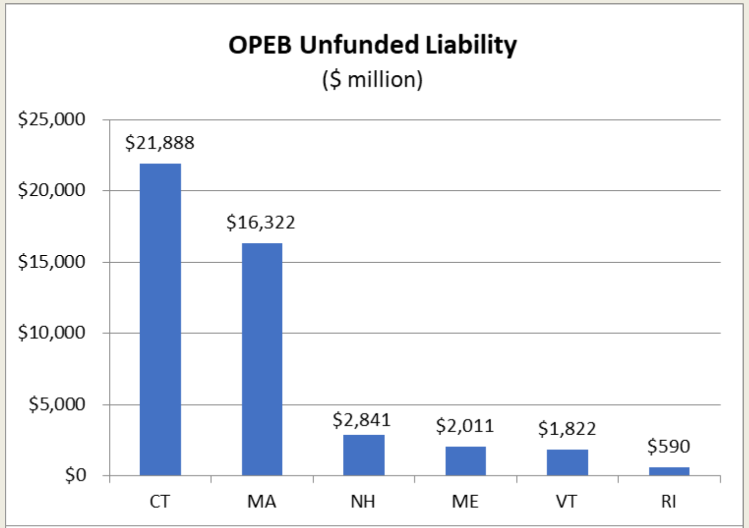
RHODE ISLAND OPEB OVERVIEW

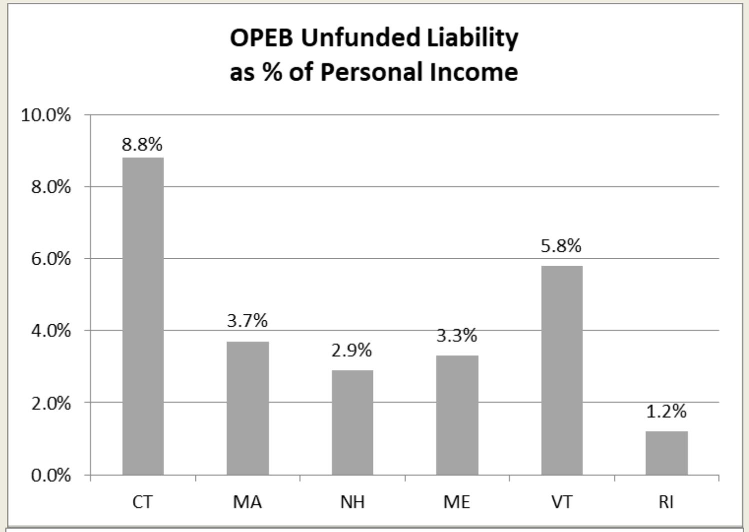
- Prior to 2008, Rhode Island funded OPEB on a pay-as-you-go basis. In FY2011, the state established a trust to accumulate assets and pay benefits and costs associated with its OPEB plans. The Trust is managed by the OPEB Board, which determines the amount of annual contributions, and oversight of OPEB benefit payments.

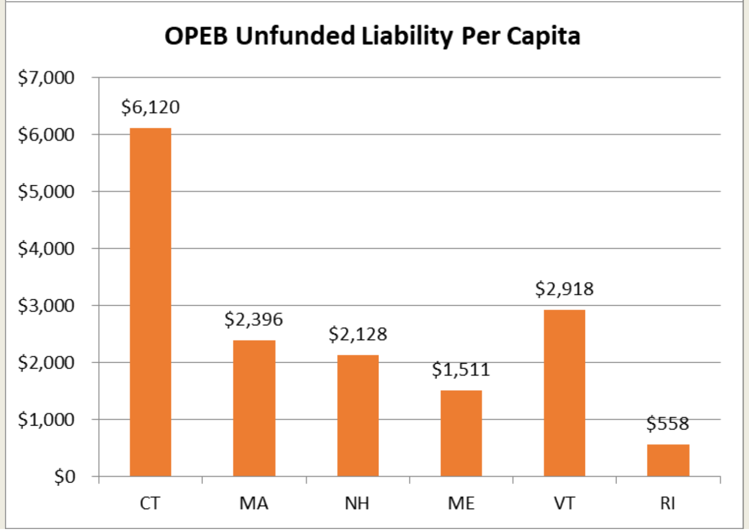
	Judges	Legislative	State Employees	Teachers	State Police	Board of Education
Annual Actuarially Determined Employer Contribution	$0	$0	$51,977,000	$0	$6,912,000	$5,571,000
Actuarial Value of Assets	$3,551,000	$2,787,000	$143,704,000	$9,382,000	$36,020,000	$23,743,000
UAAL	($2,229,000)	($1,262,000)	$525,496,000	$3,450,000	$46,403,000	$53,458,000
Funded Ratio	269%	183%	21%	73%	44%	31%
Amortization Period	30 years open	30-years open	19 years out of 30 years closed	N/A	19 years out of 30 years closed	19 years out of 30 years closed

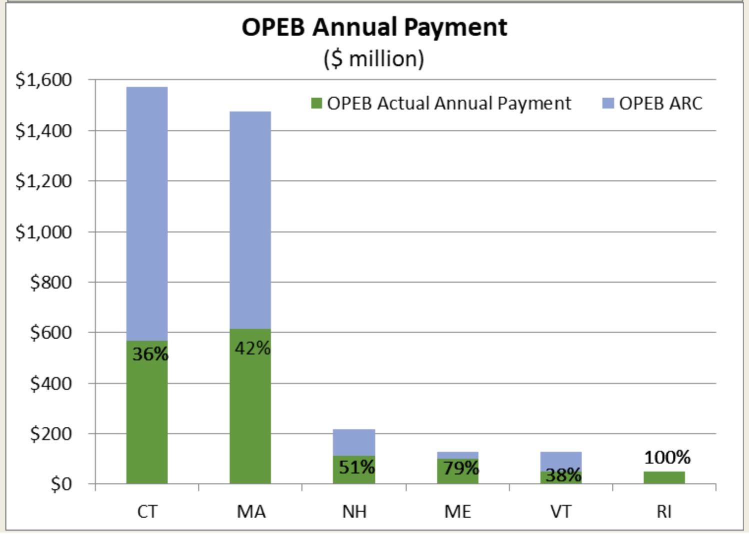
- The state has made 100% of ARC payments consistently since FY2011, except for a few occasions when the Judicial, State Police and Legislators' plans met 96%+ of ARC payments.

WAYS TO MEASURE OPEB









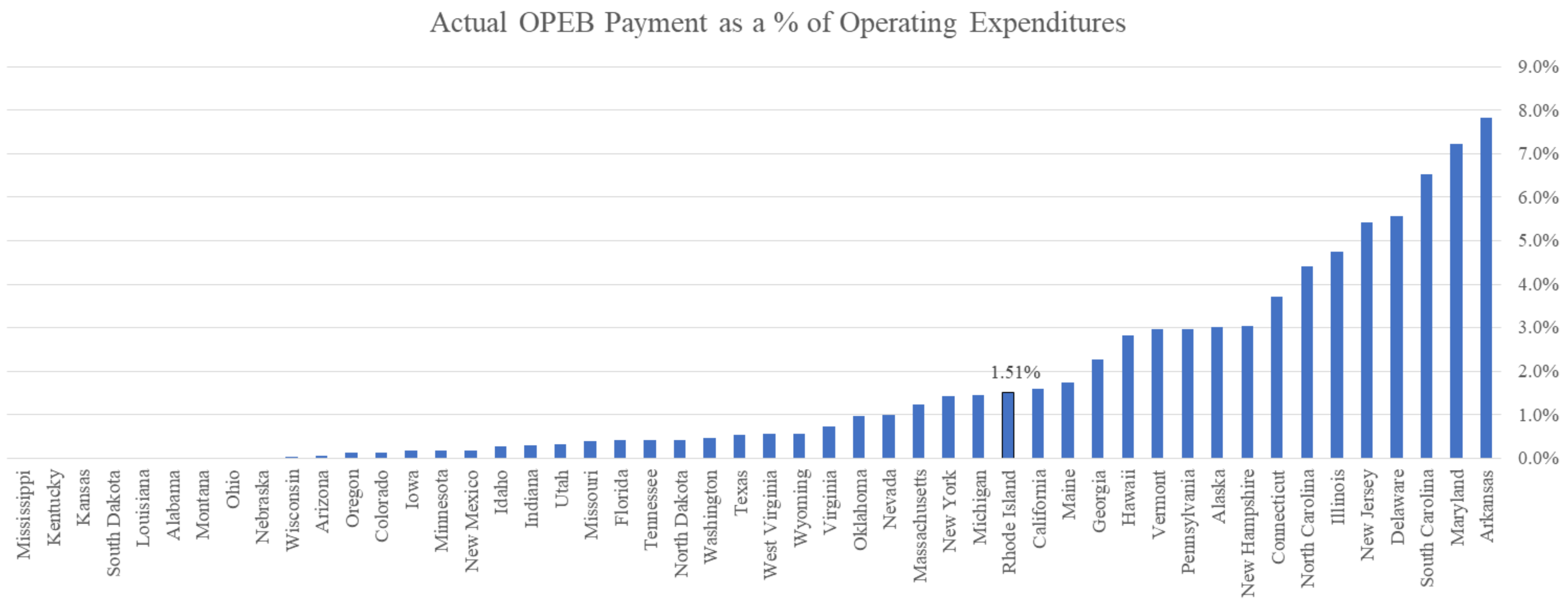
Source: S&P Capital IQ (www.capitaliq.com) and S&P's "U.S. State Retiree Medical and Other Post-Employment Benefit Liabilities Keep Rising As States Prioritize Other Obligations", October 18, 2017

WAYS TO MEASURE OPEB

State	OPEB Unfunded Liability ($ million)	OPEB Unfunded Liability Per Capita	OPEB Unfunded Liability as % of Personal Income	OPEB Actual Annual Payment ($ million)	OPEB ARC ($ million)	PAYGO as % of ARC
Connecticut	$21,888	$6,120	8.8%	$566	$1,574	36%
Massachusetts	$16,322	$2,396	3.7%	$614	$1,475	42%
New Hampshire	$2,841	$2,128	2.9%	$111	$219	51%
Maine	$2,011	$1,511	3.3%	$102	$129	79%
Vermont	$1,822	$2,918	5.8%	$49	$129	38%
Rhode Island	$590	$558	1.2%	$50	$50	100%

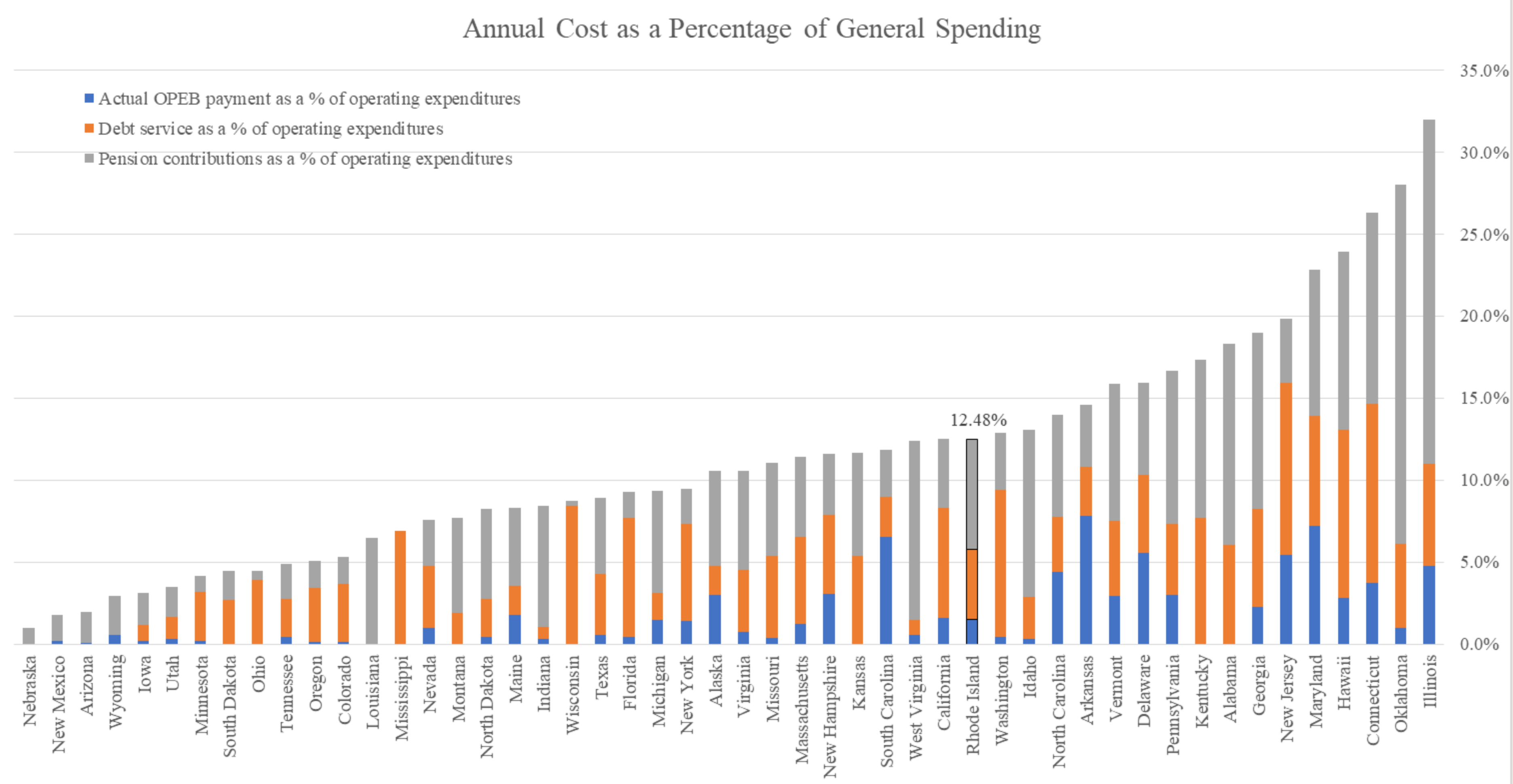
Source: S&P Capital IQ (www.capitaliq.com) and S&P's "U.S. State Retiree Medical and Other Post-Employment Benefit Liabilities Keep Rising As States Prioritize Other Obligations", October 18, 2017

WAYS TO MEASURE OPEB



Note: Contribution and expenditure data is on a budgetary basis as of fiscal 2016.
Sources: S&P State budget data or National Association of State Budget Officers expenditure report.

WAYS TO MEASURE OPEB



Note: Contribution and expenditure data is on a budgetary basis as of fiscal 2016. Sources: S&P State budget data or National Association of State Budget Officers expenditure report.

BACKGROUND & CATALYST FOR REFORM

A HISTORY OF POOR DEBT MANAGEMENT

- **38 Studios**
  - Lack of due diligence leaves state responsible for $112 million
- **Woonsocket Pension Obligation Bond**
  - 6.2% coupon on conservatively invested pension portfolio
- **RIPTA**
  - 20-year bonds for 12-year buses
- **Clean Water Finance Agency**
  - Poor cash management
- **Lack of competitive General Obligation sales**
  - State paid more to underwriters than necessary

NUMEROUS ENTITIES, PREVIOUSLY WEAK OVERSIGHT

More than 100 entities in Rhode Island have authority to issue public debt.

- State of Rhode Island
- 39 Cities and Towns
- 12 Quasi-Public Agencies
- Nearly 100 Special Districts–most with borrowing authority
  - Fire Districts
  - Housing Authorities
  - Utility Districts
  - Water Authorities
  - Conservation Districts
  - Convention & Visitors Bureaus
  - Dam Management Districts

Quasi-Public Agency	Type of Issuance
Narragansett Bay Commission	Revenue bonds
Rhode Island Commerce Corporation	Revenue bonds, moral obligation, GARVEE bonds
Rhode Island Convention Center Authority	Revenue bonds
Rhode Island Health and Educaiton Building Corporation	Revenue bonds
Rhode Island Housing and Mortgage Finance Corporation	Revenue bonds, moral obligation
Rhode Island Industrial Facilities Corporation	Revenue bonds
Rhode Island Infrastructure Bank	Revenue bonds
Rhode Island Public Transit Authority	Revenue bonds
Rhode Island Resource Recovery Corporation	Revenue bonds
Rhode Island Student Loan Authority	Revenue bonds
Rhode Island Turnpike and Bridge Authority	Revenue bonds
Tobacco Settlement Financing Corporation	Tobacco-settlement asset-backed bonds (revenue bonds)
Note: The Rhode Island Industrial-Recreational Buliding Authority insures bonds, and the Rhode Island Water Resources Board Corporate previously issued revenue bonds, before its dissolution in 2015.	

WEAK GOVERNANCE: STATE DEBT

Responsibility for issuing state debt was split between multiple offices with no one leading the process.

No single state office was responsible for:

- Managing the issuance process
- Monitoring state debt for performance after it is issued
- Analyzing legislative, administration and other proposals involving state debt
- Analyzing when and how much to refinance
- Considering how much debt to issue before hitting existing targets

PREVIOUS LACK OF PROFESSIONAL DEBT MANAGEMENT STAFF

Debt Management Employees (2016)			
California	54	Maryland	3
Michigan	26	Mississippi	3
North Carolina	16	Nevada	2.35
Connecticut	11	Alabama	2
Virginia	10	Utah	2
Louisiana	9	Alaska	1
Ohio	9	Delaware	1
Kansas	8	Indiana	1
Massahusetts	8	New Hampshire	1
Washington	8	West Virginia	1
Oregon	7	Wyoming	1
New Jersey	6	Iowa	0.5
Washington DC	6	Maine	0.5
Kentucky	5	Rhode Island	0.5
South Carolina	5	Idaho	0.25

TREASURY'S ENACTED REFORM

- At the recommendation of the Office of the General Treasurer, the Fiscal Year 2017 State budget included a series of reforms to the State's management of public debt:
  - Public Finance Management Board (PFMB) empowered to advise/assist any issuer
  - New reporting requirements to report amount of debt authorized, sold & unsold
  - New Debt Affordability Study to be conducted every 2 years
  - New Office of Debt Management funded by an expanded issuance fee

PROGRESS TO DATE

- Treasury hired its first debt manager in June 2016
- Instituted a state financial advisory exclusivity policy
- Began selling G.O. debt competitively, achieving better spreads to MMD than recent GO deals
- In April 2017 the PFMB published the first debt affordability study in almost 2 decades.
  - One of the most comprehensive DAS in the US, as it reviews debt of all public issuers and incorporates pension liabilities.
- Developing a public-facing debt portal.
- In the process of collecting first-ever annual reports on debt authorized but unissued.
- PFMB is in process of:
  - Assisting public issuers with public finance training opportunities
  - Serve as a watchdog on public debt