TOWN OF HAMDEN

OFFICE OF THE MAYOR

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Scott D. Jackson
Mayor

MEMORANDUM

From: Scott Jackson, Mayor sdj

Date: January 8, 2015

Re: State Review of Town's Plan to Issue Pension Deficit Funding Obligations

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On December 23, 2014, the Town received a letter from the State reviewing our plan to issue pension deficit funding obligations to finance a portion of the unfunded actuarial liability of the Town's Pension Plan. The letter accompanies this memorandum. The review contains a list of thoughtful recommendations by the State's Office of Policy and Management and the Office of the State Treasurer. Below are the State's recommendations contained in the letter and the Town's response.

Recommendations

Based upon the Town's submission and supplemental documentation and information, the Secretary of OPM and the Treasurer make the following recommendations.

1. That the Town carefully considers both the benefits and the loss of flexibility that arises from converting the unfunded pension liability to a fixed obligation to repay the bonds. Under the law, in addition to the debt service on the bonds, once the ramp-up period ends, the Town will be required to fund its ARC to the Plan, and should an unfunded liability in this plan arise in the future, the Town will be required to make the new higher ARC. This contribution, based on a number of factors, could be significantly different from that projected by the Town.

   Over the past three years, the Town has carefully considered both the benefits and loss of flexibility from the issuance of pension deficit funding obligations ("POBs"). The Town understands that under the provisions of Connecticut General Statutes Section 7-374c (the "Pension Statute"), the actuarially recommended contribution ("ARC") may increase or decrease during the term of the POBs due to a number of factors, and that in any case, both ARC payments and debt service payments on the POBs will be required to be budgeted by the Town on an annual basis.

2. That the Town carefully reviews the various scenarios, including the probability of each occurring, and the risk/benefit analysis, which flows from each of them. The fact that the plan is now closed, with only 36 percent of its participants being active employees (which percentage is going down each year), results in much different cash flow needs and demographics than found with most open plans. An approach that involves annual Town contributions that are nearly equal to or greater than annual pension payments could help minimize these risks in the most cost-effective manner.

   The Town has carefully reviewed numerous scenarios, including plans where the Town self-funds pension costs over time and pays the ARC without the issuance of POBs. The Town believes the combination of issuing POBs and paying the remaining ARC over the next 30 years, with the "ramp-up" in the first five years, is the most affordable and effective way of financing the Town's unfunded pension liability.

3. That the Town continue to apply guidelines or metrics in regard to its decision as to whether or not to issue POBs in the event of higher interest rates, such as a minimum spread between the borrowing cost and the 7.0 percent assumed rate of return on assets. An example of such metrics include a minimum targeted savings and/or some "rule of thumb" -- as described previously in this letter, such as 2 percent -- in terms of the spread between the cost of borrowing and the expected rate of return on assets.

   The Town plans to closely monitor interest rates on the POBs and issue the POBs when our financial advisor and underwriter believe it is in the Town's best interest. However, the Town's primary reason for issuing the POBs is to add needed assets to the Plan to prevent its insolvency, not to arbitrage the difference between the expected rate of return on assets and the borrowing cost. The Town has an assumed rate of return for its Plan of 7.0%, which is conservative as compared to other municipalities and reduces the spread between the borrowing cost and the assumed investment rate of return.

4. That the Town distributes this review letter to local decision makers and make available to the public.

   The Town plans to make the State's review letter available to the members of the Pension Committee, and to the public and bond investors by posting the letter on its website and the SEC's Electronic Municipal Market Access (EMMA) website.

5. That the Town consider establishing a more comprehensive written proxy voting policy statement for investments in the separate account manager relationships to provide consistency with each of the separate account managers and ensure that the managers are aligning with the Town in proxy voting matters.

   The Town has engaged Dahab Associates, Inc., its pension plan investment consultants, to draft a written proxy voting policy.

6. That the Town performs a comprehensive liquidity analysis and creates a written plan of action, especially for times of market turmoil where the plan would want to avoid liquidating long-term assets to meet short-term liabilities. In addition, the Town should carefully review its asset allocation plan and long term return assumption with the understanding that this is a closed plan which will have different future cash flows than an active plan. In addition, the Town should consider the risks of a large investment into the market during a period of very high equity valuation levels.

   The Town is comfortable with the Plan's liquidity and has never had an issue meeting the cash needs of the Plan. The pension consultants are well aware of current market valuations and plan to invest the proceeds from the POBs over time to reduce the risk from a market sell-off.

7. That the Town complete an experience study before the issuance of POBs, or as soon as practicable.

   The Town's actuary monitors the Plan's experience relative to the actuarial assumptions used to value liabilities. Annual gains and losses from non-investment experience have been small relative to the total liability of the Plan, which indicates that the package of assumptions is reasonably related to experience. The most recent package of assumption changes was implemented in the 2012 actuarial valuation, including a lower discount rate and mortality tables that are adjusted to reflect anticipated improvements in life expectancy. The Town plans to revisit the Plan's experience after the Town renegotiates its benefits with Plan participants in 2015.

8. That, in order to ensure compliance with the Act, the ARC calculation in the Town's annual actuarial valuation should be based on an amortization schedule that is a period of 30 years following the deposit of the POB proceeds into the pension fund.

   The Town has changed from a biannual valuation cycle to annual valuations, effective in 2014, and plans to calculate the ARC on an annual basis based on a closed 30-year amortization schedule following the deposit of the POB proceeds in compliance with the Pension Statute.

9. That the Town continue to evaluate its six-year financial plan and make adjustments to the plan if necessary as more current financial information becomes available (including up-to-date fiscal year 2015 budget projections and future actuarial information that may impact the ARC) that could affect the assumptions made in regard to the plan.

   The Town plans to update its six-year financial plan on a regular basis based on changing assumptions and actual results of operations.

10. That the Town reviews its 2015 budget to ensure that it incorporates the 50% ARC payment that is required by P.A. 14-217.

    The Town is aware of the fact that the Plan contribution of $13,750,000 in its 2014-15 budgets is less than the $14,768,025 ARC payment ($29,536,050 X 50%) that would be required once the POBs are issued. The Town's 2014-15 budgets also include a $3,400,000 debt service payment on the POBs, which will not be needed. The Town plans to amend the 2014-15 budgets to make the required ARC contribution.

11. That the Town proceeds with its plans to obtain ratings from Moody's, Fitch, and Standard & Poor's.

    The Town plans to obtain ratings from all three rating agencies.

12. Those financial arrangements, if any, which may exist between members of the Town's financing team, are fully disclosed.

    The Town is unaware of any financial arrangements between the members of the financing team.

13. That the Town's investment advisor, actuary, director of finance, and the Hamden Employees Retirement Board should closely monitor the performance of the fund and its impact upon the statutory requirements.

    Each of these members of the Town's financing team plan to closely monitor the performance of the Plan.

14. That the Town ensures compliance with the ongoing requirements of the Act, including those listed in Attachment B. If the Town believes that compliance with any of the ongoing requirements are not clear, that the Town work with the Office of Policy and Management and the Treasurer's Office to ensure compliance.

    The Director of Finance and actuary will ensure that annual valuations of the Plan are submitted in compliance with the Pension Statute and will consult with State officials regarding any questions arising regarding compliance with the Pension Statute. The valuations will include disclosures in compliance with GASB Statement 68, the successor to Statement 27 referred to in Section 7-374c(c)(3)

15. That the Town's charter include a provision requiring an actuarial analysis be conducted when pension plan enhancements are being considered.

    The Town will consider adding such a provision during the next Charter Revision. However, since the Plan will require annual valuations and the Town's pension costs will remain under scrutiny by the Legislative Council, any Plan enhancements which will increase the ARC will be carefully considered in the future.