Unfunded Liabilities: Pension

The Town carries two accounting entries to track unfunded liabilities -- one for unfunded pension obligations and one for unfunded other post-employment benefits (OPEB), primarily related to healthcare. This FAQ will address the pension obligation.

The questions periodically asked include

- What is unfunded pension liability?
- What is the amount of our pension liability?
- How much do we pay toward the pension liability?
- Why might we prepay the liability?
- Why don't we finance the whole amount with a borrowing?

What is unfunded pension liability?

Massachusetts Department of Revenue (DOR) defines the ***unfunded pension liability:***

> Unfunded pension liability is the difference between the value assigned to the retirement benefits already earned by a municipality's employees and the assets the local retirement system will have on hand to meet these obligations. The dollar value of the unfunded pension liability is redetermined every three years and is driven by assumptions about interest rates at which a retirement system's assets will grow and the rate of future costs of living increases to pensioners.

Wayland is mandated by the State to fund the pensions of all employees except teachers, who are covered by the State pension system. Starting in 1988, the State has required towns to pay toward their unfunded pension obligations and to complete payment by 2028; this deadline has since been extended to 2040.

Additional background information on the pension obligation is available in the FY2011 Financial Statements by Melanson & Heath (available on the Finance Department website).

What is the amount of our pension liability?

Wayland has been paying its obligation since 1988, and Middlesex Retirement System completes a reassessment of the accounting liability every two years. The most recent valuation of the Town's unfunded pension liability is $36,282,083 as of January 1, 2010. An assessment will be completed as of January 1, 2012, and the Town will receive the results later this calendar year.

How much do we pay toward the pension liability?

Wayland pays approximately $3.1 million per year towards this balance to fully fund by 2040. In FY2012 the Town voted to fund a pension prepayment of about $300,000. The FY2013 budget request is for $3,171,056.

Why might we prepay the liability?

Generally, the Finance Committee has not chosen to make additional pension payments because the trade-off is that the funding would need to come from either Proposition 2 ½ overrides or increased borrowings. However, recognizing that one-time receipts have supplemented the Town's free cash, last year in FY2012, the Finance Committee recommended a cash prepayment. In FY2012, the Town authorized a prepayment of approximately $300,000.

For FY2013, the Finance Committee considered a $1 million pension prepayment from cash reserves. The analysis behind the recommendation to prepay towards Wayland's unfunded pension liability is straightforward. The Middlesex County Retirement System's ("Middlesex") assumed rate of return on pension assets is 8.125%, compared to less than 1% that the Town currently earns on deposits and 1.37% which was the composite borrowing cost for the January 2012's debt offering. To clarify:

- Middlesex's assumed return is simply that, an assumption/projection; actual returns will vary.
- The 1.37% percent composite borrowing rate is for debt maturities that are shorter term than would be appropriate to consider in an analysis of issuing debt to fund the pension and OPEB liability.
- Longer maturity debt, in the 20 to 30 year range would be more appropriate to consider for an analysis of this type, and those rates are in the 4% to 4.5% range.

Why don't we finance the whole amount with debt?

Given the current low levels of interest rates, the possibility of issuing long term debt and using the proceeds to reduce the long term liabilities associated with the pension and OPEB plans is intriguing.

For Wayland, however, when considered in the context of the recent increase in outstanding debt from the high school project and the possibility of financing a new DPW building (if approved by the Town), the resulting debt burden on the Town may become an issue with residents given the associated higher taxes to cover the debt service. And making permanent aggressive prepayments is not something we can afford every year.

Also, in this year's financial audit by Melanson & Heath, in their verbal report to the Board of Selectmen, the auditors commented that our amount of debt outstanding and payable in the short term was borderline high. Adding a $36 million debt obligation to finance the Town's pension obligation would make this ratio higher (worse) and limit our ability to finance needed infrastructure maintenance and investments.