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Moody's: Most Large Local Governments Have Low Retiree Healthcare Outlays, Although Outliers are Present.

New York, March 05, 2015 — Annual budget contributions and liabilities associated with retiree healthcare, also known as other post-employment benefits (OPEBs), vary widely and burden some local governments more significantly than others, Moody's Investor Service says in a new report, "Retiree Healthcare Contributions Typically Low for Largest US Local Governments; Potential Wildcard for Outliers in Bankruptcy."

Typical non-pension OPEBs consist of retiree healthcare and life insurance. They are usually not pre-funded, and instead are paid on a pay-as-you-go basis.

"The pay-as-you-go method of funding OPEB benefits is less expensive in the near term for most of the 50 largest local governments," says lead author of the report and Moody's Associate Analyst David Gutierrez. "As such, OPEBs are not currently an outsized budgetary burden for most of the issuers."

Moody's views OPEBs differently than pensions or debt. "OPEBs are not a dollar-certain future liability as with debt or defined-benefit pensions. As such, we analyze OPEBs primarily as a budgetary expense, although the long-term obligation of unfunded liabilities is also important to our analysis," according to Gutierrez.

Usually these benefits are a small budgetary cost for issuers and are about a third the size of the median pension contribution or one-tenth the size of debt service cost across the top 50 issuers (ranked by debt outstanding). In the short term, median costs for OPEBs for local governments are not likely to significantly exceed the 1.5% of operating revenue last reported in fiscal 2013, Moody's says, but OPEB outlays will rise in the future due to healthcare inflation and growing retiree populations, and as more governments move from pay-as-you-go funding to a prefunding approach.

But, Buffalo, NY (A1 stable), Honolulu City and County (Aa1 stable) both have budgetary contributions five times the median.

Detroit's bankruptcy settlement included major cuts to retiree healthcare costs while leaving the city's pension plan only slightly impaired. Pre-bankruptcy Detroit had the highest OPEB outlays at 12.8%, with Buffalo and Honolulu City and County coming in at 8.5% and 8.1%, respectively.

Detroit's OPEB contributions were computed prior to the judicial approval of its bankruptcy settlement. The city has since slashed its OPEB liability as much as 90%, after the emergency manager negotiated significant cuts by rolling unused assets into a fund and discontinuing the plan for current retirees.

The sweeping reforms seen in Detroit are unlikely to occur in other local governments. However, some governments are shifting more of these costs to employees or discontinuing plans to new hires altogether. Moody's found 20% of the top local government issuers have taken steps to reform retiree healthcare.

While OPEB liabilities have weaker legal protections, reforms may prove difficult. Strategies include negotiating prices for services, increasing contribution rates for active employees, raising service length eligibility, reducing dependent care, and directing retirees to healthcare exchanges.

The report is available here.