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City's Retiree Benefits Problem Getting Worse Fast

As we have written on previous occasions, the City of Pittsburgh's legacy cost issue is multi-faceted—although little attention is given to some important parts of the problem. Heavy focusing of time and effort on one part of the problem can allow others to worsen. Having spent much of the past couple of years coming up with a fix for the underfunded pensions, the City now finds its unfunded liabilities for post-employment benefits other than pensions—known as OPEB—have swollen substantially in recent years. New data in the 2010 Comprehensive Annual Financial Report (CAFR) from the Controller's office illustrate the magnitude of the growth.

Pittsburgh's first valuation of OPEB, taken on January 1, 2006, revealed unfunded liabilities of \$320.3 million. Four years later the City's OPEB liability had climbed to \$488.6 million—an increase of 52 percent. Note that the current unfunded liability is larger than the City's annual budget. The rise in unfunded liability occurred despite the fact that the Act 47 team implemented changes ending retiree health care for uniformed employees hired on or after January 1, 2005 and extended cost-sharing to firefighter retirees as had been the case for police retirees.

There is no legal requirement that the City set aside assets to cover any of the liabilities. The City has always paid OPEB benefits on a "pay as you go" basis to eligible beneficiaries. The table below shows the valuations of the OPEB over the last half of the decade.

Pittsburgh's OPEB Valuations, 2006-2010 (\$000s)

Year	Assets (AA)	Liabilities (AAL)	AA-AAL
2006	\$0	\$320,367	(\$320,367)
2008	\$0	\$359,140	(\$359,140)
2010	\$0	\$488,631	(\$488,631)

The amended Act 47 recovery plan of 2009 made four main recommendations for OPEB costs:

1. Establish and begin to fund an OPEB trust fund of \$2.2 million a year beginning in 2011
2. No OPEB enhancements, including retroactive ones
3. Explore a defined contribution plan for retiree medical costs for police and fire employees hired since 2005
4. Eliminate City contributions to retiree life insurance for new hires

According to the Act 47 coordinator there have been no new or retroactive enhancements and the City is in the initial stages of establishing a trust fund. However, there has been no progress on either a new defined contribution plan or ceasing the City's life insurance contributions.

Hopefully those steps will be implemented and eventually work, because something has to be done to contain the growth in unfunded liabilities. By way of comparison, Allegheny County's OPEB liability grew 32 percent from $73 million to $96 million from 2007 to 2009 and the Port Authority's went up 11 percent from $729 million to $811 million over that same time frame. Note that both of those governmental entities also have no assets set aside to defray liabilities.

So what is to be done? When we issued our initial report on the OPEB liabilities in the region in 2008, we listed the following possible solutions: redesign benefits and implement cost-sharing, raise taxes (not a solution we would endorse), borrow money (not a desirable solution), sell assets, seek a reform to Act 111 (the collective bargaining law for police and fire). Given the time and effort the City devoted to exploring a long-term lease for parking garages as a way to fund pensions and the way that episode ended, it is doubtful the current City Council is going to be eager to explore asset sales. Moreover, at present, there is no movement in Harrisburg to change Act 111, the City has said it won't borrow money, and no one is in the mood for a tax increase. Thus there is even more pressure to pursue contractual changes to benefits. Such efforts will be fiercely opposed by bargaining units.

While there is currently no legal mandate to fund the OPEB liabilities adequately, it is clearly only a matter of time until yet another crisis develops if the current practice of underfunding continues. Making matters worse, the OPEB numbers do not include the millions of dollars in Workers Comp unfunded obligations.

There can be no excuse for the City to allow these unfunded obligations to swell and become another pension debacle. The Mayor and Council must stop the further buildup by taking serious steps to address this problem. Whether there is a legal requirement or not, retirees who have been promised certain levels of benefits will expect to collect those benefits. Clearly, now is the time to talk to future retirees about concessions they will have to make to head off a future crisis in the City. Something Pittsburgh can ill-afford with all the other intractable current and future funding problems it faces.

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