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Dealing with City Pensions: What's Next?

Following closely behind the oversight board's approval of the City's 2012 updated budget, which included putting an additional $10 million toward pensions and bringing next year's total contribution from the City, state (including the state's special allocation of $10 million), and employees to $65 million, a chorus of voices—including the City Controller, the City Finance Director, and the Act 47 coordinator—are saying that now is the time to put together a long-term fix for the City's pension problem.

Recall that Act 44 of 2009 gave the City until December 31st of 2010 to get pensions to a minimum 50 percent funded level. Devoting three decades of a share of parking tax revenue and the late 2010 shift of $45 million from reserves to pensions represented an "infusion of value" that the state felt satisfied the statute. As of now the City's pensions are 62 percent funded according to the Public Employee Retirement Commission (PERC). The question is how to improve a pension system that now has $0.62 cents of assets for every $1 in promised benefits instead of the previous $0.34 cents. The system's health has improved, but it is far from out of the proverbial woods.

The City Controller suggested in a recent editorial that everything from retirement ages to counting overtime be looked at. Separately, the Finance Director said long-term solutions need to be examined while the Act 47 coordinator said the City needs to achieve a 90 percent funding level at some point.

All this is familiar ground. In September of 2008 the Mayor testified before the Senate Urban Affairs and Housing Committee and the Senate Finance Committee that pension reforms ought to include a prohibition on income spiking just prior to retirement and encouragement of defined contribution and/or hybrid plans. The Mayor spoke highly of efforts to consolidate plans, either statewide with an incentive based approach, or multiple municipal plans within the municipality. Not long after his comments, the amended Act 47 plan called for eliminating overtime from the pension calculations of newly hired firefighters (the only union to have overtime included in final salary according to the plan) and the creation of "a new, less expensive defined benefit plan for new employees".

The key issues going forward are threefold: one, making sure there is enough money going in to cover annual benefit payments; two, making sure there is a plan to increase the funded ratio—and in the near term prevent the ratio from falling; and three, crafting the policy in light of a weakly expanding, if not declining, tax base.

A review of the Controller's audited statements on the pension trust fund from 2005 through 2010 shows that in only two years—2005 and 2008—did expenditures from the pension plans (benefit payments, refunds, and administrative expense) exceed additions (money put in by the City, state, employees, and investment income earnings). In 2008 the net result was a negative $124 million, dropping net assets in the fund at the end of the year to $260 million from $385 million at year end 2007.

From 2005 through 2008 additions to the funds averaged around $50 million. In 2009, the City raised its contribution lifting the total fund addition to just under $60 million and in 2010, a one-time transfer of $45 million in debt service funds to pensions along with a hike in the City's other contribution boosted last year's total contribution to $115 million. Unfortunately, net investment income stood at $16.8 million last year. Other than the huge decline in investment income in 2008, the $16.8 million was the smallest investment income over the period. Moreover, the earnings from interest and dividends were only $4.6 million.

On the outlay side, benefit payments have remained around $80 million since 2006 when there was a jump from the 2005 level of $72 million. Other expenses, including administrative costs, run about $2.5 million. We know from previous research that there are more retirees than active employees in the pension system, with the most recent count standing at 1.3 to 1.

In order to keep the outflow from the pension funds from exceeding inflow of revenue to the funds, the annual contribution will have to be at least $82.5 million. Otherwise, the fund portfolio will have to be tapped to make up the shortfall. In 2012, the City's direct contribution from projected revenue is $45 million with the additional $10 million from the special state allocation. Employee contributions are placed at $10 million as well. Thus, the portfolio dividend and interest income will have to be $17.5 million to cover the projected expenditures from the pension plans.

However, if the state does not have another special allocation in 2013 and the City does not boost its contribution from $45 million, the dividend and interest income will have to reach $27.5 million to keep the payments from the funds from exceeding the contributions. If the interest and dividend income fail to reach this level then the portfolio funds will have to be used to make the payments. Indeed, that will be the case for the next five years. Thus, it is crucial for the pension system managers to have a credible forecast of its earnings and portfolio market value so the City and its financial supervisors can figure out how much more the City might have to come up with to prevent erosion of its fund value.

How does the City raise the current funded ratio or keep it from slipping? Many of the reforms that have been suggested—such as retirement age changes and moving to defined contribution plans—will have to come about either by changes to the Second Class City Code, meaning the state legislature would have to amend statutes, or at the bargaining table, meaning the City, the Act 47 team, the oversight board, and the unions would have to come to an agreement. Easier said than done on both fronts.

An early version of Act 44 had language which would have permitted the option for defined contribution plans, an option that was struck out at the insistence of public sector unions. Benefit enhancements through negotiations or arbitration awards are limited under Act 47 and the oversight board statutes, but that lasts so long as those oversight mechanisms do and presently reflect many decades of pre-intervention negotiations.

The third issue is how the pensions are to achieve healthy status (80 percent or higher funded ratio) in light of a weakly expanding or declining tax base, a point the Mayor made in his 2008 testimony. Recall that the use of parking tax revenues, $13.3 million from 2011 through 2018, means those dollars are not going to the general operations of the City. Beginning in 2019 and running through 2041 twice as much ($26.6 million) of parking tax revenue will be dedicated to the pension funds. With the City's property tax, the largest revenue source, not expected to rise significantly, and the other sources of taxation limited by several state laws, there must be a strong emphasis on savings achieved through efficiencies, outsourcing, consolidation, reductions in employee count and curbs on compensation growth along with many of the pension reforms that have been discussed for years.

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