The Cost of Public Sector Retiree Benefits in Pittsburgh and Allegheny County

Eric Montarti, Senior Policy Analyst
Allegheny Institute for Public Policy

Allegheny Institute Report #08-03
October 2008

305 Mt. Lebanon Blvd.◆ Suite 208 ◆ Pittsburgh, PA 15234
Phone: 412-440-0079 Fax: 412-440-0085 www.alleghenyinstitute.org

Table of Contents

Key Findings

- Governmental Accounting Standards Board (GASB) Rule 45 made significant changes to the way state and local governments report post-employment retiree benefits other than pensions (OPEB). Rather than recording an expense when retirees are paid, GASB changes that standard to an accrual basis of reporting to reflect long-term obligations as they are earned.

- The GASB rule does not affect how governments pay for retiree benefits, rather just how they state them in their financial documents.

- The City of Pittsburgh, Allegheny County, Pittsburgh Public Schools, and the Port Authority all offer OPEB to their retirees. All four have retiree health care packages, and the City and County offer life insurance as well.

- None of these OPEB plans have assets set aside to meet long-term obligations, leaving $1.2 billion in liabilities unfunded.

- Of the four governing bodies in this report, the Port Authority carries the largest long-term OPEB obligation, $690 million, while Allegheny County has the smallest at $73 million.

- Along with unfunded pension liability, the combined shortfall total for the four entities reaches $1.98 billion.

- To deal with these problems governments must explore solutions such as curtailing benefits, selling assets, pre-funding OPEB plans, outsourcing non-core functions, and employment reductions to begin reducing the liabilities.

Introduction

Like the curtain being drawn back to reveal the man behind the ominous "Wizard of Oz", state and local governments across the nation are pulling back the cover on post-employment retirement benefits to clearly display the price tag on the promises they have made. This was not of their own volition: instead, an accounting rule change did it for them. Now all of the details are there in plain sight. All that has to be done now after the disclosure is to find a way to pay for the promises.

In so doing governments and their taxpayers will become increasingly familiar with the shorthand moniker "OPEB" which stands for other post-employment benefits. These benefits don't include pensions, as pensions are reported and disclosed currently in financial statements. OPEB includes retiree health care, a massive obligation that has garnered much attention in southwestern Pennsylvania with the contractual issues of the Port Authority. With the disclosure affecting Allegheny County government, the City of Pittsburgh, and various agencies like the Port Authority, it is instructive to examine the OPEB disclosure now so that efforts to begin to pay for the long-term obligations can be established.

GASB Rule 45 Sets Changes in Motion

Governmental Accounting Standards Board (GASB) issued Statement 45 in 2004.[1] That statement, "Accounting and Financial Reporting by Employers for Post-Employment Benefits other than Pensions", made a significant change in the way post-employment benefits—like retiree health care, dental/vision plans, and life insurance—are reported in the financial statements of state and local governments. Prior to GASB 45, the reporting of OPEB was misleading:

> When a state or local government [paid] benefits to retirees, it recognize[d] the cash going out the door and record[ed] a corresponding cost on the income statement. There [were] a couple of problems with this method. First of all, an expense [was] being recognized today for the benefits paid to retirees who have long since performed their service and earned the benefit they [were] now receiving….The obligation to provide it and the cost of deferred compensation as the benefits [were] being earned [was] not reported anywhere in the financial statements nor [was] it even disclosed".[2]

---

1 The GASB is the independent, not-for-profit organization formed in 1984 that establishes and improves financial accounting and reporting standards for state and local governments. Its members are drawn from the Board's diverse constituency, including preparers and auditors of government financial statements, users of those statements, and members of the academic community.

2 David Zion and Amit Varshney "You Dropped a Bomb on Me, GASB" Credit Suisse Equity Research, March 2007. To illustrate this change, the 2006 City Comprehensive Annual Financial Report, note 8, simply lists the other post employment benefits and the money expended on the benefits from the general fund. The only schedules of funding progress are associated with the City's three pension plans. The 2007 CAFR note 8 still describes the money going out the door for the existing OPEB packages, but then a

According to the GASB, the rule was issued "to provide more complete, reliable, and decision-useful financial reporting regarding the costs and financial obligations that governments incur when they provide post-employment benefits other than pensions".[3]

After the GASB rule was implemented for governments under a phase in based on the amount of revenues they collected, OPEB valuations would look a lot like the present valuation of pension benefits: that is to say, OPEB would have a statement of actuarial assets, accrued liabilities, a funded or unfunded accrued liability (liabilities – assets). The GASB "Schedule of Funding Progress" states

> The required content of the schedule of funding progress is equivalent to that for defined benefit pension plans and has the same purpose—to provide information about the plan's funded status and progress toward full funding from a long-term, ongoing plan perspective. The schedule should include the plan assets (*AA*), the actuarial accrued liability (*AAL*), the difference between the two (unfunded actuarial accrued liability or funding excess, *AA-AAL*), the annual covered payroll, and two ratios or indexes: the funded ratio (assets expressed as a percentage of the actuarial accrued liability, *AA/AAL*) and the unfunded actuarial accrued liability expressed as a percentage of covered payroll (*AA-AAL/Payroll*). The trend in those two ratios provides information about whether the financial strength of the plan is improving or deteriorating over time. An improvement is indicated when the funded ratio is increasing and the ratio of the unfunded actuarial accrued liability to covered payroll is decreasing.[4]

The GASB rule did not change any other requirement for governing bodies other than to report these items. Governments can continue to pay benefits out on a "pay as you go" basis from operating funds and do not have to pre-fund plans. Financial statements do have what is called an Annual Required Contribution (ARC) which is an amount that if paid on an ongoing basis would cover normal cost each year and be enough to amortize liabilities over a thirty year period. If a governing body decides to not meet this ARC, that deficiency will add to the long-term liabilities.[5] As one analyst put it "all GASB 45 does is shine a big, bright light on [the liabilities]".[6]

---

separate actuarial table shows the assets, liabilities, unfunded liabilities, and comparison with payroll in the section with pension funding. These tables are displayed later in this report.

[3] Governmental Accounting Standards Board "GASB Statement 45 on OPEB Accounting by Governments: A Few Basic Questions and Answers" (www.gasb.org)

[4] Governmental Accounting Standards Board "Financial Reporting for Post-Employment Benefit Plans other than Pension Plans", paragraph 108. Italicized shorthand made by author.

[5] Zion. The phase-in rule works as follows: governments having revenues greater than or equal to $100 million had to implement the rule by December 15, 2006; governments with revenues of at least $10 million but less than $100 million had to implement the rule by December 15, 2007; and governments with revenues of less than $10 million have to implement the rule by December 15 of this year.

[6] Ibid. Also Marcia Taylor and Dean Michael Mead "OPEB: Coming to Grips With the Cost of Retiree Health Care" ICMA, May 2006 (www.icma.org)

Since few governments have set aside assets for OPEB and pay benefits out of operating funds, the GASB disclosure has prompted some officials to begin considering pre-funding plans and determining if the benefits as offered are affordable.[7]

Local Impact: What the GASB Rule Reveals About OPEB in the Region

Due to the phase-in nature of the rule as described above, the larger local government units in southwestern Pennsylvania have by now adopted the reporting guidelines and have revealed their OPEB liability. This section looks at the City of Pittsburgh, Allegheny County, the Pittsburgh Public Schools, and the Port Authority to illustrate the impact of OPEB.

City of Pittsburgh

The City's OPEB include life insurance and retiree health care. The City funds life insurance benefits from the general fund on a "pay as you go" basis for retired police and fire employees. Non-uniformed retirees can have life insurance coverage, but it is paid by the employee via deduction from pension checks.[8]

The City also provides health care for police and fire retirees. The coverage is maintained for spouses of fire retirees upon the death of the retiree if the officer retired after 1997. Widowed spouses of police officers lose health care coverage upon the death of the retiree.[9]

According to the 2007 Comprehensive Annual Financial Report, there are 2,900 retirees receiving the life insurance benefit with the City's general fund expenditure of $371,526, which amounts to a per retiree cost of $128. There are 1,846 police and fire retirees covered under the health care benefit at a cost of $16,817,271, a per retiree cost of $9,110.

The CAFR contains the initial valuation of the OPEB offered by the City of Pittsburgh.

City of Pittsburgh, Valuation of OPEB[10]

AA	AAL	AA-AAL	Covered Payroll	AA-AAL / Payroll
0	$320,637,000	($320,637,000)	$172,624,000	183%

This valuation now puts OPEB on a similar accounting standard as pension benefits, which like OPEB are part of the compensation earned each year but are paid out after retirement. The City has no assets set aside for OPEB, which, as pointed out earlier, is not at all uncommon among state and local governments. The liabilities of $320.6

[7] Taylor
[8] City of Pittsburgh, 2007 Comprehensive Annual Financial Report, Notes to Financial Statements: "Other Post-Employment Benefits" p.64. E-mail and phone conversations with Lavonne Shannon, Benefits Manager
[9] Ibid
[10] 2007 City CAFR, note 8

million are thus entirely unfunded. Measured against the covered payroll of the City ($172.6 million), the unfunded liability represents 183 percent.

In 2007, the City's ARC was determined to be $26.7 million. The City actually put in $19.1 million, leaving a net OPEB obligation of $7.6 million, an amount that will go into the books as part of the long-term liability.[11]

Allegheny County

OPEB includes life insurance for all retirees, retiree health care for certain employees, and major medical for certain employees. Like the City, the expenditures are paid on a "pay as you go" basis from the general fund of the County.[12]

Retired members of bargaining units are eligible for a $4,000 life insurance benefit. Retired management and confidential employees are eligible for a $10,000 life insurance benefit. According to 2007 County CAFR, 3,656 retirees were receiving the life insurance benefit with a net cost to the County of $681,000, a per retiree cost of $186.

The County provides post-retirement health care benefits to certain retirees in accordance with negotiations between County and unions. There are 88 police officers receiving health care coverage. If the police officer contributed to Medicare while employed, the coverage lasts until the retiree reaches age 65. If not, the benefit is lifetime. The County's CAFR notes that the County spent $627,026 in 2007 on this benefit, a per retiree cost of $7,125.

In addition, 23 correctional officers and 7 retired sheriff employees are eligible to receive up to $300 per month towards the cost of health insurance for the correctional officer and spouse for up to five years. The 2007 County expense of $60,837 ($2,645 per retiree) was for the correctional officers and $22,817 in 2007 ($3,259 per retiree) for the sheriffs.

Lastly, the County provides post-retirement major medical insurance to certain retirees who retired prior to January 1994. These retirees are entitled to benefits for medical services rendered that are in excess of their individual plans. There are 222 employees currently benefiting at a cost of $283,332 net to the County ($1,276 per retiree).

Allegheny County, Valuation of OPEB[13]

AA	AAL	AA-AAL	Covered Payroll	AA-AAL / Payroll
0	$73,313,000	($73,313,000)	$264,631,900	27%

The table shows the valuation of the OPEB from the County's CAFR. The liabilities are much smaller than those of the City of Pittsburgh and represent a smaller percentage of the covered payroll of the City. If we were to consider the UAAL in aggregate, that is, if

[11] Ibid
[12] Allegheny County, 2007 Comprehensive Annual Financial Report, Notes to Financial Statements, "Post Employment Benefits Other than Pensions" p. 180
[13] Ibid

we combined the unfunded liabilities of the City and the County, the unfunded OPEB would be $393 million. The City of Pittsburgh, which represents about a quarter of the entire County population, takes an 81 percent share of the aggregate unfunded liabilities.

Under the OPEB annual contributions, Allegheny County would have had to contribute $6.4 million in 2007 to begin the process of eating away at the liabilities on a normal thirty year schedule. They actually contributed $1.7 million, leaving a net unfunded OPEB obligation of $4.7 million.[14]

Pittsburgh Public Schools

The School District provides health insurance coverage for retired employees and their dependents through a single-employer defined benefit healthcare plan. The plan provides health insurance for retirees and also contributes funds toward a Medicare supplement reimbursement after age 65. The reimbursement amount depends on the date of retirement divided by out of pocket expenses.[15]

Pittsburgh Public Schools, Valuation of OPEB[16]

AA	AAL	AA-AAL	Covered Payroll	AA-AAL / Payroll
0	$165,046,000	($165,046,000)	$251,150,961	66%

In 2007, the School District's ARC was $15.7 million, and the district actually contributed $11.2 million, leaving a net OPEB obligation of $4.5 million.[17]

Port Authority

The Port Authority, an independent agency charged with operating mass transit service in Allegheny County (and portions of adjacent counties), has brought the issue of retiree health care to the forefront in the region. As of this writing, the Authority and the Amalgamated Transit Union are negotiating on a new contract in which retiree health care is an item the board drastically wants to change for the financial well-being of the agency. The union, not surprisingly, wants no changes to this benefit.

According to the most recently available Port Authority audit, post retirement benefits are provided to those who become entitled to receive a pension allowance or disability allowance. Post retirement benefits of medical, hospital, prescription, dental, and vision coverage and Medicare Part B premium reimbursement is provided for the life of the retiree.[18]

According to the County's CAFR, there are three OPEB plans at the Port Authority. Two are for represented employees—the Amalgamated Transit Union and the International

[14] Ibid
[15] 2007 Pittsburgh Public Schools Comprehensive Annual Financial Report, note 6, p. 77
[16] 2007 Schools' CAFR
[17] Ibid
[18] Port Authority Single Audit, June 30,2006 Note 15 "Post-Retirement Benefits"

Brotherhood of Electrical Workers—and the third is for non-represented employees. Benefits for the union plans are negotiated between the board and the union, and the non-rep plan is determined solely by the board.[19]

The Authority funds the OPEB on a pay-as-you-go basis, i.e., there is no set aside for to meet future obligations. PAT paid a total of $25 million in 2007 with plan members paying $1.9 million. Retirees receiving benefits pay a certain percentage of cost increases after the base year, with the percentage sharing determined by agreements and varying by plan.[20]

Port Authority of Allegheny County, Valuation of OPEB[21]

Plan	AA	AAL	AA-AAL	Covered Payroll	AA-AAL / Payroll
ATU	0	$612,832,000	($612,832,000)	$112,656,000	544%
IBEW	0	$15,442,000	($15,442,000)	$3,049,000	506%
Non-Rep	0	$62,246,000	($62,246,000)	$14,023,000	444%

Measuring the Total Impact of Unfunded Liabilities

Since OPEB means "other post-employment benefits" and those are other than the pension obligations that have been measured and reported on an accrual basis for some time now, what is the total burden of all unfunded post-retirement benefits from these three governing bodies?

Combined Unfunded OPEB and Pension Liabilities[22]

Governing Body	Unfunded OPEB Liabilities	Unfunded Pension Liabilities	Combined Unfunded Liabilities
City of Pittsburgh	($320,627,000)	($523,880,000)	**($844,517,000)**
Allegheny County	($73,313,000)	($157,732,000)	**($231,045,000)**
Pittsburgh Schools	($165,046,000)	0	**($165,046,000)**
Port Authority	($690,700,000)	($52,600,000)	**($743,300,000)**
Totals	**($1,249,696,000)**	**($734,232,000)**	**($1,983.908,000)**

Per Capita Burden

The per capita impact of the unfunded OPEB and pension liability varies depending upon the location of the resident. With none of the OPEB plans pre-funded and paid out of general operating funds currently, local taxes (or fare revenues and federal and state subsidies in the case of the Port Authority) are the source for paying out retiree benefits.

---

19 County CAFR, "Component Units—Post Employment Benefits Other than Pensions" p.185.
20 Ibid
21 2007 County CAFR, note 8
22 City Pension Unfunded Liability totals Police, Fire, and Non-Uniformed Plans as stated in CAFR note "Schedules of Funding Progress" p 95; County Pension Unfunded Liability from "Funding Policy, Annual Pension Cost, Annual Required Contribution, and Schedule of Funding Progress" p 174; Pittsburgh Public Schools CAFR, "Schedule of Funding Progress for the Retiree Health Care Plan, p 83. The Schools' report no pension liability since there is a statewide teachers' pension plan, PSERS; Port Authority from County CAFR "Funding Policy, Annual Pension Cost, and Schedule of Funding" p 177

Allocating the unfunded liabilities of these four governing bodies provides an illustration of the burden of the promises made to employees through pensions and other post-employment benefits. The estimate of the burden is based upon the most recent Census data which places the County's population at 1.2 million with the City of Pittsburgh having 311,000, or 25 percent of the total.

Per Capita Impact of Unfunded Liabilities

Location of Resident	Population	City OPEB and Pension	County OPEB and Pension	PAT OPEB and Pension	Pittsburgh Schools OPEB	Total
County, outside of Pittsburgh	922,000	0% share $0	75% share ($173,284,000)	75% share ($557,475,000)	0% share $0	**($730,759,000)**
Per Capita		*$0*	*$188*	*$605*	*$0*	***$793***
Pittsburgh	311,000	100% share ($844,517,000)	25% share ($57,761,000)	25% share ($185,825,000)	100% share ($165,046,000)	**($1,253,149,000)**
Per Capita		*$2,715*	*$186*	*$598*	*$531*	***$4,029***
Total	**1,233,000**	**($844,517,000)**	**($231,045,000)**	**($743,300,000)**	**($165,046,000)**	**($1,983,908,000)**

The table above shows how the unfunded OPEB and pension liabilities based on the distribution of population in the County would look. A resident of the County living outside the City of Pittsburgh would be responsible for 75 percent of the County and Port Authority obligations, a $730.7 million amount. Based on the County population outside of the City (922,000), the per capita amount would be $793. This amount would likely rise based on the fact that a resident would also be responsible for any unfunded liabilities of the municipality and school district in which they live.

Whether it would rise to the level of a City resident is debatable due to the massive unfunded obligations of the City. Indeed, most municipalities have well funded pension programs. At the same time, the health care obligations for retired school employees could rival of those in the City. In any case, we can attribute the entire unfunded liability of the City OPEB and pensions, the City Schools' OPEB, and a proportional share (25%) of the County and PAT unfunded liabilities to the City. With a $1.253 billion tag on a population of 311,000, the per capita amount comes to $4,029, an amount 5 times the per capita County resident. Even with estimating the unfunded liability of a typical suburban municipality and school district it is safe to assume that a City resident's burden would be 3 to 4 times greater than a non-City resident. And, if unfunded workers' compensation were to be included, which it must be for a complete picture of unfunded liabilities, the City's financial picture is even more dire.

Possible Solutions

Now that governments here and across the nation either have, or soon will, accurately measure the long-term obligation associated with OPEB, many will begin to look for a way to cut into the liability and prevent further accumulation. Again, the GASB rule doesn't mandate any funding change, just that there be recognition of the cost. But the price tag is daunting and sooner or later state and local governments will have to craft solutions on liabilities that, by one estimate, exceed $1.5 trillion.[23]

So what could these governing bodies, as well as other general and special purpose governments, do? There are several options on the table.

- *Redesign Benefits and Implement Cost Sharing*—Governments could require retirees to pay more of premium and increases after their retirement date. They can end retiree benefits for new employees hired after a certain date, similar to a solution we mentioned for pension liability by switching new employees to a defined contribution plan. This type of action was taken by the cities of San Diego and Arlington in recent years as did the state of Pennsylvania.[24]
- *Raise Taxes*—Governments can raise taxes to fund OPEB, an action that would be disastrous for our region.
- *Borrow Money*—Governments could issue OPEB bonds like they issued pension bonds in recent years to establish assets and decrease liabilities. That was a road Pittsburgh went down for its pension liability in the late 1990s, an action that did not help in the long term and only added to general obligation debt. The City of Gainesville did this in 2005.[25]
- *Sell Assets*—Governments could sell assets. This might be particularly useful for special purpose governments like the Port Authority which cannot raise taxes and possibly could go out of business.
- *Work to have Act 111 reformed*—This is the state law that mandates binding arbitration in contract disputes involving police and fire. The law creates an imbalance in bargaining that favors the labor unions.[26]

A specific set of solutions that were made by the Act 47 Recovery Team in 2004 on retiree health care costs for the City of Pittsburgh that could have application to other governments:

---

[23] Zion

[24] Jose Gonze "Low OPEB Risk in Muni Bonds" Thornburg Investments (http://www.thornburginvestments.com/research/articles/opeb_risk.asp) The Commonwealth of Pennsylvania also took steps to curtail the cost of retiree health care by requiring workers to contribute a percentage of their final gross salary to health care (varies depending on time of retirement), adjustments to medical and prescription plans, and a dedicated account to invest funds to pay for future health care costs. Commonwealth of Pennsylvania, Office of the Budget "Budget Secretary Says Future Retiree Health Care Costs Estimated at $8.5 Billion" May 9, 2008 and Girard Miller "Controlling OPEB Costs" Governing Magazine, May 2008

[25] Gonze

[26] For further detail see Allegheny Institute report 05-02 "Addressing the Imbalance in Pennsylvania's Act 111"(http://www.alleghenyinstitute.org/reports/05_02.pdf)

- *Phase Out Retirement Benefit*: The City of Pittsburgh shall no longer provide retiree healthcare to employees hired following the date of the adoption of this Recovery Plan or on the expiration of an existing collective bargaining agreement if subsequent to the adoption of the plan.
- *Shift Cost Increases to Retiree*: For all employees retiring after the adoption of the plan or the expiration of the collective bargaining agreement, increases in healthcare premiums shall be paid by the retiree.
- *Keep Option to Compare Benefits Open*: The City maintains the right to change providers.
- *Curtail Benefit Increases*: The healthcare benefits currently provided shall not be increased.[27]

Some of these recommendations have been implemented through collective bargaining agreements with police and fire unions. The retiree health care benefit has been ended for police and fire officers hired after June of 2004; firefighters have been given the responsibility for paying increases to the premium, while there is a police arbitration award currently being appealed which allows those officers hired before January of 2005 to make health care contributions at the same rate as active employees; the last two points have not specifically been spelled out in the agreements, though any increase in benefits would likely be in violation of the Recovery Plan.[28]

But there is a lot more to be done in the City—which plans to revise its Recovery Plan to specifically deal with the issue of legacy costs—and elsewhere to address the impact of retiree health care and the slew of other post-employment benefits and the long term costs associated with them. There is a veritable menu of options, and it is likely we will see various combinations of phase-out dates, caps, and cost-sharing in the near future.

[27] Commonwealth of Pennsylvania, Department of Community and Economic Development, Governor's Center for Local Government Services Act 47 Recovery Plan for the City of Pittsburgh
[28] E-mail conversation with Jim Roberts, Act 47 Coordinator for the City of Pittsburgh