Pension Problems in Pennsylvania's Largest Cities: Do They Make a Case for Reform?

Eric Montarti, Senior Policy Analyst
Jake Haulk, Ph.D., President
Allegheny Institute for Public Policy

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

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Key Findings and Conclusion

- The state's ten largest municipalities (Philadelphia, Pittsburgh, Allentown, Erie, Reading, Scranton, Bethlehem, Lancaster, Harrisburg, and Altoona) had 81,164 active and retired members enrolled in 35 separate pension plans in 2007, the latest full year data available.

- On a combined basis, these pension plans had 1.2 retired members for every active member.

- For every 1,000 people, these plans had 34 active and retired members. When Philadelphia's population and membership is omitted from the group, the ratio falls to 19 per 1,000.

- Nearly all pension plan participants are enrolled in self-insured, defined benefit type plans.

- Total unfunded liabilities of these plans topped $4.5 billion with Philadelphia at $3.8 billion accounting for 83 percent.

- On a per member basis, Pittsburgh had $67,947 in unfunded liabilities in 2007, the highest of any municipality.

- Philadelphia and Scranton had troublesome funded ratios below 60 percent while Pittsburgh posted a very seriously deficient ratio of just 42 percent in 2007. Funded ratios have undoubtedly taken a hit with the 2008 drop in equity prices.

- Five of the municipalities including Harrisburg, Reading, Lancaster, Altoona and Bethlehem had fairly healthy to excellent funded ratios.

- Pension plans for the remainder of Pennsylvania's municipalities (other than the ten largest) are 96 percent funded, have a lower unfunded liability per member, a lower ratio of retired to active members, and a lower membership per 1,000 people.

The well-funded status of pension plans in the remainder of the state is a serious obstacle to a statewide consolidation of local pension plans since those municipalities will likely view such a move as a bailout. Instead the path to reform seems pointed more toward moving from a system of defined benefit plans to defined contribution plans and offering bankruptcy as an option of last resort for those municipalities that simply cannot get out from under the weight of pension liabilities.

Introduction

Rather than functioning as a single unified retirement system like those of state workers (SERS) or school teachers (PSERS), the Commonwealth's local retirement system is a collection of more than 3,100 plans independently administered by counties, municipalities, and authorities. Our 2007 report focused on the legal nature of the system, its financials, the state aid formula, and recommendations for improvement, particularly for plans with inadequate assets to cover liabilities.

Pensions and retirement benefits in general are becoming more prominent as public policy issues. The Port Authority and the transit union have recently come to a contract agreement after prolonged negotiations that threatened to end in a strike because of changes the Authority wanted to make to retiree health care. The City of Pittsburgh, which is still in municipal financial distress and under state oversight, is embarking on a plan that could lead to leasing parking garages to obtain a large infusion of funding for pensions. Moreover, the state appointed financial overseers are rewriting the City's recovery plan to focus on legacy costs.

This report examines and analyzes in detail the condition of pension plans in Pennsylvania's ten largest municipalities in terms of membership, assets, and unfunded liabilities. The objective is to determine if far-reaching statewide reform might be warranted or feasible for the troubled plans.

Methodology

According to Census Bureau Estimates of 2007 population, the state's ten largest municipalities are Philadelphia (1,449,000), Pittsburgh (311,000), Allentown (107,000), Erie (103,000), Reading (80,000), Scranton (72,000), Bethlehem (72,000), Lancaster (54,000), Harrisburg (47,000), and Altoona (46,000).[1]

Pension data for these cities was obtained from the most recent report of the Public Employee Retirement Commission, a state agency charged with monitoring the local government pension plans in the state. The Commission produces a report every two years titled "Status Report on Local Government Pensions" that contains data on all local plans in the state. Pension data for counties and county authorities was omitted. This report reflects data for 2007 valuations.[2]

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[1] Census Bureau, Population Estimates for Cities and Towns for Pennsylvania (http://www.census.gov/popest/cities/tables/SUB-EST2007-04-42.csv)

[2] Public Employee Retirement Commission "Status Report on Local Government Pension Plans", 2008 edition (www.perc.state.pa.us). For purposes of counting plans for each municipality, the measurement does not include the pensions of related authorities. So in the case of Pittsburgh, the Parking, Housing, and Redevelopment Authority plans would not be included in the municipal total but in the statewide total. This is the case for the other nine municipalities in the sample group as well since the plans are administered by separate boards of directors of the authorities and these plans don't partake of the state pension aid. The focus is on the municipal plans housed in the general purpose municipal government.

It is important to note that even though each municipality carries separate pension plans for each class of employee (police, fire, non-uniformed) the data presented in this report combines the pension data for each municipality so that the performance and measurement will be done on a unified basis for each municipality.

The most important data are the following:

- *Active Members*: The number of active employees participating and contributing to the pension plan.
- *Retired Members*: The number of retired (also disabled or surviving spouse) employees that are collecting pension benefits.
- *Number of Plans and Type*: The number of pension plans and the type of benefit offered to employees enrolled in the plan.
- *Funded or Unfunded Liabilities*: The difference between Actuarial Assets (AA) and Accrued Actuarial Liabilities (AAL). When a pension plan's actuarial assets are less than the plan's accrued actuarial liabilities, the pension plan is said to have unfunded accrued actuarial liabilities (UAAL).
- *Funded Ratio*: This is determined by dividing the Actuarial Assets by the Accrued Actuarial Liabilities, or in shorthand, (AA/AAL). A ratio of more than 100 percent means that AA exceed AAL, and a ratio of less than 100 percent means that AA are less than AAL.[3]

The Municipal Pension Picture in 2007

PERC compiled the following data based on reporting by Pennsylvania's municipal pension plans for 2007: combined membership (active and retired) of 137,692, assets of $12.3 billion and liabilities of $17.1 billion resulting in unfunded liabilities of $4.7 billion and a funded ratio of 72 percent.[4]

TABLE I
Pennsylvania's Municipal Pension Plans

Variable	2007 Data
Total Membership	137,692
Assets ($)	12,380,701,000
Liabilities ($)	17,169,962,000
AA-AAL ($)	(4,789,261,000)
AA/AAL (%)	72

Table I summarizes the statewide municipal pension situation. Now we focus on the plans in the state's ten largest municipalities, referred to hereafter as the *sample group*.

[3] PERC report, author's calculations
[4] Ibid. The data does not include county pension plans, just those of municipalities, municipal authorities, and some municipal associations.

Sample Group: Membership

Table II displays for the ten largest municipalities the active members, retired members, and the membership per 1,000 people as a measurement of the disparity between those collecting pensions to those working and paying into the system.

TABLE II
Ten Largest Municipalities, Membership in Pension Plans
(Ranked by Total Membership)[5]

City	Active	Retired	Total	Members per 1000 people
Philadelphia	28,354	35,527	63,881	44
Pittsburgh	3,248	4,462	7,710	25
Allentown	834	830	1,664	16
Erie	683	867	1,550	15
Reading	659	614	1,273	16
Lancaster	931	262	1,193	22
Bethlehem	694	489	1,183	16
Scranton	552	541	1,093	15
Harrisburg	611	438	1,049	22
Altoona	244	324	568	12
Total	36,810	44,354	81,164	Avg-34

Philadelphia represents 78 percent of the sample group's total membership. Total membership in the sample group accounts for nearly 60 percent of total membership in all municipal pension plans in the Commonwealth. Bear in mind that Philadelphia has a combined city-county government for the most part and, as a result, its plan members per 1,000 population ratio is much larger than the other cities. Overall, the group has 34 plan participants per 1,000 population. Excluding Philadelphia the group has 19.4 pension plan members per 1,000 population.

Now we examine the relationship between retired members who are collecting pensions and those who are employed and actively contributing to the pension system. Table III summarizes those statistics for the group. In the sample group total, with 44,354 retirees and 36,810 active members, the ratio of retired to active member is 1.2 to 1. Compared to the sample group average, four of the ten municipalities had a higher ratio of retired to active members: Pittsburgh, Altoona, Erie, and Philadelphia. These municipalities exhibit a situation where there are more people collecting pensions than those working and contributing. The extreme outlier in the group is Lancaster, with a ratio of 0.28 to 1.

[5] Ibid. Data on retired members provided by PERC.

TABLE III
Ten Largest Municipalities, Ratio of Retired to Active Members
(Ranked by Ratio)[6]

City	Retired to Active
Pittsburgh	1.37
Altoona	1.33
Erie	1.27
Philadelphia	1.25
Allentown	0.99
Scranton	0.98
Reading	0.93
Harrisburg	0.72
Bethlehem	0.70
Lancaster	0.28
Average	1.20

Sample Group: Number and Character of Plans

These municipalities contain 35 separate pension plans between them. All of the municipalities carry a minimum of three plans—one for police, one for fire, and one for all remaining non-uniformed personnel. The overwhelming majority (32 of the 35) are SIDB—self-insured, defined benefit plans.[7]

In the five municipalities where there is a fourth plan that plan is exclusively for non-uniformed personnel. Two are self-insured defined benefit and the remaining three include defined contribution plans in Pittsburgh and Lancaster and a hybrid type plan in Scranton[8].

Here is the membership in these plans for 2007: none of the three are paying out benefits to retired members; Pittsburgh has no active members; Scranton has 82; and Lancaster has the largest membership at 373. Combined, these members (455) represent less than one percent of the total membership in the sample group pension plans.

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[6] Ibid

[7] As described by Eggers "defined contribution plans limit employer and taxpayer exposure to investment risk because ultimate retirement benefits under a defined contribution plan are determined by the performance of an employee's retirement investments. By contrast, defined benefit plans pay a set pension amount regardless of a fund's investment performance, with taxpayers picking up the tab for any deficiency". William Eggers "Solving the Pension Crisis" in States of Transition, William Eggers and Robert N Campbell, editors, a Deloitte Research Book, 2006. Or as PERC puts it "the employer…bears the investment risk in a DB pension plan, and the employee bears the investment risk in a DC plan"

[8] PERC defines the plan as "a Taft-Hartley Act collectively bargained, jointly trusted, multi employer pension plan governed primarily by the Employee Retirement Income Security Act of 1974"

TABLE IV
Ten Largest Municipalities, Number and Type of Plans
(Ranked by Number of Plans)[9]

City	Number of Plans	Number that are SIDB Plans
Allentown	4	4
Bethlehem	4	4
Lancaster	4	3
Pittsburgh	4	3
Scranton	4	3
Altoona	3	3
Erie	3	3
Harrisburg	3	3
Philadelphia	3	3
Reading	3	3
Total	35	32

Sample Group: Unfunded Liabilities

The single best measure of the health of a pension plan is simply the difference between the plan's assets and its liabilities. If the assets are less than the liabilities, the plan is said to have unfunded liabilities. Only one municipality in the sample group (Harrisburg) did not have unfunded liabilities in 2007, and therefore it is not included in Tables V and VI .

TABLE V
Ten Largest Municipalities, Unfunded Liabilities
(Ranked by Dollar Value of Unfunded Liabilities)[10]

City	AA-AAL ($)
Philadelphia	3,775,475,000
Pittsburgh	523,879,000
Allentown	74,050,000
Scranton	59,028,000
Erie	55,978,000
Bethlehem	26,238,000
Altoona	9,156,000
Lancaster	8,816,000
Reading	7,614,000
Total	4,540,234,000

Philadelphia's unfunded liabilities dominate the overall picture, accounting for 83 percent of the sample shortfall. Together Pittsburgh and Philadelphia represent 95 percent of the group's total unfunded pension liabilities—and about 90 percent of all municipal shortfall in the state.

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[9] PERC report, author's calculations
[10] PERC report, author's calculations

Another way to measure the impact of the unfunded liabilities is to look at the per member level—that is, dividing the unfunded liabilities by the combined active and retired membership. Across the entire sample group ($4.5 billion in liabilities divided by 81,000 members) the per member unfunded liability is $55,939. By the per member measure, Pittsburgh has the largest unfunded liabilities at $67,947—22 percent above the weighted sample average. Philadelphia is also higher than the sample with Scranton not far behind. It should not come as a surprise that all three cities are in some type of state oversight.[11]

TABLE VI
Ten Largest Municipalities, Unfunded Liabilities per Member
(Ranked by UAAL per Member)[12]

City	UAAL per Member ($)
Pittsburgh	67,947
Philadelphia	59,101
Scranton	54,005
Allentown	44,501
Erie	36,114
Bethlehem	22,179
Altoona	16,119
Lancaster	7,389
Reading	5,981
Average	55,939

Sample Group: Funded Ratio

A final measure of the financial health of the pension plan is the funded ratio, or the plan's assets divided by the plan's liabilities, expressed as a percentage. The sample group's assets ($6.0 billion) divided by the liabilities ($10.5 billion) results in a funded ratio of 57 percent for the sample group of ten cities.

A funded ratio of 80 percent or more means a plan is in good shape. Obviously the higher the ratio the better. By this measure Harrisburg, Reading, Lancaster, Altoona, and Bethlehem would be considered to be on solid footing. In contrast Scranton, Philadelphia, and Pittsburgh are in bad shape and fall at or below the weighted sample group average.

[11] Philadelphia has an oversight board, Pittsburgh has both an oversight board and is in Act 47 Distressed Status, and Scranton is in Act 47 Status
[12] Ibid

TABLE VII
Ten Largest Municipalities, Funded Ratio
(Ranked by Funded Ratio)[13]

City	AA/AAL (%)
Harrisburg	118
Reading	96
Lancaster	91
Altoona	88
Bethlehem	88
Erie	78
Allentown	76
Scranton	57
Philadelphia	54
Pittsburgh	42
Average	57

Generally speaking, plans with more active members than retirees will show better funding ratios. Likewise, plans with fewer total members per 1,000 population tend to have better funded ratios. And that makes sense inasmuch as the more active members paying in and receiving local and state matching funds should mean more total money going into the plan compared to the amount going out. At the same time, taxpayers in municipalities with relative few employees will have a smaller pension burden to pick up.

Comparing Pensions in this Group to the Rest of Pennsylvania

Given the differences in pension plan situations among the sample group, it is reasonable to ask: Are there major differences between the sample group and the remainder of municipal pension plans across the Commonwealth? Table VIII below contains PERC data for all municipal pension plans in the state and the key measurements discussed in this report. The sample group column shows data for the ten largest municipalities. The column on the right titled "remainder" contains the data for the remaining municipal and municipal authority plans in the state.

[13] Ibid

TABLE VIII
Ten Largest Municipalities vs. Remainder of PA[14]

Variable	All Municipal Plans	Sample Group	Remainder
Total Membership	137,692	81,164	56,528
Assets ($)	12,380,701,000	6,032,569,000	6,348,132,000
Liabilities ($)	17,169,962,000	10,542,520,000	6,627,442,000
AA-AAL ($)	(4,789,261,000)	(4,509,951,000)	(279,310,000)
AA/AAL (%)	72	57	96
Retired-Active	0.79/1	1.2/1	0.41/1
Members per 1000	11.1	34.6	5.6
UAAL per Member ($)	34,782	55,565	4,941

In comparing the sample group to the remainder, it is clear that the sample group clearly would have its work cut out if trying to make a case for consolidation of all plans that would include a provision for the state to assume the responsibility for unfunded liabilities.

Consider:

- Unfunded liabilities in the sample group are about 16 times greater than the remainder of the state
- The funded ratio (AA/AAL) in the sample group is 57 percent as opposed to 96 percent in the remainder
- There is a ratio of 1.2 retirees for every 1 active member in the sample group; in the remainder the ratio is 0.41/1
- The average pension plan membership per 1,000 people in the sample group is 34 (19 excluding Philadelphia). For the reminder of the state's municipalities, the pension plan membership is only 5.6 per 1,000.
- The UAAL per member in the sample group is $55,565 to $4,941 in the remainder

Perhaps we can begin to see the root of the problem. Larger cities have far more public employees in pension plans relative to the municipality's population than smaller municipalities have. And this does not even address or take into account the relative generosity of the big city plans to those of the smaller towns.

Lessons and Recommendations

Given the huge differences in the financial situations among municipal pension plans in Pennsylvania and considering the gigantic problems in Philadelphia and Pittsburgh, it is obvious why forging a broad based coalition to ask Harrisburg to consolidate plans and assume the responsibility for liabilities is difficult to achieve. Taxpayers across the state who are already facing possible tax hikes to fix looming problems with teacher and state

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[14] Ibid. Harrisburg's data and their funded liabilities of $30,283,000 are included in the sample group measurement which results in the somewhat slightly lower unfunded liability total than what was presented in the table on unfunded liabilities of the sample group on page 7.

employee pensions will be very upset at talk of more billions to repair the enormous problems the big cities have created for themselves. That is especially true in light of the prospect of state and national economic weakness that could last for another year or longer.

That is not to say that reform is without merit—the question is "what kind of reform"? As we pointed out in the 2007 report, an idea that needs to be explored is a significant transition of the pension system from a defined benefit one to a defined contribution one. That would involve amending numerous state statutes and likely setting a date at which all employees hired on or after are enrolled in a 401k type plan. This would have to include state, school, county, local, and authority employees.

Until then the only option for cities with huge unfunded liabilities such as Pittsburgh is to make changes to collective bargain agreements through the Act 47 process. The cities could look for innovative solutions such as the proposed leasing of parking garages, and trying to align staffing levels with population so that the accumulation of additional liabilities is curtailed.[15]

Longer term, the Commonwealth could consider changing relevant statutes governing municipalities and perhaps the Constitution to allow communities in overwhelming financial distress to declare bankruptcy and thereby get out from under the burden of pensions it can no longer afford because its tax base has shrunk and higher tax rates would only serve to drive away even more of the tax base. For this to work, the state would have to set up a program similar to the national pension guarantee system that would pay pension recipients some fraction of the amount they would have ordinarily received.

Obviously, any municipality entering bankruptcy would have to come under the severest financial discipline by the courts including mandatory and significant expenditure reductions. Moreover, the state would need to set up a fund immediately, using assessments levied against municipalities and counties based on the size of their pension liability. The state could also reallocate some of the funds currently being contributed to cover municipal pensions to the pension insurance program.

Any bankruptcy legislation would have to spell out in clearest terms the conditions necessary for a municipality to qualify. Further, the conditions should be extremely dire such as the loss of creditworthiness, severe service reductions and job cuts already in place with more in the offing. Finally, a municipality choosing this route would face at a minimum five years of financial oversight and could face a forced merger with another municipality at the state's discretion. Therefore, a municipality would have to think long and hard about opting to declare bankruptcy. It would represent a last resort.

As a guarantee against future pension problems, the municipality would be able to offer only defined contribution pension plans going forward with any employer match

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[15] See Allegheny Institute *Policy Brief* "Proposal to Lease Parking to Fund Pensions Raises Opportunities, Questions" Volume 9, Number 4

dependent on running consistent budget surpluses. Two thirds of any such surplus would be returned to taxpayers in the form of tax cuts. Thus, employees would have an incentive to keep costs down and taxpayers would be glad to get a tax reduction.