MUNICIPAL PENSIONS

JANUARY 22, 2018

Ronald J. Grutza
Assistant Director of Government Affairs
Pennsylvania State Association of Boroughs

2941 North Front Street
Harrisburg, Pennsylvania 17110
(717) 236-9526 ext. 1044
rgrutza@boroughs.org
www.boroughs.org

The Pennsylvania State Association of Boroughs (PSAB) is a statewide, non-partisan, non-profit organization dedicated to serving 957 borough governments. Since 1911, PSAB has represented the interests of boroughs and helped to shape the laws that laid their foundation. The Association improves and assists local governments through legislative advocacy, research, education and other services. With more than 2.6 million Pennsylvanians residing in borough communities, our members strive to deliver quality leadership and service to citizens across the Commonwealth.

Two major municipal services our members deliver to their communities are police and fire protection. Borough communities in Pennsylvania typically provide their own police force. In some instances, boroughs also contract for police services from a neighboring municipality or participate in a regional police force. These arraignments for police services account for 71 percent of the boroughs in Pennsylvania with the remainder relying on State Police coverage.
With a large majority of boroughs responsible for providing police protection for their citizens, the costs to provide this vital service are not cheap. In fact, it represents a large and every growing percentage of their municipal budget. Current laws such as Act 111 of 1968 (Collective Bargaining and Binding Arbitration for Police and Fire) and Act 600 (Municipal Police Pension Law) have increased costs for public safety. Municipal officials are now looking to Harrisburg for new and innovative ways to help meet the demands of providing public safety in their community.

Borough Pensions
The universe of pensions in boroughs across Pennsylvania is diverse. Just as the demographic, geographic and economic landscape is diverse for each of our commonwealth's boroughs it must be stressed that their public workforce shares similar attributes. This dynamic is extremely beneficial to our communities and it fosters an environment where responsible fiscal creativity thrives. For instance, collectively, boroughs currently administer 1,087 plans. This includes a variety of 467 police, 21 fire, and 599 nonuniformed plans[1]. This diversity is the result of the variety of local services delivered by the borough and executed by its public workforce. Consequently, approximately 500 boroughs currently administer multiple pension plans.
Under the latest Act 44 distress scoring system (Chapter 5 of Act 205 of 1984), borough pension plans are funded at an average rate of 93 percent. That's actually four percentage points higher than in 2015. A further examination of this data reveals that 68% of boroughs with pension plans are funded at 90 percent or more. Unfortunately, not all borough employee pension benefits are the same. Therefore, when you survey the 482 police pension plans, especially those under Act 600, the unfunded liabilities rise.

I'd also like to point out that currently non-Act 600 borough pension plans are structured in a variety of ways. Some use the more manageable defined contribution or cash balance plan structures. This flexibility is working in many of our communities today.

Municipal Pensions
Municipal pension plans designed, established and managed by local governments are overwhelmingly out-performing their peers. One need only observe the soundness of the consolidated state employee/teacher plans managed by the PSERS and SERS. We often read headlines that highlight a crisis in municipal pensions, but they fail to report the fact that only 13

[1] *Status Report on Local Government Pension Plans in Pennsylvania,* 2015 Actuarial Valuation Reports (2014 data)

municipalities (out of 1,448) were classified by the Auditor General as "severely distressed" (under 50% funded) in 2016.

Bear in mind the largest plans that comprise this group categorized as "severely distressed" are Philadelphia ($5.9 billion), Scranton ($158 million) and Chester ($61 million), which are at dangerously low funding levels. These communities have no share in the attributes of the workforces in our borough communities. Nonetheless, borough pension plans are lumped in with these dozen worst-performing plans when generalizing a municipal pension crisis.

Furthermore, a commonly cited statistic is that Pennsylvania municipal pension plans have an unfunded liability of $8 billion and wrongfully suggest this represents a crisis for all municipalities. In essence, this aggregate dollar liability figure is correct; however, a staggering $7 billion (88%) of this statewide unfunded liability total is attributable to just 10 large cities. Should all 1,453 municipalities be tagged as distressed, even though the numbers prove 81% have their pensions funded at 80% or greater?

While the total unfunded municipal pension liability continues to grow, the recent data reveals the rate has slowed. Comparing the 2012, 2014, & 2016 data from the actuarial valuation reports, we can conclude the number of severely distressed (funded below 50%) municipalities fell from 26 in 2012 to 23 in 2014 and down to 13 in 2016; moderately distressed (funded from 50% - 69%) municipalities fell from 125 in 2012 to 117 in 2014 down to 80 in 2016; minimally distressed (funded 70%-89%) municipalities fell from 497 in 2012 to 411 in 2016; and the number of no distress (funded 90% or greater) municipalities actually increased from 801 in 2012 to 944 in 2016. Obviously, the trend is more municipalities leaving the distressed status, and we strongly believe that the next actuarial valuation reports in 2018 will show even more improvement.

Municipal Pension Reform Legislation

Even with promising trends, municipalities are still faced with ever increasing pension costs. The number one driver of these costs are the public safety pensions which provide a defined benefit pension in a short timeframe. Before the joint committee today is a draft proposal for a new benefit structure for public safety municipal pensions. PSAB would like to share with the joint committee our perspectives on this draft proposal.

We appreciate the sponsor's desire to move from the current structure of public safety pensions to a more manageable instrument. However, PSAB believes the proposed instrument falls short of achieving the benefits of the more manageable defined contribution plan.

We oppose the inclusion of full-time borough firefighters in this legislation. While police pensions and firefighters in cities are currently regulated by statute, firefighter plans in boroughs are governed at the local level. PSAB supports keeping these pension decisions at the borough level instead of mandated from Harrisburg.

Under Chapter 3, the legislation establishes a new benefit tier for new employees for pension plans under 80 percent funded. Mandating a reduced benefit for some communities and allowing the current benefits in other communities will establish a natural Balkanization of the labor market. If this two-tier system is implemented many candidates for public safety jobs will naturally gravitate to the municipalities with the current, more generous pension benefits.

PSAB supports many of the positive aspects of the draft legislation including, tiering within the existing pension plans which will be less costly than setting up new plans, limiting overtime to 10 percent of base salary with a 60 months averaging period to prevent spiking, eliminating Deferred Retirement Option Plans (DROP) participation especially for Pre-Act 44 costly DROPS, eliminating pension benefits from being subject to collective bargaining, and reasonable restrictions of benefit enhancements for new and existing employees. All of these reforms will help those municipalities underwater with their pension obligations.

Many aspects of the draft legislation are problematic and will have unintended consequences. In Section 503(c), it mandates portability of benefits for an employee in a standard pension plan. Tracking the portability aspect will be extremely difficult to administer from an actuarial standpoint. Costs are substantially different in various regions of the state, so providing statewide portability will add significant costs as employees change employers from lower costs areas to higher cost areas in their later years of employment. We suggest the portability section be clarified to apply only to standard pension plans established under this new legislation.

Disability insurance is regulated under the draft legislation. This mandated insurance is very expensive to purchase. When you shift the responsibility of disability for public safety employees with less than 10 years of service from the pension plan to the individual/insurance carriers you will likely not save on costs and will most likely be costlier. These type of policies are problematic on meeting the criteria to be considered "disabled" and qualify to receive any benefit payments.

PSAB opposes the mandate for **all** municipal pension plans to adjust their actuarial rate of return to the Pennsylvania Municipal Retirement System (PMRS) rate plus 1 percent in Section 901. We believe that dictating significant interest rate of return reductions is akin to taking indirect control over a municipality's minimum municipal obligation (MMO) and municipal budgets. Mandating an actuarial rate of return of no more than 1% established by the PMRS board is going to be extremely costly to individual pension plans. Decisions such as these need to be retained at the local level with the fiduciary officers of the municipality.

In addition to these concerns, we believe this interest rate limitation in Section 901 violates the non-delegation doctrine most recently expressed in *Protz v. Workers' Compensation Appeal Board*. You are essentially delegated the setting of the maximum legal actuarial rate of return to a non-elected board. PMRS operates under their own separate law which governs their board's decisions. The PMRS board is making decisions based on their members' pension plans. If the General Assembly adopts the provisions of Section 901, the very mission of the board will change. Instead of setting the rate for only their system, they will be impacting their non-member's actuarial rate of return and MMOs.

There is also an "Adjustment" in Section 901(b) that seems to mandate immediately utilizing PMRS current assumed actuarial rate of return (5.5%) to calculate all future mandatory minimum obligations. To implement this very low rate would have an extremely high cost for all existing pension plans without any justification. PMRS guarantees prior year rates of return and needs to set an excessively low actuarial rate. Again, why should non-PMRS members be constrained by the board's decisions with these limitations?

Section 903 contains provisions regulating the payment of the MMO. If a municipality does not make their MMO and submit proof to the Auditor General, they will not receive their portion of

state aid. Withholding state aid until delinquent MMOs are paid with an additional 20% amount is punitive and only further creates an undue hardship on distressed municipalities. In addition, if you implement the municipal pension bond under Chapter 13, there will be no state aid payment to some municipalities for 30 years.

We view the municipal pension bond under Chapter 13 as a risky scheme that would not be voluntary. If a municipality has less than 80% funding ratio, they must participate in the statewide municipal pension bond and lose 30 years of state aid payments. Unfortunately, this could have the effect of shifting unfunded liabilities to other municipalities that had nothing to do with the underlying underfunded pension plans.

Conclusion

In closing, we urge this joint committee to recognize that the vast majority of local government pensions are adequately funded while also offering a lifeline to communities that are truly struggling. Our members value keeping municipal pension decisions at the local level and oppose any attempt to consolidate well-funded plans with poorly funded distressed plans. We also oppose administrative mandates that would hamper the administration of well-run municipal pensions.

We wish to thank Chairman Wagner, Chairman Blake, Chair Harper, Chairman Freeman, and the members of the House & Senate Local Government Committees for offering PSAB the opportunity to share our perspectives on this important subject. Please feel free to contact me at (717) 236-9526 extension 1044 or rgrutza@boroughs.org if you have any questions on this testimony.