



PENNSYLVANIA STATE ASSOCIATION OF BOROUGH

House Local Government Committee &

House Urban Affairs Committee

Public Hearing

on

Municipal Pensions

October 1, 2015

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Municipal Pension Reform

Chairman Harper, Chairman Freeman, Chairman Petri, and Chairman Caltagirone, thank you for the opportunity to offer testimony on the subject of municipal pensions, specifically **House Bill 32** and **House Bill 974**. I regret I could not participate in person, however, I wish to provide our membership's perspectives on the issues surrounding municipal pensions. Please accept the following information as you consider municipal pension reform legislation.

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.

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 1,080 plans. This includes a variety of 482 police, 21 fire, and 577 non-uniformed plans. 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 plans.

These 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 Commonwealth. Recently published media reports of a crisis in municipal pensions when in fact only 23 municipalities (out of 1,453) were classified by the Public Employee Retirement Commission (PERC) as "severely distressed" in 2014.

Bear in mind the largest plans that comprise this group categorized as "severely distressed" are Philadelphia (\$5.3 billion), Scranton (\$150 million) and Johnstown (\$47 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 underfunded liability of \$7.6 billion and erroneously suggest this represents a crisis for all municipalities. In essence, this aggregate dollar liability figure is correct; however a staggering \$6.6 billion (86%) of this statewide unfunded liability total is attributable to just 14 large cities. Should all 1,453 municipalities be tagged as distressed, even though the numbers prove 75% of them have pensions funded at 80% or greater?

While the total unfunded municipal pension liability continues to grow, the PERC data from 2012 and 2013 show an interesting trend in the right direction. Comparing the 2012 data with the 2013 data we can conclude severely distressed (funded below 50%) municipalities fell from 24 to 22; moderately distressed (funded from 50% - 69%) municipalities fell from 109 to 103; minimally distressed (funded 70%-89%) municipalities fell from 441 to 439; and no distress (funded 90% or greater) municipalities actually increased from 646 to 661. Obviously, the trend is moving to more municipalities leaving the distressed status.

Even with promising trends in the PERC Actuarial Valuation Reports, 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. If any municipal pension reform is considered, the members of PSAB suggest the following remedies be enacted to truly help manage these costs.

- **Eliminate “spiking” of final average salary.** A major inequity of the current system, spiking refers to a police or firefighter who accumulates a high percentage of overtime in the last year of employment. Spiking significantly increases the total final average salary for purposes of determining the final pension benefit. This practice should be eliminated.
- **Pension benefits should not be a subject of collective bargaining.** Nothing can increase pension liabilities more than an Act 111 arbitration award of an increase in pension benefits. PSAB believes pension benefits should not be allowed under collective bargaining and interest arbitration.
- **Reform the Police & Firefighter Collective Bargaining Law (Act 111 of 1968).** Many provisions in Act 111 are weighted significantly at taxpayer expense and in favor of organized labor. In addition, the arbitrators’ findings are not based on the community’s financial capacity to pay for a particular benefit, which is helping to compound the adverse financial conditions encountered by numerous municipalities. Municipalities simply cannot continue to endure out of control arbitration awards without limiting them to the ability of a municipality to pay. Senator John Eichelberger has

introduced **Senate Bill 211**, which PSAB supports, to help control public safety labor costs across Pennsylvania.

- **Allow flexibility in pension plan design.** Defined benefit plans in some municipalities are unsustainable. Municipalities should possess the statutory authority to utilize defined contribution and hybrid pension plans for all newly hired police and fire employees to help manage open-ended liabilities and long-term commitments. Allowing new police and fire employees to be covered under a “cash balance” pension plan or a defined contribution plan will allow municipalities the ability to control costs and plan effectively for legacy expenses. Representative Keith Greiner has introduced **House Bill 316 (PN 1022)**, which PSAB supports, to require Act 600 municipalities use a “cash balance” pension for new police and fire employees instead of the current defined benefit. PSAB also supports Senator John Eichelberger’s **Senate Bill 755 (PN1017)** to establish defined contribution plans for new police and fire employees.
- **Freeze benefit enhancements in severely distressed plans.** Pension plans already underfunded below 50% should be prohibited from allowing any pension benefit enhancements, whether by collective bargaining or arbitration award.

In addition to these remedies, PSAB opposes the following policy considerations.

- **No further expansion of benefits.** Expanding benefits for police & fire employees or non-uniformed employees is not a sustainable option for municipalities. Our members have incurred numerous mandated pension benefit increases in the past, such as ad hoc cost-of-living increases, deferred retirement option plans (DROPs), and killed in service. We fundamentally oppose the further liberalization of mandated employee pension benefits without regard for their fiscal impact upon local governments.
- **No lowering of superannuation age and years of service.** Act 600 mandates normal retirement of police and firefighters at 25 years of service and age 50 – 55. If these parameters would be decreased, the fiscal impact would skyrocket unfunded pension liabilities in townships and boroughs.
- **No diversion of state aid pension funds.** PSAB members oppose any diversion of Act 205 state aid pension funds, any revision to the current distribution formula, and any limitation of state aid allowable use of funds (e.g., administrative expenses). We strongly believe the

current system is working to help municipalities meet their minimum municipal obligation (MMO).

- **No mandated statewide pension system.** PSAB opposes a mandated statewide pension system as this would adversely undermine local fiduciary oversight responsibilities over these assets. It would also create a system by which healthier benefit plans may bail-out poorly performing public plans. A common example would be an elevated amount of disability claims for one municipality that are beyond the control of other local governments and each municipal participant must therefore share in this aggregated financial cost. Any cost savings would be minuscule compared to the total unfunded liability of \$7.6 billion.

Let me now address specifically the legislation before both committees. **House Bill 32**, sponsored by former Representative Glen Grell, would create a statewide municipal police pension system. In addition, the legislation embodies many of the warnings I raised in the prior bullet points, such as a loss of local autonomy, expansion of benefits, and decrease in superannuation age. Accordingly, **PSAB opposes House Bill 32** and strongly urges the House Local Government Committee to reject the bill.

We believe many of the same problems our cities are now experiencing will spread to townships and boroughs with the enactment of House Bill 32. Mandating retirement at twenty years of service at age 50 is the same provision in the Third Class City Code. Currently under Act 600, boroughs and townships police retirement is at twenty-five years and between 50 to 55 years old. This change may seem small, but in actuarial terms would require more revenues to invest due to the shorter timeframe. Municipal budgets are already stretched with public safety accounting for a large percentage. With more and more municipalities disbanding their police forces and electing coverage by the State Police, why would we want to make it more difficult for municipalities to afford their own police departments?

The impact on non-Act 600 pension plans would be devastating. If a borough has less than three full-time officers, the borough may provide a pension plan to their officers. A borough currently has flexibility in terms of the type of plan and benefits it provides for the officers. Non-Act 600 plans can include defined contribution or cash balance plans. Under House Bill 32, these flexible and cost effective options for smaller departments are eliminated when a non-Act 600 borough hires an officer at 35 hours per week or when current full-time officer choose to move to the statewide system. Immediately, the small borough must meet the increased obligations of providing a defined benefit to the officer with a twenty-and-out provision at age 50. Keep in mind all of the

other costly requirements under the bill that currently non-Act 600 plans are not mandated to provide. We believe this increased mandate will drive smaller municipalities to elect State Police coverage.

House Bill 32 creates a two-tiered system of local police pensions in Pennsylvania. New hires will be forced into the statewide plan under PMRS. Current officers can keep their pension plan under statutory provisions such as Act 600 or the Borough Code. However, House Bill 32 provides an option to allow current plans, including small non-Act 600 plans, to be transferred into the new system if certain conditions are met. First, 100% of the eligible officer(s) (this could be one officer) must approve of the move to the new statewide plan. Second, if the eligible officer(s) decide unanimously, the governing body **has no choice but to approve a resolution or ordinance enrolling the current eligible officer(s) in the new statewide plan.** On page 10, line 14 of the bill, it clearly requires that once the eligible members unanimously vote to move the pension plan the governing body shall pass an ordinance or resolution. It's crystal clear that this provision is only optional for the police officers and not the locally elected officials who are the stewards of the public's money.

Prohibiting locally elected governing bodies any option on current plans is fiscally irresponsible. Further, by a single vote of all eligible officers drastic changes will occur to the actuarial liability of their pension plan. Even more devastating will be the effects of this provision in non-Act 600 plans, some of which will be forced from defined contribution plans into a defined benefit plan. *Will a plan that is currently 100% funded using the current laws be rendered underfunded with House Bill 32?*

If, for reasons of underfunding, the municipality cannot move its current pension plan into the statewide plan, a mass exodus of current officers to new employment in other municipalities would occur. Even if the officer goes to another municipality that has underfunded pensions, since the officer is now a "new hire" under the bill their pension would be under the more generous statewide plan. Boroughs cannot afford to lose highly trained and valued employees due to this loophole.

House Bill 32 will not solve any problems currently facing many municipal pension plans. In fact, to the contrary, we believe the bill creates more problems and more unfunded liabilities to existing police pension plans. **Therefore, PSAB opposes House Bill 32, PN 1205.** We urge the members of the House Local Government Committee to consider our concerns and the value of keeping municipal pension decisions at the local level.

While House Bill 32 would exacerbate the current problems with municipal pensions, Chairman Petri's **House Bill 974** moves towards solving the problems in severely underfunded plans. By focusing on these handful of troubled plans, the bill acts as a type of Act 47 for distressed municipal pension plans. We would, however,

strongly encourage the committee to consider providing stronger remedies than currently in the bill to help get out of distressed status. Otherwise, the recovery plan will be meaningless.

PSAB offers the following perspectives on House Bill 974 PN 1230:

- PERC scores distressed based on the total amount of unfunded liabilities of all the pension plans of a municipality. Parts of the bill refer to a severely distressed pension plan. Yet under Section 502 & 503 of Act 205 the distress scores are for the municipality's total unfunded liability. If the trigger in the bill is the distressed score for all of the pension plans of a municipality, it would potentially bring good plans into receivership. Theoretically, you could have a severely distressed municipality that has moderately funded non-uniformed pension plans & severely underfunded uniformed plans. We suggest the bill be amended so only the plans under 50% funded be subject to this act instead of the total plans of a distressed municipality.
- PSAB strongly advocates for better remedies to help the severely distressed municipality. Specifically, we suggest adding a lockdown of pension benefit enhancements as a part of a plan under Chapter 12. Without this crucial tool to control costs, unfunded liabilities will continue to mount.
- Page 1, line 22- requires ALL municipalities classified as severely distressed to develop a Chapter 12 recovery plan. Yet under Chapter 12 (Sec. 1203) a municipality must have **two consecutive** severely distressed determinations to be required to develop a recovery plan.
- Page 4, lines 26-27- Is the 1% minimum required payment of total unfunded liability in addition to the annual MMO?
- Page 6, line 1- We oppose the language "that is acceptable to the commission." Please consider making the PERC suggestions part of a standard, such as the plan does not comply with Section 1203. We would support "and work with the commission to achieve an acceptable plan."
- Page 6, line 30- Only municipalities that are under Chapter 12 will be complying with Section 1203. Therefore, we suggest changing "act" to "chapter" in line 30.
- Page 7, lines 8-10- Why would the commission hear appeals? We suggest using the Commonwealth Court. We suggest "A municipality that has been found to be not in compliance may appeal the issue of noncompliance to the Commonwealth Court."
- Page 7, line 19- We suggest adding after "the commission may direct the Auditor General to file a petition," that the Auditor General shall file the petition.
- Page 7, line 19- As stated previously, "severely distressed pension plan" should be changed to "the severely distressed municipality's pension plans".
- Page 7, line 23- it seems the section referenced doesn't make sense, "Section 1204." This should read Section 1205.
- Page 7, line 26- consider adding before the petition "notice of" and after the petition "within 15 days of filing".
- Page 7, line 28- As stated above, "severely distressed pension" should be changed to "the severely distressed pension plans".

- Page 7, line 29- does the “administrator” refer to the Act 205 administrator (most likely a manager or secretary)? I would think notifying the municipality in 4(i) should be the pension management entity.
- Page 8, line 3- add after circulation “within 15 days of the filing.”
- Page 8, lines 5-7- is it necessary to reiterate “Upon notification by the commission and the auditor general of the failure of the municipality to comply with any of the provisions found in sections 1203, 1204 and 1205”? In fact, you don’t need to reference this again because only the auditor general notifies the municipality of the petition. Consider striking this whole clause and just use, “the Commonwealth Court shall conduct a hearing within 15 days of notification of the petition”.
- Page 8, line 9- consider adding after petition “under subsection (a)(4).”
- Page 8, line 28- again, we have the problem of using the term “severely distressed pension plan” and it going into receivership. According to PERC they only score the municipality’s total pension plans as severely distressed, etc. Does the legislation put all of the municipality’s pension plans into receivership or just the ones below 50%?
- Page 9, line 2- change “trustee” to “receiver”
- Page 9, lines 3-4- change full name of PERC to “commission” for consistency.
- Page 9, line 5- again, consider changing “administrator” of the pension plan to “pension management entity.”
- Page 9, line 7- change “trustee” to “receiver”.
- Page 9, lines 13 et seq. For some reason now the term “authority” is used in addition to municipalities. Is there any reason why the term is not used in the formulation of a plan under 1203 or the filing of receivership?
- Page 10, line 1- change “trustee” to “receiver”.
- Page 11, line 29- change subsection (a) to subsection (d).
- Page 12, line 14- change receivership to “Trusteeship”.
- Page 12, line 16- again, pension plans are not classified by PERC as distressed but the municipality’s pension plans as a whole.
- Page 13, line 30- strike “PERC” and insert “commission”.
- Page 13, line 3- strike “with a severely distressed pension” and insert “subject to this chapter”.
- Page 13, line 8 - change “trustee” to “receiver”.

In closing, we urge the joint committees to recognize that the vast majority of local government pensions are adequately funded while also offering a lifeline to communities that are 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 caution not to develop solutions to solve pension problems in municipalities with a cookie cutter approach. Penalizing municipalities with solutions to a problem that does not exist in their communities, and will only yield minimal results statewide, is not the type of municipal pension reform our members support. Instead, we urge you to consider adopting our suggestions.

We wish to thank the committee members for offering PSAB the opportunity to share our perspectives on these two bills. If any member has questions on my testimony, please contact me at the contact information on the cover page.