Pension Reform: Effective Strategies for Reducing City Pension Costs

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James W. Linn

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They don't call it the third rail for nothing

Big Picture

- Florida cities are facing extreme challenges of :
  - declining revenues and
  - increasing costs
- One of the largest and fastest growing costs facing many cities is the cost of employee pension plans.
- FY 2010-11 pension contributions in many cities will be 30%, 40% even 50% of payroll (or more)

Impact of the "Economic Tsunami"

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- Most public pension plans had investment losses of between -10% and -15% for the year ending 9/30/08.
- Most public pension plans had modest gains (1% to 5%) for the year ending 9/30/09.
- Most public pension plans have an investment earnings assumption of between 7.5% and 8.0%.
- What does this mean for Florida cities?

Impact of the "Economic Tsunami"

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- City pension contributions are expected to increase each year for the next 4-5 years – unless investment return is significantly greater than 8% for several years.
- Why? Most public pension plans have a 4 or 5 year "smoothing period" for recognition of losses.
- Most plans have substantial unrecognized losses that will be accounted for in the next few years.

5 Year Smoothing - Example

- Assumed rate of return = 7.5%
- Actual return = minus 12.47%
- Actuarial loss = minus 19.97%

  [(minus 7.5%) + (minus 12.47%)] = minus 19.97%
- 19.97/5 = 3.99
- Minus 3.99% will be recognized each year for the next 5 years
- Result: City contributions will likely increase

  unless actual return exceeds 11.49% (7.5% + 3.99%)

Pension Cost Components

1. Normal Cost – ongoing cost of benefit, with no UAAL (unfunded actuarial accrued liability)

2. UAAL Amortization Payment
   - Actuarial losses
   - Plan improvements

Pension Cost Components

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- In many cities the UAAL amortization payment exceeds the normal cost of the plan:

Normal Cost	UAAL Amort.	Total Cost
18%	25%	43%

Pension Legacy Cost - The UAAL Issue

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- UAAL = Pension Debt

[like a variable home mortgage; but payments <u>and</u> principle can increase]

- UAAL has grown significantly in recent years, and is expected to continue to grow in the future
- By law the city is responsible for funding the UAAL
  - even if employees are laid off or transferred to other employers
  - even if the current pension plan is closed, frozen or terminated

Pension Legacy Cost - The UAAL Issue

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Why have unfunded liabilities grown even in years of good investment performance?

- Because actuarial losses have exceeded investment gains.
- Actuarial losses occur when actual experience does not meet assumptions:
  - salary increases / payroll growth
  - mortality
  - turnover
  - retirement rates

Ch. 175/185 Premium Taxes: "Golden Handcuffs"

- Chapters 175 & 185, F.S. provide for a rebate of the state excise tax on property and casualty insurance premiums to cities that have firefighter and police pension plans.
- The premium tax monies must be used exclusively for fire and police pensions, and the local pension plan must comply with the requirements of Chapter 185.

Ch. 175/185 Premium Taxes: "Golden Handcuffs"

- Ch. 175/185 premium taxes in excess of the 1998 amount must be used for "extra benefits"
- If extra benefits are part of pension formula, cost shifts to city over time
- "This benefit won't cost city anything"

  really means:

"this benefit won't cost city anything <u>in the first year</u>"

Ch. 175/185 Premium Taxes: Possible Options

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- Implement **“Share Plan”** with excess premium tax revenues instead of formula benefit (share plan = defined contribution account on top of pension)
- **“Stop/Restart”** – reduce benefits to Ch. 175/185 minimums, then immediately restore to prior level; “old” benefits above the minimums become “extra benefits;” now excess premium tax revenue can be used to help pay for “old” benefits.

What Are the Options to Reduce City Pension Costs?

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- No "silver bullet"
- Keep current City pension plan, but:
  - Reduce benefits, and/or
  - Increase employee contributions
- Terminate, freeze or close current pension plan, and set up a lower cost plan
- Changing actuarial assumptions & methods is <u>not reform</u> – merely trades short-term reductions for additional long-term cost

Key Concepts

- **"Close"** – existing plan closed to new members; current members stay in existing plan until they retire or leave the city; future employees join new plan.
- **"Freeze"** - accrued benefits of current employees in existing plan "frozen" and paid out at retirement; all current and future employees join new plan.
- **"Terminate"** – existing plan liquidated; accrued benefits paid out to plan members; City responsible for any deficit; all current and future employees join new plan.

Legal Guidelines

- Changes in retirement benefits and employee contributions are mandatory subjects of collective bargaining.
- Accrued pension benefits (benefits earned in the past) <u>cannot</u> be reduced or taken away.
- Future benefits <u>can</u> be reduced for current employees.
- City is ultimately responsible for unfunded pension liabilities.

Short and Long-term Savings

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- Significant short-term savings require reduction in unfunded liabilities.
- Only way to reduce unfunded liabilities is through plan freeze or termination.
- Long-term savings require a reduction in benefits and/or structural change (i.e., new plan).
- It is possible to achieve both short and long-term savings by combining plan freeze/termination with benefit reductions or new plan.

Pension Reform Options

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- Join FRS
- Set up Defined Contribution (DC) plan
- Reduce Benefits for New Hires (2-Tier)
- Reduce Benefits for All Employees
- Increase Employee Contributions

Join FRS

Advantages

- Standardized benefits
- No employee contributions (currently)
- Portability – easier for City to attract employees from other FRS agencies
- Gets City out of pension business (eventually)

Disadvantages

- FRS may cost more in short term
- City still must pay off current plan liabilities
- Loss of premium tax revenues
- Portability – employees can move to another FRS employer and take their pension with them
- State legislature sets benefits and contributions

Join FRS

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2 problems for Police & Fire:

- Loss of premium tax revenues
- Past service rate = 2%

DC Plan

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Advantages

- Predictable employer costs
- City does not bear investment risk
- Appeals to younger, mobile employees
- Portability – DC account balance may be "rolled over" to an IRA or other retirement plan
- Lower admin. Costs
- No actuarial liabilities

Disadvantages

- Employees bear investment risk
- Possible that DC benefits will run out while employee is still alive
- No inflation protection (COLA)
- Loss of premium tax revenues
- Portability – employees can easily move to another employer and take their DC balance with them

Reduce Benefits for New Hires (2 Tier Plan)

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Advantages

- Reduced cost over time
- Current employees keep current benefits

Disadvantages

- No immediate savings -- may take many years to achieve significant savings
- Creates lower level of benefits for new hires
- Ch. 175 & 185 legal issue
- City stays in pension business

Reduce Benefits for All Employees

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Advantages

- Immediate cost savings
- Same benefits for all employees going forward
- Fewer legal issues -- can be imposed through collective bargaining

Disadvantages

- Reduces future benefits for current employees (employees keep what they have already earned)
- City stays in pension business

Increase Employee Contributions

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- Each one percent increase in employee contribution = one percent reduction in City contribution
- Legal issue: Ch. 175/185 says employee contribution can be increased only if members agree and for benefit increase (but minimal increase possible)

Pension Reform: 2009 Legislation

Florida Retirement System

- Eliminate health subsidy – passed House only
- .25% employee contribution – passed Senate only
- Reduce DROP interest – passed but vetoed
- Increase employer contribution rates to address unfunded liabilities – passed but vetoed
- Close DB plan – discussed but no action

Pension Reform: 2009 Legislation

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Local Government Retirement Plans –

bills filed but did not pass:

- Reduce maximum benefit from 100% to 70%, 80% or 90% of avg. final comp.
- Redefine avg. final comp. (base pay; exclude OT)
- Require 5 year cost projections
- Require experience studies to review accuracy of assumptions
- City oversight of pension board expenses

Pension Reform:
2009 Legislation

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Ch. 175 & 185 Firefighter and Police Plans –

bills filed but did not pass:

- Require that majority of pension board not be plan members
- Allow negotiation of increased employee contributions without increased benefits
- Redefine "extra benefits"
- Allow cities to meet minimum benefit requirements in the aggregate
- Allow cities to join FRS or establish multiple, 2 tier or DC plan without loss of premium taxes

Stuart (2007)- All Employees

- terminated all City pension plans
- joined FRS for all employees
- purchased past service credit under FRS for all employees

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Ft. Lauderdale (2007) - General

- Closed general employee pension plan
- Set up defined contribution plan for new hires

Florida Cities with DC Plans For General Employees

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City	Employer Contribution	Employee Contribution
Belleview	7.5% + up to 2.5% match	Voluntary up to 2.5%
Cape Coral	12%	8%
Cinco Bayou	4%	4%
Milton	7%	10%
Deland	7.5%	5%
Ft. Lauderdale	9.0%	0
Ft. Walton Beach	5% + up to 2.5% match	5% + up to 2.5%
Gulfport	12%	0
Key Biscayne	12%	6%

Florida Cities with DC Plans For General Employees

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City	Employer Contribution	Employee Contribution
Lake Alfred	14.3%	5%
Mount Dora*	6% + up to 4% match	Up to 4% voluntary
North Lauderdale	13%	5%
Palmetto	15%	5%
Pinecrest	13%	7%
Port St. Lucie	10.5%	0
West Palm Beach	7.5% / 9.5%	7.5%

*Effective 10/1/10

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Coral Gables (2009) - Police

- Increased employee contributions by police officers by 5%
- Reduced pensionable earnings (exclude OT in excess of 300 hrs. and lump sum payments for comp. time)

Naples (2009) - Fire

- "Stop & Restart" implemented; premium taxes City can use to offset City pension contributions increased from $776K to 1. 67 million per year
- "Share Plan" set up with excess premium tax revenues

Pension Reform: What Florida Cities Are Doing

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Hollywood (2009) - Fire

- Reduced 13th check benefit for current employees
- Reduced pensionable earnings for current employees (exclude comp. time and blood time payouts; 70% cap on vacation leave payouts; no OT in excess of 300 hrs. over 3 year average)
- Reduced benefits and employee contributions for new hires (2 tier plan)
- "Share Plan" for all employees funded with increases in premium tax revenues

Pension Reform:
What Florida Cities Are Doing

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Port Orange (2010) – Fire [Not Yet Implemented]

- Reduced wages by 6% (imposed in lieu of increase in employee pension contribution)
- Reduced pension benefits for current and future employees
  - Push back normal retirement date
  - Reduce pensionable earnings (exclude OT)
  - Extend final averaging period from 3 to 5 years
  - Reduce maximum benefit from 90% to 80%
  - Reduce COLA
  - Reduce DROP earnings

Pension Reform:
What Florida Cities Are Doing

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Palm Bay (2010) – Fire [At Impasse - Not Yet Implemented]

- Wage freeze
- Reduce future pension benefits to Ch. 175 minimums
  - 2% benefit multiplier
  - Normal retirement – age 55 w/10 yrs service or age 52 w/25 yrs. service
  - Pensionable earnings = fixed monthly comp (excluding OT)
  - 5 year final averaging period
  - No COLA / no supplement
- All future premium tax revenue goes to share plan

Pension Reform:
What Florida Cities Are Doing

<u>**Miami Beach (2010) – General**</u> [Tentative Agreement - Not Yet Implemented]

- Wage freeze
- Pension changes for current employees:
  - Increase employee pension contribution by 2%
  - 5 year final averaging period (phased in)
- Reduced pension benefits for new hires (2 Tier)

Pension Reform: What Florida Cities Are Doing

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Miami (2010) – All Employees [Financial urgency declared – changes not yet implemented]

- Wage freeze
- Freeze current pension plans; accrued benefits of current employees frozen
- All current and future employees go to defined contribution (DC) plan

Key Questions for Cities

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- What are the city's projected pension contributions each year for the next 5 years if no changes are made and all assumptions are met?
- What are the city's projected pension contributions for the next 20 years if no changes are made and all assumptions are met?
- Can the city afford the projected contributions?
- If not, what level of pension contributions can the city afford?

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Questions?