



The Pennsylvania League of Cities and Municipalities



A Century of Commitment

Pennsylvania League of Cities and Municipalities

Testimony before the Senate Finance Committee

August 12, 2009

Municipal Pensions

Presented by:

Amy Sturges, Director of Governmental Affairs, PLCM

And

Richard Schuettler, Deputy Director, PLCM

Good afternoon Chairman Browne and members of the Senate Finance Committee. I am Amy Sturges, Director of Governmental Affairs, for the Pennsylvania League of Cities and Municipalities. With me is Rick Schuettler our Deputy Director. Thank you for the opportunity to testify as part of this panel today.

Ironically, PLCM testified about one year ago before the Senate Urban Affairs and Senate Finance Committees on this very issue. Today, we will approach our testimony from the perspective of short term and long term actions that the Pennsylvania Legislature should be taking to address the very significant issue of municipal pension costs.

Municipal Pensions Generally

There are over 3,000 local government pension plans in the Commonwealth. Over 1,000 of these plans are for police and fire personnel. Under the Third Class City Code, third class cities must provide a defined benefit pension plan for their police and paid firefighters. The Code also sets out mandatory pension benefits, such as retirement age and vesting requirements. Act 600 of 1956 requires boroughs, towns and townships with three or more full-time police officers to provide a defined benefit pension plan and also provides for mandatory benefits. Boroughs, towns and townships with fewer than three full-time officers have the option of providing a pension plan, as well as the option of falling under Act 600 or implementing another benefit structure that complies with the Borough, Town or Township Codes. Furthermore, boroughs and townships have the choice of whether to provide a pension plan to paid firefighters.

Cities, boroughs and townships also have the option of participating in the Pennsylvania Municipal Retirement System (PMRS). PMRS is a separate pension system established by state law. It provides municipalities with a choice of benefit levels and plan administration. Pension benefits of a PMRS plan do not need to comply with Act 600 or the Third Class City Code.

All municipal plans fall under the provisions of Act 205 of 1984 – The Municipal Pension Plan Funding Standard and Recovery Act. This law sets forth funding and reporting requirements for all local government pension plans and is intended to ensure that local governments can pay their

future pension obligations. The provisions of this law are administered by the Public Employee Retirement Commission (PERC). In 1985, all unfunded pension liability for each municipality was recalculated and amortized over a 30 year period. Annually, the municipal obligation to keep the plans solvent is calculated based on actuarial reports required by PERC.

Short Term Actions

In the short term, the biggest concern to local municipal officials is how they will pay for the future pension obligations of their pension plans. Most immediately, local officials are beginning to budget for 2010 and face exorbitant increases in their minimum municipal obligations (MMO payments) to their pension plans. These increases range from the hundreds of thousands of dollars to millions in our larger cities. These increases are the result of pension investment losses in 2008. These payments, if not addressed *immediately* by the General Assembly, will cause property tax increases, lay-offs, and in some cases will bankrupt communities.

PLCM views PERC's Act 205 Recovery Plan housed in House Bills 1874 and 1884, as our best possible solution to the looming 2010 MMO payments. House Bill 1874 provides an option to all municipalities for a new amortization schedule and a smoothing technique that will provide the necessary tools to reduce the 2010 obligation and spread it out over a number of years. The bill also provides options to municipalities depending on the level of unfunded liability they have in their aggregated pension plans. These options offer another series of tools to assist municipalities in meeting their obligations without going further into unfunded status. Only the most under-funded plans lose the ability to make choices under this proposal and become part of a state administered plan through PMRS. House Bill 1884 provides the necessary legislation to effectuate the PMRS part of the proposal. In PLCM's estimation, enactment of House Bills 1874 (PN 2522) and 1884 (PN 2523) as soon as possible is critical to the fiscal health of communities. Municipalities must know if the tools afforded in these bills are available and budget for 2010 accordingly. Please see the attached letter PLCM sent to the House last week urging passage.

Long Term Actions

Aside from passage of PERC's Act 205 Recovery Plan, there are several long term actions that the Legislature should be addressing that have a direct impact of the cost of pension obligations. Act 111 and legislation liberalizing pension benefits are two areas that need to be considered long term goals for pension reform by the Legislature.

Act 111

One cannot begin to fix municipal pensions in Pennsylvania, without understanding the overriding impact of Act 111 on pension benefits and resulting costs. Act 111 of 1968 is the law that governs collective bargaining for the terms and conditions of employment for police and fire personnel, including pension benefits. In Pennsylvania, police and fire personnel are prohibited from striking. In return they are given the opportunity to collectively bargain for benefits and if the bargaining process does not result in a contract, both the union and the municipal employer are held to a binding arbitration decision. Unequivocally, Act 111 has a tremendous impact on the pension benefits a police or fire force receives and the cost incurred by municipal employers, and in turn, the taxpayer.

In the year in which a contract is to expire, the collective bargaining process starts six months before the start of the fiscal year. If agreement cannot be reached, one side will request arbitration and a board of three arbitrators will be chosen. Each side picks one individual and the third is agreed to by both sides. The result is a decision by the board that is binding. This decision is essentially a mandate to the municipal employer to provide the terms and conditions decided by the board. Moreover, the arbitration board making the decision is not required to take into account what a municipality can afford in terms of benefits and the future costs of those benefits. The arbitration board can even award items that were not part of the initial negotiation sessions.

When a benefit is awarded in one municipality, it paves the way for that same benefit to be awarded in neighboring communities. A domino effect is the best way to describe how the benefit becomes a standard for pension plans across the state. For example, an arbitration board

gives an award that includes a cost-of-living adjustment for a city's retirees. When the union in the neighboring city is at the bargaining table, that award is used as a basis for what the bargaining police force asks for in its contract and if the process reaches arbitration, the union representative argues for benefits based on recent awards.

Therefore, PLCM would encourage a discussion with all stakeholders on how to level the playing field under Act 111. There needs to be a concerted effort lead by members of the General Assembly to truly reform benefits under Act 111. PLCM does not deny police and fire benefits for the important public safety services that they perform. PLCM does believe that benefits levels should not bankrupt a municipality or create the situation were tax increases are necessary to pay for benefits. Employees in the private sector have had to accept reduced benefit levels, defined contribution plans, employee contributions to healthcare and pension plans. It is time to start making such reforms in the public sector.

Liberalized Benefits or “may” Bills

Today's local government workforce of paid police and fire personnel have tremendous employment benefits compared to the public safety forces of years ago. Job security, excellent pension benefits and post-retirement healthcare benefits are the norm and far exceed private sector benefits. Despite the fact that police and fire personnel are not in need of more benefits, the General Assembly continues to introduce legislation to improve upon these benefits. All of this legislation has the potential, if it becomes law, to have a serious impact on the local government expense of public safety personnel. And, just to be clear, these proposals never provide additional funding to cover the increased employment and pension costs they would generate.

One example of the many pieces of pension legislation characterized as a “may” bill is legislation establishing a deferred retirement option plan (DROP) for police officers who have reached retirement age. The legislation would authorize the use of DROP plans in Pennsylvania. DROP plans allow officers to continue working while their monthly pension benefits are placed in an interest bearing account for a certain number of years, usually five. At the end of the

DROP period, the officer finally retires and collects a lump sum payment of his invested pension payments.

DROP plans were originally designed to be at the option of an employer as a way to keep a valued employee who was about to retire and leave with knowledge and job skills that could not be readily replaced. What would make this legislation so expensive for municipal employers is that the authorized DROP plans would first become a benefit that “may” be awarded in Act 111 arbitration; and second the plan would be available to all retiring officers even if the municipality did not want to retain certain officers beyond retirement.

To summarize, legislation that creates a benefit that “may” be offered to employees is costly to municipalities. Such benefits are then available to be awarded under Act 111 arbitration and municipal employers are forced to provide them. And like a domino effect discussed earlier, the benefit becomes the standard in union contracts across the Commonwealth.

We would be remiss if we did not take a moment to remind the committee members that municipal government pays for public safety personnel employment and pension benefits through tax revenue. The real estate property tax is the main source of revenue. Therefore, when benefits are increased through legislation or the arbitration award, the resident taxpayer foots the bill. This is a very important item to remember because property taxes are stretched to the limit in many communities. Municipalities have a millage rate limit on property taxes that cannot be exceeded without court approval. Furthermore, many elected officials know that they cannot ask their residents to pay more taxes; thereby leaving many communities faced with the unpalatable decision of having to make cuts to vital public safety services.

Consolidation of plans

Over the last several sessions the concept of a statewide police pension plan has been introduced by members of the House and Senate and discussed in public hearings. PLCM has consistently supported the concept because of the potential to address the administrative inefficiencies, lack of portability and decentralized asset management that mark our current system. Although we support a statewide system, PLCM believes the final legislation must be a win for both the

employee and employer. We cannot support a bill that in the end will cost municipal employers more in the name of consolidation.

For background purposes, previous versions of the legislation have amended the State Employees Retirement System to add an additional membership classification for municipal police officers. The legislation has applied to all municipalities and their future full-time officers. It would be mandatory for all new hires to enter the statewide system. Municipalities would have officers in two separate plans and would still administer their current plan until all the officers and their beneficiaries are deceased, while at the same time making contributions to the statewide plan.

We believe one of the most important aspects of reform through a statewide pension plan is that the benefits need to be provided outside the realm of Act 111. We cannot support a pension plan at the state level that still allows benefits to be negotiated locally. If local government cannot get out from under Act 111, a new system for administering local pensions will not reform the system. Therefore, benefits must not be negotiated under a statewide plan, but determined up front.

We believe it is possible to produce a statewide system that contains reforms, but still provides excellent benefits to new police officers and is less expensive for Pennsylvania's taxpayers.

In closing, PLCM *strongly* encourages passage of House Bills 1874 and 1884 in the coming weeks. Long term, we encourage the hard tack of reforming Act 111. We ask that you consider the hidden costs of liberalizing benefits for police and fire personnel with "may" bills. We also ask that any consolidated pension plans, any reforms for that matter, be developed in such a way to truly save taxpayers money. We offer our assistance with all these measures and can provide expert counsel to help guide the shape of reform legislation.

Again, thank you for this opportunity. We are happy to take your questions.



The Pennsylvania League of Cities and Municipalities

August 5, 2009



A Century of Commitment

The Honorable Todd Eachus
Majority Leader
House of Representatives
110 Main Capitol
Harrisburg, PA 17120-2116

The Honorable Samuel H. Smith
Minority Leader
House of Representatives
423 Main Capitol
Harrisburg, PA 17120-2066

Dear Representatives Eachus and Smith:

I write today to express our position on two bills of importance to our membership.

We have worked closely with the Public Employee Retirement Commission to help craft the Act 205 pension relief bill, HB1874. This bill provides among other reforms, an amortization and smoothing schedule which is desperately needed by our cities and municipalities given the economic downturn. The bill also creates categories of distress to help address plans in need of the Commission's intervention and transfer to a new PMRS plan. We strongly support the passage of House Bill 1874.

We are willing to accept HB1884 as is currently written if this would help HB1874 move forward to enactment. We would request, however, the opportunity to work with the Public Employee Retirement Commission and the legislative leadership to revisit HB1884 to further refine benefit levels.

The passage of the legislation crafted by PERC is designed to address the problem of pension debt and assist plans in recovery from the economic downturn. Now is not the time to enhance benefits when municipalities and their pension plans are struggling to stay afloat. Therefore, we oppose amendments to HB1884 which enhance benefit levels.

On behalf of our President, Mayor John Callahan, Bethlehem, our Board of Directors and membership, I thank you for your considerable assistance and support for our local governments across the Commonwealth.

With best regards,

Sincerely,

John A. Garner, Jr.
Executive Director

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