

Testimony on HB1828
Presented by Rob Dubow, Finance Director – City of Philadelphia
Before the Senate Finance Committee
August 19, 2009

Good morning Chairman Browne and members of the Senate Finance Committee. My name is Rob Dubow, and I am the Finance Director for the City of Philadelphia. Thank you for the opportunity to testify today on this very important piece of legislation.

I want to start by stating very clearly for the record what HB1828 is and what it is not. This bill is a vehicle which will assist Philadelphia to weather the terrible financial storm created by the global financial meltdown. It is not a bill that provides any pension reform, even though it is an amendment to Act 205. That does not mean that Philadelphia is not seeking pension reform – we are. We have an extensive reform plan laid out both in our collective bargaining proposals and in pending local legislation that would reduce our pension fund’s long term liabilities which I will discuss in further detail. This bill before you today, however, is about providing fiscal recovery tools to the City. It is also important to stress that this measure has no fiscal impact on the State’s budget, but is critically important to the short and long-term health and vitality of the City of Philadelphia.

HB 1828 has three main components:

1. Changing the amortization period for the City’s unfunded liability from an average of about 20 years to 30 years while ensuring that the annual payments cover the cost of benefits earned, interest on the unfunded liability and payment of principal – which is a concept that is a stronger financial commitment than previously required under Act 205.
2. Deferring a portion of the City’s pension contributions for FY09-10 and FY10-11 to FY12-13 and FY13-14 and repaying those deferred contributions with 8.25% interest.
3. Authorizing an additional one percent local sales tax temporarily for five years that will be dedicated to repaying the City’s partial pension payment deferral and that, when combined with the \$1.7 billion in other budget balancing measures the City has taken since November 2008, will produce sufficient resources to repay the deferral within the context of a balanced budget for each of the next five years.

We are proposing these changes because the global financial economic crisis turned what had been a mounting pension problem into a potential crisis that threatened to so severely damage the City’s budget that we would be forced to make severe cuts to key services.

Even before the economic downturn, the City’s funded ratio was plummeting while its pension costs were skyrocketing because of losses earlier in the decade and changes in things like how long retirees live. Over a nine year period ending in FY08, the funding ratio dropped from 77 percent to 55 percent, while, at the same time, the City’s general fund pension costs jumped from \$225 million to \$431 million (for a \$206 million increase).

To put those numbers in context, the \$206 million increase in pension costs is more than the annual cost of the salaries of all of our firefighters and paramedics. And, the total \$431 million cost is more than the total cost of any of city department excluding the Department of Human Services and the Police Department.

While those costs are daunting, the market crash would make them much worse if the City doesn't take any action. By FY10-11, the City's costs would be another \$130 million higher – \$561 million in total. And those costs would grow each year. They would be squeezing out the other costs in our budget if we did not take any action.

In order to prevent those pension costs from forcing us to make cuts like reducing the size of the police force, laying off firefighters, reducing the frequency of trash collection and shuttering entire departments, we are seeking the authorizations outlined in HB1828. The bill's deferrals – which would total \$150 million in FY09-10 and \$80 million in FY10-11 – and the change in our amortization schedule would substantially reduce our costs. I would like to point out, however, that even with the deferral, if this legislation were enacted, our FY10-FY11 costs would be higher than our costs were in the fiscal year that just ended. So, this bill would allow us to slow the rate of growth in costs, but, even with the change, there would be only one year – the current fiscal year – when our pension costs would not be the highest that they have ever been.

I understand that there are some legitimate questions about our proposal. The first is whether we can afford to make the repayments of our deferrals? The answer to that question is yes, we can. Our Five-Year Plan, which incorporates these changes, was conditionally approved by the state-appointed Pennsylvania Intergovernmental Cooperation Authority subject to approval of this legislation. In the Plan we demonstrated that our budget would be balanced in each year – including the years during which we had to repay our deferral. As I said before, we will be able to repay that deferral and keep our budget balanced because, even excluding the changes in this legislation, we have taken steps to shed \$1.7 billion from our five year plan.

In addition, even with the repayment of the deferral, our pension costs are lower in FY13-14 than they would be without this legislation. So, without this legislation, our costs would be higher in FY13-FY14 and we would not have the roughly \$120 million generated by the additional one percent on the sales tax that would go to repaying our deferral. Clearly, HB 1828 makes it more feasible, not less so, for us to meet our iron-clad commitment to make our pension payment each year.

Another question is whether moving to a 30 year amortization is responsible. To answer that question, I will quote from the analysis of the proposal that our actuary submitted to PERC on our behalf. In that letter, the actuary said “In aggregate, these changes represent an actuarially sound basis for addressing the financial impact of the market decline...” The actuary noted that the proposal to move to a 30-year amortization is not an atypical response to a situation like the one we are facing. He also noted that we include an amortization schedule that begins paying down principal in the very first year, something that was not required under Act 205.

The actuary also noted that we proposed to combine that change in the amortization period with a reduction in our earnings assumption and a change in the smoothing period of gains and losses to moderate the volatility of our funding requirements. He said that the combination of all of those actions is responsible by reducing the future risk of the system and spreading future investment gains over a longer period of time, holding the City to continue to meet its commitment to the proposed schedule even if there is a near term market recovery.

And another question that has been posed is, where is the reform? As I stated at the beginning of my testimony, HB 1828 is not a pension reform bill, but a financial recovery bill. But, the City does need and is pursuing comprehensive pension reform. Mayor Nutter recognizes the need to reform the pension system and under his leadership the City is taking the following steps to reduce its long term liabilities:

- Proposing a new pension plan which combines a defined benefit plan with lower benefits than our current plan and an optional defined contribution plan. The hybrid plan will apply to employees hired on or after July 1, 2009. All other employees have a 90-day period to “opt in” to the plan. This change is included in the City’s collective bargaining proposals and in legislation pending before City Council – Council Bill No. 090522.
- Increasing employee contributions in the current pension plan. This change is included in the City’s collective bargaining proposals and in legislation pending before City Council – Council Bill No. 090522.
- Eliminating the DROP for elected officials. The program, which was intended to encourage long time employees to remain in the workforce, is not typically provided to elected officials in other Pennsylvania jurisdictions. This change is included in legislation pending before City Council – Council Bill No. 090209.
- Modifying the 4.5% guaranteed earnings rate on DROP accounts prospectively. Under this proposal, the interest rate applied to DROP account balances would change from a fixed 4.5% to a rate equal to the earnings rate for the pension fund for the previous year. That interest rate would be capped at half of the pension fund’s assumed earnings rate. This change is included in legislation pending before City Council – Council Bill No. 090188.

Thus, the City has a comprehensive package of proposed reforms that require local action through our collective bargaining process and by enactment of local legislation.

We fully understand that there are many municipalities across the Commonwealth with distressed pension systems. I have been involved in several meetings and conference calls with PERC, PMRS and legislative staff reviewing various statewide proposals. And, in fact, legislation is pending on the House calendar – HB 1874 and HB 1884 that contain PERC’s proposal. Likewise, Mr. Chairman, I am familiar with your measure, SB 566. I look forward to continue to be of assistance in any way as this discussion continues and these measures are analyzed. I would also like to note that Philadelphia is not in the PERC/PMRS proposal because we are seeking our own reforms as I have highlighted, and because PMRS is not confident that it can administer our fund as noted in their recent report which I have included as Attachment K.

As I conclude, I think it is important to stress cities and states have been hit hard by the global economic meltdown. The City of Philadelphia has worked hard to be proactive and fiscally responsible as we manage our way through this crisis. Beginning in the fall of 2008, as we experienced declining tax revenues, dramatic losses on earnings in our pension fund, and soaring interest rates on debt, we took unprecedented actions in the middle of the fiscal year to re-balance our budget and five-year plan. Those mid-year cost containment and revenue enhancement measures totaled \$1 billion over the life of our five-year plan.

Unfortunately, these actions were not sufficient to keep pace with the downward spiral in the national economy. In the spring of this year, we were faced with the daunting task of closing another \$1.4 billion hole in our five-year plan. Thus, the City's current FY10 budget and five-year plan contain more belt-tightening measures, enhanced efficiencies, and additional fees on Philadelphia residents and businesses that closes half or \$700 million of this gap. Thus, on our own, the City has filled \$1.7 billion of a \$2.4 billion hole we faced. HB 1828, if enacted, provides us with essential fiscal tools that help us manage the remaining \$700 million gap.

Yesterday, PICA issued a letter informing us that because the state authorizations we sought were not enacted by August 15th, our plan is not balanced and we need to submit a revised plan indicating how we will balance our budget for the current fiscal year and each of the next four years absent these state fiscal tools. Tomorrow, Mayor Nutter will be instructing the City's department heads to proceed with initiating the lay-off process for nearly 3,000 city employees.

In order to achieve yet another \$700 million in savings on top of the \$1.7 billion we have achieved, we are left with no options but to severely reduce services. This revised plan will require eliminating nearly 1000 police and 200 fire positions, reducing trash collection from weekly to twice a month, and closing entire service departments, including Parks, Recreation, Libraries, Planning and Commerce. And, these cuts are still short of the \$700 million and further painful actions will be needed to get fully balanced in FY09-10. These actions will rip the guts out of our City, cripple the region, and negatively impact the entire Commonwealth.

Mayor Nutter and I have been meeting with you and many members of the House and Senate beginning in late April. It is now mid August and we have no time left on the game clock. Again, HB 1828 is simply authorizing fiscal tools to help the City help itself weather this economic storm and forestall implementation of this untenable plan. We respectfully request swift passage of HB 1828.

I have provided the Committee with a series of attachments that provide more detail on our response to the fiscal crisis and our pension reform proposals along with supporting documentation on all pending local legislation and related materials.

Thank you again for the opportunity to testify today and I would be glad to answer any questions.