Cities Squeezed by Pension and Retiree Health Care Shortfalls

Thirty cities at the center of the nation's most populous metropolitan areas faced more than $192 billion in unpaid commitments for pensions and other retiree benefits, primarily health care, as of fiscal 2009. These cities had a long-term shortfall of $88 billion for pensions and $104 billion for retiree health care and other non-pension benefits.

New York, the nation's largest city, accounted for more than half of the total retirement shortfall. But retirement underfunding looms as a long-term budget stress across a wider array of the cities when looked at on a per-household basis. New York, which is responsible for not just a large number of municipal employees but also multitudes of teachers, had unfunded pension liabilities of $14,302 per household.[1] Pension shortfalls per household were next highest in Philadelphia at $12,170, Portland, OR, at $11,389, and Chicago at $11,110 and pose a significant challenge for policymakers and ultimately taxpayers.

For retiree health care, the most serious underfunding per household was in New York at $22,857, followed by Boston at $18,962, Detroit at $15,682, San Francisco at $13,487, and Baltimore at $10,208.[2]

Overall, the 30 cities, which are the focus of Pew's American cities project, had 74 percent of the money needed to fully fund their pension plans over the long run but only 7.4 percent of what was necessary to cover their retiree health care liabilities as of fiscal 2009, the latest year with data available for all pension plans of all 30 cities. These findings echo an earlier Pew assessment of 61 cities' retirement funding (see *A Widening Gap in Cities: Shortfalls in Funding for Pensions and Retiree Health Care*).

Unfunded pension and retiree health care obligations pose a significant concern for city budgets. Although these unpaid bills are not due immediately, they limit policymakers' ability to invest in other priorities because they place a claim on future revenue. Every dollar that goes to plug a hole in a city's retirement funds is a dollar that cannot be spent on education, public safety, libraries, and other services. The longer unfunded liabilities go unaddressed, the larger the bill facing future city budgets and taxpayers. To shore up retirement funds, local officials may have to cut services, reduce the workforce, or raise taxes. Cities also can pay a price through higher borrowing costs because credit rating agencies incorporate unfunded retirement costs into their analyses.

Localities have employed a variety of strategies to address their growing retirement liabilities, including increasing the retirement age or vesting periods and putting larger amounts of municipal revenue into pension funds. Some cities are pushing to cut cost-of-living increases to retirees or are asking current workers to contribute more money to their own retirement benefits. Most reforms, however, affect only new hires, which does nothing to reduce the sum of unpaid bills.

Pension Investments, Annual Contributions Fall Short

As of 2009, 15 of the 30 cities had pensions funded at less than 80 percent, a level that most experts consider inadequate. Among the 30 cities examined, the five with the lowest ratio of savings to liabilities were Pittsburgh (39 percent); Portland (50 percent); Chicago (52 percent); and Boston and Atlanta (both 60 percent). On the other hand, the District of Columbia had a surplus in its pension system, with enough money to pay for 104 percent of its pension liabilities. All pension systems should strive to be 100 percent funded, and three others were close—San Francisco, Detroit, and Tampa were funded at more than 90 percent.

Although New York had the greatest unfunded pension liability per household, $14,302, its plans were funded at 70 percent, higher than several other cities'. Outside of the District of Columbia, cities with the smallest pension shortfalls per household were Tampa at $989 (90 percent funded) and San Antonio at $1,232 (87 percent funded).

Cities typically count on investment earnings from their pension funds to cover two-thirds of benefits. During the Great Recession, though, returns were lower than expected, and unfunded pension liabilities grew in nearly all of the cities.

Another reason for this growth was that a number of cities failed to make their full annual payments. As local tax revenue plummeted during the recession, even cities with well-funded systems struggled to keep up their yearly contributions.

EXHIBIT 1:
PENSIONS
FISCAL 2009

	Total unfunded liability*	Unfunded liability per household	Funding level
Atlanta, GA	$ 1,275,556	$ 6,164	60%
Baltimore, MD	$ 678,413	$ 2,889	86%
Boston, MA	$ 1,241,665	$ 5,170	60%
Chicago, IL	$11,919,459	$11,110	52%
Cincinnati, OH	$ 971,041	$ 6,993	75%
Cleveland, OH	$ 771,136	$ 4,163	74%
Dallas, TX	$ 923,150	$ 1,910	87%
Denver, CO	$ 502,836	$ 1,999	87%
Detroit, MI	$ 552,755	$ 1,742	93%
Houston, TX	$ 2,252,100	$ 2,716	80%
Kansas City, MO	$ 705,454	$ 3,559	72%
Las Vegas, NV	$ 392,634	$ 1,926	72%
Los Angeles, CA	$ 3,829,556	$ 2,949	89%
Miami, FL	$ 563,199	$ 3,529	74%
Minneapolis, MN	$ 705,760	$ 4,329	72%
New York, NY[i]	$44,156,460	$14,302	70%
Orlando, FL	$ 137,410	$ 1,400	85%
Philadelphia, PA	$ 6,935,167	$12,170	62%
Phoenix, AZ	$ 1,398,965	$ 2,708	73%
Pittsburgh, PA	$ 618,654	$ 4,497	39%
Portland, OR	$ 2,720,939	$11,389	50%
Riverside, CA	$ 176,144	$ 1,981	89%
Sacramento, CA	$ 413,000	$ 2,331	81%
San Antonio, TX	$ 569,761	$ 1,232	87%
San Diego, CA	$ 2,106,408	$ 4,414	66%
San Francisco, CA	$ 544,428	$ 1,677	97%
Seattle, WA	$ 869,988	$ 3,025	81%
St. Louis, MO	$ 237,125	$ 1,619	89%
Tampa, FL	$ 139,102	$ 989	90%
Washington, DC[ii]	$ (161,000)	$ (646)	104%

*Dollars in thousands

( ) denotes surplus

i. New York's financial report presented funding levels under two accounting methods; this was based on the entry age normal cost method that will be required by the Governmental Accounting Standards Board for all cities and states in June 2014.
ii. Data were unavailable for the District of Columbia, employees who participate in the federal Civil Service Retirement System, which was closed to all new employees in 1987.

Consistently paying the annual recommended contribution, as determined by actuaries, is key to fully funding pensions over the long term. Pew's *Widening Gap* report found that those with the discipline to make their annual pension payments weathered the Great Recession better than their counterparts. Their funding levels fell 4 percentage points from 2007 to 2009, compared with 9 percentage points in cities that did not consistently keep up their payments.

As a whole, the 30 cities in this analysis boosted their annual pension payments from $9.3 billion to $11.2 billion between 2007 and 2009. But overall, they still lost ground because—to cover the annual cost of retirement benefits earned by current workers and to pay down a portion of their shortfalls—their contributions should have increased to $12.2 billion in 2009.[3]

Cities varied significantly in this regard. Seventeen of them paid all or more of their recommended contributions in 2009, with Seattle, St. Louis, Los Angeles, and the District contributing even more. But some cities contributed significantly less, including Chicago (43 percent), Cincinnati (59 percent), Portland (62 percent), and Pittsburgh (66 percent).

Retiree Health Care Is the Bigger Burden

Still, the 30 cities were better at setting aside money for pensions than at saving for retiree health care and other non-pension benefits.[4] As of 2009, 15 had set aside nothing to cover medical benefits promised to current and future retirees, leaving $1.17 in unfunded retiree health care liabilities for every $1 in unfunded pension costs.

Only three cities had saved even half of their projected bills for retiree health care. Cincinnati led with 85 percent of those obligations funded, followed by Los Angeles with 55 percent and Denver with 51 percent.

EXHIBIT 2:

RETIREE HEALTH CARE

FISCAL 2009

	Total unfunded liability*	Unfunded liability per household	Funding level
Atlanta, GA	$ 1,085,315	$ 5,244	0
Baltimore, MD	$ 2,397,300	$10,208	4%
Boston, MA	$ 4,553,816	$18,962	0
Chicago, IL[i]	$ 1,012,031	$ 943	0
Cincinnati, OH	$ 131,370	$ 946	85%
Cleveland, OH	$ 704,407	$ 3,803	29%
Dallas, TX	$ 516,184	$ 1,068	0
Denver, CO	$ 87,110	$ 346	51%
Detroit, MI	$ 4,976,762	$15,682	<1%
Houston, TX	$ 3,096,000	$ 3,734	0
Kansas City, MO	$ 208,600	$ 1,052	0
Las Vegas, NV	$ 201,003	$ 986	0
Los Angeles, CA	$ 2,468,354	$ 1,901	55%
Miami, FL	$ 540,683	$ 3,388	0
Minneapolis, MN	$ 75,901	$ 466	0
New York, NY	$70,570,971	$22,857	4%
Orlando, FL	$ 226,106	$ 2,304	11%
Philadelphia, PA	$ 1,743,592	$ 3,060	0
Phoenix, AZ	$ 370,061	$ 716	25%
Pittsburgh, PA	$ 359,100	$ 2,610	0
Portland, OR	$ 126,179	$ 528	4%
Riverside, CA	$ 63,748	$ 717	5%
Sacramento, CA	$ 376,000	$ 2,122	0
San Antonio, TX	$ 1,030,239	$ 2,229	31%
San Diego, CA	$ 1,317,880	$ 2,762	3%
San Francisco, CA	$ 4,377,770	$13,487	<1%
Seattle, WA	$ 600,231	$ 2,087	0
St. Louis, MO	$ 243,709	$ 1,664	0
Tampa, FL	$ 86,199	$ 613	0
Washington, DC	$ 316,800	$ 1,271	49%

*Dollars in thousands

i. Chicago's totals were based on the city's share of liabilities plus its pension funds' share of liabilities under a legal settlement.

Per household, the cities' unfunded health care liabilities ranged from a low of $350 per household in Denver to the previously noted high of $22,860 per household in New York.

Unlike their funding of pensions, cities and other public employers are more likely to handle retiree health costs on a pay-as-you-go basis—covering medical bills or insurance premiums as retirees incur them—than to sock away money each year in anticipation of those costs. Most cities, like states, did not report these costs as long-term liabilities until 2006, when the Governmental Accounting Standards Board began requiring them to do so.[5] But a number of cities are rethinking their promises and how they fund them, particularly in the face of steadily increasing medical costs and growing numbers of retirees.

Cities also may have more flexibility in how they deal with retiree health care liabilities than with pensions. Some are not legally obligated to provide health care benefits to retirees but are legally bound to honor pension commitments. For example, in April 2011, a California Superior Court judge affirmed that San Diego policymakers could alter and reduce health care benefits for retirees, despite promises made in the past. But other courts have ruled in the opposite direction.

Cities Adopt Different Approaches to Closing the Gaps

Many cities have long managed their public-sector retirement systems by consistently making their annual recommended contributions and adjusting their promises to better cope with long-term costs. But the asset losses experienced during the Great Recession and continuing budget pressures have spurred policymakers to push for additional reforms to address funding shortfalls or unsustainable growth in costs.

Even after San Diego made some changes to its pension system, voters enacted sweeping reforms in June 2012. Although there are pending legal issues, all new employees except for police will be enrolled in defined contribution plans, which operate like private-sector 401(k) plans, rather than in traditional defined benefit plans that guarantee pension checks for life.[6] San Diego's current employees also saw their final salaries—used to calculate their pensions—frozen for six years unless two-thirds of the council members vote to lift the freeze early.[7]

While San Diego transformed its entire system for all new workers, recent reforms in most cities were more modest. San Francisco, one of the best-funded cities in our analysis, enacted changes to pension benefits in November 2011 that asked employees to contribute more toward their retirements and limited cost-of-living adjustments.[8] San Francisco's modifications are projected to save the city $1.3 billion over 10 years.[9]

In March 2012, the New York state Legislature enacted reforms affecting new state and local employees, including New York City. It raised the retirement age for new workers, introduced progressive employee contribution rates, changed the vesting period, and required any new retirement benefits or enhancements to be pre-funded.[10] These reforms were slated to save the city $21 billion over the next 30 years.[11]

In 2009, Cincinnati changed its retiree health care to a plan that included higher deductibles, co-payments, and out-of-pocket limits for beneficiaries.[12] Cincinnati lawmakers also recently asked the head of the retirement system to analyze the cost-of-living component and associated costs.[13] By examining how these benefits are calculated, the city hopes to slow the growth in retiree obligations.

In Chicago, which received a negative outlook from Moody's Investors Service in April 2012 because of stalled pension reform, Mayor Rahm Emanuel appointed a four-member task force in January 2013 that recommended ways to tackle growing retiree health care costs.[14] The mayor is pushing state lawmakers, who have legislative oversight in local and state pension reform, to address the state's and city's rising pension costs.[15] In January 2013, Standard & Poor's downgraded Illinois' credit rating to worst in the nation because of failures to address pensions.[16]

While pension assets have largely returned to pre-recession levels, they still must make up for years of lost growth, and liabilities continue to rise.[17] So pressure for reforms is not expected to lessen.

Endnotes

1 Pew's analysis includes teacher pension liabilities for New York, Philadelphia, and the District of Columbia because those obligations were listed in each city's comprehensive annual financial report. Among the 30 cities studied, New York has the third-highest number of public workers per capita, behind only the District of Columbia and San Francisco.

2 In Boston, the city's large retiree health care costs include benefits for retired teachers. Teachers' pension benefits, though, are paid for by the state. See "Official Statement of the City of Boston Relating to Bond Offerings," (2011), A33–A34, cityofboston.gov/Images_Documents/2011%20GOB_tcm3-25570.pdf.

3 The calculated amount established by the Governmental Accounting Standards Board (GASB) to cover normal costs and any "catch-up" payments. Under GASB Statement 45, entities are not required to pay the actuarially recommended contribution each year, but it does need to be calculated and disclosed in the public employer's annual financial statements. See GASB, "Summary of Statement No. 45," (June 2004), gasb.org/st/summary/gstsm45.html.

4 This brief uses "retiree health care" when referring to other post-employment benefits, a category that includes other non-pension benefits but with costs primarily from retiree health care.

5 Governmental Accounting Standards Board, "Summary of Statement No. 43," (April 2004), gasb.org/st/summary/gstsm43.html; GASB, "Summary of Statement No. 45," (June 2004), gasb.org/st/summary/gstsm45.html.

6 State of California Public Employment Relations Board, *San Diego Municipal Employees Association; Deputy City Attorneys Association of San Diego, American Federation of State, County and Municipal Employees, AFL-CIO, Local 127; and San Diego City Firefighters Local 145 v. City of San Diego*, February 11, 2013, Case Nos. LA-CE-746-M, LA-CE-752-M, LA-CE-755-M, LA-CE-758-M.

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12 In November 2012, siding with the City of Cincinnati, the Ohio appeals court upheld a previous decision, ruling that the city was within its legal right to change its retiree health care plans. Barry M. Horstman, "City retirees misled, but lose anyway," (November 8, 2012), news.cincinnati.com/article/AB/20121107/news01/311070145/City-retirees-misled-lose-anyway.

13 Barry M. Horstman, "No letup for Cincinnati's distressed pension plan," (January 2, 2012), news.cincinnati.com/article/20130101/NEWS010801/301010055/No-letup-Cincinnati-s-distressed-pension-plan.

14 Paul Merrion, "Moody's lowers outlook on city's main credit rating," *Crain's Chicago Business*, (April 26, 2012), accessed February 15, 2013, chicagobusiness.com/article/20120426/NEWS01/120429841/moodys-lowers-outlook-on-citys-main-credit-rating; Hal Dardick, "Panel: City retiree's health care too costly," *Chicago Tribune*, Jan. 14, 2013, accessed February 15, 2013, articles.chicagotribune.com/2013-01-14/news/ct-met-emanuel-retiree-health-care-20130115_1_korshak-case-city-workers-health-insurance; Leemore Dafny, "Retirees may not need city health insurance," *Chicago Sun-Times*, January, 21, 2013, accessed February 15, 2013, suntimes.com/news/otherviews/17717211-452/retirees-may-not-need-city-health-insurance.html; Retiree Healthcare Benefits Commission's (RHBC) report to the Mayor's Office on the state of retiree healthcare benefits, their related cost trends, and issues affecting the offering of retiree benefits after July 1, 2013, cityofchicago.org/city/en/depts/fin/provdrs/ben/alerts/2013/jan/retiree_healthcarebenefitscommissionreporttothemayor.html.

15 Hal Dardick, "Emanuel may have a play on pensions," *Chicago Tribune*, (December 17, 2012), accessed February 20, 2013, articles.chicagotribune.com/2012-12-17/news/ct-met-rahm-emanuel-pension-trump-card-20121217_1_pension-system-pension-funds-health-care.

16 Ray Long and Monica Garcia, "Illinois credit rating sinks to worst in nation, *Chicago Tribune*, January 25, 2013, accessed February 15, 2013, articles.chicagotribune.com/2013-01-25/news/chi-illinois-credit-rating-sinks-to-worst-in-nation-20130125_1_action-on-pension-reform-robin-prunty-illinois-credit; Paul Merrion, "Moody's lowers outlook on city's main credit rating," *Crain's Chicago Business*, April 26, 2012, accessed February 15, 2013, chicagobusiness.com/article/20120426/NEWS01/120429841/moodys-lowers-outlook-on-citys-main-credit-rating.

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