PENNSYLVANIA STATE ASSOCIATION OF BOROUGHS

Municipal Pensions

Senate Finance Committee

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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.

Two of the major services our members deliver to their communities are police and fire protection. Borough communities in Pennsylvania typically provide their own police force. In some instances, boroughs also contract for police services from a neighboring municipality or participate in a regional police force. These arraignments for police services account for 71 percent of the boroughs in Pennsylvania with the remainder relying on State Police coverage.

With a large majority of boroughs responsible for providing police protection for their citizens, the costs to provide this vital service are not cheap. In fact, it represents a large and every growing percentage of their municipal budget. Current laws such as Act 111 of 1968 (Collective Bargaining and Binding Arbitration for Police and Fire) and Act 600 (Municipal Police Pension Law) have driven costs for public safety higher and higher. Municipal officials are now looking to Harrisburg for new and innovative ways to help meet the demands of providing public safety in their community.

Borough Pensions

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 nonuniformed 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 pension plans.

Under the Act 44 distress scoring system, borough pension plans are funded at an average rate of 89 percent. That's actually one percentage point away from the score of "not distressed." A further examination of the statistics reveals that 62% of borough pension plans are funded at 90 percent or more. Unfortunately, not all borough employee pension benefits are the same. Therefore, when you survey the 482 police pension plans, especially those under Act 600, the unfunded liabilities rise.

I'd also like to point out that currently non-Act 600 borough pension plans are structured in a variety of ways. Some use the more manageable defined contribution or cash balance plan structures. This flexibility is working in many of our communities today.

Municipal Pensions

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 PSERS and SERS. Recently published media reports of a crisis in municipal pensions fail to report the fact that only 23 municipalities (out of 1,453) were actually 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 wrongfully 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.

Suggested Reforms

Even with promising trends in the annual 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 keep rising costs at bay.

- **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.

Policy Considerations

In addition to these suggested remedies, PSAB offers our perspectives on the following policy considerations which may be considered in the future.

- **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.
- **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 closing, we urge this committee 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. Alternatively, PSAB urges this committee to support the commonsense alternative in **Senate Bill 755**, sponsored by Senator John Eichelberger, which promotes local autonomy and creates a framework for fiscal sustainability in public safety.

We wish to thank Chairman Eichelberger, Chairman Blake, and the members of the Senate Finance Committee for offering PSAB the opportunity to share our perspectives on this important subject. Please feel free to contact me at extension 1044 or rgrutza@boroughs.org if you have any questions on this testimony.