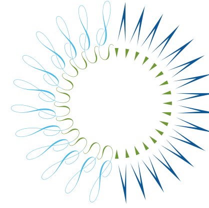

THE PEW CHARITABLE TRUSTS

A Widening gap in Cities

Shortfalls in Funding for Pensions and Retiree Health Care

JANUARY 2013

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For additional information, visit www.pewstates.org.

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Executive Summary

As the Great Recession ended, 61 key cities across America—the most populous one in each state plus all others with more than 500,000 people—emerged with a gap of more than $217 billion between what they had promised their workers in pensions and retiree health care and what they had saved to pay that bill. While states have a much larger shortfall, cities face the same daunting challenges posed by unfunded liabilities for their public sector retirement benefits.[1]

For pensions, these cities had a shortfall of $99 billion in fiscal year 2009, the most recent year with complete data. Together, they had enough money to cover 74 percent of their pension obligations, compared with 78 percent for states.[2]

The gap continued to widen in fiscal year 2010 as reflected by complete data for 40 of the cities, which saw their unfunded pension liabilities rise by another 15 percent.[3]

Besides pensions, many localities have promised health care, life insurance, and other non-pension benefits to their current and future retirees, but few have started saving to cover these long-term costs. In fact, unfunded liabilities for retiree health care loom even larger than for pensions (see Exhibit 1).[4] As of fiscal year 2009, the cities in this report had promised at least $118 billion more than they had in hand to cover health care benefits for current and future retirees. Cities had set aside enough money to cover 6 percent of their promises, compared with slightly more than 5 percent in states.[5]

Wide disparities exist in how prepared cities are to fulfill their pension obligations to employees. On the high end, Milwaukee and Washington, D.C., had surpluses at the end of fiscal year 2009, with enough money to cover 113 percent and 104 percent, respectively, of their liabilities.[6] That was better than the best-funded state, New York, at 101 percent. At the other end of the spectrum, pension systems in four cities—Charleston, West Virginia; Omaha, Nebraska; Portland, Oregon; and Providence, Rhode Island—were more poorly funded than those in Illinois, which at 51 percent was the lowest-funded state.[7] Charleston trailed all the other cities at 24 percent (see Exhibit 2).[8]

Cities have more in common when it comes to gaps in funding for retiree health care and other non-pension benefits. As of fiscal year 2009, a majority of the 61 cities had set aside little or nothing to meet those promises. Only Los Angeles and Denver had even half of the money needed (see Exhibit 3).

Why Funding Gaps Matter

Police, firefighters, clerks, and other city workers across the country depend on these public sector retirement systems to provide income and health care in their golden years. Some do not participate in Social Security and rely solely on their government pensions in retirement.[9] Many pay a portion of their salaries to help fund their pension systems. These systems also matter because, if their costs go up, funds available for other local services may go down or taxes may need to be increased to cover the shortfall. Some of the government's share of the costs comes out of the same pool of local tax dollars as spending for education, public safety, parks, libraries, and other services. Moreover, if cities are not disciplined about funding their retirement benefits, credit rating agencies take notice and borrowing costs can go up.

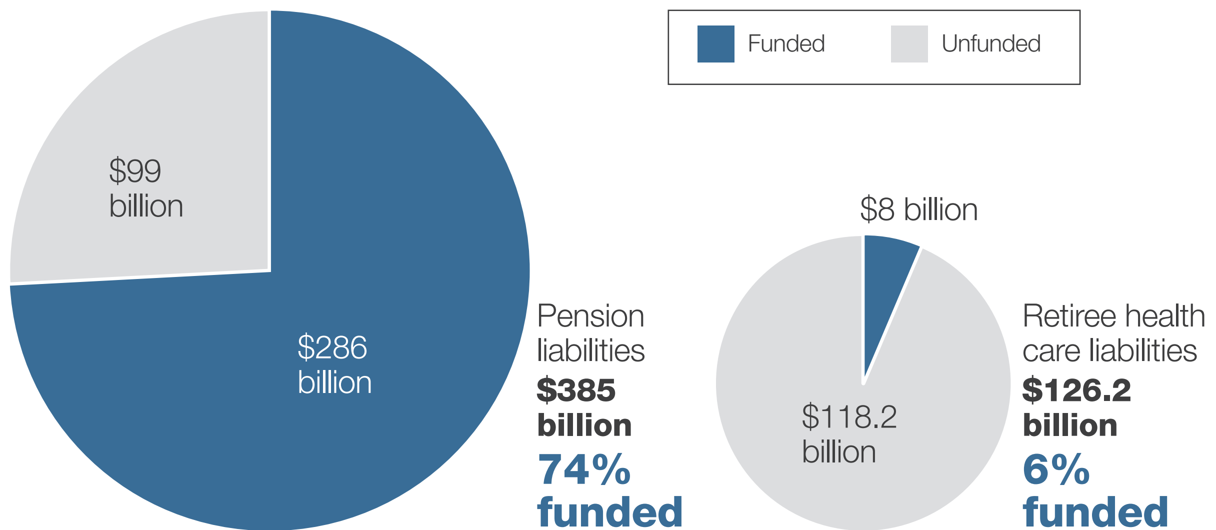
Pension costs can be a bigger weight on cities' budgets than on states' budgets.[10] According to U.S. Census Bureau data, local governments in general spend more on employee compensation, and

EXHIBIT 1:

61 CITIES' RETIREE BILLS

FISCAL YEAR 2009

The unfunded share of retirement benefits promised to city employees totaled $217.2 billion.



NOTE: Retiree health care is the primary component of Other Post-Employment Benefits, which also include other non-pension benefits such as life insurance.

SOURCE: The Pew Charitable Trusts analysis 2012.

EXHIBIT 2:

PENSION FUNDING IN 61 CITIES

FISCAL YEAR 2009

24 cities had funding levels of 80% or above | 37 cities had funding levels below 80% | (Dollars in millions)

City	Annual recommended contribution	Percent paid	Total liability	Percent funded
Albuquerque, NM	$35	100%	$1,710	84%
Anchorage, AK	14	116	1,192	68
Atlanta, GA	144	100	3,171	60
Austin, TX	107	85	3,729	75
Baltimore, MD	113	100	4,704	86
Billings, MT	3	126	267	74
Birmingham, AL	21	79	1,186	81
Boise, ID	10	127	496	74
Boston, MA	108	100	3,067	60
Bridgeport, CT	22	94	809	75
Burlington, VT	6	102	169	77
Charleston, WV	17	39	270	24
Charlotte, NC	25	98	1,366	94
Cheyenne, WY	5	67	176	92
Chicago, IL	990	43	24,971	52
Columbia, SC	9	100	388	71
Columbus, OH	129	67	5,240	74
Dallas, TX	148	90	7,359	87
Denver, CO	78	93	3,823	87
Des Moines, IA	13	95	703	84
Detroit, MI	103	76	7,910	93
El Paso, TX	49	219	1,841	84
Fargo, ND	7	60	174	69
Fort Worth, TX	71	92	2,301	81
Honolulu, HI	81	110	2,700	65
Houston, TX	275	80	11,030	80
Indianapolis, IN	27	102	1,162	94
Jackson, MS	13	64	506	65
Jacksonville, FL	92	100	4,028	63
Jersey City, NJ	41	90	1,446	69
Kansas City, MO	$57	88%	$2,486	72%
Las Vegas, NV	58	90	1,427	72
Little Rock, AR	35	44	498	59
Los Angeles, CA	658	101	35,063	89
Louisville, KY	32	111	1,202	68
Manchester, NH	15	90	436	60
Memphis, TN	44	86	3,577	84
Milwaukee, WI	60	100	4,269	113
Minneapolis, MN	52	73	2,540	72
Nashville, TN	116	108	3,107	73
New Orleans, LA	67	54	1,993	61
New York, NY*	7,284	100	148,586	70
Oklahoma City, OK	40	61	1,275	78
Omaha, NE	63	45	1,429	43
Philadelphia, PA	761	70	18,337	62
Phoenix, AZ	156	100	5,115	73
Portland, ME	4	100	170	73
Portland, OR	222	62	5,462	50
Providence, RI	67	100	1,874	42
Salt Lake City, UT	23	100	802	84
San Antonio, TX	126	100	4,544	87
San Diego, CA	162	100	6,282	66
San Francisco, CA	135	100	17,257	97
San Jose, CA	110	100	5,450	79
Seattle, WA	73	107	4,606	81
Sioux Falls, SD	7	104	403	87
Tucson, AZ	60	100	1,712	72
Virginia Beach, VA	52	100	1,550	81
Washington, DC**	106	117	4,332	104
Wichita, KS	14	100	1,049	94
Wilmington, DE	17	100	323	62

* New York City'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.

** Data were unavailable for Washington, D.C., employees who participate in the federal Civil Service Retirement System, which was closed to all new employees in 1987.

SOURCE: The Pew Charitable Trusts 2012, based on cities' Comprehensive Annual Financial Reports and plans' actuarial valuations.

EXHIBIT 3:

RETIREE HEALTH CARE FUNDING IN 61 CITIES

FISCAL YEAR 2009

■ 2 cities had funding levels of 50% or above ■ 25 cities had funding levels of 0.01% to 49%

(Dollars in millions)

City	Annual recommended contribution	Percent paid	Total liability	Percent funded
Albuquerque, NM	$14	36%	$162	4%
Anchorage, AK	9	96	132	7
Atlanta, GA	83	23	1,085	0
Austin, TX	109	18	1,036	0
Baltimore, MD	179	79	2,498	4
Billings, MT	3	41	25	0
Birmingham, AL	10	35	78	0
Boise, ID	3	49	26	0
Boston, MA	344	37	4,554	0
Bridgeport, CT	51	59	862	0
Burlington, VT	0.3	1	4	0
Charleston, WV	5	58	80	0
Charlotte, NC	14	195	207	16
Cheyenne, WY	0.2	153	3	0
Chicago, IL*	264	46	1,012	0
Columbia, SC	15	31	162	0
Columbus, OH	63	78	905	28
Dallas, TX	48	25	516	0
Denver, CO	8	73	178	51
Des Moines, IA	1	32	14	0
Detroit, MI	362	70	5,001	<1
El Paso, TX	14	20	148	0
Fargo, ND	2	23	20	0
Fort Worth, TX	110	20	1,000	<1
Honolulu, HI	105	85	1,925	2
Houston, TX	274	21	3,096	0
Indianapolis, IN	17	8	140	0
Jackson, MS	8	12	52	0
Jacksonville, FL	11	36	137	0
Jersey City, NJ	87	27	908	0
Kansas City, MO	$22	16%	$209	0%
Las Vegas, NV	24	12	201	0
Little Rock, AR	1	155	8	18
Los Angeles, CA	266	132	5,470	55
Louisville, KY	48	54	594	40
Manchester, NH	9	54	89	2
Memphis, TN	122	77	1,842	1
Milwaukee, WI	73	45	960	0
Minneapolis, MN	7	51	76	0
Nashville, TN	174	26	1,779	0
New Orleans, LA	27	0	140	0
New York, NY	67,228	3	73,674	4
Oklahoma City, OK	48	39	480	2
Omaha, NE	38	48	389	0
Philadelphia, PA	146	70	1,744	0
Phoenix, AZ	39	112	492	25
Portland, ME**	na	na	na	na
Portland, OR	14	30	138	4
Providence, RI	80	49	1,498	<1
Salt Lake City, UT	8	31	89	0
San Antonio, TX	105	48	1,486	31
San Diego, CA	104	47	1,359	3
San Francisco, CA	429	28	4,378	<1
San Jose, CA	84	31	1,558	9
Seattle, WA	38	61	600	0
Sioux Falls, SD	4	105	48	37
Tucson, AZ	8	73	132	0
Virginia Beach, VA	9	100	79	12
Washington, DC	131	62	626	49
Wichita, KS	2	79	30	0
Wilmington, DE	4	40	50	10

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

**Portland, Maine, was the only city to report no liabilities because it offers no benefits.

NOTE: Retiree health care is the primary component of Other Post-Employment Benefits, which also include other non-pension benefits such as life insurance.

SOURCE: The Pew Charitable Trusts 2012, based on cities' Comprehensive Annual Financial Reports and plans' actuarial valuations.

their pension contributions equal 9 percent of the tax revenue they collect, compared with nearly 5 percent for states.[11] Cities and states face similar challenges in setting aside enough money to pay for rising retiree health care costs, particularly as baby boomers age and swell the ranks of government retirees.

Local pension problems also trickle up. Whether they ensnare small towns or major metropolitan areas, severe local pension issues can land on the doorstep of state policy makers. Rhode Island beefed up its efforts to aid distressed localities after tiny Central Falls, burdened by high pension costs, filed for bankruptcy protection in 2011. Michigan appointed a joint state-city financial board in 2012 to help Detroit avoid bankruptcy in a crisis fueled in part by its pension and retiree health care costs and pension-related debt.[12]

How Cities Fared During the Recession

The Great Recession had a significant impact on local pension plans across the country. Overall, the aggregate funding

SCOPE OF THE STUDY

This analysis looks at 61 cities ranging in size from New York City, with more than 8 million residents, to Burlington, Vermont, with just over 42,000.[13] Together, these localities represent 45 percent of all municipal employees in the country.[14] It is the most complete examination yet of retirement funding in a broad range of U.S. cities because it assesses all defined benefit plans for which they are ultimately accountable, not just their largest ones, and also non-pension retirement liabilities. In all, 193 pension plans and 100 plans that cover Other Post-Employment Benefits, primarily health care, were studied.[15] This included separate firefighter or police pension plans, very small plans, and those closed to new employees but still paying benefits.[16] Teacher plans were included for fewer than 10 cities, based on whether the city—as opposed to a school district or state—listed the liabilities on its financial statement. (See population chart in Appendix A.)

Using cities' financial reports, this analysis combined assets and liabilities for all plans for which a city was responsible to create one aggregate funding level for pensions and one for retiree health care for each municipality. Because some plans are slow to report their results, a complete set of data was available only through fiscal year 2009, although results for 40 of the cities shed light on fiscal year 2010. This study also reviewed a sample of reforms adopted by some of these cities as recently as last year. (See the methodology in Appendix B.)

level of the 61 cities studied declined five percentage points—from 79 percent in fiscal year 2007 to 74 percent in fiscal year 2009. Half of the cities saw drops of eight percentage points or more. But the downturn was not the decisive factor that separated cities with the best-funded pension systems from those with poorly funded ones.

Most of the cities that exited the recession with the most profound pension problems were already in trouble when they entered it. In 2007, pension systems in 27 of the 61 cities were below 80 percent funded, a level many experts cite as inadequate.[17] By 2009, 37 of the cities had fallen below that mark, ranging from 24 percent in Charleston to 79 percent in San Jose, California.

Whether a city was fiscally disciplined made a big difference in how it fared. Cities with pension plans that kept up with their payments—consistently making the "annual recommended contribution" calculated by their actuaries—weathered the financial downturn better than their counterparts.[18] Between 2007 and 2009, 35 cities paid at least 90 percent of each year's annual recommended sum. The funding level of their pension plans fell at half the rate as those in cities that did not consistently make the bulk of their payments.[19]

Sixteen cities stand out for both managing to keep their pension funding above 80 percent and consistently making at least 90 percent of their annual pension payments between 2007 and 2009—one of the most volatile financial times in their history. Meanwhile, nine cities fell below both benchmarks each of those years (see Exhibit 4 on page 11).

Failure to faithfully pay annual retirement bills is one of three key factors that lead to pension underfunding. Gaps also grow when investments and other assumptions fail to meet expectations and when benefits are increased without a way to pay for them.

Reforms Taking Hold

Many cities have begun to make reforms, such as trimming the benefits they offer, raising workers' retirement age, increasing employees' contributions, shifting retirees into Medicare, or re-examining their use of traditional "defined benefit" pension plans that guarantee income for life, among other actions. The changes most commonly affect new hires but also current retirees and employees in some cases.

The four cities with the lowest pension funding levels in fiscal year 2009—Charleston; Omaha; Portland, Oregon; and Providence—all have taken steps to begin addressing their unfunded liabilities.[20] Providence, for example, suspended annual cost-of-living increases for retirees for 10 years and required

retirees 65 and older to switch from the city's insurance to Medicare.[21] Omaha imposed a restaurant tax primarily to raise money for city pensions and negotiated a new police contract with higher employee contributions and less generous retirement rules for current and future officers.[22]

Reforms are not just the province of underfunded systems. Some of the best-funded cities have sought relief after rising annual pension costs began taking up greater chunks of their budgets following the recession. For example, in San Francisco, which consistently made 100 percent of its pension contributions and saw its funding level slip from surpluses to a still-strong 97 percent in fiscal year 2009, voters overwhelmingly passed a package of reforms in November 2011, including increases in employee contributions and limits on retirees' cost-of-living adjustments.[23] Milwaukee, with a 113 percent funding level in fiscal year 2009, is considering reforms recommended by a pension task force in September 2012.[24]

Elsewhere, cities are trying a range of strategies. Little Rock, Philadelphia, and others have turned to special tax increases, along with reforms. Others, such as Chicago and New York City, have extended the time it takes employees to become fully vested in the system, capped the size of pension checks, or restricted the income that can be counted in the final average salary that determines lifelong benefits. In some cases, the changes have been dramatic—such as San Diego's voter initiative in June 2012, which shifted new hires, except for police, out of a defined benefit plan that provides a fixed income and into a defined contribution plan similar to private sector 401(k) accounts.[25] At times, courts have blocked reforms, as in Baltimore, where a federal judge in September 2012 struck down changes that would have required police and firefighters to work longer before retiring.[26]

In general, retiree health benefits are easier to change for current employees than pension benefits because courts are less likely to consider non-pension benefits to be a protected right. For example, a California Superior Court judge ruled in April 2011 that San Diego is not obligated to provide health care to current employees once they retire, despite promises made in the past.[27] But the issue is by no means settled, and other courts have ruled in the opposite direction.

Looking Ahead

Cities' pension plans will continue feeling the impact of the Great Recession. Most spread the effect of market swings on their investment portfolios over a period of years, so 2008 and 2009 losses are still being reflected. And even though investment

earnings are improving, gains have not made up for those losses. Results for fiscal year 2010 for 40 of the cities show the pension gap still widening—as many cities continue to account for drops in investment portfolios.

In addition, cities for the most part have yet to tackle the looming bill for retiree health care, and the strains will be even greater as baby boomers retire in record numbers. Cities also are likely to face greater public scrutiny of retirement costs because of financial reporting changes that soon could make their funding levels look far worse than they do today.

In the wake of the Great Recession, cities face a continuing barrage of competing demands on their budgets. Those fiscal constraints will make it both tougher and more urgent to find affordable ways to keep their retirement commitments to their workers.

Key Findings: Pensions and Retiree Health Care

When it comes to funding their public sector pensions, Milwaukee and Charleston could not be more different. At the end of fiscal year 2009, the largest city in Wisconsin had the best-funded system among 61 American cities, with 113 percent of the money it will need down the road to cover employees' pension checks. By contrast, West Virginia's largest city had just 24 percent. Yet neither had set aside a dime for another major retirement liability facing many local governments: retiree health care.

Milwaukee and Charleston capture the wider picture of how 61 key cities—the largest in each state, plus all others with populations of more than 500,000—are doing in meeting their long-term financial obligations for employees' retirements.

These cities represent only a fraction of the 19,522 municipalities across America, but they account for 45 percent of municipal employees.[28] The sample offers the broadest comparison yet of retirement funding at the city level.[29] As the results show, some cities are far more burdened than others with pension fund shortfalls. But on retiree health care, they have more in common; like Milwaukee and Charleston, a majority have set aside little to nothing to pay that bill.

Pensions

The big picture. Altogether, the 61 cities had enough assets to cover 74 percent of $385 billion in projected pension obligations as of fiscal year 2009, the most recent year with complete data for each city. That left a gap between assets and liabilities of $99 billion. More recent, complete data for 40 cities showed the gap widening in fiscal year 2010.

States' and cities' pension systems were in similar shape in fiscal year 2009, at 78 percent and 74 percent funded, respectively. But individually, the range for cities was more extreme. Milwaukee had the highest funding level at 113 percent, while Charleston was lowest at 24 percent. New York state had 101 percent of its liabilities covered, while Illinois, with 51 percent, was at the bottom.

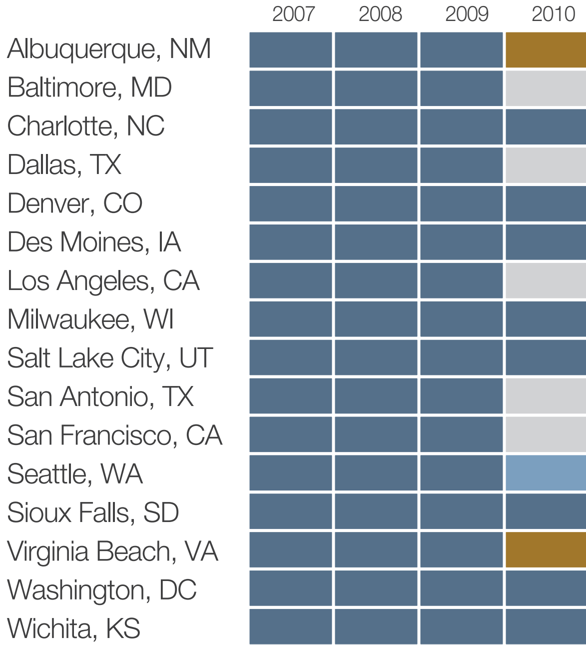
Performance on two key indicators. In evaluating how well cities are meeting

EXHIBIT 4 :

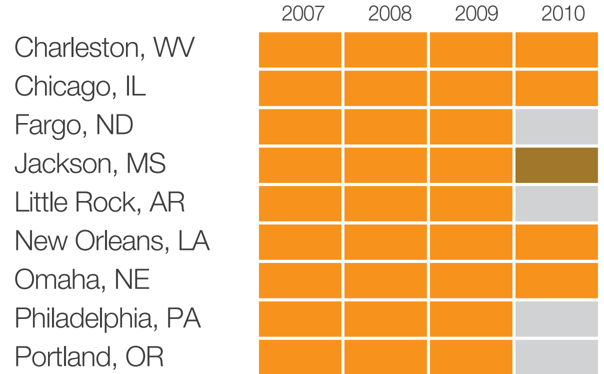
HOW CITY PENSIONS FARED IN THE RECESSION

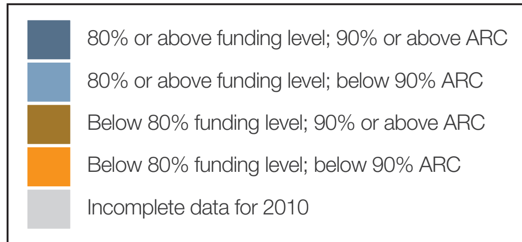
Between 2007 and 2009, 16 cities consistently performed well on two pension indicators: They kept a funding level of at least 80 percent and paid at least 90 percent of their annual recommended contributions (ARC). Nine cities consistently underperformed on both indicators.

Top performers

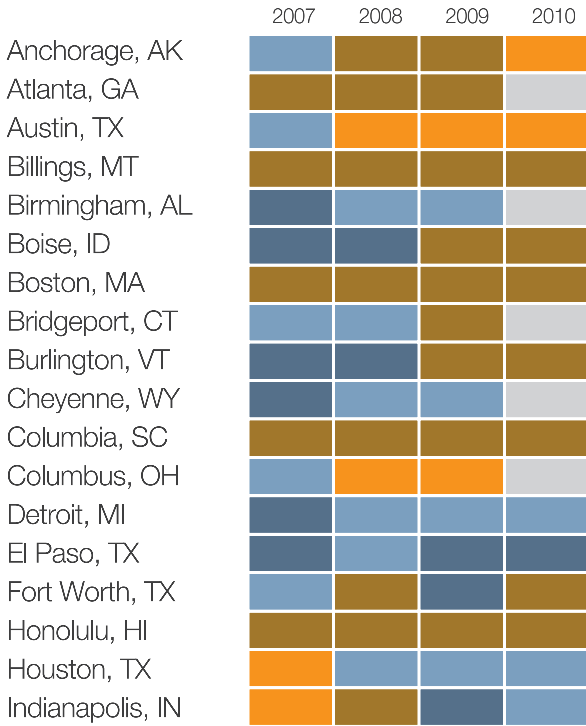


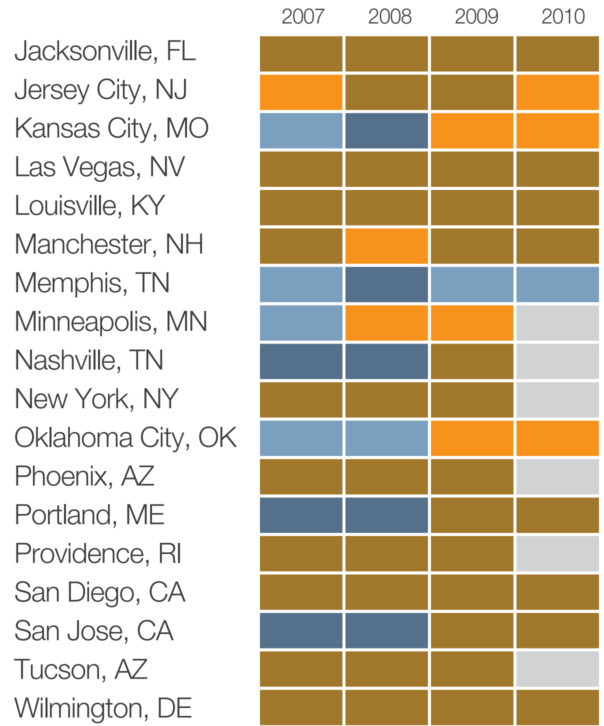
Bottom performers





The rest





NOTE: Complete data were available for only 40 cities for fiscal year 2010.

SOURCE: The Pew Charitable Trusts analysis 2012.

their pension obligations, many experts look at two indicators: (1) their funding level, which is the percentage of projected liabilities covered by assets; and (2) the extent to which they are paying the annual contribution their actuaries recommend to meet their pension obligations, generally over 30 years. This study gauged these measures over three years. For the first indicator, we used an 80 percent funding level as a benchmark; for the second, we asked whether a city had paid at least 90 percent of its annual recommended contribution (see Exhibit 4).[30]

Between 2007 and 2009—one of the most volatile financial times in their history—16 cities maintained funding levels above 80 percent and consistently made at least 90 percent of their annual pension payments: Albuquerque; Baltimore; Charlotte; Dallas; Denver; Des Moines; Los Angeles; Milwaukee; Salt Lake City; San Antonio; San Francisco; Seattle; Sioux Falls; Virginia Beach; Washington, D.C.; and Wichita.

Nine cities fell below the benchmarks for both funding level and annual pension contributions each year from 2007 to 2009: Charleston; Chicago; Fargo; Jackson; Little Rock; New Orleans; Omaha; Philadelphia; and Portland, Oregon.

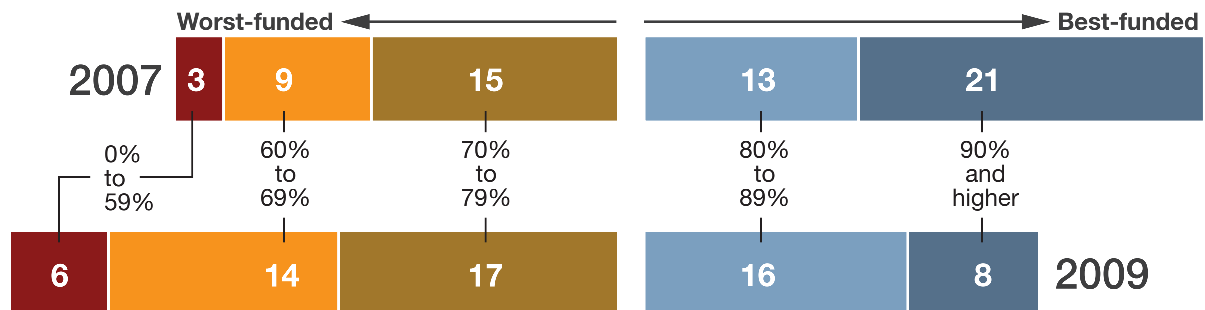
First indicator: best- and worst-funded in 2009. When it came to the first indicator, 24 cities emerged from the recession with funding levels of 80 percent or higher in fiscal year 2009; 37 cities fell below that mark. This snapshot captures cities' pension holdings at a low point because of the recession (see Exhibit 5).

Of the 24, eight cities' pension systems were at least 90 percent funded:

EXHIBIT 5:

MORE CITIES END RECESSION WITH INADEQUATE PENSION FUNDING

Between 2007 and 2009, the number of cities with pension funding levels below 80 percent increased from 27 to 37.



SOURCE: The Pew Charitable Trusts analysis 2012.

Milwaukee (113 percent); Washington, D.C. (104 percent); San Francisco (97 percent); Wichita (94 percent); Charlotte (94 percent); Indianapolis (94 percent); Detroit (93 percent); and Cheyenne (92 percent).

Four cities had no more than half of the assets they needed to cover their pension obligations: Charleston (24 percent); Providence (42 percent); Omaha (43 percent); and Portland, Oregon (50 percent). All have taken steps to reform their pension systems, but they still are grappling with significant unfunded liabilities.

The five most populous U.S. cities accounted for more than 60 percent of the 61 cites' total pension bill and 70 percent of the unfunded portion. Of the five, Los Angeles had the best pension funding level at 89 percent as of fiscal year 2009. It was followed by Houston (80 percent), New York City (70 percent), Philadelphia (62 percent), and Chicago (52 percent).

Second indicator: best and worst at making annual payments. More than half—35—of the 61 cities made at least 90 percent of their annual pension payments each year between 2007 and 2009, including 25 that paid at least 100 percent each year. Six cities regularly shortchanged their pension funds and made less than two-thirds of their annual recommended contributions: Charleston; Chicago; Little Rock; New Orleans; Omaha; and Portland, Oregon.[31] Unsurprisingly, their overall funding levels continued to sink each year.

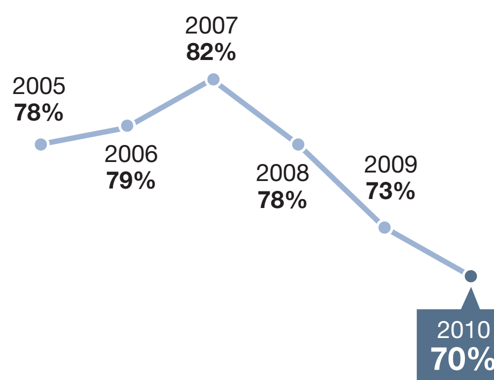
Some cities are required by state or local law to fully fund their annual recommended contributions. But others have the discretion to make a lower payment. While this allows them to divert money to other essential services during a downturn, it also increases the future annual costs of their retirement plans.

Results in 2010 and beyond. A look at 40 cities that reported results for all of their pension plans for fiscal years 2005 through 2010 showed declines in funding levels beyond the end of the recession. Their aggregate funding levels reached 82 percent in 2007, before dropping to 78 percent in 2008, 73 percent in 2009, and 70 percent in 2010 (see Exhibits 6 and 7).[32]

EXHIBIT 6:

PENSION TREND: FY 2005 – 2010

For 40 cities with complete data, aggregate funding levels fell after the Great Recession.



SOURCE: The Pew Charitable Trusts analysis 2012.

EXHIBIT 7:

PENSION GAP CONTINUES TO WIDEN

FISCAL YEAR 2010

For 40 cities with complete data for fiscal year 2010, pension funding levels fell to 70 percent from 73 percent a year earlier.

■ 13 cities had funding levels of 80% or above ■ 27 cities had funding levels below 80% (Dollars in millions)

City	Annual recommended contribution	Percent paid	Total liability	Percent funded
Albuquerque, NM	$36	100%	$1,728	78%
Anchorage, AK	31	65	1,862	67
Austin, TX	105	86	3,901	73
Billings, MT	4	103	266	67
Boise, ID	11	114	545	79
Boston, MA	116	100	2,543	62
Burlington, VT	6	100	179	73
Charleston, WV	18	40	337	19
Charlotte, NC	26	95	1,444	93
Chicago, IL	1,113	38	26,724	47
Columbia, SC	9	100	391	69
Denver, CO	73	107	3,988	86
Des Moines, IA	13	96	630	81
Detroit, MI	95	74	7,707	92
El Paso, TX	50	301	1,919	81
Fort Worth, TX	60	124	2,474	77
Honolulu, HI	95	102	3,264	61
Houston, TX	291	78	11,196	80
Indianapolis, IN	36	89	1,383	84
Jackson, MS	14	101	489	61

City	Annual recommended contribution	Percent paid	Total liability	Percent funded
Jacksonville, FL	$144	96%	$4,438	64%
Jersey City, NJ	48	88	1,428	75
Kansas City, MO	85	58	2,558	78
Las Vegas, NV	54	100	1,374	70
Louisville, KY	34	108	1,233	64
Manchester, NH	16	96	422	61
Memphis, TN	99	45	3,725	81
Milwaukee, WI	1	100	4,448	104
New Orleans, LA	96	63	1,937	56
Oklahoma City, OK	50	50	1,467	69
Omaha, NE	69	44	1,508	45
Portland, ME	4	103	171	70
Salt Lake City, UT	23	100	855	81
San Diego, CA	154	125	6,527	67
San Jose, CA	107	100	5,741	75
Seattle, WA	122	61	4,731	83
Sioux Falls, SD	9	101	410	89
Virginia Beach, VA	52	100	1,706	74
Wichita, KS	18	100	1,077	94
Wilmington, DE	18	100	364	59

SOURCE: The Pew Charitable Trusts 2012, based on cities' Comprehensive Annual Financial Reports and plans' actuarial valuations.

Retiree Health Care

The big picture. Pension shortfalls grab more headlines, but they are not the biggest retirement bill coming due for the 61 cities.

The cities had set aside just 6 percent of $126.2 billion in projected costs for what are known as Other Post-Employment Benefits, primarily retiree health care, leaving $118.2 billion in unfunded liabilities in fiscal year 2009. That compares with 5 percent set aside by states. Most cities and states have officially tallied long-term liabilities for retiree health care only since 2007, when new financial reporting standards took

effect. Many are just beginning to set aside contributions for these benefits, as they routinely do for pensions.

Only two cities had socked away at least half of the money needed to pay for future retiree health care benefits: Los Angeles and Denver. One city—Portland, Maine—had no liabilities because it offers no retiree health care.

Retiree health care benefits vary more widely than pension benefits. In some cases, retirees are allowed to participate in a city's health insurance plan but must pay the full cost of the premiums. Elsewhere, retirees and their spouses may receive full health coverage for life. New York City, for example, covers the full cost of basic health coverage for eligible retirees under age 65 and the Medicare and Medigap premiums for those over age 65.[33] Meanwhile, Philadelphia offers health benefits only for five years after retirement.[34] Denver guarantees a monthly premium reduction to its retirees (excluding emergency personnel) based on years of service, allowing it to set aside a fixed amount every year and avoid unpredictable increases in medical costs.[35]

Because retiree health promises generally have fewer legal protections than those for pensions, some cities are trimming them to reduce their long-term liabilities.

Best- and worst-funded. Los Angeles led the 61 cities with 55 percent of its retiree health care promises pre-funded in fiscal year 2009. Next were Denver (51 percent); Washington, D.C. (49 percent); Louisville (40 percent); Sioux Falls (37 percent); and San Antonio (31 percent). Far earlier than most, Los Angeles began setting aside money for retiree health insurance in 1987, and the city has been praised by bond rating agencies for this practice.[36] Denver's city code required that it begin funding municipal workers' retiree health benefits in 1992.[37]

While 27 cities had set aside some assets to offset their liabilities, 33 had not and were paying for their retirees' health care out of their treasuries on a pay-as-you-go basis (see Exhibit 3 on page 5).

Best at making annual payments. Some cities have begun tackling their retiree health care liabilities by pre-funding a portion of their expenses. Of the 27 cities with some assets set aside, five contributed more than 90 percent of the annual sums recommended by their actuaries in both fiscal years 2009 and 2010: Anchorage, Charlotte, Los Angeles, Sioux Falls, and Virginia Beach. Eight contributed more than half of their full annual payments in both years, and 14 contributed less than half.

Bigger unpaid bills for retiree health care than for pensions. In total dollars, the 61 cities had promised three times more in pension benefits

than in retiree health benefits.[38] Yet more than a third of the cities faced bigger unpaid bills for retiree health care than for pensions.[39] That is primarily because cities have saved for pensions for years, so a greater portion of those liabilities was covered (see Exhibit 8).

EXHIBIT 8:

UNFUNDED LIABILITIES: PENSIONS VS. RETIREE HEALTH CARE

FISCAL YEAR 2009

Twenty-two cities faced bigger unpaid bills for retiree health care than for pensions.

(Dollars in millions)

City	Retiree health care	Pensions
Albuquerque, NM	$156	$270
Anchorage, AK	123	380
Atlanta, GA	1,085	1,276
Austin, TX	1,036	949
Baltimore, MD	2,397	678
Billings, MT	25	71
Birmingham, AL	78	229
Boise, ID	26	129
Boston, MA	4,554	1,242
Bridgeport, CT	862	206
Burlington, VT	4	39
Charleston, WV	80	205
Charlotte, NC	174	79
Cheyenne, WY	3	14
Chicago, IL	1,012	11,919
Columbia, SC	162	112
Columbus, OH	656	1,365
Dallas, TX	516	923
Denver, CO	87	503
Des Moines, IA	14	113
Detroit, MI	4,977	553
El Paso, TX	148	295
Fargo, ND	20	53
Fort Worth, TX	995	432
Honolulu, HI	1,885	955
Houston, TX	3,096	2,252
Indianapolis, IN	140	74
Jackson, MS	52	176
Jacksonville, FL	137	1,470
Jersey City, NJ	908	443
Kansas City, MO	$209	$705
Las Vegas, NV	201	393
Little Rock, AR	7	207
Los Angeles, CA	2,468	3,830
Louisville, KY	353	384
Manchester, NH	91	174
Memphis, TN	1,824	563
Milwaukee, WI	960	-545
Minneapolis, MN	76	706
Nashville, TN	1,779	843
New Orleans, LA	140	769
New York, NY	70,571	44,156
Oklahoma City, OK	472	277
Omaha, NE	389	810
Philadelphia, PA	1,744	6,935
Phoenix, AZ	370	1,399
Portland, ME	na	46
Portland, OR	132	2,721
Providence, RI	1,497	1,084
Salt Lake City, UT	89	132
San Antonio, TX	1,030	570
San Diego, CA	1,318	2,106
San Francisco, CA	4,378	544
San Jose, CA	1,417	1,123
Seattle, WA	600	870
Sioux Falls, SD	30	50
Tucson, AZ	132	481
Virginia Beach, VA	70	289
Washington, DC	317	-161
Wichita, KS	30	59
Wilmington, DE	45	121

NOTE: Retiree health care is the primary component of Other Post-Employment Benefits, which also include other non-pension benefits such as life insurance.

SOURCE: The Pew Charitable Trusts 2012, based on cities' Comprehensive Annual Financial Reports and plans' actuarial valuations.

New York City, which faced a bigger bill for retiree health care benefits than did the other 60 cities put together, reported more than a $70 billion shortfall between what it had promised and what it had set aside for retiree health care as of fiscal year 2009. In comparison, its pension gap was $44 billion. Even though its overall pension liability was twice as big, it had saved enough to cover 70 percent of those costs but only 4 percent of its retiree health care costs.[40]

The States' Role

States can make a big difference in how well a city is meeting its retirement obligations.

In seven states, all local government employees participate in the same pension system provided for state employees.[41] In other states, cities may have the option to join other public employers in a shared plan, which may be state-administered or managed statewide, such as by an independent board of trustees. Alternatively, a city may run its plans independently. A number of cities have a mix of city-run and state-run plans. The large cities in this study were more likely than smaller cities or towns to run their pension plans independently, making their own decisions about benefits, funding, and governance structure.[42] Predominantly, these cities also managed their own retiree health care systems.[43]

Overall, this study found a bigger gap in pension funding for city-run plans than for plans managed statewide or administered by the state for city and other public employees. Across the 61 cities, plans managed by cities for their own employees had on average 66 percent of the money needed in the long run, compared with an average of 79 percent for state-administered and statewide plans that covered city workers and others.[44]

In Delaware's largest city, for example, the pension fund managed by the state for police and firefighters hired by Wilmington since early 1993 was 96 percent funded in fiscal year 2010, down slightly from 98 percent before the recession. Meanwhile, the rest of Wilmington's employees were enrolled in six city-managed plans that on average were 69 percent funded in fiscal year 2010, down 15 percentage points from fiscal year 2007.[45] Wilmington has since decided to enroll new general employees in a state-run plan.[46]

When a state-administered or statewide system sets funding, benefits, and governance rules, it can force localities to exhibit fiscal discipline. The results of this approach can be dramatic. A good example is the Illinois Municipal Retirement Fund, which manages pension benefits for general employees of nearly all Illinois cities except Chicago. In fiscal year 2009, the fund had 83 percent of the money needed to cover its long-term pension obligations—a far

better record than Chicago's 52 percent or the state's 51 percent pension funding levels.[47] Chicago manages its own plans, and the legislature and governor make funding and benefit decisions for state employees. Over many decades, the statewide municipal plan developed a solid reputation for responsible management. Created by state law, it receives no state funding and is managed independently by its own elected board of trustees. The board sets contribution rates for the local governments that participate and enforces a statute requiring that cities use real estate taxes to meet their annual pension obligation.[48]

In Delaware and Illinois, cities appeared to be better off when they enrolled workers in statewide or state-run plans. But other states tell a different story (see Exhibit 9).

Louisville enrolls the bulk of its employees in two retirement plans run by the state of Kentucky. Despite advantages to this arrangement—a requirement to make full annual pension payments, pooled and professionally managed assets, and benefits similar to other public employees—state management has left the city with growing unfunded pension liabilities. While the city consistently paid 100 percent or more of its annual recommended contributions in fiscal years 2007 to 2010, its pension funding kept losing ground, dropping over that period from 76 percent to 64 percent of liabilities. In addition to investment losses, the city's pension gap grew because it had to pay for cost-of-living adjustments that were awarded annually by state policy makers until as recently as 2011.[49] City leaders have no power to change benefits or to make other alterations to help keep its pension plans affordable.

Whether or not a city's pensions are managed independently, the state is never completely out of the picture. State laws and actions can hinder or help cities' success in fully funding their pensions.

West Virginia, for example, is now intervening to alleviate severe shortfalls it helped create in police and fire pension funds in Charleston and Huntington, its two largest cities. Over the years, the state made decisions about benefits and cost-of-living increases that inflated the cities' pension costs. Meanwhile, state officials would not let Charleston or Huntington impose a local income or sales tax to raise extra revenue. They also limited the amount of police and fire pension funds that could be invested in equities during the 1990s, so the funds missed much of the stock market boom. The state also took money from police and fire funds to replenish underfunded teachers' pensions. Finally, as other states have done recently, West Virginia also gave permission to the cities to contribute less than their annual recommended contributions to give them budget flexibility.

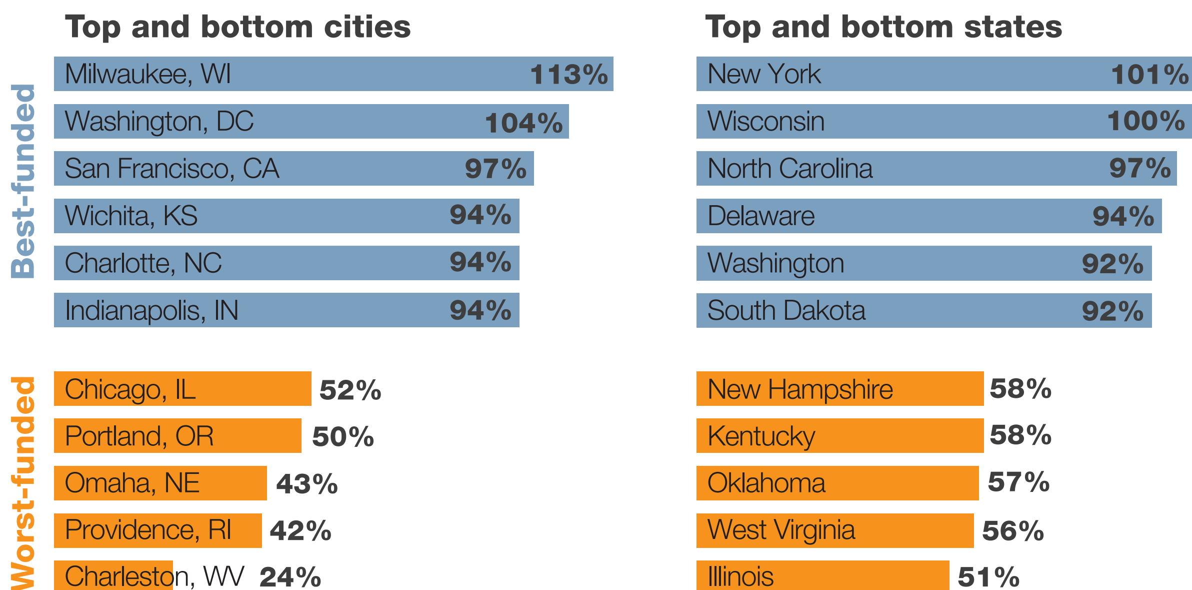
"It was a short-term Band-Aid to pass [the problem] on to the next

EXHIBIT 9:

PENSION FUNDING: CITIES VS. STATES

FISCAL YEAR 2009

The best-funded cities were not necessarily in the best-funded states, and the same was true for the worst-funded cities.



Funding levels for 61 cities and their states

Twenty-six cities had better pension funding than their own states, while 28 cities had lower funding. Six cities had the same funding level as their states.*

	CITY	STATE
Albuquerque, NM	84%	76%
Anchorage, AK	68	61
Atlanta, GA	60	89
Austin, TX	75	84
Baltimore, MD	86	65
Billings, MT	74	74
Birmingham, AL	81	74
Boise, ID	74	74
Boston, MA	60	68
Bridgeport, CT	75	62
Burlington, VT	77	73
Charleston, WV	24	56
Charlotte, NC	94	97
Cheyenne, WY	92	89
Chicago, IL	52	51
Columbia, SC	71%	69%
Columbus, OH	74	67
Dallas, TX	87	84
Denver, CO	87	69
Des Moines, IA	84	81
Detroit, MI	93	79
El Paso, TX	84	84
Fargo, ND	69	81
Fort Worth, TX	81	84
Honolulu, HI	65	65
Houston, TX	80	84
Indianapolis, IN	94	67
Jackson, MS	65	67
Jacksonville, FL	63	84
Jersey City, NJ	69	66
Kansas City, MO	72%	79%
Las Vegas, NV	72	72
Little Rock, AR	59	78
Los Angeles, CA	89	81
Louisville, KY	68	58
Manchester, NH	60	58
Memphis, TN	84	90
Milwaukee, WI	113	100
Minneapolis, MN	72	77
Nashville, TN	73	90
New Orleans, LA	61	60
New York, NY	70	101
Oklahoma City, OK	78	57
Omaha, NE	43	88
Philadelphia, PA	62	81
Phoenix, AZ	73%	78%
Portland, ME	73	73
Portland, OR	50	86
Providence, RI	42	59
Salt Lake City, UT	83	86
San Antonio, TX	87	84
San Diego, CA	66	81
San Francisco, CA	97	81
San Jose, CA	79	81
Seattle, WA	81	92
Sioux Falls, SD	87	92
Tucson, AZ	72	78
Virginia Beach, VA	81	80
Washington, DC	104	na
Wichita, KS	94	64
Wilmington, DE	62	94

* Washington, D.C. was not included in these calculations.

NOTE: Cities in bold were better funded than their states.

SOURCE: The Pew Charitable Trusts 2012, based on cities' and states' Comprehensive Annual Financial Reports and plans' actuarial valuations.

generation—a kick-the-can solution. Here we are, and it's tomorrow and we're faced with it," says David Molgaard, Charleston's city manager.[50]

To address their problems, both cities needed new authority from the West Virginia legislature. State legislation paved the way for Huntington in 2009 and Charleston in 2011 to cut costs by enrolling newly hired police and firefighters in a new, less generous statewide benefit plan. Both cities also adopted state-approved plans requiring them to put extra money into their old, underfunded pension systems.[51] Charleston agreed not to tap its old fire and police pension funds to pay current benefits, deciding instead to pay current pension checks out of other funds, including the city treasury. Contributions to the underfunded pension funds would be allowed to accumulate, with the goal of reaching full funding by 2046.[52]

When pensions put too much stress on local budgets, states may feel compelled to help. In 2008, to alleviate the local budget squeeze caused by a proposed statewide property tax cap, Indiana agreed to take over full funding for certain pension plans in cities across the state.[53] The deal relieved Indianapolis of two police and fire funds closed to new employees in 1977 that were draining city finances; consequently, its overall pension funding level shot up from 57 percent in 2008 to 94 percent in 2009.

States' oversight also influences the health of cities' pension plans. Massachusetts, Pennsylvania, and other states have commissions that oversee local pension systems, providing reports and commentary on investment and funding issues, actuarial practices, and potential reforms. Massachusetts also requires underfunded, locally run pension systems that consistently earn lower returns than the state's fund to let that fund manage their assets.[54] A Florida agency reviews local actuarial reports every three years, and other states monitor pension health in different ways.

Underfunding: Why It Matters

The health of a city's retirement system is both a cause and an effect of its overall financial outlook. Unfunded liabilities in pension and retiree health care funds are monitored by bond rating agencies to help assess a city's creditworthiness and long-term fiscal prospects. But unless a city's budget is healthy to begin with, it will be difficult to have the money to keep up with its retirement promises.

When investments plummeted in fiscal years 2008 and 2009, the lower earnings contributed to greater unfunded pension liabilities in 59 of the 61 cities. That, in turn, caused annual recommended contributions in a majority of the cities to jump at the very time their revenues dropped precipitously.[55] Cities that opted to skip or make reduced payments created some breathing room in their tight budgets but added to their pension costs down the road.

One gauge of the budget stress posed by pension costs is a city's annual recommended contribution compared with its covered payroll, the annual salaries for current employees in the pension system. For some cities whose pensions were severely underfunded—Chicago; Omaha; Portland, Oregon; and Wilmington—the amount they should have paid in annual pension costs in fiscal year 2009 amounted to more than 30 percent of payroll. For Charleston, it was more than 50 percent of payroll. The opposite was true for a number of well-funded cities. For example, Charlotte, Seattle, Memphis, San Francisco, and Wichita all had a far more manageable annual payment—at or below 10 percent of payroll.

Pension underfunding and higher annual costs can cause significant ripple effects.

Cuts to City Services or Tax Increases

Annual pension or retiree health care payments come out of the same pool of local tax dollars as spending for key services such as education, public safety, sidewalks, and parks. If annual recommended contributions for pensions go up, dollars for other services can be squeezed.

Mayor Alvin Brown of Jacksonville, Florida, called for pension reform in

his July 2012 budget address, noting that annual costs had gone up $46 million between fiscal years 2012 and 2013 to $150 million. "It's double what we are spending on the Children's Commission, our seniors, our parks, and our libraries—combined," the Democratic mayor told the City Council, at the same time he proposed cutting nearly 500 jobs.[56]

Jacksonville's pension funding level was only 63 percent as of 2009. But even cities with well-funded plans felt budget effects when annual payments rose. Los Angeles entered the recession with a 92 percent pension funding level in 2007. Then, its pension investment returns dropped 5 percent in 2008 and 20 percent in 2009, leading to a 25 percent jump in its annual contribution for fiscal year 2011.[57] The city's charter compels it to make its full annual pension payment. The budget strain and other factors resulted in cuts, including the elimination of 2,500 positions through early retirement between March and December 2010, and the layoff of 368 employees.[58] Despite pension reform in March 2011, annual costs still were projected to rise and spurred further efforts to trim benefits for new hires.[59]

Though budget cuts are generally cities' first response, some have turned to tax increases to plug pension holes, often in conjunction with reforms. For example, in the past several years, officials in Omaha; Little Rock; and Springfield, Missouri, overcame opposition to win support of tax increases to fortify their public pension funds. In 2009, Philadelphia's pension funds were just 62 percent funded. The Pennsylvania General Assembly approved a five-year one-cent increase in Philadelphia's sales tax to help the city weather revenue drops in the recession, with the funds designated for local pensions. The state also allowed Philadelphia to reduce its pension payments in 2010 and 2011, but it required the city to make up the missed payments with interest by fiscal year 2014.[60]

The Pennsylvania General Assembly approved a five-year one-cent increase in Philadelphia's sales tax to help the city weather revenue drops in the recession, with the funds designated for local pensions.

Effects on Credit Ratings

Credit ratings by bond agencies such as Fitch Ratings, Moody's Investor Service, and Standard & Poor's (S&P) matter because they can affect how much a locality must pay to borrow money to build roads or schools or even to float

bonds to raise cash for their pension funds. Credit ratings are based on several criteria, one of which is the level of unfunded liabilities for public sector retirement benefits. For example, in September 2012, Moody's downgraded Omaha's bond rating, despite recent pension reforms for police, "primarily based on persistent under-funding of its pension obligations which is not consistent with the expected financial practices of highly rated cities." The report also referred to the city's challenges with labor contracts. For two years, the city has failed to approve a new firefighters' contract containing pension concessions.[61]

Reforms can help push ratings in a positive direction. In its March 2012 report, S&P revised its outlook on Atlanta's general obligation bonds from negative to stable, partially crediting a major pension overhaul a year earlier.[62]

Cost-Shifting to Future Generations

With unfunded pension liabilities, current and future taxpayers get the bill for benefits earned today as well as years or even decades ago. The portion of the annual payment that goes to whittle down a city's unfunded liability can easily dwarf the cost of the current year's retirement benefits, much like a credit card bill in which the monthly charge for debt and interest swamps the amount of recent purchases. In Boston, for example, where pension liabilities were 60 percent funded in fiscal year 2009, three-fourths of its $108 million annual recommended contribution stemmed from its unfunded liabilities.[63] That means the city, through its taxpayers, paid about $26 million for work performed that year and $82 million for services rendered in the past.

Pressure to Cut Benefits

If investment returns fall short, cities faced with rising pension costs either must kick in more money, require employees to contribute more of their pay, or cut costs by reducing benefits. In Providence, for instance, pension systems were only 42 percent funded in fiscal year 2009. The city's combined payment for pension and retiree health care was 51 percent of the total property tax levy.[64] Local officials raised property taxes, but the pension squeeze continued to contribute to a projected

After Providence Mayor Angel Taveras (D) proclaimed the city on the "brink of bankruptcy," the City Council suspended cost-of-living increases for retirees for 10 years and capped pension benefits at 1.5 times the state's median income.

two-year, $180 million budget gap. In February 2012, Providence Mayor Angel Taveras (D) proclaimed the city on the "brink of bankruptcy," and two months later the City Council voted unanimously to suspend cost-of-living increases for retirees for 10 years and to cap pension benefits at 1.5 times the state's median income, among other changes.[65] The city's unionized employees agreed to benefit cuts, which the mayor said would save taxpayers $22.5 million in the first year and preserve the pension system for current and future retirees.[66]

In the worst cases, a small number of retirees have lost benefits, despite legal protections. In Prichard, Alabama, for instance, severe fiscal stresses, coupled with a dramatically underfunded pension plan, resulted in 150 retirees going without any pension payments between September 2009 and June 2011. At that point, retirees began receiving checks about a third of their original size.[67] In April 2012, the Alabama Supreme Court cleared the way for the city to pursue bankruptcy protection.[68] In Rhode Island, after Central Falls filed for bankruptcy in August 2011, pension checks for its 200 retired police, firefighters, and their survivors were cut by 25 percent for five years; recipients face permanent cuts of up to 55 percent afterward.[69]

Loss of Investment Opportunities

Severely underfunded cities often find investment opportunities begin to evaporate. If assets need to be kept liquid in order to write checks to current retirees, then a larger portion of the portfolio needs to be kept in cash or near cash, according to Keith Brainard, research director of the National Association of State Retirement Administrators. "A larger cash allocation is going to produce a drag on investment returns," he says.[70]

What Caused The Problem?

The Great Recession may have exacerbated cities' public sector retirement woes, but in most instances it did not cause them. During the downturn, steep market declines hit local pension investments nearly across the board. But cities that entered the recession better funded and those that consistently funded their plans weathered the storm more effectively.

How cities fared before, during, and after the downturn has depended in large part on three factors: (1) fiscal discipline in making their annual payments; (2) the accuracy of assumptions used in their pension plans; and (3) decisions about workers' benefits.[71]

Fiscal Discipline

To analyze the degree to which fiscal discipline played a role in their pension outcomes, Pew assessed the 61 cities based on their record of paying at least 90 percent of their actuarially recommended contributions between 2007 and 2009.

Nearly six out of 10 cities made at least 90 percent of their recommended payments in 2007, 2008, and 2009. During that time, the overall funding level of their pension plans dropped by four percentage points. In cities that did not consistently keep up their payments, the overall funding level dropped by nine percentage points.

Between 2007 and 2009, 16 cities both kept up their annual pension payments and maintained a funding level above 80 percent. By contrast, nine cities were among the poorest performers leading up to the Great Recession and dug an even deeper hole by consistently shortchanging their systems over those three years, paying an average of 56 percent of what was recommended (see Exhibit 4).

For some cities, chronic underpayments are written into statutes—meaning that cities are following the law but still missing the mark on paying their bills. Chicago, for instance, sets its pension contribution at a steady percentage of payroll for each of its four plans for city employees (excluding teachers). But between 2007 and 2009, that amount was just 43 percent of the annual sum actuaries determined was necessary to achieve full funding within 30 years.[72] The city's overall pension funding

Three factors influenced how cities fared before, during, and after the downturn: (1) fiscal discipline in making their annual payments; (2) the accuracy of assumptions used in their pension plans; and (3) decisions about workers' benefits.

level was 52 percent in fiscal year 2009 and 47 percent a year later.

Similarly, states such as Connecticut, New Jersey, and Pennsylvania gave permission to cities to bypass or reduce pension contributions during the economic downturn. In 2000, Bridgeport, Connecticut, issued $350 million in pension bonds, agreeing to maintain at least a 79 percent funding level in a public safety plan that was closed to new employees in January 1984 and that has more liabilities than any of the city's other four pension plans. But in 2009, state lawmakers allowed the city to limit contributions to that plan. By 2010, its funding level had fallen to 57 percent.[73]

In other cities, the law requires stricter fiscal discipline. Milwaukee, Los Angeles, and San Francisco boasted well-funded pension systems, and each has a long-standing requirement to fully cover its actuarially recommended contribution each year.

Some cities resort to borrowing to shore up their pension funds, aiming to take advantage of low bond rates. El Paso, Texas, increased its funding level from 81 percent to 84 percent with $211 million in bonds sold in June 2007 and May 2009 that went into its underfunded police and fire pensions.[74] However, borrowing to close a funding gap—typically by issuing a taxable bond at a low interest rate to invest in pension funds with a higher projected rate of return—does not always pay off.[75]

Accuracy of Assumptions

Investment returns

The two recessions of the past 12 years have raised major questions about the ability of governments at all levels to achieve the investment returns that pension plans assume they will get. Public pension systems rely on investment earnings to pay more than two-thirds of retirees' benefits.[76] In fiscal year 2009, the most common investment return assumption in the 61 cities was 8 percent.[77] States had similar expectations.

However, public pension funds suffered significant losses during the downturn. For fiscal years ending June 30, pension investments saw a median drop of 5 percent in 2008 and 18 percent in 2009, followed by median gains of nearly 13 percent in 2010, 22 percent in 2011, and 1 percent in

2012.[78] The median annualized return over the 10 years through June 30, 2012, was 6.3 percent.[79]

If a pension fund's investment return falls 4 percent short of its 8 percent assumption, it cannot simply make up that amount with a 12 percent return the next year. Every year that a pension system's investments come in under the actuarial assumption, the fund has to make up that amount plus the assumed earnings on the lost amount.

Some cities and states are beginning to lower their assumptions, and external pressures to do so are beginning to build. New rules from the Governmental Accounting Standards Board that will take effect starting in June 2014 will require lower assumptions for the portion of public pension liabilities not backed by assets. The change may significantly increase projections of what some cities owe.[80] Moody's also has proposed to use a lower so-called discount rate on unfunded pension liabilities when it evaluates cities' creditworthiness. A decrease in the discount rate has a major effect. The New York City actuary has recommended lowering the assumed rate of return for the city's five pension funds from 8 percent to 7 percent, adding at least $1.8 billion to the city's annual pension bill.[81]

Although pension plan investments began to gain value again following the recession, funding levels in many cities continued to decline in 2010 and 2011.[82] This is because most funds average out investment returns over multiple years in a process called "smoothing." Though this approach softens the impact of a bad year in financial accounts, it means the losses in one year continue to affect a city for years to come.

The two recessions of the past 12 years have raised major questions about the ability of public pension plans to achieve their assumed investment returns.

Idaho's largest city, Boise, is part of a cost-sharing pension system that does not smooth. As a result, the system took the full hit of the investment losses in 2008 and 2009 all at once: In 2009, its funding level plunged to 74 percent from 105 percent in 2007. But unlike many other pension systems, it then showed immediate gains—up to nearly 79 percent in fiscal year 2010 and about 90 percent in fiscal year 2011.[83]

Other assumptions

Many assumptions go into calculating how much a public employee ultimately will collect in pension checks over a lifetime. If any are incorrect, then even an employer making the full, actuarially recommended payments may come up short. For example, if the assumption about salary increases is too low, then the sum set aside

to cover benefits earned each year will be too low as well, leading to a shortfall.

In a 2010 report, San Jose's auditor described how faulty demographic and economic assumptions helped raise unfunded liabilities between fiscal years 2007 and 2009. This included underfunding of almost $170 million because of earlier-than-projected retirements and other factors. Once the assumptions were updated, liabilities rose by $145 million for police and fire plans and $229 million for general employees.[84] Rising pension costs led San Jose voters to pass substantial pension reforms in June 2012.

Decisions About Workers' Benefits

Unfunded benefit increases

Cities differ in the generosity of their retirement benefits. However, Pew's analysis suggests the generosity of benefits does not explain why some cities' pensions systems were better funded than others.[85] Instead, what was more important was whether cities increased their retirement benefits but failed to set aside enough money to cover them. Although big benefit increases have been relatively rare in recent years, a number of the 61 cities in this analysis boosted employee pensions during the past two decades or bolstered their retiree health offerings—sometimes without calculating the potential long-term impact on their budgets.

> "The problem is that more than a decade ago, bad decision making led to a $2 billion shortfall that no amount of prospective plan design is going to eliminate," says Mark Hovey, chief executive officer of the San Diego City Employees' Retirement System.

For instance, San Diego raised benefits in 1996 and again in 2002 while ignoring their future price tag. At the same time, it ratcheted down its contributions. This added nearly $154 million in benefit costs, of which about $82 million was necessary to cover the retroactive implications of the change.[86] The city later took cost-cutting measures, including cutting benefits for new hires and ending the city's practice of paying some of employees' share of contributions. But continuing pension challenges ultimately led then-Mayor Jerry Sanders (R) to champion more reforms in a ballot initiative overwhelmingly approved by voters in June 2012. One of the most significant changes puts new hires, except for police, into defined contribution plans instead of traditional pensions.

"Even before the June 2012 ballot initiative was passed, San Diego had largely fixed its defined benefit problem for newly hired employees. The problem

is that more than a decade ago, bad decision making led to a $2 billion shortfall that no amount of prospective plan design is going to eliminate," says Mark Hovey, chief executive officer of the San Diego City Employees' Retirement System.[87]

Pension "spiking"

A number of cities have allowed workers to include overtime, unused sick leave, or unused vacation time to boost or "spike" final average salary—a figure generally used to establish the level of benefits. Late-career promotions also can increase salaries just months before retirement. The shorter the periods used to determine final salary, the easier it is to bump it beyond normal levels. More cities are tightening how final salaries are calculated because they can have a surprisingly large effect on the size of the pension.

Joe Estep, Charleston's finance director, tells the story of a 50-year-old police lieutenant who retired in 2009 after 24 years of service. In his final three years, the lieutenant earned enough overtime to raise his salary from a base of $49,000 to a three-year average of $78,000. The extra earnings boosted his pension from $33,000 to $53,000 a year. Given his age and life expectancy, the overtime could increase his lifetime benefit payment by $574,000. The city has since taken steps to reduce overtime.[88]

Moving Forward: Reforms

Cities began to reform their public sector retirement systems before 2007, but changes have accelerated rapidly in the wake of the Great Recession. Many of the 61 cities in this analysis—even those with relatively well-funded systems—have made adjustments to address funding shortfalls or unsustainable growth in costs for pensions or retiree health care.

A clear sign of the times were the pension reform ballot measures that residents of San Diego and San Jose passed by wide margins in June 2012.[89] Both cities already had made some changes in the past couple of years, but soaring pension payments were squeezing budgets and competing with services.

In San Diego, 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 with lifetime pension checks. Current employees also are affected; the final salary used to calculate their pensions will be frozen for six years, unless two-thirds of the City Council votes to lift the freeze.[90] In San Jose, employees hired after October 2012, except for police and firefighters, now must pay half the cost of their pensions, and any future benefit increases must be approved by voters. Pending the outcome of legal challenges, current workers will have to choose between increasing their own contributions to their retirement plan and opting for a less generous plan.[91]

Changes to plans for new employees are most common. For instance, a number of Texas cities, including Austin, Dallas, El Paso, and Fort Worth, recently reduced benefits for new workers. New police and firefighters in Dallas ultimately will receive pensions that are as much as 30 percent less than pensions for employees hired before March 1, 2011.[92] But current employees and retirees also have seen their contributions increased, benefits trimmed, or cost-of-living adjustments reduced, often spurring legal challenges that test the extent of pension protections under laws or labor contracts.

At times, labor unions and city officials have come to terms on changes. In Providence, the City Council approved its significant pension reforms in April 2012,

then city officials negotiated a settlement with labor unions to keep the changes from getting tied up in court challenges.[93] In Omaha, on top of its new restaurant tax to raise money for its pension funds, officials in 2010 negotiated a new contract with police that increased employee contributions, removed overtime pay from pension calculations, and required more years of service before retirement for current and future police. Richard O'Gara, the city's human resources manager, hailed the agreement as "the first concessions by any union [in Omaha] in over 30 years."[94] However, the city's contract with firefighters got hung up in a political impasse, postponing pension savings. Moody's cited Omaha's difficulty in modifying labor contracts as one reason for downgrading its credit rating in September 2012.[95]

States also are adopting reforms that affect cities. According to the National Conference of State Legislatures, 43 states enacted significant revisions to pension systems from 2009 through 2011.[96] Many of these reforms affect cities, particularly because many local plans are part of multi-employer systems administered by states. For example, state lawmakers in New York in March 2012 approved changes for newly hired state and local employees, including most New York City workers, that increased the retirement age, lowered the multiplier used to determine benefit amounts, extended the number of years in calculations of final average salary, and required higher contributions from employees.[97]

Reforms for both pensions and retiree health fall into four categories: (1) plan design; (2) funding; (3) benefits; and (4) organization and management.

In general, reforms for both pensions and retiree health fall into four categories: (1) plan design; (2) funding; (3) benefits; and (4) organization and management.

Plan Design

Most cities have traditional defined benefit systems, in which employers guarantee retirees a regular, pre-set amount of income, no matter what shape a pension fund's investments are in at the time. But a growing number of cities are exploring alternatives that shift more of the risk of lower investment returns from government to employees.

Defined contribution plans. One of the most controversial changes involves moving employees from a defined benefit pension plan to a defined contribution system. Instead of guaranteeing benefits, government employers guarantee to make contributions each year that are invested along with the employees'

own contributions. Some plans, such as the Michigan Municipal Employees' Retirement System, offer defined contribution plans as an alternative.[98] Others, such as Anchorage's, mandate them for employees hired after a certain date. In Anchorage's system, employees contribute 8 percent of salary annually, the city contributes 5 percent, and the total is put into a plan similar to a 401(k) in which the employee controls the investments.[99]

As long ago as 1981 in Little Rock and 1987 in Washington, D.C., all new non-uniformed city employees were enrolled in defined contribution plans. Police and fire personnel (as well as teachers in Washington, D.C.) continued to receive defined benefits.[100]

Hybrid plans. Some cities and states have shown interest in a hybrid approach, which enrolls employees in both a defined benefit and a defined contribution plan. A good example is Atlanta, which created a hybrid plan in June 2011. Under the plan, newly hired employees will retire with a reduced traditional pension, plus money they and their employer have contributed over the years into a 401(k)-style investment fund. Existing employees were allowed to switch to the new hybrid or keep their defined benefit plan as long as they contributed 5 percent more of their pay to finance it.[101] Utah and Virginia have embraced the hybrid concept for newly hired city workers in the state retirement system, and Philadelphia Mayor Michael Nutter (D) has introduced a hybrid option for certain new employees.[102]

In Atlanta's hybrid plan, newly hired employees will retire with a reduced traditional pension, plus money they and their employer have contributed over the years into a 401(k)-style investment fund.

Cash balance plans. Less well-known is a variation of defined benefit plans that guarantees an annual rate of return on an employee's pension account, rather than promising a set pension income. In a cash balance plan, employees can convert the money in their account at retirement into an annuity with regular payouts for life. San Antonio is one of 847 localities in Texas, along with College Station, Lubbock, and Waco, that participate in a cash balance plan for employees, excluding police and firefighters, through the Texas Municipal Retirement System. Employees contribute 6 percent of their salary annually, the city contributes 12.6 percent, and employee accounts are guaranteed an annual return rate of 5 percent.[103] Outside of Texas, Nebraska has offered a cash balance benefit to employees since 2003, and Kansas and Louisiana

voted in 2012 to begin offering such plans to new employees.

Health care package redesign. A number of cities are trying different approaches to reduce the cost of their retiree health benefits. In August 2011, for example, the City Council of Jersey City voted to shift retirees to a new health plan that caps payments to medical providers, unless retirees opt to pay the difference in premium costs to stay with their current health plan.[104] Baltimore has made a number of changes to both its employee and retiree health care, encouraging the use of generic and lower-cost drugs and monitoring prescription use.[105]

Some cities, such as Providence, are ensuring that federally subsidized Medicare—and not the city health plan—is the primary coverage for retirees 65 and older.[106] Memphis belatedly is buying Medicare coverage for nearly 600 employees who had not paid into the program and who also must now help pay for the coverage. The Medicare "buy-back" strategy was projected to eliminate $3.1 million in annual claims and shave $100 million off a long-term $1.2 billion retiree health bill.[107]

Funding

Strengthening revenues. A fundamental rule for keeping retirement systems in good shape is to fund them adequately every year, paying for benefits as they are earned. As described earlier, sometimes that has meant higher taxes or new revenue streams.

In September 2011, Little Rock voters approved a one-cent sales tax increase to help improve the city's pension funding.[108] City officials made a case that the existing half-cent sales tax had been in place for 17 years and that, without an increase, they would have to lay off public safety workers to close an $8 million budget shortfall. In Connecticut, Bridgeport's City Council in June 2012 increased property taxes $224 for the median homeowner—only half as much as the mayor had requested—to raise an additional $5 million for education and to cover rising retirement obligations.[109]

In September 2011, Little Rock voters approved a one-cent sales tax increase to help improve the city's pension funding.

Raising taxes to finance retirement benefits can be a tough sell, particularly in hard economic times. It took city leaders of Springfield, Missouri, two tries before voters approved a three-quarter-cent increase in the local sales tax in 2009 to help close a $200 million gap in the public safety pension fund.

A selling point the second time was lowering the increase from one cent to three-fourths of a cent and promising voters the hike would come up for renewal after five years.[110]

Increasing employee contributions. Among local governments, the most common reform recently has been to ask both new and current employees to pay more for their own retirement benefits, according to a 2012 survey of human resources executives.[111] Often this is a key item to be negotiated with unions. For instance, in March 2011, Los Angeles reached a collective bargaining agreement for 19,000 existing employees to increase their contributions from 6 percent of salary to 11 percent.[112] The same month, voters approved a ballot measure requiring that newly hired police and firefighters begin contributing 2 percent of their salaries toward their retiree health care.[113]

Increasing city contributions. For some cities, the amount they contribute each year to pay for retirement benefits is set in statute as a percentage of their payroll. When that amount is too low to cover the actual costs, their unfunded liabilities can grow. That has been the case in Austin, where the pension plans had an aggregate funding level of 75 percent in fiscal year 2009. The City Council is gradually increasing its annual contribution to 18 percent of payroll, enough to match the amount its actuaries recommend.[114]

Pre-funding retiree health care. As described above, the majority of cities—as well as states—still are paying their retiree health bills on a pay-as-you-go basis. This means that the health costs of current retirees are paid out of the current budget. Because both medical costs and the number of retirees are rising, that bill will grow for years to come. Cities that choose to pre-fund their retiree health care costs, as nearly all do for pensions, will make higher annual payments to start with but will earn investment returns that will build up a nest egg to help pay the bills. San Jose is an example of a city that is now pre-funding its retiree health and other non-pension retiree benefits.[115] In 2011, it paid only about a third of its annual recommended contribution, but under an agreement with its unions, its contributions are to rise to 100 percent in 2015 for police and general employees and in 2017 for fire employees.[116]

Benefits

Changing the rules for cost-of-living increases. Cost-of-living increases are designed to keep inflation from eroding a retiree's pension income, but they can drive up a city's liabilities substantially.[117] The problem is that increases sometimes exceed inflation and often are awarded regardless of the financial health of the plan or annual investment returns.

A 10-year freeze on annual cost-of-living hikes for retirees is among reforms

A 10-year freeze on annual cost-of-living hikes for retirees is among reforms proposed by Chicago Mayor Rahm Emanuel (D).

proposed by Chicago Mayor Rahm Emanuel (D). The plan, which requires legislative approval, also would end the compounding of cost-of-living increases.[118] In testimony before state lawmakers in May 2012, Emanuel noted that with compounding, a city retiree who made $60,000 in 1995 and received a 3 percent increase each year—applied to both his pension and previous automatic increases—would receive a $100,000 annual pension in 2011.[119] Illinois lawmakers failed to approve local pension reform in their 2012 session.[120]

Changing the retirement age or vesting period. Exactly when an employee becomes eligible for retirement benefits is one factor that drives costs and is a focus of cost-cutting for many cities. In March 2012, the New York legislature raised the age at which new hires can retire with full benefits from 62 to 63 for employees of New York City or the state (except public safety personnel) and from 57 to 63 for teachers.[121] In Denver, the City Council shifted the retirement age for employees hired after July 1, 2011, from 55 with full benefits after 20 years to 60 after 25 or more years of service.[122]

A number of cities also have adjusted the eligibility for retiree health benefits. San Francisco, for instance, used to grant full retiree health benefits to employees after just five years. Even if workers left the city's employment, they could receive lifetime medical benefits once they reached age 55. That rule changed in 2009 after citizens voted to require new employees to work 20 years before qualifying for full retiree health benefits.[123]

Reducing or eliminating retiree health benefits. More local governments are asking retirees to pay an increasing share of their health care costs, and some are dropping retiree health benefits.[124] For example, Charlotte stopped providing retiree health coverage for employees hired after July 1, 2009.[125] San Diego stopped offering retiree health insurance to anyone hired after July 1, 2005, and in 2011 struck a deal with labor unions to cap benefits for those hired before 2005.[126] Some cities, including Cheyenne, Denver, and Sioux Falls, have opted for monthly stipends to help retirees pay for health insurance, limiting the city's exposure to unpredictable rises in medical costs.[127]

Closing loopholes that permit pension spiking. A key element of the formula that sets the amount of a monthly pension check is the employee's final average salary. Rules differ greatly on whether overtime, sick leave, or other temporary means of increasing pay can be counted, and on how far back the plan looks to calculate

final salary. Media attention and public scrutiny of extreme examples of pension spiking have pushed interest in reforming final salary calculations. Generally, when more years of salary are averaged together, the figure is less subject to manipulation. Chicago and downstate Illinois police and firefighters were issued pension checks based on their final day's salary until the legislature ended the practice in 2010. A new approach for those hired after January 1, 2011, takes an average of the eight highest consecutive years from the 10 years before retirement.[128] In November 2011, the New Orleans City Council expanded the years of salary that go into pension calculations, from an average of 36 months currently, to 48 months in 2014, and 60 months in 2015.[129]

Organization and Management

Shifting funding to the state. In at least one case, a state has stepped in to relieve a city of a troubled pension system. Police and firefighters' funds that were closed to new hires in 1977 had long been a headache for Indianapolis. As of fiscal year 2008, the two plans had $862 million in unfunded liabilities and no assets. Indianapolis was paying pension checks for retired firefighters and police directly from city revenues for half of the bill, while the state covered the other half. In 2008, as part of statewide tax reform, Indiana lawmakers built in some relief for localities that would lose revenue under a new property tax cap and took over full funding for Indianapolis' lowest-funded plans and those in other cities.[130] As a result, Indianapolis' overall pension funding level went from 57 percent in 2008 to 94 percent in 2009.

Joining a multi-employer system. Some cities have decided in recent years to stop managing their own pension system and shift to one with multiple local employers that is run by the state or another state-level administrator. Minneapolis consolidated three of its closed pension funds into a state-administered system in 2010 and 2011.[131] In Delaware, Wilmington also moved its general employees hired after July 1, 2011, to a state-run plan, as it had done for police and fire personnel in 1991. City Treasurer Henry Supinski says he expects the state plan to reduce expenses and ease the city's administrative burden.[132]

Changing pension board makeup. In some cities, concerns have been raised that pension board members, who have a great deal of authority over local retirement plans, do not have sufficient financial expertise or impartiality. Voters in Portland, Oregon, in 2006 revamped the police and fire retirement fund board, then dominated by public safety officers, amid worries it was approving overly generous disability payments.[133] A seven-year-long public pension crisis in San Diego was triggered, in part, by

the pension board, which consisted of city employees who voted to increase retirement benefits for themselves and co-workers. The board did not provide enough money to finance the increases, contributing to a $2 billion city budget deficit. Six trustees were charged with felony conflict-of-interest violations, though the charges were thrown out. In the wake of the scandal, voters in 2004 changed the city charter to restructure the board, require board members to have a background in finance, and shorten their terms.[134]

Increasing oversight and transparency. Some states assumed responsibility for overseeing state and local retirement systems many decades ago.[135] Today, more states are following suit. The West Virginia legislature established a board in 2009 to monitor and improve the performance of local police and fire pension funds. It has taken steps to provide training and expertise to local boards, increase the frequency of their actuarial evaluations, and make their reports comparable across the state by standardizing actuarial assumptions and appointing a single actuary to assist them.[136] Rhode Island in 2012 set up a public pension study commission, run by the state Department of Revenue, to focus on local governments that run their own plans. Twenty-four of those 36 locally administered plans were rated "at risk" in September 2011 because of low funding levels or declining annual contributions.[137]

The West Virginia legislature established a board in 2009 to monitor and improve the performance of local police and fire pension funds.

Conclusion

For a number of America's largest cities, the bill for public sector retirement benefits already threatens strained budgets. And more pressures are on the horizon as unpaid pension bills in a variety of sizes, as well as retiree health costs, continue to accumulate.

While the Great Recession exposed serious vulnerabilities in some cities' retirement systems, it also has spurred policy makers across the country to consider reforms. The fixes are not necessarily simple, either fiscally or politically. But a growing number of cities are making meaningful changes to put their pension and retiree health care plans—and city budgets—on more solid financial footing.

61 CITIES BY POPULATION: 2010

Cities featured in this report were the largest in each state, plus all others over 500,000 in population.

Rank	City	Population	Rank	City	Population
1	New York, NY	8,186,443	31	Oklahoma City, OK	582,352
2	Los Angeles, CA	3,795,761	32	Albuquerque, NM	547,392
3	Chicago, IL	2,698,283	33	Tucson, AZ	521,180
4	Houston, TX	2,108,278	37	Kansas City, MO	460,724
5	Philadelphia, PA	1,528,074	39	Virginia Beach, VA	439,122
6	Phoenix, AZ	1,448,531	40	Atlanta, GA	422,387
7	San Antonio, TX	1,334,431	42	Omaha, NE	410,170
8	San Diego, CA	1,311,516	48	Minneapolis, MN	383,108
9	Dallas, TX	1,201,715	49	Wichita, KS	383,085
10	San Jose, CA	955,091	52	New Orleans, LA	347,907
11	Jacksonville, FL	822,883	53	Honolulu, HI	338,119
12	Indianapolis, IN	821,708	64	Anchorage, AK	293,356
13	San Francisco, CA	805,340	75	Jersey City, NJ*	247,876
14	Austin, TX	795,378	97	Birmingham, AL	212,225
15	Columbus, OH	788,696	102	Boise, ID	206,252
16	Fort Worth, TX	745,231	104	Des Moines, IA	204,191
17	Charlotte, NC	734,216	118	Little Rock, AR	193,944
18	Detroit, MI	711,700	124	Salt Lake City, UT	187,082
19	El Paso, TX	651,881	130	Providence, RI	178,077
20	Memphis, TN	647,780	135	Jackson, MS	173,707
21	Baltimore, MD	620,560	152	Sioux Falls, SD	154,443
22	Boston, MA	618,147	167	Bridgeport, CT	144,463
23	Seattle, WA	610,480	191	Columbia, SC	129,612
24	Washington, DC	604,912	239	Manchester, NH	109,634
25	Denver, CO	603,440	254	Fargo, ND	105,884
26	Nashville, TN	602,537	262	Billings, MT	104,505
27	Louisville, KY	598,207	456	Wilmington, DE	70,920
28	Milwaukee, WI	595,407	498	Portland, ME	66,125
29	Portland, OR	585,474	570	Cheyenne, WY	59,739
30	Las Vegas, NV	584,539	692	Charleston, WV	51,351
			unranked	Burlington, VT	42,417

* Pension data for New Jersey's largest city, Newark, were unavailable, so Jersey City was substituted in this report.

NOTE: This 61-city sample accounts for about 15 percent of the U.S. population. It includes the 33 most populous cities, encompassing six cities in Texas, four in California, two in Arizona, and two in Tennessee.

SOURCE: U.S. Census Bureau.

Appendix B: Methodology

For this report, Pew examined the funding status of public sector retirement plans in 61 cities—the most populous one in each state plus all others with more than 500,000 people as of the 2010 census. One exception was made. Data for Newark, New Jersey, were not readily available so Jersey City was substituted. Included in our data set are the 33 largest cities in the United States. This research represents the most comprehensive examination to date of funding for city pension and retiree health care plans.

Researchers examined the retirement plans listed in each city's Comprehensive Annual Financial Report (CAFR). Principally from these documents, we collected the actuarial value of assets and liabilities for defined benefit pension plans and Other Post-Employment Benefits for fiscal years 2007, 2008, 2009, and 2010. Retirement plans' own actuarial valuations and financial reports were other key sources. Besides double-checking these numbers internally, Pew researchers also offered government officials who prepared each city's CAFR the opportunity to review and update our data. Twenty-six cities responded.

While we present cities' own numbers for most plans, some that participate in cost-sharing multiple-employer plans do not release their share of total liabilities. In those instances, we estimated the city's pension obligations based on the proportion of total annual contributions to the plan that were paid by the city. This approach recently has been adopted by the Governmental Accounting Standards Board (GASB) and will be mandatory for city financial reports beginning in 2014. In limited instances, if contribution information was unavailable, researchers used the city's share of overall payroll in a multi-employer plan to determine the financial obligations.

Pew collected data for 193 defined benefit pension plans and 100 plans that cover Other Post-Employment Benefits, which primarily account for retiree health care costs. This analysis summed each year's assets and liabilities for all plans for which a city was responsible, then divided assets by liabilities to present an aggregate annual funding level for pensions and for retiree health care for each city.

We collected data from the most recent CAFR issued as of at least March 2012,

when we began a final round of data collection. More recent data also were included when supplied by city officials. Because of lags in financial reporting, fiscal year 2009 was the most recent year with complete data for all retirement plans in all 61 cities. Pew was able to obtain fiscal year 2010 data for all pension plans in 40 cities. Pension data, particularly for smaller plans, often are not as current as other information in a city CAFR. Moreover, Pew classified cities' data based on the period ended at the time of the valuation date. A pension valuation dated January 1, 2011, would be counted as fiscal year 2010 data to reflect performance for the just-completed year.

When reporting data, Pew used the city's own actuarial assumptions. These assumptions include the expected rate of return on investments and estimates of employee life spans, retirement ages, salary growth, marriage rates, retention rates, and other demographic characteristics. Cities also use one of a number of approved actuarial cost methods and also may smooth gains and losses over time to manage volatility. Because of these variances, cities' funding levels may not be directly comparable. Still, these data are the best estimates available and provide a baseline of the long-term fiscal challenges cities face in keeping their pension and retiree health promises.

To assess how city pension plans fared over the Great Recession, which started in December 2007 and officially ended in June 2009, Pew researchers looked at funding levels for 2007 and beyond, and also at cities' performance in making their annual pension payments. For each year, we assessed whether a city had enough assets to offset at least 80 percent of its pension liabilities and paid at least 90 percent of its annual recommended contribution. By focusing on these two key indicators, we could assess how well cities' retirement funding weathered the financial crisis of 2008 and the state and local fiscal crisis that followed.

An 80 percent benchmark provides a useful yardstick to compare pension funding levels, but there is debate about its proper use because funding levels ideally should be 100 percent. Still, funding below 80 percent is widely recognized as inadequate. The Pension Protection Act of 2006, a federal law that pertains to private sector pension funds, uses an 80 percent benchmark to determine when stricter funding rules apply. Some credit rating agencies also use 80 percent to evaluate state and local governments' pension funding.

This analysis presents long-term liabilities for both pensions and retiree health care. These types of retirement benefits have some key differences: (1) Pension benefits have greater legal protections, while some cities may choose to drop most or all of their retiree health promises; (2) While some cities have made substantial

retiree health care promises, others offer minimal benefits that might not require pre-funding; (3) Pension funding levels are vulnerable to stock market swings, while retiree health costs are likely to face bigger impacts from future trends in medical inflation. Despite these differences, similarities between these two obligations suggest that it makes sense to look at them together—a practice followed by credit rating agencies and the GASB. Both types of benefits are promises to workers that impose a fiscal cost to the employer (the government and its taxpayers) that can be estimated with a reasonable degree of accuracy.

These data, of course, were based on policies and assumptions at the time of the valuation and are subject to change depending on such factors as reforms, which can reduce the size of future liabilities; investment returns; and the accuracy of assumptions, such as for employees' longevity or medical expenses. While the data do not reflect reforms or other changes adopted since 2009 or 2010, Pew researchers have noted examples of reforms in particular cities.

Endnotes

1 This report is the broadest look to date specifically at cities' retirement liabilities, though it covers a subset of all cities. By comparison, the 50 states faced a gap between assets and liabilities of $1.26 trillion for fiscal year 2009: $660 billion for pensions and $604 billion for retiree health benefits, according to the Pew Center on the States report "The Widening Gap: The Great Recession's Impact on State Pension and Retiree Health Care Costs," (April 2011), http://www.pewstates.org/uploadedFiles/PCS_Assets/2011/Pew_pensions_retiree_benefits.pdf. The gap grew to $1.38 trillion in fiscal year 2010: $757 billion for pensions and $627 billion for retiree health care, according to Pew's, "The Widening Gap Update," (June 2012), http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Pensions_Update.pdf.

2 States' pension funds were 78 percent funded in fiscal year 2009 and 75 percent funded in fiscal year 2010, according to Pew's "The Widening Gap" and "The Widening Gap Update" reports.

3 Complete pension data for fiscal year 2010 were available only for 40 of the 61 cities. Pew used the most recent comprehensive annual financial reports available for cities during a final data collection period that began in March 2012 and lasted for several weeks. Even among cities that had issued their financial reports for fiscal year 2011, some reports lacked up-to-date data for one or more of their workers' pension plans. Pension data often are not as current as other financial information. Moreover, according to Pew's methodology, even pension valuations dated January 1, 2011, for example, would be counted as fiscal year 2010 data to reflect performance for the just-completed fiscal year.

4 This report uses "retiree health care" when referring to Other Post-Employment Benefits, a category that includes other non-pension benefits but in which costs are primarily from retiree health care.

5 Pew Center on the States, "The Widening Gap," 5.

6 The funding level for Washington, D.C., represents only liabilities accrued since 1997 in defined benefit pension plans for firefighters, police, and teachers. The federal government in 1997 took over financial responsibility for benefits accrued by those workers up to then, as well as retirement benefits for judges, relieving the city of $4.9 billion in unfunded liabilities that it had inherited from the federal government. The city also contributes to a defined benefit plan (for 2,700 general municipal workers hired before 1987) that is managed by the federal Civil Service Retirement System, but an estimate of the city's share of those liabilities could not be obtained. This study does not include the costs of pension benefits for general municipal employees hired since October 1987. They are not in a defined benefit pension plan but instead receive benefits through a defined contribution system in which the city deposits money each year into a retirement account for each employee. See Government of the District of Columbia, "Comprehensive Annual Financial Report 2011," (September 30, 2011), 111–117, http://www.cfo.washingtondc.gov/cfo/frames.asp?doc=/cfo/lib/cfo/cafr/2011/cafr_2011.pdf.

7 In fiscal year 2010, New York State's funding level dropped to 94 percent, fifth-highest among states. And by fiscal year 2010, Illinois' funding level had dropped to 45 percent, according to Pew Center on the States, "The Widening Gap Update."

8 Both Charleston and Portland, Oregon, can blame extremely low savings in police and fire pension plans for the city's low overall funding level. Charleston faced a shortfall of $193 million in its police and firefighters' pension funds, which were only 11 percent and 6 percent funded, respectively, in fiscal year 2009. Meanwhile, its larger general employees' fund was 80 percent funded, with a shortfall of $12 million.

Portland, Oregon, had virtually no assets to offset unfunded liabilities of $2.3 billion in fiscal year 2009 in its pension and disability plan for police and firefighters hired before 2007. Meanwhile, the plan covering the rest of Portland's employees was estimated at 86 percent funded, with unfunded liabilities of $453 million. Portland funds the retirement costs of police and firefighters hired before 2007 on a pay-as-you-go basis, meaning the city relies on property taxes each year to pay benefits and does not attempt to set aside money for the future to meet those liabilities

9 More than one-fourth of state and local government employees do not pay Social Security taxes and are ineligible for Social Security benefits based on their government earnings, according to the U.S. Government Accountability Office report "State and Local Government Pension Plans," (March 2012), 5, http://www.gao.gov/assets/590/589043.pdf.

10 According to U.S. Census data analyzed by the Center for Retirement Research, pension contributions represented roughly 3 percent to 5 percent of local government budgets from 1957 to 2008. However, pension costs vary widely by locality. A 2010 study by the center found pensions costs that constituted as much as 15 percent to 20 percent of the budget in certain localities. Center for Retirement Research, "The Impact of Public Pensions on State and Local Budgets," (2010), http://crr.bc.edu/wp-content/uploads/2010/10/slp_13-508.pdf; Center for Retirement Research, "An Update on Locally-Administered Pension Plans," (2011), http://crr.bc.edu/wp-content/uploads/2011/07/SLP18-508.pdf.

11 About 36 percent of local government spending goes to employee compensation, compared with 13 percent for states, according to data from U.S. Census Bureau, "State and Local Government Finances Summary: 2009," (2009), http://www2.census.gov/govs/estimate/09_summary_report.pdf. Pew's calculation for pension contributions as a share of revenue was based on data from U.S. Census Bureau, "2009 Annual Survey of State & Local Public-Employee Retirement Systems," (2009), http://www.census.gov/govs/retire/historical_data_2009.html; and tax revenue data from U.S. Census Bureau, "2009 Annual Survey of State Government Finances," (2009), http://www.census.gov/govs/state/historical_data_2009.html. Pension contributions to both state and local retirement plans were divided by total tax revenue for each level of government.

12 Following an infusion of $1.4 billion in borrowed money from pension obligation certificates in 2005, the funding level in Detroit's General Retirement System increased from 73 percent in 2004 to 96 percent in 2005, and its Police and Fire Retirement System's funding went from 80 percent in 2004 to 99 percent in 2005. The city's pension plans remain well funded, but Detroit overall faces severe financial stress that has resulted in state oversight to help keep the city from insolvency. All three major credit rating agencies have placed the city's outstanding debt at "junk" status or highly speculative. The city still is paying off its pension bonds.

13 In addition to the largest city in each state, the sample includes all cities with more than 500,000 residents, according to the 2010 census. It encompasses the 33 most populous cities in the United States, including six cities in Texas, four in California, two in Arizona, and two in Tennessee. One exception was made: Pension data for New Jersey's largest city, Newark, were unavailable, so Jersey City was substituted. The study relied on the U.S. Census Bureau for population figures for cities, defined as incorporated places established to provide government services to a concentration of people. This category is distinct from metropolitan areas, which typically include cities as well as adjacent communities and which may include one or more counties that perform many of the same services as cities.

14 Municipal employment data are from U.S. Census Bureau, "Annual Survey of Public Employment and Payroll," (2009), http://www.census.gov/govs/apes/historical_data_2009.html. If census data were not available, Pew used employment numbers from an individual city's fiscal year 2009 budget or Comprehensive Annual Financial Report. In some cases, total employment numbers were estimated using data on full-time equivalent employees.

15 By contrast to the "Public Fund Survey," which is maintained by the National Association of State Retirement Administrators and examines 126 large state and local plans, the Pew study looked at all pension plans in each city. This includes plans that have been closed to new employees and some very small plans that also are not included in census information. The most recent complete set of data, as of a data collection cutoff of March 2012, was for fiscal year 2009.

16 Though small closed plans may not represent a substantial number of employees or total liabilities, they can be a significant drain to a city's coffers. For example, the old firefighters fund in New Orleans, which had 658 retired members in 2009—all hired prior to January 1, 1968—had a $155 million unfunded liability in 2009, one-fifth of the city's total unfunded liability.

17 While the target funding level for a pension plan should be 100 percent, funding below 80 percent of actuarial accrued liability is widely recognized as inadequate. An 80 percent benchmark is used by the Pension Protection Act of 2006, a federal law that pertains to private sector pension funds, to determine when stricter funding rules apply. In the context of public sector pensions, 80 percent provides a useful dividing line for comparing pension systems. But there is debate about what funding level short of 100 percent signifies a healthy plan. For a discussion of this issue, see American Academy of Actuaries, "Issue Brief," (July 2012), http://actuary.org/files/80%25_Funding_IB_FINAL071912.pdf; or an explanation by pension experts Keith Brainard and Paul Zorn, (January 2012), http://www.wikipension.com/images/0/0a/80_percent_funding_threshold.pdf.

18 The annual recommended contribution (ARC) is the amount of money actuaries deem necessary to fund the benefits earned by active employees in any given year (dubbed the "normal cost") in addition to money to pay down any unfunded liabilities. (The size of the payment also depends on a variety of other factors, such as benefits offered, contributions expected from employees, and the amount of time the city has chosen to achieve full funding.) Accounting standards currently establish the time for an unfunded liability to be paid down as no greater than 30 years, but some entities choose a different period. While some cities must make the total annual contribution because of law or pension system requirements, for others the contribution often is not a *required* amount but a *suggested* amount, leaving cities free to underfund their benefits, thus raising the annual payment in subsequent years. To calculate the ARC, actuaries rely on assumptions for a number of future variables—the investment rate of return, inflation, and retiree life span, for example.

19 According to Pew calculations, the funding level of the 35 cities that consistently paid at least 90 percent of their annual recommended contribution declined four percentage points between 2007 and 2009. The funding level for the remaining cities fell nine percentage points.

20 Portland, Oregon, voters in 2006 decided to stop new police and firefighters from enrolling in a pay-as-you-go pension plan funded by property taxes that in fiscal year 2009 had $2.3 billion in unfunded liabilities. Instead, new public safety personnel are enrolled in a better-funded state-run plan. Voters in November 2012 approved more changes to benefit rules in the pay-as-you-go plan that were expected to save taxpayers $47 million over 25 years, only slightly reducing the plan's unfunded liabilities.

Charleston and the state of West Virginia in 2011 addressed a huge shortfall in the city's pension funds for police and firefighters—which had more than $258 million in unfunded liabilities as of fiscal year 2010—by closing those funds to new enrollees and instead requiring public safety employees hired after June 1, 2011, to join a statewide plan with lower benefits.

The city also adopted a state-approved plan to stop drawing on the old police and fire pension funds for retiree checks so that current assets could be invested for the future, and committed to add money each year until the pension funds are entirely funded by 2046. Meanwhile, current pension checks for police and fire retirees would be financed on a pay-as-you-go basis out of employee contributions, a state insurance premium tax, and the city's general funds

21 Office of Mayor Angel Taveras, City of Providence, news release, (May 30, 2012), http://www.providenceri.com/mayor/taveras-administration-retirees-police.

22 Richard O'Gara, director of human resources, City of Omaha, interview with Pew Center on the States, January 20, 2011.

23 League of Women Voters of San Francisco, "Voters' Guide," description of Proposition C—City Retirement and Health Care Benefits amendment, (2011), http://lwvsf.org/pages/PropositionC_2011.html. Proposition C passed with 68 percent of the vote in November 2011.

24 Jerry Allen, executive director, City of Milwaukee's Employes' Retirement System, interview with Pew Center on the States, November 5, 2012.

25 Catherine Saillant and Tony Perry, "2 Big Cities OK Cuts to Worker Pension Costs," *Los Angeles Times*, June 7, 2012, http://articles.latimes.com/2012/jun/07/local/la-me-pensions-20120607.

26 Julie Scharper and Luke Broadwater, "Judge Strikes Down City Pension Change," *Baltimore Sun*, September 20, 2012, http://www.baltimoresun.com/news/maryland/baltimore-city/bs-md-ci-pension-ruling-20120920,0,1894776.story.

27 Craig Gustafson, "Ruling on Retiree Health Care Could Spur Negotiations," *U-T San Diego*, April 29, 2011, http://www.utsandiego.com/news/2011/apr/29/judge-retiree-health-coverage-not-mandatory-curren/.

28 Municipal employment data were gathered from the U.S. Census Bureau's "Annual Survey of Government Employment & Payroll," (2009), http://www.census.gov/govs/apes/historical_data_2009.html. In instances where census data were not available, employment numbers were collected from the individual city's fiscal year 2009 budget or Comprehensive Annual Financial Report. In some cases, total employment numbers were estimated using data on full-time equivalent employees. U.S. Census Bureau, "Number of Cities from 2010 Census of Governments," Table 2: Local Governments by Type and State: 2012, (2012), http://www2.census.gov/govs/cog/2012/formatted_prelim_counts_23jul2012_2.pdf.

29 The U.S. Census Bureau's "Annual Survey of Public-Employee Retirement Systems," http://www.census.gov/govs/retire/, provides aggregate data on revenues, expenditures, and assets—but not on funding levels—for state and local defined benefit pension plans. Its 2011 survey results were based on responses from 222 state systems and a sample of 1,576 local public employee retirement systems. The "Public Fund Survey," http://www.publicfundsurvey.org/, which is maintained by the National Association of State Retirement Administrators (NASRA), looks at 100 systems and 126 plans of states and localities, including some major cities. Smaller plans, such as those for legislators or judges, typically are not included. The "Public Plans Database," http://pubplans.bc.edu/, of Boston College's Center for Retirement Research culls information from the same systems and plans as NASRA, but with the addition of the University of California retirement system and with more actuarial detail provided. The "Philadelphia Research Initiative," http://www.pewtrusts.org/our_work_detail.aspx?id=578, a project of The Pew Charitable Trusts, compared the main challenges confronting Philadelphia's benefits system with those of nine other cities in its report "Quiet No More: Philadelphia Confronts the Cost of Employee Benefits," (June 2009), http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Philadelphia-area_grantmaking/PewBenefits_June2909.pdf.

30 In comparing funding levels, it should be noted that pension plans derive their funding levels based on different assumptions, such as for projected investment

earnings or expected life span of retirees, that may vary from plan to plan and from city to city. Accounting methods also can vary. See Endnote 17 for a discussion of 80 percent as a benchmark.

31 Four of these cities actually made all or most of their annual payments for certain pension plans, but still fell short overall because they did not sock away much money for others. For example, Charleston and Portland, Oregon, consistently paid all or most of their annual recommended contributions for their general employees' pensions but not for those of police and firefighters. Portland does not even attempt to set aside money for the pensions of police and firefighters hired before 2007 but relies on property taxes to cover those pension checks each year, leaving unfunded liabilities on the books.

Over this time period, Little Rock consistently made 100 percent of the annual payments recommended to fully fund its long-term pension promises to police and firefighters hired since 1983. Its payment record overall appears much lower because Pew's calculation also covers three defined benefit plans closed to employees more than three decades ago. In such situations, a city may pay benefit costs as they arise, an amount often less than 100 percent of what is actuarially recommended. Pew's calculation does not take into account the city's annual payments to its defined contribution retirement plan, which has covered non-uniformed city employees since 1981.

In similar fashion, New Orleans made at least 80 percent on average of its annual recommended contributions to three current defined benefit pension plans for workers, while it did not make any contributions to two smaller closed plans for police and firefighters.

32 This result tracks trends from other studies, which show funding levels for different groups of public pension plans continued to decline in 2011. At the end of fiscal year 2010, the aggregate funding level for pension systems in the "Public Fund Survey" was 77 percent, down from nearly 80 percent in fiscal year 2009. The "Public Fund Survey" is made up of large state and teachers' funds, as well as a selection of large local funds. It is maintained by the National Association of State Retirement Administrators. Estimates for fiscal year 2011 funding levels by the Center for Retirement Research at Boston College project a small further decline in that year to 75 percent. It uses the same plans in its calculations as the "Public Fund Survey," with the addition of the University of California Retirement System.

33 New York City reimburses the full Medicare premium and provides Medigap plans for retirees who have attained the requisite years of credited pension service (five- to 10-year service requirement depending on year hired; 15 years for teachers hired after April 2010). Before age 65, retirees receive basic individual or family coverage and pay for additional riders or different coverage, according to Richard Yates, deputy commissioner for the Office of Labor Relations, New York City, Pew Center on the States email correspondence, September 25, 2012. Also see "Summary Program Description," http://www.nyc.gov/html/olr/downloads/pdf/healthb/full_spd.pdf.

34 The Pew Charitable Trusts, "Quiet No More," 11.

35 Government Finance Officers Association, "Managing an OPEB Liability: Denver Employees Retirement Plan," (2007), http://www.gfoa.org/downloads/OPEBCaseStudyDERPvF.pdf.

36 California Public Employee Post-Employment Benefits Commission, "Funding Pensions & Retiree Health Care for Public Employees," (January 2008), 39–40, http://www.pebc.ca.gov/images/files/final/080107_PEBCReport2007.pdf.

37 Denver Employees Retirement Plan, "Comprehensive Annual Financial Report for Fiscal Year 2011," (2011), 23, http://derp.org/files/pubs/CAFR2011.pdf.

38 The total bill for retiree health care benefits was larger than for pension benefits in only two of the 61 cities, as of fiscal year 2009. Boston and Bridgeport each faced more than a dollar in retiree health liabilities for every dollar in pension liabilities. (The unfunded portion of their retiree health liabilities also was larger than it was for pensions.) The reason is that both cities

are responsible for retired teachers' health benefits but not their pension benefits, which are covered by the state. See "Bridgeport Comprehensive Annual Financial Report," (June 30, 2011), 55, http://www.scribd.com/doc/77057948/Bridgeport-CT-2011-CAFR. For Boston, see "Official Statement of the City of Boston Relating to Bond Offerings," (2011), A33–A34, http://www.cityofboston.gov/Images_Documents/2011%20GOB_tcm3-25570.pdf.

39 The following cities had larger unfunded liabilities for retiree health care than for pensions: Austin; Baltimore; Boston; Bridgeport; Charlotte; Columbia; Detroit; Fort Worth; Honolulu; Houston; Indianapolis; Jersey City; Memphis; Milwaukee; Nashville; New York City; Oklahoma City; Providence; San Antonio; San Francisco; San Jose; and Washington, D.C.

40 When it comes to retiree health care, New York City faced $73.7 billion in total liabilities, of which $70.6 billion was unfunded, as of fiscal year 2009. That compares with $52.5 billion in total liabilities for the other 60 cities. The nation's largest city is responsible for benefits for a wide range of employees, including municipal workers, police, firefighters, teachers, and higher education employees. The huge size of its bill was due largely to the high number of employees; six other cities had larger retiree health liabilities as a share of payroll, according to Pew calculations.

41 Hawaii, Maine, Mississippi, Montana, Nevada, New Mexico, and Wyoming had no locally administered pension plans, according to the U.S. Census Bureau's "Public-Employee Retirement Systems State- and Locally-Administered Pensions Summary Report: 2010," (April 30, 2012). http://www.census.gov/prod/2012pubs/g10-aret-sl.pdf.

42 In the 61 cities, 87 percent of pension money was in city-administered plans in fiscal year 2009. Because of their size, the large cities chosen for this study were more likely to manage their own plans than is true for localities nationally. Across the United States, about $6 of every $10 that local governments contribute toward pensions each year goes into state-administered pension systems, and states administer all but 17 percent of the holdings for all state and local pension systems, according to the U.S. Census Bureau, "Public-Employee Retirement Systems," Appendix Table A-2a, http://www2.census.gov/govs/retire/2010summaryreport.pdf.

Among the 193 big-city plans studied in this report, 113 are managed by the city. Sixty-one are cost-sharing plans, in which all local governments in the plan share one actuarial valuation; 19 are called agent plans, in which each local government has its own actuarial valuation, but the plan administrator pools investments and provides centralized administration.

43 Of 100 plans sponsored by the 61 cities for Other Post-Employment Benefits, 90 were city-managed, accounting for $117.8 billion of $118.2 billion in total liabilities for fiscal year 2009.

44 The Center for Retirement Research at Boston College in its July 2011 report, "An Update on Locally-Administered Pension Plans," found little to no difference in funding levels between locally administered plans and state-administered plans. This result differs from Pew's findings. These differences may be explained by the center's use of a different sample, which focused on local plans including counties, for example, and not specifically cities; and by dissimilarities in definitions of state- or local-administration. The report can be accessed at http://crr.bc.edu/wp-content/uploads/2011/07/SLP18-508.pdf.

45 City of Wilmington, Delaware, "Comprehensive Annual Financial Report for the Year Ended June 30, 2011," (December 27, 2011), http://www.ci.wilmington.de.us/docs/978/CAFR_2011_Wilmington_DE.pdf.

46 Henry Supinski, city treasurer, Wilmington, Pew Center on the States interview, August 8, 2012.

47 Gabriel Roeder Smith & Company Consultants & Actuaries, "Illinois Municipal Retirement Fund: Annual Actuarial Valuation Report," (December 31, 2009), A-11, http://www.imrf.org/pubs/annual_reports/2009_actuarial_valuation.pdf.

48 Louis Kosiba, executive director, Illinois Municipal Retirement Fund, Pew Center on the States interview, April 14, 2010.

49 Kentucky Retirement Systems website, news release, (July 2, 2012), https://kyret.ky.gov/index.php/news/view/2012_colas/.

50 David Molgaard, city manager, Charleston, Pew Center on the States interview, February 28, 2012

51 West Virginia Senate Bill 544, passed March 11, 2011, and signed by Governor Earl Ray Tomblin (D) on April 5, 2011, http://legiscan.com/gaits/text/244618.

52 City of Charleston, "Comprehensive Annual Financial Report for the Fiscal Year Ended June 20, 2011," (2011), 82.

53 State of Indiana Office of the Governor, "Governor Signs Property Tax Relief and Reform Bill," (March 19, 2008), http://www.in.gov/gov/files/031908_Governor_signs_property_tax_relief_and_reform_bill.pdf.

54 Office of Massachusetts Governor Deval Patrick, news release on the signing of the Municipal Partnership Act, (July 25, 2007), http://www.mass.gov/governor/pressoffice/pressreleases/2007/key-parts-of-municipal-partnership-act-signed.html.

55 Annual recommended contributions rose in 48 of the 61 cities between fiscal years 2007 and 2009. But not all cities make full pension payments each year. Only 19 actually made higher payments in 2009, compared with 2007; 19 paid the same amount, and 23 paid less. Altogether, the amount the 61 cities should have paid rose from $11.2 billion in fiscal year 2007 to $13.4 billion in fiscal year 2009, a 20 percent increase. The aggregate amount of contributions actually paid rose from $10.2 billion in fiscal year 2007 to $12.3 billion in fiscal year 2009, a 21 percent increase.

In 2010, state aid to local government dropped 2.6 percent from the previous year and property tax revenues dropped another 2.5 percent. The Pew Charitable Trusts' American Cities Project, "The Local Squeeze: Falling Revenues and Growing Demand for Services Challenge Cities, Counties, and School Districts," (2012), http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Cities_Local%20Squeeze_report.pdf.

56 Office of Mayor Alvin Brown of Jacksonville, "Address to City Council—2012-13 Proposed Budget," (July 16, 2012), http://www.coj.net/mayor/docs/7-16-12-moabbudgetspeech.aspx.

57 Pew calculations based on actuarial valuations and data from Los Angeles annual financial reports.

58 "Budget Deficit Points to More Layoffs for the LAPD," City News Service, December 5, 2010, accessed through nbclosangeles.com, http://www.nbclosangeles.com/news/local/Budget-Deficit-Points-to-More-Layoffs-for-the-LAPD-111350354.html.

59 The Los Angeles City Council in October 2012 approved a proposal by Mayor Antonio Villaraigosa (D) to trim benefits and push back retirement ages for new employees, excluding police and firefighters. "Pension Rollback Passed by Los Angeles City Council," *Los Angeles Times*, October 26, 2012, http://latimesblogs.latimes.com/lanow/2012/10/pension-rollback-passed-by-the-los-angeles-city-council.html.

60 "Philadelphia; General Obligation; General Obligation Equivalent Security; Joint Criteria," *Standard & Poor's Ratings Services*, April 5, 2012, 3, http://www.phila.gov/investor/pdfs/Philadelphia%20-%20SandP%20Final%20Report%204-5-12.pdf.

61 "Moody's Downgrades the City of Omaha's (NE) GOULT Rating to Aal from Aaa," *Moody's Investor Service*, September, 21, 2012. http://www.moodys.com/research/Moodys-downgrades-the-City-of-Omahas-NE-GOULT-rating-to--PR_255890.

62 "Atlanta: GA Debt Rating Outlook Revised to Stable from Negative," *Standard & Poor's Ratings Services*, March 23, 2012.

63 Boston Municipal Research Bureau, "The Utility of Trouble: Providing Pensions in Difficult Times: A Comprehensive Study of the Massachusetts Pension System and Its Impact on the City of Boston," (May

2010), 26–27, http://www.bmrb.org/content/upload/PENSIONFINAL2010.pdf.

64 Office of the Auditor General, "Pension and OPEB Plans Administered by Rhode Island Municipalities," (September 2011), 2, http://www.oag.state.ri.us/reports/MuniPensionsRI2011.pdf.

65 Jess Bidgood and Abby Goodnough, "Mayor of Providence Seeks Urgent Steps in City's Financial Crisis," *New York Times*, February 2, 2012, http://www.nytimes.com/2012/02/03/us/providence-ri-mayor-proposes-cuts-to-avert-bankruptcy.html; Office of Mayor Angel Taveras, "Taveras Administration, Retirees, Police and Firefighters Reach Historic Tentative Agreement on Pension Reform," news release, (May 30, 2012), http://www.providenceri.com/mayor/taveras-administration-retirees-police.

66 Office of Mayor Angel Taveras, "Providence Police Vote to Approve Negotiated Pension Settlement," news release, (December 14, 2012), http://www.providenceri.com/mayor/providence-police-vote-to-approve-negotiated.

67 Semoon Chang, "A Tale of the Prichard (AL) Pension Program," *Pensions*, 17-2, (January 16, 2012): 115, http://media.al.com/live/other/Prichard%20Pension%20Article%20Semoon%20Chang.PDF.

68 Katherine Sayre, "Alabama Supreme Court Ruling Allows Prichard Bankruptcy to Move Forward," April 20, 2012, http://blog.al.com/live/2012/04/alabama_supreme_court_ruling_a.html.

69 Rosemary Booth Gallogly, director of Rhode Island Department of Revenue, presentation at National Association of State Budget Officers' annual meeting, August 1, 2012. See also Sherman Actuarial Services, "Actuarial Valuation of the New Pension Plan of the City of Central Falls," (June 13, 2012), http://www.centralfallsri.us/wp-content/themes/2012CF/assets/FinancialInfo/BankruptcyPlan/Exhibit4-ActuarialAnalysisandViability.pdf. Central Falls emerged from bankruptcy in September 2012. See Paul Burton, "Central Falls to Emerge from Bankruptcy," September 6, 2012, http://www.bondbuyer.com/issues/121_173/federal-court-approves-central-falls-rhode-island-reorganization-plan-1043681-1.html.

70 Keith Brainard, research director, National Association of State Retirement Administrators, Pew Center on the States interview, February 28, 2012.

71 For research on practices that helped state pension plans during the past two economic downturns, see the National Institute on Retirement Security report "Lessons from Well-Funded Public Pensions: An Analysis of Plans that Weathered the Financial Storm," (June 2011), http://www.nirsonline.org/index.php?option=com_content&task=view&id=613&Itemid=48.

72 The City of Chicago has consistently contributed its statutorily required amounts of 2.26 times the employee contribution made two years prior for the Fire Fund, 2.0 for the Police Fund, 1.25 for the Municipal Fund, and 1.0 for the Laborers Fund. However, these amounts have been less than the annual recommended contribution (ARC) for most of the past 10 years. The pension fund actuaries estimate that in order to contribute an amount sufficient to meet the ARC in fiscal year 2010, the city would have needed to contribute a multiple of 6.24 for the Fire Fund, 4.61 for the Police Fund, 3.76 for the Municipal Fund, and 2.76 for the Laborers Fund. The Civic Federation, "Financial Challenges for the New Mayor of Chicago," (February 14, 2011), 20, http://www.civicfed.org/sites/default/files/Financial%20Challenges%20for%20the%20New%20Mayor.pdf.

73 "Fitch Affirms Bridgeport, CT's GOs at 'A'; Outlook Stable," *Fitch Ratings*, August 11, 2011.

74 City of El Paso, "Comprehensive Annual Financial Report for the Year Ended August 31, 2010," (2010), v, http://www.elpasotexas.gov/financial_services/_documents/FY%2010%20CAFR%20City%20of%20El%20Paso.pdf.

75 Alicia H. Munnell, Thad Calabrese, Ashby Monk, and Jean-Pierre Aubry, "Pension Obligation Bonds: Financial Crisis Exposes Risks," Center for Retirement Research at Boston College, (January 2010), http://crr.bc.edu/wp-content/uploads/2010/01/SLP_9-508.pdf.

76 U.S. Census Bureau, "Public-Employee Retirement Systems."

77 The assumptions across plans ranged from 4 percent to 8.75 percent.

78 Investment returns for public sector pension funds were based on data from Callan Associates Inc., compiled for this report with the assistance of Keith Brainard, research director, National Association of State Retirement Administrators. Annual results were for fiscal years ending in June; investment return results can vary greatly depending on whether the fiscal year ends June 30 or December 31.

79 Callan Associates Inc., "Median Returns for Periods Ending June 30, 2012," (2012), http://www.callan.com/datatools/returns/plan/ (accessed November 14, 2012).

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81 Recommendations from the New York City Office of the Actuary for fiscal year 2012 are in a series of reports referred to as the "Silver Books," (February 10, 2012), http://www.nyc.gov/html/actuary/html/pension/pension.shtml.

82 At the end of fiscal year 2010, the aggregate funding level for the pension systems in the "Public Fund Survey" was 77 percent, down from 79.8 percent in fiscal year 2009. The "Public Fund Survey" is made up of large state and teachers' funds, as well as a selection of large local funds. It is maintained by the National Association of State Retirement Administrators. Estimates for fiscal year 2011 funding levels by the Center for Retirement Research at Boston College projected a small further decline in that year to 75 percent. It uses the same plans in its calculations as the "Public Fund Survey," with the addition of the University of California Retirement System.

83 Public Employee Retirement System of Idaho, "2011 Comprehensive Annual Financial Report for Fiscal Year Ended June 30, 2011," (2011), 51, http://www.persi.idaho.gov/documents/investments/FY11/AR-FY2011.pdf.

84 Office of the City Auditor, City of San Jose, "Pension Sustainability: Rising Pension Costs Threaten the City's Ability to Maintain Service Levels—Alternatives for a Sustainable Future," (September 29, 2010), 41–42, http://www.sanjoseca.gov/DocumentCenter/View/3208.

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86 Navigant Consulting, "Investigation for the Board of Administration of the San Diego City Employees' Retirement System," (January 2006), http://sdcityattorney.com/Significant_Reports/20060120_report.pdf. In general, a retroactive benefit increase can stem from a number of factors. For example, if the pension formula is changed to use a multiplier of 2.5 instead of 2.0, then all the years of service are multiplied by the new multiplier when the pension amount is calculated. That makes the past years of service more expensive than actuaries originally envisioned. Another example of a retroactive increase might be a change in cost-of-living adjustments applied to past years.

87 Mark Hovey, chief executive officer of the San Diego City Employees' Retirement System, Pew Center

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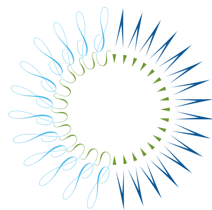

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