



City of Baltimore

Fire and Police Employees' Retirement System (FPERS) Financial Evaluation

PFM Group

June 10, 2010



Overview

- National Retiree Benefit Funding Crisis
- FPERS Trends
- Budget Impacts
- Benefit Adjustments



National Pension Funding Crisis

\$1 Trillion Gap

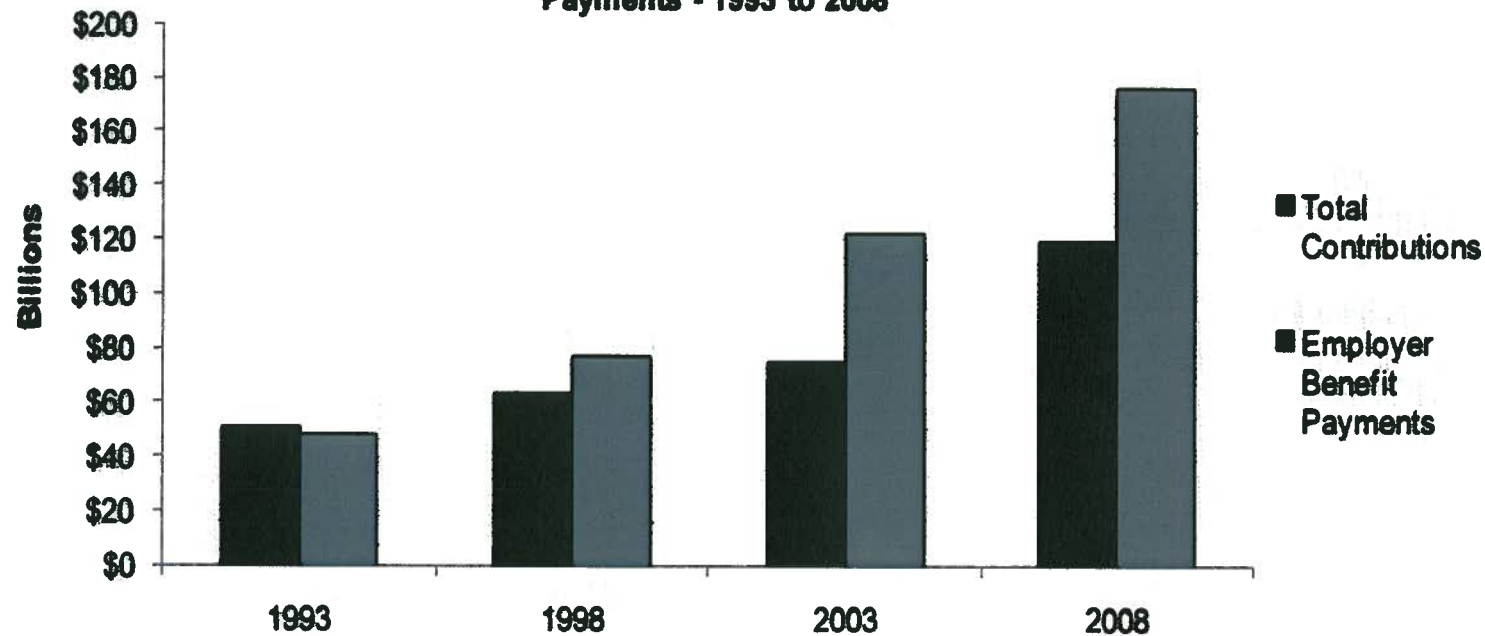
- The City of Baltimore is not alone in facing a pension funding crisis
- According to a February 2010 Pew study, the estimated total retirement program funding shortfall – for combined pensions and other post-employment benefits (OPEB), such as retiree medical – was approximately **\$1 trillion** at the end of FY2008 for state systems
 - Pew estimated 135% growth in the aggregate 50-state annual required contribution for pension obligations from just 2000 to 2008
 - As recent market losses are “smoothed” into actuarial valuations, most public employers are expected to face further, large-scale increases going forward



Retirement System Economics

- **Demographics:** Retirement of the “baby boomer” generation combined with increasing life expectancy is requiring more years of benefit payments to more retirees. From 1970 to 2006, life expectancy at age 65 increased by more than three years (to 83.5 years). From 1993 to 2008, overall participation in state and local retirement systems increased by almost 44%.
 - Benefit payments by state and local retirement systems increased 263% from 1993 to 2008, while combined employer and employee contributions to replenish these systems increased by only 133%

State and Local Government Retirement Systems - Contributions and Benefit Payments - 1993 to 2008



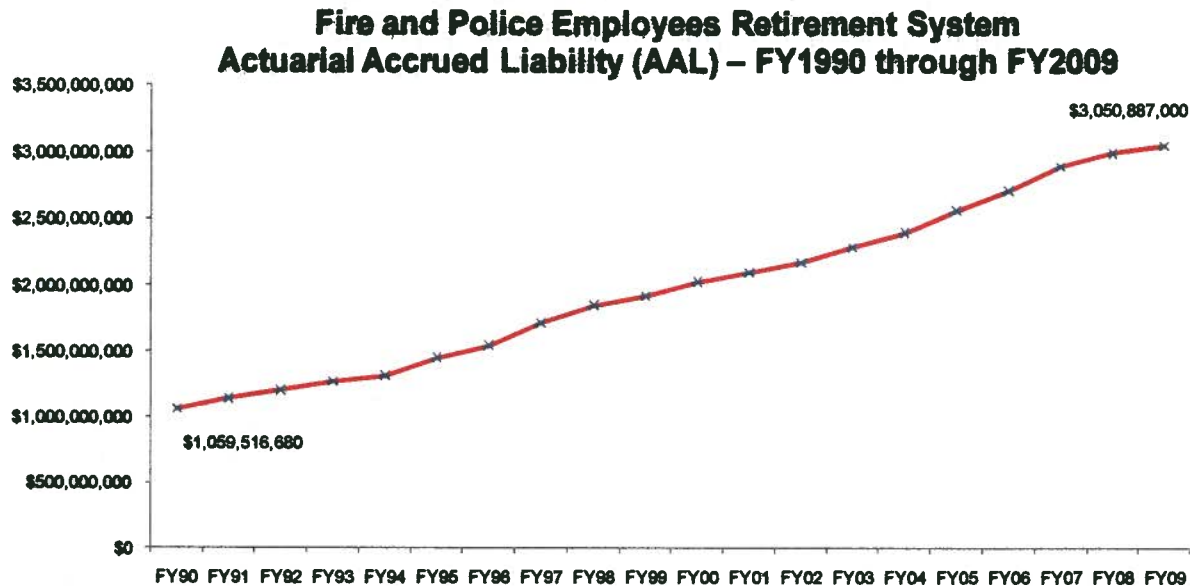


FPERS Funding Pressures

- Baltimore faces demographic pressures consistent with other public employers, compounded by a low ratio of active members to benefit recipients (0.79, vs. national median of 2.02 to 1)

Baltimore FPERS	2005	2006	2007	2008	2009	Increase / (Decrease) 2005-2009
Active Participants	4,690	4,627	4,578	4,615	4,690	0
Retirees	5,578	5,716	5,828	5,881	5,929	351
Ratio of Actives to Annuitant	0.84	0.81	0.79	0.78	0.79	--

- FPERS has seen its actuarial liability increase from \$1.1 billion to \$3.1 billion since FY1990

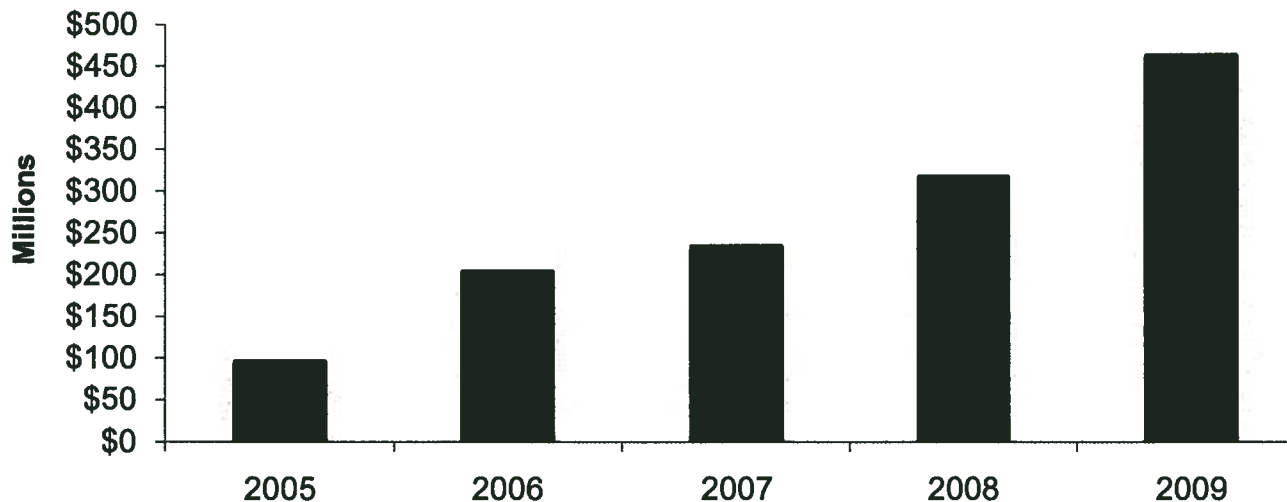




Market Losses

- **Market losses:** The S&P 500 index surged 18.2% annualized in the 1990's, helping many pension funds to experience cyclically high funded ratios, and even surpluses
 - As a result of two bear markets, the 2000's were the worst decade in market history
 - The S&P Index lost 0.9% annualized for the entire ten year period, severely eroding pension fund assets
- With the impact of these factors, the FPERs unfunded liability has already increased nearly fivefold to \$463.7 million since just FY2005

**Fire and Police Employees' Retirement System
UAAL - FY 2005 through FY2009**

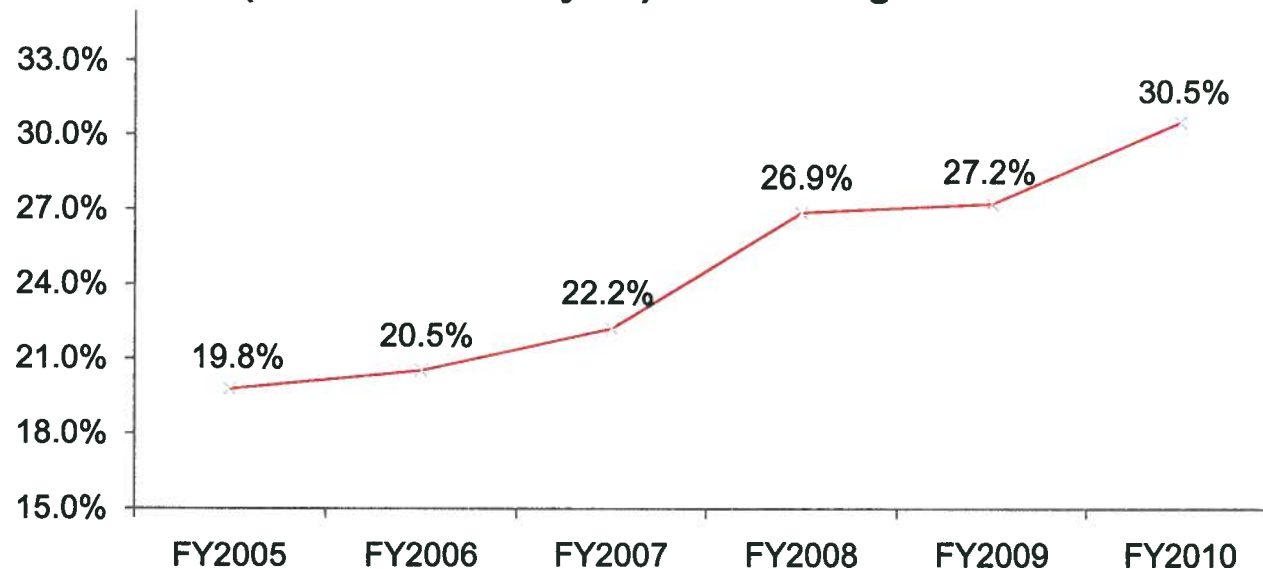




Growing Employer Contributions

- On a % of payroll basis, the City's actuarially required contributions are also growing

**City Actuarially Required Contributions to FPERs
Based on Actuarial Valuation Reports
(% of Covered Payroll) FY05 through FY10**



- With no benefit adjustments and use of the recommended 5.0% post-retirement investment earning assumptions, the City's contribution rate would be projected to nearly double from 30.5% in FY2010 to **58.85%** in FY2011



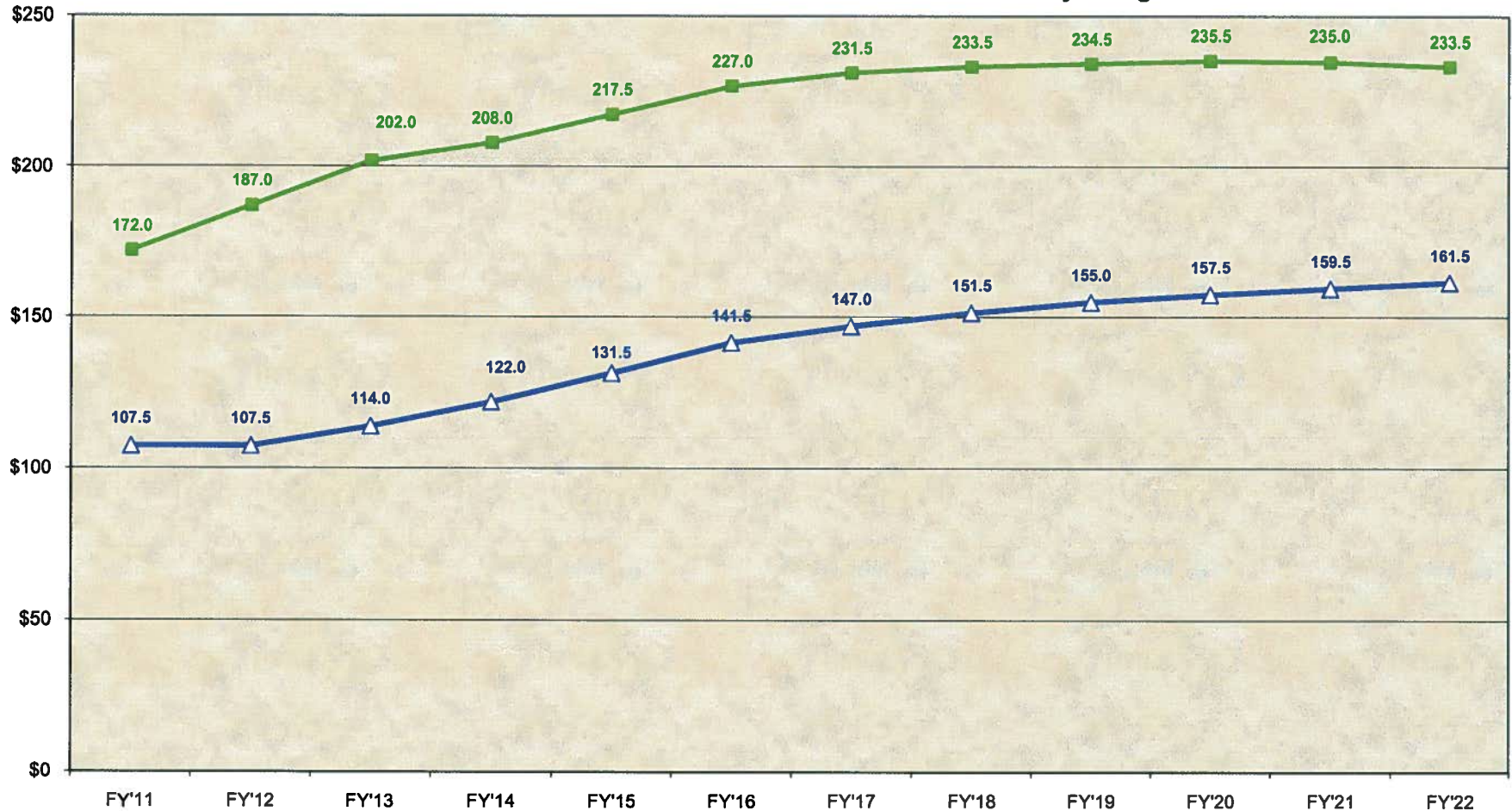
FPERS Funding

- The real FPERS funding crisis is more severe than current actuarial valuations indicate, due to multiple factors:
 - Asset smoothing will not even begin to recognize the 21.9% investment losses of FY2009 until the City FY2011 budget year, and will continue to be recognized over the following four years
 - As of June 30, 2009, FPERS had not yet recognized \$198.9 million in market losses from now closed reserves within the system
 - FPERS uses an unrealistic 6.8% investment return assumption for post-retirement assets, rather than the 5% recommended by the plan actuary and trustees
- Under these actuarial practices, the FPERS funded ratio dropped from 89.4% in FY2008 to 84.8% in FY 2009
- Using actual market assets (even with continued use of the 6.8% non-recommended investment earnings assumption), however, **FPERS funded ratio fell from 74.2% to 58.2% as of June 30, 2009**



FPERS Projections

BC FPERS Projected Employer Contributions (\$ millions)
Assumes that actuarially required contribution is made each year plus an additional \$5.7 million until the BIF, ERF & MSF balance has been fully recognized



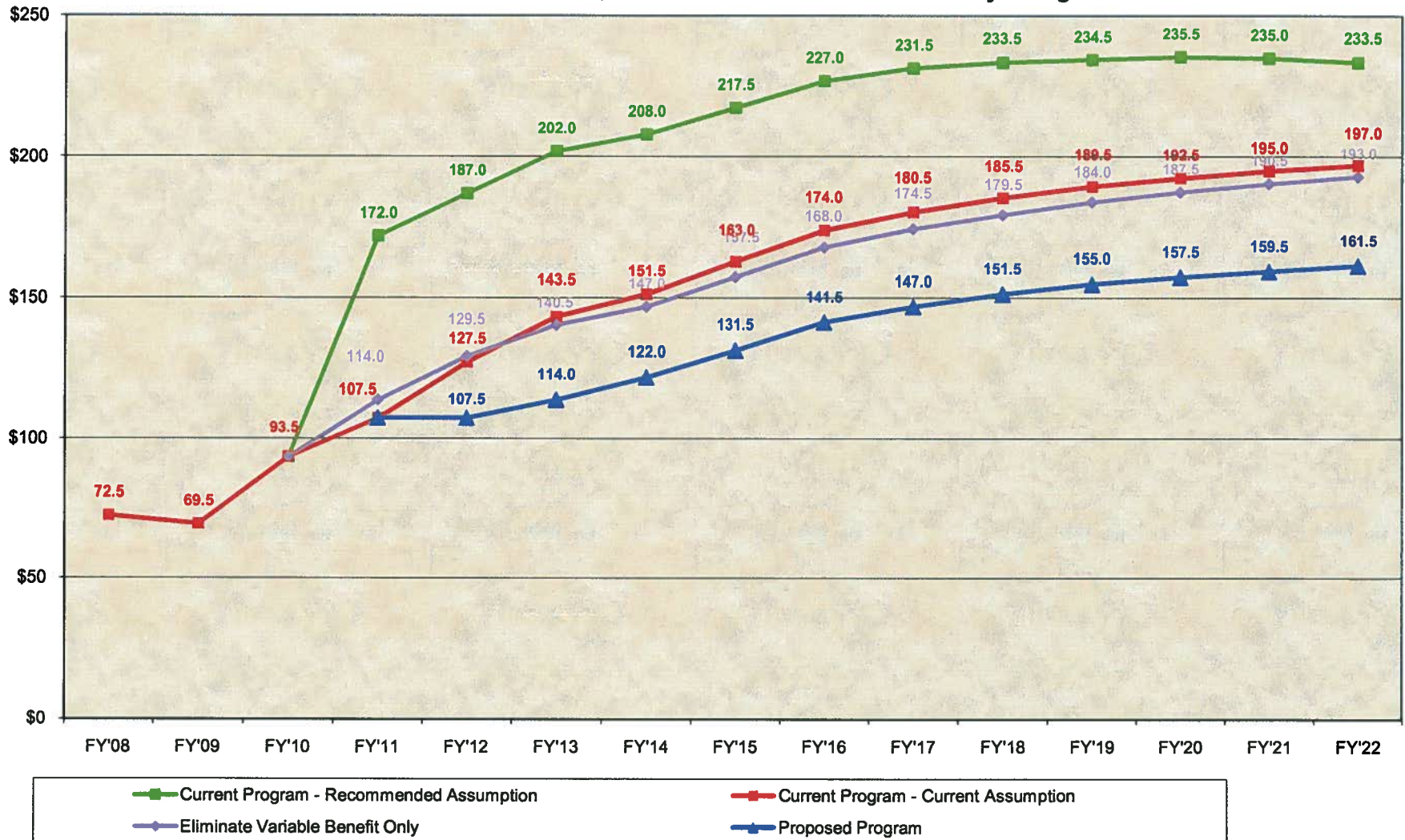
—■— Current Program - Recommended Assumption —▲— Proposed Program



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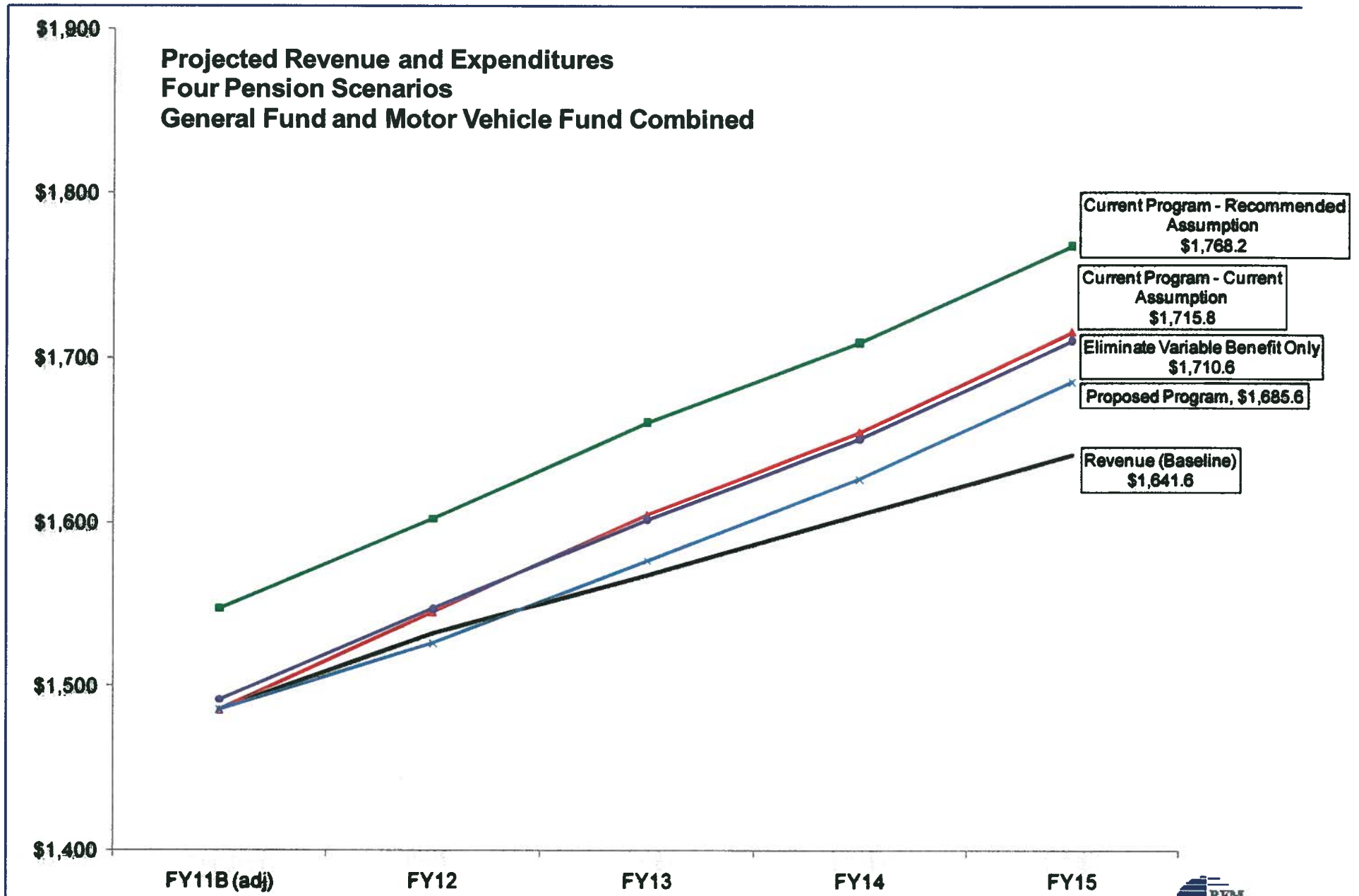


City of Baltimore Budget Impact

- PFM has worked with the City Finance Department to develop multi-year budget projections under the varying Aon pension funding scenarios:
 - If no action is taken, under the recommended actuarial assumptions:
 - A more than \$64 million hole will open in FY2011, of which \$61.9 million would be within the combined General and Motor Vehicle Funds
 - This \$61.9 million FY2011 budget gap will grow to \$126.6 million by FY2015
 - The cumulative 5-year gap would total \$455.2 million
 - In contrast, under the proposed City Council ordinance:
 - The Budget would be projected to remain in balance for FY2011 and FY2012
 - The cumulative 5-year gap would be reduced to \$67.4 million



Projected 5-Year Impacts

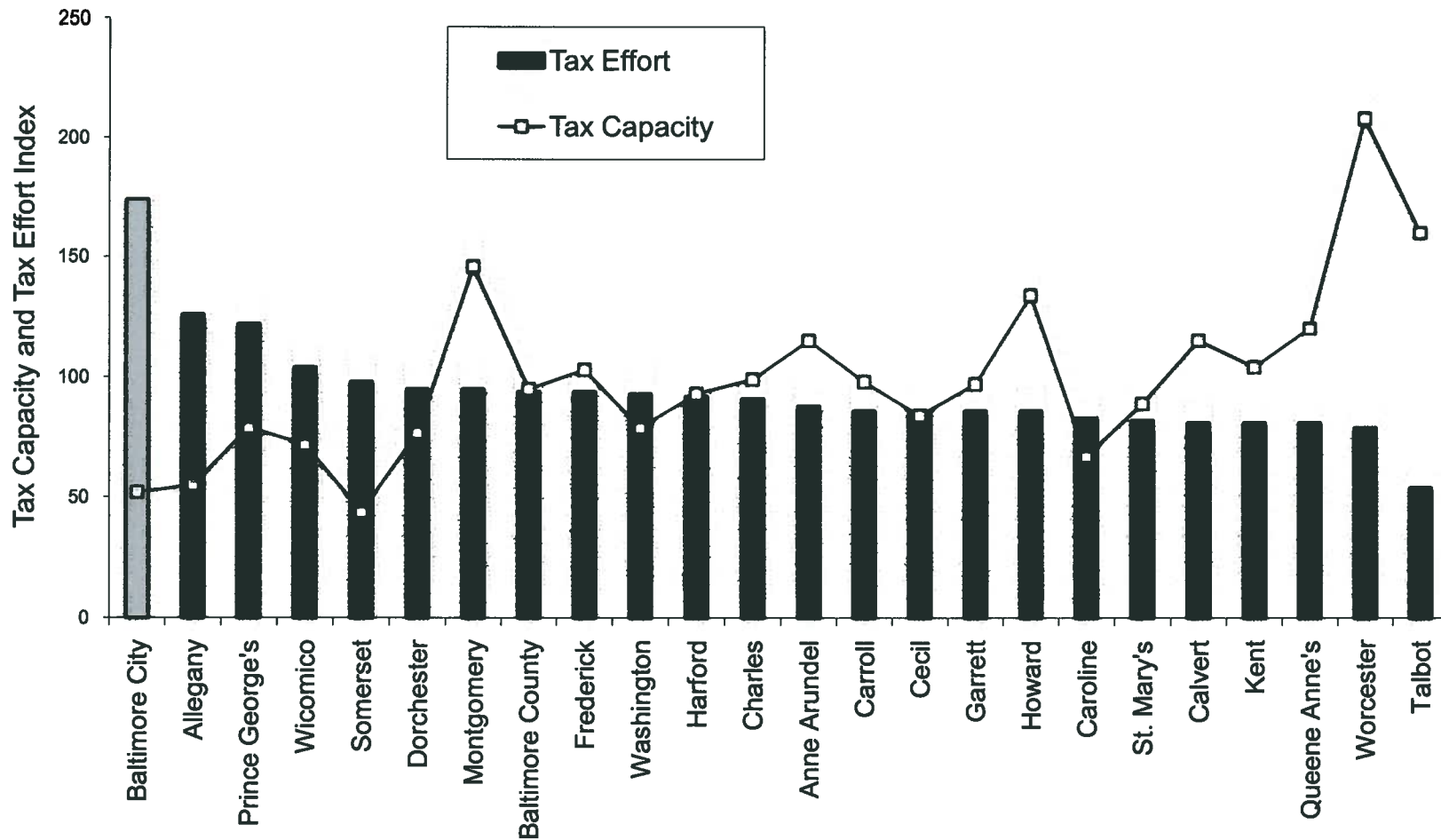




City of Baltimore Budget

Revenue Constraints

- Further revenue increases are constrained by the City's relatively weak tax base, which generates only 52% of the statewide average from equivalent tax rates, and Baltimore's already high tax burdens – found to be the highest in the state by a considerable margin

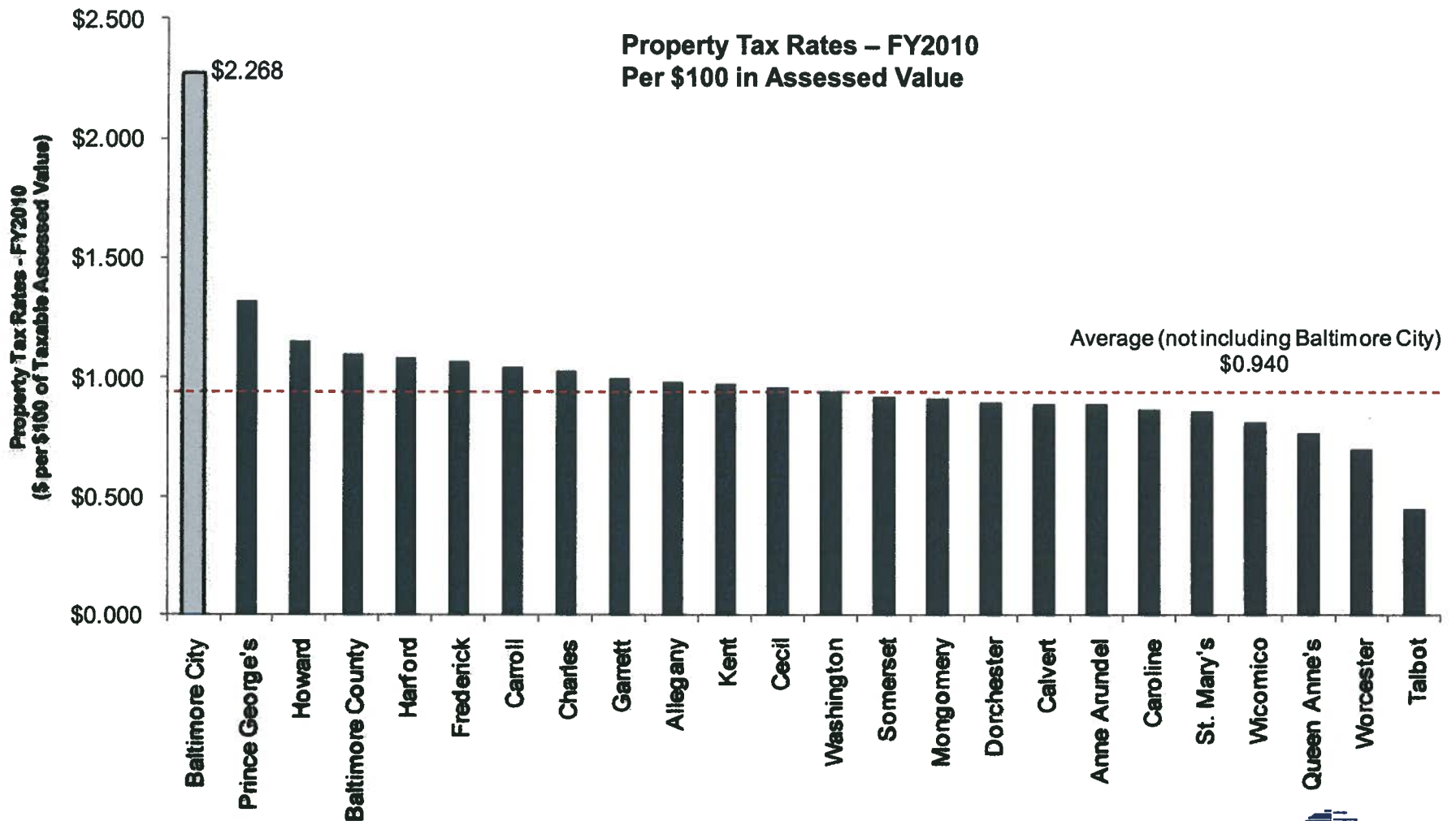




City of Baltimore Budget

Revenue Constraints

- Looking at the City's largest revenue source of property taxes, the City's current rate is more than twice the statewide average

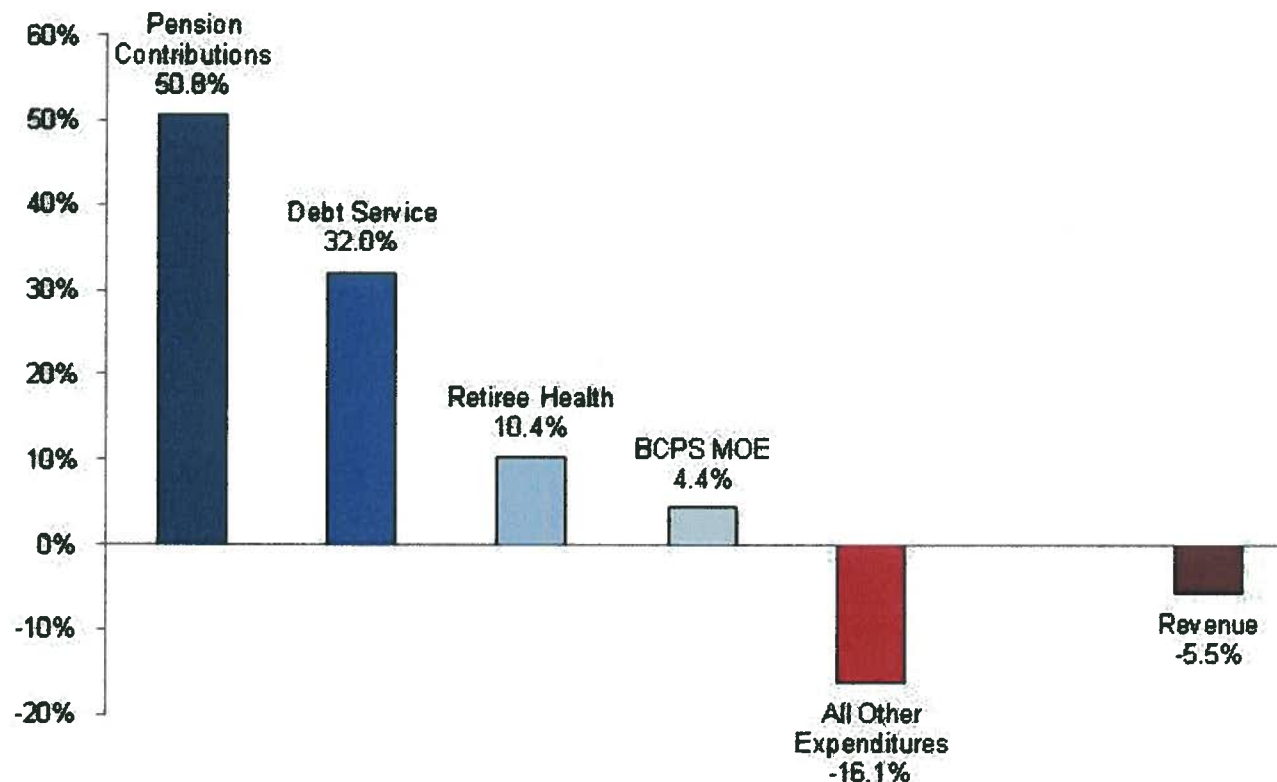




City of Baltimore Budget

Expenditure Pressures

- On the expenditure side of the Budget, the City has limited control over large, and fast growing cost centers. As of the Proposed FY2011 Budget, debt service, pension contributions, retiree health, and the Baltimore City Public Schools (BCPS) maintenance of effort requirement will have grown by an aggregate 20.7% from FY2008, while revenues are projected to fall 5.5%



- These four areas of the Budget will have increased from less than one-third to over 40% of total spending in just three years – squeezing out other services, which are slated to be cut by more than 16%



City of Baltimore Budget

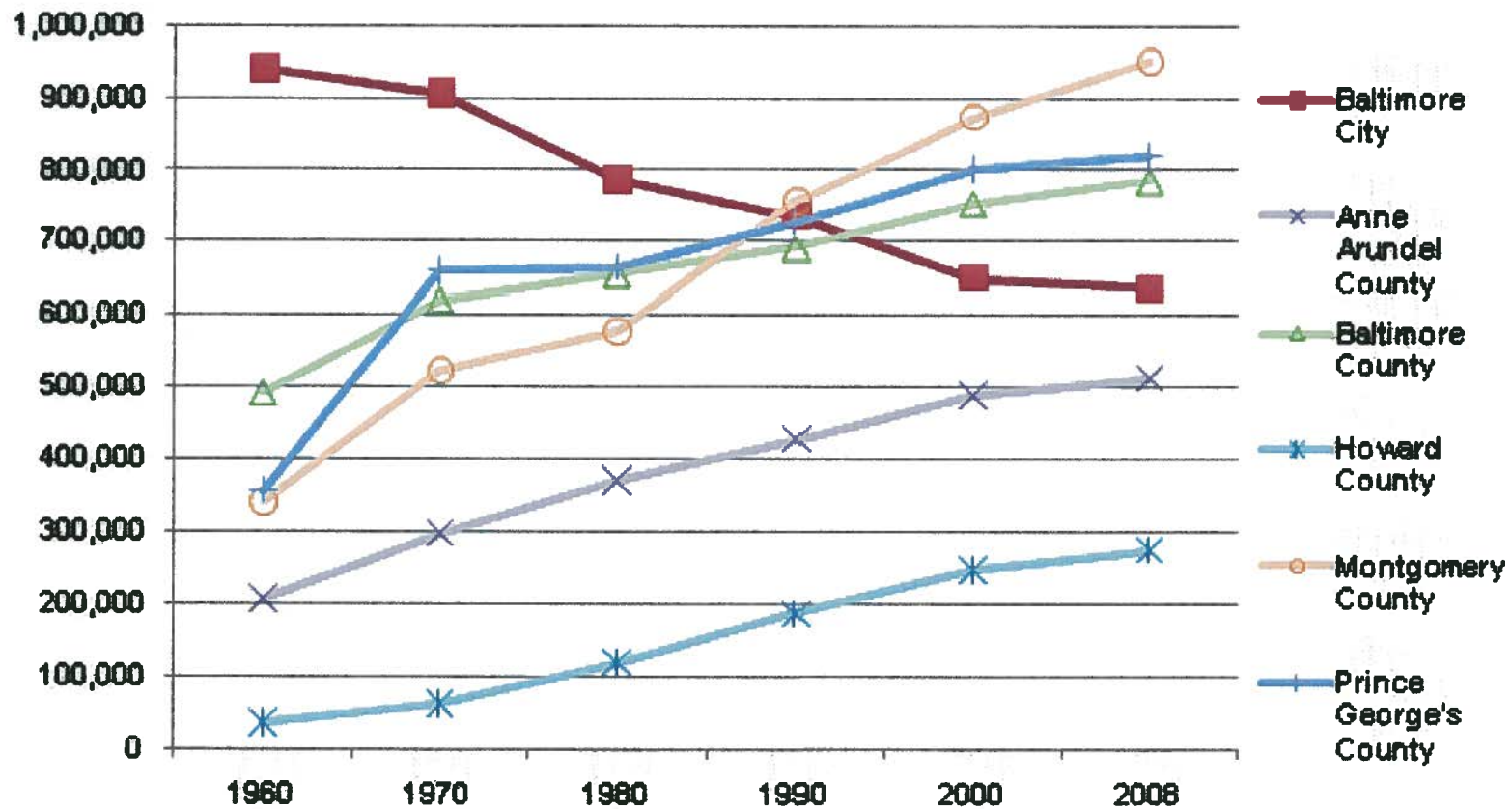
- Even without an additional \$61.9 million in FPERS costs, the proposed FY2011 Board of Estimates Budget already includes:
 - Elimination of nearly 1,000 positions (600 currently filled)
 - A second year of employee furloughs
 - A reduction in transportation and crossing guard subsidies to the Baltimore City Public Schools
 - Rotating closures of seven fire companies
 - Elimination of police aviation, marine, and mounted units
 - Closing of 29 of the City's 55 recreation centers
 - Elimination of bulk trash pickup
 - Reduced building maintenance, park maintenance, street paving, and vacant property boarding and cleaning



Economic Competitiveness

Regional Population Trends 1960-2008

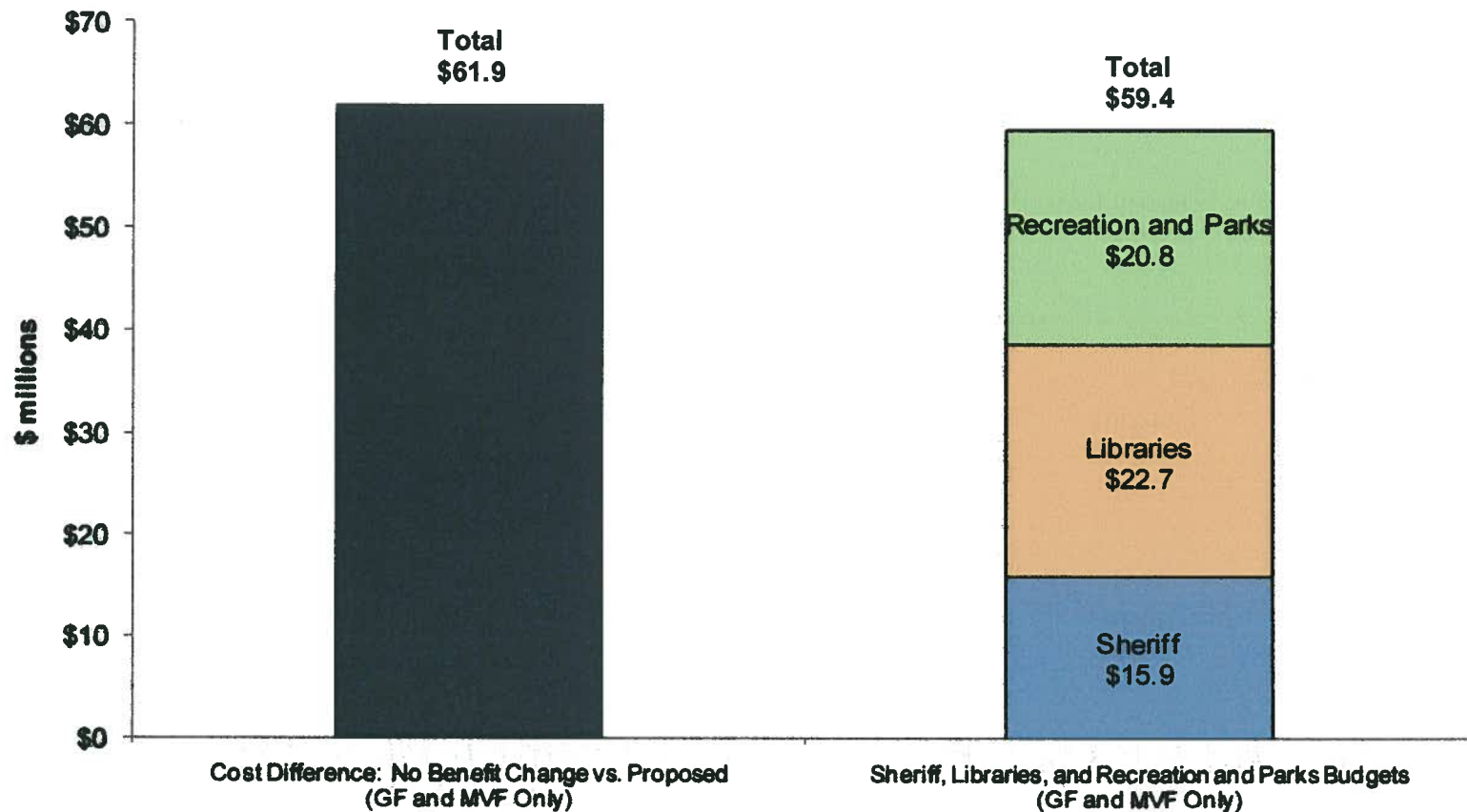
- Competitive tax rates and services are critical to the City's long-term economic competitiveness as strength as a community





City of Baltimore Budget Impact

To put the scale of the potential FPERs budget gap in perspective, \$61.9 million is greater than the \$59.4 million FY2011 General Fund and Motor Vehicle Fund budgets for the Sheriff's Office, Baltimore Parks and Recreation Department, and City Libraries combined





Benefit Adjustments

- The benefit adjustments within the proposed City Council ordinance would maintain Baltimore police and firefighter pensions well within the mainstream for public safety employees nationally and regionally

– Variable Benefit

- A regular COLA would be more consistent with the common practices among other public employers nationally and regionally. For example:
 - Anne Arundel County police and firefighter retirees received COLAs based on 60% of CPI to a maximum of 2.5%
 - Howard County police and firefighters receive a CPI-based COLA capped at 2%
 - City of Philadelphia and Pittsburgh, PA firefighters do not receive fixed COLAs
- A COLA approach would also provide retirees more predictable post-retirement increases better aligned with expected cost-of-living growth, and help to enable an enhanced minimum benefit for long-term retirees



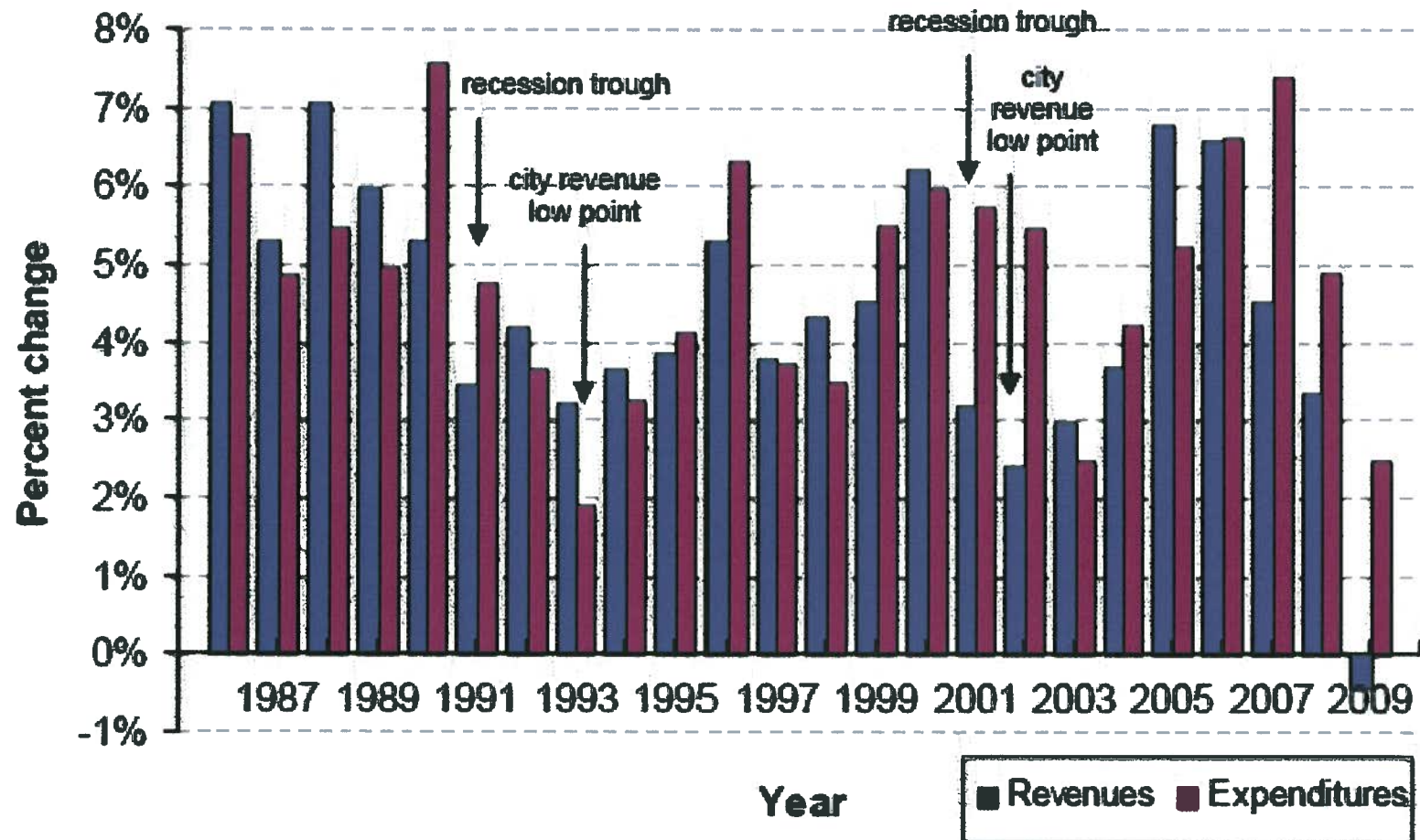
Benefit Adjustments

- Proposed benefit adjustments, continued:
 - **Age and Years of Service Requirements**
 - According to the National Conference of State Legislatures (NCSL), ten states increased the age and/or service eligibility requirements for a normal service retirement between 2005 and 2009
 - Among surrounding local governments, Baltimore County recently increased police officer retirement eligibility requirements from 20 years of service at any age to 25 years of service, or age 60 with a minimum of 10 years of service, and increased the requirements for firefighter retirements to even higher levels
 - **Increased Employee Contributions**
 - Overall, from 2005-2009, the NCSL reported that 12 state governments increased employee contributions
 - Regional governments including Baltimore County, Anne Arundel County, and Prince George's County have also increased public safety employee pension contributions in recent years
 - **Average Final Compensation Calculation**
 - Anne Arundel County, Howard County, Montgomery County, and Washington, DC pension calculations are among regional governments that base public safety pensions on 36-month calculations.



Continued Public Sector Strain

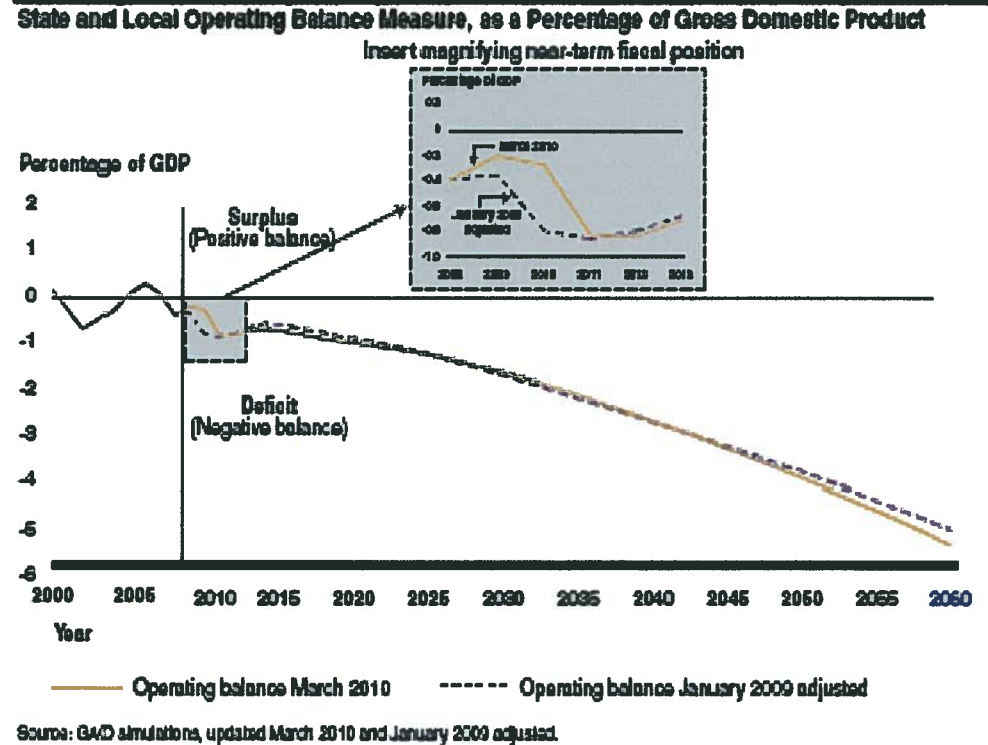
- Even in a favorable economic scenario, public sector revenue recovery will lag the end of a recession





Structural State and Local Pressures

- Further, the ongoing, recession-driven public sector fiscal crisis is *over and above a preexisting structural challenge*
- The U.S. Government Accountability Office (GAO) has developed a simulation model for the state and local sector as an entirety, projecting emergence of significant fiscal challenges over the next 10 years
 - Flat revenues as % of GDP
 - Health care costs rising faster than the overall economy, with growing retiree liabilities
 - \$163 billion combined gap (\$39 billion for 2010 and \$124 billion for 2011)



According to a recent International City-Council Management Association (ICMA) survey responded to by 2,214 cities and counties nationwide, nearly two-thirds of respondents (66%) reported that changes implemented to address immediate deficits “**represent a new way of doing business and will continue beyond the current crisis**”



Conclusion

- Given Baltimore's **General Fund and Motor Vehicle Fund** deficits and constraints, a further \$61.9 million cost increase is untenable, and corrective action is necessary
- Within the context of the City's **particular** funding crisis, the adjustments proposed for FPERs – all consistent with mainstream practices and trends – represent a reasonable approach toward improving the system's **long-term** sustainability
- It is important to note that the proposed City Council ordinance does not advance more benefit adjustments than necessary to address the current funding crisis. In fact, the bill by itself is not projected to fully resolve the FPERs funding deficit within even a five-year timeframe
- However, the proposed City Council Ordinance is projected to:
 - Reduce the magnitude of the problem to a more manageable scale
 - From a \$455.2 million 5-year problem to a \$67.4 million 5-year problem
 - Provide a 2-3-year window within which Baltimore can develop additional approaches to improve FPERs affordability and sustainability going forward