



<b>FROM</b>	NAME & TITLE	Edward J. Gallagher, Director 	<b>CITY of</b> <b>BALTIMORE</b> <b>MEMO</b>	
	AGENCY NAME & ADDRESS	Department of Finance Room 448, City Hall (396-4940)		
	SUBJECT	City Council Bill 10-0482		

DATE: May 20, 2010

**TO**  
 The Honorable President  
 And Members of City Council  
 Room 400 City Hall

Attention: Karen Randle

City Council Bill 10-0482 as submitted by Council members Holton, Cole and Stokes represents a comprehensive approach to the much needed reform of the Fire and Police Employees' Retirement System (F&P) that is no longer financially sustainable with its current benefit structure. The reform package incorporates the many changes to that benefit structure as recommended by a Task Force of the Greater Baltimore Committee that was tasked by the City Council to undertake such a study and "... to make significant recommendations to address the City's long-term pension liabilities." The Pension Task Force membership represented a cross-section of business expertise in human resources and pensions.

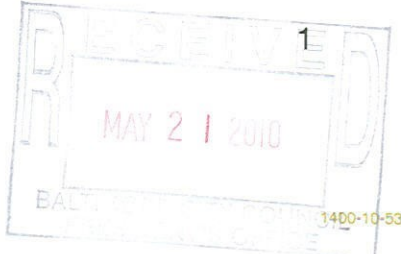
The GBC reported that the "...Task Force embarked upon its assessment of Baltimore's underfunded pension system with a firm understanding that swift and meaningful action must be taken if the plan is to remain viable over the long run." The report goes on to say that "there is a general consensus among Task Force members that unless all stakeholders agree to reforms of the Retirement System, the current underfunding will continue and further impair the City's ability to provide basic services, attract new businesses and ultimately threaten the ability of the F&P Pension plan to fulfill the commitments that have been made to the retirees."

The Context

Your Honorable Body is all too familiar with the City's fiscal situation. Even though the current years budget, Fiscal 2010, was a very difficult one to balance, which also included layoffs, the Fiscal 2011 budget currently before you, as balanced as it is, is not acceptable due to its significant reductions in service, including public safety, and its unacceptable toll of employee layoffs.

Such reductions were made necessary to deal with the unprecedented \$121 million budget shortfall for Fiscal 2011. It was clear to this Administration that such a shortfall could not be closed with cuts alone. As such, an unusual package of revenue enhancements

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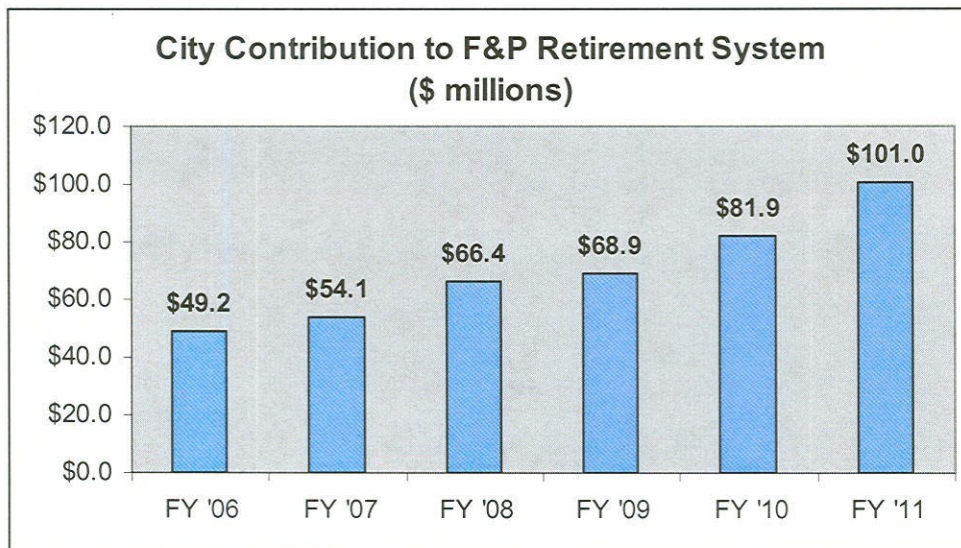


was necessary for the City Council to consider in order to be able to restore a portion of the significant cuts in public safety and other vital services.

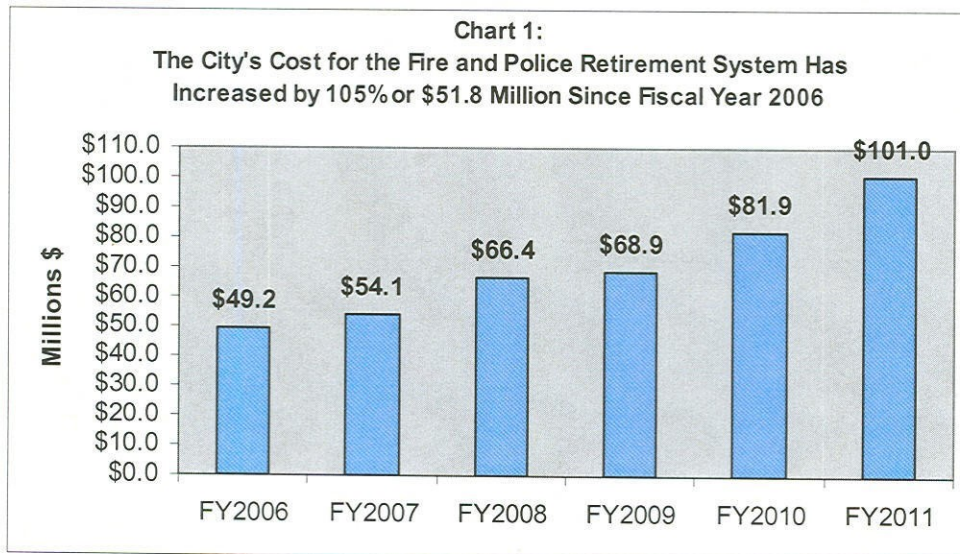
<b>Table 1: F&amp;P Retirement Costs (\$ millions)</b>			
<b>F&amp;P Cost WITH Passage of Variable Benefit Legislation</b>		<b>F&amp;P Cost WITHOUT Passage of Variable Benefit Legislation</b>	
Fiscal 2011 Contribution	\$101.0	Fiscal 2011 Contribution	\$164.9
Fiscal 2010 Contribution	\$81.9	Fiscal 2010 Contribution	\$81.9
\$ Increase	\$19.1	\$ Increase	\$83.0
% Increase	23.3%	% Increase	101.3%

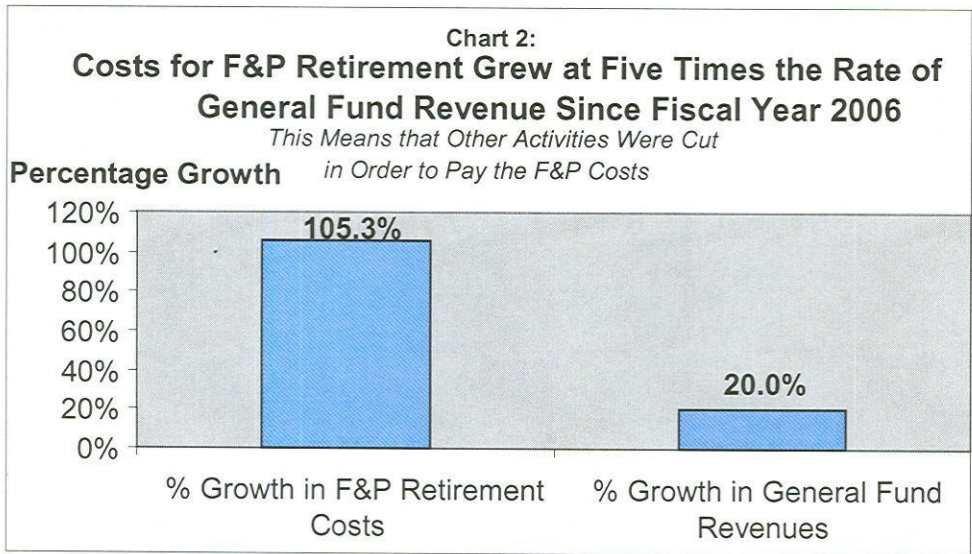
As you are aware, the \$121 million short fall does not include the additional \$63.9 million for continuation of the variable benefit of the F&P system. The resolution of the variable benefit issue has been before your Honorable Body in one form or another since March, 2009. There was certainly no way the City could afford to budget a \$164.9 million or a 101.3% increase in its Fiscal 2011 contribution in order to sustain the continuation of the variable benefit. Surely the 23.3% increase that is already included in the budget represents an extraordinary increase in and of itself. (See Table 1.)

It is important to note that the cost of not fixing the variable benefit, as massive as that is, is not the only problem with the cost of the F&P system. The graph below clear indicates the rapid, and if left unattended, geometric growth that has been experienced since Fiscal 2006.

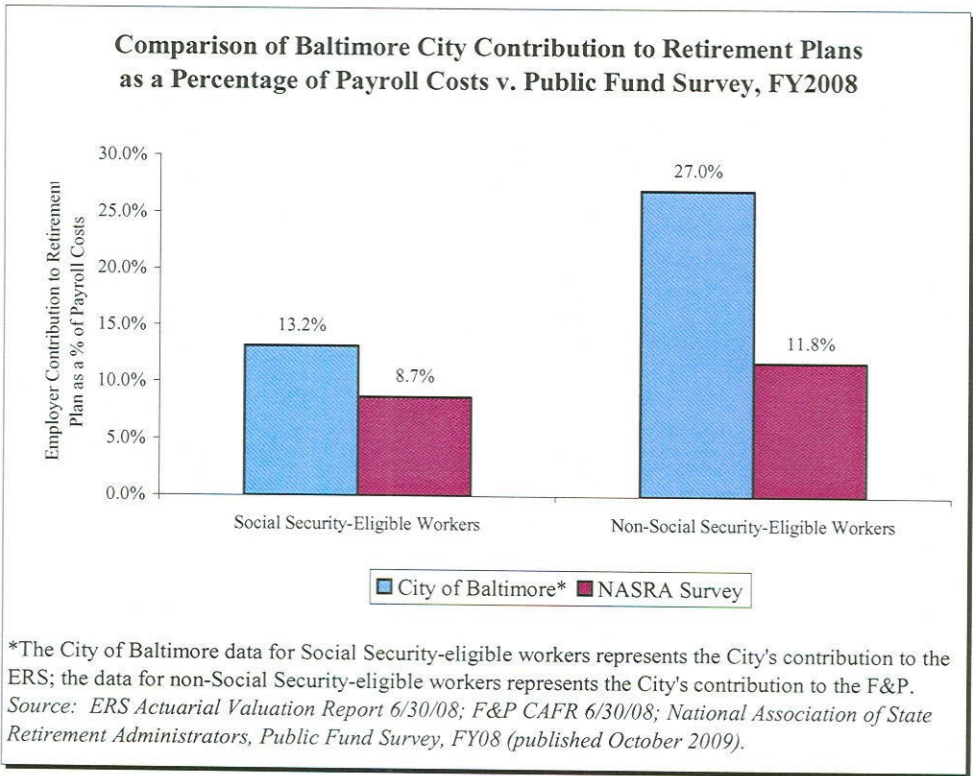


- The City's required annual cost for the F&P Retirement System has increased by \$51.8 million since Fiscal Year 2006. This represents more than a doubling of the contribution or 105% from \$49.2 million in Fiscal Year 2006 to \$101.0 million in Fiscal Year 2011. (See Chart 1)
- This additional \$51.8 million that the City is going to be paying in Fiscal 2011 toward the F&P System each year compared to just 5 years ago represents nearly the combined total General Fund budget for the Department of Recreation and Parks (\$17.4 million), State' Attorney's Office (\$25.7 million) and Circuit Court (\$8.1 million) in Fiscal 2011.
- During the same period from Fiscal Year 2006 through Fiscal Year 2011, total General Fund budgeted revenues have grown by only 20%, magnitudes less than the 105.3% growth in F&P Retirement costs. This means that the City has had to cut costs in other areas in order to accommodate this growing cost in the General Fund. (See Chart 2)





And finally, consider as well, a survey of the National Association of State Retirement Administrators (NASRA), Public Fund Survey comparing the Fiscal 2008 employer's contribution as a percent of payroll costs for social security eligible workers and non-social security eligible workers (i.e., F&P system) compared to the City of Baltimore's contributions. Specifically it found that the City of Baltimore's contribution to the F&P system as a percentage of payroll costs far exceeds benchmarks for public plans in excessive of a factor of two (27.0% vs. 11.8%).



## Proposed Reform Package Plan

City Council Bill 10-0482 represents a package of reforms to the F&P system which follows in many respects the recommendations of the Task Force of the Greater Baltimore Committee.

In summary, the proposed changes include:

Repeals the variable benefit and replaces with an age-based COLA guaranteed by the City and related to the Social Security COLA to be effective January 1, 2012.

Changes the benefit eligibility requirements for members who are not eligible for retirement as of June 30, 2010 to one that is the later of age 55 and 15 years of F&P service. Also provides for a reduced benefit for early retirement.

Replaces DROP2 for members with fewer than 20 years of service who do not already meet the DROP2 requirements with a DROP3 program that provides for a lump sum payment subtracted from the actuarial present value of the benefit.

Changes the average final compensation calculation from the average of the 18 consecutive months of earnable compensation to 36 months of earnable compensation for those members who are not eligible for current law as of June 30, 2010.

Increases members contributions over a 3 year period from the current 6% to 9% in 1% increments effective 7/1/10.

Changes the rate of interest earnings on the members' contributions from 5.5% to 3.0%.

Changes the system's investment assumption from 8.25% per year to 8.0% per year.

Expands the membership of the governing board from 9 trustees to 11 trustees to include the Director of Finance or designee as ex officio and 1 Mayoral appointee having 1 or more technical expertise in commercial banking, investment banking, auditing, investment management, investment consulting or financial legal.

## Conclusion

It should be clear that the cost of the F&P system is out of control.

It should be clear that the cost of the significant benefit improvements that have been added to the system over the years is no longer sustainable.

The City Council reached out to a community of experts on pensions and they told the City Council that ". . . unless all stakeholders agree to reforms of the Retirement System, the current underfunding will continue and further impair the City's ability to provide basic services, attract new businesses and ultimately threaten the ability of the F&P Pension plan to fulfill the commitments that have been made to the retirees."

It should be clear from the context outlined above that the City's ability to finance the current benefit structure is not possible, and has already affected the City's ability to financially support basic City services for the taxpayers, who after all are paying the bill. The Fiscal 2011 proposed Ordinance of Estimates currently before the City Council should leave little doubt of that.

Fixing the variable benefit, although a critical component of true reform is not at all sufficient to deal the future financing of the F&P retirement system. The City Council needs to seriously consider and adopt a full measure of reforms in order to protect the assets of this system and those of the City now and over the long term.

The annual contribution to the F&P system by the City must be reduced to a more affordable level at least somewhere in the neighborhood of the 16.27% of payroll that is the projected outcome of this reform bill (CC 10-0482) rather than continuing the annual average of 23% the City has experienced for the last five years.

The City Council, as fiduciary of the assets of this great municipality, has as its primary responsibility, although not its only responsibility, but as its primary responsibility to protect the financial health and well being of the City of Baltimore.

The fiscal impact of City Council Bill 10-0482 will be submitted under separate cover.

The Department of Finance recommends that the Taxation, Finance and Economic Development Committee recommend a favorable report on City Council Bill 10-0482.