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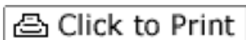

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Report questions pension health of Philly, other cities

By Jeff Shields

Inquirer Staff Writer

Philadelphia and other cities are going broke while masking their pension crises with unrealistic accounting practices, economists at Northwestern University and the University of Rochester wrote in a report released Tuesday.

The study makes much of the fact that Philadelphia's current assets would pay for benefits only through 2015 - in 2009, the city's $3.5 billion pension fund had just 45 percent of the resources needed to cover its liabilities. But the authors acknowledged that the report does not account for hundreds of millions of dollars in annual contributions by the city.

More critical and more dangerous, one author said in an interview, is the wide use of government accounting standards that artificially set liabilities lower by planning for investment returns of at least 8 percent every year on pensioners' money.

"It's only in the realm of government accounting that they're able to get away with this," said Joshua Rauh, associate professor of finance at Northwestern's Kellogg School of Management. Rauh wrote "The Crisis in Local Government Pensions in the United States" with Robert Novy-Marx, assistant professor of finance at Rochester.

The study examined 77 of the largest city and county pension plans, which account for two million of the three million nonstate municipal workers covered by pension plans.

The average household in 50 cities and counties in the study owes an average of $14,165 in such pension liabilities - $16,690 per household in Philadelphia. That still leaves households here better off than Chicago, at the top with $41,966 per household, or New York City, at $38,886.

Because of its historical failure to finance the pension fund and the weak stock market, Philadelphia has seen its pension costs skyrocket in recent years, from $197 million in 2004 to $437 million in the fiscal year ending in June 2009, with its funding level dropping from 77 percent

to 45 percent in 2009.

The city's contribution is forecast to reach $602 million by 2015 - about 16 percent of the current $3.8 billion budget, according to Mayor Nutter's most recent five-year plan.

Over this time, Philadelphia's pension system has calculated its costs assuming that its investments will make 8.75 percent a year, a figure that the fund had beaten in most years before 2008, when the fund's assets shrank by nearly 20 percent.

The attack on municipal earnings' assumptions has been raging in academia, with economists criticizing municipal pension funds for minimizing the impact of pension obligations on city budgets by counting on past stock market performance.

Last year, the Philadelphia Board of Pensions and Retirement lowered its earnings assumption to 8.25 percent, in a bow to the economy.

Philadelphia Finance Director Rob Dubow, who chairs the pension board, said Tuesday it would not be responsible to plan on a lower rate of return when the market can be depended on to perform at that level over the long haul.

"That doesn't seem like it's in the best interests of the taxpayers or the fund," Dubow said. "We ultimately understand that it's taxpayers' money. If we can earn more than treasuries and do it in a way that's responsible, that's what we should be doing."

That's always a hard choice, because the less money a pension fund earns on its investments, the more money the city's general fund must contribute to keep it solvent, leading to tax hikes and service cuts.

Politicians have little personal incentive to lower the earning assumptions because that will mean less money available for their initiatives while they create a more sound pension fund, the benefits of which may not be felt for years after they leave office.

But Rauh said Philadelphia - and the vast majority of municipalities, whose average projected rate of return is about 8 percent - are still way out of sync. With an obligation that is guaranteed, as municipal pensions are, the cities should be using the same rate as the lowest-risk investment - Treasury bills. Tuesday's annual rate on a 10-year Treasury bill, in contrast, was just over 2.4 percent.

Olivia S. Mitchell, a professor at the University of Pennsylvania's Wharton School and an expert on retirement benefits, said: "The authors are to be commended with doing a careful job in assessing the true value of these unfunded promises facing our cities and municipalities."

Mitchell said the authors' numbers are probably more accurate than values reported by cities.

"Only by using sensible economic methods to value municipal benefits, as well as assets set aside to meet them, will stakeholders be able to accurately assess the risks associated with making and keeping the public pension promises," Mitchell said. "Whether Philadelphia's pension plan will run out of money in 2014 or 2015 is less important than the fact that the underfunding is huge, and cash flow insolvency is imminent."

James McAneny, executive director of the Pennsylvania Public Employees Retirement Commission, the state's pension overseer, said Philadelphia's pension fund is not going to run out of money in five years and called any suggestion that it would "irresponsible and inaccurate."

But McAneny said he would like to see pension systems lower their expected returns to around 7 percent. "Over a long-term analysis, I think 8 percent is really pushing the envelope," McAneny said.

Bill Rubin, vice chairman of the Philadelphia Board of Pensions and Retirement, said that the debate about accounting methods is not new, and that to suggest that the city's pension would be insolvent in five years based on current assets does not account for the money put in by employees and the city each year. He likened the pension fund to the average person, who would go bankrupt if all of his or her creditors, from mortgage lenders to credit-card companies, called in their debts at once.

"I think it's crying 'Fire!' in a crowded theater," said Rubin, one of four members on the nine-member board elected by the municipal unions. "In the end, we'll have enough money to pay our people what they're due."

Nutter is seeking concessions on pensions from three of four city unions currently working without a contract. He has touted the arbitration award to the city police last year, in which officers now have the choice of entering a 401(k) type of program.

The report questions, however, whether concessions, which are generally limited to new employees, are a viable solution.

"What is clear is that state and local governments in the U.S. have massive public pension liabilities on their hands, and that we are not far from the point where these will impact the ability of state and local governments to operate," the study concludes. "Given the legal protections that many states accord to liabilities ... attempts to limit these liabilities with benefit cuts for existing workers will only go so far."

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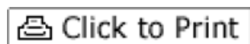

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