Retirement

Excess Charges
Our issues
(compounded by the State)

From Mary Walter, Finance Director:

This presentation was created in an attempt to simplify what are major, compounded issues that are all inter-related. There is no easy fix and it seems that when they (our state legislators) attempt to fix one thing six other things need fixing. The first part deals with the City's issues as compounded by the state (including downshifting)

Retirement

- Everyone has always said that government was ***the*** place to work because of the benefits (albeit the average wage was significantly below the private sector).
- Many communities couldn't compete with private sector jobs. Benefits were how we competed which is why government jobs tend to have better benefits.

Retirement

- Some towns have no limit to the amount of sick days you can accrue. Most allow you to "cash" them out when you leave. And many towns and school districts have other deals upon retirement.
- Overtime and special details also cause huge payouts.
- Every two years actuarial firms looked at the potential liability and adjust our rates.
- Small towns who did not have these issues were "subsidizing" other communities and wanted changes.

Important as to why there is a problem.

How are they subsidizing? Actuaries build in a 7%-11% "loading factor" (amount depends on the group) into the employer's contribution rates to cover these end of year payments which ALL towns and cities have to pay – even those who don't provide the huge payouts.

Retirement

- The poster child for excess benefits belonged to a Dover Police Chief who cashed out $190,000 in benefits and reportedly retired at about 126% of his highest year of pay. Because the payout (and employer contribution) was made "late" in his career, everyone's rates went up. If spiking had been in effect, Dover would have had to pay about $550,000.
- *So the state decided to "fix it" by passing HB 1645 in 2008.*

We've seen the state's success in "fixing" problems. I'm again not feeling what our Governor calls the "NH Advantage".

§1 - Definition of 'Earnable Compensation' – prior to HB 1645

A retiree's pension is determined through a calculation based on his or her 'earnable compensation'. Under current law this term is defined as:

The full base rate of compensation ***plus:***

- Overtime pay
- Holiday and vacation pay
- Sick pay
- Longevity or severance pay
- Cost of living bonus
- Additional pay for extracurricular and instructional activities
- Other extra or special duty pay
- Other compensation paid to the member by the employer
- Plus fair market value of non-cash compensation (meals or lodging) if subject to federal income tax

This is important because they've changed the rules that have been used since the towns and cities joined the NHRS!

§1 - Definition of 'Earnable Compensation' – after passage of HB 1645

Removes the phrase "and other compensation paid to the member by the employer," from definition of earnable compensation to address concerns about maximum benefits.

• Removing this phrase will eliminate from the calculation of an individual's retirement annuity, retirement incentive payouts by the employer in the last years of employment.

The problem is – that overtime and outside detail work is not a "bonus" nor an "end of career" payout. Employers and employees have been paying in all along for these amounts of money. By including it in the computation employers are IN EFFECT BEING DOUBLE CHARGED FOR THESE COSTS.

If they no longer want to include such things as overtime and outside details then the employer and employee should NOT have to pay retirement on it at the time it is earned and only pay out the spiking charge but you can't have us paying it for the 20 years the employee is with us and then again if it creates a spike in their benefits.

Excess Charge Penalties delayed until 7/1/2010

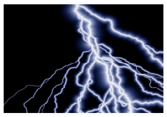
Explanation of HB 1645, Section 33 & 34
125% Calculation, for Employers
Revised Notice September 10, 2009

House Bill 223, Chapter 4 of 2009, legislation delays from August 29, 2008, ***until July 1, 2010*** the implementation of RSA 100-A:16, III-a, which addresses the funding of dramatic increases in the pensions of NHRS members resulting from excessively high end-of-career earnable compensation payments made to a retiring employee by an employer. Known as the “spiking provision” or the “125% calculation provision”, RSA 100-A:16, III-a provides that employers assume financial responsibility for the funding costs associated with those increased pension amounts

So, even though they passed this bill in 2008, there has been so much controversy on the issue that they’ve postponed it for 2 years and there’s a bill to postpone it again until 7/1/2011 but there seems to be a reluctance to do that with the money issues facing them

Retirement

Excess Charges
The State's issues
(which is becoming our issue)



What we know

- The state for years has paid 35% of the employer contribution to the New Hampshire Retirement System for fire and police employees but the current budget reduced that portion *to* 30% this year and 25% (20%?) next year, which in turn increases the portion local governments must pay.
- In 1997 the state's general fund contributed $20.8 million to the retirement system. By 2007, that number was $71.4 million and in just 2 years it was up another 31% to $94 million. By 2011 that number is expected to be more than $160 million, more than double the 2007 contribution!

Local governments can not afford to have more costs shifted down to them.

What we know

- Despite these increases, the unfunded pension obligation for the NHRS is $2.5 BILLION and climbing. Their own analysis shows that the 2010-11 employer contributions (that's the TAXPAYERS!) may have to increase 70% or more.
- At the local level, they anticipate that our contribution will grow 2.5 times from $108 million in 2007 to over $262 million in 2011!

Legislative promises made will be difficult to honor without increasing state and local taxes.

How can we keep doing this? It will be nearly impossible to change collective bargaining agreements and the taxpayers certainly can't afford to keep getting nailed with increases especially as many of them get their hours cut or they get laid off.

Local

- There is a suit pending (from 168 of the 201 members enrolled in NHRS) claiming that the reduction in the state's portion amounts to an unfunded mandate claiming the change will cost local governments $9 million in 2010 and $18 million next year.

While Claremont will be part of the class action suit, it did not join this in the beginning because of the funding request and the fact that we had been level funding our own budget and making up losses with shared revenues being suspended.

Some of the Reasons?

- We have an increased number of retirees per supporting employee.
  - The number of retirees eligible to receive public pension benefits has been growing faster than the number of employees who pay into the retirement fund.
  - In addition, the avg. benefit paid to retirees has been increasing faster than the avg. compensation to existing members of the retirement system.
- Other factors driving the costs include:
  - Higher wage levels
  - Higher health premiums
  - Policy changes in regards to who is eligible for what benefits
  - The basis used to calculating individual pension contributions

Important to note that it's not one specific reason. It will be a complicated strategy to fix it.

And then there's the "Special Account"

- In most pension funds the employer contribution rate is increased to make up the difference when the pension fund's investments do not generate expected returns. When earnings exceed expectation, the employer rate may be reduced. In NH's case, excess earnings in the past 2 decades have gone into a fund used to pay for additional pension benefits.
- The special account was created in 1983 that said that any earnings in excess of the assumption rate plus ½% were deposited in this special account. In 2005 the system earned about 10% and the year before it was 14% (the assumption rate was 9%). Any funds above 9.5% went into the special accounts and none of those excess funds went to shore up the pension side of things.

This seems to me to be a clear case of a retirement board that is made up mainly by the employees (whether current or retired) combined with a legislative membership (that I can almost guarantee has members that were former government workers) and very little representation from Employers or finance/banking people. Of course they can vote all kinds of benefits in. Very wrong NOT to be looking at the bigger picture.

The “Special Account”

- The funds accumulated in the special account have two purposes, to grant cost of living increases (COLAs) to the retirement benefits, and to subsidize retiree health benefits by paying retiree health insurance premiums after retirement.
- During the years of greater than expected ROI the special account swelled – even as benefits were expanded –
  - The COLA rates were increased
  - Medical subsidies were enlarged to include more retiree groups
  - A statute was passed to compound the medical subsidy by 8% per year.

But because the special account funds were diverted from the pension side of the NHRS holdings, the main trust fund lacked funds that would have strengthened the pension actuarial funding ratio.

So, times are good….let’s keep increasing benefits! Did anybody have a fail-safe plan in place to address what happens if times are NOT good…obviously not. So, now it has happened and who’s fault is it? Not the taxpayer. But who will pay for it? The Taxpayer – unless something is done. So somehow we have to find BALANCE.

The “Perfect” Storm

- We have flattening, then declining investment returns
- We have more retirees and the 8% per year statutory compounding of the subsidy.
- This has led to a situation in which the payment made from the special account to lump-sum fund the present and future medical subsidy obligation along with the COLAs will NOT be sufficient to deliver on that promise.
- The last time new net gains went into the special account was in FY 2000 and that account has gone from a high of $731.6 million to a balance of 213.9 million in 2007. At that time they expected the special account to be depleted by 2012.

Even if funds aren’t depleted in 2012 – the issue still needs to be addressed. The legislature says that the medical subsidy was not a “guarantee”…yet they have not had the political will to change it.

Local – Who pays what?

- The State does not contribute anything towards “Employees” which is the “other” group. This is DPW, Clerical, Administration, Assessing, Planning, etc. These employees pay 5% into their retirement (in addition to social security) and the employer pays 8.74%.
- In 2010 the State contributes 5.85% towards the police and the employee pays 9.3% (remember that they don’t pay into social security so if you subtract 6.2% that most of us have to pay they are contributing 3.1% towards their retirement and the employer pays 13.66%)
- In 2010 the State contributes 7.41% towards the fire and the employees contribute 9.3% -- they contribute 1.89% towards their retirement and the employer pays 17.28%.

So the “other” employees WILL get social security (if there’s anything still left in that) while the police and fire do NOT pay into social security so they will NOT get social security (except for those people who have second jobs – which I’m sure many know a fireman with a second job). It’s important also to remember that the employer’s share of the fire and police includes the amount of payroll taxes (6.2%) that the employer would have paid if they were getting social security so, apples to apples, that amount would be subtracted.

Local

- Total ***municipal government payments*** into the NHRS increased **45% in 2 years** (from $108 million in FY 2007 to $157 million in FY 2009)
- It is predicted that local government payments to NHRS are going to have to grow by another 67% by FY 2011 to $262 million and that is NOT including the dilemma the state is facing and downshifting to the local government with their "suspension" of the state contribution.
- It also does NOT include potential payments for the "Excess" Charge (aka "spiking").

Downshifting – will anyone ever get mad at Concord and demand something be done? Maybe we need to look at becoming a referendum state so that citizens can put something on the state ballot directly because I'm not sure anyone hears us anymore.

Spiking – local impact

- Gabriel, Roder & Smith are the consultants used by the NHRS. They did an analysis in 2008 that showed that out of the 753 recipients surveyed, 204 (27%) would cause penalty assessments to the communities ranging from hundreds of dollars to over $550,000 dollars. While Claremont is not in that predicament, we will incur spiking charges if nothing is done.

Does NHRS have a cap?

- Yes, for people hired *after* 1996 it's 150% of any one year that is used in the AFC or their final 12 months (which ever is greater). But their newest provision doesn't exempt the municipality from paying the spiking penalty for anyone who was hired *before* 1996 and thus grandfathered. We will still have to pay it.
- ***Over 34% of the city's workforce was hired prior to 1996 which increases the city's exposure.***
- The spiking provision will be a one time assessment, payable in a lump sum from the municipality to the NHRS and is takes into account the increased monthly payment that large payout made in the employee's monthly pension multiplied out over the anticipated life expectancy and any survivor benefits.

39 of 114 full time employees = 34%
If they are going to grandfather benefit prior to 1996, they should have grandfathered end of career payments from the spiking assessment for any employees hired prior to 1996.

Local

- While we substantially limited our liability 2 contracts ago by reducing sick time accruals to a max of 45 days, **at least 35%** of our current employees are grandfathered in some capacity with sick time.
- This proposal does not seek to cap their sick time, but instead to pay out any amount that would be subject to the spiking/excess charges to be paid out after they would no longer be considered for retirement calculations (currently 120 days)

An attempt at balance. Still pay them out their sick time but not incur a penalty which the local property tax payers will have to fund.

But what is the impact?

- We have 9 people who are eligible to retire right now. If they all decide to retire the City would pay out $397,975 in benefits plus an additional $184,250 (about 46%) in spiking charges for a total of $582,229.
- Of the $397,975 in benefits, $299,984 (75% of it) would have been covered considered “earnable” wages prior to HB 1645.

But what is the impact?

- If the legislature ends up not assessing this spiking language (currently talking about postponing the date to next July) then the employee still gets it paid out within the current time frames.
- ***Our merit plan employee closest to retirement would have to have 31 days of sick time paid out after the 120 days in order for the City NOT to incur spiking charges.***
- Keeping in mind that $250,000 equates to a 3% increase on the tax rate, we will be hard pressed to absorb payouts to NHRS, fund current increases we are seeing in benefit costs as well as ongoing expenses in our operating budget. This proposal gives the retiring employee the greatest flexibility that the state is giving the municipality without further impacting the local taxpayer.

The employee we have that is closest to retirement and where the city would incur a spiking charge would need to have 31 days of sick time paid out AFTER the 121 days (the current time frame where NHRS does not apply it to their benefits). The spiking that we would have to pay would be $30+K. Now some would think that 31 days paid out later would not mean that much as the person is still getting paid those days. But it does make a difference in their retirement benefit. This person will get $2K or $3K less per year so they would have to take that payout of the 31 days of sick time and invest it so to try to help cover that loss of income.

While the amount of money for these 9 employees may not seem like a lot of money, it would add about 2 ½ % onto the city's portion of the tax rate. You need to look at the total picture from the point of view of the taxpayer as well. Do you know how this will impact the School? The County?

What is proposed

- Not withstanding any other provision in this Merit Plan, the severance benefit under this section will be divided into two separate lump sum payments. The first lump sum payment shall be due and payable within 60 days after the date of the employee's retirement and shall equal the maximum portion of the separation benefit that will not result in the New Hampshire Retirement System assessing the City of Claremont for the cost of the excess benefit (as defined by RSA 100-A:16, III-a,(b)). The second lump sum payment, which shall equal the remainder of the severance benefit that was not included in the first lump sum payment, shall be due and payable either no earlier than 121 nor more than 150 days after the date of the employee's retirement or until after the number of days required so as to prevent the City of Claremont from being assessed the cost of the "excess benefit" as defined by RSA 100-A:16, III-a,(b) and/or any additional assessment penalties or costs by the New Hampshire Retirement System.

This text hopefully creates a balance. Ideally it would be great if there was a suspension of the spiking from HB 1645 until there were changes at the state level that doesn't downshift this all to the taxpayer.

And, another potential impact is the ability to "buy back" service years. (Some have gone to smaller communities, taken cuts in pay and then "bought back" previous years of time served and then cashed out when they left the NHRS. ****NOTE: Brian Rapp stated that is no longer allowed !!!! – I have not confirmed this.

Another potential impact someone who wants to leave the rat race of Londonderry or Nashua and move to the country….so they move and take a job as Police Chief in little Bradford. Bradford is thrilled, they have an experienced employee who starts at half the money he was making in Nashua or Londonderry. Two years later (at 50), he retires. Guess where his 3 highest years were? (Yes, Londonderry or Nashua). Guess who's going to pay the spiking penalty (Yes, Bradford).