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Sound the **ALARM**

New Orleans Firefighter Pension Woes
and the Legislative Session

BGR PENSION SERIES

SOUND THE ALARM

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INTRODUCTION

Pension costs are gobbling up an alarming share of the City of New Orleans' general fund budget. In 2012, the city owed \$101 million¹ – 20% of its budgeted general fund revenue – for pension-related expenses. Obligations related to the beleaguered New Orleans Firefighters' Pension and Relief Fund (Firefighters' System) accounted for \$63.6 million, or nearly two-thirds, of the cost.

These expenses are a serious problem. Unfortunately for the city and local taxpayers, there is no quick fix, and large costs loom for the foreseeable future. There are, however, steps that can be taken to begin addressing the situation. Many of these steps require legislative changes.

This report provides background on the Firefighters' System, describes the benefits available to city firefighters and discusses pending bills to reform the system. For more information on the Firefighters' System, and the other 17 defined benefit plans available to local government workers in the New Orleans metropolitan area, see BGR's 2012 report, *The Rising Cost of Yesterday: Metro Area Pension Costs and the Factors that Drive Them*. It is available at www.bgr.org.

BACKGROUND

The Firefighters' System consists of two separate funds: the New Fund and the Old Fund. The Old Fund covers firefighters who were employed prior to January 1, 1968. It contains no actively employed members. The New Fund covers those hired since 1968.

For years, the city failed to save money to pay for benefits owed to members of the Old Fund. Instead, it funded benefits on a pay-as-you-go basis. As the number of retirees grew and the number of active employees in the fund dwindled, the city's payments increased.

In 2000, in an attempt to ease this burden, the city made an ill-fated decision to play the market. It issued \$170.7 million in 30-year bonds to create a trust to cover the benefits due to members of the Old Fund. According to *The Times-Picayune*, supporters of the bond deal sug-

gested it would save the city \$60 million, and that the trust and the interest it generated would be sufficient to cover the Old Fund's benefit obligations for nearly 40 years.²

However, the trust achieved only modest returns, and after nine years of paying benefits, it was depleted.³ Since 2010, the city's general fund has shouldered both debt service on the bonds and the benefit obligations to members of the Old Fund. In 2012, those expenses totaled nearly \$35 million.⁴ Since the Old Fund has virtually no assets and no active members to infuse it with cash, the city alone is on the hook for satisfying the remaining debt and benefit obligations associated with the Old Fund. At the start of 2012, the date of its most recent actuarial valuation, the Old Fund had \$157 million in unfunded liabilities.⁵ On top of those liabilities, \$109 million of bond obligations were outstanding last fall, when the city refinanced them.⁶

The New Fund is also in poor shape. According to the most recent actuarial report, its assets cover only 40% of its benefit obligations.⁷ This is well below the accepted benchmark of 80%.⁸

Multiple factors have contributed to the situation. The city has failed to make the full actuarially required contribution for the last three years. In addition, a court order directing the city to make back-payments to city firefighters who had been denied state-mandated salary increases since 1979 boosted the level of compensation on which benefits are based.⁹

Moreover, in recent years the New Fund's investments have significantly underperformed its assumed rate of 7.5% in annual returns. Since 2002, its annual returns have averaged a mere 2%.¹⁰ While all of the 18 plans in the metro area reviewed by BGR fell short of their assumed rates, the New Fund had the lowest average rate of all during that period.

In addition, the Firefighters' System invested heavily in higher-risk assets. As of December 31, 2011, 40% of the New Fund's assets were in direct real estate investments, including two golf courses.¹¹ It also invested \$15 million in a Cayman Islands hedge fund that could not meet its obligations to investors.

As these factors have caused the New Fund’s financial health to deteriorate, the contributions required of the city have skyrocketed. In 2000, the actuarially required contribution (ARC) was just \$3 million, or 11.6% of firefighter payroll. By 2012, the ARC for the New Fund had shot up to \$28.9 million, or 107% of payroll.

In summary, multiple factors have contributed to the high costs associated with firefighter pensions. Given this background, one might expect plan generosity to suffer. So far, this has not happened.

ANOTHER COST-DRIVER: PLAN GENEROSITY

The New Orleans firefighter pension plan is remarkably generous. Firefighters contribute 6% of salary to the plan during their first 20 years of service, but nothing thereafter. Even the initial contribution rate is significantly less than the national median of 9% for public sector employees who, like the city’s firefighters, do not participate in Social Security. The 6% rate is also the lowest among the 14 non-Social Security plans available to local government employees in the metropolitan area. The contributions required of members of the 13 other plans range from 7% to 13%.¹²

The firefighters’ low contributions would be less problematic if their benefits were correspondingly smaller than the typical public sector pension plan, but the opposite is the case.

The Benefit Formula

Like other defined benefit pension plans, the Firefighters’ System calculates annual benefits according to a simple formula:

$$\textit{Benefit} = \textit{Final Average Compensation} \times \textit{Benefit Multiplier} \times \textit{Years of Service}.$$

Final average compensation is based on a member’s average earnings over some period of time, using his highest consecutive years of earnings. Shorter compensation periods generally translate into greater retirement benefits, because they pick up a narrower range of the highest earnings. The Firefighters’ System uses

a four-year period, one year longer – and therefore less generous – than the national median of three years.¹³ On the other hand, most of the plans available to local government workers in the metro area use five-year periods for new members.¹⁴

One factor contributing to the New Fund’s generosity is its benefit multiplier. The multiplier is the most sensitive and significant variable in the benefit formula. Seemingly minor adjustments to a multiplier can have a significant impact on benefit levels. For example, an increase in the multiplier from 2% to 2.2% equates to a 10% larger retirement benefit.

According to the New Fund’s annual actuarial report, the plan provides a multiplier of 2.5%. However, the multiplier increases to 3.33% for all years of service beyond 12 years if the member retires after age 50. If a firefighter serves 30 years, the multiplier becomes 3.33% for all 30 years.¹⁵ BGR has had trouble reconciling this approach with the formula set forth in state law. The relevant statute increases the multiplier to 3.33% “for each year or portion of a year beyond twelve years of service *and after age 50... .*” (emphasis added). It then states: “If the member continues service beyond thirty years, the retirement benefit *for each year or portion of a year beyond twelve years of service* shall be an amount equal to three and one-third percent of the average annual compensation for each year or portion of a year” (emphasis added).¹⁶ This raises the question of whether the Firefighters’ System – and by extension, taxpayers – are paying more in benefits than what state law requires.

Large multipliers are not out of the ordinary in the New Orleans metro area. Of the 13 other non-Social Security plans available to local government workers in the area, 10 offer multipliers of between 3% and 3.5%.¹⁷ These are, however, far above the national median of 2.4%.¹⁸

Plans for police and firefighters sometimes provide higher multipliers and allow earlier retirement than plans for other government workers. This is because of the physical demands of those jobs. However, BGR was unable to find aggregate data on the multipliers offered by public safety plans nationwide. A sample BGR collected of 20 such plans yielded a median multiplier of 2.5%.

The multiplier dictates how long a member must work to reach his maximum benefit. Thanks to the retroactively applied 3.33% multiplier, a city firefighter reaches an annual benefit equal to 100% of final average compensation after 30 years of service. This is almost 12 years sooner than a member of the national median public sector pension plan reaches his maximum. It is consistent, however, with the statewide plans for firefighters and police officers in Louisiana.

How Firefighters' System Benefits Compare to Benefits in the Public and Private Sectors

The city's firefighters receive significantly larger benefits than comparably paid public sector employees around the country. Take, for example, a current firefighter who retires with a final average compensation of \$50,000 – the average salary of all active New Orleans firefighters¹⁹ – and 30 years of service. Under the Firefighters' System, he would receive an annual retirement benefit of \$50,000. He would earn this same \$50,000 benefit if he were a member of the statewide plans for firefighters and police officers. However, the benefit is \$14,000, or nearly 40%, more than a member of the median U.S. public sector plan would earn.

The city firefighter would fare even better compared to private sector workers with similar earnings and saving rates. A private sector worker with an identical service, salary and savings history would take home just over \$25,000 per year between Social Security and a 401(k).²⁰ This is only half the annual benefit due to the city firefighter.

When benefits and contributions are taken together, the city's plan for firefighters is far more generous than the statewide plan for firefighters across Louisiana. Long-time firefighters with identical service and salary histories will receive very similar benefits under both plans, but the employee contributions required of city firefighters are much smaller than those required for members of the statewide plan. For example, the annual benefit payable to a city firefighter retiring after 30 years of service equals 77% of his lifetime contributions. This far exceeds the 31% ratio for comparable members of the statewide firefighter plan.

The Firefighters' System offers remarkably generous

cost of living adjustments (COLAs). COLAs of up to either 3% or 5% per year, depending on the retiree's age, can be granted at the discretion of the system's firefighter-controlled governing board, regardless of changes to the Consumer Price Index or the system's recent investment performance.²¹

This approach is unlike that of most public pension plans in the U.S., which grant COLAs based on either changes to the Consumer Price Index or the financial health of the plan.²² It is far more permissive than the approach taken by other pension plans for public sector workers in the metro area. The COLAs provided by the Firefighters' System have caused benefits to outpace inflation by 14% during the last 20 years. Every other plan that BGR reviewed saw its benefits lose value over that period, some by as much as 30%.

SUMMARY AND ANALYSIS OF 2013 LEGISLATION

Some bills currently pending in the state Legislature attempt to address the city's firefighter pension crisis. The most significant bill would remove the Firefighters' System from state law and bring it under local control. The others would change the structure of its governing board, increase the contributions required of firefighters and make a slight adjustment to the system's method for calculating benefits. These bills would be at issue only if the local control bill does not pass. Another bill would remit state funds intended for the city to the Firefighters' System when the city fails to contribute all funds due to the system.

Bringing Firefighter Pensions Under Local Control

HB 52 would allow the New Orleans City Council to create a new pension system for city firefighters.²³ The city-created system would assume the assets and liabilities of the current system. The bill is supported by Mayor Landrieu.

Currently, the governance and benefit structures of the Firefighters' System are set forth in state statutes. The State, however, is not responsible for paying the system's obligations. That obligation is with the city gov-

ernment. The bill would address this misalignment of powers and responsibilities and enable the city to implement the changes needed to put the New Fund on a more sustainable course.

There is a risk, however, in transferring responsibility for the system to the city. After all, the city is responsible for the Old Fund's pension bond debacle, and over the last several years it has failed to make the actuarially required contributions to keep the plan on solid footing. Those contribution requirements have risen sharply over the last several years, but the city has kept its annual appropriations to the Firefighters' System more or less constant.²⁴ The Firefighters' System has expressed concern that this underfunding would continue if the system were transferred to the city.

However, the current structure has not served the Firefighters' System or the public well. It is within that structure that the poor investment choices were made and excessive COLAs granted.

Furthermore, the retirement plan for general city workers – which is established in the city's code of ordinances and governed by a board that more evenly balances the interests of the city administration and its workforce²⁵ – is in far better shape than the Firefighters' System. As of the date of its last actuarial report, the city's plan was 75% funded,²⁶ as compared to Firefighters' System at 40%.

Revamping the Governing Board

Other bills pending before the Legislature would make changes to the system if HB 52 does not pass. The city and the Firefighters' System have competing bills to restructure the system's governing board. Currently, the board consists of 10 members, including the city's finance director, the superintendent of the fire department, five firefighters elected from the active ranks, and three members elected from the retired ranks. There are no requirements that the elected members have any relevant expertise.

HB 49, the city's alternative bill, would reduce the board's size from 10 members to five by eliminating six firefighter seats and adding a mayoral appointee. The board would then consist of the mayoral appointee, the

superintendent of the fire department, the city's director of finance, one member elected from the ranks of active firefighters and one member elected from the ranks of retired firefighters.²⁷ The end result would be a system with three mayoral appointees – one of whom is a firefighter – and two members elected by the firefighters.

The Firefighters' System-backed bill, HB 41, would add three appointed members to the board, increasing its size to 13 members. Under the bill, the mayor and the House and Senate delegations representing Orleans Parish would each appoint a member. Active and retired firefighters would continue to elect eight members, and the city finance director and the superintendent of the fire department would remain on the board. It would leave firefighters firmly in control of the system.

In addition to altering the makeup of the board, the bill would increase board members' terms from two to four years. It would also require a two-thirds vote of the board to grant a COLA. Currently, only a majority vote is needed.²⁸

Reducing Plan Generosity

The city and the Firefighters' System are both supporting bills to increase the employee contribution from 6% to 10%, and to delete the provision waiving contributions for firefighters with more than 20 years of service. The city's bill would increase contributions to 10% immediately, while the system's bill would phase the increase in over a four-year period commencing January 2014.²⁹

In addition, the system's bill provides for a series of reductions if the total annual contributions required by the system's actuary fall below certain percentages of payroll. The reductions begin if the contribution rate, inclusive of the required employee and employer contributions, falls below 35.5%. Currently, the required employer contribution rate alone is 107% of payroll, making it unlikely that total contributions would decrease below 35.5% in the near future.³⁰

Members of the statewide plans for firefighters and municipal police officers currently contribute 10%, but their plans also allow reductions if the total contribution rate falls below a certain percentages of payroll. Their

reductions are more difficult to achieve, however, since they begin at lower percentages (30.26% of payroll for the statewide firefighters' plan, and 31% for the police officers' plan).³¹

The city's preferred approach would immediately equalize New Orleans firefighters' contributions with those currently required of New Orleans police officers and other firefighters around the state.³² Incrementally increasing the contribution rate from 6% to 10% over several years, as recommended by the firefighters, would help cushion the impact of the increase on current firefighters. However, the proposed period provided for in the bill is needlessly long.

Both the mayor and the Firefighters' System are also supporting bills that would increase the final average compensation period from 48 months to 60 months.³³ This change would reduce future retirees' benefits, but only slightly for members receiving modest annual raises. Assuming raises of between 3% and 5% during the final average compensation period, the change would reduce annual benefits by less than 2%.

Recovering Unpaid Amounts

Finally, the Firefighters' System is backing HB 40, which would create a mechanism to redirect state funds intended for the city to the Firefighters' System when the city fails to make all payments due to the system. It is not clear why the Firefighters' System should receive priority over all other parties owed money by the city.

The bill would also set the interest rate payable on amounts owed to the Firefighters' System pursuant to a court judgment. The rate would be the greater of the system's assumed actuarial rate of return, currently 7.5%, or the system's market rate of return since the date of the judgment.³⁴ The Firefighters' System has averaged a mere 2% rate of return during the last 10 years. The current judicial interest rate for all Louisiana court judgments is 4%.³⁵ The bill would entitle the Firefighters' System to an interest rate far greater than its normal returns and the rate applied to all other state court judgments.

CONCLUSION

Funding the Firefighters' System is a massive burden on the city's budget. In 2012, the city owed \$63.6 million for obligations related to that system. This equates to 13% of its general fund revenues.

This staggering cost has consequences. It means less money for crime prevention, blight reduction, street improvements and a host of other important city services.

Unfortunately, there is no easy way out. The Firefighters' System faces massive unfunded liabilities, and it will remain the city's responsibility to plug the gap.

Given that the city must pay firefighters' benefits, lawmakers should bring the Firefighters' System under city control by adopting HB 52. The bill offers an opportunity to create a governing board that better balances the interests of the city's taxpayers and firefighters, and to dial back the system's excessively generous benefit structure. The bill will not get the city out of its current dilemma, but it offers hope for stopping the bleeding.

In addition, the Legislature should reject HB 40. It would give the Firefighters' System unwarranted priority over other parties owed money by the city. It would also set an unusually high interest rate on amounts owed to the system pursuant to a court judgment.

What's done is done. No one can reverse the series of errors that have led to the current pension debacle. But lawmakers can take actions to put the Firefighters' System on the right path. Those actions cannot occur too soon.

ENDNOTES

- 1 This total includes the additional \$17.5 million a district court judge has ruled the city must pay the New Orleans Firefighters' Pension and Relief Fund to meet its funding requirement for 2012. *New Orleans Firefighters' Pension and Relief Fund et al. v. City of New Orleans et al.*, Civil District Court, Parish of Orleans, State of Louisiana, No. 2012-7061, Judgment (March 28, 2013) (Giarrusso, J.).
- 2 Russell, Gordon, "Bad bond deal factors into call for N.O. tax boost," *The Times-Picayune*, October 31, 2008.
- 3 Information provided to BGR by the City of New Orleans Finance Department, August 20, 2012.
- 4 According to the city's finance department, the debt service on the pension bonds totaled \$14.4 million in 2012, and the city's contribution to the Firefighters' System totaled \$31.7 million. Of that, \$20.3 million went to cover benefits due to members of the Old Fund, according to the Firefighters' System.
- 5 Firefighters' Pension and Relief Fund of the City of New Orleans, *Actuarial Valuation Report as of January 1, 2012 (Old Fund)*, p. 6.
- 6 Official Statement, City of New Orleans, Louisiana, Taxable Limited Tax Refunding Bonds, Series 2012, Appendix A.
- 7 Firefighters' Pension and Relief Fund of the City of New Orleans, *Actuarial Valuation Report as of January 1, 2012 (New Fund)*, p. 22.
- 8 U.S. Government Accountability Office, *State and Local Government Retiree Benefits: Current Funded Status of Pension and Health Benefits*, GAO-08-223, January 2008, p. 3.
- 9 See *New Orleans Firefighters Local 632, et al. v City of New Orleans, et al.*, No. 2003-CA-1281 (La. App. 4 Cir. 2004), 876 So. 2d 211.
- 10 BGR calculations based on information presented in *Actuarial Valuation Report as of January 1, 2012 (New Fund)*, p. 24.
- 11 BGR calculation based on Firefighters' Pension and Relief Fund of the City of New Orleans, Comprehensive Annual Financial Report for the Year Ended December 31, 2011.
- 12 See BGR, *The Rising Cost of Yesterday: Metro Area Pension Costs and the Factors that Drive Them*, November 2012, p. 17.
- 13 U.S. Department of Labor, Bureau of Labor Statistics, *National Compensation Survey: Retirement Benefits in State and Local Governments in the United States, 2007*, May 2008, p. 18; and Wisconsin Legislative Council, *2010 Comparative Study of Major Public Employee Retirement Systems*, December 2011, p. 25.
- 14 For more information on the final average compensation periods used by defined benefit plans in the metropolitan area, see BGR, *The Rising Cost of Yesterday*, p. 18.
- 15 *Actuarial Valuation Report as of January 1, 2012 (New Fund)*, p. 10.
- 16 La. R.S. 11:3384(B). The Firefighters' System claims that the statute is ambiguous.
- 17 See BGR, *The Rising Cost of Yesterday*, p. 19.
- 18 BGR calculations based on data presented in the Public Fund Survey for Fiscal Year 2010, www.publicfundsurvey.org.
- 19 *Actuarial Valuation Report as of January 1, 2012 (New Fund)*, p. 16.
- 20 BGR assumed the private sector worker's employer contributed an amount equal to 3% of salary to his 401(k), and that his 401(k) account earned an average annual return of 7%. BGR converted the private sector worker's 401(k) balance at retirement into an annuity. BGR calculated the private sector worker's Social Security benefit using the formula described at www.ssa.gov/oact/cola/piaformula.html.
- 21 La. R.S. 11:3382.
- 22 Center for Retirement Research, Public Plans Database, *Charts: Distribution of State and Local Pension Plans by COLA Type, 2009*, www.pubplans.bc.edu.
- 23 La. H.B. 52, Reg. Sess. of 2013.
- 24 According to Firefighters' System annual audits and information provided by the city's finance department, the city has contributed between \$31 million and \$32 million to the system each of the last three years.
- 25 The five-member board consists of the city's finance director, its personnel director, one member elected by employee members of the system, one member elected by the retired members of the system, and one person appointed by the mayor and approved by the City Council. City of New Orleans, Code of Ordinances, Sec. 114-87.
- 26 Employees' Retirement System of the City of New Orleans, *Actuarial Valuation Report as of January 1, 2012*, p. 27.
- 27 The bill would also delete a requirement that only the board members elected by the active ranks of the department can vote on any proposal to increase the employee contribution. La. H.B. 49, Reg. Sess. of 2013.
- 28 La. H.B. 41, Reg. Sess. of 2013.
- 29 La. H.B. 50 and H.B. 64, Reg. Sess. of 2013.
- 30 *Actuarial Valuation Report as of January 1, 2012 (New Fund)*, p. 3.
- 31 La. R.S. 11:62.
- 32 The Municipal Police Employees' Retirement System and the Louisiana Firefighters' Retirement System require reduced contribution rates for members earning below the federal poverty level. The reduced rates are 7.5% and 8%, respectively. La. R.S. 11:62(3) and (6).
- 33 La. H.B. 42 and H.B. 51, Reg. Sess. of 2013.
- 34 La. H.B. 40, Reg. Sess. of 2013.
- 35 Louisiana Office of Financial Institutions, "Judicial Interest Rates," www.ofi.state.la.us/.



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