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JUNE 2021

A Retreat on Pension Reform

City of New Orleans Reverses Steps to Rein in Sharply Rising Pension Costs by Increasing Benefits

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A RETREAT ON PENSION REFORM

CITY OF NEW ORLEANS REVERSES STEPS TO REIN IN SHARPLY RISING PENSION COSTS BY INCREASING BENEFITS

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City of New Orleans Reverses Steps to Rein in Sharply Rising Pension Costs by Increasing Benefits

June 2021

WHY THIS REPORT MATTERS

With almost no public discussion or justification, the City of New Orleans retroactively increased pension benefits last fall by 32% for about 1,000 employees hired since 2018, and all future hires, at substantial cost to the public. This reversed reforms enacted just three years ago to address a steady weakening of the pension system's finances and a steep rise in the public's costs. The higher benefits will consume limited public resources that could have funded other City needs. BGR's analysis of the pension increases found significant problems with virtually every aspect of the decision-making process. Moreover, officials with the City and pension system did not respond to BGR's repeated questions about the pension increases.

KEY FINDINGS

- In late 2017, the City Council reduced pension benefits for employees hired on or after January 1, 2018, to match national norms. In response to concerns raised during extensive public discussion, the council excluded then-current employees from the benefit reduction. The reforms aligned with recommendations from a series of BGR reports that found many pension systems for local public employees, including the City's, provide benefits well in excess of national norms at substantial cost to taxpayers.

- In reversing the pension reforms in October 2020, City administrators stated that the higher benefits are necessary for competitive reasons. However, in response to a BGR public records request, they indicated they have no data substantiating problems with hiring and retention to justify the across-the-board pension increase.

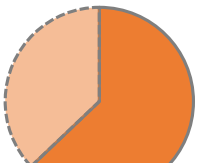
- The more generous benefits significantly exceed the national norm for public pension systems that participate in Social Security, such as the City's. An employee who starts at $40,000 and retires after 30 years will receive more in annual pension and Social Security benefits than in salary while working. The changes apply to about a third of the 3,000 employees enrolled in the New Orleans Municipal Employees' Retirement System (NOMERS), which includes all City employees except police and firefighters.

INBRIEF CONTINUED ON NEXT PAGE ▷

KEY NUMBERS

32%
pension benefit increase for about 1,000 employees hired since 2018 and all future hires

$300 million
unfunded gap between assets and accrued benefits for the NOMERS pension plan



59%
funded ratio of plan assets to plan liabilities. The recommended goal is 100%; below 70% is cause for serious concern.

700%
increase in the public's annual contributions to the retirement system since 2008

INBRIEF

- With the reversal of the pension system reforms, NOMERS' plan for closing an existing $300 million gap between its assets and employees' accrued benefits places the entire financial burden on the public in the form of large annual catch-up contributions for at least the next 25 years.

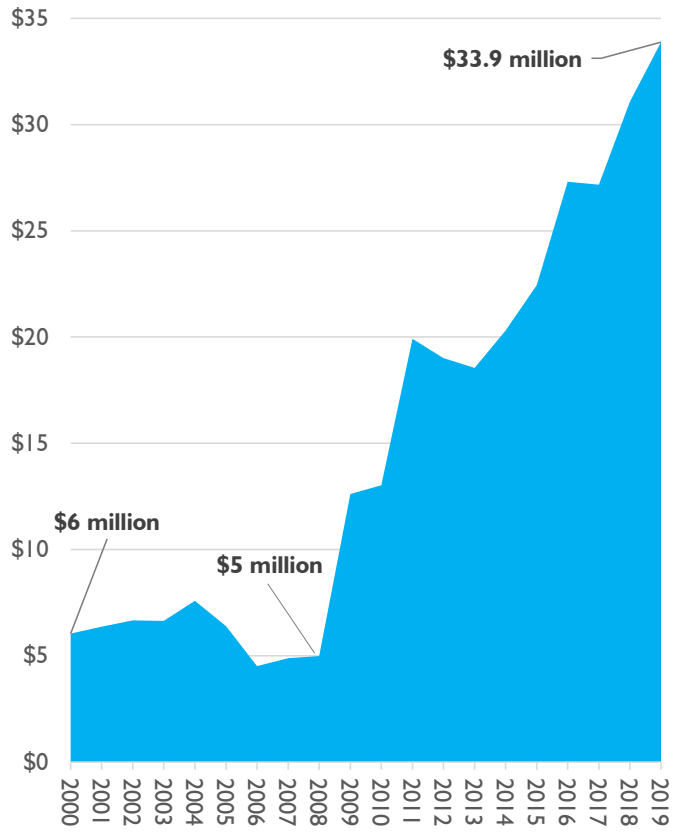
- The higher benefits rolled back efforts to control the public's pension system costs, which ballooned from $5 million in 2008 to $33.9 million in 2019, a nearly 700% increase. (See chart.)

- NOMERS' actuarial projections for the public costs of the benefit increases over 30 years have varied widely from less than $19 million to $115 million. Officials with NOMERS and the City did not respond to BGR's repeated requests seeking an explanation for these large fluctuations.

- While the City emphasized that the public's pension contributions will drop by an estimated $5.8 million in 2021, this is due to a decision to spread the catch-up payments over a longer time period. It does not reflect an improvement in the system's finances. Moreover, the public's costs could increase if the system does not achieve an ambitious target rate of return on its investments.

- An opaque decision-making process minimized public discussion and input, leaving taxpayers unaware of the substantial new costs they must bear for decades to come.

PUBLIC CONTRIBUTIONS TO THE NEW ORLEANS MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM, 2000 TO 2019
($ in millions)



Note: Public contributions totaled $33.9 million, of which $30.7 million came from the City and the balance from other participating Orleans Parish government employers.

Sources: New Orleans Municipal Employees' Retirement System financial statements and actuarial reports

SUMMARY OF RECOMMENDATIONS

- The City Council should restore the more financially sustainable benefit structure from the 2017 pension reforms. While there are legal questions about whether the council can apply the reinstatement to current employees hired since the beginning of 2018, it is not prevented from doing so for future hires. If the City administration subsequently demonstrates any problems with hiring or retention in certain departments or positions, it should seek targeted, cost-effective and sustainable compensation changes to address them rather than an across-the-board pension increase.

- NOMERS officials, the City administration and the City Council should improve their stewardship of, and public accountability for, the weakening pension system. As BGR has previously recommended, this should include consideration of alternative retirement plan designs. For example, defined contribution plans or hybrid plans that combine defined contributions with a reduced defined benefit would shift some risk from employer to employees in exchange for greater plan portability if they change jobs. The officials also should explain the widely varying cost estimates for the benefit increases.

EXECUTIVE SUMMARY

Last fall, the City of New Orleans quietly increased pension benefits by 32% for about 1,000 employees hired in the past three years and all future hires. This is highly problematic for several reasons. It reversed 2017 reforms designed to bring benefits in line with national norms, reduce the public's sharply rising pension costs and make the system more sustainable for employees. The City enacted the more generous benefits despite the continued weakening of the pension system's financial position, which requires taxpayers to fund large annual catch-up payments. The public's pension contributions have ballooned from $5 million in 2008 to $33.9 million in 2019, a nearly 700% increase. The higher benefits add new costs to a system that already places a substantial burden on taxpayers. A pension system actuary has provided three widely varying estimates of the additional costs, which officials with the City and pension system would not explain.

City administrators stated that the higher benefits are necessary for competitive reasons. But in response to a BGR public records request, they indicated they do not have data substantiating problems with hiring and retention that would necessitate an across-the-board pension increase. While the administrators emphasized that the City's pension contributions will drop by an estimated $5.8 million in 2021, this is due to a technical change to spread the catch-up payments over a longer time period. It does not reflect an improvement in the pension system's finances. Meanwhile, the City Council approved the benefit increases through an opaque process that severely limited public discussion and awareness of the changes. This stands in stark contrast to the highly publicized, data-driven process that led to the 2017 reforms.

This report seeks to inform citizens about the pension increases for the New Orleans Municipal Employees Retirement System (NOMERS), which covers all City employees except police and firefighters. It analyzes the benefit increases in the context of the system's weakening finances and the public's rising costs. The report concludes with recommendations to return the pension system to a more affordable and sustainable path. BGR provided a working draft of the report to NOMERS and City officials to review for accuracy. NOMERS officials responded with only a brief statement that they disagreed with the findings. They did not provide any specifics or corrections. Neither the City administration nor City Council responded.

Key Findings

Pension reforms. In late 2017, the City Council reduced pension benefits for employees hired on or after January 1, 2018, to match national norms for public pension systems that participate in Social Security. In response to concerns raised during extensive public discussion of the changes, the council excluded then-current employees from the benefit reduction. In another compromise to help offset the lower pensions, the council approved a 10% pay raise for employees earning less than $25,000. The reforms aligned with recommendations from a series of BGR reports that found many pension systems for local public employees, including NOMERS, provide benefits well in excess of national norms at substantial cost to taxpayers.

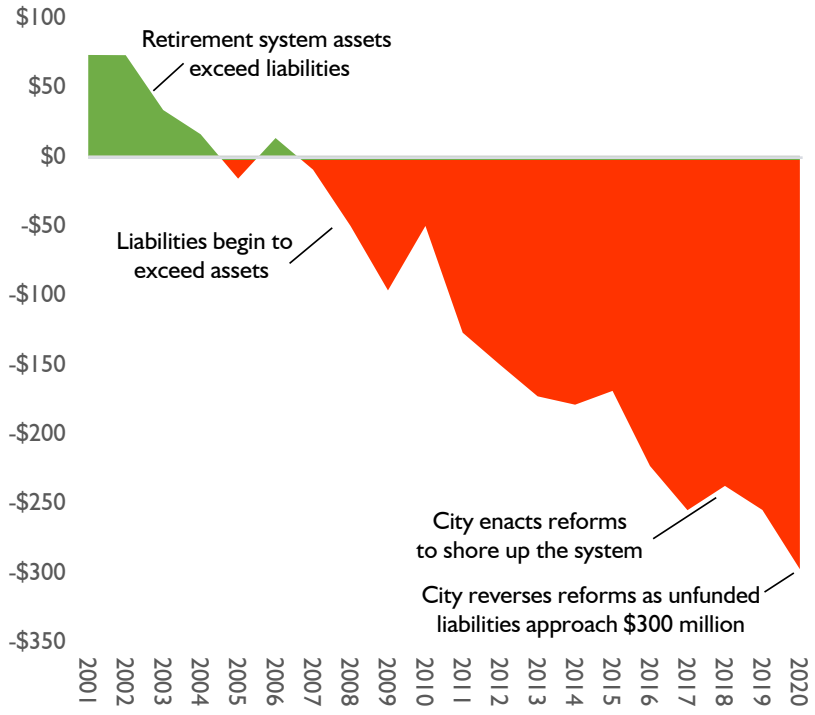
Reform reversal. The City reversed the pension reforms in October 2020 by retroactively increasing benefits for all employees hired since the start of 2018 as well as future hires. The change applied to 1,004 of the approximately 3,000 employees enrolled in NOMERS. Under the new terms, an employee who starts at $40,000 and works for 30 years will receive a pension benefit that, when combined with Social Security, will replace 105% of pre-retirement income. In other words, the employee will receive more after retiring than while working. Under the abandoned pension reforms, the employee would replace 87% of pre-retirement income – a rate in line with national norms.

Lack of data. Despite claiming the reversal was necessary for hiring and retention purposes, City administrators did not demonstrate any problems in these areas or that the across-the-board pension increases were necessary to solve them. NOMERS officials cited anecdotal accounts of applicants for City jobs seeking benefits commensurate with other public pension systems, particularly the regular plan of the Louisiana State Employees' Retirement System (LASERS). With the recent increase in NOMERS benefits, the two systems now offer the same pension benefits. However, the employee contribution for LASERS is 33% higher, which makes the NOMERS benefits far more generous. Moreover, anecdotal evidence is inadequate for a decision with substantial long-term fiscal impacts. The lack

of data and analysis supporting the pension increase contrasts with the 2017 pension reforms, which were informed by a study of employee compensation and research on public pension norms and best practices.

Lack of transparency. City officials never publicly discussed the necessity of the pension increases, which were included in a broader ordinance that also enacted voluntary retirement incentives to reduce personnel costs amid the pandemic-related fiscal crisis. In fact, a council meeting summary posted on its website discussed the retirement incentives in detail but did not mention the sizable pension increases, which garnered no news media coverage. The ordinance did not come before one of the council's committees for an in-depth review prior to approval by the full council. This contrasts with the handling of most other City ordinances with significant fiscal or policy implications, including the 2017 pension reform ordinance. That ordinance received a high-profile public vetting at multiple meetings that included significant input from employees and their representatives.

UNFUNDED LIABILITIES: THE GAP BETWEEN ASSETS AND ACCRUED BENEFITS FOR THE NEW ORLEANS MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM
($ in millions)



Note: All figures are for the beginning of the year.
Source: New Orleans Municipal Employees' Retirement System actuarial reports

A $300 million shortfall. The City increased pension benefits despite a significant weakening in NOMERS' finances during the past 20 years. As the chart illustrates, in the early 2000s, the system's assets more than covered the pension benefits that current and former employees had earned. But by 2020, the system's assets covered just 59% of accrued benefits, leaving a shortfall of nearly $300 million. Pension experts say that retirement systems should strive for 100% coverage of accrued benefits and that a drop below 70% is cause for serious concern. NOMERS officials note that they adopted a plan in 2020 to achieve full funding in 25 years. However, the plan assumes an average annual return on investments of 7.25%, which is higher than the 6% return that Standard & Poor's recommends. The system has reached or exceeded a 7.25% return just once in the last 16 years. Indeed, NOMERS' funding gap has continued to grow, even as the stock market has recovered from the Great Recession and the COVID-19 downturn to reach new all-time highs.

Rising public costs. NOMERS' plan to close the funding gap places the entire burden on taxpayers in the form of large annual catch-up contributions from the City's General Fund. These contributions have caused the public's pension costs to increase 700% during the past 12 years. The 2017 pension reforms eased some of the taxpayer burden with lower and more affordable benefits that were aligned with national norms, but the City's reversal of those reforms put the weight back on taxpayers. The estimated $5.8 million decline in the City's 2021 pension costs is largely the result of the NOMERS board's decision to spread the catch-up payments over 25 years instead of 15 years. Also, if the system does not achieve the assumed 7.25% rate of return, the public's contributions must increase to make up the difference.

Shifting cost projections. NOMERS' actuary initially projected that the more generous benefits would cost the public an estimated $115 million over 30 years. After the pension increases took effect, the actuary reduced the projected costs to $47 million. In this report, BGR raises questions about whether the divergent estimates use the same assumptions and methodology, and whether they

accurately estimate the public's costs. Officials with the City, NOMERS and the actuarial firm did not respond to BGR's repeated requests for information necessary to answer those questions. BGR contacted a national public pension expert with experience in actuarial modeling to review the cost estimates. The expert could not explain the conflicting public cost projections. In addition, they noted that the NOMERS benefit increase is highly unusual in the current era of pension reform.

Fiscal crisis. The permanent increase in pension benefits came less than two weeks after the City announced temporary furloughs for all employees to address the pandemic-related fiscal crisis. By enacting measures that successively reduced and increased personnel costs, the City appeared to be working at cross purposes, undermining its public message on the need for frugality. While the City is now slated to receive a large infusion of federal dollars to aid its fiscal recovery, federal law prohibits the City from using this one-time revenue to reduce the current pension funding gap or cover the substantially higher pension costs in the decades to come.

Conclusion and Recommendations

This report demonstrates several troubling aspects of the City's retreat on pension reform. Amid a steady weakening of the pension system's finances and a steep rise in public costs, the City abandoned reforms to address these problems and increased benefits to levels well above national norms. It did so without providing data to demonstrate the necessity of such a large and long-term increase in spending, which will consume limited public resources that otherwise could have gone to clearly documented needs. NOMERS claimed problems with employee recruitment and retention justified the change, but provided only anecdotal evidence to substantiate this. Moreover, the pension increases have made NOMERS' benefits far more generous than one of the primary competitors.

The City enacted the pension increases through an opaque process that deviated from normal practices. This prevented public discussion of the changes and left most taxpayers unaware of the substantial new costs that they will have to pay for decades to come. NOMERS' actuarial projections for those costs varied substantially before and after the City enacted the benefit increases, raising more questions about the data behind the pension changes. The refusal of City and NOMERS officials to explain these large swings in cost estimates displays a troubling lack of transparency that undermines citizens' ability to evaluate the pension increases. In short, there are significant problems with virtually all aspects of the decision-making process.

For these reasons, BGR makes the following recommendations:

- The City Council should restore the more financially sustainable benefit structure from the 2017 pension reforms. While there are legal questions about whether the council can apply the reinstatement to current employees hired since the beginning of 2018, it is not prevented from doing so for future hires. If the City administration subsequently demonstrates any problems with hiring or retention in certain departments or positions, it should seek targeted, cost-effective and sustainable compensation changes to address them rather than an across-the-board pension increase.
- NOMERS and the City administration should explain the widely varying cost estimates for the benefit increases.
- NOMERS, the City administration and the City Council should improve their stewardship of, and public accountability for, the weakening pension system. As BGR has previously recommended, this should include consideration of alternative retirement plan designs. For example, defined contribution plans or hybrid plans that combine defined contributions with a reduced defined benefit would shift some risk from employer to employees in exchange for greater plan portability if they change jobs.
- NOMERS should review its comparisons to LASERS to assess whether the substantially lower employee contribution rate for NOMERS is appropriate. NOMERS also should end its position that current employees and future hires should have the same pension benefits in the interest of fairness. This precludes benefit adjustments as an option to make the system more sustainable and affordable, and is unfair to taxpayers who must bear all the financial risk.

INTRODUCTION

Starting in 2018, the City of New Orleans reduced pension benefits for newly hired employees to help shore up the finances of the City's pension system and bring benefits in line with national norms. The changes addressed a decade of sharply rising pension costs for the City and, ultimately, taxpayers. Because the system lacks sufficient assets to cover benefits employees have earned, the City must make large catch-up contributions each year. This caused the public's pension costs to balloon from $5 million in 2008 to $33.9 million in 2019, a nearly 700% increase. The benefit reduction was a significant step toward making the pension system more affordable for the public and sustainable for employees.

City officials indicated they do not have data substantiating problems with hiring and retention that would justify such an increase.

However, less than three years after the reforms took effect, the City quietly reversed them last fall by retroactively increasing pension benefits by 32% for about 1,000 employees hired since January 1, 2018, and all future hires. An actuary for the pension system initially projected that the more generous benefits would cost the public an estimated $115 million over 30 years.[1] After the pension increases took effect, the actuary reduced the projected costs to $47 million over 30 years.[2] However, BGR's analysis raises questions about whether the estimates are apples-to-apples projections and whether they underestimate the public's costs. Officials with the City, the pension system and the actuarial firm did not respond to BGR's repeated requests for information necessary to answer those questions.

The seven-member City Council unanimously approved the increased pension benefits on October 15 at the request of the City administration. Administrators stated that the higher benefits are necessary for competitive reasons. But in response to a BGR public records request, they indicated they do not have data substantiating problems with hiring and retention that would necessitate an across-the-board pension increase. While the administrators emphasized that the City's pension contributions will drop by an estimated $5.8 million in 2021, this is due to a technical change to spread the catch-up payments over a longer time period. It does not reflect an improvement in the pension system's finances. Meanwhile, the City Council approved the benefit increases through an opaque process that severely limited public discussion and awareness of the changes. This contrasts sharply with the high-profile, data-driven process that led to the 2017 reforms.

BGR opposed the pension changes, which reversed reforms implementing key recommendations from a 2016 BGR report on local public pension systems.[3] The report found that the City's system, among others, provided generous benefits that far exceeded national norms at substantial cost to taxpayers. It is one of several reports BGR has released in the past decade analyzing the runaway costs of many public pension systems. See the sidebar on p. 9 for details.

In this report, BGR presents an overview of the pension increases in the New Orleans Municipal Employees' Retirement System (NOMERS). It examines the decision-making processes of the City administration, the pension board and the City Council. The report then analyzes the increases in the context of the system's weakening finances and the public's rising costs. Finally, it makes recommendations to return the system to a more sustainable and affordable path.

BGR provided a working draft of the report to NOMERS and City officials to review for accuracy. NOMERS officials responded only with a brief statement that they disagreed with the findings. They did not provide any specifics or corrections. Neither the City administration nor City Council responded.

OVERVIEW OF PENSION BENEFIT INCREASES

Table 1 shows the changes in pension benefits for NOMERS, which covers all City employees except police and firefighters. The changes apply retroactively to employees hired since January 1, 2018, when the reduced benefits took effect. Employees hired before that date did not see their benefits reduced and are not affected by the recent changes. Overall, the changes apply to 1,004 of the approximately 3,000 employees in NOMERS, or 33%.[4] About 90% of NOMERS participants are City employees. The rest are employees of other government entities in Orleans Parish.[5]

TABLE 1. CHANGES TO NEW ORLEANS MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM BENEFITS
(Applies to employees hired since January 1, 2018, and all future hires)

	Previous plan	New plan
Benefit multiplier*	1.9%	2.5%
Eligibility for early retirement benefits	30 years employment, or 62 years old and 20 years employment	Same as before plus option of 80 years of combined age and employment
Eligibility for reduced early retirement benefits	None	60 years old and 10 years employment
Cap on annual compensation eligible for pension benefits**	$100,000	$150,000

* This figure is multiplied by the number of years of employment to determine the percentage of final compensation that a retiring employee will receive in annual pension benefits.
** The NOMERS board of trustees may adjust the cap for inflation from time to time.

Sources: City of New Orleans Code of Ordinances and Ordinance Calendar No. 33,145.

The most significant change is the increase in the multiplier used to calculate pension benefits from 1.9% to 2.5%. Multiplying this figure by the number of years of employment determines the percentage of final compensation that a retiring employee will receive in annual pension benefits. For example, with the new 2.5% multiplier, an employee with 30 years of service would receive 75% of final compensation. That is nearly one-third more than the 57% of final compensation the employee would receive with a 1.9% multiplier, which is the national median for public pension systems like NOMERS, in which employers and employees also contribute to Social Security.[6]

BGR estimates that an employee who starts at $40,000 and works for 30 years with a 2.5% multiplier will receive a pension benefit that, when combined with Social Security benefits, will replace 105% of pre-retirement income.[7] In other words, the employee will receive more after retiring than while working. With a 1.9% multiplier, the employee would replace 87% of pre-retirement income – a rate in line with national norms.[8]

Other pension changes adopted in October for employees hired since January 1, 2018, raised the cap on annual compensation eligible for pension benefits by 50% and provided new pathways to qualify for early retirement benefits. The ordinance also included voluntary retirement incentives to address the City's pandemic-related fiscal crisis by removing higher-salaried veteran employees from the payroll.[9]

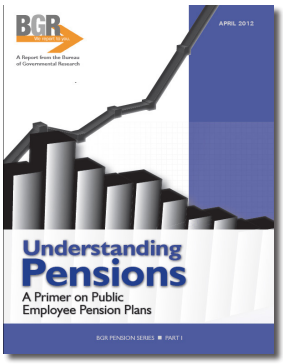
FLAWED DECISION-MAKING PROCESSES

City Administration

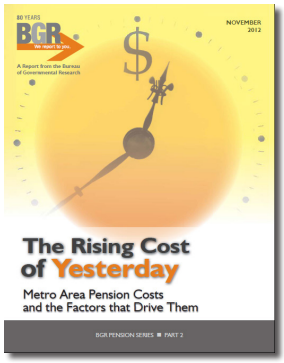
City administrators did not respond to BGR's requests to discuss their rationale for the pension increase. In a legislative summary attached to the draft ordinance, administrators briefly stated that the changes were necessary to make employee pensions more competitive.[10] However, they did not provide information or data documenting any problems with employee recruitment or retention. BGR submitted a public records request for all documents concerning the pension ordinance, including any that analyze its necessity and anticipated impacts. The City's response included reports projecting the long-term costs of the higher benefits and retirement incentives. But there was no data on hiring and retention. Nor was there any analysis demonstrating the necessity of an across-the-board pension increase as opposed to, for example, a potentially far less costly approach of targeted salary increases for any positions that the City may be having trouble filling.

This lack of basic due diligence and fiscal accountability for such a large and lengthy commitment of public dollars was particularly troubling as it came in the midst of the pandemic-related fiscal crisis. By enacting the pension increases just two weeks after announcing furloughs for all City employees, the City appeared to be working at cross purposes, sending mixed messages on the need for frugality during a time of financial distress. While the

BGR RESEARCH ON PUBLIC PENSIONS

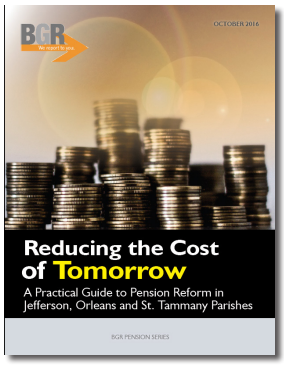


In 2012, BGR began a series of reports on public pensions with *Understanding Pensions: A Primer on Public Employee Pension Plans*. This report laid the groundwork for analyzing the factors driving public pension costs higher in the wake of the Great Recession. It discussed the various types of retirement plans and the differences between plans that are generally available to public and private sector employees. It explained the calculation of pension benefits, employee eligibility criteria, funding mechanisms and measurements of the health of a pension plan.



BGR followed that report with an analysis of 18 pension plans available to local government workers in *The Rising Cost of Yesterday: Metro Area Pension Costs and the Factors that Drive Them*. This report tallied the rising public pension costs in Jefferson, Orleans and St. Tammany parishes and found that local public sector pension benefits are far more generous and secure than what most private sector employees receive. In addition, all but one of the 18 plans were more generous than the median public sector retirement plan.

As pension reform efforts focused in 2013 on the beleaguered City firefighters' pension system, which had assets sufficient to cover just 12% of accrued benefits, BGR published *Sound the Alarm: New Orleans Firefighter Pension Woes and the Legislative Session*. The report examined how the system created a major financial burden for the public, which paid more in pension contributions than firefighter salaries. The report found that the crisis resulted from poor investment decisions, overly optimistic assumptions on investment returns, chronic underfunding and highly generous pension benefits. A subsequent legal settlement between the City and firefighters incorporated several provisions consistent with BGR's recommendations. These included a reduction in the benefit multiplier for new hires from 2.75% to 2.5%, new limitations on cost-of-living adjustments, an increase in the retirement age for new hires and greater City control over the pension plan. The report also revealed that the formula the pension system used to calculate benefits did not comply with Louisiana law, which ultimately led to a change that reduced City costs by at least $1.2 million per year.



In 2016, BGR published *Reducing the Cost of Tomorrow: A Practical Guide to Pension Reform in Jefferson, Orleans and St. Tammany Parishes*, analyzing potential changes to the 18 pension plans to reduce the costs and risks to the public. In many cases, citizens are helping to pay for public sector retirement benefits that are far more generous and secure than their own. In the eight-parish New Orleans area, roughly half of private sector workers lack access to any form of employer-supported retirement plan.

BGR urges policymakers to keep in mind this vast gulf in retirement security and strive to provide public employee benefits that, as part of a total compensation package, will attract and retain high-quality employees – while also ensuring that the level of benefits and their costs are fair to taxpayers. BGR recommends that policymakers consider alternative pension plan designs, such as defined contribution, cash balance, and hybrid plans that combine defined contributions with a reduced defined benefit component. Such alternatives would shift risk from employers to employees in exchange for greater plan portability if they change jobs. These plan designs may also better reflect the evolving expectations and career patterns of the work force.

At a minimum, the report urges policymakers to pursue reforms to the existing defined benefit offerings to bring them to a more reasonable level. Reducing the multiplier used to calculate pension benefits is one of the strongest options. For most of the plans BGR reviewed, including the New Orleans Municipal Employees' Retirement System, the multipliers exceeded the national median by wide margins. This significantly increases the rate at which employee benefits accrue and reduces how long an employee needs to work in order to receive 100% of pre-retirement income. Other reforms that the report recommends considering include requiring employees to make contributions that at least match the national medians for public pension plans, establishing a fixed retirement age more in line with the normal retirement age under Social Security, and leaving it to employees to self-fund cost-of-living adjustments.

KEY CONCERNS WITH THE CITY'S INCREASE IN PENSION BENEFITS

- The City has not demonstrated problems with hiring and retention, nor that increasing pension benefits is necessary to solve them.
- The more generous benefits are significantly higher than national norms for public pension systems that participate in Social Security.
- The higher benefits rolled back efforts to control the public's pension system costs, which ballooned from $5 million in 2008 to $33.9 million in 2019.
- City and pension system officials would not explain widely varying estimates of the public costs for the higher benefits.
- The pension system already has a $300 million gap between its assets and employees' accrued benefits that will require the City to make large annual catch-up contributions for at least the next 25 years.
- While the City emphasized pension contributions will drop by an estimated $5.8 million in 2021, this is due to implementing a longer catch-up period, not an improvement in the system's finances.
- An opaque decision-making process prevented public discussion and input, leaving taxpayers unaware of the substantial new costs they must bear for decades to come.

City is now slated to receive a large infusion of federal dollars to aid its fiscal recovery, federal law prohibits the City from using this one-time revenue to reduce the current pension funding gap or cover the substantially higher pension costs in the decades to come.[11]

Despite these fundamental flaws in the administration's pension proposal, it still won the unanimous support of the NOMERS board of trustees and the City Council. This raises questions about the decision-making processes of both entities on this issue.

NOMERS

The NOMERS board has five trustees: the City's finance director, its personnel director, a mayoral appointee, one trustee elected by current employees enrolled in the pension system, and another elected by the system's retirees.[12] The board is responsible for the operation and general administration of the retirement system. The board reviewed the City administration's proposed benefit increases last summer and obtained an actuarial projection of the annual costs. NOMERS' officials told BGR they also considered other factors, including concerns about the fairness of having two tiers of employees contributing the same 6% portion of their salaries for different benefit levels as a result of the 2018 benefit reduction for new hires.

However, such tiered systems are common among the many public pension systems in all 50 states that have enacted pension reforms in the past decade. In most cases, including in Louisiana, the reforms reduced benefits or increased employee contributions only for new hires. This is due to legal prohibitions and concerns about changing benefits for existing employees. While applying pension changes only to new hires sets up a two-tier (or more) system, employees within each class are treated the same and are aware of the benefits prior to accepting employment. And if no changes could be made for future hires, the systems would essentially be shielded from any reform. This raises its own fairness concerns because it means the public must shoulder the financial burden of stabilizing pension systems that lack sufficient assets to cover long-term liabilities, such as NOMERS.

With no data on hiring and retention, NOMERS officials said they relied on anecdotal accounts of City job applicants who wanted pension benefits that were commensurate with other public pension plans, particularly

> **The pension ordinance – unlike many other City ordinances – did not come before one of the council's committees for an in-depth review prior to approval by the full council. This is particularly unusual for an ordinance enacting complex changes with substantial long-term fiscal impacts.**

the regular plan of the Louisiana State Employees' Retirement System (LASERS). After the recent increase in NOMERS benefits, the two systems now offer the same pension benefits. However, the employee contribution for LASERS is 33% higher, which makes the NOMERS benefits far more generous.[13] Moreover, anecdotal evidence is inadequate for a decision with substantial long-term fiscal impacts. Despite this, in June 2020, the NOMERS board recommended the proposed pension changes to the City Council for its approval.

City Council

The pension ordinance – unlike many other City ordinances – did not come before one of the council's committees for an in-depth review prior to approval by the full council.[14] This is particularly unusual for an ordinance enacting complex changes with substantial long-term fiscal impacts. It also contrasts with the City Council's high-profile public vetting of the 2017 reform ordinances, which included multiple meetings with significant input from employees and their representatives. The original reform ordinance, which proposed a reduction in benefits for some current employees, led to "boisterous" debate at a committee meeting and ultimately revision of the legislation to limit it to new hires.[15] To help offset the lower pensions, the council approved a 10% salary increase for employees earning less than $25,000. This decision was based on a compensation study, marking a contrast with the lack of data informing the recent reversal of the 2017 pension reforms.

The 2020 benefit increases received little discussion and garnered no news media coverage when the ordinance came before the council. The administration did not give a presentation laying out the rationale for the pension changes as it often does for ordinances with significant financial or policy implications. Administrators received a single question on the pension increases from a councilmember who asked how the higher benefits square with efforts to reduce personnel costs through the retirement incentives contained in the same ordinance. Administrators responded by noting that the City's pension costs will decrease by an estimated $5.8 million in 2021. However, this reduction is not related to the pension changes or the retirement incentives, both of which will add to pension costs starting in 2022. Instead, the projected drop in the City's contribution is due to 2020 adjustments to the system's actuarial assumptions. These included spreading catch-up payments to close a $300 million gap between the system's assets and liabilities over a longer time period.[16] While this reduces the amount the City has to contribute each year, it increases the cumulative payments to close the gap.

The City's response to BGR's public records request concerning the pension ordinance did not include any written communications from administrators to council members demonstrating the necessity of the benefit increases. Nor did council members ask for such a justification at the October 15 meeting before approving the ordinance.

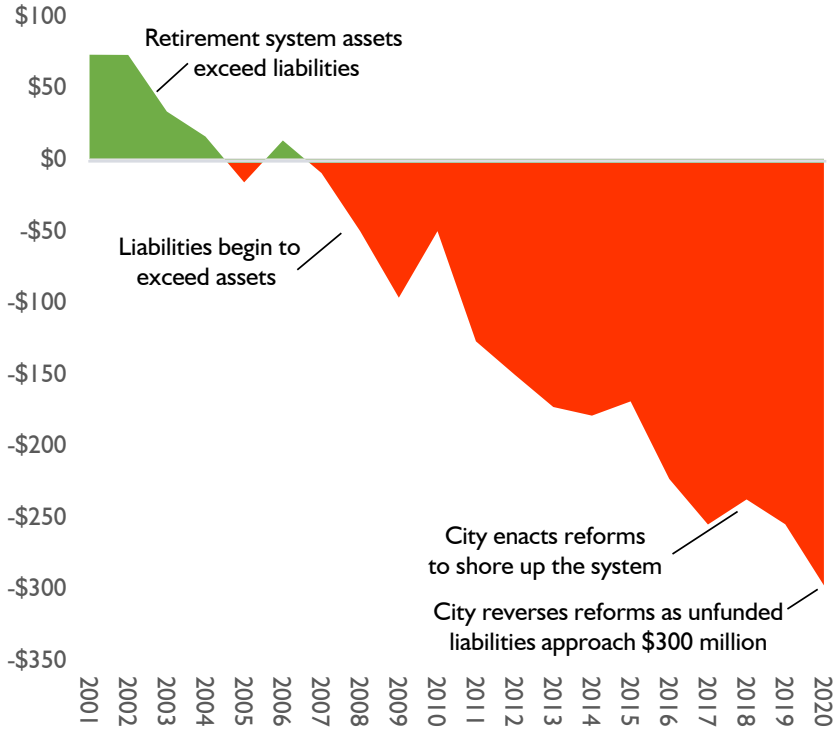
BGR opposed the benefit increases in a comment submitted electronically as required for the virtual council meeting. As part of the council's pandemic protocols, a staff member read aloud any public comments prior to a vote on an agenda item. However, in this instance, staff did not read comments until after the council had approved the changes. In addition, a meeting summary on the council's website discusses the retirement incentives in detail but does not mention the increase in pension benefits. Overall, the council's handling of the proposed pension changes displayed a troubling lack of due diligence, fiscal accountability and transparency, especially given the substantial long-term financial implications.

NEW COSTS FOR A SYSTEM WITH MOUNTING FINANCIAL CONCERNS

The City's increase in pension benefits comes as NOMERS' finances have deteriorated significantly during the past 20 years. As Chart A illustrates, in the early 2000s, the system's assets more than covered the pen-

sion benefits current and former employees had earned. But by 2020, the system had enough assets to cover just 59% of accrued benefits, leaving a shortfall of nearly $300 million. Pension experts say that retirement systems should strive for 100% coverage of accrued benefits and that a drop below 70% is cause for serious concern.[17] Reforms like the ones the City reversed in October were intended to help close the gap between the system's assets and liabilities sooner and put it on a more sustainable footing, saving taxpayers money in the process.

CHART A. UNFUNDED LIABILITIES: THE GAP BETWEEN ASSETS AND ACCRUED BENEFITS FOR THE NEW ORLEANS MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM
($ in millions)



Note: All figures are for the beginning of the year.
Source: New Orleans Municipal Employees' Retirement System actuarial reports

NOMERS' financial position has continued to weaken, even as the stock market has recovered from the Great Recession and COVID-19 to reach new all-time highs. NOMERS officials emphasized that projections based on revised actuarial assumptions and a new approach to the catch-up payments indicate the system could be fully funded by 2044. However, this hinges on achieving an average annual return on investments of 7.25%, which is higher than the 6% assumed rate of return that Standard & Poor's recommends.[18] The system has reached or exceeded a 7.25% return just once in the past 16 years. In addition, the average rate of return during the past 20 years was 5.59%.[19] To the extent that the system does not achieve the 7.25% assumed rate of return, the City's costs would increase, making it more difficult and expensive to close the gap within the projected timeframe.

> **"To the extent that the system does not achieve the 7.25% assumed rate of return, the City's costs would increase, making it more difficult and expensive to close the gap within the projected timeframe."**

In May 2020, the pension system's actuary estimated that the public costs for the higher pension benefits would total $115 million over 30 years. This was the most recent estimate when the NOMERS board recommended that the City Council approve the pension increases. In September 2020, a month before the council's vote, the actuary released a second projection that estimated the public costs for the benefit increases and retirement incentives at $19 million to $70 million, depending on how many employees took the retirement incentives. That report did not include a projection isolating the cost of the benefit increases, but it implied the cost would be less than $19 million. (See the sidebar for details.) After the pension increases took effect, the actuary prepared a third report in March 2021 that projected the public's 30-year costs at $47 million for the pension increases and $10 million for the retirement incentives.

These large swings in the cost estimates over a relatively brief time period raise questions about the consistency of the underlying assumptions and methodology and whether the shifting projections are an adequate basis for such a significant long-term financial commitment. BGR contacted a national public pension expert with experience in actuarial modeling to review the cost estimates.

SUBSTANTIAL UNEXPLAINED FLUCTUATIONS IN THE PUBLIC COST ESTIMATES

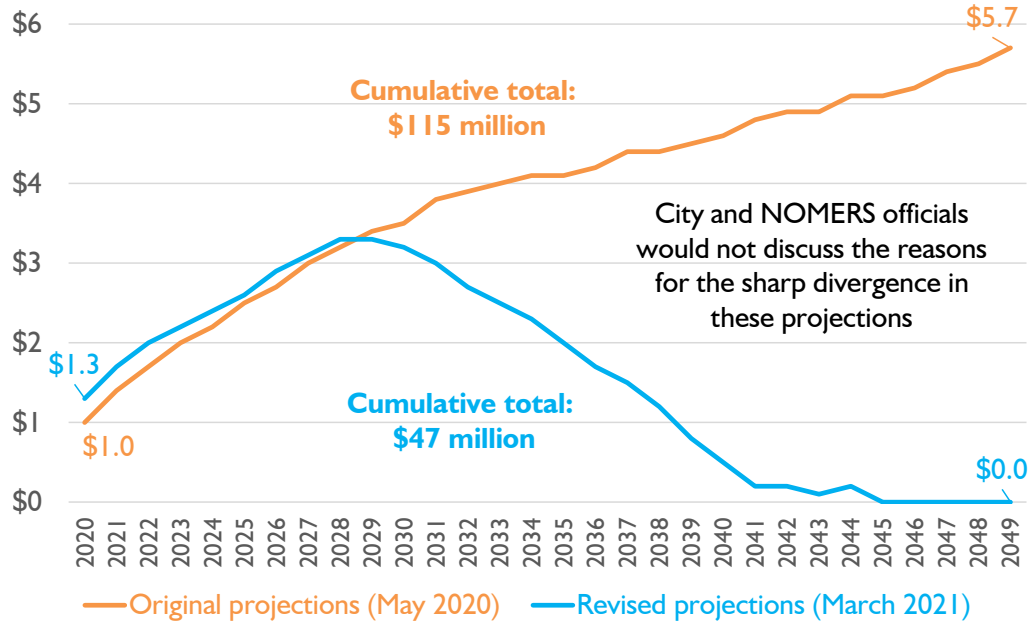
BGR sought to obtain explanations for the substantial fluctuations in the three cost projections for the higher pension benefits, but officials with the City, NOMERS and the actuarial firm did not respond to BGR's questions. For example, as Chart B shows, the first and third reports show similar projections for the annual costs of the benefit increases for the first 10 years. But the projections diverge sharply in subsequent years as the cost estimates in the first report continue to rise while the estimates in the third report decline and eventually reach zero. It is unclear what caused this divergence. In presenting the report to the NOMERS board in April, the actuary said the third report included an unspecified "methodology update." BGR sought clarification, but City and NOMERS officials did not respond.

Meanwhile, the second report appears to assign the vast majority of the public costs to the retirement incentives as opposed to the benefit increase. It estimates that the benefit increase combined with 25% of eligible employees taking the retirement incentives would cost $19 million over 30 years.* That implies the cost of the benefit increase by itself could not exceed $19 million. This is nearly $100 million less than the estimate in the first report. It is also well below the $47 million estimated cost for the benefit increase in the third report. The relatively low cost estimate in the second report is particularly important as it was the current estimate when the City Council approved the pension changes. But, again, City and NOMERS officials would not explain these large fluctuations.

In the third report, the actuary indicated that its projections are based on proprietary actuarial modeling software. However, this should not preclude a public explanation of the large variance in the cost projections as well as any changes in the underlying assumptions and methodology. In presenting the report to the NOMERS board in April 2021, the actuary noted that cost projections for pension systems can vary substantially from year to year based on investment returns. In this case, the first report used the 2019 valuation as the starting point, while the subsequent reports used the 2020 valuation. While this affects the projected costs of the obligations the pension system has already incurred, it would not affect the future additional costs of the new benefits which did not take effect until 2021. In addition, these year-to-year fluctuations in the system's financial position would not explain the differences in the cost projections for the benefit increases as they all assume the same uniform rate of return throughout the 30-year period.

* The report projects that a 50% "take rate" for the retirement incentives – i.e., the percentage of eligible employees choosing early or voluntary retirement – would nearly double the costs to $35 million. It estimates the costs would further increase to $53 million at a 75% take rate and $70 million at a 100% take rate. These steady cost increases of $17 million to $18 million for each 25 percentage-point increase in the take rate suggest that the retirement incentives would account for essentially all of the public's costs, leaving none to be covered by the benefit increases.

CHART B. PROJECTED PUBLIC COSTS OF NOMERS' PENSION BENEFIT INCREASES, 2020 TO 2049
($ in millions)

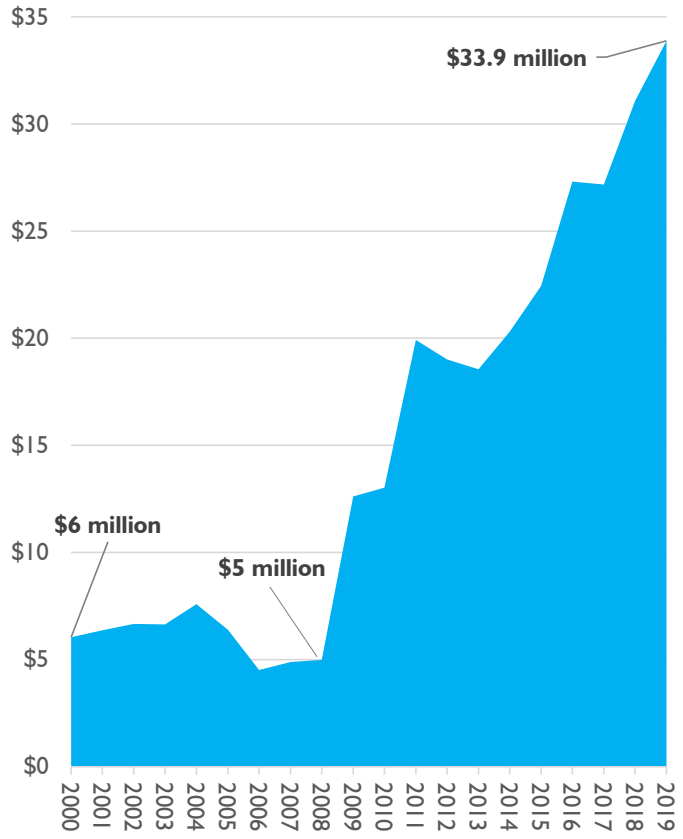


BGR analysis of actuarial projections prepared for the New Orleans Municipal Employees' Retirement System

The expert could not explain the conflicting public cost projections. In addition, they noted that the NOMERS benefit increase is highly unusual in the current era of pension reform.

The costs for the benefit increases are in addition to the City's already large annual pension contributions, which include catch-up payments to close the system's funding gap. Chart C shows the steep increase in public's pension contributions via participating government employers during the past 12 years. As previously discussed, employer costs are projected to decrease by $5.8 million in 2021. But this is due to NOMERS' decision to spread the catch-up payments over a longer time period and does not reflect an improvement in the system's finances.

CHART C. PUBLIC CONTRIBUTIONS TO THE NEW ORLEANS MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM, 2000 TO 2019
($ in millions)



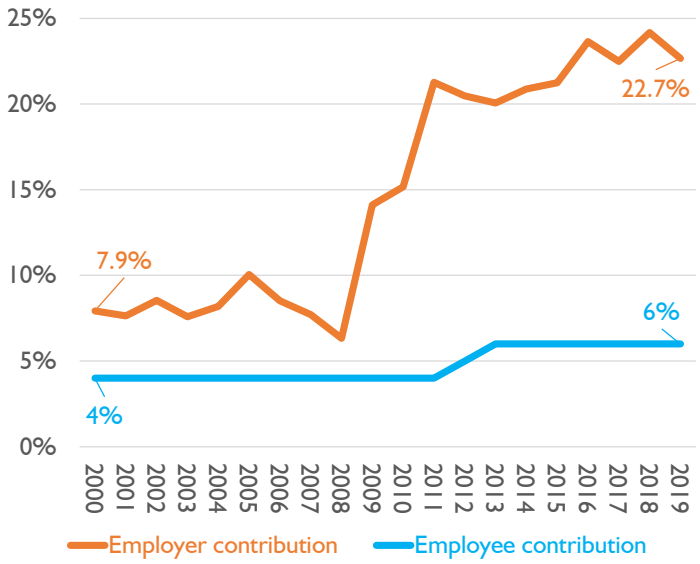
Note: Public contributions totaled $33.9 million, of which $30.7 million came from the City and the balance from other participating Orleans Parish government employers.

Sources: New Orleans Municipal Employees' Retirement System financial statements and actuarial reports

The sharp increase in the City's costs illustrates a key problem with defined-benefit pension systems, such as NOMERS, that guarantee specific retirement benefits. The employer, in this case the City, assumes all of the risk if the system's investments underperform expectations and must increase its contributions to bridge the gap. As Chart D shows, the City's annual contributions as a percentage of payroll nearly tripled from 7.9% to 22.7% during the past 20 years as the pension system's financial position weakened. This is a much larger increase than that for employee contributions, which went from 4% to 6%. The 2017 pension reforms eased some of the taxpayer burden with lower and more affordable benefits that were aligned with national norms. But the City's recent reversal of the benefit reforms put the burden back on taxpayers.

Because of the decision to spread the catch-up payments over a longer time period, the City's projected pension contribution for 2021 dropped to 15.3% of payroll. However, this remains a relatively high figure that is subject to increase if NOMERS does not achieve its targeted 7.25% return on investments.

CHART D. COMPARISON OF EMPLOYER AND EMPLOYEE CONTRIBUTIONS TO THE NEW ORLEANS MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM, 2000 TO 2019
(Figures are the percentage of payroll)



Sources: New Orleans Municipal Employees' Retirement System financial statements and actuarial reports

CONCLUSION AND RECOMMENDATIONS

This report demonstrates several troubling aspects of the City's retreat on pension reform. Amid a steady weakening of the pension system's finances and a steep rise in public costs, the City abandoned reforms to address these problems and increased benefits to levels well above national norms. It did so without providing data to demonstrate the necessity of such a large and long-term increase in spending, which will consume limited public resources that otherwise could have gone to clearly documented needs. NOMERS claimed problems with employee recruitment and retention justified the change, but provided only anecdotal evidence to substantiate this. Moreover, the pension increases have made NOMERS' benefits far more generous than one of the primary competitors.

The City enacted the pension increases through an opaque process that deviated from normal practices. This prevented public discussion of the changes and left most taxpayers unaware of the substantial new costs that they will have to pay for decades to come. NOMERS' actuarial projections for those costs varied substantially before and after the City enacted the benefit increases, raising more questions about the data behind the pension changes. The refusal of City and NOMERS officials to explain these large swings in cost estimates to citizens and taxpayers displays a troubling lack of transparency and fiscal accountability that undermines citizens' ability to evaluate the pension increases. In short, there are significant problems with virtually all aspects of the decision-making process.

For these reasons, BGR makes the following recommendations:

- The City Council should restore the more financially sustainable benefit structure from the 2017 pension reforms. While there are legal questions about whether the council can apply the reinstatement to current employees hired since the beginning of 2018, it is not prevented from doing so for future hires. If the City administration subsequently demonstrates any problems with hiring or retention in certain departments or positions, it should seek targeted, cost-effective and sustainable compensation changes to address them rather than an across-the-board pension increase.

- NOMERS and the City administration should explain the widely varying cost estimates for the benefit increases.

- NOMERS, the City administration and the City Council should improve their stewardship of, and public accountability for, the weakening pension system. As BGR has previously recommended, this should include consideration of alternative retirement plan designs. For example, defined contribution plans or hybrid plans that combine defined contributions with a reduced defined benefit would shift some risk from employer to employees in exchange for greater plan portability if they change jobs.

- NOMERS should review its comparisons to LASERS to assess whether the substantially lower employee contribution rate for NOMERS is appropriate. NOMERS also should end its position that current employees and future hires should have the same pension benefits in the interest of fairness. This precludes benefit adjustments as an option to make the system more sustainable and affordable, and is unfair to taxpayers who must bear all the financial risk.

ENDNOTES

1 The Segal Group, Inc., *City of New Orleans Employees' Retirement System: Proposed Retirement Incentive Program,* May 28, 2020, p. 16. NOMERS received an updated report in September 2020, but it did not include an estimate of the cost of the pension increases separate from voluntary retirement incentives that were also approved.

2 Memorandum from Jeffrey S. Williams of Segal to the Board of Trustees of the City of New Orleans Employees' Retirement System, March 19, 2021.

3 BGR, *Reducing the Cost of Tomorrow: A Practical Guide to Pension Reform in Jefferson, Orleans and St. Tammany Parishes,* October 2016.

4 Information provided by NOMERS. Employees hired before 2018 earn a benefit multiplier of 2.5% for their first 25 years of service and 4% for each year thereafter. They can receive normal retirement benefits at age 65 with five years of service, at any age with 30 years of service, or with 80 years of combined age and employment. They are eligible for reduced early retirement at age 60 with 10 years of service. Their annual compensation that is eligible for pension benefits is capped at $200,000.

5 This includes all employees of the Orleans Parish Communications District, the Board of Liquidation, City Debt, and the Constable of First City Court, and certain employees of the Orleans Parish District Attorney's office and Clerk of Civil District Court.

6 BGR, *Reducing the Cost of Tomorrow*, p. 9. NOMERS calculates final compensation as the average annual compensation for the highest consecutive 60-month period.

7 These calculations assume conservatively that Social Security replaces 30% of pre-retirement income. The 30% estimate is based on the average public retiree's salary. Retirees with lower salaries would replace greater proportions of their earnings through Social Security.

8 Because of lower living expenses, retirees generally need 70% to 80% of their pre-retirement income. BGR, *Reducing the Cost of Tomorrow*, p. 9.

9 BGR did not take a position on the voluntary and early retirement programs, which may help the City reduce current personnel costs. According to Segal's March 19, 2021 memorandum, 50 eligible members of NOMERS elected early or voluntary retirement.

10 The legislative summary for Ord. Cal. No. 33,145 states a general rationale "to make more competitive the retirement allowance provided to employees hired on or after January 1, 2018."

11 The American Rescue Plan Act of 2021 adds this prohibition to Title VI of the Social Security Act, Sec. 602(c)(2)(B).

12 City of New Orleans, Code of Ordinances, Sec. 114-68.

13 The employee contribution is 8% of salary for LASERS' regular plan and 6% for NOMERS, while both plans provide a 2.5% benefit multiplier to new hires.

14 BGR reviewed City Council committee agendas and minutes. BGR also requested a copy of the minutes of any committee meeting at which the ordinance was discussed. The City's response indicated no such document exists.

15 Williams, Jessica, "Amid strong opposition from city employees, Councilwoman Stacy Head pulls plan to reform pension system," *The New Orleans Advocate*, April 27, 2017.

16 The Segal Group, Inc., *City of New Orleans Employees' Retirement System: Actuarial Valuation and Review,* as of January 1, 2020, p. 5. NOMERS previously reset the schedule of catch-up payments annually at the level necessary to close the gap between assets and liabilities over a 15-year period. For 2020, the system switched from this open-ended approach to a layered schedule that catches up the initial unfunded liability over a fixed, 25-year period and spreads any losses in future years over new 25-year periods.

17 For discussion of the 100% funding goal, see the Government Finance Officers Association's recommendation at https://www.gfoa.org/materials/sustainable-funding-practices-for-defined-benefit-pensions, and the Conference of Consulting Actuaries, Public Plans Community, *Actuarial Funding Policies and Practices for Public Pension Plans*, October 2014, p. 9. See also BGR, *Reducing the Cost of Tomorrow,* p. 5. In *Why Funded Status Matters* (October 2019), the bipartisan nonprofit organization Equable writes: "Once the funded ratio of a pension fund drops below 80% for two to three years, or falls below 70% at any point, then all stakeholders should be concerned. At that point, all people who want the pension fund to be able to make its promises should demand to know if there is a serious plan in place to get the pension debt paid off, restoring the funded status to 100%."

18 Standard & Poor's, *U.S. Public Finance: Assessing U.S. Public Finance Pension and Other Postemployment Obligations for GO Debt, Local Government GO Ratings, And State Ratings*, July 21, 2020.

19 The Segal Group, Inc., *City of New Orleans Employees' Retirement System: Actuarial Valuation and Review,* as of January 1, 2020, p. 20. These return rates are based on the actuarial value of the system's assets, which is a rolling seven-year average of the market value of the assets. Ibid., p. 43.

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