

Chester's Retiree Benefit Situation

MFRAC Committee Meeting

May 25, 2021



THE KAPOOR COMPANY
ADVISORS & CONSULTANTS

Overview

- The purpose of this presentation is to provide the basic facts surrounding the City of Chester's pension and retiree health care situation
- The City's pension and retiree health care funding situation are the worst of any city in the Commonwealth
- The police pension plan remains critically underfunded and close to running out of money to pay pension benefits.
- In 2021, the City will spend approximately \$14.6 million or 27.8% of its entire General Fund budget on pension and retiree health care costs
 - Every dollar spent on these legacy costs is a dollar that the City cannot spend on other City needs. By contrast, the budget allocates only \$500,000 for capital or economic and community development initiatives
- The key question that we face is:
 - How can the City contribute enough to its employee pension plans – especially the police plan which is nearly insolvent – without drawing so much money from the City's limited resources that it cripples City operations or pushes taxes and fees to a level that residents cannot afford?

Basic Facts on Chester's Pension Situation

- Chester has three employee pension plans:
 - Police Pension Plan (PPP) for police retirees
 - Fire Pension Plan (FPP) for fire retirees
 - Officers and Employees Pension Plan (O&E) for eligible City employees not in the PPP or FPP
- These three plans are “defined benefit” plans which means that the monthly benefit payments that retirees receive during retirement are set at a specific level, regardless of the plan’s funding status. The risk for a defined benefit plan is on the City and by extension taxpayers.
 - In “defined contribution” plans, which are common in the private sector, the benefit is determined by how much is available to fund the benefit and the risk is on the retiree.
- Every two years, an actuary conducts a **valuation** which compares the assets of a pension fund to the liabilities that it owes. The last valuations completed for the City’s funds were as of January 1, 2019.
- Every year, the actuary calculates how much the City legally needs to contribute to the plans which is called the **Minimum Municipal Obligation** or “**MMO**”

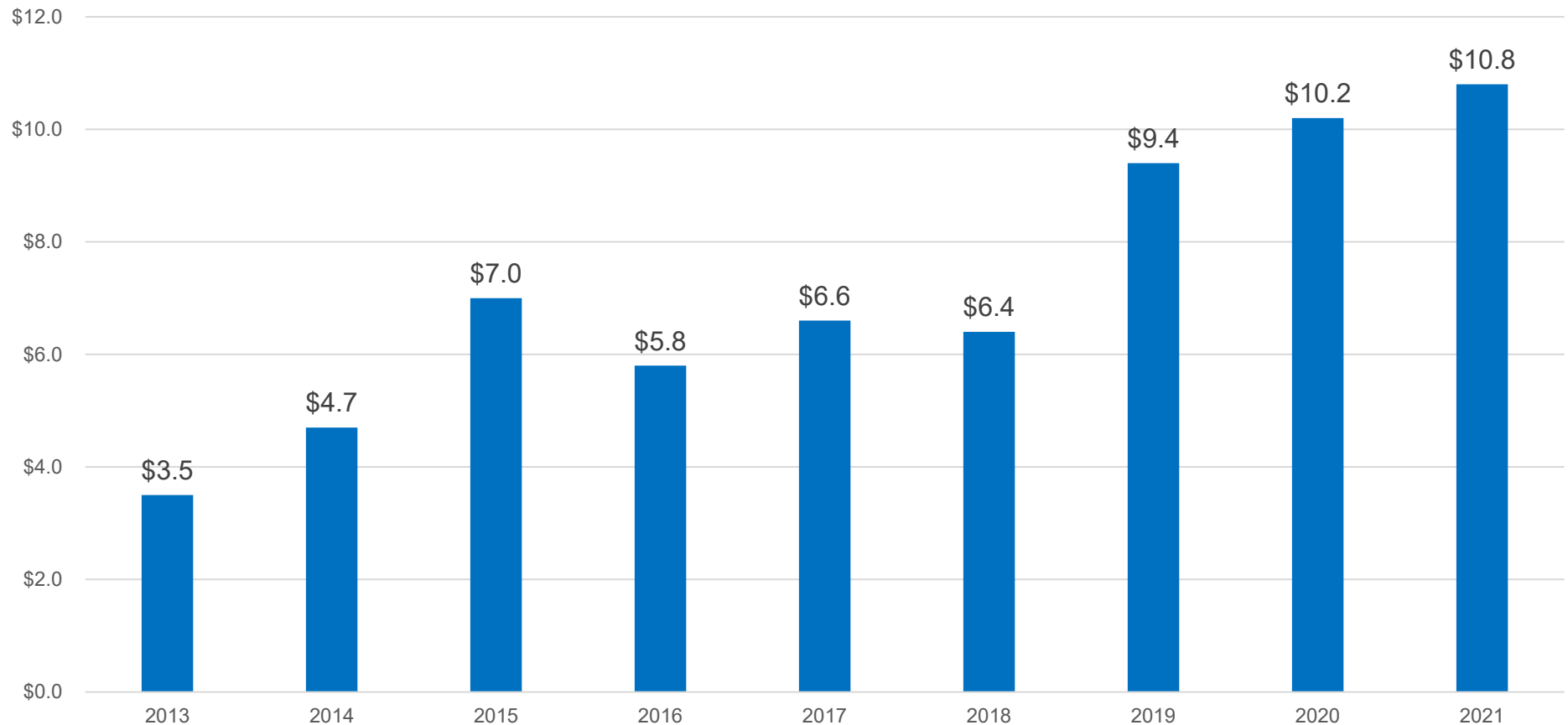
Basic Facts on Chester's Pension Situation (continued)

- Chester's MMOs have more than tripled since 2013 to \$10.8 million in 2021.
- Due to the number of retirees and its relative financial weakness, the police pension plan comprises approximately \$8.5 million or 85% of the City's 2021 MMO.
- The City has not been able to afford making its full MMO payment since 2013. As a result, the City is incurring penalties and interest costs on these missed payments and its police pension plan is dangerously close to running out of money to pay benefits.
- Chester's pension situation is the worst of any city in the Commonwealth and is even worse than reflected in the 1/1/2019 valuation because those valuations assume that there is much more money in the police pension plan than there actually is.
 - We discuss this in more detail on slide 7
- The next group of slides provides data to support the statements on this slide.

City MMO Growth

The City's combined Minimum Municipal Obligation for its three pension funds has more than tripled since 2013.

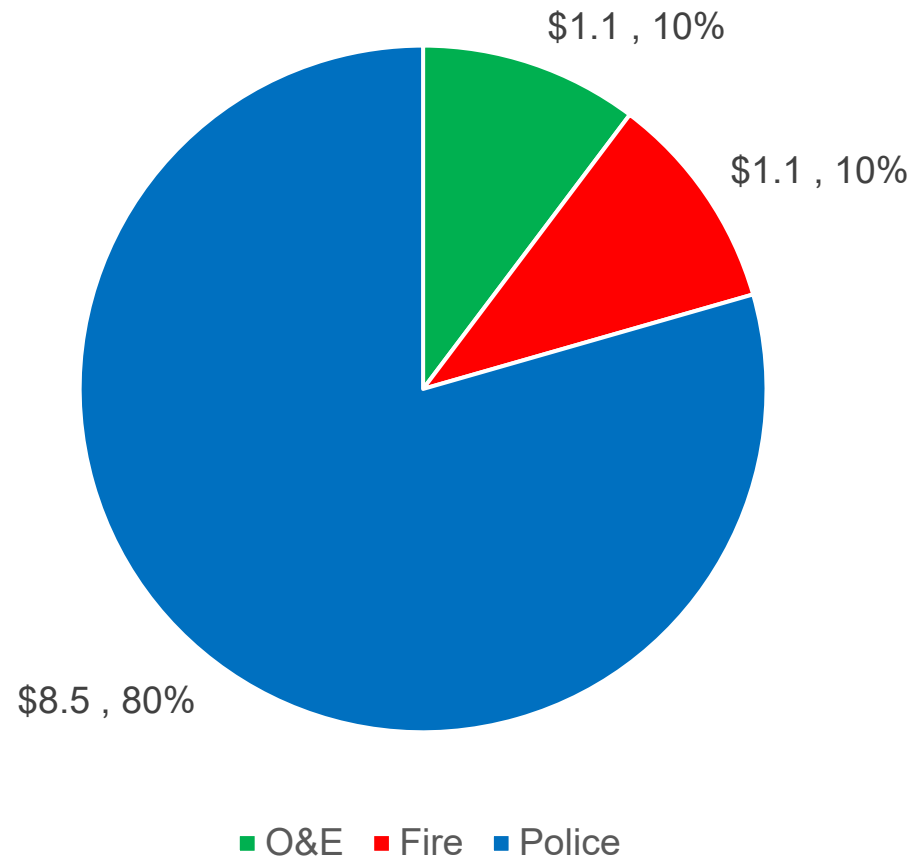
City Minimum Municipal Obligations (\$ Millions), 2013 - 2021



City MMO by Plan

Because of the number of retirees and its relative financial weakness, the police pension plan makes up approximately 80% of the City's total MMO.

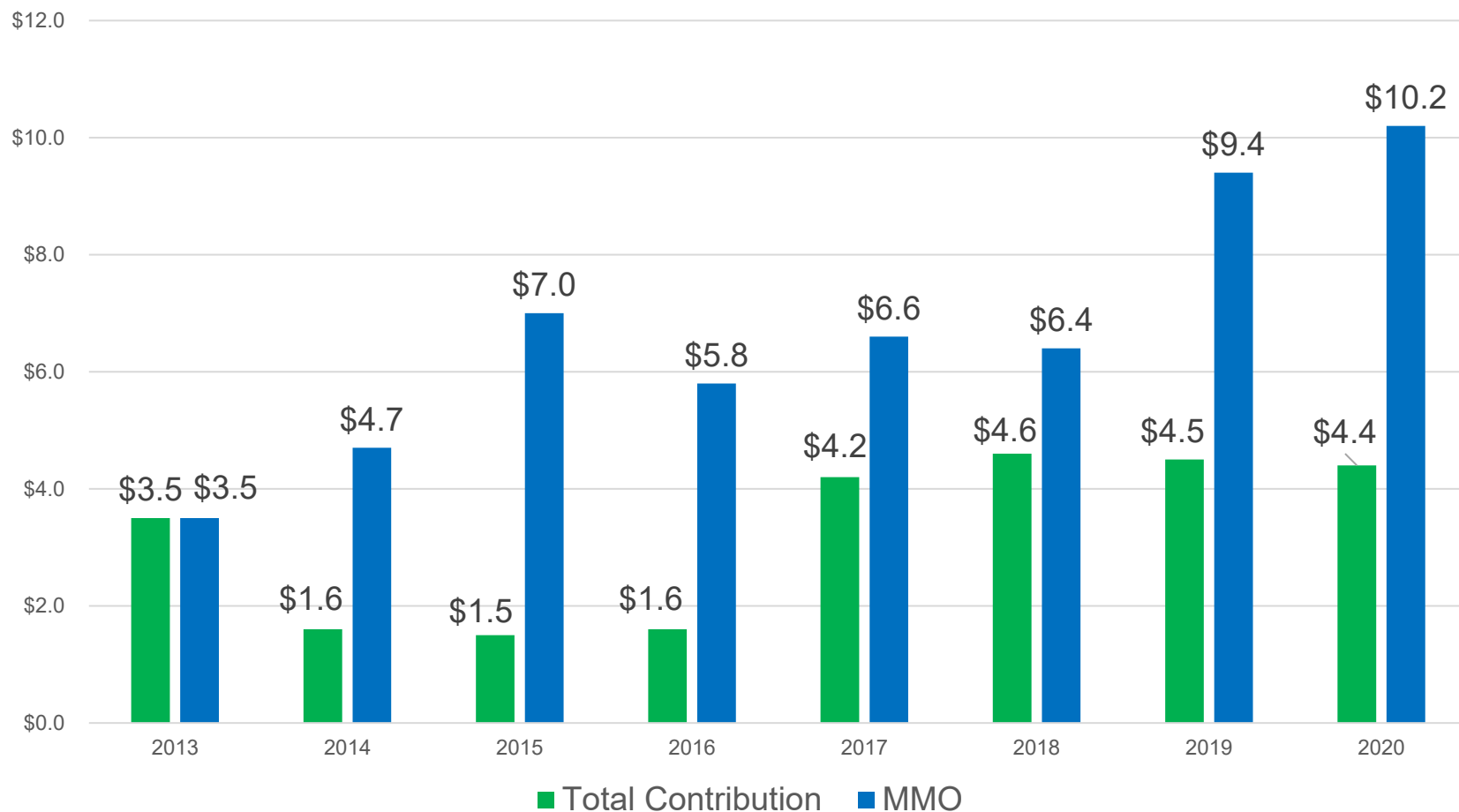
City MMO by Plan (Millions), 2021



City MMOs vs. City Contributions

The City has not been able to afford to make its full MMO payment since 2013. Last year, the City only contributed \$4.4 million towards a \$10.2 million MMO.

City Contributions Relative to MMOs (\$ Millions), 2013-2020



The True Status of Chester's Pension Funds

- Although many Pennsylvania cities have underfunded pensions, as of 1/1/2019, the Chester's situation is the worst among Pennsylvania cities. The following table reflects the funding percentages of the plans in the 1/1/19 valuation.

	PPP	FPP	O&E	Total
Liabilities	\$83,195,607	\$39,891,425	\$8,028,817	\$131,115,849
Assets	\$27,992,535	\$33,275,475	\$2,674,647	\$63,942,657
Unfunded Liability	-\$55,203,072	-\$6,615,950	-\$5,354,170	-\$67,173,192
Funded %	33.6%	83.4%	33.3%	49%

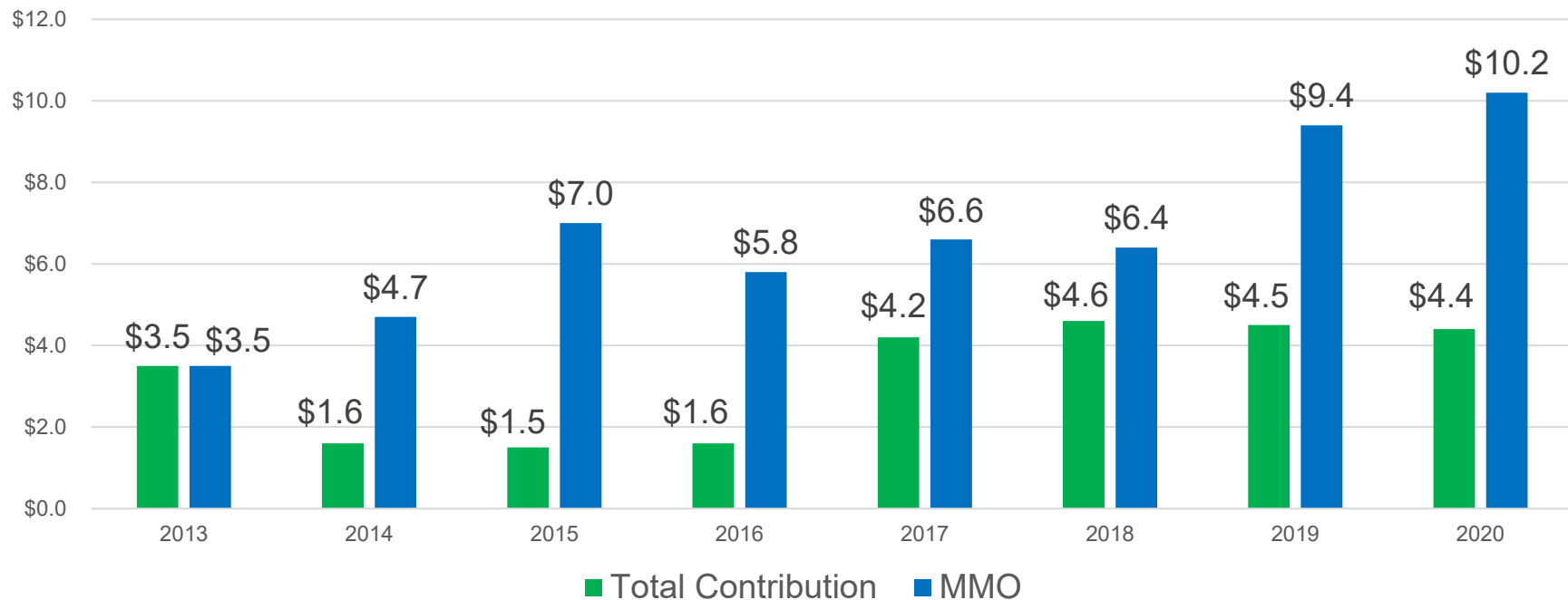
- However, the problem is even worse than what appears in the 1/1/2019 valuations because those calculations treat the MMO contributions that the City did not make in prior years and still owes as if that money was already in the plan because they are “receivables” due to the plan.**
- In the above table, the police pension plan appears to have \$27,992,535 in assets as of 1/1/2019 with a funding percentage of 33.6%. However, almost all of those assets are “receivables.” Excluding the receivables, as of 12/31/2019, the police pension plan's funding percentage was closer to 3%.
- Excluding receivables, which is a more accurate reflection of reality, will also cause the MMO to increase. The actuary is in the process of determining this amount and we expect an answer soon.



How Did Things Get So Bad in the Pension Funds?

- The City fell behind on its MMO payments in 2014 and has never been able to catch up
 - Note: Part of the reason why the police pension fund is so poorly funded relative to the fire plan is that in previous years, the City made contributions to the fire pension fund but not the police pension fund. In recent years, the City only contributed to the police pension fund

City Contributions Relative to MMOs (\$ Millions), 2013-2020



How Did Things Get So Bad in the Pension Funds? (Continued)

- The benefits offered to police employees are far richer than what Chester can afford and far rich than the standards established in Pennsylvania's Third Class City code
 - Police officers hired before 2/1/17 can retire with 20 years of service regardless of age and can accelerate their retirement date by purchasing pre-employment military time resulting in officers retiring in their 40s
 - Police officers hired before 2/1/17 receive a benefit starting at 50% of final pay and increasing to 70% with 25 years of service, plus any service increment. Those hired after receive a benefit of 50% of the higher of final monthly salary or highest annual average during any five preceding years
 - The pension benefit calculation for police officers hired before 2/1/17 included overtime which enables officers to work large amounts of overtime before retirement resulting an elevated pension benefit. Overtime is not counted in the pension benefit for officers hired after that date
 - In 2020, three police officers ages 44, 45, and 42 entered the DROP program with pensionable salaries of \$210,874, \$207,414 and \$143,311 respectively. Under the current benefit provisions, their pensions will be \$108,073, \$103,707 and \$71,652. The median household income for Chester in 2019 was \$32,403
 - The City had an unusually high number of disability pensions and until recently, disability pensions were paid at a higher rate (100% of last 12 months salary) than non-disability pensions, creating an incentive to retire on disability

Basic Facts on Chester's Retiree Health Care Situation

- In addition to pension benefits, the City also provides many of its employees and retirees with retiree health care which the City must pay for (these benefits are referred to as “other post-employment benefits” or OPEB)
 - As of February 2021, there were 178 retired employees on the City’s retiree health care plans
- While the City has put aside some money for pension liabilities (albeit not nearly enough), it has not put aside any for retiree health care liabilities and pays claims from the City’s general fund as they are received.
- As of the 12/31/2018 retiree health care valuation, the City has an unfunded retiree health care liability of \$232.9 million which is close to 3.5 times greater than the City’s unfunded liability for employee pensions at the same point
 - The following table has the OPEB liabilities by employee group as of 12/31/2018

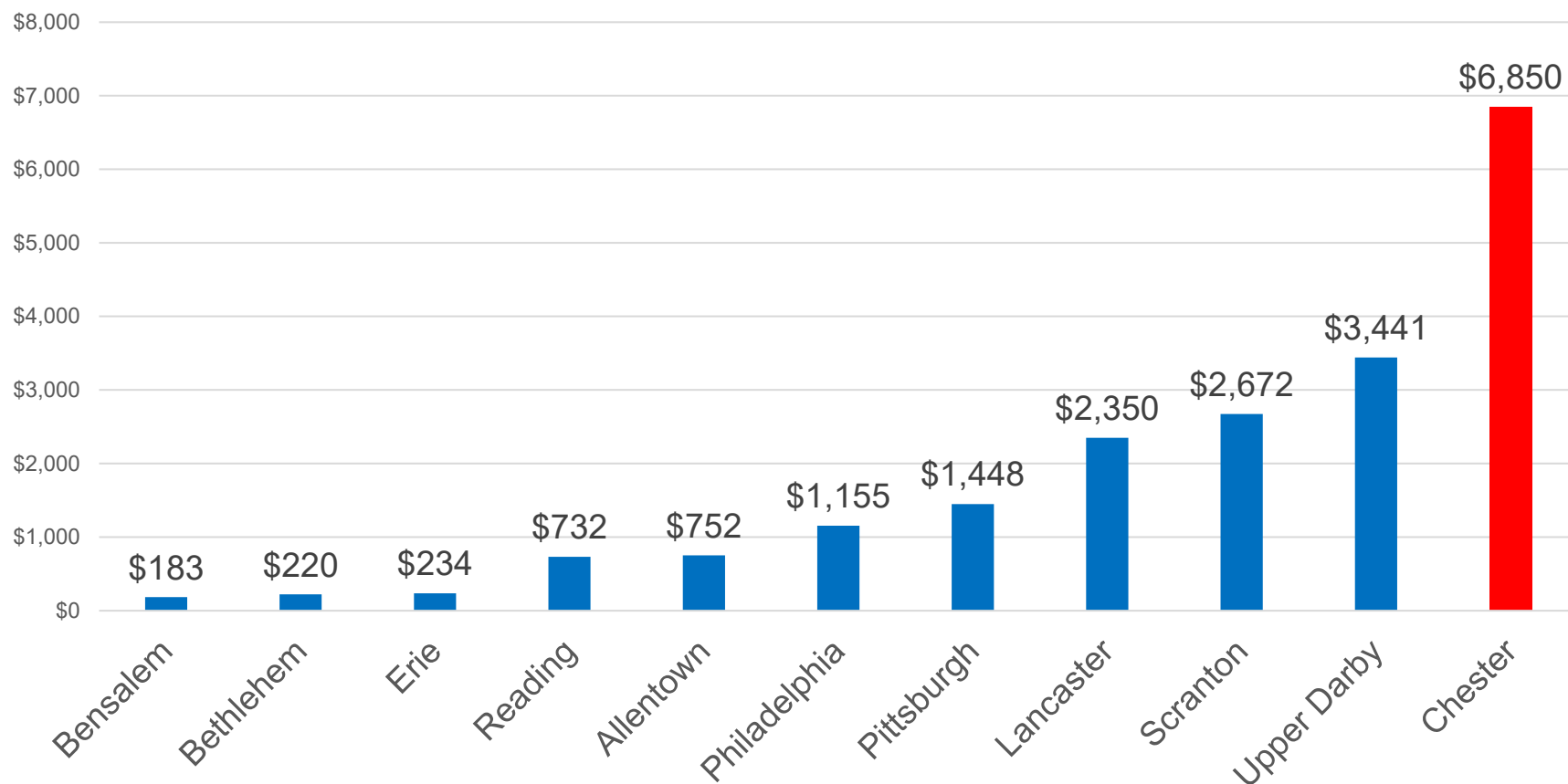
Group	OPEB Liabilities in Millions
Police	\$135.7
Fire	\$66.7
O&E	\$30.5
TOTAL	\$232.9



Putting Chester's Retiree Health Care Liabilities in Context

Chester's per capita OPEB liability (liability divided by population) is significantly higher than the OPEB liability of the 10 largest Pennsylvania municipalities.

Per Capita OPEB Liability of 10 Largest PA Municipalities + Chester



What Has Been Done?

■ What Has Been Done to Address the Situation?

- In 2017, the City and the FOP agreed to fix many of the pension benefits; however, most of the changes only apply to officers hired after February 1, 2017 and most of the cost is from already-retired police officers
- Police officers hired after 2/1/2017 and FFs hired after 1/1/2017 are not eligible for retiree health care
- In order to comply with the law, the City raised the distressed pension earned income tax on residents beginning in 2021. That money will go into the pension funds.
- Receiver has issued a directive that DROP payments from police pension fund be temporarily suspended to ensure enough money remains in the fund to pay benefits

■ What Is Being Done to Address the Situation?

- Receiver and City are working to control spending costs so that City will make \$10.8 million MMO payment this year. Also in the process of determining MMO excluding receivables
- City and Receiver team in process of moving retirees to lower cost Medicare Supplemental plan
- City and Receiver working to collect tax information for police disability pensioners to determine whether the pensioners owe offsets to the pension fund
- City and Receiver in process of conducting eligibility audit to ensure that only eligible retirees (and active employees) and their dependents are receiving retiree health care

Conclusion

How Do We Really Fix These Problems?

- There is no way to truly fix Chester's retiree benefit situation – or Chester's long-term financial health - without **both** reducing the unaffordable costs of the pension and retiree health care benefits **and** a substantial cash infusion into the plans
 - While a large one-time contribution to the pension funds will have to be part of the solution, such a payment alone will not solve the problem. The unaffordable benefits must also be addressed or else the problem will continue to grow and be handed to future generations who will have fewer options to solve it
 - Some Pennsylvania communities have sold assets to put money into pension funds without addressing benefit costs and are now facing the same financial problems that existed before the asset sale – though now, they do not have an asset to sell
- All options are on the table to deal with this crisis, including potential asset monetization
 - The Receiver has retained bankruptcy counsel