Bureau Update

BOSTON MUNICIPAL RESEARCH BUREAU

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Boston Should Not Adopt Early Retirement Incentive

Short-term benefit not worth cost of increasing pension liability

Governor Patrick has indicated that he will recommend that cities and towns be able to adopt another Early Retirement Incentive (ERI) to help control costs in light of the increasing fiscal challenges facing municipalities in FY11. The experience with the last state authorized ERI in 2002 showed that this tool has dubious benefits.

If the state wanted to help all cities and towns in Massachusetts and reduce pressure on the local property tax, it should end the double standard that exists between state and municipal management of employee health insurance. That would mean enabling municipalities to join the Group Insurance Commission or have administrative control over plan design outside of collective bargaining as the state does now.

The concern with the ERI this year is that while it would provide a gentle approach to reduce employee levels, it would cause an increase in each local retirement system's unfunded pension liability at a time when that liability will be increasing substantially due to the pension asset losses in 2008.

In 2002, the City of Boston adopted the ERI which allowed employees, other than police officers, firefighters and teachers, to add five years of credible service, age or a combination to reach retirement eligibility. The incentive was adopted by 476 employees that year. Two years later, the State-Boston Retirement System's pension liability increased by $61.8M solely because of the early retirements.

The 104 local retirement systems in Massachusetts experienced significant investment asset losses in 2008 which could increase contributions by 30% or more in FY11 or FY12 even after "smoothing" out the impact over time. The Boston Retirement Board's asset loss was 24.2% in 2008.

The substantial cost increases expected because of the asset loss in 2008 have raised suggestions of extending the time to reach full funding of the unfunded pension liability beyond the current deadline of 2030.

The State-Boston Retirement System's unfunded liability as of January 1, 2008 was $2.1 billion with full funding now scheduled to be reached by 2023. Boston's next actuarial valuation will be as of January 1, 2010 which will incorporate the 2008 asset losses and take effect in FY12.

State enabling of local retirement systems to increase their pension liability is not a good strategy at this time, especially when a more useful option to assist cities and towns is available.