

Mounting Personnel Costs Threaten Boston's Competitive Edge

**Outdated Laws And Practices Restrict Local
Response In Challenging Fiscal Times**

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Executive Summary

The City of Boston is faced with a complex, long-term budget challenge in which spending for employee benefits and salaries is absorbing a larger share of limited revenue growth. That means there are fewer resources for other services that impact the quality of life in Boston. At the same time, outdated laws and practices have restricted the City's ability to respond to these management challenges in a sustainable way. The City should continue to be vigilant in controlling its spending and, with other municipalities, seek state approval to create new tools to better manage these growing obligations. Boston cannot maintain its reputation as a competitive place to live, work and invest if it is restricted from managing effectively in today's fiscal environment.

The Research Bureau's analysis of Boston's financial trends shows that:

- **Personnel costs dominate budget growth.** Boston's spending for salaries, pensions and health insurance this fiscal year accounted for 85.6% of the \$119.5 million increase in the City's fiscal 2006 budget of \$2.049 billion. This pattern carried through over the past five years since fiscal 2001.
- **Collective bargaining is broken.** The collective bargaining contracts negotiated in 2004 are estimated to increase employee compensation by approximately \$200 million over four years, with no meaningful changes that improve service delivery. This comes at a time of limited revenue growth, when the City must manage its resources prudently, and yet the Administration is often met with inflexible employee contract language, collective bargaining rules or union grievance procedures that collectively slow down or halt initiatives to spend taxpayers' money more productively.
- **Spending for most departments has been tight.** The bulk of city spending covers expenses for pensions, health insurance, and the four major line departments of School, Police, Fire, and Public Works. Expenditures for all other city departments, including those that provide important "quality of life" services such as Library, Transportation, and Parks, have been very tight and, in aggregate, have decreased by 8.9% over the past five years.
- **The City's dependence on the property tax is increasing.** The current tax levy share of 56.6% of total operating revenue is only slightly less than the 60.9% the levy represented in fiscal 1981, the year before the full implementation of Proposition 2½. Just five years ago the levy share was 49.9%.

Boston's budgetary challenges are not unique and are shared by other cities and towns. That is why the Research Bureau has focused on the spending drivers of collective bargaining, pensions and health insurance and has developed a road map for change that will benefit Boston and other municipalities. Some recommendations will require just the commitment of Boston city officials to adopt and implement the changes. Others, in the end, call for reform of public collective bargaining and a completely new business model for health insurance that will require the complete cooperation and support from Beacon Hill and the full backing of the business community.

Importance of Spending Control

Achieving the changes recommended and managing with slow revenue growth will require the City to continue its commitment to spending control. Boston's fiscal 2006 budget exceeded the \$2 billion mark for the first time at \$2.049 billion, an increase of \$119.5 million or 6.2%. Over the past five years since fiscal 2001, city spending has increased by \$305.6 million or 17.5%, while inflation increased by 13%. However, the growth of city revenues has slowed down over the past four years from fiscal 2003, increasing by 2.6%, 1.6%, 1.9% and 6.2% respectively for an annualized average increase of 3.2%. That has caused the Menino Administration to seek state authorization for new revenue sources to lessen the City's reliance on the property tax. Confidence that Boston will keep its spending in check will be an important factor in the City winning legislative support for increased assistance.

Issue: Limited new revenue growth and increasing employee costs mean continued lean times for Boston's budget.

Recommendations: Control employee numbers and implement cost-savings measures, such as competitive service delivery (CSD).

1. The City should continue its vigilance in controlling spending and being realistic in service expectations.
2. The Administration should maintain control over the level of funded positions.
3. The City should adopt creative solutions to efficient service delivery, like CSD, as recommended by the Research Bureau.
4. The Administration should contract for an operational evaluation of one major line department each year.

Collective Bargaining

The City paid a premium for the collective bargaining contracts negotiated with its labor unions in 2004 prior to the Democratic National Convention (DNC), both in terms of the cost of the salary increases and the lack of language changes to improve service efficiency. The contracts negotiated will increase employee compensation by approximately \$200 million over four years with approximately \$40 million in new spending required this fiscal year. However, the \$200 million price tag did not produce any meaningful language changes in union contracts to improve the management of city services.

Under current fiscal conditions, municipal officials are required to manage resources more effectively but are often met with inflexible employee contract language, collective bargaining rules or union grievance procedures that collectively slow down or halt initiatives to spend taxpayers' money more wisely or deliver services more productively. The consequences of management and labor not working in collaboration in these times can be seen in the automobile industry, which is in an uncompetitive cost structure, resulting in bond rating downgrades.

Issue: Union contracts and the collective bargaining process inhibit management's ability to respond effectively in a challenging fiscal environment.

Recommendations: Offer incentives to support a collaborative approach with unions and revise Chapter 150E to allow timely responses to changing conditions.

1. The Administration and unions should seek a new approach to labor relations to better serve their mutual interests, such as assignment flexibility, work

- process redesign and competitive service delivery.
2. The Commonwealth's collective bargaining statute (Chapter 150E) should be changed to establish inherent management authority over selected areas that could not be the subject of collective bargaining.
 3. This law should be modified further to ensure timely decision-making and to provide incentives to complete negotiations in a reasonable timeframe.
 4. Superintendents should be granted further appointing authority in schools classified as under-performing. Also, Assistant Principals should be required to negotiate individual contracts with the Superintendent.

Pensions

The City, through the State-Boston Retirement System (SBRS), has managed its retirement system during recent difficult times, adhering to its pension funding schedule that will reach full funding with no unfunded liability by 2023, 18 years from now. The City's fiscal 2006 expense for the SBRS is \$186.3 million, an increase of \$39.7 million or 27.1%.

The SBRS's current funded ratio of 63.3% represents a decline in recent years due primarily to investment performance, reflecting the market, and an additional liability as a result of the Early Retirement Incentive (ERI) in 2002. Benefits negotiated in employee contracts that are pension eligible, such as acceptance of the Quinn Bill and vacation buy-back provisions, add to the liability. By comparison, the Commonwealth's funded ratio is 82.8%.

Issue: **The Boston pension system is scheduled for full funding but costs are escalating and the funded ratio is low.**

Recommendations: **Maintain full funding schedule and control liability growth.**

1. The City of Boston should remain absolutely committed to the SBRS's plan to reach full funding of its pension liability by 2023, or earlier should investment performance improve.
2. City officials should resist any efforts to modify collective bargaining contracts that would expand benefits that could increase compensation and be considered pension eligible.

Employee Health Benefits

Boston's health insurance cost increases are noticeably greater than the Commonwealth's over the past five years, in good part, due to the stark differences in their ability to purchase health insurance and adjust plan design. Since 2001, Boston's spending for health insurance has increased by 73.1% while the Commonwealth's spending has grown by 56.7%. The City generally must negotiate its changes with the unions, while the Commonwealth, through its autonomous Group Insurance Commission (GIC), has greater flexibility to purchase health insurance coverage and adjust plan design. The actions of the GIC are not subject to collective bargaining.

The City's health insurance costs in fiscal 2006 are expected to grow by \$21.3 million or 11.2% to \$211.5 million, while the total operating budget increased by 6.2%. In the past five years, Boston's health insurance costs have ballooned by 73.1% while operational spending, less health insurance, increased by 13.3%, an unsustainable situation. The rate of spending for health insurance absorbs a large share of new revenues,

thereby limiting support for the other direct city services. For example, the annual increase in health insurance last year represented 45.2% of the total increase in the City's operating budget.

Issue: Health insurance costs are ballooning, but Boston's ability to manage is limited by legislative restrictions to change plan design.

Recommendations: Establish a new, statewide business model to oversee local management of public health insurance.

1. The Commonwealth should adopt a new, statewide structure to address the skyrocketing health insurance costs and growing liability of retiree benefits faced by the state and municipalities.
2. Until a new business model is developed, Boston and other municipalities should be authorized to create local GICs that would have the power to require design changes in health insurance plans.
3. Boston should accept state legislation that requires retirees to enroll in Medicare when they turn 65.
4. Boston and SBRS should consolidate their data systems, supported by the City's MIS Department.

Retiree Benefits (OPEB)

The City of Boston is facing a new requirement to acknowledge the extent of its financial liability for retiree benefits. Starting in fiscal 2007, the City will be required to report in its financial statements its unfunded liability for other post employment benefits (OPEB) other than pensions, such as health and life insurance for retired public employees and eligible spouses. These costs are a growing liability and are funded on a pay-as-you-go basis, as the City does not reserve any funds for the cost of future benefits being earned by employees today. Of the total appropriation of \$211.5 million for health benefits in fiscal 2006, approximately \$79 million or 37.4% is for coverage for retired employees. The City is in the process of developing data from which its actuarial advisors will be able to identify the extent of its OPEB liability.

Issue: Retiree benefits, other than pensions, are a growing financial liability for which the City does not currently reserve funds.

Recommendations: Establish a statewide structure and begin pre-funding of liability.

1. The Mayor and City Council should establish a separate reserve and appropriate funds annually to pre-fund the payment of future retiree benefits, starting with the City's fiscal 2007 budget.
2. As already noted, the funding of employee health insurance and OPEB are closely aligned and would best be addressed through a new business plan that involves a state standardized approach.
3. The City should evaluate future costs of retiree health insurance and whether retirees should pay a larger premium share.

Introduction

A major problem facing Boston and all municipalities is the long-term budget challenge of employee related spending absorbing a larger share of limited revenue growth. In fiscal 2006, Boston's budget has exceeded the \$2 billion mark for the first time at \$2.049 billion, an increase of \$119.5 million or 6.2%. Like other municipalities, this growth is fueled by spending increases for salaries, pensions and health insurance that account for 85.6% of the budget increase. That leaves little room for program restoration or expansion for most departments.

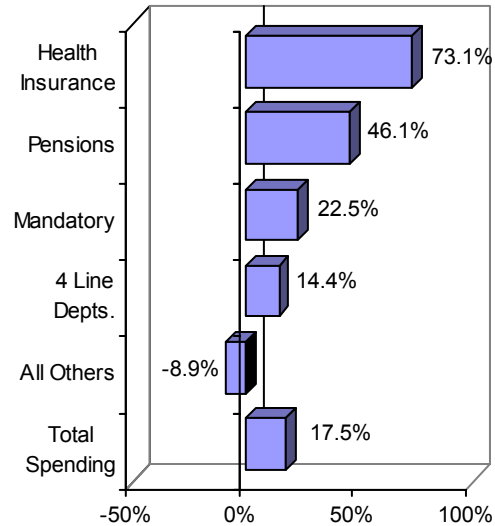
In the five years since fiscal 2001, city spending has grown by \$305.6 million or 17.5% while inflation increased by 13%. During that same time, spending for health insurance rose by 73.1%, pensions by 46.1%, the four major line departments of School, Police, Fire and Public Works by 14.4% and the mandatory expenses of debt service and state assessments by 22.5%. Consequently, all other city departments, including those that provide important "quality of life" services such as Library, Transportation and Parks, have borne the brunt of the slowdown in the City's revenue stream and their expenditures, in aggregate, have decreased by 8.9%.

Further illustrating this trend, of the total spending growth of \$305.6 million since fiscal 2001, 94.7% has been absorbed by pensions (19.2%), health insurance (29.2%) and the four major line departments (46.3%).

Since fiscal 2001, revenues available to the City have grown by 17.0%, as the City has had to rely more heavily on the property tax. The tax levy has grown by \$284.9 million, or 32.6%, during the past five years. This growth has offset the decline in state aid (-\$3.9 million) as well as other revenue sources such as investment income (-\$10.1 million). The current tax levy share of 56.6% of total operating revenue is only slightly less than the 60.9% the levy represented in fiscal 1981, the year before the full implementation of

Proposition 2½. Just five years ago the levy share was 49.9%.

Spending Growth FY01-FY06



Increased spending for collective bargaining, pensions and health insurance are the three drivers of Boston's fiscal 2006 budget, representing 85.6% of the total increase of \$119.5 million. These three areas will continue to absorb the bulk of new dollars which will require the Mayor and City Council to make difficult political choices over the next few years. Local government in Massachusetts is wrestling with how to manage its service requirements in an environment of substantial annual spending increases in these three areas at a time of limited revenue growth and restricted managerial authority. A new requirement starting in fiscal 2007 to report the unfunded liability for retiree benefits other than pensions will add new financial pressure for a funding response.

Collective Bargaining

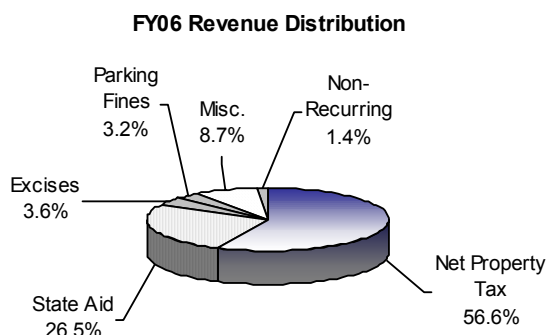
The collective bargaining contracts negotiated by the Menino Administration and the labor unions in 2004 are estimated to increase employee

FY06 Budget Snapshot

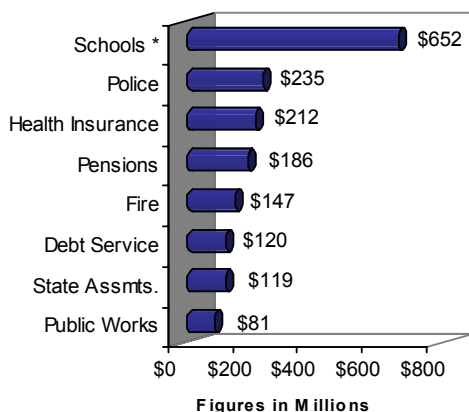
Revenues

The primary general fund revenue sources for Boston in fiscal 2006 continue to be the property tax and state aid, which constitute 83.1% of the total \$2.049 billion budget and 61.7% of the \$119.5 million overall increase. The mainstay of Boston's general fund revenue is the property tax, which at \$1.159 billion represents 56.6% of total operating revenue. The property tax is budgeted to increase by \$53.9 million or 4.9%. The second largest revenue source is state aid, which is budgeted at \$543.2 million or 26.5% of the total. This represents a growth of \$19.9 million or 3.8%.

Reimbursements for teacher pensions (\$15.1 million) account for most of the state aid increase. Lottery receipts (\$60.5 million) will grow by \$6.6 million or 12.2%, and Chapter 70 Education aid (\$203.6 million) will increase by only \$3.1 million or 1.6%. Boston also relies on non-recurring revenue for \$29.2 million, an increase of \$12.4 million or 10.3% of the growth in fiscal 2006.



Top 8 Budget Accounts



* Does not include BPS health insurance

Expenditures

The growth in this budget is due principally to increases for salaries, pensions and health insurance that represent 85.6% of the total increase. That explains why, despite the increase in the Mayor's fiscal 2006 recommended budget of \$119.5 million or 6.2%, this budget represents another year of tight departmental spending outside of negotiated salary increases. Also, the City's first \$2.0 billion budget does not change the fact that a relatively few accounts represent the bulk of city general fund spending. As shown in the chart to the left, eight budget accounts, out of the total of 62 accounts, represent 86.0% of the total recommended budget. Of those eight accounts, only four are city line departments. (See *BMRB Special Report No. 05-2*)

compensation by approximately \$200 million over four years with approximately \$40 million in new spending required in fiscal 2006. Due to a unique confluence of events, the City paid a premium for these contracts, both in terms of cost of the salary increases and what it received in return in limited beneficial language changes. The structure of these contracts, especially in their last year (fiscal 2006), established a base for significant increased spending in fiscal 2007 and beyond depending on future employee levels. The City's experience over the past three years in trying to manage more efficiently in a period of limited revenue growth and under restrictive contract provisions and practices raises the very real question of whether collective bargaining, as now constituted, is broken and should be modified to be relevant in the current fiscal environment. Both the Administration and unions may find that their mutual self-interests are better served through a new approach to labor relations.

DNC Factor

In 2004, Boston needed to negotiate all employee union contracts, most of which had already expired on June 30, 2002. New contracts had not been negotiated before the start of fiscal 2003 because the Administration had been focused on managing through the first of two consecutive years of state aid cuts. Complicating the negotiations further was the fact that the Democratic National Convention (DNC) was scheduled to begin on July 26, 2004. With the national spotlight on Boston in late July, the Menino Administration's objective was to finalize negotiations with all unions prior to July 25, thus putting itself in a weak bargaining position.

Employee Contract Results

The Administration met its objective of finalizing contracts with 35 bargaining units by July 25 but the total costs from fiscal 2003 through fiscal 2006 are estimated at an aggregate of approximately \$200 million. Starting with initial new costs of \$10 million in fiscal 2003, the cumulative increases over four years brought the added salary costs for fiscal 2006 to about \$100 million, with the total four-year increase reaching

\$200 million. The results of the negotiations are not consistent financially in that some contracts are reasonable given the City's fiscal position and others are very generous, especially those decided through arbitration. The costs of many contracts are back-loaded in fiscal 2006 (last contract year) in that a second increase in salary is provided later in the fiscal year. In some cases, the second increase kicks in half-way through the year and adds cost to fiscal 2006 and in other cases, the increase comes late in the year and has limited impact in fiscal 2006 but the full effect is felt in fiscal 2007 and future years. The Administration negotiated the first union contract on May 26, 2004 with the middle managers (Salaried Employees of North America or SENA) and gradually negotiated more contracts into July.

While several unions tried to use the DNC for leverage in the timing of contract negotiations, that was especially true for the leaders of the four police unions and the fire union. Their tactic of delaying serious negotiations eventually led the parties to expedited binding arbitration only days

Collective Bargaining Contract Increases

Union	FY03	FY04	FY05	FY06	FY07
Police (4 Unions)					
July	4.0%	2.5%	2.5%	3.5%	
January				2.0%	
Firefighters					
July		2.5%	2.5%	3.5%	
January				2.0%	
AFSCME (Laborers)					
July	2.0%	2.0%			
October			2.5%	2.5%	
June				1.0%	
SEIU Local 888 (Clerical)					
July	2.0%	2.0%			
October			2.5%	2.5%	
June				1.0%	
September					0.5%
BTU (Teachers)					
September		2.0%	2.5%	2.0%	
January				1.0%	
April				1.0%	
SENA (Middle Managers)					
July		2.0%			
October			2.5%	2.5%	

before the DNC. With little time for hearings and review, the arbitrator split the difference on the money issues and did not address any language changes. The arbitrator's decision initially applied only to the Boston Police Patrolmen's Association (BPPA) contract (four years) but the same agreement was accepted by the other three police unions soon after and the firefighters' union agreed to the decision (last three years) on July 25, just hours before the start of the DNC delegation parties. Thus, picketing at the parties by police officers and firefighters was averted.

What the City Received

The \$200 million price tag did not produce any meaningful language changes in the city union contracts to improve the delivery of city services. The biggest achievement for the Administration was to convince many unions to drop their unfair practice challenge before the Labor Relations Commission over the City's decision in 2003 to reduce the number of HMO health service providers in an effort to reduce the increase in annual premiums in light of local aid cuts. The Administration had informed the Insurance Advisory Committee, consisting of its union representatives, of its planned change and offered to bargain, but the unions did not respond. With the consolidation, the level of health care services remained the same with the only change being that doctor visit co-pays were increased by \$5.00 per visit to \$10.00. Three of the police unions and the fire and teacher unions are still challenging the City on this issue. This challenge is ironic in that the attempt to reduce the premium increase while maintaining the same services achieved a premium savings of \$8 million, which prevented the need to further reduce employee levels. The employees also benefited in the savings of their share of the premium costs.

Acknowledging its residency requirement for employees and the high cost of housing in Boston, the Administration did agree to help fund housing trusts to assist lower-paid

employees of the American Federation of State, County and Municipal Employees (AFSCME) and Service Employees International Union (SEIU). The City's estimated payment to the housing trusts in fiscal 2006 is \$320,000.

The \$200 million price tag did not produce any meaningful language changes in the city union contracts to improve the delivery of city services.

A few improvements were negotiated in the teachers' contract regarding teacher hiring and assignment, professional development and small learning communities. Also, the Superintendent was given limited discretion in filling vacancies in five under-performing schools.

Bi-Weekly Paychecks

The minimal expectation for language changes during this round of negotiations was reflected in the Administration's effort to negotiate change from weekly paychecks to bi-weekly paychecks with several unions. This change would save several hundred thousand dollars annually and improve the productivity of employees engaged in the payroll process. The middle managers union (SENA) and five smaller unions did agree to change to the bi-weekly payroll at some point during the life of their negotiated contract. However, AFSCME considered this matter a "deal breaker" after all its other contract items were settled and the Administration backed down on its request. Currently, 71.7% of non-school city employees represented by AFSCME, SEIU and the police and fire unions (6,140) are paid weekly and 2,060 employees or 85% of the remaining city departmental employees (2,424) are paid bi-weekly. Boston Police Superior Officers started being paid bi-weekly in

September 2005. School negotiators have been more successful in negotiating bi-weekly payrolls and approximately 91% of school employees are paid bi-weekly now and by 2006 all school employees except custodians (494) will be paid in this manner.

Responding To Changing Needs

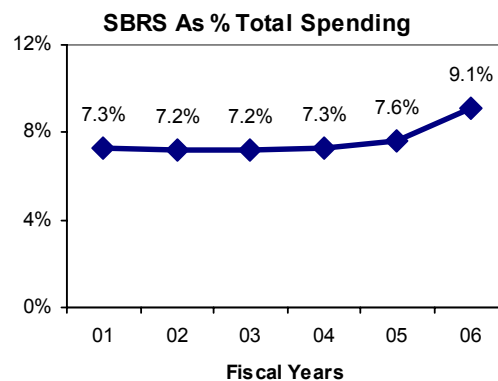
The experience of the last round of contract negotiations highlighted the weaknesses in the current collective bargaining process in this changing fiscal environment that requires more timely administrative action. Faced with local aid cuts and slow revenue growth, efforts by the Administration to manage resources more effectively are often met with inflexible contract language, collective bargaining rules or union grievance procedures that collectively slow down or halt initiatives to spend taxpayers' money more wisely. Efforts to modify change in an important area within a reasonably predictable time often are rebuffed by union leaders with the argument that talks on the proposed changes should wait to be included in main table negotiations on the full contract which could mean delays of several months or one or two years.

This practice stems from a 1994 Labor Relations Commission decision involving the Town of Brookline which essentially requires every management initiative to be addressed at the successor bargaining table, not at mid-term or a separate time to address a specific initiative. The Brookline rule, along with the impasse rules for mediation and fact finding and the Joint Labor Management Commission process for police and fire negotiations, tend to delay timely action on management initiatives irrespective of the cost savings that can be achieved or the productivity improved. Also, in situations where negotiations continue after a contract has expired, the practice of negotiating new contracts retroactive to the time the last contract expired provides no incentive for the parties to negotiate in a timely manner. As an example, the BPPA's contract expired on June 30, 2002, just as local aid cuts

were implemented and no change in practice to address this issue could be made until July 2004 when a new contract was approved. However, in this case, because the arbitrator did not address language changes, no change in practice can be made until at least July 2006 when a new contract could be in place, four years later. City officials will be back at the negotiating table within six months since most of Boston's existing union contracts will expire on June 30, 2006 with a few others expiring two or three months later.

Pensions

The extraordinary increase of \$39.7 million for pensions in fiscal 2006 reflects the weakness of recent pension investment performance, reflecting the market, and the impact of the Early Retirement Incentive (ERI) program of 2002. The City of Boston's fiscal 2006 expense for the State-Boston Retirement System (SBRS) is \$186.3 million, an increase of \$39.7 million or 27.1%. The City is required to update its pension funding schedule every three years and this spike in pension costs comes in the first year of the new schedule. The second and third years of this three-year schedule are expected, at this time, to increase by slightly less than \$10 million in both fiscal years 2007 and 2008.



The SBRS provides a retirement benefit for 20,456 active members and 14,034 retired members for the City of Boston and five other public agencies, such as the Public Health

Commission. The SBRS is a contributory defined benefit plan that covers all permanent full-time employees and part-time employees who work at least 20 hours a week. The retirement system is managed by the State-Boston Retirement Board (SBRB) which consists of five members: the City Auditor, who serves ex-officio; two individuals elected by members of the system; an individual chosen by the Mayor and an individual chosen by the other four members.

Reaching Full Funding

In 1988, the City accepted the provisions of the pension reform law that committed Boston to a funding schedule which included paying the current year's estimated present value of benefits earned during the year (normal costs) and an annual contribution toward reducing the unfunded liability to zero by the year 2028. The City has established a pension funding schedule that will reach full funding with no unfunded liability by 2023, 18 years from now. The funding schedule must be approved and updated at least every three years by the state Public Employee Retirement Administration Commission (PERAC). The schedule is calculated in accordance with the entry age actuarial cost method which takes into consideration an actuarial investment return assumption among other factors.

The Administration did have the option for fiscal 2006 to push back reaching full funding to a later year to mitigate next year's increase but correctly retained the current schedule. The City had already extended the funding schedule from 2020 to 2023 in fiscal 2003 in response to local aid cuts. A second extension would not have been prudent and would have increased costs due to additional years of interest expense.

Pension Benefit

A public employee's retirement allowance consists of two parts: an annuity portion and a pension portion. Employee contributions in the form of mandatory deductions from gross

regular compensation and interest generated constitute the annuity. The difference between the total retirement allowance specified by law and the amount provided by employee contributions is the pension, funded by city appropriations and investment returns. An individual's retirement benefit generally consists of 80% coming from the pension allowance and 20% from the employee's annuity payment.

The extent to which an employee contributes to his or her retirement fund depends on the date the employee was hired. A City of Boston employee can pay from 5% of gross regular compensation into the fund to 9%. Also, members hired on or after January 1, 1979 are required to contribute an additional 2% of their regular compensation in excess of \$30,000. Thus, an employee hired after July 1, 1996 would contribute 9% on up to \$30,000 of compensation and 11% on compensation over \$30,000. Teachers with 30 years of credible service who elected to participate in the TARP program that enables them to accelerate their retirement generally are required to contribute 11% for at least five years.

Employee Contribution To Pension Fund

Hired:	
Before 1/1/75	5%
Between 1/1/75-12/31/78	7%
Between 1/1/79-12/31/83	7%+2%*
Between 1/1/84-6/30/96	8%+2%*
7/1/96 To Present	9%+2%*

* Plus 2% for salary over \$30,000

Pension Allowance

Calculating a retirement allowance is complicated, based on age, group classification (general, hazardous or public safety

employment), the highest three-year average annual rate of regular compensation and years of credible service. Members are vested after 10 years of credible service and are eligible to retire upon reaching age 55. The maximum allowance a city employee is able to receive is 80% of his/her highest three-year average annual rate of regular compensation salary exclusive of overtime. For a smaller allowance, an employee can select a retirement package that provides one of a few plans for survivor benefits. Retirees also receive a cost-of-living adjustment each year up to a maximum of 3% on the first \$12,000 of the allowance with approval of the SBRB.

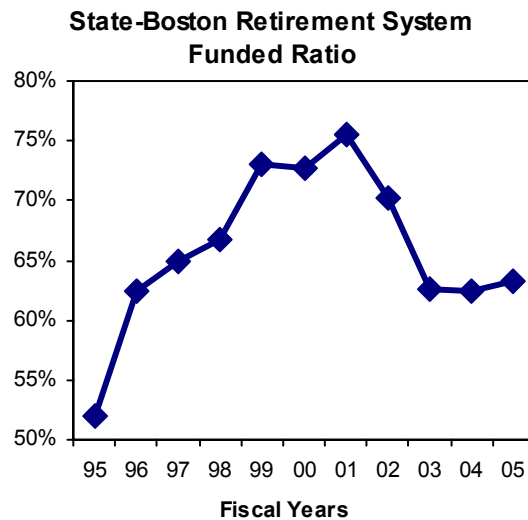
The average pension for a teacher who retired in 2003 was \$50,337. For a police officer, the average was \$53,152 and for a firefighter \$49,164. In addition, retired Boston employees continue to receive 100% of the benefits for health and life insurance that active employees receive. State law requires that municipalities that offer benefits for retirees provide at least 50% of what is given active employees.

Funding Schedule

The SBRS's funding schedule assumes a long-term investment return of 8%. However, in the five-year period from fiscal years 2000 to 2004, the average annual return was only 3.1%, consistent with the market. This situation required a correction in the City's contribution to keep the SBRS on schedule for full funding. The retirement of 490 employees due to the ERI in 2002 also has contributed to this year's increase in the schedule. Over the past 20 years, the SBRS's average annualized return was 10.3% and it was 12% in 2004.

Even with the full funding schedule, Boston's funded ratio has declined in the past few years due to weak investment performance and the addition of pension liabilities due to changes in legislation and added benefits in employee contracts. As of January 1, 2004, the date of the latest full actuarial valuation, Boston's accrued liability (\$5.421 billion) exceeded its actuarial

asset value (\$3.384 billion) by \$2.036 billion for a funded ratio of 62.4%. The funded ratio is commonly accepted as a key indicator of the financial strength of the pension plan. While greater than the funded ratio of 52% in 1995, this ratio is less than the ratio of 75.5% in 2001. The increase of the unfunded liability from \$1.420 billion as of January 1, 2002 to \$2.036 billion as of January 1, 2004 is primarily due to an investment loss of \$511.4 million during that time and an additional liability of \$61.8 million as a result of the early retirement incentive in 2002 that was accepted by 490 employees.



The unfunded liability also increased by approximately \$289.9 million or 25.4% in 1999 when the state stopped funding any additional cost-of-living (COLA) increases for retirees. The City assumed responsibility for the COLAs through SBRS, subject to annual review based on established criteria. Each year, the SBRB has approved a 3% increase on the first \$12,000 of pension allotment, the maximum allowed.

Additional benefits negotiated in employee contracts that are pension eligible further increase the liability. The pension liability increased when the Quinn Bill went into effect in Boston in July 2000 due to the higher salaries earned by eligible police officers. The Quinn

Bill was accepted by the Menino Administration in police contracts negotiated in 1998. Recent contracts have allowed employees to buy back a

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week of vacation time and the additional compensation is considered pension eligible. Just last year the middle managers (SENA) negotiated a contract with the Administration that enabled members with 20 years of service to buy back a week of vacation if no sick days are used or redeem the proportion of the first five days not used. SENA members also receive 15 sick days and six personal days a year. Police officers can redeem one week of vacation and those officers who receive five weeks of vacation may buy back two weeks of vacation. Firefighters eligible for four or five weeks of vacation can redeem one week of vacation.

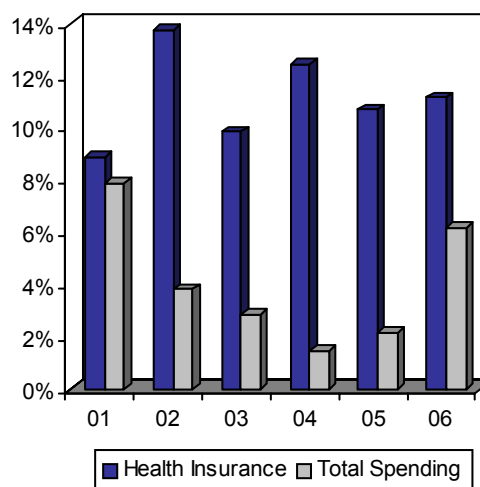
Boston Compared

While the City is on a schedule to reach full funding in 18 years, its ratio of assets to liabilities of 63.3% as of January 1, 2005 shows growth from the prior year but is below the norm for city pension plans. In a 2003 survey conducted by Wilshire Associates, a national pension consulting firm, Boston's pension assets as a percentage of liabilities was reported at 60%, far below the average of 83% for 63 city and county plans surveyed. By comparison, the Commonwealth's funded ratio is 82.8%. The Commonwealth's late start in pension reform in 1988 may account for part of Boston's lower funded ratio but new contract obligations that add to the pension liability are also a factor.

Health Insurance Benefits

The skyrocketing growth in medical expenses poses a serious fiscal challenge for state and local governments in Massachusetts. Total health insurance costs for Boston employees continue to increase at a double-digit pace while revenue growth is significantly slower, creating an unsustainable situation. In fiscal 2006, the City's health insurance costs are expected to grow by \$21.3 million or 11.2% to \$211.5 million, while the total operating budget increased by 6.2%. Increased spending for health insurance has outpaced the growth of overall city spending by a wide margin recently. In the five years since fiscal 2001, health insurance costs have ballooned by 73.1% while operational city spending less health insurance increased by 13.3%. On an average annual basis, health insurance costs have increased by 11.2% per year during the time that city spending less health insurance increased by 3.4% per year. As a result, health insurance as a percent of total operating expenses has increased from 7.0% in fiscal 2001 to 10.3% in fiscal 2006. During this time, the City's share of health premiums has remained unchanged with the taxpayers absorbing the bulk of the increases.

Growth in Health Insurance & Total Spending, FY01-FY06



The health and life insurance benefits received by retired employees contribute to an unfunded retiree benefits liability that the City must begin to address. All cities and towns are facing these same issues that may lend themselves to a uniform approach for future action.

Disproportionate Increase

In a period of slow revenue growth, the rate of spending for health insurance absorbs the bulk of new revenues, thereby limiting support for other direct city services. The annual increase in health insurance costs represented 69.8% of the total increase in the City's operating budget in fiscal 2004, 45.2% in fiscal 2005 and 17.8% this year. Using the property tax levy as a measure, the annual health insurance increase absorbed between 34-40% of the levy increase in the last three fiscal years. After health insurance, increased spending for pensions, debt service and state assessments are treated as fixed costs, leaving the balance of resources to fund the many other basic and quality of life services.

Health Insurance Growth As Percent of Net Levy & Spending Increase

	FY04	FY05	FY06
% of Net Levy	34.0%	34.8%	39.5%
% of Spending	69.8%	45.2%	17.8%

City's Health Insurance Plans

The City offers its active and retired employees a choice of HMO, POS, and indemnity plans. The majority of the plans cover prescription costs through a two or three-tiered pricing structure and allow for mail order prescription purchases for supplies of up to ninety days. Retirees can enroll in any of the managed care and indemnity plans, or those who are eligible can choose to enroll in Medicare. Retirees who are enrolled in Medicare Parts A & B have the option to purchase additional coverage through one of the City's indemnity or HMO Medicare supplemental plans. These plans cover some services that Medicare does not, and pays for some cost-sharing for those services that are not covered

100% by Medicare.

The vast majority of active employees are enrolled in managed care plans, while the majority of retirees are in Medicare supplemental plans, as shown in the table below.

Health Insurance Enrollment FY05

Plan Type	Active	Retirees
Indemnity	10.8%	18.2%
Managed Care (HMO/POS)	89.2%	24.7%
Medicare Supplemental		57.1%

Based on its negotiated employee contracts, the City pays 90% of HMO premiums, 85% of POS premiums, and 75% of indemnity premiums. The City also pays 50% of retirees' Part B Medicare premiums, covering doctors' services, outpatient hospital care, and other medical services not covered by Part A. The indemnity plans are self-insured by the City, meaning that the City pays for employee claims from appropriations through a Health Insurance Trust Fund, with the plans administered by Blue Cross Blue Shield.

Health insurance premiums for all city plans have increased by 61% to 78% over the past five years, leading to significant increased costs for Boston and its employees.

Health Insurance Yearly Family Premiums

Plan	FY01	FY06	% Share	Change FY01-FY06
BC/BS Master Med. Indemnity				
City Share	\$11,173	\$19,927	75%	78.3%
Employee Share	\$3,724	\$6,642	25%	78.3%
Harvard Pilgrim HMO				
City Share	\$6,844	\$11,913	90%	74.1%
Employee Share	\$760	\$1,324	10%	74.1%

City's Ability to Change Plans

Boston's ability to make changes in its employee health plans is restricted since the health

insurance benefits are negotiated in each employee union contract and any change is difficult to achieve. Changes would involve decisions over such issues as which health plans are offered, the amount of employee deductibles and co-payments and the premium share for the City and employees. Existing law appears to indicate that a municipality is able to negotiate changes to its HMO plans with individual unions but must negotiate with all unions before a change can be made with indemnity plans. However, the past practice of negotiating health benefits has made practical application of the ability to effect change in HMO health plans a test of political will more than a simple execution of existing law.

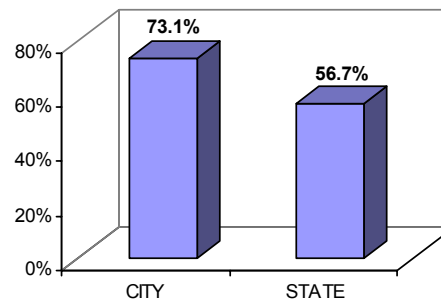
The Menino Administration's consolidation of its HMO plans in fiscal 2003, discussed in the collective bargaining section, is the most recent example of the difficulty of making changes in health plans. The City's selection of a single primary HMO provider saved approximately \$8 million through a reduction in the proposed premium increase. The employees also benefited by the premium savings. The level of health services remained the same with the only change being the employees' co-pay for office visits increasing from \$5.00 to \$10.00. The unions' response was to not discuss the plan but instead file grievances about the change. Three of the police unions, the firefighters and teachers are still challenging the City on this issue.

State Management Of Health Plans

Massachusetts state government has greater flexibility than Boston in managing its health insurance program. The ability to change plan design gives the state an advantage in controlling costs. From 2001 to 2006, Boston's spending for health insurance has increased by 73.1%, while the state's health insurance spending has increased by 56.7%.

Management of the Commonwealth's health insurance program is the responsibility of the Group Insurance Commission (GIC), an

**Growth in Health Insurance Costs
City Vs. State, FY01-FY06**



autonomous 11-member body made up of administration officials, union and retiree representatives and health policy experts. The GIC has the authority to negotiate and purchase insurance coverage for the state and adjust plan design. Plan changes instituted by the GIC are not subject to collective bargaining. The share of the premium costs paid by the employees is decided by the Legislature with approval of the Governor and also is excluded from collective bargaining.

The GIC has taken numerous administrative steps to control costs.

- Costs are controlled through the adjustment of plan design, by managing co-payments and deductibles and increasing them periodically.
- Prescription drug costs are moderated by use of a tiered pricing structure, a mail order purchase program promoted by the state, and step therapy and generics preferred programs that encourage the use of lower-cost medications.
- In a fiscal 2004 reorganization, the GIC shifted more of its health plan offerings to self-insured status, with the result being that of the 100,898 subscribers currently enrolled in non-Medicare plans, 89.5% are in plans that are self-insured, which provides important cash-flow savings.

- Last year, the GIC instituted a Clinical Performance Improvement (CPI) Initiative that encouraged the GIC's health plans to develop tiered networks of hospitals and physicians. As a first step, a number of GIC health plans ranked hospitals based on efficiency, cost and quality. Employees enrolled in those health plans pay a lower co-pay when admitted to hospitals with a more favorable ranking.

Also, in 1991, the state adopted legislation (Chapter 32A, Section 18) requiring all retirees eligible for Medicare to enroll in order to continue coverage under the GIC. The state benefits financially from retirees who are enrolled in Medicare Parts A & B, as Medicare supplemental plan rates are considerably less expensive for the state than non-Medicare plan rates.

Consequently, the GIC's ability to change plan design and implement these measures have allowed the state's insurance premiums to remain low relative to comparable city plans, as shown below. Both systems are large enough to make the overall risk pool relatively comparable for these plans.

**Health Insurance Premium
Family Plan Comparison FY06**

Plan	City Premium	State Premium
Harvard Pilgrim POS	\$1,176	\$990
Neighborhood Health Plan	\$948	\$869
Indemnity*	\$2,214	\$1,424

* Indemnity rates are the City's Blue Cross Blue Shield Master Medical plan compared to the state's Commonwealth Indemnity Basic with CIC.

Legislative Initiatives

State recognition of the impact of increasing health care costs on municipal finances has resulted in two proposals intended to provide some relief for local communities. As part of a comprehensive health care package supported by Senate President Robert Travaglini, a bill (Senate No. 2042) would allow the Mayor and Council to

set its "maximum total monthly premium contribution" with the restriction that no employee would be required to pay more than 50% of the premium costs. This change would allow the elected Executive and Legislative officials to set the share of the premiums paid by employees rather than the change being made through the collective bargaining process with all unions. That would be consistent with the state process.

The same bill would also authorize the Mayor to negotiate different premium rates with any union within the City subject to approval of the City Council. That would allow the Mayor to negotiate different plans and premium rates for different unions to achieve potential savings as well as meet the particular needs of a union's members. Practically, this feature would apply only to the unions with the largest membership base. Because existing law apparently already gives that authority to the City for HMO plans, this bill would reinforce the authority for HMO plans and extend it to indemnity plans.

Governor Romney also has filed a comprehensive health care bill (House No. 4279) that contains a section authorizing cities and towns to establish municipal Group Insurance Committees (GIC) that would have the power to require design changes in health insurance plans, including deductibles and co-pay amounts. This bill would remove plan design and changes from the collective bargaining process. The municipal GICs would be prohibited from making adjustments to the premium share of the municipality or employees.

Retiree Benefits (OPEB)

The City of Boston is facing a new requirement to acknowledge the extent of its financial liability for retiree benefits. Starting in fiscal 2007, Boston will be required to report in its financial statements its full liability and unfunded liability for other post employment benefits (OPEB) other than pensions, such as health and life

insurance for retired public employees and eligible spouses. The Governmental Accounting Standards Board (GASB) has established this standard that will be shown in GAAP financial statements for state and local governments. Currently, Boston provides the same health and life insurance benefits to its retired employees as it does to its active employees. These costs are funded on a pay-as-you-go basis, as the City does not reserve any funds for the cost of future benefits being earned by employees today. Of the total appropriation of \$211.5 million for health benefits in fiscal 2006, approximately \$79 million or 37.4% is for coverage for retired employees.

The concept behind GASB's requirement is that OPEB, as with pensions, is a promise made to employees as a condition of their employment that is part of their compensation each year. Similar to pensions, the cost of these future benefits is a part of the cost of providing public service today. Even though these benefits are not received until after employment has ended, they constitute compensation to attract and retain qualified employees and the expenses should be associated with the years of active service.

OPEB generally takes the form of health insurance and life insurance but may also include dental, vision, prescription and other healthcare benefits provided to retirees and eligible surviving spouses or dependents of deceased employees. In Massachusetts, the state and municipalities that offer post-employment benefits are obligated to provide retirees and eligible spouses with at least 50% of health and life insurance benefits provided to active employees and each community may choose to pay a larger percentage and provide other benefits as well. As previously noted, Boston offers its retirees 100% of the health and life insurance benefits received by its active employees.

While the new GASB standard requires state and

local governments to include a footnote in their financial statements indicating the actuarial accrued liabilities, the standard does not include a funding requirement. Nevertheless, the recognition of the large unfunded liability will create pressure to establish a funding solution.

**. . . the City does not
reserve any funds for
the cost of future
benefits being earned
by employees today.**

Indeed, if the City takes no action to begin funding the liability in a reasonable time, the bond rating agencies will take note. The annual OPEB cost is similar in calculations to pensions, and is equal to the current year's estimated present value of benefits earned during the year (normal costs) and a component for amortization of the total unfunded actuarial accrued liabilities over a period not to exceed 30 years. The City is in the process of developing data from which its actuarial advisors will be able to identify the extent of its OPEB liability and the unfunded portion of the liability.

A few communities in Massachusetts have already begun to set aside funds for future retiree benefit costs. The Town of Wellesley has secured special legislation with authorization to create a special account from which to pre-fund OPEB expenses and amortized liabilities. The Town's Retirement Board is empowered to manage the fund and invest funds beyond those investment vehicles now approved by the state for municipalities.

Recommendations:

Boston and other municipal officials in Massachusetts are required to manage more effectively in a new fiscal reality in which spending for employees is absorbing a growing share of limited revenue growth. However, in this new fiscal environment, municipal officials are bound by old rules and practices that are not adequate to match the changing fiscal conditions. Under existing home rule, municipalities do not have the authority to address many of these issues directly and must seek state approval to create the new tools to better deliver needed services. The Research Bureau makes the following recommendations involving state legislative change and local administrative steps to enable Boston to manage in this changing environment.

Manage Spending

1. The new fiscal reality involving limited revenue growth and increasing non-discretionary costs will require the Administration to continue to be vigilant in controlling its spending and being realistic in service expectations.

The cost for city employees represents almost 70% of total city operational spending, making position control essential. The budgeted increase of 149 new positions in fiscal 2006 should be countered with reductions elsewhere through better use of technology and improved service alignments. Creative approaches to providing services more effectively, such as utilization of competitive service delivery, should be undertaken. Significant cost savings can be realized through comprehensive management studies of the operations of major line city departments undertaken by nationally recognized professional organizations. The Administration should adopt this approach to study one line department each year. That's important because of the total growth in city operational spending over the last five years, almost half (46.3%) was absorbed by the four major line departments of School, Police, Fire and Public Works. Finally,

the City should begin to reduce its budget reliance on non-recurring revenues.

Collective Bargaining

1. A new approach to public collective bargaining is necessary in this new fiscal reality based on mutual goals for the City and unions.

The structure and process of public collective bargaining legislation and practices should be changed to facilitate the need to respond in a timely manner to changing requirements while still protecting employee interests. The Administration should recognize that front-line employees can help design service efficiencies and increase employee commitment to producing better results. Union leaders should recognize that an effective strategy to protect public jobs is to engage in a cooperative effort to create an efficient organization that can succeed in an increasingly competitive environment. Successful initiatives in other cities have involved assignment flexibility, work process redesign and competitive service delivery. The consequences of management and labor not working in collaboration in these times can be seen in the automobile industry, which is in an uncompetitive cost structure, resulting in bond rating downgrades.

2. To improve service productivity and enable timely response to the changing fiscal environment, the Commonwealth's collective bargaining statute (Chapter 150E) should be changed to establish inherent management authority over selected areas that could not be the subject of collective bargaining.

Such authority was approved for the Board of the Massachusetts Bay Transportation Authority (MBTA) in 1980 and could be a model for possible recommendations. These provisions did not affect wages and benefits paid to MBTA employees which have consistently outpaced other public sector contracts. Included in the MBTA legislation were the rights to:

- Hire, assign and promote employees

- Establish classifications of work and to set standards of performance
- Determine the number of employees needed
- Subcontract
- Assign and apportion overtime
- Hire part-time employees

3. *Chapter 150E should be modified further to ensure timely decision-making to match the demands of changing market conditions.*

Such legislation should address the Brookline rule, the impasse rules for mediation and fact finding and the JLMC process for police and fire negotiations. The parties should be given incentive to complete negotiations on a timely basis by changing Chapter 150E to prevent contracts from being funded retroactively after 12 months following the expiration of the contract.

4. *On the school side, fundamental changes are necessary to adequately meet the educational requirements from both the Federal government and Commonwealth regarding student and district improvement.*

Change from employee contract negotiations every three years is modest and at best achieves no more than nibbling at the edges of what is needed. Superintendents of a school district should be given greater appointing authority in schools classified as under-performing. The Governor's Task Force on State Intervention in Under-Performing Districts issued a report in 2004 with recommendations that warrant consideration. Also, Assistant Principals are part of the District's management team and should not be part of a bargaining unit. Superintendents were authorized to negotiate individual contracts with Principals and Headmasters by the Education Reform Act of 1993 and should be given the same authority with Assistant Principals. The Superintendent could delegate this responsibility to the school Principals.

Pensions

1. *The City of Boston should remain absolutely committed to the State Boston Retirement Board's plan to reach full funding of its pension liability by 2023.*

If future investment performance improves, the Board should act to reach full funding at an earlier date. The system is scheduled to reach full funding in fiscal 2023, five years prior to the legal requirement of 2028. In fiscal 2003, the City extended the funding schedule from 2020 to 2023 in response to local aid cuts that year. Advanced funding ensures that the City's pension promise to its employees remains sustainable over time. The need to address its future OPEB liability is another reason the City should strive to reduce the time to reach full pension funding.

2. *City officials should resist any efforts to modify collective bargaining contracts that would expand benefits that would add to employee compensation and be considered pension eligible.*

The Quinn Bill and vacation buy-back benefits are two recent examples that have increased the City's pension liability. With a funding ratio of only 63.3% and 18 years to reach full funding, pension costs will continue to be a key driver of city spending and additional liabilities will only add to those costs. Furthermore, the ability to retire at 80% of the highest three-year average annual rate of regular compensation and with 100% of active employees health benefits is a very generous retirement package in this economy and there is no need to enrich it further at taxpayers' expense.

3. *The added pension liability of \$61.8 million as a consequence of the 2002 Early Retirement Incentive program that resulted in the retirement of 490 employees should give the City pause in offering any future ERI program.*

Health Insurance

1. *The skyrocketing increases for municipal and state health insurance costs and the growing liability of retiree benefits, tied closely to health insurance expenses, are creating a serious fiscal challenge for both state and local governments that requires a new business model to meet future needs in a fiscally prudent manner.*

A standardized statewide approach for the management of public health insurance and OPEB requirements should be considered. This situation with the provision of health insurance is somewhat analogous to the unfunded pension problem in 1988 in which a statewide approach to reach full funding over time was enacted. One option would be to create a statewide municipal GIC with the same authority over plan design as the state GIC and responsibility for OPEB.

2. *Until a new business model is established, an important step forward would be to create a standardized approach that would ensure that state and local management of health insurance systems are operated on the same level playing field.*

Currently, the Commonwealth's ability to effect health benefit plan changes through actions by the Group Insurance Commission is in stark contrast with the requirement of cities and towns to negotiate changes with each of its unions or collectively with the unions depending on type of plan. The Massachusetts Taxpayers Foundation recently issued a report based on a health insurance survey conducted by the Massachusetts Municipal Association which showed that the average annual cost growth of providing health benefits to local employees was almost double that of the state in the four-year, fiscal 2001-2005 period. Municipalities should be given the same flexibility to manage the surging costs of health benefits as provided the state.

Legislation presented in the Senate and by the Governor provide a framework from which to build a local Group Insurance Committee (GIC)

for each city and town. The Governor's bill would authorize cities and towns to establish municipal GICs that would have the power to require design changes in health insurance plans, including deductibles and co-pay amounts. The Senate bill would allow the elected Executive and Legislative officials to set the share of the premiums paid by local governments and their employees. Combining the relevant sections from the two proposals would create a situation closely aligned to the current state structure. The combination of factors from both bills can create a stronger, more comparably flexible structure than either bill separately.

3. *The City of Boston should accept state legislation (CH 32B, Section 18), which requires retirees to enroll in Medicare when they turn 65 which would provide substantial premium savings.*

The City does encourage retirees to enroll in Medicare B and many do, but the City has not adopted Section 18 requiring all retirees to enroll. This year, the City of Springfield adopted Section 18 and expects to save \$5.3 million in fiscal 2006. Boston will need to manage this program carefully because Medicare charges a penalty for retirees who enroll after the first year of eligibility that increases for each year that an eligible person is not enrolled. Section 18 requires the cities and towns to pay the penalty for retirees who have been eligible but are not enrolled. It also requires that the benefits in the Medicare plan available to retirees be comparable to those in their municipal plan and thus would hold them harmless. Adopting this recommendation would not be without complication in the early years, but it would provide sufficient savings in premiums to make the change worthwhile.

4. *The City should evaluate whether changing a large HMO plan, such as Harvard Pilgrim HMO, from fully-insured to self-insured would be financially beneficial.*

Increased self-insurance would provide cash-flow

savings, as claims are paid when due throughout the month, unlike fully-insured plans which require premiums to be paid in full at the beginning of each month. The change would also afford the City greater flexibility in plan offerings, since the self-insured plans are not subject to oversight by the state Division of Insurance. Currently, only the City's two indemnity plans are self-insured. Costs should be reviewed annually, in order to track the benefits of moving plans to self-insured status.

5. The City should work with its health insurance providers to create its own Clinical Performance Initiative (CPI) patterned after the state model to improve quality and contain costs.

Based on data showing the relative cost-efficiency of doctors and hospitals, the City and its health plans should develop benefit packages that reward the most cost-effective providers and give incentives to employees for selecting these high-quality providers.

6. The City should take steps to minimize prescription drug costs.

According to the Kaiser Family Foundation, prescription drug spending is one of the fastest growing components of healthcare spending in the U.S. First, the City should raise awareness and encourage use of the mail order prescription program through a direct mail advertising campaign. Second, Boston should explore the cost-saving prescription programs established by the GIC to determine which may be viable for the City. In a recent analysis, the GIC found that every 1% increase in generic utilization resulted in plan savings of 1.2%. Finally, the City should consider carving out the prescription drug benefits to be managed by a pharmacy benefits management company.

7. The City of Boston and the State Boston Retirement System (SBRS) should consolidate its human resource management and pension databases

into a comprehensive Human Resource Management System.

The City's Health Benefits Office administers the health benefits plans for the active city employees as well as for most retirees and beneficiaries. While the City's system is the repository of most health benefits data for active and retired employees, the SBRS's system is utilized to reconcile data and manage deductions. Utilizing PeopleSoft applications, the City has invested over \$40 million in technology to build a state-of-the-art integrated administrative and financial system with annual fees exceeding \$500,000. The SBRS uses a system purchased in the early 1990s and currently is looking to replace that system. One option under consideration is the purchase of the PeopleSoft Pension module but whatever solution is implemented, integration with the City's Human Resources application is a critical component. The City's Department of Management and Information Services (MIS) should provide the technical support and infrastructure for the unified application. The requirement to better understand and manage the retirees' accrued health benefits liability reinforces the need for a single central data source.

OPEB

1. The Mayor and City Council should establish a separate reserve and appropriate funds annually to pre-fund the payment of future retiree benefits already earned and being earned currently, starting with the City's fiscal 2007 budget.

While the City is not legally obligated to initiate this funding at this time, the OPEB liability is real and delay in the start of funding this liability will require even larger payments in the future. If the City takes no action in funding this liability in a reasonable time, the credit rating agencies will take notice. Whether the City follows the Wellesley example through special legislation to establish a reserve with improved investment authority will depend on what action the

Commonwealth takes with respect to this situation. As already noted, the Research Bureau has suggested that the funding of employee health insurance and OPEB are closely aligned and would best be addressed through a new business plan that involves a state standardized approach. In any case, Boston should be prepared to establish a reserve in the fiscal 2007 budget, based on an actuarial analysis that should be completed early next year.

2. The growing cost of health insurance and the demographic changes from the aging of the baby boomers make it necessary for Boston to evaluate its future financial obligation for retiree health insurance.

The City should determine whether at some point in time it will need to require retirees to pay a larger share of their retirement health insurance premiums. Any change in premium share should be bound by existing state law regarding the maximum percentage allowed.

**City of Boston
Revenue Analysis
FY01-FY06**

Figures in 000's

Account	FY00	FY01	FY02	FY03	FY04	Budget FY05	Budget FY06	Change FY05-06	% Change	% of Total	% of Increase	Change FY01-06	% Change
Gross Property Tax	\$866,206 (41,226)	\$917,920 (43,906)	\$972,653 (46,317)	\$1,035,871 (39,841)	\$1,084,150 (42,083)	\$1,148,742 (43,713)	\$1,199,460 (40,561)	\$50,719	4.4%	58.5%	42.5%	\$281,540	30.7%
Overlay								3,151	-7.2%	-2.0%	2.6%	\$3,345	-7.6%
Net Property Tax	\$824,980	\$874,013	\$926,336	\$996,030	\$1,052,067	\$1,105,029	\$1,158,899	\$53,870	4.9%	56.6%	45.1%	\$284,886	32.6%
State Aid	\$513,681	\$547,061	\$568,000	\$530,324	\$521,232	\$523,343	\$543,202	\$19,859	3.8%	26.5%	16.6%	(\$3,859)	-0.7%
Chapter 70	186,152	197,518	205,643	205,643	200,498	200,498	203,635	3,136	1.6%	9.9%	2.6%	\$6,117	3.1%
Additional Assistance	206,638	206,638	206,638	175,126	164,211	164,211	164,211	-	0.0%	8.0%	0.0%	(\$42,427)	-20.5%
Lottery	63,066	70,978	63,492	57,556	53,968	53,968	60,546	6,577	12.2%	3.0%	5.5%	(\$10,432)	-14.7%
Other	57,825	71,927	92,226	91,998	102,554	104,665	114,810	10,182	9.7%	5.6%	8.5%	\$42,883	59.6%
Excises	68,907	72,656	80,646	83,125	59,566	65,950	74,550	8,600	13.0%	3.6%	7.2%	\$1,894	2.6%
Parking Fines	55,558	58,961	59,977	58,371	66,054	61,529	65,109	3,580	5.8%	3.2%	3.0%	\$6,148	10.4%
Investment Income	21,886	26,084	14,800	8,552	7,792	7,300	16,000	8,700	119.2%	0.8%	7.3%	(\$10,084)	-38.7%
Miscellaneous	138,845	172,898	165,084	173,520	166,076	149,174	161,669	12,495	8.4%	7.9%	10.5%	(\$11,229)	-6.5%
Subtotal Recurring	\$798,877	\$877,660	\$888,507	\$853,892	\$820,720	\$807,295	\$860,529	\$53,234	6.6%	42.0%	44.6%	(\$17,131)	-2.0%
Fund Balance	\$0	\$0	\$0	\$0	\$20,000	\$15,000	\$20,000	\$5,000	33.3%	1.0%	4.2%	\$20,000	-
Surplus Property	0	0	0	13,000	1,876	9,226	9,226	7,350	391.8%	0.5%	6.2%	\$9,226	-
Subtotal Non-Recurring	\$0	\$0	\$0	\$13,000	\$20,000	\$16,876	\$29,226	\$12,350	73.2%	1.4%	10.3%	\$29,226	-
Grand Total	\$1,623,857	\$1,751,674	\$1,814,843	\$1,862,922	\$1,882,787	\$1,929,200	\$2,048,654	\$119,454	6.2%	100.0%	100.0%	\$296,980	17.0%

Change	\$127,817	\$63,169	\$48,079	\$36,413	\$119,454	\$70,800	Average annual increase FY01-FY06
% Change	7.9%	3.6%	2.6%	1.9%	6.2%	4.0%	Average annual % increase FY01-FY06

Source: City of Boston Financial Statements and Budgets
Prepared by: Boston Municipal Research Bureau

**City of Boston
Spending Analysis
FY01-FY06**

Figures in 000's

	FY 2001	FY 2002	FY 2003	FY04	Budget FY05	Budget FY06	Change FY05-06	% Change	% of Total	% of Increase	Change FY01-06	% Change
Schools *	\$576,993	\$599,967	\$606,794	\$609,715	\$629,092	\$652,474	\$23,382	3.7%	31.8%	19.6%	\$75,480	13.1%
Police	214,286	219,548	217,406	211,363	224,902	234,527	9,625	4.3%	11.4%	8.1%	20,241	9.4%
Fire	116,859	134,625	142,653	137,754	139,569	147,084	7,516	5.4%	7.2%	6.3%	30,226	25.9%
Public Works	76,113	73,114	84,992	85,605	89,045	91,685	2,640	3.0%	4.5%	2.2%	15,572	20.5%
Sub-Total	\$984,251	\$1,027,254	\$1,051,844	\$1,044,437	\$1,082,607	\$1,125,770	\$43,163	4.0%	55.0%	36.1%	\$141,519	14.4%
Debt Service	\$106,179	\$115,563	\$121,330	\$123,925	\$120,352	\$119,746	(\$606)	-0.5%	5.8%	-0.5%	\$13,567	12.8%
Assessments	88,680	94,313	101,116	106,508	116,876	118,905	2,028	1.7%	5.8%	1.7%	30,225	34.1%
Mandatory	\$194,859	\$209,876	\$222,446	\$230,433	\$237,228	\$238,651	\$1,422	0.6%	11.6%	1.2%	\$43,791	22.5%
Health Insurance **	\$122,165	\$139,004	\$152,733	\$171,781	\$190,220	\$211,516	\$21,295	11.2%	10.3%	17.8%	\$89,351	73.1%
Pensions	127,475	129,745	134,425	136,967	146,563	186,285	39,722	27.1%	9.1%	33.3%	58,810	46.1%
Sub-total HI & Pensions	\$249,640	\$268,749	\$287,158	\$308,748	\$336,783	\$397,801	\$61,018	18.1%	19.4%	51.1%	\$148,161	59.3%
All Others	\$314,298	\$303,798	\$299,676	\$304,784	\$272,582	\$286,434	\$13,851	5.1%	14.0%	11.6%	(\$27,865)	-8.9%
Grand Total	\$1,743,049	\$1,809,677	\$1,861,125	\$1,888,402	\$1,929,201	\$2,048,655	\$119,454	6.2%	100.0%	100.0%	\$305,606	17.5%
Total Less Health Insurance	\$1,620,884	\$1,670,673	\$1,708,391	\$1,716,621	\$1,738,980	\$1,837,139	\$98,159	5.6%			\$216,255	13.3%

* Does not include health insurance. BPS health insurance is in the the general health insurance account.

**Includes school health insurance. Does not include the Public Health Commission.

Source: City of Boston Financial Statements and Budgets
Prepared by: Boston Municipal Research Bureau

**City of Boston Health Insurance*
FY01-FY06**

	CITY	BPS	TOTAL	VARIANCE	%	TOTAL CITY SPENDING	VARIANCE	%
FY00	\$79,326,103	\$32,841,861	\$112,167,964	---	---	\$1,632,978,226	---	---
FY01	87,232,847	34,932,014	122,164,861	9,996,896	8.9%	1,743,048,845	110,070,619	6.7%
FY02	99,260,487	39,743,438	139,003,925	16,839,065	13.8%	1,809,676,516	66,627,671	3.8%
FY03	108,927,233	43,806,050	152,733,283	13,729,358	9.9%	1,861,124,566	51,448,050	2.8%
FY04	124,956,847	46,824,261	171,781,108	19,047,825	12.5%	1,888,401,682	27,277,116	1.5%
FY05	139,105,481	51,114,926	190,220,407	18,439,299	10.7%	1,929,145,978	40,744,296	2.2%
FY06	151,576,119	59,939,646	211,515,765	21,295,358	11.2%	2,048,654,769	119,508,791	6.2%
Variance								
FY01-06	\$64,343,272	\$25,007,632	\$89,350,904	\$16,557,967	11.2%	\$305,605,924	\$69,279,424	3.9%
%	73.8%	71.6%	73.1%					

* Includes health, dental, and life insurance and some administrative costs. Does not include the Public Health Commission.

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