Bureau Update
BOSTON MUNICIPAL RESEARCH BUREAU

June 2015

Boston Retirement Board Approves 3% COLA

BMRB calls for increased scrutiny in future years

At its June 17th meeting the State-Boston Retirement Board (SBRB) approved an annual cost of living adjustment (COLA) of 3.0% on the first $13,000 of each retiree's pension for FY16. Since an annual 3% COLA increase on the $13,000 base is calculated into the funding schedule through 2025, the Research Bureau supported the 3% COLA for this fiscal year. However, the Research Bureau believes that rather than an automatic increase, in future years COLA increases should be subject to more scrutiny.

The City of Boston is on schedule to reach full funding of its unfunded pension liability of $1.7B by 2025. No policy decisions should be made that would delay meeting that date for full funding. Additionally, the Research Bureau is very concerned about Boston's sizeable long-term unfunded pension and retiree health insurance liabilities and their implications for future city services. This year, two of the five standards used by the Administration to evaluate its support for the annual COLA increase were not met, including its expected investment return percentage.

COLA Increase

The 104 retirement boards in Massachusetts are obligated by state law (M.G.L. c32, s.103(c)) to provide an annual COLA equal to what the federal Social Security Administration is providing its retirees and beneficiaries. Based on the Consumer Price Index for Urban Wage Earners and Clerical Workers, the Social Security Administration increases its benefits by 1.7% in January 2015. Therefore, the SBRB was required to approve a COLA increase of 1.7% for FY16, but is able to increase the COLA up to 3.0%. Because the SBRB has approved a 3.0% COLA each year since 1997 (even in FY10, when the City's budget decreased by 5.3%), the actuarial valuation schedule presumes this annual increase.

The Administration applies a five-point standard in its position on awarding the annual COLA with three of the standards required to be met to secure its approval. This year, two of the five standards will not be met, meaning the COLA meets the Administration's standards by the lowest possible margin. The first standard not met is an increase in net state aid (Cherry Sheet state aid less assessments). Boston's net state aid available for operations has decreased each year from FY08 and will decrease in FY16. The second standard not met is an investment return above the assumed rate of return in the previous calendar year. In 2014 the SBRS's earned investment return was only 4.9%, well below the assumed rate of return of 7.75%. However, since this COLA does meet the City's standard and the 3.0% COLA is built into the SBRS' actuarial schedule through FY25, the Research Bureau does not oppose the SBRB's approval of the 3.0% COLA for FY16.

COLA Changes in Other States

The fiscal crisis and ensuing recession have caused 17 states to reduce, suspend or eliminate annual COLAs for current retirees. That is a finding in a May 2014 paper issued by the Center for Retirement Research at Boston College. For example, the states of New Jersey and Rhode Island terminated all COLAs until their retirement plans are 80% funded. The SBRS is 70.7% funded. The paper indicated that the COLA cuts have been upheld in the courts because COLAs were not viewed as "a core benefit protected under the laws of the state." Challenging the awarding of a 3.0% COLA increase that is greater than what will be provided by the Social Security Administration in FY16 is not the issue today. However, in light of the projected escalation of future pension appropriations, an annual 3.0% COLA increase should not be considered automatic and should receive greater scrutiny by the Board and City in the years ahead.

Conclusion

The Research Bureau believes that with the fiscal uncertainties ahead the awarding of annual COLA base increases is an issue that will need to be considered in more detail in FY17. This increased consideration will be especially important if the SBRS continues to earn investment returns below the assumed rate of return in the funding schedule.