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Testimony of the Boston Municipal Research Bureau

Before the

Boston Retirement Board

May 17, 2017

Regarding: FY18 COLA and COLA Base Increase

Mr. Chairman and Members, my name is Samuel R. Tyler, President of the Boston Municipal Research Bureau and I am here to support the 3% annual cost of living adjustment (COLA) in fiscal 2018 and to oppose any increase in the \$13,000 COLA base. The City of Boston and Boston Retirement System (BRS) are on schedule to reach full funding of the unfunded pension liability of \$1.5 billion by 2025, less than eight years from now and the Research Bureau believes any policy decision should prioritize maintaining this funding schedule. Our recommendation is based on the importance of maintaining the 2025 funding schedule, concern about recent BRS investment returns, the trend of negative net Cherry Sheet state aid for Boston and the uncertainty of federal funding.

COLA Base Increase

The Research Bureau opposes any increase in the COLA base beyond the current \$13,000, as any such increase would increase the system's total unfunded liability. The Research Bureau is very concerned about the City of Boston's sizeable long-term unfunded pension and retiree health insurance liabilities and their implications for future city services. Based on the current actuarial valuation and review report for the Boston Retirement System as of January 1, 2016, Boston's annual pension appropriation will increase from \$218.2 million in fiscal 2018 to an estimated \$393.8 million in fiscal 2025 as it reaches full funding, a total increase of \$175.6 million or 81% over seven years. This funding schedule is very aggressive, but it should be manageable as long as the total liability is not further increased unnecessarily. Already, the City's annual pension appropriation is recommended to increase by 9.5% in fiscal 2018, far greater than the City's total recommended General Fund budget increase of 4.8% next year.

At the request of the Board, Segal Consulting has estimated that:

- Increasing the COLA base to \$14,000 would increase the City's pension liability by \$25.4 million and increase its FY18 pension appropriation by \$3.5 million.
- Increasing the base to \$15,000 would increase the liability by \$50.5 million and the budget by \$7.0 million.
- Increasing the base to \$16,000 would increase the liability by \$75.1 million and the fiscal 2018 budget by \$10.4 million.

Other factors that led the Research Bureau to make this recommendation include the following:

- The aggregate investment market return over the four years from 2013 to 2017 was 6.28% which is below the assumed annual rate of return of 7.75%.
- In a December 2014 Special Report on the BRS and Board operations, the Research Bureau suggested that the BRS and City not approve a COLA base increase until the BRS reached a funded ratio of 80%. Several states have adopted a policy that no COLA increase, annual or otherwise, would be approved until the pension system reached the 80% funded ratio. As of January 1, 2016, the BRS's funded ratio based on market valuation was 69.4%.
- The Commonwealth's defined benefit pension system is very generous by today's standards in light of changes in private sector pension benefits to reduce future liabilities. Several states are moving to defined contribution plans for new members to control pension costs. Also, Boston retirees enjoy very favorable health insurance benefits during retirement.

3% COLA Increase

The annual COLA increase can be set up to 3% of the first \$13,000 of a retiree's pension. 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 approved an increase of 0.3% in January 2017.

The Boston Retirement Board has no obligation to increase benefits beyond 0.3%, but it can increase the annual COLA up to 3.0%. The City of Boston has established a five-point standard in determining the City's financial ability to support an annual COLA increase. A majority of the factors must be positive to gain the City's support. This year, technically three of the conditions are met and two are not. The current year's net Cherry Sheet aid is \$4.8 million less than net aid in the prior year. The market investment return of 7.1% in 2016 did not meet the 7.75% assumption, and the market return rate in 2015 was -0.65%. Also, a majority of the City's union members do not have raises awarded during the current fiscal year since only three union contracts have been settled to date. However, collective bargaining reserves of \$47 million in the Mayor's fiscal 2018 recommended budget should cover the fiscal concerns of that point.

Since an annual 3.0% COLA increase on the \$13,000 base is calculated into the existing funding schedule, the Research Bureau does support the 3.0% COLA increase for fiscal 2018.

Conclusion

The COLA impact on the City's pension liability must be considered in conjunction with financial demands of departmental services and the looming cost of the retiree health insurance liability (OPEB) of \$2.26 billion as of June 30, 2015. Reaching full funding of the pension liability in 2025 would enable the City in fiscal 2026 to allocate a portion of the resources previously used to fund the annual amortized pension liability to the pension fund to help maintain full funding. The balance of the available funds could be allocated to address the OPEB liability at a higher level going forward.

The Research Bureau believes that with the fiscal uncertainties ahead, both at the state and federal levels, increasing the COLA base is not fiscally prudent at this time and should not be approved by the Boston Retirement Board. The City's annual pension appropriation increases are already aggressive and increasing the pension liability moves the City in the wrong direction.