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SENATE URBAN AFFAIRS & HOUSING COMMITTEE HEARING
JOINT PUBLIC HEARING WITH THE SENATE FINANCE COMMITTEE

IN RE: MUNICIPAL PENSIONS

WILLIAM PITT UNION
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MONDAY, SEPTEMBER 8, 2008, 10:12 A.M.

BEFORE:

HONORABLE JOHN PIPPY, CHAIRMAN
HONORABLE PATRICK M. BROWNE
HONORABLE JOHN H. EICHELBERGER
HONORABLE WAYNE D. FONTANA

I N D E X

| TESTIFIERS | PAGE |
|---------------------|------|
| Luke Ravenstahl | 5 |
| Richard Friedberg | 22 |
| Richard Miller | 32 |
| Theresa M. Miller | 46 |
| Dr. Morton Coleman | 47 |
| Eric Montarti | 58 |
| Dr. Brian K. Jensen | 73 |

*AEPB/THEPB/EU/TKPWOE/UP/TO/-T/PWOFPL/HRAOEUPB

*P/W-R/OEFR/-FPLT/STHA/ABG/RAT/-FRPBLGTS/TPHO

cxs EU/TK/-FPLT/SO/-RBGS/SO/-RBGS/EUBG/TPHOTP R O C E E D I

N G S

SENATOR BROWNE: Good morning, everyone, to this joint hearing with Senate Urban Affairs and Senate Finance Committees. We'd like to thank the University of Pittsburgh and the City of Pittsburgh for being our host today. The hearing today is to gather testimonies for the purposes of prospective action by the General Assembly relating to these pensions.

Senator Pippy is going to be here shortly, and he'll provide some comments when he arrives. I just wanted to provide just a brief statement and then turn it over to our first testifier. As you know, one of the most important obligations of a local municipal government is to pay its public service on behalf of its taxpayers, and that is, in most cases, includes salaries and pre- and post-retirement benefits.

Recently, there's been a lot of concern statewide, and I would dare to say nationwide, regarding the stability of the state and our local governments to fulfill its obligation to employment benefits.

Given the state's role in authorizing the

pensions of local governments and its actions in providing financial stability and recovery, it is our obligation to consider ways that we can either gain or provide some changes in our state statutes, which will look to a potential remedy for the concerns that exist at the state and the federal level. I look forward to receiving testimony today that will give us the information necessary for us to make these changes and take these actions.

Our testifiers today will both be from the public sector, public sector associations, and organizations that have organized task forces over the past several years in order to come up with recommendations that assist in this regard.

So I wanted to thank, again, the University of Pittsburgh to have this meeting with us today. Senator Pippy is with us, who is the Chairman of the Senate Urban Affairs and Housing Committee. I wanted to ask the Senator for any additional comments.

Senator Pippy?

CHAIRMAN PIPPY: Thank you, Senator Browne.

We have a lot of good work going on on the road network, and I should know better. I think Senator Browne covered it well. I wanted to make it clear that these hearings, the idea is to get information from all sides because it's a very pretentious issue depending on what

perspective you're looking at, so our goal is to try to get as much information, if there are changes we need to make at the state level with the administration of the programs, the equations, where the money's coming from.

We're open to that. And we'll be looking forward to try to work with all the different organizations because this is an issue that is affecting, in particular, first-, second- and third-class cities as a whole. The Urban Affairs and the Budget and Finance -- not the Budget and Finance Committee, the Finance Committee; I chair the Budget and Finance Committee -- but the Finance Committee, are having this joint hearing because of the way our tax structure is, the way our governmental structures are and the impact it has. So I want to thank the Mayor and everyone here today, and I look forward to hearing all of the testimony.

SENATOR BROWNE: Thank you, Senator Pippy. Thank you for hosting this hearing in your great City of Pittsburgh, Allegheny County. Our first testifier is the Mayor of the City of Pittsburgh.

Mayor, it's very nice to have you here.

MR. RAVENSTAHL: Thank you, Senator Browne and Senator Pippy and Senator Fontana and all of those that are here today to discuss this very important issue. I have and I believe everyone has a copy of our Power Point

presentation that we've put together.

I also want to mention before I begin, I'm joined by my budget director, Scott Hillman (ph), who is here to answer any specific questions that you all may have as a result of our testimony, so I will begin. The City of Pittsburgh's finances have significantly improved since we were declared distressed under Act 47 in 2003. By driving down the cost of government, we are on the path towards financial stability. So, for example, we have now a very healthy fund balance in excess of over \$100 million.

That's a far cry from where we were in 2003. And as a result of some of those issues, we have also a pay-as-you-go capital budget, which will allow us to not acquire any new debt over the next five years, something that we think is important and very much necessary in order to try to contain some of our long-term legacy costs.

But even with all that progress, much work remains, and any discussion of full recovery must begin by discussing unfunded pension liabilities, a problem that is not unique to Pittsburgh. We recently had an addition filed by DCED to City Council to be removed from Act 47.

They have since come back and said we are not ready to do so, and one of the major reasons that we are not able to be removed from Act 47 is that long-term legacy costs, unfunded pension liability, etcetera. And it's my hope

that through the Act 47 plan that we're going to be working on, that it begins to address this issue because one of my biggest problems originally was, while we were a good story over the past couple years, it was silent on our long-term costs.

So this new opportunity to rewrite Act 47 plan will allow us to do so, and we're going to be very aggressive in talking about this issue when I refer to pension as well as other long-term legacy costs. Our next slide is unfunded pension liabilities. It gives you a little bit of a broader perspective here.

There are at least 200 underfunded pension plans in the State of Pennsylvania according to the University of Pittsburgh Institute of Politics, an organization that we've worked very closely with on this issue. The combined local government retirement systems in Pennsylvania have a total unfunded liability of \$5.2 billion.

The largest funding gaps are attributable to demographic shifts in urban areas, so, for example, large cities with declining populations may have as many retirees as we do current employees, an initiative in Pittsburgh places as well as other cities throughout the Commonwealth. In addition to a shrinking tax base, these pension funds are paying out more money than they are receiving in current employee contributions.

So this shows that it is not a problem that is unique to Pittsburgh; rather, it is a problem, as Senator Browne mentioned in his opening remarks, that we are facing through the Commonwealth and, in fact, nationwide. A little bit about Pittsburgh's unfunded pension liabilities; these shifts I just mentioned have lead to an unfunded pension liability in our city of more than 50 percent. This is a result of our declining tax base.

So, for example, our population of a little bit over 300 thousand people is a decrease of more than 58 thousand since 1990. Unfortunately, that's a trend that has been occurring for quite some time. And while that population has decreased, the municipal functions that we are required to provide for the City and the region; including public safety, public works, etcetera, have not.

Our funding is becoming more focused on higher education, sitting in this building here today, and healthcare nonprofit institutions that benefit our entire region. And as these groups drive, residents of the City are required to bear a disproportionate and constantly increasing share of the tax burden. So essentially, our city limits haven't changed; our size has remained the same in terms of the square footage.

However, our tax base has led to some of the problems that we have. Demographic shifts; as Pittsburgh

makes necessary personnel reductions to reflect our population loss, we are left with more retirees receiving benefits than current employees contributing into the system, further exacerbating our pension liabilities.

And to highlight that, we have, for point of reference, in 2003 when we were originally declared distressed through Act 47, roughly 4 thousand employees in the City of Pittsburgh. We sit here today, five years later, with about 1 thousand, so we reduced our workforce by almost 25 percent.

I want to look at this slide real quick, and one of our, I think, toughest issues to explain is that despite some of our critics and those that believe that we have overly generous retiree packages, specifically for our fire and police personnel, that's just not the case. If you look here, our average pension benefits for our fire fighters and our police officers and our municipal workers are very, very reasonable.

So it's not as if these individuals are retiring from the City of Pittsburgh and making significant money as a result of their pension benefits. And I think it's important to know that the people out there that think these fire fighters and police officers retire and are making a lot of money, that shows otherwise that it's an annual average of \$29 thousand.

Consensus process; as I mentioned, it's not unique to Pittsburgh. We all realize that the problem does exist, and now we have to determine what to do about it. And I want to, again, thank you all for having us here to talk about this and what some of the opportunities might be. We've been committed to working collaboratively with other municipalities and stakeholders to develop a plan.

I've been very active with my colleagues throughout the Commonwealth, mayors throughout this state to talk about a consensus plan for all of us to endorse. As a result of that, we've met two or three times already, and we've met -- I'll see at annual conferences. And we have an organization now together that includes the Mayors from Meadville, who is here and you'll hear from him later, Allentown, Murrysville and Lock Haven.

And, of course, as I mentioned earlier, we're working closely with the University of Pittsburgh Institute of Politics chaired by State Representative Dan Frankel and Republican State Senator Jane Orie. So our overview of reform proposals, there are four that are more detailed on the next slides; revise the state aid pension formula, prevent spiking, permit and encourage defined contribution or hybrid plans and allow for consolidation of the plans.

The revision of state aid pension formula;
Pennsylvania now allocates state aid to municipal pension

plans. The program fully funds nearly half all participating plans, leaving those municipalities with little incentive to control their benefits. Capping the reimbursement percentage would give municipalities greater incentive to control their costs and could make some state funds available for other purposes, such as additional aid to underfunded plans or raising the per-unit reimbursement.

And, again, these are just things we have been working on throughout the past couple of years. Additionally, the state pension aid formula has worked against city recovery efforts. One police officer or one fire fighter, for example, equals two units. And as I just mentioned, mandated by the Act 47 plan, we've reduced the number of uniformed personnel, many of which retired as a result of Act 47.

And so we have a smaller number of fire fighters and police officers than we did in 2003. Unfortunately, as a result of that, it's adversely affected us because it's essentially penalizing the City of Pittsburgh by reducing our pension aid because of the number of fire fighters and police officers that we have.

And finally, on this slide, Act 205 does not account for EMS paramedics in public safety allocation formula. The next slide is a chart of our, Pittsburgh *AEZ's allocation essentially in relation to the total,

percentage of the total allocation in state pension aid. Since the high-water mark in 1989, you see \$24 million for 19.7 percent of the allocation.

We've decreased significantly by \$9 million, despite the fact that the total state allocation has increased more than \$200 million during the same period. So the state allocation has increased, but unfortunately because of the way the formulary's written, we and the City of Pittsburgh have, despite that, seen our contribution decrease by \$9 million. Spiking; pension calculations for defined benefit recipients are generally based on the employee's last three years of employment.

This practice gives employees a double incentive to maximize income during their last three years of employment, since doing so results in both increased salary and, more importantly in this case, increased pensions. In fact, the Third Class City Code now prohibits counting overtime as salary for pension purposes, and, of course, it may be prudent for the General Assembly to perhaps consider applying this to all plans.

We want to permit and encourage defined contribution or hybrid plans. With the private sector moving away from defined benefit plans, popular support for public sector defined benefits may decline. Pennsylvania currently requires counties and second- and third-class

cities to provide defined benefit plans. Moving from those to defined contribution plans reduces risk exposure, but does not necessarily reduce costs.

For example, we are in the process of, in the City of Pittsburgh, for the first time, we're going to be offering an alternative to nonuniform, nonunion employees to use and allocate their dollars towards a defined contribution plan rather than a defined benefit plan. It's something that while it won't deal with our long-term unfunded pension liability, it will prevent, of course, the recurring theme there and allow us to be more fiscally prudent.

So we just announced that last year, and hopefully -- I'm not sure if we'll be able to implement that next year, but we're going to see how that goes. And it's just something where we're thinking outside the box to try to deal with these difficult issues. And, finally, the consolidation plans we're looking at -- and I'm sure I'm preaching to the choir here with the people sitting in this room, but there are more than 3,100 local government pension plans in the Commonwealth of Pennsylvania.

That number represents over 25 percent of the public employee pension plans in the entire United States of America, and, of course, such fragmentation creates inefficiencies and higher overall administrative costs.

And this consolidation could be approached in several ways, and we go through some of the potential options that we think make sense.

We can offer incentives for plans to join the Pennsylvania Municipal Retirement System. The PMRS administers pension plans for local governments **on a contracted basis**. It currently has 864 participating plans. Plans and benefit structures can vary, which I think is important and will be necessary. And incentives could encourage additional plans to join PMRS. That's one option. The next option will be to consolidate all municipal nonuniformed employee pension funds into a single statewide system.

And your colleague, Senator Orie, has proposed consolidation of police pension plans. A similar consolidation could combine the municipal plans through the Commonwealth of Pennsylvania. This would address administrative inefficiency, lack of portability and eventually deal with the benefit disparity issue.

And, finally, for consolidation options, merge authorities' pension plans with those of the municipality within which they operate -- and, of course, we know in the City of Pittsburgh, we can be leaders by example to try to deal with this on a lot of different fronts, not just the pension, but overall government reform and

consolidation -- and require all plans with fewer than a specified number of members to consolidate with a county or state plan.

So, therefore -- and I'm just going to pull this number out of thin air, but if you have, let's say, a dozen employees or a few dozen employees or 50 employees, you would then be required to consolidate in some way, shape or form because I know now, there are some plans that have less than a dozen, single digits in some of the pension plans. So I think that will set a requirement for them to do so.

So that concludes my testimony for this morning. I thank you for your time. I look forward to working with all of you on this very difficult issue. I would be happy to take any of your questions now or provide more information to you at a later date. Thank you.

CHAIRMAN PIPPY: Thank you, Mayor.

Do we have any questions from the panel?

Senator Fontana?

SENATOR FONTANA: Thank you.

In your proposal about the consolidation plan, is there any specific plan that you prefer over the other, or is it possible, I guess, to do a little bit of all three?

MR. RAVENSTAHL: I think we're open to whatever

makes sense and whatever's, I guess, most manageable on this side. We are just proposing these options as potential plans. Of course, it could be a hybrid of the three that would -- whatever would make sense in order to best allow successful -- some sort of consolidation.

We're not going to sit here and tell you that you have to do A or you have to do B or you have to do C. I think we're open to just kind of throwing these ideas out there as potential solutions to the issue, but I think clearly what I will say is that some sort of consolidation has to happen.

The number that I referred to, 3,100 pension plans in the state, which is over 25 percent, I think that's incredible that it's that fragment, and I think something needs to be done.

SENATOR FONTANA: Thank you.

CHAIRMAN PIPPY: I'd like to note the presence of Senator Eichelberger from
cxs TPR **Altoona**.

Thank you, Senator, for being here today.

Senator Browne?

SENATOR BROWNE: Thank you, Senator Pippy.

Mayor, just for my information, the general structure of Pittsburgh's uniform pension plans, length of service, multiple investing period, what is that number?

MR. RAVENSTAHL: By state law, we have three pension plans; one for police and one for fire and one for everyone else, municipal employees and the police and fire. They are eligible for full pension at 50 years old and 20 years of service. This is a longstanding -- I believe the law was passed in 1935, 1940. And I think the demographics are a lot different than in those days.

And so we're in a situation where police and fire fighters were retiring and each get full benefits, and they can be on the pension for 35 to 40 years that they're there. And it just really exacerbates the problem in the future.

So those are key components of what those plans are. It's different from our nonuniform pension plan, which is 60 years old, 20 years service; so that it, from an actuarial standpoint, if you compare the difference of leaving at 50 and 60, the amount is incredible. So those are statutory requirements.

SENATOR BROWNE: The annuity caps --

MR. RAVENSTAHL: They're up to 50 percent of the salary. As that one slide pointed out, the amount paid to Social Security, which it's a little bit higher -- maybe it's more than -- maybe it's 5 percent, but it's there -- but it's 50 percent of their last salary. In our particular case, police is just straight salary.

On the fire, through an arbitration award some years go, the fire has overtime in their calculation. That's why you saw there was a \$7 or \$8 thousand difference between the average pension that's there. So that's sort of the results of the spiking because what you can have is you can have somebody working extensively for just the last three years of their career and, substantially, it materially affects the final pension particularly.

SENATOR BROWNE: Is the position of the City for us, as you look at this, is it the possibility of including overtime as the base of the final salary?

MR. RAVENSTAHL: That's correct, because I think that it's a variable there that you can't really account for in the final analysis, and so it's sort of a -- it creates a barrier to uniform set of benefits. You have the police with one particular set of benefits, fire with a set of benefits and municipal.

SENATOR BROWNE: And that component of our pension is awarded by the arbitrator?

MR. RAVENSTAHL: That's from the arbitrator. That's correct. Now, one thing that I should just point out is the case law from the Supreme Court is clear, that people who currently have benefits or promised benefits, none of these would affect them. But our ideas are prospective as we move forward. So it will take a long

time to resolve it, but we need to move forward.

SENATOR BROWNE: The overtime, I think especially for those complying with the state law, there's third-class cities that provide overtime in their pension, which is not even a plan for state law. That is something I want to know, how you're able to set up an evaluation of a plan when you really can't predict the final big salary. So it's something that we all need to do, not only for the City of Pittsburgh, but everywhere.

Do you find that prospects, that defined contribution system, which we are discussing in Harrisburg, is something that would be accepted by the municipal, nonunion and union for future employees?

MR. RAVENSTAHL: Hard to say on the nonunion. It's our hope that, for example, myself, as a younger city employee, I would -- this is my personal preference -- prefer to put my money in a defined contribution plan, as would perhaps some of the younger employees that we're bringing on.

Now, older, I can't speak for them, but I think the nonunion employees would be much more open to this idea. Of course, we will be able to gauge our success once our program has been implemented. I can tell you that the union employees, union representatives specifically, when this issue was raised, were very defensive and not

necessarily open to considering this option or alternative.

It doesn't mean that they won't. I won't speak for them, but I can tell you that certainly they reacted in a way where they weren't necessarily welcoming this discussion. And so, therefore, as a result of that, of course, we decided to, at least in the initial stages, offer to --

SENATOR BROWNE: Is it possible that would have to be done as part of a larger pool of reform because we were able to convince Senator Orie, and I think it is something that is (inaudible) something that's being seriously **considered**. The **600-pound** gorilla in the room is the unfunded pension liabilities and what we could with that, and defined contribution plans may be the way to go. So we'll look into both of those.

MR. RAVENSTAHL: Thank you.

CHAIRMAN PIPPY: Thank you, gentlemen. One quick question. What was the amount of money that has been going into the plan over the last couple of years? Partially, I believe you received about 16 million from the Commonwealth with a peak of about 24 million in the late '80's, 25 million.

And we're trying to reach why the state contribution side has declined. What -- how is the City -- because I understand under Act 47, we've had some

challenges, but you're coming in the Senate. What are the steps you're going to take to deal with some of the unfunded liability and cut down that percentage?

MR. HILLMAN: Well, the liability, the Mayor's taken several steps. I mean, the Mayor's hired a new investment consultant to our plan. We have had managers accumulated over the years. One thing that the Mayor has done is he's working with City Council, and he's made a pledge to add to, not just to put the MMO, but add 15 percent on it every year in order to try to jump start the fund.

Although, this is not the final answer to the problem. It's something that the Mayor has proposed and Council has accepted to move forth. It's a tricky situation. It's a, to use the reference again, 600-pound gorilla. Our -- the Mayor's fact, as the Mayor pointed out, in the year 2005, the City shed 200 fire fighters for fiscal responsibility and inefficiency.

Those are 400 state aid units that have come, so that's had an impact on the amount of revenue from the state. Currently with that, these are 200 individuals who now appear on the retired side of the equation. So that's why there's been a dramatic increase in our actuarial liability with the new report that we just submitted to the state a couple weeks back. So in those areas where we can

put additional funds into the pension plan, the Mayor's been up front about that.

MR. RAVENSTAHL: But essentially the answer to your question is, yes, we have 15 percent. We've increased above and beyond 15 percent each and every year going forward, so we are trying to deal with the issue and recognize to be proactive and realize that if we're here knocking on your door, we know what we need to do in our municipality.

CHAIRMAN PIPPY: Thank you, Mayor. I appreciate that. I think whatever, if we can get to the solution, it's going to require local involvement and participation.

Gentlemen, thank you.

MR. RAVENSTAHL: Thank you.

CHAIRMAN PIPPY: Our next presenters are from the Pennsylvania League of Cities and Municipalities. The two gentlemen are Mr. Friedberg, who's the Mayor of the City of Meadville, as well as Richard Miller, Esquire, with Campbell, Durrant, Beatty, Palombo and Miller.

Thank you, gentlemen. Begin when you're ready.

MR. FRIEDBERG: Good afternoon, Chairman Pippy, Chairman Browne, members of the Senate Urban Affairs and Housing Committee and members of the Senate Finance Committee. I'm Richard Friedberg, Mayor of Meadville. With me today is Richard Miller, and I won't take that much

time.

We're here representing the members of the Pennsylvania League of Cities and Municipalities and hope to provide you with some general information about a very large and complex topic, municipal pensions. In order to frame the topic somewhat, my testimony today will concentrate on pensions for police and fire personnel in cities of the third class, boroughs and townships, and is limited to four areas; general information regarding municipal pensions, Act 111 of 1968, legislative mandates liberalizing pensions and the concept of the statewide pension system.

As Mayor Ravenstahl stated, there are over 3 thousand local government pension plans in the Commonwealth. Over a thousand of these plans are for police and fire personnel. Under the Third Class City Code, third-class cities must provide a defined benefit pension plan for their police and paid fire fighters.

The Code also sets out mandatory pension benefits, such as retirement age and vesting requirements. Act 600 of 1956 require boroughs, towns and townships with three or more full-time police officers to provide a defined benefit pension plan and also provides for mandatory benefits.

Boroughs, towns and townships with fewer than

three full-time officers have the option of providing a pension plan as well as the option of falling under Act 600 or implementing another benefit structure that complies with the borough, town or township codes. Furthermore, boroughs and townships have the choice of whether to provide a pension plan to paid fire fighters.

Cities, boroughs and townships also have the option of participating in Pennsylvania Municipal Retirement System. PMRS is a separate pension system established by state law. It provides municipalities with a choice of benefit levels and plan administration. Pension benefits of a PMRS plan do not need to comply with Act 600 or the Third Class City Code.

All municipal plans fall under the provisions of Act 205 of 1984, the Municipal Pension Plan Funding Standard and Recovery Act. This law sets forth **funding** and reporting requirements for all local government pension plans and is intended to ensure that local governments can pay their future pension obligations.

The provisions of this law are administered by the Public Employee Retirement Commission, PERC. In 1985, all unfunded pension liability for each municipal obligation to keep the plans solvent is calculated based on actuarial reports required by PERC. Future pension obligations are a significant source of concern for local

officials.

Annually, if not daily, they are looking at the future obligations they have to retirees and trying to make the best choices to meet those needs. A couple of significant factors are outside the control of local governments, however. Act 111 and legislation liberalizing pension benefits are two areas that have a tremendous impact on local government expenses.

One cannot study municipal pensions in Pennsylvania without understanding the overriding impact of Act 111 on pension benefits and resulting costs. Act 111 of 1968 is the law that governs collective bargaining for the terms and conditions of employment for police and fire personnel, including pension benefits.

In Pennsylvania, fire and police personnel are prohibited from striking. In return, they are given the opportunity to collectively bargain for benefits, and if the bargaining process does not result in a contract, both the union and the municipal employer are held to a binding arbitration decision.

Unequivocally, Act 111 has a tremendous impact on the pension benefits a police or fire force receives and the cost incurred by municipal employers and, in turn, by the taxpayers. In the year in which a contract is to expire, the collective bargaining process starts six months

before the start of the fiscal year.

If agreement cannot be reached, one side will request arbitration, and a board of three arbitrators will be chosen. Each side picks one individual, and the third is agreed to by both sides. The result is a decision by the board that is binding. This decision is essentially a mandate to the municipal employer to provide the terms and conditions decided by the board. Moreover, the arbitration board making the decision is not required to take into account what a municipality can afford in terms of benefits and the future obligations of those benefits.

The arbitration board can also award items that were not part of the initial negotiation sessions. When a benefit is given in an arbitration board in one municipality, it paves the way for the same benefit to be awarded in neighboring communities. A domino effect is the best way to describe how the benefit becomes a standard for pension plans across the Commonwealth.

For example, an arbitration board gives an award that includes a cost-of-living adjustment for a city's retirees. When the union in the neighboring city is at the bargaining table, that award is used as a basis for what the bargaining police force asks for in its contract. And if the process reaches arbitration, the union representative argues for benefits based on recent awards.

Today's local government workforce of paid police and paid fire personnel have tremendous employment benefits compared to the public safety forces of years ago. Job security, excellent pension benefits and post-retirement healthcare benefits are the norm and far exceed private sector benefits.

Despite the fact that police and fire personnel are not in need of more benefits, the General Assembly continues to introduce legislation to improve upon these benefits. All of this legislation has the potential, if it becomes law, to have a serious impact on the local government expense of public safety personnel.

And just to be clear, these proposals never provide additional funding to cover the increased employment and pension costs they would generate. House Bill 2472 is just one example of the many pieces of legislation that were introduced this session that would have a financial impact on municipal budgets.

House Bill 2472 establishes a deferred retirement option plan, DROP, for police officers who have reached retirement age. The legislation would authorize the use of DROP plans in Pennsylvania. DROP plans allow officers to continue working while their monthly pension benefits are placed in an interest-bearing account for a certain number of years, usually five.

At the end of the DROP period, the officer finally retires and collects a lump sum payment of his invested pension payments. DROP plans were originally at the option of an employer to keep a valued employee who was about to retire and leave with knowledge and job skills that could not be easily or readily replaced.

What would make this legislation so expensive for municipal employers is that the authorized DROP plans would first become a benefit that could be awarded in arbitration, and second, the plan would be available to all retiring officers even if the municipality did not want to retain certain officers beyond retirement.

Furthermore, retirement eligible officers will continue to work during the DROP term. During this time, they will collect both a salary and pension from their municipal employer who has planned to pay one or the other, but not both. Additionally, the extended employment time means older, higher paid officers will stay on, leaving less opportunity for younger, lower paid officers to join the ranks.

Finally, the DROP legislation does not address other items, such as the procedure should an officer in a DROP plan become disabled. Areas of legislation that are left open to interpretation will only result in legal expenses for municipalities until such questions are sorted

out.

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summarize, such legislation creates a benefit that may be offered to employees.

In reality, these benefits are now available to be awarded under Act 111 arbitration, and municipal employers are forced to provide them. And like the domino effect discussed earlier, the benefit becomes the standard in union contracts across the Commonwealth. We would be remiss if we did not take a moment to remind the Committee members that municipal government pays for public safety personnel employment and pension benefits through tax revenue.

The real estate property tax is the main source of revenue. Therefore, when benefits are increased through legislation or an arbitration award increases expenses, the resident taxpayer foots the bill. This is a very important item to remember because property taxes are stretched to the limit in many communities. Municipalities have a millage rate limit on property taxes that cannot be exceeded without court approval.

Furthermore, many elected officials know that they cannot ask their residents to pay more taxes, thereby leaving many communities faced with the unpalatable decision of having to make cuts to vital public safety

services.

*TPHAOU/-FPLT/THRAFR/-RBGS/WHAOEUL/OERPBLG/PWEPB/TPEUT/-

ZOver the last several sessions, the concept of a statewide municipal police pension plan has been introduced by members of the House and Senate and discussed in public hearings.

PLCM has consistently supported the concept because of the potential to address the administrative inefficiencies, lack of portability and decentralized asset management that mark our current system. Although we support a statewide system, PLCM believes the current language needs substantial revision. We would like to spend a few minutes on this issue because we believe we will continue to see this concept introduced, and we believe that we have amendments that are a win for both the employee and employer.

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background purposes, the current bill is Senate Bill 596. It amends the State Employees Retirement System to add an additional membership classification for municipal police officers. The legislation applies across the board to all municipalities and their future full-time officers. It would be mandatory for all new hires to enter the statewide system, rather than the local plan.

Municipalities would have officers in two separate plans and would still administer their current plan until all the officers and their beneficiaries are deceased, while at the same time, making contributions to the statewide plan for new hires.

In terms of general provisions, the statewide plan would provide four benefit levels for new hires; municipalities would be authorized to provide part-time officers with a pension plan; municipalities would have the option to provide a supplemental retirement benefit plan, a 457 plan; and the bill allows municipalities to move their current officers and beneficiaries into the statewide plan if their local plan is fully funded, and two-thirds of the members vote to move into the statewide plan.

In discussing our concerns with the current proposal and offering alternatives, we have argued that the most important aspect of statewide pension reform is that the benefits need to be provided outside the realm of Act 111. In other words, we cannot support a pension plan at the state level that still allows benefits to be negotiated locally within the confines of Act 111.

If local government cannot get out from under Act 111, a new system for administering local pensions will not work. Therefore, benefits must not be negotiated under a statewide plan, but determined up front in the

legislation. And parenthetically, this is how it's done in statewide pension plans in states such as Indiana, which has municipal police and fire pension plans, so arbitration doesn't happen because they can't arbitrate the percentages.

We've also suggested that the four benefit levels in Senate Bill 596 need to be reduced to one which is consistent with the benefits currently available under Act 600 or the Third Class City Code. Finally, we have explained that there should be no local obligation to provide part-time officers with a pension, that the supplemental retirement plan should be clearly at the option of the municipal employer; and that constitutionally, all current officers and beneficiaries must agree to move into the statewide plan, not just two-thirds of the members and beneficiaries.

In future sessions, we hope that PLCM will continue to be able to offer our alternative approach to a statewide municipal pension system. We believe we can help produce a bill that reforms Pennsylvania's local pension system, still provides excellent benefits to new police officers and is less expensive for Pennsylvania's taxpayers.

In closing, PLCM is working on several fronts to address the significant costs of municipal pensions. We

monitor legislation and oppose bills that liberalize benefits creating more expense. We have offered alternatives to Senate Bill 596 in hopes of reforming the pension system in a positive way.

We have been in discussions with the City of Pittsburgh concerning its approach to pension reform and will continue to work with and support Pittsburgh's initiatives as much as possible. Again, thank you for this opportunity, and if you have any questions, I'd be happy to answer them. Rich Miller has some additional comments.

MR. MILLER: I do have a few comments, but certainly if you have questions.

CHAIRMAN PIPPY: Go ahead, Mr. Miller.

MR. MILLER: Just a couple of quick comments that echo Mayor Friedberg. Again, the League of Cities absolutely supports consolidation because it believes that local governments can achieve economies of scale through regional efforts with consolidation. What's critical, as every group mentioned, to local governments is that the savings associated to those economies of scale be used to offset the unfunded liability that you heard Mayor Ravenstahl talk about.

Right now, it's over \$5 billion in unfunded liability in the State of Pennsylvania, and that number's predicted to grow. So our request is that any savings

that's achieved through that process be used to offset those obligations. Pending legislation that we've seen in the form of Senate Bill 596 and other legislations that we've seen over the years is expanding benefits.

A personal study showed that the present form of Senate Bill 596 expands benefits by, in the neighborhood of \$70 or \$80 million. From the local government's perspective, there's no need to increase the level of benefits already being provided. That's why we suggest you get some form of reduced or at least status quo level of benefits provided under Act 600. It should be worked out through the legislative process, and all moneys achieved, savings achieved to the economies of scale, they need to be used to reduce the unfunded liabilities that currently exist.

At a minimum, I think if legislation is proposed, it should not increase benefits initially. There should be some kind of put-back period to ensure that the amount of savings that's being predicted is actually achieved because, as the Mayor said, once you give those benefits and the Constitution is affected, you can't put that genie back in the bottle.

You hire new officers under a statewide system that has additional benefits. You can't reduce those benefits going forward, so we're hoping that some caution

is given to passing any consolidation legislation that affects municipal pensions. And even the predictions from PERC could be understated.

For example, there's no question that the P1 and P2 levels -- now I'm getting a little more specific with regard to Senate Bill 596, but those levels are in addition to in excess of what is currently provided under the Third Class City Code and Act 600. But that's only half the story. One of the benefit levels provides for a 20-and-out pension, unreduced, which the current legislation 600 requests the Code does not provide it.

Many of these municipalities also have post-retirement healthcare benefits. They pay to the point that someone achieves retirement. You heard Mr. Kunka talk about people retiring at age 50 and having not only pension liability, but post-retirement healthcare liability for that period and for the next 30 or 35 years.

Consider what the assumptions would be if a person could retire after 20 years of service, hired at age 21 or 25 and retiring at 41 or 45 with that same type of post-retirement healthcare liability. So the reality is, some of the liability that has been assessed by pending legislation might not even be predicted because it's not directly associated with pension legislation itself.

There are a number of positive factors

associated with statewide legislation, including portability. One of the problems that we see and certainly one of the things that the FLP and representatives of uniformed employees are clamoring for is portability. A statewide system would provide that.

The type of system that the Mayor mentioned, Mayor Ravenstahl mentioned, the time requirement to provide some form of defined benefit, a combination of defined benefit and defined contribution, would give that same portability. We're seeing that being requested by some employees. They don't have to wait 20 years before they're entitled to any benefit.

Certainly the other example that I would mention to this Committee that's key is you've got to have the regionalization. We're seeing a lot more efforts and a lot more state resources dedicated to investigating regionalization with police forces throughout our state.

I won't go into a long, lengthy discussion about the positives associated with that, but certainly a statewide system gives municipalities the ability to regionalize police forces without receiving the impact it has on employee pensions.

It is the single biggest hurdle we face in trying to regionalize police forces is a combination of determining what the new system's pension benefit will be,

especially if you have a third-class city and an access center community or two access center communities with substantially varied pension benefits in play.

A statewide system would address those issues and help us achieve more economies of scale in other areas, so we definitely support the legislation. The League supports the legislation and certainly in a way that is fiscally responsible, which we don't think the current bill does.

CHAIRMAN PIPPY: Senator Fontana?

SENATOR FONTANA: Thank you.

How do you define the part-time employees?

MR. FRIEDBERG: In my city?

SENATOR FONTANA: Yeah.

MR. FRIEDBERG: Currently we don't have any part-time police and fire employees.

SENATOR FONTANA: Police or fire?

MR. FRIEDBERG: They're all full-time.

SENATOR FONTANA: They're all -- are they represented by a bargaining unit?

MR. FRIEDBERG: Yes. The police are FLP, and the fire are IFF.

SENATOR FONTANA: Thank you.

MR. FRIEDBERG: And I might point out that we, Meadville is -- I can't say we're the only one, but we're

one of the few cities in Pennsylvania that is not in a distressed pension plan, which is good and bad, which means the only flexibility you have in unfunded liability and to recover actuarial losses is to increase the real estate.

If you're in a distressed municipality, you know that you have to **increase** the earned income tax, so we don't have that option. But the plans are -- there's so many different ways to be funded. We are funded at 94 percent, which is relatively good in Pennsylvania. But it's -- the pressure, the same pressures are there.

We've had to reduce the number of employees too to avoid tax increases over the years, and so we have fewer people getting in units for state aid. And some of those people have reduced and eligible for some or all, and we did a lot of reductions just rather than terminate them. But we did have a couple terminations as well, so the problem is out there. We need to act now.

CHAIRMAN PIPPY: Does the League of Cities and Municipalities have a paper or executive summary outlining some of the things that you testified to?

MR. MILLER: Yes, we have.

CHAIRMAN PIPPY: If you can provide that to us, that would be helpful to us, both committees, as we're dealing with this issue. And we look forward to continuing to work with you. The only question I have, or the second

question, is the savings you mentioned, how that money should be redirected to deal with the unfunded liability.

I'm trying to think how would we do that. If we're consolidating, you're not going to have as many pension managers that's paid for by the local, as you mentioned, property tax, so it wouldn't be state money saved. So it would, it would be your own money that you could put into the plan. Are you asking us to mandate? I'm just trying to figure out how we would calculate these savings.

MR. MILLER: And there are a variety of ways, and we would be open to anything. The point of the issue though is not to rededicate them into what we perceive right now as increased benefits.

CHAIRMAN PIPPY: Okay.

MR. MILLER: The pending legislation has new levels of pension entitlements that are in excess of what the current laws provide for. Even PERC said, it's an analysis, that you have to assume for the Act 111 process that every community at some point is going to be P1 or P2 level, the highest two levels that are provided for pending legislation.

Those are benefits that are much in excess of what these municipalities are currently providing. So whether it's achieved, whether it's enacted at the local

level by a less administrative cost, whether it's achieved at the state level by the investments is critical.

And we certainly do want to use that to produce the unfunded liability, but we certainly don't think at this point there's a strong argument that the benefits that are divided now are not sufficient. So any kind of legislation that proposes to withstand those benefits, we would, the League of Cities would object to it.

CHAIRMAN PIPPY: Thank you. If you could give that to us at some time, that'd be helpful. Thank you very much, gentlemen.

Oh, excuse me. Senator Browne?

SENATOR BROWNE: Thank you, Mr. Chairman.

Just a couple questions. One thing that, Mayor, in your testimony on the consolidation bill is that the percentage of employees (inaudible) employees and beneficiaries, two-thirds --

MR. FRIEDBERG: But I don't -- he's the lawyer. You really -- you get a contract for a whole bargaining unit. If one person says, I want to stay in the old plan and you have 60 percent police and, yeah, we're going over that percentage anyway. But I'm not sure legally what to do because there's a contract that is made with that bargaining unit at the time, and now someone's trying to change that interest.

SENATOR BROWNE: Is it tending to be a majority vote -- and that's considered constitutional, so I --

MR. FRIEDBERG: I may be wrong.

MR. MILLER: No, no. There certainly is a question. And I think both sides of the aisle, labor and management, would concede that there is some question regarding the ability to impose that type of change raised in some of the meetings we had with PERC about the proposal. Representatives of labor and management were there. There is a question.

Ultimately, the problem is, any risk associated with litigation relative to those issues fall at the feet of local government, so we certainly want to address that issue as part of the legislation. One of the things that we proposed in the white paper that is presented, prepared by the League of Cities, is an alterative benefit structure that was only intended to apply to new employees so that you wouldn't have any of the issues associated with changing the benefit structures or voting requirements of active police officers.

It did two things. It created a defined benefit structure, which was somewhat consistent with the current legislation, Act 600, Third Class City Code, and it only applied to new hires; but it also provided portability to current employees that are in the systems that currently

exist. So there are alternatives to deal with those issues. We would be very interested in talking to Representatives.

SENATOR BROWNE: In the information that my Committee received from PERC is that there is a significant percentage of municipal retirement plans that are not in compliance with state law, noncompliance with Third Class City Code by offering benefits and provisions that are not permitted under the Code.

And one of the problems with getting plans back into compliance is there's really no way to enforce it. There's no other state office that is in charge of that authority. The Attorney General can't do it. It's really a question of whether the locals themselves and the government themselves if there is an issue of lack of compliance with state code. Are you aware of this, and would you be willing to support some type of external enforcement mechanism?

MR. FRIEDBERG: What kind of noncompliance?

SENATOR BROWNE: One example is overtime.

MR. FRIEDBERG: Oh.

SENATOR BROWNE: That's one.

MR. FRIEDBERG: We don't count -- it's never been awarded into arbitration. We would support mandating.

SENATOR BROWNE: Well, that was the state law right now.

MR. FRIEDBERG: I think there are arbitration awards that have been awarded.

SENATOR BROWNE: Which is not in compliance with state law.

MR. MILLER: Senator Browne, I would agree -- I mean, I don't know the number, if it's a majority of those --

SENATOR BROWNE: It's a good number.

MR. MILLER: Yeah, and I certainly would agree. We've run into a number of communities that have plans that provide excess benefits. There's no question whether it's full-time or any form of spiking of the benefit formula, and certainly we'd support some type of restriction. The restriction you have on it now is the Auditor General comes in every two years and does its audit the unit values or state aid and issues an audit plan. And ultimately it says change this.

SENATOR BROWNE: But it has no means to enforce it?

MR. MILLER: Other than in certain circumstances -- and this has changed. Ten years ago, it used to withhold the state aid for municipalities that did not have strict compliance with code requirements. What they do now is they simply tell municipalities, we're not going to grant you unit value to pay for the inappropriate

benefits, so you need two actuarial studies; one that shows what the costs would be if your plan was compliant, and one that shows what the plan cost is based on the noncompliance.

Your state aid is being kept on the value of the former analysis, not the latter, so that's something that they -- they don't need unit value or state compensation for those excess benefits. But you're right, beyond that, there's not a threat or sanction.

SENATOR BROWNE: One last question, Mr. Chairman.

There's one provision, I think, that encourages at least the provision of overtime and the annuity, and that is the allowance of use of the last three weeks of pay as the base for the final annuity. It's either -- the higher of the two. There's --

MR. MILLER: Last 12 months or last five years, whichever has the highest value?

SENATOR BROWNE: Well, the provision in the Third Class City Code is the last three weeks. Now, I'm not sure the history of that, why that's in law. Maybe because the municipality system might provide a promotion to retire, but it seems to determine what the annuity's going to be when it's only based on the last three weeks.

That is in the Third Class City Code, the last

three weeks. I'd be very interested to see if the League of Cities and Municipalities can take a position on that so we can act accordingly.

MR. MILLER: We certainly understand that we focus compensation values at the end of -- if there's a tendency to have those spiked values. What we're seeing even in places that use the last 12 months, based on collective bargaining agreements to give overtime opportunity where overtime is included in the calculation, it's for people with seniority.

So literally, people that are in their last 12 months of employment take every overtime opportunity that's available, sometimes doubling their compensation value before retirement. So based on the way that the contracts provide for the allocation of overtime on seniority, it exacerbates the by giving it to the people that are setting up for retirement.

MR. FRIEDBERG: During my time there, I think we've gone through three or four police contracts, and we have never included overtime, never. We do calculate on the last three years of employment, but we do not include any overtime. So for the last three years, it wouldn't calculate the benefits. And I know I was looking to have that clarified in the Third Class City Code.

SENATOR BROWNE: As far as I'm concerned, this

shouldn't even be a question. The Third Class City Code does not allow it, so the fact that local government actually provides it, the violations in the law is baffling to me and something we need to look at.

MR. MILLER: We have been successful in some of these municipalities in getting that changed through the collective bargaining arbitration process, but typically is on a prospective basis when you raise the issue. And unfortunately, because the way Act 111 set up, there is oftentimes quid pro quo.

If you're reducing the cost of these agreements and bringing plan provisions into compliance, there may be some offsetting advantage that's achieved by the bargaining unit or wage increases or something else. But there has been success at the local level for police on a prospective basis for new hires.

CHAIRMAN PIPPY: Thank you, gentlemen.

MR. MILLER: Thank you.

CHAIRMAN PIPPY: We're going to take a quick two-minute break. Our next presenters will be University of Pittsburgh. You're welcome to come up and set up.

We're running a little late.

(A brief recess was taken.)

CHAIRMAN PIPPY: Thank you, everyone, for being here. We'll continue the program. With us, we're very

fortunate to have representatives from the University of Pittsburgh and the Institute of Politics.

Ms. Miller, I'll let you start.

MS. MILLER: Good morning. Welcome to the University of Pittsburgh. I'm Terry Miller, the Director of the Institute of Politics, and I thank you for being here this morning. The Institute of Politics here at the University has a Institute of Politics Fiscal Policy and Governance Committee. We have policy committees that carry out the mission of education, community and education.

And in response to the growing awareness of the municipal pension problem in Pennsylvania, one of our committees was determined to create a pension subcommittee to look at this problem. The committee is co-chaired by Representative Dan Franklin and Senator Jane Orie.

And over the course of the last year, they've received communications, did a policy research analysis of stakeholder groups and put together a group of policy recommendations to be considered by the committee. The committee was staffed by our Director Emeritus, Dr. Coleman, who will provide an overview of the policies, activities and recommendations by the committee.

DR. COLEMAN: Thanks, Terry.

I'm Morton Coleman. Senator Pippy said in the break, he said, knowing that I'm a university professor and

our lack of ability to be brief, he said try to be brief. And we're running late, so I'll try to do that.

CHAIRMAN PIPPY: Thank you, Doctor.

DR. COLEMAN: Let me talk a little bit about some of the issues that we've had to deal with, and a lot of them have been argued and discussed. We have lots of plans, as you know. The issue that I think is interesting to me is that 67 percent, 67 percent have less than 10. Almost more than a quarter of them, half of them came since then, so we've expanded a number of plans.

There are 140 thousand members in these plans, so we're talking about big time stuff. They're underfunded; 200 are nonfunded right now, and we use the criteria for underfunding that they have 70 percent of assets to liabilities and it exceeds their annual payroll. In all the states and districts, only one does not have underfunded, so every one except one has an underfunded plan.

We know they lack efficiency and portability, and we know that the management of these plans are widely different. We have some very sophisticated plans, and we have some very unsophisticated plans. The General Assembly has done a lot of good stuff with Act 205. I won't go through that and all the details. But if we looked at the amount of money, if we add the underfunded plans up -- I

think Scott mentioned it -- it's about \$6.7 billion.

The subcommittee -- by the way, this is a draft. We have lots of things to do with this yet, but the subcommittee saw the problems; rising pension costs, lack of portability, inefficient administration and inefficiency in the statute. So that was our goal; how do we solve those problems. We had limitation.

We only did pension. We didn't do public schools, counties; we didn't do healthcare, which we may have to do yet because legacy costs -- healthcare may be more than pensions themselves. And we looked at issues that we couldn't really deal with. 111's a problem, but it's easily enacted, and arbitration overrides local government.

And as it says in the Constitution, you can't change 111. We couldn't do a lot for benefits for present employees. Because of the Constitution, you can't change contracts. So there are limits, and we tried to do things that we thought were possible to help this plan at least with incremental changes.

In order to do that, we've met with the Borough Association, the Township Association, the League of Cities, the County Association. We met with 23 labor unions once, and we met with them again. And we will meet with all these groups before we're finalized and hopefully

come back to the Governor's office to get a final say.

Key facts; we got two issues that we deal with. We can either increase assets or decrease liabilities. We're going to be working mainly on the increase asset side; how do we create better investments, better administration.

So given that, the subcommittee came out with ten possibilities of what we could do, and we reduced them to five. So let me go through those five in a couple minutes, and I think, I still think I'll make my ten minutes.

CHAIRMAN PIPPY: Thank you, Doctor.

DR. COLEMAN: The first one is continuing education for investment officers. I think it's criminal that we ask hairdressers to have licensure, or at least have some education, and people who invest public money don't. So we're asking -- and we talked to the City -- we're asking at least six hours a year by the investment officer have continuing education on investment policies.

Everywhere we've gone, we've had a consensus; boroughs, townships, cities, unions all agree that we should do something on continuing education. The second one was the issue that we've been talking about. The City was talking about consolidation of pension plans.

We -- PMRS right now has 800 pension plans voluntarily in the state. We think PMRS could restructure. Local governments trust them.

And so we are talking about a mandatory system that starts with the smaller plans to the larger plans over a 12-year period, but we're not consolidating anything but assets. PMRS also has a plan. If people want to join it, they're capable of doing it. So the second one is on consolidation. The third one is revise the state formula, and ours is relatively simple.

We know that the -- right now, as you know, about 40 percent of all plans get 100 percent funded by the state. They are receiving presently \$3,206 for nonuniform people, and double that for uniformed people. When you talk to the boroughs and townships, you say, well, we want to redistribute some money, and it might help you get 100 percent of your money back. They're going to fight it to the death.

So we figured we have to figure out a way of holding them harmless, adding more money, either to inflation or maybe even an additional tax for the insurance company to produce some money in the distressed city. 205 had originally -- and that money would be redistributed based on merit through the Auditor General's office, so that's where we would hope to get to. So that's our third

recommendation.

The fourth one -- and I've heard this; we've talked about this before -- is that there should be fiduciary responsibility by the people who do the actuarial material. We should have standard reporting systems. Everybody should be kept to that system so that PERC and others are very clear as to what each municipality actually has.

And, finally, our final recommendation is that if you're under 80 percent funded, you cannot increase benefits. And it was interesting, when I talked to the unions, I thought, well, maybe they'll have a problem with that. They said, maybe you should look more at 81 or 82 percent because if you do that, if you raise the benefits, you may be under 80.

So they're very comfortable with the idea that we control funding, control benefits by 80 percent. So we have in the back a lot of mapping. We have a lot more detail. Those are our five recommendations. It's up to you if anybody has any questions.

I did it in ten minutes, Senator.

CHAIRMAN PIPPY: You were great, **Doctor**. Thank you. Actually I'm shocked because I know you usually share a lot more wisdom. But I won't ask you many questions since you were kind enough to give us the draft, and a lot

of the recommendations you just made have a lot of detail associated with them. First of all, I forgot to thank Terry Miller and the Institute for setting up the entire hearing here today.

Your organization over the years has always had a reputation for being a nonpartisan objective, and that's really been the consensus for the all the members on this Committee. And I want to add that, over the last couple years, under your leadership -- I don't know if aggressive's the right term, but has really reached out to try to bring people together to the point where you're talking and saying, why can't we get some more help. And I think we need to solve this, so I want to thank you for the efforts and the recommendations. I know we have some questions from the panel.

Senator Browne?

SENATOR BROWNE: Thank you, Senator.

Thank you. I just wanted to echo Senator Pippy's comments in your work. It's been excellent.

DR. COLEMAN: Just let me say one thing. We have an outstanding committee, and they worked really hard. We had a lot of support and a lot of variety of people that sat on the committee, union business foundations, etcetera.

SENATOR BROWNE: One of the general concerns we have that I hear from members about consolidation of plans

is the argument that we have 67 percent of the plans are less than 10 members, and that presents a problem. I don't see a direct correlation on the sides of the plan and underfunding.

It seems that the vast majority of the funding comes from the larger plans, not from the smaller plans. And consolidation as a major issue is going to be what to do with that funding of the larger plans, even though the smaller (inaudible) scale?

DR. COLEMAN: I think the -- well, we are going to do an analysis to get all of them under PMRS. But I think that consolidation is not so much just **underfunding**. It's both efficiency and portability, so you have a much more efficient system. We don't waste money. And the second thing is to have portability, where people can move from one plan to another, which I think would be helpful. So it's the formula that will work for underfunding.

And actually, to be honest, even our, the idea of changing the formula and getting some distressed money, it will be helpful. But it's not just Philadelphia or Pittsburgh and Scranton's problems. They're much more significant than even those recommendations we outlined.

SENATOR BROWNE: And the consolidation option, the question of the unfunded liability is not part of that consideration?

DR. COLEMAN: Well, it's the same formula PMRS is using, but we are going to solve the underfunding through consolidation.

SENATOR BROWNE: That's going to be consolidation. That's probably our major issue that we need to deal with. Right now in Senator Orie's bill, unless you are underfunded, you can't --

DR. COLEMAN: Yeah, you can't get in. And the issue that, I think, with Senator Orie's bill is including the nonuniformed employees because, as you say, the city, the communities lose double reimbursement. But if you include everybody, that would be helpful to everybody, I think.

SENATOR BROWNE: Do you have a position on defined contribution plans?

DR. COLEMAN: We worked on this very hard, and we thought of it as a supplement. We have a committee now working on it with the union to see if we can come up with a compromise that will be useful. We found that defined contribution doesn't save that much more money than defined benefits.

The only good thing about them is that the municipalities are not committed over time. The money is given out at one time. They don't have to worry 30 years in the future. But we are working on that. We have the

committee looking at it, and we hope to come up with a recommendation on that one soon. We'll play with it for a while.

SENATOR BROWNE: Thank you.

CHAIRMAN PIPPY: Senator Eichelberger?

SENATOR EICHELBERGER: Now, Professor, did you see any other states that have good models that we can look at?

DR. COLEMAN: Yeah. We looked at -- well, obviously, the 80 percent funded came from another state. The idea of, Missouri's idea of funding, we took something from, something from Massachusetts.

As far as arbitration is concerned, New York and Ohio, although they have arbitration, they have different sets of arbitrators than we do. It seems to work out with a fair base, so we have looked at other states. And we have a lot of material from other states if you would like to have it.

SENATOR EICHELBERGER: I would appreciate that. I think that would be very valuable.

CHAIRMAN PIPPY: Senator Fontana?

SENATOR FONTANA: Thank you.

I appreciate all your hard work. I'm sure it's a complicated issue. When you talk about consolidation and it's going to bring efficiency, can you name some efficiencies just for my benefit that will bring by doing

that?

DR. COLEMAN: Yeah, increasing investment rather than having all these little plans with their own investment officers that's very costly and inefficient. The overhead costs, the local plans are three times higher at least than state funding. So we could save money in administration. We would save money on investment bankers and on actuarial costs. And you would have greater investment options because you would have a larger pool, so all of those things.

SENATOR FONTANA: One of your points that I note that you mentioned, you said something about pension needs.

DR. COLEMAN: That's one of our goals. I mean, when we come out of here, nothing can be -- as far as I can see, elected officials have difficulty making tough choices if they don't have public interest and public support, and pension is a very tough issue. So one of our goals is, once we get an agreement, is go out and talk to people all over the state, get support for the ideas, or at least educate them.

SENATOR FONTANA: It would be very helpful. This is a complicated issue obviously for myself to **comprehend** every reason why you should or shouldn't. I'm sure even some of the people that are in the pension plans have trouble understanding it and their family, so it

certainly would be a help to put that out there. Which, out of those five, which one do you think is the most difficult to do and why?

DR. COLEMAN: I think there are two of them. I think 1, 4 and 5 are easier; fiduciary responsibility, benefits shouldn't be given at 80 percent, continuing education. Consolidation is a problem, and it's a problem in two ways; people don't like to consolidate and, secondly, should PMRS be the agency to do it. We found that when we talked to boroughs, townships and communities, they like working with PMRS.

It has a local government sort of relationship, so they like it. So consolidation is going to be an issue, and they'll do it slowly. 800 plans are already in. Plans seem to be happy there. Changing the formula, I think, will cause some problems and how we redistribute is going to cause some problems. But I think both of those are worth the effort.

SENATOR FONTANA: Thank you.

CHAIRMAN PIPPY: Thank you very much.

DR. COLEMAN: Thank you.

CHAIRMAN PIPPY: Our next presenter is from the Allegheny Institute for Public Policy, Eric Montarti.

MR. MONTARTI: That's right.

CHAIRMAN PIPPY: He's the Policy Analyst.

Please feel free to get set up. Although, I hope that you won't be reading everything you gave us.

MR. MONTARTI: Absolutely not. Thank you, again, for inviting me here. My name is Eric Montarti. I'm with Allegheny Institute. We're a nonpartisan, nonprofit organization here in southwestern Pennsylvania that focuses on local government issues, and pensions being a high profile issue, we're definitely interested in that.

As we said, as everybody's aware, there are over 300 thousand local government pension plans. So in the interest of that, we just want to focus on three questions which will make up the characteristics of those pension plans. Separated by class, we'll start. This is giving you a picture of all the classes of municipalities, along with municipal authorities, counties and associations, basically councils of governments representing that last category.

I'll just do the biggest group there is second-class townships. Cities and first-class townships, they represent, by municipal class, 6 percent statewide. It's easy to see why there are so many plans. If you look at bigger cities, you're talking about four pension plans, three pension plans, like here in the City of Pittsburgh, that separate out municipality or nonuniform workers, police and then fire where there's a paid

professional fire department.

How well funded are the plans? The way that we started to look at this was, you know -- because this was a new area of research for us as well -- if you looked at -- if you took these local government pension plans and merged them into one big plan, like state or school teacher pension plans, we're looking at the aggregate.

And as you can see, the local pension plan, if there was one, it'd have currently about 137 thousand members. They have about 4.7 billion in unfunded liabilities between the assets and the liability of all those plans compared to the states that have more members, and there'd be more unfunded liabilities compared to the schools.

And then the number in the box up there, that's mostly what we're talking about this morning. That's basically your assets of your plan divided by the liabilities of the plan. If your assets and liabilities are exactly, you might be 100 percent funded. So the locals would be, if an aggregate, would be about 77 percent funded.

And, again, because you have so many plans, they're all over the place in terms of the amount of assets and liabilities and the number of members in the plan, and so on and so forth. And I should mention what I did not on

the onset. All this data comes from the most recent Public Employee Retirement Commission, which was 2006, and represents year-end 2005 data. Most of it is from that report.

This looks at the plans by funded ratio. Again, that's the asset divided by the liability. You see the majority of them, almost 19 hundred of them, have a funded ratio of 100 percent or greater, and the majority of them, mostly the other ones are 79 percent funded. The question is what do you do with 140 plans that are 59 percent or lower, if we're defining 59 percent as sort of an area of concern.

In that group, I think what's most important to note, in that group of 140 plans, is that you have the nonuniform, police and fire plans of the two largest municipalities in the state, Philadelphia and Pittsburgh. And their liabilities, if you think back to that -- if you look at the aggregate, you have about 4.7 billion in unfunded. Pittsburgh and Philadelphia together represent about three-quarters of that \$4.7 billion.

So obviously the problem is, you don't have a lot of the plans there in terms of a bunch of them, even though a bunch are unfunded. It's just the biggest ones are there, so how do you deal with that. We talked a little bit -- some of the earlier commentators talked about

pension aid. And we'll go into more detail in my testimony in the record.

Just a couple of charts; the pension aid, part of the pension cost is offset by the pension aid system administered by the Auditor General's office. This just looks at the total from 1985. That's basically right after the passage of Act 205. It was \$62 million in state aid available statewide, and as of 2005, that number's grown to 190.5 million. That's just the total.

This shows you -- because, again, the wrinkles with the formula in the state aid is that it's not means tested. Anybody can apply for it. I mean, there are, of course, there's private pension plans that counties can, authorities can, but defined contribution plans cannot.

I believe there's plans that have not been funded for three years and plans that I think that are out of compliance. I'm not sure exactly what that means. And then there's just municipalities that simply don't apply for the aid. But it is open to anybody that applies.

This shows you comparison between the number of municipalities that apply for aid, the numbers that are given full reimbursement versus partial reimbursement because of the formula because you have so many plans and so much variation in the funding levels.

This shows you, based on the unit count

submitted to the Auditor General's office, how many of those municipalities are getting their entire pension costs covered versus the ones that get the unit reimbursement and not the full pension.

So as you can see, the change from 1985 to 2005, it's basically equalized, now a 50/50 split between the number of municipalities that are getting aid, those that are getting full and those that are getting partial reimbursement. This one shows unit value, and, again, the way that works is a municipality fills out the AG-385 and sends it to the Auditor General's office. Nonuniformed is one employee; uniformed are double counted, two units.

This shows what that unit value looked like, that is, the resulting per unit amount of the total pool of state aid divided by the number of units submitted, was \$1,146 in 1985 and \$2,927 in 2005. And as I said before, we have, in terms of looking at the big picture in the state, there's not a lot of pension plans that are poorly funded; but the ones that are, it's going to be bigger ones.

We're sitting in the City of Pittsburgh today, so given the Institute's focus on the City and the region, we want to look a little bit closer at Pittsburgh's picture. This shows -- this is from the Controller's Office, and it's just the funded ratios for the three

pension plans for the City and then the average of those plans. So they're basically 42 percent funded as of December 1, 2007.

Basically what the cities gone through since early to mid '90's, the first thing we did was attempt to issue pension bonds to bring up the ratio. At one point, I think it was around 17 percent funded on average, and the funded ratio went from 17 percent average to 67 percent in 2000.

Then the assets that were invested started to drop, and we've been about, around 40 percent average for most of this decade. In 2002, the Institute looked at the pension issues and what it meant for the City and the City's taxpayers and described it as a, quote, a **deep in the hole gambler who took out a sizeable loan to win back his losses.**

When the Pittsburgh 21 Task Force looked at it, they said basically, quote, the City traded an increase in debt and debt service payments for a decrease in the unfunded liability and pension payments. This is where we are now in the most recent five years from the City. Again, this is from the Controller's report. It shows the assets of the three plans versus the liabilities.

As you can see, the assets have gone down from 381 million to 377. The liability has gone from 752

million to 899 million. That's about a 19 percent increase. And then finally, this shows you the way that the membership is counted in those pension plans, active members of the people that are working; and then retirees, beneficiaries of retirees and terminated, but invested members.

In 2002, right around when Act 47 team first came in, it was basically a 1 to 1 ratio of active retirees. In 2007, it was 32 hundred active members to 45 hundred retirees. What should be done for the pension plans that are in trouble? Some people, some of the folks here testifying today talked about consolidation, consolidating plans. I guess it could take a variety of forms.

The problem is getting the 3 thousand plans. There may be municipalities that aren't interested in consolidating. You may have some municipalities that are very well funded that are going to use it as a bailout of the lower-performing plans. So there may be a new push, and maybe it's something worth investigating if the state is looking at where SERS and PSERS and state workers and the public school employees plans are at the time.

The problem is, at least my looking at it is, there's not a lot of examples where you have local government pension plans that are then absorbed into the

state, whether they're absorbed into a state system or a new system is created for those local government pension plans, like either forwarding them all into SERS or creating a new local government retirement system.

I managed to talk with somebody at the National Conference of State Legislatures, who's a pension expert, and said he could think of one instance in the last 25 years where something like this has happened, and that was in Oklahoma in 1981, where they created, the Legislature passed legislation to create a unified fire and unified police retirement system.

And basically the way -- I talked to these folks in Oklahoma, and it was sort of a wholesale takeover, that the state took over the assets and the liabilities in the plan. And they have a board that administers and defines the pension benefit, but it doesn't dissolve the municipalities completely.

They still have to contribute into the pension, into the retirement, and so do the employees. If the local governments decide -- let's say you're in one of the bigger cities in Oklahoma, let's say Oklahoma City, and the police decide that they want to have a better benefit than the state provides.

If the local government agrees to that -- and it's on their back to pay for it. It's not like they can

say, well, we're going to have a real nice pension in hands, but now it's going to be taken care of by the state system. It doesn't happen that way. And then also the nonunion people are still at the local level.

They are not consolidated, and they're not put to the state level. I'm talking about where you have local pensions now being folded into a state system. There's only really that one example in Oklahoma. And from my conversations with those folks, they said in their time in their professional experience, they've never been contacted by another state looking for, hey, how do you do this; we're interested in doing that.

Massachusetts, which was mentioned earlier, they did a recent change where they're basically -- when they see a pension plan in trouble, they have to meet two benchmarks; they have to be less than 65 percent funded, and they have to fail to meet a, it's called a PRIN, a P-R-I-N. It's like a statewide average under an investment term.

If they fall below that average, basically what happens is the State of Massachusetts, through some Public Employee Retirement Commission, takes over that pension and basically manages the assets. Again, it's not like they're taking the pension plans off the hands of the municipal officials. They're basically bringing it in-house and

receiving investments, and then they can actually get out of that oversight.

What we've seen so far, again, being here in Pittsburgh and the pension issues here and what we've seen in recent years, Act 47 teams recommended some things; pension aid changes, looking upon something as simple as making contributions earlier in the year -- you said usually Pittsburgh spreads them out during the year; they recommend just doing that earlier in the year -- apply any windfall pension funds.

We know now that under the state law, as soon as the casino is built, the host fee is supposed to be intercepted by an oversight board, and that's supposed to be dedicated to pension and debt purposes. And then the group that did a study from the oversight board, the ICA, said they should certainly increase the rate of funding, and I guess that sort of goes in line with gaming money.

But basically what we've recommended, and it's been mentioned today, is phase in defined contribution plans, moving away from defined benefit plans where we're saying, okay, if higher, you know, here's your pension benefit; we're going to take the three best years and when you retire, you're guaranteed to get that pension no matter what happens, versus defined contribution where you give the employee or management to pick the assets or what you

want to invest in.

And if they go up, then if what you picked is a boom, then good for you on retirement; if they don't, then not so good. There seems to be a lot of examples of states now; Georgia, New Jersey, Colorado, Alaska, Ohio.

Basically what they're doing is they're setting a start date; January 1 of a certain year, you're now in this defined contribution plan.

*-FPLT Some other recommendations, if the decision from the state seems to be, comes to, well, we just need to provide more sources of aid, then maybe some other source or some other assets possibly that could generate a revenue fund, again, keeping the benefits in mind with what the community can go for.

And, you know, maybe eventually it just comes down to a, sort of a carrot-and-stick approach in which the state could extend aid or matching funds to pension plans in need in return for a tradeoff on moving to defined contribution plans for new hires and an overall reduction in payroll. So with that, thanks for your time. I hope that wasn't too much, and I'm happy to take any questions.

CHAIRMAN PIPPY: Thank you. We always appreciate the back-up details as well, so the information provided supports a lot of your comments.

Senator Browne?

SENATOR BROWNE: Thank you, Mr. Chairman.

The trend line in Pittsburgh, is there a point in time where the system can't make their obligations? Have you ever --

MR. MONTARTI: I don't believe so. I mean, they're meeting their MMO every year through the combination of state aid, and I know the local share that's gone into the pension aid has gone up. But, you know, there's been -- I think from the oversight board, what I think basically the point of view was, look, they're not going to default on these things, but it's going to push it onto future and future generations of taxpayers.

Now, whether that's something that current officials are worried about, I'm not sure. But that's basically, I think, where the trend line or maybe the attitude is. It was definitely the whole conversation as the members of the local delegation were talking about merging the city and county.

I mean, that was definitely enough of an issue that people were talking about it. Pension debt, just a general obligation of the City, and if you talk about merging that data out, who's responsible for it and that sort of thing.

SENATOR BROWNE: It's becoming clear, as we continue to discuss this issue, that at least in our larger

cities, that they're just not able to afford the best retirement benefit structure that may have been put in place. There's no way that they can afford that. And is the recommendation of the Institute that we need state bailout?

MR. MONTARTI: No. I don't think it would be a state bailout. I mean, I guess the prevailing wage seems to be -- there's nothing that can be done about people that are vested in the system now because those benefits are guaranteed. You can't yank them away. But I think if it's enough of an issue to say, wow, this is problematic; we need to get something done about this, then there has to be movement by both the state and local. Nothing can change about -- someone mentioned before, you know, three police officers in a third-class city, you have to offer them a defined benefit plan.

I mean, the city itself, not just the third-class city,
*OUTbut some of the others ones out around the county, they just can't say willy-nilly unless they're going to go two police officers so that they can get rid of that defined pension, defined benefit plan.

So there has to be some state level changes. But if it's something like -- if we're talking about looking at it as, well, we're going to Pittsburgh and

Philadelphia and bailing out their pension plans, it may be something like a tradeoff.

You say, okay, look; we will now bring these assets and liabilities from these plans into either the existing SERS system or creating a new local government system, but here's what we want in return: As of this date, January 1, March 1, whatever of what year, everybody that is hired after that date, police, fire, nonuniform that is in a 401K plan to begin the movement away from the defined benefit plans.

And then the cities and municipalities **start to say**, we can also make some other changes; maybe now we can look at some of our functions and move those functions away from municipal employees who do outsourcing or have a competitive bid and have them function more by someone who's not a municipal employee in their defined contribution plan.

Then they come back to the state and say, wow, look at these savings we've achieved here on pension plans; we've increased our funded ratio and we're now solving, or taking care of our retirees. Then maybe it's, again, if we have this pool of state aid, then maybe we will get sent back to municipalities on a maximum basis.

SENATOR BROWNE: I appreciate your comments on that because that will be something -- a state action is

very difficult if it's in any way perceived to be, a main thrust of it is to bail out.

MR. MONTARTI: I totally agree. I totally agree.

CHAIRMAN PIPPY: Thank you for your testimony. I appreciate it.

Our final presenter will be Dr. Brian Jensen, the Senior Vice President of the Government Structure Program for the Allegheny Conference on Community Development. He's also a very patient person, so we appreciate it.

DR. JENSEN: Thank you.

CHAIRMAN PIPPY: Now, looking through your testimony ahead of time, I am aware that we have a lot of local pension plans, over 3 thousand. So if you have the opportunity to summarize, we may not need you to go over a lot of the details.

DR. JENSEN: I will be brief.

CHAIRMAN PIPPY: I appreciate that.

DR. JENSEN: I was going to say good morning, but I'll say good afternoon. And thank you for this opportunity to speak this afternoon regarding Pennsylvania's municipal pension situation. My name is Brian Jensen. I am Senior Vice President with the Pennsylvania Economy League of Southwestern Pennsylvania

where I manage the Local Government Function and Structure program.

The goal of that program is to make Pennsylvania's local government, particularly that of southwestern Pennsylvania, Allegheny County and the City of Pittsburgh less costly, more efficient, more effective, better focused, more coherently led and more competitive economically.

The Economy League has promoted the value of better government for over 70 years. From the early 1950's, when our organization staffed a state commission that recommended a complete rationalization of functions and service delivery within Allegheny County local government to our extensive early-1990's program to promote functional consolidation between Allegheny County and the City of Pittsburgh, the Economy League has actively sought to foster intergovernmental cooperation to enhance effectiveness and cost efficiency.

It is in the light of the Economy League's tradition of researching and promoting good government management practices and structures that we undertook an analysis of Pennsylvania's municipal pension situation. This afternoon, I would like to convey to the Committee some of the highlights of our research and offer some conclusions on what we think it means for the current

discussion.

Pennsylvania is an extreme outlier among the 50 states with our radical decentralization of municipal pension plans. Like was said all morning, our state has over four times as many public employee pension plans as any other state. Twenty-five percent of the nation's public employee pension plans belong to Pennsylvania's local governments and special districts.

Our overly-fragmented municipal pension mishmash -- it would be inaccurate to call it a system because there is nothing systematic about it -- continues to grow with the number of local pension plans increasing steadily each year. One consequence of having so many local government pension plans is that they tend to be very small. Two-thirds of our state's public pension plans have ten or fewer members, and nearly half have five or fewer members. Only 13 percent have more than 25 active members.

Small plans are more costly to administer than large plans. In 2005, the average per member administrative cost for Pennsylvania local pension plans with 10 or few members was just about \$1,400 compared to \$250 for the 5 municipal pension plans with over 1 thousand members.

Putting local government employees into larger pension plans would reduce administrative costs, generating

about \$22 million in savings based on these figures. On top of this, there is evidence that small plans tend to lag larger plans in returns on investment.

Large, centralized pension systems have larger amounts available for investment as well as the ability to employ more sophisticated investment instruments than is typically practiced by small, fragmented systems. The high administrative costs and low returns that result from such radical fragmentation exacerbate the dire fiscal condition of many of our municipal pension plans.

According to the Pennsylvania Public Employee Retirement Commission, in 2005, the unfunded accrued liability of our municipal pension plans was nearly \$5.1 billion. As you can see from the map, the incidence of underfunded pension plans is distressingly widespread in Pennsylvania. While cities have the most acute problem, boroughs and rural townships are not immune from pension distress.

Pennsylvania needs to act soon to correct its mounting local government pension problems. Consolidating the administration of our numerous pension plans would be a good first step towards capturing the economies of scale and better investment returns necessary to guarantee livable retirement incomes for our municipal retirees and their families, while at the same time, protecting

taxpayers from continually escalating tax burdens.

Taking it a step further, full consolidation of pension plans would make it easier to rationalize local government. One of the biggest obstacles to the consolidation of police departments and to broader municipal consolidation generally has been the challenge of resolving differing pension provisions.

Fewer, better funded, better outfitted and better staffed police departments would be a happy consequence of a unified municipal pension system. cxs PW-R/ROE/-Z/AEPB/PWOR/ROE/TW-P/-Z/RA
Another approach that should be considered is redesigning the formula for distribution of state aid for pension plans to provide greater support to truly needy and deserving municipalities.

The current state aid allocation formula results in full funding of nearly half of all municipal plans, allowing those municipalities to increase benefits or reduce member contributions at no local cost. Such full-funding reduces the amount available to truly needy municipalities and has led to a substantial disparity in funding.

Distribution amounts could be frozen at a particular point in time, and subsequent increases in the revenue base could be targeted to plans that continue to be

underfunded despite demonstrated efforts to manage their problems through best practices.

Finally, in order to remove barriers to functional and structural consolidation, the Commonwealth should partner with willing municipalities by helping to defray cost increases that result from the leveling-up that typically accompanies such mergers. Such short-term investments from the state will reap long-term fiscal benefits and improve municipal service levels.

Thank you, Mr. Chairman,
cxs TPEUT/-Z/AEPB/KWREUPL/PROF/S-FS/EFRT/-Z/-FPLand with that, I would be happy to answer any questions.

CHAIRMAN PIPPY: Thank you, Dr. Jensen.

Senator Fontana?

SENATOR FONTANA: Thank you.

You don't mention anything about direct contribution by the employees. Is there a reason for that?

DR. JENSEN: No mention of contribution by employees?

SENATOR FONTANA: Right, direct contribution rather than defined.

DR. JENSEN: Oh, the problem right now is it's hard to find benefit pension plans. Defined contribution plans have been attempted in other parts of the country to greater or lesser success. The problem that we have is

with our defined benefit plans, and that's what my study is focused on.

SENATOR FONTANA: Thank you.

CHAIRMAN PIPPY: Senator Browne?

SENATOR BROWNE: Thank you, Doctor. Based the information, a vast majority of unfunded liabilities in our municipal pension system really comes from two cities, Philadelphia and Pittsburgh.

If we do something about those two systems, it leads to my understanding that our current municipal pension mismatch, I guess, or system is about 90 percent funded. So isn't it really, isn't it really the case then that the problem we have with Pennsylvania pensions is really just the problems we have in those two systems?

DR. JENSEN: Well, I would hate to characterize it that way. Certainly Philadelphia and Pittsburgh, being the largest municipalities in Pennsylvania, have the largest problems and it's going to be the bulk of the problem, but that's not to say that cities like Erie and Altoona and Johnstown don't have equally distressed pension situations facing them.

So if we could somehow solve, magically solve Philadelphia and Pittsburgh without affecting the others, does that create a better situation? Well, it doesn't really. We still have to address the whole system. I'm

all in favor in trying to do whatever we can for Philadelphia and Pittsburgh, but we can't forget all those other municipalities that are out there.

SENATOR BROWNE: I appreciate that. That's an argument that we often hear that we have to address because from many parts of the state, that's what you hear. If you look across your map, it's pretty clear that this is not exclusive to those areas.

DR. JENSEN: That's correct.

SENATOR BROWNE: My largest municipality, it's a major issue, in the City of Allentown; part of it because of its own doing, but it's still something that has similar pension concerns. So I appreciate that. Thank you.

CHAIRMAN PIPPY: Thank you, Dr. Jensen. I'll add that if you have any other input that you would like to provide, provide that to the executive directors. It will help, I think. We have all these other organizations who have testified today and many others providing input -- and if we have any questions, etcetera, as we try to develop some type of legislation. But we do appreciate your testimony, and that concludes this hearing.

(The hearing was concluded at 12:15 p.m.)

I hereby certify that the proceedings and evidence are contained fully and accurately to the best of my ability in the notes taken by me on the within proceedings, and that this copy is a correct transcript of the same.

Jennifer L. Sirois, Court Reporter,
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