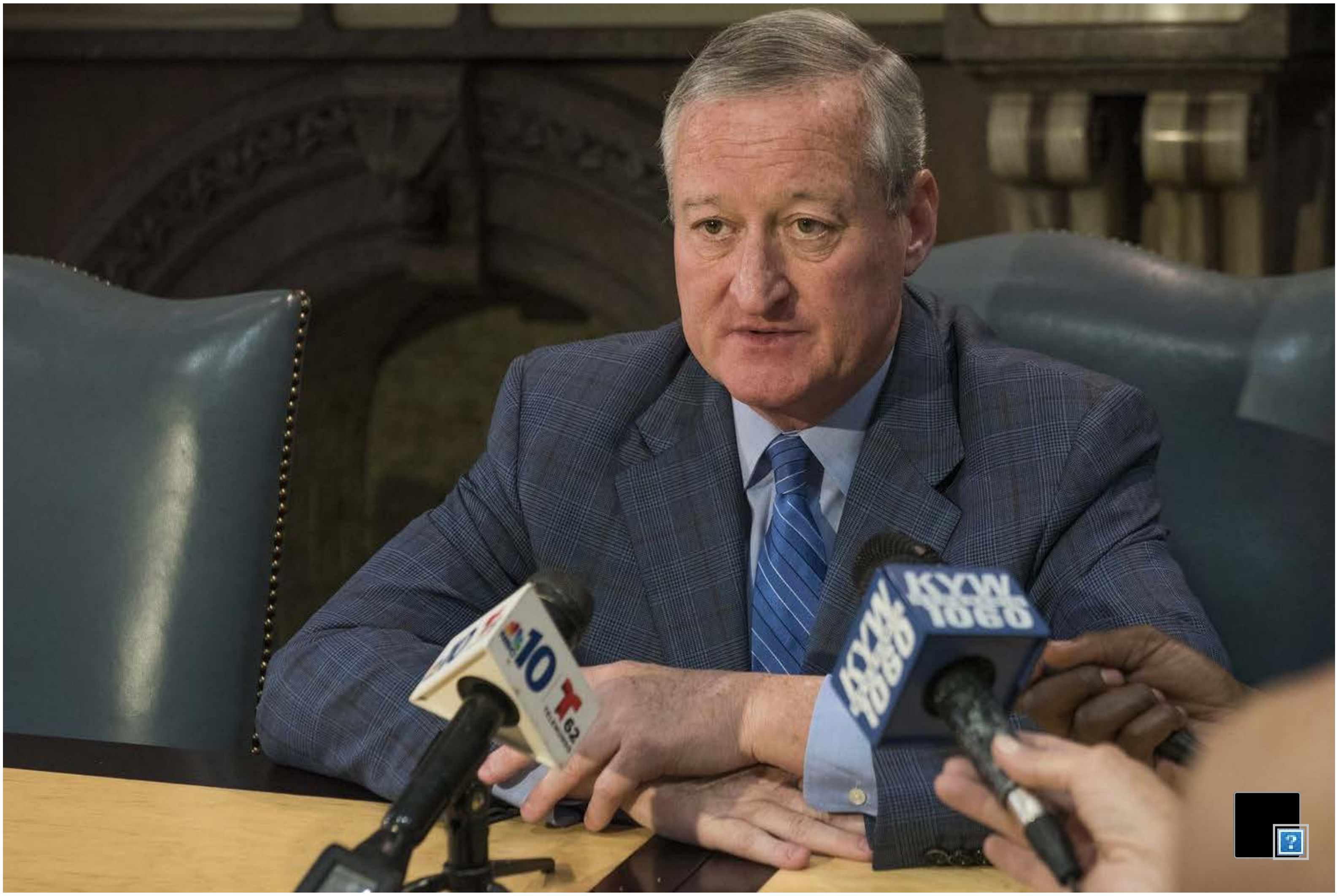
by Claudia Vargas August 1, 2018 - 6:00 AM



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While the Kenney administration has negotiated contracts with the city's four major labor unions during the last two years that gave them all substantial raises, it also says it has taken action to reform the severely underfunded pension fund by requiring employees to kick in more money for their retirement benefits.

City officials contend the additional contributions, a $65,000 cap on future payments for new non-uniformed workers, and increased infusions of cash from the sales tax will lift the pension plan to the targeted 80 percent funding level by 2029.

Finance experts say, however, that the city's projections are unrealistic. They cite the city's 7.65 percent assumed rate of return on investments, which they say is too high and risky, and the continuation of two pension-bonus programs.

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For now, the plan has only 45 percent of the $11.3 billion it needs to pay current and future retirees their promised pensions.

The goal of getting to 80 percent in 12 years probably is too optimistic and "notable improvement will likely require more time to come to fruition," S&P credit analysts said in a report released last week.

Michael Karp, a longtime member of the Pennsylvania Intergovernmental Cooperation Authority, a state board that oversees Philadelphia's finances, recalled similar projections made 10 years ago.

"We talk about 80 percent, but we never get there. We never get out of that 45 percent. We seem to be stuck on that," Karp said during last week's PICA meeting.

Rob Dubow, the city finance director, said that the aftermath of the Great Recession and the fact that retirees are living longer have impacted the fund.

In an interview with the Inquirer and Daily News, Dubow said that while some might dispute how long it will take the pension fund to reach 80 percent, the increased contributions will move the plan closer to the target than if the city had done nothing.

"You can get to an increased funding percent either through reducing the growth in liabilities or increasing assets," Dubow said. "We get there with a slightly different combination than we started with, but we still get there, and that's the important thing."

When Kenney signed a contract in 2016 with the city's blue-collar workers, represented by AFSCME District Council 33, he contended he had achieved pension reform by creating a hybrid plan that would cap defined benefits at $50,000 for all new employees and require current employees to pay more into the fund. Employees who had a salary of $45,001 or higher would contribute between 0.5 and 3 percentage points more. (The average salary for DC33 employees is $38,000.)

The city wanted to use the DC33 contract as a target for the other three unions, which have higher average salaries and whose increased contributions would have a bigger impact. Officials said if everyone agreed to DC33's plan, the city would reach 80 percent funding by 2030.

None of the unions signed on, however. In fact, the city ended up increasing DC33's cap and reduced the contribution rates. Yet the city maintains that 80 percent projection.

Now, all non-uniformed employees, union and nonunion, with a salary of $45,001 or higher will contribute between 0.5 and 2.75 percentage points more, depending on salary. For new employees, pensions will be capped at $65,000. Elected officials will pay more into the fund, but they will not be forced to go into the plan that would cap their benefits.

All police and firefighters, whose contracts were decided through arbitration, will continue to have a defined-benefits plan. Most current members will have to contribute an additional 1.84 percentage points of their salaries; new members, 2.5 percentage points above the 5 percent rate, or 7.5 percent.

The city's actuary predicts that the increased contributions will pump an additional $290 million annually into the pension fund over the next 10 years for a total of $1.4 billion.

During the same 10-year period, the city plans to add $9.6 billion into the fund, including $750 million in sales tax revenue.

Those additional contributions, combined with a steady 7.6 percent rate of return will lead the plan to 82 percent funding in 2029, according to the actuary.

The fund has prospered during the last two years. In fiscal year 2017, it had a 13 percent investment gain and preliminary numbers for fiscal year 2018, which ended June 30, have it at 8.1 percent.

But in 2016, the fund's investments lost $149 million, and taxpayers often have to make up losses when the fund doesn't perform as expected.

In addition to the investment return risk, S&P analysts found that Philadelphia's Pension Adjustment Fund, which doles out bonuses to retirees when the fund does well, will prevent the city from making significant gains in the good market years.

"It is an imbalance," Todd Kanaster, an analyst with S&P, said of the Pension Adjustment Fund. "When the market doesn't do well, there's no sharing. That's entirely borne on the city. If there's a gain, it's split with the retirees. There goes a lot of the asset gain."

City spokesperson Mike Dunn said the Pension Adjustment Fund is the equivalent of a cost-of-living adjustment, which the mayor describes as important and fair.

In the last three years, the Pension Adjustment Fund has sent retirees nearly $70 million in bonus checks.

PICA has been critical of the city's pension adjustment fund, as well as the city's continuance of the controversial Deferred Retirement Option Plan (DROP), which the authority says has cost the city at least $237 million over the 16-year period ending in 2015.

City officials say that one of the biggest achievements in the new contracts is making the hybrid plan mandatory for new non-uniformed employees; the previous administration had a similar plan but it was mostly voluntary.

"We tried to develop a plan that we thought would work for Philadelphia," Jim Engler, the city's deputy mayor for policy and legislation, said in an interview. "We tried to do that in a way that was holistic, provided at least a continued secure pension benefit for employees, reduced the city's liabilities in a similar way and was able to be achievable, and I think that's what we got by securing a mandatory new plan."

Analysts at both S&P and Moody's said that the new, stacked hybrid plan for new non-uniformed employees are a positive and should improve funding levels over time.

"It's not going to lower the unfunded liability today," said Tom Aaron, a vice president and analyst at Moody's Investors Service. "Over time as more and more of new employees are in the hybrid plan, the city's risk profile would be coming down a bit and that's a positive."

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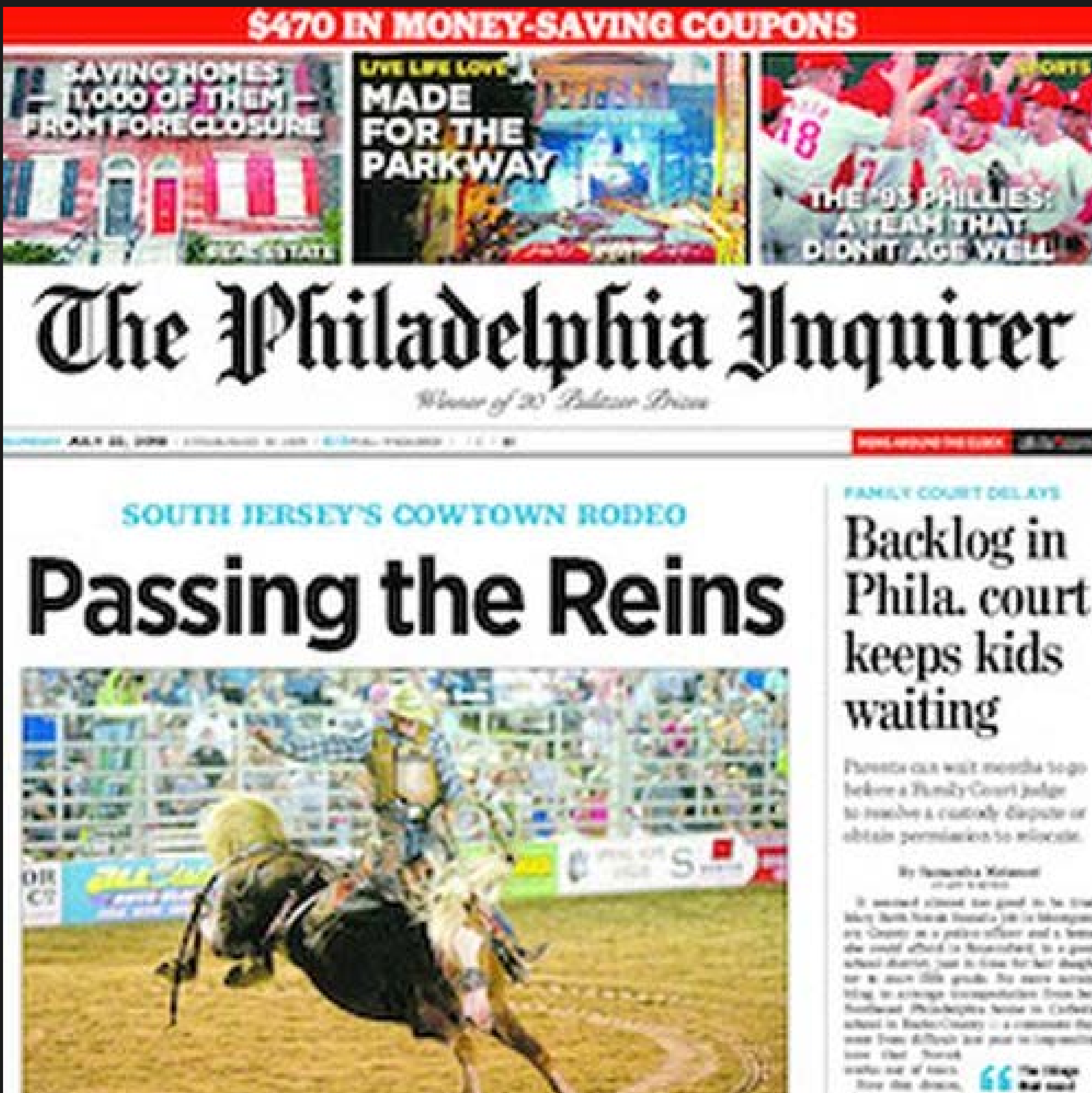

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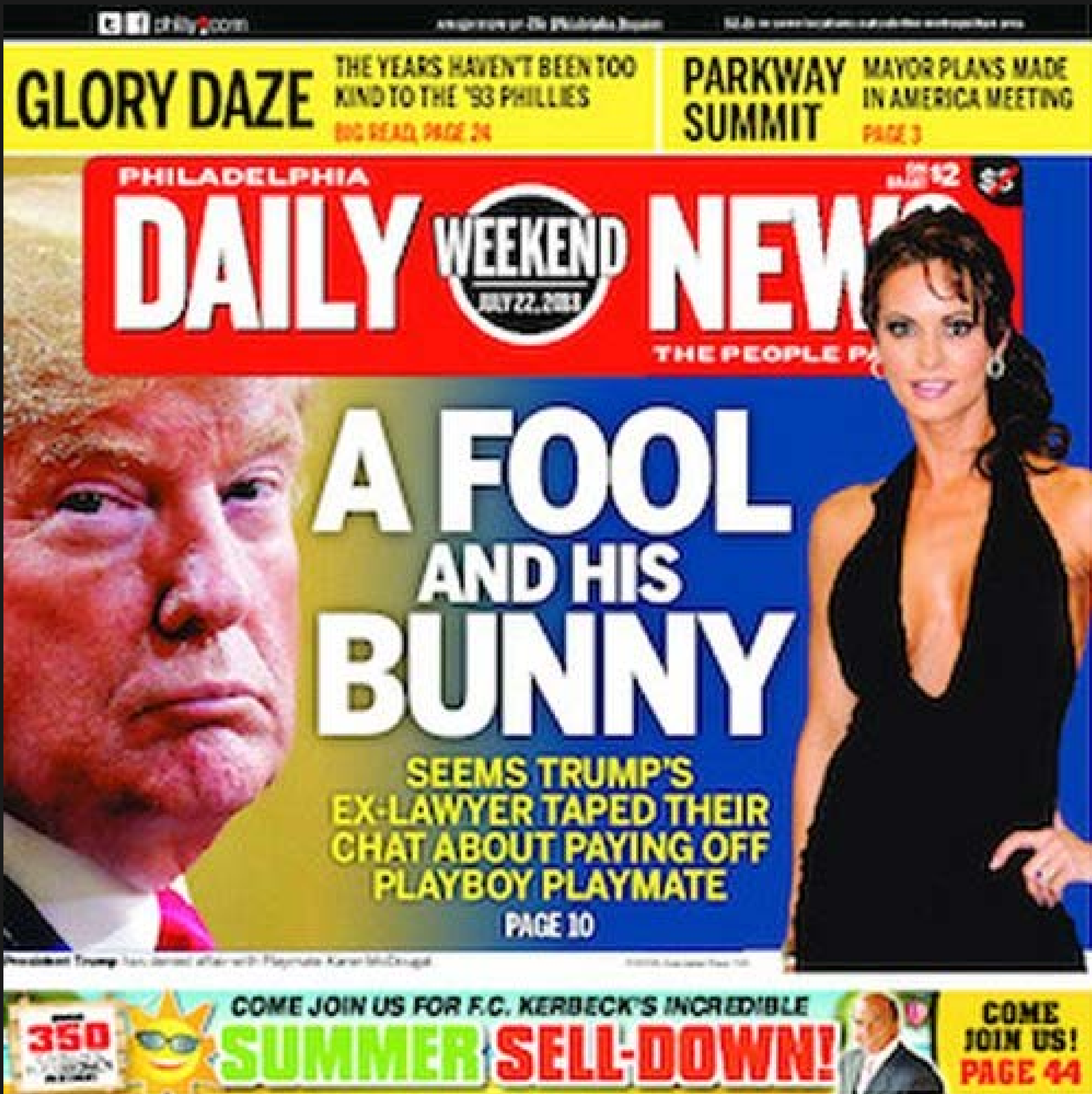

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