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How Much Will the Proposed Early-Retirement Bill Cost the City?

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THE LEGISLATURE IN ALBANY is currently considering a bill that would allow certain public employees to retire at age 55 rather than 62 without a loss in pension benefits. IBO estimates that the bill would increase the city's pension and fringe benefit costs by $68.1 million in the first year after accounting for savings from hiring entry-level replacements.

Other estimates of the cost of this bill have varied widely, ranging from the Bloomberg Administration's $200 million projection to the estimate provided by a union-hired actuary that there would be no cost to the city. The no-cost estimate, by Jonathan Schwartz, a former Chief Actuary of the City of New York, was initially used by the Legislature in considering the bill, although once his relationship with the union was publicized, legislative leaders have committed to obtaining a new and independent cost estimate before proceeding.

Background. In 1995, the city and the unions representing many of its non-uniformed city workers negotiated a deal that allowed qualified workers to opt into an early-retirement plan. Those who elected to join the new plan could retire at age 55 with at least 25 years of service but still receive their full pension as if they worked to age 62, which remains the standard age for such workers to retire with a full pension. This program is known as Chapter 96, after the state legislation that authorized it. Although the city would incur higher pension costs for those leaving early, the city expected to offset the higher pension costs with lower payroll expenses because the Giuliani Administration did not plan to replace many of those taking the offer. Employees wishing to participate had to accept by June 28, 1995.

The current legislation (A05754A/S03244A) would give most employees who were eligible but did not take the offer in 1995 a second chance to opt into the plan. Unlike the original, collectively bargained Chapter 96 plan, this second chance or "reopener" legislation is not supported by the Bloomberg Administration, which does not expect the higher pension and other benefit costs to be offset by other personnel savings.

As in the original Chapter 96 legislation, this proposal would not cover uniformed workers in the police, fire, corrections, and sanitation departments. The bill makes the option available to most members of the New York City Employment Retirement System (NYCERS) and the Board of Education Retirement System (BERS), providing they would have qualified on June 28, 1995 and are currently in either the Tier II pension plan, which generally covers workers who joined between July 1973 and July 1976, or the basic Tier IV 62/5 pension plan for those who joined after July 1976. (United Federation of Teachers members in the BERS are not eligible for this program, having recently been granted a similar early retirement benefit.) Eligible NYCERS and BERS members in designated "physically taxing" positions could collect a full benefit as early as age 50 with 25 years of service. NYCERS members who are already in other special early-retirement plans

New York City Independent Budget Office
Ronnie Lowenstein, Director
George Sweeting, Deputy Director
110 William St., 14th Floor
New York, NY 10038
Tel. (212) 442-0632
Fax (212) 442-0350
iboenews@ibo.nyc.ny.us
http://www.ibo.nyc.ny.us

would be excluded from the reopener. As in 1995, there would be a limited time period for a member to make the election: 120 days from the date of enactment.

Not a Free Ride. Those electing to participate in the Chapter 96 reopener will have to make higher pension contributions than they would otherwise in order to offset some of the higher costs to the pension system. These additional member contributions are not only applied prospectively but will also be computed on a retroactive basis. They are in addition to the basic contribution of 3.0 percent that is required of current Tier IV NYCERS and BERS members for the first 10 years of creditable service and, if applicable, Tier II member contributions.

For retroactive calculations, members—excluding those in physically taxing positions—must make additional contributions of 4.35 percent of wages earned for all creditable service performed between January 1, 1995 and December 31, 1997; 2.85 percent of wages earned between January 1, 1998 and November 30, 2001; and 1.85 percent of wages earned after December 1, 2001. Members in physically taxing positions who elect to participate must make additional member contributions of 1.98 percent of wages earned for creditable service performed after January 1, 1995.

The additional contributions end after 30 years for Tier IV members and after 25 years for Tier II members. In calculating the retroactive member contributions, the outstanding balances are computed based on a 5 percent annual compounded interest rate. For example, a participant who earned $30,000 in 1998 would make an additional member contribution of $1,393 for that year—$855 (2.85 percent of $30,000) plus $538 in interest payments.

The requirement for retroactive contributions will make the cost of electing to take the benefit quite expensive for many of those eligible. Participants who cannot make a lump sum payment that would exceed $10,000 for most of those eligible would presumably be offered the choice of either a pension loan, or accept a pension that is reduced to reflect the shortfall in retroactive contributions. IBO expects that requiring these additional contributions will decrease participation. By contrast, in the recently enacted 55/25 early retirement plan for city employees represented by the United Federation of Teachers, there is no corresponding retroactive additional contributions.

IBO's Estimate. The cost to the city of this legislation reflects three items: the extra pension contributions needed from the city after accounting for the additional member contributions, the additional health insurance and other fringe benefit costs, and the offsetting savings from lower salaries of new workers replacing those who take the early retirement. IBO's estimates largely follow the Office of the Actuary's methods, with one key exception: because we did not have access to data from NYCERS and BERS, we used averages derived from payroll data in our calculations. Based on the payroll data, IBO estimates that there are approximately 17,000 city workers in NYCERS and BERS who could eventually qualify for the reopener and who are not yet 62 years old. Assuming that the additional member contributions will discourage some of those who are eligible, we estimate that ultimately 7,980 city employees will take advantage of the offer.

Because workers who elect to participate will be leaving the city payroll earlier than expected, there will be less time for pension contributions and the earnings that they would have generated to accumulate. Even with the additional member contributions, the city would also need to increase its contributions to keep the pension plans sufficiently funded. To estimate the level of these additional pension costs, we first simulated the pension benefits that these employees would receive under current rules. Next, we simulated what they would receive under the proposed Chapter 96 reopener. We then estimated the pension obligations and the corresponding payments (with adjustments for the basic and additional member contributions) required to fund those obligations under the two simulations over the expected remaining working time of each employee, discounted using the city's 8 percent actuarial interest rate assumption. The city's additional required contribution represents the discounted value of the difference in the pension obligations under the two simulations.

These simulations used observed data on the average age at which the employees eligible to take advantage of the Chapter 96 reopener began working for the city, average starting salary, typical overtime, and life expectancy. Salaries were assumed to grow by 3 percent per year, which is consistent with assumptions

Estimated Fiscal Impact of the Early Retirement Bill In the First Year

Dollars in millions

Cost impact	First Year Additional Costs
Estimated Yearly Pension Costs	$68.9
Estimated Yearly Pension Costs (city funds only)	$60.1
Individual Health Insurance	6.9
Family Health insurance	22.9
Welfare Funds	6.0
Total Costs	$95.9
Savings from Lower Priced Employees	27.8
Net Costs	**$68.1**

SOURCE: IBO.

of the city's Office of the Actuary. The simulations were run separately for men and women to take into account gender differences in average starting age, starting salary, and mortality.

The estimated difference in required pension contributions for the first year under the current system and under the proposed change is $99.9 million, before accounting for the additional member contributions. The additional contributions from members would offset $31 million of that cost, leaving an added $68.9 million contribution required of the city in the first year.

The reopener would raise the city's health and fringe benefit expenses by adding up to seven years that an individual would have to be covered under retiree plans, while the city would simultaneously be paying benefits for replacement workers. Because the reopener is not part of a plan to reduce the city's workforce, IBO assumes that all workers who elect to take the early-retirement option will be replaced. Our estimate of the additional fringe benefit costs assumes annual primary health insurance inflation of 9.4 percent. Estimates were run separately for those using family health insurance coverage and those with individual health insurance coverage. The additional first-year costs for health and fringe benefits totals $35.9 million.

While IBO assumes that city employees electing to take advantage of the reopener benefit will be replaced, we also expect that there will be some savings from hiring entry level replacements with lower salaries. To the extent that more senior workers elect the reopener, there will be promotions of mid-career workers creating a cascading effect that results in entry-level openings. Based on a difference of $7,108 between the average salaries of those likely to elect the reopener and a composite starting salary for these positions, IBO estimates that savings from lower paid replacements will total $27.8 million in the first year.

Longer-Term Costs. It should be emphasized that these are first-year costs. Pension costs are extremely sensitive to investment returns. If investment returns in subsequent years fall below the 8 percent assumed for an extended period of time, the projected additional pension liability will grow significantly. Conversely, the pension liability would shrink if returns exceed 8 percent.

In particular, fringe benefit costs will rise in each subsequent year driven by the increase in the number of retirees to be covered as well as the expected 9.4 percent annual increase in health care costs. By 2012, IBO estimates that the annual increase in the cost of health and fringe benefits due to the reopener will have more than doubled from $35.9 million to $79.6 million. Meanwhile, the replacement wage savings will gradually decline as the number of employees being replaced falls, and as current replacements advance up the wage ladder.

Comparisons with the Mayor's Cost Estimate. Mayor Bloomberg and senior members of his administration have cited a cost of $200 million for the reopener, considerably higher than IBO's $68.1 million estimate. A number of factors account for this difference. Most importantly, the Bloomberg Administration's $200 million estimate is a composite of two separate forecasts—one by the Office of the Actuary and the other by the Mayor's Office of Management and Budget (OMB)—for two different periods of time. The Office of the Actuary estimated that the additional annual pension cost would be $88.1 million in the *first year* after the bill takes effect. In contrast, OMB's estimate of $119.9 million is for the *long-term* or actuarial cost of the additional health and other non-pension fringe benefits.

The Actuary was estimating the effect of the reopener on the NYCERS and BERS pension plans as a whole and included the additional pension costs for all members of NYCERS and BERS who would be eligible for the program. IBO's estimate is concerned solely with the costs to the city. Not all NYCERS members are city employees, so IBO assumes that the city would not bear reopener pension costs associated with employees of agencies such as the Metropolitan Transportation Authority, Off-Track Betting Corporation, Health and Hospitals Corporation, and New York City Housing Authority. Because the city subsidizes some of these organizations, it is possible that the additional pension cost burden that would be placed on these agencies and authorities could eventually result in requests for greater subsidies from the city. Nevertheless, by using the Actuary's estimate without adjusting for these workers, the Mayor's office is overstating the additional direct pension cost to city.

The Bloomberg Administration's $200 million estimate also included the entire NYCERS pension cost as estimated by the Actuary, even though the city traditionally only funds about 87 percent of the system's costs for city workers, with the rest paid with other funding sources. IBO's estimate of the additional pension costs took this factor into account.

Taken together, these differences account for most of the variation in the estimated first year pension costs, totaling $19.2 million, roughly 15 percent of the difference between IBO's and the Mayor's estimates of the total cost of the reopener.

The biggest differences in the cost estimates result from the treatment of health and fringe costs and salary savings from replacement workers. OMB's estimate of the additional fringe costs is presented on a long-term actuarial basis rather than as they come due each year. Although recent changes in government accounting standards now require reporting of the outstanding liability for retiree health benefits on an actuarial basis, there is no requirement that these liabilities be funded on that basis. Moreover, the city continues to pay retiree benefits as they come due each year. IBO's estimate of the additional health and other fringe costs for early retirees follows this pay-as-you-go approach. Finally, the Mayor's budget office assumes no savings from replacing early retirees with lower paid entry-level workers. Instead, OMB assumes that replacements will have the same salaries as those who leave.

This report prepared by Martin Davis