New York Times Calls Out City's Pension System

In a nearly 4,000-word lead article on Sunday, the *New York Times* clearly articulated exactly what is wrong with the city's five separate pension plans: too-optimistic investment assumptions, excessive fees, overly generous pension benefits, and political interference. Mere tweaking on the margins will only delay the inevitable Detroit experience: drastic benefit cuts for retirees and higher taxes on taxpayers.

In 2000, the city's contributions to its five pension plans (general city workers, police, firefighters, teachers, and other school personnel) consumed just two percent of the city's budget, and the plans were considered to be adequately funded. For instance, the plan insuring the city's general workers was actually overfunded by 36 percent. Today those pension plans soak up *more than 11 percent* of the city's budget, while those plans are *less than 60-percent funded*, and declining.

The *Times* article came on the heels of city Comptroller Scott Stringer's praises last week for de Blasio's new financial plan for the city, which included giving the city's teachers eight-percent raises. This sets the stage for some 150-plus other union contracts that are up for renewal. Nevertheless, Stringer said:

> By fully accounting for these costs, we now have a budget that shows a clear picture of the city's long-range finances….
>
> The new mayor found ways to fund critical programs and services while also setting aside money for the city's future.

It may be that the *Times* intended to provide Stringer with a dose of reality that was missing from his comments last week. First of all, the fees to manage the city's five pension plans are too high. Each plan has its own board of trustees that sets investment policy and, in efforts to reach for higher returns, much of the plans' current assets (estimated at more than $160 billion) are invested in higher-yield, higher-risk investments with higher management fees. For example in 1997, the city's biggest fund, NYCERS (New York City Employees' Retirement System), paid $17.3 million in fees to manage its $32-billion portfolio. In 2010, those fees ballooned to $175 million, while the fund itself barely grew, to just over $35 billion.

Part of the problem is that promises made to employees were never properly funded. For example, a newly hired New York City police officer can retire in as few as 22 years at half-salary. That benefit is likely to continue to him and to his surviving spouse for many more years than he worked. In 2013, the NYPD had more than 12,000 retirees younger than 55, pulling down an average of $43,000 a year in pension benefits. City taxpayers now pay more in retirement benefits than they do in current wages and salaries.

As high as those fees may be, and as over-generous as those benefits may be, they pale into insignificance compared to the ludicrous investment assumptions that underlie each of those plans.

That's because, when it comes to making those assumptions, politicians in Albany and not the plans' trustees make them. And they necessarily reflect the political reality of union influence and a continuing inability to risk political repercussions by doing the right thing.

At present each of the plans assumes that the investments will earn eight percent a year. Back in 2003, investment advisor John Mauldin estimated that such optimistic assumptions would result in pension shortfalls of all state and city retirement plans of more than $2 trillion. He was wrong. He now estimates those shortfalls at between $4 and 5 trillion, and counting.

According to Mauldin, a more realistic assumption is between three and four percent a year, but if such realism were reflected in plans' implementation, that would require a *doubling* of pension plan contributions, a politically impossible task. Mauldin points out that, over the last 18 years, those plans have earned less than four percent and, when inflation is taken into account, they have made less than two percent. So it's the inevitable mathematics that will drive the ultimate solution: When the money isn't there to write the checks, the checks won't be written.

Late last year investment research company Morningstar, Inc. released its study of pension plans of 25 cities, and found that, on the average, they were only 66-percent funded. New York City, the largest of the cities studied, had plans that were only 60-percent funded. And that now appears to be too optimistic. When Robert C. North, New York City's pension plan actuary, prepared his final report prior to his retirement, he estimated that NYCERS was only 40-percent funded, which confirmed a comment by Sean McShea, president of Ryan Labs, a New York-based pension advisory service, who said: "They're never going to catch up."

The day of reckoning may be even closer than many are expecting. As plan administrators continue to assume rates of return far above real world performance and the city's mayor continues to cater to union demands for more and more benefits, the mathematical reality hastens the day when the irresistible force of chronic underfunding meets the immovable object of pension promises, with the inevitable consequences: Taxpayers will be forced to pay more while retirees will be forced to take less.

This is the "clear picture of the city's long-range finances" that New York City's Comptroller Scott Stringer failed to mention while praising de Blasio's new budget last week.

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