August 25, 2015, Ballot Measure for Paying Off Prescott's Unfunded Public Safety Pension Obligations

What is this financial crisis affecting the City of Prescott?

Like all cities, towns, counties, and fire districts statewide with police and/or fire personnel, the City of Prescott participates in the Public Safety Personnel Retirement System (PSPRS). The costs to all of the participating governments have dramatically increased in recent years, and will continue to rapidly escalate in the future. Although, through the years, Prescott has paid the employer pension system contributions required by PSPRS, the gap between full funding of the City's obligations to its current and future retirees, and the present funding level, has grown to $70 million. PSPRS has mandated that the unfunded obligations of member governments be paid over the next 22 years. If Prescott pays off its obligations during that period, the payments will total an estimated $165 million. In order to pay off this extraordinary amount, City financial resources will be compromised, requiring extraordinary cuts to services and amenities beginning in early 2016, including, but not limited to, reductions to our police and fire forces.

What kind of pension system is this?

Arizona PSPRS is a defined-benefit, statewide retirement system for public safety employees. This is not a "pooled system"; rather, a separate account is maintained for the police and fire employees of each participating political subdivision. The City of Prescott did not create this system—one that it cannot change, and to which the City is obligated to pay the amounts set by PSPRS. Prescott firefighters and police officers are not at fault for choosing public service professions with a pension program that has now been proven to be unaffordable for the City, and other public entities, to pay for as presently configured.

Why haven't we heard about it before? How could it get so deep in the red?

In past years, PSPRS has understated its poor financial health, not charged participating governments amounts adequate to support their future pension costs, sustained investment reversals during the recent recession, and been subjected to a major court decision (the Fields case) dictating that cost of living increases be paid to retirees, regardless of the Consumer Price Index or ability of the governments to pay them. Following the Fields case, and with PSPRS in trouble financially, the future pension obligations have been recalculated and imposed by PSPRS on the participating governments.

If it's not dealt with, what will happen?

- Inaction will create a financial spiral leading to a negative impact on City finances, and in turn, leading to a reduction to the City's core services and amenities
- Each year General Fund services and service levels, including the library, parks, and public safety, will have to be reduced to pay down the PSPRS liability for which the City is obligated; this will adversely affect response times, emergency medical services (EMS), traffic enforcement, and the visibility of community-oriented police programs
- The City's International Organization for Standardization (ISO) rating will be adversely affected, driving private property insurance costs higher
- Capital needs (vehicles and equipment) required to provide public safety services will erode and then eliminate the General Fund reserve balance
- The City's bond rating and debt capacity will be downgraded, increasing the cost of borrowing when necessary
- The City will be unable to pay market-level compensation to its personnel; employee layoffs will be necessary to help pay off the PSPRS liability

What if the City chooses to not pay off its unfunded obligations?

This is not an option. The City's financial obligations to public safety retirees must be paid, and will be enforced by the state courts.

Why doesn't the City declare bankruptcy to avoid the unfunded obligations?

It is not practical for the City to utilize bankruptcy proceedings to avoid the unfunded obligations of PSPRS. Based on current and projected future General Fund revenue, the City will not be insolvent, but rather will have to make widespread service cuts in order to come up with the money to pay the unfunded pension obligations.

Why doesn't the City withdraw from PSPRS and create its own pension system?

There is no provision in state law for withdrawal.

What action can be taken to resolve this financial crisis, and preserve the quality of life our residents and visitors enjoy?

A ballot measure will go before City voters at the August 25, 2015, election, asking voters whether there should be an increase in the City sales tax by 0.55%, with all the money generated being restricted to paying off the unfunded pension obligations. When they're paid off, this specific sales tax increment will end. If the voters approve the increase, it will enable the City to uphold its responsibility to our public safety retirees, and avoid the cuts to services and amenities that will otherwise be required.

What's to prevent the same kind of crisis from occurring again in the future?

In addition to creating the financial means to pay off the City's financial obligations via the proposed 0.55% sales tax increment, pension reform at the state level is necessary. A task force including the Arizona Legislature and League of Arizona Cities and Towns is actively working on a proposal with this goal (see Attachment 1 for more information). Major statewide public safety pension reform is absolutely required to prevent a repeat of this crisis. Even with such reform, in any event, Prescott's unfunded obligations, currently $70 million and growing, must still be paid.

Attachment 1 – Public Safety Pension Reform

2011 System Reforms – SB 1609 and the "*Fields* Decision"

- The Legislature enacted PSPRS reforms in 2011 that increased the employee share of the pension cost, reduced/eliminated Permanent Benefit Increases (PBI) for existing and future retirees, and increased the required years of service for public safety personnel hired after January 1, 2012, to be able to retire.
- There have been multiple legal challenges to the reform that question the constitutionality of the changes.
- The first decision has been entered on the *Fields* case, which restores the original PBI formula for members who were retired as of July 1, 2011, and requires retroactive and future payment of the benefit. The system-wide cost of the Fields decision was $1.35 billion.
- The *Hall* case is a continuing case that further questions the constitutionality of the changes. If the Plaintiffs win the *Hall* case, it would restore the original PBI formula for those retired after July 1, 2011 and current active members, plus reverse changes in the employee contribution rate. The system-wide cost is estimated at an additional $931 million.
- Any new reforms *must* be made prospectively, for new employees, to assure that the changes withstand any legal challenges.

Future Reform - League of Arizona Cities and Towns PSPRS Task Force

- The task force consisting of city officials, finance officers, and other personnel has identified the principles necessary to manage the present and future costs of the PSPRS system.
- The task force has created a "yardstick" which sets forth standards for evaluation of reform proposals that meet the legal test of constitutionality and address both employer and employee issues.
- The Committee has drafted a comprehensive reform proposal that identifies the goals, characteristics, and elements of a viable and sustainable public safety pension system for the State of Arizona, and measures the effectiveness (or not) of other reform proposals. The following general design elements make this reform proposal *free from legal challenge*.
    - New system for all public safety employees hired after July 1, 2016
    - Equal employer/employee cost sharing
    - Pooled assets and liabilities (all employers and employees pay the same percentage across the state)
    - Increased benefits only if the plan is fully funded before and after the change
    - Sound funding and investment policy
    - Consolidated administration which eliminates the local board authority
- The liability of the "old" system will be paid off for Prescott with the 0.55% sales tax, and the new sustainable system will never reach the cost proportion of the current systems