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Court's Pension Ruling Could Cost Arizona Taxpayers Millions.

Court reinstates judges' cost-of-living increases

A unanimous Arizona Supreme Court ruling will restore cost-of-living raises to retired judges and elected officials at an eventual cost of roughly \$375 million to the retirement system and taxpayers.

The 5-0 decision made public Thursday upheld a Maricopa County Superior Court ruling that declared unconstitutional the Arizona Legislature's actions in 2011 to suspend raises because of the pension trust's poor financial health.

"It's a pretty clear indication of what the law in Arizona is now," said Ken Fields, a retired Maricopa County Superior Court judge and one of two retirees who sued to reinstate the raises. "It was a difficult decision, but it's not going to be a popular decision."

Elected officials and judges share the most generous pension program in the state. In their ruling, the justices noted that their decision eventually will benefit them as retirees.

A key state lawmaker said the ruling likely will pressure the Legislature to put a measure before voters, possibly this fall, to amend the Arizona Constitution by inserting provisions that could diminish benefits and rein in the rising cost of public pensions.

"This ruling wipes out most of the pension-saving reforms we enacted a few years ago," said Rep. John Kavanagh, R-Fountain Hills, who is pushing for a voter referendum. "This will cost a lot of money and a lot of taxpayer money to buttress this system that has been poorly managed."

The ruling also will restore cost-of-living increases to retired public-safety and correctional officers, who, like judges and elected officials, are part of the Public Safety Personnel Retirement System trust and saw their pension raises suspended by legislative action nearly three years ago.

System Administrator Jim Hacking said in a statement that retroactive raises for all PSPRS retirees will cost the trust \$40 million immediately. He said an additional \$335.6 million will be set aside to fund cost-of-living adjustments going forward.

Among those getting retroactive raises are 978 retired judges and elected officials who will receive \$7.9 million, according to the pension system. Those payments are not shared equally. But, on average, that amounts to more than \$8,000 per retiree.

The system did not provide the ruling's precise cost to taxpayers, but Hacking said it will force the system to increase what it charges governments for pension benefits.

Governments are assessed at a rate applied to an employee's wages based on total liabilities.

Rates for some governments could exceed 50 percent of each employee's wages, and major

increases are expected to occur in July 2015, according to the pension system.

The Arizona Republic found last year that lower-than-anticipated investment returns and pension enhancements caused employer trust payments to rise so much that some governments were unable to hire new police officers and firefighters because of the associated pension costs.

Contributions to the trust from employers have increased about 425 percent in the past decade to \$451 million annually, according to trust financial statements.

The system manages a \$7.2 billion trust that provides retirement benefits for more than 53,000 retirees, beneficiaries and active members.

Judges are part of the Elected Officials' Retirement Plan. With slightly more than 2,000 members, half of whom are retired, they make up the smallest group in the system.

That plan was closed this year to new members, but it has allowed elected officials and judges to receive 80 percent of their ending salaries after 20 years of service.

Trust records show that 151 retirees have lifetime pensions in excess of \$100,000 a year.

Retirees in the plan received a partial 2.47 percent cost-of-living adjustment in 2011, after receiving guaranteed 4 percent annual bumps in prior years regardless of the trust's investment returns.

No raises were given the past two years because of the Legislature's 2011 action to curb costs in the face of the trust's eroding financial position.

The trust currently is underfunded by nearly \$5.7 billion, trust financial records show.

Permanent benefit increases have allowed some elected officials, including judges, to make nearly as much — or more — in retirement as when they served.

Trust records show that Fields, for example, has an annual pension of \$125,264, while his ending salary was about \$135,844 when he retired in 2007.

The ruling notes that the raises were given even though the funding ratio — a measurement used to determine the trust's financial health and taxpayer contributions — had gone from nearly 142 percent in 2000 to nearly 67 percent in 2010.

In layman's terms, it had nearly half again as much money as it needed to fund its current and future pension liabilities in 2000.

By the end of the decade that followed, it had only enough money to pay for 67 percent of its current and future liabilities.

The funding level for the elected officials' plan now stands even lower, at 55 percent, worst among the three retirement plans in the system. Its funding level dropped because of previous investment losses and financial sweeteners given to retirees.

Overall, the entire Public Safety Personnel Retirement System has a funding ratio of nearly 59 percent.

The system's increasingly perilous financial condition and over-reliance on taxpayer-funded contributions caused the Legislature in 2011 to pass sweeping reforms that required those in the systems to pay more for their retirement benefits, while cost-of-living pension increases were

temporarily suspended and adjustments were made for future cost-of-living raises.

A separate lawsuit that challenges members' increased payments into the system also is working its way through the courts.

Fields and Jefferson Lankford, a retired state court judge, sued on behalf of themselves and other retirees in September 2011, claiming the Legislature's cost-containment measures were illegal.

They cited federal contract law and Arizona's Constitution, which was amended by voters in 1998 to say "public retirement benefits shall not be diminished or impaired."

Though Arizona is a right-to-work state and not considered friendly to public employees or unions, it now has one of the nation's strongest constitutional protections for public pensions.

The judges won their case in Maricopa County Superior Court, but the retirement system appealed to the state's high court.

The Supreme Court justices held that when the Legislature curbed raises, it diminished retired members' benefits and violated the Constitution.

The justices also noted that although they are not currently members of the pensioner class, they will be eligible for the benefit increases when they retire.

Their opinion said, "(T)he rule of necessity establishes that a judge is not disqualified because of a personal interest if no other judge is available to decide the case."

Because a disqualification would "result in a denial of a litigant's constitutional right," the judges had to decide the matter, the ruling said.

Those who became elected officials or judges this year are no longer part of the plan. Gov. Jan. Brewer last year signed into law legislation that will eventually close the Elected Officials' Retirement Plan and put new politicians into a 401(k)-style savings plan similar to that of private-sector employees.

Kavanagh, the House Appropriations chairman, said he would prefer to not make similar 401(k)-style changes to pension plans for future public-safety and corrections officers.

A defined-benefit plan is the best way to recruit public-safety employees, and it provides them with secure retirements, he said.

However, he said lawmakers may have no choice but to change those pension plans.

"If the very fortunate recipients of this system keep resisting reasonable reforms, then opponents of defined (pension) benefits will prevail, and it will be the end of them for public employees," Kavanagh said. "Taxpayers will not continue to bail out people with platinum pensions when they are struggling."

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