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For Many State and Local Workers Public Pensions Offer Little Retirement Security, Urban Institute Study Shows.

WASHINGTON, DC, April 30, 2014 — That shiny retirement nest egg may not be so golden for the nation's 19 million state and local government workers, an exhaustive Urban Institute analysis of 660 state-administered pension plans shows.

The plans, detailed in a unique database, are graded on how well they place short- and long-term employees on a path to retirement security; how well employee incentives help government attract and retain a productive workforce; and whether the plans set aside enough funds to finance promised benefits.

By these measures, only 1 percent of the 660 plans earned an A grade, while 11 percent had an F grade.

Among the best:

- Texas plans covering general employees in counties, districts, and municipalities
- Nebraska plans covering general state and local employees
- Rhode Island plans for teachers and general state and municipal employees
- A Florida plan covering general state and local employees
- A California plan covering local police and firefighters

Among the worst:

- A Massachusetts plan covering state police, teachers, and general state and local employees
- A New Jersey plan for state police, teachers, and general state and local employees
- A Colorado plan for veteran state troopers
- An Ohio plan covering teachers
- A Nevada plan covering local police and firefighters

Traditional pension plans, fading away in the private sector, still cover seven in eight full-time state and local government employees. Nearly all the plans pay annual retirement benefits equal to a percentage of the worker's final average salary — typically calculated over the last three or five years — multiplied by years of service.

The State and Local Employee Pension Plan (SLEPP) database presents state-administered plans covering teachers, police officers, firefighters, and other government workers in all 50 states and the District of Columbia employed in 2014. Information includes employee contribution rates, vesting requirements, benefit formulas and eligibility rules, early-retirement reductions, cost-o--living adjustments, and actuarial assumptions.

Career Stages and Public Pensions

The analysis by the Institute's Program on Retirement Policy concludes that many workers, because they must contribute to their plans and do not usually spend their entire careers in government service, gain nothing from their state pension plans. They would have a richer retirement if they could simply invest on their own.

At the other end of the career span, long-tenured employees in 63 percent of plans lose lifetime pension benefits if they stay on the job beyond age 57.

For those at mid-career, much of their benefits will be typically earned in a single year, creating strong incentives for these workers to remain on the job until they realize these windfalls, even if they are ill-suited to the job or could be more productive or satisfied elsewhere.

"The traditional pension plans generally provide lucrative retirement incomes to long-term employees but offer little retirement security to workers who change employers several times over their career," said Richard Johnson, the Urban Institute's director of the Program on Retirement Policy. "Traditional plans tend to encourage older employees to retire early, a problematic feature as the workforce grows older. These plans may complicate government efforts to recruit younger employers and retain older ones."

Findings

- Only 19 percent of plans enable state and local government employees hired at age 25 to accumulate any employer-financed pension benefits within the first 10 years of employment. For teachers, the figure is just 14 percent.
- In 22 percent of all plans, age-25 hires must work more than 25 years before their future pension benefits are worth more than their plan contributions. In 39 percent of teachers' plans, age-25 hires who leave before 26 years of service get nothing from their pension plans other than their own contributions.
- Recent reforms, focused mainly on cutting costs, have made things even worse. About a fifth of the plans changed their benefit rules between 2010 and 2013, with half effectively raising the time that employees must serve before getting anything out of their pension plans by three years or more.
- Employees who keep working after they have maximized their pension benefits often suffer steep losses. On average, age-25 hires lose 48 percent of their maximum net lifetime benefits by working until age 67, Social Security's full retirement age for those born after 1959.
- In traditional plans, there is often a year in which lifetime benefits jump, usually by triple the worker's salary. On average, that one-year benefit surge accounts for nearly half of the expected lifetime benefits accumulated to that point. These spikes occur most often at age 55 for employees hired at age 25.
- In more than 10 percent of traditional plans (and more than 25 percent of police and fire plans) the maximum annual jump in lifetime pensions exceeds six times annual salary. The maximum across all plans approaches 11 times salary.

Recommendation

Short-career workers end up subsidizing often extremely generous benefits received by very long-tenured retirees. Cash balance plans and other alternative benefit designs, the researchers suggest, would enable all state and local government employees to accumulate retirement savings gradually, including those with short careers, rather than restricting benefits to those with the longest tenures. Such alternatives would also attract younger employees who change jobs more frequently than earlier generations.

Cash balance plans feature employee accounts to which both workers and employers contribute. Employees can withdraw the funds when they leave the government, or convert their balances into a lifetime annuity when they retire.

The Database and the Research Project
Richard Johnson led the creation of the database and the Public Pension Project's research. The research team, which includes Barbara Butrica, Owen Haaga, Benjamin Southgate, and Eugene Steuerle, has published

- "How Long Must State and Local Employees Work to Accumulate Pension Benefits?"
- "When Do State and Local Pension Plans Encourage Workers to Retire?"
- "Do State and Local Pensions Lock In Mid-Career Employees?"

The State and Local Employee Pension Plan database was compiled with funding from the Alfred P. Sloan Foundation. The Laura and John Arnold Foundation provided financial support for the research publications.

Document date: April 30, 2014
Released online: April 30, 2014

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