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Philadelphia Pays Retirees Bonus Amid Pension Gap.

(Bloomberg) — Philadelphia has less than half the money it needs to keep its promises to retiring workers. Yet instead of socking away investment earnings, the city must spend the cash.

When the pension fund of the fifth-most-populous U.S. city performs better than its target, some retirees get a bonus — which will occur this year for the first time since 2008. As Philadelphia, like municipalities nationwide, struggles to meet mounting retirement obligations, it can't earn its way out of the hole, underscoring the challenge of honoring politicians' past pledges.

The pension system as soon as next quarter will give an extra $62.4 million to retirees, enough to heat and light schools or pay the starting salaries of almost 1,400 teachers. The payouts exacerbate the distress of the pension, which is 47 percent funded, said Lawrence Tabas, chairman of the Pennsylvania Intergovernmental Cooperation Authority, the state-appointed overseer of the city's finances.

"We're in a crisis situation," Tabas said by telephone. "If we continue to do nothing and have white papers and task forces and discussions, there will come a time when we won't be able to meet the obligations."

Unique Case

Philadelphia's is the only system in Pennsylvania that ties payment of the extra cash to investment returns, said James McAneny, executive director of the state's Public Employee Retirement Commission, which monitors local plans.

About two-thirds of plans around the country provide stipends pegged to inflation or predetermined rates, rather than investment performance, according to a survey by the National Association of State Retirement Administrators.

Tabas's oversight agency said last month that the city should restore the original requirement from the 1999 bill creating the bonus that the pension be at least 76 percent funded before providing the benefit. The city may distribute more than $200 million in stipends even as the plan remains distressed under some scenarios, the agency said.

There are cases elsewhere in the country where retirees had to give up perks. As part of Detroit's bankruptcy resolution, pensioners there have to repay $212 million of excess interest from a city-run savings plan.

$2 Trillion

States and cities are grappling with pension deficits after suffering investment losses during the financial crisis. From 2004 to 2012, the unfunded liabilities of the 25 largest U.S. public pensions tripled to almost $2 trillion, according to a Moody's Investors Service study.

"Asset performance has been very, very volatile," Al Medioli, a senior credit officer at Moody's, said in an interview. “It can take a long time to recover from the volatility.”

In Philadelphia, where almost 30 percent of people live in poverty, seniors shouldn’t have to wait for the pension to strengthen before receiving the bonus, said James Kenney, a former councilman. In 2007, he pushed through a bill removing the 76 percent requirement and likened retirees to “combat veterans” who earned the perk. Kenney resigned last week to run for mayor in the May primary.

“There are certainly large structural problems with the pension fund that need to be addressed,” Lauren Hitt, a spokeswoman for Kenney, a Democrat, said in an e-mail. “But we shouldn’t be trying to fix the fund on the backs of our retirees who are scraping by on pension payments that aren’t adjusted for inflation.”

Stock Up

Siphoning investment earnings to pay stipends makes it harder for pensions to sustain themselves through market swings, said Jean-Pierre Aubry, assistant director of state and local research at the Center for Retirement Research at Boston College.

“You’re cutting off the gains that should be stocked in order to bolster you from the periods of low returns,” he said.

Philadelphia’s system logged an 11.5 percent return for the year through June 2014, according to the city controller. The stipends kick in when the pension earns 8.85 percent — one percentage point above the target rate of return.

As soon as April, beneficiaries in the system for a decade may see a bonus, said Francis Bielli, executive director of the board of pensions and retirement. Officials haven’t determined how many people are eligible and may spread payments over two checks, he said. The payouts amount to half the extra investment earnings.

2008 Payout

The city last paid the bonus in 2008, distributing $40.5 million, Bielli said. He declined to comment on the effect of the stipends or the oversight board’s recommendations.

The fund has about $4.8 billion of assets to pay $10.1 billion of obligations. It is in weaker shape than 17 of the 21 plans of the 10 most populous U.S. cities, according to the state oversight agency.

Pension costs are consuming more of Philadelphia’s resources: The expense has grown to 39 percent of payroll this fiscal year from 17 percent in 1991, according to the agency.

Investment losses and inadequate contributions fueled the fund’s decline, the authority said. Philadelphia supports more retirees and beneficiaries — about 35,000 — than current workers in the system, who number about 27,000.

Credit-rating companies cite the pension burden as a concern. Moody’s Investors Service ranks Philadelphia A2, its sixth-highest level and two below its median local-government grade.

Mayors’ Efforts

City mayors have tried to limit the stipend.

In 2007, the City Council sided with Kenney to authorize the perk regardless of the funded status, overriding a veto by Mayor John Street. In 2009, Mayor Michael Nutter presented a bill to restore the minimum funding level, yet the council didn't take it up.

Last year, Nutter proposed selling the Philadelphia Gas Works for $1.86 billion to bolster the pension. The council rejected holding hearings on the plan, saying it didn't benefit constituents.

Jane Roh, a spokeswoman for Council President Darrell Clarke, said staff members are reviewing the oversight authority's recommendations. Nutter, a term-limited Democrat in his final year of office, doesn't plan to submit another bill, said a spokesman, Mark McDonald.

"Everything will end up getting cut as larger and larger portions of every dollar go to the pensions," said Tabas of the intergovernmental authority.

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