Fixing Pittsburgh's Pension Problems

Prepared Remarks before the Post Agenda Session
Pittsburgh City Council
1:30 PM
Thursday, February 25, 2010

Robert P. Strauss[1]
Professor of Economics & Public Policy
School of Public Policy and Management
The Heinz College
Carnegie Mellon
Pittsburgh, Pennsylvania
15213

www.andrew.cmu.edu/user/rs9f
rpstrauss@gmail.com

[1] The author acknowledges the research assistance of Ms. Snigdha Verma, 2nd year student in public policy and management at the School of Public Policy and Management, The Heinz College, Carnegie Mellon. These remarks are the sole responsibility of Professor Strauss.

"To do what's right is easy, to know what's right to do is another matter."
----------President Lyndon B. Johnson

1 Introductory Remarks

The Past as Prolog

In conjunction with enactment of the Employee Retirement Income Security Act of 1974 (ERISA), the US Congress' House Labor Committee issued a massive study of the financial position of private and public employer retirement plans. Buried within that tome was the candid admission that public retirement plans were in financial peril that was probably more severe in many cases than their private sector counterparts. However, the House Labor Committee concluded, and their Senate counterparts agreed, that federal intervention to shore up the public pension plans was infeasible because these state and local plans were so badly under-funded that trying to reform their financing was unlikely to prove successful, and arguably would put the Congress in the unenviable position of having to throw more resources into these public plans as they neared bankruptcy. Consequently, federal pension reform in 1974 focused primarily on private employer plans through the establishment of strict fiduciary standards for pension trustees and their financial advisors, and the protection of retirement benefits from employer predation. Also, the Pension Benefit Guarantee Corporation was established to deal with severe situations in which private employers went bankrupt and/or private retirement plans were unable to meet their contractual obligations.

The Labor Committee's study had a lot of data about public retirement plans. Which state's public plans were the most under-funded? Pennsylvania. What's happened in the intervening years, and accelerated in the past 10 years, has been the epidemic of public plan under-funding that the Pew Center for the Study of the States estimates now at $1 trillion. Pennsylvania's various state pension plans are under-funded, and the implications for the stability of local property tax rates are increasingly dire.

Upon his election, Pittsburgh Mayor Tom Murphy vowed to unilaterally "fix" Pittsburgh's under-funded retirement plans, and in 1998 sold $256 million in non-callable bonds the proceeds of which were put under the control of the Pittsburgh Pension Board. Why Mayor Murphy locked the city into paying 6.5% with a 26 year maturity the bulk of which, $237 million, matures after 2009 remains a mystery to me. That it did not attract interest of the Internal Revenue Service or various state law enforcement authorities is disappointing but not surprising. My colleague at Duquesne University characterized this decision as a 'swing for the bleachers.'[2] While this led to the pension fund being 64% in 1999, Burnham calculates that the average return in the fund for 1998-2002 was 2% compared to the 6.5% coupon cost of the pension bonds.[3] Of course, what has happened since has been equally disappointing.[4]

---

[2] See James B Burnham (2003), "Risky Business: Evaluating the Use of Pension Obligation Bonds," *Government Finance Review*, June 2003. http://www.gfoa.org/downloads/GFRJune03.pdf
[3] Burham (2003), p. 15.
[4] See Table 3 below for subsequent years results.

Right now, the City's pension plans stand at about 30% funded, well down from where Mayor Murphy started off. The gamble failed, Mayor Murphy retired, and we are here today to discuss the resulting havoc.[5]

My Bottom Line Advice

My major points to you this afternoon are very simple, and likely not very welcome. First, it's time for the Pittsburgh Pension Board to stop swinging for the bleachers. To accomplish this, it and City Council will have to adopt a serious set of fiduciary standards that imposes on each member a duty, through an oath of office, that reflects the realities of modern investment opportunities and the relative ease with which current impediments to local financial ingenuity, at the expense of retirees can be enjoyed. Until municipal pension board members and City Council have to conduct themselves as a prudent *investor* would conduct himself, I would not put another penny into the plans. Second, until and unless the Pittsburgh City Council and Pittsburgh Parking Authority each adopts an oath of office that obligates each member to act solely in the public's interest and prohibits direct and indirect conflicts of self-dealing and conflicts of interest, I would not lease or sell the Pittsburgh Parking Authority.

Now, whether or not Council, the Public Authority and the Pension Board decide to lift the ethical bar they have to honor remains an open question. However, unless each does, then I think all bets are off, and the fiscal blood letting that is occurring will continue. Couple this financial hemorrhage with the continued exodus of students from the Pittsburgh Public Schools,[6] one can readily predict an accelerated hollowing out of the City, and the continued slow economic death of South West Pennsylvania.

2. How Much Money do the Pittsburgh Pension Funds Really Need?

Health and Pension Costs of Retirees

Various responsible and interested parties have stated that if somehow $200 million is put into the totality of the retirement plans (fire, police and municipal employees), then the plans will be 50% funded, and the promise made to the Pennsylvania General Assembly last year, that created some breathing room, will be kept. Unfortunately, I think the amount the pension funds need is much, much higher. I think the pension plans need an infusion of perhaps $1 billion, not $200 million. To understand this assertion, recognize that the foreseeable financial obligations to retirees are composed not only of cash benefits, but also contractual health benefits that retirees currently enjoy.

Data on City of Pittsburgh's retiree health care costs are hard to come by; however, the June 30, 2009 Act 47 recovery plan indicates at page 15 that 2008 actual health care costs were $26.7 million or 33.97% of actual cash pension benefits. The Act 47 Plan reports projected retiree cash benefits through 2029, and are replicated in column 2 of Table 1. Table 1 below presumes constant cash benefit payments after 2029 and through 2040, a 30 year period for amortization purposes, and estimates health benefits at 33.97%

---

[5] My earlier presentations,available online, on the broader issue of Pittsburgh's finances are listed in Appendix 5 of this paper.

[6] Data on Pittsburgh's population and enrollment in the Pittsburgh City Schools can be found at: http://www.andrew.cmu.edu/user/rs9f/pittsburgh_population_vs._school_enrollment.pdf

of cash benefits. The purpose of these calculations is to provide rough estimates of resource needs to honor obligations to retirees. They do *not* include what is needed to pay off the earlier-mentioned pension bonds floated by Mayor Murphy.

If one adds up over 30 years, from 2010 to 2040, the projected annual health care costs, they add to about $1 billion, while the sum of the projected pension benefit costs is a bit over $3.1 billion; the total is over $4.2 billion. If one puts these payment streams to retirees into present value amounts, depending on the interest rate one discounts by, one gets totals of these future obligations, retirement and health costs, today of between $1.5 billion and $2.3 billion. Finally, if one turns these totals into annuities or what one would have to pay annually to cover the projected costs, one finds annual costs of between $137 and $138 million/year. The General Fund of the City of Pittsburgh has been around $475 million, so something on the order of 28.8% is in effect going out the door for retiree health and pension benefits.

To offset these liabilities are cash inflows from employee contributions of $9.8 million (in 2008), City or employer contributions of $23.4 million (in 2008), and state contributions of $15.0 million, or a total cash inflow of $48.2 million. Whether or not the state will continue to contribute $15.0 million, in view of its own unfunded pension problems, is hard to know. But let us assume that it continues at its current level.

If level outflows to retirees are about $135 million/year, and inflows continue at about $48.2 million, there is an annual deficiency of $86.8 million. Again, the City's budget is about $476 million. Meeting this shortfall with a tax increase would mean an overall tax increase of over 18%. If the $86 million were to come from just an increase in real estate taxes, which were $143 million a few years ago, millage would have to rise about 60%, from 10.8 mills to 17.3 mills.

Of course, the pension plans have assets which provide returns; however, at around $260 million, they are hardly sufficient which is why many want to put $200 million into the plans. However, even if the plans wind up with $500 million, the plans are hardly going to provide returns that, with ongoing contributions, will be adequate to meet retirees' health and pension costs over the next several decades. A 5% return on $500 million provides $25 million/year. Even if the plans were to have $1 billion in assets and earn 5%, that would only throw off $50 million/year, and my back of the envelope calculations suggest, because of the necessity of covering health costs, that one needs to see $86 million/year.

Actual Investment Returns of City of Pittsburgh Plans

Each year, since enactment of Act 205, Pennsylvania municipal pension plans are required to file on a standardized basis their beneficiary, income, and asset information to the Pennsylvania Employee Retirement Council (PERC). For the calendar year reports that could be readily obtained, the ratio of net income to the market value of assets shows rather disappointing rates of return, from 3.07% to 3.9%/year. According to the March, 2010 *Economic Report of the President,* Taxable AAA corporate bonds paid about 5.5% to 6.0%/year for the same years. (See Table 3) or less than the 6.5 % coupon on the Murphy pension bonds.

The rather mediocre returns in Table 3 motivate my first point made above, namely the Pittsburgh Pension Board has to be much more careful than in the past about what it invests in. The only way I think it can do so is to adopt a set of fiduciary standards that make it improper to take undue risk that a prudent investor would not undertake, and improper to toss consulting or investment advice to the friendliest face that shows up at the door. A close reading of Section 703 A of Act 44 of 2008 indicates that the Pennsylvania actually took several steps back, in terms of ethical standards, from where Act 205 was in terms of prohibiting indirect self dealing, since Act 44 replaces a prohibition against various direct *and indirect local* bad acts with a mere requirement to disclose, and at worse negates any contract that a lobbyist might have connived a set of pension directors into. Only direct conflicts of interest are addressed in Act 44. Indirect campaign contributions and other forms of inducements are clearly available as a way to win business. More importantly, Pennsylvania municipal pension trustees are not obligated to be a prudent investor in their investment decisions.

The challenge facing the Pension Board is how to find on average $137 million/year when employee contributions have been about $10 million, and employer contributions about $23 million, and the state has provided $15.0 million. That is, where is about $87/year million of new money going to come from to meet the obligations of retirees, and their dependents?

Table 1 Estimated Retiree Health Care and Pension Costs for Pittsburgh

Year	Retiree Health Care Costs	Retiree Pension Benefit Costs	Total Retiree Health Care and Pension Benefit Costs
2010	$27,562,650	$81,124,725	$108,687,375
2011	$28,032,473	$82,507,546	$110,540,019
2012	$28,562,411	$84,067,306	$112,629,717
2013	$29,138,337	$85,762,421	$114,900,758
2014	$29,746,266	$87,551,727	$117,297,993
2015	$30,447,609	$89,615,979	$120,063,588
2016	$31,209,168	$91,857,464	$123,066,632
2017	$31,871,223	$93,806,080	$125,677,303
2018	$32,586,789	$95,912,195	$128,498,984
2019	$33,262,460	$97,900,887	$131,163,347
2020	$33,931,791	$99,870,918	$133,802,709
2021	$34,573,709	$101,760,267	$136,333,976
2022	$35,248,435	$103,746,178	$138,994,613
2023	$35,832,369	$105,464,861	$141,297,230
2024	$36,347,249	$106,980,300	$143,327,549
2025	$36,779,707	$108,253,147	$145,032,854
2026	$37,126,445	$109,273,695	$146,400,140
2027	$37,342,062	$109,908,317	$147,250,379
2028	$37,458,249	$110,250,290	$147,708,539
2029	$37,581,174	$110,612,093	$148,193,267
2030	$37,581,128	$110,611,958	$148,193,086
2031	$37,581,128	$110,611,958	$148,193,086
2032	$37,581,128	$110,611,958	$148,193,086
2033	$37,581,128	$110,611,958	$148,193,086
2034	$37,581,128	$110,611,958	$148,193,086
2035	$37,581,128	$110,611,958	$148,193,086
2036	$37,581,128	$110,611,958	$148,193,086
2037	$37,581,128	$110,611,958	$148,193,086
2038	$37,581,128	$110,611,958	$148,193,086
2039	$37,581,128	$110,611,958	$148,193,086
2040	$37,581,128	$110,611,958	$148,193,086
Total	$1,078,032,986	$3,172,957,934	$4,250,990,920

Table 2
Present Value and Annualized Costs of Total Health Care and Retirement Benefits at Varying Discount Rates

	Discount Rate of 8.50%	Discount Rate of 7.50%	Discount Rate of 5%	Discount Rate of 4%
Present Value of Total Health and Retirement Cost	$1,479,867,495	$1,627,137,249	$2,125,200,192	$2,395,881,703
Annualized Cost over 30 years	$137,460,697	$137,503,782	$138,246,882	$138,554,343

Table 3

Overall Rate of Return of Pittsburgh Retirement Plans From Act 205 Reports (Selected Calendar Years)

	2003	2004	2006
Pension Investment Returns 1/	3.26%	3.07%	3.90%
AAA Corporates 2/	5.67%	5.63%	5.59%

1/Calculated from Act 205 reports from respective years.
2/ Economic Report of the President, 2010, Table B-73.

3.0 How Much Money would Leasing the Garages of the Pittsburgh Parking Authority Generate?

In November, 2008, I floated to several public officials the idea of leasing or selling several of the City's public authorities as a way to fill up the pension fund. Councilman Peduo was supportive of an investigation of the idea. In early January, 2009, I found four Heinz graduate students to work the numbers on what an outright sale of the Water and Sewer Authority and what an outright sale of the Parking Authority might generate. The Eden Hall Foundation allowed me to spend some hundreds of remaining dollars on the project, and the four students generated a report that is on my web page.[7]

Subsequent to the initiation of this project at the University, there has been public discussion that $200 million, obtained from the long-term lease of the Pittsburgh Parking Authorities' garages, could readily solve the City's pension problems. However, as we

[7] http://www.andrew.cmu.edu/user/rs9f/water_parking_10_30_09.pdf

shall see below, I think the parking facilities that the City owns could be worth much more than the approximate $200 million that private interests are talking about putting on the table. This leads me to worry that that because the Parking Authority board of directors are not required by law to sell/lease at the highest possible price, they, the Mayor and Council could get snookered in much the same way as the Chicago City Council got snookered as chronicled by the Inspector General of Chicago.[8]

I should note parenthetically that the idea of selling the Water and Sewer Authority proved unworkable due to the fact that the present value of its operations looked like a money loser, and that, despite having issued a great deal of debt over the past decade, the underlying quality of its capital stock remains a large unknown and the wastage or leakage rates for the system are rising. On the other hand, the notion of selling the Parking Authority garages could generate positive cash flow. Late this fall, and to the present, Ms. Snigdha Verma, a second year Heinz public policy student, picked up where the other students left off, and upon reworking the analysis, she and I find that leasing the parking garages could be worth than $200 million.

The key to understanding what the parking garages in the City are worth has to do with how high parking rates can be raised without chasing away those who want to park where the Parking Authority's garages are located. Based on what was observed when the parking tax was increased over the past several years, the earlier student project estimated the price elasticity of demand for parking to be -.3. What this means is that a 1% increase in the price of parking is associated with only a .3% decline in utilization. So, raising prices will actually lead to more revenue coming in. Since the parking garages have basically fixed labor and maintenance costs, parking rate increases could generate substantial monies for the City's budget and/or for the City's pension funds.

There are other key assumptions that need to be made to estimate the range of values that a long term, here taken to be 30 year, lease would be worth.

Over the recent past, the Parking Authority reported slowly growing gross revenues which we estimate to be $53.7 million in 2010. Over the past several years, the Authority reports operating margins or profit margins of 32%; this implies net income of about $17 million project in 2010. What private interests are going to look at when making an offer to pay a lump sum amount for, say, a 30 year lease (2010-2040), is how much they can increase parking rates to grow that $17 million of net income. Since the Parking Authority reports a very high utilization rate, we assume that capital and labor costs will remain constant, but that parking rates could be increased. The basic argument in favor of turning over the public parking to a private interest is that elected officials will no longer be blamed for raising parking rates. Rather, higher rates will be the result of private decision making.

Table 4 shows what before income tax income (revenues-operating costs) would look like to a private leasing company under the assumption that it raises rates each year. The table entries are simply the result of compounding, and they go up rather considerably. At 5% increase per year, parking rates would double by 2025, while at 15%/year, which

---

[8] See http://www.governing.com/column/successful-fiasco-chicagos-parking-meter-mishap and http://www.chicagoinspectorgeneral.org/pdf/IGO-CMPS-20090602.pdf

admittedly is an extreme assumption, parking rates would double by 2018. Another way to view Table 4 is that these are profit opportunities for the Parking Authority should it decide to pursue an aggressive strategy of increasing parking rates, since it is tax exempt.

Table 4
Net, Pretax Income from a Long-Term Lease to Private Leasing Company Under Varying Assumptions about Parking Fee Growth Rates: 2010-2040

Year	5% per Year	10% per Year	15% per Year
2010	$17,174,282	$17,174,282	$17,174,282
2011	$18,032,996	$18,891,710	$19,750,424
2012	$18,934,646	$20,780,881	$22,712,988
2013	$19,881,378	$22,858,969	$26,119,936
2014	$20,875,447	$25,144,866	$30,037,927
2015	$21,919,219	$27,659,353	$34,543,616
2016	$23,015,180	$30,425,288	$39,725,158
2017	$24,165,939	$33,467,817	$45,683,932
2018	$25,374,236	$36,814,599	$52,536,521
2019	$26,642,948	$40,496,059	$60,416,999
2020	$27,975,096	$44,545,664	$69,479,549
2021	$29,373,850	$49,000,231	$79,901,482
2022	$30,842,543	$53,900,254	$91,886,704
2023	$32,384,670	$59,290,279	$105,669,710
2024	$34,003,904	$65,219,307	$121,520,166
2025	$35,704,099	$71,741,238	$139,748,191
2026	$37,489,304	$78,915,362	$160,710,420
2027	$39,363,769	$86,806,898	$184,816,983
2028	$41,331,957	$95,487,588	$212,539,530
2029	$43,398,555	$105,036,347	$244,420,460
2030	$45,568,483	$115,539,981	$281,083,529
2031	$47,846,907	$127,093,979	$323,246,058
2032	$50,239,253	$139,803,377	$371,732,967
2033	$52,751,215	$153,783,715	$427,492,911
2034	$55,388,776	$169,162,087	$491,616,848
2035	$58,158,215	$186,078,295	$565,359,375
2036	$61,066,125	$204,686,125	$650,163,282
2037	$64,119,432	$225,154,737	$747,687,774
2038	$67,325,403	$247,670,211	$859,840,940
2039	$70,691,673	$272,437,232	$988,817,081
2040	$74,226,257	$299,680,955	$1,137,139,643

Table 5 recalculates the income flows but in *after tax* terms under the assumption that the income tax rate facing the private investors, federal and state, is 25%. The annual after tax net incomes, under varying assumptions about parking rate increases, are accordingly lower.

Table 5
After-tax income streams to private leasing company
Under different parking rate increase assumptions

Year	5% per Year	10% per Year	15% per Year
2010	$12,880,712	$12,880,712	$12,880,712
2011	$13,524,747	$14,168,783	$14,812,818
2012	$14,200,984	$15,585,661	$17,034,741
2013	$14,911,034	$17,144,227	$19,589,952
2014	$15,656,585	$18,858,650	$22,528,445
2015	$16,439,415	$20,744,515	$25,907,712
2016	$17,261,385	$22,818,966	$29,793,868
2017	$18,124,455	$25,100,863	$34,262,949
2018	$19,030,677	$27,610,949	$39,402,391
2019	$19,982,211	$30,372,044	$45,312,750
2020	$20,981,322	$33,409,248	$52,109,662
2021	$22,030,388	$36,750,173	$59,926,111
2022	$23,131,907	$40,425,190	$68,915,028
2023	$24,288,503	$44,467,710	$79,252,282
2024	$25,502,928	$48,914,480	$91,140,125
2025	$26,778,074	$53,805,929	$104,811,143
2026	$28,116,978	$59,186,521	$120,532,815
2027	$29,522,827	$65,105,174	$138,612,737
2028	$30,998,968	$71,615,691	$159,404,648
2029	$32,548,916	$78,777,260	$183,315,345
2030	$34,176,362	$86,654,986	$210,812,646
2031	$35,885,180	$95,320,485	$242,434,543
2032	$37,679,439	$104,852,533	$278,799,725
2033	$39,563,411	$115,337,786	$320,619,684
2034	$41,541,582	$126,871,565	$368,712,636
2035	$43,618,661	$139,558,721	$424,019,532
2036	$45,799,594	$153,514,594	$487,622,461
2037	$48,089,574	$168,866,053	$560,765,831
2038	$50,494,052	$185,752,658	$644,880,705
2039	$53,018,755	$204,327,924	$741,612,811
2040	$55,669,693	$224,760,716	$852,854,732

Note: calculations assume net incomes from Table 4 above, and effective income tax rate of 25%.

We now turn to the question of how a private, for-profit firm should value any of these 30 year streams of income, given the varying assumptions about how much they would raise parking rates. This in turn will be driven by what their own discount rate or borrowing rate might be to raise the capital to pay for the long-term lease. Right now AAA Corporate bond rates are at about 5%, and we can make higher interest rate assumptions to reflect possibly greater risk, say 7.5% and 8.5%. Table 5 shows what the after tax income streams are worth under varying assumptions. Note that I show what the present value of a constant, no increase parking rate scenario would be.

Table 6
Present Value of After-Tax Income Streams (2010-2040)
under varying assumptions
about Parking Rate increases and the Discount Rate of Private Investor

Investor's Discount or Borrowing Rate	0% Growth Rate in Parking Rates	5 % Growth Rate in Parking Rates	10% Growth Rate in Parking Rates	15% Growth Rate in Parking Rates
5% Discount	$198,008,745	$398,688,689	$872,992,036	$2,133,449,711
7.5% Discount	$153,494,787	$286,193,941	$574,816,376	$1,308,158,320
8.5% Discount	$139,454,113	$254,195,315	$493,319,484	$1,089,453,633

What we see in Table 6 is that if parking rates do not go up at all, then at any range of discount rates, there is less than $200 million to be made. At the other extreme, if parking rates grow at 15%/year, admittedly an extreme assumption, and if the investors face a borrowing cost themselves of 5%, the could pay up to $2 billion and still make a little money. If they are able to buy the lease for $200 million, and borrow at 5%, then private investors will walk away with all the economic profits: $2.1 billion - $.2 billion =$1.9 billion. Even if parking rates only go up 5%/year, were investors facing the AAA bond rate, they could pay up to $398 million for the investment opportunity. If they get it for $200 million, they walk away, in effect, with $198 million. If the investors, due to various kinds of depreciation shields on properties they own are themselves tax exempt, then the numbers in Table 6 get larger --- that is, they get larger by the 25% in income taxes that are not paid. Admittedly a range of between $139 million and $4.1 billion in what a lease might be worth simply reflects assumptions, but it also underlines the point I made at the outset, namely that the negotiators for the public interest have to maximize the lease selling price, and not simply assume, as private interests have talked about, that it is worth $200 million.

If we link what the pension funds need to what can be garnered from a long term lease, it is clear that $200 million is inadequate to make the pension plans partially, let alone entirely whole.

4.0 Some Concluding Comments and Suggestions

The situation Pittsburgh faces is actually worse than New York City faced because it does not have the political influence in Harrisburg that New York City did, and unfortunately has very little influence in Washington, DC to send meaningful amounts of funding for the pension funds. Moreover, interest, principal and retirement obligations in Pittsburgh's budget are horrendously high, much higher than New York City faced, and the recent debacle over snow removal reflects the City's dwindling capital and labor resources.

To this day, Pittsburgh has not faced up publicly to the totality of its financial challenges. I think a fair assessment of the two oversight boards is that they are part of process that results in Pittsburgh being kept on the operating table without any meaningful help in the form of financial assistance from Harrisburg, or in terms of tough love from the oversight committees. They continue to fail to require consolidated reporting and accounting, and continue to fail to disclose of the extent of the City's financial problems. In the case of the ICA, they have the authority to obligate the City to disclose on a consolidated basis, but have failed to do so.

So what can be done right now?

The first step in dealing with the pension problem, in my opinion must be to raise the ethical and fiduciary standards of Council and the various boards and commissions. As I hope my tour of spreadsheet arithmetic above has shown you, it's very easy to squander monies put into a pension plan by bad investing, and it's equally easy to lease valuable assets at a fraction of their worth with the result that private interests get rich, and the City loses further control of its destiny. Here I would also remind you that the Parking Authority can make more money for the City and its pension plans, but only if the Mayor, Council and Authority are willing to take the political heat for raising rates.

The second step in dealing with the pension problem is to begin to unravel the causes and remedies of very high ratios of disabled to retired workers. Time limitations prevented me from exploring if comparable cities have ¼ of their retirees being deemed as disabled. This strikes me as extraordinarily high, and could easily reflect poor control over who deems an employee disabled, employee's doctor or employer's doctor.

The third step in dealing with retirement costs is to begin to pay attention to the health cost component of it, and begin to explore ways to control retiree health costs as well as employee health costs. It is my understanding that retirees do not get supplemental policies that make Medicare the first line of health insurance and thereby defray part of these costs on the Medicare trust fund. Rather, they get policies that are better than Medicare. Using Medicare first could save the City significant amounts of money.

The fourth step, and perhaps the easiest, is for the Mayor, Council and the Pension Board to make public not only the various retirement plans but also underlying collective bargaining agreements and Act 205 reports. Many jurisdictions in other states do this, and it will help educate the taxpaying public what is going on.

Appendix 1: US Department of Labor Synopsis of ERISA

The Employee Retirement Income Security Act (ERISA) protects a retirement plan's assets by requiring that those persons or entities who exercise discretionary control or authority over plan management or plan assets, have discretionary authority or responsibility for the administration of a plan, or provide investment advice to a plan for compensation or have any authority or responsibility to do so are subject to fiduciary responsibilities. Plan fiduciaries include, for example, plan trustees, plan administrators, and members of a plan's investment committee.

The primary responsibility of fiduciaries is to run the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries must act prudently and must diversify the plan's investments in order to minimize the risk of large losses. In addition, they must follow the terms of plan documents to the extent that the plan terms are consistent with ERISA. They also must avoid conflicts of interest. In other words, they may not engage in transactions on behalf of the plan that benefit parties related to the plan, such as other fiduciaries, services providers, or the plan sponsor.

Fiduciaries who do not follow these principles of conduct may be personally liable to restore any losses to the plan, or to restore any profits made through improper use of plan assets. Courts may take whatever action is appropriate against fiduciaries who breach their duties under ERISA including their removal.

http://www.dol.gov/dol/topic/health-plans/fiduciaryresp.htm

Appendix 2: State of Washington Standard of Investment and Management RCW 43.33A140

The state investment board shall invest and manage the assets entrusted to it with reasonable care, skill, prudence, and diligence under circumstances then prevailing which a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an activity of like character and purpose.

The board shall:

(1) Consider investments not in isolation, but in the context of the investment of the particular fund as a whole and as part of an overall investment strategy, which should incorporate risk and return objectives reasonably suited for that fund; and

(2) Diversify the investments of the particular fund unless, because of special circumstances, the board reasonably determines that the purposes of that fund are better served without diversifying. However, no corporate fixed-income issue or common stock holding may exceed three percent of the cost or six percent of the market value of the assets of that fund.

Appendix 3: Article about Pay-to-Play in New York by Stephen Grocer, *Wall Street Journal*

Former LA Pension Fund Board Member Pleads Guilty to Felony

Written by Stephen Grocer, Wall Street Journal

Thursday, 03 December 2009

Elliott Broidy, the former LA city pension commissioner, pleaded guilty on Thursday to the felony charge of rewarding official misconduct and is cooperating with New York's pay-to-play probe concerning the fund, according to Attorney General Andrew Cuomo.

Broidy, a California money manager and Republican fundraiser, admitted that he made nearly $1 million in payoffs to four senior New York state officials while pursuing an investment from the state public pension fund.

(Cuomo's release announcing the guilty plea is at the bottom, along with a bio of Broidy posted by his company.)

Also, Benzinga.com has this report on Broidy:

Broidy, chairman of Markstone Capital Partners of Los Angeles and a prominent GOP fund-raiser, is currently under investigation for his investment in a low-budget movie produced by a top executive from New York state pension fund.

This event has marked a new turn in 'Pay-per-play' investigations carried out by the New York Attorney General. Interestingly, the day Broidy invested $300,000 in the movie named 'Chooch', the pension fund approved a $200 Million investment in one of his funds.

However, Broidy did not directly invest in the movie. He did it under an associate's name. Other people who invested in movie include Hank Morris and Barrett Wissman, a money manager and music impresario. They both contributed $100,000 and $150,000 respectively. The movie was being produced by David Loglisci, then head of private equity for the New York state pension fund, and his brothers.

Currently Loglisci, along with Morris, who was a political adviser to one of the fund's former trustees, has been criminally charged in the case. The New York Attorney General is currently probing the matter to see if the investments made by the fund were influenced by vested interests of the officials rather than the retirees. Loglisci has denied any such

charges.

Reportedly, Broidy gave about $90,000 to actress Peggy Lipton to help pay for her expenses in 2004-05. Lipton is said to be romantically involved with the chief of staff for the sole trustee of the pension fund. Broidy also gave $44,000 to a relative of Lipton.

Broidy owns a private-equity firm, Markstone, which manages about $800 Million and specializes in investments in Israeli companies.

Cuomo's release:

CUOMO ANNOUNCES GUILTY PLEA BY FOUNDER OF PRIVATE EQUITY FIRM IN CONTINUING INVESTIGATION OF PAY-TO-PLAY KICKBACK SCHEME AT STATE PENSION FUND

Elliott Broidy Pleads Guilty to Felony Charge of Rewarding Official Misconduct Through Gifts of Nearly a Million Dollars For $250 Million Investment in Markstone

Gifts Included Payments to an Official's Friends, a Sham Consulting Contract, Luxury Travel Expenses in Israel for Officials and Family Members, and a Concealed Payment to the Loglisci Brothers' Movie, "Chooch"

NEW YORK, N.Y. (December 3, 2009) — Attorney General Andrew M. Cuomo today announced a felony guilty plea by Elliott Broidy, a founder and Chairman of Markstone Capital Group LLC, for his involvement in a pay-to-play kickback scheme at the Office of the New York State Comptroller ("OSC").

Broidy acknowledged paying nearly one million dollars in gifts for the benefit of OSC officials to obtain a $250 million investment from the New York State Common Retirement Fund ("CRF") in Markstone Capital Partners, L.P. (the "Markstone Fund"). Broidy pleaded guilty to a felony charge of rewarding official misconduct and will cooperate in the Attorney General's ongoing investigation. Broidy will also forfeit $18 million in connection with his plea.

Today's announcement arises from a two-year, ongoing investigation into corruption involving the OSC and the CRF. The charges to date allege a complex criminal scheme involving numerous individuals operating at the highest political and governmental levels under former Comptroller Alan Hevesi, in which the State pension fund was used as a piggy bank for the Comptroller's chief political aide and a favor bank for political allies and other friends.

"Broidy paid nearly a million dollars in bribes to get a quarter billion dollar investment. For Broidy, this was a small price to pay. For New York taxpayers, the harm is incalculable," said Attorney General Cuomo. "Corruption corrodes the integrity of the pension system and the public's trust in government. That is too high a price to bear."

Markstone is a private equity firm headquartered in Los Angeles, California with an office in Israel. The Markstone Fund focuses on corporate buyout investments in privately held companies in Israel.

Broidy resigned from his management role in Markstone on December 1, 2009. Broidy was also a trustee of the Los Angeles Fire and Police Pension fund from 2002 until he resigned in May 2009.

In his allocution to the Court, Broidy acknowledged making a series of payments to help induce and then increase the CRF's investment in the Markstone Fund. The CRF ultimately committed $250 million to the Markstone Fund and paid over $18 million in management fees to Markstone. Broidy acknowledged that he had an agreement or understanding with certain high-ranking OSC officials: in exchange for certain benefits from Broidy, the OSC officials would exercise their judgment or discretion to benefit Markstone. Broidy acknowledged the following illicit arrangements:

● Broidy funneled $300,000 to "Chooch," a movie produced by brothers of David Loglisci, the Chief Investment Officer at OSC under Hevesi. To hide the payments, Broidy made them through a friend, with the understanding that Broidy would reimburse him, which Broidy did.

● Broidy entered into a sham consulting agreement with a family member of a senior OSC official. Broidy paid more than $380,000 to the consultant over a period of more than two years.

● Broidy paid over $90,000 to the girlfriend of a high-ranking OSC official from April 2004 through October 2005. The payments were used to cover the girlfriend's living expenses and rent. Broidy also covered the girlfriend's hospital bills. Broidy also agreed to pay $5,500 a month to a relative of the girlfriend beginning in October 2003, for a total of $44,000. These payments were concealed through a sham loan agreement between Broidy and the relative.

● In connection with the CRF's investment in the Markstone Fund, Broidy traveled to Israel with a very high-ranking OSC official on at least five occasions and on one occasion to Italy. Relatives of the OSC official were present on some of the trips. Broidy subsidized these trips, paying for accommodations and services for the OSC official, the relatives, and Loglisci. Broidy paid at least $75,000 for first class airfare, luxury hotel suites, a car and driver, a helicopter tour, and security detail on these trips. To conceal these payments, Broidy financed these expenses through charities and caused false invoices to be submitted to the OSC.

Broidy pleaded guilty before Justice Bart Stone in the State Supreme Court, New York County, Part 31, and was released on his own recognizance with travel restrictions. Broidy faces a possible sentence of up to 4 years in prison for the charge of rewarding official misconduct, a Class E felony.

Attorney General Cuomo's investigation into corruption at the CRF has led to a number of criminal charges to date, including charges against Morris and Loglisci, former Liberal Party Chair Ray Harding, and investment advisor Saul Meyer. Meyer, Harding, hedge fund manager Barrett Wissman, and Julio Ramirez, an unlicensed placement agent, have pled guilty to Martin Act securities fraud charges for conduct related to the pension fund. Morris and Loglisci are presumed innocent until they are proven guilty in court.

Cuomo also issued subpoenas in May to over 100 investment firms and agents after his investigation found that 40 to 50 percent of agents obtaining investments from New York pension funds were unregistered.

Earlier this year, Cuomo announced his Public Pension Fund Reform Code of Conduct, which would eliminate pay to play in state public pension funds. To date, seven firms have signed onto the Code: The Carlyle Group, Riverstone Holdings, Pacific Corporate Group, HM Capital, Falconhead Capital, Levine Leichtman Capital Partners, and Access Capital Partners. These firms collectively have agreed to return nearly $60 million associated with New York State Common Retirement Fund investments; these funds will principally be provided to the CRF for the benefit of the pension holders.

In July, the United States Securities & Exchange Commission proposed new pay-to-play rules that would institutionalize Cuomo's Code of Conduct nationwide.

The investigation was conducted by Stacy Aronowitz, Deputy Chief of the Public Integrity Bureau, and Assistant Attorneys General Emily Bradford, Rachel Doft, Noah Falk, and Amy Tully, under the supervision of Ellen Nachtigall Biben, Special Deputy Attorney General for Public Integrity, and Linda A. Lacewell, Special Counsel.

Here is Broidy's bio:

Elliott Broidy, Co-Founder and Chairman of Markstone Capital Group

Mr. Broidy is Chairman and Chief Executive Officer of Broidy Capital Management, a private investment company which he founded in 1991. The firm specializes in investing in private equity and marketable securities. Mr. Broidy is Chairman of Tomcar Ltd., an off-road vehicle manufacturer, and of ESI Holdings, Inc., an event management and logistics company. He also serves on the Board of Directors of Foley Timber and Land Company. Mr. Broidy was appointed by the President to serve on the Board of Trustees of The John F. Kennedy Center for the Performing Arts. He previously served on the United States Homeland Security Advisory Council, as well as the Future of Terrorism Task Force and New Technology Task Force. Mr. Broidy served for a period of seven years as a Commissioner of the Los Angeles City Fire and Police Pension Fund. He is a member of the Young Presidents Organization (YPO) and serves on the governing boards of several large charitable and educational organizations, including the Board of Leaders of the University of Southern California Marshall School of Business and the Board of Trustees of the Simon Wiesenthal Center, Museum of Tolerance. Mr. Broidy also previously served on the Boards of Trustees of Hebrew Union College, and Wilshire Boulevard Temple and was a founding member of the Board of Governors of the California-Israel Chamber of Commerce, an organization promoting trade with and encouraging investment in Israel. From 1982 to 1991, Mr. Broidy was Managing Director of Bell Enterprises, a private investment company. In this role, he was involved in a wide range of investments, including management of marketable securities, real estate, private equity and other alternative investments. Mr. Broidy began his career with Arthur Andersen & Co. and is a Certified Public Accountant. He received a B.S. in Accounting from the University of Southern California.

Appendix 4: Moody's Aaa Corporate Bond Yields

Online Papers and Speeches on Pittsburgh's Finances

Professor Robert P. Strauss
Carnegie Mellon University
Pittsburgh, Pennsylvania

The Feasibility of Privatizing Pittsburgh's Public Authorities to Forestall Bankruptcy
An Independent Study Project by
Lora Mae Aquinde
Andrew Bray
Sanya Gurnani
Robert Kaminski
Advised by Professor Robert P. Strauss
Spring, 2009, Revised 10/30/09
School of Public Policy and Management
Heinz Collge
Carnegie Mellon University
http://www.andrew.cmu.edu/user/rs9f/water_parking_10_30_09.pdf

Fixing Pittsburgh's Finances
A Presentation to Pittsburgh Mayor Luke Ravenstahl's Pension Summit
Professor Robert P. Strauss
David L. Lawrence Convention Center
Pittsburgh, Pennsylvania
April 12, 2007
http://www.andrew.cmu.edu/user/rs9f/April_12_07.ppt

Pennsylvania's Public Sector: Past, Present and Future
Professor Robert P. Strauss and Joshua Hart
Conference on Fiscal Federalism
Andrew Young School of Public Policy
Georgia State University
April 21, 2006, 12:30 AM
Atlanta, Georgia
http://www.andrew.cmu.edu/user/rs9f/andrew_young_school_strauss_hart_4_30_07_rps.pdf

Commuter Taxation with Some Representation
Professor Robert P. Strauss
Forum, Pittsburgh Post-Gazette Sunday Octoer 3, 2004 pp. B-1,B-2.

http://www.post-gazette.com/pg/04277/389014.stm

Restoring the Public's Trust in the City of Pittsburgh's Finances
Professor Robert P. Strauss
February 5, 2004, 9AM, City Council Chambers
http://www.andrew.cmu.edu/user/rs9f/Pittsburgh_City_council_2_5_2004.pdf

Does Pittsburgh Deserve PICA-West?
Professor Robert P. Strauss
Prepared Testimony (postponed) before a Special Hearing of the
Pennsylvania Senate Finance Committee
Pittsburgh City Council Chambers
September 8, 2003
http://www.andrew.cmu.edu/user/rs9f/pa_senate_testimony_9_5_03.pdf

Pittsburgh's PIckle
Professor Robert P. Strauss
Pittsburgh Tribune Review
August 31, 2003
http://www.andrew.cmu.edu/user/rs9f/trib_pgh_pickle_8_31_03.html