Massachusetts Taxpayers Foundation

The Crushing Burden of Municipal Retiree Health Care Liabilities

JANUARY 2012

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Overview

The skyrocketing costs of employee benefits—employee health care, pensions, and retiree health care—are forcing cuts in basic services in scores of communities across the state. These costs rose from 13.5 percent of municipal budgets statewide in 2001 to 20 percent in 2010 and, left unchecked, will consume nearly a third of local budgets by 2020.

While the state took two important steps to curb this trend by enacting municipal health care and pension reform legislation in 2011, cities and towns still face billions of dollars in retiree health care liabilities. Since these liabilities are almost totally unfunded, the costs of employee benefits are in fact much larger than the annual budget numbers suggest.

Exceedingly generous retiree health care benefits have saddled municipalities statewide with staggering liabilities—approximately $20 billion for just the 50 largest municipalities in the state, as described in the Foundation's February 2011 report, *Retiree Health Care: The Brick That Broke Municipalities' Backs*.

This analysis follows up on that report by focusing on the costs of funding retiree health care in 10 geographically dispersed, midsized, industrial Massachusetts cities: Brockton, Fitchburg, Haverhill, Holyoke, Lawrence, Lowell, New Bedford, Pittsfield, Springfield, and Worcester. For years, these cities have struggled to build a strong economic base, but the costs of retiree health care threaten to overwhelm both businesses and homeowners. While this report focuses on these cities, the issues affect virtually every municipality in the Commonwealth.

As shown in Table 1 on page 2, these 10 cities have a combined retiree health care liability of $4.5 billion, all of it unfunded. Worcester, Springfield, and Brockton have the largest unfunded liabilities, all over $690 million. Even at the low end, Fitchburg has a huge liability of $187 million. The liability defines how much these cities would need to set aside today in order to provide these benefits for current retirees and active employees already eligible for benefits, based on a variety of assumptions.[1]

The total unfunded retiree health care liability is more than twice the total unfunded pension liability in these 10 cities; in Brockton, the unfunded retiree health care liability is six times the unfunded pension liability. Yet the pension funds in these communities are also grossly underfunded, with half funded at less than 50 percent, and none above 80 percent. Already struggling to pay for their pension obligations, these cities have no hope of meeting their retiree health care obligations.

[1] Each community calculates its own liability and chooses its own assumptions for investment performance and health care cost growth, among others. A higher assumed rate of return and a lower cost growth assumption would reduce the liability. The health plan design, number of people covered, and employees' share of contributions all also affect the liability.

Table 1
Unfunded Retiree Health Care and Pension Liabilities
(thousands of dollars)

Municipality	Retiree Health Care Liability	Unfunded Retiree Health Care Liability	Unfunded Pension Liability
Brockton	$693,570	$693,570	$113,609
Fitchburg	186,634	186,634	93,300
Haverhill	299,042	299,042	138,200
Holyoke	300,166	300,166	130,099
Lawrence	323,977	323,977	187,334
Lowell	432,752	432,752	174,924
New Bedford	478,609	478,609	318,636
Pittsfield	236,149	236,149	110,879
Springfield	761,576	761,576	550,900
Worcester	765,312	765,312	308,183*
Total	**$4,477,786**	**$4,477,786**	**$2,126,064**

**In addition to its unfunded pension liability, Worcester has approximately $161 million in outstanding pension obligation bonds.*

Retiree health care liabilities are so large because these benefits are almost universally available to municipal employees in Massachusetts, despite having eroded sharply in the private sector. Virtually every community in the state contributes at least 50 percent towards the cost of retiree health care premiums once an employee—including most part-time employees who work at least 20 hours per week—completes just 10 years of service. By comparison, according to a 2010 survey by the state, only 14 percent of all Massachusetts employers offered health care benefits to retirees over age 65, including those employers that do not contribute anything to premiums.

Municipalities have two ways to fund retiree health care costs: pay-as-you-go or making an annual required contribution (ARC).[2] All 10 cities currently use pay-as-you-go to fund retiree health care, which means they pay only the annual costs of benefits for current retirees and do not fund the benefits that active employees have earned. Relying on pay-as-you-go means that the city falls short of meeting its ARC. Every year that a community does not meet its ARC, it defers that obligation to the future and increases its unfunded liability.

[2] The annual required contribution, or ARC, includes two parts: an amortization payment and the "normal cost" payment. The amortization payment, which increases each year, is the annual cost to reduce the existing unfunded liability over a period of time, in this case 30 years. Since the future costs for current retirees are incorporated into the unfunded liability, the amortization payment includes those expenses. The normal cost is the amount a municipality must set aside to fund all of the retiree health care obligations payable in the future that were incurred for active employees during that year.

The annual costs to tackle these liabilities are enormous. As shown in Table 2, paying for retiree health care benefits over the next 30 years would require a total annual contribution of at least $323 million for these 10 cities, compared to the $131 million they currently spend on a pay-as-you-go basis.

As a result, these communities are underfunding retiree health care benefits by almost $200 million each year. By deferring more than half of the ARC each year, municipalities lose the interest and investment income they would have earned on that money, which adds to their obligations. That lost interest compounds every year they continue to defer payment and builds dramatically over time; without change, these cities will increase their obligations by at least $2 billion in just 10 years.

However, if municipalities continue pay-as-you-go funding, the liabilities do not disappear, and the annual costs will continue to rise. Retiree health care spending increased by 11.6 percent between fiscal 2009 and fiscal 2010 in the eight cities for which that data was available, while revenues were flat. Although municipalities may operate under the illusion that pay-as-you-go adequately meets their obligations, they are digging deeper and deeper holes that taxpayers must fill in the future, either through increased taxes or cuts in basic services.

Table 2
Annual Required Contributions and Pay-As-You-Go Costs of Retiree Health Care
(thousands of dollars)

Municipality	Annual Required Contribution	Pay-As-You-Go Costs	Difference
Brockton	$57,791	$20,809	$36,983
Fitchburg	13,980	5,737	8,243
Haverhill	17,245	12,298	4,947
Holyoke	20,455	7,440	13,015
Lawrence	33,661	8,650	25,011
Lowell	32,946	9,685	23,261
New Bedford	33,457	12,105	21,352
Pittsfield	16,987	9,012	7,975
Springfield	43,555	25,004	18,551
Worcester	52,960	20,598	32,362
Total	**$323,036**	**$131,337**	**$191,699**

Note: Holyoke and Springfield pay-as-you-go costs are for fiscal 2009; all other cities are for fiscal 2010.

The scenario in Brockton over the last two years illustrates the problem faced by these 10 cities, along with scores of other communities across the state. Between fiscal 2008 and fiscal 2010, Brockton's liability rose from $635.2 million to $693.6 million—an increase of $58.4 million or almost 10 percent—and drove its ARC up by $11.5 million to more than $57 million. While the city continues to rely on pay-as-you-go funding, those costs rose by almost a third, from $15.8 million to $20.8 million, between fiscal 2008 and fiscal 2010. During those two years, the city eliminated 71 total positions, including 10 police officers and recruits. For the fiscal 2011 budget, the city eliminated 57 teachers and dozens of other positions.[3]

On the other hand, Worcester illustrates how even modest reforms can produce dramatic savings, in this case reducing the city's unfunded retiree health care liability by almost $400 million, or nearly one-third (see sidebar on page 5). But even with those changes, the city still has an unaffordable retiree health care liability that is twice the size of its unfunded pension liability, underscoring the need for more significant reforms in retiree health care benefits.

Whether municipalities choose to fund their retiree health care costs by making an annual payment or continue their current practice of pay-as-you-go, their liabilities represent the real cost, in today's dollars, of these benefits. To meet such an enormous expense, municipalities face two devastating options: implement draconian property tax increases or eviscerate local services.

As detailed in this report, the property tax increases needed to fund these liabilities are exorbitant. The sections that follow separate the impact on residential and business property taxpayers.[4]

Not only is it unreasonable to expect property owners to bear enormous property tax increases, the Foundation recognizes that it is exceedingly unrealistic that such increases will actually happen. In all 10 municipalities, voters would have to approve dramatic overrides to pay for benefits that almost none of them receives from their employers. The last operating overrides in any of these 10 cities were approved 20 years ago, in Holyoke and Worcester. In fact, four cities—Haverhill, Lowell, New Bedford, and Pittsfield—have never even taken an operating override vote.

Nevertheless, these are obligations that must be paid, and without property tax increases—or reforming current benefits—the only way to fund these benefits is by dramatically cutting local services. Without reforms, over the next 30 years municipalities would be forced to siphon tens of millions from education, public safety, and other critical services simply to fund the annual costs of retiree health care, leading to the layoffs of hundreds if not thousands of municipal employees.

[3] Many teaching positions were restored later in the school year after the school district received non-recurring federal grants.

[4] The residential calculations also include property classified as open space (only Pittsfield has open space property and it makes up less than 0.5% of the residential levy). Business calculations include commercial, industrial, and personal property classifications. Personal property is largely a tax on businesses and includes property such as machinery, poles, wires, and pipes.

Worcester: Major Savings But Still Unaffordable

The good news in Worcester is that with modest reforms to its health plans, the city was able to shave nearly $400 million off its unfunded retiree health care liability in fiscal 2010. The bad news is the remaining unfunded balance of $765 million is still unaffordable.

In recent years, Worcester has adopted a series of changes in health care benefits for retirees under 65. The city also recently began transferring all Medicare-eligible retirees to Medicare, a step that is now required by state law for all municipalities.

Among the most notable changes was the adoption of higher contribution rates for non-Medicare eligible retirees, who now must cover 25 percent of their premiums for standard plans, compared to previous contribution rates between 10 percent and 13 percent for most enrollees. The city also introduced new and higher copayments for medical procedures and office visits for its under-65 retirees, including copays for inpatient and outpatient hospital procedures of $250 and $150, respectively.

The changes collectively helped reduce Worcester's long-term retiree health care liability by a third from $1.15 billion in fiscal 2009 to $765 million in fiscal 2010. Nonetheless, the city is still failing to keep pace with the liability's rate of growth.

For example, to fund the liability over a 30-year term, Worcester should have set aside $53 million in fiscal 2010 to fund its retiree liability. The city fell short of that amount by $32.4 million.

The passage of municipal health reform in 2011 has made it easier for the state's cities and towns to make changes in their health plans. But as the Worcester experience shows, despite the opportunity for significant reductions in liabilities created by municipal health reform, that step alone will not solve the retiree health care challenge. The Legislature must address the problem directly by tightening eligibility standards and giving municipalities the flexibility to curtail costs.

Impact on Residential Taxpayers

Paying for retiree health care liabilities would place a staggering burden on the residential taxpayers of these 10 cities. This section describes two ways to address this enormous burden, one in terms of a single payment today and the other in terms of annual payments over a long period of time, specifically:

- The lump sum cost to the average homeowner today to fund these liabilities.
- The average residential tax increases, or annual payments, needed to fund retiree health care benefits over the next 30 years.

Table 3
Residential Share of Unfunded Retiree Health Care Liability, By Property Type
(thousands of dollars)

Municipality	Unfunded Retiree Health Care Liability (A)	Residential Share of Total Property Tax Levy (B)	Residential Share of Unfunded Liability (C)	Share of Unfunded Liability, Single Family Homes (D)	Share of Unfunded Liability, All Other Residential (E)
Brockton	$693,570	65%	$453,448	$325,044	$128,404
Fitchburg	186,634	75%	140,052	86,312	53,740
Haverhill	299,042	75%	223,107	137,777	85,330
Holyoke	300,166	50%	151,238	97,048	54,190
Lawrence	323,977	59%	192,682	66,773	125,909
Lowell	432,752	69%	299,648	156,411	143,237
New Bedford	478,609	68%	324,298	174,963	149,336
Pittsfield	236,149	65%	152,846	117,287	35,559
Springfield	761,576	60%	459,663	314,243	145,421
Worcester	765,312	63%	478,381	287,725	190,655
Total	**$4,477,786**	—	**$2,875,364**	**$1,763,583**	**$1,111,781**

Table 3 depicts the share of the total liability that all residential property owners are responsible for in each city, based on their share of the total tax levy. As shown in column C, residential property owners in these 10 cities are responsible for $2.9 billion of the total unfunded retiree health care liability.

The table further divides the residential liability between property types, namely single family homes (column D) and all other residential properties such as condominiums, apartments, and multifamily dwellings (column E).[5] Although multifamily homes and condominiums compose a significant share of residential properties—ranging from 23 percent in Pittsfield to 65 percent in Lawrence—this section focuses on the impact on single family homeowners because, as column D shows, they bear more than 50 percent of the residential liability in nine of the 10 communities analyzed.

Liability Per Homeowner

As detailed in column C of Table 4 on page 7, the single family homeowner in these 10 cities owes on average an astonishing $13,685 today to pay for the unfunded retiree health care liability.[6]

In all 10 cities, each single family homeowner is responsible for at least $10,000 of the retiree health care liability, although the amounts vary considerably by municipality. Brockton's liability of $19,826

[5] The single family and "all other" shares of the residential liability are based on the assessed value of each city's single family properties as a percentage of total residential property.

[6] The liability per single family homeowner was determined by dividing the single family share of a city's unfunded retiree liability (column A) by the number of single family properties in a given community (column B).

is the highest in the group, while Fitchburg, Haverhill, Holyoke, Lawrence, Lowell, and New Bedford all top the $13,000 mark.

The enormity of these liabilities is underscored by the fact that the obligations for single family homeowners range from 23 percent to just under 60 percent of the median household income in these 10 communities, as shown in column E of Table 4.

In Holyoke, where single family homeowners are responsible for almost one-third of the city's total $300 million unfunded retiree health care obligation, the $18,297 liability for each single family home is 59 percent of the city's median household income of $30,770. The $15,660 that homeowners in Lawrence are responsible for is more than 50 percent of the median household income. In Brockton and New Bedford, the liability is 41 percent of median household incomes, and in all but one community the liability is equal to at least 25 percent of median household income.

Table 4
Single Family Homeowner Share of Retiree Health Care Liability

Municipality	Share of Unfunded Liability, Single Family Homes ($1,000s) (A)	Number of Single Family Homes (B)	Liability Per Single Family Home (C)	Median Household Income (D)	Liability As a % of Median Household Income (E)
Brockton	$325,044	16,395	$19,826	$48,823	41%
Fitchburg	86,312	6,446	13,390	45,481	29%
Haverhill	137,777	10,220	13,481	59,051	23%
Holyoke	97,048	5,304	18,297	30,770	59%
Lawrence	66,773	4,264	15,660	30,888	51%
Lowell	156,411	11,780	13,278	49,698	27%
New Bedford	174,963	12,332	14,188	34,893	41%
Pittsfield	117,287	11,273	10,404	41,297	25%
Springfield	314,243	26,045	12,065	36,114	33%
Worcester	287,725	24,811	11,597	44,580	26%
Total	**$1,763,583**	**128,870**	**$13,685**	**N/A**	**N/A**

Note: Median household income data from the 2008 to 2010 American Community Survey, U.S. Census.

Increases in Property Taxes

A second way of understanding these enormous costs is to calculate the tax increases that would be borne by single family homeowners if each city were to begin funding its liability by meeting its annual required contribution, or ARC, the amount required to fund benefits for current retirees and active employees. Table 5 shows that funding these benefits would add hundreds or, in some cases, more than a thousand dollars to homeowners' property tax bills every year for the next 30 years.

As discussed in the overview and shown in column A, these 10 cities currently underfund their ARCs by approximately $192 million. In total, residential property owners would shoulder $123 million of that shortfall in the form of additional taxes, as reflected in column B.

Of the $123 million residential shortfall, single family homeowners would be responsible for $72.7 million (column C). Multifamily homeowners, condominium owners, and other residential property owners would fund the nearly $50 million balance.

Column D shows that funding the shortfall results in an average property tax increase of $565 per single family homeowner for the 10 cities, with five cities raising tax bills by more than $600. These increases—which would remain in place for 30 years—translate to additional taxes that range from 6 percent to 50 percent of the current average single family tax bill, as detailed in column F.

Table 5
Increase in Average Single Family Tax Bills to Fund Retiree Health Care

Municipality	ARC Shortfall ($1,000s) (A)	Total Residential Share of ARC Shortfall ($1,000s) (B)	Single Family Property Share of Shortfall ($1,000s) (C)	Tax Bill Increase Per Single Family Property (D)	Average Tax Bill (E)	Tax Bill Increase (F)
Brockton	$36,983	$24,179	$17,332	$1,057	$2,954	36%
Fitchburg	8,243	6,186	3,812	591	2,820	21%
Haverhill	4,947	3,691	2,279	223	3,648	6%
Holyoke	13,015	6,558	4,208	793	2,915	27%
Lawrence	25,011	14,875	5,155	1,209	2,397	50%
Lowell	23,261	16,106	8,407	714	3,205	22%
New Bedford	21,352	14,468	7,805	633	2,762	23%
Pittsfield	7,975	5,162	3,961	351	2,795	13%
Springfield	18,551	11,197	7,655	294	2,638	11%
Worcester	32,362	20,229	12,167	490	3,307	15%
Total	**$191,699**	**$122,649**	**$72,781**	**$565**	**N/A**	**N/A**

Note: The average tax bill data is for a single family home in fiscal 2011, as reported by the state's Division of Local Services.

Every homeowner in Lawrence would pay an additional $1,209 in property taxes to fund retiree health care costs, an increase of 50 percent over the current average tax bill for a single family home in the city. In the four additional cities with increases greater than $600—Brockton, Holyoke, Lowell, and New Bedford—property tax bills would rise between 22 percent and 36 percent.

In Worcester, the average single family tax bill would grow by $490, or 15 percent. In Pittsfield and Springfield, which have adopted less costly benefit plans offered through the state's Group Insurance Commission, tax bills would increase by $351 and $294, respectively, or greater than 10 percent. Haverhill would see the smallest increase of $223—still a 6 percent increase on the average single family tax bill.

Table 6 compares the increase needed to fund retiree health care by meeting the ARC to the total increase in each city's average property tax bill since fiscal 2006. In seven cities, the increase in one year simply to fund retiree health care is greater than or equal to the total increase in tax bills over the last five years.

In Brockton, to fund retiree health care the average single family tax bill would need to increase by 36 percent, or $1,057, in one year; in comparison, the average tax bill rose by only 12 percent between fiscal 2006 and fiscal 2011. Fitchburg's single family homeowners would see their property taxes rise by $591 to meet the ARC—a single year increase of 21 percent that is one-and-a-half times the total five-year increase in the average property tax bill between fiscal 2006 and fiscal 2011.

Table 6
Increases in Property Taxes to Fund Retiree Health Care vs. Total Increases in Average Single Family Property Tax Bill Since 2006

Municipality	Increase in Average Single Family Tax Bill to Meet ARC	Total Increase in Average Single Family Tax Bill, FY 2006 to FY 2011
Brockton	36%	12%
Fitchburg	21%	15%
Haverhill	6%	16%
Holyoke	27%	22%
Lawrence	50%	23%
Lowell	22%	22%
New Bedford	23%	18%
Pittsfield	13%	19%
Springfield	11%	18%
Worcester	15%	15%

Impact on Business Taxpayers

Because businesses pay a disproportionate share of taxes relative to their property values in these 10 cities, they would also bear a disproportionate share of the retiree health care liability. Businesses across the 10 communities would on average see a huge 20 percent property tax increase, large enough to force many employers with already tight margins to lay off employees and in some instances to go out of business.

As Table 7 shows, under the state's system of tax classification for commercial, industrial, and personal properties, the average business tax rate ($30.34 per $1,000 of assessed value) is almost double the average residential tax rate ($15.25) for the 10 cities as a whole. In Holyoke, Lawrence, Lowell, New Bedford, Pittsfield, and Worcester, local employers pay a tax rate that is more than twice the rate paid by residential property owners. Across the 10 cities, businesses are shouldering an average of approximately 35 percent of the total tax burden despite owning an average of only 21.5 percent of the total assessed value of all properties.

Table 7
Business and Residential Shares of the Tax Levy and Tax Rates (FY 2011)

Municipality	Business Property Taxes as % of Total Property Tax Levy	Business Properties as % of Total Assessed Value	Business Shift*	Tax Rate per $1,000 of Assessed Value	
				Residential	Business
Brockton	34.6%	21.5%	1.61	15.29	29.55
Fitchburg	25.0%	20.0%	1.25	16.20	21.60
Haverhill	25.4%	16.9%	1.50	13.93	23.27
Holyoke	49.6%	29.5%	1.68	15.78	37.08
Lawrence	40.5%	23.2%	1.75	13.45	30.41
Lowell	30.8%	17.6%	1.75	14.27	29.73
New Bedford	32.2%	18.4%	1.75	12.88	27.14
Pittsfield	35.3%	21.1%	1.67	15.19	30.95
Springfield	39.6%	24.7%	1.60	19.49	38.97
Worcester	37.5%	21.8%	1.72	16.06	34.65
10 City Average	**35.1%**	**21.5%**	**1.63**	**15.25**	**30.34**

**Under the tax classification system for these 10 cities, the business tax rate (commercial, industrial, and personal property) can be up to 75 percent greater than what the rate would be if a municipality had a single, uniform tax rate applied to all properties. The residential and open space tax rate must be at least 50 percent of such a uniform rate.*

Because businesses pay 35 percent of the total property tax levy in these 10 cities, they are responsible for a commensurate 35 percent share of the retiree health care liability. As detailed in Table 8, the business portion of the unfunded liability in these cities is approximately $1.6 billion of the total unfunded liability of $4.5 billion.

At the high end, Holyoke businesses are responsible for 50 percent of the city's liability; Lawrence and Springfield businesses support about 40 percent; and Fitchburg and Haverhill businesses are at the low end at 25 percent.

Table 9 (page 12) depicts the enormous impact that funding this liability would have on business taxpayers—a nearly $70 million, or 20 percent, increase over the fiscal 2011 levy that would be in place each year for 30 years. Six communities would need to boost business taxes by more than 20 percent, and only Haverhill would see a single-digit percentage increase.

Lawrence businesses would experience the most severe property tax jump of 50 percent, raising the city's business levy by $10.1 million to a total of $30.2 million. Brockton would require an additional $12.8 million from its business community, a 36 percent property tax hike that would bring business' total tax bill to $48.6 million. Worcester would need to increase its business taxes by 15 percent, adding $12.1 million to the fiscal 2011 levy of $82 million.

Table 8
Business Share of Unfunded Retiree Health Care Liability
(thousands of dollars)

Municipality	Unfunded Retiree Health Care Liability	Business Share of Total Property Tax Levy	Business Share of Unfunded Liability
Brockton	$693,570	35%	$240,122
Fitchburg	186,634	25%	46,581
Haverhill	299,042	25%	75,935
Holyoke	300,166	50%	148,928
Lawrence	323,977	41%	131,295
Lowell	432,752	31%	133,103
New Bedford	478,609	32%	154,311
Pittsfield	236,149	35%	83,303
Springfield	761,576	40%	301,913
Worcester	765,312	37%	286,931
Total	**$4,477,786**	**N/A**	**$1,602,422**

Table 9
Increase in Business Property Taxes to Fund Retiree Health Care
(thousands of dollars)

Municipality	ARC Shortfall (A)	Business Share of Shortfall (B)	Total Business Property Tax Levy, FY 2011 (C)	Percent Increase in Business Tax Levy (D)
Brockton	$36,983	$12,804	$35,776	36%
Fitchburg	8,243	2,057	9,811	21%
Haverhill	4,947	1,256	20,546	6%
Holyoke	13,015	6,458	23,728	27%
Lawrence	25,011	10,136	20,101	50%
Lowell	23,261	7,154	32,132	22%
New Bedford	21,352	6,884	30,036	23%
Pittsfield	7,975	2,813	22,479	13%
Springfield	18,551	7,354	66,000	11%
Worcester	32,362	12,133	81,832	15%
Total	**$191,699**	**$69,050**	**$342,440**	**20%**

These 10 cities typically have trailed the state as a whole during periods of economic growth and suffered more acutely in economic downturns. As Table 10 summarizes, these cities all have unemployment rates higher than the non-seasonally adjusted statewide rate of 6.4 percent. Lawrence, New Bedford, and Springfield have rates in the double digits, while Brockton, Fitchburg, Holyoke, and Lowell have rates that are a third to 50 percent above the statewide average.

The unemployment trends also contribute to higher-than-average poverty levels in these cities. Holyoke, Lawrence, New Bedford, and Springfield have poverty rates for individuals that are approximately double the state's rate of 11.4 percent, while Brockton, Fitchburg, Lowell, Pittsfield, and Worcester are approximately 50 percent greater than the statewide rate. Among families, Holyoke and Lawrence have poverty rates that are approximately triple the state's rate of 8.2 percent, while six other communities have family poverty rates that are at least 50 percent greater than the state's level.

Table 10
Unemployment and Poverty Levels

Municipality	Unemploy-ment Rate Nov. 2011	Individuals Below Poverty Line	Families Below Poverty Line
Brockton	8.8%	16.1%	12.8%
Fitchburg	9.8%	20.4%	15.0%
Haverhill	7.3%	11.9%	8.4%
Holyoke	9.6%	29.3%	26.2%
Lawrence	14.4%	27.3%	24.6%
Lowell	8.7%	17.2%	14.5%
New Bedford	11.7%	22.5%	19.8%
Pittsfield	7.0%	16.2%	11.7%
Springfield	10.4%	26.9%	22.0%
Worcester	7.7%	18.1%	14.3%
Statewide	***6.4%***	***11.4%***	***8.2%***

**The unemployment data is from the state Executive Office of Labor and Workforce Development (EOLWD) and not seasonally adjusted. The statewide seasonally adjusted unemployment rate is 7.0 percent. Poverty data is from the U.S. Census Bureau's 2008-2010 American Community Survey.*

The magnitude of the property tax increases needed to fund retiree health care liabilities would be a huge blow to the businesses and economies of these cities. The vast majority of these businesses are undoubtedly operating with tight margins so the property tax increases would inevitably lead to layoffs or the cancelation of expansion plans. Some fraction of these businesses would have no option but to close.

Conclusion

The enormous property tax increases needed to fund retiree health care liabilities demonstrate the magnitude of the problem facing cities and towns over the next decade and beyond. It is unrealistic to expect that taxpayers should or would bear this burden, and it is equally unrealistic to expect that these cities would decimate basic services like schools and public safety to pay for these benefits.

Simply put, cities and towns can no longer afford to provide retiree health care benefits in their current form. Implementing the recently enacted municipal health care reform is an important step to reduce these liabilities, but the obligations are so enormous that the Legislature needs to address the issue directly by adopting the kinds of recommendations put forward in this report.

Even with these changes, municipal retirees would still enjoy a level of health care benefits that has almost totally disappeared for virtually all other retirees in the Commonwealth. Delaying the inevitable will simply require more drastic cuts in benefits at a later date.

Recommendations

It is urgent that municipalities and the Legislature take steps to rein in these huge and growing liabilities. Delay will only require more difficult and sweeping action later.

There is a serious question whether many communities can afford to continue to provide any sort of retiree health care, particularly in combination with their pension obligations and the costs of employee health care. At a minimum, the extraordinarily generous retiree benefits must be scaled back, and the sooner communities act the more likely they will be able to preserve some form of those benefits.

This report makes a series of recommendations to address this problem. While municipalities have some flexibility to implement changes, several of the key reforms require legislative action. Because of the severity of the problem, the changes in benefits need to apply to current employees, and in some cases to current retirees, rather than only for new hires as in the case of pension changes. It is important to emphasize that even if all the recommendations were adopted, municipalities would still be providing their retirees with far more generous health benefits than all but a tiny fraction of Massachusetts employers.

Implement Municipal Health Reform

Municipal health reform is a huge and immediate opportunity for municipalities to reduce both current health care costs and long-term retiree health care liabilities. By implementing the health plan changes now permitted under state law, municipalities can lower the cost of retiree premiums and slow the rate of growth of these premiums, which will reduce municipalities' long-term retiree health care liabilities and annual required contributions.

Tie Benefits to Years of Service and Raise the Minimum Service for Eligibility

Instead of allowing all retirees to be eligible for full retiree health care benefits after just 10 years of service, the Foundation recommends that these benefits be tied to length of service, as is the case with pensions. For example, employees could receive the municipality's maximum premium contribution of 75 percent at 35 years of service, with the contribution reduced proportionately for shorter tenures.

At the same time, the Legislature should consider raising the minimum length of service required to be eligible for these benefits from 10 years to 15 or even 20 years.

Raise the Eligibility Age for Retiree Health Care

The Foundation recommends that the eligibility age for retiree health care benefits be raised from 55 to 60, consistent with the recent reforms to the pension system. However, because the enormous retiree health care liabilities reflect what municipalities already owe—and do not account for new hires—this change must apply to current employees as well as new hires.

Currently, municipalities begin providing retiree health care benefits as early as age 55—ten years before they are eligible for Medicare. As a result, these retirees are enrolled in the same health plans as active employees with premiums that are significantly higher than Medicare premiums. Raising the eligibility age reduces the length of time for which a municipality would have to pay pre-Medicare premiums and be responsible for the overlapping health care costs of both the retiree and the retiree's replacement.

Increase Eligibility Hours and Prorate Benefits for Part-Time Employees

Under state law employees must work only 20 hours per week to be eligible for retiree health care. Thus, an employee who works 20 hours per week for 10 years is entitled to the same retiree health benefit as an employee who works 40 hours per week for 35 years.

The Foundation recommends that the eligibility for retiree health benefits be raised to 1,400 hours or approximately 27 hours per week for part-time employees. In addition, the benefit should be tied to the number of hours an employee works. For example, an employee working three-fourths of a full-time schedule would be entitled to 75 percent of the benefits of a full-time employee with the same years of service.

End Spousal/Dependent Coverage

Providing spousal/dependent coverage to retirees is an expensive obligation and is unusually generous even among the dwindling ranks of employers still offering retiree health care. The Foundation recommends eliminating spousal/dependent coverage for all future retirees who are eligible for health benefits.

Costs for spousal/dependent coverage are at least twice as much as individual coverage. For example, in Haverhill's least expensive plan, the city pays approximately $15,800, or over $9,900 more, for an early retiree who elects family coverage instead of individual coverage. For supplemental Medicare plans, the city pays twice as much for retiree-plus-spouse coverage as it does for retiree-only coverage.

Reduce Municipal Share of Premium Contributions

Municipalities currently contributing more than 50 percent towards retiree health care premiums can reduce their contributions without requiring legislative action. However, for communities that adopt the new municipal health care law, there is a three-year moratorium on reducing the community's contribution for retiree premiums.

Municipalities, particularly those that contribute at the higher end, should revisit their contribution rates at the end of the moratorium required by the municipal health care law. For those municipalities that do not adopt the law, they should consider reducing their premium contributions sooner.