Retiree Health Care: 
*The Brick That Broke Municipalities’ Backs*

FEBRUARY 2011

MTF
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MASSACHUSETTS TAXPAYERS FOUNDATION

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We would like to recognize MTF Policy Analyst Carolyn Ryan as the principal author of this report.
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Retiree Health Care: The Brick That Broke Municipalities’ Backs

Taxpayers have long understood government pension liabilities and the impact on local budgets, but government obligations for other post-employment benefits provided to employees (OPEB), namely retiree health insurance, have only recently started to receive similar attention. New reporting requirements force governments to disclose their OPEB liabilities, and the numbers show that retiree health benefits are no longer the marginal annual budget items they were when initially offered to employees. Instead, the rapid acceleration of health care costs combined with overly generous benefits have created staggering OPEB liabilities which exceed unfunded pension liabilities in almost all Massachusetts communities. Without action, these OPEB liabilities will continue to escalate with enormous consequences for cities and towns.

While a handful of Massachusetts communities have begun to fund their OPEB liabilities with modest contributions, the aggregate liability is more than 99 percent unfunded. Enormous OPEB liabilities, combined with existing pension obligations, threaten the long-term stability of local government finances and are already crippling municipalities’ ability to provide basic services, including public education.

What is OPEB?
The term OPEB refers to all benefits, other than pensions, that retirees receive. For public employees in Massachusetts, OPEB largely consists of retiree health insurance but also includes life insurance. As with pension benefits, employees are entitled to these benefits after meeting certain eligibility requirements, such as a vesting period and minimum retirement age.

The increased focus on government OPEB obligations comes partly as a result of requirements issued by the Governmental Accounting and Standards Board (GASB) in June 2004. Referred to as GASB 45, these standards require all government entities to report their annual OPEB obligations, unfunded liabilities, and various assumptions in annual financial statements. GASB 45 brought governments in line with private sector reporting requirements that have existed for 20 years.

Under GASB 45, governments must disclose the present value of their incurred OPEB costs for both current retirees and active employees already eligible for benefits. The liability defines how much the governments need to set aside today in order to continue to provide these benefits over time, based on a variety of assumptions. Such reporting also helps to gauge the true cost of employee compensation by forcing governments to quantify the present value of a future retirement benefit, even though an employee may not receive that benefit for many years.

Like the earlier pension statements issued by GASB, Statement 45 outlines technical and reporting requirements but does not set policies for governments to address liabilities. As a technical rulemaking board, this is typical for GASB. Although there is no requirement to pre-fund these liabilities, those governments that choose pay-as-you-go over pre-funding place a heavier burden on future taxpayers.

GASB 45 included a three-year phase-in of reporting requirements, with the largest governments being the first to implement the policy. Fiscal year 2009 was the first in which all 351 Massachusetts communities were required to disclose OPEB liabilities.

OPEB has historically received less attention than public sector pensions and employee health insurance, but it is an...
important component of employee costs. Although GASB 45 forced disclosure, the
total liabilities remain a buried note at the back of financial statements. In theory,
OPEB data should be readily available, but in reality it is often difficult to find.
Decentralized reporting and the lack of funding requirements lead to haphazard
availability of local government OPEB data.

To fill the void and provide a clearer picture
of the impact on taxpayers, the Taxpayers
Foundation researched and analyzed data
from the 50 largest communities in the state,
based on population, providing the first
broad look at municipal OPEB liabilities in
Massachusetts.

Huge Liabilities
The total OPEB liability for the top 50
communities is a breathtaking $20 billion—
nearly $5 billion larger than earlier estimates
of the total liability for all 351 communities
in the state.¹ The OPEB liability for the
remaining 300 communities, plus regional
school districts, will likely add at least $5 to
$10 billion to this burden. The retiree health
care problem threatens to wreak havoc with
local government budgets, and no individual
community is immune. Governments
already owe this, and the liability is rising
every year.

Retiree health care liabilities² are driven by
several factors which can vary from
community to community. Table 1 and
Appendix A provide details on the liabilities
for all 50 municipalities, which range from
$59 million in Dartmouth to more than $4.5
billion in Boston. Each community
calculates its own liability and chooses its
own assumptions for investment
performance and health care cost growth. 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.

The $20 Billion Liability

Table 1 shows a total liability of approximately
$18 billion, but we use a $20 billion liability
throughout this report for several reasons:

- Two communities did not have any data
  available. Based on liabilities in similar
  communities, we estimate that the
  liabilities in Fall River and Woburn
  would add $500 to $750 million to the
  aggregate liability.

- GASB guidelines require that entities
  relying on pay-as-you-go use a short-
term interest rate assumption, but
  Weymouth and Lynn use an 8 percent
  return assumption. If these communities
  had followed GASB guidelines, we
  estimate it would add $500 to $650
  million to the aggregate liability.

- Many communities are relying on old
data to report their liabilities. For 34
  communities, the most recent actuarial
valuations were conducted prior to 2009.
  In most cases, unfunded liabilities will
  have grown because of communities’
  failure to begin to address the problem.

¹ Two of the top 50 communities, Fall River and
Woburn, do not have any OPEB data available
despite the requirement to do so. As discussed later,
this liability is almost totally unfunded.
² Since OPEB is almost entirely retiree health care,
we use the two terms interchangeably.
Table 1
Municipal OPEB and Pension Liabilities (in thousands)

<table>
<thead>
<tr>
<th>Pop. Rank</th>
<th>Municipality</th>
<th>OPEB Liability</th>
<th>Pension Liability</th>
<th>OPEB + Pension Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Unfunded</td>
<td>Unfunded</td>
<td>Unfunded Liability</td>
</tr>
<tr>
<td>1</td>
<td>Boston</td>
<td>4,553,816</td>
<td>2,920,165</td>
<td>7,473,981</td>
</tr>
<tr>
<td>2</td>
<td>Worcester*</td>
<td>765,312</td>
<td>297,675</td>
<td>1,062,987</td>
</tr>
<tr>
<td>3</td>
<td>Springfield</td>
<td>761,576</td>
<td>402,504</td>
<td>1,164,080</td>
</tr>
<tr>
<td>4</td>
<td>Cambridge</td>
<td>598,995</td>
<td>67,004</td>
<td>665,999</td>
</tr>
<tr>
<td>5</td>
<td>Lowell</td>
<td>432,752</td>
<td>150,668</td>
<td>583,419</td>
</tr>
<tr>
<td>6</td>
<td>Brockton</td>
<td>635,224</td>
<td>32,623</td>
<td>667,847</td>
</tr>
<tr>
<td>7</td>
<td>New Bedford</td>
<td>478,609</td>
<td>319,667</td>
<td>798,276</td>
</tr>
<tr>
<td>8</td>
<td>Quincy</td>
<td>435,548</td>
<td>165,187</td>
<td>600,735</td>
</tr>
<tr>
<td>9</td>
<td>Fall River</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>10</td>
<td>Lynn</td>
<td>450,682</td>
<td>214,078</td>
<td>664,760</td>
</tr>
<tr>
<td>11</td>
<td>Newton</td>
<td>531,675</td>
<td>137,886</td>
<td>669,561</td>
</tr>
<tr>
<td>12</td>
<td>Somerville</td>
<td>570,929</td>
<td>96,631</td>
<td>667,559</td>
</tr>
<tr>
<td>13</td>
<td>Lawrence</td>
<td>323,977</td>
<td>146,233</td>
<td>470,210</td>
</tr>
<tr>
<td>14</td>
<td>Framingham</td>
<td>389,843</td>
<td>64,895</td>
<td>454,738</td>
</tr>
<tr>
<td>15</td>
<td>Haverhill</td>
<td>299,042</td>
<td>138,230</td>
<td>437,272</td>
</tr>
<tr>
<td>16</td>
<td>Waltham</td>
<td>517,000</td>
<td>89,420</td>
<td>606,420</td>
</tr>
<tr>
<td>17</td>
<td>Plymouth</td>
<td>264,991</td>
<td>44,547</td>
<td>319,538</td>
</tr>
<tr>
<td>18</td>
<td>Brookline</td>
<td>323,000</td>
<td>108,623</td>
<td>431,623</td>
</tr>
<tr>
<td>19</td>
<td>Malden</td>
<td>164,766</td>
<td>57,893</td>
<td>222,659</td>
</tr>
<tr>
<td>20</td>
<td>Chicopee</td>
<td>165,267</td>
<td>94,628</td>
<td>259,895</td>
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<tr>
<td>21</td>
<td>Taunton</td>
<td>335,113</td>
<td>89,769</td>
<td>424,883</td>
</tr>
<tr>
<td>22</td>
<td>Medford</td>
<td>247,639</td>
<td>66,794</td>
<td>314,433</td>
</tr>
<tr>
<td>23</td>
<td>Weymouth</td>
<td>131,756</td>
<td>53,587</td>
<td>185,343</td>
</tr>
<tr>
<td>24</td>
<td>Peabody</td>
<td>419,806</td>
<td>78,341</td>
<td>498,146</td>
</tr>
<tr>
<td>25</td>
<td>Revere</td>
<td>160,287</td>
<td>66,438</td>
<td>226,725</td>
</tr>
<tr>
<td>26</td>
<td>Barnstable</td>
<td>159,322</td>
<td>54,693</td>
<td>214,015</td>
</tr>
<tr>
<td>27</td>
<td>Methuen</td>
<td>209,816</td>
<td>67,016</td>
<td>276,833</td>
</tr>
<tr>
<td>28</td>
<td>Attleboro</td>
<td>274,301</td>
<td>29,194</td>
<td>303,495</td>
</tr>
<tr>
<td>29</td>
<td>Pittsfield</td>
<td>224,749</td>
<td>105,976</td>
<td>330,725</td>
</tr>
<tr>
<td>30</td>
<td>Leominster</td>
<td>154,772</td>
<td>19,511</td>
<td>174,283</td>
</tr>
<tr>
<td>31</td>
<td>Fitchburg</td>
<td>177,764</td>
<td>75,856</td>
<td>253,620</td>
</tr>
<tr>
<td>32</td>
<td>Westfield</td>
<td>178,430</td>
<td>70,609</td>
<td>249,039</td>
</tr>
<tr>
<td>33</td>
<td>Arlington</td>
<td>139,440</td>
<td>47,385</td>
<td>186,825</td>
</tr>
<tr>
<td>34</td>
<td>Salem</td>
<td>159,946</td>
<td>79,394</td>
<td>239,339</td>
</tr>
<tr>
<td>35</td>
<td>Holyoke</td>
<td>300,166</td>
<td>90,362</td>
<td>390,528</td>
</tr>
<tr>
<td>36</td>
<td>Billerica</td>
<td>233,836</td>
<td>73,500</td>
<td>307,336</td>
</tr>
<tr>
<td>37</td>
<td>Beverly</td>
<td>209,173</td>
<td>56,430</td>
<td>265,603</td>
</tr>
<tr>
<td>38</td>
<td>Woburn</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>39</td>
<td>Marlborough</td>
<td>111,574</td>
<td>56,153</td>
<td>167,727</td>
</tr>
<tr>
<td>40</td>
<td>Everett</td>
<td>137,107</td>
<td>99,111</td>
<td>236,218</td>
</tr>
<tr>
<td>41</td>
<td>Chelsea</td>
<td>184,806</td>
<td>68,366</td>
<td>253,172</td>
</tr>
<tr>
<td>42</td>
<td>Amherst</td>
<td>68,990</td>
<td>**</td>
<td>N/A</td>
</tr>
<tr>
<td>43</td>
<td>Braintree</td>
<td>158,006</td>
<td>47,920</td>
<td>205,926</td>
</tr>
<tr>
<td>44</td>
<td>Dartmouth</td>
<td>59,273</td>
<td>36,744</td>
<td>96,017</td>
</tr>
<tr>
<td>45</td>
<td>Chelmsford</td>
<td>162,400</td>
<td>52,175</td>
<td>214,575</td>
</tr>
<tr>
<td>46</td>
<td>Shrewsbury</td>
<td>85,122</td>
<td>19,592</td>
<td>104,714</td>
</tr>
<tr>
<td>47</td>
<td>Andover</td>
<td>245,108</td>
<td>36,946</td>
<td>282,054</td>
</tr>
<tr>
<td>48</td>
<td>Watertown</td>
<td>118,381</td>
<td>43,511</td>
<td>161,892</td>
</tr>
<tr>
<td>49</td>
<td>Falmouth</td>
<td>108,886</td>
<td>40,786</td>
<td>149,672</td>
</tr>
<tr>
<td>50</td>
<td>Natick</td>
<td>111,744</td>
<td>40,383</td>
<td>152,127</td>
</tr>
</tbody>
</table>

| Total     | 17,930,716    | 7,225,337      | 18,669,656        | 25,087,064          |

* Worcester also has approximately $168 million in outstanding pension obligation bonds.
** The Foundation does not have complete data for the communities in regional pension plans.
Just how big is this burden? For these 50 communities, the unfunded liability is two-and-a-half times larger than the total unfunded pension liability. Every community has a larger unfunded OPEB liability than unfunded pension liability. In Peabody, for example, the unfunded OPEB liability is more than five times larger than its unfunded pension liability.

This trend is particularly troubling among communities that are already suffering from large unfunded pension obligations. Lynn, Chelsea, and Pittsfield all have pension systems that are less than 50 percent funded and have unfunded OPEB liabilities that are more than twice as much as their unfunded pension liabilities. In more than half of the 50 communities, excluding those in regional pension plans, the total OPEB liability is greater than the total pension liability. Attleboro, Peabody, Waltham, and Somerville each has a total OPEB liability that is more than double its total pension liability.

With pension obligations already weighing down municipal budgets, communities cannot realistically expect to satisfy both their retiree health care and pension liabilities. If municipalities continue business as usual with retiree health care, many can expect to be paying more to provide a year of retiree health benefits than the average retiree receives in pension benefits. Once a supplemental benefit, retiree health care is becoming the most costly aspect of retirement compensation.

As breathtaking as these liabilities are, they almost certainly are understated because most of the communities have used artificially low assumptions about the growth of health care costs in liability calculations. All but five of the 50 municipalities assume that health cost growth will drop to five percent annually, most commonly within five years, which seems highly unlikely. As shown in Table 2 and Appendix B, this does not reflect actual experiences over the last decade.

### Table 2
Cost Growth Assumptions versus Actual Health Insurance Expenditures

<table>
<thead>
<tr>
<th>Municipality</th>
<th>Assumed Long-Term Growth (%)</th>
<th>Average Annual Growth Since 2001 (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Methuen</td>
<td>5.0</td>
<td>12.7</td>
</tr>
<tr>
<td>Brookline</td>
<td>5.0</td>
<td>11.6</td>
</tr>
<tr>
<td>Framingham</td>
<td>5.0</td>
<td>11.1</td>
</tr>
<tr>
<td>Medford</td>
<td>5.0</td>
<td>10.1</td>
</tr>
<tr>
<td>Marlborough</td>
<td>5.0</td>
<td>9.8</td>
</tr>
<tr>
<td>Everett</td>
<td>5.0</td>
<td>8.2</td>
</tr>
</tbody>
</table>

**Annual Obligations**

The annual costs to tackle OPEB liabilities are daunting. To pay for this $20 billion liability over the next 30 years would require an annual contribution (ARC) of at least $1.2 billion for just these 50 cities and towns, compared to the $500 million they currently spend on a pay-as-you-go basis.4

The $1.2 billion 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

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3 As reported to the Massachusetts Department of Revenue.
4 Excludes Fall River and Woburn.
OPEB obligations payable in the future that were incurred for active employees during that year.

Municipalities have two ways to fund liabilities: pay-as-you-go or paying the ARC. All 50 communities currently fund OPEB on a pay-as-you-go basis and calculate the ARC mainly to comply with GASB 45. However, every year that a community does not meet its ARC, it defers that obligation to the future and increases its unfunded liability. With current pay-as-you-go funding at $500 million and the ARC at $1.2 billion, these 50 communities face two paths that both lead to the same disastrous result.

By deferring $700 million in contributions each year, municipalities lose the income they would have earned on that money, which adds to their obligation. That lost interest compounds every year they continue to defer payment and builds dramatically over time.

Based on a four percent rate of return, these municipalities lose $28 million of interest earnings by not paying the $700 million for one year. By deferring the $700 million each year for five years, the municipalities would sacrifice more than $400 million in interest income. Skipping the $700 million payment each year for 30 years would lead to an astonishing $19.8 billion in lost interest income (Appendix C).

Of the 50 communities, only Arlington has designated a special OPEB trust, which holds $2.9 million or about two percent of the town’s total liability. A handful of other communities have made small contributions to special funds for OPEB, but those contributions were not placed into irrevocable trusts at the time of their most recent valuations. With such an enormous and growing gap between current payments and the ARC, these communities have no way to meet the ARC now or in the future.

On the other hand, if municipalities continue pay-as-you-go funding, the liabilities do not disappear and paying for annual costs will become more and more unmanageable. Health care costs will continue to grow and consume an ever larger share of limited revenues. While municipalities 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.

Whether communities choose the path of pre-funding or pay-as-you-go, retiree health care costs are simply unaffordable. Employee benefits have already eroded local budgets and forced cuts to basic services—and municipalities have not even begun to fund OPEB liabilities. This hemorrhaging will intensify as the soaring costs of retiree health care and other employee benefits force more severe cuts than municipalities have already implemented.

The Legislature and municipalities face a clear and critical choice: cut back retiree health care benefits to an affordable and sustainable level or see cities and towns sink farther and farther into debt while decimating local services.

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5 The median assumed rate of return in actuarial valuations for the top 50 communities is four percent.

6 GASB requires that contributions be irrevocable and placed in a specially designated trust that is protected from creditors. Since these communities did not establish irrevocable trusts—and therefore funds could be tapped for other purposes at any time—these assets are not counted in actuarial valuations. Boston and Brookline established irrevocable trusts after their most recent valuations.
Table 3
Increase in Average Single Family Tax Bills to Meet OPEB Obligations
Communities with increases over 50 percent

<table>
<thead>
<tr>
<th>City/Town</th>
<th>Average Single Family Tax Bill (FY10)</th>
<th>Increase Needed, per Single Family Parcel</th>
<th>Tax Bill Increase</th>
<th>Total 30-yr Payment, Average Single Family Homeowner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lawrence</td>
<td>2,374</td>
<td>6,053</td>
<td>255%</td>
<td>181,604</td>
</tr>
<tr>
<td>Boston</td>
<td>2,762*</td>
<td>3,261</td>
<td>118%</td>
<td>97,827</td>
</tr>
<tr>
<td>Holyoke</td>
<td>2,764</td>
<td>2,433</td>
<td>88%</td>
<td>72,989</td>
</tr>
<tr>
<td>Attleboro</td>
<td>3,153</td>
<td>2,614</td>
<td>83%</td>
<td>78,434</td>
</tr>
<tr>
<td>Brockton</td>
<td>2,713</td>
<td>1,858</td>
<td>68%</td>
<td>55,740</td>
</tr>
<tr>
<td>Worcester</td>
<td>3,129</td>
<td>2,049</td>
<td>65%</td>
<td>61,478</td>
</tr>
<tr>
<td>Lowell</td>
<td>3,072</td>
<td>1,971</td>
<td>64%</td>
<td>59,118</td>
</tr>
<tr>
<td>Taunton</td>
<td>2,612</td>
<td>1,571</td>
<td>60%</td>
<td>47,135</td>
</tr>
<tr>
<td>Revere</td>
<td>3,347</td>
<td>1,964</td>
<td>59%</td>
<td>58,933</td>
</tr>
<tr>
<td>New Bedford</td>
<td>2,838</td>
<td>1,577</td>
<td>56%</td>
<td>47,308</td>
</tr>
</tbody>
</table>

*Boston’s average family tax bill is for FY 2009 and includes the residential exemption.

Overwhelming Burden on Taxpayers

Another way of understanding these massive liabilities is to measure the potential impact on taxpayers, and the burden would be overwhelming.7

As shown in Table 3 and Appendix D, 10 communities would need to increase the average single family tax bill by more than 50 percent and maintain that increase for 30 years to pay for the full ARC. Lawrence homeowners would see an astonishing 255 percent increase and Boston a 118 percent increase in their bills.

In 29 of the 40 communities, tax bills would need to jump by 20 percent or more to pay the ARC. Even at the lowest end, Falmouth homeowners would see an 8 percent increase in property taxes.

Over 30 years, the average single family homeowner in Boston would pay nearly $100,000 in additional taxes to meet the city’s annual OPEB obligations. In eight other communities—Worcester, Lowell, Brockton, Newton, Lawrence, Revere, Attleboro, and Holyoke—the average homeowner would pay more than $50,000 in additional taxes over 30 years.8

It is absolutely inconceivable that taxpayers would, or should, be asked to pay such extraordinary and unaffordable amounts—yet that is the obligation on the backs of taxpayers if the benefits are not changed.

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7 The Foundation used the Department of Revenue’s data on residential parcels and tax bills to analyze the implications of paying the full ARC for taxpayers in 40 of the 50 communities. Residential tax bill data was not available for Barnstable, Brookline, Chelsea, Everett, Malden, Marlborough, Somerville, and Watertown, in addition to Fall River and Woburn.

8 Municipalities increase the amortization portion of their ARC each year (usually by 4.5 percent), but the Foundation assumed the entire ARC remained level for 30 years because several communities do not provide details of the amortization portion. As a result, the total 30-year payments may be low estimates for some communities.
A Disappearing Benefit
Massachusetts municipalities already stand apart from the great majority of employers by offering retiree health care at all, but the richness of benefits—extraordinary plans, substantial employer contributions, and low eligibility barriers—places them among the most generous employers in the nation.

In the private sector, retiree health care is rapidly becoming a thing of the past. Only 28 percent of private sector employers with at least 500 employees offered health care benefits to early retirees in 2009, down from 46 percent in 1993, while just 21 percent of these employers provided supplemental health care coverage for Medicare-eligible retirees compared to 40 percent in 1993.9 These percentages include employers that require retirees to pay the full premium cost, so an even smaller fraction actually contribute anything to the cost of premiums.10

In Massachusetts, employer-provided retiree health care is also a rarity. According to the state’s 2009 survey, only 9.6 percent of all employers offered early retiree health care. Slightly more—12 percent of all employers—provided supplemental coverage to Medicare-eligible retirees. A survey by Associated Industries of Massachusetts (AIM) found similar results: in 2010, only eight percent of employers offered retiree health care coverage. These numbers also include employers that do not contribute anything to the cost of premiums.

Even in the public sector, retiree health care is more the exception than the rule. According to a national survey by Cobalt Community Research, just 28 percent of local governments provided retiree health care in 2010.11 The Department of Health and Human Services found similar results in a 2009 national survey—36.4 percent of state and local governments offered health care to early retirees and 25.4 percent offered supplemental health care to retirees 65 and older. As with the private sector data, these numbers include governments that do not contribute anything to the cost of premiums.

The 100 largest government entities in Oregon have a total OPEB liability of only $3 billion. That includes Oregon state government, which reduced its already modest retiree health care subsidy for new hires in 2003. Among local governments in the U.S., Boston has the fourth largest unfunded OPEB liability, behind only New York City, Los Angeles County, and Detroit.12

Several factors explain the extraordinarily large municipal liabilities in Massachusetts. The state’s cities and towns offer exceedingly generous health benefits, including such relics as $5 co-pays and no deductibles. Many municipal retirees are not required to enroll in Medicare, leaving municipalities to pay for the more expensive non-Medicare plans. Finally, the eligibility

---

10 Employers who provide only access to employer health care, and make no contribution, still have a liability if retirees are included in the same health plan(s) as active employees. Using a single rate for both retirees and actives results in retiree premiums lower than they would otherwise be in a retiree-only plan, and active employee premiums are slightly higher than if retirees were excluded. This is known as the implicit rate subsidy.

requirements for retiree health care have few restrictions.

As a rule, municipal health plans in Massachusetts are significantly richer than plans offered by other employers, including the state and federal governments.\textsuperscript{13} While these other employers have responded to the reality of escalating health care costs, municipalities have lagged in adjusting plan benefits because all changes are subject to collective bargaining. Retirees are included in these same expensive plans with the same generous benefits. And, unlike other public and private entities, Massachusetts municipalities have no dollar cap on their contribution for retiree health care.

Adding to the problem, thousands of Medicare-eligible retirees are not enrolled in Medicare, even though the municipality and employee have already paid for it.

Municipalities also have eligibility requirements that are remarkably expansive. Between current retirees and active employees already eligible for benefits, these 50 municipalities must provide lifetime health care to 150,000 people.

- After only 10 years of service, employees are entitled to lifetime health care benefits upon retirement. By contrast, the pension system tailors benefits to years of service so an individual who works for 30 years receives a much greater benefit than one with 10 years of service.

- Retirees are eligible for health care benefits as early as age 55, 10 years before they qualify for Medicare.

- The state mandates that municipal employees must work only 20 hours per week to be eligible for the same benefits as full-time employees. Such part-time employees also need to have only 10 years of service to receive retiree benefits, so a part-time employee must work the equivalent of only five years of full-time service to obtain lifetime retiree health care benefits.

- State law requires that retiree health benefits include spouse and dependent coverage which costs more than twice as much as individual coverage. At local option, spouses retain lifetime coverage upon the death of a retiree.

\textsuperscript{13} The Foundation will be releasing a study which compares the benefits offered by a sample of municipal plans with other public and private sector plans.
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 escalating 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.

Unfortunately, communities have limited flexibility to address this problem since so many of the benefits are mandated by state law. Nevertheless, cities and towns have some opportunities to make changes on their own, which they should seize.

This report makes a series of recommendations to address this problem, divided into those that require legislative action and those that municipalities can implement under current law.

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.

Legislative Recommendations

Provide Local Officials the Authority to Adjust Plan Design

One of the most important steps to control the costs of municipal health care for both employees and retirees is to give local officials the authority to change plan design outside of collective bargaining. Unlike the state and private sector employers, municipal officials’ hands are tied by having to go through collective bargaining to make even minor plan changes. The result is overly rich plans, and since retirees are enrolled in the same health plans as active employees, this also drives up OPEB liabilities. Making modest changes, but still keeping benefits at least on par with the state’s Group Insurance Commission, would have the dual impact of immediate and large savings in operating budgets while taking a significant bite out of OPEB liabilities.

Contribute Set Dollar Amounts and Cap Municipal Contributions

A key strategy for communities to control their OPEB liabilities, which would require legislative action, would be to contribute a set dollar amount toward premiums and to place a cap on their contributions. Municipalities currently tie their contributions to a percentage of a plan’s cost with a minimum 50 percent required by state law. The dollar approach would reduce liabilities by helping to protect the municipality from the relentless growth in health care costs and encourage retirees to choose less expensive health care plans. For example, Gainesville, Florida switched from percentage to dollar contributions in 2009 and reduced its liability by 12 percent.15

14 Retiree health care benefits do not have the same legal protections as pensions.

Massachusetts municipalities are not permitted to cap their benefits, but contribution limits are prevalent in both the private and public sectors. For example, a local Fortune 100 company—one of the few private employers still providing retiree health care—caps its contribution at 100 percent of 2005 costs. Colorado caps its monthly contributions for early and Medicare-eligible retirees at $230 and $115 respectively, and Florida offers a maximum health insurance subsidy of $150 per month to state employees.

**Require Medicare Enrollment**

Current state law requires that all state retirees enroll in Medicare as their primary coverage. However, there is no such requirement for municipalities—only a local option. The additional costs of covering Medicare-eligible retirees in non-Medicare plans adds substantially to OPEB liabilities. For example, if just one-third of the Medicare-eligible retirees in Newton who are currently not enrolled in Medicare made the switch, the city’s liability would drop by almost $15 million. If all 150 made the switch, the liability would drop by about $45 million, or 8.5 percent.

The majority of communities have imposed the Medicare requirement, and in those that do not have a formal requirement many retirees have chosen Medicare as their primary coverage. Nevertheless, there are thousands of retirees statewide who are not enrolled despite the fact that both the municipality and the employee have paid into the Medicare system. As recently proposed by the Governor, the state should mandate that all Medicare-eligible municipal retirees enroll in Medicare.

**Tie Benefits to Years of Service**

Instead of allowing all retirees to be eligible for full retiree health care after just 10 years of service, the Foundation recommends the Legislature make retiree health care benefits commensurate with length of service, as the pension system already does.

There are a number of ways this could be accomplished. Under one option, employees would receive the municipality’s maximum subsidy at 35 years of service, with the contribution reduced proportionately for shorter tenures. For example, if a municipality’s maximum retiree health care contribution is 75 percent of the premium, contributions could be scaled downward as follows:

<table>
<thead>
<tr>
<th>Years of Service</th>
<th>Percent of Full Municipal Contribution</th>
<th>Municipal Contribution, Based on a 75% Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>35 or more</td>
<td>100%</td>
<td>75%</td>
</tr>
<tr>
<td>30 to &lt;35</td>
<td>85%</td>
<td>63.75%</td>
</tr>
<tr>
<td>25 to &lt;30</td>
<td>70%</td>
<td>52.5%</td>
</tr>
<tr>
<td>20 to &lt;25</td>
<td>55%</td>
<td>41.25%</td>
</tr>
<tr>
<td>15 to &lt;20</td>
<td>40%</td>
<td>30%</td>
</tr>
<tr>
<td>10 to &lt;15</td>
<td>25%</td>
<td>18.75%</td>
</tr>
</tbody>
</table>

A slightly more complicated version would tie the scale to the pension benefit, which includes age as a factor. Only employees receiving the maximum pension benefit of 80 percent of final average salary would receive the maximum premium contribution. Alternatively, municipalities could contribute a flat dollar amount per year of service towards monthly health care premiums for eligible retirees.

**Raise the Retiree Health Care Eligibility Age**

The Foundation recommends the Legislature increase the retiree health care eligibility age from 55 to 62. This substantially shortens the time frame 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. Increasing the eligibility age may also encourage some employees to defer retirement, allowing the community to benefit longer from their knowledge and years of experience.\textsuperscript{16}

Several state governments have raised the eligibility age for retiree health benefits. In 2008, Rhode Island raised eligibility to 59. New York state raised the minimum retirement age—which dictates the retiree health care eligibility age—from 55 to 62 for new hires.

**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 Legislature raise the eligibility for retiree health benefits 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 imposed on municipalities and is unusually generous even among the dwindling ranks of employers still offering retiree health care. The Foundation recommends that the Legislature eliminate the requirement that municipalities offer spousal/dependent coverage to 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 Somerville’s least expensive plan, the city pays $17,610, or over $11,000 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.

**Municipal Recommendations**

**Decrease the Municipal Share of the Premium Contribution**

State law requires municipalities to contribute a minimum of 50 percent toward retiree health care premiums, and in the 50 communities the average municipal contribution is 75 percent.

Municipalities currently contributing more than 50 percent can reduce their contributions without needing a legislative change. It is an open question whether municipalities must bargain changes in premium contributions or plan design for retirees. Recognizing that such a change could be disruptive for some retirees, municipalities could phase down their contribution over time.

**Require Medicare Enrollment**

As discussed earlier, municipal retirees are not required to enroll in Medicare. Communities do have the option to adopt this policy on their own, and the Foundation

\textsuperscript{16} Governor Patrick has proposed increasing the pension eligibility age, but that does not automatically affect the retiree health care eligibility age.
recommends that municipalities exercise that option if they have not yet done so.

**Other Recommendations**

**Detail Costs in Annual Budgets**

One of the key reasons GASB 45 was implemented was to force municipalities to measure and recognize the liabilities they incur every year, rather than simply pushing the obligation onto future taxpayers outside of the public limelight.

In the annual budget, municipalities should publish that year’s total normal cost, which is the amount the municipality should set aside to pre-fund the retiree health benefits that active employees earned that year. This will help municipalities determine their total spending on employee compensation and benefits. Municipalities should also track spending on retiree health care by making it a separate line item in the annual operating budget.

**Centralize Reporting**

GASB requires that all OPEB plans with at least 200 members conduct biennial valuations, but many municipalities in Massachusetts have not met this standard. In addition, as the Foundation discovered, most municipalities do not make this data readily available. With such limited transparency and lack of enforcement, municipalities have little incentive to update their valuation if it would increase their liabilities.

The Foundation recommends the state implement and enforce reporting standards for municipalities. As Governor Patrick recently proposed, municipalities should be required to report on key data points—the liability, annual required payment, pay-as-you-go costs, and assumed rate of return—annually to the state. This would allow taxpayers and other interested parties to view their community’s liability, compare it to other communities, and encourage municipalities to address their large liabilities.
Appendices

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Abbreviations Used in Tables

AAL: Actuarial Accrued Liability
ARC: Annual Required Contribution
AVA: Actuarial Value of Assets
FY: Fiscal Year
Paygo: Pay-as-you-go
UAAL: Unfunded Actuarial Accrued Liability
## Appendix A
### OPEB Liability by Municipality

<table>
<thead>
<tr>
<th>Pop. Rank</th>
<th>Municipality</th>
<th>Retired Members</th>
<th>Active Members</th>
<th>AVA (1,000s)</th>
<th>UAAL (1,000s)</th>
<th>AAL (1,000s)</th>
<th>Assumed Rate of Return</th>
<th>ARC (1,000s)</th>
<th>Paygo Cost (1,000s)</th>
<th>Paygo as a % of ARC</th>
<th>Paygo FY</th>
<th>Date of Valuation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Boston</td>
<td>14,000</td>
<td>15,000</td>
<td>0</td>
<td>4,553,816</td>
<td>4,553,816</td>
<td>5.3%</td>
<td>252,685</td>
<td>153,433</td>
<td>61</td>
<td>2010</td>
<td>6/30/09</td>
</tr>
<tr>
<td>2</td>
<td>Worcester</td>
<td>5,285</td>
<td>4,348</td>
<td>0</td>
<td>765,312</td>
<td>765,312</td>
<td>4.0%</td>
<td>70,142</td>
<td>19,507</td>
<td>28</td>
<td>2009</td>
<td>6/30/08</td>
</tr>
<tr>
<td>3</td>
<td>Springfield</td>
<td>4,917</td>
<td>4,179</td>
<td>0</td>
<td>761,576</td>
<td>761,576</td>
<td>3.5%</td>
<td>43,555</td>
<td>25,004</td>
<td>57</td>
<td>2009</td>
<td>6/30/08</td>
</tr>
<tr>
<td>4</td>
<td>Cambridge</td>
<td>2,168</td>
<td>2,786</td>
<td>0</td>
<td>598,995</td>
<td>598,995</td>
<td>4.5%</td>
<td>39,272</td>
<td>18,558</td>
<td>47</td>
<td>2009</td>
<td>1/1/09</td>
</tr>
<tr>
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<td>Lowell</td>
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<td>3,029</td>
<td>0</td>
<td>432,752</td>
<td>432,752</td>
<td>3.5%</td>
<td>31,917</td>
<td>8,738</td>
<td>27</td>
<td>2009</td>
<td>1/1/08</td>
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<tr>
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<td>Brockton</td>
<td>2,577</td>
<td>3,064</td>
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<td>34</td>
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<td>6/30/09</td>
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<td>N/A</td>
<td>0</td>
<td>478,609</td>
<td>478,609</td>
<td>3.5%</td>
<td>31,933</td>
<td>12,537</td>
<td>39</td>
<td>2009</td>
<td>7/1/07</td>
</tr>
<tr>
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<td>Quincy</td>
<td>1,928</td>
<td>2,307</td>
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<td>435,548</td>
<td>435,548</td>
<td>3.5%</td>
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<td>10,967</td>
<td>35</td>
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<td>7/1/07</td>
</tr>
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<td>Fall River</td>
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<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
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<td>38</td>
<td>2009</td>
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<tr>
<td>11</td>
<td>Newton</td>
<td>2,500</td>
<td>2,453</td>
<td>0</td>
<td>531,675</td>
<td>531,675</td>
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<td>14,141</td>
<td>30</td>
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<td>6/30/10</td>
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<td>Somerville</td>
<td>1,880</td>
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<td>0</td>
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<td>570,929</td>
<td>3.5%</td>
<td>34,353</td>
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<td>44</td>
<td>2009</td>
<td>6/30/08</td>
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<td>Lawrence</td>
<td>401</td>
<td>665</td>
<td>0</td>
<td>323,977</td>
<td>323,977</td>
<td>4.0%</td>
<td>33,661</td>
<td>7,843</td>
<td>23</td>
<td>2009</td>
<td>1/1/09</td>
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<td>Framingham</td>
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<td>1,895</td>
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<td>389,843</td>
<td>4.0%</td>
<td>26,539</td>
<td>12,181</td>
<td>46</td>
<td>2009</td>
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<td>1,838</td>
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<td>299,042</td>
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<td>11,227</td>
<td>68</td>
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<td>1/1/09</td>
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<td>Waltham</td>
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<td>517,000</td>
<td>4.0%</td>
<td>30,129</td>
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<td>59</td>
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<td>4.5%</td>
<td>21,182</td>
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<td>57</td>
<td>2009</td>
<td>7/1/06</td>
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<td>Brookline</td>
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<td>323,000</td>
<td>5.3%</td>
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<td>46</td>
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<td>19</td>
<td>Malden</td>
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<td>1,135</td>
<td>0</td>
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<td>164,766</td>
<td>5.0%</td>
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<td>5,309</td>
<td>33</td>
<td>2008</td>
<td>6/30/08</td>
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<td>1,182</td>
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<td>165,267</td>
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<td>335,113</td>
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<td>2009</td>
<td>6/30/08</td>
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<td>131,756</td>
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<td>0</td>
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<td>1/1/07</td>
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<tr>
<td>24</td>
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<td>1,296</td>
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<td>419,806</td>
<td>3.5%</td>
<td>26,183</td>
<td>9,926</td>
<td>38</td>
<td>2008</td>
<td>7/1/06</td>
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<td>25</td>
<td>Revere</td>
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<td>160,287</td>
<td>160,287</td>
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<td>6,912</td>
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<td>7/1/07</td>
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<td></td>
<td>Municipality</td>
<td>Retired Members</td>
<td>Active Members</td>
<td>AVA (1,000s)</td>
<td>UAAL (1,000s)</td>
<td>AAL (1,000s)</td>
<td>Assumed Rate of Return</td>
<td>ARC (1,000s)</td>
<td>Paygo Cost (1,000s)</td>
<td>Paygo as a % of ARC</td>
<td>Paygo FY</td>
<td>Date of Valuation</td>
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<tr>
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<td>Barnstable</td>
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<td>0</td>
<td>159,322</td>
<td>159,322</td>
<td>5.0%</td>
<td>11,202</td>
<td>5,060</td>
<td>45</td>
<td>2009</td>
<td>6/30/08</td>
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<td>794</td>
<td>0</td>
<td>209,816</td>
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## Appendix B

### Health Care Cost Growth Assumptions by Municipality

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<th>Pop. Rank</th>
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<th>Date of Valuation</th>
<th>Initial Growth (%)</th>
<th>Long-Term Growth (%)</th>
<th>Phase Down Period (years)</th>
<th>First Year Long-Term Growth Applies</th>
<th>Actual Growth Annual Average 2001-2009 (%)</th>
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1. Actual annual growth as reported to the state’s Department of Revenue.
3. **Barnstable and Amherst numbers likely reflect a change in reporting between 2002 and 2009.
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<td>Shrewsbury</td>
<td>7/1/09</td>
<td>8.5</td>
<td>5</td>
<td>7</td>
<td>2016</td>
<td>8.7</td>
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<tr>
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<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
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<tr>
<td>49</td>
<td>Falmouth</td>
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<td>9</td>
<td>5</td>
<td>7</td>
<td>2015</td>
<td>14.1</td>
</tr>
<tr>
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<td>10</td>
<td>5</td>
<td>5</td>
<td>2013</td>
<td>10.8</td>
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** Barnstable and Amherst numbers likely reflect a change in reporting between 2002 and 2009.
Appendix C
Impact of Underfunding the Annual Required Contribution
Based on 4.0 percent annual rate of return

<table>
<thead>
<tr>
<th>FY</th>
<th>Amount Underfunded (1,000s)</th>
<th>Foregone Interest (1,000s)</th>
<th>Cumulative Foregone Interest (1,000s)</th>
<th>Total Underfunding (1,000s)</th>
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<td>28,000</td>
<td>728,000</td>
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<td>26,657,823</td>
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<td>11,652,136</td>
<td>28,452,136</td>
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<td>30,318,221</td>
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<tr>
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<td>700,000</td>
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<td>34,277,308</td>
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<td>40,829,835</td>
</tr>
<tr>
<td>Total</td>
<td>21,000,000</td>
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<td>19,829,835</td>
<td>40,829,835</td>
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</table>
## Appendix D

### Impact on Average Property Tax Bill by Municipality

<table>
<thead>
<tr>
<th>Pop Rank</th>
<th>Municipality</th>
<th>ARC (1,000s)</th>
<th>Paygo (1,000s)</th>
<th>Difference (1,000s)</th>
<th>Tax Bill Increase, Per Parcel</th>
<th>Total 30-yr Payment, Average Single Family Homeowner</th>
<th>Average Single Family Tax Bill (FY10)</th>
<th>Tax Bill Increase (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Boston</td>
<td>252,685</td>
<td>153,433</td>
<td>(99,252)</td>
<td>3,261</td>
<td>97,827</td>
<td>2,762</td>
<td>118</td>
</tr>
<tr>
<td>2</td>
<td>Worcester</td>
<td>70,142</td>
<td>19,507</td>
<td>(50,635)</td>
<td>2,049</td>
<td>61,478</td>
<td>3,129</td>
<td>65</td>
</tr>
<tr>
<td>3</td>
<td>Springfield</td>
<td>43,555</td>
<td>25,004</td>
<td>(18,551)</td>
<td>714</td>
<td>21,416</td>
<td>2,685</td>
<td>27</td>
</tr>
<tr>
<td>4</td>
<td>Cambridge</td>
<td>39,272</td>
<td>18,558</td>
<td>(20,714)</td>
<td>1,027</td>
<td>30,810</td>
<td>3,564</td>
<td>29</td>
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<tr>
<td>5</td>
<td>Lowell</td>
<td>31,917</td>
<td>8,738</td>
<td>(23,178)</td>
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<td>59,118</td>
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<td>64</td>
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<tr>
<td>6</td>
<td>Brockton</td>
<td>46,244</td>
<td>15,808</td>
<td>(30,436)</td>
<td>1,858</td>
<td>55,740</td>
<td>2,713</td>
<td>68</td>
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<tr>
<td>7</td>
<td>New Bedford</td>
<td>31,933</td>
<td>12,537</td>
<td>(19,396)</td>
<td>1,577</td>
<td>47,308</td>
<td>2,838</td>
<td>56</td>
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<tr>
<td>8</td>
<td>Quincy</td>
<td>31,433</td>
<td>10,967</td>
<td>(20,466)</td>
<td>1,501</td>
<td>45,030</td>
<td>4,373</td>
<td>34</td>
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<tr>
<td>10</td>
<td>Lynn</td>
<td>28,993</td>
<td>11,005</td>
<td>(17,988)</td>
<td>1,573</td>
<td>47,200</td>
<td>3,466</td>
<td>45</td>
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<tr>
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<td>Newton</td>
<td>47,573</td>
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<td>1,975</td>
<td>59,245</td>
<td>8,320</td>
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<tr>
<td>13</td>
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<td>181,604</td>
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<td>255</td>
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<td>Waltham</td>
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<td>22,858</td>
<td>3,803</td>
<td>20</td>
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<tr>
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<td>520</td>
<td>15,606</td>
<td>3,902</td>
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<tr>
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<td>444</td>
<td>13,329</td>
<td>2,490</td>
<td>18</td>
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<tr>
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<td>Taunton</td>
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<td>47,135</td>
<td>2,612</td>
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<td>Medford</td>
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<td>843</td>
<td>25,288</td>
<td>3,322</td>
<td>25</td>
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</tbody>
</table>

* Boston’s average family tax bill is for FY 2009 and includes the residential exemption.
<table>
<thead>
<tr>
<th>Pop Rank</th>
<th>Municipality</th>
<th>ARC (1,000s)</th>
<th>Paygo (1,000s)</th>
<th>Difference (1,000s)</th>
<th>Tax Bill Increase, Per Parcel</th>
<th>Total 30-yr Payment, Average Single Family Homeowner</th>
<th>Average Single Family Tax Bill (FY10)</th>
<th>Tax Bill Increase (%)</th>
</tr>
</thead>
<tbody>
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<td>Peabody</td>
<td>26,183</td>
<td>9,926</td>
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<td>44,979</td>
<td>3,273</td>
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<tr>
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<td>2,997</td>
<td>(7,912)</td>
<td>935</td>
<td>28,059</td>
<td>5,282</td>
<td>18</td>
</tr>
</tbody>
</table>

**Note:** Eight communities are excluded because average property tax bill data was not available: Barnstable, Brookline, Chelsea, Everett, Malden, Marlborough, Somerville, and Watertown. Fall River and Woburn are excluded because OPEB data was not available.
Appendix E
Methodology and Tax Calculations

Methodology
The Foundation collected the data on retiree health care liabilities from each community’s most recent annual financial statements. As noted in the report, GASB requires that this data—which is found in Appendices A, B, and D—be included in annual financial statements.

Only a handful of the 50 communities had annual financial statements available directly on their websites. For the large majority, we collected the information from Official Statements published when they issue bonds. Many municipalities issue short-term debt on a regular basis to manage cash flow, so they publish an Official Statement—with the most recent financial statements as an appendix—nearly every year. The Municipal Securities Rulemaking Board (MSRB) maintains a comprehensive online database of Official Statements, through which we collected most financial statements.

We were not able to obtain recent financial statements through either their own websites or Official Statements for four communities—Fall River, Woburn, Watertown, and Dartmouth. We called each community and Watertown and Dartmouth provided us with the information we requested.

Clarification of Tax Calculations
The calculations of the percentage increases in property tax bills and the total amount a single family homeowner would pay over 30 years (found in Table 3 and Appendix D) assume that the retiree health care costs would be paid entirely by single family residential homeowners. While some of the burden would of course be borne by commercial and industrial property owners, those additional costs would be passed along to consumers in some fashion. Our calculation of the increase in residential property taxes captures the full effect of these additional obligations on taxpayers and consumers. In either case, the estimates are only illustrative because retiree health care obligations far exceed the capacity of homeowners or businesses to pay for these liabilities.

Acknowledgement

We would like to thank Jim Link for his helpful comments on this report.
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Former Managing Partner
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