National Conference of State Legislatures (NCSL)
International Association of Fire Fighters (IAFF)
United States Conference of Mayors (USCM)
Fraternal Order of Police (FOP)
National Association of Counties (NACo)
National Education Association (NEA)
National League of Cities (NLC)
International City/County Management Association (ICMA)
National Association of Police Organizations (NAPO)
National Association of State Auditors Comptrollers and Treasurers (NASACT)
American Federation of State, County and Municipal Employees (AFSCME)
Government Finance Officers Association (GFOA)
International Public Management Association for Human Resources (IPMA-HR)
National Conference of State Social Security Administrators (NCSSSA)
National Conference on Public Employee Retirement Systems (NCPERS)
National Council on Teacher Retirement (NCTR)
National Association of State Retirement Administrators (NASRA)

December 15, 2015

On behalf of the national organizations listed above, representing state and local governments, elected officials, employees and retirement systems, we are writing to express our strong opposition to public pension requirements contained in the Puerto Rico Assistance Act of 2015 (S. 2381). These provisions are not limited to the territory of Puerto Rico, but impose a federal mandate on all state and local governments in areas that are the fiscal responsibility of sovereign States and localities, and are conflicting, administratively burdensome and costly.

The provisions are not germane to the underlying legislation, nor do they protect benefits, save costs or improve retirement system funding. They also have neither been introduced this Congress as stand-alone bills nor received consideration under regular order, including in the many hearings pertaining to Puerto Rico.

State and local government retirement systems are established and regulated by state laws and, in many cases, further subject to local governing policies and ordinances. State and local governments have and are taking steps to strengthen their pension reserves and operate under a long-term time horizon. Since 2009, every state has made changes to pension benefit levels, contribution rate structures, or both. Many local governments have made similar modifications to their plans. A compendium of information that corrects many misperceptions regarding the financial condition of these governments and their retirement plans can be found in the attached document, ***State and Local Fiscal Facts: 2015***.

Federal interference into the fiscal affairs of state and local governments is neither requested nor warranted. Therefore, we strongly urge the exclusion of provisions impacting state and local government retirement systems from legislation relating to Puerto Rico assistance or any other legislation under consideration.

If you have any questions or would like additional information, please feel free to contact any of our organizations' legislative staff listed below. We would be more than happy to meet with your office to discuss this important matter further.

Sincerely,

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Attachment (1)

State and Local Fiscal Facts: 2015

State and Local Finances ■ Municipal Bonds ■ State and Local Pensions

Fiscal Condition of State and Local Governments

In the past few years, state and local government revenues have been slowly improving. While challenges remain, officials have been taking steps to replenish rainy day funds and address long-term structural imbalances.

State Finances[1 2]

For states, 2014 brought a moderate improvement in fiscal conditions and the trend for 2015 is that improvements will continue. General fund spending and revenues are projected to increase for the fifth consecutive year based on state-enacted budgets. Since the end of the recession, states have transitioned to a sustainable period of fiscal rebuilding, but progress remains slow and fiscal challenges are likely to continue because of rising spending demands in areas such as healthcare and education and limited gains in revenue collections.

- Forty-three states enacted higher general fund spending in FY15 than in FY14.
- States have enacted minimal mid-year spending cuts over the last several years indicating that states' fiscal situations have stabilized.
- States have replenished some spending for areas cut back during the recession, such as K-12 and higher education.
- Forty-one states and the District of Columbia expect to meet or exceed their FY 2015 revenue projections.

City Finances[3]

City fiscal conditions are improving as the recession recedes. A number of factors determine the revenue performance, spending levels and overall fiscal condition. Among the factors that negatively influence city conditions are a decrease in federal and state aid and an increase in infrastructure demands, cost of services and employee compensation. Positive factors include the health of the local economy and the value of the local tax base.

Issued By:

NGA — National Governors Association

NCSL— National Conference of State Legislatures

CSG — The Council of State Governments

NACo — National Association of Counties

NLC— National League of Cities USCM—

U.S. Conference of Mayors

ICMA — International City/County Management Association

NASBO — National Association of State Budget Officers

NASACT — National Association of State Auditors, Comptrollers and Treasurers

GFOA — Government Finance Officers Association

NASRA—National Association of State Retirement Administrators

- Property tax revenue is anticipated to have positive growth for the first time in five years.
- Sales and income tax revenues continue to show positive rates of increase.
- Ending balances are nearing pre-recession highs, but are still below 2006 levels.
- For the first time since 2008, more cities are increasing, rather than decreasing, the size of municipal workforces.

Full recovery for cities is still on the horizon. The trend in 2015 and beyond will be determined by a number of factors including national employment, the real estate market, internet commerce and external policy shifts that could affect a government's long-term fiscal health.

County Finances[4]

For counties, recovery remains sluggish and uneven. Last year was one of significant growth for county economies, yet most have not returned to pre-recession levels. Notably:

- Unemployment has yet to return to pre-recession lows in 95 percent of county economies.
- Job growth accelerated in 2014, while economic output expanded and county housing markets stabilized across the country.
- Economic recovery is starting to spread, although only 65 county economies have fully recovered.

Municipal Bankruptcy

While the fiscal condition of state and local governments as a whole is improving, there are governments where fiscal stress continues. Generally, these governments' fiscal troubles are based on long-standing economic problems and other unique circumstances. It is important to note that bankruptcy, while headline-grabbing, is rare and is not an option for most localities.

- Bankruptcy is not a legal option for state sovereign entities. States have taxing authority and have constitutional or statutory requirements to balance their budgets.
- States determine whether their political subdivisions may pursue bankruptcy in the event of insolvency.
- Only 12 states authorize Chapter IX bankruptcy filings for their general purpose governments and 12 states conditionally authorize such filings. Twenty-six states have either no Chapter IX authorization or such filings are prohibited.
- Bankruptcies remain rare and are a last resort for eligible municipal governments. Since 2010, only 8 out of 37 filings have been by general purpose govern- ments. The majority of filings have been submitted not by cities, but by lesser-known utility authorities and other narrowly-defined special districts throughout the country.[5]
- Chapter IX of the federal Bankruptcy Code does not provide for any federal financial assistance, and filing under this section of the law is not a request for federal funding.

Federal Intervention

The Founding Fathers believed in a balance between state and federal power. The 10th Amendment reads "*The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.*" State and local governments can weather difficult economic periods and officials are taking steps to restore fiscal stability. Interference in the fiscal affairs of state and local governments by the federal government is neither requested nor warranted. Long-term issues such as outdated methods of taxation, rising health care costs and growing pension liabilities are already being discussed by state and local government leaders and changes in many areas are underway.

Municipal Bonds

Municipal securities are predominantly issued by state and local governments for governmental infrastructure and capital needs purposes, such as the construction or improvement of schools, streets, highways, hospitals, bridges, water and sewer systems, ports, airports and other public works. Between 2003 and 2013, states, counties, and other localities invested $3.5 trillion in infrastructure through long-term tax-exempt municipal bonds[6]; the federal government provided $1.43 trillion.[7]

On average, 11,000 municipal issuances are completed each year.

The principal and interest paid on municipal bonds is a small and well-protected share of state and municipal budgets:

- Debt service is typically only about 5 percent of the general fund budgets of state and municipal governments.
- Either under standard practice or as required by law or ordinance, debt service most often must be paid first before covering all other expenses of state and municipal governments.
- Municipal securities are considered to be second only to Treasuries in risk level as an investment instrument. The recovery rate of payment for governmental debt far exceeds the corporate recovery rate.

Types of Debt and Default

Municipal debt takes two forms: General Obligation, or GO Debt, backed by the full faith and credit of a general purpose government like a state, city, or county; and Non-GO debt issued by governments and special entities that is usually backed by a specific revenue source (special taxes, fees or loan payments) associated with the enterprise or borrower.

There are two types of defaults: (1) the more minor "technical default," where a covenant in the bond agreement is violated, but there is no payment missed and the structure of the bond is the same and (2) defaults where a bond payment is missed, or in the rare event that debt is restructured at a loss to investors.

From 1970 through 2014, there were 92 rated municipal bond defaults, of which only six were rated city or county governments. The majority of rated defaulted bonds were issued by not-for-profit hospitals or housing project financings.

Historically, municipal bonds have had lower average cumulative default rates than global corporates overall and by like rating category. Between 1970 and 2013, the average 10-year default rate for Moody's Aaa-rated municipal bonds was zero compared to a 0.49 percent default rate for Moody's Aaa-rate corporate bonds.[8] Furthermore, over the last five years, during which state and local governments struggled to recover from the recession, rated state and local GO defaults were remarkably low at 0.004 percent.[9]

- In the double-A rating category to which the majority of municipal ratings were assigned, average cumulative default rates are much lower for municipals than for corporates with the same double-A symbol.[10]
- There has only been one state that has defaulted on its debt in the past century, and in that case bondholders ultimately were paid in full.

Federal Tax Exemption

The federal tax exemption for municipal bonds is an effective, efficient and successful way for state and local governments to finance infrastructure. Municipal securities existed prior to the formation of the federal income tax in 1913. Since then, the federal Internal Revenue Code has exempted municipal bond interest from federal taxation. Many states also exempt from taxation the interest earned from municipal securities when their residents purchase bonds within their state. Because of the reciprocal immunity principle between the federal government and state and local governments, state and local governments are prohibited from taxing the interest on bonds issued by the federal government.

State and Local Pensions

Although some state and local government pension trusts are fully funded with enough assets for current pension obligations, there are legitimate concerns about the extent of underfunding in certain jurisdictions. In most cases, a modest increase in contributions to take advantage of compound interest, modifications to employee eligibility and benefits, or both, will be sufficient to remedy the underfunding problem.[11]

Significant Reforms Enacted

State and local employee retirement systems are established and regulated by state laws and, in many cases, further subject to local governing policies and ordinances. Federal regulation is neither needed nor warranted, and public retirement systems do not seek federal financial assistance. State and local governments are taking steps to strengthen their pension reserves and operate under a long-term time horizon.

- Between 2009 and 2014, every state made changes to pension benefit levels, contribution rate structures, or both. Many local governments have made similar fixes to their plans.[12]
- Although pension obligations in some states are backed by explicit state constitutional protections or statutes, states generally are permitted to change retiree health benefits, including terminating them, as they do not carry the same legal protections. Therefore, it is misleading to combine unfunded pension liabilities with unfunded retiree health benefits.
- Thirty-three states hold approximately $33 billion in other post-employment benefits (OPEB) assets as of FY 2013. This figure is up from 18 states reported for the period FY 2009-FY 2011. At the same time, state government units offering retiree health care benefits have declined during the past decade.[13]

Pension Finances

Public retirees and their employers contribute to their pensions while they are working. Assets are held in trust and invested in diversified portfolios to prefund the cost of pension benefits[14] for over 14 million working and 9 million retired employees of state and local government.[15] Public pension assets are accumulated, invested, and paid out over decades, not as a lump sum.

- Public employees typically are required to contribute 5 to 10 percent of their wages to their state or local pension. Since 2009, 36 states have increased required employee contribution rates.[16]
- As of September 30, 2014, state and local retirement trusts held $3.7 trillion in assets.[17]
- For the vast majority of state and local governments, retirement systems remain a small portion of their budget. On average, the portion of combined state and local government spending dedicated to retirement system contributions is four percent.[18] Current pension spending levels vary widely and are sufficient for some entities and insufficient for others.
- Funded levels - the degree to which a plan has accrued

assets to pay expected benefits for current and future retirees - among pension plans vary substantially. Although a number of plans are more than 100 percent advance-funded, on average, the funded level in 2013 was 72 percent, and 22 percent were less than 60 percent funded.[19]

- Many public pension plans have reduced their return assumption in recent years. Among the 126 plans measured in the Public Fund Survey, more than one-half have reduced their investment return assumption since FY2008. The median return assumption is 7.75 percent. For the 25-year period ending June 30, 2014, the median annualized public pension investment return was 8.8 percent; the 10-year median was 7.3 percent.[20]

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