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POLICY BRIEF

OCTOBER 2010

Trouble Brewing in Orange County

BY STUART BUCK

Orange County will soon face enormous budgetary pressures from the growing deficits in public pensions, both at a state and local level. In this policy brief, I estimate that Orange County faces a total $41.2 billion liability for retiree benefits that are underfunded – including $9.4 billion for the county pension system and an estimated $30.8 billion share of unfunded liabilities for California state retiree benefits. These estimates are made by correcting the state and local pension plans' figures, which use a too-optimistic assumption that their investments will grow by about 8% per year for the indefinite future.

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Unless state and county pensions are brought under control, these skyrocketing costs could easily force Orange County to limit or forego many other important public expenditures, such as road repair, schools, and healthcare.

BACKGROUND

The Orange County Employees Retirement System (also known as OCERS) covers nearly 12,000 retirees and over 22,000 current employees. As of May 31, 2010, OCERS had about $7.6 billion in assets.

Currently, employees can retire at age 50 with 10 years or service, or at any age with 30 years of service (20 years for safety employees), or at age 70 with any amount of service. Police and fire employees get a pension equal to 3% of their final year's salary times their years of service (i.e., a 30-year employee would get 90% of his final salary for the rest of his life). Other employees can retire with 2% of their final average salary times years of service.

As is often the case, enterprising newspaper reporters have been able to uncover numerous city employees receiving lavish pensions that far outstrip the California median income. In July 2010, the *Orange County Register* noted that "More than five hundred former high-level Orange County employees are collecting six-figure pensions - as much as $244,000 per year. Those top-paid pensioners pocketed nearly $60 million in 2009 from the financially troubled Orange County Employees Retirement System."[1] The journalists further noted that these "large pensions are all legal and largely the product of retirement formulas approved by policy-makers during good economic times. The generous pension plans have encouraged employees to retire earlier with a larger share of their salaries."

Perhaps the most outrageous example is former treasurer Robert Citron, who led the county into bankruptcy in 1994 and "was convicted of skimming $89 million in interest from schools and other agencies, putting the money on the county books to hide his risky investments," but who nonetheless today receives a yearly pension from Orange County of around $148,000.

As for retiree health benefits, a recent Orange County Register investigation found that "Orange County and its cities are on the hook for nearly $1 billion in long-term costs for health benefits for retired public employees." That situation has actually improved compared to 2006, when the unfunded liabilities hit $1.4 billion.[2] After that, Orange County took actions to "reduce the monthly benefit by 50 percent for some retirees reaching Medicare age," and to "reduce the yearly cost-of-living raise for some retirees."[3]

Adding it all up, Orange County is facing a $9.4 billion liability for its pension system, $1 billion for its retiree healthcare benefits, and $30.8 billion for its estimated share of California state pension and healthcare benefits. The total is $41.2 billion, which amounts to about $13,690 per person in Orange County, including children.

FINDINGS

Unfortunately, Orange County's financial situation is likely even worse. The current estimates of pension liabilities have been made on the assumption that Orange County's pension system will earn 7.75% on its investments in perpetuity. If we use a more conservative assumption that Orange County's investments will earn about 5.19% -- which is the corporate bond rate that private pension plans currently use – OCERS actually has an unfunded liability of about $8.8 billion.

On top of that, if we look at the actual market value of OCERS investments rather than the "actuarial" value (which doesn't yet fully take into account all of the market losses in 2008 and 2009), the unfunded liability rises again to nearly $9.4 billion. That figure may change from month to month as the value of OCERS investments changes, but it is undoubtedly much higher than anything that OCERS currently admits.

We should also take into account Orange County's share of the unfunded pension and healthcare liabilities incurred by the California state government, as those unfunded liabilities will also affect Orange County taxpayers. In a separate report, I estimate that California's unfunded liabilities are in actuality around $378.4 billion. Orange County's population in July 2008 was 3,010,759, while California's population was 36,961,664 in July 2009, according to the U.S. Census Bureau. Orange County's pro rata share of the state's unfunded liabilities is therefore roughly $30.8 billion.

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As a subset of the above figures, Orange County teachers make up 2.34% of the membership of the California teachers' pension plan, which is underfunded in the amount of $101.5 billion. Orange County teachers are therefore likely responsible for an estimated $2.38 billion in underfunding.

CONCLUSION

The prospects for reform are growing. Orange County recently "approved a contract with the deputy sheriff's union that moves the retirement age to 55 from 50 for new hires and requires deputies to contribute part of their pension costs."[4] The county reduced retiree health benefits in 2006, fearing a large unfunded liability.[5] There is also a lawsuit pending on appeal challenging a 2001 pension increase – made retroactive at the time – that gave public safety employees the chance to retire at age 50 with a 3% multiplier (3% of their final salary for every year of service). Moreover, Orange County's "new hybrid plan, which was rolled out May 7, allows employees to choose between the current pension formula (2.7 percent of salary for each year worked, beginning at age 55); and the new lower pension formula (1.62 percent of salary for each year worked, beginning at age 65) – but combined with a 401K-type plan, with matching

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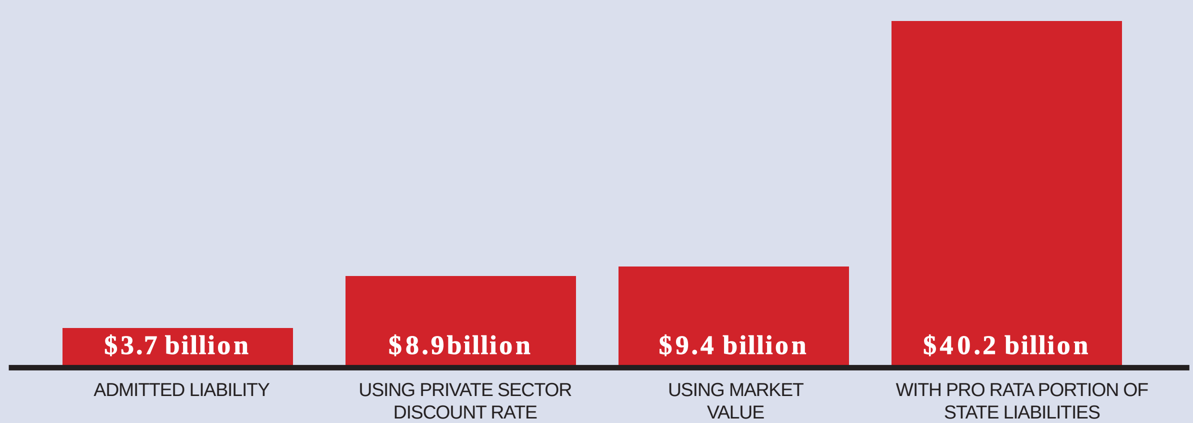
ORANGE COUNTY'S UNFUNDED PUBLIC PENSION OBLIGATIONS



contributions from the county up to 2 percent."[6]

And on a statewide level, the *Los Angeles Times* recently reported that "Gov. Arnold Schwarzenegger recently reached tentative deals with six state workers' unions to reduce benefits and hike employee retirement fund contributions for new hires. He has also vowed to veto any budget for the current year — now almost three weeks overdue — that does not roll back retirement benefits to 1999 levels and require workers to contribute an additional 5% of pay toward retirement."[7] On the other hand, a pension reform bill "intended to curb pension spiking has become so watered down that it would now do little to prevent California public employees from boosting their end-of-career paychecks, critics say, prompting reform advocates and bill sponsor state Controller John Chiang to withdraw support."[8]

Absent significant reform at both the city and state level, Orange County's staggering pension and retiree health benefit liabilities will constrain the city's ability to engage in any other public spending in the foreseeable future. As David Crane, a Schwarzenegger appointee to the California teachers' pension system, has said, "All of the consequences of rising pension costs fall on the budgets for programs such as higher education, health and human services, parks and recreation, and environmental protection that are junior in priority and therefore have their funding reduced whenever more money is needed to pay for pension costs."[9]

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[1] Tony Saavedra and Ronald Campbell, "O.C.'s six-figure retirees outpace state," *Orange County Register*, 9 July 2010, available at http://www.ocregister.com/articles/-256977--.html.

[2] Public Employee Post-Employment Benefits Commission, "Funding Pension & Retiree Health Care for Public Employees," p. 90, available at http://www.pebc.ca.gov/images/files/final/080107_PEBCReport2007.pdf.

[3] Tony Saavedra, "Health benefits for retirees will cost O.C. agencies $1 billion," *Orange County Register*, 9 Sept. 2010.

[4] Tony Perry and Marc Lifsher, "Municipalities take aim at public pensions," *Los Angeles Times*, 18 July 2010, available at http://www.latimes.com/news/local/la-me-pensions-20100719,0,898989.story?track=rss.

[5] Christian Berthelsen, "O.C. Board Trims Benefits for County Government Retirees," *Los Angeles Times*, 13 Sept. 2006, available at http://articles.latimes.com/2006/sep/13/local/me-ocsupes13.

[6] Kimberly Edds, "Commission gets an earful on pension reform," *Orange County Register*, 23 Aug. 2010, available at http://totalbuzz.ocregister.com/2010/08/23/commission-gets-an-earful-on-pension-reform/39689/.

[7] Tony Perry and Marc Lifsher, "Municipalities take aim at public pensions," *Los Angeles Times*, 18 July 2010, available at http://www.latimes.com/news/local/la-me-pensions-20100719,0,898989.story?track=rss.

[8] Catherine Saillant, "California pension reform effort loses support," *Los Angeles Times*, 18 Aug. 2010, available at http://articles.latimes.com/2010/aug/18/local/la-me-0818-pension-reform-20100818.

[9] Quoted in Steven Greenhut, "Progressives for Pension Reform?," *City Journal*, 9 Sept. 2010, available at http://www.city-journal.org/2010/eon0909sg.html.

ABOUT THE AUTHOR

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