

Alternate Revenue Source Initial Consideration

Washington State Law Enforcement
Officers' and Fire Fighters' Plan 2
Retirement Board

May 24, 2006

Brief Summary

- Strategic Plan
- Funding Examples from Washington
- Funding Examples from Other States

Strategic Plan

- Priority Goals

- Enhance Benefits for the Members
- Maintain the Financial Integrity of the Plan

- Key Tactic

- Research Alternative Revenue Sources

Funding Examples - Washington

- Firemen's' Pension Fund
 - 25% of the tax collected on fire policies, the fire component of homeowner's & commercial multi-peril policies

Funding Examples - Washington

- Volunteer fire fighters' and reserve officers' relief and pensions
 - 40% of funds from fire insurance premium tax
- First Class City Police Relief and Pension
 - Funds collected for licenses issued
 - Fines and forfeitures for violation of city ordinance

Funding Examples – Other States

- Florida Municipal Police & Fire
 - Premium tax on property (1.85%) and casualty (0.85%) insurance
- Oklahoma Teachers' Retirement Fund
 - 3.75% of sales and income tax
 - 5% of lottery revenue

Funding Examples – Other States

- Illinois Fire Fighter Pension for Cities over 500,000
 - Property tax levy - 2.26 times employee contributions from two years prior to assessment year

Funding Examples – Other States

- West Virginia

- Proposed \$5.5 billion sale of Pension Obligation Bonds
- Fire Protection Fund receives one-half of 1% of insurance premium tax

Funding Examples – Other States

- Rhode Island
 - Sale of surplus property

- California
 - Transfer of surplus real estate to retirement fund

Alternate Revenue Source

Questions?

LAW ENFORCEMENT OFFICERS' AND FIRE FIGHTERS' PLAN 2 RETIREMENT BOARD

Alternate Revenue Source Initial Consideration

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1. Issue

Researching alternate revenue sources was identified as a key tactic for achieving the Board's priority goals of enhancing benefits for the members and maintaining the financial integrity of the plan.

2. Staff

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3. Members Impacted

Alternate Revenue Source potentially impacts all members and retirees of LEOFF Plan 2. As of September 30, 2004 there were 14,754 active members and 432 retirees as reported in *The Office of the State Actuary's 2004 LEOFF 2 Actuarial Valuation Report*.

4. Current Situation

LEOFF Plan 2 has two sources of revenue, contributions and investment earnings. Contributions are collected as a percentage of pay from the members (6.99%), employers (4.20%), and the State (2.79%). The actual rate of investment return on the market value of assets was 13.73% as reported in the 2004 Actuarial Valuation Reports and the market value of assets was reported as just under \$3 billion.

The total revenue as indicated by the change in market value of assets during 2003-2004 totaled \$455 million (\$51 million employee contribution, \$52 million employer/state contribution, \$351 million investment return.) The current funded ratio of LEOFF Plan 2 is 117%.

5. Background Information and Policy Issues

Board Strategic Plan

The LEOFF Plan 2 Retirement Board established several priority goals in the 2004-2009 strategic plan. Two of those priority goals were to “enhance benefits for the members” and “maintain the financial integrity of the plan”. Researching alternate revenue sources was identified as a key tactic for achieving both of these priority goals.

LEOFF Plan 2 Funding and Revenue

As stated in the 2004 LEOFF Plan 2 Actuarial Valuation by the Office of the State Actuary, the funding policy contained in statute outlines the intent to achieve the following goals:

- To provide a dependable and systematic process for funding benefits to members and retirees;
- To continue to fully fund LEOFF Plan 2 as provided by law;
- To establish long-term employer contribution rates that will remain a relatively predictable proportion of the future state budgets; and
- To fund, to the extent feasible, benefit increases over the working lives of those members so that the cost of those benefits are paid by the taxpayers who receive the benefit of those member’s service.

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Broad Perspective of Funding and Revenue

Nationally, opinions are mixed on the financial integrity of public pension plans. As a group, state and local pension systems reportedly have nearly 90 percent of the funds required for each dollar they owe in liabilities. However, this still represents a funding gap between assets and liabilities of more than \$260 billion. Individually, many plans are in poor financial shape. One report on public plan funding identified retirement systems in 13 states that had actuarial assets that were less than 75 percent of actuarial liabilities.

Financial problems have occurred in many plans for a variety of reasons including poor investment returns, benefit enhancements granted during good market times, increasing number of retirements, contribution rate holidays, and some states “failures to properly fund their plans”. Keith Brainard, Research Director for the National Association of State

Retirement Administrators recently commented, “The funding levels of many plans declined so suddenly, that pretty much brought to a halt the discussion of benefit enhancements. That doesn’t mean that it’s going to be gone forever, but for the time being, that seems to have gone off the table as systems focus more on restoring their funding levels.”

Consequently, many states are reviewing different strategies for addressing pension funding issues. Beyond the stock market’s rebound following the slump at the beginning of the decade, many pension plans have considered or enacted alternate revenue sources.

Alternative Revenue Sources

Although most of the consideration being given to alternate revenue surrounds shoring up unfunded liabilities, some plans have alternate revenue sources as a means to pay for benefits. These sources are normally ongoing for funding either current or enhanced benefit packages. Common alternative revenue sources include premium taxes on property, casualty, and fire insurance; sales tax; and property tax levies.

Other sources that have been utilized less frequently include the dedication of lottery or gaming revenues, pension obligation bonds, and transfer of state assets (such as real estate) to the pension fund. Appendix B provides examples of various funding mechanisms used by some other states.

Examples of the use of taxes to fund pension benefits can be found in Washington State for the Firemen’s Pension Fund (Pre-LEOFF), the Volunteer Fire Fighters' and Reserve Officers' Relief and Pensions, and the First Class City Police Relief and Pension fund (Pre-LEOFF).

For the Firemen’s Pension Fund, the state collects a two percent tax on the premiums of all insurance policies written. Twenty-five percent of the tax collected on fire policies and the fire component of homeowner's and commercial multi-peril policies, are distributed to cities and fire districts that have firemen's pension funds. Premiums attributed to losses from such things as burglaries, tornadoes, floods, etc., are not shared with cities. For the homeowner's and commercial multi-peril policies, actual data is collected on the loss experience due to fire as a percent of total losses. These percentages are then applied to the total premium taxes collected from these policies to get the taxes attributed to the fire component. In 2005 the state distributed \$3,004,755.02 to cities and districts from the fire insurance premium tax. Appendix A lists the cities and districts and the amounts received from the 2005 distribution.

The Washington State Volunteer Fire Fighters’ pension funding also comes in large part from the use of tax oriented sources. Forty percent of all moneys received by the state from taxes on fire insurance premiums are paid into the volunteer administrative fund. The state volunteer board then computes a percentage of these amounts to be paid into the principal fund.

The First Class City Police Relief and Pension fund receives revenue, beyond salary reductions, from funds collected for all licenses issued and from fines and forfeitures collected or received for violation of city ordinances.

6. Supporting Information

Appendices

- **Appendix A: Distribution of Fire Insurance Premium Tax – RCW 41.16**
- **Appendix B: Alternate Revenue Source Examples**

Appendix A: Distribution of Fire Insurance Premium Tax – RCW 41.16

City/District	Number of Paid Firefighters as of January 1, 2005	Amount
Aberdeen	35	\$23,906.89
Anacortes	18	12,294.97
Auburn	77	52,595.17
Bellevue	190	129,780.28
Bellingham	134	91,529.25
Bothell	48	32,786.60
Bremerton	56	38,251.03
Camas	34	23,223.84
Centralia	21	14,344.14
Chehalis	13	8,879.70
Edmonds	52	35,518.81
Ellensburg	21	14,344.14
Everett	181	123,632.79
Hoquiam	22	15,027.19
Kelso	12	8,196.65
Kennewick	74	50,546.00
Kent	138	94,261.47
Kirkland	69	47,130.73
Longview	43	29,371.33
Lynnwood	53	36,201.87
Mercer Island	29	19,808.57
Moses Lake	27	18,442.46
Mountlake Terrace	33	22,540.79
Mount Vernon	26	17,759.41
Olympia	79	53,961.27
Pasco	47	32,103.54
Port Angeles	22	15,027.19
Port Townsend	11	7,513.60
Pullman	21	14,344.14
Puyallup	56	38,251.03
Raymond	16	8,879.70
Redmond	128	87,430.93
Renton	106	72,403.73
Richland	52	35,518.81
Seattle	1,015	693,299.91
Shelton	7	4,781.38
Spokane	291	198,768.74
Sumner	17	11,611.92

City/District	Number of Paid Firefighters as of January 1, 2005	Amount
Sunnyside	14	9,562.76
Tacoma	406	277,319.97
Toppenish	5	3,415.27
Tukwila	60	40,983.25
Vancouver	177	120,900.58
Walla Walla	46	31,420.49
Wenatchee	34	23,223.84
Yakima	80	54,644.33
King County #2	35	23,906.89
King County #10	121	82,649.55
Spokane County #1	150	102,458.12
Totals	4,399	\$3,004,755.02

Source: Municipal Research and Services Center of Washington

Appendix B: Alternate Revenue Source Examples

State/System	Alternate Funding Source
Colorado Volunteer Firefighters	<ul style="list-style-type: none"> • Volunteer plans receive funding from property tax revenues, moneys paid or given to the funds, and state matching funds. State matching funds come from insurance premium tax proceeds.
Florida Municipal Police & Fire	<ul style="list-style-type: none"> • Participating cities and special fire control districts are eligible to receive annual distributions of state premium tax collections on property and casualty insurance policies written within the city/district limits or boundaries of the participating plan. • The amount of premium taxes collected is equal to 1.85% of all property insurance written within the city limits or boundaries (in the case of fire districts) of the participating plan. • A 0.85% tax is levied on all casualty insurance premiums written within the city limits of the participating plan. These amounts transferred to the Police Officers' and Firefighters' Premium Tax Trust Fund. • These funds are then available for distribution on or before July 1 to the participating pension plans on an annual basis, once the plan has been determined to be in compliance with all applicable statutory requirements. Further funding for these plans is provided by employee contributions, other revenue sources and employer contributions.
Idaho Firefighters Retirement Fund	<ul style="list-style-type: none"> • Funding is paid by member contributions, employer contributions and receipts from a fire insurance premium tax.

State/System	Alternate Funding Source
<p>Illinois Fire Fighter Pension for Cities over 500,000</p>	<ul style="list-style-type: none"> • Each city shall levy a tax annually upon all taxable property therein for the purpose of providing revenue for the fund. • The city shall levy a tax annually at a rate on the dollar of the value, as equalized or assessed by the Department of Revenue of all taxable property within such city that will produce, when extended, not to exceed an amount equal to the total amount of contributions by the employees to the fund made in the calendar year 2 years prior to the year for which the annual applicable tax is levied, multiplied by 2.23 through the calendar year 1981, and by 2.26 for the year 1982 and for each year thereafter. • To provide revenue for the ordinary death benefit, the city council levies a tax, which is in addition to and exclusive of the taxes authorized to be levied upon all taxable property in the city at such rate per cent of the value of such property as shall be sufficient to produce for each year the sum of \$142,000.
<p>Oklahoma Teacher's Retirement Fund</p>	<ul style="list-style-type: none"> • The employer contribution rate includes 3.75% of sales, income and other taxes collected by the state, which represents approximately 4.7% of the system membership payroll. School districts contribute 7.05%. The Oklahoma Legislature in 2005 approved a bill dedicating a portion of lottery revenues. • Earmarked (for \$6 billion in pension liabilities) a 5% portion, estimated at \$3.1 million this year, of the state's new lottery approved by voters last year.
<p>Rhode Island</p>	<ul style="list-style-type: none"> • City of Newport utilizes City's share of hotel/motel tax revenue as dedicated pension revenue source. • A 2004 state proposal outlined a series of potential revenue streams to inject into the pension plans to increase overall assets, thereby reducing the projected unfunded pension liabilities. These include: • Fiscal Fitness Proposals – Using the proceeds from the sale of State properties to buttress the State pension systems rather than permitting the resources to transfer to the State's General Revenue Fund. • Gaming Revenues – Dedicating net growth in State gaming revenues to the pension system. Half of the funds would go to reduce the unfunded liability and the other half to reduce the Employer contribution. • Surplus Funding Proposal – Earmarking surplus funds to reduce the pension Capital Fund liability. Fifty percent of any State end-year

State/System	Alternate Funding Source
	<p>balance that exceeds \$30.0 million would be earmarked. In other words, \$0.50 of every \$1.00 the State has in surplus in excess of \$30.0 million would go to the State's pension systems.</p> <ul style="list-style-type: none"> • Capital Fund Accounts – Redirecting funds from the State's Sinking Fund (designed for debt relief) and the State Capital Fund to reduce the unfunded liability. • Municipal Pension Plans – Exploring whether municipalities can redirect over-funded pension assets to teacher pensions to reduce the teacher unfunded liability.
<p>Washington Firemen's Pension Fund RCW 41.16 (Pre-LEOFF)</p>	<ul style="list-style-type: none"> • The state collects a two percent tax on the premiums of all insurance policies written. Twenty-five percent of the tax collected on fire policies and the fire component of homeowner's and commercial multi-peril policies, are distributed to cities and fire districts that have firemen's pension funds. Premiums that attributed to losses from such things as burglaries, tornadoes, floods, etc., are not shared with cities. For the homeowner's and commercial multi-peril policies, actual data is collected on the loss experience due to fire as a percent of total losses. These percentages are then applied to the total premium taxes collected from these policies to get the taxes attributed to the fire component. In 2005 the state distributed \$3,004,755.02 to cities and districts from the fire insurance premium tax. • Funding sources: <ul style="list-style-type: none"> • All bequests, fees, gifts, emoluments, or donations given or paid thereto; • twenty-five percent of all moneys received by the state from taxes on fire insurance premiums; • taxes paid pursuant to the provisions of RCW 41.16.060; • interest on the investments of the fund; and • contributions by fire fighters as provided for herein. • If a report by a qualified actuary establishes that all or any part of the additional twenty-two and one-half cents per thousand dollars of assessed value levy is unnecessary to meet the estimated demands on the fund under this chapter for the ensuing budget year, the levy of said additional twenty-two and one-half cents per thousand dollars of assessed value may be omitted, or the whole or any part of such dollar rate may be levied and used for any other municipal purpose.

State/System	Alternate Funding Source
<p>Washington</p> <p>First Class City Police Relief and Pension RCW 41.20(Pre-LEOFF)</p>	<ul style="list-style-type: none"> At the time the annual tax levy of the city is made, the city council, or other legislative body, shall order the transfer of an amount of money into the fund, sufficient with the salary deductions, to meet the financial requirements thereof: (1) From moneys collected or received from all licenses issued; (2) From fines and forfeitures collected or received in money for violation of city ordinances.
<p>Washington</p> <p>RCW 41.26.040 – Creation of L2</p>	<ul style="list-style-type: none"> All funds held by any firemen's or policemen's relief and pension fund shall remain in that fund for the purpose of paying the obligations of the fund. The municipality shall continue to levy the dollar rate as provided in RCW 41.16.060, and this dollar rate shall be used for the purpose of paying the benefits provided in chapters 41.16 and 41.18 RCW. The obligations of chapter 41.20 RCW shall continue to be paid from whatever financial sources the city has been using for this purpose.
<p>Washington</p> <p>RCW 41.24.030 – Volunteer Fire Fighters' and Reserve Officers' Relief and Pension Principal Fund created</p>	<ul style="list-style-type: none"> Funding sources: <ul style="list-style-type: none"> Bequests, fees, gifts, emoluments or donations Annual fees from members and/or employers. Membership includes firefighters, reserve officers and emergency workers. 40% of all moneys received by the state from taxes on fire insurance premiums are paid into the administrative fund. The state board computes a percentage of these amounts to be paid into the principal fund. The current tax on fire insurance premiums is 2% of the premium amount.
<p>West Virginia</p>	<ul style="list-style-type: none"> A Fire Protection Fund receives one-half of one percent of insurance premium state-wide annually and distributes a prescribed amount to each qualifying fire department. The insurance premium tax generated \$350,000 in 2004 for the fund. Recent state proposal to sell \$5.5 billion in pension obligation bonds to fund the state's teachers, state police and judicial pension programs.