Adequacy of Benefits

Initial Consideration

WASHINGTON STATE

Law Enforcement Officers' and Fire Fighters'

Plan 2 Retirement Board

October 27, 2004

Outline

- How well does LEOFF Plan 2 meet retirees' needs?
  - Income Replacement: How much does a retiree need to maintain standard of living?
  - Income Sources: Three-Legged Stool
  - Inflation: How well does a retiree maintain standard of living during retirement?

Income Replacement Rates

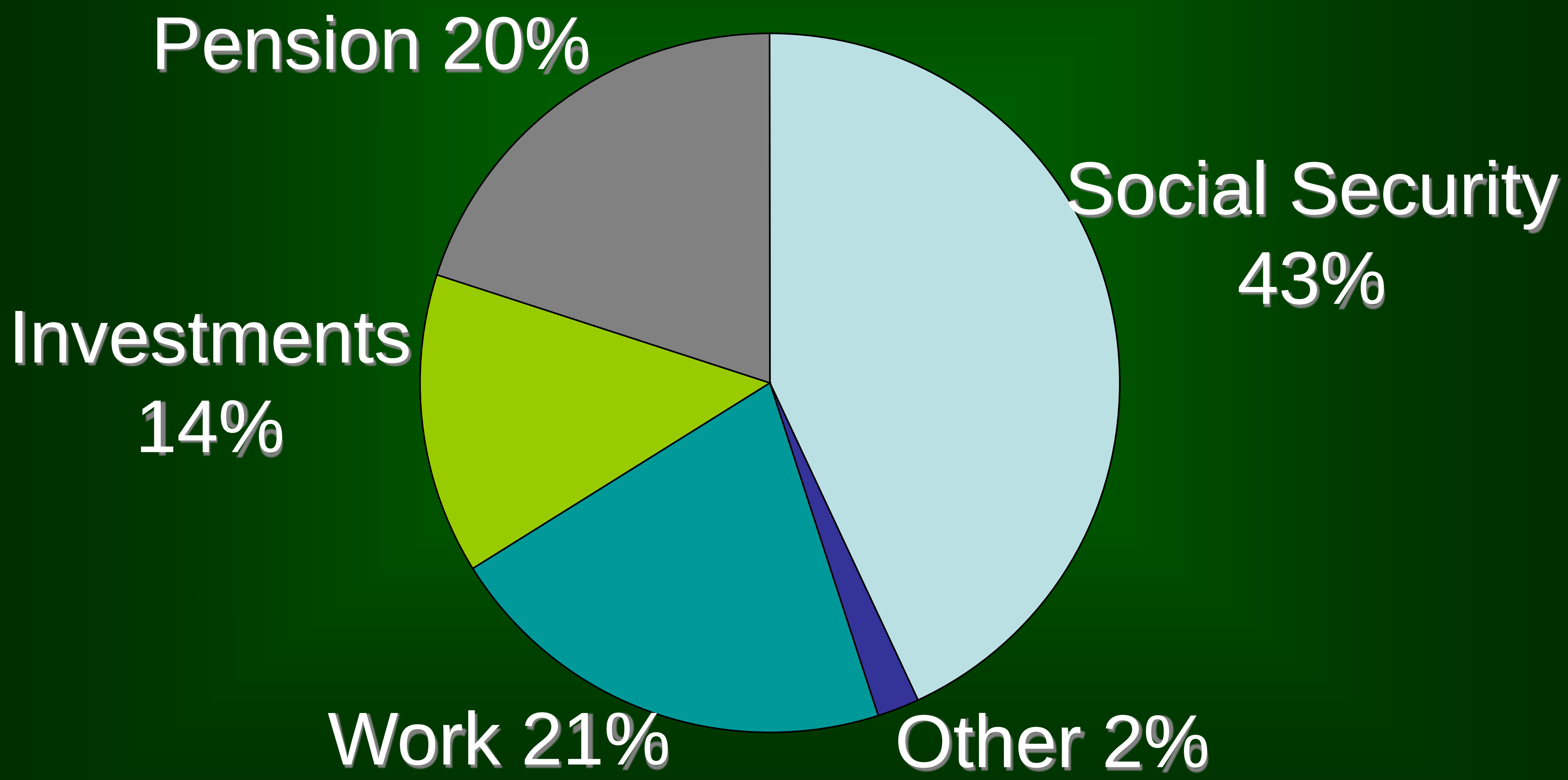
- Maintain same standard of living in retirement
- Income replacement rate - 60% to 90%
- Income needs lower in retirement
- Multiple factors affecting individual needs

Income Sources

Three-Legged Stool

- Social Security
- Employer Pension
- Personal Savings

Income Sources



Source: EBRI Notes, November 2003

Income Sources

Social Security

- Has been strongest leg of stool
- Long-term solvency issues
  - Reduced benefits
  - Increased taxes
- Replaces 41.3% of income on average
- Replace only 29.9% by 2030

Income Sources

Social Security and LEOFF Plan 2

- Association of Washington Cities 2004 Police/Fire Survey
- 123 Respondents with Law Enforcement members
- 93 Respondents with Fire Fighter members

Income Sources

Social Security and LEOFF Plan 2

- 74% of Law Enforcement Officers covered
- 8% of Fire Fighters covered
- Uncovered members must rely more on pension, savings, and post-retirement employment.

Income Sources

Employer Pension

- LEOFF Plan 2
- Deferred Compensation

Income Sources

Personal Savings

- Unrealistic expectations
- Confidence of comfortable retirement
- Savings levels very low
- Few know what’s needed
- Education changes behavior

Inflation

- How well is a LEOFF Plan 2 benefit protected from inflation?

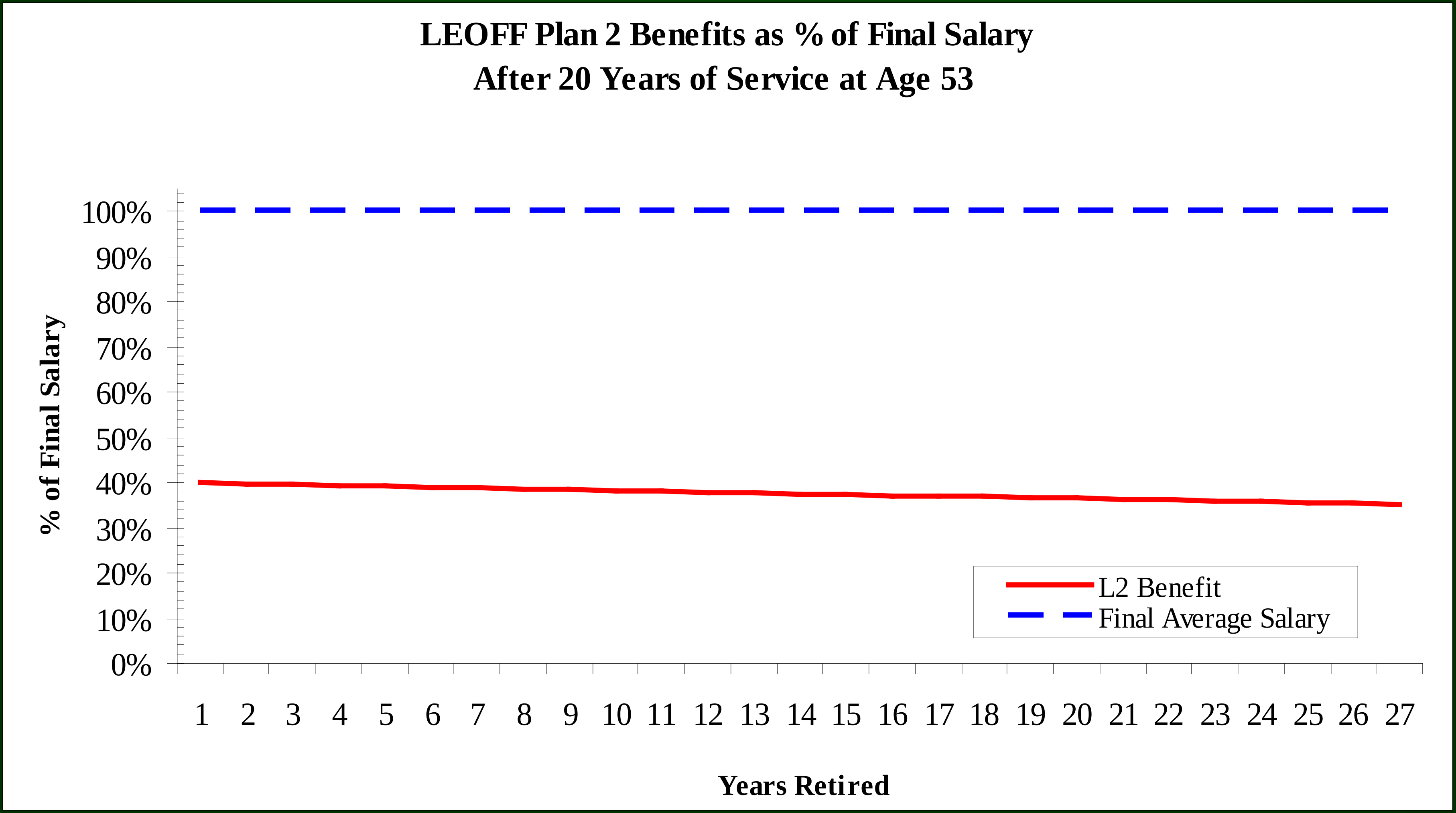
- Two Areas of Impact
  - General Inflation
  - Health Care Costs

LEOFF Plan 2 Replacement

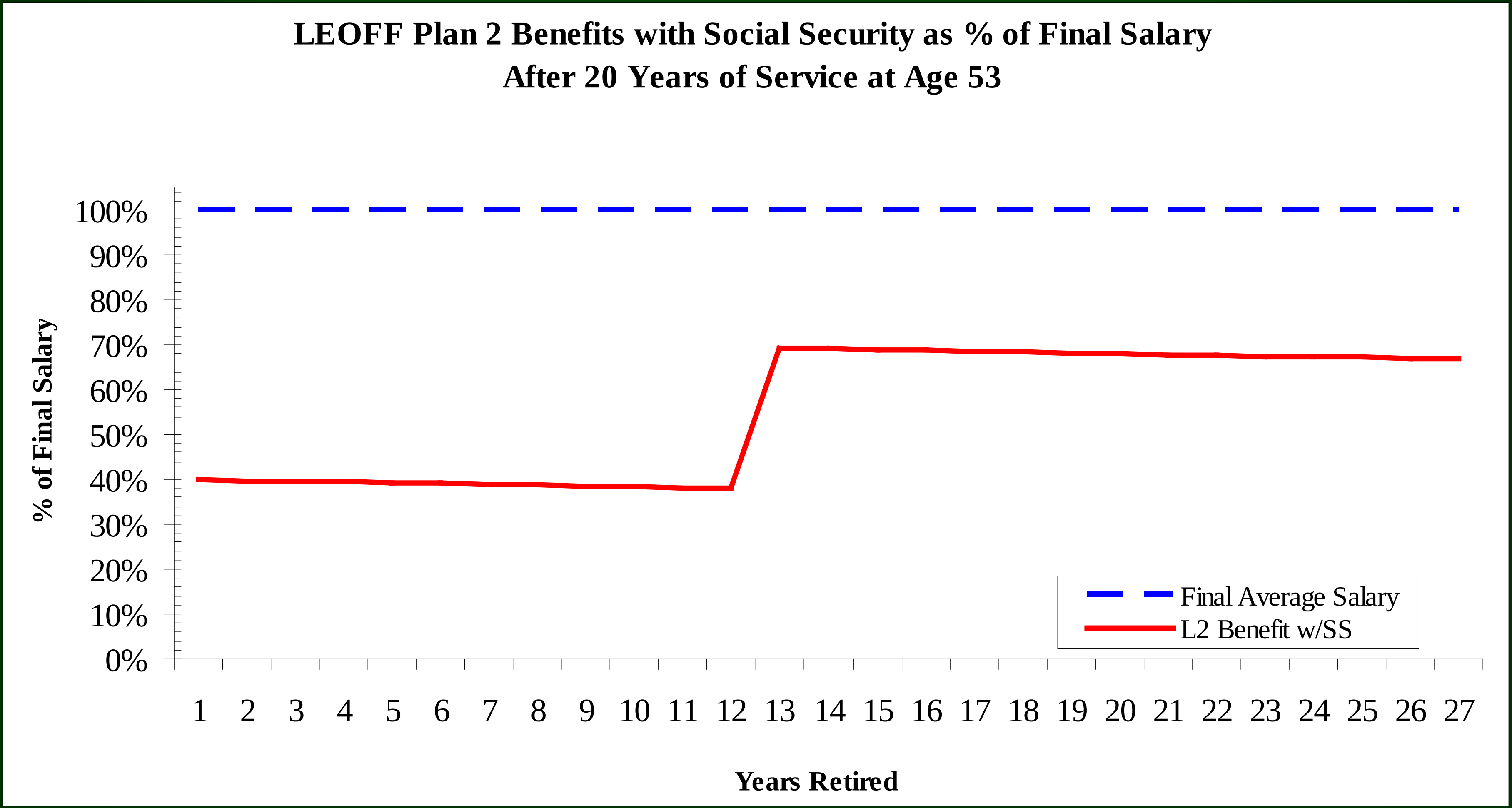
- LEOFF Plan 2 Examples

- Example Assumptions
  - Current LEOFF Plan 2 Provisions
  - Retirement at age 53 with 20 years
  - Final Average Salary (FAS) = $65,000
  - Inflation at 3.5% annually (Actuarial Assumption)
  - Annual COLA increase 3%
  - Social Security beginning at 66

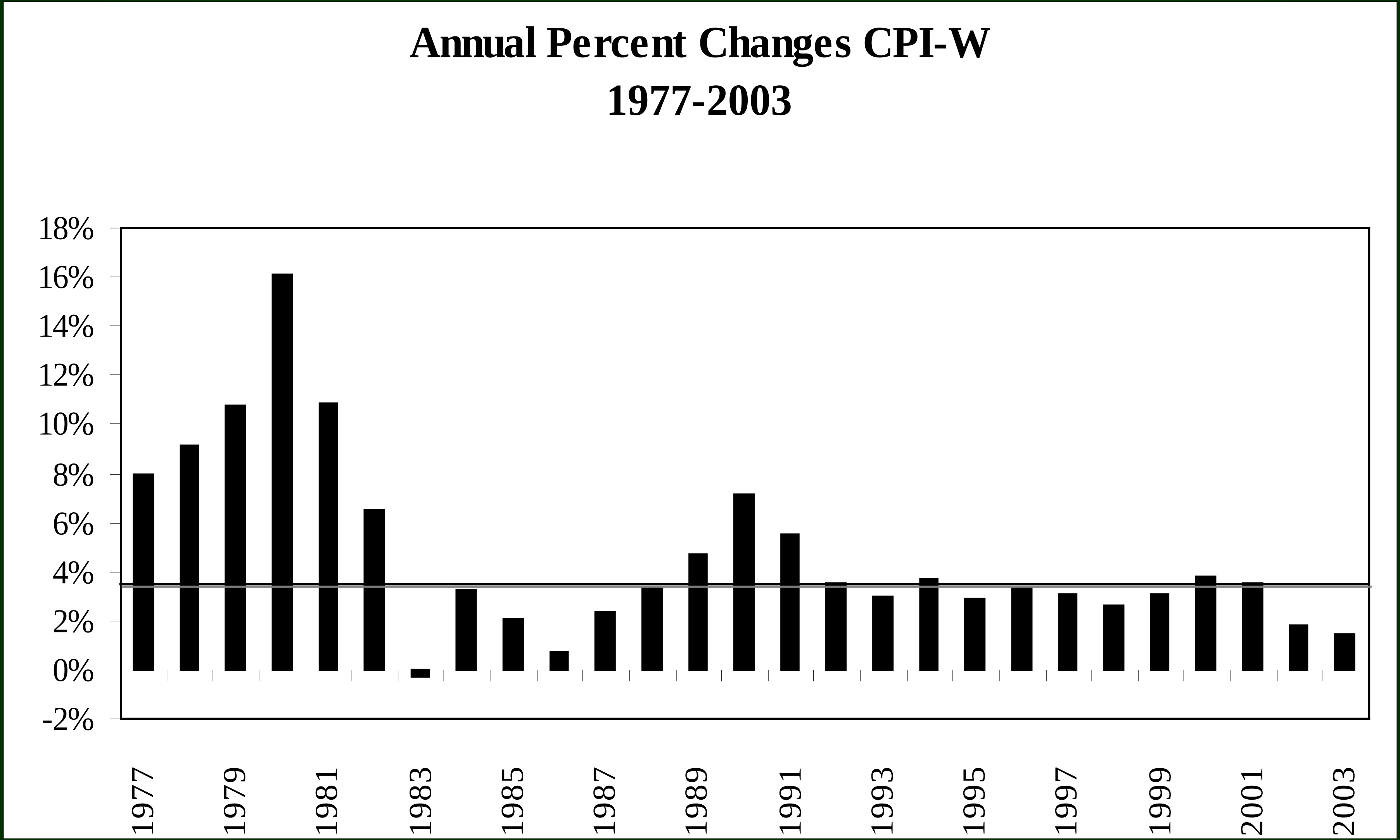
LEOFF Plan 2 Replacement Rate



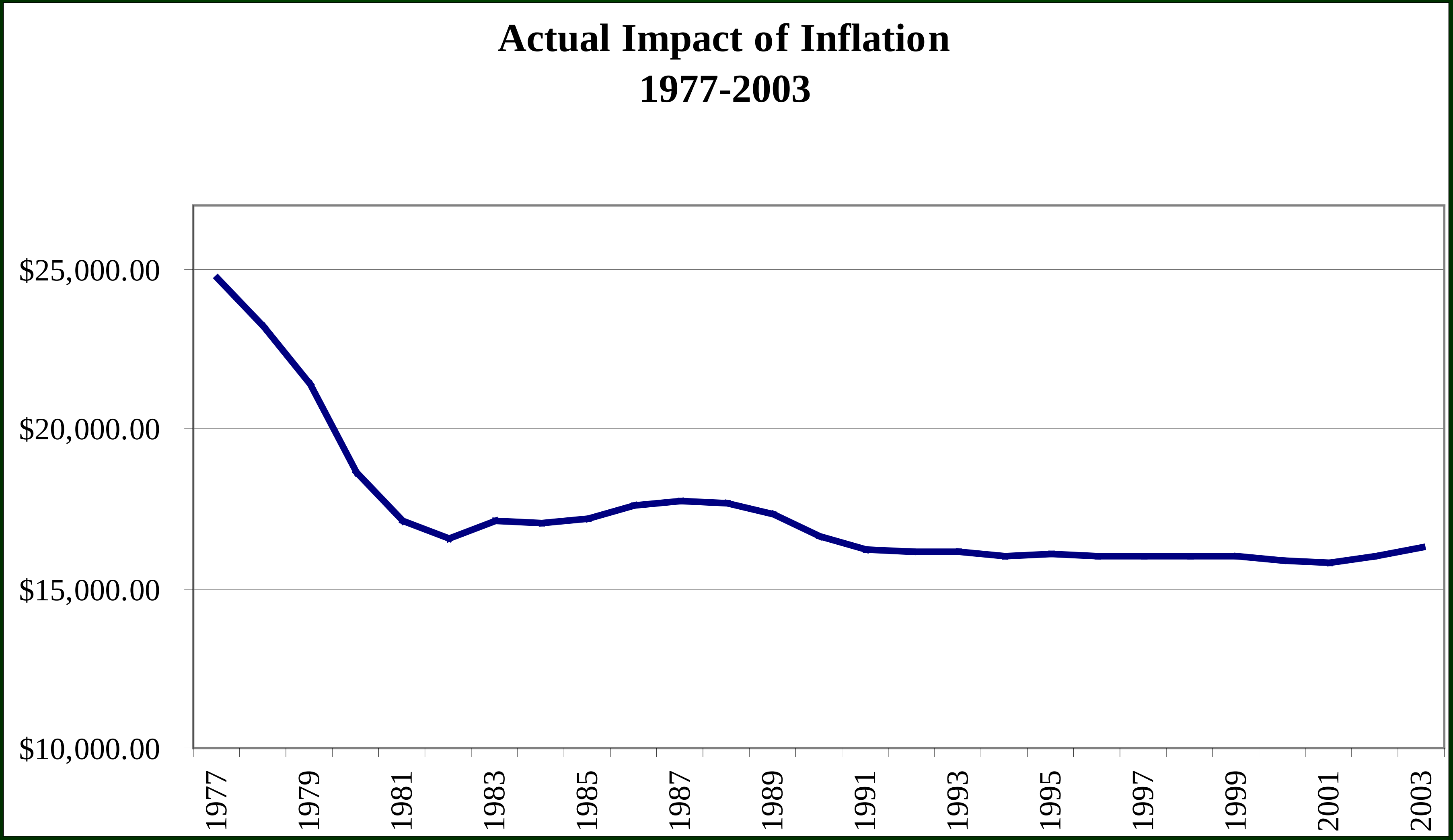
LEOFF Plan 2 Replacement Rate



Historical Inflation



Inflation Impact



Health Care Costs

- Higher expenditures for Retirees
  - 5.2% of Expenditures for Age 45-54
  - 12.8% of Expenditures for Age 65+

- Costs Increasing
  - Premiums nationwide up 13% in 2001, 14.9% in 2003, and 14.3% in 2004
  - Health Care accounts for 15.5% of GDP
  - May reach 18.4% of GDP in 10 years

Questions?

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

Adequacy of Retirement Benefits

Initial Consideration

October 27, 2004

1. Issue

This report examines the adequacy of retirement benefits by addressing two key questions: "How well does the retirement plan help meet post-retirement income replacement goals?" and "How well does the retirement benefit protect its value over time?"

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3. Current Situation

The following is a summary of the key service retirement provisions in LEOFF Plan 2:

Service Retirement Allowance

- Eligible LEOFF Plan 2 retirees receive 2% of final average salary (FAS) for each year of service credit without limit.

Eligibility for Retirement

- A LEOFF Plan 2 member is eligible to retire with full benefits at age 53 with at least 5 years of service credit
- A LEOFF Plan 2 member is eligible to retire early with reduced benefits at age 50 with at least 20 years of service credit with a 3% per year reduction from age 53.

Cost of Living Adjustment (COLA)

On July 1 of every year, a LEOFF Plan 2 retiree who has been retired at least one year receives an adjustment by the percentage change in the Consumer Price Index for urban wage earners and clerical workers for Seattle-Tacoma-Bremerton (CPI-W), to a maximum of 3% per year.

4. Background Information and Policy Issues

During the last 5 years a survey by Deloitte & Touche's Human Capital Advisory Services and the International Society of Certified Employee Benefit Specialists asked the Society's membership to identify benefit priorities during the coming year. When asked to respond as an employee, respondents consistently ranked "evaluating the adequacy of my current level of retirement savings" as one of the top priorities.

This result is reflective of a population that is growing older with the realization that retirement is not too far off and that they had better start preparing now for that period of their lives. It is clear that employees are becoming more sensitive to issues such as the availability of Social Security and benefits from employer pensions along with concerns of rising health costs. As this report will discuss, all of these factors and more have an influence on the overall adequacy of benefits.

The adequacy of benefits can be examined from several different perspectives. This report looks at how well the LEOFF Plan 2 plan design provides retirement income needed to maintain a desired standard of living throughout retirement.

The report first examines the concept of income replacement. That is, how much of a member's pre-retirement income will be replaced by retirement benefits. This includes a discussion on post-retirement income sources and provides examples demonstrating the replacement value of LEOFF Plan 2.

The report then examines the concept of benefit protection. That is, how well the benefit is protected from various influences such that a person maintains the value of their benefit throughout retirement. This includes a discussion of the actual impacts of inflation (versus assumptions) and the erosion of benefit adequacy by increasing health care costs.

Income Replacement Rates

There are several issues involved in analyzing retiree income according to most research.[1] The first of which addresses what the income needs of a retiree are compared to the needs of an active employee.

Retirement income is often referred to in terms of "replacement rates" or the percentage of pre-retirement income "replaced" by retirement income sources. Ideally, families in retirement should be able to maintain the same standard of living that they enjoyed while working. This is not an unreasonable goal: Retirees typically need less money because they have lower costs than active members. On this basis, most studies suggest that somewhere between a 60% to 90% replacement rate would be adequate for most retirees. As this wide range indicates, there is no single replacement rate that has been accepted as a standard.

[1] William J Wiatrowski, "Factors affecting retirement income", Monthly Labor Review, March 1993

Most studies suggest that any given replacement rate is subjective because income replacement needs are based on lifestyle choices and other assumptions about retirees. For example, it is generally assumed that retirees will no longer have children in the household to support and may have paid off their home mortgages. In addition, expenses associated with work, such as transportation and clothing may be reduced.[2] Other research cites that taxes may be lower during retirement and there is a reduced need to save for retirement as retirees begin to consume their assets. Of course, individual circumstances such age at retirement, location of retirement, value of personal assets, lifestyle, health factors, availability of medical insurance, and expenses related to long term care will affect the amount of retirement income needed.[3]

While most studies support that retirees have lower income needs than working employees, additional factors are emerging that affect the income replacement discussion. For example, as life expectancy increases, today's retirees are faced with additional responsibility and the cost of caring for elderly parents. Because of complications like this involved with forecasting retirement income needs, many reports recommend that individuals should be cautious in utilizing a specific income replacement rate and encouraged to plan according to their expected plans in retirement.

However, even this perspective must be taken with some note of caution. The 2004 Retirement Confidence Survey by the Employee Benefit Research Institute, American Savings Education Council, and Mathew Greenwald & Associates, Inc., found that many workers often have expectations about retirement that cannot be achieved and unrealistic expectations about how much income they will need when they retire. The survey found that one in 10 workers think they will need less than 50 percent of their pre-retirement income in order to live comfortably in retirement (10 percent). Almost 3 in 10 believe they will need 50 to 70 percent (28 percent). Another 3 in 10 think they will need 70 to 85 percent (28 percent) and one in 10 expect to need 85 to 95 percent (11 percent) of pre-retirement income. Just 8 percent think their income in retirement will need to be about the same as right before retirement and 7 percent expect to need a higher income (See Figure 1).

Figure 1 - Percentage of Pre-retirement Income Needed in Retirement

Less than 50%	10%
50% - 70%	28%
70% - 85%	28%
85% - 95%	11%
95% - 105% (about the same)	8%
105% or more (higher)	7%
Don't know	7%

Source: Employee Benefit Research Institute, American Savings Education Council, and Mathew Greenwald & Associates, Inc., 2004 Retirement Confidence Survey.

[2] William J Wiatrowski, "Factors affecting retirement income", Monthly Labor Review, March 1993
[3] Laura Harper and Robert Wm. Baker, "Adequacy of Retirement Benefits", Select Committee on Pension Policy, June 15, 2004

These findings contend that few workers appear to have an idea of how much it takes to live comfortably in retirement. This is further supported in that only about 4 in 10 workers in the same survey reported they had taken steps to calculate how much they need to save for retirement.

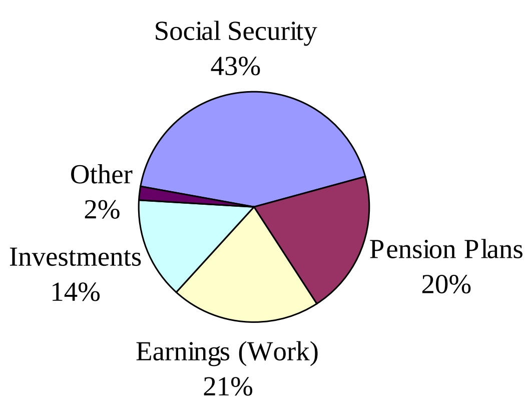
Post-Retirement Income Sources

The second issue involved in analyzing retiree income is how much retirement income a retiree can expect to receive from various sources**.** The United States has traditionally depended on a model referred to as the "three-legged Stool" to finance retirement. The sources of retirement income included as part of the three-legged stool are Social Security, employer pensions, and personal savings.[4]

The largest source of retirement income for Americans has been Social Security. As illustrated in Figure 2, many older Americans (age 65 or older) rely largely or entirely on their monthly Social Security checks. Also important though is pension plan income.

Many researchers suggest that the three-legged stool is becoming wobbly. Most frequently cited reasons are the long term solvency problems with Social Security, funding challenges for tradition employer defined benefit plans, and low savings level. As a result, many state that the three-legged stool is growing a fourth leg in the form of earnings from post-retirement employment. A growing number of Americans are earning money on the job after they've officially retired, sometimes because they feel they must. [5]

Figure 2: Elderly Rely Heavily on Social Security
Source: EBRI Notes, Novemeber2003



[4] Eric M. Engen, William G. Gale, and Cori Uccello, "Lifetime Earnings, Social Security Benefits, and the Adequacy of Retirement Wealth Accumulation", April 2004, Working paper #2004-10.
[5] http://www.ebri.org/benfaq/retfaq1.htm 10/11/04

Social Security

Ever since Social Security was created as part of the New Deal, it has been seen as one of the key legs in the three-legged stool. While Social Security and Medicare have long been the most stable leg of the stool, both are facing projected long-term shortfalls due to a combination of the imminent retirement of the baby boomer generation, lengthening life spans, and rising per-capita health care expenditures.

Today, the average earner who retires at 65, Social Security currently provides benefits equal to 41.3% of pre-retirement earnings, or 38.5% of earnings after deducting Medicare Part B premiums. But for someone retiring in 2030, Social Security benefits are projected to replace 29.9% of pre-retirement earnings. The reason for the decline include the slated increase in the normal retirement age 67, the rising cost of Medicare Part B premiums, which are automatically deducted from Social Security benefits, and the expanding taxation on Social Security benefits under the personal income tax.[6]

With the expected retirement of the baby boomer generation, Social Security is only expected to be solvent until somewhere between 2037 and 2042. Much of the research dedicated to this topic suggest that to maintain the viability of Social Security, additional benefit cuts will be required (beyond increasing the normal retirement age to 67) or significant tax increases will be needed. In either event, it is likely that the amount of pre-retirement income replaced by Social Security will decrease further.

Social Security and LEOFF Plan 2

LEOFF Plan 2 members are not uniformly covered by Social Security. Although a comprehensive study on Social Security coverage for LEOFF Plan 2 members has not been completed, the 2004 Police/Fire Survey conducted by the Association of Washington Cities (AWC) gives some initial insights into Social Security coverage for LEOFF members. The AWC survey respondents included Cities, Counties, Fire Districts, and other entities such as Ports.

The survey was segregated between coverage for Fire Fighter and Law Enforcement members. Out of the 123 respondents with Law Enforcement members, 74% indicated that their LEOFF members are covered by Social Security. This contrasts from the 93 respondents with Fire Fighter members, out of which only 8% indicated Social Security coverage for their LEOFF members.

Although this may not represent a scientific sampling of the LEOFF Plan 2 population, it is sufficient to conclude that only a portion of LEOFF members have access to Social Security as a source of income in post-retirement. Conversely, a portion of the LEOFF population is missing this leg from the three-legged stool and will have to rely on LEOFF Plan 2 benefits and personal savings more heavily in retirement, or turn to other retirement income sources such as post-retirement employment.

[6] "Future Retirees at Risk", American Prospect, Alicia Munell, May 4, 2004 cited in Laura Harper and Robert Wm. Baker, "Adequacy of Retirement Benefits", Select Committee on Pension Policy, June 15, 2004.

Employer Pension

With respect to public and private pension plans, funding has diminished in recent years. In the public sector, state and local retirement plans are facing significant future contribution requirements after many plans improved benefits and took funding holidays in response to the gains of the late 1990's which were then followed by poor market performance from 1999 to 2002. Similarly in the private sector, 58% of private pension plan sponsors surveyed by Deloitte Consulting in early 2004 listed the following two primary concerns about their pension plans: the amount of future cash contributions and the effect of the plan's expense on financial statements. These sponsors identified reducing cost as the single largest expected outcome from a new retirement plan design.[7] A specific discussion on the level of income replacement provided by LEOFF Plan 2 follows in a later section.

Personal Savings

There is widespread concern that today's workers aren't saving enough to finance a comfortable retirement. Personal savings rates for a majority of households have been extremely low in recent years, and some households save very little and have few financial assets. The Federal Reserve's 2001 Survey of Consumer Finances reported that the typical household approaching retirement had only $55,000 in its supplemental retirement account, an amount which is needed to support two decades in retirement.[8] More recently, the 2004 Retirement Confidence Survey further supports that personal savings levels have remained low. As shown in Figure 3, 45% of the people surveyed have less than $25,000 in savings and investments, excluding the value of their primary residence.

Figure 3 - Total Savings and Investments by Age

	All	25-34	35-44	45-54	55+
Less than $25,000	45%	64%	48%	30%	29%
$25,000 - $49,000	11%	17%	11%	9%	5%
$50,000 - $99,000	9%	7%	10%	9%	10%
$100,000 - $249,000	10%	2%	9%	19%	13%
$250,000 or more	8%	3%	7%	10%	13%
Don't know / Refused	18%	8%	15%	24%	30%

Source: Employee Benefits Research Institute, American Savings Education Council, and Matthew Greenwald & Associates, Inc. 2004 Retirement Confidence Survey.

[7] Laura Harper and Robert Wm Baker, "Adequacy of Retirement Benefits", Select Committee on Pension Policy, June 15, 2004.

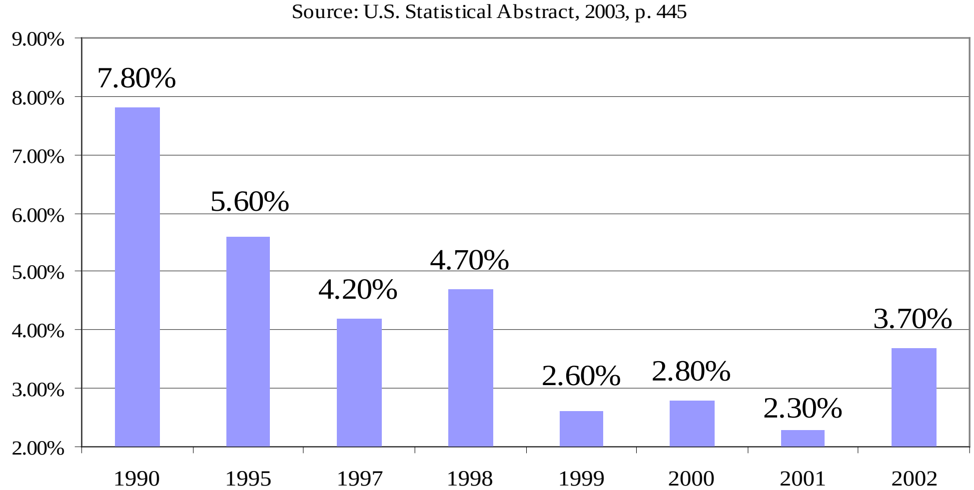
[8] "Future Retirees at Risk", American Prospect, Alicia Munell, May 4, 2004 cited in Laura Harper and Robert Wm Baker, "Adequacy of Retirement Benefits", Select Committee on Pension Policy, June 15, 2004. This statement assumes a normal retirement age of 65. A LEOFF Plan 2 retiree may be in retirement for 3 decades if they retire at age 53.

A factor complicating researchers' ability to evaluate savings is that it is difficult to distinguish between total savings and those exclusively directed at future retirement.[9] One indicator may be money saved in tax-sheltered retirement accounts, such as individual retirement accounts (IRAs). Both the number of people contributing and the amounts contributed to IRAs has been declining since 1990, perhaps partially because of the creation of Roth IRAs, which are not reported on tax returns. About one adult American in five has an IRA.

In 1999, IRA holdings peaked at more than $2.65 trillion. In 2002 IRAs held only $2.3 trillion. Although the decline largely reflects falling stock prices, this is not entirely responsible for the decline thus supports the premise that personal savings levels have declined. The premise is further supported with findings by the U.S. Census Bureau published in the 2003 U.S Statistical Abstract citing savings as a percentage of disposable income. The findings displayed in Figure 4 show a decline in savings over the last decade.

Figure 4 - Savings as a Percentage of Disposable Income

Source: U.S. Statistical Abstract, 2003, p. 445



Another indicator used to measure personal retirement savings adequacy is people's current saving behavior. The Employee Benefits Research Institute recently published its 14th annual Retirement Confidence Survey, a study of the attitudes and behaviors of American workers and retirees toward saving, retirement planning and long-term financial security.

The following are some of the survey's key findings supporting that personal savings may be a weak leg in the three-legged stool.

- Four in ten workers say they are not currently saving for retirement.
- Only about four in ten have taken steps to calculate how much they need to save in order to live comfortably in retirement, and one-third of those say they don't know or can't remember the result of the calculation.

[9] http://www.ebri.org/benfaq/retfaq11.htm 10/11/04

- Almost half of workers who have not saved for retirement feel at least some confidence about their ability to have a comfortable retirement.
- A majority of Americans report that they have saved some money for retirement, but many have saved only a small amount, and savings rates have not increase in recent years.
- Some workers have expectations about their retirement that cannot be achieved.
- More than four in ten workers who tried to do a savings need calculation reported changing their retirement planning as a result.
- Three in ten, or those who received retirement education through the workplace, changed their retirement planning.

LEOFF Plan 2 Income Replacement

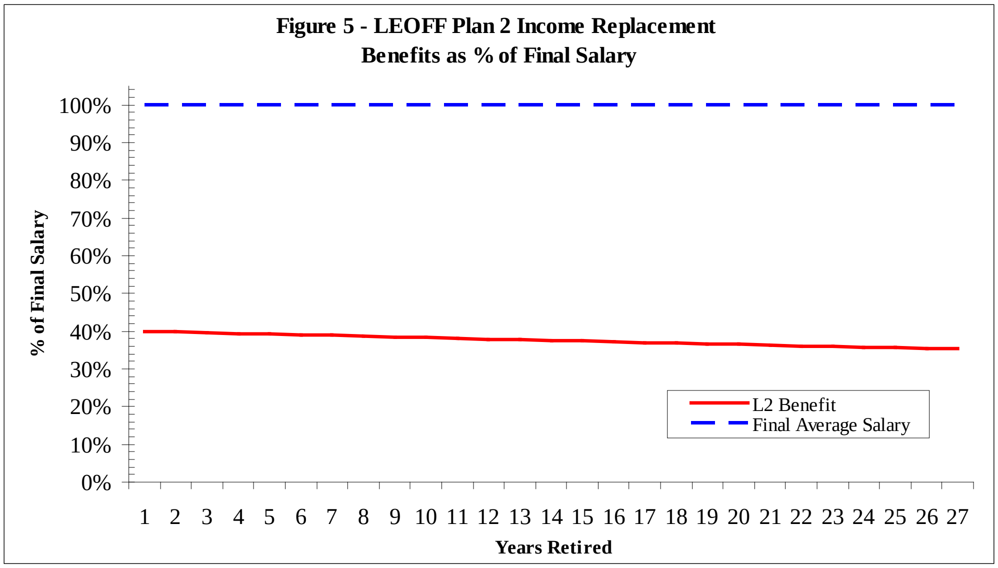
The pension provided by LEOFF Plan 2 represents the employer pension leg on the three-legged stool. This section examines the level at which the design of LEOFF Plan 2 provides income replacement by looking at example benefit computations under the current plan design and assumptions, and comparing the resulting benefits to pre-retirement income levels.

The computations in this section are based on the following assumptions:

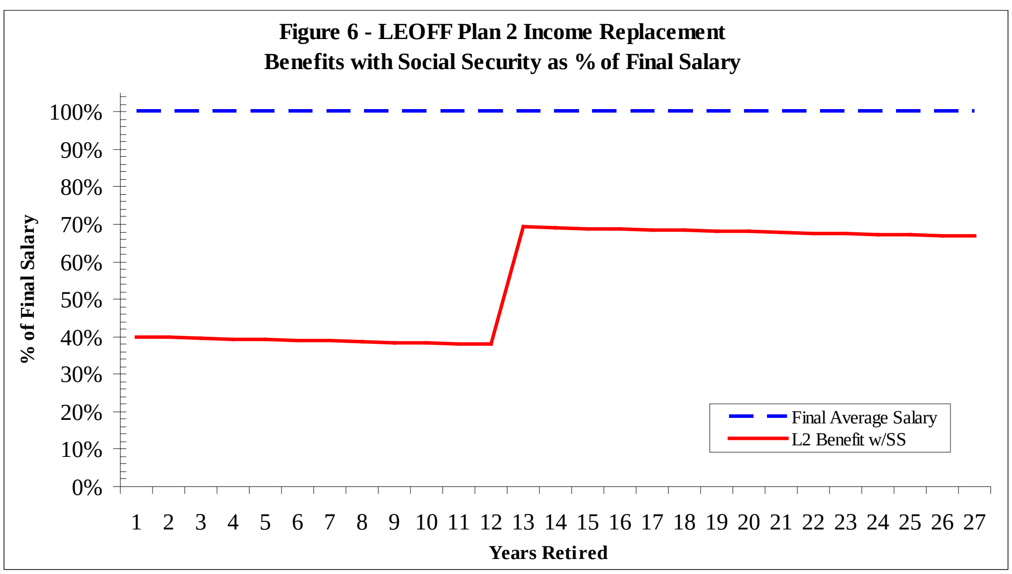
- Current LEOFF Plan 2 provisions
- Final Average Salary (FAS) $65,000
- 20 years of service
- Retirement at age 53
- Inflation at 3.5% annually (actuarial assumption)
- Cost of Living increase at 3% annually
- Social Security beginning at age 66 when members would receive unreduced benefits.

In Figure 5, the member retires at age 53 with 20 years of service resulting in a full LEOFF Plan 2 benefit of $26,000 annually. The LEOFF Plan 2 benefit initially replaces 40%[10] of final salary ($65,000). With the inflation assumption of 3.5%, offset by the 3% COLA assumption, the benefit retains much of its replacement value. After 10 years of retirement the replacement level is reduced to about 38% of final salary. After 20 years of retirement the replacement level is reduced to just above 35% of final salary.

[10] The LEOFF Plan 2 benefit formula u ses a 2% multiplier. Therefore, a retiree with 20 years of service will receive 40% of final average salary. A retiree with 30 years will receive 60%. A retiree with 15 years will receive 30%.



When Social Security is available, the total income replacement is much higher as shown in Figure 6. For the first 12 years of retirement, the income replacement levels are the same with and without Social Security. However, assuming the retiree receives Social Security in the thirteenth year of retirement at age 66, the income replacement level jumps to 69% of final salary. While Social Security is fully indexed, its share of the combined benefits is not enough to offset the overall effect of the inflation assumption. Thus, 20 years after retirement the income replacement level has decreased slightly to 68% of final salary. After 23 years of retirement (10 years after Social Security began) the income replacement level is 67% of final salary. With Social Security and the LEOFF Plan 2 benefit combined in this example, the retiree moves into the suggested 60% to 90% replacement rate range.



Protection of Benefits

The previous sections looked at income replacement levels and the sources that retirees may draw income from. The following sections analyze retiree income by examining how well a retiree's post-retirement income is protected. The primary question here is how well the retirement benefit will keep up with the cost of living. While there are a number of factors that may affect a retiree's purchasing power, the impact of inflation and health care costs are two of the most prevalent.

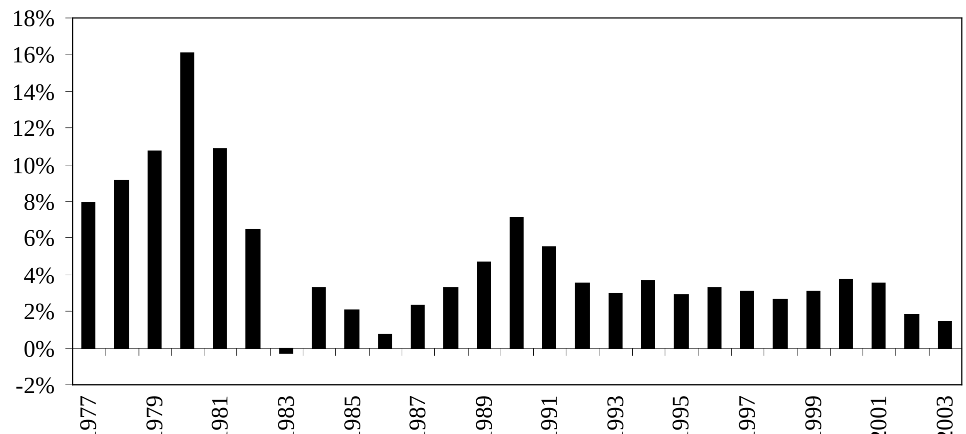
Inflation

In the following discussion it is necessary to recognize that the income replacement examples in Figure 5 and Figure 6 used assumptions for the rate of inflation and cost of living increases. These assumptions generate a very straightforward linear result which suggests that a LEOFF Plan 2 retiree's benefit is relatively well protected from inflation. Because the real rate of inflation fluctuates over time and is not necessarily linear like the assumption, it is useful look back at the historical inflation rates to determine hypothetically how LEOFF Plan 2 benefits may be impacted by different levels of actual inflation.

Figure 7 shows the annual percentage change in the CPI-W for the Seattle-Tacoma-Bremerton area from 1977 to 2003. The CPI-W (Seattle-Tacoma-Bremerton) is used for determining the COLA adjustments LEOFF Plan 2. The specific CPI –W values are listed in Appendix A.

With brief exceptions in the late 1970s and early 1980s, the rate of inflation since the inception of LEOFF Plan 2 has remained relatively stable. As shown in Figure 7, the rate of inflation has been higher than the inflation rate assumption (3.5%) in some years and lower than the assumption in others since the mid 1980s, but has continued to hover around the assumption.

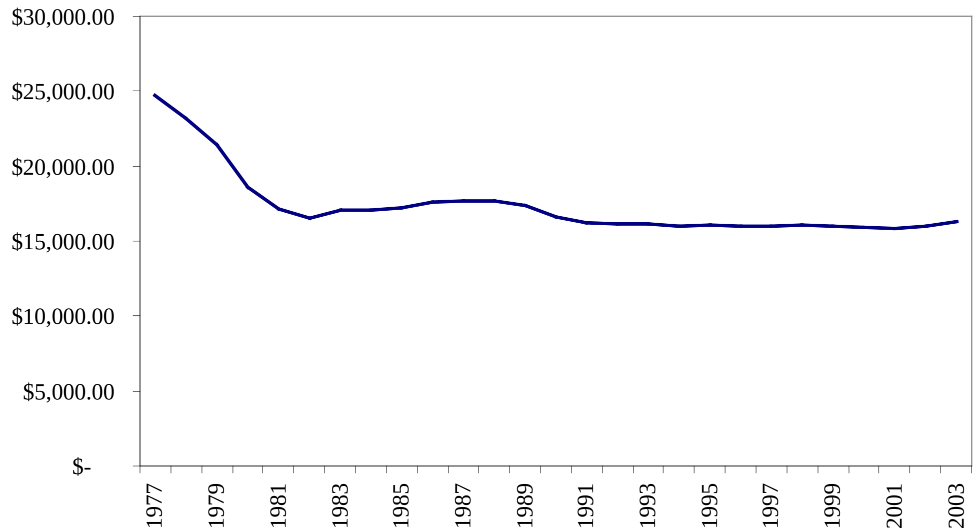
Figure 7 - Annual Percent Changes
CPI-W Seattle-Tacoma-Bremerton
1977-2003



It is suggested in Figure 7 that the timing of retirement can have a direct bearing on how well the value of a retirement benefit is maintained. For instance, a member retiring in 1979 would have been subject to over 16% inflation in 1980, 10.8% inflation in 1981, and 6.5% inflation in 1982 resulting in more than 20% loss of purchasing power. A member retiring more recently however would have experienced far more even levels of inflation and less diminishment of their benefit as the inflation rates rose only 1.8% in 2002 and 1.4% in 2003.

Figure 8 further demonstrates what the actual impacts of inflation could be on a LEOFF Plan 2 benefit. While certainly not realistic, Figure 8 assumes the hypothetical member retired in 1977 with a $26,000 annual benefit. This allows us to look at what the impact to a retiree's benefit would be during both periods of high inflation and periods of moderate inflation. A few important points become immediately apparent when the actual impact of inflation is examined in this manner.

Figure 8 - Actual Impact of Inflation
1977-2003



The first point demonstrated in Figure 8 is that a retiree's LEOFF Plan 2 benefit is not well protected during periods of high inflation. During the period of 1977 to 1982 the hypothetical retiree's benefit is reduced in value from $26,000 down to about $16,500. Clearly, when inflation is double, or even quadruple the inflation rate assumption, the loss of purchasing value quickly outpaces the 3% maximum COLA provided by the plan.

The second point demonstrated in Figure 8 is that during periods of relatively moderate and stable inflation, a LEOFF Plan 2 retiree's benefit is relatively well protected by the plan's COLA. From the mid-80's to the present, the inflation rate was stable and generally fluctuated between 2% and 4%. As can be seen in Figure 8, as long as inflation continues to hover about 2% to 4%, the value of the retirement benefit will remain relatively constant due to COLA adjustments.

Lastly, Figure 8 demonstrates that when a period of high inflation occurs and benefit value is significantly diminished, the current design of the plan's COLA does not provide significant opportunity to regain the lost value. As the graph shows, the benefit value in 1982, after a large drop in value due to a period of high inflation, is nearly identical to the benefit level in 2003 after 20 years of stable inflation.

Health Care Costs[11]

The cost of health care is quickly becoming one of the most important risks facing retirees today. As health care costs rise beyond normal inflation, they command a greater share of retirees' income, forcing them to scale back on other living expenses and thus diminishing the overall adequacy of retirement benefits.

According to Melissa Ahem, a health care economist and associate professor of health policy and administration at Washington State University Spokane, some of the driving forces behind rising health care costs are:

- Consumers who want it all, from free choice of physician and loaded benefit packages to unlimited services
- Increasing numbers of uninsured and associated costs for care delivered in hospital emergency rooms
- Increased direct to consumer marketing of pharmaceuticals
- Lack of personal responsibility for health
- Large number of baby boomers moving rapidly toward being Medicare recipients

For much of the 1990's, health care costs in the country were held in check. With a tight labor market, employer-provided health care was a competitive necessity to attract and retain employees. The ability to control costs made these popular benefits economically feasible for employers to offer.

Recently this tend has begun to reverse. In 2001, employers experienced an average health care premium increase of 13%.[12] The National Conference of State Legislatures, citing Deloitte & Touche's September 2003 Employer Survey, reports that the cost of employer-sponsored health care plans rose 14.9% in 2003, from an annual $5,239 per employee in 2002 to $6,020 per employee. Survey respondents predicted that their 2004 plan costs would raise again an average of 14.3% to $6,880 per employee.

Nationally, health care spending is projected to be $1.79 trillion, or 15.5% of the total gross domestic product (GDP) in 2004. This will be $6,167 per capita.[13] In the next 10 years

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[11] This section was adapted directly from the following sources: Laura Harper and Robert Wm Baker, "Adequacy of Retirement Benefits", Select Committee on Pension Policy, June 15, 2004 and Robert Wm. Baker, "Retiree Health Insurance", Select Committee on Pension Policy, September 7, 2004.

[12] Committee on Education and the Workforce, Sounding the Alarm: Rising Health Care Costs Increase the Ranks of the Uninsured cited in Laura Harper and Robert Wm. Baker, "Adequacy of Retirement Benefits", Select Committee on Pension Policy, June 15, 2004

[13] Health Affairs, 2/11/04 cited in Laura Harper and Robert Wm. Baker, "Adequacy of Retirement Benefits", Select Committee on Pension Policy, June 15, 2004

health care spending is expected to increase further. According to the Centers for Medicare and Medicaid Services, health care spending could reach 18.4% of GDP.

Individual health care expenses are impossible to predict; health care can be expensive even for healthy retirees. The average consumer age 65 and older pays not only a larger share of their income for health care; they also pay a greater absolute amount than someone in their peak earning years (see Figure 9). According to the Bureau of Labor Statistics, Consumer Expenditure Survey, the average household whose head was age 45 to 54 paid $2,550 in health care expenditures in 2002, or 5.2% of their total household expenses. In comparison, the average household whose head was age 65 or older paid $3,586 in health care expenditures in 2002, or 12.8% of their total household expenses.

Figure 9 - Average Consumer Expenditures By Age

	45 - 54		65 and Over	
	Dollars	**Percent**	**Dollars**	**Percent**
Total Expenditures	$48,748	100%	$28,105	100%
Food & Drink	$6,693	13.7%	$4,147	14.8%
Housing	$15,476	31.7%	$9,176	32.6%
Apparel	$2,029	4.2%	$972	3.5%
Transportation	$9,173	18.8%	$4,481	15.9%
Health Care	**$2,550**	**5.2%**	**$3,586**	**12.8%**
Entertainment	$2,565	5.3%	$1,139	4.1%
Miscellaneous	$3,367	6.9%	$1,638	5.8%
Cash Contributions	$1,571	3.2%	$1,679	6.0%
Insurance & Pensions	$5,323	10.9%	$1,286	4.6%

Source: Bureau of Labor Statistics, Consumer Expenditure Survey, 2002

Moreover, paying for long-term care can wreak havoc on retirement savings. According to the American Health Care Association, the average American man can now expect to spend $56,895 on long-term care while the average American woman will spend close to double that, at $124,370. The price of long-term care is increasing around 6 percent a year. Medicare covers only about 50% of seniors' regular health expenses, excluding nursing home care. The American Association of Retired Persons/People estimates that the national average for the cost of one month in a nursing home is $4,654 or $55,848 annually. These costs may vary widely depending on geographic location.

Inflation and Retiree Expenditures[14]

In looking at the expenditures in Figure 9, it becomes apparent that the Age 65 and Over population have distinctly different spending patterns than younger consumers. As a result, the Consumer Price Index for urban wage earners and clerical workers (CPI-W), which measures price changes in the market basket of a younger working population, may not necessarily be representative of the price changes experienced among older consumers. The

[14] This section was adapted directly from Robert Wm. Baker, "Retiree Health Insurance", Select Committee on Pension Policy, September 7, 2004.

CPI-W for the Seattle-Tacoma-Bremerton region is used to adjust the monthly allowances of retired LEOFF Plan 2 members.

Concern over the disparity in consumption patterns of retirees and workers resulted in the establishment of an experimental CPI by the U.S. Department of Labor, Bureau of Labor Statistics. Called the CPI-E, this index measures the changes in consumer prices experienced by the population age 62 and older – age 62 being the youngest at which a retiree may receive Social Security.

Comparing the changes in the consumer prices as measured by the CPI-U (all urban consumers) and the CPI-W (wage earners and clerical workers) for the Seattle-Tacoma-Bremerton region, with the experimental CPI-E for the nation produces an interesting result.

In the mid-to-late 1980s, the CPI-E rose more quickly than either of the two indices for the Seattle region. By the mid-to late 1990s, however, the Seattle CPI-U began to converge with the CPI-E and track in unison. As a result, the CPI-U for the Seattle region closely reflected the changes in consumer prices experienced by the Age 62 and older population nationwide. This suggests that the cost of living adjustments based on CPI-W currently in the LEOFF Plan 2 design may not align with the actual inflation experience of LEOFF Plan 2 retirees.

6. Supporting Information

Appendix A – CPI-W (Seattle-Tacoma-Bremerton)

Year	CPI-W Value	CPI-W Annual % Change
1977	177.6	7.96%
1978	193.8	9.12%
1979	214.6	10.73%
1980	249.1	16.08%
1981	276.1	10.84%
1982	294	6.48%
1983	293.2	-0.27%
1984	302.8	3.27%
1985	309.1	2.08%
1986	311.3	0.71%
1987	318.6	2.35%
1988	329.1	3.30%
1989	344.5	4.68%
1990	369	7.11%
1991	389.4	5.53%
1992	403.2	3.54%
1993	415.2	2.98%
1994	430.4	3.66%
1995	442.9	2.90%
1996	457.5	3.30%
1997	471.7	3.10%
1998	484.1	2.63%
1999	499.1	3.10%
2000	517.8	3.75%
2001	536.2	3.55%
2002	545.9	1.81%
2003	553.6	1.41%