



## Omaha Must Control Its Pension Problem

On September 12, the City of Omaha joined the federal government in losing its AAA credit rating, being downgraded to AA by the national rating agency Standard & Poors (S&P). This downgrade comes a year after Moody's Investor Services, another national rating agency, stripped Omaha's General Obligation Bond Rating of its AAA rating, lowering it to Aa1, a rating Moody's reaffirmed this year. In both cases, the rating agencies indicated the unfunded pension liabilities as the primary reason for reducing the ratings. Similarly, the city's AA ratings for certificates of participation and lease revenue bonds were also downgraded to AA by S&P.[i]

Lower than optimal bond ratings from the two most prominent rating agencies in the country could have a significant impact on Omaha's economic future. For example, a lower bond rating makes it more difficult for the city to borrow money for major projects; a lower bond rating may lead to a higher borrowing rate, or lenders may become hesitant about whether the city will be able to pay its obligations. If it becomes difficult for the city to fund major projects, they are either not undertaken or the city must find alternate ways to finance the projects, whether by cutting spending or increasing taxes.

Considering the agencies themselves have pointed to Omaha's public pension liabilities as the primary reason the ratings have fallen, that should be the first place policymakers should go to reform the system and regain AAA from both S&P and Moody's. Although the city estimates its unfunded pension liability at approximately \$800 million, Moody's estimates the real number as twice that amount, at least \$1.6 billion.[ii] In the Platte Institute's May 2013 study, economist and pension expert Andrew G. Biggs—using fair market valuation as opposed to actuarial valuation—calculated that Omaha's Fire and Police pensions alone were 75 percent unfunded, with an unfunded liability of \$1.43 billion.[iii]

With the city currently negotiating contracts with the Civilian Union and Police

Management, and Police Union negotiations to begin soon, it is now time to reform these pensions and reassure lenders that Omaha has its public pension systems under control. The progress made in last year's Fire contract, which increased firefighter's contributions while reducing other pension benefits, should serve as a model for the other unions' contracts. Additionally, the Fire contract's expiration in 2014 provides an opportunity to make additional progress in bringing these pension systems under control.[iv]

These are not the only reforms that should be made; shifting pensions from their current defined benefit structure to defined contribution plans, which are used in the private sector and have been adopted by most other Nebraska localities, would also be a significant change, making pensions more transparent, predictable, and easier to manage.[v]

The recent bankruptcy of Detroit, the largest municipal bankruptcy in American history,[vi] demonstrates how detrimental uncontrolled public pensions can be. All Omahans, pensioners and taxpayers alike have something to lose if changes are not made. Last year, when Moody's downgraded Omaha, the City Actuary pointed out that if nothing was done, the pension system would completely run out of money in 20 years.[vii] Such an outcome would hurt not only those reliant on their pensions, but also citizens of Omaha who may have their taxes raised or other services cut so the city can fulfill its obligations. It should also be noted that under current law, funding pension liabilities takes preference over funding basic city services, including basic public safety. Such an outcome is detrimental to all citizens and is a grim reality we may have to confront if the public pension system is not reformed.

If Omaha is to continue to thrive, public pensions must be reformed, and they must be reformed now.

[i] *WOWT*, "Omaha Bond Rating Reports Released," September 13, 2013. Accessed September 27, 2013, <http://www.wowt.com/home/headlines/Omaha-Bond-Rating-Reports-Released-223671181.html>; *WOWT*, "Omaha Bond Rating Downgraded," September 21, 2012. Accessed September 27, 2013, <http://www.wowt.com/home/headlines/Omaha-Bond-Rating-Downgraded-170737706.html>; Erin Golden, "City of Omaha's bond rating downgraded; pension

concerns cited," *Omaha World Herald*, September 13, 2013. Accessed September 27, 2013, <http://www.omaha.com/article/20130912/NEWS/130919466>.

[ii] *WOWT*, "Omaha Bond Rating Reports Released," September 13, 2013. Accessed September 27, 2013, <http://www.wowt.com/home/headlines/Omaha-Bond-Rating-Reports-Released-223671181.html>.

[iii] Andrew G. Biggs, "Honest Accounting and Public Employee Pensions in Nebraska," Platte Institute for Economic Research May 2013. Accessed September 27, 2013, [http://www.platteinstitute.org/docLib/20130520\\_Platte-Pension\\_\(3\).pdf](http://www.platteinstitute.org/docLib/20130520_Platte-Pension_(3).pdf).

[iv] *WOWT*, "Omaha Bond Rating Reports Released," September 13, 2013. Accessed September 27, 2013, <http://www.wowt.com/home/headlines/Omaha-Bond-Rating-Reports-Released-223671181.html>.

[v] David J. Kramer, "Nebraska's Public Pension System," Platte Institute for Economic Research, June 2013. Accessed September 27, 2013, [http://www.platteinstitute.org/docLib/20130621\\_Kramer\\_Pension\\_Paper.pdf](http://www.platteinstitute.org/docLib/20130621_Kramer_Pension_Paper.pdf); "The Problem with Defined Benefit Plans" in *Platte Institute Quarterly*, Summer 2013. Accessed September 27, 2013, [http://www.platteinstitute.org/docLib/20130826\\_PlatteQuarterly-Summer2013.pdf](http://www.platteinstitute.org/docLib/20130826_PlatteQuarterly-Summer2013.pdf).

[vi] Heidi Moore, "Detroit, tip of a vast pensions liability iceberg," *The Guardian*, July 18, 2013. Accessed September 27, 2013, <http://www.theguardian.com/commentisfree/2013/jul/18/detroit-pensions-liability-iceberg>.

[vii] *WOWT*, "Omaha Bond Rating Downgraded," September 21, 2012. Accessed September 27, 2013, <http://www.wowt.com/home/headlines/Omaha-Bond-Rating-Downgraded-170737706.html>.