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Funding CalSTRS

LEGISLATIVE ANALYST'S OFFICE

Presented to:
Assembly Public Employees, Retirement and Social Security Committee
Hon. Rob Bonta, Chair

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Full Funding Should Be Key Goal

- ☑ ***State Required to Address Situation.*** The state is obligated under law to ensure that the California State Teachers' Retirement System (CalSTRS) is "financially sound," whether added contributions come from the state, school districts, and/or teachers.

- ☑ ***Full Funding Plan Minimizes Intergenerational Cost Shifts.*** A plan aiming for "full funding" of CalSTRS' unfunded liabilities would minimize the costs that future generations incur for benefits already earned. Anything less would continue the practice of shifting the costs of teacher pensions from one generation to the next.

- ☑ ***Plan Should Aim for Full Funding in About 30 Years.*** In our view, the plan should aim to fully eliminate the unfunded liability in about 30 years.

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Major Cost Increases for State and School Districts Likely

☑ ***Over $5 Billion in Additional Contributions Likely Needed.*** Assuming a gradual ramp up, the scenarios presented by CalSTRS would likely result in additional contributions from the state, school and community college districts, and/or teachers totaling over $5 billion per year by the early 2020s.

☑ ***Majority of Funding From State and Districts.*** While teachers may play some role in the funding plan, the majority of the needed funding probably will come from the state and school districts. A full-funding plan for CalSTRS will have a significant effect on state and school district budgeting.

☑ ***Cost Similar to State Spending on Universities.*** By 2020-21, when all of the ramped-up scenarios presented by CalSTRS would be fully phased in, the additional contributions needed would be roughly the amount of state General Fund spending on the University of California and the California State University combined, as proposed in the *2014-15 Governor's Budget*.

Scenarios For Addressing $71 Billion CalSTRS Unfunded Liability [a]

Additional Contributions Above Current Law (In Billions)

Pace of Annual Ramp Up[b]	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
3 percent	$0.9	$1.8	$2.9	$4.0	$5.1	$5.7
4 percent	1.2	2.5	3.8	5.1	5.3	5.5
5 percent	1.5	3.1	4.8	4.9	5.1	5.3
6 percent	1.8	3.7	4.7	4.9	5.1	5.3

[a] Based on estimates provided by the California State Teachers' Retirement System (CalSTRS) at its February 6, 2014 board meeting.

[b] Annual increase of additional contributions until long-term rate is reached, as measured by percentage of statewide teacher payroll. For example, a 3 percent annual ramp up increases contributions from state, districts, and/or teachers above those required in current law by 3 percent of payroll in year one, 6 percent in year two, and so on.

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More Costly the Longer We Wait

☑ ***Delay Costs Around $150 Million Annually in the Near Term.*** Each year that a funding plan for CalSTRS is delayed, the state will have fewer resources in the future that could otherwise support ongoing public programs. These costs compound over time. In the near term, each year of delay may require an added $150 million of annual, ongoing contributions—assuming CalSTRS meets its investment assumptions. (In other words, a two-year delay may add $300 million to future annual costs, and a four-year delay may add over $600 million to future annual costs.)

☑ ***Added Cost of Two-Year Delay.*** If the state delays action until 2017-18, ongoing costs of a funding plan would be around $300 million higher than if the same plan began in 2015-16. This added cost would be roughly equivalent to current state spending on the Department of Fish and Wildlife.

☑ ***Costs of Six-Year Delay Even Greater.*** By 2021-22, the costs of delay would be about $1.1 billion each year, roughly the amount of current state spending on the Department of Motor Vehicles.

Delaying Funding Plan for CalSTRS Costs Over $150 Million Annually[a]

Additional Contributions Above Current Law (In Billions)

Implementation Date	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
2015-16	$4.2	$4.4	$4.5	$4.7	$4.9	$5.0	$5.2
2017-18	—	—	4.8	5.0	5.2	5.4	5.6
Cost of Delay	**—**	**—**	**$0.3**	**$0.3**	**$0.3**	**$0.3**	**$0.3**
2015-16	$4.2	$4.4	$4.5	$4.7	$4.9	$5.0	$5.2
2019-20	—	—	—	—	5.5	5.7	5.9
Cost of Delay	**—**	**—**	**—**	**—**	**$0.6**	**$0.7**	**$0.7**
2015-16	$4.2	$4.4	$4.5	$4.7	$4.9	$5.0	$5.2
2021-22	—	—	—	—	—	—	6.3
Cost of Delay	**—**	**—**	**—**	**—**	**—**	**—**	**$1.1**

[a] Based on estimates provided by the California State Teachers' Retirement System (CalSTRS) at its February 6, 2014 board meeting. Estimates assume no ramp up in contributions after initial implementation dates shown. Costs of delay would be higher if the funding plan ramps up contributions after those dates.

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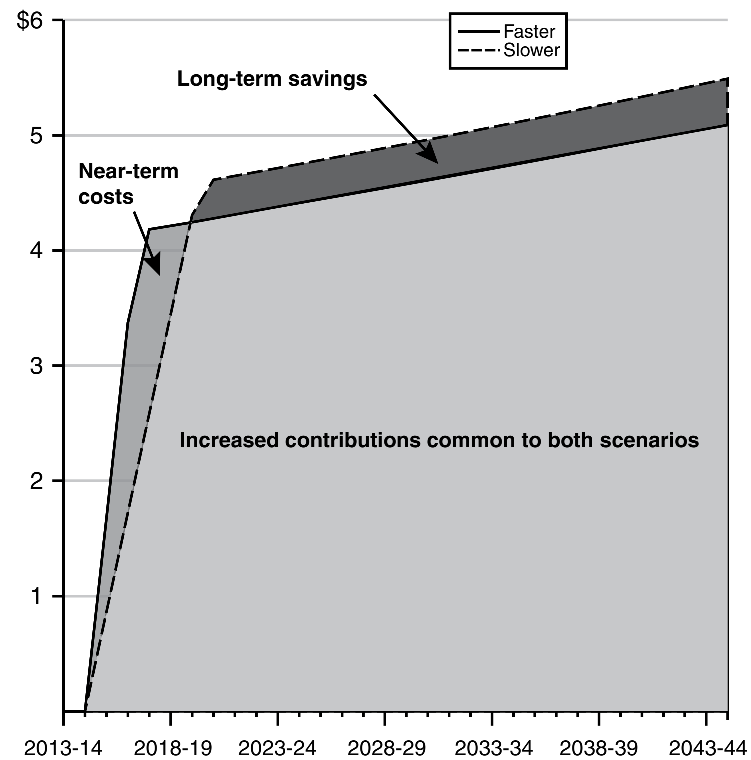
Faster Ramp Up Reduces Long-Term Costs

- ☑ ***Faster Ramp Up Means Long-Term Savings.*** The figure below displays the near-term costs of a ramp up of contributions by 6 percent of teacher payroll each year compared to a slower 3 percent per year ramp up. The higher near-term costs of a faster ramp up, however, would be more than offset by long-term savings over the 30-year period. The future annual savings would be around $350 million (growing over time)—more than the amount of spending for the Department of Child Support Services.

Faster Ramp Up: Long-Term Savings Double the Higher Near-Term Costs[a]

Additional Contributions Above Current Law (In Billions)



[a] Displays the near-term higher costs of an annual ramp up in contributions equal to 6 percent of teacher payroll and the long-term savings of a 6 percent ramp up compared to a slower 3 percent annual ramp up. Both scenarios assume full funding over 30 years. Adjusted for inflation.

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Acting Quickly Reduces Costs and Risk of Further Deterioration

- ☑ ***Setting Aside Some Money Now Would Be Smart.*** With regards to CalSTRS, the most important action the state can take to minimize long-term costs is to act quickly to increase funding to the system. Setting aside some money for CalSTRS in 2014—when the state's budget situation is fairly strong—would be smart.

- ☑ ***"0 Percent Scenarios" Show Risk of Further Depletion. . .*** At its recent meeting, the CalSTRS board reviewed various scenarios considering how much additional funding would be needed if the system recorded a 0 percent return in both 2014-15 and 2015-16. These scenarios demonstrate how quickly the funded status can decline—even if additional contributions to the system are being phased in.

- ☑ ***. . .And Underscore Need to Monitor Progress of Plan.*** In the 0 percent scenarios, the additional contributions needed increase substantially over the amount needed in scenarios that assume the system meets its investment return assumptions. The scenarios underscore the need to revisit the funding plan periodically over time.

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Considerations for Funding Plan

- ☑ ***CalSTRS Costs Grow Faster Than Most Other State Liabilities.*** Each year the state delays action on the unfunded liability, the state loses another 7.5 percent return under the actuarial assumptions, an amount that compounds over time. In contrast, infrastructure and budgetary liabilities—including items on the Governor's wall of debt—tend to grow at slower rates. Therefore, addressing the CalSTRS liability may be more important than these other state liabilities.

- ☑ ***Full Funding Plan Minimizes Long-Term Costs.*** The rapid long-term growth of unfunded pension costs is a key reason for the state to aim for full funding of CalSTRS over the next 30 years or so. The Legislature, however, could consider other funding plan options. If a 30-year full-funding plan is not chosen, we think the next best choice would be aiming for *full funding* of unfunded liabilities over the next 40 years or so, rather than aiming for *partial funding* over the long term. Either alternative is less than CalSTRS' "definitive approach."

Considerations for Funding Plan *(Continued)*

- ☑ ***Proposition 98.*** There are differing opinions about whether an increase in school district contributions would require an adjustment in the Proposition 98 minimum guarantee. We advise the Legislature to focus first on the fundamental issue of how costs should be split among the state, school districts, and teachers. Once this very difficult issue is resolved, Proposition 98 budgets can reflect the agreement.

- ☑ ***"Grand Bargain" Possible.*** The *2014-15 Governor's Budget Summary* comments that the state's long-term role as a direct contributor to CalSTRS should be evaluated. We agree. While the state can—and probably should—play a key role in addressing the unfunded liability for benefits already earned, this discussion presents a key opportunity to increase local control over pension benefits for future teachers. A deal could involve significant state contributions to pay *existing* unfunded liabilities over the next few decades, coupled with a shift of direct financial responsibility for *future* teachers' benefits to districts and teachers alone.