LAO
60 YEARS OF SERVICE

January 14, 2004

Hon. Bill Lockyer
Attorney General
1300 I Street, 17th Floor
Sacramento, California 95814

Attention: Ms. Tricia Knight
Initiative Coordinator

Dear Attorney General Lockyer:

Pursuant to Elections Code Section 9005, we have reviewed the proposed statutory initiative regarding State Teachers' Retirement System (STRS) benefits (File No. SA2003RF0062).

Key Provisions

The STRS is a statewide system providing benefits primarily to certificated employees (teachers) in local school districts. Current retirement contributions to STRS are specified in law. Teachers contribute 8 percent of their salary (2 percent of which goes into a supplemental retirement plan), and districts pay 8.25 percent. In addition, the state contributes 4.517 percent of salary from the General Fund—2.017 percent for basic benefits and 2.5 percent for purchasing power protection.

For individuals retiring at 55 years of age or older with at least 15 years of service (the last five of which must be directly with students), the measure increases teacher retirement benefits in the following manner:

- ***Retirement Formula.*** Pension benefits would increase to 3 percent of salary for each year of service ("3 percent at 55"). The current retirement benefit is "2 percent at 60."
- ***Purchasing Power Protection.*** Benefits would be maintained at 100 percent of their original purchasing power to protect against inflation. Current pensions are maintained at 80 percent purchasing power protection.
- ***Salary for Calculating Pension.*** The measure changes the salary used to calculate pension benefits to the one-year period with the highest pay. Currently, the one-year period applies only to teachers who (1) have at least 25 years of service or (2) work in school districts that elect to pay for the

higher benefit. All others are subject to a three-year pay period for calculating retirement benefits, which generally results in a smaller pension.

Fiscal Effect

Cost of Benefits (Other Than Purchasing Power Protection). By increasing the retirement formula percentage, lowering the retirement age, and increasing the salary base for calculating pension benefits, the measure would raise annual retirement contributions to STRS by one-third. Specifically, the proposal would raise the annual cost to pay for future retirement benefits (“normal cost”) and instantly create a large debt for the past years of service (“unfunded liability”). These two cost components would require additional retirement contributions from teachers, schools, and/or the state.

The STRS estimates that annual contributions would have to increase by 6.803 percent of salary for benefits—3.428 percent on an ongoing basis for the normal cost and 3.375 percent for 30 years to pay off the unfunded liability. This would amount to approximately $1.7 billion in additional retirement contributions in the first full year the additional retirement benefits were in effect. These costs would grow annually with teacher payroll. After paying off the unfunded liability in 30 years, only the annual normal cost payment would continue.

Cost of Purchasing Power Protection. The fund that pays for purchasing power protection currently has a surplus. The measure’s 100 percent purchasing power protection provision, therefore, would not require an immediate increase in annual retirement contributions. After 12 years, however, STRS estimates that current contributions would be insufficient to maintain purchasing power protection payments.

Who Pays Additional Costs Not Specified. In the past, the state General Fund has paid for any benefit increases or funding shortfalls. Yet, the measure does not specify how these additional costs would be funded. Consequently, the Legislature would need to approve implementing legislation designating increased contributions from teachers, school districts, and/or the state. Any additional teacher contributions for retirement would reduce the additional cost to the state and/or school districts.

Administration. The STRS does not currently collect member data on years of service directly with students, which affects eligibility for the proposed retirement benefits. In addition, it is unclear whether school districts track such information. Therefore, it is possible that the measure would require additional administrative costs for either STRS or school districts to track these data to determine eligibility.

Fiscal Summary. This measure would have the following major fiscal impact:

- Increased state and/or school district retirement costs of up to $1.7 billion annually.

Sincerely,

Elizabeth G. Hill
Legislative Analyst

Donna Arduin
Director of Finance