MARCH 12, 2019

CalSTRS Pension Proposals

PRESENTED TO:

Assembly Budget Subcommittee No. 2
On Education Finance
Hon. Kevin McCarty, Chair

LEGISLATIVE ANALYST'S OFFICE

Background on California State Teachers' Retirement System (CalSTRS)

CalSTRS Administers Pension Benefits for Teachers and Other Certificated Employees

- System covers 950,000 active employees, retirees, and beneficiaries.

CalSTRS Receives Funding From Four Sources

- Districts make contributions from their local operating budgets.
- The state makes contributions through an annual non-Proposition 98 General Fund appropriation.
- Employees make contributions through payroll deductions.
- Contributions are invested and generate investment returns over time.

CalSTRS Historically Has Been Underfunded

- For most of its 100-plus year history, contributions to CalSTRS have been insufficient to pay for pension benefits as employees earn them.
- The estimated gap between the cost of future benefits and the assets available to pay for those benefits is known as an unfunded liability. Estimates of the unfunded liability rest on many assumptions (including investment returns and life expectancy).
- The unfunded liability grew notably during the 2000s, primarily due to (1) benefit increases approved in the late 1990s, (2) large investment losses during the Great Recession, and (3) less optimistic assumptions about future investment returns.

Underfunding of CalSTRS Has Notable Drawbacks

- Costs are shifted to future generations.
- Pension benefits are more expensive to provide in the long run.

Background on 2014 Funding Plan

State Enacted CalSTRS Funding Plan in 2014

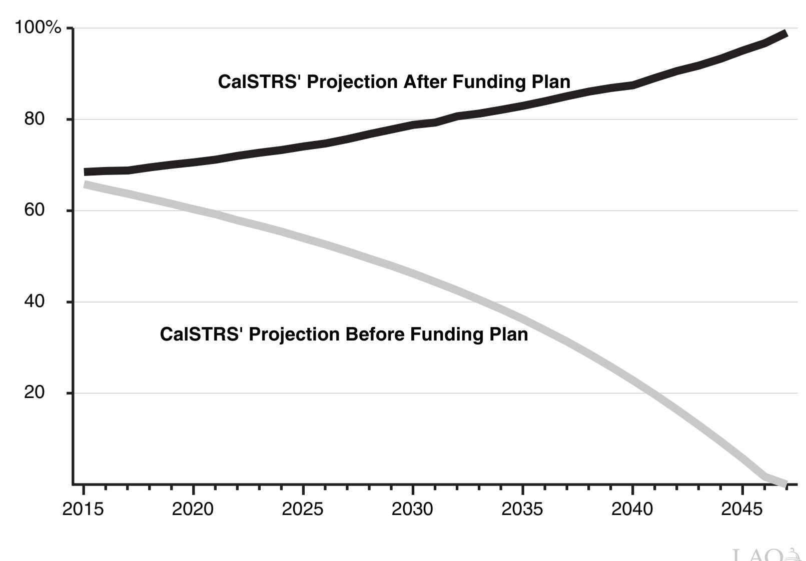
- Intended to pay down the CalSTRS unfunded liability by the mid-2040s.
- Phased in higher contribution rates for districts, the state, and employees. For districts, the plan set forth a statutory schedule increasing rates over a seven-year period.

Funding Plan Reflects a Significant Accomplishment

- Reflected the results of several years of hearings examining possible options.
- Dramatically improved the outlook for CalSTRS funding over the next several decades.

CalSTRS' Funding Outlook

Assets as Percent of Accrued Liabilities

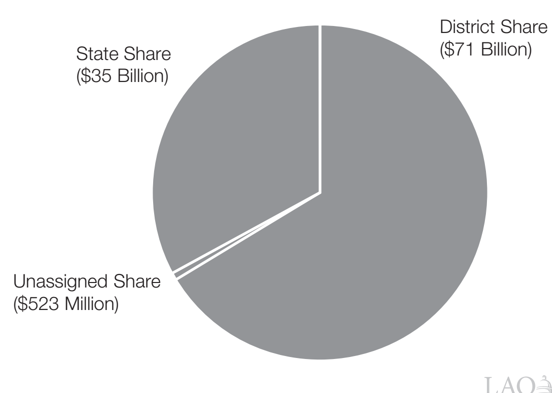


Update on CalSTRS Unfunded Liability

CalSTRS Has an Unfunded Liability of About $107 Billion

- CalSTRS currently estimates it has about 63 percent of the assets needed to pay pension benefits earned to date.
- Currently about two-thirds of the unfunded liability is assigned to districts and one-third to the state. These shares can fluctuate over time. (A small share is not assigned to either party.)

Current Allocation of CalSTRS Unfunded Liability
As of June 2017



Update on District Rates and Contributions

District Contributions Have Increased More Than $3 Billion Since Adoption of the Funding Plan

- In 2013-14, district contributions were set at 8.25 percent of payroll. The associated costs were $2.3 billion.
- Under the statutory schedule established by the plan, district contributions have risen to 16.28 percent of salary in 2018-19. The administration estimates district CalSTRS costs have grown to $5.4 billion.

District Contributions Are Likely to Increase Another $1.4 Billion Over Next Two Years

- Rates are set to increase to 18.1 percent in 2019-20 and 19.1 percent in 2020-21.

After 2020-21, the District Contribution Rate Can Fluctuate

- After 2020-21, the funding plan allows the CalSTRS board to increase or decrease the district rate by up to 1 percentage point per year.
- Under the plan, the district rate is capped at 20.25 percent.

District Pension Costs Are Affected by Local Payroll Decisions

- A district's pension costs are affected by its decisions about salaries and staffing levels.
- Districts with the largest increases in salary and staffing are experiencing faster increases in their pension costs compared with other districts.

Governor's Proposals

Designates $700 Million for District Budget Relief Over the Next Two Years

- Allocates about $350 million per year in 2019-20 and 2020-21.
- District contribution rates would be 1 percentage point lower than under current law (17.1 percent in 2019-20 and 18.1 percent in 2020-21).
- Proposal would reduce pension costs paid out of local budgets and free up funds for other district priorities.

Allocates $2.3 Billion for Paying Down District Share of Unfunded Liability

- According to CalSTRS, this payment would reduce the district contribution rate by about four-tenths of a percentage point beginning in 2021-22. The exact rate reduction depends upon a number of factors and is likely to fluctuate from year to year.

Both Proposals Would Be Funded With Non-Proposition 98 General Fund

Assessment of District Budget Relief Proposal

Administration Proposes District Budget Relief When School Funding Is at Historic High

- Proposition 98 minimum guarantee has grown nearly $22 billion (37 percent) from 2013-14 through 2018-19.
- Under the Governor's budget, funding per student would increase 3.8 percent from 2018-19 to 2019-20.
- Adjusted for inflation, school funding per student is at an all-time high.

Consider Modifying Proposal to Provide Relief During Next Economic Downturn

- State could set aside funding now but not immediately adjust district rates.
- Later, during a downturn, state could use the additional funds to pay a portion of district pension costs. This approach could reduce the need for pension increases in future years when school funding is flat or declining.
- Though districts view rising pension costs as difficult to manage today, these difficulties could become much more pronounced during a downturn.

Assessment of District Unfunded Liability Proposal

Proposal to Pay District Share of Unfunded Liability Involves Trade-Offs Among Various Debts and Liabilities

- The Governor's budget estimates the state has a surplus of around $20 billion. Using a portion of that surplus to address retirement liabilities is prudent. Setting money aside today will reduce pension costs in the future.
- Under the Governor's proposal, the state would pay a greater share of the CalSTRS unfunded liability than assigned to it under the funding plan.
- The state has many other debts and obligations, including unfunded liabilities associated with pension plans for its own employees.