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TO: Honorable Teel Bivins, Chair, Senate Committee on Finance

FROM: John Keel, Director, Legislative Budget Board

IN RE: **HB3208** by Heflin (Relating to the temporary provision of lump-sum payments to certain retiring members of the Employees Retirement System of Texas.), **As Engrossed**

Estimated Two-year Net Impact to General Revenue Related Funds for HB3208, As Engrossed: a positive impact of $21,136,596 through the biennium ending August 31, 2005.

The bill would make no appropriation but could provide the legal basis for an appropriation of funds to implement the provisions of the bill.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2004	$2,727,080
2005	$18,409,516
2006	$19,143,646
2007	$19,143,646
2008	$19,143,646

All Funds, Five-Year Impact:

Fiscal Year	Probable Savings/ (Cost) from *GENERAL REVENUE FUND* 1	Probable Savings/ (Cost) from *GR DEDICATED ACCOUNTS* 994	Probable Savings/ (Cost) from *OTHER SPECIAL STATE FUNDS* 998	Probable Savings/ (Cost) from *FEDERAL FUNDS* 555
2004	$2,727,080	$345,270	$0	$1,080,742
2005	$18,409,516	$2,154,124	$23,070	$6,648,512
2006	$19,143,646	$2,095,006	$22,154	$6,612,046
2007	$19,143,646	$2,095,006	$22,154	$6,612,046
2008	$19,143,646	$2,095,006	$22,154	$6,612,046

Fiscal Year	Probable Savings/ (Cost) from *STATE HIGHWAY FUND* 6
2004	$1,040,354
2005	$5,745,176
2006	$5,516,429
2007	$5,516,429
2008	$5,516,429

Fiscal Analysis

The bill would provide an early retirement incentive in the form of a lump-sum bonus equal to 25 percent of the employee's total regular salary, for those employees eligible to retire on or after August 31, 2003 and before September 1, 2005. To receive this lump sum payment, a state employee who is eligible to retire as of August 31, 2003 must retire on that date and a state employee who is first eligible to retire after August 31, 2003 and before September 1, 2005 must retire in the month that the employee first becomes eligible.

Methodology

The bill would implement recommendation GG 13 from the Comptroller's e-Texas report, Limited Government, Unlimited Opportunity.

In order to estimate the fiscal impact of this bill, the Comptroller's Office compiled salary data and retirement dates for all employees who are currently eligible or would become eligible to retire within the 2004-05 biennium. It was assumed that employees eligible to retire by August 31, 2003 would retire at the normal rate, although retirement would slow the last three months of fiscal 2003 as potential retirees waited until the August 31 deadline to receive the bonus. It was assumed that employees who became eligible during 2004-05 would retire at a five percent higher rate than in past years as a result of the incentive.

Savings were calculated by taking 35 percent of a retiree's annual salary, prorated for the number of months worked in the fiscal year, and subtracting the 25 percent bonus. Based on this methodology, the biennial savings to General Revenue are estimated to be $32.8 million. If the incidence of retirement is spread throughout fiscal year 2003, the savings in the first year may be lower.

On average, state employee salaries are only 17 percent above the minimum for their salary range, if career ladder correctional employees are excluded. Agencies may have difficulties replacing employees who retire at a salary more than 17 percent lower than they were paying the employee who retired. This is particularly true at agencies such as MHMR and TDCJ; given their salary policies, it is unlikely that many employees can be replaced in the same classification at even a five percent lower salary. If appropriations at these agencies are cut by 35 percent of the salaries of those who retire, services are likely to be affected; at other agencies there may be some service impacts as well.

There are additional costs associated with the early retirement incentive. It is unlikely that return-to-work retirees will fill all of the retiree positions. As a result, the state will incur additional contribution costs for the group insurance program. Assuming that 2,000 of those eligible to retire in fiscal year 2003 are induced to do so by the bonus, and their positions are filled for nine months in fiscal year 2004, additional group insurance costs are estimated to be $8.7 million in General Revenue for the 2004-05 biennium. If similar assumptions were made for fiscal years 2004 and 2005, the estimated additional biennial cost would total $11.7 million in General Revenue. As a result of these additional costs, the biennial cost savings to General Revenue would decrease from an estimated $32.8 million to an estimated $21.1 million. (See Fiscal Impact table.)

Finally, although the ERS actuary reports that this bill would not require an increase in the state's retirement contribution rate, the bill would increase the retirement system's unfunded liability by $34.5 million. In the future, when an actuarially sound contribution is made, the state contribution rate will need to be increased by an amount sufficient to fund this liability plus interest.

Local Government Impact

No fiscal implication to units of local government is anticipated.

Source Agencies: 304 Comptroller of Public Accounts, 327 Employees Retirement System

LBB Staff: JK, SD, JO, GO, MS, ZS, WP, WM