LEGISLATIVE BUDGET BOARD
Austin, Texas

FISCAL NOTE, 78TH LEGISLATIVE REGULAR SESSION

April 23, 2003

TO: Honorable Bill Ratliff, Chair, Senate Committee on State Affairs

FROM: John Keel, Director, Legislative Budget Board

IN RE: **SJR38** by Brimer (Proposing a constitutional amendment providing that payment of retirement and related benefits to certain public employees is a contractual obligation that cannot be reduced or impaired.), **As Introduced**

No significant fiscal implication to the State is anticipated, other than the cost of publication.

The cost to the state for publication of the resolution is $85,275.

Long term costs for paying for benefit payments to members of the Statewide Emergency Services Personnel Retirement Fund would likely increase. If this plan is actuarially unsound, the state is statutorily required to contribute up to one third of the local contributions to the plan, currently estimated to be $606,000 annually. Under the proposed constitutional amendment, if this amount was ever insufficient to pay the costs of benefits, the state would be constitutionally bound to make up for any shortfalls. It is estimated that the system is actuarially unsound, however it is not anticipated that any required benefit payments would commence for quite some time. If the state contributes one third of local contributions, the present value of future benefit payments is currently estimated to be not significant, but that could change if experience does not meet plan assumptions.

Local Government Impact

The proposed constitutional amendment would apply to public retirement systems other than statewide systems, and the Statewide Emergency Services Personnel Retirement Fund. Under the resolution, payment of retirement benefits that a person has accrued (and increases that the legislature may authorize) is a contractual obligation of the retirement system and may not be reduced or impaired. Unless investment returns are well above plan assumptions of 8 or 8.5 percent for the next few years, losses will be realized and for plans to remain actuarially sound, overall contributions may have to be significantly increased, or benefits reduced in some way. The proposed constitutional amendment may only allow increased plan sponsor contributions; based on current asset values these would need to be doubled and might increase more. Plans not receiving increased contributions would eventually become "pay as you go" and for some, costs could be more than 100 percent of payroll.

Due to their size, major municipal plans would have the majority of any fiscal implications, and 13 of the largest are used for examples in this analysis. Additional similar fiscal implications would occur for other plans and their sponsors. Certain plans have provisions that reduce plan sponsor liabilities for cost increases; sponsors for these plans would have a direct fiscal impact from the constitutional amendment. Some plans have statutory provisions that reduce benefits if fund balances are insufficient to pay benefits; other plans have agreements or provisions to increase member contributions when contribution increases arise. Pension plan costs come from either the "normal costs" which are paid by the plan sponsor for the benefit accruals in a given fiscal year, or from paying off unfunded liabilities. A plan's obligation for prior benefit accruals is the actuarial accrued liability (AAL). The AAL minus the value of assets is the unfunded liability of the system, though the AAL is the full obligation of a plan sponsor. The resolution would remove the ability of cities to reduce this obligation through plan design changes. Being unable to impair benefits would mean recent plan design changes such as lower retirement eligibility, Deferred Retirement Option Plans (DROPs), and automatic post retirement benefit increases greater than inflation can't be changed. Allowable changes would be reducing or ending future benefit accruals, though these would not reduce current obligations. Retiree health obligations may implicitly be affected.

For reviewed plans, we estimate (market-value) unfunded liabilities as of December 31, 2002 using the latest available actuarial valuation and market fund values as of December 31, 2002 (in some cases these are estimated.) We project the impact of earning 4.5 percent investment return over the next five years as a likely "test" scenario. Projected returns are below historic averages due to low inflation, historically low interest rates for Treasury bills and other fixed income, and reduced expectations for the stock market in the short term. If these lower returns come to pass, plans may need to revisit economic assumption changes made in the 1990s, which would increase liabilities and costs. A combination of modest returns and economic assumption changes is anticipated to have effects similar to the test scenario. Due to shortfalls in municipal budgets and deferred recognition of asset losses, we assume no increases in contribution rates above current levels are made to pay off unfunded liabilities. We assume contribution increases made by cities due to payroll growth are partially offset by similar increases in benefit payments, liabilities grow at investment rate assumptions, and other experience is as expected. Contribution increases due to payroll growth above the amount described above are excluded from this analysis, but would add to city costs.

The scenario that systems earn their assumed investment rates for five years but receive no contribution increases results in unfunded liabilities growing by roughly 50 percent from current amounts as do contribution increases. A scenario where plans earn no interest over the next five years roughly doubles liability and contribution increases as compared with the test scenario. Contribution increase estimates are based on the normal cost plus paying off the unfunded liability as a level dollar amount over 30 years. While public plans often use a different methodology that places greater payments in the future, this method is required of private pensions and has the same present value. We assume no plans increase benefits above current levels, though many statutory plans can do so without changing their statutes. Plan sponsors that immediately increase contributions to make their systems actuarially sound would face smaller future increases in contributions. Plans analyzed include municipal employees, firefighters, and police. For San Antonio, only the combined firefighter and police plan is included. Liabilities and costs are aggregated by municipality to show the fiscal impact of maintaining current plan designs.

Austin retirement systems have unfunded liabilities of $650 million which increase to $1.1 billion in 2007 under the test scenario; this translates into $2,600 per household or $4,350 per household respectively. Contributions are $45 million now; realizing 2002 losses require a $45 million increase, and the test scenario has an $80 million increase.

Dallas retirement systems have unfunded liabilities of $1.9 billion which increase to $3.7 billion in 2007 under the test scenario; this translates into $4,450 per household or $8,600 per household respectively. Contributions are $110 million now; realizing 2002 losses require a $155 million increase, and the test scenario has a $310 million increase.

El Paso retirement systems have unfunded liabilities of $440 million which increase to $820 million in 2007 under the test scenario; this translates into $2,550 per household or $4,700 per household respectively. Contributions are $20 million now; realizing 2002 losses require a $35 million increase, and the test scenario has a $65 million increase.

Fort Worth retirement systems have unfunded liabilities of $510 million which increase to $1.0 billion in 2007 under the test scenario; this translates into $2,590 per household or $5,240 per household respectively. Contributions are $25 million now; realizing 2002 losses require a $35 million increase, and the test scenario has an $80 million increase.

Houston retirement systems have unfunded liabilities of $2.4 billion which increase to $4.9 billion in 2007 under the test scenario; this translates into $3,450 per household or $7,150 per household respectively. Contributions are $100 million now; realizing 2002 losses require a $230 million increase, and the test scenario has a $450 million increase.

San Antonio retirement systems have unfunded liabilities of $480 million which increase to $954 million in 2007 under the test scenario; this translates into $1,192 per household or $2,371 per household respectively. Contributions are $44 million now, realizing 2002 losses requires a $25 million increase, and the test scenario has a $63 million increase.

Source Agencies: 304 Comptroller of Public Accounts, 325 Fire Fighters' Pension Commissioner, 327 Employees Retirement System, 338 Pension Review Board

LBB Staff: JK, JB, JO, RR, WM