

CalSTRS and Proposition 98

LEGISLATIVE ANALYST'S OFFICE

Presented to:

Assembly Public Employees, Retirement and Social Security
Committee

Hon. Rob Bonta, Chair

Senate Public Employment and Retirement Committee

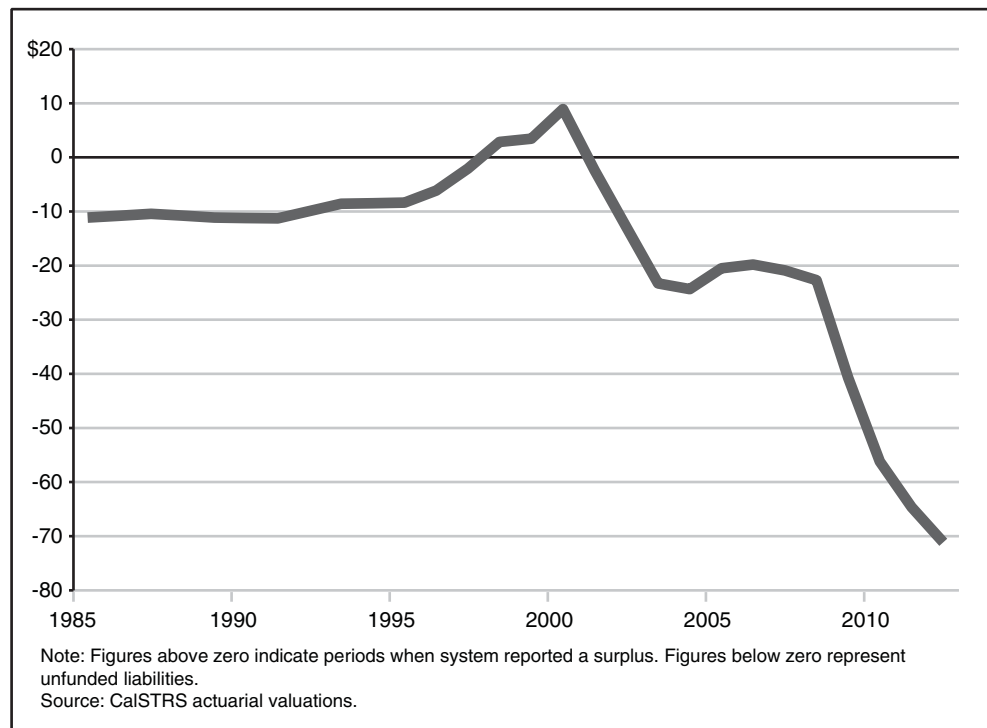
Hon. Norma Torres, Chair





What Are CalSTRS' Unfunded Liabilities?

(In Billions)



- Essentially Means Benefits Already Earned Are Not Funded by Assets on Hand**
 - Delay in funding tends to further increase long-term costs.

- In Retrospect, Prior Contributions to System Were Not Sufficient to Fund the Benefits That Teachers Earned**
 - Investments weaker than previously assumed in system valuations during some periods.
 - Contribution decreases or changes.
 - Benefit increases.
 - Other actuarial (including demographic) factors.



How Did We Get Here?

- ☑ **Complex Series of Events Over Time**
- ☑ **Little Clarity About Responsibility for Funding CalSTRS**
 - ***Districts?*** Districts employ teachers. Districts are responsible for determining other (non-pension) compensation items for teachers at the bargaining table.
 - ***State?*** In the past, state has increased its contributions to address unfunded liabilities. State law provides that current and past teachers are “entitled to a financially sound retirement system.” State sets benefit and contribution levels.
 - ***All Three Contributor Groups?*** State has ability under law to require contributions of itself, districts, and/or teachers.
 - ***But. . .How?*** State law does not clearly specify which of these contributors must pay more to address unfunded liabilities in general.
- ☑ **CalSTRS Differs From Other Pension Systems**
 - ***Contribution Rates Fixed in State Law.*** The CalSTRS board generally lacks authority to adjust contribution rates in response to lower investment returns or changes in demographic estimates.



Who Benefited From Insufficient Prior Funding?



Each Group of CalSTRS Contributors Benefited

- ***Districts Benefited.*** Provided valuable compensation benefit to teachers at a lower cost.
- ***Teachers Benefited.*** Received valuable compensation benefit at a lower cost.
 - Some of the teachers who benefited have retired already.
 - Teachers hired beginning in 2013 are earning somewhat smaller benefits as a result of the state's new pension law.
- ***State Benefited.*** By not providing additional funding, the state budget benefited.
 - Directly benefited nonschool part of the state budget. (The state's CalSTRS contributions generally have been funded outside of its Proposition 98 budget.)
 - Indirectly benefited Proposition 98 budget too. Made it easier for state to fund the minimum guarantee for schools and community colleges over time.



What About Proposition 98?



Constitutional Requirement to Fund Schools and Community Colleges at a Minimum Level Each Year

- Approved by voters in 1988. Amended in 1990.
- Original package of implementing legislation adopted in 1989.
- These laws have been amended frequently to adjust for changing policies and budgetary conditions.



State Statutes Include Provisions Regarding the Administration of Proposition 98

- Certain state spending for schools—including debt service on state bonds for school facilities and the state's contributions to CalSTRS—has been paid from the non-Proposition 98 portion of the budget.
- Other state expenditures—including subsidized child care—at times have been counted in the Proposition 98 guarantee and at other times have not been counted.
- Statutes indicate that if a program in effect in 1986-87 (before Proposition 98's approval) later becomes a new responsibility of schools, then the Proposition 98 guarantee should be increased accordingly.



How Do the Statutory Provisions Apply Here?

- ☑ **If Required School District Contributions to CalSTRS Are Increased, Does Proposition 98 Need to Be Adjusted Upward?**

- ☑ **Legal Opinions Differ**
 - Attorney General: So long as the state does not reduce its existing CalSTRS contribution, no Proposition 98 adjustment likely would be required.
 - Legislative Counsel: If the state increases district contributions to support CalSTRS programs authorized *as of* 1986-87, an upward Proposition 98 adjustment likely would be required.
 - The opinion implicitly assumes that this calculation can be quantified.

- ☑ **These Opinions May Inform the Debate, but Significant Policy and Fiscal Judgments Still Required**
 - Even if the state *could* place the entire additional funding burden on districts, would it *want* to do so?
 - Much or most of the added contributions now required are for CalSTRS benefits that were established or investment results that occurred *after* 1986-87.
 - We think that it is impossible to devise a single calculation that fairly summarizes everything that has changed in CalSTRS during the last quarter century.



How Should the Legislature Approach This Issue?

- Focus Now on the Big Policy Questions Concerning CalSTRS Funding**

- How Should CalSTRS Benefits Be Funded in the Future?**
 - Districts and teachers fund teacher salaries and other teacher benefits.
 - For future teachers, we suggest that teacher pensions be funded the same way—with little or no direct state involvement.
 - This would make school districts and teachers like other local governments and local employees.



How Should the Legislature Approach This Issue? *(Continued)*

How Should the Costs to Address the Unfunded Liability Be Allocated?

- Each contributor group benefited from the inadequate funding of CalSTRS in the past.
- We think it is appropriate that each group contribute to the over \$5 billion additional annual cost over the next several decades.
- For example, the Legislature could decide that the state should bear 50 percent of the costs, districts 35 percent, and teachers 15 percent.
- If it chose, the Legislature could place less of a burden on post-2013 teachers, given that they are earning lower benefits. (This would require the state, districts, and/or pre-2013 teachers to pay more than otherwise would be the case.)

Lastly: What, if Any, Proposition 98 Adjustments Are Needed?

- Proposition 98 budgets could be adjusted, if desired, to conform to the intent of the funding plan.
- As with any major school funding change, future litigation is possible, especially if some key groups in the education community disagree with the funding plan.



A Grand Bargain: Funding CalSTRS in the Future



Shared Responsibility for Existing Unfunded Liabilities

- ***Everyone Contributes.*** State, districts, and teachers each contribute more to address today's unfunded liabilities over the next three decades or so.
- ***State Would Pay a Large Share of the Added Costs.*** The state arguably could impose most or all of these costs on districts. We think, however, the state reasonably can choose to pay a large share of the added costs over the next three decades.
 - Realistically, the state budget is unlikely to be able to bear *all* of the costs.
- ***Proposition 98.*** The state would increase its contributions to CalSTRS outside of Proposition 98 until today's unfunded liabilities are paid off. Districts would continue to make their CalSTRS payments from their general purpose (generally, Proposition 98) local budgets. Proposition 98 would not be adjusted upward.
- ***Beginning in the 2040s, No Direct State Funding Role.*** Once today's unfunded liabilities are completely paid off, as determined by law, direct state contributions to CalSTRS would end. The additional unfunded liability contributions from teachers and districts also could end.
 - This is not a new idea. In past decades, state laws explicitly limited the number of years of state contributions.
- ***New Pension Law Lowered Future Benefit Costs.*** Current district and teacher contributions may be enough for defined benefits for post-2013 teachers.



A Grand Bargain: Funding CalSTRS in the Future *(Continued)*



For Future Teachers, Local Responsibility for Teacher Compensation

- **Clarify Responsibilities.** School districts and teachers could be given clear responsibility for funding future teachers' benefits.
- **Rate Adjustment Authority for CalSTRS.** CalSTRS likely would need to be able to adjust district contributions up or down based on changing investment and demographic conditions, just as CalPERS does for other local governments.
- **State Funding for Schools.** The education community can always seek additional state funding in the future for school compensation costs, even though the state would not have a direct funding role for CalSTRS. At that time, state leaders could consider such requests for additional Proposition 98 or other school funding and weigh them against other budget priorities.



When Is Action Needed?

- More Costly the Longer We Wait.*** Over time, absent corrective action, the costs to address CalSTRS' unfunded liabilities will grow substantially.
- State Fiscal Condition Creates Golden Opportunity.*** After a decade of significant annual budget deficits, the state budget situation is much improved now.

 - ***Many Funding Priorities.*** We recognize the state has several budget priorities, including building reserves, paying off other budgetary debts, restoring funding to public programs, and other policies.
 - ***But. . .Addressing CalSTRS Will Not Get Easier.*** The longer the state waits to address this huge problem, the more that budgets of the state and schools will be stressed in the future.
- We Suggest Taking Action Now.*** We recommend adopting a plan to fully address CalSTRS' unfunded liabilities over the next 30 or so years.

 - ***Money Can Be Set Aside Now.*** Even if final agreement on the plan is not reached this year, the state can set aside a portion of its budget reserves in 2014 to assist in its transition to higher CalSTRS contributions in future years.