

Department of Legislative Services
 Maryland General Assembly
 2016 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 674 (Senator Peters, *et al.*)
 Budget and Taxation

Teachers' Retirement and Pension System - Employer Contribution for Local Employees

This bill caps at 4.05% the normal cost rate used to calculate each local board of education’s share of the employer contribution for the Teachers’ Retirement System (TRS) and Teachers’ Pension System (TPS). The cap applies to fiscal 2017 *only* if the State’s fiscal 2017 budget as enacted includes funding to make up the difference between the 4.05% rate and the actual normal cost rate. Otherwise, the cap takes effect in fiscal 2018.

The bill takes effect July 1, 2016.

Fiscal Summary

State Effect: Since the FY 2017 State budget as introduced does not include funds for this purpose, general fund expenditures for teacher pension costs increase by \$26.1 million in FY 2018, and by decreasing amounts through FY 2024, based on actuarial and payroll growth assumptions. To the extent that actual experience differs from these assumptions, total State expenditures may vary. No effect on State revenues.

(in dollars)	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Revenues	\$0	\$0	\$0	\$0	\$0
GF Expenditure	0	26,100,000	21,200,000	17,000,000	12,200,000
Net Effect	\$0	(\$26,100,000)	(\$21,200,000)	(\$17,000,000)	(\$12,200,000)

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate effect

Local Effect: Local board of education contributions for TRS/TPS members decrease by a combined total of \$26.1 million in FY 2018, and by decreasing amounts through FY 2024, based on actuarial and payroll growth assumptions. To the extent that actual experience differs from these assumptions, the total savings to local boards of education may vary. No effect on local revenues.

Small Business Effect: None.

Analysis

Current Law: Chapter 1 of the first special session of 2012 required local school boards to pay the normal cost for their employees who are members of TRS/TPS, phased in over five years. Prior to that, the State paid 100% of the annual employer contribution on behalf of teachers employed by local school boards. Based on 2012 projections of the normal cost, Chapter 1 required local school boards to pay 50% of the normal cost in fiscal 2013, phasing up to 100% of the *projected* normal cost by fiscal 2016. For those four years, Chapter 1 specified the exact dollar amount to be paid by each local school board based on the projected normal cost and the local share of that cost. Beginning in fiscal 2017, however, local school boards must pay 100% of the *actual* normal cost. Beginning in fiscal 2013, Chapter 1 also requires county governments and Baltimore City to adjust their maintenance of effort payments to local school boards to compensate them for teacher pension costs. Beginning in fiscal 2017, the fiscal 2016 payments by the counties are included in subsequent years' per-pupil maintenance of effort calculations. Depending on enrollment trends in each county, some local school boards may be responsible for a portion of any increase in normal cost payments between fiscal 2016 and each succeeding year.

Chapter 1 also established Teacher Retirement Supplemental Grants to provide financial support to local jurisdictions with limited capacity to pay their share of the normal cost. Under the grant program, nine local governments receive a total of \$27.7 million annually in supplemental grants. In addition, Chapter 1 repealed the requirement that local school boards reimburse the State for their TRS/TPS employees paid with federal funds beginning in fiscal 2015.

Statute defines the “normal contribution rate” as a fraction that has as its numerator the sum of all normal contributions, net of member contributions, and as its denominator, the aggregate annual earnable compensation of members of the State system. “Normal contributions” (or “normal cost”) is an actuarial term that is not defined in statute, but refers to the actuarial value of pension benefits earned by an active member or group of active members in a given year.

Background: Shortly after the enactment of Chapter 1, as part of a regular review of actuarial assumptions used to calculate the value of benefits owed by the system, the Board of Trustees of the State Retirement and Pension System (SRPS) voted to change many of those assumptions to bring them closer in line with actual experience. This had the effect of substantially raising the normal cost rate for all systems, including TRS/TPS, beginning in fiscal 2014.

As **Exhibit 1** shows, the normal cost had been projected to decline gradually, but instead it increased from 4.62% in fiscal 2013 to 5.83% in fiscal 2014. Since then, it has declined as predicted, but it has not reached the 4.05% level it was projected to reach by fiscal 2017. Under current projections, it is not expected to reach that level until the 2022 valuation, which determines funding levels for fiscal 2024. In fiscal 2017, the \$279.8 million that the local boards of education are required to pay absent the bill is \$31.3 million higher than they would have had to pay if the normal cost rate had in fact reached 4.05%.

Exhibit 1
Projected vs. Actual Normal Cost Contributions for Local Boards of Education
Fiscal 2013-2017
(\$ in Millions)

	<u>FY 2013</u>	<u>FY 2014</u>	<u>FY 2015</u>	<u>FY 2016</u>	<u>FY 2017</u>
Projected Normal Cost Rate	4.62%	4.46%	4.32%	4.18%	4.05%
Actual Normal Cost Rate	4.62%	5.83%	5.64%	5.12%	4.56%
Local Share of Normal Cost	50%	65%	85%	100%	100%
Required BOE Contribution	\$136.6	\$173.2	\$221.6	\$254.8	NA
BOE Normal Contribution w/Actual NC	\$136.6	\$219.6	\$282.6	\$307.3	\$279.8
Difference Paid by the State	\$0	\$46.4	\$61.0	\$52.5	NA

BOE: Board of Education
NC: Normal cost

Note: Normal cost rate projections were based on the June 30, 2011 actuarial valuation.

Source: State Retirement Agency; Department of Legislative Services

In the intervening years, local governments have benefited from the General Assembly's decision to use projected normal cost rates during the phase-in process rather than actual normal cost rates. As Exhibit 1 also shows, had actual normal cost rates been used during the four years of the phase-in, local boards of education would have had to pay an additional \$159.9 million over the four years; instead, the State covered the additional cost.

State Fiscal Effect: The Governor's fiscal 2017 operating budget, as introduced, does not include any funding to make up the difference between the actual normal cost rate and 4.05%. As the General Assembly cannot add appropriations to the budget, this analysis assumes that no such funds will be in the budget as enacted, meaning that the bill's cap does not take effect until fiscal 2018.

Exhibit 2 shows the bill’s effect on State pension contributions based on payroll growth projections for local boards of education by the Department of Legislative Services and on actuarial projections of future normal cost rates by the SRPS actuary. To the extent that actual experience differs from these projections, the fiscal effect will vary. Based on current projections, the normal contribution amount paid by the State under the bill will continue to decline until the actual normal cost rate drops below the capped rate, which is projected to occur in fiscal 2024. The State’s share of TRS/TPS contributions is paid entirely with general funds. **Exhibit 3** shows the distribution of the savings for each local board of education in fiscal 2018 based on each county’s share of the total teacher salary base.

Exhibit 2
Fiscal Effect of Capped Normal Cost Rate under the Bill
Fiscal 2018-2021
(\$ in Millions)

	<u>FY 2018</u>	<u>FY 2019</u>	<u>FY 2020</u>	<u>FY 2021</u>
Projected Normal Cost Rate	4.47%	4.39%	4.32%	4.24%
Capped Normal Cost Rate	4.05%	4.05%	4.05%	4.05%
Total BOE Normal Contribution	\$278.0	\$273.4	\$271.6	\$273.3
Capped BOE Contribution	\$251.9	\$252.2	\$254.6	\$261.0
Difference Paid by the State	\$26.1	\$21.2	\$17.0	\$12.2

BOE: Board of Education

Note: Normal cost rate projections are based on the June 30, 2015 actuarial valuation.

Source: State Retirement Agency; Department of Legislative Services

Exhibit 3
Local Board of Education Savings under the Bill
Fiscal 2018

	Projected Payment	Capped Payment	Local Savings
Allegany	\$2,745,813	\$2,487,817	-\$257,996
Anne Arundel	23,601,841	21,384,218	-2,217,623
Baltimore City	24,802,200	22,471,792	-2,330,408
Baltimore	31,400,714	28,450,311	-2,950,403
Calvert	5,292,410	4,795,137	-497,273
Caroline	1,634,262	1,480,707	-153,555
Carroll	7,413,127	6,716,591	-696,535
Cecil	4,834,508	4,380,258	-454,249
Charles	7,921,077	7,176,814	-744,262
Dorchester	1,377,797	1,248,340	-129,457
Frederick	12,036,404	10,905,467	-1,130,937
Garrett	1,169,597	1,059,702	-109,895
Harford	10,106,678	9,157,057	-949,621
Howard	21,160,943	19,172,666	-1,988,276
Kent	653,408	592,014	-61,394
Montgomery	58,302,601	52,824,505	-5,478,097
Prince George's	40,935,634	37,089,333	-3,846,301
Queen Anne's	2,262,776	2,050,166	-212,610
St. Mary's	4,750,909	4,304,515	-446,394
Somerset	989,535	896,559	-92,976
Talbot	1,271,457	1,151,991	-119,466
Washington	6,294,854	5,703,391	-591,463
Wicomico	4,514,489	4,090,308	-424,180
Worcester	2,513,519	2,277,349	-236,170
Total	\$277,986,551	\$251,867,009	-\$26,119,542

Source: Department of Legislative Services

Additional Information

Prior Introductions: None.

Cross File: HB 934 (Delegate B. Barnes, *et al.*) - Appropriations.

Information Source(s): Department of Budget and Management, Maryland State Retirement Agency, Department of Legislative Services

Fiscal Note History: First Reader - February 24, 2016
md/rhh

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