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Testimony of the PA Association of School Business Officials
Senate Finance Committee
Public School Employee Pensions
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Jay Himes, Executive Director

Good morning, I am Jay Himes, executive director of the PA Association of School Business Officials (PASBO). We are an association of 3,000 members, two-thirds of which are K-12 non-instructional administrators who provide finance, accounting, operations, facilities, transportation, food service, technology, communication, human resources, purchasing and safety services to support classroom learning in schools in Pennsylvania. I want to thank Chairman Browne and the other members of the Finance Committee for the opportunity to present our comments on this important issue.

The subject of today's hearing has been described as a "pension tsunami" and a "retirement disaster." Unfortunately, that is not media headline hyperbole. We have a real school finance crisis looming. As this committee knows, we are on course to raise the Employer Contribution Rate (ECR) to the Public School Employees Retirement System (PSERS) from the current rate of 4.76% to 8.22% in 2010-11, 10.59% in 2011-12 and then 29.22% in 2012-13. This huge increase has been described as a spike. Unfortunately it is better described as a launch since it does not decline but rather stays at this extremely high and unsustainable rate for seven years. The ECR stays above 20%, the historical high, for a total of 20 years.

You have heard the reasons for the launch. We have had a perfect storm of stock market decline, enhanced benefits by 25%, reamortization of PSERS gains and losses to prevent past rate increases and state and school district rate reductions over the last five years. It is useless to point fingers and assess blame at this point. No single factor created our dilemma and no single remedy is going to get us out of our financial predicament. Everyone (schools, state government and employees) will all have to bear the burden of reshaping our public school retirement system and how it is funded.

Some have argued that we are in a historical cycle of the ECR. Indeed, if we go back more than 20 years, we experienced an ECR in the 20% range. As seen in Chart I, we did have an ECR in excess of 20% in the 1985-86 fiscal year. But our current situation is just not a repeating historical pattern.

First, there was not a launch in 1985-86. It was a gradual increase and a succeeding decline—truly a spike. Second, the 2012-13 rate projection of 29.22% is almost 50% higher than in 1985-86. Third, school districts no longer have the local discretion on property tax rate adjustments to provide retirement funding. Today, school districts' ability to pay for pension increases is governed by Act 1.

It is important to note that school districts are not responsible for setting the ECR. The ECR is set according to state law, and we should make sure we prevent any repeat of reducing the ECR below the normal cost (about 7%) of the system for future years. It will not help in the short-term, but it will prevent a future generation from experiencing the current scenario.

Some have also argued that the culprit is the declining ECR for most of this decade while employees have paid more than their fair share. A declining ECR during a period when employee contributions did not drop has without question contributed to our impending crisis. But on the other hand, don't forget that employee contributions are in essence loans to the system that help fuel investment returns that provide the bulk of the PSERS assets. At retirement, employees can get back ALL of their contributions with guaranteed interest. So last year when the PSERS return on investment was a minus 26%, employee contributions earned a 4% return creating even greater liability.

In fact, this very generous feature of the retirement system is never mentioned in the COLA discussion. The return of employee contributions really provides a buffer for cost-of-living increases if utilized for in the proper fashion. Eliminating the return of all employee contributions at retirement is one of the many remedies that need to be fashioned into a relief package to reduce the 2012-13 launch.

We do need a restructuring of the Retirement Code for school employees. A 30% ECR is not achievable because it is not affordable. Schools can not afford it, the commonwealth can not afford it and taxpayers can not afford it. Not only will it have drastic consequences for state and school finance, virtually tripling the ECR in 2012-13 will have drastic consequences for our student achievement efforts which are now producing success in the classroom.

The next series of charts (slides 2-5) show the actual cost in dollars to four districts of different size, geographic location and wealth. (They were not chosen randomly but are four consecutive school districts in an alpha listing of all local education agencies.) Altoona is larger urban district. In actual dollars the launch year will require about $15 million in additional employer contributions. The impact of the escalating ECR starting next year is about $25 million.

The next three slides show the same data set for smaller districts (and in some cases with much less tax base resources): Ambridge in Beaver County, Annville-Cleona in Lebanon County and Antietam in Berks County.

To put this cost in the aggregate, PSERS now has a total covered payroll for all school employees of about $12 billion. For every 1% increase in the ECR, $120 million additional school and state dollars will be required. A quick look at the launch year math where the ECR almost triples would result in $2.4 billion (in current dollars) in additional school and state resources to fund a single year increase. To put perspective on this burden, the current Basic Education Funding line item (the largest state subsidy to school districts) was less than six billion dollars last year and the BEF increase was $300 million.

Additionally, there will also be ancillary costs in addition to the direct ECR cost to school districts and the state. School districts will also have to absorb the additional cost of the retirement launch on their Intermediate Units and Career and Technology Centers. These LEAs have no taxing power and are funded largely by school district tuition and program revenues. These pass through costs will further increase the retirement funding burden as will the fact that ballooning retirement costs produce a huge windfall to charter schools. Every dollar in increased retirement expense for school districts increases the payment to charter schools. We would urge an immediate change to the School Code to address this problem. The total aggregate costs of the pass throughs to school districts are reflected on slide 6.

While it is difficult to predict how this massive draining of resources will affect educational quality, we can take a glimpse at the impact in terms of federal programs, the largest of which is Title I directed to help schools with higher concentrations of students in poverty. Federal funding for Title I will not take into consideration the additional retirement costs in Pennsylvania. As a result, even with increases, with Title I funding as shown on slide 7 (using actual data for one district), less instructional resources will be available.

How do we get to such huge numbers? The workforce for local education agencies is long term in nature. While perhaps employees do not spend 35 years in the same position or with the same employer, they predominantly have long term careers in education. As a result, the compounding of salary and benefits over 35 years with full retirement benefits creates massive liabilities. The last two charts show an example of a $41,000 newly hired school employee who receives a 3.5% annual salary adjustment combined with a benefit rate of 32% plus. In the case of a certified employee, the attendant professional development costs also increase at 3% annually. Including more than $200,000 in employee contributions for PSERS, the total cost of this 35-year employee is more than $3.6 million.

Adding the liability for an annual retirement benefit of more than $111,000 to this example means a combined salary, benefits, professional development and retirement cost of more than $6.5 million per employee over his or her lifetime.

How do we solve this problem? Unfortunately we have no easy solutions. A look at appellate court decisions would solidify the contract impairment protection under the state Constitution for existing employees. If we can only apply changes prospectively to new employees, there is a delayed financial benefit since the benefit will only accrue at the rate that current employees retire and are replaced by new employees. Regardless of the delayed benefit, a reduction of the current benefit levels is necessary.

As stated previously, there is no easy or single solution that can reduce the ECR to an affordable and manageable level. In our opinion, the ECR should be no higher than the historic highest rate of approximately 20%. There must be a multi-dimensional approach where the burden is spread among schools and the state and benefit restructuring for employees occurs.

For Schools

The following in our opinion should be part of retirement reform legislative package:

- Mandate an ECR of 11% for 2011-12 regardless of what the current rate setting methodology establishes.
- Create a series of gradual increases (perhaps up to a 3% per year increase) in the ECR to reach the maximum level required to sustain a viable and stable Public School Employees Retirement System. These increases will be financially painful to school budgets but escalating the ECR on a gradual basis is a necessity.

For the State

- Consider asset sales to provide a one time revenue infusion to help reduce the launch year rate that is not affordable or achievable.
- Use any tax revenue from the Marcellus Shale gas extraction tax for reducing the ECR.
- Reamortize the existing gains and losses of the system to achieve as much short-term relief as possible and as conservatively as possible.
- As a last resort only, the commonwealth could look very carefully at pension bonds. We caution, however, that any debt for payment of the pension obligation should be structured extremely conservatively to assure that floating bonds do not make the problem worse.

For Plan Design

- Immediately reduce the multiplier of 2.5 for new school employees to the pre-Act 9 rate of 2. At this level, the benefit level will continue to attract and reward school employees without creating a great schism between new and old employees. Reducing substantially the benefit for new employees will create another level of collective bargaining and compensation issues for schools.
- Eliminate return of employee contributions at retirement.
- Use the highest five as opposed to the highest three years of salary to calculate retirement benefits.
- Return to the ten year vesting provision.
- Increase the retirement age.
- Consider changing to a hybrid structure of defined benefit and defined contribution if the combination of all other remedies can not produce significant savings.

We see the mission of a retirement restructuring as two fold: (1) we have to lower the ECR in the short-term and (2) provide for the long-term financial stability of PSERS. It is a daunting challenge to the General Assembly, the Governor and the education community. We must work together to solve this crisis and we offer our association's help in whatever way possible to reach a solution.

This package of retirement reforms will only get the ECR to manageable level in the short term. But reducing the ECR should be an immediate priority of the General Assembly and Governor. Our association and our Retirement Reform Task Force will pledge to assist and cooperate in any manner that moves us closer to addressing this financial crisis. Thank you for the opportunity to present our comments. I will be glad to respond to any questions or comments the committee may have.

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