Legislative Analysis

Mary Ann Cleary, Director
Phone: (517) 373-8080
http://www.house.mi.gov/hfa

MICHIGAN PUBLIC SCHOOL EMPLOYEES' RETIREMENT SYSTEM (MPSERS) EMPLOYER CONTRIBUTION REVISONS

House Bill 4190
Sponsor: Rep. Jeff Farrington

House Committee: Financial Liabilities
Complete to 4-18-13

A SUMMARY OF HOUSE BILL 4190 AS INTRODUCED:

The bill would amend the Public School Employees Retirement Act to revise the calculation method for Michigan Public School Employees' Retirement System (MPSERS) contribution rates for local school districts from a payroll basis to a current operating expenditures (COE) basis.

Background
Over the last decade, the unfunded actuarial accrued liability (UAAL) of the MPSERS has increased substantially. This, along with declining payroll in the system, has caused the contribution rate paid by employers in the system to increase from 13% of payroll in fiscal year (FY) 2003-04 to 27% in FY 2012-13 (prior to 2012 statutory changes), with further increases projected for future years.[1]

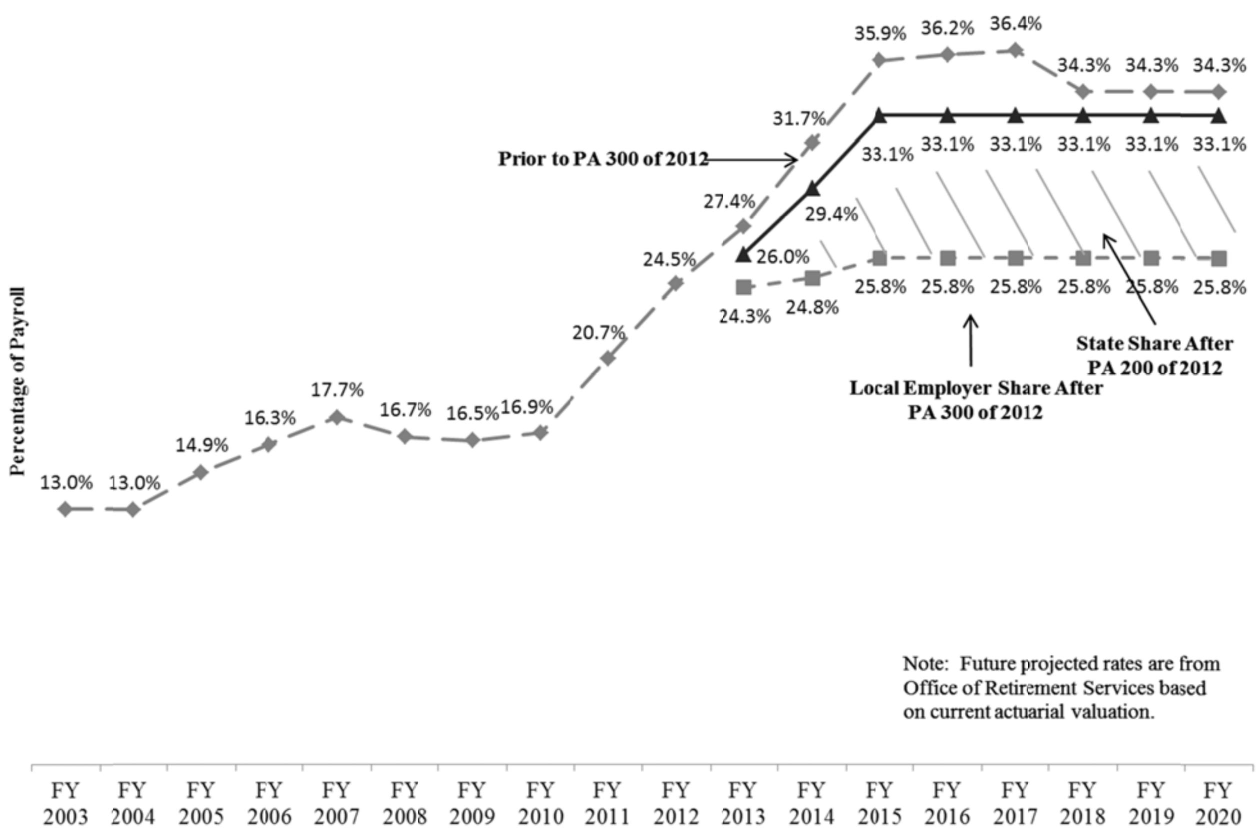
Changes to MPSERS employee benefit and contribution levels made by PA 300 of 2012 (PA 300) have reduced projected rate increases while also beginning to prefund retiree health care benefits, thereby substantially reducing the calculated UAAL for those benefits. [2] The net result is that the employer contribution rate is now projected to peak at about 33% of payroll rather than 36%.

PA 300 also capped the local employer rate for the UAAL at 20.96%, which when added to the normal cost of pension and health care (reflecting the amount necessary to prefund the benefits earned by current employees in any given year, currently estimated at 3.5%), would approximate the total maximum FY 2011-12 rate of 24.46% of payroll. PA 300 provided for state contributions to pay the amount of the annual required contributions that exceed the employer maximum rate. (See Figure 1)

UAAL costs are amortized and paid off as a percentage of payroll over a long-term period. The current 30-year amortization period has 25 years remaining in it.

[1] A recent report detailing the history of MPSERS as well as recent legislative changes is available on the HFA website: http://www.house.mi.gov/hfa/PDFs/MPSERS%20report%20Apr2013.pdf
[2] A more complete summary of the bill is available on the Michigan Legislature website: http://www.legislature.mi.gov/documents/2011-2012/billanalysis/House/pdf/2011-HLA-1040-6.pdf

FIGURE 1
Projected MPSERS Employer Contribution Rates



<u>Payroll Growth</u>

Consistent with existing actuarial assumptions, the MPSERS contribution rate projections are based on 3.5% annual payroll growth. Over the last decade, however, this assumption has not been realized. Other than investment returns underperforming relative to actuarial assumptions in recent years, the biggest factor driving the increase in the current unfunded liability contribution rates within MPSERS has been the decline in the amount of payroll against which system costs can be charged.

As shown in Figure 2 below, the MPSERS payroll decreased from $10.0 billion in FY 2002-03 to $9.2 billion in FY 2010-11. In FY 2002-03, payroll was projected to grow to $13.2 billion in FY 2010-11 under actuarial assumptions. Thus, the current payroll is 31% lower than had been projected in FY 2002-03. This gap is due to a combination of factors:

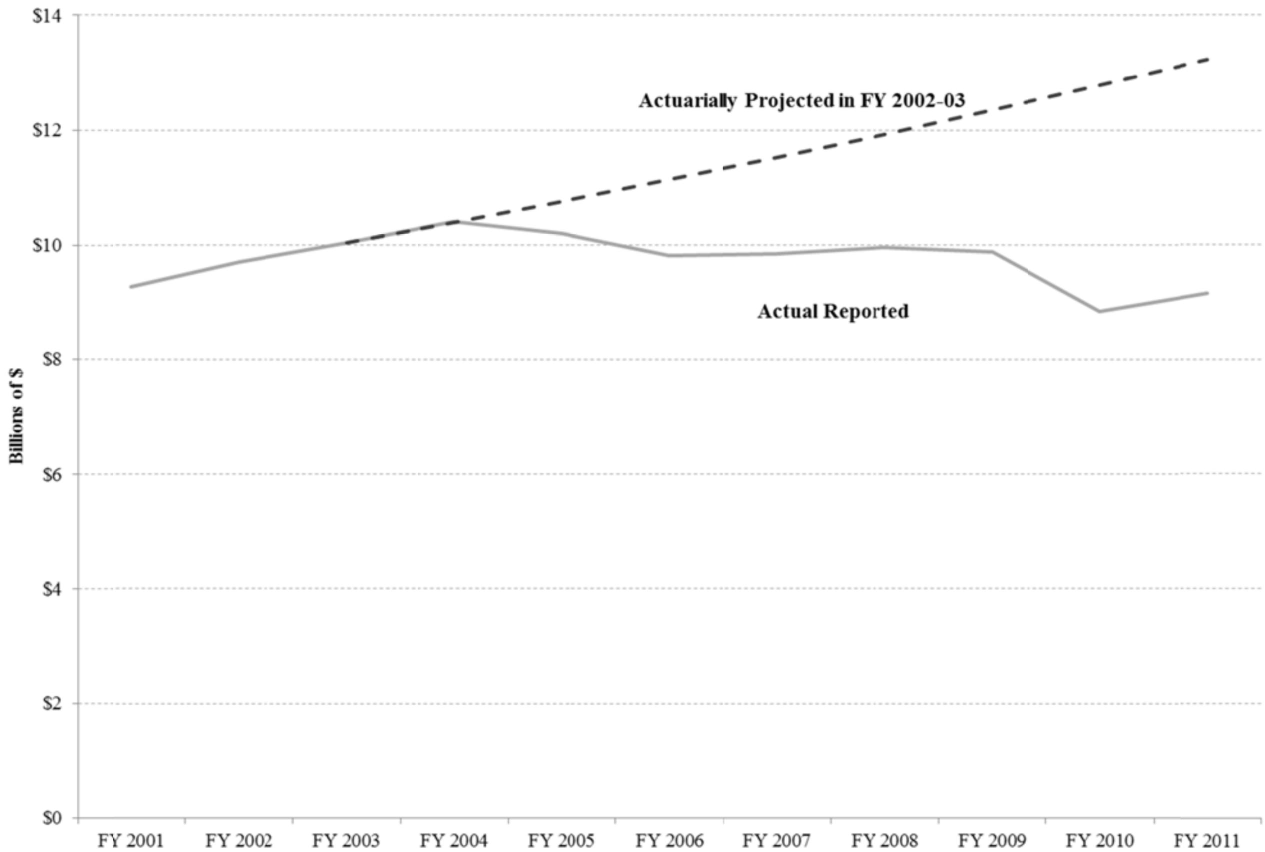
- Declining statewide pupil counts
- Privatization of non-instructional staff and substitute teachers
- Flat or reduced state/local funding for school districts, resulting in lower wage growth
- The increase in the number of charter schools—which are not required to participate in MPSERS—and related reductions in traditional public school enrollments and employment levels

In total, the number of active employees in the retirement system declined from 326,938 in FY 2002-03 to 236,660 in FY 2010-11, a reduction of 28%.

While the factors above do not increase the amount of the system's unfunded liability at any given time, the same dollar amount collected on a smaller payroll base equates to a higher percentage of that payroll. Additionally, this phenomenon allows some school districts that have privatized more services to leave their "stranded" costs from former employees on the system as a whole, so that other districts face increased costs.

If payroll grows at a lower rate, unfunded liability costs will be spread over a smaller base and the required state contributions to MPSERS will increase, since the local employer rate is now capped.

FIGURE 2
MPSERS Payroll



<u>Current Operating Expenditures</u>
House Bill 4190 would revise the employer contribution method for local school districts to apply costs on a combination of payroll and current operating expenditures beginning in FY 2013-14. The normal cost of pension and health care would continue to be charged on each local school district's MPSERS payroll (as normal costs correspond directly to current payroll), but the bill would shift the cost of paying the UAAL (11.9%) to a district's COE. The COE rate is calculated to be the equivalent to the current UAAL cap on payroll (20.96%). Community Colleges, District Libraries, ISDs, and Public School Academies would still be charged based on MPSERS payroll.

COE is a broader measure of school district financial activity and, therefore, is more likely to meet, or come closer to, the 3.5% growth assumption. Since FY 1994-95, the first year of implementation of Proposal A, statewide COE has increased by an annualized 2.5% while statewide MPSERS payroll has increased by an annualized 1.1%.

The combination of charging unfunded liability costs based on COE and requiring state contributions above the local employer cap could effectively deal with the stranded cost factors described above. Additional UAAL rate increases resulting from the failure to meet the 3.5% annual growth assumption for other reasons (declining enrollments, charter schools, etc.) would still be funded by the state.

Additionally, this approach would result in school districts considering privatization of services to weigh the true savings associated with that action, given that unfunded liability costs would no longer be merely shifted to other districts.

PA 300 defined current operating expenditures for a local public school district as the following:

> *… includes functions 1xx, 2xx, 45x, and all object codes except 6xxx, as defined in the Michigan Public School Accounting Manual Bulletin 1022, and is equal to the total instructional and support services expenditures, including the total general fund charges incurred in the general, special education, and vocational education funds for the benefit of the current fiscal year, whether paid or unpaid, and all expenditures of the instructional programs plus applicable supporting service costs reduced by capital outlay, debt service, community services, and outgoing transfers and other transactions.*

PA 300 also included in each local school district's COE the COE of any public school academy it authorizes after PA 300 was enacted, September 4, 2012. This would prevent a district from shifting its share of MPSERS costs to other districts in the system by chartering some or all of its schools.

FISCAL IMPACT:

The bill would have no fiscal impact on the overall MPSERS costs but would redistribute the UAAL costs among local school districts. Districts that have a high MPSERS payroll compared to their total COE would see cost reductions, while those with a low MPSERS payroll compared to their total COE would face cost increases. A detailed estimate of cost changes for individual districts is not yet available.

The bill would likely change the proportion of contributions paid by the state share versus that paid by local school districts. Absent any change, if payroll grows at a lower rate than assumed, unfunded liability costs will be spread over a smaller base and the required state contributions to MPSERS will increase over time, since the local employer rate is now capped. Given that COE has grown more over the last two decades (or declined less rapidly over the last few years) moving to a COE method should stabilize that base and prevent a larger share of UAAL costs from being shifted to the state level.

Fiscal Analysts: Bethany Wicksall
Kyle I. Jen