PSERS: What You Need to Know

The Public School Employees Retirement System (PSERS), which provides qualified district employees a guaranteed defined-benefit pension, was a key subject at the May 16, 2012 Council Rock Budget Forum. Council Rock Director of Business Administration, Robert Reinhart, identified the district's state-mandated contribution to PSERS as the single expenditure driving the 2012-13 tax increase of 1.88 mils (1.7%). In fact, if it were not for the increase in PSERS, the 2012-13 budget would be lower than the 2011-12 budget. The 1.7% tax increase is estimated to provide $2.2 million in revenue toward the $3.8 million state-mandated increase in PSERS.

PSERS Funded by Employee, Employer, and State Contributions
The PSERS contribution by employees and local school districts is fixed by state law. In 1983, employee members' contribution rate was raised from 5.25% to 6.25% for new members. Since 2000, most employees have been contributing 7.5% of their salary to PSERS. Employees hired after July 2011, who took a one-time option to keep the same benefit payout level as those hired before July 2011, pay 10.3%.

Mr. Reinhart stated at the Budget Forum that the CR School Board "does not have any authority to change the funding mechanism or the rate it pays." Over the years, the state has varied the mandated percentage amount of payroll that each school district pays to PSERS. No matter what percent is set by the state, the percentage is the same for each PA school district. The compulsory dollar amount varies because of the difference in each district's total payroll. In 2011-12, Council Rock was required to pay 8.65% of eligible employees' payroll to the PSERS Fund; for 2012-13 the rate was raised to 12.36%. The state's future mandated percentage increases over the next four years are: 16.75%, 21.25%, 25.56% and 26.26%.

The state has reimbursed districts at least half of its PSERS costs for employees hired after June, 30, 1994. More impoverished districts receive a higher state reimbursement rate. In the 2011-12 budget year, Pennsylvania contributed about $1.07 billion to PSERS and in the current budget the state's obligation increased by $256 million.

Current Pension Benefit
"The formula for benefits under PSERS is the employee's years of service, times the employee's multiplier (2% or 2.5%) times the average of the employee's three highest years of salary."[1]

Employees hired before July 1, 2011, get 2.5% times the number of years of service. Those hired after July 2011 have a 2% multiplier, but have a one-time option in the first 45 days of employment to up their contribution from 7.5% to 10.3% in order to keep the 2.5% multiplier. These same newer employees have a shared risk provision that could change their contribution rate every three years.

Early History of PSERS
On July 18, 1917, the Pennsylvania Public Employees Retirement Act became law to provide guaranteed retirement benefits to all school employees who met the requirements. Over the years the legislature passed laws that continually refined employee eligibility, retirement benefit parameters, and the governance of the PSERS Fund.

Until 1933, the PSERS Fund was "invested exclusively in Pennsylvania state, county, city, borough, and township bonds with preference for school district bonds."[2] Because funds were not tied to the stock market, PSERS solvency was not threatened by the Great Depression. In 1933, US government bonds were added to the list of legal investments, and at the "height of the depression, the year's annual report noted that through the PSERS bond investments, jobs had been created building schools and roads in Pennsylvania." [2]

PSERS Surplus Years
Retirement Code, Act 96, enacted in 1975 had a profound effect on the system because it liberalized PSERS authority to invest in common stock and PSERS became an independent administrative board.

Between 1997 and 2002, the PSERS Fund was taking in more money from member contributions than it was paying out, plus getting robust returns from investments, resulting in a cumulative surplus of $6.9 billion.

PSERS Fund Turns from Surplus to Deficit
In the 1990s, the pension system was funded at 126%. During that time the state and school districts decreased their contributions to the PSERS Fund, while employees continued to pay their full share. By 1999, PSERS was underfunded and could not meet its future obligations. The burst of the dot com bubble in March 2000 resulted in investment losses in the PSERS Fund. The PSERS Fund quickly found itself in a hole, because the investment losses were compounded by the state's suppressed contributions that eventually reached 0%.

In May 2001, under the leadership of Governor Tom Ridge, in order to justify the 50% pension raises that the legislators gave themselves and other public employees, Act 9 was passed. Act 9 bumped up the pensions of PSERS members by 25% (increasing the multiplier from 2% to 2.5%), increased Health Premium Assistance from $55 a month to $100, and reduced vesting requirements from 10 years to 5 years.

Four months after the passage of Act 9, the 9/11 terrorist attacks occurred and PSERS lost billions in the market collapse that followed. Despite this, in 2002, the Republican legislature gave a two-part cost-of-living increase (COLA) to retirees who were left out of the 2001 pension increases. The COLAs and market losses changed what once was a $2.5 billion surplus into a $1.5 billion deficit by 2003.

In 2008, with the global market collapse of the "Great Recession," the PSERS Fund lost 28.7% of its value; the worst of any state according to a study by the Pew Center on the States.

PSERS 2010 Reforms
Under the initiative of Governor Ed Rendell, the state legislature passed Act 120 of 2010 that rolled back the benefit enhancements of 2001 only for employees joining the plan after July 1, 2011. For these newer employees, the pension multiplier was reduced to 2%, the retirement age increased, the lump sum payment option was eliminated, and the vesting period was changed from 5 to 10 years.

New members also have a shared risk program and "benefit when investments of the PSERS Fund are doing well and share some of the risk when investments underperform. Starting July 1, 2015, new members' contribution rate will stay within the specified range, but could increase or decrease by 0.5% every three years, depending on the investment performance of PSERS." [3] If the pension multiplier is 2%, the range of fluctuation of the employees' contribution is between 7.5% and 9.5%; and if the employee multiplier is 2.5%, the range is between 10.3% and 12.3%.

To buy time for the state treasury and school districts to fund PSERS, Act 120 spreads the looming unfunded liability out over several years. The longer spread pushed the first pension spike for state and local school districts to a 4% increase in 2012-13.

CR Minimizes Effect of PSERS Mandated Increase on Taxpayers

Council Rock's ability to raise taxes is limited by Act 1 (The Tax Payer Relief Act of 2006) that uses a complicated state formula to dictate the maximum percentage that each district can raise taxes each year without referendum. The Council Rock Act 1 limit for 2012-13 is 1.7% plus an exception of 1.3% based on the increased PSERS payments. Although the CR board authorized the administration to apply for the exception, they also directed the administration to build a budget without using that exception.

Being mindful of taxpayers' burden, CR did not pass the exception on to taxpayers, and instead reduced expenditures. The district also used $2 million from the budgetary reserve to finance this school year's budgetary needs.

Future Escalating PSERS Payments

Because the state legislature postponed the needed increase in employer contributions for a decade, school districts and the Commonwealth have not paid what they should in any of the last 10 years. As a result, the impact of needed increases to the state and school district's budgets for their share over the next 4 years is staggering and will require tax increases or severe budgetary cuts for both the state and school district's to meet anticipated future obligations to PSERS.

To make up the PSERS deficit, the percentage of the school district's contributions will rise every year for the next 4 years from 12.36% to 26.26%. These mandatory, continually increasing, payments for school districts and the state's share will be challenging. In the 2012-13 fiscal year budget alone, the general fund appropriation for the Commonwealth's matching share of the employer contribution to PSERS is $856.1 million, up $255.9 million, or 43%.

PSERS Investments Still Falling Behind Expectations

Governor Corbett's budget proposal of February 2012 estimates that retirements will rise by nearly 10% in 2012-13 and by nearly 24% by 2016-17. At the same time, when there are fewer employees paying into PSERS than previous years, the fund's investment returns have been lower than expected. It was announced in September that fiscal year 2011-12 PSERS investments only earned 3-4% which are far below the 7.5% return that is built into the pension system's accounting. PSERS unfunded liability at the end of 2011 of nearly $26.5 billion will grow to at least $43 billion by 2019. Last year's worse than expected investment returns have to be made up by increases in future investment returns, by even more onerous increases to PSERS payments by the state and school districts, or contributions from workers and/or tax dollars.

CR Strategies to Meet Future PSERS Obligations

Council Rock's current PSERS contribution of 12.36% of payroll is $13,055,088 and will more than double by 2016-17. The district estimates that the 26.26% of payroll will be $27,789,088. Yet CR is slightly better off than other school districts because it has set aside $7.4 million to offset future PSERS increases. Still, meeting CR's future PSERS payments will be challenging.

Further PSERS Reforms Needed

Unless future investments make up recent losses, employees and/or taxpayers will have to fund the difference caused by these losses. Since school district revenues have been negatively affected by the “Great Recession,” mandated PSERS increases could result in severe cuts to district’s budgets that could negatively impact delivery of quality public education.

Reforms needed to ensure that the PSERS Fund and Pennsylvania school districts are solvent, to meet future PSERS obligations, are still being debated. To add your voice to this discussion, contact your state legislators.

[1] Sunshine Review. Pennsylvania Public Pensions
http://sunshinereview.org/index.php/Pennsylvania_public_pensions#History
[2] Public Employees Retirement System: History -
http://www.psers.state.pa.us/about/history5.htm
[3] Synopsis of Pension Reform Legislation Act 120 of 2010 (House Bill Number 2497, Printer’s Number 4476)
http://www.psers.state.pa.us/content/pfr/resources/Act_120_AMH_Insert_revision_01_2012.pdf