F I S C A L   I M P A C T   R E P O R T

SPONSOR Munoz/Anderson **ORIGINAL DATE** 1/28/2020 **LAST UPDATED** 2/15/2020 **HB**

SHORT TITLE PERA Solvency **SB** 72/aSPAC/aSFC/aSFl#1/aHAFC

ANALYST Jorgensen

REVENUE (dollars in thousands)

Estimated Revenue				Recurring or Nonrecurring	Fund Affected
FY21	FY22	FY23	FY24		
$10,208.8	$20,417.7	$43,107.2	$65,796.7	Recurring	PERA Fund

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

FY21	FY22	FY23	FY24	4 Year Total Cost	Recurring or Nonrecurring	Fund Affected
$2,785.8	$5,571.7	$8,357.5	$11,143.4	$27,858.4	Recurring	General Fund
$2,318.6	$4,637.1	$6,955.7	$9,274.3	$23,185.7	Recurring	OSF
-	$-	$6,240.3	$12,480.7	$18,721.0	Recurring	Local Gov't
$5,104.4	$10,208.8	$21,553.6	$32,898.3	$69,765.2	Recurring	Employee Contribution Fund
$10,208.8	**$20,417.7**	**$43,107.2**	**$65,796.7**	**$139,530.3**		**All**

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates Appropriation in the General Appropriation Act

SOURCES OF INFORMATION
LFC Files

Responses Received From
Administrative Office of the Courts (AOC)
New Mexico Attorney General (NMAG)
Public Employee's Retirement Association (PERA)
New Mexico Association of Counties (NMAC)

SUMMARY

Synopsis of HAFC Amendment

The House Appropriations and Finance Committee amendment to Senate Bill 72 strikes the appropriation of $76 million. The appropriation in SB72 duplicated an appropriation in the

General Appropriation Act as passed by the House.

Synopsis of SFl#1 Amendment

The Senate Floor Amendment to Senate Bill 72 reimposes a maximum pension cap of 90 percent of earnings. The original bill removed this cap to encourage longer careers.

Synopsis of SFC Amendment

The Senate Finance Committee (SFC) amendment to Senate Bill 72 reduces the triggers at which additional employer and employee contributions are reduced. Under the original bill, when a PERA plan reached a funded ratio greater than or equal to 90 percent, the employer contribution rate was reduced by 0.5 percent; when a plan funded ratio was between 100 percent and 110 percent, the employer contribution was decreased by 1 percent; and when a plan funded ratio was over 110 percent, the employer contribution was reduced by 2 percent. Under the amendment, both employer and employee contributions will be reduced and all of the targets were adjusted downward by 10 percent. The table below shows the thresholds for employer and employee contribution reductions:

Thresholds for Employer Contribution Reductions

Funded Ratio	**Original Bill**	**SFC Amendment**
80%-90%	N/A	0.50%
90%-100%	0.50%	1%
100%-110%	1%	2%
Over 110%	2%	N/A

Synopsis of SPAC Amendment

The Senate Public Affairs Committee (SPAC) amendment to Senate Bill 72 adds language specifying that the variable cost-of-living-adjustment (COLA) will be compounding.

Synopsis of Original Bill

Senate Bill 72 (SB72) makes the following changes to the Public Employees Retirement Act (PERA):

1. Beginning in FY21, increases state and local government employee and employer pension contributions by 0.5 percent each year for four years for a total increase of 2 percent with the following exceptions:
    a. State police and adult correctional officers;
    b. Those earning annual salaries less than $25 thousand.
    c. Increased contributions from local governments will not begin until FY23
2. Creates triggers to automatically reduce pension contributions as the funding of the plans improves.
3. Reduces the vesting period for tier 2 state employee and public safety members to 5 years.
4. Removes the 90 percent cap on pension earnings for all employees.

5. Allows juvenile correctional officers and adult and juvenile probation and parole officers to join the state police and adult correctional officers retirement plan.

In addition to changes made affecting current and future employees, SB72 also makes the following changes to the cost of living adjustment (COLA) for current retirees:

1. Suspends the compounding COLA for three years and replaces it with a noncompounding 2 percent COLA for all members with the exception of those on disability retirement, those with 25 years of service or more and whose pension is less than $25 thousand per year, and those age 75 or older as of June 30, 2020.
   a. $76 million is appropriated from the general fund to PERA to pay the estimated cost of the noncompounding COLA.
2. Beginning in FY24, implements a new COLA calculation tied to investment performance and funded ratio of PERA plans. The new COLA pays an automatic 0.5 percent up to a maximum of 5 percent.
   a. Individuals who receive disability retirement, have 25 years of service and an annual pension benefit less than $25 thousand, and are over age 75 as of June 30, 2020 are exempted from the variable COLA and will instead receive a compounding COLA of 2.5 percent.
3. Allows all PERA retirees to be reemployed by ERB-affiliated employers and receive COLAs on their pensions during the course of their re-employment.

FISCAL IMPLICATIONS

SB72 contains a nonrecurring appropriation of $76 million to pay costs of providing a noncompounding COLA for certain members in FY21-FY23.

SB72 increases employer and employee contributions by 0.5 percent per year for four years resulting in a 2 percent increase in both contribution rates. The changes apply to state and local government employees receiving a regular retirement and workers covered by municipal police and fire plans. State police and adult correctional officers are exempted from the changes and contributions for local governments do not begin until FY23.

LFC analysis shows 19.1 thousand state employees with a combined payroll of $1.02 billion will be affected by the changes proposed. In the first year of implementation, the impact on the state will be approximately $5 million. Approximately 55 percent of the state payroll comes from the general fund with the remainder coming from other funding sources. The total impact on the state is shown in the table below:

Estimated State Employer Operating Budget Impact

Fund	FY21	FY22	FY23	FY24	Total
General Fund	$ 2,785.8	$ 5,571.7	$ 8,357.5	$ 11,143.4	$ 27,858.4
Other State and Federal Funds	$ 2,318.6	$ 4,637.1	$ 6,955.7	$ 9,274.3	$ 23,185.7
Total	**$ 5,104.4**	**$ 10,208.8**	**$ 15,313.2**	**$ 20,417.7**	**$ 51,044.2**

In addition to state employer contributions, local governments will pay contribution increases as well. According to PERA's 2019 comprehensive annual financial report (CAFR), the total salaries paid by county and municipal governments in FY19 were $1.25 billion. The first year cost of a 0.5 percent increase is estimated at $6.2 million for all three of the affected funds. The total impact on local government employers by plan is shown in the table below:

Estimated Local Government Employer Operating Budget Impact

Plan	FY23	FY24	FY25	FY26	4 Year Total
Municipal General	$4,508.0	$9,015.9	$13,523.9	$18,031.9	$ 45,079.7
Municipal Fire	$659.8	$1,319.6	$1,979.5	$2,639.3	$6,598.2
Municipal Police	$1,072.5	$2,145.1	$3,217.6	$4,290.2	$10,725.5
Total	**$6,240.3**	**$12,480.7**	**$18,721.0**	**$24,961.3**	**$62,403.3**

Finally, employees will have to make increased contributions at the same rate as their employers. For state employees, contribution increases begin in FY21 while local employees do not pay additional contributions until FY23. State employee contributions increase by 0.5 percent per year through Employee contribution increases will double the employer increases as shown in the table below:

Employee Contributions

Employer	FY21	FY22	FY23	FY24	FY25	FY26
State	$5,104.4	$10,208.8	$15,313.2	$20,417.7	$20,417.7	$20,417.7
Local	$ -	$ -	$6,240.3	$12,480.7	$18,721.0	$24,961.3
Total	**$5,104.4**	**$10,208.8**	**$21,553.6**	**$32,898.3**	**$39,138.7**	**$45,379.0**

SB72 includes triggers which will reduce pension contributions as the health of the fund improves. The triggers reduce the contribution rates as follows: 0.5 percent when a plan is between 90 percent and 100 percent funded; 1 percent when a plan is between 100 percent and 110 percent funded; and 2 percent when a plan is over 110 percent funded. The triggers will not reduce contribution rates below the current FY20 rates.

SB72 reduces plan costs by altering the COLA payments. Currently, retirees making over $25 thousand per year receive a 2 percent compounding COLA regardless of inflation. SB72 replaces the current compounding COLA with a noncompounding COLA for three years, reducing PERA's projected unfunded liability by $700 million. After the three year COLA suspension, a variable rate COLA will be instated. The COLA formula proposed by SB72 will make compounding payments based on a combination of investment performance and pension funded status. The bill proposes a minimum annual compounding COLA of 0.5 percent but allows up to a 3 percent COLA to be paid depending on performance. If the plan funded ratio increases to over 100 percent, the 3 percent COLA cap is removed and COLAs up to 5 percent may be paid.

PERA Variable COLA Payment Calculator						
		Funded Ratio				
		60%	70%	80%	90%	100%
Investment Return	5.0%	0.50%	0.50%	0.50%	0.50%	0.50%
	5.5%	0.50%	0.50%	0.50%	0.50%	0.50%
	6.0%	0.50%	0.50%	0.50%	0.50%	0.50%
	6.5%	0.50%	0.50%	0.50%	0.50%	0.50%

	7.0%	0.60%	0.70%	0.80%	0.90%	1.00%
	7.5%	0.90%	1.05%	1.20%	1.35%	1.50%
	8.0%	1.20%	1.40%	1.60%	1.80%	2.00%
	8.5%	1.50%	1.75%	2.00%	2.25%	2.50%
	9.0%	1.80%	2.10%	2.40%	2.70%	3.00%
	9.5%	2.10%	2.45%	2.80%	3.00%	3.50%

Source: PERA

SIGNIFICANT ISSUES

Pension benefits are determined by three factors: final average salary, years of service (or service credit), and a pension multiplier with a formula that looks like:

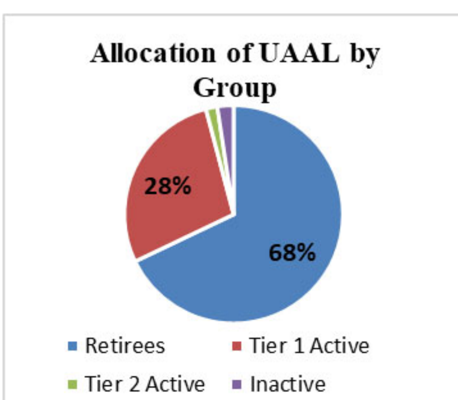
Pension = Final Average Salary X Service Credit X Pension Multiplier

Because retirement payments are fixed regardless of investment returns or contribution levels, the soundness of the retirement funds are judged on their ability to meet not only current obligations but also the obligation to future retirees. In order for a pension plan to remain solvent, the employer and employee contributions and investment returns must be able to cover the cost of benefit payouts and the administrative expenses of the fund. The financial health of a defined benefit pension plan is often measured using metrics including: the funded ratio which divides the plan assets by the total plan liabilities; the unfunded actuarially accrued liability (UAAL) or amount of liabilities attributable to paying future obligations minus plan assets; and the funding period, or the amount of time it would take for current levels of contributions and investment income to pay down the entire amount of the pension liability.

PERA has a UAAL of $6.7 billion and has sufficient assets to pay for 70 percent of the total liabilities. Based on current contributions and an investment return assumption of 7.25 percent per year, PERA will never achieve 100 percent funding. The inability to achieve full funding is referred to as an infinite funding period. The longer a pension plan's funding period is, the more sensitive the plan will be to changes in investment returns.

Much of the underfunding of the plan is due to the richness of the benefit; the PERA plan offers employees hired before July 1, 2013 90 percent income replacement for a 30 year career and employees hired after July 1, 2013 earn 90 percent income replacement for a 36 year career. This benefit is in addition to social security eligibility. Additionally, the fund liability increased significantly in 1995 when the service credit multiplier was increased by 0.5 percent and applied to all service credit already earned by active employees. The retroactive increase in benefits resulted in a number of retirees receiving an enhanced benefit for which contributions were never made.

PERA estimates the members who are employees account for the UAAL.



UAAL is largely driven by currently retired while active approximately one-third of

Allocation of UAAL by Group

Employee Group	Percent UAAL	Amount UAAL, in millions
Retirees	68%	$4,523.5
Tier 1 Active	28%	$1,865.4
Tier 2 Active	2%	$113.3
Inactive	2%	$159.9

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

SB76 includes an appropriation of $76 million. The General Appropriations Act as passed by the House of Representatives has a $75 million appropriation in Section 10 that duplicates the appropriation made in this bill.

OTHER SUBSTANTIVE ISSUES

Local governments have expressed concern that employer pension costs may exceed those reflected in this FIR because many local governments pay for, or “pick-up”, a portion of the employee pension contribution. The pick-up rates vary, but a number of employers pick-up 75 percent of employee pension contribution. Though SB72 provides that employers must opt in to higher contribution rates, many employers may feel compelled due to collective bargaining agreements or past precedent, to pay the increased share of employee contributions.

CJ/al/rl/sb