Fiscal impact reports (FIRs) are prepared by the Legislative Finance Committee (LFC) for standing finance committees of the NM Legislature. The LFC does not assume responsibility for the accuracy of these reports if they are used for other purposes.

Current and previously issued FIRs are available on the NM Legislative Website (www.nmlegis.gov) and may also be obtained from the LFC in Suite 101 of the State Capitol Building North.

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

ORIGINAL DATE 2/4/19
SPONSOR Salazar **LAST UPDATED** **HB** 338

SHORT TITLE Public Employee Retirement Changes **SB**

ANALYST Jorgensen

REVENUE (dollars in thousands)

Estimated Revenue			Recurring or Nonrecurring	Fund Affected
FY20	FY21	FY22		
$14,430.7	$14,430.7	$14,430.7	Recurring	PERA Fund (Employee)
$16,835.8	$16,835.8	$16,835.8	Recurring	PERA Fund (Employer)

(Parenthesis ( ) Indicate Revenue Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY20	FY21	FY22	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$8,872.5	$8,872.5	$8,872.5	$26,617.5	Recurring	General
	$7,963.3	$7,963.3	$7,963.3	$23,890.0	Recurring	OSF/Federal
Total	$16,835.8	$16,835.8	$16,835.8	$50,507.5	Recurring	Various

(Parenthesis ( ) Indicate Expenditure Decreases)

Relates to Senate Bill 14, education retirement changes

SOURCES OF INFORMATION
LFC Files

Responses Received From
Administrative Office of the Courts (AOC)
New Mexico Attorney General (NMAG)
Department of Public Safety (DPS)
Public Employees Retirement Association (PERA)

SUMMARY

Synopsis of Bill

House Bill 338 (HB338) makes the following changes to the Public Employees Retirement Act (PERA):

1. Increases employee contributions for all plans that are less than 80 percent funded by 1.5 percent from fiscal year 2020 through 2022.
2. Beginning in fiscal year 2023, allows the employee contribution to be increased up to 1.5 percent above the fiscal year 2019 rate depending on the funded status of the plan. Once the plan is 100 percent funded or more, the contribution rates return the fiscal year 2019 statutory level.
3. Increases employer contributions for all plans that are less than 80 percent funded by 1.75 percent from fiscal year 2020 through fiscal year 2022.
4. Beginning in fiscal year 2023, allows the employer contribution to be increased up to 1.75 percent above the fiscal year 2019 rate depending on the funded status of the plan. Once the plan is 100 percent funded or more, the contribution rates return to the fiscal year 2019 statutory level.
5. Suspends the cost-of-living adjustment (COLA) from fiscal year 2020 to 2023.
6. Requires non-public safety retirees to be 65 years old before a COLA may be received and requires public safety retirees to attain age 60 before they are eligible for COLA payments.
7. Removes the current seven-year COLA wait period.
8. Beginning in fiscal year 2023, the COLA will be calculated by a formula which reduces the benefit to reflect inflation and funded status of the pension plans.
9. Includes definitions for “coverage plan funded ratio” and “funded ratio”.

None of the provisions affecting the COLA will apply to individuals with an annual pension of less than $20 thousand or to those on disability retirement.

FISCAL IMPLICATIONS

HB338 increases contributions for state general plan 3, which covers non-public safety employees, but does not require an increase for state public safety employees because police and correctional officer pension plan is currently 130 percent funded. Local governments would also be subject to increased contributions but because the funding for these increases is not derived from a state source, the additional revenue is not shown on the revenue or estimated additional operating budget impact tables.

The first line of the revenue table shows the impact of a 1.5 percent increase in employee contributions and the second line shows the effect of a 1.75 percent increase on the employer. These increases are prescribed through fiscal year 2022.

The estimated additional operating budget impact table shows the effect of HB338 on state revenues due to increased employer contributions. LFC estimates that general fund appropriations account for approximately 53 percent of total personnel spending. Based on this calculation, the general fund cost of a 1.75 percent employer contribution increase is $8.9 million while the other state funds cost is approximately $8 million. Because there is no appropriation in HB338, state agencies would have to absorb an annual increase of $16.8 million to cover costs

imposed by the legislation.

Beginning in fiscal year 2023, the employee and employer contribution rates will vary based on the funded ratio of the pension plan with contribution rates increasing the lower the funded ratio is. The rates and associated costs are shown in the table below:

HB338 Proposed Employer Contribution Rates

		Pension Plan Funded Ratio					
Plan	**Current Rate**	**≤80%**	**80%-85%**	**85%-90%**	**90%-95%**	**95%-100%**	**≥100%**
State General Plan 3	16.99%	18.74%	18.49%	18.24%	17.99%	17.49%	16.99%
Additional Revenue		$ 16,835.8	$ 14,430.7	$ 12,025.6	$ 9,620.5	$ 4,810.2	-
General Fund Cost		**$ 8,872.5**	**$ 7,605.0**	**$ 6,337.5**	**$ 5,070.0**	**$ 2,535.0**	**-**
State Police & Corrections	25.50%	27.25%	27.00%	26.75%	26.50%	26.00%	25.50%
Additional Revenue		$ 1,458.4	$ 1,250.0	$ 1,041.7	$ 833.4	$ 416.7	-
General Fund Cost		**$ 1,311.1**	**$ 1,123.8**	**$ 936.5**	**$ 749.2**	**$ 374.6**	**-**
Total Additional Revenue		**$18,294.2**	**$15,680.8**	**$13,067.3**	**$10,453.8**	**$ 5,226.9**	**-**
Total General Fund Cost		**$10,183.6**	**$ 8,728.8**	**$ 7,274.0**	**$ 5,819.2**	**$ 2,909.6**	**-**

Increasing the employer contribution will cost the general fund approximately $16.8 million per year with $8.9 million, or 53 percent, coming from the general fund. Without an additional appropriation, agencies would be forced to absorb the cost of an employer increase in their operating budgets.

In addition to increasing the employer and employee contributions, HB338 makes a series of changes to the COLA. The COLA changes include a 3 year suspension, adjusting the COLA based on the funded ratio of the plan and inflation, and replacing the current 7 year COLA delay for recent retirees with minimum retirement ages of 65 for non-public safety members and 60 for public safety members, before which a retiree is ineligible to receive a COLA.

While the COLA provisions will create significant savings to the PERA fund, they will not require the state to alter contributions and so are not included in the summary tables.

PERA reports HB 338 is projected to eliminate PERA's unfunded liability and trend toward the goal of a 100 percent funded level in 25 years, or 2043. Suspension of the annual COLA for a three-year period immediately reduce PERA's unfunded liability by over $600 million.

HB338 will increase employer and employee contributions for county and municipal workers as well as non-state public safety officers. Neither the New Mexico Association of Counties nor the New Mexico Municipal League provided an estimate of the increased costs that will be incurred by local governments.

Contribution increases will not affect state police and adult correctional officer plan 1, which is currently funded at 130.2 percent and will not affect members who are employed fulltime and earn less than $20,000 per year or members on disability.

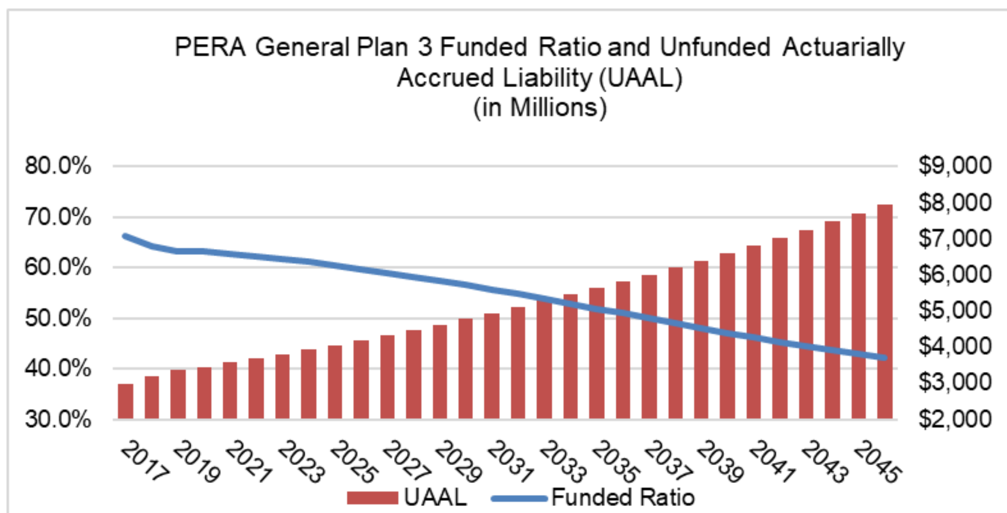
SIGNIFICANT ISSUES

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 $6.1 billion and has sufficient assets to pay for 71.6 percent of the total liabilities. Of the two pension plans managed by PERA that serve employees of the State of New Mexico, state general plan 3 and the police and adult correctional officers plans, the state general plan is the most underfunded. The graph below illustrates the plan's unfunded liability and funded ratio over time:



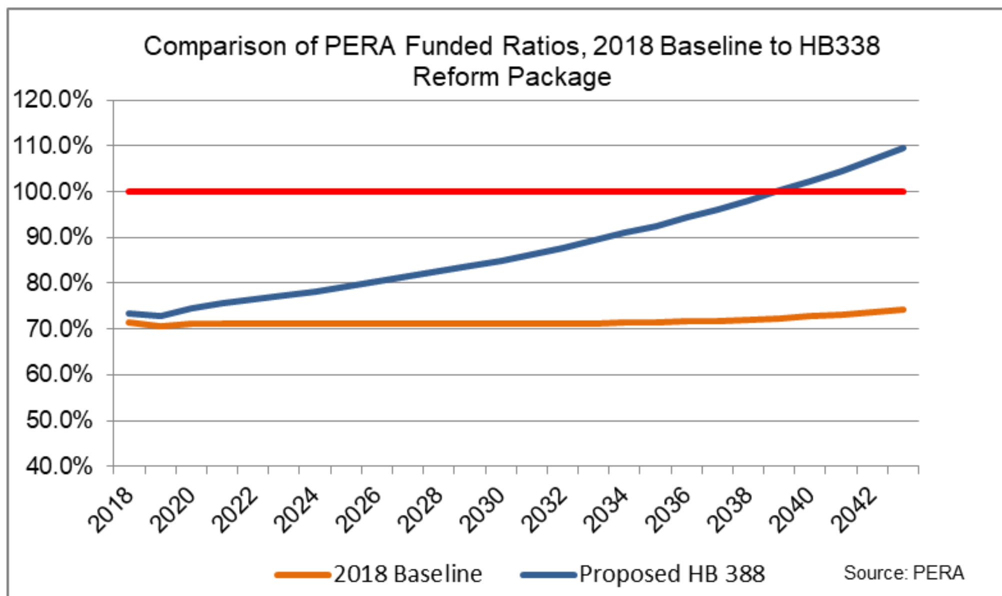
Based on current contributions and an investment return assumption of 7.25 percent per year, it PERA will never achieve 100 percent funding. The inability to achieve full funding is referred to as an infinite funding period. The longer a pension plan's funding period is, the more sensitive the plan will be to changes in investment returns. Should the fund fail to meet the assumptions, the funded ratio could quickly get significantly worse. Recognizing this, the PERA set a policy requiring the pension plan to attain 100 percent funding within by 2043.

The declining funded ratio of PERA's state general plan 3 suggests the plan is significantly underfunded. 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.

Currently, PERA pays a fixed COLA of 2 percent regardless of inflation. Prior to pension reform legislation of 2013, the COLA was set at 3 percent. Because the COLA was paid at a statutory rate regardless of inflation, in many years, the COLA awarded was actually higher than inflation as measured by the consumer price index (CPI). PERA estimates that over the past 20 years, COLA payments outpaced CPI by 28 percent.

Should HB338 be enacted, PERA estimates a significant increase in the funded ratio over time, reaching 109 percent funding by 2043 as shown in the graph below:



PERFORMANCE IMPLICATIONS

The compensation package offered by the State of New Mexico is already heavily skewed toward benefits with the state offering approximately 58 percent of total compensation through salary while private industry offers approximately 70 percent in salary. Increasing employee contributions to pension funds will further diminish employee take home pay while increasing employer contributions may crowd divert funds which otherwise could be used for salary increases.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

The Education Retirement Board (ERB) is pursuing pension reform legislation in the 2019 session as well. The largest benefit change contained in the ERB-supported reform package, Senate Bill 14, is the addition of a new benefit tier. The new tier would change the pension multiplier based on the number of years of service for an ERB-affiliated employer. The PERA proposal does not change the current tier structure and both PERA state general plan tiers offer a

higher benefit than ERB's current plan. Increasing the differences in the benefit packages offered to teachers and to state employees may raise equity concerns.

OTHER SUBSTANTIVE ISSUES

HB338 significantly improves the funded status of the pension plan by reducing COLA payments to retired members and increasing the employer and employee contribution required of active members. The effects of the plan's various elements are estimated in the table below:

Element	Net Present Value of Change	30 Year Funded Ratio	Funding Period
Baseline - No change	N/A	78.2%	45 years
3 Yr COLA freeze	$634	89.1%	36 years
COLA deferred to age 65/60	$43	79.1%	44 years
Increase contributions by funded ratio triggers	$710	91.5%	35 years
COLAs based on funded ratio	$864	97.7%	32 years
All Element Impact	**$2,176**	**115.4%**	**24 years**

The majority of the savings to the plan come from alterations made to the COLA. PERA estimates that 67 percent of the total liability is attributable to current retirees who make up 41 percent of total membership.

Based on the 2018 cohort of retirees, the imposition of a minimum age of 65 for non-public safety COLA eligibility would effectively delay receipt of a COLA by 4 years as the current retirement age of non-public safety workers is 61. Public safety employees typically retire earlier, at age 54 which will result in their COLA being differed for 6 years.

The New Mexico Supreme Court has found that future annual cost-of-living adjustment under the Educational Retirement Act did not create constitutionally-protected property right until paid and did not reduce substantive retirement benefits. *Bartlett v Cameron, et al,* 316 P.3d 889 (2013).

The effect of salary increases and increased hiring must be taken into account when projecting the funded status of pension plans. While increasing salaries may increase income to the pension funds, it will also increase the size of the pensions paid, and thus the total liability to the fund. In the short- to medium-term, increasing employee salaries tends to increase pension plan liability, but in the long term, the additional income from increased pension revenue investment will offset the increase in liabilities. However, if increased salaries improve employee retention, they may hurt the funded status as more members become vested, adding to the liability. Additionally, when employees leave state service they are entitled to be refunded the employee contribution, but employer contributions remain with the fund so that high employee turnover improves pension plan funding while reducing turnover may have the opposite effect.

CJ/gb