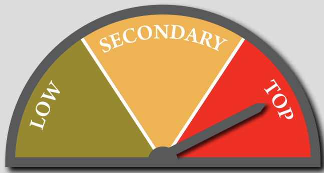
Policy Changes to Make a Difference

Public Pensions

Priority



Legislation Offered

Multiple bills in 68th General Assembly

Overview

The material describes the magnitude of the overpromise for public pensions and makes recommendations. It is the second time this chapter has appeared in a Citizen's Budget.

Recommendations

- Isolate current costs from bailout costs to create transparency and end inter-generational theft
- Provide retirement choice and "catch-up" option for young workers
- Sunset the AED and SAED payments to make PERA accountable for reaching fully-funded status
- Relieve taxpayers from the responsibility of future bailouts

Original Article

The entire original article can be found at http://tax.i2i.org/files/2010/11/CB_PensionLiability.pdf.

Summary

Colorado state government and school districts will pay more than $1 billion to the Public Employers Retirement Association (PERA) in 2013. Despite accounting for an estimated 13.5 percent of the state general fund budget, PERA ignores the cost to K-12 education and state colleges and universities.

In 2013, the cost of the PERA "rescue" will be nearly $400 million – funds from the state budget that might otherwise have been spent on priorities like education, transportation and public safety that would build a stronger future and a solid economic foundation.

Since 2004, state lawmakers approved three separate bills to increase PERA funding with the intent of digging out from its $25 billion deficit.

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These rescue payments—which reduce wages and benefits paid to teachers and state employees—will increase to more than $621 million annually by 2018 and, under current law, continue indefinitely.

Schools, students, and teachers are severely affected by the cost of the PERA rescue, which currently costs $299 per student, or nearly $6,000 for a classroom of 20 students. By 2018, this cost will soar to more than $467 per student, or $9,340 for a classroom of 20.

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Because of the cost of PERA rescue payments, school districts are reducing teacher salaries, all while increasing payments to PERA. As a result, both young teachers and state employees will earn less while working, work longer to reach retirement eligibility, and receive lower retirement benefits due to the PERA "rescue" plan.

According to PERA's own calculations, these payments will continue for at least 35 years, by which time almost all of PERA's current management will be retired and every seat in the state Senate and House of Representatives will have changed hands at least five times. As a result, there is virtually no accountability to ensure that the current bailout plan does not extend for an additional 10, 20 or 30 years.

While PERA members have a reasonable expectation to receive basic retirement benefits that are promised by state law, it is unconscionable for lawmakers and the PERA Board of Trustees to continue to promise benefits that are unaffordable and unsustainable – and to do so at the expense of new teachers and state employees who will be hired in the coming years.

Situation

The financial status of PERA, Colorado's largest pension system, is a growing problem for state and, especially, school district budgets. However, the debate over how to remedy PERA's problems so often becomes mired in the argument over whether to replace or preserve the current system that an in-depth, dispassionate look at PERA's mathematical problems gets lost in the crossfire. Meanwhile, the magnitude of the problem grows even larger, consuming tremendous resources—more than $341 million just in 2012—that could otherwise be spent on education, transportation, public safety or other budget priorities.

This chapter will not focus on arguments for or against various reform measures, although it will suggest some policy solutions. Instead, it will focus on the cost of existing measures passed by the legislature to improve PERA's financial status and the impacts of those measures on employees, schools, students and the state budget.

Ironically, the budget of Colorado state government does not itemize the cost of PERA, so the best available estimates must be extrapolated from PERA's 2011 Certified Annual Financial Report, published in the summer of 2012 and containing data that was current as of December 31, 2011. To the extent that the state budget does address PERA's cost, it nonetheless ignores the cost to K-12 education and state colleges and universities.

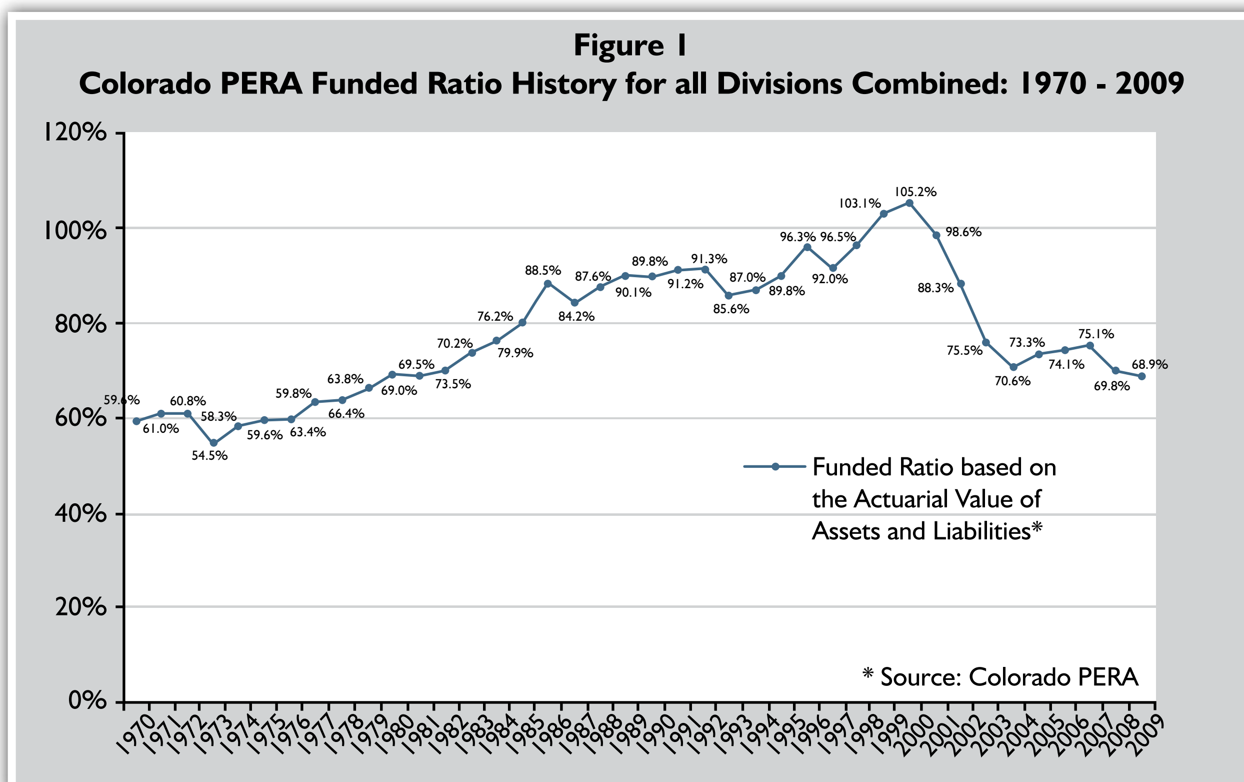

Figure 1
Colorado PERA Funded Ratio History for all Divisions Combined: 1970 - 2009

According to the 2011 report, PERA held $37.5 billion in assets and owed $62.5 billion in promised benefits, making its funding ratio 59.9 percent. Those two factors result in an acknowledged funding shortfall (aka "unfunded actuarially assumed liability" or UAAL) of more than $25 billion.[1]

PERA's funding ratio has been declining since 2000 when it reached 105 percent, riding the booming stock market performances of the 1990s. When the tech bubble burst and the stock market faltered still more following the terrorist attacks of September 11, 2001, PERA's funding ratio fell to 70.6 percent by the end of 2004. The funding ratio improved to 75.1 percent by 2007, but has fallen since, most notably due to the stock market's precipitous decline during the financial crisis of 2008.

For many years, PERA rebuffed suggestions that a 100 percent funding ratio was necessary. However, in November 2007, the Board of Trustees adopted a funding policy wherein it acknowledged the necessity of "achieving and maintaining a minimum 100 percent funding ratio."[2]

Market value is the more accurate and reliable standard, representing the difference, on any given date, between the current market value of assets and actuarial estimate of liabilities (i.e., benefits owed to PERA members).

PERA's funding ratio can be difficult to identify precisely at times because it can be calculated on two bases: market value and actuarial value.

Market value is the more accurate and reliable standard, representing the difference, on any given date, between the current market value of assets and actuarial estimate of liabilities (i.e., benefits owed to PERA members). Actuarial value is a more arcane measure because, rather than use the current market value, it calculates the "actuarial value" of assets using a "smoothing method" that spreads gains and losses over four years. For example, the 2008 stock market decline was only partially included in that year's actuarial value and wasn't fully realized on paper until 2011. The "smoothing method" was adopted to diffuse the obvious impact of large gains or losses in the market and to thereby discourage "overreaction" to market changes.

In addition to peaks and valleys in the stock market, PERA's funded status is affected by legislation that changes contribution rates, benefit payments, and retirement eligibility criteria. The PERA Board of Trustees also plays a role by adopting policies that address actuarial details, most notably assumed return on investments (ROI) and the price charged to members who wish to purchase additional years of service credit in order to bolster their benefits at retirement.

Membership

PERA boasts more than 483,467 members, including active workers, retirees and beneficiaries, and inactive members who are no longer working for a PERA employer and not receiving benefits. PERA reports that retirees and beneficiaries live in all 50 states and that 87 percent reside in Colorado.[3]

In 2011, PERA's State Division trust fund comprised almost 32 percent of the total assets managed by PERA. The State Division included 54,956 active members, 33,212 retirees and other beneficiaries, and 58,597 inactive members. State Division payroll totaled $2.393 billion. (This analysis does not include PERA's Judicial Division which includes employees of Colorado's 22 judicial districts, as well as county courts, totaling 654 current or retired employees and a payroll of $39 million.)

The School Division was larger still, accounting for 51.3 percent of PERA's funds in 2011. It consisted of 114,820 active members, 51,898 retirees and other beneficiaries, and 89,225 inactive members. School Division payroll totaled $3.821 billion. Denver Public Schools Retirement System, which merged with PERA in 2010, brought 13,571 active members, 6,311 retirees and $491 million in covered payroll.

Significantly, 44 percent (88,304) of active members in 2011 were not yet "vested." That is, though they are paying into the system and their employer is paying on their behalf, they are not eligible to receive benefits upon retirement because they have not worked for a PERA employer for a minimum of five years.

When a PERA member becomes "inactive" by terminating work for an employer who participates in PERA, they can either leave "their" money with PERA or withdraw it. Inactive members who choose to withdraw receive only their own contribution plus 3 percent interest. They do not receive any of the contributions that their employer made on their behalf. Further, inactive members – despite numbering 168,670 of PERA's 483,467 total members – have no representation on the PERA Board of Trustees.

Legislation

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At first glance, it may appear that PERA's shortfall is due to lagging investment returns or insufficient contributions by state government and school district employers. In reality, however, the cost driver is a benefit structure that simply cannot be supported by normal economic conditions.

From 2004 to 2010, the state legislature passed three PERA "rescue" bills (Senate Bill 2004-257, Senate Bill 2006-235, and Senate Bill 2010-001) intended to help PERA shore up its declining fund ratio.

PERA's 2011 financial report explains: "The Board worked extensively in 2004 and 2006 with elected officials to pass Senate Bill 04-257 and Senate Bill 06-235 which were designed to move Colorado PERA toward full funding over the coming decades."

Both measures relied heavily on the optimistic assumption that PERA's investments would return an average of 8.5 percent annually over 30 years. Despite both of those measures, the financial crisis of 2008 devastated PERA which lost 26 percent of the value of its investment assets in that single year.[4]

Nonetheless, PERA resisted making any changes to its plan during the 2009 session of the state legislature before proposing legislation in 2010. In advocating for Senate Bill 10-001, PERA asked for additional contribution increases and, for the first time, took the position that the annual cost of living adjustment (COLA) could be reduced for all members, including those already retired. In some cases, PERA suggested stronger medicine than the legislature was willing to swallow – asking that benefits be based on the highest average salary for five years and that the retirement age be raised to 60 for those hired in 2011 or later. Instead, legislators allowed the average-salary calculation to remain at just three years and left the current retirement age (58) in place for anyone hired before 2017 – almost seven years after the legislation was adopted.

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Funding

For each employee, PERA receives a 10.15

percent contribution from the employer, and an 8 percent contribution deducted from the paycheck of each employee. However, the rescue bills added a supplemental contribution that increases the employer contribution by an additional 10 percent of payroll by 2018.

When the rescue legislation is fully implemented, state and school districts will send a check to PERA for just over 20 percent of their payroll. Add to that the 8 percent deducted from employees' paychecks, and PERA will receive contributions equal to 28 percent of the combined payroll (nearly $7 billion in 2011) of all covered employees.

Yet when state government and some school districts froze salaries to cope with budget shortfalls, those state and school employers were still required by law to increase PERA contributions on behalf of their employees.

The 2006 and 2010 legislation included a mechanism intended to require working PERA members to share the burden for half of the additional contributions by trading a portion of their annual wage increases and for a correspondingly larger contribution to PERA to shore up their retirement benefits. Yet when state government and some school districts froze salaries to cope with budget shortfalls, those state and school employers were still required by law to increase PERA contributions on behalf of their employees. The requirement persists, despite the absence of any salary increase from which the PERA contribution could be subtracted.

Yet for employees of school districts and other government entities for which personnel costs constitute the lion's share of the budget, the inescapable reality is that increased contributions to PERA most certainly suppress wages and other benefits (as demonstrated below). No other line item in these budgets is large enough to produce the savings necessary to pay for the tremendous cost of the PERA rescue plan.

In 2011, state government contributed $283 million, while state employees contributed another $259 million. That year's data is skewed by legislation that temporarily shifted 2.5 percent of the required contribution from employers to employees, reducing the state government contribution by almost $62 million and increasing the employee contribution by the same amount.

Employers in the school division contributed $542 million to PERA in 2011; employees contributed $316 million. (The 2.5 percent shift to employees applied only to state government, not to other employers.)

In total, PERA received just over $2 billion in contributions in 2011.

PERA's 2011 financial report suggests that from an actuarial perspective schools and the state still are not paying enough, although the PERA administration has been careful not to advocate for still higher contributions.

PERA calculates that from 2007 to 2011, contributions by government employers were $1.68 billion below the amount necessary to adequately fund the retirement plan. Actuarially "insufficient" payments by schools represented $895 million of that shortfall.

"Even with SB 2010-001, the deficiency is expected to continue until statutory benefit and contribution changes are fully implemented (in 2018)," the financial report states.[5]

In order for government employers, funded by taxpayers, to fully finance PERA's benefit structure, employer contribution rates would need to be increased to 20.01 percent of payroll for the State Division and 19.79 percent for the School Division. These rates would be in addition to the 8 percent contribution deducted from employees' paychecks.

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Are school districts and other government employers under-funding PERA? The legal answer is obviously, "no." Employers are making the contributions required by state law. Unlike other states, Colorado is not "borrowing" from its pension fund to balance its budget, and PERA has not suggested any quick-fix schemes like derivatives and interest-rate swaps that have backfired elsewhere.

However, some actuaries would contend that PERA is under-funded simply because PERA employers are contributing less than the "actuarially required contribution" necessary for PERA to amortize its liabilities within 30 years. That theory dubiously assumes that benefits are unalterable and that means of balancing the equation is by demanding higher contributions from schools and other government employers.

How can it be that a pension system that receives more than $2 billion a year in contributions has seen its funding ratio decline in nine of the past 12 years? Because it currently pays out $3.9 billion a year in benefits.[6] Even after earning $725 million in investment income, PERA ran a deficit of nearly $1.2 billion in 2011 alone. (2011 CAFR, p. 23)

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For example, an employee who averaged $65,000 in his or her final three years of work and worked for PERA employers for 30 years would be entitled to receive $48,750 per year in retirement benefits. Those benefits increase each year by inflation as measured by the consumer price index (CPI) – but, per Senate Bill 2010-001, not by more than 2 percent per year.

The COLA reduction in Senate Bill 2010-001 is the focus of an as-yet-unresolved lawsuit — *Justus vs. Colorado* — in which plaintiffs, representing PERA beneficiaries, claim a contractual right, for the rest of their lives, to the COLA rate in effect when they retired. Many PERA beneficiaries retired when the COLA was a guaranteed 3.5 percent, regardless of the rate of inflation. Although a district court ruled that PERA members have no contractual right to the COLA, a three-judge panel on the Court of Appeals reversed that ruling but declined to rule on the constitutionality of the legislation, instead remanding the case to district court to consider "whether the (COLA) reduction was reasonable and necessary.[7]

For most PERA members, retirement age is governed by a Rule of 80 or Rule of 85, meaning they can retire when their age and years of work for a PERA employer total 80 or 85. A PERA member with 30 years of service can retire at age 55 and receive 75 percent of his highest average salary. Senate Bill 2010-001 made modest changes to the retirement age, increasing to 58 for those hired from 2011 to 2016 and to 60 for those hired after January 1, 2017. Those changes applied only to future PERA workers; not to anyone working for PERA when the legislation was passed.[8] It should be noted that this analysis is not intended to criticize PERA members for receiving the retirement benefits that have been promised according to Colorado statute. While groups purporting to represent PERA members actively lobby against any benefit reductions and by doing so make necessary change more difficult to accomplish, the responsibility for ensuring that the benefit structure is sustainable rests with the PERA Board of Trustees and staff and, ultimately, with state legislators and the governor.

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Pressure on Investment

Nothing is more important to the financial health of a pension fund than its investments and the income they generate. Over the past 30 years, PERA's investment income ($43.9 billion) has been far greater than the contributions ($31.1 billion) it receives from employers and employees. At the same time, PERA has paid out just under $40 billion in benefits. Meanwhile, its funding ratio grew from 73.5 percent in 1982 to 105.2 percent in 2000 but has since fallen to 59.9 percent, erasing more than 20 years of gains.[9]

In good years, pension funds can pay for all required benefits from contributions and a fraction of their investment income. For example, PERA's actuarial models are presently based on an 8 percent annual return on investment. For 2011, an 8 percent return would have yielded $3.9 billion, virtually the same amount it paid out in benefits and expenses. At that rate, PERA could add the entire $2 billion it receives in contributions to its investment portfolio.

Instead, PERA's investments returned 1.9 percent (or $724 million). Not only was PERA required to use all of its contributions and investment income to pay benefits, but it was also forced to cash out almost $1.2 billion of its investments to pay the balance of its benefit obligations.[10]

If 2011 was bad, 2008 was disastrous – not just for PERA but for all investors. In PERA's case, it lost $12.3 billion in net assets in 2008 alone. As a result, PERA has been treading water financially for the past five years, during which its net assets have grown by slightly more than 1 percent.[11]

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That performance came on the heels of heavy losses from 2001 to 2004 when PERA's investments fell by $7.8 billion.[12]

However, it's not that PERA is investing poorly compared to others in the market. In 2011, PERA's meager 1.9 percent return was considerably better than its comparative benchmark, which produced a 1.3 percent return. In fact, PERA has exceeded its benchmarks, albeit by modest amounts, in three of the past five years. Likewise PERA's rate of return compares favorably with Standard & Poor's 500 or the Dow Jones Industrial Average. One hundred dollars invested in the S&P 500 on Jan. 1, 2007, would be worth $98.63 as of Dec. 31, 2011; the same amount invested in the DJIA would be worth $97.99. Apply PERA's actual performance during the same period and the $100 grows to $111.01.

PERA's problem is not investment performance but rather that its benefit structure puts extreme pressure on PERA investment managers to cover that deficiency.

Colorado statute calls for PERA to be able to amortize its benefit obligations over a 30-year period in order to be deemed actuarially sound.[13] PERA has been unable to comply, even after the series of rescue measures passed by the legislature. PERA projects that when all of the rescue measures are fully implemented—and with an 8 percent annual return on investments—the State and School divisions can be 100 percent funded in 35 years.

But what if PERA fails to realize its projected 8 percent return on investment? After all, if PERA had averaged 8 percent ROI over the previous five years it would have reaped an additional $15 billion in investment income with total assets of $55 billion, rather than the current $40 billion. (Assets in all PERA funds total $40 billion; the total in PERA pension and health care trust funds is $37.5 billion.) While most investors would consider the massive losses scattered

over the past 12 years to be an event from which a full recovery is unlikely, PERA continues to project an 8 percent rate of return over a 30-year horizon.

If the ROI is reduced to just 7.5 percent, PERA's shortfall (UAAL) grows from $25 billion to $28.5 billion. Reduce the projection from 8 percent to 6.5 percent and the shortfall explodes to $36.5 billion.

For many of today's investors, a 6.5 percent annual return sounds optimistic, notwithstanding that the 30-year average return for most indexes from 1980 to 2010 ranges from 8.3 percent to 11.3 percent. Still, even a 6.5 percent average annual return would be disastrous for PERA. It would have dire consequences for PERA beneficiaries because, as demonstrated below, state government and school districts can hardly afford the cost of the current PERA rescue payments which grow and continue indefinitely.

Hidden Cost

Contributions to PERA cost state government and school districts more than $1 billion per year. That's 13.5 percent of the entire state general fund budget.

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The PERA rescue legislation of 2004, 2006 and 2010 combined to increase employer contributions from 10.15 percent of salary to 20.15 percent of salary by 2018. For 2013, that contribution will be 16.55 percent of salary – in addition to the 8 percent paid directly by employees.

As a result, employers in the State Division will pay an estimated $243 million for the standard contribution (10.15 percent) and another $153 million for the 6.4 percent rescue contribution, based on the most recent data available. Employers in the School Division will pay about $388 million toward the standard contribution and some $244 million for the rescue plan. (Although school district payroll costs are not specifically provided in the state budget, public schools receive an average of 63.6 percent of their total program funding from state funds.) If school districts were not required to pay for the PERA rescue, they could spend that $244 million on improving education for students.

Thus, the combined impact of PERA on the state budget reaches more than $1.028 billion – of which $398 million is paid to help rescue PERA from its $25 billion deficit. If the rescue plan were to be fully and immediately implemented to a rate of 10 percent of salary, the cost would rise to $621 million. If that seems like an unbelievable figure, recall that PERA's financial report confirms that PERA members in the State and School divisions were paid a combined $6.2 billion in salary in 2011.

Now consider that these rescue payments continue indefinitely until PERA reaches 103 percent funding — a goal estimated to be 35 years away even under PERA's own optimistic projections and which it has reached just one time in 81 years.[14] Allowing for annual payroll increases of 5 percent, the state and school districts will spend an estimated $56 billion over the next 35 years just for PERA's rescue plan – in addition to the $57 billion it will pay as the standard employer contribution.

Now consider the enormous impact of these payments on other budget priorities.

The $398 million cost of the rescue plan for 2013 is greater than the combined general and cash funds budgets for nine entire departments in state government: Agriculture ($35 million), Governor's Office ($52 million), Labor & Employment ($60 million), Law ($21 million), Legislature ($36 million), Military & Veterans Affairs ($8 million), Personnel ($19 million), Regulatory Agencies ($73 million), and State ($20 million). When fully implemented in 2018, the rescue plan will be more costly than the current general fund expenditure for any state department except for the four

largest: Education, Corrections, Health Care Policy & Finance, and Human Services.[15]

Hardship for Schools

Since 2010, Colorado has reduced funding for K-12 education by $604 per student, in order to balance the state budget amid poor economic conditions and reduced tax revenues.[16]

Although the cost of the PERA rescue plan is severely understated in the state budget, the $244 million expense paid by employers in the School Division equates to $299 for each of the 817,221 full-time equivalent students funded by the School Finance Act. That is nearly twice the cost of the 2009-10 mid-year budget cuts ($129 million) that hit school districts particularly hard. Rescuing PERA costs nearly $6,000 in a classroom of 20 students.

Moreover, the cost of the PERA rescue will increase by another 56 percent when fully implemented in 2018 and for at least 35 years — by which time the children of today's first graders will be old enough to drive. When fully implemented, the cost will soar to more than $467 per student or $9,340 per classroom.

Ultimately, policymakers must ask whether spending nearly $1,000 per student or 14.5 percent of the total K-12 program on pensions is in the best interest of our students.

These figures count only the rescue payment that schools send to PERA. The standard employer contribution is another 10.15 percent or $474 per student.

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Squeezing Teachers

Like students, teachers are being squeezed by PERA's costly rescue plan.

In August 2012, Adams 12 School District teachers protested a 2 percent salary reduction that the school district enacted explicitly to offset the rising cost of PERA's rescue contribution. For 2012-13, Adams 12 will pay $190 million in salaries, plus $36 million for PERA and Medicaid, with PERA accounting for well over $30 million.

In 2010-11, Colorado Springs School District 11 paid $21 million to PERA, according to the *Colorado Springs Independent*. Those payments, combined with funding reductions by the state legislature, led the district to close schools and make cuts that affected everything from textbooks to class size to laying off teachers and suspending pay increases.

District 11 chief financial officer Glenn Gustafson "desperately wants to impress upon you … why the Public Employees Retirement Association is eating the district alive," wrote reporter Pam Zubeck.

"PERA is going to force us down this road that's not the road we wanted to go down, because we don't think it's the best road for the district," Gustafson told the *Independent*.

"To improve student achievement, it's more important than ever to attract qualified and talented teachers. But we're shifting a disproportionate amount of compensation to retirement benefits and health care. We will be challenged to give any pay increases."[17]

Gustafson cited the disadvantage for Colorado schools when competing to hire the best teachers against schools in Nebraska and Wyoming that can pay 21 percent and 11 percent more, respectively. A Dallas suburb pays starting teachers 48 percent more than District 11 can offer.

In November 2011, Burlington School District RE-6J, a small school with a total enrollment of 738 funded pupils, faced a

$300,000 budget deficit and asked voters for a mill levy increase. For the fourth time in as many years, voters rejected the tax increase.

In the 2011-12 fiscal year, the district paid just over $3 million in salaries, a figure that has steadily declined in recent years. PERA received an employer contribution of $449,361, of which $149,294 went solely toward the rescue plan. Because of the mandated expense of paying for PERA's rescue plan, the district had to double its budget cuts. For 2012-13, the district decreased salaries by another $54,399 but the mandatory PERA contribution *increased* by $38,594.

Penalizing Young Workers

The PERA rescue plan is particularly pernicious to young teachers and other newly-hired workers, who are paid less while they work, earn lower retirement benefits, and work longer to reach retirement age – all to preserve benefits for older workers and retirees.

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Because some 80 percent of a school district's budget pays for salaries and benefits, employees necessarily will bear the burden of paying for PERA's rising contribution rates. No other budget item can be cut or reduced to provide the necessary savings to pay for PERA. The timing of these increases is particularly painful for school districts that have cut their budgets to account for declining state funding.

For recently-hired employees, the situation is even worse.

As previously detailed, PERA actuarial analysts do not expect the funding to reach 100 percent for at least 35 years in the State and School divisions. That means the "rescue" payments will rise from 6.4 percent of salary in 2013 to 10 percent in 2018 — and stay there until today's twenty-somethings are ready to retire.

Every teacher or state employee who starts work today will see their wages and benefits reduced by 10 percent in perpetuity. Adding insult to injury, lower salaries result in lower retirement benefits.

Put another way, teachers and other government employees essentially lose a full year's pay every 10 years to pay for the PERA bailout.

All the while, older PERA members retire at an earlier age and collect their promised benefits – minus a slightly reduced annual COLA.

To any PERA member, this inequitable situation should reveal the insincerity of PERA's Statement of Funding Policy: "The Board's minimum 100 percent funded ratio goal over time avoids externalizing the costs of amortizing unfunded accrued liabilities *onto others in the future, and provides for fairness and intergenerational equity* for taxpayers, employers and employees with respect to the costs of providing benefits"[18] (emphasis added).

It could be understood if younger PERA members—working for less, working longer, and receiving less in benefits—view the pronouncement with appropriate skepticism. After all, while some form of PERA rescue may be necessary, younger workers should not be forced to pay both for their own retirement and PERA's past debts. Annual payments that will soon exceed $600 million a year with no end in sight are simply unaffordable and unsustainable, especially when they undermine spending on priorities, like education, that are crucial for our future.

Policy Proposals

1. **Create transparency and end inter-generational theft**
   Under PERA's current funding structure, young workers and those

hired in the next three decades will pay a large share of the cost to provide pension benefits for today's retirees and workers nearing retirement age. This structure penalizes younger workers who will receive lower salaries while working, earn lower benefits at retirement, and work longer to reach retirement age.

PERA uses the complexity of its current pension system—which relies on contributions from today's workers to ensure benefits of today's retirees—to conflate the costs of bailing out PERA's financial losses with the cost of paying benefits for today's younger workers when they reach retirement age.

The actuarial tables in PERA's annual financial report justify speculation that the rescue payments which force employers to pay an amount equal to 20 percent of workers' wages to PERA will continue past our lifetime. Lawmakers should require an independent actuarial analysis to determine what level of benefits can be sustained solely from PERA's standard employer and employee contributions of 10.15 percent and 8 percent, respectively, and require PERA to structure benefits accordingly.

By isolating these costs, lawmakers can separate the actual cost of pension benefits from the ongoing cost of three PERA bailouts.

2. **Provide retirement choice and "catch-up" option for young workers**
   All new hires should be allowed the option of transferring to a defined contribution program with individual accounts, whereby they can exercise greater control over their retirement investments. For those choosing the defined contribution option, the SAED and AED contribution to PERA should be reduced by half so that employees can regain a portion of the wages lost to the PERA rescue payments.

   All current PERA members should be allowed the option of taking the same amount they could withdraw from PERA if they ceased working for a State or School division employer and transfer that amount to a defined contribution plan. Those who have less than five years of service with a PERA employer should also have the SAED and AED contributions made on their behalf reduced by half and transferred to salary.

3. **Sunset the AED and SAED payments to make PERA accountable for reaching fully-funded status.**
   Under current law, PERA expects the state and local school districts to continue making bailout payments (AED and SAED contributions) for at least 35 more years in the State and School Divisions. By that time, every seat in the State Senate and House of Representatives will change hands at least five times and almost all of PERA's current officials will be retired, as well. Moreover, those 35 years will see nearly three full generations of students start kindergarten and graduate from high school, while their school budgets are being severely restricted by the cost of the PERA bailout. As a result, there is virtually no accountability to ensure the current bailout plan does not extend for an additional 10, 20 or 30 years, taking billions more away from other priorities, like education, transportation and public safety.

4. **Relieve taxpayers from the responsibility of future bailouts**.
   In the past decade, lawmakers have passed three bills designed to rescue PERA from investment losses and costly benefits. Only the last bill took significant steps to reduce the future cost of benefits, but all three obligated employers or

employees to pay still more to help PERA attain solvency someday. Even after the latest "fix," Senate Bill 2010-001, PERA does not expect to fully amortize its liabilities for 35 years or more. To reach that goal, PERA needs an average return on investment of 8 percent per year.

Under current law if PERA's investments fail to realize its lofty projections, taxpayers are still on the hook to make PERA whole, even though taxpayers have no control over PERA's investment choices.

It's time to end this "heads we win, tails you lose" racket. Taxpayers cannot afford it. Neither can young employees whose earnings are reduced in order to fully fund the retirement of earlier workers and retirees.

If PERA's investments fail to achieve returns necessary to pay benefits, then lawmakers should require PERA's Board of Trustees to equitably reduce the cost of benefits to all members – not simply increase the burden on younger workers.

The state, public schools and young public employees can scarcely afford the current schedule of bailout payments, which takes funds from other budget priorities. Additional bailout payments must be off the table, and PERA must be required to return to funding its pension plan from contributions which are affordable and sustainable both to employers and employees.

5. **Link the retirement age to the age for Social Security eligibility.**

A key policy question for lawmakers to consider is whether PERA should serve as a plan that supports workers in retirement or an investment plan that provides supplemental income to able-bodied workers who "retire" from a PERA-covered job and go to work for another employer while collecting a PERA pension. Linking the retirement age for PERA members to that of Social Security would provide two public policy benefits:

First, it would create equity between taxpayers and the government employees whose salaries and retirement benefits are largely financed by taxpayers. It's simply unfair to expect ordinary Coloradans to work longer to rescue a pension plan that allows state workers to retire as early as age 50 or 55. Just as importantly, this policy change could significantly reduce future benefit costs.

Second, by reducing the cost of PERA's benefit structure and returning PERA to its intended purpose of providing retirement benefits, rather than a supplemental income plan for those who "retire" at 50 or 55 so they can collect PERA benefits, plus a salary from a non-PERA employer.

A PERA member's average age at retirement is 58.19 According to the U.S. Department of Health and Human Services, a 58-year-old male can expect to live another 20.4 years and a 58-year-old female can expect to live another 24.6 years. The approximate average of 22.5 years leads to age 81. By contrast, a 67-year-old male can expect to live another 14.8 years and a female another 18.4 years — an approximate average of 16.6 years. By linking PERA's retirement age to that of Social Security (at least for current PERA members under age 40 and for all new hires), PERA could reduce the duration of its retirement benefits from an expected average of 22.5 years per affected retiree to 16.6

years[20] – a reduction of 5.9 years or approximately 26 percent. Raising the retirement age also would have the benefit of deferring the expected payout period by nine years if the retirement age were raised from 58 to the private sector's age of 67 years. If combined, both factors could reduce the costs for the affected portion of the plan by 20 percent to 35 percent.

Any change that would reduce the cost of benefits by one-fourth would be a significant step toward making PERA sustainable. Reducing the cost of the plan would allow the state and school districts to reduce PERA payments and put those funds into other priorities, like classrooms and salaries thereby reducing the burden on young workers to pay both the cost of their own retirement and that of current retirees.

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Mark Hillman was the author of this chapter. See his biographical information in the major authors section.

Barry Poulson reviewed the chapter for accuracy and interpretation. He is a retired professor of Economics at the University of Colorado at Boulder. He serves as a Scholar for both the Heritage Foundation and for the Americans for Prosperity, as an Advisor for the American Legislative Exchange Council and as a Senior Fellow with the Independence Institute. He was president of the North American Economics and Finance Association and served on the Colorado Tax Commission.

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