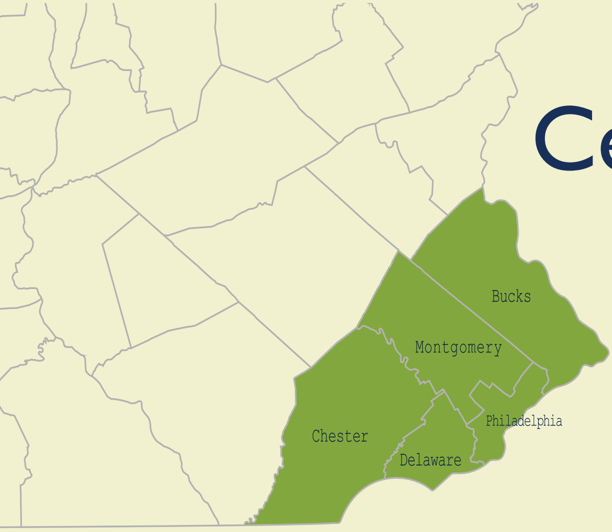

Center On Regional Politics

Bulletin

Volume 5, Number 1 | Summer 2016

A MESSAGE FROM THE DIRECTOR

The interrelated problems of adequately funding public pensions and public schools continue to weigh on Pennsylvanians, as reports summarized in this bulletin suggest. Both problems reflect what I call the cost of politics. They add up to roughly $3 billion a year that could have been used to improve schools or cut taxes or perhaps both. Our new report on pensions shows that the unfunded liability of our state and municipal plans now exceeds $60 billion. Our new report on fund balances for all 500 school districts shows that most have inadequate reserves to meet emergencies or pay higher pension costs stretching far into the future.

How do I calculate the cost of politics? The Basic Education Funding Commission concluded that our decades old policy of providing "hold harmless" funding to districts losing students is misallocating $1 billion a year but in fairness cannot be abruptly ended. Roughly $1 billion in the state's 2016-17 budget is paying for the legislature's past failures to fund the school employees' retirement system. Because school districts pay about half the employers' pension costs, they would have an additional $1 billion that could have been used to improve programming or cut taxes. In each case, we let short-term politics overwhelm long-term policy.

There are small signs of progress. This fiscal year's budget fully funds school pensions for the first time in years and distributes $200 million for schools through a fairer formula. Bipartisan support for pension reforms, some highlighted in CORP reports, seems possible this fall. Philadelphia's largest public union settled a contract that includes two CORP-highlighted reforms, a mandatory stacked hybrid benefit and tiered contributions for new workers.

In the election-year summer of 2016, we will take what we can get. And keep on working on these huge challenges.

Joseph P. McLaughlin, Jr.

CORP PENSION UPDATE: MOUNTING LIABILITIES WITH MODEST SIGNS OF PROGRESS

A new CORP Issue Memo documents the still growing unfunded liabilities of Pennsylvania's state and local pension funds and summarizes approaches in the Commonwealth and elsewhere to reduce burdens that will be weighing on taxpayers and citizens for years to come. The bad news is that Pennsylvania's combined state and local unfunded liability tops $60 billion and with record low fund earnings last year, appears to be headed in the wrong direction. The good news is that there are signs of progress, albeit modest, including some ideas surfaced in CORP reports.

Entitled "The Problem of Funding Pensions: An Update," the report, issued in June 2016, identifies five categories of reforms being tried or adopted in Pennsylvania and in other states and cities around the country. These are (1) increasing employee contributions; (2) reducing benefits, usually for new members, through changing retirement ages, vesting periods, and final average salary calculations; (3) changing plan structures from defined-benefits to defined-contributions or to hybrids; (4) raising taxes or creating new funding streams for pension debt; and (5) selling assets or otherwise monetizing revenues to benefit pension funds.

The report notes that several ideas surfaced in CORP's *Report of the Public Pension Working Group* published in June 2013 have been reflected in public policy debates in the last three years. These ideas include:

- dedicating existing revenue streams to pay down unfunded liabilities;
- developing so-called stacked hybrid plans that combine defined-benefit and defined-contribution features;
- ending the use of state aid to pay for municipal pension administrative costs;
- and consolidating plans with low funding ratios into the Pennsylvania Municipal Retirement System (PMRS).

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The new report also highlights a New York State statute that imposes a tiered contribution requirement on newly hired state and local employees that has found traction in Philadelphia. Similar to a graduated income tax, New York public employees with higher salaries will contribute to their pension plans at a higher rate as their salaries rise above certain thresholds.

Since the CORP update was published in June, Philadelphia's largest municipal union, District Council 33, which represents blue-collar workers, has agreed to a four-year contract with both a stacked hybrid benefit and tiered contributions for new hires. The report also notes that the City of Philadelphia is also benefitting from the dedication of a portion of its sales tax to pay down its unfunded liability, as recommended by the working group report in 2013.

Meanwhile, in Harrisburg, the Pennsylvania House of Representatives earlier this summer passed legislation that provides new state and public school employees with a stacked hybrid benefit that also closely resembles the model described in CORP's report. The Senate is working on legislation that would provide new state and school employees with a so-called side-by-side hybrid plan, partly defined-benefit and partly mandatory defined-contribution.

After last summer's veto of Senate Bill 1, which would have put all state and school employees into a mandatory defined-contribution system, Governor Wolf and legislative leaders have said this summer that action on the pension issue will be a priority when sessions resume in the fall.

The Senate Finance Committee also is considering legislation that would incorporate provisions recommended by the Governor's Task Force on Municipal Pensions, which was led by Auditor General Eugene DePasquale. These include ending the use of state aid to pay municipal pension administrative costs and consolidation of plans with low funding ratios into PMRS, both among steps also highlighted by CORP. The task force's controversial proposal to remove pensions from collective bargaining was not included in the legislation.

The update summarizes trends in the funding status, key assumptions, investment performance, and number of active and retired members, of the three largest funds in the Commonwealth: The Pennsylvania State Employees' Retirement System, the Pennsylvania Public School Employees' Retirement System, and the Philadelphia Municipal Retirement System. It also summarizes key pension legislation pending in the Pennsylvania House and Senate.

Six Southeast Pennsylvania Municipal Pension Plans Are Considered Severely Distressed

Not published in time for inclusion in our pension update were the Act 205 distress scores for Pennsylvania's municipal pension plans at the end of 2015. The table below summarizes the status of plans in the five-county Southeast that were submitted to the state within the required period. Plans less than 50% funded are considered severely distressed; between 50% and 69%, moderately distressed; and between 70% and 89%, minimally distressed. Plans funded at 90% or above are considered not distressed.

Six Southeast plans were in the severely distressed category. Philadelphia's Municipal Retirement System, the third largest public pension system in the Commonwealth after the two state systems, was 45% funded at the time the report was due. Philadelphia's lower funded status can be attributed to a lowering of its actuarial assumption and very low earnings on investments. (More data on Philadelphia and the two state systems are in the pension update report.) Three plans in Delaware (Chester City, Colwyn, and Millborne Borough) and one each in Bucks (Tullytown Borough) and Chester (Thornbury Township) also are in the severely distressed category. Twelve plans were moderately distressed, an improvement from recent years, and 88 plans were minimally distressed.

Southeast PA Distressed Pension Systems as of 2015

COUNTY	Severely Distressed <50% Funded	Moderately Distressed 50-69% Funded	Minimally Distressed 70-89% Funded	Total for County
Bucks	1	2	19	22
Chester	1	1	19	21
Delaware	3	7	24	34
Montgomery	0	2	25	27
Philadelphia	1*	0	1**	2
Total for Region	6	12	88	106

* City of Philadelphia Public Employees' Retirement System
** Philadelphia City Redevelopment Authority
Source: Public Employee Retirement Commission

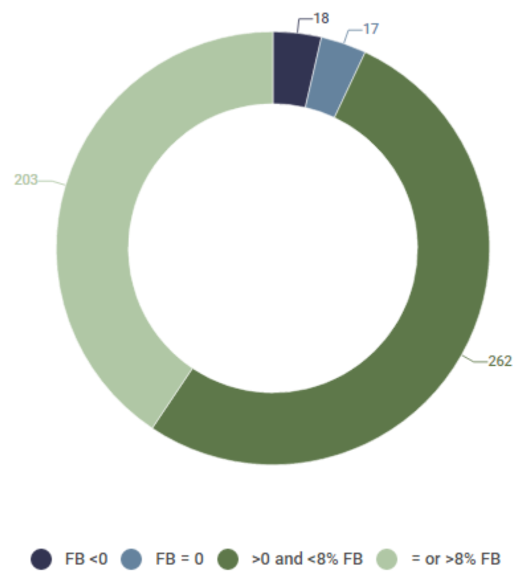
NEW CORP POLICY BRIEF: ARE PA SCHOOLS REALLY FLUSH?

A policy brief published by the Center on Regional Politics in July 2016 provides data on the status of fund balances for Pennsylvania's 500 school districts at the close of fiscal year 2014-15. The data show that total reserve funds for districts, charter schools, and technical schools have increased by about $400 million since 2012-2013, from $4.3 billion to $4.7 billion. But only six of the 500 school districts have unassigned fund balances equal to or larger than their state subsidy.

The brief summarizes aggregate trends for districts, as well as charters and technical schools, while data on specific districts' reserve funds have been made available through the CORP website, listed both alphabetically by county and by House and Senate districts. The brief explains the four types of fund balances under government accounting standards and the restrictions on unassigned balances under state law. Districts may use "committed" fund balances to save for capital improvement projects in order to avoid borrowing. Meanwhile, "unassigned" balances are available for use without restrictions and serve as a hedge against economic and budgetary uncertainty. For example, districts with unassigned funds used these to sustain their operations during delays in state subsidy payments in the 2015-16 state budget impasse.

The financial industry suggests that a government unassigned fund balance should be between 5% and 10% of total operating expenditures. A 5% balance would be sufficient to fund a district for just over two weeks, should it incur declining revenues due to economic conditions or be faced with unforeseen expenses such as legal judgments, natural disasters, or higher borrowing costs due to state budget delays. The Pennsylvania School Code (24 PS §6-688) limits the amount of unassigned fund balance to 8% for a district whose expenditures exceed $20 million if it is going to raise taxes. The Government Finance Officers Association recommends minimum unassigned reserves between 5% and 15% of total expenditures. The data show that many districts are not meeting these minimum recommendations. Instead, 35 districts have negative or zero unassigned fund balances, while 262 have positive fund balances below 8%. On average, the brief notes, school districts have unassigned fund balances just above the minimum recommendation of 5%. Charters, which operate as non-profits, have slightly higher fund balances, on average, while technical schools have somewhat lower unassigned reserves. However, these balances are not distributed normally across districts. Instead, the majority of districts have unassigned fund balances below 10%, while a smaller number have unassigned reserves that represent a much higher share of total expenditures.

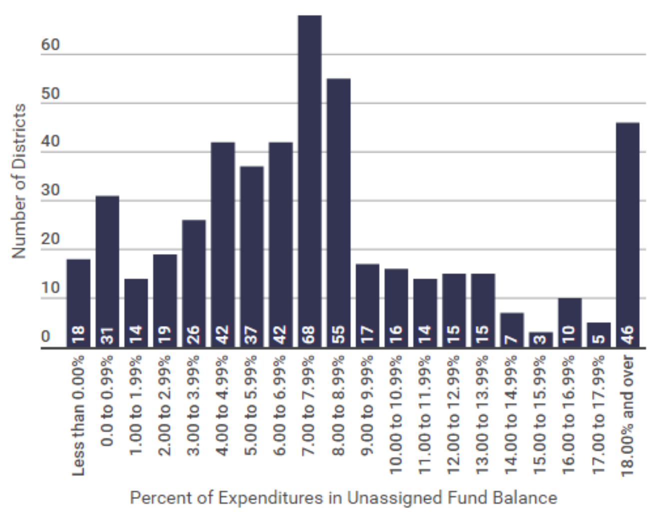
School District Unassigned Fund Balances, 2014-15



The unassigned fund balance taxing limit is 8% according to the PA State Code.

Source: PA Department of Education

Distribution of Districts by Percent of Expenditures in Unassigned Fund Balance, 2014-15



Source: PA Department of Education

NEW *COMMONWEALTH: A Journal of Pennsylvania Politics and Policy* PARTNERS WITH TU PRESS

COMMONWEALTH, a journal originally founded in 1987 by the Pennsylvania Political Science Association, has rebranded itself in partnership with Temple University Press and the Pennsylvania Policy Forum to focus on Pennsylvania politics and policy. The Pennsylvania Policy Forum is a consortium of faculty members and academic and policy institute leaders from 14 Pennsylvania colleges and universities who share an interest in generating ideas, analyses, and symposiums that might prove useful to citizens, elected officials, and civic leaders in addressing major issues confronting the Commonwealth and its local governments. The journal is meant to appeal to policymakers, journalists, think-tanks, practitioners, and academics alike. The most recent issue focuses on the special topic of education policy in Pennsylvania with essays on:

• Contrasting views on abolishing the property tax to fund schools by PA Senator David Argall and Jon Hopcraft (pro) and economist William A. Fischel (con) of Dartmouth College;

• Examining what a student-based allocation system for education spending would mean in PA by Marguerite Roza and Amanda Warco of Georgetown University;

• Evaluating the effectiveness and demographic trends for performance on the Keystone Exams by Adam McGlynn of East Stroudsburg University;

• Analyzing the implications of an aging PA population and PA's tax structure on public education finance by Maureen W. McClure and Vera Krekavona of the University of Pittsburgh;

• And investigating special education funding in PA by William T. Hartman of Penn State University.

The journal is free online for the first year and can be found at: tupjournals.temple.edu/index.php/commonwealth. Yearly, the journal will produce three issues, one focusing on a special topic, and the others general-topic containing research-based articles, expert political analysis of policy issues in the state, essays, and book reviews.

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Craig M. Wheeland	Associate Vice President and Professor, Villanova University

OTHER CORP PUBLICATIONS AVAILABLE

RESEARCH AT A GLANCE: Explaining School Fund Balances – Are PA Schools Really Flush? | July 2016

POLICY BRIEF: Explaining School Fund Balances: An Update | July 2016
    Access the Data and Distribution according to House and Senate District

ISSUE MEMO: The Problem of Funding Pensions: An Update | June 2016

RESEARCH AT A GLANCE: How Well Does Philadelphia Support its Public Schools? A New Perspective | January 2016

POLICY BRIEF: How Well Does Philadelphia Support its Public Schools? A New Perspective | January 2016

RAND Corporation Research Report: The Economic Impact of Achievement Gaps in Pennsylvania's Public Schools | July 2015

POLICY BRIEF: Explaining School Fund Balances: An Update | June 2015
    Access a Statistical Supplement Comparing Fund Balances for PA's 500 School Districts

POLICY BRIEF: Forecasting Fiscal Futures of Pennsylvania School Districts: Where Law and Current Policy Are Taking Our Public Schools | May 2015
    Access Data on Five Year Fiscal Forecasts for All 500 School Districts by House District, Senate District, and School District

POLICY BRIEF: Understanding Measures of Tax Effort and Tax Capacity | April 2015

POLICY BRIEF: The Politics of Educational Change: What Can We Learn from the School Consolidation Acts of 1961 and 1963? | March 2015

POLICY BRIEF: Hold Harmless Education Finance Policies in the U.S.: A Survey | December 2014

POLICY BRIEF: Growth and Stability in Public School Revenue Sources: Can We Have Both? | October 2014

POLICY BRIEF: Explaining School Fund Balances: Are PA Schools, with $4.3 Billion in Reserve Funds, Really Flush? Just the (Dry) Facts | August 2014
    Access a Statistical Supplement Comparing Unassigned Fund Balances and Aid Ratios for PA's 500 School Districts

ISSUE MEMO: How Pennsylvania Funds Public Schools: The Story of the Local Share | May 2014

ISSUE MEMO: How Pennsylvania Funds Public Schools: The Story of the State Share | May 2014

Pension Working Group Report | June 2013

All available at temple.edu/corp.

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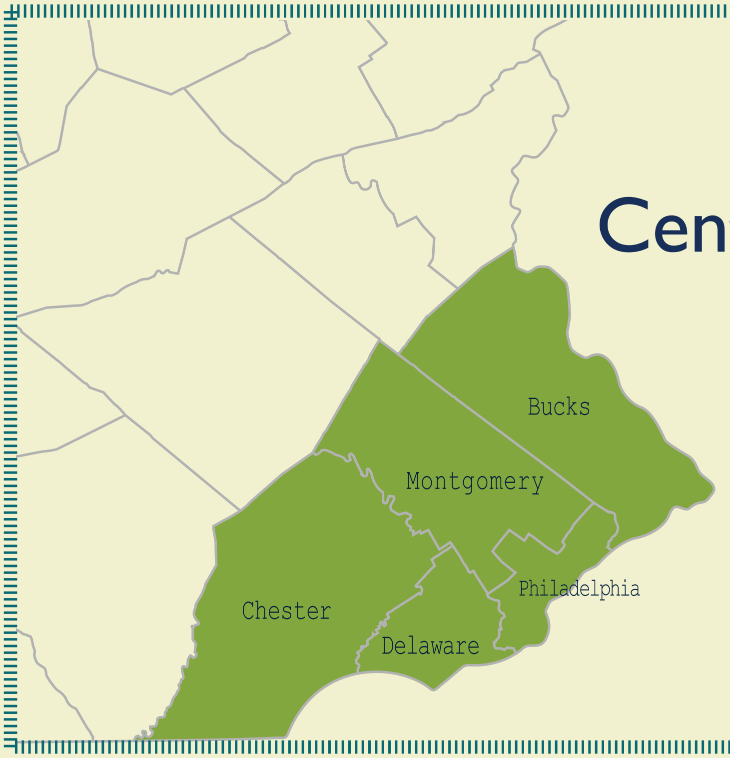

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