Business Partner Webinar:

Managing the Rising Costs of Long-term Liabilities During Fiscal Uncertainty

May 23, 2024

csba

Housekeeping

- At the end of the presentation, we will have a Question-and-Answer segment where we will try our best to answer your questions
- Please, use the Q & A feature of Zoom to type your questions. This is located on ribbon below the speaker.

- Your questions will be answered either in the Q & A panel or live by our presenters
- All attendees will receive a link to the video of this webinar as well as the slide deck

Today’s Presenters

- **Chris Reefe**, CSBA Legislative Director
- **Ryan Nicasio**, PARS Senior Vice President

Moderator:

- **James Collins**, CSBA Senior Director, Business Development

What is the May Revise?

- The May Revise is the formal presentation of updated general fund revenues received due to the annual April 15 income tax filing deadline.
- Required by law to be presented on or before May 14, and is an opportunity for the Governor to provide an update on:
  - State general fund revenues for the current year and coming budget year.
  - Governor’s proposals to expand or reduce programs and expenditures.
- State law also requires the May Revise to include an update on Proposition 98 funding and the state’s efforts to meet the constitutional guarantee.

May Revise Overview

State Budget Deficit

- Projected budget deficit in the January Budget was estimated to be $37.9 billion.
- May Revision projects a growth in the deficit by $7 billion, increasing to an overall deficit of $44.9 billion.
- However, early budget actions taken by the Legislature in April helped to reduce the size of the deficit by $17.3 billion.
- This resulted in a revised budget deficit of $27.6 billion.

Proposition 98 Overview

- Revised minimum guarantee for the current year is $102.6 – $3.5 billion below the January Budget estimate.
- For 2024–25, the minimum guarantee is estimated to be $109.1 billion
- When accounting for adult education, Proposition 28 and other agencies, the Prop 98 total for the split is $107.3 billion
  - TK–12 share: $95.5 billion – 89%
  - Community College share: $11.8 billion – 11%
- The revised three-year estimate for Prop 98 is:
  - $97.5 billion in 2022-23*
  - $102.6 billion in 2023-24
  - $109.1 billion in 2024-25

Proposition 98 Overview Continued

- According to the Department of Finance, revised estimates of Prop 98 over the three-year period spanning 2022–23, 2023–24 and 2024–25 represent an approximate decrease of $14.8 billion relative to the 2023 Budget Act.
- To bridge an estimated shortfall of $8.8 billion in funding of Prop 98 in 2022–23, the Governor is proposing a new interpretation of Prop 98 – referred to as a "funding maneuver."
- Prop 98 continues operating under Test 1 in the current year and budget year, i.e., current year funding adjusted for increases in property tax revenue.
- Test 1 is estimated to be 39.28% of the overall state budget

Public School System Stabilization Account Prop 98 Reserve

To make up the difference between the budget shortfall and the lower Prop 98 funding guarantee, the Governor proposes using all of the Prop 98 Reserve over a two-year budget period.

- $5.8 billion in the current 2023–24 fiscal year
- $2.6 billion in the 2024–25 budget year
- This would exhaust the reserve after 2024–25
- Local reserve cap remains in place in the current year, but would not apply for the 2024–25 fiscal year

Cost-of-Living Adjustment (COLA)

1.07% COLA included for LCFF, county offices of education and programs historically provided the COLA:

- LCFF Equity Multiplier
- Special Education
- Child Nutrition
- State Preschool
- Youth in Foster Care
- Mandates Block Grant
- Adults in Correctional Facilities Program
- Charter School Facility Grant Program
- American Indian Education Centers and the American Indian Early Childhood Education Program

School Employer Pension Costs

CalSTRS

Fiscal Year	Contribution Rate**
2021-22	16.92%*** (-2.18)
2022-23	19.1%
2023-24	19.1%*
2024-25	19.1%*
2025-26	19.1%*

CalPERS

Fiscal Year	Contribution Rate
2021-22	22.91%*** (-2.16)
2022-23	25.37%
2023-24	26.68%
2024-25	27.05%
2025-26	28.5%*
2026-27	28.9%*

* Credit: Capitol Advisors Group
* Latest projected rates based on most recent projections
** CalSTRS Board now allowed to adjust employer contribution rate up or down by up to 1% each year, but no higher than 20.25% and no lower than 8.25%
***Reflects rate relief provided by state through 2020 Budget Act

The Proposition 98 “Funding Maneuver”

How did we get here?

- Delayed collection of 2022 federal and state income taxes due to states of emergencies relating to 2023 severe winter storms.
- Resulted in state flying “fiscally blind.”
- 2023 Budget Act was adopted using projected state revenues, rather than actual revenues.
- Unknown until later in 2023 – the states big three tax revenues (income, sales and corporate taxes) fell 25 percent.

Loss of revenue

- Prop 98 is in unprecedented territory.
- Revenues came in $8.8 billion below the funded 2022–23 Prop 98 Guarantee.
- This created a substantial shortfall never seen in Prop 98 history.
- It is forcing the state to either honor the funding provided to schools and find the money somewhere else or to lower the Prop 98 Guarantee.

Proposition 98 shortfall and proposed "funding maneuver"

- Rather than acknowledge the $8.8 billion as counting towards the guarantee, the Governor's funding maneuver proposes to use the state's strong cash position to borrow from itself.
- The state would borrow from its own cash now to cover the $8.8 billion gap.
- It would repay it to the general fund over a five-year period beginning 2025–26 – $1.76 billion annually.
- Essentially, if adopted, the state is providing itself a no-interest loan.

CSBA advocacy on the maneuver

CSBA is opposed to the maneuver for several reasons:

1) Undermines the principles of the guarantee
2) Runs contrary to the spirit, statutory and constitutional requirements enshrined in Prop 98
3) Sets a troubling precedent, which could be used by future governors and Legislatures to avoid complying with the Prop 98 funding guarantee.

CSBA's message

We are urging the Legislature to:

- Protect, not undermine Prop 98
- Reject the maneuver
- Any efforts to reduce or alter education funding must align with the statutory and constitutional provisions of Prop 98

Governor’s Budget Proposals

Special Education Funding

- The Governor’s proposed budget funds special education at $8.024 billion – an increase of $295 million from all funding sources over 2023–24.
- It includes an increase of approximately $134 million in ongoing Prop 98 funds for ADA growth.
- $19.6 million for COLA.

Universal School Meals Program

- Total funding for the Universal Meals program in 2024–25 is being proposed at $298.3 million.
- This includes:
  - $179.4 million in ongoing Prop 98 funds
  - $19.5 million COLA
  - $118.916 million in one-time funds to reimburse districts for meals served in the current fiscal year.
  - The one-time funds to reimburse for meals in 2023–24 will be provided to districts based on current year meal counts.

School Facilities

- Increase the reduction of the School Facilities Aid Program by an additional $375 million for a total reduction of $875 million over the two-year fiscal period of 2023–24 and 2024–25.
- In prior year budgets $550 million for the Preschool, Transitional Kindergarten and Full-Day Kindergarten Program was delayed until the next fiscal year.
- Rather than delay again, the May Revise proposes to eliminate this funding.
- Regarding a state school facilities bond, discussions continue on the placement of a statewide bond on the November 2024 ballot.
  - The Legislature has until June 27 to place the bond on the ballot.

Electric School Buses

- According to the Department of Finance, the May Revise proposes to increase funding for electric school buses from $500 million to $895 million.
- The $395 million increase will be funded with:
  - $145 million in Prop 98 funds
  - Shifting $254 million from deleting provisions to increase the number of special needs children in the California State Preschool Program.

Educational Revenue Augmentation Fund

- Proposes to include charter schools in the calculation of the Educational Revenue Augmentation Fund (ERAF).
- A complex funding formula, it was created in 1992 to release pressure on the state general fund to meet the Prop 98 Guarantee.
- It did this by shifting some of the state's local government property taxes to school districts and community colleges.
- Including charter schools in the ERAF calculation is a **win for CSBA's Education Legal Alliance**.
- It will ensure that the calculation of the fund shift accurately and adequately assesses the total number of public schools in the state.

California State Preschool Program

- The May Budget Revision proposes to delete current statutory language that would increase the number of special needs students in the California State Preschool Program to 10 percent by July 2026.
- According to the Department of Finance, in deleting this language, the Revision shifts $254 million to the Electric Vehicle account for the purchase of electric school buses.
- This shift will impact both full-day and part-day preschool programs and will greatly lessen the ability of these programs to increase the enrollment of children with special needs.

Expanded Learning Opportunities Program (ELOP)

- Maintains the prioritization of $4 billion in ongoing Prop 98 funds to address "lost learning opportunities" due to the pandemic.
- Proposes the following changes on funding and expense of ELOP moneys:
  - Requires that encumbered 2021–22 and 2022–23 moneys be spend by September 30, 2024.
  - Moving forward, requires local ELOP funding to be fully expended within two years.
  - Requires local educational agencies to declare their intent to offer ELOP beginning in 2025–26.
  - Allows the state to reallocate unspent ELOP funds.

Attendance Recovery and Instructional Continuity

- In the January Budget, the Governor proposed significant new programs to mitigate learning loss and chronic absenteeism.
- The May Revise proposes the following changes:
  - Delaying implementation of the attendance recovery program until July 1, 2025.
  - Permitting Saturday and Sunday attendance programs to count for reporting of chronic absenteeism.
  - Clarify criteria when student participation extends beyond 15 days.

Broadband Infrastructure Grant Program

- Established in 2019 to provide broadband connectivity over a five-year period.
- Expanded in the 2023 Budget Act for another four years.
- However, May Revise proposes deleting the extension of the program, effectively ending it June 30, 2024.

Continues funding for existing programs

Consistent with CSBA’s priority to fund existing programs, the May Revise continues funding for significant programs established or expanded during the pandemic:

- Universal Transitional Kindergarten
- Home-to-School Transportation Program
- Community Schools Grant Program
- Teacher recruitment and development programs

Thank you

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Managing the Rising Costs of Long-term Liabilities During Fiscal Uncertainty

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PARS

OPEB solutions program

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OPEB/GASB 75

- **Other Postemployment Benefits (OPEB)** are benefits (other than pensions) that state and local governments provide to retired employees

- **GASB 75 *is the required national standard*** for retiree healthcare accounting and financial reporting set by the Governmental Accounting Standards Board (GASB)

Latest Trends in OPEB

- Currently, school districts have several options for dealing with their unfunded obligations:

1) Pay-As-You-Go

2) Set aside funds in a general reserve fund

3) **Trust Funding (Prefunding)** into a separate trust

   - **Address unfunded OPEB obligations by prefunding a Section 115 Trust**

Using the 115 Trust for a "Rainy Day"

Retiree Medical Benefits GASB 75

OPEB

In Partnership with csba

Assets can be used to:

- Reimburse agency; or
- Pay benefits provider

General Fund

prefund either or both

Prefund Pension (PRSP) GASB 68

Pension

Pension Rate Stabilization Program

Assets can be used to:

- Reimburse agency; or
- Pay retirement system

Subaccounts

OPEB and pension assets are individually sub-accounted, and can be divided by dept., bargaining group, or cost center.

Anytime Access

Trust funds are available anytime; OPEB for OPEB and pension for pension.

Financial Stability

Assets in a Section 115 Combination Trust can be used to address unfunded liabilities.

Economies-of-Scale

OPEB and pension assets aggregate and reach lower fees on tiered schedule sooner—saving money!

Flexible

Allows separate investment strategies for OPEB and pension subaccounts.

Pay-as-You-Go vs. OPEB Prefunding

Sample District	July 1, 2011 Valuation 3.00% Discount Rate Pay-as-you-go	July 1, 2021 Valuation Discount Rate: 5.00% Prefunding
Actuarial Accrued Liability (AAL)	$16,695,000	$6,711,695
Actuarial Value of Assets	$0	$5,931,443
Net OPEB Liability (NOL) Unfunded Actuarial Accrued Liability (UAAL)	$16,695,000	$780,252
Funded Ratio (%)	0%	88.4%
Annual Benefit Payments (Pay-as-you-Go)	$652,000	$440,642 *for FY 2021-22*

Rule of thumb: For every one percent increase in the discount rate, the unfunded liability is lowered by 10-12%.

Misconceptions About Trust OPEB Prefunding

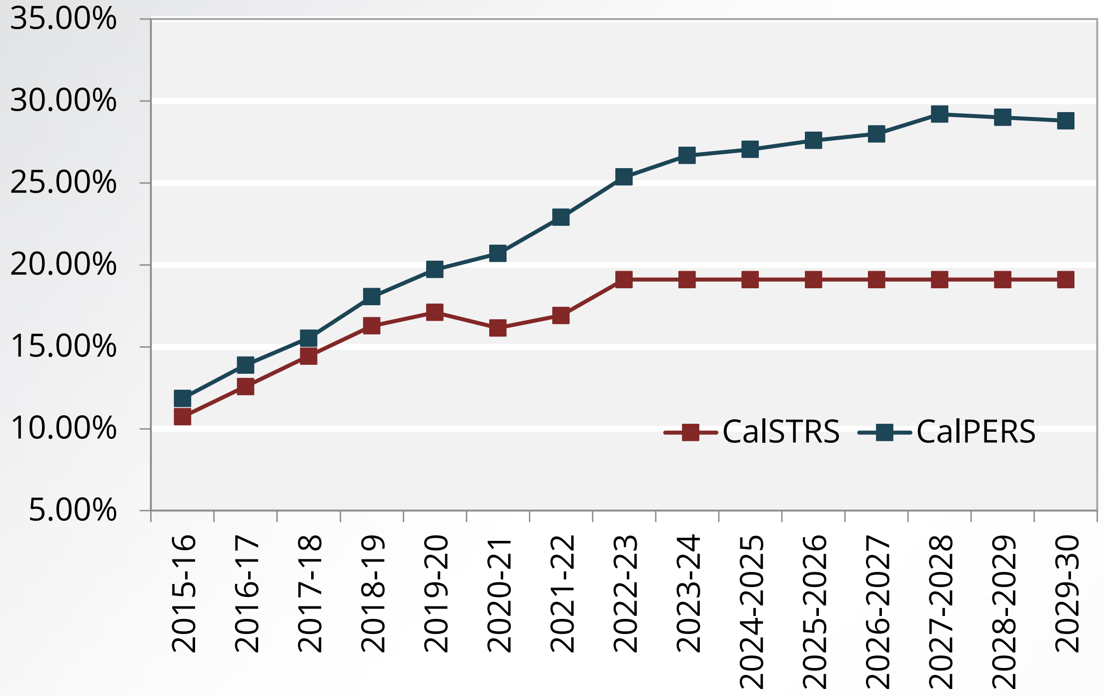
1) I can lower my liability by putting money in the general fund

2) If I set up a prefunding trust, I am obligated to make regular contributions

3) If I set up a prefunding trust, the money will be stuck there even if I eliminate OPEB benefits

How Much Have Pension Costs Grown?

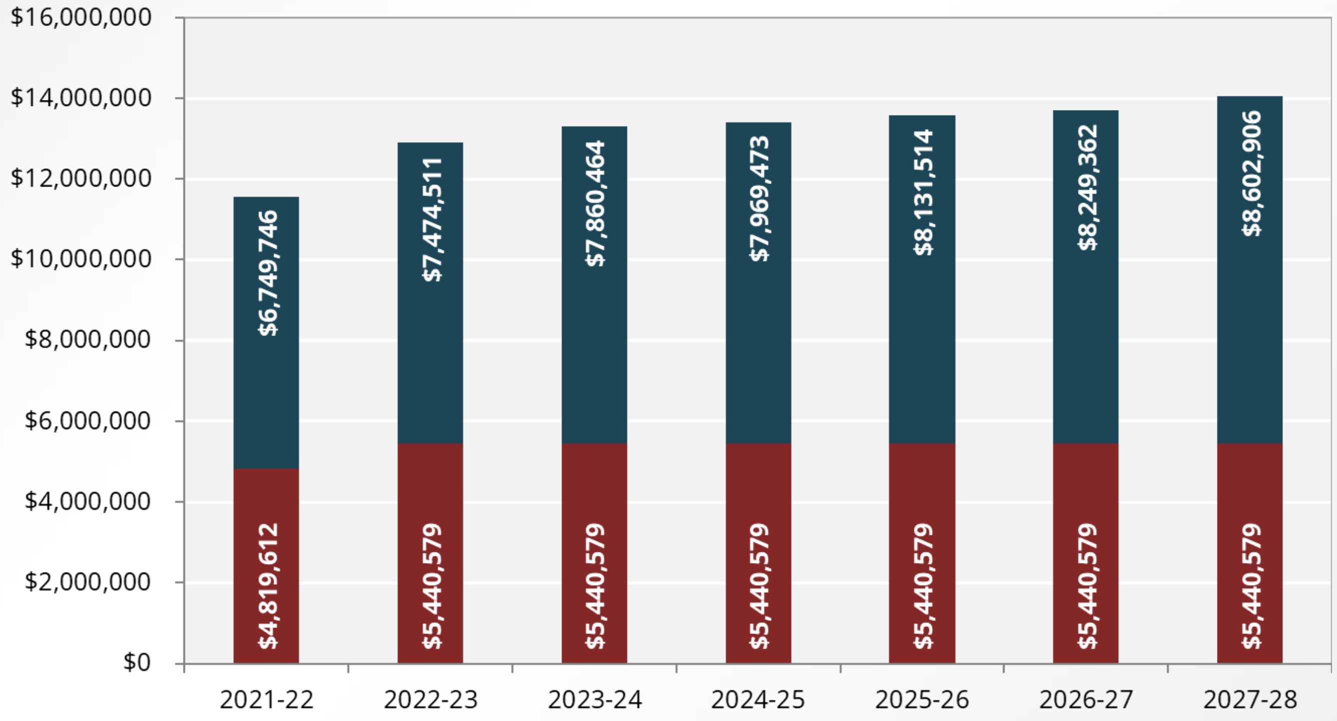
CalSTRS/CalPERS rate increases through 2029-30:



Fiscal Year	CalSTRS	CalPERS
2015-2016	10.73%	11.85%
2016-2017	12.58%	13.89%
2017-2018	14.43%	15.53%
2018-2019	16.28%	18.06%
2019-2020	17.10%	19.72%
2020-2021	16.15%	20.70%
2021-2022	16.92%	22.91%
2022-2023	19.10%	25.37%
2023-2024	19.10%	26.68%
2024-2025	19.10%	27.05%
2025-2026	19.10%	27.60%
2026-2027	19.10%	28.00%
2027-2028	19.10%	29.20%
2028-2029	19.10%	29.00%
2029-2030	19.10%	28.80%

Sample Agency Contribution Increases

Annual pension costs increase from **$11.6 million** to **$14.0 million** in 2027-28



Why Prefund Liabilities?

1 **Create a Rainy-Day Fund**

Assets can be used as an emergency source of funds for either OPEB or pension-related costs when District revenues are impaired based on economic or other conditions

2 **Address Long-term Costs**

OPEB and/or STRS/PERS costs are a long-term burden; prudent diversified investment planning is important to current and future management of obligations

3 **Address Liabilities**

Contributions placed into an exclusive benefit trust are assets which address the district's ongoing OPEB and/or pension liabilities

4 **Stabilize Costs**

When pension contribution rates or OPEB costs increase, assets can be transferred from the Trust program directly to CalPERS/CalSTRS or OPEB provider, which can help to pay large contribution increases

Why Prefund Liabilities? (cont.)

5 **Chance to Retain Retiree Benefits (OPEB)**

Districts with lower liabilities have a better chance to retain some level of retiree medical benefits

6 **Achieve Better Returns**

Prefunding with in 115 Trust enables diversified investing that may achieve greater returns than County Treasury Pools

7 **Strengthen Credit Rating**

Credit rating agencies may look more favorably upon districts who take steps to reduce liabilities

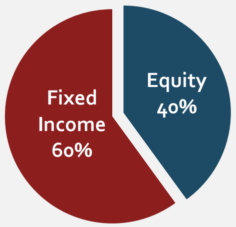
Target Index Based Strategies

Fixed Income

Expected Returns

5-Year, 6.50% | 30-year 5.10%

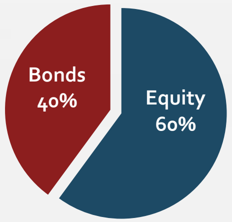
Conservative



Expected Returns

5-Year, 7.30% | 30-year, 6.30%

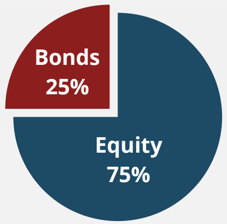
Balanced



Expected Returns

5-Year, 7.60% | 30-year, 6.90%

Growth



Expected Returns

5-Year, 7.80% | 30-year, 8.20%

Expected Returns modeling as of December 31, 2023

Sample Pension Funding Policies

1. Contribute predetermined percentage each fiscal year based on certain budget, unrestricted fund balance, or reserve thresholds
2. Contribute full amount of annual employer STRS and/or PERS contributions, allowing anytime access to trust assets
3. Contribute funds to stabilize contribution through FY 25-26
4. Annually identify any one-time general purpose funds appropriated to district through the state budget, and recommend portion to be allocated to trust

Sample Pension Funding Policies (cont.)

5	OPEB Account shall maintain an equal share of assets to liabilities based on latest Actuarial Valuation; if condition met, District will contribute remaining unrestricted fund balance (exceeding mandated 8%) to pension prefunding account
6	Contribute one-time revenue source and set forth policy to draw down only on investment earnings in short term time horizon, preserving principal
7	Commit funds in adherence with Reserve Cap of 10% on surplus funds (effective FYE 23-24)

Remember: Benefits of Prefunding!

- Assets can be **accessed <u>at any time</u>** for OPEB or Pension expenses
- **Address your liabilities** by creating an asset and potential greater return
- **Save for a rainy day**!

Supplementary Retirement Plan (SRP)

Early Retirement Incentives

OPEB solutions program

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Cost Cutting vs. Cost Saving

Layoffs	Reorganization, Reassignment
Furloughs	Step and Column Freezes
Position Elimination	Salary Schedule Reductions
Increased Class Size	

SRPs offer districts possibility of "cost savings" approach, intended to be a "win-win."

Why Consider a SRP?

- Financial incentive to encourage employees to retire from service earlier than normal to achieve fiscal savings for the district
- Savings created by:
  - Accelerating rate of natural retirement attrition
  - Replacing the departing employee with lower salaried employees
  - Eliminating higher salaried employees to reduce the number of positions otherwise needed to achieve savings
- SRP normally offered to a group of employees deemed eligible based on a set of criteria during a short period of time or “window” period

PARS offers a <u>complimentary analysis</u> to assess the fiscal/operational feasibility of a SRP

Questions?

OPEB solutions program

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Interested in learning more?

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OPEB solutions program

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