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FISCAL NOTE

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Bill Topic: MODIFICATIONS TO PERA TO ELIMINATE UNFUNDED LIABILITY

- Summary of Fiscal Impact:
- State Revenue
- State Expenditure
- State Transfer
- TABOR Refund
- Local Government
- Statutory Public Entity

This bill makes modifications to the Colorado Public Employees' Retirement Association (PERA). It creates ongoing state and local revenue reductions and expenditure increases, and increases revenue to PERA.

Appropriation Summary: The bill requires an appropriation of at least \$17.5 million in FY 2018-19, split between every state agency.

Fiscal Note Status: The fiscal note reflects the introduced bill. It is a preliminary analysis and will be updated as additional information becomes available.

Table 1
State Fiscal Impacts Under SB 18-200

Table with 4 columns: Category, Sub-category, FY 2018-19, FY 2019-20. Rows include Revenue, Expenditures, and Transfers.

**Summary of Legislation**

This bill makes several changes related to the Colorado Public Employees' Retirement Association (PERA). These are described in order of the bill.

**Change to number of years in the highest average salary calculation.** Under current law, the retirement benefit paid to a PERA member depends on his or her date of hire, years of service credit, and age at retirement, and is calculated using a percentage of the member's highest annual salary (HAS) over a period of time, including a base salary year. The bill changes the number of years factored into the HAS calculation for members who are not vested by or are hired on or after January 1, 2020, as shown in Table 2.

**Table 2**  
**Highest Annual Salary Period Under SB 18-200 After Base Year**  
*for members not vested or hired on or after January 1, 2020*

| <b>As of 1/1/20</b>             | <b>All Divisions except Judicial</b> | <b>Judicial</b>        |
|---------------------------------|--------------------------------------|------------------------|
| <b>Vested</b>                   | 3 periods of 12 months               | 1 period of 12 months  |
| <b>Not Vested or New Member</b> | 7 periods of 12 months               | 3 periods of 12 months |

**Salary definition.** The bill modifies the definition of salary so that pre-tax payroll deductions are counted towards salary, as is unused sick leave converted to cash payments. The bill clarifies that insurance premiums paid by employers are not counted as salary.

**Requirements for local government employers that terminate PERA affiliation.** The bill clarifies provisions related to a local government division employer that ceases operations or participation in PERA, so that when an employer has terminated its affiliation with PERA, it is the PERA board that determines the amount to be paid by that employer to fully fund its share of the unfunded liability of the defined benefit plan and of the health care trust fund. The board's determination may be appealed by the employer through the administrative review process established in PERA rule. The local government's employees become inactive members of PERA effective on the termination date, and may elect to have their member contributions credited to an alternative pension plan or refunded. In the absence of such election, the member contributions will remain with PERA.

**Increase in employer and member contribution rates.** The bill increases the PERA employer contribution rates by the percentages and schedules shown in Table 3. These increases are credited to PERA's defined benefit trusts regardless of employee's plan election.

**Table 3**  
**Phase-in of 2% Employer Contribution Rate Increase Under SB 18-200**

|                     | <b>State</b> | <b>Troopers</b> | <b>School</b> | <b>DPS</b> | <b>Local</b> | <b>Judicial</b> |
|---------------------|--------------|-----------------|---------------|------------|--------------|-----------------|
| <b>Current Law*</b> | 10.15%       | 12.85%          | 10.15%        | 10.15%     | 10.0%        | 13.66%          |
| <b>As of 7/1/18</b> | 11.15%       | 13.85%          | 11.15%        | 11.15%     | 11.0%        | 14.66%          |
| <b>As of 1/1/19</b> | 12.15%       | 14.85%          | 12.15%        | 12.15%     | 12.0%        | 15.66%          |

The bill also increases the PERA employee contribution rates by the percentages shown in Table 4. These rates are multiplied by gross salary under the bill.

**Table 4  
 Phase-in of 3% Member Contribution Rate Increase Under SB 18-200**

|                     | State | Troopers | School | DPS   | Local | Judicial |
|---------------------|-------|----------|--------|-------|-------|----------|
| <b>Current Law</b>  | 8.0%  | 10.0%    | 8.0%   | 8.0%  | 8.0%  | 8.0%     |
| <b>As of 7/1/18</b> | 8.5%  | 10.5%    | 8.5%   | 8.5%  | 8.5%  | 8.5%     |
| <b>As of 1/1/19</b> | 9.0%  | 11.0%    | 9.0%   | 9.0%  | 9.0%  | 9.0%     |
| <b>As of 7/1/19</b> | 10.0% | 12.0%    | 10.0%  | 10.0% | 10.0% | 10.0%    |
| <b>As of 1/1/20</b> | 11.0% | 13.0%    | 11.0%  | 11.0% | 11.0% | 11.0%    |

**Automatic contribution and cost of living rate adjustments.** Beginning January 1, 2020, the bill requires employer and employee contribution rates and the cost of living adjustment (COLA) to remain unchanged unless triggered by certain circumstances, as shown in Table 5. These increased amounts rely on the following definitions in the bill:

- *"Weighted average"* means the most recent valuation of the proportion of unfunded actuarial accrued liability attributable to each division.
- *"Blended total contribution amount"* is the weighted average of the total amounts paid by employers and members to PERA by all divisions, not to include the portions of employer contributions remitted to the health care trust fund and the COLA reserve.
- *"Blended total required contribution"* is the weighted average of the total reported actuarially determined contribution rates and member contribution rates for PERA's trusts.

When the blended total contribution amount is less than 98 percent or more than 110 percent of the blended total actuarially required contribution, adjustments must be determined by PERA, equally apportioned, and be the maximum yearly adjustment allowed with certain exceptions. Adjustments may occur only once in a calendar year.

**Table 5  
 Automatic Contribution and COLA Rate Adjustments Under SB 18-200**

***When the blended total contribution amount is less than 98% of the blended total actuarially required contribution:***

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|                            |  |
|----------------------------|--|
| COLA Rate                  | reduced up to 0.25%; not to be reduced to less than 0.5% total                 |
| Employer Contribution Rate | increased up to 0.5%; not to exceed statutory contribution rates plus 2% total |
| Member Contribution Rate   | increased up to 0.5%; not to exceed statutory contribution rates plus 2% total |

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***When the blended total contribution amount is greater than or equal to 110% of the blended total actuarially required contribution:***

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|                            |  |
|----------------------------|--|
| COLA Rate                  | increased up to 0.25%; not to exceed 2% total                        |
| Employer Contribution Rate | reduced up to 0.5%; not to be less than statutory contribution rates |
| Member Contribution Rate   | reduced up to 0.5%; not to be less than statutory contribution rates |

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**Defined contribution supplement.** Beginning January 1, 2022, the bill requires an adjustment to each PERA division's employer contribution rates in order to include a defined contribution supplement. The defined contribution supplement will be the amount that would have otherwise gone to the defined benefit trusts to pay down the unfunded liability, plus investment earnings on that amount, and will be made on behalf of employees who begin employment on or after January 1, 2020.

**Earned service credit for part-time work for new members.** The bill modifies the way service credit is earned for part-time work for PERA members who begin employment on or after January 1, 2020. These members earn a full year of service credit for 12 months of employment if the member works full time or works at least 8 months but less than 12 months in a year. However, if the member does not work full time, the earned service credit will be determined by the ratio of part-time work to full-time work and the number of months for which contributions are remitted to the number of months required for a year of service credit.

**Service retirement and reduced service retirement eligibility for new and current members.** For PERA members who begin employment on or after January 1, 2020, the bill modifies service retirement eligibility as shown in Table 6, and specifies that no contractual right is created related to these age requirements. The bill also modifies the reduced service retirement eligibility as shown in Table 7. In addition, individuals who are current PERA members as of December 31, 2019, must be the age specified on the table, plus one year for every four years that the member's age is less than 46 years on January 1, 2020, not to exceed 65 years for any member in order to be eligible for regular or reduced retirement. State troopers are not included in this formula.

**Table 6**  
**Service Retirement Eligibility Under SB 18-200**  
*for members hired on or after January 1, 2020*

| Division                          | Years of Service Required to Retire at Any Age |                  | Years of Service Required to Retire at a Specific Retirement Age |                  | Years of Service Required to Retire at Age 65 |                  |
|-----------------------------------|--|------------------|--|------------------|---|------------------|
|                                   | <i>Current Hires</i>                           | <i>SB 18-200</i> | <i>Current Hires</i>   | <i>SB 18-200</i> | <i>Current Hires</i>                          | <i>SB 18-200</i> |
| <b>State, Local, and Judicial</b> | 35 years                                       | 40 years         | Age 60, 30 years   | No specific age  | 5 years                                       | 5 years          |
| <b>Troopers</b>                   | 30 years                                       | 35 years         | Age 50, 25 years<br>Age 55, 20 years                             | Age 55, 25 years | 5 years                                       | 5 years          |
| <b>School and DPS</b>             | 35 years                                       | 40 years         | Age 58, 30 years   | No specific age  | 5 years                                       | 5 years          |

**Table 7**  
**Reduced Service Retirement Eligibility Under SB 18-200**  
*for members hired on or after January 1, 2020*

|                       | Current Law                                  |  | SB 18-200                    |   |
|-----------------------|--|--|------------------------------|---|
|                       | Age Requirement                              | Service Credit Requirement                                       | Age Requirement              | Service Credit Requirement                |
| <b>All Divisions</b>  | 50 years old<br>55 years old<br>60 years old | 25 years of service<br>20 years of service<br>5 years of service | 55 years old<br>60 years old | 25 years of service<br>5 years of service |
| <b>State Troopers</b> | 50 years old                                 | 20 years of service  | 50 years old                 | 20 years of service                       |

**Cost of living adjustment.** The annual cost of living adjustment (COLA) for benefit recipients who began membership prior to January 1, 2007, is currently 2 percent. For the years 2018 and 2019, the bill reduces the COLA to 0 percent. For each year thereafter, the bill sets the COLA at 1.25 percent. This amount may be otherwise adjusted by the automatic adjustment provisions explained above. The bill also requires benefit recipients whose effective date of retirement is on or after January 1, 2011, and who have not received a COLA on or before May 1, 2018, to receive retirement benefits for at least three years following retirement before receiving a COLA adjustment.

**Defined contribution plan.** Currently, members in the state division hired after January 1, 2006, may elect to participate in PERA's defined contribution plan rather than its defined benefit plan. Under current law, a defined contribution account receives the monthly employer contribution, as outlined in Table 3 above, while the amortization equalization disbursement (AED) and supplemental amortization equalization disbursement (SAED) payments are credited to pay down the unfunded liability of the defined benefit plan. Beginning January 1, 2020, anyone hired in the school, Denver Public Schools, local government, and judicial divisions may elect to participate in the defined contribution plan. An employee who elects the defined contribution plan will receive their full employee contribution amount, and the employer contribution amount under current law. The additional employer contribution amount created by the bill will be credited to pay down the unfunded liability of the defined benefit plan.

**Public Pension Legislative Oversight Committee.** The bill replaces the existing Police Officers' and Firefighters' Pension Reform Commission with the Public Pension Legislative Oversight Committee, which is required to study and develop proposed legislation relating to the funding and benefit designs of PERA and the Fire and Police Pension Association. The committee is comprised of four senators appointed by the Senate President; six representatives appointed by the House Speaker; and four experts in the area of pensions or retirement plan designs appointed by the State Treasurer. The committee may commission an independent review of the economic and investment assumptions used to model the PERA financial situation every three years.

**State Revenue and TABOR Impact**

The bill's change in salary definition and increase in employee contributions will reduce taxable income for PERA members. In addition, the bill's highest annual salary calculation and COLA reduction will reduce benefit payments from the PERA trusts, which will also reduce state tax collections. This General Fund reduction has not been estimated.

State revenue is not currently expected to exceed the TABOR limit in the current forecast period and no refund will be required; however, refunds in future years when the state next collects a TABOR refund obligation will be reduced.

**State Expenditures**

This bill will increase state expenditures by at least \$17.5 million in FY 2018-19, and by at least \$35.1 million in FY 2019-20 and each year thereafter, as shown in Table 8.

**Assumptions.** This fiscal note uses the Joint Budget Committee's (JBC's) estimated salary base for FY 2018-19 to evaluate employer and employee contribution increases. The JBC estimates include adjustments approved for the current fiscal year related to salary and staffing increases, but do not include supplemental or pending legislation, which may add to the base. The fiscal note does not include proposed merit pay increases or a rate of inflation, nor does it delineate between employee retirement plan elections.

In addition, as of this writing, the fiscal note does not estimate:

- future automatic adjustments, up to 2 percent, of the employer and employee contribution rates;
- the future cost of the defined contribution supplement;
- the impact on the value of the PERA benefit as it relates to the state's total compensation plan, nor any change to employee behavior related to retention and retirement; nor
- the impact to institutions of higher education.

**Employer contributions.** As discussed in the Assumptions section, employer contributions have been calculated using the Joint Budget Committee's estimated salary base for FY 2018-19 and reflect the 1 percent and 2 percent increases under the bill. The estimated salary base is assumed to reflect gross salary and includes no growth assumptions. Precise impacts to each state agency's personal services lines have not been estimated, and will be provided in a future fiscal note.

**Table 8  
 State Employer Contribution Increase Under SB 18-200\***

| FY    | % Increase | General Fund | Cash Funds  | Reappropriated Funds | Federal Funds | Total Funds         |
|-------|------------|--------------|-------------|----------------------|---------------|---------------------|
| 18-19 | 1%         | \$9,622,253  | \$4,254,615 | \$1,933,840          | \$1,735,968   | <b>\$17,546,676</b> |
| 19-20 | 2%         | \$19,244,505 | \$8,509,229 | \$3,867,680          | \$3,471,936   | <b>\$35,093,350</b> |

\* Uses JBC's FY 2018-19 estimated salary base. Totals may not sum due to rounding.

**Employee contributions.** Total employee contributions are expected to increase by at least \$13.2 million in FY 2018-19, and by at least \$43.9 million in FY 2019-20, using the estimated salary base.

**Automatic rate adjustments.** Beginning in the second half of FY 2019-20, the bill creates a mechanism in statute to automatically raise or lower the employer and member contribution rates, as shown in Table 5. If these adjustment mechanisms are triggered, employer and member contributions may increase up to 0.5 percent per year, capped at an additional overall 2 percent.

As such, the amounts shown in Table 8 and discussed under employer contributions could increase up to 2 percent in future years. The fiscal note assumes that these rate adjustments will be addressed during the annual budget process.

**Defined contribution supplement.** Beginning in the second half of FY 2021-22, the bill requires an adjustment to the employer contribution rate equal to the amount that would have otherwise gone to the defined benefit trusts to pay down the unfunded liability, plus any investment earnings on that amount, that occur as a result of defined contribution plan elections by employees hired after January 1, 2020. This additional contribution is conditional on the financial health of the PERA trusts and has not been estimated.

**Total compensation.** If the value of the state's retirement benefit is reduced in a future annual compensation report, state expenditures will increase. This potential impact has not been estimated.

**All state agencies.** All state agencies will have an increase in workload and costs to update employee information and process the new payroll deductions.

**Public Pension Legislative Oversight Committee.** Legislative Department expenditures will increase for per diem and staffing costs related to the Public Pension Legislative Oversight Committee. Because it replaces an existing committee of the same size and scope, however, these costs do not require an appropriation. The committee may commission an independent review of the assumptions used to model the PERA financial situation, which is expected to cost \$200,000 per contracted study. This amount is will be requested when needed through the annual budget process.

**Local Government, Special District, and School District Impact**

Beginning in FY 2018-19, the bill will increase expenditures for local governments, special districts, and school districts. For informational purposes, PERA's estimate of the cumulative impact to these entities is provided in Table 9. PERA's estimates use December 31, 2016, divisional payroll and include a payroll growth projection of 3.5 percent.

**Table 9**  
**PERA Estimates of School, Local, and DPS Division Impacts Under SB 18-200**

|                 | Impact Type                    | FY    | School  | Local    | DPS*    |
|-----------------|--------------------------------|-------|---------|----------|---------|
| <b>Employer</b> | Contribution Rate Increase     | 18-19 | \$46.2m | \$6.5m   | \$6.8m  |
|                 |                                | 19-20 | \$95.6m | \$13.4m  | \$14.1m |
|                 | Gross Salary Definition Change | 18-19 | \$19.5m | \$2.7m   | \$2.9m  |
|                 |                                | 19-20 | \$21.2m | \$2.9m   | \$3.1m  |
| <b>Employee</b> | Contribution Rate Increase     | 18-19 | \$8.1m  | \$1.1m   | \$1.2m  |
|                 |                                | 19-20 | \$10.0m | \$1.4m   | \$1.5m  |
|                 | Gross Salary Definition Change | 18-19 | \$34.7m | \$4.9m   | \$5.1m  |
|                 |                                | 19-20 | \$74.6m | \$119.7m | \$1.3m  |

\* DPS employer amounts may vary significantly based on the DPS contribution offset for Pension COPs.

**Local government examples.** The impact of the employer contribution increase on local governments will vary by the size of the local government and its number of employees. The fiscal note highlights three examples that are representative of a large, medium-sized, and small local government.

*Colorado Springs.* City of Colorado Springs expenditures are expected to increase by approximately \$1.8 million in FY 2018-19, and \$2.5 million in FY 2019-20 and thereafter. Its employees will contribute an additional \$1.4 million in FY 2018-19, and \$2.7 million in FY 2019-20.

*Boulder County.* Boulder County expenditures are expected to increase by approximately \$650,000 in FY 2018-19, and \$1.3 million in FY 2019-20 and thereafter. Its employees will contribute an additional \$680,000 in FY 2018-19, and \$1.4 million in FY 2019-20.

*Alamosa.* City of Alamosa expenditures are expected to increase by approximately \$16,000 in FY 2018-19 and \$32,000 in FY 2019-20 and thereafter. Its employees will contribute an additional \$8,300 in FY 2018-19 and \$24,000 in FY 2019-20.

**School district impacts.** School district expenditures will increase similar to the manner of state and local governments, but have not yet been estimated as of this writing.

**PERACare.** Defined contribution plan participants are not eligible for the disability, survivorship, and retiree health care benefits that defined benefit plan participants are eligible for; however, defined contribution plan members may enroll in PERACare, PERA's health insurance plan. If local employers elect to offer this benefit to defined contribution plan participants, their costs will increase.

**Statutory Public Entity Impact**

The bill will increase revenue to the PERA trusts, with the exception of its health care trusts.

**Projected actuarial funded status for PERA's trusts.** The bill reduces the estimated amortization periods necessary to eliminate the unfunded actuarial accrued liability in all of PERA's trusts, as shown in Table 10.

**Table 10**  
**PERA's Unfunded Liability Under SB 18-200**

| <b>Division</b>       | <b>Amortization Period Under Current Law</b> | <b>Amortization Period Under SB 18-200</b> |
|-----------------------|--|--|
| State                 | 57 years                                     | 24 years                                   |
| School                | 77 years                                     | 24 years                                   |
| Local Government      | 54 years                                     | 14 years                                   |
| Judicial              | 53 years                                     | 19 years                                   |
| Denver Public Schools | 55 years                                     | 20 years                                   |

*Source: Colorado Public Employees' Retirement Association. Based on 2016 valuation.*



**Cost of living adjustment impact.** The bill's adjustment to the COLA payment is expected to reduce PERA benefit payments by \$92.2 million in FY 2018-19 and \$65.5 million in FY 2019-20. This estimate uses an annualized January 2018 benefit payroll and applies 0 percent increase in 2018 and 2019, and 1.25 percent increase for 2020. The impact to future PERA benefit payments as a result of the three-year timeout for benefit recipients whose effective date of retirement is on or after January 1, 2011, and who have not received a COLA on or before May 1, 2018, has not been estimated.

**Automatic rate adjustments.** The fiscal note has not estimated the revenue increase to PERA's trusts from the automatic COLA, employer, and employee rate contributions as of this writing.

**Defined contribution supplement.** Beginning in 2022, PERA will annually calculate an additional contribution rate to be paid by each division to supplement the amount that would have otherwise gone to the defined benefit trusts to pay down the unfunded liability, plus any investment earnings on that amount, that occur as a result of defined contribution plan elections for employees hired after January 1, 2020. The additional contribution, if any, is conditional on the financial health of the PERA trusts. Because of this mechanism, any impact to PERA's trusts resulting from members electing the defined contribution plan will be offset by the defined contribution supplement paid by each division.

**Impact on the PERA health care trust funds.** The defined contribution election will have a negative impact on the PERA health care trust funds. PERA assumes, based on state division participation, that 12 percent of division employees will elect the defined contribution plan, which will result in an extended amortization period for these divisional health care trust funds. The fiscal note has not estimated this decrease.

### **Effective Date**

The bill takes effect upon signature of the Governor, or upon becoming law without his signature.

### **State Appropriations**

The bill requires an appropriation of at least \$17.5 million in FY 2018-19, split between every state agency. The appropriation amount for each agency has not yet been estimated and will be provided in a future fiscal note.

### **State and Local Government Contacts**

All State, Local, and Statutory Agencies