



Unfunded Teacher Liabilities

VACO Conference
Joe Casey, Henrico County

Why Are We Here?

GASB 68 new balance sheet liability and bond rating agency higher weight assigned to such liability

- To recognize that a large unfunded pension liability will impact Virginia (as a State and collective localities)
- To best position Virginia to reflect this liability in its ability to record-reduce w/ citizen-business-job impact focus

To position State-localities for fiscal sustainability

- Intergenerational equity in cost of services
- Taxpayers today pay and not pass cost to next generation (Don't "Kick the Can")
- Economic development positioned to create jobs and sustain essential services (schools, public safety)

How Did We Get Here?

Actuarial calculation impacts raised rates-liability

- FY10: Lowered invest income assumption from 7.5% to 7.0%
- Annual salary increase assumption still at 3%
 - Trends have been much lower (<.5%/year average since 2008)

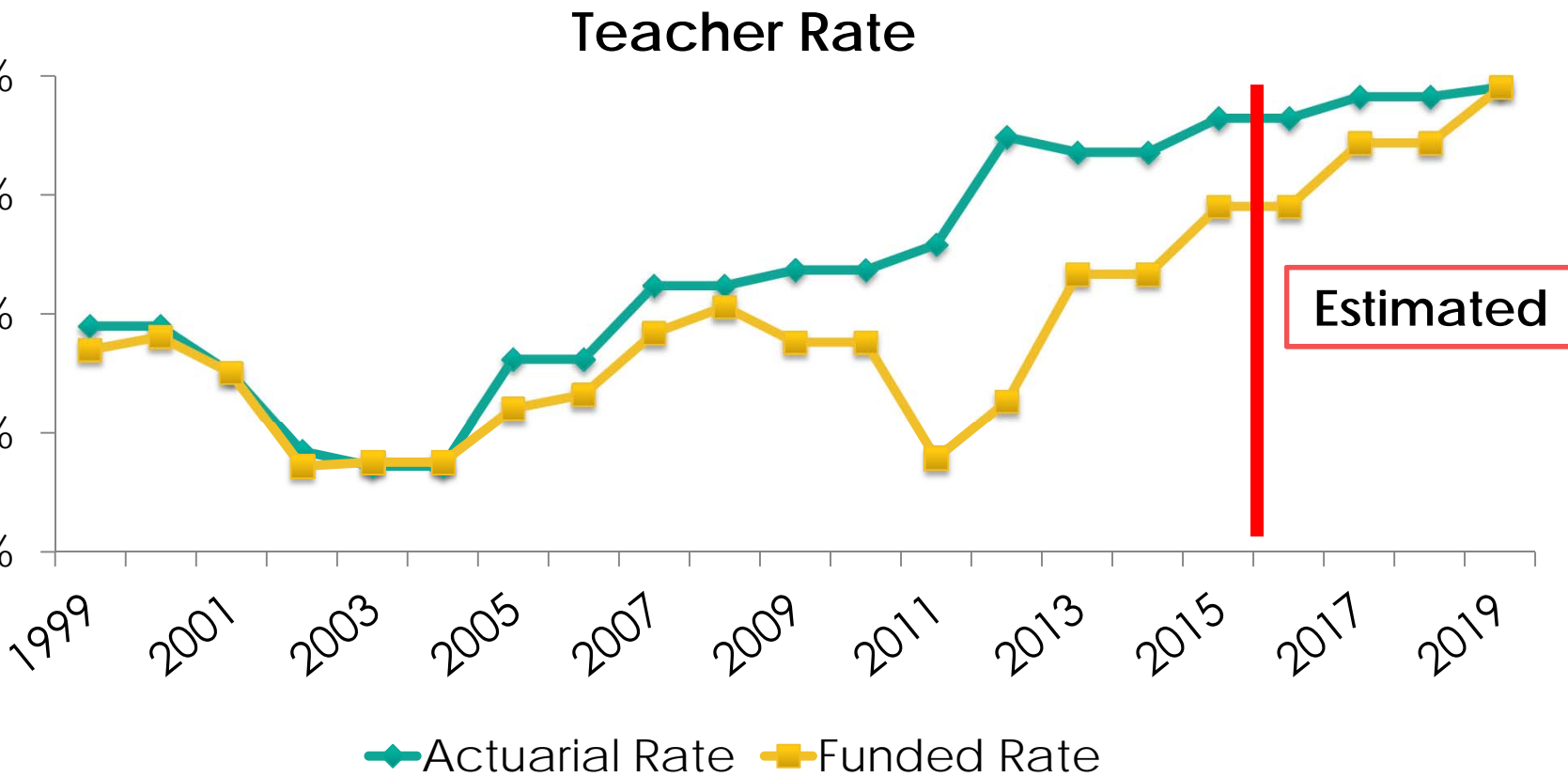
Other impacts to unfunded liability and rates

- Timing difference between underperforming investments and actuarial reports (remedied by future higher rates)
 - FY13: Rolling five-years had FY13's 11.8% investment return, but also had FY09's 21.1% investment loss
- State's lower VRS teacher rate than actuarial rate
 - 3 separate "loans" w/ interest for past-future liability

State's preference to not recognize

- Even though no budgetary impact to State

State's Selection of Lower Rate in Contrast to Actuarial Rate



**Locality Rates Funded Are Always 100% Of Actuarial Rate
(No Option – Preferred Business Practice)**

FY15-FY16 VRS Teacher Rates

	Board Certified Full Employer Contribution Rate	FY15 % to be Adopted by General Assembly	Estimated Employer Contribution Rate to be Adopted	FY13 and FY14 Employer Contribution Rates
Teachers	18.20%	79.69%	14.50%	11.66%

"% to Be Adopted" gives rise to a new 20 year liability loan

Contribution rates are net of 5% employee contribution rate

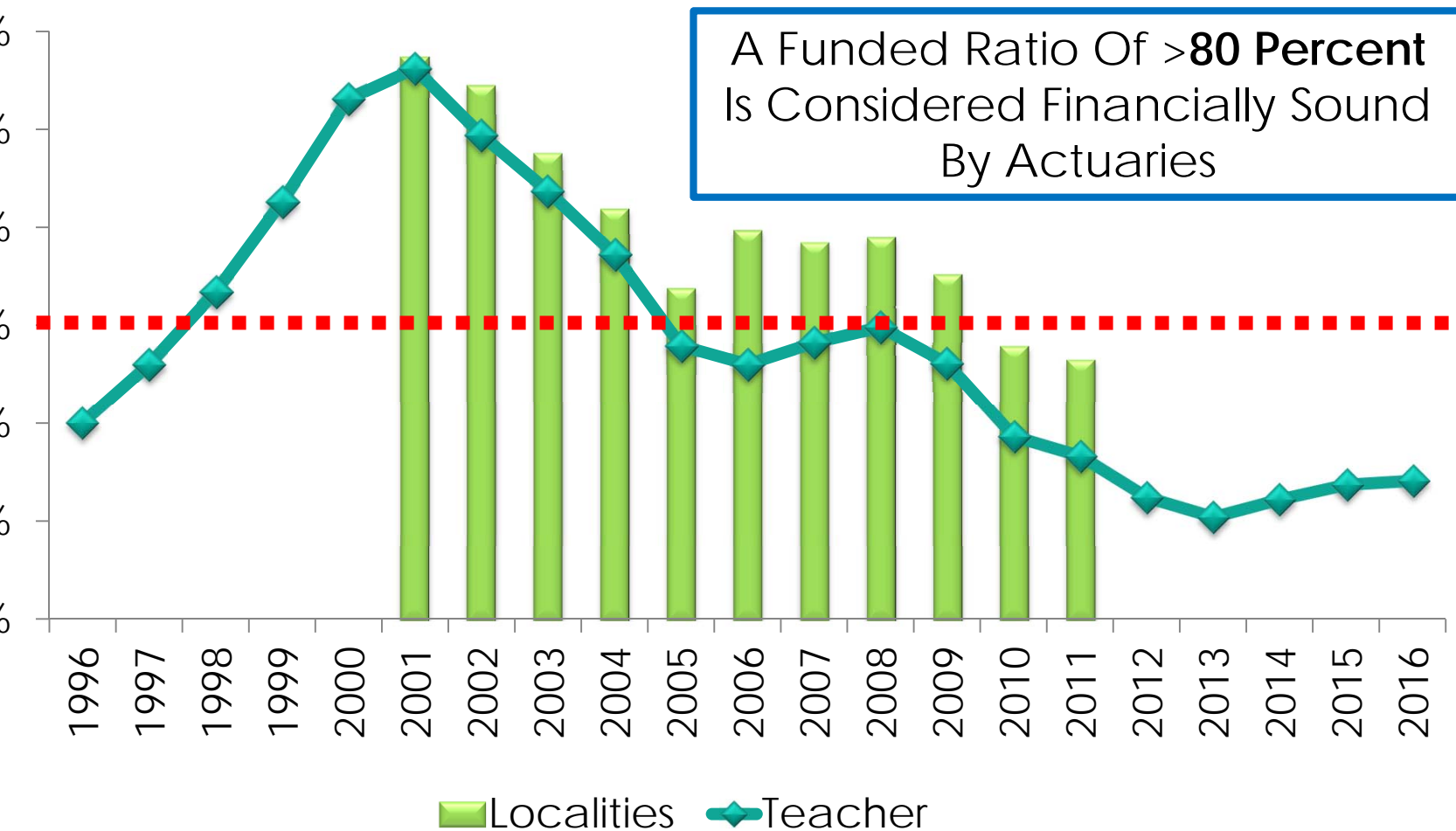
FY15 increased rates are ~ 24% higher

- Funding \$: Local \$128.5 million (63%), State \$75.5 million (37%)
- \$1300/teacher impact (~= to teacher raise, if one were given)
- Local funding constraints may raise student: teacher ratio

FY15: Total teacher liability \$15 billion; 62.1% unfunded

Future "% to Be Adopted" = 89.9% in FY17 and 100% in FY19

Teacher and Localities - Ratio Funded Status



Who Should Record the Teacher's Liability?

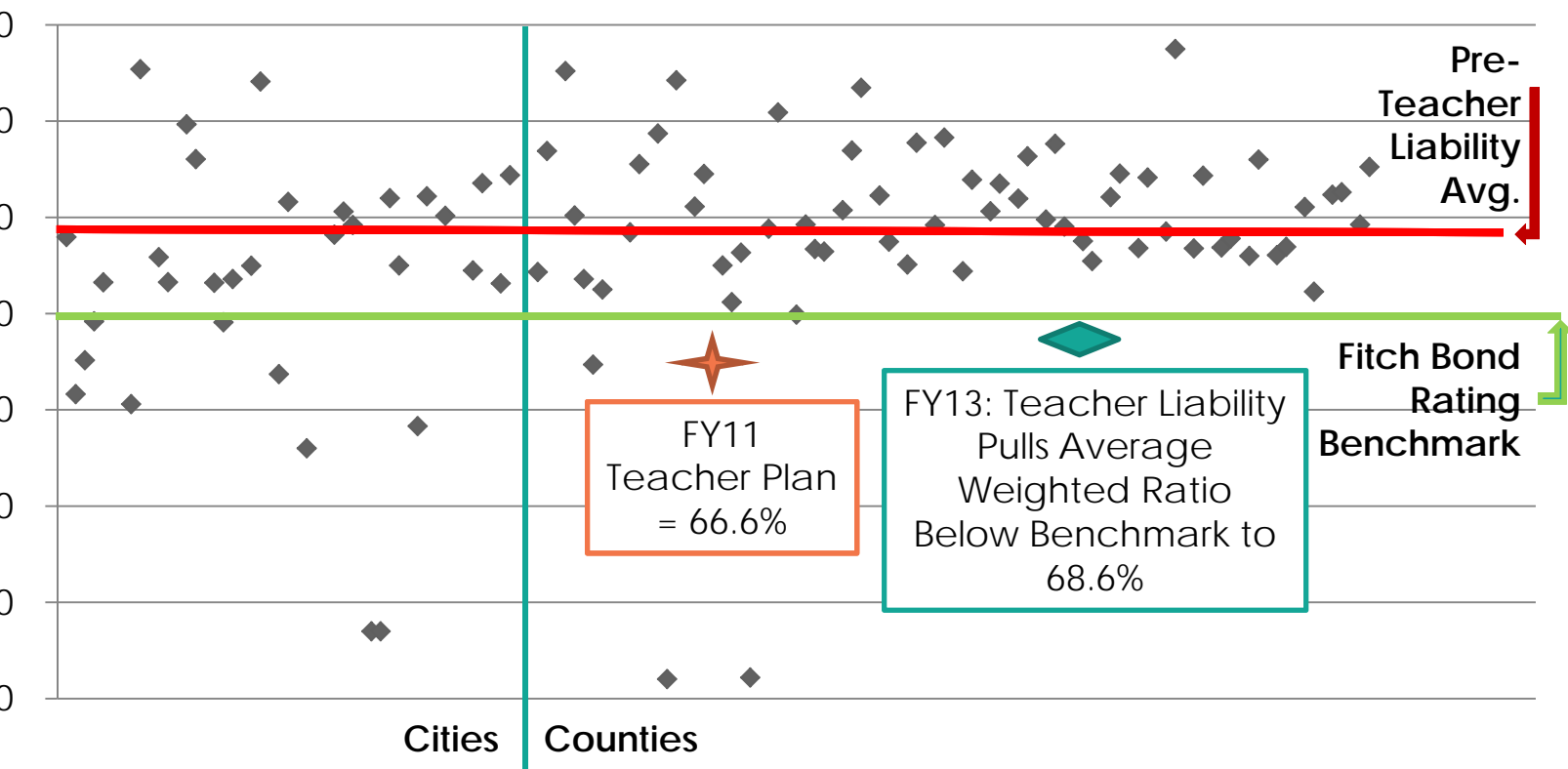
Localities prefer proportional responsibility

- Share of VRS costs: Local 63%, State 37%,
- Recognizes teacher VRS system is a shared State program meeting intentions of GASB 68 liability recordation
- State's selection of arbitrary and lower rates increased liability and State's responsibility to record liability
- Administratively simple to record liability
 - State's payment to localities changed to direct payment to VRS

State prefers locality record 100%

- Technically can shift 100% liability with localities' payment to VRS (even if State is \$ origin)
- Teachers are 100% local employees (at least for this topic)
- Even though no expense impact (only balance sheet)

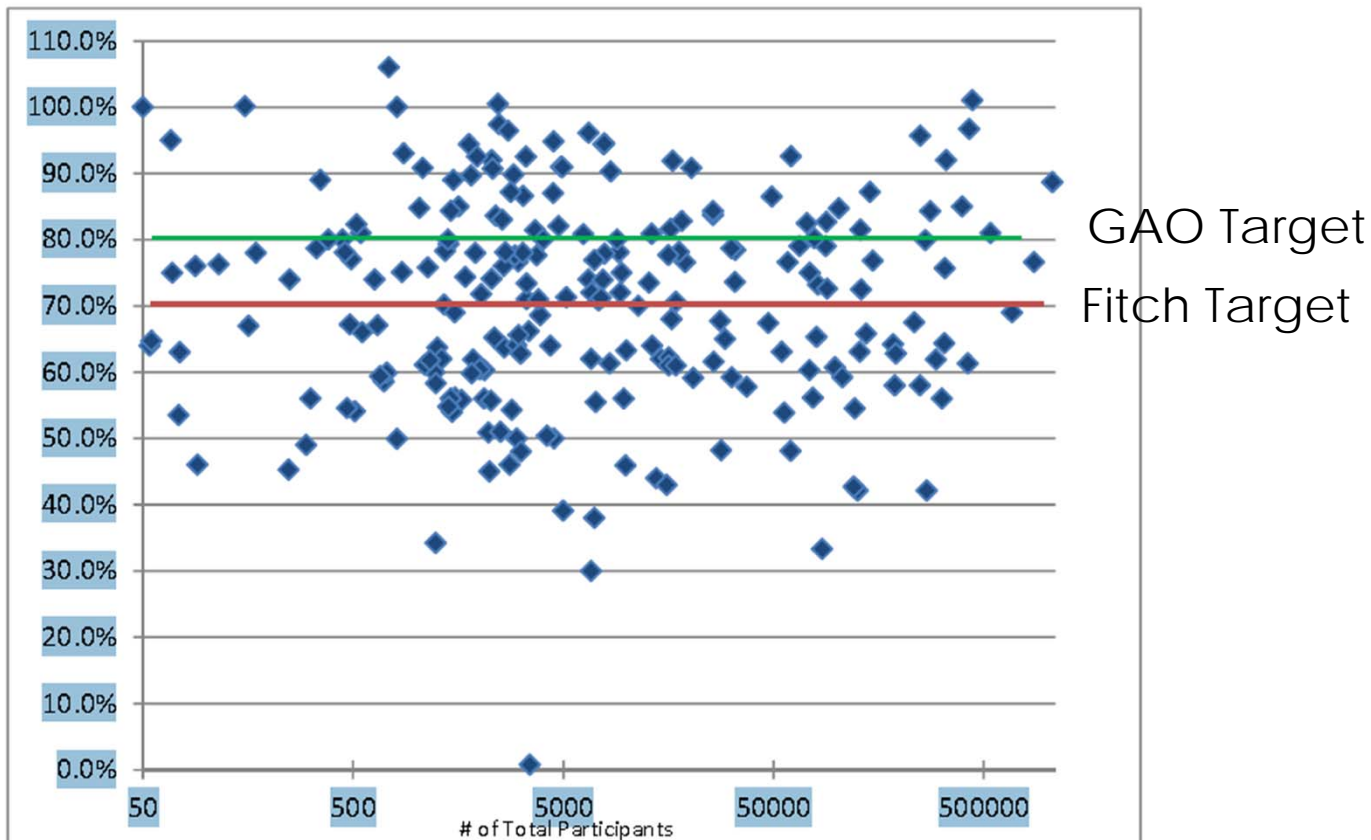
Threat of Local Governments Crossing Below the Line with Lower Unfunded Teacher Ratio



Pre-teacher Liability: FY11 Chart shows localities generally > "rating line"
 Post-teacher Liability: Teacher unfunded ratio now 62.4% in FY13 may push many below the "rating line"
 Local impact high - Teachers are 62.2% of total local workforce

Virginia is Not Alone in this Challenge, But Can Position Itself Ahead

2013 Funded Level Distribution



~250 State and local pension plans

New Paradigm: How to Position State and Localities Best for New Jobs

Is the whole (State) > then the sum of the parts (localities) for recruiting, retaining and expanding business and new jobs or are we one goal-oriented team?

Questions asked by prospects to locality may be more in-depth in seeking a stable locality for their business

- What are the taxes my business will pay (today, tomorrow)?
- How good are the local schools for my employees' children and future employees?
- How safe is the locality for my company and my employees?
- What's the quality of life for my employees and their families?
- What is your bond rating?

How do rating agency "negative outlooks" or downgrades as result of teacher liability affect business decisions (and new job creation)?

- If State impact < local impact of teacher liability, then shouldn't that be a consideration in proportional sharing of liability?

Locality Role in Job Creation

Due diligence factors done by all businesses

- Quality of life attributes (Schools, safety, housing)
- Fiscal health (financial statements, bond ratings)

Small to mid-sized business expansion primarily local

- Many small businesses perform their own due diligence
- Prospects call locality first and may not call State
- Largest volume of activity and # of new jobs in total

Large companies may want State incentives

- Infrequent in volume and lower jobs in total
- Prospects or their consultants may call State, but not always
- State defers to locality to “close the deal”
 - Infrastructure, zoning, local incentives, tax structures

If We're For Jobs, then Economic Development Impact Analysis Should Be Done

Proportional liability impact to bond ratings and correlation to new business investment

State vs. aggregate local government bond rating impact

- Per VRS: “Could affect local government bond ratings”
- Per Financial Advisor to Mandates Commission: “Proportional liability will not affect State’s bond rating”

Question not Answered:

- If 100% local government liability recordation is more adverse to economic development and job creation than proportional liability, why wouldn't State recognize proportional liability?

Local Government Employees

One commonality - all local government employees don't know who is grant funded, part of SOQ formula, part of Compensation Board funding, local tax-fee prefer uniform rationale for salary and benefit programs want to serve their local citizens, students, businesses



if State Now Considers Teacher 100% Local, Then Other Considerations?

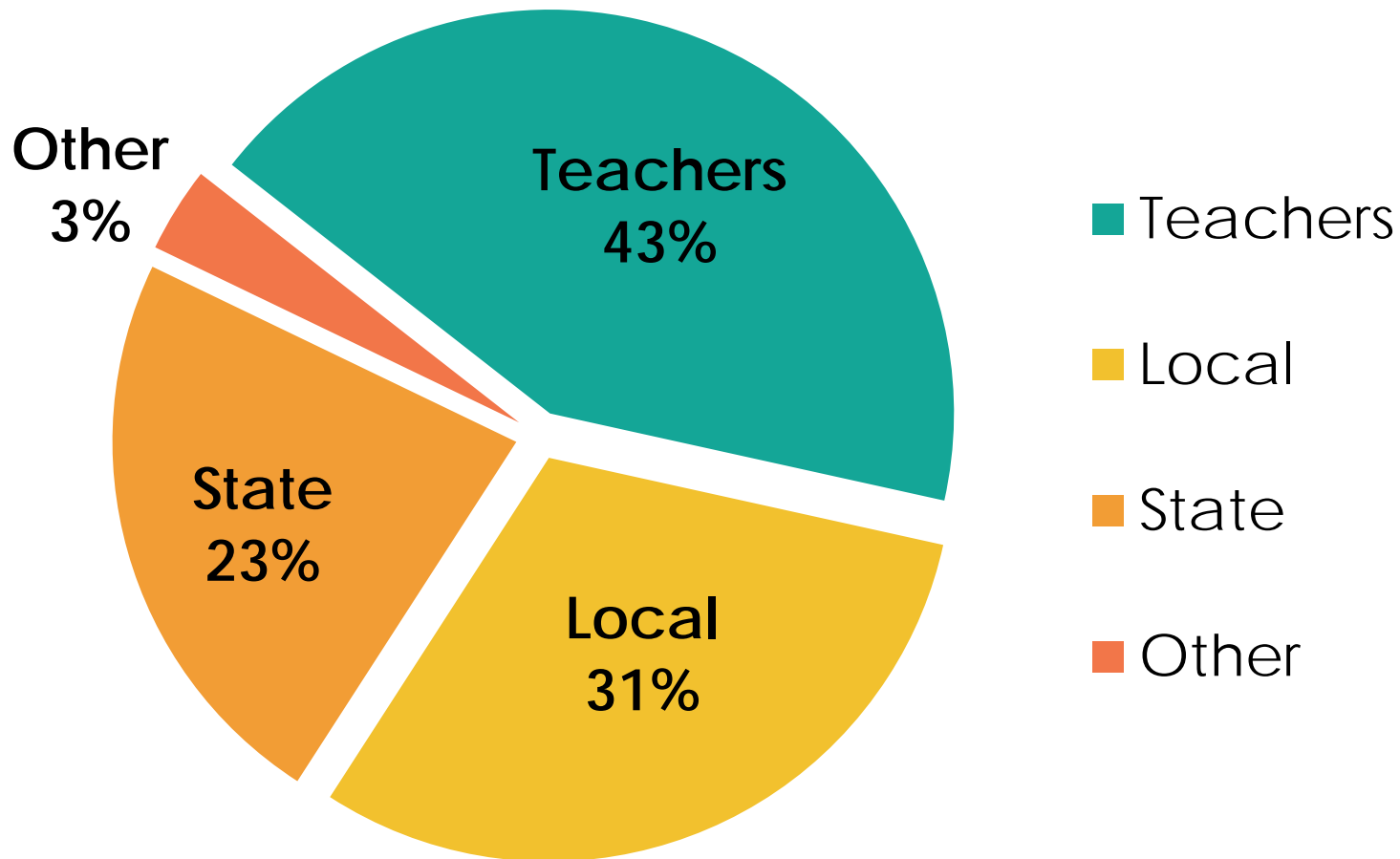
Easier-flexible school funding formula on how best to spend at school level

- Avoid salary initiative challenges (“use it or lose it”)
- Consistency amongst school, compensation board, and grant positions funding of salary-benefits
 - Opportunity to reform all with simple funding formula w/out all costly compliance reporting

Local VRS Bd representation

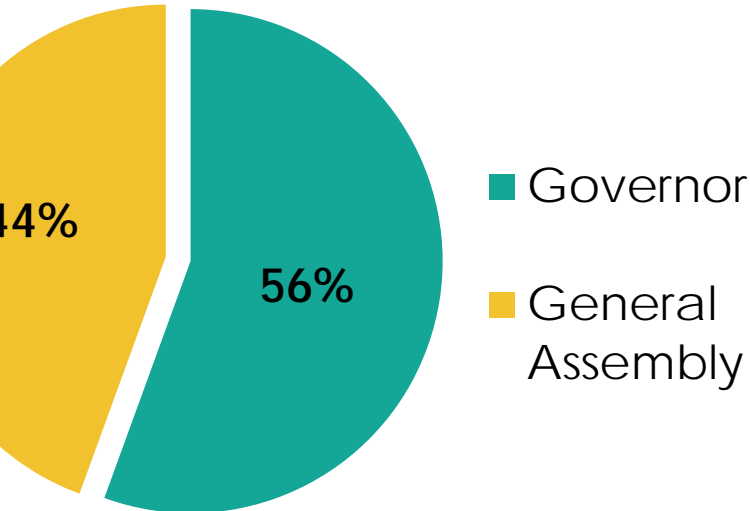
- Future input into Board actions, customer service
 - Customer service even more important w/ hybrid plans when employee’s own \$ centrally managed by State

If This Is How Customers of VRS are Represented, Then...

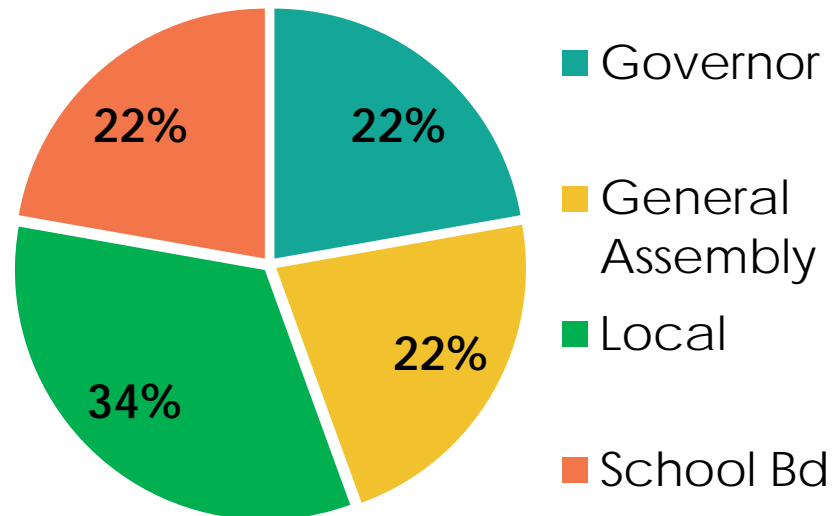


Should VRS Board Reflect Proportional Oversight and Liability?

How Currently Selected



Proportional Selection?



Proportional Representation Still Favors State

State representation 44% (23% of employees)
Local representation 56% (74% of employees)

VACO Prelim 2014 Legislative Program - Unfunded Teacher Pension Liability

Local governments and the state **share responsibility** for paying the cost of teacher pensions, but under GASB 68, the payer of retirement benefits will have to claim all unfunded liabilities for teacher retirement plans after June 15, 2014 on their financial statements. VACO urges the **state to not mandate this cost shift to localities** by paying its share of teacher pension contributions directly to VRS. This would demonstrate to credit rating agencies and localities that the state is committed to paying its fair share of unfunded teacher pension liabilities. It would also **better protect the bond ratings of Virginia's localities** by more accurately reflecting the local share of the unfunded liability.

Governor's Mandates Commission: November 1, 2013 Actions

Supported VACO preliminary
legislative position statement

Also supported classification of 100%
State appointed VRS Board as being a
mandate with adverse impact to local
government

Proposed Moody's Criteria

	Economy	Finances	Management	Debt-Pensions
Current	40%	30%	20%	10%
Proposed	30%	30%	20%	20%

Proposed Factors (Each 5%)	AAA	AA	A	Baa
Pension Liab/Value	<1.1%	1.1 – 2.6%	2.6 – 6.0%	6.0 – 15%
Pension Liab/Rev	<.5x	.5 – 1.0x	1.0 – 4.5x	4.5 – 7.5x

Pension factors are proposed to be 10% of debt-pensions 20% criteria

Proposed Collective Analysis - Effect Upon Bond Rating Calculation

NPL/Value and NPL/Rev	Pre-Liability	Post-Not Shared	Post-Shared	# of New Jobs Created
te	??	??	??	??
A Localities	??	??	??	??
Localities	??	??	??	??
localities	??	??	??	??

Other factors can also be analyzed

- Net asset impact and other financial indicators
- Other metrics of economic development

If shared liability is least impacting, then support for shared liability has a rationale

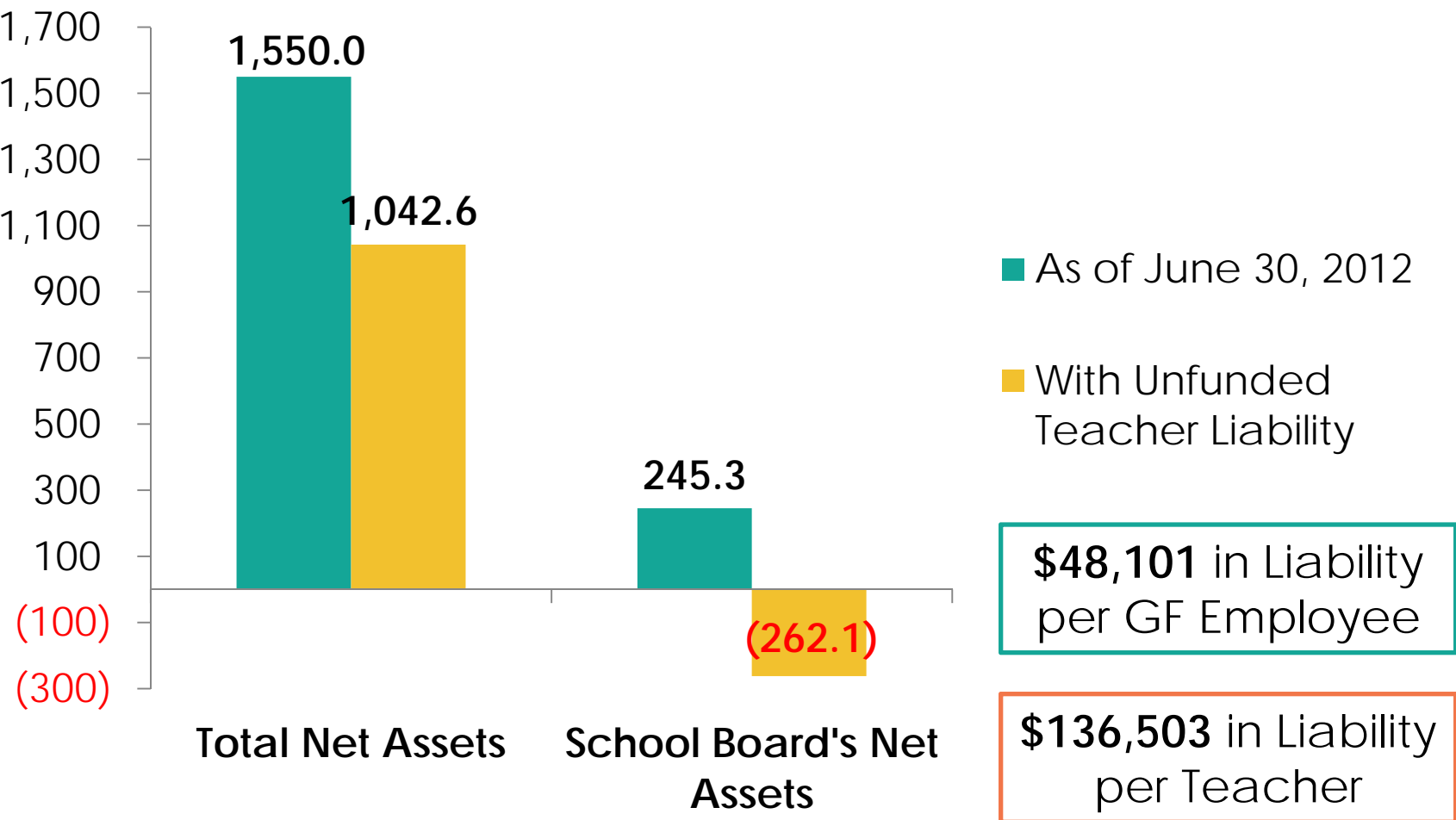
Proposed Collective Analysis - Effect Upon Bond Rating Calculation

Local Board	Estimated GASB NPL (in millions)	Bond Rating	2013 Job Growth as a Share of State Total
x	\$ 2,658.22	AAA Aaa AAA	25%
e William	\$ 967.11	AAA Aaa AAA	1%
oun	\$ 885.26	AAA Aaa AAA	4%
ia Beach	\$ 816.24	AAA Aaa AAA	3%
erfield	\$ 543.90	AAA Aaa AAA	2%
co	\$ 507.38	AAA Aaa AAA	9%
ton	\$ 490.04	AAA Aaa AAA	1%
apeake	\$ 450.94	AA+ Aa1 AAA	3%
lk	\$ 431.11	AA+ Aa2 AA+	1%
port News	\$ 328.25	AA+ Aa1	2%
Teacher	\$15,160.26	-	51% of State-wide Job Growth

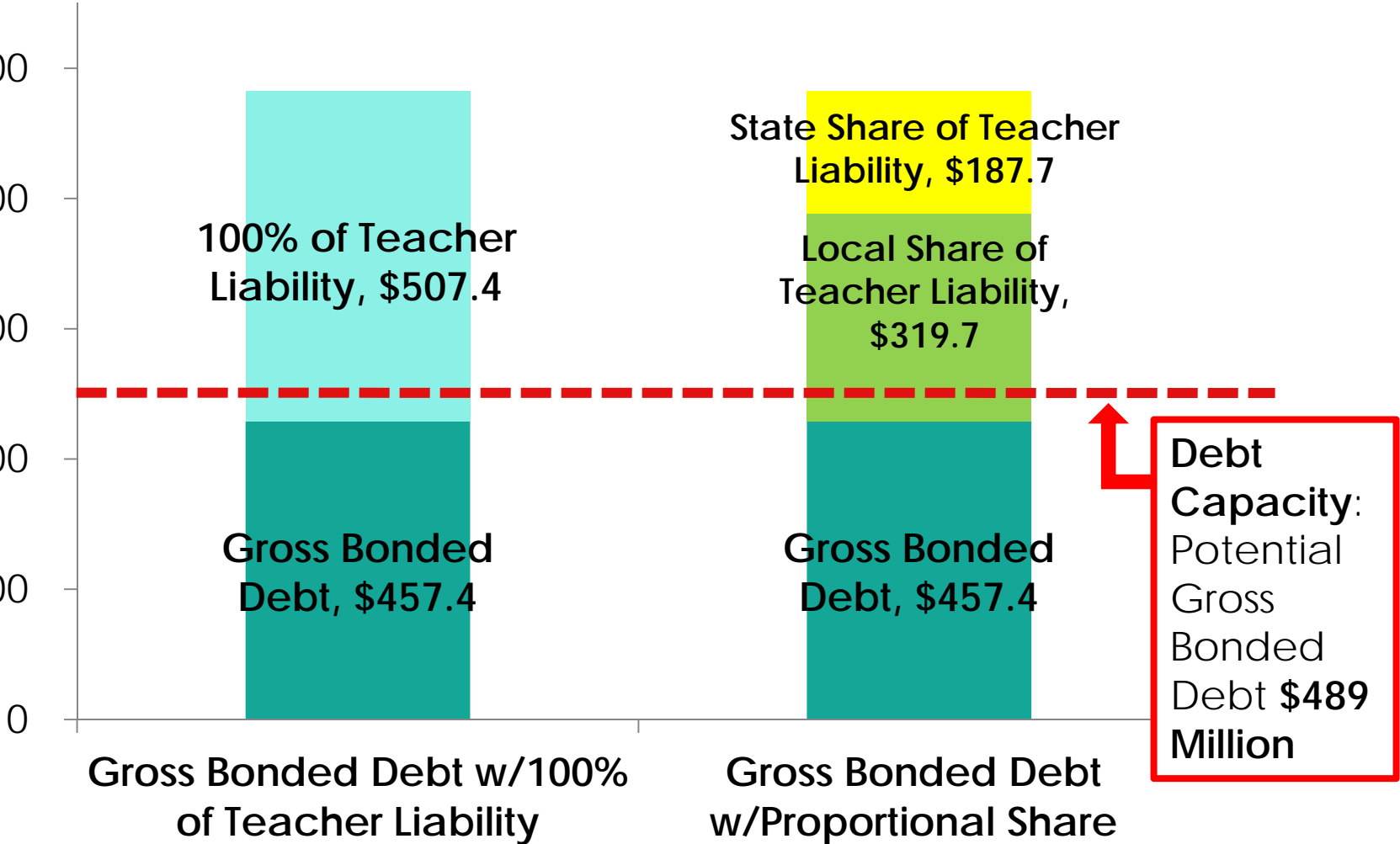
Aggregate Funded Status

61.2%

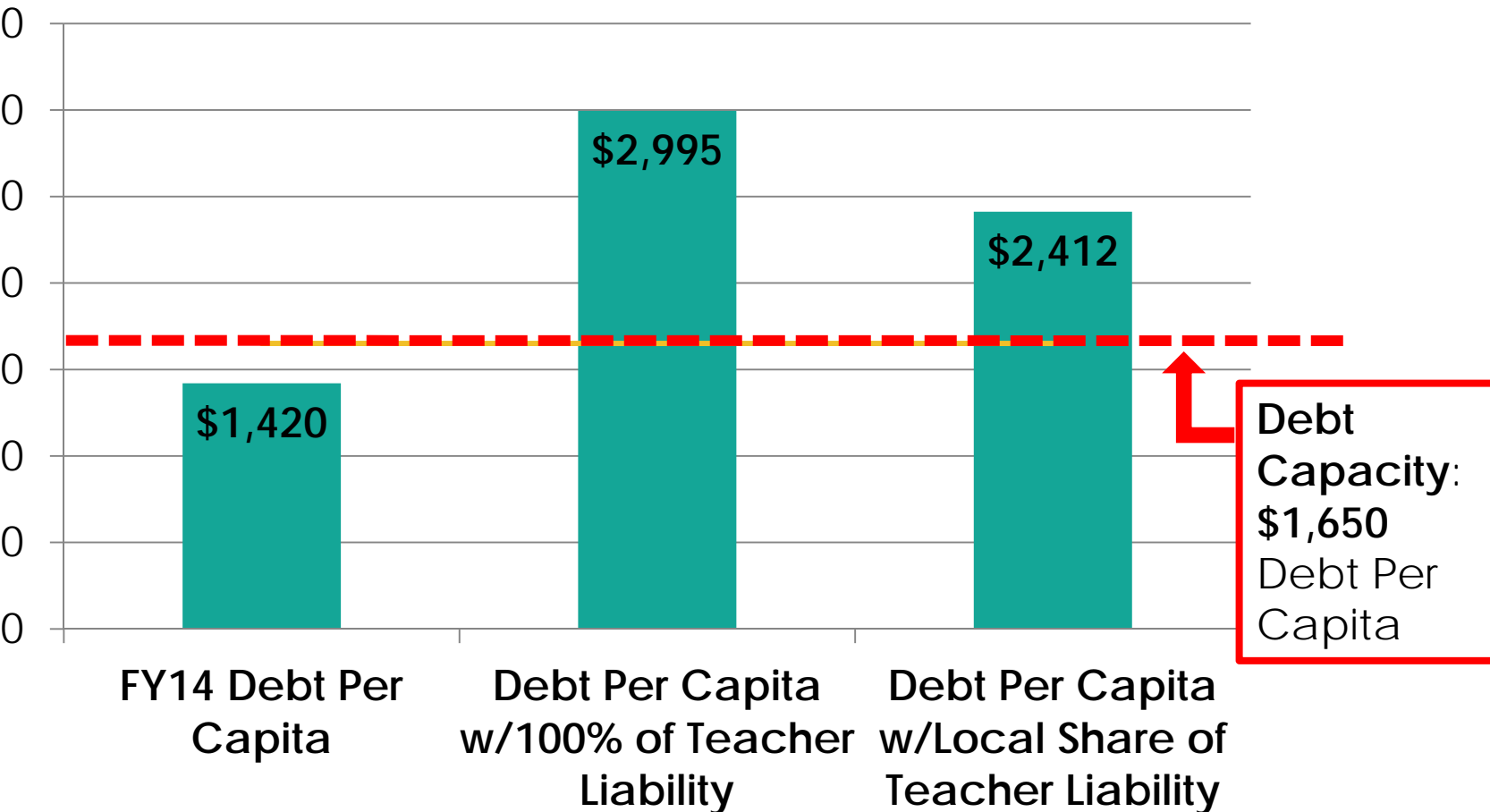
Henrico's Impact of \$507 Million Unfunded Teacher Liability - Net Assets



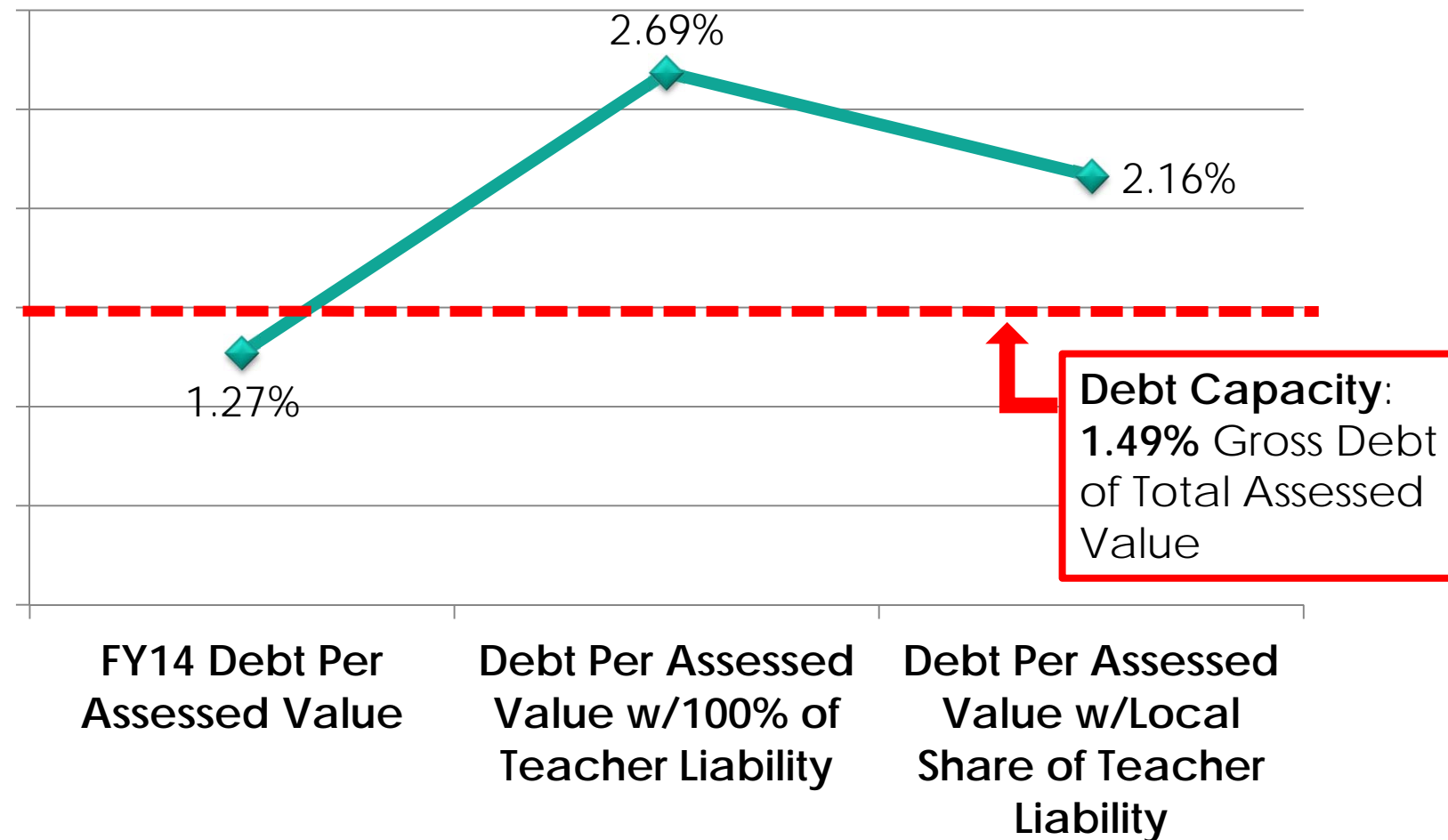
Henrico's Impact - Gross Bonded Debt



Henrico's Impact - Debt Per Capita



Henrico's Impact - Debt to Assessed Value Ratio



100% local government liability recordation
more adverse to economic development
and job creation than proportional liability,
why wouldn't State recognize proportional
liability?

QUESTIONS