New York City Independent Budget Office

Focus On:
The Preliminary Budget

March 2018

Mayor's Budget Adds $50 Million a Year to Meet Cost of Supplemental Retirement Benefit for Some School Staff

The February 2018 Financial Plan includes an additional $50 million annually from 2019 through 2022 (all years refer to city fiscal years) to cover the cost of tax-deferred annuities (TDA) that guarantee an 8.25 percent rate of return for some members of the Board of Education Retirement System (BERS) and Teachers' Retirement System (TRS).

BERS is a pension program open to all nonpedagogical employees of the city's Department of Education (DOE), plus those at a number of charter schools authorized to participate under state law, and the School Construction Authority. Membership in TRS is open to pedagogical and administrative staff of the DOE, the City University of New York, and participating charter schools. In addition to a traditional defined benefit pension plan, BERS and TRS are authorized by state law to offer an optional supplementary retirement benefit governed by section 403(b) of the Internal Revenue Code, known as a tax-sheltered or tax-deferred annuity.

While TDAs are often available as an option in retirement programs, New York City educators have access to a more valuable, less common product. BERS members may choose from a TDA with either a traditional variable-return fund based on the performance of market investments, or a fixed-return fund, with a guaranteed rate set by state statute. TRS offers four variable-return plans in addition to a fixed-return fund.

For employees represented by the United Federation of Teachers (UFT), the TDA fixed-return rate is 7.0 percent; for non-UFT employees, who may be in either BERS or TRS, the fixed rate of return is 8.25 percent. The members' TDA funds are invested along with the pension fund assets of the particular plan for which they are eligible; if the pension funds do not achieve the guaranteed rate of return (either 7.0 percent or 8.25 percent) in any given year, the city is responsible for covering the shortfall. In years when fund performance exceeds the guaranteed rate, the excess earnings remain in the fund's investment pool. Over the past 10 years, the BERS and TRS pension funds have averaged returns of 6.0 percent and 5.6 percent, respectively.

The additional $50 million included in the financial plan for each year from 2019 through 2022 represents the Office of the Actuary's estimate of the annual cost to the city to make up the difference between the actual returns achieved by the BERS and TRS pension funds and the guaranteed rate of return for the fixed 8.25 percent TDA. IBO estimates that a total of 32,700 city employees, or 10.1 percent of the city's workforce, are eligible for the 8.25 percent fixed-rate TDA benefit. A much larger share of BERS members than members of TRS are eligible for the 8.25 percent tax-deferred annuity, 67.7 percent compared with 8.4 percent, respectively.

BERS and TRS are the only city pension funds authorized to offer TDAs to their members and the only funds offering guaranteed rates of return on retirement investments. Prior to the Great Recession, both TRS and BERS offered their members the guaranteed 8.25 percent return on investment in their fixed-return TDAs. In 2009, the State Legislature amended the law to reduce the benefit for employees represented by the UFT to 7.0 percent. The benefit for non-UFT members was not similarly reduced.

Funds from the TDA fixed-return funds are combined with the two pension systems' respective pension assets for investment purposes; effectively, each pension fund

8.25 Percent Tax-Deferred Annuities Have Cost the City an Average of $22 Million a Year Since 2012
Dollars in millions

	Board of Education Retirement System		Teachers' Retirement System		Total		
	Investment Returns	Statutory Payments	Investment Returns	Statutory Payments	Investment Returns	Statutory Payments	Net Income (Loss)
2012	$16.9	$(20.2)	$33.1	$(136.6)	$50.0	$(156.8)	$(106.8)
2013	96.1	(116.5)	201.7	(151.3)	297.9	(267.9)	30.0
2014	124.8	(147.1)	327.6	(165.8)	452.4	(312.8)	139.6
2015	28.1	(60.6)	53.9	(180.4)	82.0	(240.9)	(158.9)
2016	27.9	(67.5)	38.7	(195.6)	66.5	(263.0)	(196.5)
2017	148.3	(75.8)	302.9	(211.8)	451.2	(287.6)	163.6
TOTAL	**$442.1**	**$(487.7)**	**$957.9**	**$(1,041.4)**	**$1,400.0**	**$(1,529.1)**	**$(129.1)**
AVERAGE	**$73.7**	**$(81.3)**	**$159.6**	**$(173.6)**	**$233.3**	**$(254.8)**	**$(21.5)**

SOURCES: Board of Education Retirement System; Teachers' Retirement System; Comptroller's Comprehensive Annual Financial Reports
NOTE: Calculations based on IBO estimates of participation by collective bargaining unit.

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is a single pot of money combining traditional pension assets and fixed-return TDA assets. This allows the funds to benefit from larger investment pools and more diversified portfolios. Because the pool of TDA funds is not segregated by investment type, IBO estimated the proportion of assets earning 7.0 percent and those earning 8.25 percent using data from the city's Payroll Management System on collective bargaining unit membership and TDA payroll deductions since 2012. By the end of 2017, BERS had assets of $5.7 billion, of which 17.0 percent were assets of the fixed-return fund earning an 8.25 percent return. Combined assets for TRS in 2017 stood at $72.4 billion, of which 3.8 percent were from the 8.25 percent fixed-return fund.

In years in which the return on investments is high, the inclusion of the TDA funds in the investment pool is a benefit for the city; all returns exceeding 8.25 percent, or 7.0 percent for UFT members, are kept in the pension systems' investment pools, and can offset the city's required contribution in future years. But in years when the returns on investments are below the guaranteed rates, the city must make up the difference between market returns and the fixed rate.

IBO estimates that since 2012, the city has made a total of $488 million in statutory payments to the BERS tax deferred annuity fixed-return fund for assets guaranteed to earn 8.25 percent. Over the same period, we estimate that these investments earned a total of $442 million after expenses, for a net loss of $46 million. Similarly, IBO estimates that the TRS fixed-return fund's assets guaranteeing 8.25 percent cost the pension plan just over $1 billion and earned $958 million in returns from 2012 through 2017, for a net loss of $84 million.

In the current financial plan the city has assumed that the investments in BERS and TRS tax-deferred annuities fixed-return funds with a guaranteed 8.25 percent rate of return will cost the city an additional $50 million annually. This assumption is a break from past practice. The city's Office of the Actuary forecasts a return of 7.0 percent for pension investments for the purpose of its funding models.

Until this year, actuarial gains (when the pension funds earn more than 7.0 percent) and losses (when earnings fall short of 7.0 percent) for the fixed-return funds have been spread out over a period of years, just as the city does when the pension funds have any other unexpectedly good or bad investment year. This year, the city has elected to acknowledge the additional 1.25 percent as an ongoing cost to the city that will average $50 million annually, and will pay that amount up front each year. In years when returns exceed the target, the city will receive a credit of some or all of this payment in the form of lower required pension contributions.

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