OFFICE OF THE SUPERINTENDENT
Wilmette Public Schools

INFORMATION ITEM

Date: **December 18, 2017**

To: **Board of Education**

From: **Dr. Raymond Lechner, Ph.D.**
Superintendent

Subject: **Clarifying District 39 Teacher Pension Obligations**

Recent questions from community members have focused on teacher pensions and related District 39 expenses. This report is intended to give the community greater understanding of this topic.

EXECUTIVE SUMMARY

The Teachers Retirement System (TRS) provides pensions to Illinois teachers. It is funded much like social security; the intent is for teachers and "employers" to both contribute. Historically, the State of Illinois has assumed responsibility for school district contributions. In recent years, the state has taken steps to shift some of its pension obligations to local school districts including the requirement for districts to contribute more when salary increases in excess of 6% impact a teacher's pension. District 39 has taken steps to control its pension-related costs; the teacher contracts since 2013 tie salary increases to CPI and include a retirement incentive of 5%. As a result, salary increases over 6% for pension calculations are infrequent. There are circumstances where increases for retiring teachers can exceed 6%, but this is generally out of the District's control. These situations are enumerated below, along with data showing that in the past five years, only six payments were made to TRS for excess salaries, totaling $25,720.

BACKGROUND

In order to look at the Teachers Retirement System (TRS) and its impact on District 39, it's important to consider the statewide situation. Similar to social security, the intent is for teachers to pay a portion of their salary to TRS (currently 9%) and the employer to also make a contribution. Historically, Illinois agreed to support education by paying the "employer" portion of TRS contributions. Legally it has been the State of Illinois' obligation to make that payment "on-behalf" of school systems.

However, the State of Illinois has a long history of not meeting its funding obligations to TRS. While the state has improved in making contributions in recent years, there are many years of non-payments and lost interest to make up; as a result, TRS remains underfunded. In addition, because suburban Chicago area teachers tend to have higher salaries than downstate teachers, the benefit of the state's increasing contributions are greater for suburban areas; this unfortunately creates inequity.

As the state tries to improve this situation, it looks for ways to get more local funds into TRS and has taken five steps in this direction. 1) elimination of the Early Retirement Option in Fiscal 2017, keeping teachers in the workforce longer; 2) tracking the pension contributions the State of Illinois makes on behalf of each school district, now reported in the Annual Financial Report; 3) charging districts for Teacher Health Insurance Security (THIS); 4) requiring school district contributions to TRS; currently the amount is .58%; and 5) requiring districts to make Excess Salary Payments to TRS. Collectively, this has shifted pension obligations toward local school districts. This report focuses primarily on the Excess Salary Payments.

EXCESS SALARY PAYMENTS

The current law regarding excess salary payments to TRS was passed in June 2005 and went into effect immediately for Fiscal Year 2006. Excess Salary Payment refers to charges a school district pays, as required by law, to TRS when a salary increase is in excess of 6% and factors into a teacher's pension; it is based on an actuarial calculation. TRS calculates individual pensions based on the highest four consecutive years of earnings among the last 10. Some have named this payment a penalty. However, TRS addressed this directly in a 2015 article (Appendix 1) noting:

> "...this is incorrect because the words "penalty" and "fine" are not used in the law. School districts are not breaking the law when granting raises in excess of 6 percent so they cannot be assessed a penalty. The law does not outlaw raises by school districts that exceed 6 percent. The law only transfers the responsibility of paying for the pension created by a raise in excess of 6 percent."

Prior to 2005, there was no legal limit on salary increases that would generate any financial consequence from TRS; there was no concept of excess salary or any provision for school districts to pay TRS. At that time, salary increases for D39 teachers were governed only by the collective bargaining agreement. As in most other districts, larger increases close to retirement were common practice in District 39. The purpose was to incentivize early retirements, which helped reduce overall local salary costs. The effect of early retirements, however, pushed greater pension obligations to the state. This led to the elimination of the early retirement option noted above. Under the 2005 law, annual salary increases up to 6% are legal and allowable for teachers heading into retirement. Districts have to pay TRS based on a formula for any increases over 6% that are used in calculating a teacher's pension.

D39's CURRENT SITUATION

District 39 has made direct efforts to avoid making payments to TRS for excess salaries. Beginning in 2008, D39 lowered its incentive for teachers approaching retirement to 6%. Then, after identifying that payments were still being charged, lowered the incentive again. Since the 2013 teacher contract, D39 has had a 5% limit on salary increases once a teacher's retirement plan is approved. This is only 1% more than what non-retiring teachers can get.

Salary increases for those not approaching retirement have been based on CPI with a cap of 4% in the last two teacher contracts; a teacher can earn more through educational advancements and/or stipends for additional work. Teachers can seek approval for retirement up to five years in advance. If a teacher's retirement plan is in effect, increases in earnings, including any additional educational advancements or stipends are capped at 6% to avoid any excess salary payment to TRS. However, a teacher without an approved retirement plan has a potential of earning more than 6% (e.g. salary increase plus stipends for additional work).

Given D39's teacher contract, and the way TRS calculates pensions, there are some circumstances where D39 would need to pay TRS for excess salary:

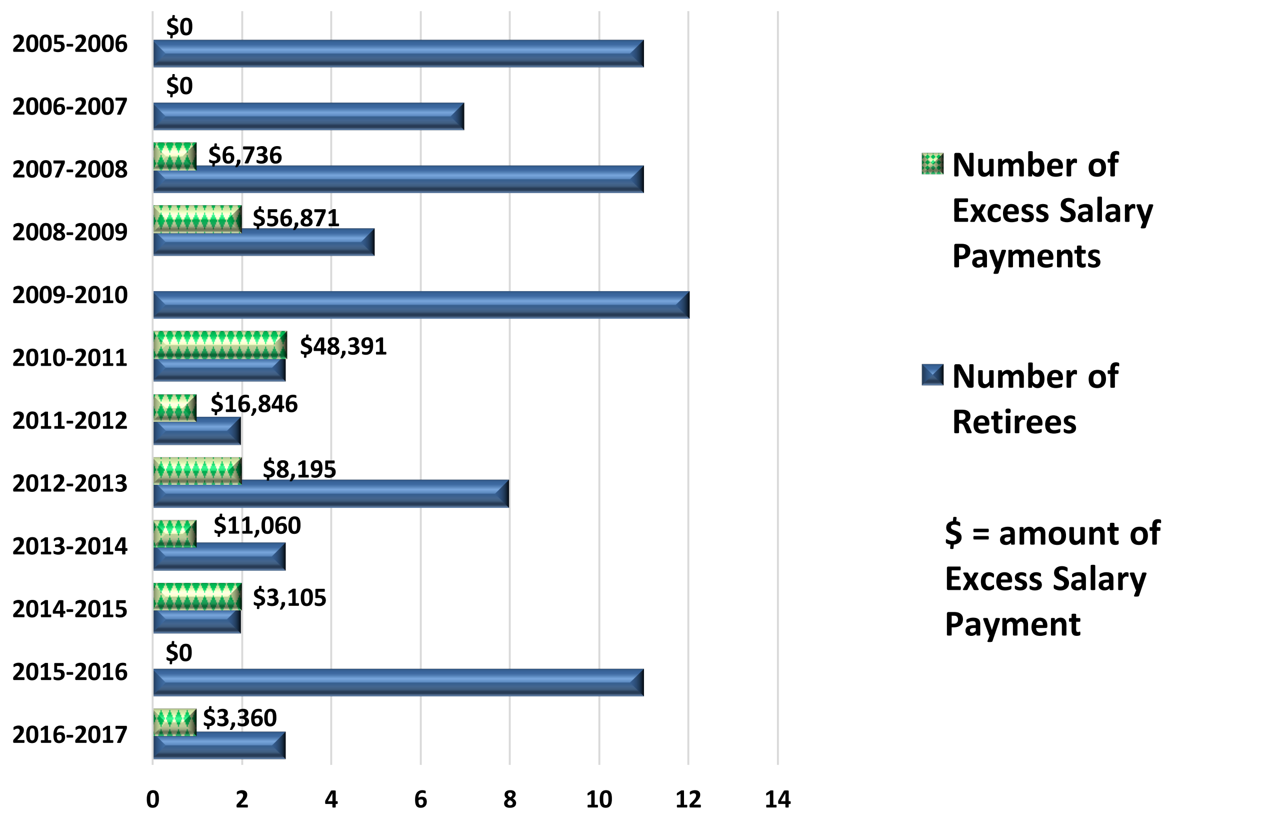
1. *A teacher who doesn't have retirement approved earns more than 6% overall salary increase due to stipends or educational enhancements in a given year.* If that teacher announces plans for retirement with less than four years notice, and has one year with a greater than 6% increase that factors into the pension calculation, TRS would charge the District for the excess salary (based on an actuarial formula). However, without knowledge of the teacher's retirement, the District could not have avoided that excess salary in the year it was earned. Overall D39 may save money because it doesn't have to pay the 5% retirement incentive for the full five years, but will have an excess salary payment for one year.
2. *A teacher gets a five-year retirement plan approved, but retires unexpectedly before the five-year period is over.* D39 may save money overall because it doesn't have to pay the 5% retirement incentive for the full five years, but may have an excess salary payment if the four highest years included one or more prior to the retirement approval that had a greater than 6% increase.
3. *A teacher resigns from D39, but doesn't retire.* If that teacher does not obtain another teaching position, some or all of their highest four years for pension calculations would include years in D39. In addition, some of or all of those four years may include salary increases over 6%. If so, TRS would charge the District for salary paid in excess of 6%, and this might happen many years after this teacher resigned. The District could not have prevented those over 6% increases nor anticipated that this teacher would not have earned higher pay after resigning from D39.

There are several reasons excess salary payments are not common:

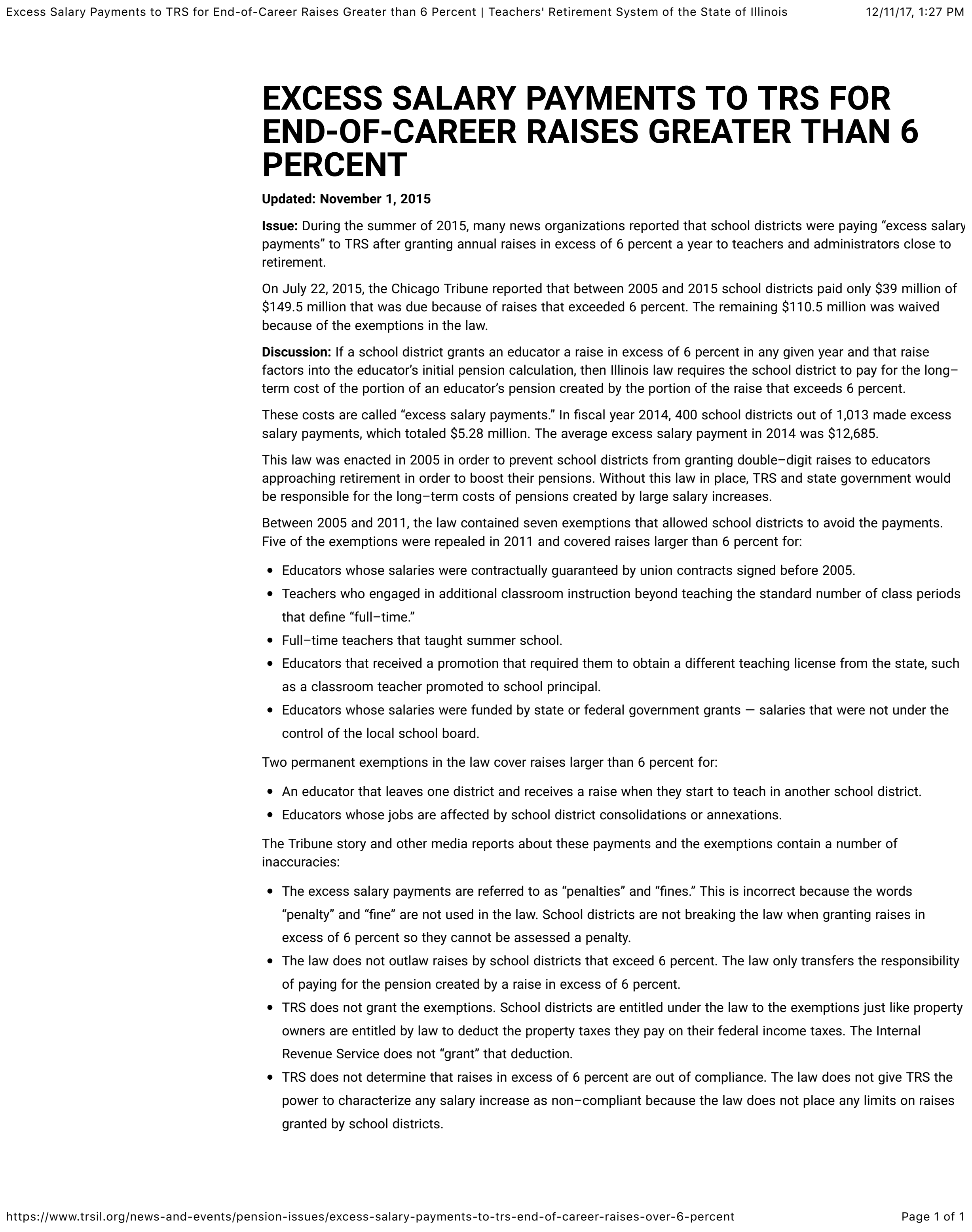
1. D39's current teacher contract incentivizes teachers to seek approval for retirement five years in advance by guaranteeing a 5% annual increase, which is 1% more than they would otherwise get. The current CPI based contract has a salary increase ceiling of 4%.
2. Because the TRS cap is 6%, teachers with an approved retirement plan can still earn 1% additional through stipends, including educational advancement, without triggering an excess salary payment. This is carefully monitored.
3. Educational advancements, which are salary additions for graduate coursework in education, are most common in the earlier career years. As a result, this rarely triggers excess salary payments. In rare cases, a teacher without approved retirement earns educational advancement in their final years, generating an excess salary payment by the District. However, when this happens, both the District and the state actually spend less than if the advancement had been earned much earlier; if the teacher had earned the advancement a number of years prior, the District would have paid a higher salary for a greater number of years and the teacher's overall pension would be greater.

Below you will find the entire D39 history of excess salary payments. You will see that the impact has been reduced because of steps the District has taken. Over the past five years only six payments were made to TRS totaling $25,720. All of these involve factors outside the District's control; it is not possible to avoid excess salary payments every single year. If a teacher opts to discontinue working in the District without taking advantage of the D39 retirement incentive, the District cannot anticipate nor budget for the excess salary payment that may occur.

TRS Total Retirees and Excess Salary Payments



APPENDIX 1



EXCESS SALARY PAYMENTS TO TRS FOR END-OF-CAREER RAISES GREATER THAN 6 PERCENT

Updated: November 1, 2015

Issue: During the summer of 2015, many news organizations reported that school districts were paying “excess salary payments” to TRS after granting annual raises in excess of 6 percent a year to teachers and administrators close to retirement.

On July 22, 2015, the Chicago Tribune reported that between 2005 and 2015 school districts paid only $39 million of $149.5 million that was due because of raises that exceeded 6 percent. The remaining $110.5 million was waived because of the exemptions in the law.

Discussion: If a school district grants an educator a raise in excess of 6 percent in any given year and that raise factors into the educator’s initial pension calculation, then Illinois law requires the school district to pay for the long–term cost of the portion of an educator’s pension created by the portion of the raise that exceeds 6 percent.

These costs are called “excess salary payments.” In fiscal year 2014, 400 school districts out of 1,013 made excess salary payments, which totaled $5.28 million. The average excess salary payment in 2014 was $12,685.

This law was enacted in 2005 in order to prevent school districts from granting double–digit raises to educators approaching retirement in order to boost their pensions. Without this law in place, TRS and state government would be responsible for the long–term costs of pensions created by large salary increases.

Between 2005 and 2011, the law contained seven exemptions that allowed school districts to avoid the payments. Five of the exemptions were repealed in 2011 and covered raises larger than 6 percent for:

- Educators whose salaries were contractually guaranteed by union contracts signed before 2005.
- Teachers who engaged in additional classroom instruction beyond teaching the standard number of class periods that define “full–time.”
- Full–time teachers that taught summer school.
- Educators that received a promotion that required them to obtain a different teaching license from the state, such as a classroom teacher promoted to school principal.
- Educators whose salaries were funded by state or federal government grants — salaries that were not under the control of the local school board.

Two permanent exemptions in the law cover raises larger than 6 percent for:

- An educator that leaves one district and receives a raise when they start to teach in another school district.
- Educators whose jobs are affected by school district consolidations or annexations.

The Tribune story and other media reports about these payments and the exemptions contain a number of inaccuracies:

- The excess salary payments are referred to as “penalties” and “fines.” This is incorrect because the words “penalty” and “fine” are not used in the law. School districts are not breaking the law when granting raises in excess of 6 percent so they cannot be assessed a penalty.
- The law does not outlaw raises by school districts that exceed 6 percent. The law only transfers the responsibility of paying for the pension created by a raise in excess of 6 percent.
- TRS does not grant the exemptions. School districts are entitled under the law to the exemptions just like property owners are entitled by law to deduct the property taxes they pay on their federal income taxes. The Internal Revenue Service does not “grant” that deduction.
- TRS does not determine that raises in excess of 6 percent are out of compliance. The law does not give TRS the power to characterize any salary increase as non–compliant because the law does not place any limits on raises granted by school districts.