Unfunded Pension Liabilities Cost You

By Rep. Frank Ryan (R-Lebanon)

As we continue to explore the reasons behind our efforts to eliminate property taxes, the concerns with unfunded pensions costs at the school district level must be examined to get a full perspective of why property taxes are such a problem.

Just the mention of the term unfunded pension liabilities causes the person with even the strongest will to react with a deer in the headlights stare.

Unfortunately, unfunded pension liabilities are one of the major cost drivers of why your property taxes are escalating. For instance, in the average school district, pension costs are approximately 30 to 35 percent of payroll compared to approximately 8 percent in those few companies that still have pension plans. The actual rate paid by a school district is an actuarial rate determined by the state and “inflicted” on the school district in order to amortize the outstanding pension cost (hence the deer in the headlight comment!)

The Commonwealth’s pension actuarial assumptions are key to understanding the problem. These assumptions have occasionally been in error over the years which causes this unfunded liability problem. These assumptions could be wrong because of major recessions, overestimates of expected earnings or a multitude of other factors which have tremendous impact on future contributions rates required by the State to the school districts to fund the unfunded liability.

These unfunded pension costs are a liability for the homeowner in each school district. You heard it correctly! You, as a homeowner, are responsible for the unfunded pension liability. The liability can either be paid by the property taxes or by the earned income tax if your community voted to permit that.

The comprehensive annual financial report (CAFR) is where you go to find this type of information. For example, the 2018 CAFR (pronounced Caf-four) for the Commonwealth clearly shows that the state has no liability on its financials for the school districts.

In our own area, we have a particularly well-managed school district with Palmyra Area School District. The CAFR for 2018 for Palmyra shows a net deficit of $28 million and an unfunded pension liability of $71 million (page 22 of the report). Absent the unfunded pension liability, the school district would be in an outstanding financial position.

As a certified public accountant who specializes in keeping organizations out of bankruptcy, I can assure you Palmyra’s financial resources are extremely well managed. In my mind, perhaps in the top 5 percent of the Commonwealth.

Other school districts financials are significantly distressed such that Erie school districts receive an additional $13 million grant annually from the Commonwealth to pay its bills. In the last budget year, Allentown school district received a $10 million grant to balance its budget.

On the other hand, however, Palmyra Area School District is shorted over $1 million annually by the state because of the way the state calculates the funding formula and the hold harmless provision that was enacted years ago. This issue was part of an article I did as part of this series to explain the complexity of getting rid of property taxes.

Other factors which have influenced this very troubling circumstance of unfunded liabilities include:

– Former Gov. Tom Ridge enacted Act 9 of 2001 which increased pension benefits going forward and retroactively by 25 percent (lawmakers incidentally increase their pensions by 50 percent at the same time which is why I do not accept the pension)

– During Gov. Rendell's administration, due to severe financial problems in the Commonwealth, used actuarial assumptions which understated what the state was required to contribute to the pension plans.

– Act 29 of 1994 prescribes that the state will pay approximately 50 percent of the school district pension obligations but there is no requirement that the assumptions used by the State are prudent or rational. In the past two budget years the state has made all required contributions.

– PSERS pension performance has been lackluster compared to other states pension plans. The required rate of return on the pension assets is 7.25 percent. That shortfall must be made up by the taxpayers.

– Pension management costs are estimated to be $5 billion higher than they should be based upon a commission that was just released. We are working on those solutions and I have introduced a number of bills to rectify this. These excess costs are paid for by property tax owners.

Finally, under Act 1 of 2006, The Taxpayer Relief Act, taxpayers had the option of substituting an earned income tax to offset property tax increases. In the case of Palmyra school district, that was overwhelmingly rejected (Page 18 of the report). This clearly means that property taxes are the only source of solving these problems.

It is extremely important to fully understand the scope of the property tax problem as we attempt to eliminate the property tax. We all have a hand in the solutions and it is complicated. We are on the way to finding a rational solution for all.

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