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Fitch Ratings: TRS Pension Change Unlikely to Stress Texas School Districts

Fitch Ratings-Austin-02 October 2018: A recent change to the assumed return of the Teachers' Retirement System of Texas (TRS) is not expected to materially affect local school districts' spending flexibility, according to Fitch Ratings.

The TRS board at its July 2018 meeting voted to lower the investment return assumption for the TRS pension plan to 7.25% from 8%. This move increases the plan's current \$35.5 billion unfunded liability by \$10 billion. If current statutorily fixed contribution rates are left unchanged, this adjustment extends the time needed to pay down the unfunded liability to 86 years from 32 years currently (assuming all other funding assumptions are met). The state currently contributes 6.8% of salaries, members contribute 7.7%, and school districts that do not contribute to social security contribute 1.5% of certain salaries.

The TRS legislative funding request for the 2020-2021 biennium includes an increase in the state contribution rate to 8.62% from 6.8%, at a cost of \$1.68 billion for the biennium; this increase assumes no change in member or district contribution rates. TRS estimates that this increase would reduce the period needed to amortize the unfunded liability from 86 years to 31-35 years—consistent with the current 32 years.

The state likely will consider sharing the burden of increased contributions with plan members and local districts, in line with legislative reforms to the state's pensions in recent sessions. Fitch has consistently considered the risk that the state could increase district contributions to TRS in its assessment of each entity's expenditure framework, and believes most districts can accommodate a moderate increase without compromising flexibility. Nevertheless, Fitch will monitor consideration of this issue during the 2019 Texas legislative session and the potential impact to local districts' expenditure flexibility that would result from increasing pension contributions.

The lower 7.25% investment return assumption approved by TRS is a step in the right direction toward a more realistic assessment of the long-term funding burden that the state and local school districts will have to carry, although the rate remains above the 6% level which Fitch uses for assessing pension liabilities.

The TRS pension system is currently the 13th largest in the world. The pension trust fund ended fiscal 2017 with a market value of \$147 billion. According to the TRS appropriation request, the system plans to distribute more than \$26 billion in retiree benefit and healthcare payments to more than 400,000 retirees and healthcare providers during the 2020-2021 biennium.

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