SUNLIGHT
POLICY CENTER
OF NEW JERSEY

UGLY TRUTHS AND HARD FACTS ABOUT NEW JERSEY'S PENSION CRISIS, PART II:

NJEA LEADERSHIP HAS SECURE, GOLD-PLATED PENSIONS WHILE TEACHERS' PENSIONS ARE INFERIOR AND AT RISK

MIKE LILLEY

DECEMBER 9, 2020

UGLY TRUTHS AND HARD FACTS ABOUT NEW JERSEY'S PENSION CRISIS, PART II:

NJEA LEADERSHIP HAS SECURE, GOLD-PLATED PENSIONS WHILE TEACHERS' PENSIONS ARE INFERIOR AND AT RISK

Executive Summary

It's time for New Jersey's teachers to wake up to the ugly truths and hard facts about their pensions:

1. They are vastly inferior to the pensions that the New Jersey Education Association (NJEA) leadership provides for themselves – all paid for by teachers' dues.

2. The NJEA is not telling teachers the truth about their pension fund: the Teachers' Pension and Annuity Fund (TPAF) is in such deep trouble that teachers' and even retirees' retirements may be at risk.

3. TPAF is unfair to new and younger teachers, the majority of whom will lose money participating in TPAF and end up subsidizing the minority of teachers who make teaching a life-long career.

What is worse is that our teachers have very little choice in the matter. They have little choice but to join the NJEA and have their highest-in-the-nation dues withheld from their paychecks. They never even see the $991 that goes to the NJEA every year.

Fortified with these millions of dollars of teachers' dues, the NJEA leadership have rewarded themselves with very generous and very secure pensions. Sunlight's research reveals that the NJEA leadership's pensions are superior in virtually every respect to teachers' pensions, and that the NJEA leadership can expect multi-million-dollar pensions worth as much as $5.5 million, or six-times greater than what a teacher can expect. Their pensions are also over-funded, with $1.37 set aside for every $1 owed, so the NJEA leadership can sleep well at night knowing their pensions will be paid off as promised.

Nor do teachers have a choice about participating in TPAF: they are forced to join TPAF as a condition of their employment. But the NJEA leadership have not secured teachers' pensions the way they have secured their own. The fact is that TPAF is in deep trouble. It is one of the single worst public pensions in America. It is severely underfunded, with only 27 cents set aside for every $1 owed, and is bleeding assets. Absent some federal bailout, it is projected to become insolvent by 2027.

Teachers need to know that should TPAF become insolvent, all bets are off. Its $4.5 billion-plus of benefits payments would have to be funded from the state budget – a near impossibility for a state in perpetual budget deficit like New Jersey. In such a disaster scenario, all teachers would likely see their pensions reduced, including longer-serving teachers with stronger legal protections. Most alarmingly, even retirees could see their benefits threatened.

Should a TPAF insolvency be resolved under a federal-bankruptcy-style process, unfunded pension liabilities would be particularly vulnerable to reduction. With TPAF only 27 percent-funded, the remaining 73 percent of its liabilities are unfunded and could be on the chopping block. If an insolvency were resolved according to state laws, all the legal protections gained for TPAF pensioners may not protect them. Even if courts found that TPAF members had a legal right to their pensions as promised, courts cannot force the legislature to appropriate funds. Pension payments would then be forced to compete with other necessary government functions in the middle of a severe fiscal crisis. In both cases, TPAF pensions would be at risk.

The NJEA leadership has not told teachers the ugly truth because teachers would be rightfully outraged that their retirements are at risk. Former San Jose, CA Mayor Chuck Reed points the finger at public employee unions like the NJEA that ignored the fact that "underfunding pensions is cheating their members."[1] Fortified with the truth, teachers should direct their outrage at their state union, the NJEA, which cheated them by allowing TPAF's funding to deteriorate to these perilous levels.

In addition to being structurally unsound, TPAF is also fundamentally unfair. Today's younger workers tend to be more mobile and change jobs more frequently than past generations, but this behavior is penalized by TPAF. As a result, Sunlight estimates that 60 percent of new and younger teachers will end up being forced to lose money – as much as tens of thousands of dollars – and subsidize the 40 percent who choose to make teaching in New Jersey a life-long career. This raises fundamental questions of fairness, with implications for recruitment and retention.

It may also raise questions of equity because research shows that high-minority schools are more likely to have younger teachers. So TPAF's structure could be affecting recruitment and turnover, and thus the quality of instruction, in these schools as well.

Teachers are getting a very bad deal from their state union leadership. They are being forced to pay thousands of dollars more for inferior pensions that are at risk due to their leadership's negligence. Yet, with their pensions gold-plated and secure, the NJEA leadership is blocking reform efforts that could put TPAF on a more secure and

sustainable path. Teachers would be justified in asking if that would be the case if the leadership's own pensions were at risk.

Teachers should demand better. They should demand to be told the truth about their pensions and demand answers for why they are in such peril. They should demand reforms that will secure their retirements and make the system fair for all teachers. They should demand a retirement system that works for everyone, not just the NJEA leadership.

UGLY TRUTHS AND HARD FACTS ABOUT NEW JERSEY'S PENSION CRISIS, PART II:

NJEA LEADERSHIP HAS SECURE, GOLD-PLATED PENSIONS WHILE TEACHERS' PENSIONS ARE INFERIOR AND AT RISK

Introduction

The leadership of the New Jersey Education Association (NJEA) is sitting pretty. They have secure, multi-million-dollar pensions awaiting their retirements. Recently retired former Executive Director Ed Richardson stands to gain a $5.5 million pension. And he doesn't have to worry about whether it will be paid off as promised because it is over-funded.

This stands in glaring contrast to New Jersey teachers, who are getting a very bad deal on their own pensions. The teachers don't have a choice in the matter. They are essentially forced to join the NJEA and have their highest-in-the-nation dues withheld from their paychecks. It is these millions of dollars of dues that are funding Richardson's gold-plated pension.

Nor do teachers have a choice about participating in their pension plan, the Teachers' Pension and Annuity Fund (TPAF). They must join TPAF as a condition of their employment. But unlike their leadership's pension plan, TPAF is in deep trouble. If TPAF becomes insolvent, all teachers and retirees could have their retirements threatened.

That's the ugly truth for today's teachers: they are trapped in a broken pension system but their leadership refuses to tell them the truth and blocks reforms that could make TPAF more secure and fairer for teachers. After all, the leadership is sitting pretty.

I. NJEA Leadership Made Sure Their Own Pensions Were Very Rich and Very Secure

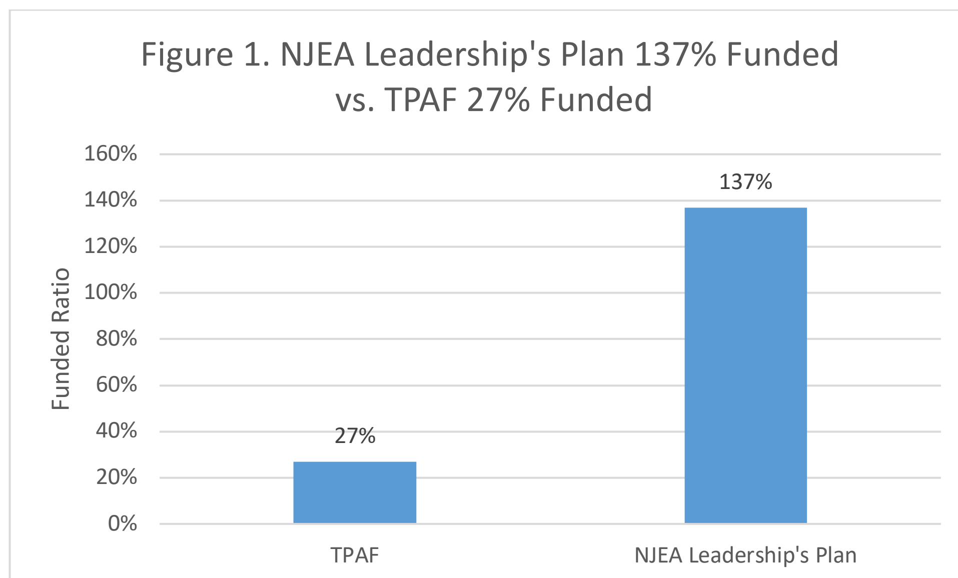
The NJEA leadership made sure that their own pension plan ("NJEA Leadership's Plan") is a very sound and very generous pension plan.[2] Like TPAF, the NJEA Leadership's Plan is a defined benefit plan, meaning that the NJEA guarantees the pay out of pension benefits, just as the state does for TPAF. But the NJEA Leadership's Plan is subject to the federal Employee Retirement Income Security Act (ERISA), which requires that pension plans be adequately funded. While TPAF is not subject to ERISA,

the NJEA leadership clearly understands the importance of sound pension funding – at least when it pertains to their own pensions. This underscores the fact that the NJEA leadership knew very well what sound pension funding looked like and yet chose to let TPAF's funding deteriorate until it was too late. (See Sunlight's previous report "Ugly Truths and Hard Facts About New Jersey's Pension Crisis, Part I" for a detailed account of the NJEA leadership's and the state's past neglect with regard to TPAF's funding.)

Thanks to Teachers' Dues, NJEA Leadership's Plan Is Over-Funded

Thanks to a legislative regime that deprives teachers of any real choice, teachers are essentially forced to join the NJEA and have their dues withheld from their paychecks. As detailed in Sunlight's report "New Jersey Teachers' Dues: Why Are They the Highest in the Nation and What Are They Paying for?" New Jersey teachers pay the highest dues in the nation at $1,400 per year, with $991 flowing directly to the NJEA. The teachers never even see the money.

There, fortified with these hundreds of millions of dollars of teachers' dues, the NJEA leadership has ensured that their own pensions are very, very secure. As shown in Figure 1, the NJEA Leadership's Plan is 137 percent funded (meaning that there is $1.37 set aside for each $1 owed),[3] as compared to TPAF's 27 percent (27 cents set aside for each $1 owed). The NJEA Leadership's Plan is actually over-funded.



Sources: 2018 IRS Form 5500, TPAF GASB 67 Report

The inescapable conclusion is that the NJEA's richly compensated top executives have ensured their gold-plated pensions are rock-solid, while a teacher, who funds these pensions with her highest-in-the-nation dues, has to worry whether her pension will ever be paid out as promised.

NJEA Leadership's Plan Is Vastly Superior to TPAF

Not only are the NJEA leadership's pensions much more secure, they are also vastly superior to teachers' pensions. The numbers are striking. Table 1 provides a comparison between the current TPAF plan and the NJEA Leadership's Plan. In every measure, the NJEA Leadership's Plan proves superior to TPAF. This is also true for longer-serving teachers who have more generous pensions that are still inferior.[4]

Table 1

Measure	TPAF	NJEA Leadership's Plan	Advantage
Annual Contribution Rate	7.5% of salary	3.5% of salary	NJEA LP
Years to Vesting	10 yrs.	5 yrs.	NJEA LP
Retirement Age	65 yrs.	62 yrs.	NJEA LP
Years of Service Multiplier	1.67%	2.0% Plus*	NJEA LP
Final Salary	Last 5 yrs.	Last 3 yrs.	NJEA LP
Annual COLA	0	2.50%	NJEA LP
Early Retirement Years of Service	30	20	NJEA LP
Early Retirement Penalty	Yes	No	NJEA LP

Source: TPAF Actuarial Valuation Report; 2018 IRS Form 5500. *Three additional payments for length of service.

Annual contribution rate: Teachers must contribute 7.5 percent of their annual salaries to their pensions. NJEA Leadership's Plan requires only a 3.5 percent annual contribution. Thus, the typical teacher is forced to contribute $5,148 annually into TPAF,[5] or $2,746 more per year than a comparable NJEA employee, for a greatly inferior pension plan.

Years to vesting: Under TPAF's formula, teachers must complete 10 years of service before they qualify for their pension plan while NJEA leadership only need 5 years of service. As detailed in Section III, 45 percent of teachers do not vest, and given the forced subsidy that non-vesting teachers must provide, this can cost teachers thousands of dollars (see Figure 10).

Retirement Age: TPAF's normal retirement age for teachers hired is 65 years. NJEA Leadership's Plan's retirement age is 62.

Final Salary: TPAF's Final Salary is based on the average of a teacher's salaries over the last five years of service. The NJEA Leadership's Plan's Final Salary is based on the last three years. For teachers, whose salaries automatically step up every year and who

earn their highest salaries in their last years of service, it is more advantageous to use the average of the final three years rather than the final five years.[6]

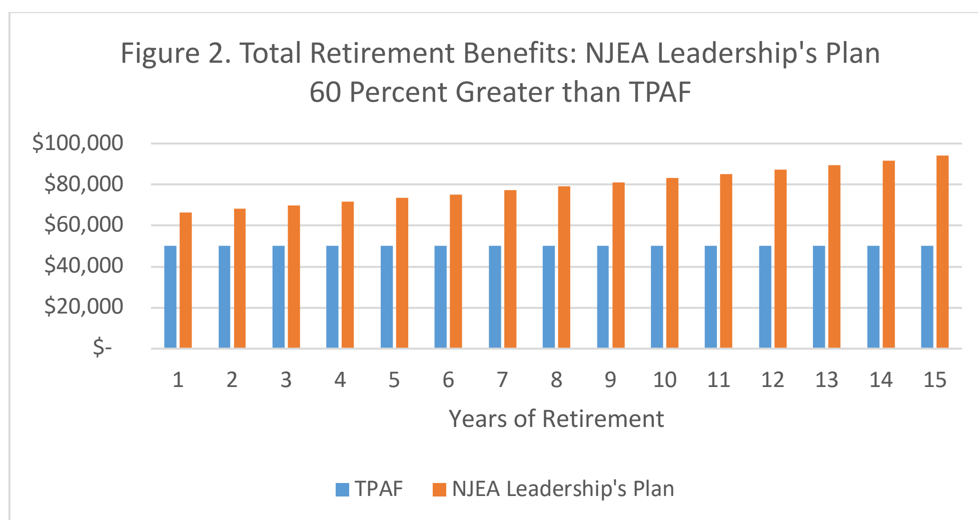
Years of Service (YOS) Multiplier: Both pension plans rely on a formula: YOS Multiplier x YOS x Final Salary. For TPAF, the retirement multiplier is 1.67 percent (1/60). The NJEA Leadership's Plan has a retirement multiplier of 2.0 percent (1/50) plus an additional three supplements of 1/2 to 2/3 of a percent depending on YOS.[7]

COLA: Very importantly, the NJEA Leadership's Plan provides a 2.5 percent annual cost-of-living adjustment (COLA), which means that the retiree's annual pension benefit compounds annually at 2.5 percent for every year of retirement. As will be seen below, the COLA makes an enormous difference in total pension benefits paid out over the length of a retirement. The longer the retirement, the greater the impact of the COLA.

Illustrative Example: For ease of comparison, we will assume a Final Salary of $100,000.[8] Thus, for a teacher retiring at 65 with 30 years of service:

> TPAF formula: 1.67% x 30 x $100,000 = $50,100 annual pension benefit
>
> NJEA Leadership's Plan formula: 2.0%-plus x 30 x $100,000 = $66,520 annual pension benefit, compounded annually with a 2.5 percent COLA.

With a 15-year retirement,[9] the total benefits under the TPAF formula would amount to $765,000. With its 2.5 percent COLA, the NJEA Leadership's Plan formula would result in total pension benefits of $1,192,832, or 60 percent greater than under the TPAF formula. Figure 2 shows the affect the COLA has on annual pension payments. All told, the NJEA Leadership's Plan formula is a great deal richer than the TPAF formula.

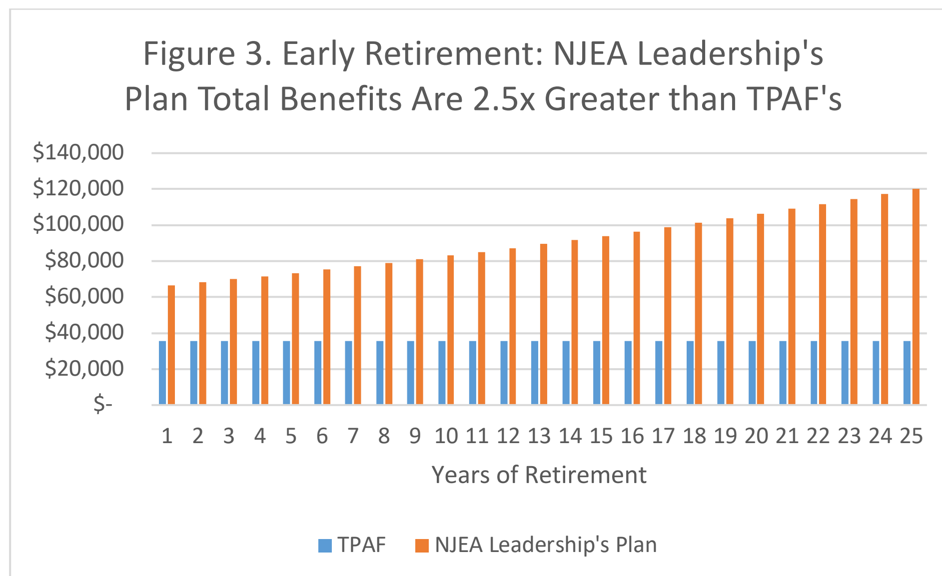


Source: TPAF Actuarial Valuation Report; 2018 IRS Form 5500.

Early Retirement: Under TPAF, a teacher with a minimum of 30 years of service may retire early, but if younger than 65 years, the teacher's pension benefit will be reduced by 3 percent for every year that the retirement date precedes 65. So for a teacher with 30 years of service who chooses to retire at 55, the annual pension benefit would be reduced by 30 percent.[10]

Under the NJEA Leadership's Plan, an employee with 20 years' service can retire early upon reaching the age of 55 without a penalty. So a 20-year NJEA employee could choose to retire at 55, not 62, and still receive a pension worth $1,566,133, which is 75 percent more generous than an early retirement pension under TPAF (see below). So the NJEA leadership have a real choice about retiring early after only 20 years of service. The teacher must work 30 years and then pay a substantial penalty, which is not much of a choice at all.

Illustrative Example. Figure 3 below compares the generosity of the two plans for a hypothetical teacher who retires at 55 with 30 years' service (the minimum years of service for TPAF). With the 30 percent early retirement penalty, the TPAF plan will pay a teacher $35,700 annually for 25 years for a total benefit amount of $892,500. Under the NJEA Leadership's Plan, with a COLA and no penalty, the total benefit payment over a 25-year retirement would be $2,272,174, or 2.5x greater than TPAF. But remember that the NJEA leadership also have a real choice to make: retire early at 55 with 20 years of service and still gain a substantially richer pension than a teacher's with 30 years of service. There is almost no comparison between the two plans.



Source: TPAF Actuarial Valuation Report; 2018 IRS Form 5500.

NJEA Leadership’s Gold-Plated Pensions: Ed Richardson’s $5.5 Million Pension

Sunlight Policy has documented the rich compensation packages for the NJEA executive staff – paid for by teachers’ highest-in-the-nation dues. Who can forget former Executive Director Ed Richardson’s 2015 compensation of $1.2 million – or about 17x what the average teacher made? Since we know NJEA Leadership’s Plan pensions are generous and that they are based on employee salaries, now that he is retired after 26 years with the NJEA, what would Ed Richardson’s teacher-funded pension look like?

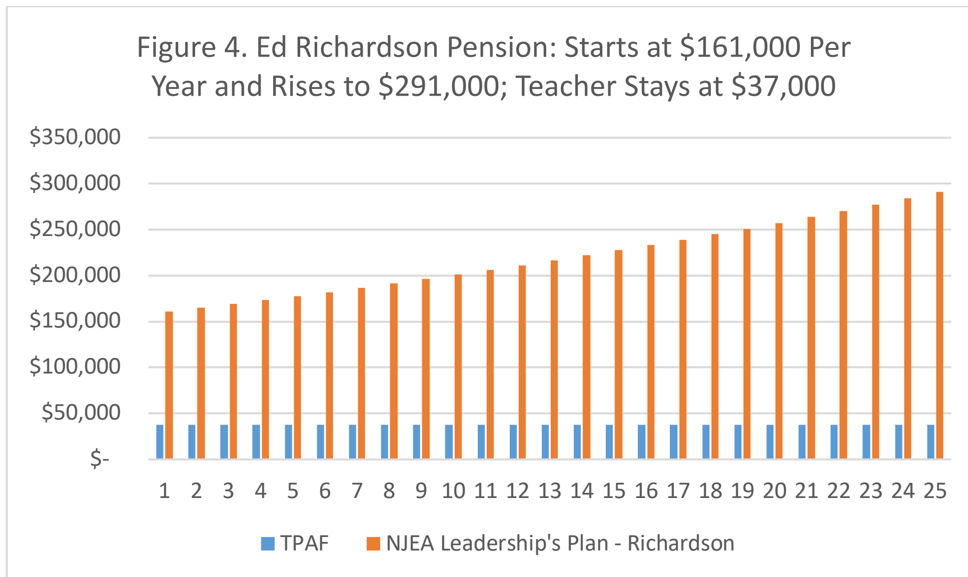
We do not have Richardson’s actual Final Salary numbers, but we do have his base salaries for 2015 to 2017, the latest data available. Richardson’s average base salary for those years far exceeded the $275,000 limit under the Internal Revenue Code,[11] so his Final Salary for his pension would be $275,000. Assuming Richardson retired at 55 with 26 years of service[12] and will have a 25-year retirement with a 2.5 percent annual COLA, his pension formula would be as follows:

> 2%-plus x 26yrs. x $275,000 = $160,930 annual benefit, compounded at 2.5% a year.

Assuming a teacher retires at 55 with 30 years of service, a Final Salary of $106,335,[13] a 25-year retirement, a 30 percent early retirement penalty, and no COLA, the TPAF formula would be:

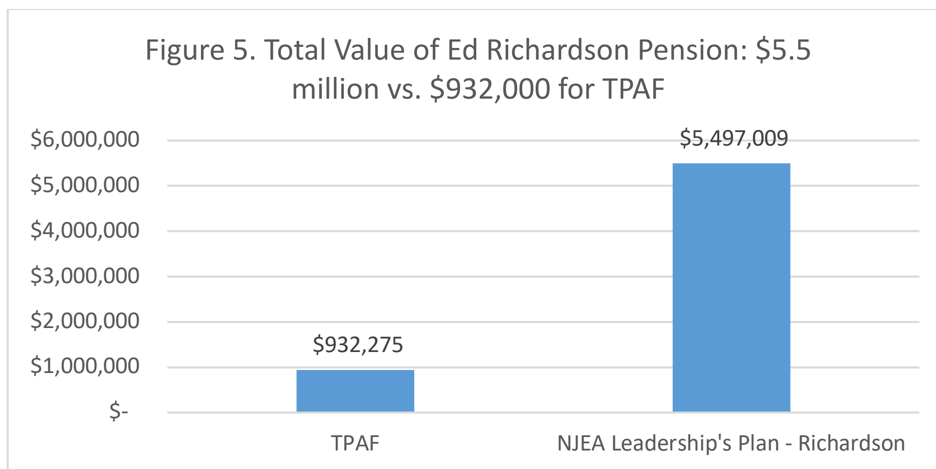
> 1.67% x 30yrs. x $106,335 = $53,273 annual pension benefit, less a 30% penalty for early retirement, for a total annual benefit of $37,291.

Figure 4 compares the hypothetical total pension benefits for Ed Richardson with the average teacher’s. Richardson’s pension starts at Year 1 with $161,000 and reaches $291,000 in Year 25. The teacher’s pension stays at $37,000 throughout her retirement.



Source: TPAF Actuarial Valuation Report; 2018 IRS Form 5500.

As shown in Figure 5, in total, over a 25-year retirement, Richardson's hypothetical pension amounts to a very generous $5,497,009, or $4,564,734 greater than the teacher's total of $932,275. Richardson's total pension would be 5.9 times larger than a teacher's. Note well that Richardson could work 26 years to get his gold-plated pension, while the teacher would have to work 30 years to get her much smaller one.



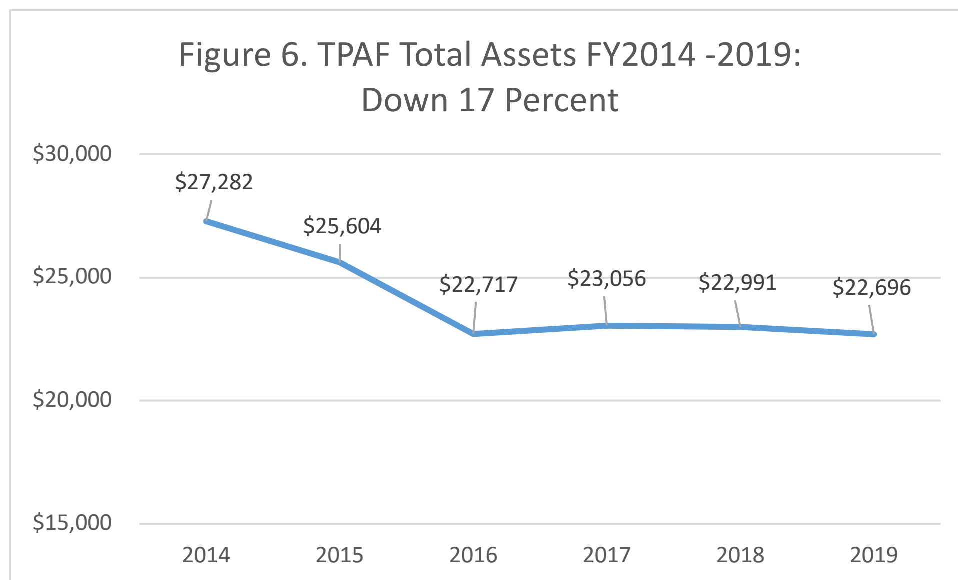
Source: TPAF Actuarial Valuation Report; 2018 IRS Form 5500.

That's a lot of teachers' dues going to Ed Richardson's very comfortable retirement.

II. TPAF Is Severely Underfunded and Puts Teachers' Pensions at Risk

Unfortunately for teachers, TPAF stands at the other end of the spectrum from the NJEA Leadership's Plan. Absent some sort of federal bailout, TPAF is at substantial risk of insolvency. But these hard facts have not been communicated to teachers. Teachers have been led to believe that their pensions are protected, but in an insolvency scenario, that would probably not be the case.

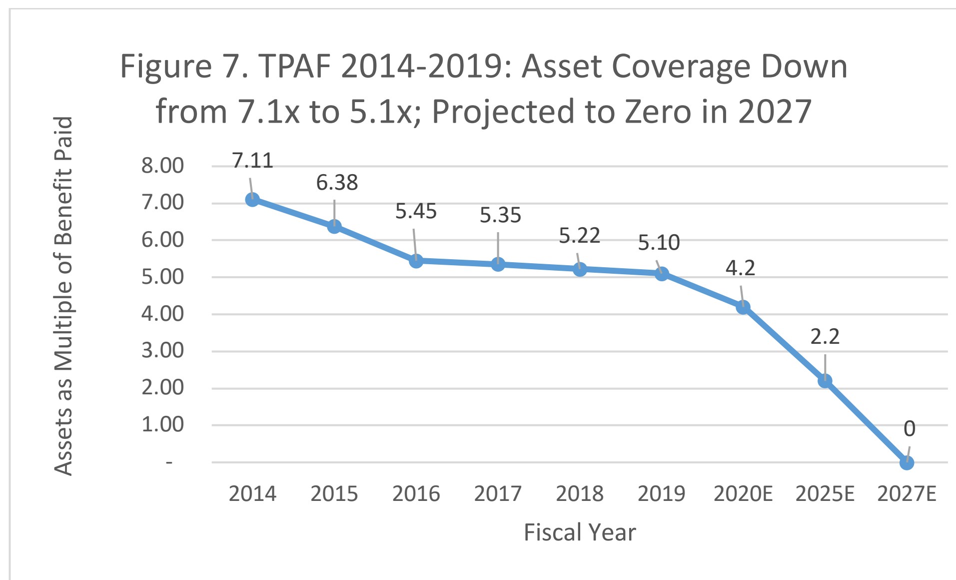
TPAF's actuary, Cheiron, stated: for the ten years from FY2010 to FY2019 "the average net cash flow as a percent of assets is -9.4%, which is greater then the long-term investment assumption."[14] That is, TPAF's investment returns were not sufficient to overcome the large negative gap between what was contributed to TPAF and what was paid out in benefits. So assets had to be sold to pay out benefits. This can be seen in Figure 6 below. Despite fairly strong market returns, from FY2014 to FY2019, TPAF's assets declined from $27.3 billion to $22.7 billion, or 17 percent.



Source: TPAF Actuarial Valuation Report

Meanwhile, the amount of pension benefits paid out annually continues to increase as more teachers retire and live longer lives.[15] This results in fewer and fewer assets being able to cover pension payments. This downward trajectory means that at some point in the near future, TPAF's assets will go to zero. Or, as Cheiron stated: a plan bleeding assets like TPAF "is expected to defund with increased risk of insolvency …"[16] Unfortunately, the fiscal effects COVID19 pandemic will likely accelerate TPAF's deterioration.

This is precisely the conclusion of the Center for Retirement Research at Boston College (CRR). As shown in Figure 7, CRR projects that TPAF, with its severely negative cash flow of -8.1 percent, will likely have only enough assets to cover two years of benefits payments after FY2025.[17] That is, TPAF will run out of assets in FY2027. The New Jersey Pension and Health Benefit Study Commission projected a 2027 depletion date as well.[18] Once TPAF is insolvent, the $4.5 billion-plus of TPAF benefit payments would have to be funded by appropriations from the state budget every year – a near-impossibility considering New Jersey's structural budget deficits. This would be a disaster scenario for TPAF beneficiaries.



Source: TPAF Actuarial Valuation Report and Center for Retirement Research

Teachers Have Not Been Informed of these Facts. The ugly truth is that the NJEA leadership has not been forthcoming with teachers about TPAF's woeful condition and its negative implications for teachers' pensions. In its monthly magazine for members, *NJEA Review,* the NJEA states that as of 2019, TPAF was funded at 40.3 percent.[19] But surely the NJEA leadership knows that this is based on the state's using unrealistic, outdated assumptions, a problem that the Government Accounting Standards Board addressed with its GASB 67 rule, which New Jersey implemented in 2015. GASB 67 uses more realistic assumptions to determine a pension plan's liabilities, and under the state's GASB 67 report, TPAF's funding stood at 27 percent, not 40.3 percent.[20] Nor does the *NJEA Review* mention the severely negative cash flows, the diminishing assets or the prospect of near-term insolvency. It merely speaks of TPAF taking decades to get healthy enough to restore COLAs, as if that is even remotely a possibility.

The Non-Forfeitable Right: Giving Teachers a False Sense of Security

In 1997, teachers gained the non-forfeitable right to their pensions, meaning that their promised future pension benefits could not be reduced. In 2010, the non-forfeitable right was repealed for new teachers, so there are currently 49,140[21] younger teachers without the non-forfeitable right. In an insolvency scenario, these teachers are the most vulnerable to pension reductions. They have the least legal protection and lack the clout of the career teachers who are most invested in the system and the biggest beneficiaries of TPAF.

But should TPAF become insolvent, even longer-serving teachers, who have been told that they are protected by the non-forfeitable right, may not be as protected as they have been led to believe.

Noted legal scholar Professor Amy B. Monahan of the University of Minnesota published an extensive study of the legal recourse available to pension beneficiaries if a pension fund becomes insolvent. In the study, Monahan devoted substantial research to New Jersey because it is one of the states most at risk for near-term insolvency. Monahan notes that in states like New Jersey that have strong statutory protection of pension benefits (such as the non-forfeitable right), "participants may have a false sense of security regarding the likelihood of payment."[22]

This appears to have happened with the NJEA. As discussed in Sunlight's previous pension report "Ugly Truths and Hard Facts About New Jersey's Pension Crisis, Part I," after the NJEA won the non-forfeitable right, the NJEA failed to ensure that TPAF was adequately funded. Rather, the NJEA helped undermine TPAF's funding by participating in legislative deals that depleted assets, enhanced benefits and blocked all reform attempts. This may have severe consequences in an insolvency scenario.

A TPAF Insolvency Would Threaten Teachers' Pensions

The two most likely options to resolve a TPAF insolvency would be a process along the lines of federal bankruptcy law or one based on state law. In either case, TPAF pensions would be vulnerable to a restructuring, with reduced benefit payments for teachers and retirees.

In a Federal Bankruptcy Process, Unfunded Pension Liabilities Could Be Cut. While there is currently no bankruptcy code for states, it is possible to look at municipal bankruptcies under the federal Bankruptcy Code to determine how a federal bankruptcy process might play out in New Jersey. Should federal bankruptcy laws be employed, they would override state laws and even the New Jersey constitution under

the Supremacy Clause of the US Constitution.

Under federal bankruptcy law, New Jersey's failure to fund TPAF would put teachers in the precarious position of being unsecured creditors of the state. Assets that have been set aside by the legislature for specific purposes are fully protected from creditors. In the public pension context, this means that payments that have been made to fund TPAF are available only to TPAF beneficiaries.[23] But unfunded pension liabilities are unsecured claims that can be restructured.[24]

This differential treatment has played out in municipal bankruptcy cases, which have often involved cities with large, unfunded pension debts. Regarding these cases, the Congressional Research Service concluded that public employees – even those with the non-forfeitable right – "face a significant risk that their pensions will ultimately not be fully repaid."[25] Indeed, in the case of Detroit's bankruptcy, public-pension beneficiaries received approximately 60 percent of the unfunded portion of their benefits.[26] TPAF is currently 73 percent unfunded, and in a Detroit scenario, teachers would see their pensions reduced by 30 percent. The ugly truth is that all New Jersey teachers should be very concerned about the possibility of a TPAF insolvency that followed current federal bankruptcy law.

This conclusion is supported by former San Jose Mayor Chuck Reed. Reed confronted a severely underfunded municipal pension system and fought for years to save San Jose from bankruptcy. Reed knew that in a bankruptcy, unfunded pension liabilities would be subject to cuts just like San Jose's other unsecured liabilities:

> The most interesting question for me is, what will it take for the [public] employee unions to decide underfunding their pension benefits is bad for their members? … I tell people, the part of your pension that's underfunded … is on the bargaining table in a bankruptcy. Where you want to be as an employee is 100% funded, so that if the jurisdiction files bankruptcy, that 100% is off the table.[27]

It bears repeating: TPAF is 27 percent funded. The remaining 73 percent would be on the table.

In an Insolvency Under State Law, Pensions May Not Be Safe. Absent some sort of federal bankruptcy process, an insolvency would play out according to New Jersey law. Yet the outcome may be no better for TPAF beneficiaries. Monahan concludes that in such an insolvency, a pensioner would have the legal right to her benefits and could even have that right vindicated in court, but that a court cannot force the state to make the pension payments. As Monahan says, New Jersey's pension protection laws are "unlikely to provide effective recourse to retirees due to the inability

of courts to force legislatures to appropriate funds, raise taxes or incur debt." In other words, even under New Jersey law, "pension fund insolvency leaves payment of benefits in doubt."[28]

Ultimately, Monahan argues that pensioners would have to depend on politicians voluntarily making the necessary appropriations: "The payment of pension benefits in the event of fund depletion will come down to the political will to pay such benefits."[29] It would be "a political question, and not a legal one."[30] But it would be a political question in the middle of a crisis, and pensioners' claims would have compete with other necessary government functions like school aid, public security, healthcare and transportation. No doubt it would be of great concern to TPAF pensioners that the fate of their pensions could rest on the goodwill of politicians in the middle of a crisis.

Yet Teachers Are Unaware. The bottom line is that the NJEA leadership has not communicated these unpleasant possibilities to its members. Teachers and retirees are thus unaware of the threat to their retirements and the need for meaningful reforms. Apparently, this state of ignorance is precisely where the NJEA leadership wants them to be.

III. The Majority of Younger Teachers Lose Money by their Forced Participation in TPAF

A *New York Times* study of teacher pensions concisely captured the prevailing reality:

> As teachers across the country retire, their pensions are being subsidized by newly hired teachers to a surprising degree. ... [A]s more and more plans develop shortfalls states have been imposing cost-cutting measures, and recent research shows that the newest hires are bearing the brunt of the changes, raising questions of fairness.[31]

This is precisely what has occurred in New Jersey. New and younger teachers -- those who were hired after the 2010 and 2011 Christie-Sweeney pension reforms[32] -- saw their contribution rates go up, their benefits cut and their work requirements increased.[33] In order to reduce the prohibitive cost of pensions for the state, lawmakers enacted the following reforms:

- Teacher contribution rates were increased to 7.5 percent of salary from 5.5 percent for all teachers.
- Retirement age raised to 65 from 60.

- YOS Multiplier dropped from 1.82 percent (1/55) to 1.67 percent (1/60).
- Years of service required for early retirement increased from 25 years to 30 years.
- Early retirement penalties were increased to 3 percent per year for each year under age 65.
- Final Salary becomes the average of the final five years rather than the final three.
- Annual cost-of-living adjustment (COLA) stopped for all teachers and retirees.
- Non-forfeitable right to pensions repealed, so teachers hired after 2010 can have their future benefits reduced.

Other aspects of TPAF remained the same, but these also hurt new and younger teachers. If a teacher leaves the teaching profession[34] or leaves the state, the pension does not travel, nor do service years. As the Urban Institute concluded: "State pension plans have fallen behind the needs of a modern, mobile workforce ..." They offer "little to young workers who want the flexibility to accommodate family obligations and changing work opportunities and who do not stay with the state their entire careers."[35]

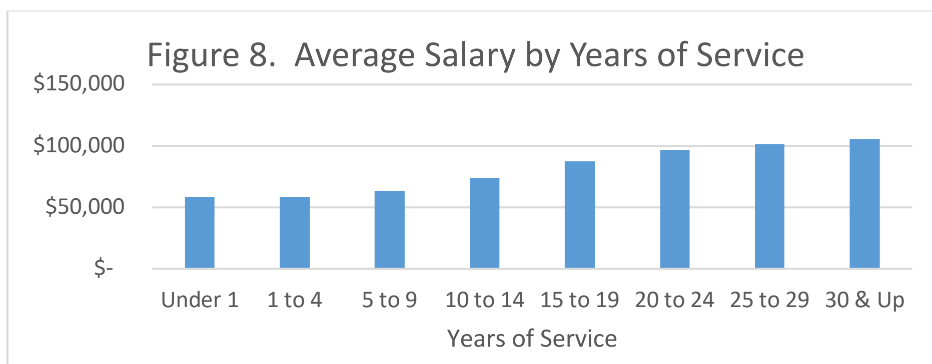
TPAF Benefits Longer-Serving Teachers

TPAF's pension formula is: YOS Multiplier x YOS x Final Salary.[36] The pension formula benefits longer-serving teachers in three ways:

1. Teachers who were hired before 2010 have a 9 percent higher YOS Multiplier than teachers hired after 2010.

2. Longer-serving teachers perforce have more YOS.

3. Because teachers' salaries are back-end loaded, they see larger salary gains as they move along in their career, and the Final Salary is based on the last three-to-five years of service. Figure 8 below shows the backend-loaded nature of teachers' salaries.



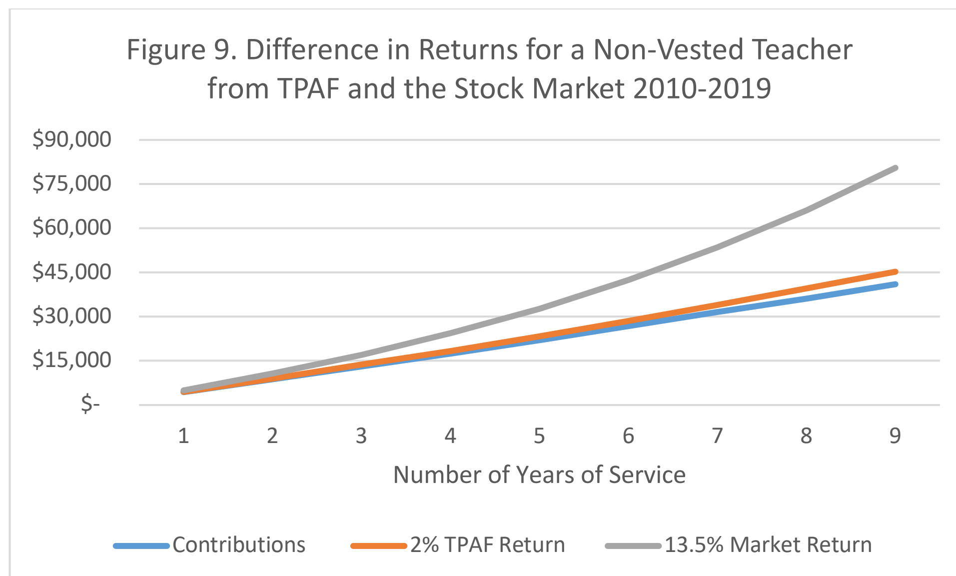
Source: TPAF Actuarial Valuation Report

Teachers Who Never Vest Lose Thousands of Dollars in Retirement Savings

Every year, teachers must contribute 7.5 percent of their salaries to their pensions but only vest in TPAF once they have completed 10 years of service. Currently, 45 percent of teachers never vest.[37] The 20 percent of teachers who leave before completing three years[38] get only their contributions refunded. Teachers who complete three years but do not complete 10 years will receive back their accumulated deductions plus 2 percent interest. All non-vested teachers who leave the profession or the state lose out on the state contributions to TPAF on their behalf. This invested capital instead remains in the system and subsidizes those who remain in TPAF.

This presents a substantial loss for the 45 percent of teachers who do not complete 10 years of service. Today's non-vested teachers, who joined TPAF from 2010 to 2019, could have invested this money in the stock market and earned a compound annual return of 13.5 percent[39] rather than have it sit with TPAF and earn 2 percent a year.

Figure 9 below shows the difference between the actual 13.5 percent market return and the 2 percent return. The numbers indicate that had a non-vested teacher been able to invest in the stock market (via a 401(k), for example), she would have made a cumulative $9,294 more over five years, and an eye-popping $35,254 over nine years.[40] These numbers reflect the true opportunity cost for today's young, non-vested teachers who leave teaching.

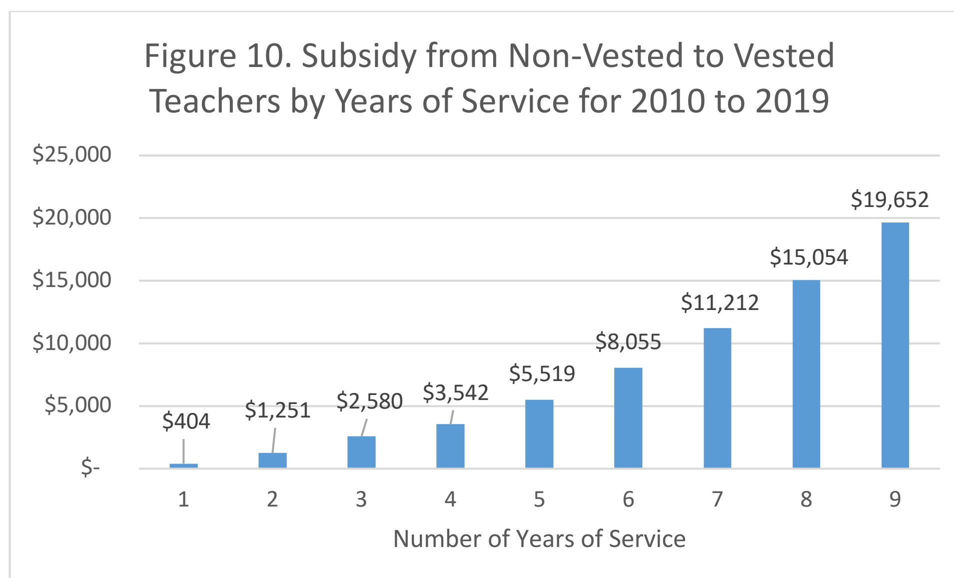


Source: TPAF Actuarial Valuation Report

And Subsidize Vested Teachers with Low-Interest Loans

In effect, these non-vested teachers are being forced to subsidize TPAF and its vested beneficiaries with low- or no-interest loans. For the 25% of teachers who do not complete three years,[41] their TPAF contributions are effectively interest-free loans. Those who work for more than three years are making 2 percent loans to TPAF.

TPAF is thus borrowing money from non-vested teachers at zero or two percent and then investing the proceeds and keeping any returns above zero or two percent for the benefit of its vested members. From 2010 to 2019, TPAF earned a compound average of 9.23 percent per year on its investments,[42] so TPAF was netting over 7 percent a year off of these cheap loans, which compounded. Figure 10 shows how much on average these subsidies are. For example, on average, a teacher who leaves teaching after five years will have provided a $5,519 subsidy to vested teachers, or over $1,100 per year of service. Similarly, teacher who leaves after 9 years will have provided a subsidy of $19,652, or over $2,100 per year of service.[43]



Source: TPAF Actuarial Valuation Report

Even Vested Teachers Need Long Careers to Break Even

As bad as it is for young, non-vested teachers, many teachers who complete 10 years of service and vest will also lose money if they choose not to make teaching in New Jersey a life-long career.

Three separate studies[44] looked at TPAF and determined the number service years it would take for pension payouts to exceed the value of the contributions (the so-called "break-even" rates). These studies found that because the TPAF's pension formula

benefits career teachers, it takes a substantial number of years for the promised pension benefits to exceed the amount of money contributed, which could have been invested in the market.

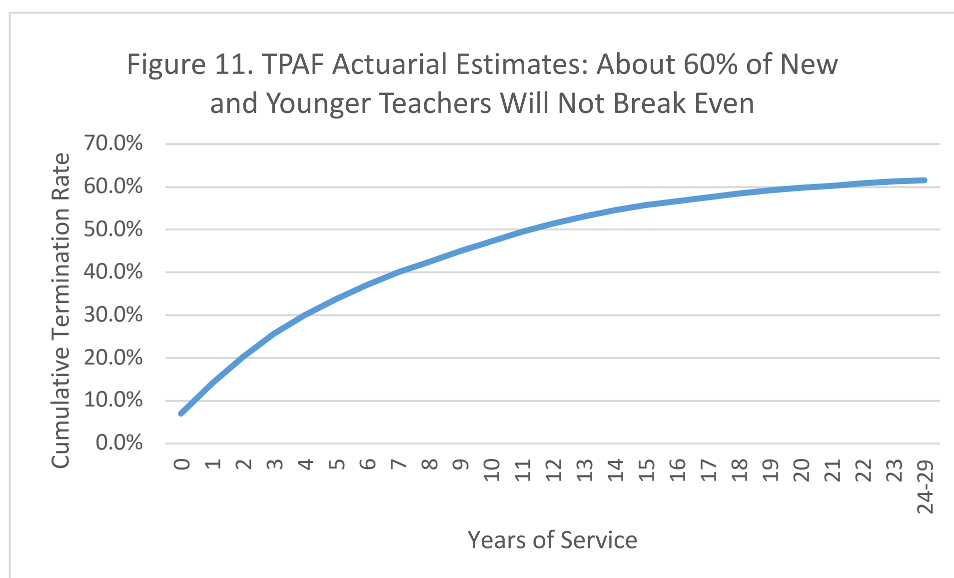
Accordingly, Table 2 shows that break-even rates range from 18 to 30 years for new and younger New Jersey teachers, which inevitably results in a majority of teachers losing money on their pensions and subsidizing the minority. So even teachers who do vest have to work for an additional 8 to 20 years before their pension benefits are greater than what they have paid into the system.

Table 2

Study	Break Even	Will Break Even	Will Not Break Even
TeacherPensions.org	30 yrs.	44%	56%
Equable	25 yrs.	48%	52%
Fordham Institute	18 yrs.	-	-

Sources: TeacherPensions study, Equable study, Fordham study.

TPAF's own actuarial estimates for teacher termination rates present an even bleaker picture. As Figure 11 shows, a break-even of 18 years of service would result in 58.5 percent of teachers losing money and subsidizing the other 41.5 percent. For 25 and 30 years of service, the percentage of teachers losing money reaches 61.6 percent, leading to their subsidizing the remaining 38.4 percent.



Source: TPAF Actuarial Valuation Report

The *TeacherPensions.org* study concluded: "Instead of benefiting from their pension plans, most teachers are net contributors. Recent pension reforms [like the Christie-Sweeney reforms], focused mainly on cutting costs, generally make this situation worse

and force new teachers to work even longer before they benefit from their plans."[45] This is clearly the case in New Jersey: 60 percent of today's younger teachers will have been forced to lose money and subsidize the remaining 40 percent. TPAF is manifestly an unfair system for these teachers.

Implications for Equity

There is also a question of how this unfairness to younger teachers affects equity. Studies of other states have shown that older teachers with longer careers -- those more likely to vest and exceed pension break-evens -- congregate in low-minority school districts. High-minority school districts tend to have younger, more junior teachers, who are not benefiting from the public funding for the pension system. This has implications for overall fairness as well as for teacher recruitment and turnover. Moreover, pension dollars contribute to the overall amount of public funds that go into a school system, so the more money siphoned off to fund pensions, the less that is available for state aid to high-minority school districts.[46] These broader consequences of an unfair pension system could in turn harm the quality of the education that minority students are getting.

A thorough analysis of New Jersey's high-minority school districts is needed to determine whether these districts have a greater proportion of younger teachers, who tend to lose money in the current pension system, and whether this has implications for teacher recruitment and turnover.

Whatever school district they are in, today's new and younger teachers are ill-served by the pension system they are forced to join.

Conclusion: Teachers Must Demand Better

San Jose Mayor Reed knew where to point the finger: "When the public employee unions decide that underfunding pensions is cheating their members, maybe they'll decide some kind of reform is appropriate."[47]

That is what has happened in New Jersey. The NJEA cheated its members by allowing TPAF's funding to deteriorate to where three-quarters of TPAF's pension promises are unfunded. Yes, when the NJEA participated in these political deals, the NJEA gained benefit enhancements and legal protections, but these would be of little worth if TPAF becomes insolvent.

In an insolvency crisis, this severe underfunding of TPAF could have profoundly negative implications for the full payment of TPAF benefits. Under a federal-style

bankruptcy process, TPAF's massive unfunded pension promises – even for retirees – would likely be on the chopping block. And under state law, if the need to fund pension benefit payments from the state budget impairs the state's ability to exercise the basic functions of government, courts cannot force the legislature to spend money or incur debt. In these scenarios, the non-forfeitable right would offer little protection.

The bottom line is that the status quo is putting teachers at risk, not protecting them, and the NJEA leadership is not communicating the reality of the situation.

Teachers need to demand the truth. They need to demand answers for why their leadership allowed their retirements to be put at risk. They need to ask why the NJEA leadership has secured their own gold-plated pensions but not those of the teachers, whose highest-in-the-nation dues pay for them.

Most importantly, teachers need to recognize these ugly truths and hard facts and demand reforms that secure their retirements and make the system fair for all teachers. Those reforms are out there – most notably Senate President Steve Sweeney's *Path to Progress* – and provide a starting point for serious discussions about how to save teachers' pensions and put New Jersey's pension system back on a sustainable path. But the NJEA leadership has steadfastly dismissed the need for reforms and continues to "oppose all elements" of *Path to Progress*.[48] A teacher would be justified in asking if that would be the case if the leadership's own pensions were at risk.

Teachers must demand better from their NJEA leadership.

APPENDIX A

Terms of the Teachers' Pension and Annuity Fund (five Tiers of beneficiaries) and NJEA Employees' Retirement Plan (two tiers of beneficiaries)

TPAF Terms	Tier 1	Tier 2	Tier 3	Tier 4	Tier 5
Start date of covered employees	Before 7/1/2007	7/1/2007 - 11/1/2008	11/2/2008 - 5/21/2010	5/21/2010 - 6/27/2011	After 6/28/2011
Vesting (years)	10	10	10	10	10
Normal Retirement Age	60	60	62	62	65
Years of Service Multiplier	1.82%	1.82%	1.82%	1.67%	1.67%
Number of Years for Final Salary	Top 3	Top 3	Top 3	Top 5	Top 5
Years of Service for Early Retirement	25	25	25	25	30
Non-Forfeitable Right	Yes	Yes	Yes	No	No
Early Retirement Penalty (per year)	3% before 55	1% 55-59, 3% before 55	1% 55-61, 3% before 55	1% 55-61, 3% before 55	3% before 65
COLA	None	None	None	None	None
Employee Contributions (% of salary)	7.5%	7.5%	7.5%	7.5%	7.5%

Source: TPAF Actuarial Valuation Report

NJEA Plan Terms	Tier 1	Tier 2
Start date of covered employees	Before 9/1/2004	After 9/1/2004
Vesting (years)	None	5
Normal Retirement Age	55	62
Years of Service Multiplier	2% Plus*	2% Plus*
Number of Years for Final Salary	Last 3	Last 3
Years of Service for Early Retirement	20	20
Early Retirement Penalty (per year)	None	1.2% before 55
COLA	2.50%	2.50%
Employee Contributions (% of salary)	3.5%	3.5%

* Tier 1 beneficiaries can qualify for all three supplemental multipliers; Tier 2 can qualify for two. See Appendix B for formula and source.

APPENDIX B

NJEA Leadership's Plan pension formula

Final Salary is average basic salary earned during the last 3 years of employment, but not greater than the IRS 401(a)(17) limit ($275,000).

1. 2% (1/50) x Years of Service x Final Salary; plus

2. 0.5% (1/200) x Years of Service x Final Salary for 5 years of continuous service up to 2000; plus

3. 0.67% (1/150) x Years of Service x Final Salary for number of years of continuous service between years 16 and 20, inclusive; plus

4. 0.67% (1/150) x 26th Year of Service x Final Salary.

Source: New Jersey Education Association Employees' Retirement and Trust Fund, IRS Schedule SB of Form 5500 2018, Part V – Summary of Plan Provisions, https://burypensions.files.wordpress.com/2020/08/njea-5500.pdf. Thanks to *BuryPensions* for downloading a PDF.

ENDNOTES

[1] Andrea Riquier, "Chuck Reed warned of city services 'insolvency' after the Great Recession. He thinks the corona-crisis may be worse." *Marketwatch.com*, August 27, 2020, https://www.marketwatch.com/story/chuck-reed-warned-of-city-services-insolvency-after-the-great-recession-he-thinks-the-corona-crisis-may-be-worse-11598540258.
[2] NJEA Employees' Retirement and Trust Fund, which covers the NJEA leadership and other NJEA employees. See Appendix A for a description of the plan.
[3] The 137 percent funded ratio results from using a 5.69 percent discount rate. New Jersey Education Association Employees' Retirement and Trust Fund, IRS Schedule SB of 2018 Form 5500, 1, https://burypensions.files.wordpress.com/2020/08/njea-5500.pdf. Hereinafter, "IRS Form 5500." (Thanks to BuryPensions for downloading a PDF). The NJEA Auditor's Report as presented in the *NJEA Review* calculates the NJEA Leadership's Plan's funded ratio as 99 percent for 2018. The auditors use a conservative discount rate of 4.19 percent versus the 5.69 percent used in IRS Form 5500. TPAF's GASB 67 discount rate for 2018 was 4.86 percent, which blends the rates for TPAF's funded and unfunded liabilities. Per GASB, because the NJEA Leadership's Plan is fully funded, it could use a higher discount rate that is closer to the plan's investment return assumption of 7.50 percent. Therefore, Sunlight believes that when comparing the NJEA Leadership's Plan to TPAF, it is appropriate to use IRS Form 5500's discount rate of 5.69 percent because it is higher than TPAF's 4.86 percent, which reflects the reality of the NJEA Leadership's Plan's fully funded status.
[4] See Appendix A for a comparison of the two plans' terms for the various tiers of beneficiaries.
[5] The median salary for a New Jersey teacher is $68,650 at a contribution rate of 7.5 percent, equaling $5,148.
[6] See Appendix A for a break-down of the Final Salary formulas for the various tiers of TPAF.
[7] See Appendix B.
[8] $100,000 is used for ease of comparison. A teacher 55 or older with 30 years or more of service averages $106,335 in annual salary. Cheiron, "Teachers' Pension and Annuity Fund of New Jersey, Actuarial Valuation Report as of July 1, 2019," New Jersey Division of Pensions & Benefits, April 2020, 51, https://www.state.nj.us/treasury/pensions/documents/financial/actuarial2019/2019tpaf.pdf (hereinafter "Actuarial Valuation Report").
[9] The average life expectancy in New Jersey is 80.4 years, allowing for a 15-year retirement.
[10] IRS Form 5500.
[11] Richardson's base salaries: 2015 - $339,771; 2016 - $351,406; 2017 - $362,305. NJEA IRS Form 990, 2015-2017.
[12] Richardson retired in 2019 after 26 years of service. Therefore, he would qualify for all three of the supplemental benefits under the NJEA Employee Plan. According to LinkedIn, Richardson graduated from college in 1983, so he was almost certainly not younger than 55 when he retired and thus would not accrue any penalty. See Appendix B.
[13] See Endnote 8.
[14] Actuarial Valuation Report, 8.
[15] During the same period, liabilities increased 3.8 percent. TPAF Valuation Reports 2014-2019.
[16] Actuarial Valuation Report, 8.
[17] Jean-Pierre Aubry, Alicia H. Munnell, and Kevin Wandrei, *2020 Update: Market Decline Worsens the Outlook for Public Plans,* Center for Retirement Research at Boston College, May 2020, https://publicplansdata.org/2020/05/12/2020-update-market-decline-worsens-the-outlook-for-public-plans/.
[18] New Jersey Pension and Health Benefit Study Commission, "A Roadmap to Resolution," February 24, 2015, 4.
[19] Sarah Favinger, "Pension funding update," *NJEA Review* vol. 94, no. 1 (September 2020), https://www.njea.org/pension-funding-update/.
[20] Cheiron, "GASB 67 Report as of June 30, 2019," New Jersey Division of Pension and Benefits, March 2020, 8, https://www.nj.gov/treasury/pensions/documents/financial/gasb/gasb67-tpaf19.pdf. The 40.3 percent funded ratio uses a 7.3 percent discount rate for the liabilities, which is the investment return assumption. This very high discount rate results in lower measure of liabilities and a higher funded ratio. GASB 67 uses the investment return assumption (7.3 percent) as the discount rate for funded liabilities,

but uses a lower discount rate for unfunded liabilities, arriving at a more realistic, blended discount rate of 5.60 percent. This results in a 27 percent funded ratio.

[21] Actuarial Valuation Report, 47.

[22] Amy B. Monahan, "When a Promise is Not a Promise: Chicago-Style Pensions," University of Minnesota Law School, Legal Studies Research Paper Series Research Paper No. 16-17, May 9, 2016, 51, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2777736. (Hereinafter, "Monahan.")

[23] This perhaps explains why the NJEA is so keen to make the state pay as much as possible into the pension system, even though this represents throwing good money after bad. In its FY2021 budget, at the urging of the NJEA, the state made a record $4.7 billion payment and Governor Murphy has committed to ramping up pension contributions further. While these payments are unlikely to save TPAF from insolvency, it does mean that there will be more and more assets shielded from other creditors should insolvency occur.

[24] David Skeel, "State Bankruptcy Revisited," *National Affairs*, vol. 44 (Summer 2020), 66. Hereinafter "Skeel."

[25] Kevin M. Lewis, "When the City Goes Broke: Pensions, Retirees and Municipal Bankruptcies," Congressional Research Service, April 10, 2018, https://fas.org/sgp/crs/misc/LSB10116.pdf.

[26] Skeel, 66.

[27] Andrea Riquier, "Chuck Reed warned of city services 'insolvency' after the Great Recession. He thinks the corona-crisis may be worse." *Marketwatch.com*, August 27, 2020, https://www.marketwatch.com/story/chuck-reed-warned-of-city-services-insolvency-after-the-great-recession-he-thinks-the-corona-crisis-may-be-worse-11598540258.

[28] Monahan, 1. Monahan differentiates *Robinson v. Cahill*, where the New Jersey Supreme Court forbade all educational expenditures until the state satisfied the constitutional requirement of a "thorough and efficient" education for all students. This created pressure on the legislature to either have no education system or a compliant one, and the legislature relented. But Monahan concludes that in the case of pensions, "it may be difficult to find funds sufficiently related to pensions to sequester that would not also bring about severe collateral harm" so that the court would be unwilling to impose the sanction. Monahan, 34.

[29] Monahan, 55.

[30] Monahan, 56.

[31] Karl Russell and Mary Williams Walsh, "The State of Teachers' Pension Plans," *The New York Times,* March 6, 2017, https://www.nytimes.com/interactive/2017/03/06/business/dealbook/state-teachers-pensions.html.

[32] P.L 2010, Ch. 1 and P.L. 2011, Ch. 78.

[33] See Appendix A for the various changes to TPAF over the years.

[34] An exception is if the teacher accepts a position covered by a different New Jersey State-administered retirement system. New Jersey Division of Pensions & Benefits, "Teachers' Pension and Annuity Fund Member Guidebook," February 2020, 11, https://www.state.nj.us/treasury/pensions/documents/guidebooks/tpafbook.pdf (hereinafter "TPAF Guidebook").

[35] Richard W. Johnson, C. Eugene Steuerle, and Caleb Quackenbush, "How Pension Reforms Neglect States' Recruitment and Retention Goals," Urban Institute, Program on Retirement Policy, Older Americans' Economic Security, Number 31, July 2012.

[36] See Appendix A for a full break-down on the various tiers of TPAF beneficiaries.

[37] Actuarial Valuation Report, 55.

[38] Ibid.

[39] Moneychimp, Compound Annual Growth Rate (Annualized Return) Calculator, *moneychimp.com*, http://www.moneychimp.com/features/market_cagr.htm.

[40] Using average salaries for each cohort of teachers and the 7.5 percent annual contribution requirement. Actuarial Valuation Report, 51.

[41] Actuarial Valuation Report, 55.

[42] Actuarial Valuation Report, 34.

[43] Sunlight's calculations using Actuarial Valuation Report data on yearly teacher attrition rates (p. 55), average teacher salaries by years of service (p. 47), average compounded annual return on TPAF investments for 2010 to 2019 (p. 34), and the amount of refunds to non-vested teachers who leave teaching (p. 69).

[44] Chad Alderman and Richard W. Johnson, “Negative Returns: How State Pensions Shortchange Teachers,” TeacherPensions.org, Urban Institute, Bellwether Education Partners, September 2015, https://www.urban.org/sites/default/files/publication/71521/2000431-Negative-Returns-How-State-Pensions-Shortchange-Teachers.pdf (hereinafter, “TeacherPensions study”); Equable Institute, “Teachers' Pension & Annuity Fund at a Glance,” *equable.org*, accessed September 18, 2020, http://s30683.p1166.sites.pressdns.com/wp-content/uploads/2019/09/Equable_Infographic_NJ.pdf (hereinafter, “Equable study”); and Martin F. Lueken, “(No) Money in the Bank: Which Retirement Systems Penalize New Teachers?” Thomas B. Fordham Institute, January 2017, 17, https://fordhaminstitute.org/national/research/no-money-bank-which-retirement-systems-penalize-new-teachers (hereinafter, “Fordham study”).

[45] TeacherPensions study, 2.

[46] Marguerite Rosa and Katherine Hagan, “The Equity Problem in Teacher Pensions,” Edunomics Lab at Georgetown University, January, 2017.

[47] Andrea Riquier, “Chuck Reed warned of city services ‘insolvency’ after the Great Recession. He thinks the corona-crisis may be worse.” *Marketwatch.com*, August 27, 2020, https://www.marketwatch.com/story/chuck-reed-warned-of-city-services-insolvency-after-the-great-recession-he-thinks-the-corona-crisis-may-be-worse-11598540258.

[48] New Jersey Education Association, “Gov. Murphy pocket vetoes Path to ‘Progress' legislation,” *NJEA Review* vol. 93, no. 7 (February 2020), https://www.njwa.org/gov-murphy-pocket-vetoes-path-to-progress-legislation/.

SUNLIGHT

POLICY CENTER

OF NEW JERSEY