Analysis of the Supplemental Employee Retirement Plan (SERP)

The decision to retire is a highly personal one. It is affected by how much you enjoy your current work, planning for future activities such as travel or leaving an estate to heirs, and guesses about future health, expected years of life or planning for future health expenses. Some of these considerations are financial and some are not.

AFT 2121 has done an extensive analysis of the SERP proposed by the District to determine which of our members would benefit financially from the program and which would not. **We will first present an analysis for full-time faculty members and then for part-time faculty.** One very general conclusion can be stated at the outset. <u>For a all faculty members looking forward to working three or more years into the future, the SERP does not provide sufficient financial incentive to change those plans. But for other faculty, closer analysis is necessary.</u>

The analysis of the current SERP offer is more complex than in previous years as a result of the changes to the salary schedule in the new contract. The number of years of service to the college has become a more important factor. It is also true that for those younger than 63, each year of service adds more to the CalSTRS benefit than for those already 63. The analysis that follows assumes someone 63 or older.

Before the current contract, the salary schedule included only 17 steps. Because prior salary increases had been relatively meager, the best way for someone who had been on step 17 for many years to increase their CalSTRS benefit was to work additional years. Each additional year of service increased their benefit by 2.4 percent.

Under the new contract, step placements reflect the total number of years of service to the college and for the current academic year a new "longevity step" was implemented for salary columns F through G for those on step 25 or above. This longevity step was the equivalent of three annual step increases and increased the salaries of those affected by 10.6 to 12.6 percent. These salary increases generated potential CalSTRS benefit increases of between 15 and 17 percent. <u>This change, by itself, makes retirement both more feasible and attractive.</u> Also, because salaries are now higher, the dollar value of the SERP offer is higher.

<u>For any faculty on step 25 or above who were planning on retiring either this year or next year, it is financially beneficial to accept the SERP offer.</u> <u>If a faculty member on step 25 or above was thinking about working another two years, the picture is less clear.</u> Over a ten-year time horizon, there is a financial advantage to continuing to work, and this advantage increases every year after year ten. The advantage Is true for all columns, but it increases with movement from column E through G. In this case, <u>the faculty member must weigh the financial gain relative to working for two more years</u>.

In the 2019/20 academic year, a longevity step for those on steps 23 and 24 will be implemented and will result in wage increases of between 7.5 and 8.2 percent for faculty currently on steps 22 or 23 if they work another year. For faculty currently on step 24, if they work another year, they will receive the full effect of the step 25 longevity step. <u>As a result, for faculty currently on steps 22, 23, and 24, there is a significant long-term financial advantage to continuing to work even one more year</u>. For these faculty, accepting the SERP is probably not a good idea.

In all our simulations, we have made the following assumptions, because they generate the most positive outcome in supporting the SERP:

- The member selects the <u>5-year monthly payment</u> option if they are going to immediately roll-over the payments, tax-free, into a 403(b) account paying 2%, if they want their nest egg to grow a quickly as possible. <u>The 2% return is based on investments in Treasury bonds which are unlikely to decline in value even during recessions</u>. *If the expected rate of return is higher, the SERP becomes more financially viable*,
- The member selects the <u>9-year monthly payment</u> option if they are going to spend the payments, which maximizes the total dollar amount of payments,

We are presenting <u>three scenarios</u>, based on the age, years of service and salary schedule position of a particular faculty member. For each scenario, there are two options:

1. The faculty member immediately rolls-over the SERP payments, tax-free, into a 403(b) account, to build a nest egg for heirs or future expenses, **(*note: this 403(b) account must be in place before retirement.*)**
2. The faculty member spends the entire amount of the SERP payments and does not make any investment.

Scenario 1 assumes:

- The faculty member is currently on column G, Step 25,
- The faculty member is 63 or older, so they qualify for the 2.4% CalSTRS age factor
- The faculty member has 25 years or more of service, so their pension benefit is based on their highest single year of salary

Under Option 1, in which the member retires this spring and invests the SERP payments, over a period of ten years, their total CalSTRS pension income would be $720,000. At the end of this period, their 403(b) account would be worth $93,600. If they work for two more years, over that same ten years, their total income would be $911,000, a difference of $191,000. (*If the rate of return on the 403(b) was 5%, the account would be worth $112,000.*)

Of course, part of that $191,000 difference is the extra income they received from their salary during the two extra years of work. If the difference between their salary and their potential pension benefit is excluded, the benefit of working the extra two years is reduced to $84,000. This amount is somewhat less than the value of the 403(b) account had the person taken the SERP. However, for every year after this, the annual pension benefit for the person taking the SERP be $72,000, but for those working two more years it would be $82,500, a difference of $10,500. If this person lives an addition 10 years, the total difference would be an additional $105,000. The benefit of continuing to work increases significantly as life span increases. This is true for every scenario.

Under Option 2, in which the member retires, selects the 9-year payment option, and spends the SERP payments, over a period of ten years, their total income would be $803,000. If they had worked two more years, their total income would be $911,000, or a difference of $108,000. If we again exclude the additional salary amount, the difference is just $19,000. Under this option, there is no 403(b) nest egg.

Scenario 2 is similar to scenario 1, except that the faculty member currently has only 22.7 years of service credit, so they will still not have 25 years of service credit even if they decide to wait two years to retire. In this case, their pension benefit will be based on their highest three consecutive years of salary. In this case, under **Option 1**, as a result of scheduled salary increases in the next two years, the <u>benefit after ten years of working an additional two years of work would be $236,000 more income</u> and their 403(b) account would still be worth $93,600. If we exclude their salary vs pensions difference, the extra pension benefit of working an additional two year is $105,000. This person benefits even more from working another two years. Under **Option 2**, the <u>benefit after ten years of working an additional two years would be $152,000, or $40,000 if the salary difference is excluded.</u>

Scenario 3 is the same as Scenario 1, but looks at a faculty member who is 63, on **Column F, Step 25**, with 25 years of service. In this case, under **Option 1**, the total difference between their SERP generated income and the income they would receive by working two more years would be $164,000. If we exclude their salary vs pensions difference, the extra pension benefit of working an additional two year is $67,000. At the end of the ten-year period, their 403(b) account would be worth only $87,300 (or $104,000 at 5%). If they chose **Option 2** and use the SERP payments as spendable income, it would reduce their income differential to $86,000, If we exclude their salary vs pensions difference, the extra pension benefit of working an additional two years is only $6,700.

Clearly, there is less benefit to working an additional two years for someone on column F than someone on column G. Also, this analysis has used a very conservative rate of return on the 403(b) account. If the rate of return was higher, the 403(b) account would be larger, and thus the SERP would be more attractive.

Analysis of the SERP for Part-time Faculty

The analysis of the SERP proposal is much more complex for part-time faculty who are enrolled in the CalSTRS Define Benefit pension plan, and the decision to accept the SERP is harder. First, what increases the complexity?

For part-time faculty, CalSTRS service credits accrue based on the teaching load assigned each semester. For simplicity, we start by assuming a faculty member has had a constant load of 0.6 every semester while teaching at CCSF. If that is the case, they would have to have taught here for 42 years to quality for their pension benefit to be based on their highest one year of earnings. This is highly unlikely.

If the faculty member has less than 25 years of service credit, in calculating the pension benefit, CalSTRS uses an average of the "compensation earnable" for the current and past two years. "Compensation earnable" is the full salary listed in the Part-time salary schedule for each column and step. The pension benefit is this compensation earnable, times the age factor, times the number of years of service. The SERP offer is based on the highest amount of actual earnings, as reflected in the faculty member's most recent two CCSF W2 forms. Thus, the SERP offer for a part-time faculty member is much smaller than for a full-time faculty member. **Because the SERP is based on only a fraction of the salary schedule salary, based on teaching load, as the analysis below indicates, taking the SERP offer is less advantageous for part-time faculty.**

Another complexity results from the uncertainty of the implementation of new salary steps for part-time faculty. The new contract guarantees one new step, 14, to be implemented in Fall 2019. However, the next two additional steps are dependent on budgetary conditions. The analysis below includes both possible outcomes.

Finally, if the faculty member has been teaching somewhere in addition to CCSF, this greatly complicates the calculation of the CalSTRS pension benefit. If this applies to you, it is essential to read the "Benefits for Part-Time Educators" booklet available on the CalSTRS web site at:

https://www.calstrs.com/sites/main/files/file-attachments/benefits_for_part-time_educators.pdf

We also strongly recommend that you talk to a CalSTRS benefits counselor BEFORE you make your retirement decision. This is true, whether you decide to retire this year, or any time within the next three years.

For the following analysis, two factors affect part-time faculty differently than full-time faculty. First, service credits accrue more slowly based on teaching load. Teaching two additional years at 0.6 load increases service credits by just 1.2. Secondly, the part-time salary schedule currently has only 13 steps. Next academic year, a 14th step will be added. It is unclear whether steps 15 and 16 will also be implemented.

We are presenting two scenarios, based on whether all three new steps are implemented or just one. For each scenario, there are two options:

1. The faculty member immediately rolls-over the SERP payments, tax-free, into a 403(b) account, to build a nest egg for heirs or future expenses, **(*note: this 403(b) account must be in place before retirement.*)**
2. The faculty member spends the entire amount of the SERP payments and does not make any investment.

Scenario 1 assumes:

- The faculty member is currently on part-time column G, Step 13,
- All three new steps are implemented,
- The faculty member is 63 or older, so they qualify for the 2.4% CalSTRS age factor,
- The faculty member has worked continuously at a load factor of 0.6,
- The faculty member has 15 years of service credit, so their pension benefit is based on the average of the highest 36 months of salary.

Under Option 1, in which the member retires this spring and invests the SERP payments, their pension benefit would be $30,100 per year, over a period of ten years, their total CalSTRS pension income would be $301,000. At the end of this period, their 403(b) account, under the 5-year payout option, would be worth $39,200. If they work for two more years, their pension benefit would be $36,400. Over that same ten years, their total income would be $486,000, a difference of $185,000. (*If the rate of return on the 403(b) was 5%, the account would be worth $48,900.*)

Of course, part of that $185,000 difference is the extra income they received from their salary during the two extra years of work. If the difference between their salary and their potential pension benefit is excluded, the benefit of working the extra two years is still $50,900. This amount is significantly higher than the value of the 403(b) account had the person taken the SERP. In addition, for every year after this, the annual pension benefit for the person taking the SERP be $30,100, but for those working two more years it would be $36,400, a difference of $6,300 per year. **Given that the pension benefit is relatively low, the additional $6,300 per year may be significant in the decision to accept the SERP.**

If this person lives an additional 10 years, their total pension income over 20 years if they took the SERP would be $602,00, and if they worked an additional two years, their total income over that period would be $850,000. The benefit of continuing to work increases significantly as expected life span increases.

Because the pension benefit is low, if this person were to accept the SERP, it might be preferable to take **Option 2**, which is to select the 9-year pay-out option and use the SERP payments to cover living expenses, rather than rolling the payments into a 403(b) account. **Under Option 2**, if the person takes the SERP, for the first nine years or retirement, their retirement income would be $34,100 per year, but in year ten and every year after that the annual income would drop to $30,100. Their total income over ten years would be $337,400. Because they spent the SERP payments rather than putting them in a 403(b), there would be no nest egg at the end of the ten-year period.

If they worked for two more years, when they retire, their annual pension benefit would be $36,400 for as long as they live and over the ten-year period, their total income would be $364,000. But for every year after year 10, their annual income would be $6,300 higher than if they had accepted the SERP.

Scenario 2 is identical to Scenario 1, except, it assumes that only one new step is implemented. Under **Option 1** in which the SERP payments are rolled-over into t 403(b) account, the benefit of working the two additional years is reduced by a small amount. The annual pension benefit would be $35,700 rather than $36,400 had all three new steps been implemented. Taking the SERP would result in a pension benefit of $30,100 and at the end of ten years, the 403(b) account would be worth $39,200. **Option 2** is to take the SERP and spend it to cover expenses. Under this option, the annual income for the first nine years would be $34,100, but it would fall to $30,100 every year after that.

This analysis highlights very clearly how the pensions for part-time faculty are affected adversely by their part-time status. However, while their potential pension income is low, for them, the generosity of the SERP offer is significantly less, so the benefit of taking the SERP is less. <u>**For most part-time faculty, unless there is a pressing need to retire now, working an additional two years will be preferable, because it has a significant positive impact on lifetime income.**</u>

This analysis is for those in the CalSTRS Defined Benefit system. For part-time faculty in the Cash Balance system, the CalSTRS benefit will be somewhat less, which will make the SERP more attractive. Moreover, part-time faculty may have access to additional income for employment in other districts. It is almost impossible to do a general analysis of this situation, **so talking to a CalSTRS counselor before making your decision is essential.**