

## MEMORANDUM



**DATE:** February 20, 2015  
**TO:** House Appropriations Committee  
**FROM:** Kyle I. Jen, Deputy Director  
**RE:** Departmental Economic Adjustments and Retirement Legacy Costs

In response to several questions from committee members, this memorandum provides information on departmental economic adjustments and retirement legacy costs in the FY 2015-16 Executive Budget Recommendation.

### **Economic Adjustments**

The FY 2015-16 Executive Recommendation includes economic adjustments to reflect projected changes in costs related to state employee compensation and other standard costs across state departments. Unlike previous years, the net effect of these adjustments is a reduction in appropriation amounts from FY 2014-15. As shown in the attached table from the State Budget Office, Gross appropriations are reduced by \$13.7 million. Of that amount, the net reduction in GF/GP appropriations is \$5.5 million.

Changes in Gross appropriations for individual cost components are as follows:

**Salary and Wages:** An increase of \$46.2 million for employee salary and wages. State employees are scheduled to receive a 2.0% increase in base pay effective October 1, 2015. The cost increase from FY 2014-15, however, equates to only 1.5%, as a one-time 0.5% payment was made to employees on October 1, 2014.

**Insurance Costs:** An increase of \$20.1 million for health insurance and other employee insurance-related costs. This reflects an assumed increase in insurance costs of 3.19% from FY 2014-15.

**Retirement and OPEB Costs:** Reductions of \$27.5 million in pension and defined contribution retirement costs and \$55.3 million in Other Post Employment Benefit (OPEB, or retiree health care) costs. These reductions reflect an anticipated decline in unfunded liabilities for the State Employees Retirement System (SERS). The declines can be attributed to two major factors:

- Improved investment performance for SERS assets. This is partly the result of the five-year smoothing mechanism utilized by the state retirement systems. Major investment losses from FY 2007-08 are no longer being smoothed in, whereas more recent investment gains continue to be smoothed in.
- Moderation in per capita health care costs.<sup>1</sup>

As a percentage of payroll, the total retirement contribution rate (including FICA) for state employees hired since 1997 will drop from 61.95% in FY 2014-15 to 58.55% in FY 2015-16.

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<sup>1</sup> The state began prefunding state employee OPEB costs in FY 2011-12. For information on that policy change, see this HFA memorandum: <http://www.house.mi.gov/hfa/PDF/Retirement/OPEBmemo.pdf>.

**Other Departmental Costs**

- A reduction of \$1.9 million for worker’s compensation costs.
- An increase of \$1.5 million for Building Occupancy Charges (for buildings occupied by departments that are owned by the state).
- An increase of \$153,000 for rent (for building occupied by departments that are rented from private owners).

**Retirement Legacy Costs**

The FY 2015-16 Executive Recommendation continues to include boilerplate language breaking out retirement legacy costs—that is, annual costs paid into the retirement system for unfunded liabilities tied to pension and OPEB benefits accrued by state employees in prior years. State employees hired since 1997 have entered a defined contribution, 401k-style retirement system rather than the SERS pension system, and employees hired since 2012 receive a defined contribution cash benefit in lieu of retiree health benefits. Unfunded liability costs are spread over the salaries and wages of all employees, regardless of whether they are members of the SERS pension system.

The attached table from the State Budget Office summarizes these legacy costs. Estimated legacy costs tied to pension unfunded liabilities for FY 2015-16 total \$748.3 million, and legacy costs tied to OPEB unfunded liabilities total \$576.1 million. Total legacy costs of \$1.3 billion equate to approximately 40% of total estimated employee salary and wages of \$3.3 billion for FY 2015-16 (Gross appropriations).

The table below shows estimated FY 2015-16 compensation-related costs for a hypothetical state employee with an annual salary of \$50,000 hired after 1997:

<b>Category</b>		<b>% of Salary</b>
Salary and wages	\$50,000	
Insurance (average)	10,158	20.32
FICA	3,825	7.65
Normal retirement costs*	5,330	10.66
Legacy retirement costs*	20,120	40.24
Other**	767	1.53
<b>TOTAL</b>	<b>\$90,200</b>	<b>80.40</b>

\*Includes both pension/defined contribution costs and OPEB costs

\*\*Worker’s compensation and longevity

Please call if you have questions about this information.

Attachments (2)

**FY2016 STATEWIDE ECONOMIC INCREASES (In Thousands)**

**Gross Funding**

Department	FY16 Economics										Total
	Total S&W	Insurance	Retirement	OPEB	Worker's Comp	BOC	Rent	Food, Fuel, Medicine	Longevity	Other	
Agriculture & Rural Development	465.7	212.5	(243.9)	(569.1)	(30.5)	2.8	0.0	0.0	0.0	0.0	(162.5)
Attorney General	656.2	195.2	(330.2)	(802.0)	2.1	(60.2)	0.0	0.0	0.0	0.0	(338.9)
Auditor General	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Civil Rights	109.4	38.4	(92.5)	(154.3)	(7.7)	(6.8)	0.0	0.0	0.0	0.0	(113.5)
Community Health	3,194.1	1,270.7	(1,661.0)	(3,895.4)	205.2	160.1	173.5	0.0	0.0	0.0	(552.8)
Corrections	12,123.2	5,700.5	(6,723.7)	(14,832.1)	(1,500.0)	(10.5)	31.3	0.0	0.0	0.0	(5,211.3)
Education	582.7	216.6	(287.5)	(709.6)	(2.1)	56.4	0.0	0.0	0.0	0.0	(143.5)
Environmental Quality	1,182.8	504.3	(633.0)	(1,446.7)	28.6	(28.0)	75.9	0.0	0.0	0.0	(316.1)
Executive Office*	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Human Services	9,923.2	4,555.8	(4,994.6)	(12,106.1)	(44.7)	336.4	0.0	0.0	0.0	0.0	(2,330.0)
Insurance & Financial Services	365.8	141.3	(187.6)	(446.1)	(1.0)	(17.6)	0.0	0.0	0.0	0.0	(145.2)
Judiciary	879.5	191.5	(253.3)	(576.0)	(68.3)	(170.5)	27.6	0.0	0.0	0.0	30.5
Legislature*	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Licensing & Regulatory Affairs	2,516.8	1,063.8	(1,337.9)	(3,093.8)	(70.9)	(922.4)	0.0	0.0	0.0	0.0	(1,844.4)
Military and Veterans Affairs	725.3	244.7	(368.7)	(885.9)	(102.9)	0.0	0.0	0.0	0.0	0.0	(387.5)
Natural Resources	1,681.0	728.8	(874.2)	(2,054.3)	77.0	125.7	0.0	0.0	0.0	0.0	(316.0)
State	1,138.2	537.2	(615.5)	(1,395.3)	(35.6)	167.4	0.0	0.0	0.0	0.0	(203.6)
State Police	2,959.9	1,173.5	(1,889.3)	(3,012.7)	44.3	1,565.6	(281.7)	0.0	0.0	0.0	559.6
Technology, Management & Budget	2,794.7	1,153.0	(1,440.3)	(3,318.7)	82.3	609.9	126.4	0.0	0.0	0.0	7.3
Transportation	2,513.5	1,129.9	(1,315.9)	(3,073.7)	(432.6)	(326.0)	0.0	0.0	0.0	0.0	(1,504.8)
Treasury	1,701.2	765.9	(877.6)	(2,076.5)	(87.4)	74.3	0.0	0.0	0.0	0.0	(500.1)
Michigan Strategic Fund	674.7	319.6	(352.6)	(824.0)	1.3	(22.8)	0.0	0.0	0.0	0.0	(203.8)
<b>TOTAL</b>	<b>46,187.9</b>	<b>20,143.2</b>	<b>(24,479.3)</b>	<b>(55,272.3)</b>	<b>(1,942.9)</b>	<b>1,533.8</b>	<b>153.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>(13,676.5)</b>

Notes: Legislature economics are submitted and reported as an investment  
 Executive Office includes S&W economics only; retirement, OPEB and Insurance economics are included in DTMB  
 DTMB includes Executive Office fringes

# FY2016 BUDGET DEVELOPMENT

## Legacy Costs Breakout - Health Care & Pensions

For FY2016 Standard Boilerplate

Department	Total Legacy Costs Gross	Pension-Related Legacy Costs (Retirement) Gross	Health Care Legacy Costs (OPEB) Gross
Agriculture & Rural Development	12,751,500	7,237,700	5,513,800
Attorney General	17,778,100	10,007,000	7,771,100
Civil Rights	2,997,500	1,701,400	1,296,100
Community Health	87,425,100	49,623,700	37,801,400
Corrections	332,330,600	188,628,700	143,701,900
Education	15,932,000	9,042,900	6,889,100
Environmental Quality	32,415,600	18,399,000	14,016,600
Executive Office	0	0	0
Human Services	271,619,000	154,170,400	117,448,600
Insurance & Financial Services	9,998,900	5,675,400	4,323,500
Judiciary	13,723,300	7,772,600	5,950,700
Legislature and Auditor General	28,034,000	15,465,300	12,568,700
Licensing & Regulatory Affairs	68,953,000	39,137,600	29,815,400
Military and Veterans Affairs	19,866,900	11,276,300	8,590,600
Natural Resources	46,042,200	26,133,200	19,909,000
State	31,253,000	17,739,100	13,513,900
State Police	122,920,900	66,961,400	55,959,500
Technology, Management & Budget	76,448,100	43,360,600	33,087,500
Transportation	68,873,400	39,092,200	29,781,200
Treasury	46,551,300	26,422,100	20,129,200
Michigan Strategic Fund	18,468,200	10,482,500	7,985,700
<b>TOTAL</b>	<b>1,324,382,600</b>	<b>748,329,100</b>	<b>576,053,500</b>