




ACCELERATING EQUITY:

Integrating Teacher Pension Funding into
Fair School Funding

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OVERVIEW



Illinois had the most inequitable school funding system in the country until the State enacted Evidence-Based Funding (EBF) in 2017. It was a historic moment for Illinois, with State leaders from both sides of the aisle coming together in the best interests of students. Under EBF, as new State dollars become available, they flow first to the school districts that need them the most, and no district loses money.

Now it's time to address the other great inequity in school funding: how employer costs for teacher pensions are handled. In Illinois, State government pays the overwhelming majority of these costs in a manner that has things backward: school districts that are better off and have greater local property wealth benefit from significantly more State dollars than poorer districts do. The equity gap is startling: districts funded over 100% of adequacy receive \$328 per pupil more than districts funded below 80% of adequacy.

Increasing equity in pensions requires a rethink.

Districts are understandably concerned about taking over pension costs from the State. But by leveraging the mechanics of EBF, a greater number of poorly funded districts will actually receive more dollars. The key is to strategically use the \$1+ billion dollars freed up in pension funds to help hold districts harmless. Moving forward, rather than provide additional pension dollars to the wealthiest districts, these dollars could be pushed through the formula

instead—on top of the \$350 million increase already dedicated to the formula each year.

Current law already outlines a mechanism for shifting pension costs to districts. However, because the shift would only occur as new teachers are hired and because lower-income districts have higher teacher turnover, the approach is inequitable in the short-term. Rather than shift pensions in an inequitable manner, this report proposes to build on the equity of EBF.

Integrating pensions into the formula also provides more transparency. Under EBF, the Base Funding Minimum (BFM) provides a mechanism to ensure that districts keep their State funding. At first blush, most districts in the State – even the wealthiest of “Tier 4” districts – receive far less funding from the State than the formula says they need. But, this does not consider the dollars they receive in pension funding. When this is considered, some wealthy districts get far more from the State than is often recognized. Right-sizing the BFM ensures that the State does not pay more to a district than is expected.

With so many students so far from adequacy, we need to be keenly aware of where every dollar goes. Right now, pension dollars flow inequitably to districts. The State should examine this inequity and better understand approaches to improving equity.

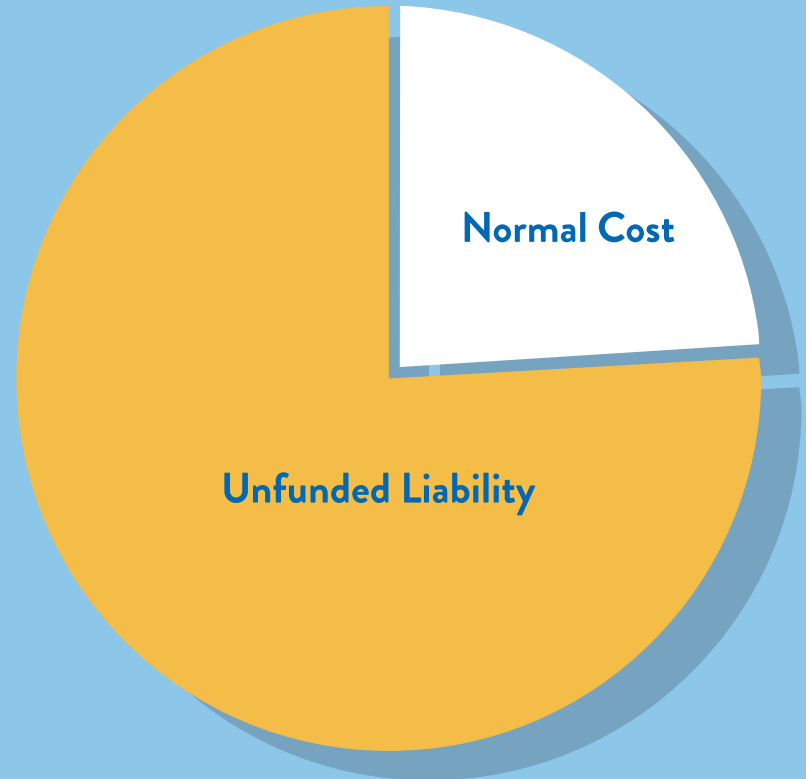
**PROBLEM:
STATE FUNDING OF
TEACHER PENSIONS IS
INEQUITABLE**

PROBLEM: STATE FUNDING OF TEACHER PENSIONS IS INEQUITABLE

In Illinois, State government pays the overwhelming majority of employee costs for teacher pensions. The State's FY19 teacher pension payment was about \$4.5 billion. That amount covers both "normal cost" and "unfunded liability."

About a quarter of the State's annual contribution to the Teachers' Retirement System (TRS) paid for current or "normal" cost. The rest covered debt from previous years, known as "unfunded liability."

Note: Chicago's teachers are covered under the Chicago Teachers' Pension Fund (CTPF) rather than TRS. Historically, Chicago Public Schools (CPS) has paid employer costs for CTPF. In the new formula, the State took on CTPF normal cost payments. CPS still pays their unfunded liability and the formula takes this expense into account.



PROBLEM: STATE FUNDING OF TEACHER PENSIONS IS INEQUITABLE

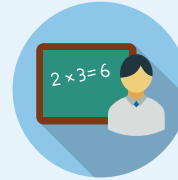
**The current system
for payment of teacher
pensions doubles
down on inequity.**

School districts determine the amount of their teacher salaries, and State government pays most of the associated pension costs. A higher salary means a larger pension upon retirement.

While the goal of EBF is to get more State resources to the neediest school districts, funding teacher pensions with State money does the opposite: it gets more State resources to the school districts that already have the highest teacher salaries and the most staff.



The State pays the certified amount, which represents the amount needed to pay off 90% of the pension debt by 2045. In FY19, that equaled 42.8% of payroll.



Teachers pay 9% of salary.



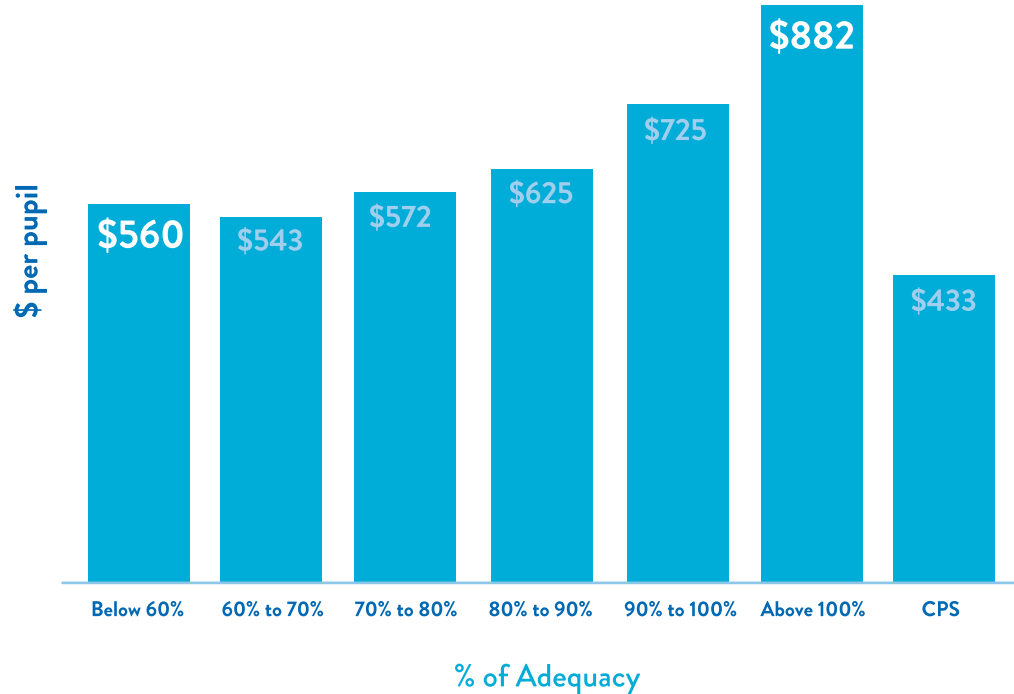
School districts pay 0.58% of payroll.

Richer school districts (those more than 100% funded) **get \$328 more per pupil** than poorer districts (those funded below 80%).

When we look at this disparity over the entirety of the pension payment (including unfunded liability), it's even more alarming: districts over 100% funded benefit about \$1,150 per pupil more than districts funded below 80% of adequacy.

If pension costs increase, those new funds would go out the door inequitably as well.

Value of State-Paid Normal Cost to School Districts

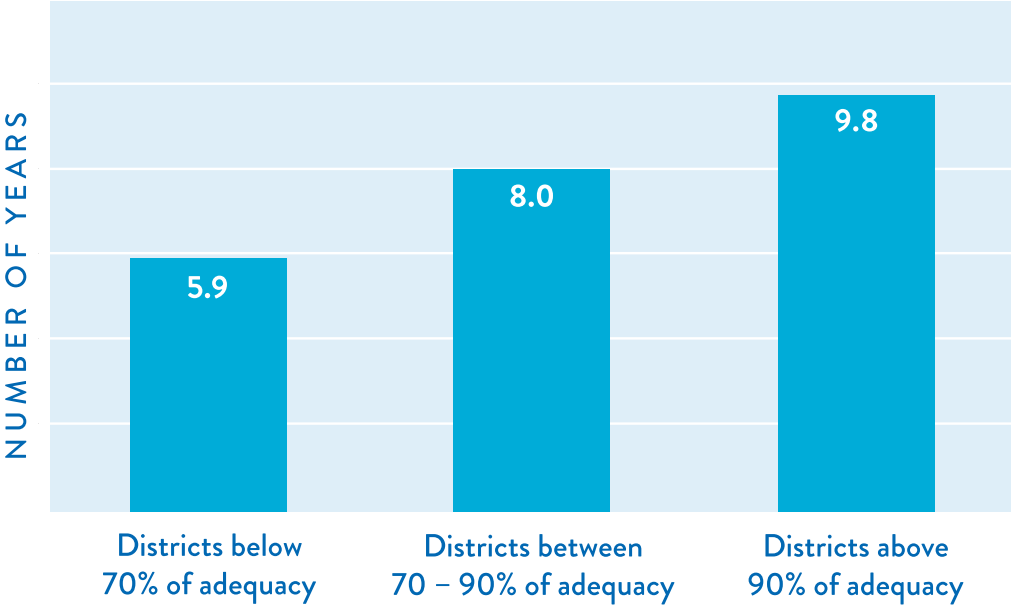


After several years of cost shift discussions, a "Tier 2" proposal was enacted in 2017. It requires districts to begin paying the normal cost of their teachers' pensions as soon as TRS implements a new benefit tier. This law is now in limbo because TRS cannot implement the new benefit tier without passing another law to make some technical changes. Nevertheless, despite its efforts to correct a long-term inequity, phasing in a cost shift as new employees are hired creates its own short-term inequity since lower-income districts have higher teacher turnover rates.

There is also no guarantee that the savings to the State would be recaptured in the formula and allocated beyond the current \$350 million minimum funding level.

ANNUAL TEACHER TURNOVER RATE

How many years is expected to reach 100% turnover?*



*This doesn't mean 100% of teachers have left because it would include positions that turned over multiple times. That is, the turnover rate will reach 100% but the number of teachers who have left will not be 100%.

As if that weren't enough...

Current law has an end-of-career penalty that is inequitable. Known as the “6% penalty payment,” it is about to become a 3% penalty payment that is even more inequitable.



PROBLEM: STATE FUNDING OF TEACHER PENSIONS IS INEQUITABLE

One way the State has sought to share costs for teacher pensions and minimize end-of-career pay spiking is through the “6% penalty payment.” Since 2005, districts have been charged for pension costs resulting from salary increases over 6% in any of the years determining a teacher’s “Final Average Salary.” In 2018, the 6% threshold was reduced to 3%.

In theory, one might think this policy is a small step toward enhancing equity, since rich districts have higher salaries. But in fact, it appears to have hurt needier school districts more than ones that are better off. And the penalty will increase for poorer districts as funding equity improves and they need to increase salaries to reach adequate levels.

Districts paid an average of 16% greater penalty amount per low-income student, which equals a:

\$6 penalty per non-low-income student; and

\$7 penalty per low-income student.

OPPORTUNITY: THE NEW EVIDENCE- BASED SCHOOL FUNDING FORMULA

There are four steps to Illinois' evidence-based funding formula.



STEP ONE: Calculate the school district's Base Funding Minimum.

Under the new school funding formula, each school district is guaranteed to receive from the State an amount at least equal to the State payment it received the prior year. This hold-harmless payment is known as the district's "Base Funding Minimum." It ensures that no district loses funding.



STEP TWO: Determine the district's Adequacy Target.

The Adequacy Target considers 34 "cost factors" to determine how much funding a district needs to adequately educate its students. Those factors include ratios of students-to-teachers, counselors, librarians, nurses, and other personnel; supports for low-income students and English learners; and an adjustment for regionalized cost differences. Every school district and the make-up and needs of its student populations are unique; the amount of its Adequacy Target is as well.



STEP THREE: Calculate the district's Local Capacity Target to account for differences in the ability across districts to raise funds through property taxes.

The Local Capacity Target calculation expects districts with higher property values to invest more resources in local schools than districts without much of a property tax base.

The sum of the Local Capacity Target plus the Base Funding Minimum shows how much funding a district has available. Comparing that sum to the district's unique Adequacy Target shows how close the district is to being adequately funded.



STEP FOUR: Distribute new State funds.

The difference between a district's Adequacy Target and Local Capacity Target is its Expected State Payment. If Illinois fully funded education, the State would simply write a check for the Expected State Payment. But since the appropriation is over \$7 billion short of full funding, State government distributes funds based on how adequately funded each district is, with each district falling into one of four tiers reflecting how close it is to its Adequacy Target.

Tier 4

Districts with more than 100% of their Adequacy Target

Tier 3

Districts between 90% - 100% of their Adequacy Target

Tier 2

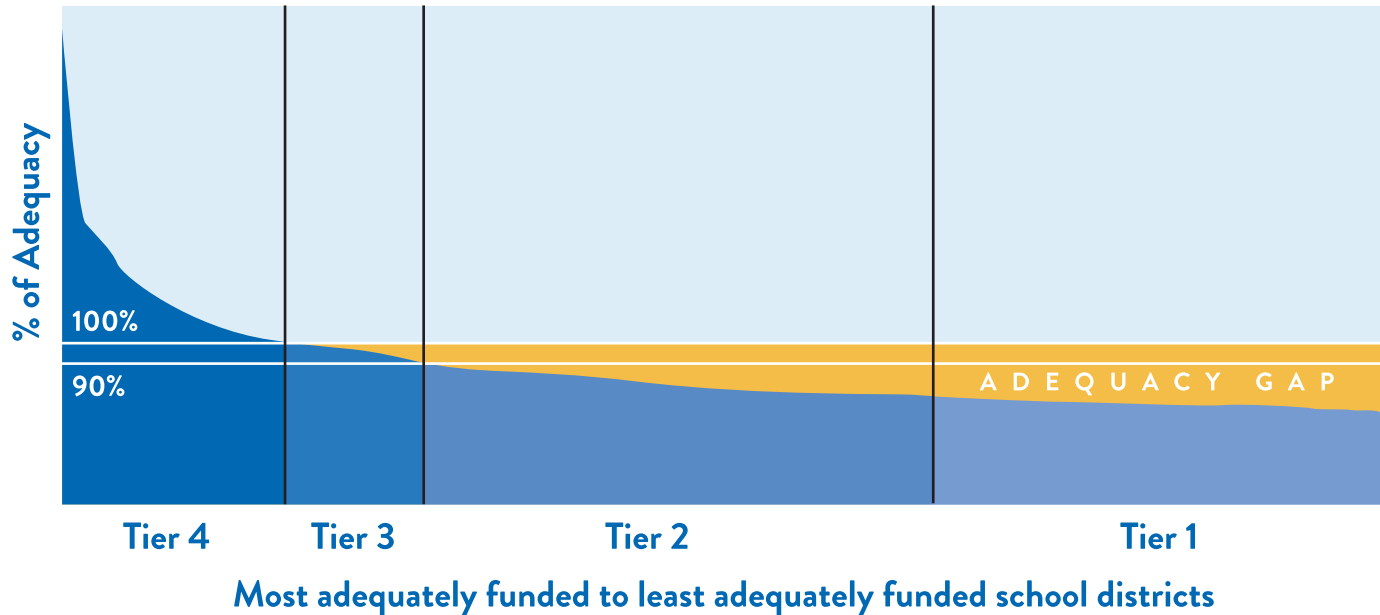
Districts with less than 90% of their Adequacy Target

Tier 1

Districts with less than 65% of their Adequacy Target

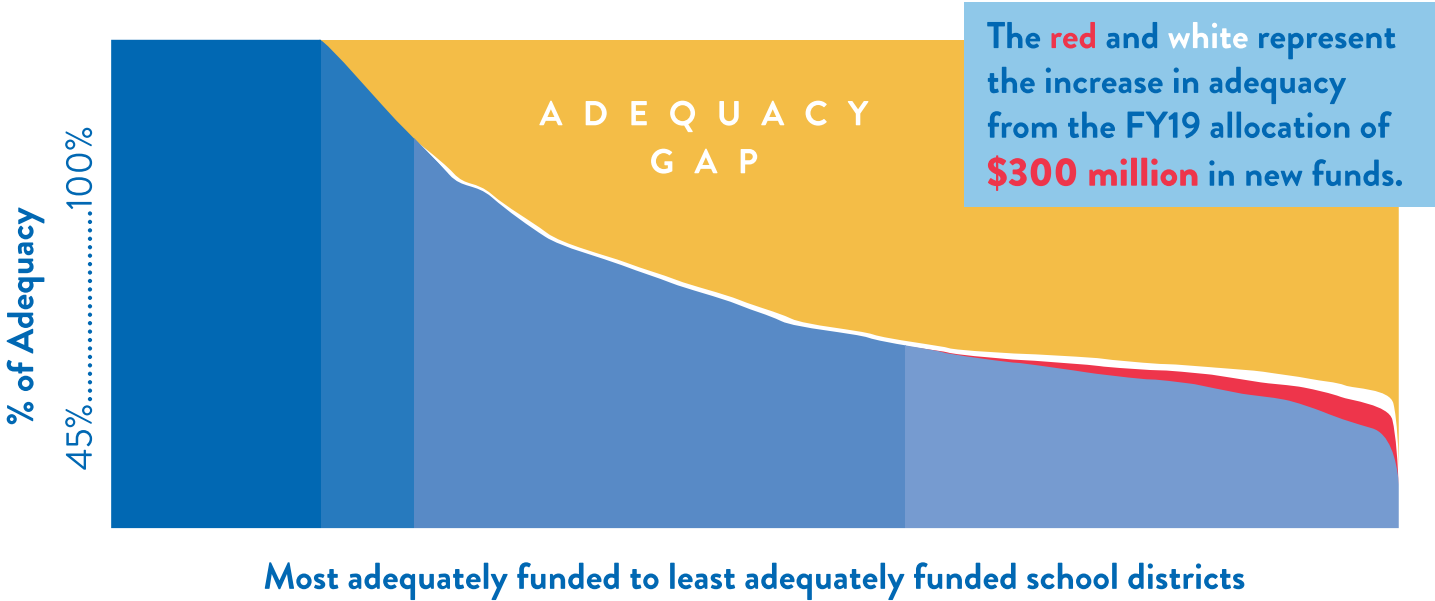
School Districts' Tiers in Evidence-Based Funding

This chart shows the distribution of school districts in tiers of funding adequacy. School districts are classified in four tiers: Tier 4 (over 100% funded); Tier 3 (90% - 100% funded); Tier 2 (<90% funded); and Tier 1 (<65% funded). The yellow section represents the “Adequacy Gap” or how much the State needs to invest in order to bring every district up to its Adequacy Target and to achieve full funding.



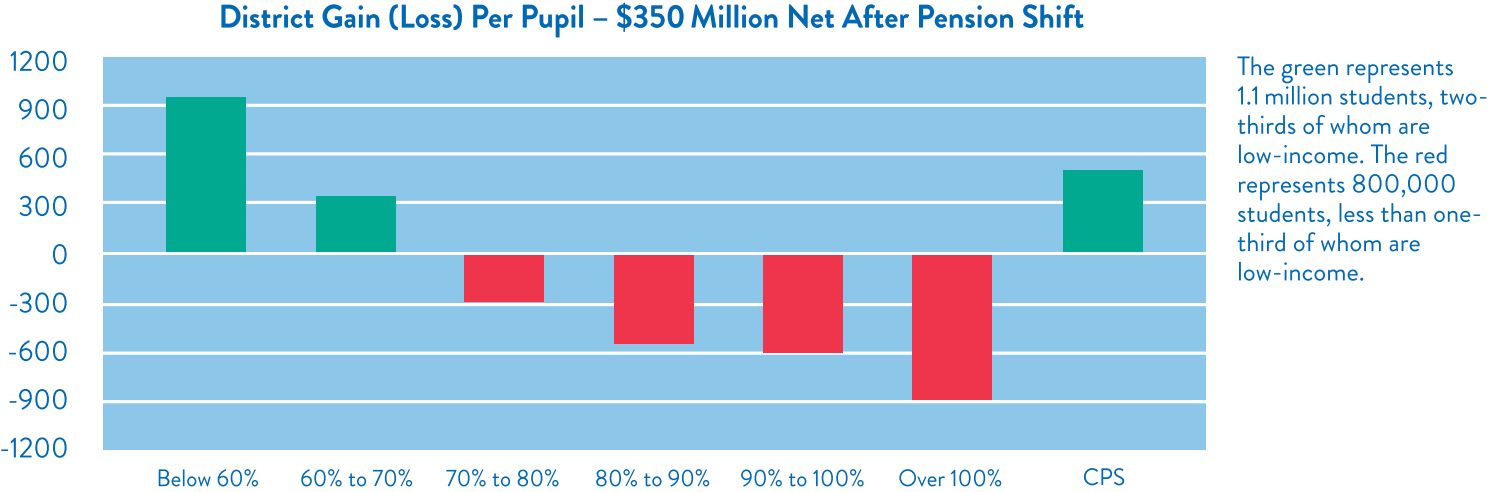
\$300M in New Funds in FY19 Started to Close the Adequacy Gap

This chart is the same as the prior one, zoomed in on the funding ratios from 45% to 100%. The red and white represent the increase in adequacy as a result of the FY19 allocation of \$300 million in new funds. The first 50% of new evidence-based funding (in red) goes to Tier 1 districts. The next 49% (in white) goes to Tier 2 districts. (Tier 1 districts are also in Tier 2.)



Re-allocating pensions funds through the formula would be equitable, but many districts – even underfunded ones – would lose.

While a traditional cost shift swap, with all \$1.15 billion in pension savings re-allocated through the formula’s tier distribution, would be highly equitable, it is not feasible: many districts would have more in pension payments than they would get back from the tiers, creating many “losing” districts. Some proposals have suggested a gradual cost shift over time. However, doing so would provide no assurances that the savings to the State would be reinvested in the formula.



PROPOSAL: THE EQUITY BOOST

The Equity Boost uses the new school funding formula to address the inequity of payment of teacher pension costs and brings the State closer to fully funding education.

There are four parts to the Equity Boost.

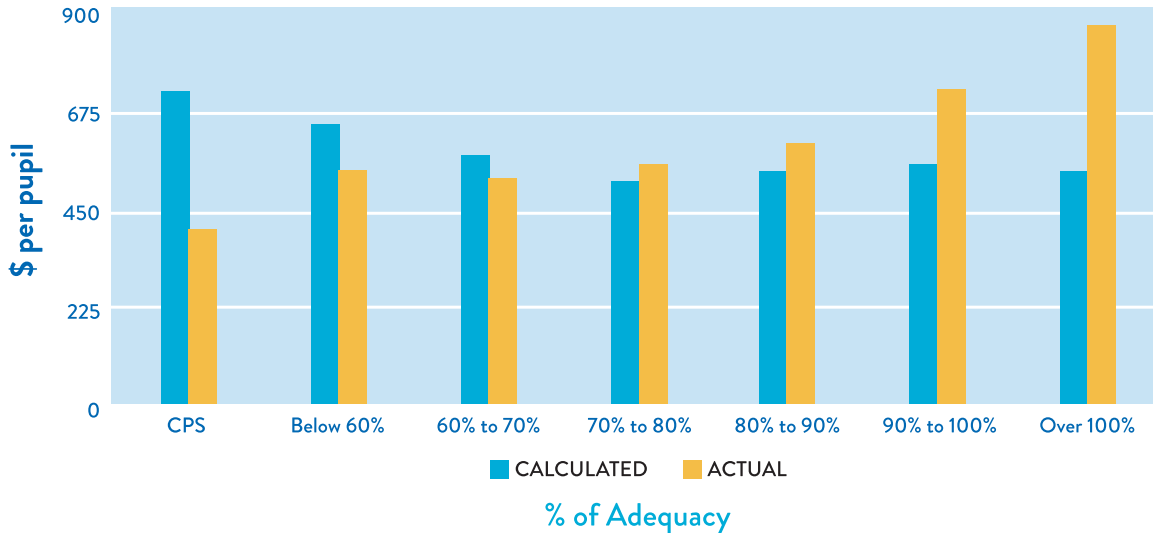
- 1** Calculate Adequacy Targets using calculated normal cost instead of actual cost.
- 2** Move responsibility for paying normal pension cost to school districts (a total of about \$1.15 billion). At the same time, offset these amounts by having each district receive from the State an amount equal to its normal pension costs through the “hold harmless” or Base Funding Minimum (BFM) of the new formula.
- 3** Make the pension portion of the BFM subject to a continuing appropriation, just like the current pension payment is. If normal costs increase in any future years, those increases should be put through the formula and not count towards the \$350 million minimum funding level.
- 4** Gradually phase out \$70 million in excess state payments that some districts will have in their BFM, then equitably re-distribute that amount through the formula. This approach means these dollars will first flow to the districts that need them the most, reducing the adequacy gap further.

PART I

Calculate Adequacy Targets using calculated normal cost instead of actual cost.

Actual normal cost is what current law calls for in the calculation of adequacy. It means that when the model calculates how much funding a district needs for full funding, it uses the current, inequitable, non-evidence-based value of today's normal cost.

Calculated normal cost instead looks at the payroll each district would need to be adequately funded. This better reflects the spirit of EBF.



As the new formula was drafted, negotiators fought to include a poverty element in the adequacy target by class-size ratios that are smaller as the low-income rate in a district increases. Using actual rather than calculated normal cost is regressive enough to negate the entirety of this class-size equity provision.

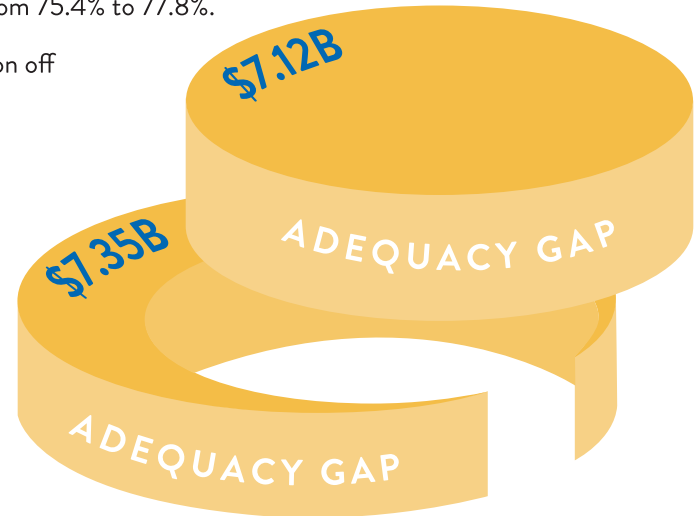
PART II

Move \$1.15 billion in State pension payments to school districts while offsetting these amounts through the hold harmless Base Funding Minimum.

The baseline Adequacy Gap is \$7.35 billion when using actual normal cost. The Adequacy Gap rises to \$8.14 billion when using calculated normal cost, but after pension costs are moved into the hold-harmless Base Funding Minimum, the Adequacy Gap shrinks to \$7.12 billion without any district losing money.

The average district's funding percentage increases by nearly 2.5%, from 75.4% to 77.8%.

This step of the Equity Boost is cost neutral, while shaving \$233 million off the Adequacy Gap. This is because, while the State will hold districts harmless, districts will be expected to take on some part of the cost of pensions over time—with high property wealth districts expected to take on more than low property wealth districts.



PART III

Make the pension portion of the Base Funding Minimum and any future normal cost increases subject to a continuing appropriation, just like the current pension payment is.

Whether or not normal cost increases or decreases, the Equity Boost ensures that funds stay in education, closes equity gaps, and moves districts closer to adequacy.

In 2023, the number of teachers in the “Tier 2” level of benefits will surpass the number of teachers in the higher “Tier 1” level of benefits. If this trend stays the same and normal cost decreases, we can skip Part III and proceed to Part IV.

But normal cost could increase, especially if the “Tier 2” level of benefits is changed. Those increased normal cost funds would be distributed highly inequitably if they continue to flow from the State to TRS. It makes more sense to capture these funds and re-invest them in the formula to close equity gaps rather than exacerbate them. A continuing appropriation would make sure that those dollars stay in the formula on top of the Minimum Funding Level.

PART IV

Gradually phase out Excess State Payments.

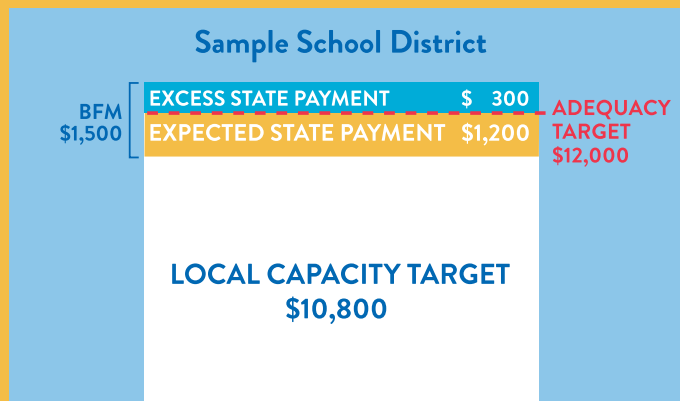
By far, most districts that are “over-funded” get their extra dollars from local resources. Few districts appear to receive more than their Expected State Payment because the State’s pension payment is invisible in the model.

But with more candid accounting of the pension payments, the formula will show 117 districts receive a total of about \$70 million more than their Expected State Payment. Over time, by phasing out this funding and reinvesting it in the formula, Illinois creates even more equity for school districts.

Once implemented, the Excess State Payment phase-out and the integration of pension costs into the formula will close the Adequacy Gap by over \$300 million.

What is an “Excess State Payment?”

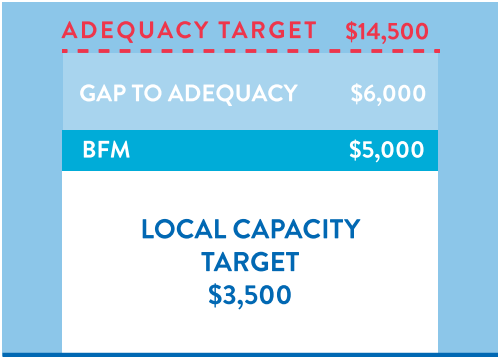
Every district has an Adequacy Target based on its need and a Local Capacity Percentage (LCP) based on its property values. A district with a \$12,000 per pupil Adequacy Target and a 90% LCP is expected to raise \$10,800 locally. Its Expected State Payment is the rest of what it takes to reach adequacy: \$1,200. Regardless of how much a district raises locally, its only Excess State Payment is the portion of State funds it gets beyond \$1,200. If the BFM is \$1,500, this district would have an Excess State Payment of \$300. Districts might receive Excess State Payments as their enrollment drops, demographics change, or property values rise.



EXAMPLE: TIER 1 DISTRICT

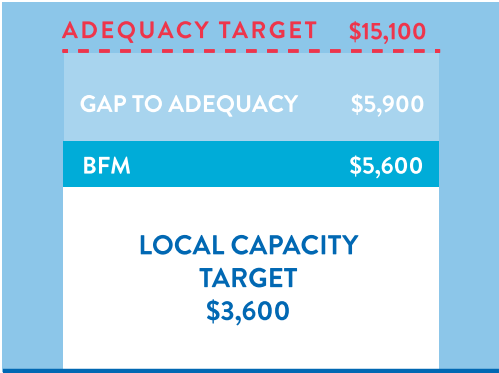
Pre-Equity Boost

The District's Adequacy Target is \$14,500 per pupil. Its Local Capacity Percentage is 24%, so it is expected to raise about \$3,500 locally. The District's Base Funding Minimum is \$5,000, leaving it just 59% funded and with a \$6,000 gap to adequacy. It will get \$473 per pupil when \$350 million is allocated to the formula. The district gets a benefit of \$600 per pupil from the State's normal cost payment, but this is not reflected in the formula.



Post-Equity Boost

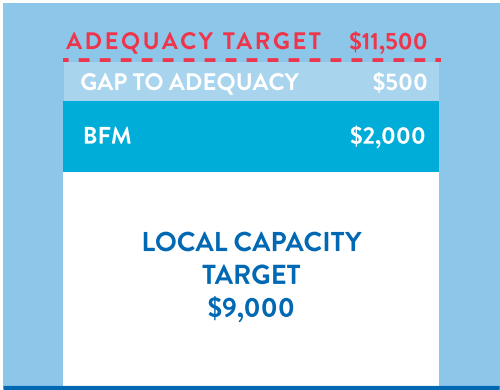
The District's Adequacy Target is now \$15,100, which is higher because its calculated pension costs have been added. Its Local Capacity Percentage of 24% remains the same and it is now expected to raise about \$3,600 locally. The District's Base Funding Minimum is now \$5,600, which is increased because its normal cost payment is added to the BFM, and it will pay that \$600 per pupil to TRS for its normal cost payment. The district is 61% funded with a \$5,900 gap to adequacy. It will get \$500 per pupil when \$350 million is allocated.



EXAMPLE: TIER 3 DISTRICT THAT MOVES TO TIER 4

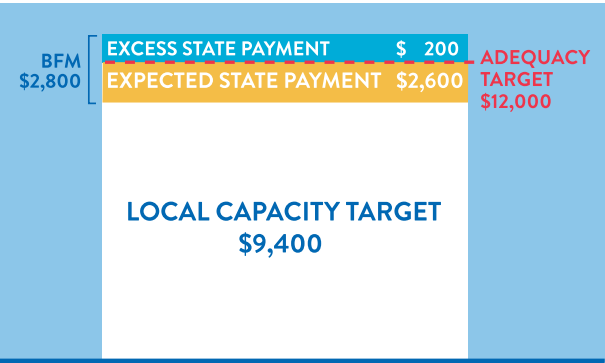
Pre-Equity Boost

The District’s Adequacy Target is \$11,500 per pupil. Its Local Capacity Percentage is 78%, so it is expected to raise about \$9,000 locally. The District’s Base Funding Minimum is \$2,000, leaving it 96% funded and with a \$500 gap to adequacy. It will get \$26 per pupil when \$350 million is allocated to the formula. The district gets a benefit of \$600 per pupil from the State’s normal cost payment, but this is not reflected in the formula.



Post-Equity Boost

The District’s Adequacy Target is now \$12,000, which is higher because its calculated pension costs have been added. Its Local Capacity Percentage of 78% remains the same and it is now expected to raise about \$9,400 locally. The District’s Base Funding Minimum is now \$2,800, which is increased because its normal cost payment is added to the BFM, and it will pay that \$800 per pupil to TRS for its normal cost payment. The district is 101% funded with an Excess State Payment of \$200, which would be phased out over three years. It will get \$1 per pupil when \$350 million is allocated.



The Equity Boost is a win-win solution.

- **It provides predictability and stability for school districts that have been fearing a sudden pension cost shift.**
- **The amount added to the hold harmless Base Funding Minimum for pensions will stretch further as pension normal costs go down.**
- **It protects teacher pensions and directs more State dollars to the neediest districts.**
- **The State will fully fund education sooner.**

Stand for Children is a non-profit education advocacy organization focused on ensuring all students receive a high quality, relevant education, especially those whose boundless potential is overlooked and under-tapped because of their skin color, zip code, first language, or disability.



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