LEGISLATIVE FISCAL ESTIMATE

[First Reprint]

SENATE, No. 3312

STATE OF NEW JERSEY
217th LEGISLATURE

DATED: JULY 13, 2017

SUMMARY

Synopsis:	Transfers State Lottery Enterprise to TPAF, PERS, and PFRS.
Type of Impact:	State Revenue and Expenditure Reduction; Revenue Increase and Asset Gain, Certain State Administered Retirement Systems
Agencies Affected:	Division of Pensions and Benefits and Division of Investments, Department of the Treasury; State Lottery Commission.

Office of Legislative Services Estimate

Fiscal Impact	FY 2018 – FY 2048
State Revenues	Annual Reduction-See Comments Below
State Expenditures	Annual Reduction– See Comments Below
Certain State Administered Retirement Systems	Increased Annual Income – See Comments Below

- The Office of Legislative Services (OLS) estimates that the bill will annually decrease State revenues available to the General Fund for a 30-year period by the amount of the net proceeds of the State Lottery. The Executive estimates the FY 2018 lottery net proceeds at $1.014 billion. The annual amount of lottery net proceeds over the remaining 29 years is indeterminate. All State Lottery revenue will return to the State Lottery Fund in the 31st year, and at that time Lottery net proceeds become available for transfer to the General Fund as required by law.

- The OLS estimates that the bill will reduce State expenditures, by revising the statutory calculation of the annually determined contribution (ADC) by the State to Teachers' Pension and Annuity Fund (TPAF), the Public Employees' Retirement System (PERS), and the Police and Firemen's Retirement System (PFRS) over the same 30-year period. The annual expenditure reduction for the first five fiscal years is set forth in the bill and described below; thereafter, the annual reduction is indeterminate.

- With respect to the bill's impact on the annual revenue received by the TPAF, PERS and PFRS, in the first five fiscal years the sum of State-funded employer contributions and lottery net proceeds will be no different than if the bill were not enacted. Thereafter, the sum of State-funded employer contributions and lottery net proceeds should increase, by indeterminate amounts, assuming that lottery net proceeds do not suffer a drastic decline.

- This bill will increase the assets of the TPAF, PERS, and PFRS by contributing the State Lottery to each of those funds in proportions specified in the bill for a 30-year period. The bill stipulates the initial value of the asset contribution at $13.535 billion. The asset contribution will increase the funded ratios of the three retirement systems as follows: TPAF, from 47 percent to 63.9 percent; PERS (State) from 37.8 percent to 49.6 percent; and PFRS (State) from 41.2 percent to 44.5 percent.

BILL DESCRIPTION

Senate Bill No. 3312 (1R) of 2017 contributes the State Lottery Enterprise to the Teachers' Pension and Annuity Fund (TPAF), the Public Employees' Retirement System (PERS), and the Police and Firemen's Retirement System (PFRS) for a term of 30 years. Under the bill, the TPAF, PERS, and PFRS receive a portion of the proceeds of the Lottery Enterprise, based upon their members' past or present employment in schools and institutions in the State.

Under the bill, the entirety of the Lottery Enterprise will be contributed to newly created Common Pension Fund L. The bill directs that operation of the State lottery remain with the Division of the State Lottery, which will continue in its current form as a division within the Department of the Treasury. The State Lottery Commission will continue to have seven members, but the bill will add the Director of the Division of Investment as a member of the Commission and remove one public member. The State Lottery Commission will continue to exercise regulatory oversight over the State Lottery by adopting lottery rules and approving all games.

The bill provides that with the exception of a few retained assets and liabilities (such as annuities purchased to pay previous prize winners), all of the assets and liabilities of the State lottery, including all State lottery intellectual property, will be conveyed, as delineated in a Memorandum of Lottery Contribution required to be executed by this bill, to the retirement systems for the term of the lottery contribution. The intellectual property will continue to be used by the Division of the State Lottery under a no-fee license provision in the bill.

The lottery contribution will take effect when the Treasurer delivers the Memorandum of Lottery Contribution to the Director of the Division of Investment. During the term of the lottery contribution, the gross proceeds of the State Lottery will be paid into an operating account within Common Pension Fund L for payment of operational and administrative costs. The Division of the State Lottery will manage the operating account. The bill requires the Division of the State Lottery to transfer into a second account, the investment account, State lottery proceeds net of operating and administrative expenses on a periodic basis. Administrative expenses include prize payments and advertising costs.

Consistent with current State law, annual lottery net proceeds must be at least 30 percent of gross proceeds. The net proceeds may be used by each retirement system for payment of benefits to members of the retirement systems or may be invested on behalf of the retirement systems by the Director of the Division of Investment.

The bill allocates a percentage of the lottery contribution to each of the retirement systems as follows: 77.78 percent for TPAF; 21.02 percent for PERS; and 1.20 percent for PFRS. The allocable percentages were determined based on (1) the relative percentages of the total actuarial accrued liabilities of the retirement systems; (2) the relative percentages of the total actuarial accrued liabilities of the eligible member portions of such retirement systems; (3) the relative percentages of the total unfunded actuarially accrued liabilities of the retirement systems; (4) the relative percentages of the total unfunded actuarially accrued liabilities of the eligible member portions of such retirement systems; (5) the relative percentages of the total number of members in each retirement system; and (6) the relative percentages of eligible members participating in each such retirement system. The bill provides each retirement system an initial equitable interest in Common Pension Fund L, equal to its allocable percentage of the entire lottery contribution made on its behalf.

The bill sets the initial value of the lottery asset contribution at $13.535 billion, and provides that the contribution increases the funded ratio of each retirement system benefiting from the contribution.

The bill revises the calculation of the annually determined by the State to the TPAF, PERS and PFRS. The amount as determined under current law is annually adjusted by the product of the allocation percentage (the same percentage used to allocate the assets and annual net revenues of Lottery to the retirement systems as established in the bill); the adjustment percentage (also established in the bill at 88.27 percent for TPAF, 57.29 percent for PERS, and zero for PFRS); and the special asset adjustment. The special asset adjustment is annually calculated determined based on an amortization of the special asset value over the remaining term of the lottery contribution, at the regular interest rate applicable to the retirement systems, but not to exceed the maximum special asset adjustment. However, for FY 2018 through FY 2022, the adjustment percentage is set at 100 percent for all three systems, and the special asset adjustment is a fixed dollar amount. The bill specifies that if after FY 2022, the funded ratio of a retirement system falls below 50 percent for any State fiscal year, the adjustment percentage for that fiscal year is reduced by a number of percentage points equal to three times the difference between 50 percent and the funded ratio, rounded to the nearest percentage point.

FISCAL ANALYSIS

EXECUTIVE BRANCH

None Received.

OFFICE OF LEGISLATIVE SERVICES

The OLS concludes that the bill will increase the assets of three retirement systems, the Teachers' Pension and Annuity Fund (TPAF), the Public Employees' Retirement System (PERS), and the Police and Firemen's Retirement System (PFRS), by contributing the State Lottery to each of those funds, in proportions specified in the bill, for a 30-year period. The OLS estimates that the bill will annually decrease State revenues available to the General Fund for the same 30-year period by the amount of the net proceeds of the State Lottery. The Executive estimates the FY 2018 lottery net proceeds at $1.014 billion. The annual amount of lottery net proceeds over the remaining 29 years is indeterminate. Further, the OLS estimates that the bill will reduce State expenditures, by revising the statutory calculation of the annually determined contribution (ADC) by the State to TPAF, PERS and PFRS over the same 30-year period. The annual expenditure reduction for the first five fiscal years is set forth in the bill and described below; thereafter, the annual reduction is indeterminate.

The bill stipulates the initial value of the asset contribution at $13.535 billion. According to the State Treasurer, as stated in testimony to the Senate Budget and Appropriations Committee on June 15, 2017 this asset contribution will increase the funded ratios of the three retirement systems as follows: TPAF, from 47 percent to 63.9 percent; PERS (State) from 37.8 percent to 49.6 percent; and PFRS (State) from 41.2 percent to 44.5 percent. The impact of funded ratios will then vary over the 30-year term based on the impact of the annual allocation of lottery net revenues to the systems and the periodic revaluation of the Lottery asset. These results assume that annual actuarial valuations of the TPAF, PRES and PFRS acknowledge that the Lottery assets held in Common Pension L are properly recognized as assets of the systems.

The contribution of the State Lottery to the retirement systems should have no direct impact on the gross revenue or the net proceeds of the State Lottery. Beginning in FY 2018, for 30 years lottery revenue collections will shift from the State Lottery Fund to Common Pension Fund L, and will become unavailable for that time period for transfer to the General Fund as State revenue available for budgetary purposes. As noted above, the estimated net proceeds of the State Lottery for FY 2018 are $1.014 billion. The future trend of lottery net revenues is indeterminate; net revenues could increase or decrease based on a number of factors, such as economic conditions and Lottery operational decisions. All State Lottery revenue will return to the State Lottery Fund in the 31st year, and at that time lottery net proceeds become available for transfer to the General Fund as required by law.

The bill revises the statutory calculation of the annually determined contribution (ADC) by the State to TPAF, PERS and PFRS. The amount determined under current law is annually reduced by the product of the allocation percentage (the same percentage used to allocate the assets and annual net revenues of the State Lottery to the retirement systems, established in the bill at 77.78 percent for TPAF, 21.02 percent for PERS and 1.2 percent for PFRS); the adjustment percentage (also established in the bill at 88.27 percent for TPAF, 57.29 percent for PERS, and zero for PFRS); and the special asset adjustment. For FY 2018 through FY 2022, the adjustment percentage is set at 100 percent for all three systems, and the special asset adjustment is a fixed dollar amount, as follows:

FY 2018: about $1.001 billion
FY 2019: about $1.037 billion
FY 2020: about $1.070 billion
FY 2021: about $1.084 billion
FY 2022: about $1.096 billion.

These amounts, stipulated for the first five fiscal years of the bill's impact, represent a reasonable estimate of annual Lottery net receipts. Thus, the loss of revenue to the General Fund from the bill is offset by an approximately reduction in the amount the State would be statutorily required to contribute to the retirement systems. The State Treasurer's testimony cited above indicated that this calculation for these first five fiscal years "...will lower the State's ADC in amounts equal to the projected net proceeds to be generated by the Lottery".

In FY 2023 and thereafter, the special asset adjustment is an amount "determined based on an amortization of the special asset value over the remaining term of the lottery contribution, at the regular interest rate applicable to the retirement systems", but not to exceed the maximum special asset adjustment. The bill provides that the maximum special asset adjustment shall be determined based on a 30-year amortization of the initial special asset value at the regular interest rate applicable to the retirement systems. Under this formula the special asset adjustment will likely decrease, and the ADC will increase, compared to the amounts of the adjustment and resulting ADC in fiscal years 2018-2022. The Executive has provided no detailed projections of the ADC that would result from this formula in those years. The OLS notes that the formula will not result in a higher ADC than would otherwise result under current law, and that either the special asset adjustment as calculated or the maximum adjustment will be less than the adjustments stipulated for fiscal years 2018-2022.

With respect to the bill's impact on the annual revenue received by the TPAF, PERS and PFRS, in the first five fiscal years the sum of State-funded employer contributions and lottery net proceeds will be no different than if the bill were not enacted. Thereafter, the sum of State-funded employer contributions and lottery net proceeds should increase, by indeterminate amounts, assuming that lottery net proceeds do not suffer a drastic decline. This result is attained primarily by the change in the adjustment percentage from 100 percent to lower percentages beginning in FY 2023, and the ceiling on the special asset adjustment (which serves as a floor under the ADC).

Section:	*State Government*
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This legislative fiscal estimate has been produced by the Office of Legislative Services due to the failure of the Executive Branch to respond to our request for a fiscal note.

This fiscal estimate has been prepared pursuant to P.L.1980, c.67 (C.52:13B-6 et seq.).