

Report: State pension costs still could reach ‘unaffordable’ levels

By: KEITH M. PHANEUF | June 11, 2018

Despite numerous reforms in recent years, state government’s pension costs still could reach “unaffordable” levels in the early 2030s, according to a new “stress test” analysis prepared for the Pew Charitable Trusts.



In a report published by Harvard University, analysts also warned there is “significant risk” Connecticut will again

look to extend those surging costs well into the future, effectively creating a series of “permanent high costs” that strip resources from other segments of the state budget.

“The clear finding for Connecticut is that market downturns could increase that cost beyond the state’s capacity to pay under the current funding policy,” analysts Greg Mennis, Susan Banta and David Draine wrote. “As a result, current high costs are likely to persist for decades under scenarios where investments underperform.”

In a report titled “Assessing the Risk of Fiscal Distress for Public Pensions: State Stress Test Analysis,”

(<https://www.hks.harvard.edu/centers/mrcbg/publications/awp/awp92>) the researchers analyzed public-sector pension programs in 10 states, and their ability to remain solvent and unaffordable — particularly in the next recession.

...public pension systems may be more vulnerable to an economic downturn than they have ever been.

Pew Center analysis

Surging retirement benefit costs represent one of the fastest-growing major expenses within Connecticut’s budget — a problem that stems from more than seven decades of inadequate state savings.

Pension programs for state employees and municipal school teachers, collectively, hold assets equal to just 41 percent of their long-term obligations.

Connecticut has tightened pension benefits for retired state employees through union concessions deals reached in 2011 and 2017. While the legislature also mandated last year that teachers’ contribute more toward their eventual pensions, the state reduced its contribution by a matching amount, negating an potential improvement in that pension’s fiscal health.

In recent years the state also has assumed a more conservative rate of return on pension fund investments. It lowered the rate for the state employees’ pension, in two stages, from 8.25 percent to 6.9 percent, and for the teachers’ fund from 8.5 percent to 8 percent.

But critics still charge these rate assumptions — set by retirement boards made up of representatives from state government and employee unions — are unrealistic.

(<http://www.mirrorsignup.org>)

Critics in financial services and academic circles have argued that, since the last recession ended in 2009, a better target is closer to 3 percent or 4 percent, pointing to the yield on certain U.S. Treasury bonds.

Moody's Investors Service proposed a new methodology in July 2012 that used the return of high-quality corporate bonds as its new guideline, noting that their average yield was 5.5 percent in 2010 and 2011.

The new analysis from Pew assumed states would average a 5 percent return on investments in the coming decades.

If Connecticut follows its current funding policy, pension contributions that currently represent about 33 percent of payroll could approach 80 percent by 2033. Over the same period, these costs would consume a greater share of state revenue, jumping from 14 to 20 percent, the report warned.

Connecticut is not alone in its problems, though it's pension debt per capita is significantly higher than that of many other states. States' pension costs have nearly doubled — when analyzed as a percentage of their revenue — since 2000.

States also are taking on more risk in their pension portfolios as they have to pay out more each year in benefits — leaving less and less to invest.

"These factors indicate that public pension systems may be more vulnerable to an economic downturn than they have ever been," Pew analysts wrote.

Risky investment strategies, a history of poor savings habits and questionable assumptions about investment returns often lead to a problem no state can solve in the short term.

The result: Connecticut and some other states have looked to stretch their pension problems farther into the future in hopes of stabilizing the annual cost.

Gov. Dannel P. Malloy, state employee unions and the legislature agreed in early 2017 to restructure payments into the state employee pension fund.

The deal is designed to keep the annual pension contribution — projected in one report to grow from \$1.6 billion in 2017 to as much as \$6.6 billion by 2032 — capped closer to \$2.4 billion per year during that period.

To get that relief, though, Connecticut would ask a future generation to pick up at least \$14 billion of today's obligations after 2032.

"This report clearly shows that Connecticut's pension costs are the result of generations in which we did not adequately pre-fund the systems," said Chris McClure, spokesman for Malloy's budget office. "Over the last eight years the Malloy administration has made mighty strides to address this problem."

Besides two new employee tiers with "sharply reduced" pension benefits and higher employee contributions, the administration has reduced the executive



MARK PAZNIOKAS / CTMIRROR.ORG FILE PHOTO

Gov. Dannel P. Malloy (file photo)

branch workforce by 12 percent since 2011, McClure said.

“The Pew study shows that we are not out of the woods yet, and that a worst-case market could delay our recovery,” he added. “At the same time, the state is in a better position today than it was in 2008 to withstand the next market downturn and avoiding insolvency.”

As these surging pension costs become unaffordable, Pew analysts wrote, extending them into the future — at even greater expense — becomes a likely choice. Connecticut is one of two states, along with Pennsylvania, analysts added, where “The risk of permanent high costs is most acute.”

The state already has begun options to cap teacher pension contributions as well, and shift billions of dollars in added expenses onto future taxpayers. The \$1.2 billion annual contribution Connecticut faces now could top \$6.2 billion by the early 2030s according to a 2015 study by the Center for Retirement Research at Boston College.

Connecticut may not have the same legal flexibility, though, to restructure payments into the teachers pension fund.

That’s because the state borrowed \$2 billion in 2008 to shore up the teachers’ pension and pledged to its bond investors not to short-change pension contributions for the life of the 25-year bond issuance.



JACQUELINE RABE THOMAS / CTMIRROR.ORG

State Treasurer Denise L. Nappier

In other words, if the state wants to pay less into the teachers’ pension than fund actuaries recommend — with a very limited exception — it needs to pay off the bonds first.

The state’s bond counsel, Day Pitney of Hartford, spelled this out in an opinion provided in late April 2016.

Still, the legislature and Malloy continue to study legal options to restructure the teachers’ pension fund in future years.

State Treasurer Denise L. Nappier noted that the legislature authorized Connecticut’s own pension stress-test analysis, which the Malloy administration will conduct this fall.

“Any stress testing, however, is only as good as the integrity of the data that goes into it,” she said, urging the administration to work with her office to analyze how the state’s pensions would react to a worst-case economic

downturn.

“To be sure, Connecticut has had to come to grips with its undisciplined past, and finally has imposed some fiscal discipline on itself,” Nappier added. “It helps no one, however, to either overstate or underestimate the funding challenge ahead of us.”

Comments

17 comments

