Bond Case Briefs

Municipal Finance Law Since 1971

Worst-Funded U.S. Pension Shows Kentucky's Neglect: Muni Credit.

Kentucky's worker retirement plan, the nation's worst-funded state pension, is losing ground even after a three-year rally in stocks, underscoring the fiscal peril of forgoing payments into the pools.

A 15.5 percent return in fiscal 2014 wasn't enough to bolster the Kentucky Employees Retirement System, which serves 119,735 workers and retirees. Officials shortchanged the plan for more than a decade. They diverted the cash elsewhere, leaving KERS with 21 percent of the funds needed to pay promised benefits in 2014 as distributions exceeded revenue. No single U.S. state plan has a lower ratio, according to the Center for Retirement Research at Boston College.

KERS is one of five pensions in the Kentucky system, which the legislature restructured in 2013 to cut costs and ensure full funding. Its deficit shows that investment returns aren't enough to turn around struggling pensions. Forty-eight states have enacted changes to their plans since 2009 to lower expenses and provide adequate contributions, according to the National Conference of State Legislatures.

"We won't run out of money" as long as KERS gets full funding from the state and meets projected investment returns, said William Thielen, executive director of Kentucky Retirement Systems, which oversees the five pensions pools from Frankfort. "If we fail to meet those assumptions it will threaten our solvency."

Rebound Ripple

U.S. stocks have rebounded from the depths of the recession, pushing the Standard & Poor's 500 Index to three straight annual gains of more than 10 percent for the first time since the 1990s. States that fully funded their plans saw greater benefit from the rally.

Public pension assets have grown about 37 percent since 2009 on average, according to the National Association of State Retirement Administrators. While some plans grew by as much as 66 percent, states that didn't fully fund pensions — Kentucky, New Jersey and Pennsylvania — gained 22 percent or less.

"The funds that increased at the fastest rate had been getting a higher percentage of their required contribution," said Keith Brainard, the Georgetown, Texas-based research director for the association. "Fund returns aren't enough if you have more money going out than you take in."

Cash Diverted

As municipalities mended their finances following the recession, some used pension cash to plug budget deficits. New Jersey, after overhauling and pledging to fund its pensions, skipped $2.5 billion of promised contributions as revenue missed projections.

Partly because of inadequate contributions, the average funding level of state and local pensions has deteriorated even though investment returns have improved, according to a report last year from Moody's Investors Service on the 25 largest public plans. While returns averaged 7.5 percent from 2004 to 2013, unfunded liabilities tripled to almost $2 trillion.

Kentucky's pensions haven't been fully funded since fiscal 2002, Thielen said. The state has confronted budget deficits in the wake of the recession.

The KERS plan for workers in nonhazardous jobs shrank in the fiscal year that ended June 30. It paid out about $914 million of benefits and expenses, or $182 million more than it received from investments and contributions from workers and the state. The state made about $300 million of the $520 million contribution that actuaries had determined was needed to keep pace with outlays.

Benefit Switch

In 2013, lawmakers passed steps designed to cut the expense of Kentucky's plans by moving future workers into a type of plan that doesn't promise specific benefits. They also limited cost-of-living adjustments.

In fiscal 2015 and beyond, the state also committed to make full payments. If Kentucky receives that money and earns its 7.5 percent estimated rate of return, its funding ratio may still shrink to as low as 15 percent in coming years, though it will climb back to 100 percent over 30 years, Thielen said.

The strategy "will work — if we don't neglect it or negate it," Democratic Governor Steve Beshear said in his State of the Commonwealth address Jan. 7.

A proposal for extra funding beyond the actuarially required contributions may come up in the legislative session that started this week, Thielen said.

"We need some additional funding over and above" that payment, he said.

Political Risk

The risk is that a future legislature rolls back the steps passed in 2013 and uses the money for other expenses, Thielen said.

"Politics has a way of being sporadic," he said. "If we have a down year, that has a significant impact on our unfunded liabilities."

The system's precarious balance worries workers who depend on it for income later in life, said Jim Carroll, a retiree and co-founder of Kentucky Government Retirees, which advocates for state workers.

"The reform is doing nothing to help the state pension plan because we have such a deep hole," Carroll, 62, a former public information officer for the state, said in a phone interview. "We're deeply concerned about the financial status of the plan."

Bloomberg Muni Credit

By Darrell Preston

Jan 8, 2015 5:00 PM PT

To contact the reporter on this story: Darrell Preston in Dallas at dpreston@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net
Mark Tannenbaum, William Selway

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com