Illinois Must Pay $845 million More to Pension Systems Next Year, Report Finds.

A new report on Illinois underfunded pension systems says the state needs to put more money into the benefits programs before they become unsustainable and consume an even larger share of the state's tax revenue.

The state will be required to contribute $9.39 billion to six pension funds in fiscal 2020, about $845 million more than the previous year, according to the report.

In addition to being underfunded, the state's pension systems are susceptible to a volatile stock market, the report found. Two public finance watchdogs said the report underscores the need for changes moving forward, including some changes that won't be popular.

"It's definitely wonky and often times very difficult for ordinary citizens to understand, but we're talking about hundreds of billions of dollars and how do we actually calculate that and what do we assume when we are coming up with the expectations which have massive implications for Illinois taxpayers in general," Truth In Accounting Research Director Bill Bergman said.

The Illinois Auditor General released its annual State Actuary's Report on Thursday. The report has been required since 2012. The state contracted with Cheiron, an actuarial consulting firm, to serve as the State Actuary to review assumptions, issue reports to pension boards and identify recommended changes.

"The funded ratio of the retirement systems ranged from 47.9 percent to 15.3 percent, based on the actuarial value of assets as a ratio to the actuarial liability," the report said. "If there is a significant market downturn, the unfunded actuarial liability and the required State contribution rate could both increase significantly, putting the sustainability of the systems further into question."

Cheiron also "noted that the systems are, or will be, experiencing negative cash flows which may impact the interest rate returns that are realized."

The state's Teachers, State Universities and General Assembly retirement systems are already seeing negative cash flows while the State Employee and Judges retirement systems are projected to have negative cash flows in the near future, the report said.

"Contributions should ramp up as quickly as possible to a level that is expected to prevent the unfunded actuarial accrued liability from growing," the report said. "Continuing the practice of underfunding the systems increases the risk of needing even larger contributions in the future that may make the systems unsustainable."

The report should serve as a warning call as it seeks more state money sooner for the growing pension liability, said Ted Dabrowski, president of the financial analysis website Wirepoints.

"If billions more a year have to go into pensions, you're talking about huge cuts to everything else, whether it’s education or health care or roads,” Dabrowski said. “It creates a real spiral, a death spiral problem because people are already tired of paying taxes. They’d have to pay a ton more.”

Dabrowski said he expects to see the state’s tax base erode if policymakers only look at increasing taxes. He said the state’s continued out-migration with most recent numbers showing people leaving the state at a faster pace over the past five years. The most recent U.S. Census Data showed Illinois lost 45,000 people from 2017 to 2018.

The report deemed the actuary’s estimated rate of return on investments “reasonable,” but Bergman questioned that conclusion, noting that those assumptions often lead to the state shorting the pension funds and increasing the pension debt.

Bergman said by budgeting pension funding with an assumed rate of return, not a risk-free discount rate, taxpayers are increasingly on the hook to fill the gap if investment returns don’t meet the estimates.

The math around the assumed rate of return is not just an issue for the state pensions, Bergman said it also affects local police and fire funds as well.

The report said that on the state’s targeted funding goal of 90 percent by 2045 was inadequate.

“This contribution level does not conform to generally accepted actuarial principles and practices,” the report said. “Generally accepted actuarial funding methods target the accumulation of assets equal to 100 percent of the actuarial accrued liability, not 90 percent.”

Dabrowski said it was refreshing to see that recognition. He also said it’s further evidence that a proposal from the Center for Tax and Budget Accountability is the wrong plan.

The Center for Tax and Budget Accountability proposed in May moving the goal posts for funding the state’s pensions “from a target of a 90 percent funded ratio in [fiscal year] 2045 to a target of between 70 and 80 percent.”

“Those proposals by the [Center for Tax and Budget Accountability] should be dismissed, disregarded and thrown away because I think Chiron was spot on that 100 percent funding is where we need to be headed if we really want these pension funds to be healthy,” Dabrowski said.

Earlier this month, credit rating agency Fitch also flagged the Center for Tax and Budget Accountability’s plan as a potential concern.

Gov.-elect J.B. Pritzker has advocated for state resources put in up front, somewhat mirroring the center’s plan. Pritzker picked a member of the center to serve on his budget transition team.

Dabrowski said the solution is to change the state constitution to reduce the debt owed to state workers.

“The debt is so large that there’s no way to just raise taxes or borrow some money,” he said. “Those days are over. It’s so badly funded and the promises are so large.”

He said unions should come to the table to reduce the debt or pensions could become insolvent.

Pritzker, along with other Democrats and union groups, have been opposed to the idea of changing the pension protection clause in the state’s constitution. They have mostly advocated for changing the state constitution’s flat tax provision to a progressive tax to increase how much the state collects from income taxes.

The Commission on Government Forecasting and Accountability earlier this month pegged the state's five pension funds with a combined $134 billion of unfunded liabilities and an average funded ratio of 40.2 percent. That doesn't include other post-employment benefits, or OPEBs.

Pew Charitable Trusts put out a report this month based off 2016 data that put the total liability of OPEB in Illinois at $53.4 billion with a -0.2 percent funded ratio, the worst in the country. Truth In Accounting pegs the unfunded retiree health care costs at $52.5 billion based on 2017 data. Wirepoints pegs the cost OPEBs at $72.6 billion. That's on top of the $134 billion in pension debt.

Major credit-rating agencies say the state's unfunded liabilities is one of the biggest reasons the state has the worst credit rating in the nation, a notch above junk status with a negative outlook.

By Greg Bishop | Illinois News Network