

## Pension Task Force Oct 13, 2021

- **Long-Term Fiscal Health** - Requires addressing our long-term liabilities in a prudent way. Prefunding benefits is a key component; however, prefunding has a very real cost that needs to be accounted for in annual budgets for a very long time, up to 30 years
- **Bond Rating** – our long-term liabilities threaten the state’s bond rating. This is a key thing that rating agencies look at when evaluating states’ credit risks, and we are vulnerable because our liabilities are large relative to the size of our state’s economy. If our bond rating drops, it will likely increase the state’s borrowing costs and the costs of other entities that rely on the state’s moral obligation
- **Pension and OPEB Costs** - have grown faster than revenues and other expenses and this trend is expected to continue.
  - Looking back....From FY2012 to FY2022, pension costs have increased by \$216.3 million (a compound annual growth rate of 12.9%). OPEB costs have increased by \$26.5 million (a compound annual growth rate of 4.7%)
  - Looking forward....The latest consensus revenue forecast expects source General Fund revenue to grow at a compound rate of about 2.1% from FY22 to FY26. In a best-case scenario when all our actuarial assumptions are met, our pension costs are assumed to increase by at least 3% a year until FY38.
- **Benefits of Prefunding OPEB Obligations** - Prefunding will shore up the benefit for the future, save the taxpayers money by using investment gains to fund future benefits, and help the state’s bond rating and balance sheet by reducing long- term liabilities by \$1.68 billion just by prefunding the state’s two OPEB benefits. But prefunding OPEB comes at a cost – it requires an upfront, decades-long commitment of close to \$40 million in additional expenses above what we are currently paying to prefund both OPEBs. To commit to these additional budgetary obligations will require offsetting savings in other areas such as pension costs to free up capacity in the budget.
- **Risks of No Action** - If OPEB costs continue to rise and the state does not find the budgetary capacity to commit to prefunding, it may force changes to the benefit.

### Prefunding OPEB

Benefit of prefunding is the reduction in the accrued liability

Prefunding is more budget pressure ~\$40M in total

Teachers’ OPEB prefunding budget cost \$15-\$17m – normal cost ~\$14m EF obligation?

State Emps’ OPEB prefunding budget cost is \$20-25m (GF \$8-10m) a 3.5-4% payroll add

## **Base Budget Context - 10 Year Annual Budget**

The chart below shows annual **base** appropriation amounts for Pension and OPEB obligations.

	FY 2012	FY 2022	\$chg & %chg	10yr CAGR %
Teachers' Pension (GF&EF)	51.7	189.7	138.0 / 267%	13.9% avg
State Emps' Pension (all funds)	40.3	118.6	78.3 / 194%	11.4% avg
Subtotal Pensions	92.0	308.3	216.3 / 235%	12.9% avg
Teachers' OPEB Paygo GF	23.1 <i>corpus</i>	35.1	12.0 / 52%	4.3% avg
State Emps' OPEB Paygo (all funds)	22.7	37.2	14.5 / 64%	5.1% avg
Subtotal OPEB	45.8	72.3	26.5 / 57.9%	4.7% avg
<b>Total Annual Budget (all funds)</b>	<b>137.8</b>	<b>380.6</b>	<b>242.8 /176%</b>	<b>10.7% avg</b>

## **Onetime Funds**

In the past four years, an additional **\$139.7m** onetime GF was also applied to these systems:

FY18/19 VSTERs \$39.5m

FY19 Teachers' OPEB \$47.8m (includes internal loan payoff)

FY21 State Emps' OPEB \$52.4m

**\$150m** onetime GF currently reserved (see in Sec.C.101 of Act 74) - can this be increased?

## **Base Budget Growth Rates**

Growth in total of all state funds, excluding EF, has been 2.4% annually over past 10 years. Baseline GF appropriations have grown at 3.5% on average annually over same 10-year period. If you look at only the GF portion for Pension & OPEB appropriations – they have grown 12.4% over this 10-year period. The 12.4% is in part driving the 3.5% GF average, so when you remove Pension/OPEB what is left is 2.5% for all other base GF growth. The accumulated Pay Act pressure took up 0.6%, leaving less than 2% annually for all other GF needs – resulting in: VSC at the brink – Housing/VHCB formula restricted – Mental Health limited increases etc. ([See Report on Unfunded Obligations](#))

## **Unfunded Liability Growth -8 Year Picture**

	June 30, 2012	June 30, 2020	\$ chg	% chg
Teachers' Pension	945.5	1,933.0	987.5	104%
State Emps' Pension	401.8	1,040.5	638.7	159%
Subtotal Pensions	1,347.3	2,973.5	1,626.2	120.7%
Teachers' OPEB	998.4	1,259.4	261.0	26%
State Emps' OPEB	827.2	1,227.6	400.4	48%
Subtotal OPEB	1,825.6	2,487.0	661.4	36.2%
<b>Total Unfunded Liability</b>	<b>3,172.9</b>	<b>5,460.5</b>	<b>2,287.6</b>	<b>72.1%</b>

Pension liability growth has many drivers – experience update, return rate lowered etc.

OPEB liability growth is mostly due to lack of prefunding and lower muni discount rate change

## **Historical Context**

OPEB expansion sometime around 2000 – never properly funded

There have been adjustments, reductions and added resources since then

- 2008 –Pension ADECs to be fully funded – tiered health care benefits structure VSERS new hires after July 2008, VSTRS changed in 2010 tied to years of service.
- 2104 – Moved to Paygo for Teachers' OPEB – EGWP, OPEB to federal grants, additional contributions from school employers and new hires.