

Public Pension Status and Outlook



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The Independent Fiscal Office (IFO) publishes this research brief to provide an update on the status of public pension funds in the Commonwealth. The text that follows uses the latest data to provide a current snapshot and short-term projection of the financial outlook for the state's pension systems and potential implications for the state budget.

Notable Legislation

As part of its statutory duties, the IFO works with the state pension systems and contracted actuaries to analyze proposed pension legislation. The acts below were analyzed by the IFO prior to enactment and are notable for current and future impacts to the systems.

- **Act 5 of 2017:** For both state systems, the State Employees' Retirement System (SERS) and Public School Employees' Retirement System (PSERS), the act established three new retirement classes (six total) for new employees hired on or after January 1, 2019 (SERS) or July 1, 2019 (PSERS). In lieu of traditional defined benefit plans, Act 5 established two hybrid defined benefit and defined contribution plans and a pure defined contribution plan. Changes were also made to benefit accrual rates, employee contributions and retirement ages.
- **Act 105 of 2019:** Allows qualified employers to issue bonds to pre-fund 75% to 100% of their unfunded actuarial liability (UAL). Agreements to pre-fund the UAL must be entered into by December 31, 2024 and the payments must be made to SERS by May 1, 2025. To date, two employers have made advance contributions: (1) The Pennsylvania State University (\$1.1 billion in 2020) and (2) the Pennsylvania State System of Higher Education (\$825 million in 2021).
- **Act 128 of 2020:** Enacts administrative and reporting changes for SERS and PSERS. Most notably, the act requires both systems to conduct prescribed stress testing. The IFO will compile those data in a report that summarizes outcomes and calculates the ratio of projected employer pension contributions to projected state revenues. Regular stress testing provides policymakers with useful information regarding the potential budget implications if investment returns diverge from assumed rates.

State Pension Systems

Table 1 (next page) displays recent and projected investment returns, employer contribution rates and UAL for SERS and PSERS. State contributions to SERS include two advance contributions for a combined \$1.9 billion pursuant to Act 105 of 2019. Recently, PSERS published a preliminary return for FY 2020-21 to exceed 25%, net of fees.¹ Similarly, SERS testified that net-of-fee returns for July 1, 2020 to June 30, 2021 are an estimated 28%. The official rates of return will not be finalized for several months, and new actuarial projections will not be available until 2022, as the systems incorporate changes to actuarial assumptions and methodologies. However, these strong preliminary returns will reduce the UAL and employer contribution rates in future years for both systems.

¹ *PSERS Projects Its Highest Net Investment Return in Two Decades* (August 4, 2021) at https://www.media.pa.gov/Pages/Public-School-Employees-Retirement-System_details.aspx?newsid=166.

Table 1: State Pension System Funding Outlook

FY Ending	SERS ¹				PSERS			
	Employer Rate	\$ State Contrib	System Return	Unfunded Liability	Employer Rate	\$ State Contrib	System Return	Unfunded Liability
2005-2010	3.53%	\$225	3.50%	\$9,736	5.34%	\$337	2.99%	\$19,699
2010-2015	10.87	745	6.90	19,452	11.63	699	9.73	37,336
2016	25.01	1,622	6.51	19,923	25.84	1,719	1.29	42,724
2017	29.51	1,897	15.08	19,662	30.03	2,064	10.14	44,512
2018	33.24	2,049	-4.55	22,793	32.57	2,264	9.27	44,855
2019	32.93	2,115	18.75	23,039	33.43	2,488	6.68	44,134
2020	33.59	3,186 ²	11.11	22,395	34.29	2,628	1.11	44,035
2021	33.48	2,936 ³	7.00	17,217	34.51	2,702	25.00 ⁴	44,574
2022	33.81	2,146	7.00	16,436	34.94	2,734	7.00	44,713
2023	34.51	2,191	7.00	14,931	35.80	2,894	7.00	44,654

Note: Dollars in millions. Data sourced from various system projections, releases and financial reports, unless noted otherwise. For year ranges (e.g., 2005-2010), Employer Contribution Rate and State Contributions are averages. System Return is 5-year performance as noted in system CAFR. Unfunded Liability is final year UAL. Calculations by the IFO.

1 SERS reported on calendar year basis except for Employer Contribution Rate. Includes all funds.

2 Includes \$1.1 billion prepayment in unfunded liability from The Pennsylvania State University.

3 Includes \$825 million prepayment in unfunded liability from the Pennsylvania State System of Higher Education.

4 PSERS returns for 2021 are preliminary. Final figures are not yet available and will affect UAL and employer contribution rates once finalized.

Table 2 uses data from various IFO, SERS and PSERS reports to project the share of General Fund (GF) revenue that will be needed to support the state's pension obligations. Since FY 2015-16, Commonwealth pension obligations have outpaced revenue growth as FY 2019-20 obligations accounted for 10.2% of revenues versus 7.7% in FY 2015-16. This outcome is partially attributable to the phase-out of the rate collars enacted by Act 120 of 2010, which ended after FY 2016-17.

Table 2: Share of General Fund Revenues for Employer Pension Contributions

FY Ending	SERS	PSERS	Total	Annual Growth	Share of Revenue
2016	\$665	\$1,719	\$2,384	--	7.7%
2017	784	2,064	2,848	19.5%	9.0
2018	840	2,264	3,104	9.0	9.0
2019	856	2,488	3,344	7.7	9.6
2020	877	2,628	3,505	4.8	10.2
2021	650	2,702	3,352	-4.4	8.7
2022	931	2,734	3,665	9.3	9.5
2023	982	2,894	3,876	5.8	10.2

Note: Dollars in millions. SERS General Fund portion estimated by the IFO and excludes COVID-19 relief funds. FYE 2020 General Fund revenues increased by approximately \$2.0 billion due to revenue delays resulting from the COVID-19 pandemic. FYE 2021 values reduced by same amount.

Source: Various reports issued by the IFO, SERS and PSERS. Calculations by the IFO.

For FY 2020-21, the state used funds from the Coronavirus Aid, Relief and Economic Security (CARES) Act to fund employer contributions that typically rely on General Fund monies. The shift of funding source reduced the share of General Fund revenues used for pensions in FY 2020-21. The FY 2021-22 budget contains \$3.8 billion in revenue deposits from the American Rescue Plan Act (ARP). However, they are not included in the General Fund revenue base for that fiscal year in Table 2. The IFO will update these projections as part of its *Five-Year Economic and Budget Outlook* in mid-November.

Table 3: State Pension Funding Comparisons

State	2014			2019		
	Funded Ratio	Rank	Per Capita	Funded Ratio	Rank	Per Capita
New York	98.1%	6	\$186	96.1%	5	\$450
Delaware	92.4	9	810	83.4	12	2,083
West Virginia	77.7	23	2,066	83.4	13	1,773
Ohio	80.3	20	3,162	80.0	18	3,603
Georgia	83.3	17	1,639	78.7	19	2,441
Virginia	75.1	27	2,569	77.2	22	2,760
Maryland	71.3	31	3,085	71.6	27	3,566
Pennsylvania	59.6	46	4,257	58.0	43	5,074
New Jersey	42.5	48	12,762	39.7	49	14,054
Illinois	41.3	49	8,658	38.9	50	11,468
U.S.	74.8	--	2,933	71.3	--	3,803

Note: Per capita column equal to unfunded actuarial liability divided by state population. Excludes local pension systems.

Source: The State Pension Funding Gap: 2019 and 2014, Pew Charitable Trusts.

Table 3 uses data compiled by the Pew Charitable Trusts for its annual 50-state pension funding brief.² The states are ranked by 2019 funded ratio. For 2019 (most recent data available), Pennsylvania residents are obligated by \$5,075 per person in unfunded pension liabilities, up from \$4,250 in 2014. That amount exceeds all border states except for New Jersey and is nearly 11 times higher than New York. Pennsylvania also has a lower funded ratio (58%) than all states listed except New Jersey (40%) and Illinois (39%).

Local Pension Systems

Pursuant to Act 205 of 1984 and Act 44 of 2009, the Pennsylvania Auditor General biennially compiles data from municipal pension systems' actuarial evaluations and publishes distress scores for each municipal defined benefit pension plan. There are four categories for municipal pension plans: (1) Not Distressed (funded at or above 90%); (2) Minimally Distressed (70% to 90% funded); (3) Moderately Distressed (50% to 70% funded); and (4) Severely Distressed (funded below 50%). At each level of distress, municipal employers have optional and/or mandatory protocols that may or must be followed.

² See "The State Pension Funding Gap: Plans Have Stabilized in Wake of Pandemic," The Pew Charitable Trusts (September 2021) at www.pewtrusts.org/en/research-and-analysis/issue-briefs/2021/09/the-state-pension-funding-gap-plans-have-stabilized-in-wake-of-pandemic.

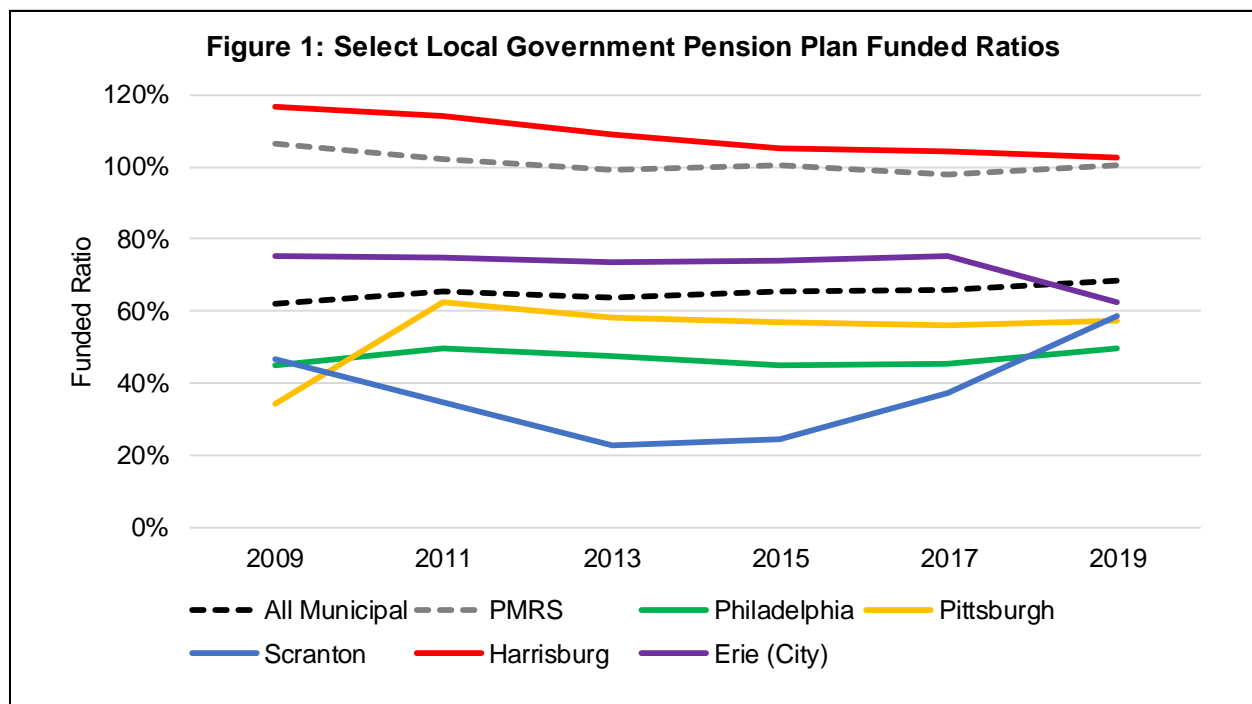
Since 2009, the share of municipal systems that qualify as distressed at any level decreased from 46% to 37%, a reduction of 115 systems. The number of severely distressed systems decreased from 27 to 6 systems. However, the dollar value of unfunded actuarial liabilities increased during that time from \$7.2 billion to \$8.7 billion, as displayed in **Table 4**.

Year	Philadelphia		Pittsburgh		All Other	
	UAL	Share	UAL	Share	UAL	Share
2009	\$4.93	68.5%	\$0.65	9.0%	\$1.61	22.4%
2011	4.77	68.3	0.38	5.4	1.84	26.3
2013	5.33	66.7	0.48	6.1	2.18	27.3
2015	5.94	71.6	0.52	6.2	1.84	22.2
2017	6.17	70.2	0.57	6.5	2.05	23.3
2019	5.93	68.0	0.56	6.5	2.23	25.5

Notes: Years represent actuarial valuation years. "Share" column represents the share of the total state municipal system UAL (the sum of Philadelphia, Pittsburgh, and All Other).

Source: Pennsylvania Auditor General, *Status Report on Local Government Pension Plans* (2010-2020).

Figure 1 displays funded ratios for select municipal systems compared to two aggregate groups: (1) all municipal systems and (2) local government plans enrolled in the Pennsylvania Municipal Retirement System (PMRS), an independent state agency that provides oversight for over 1,100 local government plans. PMRS uses more conservative return assumptions (5.25%) than most government plans (e.g., SERS and PSERS assume 7.00%) and imposes various conditions that must be met by participating employers.



Overall, municipal plans increased their funded ratios since 2009. These figures reflect losses incurred during the 2008 to 2009 recession, which would have been amortized over the next decade. Some highlights are as follows:

- Total municipal plan funding increased by 6.3 percentage points, to 68.3%.
- The average funded ratios for plans administered by PMRS decreased from 102.4% to 100.3%.
- The funded ratio for the Philadelphia city pension system increased to 49.7%, up from 45.0%.
- Pittsburgh significantly increased its funded ratio from 34.3% to 57.5%.
- Scranton's funded ratio rose from 46.6% to 58.4%.
- The funded ratio for the City of Erie (75.2% to 62.4%) declined considerably, as did Harrisburg's pension system (116.8% to 102.8%), which remains fully funded.

Table 5: Total Pennsylvania Pension Liability

	2014-15	2019-20
State	\$56.8	\$66.4
County	1.3	1.3
<u>Municipal</u>	<u>8.3</u>	<u>8.7</u>
Total	66.4	76.4
Per Capita	5,193	5,970

Note: Dollars in billions, except per capita amount.

Source: Reports from SERS, PSERS and the Pennsylvania Auditor General. Calculations by the IFO.

Table 5 combines the most-recent local government UALs with the 2020 state UALs for a calculation of the total public pension UAL in Pennsylvania. In total, the Commonwealth's public pension systems had \$76.4 billion in unfunded liabilities, equivalent to nearly \$6,000 per resident. These data do not reflect the strong investment returns earned since that time, which would reduce the per capita amount. The figures in Table 5 are for illustrative purposes only, and do not imply that state residents have any legal obligation to provide support to a county or municipal system that might require future assistance.

Staff Acknowledgements

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