Public Pension Oversight Board

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Pensions & The Budget

FY 2017 & FY 2018 Finances

Revenues

- Actual revenue shortfall for FY 2017 $138.5 million. The revenue drop-off occurred late in the year, so there was a scramble to reduce spending by year-end.

- Consensus Forecasting Group expects a revenue shortfall of $200 million for FY 2018 (this year). There is uncertainty in the economic outlook for FY18 that warrants great caution

The ADC (ARC)

- Using realistic actuarial assumptions, the FY 2018 ADC (ARC) should be about $700 million more than is budgeted
- If FY 2018 budgeted expenditures are reduced by only $200 million, the Budget Reserve Trust Fund (Rainy Day Fund) will be entirely depleted

Fiscal Needs

- The Budget Reserve Trust Fund (Rainy Day Fund) should be at least 5% of annual revenues – about $550 million

- For FY 2019, the full ADC (ARC) will be included in the budget – an additional $700 million more than in FY 2018.

- To be fiscally responsible, we need an additional $1,000,000,000 – one billion dollars – per year.

How to raise $1 billion?

Only three options!

- Cut spending
- Increase taxes
- Adjust benefits

Raising $1 Billion

Decrease spending on government services

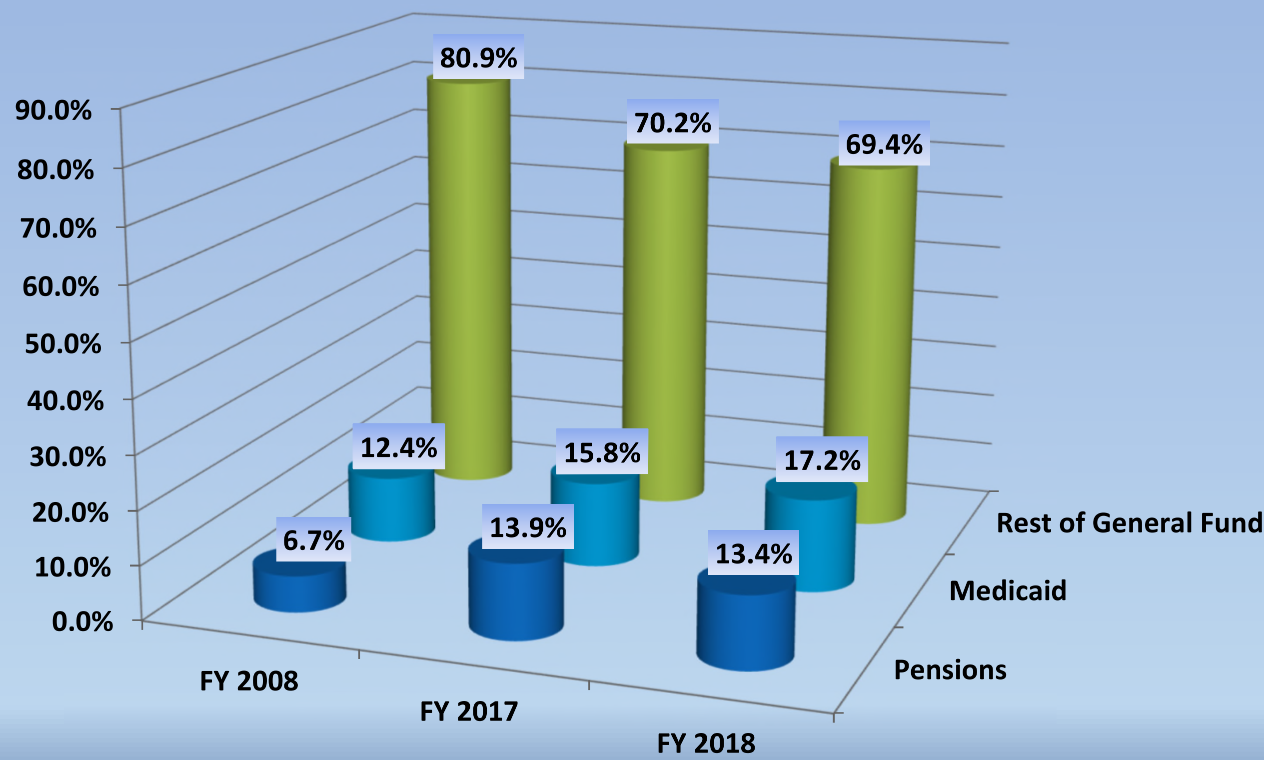
- In the last budget cycle, spending for many programs was reduced by 9%.
- Important government services were not subjected to cuts – K-12 education (SEEK), Medicaid, public protection, debt service, etc.

Raising $1 Billion

Decrease spending on government services

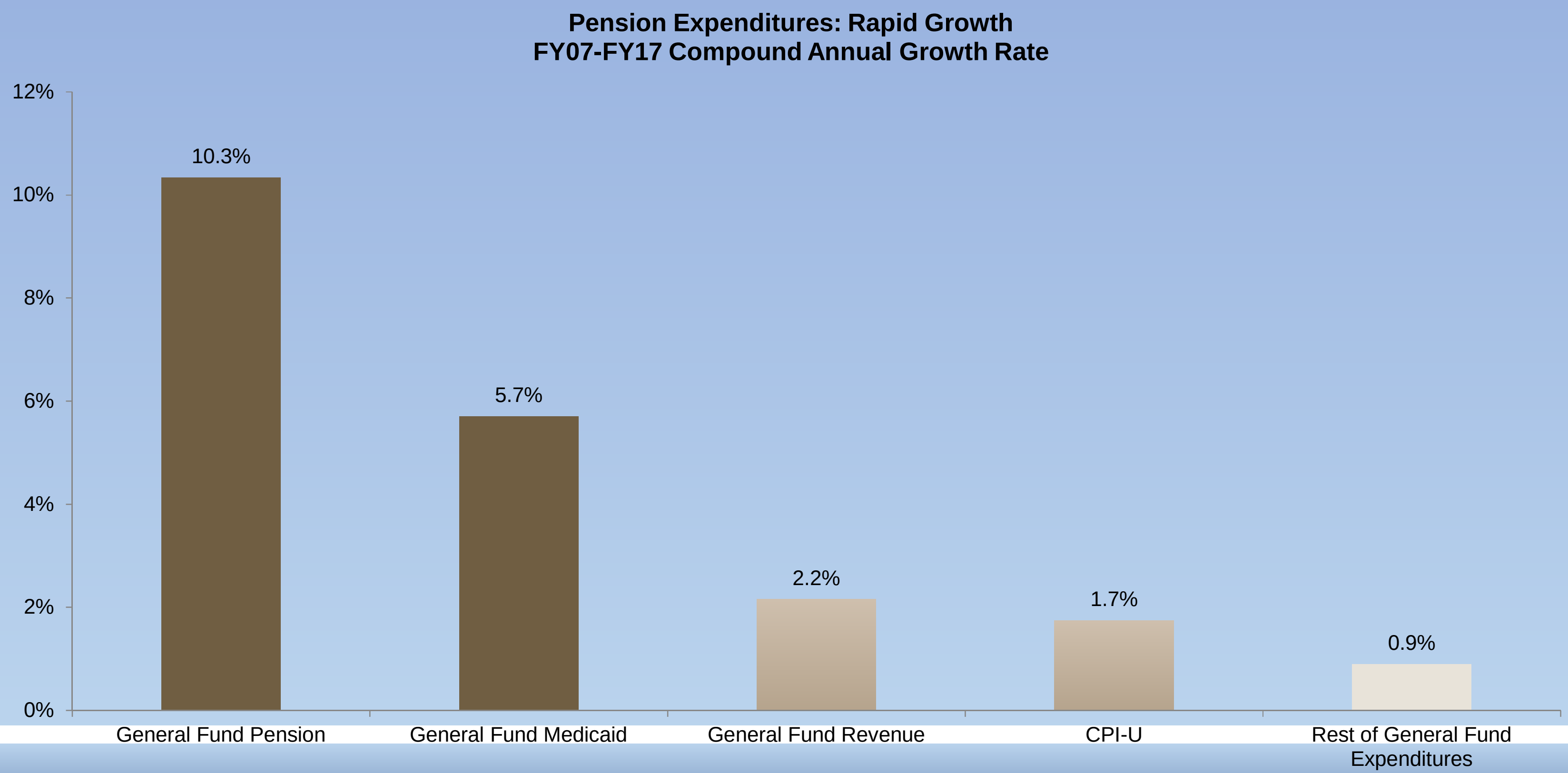
- Protecting those same programs from cuts in FY 2019 would require that all other programs be cut by 34.4%
- Protecting those same programs but additionally subjecting education (SEEK) to cuts, requires cuts of 16.86%.
- SEEK would be reduced by $510 million (out of SEEK's $3.024 billion appropriation)

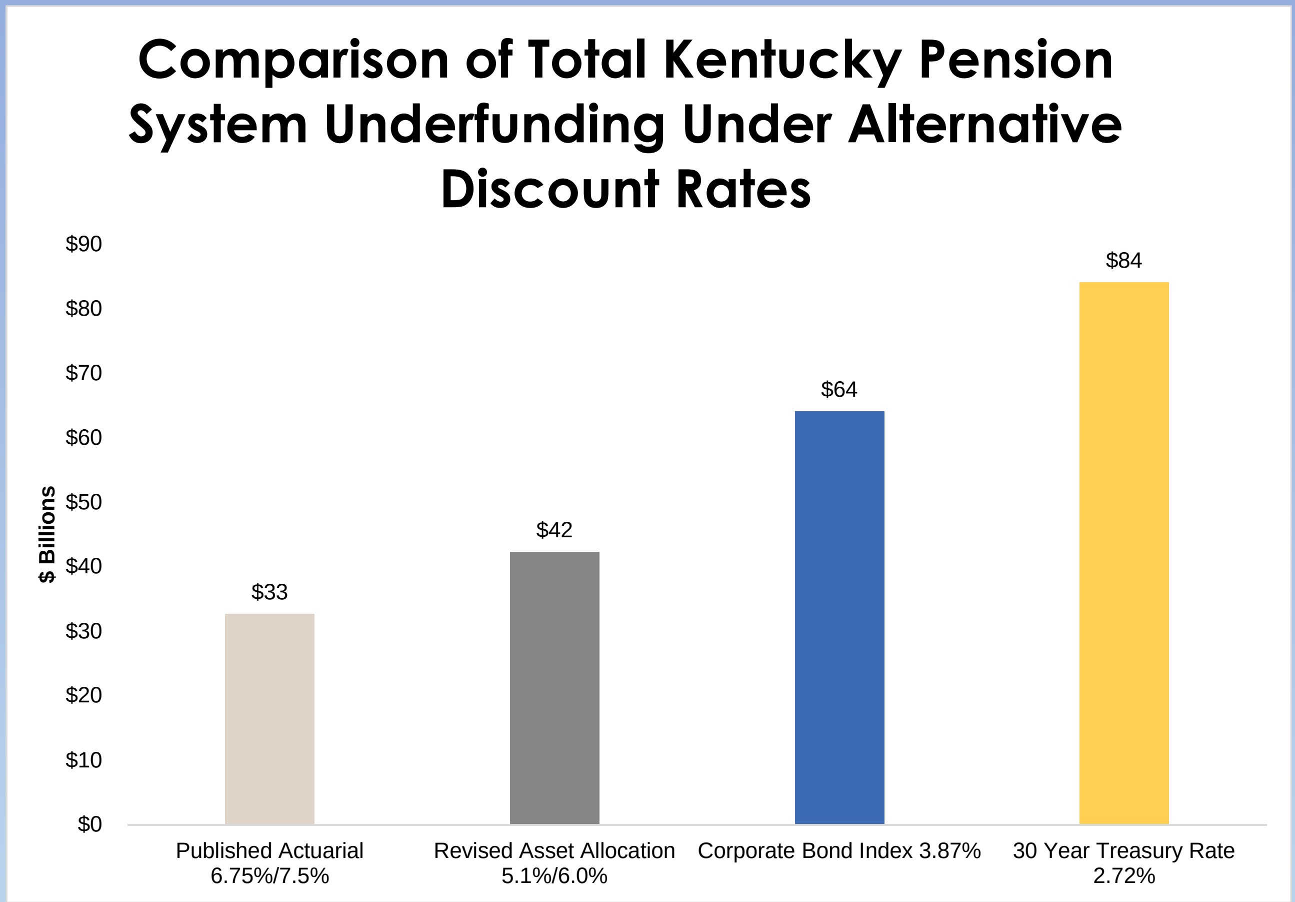
Pensions and Medicaid as growing share of spending



Reminders from PFM Report #2

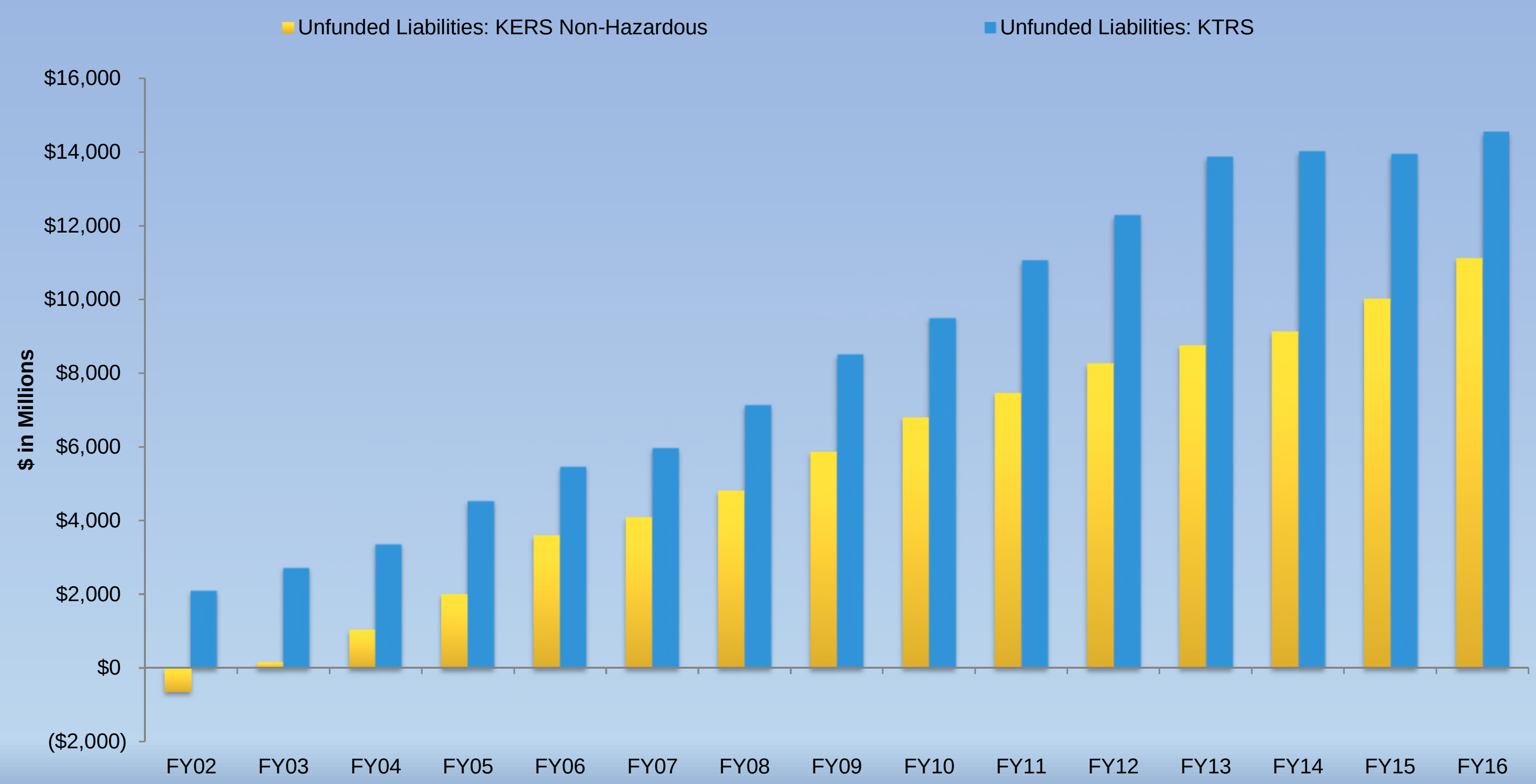
Pension Expenditures are Crowding out the Rest of the Budget and Growing Much Faster than Revenues



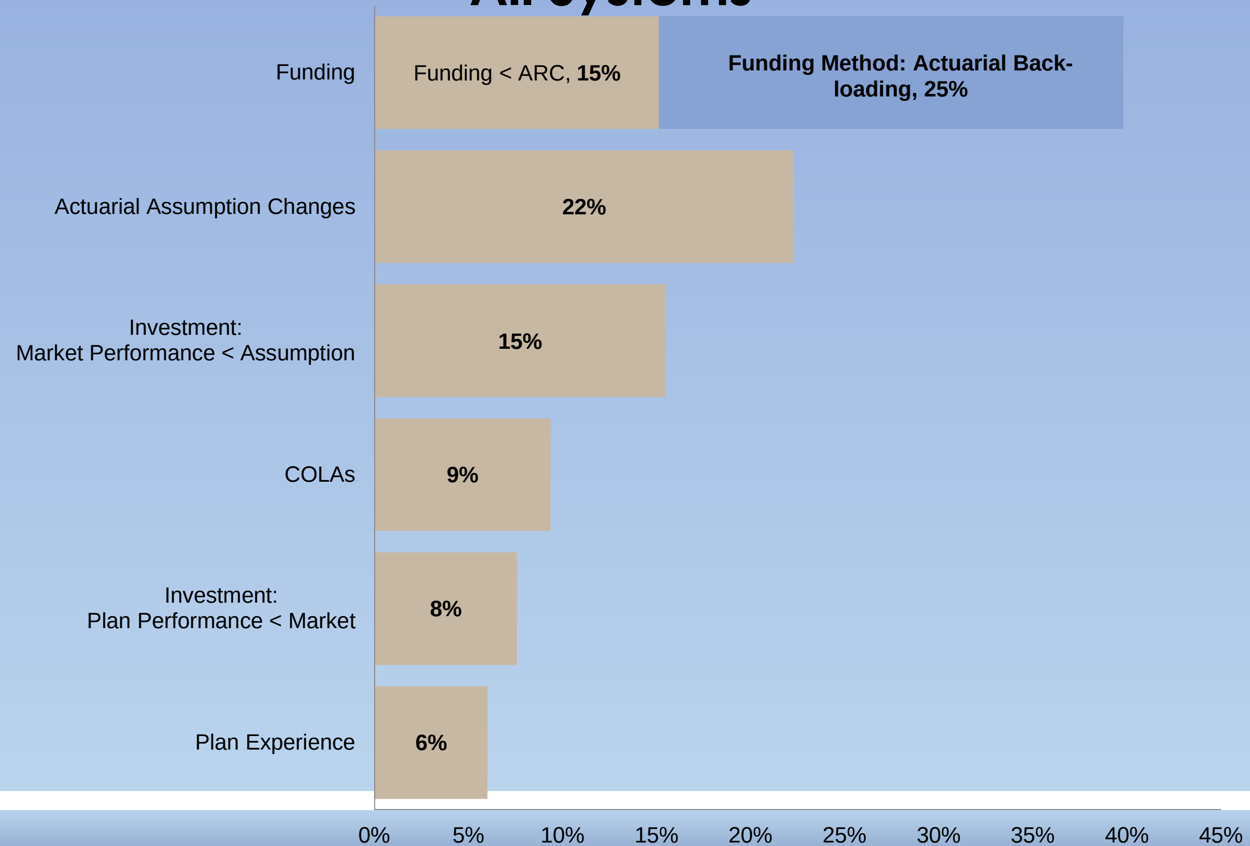

Comparison of Total Kentucky Pension System Underfunding Under Alternative Discount Rates
$ Billions
$90
$80
$70
$60
$50
$40
$30
$20
$10
$0
$33
$42
$64
$84
Published Actuarial 6.75%/7.5%
Revised Asset Allocation 5.1%/6.0%
Corporate Bond Index 3.87%
30 Year Treasury Rate 2.72%

FY2015 Worst-Funded Pension Ratios Aggregate of State Liabilities		
	Median	**74.6%**
	Average	**73.2%**
46	Rhode Island	55.5%
47	Connecticut	49.4%
48	Illinois	40.2%
49	New Jersey	37.8%
50	**Kentucky**	**37.4%**

The Unfunded Liability of Kentucky's Two Largest State Pension Systems has Increased Dramatically



Summary Components of $25.3 Billion Increase in Unfunded Pension Liabilities: All Systems



Budgetary Impact if There is No Pension Reform?

KRS Plans	Old 2016 assumptions			Revised assumptions	
	Funded %	Inv. Return	P/R Growth	Inv. Return	P/R Growth
KERS - Non-haz	16.0%	6.75%	4%	5.25%	0%
KERS - Haz	59.7%	7.50%	4%	6.25%	0%
CERS - Non-haz	59.0%	7.50%	4%	6.25%	2%
CERS - Haz	57.7%	7.50%	4%	6.25%	2%
SPRS	30.3%	7.50%	4%	5.25%	0%

Budgetary Impact if There is No Pension Reform?

KRS Plans	FY 2016	FY 2018		
Percent of payroll	Old Assumptions	Preliminary Revised Assumptions	Percent Increase	Additional Dollars
KERS - Non-haz	50.39%	84.06%	66.68%	$ 221.3
KERS - Haz	21.82%	41.12%	88.45%	17.3
CERS - Non-haz	19.18%	28.86%	50.47%	325.2
CERS - Haz	31.55%	50.67%	60.62%	113.3
SPRS	89.67%	154.10%	71.85%	12.8
				689.9
			TRS	819.1
				$ 1,509.0

The TRS and CERS-NH plans are in good shape -- aren't they?

<u>NO. TRS and CERS-NH plans are NOT in good shape.</u>

- While they are in better shape than other Kentucky plans, the funding level for both plans is below 60% -- 59.0% for CERS-NH and 54.6% for Teachers.

- Using realistic assumptions, TRS' and CERS-NH's funding levels are actually much lower and the unfunded obligation much higher.

The TRS and CERS-NH plans are in good shape -- aren't they?

NO. TRS and CERS-NH plans are NOT in good shape.

- Using the same investment rates of return that corporate plans are required to use – the Corporate Bond Index rate – the TRS unfunded liability goes from $15 billion to $34 billion and the CERS unfunded liability goes from $5 billion to $9 billion.

- Using the same Corporate Bond Index rate that is required of all private pension plans, the aggregate underfunding for all eight of Kentucky's plans goes from $33 billion to $64 billion.

The TRS and CERS-NH plans are in good shape -- aren't they?

NO. TRS and CERS-NH plans are NOT in good shape.

Think of it this way.

- You have been making payments on your largest obligation – your home mortgage. (Or, in this case, a pension obligation.
- Payments are required well into the future, until the fully paid.
- Ignoring the future, so far you have only paid less than 60% of what you should have paid.

What would you expect the mortgage company do?

The TRS and CERS-NH plans are in good shape -- aren't they?

- If Kentucky plans were subject to federal standards for single-employer private plans, TRS and CERS-NH, the Internal Revenue Code would require that all benefits be frozen. This is true even using the results of the erroneous 2016 actuarial assumptions, not the more conservative and realistic discount rates and other assumptions required of private plans.

- Unfortunately, under any set of assumptions, the TRS and CERS-NH plans are NOT in good shape.

- Implementing the appropriate changes will require a long-term (30 year) commitment to reforms that are necessary to rebuild the foundation and that allows a path to fully sustainable fiscal health.

Context for PFM Report #3

Pensions are STILL severely underfunded ($35 Billion - $82 Billion)

There is uncertainty in the economic outlook for the future that warrants great caution

Budget Reserve Trust Fund (Rainy Day Fund) is far below the 5% common target

How to solve the $64 Billion problem?

The Commonwealth needs to free-up $1,000,000,000 ($1 Billion)

More information, including
PFM Report #3

www.KentuckyPensions.com