POLITICS AND GOVERNMENT

PERA's investments generated billions in 2020. But the Colorado pension's financial condition worsened.

Banner stock market generated 17.4% returns on PERA's investments. But it wasn't enough to cover $3.1 billion in new costs the pension expects following a demographic study.

Brian Eason 4:16 AM MDT on Jun 21, 2021

Credibility: Original Reporting On the Ground Subject Specialist

It was another frustrating year for Colorado's 631,000 public pension members.

Despite a banner stock market year that saw Colorado's Public Employees' Retirement Association generate 17.4% returns on its investments — more than double its target — the state's public pension still ended 2020 in worse financial shape than it started.

PERA's unfunded debt to retirees grew by $1.2 billion, to $31 billion, and at current projections, it would take 43 years to reach full funding. That's well outside the 30-year target required by state law.

The PERA board on Friday released its 2020 financial report, making official what PERA's leaders have been expecting since at least November. The deteriorating funding means public workers and the government agencies that employ them will have to contribute more, and retirees will receive less starting in July 2022. These changes are the latest ripple effect of the 2018 pension overhaul that automatically adjusts contributions and benefits whenever the pension's funding veers off course.

The main culprit this time around wasn't an economic shock; PERA actually weathered the pandemic in decent shape, thanks to surging stock prices. Instead, it was a periodic review of PERA's financial and demographic assumptions, known in pension lingo as an "experience study," that's the latest cause of distress for the embattled retirement system.

Here are some key takeaways from PERA's latest financial reports and how the study affected them.

Investments had a banner year. Everything else went wrong.

Making sense of PERA's financial problems calls for a quick lesson in how pensions are funded.

Pension finances are based on complicated assumptions about the future. The expected rate of return tends to get the most attention, and it's easy to understand why: No one has a crystal ball that can predict what the markets are going to do today, much less over the next 30 years. PERA expects to earn 7.25% annually on its investments, a target it had struggled to meet until the market bonanza of the last few years.

But the cost of benefits that the system expects to pay moving forward is a moving target, too. If retirees live longer or retire earlier than expected, benefit costs go up. If the state government or school districts employ fewer workers than expected, less money enters the system to pay off the unpai[d] debt PERA already owes.

Executive Director Ron Baker says to think of it like a basic math problem: contributions plus investment returns have to equal the benefits PERA pays out.

"It's two sides of an equation," he said at Friday's meeting. "One side (the investments) went well this year. The benefit side didn't."

"Went well" might be an understatement. PERA's investments have been so good the last few years the retirement system is now averaging 9.4% returns over the last decade. PERA remains just shy of its investment target over the 20-year stretch that includes three recessions and the precipitous 26% drop of 2008.

In dollar terms, PERA's investment gains allowed it to shave $2.7 billion from its unfunded debt in 2020 — if only that had been the end of the story.

On the benefit side of the equation, long-term costs went up by $3.1 billion due to the experience study. A wave of employee departures amid the pandemic cost the system nearly $300 million more. The contributions PERA relies on to pay off its debts are tied to the payroll of the current workforce, so when school districts needed fewer bus drivers, maintenance staff and custodians amid remote learning, it meant less money flowing into the retirement system.

Whether due to layoffs, retirements or employees simply quitting their jobs, PERA's largest divisions — the state, schools and local governments — ended 2020 with between 2% and 8% fewer active workers than they had a year earlier.

Colorado state employees

As of March 2021, Colorado had 110,008 full-time and part-time employees on the payroll. That's about 1,000 fewer than in March 2016. In the chart below, the people most impacted during the pandemic were part-time employees (blue), which saw a 20.3% decline. Full-time workers saw a 1% drop from a year earlier. Overall wages (yellow line) increased even with fewer employees, likely due to overtime earned filling in for colleagues on sick leave.

Total pay ($) Full time Part time No. of employees

Source: Colorado Office of the State Controller

The Colorado Sun

Funding ratio improved; PERA's financial health got worse

Oddly, PERA's funding ratio — a common measure of a pension's finances — actually improved, even as its debts got worse. PERA now has 62.8% of the assets needed to pay off future benefits owed, up from 61.9% in 2019.

But the projected time needed to pay off PERA's debts got worse. At current funding levels, it would now take 43 years for the school division to reach 100% funding, and 33 years for the state. Both are outside the 30-year window required by state law and recommended by government accounting expe

What it means for workers, retirees and taxpayers

The latest financial report will mean more financial heartache for the people who depend on the pension, and more strain on schools and state and local government budgets.

Effective July 2022, retiree cost-of-living adjustments will drop to 1% per year from 1.25% currently, effectively reducing retiree buying power at a time when Federal Reserve officials now expect inflation of 3% to 4% over the next few years. Public sector workers and their employers will have to contribute an additional 0.5% each from their pay.

The changes are technically temporary, but pension members are unlikely to see relief any time soon. PERA's funding would have to improve significantly for the auto-adjust provision to reverse the austerity measures.

Marcus Pennell, who chairs the PERA board, on Friday acknowledged how difficult this will be for retirees. But he said it was better to make sacrifices now than to repeat the history of the 1990s and 2000s, when the pension paid out more benefits than it could afford, culminating in multiple financial crises.

"Those are real dollars that aren't going into their (the retirees') pockets," he said. "But I think it's a better story than if we gave the annual increase away and then increased the probability that we're insolvent."

In a statement, Baker said, "We understand the changes we're announcing today are difficult for our members and retirees. However, the impact is clear: This change will help PERA stay on track to reach its goal of keeping PERA secure for its members now and in the future."

The bottom line: Colorado governments are still underfunding the pension

The fact that year after year of investment gains hasn't stopped the financial bleeding underscores that there's another cause for PERA's ongoing woes. The government is simply not contributing enough to pay off the cost of the benefits it promised to its workforce.

Indeed, this has been true for decades. Since 2003, the government has contributed $5.8 billion less than the amount required to fully fund benefits, despite multiple rounds of reforms designed to get the government to contribute its full share. In 2020, government contributions fell $280 million short, exacerbating PERA's funding gap.

Each year of underfunding makes it that much harder for PERA to climb out of the hole.

Today, the state and school districts contribute 20.9% of pay to the pension, the vast majority of which goes to pay off the unfunded debt. That'll rise to 21.4% in 2022, but it still won't be enough. If Colorado was required to fully fund the actuarial cost of benefits, as many other states are, the state would need to contribute 23.5% of pay, and schools would owe 24.5%. Notably, PERA members don't participate in Social Security, so Colorado public agencies aren't paying into the system on their behalf through payroll taxes.

The state also contributes $225 million a year, but the legislature withheld that payment in 2020 due to a short-lived budget crisis. The annual payment was restored this year, but the damage has been done. PERA didn't just lose $225 million; it also lost any investment returns those dollars would have brought in. With compounding interest, that represents a $990 million long-term hit to the pension's funding, according to PERA's actuaries.

Now, with the auto-adjustment kicking in, the state and its workforce will be paying for this and prior funding shortfalls for years to come.

Brian Eason
Special to The Colorado Sun

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John Ingold 3:01 AM MDT

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