STATE AND LOCAL PENSIONS
A LONG-TERM VIEW

This is a follow-up to SLGE's recent release "Infographic: Public Plans Data 2016 Snapshot," with a focus on fund management and performance, both before and since the Great Recession.

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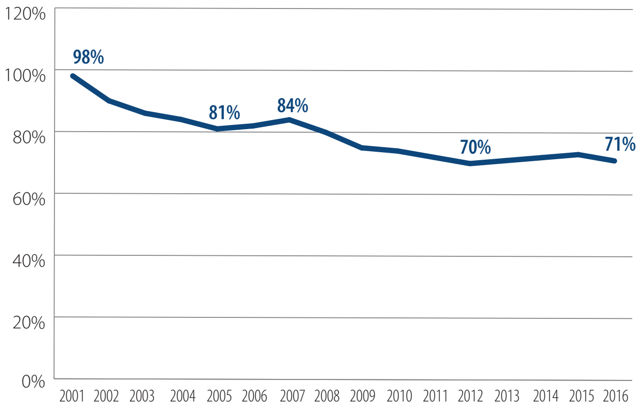
Funded ratios represent the relationship between a pension fund's actuarial assets and actuarial accrued liability.[1] While the tech boom of the 1990s fueled funded ratios at or above 100%, subsequent recessions have brought ratios lower.

Funded Ratio: Average for State and Local Funds

Figure 1

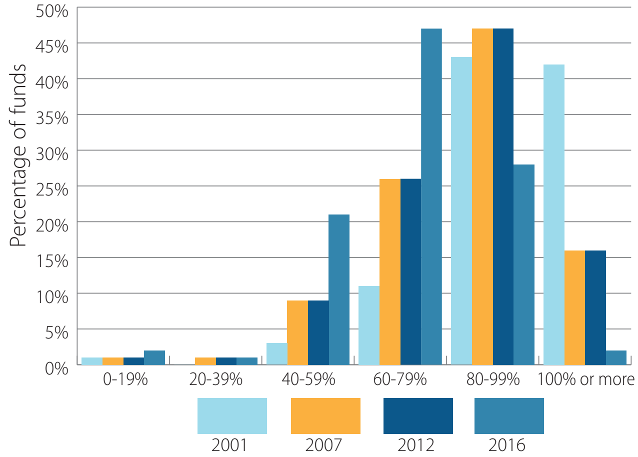


[1] http://publicplansdata.org/resources/terms-concepts/

Even with the share of pension plans in the 100%+ category declining from their highs in 2001-2007, many plans remain on track to reach full funding, with 77% in the 60-100% range in 2016.

Distribution of Funded Ratios: State and Local Funds

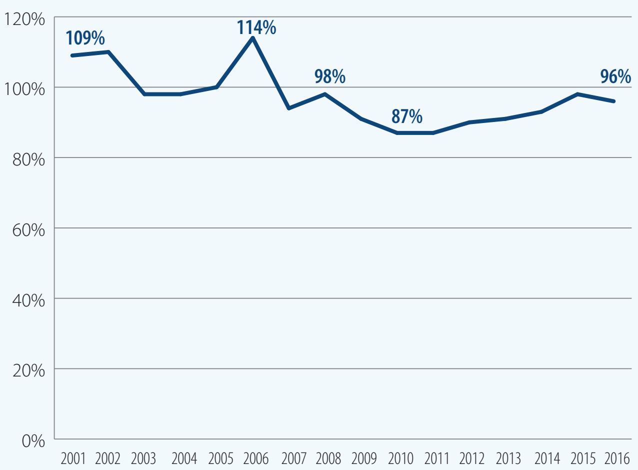
Figure 2



Beyond funded ratios, it is also important to see whether plan sponsors contribute their full employer contribution on an annual basis. The percentage of the actuarially determined contribution paid each year dipped with the Great Recession, hitting 87% in 2010. This decline may have been due to conscious decisions to limit financial contributions during a period of extreme financial stress. Nevertheless, as the effects of the recession have passed, most plan sponsors are now paying the full or close to the full required contribution. The average required contribution paid was 96% in 2016.

Required Contribution Paid: Average for State and Local Funds

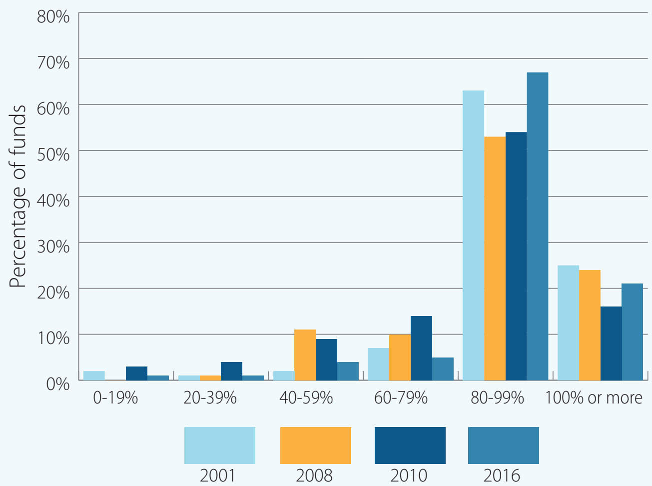
Figure 3



The distribution of those contribution percentages shows that in the trough of the Great Recession, which affected this statistic most significantly from 2008 to 2010, the share of plan sponsors contributing less than 40% of the required contribution increased from 1% to 7%. On the positive side, those contributing 80% or more of their required contribution never dipped below 70% of the funds represented, and as of 2016, that total is back up to 89% of funds.

Distribution, Percentage of Required Contribution Paid, State and Local Funds

Figure 4



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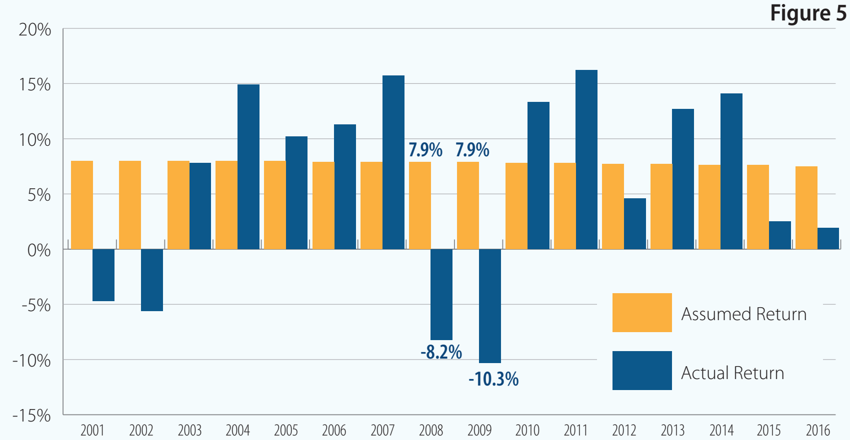
Investment returns and assumptions also impact funded ratios, particularly when assumptions may not keep up with changes in the market. The average investment return was projected to be fairly stable, if slightly declining, between 8.03% in 2001 and 7.54% in 2016. However, recessionary losses in 2001-2002 and 2008-2009 had a significant impact on the funded ratios for these public funds.

Market fluctuations are to be expected, but if investment assumptions in a recession are not adjusted to match longer-term actual experience, the result can impact the funded ratio.

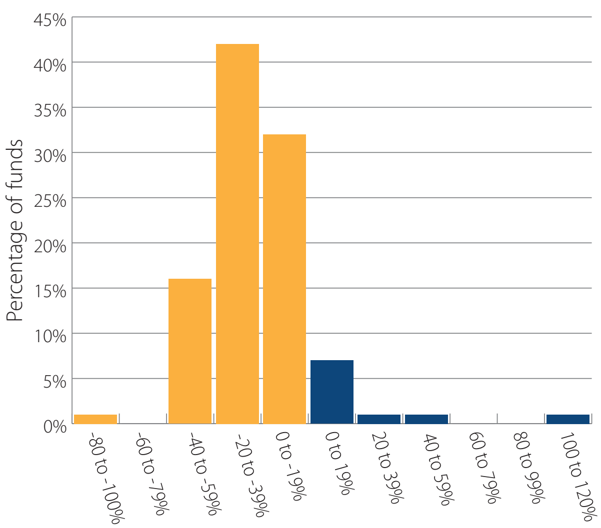
Assumptions and Returns, State and Local Funds

Figure 5



Investment Returns, Cumulative Difference Between Actuals and Assumptions (2006-2015)

Figure 6

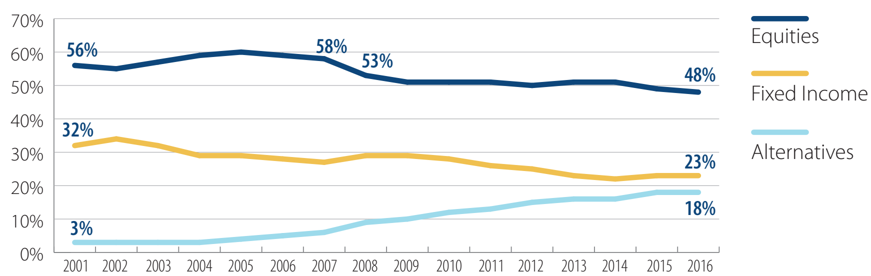


Based on the compound impact of each year's investment returns and investment return assumptions, 2006-2015 for all funds where both figures were available for each year (n = 147). For funds where actuals are higher than assumptions, the difference is shown positive; lower than assumptions, negative.

For both state and local pension plans, the return on investment performance depends upon the investment portfolio. While some portions of the average portfolio have remained stable (e.g., real estate, 4-7%, and cash, 2-3%), the share invested in equities declined in the space of a single year (from 58% to 53%, 2007-2008), and fixed income instruments declined gradually over time. The other significant change has been the growth in alternative investments, which includes hedge funds, private equity, and other non-traditional instruments. These have increased from just 3% of the total portfolio in 2001 to 18% in 2016. That growth may be attributable to new types of investments becoming available and to attempt to diversify portfolios, manage risk, and increase potential return.

Asset Allocation, State and Local Funds

Figure 7



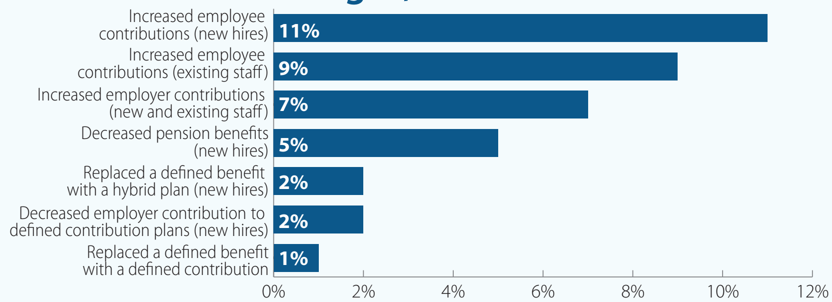
Source data: The Public Plans Database is a collection of data from 170 of the largest state and local pension funds. The database is maintained through a collaboration of the Center for State and Local Government Excellence (SLGE), Center for Retirement Research at Boston College (CRR), and the National Association of State Retirement Administrators (NASRA). All data used in this analysis is unweighted.

Looking ahead, the majority of state and local government pension plans are well positioned to meet their obligations by making their full required contributions, building up pension reserves, and adjusting both their investment return assumptions and, as appropriate, their asset mix.

Survey data show 17% of governments have made changes to their contribution levels, plan structure, or eligibility requirements in the past year, with many more having made similar adjustments since 2008. The most common change has been to increase contributions for both the employee and the employer. When pension benefits have been decreased, the changes most often have applied to new hires.

Pension Plan Changes, 2016-2017

Figure 8



Source: SLGE/IPMA-HR/NASPE Workforce Survey, 2017; partial list of responses.