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Addressing Illinois' Pension Debt Crisis With Reamortization

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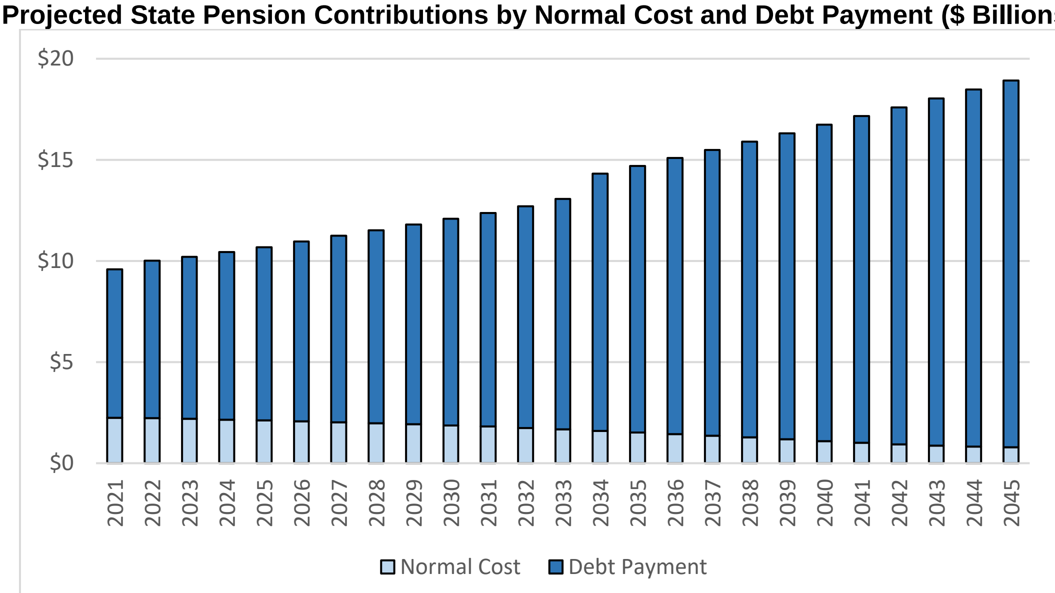
1. THE CURRENT PENSION RAMP IS A DEBT SERVICE PROBLEM THAT STRAINS THE STATE'S FISCAL CAPACITY TO FUND SERVICES

One of the most serious challenges to the state's fiscal system is the amortization schedule for repayment of the debt owed to Illinois' five state public pension systems created during the Edgar Administration under P.A. 88-593—known as the "Pension Ramp." As shown in Figure 1, the Pension Ramp currently calls for these debt payments to grow unsustainably, even as the cost of covering newly earned pension benefits—the so-called "normal cost"—falls over time. Moreover, the Pension Ramp created under P.A. 88-593 was not created utilizing any actuarial basis at all—it was a politically determined payment plan that simply deferred costs into the future and set an unrealistic funding goal.

Figure 1
Projected State Pension Contributions by Normal Cost and Debt Payment ($ Billions)



Source: State pension funds actuarial valuations.

The unrealistic Pension Ramp was passed not so much as a payment plan, but instead to create a legislatively authorized way to continue the irresponsible practice of borrowing against state pension obligations to fund other services. According to the Commission on Government Forecasting and

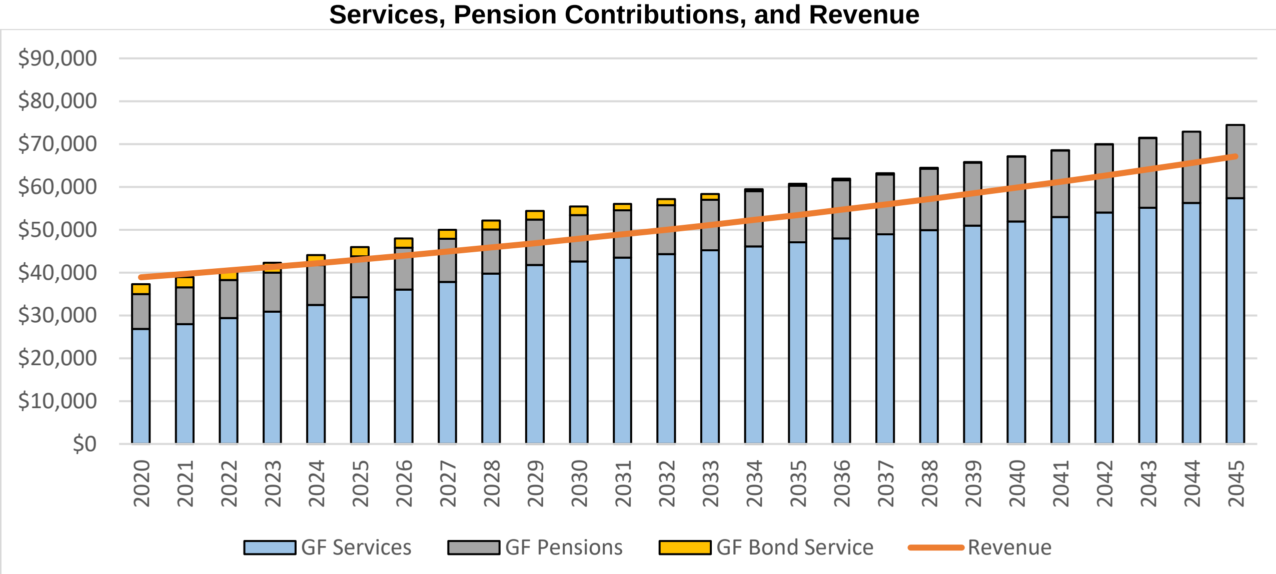
Accountability (**COGFA**), of the $115 billion in pension debt Illinois accrued between Fiscal Year (**"FY"**) 1996—the year after the Pension Ramp passed—and FY2018, $51.1 billion, or 44 percent, was attributable to this now legislatively authorized borrowing. Another $32.2 billion, or 28 percent, was a result of changes in actuarial assumptions; $31.2 billion, or 27 percent, was caused by underperforming investment returns and changing demographic factors. Just $.74 billion, or less than 1 percent, was the combined impact of salary and benefit increases.[1]

To illustrate just how much the fiscal problems created by the Pension Ramp are driven by the schedule it creates for repaying debt, rather than the normal cost of covering benefits being earned, look no further than the contribution for FY2019. In that year, the all-funds contribution to the five state pension systems totaled some $8.3 billion, of which about $6.1 billion, or 74 percent, was debt service on unfunded liabilities. This represents a nearly 420 percent increase over the total contribution required under the Pension Ramp a decade earlier in FY2008 of just under $2.0 billion.

COGFA projects that, under the existing Pension Ramp, the total all-funds pension contribution will increase rapidly in the coming years, surpassing $10 billion in FY2022 and reaching over $18 billion by FY2045. If Illinois does not address this tremendously back-loaded growth in debt service under the Pension Ramp, the state's fiscal capacity to continue to fund core General Fund services such as education, healthcare, and public safety—which collectively account for over 90 percent of all General Fund spending on current services—will be sorely constrained.

In fact, Figure 2 shows that the growth in contributions under the current Pension Ramp constitutes the majority of the projected structural deficit—that is, the now long-term trend in Illinois that has seen expenditures on core services grow more rapidly from year-to-year than state-based revenues, adjusting solely for inflation and population growth. This means that even when no law is changed, no service added or expanded and no revenue cut, the state's General Fund sees year-to-year growth in its accumulated deficit.

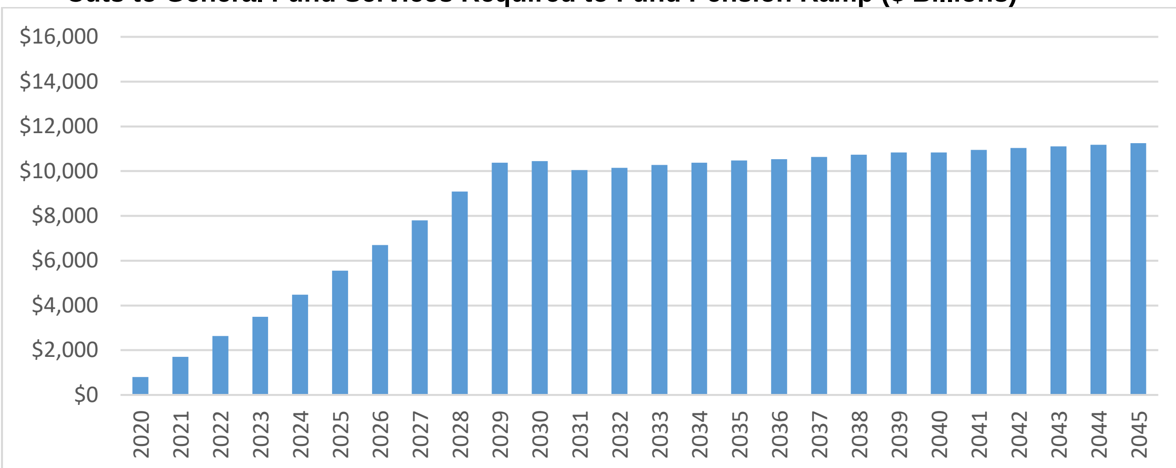
Figure 2
Projected Growth in General Fund Expenditures on Current Services, Pension Contributions, and Revenue



Source: CTBA projections based on FY2019 COGFA data. Includes funding for EBM.

Figure 3 shows the same data presented in Figure 2 from another perspective: The amount of General Fund current services spending on education, healthcare, human services, and public safety that would need to be cut in order to make the currently projected contributions under the Pension Ramp with the state's current revenue system, assuming revenue and service cost growth follow inflation and population trends.

Figure 3
Cuts to General Fund Services Required to Fund Pension Ramp ($ Billions)



Source: CTBA projections based on FY2019 COGFA data. Includes funding for EBM.

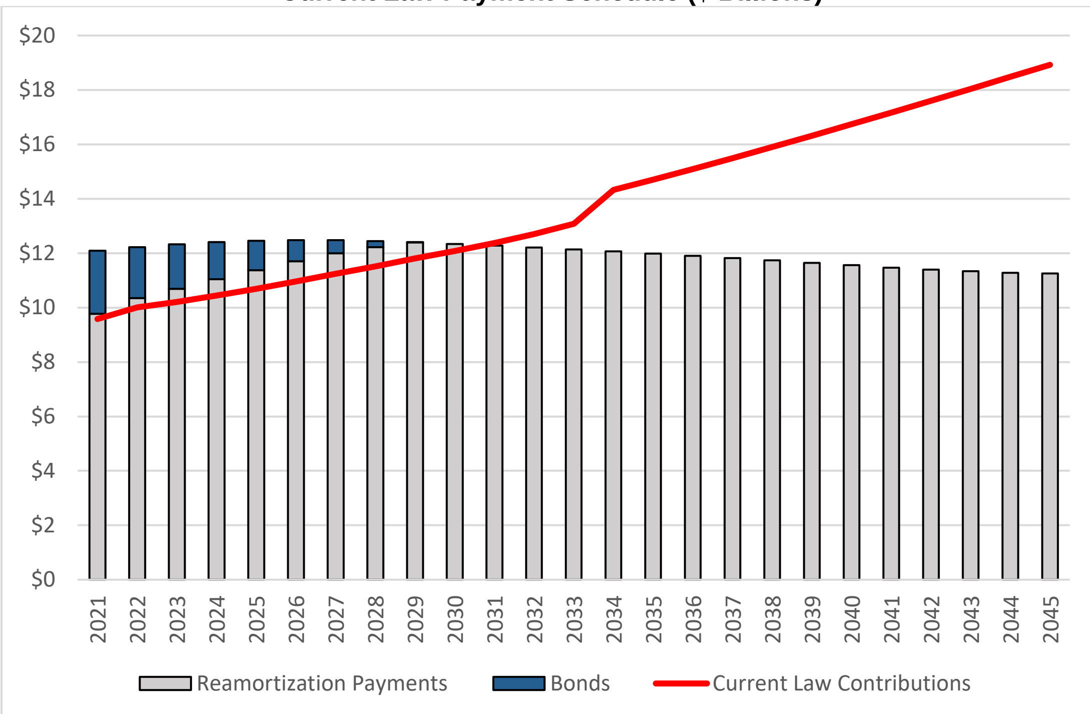
2. REAMORTIZING THE PENSION DEBT CAN SAVE $45 BILLION IN DEBT SERVICE PAYMENTS THROUGH FY2045, WHILE STILL GETTING THE PENSION SYSTEMS 72 PERCENT FUNDED

CTBA proposes to resolve the fiscal issues created under the Pension Ramp by reamortizing the pension debt. Under this approach, the state would move to a level-dollar repayment plan in which debt service payments on the state's unfunded pension liability would be equal in each year, rather than back-loaded. To work, this level-dollar reamortization requires greater contributions on the front end than under the current Pension Ramp, but over time the compounding of interest on these slightly greater up-front payments leads to significant savings. The second element of reamortization is to move from a target of a 90 percent funded ratio in FY2045 to a target of between 70 and 80 percent. According to the Congressional Budget Office, an 80 percent funded ratio is a baseline for a healthy pension system. Given that the five state pension systems are only around 40 percent funded today, this proposed reamortization puts them on a clear path to full health. The funded ratio could continue to grow after FY2045 to a higher target.

Given the state's current troubled fiscal condition, generating the additional up-front payments required by the reamortization will be difficult. Hence, to facilitate making those up-front payments without requiring cuts to current services or raising taxes, CTBA proposes issuing a series of annual pension obligation bonds to cover the difference between the contributions called for under the reamortization plan and those called for under the current Pension Ramp. With a funding target of 72 percent in FY2045, these bonds would total $9.8 billion over nine years.

Figure 4 shows this reamortization plan compared to payments under the current Pension Ramp, with the amounts bridged by pension obligation bonds highlighted in dark blue.

Figure 4
CTBA Level-Dollar Reamortization Compared to Current Law Payment Schedule ($ Billions)



Source: CTBA analysis of data from COGFA and state pension funds actuarial reports.

Even accounting for the interest cost of these bonds (and assuming an extremely conservative estimate of 6.55 percent interest rates):

- Illinois would save some $45 billion from what it is required to pay under the current Pension Ramp through FY2045 by moving from the current Pension Ramp debt repayment plan to the level-dollar reamortization outlined above;
- The $45 billion in reduced taxpayer cost is net of the new pension obligation bond costs as well, since the reamortization payments identified in Figure 4 include both payments of unfunded liability to the five pension systems and all debt service on the $9.8 billion in pension obligation bonds issued over the FY2021-FY2029 sequence;
- Had a similar level-dollar reamortization been implemented in 2019, Illinois would have saved some $67 billion through 2045. **Delaying reamortization for 2 years cost the state some $22 billion**;
- The five pension systems would be 72 percent funded in FY2045.

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ENDNOTES

[1] Commission on Government Forecasting and Accountability, "Illinois State Retirement Systems: Financial Condition as of June 30, 2018." April 2019.