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PERA at risk of insolvency if another recession comes, director says

In the event of a downturn, the state pension fund would tip toward insolvency

By **BRIAN EASON** | brianeason@denverpost.com | The Denver Post
PUBLISHED: January 20, 2017 at 6:29 pm | UPDATED: January 21, 2017 at 3:44 pm

The financial footing of the state pension fund is increasingly precarious, board members learned in a Friday briefing, with the entire public retirement system now at risk of tipping into insolvency if the economy dips into another recession.

The situation is not nearly as dire as it was seven years ago, when Colorado's Public Employee Retirement Association raised retirement ages, cut benefits and upped taxpayer contributions, all to avoid the very real prospect of running out of money to pay retirees. But officials are considering possible moves to prevent another crisis.

"We're not on the brink of running out of money," Greg Smith, the PERA executive director, told the board. "But what we are is at a much higher risk profile than we're comfortable with.

"That's not just a risk for members. That's a risk for employers, that's a risk for taxpayers, that's a risk for Colorado communities," he said.

Two months earlier, in a November letter to the Legislative Audit Committee, Smith warned that the judicial division had dipped into orange on PERA's color-coded "signal light" scale, a designation that sets off alarm bells and triggers the consideration of a corrective plan.

But an updated actuarial report from financial consultant Cavanaugh Macdonald found that the judiciary is not the only branch with serious concerns: All four of PERA's other pension funds are now in the orange, meaning it would take them 50 years or longer to pay off their unfunded liabilities. The recommended period is 30 years or less.

To put that risk into context: If PERA's investments simply repeated their performance of the last 10 years over the next decade — a 6 percent annual return — the school division, which covers more than 120,000 teachers, would eventually run out of money, the consultants said.

If a downturn occurred on par with 2008, when the housing market crashed and PERA's investments gave up 25 percent of their value in a single year, all five divisions would eventually run out of money.

On the other hand, if the stock market repeated the boom of the 1990s, when PERA saw double-digit annual returns, the fund would bounce back to well within its targeted funding levels.

The deteriorating projections come as a result of a board decision last year to revise its assumed investment return downward to 7.25 percent from 7.5 percent annually. That's more conservative than the typical public pension fund, but Republican State Treasurer Walker Stapleton and some financial experts argue that it's still too optimistic.

The board also voted to change its mortality formulas to reflect longer life expectancies.

Those two changes combined have PERA leaders talking once again about asking lawmakers to make an unpopular choice: cut retiree benefits, increase contributions, or both.

Neither will be an easy ask. Cuts to benefits run the risk of pensioners suing the state for broken promises, and board members on Friday pushed back against the idea of reducing or eliminating retiree cost-of-living adjustments.

Board member Susan Murphy said that to forgo cost-of-living increases for a teacher who retires at 70 and lives to be 100, would "effectively force that teacher into poverty."

In the past, the legislature has increased contributions both from employees and the state itself. But asking taxpayers to make up the difference would be a hard sell. Lawmakers already are mulling a tax hike to pay for roads, and Gov. John Hickenlooper last week requested another to pay for schools.

The danger is not imminent, the consultants said. With more than $42 billion in the bank, insolvency would likely happen over the course of decades, not years or months.

But Stapleton, an outspoken critic of PERA's funding levels, said the problem is more urgent than that, saying the state's credit rating could take a hit, increasing borrowing costs if the situation is allowed to deteriorate further.

"If a division becomes insolvent, the credit markets' reaction to that is immediate — regardless of what period of time you think you have to remedy," Stapleton said.

Smith said he's embarking on a listening tour in the coming months to inform the staff's recommendations to the legislature. He said PERA is already working on an interim fix for the judicial division, with harder discussions ahead for the rest of the system.

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Brian Eason

Statehouse reporter Brian Eason joined The Post from the Indianapolis Star, where he covered city hall for the news outlet's watchdog team beginning in 2014. Before that, he was an investigative reporter at The Clarion-Ledger in Jackson, Miss., and covered local government at The Leaf-Chronicle in Clarksville, Tenn. He graduated in 2009 from the University of Missouri with degrees in journalism and political science.

Follow Brian Eason @brianeason