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Pension Debt: The Still Unsolved Problem Threatening Lincoln

Prior to 2008, Lincoln's pension fund appeared to be in sound condition, but the losses of the financial crisis exposed underlying weaknesses that leave both employees and taxpayers at risk.

- **In June 2016, Lincoln passed an ordinance that lead to n accounting method change for how the Lincoln Police and Fire Pension Fund (PFPF) calculates its liabilities — i.e. the value of promised pensions.** This modification affected the *recognized value* of promised PFPF pension benefits, but did not change the actual amount of retirement benefits themselves. The change caused some discrepancy, which is reflective of a fundamental challenge facing Lincoln's PFPF: whether the actuarial accounting practices used by Lincoln accurately reflect the value of the promised pension benefits;

- **Lincoln's PFPF unfunded liabilities are probably more than four times as much as reported.** Depending on the long-term investment assumption used to "discount" the value of promised pensions, unfunded liabilities are likely closer to $190 million, not the $44 to $84 million based on reports from PFPF.

- **The financial crisis exposed serious, systemic problems with the funding policies for PFPF.** There are three underlying causes for the existing $190 million in pension debt: (1) the city not paying the full actuarially determined employer contribution to the pension systems, (2) underperforming the assumed investment returns, and (3) undervaluing the amount of all promised future benefits to employees by using a discount rate that is too high;

- **Over the past 20 years, the PFPF's funded ratio has fallen from 147% to 82.2%.** Lincoln has not consistently paid the full required contribution to the pension fund. From 2002 to 2008, Lincoln paid as little as 60% of the required contribution. Since 2009, the city has either paid more than the actuarially determined amount or fallen just slightly short;

- **Though Lincoln has adjusted its assumed rate of return in recent years, the PFPF assets have historically failed to consistently meet those figures.** PFPF temporarily lowered its assumed rate of return from 7.5% to 6.75% and then to 6.4% in the past two years. The assumed rate of return was increased back to 7.5%, after merging with the "13th Check" fund. Looking at the 15-year average, PFPF's investment return was more than 230 basis points below the assumed 7.5% return. This underperformance resulted in an increase of the PFPF's unfunded liability by over $60 million since 2009;

- **Lincoln's pension plan reported one of the worst returns in the country, -2.76%.** As the investment returns for bonds and fixed income instruments have fallen, PFPF has had to shift the plan's asset allocation to higher risk asset classes to keep targeting a 7.5% return. This means there is a larger volatility of investment returns as the PFPF portfolio more consistently tracks market swings, and consequently, more volatile pension contribution rates;

- **Ever-increasing employer contributions would almost certainly crowd out the city of Lincoln's capacity to finance other public services such as public safety, road repairs and snow removal.** Trends over the past decade have seen contribution rates rise faster than city revenue. In 2001, the required contribution by the city was equal to less than 1% of Lincoln's general fund revenue. By 2015, it increased to 6.2%;

- **Pension reform that effectively addresses the current crisis facing the city is a two-step process.** First, Lincoln needs to cap the growth of liabilities exposed to volatility and significant risk by moving new employees to either a cash balance or defined contribution plan. Second, it needs to ensure that the funding policy for existing liabilities does not remain a threat to city budgets with aggressively optimistic assumptions.

Learn More at PlatteInstitute.org/Pensions or contact Sarah Curry at sarah.curry@platteinstitute.org