FY 16-FY 17 Budget Recommendations

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KPERS

KPERS

Governor's Allotments

How KPERS is Affected

- The Governor's December 2014 allotments included reducing the employer contribution rate from 11.27% to 8.65% for the last 6 months of FY 2015
- $52 million in State General Fund reductions, approximately $58 million total reduction in contributions to the KPERS Trust Fund
- The reduction in FY 2015 results in additional contributions of $76.7 over the next 20 years
- Lower contributions in FY 2015 are not projected to keep KPERS from being fully funded by the end of the amortization period (FY 2033), but do slow the rate at which KPERS' funded ratio improves and increase total future contributions
- The dollars were removed through the Governor's allotment authority, the Legislature will have to enact the rate change

- Recommended authorizing $1.5 billion in pension obligation bonds
- KPERS would receive slightly less in actual assets due to costs of issuing bonds, which would be around 1%
- Pension obligation bonds would be taxable bonds
- As of the beginning of the year, taxable bond rates were in the 4.4% to 4.75% range
- Debt service would roughly be $90-$95 million per year (higher if any initial principal payments are delayed or interest is capitalized)
- With current bond rates relatively low, the opportunity for KPERS' investment returns exceeding the bond rate exists

KPERS

Governor's Budget

Pension Obligation Bonds

- Adding the proceeds of a pension obligation bond immediately improves the System's funded ratio and lowers the unfunded actuarial liability (UAL)
- Investment income may increase as more assets are available to be invested in the short-term
- Additional contributions from bond proceeds have effect of lowering future employer contribution rates if all assumptions are met in the future
- Lower employer contribution rates would not include the debt service on the pension obligation bonds, which are assumed to be paid from a source other than KPERS

- Market timing risk increases with a large lump sum payment into the system
- $1.5 billion in bonds would likely be issued in two or more stages
- KPERS would utilize investment strategies to prudently invest the proceeds in a manner consistent with its asset allocation and reduce market timing risk as much as possible

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Pension Obligation Bonds

2004 Bonds

- The 2003 Legislature authorized $500 million in pension obligation bonds to increase the System's assets
- Approximately $5 million in fees and bond insurance and $55 million in capitalized interest
- KPERS received about $440 million in additional assets in March of 2004
- Debt service on the bonds (about $33 million annually) is appropriated from the State General Fund to the Department of Administration
- As of 9/30/2014, the investment return on the proceeds of the 2004 pension obligation bonds (7.45% return) has exceeded the bond rate (5.39%) by more than $174 million

Governor's Budget

Reamortization

KPERS

- The Governor recommends extending the amortization period by 10 years to FY 2043
- The amortization period is similar to a mortgage on a house, the unfunded actuarial liability is split into annual payments
- The current amortization period is a 40-year closed period that began in FY 1993 and ends in FY 2033
- It is amortized using a level percent of payroll. As a result:
  - The payments are structured to grow over time as the payroll grows.
  - Payments are less than interest during early years of the amortization period.
- Extending the amortization period reduces the employer contribution rate in the short-term but increases the long-term cost
- Reamortizing will keep the funded ratio of the system lower and result in higher unfunded actuarial liabilities for a longer period of time

KPERS

Governor's Budget

Cumulative Impact of Recommended Package

Assumptions:

- Employer contribution rate of 8.65% in last half of FY 2015; 9.69% in FY 2016; and 9.59% in FY 2017.
- 10-year extension of amortization period
- Net bond proceeds of $1.5 billion deposited 12/31/2015
- Elimination of additional funding from Expanded Lottery Act Revenue Fund (ELARF)

Impact:

	Current (Baseline) Scenario		Alternate Scenario	
Maximum contribution rate		14.83% in FY 2019		9.88% in FY 2018
Total contributions through 2046 (nominal dollars)		$16.37 billion		$20.11 billion ($3.74 billion more than baseline)
Year funded ratio reaches 80%		2025		2029
Unfunded actuarial liability	2015	$7.26 billion	2015	$5.83 billion
	2023	$5.25 billion	2023	$5.71 billion
	2033	$0.03 billion	2033	$4.70 billion
	2041	$0.03 billion	2041	$1.09 billion