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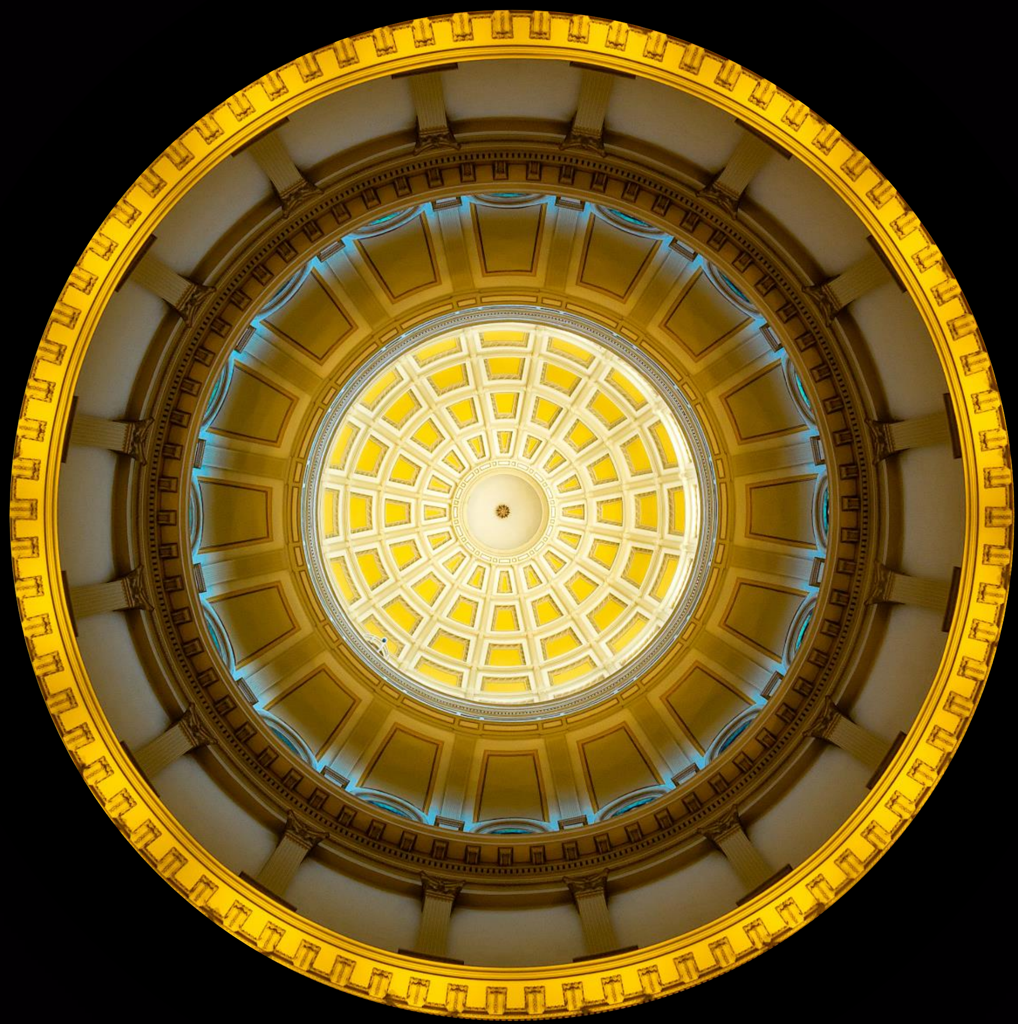


State and Local Governments

Managing Public Sector Pension Plans in the time of COVID-19

March 2021

Contents

Introduction

In February 2020, the United States officially entered a recession after the longest expansion period in its economic history.[1] At that time, public sector pension plans still had not fully recovered from the Great Recession, with many large retirement systems severely and increasingly underfunded for several years. The current economic environment stemming from the global COVID-19 pandemic will likely strain state and local budgets in coming years, as governments are faced with additional spending on health and public services, coupled with declining revenues from taxes (personal and business) and other income, such as tolls and licenses. As a result, governments will experience significant budget challenges as they continue to struggle with tough decisions over resource allocation, including decisions on short and long-term pension contributions and investment strategies.

This whitepaper provides an overview for public sector pension stakeholders of the possible impacts from the current economic environment on the financial standing of the public sector, including what that could mean for public sector pension plans. Even though pension executives and employee union representatives might not be making decisions on their state and local budget management and resource allocation, they should be aware of the tools available to local officials to help them weather an economic downturn and address solvency challenges. Understanding these factors and considerations can assist pension stakeholders to develop a more informed position to potentially influence tools utilized and promote actions that address public sector pension financial distress.

Funding environment of public sector pensions

Public sector pension funding pre-pandemic

83 percent of state and local government full-time employees participated in a defined benefit pension plan in 2018. Nearly 30 percent of these employees are not entitled to Social Security benefits, making these individuals more dependent on state and local pension benefits for retirement income.[2] Public sector pensions, unlike their private sector counterparts, are not subject to the Employee Retirement Income Security Act of 1974 (ERISA) and are not protected by the pension insurance programs operated by the Pension Benefit Guaranty Corporation. Hence, public sector employees face unhedged risks if these retirement systems are not able to meet their future obligations to participants.

In recent decades, inadequate contributions into the plans have left the unfunded pension liabilities near all-time highs for many states and cities, with the greater than ever disparity between well-funded and underfunded state retirement systems.[4] According to Federal Reserve data, in 2017, public sector pensions had **exceeded $4 trillion in unfunded liabilities**. [5] This existing funding gap, roughly equal to the size of Germany's economy, and the accompanying decline in state pension funding levels, increases pressure on state and local budgets which are further aggravated by the pandemic-related impacts.

Annual benefit payments to state and local government retirees equal roughly 1.5% of national Gross Domestic Product (GDP), with over 10 million beneficiaries relying on these payments to sustain themselves in retirement.[3]

Economic impacts of COVID-19 pandemic

From the time the Great Recession started through 2012, the funded ratio fell from 86.5 percent to 72.4 percent, and it has remained relatively steady since.[6]

Economic downturn from the pandemic presents significant risks to state and local retirement systems and their participants. The underfunding issues of public sector pension plans will likely be exacerbated by the current and anticipated economic fallout from the global pandemic. Following the 2001 recession, the average funded ratio of state and local pension funds fell from 101.9 percent in fiscal year 2001 to 89 percent in fiscal year 2003.[6] The Great Recession contributed to a continued decline in funding ratios. The long-term impact on pension funding ratios from the current economic recession remains to be seen, as some of the largest pension systems have unfunded liabilities over $200 billion and growing.[7]

Revenue uncertainties, including loss of tax base from unemployment, coupled with mounting pandemic-response costs are foreshadowing long-term financial difficulties for US states and local governments.[9] State governments have funded a large portion of the pandemic response efforts (including health care facilities and emergency workers), as well as programs that citizens rely on during an economic crisis (unemployment and social services systems). This surge in spending, coinciding with declining revenue, will likely have destructive effects on state budgets. Moody's Analytics estimates that collectively, state governments will have budget shortfalls of $312 billion through the end of summer 2022, or $500 billion inclusive of local governments.[9]

State tax collections for March through July 2020 were 7.5% less than the same period in 2019. For fiscal year 2021, states estimate tax revenue could decline by an average of 12.5% or more across all state budgets, levels not seen since the Great Recession.[8]

To ease the burden of COVID-19 response spending on states, Congress passed the Coronavirus Aid, Relief and Economic Security (CARES) Act, which included $150 billion in direct assistance for state, territorial, and tribal governments. While the aid package allocated a minimum of $1.25 billion to each state and stipulated that local governments with a population of at least 500,000 were eligible for direct payments, it came with restrictive guidance on what constituted eligible expenses.[10] As an additional tool to help public sector governments, the Federal Reserve established the Municipal Liquidity Facility (MLF) to offer states and local governments liquidity relief through direct purchase of up to $500 billion of short-term notes.[11] A second stimulus bill, the Coronavirus Response and Relief Supplemental Appropriations Act of 2021, passed in December 2020, provided an extension for state and local governments to spend money allocated under the CARES Act, but stripped out new funding. [12] Similar to the two previous aid packages, a third stimulus package, the American Rescue Plan, provides additional state and local funding that can be used to cover costs related to COVID-19 and infrastructure investments through the end of 2024, but restricts distribution of funds to pension systems.[14] In summary, none of the aid funds are intended to prop up underfunded retirement systems; however, they do provide some leeway for states and cities to spend federal aid on other eligible expenses, potentially freeing up money to put toward the pension plans.

CARES Act eligible expenses guidelines:

- Directly relate to COVID-19's public health emergency.
- Not already accounted for in the budget approved before March 27, 2020.
- Occur between March 2020 and December 2021.[13]

Budget management will become even more critical as a result of these developments. In addition to strained budgets, states and cities face the risk of lowered credit standings due to the negative economic outlook and declining revenues. This may hinder their access to capital markets for additional liquidity, as cost of debt could increase, further depleting financial resources to fund pension plans.[15]

Politicians and public sector executives may face difficult decisions on prioritizing spending and meeting their payment obligations, including pension funding, in the months ahead. To help preserve solvency, state and local governments may choose to make structural changes to the plans as they did after the Great Recession. According to a recent analysis by the Federal Reserve Bank of Kansas City, in many cases, these structural changes led to higher costs and lower benefits for state and local employees.[6]

In 2020, states began making difficult decisions in terms of balancing pension funding with other spending priorities in the time of COVID-19. For example, Kentucky, one of the lowest funded pension systems in the country, announced a delayed payment to their state employees retirement funds, while others (Maryland, California, Utah, Delaware, Georgia, and Nevada) reduced their 2020 contributions into their pension plans.[17] This paralysis coupled with declining funding ratios could be detrimental to these retirement systems. According to The Sustainability of State and Local Government Pensions study published by the Brookings Institution, without adjustments, a sizeable share of plans will exhaust assets within 30 years under the 1.5 percent real rate of return scenario.[3] The global pandemic may serve as the tipping point for a surge in public sector insolvencies further shrinking the 30-year asset depletion estimate.

Plan structural changes implemented after the Great Recession:[16]

- Increased required employee contributions (Figure 1)
- Reduced benefit levels by changing the formula for the annual pension benefit, limiting cost-of-living adjustments, or by increasing the age and service requirements (Figure 2)
- Introduced risk-sharing features to their pension structures: conversion to hybrid, cash balance or individual accounts plans (Figure 3)

Figure 1. States that have increased employee contribution rates, 2009-2018[18]

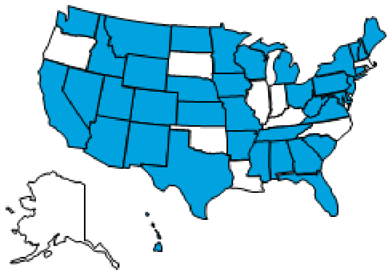


Figure 2. States that reduced pension benefits, 2009-2018[18]

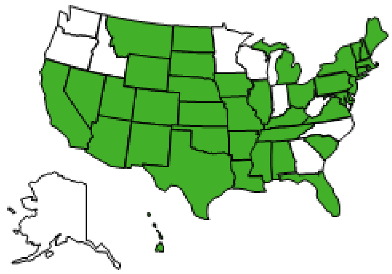
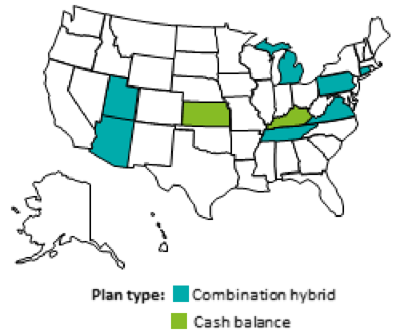


Figure 3. Statewide Hybrid Plans Established, 2009–2018[18]



Drivers of state and local insolvency

In order to weigh in on the appropriateness of the proposed actions to address insolvency, pension stakeholders should understand the drivers of the situation at hand. The good news is that a city or state does not become insolvent overnight. However, an event or incident, such as a global pandemic, can effectively push a local government over the edge. Insolvency may not be attributable to one single factor, but to a combination of events often simultaneously creating pressure on revenue and expenses.[20] Therefore, it is important to be aware of underlying economic and demographic trends and spending decisions that can affect government's ability to meet financial obligations.

Financial drivers

At a high level, mismatched revenues and expenses ultimately lead to budget deficits and the inability to meet financial obligations; however, there are different forces in play for each driver. As taxes are a large source of revenue, states and cities need to closely monitor economic and demographic trends that can impact their tax base. For example, a declining housing market means less property tax income; a high unemployment rate means a shrinking income tax base. Demographic factors can also affect the expenses that state and local governments incur. For example, as the US population ages, the ratio of retirees to workers in state and local governments is projected to increase about 33 percent over the next 25 years.[3] On the expense side, it can become difficult to balance infrastructure, education, public health, public housing, and many other spending needs competing for the limited resources. Additionally, states and local governments with declining revenues may become unable to cover salaries, offer attractive pension and health care benefits, and may struggle to maintain employees and/or attract new talent. A state or city in distress becomes more susceptible to unexpected events, pushing it into insolvency.[19] The table below covers some underlying factors that may drive a state or city toward the fiscal cliff.

Revenue side potential insolvency drivers

- Investment in risky assets — Increases volatility of returns and portfolio values
- Mismanaged revenue-bond-related projects — Projects backed by bonds fail to produce revenues in order to repay debt
- Declining or aging population — Shrinks income tax base which puts pressure on generating revenue
- Loss of corporate businesses — Contributes to area unemployment and loss in tax revenue

Expense side potential insolvency drivers

- Poor infrastructure — Increases need for investment, likely funded with debt
- Rising long-term obligations — Increases obligations, such as public employee retirement costs
- Extensive public sector borrowing — Results in a potential inability to meet financial obligations, lowers credit standing and reduces ability to raise additional liquidity
- Lucrative pensions and benefits — Results in more obligations than declining revenue stream can cover
- High public sector salaries — Creates misalignment of funds by allocating a larger percent of the budget to salaries compared to peer averages
- Large police or fire force with benefits — Results in higher overall benefit expenses in a lifetime to account for due to earlier retirements than other public sector workforces

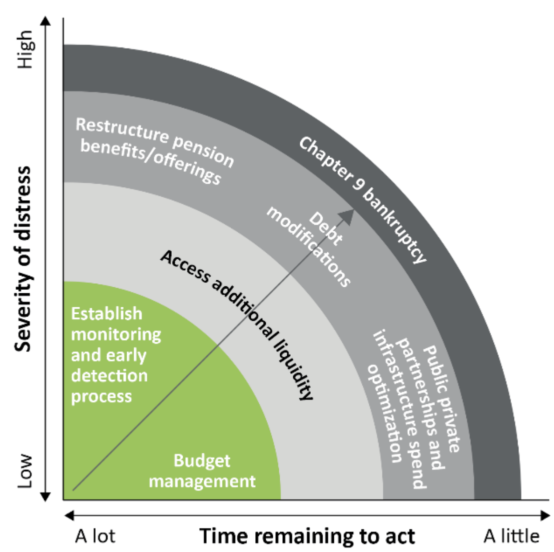
Other potential insolvency drivers

- Natural disasters (fires, hurricanes, pandemics, etc.) — Leads to companies and individuals potentially relocating, causes decrease in bond prices or requires reallocation of funds to cover unexpected costs
- Corruption and bad governance — Leads to misuse of funds, fraud implications, and legal implications
- Poor budgeting, forecasting and/or antiquated systems — Translates into reactive budgetary tracking and a mismatch of revenues and expenses. 80% of budget officers, especially in smaller government jurisdictions, still rely on spreadsheets and handmade systems for forecasting and budgeting.[20]
- Economic conditions or financial crises such as a housing market crisis — Undermines property tax and income tax revenues while requiring government injection to stimulate the economy

Solvency levers for state and local governments

Once pension stakeholders understand the financial drivers of their specific localities, they can better prepare themselves to assess and discuss the options to restore their locality's financial health in order to improve the employer's/ government's ability to make contributions to pension plans and meet obligations to retirees. State and local governments have multiple mechanisms (i.e., levers) available to them to help address fiscal challenges. The utility of these levers depends on the severity of financial distress and the amount of time remaining to act and save them from becoming insolvent and ultimately defaulting on its obligations, as seen in Figure 4. By monitoring local fiscal

Figure 4: Levers available to state and local governments facing distress



conditions, officials often can identify problems early and take actions to try to avoid more expensive and complex interventions such as bankruptcy filing.

Non-Bankruptcy options

As bankruptcy proceeding outcomes could have severe negative impacts on the city and its constituents, including pension plan participants, other options should be exhausted before pursuing this route if possible. In addition, there are certain limitations imposed by states around Chapter 9 eligibility (the only bankruptcy Chapter available to the public sector under the Bankruptcy Code of the United States), which make it more challenging or potentially impossible for many cities to use this option (see Final Option — Bankruptcy and its Analogues section below).

Local government financial situations, political climates, and priorities determine what levers are available and reasonable on a case by case basis. In addition to benefits, each option comes with a set of considerations. To help navigate these nuances of complex pre-bankruptcy filing levers, pension stakeholders could engage an external party with the applicable knowledge and experience in both government turnaround work and pensions. Some of these action items can also be pension specific, including the restructuring of retirement options, and pension stakeholders may be spearheading these recommendations. Actions to help improve the financial position of a city may include, but are not limited to:

Actions	Potential Tools	Considerations
Establish Monitoring and Early Detection Process Select indicators that can help to consistently assess local financial conditions, including deficits or minimum fund balances, cash-to-liabilities ratios, and sufficient cash for services	• Establish and utilize Key Performance Indicators (KPIs) to drive budget and program continuation decisions • Utilize economic data such as unemployment rates or demographic information to identify potential indicators of upcoming financial distress	• Identifying and utilizing appropriate KPIs can be challenging • An ongoing monitoring program can be expensive • Establishing an effective program may require knowledge from a third party
Budget Management Review budget for potential ways to decrease expenses and increase revenues to balance budgets	• Prioritize spending programs, perform cost benefit analyses, and realign fixed costs • Perform regular cash flow analyses to assess near-term liquidity issues • Identify means to boost revenue streams • Incorporate digital government initiatives to focus on efficiency	• Reducing spending could compromise the safety of citizens and the programs that support them • Increased taxes to enhance revenue can force citizen to leave the locale • Investment in technology and innovations may lead to a lower workforce need
Access Additional Liquidity Identify available options, strengthen credit standing to facilitate access to funds	• Purchase bond insurance to guarantee scheduled payments to investors to enhance credit ratings, reduce overall interest paid, and increase attractiveness to potential investors • Monitor and access additional financing such as the MLF to manage immediate budget issues	• Coverage could be cost prohibitive for some localities, if it's possible, depending on overall credit quality • Government program participation could come with stringent requirements and conditions • Additional leverage may deteriorate ability to meet obligations
Debt Modifications Refinance or restructure debt to free up cash flow and reduce cost of long-term financing	• Monitor market conditions for opportunities to refinance existing debt • Renegotiate terms of existing contracts to create greater flexibility	• Modifications require cooperation from creditors, which can be challenging to achieve • Future access to new rounds of financing may be constrained due to reputational costs

Public Private Partnership (P3) & Infrastructure Spending Optimization Attract private funding for large infrastructure projects to stabilize lifecycle operating and capital costs and free up funds for pension contributions over the long term	• Monetize assets through concessions for construction, financing, operation, and/or maintenance via P3 • Resolve deferred maintenance backlog • Employ innovative project delivery with pay-for-success or performance-based contracts to financially incentivize a high level of service and penalize underperformance of government-set standards • Consider optimization or re-prioritization of forward-looking Capital Investment Plans (CIP) • Consider divestment (i.e., sale) of aging non-core assets owned by the government	• P3s are complex structures and complexity could mean higher costs • Misalignment of time commitments: political mandates are typically far shorter than the duration of a P3 project • Potential cost to the public authority by the loss of flexibility to make changes to the facility/project • Lack of control over project design and specific requirements
Restructure Pension Benefits/Offerings Lower the costs by adjusting benefits and options for new participants	• Suspend cost of living adjustment (COLA) • Tie COLA to funded status of the plan or returns on assets • Increase retirement age for new employees • Lower benefits for new employees • Increase employee contributions into plan for new employees • Create hybrid defined contribution, defined benefit plans	• Reducing benefits for new employees may create difficulties when attracting talent and could create additional operational complexity • Pushback from employees, particularly those subject to collective bargaining agreements • Increased publicity and scrutiny

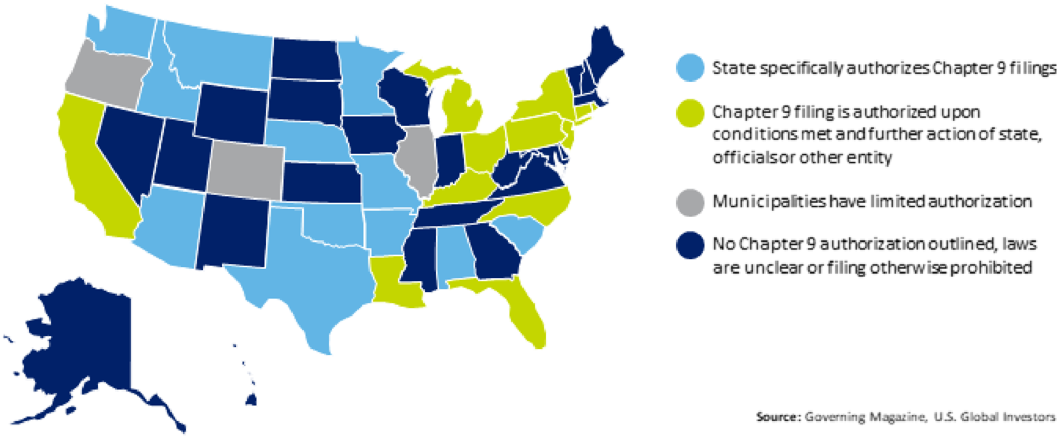
The underlying cause of distress is another determinant in determining which of the above levers can be utilized, because levers may not address all the relevant demographic distress factors, which can require longer-term solutions. When the financial distress has become deep-rooted and has lasting repercussions, Chapter 9 bankruptcy may become the only viable solution for cities that are eligible to file.

Final option — bankruptcy and its analogues for states & local governments

When state and local governments exhaust all options and levers to reverse the course toward insolvency, seeking some form of legal protection from creditors during debt relief and restructuring may be the only option left for addressing fiscal emergency.[21] Cities, towns, and other municipalities, can file under a Chapter 9 bankruptcy petition, entitled “Adjustments of Debts of a Municipality”. However, per the current bankruptcy code, this mechanism is not available for states and territories, who have to look for alternative restructuring mechanisms. This paper does not cover these case by case alternatives, but some details about the Puerto Rico Oversight Management and Economic Stability Title III Petition and its impact on Puerto Rico public pension plans are included in the Appendix.

Chapter 9 grants a filing entity protection from creditors while it develops and negotiates a plan for reducing its debts and continues to serve its public constituents. During the proceedings, day-to-day operations and responsibilities remain as usual for the local government. Debt modifications can take the form of extended maturities, reduced principal or interest payments, or refinancing obligations with new loans. Unlike other bankruptcy chapters, Chapter 9 does not have a provision for liquidation of assets and distribution of proceeds to creditors, and it gives the states ultimate authority over whether a city can file for relief under Chapter 9.[22] Only 12 states explicitly authorize their municipalities to file for bankruptcy without conditions, and 15 more states have implemented various limitations and qualifying restrictions, including approval from a state agency or official before filing or declaring a financial emergency. See Figure 5 for additional details.[23]

Figure 5: US states have different approaches to city bankruptcy (as of November 2015)[23]



Retrieved on February 19, 2021 from https://www.businessinsider.com/municipal-bankruptcies-are-rare-2015-11

In addition to the high regulatory and legal hurdles that make Chapter 9 bankruptcies quite uncommon, public sector governments have to take into consideration other monetary and reputational costs. The process is often expensive, time consuming, and triggers significant pushback from stakeholders.[24] Public sector employees oppose potential changes to their salaries and benefits, creditors face losses from debt restructuring, and citizens resist higher taxes coupled with budget cuts and austerity measures to cover payments for receivers and bankruptcy-related legal fees.

Another added cost comes from lower credit ratings that translate into higher cost of borrowing not just for the filing entity, but often for its neighboring local and state governments. Depending on the size of the entity and the severity of its problems, the bankruptcy process can be a matter of years which can turn residents and business away, further undermining revenue streams.

In the first three months of Detroit's bankruptcy proceedings, Detroit incurred legal costs of $11.4 million. Jefferson County, Alabama, with a population of nearly 80% of Detroit's, spent nearly $35 million in legal fees to exit municipal bankruptcy. Vallejo, California, with a population of about 116,000, has spent about $13.2 million. Stockton, California, has spent about $12 million.[25]

Historical examples of cities that filed for Chapter 9 in recent years demonstrate a variety of outcomes possible for involved pension plan participants. As mentioned above, the restructuring process may involve an agreement to lower monthly benefits, end annual cost-of-living increases, and/or freeze new employee entries into the existing pension plan. The participants do not have strong leverage to prevent benefit adjustment as they face the risk of budget costs and layoffs if the city or state's financial crisis deteriorates even further. Please see the Appendix for additional information, including driver, lever, and bankruptcy outcomes for historical Chapter 9 filings and other similar restructuring events for territories.

Conclusion

State and local government financial distress is frequently a consequence of economic downturns, and it remains to be seen how many state and local governments will face insolvency in the months and years ahead due to the economic fallouts from COVID-19. Soaring expenses and plummeting revenues may decimate the public sector's ability to meet its obligations, including funding its pensions and protecting plan participants. This distress could create further financial deterioration, as the sustainability of a public sector pension plan is intimately linked to its overall city and or/state's financial stability. It is critical for politicians, public sector executives, and other plan stakeholders to understand fiscal and economic developments and their potential impact in order to intervene and mitigate financial problems at an early stage, serving the interests of constituents and hopefully avoiding a complicated last resort bankruptcy filing. If bankruptcy is unavoidable, cities that file are almost certainly looking at a lengthy and expensive process with hard to predict outcomes for public sector plan stakeholders.

Pension stakeholders can engage with a third party with experience in restructuring, bankruptcies, and pension complexities to help navigate the turnaround process and prepare them to be a part of critical conversations and decisions. A severely underfunded plan coupled with a distressed public sector sponsor(s) is a difficult situation, but there are remediation tools available to best serve the interest of pension plan participants.

Appendix

Examples of city and territorial bankruptcies and impact on public sector pensions

Bankruptcies or similar restructuring mechanisms in Puerto Rico; Detroit, Michigan; Central Falls, Rhode Island; and Vallejo, California resulted in different experiences for pensioners, but most led to some type of benefit cut or adjustment as described below.

Commonwealth of Puerto Rico[26, 27]

Pension benefits cut by up to 8.5% under the Proposed Plan of Adjustment

The Drivers

- Extensive borrowing: Over the last 70 years, Puerto Rico accumulated approximately $72.0 billion in debt and an additional $54.5 billion in pension liabilities, relying on borrowed funds to balance its budget.
- Declining or aging population: Puerto Rico suffered from an aging population and loss of residents since the early 2000's.
- Loss of corporate business: Factories and companies left the island due to expiring tax benefits.
- Natural disaster: After devastating impacts from Hurricanes Irma and Maria in 2017, bond prices plummeted.
- Budget inefficiency: By 2016, Puerto Rican retirement plans had depleted the assets that were set aside to pay retiree benefits and were insolvent.

The Pension Impacts

- To address the retirement plans during restructuring (enabled by the Puerto Rico Oversight, Management, and Economic Stability Act and the establishment of the Financial Oversight and Management Board of Puerto Rico), retirees received priority over general bond holders for the first time in bankruptcy proceeding history.
- The Plan reduced monthly pension benefits by a maximum of 8.5% for retirees that had more than $1,200 per month in benefits, impacting about 65,000 pensioners, equating to about 26% of current and future retirees.
- The Plan also established an independently managed pension reserve trust that will receive 10% of the excess cash budget surplus over Fiscal Plan projections in any of the next 15 years. The hope is that this can provide for a possible pension asset restoration and make up for the 8.5% cut for impacted retirees.

The Takeaway Puerto Rico's restructuring plan of cash budget surplus, while not a confirmed outcome, could serve as an option for other cities and territories as they look for options to gain back lost benefits from restructuring efforts.

Detroit, Michigan[19,28, 29, 30]

A 4.5% reduction in benefits and an end to annual cost-of-living adjustments

The Drivers

- Declining or aging population: Population decline resulted in a declining tax base.
- Economic conditions and financial crises: From high unemployment, low property values, and recession, the city was unable to meet high pension and retiree-benefit costs, as well as maintain city services.
- High pension and retiree-benefit costs: The city suffered from massive unfunded pension liabilities ($3.5 billion) and unfunded retiree health care promises (nearly $6 billion).[18]
- Loss of corporate business: Loss of income and economic stability from the auto industry.
- Budget inefficiency: Detroit was using city funds to invest in infrastructure projects instead of making pension contributions. By 2005, the city was forced to borrow $1.4 billion for its pension fund, but Detroit's pension funding problems were exacerbated by the financial crisis.

The Pension Impacts

- Detroit's Plan of Adjustment allowed pensioners to retain between 95.5% and 100% of their monthly pension allowance, after eliminating the cost of living assumption.
- This may likely not have been possible without the "Grand Bargain", a combination of philanthropic, corporate, and state of Michigan donations, matched by public-employee-union agreements to accept reduced benefits.
- Coupled with significant union concessions, including a 4.5% reduction in current-retiree pension payments, an end to annual cost-of-living adjustments (with safeguards for low-income

	pensioners), and a freeze on new-employee entries into the existing pension plan, the "Grand Bargain" allowed Detroit to emerge from bankruptcy. **The Takeaway** Detroit's bankruptcy experience can serve as an example to other cities of private-public partnerships and union concessions that may be needed to move past a city or state insolvency.
Vallejo, California[31,32,33]	**Retirees benefits unharmed and contributions into retirement system continued** **The Drivers** • Housing Market and financial crises: Vallejo experienced three years of budget shortfalls due declining tax revenues from a high foreclosure rate and rising pension costs. • Large police or fire force with benefits: Public safety employees' salaries, pensions, and overtime pay accounted for 74% of the city's general budget.[19] **The Pension Impacts** • During its bankruptcy, the city cut costs, including bond payments and retiree health benefits, but did not reduce contributions to the California Public Employees Retirement System (CalPERS), because CalPERS threatened a costly legal battle. • After emerging from bankruptcy, Vallejo experienced a budget gap again in 2019, with one reason stemming from CalPERS contributions. The city looked to cut or slow city hiring and make other cost cuts.[17] • Vallejo spending on pensions is projected to reach 20% by 2024. **The Takeaway** Vallejo may be an example for cities and states that continue to face rising pension contributions even after emerging from bankruptcy, prompting a continuous stressor of impeding financial distress unless contributions are re-negotiated or reformed.
Central Falls, Rhode Island[34,35]	**Retirees pension benefits slashed by as much as 55% and property taxes increased** **The Drivers** • Loss of corporate business and unemployment: Central Falls' financial stability was impacted by factory closings and high unemployment. • Increasing long-term obligations: The unfunded pension and retiree benefits reached $80 million, five times the city's annual revenue.[15] As a result, the city had multi-million-dollar budget deficits. • Financial crisis: The recession ultimately pushed the city to file Chapter 9. **The Pension Impacts** • There were various layoffs and reductions in the city's workforce as part of the restructuring efforts. • State of Rhode Island officials appointed a financial manager, called a receiver, to ensure the city repaid its bondholders at the expense of taxpayers and public retirees who saw their pension benefits slashed by up to 55% with new rates over a period of five years. • By 2014, the city had a $1.7 million budget surplus and passed its first budget independent of state oversight in 2017, and in June 2018, Central Falls was making its full annual required contribution to pensions. **The Takeaway** The severe cut in pension benefits allowed the city to produce a budget surplus even after filing for bankruptcy. Other public sector leaders may face a similar cost/benefit analysis and use renegotiating pension rates as a tool to prevent cities and states from facing insolvency.

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A special thank you to the other Deloitte contributors of this report: Timothy Hurley, John Lisciandro, James Gabb, Igor Dabik, John Petriello, Patty Garcia, and Brenna Zhang.

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