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FACT SHEET

The State of U.S. Public Pensions in 2024

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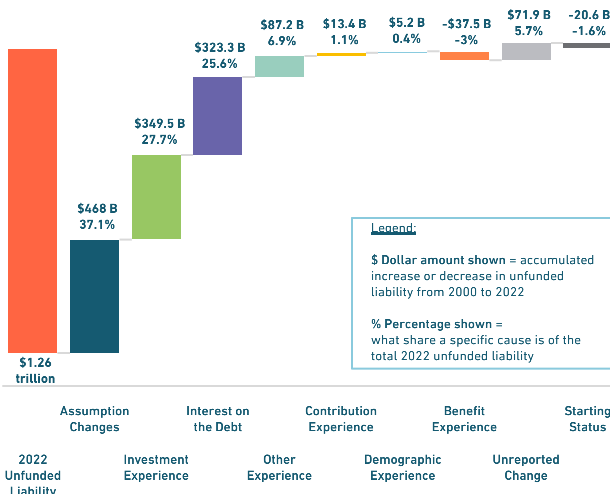
State and municipal retirement systems are on track to outperform their investment targets in 2024, along with solid improvements to the national average funded ratio. However, despite positive signals for America's public retirement plans this year, unfunded liabilities have remained paralyzed at or above the $1 trillion level since the Great Recession. Today, public pensions face growing threats from valuation risk and insufficient funding policies, despite record high contribution rates. Plus, workers are experiencing diminished spending power caused by a lack of adequate inflation protection of benefits.

PUBLIC PENSION FUNDING TRENDS

- U.S. state and local public pension funds still have not fully recovered from the Global Financial Crisis, when funded ratios declined from 92.3% in 2007 to to 62.4% in 2009.
- The national funded ratio average is projected to increase from 75.8% in 2023 to **80.6% in 2024**.
- The national public pension funding shortfall is on track to improve slightly, inching down from $1.61 trillion in 2023 to **$1.34 trillion in 2024.**
- Preliminary 2024 investment returns for state and local plans are ***7.4%*** on average, through June 30, 2024. Most public pension plans are projected to overperform their assumed return targets (6.9% on average).
- Pension fund allocations to private capital increased again to a historic high of ***13.7%*** — a reported value of ***$694 billion*** as of 2023. This has driven up the share of pension fund investments that are exposed to valuation risk to ***27.9%***. Investments in all alternatives continue to be more than one-third (33.8%) of pension fund assets.
- Employer contribution rates have ***passed 30% of payroll on average for the third year*** in a row. More than two-thirds of government employer pension costs are for unfunded liability payments.
- Most state and municipal pension plans in the United States are **distressed** or **fragile** based on Equable Institute's analysis of plan funded ratios.
- Unfunded liability payments have risen ***1,388%*** since 2001, while normal cost payments have risen just 40%.
- The average assumed rate of return for state and local pension plans is **6.88%** (as of June 2024), down from 8.1% in 2001.

WHAT'S DRIVING THESE TRENDS?

A new historical analysis from Equable Institute that examines the root causes of unfunded liabilities reveals three factors contribute to 90% of the collective state and local unfunded liabilities as of 2022 (the most recent year with complete causal data).



1. Assumption Changes *e.g., Changes to actuarial assumptions*

These improvements in the quality of expectations about investment returns, payroll forecasts, mortality rates, etc. often mean an increase in the measured value of benefits or a decrease in expected investment returns, which can mean unfunded liabilities increase. While this additional reported funding shortfall does need to be paid down, it is a good thing that public pension plans are improving the accuracy of their accounting.

2. Investment Experience *e.g., Underperforming investment returns*

While recent years have led to positive overall returns over the last two decades, there are still at least $300 billion in unfunded liabilities that have come from investments earning less than expected.

3. Interest on the Debt *e.g., Interest growth on liabilities*

When contribution amounts are expected to be greater or less than interest accumulating on liabilities, this leads to an "expected change." Even when actuarially required contributions are fully paid, they may not be sufficient to reduce unfunded liabilities if the funding policy used to calculate those contributions allows for interest to continue adding to unfunded liabilities.

TRENDS TO WATCH IN 2024 & BEYOND

VALUATION RISK

- Public pension funds face an emerging concern: "valuation risk" — the reported value of assets used to determine contribution rates is dependent on the accuracy of "fair price" valuations. Nearly one-third of the $5 trillion in assets that pension funds reported having in 2023 was based entirely on non-transparent valuation approaches from asset managers (not market-based prices like stocks. If these valuations are off, then today's contribution rates have been miscalculated.
- The risk profiles of U.S. state and local pension funds have shifted significantly toward alternative investments in recent years. As of the end of 2023, 27.9% of pension fund assets are invested in alternatives exposed to valuation risk, including: 13.7% in private capital investments, 5% in hedge fund strategies, and 9.2% in real estate. Just 8% of pension fund assets were allocated to these categories combined in 2001.
- The effect of valuation risk on pension funds is imminent. Private equity and real estate investments are spread across a complex range of funds and asset types. The process of updating the valuation of those investments typically has a three-to-nine-month lag from the point of time being measured. Widespread markdowns of asset values are likely to continue over the next several months, which will ultimately change the performance of public pension funds. This matters for getting contribution rates right.
- Most pension funds are using investment assumptions around 7%, but there is a less than 50% chance of earning that much over the next 10-years (on average, nationally). This means states face the choice of contributing more money into their pension funds support more realistic investment assumptions, or to tacitly authorize pension fund trustees to take on higher risk/higher reward investments in the coming years.

INFLATION PROTECTION & COLAS

- States have shifted away from offering benefit tiers with fixed rate cost-of-living adjustments (COLAs) and increasingly favor COLAs linked to local measures of the Consumer Price Index. An emerging concept has been to link COLAs to both inflation *and* fund performance such that COLAs based on actual inflation are paid out when funded ratios are below certain thresholds.
- For pension plans with COLAs, the average actual COLAs paid in 2022 and 2023 nationally were 1.83% and 2.02%, respectively. This is significantly less than the rate of inflation over the last two years (9.1% in 2022 and 3.0% in 2023).
- A total of 878 state and local pension benefit classes lack inflation protection entirely.
- New benefit tiers often lower valued COLAs due to a change in provisions from legacy plans, such as a lower maximum rate, or no longer offering a compounding COLA
- Lower valued COLAs have been a major contributor to the reduction in the value of public employee pension benefits generally.

READ THE REPORT

This fact sheet was released in conjunction with Equable Institute's annual report on the status of statewide public pension systems. The report analyzes trends in public pension funding, investments, contributions, cash flows, and benefits for 245 of the largest statewide and municipal retirement systems, covering more than 370 plans, in all 50 states to illuminate the scale and effects of these challenges.

STATE OF PENSIONS 2024