



**SUNLIGHT**  
POLICY CENTER  
— OF NEW JERSEY —

## ISSUE UPDATE

**EVEN AFTER MURPHY’S BILLIONS IN CONTRIBUTIONS, ONE DOWN YEAR AND STATE PENSIONS ARE IN TROUBLE AGAIN**

**FOR FY2022, THE TEACHERS’ PENSION FUND LOST \$2 BILLION IN ASSETS AND IS BELOW 35% FUNDED AGAIN**

JANUARY 4, 2022

## EVEN WITH MURPHY'S BILLIONS IN CONTRIBUTIONS, ONE DOWN YEAR AND STATE PENSIONS ARE IN TROUBLE AGAIN

### Introduction

With an eye on national office, Governor Murphy has touted his fiscal stewardship of the state, and in particular his making the first full pension payments in 25 years. Indeed, the bond-rating agencies upgraded New Jersey's bonds in part because of these payments. Murphy [claimed](#):

“When we keep making this payment, we'll go from a pension system that many said was destined for bankruptcy, to one that is solvent, healthy, and sustainable.”

But “solvent, healthy, and sustainable” was easier to say back in the spring of 2021. That was after the pension plan had stellar investment returns of 28.6% for FY2021 (ended June 30, 2021). Added to that was a proposed FY2022 state budget that was 36% larger than pre-pandemic levels due to billions in federal pandemic aid and record tax revenues. That was then.

Now, only one fiscal year later, Murphy's words look like so much happy talk. The markets hit a rough patch in FY2022 (ended June 30, 2022), and New Jersey's state pension plans -- and particularly its largest plan, the Teachers Pension and Annuity Fund (TPAF) -- are showing once again how precarious their condition really is.

For FY2022, the state's investment returns were [down -7.9%](#). For TPAF, this resulted in being forced to sell \$2 billion of assets to meet its pension obligations to retirees, according to Sunlight Policy Center estimates. This likely resulted in TPAF's funded ratio dropping below 35% again, meaning that the state had less than 35 cents set aside for each dollar owed to retirees. And the markets have dropped further since then.

The [Pew Charitable Trusts](#) summed up the reality of the situation:

“This volatility is a reminder that ... *states cannot count on outside investment returns to bail out underfunded pension plans ...*” [emphasis added]

Pew's warning applies precisely to New Jersey. Despite Murphy's allocating over 13% of the state's inflated COVID budgets to pensions – a total of \$18.5 billion for FY2021-2023 – New Jersey is still counting on outside investment returns to bail out its underfunded pension plans. What happens if the markets continue downward? What happens when the federal aid goes away? What happens when tax revenues normalize?

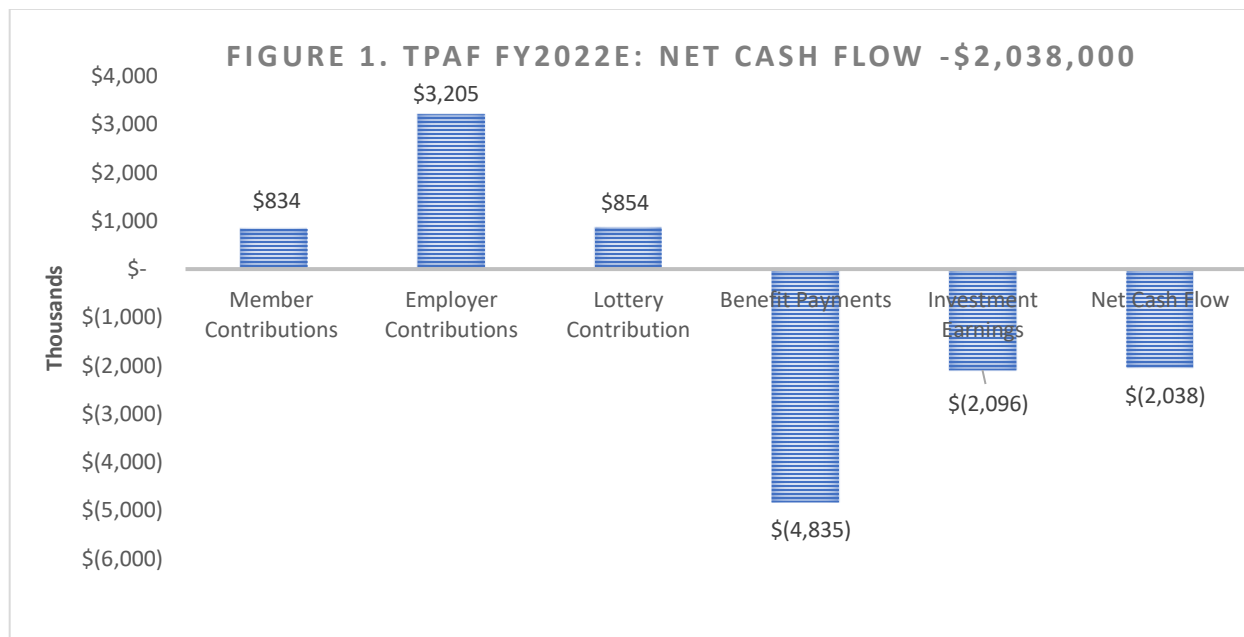
The reality is that TPAF's 35% funded ratio is not healthy. If the state budget shrinks, spending so many billions on unreformed pension plans will not be sustainable. Questions about TPAF's long-term solvency will return. Murphy will be long gone, but New Jersey taxpayers will be on the hook all of this. They should know the facts.

## **Despite Record Contribution in FY2022, TPAF’s Assets Declined -\$2 billion**

New Jersey’s state pension funds have been woefully underfunded for decades and provide an example of the perils of underfunded pension funds relying on investment returns. Even with Murphy’s record pension contributions, Sunlight estimates that New Jersey’s largest public pension plan, the Teachers Pension and Annuity Fund (TPAF), was only break-even for FY2022 in terms of operating cash flow.<sup>1</sup> As has been the case in the past, TPAF’s ability to pay out annual benefits owed to retirees without having to sell assets depends on investment earnings, which makes TPAF highly vulnerable to a market downturn.

FY2022 was precisely such a year. TPAF’s investments are part of the state’s overall portfolio and should be expected to suffer the same -7.9% loss. Because TPAF was breakeven in operating cash flow, it was likely forced to sell about 7.9% of its assets to meet its \$4.8 billion in benefit payments.

As seen in Figure 1, TPAF’s cash inflows came from \$834 million in member (employee) contributions, \$3.2 billion in employer contributions (appropriation from the state legislature) and \$854 million in lottery proceeds. Against those inflows was the outflow of \$4.8 billion in benefits payments (excluding de minimis administrative costs). The -\$2.096 billion investment loss thus results in a negative net cash flow of -\$2.038 billion.

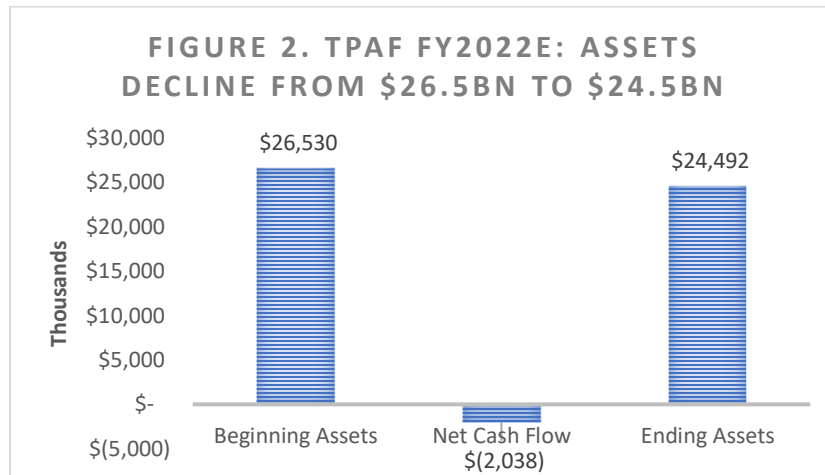


Sources: Member and lottery contributions and benefits payments are projected for FY2022 by the [TPAF GASB 67 Report](#) (p. 31). Actual employer contribution for FY2022 provided by the TPAF [Actuarial Valuation Report](#) (p. 4). Actual FY2022 investment return of -7.9% provided by the NJ Division of Investment’s [Director’s Report](#) (p. 5) and rendered as a dollar amount by multiplying the return against the amount of assets invested.

<sup>1</sup> According to Pew, operating cash flow includes all contributions into and payments out of a pension fund. Importantly, it does include investment returns. This is the first year TPAF has not had negative operating cash flow in at least 25 years.

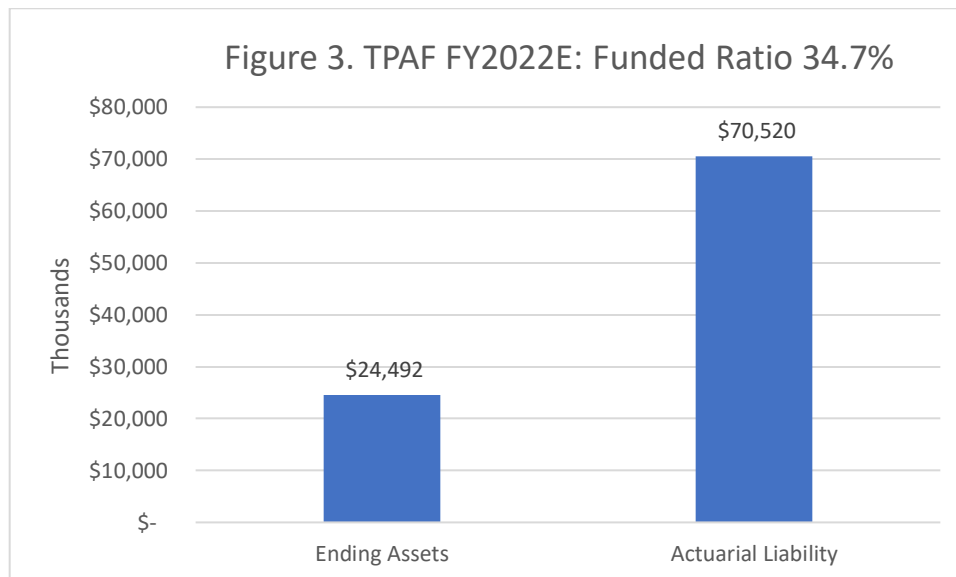
## **So TPAF Was Forced to Sell \$2 billion of Assets**

Pension benefits must be paid regardless of investment returns, so TPAF was likely forced to sell about \$2 billion in assets to meet its benefit payment obligations to retirees. As shown in Figure 2, TPAF began FY2022 with about \$26.5 billion in assets, had to sell about \$2 billion, and ended up with about \$24.5 billion.



Source: FY2022 beginning assets provided by the [TPAF GASB 67 Report](#) (p. 31).

As shown in Figure 3, to arrive at TPAF's estimated FY2022 funded ratio (the amount of assets set aside to meet future pension benefit payments), TPAF's ending assets of \$24.492 billion are divided by TPAF's total actuarial liability of \$70.52 billion, or 34.7%.



Source: Actuarial liabilities as of July 1, 2022 as provided by TPAF [Actuarial Valuation Report](#) (p. 4).

## **The Very Low 34.7% Funded Ratio Is Based on Optimistic Assumptions**

But even this very low 34.7% funded ratio benefits from some very charitable assumptions.

- **Very high discount rate.** The amount of liabilities (the denominator) is derived from a 7% discount rate for the pension liabilities, a very high rate for what is essentially a guaranteed obligation of the state.<sup>2</sup>
- **Discount rate based on high return assumption.** The 7% discount rate derives from the plan's 7% investment return assumption, but [Pew Charitable Trust](#) emphasizes that “a reasonable return assumption for the typical pension plan will be closer to 6%” for the foreseeable future. Were New Jersey to use a 6% return assumption, and in turn a 6% discount rate, the funded ratio would be substantially lower.
- **Full pension payments assumed -- forever.** The Government Accounting Standards Board (GASB) Rule 67 allows New Jersey to use the 7% discount rate because it assumes that New Jersey will continue to make the full, required pension contributions for every year in the future. In other words, New Jersey will be expected to make pension contributions of \$6.5 to \$7.3 billion per year until 2047.<sup>3</sup> If New Jersey does not contribute this full amount, then GASB 67 will revert to a lower discount rate and TPAF's funded ratio will drop commensurately.

TPAF's 34.7% funded ratio is extremely low, likely one of the very lowest in the nation. And even this level is questionable because of all the optimistic assumptions. New Jersey taxpayers are on the hook for the 65% of these pension obligations that is unfunded, yet this reality has not been conveyed to them.

## **TPAF Retirees Will Soon Outnumber Active Workers**

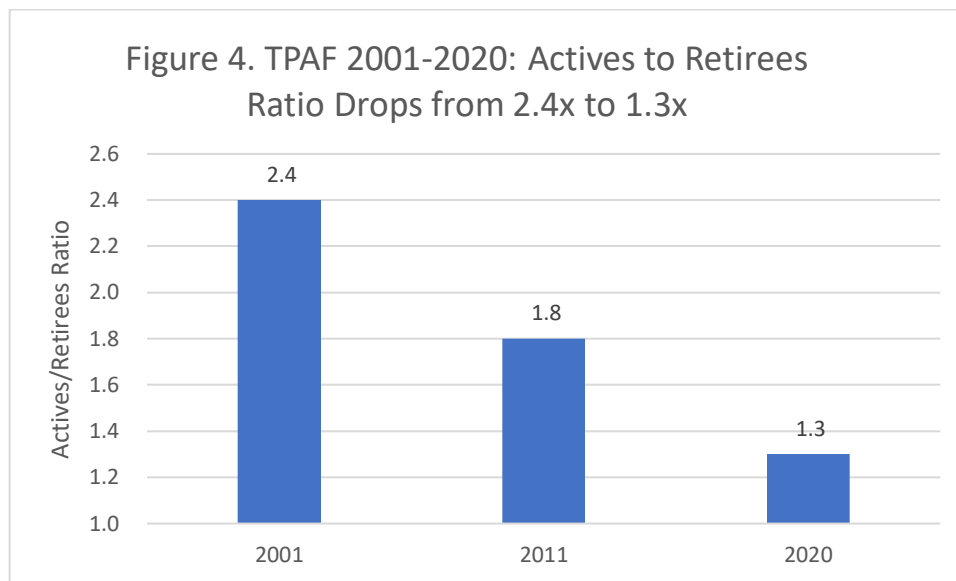
And the funded ratio is not the only problem with TPAF. In his 2022 [report](#) for the Garden State Initiative, highly regarded pension expert Andrew Biggs concluded that with retirees living longer and increasing in number, TPAF is approaching a demographic “tipping point,” where the number of retirees receiving benefits exceeds

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<sup>2</sup> Reputable economists argue that pension liabilities should carry a risk-free discount rate because they are “a form of government debt with strong statutory and contractual rights.” Oliver Giesecke and Joshua Rauh, “[Trends in State and Local Pension Funds](#),” Annual Review of Financial Economics, Volume 15, October 2022. With a risk-free discount rate, TPAF's funded ratio would drop into the low-to-mid-20% area per [Stanford's Public Pension database](#).

<sup>3</sup> [Preliminary Official Statement](#) for New Jersey Transportation Trust Fund Authority Bonds, 2022, Series CC, dated November 21, 2022, Appendix 1, p. I-51. The state's overall pension contribution includes all the state lottery proceeds -- 78% of which go to TPAF -- so this revenue stream will be consumed by the pensions until 2047 as well.

the number of active workers contributing into the pension system. As seen in Figure 4, the ratio of active contributors to retirees has declined from 2.4x in 2001 to 1.3x in 2020.



Source: NJ Division of Pensions and Benefits [Annual Comprehensive Financial Report](#) (p. 186-7) and Andrew Biggs, [“The Looming Tipping Point of New Jersey’s Pension System,”](#) Garden State Initiative, January, 2022, p. 4.

According to TPAF’s [actuarial report](#) (p.7): “As more of the liability moves from actives to inactive [retirees], the Fund will experience more volatility in contribution rates.” In other words, as this ratio dips below 1.0x, more money will be owed to retirees who are no longer contributing into the plan, which could result in a situation where either the amount contributed by active workers must increase, or the amount contributed by taxpayers must increase, or both. And remember that this decline occurred *before* the wave COVID-related early retirements that likely pushed this ratio down further.

This is another way in which TPAF is not a healthy pension plan.

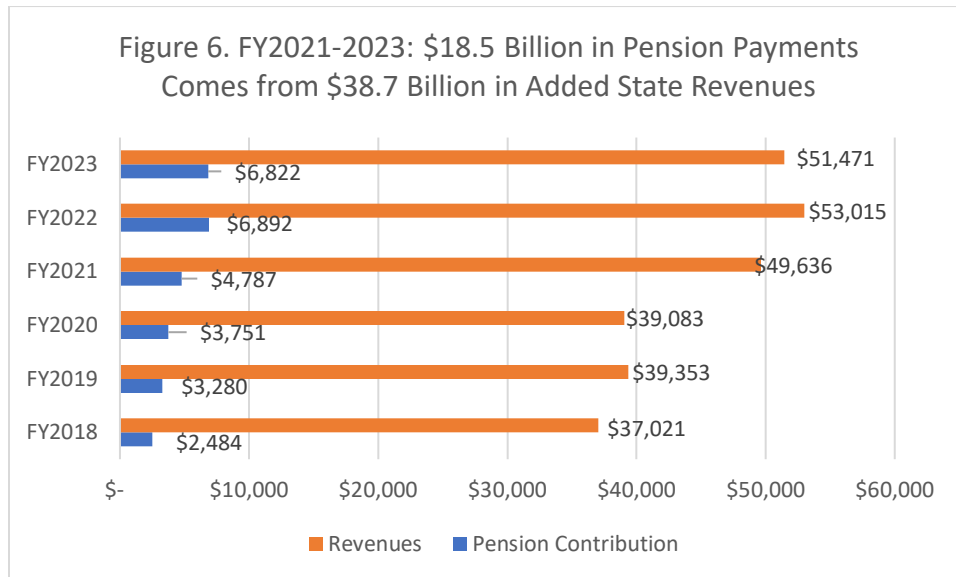
### **The TPAF Choice: Unsustainable State Contributions or Depletion of Assets**

All told, as governor, Murphy has made over \$28 billion in pension contributions, with \$18.5 billion made during the three pandemic budgets of FY2021-2023.

But these massive contributions were only made possible by the windfall of federal pandemic relief and record tax receipts. As shown in Figure 5, these windfalls drove up revenues for the three pandemic budgets to an average of \$51.4 billion, which is more than 33% over the average of the last three pre-pandemic budgets (FY2018, FY2019, FY2020) of \$38.5 billion. Pension contributions of \$18.5 billion appear affordable when state budgets have \$38.7 billion more to spend.

As shown in Figure 6, the FY2023 pension contribution amounted to 13.2% of this inflated budget, but sustaining a \$6.8 billion pension contribution will prove much more

burdensome when the federal money goes away, particularly when the markets swoon and/or the economy falls into recession, and tax revenues fall back to earth.



Source: [Preliminary Official Statement](#) for New Jersey Transportation Trust Fund Authority Bonds, 2022, Series CC, dated November 21, 2022.

Of course, in tough times, when tax revenues are lower and the demand for state assistance is higher, spending \$6.8 billion on pensions will mean less money for schools, social programs, public safety, and basic infrastructure. But if the state does not pour \$6.8 billion a year into the pension system, then TPAF's unreformed structure means that it will rely entirely on investment returns to avoid having to sell assets to meet its obligations to retirees. A lose-lose situation.

### Conclusion

So only one fiscal year after Murphy's happy talk, New Jersey's pensions have been revealed to be neither healthy nor sustainable, and potentially not even solvent in the long run. It is of course New Jersey taxpayers who will ultimately be on the hook for meeting New Jersey's pension obligations to retirees. They should be told the truth.

What about New Jersey's teachers? They have been told by Murphy and their union, the NJEA, that their pensions are sound. But their pensions are not sound. They should be told the truth.

But Murphy is not telling them the truth. Nor has he undertaken the difficult task of pension reform the way that the governors of [Pennsylvania](#), [Kentucky](#), [Tennessee](#), [Wisconsin](#) and other states have. With his eyes set on national office, Murphy will likely be long gone when the reckoning comes. Too bad for the citizens (and teachers) who elected him.