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Pension Costs Burden Local Government Budgets.

The unsustainable nature of defined benefit contribution plans is the primary budget challenge for local governments even though local revenue growth is improving, Wells Fargo Securities said in a report released Monday.

In its annual local budget outlook, Wells Fargo said the main challenge remaining for local governments is tied to the high costs of their pension liabilities. After peaking in 1997, cash flows for state and local pensions began to slow "nearly in lockstep with the deceleration in the key age ranges for state and local government employees," the report said.

While the Great Recession exacerbated the long-term trend of public pension challenges, the dominant factors relating to problems today for some municipalities relate to the demographic shift in worker composition at the state and local levels, the report said.

"While the more prominent cities of Stockton, Detroit and Chicago are among the severe cases of pension problems, several municipalities have attempted to make progress on pension reform," the report said. "However, in many cases these reforms have been met with court challenges, further complicating the reform process."

Wells Fargo noted that in the past three years there are at least 54 court cases challenging public pension reform efforts that have been brought at the state and local level including in Colorado, Florida, Massachusetts, New Hampshire, Rhode Island and Minnesota.

Given the difficulty of pension reform efforts, Wells Fargo anticipates pension liabilities to be an ongoing budget burden in the next few years.

Local governments in some states also continue to face reductions in state aid. Nearly 30% of total local government revenues is state aid. While the number of states reducing aid to local governments has declined, the degree of dependence of local governments on state aid is still high and the outlook is closely tied to the stability of state budget situations, the report noted.

"The potential negative effects of the federal budget cuts known as sequestration represent another potential looming cloud over local governments in the year ahead," the report said.

The main concern for the outlook for state government budgets are metro areas with high concentrations of federal workers. For example, areas with high concentrations of defense-related contractors and the military have the potential to affect sales tax and property tax collections as furloughs weigh on local area income growth.

On a positive note, sales tax collections were up 5.7% over last year's levels -a sign that some of the job gains in addition to wage and salary growth are tying into local revenue collections.

Wells Fargo expects local sales tax collections to improve at a modest pace over the coming year with retail spending hovering around 4.5% through the end of the year before accelerating to 5.5% by the end of 2014. Retail sales should rise to 5.1% in calendar year 2014 up from 4.3% so far observed this year.

The stronger pace of job growth over the past few months has helped stabilize local sales tax collections.

Texas holds four of the top 10 major cities for fastest job growth with Austin, Houston, San Antonio and Dallas according to a list compiled by Wells Fargo.

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