
WSJ: Pension Pinch Busts City Budgets.

Municipalities Grapple With Burgeoning Retiree-Benefit Costs; A Costly Perk in Springfield, Ill.

It pays for veteran firefighters and police officers here to retire around the anniversary of their hiring date—but it's costly for this city of 117,000.

Under current labor agreements, employees get a 5% bump in the pay periods around that date every year. Workers who retire during the short window get a perk: Their pensions are based on the temporarily boosted paycheck. The provision, which starts after two decades on the job, adds an average of $65,000 in lifetime payouts for each retiree who takes advantage.

Nationwide, pension costs are eating up more of city general funds, leaving less money to spend on day-to-day needs, such as garbage pickup or parks maintenance. The median spending on pensions among the country's 250 largest cities rose to 10% of general budgets in 2012, up from 7.75% in 2007, according to data provided to The Wall Street Journal by Merritt Research Services LLC. A few cities weren't available by August 2013, when Merritt collected the information.

Springfield's annual payments to the public employee retirement system have nearly tripled in the past decade to $19.8 million. The city says it spent 20% of its operations budget on pensions in the 2012 fiscal year, one of the nation's highest rates. Merritt puts the percentage at closer to 25%, based on public filings. (Merritt and the city differ on how to treat the calculation for some city employees, including those who work for Springfield's electric and water utility.)

The price of the problem can be seen around the Illinois state capital. Library branches that closed in the wake of the recession have never reopened. The Springfield Municipal Band, which was established through a 1936 referendum, has shrunk. In older neighborhoods such as Harvard Park, heavy rains overwhelm storm sewers and roads. Vacuum trucks fan out and suck up water because the city hasn't been able to afford needed road repairs.

"I have seen kids 8 and 10 years old wading waist-deep into it," said Polly Poskin, president of the Harvard Park Neighborhood Association. "The city has settled for a temporary fix, and we live with a permanent problem."

In the Enos Park neighborhood, residents have been tearing down blighted houses and building sculpture gardens to reverse years of decline. They hoped to restore the neighborhood's pockmarked main artery to the historic brick that sits below. The city's response: It will be able to repave only eventually.

Steve Combs, president of Enos Park Neighborhood Improvement Association, said residents have become resigned to the city's constraints. For new projects, he said, "there isn't even a line right now."

Pension problems have been mounting for years in Springfield. The city contributes to three pension funds: one each for police and fire, which are controlled by local boards, and to a smaller extent, a statewide fund for other city workers. A 2008 report commissioned by the mayor at the time warned that growing pension payments would “squeeze out basic municipal services.”

Years of salary increases and benefits fed the problem. The police and fire departments most recently had five-year contracts with 4% annual pay increases—plus the temporary 5% anniversary bump for veteran officers. Police agreed to a new contract last year with smaller raises, while firefighters are negotiating a new contract. Meanwhile, the number of retirees has grown.

To be sure, police and firefighters contribute a sizable chunk of their salaries to the pension funds—9.91% for police and 9.455% for firefighters. Also, as police and firefighters typically aren’t eligible to collect Social Security, municipalities don’t have to pay Social Security taxes on their salaries.

An analysis by Springfield officials earlier this year said below-par investment returns have exacerbated the pension problems, with the police and fire funds falling far short of the forecast annual return of 7.5%. Actuarial reports, which use an average return over several years to smooth sharp market swings, show the funds met their annual forecast only once in the past decade. That has left them with only about half the assets needed to pay all promised benefits, after being around 75%-funded a decade ago.

The result: The long-term obligations continue to increase, and funding shortfalls keep getting pushed into the future.

The police fund has called the 7.5% target set by the city increasingly unrealistic.

But Mayor J. Michael Houston, a former bank chief and investment management executive, opposes lowering the return target, saying it’s realistic over the long term. In the meantime, he’s cut some city positions and put surplus funds at the end of the last year into the pensions.

“The more money that we’re putting in the pension funds, the less money we can put into other services for people within the community,” Mr. Houston said. “This is not a problem that was created overnight. We need to approach the solution on a long-term basis.”

Chicago-based consultancy Marquette Associates, which has advised the police and fire funds for the past three years, declined to comment.

Standard & Poor’s Ratings Services in its most recent report on the city’s finances acknowledged the steps Springfield is taking to alleviate its problems, including the workforce cuts and additional pension contributions. Still, when city debt is combined with the cost of promised pension and retiree health-care benefits, the total is $6,956 per capita. The credit-rating firm views a number more than $5,000 as high.

Although Illinois is one of only a handful of states with locally run pension funds, the state dictates how they can invest. So while cities control salary negotiations, retirement benefits are set by the Legislature. Lawmakers, for example, voted in 2004 to give the spouse of a retired firefighter continuing benefits after any death, affecting about 290 local funds. Springfield estimated it cost an additional $653,000 in the first year.

In Springfield, the temporary pay spike may soon be a thing of the past. The new police contract ends the perk next year, and the firefighters are likely to lose it, too. Former firefighter John Sullivan, now president of the Springfield Firefighters’ Pension Fund, said the benefit was originally designed to entice more highly paid older employees to leave. But, he said, “ideas have changed.” Also, starting next year, the city will raise the sales tax to 8.5% from 8%. That follows an increase in sewer rates earlier this year.

The state has its own pension woes. Illinois has chronically underfunded its retirement system for state workers, university employees and teachers, while also seeing investment returns fall short of forecast levels. As a result, the state’s credit rating is the lowest in the country.

As for the Legislature, so far lawmakers confronted rising costs only by reducing retirement benefits for newly hired state and local government employees. But those savings will take years to materialize.

“The real question for municipalities like the city of Springfield is: How long can we hang on?” said William McCarty, director of Springfield’s budget and management office.

By MARK PETERS