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Detroit Bankruptcy Prods Cities to Target Pensions: Muni Credit.

Local officials in at least 10 states are trying to cut pensions of municipal workers, or eliminate defined-benefit plans, pointing to Detroit as a symbol of the peril of growing retirement costs.

From New York to California, mayors and county officials are asking legislatures, courts or voters to allow the changes as a way to maintain government services as pensions consume a larger portion of budgets. The pressure may help extend a rally in municipal debt of issuers such as cities and school districts after the securities trailed the $3.7 trillion municipal market for the past five years.

Elected officials are intensifying efforts to trim benefits even as local economies and tax revenue recover more than four years after the longest recession since the 1930s. They're searching for ways to reduce the costs of pensions that cover more than 14 million workers and are underfunded by at least $1 trillion, according to a January report by the Nelson A. Rockefeller Institute of Government in Albany, New York.

"Detroit should give everyone a long pause," said Tom Tait, the Republican mayor of Anaheim, California, who is pushing a statewide ballot initiative to allow local governments to cut benefits for current employees. "It's a necessary tool to save the cities and, as we've found in these other cities, to save the pension plans."

Cost Cut

Legislatures in many instances have changed laws to reduce benefits of state employees, or forced them to pay more. Seven states, including Virginia and Tennessee, have agreed to phase out defined-benefit plans for certain employees, including some from local governments who are included in the state program.

Cities pressing for more control over pensions include Chicago, Houston, New Orleans, San Jose, California, and Syracuse, New York, where mayors say they have limited ability to control costs.

In Houston, the fourth most populous U.S. city, pensions accounted for 11 percent of the $2 billion budget, up from 6.9 percent a decade earlier, according to budget documents. In San Jose, the 10th most populous, pensions totaled 20 percent of the $1.1 billion budget, up from 9 percent in 2004.

Reducing Yields

Some municipal efforts to cut pension costs probably will succeed, boosting investor confidence and reducing yields, said Greg Donaldson, chief investment officer at Evansville, Indiana-based Donaldson Capital Management, which oversees $300 million in munis.

"The math in many of these pension plans just doesn't work," Donaldson said.

Investors are showing confidence in local-government debt in 2014, driving the securities to a 3.7

percent gain, while the entire municipal market has earned 3.3 percent, Bank of America Merrill Lynch data show.

A muni rally drove benchmark 10-year yields to an eight-month low of 2.5 percent yesterday, Bloomberg data show. For local debt, the outperformance marks a reversal after five years where city and county debt trailed the rest of the market.

Pension shortfalls emerged as the 18-month recession that ended in 2009 drove down stocks, trimming the value of investments used to pay benefits. Governments for years had also failed to put aside enough money.

Public pensions around the country remain “on a risky and shaky foundation” and some retirees won’t receive promised benefits, according to the Rockefeller Institute report.

State Laws

State laws often don’t allow localities to reduce employee pensions because they’re part of statewide funds that pay uniform benefits, said David Matkin, a professor of public administration at the State University of New York in Albany.

Detroit’s pension deficit of as much as $3.9 billion gained public attention last year as the city filed the largest U.S. municipal bankruptcy, emboldening local officials to advocate for reduced benefits. Detroit’s emergency manager, Kevyn Orr, estimates pension and retiree health-care liabilities make up half of Detroit’s $18 billion in debts cited in its July bankruptcy filing.

Orr this month proposed cutting pensions by as much as 10 percent for retired police officers and firefighters and as much as a third for other municipal retirees. U.S. Bankruptcy Judge Steven Rhodes, who is overseeing the Detroit case, ruled last year that pensions can be cut.

‘Lightning Rod’

“Detroit has presented something of a lightning rod for the elected officials,” said Teague Paterson, a Sacramento, California, attorney representing municipal workers’ unions in the state.

“Until recently, government agencies have been reticent to make changes, especially for public safety employees, who have been the golden children of the public sector workforce,” Paterson said. “But with the cries for reform we are now hearing, the police and fire unions are also in the hot seat.”

Local officials in the 10 states — including Michigan, Rhode Island and Pennsylvania — said in interviews that they’re seeking to change pension plans for existing or new employees, or both.

Lawmakers in at least three states, Florida, Illinois and Oklahoma, are considering legislation that would allow local governments to offer pension plans with lesser benefits for new employees or reduce benefits for existing workers, said Steve Kreisberg, director of collective bargaining for the American Federation of State, County and Municipal Employees, a union representing 1.6 million workers.

Raising Taxes

In Pennsylvania, 23 mayors are seeking legislative approval to freeze cost-of-living increases for current workers and revise a defined-benefit plan in a way that would result in reduced government contributions, said Rick Schuettler, executive director of the Pennsylvania Municipal League. The group’s members include cities and towns.

Some Pennsylvania cities have already raised taxes to meet higher pension costs and can’t boost them further without driving out businesses and residents, said Ed Pawlowski, mayor of Allentown and president of the state Municipal League.

“The more you raise taxes, the more folks move out and the more you lose in revenues,” said Pawlowski, a Democrat.

Houston, with about 2.2 million residents, filed a lawsuit in state court last month against the firefighters’ pension fund seeking permission to negotiate benefits, saying a law preventing the city from doing so violates the Texas constitution. The lawsuit said the city shouldn’t “ignore the lessons to be learned from the recent Detroit bankruptcy.”

Changing Rules

The board that controls the firefighters pension is fighting the lawsuit. No trial date has been set.

“When a firefighter joins the Houston Fire Department, he is told what benefits he or she will receive, and the city is wanting to change the rules mid-stream,” said Todd Clark, a firefighter who is chairman of the board.

In New York, Syracuse Mayor Stephanie Miner is pushing for localities to get power to cut benefits. Syracuse’s annual pension cost doubled to $32.5 million in her first four-year term, said Miner, a Democrat re-elected last year. The city projects operating budget deficits of more than $20 million annually through 2016, exacerbated by pension obligations, she said.

The state retirement system, which the city pays into for its workers, “just sends us a bill and the bill keeps escalating,” she said. “It’s an emergency right now.”

Risking Lives

Mayors face battles when seeking pension cuts at state capitols, said Matkin, the public-administration professor.

“The cities say they want more discretion, then the firefighters come in their uniforms and stand before subcommittees and say, ‘We are risking our lives every day to keep you safe. We run into burning buildings. Don’t touch our pensions,” he said.

Rather than penalize public workers, cities should curb budget deficits by raising taxes or eliminating corporate tax breaks, said Ron Saathoff, pension resources director of the International Association of Fire Fighters, a Washington-based union representing 240,000 members.

“Both at the state and local levels there are efforts to change existing laws and remove the constitutionally protected rights that people have earned,” Saathoff said.

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