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After a Few Years Afloat, Pension Plans Start Sinking Again.

Public pension plans across the country are missing their annual investment targets by wide margins this year, a trend that could put continued pressure on their governance and benefits.

In fiscal year 2015, which ended June 30, no plan so far has hit its annual return assumption, and major plans are reporting returns as low as 2 percent — well below the annual average target between 7 and 8 percent.

But what's shaping up to be a poor year for pension plans could provide ammunition to those who want to change them. That's because last year, new accounting changes took effect that now take investment returns into account when calculating pension plans' funded status. In fiscal 2014, stocks and bonds soared and many pension plans reported big improvements in their funded ratios. But with low returns this year, some plans could look less healthy than they did a year ago. Plans will publish their new funded status in their annual financial reports, which come out later this year.

"This is going to further call attention to the fragility of these underfunded [plans]," said Peter Kiernan, a public finance lawyer at Schiff Hardin. "States and cities are saying they're restoring their plans to health and that they've made it through the Great Recession [but] they're being proven wrong."

The nation's two largest public pension plans — the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System — reported annual returns of 2.4 percent and 4.8 percent, respectively. The funds, which combine for nearly $500 billion in assets, have a target annual investment return of 7.5 percent.

Other major state plans are reporting similarly low returns: the Maryland State Retirement and Pension System earned 2.7 percent, the Virginia Retirement System earned 4.6 percent and the Rhode Island State Employees' Retirement plan earned 2.2 percent. New Jersey will likely miss its mark too as the state employee plan has so far earned 4.6 percent on its investments through the first 11 months of its fiscal year. The state plans' targets range from 7 percent in Virginia to 7.9 percent in New Jersey.

At the municipal level, Philadelphia's public employees plan appears headed for an abysmal year as results through February show a mere 0.5 percent return; Los Angeles' investment return for fiscal 2015 was 2.8 percent; and in New York City, four of the five plans posted an investment return of less than 5 percent with one month to go in the fiscal year, while the city's police plan earned 5.4 percent over the same time period.

The poor performance comes after two years of double-digit returns for many plans. Most plans attribute the slump this year to turmoil in the international market, primarily caused by the financial crisis in Greece. Global stocks and bonds, which account for a significant portion of pension plan portfolios, took a big hit this year. In Maryland and Rhode Island for example, global and international equities are about one-quarter of plan investments.

Another big culprit is the bond market with its continued low interest rates, said Keith Brainard, director of research at the National Association of State Retirement Administrators. Indeed, mutual funds indexed to the bond market returned less than 2 percent this past year. Fixed-income bonds tend to account for a smaller percentage of plan assets compared with global equities, but together, these two poorly performing assets can account for around 40 percent of plan portfolios.

Still, one poor year is no indication that pension plan returns will start sinking into the red like they did in 2008 and 2009 after the stock market crash. Many plans also had a poor year in 2012 only to be followed by double-digit returns again.

“As we say with regard to investment returns,” said Brainard, “it’s a marathon, not a sprint. One year of returns is less important than the longer term trends.”

Some plans also released their three- and five-year investment return averages, and even with 2015’s low numbers, they’re well above the 7 to 8 percent needed for long-term stability because they include the stock market rebound. CalPERS, for example, earned 10.7 percent over each of the last five years. But plans did not release information on their new 10-year average investment return, which would include the stock market crash in 2008-2009. Using last year’s information, which doesn’t incorporate 2015’s low returns, the 10-year investment return average for many of these plans was around 7 or 8 percent.

Even so, politicians and other stakeholders seeking cuts in pension benefits will likely use the bad year for plans to argue their case. In California, ex-San Jose Mayor Chuck Reed is pushing for a ballot initiative that would amend the state’s constitution to let localities make changes to their pension benefits for existing workers. And in New Jersey, Republican presidential candidate and Gov. Chris Christie has underfunded his pension system and wants to reduce the state’s financial commitments to retirees.

“Taxpayer advocacy groups will seize on this,” said Kiernan. “Any sitting governor that has a problem like this could be affected.”

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