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Moody's: California's State and Local Pension Costs Rising in Face of Limited Reform Options.

New York, September 02, 2015 — The State of California (Aa3 stable) provides the strongest level of legal protections for its public pension benefits via a series of state supreme court decisions, which limits both the state's and its local governments' options to address pension challenges apart from making higher budgetary contributions, Moody's Investors Service says.

Numerous court decisions, collectively known as the "California Rule," have given California pensioners ironclad legal safeguards limiting reforms on pensions and retiree health benefits to future employees, says Moody's in its new report "California and its Local Governments Face Sustained Pension Cost Hikes."

"Because of the California Rule, recent statewide pension reforms will take years to materialize because they are limited to new employees. State and local government contributions to address accumulated unfunded pension liabilities will therefore continue rising for the next several years." says author of the report and Moody's AVP — Analyst Thomas Aaron

Two of the largest US public pension systems, the California Public Employees Retirement System (CalPERS, Aa2 stable) and the California State Teachers Retirement System (CalSTRS, Aa2 stable), comprise a significant portion of pension exposure for the state and its local governments. In addition, there are a number of large cities and counties with localized plans with benefits set at the local level.

California currently has the highest adjusted net pension liability of any state, with an FY 2013 figure of $189.4 billion. However, the state's huge economy places this amount at 92.5% of revenues, which is 17th highest among states and above the 50-state median of 52.8% of revenues.

In 2012, the state passed a broad set of pension reforms which impacted state, most local governments and many participants in CalPERS and CalSTRS. The Public Employees' Pension Reform Act (PEPRA) instituted changes for employees hired after January 1, 2013 or later. This included capping levels of "pensionable" compensation and less generous pension benefit formulas.

Additionally, in 2014, the state implemented reforms and mandatory contribution increases designed to substantially improve CalSTRS' funding trajectory and prevent unfettered growth in the plan's unfunded liabilities, which would have led to asset depletion by the mid-2040s.

While state and local pension costs continue to increase, the maturation of pension plans and their continued reliance on equities and other risky investments lends an additional element of contribution volatility. Efforts to reduce volatility risk are being considered, but would push contribution requirements for the state and local governments beyond what is already anticipated.

The report is available to Moody's subscribers here.