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Public Pension Funds Roll Back Return Targets.

Public pension funds from California to New York are cutting investment-return predictions to their lowest levels since the 1980s, a shift that portends greater hardships for employees and cash-strapped governments as Americans age.

New upheavals in global markets and a sustained period of low interest rates are forcing officials who manage retirements for nearly 20 million U.S. beneficiaries to abandon a long-held belief that stocks, bonds and other holdings would earn 8% each year, as well as expectations that those gains would fund hundreds of billions of dollars in liabilities.

More than two-thirds of state retirement systems have trimmed assumptions since 2008 as the financial crisis and an uneven U.S. recovery knocked many below their long-term goals, according to an analysis of 126 plans provided by the National Association of State Retirement Administrators. The average target of 7.68% is the lowest since at least 1989. The peak was 8.1% in 2001.

On Friday, the New York State Common Retirement Fund, the third-largest public pension by assets, said it plans to drop its assumed returns to 7% from 7.5% after cutting a half-percentage point five years ago. That followed Thursday's vote by the San Diego County Employees Retirement Association to drop its level to 7.5% from 7.75%.

"Realism," said Brian McDonnell, managing director for pension consultant Cambridge Associates, is "creeping in."

Moving expectations below 8% isn't just an arcane accounting move. It has real-life consequences for systems that use these predictions to calculate the present value of obligations owed to retirees. Even slight cutbacks in return targets often mean budget-strained governments or workers are asked to pay significantly more to account for liabilities that are expected to rise as lifespans increase and more Americans retire. A drop of one percentage point will typically boost pension liabilities by 12%, said Jean-Pierre Aubry, an assistant director at the Center for Retirement Research at Boston College.

Public pension funds use a combination of investment income and contributions from employees, states and cities to fund benefits.

In Boulder, Colo., the city eliminated 100 positions and consolidated city programs as a way of compensating for three reductions in the state's investment forecast and a rise in pension contributions, as the economy sputtered. It also stopped planting tulips in most areas and shifted to less expensive wildflowers as a way of making an additional $1.7 million in pension payments, according to the city's chief financial officer, Bob Eichem. "You do more with less," Mr. Eichem said.

U.S. pensions first started to reconsider their investment-return assumptions after being stung by deep losses during the 2008 financial crisis. The event helped drop 10- and 15-year annual returns at large public pensions to 6.9% and 5.8%, respectively, according to the Wilshire Trust Universe Comparison Service. The retirement systems' median return was 3.4% for the 12 months ended June

30 amid downturns in foreign stocks and bonds, their worst annual performance since 2012.

Retirement systems argue that lowering assumptions fortifies their fiscal health, because the influx of extra contributions means they become less reliant on generating big returns.

Some big funds are preparing to pull their goals back even further. The California Public Employees' Retirement System, the nation's largest pension, is discussing a new reduction below its level of 7.5%. The Oregon Public Employees Retirement System and the Texas Municipal Retirement System, the 14th and 35th largest, both approved lowering their forecasts in late July by a quarter of a percentage point. "Those days" of believing 8% could be earned annually "aren't here anymore," said New York state Comptroller Thomas P. DiNapoli.

But some critics contend that pensions are still relying on unrealistic expectations to fill ballooning funding gaps even as they move targets below 8%. The lower assumptions remain considerably higher than levels seen in the 1960s, when pensions estimated 3% to 3.5% returns from portfolios primarily comprised of cash and bonds. Pension officials pushed their predictions higher in subsequent decades as they embraced riskier holdings of stocks, real estate, commodities and hedge-fund assets.

"It's clearly not enough," said Josh McGee, a senior vice president of public accountability at the Laura and John Arnold Foundation, a nonprofit that has worked across the U.S. for changes to guaranteed pension benefits.

Pension funds said that while performance has lagged behind of late, they generally have been able to hit their targets over longer periods and expect to continue to do so.

A panel of U.S. actuaries and pension specialists has recommended that public systems move their assumed future returns down to 6.4%, and many corporations already use a more conservative rate for their pension funds. The average for companies listed in the Fortune 1000 dropped to 7.1% in 2014 from a high of 9.2% in 2000, according to a Towers Watson survey.

The most aggressive move downward among public employee pensions belongs to Delaware, where the state retirement system has dropped to a target of 7.2% from 8.5% in 2003, the largest change since 2001 among state plans tracked by the National Association of State Retirement Administrators. David Craik, the retirement system's pension administrator, said he wouldn't rule out further decreases.

"I'm kind of surprised others aren't going as low as we did," Mr. Craik said.

More big pullbacks by public plans would likely create deeper financial pain for governments and employees that have already cut services and benefits. Local and state contributions to retirement systems have more than doubled over the past decade, to $121.1 billion in 2014, according to the U.S. Census Bureau. During that same time worker pension contributions rose 50%, to $45.5 billion.

In Fullerton, Calif., officials are sharing a fire chief and command-level staff with one neighboring town and splitting up tree-cutting contracts with other cities in the wake of a half-percentage point cut in return assumptions for the state's retirement system. It was able to save $1.2 million.

"The pension costs are high and will continue to be high," said Joe Felz, Fullerton's city manager. "It's tops to bottom looking where we can get savings."

Still, some retirement systems believe 8% is possible, as 39 of them maintain forecasts at or above that old industry mark, according to the National Association of State Retirement Administrators.

Two of them—the Houston Firefighters' Relief and Retirement Fund and the Connecticut Teachers' Retirement System—assume returns of 8.5%, the highest of any other plans.

"We strongly believe, and past history shows, we can continue to achieve the 8.5% long term," said Todd Clark, chairman of the Houston firefighters' fund. The Connecticut fund didn't respond to requests for comment.

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