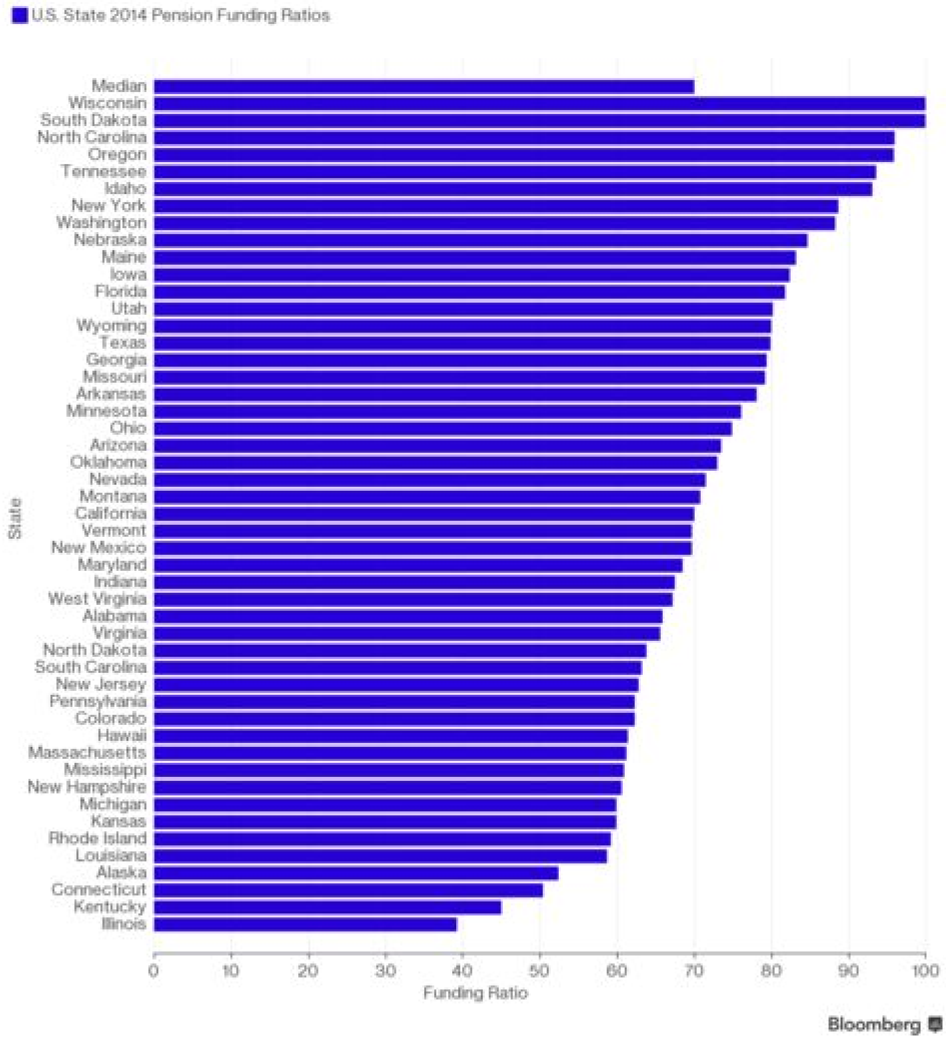
State Pension Funding Levels in U.S. Improve for a Second Year.

The finances of more than two-thirds of U.S. state pension plans improved in fiscal year 2014, as a soaring stock market boosted returns and many states stopped incorporating losses from the recession into their pension calculations.

The median state pension last year had 70 percent of the assets needed to meet promised benefits, up from 69.2 percent in 2013, according to data compiled by Bloomberg. It was the second straight increase in pension funding. Public pensions had median investment gains of 16.9 percent for the 12 months ended June 30, 2014 according to Wilshire Associates.

"It's generally agreed that 2014 was mostly a year of improvement for public pension funds," said Josh Gonze, who co-manages $10.5 billion of municipal bonds at Thornburg Investment Management in Santa Fe, New Mexico. Thornburg's $7.3 billion Limited Term fund is the 13th largest open-end tax-exempt mutual fund, according to data compiled by Bloomberg.

The Federal Reserve's policy of keeping short-term interest rates near zero and an improving economy boosted the Standard & Poor's 500 Index of U.S. stocks by 24.6 percent in the 12 months through June 30, 2014 including dividends, helping to ease the strain on public pensions.



Broad numbers mask big difference in the health of public pensions between states. Eight of 13 states whose funding level declined were states with below average funding levels.

"We have states that seem to be in genuine trouble," Gonze said, listing Illinois, Kentucky, Alaska and New Jersey. "And clearly states that are not in any trouble at all."

Illinois, with a pension shortfall of more than $100 billion, remains the state with worst-funded retirement system, with a ratio of assets to liabilities of 39.3 percent, followed by Kentucky at 45 percent and Connecticut at 50.4 percent.

In May, the Illinois Supreme Court struck down a 2013 pension overhaul saying it violated the state constitution's ban on reducing worker retirement benefits. The ruling highlighted the lack of legal flexibility some states have in addressing their pension funding deficits.

Accounting Change

New Jersey's pensions are projected to run out of assets to pay liabilities between 2021 and 2032, depending on the retirement system, under new accounting rules that most states began implementing in 2014, according to Moody's Investors Service.

New Governmental Accounting Standards Board rules require public pensions to use a lower discount rate to value liabilities for plans with projected asset depletion dates and market value rather than the actuarial value of assets among other things.

Puerto Rico, Illinois and New Jersey are the three issuers whose pension funding deficits are serious enough that Thornburg is avoiding their securities, Gonze said. Thornburg's limited term fund focuses on debt maturing in 10 years or less.

More Retirees

Loop Capital Markets, in a report last month, said it expects "continued bifurcation" among governments in terms of the fiscal health of their pensions.

"A combination of strong pension protections, coupled with low funded levels, should be especially noted as they indicate escalating budgetary pressure," Loop's report said. "For those perennially struggling with funding pension payments and low funded levels, these pressures are not expected to abate without significant change in plan fundamentals."

State that had the biggest improvement in funding include Idaho, whose, pension funding ratio rose 7.6 percentage points to 93.1 percent and Oklahoma, whose actuarial value of assets divided by actuarial accrued liabilities gained 6.5 percentage points to 73 percent.

In the last six years Idaho's pension funding has improved by 19.2 percentage points, the most of any state, according to data compiled by Bloomberg.

Michigan's pension funding ratio has declined the most during that period to 59.9 percent from 83.6 percent. Michigan is one of three states, including Alaska and Ohio that have more retired public employees than active members, according to Loop.

Bloomberg News

by Martin Z Braun

October 12, 2015 — 9:00 PM PDT Updated on October 13, 2015 — 5:01 AM PDT