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S&P Report Discusses Cost to State, School Districts of California's Teacher Pensions.

SAN FRANCISCO (Standard & Poor's) April 12, 2016—In 2014, California enacted legislation to eliminate its teachers retirement system's unfunded pension liability by 2046. In a report published today, Standard & Poor's Ratings Services says that the additional contributions under the law should bolster the pension system's funded status over the long-term. Insofar as the law reduces the likelihood that the unfunded liability will spiral out of control, it's favorable for the credit quality of both the state and its school districts. However, the additional contributions mandated by the reforms could also strain the finances of either the state or some school districts, depending upon future investment performance.

The report is titled, "Post-Funding Reform, CalSTRS Defined Benefit Remains Guaranteed; Cost To State, School Districts Is Anything But."

The legislation—AB 1469—was adopted because by 2014 annual contributions to the California State Teachers Retirement System (CalSTRS) had fallen to a level such that the long-term solvency of its defined benefit plan was in jeopardy.

"Standard & Poor's generally views AB 1469 favorably because it should stabilize CalSTRS' long-term funding situation," said credit analyst Gabriel Petek. "At the same time, we also view the contribution increases it calls for as large enough to have material fiscal implications. Funding the higher contributions could strain the state's budget—or those of the local school districts. We can envision plausible circumstances in which the added fiscal pressure caused by the higher contributions could weaken credit quality. At this point, however, it's unclear whether—or if—the higher contribution rates will stress the finances of either the state or any particular school district to this degree.

Part of our uncertainty stems from the fact that AB 1469 did not allocate CalSTRS' unfunded liability to the state and school districts in a strictly proportional fashion. And the way the funding mechanism is designed means that the state's contribution rates (and therefore the fiscal implications to the state) are influenced disproportionately by CalSTRS' investment performance.

As for the school districts, those with declining enrollments or limited budget flexibility could be challenged by the increasing contribution rates that the law specifies.

Only a rating committee may determine a rating action and this report does not constitute a rating action.

The report is available to subscribers of RatingsDirect at www.globalcreditportal.com and at www.spcapitaliq.com. If you are not a RatingsDirect subscriber, you may purchase a copy of the report by calling (1) 212-438-7280 or sending an e-mail to research_request@standardandpoors.com.

Ratings information can also be found on Standard & Poor's public Web site by using the Ratings search box located in the left column at www.standardandpoors.com. Members of the media may request a copy of this report by contacting the media representative provided.

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