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Public Pensions Facing Worst Returns Since Recession.

A volatile stock market over the past year has taken a toll on public pension assets.

Public pension plans are reporting dismal investment returns this year, a development that will likely mean governments will have to pony up more money in the coming years.

So far, no major pension plan has reported a preliminary annual investment return of more than 1.5 percent. That's thanks to a volatile stock market that's seen wild swings spurred mainly by political and economic events abroad. Some smaller plans, such as the New Mexico Educational Retirement Board, have reported earnings as high as 2.6 percent. Still for many, this year marked their worst earnings year since the Great Recession.

The slim earnings for fiscal 2016, which ended June 30 for most plans, is well below the average earnings target of about 7.5 percent. It also marks the second year in a row that plans have missed the assumed rate of return: Most reported an investment gain between 2 percent and 4 percent in fiscal 2015.

Plans rely heavily on investment earnings — roughly 80 cents on every dollar paid out to retirees is from investments. When plans don't meet their earnings target in any given year, it negatively impacts their assets because annual payments from current employees and governments aren't enough to cover the annual payouts to retirees.

The nation's largest pension plan, for example, reported a preliminary investment return of 0.6 percent for fiscal 2016. The meager return means that the California Public Employees' Retirement System (CalPERS) ended the year with $295 billion — about $7 billion less than a year ago.

Meanwhile, pension liabilities aren't improving and, in some cases, are actually increasing. Public pension plans nationally were nearly 74 percent funded in 2015 with more than $1 trillion in unfunded liabilities. "Clearly this is going to generate some fresh unfunded liabilities," said Tom Aaron, a senior analyst at Moody's Investors Service.

Even an investment return of 5 percent for the year would increase plans' overall liabilities by 10 percent, according to a Moody's analysis of 56 major public pension plans. "This comes at a time," Aaron added, "when state and local governments are already dealing with heightened contribution requirements to amortize past unfunded liabilities."

With two bad years in a row, any pension funding gains made in 2013 and 2014 — when many pensions earned double-digit returns — have essentially been wiped out.

Other plans across the country are reporting similar preliminary results to CalPERS. The California State Teachers' Retirement System reported a 1.4 percent return, resulting in a decline of $3 billion in assets. New York State's pension fund, which closed its fiscal year on March 31, reported a 0.2 percent investment return. Its total assets declined by about $5 billion. San Diego County's $10.2 billion pension fund claimed a 0.5 percent return. And the Oregon Investment Council reports the state’s public employees’ plan has logged a 1.24 percent return for the year.

The main culprit for the poor performance was investment losses in domestic and global equities. Since August of last year, the stock market has swung wildly — twice thanks to bad economic news from China, and more recently due to uncertainty around Britain’s decision to leave the European Union.

Another issue is that pension plans are relying less on more stable but low-yield investments like bonds. Instead, they rely more on potentially higher-yield investments in public and private equities. It hasn’t paid off: The median annual return for public pensions over 20 years is expected to hit about 7.5 percent for the 2016 fiscal year — the lowest point in more than 15 years — according to a recent estimate from the Wilshire Trust Universe Comparison Service.

June and July, however, have been marked by stock market gains. By the time CalPERS released its investment return data in July, assets had crept back up to about $302 billion — roughly where they were a year ago.

Either way, governments will likely have to budget more in the coming years to cover expected shortfalls. The New York state controller recently warned New York City it might have to pony up at least $100 million in additional pension payments starting in 2018 if the city’s fund continues to post low earnings. In Oregon, the state’s pension actuary projected it would have to pay $885 million more in total pension costs next year thanks in part to low earnings but also because it lowered the plan’s assumed rate of return to 7.5 percent.

Many other plans are also taking steps to gradually lower their assumed rate of return, said Cathie Eitelberg, a senior vice president at The Segal Group. While that has the effect of increasing the cost for governments and employees, it reduces the risk the pension plan will miss its investment target. “They’re all very focused on risk management going forward and how they can better manage volatility,” said Eitelberg.

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