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Fitch: CalPERS Funding Change Means More Pressure for California Local Governments.

Fitch Ratings-San Francisco-16 February 2018: A recent change to the California Public Employees' Retirement System's (CalPERS) pension funding rules could heighten budgetary pressure on some of the state's local governments, according to Fitch Ratings.

The action by CalPERS (the nation's largest public employee pension plan) would shorten the amortization period for unfunded liabilities from 30 years to 20 years and raise employer contributions beginning in 2021. It follows previous CalPERS steps that phase in lower assumed earnings on pension assets and revise mortality assumptions for plan members, which have likewise led to earlier contribution increases for participating governmental employers. These actions together are intended to accelerate funding progress and improve CalPERS' long-term sustainability.

That said, the changes are likely to precipitate short-term pressure to some governmental budgets. Potential cost pressures will vary by locality and may depend on legal decisions going forward, but local governments in California will be especially challenged given their limited ability to raise revenues and a history of judicial decisions protecting existing pension arrangements.

California's Supreme Court is expected to soon review several recent appellate decisions that have questioned the "California Rule," a 1955 precedent that established pension benefits, once granted, as a vested contractual right that cannot be subsequently impaired unless offset by a comparable new benefit. This principle has been cited as an impediment to pension benefit reductions in 12 states in addition to California. Some clarity on this point may be forthcoming from California's Supreme Court, but Fitch expects that legal challenges will continue to slow governmental efforts to reduce pension liabilities.

CalPERS changes are emblematic of a larger trend throughout the country of public pensions accounting for an increasing share of many local governments' expenses, not just in California. A recent report by the League of California Cities found that pension contributions will double as a share of governmental budgets in the next seven years. These pending increases follow a steady expansion in pension costs for local governments over the past decade.

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