Bond Case Briefs

Municipal Finance Law Since 1971

S&P Fifteen Largest U.S. City Pensions See Modest Gains In 2018, But Recession Risk And Rising OPEB Cost Challenges Persist

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Since the Great Recession, municipal defined-benefit pension plans have taken center stage as one of the key sources of long-term credit risk in what has historically been a remarkably stable, low-risk asset class. The 2008 financial crisis and subsequent economic downturn led to steep declines in asset values for U.S. municipal pension funds, followed by a period of inconsistent and often below-target investment performance. S&P Global Ratings believes that these issues have frequently been exacerbated by underfunding, where many municipalities continue to contribute less than actuarially recommended rates to their pension funds and where states have often failed to update statutory formulas in a timely manner to better align with actuarial recommendations. As funding levels have consequently been pressured, so too has the post-recession economic recovery been among the weakest in history, creating more acute budgetary pressure directly related to pension and other postemployment benefits (OPEBs) for many local governments, while focusing market attention ever more sharply on the risks that postretirement obligations pose for local government budgets and credit quality.

In this year's annual survey of the 15 largest American cities, S&P Global Ratings continues to see a picture that is decidedly mixed in terms of where the largest cities stand with respect to their pension and OPEB liabilities. Primary fixed costs—covering pensions and OPEB as well as debt service payments—are generally high and in many cases poised to rise considerably in the coming years due to poor pension funding levels, actuarial assumptions and methods that defer meaningful funding progress into the future, and movement toward the adoption of more conservative actuarial assumptions that revise funding levels downward and require higher employer contributions. We expect that cities with poorly funded pension plans will continue to struggle with cost pressures, as rising pension payments compete for the dollars needed to fund priority services and infrastructure investment. On the other hand, we continue to observe many cities that are proactively addressing their pension and OPEB liabilities through meaningful reforms that, though often more costly in the short term, will better position them in the long run to meet their obligations without impairing their fiscal health.

This year, we take stock of some of the key trends we have traditionally focused on in our survey of the largest U.S. cities' pensions—cost trends and affordability, funding levels, and ongoing pension reform efforts—while highlighting some new themes that we think deserve emphasis, including what we expect will be greater focus on OPEB obligations; the potential effects of a recession on funding levels and costs; and the quantitative measurement of funding progress, enabling a more precise pinpointing of funding shortfalls and the risk of cost acceleration.

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