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Muni Pension Risk? It's in the Past for Now.

Unfunded pensions for state and local governments were once expected by some to sink the whole market. That never happened. Instead, unfunded pension liabilities are in their best condition in nearly a decade, according to Pew Charitable Trusts, and are less of a financial burden on many state and local governments. The improvement in pension liabilities supports the case that credit quality in the muni market has improved and is strong overall.

How do pensions work?

The state or local governments that provide pensions must contribute and invest funds to pay for future benefits. The employees usually must contribute, as well. Future benefits are based on a variety of factors such as projected retirement dates, growth in salaries and life expectancies.

Municipal pension plans vary in terms of funding levels, annual expenses, and the ability and willingness to fully fund their plans. If the value of a plan's assets falls, or the future retirement benefits promised become more expensive, the municipality generally must contribute more. Those costs compete with other costs, such as other public services or debt payments. Large payments to pensions can take funds away from payments to other resources—such as keeping the municipality operating, or making payments to bondholders. If pension expenses become too burdensome, the municipality risks defaulting on its bonds.

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