

# U.S. State and Local Pension Risks Amid COVID-19

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Volker Alliance, “Special Briefing on Assuring Public Worker Retirement Security Amid COVID-19 Fiscal Stress”



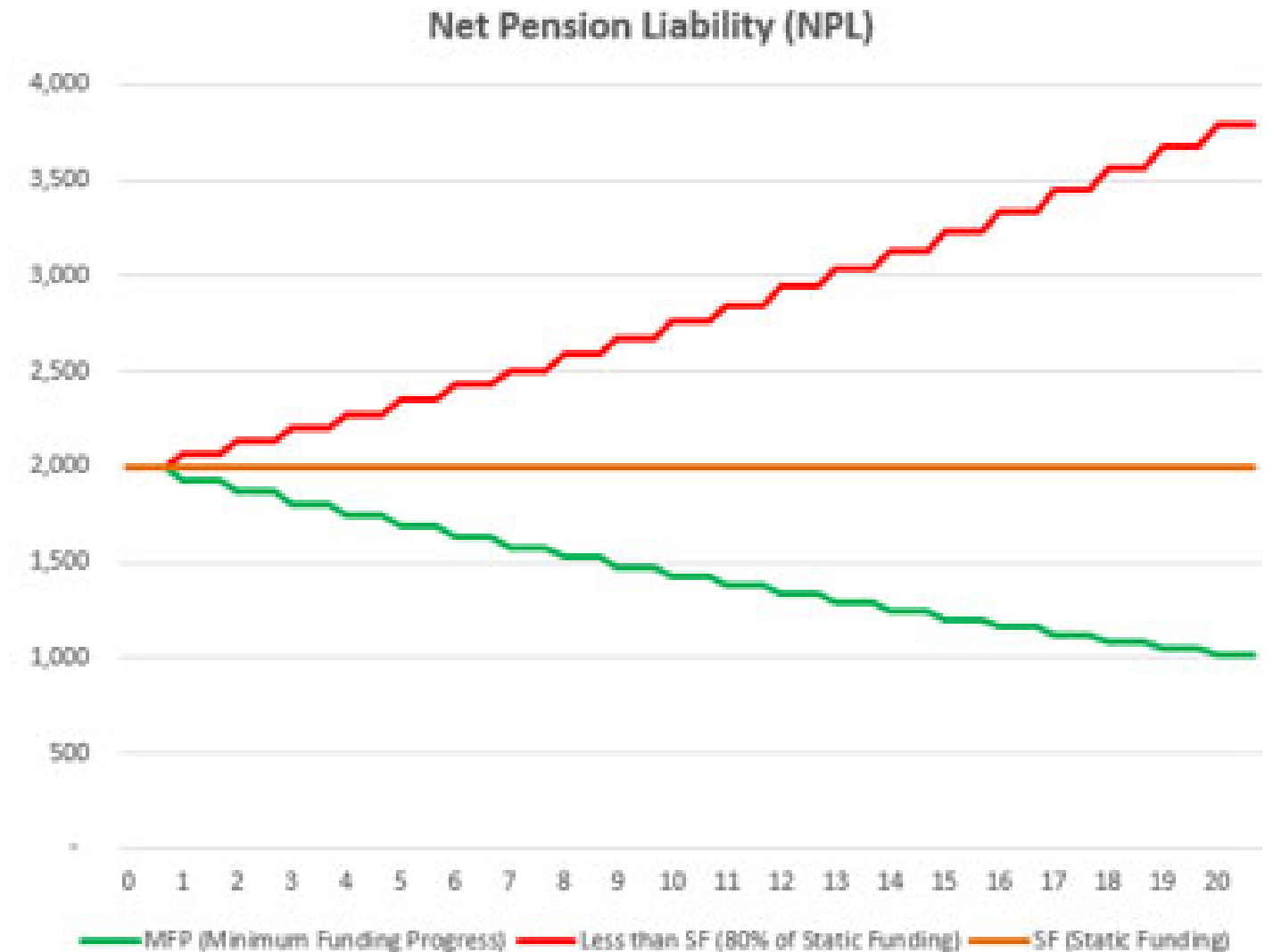
# How S&P Global Ratings Measures Pension and OPEB Affordability

## Funding Discipline

- Actuarial Plan
  - Minimal deferral to future
- Last Year
  - Service cost plus interest (Static)
  - Paying down principal (MFP)

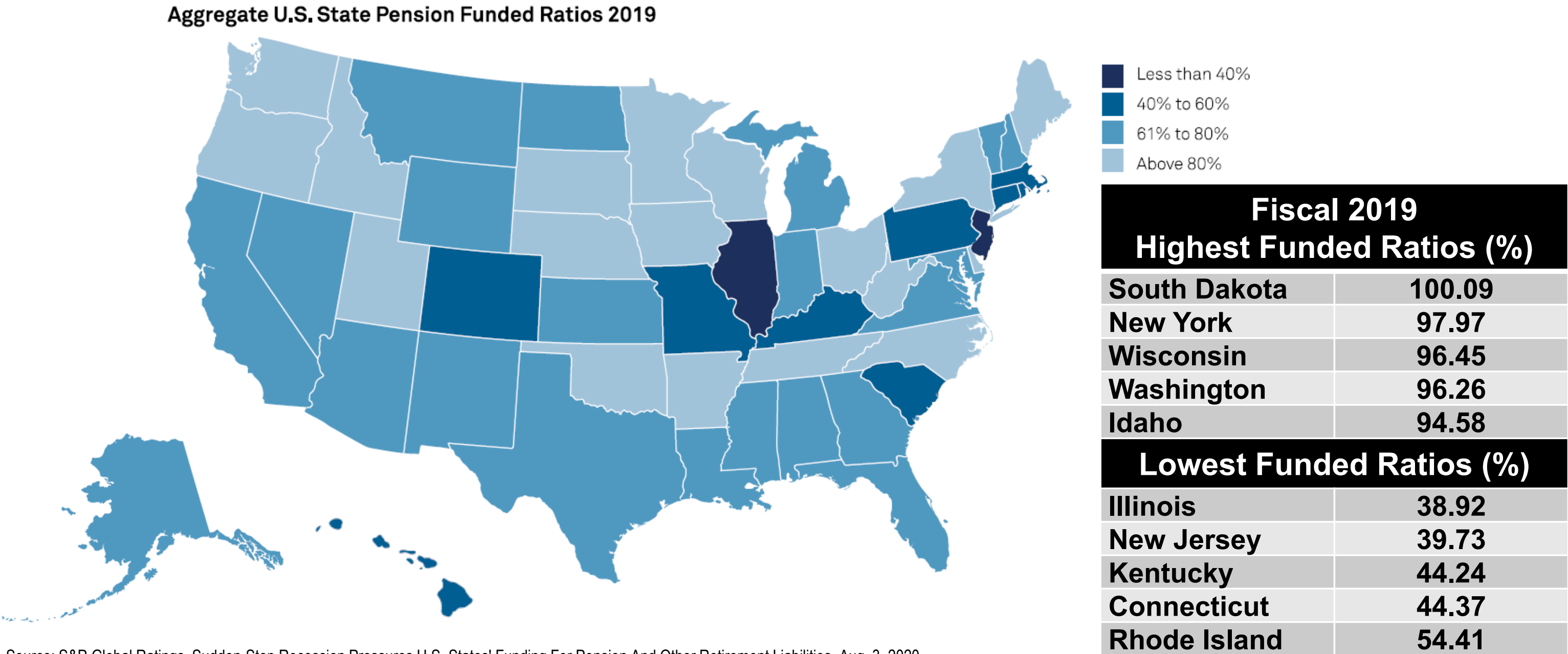
## Assumed Rate of Return and Discount Rate

- Currently 6.0%
- Focus on contribution volatility and market shocks



For more information see S&P Global Ratings, Guidance: Assessing U.S. Public Finance Pension And Other Postemployment Obligations For GO Debt, Local Government GO Ratings, And State Ratings; and Guidance FAQ: How S&P Global Ratings Will Implement Pension And OPEB Guidance In U.S. Public Finance State And Local Government Credit Analysis

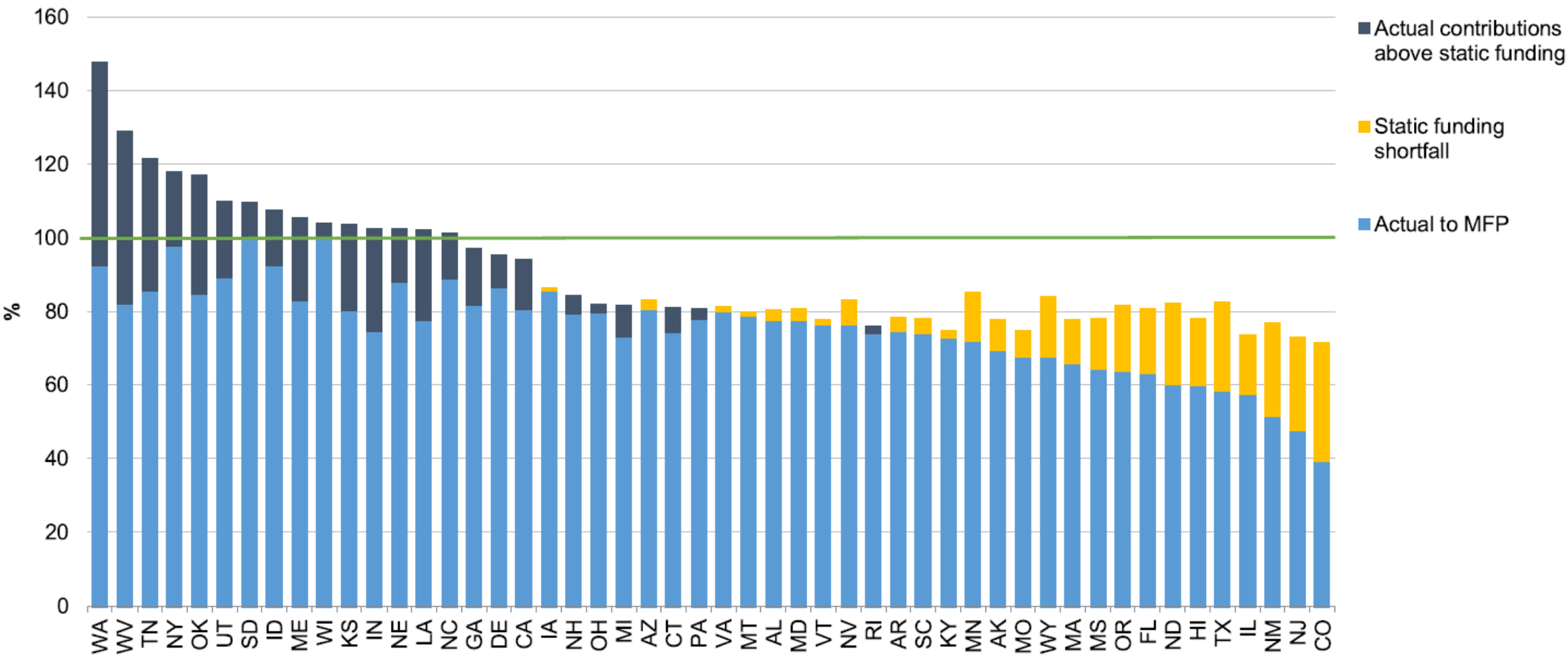
# Aggregate U.S. State Pension Funding Ratios Remained Stable



Source: S&P Global Ratings, Sudden-Stop Recession Pressures U.S. States' Funding For Pension And Other Retirement Liabilities, Aug. 3, 2020  
At the time of our survey a 2019 CAFR was unavailable for California and prior year data is depicted. States with plan reporting periods that align with calendar year-end, we utilized reports ending Dec. 31, 2018 . Source: S&P Global Ratings

# More States Increased Contributions To Cover Growing Liabilities in Fiscal 2019

State Pension Plan Aggregate Actual Contribution Funding Progress



At the time of this report a 2019 state CAFR was unavailable for California and prior-year data is depicted. States with plan reporting periods that align with a calendar year-end, we utilized reports ending Dec. 31, 2018.

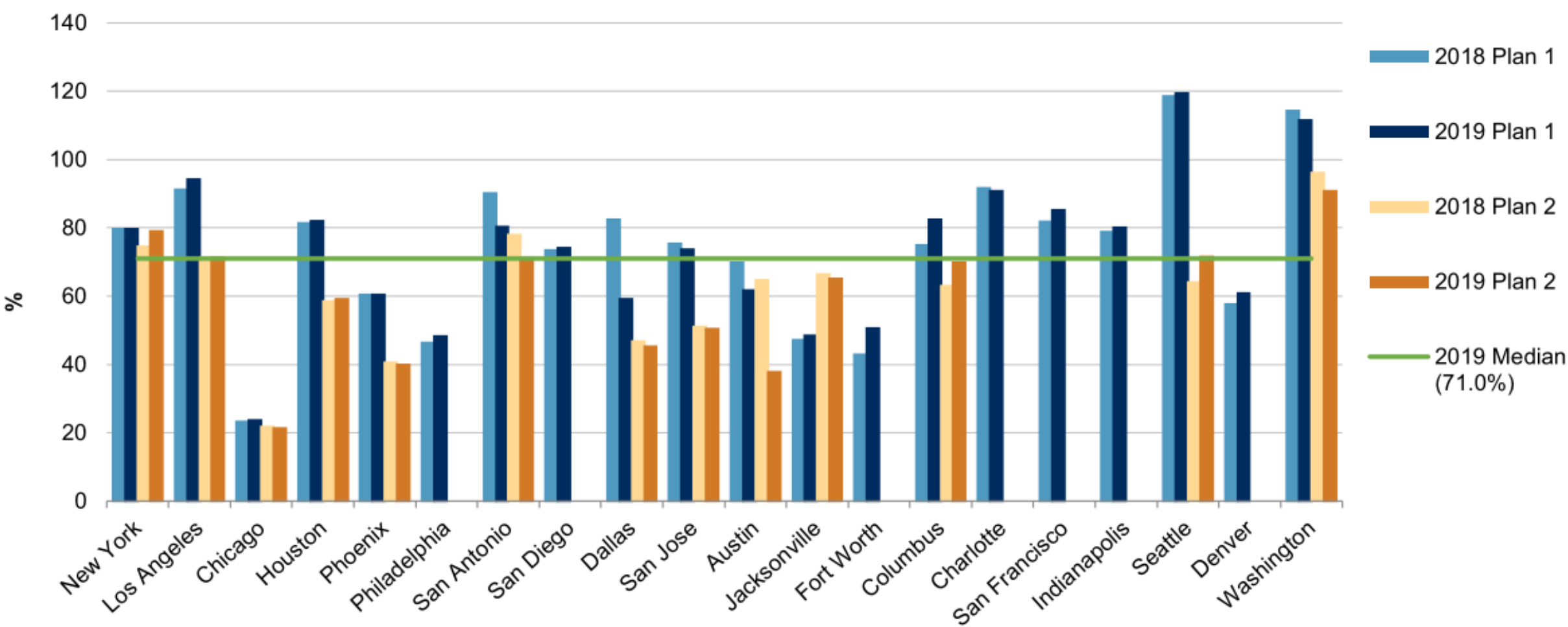
Source: S&P Global Ratings. Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

Source: S&P Global Ratings, Sudden-Stop Recession Pressures U.S. States' Funding For Pension And Other Retirement Liabilities, Aug. 3, 2020

At the time of our survey a 2019 CAFR was unavailable for California and prior year data is depicted. States with plan reporting periods that align with calendar year-end, we utilized reports ending Dec. 31, 2018 . Source: S&P Global Ratings

# 20 Largest U.S. Cities' Pension Funded Levels Were Stable Entering Fiscal 2020

Top Plans' Funded Ratios For The Past Two Years

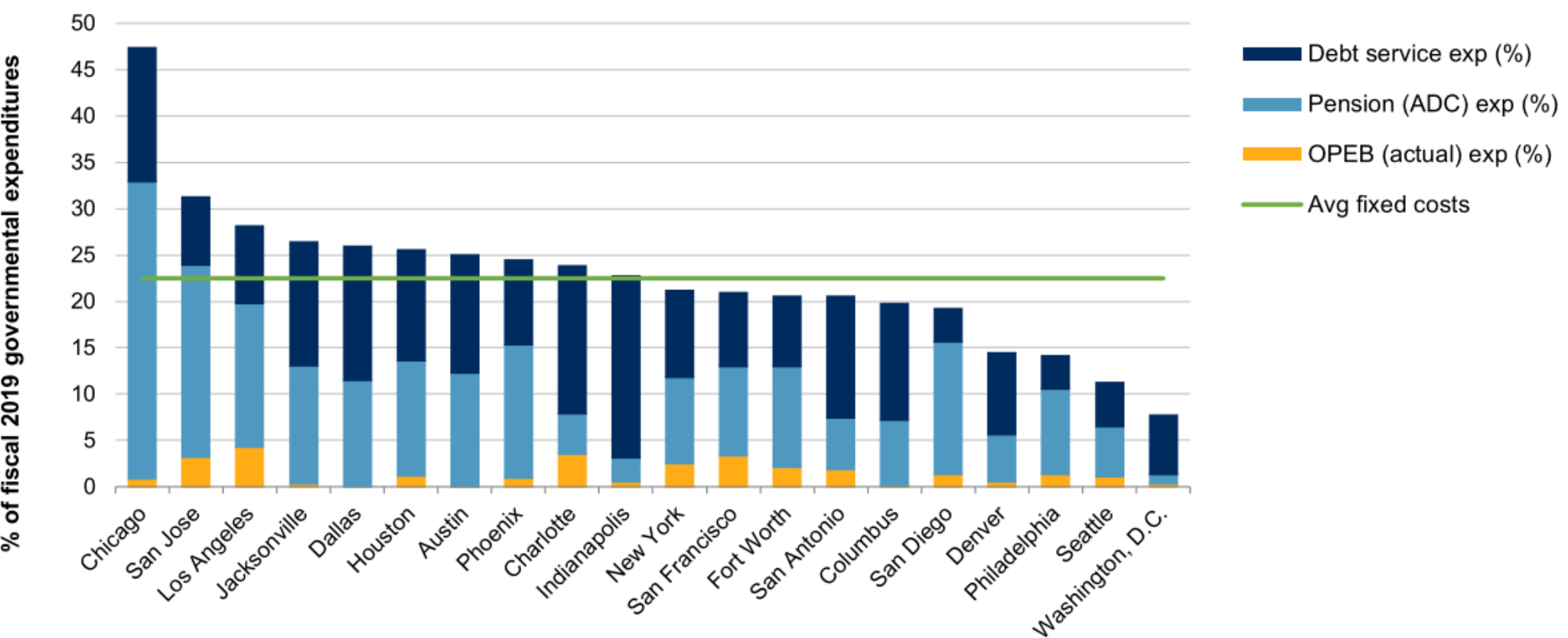


Funded ratio based on most recently available GASB Funded Ratio, as reported in the city's audit or plan CAFR.  
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Source: S&P Global Ratings, Mounting Pressures Threaten Stability Of 20 Largest U.S. Cities' Pension Funding, Oct. 26, 2020

# Fixed Costs Remain Elevated For Most of the Largest Cities and are Likely to Grow

Primary Fixed Costs -- Pensions, Debt Service, And OPEB



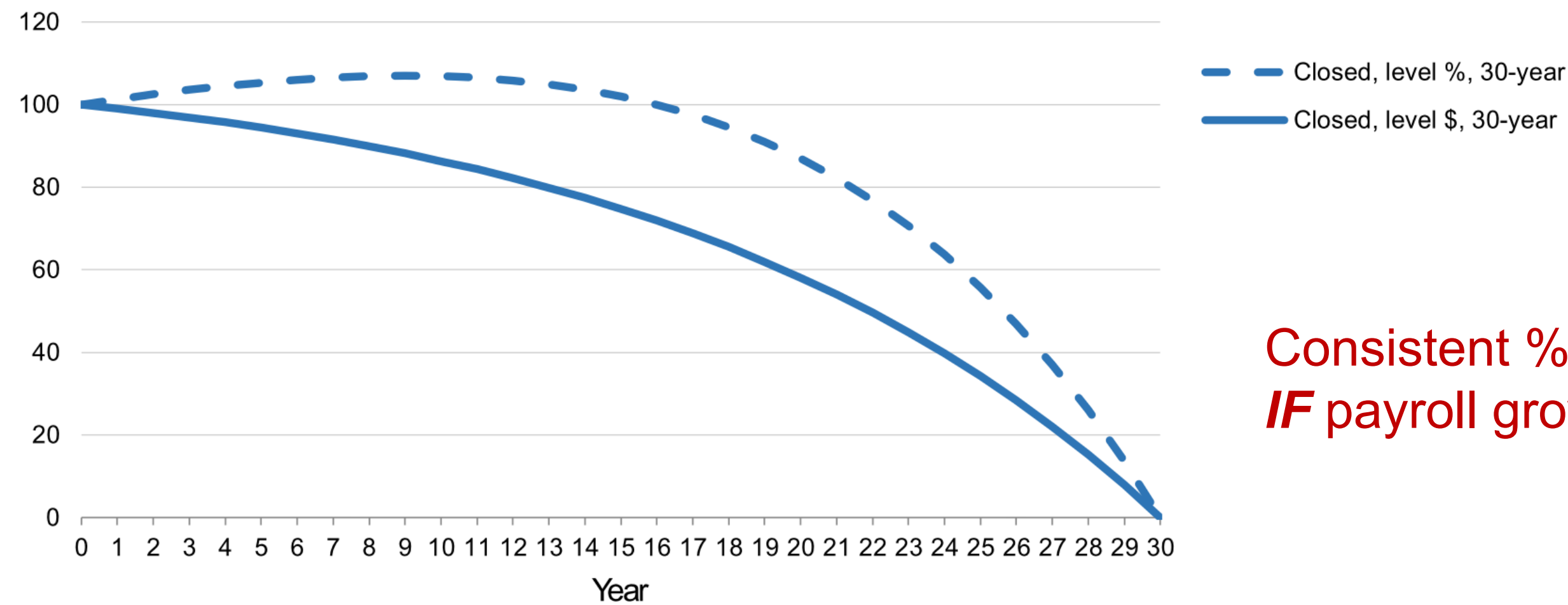
OPEB—Other postemployment benefit actual payment. Pension ADC—Actuarially determined contribution. Debt service—principal and interest payment on debt. S&P Global Ratings will frequently adjust financial data based on analytical discretion account for items such as one-time expenditures. Chart is based on unadjusted financial data.

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Source: S&P Global Ratings, Mounting Pressures Threaten Stability Of 20 Largest U.S. Cities' Pension Funding, Oct. 26, 2020

# Contribution Deferrals

Percent Of Unfunded Liability Remaining Under Different Amortization Methods



Consistent % of budget  
***IF*** payroll growth is met!

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Source: S&P Global Ratings, The Increasing Cost of Governmental Pensions: Discount Rate and Contribution Practices, Sept. 27, 2020

# Pension Obligation Bonds (POBs)

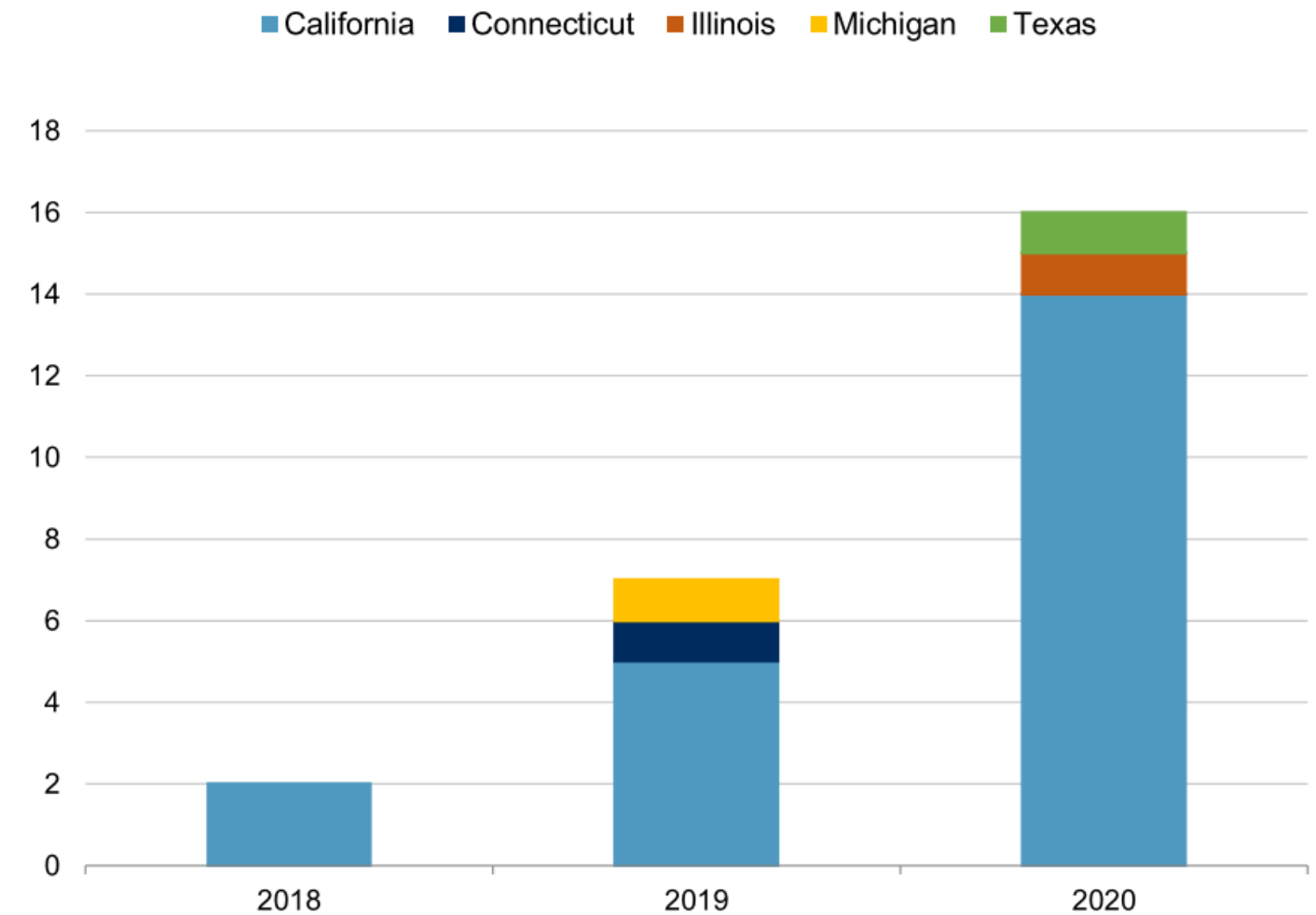
## Why the Increase?

- “Arbitrage”
- Contribution smoothing

## Considerations

- Market risk
- Contribution trajectory

Count Of POBs Rated By S&P Global Ratings



Source: S&P Global Ratings, Pension Brief: POBs See Increasing Activity In Low-Interest-Rate Environment, Oct. 14, 2020; Image © 2020 by Standard and Poor's Financial Services LLC. All rights reserved.



# Risks on the Horizon for Public Pension Plans

- Governments may **reduce required or excess contributions** to pension and OPEB plans for budgetary relief
- Persistent **low interest rates** may increase asset allocation into riskier investment
- Declining **public employee payrolls** weaken plan demographics and increase future costs
- Issuers may consider taking on additional risk by issuing **Pension Obligation Bonds**

# Select Pension and OPEB Publications

## Surveys



- Sudden-Stop Recession Pressures U.S. States' Funding For Pension And Other Retirement Liabilities
- Overall Not-For-Profit Health Care Pension Funded Ratios Are Stable
- Mounting Pressures Threaten Stability Of 20 Largest U.S. Cities' Pension Funding
- U.S. States Are Slow To Reform OPEBs As Decline In Liabilities Masks Increased Risk

## Financing



- Pension Brief: POBs See Increasing Activity In Low-Interest-Rate Environment
- OPEB Brief: The Credit Impacts Of OPEB Obligation Bonds
- Pension Brief: Are Asset Transfers A Gimmick Or A Sound Fiscal Strategy?
- Pension Obligation Bonds' Credit Impact On U.S. State And Local Government Issuers

## Other



- Pension Brief: Liquidity Is A Rising Concern For U.S. Public Pensions In Down Markets
- Pension Brief: Credit Effects Of Municipal Pension Plans Approaching Asset Depletion
- Pension Spotlight: Massachusetts

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