California pension funds close to bankruptcy

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The two largest pension funds in California, the California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS), have lost billions of dollars in value. Hundreds of thousands of retiring state employees and teachers now face the stark choice of accepting much reduced pension checks or working past their retirement age.

CalPERS is the largest pension fund in the US and the fourth largest in the world. At its height in October 2007 it had $260 billion in assets, comparable to the GDP of Poland, Indonesia or Denmark. At the end of 2008 CalPERS was worth $186 billion, one of its worst annual declines since the fund's inception in 1932. It is one of the latest casualties of the financial collapse on Wall Street.

After years of gambling in real estate investments, the state workers pension fund has lost more than 41 percent of its value, after peaking last fall. Its real estate holdings have dropped from $9 billion to $5.8 billion, according to the *Sacramento Bee*.

CalPERS manages pension and health benefits for more than 1.6 million retirees and their families. The pensions are guaranteed by law, but given the current economic malaise employers may be asked to contribute more from their payrolls. The average employer, a taxpayer-funded government agency, contributes 12.7 percent of their payroll to CalPERS, while workers must contribute 5 to 7 percent of their salaries.

For now, a "rainy day fund" is being used to offset the worst in losses. It is likely, however, that CalPERS will ask for additional funds starting in July 2010 from state employers and July 2011 from local employers. The increases could be from 2 to 5 percent. Since the employers are public entities, the money will have to come from taxpayers or from budget cuts to other social programs.

CalPERS's losses are intimately tied with the collapse of the housing bubble and the economic downturn in general. The Dow Jones Industrial Average has dropped 39.8 percent during the same period that CalPERS fell 31 percent. Because of the fund's aggressive purchasing of real estate during the property bubble, CalPERS is now the largest owner of undeveloped residential land in America, much of it purchased in Arizona, California and Florida, some of the states hardest hit by the real estate crash. Many of these properties were purchased when their prices were at their peak.

The pension fund is expected to report paper losses of 103 percent on its residential investments in the fiscal year that ended June 30. It is estimated 80 percent of these investments were paid with borrowed money, which means that CalPERS will eventually be obligated to pay them back at the original market price.

The second largest pension fund in the US, CalSTRS, covers 794,812 teachers. Its value has fallen from $162.2 billion to $129.3 billion. CalSTRS's pension funds are guaranteed just like CalPERS, but unlike CalPERS, it does not have the authority to ask for increased contributions from employers. CalSTRS is funded by school districts contributing 8.25 percent of its payroll. The state general fund pays 2 percent and a further 8 percent comes from the members' salaries. Any contribution changes would have to be added by the state legislature and approved by the governor.

While CalPERS' losses are currently being defrayed by the rainy-day fund, state administrators are hoping that the economic situation will improve, otherwise CalPERS and other pension funds will have to ask for further contributions. California Treasurer Bill Lockyer, who sits on the CalPERS board, told the *San Francisco Chronicle* that the current crisis means "both state and local government employers would be spending more on retirement than on some immediate program needs. Paying the commitments to pension obligation is a high priority, and it would take precedence over many other spendings."

He added, “You either cut some other program expenditures or you tax something.” In other words, the pension deficit will be placed on the backs of working people who had no control over the investment decisions made by the government, let alone the recklessness and avarice of the banking executives and Wall Street speculators who are responsible for the crisis.

In the midst of a severe recession, this will only add to social anxiety and financial insecurity, particularly since hundreds of thousands of public school teachers and state employees covered by these massive pension funds have seen the value of their personal retirement savings, including 401(k)s and IRAs, reduced by 25 percent or more.

Pacific Grove, a coastal town north of San Francisco, highlights what cities and towns are being forced to do. In fiscal 2002, Pacific Grove paid less than $100,000 to CalPERS, only 1 percent of the town’s general fund revenue. By 2006, this cost shot up to more than $2.2 million, or 15 percent of its revenue.

The city of 15,000 would have to spend $10 million or more to pay its pension obligations if it were to pull out of CalPERS. The recreation department staff has already been reduced from seven to one and budgets for the library and Pacific Grove Museum of Natural History, a 125-year-old institution, were cut in half.

Joanne Nolan Stewart, a 48-year-old with two children, told the *Wall Street Journal*, “The people who used to run the recreation programs grew up here and sheltered the kids like they were their own.” Joanne is also an account manager for AT&T and said, “If I were to retire, my retirement would be one-quarter of what I make today for the rest of my life.”

California’s pension and budget defaults are not isolated phenomena. All across the US state pension funds have been collapsing due to the broader economic crisis. According to the Center for Retirement Research at Boston College, state governments have run up pension fund losses totaling $865.1 billion. Assets for 109 pension funds dropped 37 percent to $1.46 trillion in the 14-month period ending December 16. By comparison, the S&P 500 fell 41 percent in the same period.

To return to 2007 funding levels by 2010, the 109 funds would need annual returns of 52 percent, the center found. Alicia Munnell, the center’s director, told Bloomberg.com, “Even if markets recover, this will be a one-time loss that will have to be made up in the future by taxpayers.”

State and local governments contributed more than $64.5 billion to pension plans in fiscal 2005-2006, according to the US Census Bureau, which is about 57 percent of the $113.2 billion spent on police and firefighters. A report by the Pew Center on the States did a survey in December 2007 that found that states owed $2.35 trillion in pension payments over 30 years.

Unsurprisingly, state authorities are attempting to cut benefits for new state hires in order to ameliorate the crisis. In Kentucky, lawmakers set the minimum age of retirement at 57 for employees hired after September 1, and required 30 years of service, up from 27, to receive full benefits. They also capped cost-of-living adjustments, tied to the Consumer Price Index, at 1.5 percent. Democratic Governor of New York David Paterson, trying to close a $15.4 billion gap over 15 months, also wants to reduce new workers’ benefits while raising the retirement age from 55 to 62.

Rhode Island state and local governments were scheduled to make contributions to their pension funds equaling 25 percent of their payroll expenses in 2010, and the contributions may increase up to 30 percent in 2011 with a deepening recession. With increasing membership growth in state pension plans, these defaults will be even more exacerbated. State funds have been experiencing 12 percent growth since 2002, with 23.1 million now participating.

Company pension funds, or so-called defined benefit plans, have also been starved by the economic crash, falling to $1.2 trillion as of December 31 compared to $1.6 trillion a year earlier.