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Taxpayers may face big blow for pensions

Riordan joins alarm chorus

By Troy Anderson, Staff Writer
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Already facing deficits of more than $110 billion, public-employee pension plans in Los Angeles and elsewhere in the state have overestimated future investment income in a move that could imperil the systems and require taxpayer bailouts, former Mayor Richard Riordan and other financial experts warn.

Pension systems in California are operating on assumptions of a 7.5 percent to 8.5 percent annual return on investment portfolios, but investment experts say historical trends suggest stocks will increase by only 6 percent to 7 percent annually.

Coupled with rising retirement rates and growing pension benefits, the resulting squeeze could leave dozens of pension funds without enough money for payouts.

"I'm worried about the whole state," Riordan, who worked with Los Angeles-based Rubalcava Capital Management in reviewing pension systems, said Thursday.

"I think the clear thing is that L.A. is better off than the vast majority of cities in California. ... However, (Los Angeles officials) are going to have to revisit their assumptions on annual returns sooner rather than later. ... There are big problems ahead, and they should be tackled right now."

Los Angeles city and county officials defend their pension systems, saying they are in far better condition than those in Orange County and San Diego, where unfunded liabilities are threatening to bankrupt those jurisdictions.

And Los Angeles City Administrative Officer William Fujioka said city officials met with Alex Rubalcava, president of Rubalcava Capital Management, and found some "very significant errors in his estimates and assumptions."

"There was a comparison of us to San Diego," Fujioka said. "I take strong exception to that. The city of Los Angeles has done an exceptional job in managing our retirement benefits. Unlike other major cities throughout California, we have not raised our benefits for city employees."

Still, Rubalcava and other financial experts say that if the price-to-earnings ratio for Standard & Poor's 500 falls from its current 19 to its historical median of 15 - which some top financial experts expect - pension plans such as Los Angeles' could require rising contribution rates from taxpayers.

Such a scenario would only add to the state's already massive unfunded liabilities for pensions and retiree health benefits - estimated at a combined $150 billion to $190 billion - and to the amount taxpayers would have to contribute to keep the systems solvent.

Riordan and other financial experts plan to address the issue at an upcoming Los Angeles Area Chamber of Commerce luncheon.

Ron Gastelum, executive vice president of the chamber, said he hopes the income assumptions that pension system administrators have made are correct because the funds already are taking a growing amount of taxpayer money.

"However, credible economists and investors, such as Warren Buffett, and community leaders like former Mayor Dick Riordan are suggesting that these assumptions may not be prudent, and given the amount of money involved and the expectations of pensioners, it bears a fresh look," Gastelum said.

The warning comes atop City Controller Laura Chick's announcement earlier this week that she will audit the city's pension systems.

But Chick spokesman Rob Wilcox said the information Riordan and financial experts used in reviewing the systems is "based on faulty assumptions which are largely disputed.

"However, this is why the City Charter requires a top-to-bottom audit of our pension systems, which we are in the process of starting," Wilcox said. "Working with the mayor and City Council, we will disclose and correct any problems found."

Rubalcava said he's not trying to predict how stock markets will perform, but is concerned about pension deficits. Dialogue should be opened with elected officials and pension system administrators, he said.

He also noted that some pension plans haven't met their investment-return projections in recent years.

For instance, the Los Angeles City Employees Retirement System is only 73 percent funded and has a $2.95 billion unfunded liability. It had a 4.4 percent return over the past five years, but bases annual contributions from taxpayers on the assumption of an 8 percent return.

But LACERS General Manager Robert Aguallo said the $9.4 billion fund's 10-year investment-return performance is 9.9 percent, and he stands by the assumptions.

"Clearly, Mr. Rubalcava has a different opinion than our experts," Aguallo said. "In the pension world, we typically use a wide spectrum of years when looking at our performance. We look at one, three, five and 10 years."

Rubalcava said the 10-year performance measure is not a good one because it includes 1995 through 2000 - when the stock market was overvalued.

The Los Angeles Fire & Police Pensions system had a 5.25 percent return over the past five years, is 90 percent funded and has an unfunded liability of $1.4 billion. It bases annual contributions from taxpayers on an 8.5 percent investment-return assumption.

Even if the fund meets that 8.5 percent assumption in the years to come, the taxpayer contribution still will rise from $323 million annually to $339 million in 2009. But if the fund returns only 5 percent, the contribution will rise from $330 million to $423 million in 2009, according to a fund report.

General Manager Michael A. Perez pointed out that the $13.5 billion fund returned 9.24 percent over 10 years and 10.52 percent over 20 years.

"Our actuary comes up with our interest-rate assumption, as well as two other economic assumptions, and the board goes through a thorough review process to adopt these assumptions," Perez said.

The Los Angeles County Employees Retirement Association had a 3.7 percent return over the past five years, is 86 percent funded and has an unfunded liability of $4.9 billion. It bases annual contributions on a 7.75 percent investment income assumption.

LACERA Assistant Executive Officer Gregg Rademacher said the $32 billion fund returned 9.5 percent over the past decade.

"We're a long-term investor," Rademacher said. "We believe our long-term assumption of 7.75 percent is appropriate, understanding that in the short term we may do better than 7.75 percent and in some years we may do less than 7.75 percent."

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