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Cash-Hungry Cities Seek Buyers for Sewer Systems to Pay Pensions.

- **Illinois city joins peers in exploring sale of waste system**
- **Asset sales offer chance to pay down debt, but carry risk**

As cities across the U.S. struggle under the weight of ballooning pension costs, some are putting their public water and sewer systems on the auction block to come up with cash.

Municipalities took in more than a half a billion dollars over the past five years by selling their water and waste utilities to private companies, according to data compiled by Bloomberg. Such sales are increasing in places such as Illinois, where the state alone owes \$137 billion to its pension funds and dozens of cities have saved far less than they need to cover all the benefits promised to police, firefighters and other public employees.

In the last decade or so, selling off municipal assets had become a tool of last-resort used by governments facing dire financial strain. Arizona famously sold its capitol in 2010 as it struggled to fill an historic \$3 billion budget deficit. But water and sewer utilities offer municipalities a chance to come up with much-needed cash and relief from maintenance costs at a time when states and localities have a combined \$4.2 trillion in unfunded pension liabilities.

“A lot of these municipalities are having other financial pressures,” said Ryan Wobbrock, a senior credit officer at Moody’s Investors Service. “Being able to sell the system can provide cash to meet those other obligations like the pension or put the system in the hands of a much larger entity that can leverage its economies of scale and make the necessary investments.”

Granite City, Illinois, a rust-belt town of 30,000 people on the Mississippi River, is facing a \$130.8 million pension shortfall and has put part of its sewer system up for sale to raise funds. Illinois American Water — a subsidiary of American Water Works Co., the largest publicly traded water utility in the U.S. — has offered the only bid, though city officials won’t say yet for how much or how they would spend the cash.

Pension Bond

Granite City sold a \$40 million pension obligation bond in 2017 to make a payment into its pension systems that have roughly 42% of the cash they need to pay future benefits, betting that borrowing costs for the bond would be lower than its pension investment returns, according to Moody’s. Still, the city has not made its required pension payments for the past two fiscal years, according to budget documents.

“It wasn’t paying into its pension system when it should have been paying for many years,” Amanda Kass, associate director of the Government Finance Research Center at the University of Illinois at Chicago. “For some places like Granite City, yes the problem has kind of snowballed and they may not be able to remedy it on their own.”

Alton, Illinois earlier this year sold its wastewater system to Illinois American and used the entire \$53.8 million to chip away at its \$134 million in pension liabilities. Godfrey, Illinois also sold a system this year that desperately needed upgrades to Illinois America. Mayor Mike McCormick says he's stashing the money in a rainy day fund.

American Water and its rival Aqua America Inc. have spent about \$655 million since 2014 buying 135 utilities in states including Pennsylvania, Illinois, Indiana, Virginia and West Virginia and Texas, according to filings with the Securities and Exchange Commission. Both companies say they are on the hunt for more. They are likely to find willing sellers as well, said Michael Bennon, managing director at the Stanford University Global Projects Center.

"There is certainly a bit of a trend in that a lot of the cities that are considering these transactions are burdened by pension liabilities or have other fiscal constraints," said Bennon, who advised Connecticut when the state was exploring the possibility of an asset sale to shore up its pension system. "That's not the right reason to consider one of these contracts, of course, but it is a common one."

Carries Risk

In Pennsylvania, the city of Allentown and Middletown Borough sold long-term leases for their sewer and water systems to pay down pension debt in 2013 and 2014. Jacksonville, Florida, is exploring the sale of JEA — the largest community-owned water, wastewater and electric power utility the state. The city is seeking at least \$3 billion in net proceeds from the profitable utility after paying off \$3.6 billion in outstanding debt on its books, according to financial filings.

Jacksonville has cited a changing utilities industry as one of the reasons for a sale of an asset that was able to contribute \$132.8 million to the city's general fund last fiscal year. The city's three pension funds are a collective 55.7% funded and have \$3.2 billion in unfunded liabilities, according to its most recent financial report.

Still, using proceeds from an asset sale to shore up a pension system carries risk of its own, said Thomas Aaron, a senior analyst at Moody's. An infusion of cash from a sale would immediately increase a plan's assets, but those funds would be invested according to the style of the plan — meaning they are subject to market forces, Aaron said.

"If those proceeds are then invested in high-risk, high-return investments that carries risk," Aaron said. "As you move out a few years into the future, if those assets under perform relative to expectations or in a worst-case, they suffer significant losses, there's no longer an option to bring in additional funds to pay down the pension debt."

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