

# **Bond Case Briefs**

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## **Pension Obligation Bonds - Beware of Quick Fixes.**

Speaking of pensions, Municipal Market Advisors' Matt Posner predicts that 2014 could mark an increase in governments issuing Pension Obligation Bonds to cover shortfalls in pension funding. These bonds are taxable debt that governments sell in order to dump the proceeds into pension funds to help fill funding gaps. They make the fund appear healthier, but also put more debt on the government's books that must be paid out to bondholders. As such, "POBs are almost always a drag on credit quality," Posner, a municipal analyst, writes in his [Municipal Issuer Brief](#).

Posner lists four reasons for why POBs may become more attractive this year:

- Rising awareness of unfunded pension liabilities thanks to new accounting standard being applied this year that will require states to include pension liabilities in their balance sheets;
- Robust pension investment performance of late that may lead managers to believe these results can be continued, which is needed to properly pay back POBs;
- Moody's focus on pension obligations could compel issuers to replace those liabilities with POBs and
- State and local budgets under pressure from rising expenses and a weaker economic recovery may be tempted by the one-time budget savings allowed by POBs.

Posner warns that any government that issues POBs is sending up a red flag to investors. "Governments that have used POBs are likely to be viewed with some suspicion by investors [because this is] reflective of a gimmick," he writes.