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Atlanta's Teacher Pension Gamble.

To shore up one of the worst-funded pension plans in Georgia, Atlanta's school system is considering borrowing money to bet on the stock market.

Atlanta Public Schools officials say selling up to $540 million worth of bonds could save money by taking advantage of historically low interest rates and by giving the school system breathing room to invest the proceeds for the long haul.

Critics say that's a risky strategy that can exaggerate losses if the stock market slumps. School officials, who haven't decided whether to recommend such a bond issue, say they understand the risks and believe it has high odds of succeeding.

"It's a ridiculous idea. It's speculating," said attorney Edward Siedle, who formerly worked for the U.S. Securities and Exchange Commission and now runs a firm that investigates pension abuses. "Everything has got to go exactly right for this to work."

A panel commissioned by the Society of Actuaries, the experts who figure out what shape pension plans are in, warned this year that public pension plans shouldn't use the strategy to shore up pensions.

Atlanta Public Schools could be the first government in Georgia to try this financial device, called a pension obligation bond. The school system is considering it because paying for pension benefits has become a huge cash drain. The pension plan has less than 16 cents in assets for each dollar of benefits it has promised, and is essentially paying out cash nearly as fast as it comes in.

The pension debt has been building for 35 years. When many Atlanta teachers transferred from the city-run school pension plan to the Teachers Retirement System of Georgia in the late 1970s, they brought most of the school retirement plan's assets with them. About 3,100 active and retired school system employees remain in the city pension fund — many of them bus drivers and custodians — and it is overseen by a city of Atlanta pension board.

To close the funding gap, the district's annual contributions would have to rise from $48 million this year to almost $84 million over the next decade.

Higher return hoped

The district believes the bond issue could lower those payments. The idea would be to borrow money at a low interest rate and inject it into the pension fund, which could earn a higher return from stocks and other investments. School system actuaries estimate that in today's dollars, this plan would save $53 million over the 20-year life of the deal.

"While it's risky, we have money we're throwing at the pension right now that's at risk as well," said Jason Esteves, a chairman of the school board's Pension Fund Task Force, which includes current and former board members, the superintendent and outside financial experts. "It really is pick your

poison.”

The task force expects to make a recommendation in May. Incoming Atlanta Superintendent Meria Carstarphen, who takes leadership of the school district in July, will be included when the group next meets in a week or two, Esteves said.

A pension bond would have to win approval by Atlanta voters. A bond issue for the full $540 million could require a property tax increase of about $35 a year on a $250,000 home, but a smaller bond issue could be paid off from existing general funds. A tax hike to pay down the pension liability without bonds isn’t being discussed. Other solutions under consideration include higher annual payments or a combination of higher payments and a smaller pension bond.

Pension obligation bonds have been used across the country over the past 20 years, with results ranging from financial windfalls to municipal bankruptcies.

Researchers for Boston College’s Center for Retirement Studies found in 2010 that most governments that had issued them between 1992 and 2007 were losing money on them, and the only profitable deals were set up either decades ago or during recessions, when stock prices and interest rates were low.

They recently found that, while markets have recovered dramatically since the 2007-2009 crash, about half of the pension bond deals are still losing money.

The researchers also found that governments under financial pressure were the most likely to use pension obligation bonds. APS projects that it could borrow money via the bonds at an interest rate of about 4.5 percent, making annual payments of about $42 million for 20 years.

The district forecasts that the invested money would earn 7.5 percent a year — the same as its assumed rate of return for its pension plan — allowing it to pay off the loan and rescue the pension plan, which was $532 million in the hole as of mid-2012.

Critics emphasize risks

But pension bond deals often don’t work so well in the real world, critics say.

“It’s buy low, sell high. If you can do that, you’d be a billionaire,” said Thad Calabrese, a public and nonprofit financial management professor at New York University whose research concluded that pension obligation bonds haven’t enabled school districts to increase educational spending. “If your investment strategy is dependent on market timing, you’re doomed.”

The greatest risk is that a market downturn would leave APS in an even bigger hole.

APS’s actuary, Segal Consulting, looked at a hypothetical worst-case scenario for the pension bond proposal and projected that APS would end up nearly $96 million worse off. That projection was based on the last 10 years of actual returns in the financial markets, which includes the 2008-2009 recession.

Critics say another problem with pension bonds is they increase the risk of financial distress. The government takes on a bond debt that it has to make payments on every year with cold, hard cash, instead of a long-term pension liability where it has some flexibility to defer contributions when funds are short.

Segal Consulting warned that even if the pension bond deal appears to save money, APS needs to

pay attention to “the loss of flexibility in difficult economic times, because of the need to make timely payments … in order not to default on the bonds.” Siedle, the former SEC official, said governments turn to risky solutions like pension bond deals because it’s politically unpalatable to do more prudent fixes, such as cutting pension benefits and raising taxes and workers’ share of pension contributions. The Atlanta school board hasn’t discussed those possibilities.

Bonds worked in Kentucky

“This is essentially a Hail Mary gamble to solve a financial crisis,” he said.

But some who have used them say the bonds still make sense when used properly.

The $17.5 billion Kentucky school pension system issued a $468 million pension obligation bond in 2010, after years of raiding the pension fund to pay retirees’ health benefits.

The pension system got an interest rate below 4 percent, investing not too long after the stock market began rebounding from the 2009-2009 crash. “We’ve had positive returns every year since we got it,” said Beau Barnes, general counsel for the Teachers’ Retirement System of Kentucky. “It turned out to be a good story.”

But he acknowledged that hasn’t been the case for everyone. “You need to consider market timing and interest rates,” he said.

And the earnings haven’t been enough to keep up, even though the system also increased the amount schools and teachers have to contribute.

State pension fund officials recently proposed another round of pension obligation bonds, which could mean investing a large sum when Wall Street is more than five years into a bull market. So far, the Kentucky legislature hasn’t given its approval.

“If we can do better than whatever interest rate we achieve on those bonds,” said Barnes, “then we would be OK.”

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