Bond Case Briefs

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Record Bonds Lure Michigan Cities as Pension Plug: Muni Credit.

Michigan municipalities, facing a year-end deadline to borrow for retirement costs, are planning record bond sales to pay for workers' health care and pensions.

The Detroit suburb of Macomb County plans a $270 million sale of municipal debt, its biggest ever, to finance retiree health-care costs, while Kalamazoo is considering a historic $100 million bond offer for similar expenses. Bloomfield Hills plans to borrow a record $17 million for pensions. The law allowing the practice expires Dec. 31.

U.S. states and cities are struggling with how to pay for promises to workers after the recession ravaged their finances. Yet few communities see debt as the answer — sales of revenue-backed pension bonds have tallied $356 million this year, data compiled by Bloomberg show. Interest rates close to five-decade lows are making it more attractive to pursue the risky strategy of investing borrowed funds in financial markets.

"We can't afford to wait," said Peter Provenzano, Macomb County finance director. "Timing the market is difficult. You could sit on the sidelines and miss out on an opportunity."

Michigan Twist

Municipalities have sold pension bonds since 1985, led by Illinois and California, according to the Center for Retirement Research at Boston College. This year's issuers include Orange County and the city of Riverside, both in California.

Investing borrowed cash to pay for health expenses is a new twist in Michigan, where 284 municipalities owed a combined $12.7 billion in unfunded liabilities for retiree medical care, according to a 2013 Michigan State University study. About half didn't require employee contributions.

The practice of issuing debt for retirement costs draws criticism from Matt Fabian, managing director at Municipal Market Advisors, as a maneuver that avoids difficult decisions.

"Pension-obligation bonds are almost always a terrible idea," said Fabian, whose research firm is based in Concord, Massachusetts. The borrowing shows a lack of political will to raise taxes or reduce benefits, he said.

The risk for investors is pronounced in Michigan, where Detroit is seeking bankruptcy relief by favoring city pensioners over bondholders, including holders of securities issued to finance pensions, Fabian said.

Timing Risk

From the issuer's standpoint, the sales' timing dictates the success of pension bonds, according to a

July analysis by the Boston College center. Reinvested proceeds must earn more than it costs to service the debt, which is typically taxable.

Because of stock-market gains following the recession that ended in 2009, the majority of pension bonds have generated positive returns as of February 2014, according to the center. That's a reversal from mid-2009, when the financial crisis left most of the deals in the red. The analysis is complicated because many of the securities have 30-year maturities, according to the center.

"You really don't know until that end date of the bonds how it turns out," said Jean-Pierre Aubry, assistant director for state and local research at the center.

Grand Rapids won't use debt to finance $135 million in unfunded health-care liabilities, said Scott Buhrer, the city's chief financial officer.

Bull Market

"The best way to have odds in your favor is to do this when stock prices are depressed," Buhrer said. "We're in the latter stage of a bull market."

Michigan didn't allow such borrowing until a 2012 law, which limits sales to local governments with at least a AA credit rating, third from the top, and requires state approval. A bill to extend the law for a year awaits action in the house after passing the senate. Republican Governor Rick Snyder supports the extension, said his spokeswoman, Sara Wurfel.

Borrowing for retirement costs works when coupled with benefit changes, said John Axe, a bond attorney based in Grosse Pointe Farms, Michigan.

Axe said he represents six municipalities that are considering borrowing for the expenses, though he declined to name them.

Macomb County is paying half the recommended $30 million annual expense for current and future health-care costs, and won't be able to afford the premiums by the mid-2020s, said Provenzano, the finance director. The bonds will allow the county to keep up with projected cost increases, he said. The plan projects that debt proceeds will earn an average of 7.5 percent annually.

Proactive View

"We're being proactive about this," Provenzano said.

Money from the issue will be invested over the course of a year to adjust to swings in financial markets, he said.

The county has a AA+ grade from Standard & Poor's, its second-highest level. With 850,000 residents, Macomb abuts Detroit's northeast border and is dominated by 155 auto plants and suppliers, and the General Motors Technical Center in Warren. The county's $53,628 median household income compares with about $48,500 statewide.

Oakland County, which also borders Detroit, sold $350 million in general-obligation bonds last year to refinance debt issued in 2007 for retiree medical benefits.

Investments from the 2007 issue gained more than projected, resulting in overfunding for health benefits, said Robert Daddow, county deputy executive. The refinancing will save at least $125 million over the 13-year bond repayment, he said.

Plan Closed

The county also reduced costs by closing its defined-benefit health plan to new hires in 2006, Daddow said.

Kalamazoo may sell as much as $100 million of debt to partly finance $188 million of retiree health-care liabilities. A city panel this week recommended the bonds and negotiations with retirees and unions to lower medical costs.

The city pays $6 million annually from its $50 million general fund toward retiree health care.

If investment returns fall short of repaying the debt and health insurance, the city would renegotiate with employees for savings, said Tom Skrobola, Kalamazoo finance director. Without revenue from borrowing, the city won't keep up with rising medical costs and demands for other city services, he said.

"We've had great success with bargaining, but it's not enough," he said. "It has to be a combined approach."

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