Bond Case Briefs

Municipal Finance Law Since 1971

Pension Time Bomb Ticks as Disclosure Rules Toughen: Muni Credit.

Jersey, like other municipal governments, used an accounting sleight-of-hand for years to boost pension-funding levels. New rules are putting an end to the practice.

Last month, the state became the first to disclose weaker funding ratios under the revamped approach, according to Fitch Ratings. Under the new regime, which officials nationwide have phased in starting in 2013, governments must determine when their pensions will run out of money and reflect that projected investment returns will taper off after that date.

New Jersey's experience shows how funding ratios can plummet as a result. In documents for a bond sale last month, the Garden State said its plans will start running out of cash in 2021. Based on that calculation, it had 32.6 percent of assets to pay promised retirement benefits, down from 54.2 percent in 2013. By making pensions look worse off, the new rules may jolt localities into action, said Matt Fabian at Municipal Market Advisors.

"We're optimistic that the new accounting treatment will generate a stronger policy response," said Fabian, a managing director at the Concord, Massachusetts-based research firm.

U.S. state and local retirement plans are short at least $1.3 trillion because of investment losses triggered by the recession and insufficient contributions, according to Federal Reserve data. The deficit strains government finances, forcing officials to balance payments into pension plans with money for schools and roads.

GASB Says

The Norwalk, Connecticut-based Governmental Accounting Standards Board, which makes accounting rules for states and localities, released the rule in August 2012 to improve pension disclosure. The change transforms how governments report the cost in financial statements, in current dollars, of benefits that won't be paid for decades. The overhaul followed criticism from investors in the $3.6 trillion municipal-bond market that governments were underestimating the expense.

Dallas said in documents for a bond sale this month that the shift could have a "significant" impact on its financial statements and unfunded pension liability of about $1.8 billion. The city won't have more specifics until it gets data from its retirement plans later this year, Jeanne Chipperfield, Dallas's chief financial officer, said in an e-mail. Its two largest pension funds were at least 78 percent funded, according to fiscal 2013 financial statements.

Prairie Headwinds

California is among states that anticipated the shift and passed laws to increase funding or curb benefits, said Keith Brainard, the Georgetown, Texas-based research director for the National Association of State Retirement Administrators. Since 2009, almost every state, including New

Jersey, has enacted such changes, according to Brainard's group.

Efforts to reduce pension deficits face headwinds in states grappling with financial strains. In Kansas, Governor Sam Brownback may deepen the retirement liability by diverting money from the plans to balance the budget.

New Jersey, after overhauling and pledging to fund its pensions, skipped $2.5 billion of promised contributions for fiscal 2014 and 2015 as revenue missed projections.

"The problem New Jersey faces is much worse than it was," said Douglas Offerman, senior director with Fitch. "The cost becomes higher as the state tries to catch up with its underfunding."

The accounting change "does not materially impact New Jersey's fiscal position or the system's current assets of approximately $40 billion," Christopher Santarelli, spokesman for Treasurer Andrew Sidamon-Eristoff, said in an e-mail.

Decision Time

Illinois, which had the weakest funding ratios among U.S. states in 2013, at 39.3 percent, won't report under the new rules until the end of this fiscal year, said Abdon Pallasch, the state's assistant budget director. Last month, a ruling by a circuit court judge struck down a 2013 law that raised the retirement age. Illinois's attorney general appealed the decision to the state Supreme Court.

"If the court upholds pension reform it means we will be reporting better numbers," said Pallasch.

In most cases, retirement systems getting the required payments won't deplete their assets, so they wouldn't see funding ratios drop under the new approach, Brainard said.

Kentucky, with the second worst-funded state plans for 2013, with 44 percent of promised assets, overhauled its system last year and officials pledged to keep up with funding.

"Our actuaries say if we meet our assumptions we won't run out of money," said William Thielen, executive director of Kentucky Retirement Systems. "It may drop a bit more in the near-term, but in the long run it will come back."

Scrimpers' Remorse

Governments are supposed to set aside money every year to invest to pay promised pension benefits. Municipalities that scrimp on the payments and funnel the money toward services or to fill budget holes have to catch up as workers approach retirement age.

"If you are not investing assets in a manner to achieve a long-term rate, you generally are not going to earn a long-term rate," said Scott Reeser, project manager for GASB.

Under GASB's overhaul, governments calculating pension costs for the period after the depletion date must use lower assumed rates of return. Instead of projected annual earnings of about 8 percent, as is typical for many systems, they have to use a return based on 20-year general-obligation bonds rated at least AA, the third-highest level, said Reeser. The bonds yielded 3.19 percent as of Dec. 12, Moody's Investors Service data show.

"That rate is generally lower than most governments use as a long-term expected rate of return," Reeser said. "The lower the discount rate used, the higher the liability."

Bloomberg Muni Credit

By Darrell Preston

Dec 17, 2014 8:50 AM PT

To contact the reporter on this story: Darrell Preston in Dallas at dpreston@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net