

Bond Case Briefs

Municipal Finance Law Since 1971

A Pension for Trouble.

Sometimes knowing what not to invest in is better than knowing what to buy. No longer hiding in plain sight are the public unfunded state, city and teachers pension liabilities. The numbers are staggering. Some of our elected officials have chosen to load their unfunded liabilities onto the backs of municipal bond investors. Don't fall for it.

Here are some specifics: According to Bloomberg, there have been \$340 million worth of pension bonds sold so far in 2015. But wait—billions more are on the way. Those currently on the radar screen include Kentucky Teachers Retirement for \$3.3 billion; Pennsylvania with \$9 billion; Kansas with \$1.5 billion; and New Haven, CT with \$125 million.

From the Detroit bankruptcy, Pension Obligation COP bond owners recovered a measly 13 cents on the dollar. That's all, just 13 cents. The pension plans (composed of voters) fared far better.

The rationale proposed by these under funded entities is to sell taxable municipal bonds, then inject the proceeds into their respective funds. They're betting the farm that they can earn more investing in the markets than it costs them to pay you, the pension bondholder. Sounds like a good idea. Until, you remember that the equity markets have hit all-time highs. How much higher do these savants think it will go before it retreats?

A decade ago New Jersey tried the same thing and Illinois followed. The market went against them. Their pension payments fell behind. Now they're in even worse shape than if they had never issued the pension bonds. These pension bond issues are generally going against professional wisdom and advice. The Government Finance Officers Association recommends against it. BlackRock, a manager overseeing \$116 billion in state and local debt, does too.

What do the rating agencies have to say about Pension Obligation Bonds? A lot. Moody's is now weighing in on those unfunded liabilities in their overall bond ratings. For that I am glad. However, beware that retail investors will be the last to learn about any downgrades due to unfunded pensions.

Do not invest in any taxable pension obligation bonds. Corporate bonds will prove a better source of taxable income.

One that I like is DirecTV. They may be blessed by the regulators to be acquired by AT&T. If the acquisition happens the two companies combined will have a formidable market share of the video and television business. It also appears there will be business synergies. Buy DirecTV 3.80% due March 15, 2022 CUSIP: 25459HBF1.

The issue size is \$1.493 billion so execution is not a problem. If you pay 104, that's 3.16% yield to maturity on this non-callable bond. Even though the bond has a change of control provision investors will welcome the acquisition because the rating agencies have it on an upgrade watch.

Most investors are familiar with REITs. Digital Realty is a specialized REIT in the technology space.

Its facilities house tech industry enterprise data centers that Digital Realty customizes and leases to their clients. Buy Digital Realty bonds, 3.625% due October 1, 2022, CUSIP: 25389JAK2. If you pay 100.75, you'll earn 3.51% to maturity with a well-deserved BBB investment grade rating.

Leave those Pension Obligation Bonds to those who don't do their homework. The risk isn't worth it.

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Marilyn Cohen, Contributor

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