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Kansas \$1 Billion Bond Sale Bolsters Pensions Eyeing Hedge Funds.

Kansas Governor Sam Brownback is borrowing \$1 billion to let it ride in financial markets as U.S. stocks hold close to record highs.

The state issued bonds Wednesday with a top yield of about 4.93 percent to inject cash into its underfunded workers' retirement system. Officials expect to gain by plowing the money into stocks, bonds and hedge funds, anticipating that they can make more on the investments than the cost to borrow.

The tactic has been popular with states and cities, which have sold \$105 billion of bonds to make up for years of failing to save enough for benefits promised to public employees, according to the Center for Retirement Research at Boston College. It can aid those that borrow ahead of a stock-market rally, or push them deeper in the hole if they're caught by a crash.

The ability to come out ahead "is a crapshoot a lot of times," said Michael Johnson, managing partner at Gurtin Fixed Income Management, which oversees \$9.5 billion of munis in Solana Beach, California. "Longer-term, that tends to be true, but you can't tell for sure all the time. It's fairly easy for this to go the other way."

Brownback, a Republican, proposed the bond sale as a way to reduce annual pension contributions after the state's revenue declined because of tax cuts. Kansas struggled to balance budgets when the economy didn't grow fast enough to make up for the lost revenue.

Riskier Strategy

Moody's Investors Service and Standard & Poor's both cut Kansas's credit rating last year because of the budget shortfalls. By 2013, its retirement system was the fifth-worst-funded among states, with about 56 percent of the assets needed to cover the pension checks due as workers retire, according to data compiled by Bloomberg.

The bonds will ease pressure on the budget but do little to fix the retirement system, Moody's said in a report Monday.

While the borrowing is part of a plan to fully fund the pensions by 2033, "adding \$1 billion of debt to do it represents a riskier strategy than the simpler alternative of making larger annual pension contributions," the credit-rating company said.

Melika Willoughby, a spokeswoman for Brownback, didn't return a voicemail or e-mail seeking comment.

Returns Slide

Kansas's sale comes as the investment earnings of state and local pensions slipped to 3.4 percent

during the year ended in June, the worst performance since 2012, according to Wilshire Associates Inc. The funds expect to make about twice that to keep up with their obligations.

State lawmakers stipulated that the taxable bonds can only be sold if the interest rate is 5 percent or less. The 30-year debt, the longest-maturity securities, priced to yield 4.927 percent, data compiled by Bloomberg show.

With the Standard & Poor's 500 Index close to the record reached in May, the Kansas Public Employees Retirement System wants to pare its domestic-equity holdings and put more into hedge funds, state Treasurer Ron Estes said.

Hedge Funds

"We are looking at hedge funds more as something to add to the mix," said Estes, who is on the pension's board of trustees. "We just have to continue making good investment choices. If we beat 5 percent, we're better off than we were."

As of June 30, 2014, the plans allocated 2.9 percent to alternatives like private-equity funds, including those from Apollo Global Management, Pine Brook Capital Partners and Warburg Pincus, according to the pension's annual report.

Over the past 10 years, alternatives have gained 13.2 percent for the Kansas pension plan, beating all other assets. The system assumes 8 percent annual returns.

With bond proceeds, the 281,000-member retirement system will have 73 percent of assets needed to meet projected obligations by 2020, rather than 66 percent, according to estimates in offering documents.

Some governments that have borrowed for their pensions haven't reaped benefits. Those that did so at the end of the 1990s technology bubble and before the 2007 stock-market peak paid more to borrow than they made, according to a study last year by the Center for Retirement Research.

Kansas has fared better. It issued \$500 million of pension bonds in 2004 with a top yield of 5.5 percent.

While those securities looked like a losing bet after the credit-market crisis caused stocks to plummet, the state appears to have come out ahead as markets rebounded, according to the center's study.

"I'd rather my local government not bet on the direction of the stock market," said Hugh McGuirk, Baltimore-based head of municipal investments at T. Rowe Price Group Inc., which oversees \$22 billion of local debt.

"It's a way to delay facing up to some of the difficult decisions they're going to have to make, and it might put them even deeper in the hole."

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