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Alaska Dusts Off Plans for \$1.6 Billion Pension-Obligation Bond.

Alaska may double this year's supply of pension obligation bonds as it considers borrowing \$1.6 billion to help fund its cash-strapped retirement trust.

As of 2013, Alaska had the fourth-worst funded pension among U.S. states, reporting it had 52.3 percent of the money needed to pay retirees, better than only Illinois, Connecticut and Kentucky, data compiled by Bloomberg show.

Since then, the state has done some one-time fixes — like a \$1 billion cash injection into the trust last year — but hasn't made strides to permanently fix the fund, said Deven Mitchell, the state's debt manager at the Alaska Department of Revenue.

Prompted by Governor Bill Walker, Alaska is looking into the possibility of a \$1.6 billion general obligation pension bond, Mitchell said. "It appears that this interest rate environment provides an opportunity for us to get in on the leveraging side at a low rate," Mitchell said. "We're thinking it's not a bad time to consider this alternative."

The state's plan isn't new. Alaska almost issued pension obligation bonds in 2008, back when its funded ratio was at 75.7 percent, Mitchell said. At the time, the state legislature created the Pension Obligation Bond Corporation, a conduit that the securities could be issued through, and approved up to \$5 billion of debt, Mitchell said.

The deal team published a preliminary offering statement, gave rating company presentations and was in the process of picking a sale date when the stock market started to crash. The pension obligation bond dreams were over.

"The funny thing is, if we had bitten the bullet and ate the high interest rates [in early 2009], we would have been doing great now," Mitchell said. For a pension obligation bond to be "in the money," the eventual investment returns made with the proceeds have to exceed the initial borrowing rates.

This time around, Governor Walker has asked Mitchell to pick up from where they left off in 2008 and see if the economics still make sense. Mitchell said the deal will be ready to come to market if Governor Walker gives the green light. Because of the work done in 2008, the governor won't need legislative approval to issue the potential bonds.

Selling bonds to pay back other debts may not seem intuitive, but it's becoming a regular occurrence for those struggling to fund their pension systems. This year, state and local governments have sold the most GO pension obligation bonds since 2008 even as sentiment against them has grown.

The Government Finance Officers Association recommended, in a January advisory, that state and local governments refrain from issuing the bonds, reminding its 17,500 members that the proceeds from the deal might not return as much as the interest rate on the bond itself.

“People really don’t know what’s going to happen in the market, a lot of folks in the market don’t know what’s going to happen in the market,” said Dustin McDonald, a director at the federal liaison division of the GFOA. “Ultimately you’re betting on positive market outcomes that you may or may not see.”

Fitch reiterated the concerns in an Aug. 13 report, telling investors the debt “won’t fix U.S. public pensions” and the issuance of these types of bonds will only ever be neutral or negative for a credit. According to Matt Fabian, a partner at Municipal Market Analytics, “they’re always a bad idea.”

If Alaska goes through with its deal, this year’s total pension obligation bonds issues will be more than \$3 billion, almost ten times last year’s supply, according to data compiled by Bloomberg.

Issuers have argued that not all pension obligation bonds are equal. If the bond proceeds go directly to the pension trust and just reduce rather than replace annual payments, then there’s nothing for investors to be concerned about, said Kansas State Treasurer Ron Estes. Kansas sold \$1 billion of pension obligation bonds in August, raising its funded ratio to 65 percent from 62, Estes said.

“There are risks in doing this, but the biggest risk is not funding your pension,” Estes said. Mitchell said he’s framing Alaska’s potential deal to mimic Kansas’s. So far Mitchell has arranged an underwriting syndicate and put together a “shell” of a preliminary offering statement.

As Alaska considers ways to repair its pension system, it also faces a \$3.5 billion structural budget deficit, equal to about 55 percent of general fund expenditures, according to a note from Standard & Poor’s from Nov. 2.

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