

# Foreword: Is the Benefits Bond Window Finally Open?

Special Report | May 2016, Updated April 2020



Since 2009, we have published a number of educational pieces about how to evaluate the benefits and risks associated with benefit bond (e.g., POB or OPEB-OB) issuance. As we have noted on each occasion, due care should be exercised in the evaluation and decision relating to issuance. A benefit plan sponsor should understand that, especially in the nearer term, it is possible to be worse off from a budgetary perspective than if the bond had not been issued. In past recent decades over the longer term, however, (i.e., 20 or 30 years), stocks have almost always outperformed bonds meaning the sought-for arbitrage would have materialized.

Further, we have also noted steps that can be taken to help improve the likelihood of attaining a financially positive outcome, even in the nearer term, when an issuer determines that a POB or OPEB-OB merits exploration.

Among those steps are:

- Issue when the “benefits bond window” is open (i.e., when market interest rates for issuing the bond are relatively low at the same time that assets in the pension fund are not at a frothy peak)
- Consider debt structure based on liability structure
- Size the issuance to avoid an over-funding situation
- Undertake structural changes necessary to create an affordable, sustainable and sufficient benefit plan
- Evaluate the impact of a benefit bond issuance on the issuer's overall debt portfolio and financial metrics

With the novel coronavirus pandemic gripping the globe and the markets pitching like the deck of a schooner in a hurricane, why are we focusing on benefit bonds now?

The financial and economic tsunami that has swamped our economy may have also opened the “benefits bond window.” The benefits bond window is the elusive period during a recessionary bear market when both issuance rates and equity values are low, relative to past historical norms. It is during these periods when benefit bond issuance could offer the highest probability of both near- and long-term success.

We hope you will read the updated 2016 Benefit Bonds piece attached (charts and graphs updated to include more current data). While the original piece is more than three years old, the concepts of risk and opportunity remain the same. What has changed are some of the key dynamics of the decision-making paradigm. These changes make a re-evaluation of the strategy a reasonable action for some.

Finally, while issuing within a benefits bond window improves the probability of success, it does not assure success. Risks are always inherent in the execution of this strategy and individual issuer circumstances are likely to differ significantly, which could make benefits bond issuance a better or worse option. If you would like to evaluate or re-evaluate this strategy as part of your overall benefit plan strategy, PFM stands ready to assist.

# Benefits Bonds: Not (Quite) Dead Yet

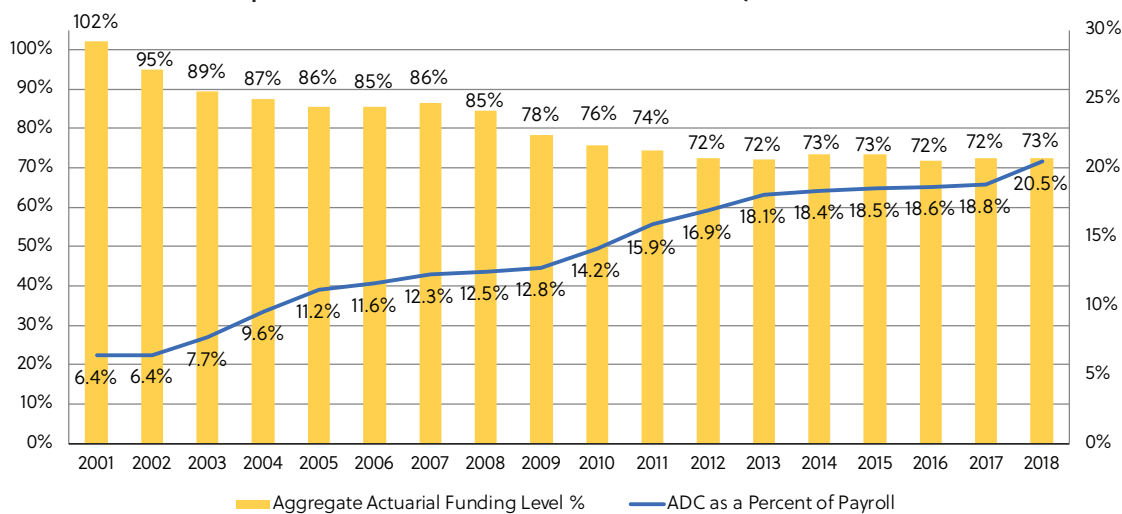
## Considerations for Pension Obligation and OPEB Obligation Bonds

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State and local governments have issued more than 594 pension obligation bonds (POBs) and more than 104 bonds for Other Post-Employment Benefit (OPEB) liabilities for a total par amount of more than \$70.5 billion of “benefit bonds” since the first POBs were issued in 1985.<sup>1</sup> Although issuance has fluctuated over time — at times trending upward at points in the market cycle that involved elevated amounts of risk, when viewed in hindsight — the interest in using benefit bonds to address unfunded retiree benefits liabilities is ongoing. This interest is driven by the long-term trends in pension and OPEB funding. Pension funding ratios have declined steadily since 2000, leaving fewer and fewer assets available to pay promised benefits, even as the employer’s cost of contributing to the pension fund has increased steadily and comprised ever-increasing proportions of the budget, as seen in Exhibit 1.

**Exhibit 1: Actuarial Asset Value as % of Liabilities and Annual Required Contribution (ARC) as a Percent of Payroll, 2001-2018**



Source: Public Plans Database.

However, the Governmental Finance Officers Association (GFOA) has issued advisories recommending that issuers do not issue POBs<sup>2</sup> or OPEB bonds.<sup>3</sup> In light of these important and well-reasoned advisories, we have revisited client updates we previously provided in 2009, 2011, and 2013. When used judiciously with planning, forethought, and as part of a broader strategy to address funding and liabilities, analysis of historical outcomes indicates that benefit bonds can continue to be an effective tool for some governments in addressing unfunded pension and OPEB liabilities. Given the risks and complexities reflected in the GFOA advisories, we suggest that issuers contemplating benefit bond issuance undergo a thorough review of the financial sustainability of their benefit structure, debt and credit profiles, investment policies, the proposed structure of the bonds, current and historical market conditions, the local legal and labor relations environment for benefit changes, and other key factors before proceeding.

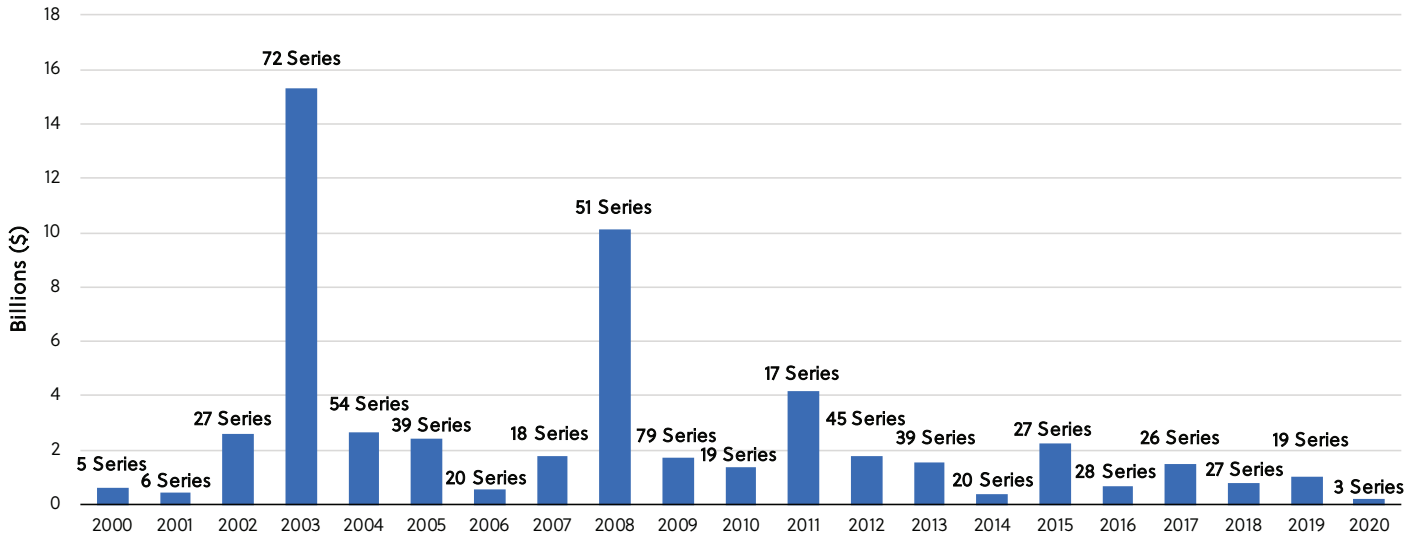
<sup>1</sup> POB data based on available Bloomberg data; OPEB bond data from Bond Buyer, January 28, 2016: “GFOA: States, Localities Shouldn’t Issue OPEB Bonds.”  
<sup>2</sup> January 2015 <http://www.gfoa.org/pension-obligation-bonds>.  
<sup>3</sup> January 2016 <http://www.gfoa.org/other-postemployment-benefits-opeb-bonds>.



## Mechanics, Security, and Ratings Implications

Benefits bonds generally are taxable municipal bonds issued for the express purpose of funding retirement benefits. The first POB was issued in 1985 by the City of Oakland, California. Since then, state and local governments have issued tens of billions of dollars in bonds to improve the funding levels of pension and OPEB plans, as shown in Exhibit 2 below.

**Exhibit 2 – Nationwide Municipal Pension Obligation Bond Issuance, 2000-2020**

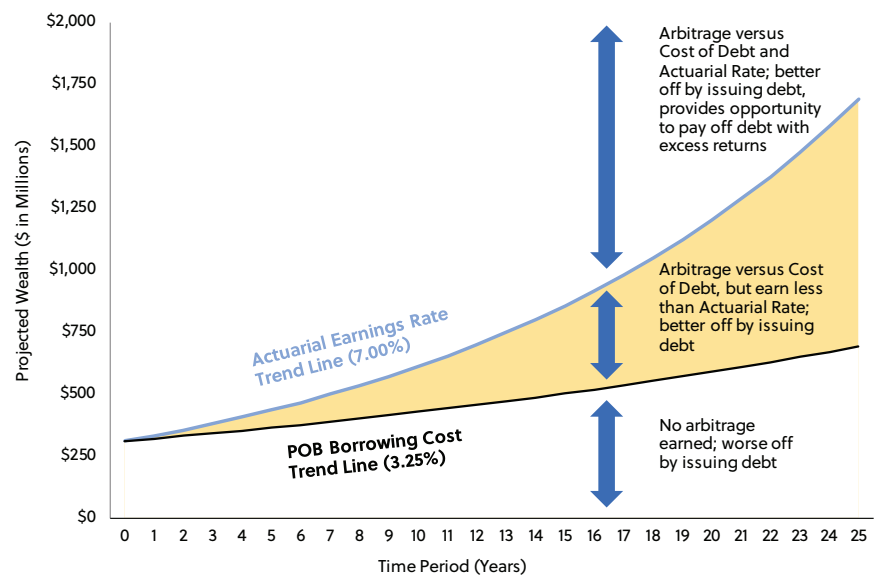


Source: Ipreo.

### Mechanics and Strategies of Issuance

The potential advantage of issuing benefits bonds is that a public employer can issue high-quality taxable debt at an interest rate significantly below the expected return of the pension fund or the OPEB trust. The objective of this debt issuance is to sell securities and invest the proceeds in a manner that produces a return that exceeds the cost of capital and, hopefully, the plan discount rate, as shown in Exhibit 3. If successful, such excess returns from the investments will reduce required employer contributions and create a more stable/solvent fund, thus providing a benefit to both taxpayers and plan beneficiaries. Unfortunately, benefits bond issues often have fallen short of their intended goal because of structural shortcomings and/or ill-timed issuance from a market perspective.<sup>4</sup>

**Exhibit 3 – Arbitrage Example**



For Illustrative Purposes Only.

<sup>4</sup> Issuers of benefits bonds have taken differing stances on the appropriate time frame over which to evaluate the results of this strategy. Typically, the bonds are issued with terms of 20 or 30 years and the liabilities of the plan stretch well beyond this time frame. However, due to the nature of governmental election cycles and the often short-term views of market investors and analysts, the success or shortcomings of these transactions are frequently viewed over short time frames. This mismatch of time spans can accentuate the perceived successes or shortfalls of such strategic decisions based on the market dynamics at the time of evaluation.



Although issuing benefits bonds does not really change the overall obligations of the employer, it does change the character of the obligations by replacing a so-called “soft debt” (the pension liability) with a “hard debt” (bond indebtedness). Whereas many governments have delayed, skipped, or underfunded their scheduled actuarially calculated pension contributions at times during the past 10 to 20 years, municipal bond issuers typically would not consider delaying payment of bond indebtedness (either principal or interest) because of the consequences they would face. Therefore, issuing “hard debt” may compromise a government’s future financial flexibility. Furthermore, a benefits bonds issuance will typically count against the issuer’s debt capacity, potentially inhibiting its ability to issue debt for other projects. On the other hand, since contributing less than the actuarially determined contributions (ADC) to pensions has led to reduced funding ratios and the larger stress that pensions are under, increasing ADC-funding discipline in the short-term can have long-term advantages for the stability and security of the pension fund.

### **Bondholder Security**

Although the conversion of a “soft debt” to a “hard debt” has been a major factor for issuers considering benefit bonds over the past three decades, some bankruptcy outcomes have paradoxically indicated an opposite effect, treating benefit bondholder rights below that of the retirees and pension systems. The bankruptcy plans for the City of Detroit and the City of Stockton imposed significantly greater reductions on bondholders than on the pensions of retired workers.<sup>5</sup> Further, the plan of adjustment for the City of Detroit and the plan of adjustment for the City of San Bernardino specifically maintained most (Detroit) or all (San Bernardino) of the pensioners’ value while pension obligation bondholders had their rights cut down to a fraction of their value.<sup>6</sup> In Detroit, 82% of the pension value was retained, while the holders of pension obligation certificates of participation (COP) recovered only 15% of their value.<sup>7</sup> In San Bernardino, bondholders recovered less than 50% of their POB value in the city’s bankruptcy, while the pension plan and related payments to California Public Employees’ Retirement System (CalPERS) would remain completely intact.<sup>8</sup> Although the rating agencies differ on what, if any, precedents were set by bankruptcy outcomes, at least there is evidence for issuers and investors alike to question the traditional wisdom that benefit bonds are more of a “hard liability” than the existing “soft” pension liability.

### **Ratings Implications**

In addition to the public’s renewed interest in retiree benefits, rating agencies are looking at and evaluating pension liabilities through a new lens. In light of additional scrutiny following the financial crisis, as well as the overall increase in pension liabilities across state and local governments and the resultant pressures on financial results, rating agencies have begun to value pension obligations differently. Some agencies now are conducting ratings evaluations by using a common discount factor for valuing the liabilities for the issuers they rate. For most plans, the new common discount rate is less than what they originally used, thus increasing the calculated size of the liability. With that said, the rating agencies generally are looking for a long-term strategic plan that shows management is up to the task of running a fiscally responsible organization, including, if appropriate, debt issuance and retirement plan management. As a credit matter, the rating agencies have a generally dim view of benefits bonds, although when viewed through the prism of a long-term plan, the view typically has not resulted in an explicit ratings action. For example, a situation where benefits bonds have been viewed more negatively is when they are used to provide short-term deficit financing of annual contributions rather than as part of a long-term strategic plan to create a healthy system.

5 “Why Detroit’s Bankruptcy Plan Outcome Doesn’t Affect U.S. Municipal General Obligation Ratings,” Standard & Poor’s, November 7, 2014; “Detroit, Like Stockton, Reveals Growing Tension between Pensions and Bonds,” Bond Buyer, November 10, 2014.

6 “Detroit, Like Stockton, Reveals Growing Tension between Pensions and Bonds,” Bond Buyer, November 10, 2014; “Judge Rejects San Bernardino’s Bankruptcy Proposal,” Wall Street Journal, December 24, 2015.

7 “Detroit, Like Stockton, Reveals Growing Tension between Pensions and Bonds,” Bond Buyer, November 10, 2014; “Recoveries in Distress: Holders of Municipal Bonds Compete with Retirees and Employees,” Moody’s Investors Service, November 14, 2014.

8 “Judge Rejects San Bernardino’s Bankruptcy Proposal,” Wall Street Journal, December 24, 2015.



As mentioned earlier, the issuance of benefits bonds does not really increase the employer's total obligations, but it does increase its explicit indebtedness. Even though in theory this can be a dollar-for-dollar tradeoff, the increase in indebtedness can actually numerically outweigh the equivalent reduction in pension liability in the rating evaluation, depending on the issuer's overall profile and the individual rating agency's framework. This was one of the concerns addressed in GFOA's best practice: "Rating agencies may not view the proposed issuance of POBs as credit positive, particularly if the issuance is not part of a more comprehensive plan to address pension funding shortfalls."<sup>9</sup> However, as the GFOA statement implies, this is not a categorical weakness, and the result will depend on the issuer and deal structure. The municipal advisor can assist in analyzing this potential impact.

While we agree with many of the elements of the GFOA's position against bonding for pension and OPEB obligations, as noted earlier, we think each jurisdiction has its own set of facts and circumstances. The issuer must do the proper homework, consider how to best mitigate the various risks, and structure the issuance and reinvestment to address those issues. We do not believe POBs or OPEB obligation bonds are categorically bad.

### **Closed Plans**

When a plan is closed and additional benefits cease to accrue, there may be less of an impact from some of the variables that otherwise increase an issuer's risk for issuing benefits bonds (e.g., inflation and wage assumptions). In these situations, the benefit bonds may act as an advance payment, locking in funding costs without a specific target of earning a substantial "arbitrage" or excess return. In this scenario, the primary concern is being able to issue debt at low rates and reduce the volatility of a more certain set of payments, rather than a high rate of return on the reinvestment of bond proceeds. However, as with any retirement plan, if the employer retains the liability for paying the benefits of the actives and retirees still in the plan, the employer also still bears the responsibility for funding the plan if the assets fall below the level that is required to fund future benefits.

Benefit bonds can provide additional flexibility to shift or even end the liability for the benefit payments in the special case of closed plans. Benefit bond proceeds could be used to purchase an annuity or invest in specific laddered instruments to match future cash flows, which would reduce risk and volatility but retain the liability and funding responsibility, as described above. Alternatively, the proceeds could be used to make an upfront payment to an insurer in exchange for transferring the pension risk. This pension risk transfer shifts responsibility for the liability, manages assets to meet future cash flows, and administers the pension benefits to the insurance company. In some sense, pension risk transfers may sound like the kind of complicated financial engineering that has fallen out of favor in the public sector in the wake of the Great Recession, but compared to derivatives, hedges, and other finite contracts, the pension risk transfer does not involve counterparty,<sup>10</sup> renewal, or rate risk to the issuer, and the outcome actually reduces exposure to market changes and rate volatility.

Plan sponsors also may consider benefit bonds as a tool while in the process of evaluating whether to close a pension or OPEB plan, either by merging into a larger state plan or by replacing the defined benefit (DB) plan with a defined contribution (DC) model, or, for OPEB, simply terminating the benefit. Benefit bonds can fund gaps in asset levels that may be required by the state when contemplating a merger. In the case of closing the plan to change from DB to DC or end the benefit, benefit bonds can be used in order to offer buy-outs to the existing retirees or vested active employees. Here again, the fixed cost and term of a bond would be traded for eliminating the volatility of funding benefit streams for the life of the beneficiaries.

<sup>9</sup> January 2015 <http://www.gfoa.org/pension-obligation-bonds>.

<sup>10</sup> Counterparty risk is shifted from the issuer to the retirees, who will have counterparty risk relative to the insurance company, with state guaranty limits and protections varying by state.



## The Benefits Bonds Window

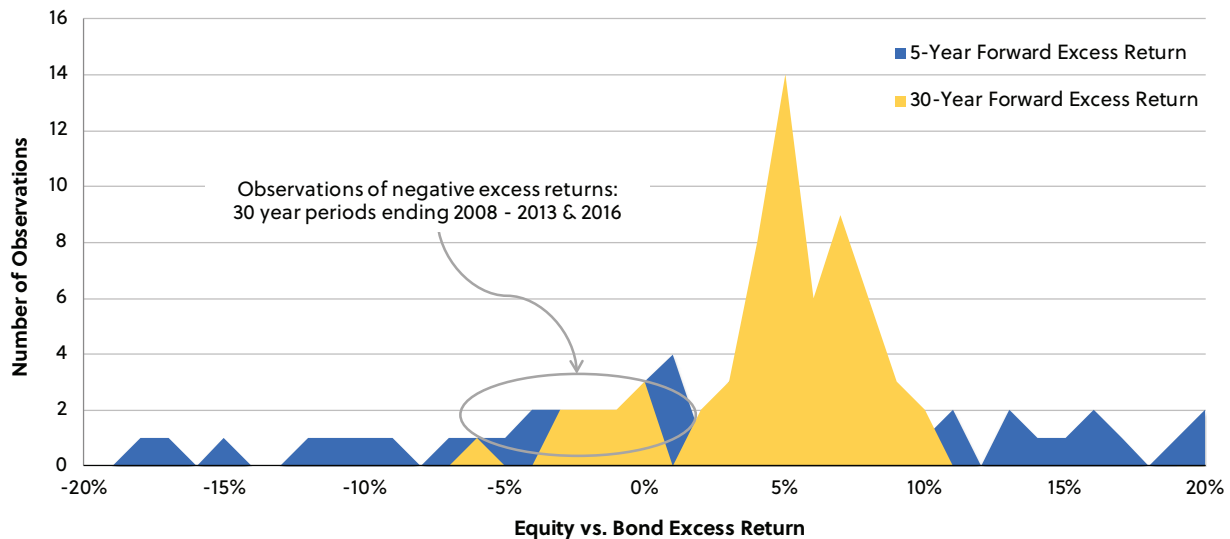
For the most part, benefits bond issuances have historically been reactive efforts to improve funding ratios or replace annual contributions that governments cannot afford. Unfortunately, issuing debt in a crisis situation because there is no real alternative or because the coffers cannot fund normal costs is a recipe for disaster. Instead, governments should think of benefits bonds as another option in their funding strategy — not the only one.

Using history as a guide, the likelihood of equity-oriented investments outperforming the cost of issuing bonds appears high when measured over 20 or 30 years. However, the returns of the portfolio allocations required to yield positive results tend to be relatively volatile, so in the short run (within five or 10 years) there is a significant possibility the portfolio returns will lag the cost of debt during the next recessionary bear market period.

Analysis of historical results, as shown in Exhibit 4 below, indicates that in the preponderance of 30-year periods, the return on equities has exceeded the typical borrowing cost of a benefit bond, with the notable exception of the immediate period following the financial crisis. Return on equities also exceeded typical borrowing costs in the majority of five-year periods, although the results demonstrate both more negative results and wider volatility.

In order to avoid the short-term risks inherent in a benefits bond strategy, governments should seek to issue the bonds at a time when market metrics are attractive for both issuing debt and reinvesting proceeds in equity-oriented strategies. Based on historic market patterns, this relatively uncommon capital markets “window” is likely to arise once a recession begins to reach its bottom, at a time when interest rates are relatively low (producing market liquidity and growth), and when stock prices are still depressed on a long-term valuation basis (commonly referred to as a “recessionary bear market”). This low interest rate and low stock price combination is rare except in the late stages of a recession.

**Exhibit 4: Distribution of Excess Returns\* vs. Fixed Borrowing Costs (1926-2019)**



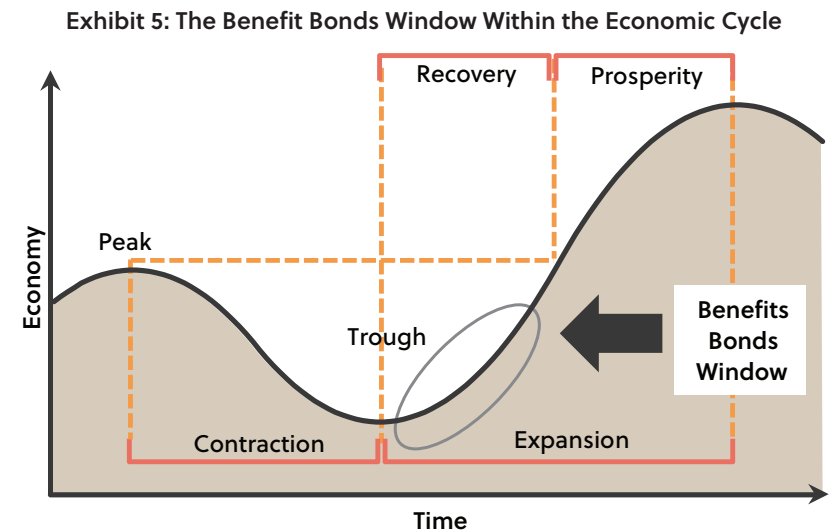
\*Excess Returns is defined as S&P Forward Return minus AA Corporate bond yield.  
Source: Ibbotson and Bloomberg.

### The Window: Open or Closed

The cyclical nature of the benefits bonds window is illustrated in Exhibit 5 on the following page. The graphic shows where this specific bond window fits into the broader economic cycle, and depicts the capital market characteristics that typically accompany recessions and economic recoveries.



The question is not whether the benefits bonds window will open, but rather when and for how long it will remain open. In a recession, a combination of factors – including monetary policy, Federal Reserve (Fed) intervention, and investor behavior – often lead to lower taxable borrowing rates. However, if the stock market rallies strongly from distressed levels in anticipation of a strong economic recovery, the pension fund's opportunity to invest in stocks at discounted prices (after selling bonds to raise necessary investment capital) could evaporate rapidly. Therefore, astute financial officials and plan administrators must develop issuance strategies well in advance of the window's opening.



As noted earlier, in order for benefits bonds to be successful, the return from the invested proceeds must exceed the cost of borrowing over time. Otherwise, the government will not only have to pay the additional debt service from the issuance, but it also may see contributions to its pension fund or OPEB trust increase. This exact scenario has occurred frequently when governments invest at market peaks, which appears to be one of the reasons GFOA issued its best practice recommending against issuing benefit bonds.

Some decision-makers may not want to accept the risk and volatility involved in deciding when and whether to issue based on interpretation of the benefit bonds window, or wish to avoid the perception of “timing the market.” These concerns are perfectly valid. On the other hand, financial officials routinely make decisions based on market conditions that impact taxes and fees, reserve levels, investment asset allocations, and debt issuance timing.

### The Lure of Low Interest Rates

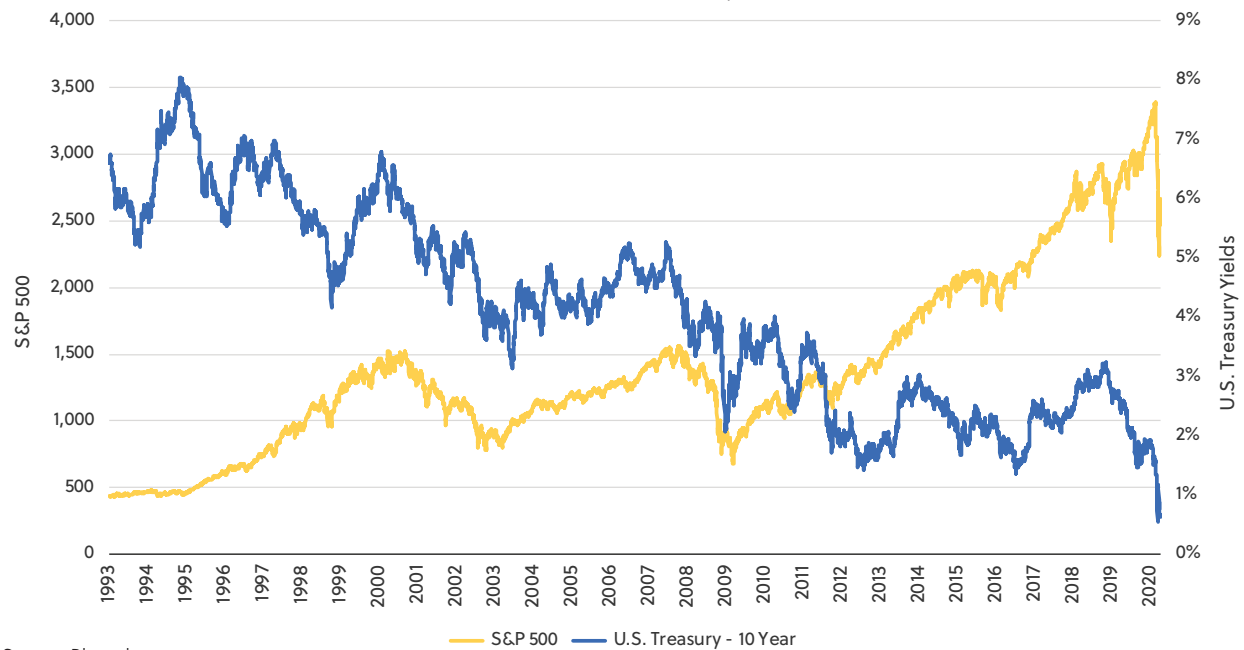
We often encounter individuals who ask the question, “If borrowing rates are less than the pension fund's assumed rate of return, why shouldn't we issue benefits bonds?” While low interest rates are part of the equation for a promising benefits bonds issuance, history suggests that the more important part of the equation is the reinvestment markets. If the reinvestment markets are not at cyclically low levels, they typically will lack the headroom to rise enough to make the issuance a worthwhile cost-saver in the near term. For example, looking at the markets since 1993 in Exhibit 6 on the following page, prior to the inception of the current bear market, many experts — including PFM's asset management affiliate PFM Asset Management LLC — would have been hard-pressed to predict 10%+ annual returns of the next five or 10 years from all-time highs. In fact, expectations had been that equity returns in the intermediate term would be somewhat lower than historical averages and domestic bond returns will be dramatically lower than historical averages.<sup>11</sup>

In addition to investing benefits bonds proceeds at inopportune times, selling benefits bonds may relieve the pressure to address structurally imbalanced benefit levels. Depending upon the richness of pension or retiree healthcare benefits, it may be the case that the government employer simply will not be able to fund the respective benefits levels over the long term. In those cases, utilizing benefits bonds will only push off the necessity of addressing benefits levels by creating the illusion that the fund or trust is structurally sound and well-funded. Unless a government is closing a fund, it is strongly recommended that plan design changes accompany (and preferably precede) benefits bonds so that the government comprehensively addresses the structural imbalance.

<sup>11</sup> PFM's 2020 Capital Markets Assumptions. A copy of PFM's 2020 Capital Markets Assumptions are available upon request.



Exhibit 6: S&P 500 vs. 10-Year U.S. Treasury Yields Since 1993



Source: Bloomberg.

## Legal and Labor Relations Environment

The risks involved with how benefit bonds may perform, and either improve or hinder a government's efforts to improve its financial health and benefits funding condition, are inter-related with the legal and labor relations environment of the government's state and local area. Most states are considered to have some form of protection for pension benefits that have already been earned. Therefore, while the ability to modify those benefits for new employees or existing employees in some ways may vary from state to state, in general financial officers can approach a POB with a long-term debt service schedule with some degree of confidence that their government will not be able to simply walk away from the underlying pension benefit liability one day without some transfer of fair value. On the other hand, as GFOA stressed in its best practice on OPEB bonds, the landscape for OPEB is less certain: "Unlike pension benefits, health-care benefits are not guaranteed by state law in many jurisdictions, and employers may choose to reduce, cap, or eliminate these benefits. Third, state or federal health-care initiatives might also significantly change the way health-care benefits are provided in the future."<sup>12</sup> In particular, the government should focus on the possibility that healthcare benefits could be modified, and to what extent, over a 20 to 30-year period before proceeding with an OPEB bond. Conversely, some degree of flexibility can be a positive factor in evaluating the potential effectiveness of benefits bonds as one element of an overall strategy, as described below.

## What You Should Consider

While it is always better to fund retirement obligations with cash, there may be situations where a benefits bonds issuance can make sense. In those cases, there likely has been significant preparation and evaluation in advance — potentially years in advance — of the actual issuance. The following are some important items a government should consider before deciding to issue benefits bonds:

**First, stop the bleeding:** Underfunded pension and OPEB plans did not materialize out of the blue; undoubtedly, there were many factors that contributed to a poorly funded plan. Whether long-term investment performance was poor, or there were benefits increases (or more financially detrimental, retroactive benefits increases) or pension funding holidays, the bleeding must be stanching in order to address the chronic declining fiscal health of the plan.

<sup>12</sup> January 2016 <http://www.gfoa.org/other-postemployment-benefits-opeb-bonds>.





Most often, the solution may come from plan reforms, potentially even as severe as closing the DB pension or OPEB plan, but may also include stronger funding policies or more risk sharing with employees. In any case, if the root causes contributing to the declining funded status are not addressed, issuing debt is like bailing out the Titanic with a bucket. It may feel good to help, but ultimately, you are doomed to sink. And often, the short-term actions make the long-term fix far more expensive.

**Prepare to issue when the benefits bonds window is open:** As noted earlier, it is uncertain when and how long the benefits bonds window will be open. Since the window can be seen with certainty only after the fact, it is not important, nor is it likely to get it exactly right. It is important to issue and reinvest at a time with the right characteristics. Consequently, governments will need to lay the groundwork early to take advantage of future opportunities. In particular, having conversations with the authorizing body, preparing any legal or authorizing documents, and considering structures and sizes for the issuance in advance will help expedite the process. The time to use the strategy will likely occur when the markets are stressed, so prepare for benefits bonds issuance in advance, at a time when cooler heads and rational thinking will prevail. Remember, preparing for the event does not mean you are required to issue the bonds.

**Structure the issuance appropriately:** A government can use numerous structures and types of bond components to form a comprehensive benefits bonds debt issuance strategy. Debt structures can be issued on a “level debt service” basis, where they can assume a shape similar to the current planned liabilities, or they can be structured to create budgetary flexibility or “savings” in targeted years. Depending on market dynamics, issuance size, and risk appetite, components can include both fixed- and variable-rate debt. Factors such as current and projected cost and budget dynamics must be taken into account holistically in order to optimize the structure and provide the greatest likelihood for achieving positive results. A key consideration should be sizing the benefits bonds issuance to increase the solvency of the plan without creating a potential “overfunding” problem. For that reason, a plan that is significantly underfunded (which, in our view, is less than 80% funded at the recent February 1, 2020 equity market levels) should consider a multi-tranche approach to the debt issuance. This “dollar cost averaging” approach to debt issuance will help ensure that the negative effects of unintended/unforeseen consequences are reduced.

Another consideration in the bond structure is the amortization schedule. The GFOA best practice warned, “The POBs are frequently structured in a manner that defers the principal payments or extends repayment over a period longer than the actuarial amortization period, thereby increasing the sponsor’s overall costs.”<sup>13</sup> As described above, the debt can be structured to provide budgetary savings; however, this benefit should be weighed against the downsides of increasing total interest cost or unreasonably extending the length of time to pay off the liability. It would be common for an issuer considering benefit bonds to be following a level percent of pay amortization, which by its structure defers principal payments, and/or to have a relatively long remaining amortization period — i.e., over 20 years — so this will not be an issue in many cases, but should be considered as part of the evaluation.

**Protect the taxpayers:** Since retirement plan contributions and debt service payments are met by the taxpayer, governments should protect the public where legally possible. It is important to explore the ability to create debt covenants that limit the ability of future governing bodies to increase benefits while the debt is outstanding.

**Ensure you have a current funding policy:** The elimination of the former Actuarial Required Contribution (ARC) reporting requirement as a result of the current Governmental Accounting Standards Board (GASB) pension and OPEB standards means more responsibility falls on governments to specify a funding benchmark and policy. Employers and plan sponsors should discuss the funding policy with their financial advisors and actuaries. Even plans that have contribution requirements, amortization schedules, and other assumptions and components governed by state law should review the need to have an updated funding policy tailored to their particular situation, possibly with an enhanced or recommended funding policy that addresses the funded status of the

<sup>13</sup> January 2015 <http://www.gfoa.org/pension-obligation-bonds>.



plan more aggressively than the statute. A pension or OPEB funding policy that is written and formally adopted by the plan sponsor should also ensure that the normal cost of the benefit is funded annually, that the Actuarial Determined Contribution (ADC) is clear and annually funded, and that the debt proceeds can be deployed to make the most positive impact, without risk of the intent being degraded by a lack of consistent and adequate contribution funding.

**Communicate your strategies:** The role of a finance director is always complicated, but especially so in these turbulent economic times. Add in the GASB Statements 67, 68, 74, and 75 on pension and OPEB accounting and reporting, ratings agencies inserting themselves in the public pension discussion, and certain segments of the actuarial community advocating an entirely new way of valuing pension liabilities, and you have the makings of a potentially indecipherable story that can confuse and frustrate the public. Regardless of the time period, markets are unpredictable: sometimes they go up and sometimes they go down. As a result, even a well-timed debt issuance may not appear successful during the entire term of the outstanding debt. There may be times when the aggregate cost (debt service plus annual pension cost) may be higher than what was expected. With the potential for negative year-to-year financial implications, the various scenarios should be discussed with the authorizing governing body and communicated to the public. There should be a clear outline of the strategy to manage/contain benefits growth, create funding certainty, and alleviate risks along with discussion of any other exogenous variables that could impact the strategy negatively in the short- or long-term. There will certainly be naysayers, but addressing the issues up front with a consistent message is a matter of prudent public policy.

## Conclusion

The GFOA advisories on benefit bonds should give issuers pause. When used judiciously, and with planning and forethought, we believe benefits bonds still can be an effective tool for some governments in addressing unfunded pension and OPEB liabilities. However, even if benefits bonds are issued to address a current “crisis” in the underfunding of pension or OPEB funds, governments must develop policies and strategies to manage their pension and OPEB liabilities over time and the potential for under funding in the future. Funding strategies such as benefits bonds should be considered only in conjunction with refining the ongoing benefits structure and the investment policies of the fund or trust in order to position the issuer and its employees for future financial stability. Without a broad approach that seeks to address the multiple facets of an underfunded plan, issuers risk finding themselves in similar underfunded positions at future points in time, despite a funding infusion such as a benefits bonds issuance.

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