

Pension Crisis

By Ronald Schwartz, CFA

SEIX INVESTMENT ADVISORS



Unfunded pension liabilities continue to be a key credit concern for State and Local Governments across the municipal market and municipal investors should take notice. With Fiscal Year 2016 numbers now nearly fully reported, the median funding ratio for states declined to 72%, an 8% decline from 2015 to 2016. Investment returns averaged below 1% for the year, dramatically underperforming most plans' projected returns of 7%-8%.

Lower investment returns and adjusted assumptions have created wider dispersions between good and bad plans. Not surprising, states with well-publicized poor funding level (Illinois, Kentucky, New Jersey, Pennsylvania and Connecticut) have seen ratings downgrades and generally widening credit spreads. We believe plans with funding levels below 80% have difficult decisions ahead as to how they will address their plans' funding levels while balancing the broader needs of their constituents.

Cities and counties face many of the same pension issues as states, but have substantially fewer resources to enact a solution. Many states have begun to downstream pension expenses by reducing or eliminating some pension contributions. This decrease in funding creates additional budgetary pressures on smaller cities and counties. In our own research, (reviewing 2,500 plans) we found the average funding level for counties to be 74.8% and 72.3% for cities.

Recently, the Federal Reserve Board estimated the total unfunded liability for state and local plans is an astounding \$2.0 trillion, representing just under 11% of US GDP for 2016. In many cases, the growth rate for pension costs exceeds the growth rate for tax revenues creating large budgetary challenges. Going forward, this will only be exacerbated by demographic shifts to an older population, migration challenges for

some localities, and declining investment returns. Growing pension liabilities will continue to compete with essential services for the limited pool of tax revenues. Hard choices will need to be made with regard to funding priorities for capital needs, pensions, and debt payments. For these reasons, we closely monitor the funding levels for our general obligation bond holdings and actively seek to limit our exposure to credits with poor funding levels. ■

Ronald Schwartz, CFA, Managing Director and Senior Portfolio Manager, is responsible for managing the Tax-Exempt strategies at Seix Investment Advisors LLC.

This information and general market-related projections are based on information available at the time, are subject to change without notice, are for informational purposes only, are not intended as individual or specific advice, may not represent the opinions of the entire firm, and may not be relied upon for individual investing purposes. All information contained herein is believed to be correct, but accuracy cannot be guaranteed. It is not intended to be, and should not be construed as investment, legal, estate planning, or tax advice. Investors are advised to consult with their investment professional about their specific financial needs and goals before making any investment decisions.

All investments involve risk. Debt securities (bonds) offer a relatively stable level of income, although bond prices will fluctuate providing the potential for principal gain or loss. Intermediate-term, higher-quality bonds generally offer less risk than longer-term bonds and a lower rate of return. Generally, a portfolio's fixed income securities will decrease in value if interest rates rise and vice versa. A portfolio's income may be subject to certain state and local taxes and, depending on your tax status, the federal alternative minimum tax. There is no guarantee a specific investment strategy will be successful.

Past performance is not indicative of future results.

©2017 Seix Investment Advisors LLC is an investment adviser registered with the SEC and an affiliate of Virtus Investment Partners, Inc. All third party marks are the property of their respective owners.

Learn more at www.seixadvisors.com.

SEIX 
**INVESTMENT
 ADVISORS LLC**®
 A VIRTUS INVESTMENT PARTNER