Stoever Glass&Co
30 Wall Street, New York, NY10005

GOVERNMENT PENSION FUNDS MAY BE STRONGER THAN YOU THINK

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Dick Larkin
Director of Credit Analysis
Stoever Glass & Co., Inc.
P: (862) 432-8818
E: dlarkin@stoeverglass.com

Detroit's and Puerto Rico's financial melt-downs highlighted attention to benefits which will continue to be paid long after this fiscal year. Governments could pay pension benefits for 10-15 years or more even with unfunded liabilities as high as 50%. This is the case, even if government contributions are not made.

In Detroit, I calculated that there was no immediate cash crisis that prompted bankruptcy. In fact, an independent reviewer (Governing Magazine) estimated that Detroit's pension was 91% funded, among the 10 best funded large city pension funds in the country. Yet pensions took the brunt of criticism during Detroit's bankruptcy. Since 2012, I believe Detroit did not need to restructure debt with bankruptcy.

The media has highlighted pension funding as "public enemy No. 1" for state and local governments. Indeed, it is a big challenge that requires political and managerial guts to discipline governments, which have been generous providing benefits in the future in order to permit them not to raise taxes right now. Those days are over.

Puerto Rico is an outlier, with barely one year's costs accumulated. Extraordinary action will be required. But that marks everything that is a financial disaster for Puerto Rico's Government.

Underfunded pension funds are a challenge. For virtually all governments, however, underfunding is not insolvency. Governments maintaining a steady unfunded liability position will remain solvent. Issuers that continue to shirk pension fund payments can only expect rating downgrades and the equivalent of bankruptcy.

Finally, pension funding levels will see resurgence in 2017, with a 12.06% total return in the S&P 500 through December. These returns are well above the conservative 4% returns that many feel should be the assumption for future pension calculations.

About the Author

RICHARD P. LARKIN, Stoever Glass & Co., Inc.

Richard Larkin, a recognized 40 year industry veteran, has joined SG & Co. as Director of Municipal Credit Analysis. Mr. Larkin began his career in credit rating analysis at Standard & Poor's in 1975. After rising through the ranks in various analytical and management positions, Dick left S&P as its Chief Municipal Rating Officer, responsible for municipal rating policy, practices, governance and criteria. In 1998, Mr. Larkin joined Fitch Ratings as Chairman of its Public Finance Criteria Committee.

"Dick will be a unique resource to Stoever Glass' municipal clients. His knowledge in specific issues and areas of the municipal bond industry will aid our representatives and their clients in making educated decisions, in a sector where this type of research is unique," said Roland Stoever of Stoever Glass.

Disclosures: