The New York Times **Business**

States Risk Bigger Losses to Fund Pensions

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Many state and local governments, facing ballooning pension promises to police officers, firefighters, teachers and other public employees, are rushing to sell bonds to cover the shortfall. That strategy has sometimes backfired in recent years, leaving taxpayers on the hook for even more debt.

States and municipalities are drawn to bond sales because they bring instant cash, easing budget pressures without further tax increases or reductions in retirement benefits.

But critics say the bonds could prove costly for some officials using them — and for the local taxpayers. The cities and states have to pay a fixed rate of interest on the bonds, and are essentially betting they can earn a higher rate of return by investing the proceeds in their pension funds.

But recent investment losses have already left some cities and states on the hook for a mounting debt, covering not just the retirement money for their workers but also the interest on the bonds. New Orleans, Pittsburgh and New Jersey have all placed losing bets in recent years.

Almost all pension funds have suffered sizable losses over the last three years. Government pension plans can dig themselves into deeper holes because, unlike corporate pension plans, they are not bound by federal requirements to maintain a certain level of funding. Some have no reserves at all: they just pay as they go, out of revenues.

With money tight, municipalities are desperately looking for financial help. This year, pension bonds will account for nearly 5 percent of all new municipal bonds, up from less than 1 percent in each of the last five years.

In the first nine months of this year, Illinois, Oregon's school boards, New Jersey's economic development authority and more than a dozen towns and counties sold $13.3 billion in bonds for pension purposes, almost as much as the total sold for pensions throughout the 1990's, according to Thomson Financial, a research firm.

More sales are coming. Wisconsin and Oregon each plan one before the end of this year, and

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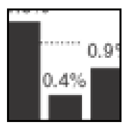

Chart: Surging Debt

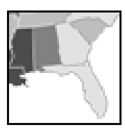

Chart: Trouble Spots

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Kansas has authorized a sale. West Virginia, home of the nation's weakest public pension plan — according to a study by Wilshire Associates, an investment advisory firm in Santa Monica, Calif., the state teacher's plan has only $1 for every $5 it owes — is fighting a court battle to sell $3.9 billion of the bonds without first holding a referendum. In California, a planned $1.9 billion bond sale for state employees' pensions contributed to the fiscal uproar that led to the recall of Gov. Gray Davis.

Other officials have weighed the risk and declined. "It's really tough to justify," said Robert C. North, the chief actuary for New York City's five employee pension plans. For years, Mr. North said, investment bankers have been urging the city to sell bonds to pay for its pension promises, and every time, he argues against it because he believes there are sounder and cheaper ways of financing pensions.

"On a risk-adjusted basis, the only people who can make money on this are the investment bankers," Mr. North said.

This risk is not always made sufficiently clear, critics say, by financial consultants who stand to make money from the bond sales.

New Orleans recently found out just how deep a hole it had dug for itself by selling bonds in late 2000 to finance the pensions of 820 retired firefighters. In May, city officials asked the manager of the bond sale, UBS Financial Services, for a progress report and were shocked to learn that the deal was expected to cost the city $270 million over time.

"We were thinking that we were going to make money on it," said Suzy Mague, fiscal officer for the New Orleans city council.

City officials say their rosy expectations were created by PaineWebber, the lead underwriter, when it described the bond transaction. (PaineWebber, which collected a $3 million fee for its role in the bond sale, has since merged with UBS.)

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