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How Refinancing Debt Can Help Pensions

North Carolina wants to use existing low rates to shore up retiree pensions and health-care debt.

By Liz Farmer

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In the low interest rate environment, states and localities have been saving billions by refinancing old debt. In most cases, the savings have benefited the general fund balance. But in North Carolina, State Treasurer Dale Folwell is making a push to instead use those savings to pay down pension and retiree health-care debt.

Starting this spring, Folwell plans to refinance "every dollar we possibly can." He'll ask the General Assembly to divert the savings to the treasurer's office, where he'll then divvy up the extra dollars: 15 percent goes into the pension fund and 85 percent goes toward retiree health-care debt, which has a larger unfunded liability.

The approach has garnered rave reviews, but some question just how big a dent any such savings can make in an unfunded liability that in North Carolina totals nearly $38 billion between retiree pensions and health care.

It's true the money can add up. Since 2009, North Carolina has refinanced roughly $4 billion in debt, amounting to savings of nearly $289 million, according to the state's most recent debt affordability study.

Nationwide, more than half of the total bonds issued in the municipal market since 2009 have been to refinance deals. Last year, roughly $275 billion of the nearly $450 billion in total bond issuance was to refinance existing debt. Refinancing deals are still expected to drive issuance this year, even with the Federal Reserve slated to raise short-term interest rates.

The savings per deal can vary. Connecticut saved nearly $76 million last year when it refinanced $501 million in general obligation bonds. In 2015, Washington state refinanced $421 million and saved $32 million in debt costs.

Municipal bond expert Matt Fabian also notes that savings from refinancing debt aren't immediate. Similar to refinancing a home, the debtor makes lower payments on the debt going forward, meaning the total savings are realized over time. For instance, Connecticut in 2014 refinanced $822 million in general obligation bonds and saved $94.8 million over the next 11 years."So the savings are real but it's on paper," says Fabian, a partner at Municipal Market Analytics. "In effect, it's a promise to pay [over time] from the general fund the savings they just generated."

Still, Fabian praises North Carolina because refinancing essentially produces "found" money. "Any time you can start paying down a debt without raising taxes or cutting spending, that's a good thing," agrees Donald Boyd, director of fiscal studies at the Nelson A. Rockefeller Institute of Government. He adds that it's also better fiscal policy to put found money into a one-time use, rather than into recurring expenses like the current year's budget.

Folwell thinks that credit ratings agencies will look favorably upon the tactic. North Carolina already has a top AAA rating, but he thinks that by urging local governments to follow the state's lead, it will strengthen their credit ratings as well. "If you take a portion -- if not all – of those interest savings and put it toward another liability," says Folwell, "it is a win-win in the eyes of the community, the state and the rating agency."