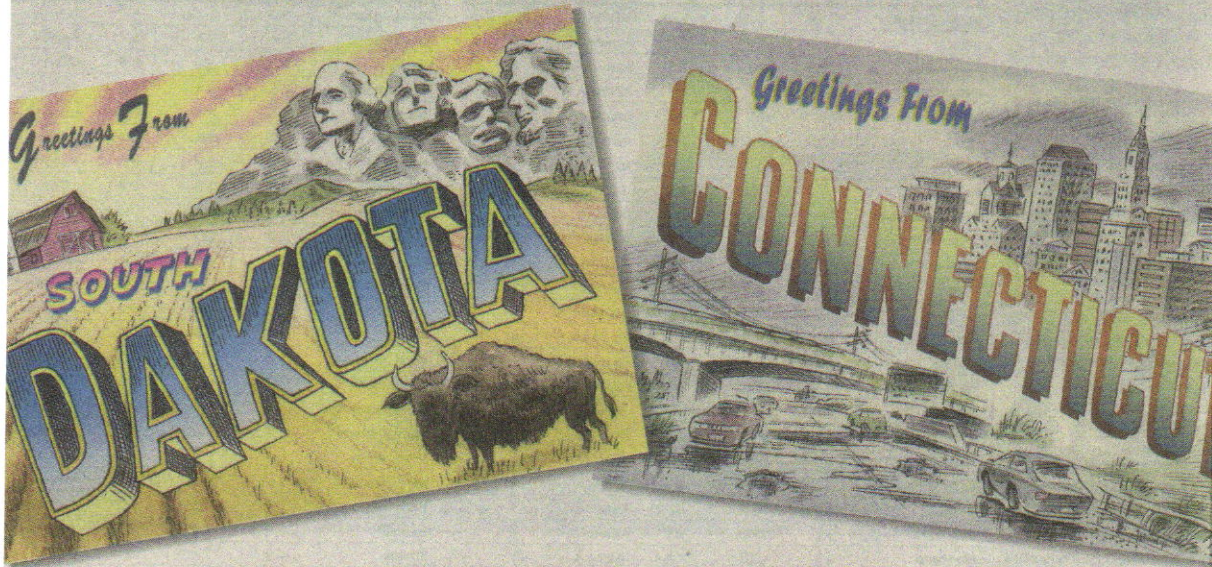


## COVER STORY

Mounting pension shortfalls and high debt are upping the risk for state muni-bond investors. How Connecticut sank to the bottom.



# State of the States

**by Andrew Bary** States have long been considered the best group of issuers in the municipal bond market, thanks to modest debt levels and ample taxing power. That's still the case, though many states, including Illinois, Connecticut, New Jersey and Hawaii, are bedeviled by large unfunded pension liabilities stemming from weak investment returns and inadequate state contributions to the plans. Adding to the strain are huge and growing unfunded liabilities for post-retirement health care for state employees. • That strain was brought into sharper focus recently with **Berkshire Hathaway's** disclosure that it had terminated \$8 billion of municipal derivatives contracts. Those contracts were effectively bullish bets on state finances. Berkshire CEO Warren Buffett is bullish no more. The company's \$30 billion bond portfolio is light in munis, and Buffett is warning about rising municipal bankruptcies and of the risks of insuring tax-exempt debt. "The