Investors Haul In Nearly Half the Tobacco Settlement Cash

An updated tally by ProPublica shows that tobacco bondholders are due $2.6 billion of the $6 billion in this year's payouts to state and local governments from Big Tobacco.

by Cezary Podkul and Claire Kelloway ProPublica, Sep. 11, 2014, 8 a.m.

Each April, cigarette manufacturers pay states billions of dollars to reimburse them for the health-care costs of smoking. About $100 billion has been paid so far, all under a landmark 1998 legal settlement with Big Tobacco. The payments are to go on forever as long as people smoke.

Much of the money, however, doesn't go to government coffers anymore. As ProPublica reported last month, a large chunk now flows to investors – the result of deals that politicians and Wall Street bankers arranged to get cash up-front by trading away the tobacco income decades into the future.

How much are investors getting? About 44 percent, or nearly one in every two dollars the tobacco companies pay out each

year, an updated analysis by ProPublica shows.

The figure incorporates new data from California and New York counties and cities that also share tobacco settlement money. It updates our earlier estimate that at least one in three dollars goes to investors who bought bonds used to "securitize" the money coming in. *See "How Tobacco Bonds Work."*

Until now, it has been unclear how much money has been tied up in securitizations. The deals aren't tracked by the National Association of Attorneys General, which monitors the payments. State and local officials aren't required to report how they spend the money.

This year, investors were pledged $2.6 billion of the $6 billion paid out by tobacco companies. Forty-six states, five territories and the District of Columbia get a share under the terms of the 1998 settlement, which grew out of a multi-jurisdictional lawsuit over the cost of illnesses caused by smoking.

California and New York are unique in that, unlike the other states party to the settlement, they share their settlement proceeds with county governments and some cities.

All told, 35 New York counties, plus New York City, and 24 California counties and the City of San Diego have securitized all or a portion of their settlement dollars as of 2014, according to bond documents reviewed by ProPublica and interviews with dozens of county officials.

Anti-smoking groups have criticized securitization. That's because attorneys general who negotiated the legal settlement had hoped part of the money would be spent on smoking prevention.

Language in the settlement says the intent was to achieve

"significant funding for the advancement of public health" and "the implementation of important tobacco-related public health measures."

"It's incredibly disappointing," said Cathy Callaway, associate director of state and local campaigns for the American Cancer Society Cancer Action Network.

Securitization, she said, "just continues to dwindle the pot of revenue that could be used for tobacco control programs and should be used for tobacco control programs."

Nationally, states are spending only about 15 percent of the $3.3 billion the Centers for Disease Control recommends they should for tobacco control, according to the Campaign for Tobacco-Free Kids, an anti-smoking group. Anti-smoking groups estimate that during their 2014 fiscal years, states brought in $25 billion from tobacco taxes and the 1998 settlement.

Nothing in the settlement directs how governments should spend the tobacco money. And some states that have securitized, like Alaska, still fund significant tobacco control programs. But more often, the money from issuing tobacco bonds went to other uses.

In New Jersey, for instance, lawmakers used proceeds from their tobacco bond sales to plug budget holes. Across the New York counties, ProPublica found that the most common use of the money from securitizing was to repay old debts to save on interest payments.

Those savings came at a cost: Because the tobacco bonds are payable only from the 1998 settlement proceeds, investors demanded higher interest rates than for less-risky general obligation debts backed by taxpayers. That means investors discounted the future cash from the settlement at higher rates and governments got less money up front – sometimes

as little as two cents on the dollar, ProPublica found.

As of this year there are approximately $36 billion in tobacco bonds outstanding.

Proponents of securitization say it allows governments to avoid the risk of nonpayment. By cashing in early, the money was immediately available for projects to benefit taxpayers. Because only tobacco settlement income could be used to repay the bonds, investors and not the governments would take a hit if one of the cigarette manufacturers went belly-up or the annual payments shrank.

The payments are based largely on cigarette sales and have been dropping as smoking bans and prevention efforts bear fruit. But the settlement also requires an annual inflation adjustment of at least 3 percent, which slows the decline.

More importantly, tobacco companies remain profitable and able to pay. Overall U.S. tobacco industry sales are declining but still are estimated to top $41 billion this year, according to IBISWorld, a market research firm. Profit margins are expected to grow.

As such, the money is likely to keep benefitting residents in place like Southern California's San Bernardino County, which never securitized. The county receives $17 million to $22 million each year and uses it to pay off debt from a medical center and to fund public health programs that include smoking cessation.

Said Gary McBride, the county's chief financial officer: "We're still happily collecting our money."

http://www.propublica.org/article/investors-haul-in-nearly-half-the-tobacco-settlement-cash?utm_medium=social&utm_campaign=sprout&utm_source=twitter