**Association of Bay Area Governments**

**Finance Committee**

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**October 21, 2021** **Agenda Item 6.a.**

**Pension Obligation Refinancing**

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## Subject:

ABAG Pension Obligation Refinancing

## Background:

The basic concept of the refinancing is to issue a new set of taxable bonds at an interest rate below that being charged by PERS on the outstanding liability. In order to accomplish this task, we need to utilize a few experts,

- Bond Counsel - NixonPeabody: The Nixon team is expert in documentation of the bond issue and structure securing the payment for the bondholders and has considerable experience in pension obligation refunding. NixonPeabody is the firm that guided the transfer of responsibility of ABAG FAN over to the ACFA Governing Board
- Financial Advisor – Public Financial Management (PFM): the financial advisor acts in a fiduciary capacity on behalf of the issuer, representing the issuer in matters of issue structure and fairness or the interest rate and overall cost and also provides the state-required Good Faith Estimate of total issuance and interest costs. PFM has been financial advisor in the ABAG FAN transition and also has significant experience in the structure and issuance of pension refundings.
- Underwriter – TBD: the underwriter helps prepare the issuance documents and acts between the initial issuance and final sale to bondholders.

Both Nixon and PFM have worked on the BATA financing team for several years and helped guide the transition of ABAG FAN to MTC administration.

The transaction itself will be fairly simple. The bonds will be issued through Advancing California Finance Authority (ACFA) and ultimately privately placed through the underwriter. Proceeds will be paid to PERS and we will get a subsequent actuarial report confirming the reduction of the liability. General financing terms include:

- Term: not to exceed 15 years
- Rate: 10-year treasury + 1.0% - adjusted annually
- Annual adjustment cap + .50%
- Cap rate: 3.40%
- Annual payment: $1.2 million increasing to $1.4 million
- Security: annual ABAG dues and available balances

The bonds will be privately placed; however, they will be structured to be available for resale to public investors at any time. The payment will be set at a fixed amount despite the variable interest rate on the bonds. The payment provides a clear discount from the current $1.7 million PERS amortization payment. Based on current rates, the initial payments provide savings of

$500,000 with minimum annual savings of $250,000 as rates increase. Any difference between the payment calculated and owed to bondholders and the scheduled payment will put toward additional principal retirement.

The obvious advantage is the savings from the current PERS amortization. However, there are risks as well as rewards in any refinancing where the liability is not completely known.

Benefits:

- General savings over current PERS costs – minimum annual savings estimated at $250,000
- Earning higher rate on PERS account than paying on bonds
- Rates will float to protect against lower rates
- Interest rates are capped, PERS is not
- Payment increases are capped on an annual basis
- Payment increases timed to match potential increase in ABAG dues structure

Risks:

- No guarantee PERS will not change actuarial calculations
- No guarantee PERS will not create new unfunded liability
- Shared liability pool is less predictable

There are two distinct areas of concern for which the refinancing will not guarantee total success. First, PERS is already evaluating adjustments to the discount rate which will result in an increase in the unfunded liability. While we can adjust for the expected new discount rate, PERS can adjust it further in the future. In addition, ABAG is part of a liability pool. It is far more difficult to evaluate the ABAG liability if the liability of the pool should increase in the future. PERS has indicated they track liabilities on an individual basis which would protect the ABAG position in the future.

Staff is requesting the ABAG Finance Committee agree to pursue the refinancing. Future steps will be:

- Retention of finance professionals. The legal, financial advisor and underwriter will be contracted through ACFA with fees paid out of the financing.
- Preparation of ABAG resolution agreeing to maintain dues at 110% of annual debt service for the life of the financing with debt service as the budgetary priority.
- Confirmation of ABAG ability of commit dues and assets to repayment of bonds.
- Development of ACFA issuance documents.
- Resolution of issuance approved by ACFA and MTC.

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Once we receive legal confirmation of the ability to commit set dues and commit them to debt service we will prepare the necessary issuance documents. The process will take approximately 60-90 days from completion of the legal analysis.

## Recommended Action:

The ABAG Finance Committee is requested to recommend ABAG Executive Board authorization to develop a pension bond financing to refinance the current unfunded ABAG pension obligation to PERS in an amount approximately $17 million that will be paid to PERS with the bonds paid off over 15 years.

## Attachment:

Presentation

## Reviewed:

Therese W. McMillan