MEMORANDUM

Date: February 4, 2021

To: The Honorable Chair and Members
Pima County Board of Supervisors

From: C.H. Huckelberry
County Administrator

Re: **Issuance of Debt to Address the Growing Pension System Payments of the County**

As previously discussed in the Memorandum to the Board dated January 5, 2021, the County has an unfunded liability of $259,986,600 (41.1% funded) for the Public Safety Personnel Retirement System (PSPRS) Plan and $83,230,103 (46.5% funded) for the Corrections Officer Retirement Plan (CORP) per the independent actuaries June 30, 2020 valuations.

These unfunded liabilities are paid as part of the annual contributions the County makes to these pension plans over a fixed time period through fiscal year 2037. As an alternative, the County has the opportunity to issue low interest rate debt to refinance a significant portion of the existing pension debt represented by these unfunded liabilities. This low interest rate debt is expected to provide the County significant annual General Fund savings, a portion of which could be used to fund any remaining unfunded liability in the PSPRS and CORP pension plans due to changes in actuarial assumptions.

County staff has worked extensively with the County's Financial Advisor (RBC Capital Markets) and legal bond counsel (Squire Patton Boggs) to develop the financing plan and approach described herein.

The following chart shows the projected payments, or contributions, into the PSPRS and CORP pension plans the County is required to make to pay off the County's existing pension debt or unfunded actuarial accrued liability. Also shown are the "normal" pension cost contributions the County is required to make annually to meet the ongoing benefit payments.

Pima County Total Estimated Contributions for PSPRS and CORP by Fiscal Year

Year	Normal Pension Costs	Unfunded Actuarial Accrued Liability	Total
2021	$ 4,373,744	$ 24,777,748	$ 29,151,492
2022	4,104,337	26,386,887	30,491,224
2023	3,922,504	28,108,439	32,030,943
2024	3,713,298	29,258,545	32,971,843
2025	3,481,395	30,611,627	34,093,022
2026	3,172,788	31,580,173	34,752,961
2027	2,862,815	33,025,653	35,888,468
2028	2,538,050	34,698,923	37,236,973
2029	2,235,146	36,234,682	38,469,828
2030	2,029,251	38,916,654	40,945,905
2031	1,789,625	40,984,132	42,773,757
2032	1,523,035	42,785,297	44,308,332
2033	1,353,406	46,277,743	47,631,149
2034	1,238,142	50,681,977	51,920,119
2035	1,129,435	56,785,677	57,915,112
2036	1,066,625	66,764,160	67,830,785
2037	997,642	7,542,362	8,540,004

Source: RBC Capital Markets Pima County PSPRS and CORP Analysis as of September 30, 2020 using the PSPRS and CORP June 30, 2019 Actuarial Valuation Reports.

As noted in the chart above, the unfunded liability contributions are forecasted to increase significantly over the next 16-year period. These increases are based on a number of actuarial assumptions, including such variables as investment earnings on monies held by the Plans, payroll growth, mortality rates for retirees in the Plans, benefit levels and other factors.

To the extent that the actual experience for these variables differs from what is currently assumed by the actuaries, the unfunded liability of the County and the annual contribution amounts will change. For example, investment earnings on monies held in the Plans is assumed by the actuaries to equal an annual return of 7.30% per year. If the actual investment return comes in below this assumption, the unfunded liability of the Plans will increase and the required contributions of the County will also increase. Conversely, when the actual results are better than what is assumed by the actuaries, the unfunded liability will decrease and the County's required contributions will decrease.

The fact that the unfunded liability amounts will fluctuate from the amounts presented in the table above based on actual results is an important element and something the County is taking into consideration when evaluating the alternative financing approach discussed below.

The concept of issuing County debt to pay down a significant portion of the County's unfunded plan liabilities, or pension debt, would entail issuing taxable debt obligations, which based on current market interest rates could be between 2.00% and 2.25%. The County's current contributions to the Plans are based on a discount rate of 7.30%; therefore, the County would be significantly lowering its assumed rate to pay off the unfunded liability.

To accomplish this financing approach, the Board would authorize by resolution the issuance of not to exceed $300 million of fixed rate taxable Pledged Revenue Obligations (Obligations). The proceeds of this financing would be paid into the County's PSPRS and CORP pension plans, thereby reducing the County's unfunded liability and in turn the County's annual required pension contributions from the General Fund. Annual debt service on the Obligations would be secured by and paid from a portion of various tax revenues paid into the County's General Fund (specifically State-shared sales taxes and vehicle license taxes deposited to the County's General Fund; County-imposed excise taxes, fees, fines, franchise taxes and penalties; and payments to the County made in lieu of taxes by various jurisdictions). The annual debt service payments made from these General Fund sources would be significantly less than the currently forecasted annual contributions to the pension Plans.

To accomplish the Pledged Revenue Obligations financing, the County's bond lawyers have indicated the financing needs to be structured as a lease/leaseback financing as the $300 million expense was not budgeted for in the Fiscal Year 2021 Adopted Budget. For purposes of the proposed Pledged Revenue Obligations, County staff identified the Sheriff's office facilities on East Benson Highway to be used for this purpose. This financing structure is very familiar to the County as it is similar to the legal structure used for the County's Certificate of Participation financings, with the key exception being that in the Pledged Revenue Obligation financing, the land and facilities do not serve as collateral or security for the debt Obligations.

Subject to the Board's adoption of an Authorizing Resolution to permit the issuance of the Pledged Revenue Obligations, County staff would look to move forward with the financing over the next several months while interest rates are forecasted to remain low. The proposed authorization would be for the issuance of not to exceed $300 million of taxable Pledged Revenue Obligations. This amount of authorization is estimated to fund the County's pension plans at approximately the 90% funded level (meaning the County would still have an approximate 10% unfunded liability), which County staff and the County's Financial Advisor believe is prudent in order to avoid the County being in an overfunded position relative to the pension plans. Based on these assumptions, as well as assumptions on the interest rates at which the Pledged Revenue Obligations can be sold to investors, the projected results for the County are shown below:

Pima County
Estimated Savings from Financing Approach for Pensions

		Estimated Post Financing Costs				
Fiscal Year Ending	Current Forecast of County Pension Contributions	Normal Cost Contributions	Unfunded Actuarial Accrued Liability	Pleded Revenue Obligations Estimated Debt Service	Total Estimated County Costs	Estimated Annual Savings for General Fund*
2021	$ 29,151,492	$ 4,373,744	$ 24,777,748	-	$ 29,151,492	-
2022	30,491,224	4,104,337	2,611,750	$ 6,397,208	13,113,295	$ 17,377,929
2023	32,030,943	3,922,504	2,783,057	6,617,802	13,323,363	18,707,580
2024	32,971,843	3,713,298	6,407,150	18,747,802	28,868,250	4,103,593
2025	34,093,022	3,481,395	6,540,643	20,075,088	30,097,126	3,995,896
2026	34,752,961	3,172,788	6,634,949	20,901,066	30,708,803	4,044,158
2027	35,888,468	2,862,815	6,780,134	22,238,464	31,881,413	4,007,055
2028	37,236,973	2,538,050	6,947,224	24,180,437	33,665,711	3,571,262
2029	38,469,828	2,235,146	7,099,552	25,395,330	34,730,028	3,739,800
2030	40,945,905	2,029,251	7,367,985	27,946,008	37,343,244	3,602,661
2031	42,773,757	1,789,625	7,573,705	28,943,609	38,306,939	4,466,818
2032	44,308,332	1,523,035	7,750,037	30,423,042	39,696,114	4,612,218
2033	47,631,149	1,353,406	8,101,421	31,864,567	41,319,394	6,311,755
2034	51,920,119	1,238,142	8,542,919	35,263,244	45,044,305	6,875,814
2035	57,915,112	1,129,435	9,161,462	36,717,206	47,008,103	10,907,009
2036	67,830,785	1,066,625	10,184,109	37,821,949	49,072,683	18,758,102
2037	8,540,004	1,037,598	4,502,905	-	5,540,503	2,999,501

* (1) Savings assume monies in Pension Plans are invested at an overall average rate of 6.00% per annum. A lower actual earnings rate will results in less savings for the County; a higher earnings rate will result in additional savings for the County.

(2) A portion of any savings realized will be deposited in to a Pension Reserve Fund held by the County to offset any future increases in unfunded liability and required pension contributions.

In reviewing the above chart, it is important to note that the "Estimated Annual Savings" totaling $118 million are dependent on the actual investment return earned by PSPRS on the proceeds of the Obligation issue that are paid into the pension plans to reduce the unfunded liability.

To be more conservative in calculating the possible savings, County staff and its Financial Advisor used an assumed earnings rate of 6.00% to calculate the unfunded actuarial accrued liability in the chart above instead of the 7.30% assumed by the Plan's actuaries to provide a more realistic assessment of the estimated benefits of this financing approach. To the extent the actual earnings exceed the 6.00% assumed return, the savings to the County will be greater; and to the extent the actual earnings are lower than the assumed 6.00%, the savings to the County will be lower. In the event that the actual earnings rate over the duration of the financing period is lower than the interest rate on the Obligations (currently assumed to be a rate of approximately 2.15%), the proposed financing plan would actually result in a higher cost to the County than not issuing the proposed Obligations. Given the low interest rates expected for the Obligation issue, staff believes it is unlikely that the actual earnings level over the next 15 years would average out to be less than the estimated 2.15% borrowing cost.

In conjunction with the issuance of the Obligations, the County also plans to establish a "Pension Fund Reserve". The Reserve will be funded from a portion of the projected savings achieved from the proposed financing, along with any budgeted savings in personnel costs in the Sheriff's Department General Fund. The Reserve will provide a source of funds from which the County can make any additional contributions that may be required in future years.

County staff is working with the County's Financial Advisor and legal bond counsel to draft the necessary legal documents, including the Resolution authorizing the issuance of up to $300 million in Pledged Revenue Obligations for consideration by the Board at its February 16, 2021 meeting. If any member of the Board would like additional information concerning the planned financing approach prior to that meeting, please do not hesitate to reach out and we will provide that information.

CHH/mp

c: Jan Lesher, Chief Deputy County Administrator
Michelle Campagne, Director, Finance and Risk Management