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.
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:
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