Pension Brief: POBs See Increasing Activity In Low-Interest-Rate Environment

October 14, 2020

With record low interest rates, pension plan sponsors are increasingly turning to pension obligation bonds (POBs) for a variety of reasons. At S&P Global Ratings, we understand the importance of monitoring not only expected interest savings, but also the risks associated with market volatility. (See Related Research for links to other articles with our views on pension-related obligation bonds.)

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Between Jan. 1, 2018, and Oct. 1, 2020, S&P Global Ratings has rated 25 new POB issuances in the public sector totaling nearly $3 billion--22 by cities and three by fire districts.

Count Of POBs Rated By S&P Global Ratings

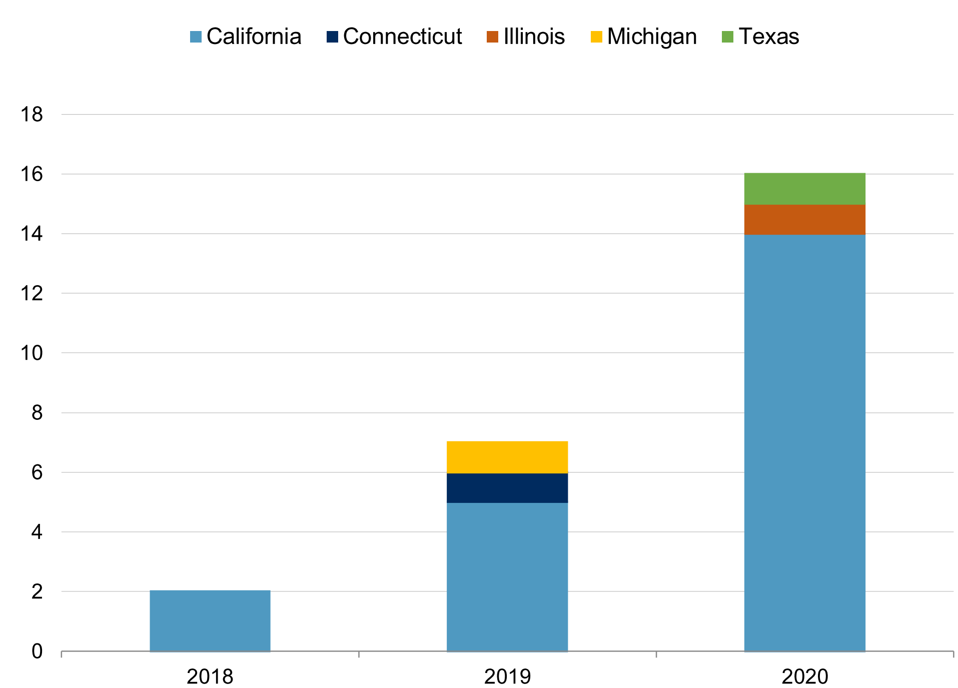

Table 1

22 City POBs--Averages

	Pre-POB (%)	Post-POB (%)	Result (%)
Affected pension funded ratios	69	96	+27
Net direct debt as % of government revenues	132	244	+112
Pension + OPEB contributions as % of government expenditures	12.5	4.8	(7.7)
Debt service as % of government expenditures	5.3	12.1	+6.8

Some Sponsors Have Used Expected POB Savings To Speed Up Funding Progress

Directly comparing the 7.7-point decrease to contributions against the 6.8-point increase to debt service might lead to a conclusion that expected savings are overhyped and represent less than 1% of government expenditures in cost savings, but this comparison is not necessarily apples-to-apples since the debt repayment schedule may not mimic that of the pension amortization. Many sponsors are repaying the bond on a more conservative schedule than the pension amortization by either shortening the amortization length or shifting from an increasing level percent of pay basis to that of a level dollar, which pushes formerly-deferred costs forward in the schedule. Annual savings in such cases are expected to grow over time.

For example, Baldwin Park, Calif., issued $54 million in POBs in January 2019 to nearly fully fund its CalPERS Miscellaneous and Safety liabilities. The city structured the POBs using a 25-year, level dollar amortization, which we noted to be three years shorter than the combined pension amortization lengths as well as more front loaded than the increasing pension payment schedule.

A vast majority of the POBs we rated are from California, where CalPERS Miscellaneous and Safety plans amortize unfunded liabilities using a layered approach that amortizes new unfunded liabilities individually each year as a new "base." POBs have been used in California as a means to smooth volatile contributions. Additionally, CalPERS recently switched from a 30-year level percent of pay basis to 20-year level dollar, which pushes previously deferred costs forward to be addressed more quickly, but this only applies to new bases going forward. When the POB is amortized under a level dollar approach, it applies to all current and future bases being paid down and has a broader impact on the budget as well as plan funding.

California Issuers Get A New Lease On Life By Using Streets To Fund Pensions

A POB is defined by where the money goes, such as a pension trust, and not how it is being repaid. S&P Global Ratings assigns ratings to POBs based on the issuer's repayment pledge. Typically, POBs are rated on par with the general obligation (GO) or general creditworthiness of the issuer if all legally available resources, or its full faith and credit, are used to secure the bonds. In

California, as an effort to speed up and simplify POB issuances, some cities are securing them with lease appropriations which are often easier to issue. The cities of West Covina and Torrance leased certain streets valued above the desired POB par amount to fund pension obligations for the cities, structured in a way that there would be no material risk to street ownership or abatement risk. However, S&P Global Ratings views lease appropriations as weaker than a GO or legally available funds pledges, and begin our rating analysis at least one notch below that of an issuer's GO rating. Both Torrance and West Covina lease appropriation bonds were rated one notch below our view of their general creditworthiness to account for appropriation risk.

Table 2

POBs Rated By S&P Global Ratings Jan. 1, 2018-Oct. 1, 2020

Issuer	State	Rating date	Amount (Mil. $)	Pension plan	Issue rating
Riverside	CA	5/21/2020	432	CalPERS Misc & Safety	AA/Stable
Torrance	CA	9/23/2020	349	CalPERS Misc & Safety	AA/Negative
Tulare County	CA	5/18/2018	251	TCERA	AA-/Stable
Ontario	CA	5/7/2020	237	CalPERS Misc & Safety	AA/Stable
Pomona	CA	8/6/2020	220	CalPERS Misc & Safety	AA-/Negative
West Covina	CA	7/17/2020	204	CalPERS Misc & Safety	A+/Stable
Arlington	TX	7/9/2020	192	TMRS	AAA/Stable
Montebello	CA	5/15/2020	153	CalPERS Misc & Safety	A+/Negative
Hawthorne	CA	9/11/2019	122	CalPERS Misc & Safety	AA-/Stable
El Monte	CA	5/26/2020	119	CalPERS Misc & Safety	A+/Negative
Bridgeport	CT	9/24/2019	117	Public Safety Plan A	A/Stable
Carson	CA	6/4/2020	108	CalPERS Safety	AA-/Stable
Inglewood	CA	6/11/2020	102	CalPERS Misc & Safety	AA-/Stable
Azusa	CA	9/9/2020	70	CalPERS Misc & Safety	AA-/Stable
Glendora	CA	8/13/2019	64	CalPERS Misc & Safety	AAA/Stable
Baldwin Pk	CA	1/23/2019	54	CalPERS Misc & Safety	AA-/Stable
La Verne	CA	7/16/2018	54	CalPERS Misc & Safety	AA+/Stable
Wauconda Fire Protection District	IL	9/14/2020	26	Firefighters plan	A+/Stable
Monterey County Regional Fire Protection District	CA	11/13/2019	20	CalPERS Misc & Safety	AA-/Stable
North County Fire Protection District	CA	6/4/2020	20	CalPERS Safety	AA-/Stable
Larkspur	CA	3/18/2020	19	CalPERS Misc & Safety	AAA/Stable
Grass Vy	CA	2/20/2020	16	CalPERS Misc & Safety	AA/Stable
Marysville	CA	9/5/2019	15	CalPERS Misc & Safety	A/Stable
Chowchilla	CA	4/17/2020	11	CalPERS Misc & Safety	A+/Stable
Rogers City	MI	6/3/2019	6	MI MERS (A)	A/Stable

Related Research

Pension Obligation Bonds' Credit Impact On U.S. State And Local Government Issuers, Dec. 6, 2017

OPEB Brief: The Credit Impacts Of OPEB Obligation Bonds, March 11, 2019

This report does not constitute a rating action.