County of Butte

Pension Obligation Bond Payment Strategy Summary

Butte County
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Butte County Administration

Pension Obligation Bond Payment Strategy Summary - May 2019
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BACKGROUND

In 2004 the County of Butte issued pension obligation bonds (POBs) in three series (Series A, B and C) to save future interest costs associated with the County's employee pension obligations. Prior to the bond issues, the California Public Employee Retirement System (CalPERS) was charging Butte County 8.25% per year for approximately $50 million in unfunded pension plan liabilities.

The County's POB 2004 Series A issued for $28.02 million are taxable fixed rate bonds with annual principal payments, which started on June 1, 2014 and continue through June 1, 2034. The bonds have an interest rate of 5.408% through fiscal year 2023-24 and an interest rate of 6.076% from fiscal year 2024-25 through maturity.

The County's POB 2004 Series B issued for $21.875 million are taxable variable rate bonds with annual mandatory sinking fund principal payments, which started on June 1, 2014 and continue through June 1, 2034. The bonds' variable rate is set monthly at London Interbank Overnight Rate (LIBOR) plus 30 basis points.

The County's POB 2004 Series C was a short-term bond series that was paid in full on September 1, 2007.

The County issued POBs in 2004 to save future costs that are ultimately charged to various County departmental budgets as a percentage of payroll. CalPERS was charging the County a higher interest cost than the interest cost that was available in the municipal bond market at that time.

In late 2011, with bond principal payments approaching, and annual debt service expected to increase over time, the Finance Work Team comprised of seven County department heads reviewed the POB obligations, payment management to date, and financing options with assistance from KNN Public Finance (KNN), a municipal bond financial advisor. KNN was hired to help answer technical and bond market questions to fine-tune the County's strategy.

Subsequently, the Finance Work Team asked KNN to develop a payment scenario with a five year ramp up of payroll collections to get to a more sustainable department budget collection rate over the remainder of the debt period.

PENSION BOND PAYMENT STRATEGY

On January 10, 2012 at the recommendation of the Finance Work Team and KNN, the Board adopted a payment strategy for the POBs that maintained a consistent percent of payroll charges to department budgets with a five year ramp up to approximately 3% of payroll. The strategy also included a provision for the County to annually revisit the strategy to update the balances and rates and determine if a pre-payment plan for Series B has become advantageous. The initial ramp up and projected payroll collections rates were as follows:

Projected Payroll Collection Rates

Fiscal Year	Total % of Payroll	Miscellaneous Rate	Safety Rate
2012-2013	2.00%	1.70%	3.41%
2013-2014	2.25%	1.89%	4.06%
2014-2015	2.50%	2.10%	4.51%
2015-2016	2.75%	2.31%	4.96%
2016-2017	3.08%	2.58%	5.54%

(through 2034)

Note: Every year the amount collected as a percentage of payroll will be significantly higher for public safety plan employees than for miscellaneous plan employees because of the significant difference in CalPERS unfunded pension liabilities paid off in 2004 for the two pension plans when the POBs were issued. The payroll collection rates in fiscal year 2011-2012 are 1.43% for miscellaneous payroll and 3.07% for safety payroll.

CURRENT STATUS

The implementation of the Pension Obligation Bond Payment Strategy has continued since it was adopted in 2012. Due to the low variable interest rate since 2012, payroll collection rates are lower than originally projected. Annually staff provides KNN current balances and data so KNN can update the strategy using current and projected interest rates and consider options to pre-pay and/ or restructure Series B.

In 2020 the County refunded the Series B Pension Obligation Bonds as historically low interest rates gave the County an opportunity to negotiate new terms with the holder of the Series B bonds for a fixed rate of 1.17% and prepaid $9.5 million; thus eliminating the variable interest rate risk over the remaining loan term.

Department payroll collections for the Series A and new refunded bonds debt service will average approximately 2.36% of payroll per year for the remaining terms of the bonds (2034 for series A and 2029 for the newly issues bonds). The collection rate for the Series A and refunded bonds is projected to average 2.58% until the refunded bonds mature in 2029 and decrease to 2.00% thereafter, until the Series A bonds mature in 2034. Since FY 2012-13, the average department collections rate has also been 2.36% of payroll.