PORTLAND PUBLIC SCHOOLS
OFFICE OF Chief Financial Officer

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Date: May 25, 2021

To: School Board of Directors

From: Nolberto Delgadillo, CFO

Subject: Update to Issue Revenue Bonds to Finance Pension Liability at Max TIC of 4%

BACKGROUND

A Limited Tax Pension Bond (i.e. PERS Obligation Bond or POB) are bonds issued by state or local governments to fund public employee pensions. This is seen as a financial strategy to potentially lower costs of pension funding by benefiting when the true interest cost (TIC) of the POB is low relative to the potential future return of investments. Fundamentally, if returns are greater than the borrowing rate then borrowers should expect to have lower pension costs than they would otherwise be; if returns equal borrowing rate, then borrowers should expect to break even; and if returns are less than the borrowing rate then borrowers would be worse off than if they had not issued the bonds.

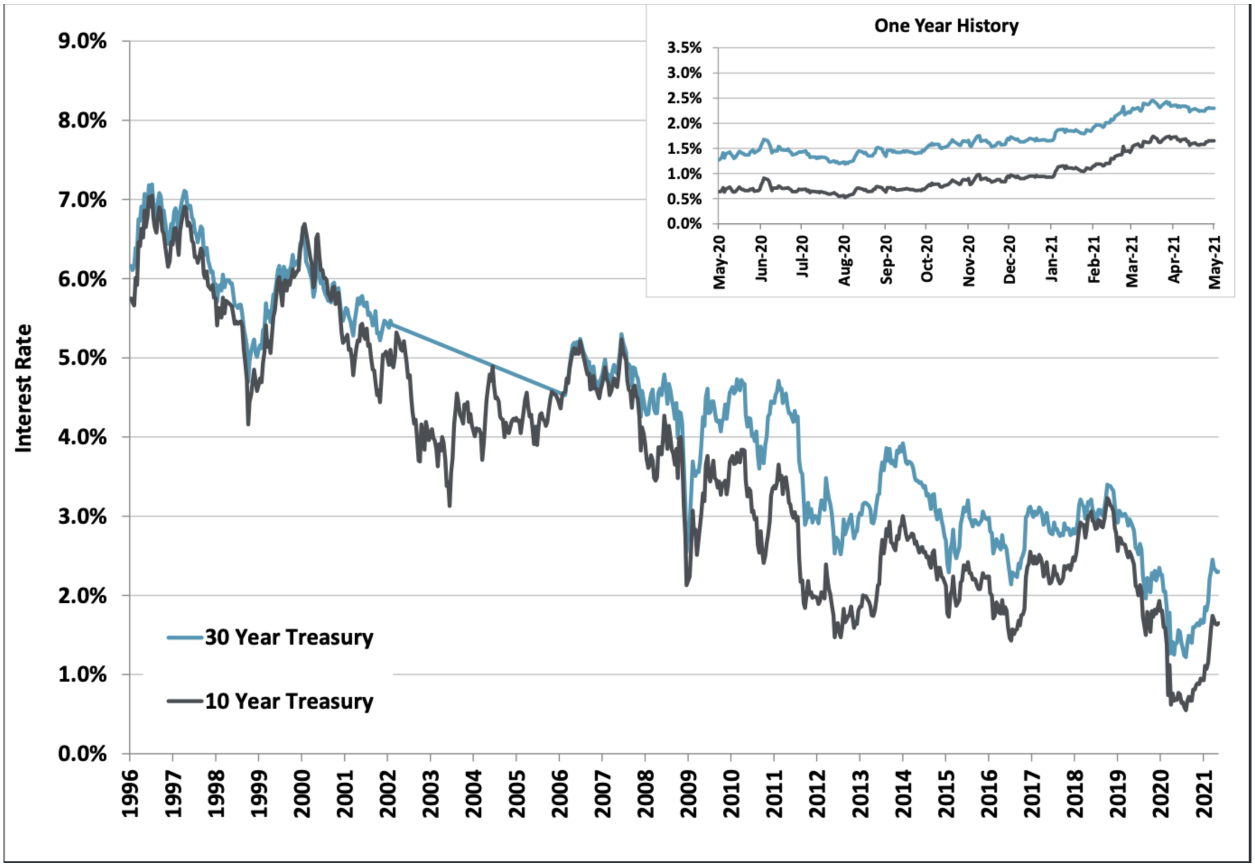
The current historically low interest rates make it worth considering pursuing a Limited Tax Pension Bond (i.e. PERS obligation bond) to finance and refinance the District's share of the estimated unfunded pension liability. The district has previously done this in 2002, 2003 and 2012, and has successfully saved millions of dollars. We are working with our bond financial advisors, Piper Sandler & Co and bond counsel, Hawkins, Delafield and Wood to prepare this recommendation.

RELATED POLICIES/BEST PRACTICES

Under federal tax law, POBs must be sold on a taxable basis, so borrowing rates are higher than on capital (tax-exempt) borrowings. Furthermore, prior to the issuance of full faith and credit pension bonds, Portland Public Schools has obtained a statistically based assessment from ECONorthwest entitled "Issuance of Pension Obligation Bonds – A Risk/Reward Analysis" pursuant to ORS 238.697(1)(a).

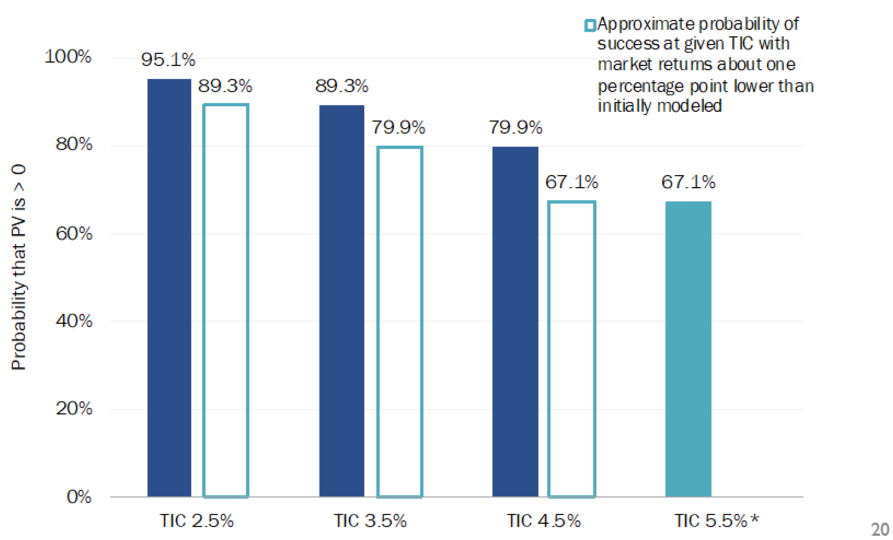
ANALYSIS OF SITUATION

The concept is to borrow at low interest rates and send bond proceeds to a PERS side account; if returns exceed the borrowing rate, then the school district will save. The current market conditions favor low interest rates:



However, there is some uncertainty with what the earning rates (this is a projected rate of return) will be. To account for the variation in the earning rates, the analysis included modeling out the variation in the probability of producing a favorable return:

*The fourth TIC of 5.5% was added to our analysis to help evaluate the potential risk associated with less-favorable future market conditions relative to those anticipated in our original report. For example, the 5.5% TIC scenario provides output that is roughly analogous to a 4.5% TIC bond issue with market returns approximately one percentage point below those anticipated in our original analysis. The 4.5% TIC scenario can be similarly compared to the 3.5% TIC scenario output, and so on.



What the chart shows on the y-axis is the probability that the present value will be greater than zero (i.e. lowering pension costs/saving money). The x-axis represents what the true interest cost borrowing rate would be. For TICs 2.5%, 3.5% and 4.5% the solid-colored bar is the probability under the initial earnings simulations, while the white bars represent the probability of success under market returns of about one percent lower.

Information to further inform whether market rate returns may be about one percent lower is scheduled to be released in June-2021. Therefore, this analysis uses the available market return data and created an updated scenario to model out unfavorable market conditions by using the TIC as a proxy for unfavorable market conditions by about one percent.

An example of how to read this is, with the current market information that we have now , if the bond were sold at a TIC of 4.5%, there is an approximate probability of 79.9% for lowering pension costs. If market returns will be about one percent lower than the information we have now (6.2%), there would be an approximate probability of success of 67.1%.

The current projection is anticipating securing a TIC of approximately 3.5%.

FISCAL IMPACT

The district's previous three PERS Bond issuances done in 2002, 2003 and 2012, were for a combined $491,673,897 and generated present value savings of approximately $184.6 million.

For this issuance the payoff amount is projected to be approximately $393,266,844 million. Under the base case scenario of an assumed earning rate of 7.2% and a TIC of 3.5% the estimated present value savings is projected to be approximately $125.7 million.

TIMELINE FOR IMPLEMENTATION / EVALUATION

- May 25: Board Approves Resolution
- April-June: Development of Disclosure Document, Rating
- May 24th: During this week complete diligence and rating calls
- June 30: Bond Sale
- July 15: Closing, funds sent to PERS
- August 1: Payroll rates reduced.

BOARD OPTIONS WITH ANALYSIS

Option 1 – Not pursue the bond: the primary drawback is potential of missing out on an opportunity to significantly reduce pension costs and save the district millions of dollars. The primary benefit is eliminating all risks associated with pursuing pension obligation bonds.

Option 2 – Wait for the June-2021 report to get more information regarding market conditions: The primary benefit is that there will be more up to date information to inform models for probability of success. The primary drawback is that the wait will push out the timeline and therefore potentially increase the likelihood of not being able to secure the lowest interest rate possible.

Option 3 – Pursue the pension obligation bond so long as the true interest cost does not go above a specific threshold: The primary benefit for specifying a max TIC is providing management with approval to move forward but with guidance that matches risk tolerance. The primary drawback is that timing to complete the POB process may cause for the TIC to go above the threshold and therefore miss out on the opportunity to lower pension costs.

CONNECTION TO BOARD GOALS

Although there is no direct connection to a specific board goal, the opportunity to lower pension cost will provide us with an opportunity to continue to focus as many dollars as possible to achieving the board goals.

STAFF RECOMMENDATION

The primary recommendation does not change from the prior staff report, which is to pursue option 3 to approve "Resolution Authorizing Pension Bonds and Related Matters" so long as the true interest cost does not go above a specific threshold. The specific threshold would be a max TIC of 4.0%. After consulting with the board of directors, we revised the max TIC from 4.5% to 4.0%.

Taking into account that the analysis approximates a base market condition with a TIC of 3.5%, by approving the resolution with a max TIC of 4.0%, it provides flexibility in securing the bond. In the unlikely event that interest rates rose up to 4.0% by the time the bond sale occurred, based on the ECONorthwest, analysis, if the bond were sold at a TIC of 4.0%, there is an approximate probability of between 67% and 79% for lowering pension costs.

The current market conditions favor the likelihood of securing a TIC closer to 3.5%, therefore, there is an approximate probability of greater than 79.9% for lowering pension costs. The following table provides additional rationale that the expected value of this POB strategy is positive (in present value terms) through a broad array of scenarios.

Summary PV Statistics, by Scenario

*The fourth TIC of 5.5% was added to our analysis to help evaluate the potential risk associated with less-favorable future market conditions relative to those anticipated in our original report. For example, the 5.5% TIC scenario provides output that is roughly analogous to a 4.5% TIC bond issue with market returns approximately one percentage point below those anticipated in our original analysis. The 4.5% TIC scenario can be similarly compared to the 3.5% TIC scenario output, and so on.

No. of Tranches	1	1	1	1
Rate (TIC)	2.5%	3.5%	4.5%	5.5%*
Mean	$548,932	$402,262	$274,215	$162,064
Std Deviation	$419,122	$370,750	$329,071	$293,051
Maximum	$3,393,617	$2,967,149	$2,592,638	$2,262,810
Minimum	$(336,091)	$(385,105)	$(428,435)	$(466,879)
95th Perc	$1,322,700	$1,088,074	$882,791	$703,077
90th Perc	$1,104,226	$893,399	$709,810	$548,797
75th Perc	$770,245	$599,774	$450,156	$320,087
50th Perc	$480,961	$342,299	$220,903	$114,852
25th Perc	$248,540	$136,280	$38,418	$(47,779)
10th Perc	$85,882	$(8,851)	$(91,354)	$(163,865)
5th Perc (VaR)	$2,913	$(82,433)	$(157,047)	$(222,771)
Zero Bound Perc	95.1%	89.3%	79.9%	67.1%

This table summarizes the simulations of the present value of potential gains from implementing a POB strategy. All dollar amounts are per $1 million of POB funding.

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As a member of the PPS Executive Leadership Team, I have reviewed this staff report.

__*CH*______ *(Initials)*

ATTACHMENTS

A. Presentation from Carol Samuels, Managing Director, Piper Sandler

B. Resolution Authorizing Pension Bonds and Related Matters