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DATE: May 18, 2021
TO: Portland Public Schools Staff and Board of Education
FROM: Andrew Dyke, ECONorthwest
SUBJECT: Review of Pension Obligation Bond Scenarios

Introduction

ECONorthwest recently conducted an analysis for the Oregon Association of School Business Officials (OASBO) to evaluate the risks and rewards of Pension Obligation Bond (POB) issuance by public employers that are part of the Oregon Public Employee Retirement System (OPERS). Employers may benefit from a POB bond issue if the costs of bond repayment are low relative to the potential earnings from the corresponding PERS side account over the same period as the bond issue. However, a successful outcome is not guaranteed. The costs of the POB debt would be known, but the future rates of return to side account deposits are not known with certainty. The ECONorthwest analysis provides information about the potential magnitude of the risks associated with this uncertainty.

ECONorthwest relied on this prior analysis to review and provide context for the three POB scenarios presented by Piper Sandler to the PPS School Board on May 11, 2021. ECONorthwest was not involved in scenario development. The scenarios are described briefly below, along with an assessment of each scenario's outcomes with respect to results from the prior analysis.

Based on this review we conclude that, in combination with the ECONorthwest analysis, the three scenarios provide a range of plausible outcomes that illustrate the potential risks to PPS from a POB bond issue at a True Interest Cost (TIC) of 3.5%. Actual outcomes could be better or worse than those described below.

Review of POB bond scenarios

All three scenarios assume a TIC of 3.5% and rely on a similar approach to calculating the benefits (rate credits) derived from side account deposits, and the costs of the bond issue. The difference (benefits minus costs) identifies the potential net savings associated with a bond issue under specific assumptions about side account earnings. The assumed earnings rate on side account deposits differentiates the scenarios.

2002 scenario

The 2002 scenario assumes returns consistent with the experience of districts, including PPS, that issued POB bonds in 2002. Returns for the final two years of the side account are assumed to be 7.2% annually. ECONorthwest modeling suggests approximately a one-in-seven (15%) chance that side account returns would produce net savings as good or better than those suggested by this scenario.

Base Case scenario

The Base Case scenario assumes a constant 7.2% annual rate of return on side accounts for the life of the side account. ECONorthwest modeling suggests an approximately one-in-three (33%) chance that side account returns would produce net savings as good or better than those suggested by this scenario.

2007 scenario

The 2007 scenario assumes returns consistent with annual returns observed during and subsequent to the Great Recession, beginning 2007. Returns for the final seven years of the side account are assumed to be 7.2% annually. ECONorthwest modeling suggests an approximately three-in-five (60%) chance that side account returns would produce net savings as good or better than those suggested by the scenarios.

Probability of positive net savings

Other results from the ECONorthwest analysis provide additional context. Specifically, the modeling suggests an approximately four-in-five (80%) chance that side account returns would produce greater than zero net savings, in present value terms. Additional information published by ECONorthwest characterizes the likelihood and potential magnitude of negative net savings potentially produced by side account deposits in less-favorable scenarios.

Caveats and disclaimers

The analysis provided in this document was developed by ECONorthwest for informational purposes only. All possible professional care was taken to prepare a realistic emulation of the likely POB side account behavior, and the OPERS procedures for accommodating POBs. It should be recognized, however, that there are practical limits to the precision with which market and agency behavior can be modeled. The generic nature of the modeling performed may or may not be relevant to the circumstances of any one public employer. Additionally, nothing herein should be construed as offering investment advice or fairness opinions for the purpose of issuing securities. For this, interested parties should seek out professional counsel.

ECONorthwest has no vested interest in the issuance of POBs by Portland Public Schools or any other public employer.