

AK LEGISLATURE FINANCE COMMITTEES FILES 2007-2008 3146

28

CHAPTER EIGHT

New York

A greater number of POBs (roughly 95) have been issued by the state and local governments in New York over the past decade than from any other state.

The issuance of POBs by local governments in New York was first authorized in 1989. The State and Local Employees Retirement System of the State of New York ("ERS"), the New York State Police and Fire Retirement System ("PFRS") and the New York State Teachers Retirement System ("TRS"; in the aggregate referred to as the "NYS Retirement System") were all modified in 1989 with respect to the method by which the annual contribution amounts were to be calculated in the future. As a result, each system was significantly underfunded, requiring a "catch-up" payment to return to actuarial full funding. Participating local governmental units were offered the option of (1) amortizing the UAAL amount due by a date certain through a direct loan from the State which carried an 8% (for TRS) or 8 $\frac{1}{4}$ % (for ERS and PFRS) rate of interest until the liability was fully met, or (2) financing the UAAL through the issuance of general obligation bonds over a statutory period (applicable to the particular retirement system), or (3) paying cash by the date certain. Few local governments, except small jurisdictions with few employees, took the third option.

During the period 1989 through 1993, counties, cities and larger school districts, in particular, issued general obligation bonds to pay off their then current balance of unamortized UAAL whenever interest rates dipped sufficiently to permit a lower net interest cost on their own bonds than the 8% or 8 $\frac{1}{4}$ % rate being charged by the State. During this period, local governments could issue ten year general obligation bonds with net interest costs in the range of 6% to 7.375% depending on their credit rating. The 1989 legislation further provided that at such time as the remaining amortization period was less than five years, local governments could no longer issue

their own debt to pay off the outstanding balances. Thus, with a permitted maximum statutory amortization period of seventeen years for most UAALs, the possibility of financing of the 1389 UAALs ended in the 2001-2002 fiscal year of most local governments.

Beginning in 1995, the State adopted legislation almost every year creating new retirement incentive programs for various categories of State and local government employees, largely to support a goal of efficient downsizing of government. Generally, the legislation establishing these programs did not at the time include provisions for financing of the resulting unfunded liabilities. Such costs, which added to any existing UAAL, were paid either by amortization through the NYS Retirement System or by cash.

Concurrently in this time period, another type of pension-related program was developed by the State legislature which authorized local governments to create service award and defined benefit programs for volunteer ambulance and fire-fighting personnel. The legislation permitted the financing of contributions to certain of such programs attributable to years of volunteer service rendered during the five years prior to adoption of such programs. Such financing cannot be amortized over a period exceeding five years.

In 2003, new legislation was adopted for the purpose of structural reform in the method and manner of employer contributions to the NYS Retirement System, which legislation also included two provisions for the issuance of POBs:

1. Local governments are now permitted to issue POBs for any outstanding obligations to the State for any existing retirement incentive program (*i.e.*, the retirement incentive programs established annually in the years from 1995 through 2002). (This provision was drafted by Orrick attorneys on behalf of the New York State Association of Counties.) The amortization period is limited to five years.
2. Similar to the 1989 legislation, a local government (and the State itself with regard to its own employees) is permitted to amortize a portion of its normal annual contribution for one fiscal year – that is, local governments are permitted

to amortize the amount due on December 15, 2004 to the ERS or PFRS component of the NYS Retirement System (except deficiency payments, adjustments relating to prior year payments, obligations for retirement incentives or other similar amounts) to the extent that such amount exceeds 7% of the estimated "pensionable salary" base for the then current fiscal year (2004-2005). This "amount eligible for amortization" may be amortized over a five year period at 8% with the State, or local governments are authorized to issue their own debt obligations to pay such amount, with maximum maturity not to exceed five years. On or about October 15, 2003, the State Comptroller is to determine the "amounts eligible for amortization."

The only type of financing specifically authorized for POBs in New York State are general obligation bonds (which obligations include a pledge of the full faith and credit and taxing power of the local government). These bonds must be issued in the same manner, under the same procedural requirements and subject to the same debt limits and other constraints as for any capital project of the local government. Mandatory or permissive referendum requirements applicable to general obligation bonds of the particular type of local government apply to bond resolutions authorizing POBs. For example, school districts must receive voter approval before issuing debt for any purpose authorized by the 2003 legislation. (Note that the legislation in 1989 exempted such school district POBs from the voter approval requirement; this omission in the 2003 legislation may be corrected during a future legislative session.) Likewise, fire districts would need prior voter approval. The bond resolutions of counties, towns and villages which authorize payment for five years or less are not subject to mandatory or permissive referendum. Similarly, city bond ordinances should not be subject to mandatory or permissive referendum unless specified by applicable special city charter provisions.

Once a bond resolution has been adopted by a local government authorizing the issuance of POBs, it is generally necessary to publish a legal notice of estoppel including a summary of the bond resolution and allow the 20-day estoppel period to elapse prior to the sale of the POBs. The purpose of the estoppel notice is to ensure that debt issued by the local government cannot be challenged on any basis.

procedural or otherwise, except on constitutional grounds once the estoppel period elapsed.

The New York State Legislature has also authorized the State itself to borrow in order to fund its UAAL on at least two occasions. In 1996, the State through the Dormitory Authority of the State of New York issued \$773,475,000 of POBs as annual appropriation debt. These bonds had a final maturity in 2003. The 2003 legislation described above also amended the State Retirement and Social Security Law to authorize the State to amortize a portion of the State's contribution bill for the fiscal year ending March 31, 2005. The amortizable portion is calculated in the same manner as that permitted local governments. Likewise, the State may either amortize that portion through the office of the State Comptroller for five years at 8% or issue POBs.

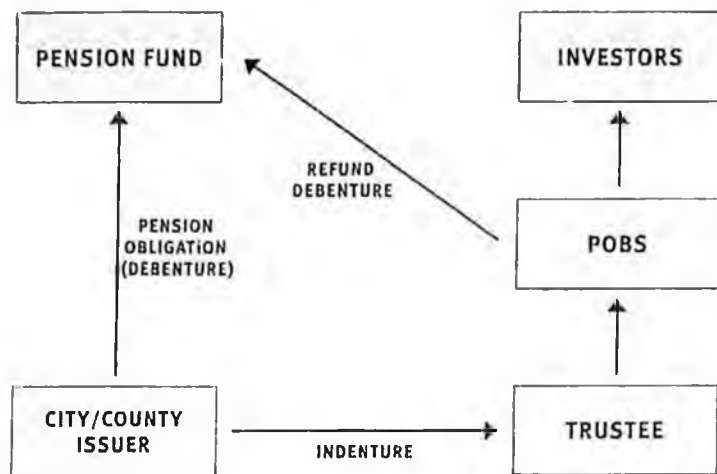
CHAPTER NINE

California

Pension obligation bonds had their start with the famous City of Oakland, California pension bond financing in 1985, the first POB in the country, which Orrick helped to invent and for which it served as bond counsel. That financing and a number of copy-cats that rapidly followed were tax-exempt and primarily driven by then legal arbitrage possibilities. As explained in Chapter 6, tax-exempt POBs largely came to an end with the introduction of tax legislation that became part of the Tax Reform Act of 1986.

A new taxable version of POBs surfaced in late 1993. During the last decade since, thirteen or so cities and seventeen or so counties in California have issued over 60 POBs (second only to New York) aggregating more than \$11 billion (more than from any other state). With the exception of one tax-exempt transaction rule (see Chapter 6C) POB transactions issued as lease revenue bonds, all of these POBs have been issued under the local agency refunding law (drafted by Orrick a few years before for other purposes). California cities and counties do not have specific authority to issue POBs.⁶ However, the local agency refunding law is available to all local public entities in California to refund prior bonds or "other evidence of indebtedness." The pension obligation to the county pension system, the California Public Employees Retirement System or other retirement system is memorialized as a "debenture," thereby becoming an "evidence of indebtedness," which can be refunded by POBs under the local agency refunding law.

⁶ The State of California enacted specific authority for State POBs in 2003.



The POBs are typically structured as obligations payable from the general fund of the city or county issuer. They are not full faith and credit taxing power general obligation bonds backed by the issuer's taxing power, because the California Constitution's debt limitation requires such type of bonds to be approved by two-thirds of the electorate. Instead, California POBs have generally been designed to be valid without voter approval under a judicially created exception to the State Constitution debt limitation, which exception is generally referred to as "obligations imposed by law". See discussion in Section A2 of Chapter 5. Because this exception to the Constitutional debt limit was and is much less developed in the case law (few cases not directly on point) than the other two judicially created exceptions (for lease financing and revenue bonds) each POB issue in California has been validated pursuant to California's validation statute (Code of Civil Procedure §§860 *et seq.*).

While there have been many validation actions for POBs, so far they have all ended with a default judgment and no published opinion, meaning that they have no precedential value or application to any transaction other than the specific transaction(s) validated.

What is validated in such validation actions is not legal principles but the bonds and the other principal legal documents approved in a bond resolution. Before the

validation action is filed, it is necessary for the state or local government issuer to first adopt the resolution and authorize the bonds, the documents and the validation action. The validation action is filed in the superior court of the county in which the issuer is located, and an order for publication of summons is received. Summons can then be published (usually in a newspaper of general circulation in the city or county in which the issuer is located), which takes a minimum of 21 days. If no one answers the complaint by the date specified in the summons, which must be at least 10 days after completion of publication, the clerk can enter a default, and schedule a hearing before the judge for the default judgment (the timing of which will depend on the jurisdiction, and may be a day or two or, in some jurisdictions, at least 15 days after the clerk enters the default).

So assuming the very best case, obtaining a validation judgment takes a minimum of 31 to 46 days (depending on the jurisdiction) after filing the validation complaint. Of course, issuers are at the mercy of the judge and the clerk, and it sometimes takes a week or more to get an order for publication of summons, or longer than 15 days after the clerk enters a default to schedule the hearing. In addition, the judge could take the matter under submission for an indefinite amount of time, or even disagree with the proposed default judgment, and decline to validate the transaction. Once granted, the default judgment may be appealed on jurisdictional grounds within 30 days. Therefore, it is typically assumed that the validation action will take approximately 60 days (not including the appeal period). It is generally considered reasonable to sell the POBs without waiting for the 30 day appeal period to run, assuming no one has answered the complaint, because the grounds for appeal are so narrow, but usually the bond closing does not occur until after the appeal period has expired.

If someone does answer the complaint, then there is true two party litigation on the merits. While some expedited procedures are available, the timing for resolution of the litigation cannot be predicted, and may take many months unless settled or abandoned. So far, no one has answered the complaint and default judgments have been obtained for every city and county POB issuer. However, the same was not true of the State of California, whose validation complaint was answered by the Howard Jarvis Taxpayers Association, and resulted in a decision on September 23, 2003 by

the Sacramento County Superior Court declining to validate the State's proposed POBs, which decision, as of this writing, is being appealed by the State.

The validation actions can and usually do validate not only the POBs to be issued but also any future POBs or refunding POBs. Not all validation actions are as inclusive or as flexible as they could be (some leaving out future new money or refunding POBs or costs of issuance or locking in semiannual interest payment dates, etc.), and must be carefully reviewed before relied on for future POBs or refunding POBs.

Note, as mentioned in Section A2 of Chapter 5, that the "obligations imposed by law" concept that is generally used to support POBs in California does not support reserves or capitalized interest because inclusion of such components in the bond issue are considered volitional not mandatory (as evidenced by the numerous California POBs issued without them) and therefore not "obligations imposed by law." Costs of issuance, on the other hand, can be included on the theory that they cannot be avoided. The inability to include capitalized interest makes achieving current budget relief more challenging (see discussion of structure options in Section C of Chapter 5). Alternatively, the POBs could be issued as annual appropriation bonds or asset-strip lease revenue bonds (see Section A3 and 4 of Chapter 5), which can include reserves and capitalized interest.

CHAPTER TEN

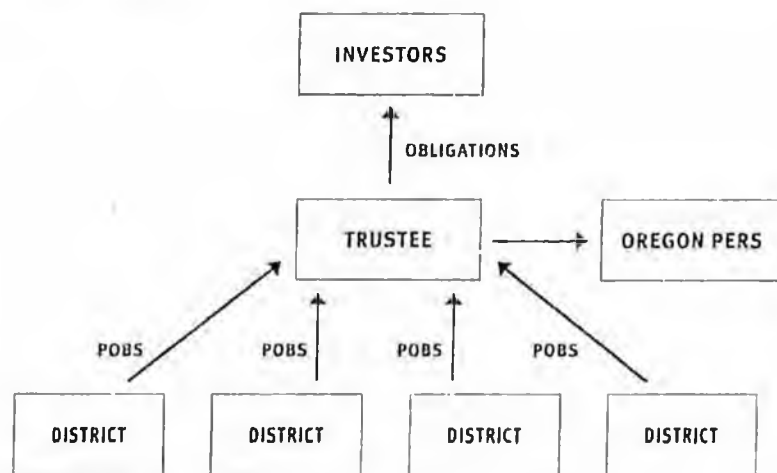
Oregon

State and local government issuers in Oregon have been among the most active users of POBs to finance their share of unfunded liability to the Oregon Public Employees Retirement System. POBs are issued in Oregon either as limited tax bonds or as revenue bonds.

Prior to the passage of the Pension Bonding Act in 2001, the City of Portland, Multnomah County and Josephine County issued significant sized POBs under Oregon's Uniform Revenue Bond Act. In 2001, the Oregon Legislative Assembly approved the Pension Bonding Act (which Orrick attorneys were involved in drafting). The Pension Bonding Act granted authority to "governmental units," including cities, counties, school districts, special districts, public corporations and intergovernmental corporations, to sell full faith and credit obligations for the purpose of refinancing pension obligations. POBs issued under the Pension Bonding Act are not subject to voter approval or annual appropriation and may be issued by local governments individually or jointly.

Significant pooled POB issues have been done by Oregon school districts, community college districts and local governments. In these transactions, the participants pledge their full faith and credit within the limitations of the Oregon Constitution and issue limited tax bonds, payable from available general funds of the issuer. Available general funds include all ad valorem property tax revenues received from levies under each issuer's permanent rate limit and all other unrestricted taxes, fees, charges and revenues legally available to pay debt service on the POBs. The issuers are not authorized to levy additional taxes to pay the POBs.

In the pooled school district and community college district transactions, individual districts issued limited tax POBs in favor of a bond Trustee, which in turn issued obligations that represent a proportionate and undivided interest in and right to receive POB payments pursuant to a Trust Agreement. The POBs were further secured by an Intercept Agreement between the State Department of Education and the school districts and community colleges under which the Trustee was authorized to intercept specific education revenues otherwise paid by the State to the school districts and community colleges in an amount equal to the debt service on each issuer's POBs. Specific examples of recently completed Oregon pooled POB issues include: \$153,582,299.60 Oregon Community College Districts Limited Tax Pension Obligations, Series 2003 (Federally Taxable); \$927,079,763.45 Oregon School Boards Association Limited Tax Pension Obligations, Series 2003 (Federally Taxable); and \$238,743,693.40 Oregon Local Governments Limited Tax Pension Obligations, Series 2002 (Federally Taxable). Each of the pooled transactions have been enhanced by bond insurance. By pooling these transactions, the issuers were able to increase the amount of bonds sold, which increased access to investors, and to lower interest rates and reduce costs of issuance.



Other jurisdictions, including the City of Portland, City of Corvallis, Multnomah County, Marion County, Josephine County, Eugene Water and Electric Board and Portland Community College District have sold POBs on a stand-alone basis.

As an alternative to issuing POBs as limited tax bonds pursuant to the Pension Bonding Act as described above, issuers have the option to issue POBs as revenue bonds pursuant to the Uniform Revenue Bond Act or the Pension Bonding Act. The Uniform Revenue Bond Act allows municipalities to issue revenue bonds for any public purpose secured by designated "revenues," which may include taxes and virtually all other general and special fund revenues and receipts of the municipalities. The Uniform Revenue Bond Act requires notice and a 60-day referendum period during which revenue bonds are normally subject to referral to a vote of the electorate if within the 60-day period 5% or more of the voters file petitions requesting a vote on the bonds. Revenue bonds issued pursuant to the Pension Bonding Act are exempt from this requirement.

In a special election on September 16, 2003, Oregon voters approved an amendment to the Oregon Constitution that authorizes the State Treasurer to issue POBs as general obligation bonds of the State of Oregon for the purpose of paying substantially all of the State's UAAL. The amendment provides that the general obligation of the State must contain a direct promise on behalf of the State to pay the principal, premium, if any, and interest on that indebtedness. The State also will pledge its full faith and credit and taxing power to pay that indebtedness; however, the ad valorem taxing power of the State may not be pledged to pay that indebtedness. The amount of POB indebtedness authorized by the amendment that may be outstanding at any time cannot exceed 1% of the real market value of all property in the State. The State presently expects to issue approximately \$2 billion in POBs and to list them on the Luxembourg Stock Exchange in order to facilitate sales to European investors.

In 2003, the Oregon Legislative Assembly made substantial changes to Oregon PERS. The amount of litigation surrounding PERS in Oregon is increasing, and a

number of challenges to the legislative changes are pending in the courts. Several lawsuits have been filed in the Oregon Supreme Court and in the federal district court in Oregon seeking to have changes that were enacted to PERS enjoined or declared an unconstitutional impairment of contract or unconstitutional taking of property. Although these cases are not directly related to any particular bond issues, their outcome could have far-reaching implications with respect to PERS and related liability.

CHAPTER ELEVEN

Similar To POBs

Pension obligations are similar to other state and local government non-bond obligations, which it may be possible to fund in a manner similar to POBs. While this pamphlet is intended to cover primarily POBs, and they are the most frequently used and highly developed of this category, it is useful to note, at least briefly, that there may be other applications of the same concepts discussed above. Several examples (not an exhaustive list) may include such other actuarially based insurance or benefit obligations as workers compensation, health benefits and unemployment insurance or such non-actuarial obligations imposed by law as court rendered judgments for damages against the state or local government and, in California, county obligations under the Teeter delinquent property tax program.

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Research:

Pension Obligation Bonds Are Surging After Brief Hiatus

Publication date: 20-Jan-2004

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Pension obligation bonds (POBs), the once-arcane debt instrument used to finance unfunded pension liabilities, have returned with a vengeance after a brief hiatus, and are again making their mark on the public finance landscape. A number of conditions have fallen into place to spark this resurgence, including:

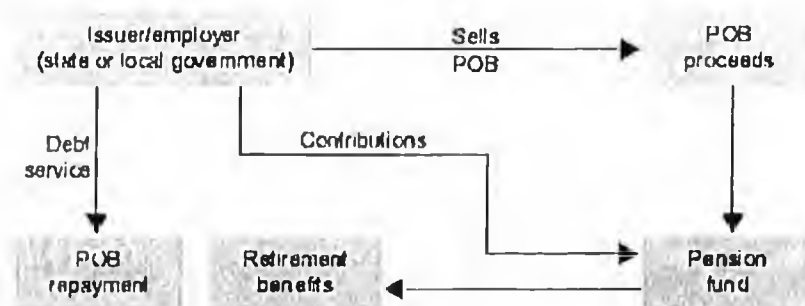
- The rapid growth in unfunded liabilities for public pension funds over the last few years, driven by investment losses, benefit enhancements, and greater longevity of pension plan beneficiaries;
- The relatively low interest-rate environment, which widens the spreads between the POB interest costs paid by the issuer/employer and the assumed investment return rate of the pension systems, which makes the economics of the transaction more attractive; and
- The potential cost savings from a POB, as many state and local employers struggle with budgetary imbalances and other savings alternatives become scarce.

Because of the confluence of these factors, POBs are back. This report details the mechanics of how POBs work, their history, the special risks unique to this debt instrument, the critical rating factors and implications, and future prospects.

■ How POBs Work

While the financial implications of POBs are complex, the actual mechanics are relatively simple. Generally, the municipal employer will use the findings from the most recent actuarial valuation, or have a new valuation completed, to determine the pension system's unfunded actuarial accrued liability (UAAL). Then, it will decide what portion of the UAAL (either all or a part) will be funded with the POB. In the 1990s most employers funded the entire UAAL, but for various reasons discussed below, many now tend to finance less than the full amount. Once the POB is sized and sold, the net proceeds are placed in the pension trust fund to be commingled with the other funds, and usually invested according to the existing asset allocation guidelines (see Chart). Thus, the pension fund experiences a rapid increase in assets resulting in a higher funded ratio (actuarial value of assets divided by actuarial accrued liability). For the POB to generate savings for the employer, the investment return rate on the POB proceeds must be greater than the interest cost of the bonds (and ideally equal to, or exceed the pension system's investment return assumption), and the larger the spread between these two rates the better. The employer, as POB issuer and obligor, would then be projected to achieve lower total pension contribution and debt service costs than it would have if it had not sold the POB.

Pension Obligation Bond Mechanics



■ Brief History

While there were a few issues in the 1980s, the first big wave of POBs really came in the early 1990s. By the end of the decade about \$15 billion of POBs had been issued. The years 2000 and 2001 were slow from a POB standpoint, with 2000 correlating to the apex of U.S. public pension funding at an average funded ratios of slightly over 100%, up from only about 80% in 1990. These robust funding gains were fueled by above-average equity returns during the period and a general shift in the weighting of public pension assets to this asset class from fixed-income. The corollary to a high funding level is a lower or nonexistent UAAL. Falling funding ratios, now estimated to be heading towards the 90%, have been exacerbated by a combination of adverse circumstances, some uncontrollable and some self-inflicted. These factors include the decrease in asset values from poor equity returns and the increase in liabilities from benefit enhancements and demographic changes (for example, members living longer). The second wave of POBs, driven by burgeoning unfunded liabilities, has come on strong in 2002 and 2003. As in the first wave, California counties have been leading the pack, and there are a number of repeat borrowers, but there are also significant new players. The state of Illinois, which issued in June of this year, now holds the POB record for sheer size at \$10 billion — almost four times larger than the previous record. Oregon sold a \$2 billion issue last fall, and other states that have recently completed or plan a POB sale include Kansas, Wisconsin, and West Virginia.

■ POB Risks

The principal risks to the issuer of a POB fall into a number of categories:

- Arbitrage (investment return/POB interest cost);
- Leverage;
- Market risk; and
- Political.

POBs are essentially an arbitrage play, the success of which is dependent on the premise that the pension fund assets (including POB proceeds) will earn on average more than the interest cost on the POBs and hopefully the assumed investment return rate (generally about 8%) or better each year for the life of the bonds. If the bonds are sold at an interest cost of 6%, for example, the spread could generate handsome savings if the investment returns goals are met over the life of the bonds. The problem is that there is no certainty that the average 8% return will be realized over time, and therein lies the principal risk of the POB to the issuer. If the pension fund earns 8% or more on the POB proceeds, then the result will be success by virtue of having to pay lower pension-related costs (contributions plus POB interest) than without the POB. However, if the investment return is less than the POB interest cost, the transaction becomes a drag on cash flows. Not only will the employer have the new POB debt service costs but also higher contribution rates attributable to new unfunded liabilities from under performing investment returns. If returns are above 6% (as in the example above) but below 8%, the employer will have increasing contribution rate costs, but it would have had them even without the POB. When investment returns are less than the POB interest costs, the POB puts additional strains on financial operations rather than helping.

While the 1990s produced some impressive investment returns, no pension fund consistently earns 8% or higher every year in perpetuity; returns vary dramatically and may (or may not) average the investment return assumption or even the POB interest rate cost. The POB paradigm has a goal to average or beat the 8% investment return assumption over the long-term. With the appropriate asset allocation strategy this goal may be attainable, but market experience over the last several years has led some to believe that an 8% return assumption may be too aggressive.

Another factor in evaluating the success of a POB is that its full effect can only fully be tallied at final maturity of the bonds. Due to market gyrations, a POB may look like a great success for several years, or even a decade, only to see investment gains erode, and at maturity are pronounced a failure. Conversely the exact opposite may be true, with poor results in the early years later overcome to achieve projected benefits in the final analysis.

In any event, we do know that even if projections are met on average over the life of the POBs, there will be years with returns that are higher, and some that are lower (maybe significantly), than the 8%

bogey. We do not have to look back very far to see evidence of such swings: in fiscal 2001 the S&P500 index of domestic equities fell 16%, in 2002 it fell another 19%, but in 2003 it fell only 1.6%. These market declines hurt issuers with POBs outstanding: most had to pay increased contribution rates to cover the new actuarial losses, plus they had the higher debt service costs due to the POB.

The risk of adding too much leverage is another factor for POB issuers to consider. Borrowing for any purpose increases leverage, and incurring debt to pay unfunded liabilities is no different. While the issuer is substituting one type of long-term liability (POB) for another (UAAL), there is a difference. In most cases, bond debt service is a "harder" obligation than the "softer" contribution payments used to amortize the UAAL. Bond debt service must be paid in full and on time or the issue falls into default, with wide ramifications. For certain employers, contribution payments, on the other hand, may be temporarily deferred or reduced without serious negative consequences. Therefore, the size of the POB relative to the total debt structure of the issuer must be measured in terms of what level of debt service can be managed if actual future investment returns do not meet the original POB plan projections.

Because POBs generate very large infusions of funds into the pension system compared with the more steady investment and reinvestment of interest, dividends, and contributions by the fund, the plan for investing POB proceeds must be considered. Should the monies be invested according to the existing asset allocation guidelines, or should POB proceeds have a special allocation strategy because of current market conditions or expectations? If the chief investment officer of the fund believes that international equities, for example, are overvalued, maybe a delay in filling that allocation would be warranted. On the other hand, in that pension funds are long-term investors, most have stuck with their traditional allocations for proceeds, eschewing market timing strategies. Whatever the strategy may be, it should be fully vetted before the POB sale.

Another aspect that few envisioned when this instrument was first initiated is the political risk hidden, almost like a Trojan horse, within the POB structure. As was mentioned in a feature on this subject, ("Pension Obligation Bonds: Unique Rating Documentation", RatingsDirect, March, 4, 1999), POBs can become victims of their own success. For example, if a POB is issued for the full UAAL, resulting in a 100% funded ratio, and subsequent higher-than-average returns push the ratio to 110% or 120%, there will arise tremendous political pressure to distribute the so-called "excess" funding by increasing benefits, thus incurring new liabilities. The excess funding touted in the late 1990s turned out to be illusory. Even systems bolstered by POBs that did not increase benefits found themselves in underfunded positions following the market declines from 2000 to 2003. Those that fell victim to the siren's song and increased benefits have even lower funding levels. Some pension funding ratios declined to the extent that the employers' opted to go back to the market to issue POBs for a second time.

■ Analysis

The rating process for POBs basically parallels that of long-term debt with similar security plus with certain additional analytical factors pertinent to the POB and pension system. Most POBs issued to date have a GO or general fund pledge. Also, a high percentage of those sold have been additionally secured by bond insurance. In Standard & Poor's analysis specific to POBs we focus on the effect of the bonds on the issuer's debt structure and its ability to meet its obligations. The financial review includes the impact on both the balance sheet and the operating statement or cash flows. The status of the issuer's pension fund on a pro forma basis is also part of the review as with any similar analysis.

From the balance sheet perspective, we look at how the POB fits into the issuer's total debt plan. Does the POB dramatically alter the issuer's debt profile? We look at total debt with and without the POB so as not to penalize a POB issuer in comparison to another issuer that might have relatively low debt (and no POBs) but sizable unfunded pension liabilities. Also, we evaluate the leverage added by the POB. Does it markedly increase hard, fixed costs (bond debt service) in place of a softer, more discretionary obligation (pension contributions)? If sub par investment returns put upward pressure on contribution rates will they, coupled with the new higher debt service costs due to the POB, put the issuer's budget under greater strain? The issuer must also be cognizant of the effect the POB issuance may have on statutory debt limits. Will the POB use up debt capacity that might be needed for other, more pressing needs?

From a cash flow standpoint, Standard & Poor's reviews projected debt service and contribution costs, with and without the POB, including the validity of the assumptions including those for POB interest

costs and pension fund investment returns. How do the projections compare in total and on an annual basis? The spread between interest costs and investment return generates the savings expected from the transaction. What is the magnitude of annual savings and total present value savings? Where (in what years) are the savings taken? Are the savings front-loaded in an attempt to mask budgetary stress? Will any front-loading lead to higher, unsustainable contribution rates in later years? Do the potential savings from the POB outweigh the risks involved? The analysis of the cash flows is a critical component to understanding the full impact of the transaction.

As part of the POB analysis we also review the current status of the recipient of bond proceeds □ the pension system itself. What is the statutory relationship between the issuer/employer and fund? How have the laws and precedents for making contributions affected funding progress and how do they play into the POB strategy? Have funding levels generally been increasing over time? What are the funding goals and how will the POB impact these objectives?

The pension fund's general actuarial methods and assumptions also will be reviewed for comparative purposes. The fund's asset allocation strategy will be studied for consistency with the POB assumptions and for the general risk profile. An aggressive investment strategy may make the POB objectives more difficult to achieve on a consistent basis.

■ Rating Implications

Employers looking to help manage their unfunded liabilities through the issuance of a POB should weigh the pros and cons very carefully. Any applicable risks from the above list should be evaluated. There should be a clear POB plan with attainable actuarial and investment assumptions and a conservative structure. Prudent allocation for projected savings over time limits the chances for problems

It is possible for POBs to have a negative effect on credit quality, especially in the investment environment over the last several years or if they were structured poorly at the outset. Standard & Poor's will continue to evaluate POB risks in light of each employer's individual profile at the time of sale as well as their projected effects over time. POBs may work as planned over the long-term, but short-term fiscal dislocations resulting from these structures are part of their baggage.

■ Special Rating Documentation Requirements for POBs

The unique nature of POBs requires certain additional documentation not normally requested for other types of ratings:

- POB financing plan, including its effect on the overall debt plan;
- Projections of UAAL contributions and debt service with and without the POB;
- Latest pension fund annual report;
- Most recent actuarial valuation and experience studies of the fund; and
- Pension fund's current asset allocation strategy and plan for investing POB proceeds.

Research:

Managing State Pension Liabilities: A Growing Credit Concern

Publication date: 20-Jan-2005

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State governments have a long history of providing retirement security for their employees--and in many cases certain local government employees--through large, defined benefit pension systems, which, throughout the 20th century, had been successful in meeting their intended goals. However, after state pension funds reached their apex of financial soundness, based on funding levels, in 2000 they have since deteriorated--in many cases precipitously--leaving most funds with the problem of managing new, large unfunded liabilities. The rapid growth and significant magnitude of these liabilities has become an increasing credit concern for many state ratings, reaching crisis proportions in some cases.

This article provides a brief overview of public pension funds in the U.S., along with the factors leading to their current status and some of the options available for managing pension liabilities. In addition, the status of a number of state funds, with a range of funding levels, and some of the strategies states have used to address their respective pension situations, will be examined.

■ Historical Background

Defined benefit pension plans, as used by most states, provide a systematic method for setting aside sufficient monies to pay promised retirement benefits to employees in the future. The benefits are funded by contributions, usually from both employer and employee, and the investment income derived from such contributions. Most states have two principal funds: one for state employees, and possibly certain local government employees, called public employee' retirement systems; and one for teachers, referred to as state teachers' retirement systems. Some have one, monolithic system for all government employees (state and local), while others have multiple systems for individual job specialties, such as judges and safety officers.

Public pension funds in the U.S., of which the lion's share of assets belong to state funds, have come a long way from their humble beginnings--some dating to the beginning of the 20th century. Starting with little or no assets to offset liabilities, and some initially operating on a pay-as-you-go-basis, pension funds gradually improved their funding ratios (actuarial value of assets divided by actuarial accrued liability) to the 50% level in the mid-1970s, and further to around 80% by 1990. Early on, pension assets were invested largely, if not exclusively, in fixed income investments. Gradually, investment strategies became more diversified, however, and by the end of the 1990s public funds had increased their allocations to equities and other higher yielding asset classes significantly. This shift in allocations coincided with, and to some extent was fueled by, the bull markets in domestic equities that lasted from the early 1980s through fiscal 2000. At June 30 (the fiscal year-end for most public pension funds), 2000, the average funding ratio for all U.S. public funds was slightly above 100%, and was even higher for state funds.

The party to celebrate the final defeat of unfunded pension liabilities was short-lived, unfortunately, as dark clouds soon began to appear. Trends that would adversely affect actuarial balance impacted both liabilities and assets. Liabilities were being inflated not only by normal growth and inflationary pressures but also by overt changes in benefits and actuarial assumptions. The late 1990s saw a number of improvements to pension benefits, which automatically boosted liabilities, and the actuarial consequences of many of these changes really kicked in after 2000 due to the normal delayed reaction in contribution increases. Demographic and lifestyle trends--along with the resultant assumption changes, such as retirees living longer (a global phenomenon) and more employees taking early retirement--had a similar, expansionary effect on liabilities. However, the biggest component in the steep decline in funding levels from fiscals 2001 to 2003 came from the asset side, and was caused by the bottom falling out of the domestic equity markets. The investment return assumption requirement for most public funds to maintain actuarial balance, about 8%, could not be sustained when the average allocation to domestic equities stood at 40%-50% and the annual returns of the S&P 500 Index were

negative 16%, negative 19%, and positive 2% in fiscals 2001, 2002, and 2003, respectively. The net result was that, by June 30, 2003, average funding ratios for state funds had fallen from an average overfunded level in 2000 to an estimated 80%-90% in just three short years. While the S&P 500 saw a 17% gain at fiscal year-end June 30, 2004, public pension fund actuarial results, on average for the year, will not report major funding gains due to the effects of the actuarial smoothing of gains and losses over a period of years used by most. With five-year smoothing, for example, a fund in fiscal 2004 would still be accounting for a portion of the losses (or gains) from the prior four years.

■ Alternatives to Improve Funding

The range of options to fix a pension mismatch of assets and liabilities is relatively narrow, and almost all are difficult to implement due to legal, economic, or political impediments. Corrective measures should act to stop or slow pension liability growth or grow assets, or both. From a liability standpoint, most states have constitutional or statutory pension benefit protections that preclude any reductions in benefits already promised to existing employees. One way around these restrictions is to close off the current benefit to new employees and offer new employees a reduced level of benefits. This tactic of creating a new tier of benefits has been used by a number of funds to reduce liability growth. Completely closing existing plans and creating new, less generous defined benefit plans, and even new defined contribution plans, is another option.

Changing actuarial assumptions to reduce liabilities has been used in the past; the current demographic and economic realities related to the major variables, however, make these options difficult. The raising of the actuarial investment return assumption to 8.25% from 8.00%, for example, would automatically lower actuarial liabilities, all other assumptions being equal. However, the investment experience over the past three or four years and current expectations would tend to preclude such a change at this time.

The principal options to improve pension balance by increasing assets fall into three main categories:

- The pension fund may alter its asset allocation strategy to enhance investment returns;
- The pension fund sponsor may sell pension obligation bonds (POBs), placing the proceeds in the pension trust and thus reducing or eliminating the unfunded actuarial accrued liability (UAAL); and
- Annual contribution rates for sponsors or employees may be increased.

Pension funds in the U.S., as major global investors with more than \$2 trillion in assets, have developed sophisticated asset allocation plans over the years, and, with access to professional asset managers, attempt to maximize returns within their prescribed tolerance for risk. For an individual fund to dramatically enhance yields by altering its allocations, there would most likely need to be a sea change in thinking about the fund's view of risk. Minor tweaking of strategies is a more regular occurrence as funds seek to keep up with changing markets, risk profiles, and expected returns of various asset classes, but major strategy changes leading to markedly improved results are rare.

Some states, as sponsors, have opted to pursue the POB route to significantly boost assets in one bold move, while at the same time taking advantage of the projected lower carrying charges this vehicle offers to a sponsor. (For further information, see report titled "Pension Obligation Bonds Are Surging After Brief Hiatus," published Jan. 20, 2004, on RatingsDirect). While no panacea, POBs are basically an arbitrage play based on the premise that, as a result of the bond proceeds being invested at an expected yield above the cost of the bonds, net savings will be achieved by the sponsor over the life of the bonds. In other words, after the issuance of the POB, combined debt service plus pension contribution costs will be lower than they would have been without a POB. The success of this formula depends on the realization of a certain investment return, which is in no way guaranteed. Whether a POB succeeds or fails cannot fully be evaluated until the final maturity of the bond, and it is a given that some years will be winners and others losers. The bad years may add short-term fiscal stress to the POB issuer (pension sponsor), which could be significant based on the amount of leverage the POB exerts. With most POBs having been issued over the past 10 years or so, it would be premature to pronounce them an unqualified success (or failure). The best that can be said to date is that POB results have been mixed, with some having met or exceeded expectations while others have come up short based largely on the vicissitudes of market timing.

The last major option for increasing assets, and the most common alternative used to manage new, unfunded liabilities, is to simply increase annual contribution rates. Indeed, a major principle of an actuarially funded defined benefit plan is that, if assets and liabilities become unbalanced, increasing

(or decreasing if the system is overfunded) contributions will bring the system back into balance. Sometimes employee contributions are increased, but usually it is the sponsor that steps up to the plate: the investment risk of a public defined benefit plan and the burden to make good on benefit promises are ultimately the responsibilities of the sponsor. Thus, the principal byproduct of the current state pension funding crisis has been increasing contribution costs coming at a time when states, in recent years, have been squeezed by weak revenues and burgeoning expenses, including security and health care cost pressures.

■ How Are Some States Managing Their Pension Liabilities?

Arizona.

The Arizona State Retirement System, a multiple-employer defined benefit plan, provides pension benefits for employees of the state, political subdivisions, and public schools, with more than 500 employers and 222,000 active members. The system's funded ratio fell to 98.4% at June 30, 2003, after a decade of more than 100% funding. As reported in the June 30, 2003, actuarial valuation, the major contributor to this decline was investment losses for the year that resulted in a decrease in the actuarial value of assets by \$1.2 billion. In November 2002, the state retirement system board removed the requirement that actuarial assets be within 20% of market value, and changed the period for recognizing investment gains or losses to 10 years from five years. At June 30, 2003, the system's market value of assets (\$18.1 billion) was 77% of actuarial value. The 2003 actuarial valuation developed hypothetical contribution rates for both employees and employers (odd-year calculations are not actually implemented) of 6.96% each, compared with 1.92% each in 2001.

California.

California has two large state pension funds: one for state and certain local employees--California Public Employees' Retirement System (CalPERS)--with assets exceeding \$170 billion; and the other for teachers--California State Teachers' Retirement System (CalSTRS)--with more than \$115 billion in assets. These systems have been experiencing some of the same pressures as pension funds in other states, and have experienced declines in funding levels. For example, the funded ratio for the state member category of CalPERS had fallen to 84% as of June 30, 2003, compared with 111% in 2000. State contributions to CalPERS for its employees, as actuarially determined, have risen from \$160 million in fiscal 2001 to \$2.2 billion in fiscal 2004. In the same vein, the funded ratio for the CalSTRS defined benefit plan fell from 110% in 2000 to 82% in 2003. However, total amounts contributed to CalSTRS by members, employers, and the state, as set by statute, increased just 10% during the same period.

A number of changes for both pension systems have been proposed over the last year. In relation to CalPERS, the state's 2005 budget included certain pension reforms, such as a two-year delay of contributions into CalPERS from new miscellaneous and industrial employees, thus obviating the state's obligation to make contributions on their behalf over that period. A \$900 million POB was proposed, the proceeds of which would be used to pay a portion of the current contribution payment as opposed to paying a portion of the unfunded actuarial accrued liability like most other POBs. Court validation of the POBs is being sought. The 2005 state budget also included proposals to increase employee contribution rates and lower benefits for new employees to pre-1999 levels.

In December 2004, CalSTRS proposed a number of options to help address the funding deficiency in its defined benefit plan. At June 30, 2003, the system's unfunded actuarial obligation totaled \$23.1 billion. The first option was for the state to issue a POB to pay down the entire liability. Other options included a change in the amortization period of the unfunded liability and a number of changes to how benefits are calculated. One option that could have a large effect on the amortization cost is to eliminate the 2% benefit adjustment. Several alternatives included increases in contribution rates by all three contribution bases: members, employers, and the state.

On July 1, 2003, the state did not make its full contribution payment to CalSTRS' supplemental benefit maintenance account, although it did make the required payment to the system's defined benefit program. The state paid \$59 million of the \$559 million required supplemental benefit maintenance account amount. In October 2003, CalSTRS filed suit in Sacramento County Superior Court to have the \$500 million payment restored. The state is currently defending the action.

Of late, proposals to replace the two California state defined benefit plans with defined contribution plans, and to eliminate state contributions to CalSTRS, have been actively debated.

Florida.

The Florida Retirement System was created in 1970. The system was created to provide a defined benefit pension plan for participating employees. The plan is administered by the state division of retirement in the department of management services. Participation by local governments in the state is optional, but is generally irrevocable once the government opts to participate in the plan. Currently there are 866 participating employers and 956,875 individual participants. Of the total participants, 23.5% are retirees and beneficiaries. Contrary to trends for most other states, the actuarial value of assets in the system has consistently exceeded the actuarial accrued liabilities in recent years. The funded ratio of the pension system has ranged from 112% in fiscal 2004 to 118% in fiscal 2000. Investment performance in fiscal 2004 was strong, with a return of 16.6% compared with the 7.75% assumed rate of return. The actuarial value of assets at July 1, 2004, was \$106.7 billion. The solid asset position of the Florida Retirement System has provided budget relief in the form of lower contribution requirements for the state and participating local governments.

Illinois.

Illinois sponsors five defined benefit retirement plans for about 630,000 members and annuitants, including public employees, teachers, university personnel, and judges. By 2003, the funded ratio of the Illinois funds ranked near the bottom compared with other states in the U.S. Contributing to the \$26.9 billion increase in unfunded liabilities from 2000 to 2003 were:

- Contribution shortfalls (\$4.8 billion of the total),
- Investment losses (\$14.1 billion), and
- Benefit improvements (\$3.3 billion).

Adding to the state's pension woes is a 2002 early retirement incentive plan for state employees, which resulted in a liability that, at \$2.5 billion, was quadruple the original estimate. Part of the variance was due to a much larger number of employees (11,032) taking part in the program than originally projected (7,215). Due to the requirement of a 10-year amortization of this liability, the early retirement program contribution for 2005 is \$382 million, compared with the originally projected \$70 million.

In 2003, the state sold a \$10 billion POB, the largest on record, using the proceeds to fund a portion of the UAAL (\$8.1 billion) and to pay (\$1.9 billion) the state's current pension contribution for fiscals 2003 and 2004. The POB increased the combined system's funded ratio by seven percentage points. At the end of fiscal 2003, the funded ratio for the combined systems was 57% (after giving effect to the POB), and the UAAL was \$35.8 billion.

New York State.

The New York State comptroller is the sole trustee of the state's common retirement fund, which includes all assets of the New York State Retirement System. Members of the system are typically employees of New York State or employees of municipalities in the state (excluding New York City). As of March 31, 2004, there were 2,985 participating government employers in the system. The overall membership in the system exceeds 970,000; this includes 641,721 members and 328,357 retirees and beneficiaries. Overall, membership has expanded continuously, but the growth from retirees has been most significant. Retirees now make up 34% of the system's members, compared with 26% in 1990. Benefit payments continue to rise, reflecting improvements in final average salaries, cost of living adjustments, and benefit improvements. The increased benefit payments, coupled with the performance of the stock market after 2000, have required significant employer contribution increases, with significant increases forecasted for the next two years as well. At March 31, 2004, about 63% of the pension system assets were invested in various stocks. For the largest component in the system--the New York State and Local Employees' Retirement System--employer contributions had averaged 1.75% from fiscals 1996 through 2003. Contributions will increase in fiscal 2004 to 5.9%, totaling \$1.2 billion. This rate is projected to more than double in fiscal 2005 to 12.9%, or a \$2.6 billion contribution, followed by an estimated 11.4% contribution rate in fiscal 2006. Similar increases are forecasted in the New York State and Local Police and Fire Retirement System (PFRS) for fiscal 2004. The contribution rates for fiscals 2005 and 2006 are projected to be even steeper for PFRS, however, growing to 17.6% and 16.3%, respectively. These contribution increases have been, and will continue to be, a significant source of budget pressure for the state and its local governments. The legislature has allowed a portion of the increase to be funded with the issuance of bonds or a loan from the state comptroller. For governments that choose this option, fixed costs to service pension contributions will include an interest component, with the fixed costs extended for up to 10 years. The system uses the aggregate actuarial funding method, which does

not identify or separately amortize unfunded actuarial liabilities. Due to the use of this funding method, there is no disclosure or schedule provided on funding progress.

Oregon.

Oregon has historically delivered pension benefits for state and local employees through a single system called the Oregon Public Employees Retirement System (OPERS). After experiencing relatively high funding levels through the 1990s, the UAAL of OPERS at Dec. 31, 2001, was estimated at \$9.7 billion, almost three times the prior year. With 2002 investment losses, this figure was estimated to be almost \$15 billion--of which about one-third was the state's share. Contributing factors to the increase in UAAL included some of the usual suspects: benefit increases in the late 1990s and poor investment returns. In addition, under the plan, tier-one members were guaranteed a minimum 8% on their regular account assets regardless of actual investment returns earned by the system, and in 2001 and 2002, like most other funds, the system generated negative returns.

In 2003, the state initiated a number of reforms to OPERS, including:

- Modernizing the mortality tables and requiring regular updates;
- Shifting future employee contributions to a defined contribution plan;
- Converting the annual 8% guaranteed rate of return to an assumed 8% to be received over the length of members' service;
- Temporarily suspending future cost of living increases for retirees in certain instances; and
- Creating a new, more independent, retirement system board.

In addition, for new employees hired after Aug. 29, 2003, the state created a new retirement plan called the Oregon Public Service Retirement Plan, which includes both defined benefit and defined contribution components. Employer contributions fund the defined benefit plan, and employee contributions fund the defined contribution plan.

The legislative changes to OPERS resulted in an estimated reduction in the state's UAAL to \$2.2 billion from \$4.6 billion. A number of lawsuits have been filed challenging some of the OPERS changes. The state intends to continue to defend the challenges. In October 2003, the state sold \$2 billion of GO POBs to further reduce its UAAL. The preliminary results of the OPERS 2003 actuarial valuation reported the pension system's funded ratio at about 97%. Employer contribution rates under the valuation showed an increase to 18.27% from 9.96%.

West Virginia.

The West Virginia Teachers' Retirement System (TRS) is a multiple-employer, defined benefit plan for 55 county school systems, certain state higher education employees, and the state boards of education and higher education. The state provides substantially all funding for the system. TRS has occupied the bottom rung among state plans in terms of funded ratios for some time. As of July 1, 2003, the funded ratio was 19%, and the UAAL was \$5.1 billion. The state supreme court has ruled that the UAAL of TRS is a public debt, and has required the state to fund TRS in an actuarially sound manner. This requirement entails the elimination of the UAAL over a 40-year period beginning July 1, 1994, enabling TRS to meet cash flow requirements to fulfill future obligations to members.

While for a number of years West Virginia has attempted to clear the way to issue a POB to help lower or eliminate the UAAL in TRS and other state funds, its efforts have been blocked by legal issues, including the requirement for voter approval. If bonding is not an option, the state may have to pursue other avenues to cure its pension ills.

■ Looking Ahead

States are under varying degrees of pressure to fund the burgeoning liabilities of their pension systems. The common theme lies in developing strategies to manage increasing contribution rates at a time when other demands are conspiring to break the budget: growing health care, education, and security costs to name a few. Options to reduce pension liabilities or even slow their growth, and thus moderate contribution rates, are few and usually difficult to bring to fruition. Even with adequate investment returns, the pension funding problem will be in the forefront for at least a few more years, and possibly much longer if the markets don't cooperate. As if pension liabilities were not enough to handle, states and other governments will soon have to deal with funding issues related to liabilities from Other Postemployment Benefits (OPEB)--largely retiree health care costs. The GASB has established new accounting rules for reporting on OPEB liabilities. (For further information, see report titled "Reporting &

Credit Implications of GASB 45 Statement on Other Postemployment Benefits," published Dec. 1, 2004, on RatingsDirect.) Both pension and OPEB liabilities will act to constrain ratings over the foreseeable future.

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Research: Pension Obligation Bonds: Were They A Good Bet?

Publication date: 08-Nov-2001

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What do the volatility in equity prices and the decline in market indices over the past year or two mean for the security of public pension investments and, further, what is their effect on the strategy, used by a number of governmental pension sponsors over the last decade, of selling pension obligation bonds to fund the unfunded liability of their pension funds? Specifically, given the current and expected market conditions, was the POB strategy a good idea and, if so, does it still have validity, and does this technique represent a viable opportunity for governmental sponsors who may find themselves wrestling with unfunded liabilities as a result of the declines in equity performance?

Brief History

While a few POBs were done in the 1980s, they really came into their own in the 1990s with more than \$10 billion being sold. Over the last two years, only a few, relatively small, POBs have been floated. The average principal amount for POBs ranged from \$100 million to \$300 million with a few exceeding \$1 billion or more. Most POBs issued to date have been general obligation or general fund secured, capitalizing on the credit quality of the pension system's sponsor.

The POB Experience Through 2000

With this kind of debt instrument, timing is very important and issuers of POBs in the early- to mid-1990s could not have had better timing. While public pension funds during the 1990s were boosting their average allocations in domestic equities from 33% to almost 50%, the returns on this asset class were sustained at levels well above the historical experience. The average annual increase in the S&P 500 index for the 10 fiscal years ended June 30, 2000 (most public pension funds have June fiscal years), was almost 16%, compared to a historical average of about 10%. The five-year total portfolio return for public funds has averaged more than 13%. These performances should be viewed in the context of average investment return assumptions for public pension systems of only about 8%.

Following the issuance of POBs to increase the funding status or to fully fund a system, this excess return phenomenon could easily result in funded ratios greatly exceeding 100%. However, in that actuarially funded pension systems tend to be self-balancing, this overfunding imbalance would have been corrected by actions taken to affect either the pension fund's assets or liabilities, or both. In these circumstances, pension fund sponsors would, upon the recommendation of their actuaries, decrease or temporarily eliminate pension contributions (contribution holiday), thus slowing the growth of assets. On the liability side, some sponsors made the decision to improve employee benefits, instantly increased liabilities but also balancing overfunding. Regardless of how the "problem" of overfunding was managed by sponsors or pension funds that used POBs prior to fiscal 2000, POBs produced, as promised, an economic benefit and in most cases it was substantial.

2001: Harbinger of Tough Times for POBs?

For the fiscal year ended June 30, 2001, the S&P 500 declined 15.8% (and fell a further 15% in the next quarter), which was its worst performance since fiscal 1982. This fiscal 2001 result followed the below-average performance of positive 6% for fiscal 2000. Following two decades of above-average equity returns, it is probable that these returns will approach the historical pattern going forward.

While a long-term environment of weak investment returns will lower pension funding levels, it may be premature for issuers of POBs and pension funds in general to adjust investment expectations based on the most recent results. As more data become available, if it is apparent that a trend is developing, some reactive changes may be needed. Regardless of the causes, any investment underperformance over an extended period of time will lead to actuarial losses and new unfunded liabilities, resulting in the need to increase contribution rates to bring the systems back into balance. It should be kept in mind that such a need would be in sharp contrast to recent years, when a decrease in the needed contribution rates actually provided budgetary flexibility for fund sponsors. Many funds now use smoothing methods for actuarial purposes in valuing assets to spread investment gains and losses over up to five years. This practice would temper the effects of the fiscal 2000 and 2001 investment return experience. With five-year smoothing, for example, only 20% of the fiscal 2001 losses would be included in the June 30, 2001 valuation, which would still be taking into account prior year gains as far back as 1997.

No matter how sponsors who utilize a POB strategy choose to manage their actuarial gains from the excess investment returns following POB sales (lower contributions or increased benefits), most are likely still fully funded, albeit with a lower cushion. In a long-term lower return environment with declining funding levels, those systems that have taken the bulk of their excess funding out of their POB structure may see trouble ahead.

For example, say a state sold POBs in 1985 with a 30-year amortization to fully fund its retirement system and had average annual investment returns of 12% against its investment assumption of 8%. However, instead of permitting the natural increase in the funded ratio that these conditions would have caused, the state managed its funding ratio, through contribution holidays and benefit improvements, to maintain the ratio at around 100%. If we are in fact heading into a lower return period (the average annual increase in the S&P 500 for the 16 years from 1966 to 1982 was a meager 2.7%, for example), the state may have already reaped all its gains from the transaction structure and be headed for losses. If actuarial losses start to be incurred, contributions will have to increase. If returns fall below the interest cost on its POB that will mean that the POB will have become a net financial drain. If investment yields fall below POB interest cost, total debt service, including that on the POB, plus normal and new unfunded actuarial accrued liability (due to low returns) contributions, will now be higher than if the POB had not been sold. To judge the full effect of a POB, however, any future losses have to be weighed against prior period gains. With a POB, its ultimate success, or failure, can only be judged at its final maturity is approached. The financial dynamics may be a winning formula for 25 years, for example, and then a losing one in the last five years (or vice versa).

POBs Going Forward

Standard & Poor's factors the effects of a pension obligation bond strategy into the long-term rating of the sponsor. Standard & Poor's has viewed POBs as a strategy for savings on carrying charges as long as the transaction was structured conservatively and the assumptions were reasonable and attainable. This requires a clear financing plan including reasonable assumptions and manageable leverage. Prudent expectations for investment returns and the cautious use of resultant savings help insure a POB's success. Another positive factor for a POB is, of course, to be fortunate enough to sell the bonds in a low interest rate environment, thereby increasing the spread between interest costs and investment return expectations and lowering the risk of underperformance. The long-term expectations for investment returns have not yet changed because of the recent return experience or current economic and political conditions and public funds will rely on diversification of investments to maintain necessary total returns. Thus, a sound POB plan today should be as viable as it was 10 years ago. The 2000 Public Pension Coordinating Council Survey of State and Local

Government Retirement Systems reported total public pension fund unfunded liabilities at more than \$100 billion, which would be the theoretical limit of POB bonding capacity nationwide.

Conclusion

Pension obligation bonds, despite recent equity market gyrations, have largely been a boon to the sponsors who have used this strategy. Over the last 10 years, during which period the vast majority of these bonds were issued, investment yields have comfortably exceeded the investment return assumptions of public pension funds and the interest cost of the POBs, generating handsome actuarial gains.

Do the math: actual return of approximately 12% minus expected return of 8% equals 4% gravy. Some of the gravy was used to lower current contributions and some to increase benefits. By any economic measure POBs have been a success. However, for a POB to be a total success the math has to work (or generate net savings) over the full amortization of the bonds and for most POBs we are not even halfway there. To use a baseball analogy, POBs are ahead 3-1, but it's only the fourth inning. If the POB plan was sound to begin with, they should still be winning at the final out. The same ingredients that helped outstanding POBs succeed--conservative planning and expectations coupled with fortuitous timing--will also help future POBs to be a viable alternative for savings.

CS House Bill 13
Work Draft Version M
Sectional Analysis

Prepared by Representative Mike Hawker's Office

*** Indicate sections changed in the CS; Changes are in italics*

- Section 1:**** Allows a Teacher's Retirement System (TRS) employer to make a lump sum payment to prepay all or a part its share of the unfunded accrued actuarial pension liability (UAAL); allows the commissioner to accept a lump sum payment that is less than the full amount; allows administrative fees to be charged; outlines how the lump sum payment and earnings or losses will be credited; and holds an employer who prepays its liability harmless if there are future state discretionary payments that benefit multiple employers. Requires the administrator of the TRS plan to recalculate the employer contribution rate within 180 days of the lump sum payment.
- **REWORDED IN CS to accommodate payments made by another entity on behalf of an employer.*
- Sections 2 - 5:**** These sections allow the Alaska Housing Finance Corporation (AHFC) to create a subsidiary to aid an employer in the financing of a prepayment of all or a portion of that employer's UAAL.
- **SECTION 4 CHANGED IN CS. Section 4 exempts Pension Obligation Bonds from the AHFC debt cap. The CS adds a minimum arbitrage spread requirement.*
- Section 6:** Outlines how municipalities can join together to issue debt obligations and allows funds diversion agreements between the municipalities and state agencies.
- Section 7:**** ***NEW SECTION which exempts the Alaska Pension Obligation Bond Corporation from the Procurement Code.*
- Section 8:**** Adds Article 8 to the State Bonding Act, which authorizes the state bond committee to issue Pension Obligation Bonds (POBs) and provides guidelines and requirements for bond issuance, sale, structure, repayment and the investment and accounting of bond and investment proceeds.
- **REWORDED IN CS to accommodate payments made by another entity on behalf of an employer.*
- Section 9:**** Creates the Alaska Pension Obligation Bond Corporation, which is authorized to issue POBs. Provides guidelines and requirements for bond issuance, sale, structure, repayment and the investment and accounting of bond and investment proceeds.
- **REWORDED IN CS to accommodate payments made by another entity on behalf of an employer.*
- Sections 10** - 11:** Adds facilitating language to two sections of the accounting statute for the Public Employees Retirement System (PERS) to accommodate lump sum payments.
- **SECTION 10 REWORDED IN CS to accommodate payments made by another entity on behalf of an employer.*

- Section 12:**** Allows a PERS employer to make a lump sum payment to prepay all or a part its share of the accrued actuarial pension liability; allows the commissioner to accept a lump sum payment that is less than the full amount; allows administrative fees to be charged; outlines how the lump sum payment and earnings or losses will be credited; and holds an employer who prepays its liability harmless if there are future state discretionary payments that benefit multiple employers. Requires the administrator of the PERS plan to recalculate the employer contribution rate within 180 days of the lump sum prepayment.
- **REWORDED IN CS to accommodate payments made by another entity on behalf of an employer.**
- Section 13:** Adds to the statutory policies established for the Municipal Bond Bank Authority. Provides a directive to assist governmental employers to meet their unfunded retirement system obligations by issuing POBs on their behalf. Specifies that the bond bank should provide the lowest rates possible without subsidizing the employers beyond their means.
- Sections 14 - 15:** These sections allow the Municipal Bond Bank to create a subsidiary to aid an employer in the financing of a prepayment of all or a portion of that employer's UAAL.
- Section 16:** Exempts "Pension Obligation Bonds" from the current limit for revenue bonds that the Municipal Bond Bank may issue each year.
- Section 17:** Authorizes the Municipal Bond Bank to issue "Pension Obligation Bonds."
- Section 18:** Exempts "Pension Obligation Bonds" from the current limit for total revenue bonds and notes that the Municipal Bond Bank may have outstanding at any time.
- Section 19:** Adds a definition for "governmental employer" to the definitions section for the Municipal Bond Bank.
- Section 20:** Immediate effective date.

HB

13

SFIN

FILE

SENATE FINANCE COMMITTEE REPORT

DATE: 4/27/07

FURTHER:

DATE TURNED IN TO OFFICE: 3-28-08

Finance Committee considered CS FOR HOUSE BILL NO. 13(FIN)

HB 13 RETIREMENT SYSTEM LIABILITY/BONDS/CORP.

"An Act relating to prepayments of accrued actuarial liabilities of government retirement systems; relating to the Alaska Municipal Bond Bank Authority, the Alaska Housing Finance Corporation, and the state bond committee; establishing the Alaska Pension Obligation Bond Corporation; permitting the Alaska Municipal Bond Bank Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance Corporation, the state bond committee, and the Alaska Pension Obligation Bond Corporation to assist state and municipal governmental employers by issuing bonds, notes, commercial paper, or other obligations to enable the governmental employers to prepay all or a portion of the governmental employers' shares of the unfunded accrued actuarial liabilities of retirement systems; authorizing a governmental employer to issue obligations to prepay all or a portion of the governmental employer's shares of the unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or other contractual agreement with a trustee, the Alaska Municipal Bond Bank Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance Corporation, the state bond committee, or the Alaska Pension Obligation Bond Corporation in connection with the issuance of obligations for that purpose, and relating to those obligations; relating to revision of the employer contribution rate in connection with financed prepayment of unfunded accrued actuarial liabilities of government retirement systems; and providing for an effective date."

and recommends:

- be replaced with SCS or CS CS HB 13 (FIN)
- adopt previous SCS or CS _____ (_____)
- attached amendment(s)
- adopt _____ Letter of Intent
- further referral to _____ Committee

SENATE BILL:	
<input type="checkbox"/> Same Title	
<input type="checkbox"/> New Title	
<hr/>	
HOUSE BILL:	
<input type="checkbox"/> Same Title	
<input type="checkbox"/> Technical Title Change	
<input checked="" type="checkbox"/> New Title w/ SCR # _____	

NEW FISCAL NOTE(S):

PREVIOUS FISCAL NOTE

Department	Date	Fiscal	Indet.	Zero	FN#
REV	7/6/08		✓		
ADM	12/3/07			✓	

Department	Date	Fiscal	Indet.	Zero	FN#

APPROPRIATION - no fiscal note

SIGNATURES AND RECOMMENDATIONS:	PRINTED LAST NAME	DO PASS	DO NOT PASS	NO REC	AMEND
	Elton	✓			
	Thomas	✓			
	Olson			✓	
CO-CHAIR:	Hoffman	✓			
CO-CHAIR:	Stern	✓			

FISCAL NOTE

STATE OF ALASKA
2008 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: CSHB 13(FIN)
() Publish Date: _____

Identifier (file name): HB013CS(FIN)-DOA-DRB-12-03-07 Dept. Affected: Administration
Title: An Act relating to prepayments of accrued actuarial liabilities of RDU: Centralized Administrative Services
government retirement systems and establishing the AK Pension Obligation Bond Corp. Component: Retirement and Benefits
Sponsor: Rep. Hawker, Fairclough, Kelly, Roses, Dahlstrom, Johnson, Johansen, Lynn, LeDoux
Requester: Senate Finance Component Number: 64

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information						
		FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
OPERATING EXPENDITURES								
Personal Services	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Travel	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contractual	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Supplies	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equipment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Land & Structures	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants & Claims	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Miscellaneous	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES ()	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)	
1002 Federal Receipts	0.0
1003 GF Match	0.0
1004 GF	0.0
1005 GF/Program Receipts	0.0
1037 GF/Mental Health	0.0
Other Interagency Receipts	0.0
TOTAL	0.0

Estimate of any current year (FY2008) cost: _____

POSITIONS

Full-time	0	0	0	0	0	0	0
Part-time	0	0	0	0	0	0	0
Temporary	0	0	0	0	0	0	0

ANALYSIS: *(Attach a separate page if necessary)*

This bill creates the Pension Obligation Bond Corporation for the purpose of issuing pension obligation bonds to allow state and municipal employers to prepay unfunded accrued actuarial liabilities of the retirement systems. The division anticipates no additional operating or personnel costs to process any transactions that may occur as a result of passage of this bill.

Sec. 24.08.036. Fiscal notes on bills affecting state retirement systems. Before a bill which would have an effect on the retirement systems of the state is reported to the rules committee, there shall be attached to the bill an analysis of the long-term and short-term costs to the state if the bill is adopted, as well as the impact of the bill on the actuarial soundness of the fund. The analysis is in addition to the fiscal note requirements of AS .08.035.

Prepared by: <u>Patrick Shior, Director</u>	Phone <u>465-4817</u>
Division: <u>Retirement and Benefits</u>	Date/Time: <u>12/3/07 12:00 AM</u>
Approved by: <u>Annette Kreitzer, Commissioner</u>	Date: <u>12/4/2007</u>
<u>Department of Administration</u>	

FISCAL NOTE

STATE OF ALASKA
2008 LEGISLATIVE SESSION

Fiscal Note Number: _____
Bill Version: CSHB 13
() Publish Date: _____

Identifier (file name): CSHB13(FIN)-DOR-TRE-2-6-08 Dept. Affected: Revenue 04
Title: Retirement System Liability/Bonds/Corp. RDU: Taxation and Treasury
Component: Treasury
Sponsor: Representative Hawker
Requester: Senate Finance Component Number: 121

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

	Appropriation Required	Information						
		FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
OPERATING EXPENDITURES								
Personal Services								
Travel								
Contractual								
Supplies								
Equipment								
Land & Structures								
Grants & Claims								
Miscellaneous								
TOTAL OPERATING	*		*	*	*	*	*	*

CAPITAL EXPENDITURES								
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CHANGE IN REVENUES ()								
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FUND SOURCE (Thousands of Dollars)

	FY 2009	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014
1002 Federal Receipts							
1003 GF Match							
1004 GF							
1005 GF/Program Receipts							
1037 GF/Mental Health							
Other Interagency Receipts							
TOTAL	*		*	*	*	*	*

Estimate of any current year (FY2008) cost: 0.0

POSITIONS

	0	0	0	0	0	0	0
Full-time							
Part-time							
Temporary							

ANALYSIS: (Attach a separate page if necessary)

The bill expands the powers of the Alaska Municipal Bond Bank Authority (Bond Bank) and the State Bond Committee (SBC) and creates the Pension Obligation Bond Corporation (POBC) for the purpose of issuing obligations to provide funds to prepay unfunded accrued actuarial liabilities of the retirement systems. The premise of undertaking this type of transaction is borrowing at rates that are at least 1.5% lower than the actuarial assumed rate of return on the pension funds (8.25%).

The fiscal note is indeterminate in cost as it is uncertain how or if a transaction will develop if the legislation is passed. If a transaction is undertaken it is likely that it will be of considerable size, up to several billion dollars, and occur in FY 2008. Contractual costs include rating agency fees, financial advisor, bond counsel, printing, cusip service, underwriting, & other miscellaneous costs would need to be funded in the year of issuance as well as ongoing costs for administrative monitoring and cost of contractors over the life of the bonds.

Prepared by: Brian C Andrews
Division: Revenue / Treasury
Approved by: Jerry Burnett
Department of Revenue

Phone 907 465-3669
Date/Time 2/6/08 12:00 AM
Date 2/6/2008

SENATE CONCURRENT RESOLUTION NO.
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FIFTH LEGISLATURE - SECOND SESSION

BY THE SENATE FINANCE COMMITTEE

Introduced:
Referred:

A RESOLUTION

1 Suspending Rules 24(c), 35, 41(b), and 42(e), Uniform Rules of the Alaska State
2 Legislature, concerning House Bill No. 13, relating to prepayments of accrued actuarial
3 liabilities of government retirement systems; relating to the Alaska Municipal Bond
4 Bank Authority; permitting the Alaska Municipal Bond Bank Authority or a subsidiary
5 of the authority to assist state and municipal governmental employers by issuing bonds,
6 notes, commercial paper, or other obligations to enable the governmental employers to
7 prepay all or a portion of the governmental employers' shares of the unfunded accrued
8 actuarial liabilities of retirement systems; authorizing a governmental employer to issue
9 obligations to prepay all or a portion of the governmental employer's shares of the
10 unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or
11 other contractual agreement with a trustee or the Alaska Municipal Bond Bank
12 Authority or a subsidiary of the authority in connection with the issuance of obligations
13 for that purpose, and relating to those obligations; and providing for an effective date.

1 **BE IT RESOLVED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

2 That under Rule 54, Uniform Rules of the Alaska State Legislature, the provisions of
3 Rules 24(c), 35, 41(b), and 42(e), Uniform Rules of the Alaska State Legislature, regarding
4 changes to the title of a bill, are suspended in consideration of House Bill No. 13, relating to
5 prepayments of accrued actuarial liabilities of government retirement systems; relating to the
6 Alaska Municipal Bond Bank Authority; permitting the Alaska Municipal Bond Bank
7 Authority or a subsidiary of the authority to assist state and municipal governmental
8 employers by issuing bonds, notes, commercial paper, or other obligations to enable the
9 governmental employers to prepay all or a portion of the governmental employers' shares of
10 the unfunded accrued actuarial liabilities of retirement systems; authorizing a governmental
11 employer to issue obligations to prepay all or a portion of the governmental employer's shares
12 of the unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or
13 other contractual agreement with a trustee or the Alaska Municipal Bond Bank Authority or a
14 subsidiary of the authority in connection with the issuance of obligations for that purpose, and
15 relating to those obligations; and providing for an effective date.

SENATE CS FOR CS FOR HOUSE BILL NO. 13(FIN)
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FIFTH LEGISLATURE - SECOND SESSION

BY THE SENATE FINANCE COMMITTEE

Offered:

Referred:

Sponsor(s): REPRESENTATIVES HAWKER, Fairclough, Kelly, Roses, Dahlstrom, Johnson, Johansen, Lynn, LeDoux

A BILL

FOR AN ACT ENTITLED

1 "An Act relating to prepayments of accrued actuarial liabilities of government
2 retirement systems; relating to the Alaska Municipal Bond Bank Authority, the Alaska
3 Housing Finance Corporation, and the state bond committee; establishing the Alaska
4 Pension Obligation Bond Corporation; permitting the Alaska Municipal Bond Bank
5 Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance
6 Corporation, the state bond committee, and the Alaska Pension Obligation Bond
7 Corporation to assist state and municipal governmental employers by issuing bonds,
8 notes, commercial paper, or other obligations to enable the governmental employers to
9 prepay all or a portion of the governmental employers' shares of the unfunded accrued
10 actuarial liabilities of retirement systems; authorizing a governmental employer to enter
11 into a lease or other contractual agreement with a trustee, the Alaska Municipal Bond
12 Bank Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing

1 Finance Corporation, the state bond committee, or the Alaska Pension Obligation Bond
 2 Corporation in connection with the issuance of obligations by a state entity for the
 3 purpose of prepaying all or a portion of the governmental employer's share of the
 4 unfunded accrued actuarial liabilities of retirement systems, and relating to those
 5 obligations; relating to revision of the employer contribution rate in connection with
 6 financed prepayment of unfunded accrued actuarial liabilities of government retirement
 7 systems; and providing for an effective date."

8 **BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:**

9 * Section 1. AS 14.25.070 is amended by adding new subsections to read:

10 (d) All or a portion of the employer's share of any accrued actuarial liability to
 11 the plan may be prepaid in a lump sum. The commissioner of administration may, by
 12 regulation, establish a minimum amount for the lump sum payment of a portion. The
 13 administrator shall charge to the employer appropriate and reasonable administrative
 14 costs to the plan attributable to a lump sum payment that are not greater than
 15 administrative costs applied to other employer contributions. If an employer is
 16 grouped with any other employer in accounting for contributions, the lump sum
 17 payment for the employer shall be accounted for separately in accordance with
 18 regulations adopted by the commissioner. The regulations must provide for crediting
 19 to each lump sum payment account all earnings and losses received from investment
 20 of that payment. The lump sum payment shall be used solely to offset contributions
 21 under this section required of the employer for which the payment was made, taking
 22 into account earnings and losses from its investment. A lump sum payment made by or
 23 on behalf of an employer under this subsection, together with all earnings and losses
 24 from investment of that payment, may not be considered in calculating that employer's
 25 share of any discretionary payment authorized by the state that benefits multiple
 26 employers.

27 (e) If all or a portion of an employer's share of any accrued actuarial liability
 28 to the plan is prepaid in a lump sum under (d) of this section, the administrator shall

1 calculate a revised employer contribution rate for that employer in recognition of that
2 prepayment not more than 30 days following the prepayment.

3 * Sec. 2. AS 18.56.010 is amended by adding a new subsection to read:

4 (g) The legislature finds that permitting the Alaska Housing Finance
5 Corporation to create a subsidiary to assist in the financing of prepayment of all or a
6 portion of a governmental employer's share of unfunded accrued actuarial liability of
7 retirement systems serves a public purpose in benefiting the people of the state. The
8 Alaska Housing Finance Corporation may act on behalf of the state and its people in
9 serving this public purpose for the benefit of the general public.

10 * Sec. 3. AS 18.56.086 is amended to read:

11 Sec. 18.56.086. Creation of subsidiaries. The corporation may create
12 subsidiary corporations for the purpose of financing or facilitating the financing of
13 school construction, facilities for the University of Alaska, facilities for ports and
14 harbors, prepayment of all or a portion of a governmental employer's share of
15 unfunded accrued actuarial liability of retirement systems, or other capital
16 projects. A subsidiary corporation created under this section may be incorporated
17 under AS 10.20.146 - 10.20.166. The corporation may transfer assets of the
18 corporation to a subsidiary created under this section. A subsidiary created under this
19 section may borrow money and issue bonds as evidence of that borrowing, and has all
20 the powers of the corporation that the corporation grants to it. However, a subsidiary
21 created for the purpose of financing or facilitating the financing of prepayment of
22 a governmental employer's share of unfunded accrued actuarial liability of
23 retirement systems may borrow money and issue bonds only if the state bond
24 rating is the equivalent of AA- or better and subject to AS 37.15.903. Unless
25 otherwise provided by the corporation, the debts, liabilities, and obligations of a
26 subsidiary corporation created under this section are not the debts, liabilities, or
27 obligations of the corporation.

28 * Sec. 4. AS 18.56.110(g) is amended to read:

29 (g) Notwithstanding AS 18.56.090(a)(11) and (a) of this section, the
30 corporation may not issue bonds in any 12-month period beginning after June 30,
31 1983, in an amount that exceeds the amount of bonds authorized to be issued during

1 the preceding period, unless a different amount is authorized by the legislature. This
 2 subsection does not apply to

3 (1) the issuance by the corporation of refunding bonds;

4 (2) [OR TO] the issuance by the corporation of bonds the proceeds of
 5 which are intended to be used to refinance mortgage loans held by the corporation; or

6 (3) the issuance by a subsidiary of the corporation of bonds to
 7 prepay all or a portion of a governmental employer's share of unfunded accrued
 8 actuarial liability of retirement systems if the board of the subsidiary first finds
 9 that the actuarially assumed rate of return on the funds managed by the Alaska
 10 Retirement Management Board is projected to exceed the true interest cost to be
 11 paid on the bonds by at least 1.5 percent annually.

12 * Sec. 5. AS 18.56.390 is amended by adding a new paragraph to read:

13 (14) "governmental employer" means the State of Alaska or a
 14 municipality or other state or municipal governmental entity within the state, including
 15 an agency, instrumentality, district, school district, public corporation, department,
 16 division, or other subdivision of the state or of a municipality, in its capacity as an
 17 employer.

18 * Sec. 6. AS 29.47 is amended by adding a new section to read:

19 **Sec. 29.47.480. Accrued actuarial liabilities of retirement systems.** (a) A
 20 municipality, or two or more municipalities jointly, may enter into a lease or other
 21 contractual agreement with a trustee, or the Alaska Municipal Bond Bank Authority or
 22 a subsidiary of the authority, a subsidiary of the Alaska Housing Finance Corporation,
 23 the state bond committee, or the Alaska Pension Obligation Bond Corporation in
 24 connection with the issuance of obligations by a state entity to prepay all or a portion
 25 of each participating municipality's share of the accrued actuarial liabilities of
 26 retirement systems. Obligations issued for purposes described in this subsection must
 27 be secured and payable as provided in the agreement or under an authorizing
 28 ordinance. The agreement or ordinance may provide for reserves and for protective
 29 covenants.

30 (b) Amounts paid by a participating municipality in connection with
 31 obligations issued by a state entity under this section, together with proceeds of the

1 obligations and interest or earnings, may be pooled into one or more funds or
 2 accounts, including one or more debt service funds. The assets in any of the funds or
 3 accounts may be pledged to the holders of the obligations.

4 (c) A municipality may enter into a funds diversion agreement with a state
 5 agency regarding payment of money on behalf of the municipality that may be applied
 6 to payments under a lease, other agreement, or obligation issued under this section.
 7 The funds diversion agreement must provide, subject to any conditions set out in the
 8 funds diversion agreement, that all or a portion of the funds otherwise payable to the
 9 municipality by the state agency shall be paid directly to the trustee, the Alaska Bond
 10 Bank Authority, or its subsidiary, a subsidiary of the Alaska Housing Finance
 11 Corporation, the state bond committee, or the Alaska Pension Obligation Bond
 12 Corporation, to satisfy, in whole or part, the municipality's payments under the lease,
 13 other agreement, or obligations. Nothing in this subsection or in a funds diversion
 14 agreement entered into under this subsection obligates the state or a state agency to
 15 pay any amount to or on behalf of a municipality that the municipality is not otherwise
 16 entitled to receive or to make any payments of principal or interest on the obligations.

17 (d) For purposes of this section, "obligations" means bonds, notes, commercial
 18 paper, certificates of participation, or other contractual obligations.

19 * Sec. 7. AS 36.30.850(b) is amended by adding a new paragraph to read:

20 (46) contracts of the Alaska Pension Obligation Bond Corporation
 21 under AS 37.16.010 - 37.16.900.

22 * Sec. 8. AS 37.15 is amended by adding new sections to read:

23 **Article 8. Pension Obligation Bonds.**

24 **Sec. 37.15.900. Bond authorization.** (a) For purposes of financing
 25 prepayment of all or a portion of a governmental employer's share of unfunded
 26 accrued actuarial liability of retirement systems, including the costs of issuance and
 27 administration, the issuance and sale of bonds of the state by the committee is
 28 authorized as provided in this section and AS 37.15.903 - 37.15.955, but only if the
 29 state bond rating is the equivalent of AA- or better. The net proceeds of the sale of the
 30 bonds remaining after payment of costs of issuance and administration shall be
 31 transferred to the commissioner of administration for the account of the governmental

1 employer whose share of unfunded accrued actuarial liability is to be prepaid for
2 application to that liability. Accrued interest paid on the bonds shall be paid into the
3 pension obligation bond redemption fund.

4 (b) The total unpaid principal amount of bonds, including refunding bonds,
5 but excluding refunded bonds, is limited as provided in AS 37.15.903. The bonds do
6 not constitute a general obligation of the state. Authorization by the voters of the state
7 or the legislature is not required.

8 (c) The committee may enter into agreements with other state agencies as
9 necessary or convenient to implement this section and AS 37.15.903 - 37.15.955.

10 (d) The committee may contract for the services of underwriters, paying
11 agents, trustees, bond printers, rating agencies, bond insurance, credit enhancement
12 providers, accountants, financial advisors, and bond counsel, and for other services as
13 are necessary to accomplish the bond issuance and sale.

14 **Sec. 37.15.903. Pension obligation bond limit.** The total unpaid principal
15 amount of bonds, including refunding bonds, but excluding refunded bonds, issued by
16 all state entities added together, for the purposes of financing prepayment of all or a
17 portion of a governmental employer's share of unfunded accrued liability of retirement
18 systems, may not exceed \$5,000,000,000.

19 **Sec. 37.15.905. Bond redemption fund.** (a) There is established a special fund
20 of the state, known as the pension obligation bond redemption fund, which is a trust
21 fund for paying and securing the payment of the principal of and interest and
22 redemption premium, if any, on the bonds, and which shall be at all times completely
23 segregated and set apart from all other funds of the state. The bond redemption fund
24 shall be drawn on only for the purpose of paying the principal of and interest and
25 redemption premium, if any, on the bonds, together with related trustee fees, if any.

26 (b) Money in the bond redemption fund may be invested in the same manner
27 and on the same conditions as permitted for investing of money belonging to the state
28 or held in the treasury under AS 37.10.070; however, the committee may agree with
29 the bondholders to further limit these investments. Earnings on investments must be
30 retained in the bond redemption fund.

31 (c) Separate accounts may be created in the bond redemption fund for the

1 purposes of paying and securing the bonds. The accounts may be combined for
2 purposes of investment and for financial support to achieve the purposes of
3 AS 37.15.910(c).

4 **Sec. 37.15.910. Bond terms.** (a) The bonds may be issued and sold at public
5 or negotiated sale in the manner, in the amounts or series, and at the time or times that
6 the committee determines. The bonds, or each series of them, shall be sold at the price
7 and on the terms, conditions, and covenants set by the committee after considering
8 market conditions. Interest rates may be fixed or variable.

9 (b) The bonds mature at the time or times fixed by the committee. The bonds
10 may be subject to redemption before their fixed maturities, as determined by the
11 committee, with or without a premium or premiums. The bonds may be in
12 denominations determined by the committee; may be issued in fully or partially
13 registered form; must be payable as to principal and interest at the place or places
14 determined by the committee; must be signed on behalf of the state in the manner
15 provided by the committee; and must be issued under and subject to the terms,
16 conditions, covenants, and protective features safeguarding payment of the bonds as
17 found necessary by the committee.

18 (c) If the committee finds it reasonably necessary, the committee may select a
19 trustee or trustees for the holders of the bonds, or any series of them, for the
20 safeguarding and disbursement of any of the money in the bond redemption fund or
21 for duties with respect to the enforcement, authentication, delivery, payment, and
22 registration of the bonds as the committee may determine. The committee shall fix the
23 rights, duties, powers, and obligations of the trustee or trustees.

24 (d) In its determination of all matters and questions relating to the issuance
25 and sale of the bonds and the fixing of their maturities, terms, conditions, and
26 covenants as provided in (a) of this section, the decisions of the committee shall be
27 those that are reasonably necessary for the best interests of the state and its inhabitants
28 and that will accomplish the most advantageous sale of the bonds. Decisions of the
29 committee, as expressed in a bond resolution, are final and are conclusively
30 considered to comply with the requirements of AS 37.15.900 - 37.15.955.

31 **Sec. 37.15.915. Bond resolution.** The committee shall authorize the issuance

1 of bonds by adopting a resolution and shall prepare all other documents and
2 proceedings necessary for the issuance, sale, and delivery of the bonds or any part or
3 series of them. The bond resolution must fix the principal amount, denominations,
4 date, maturities, manner of sale, place or places of payment, rights of redemption, if
5 any, terms, form, conditions, and covenants of the bonds or each series of them.

6 **Sec. 37.15.920. Enforcement by bond owner.** (a) The owner or owners of not
7 less than 10 percent of the aggregate principal amount of any series or issue of bonds
8 or the trustee for the owners of the bonds or any series of them may, by appropriate
9 proceedings in state court, require and compel the transfer, setting aside, and payment
10 of money and the enforcement of all of the terms, conditions, and covenants as
11 required and provided in AS 37.15.900 - 37.15.955, as appropriate, and the bond
12 resolution.

13 (b) A proceeding under (a) of this section may be commenced and conducted
14 only in the Superior Court for the State of Alaska, First Judicial District at Juneau.

15 **Sec. 37.15.925. Amounts required for payments.** The committee shall,
16 before June 30 of each year or from time to time within the year, as appropriate,
17 commencing with the year in which the bonds are issued, certify to the commissioner
18 of revenue and the commissioner of administration the amounts required in the current
19 fiscal year and the next ensuing fiscal year by the bond resolution or resolutions to be
20 paid from the general fund into the bond redemption fund and to be paid into and
21 maintained in any reserve fund or account or other fund or account created by the
22 bond resolution or resolutions, and shall also certify to the commissioners the last date
23 or dates on which payments may be made.

24 **Sec. 37.15.930. Purposes and sufficiency of revenue.** The proceeds of bonds
25 may be used for the purposes described in AS 37.15.900(a), as appropriate. Bonds
26 may not be issued unless the committee first finds that the actuarially assumed rate of
27 return on the funds managed by the Alaska Retirement Management Board is
28 projected to exceed the true interest cost to be paid on the bonds by at least 1.5 percent
29 annually.

30 **Sec. 37.15.935. Refunding.** (a) The committee may refund the bonds or any
31 part of them at or before their maturities or redemption dates by the issuance of

1 refunding bonds of the state if the state bond rating is the equivalent of AA- or better
2 and if, in the opinion of the committee, refunding is advantageous to and in the best
3 interest of the state and its inhabitants.

4 (b) The issuance of refunding bonds need not be authorized by the voters of
5 the state or by an act of the legislature. The committee shall adopt the resolution or
6 resolutions and prepare all other documents and proceedings necessary for the
7 issuance, exchange or sale, and delivery of the refunding bonds. All provisions of
8 AS 37.15.900 - 37.15.955 are applicable to the refunding bonds and to the issuance,
9 sale, or exchange of them, except as otherwise provided in this section.

10 (c) Refunding bonds may be issued in a principal amount sufficient to provide
11 money for the advance or current refunding of all bonds to be refunded and interest on
12 the refunded bonds and, in addition, for the payment of all costs of issuance and
13 administration of the refunding bonds. These expenses also include the difference in
14 amount between the par value of the refunding bonds and any amount less than par for
15 which the refunding bonds are sold; the premium, if any, necessary to be paid to call
16 or retire the outstanding bonds and the interest accruing on them to the date of the call
17 or retirement; and other of these costs. The committee is authorized to incur expenses
18 to carry out this section.

19 (d) The committee may contract with a refunding trustee to hold the proceeds
20 of refunding bonds in trust until the proceeds, together with earnings on the proceeds,
21 are applied to pay the principal of, premium, if any, and interest on the bonds to be
22 refunded. Until the refunding bond proceeds are applied, the proceeds may be invested
23 in direct obligations of, or obligations guaranteed by, the United States or an agency or
24 corporation of the United States whose obligations constitute direct obligations of, or
25 obligations guaranteed by, the United States.

26 **Sec. 37.15.940. Bonds as legal investments.** The bonds are legal investments
27 for all banks, trust companies, savings banks, savings and loan associations, and other
28 persons carrying on a banking business, all insurance companies and other persons
29 carrying on an insurance business, and all executors, administrators, trustees, and other
30 fiduciaries. The bonds may be accepted as security for deposits of all money of the
31 state and its political subdivisions.

1 **Sec. 37.15.945. Statutory construction.** AS 37.15.900 - 37.15.955 shall be
2 liberally construed to carry out the purposes for which they were enacted.

3 **Sec. 37.15.950. Regulations.** The committee may adopt regulations necessary
4 to implement the provisions of AS 37.15.900 - 37.15.955.

5 **Sec. 37.15.955. Definitions.** In AS 37.15.900 - 37.15.955,

6 (1) "bond redemption fund" means the pension obligation bond
7 redemption fund established in AS 37.15.905;

8 (2) "bond resolution" means a resolution or resolutions adopted by the
9 committee under AS 37.15.915 authorizing the issuance of bonds;

10 (3) "bonds" means the pension obligation bonds authorized in
11 AS 37.15.900 - 37.15.955;

12 (4) "committee" means the state bond committee created in
13 AS 37.15.110 or any other committee, body, department, or officer of the state that
14 succeeds to the rights, powers, duties, and obligations of the state bond committee by
15 law;

16 (5) "costs of issuance and administration" means all costs associated
17 with issuance and administration of pension obligation bonds and refunding bonds,
18 including costs of bond printing, official statements, financial advisors, travel costs,
19 rating agencies, bond insurance, letters and lines of credit for credit enhancement,
20 underwriters, legal services, paying agents, bond registrars, bond and escrow trustees,
21 arbitrage rebate, and all other costs, including administrative costs, both direct and
22 indirect.

23 * **Sec. 9.** AS 37 is amended by adding a new chapter to read:

24 **Chapter 16. Alaska Pension Obligation Bond Corporation.**

25 **Sec. 37.16.010. Alaska Pension Obligation Bond Corporation.** There is
26 established the Alaska Pension Obligation Bond Corporation. The corporation is a
27 public corporation and government instrumentality in the Department of Revenue
28 managed by a board of directors. The purpose of the corporation is to finance
29 prepayment of all or a portion of a governmental employer's share of unfunded
30 accrued actuarial liability of retirement systems.

31 **Sec. 37.16.020. Board of directors.** The directors of the corporation are the

1 commissioner of commerce, community, and economic development, the
 2 commissioner of administration, and the commissioner of revenue. If a director is
 3 absent or otherwise unable to act, the director's designee in the department shall act as
 4 a director of the corporation in the director's place.

5 **Sec. 37.16.030. Bond authorization.** (a) For purposes of financing
 6 prepayment of all or a portion of a governmental employer's share of unfunded
 7 accrued actuarial liability of retirement systems, including the costs of issuance and
 8 administration, the issuance and sale of bonds by the corporation is authorized as
 9 provided in this section and AS 37.16.040 - 37.16.900, but only if the state bond rating
 10 is the equivalent of AA- or better. The net proceeds of the sale of the bonds remaining
 11 after payment of costs of issuance and administration shall be transferred to the
 12 commissioner of administration for the account of the governmental employer whose
 13 share of unfunded accrued actuarial liability is to be prepaid for application to that
 14 liability. Accrued interest paid on the bonds shall be paid into the reserve fund.

15 (b) The total unpaid principal amount of bonds, including refunding bonds,
 16 but excluding refunded bonds, is limited as provided in AS 37.15.903. The bonds do
 17 not constitute a general obligation of the state. Authorization by the votes of the state
 18 or the legislature is not required.

19 (c) The corporation may enter into agreements with other state agencies as
 20 necessary or convenient to implement this section and AS 37.16.040 - 37.16.900.

21 (d) The corporation may contract for the services of underwriters, paying
 22 agents, trustees, bond printers, rating agencies, bond insurance, credit enhancement
 23 providers, accountants, financial advisors, and bond counsel, and other services as are
 24 necessary to accomplish the bond issuance and sale.

25 **Sec. 37.16.040. Reserve fund.** (a) The corporation may establish and maintain
 26 a special fund called the Alaska Pension Obligation Bond Corporation reserve fund in
 27 which there shall be deposited or transferred

28 (1) all money appropriated by the legislature for the purpose of the
 29 fund in accordance with the provisions of (g) of this section;

30 (2) all proceeds of bonds required to be deposited in the fund by terms
 31 of a contract between the corporation and its bondholders or a resolution of the

1 corporation with respect to the proceeds of bonds;

2 (3) all other money appropriated by the legislature to the reserve fund;
3 and

4 (4) any other money or funds of the corporation that it decides to
5 deposit in the fund.

6 (b) Subject to the provisions of (h) of this section, money in the reserve fund
7 shall be held and applied solely to the payment of the interest on and principal of
8 bonds of the corporation as the interest and principal become due and payable to the
9 retirement of bonds, or to the payment or prepayment of a portion of the participating
10 governmental employer's share of the accrued actuarial liabilities of retirement
11 systems. Money may not be withdrawn if a withdrawal would reduce the amount in
12 the reserve fund to an amount less than the required debt service reserve except for
13 payment of interest then due and payable on bonds and the principal of bonds then
14 maturing and payable and for the retirement of bonds in accordance with the terms of
15 a contract between the corporation and its bondholders and for which payments of
16 other money of the corporation is not then available.

17 (c) Money in the reserve fund in excess of the required debt service reserve as
18 defined in (b) of this section, whether because of investment or otherwise, may be
19 withdrawn at any time by the corporation to pay or prepay a portion of participating
20 governmental employer's share of the accrued actuarial liabilities of retirement
21 systems or transferred to another fund or account of the corporation subject to the
22 provision of (h) of this section.

23 (d) Money in the reserve fund may be invested in the same manner and on the
24 same conditions as permitted for investment of funds belonging to the state or held in
25 the treasury under AS 37.10.070; however, the corporation may agree with the
26 bondholders to further limit these investments.

27 (e) For purposes of valuation, investments in the reserve fund shall be valued
28 at par or, if purchased at less than par, at cost unless otherwise provided by resolution
29 of the corporation. Valuation on a particular date shall include the amount of interest
30 then earned or accrued to that date on the money or investments in the reserve fund.

31 (f) Notwithstanding any other provision of this chapter, bonds may not be

1 issued by the corporation unless there is in the reserve fund the required debt service
2 reserve for all bonds then issued and outstanding and for the bonds to be issued;
3 however, the corporation may satisfy this requirement by depositing as much of the
4 proceeds of the bonds to be issued, on their issuance, as is needed to meet the required
5 debt service reserve. The corporation may at any time issue its bonds or notes for the
6 purpose of increasing the amount in the reserve fund to the required debt service
7 reserve, or to meet whatever higher or additional reserve that may be fixed by the
8 corporation with respect to the fund.

9 (g) To assure the maintenance of the required debt service reserve in the
10 reserve fund, the legislature may appropriate annually to the corporation for deposit in
11 the fund the sum, certified by the chair of the corporation to the governor and to the
12 legislature, that is necessary to restore the fund to an amount equal to the required debt
13 service reserve. The chair annually, before January 30, shall make and deliver to the
14 governor and to the legislature a certificate stating the sum required to restore the fund
15 to that amount, and the certified sum may be appropriated and paid to the corporation
16 during the then current state fiscal year. Nothing in this subsection creates a debt or
17 liability of the state.

18 (h) All amounts received because of money appropriated to the reserve fund
19 shall be held and applied in accordance with (b) of this section.

20 (i) All references to the reserve fund in this section include special accounts
21 within the reserve fund that may be created by the corporation to secure the payment
22 of particular bonds.

23 (j) The commissioner of revenue may, subject to appropriation, lend surplus
24 money in the general fund to the corporation for deposit to any account in the reserve
25 fund in an amount equal to the required debt service reserve. The loans shall be made
26 on the terms and conditions that may be agreed on by the commissioner of revenue
27 and the corporation, including, without limitation, terms and conditions providing that
28 the loans need not be repaid until the obligations of the corporation secured and to be
29 secured by the account in the reserve fund are no longer outstanding.

30 (k) In this section, "required debt service reserve" means, on the date of
31 computation, the amount required to be on deposit in the reserve fund as provided by

1 resolution of the corporation.

2 **Sec. 37.16.050. Bond terms.** (a) The bonds may be issued and sold at public
3 or negotiated sale in the manner, in the amounts or series, and at the time or times that
4 the corporation determines the bonds, or each series of them, shall be sold at the price
5 and on the terms, conditions, and covenants set by the corporation after considering
6 market conditions. Interest rates may be fixed or variable.

7 (b) The bonds mature at the time or times fixed by the corporation. The bonds
8 may be subject to redemption before their fixed maturities, as determined by the
9 corporation, with or without a premium or premiums. The bonds may be in
10 denominations determined by the corporation; may be issued in fully or partially
11 registered form; must be payable as to principal and interest at the place or places
12 determined by the corporation; must be signed in the manner provided by the
13 corporation; and must be issued under and subject to the terms, conditions, covenants,
14 and protective features safeguarding payment of the bonds as found necessary by the
15 corporation.

16 (c) If the corporation finds it reasonably necessary, the corporation may select
17 a trustee or trustees for the holders of the bonds, or any series of them, for the
18 safeguarding and disbursement of any of the money in the bond reserve fund or for
19 duties with respect to the enforcement, authentication, delivery, payment, and
20 registration of the bonds as the corporation may determine. The corporation shall fix
21 the rights, duties, powers, and obligations of the trustee or trustees.

22 (d) In its determination of all matters and questions relating to the issuance
23 and sale of the bonds and the fixing of their maturities, terms, conditions, and
24 covenants as provided in (a) of this section, the decisions of the corporation shall be
25 those that are reasonably necessary for the best interests of the state and its inhabitants
26 and that will accomplish the most advantageous sale of the bonds. Decisions of the
27 corporation, as expressed in a bond resolution, are final and are conclusively
28 considered to comply with the requirements of this chapter.

29 **Sec. 37.16.060. Bond resolution.** The corporation shall authorize the issuance
30 of bonds by adopting a resolution and shall prepare all other documents and
31 proceedings necessary for the issuance, sale, and delivery of the bonds or any part or

1 series of them. The bond resolution must fix the principal amount, denominations,
2 date, maturities, manner of sale, place or places of payment, rights of redemption, if
3 any, terms, form, conditions, and covenants of the bonds or each series of them.

4 **Sec. 37.16.070. Enforcement by bond owner.** (a) The owner or owners of not
5 less than 10 percent of the aggregate principal amount of any series or issue of bonds
6 or the trustee for the owners of the bonds or any series of them may, by appropriate
7 proceedings in state court, require and compel the transfer, setting aside, and payment
8 of money and the enforcement of all of the terms, conditions, and covenants as
9 required and provided in this chapter, as appropriate, and the bond resolution.

10 (b) A proceeding under (a) of this section may be commenced and conducted
11 only in the Superior Court for the State of Alaska, First Judicial District at Juneau.

12 **Sec. 37.16.080. Purposes and sufficiency of revenue.** The proceeds of bonds
13 may be used for the purposes described in AS 37.16.030(a), as appropriate. Bonds
14 may not be issued unless the corporation first finds that the actuarially assumed rate of
15 return on the funds managed by the Alaska Retirement Management Board is
16 projected to exceed the true interest cost to be paid on the bonds by at least 1.5 percent
17 annually.

18 **Sec. 37.16.090. Refunding.** (a) The corporation may refund the bonds or any
19 part of them at or before their maturities or redemption dates by the issuance of
20 refunding bonds of the corporation if the state bond rating is the equivalent of AA- or
21 better and if, in the opinion of the corporation, refunding is advantageous to and in the
22 best interest of the state and its inhabitants.

23 (b) The issuance of refunding bonds need not be authorized by the voters of
24 the state or by an act of the legislature. The corporation shall adopt the resolution or
25 resolutions and prepare all other documents and proceedings necessary for the
26 issuance, exchange or sale, and delivery of the refunding bonds. All provisions of this
27 chapter are applicable to the refunding bonds and to the issuance, sale, or exchange of
28 them, except as otherwise provided in this section.

29 (c) Refunding bonds may be issued in a principal amount sufficient to provide
30 money for the advance or current refunding of all bonds to be refunded and interest on
31 the refunded bonds and, in addition, for the payment of all costs of issuance and

1 administration of the refunding bonds. These expenses also include the difference in
 2 amount between the par value of the refunding bonds and any amount less than par for
 3 which the refunding bonds are sold; the premium, if any, necessary to be paid to call
 4 or retire the outstanding bonds and the interests accruing on them to the date of the
 5 call or retirement; and other of these costs. The corporation is authorized to incur
 6 expenses to carry out this section.

7 (d) The corporation may contract with a refunding trustee to hold the proceeds
 8 of refunding bonds in trust until the proceeds, together with earnings on the proceeds,
 9 are applied to pay the principal of premium, if any, and interest on the bonds to be
 10 refunded. Until the refunding bond proceeds are applied, the proceeds may be invested
 11 in direct obligations of, or obligations guaranteed by, the United States of an agency or
 12 corporation of the United States whose obligations constitute direct obligations of, or
 13 obligations guaranteed by, the United States.

14 **Sec. 37.16.100. Bonds as legal investments.** The bonds are legal investments
 15 for all banks, trust companies, savings banks, savings and loan associations, and other
 16 persons carrying on a banking business, all insurance companies and other persons
 17 carrying on an insurance business, and all executors, administrators, trustees, and other
 18 fiduciaries. The bonds may be accepted as security for deposits of all money of the
 19 state and its political subdivisions.

20 **Sec. 37.16.110. Debt service repayment contracts.** The corporation shall
 21 enter into contracts with governmental employers for the purpose of recouping
 22 amounts paid as debt service on bonds issued by the corporation for the benefit of
 23 governmental employers. The corporation may pledge the revenue of the contracts as
 24 security for the bonds issued by the corporation.

25 **Sec. 37.16.800. Statutory construction.** This chapter shall be liberally
 26 construed to carry out the purposes for which it was enacted.

27 **Sec. 37.16.810. Regulations.** The corporation may adopt regulations necessary
 28 to implement the provisions of this chapter.

29 **Sec. 37.16.900. Definitions.** In this chapter,

30 (1) "bond resolution" means the resolution or resolutions adopted by
 31 the corporation under AS 37.16.060 authorizing the issuance of bonds;

1 (2) "bonds" means the pensions obligation bonds authorized in this
2 chapter;

3 (3) "corporation" means the Alaska Pension Obligation Bond
4 Corporation created in AS 37.16.010;

5 (4) "costs of issuance and administration" means all costs associated
6 with issuance and administration of pension obligation bonds and refunding bonds,
7 including costs of bond printing, official statements, financial advisors, travel costs,
8 rating agencies, bond insurance, letters and lines of credit for credit enhancement,
9 underwriters, legal services, paying agents, bonds registrars, bond and escrow trustees,
10 arbitrage rebate, and all other costs, including administrative costs, both direct and
11 indirect;

12 (5) "reserve fund" means the Alaska Pension Obligation Bond
13 Corporation reserve fund established in AS 37.16.040.

14 * Sec. 10. AS 39.35.100(b)(3) is amended to read:

15 (3) A separate account for each employer shall be maintained. The
16 account shall be credited with contributions made by or on behalf of the employer.
17 Except as provided in AS 39.35.270(d), this [THIS] account shall be charged with
18 the employer's actuarial charge for pension, death benefits, and other benefits paid
19 under this plan to or on behalf of the employee of the employer. Except as provided
20 in AS 39.35.270(d), after [AFTER] an allowance for interest credited to employee
21 contribution accounts and employee savings accounts, the investment income of the
22 pension fund shall be allocated to the retirement reserve account and to each employer
23 asset share account according to the ratio that the average of the assets in the account
24 as of the beginning and as of the end of the fiscal year bears to the total of the average
25 balance of the retirement reserve account and all employer accounts.

26 * Sec. 11. AS 39.35.100(b)(4) is amended to read:

27 (4) An expense account shall be maintained for the plan. Except as
28 provided in AS 39.35.270(d), this [THIS] account shall be charged with all
29 disbursements representing administrative expenses incurred by the plan. At the end of
30 the year, the expense account shall be allocated to each employer in accordance with
31 (3) of this subsection. Expenditures from this account shall be included in the

1 governor's budget for each fiscal year and are subject to approval by the legislature.

2 * Sec. 12. AS 39.35.270 is amended by adding new subsections to read:

3 (d) All or a portion of the employer's share of any accrued actuarial liability to
4 the plan may be prepaid in a lump sum. The commissioner may, by regulation,
5 establish a minimum amount for the lump sum payment of a portion. The
6 commissioner shall charge to the employer appropriate and reasonable costs to the
7 plan attributable to a lump sum payment that are not greater than administrative costs
8 applied to other employer contributions. If a lump sum payment is made, the payment
9 shall be accounted for separately in accordance with regulations adopted by the
10 commissioner. The regulations must provide for crediting to each lump sum payment
11 account all earnings and losses received from investment of that payment. The lump
12 sum payment shall be used solely to offset contributions under this section required of
13 the employer that made the payment or on whose behalf the payment was made,
14 taking into account earnings and losses from its investment. A lump sum payment
15 made by or on behalf of an employer under this subsection, together with all earnings
16 and losses from investment of that payment, may not be considered in calculating that
17 employer's share of any discretionary payment authorized by the state that benefits
18 multiple employers.

19 (e) If all or a portion of the employer's share of any accrued actuarial liability
20 to the plan is prepaid in a lump sum under (d) of this section, the administrator shall
21 calculate a revised employer contribution rate for that employer in recognition of that
22 prepayment not more than 30 days following the prepayment.

23 * Sec. 13. AS 44.85.010 is amended to read:

24 Sec. 44.85.010. Legislative policy. (a) It is the policy of the state to

25 (1) [TO] foster and promote by all reasonable means the provision of
26 adequate capital markets and facilities for borrowing money by municipalities in the
27 state to finance capital improvements or for other authorized purposes, to assist these
28 municipalities in fulfilling their capital needs and requirements by use of borrowed
29 money within statutory interest rate or cost of borrowing limitations, to the greatest
30 extent possible to reduce costs of borrowed money to taxpayers and residents of the
31 state, and equally to encourage continued investor interest in the purchase of bonds or

1 notes of municipalities as sound and preferred securities for investment;

2 (2) [TO] encourage municipalities to continue their independent
3 undertakings and financing of capital improvements and other authorized purposes
4 and to assist them by making capital funds available at reduced interest costs for
5 orderly financing of capital improvements and other purposes especially during
6 periods of restricted credit or money supply, particularly for those municipalities not
7 otherwise able to borrow for capital needs;

8 (3) [TO] assist municipalities to provide for adequate insurance
9 coverage by authorizing the Alaska Municipal Bond Bank Authority to issue
10 negotiable or nonnegotiable revenue bonds, notes, or certificates of participation either
11 directly or through an entity it may create for the purpose of providing a self-insurance
12 program for municipalities or municipal joint insurance arrangements organized under
13 AS 21.76;

14 (4) assist governmental employers to prepay all or a portion of
15 their share of unfunded accrued actuarial liabilities of retirement systems in an
16 effort to reduce their costs of satisfying their contractual obligations to provide
17 retirement and other benefits to public employees through the issuance of bonds,
18 notes, commercial paper, or other obligations by the bond bank authority or by a
19 subsidiary corporation created by the bond bank authority under AS 44.85.085,
20 but only if the state bond rating is the equivalent of AA- or better; this assistance
21 is limited as provided in AS 37.15.903.

22 (b) The legislature further declares that

23 (1) the exercise of the powers of the state in the interest of its
24 municipalities and in the interest of public employees of the state and of its
25 municipalities is required to further and implement the policies declared in (a) of this
26 section by authorizing the creation of a state bond bank authority as a body corporate
27 and politic that will have full powers to borrow money and to issue its bonds and notes
28 to make capital funds available for borrowing by municipalities and for borrowing
29 by or on behalf of governmental employers, by authorizing governmental
30 employers to contract with the bond bank authority or with a subsidiary created
31 under AS 44.85.085 for the purpose of reducing future costs of providing

1 retirement and other benefits to employees, and by granting broad powers to the
 2 bond bank authority to carry out the declared policies, which are in the public interest
 3 of the state and its taxpayers and residents;

4 (2) state funds should be applied or authorized to be paid to a state
 5 bond bank authority only to provide adequate assurance and security to the holders of
 6 the bonds or notes of the bond bank authority;

7 (3) the bond bank authority should conduct its operations to provide
 8 the lowest rates in terms of borrowing to municipalities as is consistent with a self-
 9 supporting operation with no expectation of subsidization with state funds; the
 10 legislature does not intend that the bond bank authority be utilized as a means to
 11 finance municipalities beyond their capability to meet repayment schedules and debt
 12 service requirements of bonds or notes;

13 (4) the bond bank authority or its subsidiary should conduct its
 14 operations to provide the lowest rates in terms of borrowing to governmental
 15 employers under AS 44.85.085 and 44.85.086 as is consistent with a self-
 16 supporting operation with no expectation of subsidization with state funds; the
 17 legislature does not intend that the bond bank authority or its subsidiary be
 18 utilized as a means to finance governmental employers under AS 44.85.085 and
 19 44.85.086 beyond their capability to meet repayment schedules and debt service
 20 requirements of bonds, notes, commercial paper, or other obligations to the bond
 21 bank authority or its subsidiary.

22 * Sec. 14. AS 44.85.080 is amended to read:

23 Sec. 44.85.080. Powers of bond bank authority. The bond bank authority
 24 may

- 25 (1) sue and be sued;
- 26 (2) adopt and alter an official seal;
- 27 (3) make and enforce bylaws and regulations for the conduct of its
 28 business and for the use of its services and facilities;
- 29 (4) maintain an office at any place in the state;
- 30 (5) acquire, hold, use, and dispose of its income, revenue, funds, and
 31 money;

1 (6) acquire, rent, lease, hold, use, and dispose of other personal
2 property for its purposes;

3 (7) subject to AS 44.85.100(b), borrow money and issue its negotiable
4 bonds or notes and provide for and secure their payment, provide for the rights of their
5 holders, and purchase, hold, and dispose of any of its bonds or notes;

6 (8) fix and revise from time to time and charge and collect fees and
7 charges for the use of its services or facilities;

8 (9) accept gifts or grants from the United States, or from any
9 governmental unit or person, firm, or corporation, carry out the terms or provisions or
10 make agreements with respect to the gifts or grants, and do all things necessary,
11 useful, desirable, or convenient in connection with procuring, accepting, or disposing
12 of the gifts or grants;

13 (10) do anything authorized by this chapter, through its officers,
14 agents, or employees or by contracts with a person;

15 (11) make, enter into, and enforce all contracts necessary, convenient,
16 or desirable for the purposes of the bond bank authority or pertaining to a loan to a
17 political subdivision, a purchase or sale of municipal bonds or other investments, or
18 the performance of its duties and execution of any of its powers under this chapter;

19 (12) purchase or hold municipal bonds at prices and in a manner the
20 bond bank authority considers advisable, and sell municipal bonds acquired or held by
21 it at prices without relation to cost and in a manner the bond bank authority considers
22 advisable;

23 (13) invest funds or money of the bond bank authority not required at
24 the time of investment for loan to political subdivisions for the purchase of municipal
25 bonds, in the same manner as permitted for investment of funds belonging to the state,
26 except as otherwise provided in this chapter;

27 (14) prescribe the form of application or procedure required of a
28 political subdivision for a loan or purchase of its municipal bonds, fix the terms and
29 conditions of the loan or purchase, and enter into agreements with political
30 subdivisions with respect to loans or purchases;

31 (15) render services to a political subdivision in connection with a

1 public or private sale of its municipal bonds, including advisory and other services,
2 and charge for services rendered;

3 (16) charge for its costs and services in review or consideration of a
4 proposed loan to a political subdivision or purchase by the bond bank authority of
5 municipal bonds of the political subdivision, whether or not the loan is made or the
6 municipal bonds purchased;

7 (17) fix and establish terms and provisions with respect to a purchase
8 of municipal bonds by the bond bank authority, including date and maturities of the
9 bonds, provisions as to redemption or payment before maturity, and any other matters
10 that [WHICH] in connection with the purchase are necessary, desirable, or advisable
11 in the judgment of the bond bank authority;

12 (18) procure insurance against any losses in connection with its
13 property, operations, or assets in amounts and from insurers as it considers desirable;

14 (19) to the extent permitted under its contracts with the holders of
15 bonds or notes of the bond bank authority, consent to modification of the rate of
16 interest, time and payment of installment of principal or interest, security or any other
17 term of a bond or note, contract or agreement of any kind to which the bond bank
18 authority is a party;

19 (20) by regulation, create a new entity or new entities for the purpose
20 of issuing negotiable or nonnegotiable revenue bonds, notes, or certificates of
21 participation to finance a self-insurance program for municipalities or municipal joint
22 insurance arrangements organized under AS 21.76 or to provide assistance to
23 governmental employers under AS 44.85.085(a); the powers, duties, and
24 membership of the new entity or entities shall be limited to the powers, duties, and
25 membership of the authority and stated in the regulation; the new entity or entities
26 shall each be a public corporation and an instrumentality of the state with the same
27 legal existence and continuing succession as the bond bank authority; and

28 (21) do all acts and things necessary, convenient, or desirable to carry
29 out the powers expressly granted or necessarily implied in this chapter.

30 * Sec. 15. AS 44.85 is amended by adding new sections to read:

31 Sec. 44.85.085. Creation of subsidiary corporation. (a) The bond bank

1 authority may create one or more subsidiary corporations for the following purposes:

2 (1) providing financial and other assistance to governmental employers
3 to enable the governmental employers to reduce their costs of providing retirement
4 and other benefits to their employees by prepaying all or a portion of their shares of
5 the unfunded accrued actuarial liabilities of retirement systems;

6 (2) receiving payments and providing servicing for payments to or
7 from participating governmental employers; and

8 (3) performing other duties and providing other services as the
9 subsidiary corporation considers necessary or desirable to further the purposes set out
10 in (1) and (2) of this subsection.

11 (b) The bond bank authority may incorporate under AS 10.20.146 - 10.20.166
12 a subsidiary corporation created under (a) of this section. The bond bank authority
13 may transfer assets of the bond bank authority to the subsidiary corporation and may
14 agree to secure bonds, notes, commercial paper, or other obligations of the subsidiary
15 corporation with a reserve fund established under AS 44.85.270.

16 (c) A subsidiary corporation created under (a) of this section may, if the state
17 bond rating is the equivalent of AA- or better, and subject to AS 37.15.903, borrow
18 money and issue bonds, notes, commercial paper, or other obligations as evidence of
19 that borrowing and may have all the powers of the bond bank authority that the bond
20 bank authority grants to it. The provisions of AS 44.85.130 - 44.85.170 and 44.85.270
21 - 44.85.390 apply to the subsidiary corporation and to bonds, notes, commercial paper,
22 or other obligations issued by the subsidiary corporation. Unless otherwise provided
23 by the bond bank authority, the debts, liabilities, and obligations of the subsidiary
24 corporation are not the debts, liabilities, or obligations of the bond bank authority.

25 (d) The staff of the bond bank authority serves as staff of a subsidiary
26 corporation created under (a) of this section. The bond bank authority shall determine
27 the membership or the process for selecting the membership of the board of directors
28 of the subsidiary corporation. The bond bank authority may permit some or all of its
29 directors to serve on the board of directors of the subsidiary corporation.

30 **Sec. 44.85.086. Powers of subsidiary corporation.** A subsidiary corporation
31 created under AS 44.85.085 has the following powers in addition those granted to it

1 under AS 44.85.085(c):

2 (1) to make loans to and enter into contracts with governmental
3 employers;

4 (2) to incur debt, subject to AS 37.15.903, in furtherance of its
5 purposes, in the form of bonds, notes, commercial paper, or other obligations as the
6 subsidiary corporation considers appropriate, but only if the state bond rating is the
7 equivalent of AA- or better;

8 (3) to secure its debt with a pledge of any assets that are available to
9 the subsidiary corporation for the purpose, including identified revenue and
10 contractual payments from participating governmental employers, and the general
11 assets and revenue of the subsidiary corporation; and

12 (4) to enter into contracts with underwriters, bond counsel, financial
13 advisors, accountants, actuaries, and other contractors to provide assistance as the
14 subsidiary corporation considers desirable to accomplish its purposes.

15 * Sec. 16. AS 44.85.100(b) is amended to read:

16 (b) The bond bank authority shall include in the report required by (a) of this
17 section an estimate of the amount of revenue bonds of the bond bank authority to be
18 issued during the fiscal year following the fiscal year in which the report is submitted.
19 Other than refunding bonds and other than bonds, notes, commercial paper, or
20 other obligations issued under AS 44.85.086 and 44.85.180(a)(5), the [THE] bond
21 bank authority may not issue revenue bonds [, OTHER THAN REFUNDING
22 BONDS,] in excess of \$75,000,000 during any fiscal year beginning after June 30,
23 1981, unless the legislature, by law, approves the estimate required by this subsection
24 for that fiscal year.

25 * Sec. 17. AS 44.85.180(a) is amended to read:

26 (a) Subject to AS 44.85.100(b), the bond bank authority may issue its bonds or
27 notes in principal amounts that it considers necessary to provide funds for any
28 purposes under this chapter, including

29 (1) the purchase of municipal bonds;

30 (2) the making of loans through the purchase of municipal bonds,
31 notes, or certificates of participation secured by an agreement between the bond bank

1 authority and a municipality or a municipal joint insurance arrangement organized
2 under AS 21.76;

3 (3) the payment, funding, or refunding of the principal of, or interest or
4 redemption premiums on, bonds or notes issued by it whether the bonds or notes or
5 interest to be funded or refunded have or have not become due;

6 (4) the establishment or increase of reserves to secure or to pay bonds
7 or notes or interest on bonds or notes and all other costs or expenses of the bond bank
8 authority incident to and necessary or convenient to carry out its corporate purposes
9 and powers;

10 (5) assisting governmental employers to prepay all or a portion of
11 their share of the unfunded accrued actuarial liabilities of retirement systems,
12 with security as the bond bank authority considers reasonable; however, to carry
13 out this paragraph, bonds and other obligations may only be issued if the state
14 bond rating is the equivalent of AA- or better; bonds issued under this paragraph
15 are subject to AS 37.15.903.

16 * Sec. 18. AS 44.85.180(c) is amended to read:

17 (c) Notwithstanding the provisions of (a) and (b) of this section, the total
18 amount of bond bank authority bonds and notes outstanding at any one time [,
19 EXCEPT BONDS OR NOTES ISSUED TO FUND OR REFUND BONDS OR
20 NOTES,] may not exceed \$750,000,000. This subsection does not apply to

21 (1) bonds or notes issued to fund or refund bonds or notes;

22 (2) bonds, notes, commercial paper, and other obligations issued
23 under AS 44.85.086 or 44.85.180(a)(5).

24 * Sec. 19. AS 44.85.410 is amended by adding a new paragraph to read:

25 (8) "governmental employer" means the State of Alaska or a
26 municipality or other state or municipal governmental entity within the state, including
27 an agency, instrumentality, district, school district, public corporation, department,
28 division, or other subdivision of the state or of a municipality, in its capacity as an
29 employer.

30 * Sec. 20. This Act takes effect immediately under AS 01.10.070(e).

Page 2 amended 03-LS0084NK

CS FOR HOUSE BILL NO. 13(FIN)
IN THE LEGISLATURE OF THE STATE OF ALASKA
TWENTY-FIFTH LEGISLATURE - FIRST SESSION

BY THE HOUSE FINANCE COMMITTEE

Offered: 4/23/07
Referred: Rules

Sponsor(s): REPRESENTATIVES HAWKER, Fairclough, Kelly, Roses, Dahlstrom, Johnson, Johansen, Lynn, LeDoux

A BILL
FOR AN ACT ENTITLED

1 "An Act relating to prepayments of accrued actuarial liabilities of government
2 retirement systems; relating to the Alaska Municipal Bond Bank Authority, the Alaska
3 Housing Finance Corporation, and the state bond committee; establishing the Alaska
4 Pension Obligation Bond Corporation; permitting the Alaska Municipal Bond Bank
5 Authority or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance
6 Corporation, the state bond committee, and the Alaska Pension Obligation Bond
7 Corporation to assist state and municipal governmental employers by issuing bonds,
8 notes, commercial paper, or other obligations to enable the governmental employers to
9 prepay all or a portion of the governmental employers' shares of the unfunded accrued
10 actuarial liabilities of retirement systems; authorizing a governmental employer to issue
11 obligations to prepay all or a portion of the governmental employer's shares of the
12 unfunded accrued actuarial liabilities of retirement systems and to enter into a lease or

1 other contractual agreement with a trustee, the Alaska Municipal Bond Bank Authority
 2 or a subsidiary of the authority, a subsidiary of the Alaska Housing Finance
 3 Corporation, the state bond committee, or the Alaska Pension Obligation Bond
 4 Corporation in connection with the issuance of obligations for that purpose, and relating
 5 to those obligations; relating to revision of the employer contribution rate in connection
 6 with financed prepayment of unfunded accrued actuarial liabilities of government
 7 retirement systems; and providing for an effective date."

8 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

9 * Section 1. AS 14.25.070 is amended by adding new subsections to read:

10 (d) All or a portion of the employer's share of any accrued actuarial liability to
 11 the plan ^{may} be prepaid in a lump sum. The commissioner of administration may, by
 12 regulation, establish a minimum amount for the lump sum payment of a portion. The
 13 administrator shall charge to the employer appropriate and reasonable administrative
 14 costs to the plan attributable to a lump sum payment that are not greater than
 15 administrative costs applied to other employer contributions. If an employer is
 16 grouped with any other employer in accounting for contributions, the lump sum
 17 payment for the employer shall be accounted for separately in accordance with
 18 regulations adopted by the commissioner. The regulations must provide for crediting
 19 to each lump sum payment account all earnings and losses received from investment
 20 of that payment. The lump sum payment shall be used solely to offset contributions
 21 under this section required of the employer for which the payment was made, taking
 22 into account earnings and losses from its investment. A lump sum payment made by or
 23 on behalf of an employer under this subsection, together with all earnings and losses
 24 from investment of that payment, may not be considered in calculating that employer's
 25 share of any discretionary payment authorized by the state that benefits multiple
 26 employers.

27 (e) If all or a portion of an employer's share of any accrued actuarial liability
 28 to the plan is prepaid in a lump sum under (d) of this section, the administrator shall

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

State Capitol
Juneau, Alaska 99801-1182
Deliveries to: 129 6th St., Rm. 329

MEMORANDUM

March 26, 2008

SUBJECT: Pension obligation bonds (CSHB 13(FIN),
Work Order No. 25-LS0084K)

TO: Senator Bert Stedman
Co-Chair of Senate Finance Committee
Attn: Darwin Peterson

FROM: Tamara Brandt Cook *TBC*
Director

Does CSHB 13(FIN), authorizing entities of the state and municipalities to issue pension obligation bonds, pose constitutional or other legal problems?

There are provisions of the state constitution that may limit the uses of this legislation. Mechanisms that have worked in other states to fund pension liability through pension obligation bonds may be difficult to apply in Alaska because of Art. IX, sec. 7 (prohibition against dedicated funds), sec. 8 (state debt), sec. 9 (local debts), sec. 11 (exceptions to restrictions on acquisition of debt), and sec. 13 (money must be appropriated). The Alaska Supreme Court has noted, for example, that the prohibition against dedicating state funds is found only in the constitutions of Alaska and Georgia. (*Myers v. Alaska Housing Finance Corp.*, 68 P.3d 386 (Alaska 2003)). There is at least a slight chance that the prohibition against dedicated funds applies to municipalities as well as to the state. (*Fairbanks v. Convention and Visitors Bureau*, 818 P.2d 1153, 1158, footnote 7 (Alaska 1991) declining to address the question of whether the prohibition against dedicated funds applies to political subdivisions)

Under the state constitutional provisions noted, it is not clear to me how certain provisions of CSHB 13(FIN) are to be applied. Under sec. 37.15.905 the state bond committee may "obligate and bind the state to set aside and pay into the bond redemption fund. . . ." If this is subject to appropriation, in what sense is the state bond committee obligating and binding the state? Likewise, amounts required for bond payments under the terms established by the bond resolution (secs. 37.15.925 and 37.16.060) could be subject to appropriation despite the fact that the language of the bond resolution may not indicate that. Since the pension obligation bonds will not constitute debts of the state under art. IX, sec. 8, it is unlikely that the state will, as a matter of constitutional law, be liable for bond payments to bond holders (see secs. 37.15.920 and 37.16.070), although the state could find itself liable for damages to bond holders if they are misled on this point. Art. IX, sec. 11 only permits "the issuance of revenue bonds by a public enterprise

Senator Bert Stedman

March 26, 2008

Page 2

or public corporation of the State or a political subdivision, when the only security is the revenues of the enterprise or corporation."

Under sec. 37.16.110 the Alaska Pension Obligation Bond Corporation is permitted to "enter into contracts with governmental employers for the purpose of recouping amounts paid as debt service on bonds issued by the corporation for the benefit of governmental employers." The corporation is then authorized to pledge the revenue of the contracts as security for the bonds. If payments by the state on the contracts are not subject to appropriation, there will be an issue under Art. IX, sec. 7 (prohibition against dedicated funds) and sec. 13 (appropriation requirement). If payments by municipalities are not subject to local budget and appropriation processes, the contracts themselves could constitute an unconstitutional municipal debt under sec. 9. While it is clear that sec. 9 applies to municipal bonds, the court has left open the possibility that other types of debt, in addition to bonds, might be subject to that provision. (Chefornak v. Hooper Bay Construction Co., 758 P.2d 1266 (Alaska 1988)) The court stated at pages 1269 and 1270, emphasis added:

Thus, we think it clear that the framers of our constitution intended section 9 to restrict a municipality's ability to voluntarily borrow funds or issue bonds. ... We conclude that the restrictions on contracting debt contained in article IX, sec. 9 are applicable only where a political subdivision has endeavored to borrow money, via the issuance of bonds or other paper indebtedness.

Understand that I am not calling the constitutionality of sec. 37.16.110 into question, but, rather pointing out that the contracts for recouping debt service may, as a practical matter, constitute only a limited form of security for the pension obligation bonds because they may have to include a nonappropriation clause.

Indeed, I stress that the provisions of CSHB 13(FIN) can be applied in ways that do not raise constitutional issues. My conclusion is only that the constitutional limits on acquiring state and municipal debt, coupled with the prohibition against dedicating funds and the appropriation requirement, may make pension obligation bonds in this state more difficult to issue and market and, thus, less useful than those types of bonds have been in other states. Some methods of creative financing have, in fact, been upheld by the court in Alaska, although the facts involved in those instances do not appear to be directly applicable to the pension obligation bond situation under CSHB 13(FIN). (Carr-Gottstein Properties v. State, 899 P.2d 136 (Alaska 1995) involving the issuance of certificates of participation for a capital project where the state lease payment obligation was subject to appropriation; Myers v. Alaska Housing Finance Corp., 68 P.3d 386 (Alaska 2003) involving the sale of a present interest in a tobacco litigation settlement revenue stream)

TBC:lmb
08-166.lmb

*corrected
(by legal
staff)*

*Adopted
as corrected*

AMENDMENT

7

OFFERED IN THE SENATE

BY SENATOR STEDMAN

TO: CSHB 13(FIN)

- 1 Page 1, lines 10 - 12:
- 2 Delete "to issue obligations to prepay all or a portion of the governmental
- 3 employer's shares of the unfunded accrued actuarial liabilities of retirement systems
- 4 and"
- 5
- 6 Page 2, line 4:
- 7 Delete "for that purpose"
- 8 Insert "by a state entity for the purpose of prepaying all or a portion of the
- 9 governmental employee's share of the unfunded accrued actuarial liabilities of
- 10 retirement systems"
- 11
- 12 Page 4, lines 15 - 18:
- 13 Delete "A municipality, or two or more municipalities jointly, may issue obligations to
- 14 prepay all or a portion of each participating municipality's share of the accrued actuarial
- 15 liabilities of retirement systems."
- 16
- 17 Page 4, line 22, following "obligations":
- 18 Insert "by a state entity"
- 19
- 20 Page 4, line 29, following "issued":
- 21 Insert "by a state entity"

adopted

25-LS0084\K.4
Cook
3/25/08

AMENDMENT

3

MAR 25 2008

OFFERED IN THE SENATE
TO: CSHB 13(FIN)

BY SENATOR STEDMAN

- 1 Page 6, lines 15 - 17:
- 2 Delete "The committee, on behalf of the state, may obligate and bind the state to set
- 3 aside and pay into the bond redemption fund, on a monthly or other periodic basis."

3/27/08 Andrews

State of Alaska

Public Employees' Retirement System (PERS) and Teachers' Retirement System (TRS)

Cash Contribution and Pension Obligation Bond Analysis
Version 4 - Prepared March 13, 2008

	Input
Pension Obligation Bond Interest Rate:	5.25%
Growth Rate of POB Payments:	4.00%
Present Value Interest Rate:	8.25%
Cash Contribution < \$1B (\$ in millions):	\$ 450

March 27, 2008

**Public Employees' Retirement System
Cash and Pension Obligation Bond Analysis
Actual June 30, 2006 Valuation Results**

Pension Obligation Bond Interest rate: 5.25%
 Projected FY09 Salary (in thousands): \$1,877,510
 Unfunded Liability at June 30, 2006 (in thousands): \$5,347,505

Employer Contribution Rate as a Percent of Payroll

POB Amount \$	Pension Obligation Bonds (in billions)												
	Percent of Unfunded Liability												
% of Unfunded	0%	9%	19%	28%	37%	47%	56%	65%	75%	84%	94%	103%	112%
\$ -	35.22%	34.03%	34.04%	33.45%	32.86%	32.26%	31.67%	31.08%	30.49%	29.90%	29.31%	28.72%	28.13%
\$ 0.45	33.53%	32.94%	32.34%	31.75%	31.16%	30.57%	29.98%	29.39%	28.80%	28.21%	27.62%	27.03%	
\$ 1.0	31.46%	30.87%	30.28%	29.69%	29.09%	28.50%	27.91%	27.32%	26.73%	26.14%	25.55%		
\$ 1.5	29.58%	28.99%	28.40%	27.81%	27.21%	26.62%	26.03%	25.44%	24.85%	24.26%			
\$ 2.0	27.70%	27.11%	26.52%	25.93%	25.33%	24.74%	24.15%	23.56%	22.97%				
\$ 2.5	25.82%	25.23%	24.64%	24.05%	23.45%	22.86%	22.27%	21.68%					
\$ 3.0	23.94%	23.35%	22.76%	22.16%	21.57%	20.98%	20.39%						
\$ 3.5	22.06%	21.47%	20.88%	20.28%	19.69%	19.10%							
\$ 4.0	20.18%	19.59%	19.00%	18.40%	17.81%								
\$ 4.5	18.30%	17.71%	17.12%	16.52%									
\$ 5.0	16.42%	15.83%	15.24%										
\$ 5.5	14.54%	13.95%											
\$ 6.0	12.66%												

Savings on Employer Contribution Rate

POB Amount \$	Pension Obligation Bonds (in billions)												
	Percent of Unfunded Liability												
% of Unfunded	0%	9%	19%	28%	37%	47%	56%	65%	75%	84%	94%	103%	112%
\$ -	0.00%	0.59%	1.16%	1.77%	2.36%	2.96%	3.55%	4.14%	4.73%	5.32%	5.91%	6.50%	7.09%
\$ 0.45	1.69%	2.28%	2.88%	3.47%	4.06%	4.65%	5.24%	5.83%	6.42%	7.01%	7.60%	8.19%	
\$ 1.0	3.76%	4.35%	4.94%	5.53%	6.13%	6.72%	7.31%	7.90%	8.49%	9.08%	9.67%		
\$ 1.5	5.64%	6.23%	6.82%	7.41%	8.01%	8.60%	9.19%	9.78%	10.37%	10.96%			
\$ 2.0	7.52%	8.11%	8.70%	9.29%	9.89%	10.48%	11.07%	11.66%	12.25%				
\$ 2.5	9.40%	9.99%	10.58%	11.17%	11.77%	12.36%	12.95%	13.54%					
\$ 3.0	11.28%	11.87%	12.46%	13.06%	13.65%	14.24%	14.83%						
\$ 3.5	13.16%	13.75%	14.34%	14.94%	15.53%	16.12%							
\$ 4.0	15.04%	15.63%	16.22%	16.82%	17.41%								
\$ 4.5	16.92%	17.51%	18.10%										
\$ 5.0	18.80%	19.39%	19.98%										
\$ 5.5	20.68%	21.27%											
\$ 6.0	22.56%												

Data, Assumptions, Methods and Plan Provisions

Results are based on actual 6/30/06 valuations

Percent of pay calculation based on total payroll and amounts use projected FY09 payroll

Cash contribution and pension obligation bonds are receivable as of the valuation date

Total cash and pension obligation bonds are not to exceed the total unfunded accrued liability

All other data, assumptions, methods, and plan provisions are the same as those described in the June 30, 2006 valuation report

The above contribution amounts and rates are for illustrative purposes only. The actual rates and amounts will incorporate the delay between the valuation date and the deposit of the bonds and the cash contribution.

**Public Employees' Retirement System
Cash and Pension Obligation Bond Analysis
Actual June 30, 2006 Valuation Results**

Pension Obligation Bond Interest rate: 5.25%
 Projected FY09 Salary (in thousands): \$1,877,510
 Unfunded Liability at June 30, 2006 (in thousands): \$5,347,500

Annual FY09 Employer Contribution Amount (in millions)

POB Amount % of Unfunded	Pension Obligation Bonds (in billions) Percent of Unfunded Liability													
	0%	9%	19%	28%	37%	47%	56%	65%	75%	84%	94%	103%	112%	
\$ -	\$ 661.3	\$ 650.2	\$ 639.1	\$ 628.0	\$ 616.9	\$ 605.7	\$ 594.6	\$ 583.5	\$ 572.5	\$ 561.4	\$ 550.3	\$ 539.2	\$ 528.1	
\$ 0.45	\$ 629.5	\$ 618.5	\$ 607.2	\$ 596.1	\$ 585.0	\$ 574.0	\$ 562.9	\$ 551.8	\$ 540.7	\$ 529.6	\$ 518.6	\$ 507.5		
\$ 1.0	\$ 590.7	\$ 579.6	\$ 568.5	\$ 557.4	\$ 546.2	\$ 535.1	\$ 524.0	\$ 512.9	\$ 501.9	\$ 490.8	\$ 479.7			
\$ 1.5	\$ 555.4	\$ 544.3	\$ 533.2	\$ 522.1	\$ 510.9	\$ 499.8	\$ 488.7	\$ 477.6	\$ 466.6	\$ 455.5				
\$ 2.0	\$ 520.1	\$ 509.0	\$ 497.9	\$ 486.8	\$ 475.6	\$ 464.5	\$ 453.4	\$ 442.3	\$ 431.3					
\$ 2.5	\$ 484.8	\$ 473.7	\$ 462.6	\$ 451.5	\$ 440.3	\$ 429.2	\$ 418.1	\$ 407.0						
\$ 3.0	\$ 449.5	\$ 438.4	\$ 427.3	\$ 416.1	\$ 405.0	\$ 393.9	\$ 382.8							
\$ 3.5	\$ 414.2	\$ 403.1	\$ 392.0	\$ 380.8	\$ 369.7	\$ 358.6								
\$ 4.0	\$ 378.9	\$ 367.8	\$ 356.7	\$ 345.5	\$ 334.4									
\$ 4.5	\$ 343.6	\$ 332.5	\$ 321.4	\$ 310.2										
\$ 5.0	\$ 308.3	\$ 297.2	\$ 286.1											
\$ 5.5	\$ 273.0	\$ 261.9												
\$ 6.0	\$ 237.7													

Savings on Annual FY09 Employer Contribution Amount (in millions)

POB Amount % of Unfunded	Pension Obligation Bonds (in billions) Percent of Unfunded Liability													
	0%	9%	19%	28%	37%	47%	56%	65%	75%	84%	94%	103%	112%	
\$ -	\$ -	\$ 11.1	\$ 22.2	\$ 33.3	\$ 44.4	\$ 55.5	\$ 66.7	\$ 77.8	\$ 88.8	\$ 99.9	\$ 111.0	\$ 122.1	\$ 133.2	
\$ 0.45	\$ 31.8	\$ 42.8	\$ 54.1	\$ 65.2	\$ 76.3	\$ 87.3	\$ 98.4	\$ 109.5	\$ 120.6	\$ 131.7	\$ 142.7	\$ 153.8		
\$ 1.0	\$ 70.6	\$ 81.7	\$ 92.8	\$ 103.9	\$ 115.1	\$ 126.2	\$ 137.3	\$ 148.4	\$ 159.4	\$ 170.5	\$ 181.6			
\$ 1.5	\$ 105.9	\$ 117.0	\$ 128.1	\$ 139.2	\$ 150.4	\$ 161.5	\$ 172.6	\$ 183.7	\$ 194.7	\$ 205.8				
\$ 2.0	\$ 141.2	\$ 152.3	\$ 163.4	\$ 174.5	\$ 185.7	\$ 196.8	\$ 207.9	\$ 219.0	\$ 230.0					
\$ 2.5	\$ 176.5	\$ 187.6	\$ 198.7	\$ 209.8	\$ 221.0	\$ 232.1	\$ 243.2	\$ 254.3						
\$ 3.0	\$ 211.8	\$ 222.9	\$ 234.0	\$ 245.2	\$ 256.3	\$ 267.4	\$ 278.5							
\$ 3.5	\$ 247.1	\$ 258.2	\$ 269.3	\$ 280.5	\$ 291.6	\$ 302.7								
\$ 4.0	\$ 282.4	\$ 293.5	\$ 304.6	\$ 315.8	\$ 326.9									
\$ 4.5	\$ 317.7	\$ 328.8	\$ 339.9	\$ 351.1										
\$ 5.0	\$ 353.0	\$ 364.1	\$ 375.2											
\$ 5.5	\$ 388.3	\$ 399.4												
\$ 6.0	\$ 423.6													

Data, Assumptions, Methods and Plan Provisions

Results are based on actual 6/30/06 valuations

Percent of pay calculation based on total payroll and amounts use projected FY09 payroll

Cash contribution and pension obligation bonds are receivable as of the valuation date

Total cash and pension obligation bonds are not to exceed the total unfunded accrued liability

All other data, assumptions, methods, and plan provisions are the same as those described in the June 30, 2006 valuation report

The above contribution amounts and rates are for illustrative purposes only. The actual rates and amounts will incorporate

the delay between the valuation date and the deposit of the bonds and the cash contribution

**Public Employees' Retirement System
Cash and Pension Obligation Bond Analysis
Actual June 30, 2006 Valuation Results**

Pension Obligation Bond interest rate: 5.25%
 Projected FY09 Salary (in thousands): \$1,877,510
 Unfunded Liability at June 30, 2006 (in thousands): \$5,347,505
 Interest Rate for Present Value: 4.09%

Present Value of Savings on Employer Contribution Amount (In millions)

POB Amount % of Unfunded	Pension Obligation Bonds (In billions) Percent of Unfunded Liability												
	\$ -	0.5	1.0	1.5	2.0	2.5	3.0	3.5	4.0	4.5	5.0	5.5	6.0
	0%	9%	19%	28%	37%	47%	56%	65%	75%	84%	94%	103%	112%
Cash (in billions)	\$ -	\$ 186.5	\$ 373.0	\$ 559.4	\$ 745.9	\$ 932.4	\$ 1,118.9	\$ 1,305.4	\$ 1,491.9	\$ 1,678.4	\$ 1,864.9	\$ 2,051.4	\$ 2,237.9
\$ 0.45	\$ 492.0	\$ 1,014.5	\$ 1,537.0	\$ 2,059.5	\$ 2,581.9	\$ 3,104.4	\$ 3,626.9	\$ 4,149.4	\$ 4,671.9	\$ 5,194.3	\$ 5,716.8	\$ 6,239.3	\$ 6,761.8
\$ 1.0	\$ 1,093.4	\$ 1,615.9	\$ 2,138.3	\$ 2,660.8	\$ 3,183.3	\$ 3,705.8	\$ 4,228.2	\$ 4,750.7	\$ 5,273.2	\$ 5,795.7	\$ 6,318.2		
\$ 1.5	\$ 1,640.1	\$ 2,162.5	\$ 2,685.0	\$ 3,207.5	\$ 3,730.0	\$ 4,252.5	\$ 4,774.9	\$ 5,297.4	\$ 5,819.9	\$ 6,342.4			
\$ 2.0	\$ 2,186.7	\$ 2,709.2	\$ 3,231.7	\$ 3,754.2	\$ 4,276.7	\$ 4,799.1	\$ 5,321.6	\$ 5,844.1	\$ 6,366.6				
\$ 2.5	\$ 2,733.4	\$ 3,255.9	\$ 3,778.4	\$ 4,300.9	\$ 4,823.3	\$ 5,345.8	\$ 5,868.3	\$ 6,390.8					
\$ 3.0	\$ 3,280.1	\$ 3,802.6	\$ 4,325.1	\$ 4,847.6	\$ 5,370.0	\$ 5,892.5	\$ 6,415.0						
\$ 3.5	\$ 3,826.8	\$ 4,349.3	\$ 4,871.8	\$ 5,394.2	\$ 5,916.7	\$ 6,439.2							
\$ 4.0	\$ 4,373.5	\$ 4,896.0	\$ 5,418.4	\$ 5,940.9	\$ 6,463.4								
\$ 4.5	\$ 4,920.2	\$ 5,442.7	\$ 5,965.1	\$ 6,487.6									
\$ 5.0	\$ 5,466.9	\$ 5,989.3	\$ 6,511.8										
\$ 5.5	\$ 6,013.5	\$ 6,536.0											
\$ 6.0	\$ 6,560.2												

Data, Assumptions, Methods and Plan Provisions

Results are based on actual 6/30/06 valuations

Percent of pay calculation based on total payroll and amounts use projected FY09 payroll

Cash contribution and pension obligation bonds are receivable as of the valuation date

Total cash and pension obligation bonds are not to exceed the total unfunded accrued liability

All other data, assumptions, methods, and plan provisions are the same as those described in the June 30, 2006 valuation report

The above contribution amounts and rates are for illustrative purposes only. The actual rates and amounts will incorporate the delay between the valuation date and the deposit of the bonds and the cash contribution.

Teachers' Retirement System
Cash and Pension Obligation Bond Analysis
Actual June 30, 2006 Valuation Results

Pension Obligation Bond Interest rate: 5.25%
Projected FY09 Salary (In thousands): \$ 637,370
Unfunded Liability at June 30, 2006 (in thousands): \$ 3,088,151

Employer Contribution Rate as a Percent of Payroll

		Pension Obligation Bonds (in billions)								
		Percent of Unfunded Liability								
POB Amount \$		\$ -	\$ 0.5	\$ 1.0	\$ 1.5	\$ 2.0	\$ 2.5	\$ 3.0	\$ 3.5	
% of Unfunded		0%	16%	32%	49%	65%	81%	97%	113%	
	\$ -	44.17%	42.80%	41.43%	40.07%	38.70%	37.33%	35.96%	34.60%	
	\$ 0.45	39.46%	38.10%	36.73%	35.36%	33.99%	32.63%	31.26%		
	\$ 1.0	33.71%	32.35%	30.98%	29.61%	28.25%	26.88%			
	\$ 1.5	28.49%	27.12%	25.75%	24.39%	23.02%				
Cash (in billions)	\$ 2.0	23.26%	21.89%	20.53%	19.16%					
	\$ 2.5	18.03%	16.67%	15.30%						
	\$ 3.0	12.81%	11.44%							
	\$ 3.5	7.58%								

Savings on Employer Contribution Rate

		Pension Obligation Bonds (in billions)								
		Percent of Unfunded Liability								
POB Amount \$		\$ -	\$ 0.5	\$ 1.0	\$ 1.5	\$ 2.0	\$ 2.5	\$ 3.0	\$ 3.5	
% of Unfunded		0%	16%	32%	49%	65%	81%	97%	113%	
	\$ -	0.00%	1.37%	2.74%	4.10%	5.47%	6.84%	8.21%	9.57%	
	\$ 0.45	4.71%	6.07%	7.44%	8.81%	10.18%	11.54%	12.91%		
	\$ 1.0	10.46%	11.82%	13.19%	14.56%	15.92%	17.29%			
	\$ 1.5	15.68%	17.05%	18.42%	19.78%	21.15%				
Cash (in billions)	\$ 2.0	20.91%	22.28%	23.64%	25.01%					
	\$ 2.5	26.14%	27.50%	28.87%						
	\$ 3.0	31.36%	32.73%							
	\$ 3.5	36.59%								

Data, Assumptions, Methods, and Plan Provisions

Results are based on actual 6/30/06 valuations

Percent of pay calculation based on total payroll and amounts use projected FY09 payroll

Cash contribution and pension obligation bonds are receivable as of the valuation date

Total cash and pension obligation bonds are not to exceed the total unfunded accrued liability

All other data, assumptions, methods, and plan provisions are the same as those described in the June 30, 2006 valuation report

The above contribution amounts and rates are for illustrative purposes only. The actual rates and amounts will incorporate

the delay between the valuation date and the deposit of the bonds and the cash contribution.

Teachers' Retirement System
Cash and Pension Obligation Bond Analysis
Actual June 30, 2006 Valuation Results

Pension Obligation Bond interest rate: 5.25%
Projected FY09 Salary (In thousands): \$ 637,370
Unfunded Liability at June 30, 2006 (In thousands): \$ 3,088,151

Annual FY09 Employer Contribution Amount (In millions)

		Pension Obligation Bonds (In billions) Percent of Unfunded Liability								
POB Amount \$		-	0.5	1.0	1.5	2.0	2.5	3.0	3.5	
% of Unfunded		0%	16%	32%	49%	65%	81%	97%	113%	
	\$ -	\$ 281.5	\$ 272.8	\$ 264.1	\$ 255.4	\$ 246.7	\$ 237.9	\$ 229.2	\$ 220.5	
	\$ 0.45	\$ 251.5	\$ 242.8	\$ 234.1	\$ 225.4	\$ 216.6	\$ 208.0	\$ 199.2		
	\$ 1.0	\$ 214.9	\$ 206.2	\$ 197.5	\$ 188.7	\$ 180.1	\$ 171.3			
	\$ 1.5	\$ 181.6	\$ 172.9	\$ 164.1	\$ 155.5	\$ 146.7				
Cash (In billions)	\$ 2.0	\$ 148.3	\$ 139.5	\$ 130.9	\$ 122.1					
	\$ 2.5	\$ 114.9	\$ 106.2	\$ 97.5						
	\$ 3.0	\$ 81.6	\$ 72.9							
	\$ 3.5	\$ 48.3								

Savings on Annual FY09 Employer Contribution Amount (in millions)

		Pension Obligation Bonds (In billions) Percent of Estimated Unfunded Liability								
POB Amount \$		-	0.5	1.0	1.5	2.0	2.5	3.0	3.5	
% of Unfunded		0%	16%	32%	49%	65%	81%	97%	113%	
	\$ -	\$ -	\$ 8.7	\$ 17.4	\$ 26.1	\$ 34.8	\$ 43.6	\$ 52.3	\$ 61.0	
	\$ 0.45	\$ 30.0	\$ 38.7	\$ 47.4	\$ 56.1	\$ 64.9	\$ 73.5	\$ 82.3		
	\$ 1.0	\$ 68.6	\$ 75.3	\$ 84.0	\$ 92.8	\$ 101.4	\$ 110.2			
	\$ 1.5	\$ 99.9	\$ 108.6	\$ 117.4	\$ 126.0	\$ 134.8				
Cash (In billions)	\$ 2.0	\$ 133.2	\$ 142.0	\$ 150.6	\$ 159.4					
	\$ 2.5	\$ 166.6	\$ 175.3	\$ 184.0						
	\$ 3.0	\$ 199.9	\$ 208.6							
	\$ 3.5	\$ 233.2								

Data, Assumptions, Methods and Plan Provisions

Results are based on actual 6/30/06 valuations

Percent of pay calculation based on total payroll and amounts use projected FY09 payroll

Cash contribution and pension obligation bonds are receivable as of the valuation date

Total cash and pension obligation bonds are not to exceed the total unfunded accrued liability

All other data, assumptions, methods, and plan provisions are the same as those described in the June 30, 2006 valuation report

The above contribution amounts and rates are for illustrative purposes only. The actual rates and amounts will incorporate

the delay between the valuation date and the deposit of the bonds and the cash contribution

Teachers' Retirement System
Cash and Pension Obligation Bond Analysis
Actual June 30, 2006 Valuation Results

Pension Obligation Bond Interest rate: 5.25%
 Projected FY09 Salary (in thousands): \$ 837,370
 Unfunded Liability at June 30, 2006 (in thousands): \$ 3,088,151
 Interest Rate for Present Value: 4.09%

Present Value of Savings on Employer Contribution Amount (in millions)

POB Amount \$	Pension Obligation Bonds (in billions)								
	Percent of Unfunded Liability								
% of Unfunded	0%	16%	32%	49%	65%	81%	97%	113%	
\$ -	\$ -	\$ 125.9	\$ 251.8	\$ 377.7	\$ 503.5	\$ 629.4	\$ 755.3	\$ 881.2	
\$ 0.45	\$ 464.3	\$ 590.2	\$ 716.1	\$ 842.0	\$ 967.8	\$ 1,093.7	\$ 1,219.6		
\$ 1.0	\$ 1,031.8	\$ 1,157.7	\$ 1,283.6	\$ 1,409.4	\$ 1,535.3	\$ 1,661.2			
\$ 1.5	\$ 1,547.7	\$ 1,673.6	\$ 1,799.5	\$ 1,925.3	\$ 2,051.2				
\$ 2.0	\$ 2,063.6	\$ 2,189.5	\$ 2,315.4	\$ 2,441.2					
\$ 2.5	\$ 2,579.5	\$ 2,705.4	\$ 2,831.3						
\$ 3.0	\$ 3,095.4	\$ 3,221.3							
\$ 3.5	\$ 3,611.3								

Cash (in billions)

Data, Assumptions, Methods and Plan Provisions

Results are based on actual 6/30/06 valuations

Percent of pay calculation based on total payroll and amounts use projected FY09 payroll

Cash contribution and pension obligation bonds are receivable as of the valuation date

Total cash and pension obligation bonds are not to exceed the total unfunded accrued liability

All other data, assumptions, methods, and plan provisions are the same as those described in the June 30, 2006 valuation report

The above contribution amounts and rates are for illustrative purposes only. The actual rates and amounts will incorporate the delay between the valuation date and the deposit of the bonds and the cash contribution.

2/27
adopted, as amended

AMENDMENT

OFFERED IN THE SENATE
TO: CSHB 13(FIN)

BY SENATOR STEDMAN

1 Page 3, line 20, following ".":

2 Insert "However, a subsidiary created for the purpose of financing or facilitating
3 the financing of prepayment of a governmental employer's share of unfunded accrued
4 actuarial liability of retirement systems may only borrow money and issue bonds if the
5 state bond rating is AA- or better."

(the equivalent of AA-)

6
7 Page 5, line 26, following "37.15.555":

8 Insert ", but only if the state bond rating is AA- or better"

9
10 Page 8, line 26, following "if":

11 Insert "the state bond rating is AA- or better and if"

12
13 Page 11, line 2, following "37.16.900":

14 Insert ", but only if the state bond rating is AA- or better"

15
16 Page 15, line 14, following "if":

17 Insert "the state bond rating is AA- or better and if"

18
19 Page 19, line 12, following "AS 44 85.085":

20 Insert ", but only if the state bond rating is AA- or better"

21
22 Page 23, line 7, following "may":

23 Insert ", if the state bond rating is AA- or better."

1

2 Page 23, line 27, following "appropriate":

3 Insert ", but only if the state bond rating is AA- or better"

4

5 Page 25, line 1, following "reasonable":

6 Insert "however, to carry out this paragraph, bonds and other obligations may

7 only be issued if the state bond rating is AA- or better"

adopted

3/27

ISSUED

MAR 24 2008

25-LS0084\K.2
Cook
3/25/08

AMENDMENT 2

OFFERED IN THE SENATE
TO: CSHB 13(FIN)

BY SENATOR STEDMAN

1 Page 3, line 19, following "may":

2 Insert "subject to AS 37.15.903,"

3

4 Page 6, line 2:

5 Delete "may not exceed \$5,000,000,000"

6 Insert "is limited as provided in AS 37.15.903"

7

8 Page 6, following line 10:

9 Insert a new section to read:

10 "Sec. 37.15.903. Pension obligation bond limit. The total unpaid principal
11 amount of bonds, including refunding bonds, but excluding refunded bonds, issued by
12 all state entities added together, for the purposes of financing prepayment of all or a
13 portion of a governmental employer's share of unfunded accrued liability of retirement
14 systems, may not exceed \$5,000,000,000."

15

16 Page 11, line 9:

17 Delete "may not exceed \$5,000,000,000"

18 Insert "is limited as provided in AS 37.15.903"

19

20 Page 19, line 12, following "AS 44.85.085":

21 Insert "this assistance is limited as provided in AS 37.15.903"

22

23 Page 23, line 7, following "may":

1 Insert ", subject to AS 37.15.903,"

2

3 Page 27, line 25, following "debt":

4 Insert ", subject to AS 37.15.903,"

5

6 Page 25, line 1, following "reasonable"

7 Insert "; bonds issued under this paragraph are subject to AS 37.15.903"

STATE OF ALASKA

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

SARAH PALIN, GOVERNOR

333 WILLOUGHBY, 11TH FLOOR
PO BOX 110400
JUNEAU, ALASKA 99811-0400
TELEPHONE: (907) 465-2301
FACSIMILE: (907) 465-2389

The Honorable Senator Bert Stedman, Co-Chair
The Honorable Senator Lyman Hoffman, Co-Chair
Senate Finance Committee
Juneau, AK 99801

cc Miles
Darwin

RECEIVED

MAR 11 2008

Dear Senator Stedman and Senator Hoffman,

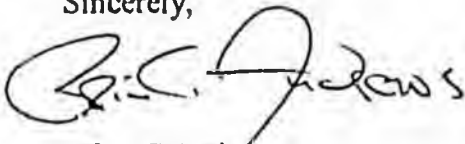
COPY

I appreciated you allocating time on February 29th for concluding my presentation on Pension Obligation Bonds (POBs). During the hearing, your committee requested information regarding the costs the State would incur as a result of POBs carrying a lower credit rating than the State's General Obligation credit rate.

Rating agencies consider debt obligations, such as POBs to be inherently riskier than general obligation bonds. The spread between these two types of bonds is about .15% or 15 basis points (bps). On a 2 billion dollar issuance the 15 bps would account for a difference of \$3 million. If we were able to do a \$2 billion POB transaction at a refinancing cost of 5.25%, versus our current cost of 8.25%, there would be a potential savings of 3% or \$60 million in the first year. Add to this the 15 bps we could gain if we are able to do the transaction at the State's general obligation credit rating, and the savings would potentially be 3.15% or \$63 million.

I have enclosed three recent communiqués for the investment banking community on this subject. If you have any questions please give me a call. I appreciate the attention you and the committee are giving to the matter of POBs and the retirement system's unfunded liabilities.

Sincerely,



Brian C. Andrews
Deputy Commissioner
Department of Revenue

CC: The Honorable Senator Charlie Huggins
The Honorable Senator Kim Elton
The Honorable Senator Donny Olson
The Honorable Senator Joe Thomas
The Honorable Senator Fred Dyson
The Honorable Representative Mike Hawker

2008-03-11-16-57-34



Memorandum

Date: March 4, 2008

To: Brian Andrews
Deven Mitchell

From: Goldman, Sachs & Co.

Subject: Indicative Pricing for Potential State of Alaska Pension Bonds

Thank you for the opportunity to speak with you last week and to offer comments at the Senate Finance Committee about the potential for Pension Obligation Bonds (POBs) to have a positive economic impact on the State's pension system. We look forward to continuing to assist the State in evaluating Pension Bonds and developing an approach to executing a transaction that can best take advantage of the opportunity while at the same time managing the costs and risks associated with the transaction.

The purpose of this memo is to provide current market pricing indications to help you and other State decision makers continue to evaluate the potential transaction. As you know, taxable municipal bonds are priced based on a spread to an underlying reference rate, typically either a U.S. Treasury Bond or the 20-year LIBOR (London Interbank Offered Rate) swap rate, depending on investor. The spread itself is based on the credit quality of the borrower and the terms of the security structure. In the municipal finance world, the highest quality credits with the lowest associated cost are typically general obligation bonds. Other credit structures such as 'subject to appropriation bonds' or state credits backed by specific revenue sources will generally carry a cost that is somewhat higher than a general obligation bond.

We are well aware that the State's Pension Bonds will not be issued as General Obligation debt and that the intent is to use a subject to appropriation structure. This is quite similar to the approach that has been used by a number of other issuers of POBs and will result in strong pricing based on the State's well regarded credit and the fact that investors view the risk of non-appropriation as modest, especially in the context of a pension financing. In the case of Alaska, this general comfort level with appropriation risk exists because Alaska has a history of issuing (and making good on) appropriation debt and due to the constitutional underpinnings of the State's obligations to provide for its contractual pension benefits. As we have discussed, we believe the rating agencies should rate State of Alaska Pension Bonds (subject to appropriation) one notch below the State's General Obligation credit. As of yesterday's market close, this would translate into the following indicative interest rates.

Indicative State of Alaska Taxable Pension Bond Interest Rates: as of Market Close 3/3/2008¹

Structure	Ratings	Underlying 20-year LIBOR Rate	Spread (bp)	Total Rate
Hypothetical General Obligation Bonds	AA/AA2/AA	4.80%	+ 60 - 70	5.40 - 5.50%
Proposed Subject to Appropriation Bonds	AA-/Aa3/AA- (expected)	4.80%	+ 75 - 85	5.55 - 5.65%

Two important caveats to these rates. First, as we discussed last week, when introducing the credit, it will be important that major buyers of taxable debt treat these bonds as they have other major state pension issues (i.e. Illinois, Wisconsin, Oregon) in terms of their risk assessment or risk weighting. We have no reason to believe that they won't and have assumed in our indicative spreads risk weighting that is similar to these precedent transactions. Second, the current capital markets environment is quite volatile. As such, we encourage you to continue to closely monitor market conditions as HB13 moves forward. In that spirit, we will update this information for you regularly throughout the balance of the legislative session.

We hope this information is useful. We will call to follow up and meanwhile, feel free to contact any of us.

¹ Exclusive of issuance costs, which would be roughly 5-7 bp for both structures.

Memorandum

To: Brian Andrews
Deven Mitchell
State of Alaska

From: Eric Whaley, Vice President
Greg Sundberg, Managing Director
Jeff Brown, Managing Director
Isaac Sine, Vice President
Merrill Lynch Public Finance

Date: March 3, 2008



Subject: Pension Obligation Bond Rating Considerations – Appropriation Bonds

The language in House Bill 13 provides for the issuance of pension obligation bonds (POBs) to pre-fund the State's accrued liabilities of government retirement systems. As currently drafted, the bill structures the POBs to be secured by annual appropriations of the State. This memo highlights: 1) how bonds that are secured by State appropriations compare in ratings and credit to State general obligation bonds and 2) the limited pricing differences between appropriation and general obligation bonds.

Appropriation Bonds Versus General Obligation Bonds

Appropriation bonds are very common in the municipal bond market and are usually rated just below an issuer's general obligation rating. Standard and Poor's clearly states in its latest *Public Finance Criteria: Appropriation-Backed Obligations* write-up that appropriation-backed obligations "are rated typically one notch off the GO ratings, as a reflection that appropriation-backed obligations are not legally debt and do not bear the same legal protections as GO bonds." This general "one-notch" differential between appropriation and general obligation credits holds true in Alaska, where the State's appropriation/lease credits for the Virology Lab and Seafood & Food Safety Lab are rated AA-, one notch below the State's AA general obligation credit.

Limited Impact on Bond Yields

Even with one-notch lower ratings, it is our opinion that the State's appropriation bonds represent a high investment grade credit and would price very similarly to the State's general obligation bonds; particularly since both fall within the double-A category (i.e. AA- to AA+). In addition, because pension obligation bonds must be sold as taxable obligations and will likely be met with global investor demand, there is a high likelihood that any State pension obligation debt will qualify for a "corporate-equivalent" bond rating. Since the rating agencies apply two different standards to municipal and corporate debt, it is quite probable that the State's likely AA-pension obligation bond rating would translate to a AAA corporate rating. Taxable municipal bonds can get bumped up to AAA when rated on a "corporate equivalent" basis because A-rated municipal bonds default far less frequently than corporate bonds with top triple-A ratings; further, even when municipal bonds default investors generally receive most if not all of their principal back. In recent work for other issuers of pension obligation bonds, we have successfully pursued the strategy of obtaining corporate-equivalent ratings, making these bonds extremely attractive to taxable investors in the global market. It is worth noting that both the State's appropriation and general obligation credit would likely carry the same AAA corporate equivalent bond rating, narrowing even further any possible pricing differential. In summary, the probable half-notch differential in credit ratings between the State's general obligation and appropriation debt will not likely result in any measurable difference in interest cost between the two forms of security.

We hope this helps answer any remaining questions related to the likely credit rating and pricing of any future State of Alaska pension obligation bonds. Please contact Greg Sundberg (206-830-6026), Eric Whaley (206-830-6027), Jeff Brown (206-830-6025), or Isaac Sine (206-830-6028) if you have any questions or would like additional information. We look forward to seeing you again next time we are up in Juneau.



Alaska Pension Obligation Bond Discussion

Alaska's legislation for pension funding bonds contemplates using a security that will be subject to annual appropriation.

What is the difference between general obligation bonds and "appropriation" bonds?

Where general obligation ("G.O.") bonds pledge the full faith and credit of the State, including its taxing power, to repayment of the bonds, appropriation bonds pledge only the amounts included for debt service in the annual budget and must be appropriated annually by the legislature.

Bond Ratings

Appropriation bonds receive a one notch lower rating by the rating agencies.

Agency	Alaska G.O. Rating	Est. Appropriation Rating
Moody's	Aa2	Aa3
S&P	AA	AA-
Fitch	AA	AA-

Appropriation Pledge and Pension Bonds

The appropriation pledge has been by many other issuers of pension bonds and has received excellent acceptance in the taxable markets where pension bonds are sold. States that have issued appropriation pension bonds:

- New Jersey \$2.8 billion 1997 Bonds
- Wisconsin \$1.8 billion 2003 Bonds
- Kansas \$500 million 2004 Bonds
- Wisconsin \$960 million 2008 Bonds (pending)

Investor Acceptance of Appropriation Pension Bonds

State pension bonds are sold in the global market for taxable securities and investors evaluate these bonds in accordance with the securities and banking regulations promulgated in each country. To facilitate common treatment across borders, banking firms follow international rules known as Basel I, and beginning in 2008 for many non-US banks, Basel II. Under Basel I, appropriation bonds are recognized by some investors as similar to G.O. bonds and accorded the same regulatory capital charges for owning the bonds (a key determinant in investor appetite for bonds). Under Basel II, it is likely that such securities will require less capital, making them more attractive. This is because Basel II rules will allow the relatively low default history of municipal bonds generally and appropriation bonds in particular to be accounted for.

Although appropriation bonds will never be viewed as strict equivalents to G.O. bonds, issuance by other states and the historical stability of the practice in domestic tax-exempt markets makes appropriation bonds a strong alternative for states such as Alaska.

Appropriation bonds do require slightly higher interest rates in the global markets, ranging from 10 basis points to 40 basis points. Turbulent markets tend to widen this difference as many investors limit their purchases to treasuries, sovereigns and G.O. bonds. As markets stabilize later this year, we expect these spreads to narrow.

Bolstering the Appropriation Pledge

Careful drafting of authorizing legislation can help investor acceptance of Alaska's appropriation pledge. Language should be included that:

- Expresses the intent of the legislature to continue appropriations (Moral Obligation)
- Accords debt service High Priority Status in the annual budget
- Sets forth the appropriation mechanism – allowing the Governor and the Budget Director to covenant that an appropriation request will be included in each annual budget request
- Allows for the establishment of adequate reserves
- Allows for a Stabilization Fund
- Permits Debt/Hedging Management Techniques so that the bond structure can be best structured to market demand

Alaska's Current Rating Profile and Pension Bonds

Alaska's current credit profile, particularly relative to other comparably rated credits, will help in mitigating any appropriation credit "premium." Key among the State's credit strengths that should be emphasized in the marketing of any pension obligation bonds are:

- Conservative budgeting and expenditure practices
- Unprecedented levels of reserves
 - \$5.60 billion in General Fund and other non-segregated investments (1/31/08)
 - \$3.15 billion in Constitutional Budget Reserve Fund (1/31/08)
 - \$39.9 billion in Permanent Fund (12/31/07)
- Oil provides a tremendously valuable primary revenue source



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- We will not vary the price or other terms of any product or service offered by Citibank or its subsidiaries on the condition that you purchase another product or service from Citibank or any Citi affiliate, unless we are authorized to do so under an exception to the Anti-tying Rules.
- We will not require you to provide property or services to Citibank or any affiliate of Citibank as a condition to the extension of a commercial loan to you by Citibank or any of its subsidiaries, unless such a requirement is reasonably required to protect the safety and soundness of the loan.
- We will not require you to refrain from doing business with a competitor of Citi or any of its affiliates as a condition to receiving a commercial loan from Citibank or any of its subsidiaries, unless the requirement is reasonably designed to ensure the soundness of the loan.

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Presentation to the State of Alaska
Regarding Pension Obligation Bonds (POBs)

2/29/08
February 29, 2008
