MAYOR JORGE O. ELORZA
CITY OF PROVIDENCE

CITY OF PROVIDENCE PENSION OBLIGATION BOND (POB)

Why we must act now to invest in Providence's future

April-May 2022

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The City of Providence’s pension system is facing a financial crisis, and the City is left with few options to meaningfully address the problem.

Historical context

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- In the 1990s and 2000s, the City:
    - Promised unsustainable retirement benefits increases that exceeded what the City could afford.
    - Failed to fund the associated costs of the unsustainable benefit increases.

- Now, the City's annually required pension contributions are steadily increasing as a result of sins of the past.

- Although the City has made 100% pension payments for the last 10 fiscal years, payments have grown 5% year over year, significantly outpacing the growth of the City's tax base to pay for the increase.

Current pension system status

Currently, the pension system is just 23.94% funded, even after making 100% of the City's pension payments for ten years.

The City's pension expenses are growing at over 5%, while revenue is growing at only 2%.

- **The City is reaching a crisis point, and we are on an unsustainable path.**

- Approximately 91% of the City's pension liabilities are from current retirees. Only 9% of the costs are due to current employees.

Current status of pension system

- **Required payments will surpass $150 million in the next decade and $200 million in less than 20 years.**
- To put that in context, currently pension costs consume 14.4% of the City's General Fund revenues. By 2035, it will become 21.4%.
- As pension payments comprise a bigger and bigger portion of the City's overall budget, remaining funds for infrastructure improvements, programming and the provision of City services will be diminished.

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The City has limited options to address its pension challenge

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- Methods of addressing the crisis are limited.
  - Further retiree reform has been blocked by the RI Supreme Court.
    - The 2020 Supreme Court decision, combined with the 2012 consent decree,makes it effectively impossible to do further pension reform with current retirees, who comprise 91% of the City's pension liability.
  - Bargaining with current employees helps to control future costs; it does not address existing liabilities.
  - Long-term leases or sales of City assets are not currently feasible.

- While the City has limited options, **doing nothing is <u>not</u> an option.**

Confronting the challenge:
The City and its partners are committed to a solution

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- Within the noted limitations, incremental reforms have helped, but were, and remain, insufficient to drive sustainability and affordability.
  - Cicilline administration reinstated full pension payments.
  - Taveras administration brokered retiree reform and a new payment schedule.
  - The City has made 100% pension payments for the last 10 fiscal years.

Confronting the challenge:
The City and its partners are committed to a solution

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- Elorza administration has:
  - Eliminated the inherited $13 million deficit earlier than expected.
  - Created the largest City rainy day fund in over 40 years.
    - Achieved its goal of securing 5% of total expenditures or revenues in reserves.
  - Improved the City’s bond rating.
    - In November 2021, Fitch Ratings affirmed the bond rating of the City at “A-”, and for the first time in over eight years, assigned a Positive Outlook to the City’s Rating.

Confronting the challenge:
The City and its partners are committed to a solution

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- The City's union members are now paying a larger share of their retirement benefits.
- Last year, the FOP and IAFF locals agreed to new contracts that advance historic pension reform.
  - Police officers and firefighters now make the highest annual contributions in the state toward their City pensions, at 13.5% and 16% respectively.
  - Employees are also contributing to pre-fund retiree health care (Other Postemployment Benefits, or OPEB).
- The Mayor and Council President have agreed to commit any unused ARPA funding from the City's revenue recovery category to our OPEB liability.

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Despite these efforts and payments, the pension system today is just 24% funded, and the gap between payments and revenue will continue to grow and erode the City's – and State's – economic competitiveness.

Doing nothing is not an option.

With a growing crisis and limited options to meaningfully address the problem, Mayor Elorza and Council President Igliozzi created a Pension Working Group (PWG). The PWG as co-chaired by RIPEC, the Greater Providence Chamber of Commerce, and the Providence Foundation and it included a panel of experts who helped to develop a recommended path forward.

Experts weigh in

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- The PWG made several primary recommendations, two of which are important to note:
  1. Bankruptcy is not an option.
  2. The City should pursue state legislative and city voter authorization to issue a pension obligation bond sized to deposit $500 million into the ERS if advantageous borrowing conditions and terms are met.

- With appropriate guardrails in place, the City can mitigate risk.

Bankruptcy is not an option

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- Bankruptcy protection is not available to the City, and the City would have to meet a great deal of difficult requirements to be eligible.
- Providence has maintained stable and prudent fiscal positions and is not, nor will be in the near-term, insolvent.
- The City's current finances and management strategy have enabled the City to address deficits
- The City can pay its current bills and its fiscal outlook has steadily improved.
- There is a pathway for the City to address its fiscal challenges.
- City stakeholders are committed to working together to find a meaningful solution.

Why a POB: less risky than the status quo

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- The core challenge facing the City now – and for years to come – is that the City’s pension expenses are growing at over 5%, while revenue is growing at only 2%.
  - The PWG recommended a deposit of this size into the Employee Retirement System because it is expected to ***balance*** the City’s pension expenses and expected revenue growth.
  - This would meaningfully address the City’s pension crisis and provide a **sustainable, long-term solution**.

Why a POB: less risky than the status quo

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- By acting now, the City will be taking advantage of favorable interest rates.

- The principal and interest payments, plus the pension fund payments on the remaining unfunded liability, will grow at a rate in line with the growth of the City's natural tax base.
  - A more sustainable growth structure will allow the City to continue to make investments in infrastructure and programming for residents and businesses.

Important considerations for a POB

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- A POB seeks to take advantage of current borrowing conditions to better align the City's long-term liabilities with its recurring revenues – somewhat like refinancing an unfavorable home mortgage.
  - The City would include a 10-year par call feature on *at least* a portion of the bond to give the City the option to refinance in the future if more favorable borrowing terms exist.

- The City's POB plan is fiscally conservative and well thought out, but we are only able to take advantage of this opportunity for a short period of time.

Guardrails: minimizing risk

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- The PWG recommended a series of guardrails to mitigate the risks associated with a POB.
- These guardrails, and others, are included in the bill before the General Assembly:
  - The City will seek City voter approval.
  - The City will defer ZERO payments. During the life of the bond, NO annual pension payments will be less than today.
  - Level debt service (no backloading).
  - Annual year over year growth no greater than ~2% per year (aligned with recurring City revenue growth).
  - 10-year par call option.
  - Legislation and voter authorization gives the City the option to borrow, but that option will be used ONLY if favorable interest rates exist at time of issuance.
  - Deploy investment strategy that mitigates risk while balancing rate of return.

Who supports this proposal?

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- **Mayor Jorge Elorza**
- Pension Working Group Co-chairs:
    - Michael DiBiase, Rhode Island Public Expenditure Council President & CEO
    - Laurie White, Greater Providence Chamber of Commerce President
    - Cliff Wood, Providence Foundation Executive Director
- Council President John Igliozzi
    - **The Council passed a resolution in support of the POB. Co-sponsors:**
        - Councilwoman Helen Anthony, PWG Member
        - Councilman Pedro Espinal, PWG Member
        - Councilman John Goncalves
        - Councilwoman Nirva LaFortune
        - Councilman Nick Narducci
        - Councilwoman Jo-Ann Ryan
        - Councilman Michael Correia
        - Councilman Jim Taylor
        - Councilwoman Carmen Castillo
        - Councilwoman Mary Kay Harris
        - Councilwoman Kat Kerwin
        - Councilwoman Rachel Miller
        - Councilman Oscar Vargas

Who supports this proposal?

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- **POB Bill Co-sponsors:**

Rep. Scott Slater	Rep. Ray Hull	Rep. Grace Diaz	Rep. Anastasia Williams	Rep. David Morales
Rep. Edith Ajello	Rep. Marcia Ranglin-Vassell	Rep. Jose Batista	Rep. Gregg Amore (East Providence)	Rep. William O'Brien (North Providence)
Rep. Carlos Tobon (Pawtucket)	Rep. Carol Hagan-McEntee (Narragansett, South Kingstown)	Rep. Joshua Giraldo (Central Falls)	Rep. Justine Caldwell (East and West Greenwich)	Rep. Charlene Lima (Cranston, Providence)
Rep. Leonela Feliz (Pawtucket)	Rep. Karen Alzate (Pawtucket)	Rep. Patricia Serpa (West Warwick, Coventry, Warwick)	Rep. David Bennett (Cranston, Warwick)	Rep. Camille Vella-Wilkinson (Warwick)
Rep. Brandon Potter (Cranston)				

Who supports this proposal?

- **POB Bill Co-sponsors:**

Senator Maryellen Goodwin	Senator Ana Quezada	Senator Frank Ciccone	Senator Tiara Mack	Senator Sam Bell
Senator Zam Zurier	Senator Josh Miller	Senator Jonathon Acosta (Central Falls)	Senator Sandra Cano (Pawtucket)	Rep. William O'Brien (North Providence)

Why is now the right time?

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- Timing is critical.
  - Currently experiencing low borrowing costs and favorable market conditions.
  - Fitch Ratings affirmed the bond rating of the City at “A-”, and for the first time in over eight years, assigned a Positive Outlook to the City’s Rating which reduces the cost of a POB.

- There is broad alignment and support at the City level.
  - Mayor Elorza, the Providence City Council, all unions, and members of Providence General Assembly delegation are working together.

Doing nothing vs. POB

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	Do Nothing Scenario	POB Scenario
Expected to reach 60% funding*	2035	2026
Annual payment at year of 60% funding	$183M	$99.8M

*A pension system funded at 60% is considered to be out of “critical” status.

- Doing nothing is not sustainable for the City’s budget.
- With a POB, the City’s pension system would reach 60% funding and be out of “critical” status nearly ten years sooner than if we did nothing.
- With a POB, the City’s expected General Fund annual payment would sustain a more reasonable percentage of the City’s budget, stabilizing at just 14% percent compared to rising as high as 25% if we do nothing.

Testing future market scenarios

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- The POB has been thoroughly studied by the City's financial advisors.
  - The City and our advisors have tested many different scenarios.

- **Stress tests indicate that this POB is worth pursuing.**

Stress Tests: $500 Million 25-Year POB, Assumed 4.39% All In TIC, Level Debt Service

Scenario	$ NPV Projected Differential: $500 Mil Level Debt Service POB & 25 Year Reamort vs 25 Year Reamort UAL with No POB (1)	Investment Returns For Scenario
Base Case, 7.0% Actuarial Assumed Investment Return	$ 180 million	7.0%
6.75% Discount Rate	$ 165 million	6.75%
6.5% Discount Rate	$ 151 million	6.5%
5.5% Discount Rate	$ 91 million	5.5%
Breakeven Long-Term Investment Returns	Zero	4.39%
Great Recession Investment Returns (Historic calendar years 2008-2012 Investment Returns of the City's Retirement System Repeat After Issuance), Followed by 7.0%	$ 78 million	CAGR +3.56% first 5 years: 2008 -25.5% 2009 22.7% 2010 14.3% 2011 2.5% 2012 11.2%
First Year Inv Returns That Eliminate Expected Differential (followed by 7.0%)	Zero	Negative 29%

Notes: (1) These are summarized results of projections, and there can be no assurance that after the life of the bond issue or at any given point in time there is a positive differential of investment returns versus borrowing costs. NPVs are calculated at 4.0%.
(2) Bond interest rates are estimated at 3/2/2022 for 25 year level debt service. Different debt service patterns will have different borrowing costs. Borrowing costs may change by the time legislation, voter approval, and other necessary steps are taken and bonds are priced.

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In summary, a pension obligation bond that deposits $500 million into the Employee Retirement System would allow the City to meaningfully address the pension crisis.

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To move forward with a pension obligation bond, the City needs authorization from the General Assembly, the Providence City Council, and Providence voters.

Special Referendum Election: June 7

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- There will be one question on the ballot in this special election:
  - Should the City pursue a POB?
- THREE WAYS TO VOTE:
  - **BY MAIL:** Apply for a mail ballot application between NOW-May 17. Once you receive your mail ballot, mail or return your ballot by June 7.
  - **EMERGENCY VOTING:** Vote early at Providence City Hall.

    Deadline is Monday, June 6, 2022 at 4:00 PM

    May 18 – June 6, 2022,

    Monday-Friday, 8:30AM-4:30PM
  - **ON ELECTION DAY:** Vote at your assigned polling location.Not sure of your polling location? Visit vote.sos.ri.gov!

    Tuesday, June 7, 2022, 7:00AM-8:00PM

Process and next steps

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- Special election in Providence scheduled for June 7.
- To proceed, the City needs a Special Act of the Legislature.
  - Bills are currently before the House and Senate.
  - The legislation does not include, nor is the City requesting, the state to back or make payments on this bond.
  - The bond would be solely the City's responsibility.
- Then, the City Council must approve the bond borrowing authority.
- If the preceding steps occur in optimal timing, the City could close on a bond as early as late August.

In summary

- The City of Providence’s pension system is on an unsustainable path, and doing nothing is not an option.
- Authorizing legislation is a required step in the process to pursue a POB. The City has exhausted all other options that would meaningfully address the size of the liability.
- The City is seeking permission to pursue a long-term solution to this crisis, with the backing of the Providence City Council and voters.
- The City alone is responsible for the POB debt.

Visit the City's website for more information on the Save Providence: Vote Yes on 1 efforts and additional resources.

For more information, visit:
www.providenceri.gov/yeson1

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THANK YOU

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APPENDICES

City of Providence

GFOA View (in 2015)

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GFOA View (In 2015)	City POB
Invested POB proceeds might earn less than borrowing costs.	• Probability of market earning less than ~4% is low (but they do exist) • Stress test will better quantify risk.
"Issuing taxable debt to fund the pension liability increases the jurisdiction's bonded debt burden and potentially uses up debt capacity..."	• The pension liability is already a "hard" debt. • With GA approval, POB will not count towards 3% cap.
Pension bonds are complex instruments that carry considerable risk... and may include swaps or derivatives.	• Criticism is outdated. • No derivatives, swaps, or variable rates.

GFOA View (in 2015), continued

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GFOA View (In 2015)	City POB
Pension bonds are "typically issued without call options" making it more difficult to refund bonds if interest rates fall or a different debt service structure is desired in the future.	• POB would include 10-year par call provision.
"Pension bonds are frequently structured in a manner that defers the principal payments…"	• **POB would not have any interest-only payment years.** • No reduced payments.
"Rating agencies may not view the proposed issuance of Pension bonds as credit positive…"	• Most recent POB transaction are credit-neutral. • More likely to be credit-positive than credit-negative.

Other municipal POB examples

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THE BOND BUYER

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MASSACHUSETTS

Massachusetts city to issue $475M of pension bonds

By Paul Burton December 10, 2021, 10:20 a.m. EST 5 Min Read

In June 2021, Quincy approved a $475 million 30-year bond to pay down the city's pension obligation. For context, the City of Quincy had a fiscal year 2022 budget of $345 million.

Full story: https://www.bondbuyer.com/news/massachusetts-city-to-issue-475m-of-pension-bonds

Other municipal POB examples

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FINAL OFFICIAL STATEMENT DATED FEBRUARY 10, 2022

NEW MONEY ISSUE: Book-Entry-Only **RATINGS: S&P Global Ratings: "AA"**

In the opinion of Bond Counsel, under existing law, interest on the Bonds is included in gross income for federal income tax purposes pursuant to the Code. In the opinion of Bond Counsel, under existing statutes, interest on the Bonds is excluded from Connecticut taxable income for purposes of the Connecticut income tax on individuals, trusts and estates and is excluded from amounts on which the net Connecticut minimum tax is based in the case of individuals, trusts and estates required to pay the federal alternative minimum tax. (See "Tax Matters" herein.)

City of Norwich, Connecticut
$145,000,000
General Obligation Bonds, Issue of 2022
(Federally Taxable)

Dated: Date of Delivery **Due: Serially, August 1, 2022 – 2036 as detailed below:**

Year	Principal	Coupon	Yield	CUSIP [1]	Year	Principal	Coupon	Yield	CUSIP [1]
2022	$ 4,430,000	1.348%	1.348%	669402E21	2030	$ 4,915,000	2.624%	2.624%	669402F20
2023	4,200,000	1.648%	1.648%	669402E39	2031	5,050,000	2.724%	2.724%	669402F38
2024	4,275,000	1.848%	1.848%	669402E47	2032	5,190,000	2.824%	2.824%	669402F46
2025	4,360,000	2.069%	2.069%	669402E54	2033	5,345,000	2.954%	2.954%	669402F53
2026	4,455,000	2.234%	2.234%	669402E62	2034	5,505,000	3.074%	3.074%	669402F61
2027	4,560,000	2.384%	2.384%	669402E70	2035	5,680,000	3.174%	3.174%	669402F79
2028	4,670,000	2.468%	2.468%	669402E88	2036	5,870,000	3.274%	3.274%	669402F87
2029	4,790,000	2.568%	2.568%	669402E96					

Norwich, CT: Full details available in included handout.

RI vs. City of Providence Retirement System Investment Performance

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