SUBJECT: Obligations issued by cities to pay unfunded liabilities of pension funds

COMMITTEE: Local Government Ways and Means — favorable, without amendment

VOTE: 6 ayes — Hill, Hegar, Laubenberg, McReynolds, Mowery, Quintanilla

0 nays

1 absent — Puente

SENATE VOTE: On final passage, April 25 — 31-0, on Local and Uncontested Calendar

WITNESSES: No public hearing

DIGEST: SB 1696 would authorize certain municipalities to issue obligations — including bonds, certificates, notes, or book-entry obligations — to pay for all or any part of an unfunded liability of a municipal pension fund. It would apply only to a municipality with a population of 100,000 or more. "Public pension fund" would mean a continuing, organized program or plan of service retirement, disability retirement, or death benefits for officers of employees of a municipality, including a plan qualified under the U.S. Internal Revenue Code, sec. 401(a). The definition would *not* include:

- a program that provided only workers' compensation benefits;
- a program administered by the federal government;
- a plan described by Internal Revenue Code, sec. 401(d);
- individual retirement accounts described by Internal Revenue Code, secs. 403(b), 408(a), or 408(b);
- an eligible deferred compensation plan as defined by Internal Revenue Code, sec. 457(b); or
- a program for which benefits would be administered by a life insurance company or for which the only funding agency was a life insurance company.

Before authorizing issuance and delivery of an obligation, the municipal governing body would have to enter into a written agreement with the governing body of the public retirement system with fiduciary responsibility for the pension fund's assets or for funds that were to receive the net proceeds of the obligations to be issued. The agreement would have to state the amount of the unfunded liability and when the public pension fund would accept the net proceeds of the obligations to be issued.

The municipality would have to deposit the net proceeds of obligations issued to the credit of the public pension fund, and the deposit would become part of the public pension fund's assets.

An obligation issued could be made payable by the municipality from the fund from which compensation would be paid to its officers and employees; from its general fund; or from taxes, revenues, both taxes and revenues, or any other sources of money that the municipality could use under state law to secure or pay any kind of bond or obligation. An obligation issued under the bill's provisions would be a complete or partial refinancing of a commitment of the municipality to fund its unfunded liability.

Obligations issued could be sold at private or public sale and would have to mature within 30 years of the date of issuance.

The governing body of a municipality that issued such obligations could exercise any of the rights or powers of the governing body of an issuer under Government Code, ch. 1371, related to obligations for public improvements, and could enter into a credit agreement under that law. An obligation issued under this bill, however, would not have to be rated as required by ch. 1371.

SB 1696 would prevail over any conflict between its provisions and those of another law respecting the issuance of obligations of a municipality or a municipal home-rule charter.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2003.

SUPPORTERS SAY:

Municipalities in Texas face shortfalls in their public pension funds estimated at $2.5 billion. By authorizing pension obligation bonds, SB 1696 could provide an effective tool for managing cities' finances.

Under this legislation, a city of at least 100,000 people could issue obligation bonds at a taxable rate in the amount of any unfunded liability in the city's pension fund. This would create a fixed external debt for a municipality to replace the internal debt of carrying unfunded liability for a public pension fund. By issuing fixed-rate bonds, cities could take advantage of the current historically low interest rates to finance their debts at much lower interest rates than the currently assumed 8 to 8.5 percent interest rate.

In better economic times, other alternatives, such as creating a sinking fund, might be more desirable to address unfunded liabilities, but that option does not seem realistic in the midst of budget shortfalls. SB 1696 would allow cities to issue pension obligation bonds to give public employees, including valued safety officers, the security of knowing that their pension systems were financially sound enough to meet future obligations.

OPPONENTS SAY:

The pension obligation bond concept would amount to a "kiting" scheme in which a city would borrow from one source of credit to pay off another. In issuing these bonds, cities would have an expectation of paying a lower interest rate on bonds while earning a higher percentage rate over time with the fund monies. However, if the pension fund did not achieve overall earnings, the losses on the bonds would be added to the pension fund's unfunded accrued liability, compounding overall costs. Cities could be confronted with owing for obligation bonds while still failing to cover the unfunded liabilities of their pension funds.

The pension obligation bond arrangement might work effectively in the short term — for example, over five years — but the bill would allow a repayment period of up to 30 years. This could create too much financial uncertainty for cities and their pension funds and could lead to tax increases and reductions in services in the future.

Rather than authorize another debt instrument, the Legislature should require fiscal discipline for Texas cities' municipal pension funds. Cities would be better off putting their monies into a sinking fund, where they would be invested securely and prudently, rather than paying off bonds with interest. If cities are to guarantee pensions, as promised, to public employees, they must make secure financial commitments, especially as the number of annuities grows with increasing retirement by Baby Boomers.

In addition, the bill specifically would list taxes as a source from which a city could repay its obligation. Since the bill could have far-reaching effects on a city's future finances, it would seem more appropriate for the Legislature to require voter approval for the issuance of pension obligation bonds.