# Pension Obligation Bonds (“POB”)

## Understanding the Basics

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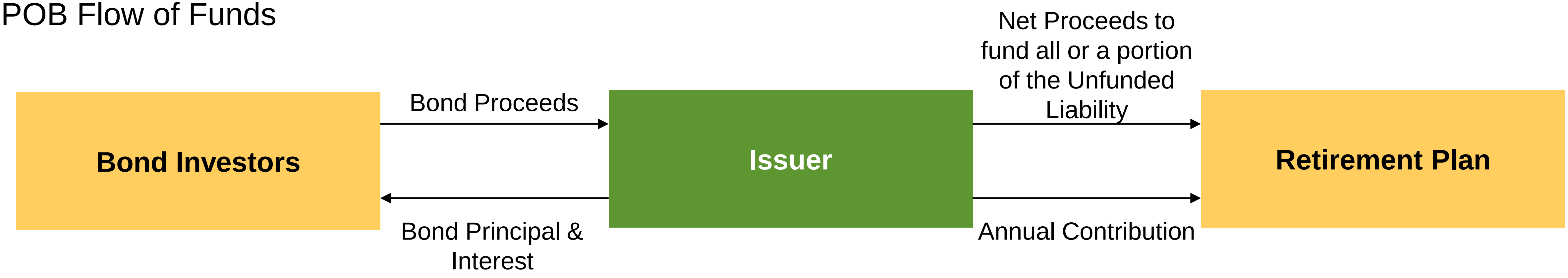
# Overview and Flow of Funds

## Key Features

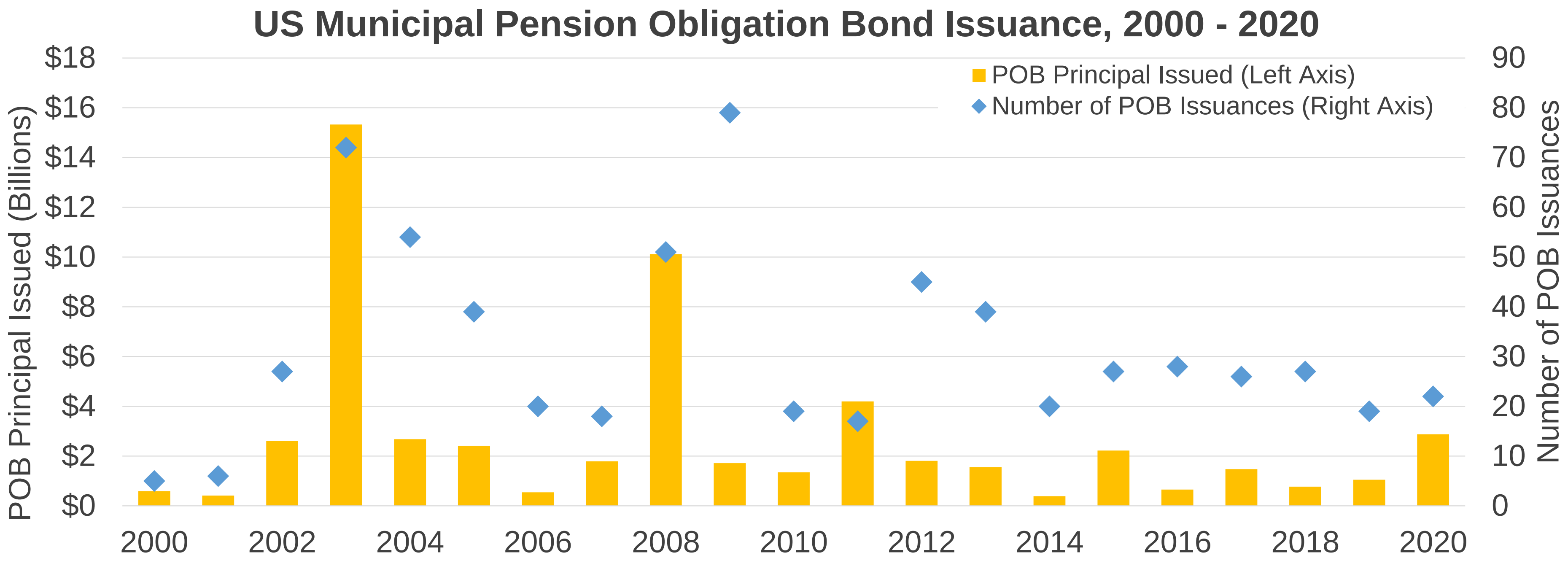
| Features | Description |
|---|---|
| **Purpose** | • Bonds are issued to finance the unfunded portion of an issuer's pension liabilities<br>• Proceeds are deposited to the issuer's pension fund |
| **Tax Status** | • Federally taxable unlike tax-exempt municipal bonds |
| **Security** | • Absolute and unconditional obligation; paid from legally available funds |
| **Assumed Benefit** | • Lower budget cost of new lower employer contribution plus debt service versus current higher employer contribution<br>• "Pension arbitrage" earning more on the proceeds than the cost of issuance |

## POB Flow of Funds



# History of Issuance (since 2000)

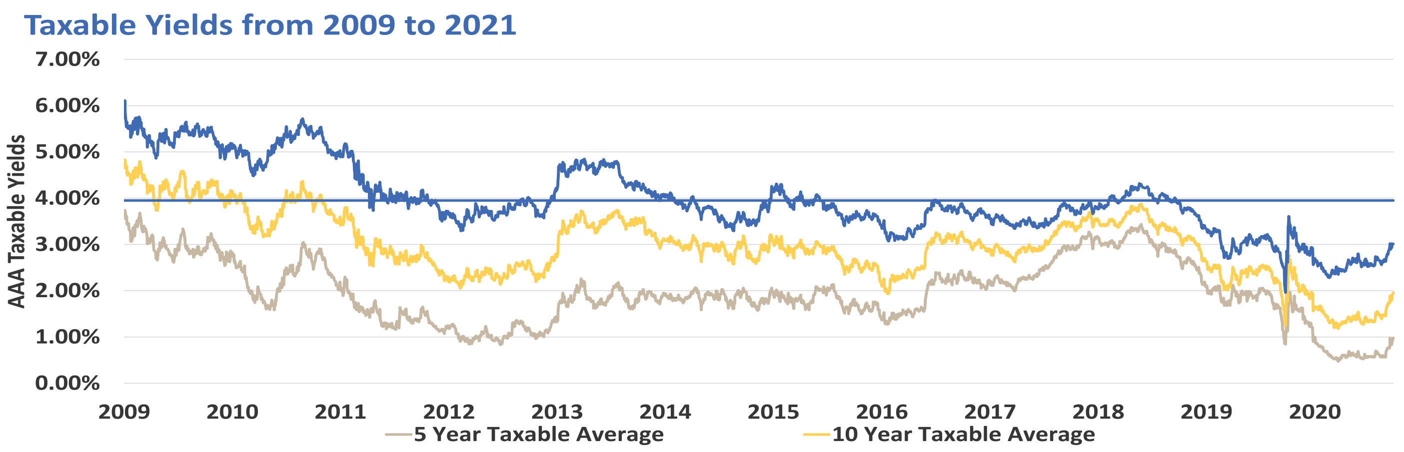
- Over the last 20 years, state and local government entities have:
  - Issued a total of 660 series of pension obligation bonds (5 issues in Florida)
  - With total principal of more than $56.6 billion




Source: Ipreo as of 1/14/2021

# Why do POBs seem attractive today?

- Since 2018, taxable municipal debt issuance has become more common
- Cost effectiveness of POBs improved:
  - Interest rates have been dropping
  - Spreads for investment grade credits have narrowed relative to the high-grade benchmark
  - The spread between issuance cost and the expected return on investments has widened




*Source: AAA Taxable Yields from Refinitiv (06/16/2009 - 03/08/2021)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# Considerations for POBs

**Municipal Issuers**

- Does the POB produce budget savings sufficient to offset the risks?
- What pension or policy reforms will be needed to increase the future resilience of the plan?
  - Funding (contribution) policy development
  - Pension Stabilization Trust creation and funding
  - Other?
- Will the proceeds be invested in a manner that improves likely future outcomes from sufficient "pension arbitrage" or liability defeasance?
- If there is negative investment experience subsequent to the POB, can the budget sustain the increased costs?
- How will rating agencies view the issuance of the POB?

**Pension Trustees**

- Is the employer looking to obtain concessions in exchange for issuing the POB?
- Are employer policies and other strategies in place to avoid future reversion to the current situation?
- Will the infusion of cash be used as an opportunity to revise assumptions to improve plan sustainability?
- How will the significant cash flow be invested:
  - In equities, attempting to maximize pension arbitrage
  - In the plan's asset allocation
  - In bonds, to defease known liabilities

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