Senate Bill 1067 – Pension Obligation Bonds

BILL SUMMARY

Senate Bill 1067 would clarify that Pension Obligation Bonds (POBs) are not to be treated as refunding bonds, therefore requiring a local vote before new bonds are issued.

SB 1067 would also require notice of the resolution providing for the issuance of new bonds be published on the municipality’s website for 30 days before issuance.

ISSUE BACKGROUND

POBs are bonds issued by local governments to cover the unfunded portion of their outstanding soft pension liabilities by creating new hard debt, often referred to as arbitrage. As pension costs for locals have continued to increase and interest rates have remained low, many locals have turned to POBs to pay down pension unfunded liabilities for public employees, supposedly benefiting from the interest rate savings (arbitrage).

The California Constitution requires municipalities to obtain a two-thirds approval of the electorate to issue debt obligations. However, POBs are currently treated as “refunding bonds” in state law, meaning local governments do not have to obtain voter approval to issue these bonds. Yet, the Appellate Court did not recognize unfunded liabilities as a “debt” but as an “estimate.” Court validation of the debt is a disingenuous end run around the taxpayers who are ultimately responsible for honoring the debt elimination.

In the last few years, nine cities in California have issued nearly $700 million in POBs, and there are sure to be more attempts forthcoming. If municipalities plan to issue more debt in the municipal fixed income market, taxpayers should have a greater part to play in that decision.

REASON FOR LEGISLATION

Given the resurgence of local governments issuing POBs to cover outstanding unfunded pension liabilities, taxpayers should be wary of their governments issuing more debt to cover another kind of debt. POBs can be a dangerous tool and essentially amount to interest rate arbitrage while subjecting the proceeds to investment risk incurred by its retirement system.

SB 1067 will require local governments to get approval from the electorate before issuing more pension obligation bonds.

SUPPORT

Pending

CONTACT

Spencer Street, Legislative Aide
Spencer.Street@sen.ca.gov, (916) 651-4037


2 County of Orange v. Assn. of Orange County Dep. Sheriffs, 121 Cal. Rptr. 3d 151 (Cal. App. 2d Dist. 2011)

3 Webster, Keely. Pension bonds are staging a comeback in California. Bond Buyer. 26 Sept 2019.