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Bridgeport, CT comes to market once again with pension obligation bonds

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Looking to take advantage of historically low interest rates, the **City of Bridgeport, Connecticut** will issue USD 151.9m in debt this week, including USD 116.6m in pension obligation bonds (POBs), said Kenneth Flatto, the city's finance director and CFO.

It isn't Bridgeport's first POB issuance; the city previously issued USD 350m in POBs in 2000, and will distribute the proceeds of this transaction to finance the same pension system, Plan A. Plan A currently has a 21% funded ratio, and following the debt issuance this week, the funded ratio is expected to grow to 59.8%. Bridgeport also issued USD 99.5m in POBs in January 2018 to support two other pension plans.

"The old POBs are maturing in 10 years and that pension fund did become underfunded again over the last decade, it was not anything to do with old POBs, the city had taken a holiday from making contributions from 2011-2014," Flatto said.

The issuance includes USD 116.6m in Series 2019C to be distributed to the pension fund, USD 22.2m in Series 2019D and USD 13.1m in Series 2019E bonds. The Series D and E bonds are issued to refund existing general obligation bonds and to pay for the costs of issuance.

This issuance is structured such that the Series C bonds have backloaded maturities, starting in 2029, to balance the existing debt service obligations with the 2000 POBs issued for Plan A. Once those bonds mature in 2030, the city's debt service costs will drop by USD 30m. Anticipated debt service costs on the 2019 POBs is less than USD 6.5m a year through 2030, and in 2031, it will increase to approximately USD 10.5m a year.

“It helps offset a net unfunded liability, it adds some debt on the debt, but it diminishes rapidly when the old POBs mature,” Flatto said. “It’s a way to clean up the balance sheet, a smart financing mechanism to save the city money, help the pension plan to stay whole … with a modest impact on our debt structure.”

The city expects to save USD 3.6m over 25 years, according to the state’s Office of Policy and Management (OPM).

POBs are discouraged by the Government Finance Officers Association, a national professional association of public finance officials.

“Pension and health-care related costs are growing so fast that POBs are one of several difficult options to cover these costs,” said Jon Schotz, managing partner at Saybrook Fund Advisors. “But I don’t know why issuers would do POBs, if you look over time, they haven’t worked. It’s very rare that municipalities can invest pension assets and see a return at a rate higher than their borrowing costs without taking on more risk.”

The arbitrage risk associated with POBs is somewhat neutralized because of the low rate environment, which means market conditions are in the city’s favor, Flatto said.

“We’ve been averaging 8% on the investment portfolio in the last decade, and even over the last 15 years, 7.5% including the recession,” Flatto said. “The spread of what we’ll earn on the return, versus the financing on the low interest cost is advantageous to the city and the pension plan.”

Bridgeport anticipates investment returns of 6.5%, and the OPM estimates the city will be able to get the transaction done with a true interest cost of 3.99%, subject to market conditions.

“Despite the impairment of POBs in bankruptcy, the market is willing to take the credit risk because of a lack of supply and high demand for yield,” Schotz said.

The issuance will help the city manage its expenses in the future, Flatto said.

“If we don’t do anything, our required contributions ramp up rapidly, so this allows us to keep contributions level,” Flatto said.

Partially funded

Bridgeport has four pension plans: Plan A, which will receive the distribution of the bond proceeds, Police Retirement Plan B, Firefighters’ Retirement Plan B and the Janitors’ and Engineers’ Retirement Fund.

The net funded ratio of the city's four pension plans is 39.13%, according to the FY18 Comprehensive Annual Financial Report (CAFR). The city's fiscal year begins 1 July.

The Police Retirement Plan B and Firefighters Retirement Plan B have funded ratios of 81.2% and 102.9%, respectively. The city issued USD 99.5m in POBs in January 2018 to prepay unfunded liabilities associated with those plans.

The plan receiving the distribution of the 2019 bond proceeds, Plan A, is closed, and the average age of beneficiaries is 79 years. It has a funded ratio of 21% as of FY18. The Series 2019C distribution will increase the funded ratio to 59.8% in FY20, and a 100% funded ratio is expected by 2037, according to OPM, assuming a 6.5% rate of return. Even if investment returns total 4% through the life of the debt, the funded ratio is expected to total 97.5% in 2037.

The city previously issued USD 350m in POBs in 2000 for Pension Plan A. Annual debt service is approximately USD 33m a year and remain outstanding for another 10 years.

Plan A is severely underfunded for a variety of reasons, including severe market downturns, an overly optimistic rate of return assumption, and a failure to fund the actuarially determined employer contribution, according to OPM.

Between 2011 and 2014, the city did not make annual required contributions (ARC), though it has made full ARC payments since FY15.

"A deposit of USD 120m will stabilize Pension Plan A and preserve its capacity to continue to pay benefits to its 650 beneficiaries," according to OPM. "However, given the city's past experience in issuing POBs and funding Pension Plan A, several considerations are critical to success of this new plan."

"The issuance of POBs is a serious undertaking with potential benefits and risks to the city," according to OPM.

Bridgeport has USD 760.7m in general obligation debt outstanding.

Bridgeport is rated Baa1/stable by Moody's Investors Service and A/stable by S&P Global Ratings and Fitch Ratings.

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