34:1B-7.45 to 34:1B-7.53

LEGISLATIVE HISTORY CHECKLIST
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(Pension Bond Financing Act of 1997)

NJSA: 34:1B-7.45 to 34:1B-7.53

LAWS OF: 1997 **CHAPTER:** 114

BILL NO: S1905

SPONSOR(S): Ewing

DATE INTRODUCED: March 30, 1997

COMMITTEE: **ASSEMBLY:** ---

SENATE: Budget

AMENDED DURING PASSAGE: No

DATE OF PASSAGE: **ASSEMBLY:** June 5, 1997

SENATE: June 5, 1997

DATE OF APPROVAL: June 5, 1997

FOLLOWING STATEMENTS ARE ATTACHED IF AVAILABLE:
SPONSOR STATEMENT: Yes

COMMITTEE STATEMENT: **ASSEMBLY:** No

SENATE: Yes

FISCAL NOTE: Yes (2)

VETO MESSAGE: No

MESSAGE ON SIGNING: No
FOLLOWING WERE PRINTED:
REPORTS: No

HEARINGS: No

KBP:pp

§§1-9 -
C.34:1B-7.45 to
34:1B-7.53
§10 - Note to §§1-9

P.L. 1997, CHAPTER 114, ***approved June 5, 1997***
Senate, No. 1905 ***(First Reprint)***

AN ACT authorizing the issuance of bonds, notes or other obligations by the New Jersey Economic Development Authority for the purposes of financing, in full or in part, the State's portion of the unfunded accrued liability under the State retirement systems and supplementing Title 34 of the Revised Statutes.

BE IT ENACTED *by the Senate and General Assembly of the State of New Jersey:*

1. This act shall be known and may be cited as the "Pension Bond Financing Act of 1997."

2. The Legislature finds and declares that:

a. The State currently makes contributions on an annual basis to fund the State's obligations under its various pension funds and retirement systems, consisting, in part, of the "unfunded accrued liability contribution" representing pension benefits earned in prior years which, pursuant to standard actuarial practices, are not yet fully funded.

b. The State's current unfunded accrued liability is approximately $3.2 billion for the following State pension funds and retirement systems: the Teachers' Pension and Annuity Fund; the Public Employees' Retirement System - State portion only; the Police and Firemen's Retirement System - State portion only; the State Police Retirement System; the Judicial Retirement System; the Prison Officers' Pension Fund; and the Consolidated Police and Firemen's Pension Fund; and the primary reason for this unfunded accrued liability is the required inclusion of funding for pension adjustment or cost-of-living-adjustment benefits within these funds or systems.

c. It is in the public interest to fund this unfunded accrued liability, in full or in part, through the issuance of bonds, notes or other

EXPLANATION - Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and intended to be omitted in the law.

Matter underlined thus is new matter.
Matter enclosed in superscript numerals has been adopted as follows:
[1] Senate SBA committee amendments adopted April 17, 1997.

obligations by the New Jersey Economic Development Authority which shall be retired through annual payments to be made by the State, subject to appropriation by the State Legislature.

d. By issuing bonds, notes or other obligations to fund, in full or in part, this unfunded accrued liability, the State will achieve significant savings and will eliminate the need for pension contributions on an annual basis to fund this unfunded accrued liability.

e. It is intended that the proceeds from sale or sales of bonds, notes or other obligations for the purposes of funding the unfunded accrued pension liability shall not be less than approximately [1][$2.9] $2.7[1] billion; provided, however, that notwithstanding the foregoing, any series of bonds, notes or other obligations issued under this act, whether or not yielding proceeds of [1][$2.9] $2.7[1] billion or less, shall be authorized and valid if issued in accordance with section 4 of this act.

f. It is anticipated that the bonds, notes or other obligations to be issued will be amortized over a shorter period of time than the actuarial amortization [1]of the unfunded liability[1]; and the difference between the payment of principal and interest on the bonds, notes or other obligations and the estimated contributions by the State under the actuarial amortization will provide significant savings to the State.

3. As used in this act:

a. "Bonds" means bonds, notes or other obligations issued by the authority pursuant to this act.

b. "New Jersey Economic Development Authority" or "authority" means the New Jersey Economic Development Authority created pursuant to section 4 of P.L.1974, c.80 (C.34:1B-4).

c. "Refunding bonds" means bonds, notes or other obligations issued to refinance bonds, notes or other obligations previously issued by the authority pursuant to section 4 of this act.

d. "Unfunded accrued pension liability" means the unfunded accrued liability of the State under: the Teachers' Pension and Annuity Fund, determined as of March 31, 1996 under N.J.S.18A:66-18; the Judicial Retirement System, determined as of June 30, 1996 under section 33 of P.L.1973, c.140 (C.43:6A-33); the Prison Officers' Pension Fund, determined as of June 30, 1996 under P.L.1941, c.220 (C.42:7-7 et seq.); the Public Employees' Retirement System, determined as of March 31, 1996 under section 24 of P.L.1954, c.84 (C.43:15A-24); the Consolidated Police and Firemen's Pension Fund, determined as of June 30, 1996 under R.S.43:16-5; the Police and Firemen's Retirement System, determined as of June 30, 1995 under section 15 of P.L.1944, c.255 (C.43:16A-15); and the State Police Retirement System, determined as of June 30, 1996 under section 34 of P.L.1965, c.89 (C.53:5A-34), and certified by the State Treasurer and reported to the authority pursuant to section 4 of this act.

4. Notwithstanding the provisions of any law, rule, regulation or order to the contrary:

a. The authority shall have the power, pursuant to the provisions of this act and P.L.1974, c.80 (C.34:1B-1 et seq.), to issue bonds and refunding bonds, incur indebtedness and borrow money secured, in whole or in part, by monies received pursuant to sections 5 and 6 of this act, for the purpose of providing funds for the payment, in full or in part, of the unfunded accrued pension liability, as such unfunded accrued pension liability is certified by the State Treasurer and reported to the authority, and any costs related to the issuance thereof. The authority may establish reserve or other funds to further secure bonds and refunding bonds. [1]<u>The bonds shall be in the amount to yield proceeds of $2.75 billion to fund, all or in part, the unfunded accrued pension liability, plus additional bonds to pay for the costs of issuance.</u>[1]

b. The authority may, in any resolution authorizing the issuance of bonds or refunding bonds, pledge the contract with the State Treasurer, provided for in section 6 of this act, or any part thereof, for the payment or redemption of the bonds or refunding bonds, and covenant as to the use and disposition of money available to the authority for payments of bonds and refunding bonds. All costs associated with the issuance of bonds and refunding bonds by the authority for the purposes set forth in this act may be paid by the authority from amounts it receives from the proceeds of the bonds or refunding bonds and from amounts it receives pursuant to sections 5 and 6 of this act, which costs may include, but are not limited to, any costs relating to the issuance of the bonds or refunding bonds, administrative costs of the authority attributable to the payment of the unfunded accrued pension liability, and costs attributable to the agreements described in subsection c. of this section. The bonds or refunding bonds shall be authorized by resolution, which shall stipulate the manner of execution and form of the bonds, whether the bonds are in one or more series, the date or dates of issue, time or times of maturity, [1]<u>which shall not exceed 38 years,</u>[1] the rate or rates of interest payable on the bonds, which may be at fixed rates or variable rates, and which interest may be current interest or may accrue, the denomination or denominations in which the bonds are issued, conversion or registration privileges, the sources and medium of payment and place or places of payment, terms of redemption, privileges of exchangeability or interchangeability, and entitlement to priorities of payment or security in the amounts to be received by the authority pursuant to sections 5 and 6 of this act. The bonds may be sold at a public or private sale at a price or prices determined by the authority. The authority is authorized to enter into any agreements necessary or desirable to effectuate the purposes of this section, including agreements to sell bonds or refunding bonds to any person and to comply with the laws of any jurisdiction relating thereto.

c. In connection with any bonds or refunding bonds issued pursuant to this act, the authority may also enter into any revolving credit agreement, agreement establishing a line of credit or letter of credit, reimbursement agreement, interest rate exchange agreement, currency exchange agreement, interest rate floor or cap, options, puts or calls to hedge payment, currency, rate, spread or similar exposure, or similar agreements, float agreements, forward agreements, insurance contract, surety bond, commitment to purchase or sell bonds, purchase or sale agreement, or commitments or other contracts or agreements and other security agreements approved by the authority.

d. No resolution adopted by the authority authorizing the issuance of bonds or refunding bonds pursuant to this act shall be adopted or otherwise made effective without the approval in writing of the State Treasurer. Except as provided by subsection i. of section 4 of P.L.1974, c.80 (C.34:1B-4), bonds or refunding bonds may be issued without obtaining the consent of any department, division, commission, board, bureau or agency of the State, other than the approval as required by this subsection, and without any other proceedings or the occurrence of any other conditions or other things other than those proceedings, conditions or things which are specifically required by this act.

e. Bonds and refunding bonds issued by the authority pursuant to this act shall be special and limited obligations of the authority payable from, and secured by, such funds and moneys determined by the authority in accordance with this section. Neither the members of the authority nor any other person executing the bonds or refunding bonds shall be personally liable with respect to payment of interest and principal on these bonds or refunding bonds. Bonds or refunding bonds issued pursuant to the provisions of this act shall not be a debt or liability of the State or any agency or instrumentality thereof, except as otherwise provided by this subsection, either legal, moral or otherwise, and nothing contained in this act shall be construed to authorize the authority to incur any indebtedness on behalf of or in any way to obligate the State or any political subdivision thereof, and all bonds and refunding bonds issued by the authority shall contain a statement to that effect on their face.

f. The authority is authorized to engage, subject to the approval of the State Treasurer and in such manner as the State Treasurer shall determine, the services of financial advisors and experts, placement agents, underwriters, appraisers, and such other advisors, consultants and agents as may be necessary to effectuate the purposes of this act.

g. The proceeds from the sale of the bonds, other than refunding bonds, issued pursuant to this act, after payment of any costs related to the issuance of such bonds, shall be paid by the authority to the Teachers' Pension and Annuity Fund, the Judicial Retirement System, the Prison Officers' Pension Fund, the Public Employees' Retirement System, the Consolidated Police and Firemen's Pension Fund, the Police and Firemen's Retirement System, and the State Police Retirement System to be applied to the payment, in full or in part, of the unfunded accrued pension liability of the State under these funds and systems as directed by the State Treasurer, or in such other manner as the State Treasurer and the authority may determine.

h. All bonds or refunding bonds issued by the authority are deemed to be issued by a body corporate and politic of the State for an essential governmental purpose, and the interest thereon and the income derived from all funds, revenues, incomes and other moneys received for or to be received by the authority and pledged and available to pay or secure the payment on bonds or refunding bonds and the interest thereon, shall be exempt from all taxes levied pursuant to the provisions of Title 54 of the Revised Statutes or Title 54A of the New Jersey Statutes, except for transfer, inheritance and estate taxes levied pursuant to Subtitle 5 of Title 54 of the Revised Statutes.

i. The State hereby pledges and covenants with the holders of any bonds or refunding bonds issued pursuant to the provisions of this act, that it will not limit or alter the rights or powers vested in the authority by this act, nor limit or alter the rights or powers of the State Treasurer in any manner which would jeopardize the interest of the holders or any trustee of such holders, or inhibit or prevent performance or fulfillment by the authority or the State Treasurer with respect to the terms of any agreement made with the holders of these bonds or refunding bonds or agreements made pursuant to subsection c. of section 4 of this act except that the failure of the Legislature to appropriate moneys for any purpose of this act shall not be deemed a violation of this section.

j. Notwithstanding any restriction contained in any other law, rule, regulation or order to the contrary, the State and all political subdivisions of this State, their officers, boards, commissioners, departments or other agencies, all banks, bankers, trust companies, savings banks and institutions, building and loan associations, saving and loan associations, investment companies and other persons carrying on a banking or investment business, and all executors, administrators, guardians, trustees and other fiduciaries, and all other persons whatsoever who now are or may hereafter be authorized to invest in bonds or other obligations of the State, may properly and legally invest any sinking funds, moneys or other funds, including capital, belonging to them or within their control, in any bonds or refunding bonds issued by the authority under the provisions of this act; and said bonds and refunding bonds are hereby made securities which may properly and legally be deposited with, and received by any State or municipal officers or agency of the State, for any purpose for which the deposit of bonds or other obligations of the State is now, or may hereafter be, authorized by law.

5. [1]a.[1] The State Treasurer shall, in each State fiscal year, pay from the General Fund to the authority, in accordance with a contract or contracts between the State Treasurer and the authority, authorized pursuant to section 6 of this act, an amount equivalent to the amount due to be paid in such State fiscal year to pay the debt service incurred for such State fiscal year on the bonds or refunding bonds of the authority issued pursuant to this act and any additional costs authorized by section 4 of this act.

[1]b.[1] In addition to such terms and conditions as are agreed upon pursuant to section 6 of this act, the contract or contracts shall provide that [1][in each State fiscal year, amounts payable thereunder shall be equal to or more than the amount that would be required in that State fiscal year to be applied toward the amortization schedule of the unfunded accrued pension liability, as that liability is defined in subsection d. of section 3 of this act and actuarially determined as of the dates specified therein, and shall further provide that][1] all such payments from the General Fund shall be subject to, and dependent upon, appropriations being made from time to time by the Legislature for such purposes [1]and shall further provide for a payment schedule and requirements as follows:

(1) For State fiscal year 1998, an amount not less than the amount that would be required to be applied in that State fiscal year to the amortization schedule of the unfunded accrued pension liability, as that liability is defined in subsection d. of section 3 of this act and actuarially determined as of the dates specified therein (hereinafter "unfunded accrued pension liability payment");

(2) For each of the State fiscal years from 1999 through 2004, inclusive, an amount not less than the sum of the respective unfunded accrued pension liability payment plus $25 million;

(3) For each of the State fiscal years from 2005 through 2020, inclusive, an amount not less than the respective unfunded accrued pension liability payment;

(4) For each of the State fiscal years from 2021 through 2035, or such State fiscal year after 2021 and prior to 2035 in which the last of the bonds issued under this act are retired, as appropriate, an amount not less than the unfunded accrued pension liability payment for State fiscal year 2020 and not more than the unfunded accrued pension liability payment for State fiscal year 2021;

(5) No payments under the contract or contracts shall be required for bonds that are defeased or bonds for which a deposit sufficient to provide for all payments on the bonds has been made; and

(6) Notwithstanding any other provision of this section to the contrary, under all payment provisions set forth in this section, annual amounts to be paid shall be sufficient to pay the debt service on the bonds and any refunding bonds, and any additional costs authorized by section 4 of this act for the appropriate years.[1]

6. The State Treasurer and the authority are authorized to enter into one or more contracts to implement the payment arrangement that is provided for in section 5 of this act. The contract or contracts shall provide for payment by the State Treasurer of the amounts required to be paid pursuant to section 5 of this act and shall set forth the procedure for the transfer of moneys for the purpose of paying such moneys. The contract or contracts shall contain such terms and conditions as are determined by the parties, and shall include, but not be limited to, terms and conditions necessary and desirable to secure any bonds or refunding bonds of the authority issued pursuant to this act; provided, however, that notwithstanding any other provision of any law, rule, regulation or order to the contrary, the authority shall be paid only such funds as shall be determined by the contract or contracts and further provided that the incurrence of any obligation of the State under the contract or contracts, including any payments to be made thereunder from the General Fund, shall be subject to and dependent upon appropriations being made from time to time by the Legislature for the purposes of this act.

7. The State Treasurer shall, on or before April 1 of each year, issue a report on the financing provided for in this act to the Governor, the Senate President, the Speaker of the General Assembly, and the chairs of the Senate Budget and Appropriations Committee and the Assembly Appropriations Committee or the respective successor committees. The report shall include, but not be limited to: the outstanding debt and the payments provided for in section 5 of this act for the current State fiscal year; the cumulative amount of debt incurred, debt retired and payments and, as appropriate, debt outstanding from prior State fiscal years for which bonds or refunding bonds have been issued pursuant to this act; and estimates of same for the remainder of time in which any debt incurred pursuant to this act is outstanding.

8. It is the intent of the Legislature that in the event of any conflict or inconsistency between the provisions of this act and any other law pertaining to the purposes of this act, to the extent of the conflict or inconsistency, the provisions of this act shall be enforced and the provisions of the other law shall be of no effect.

9. If any clause, sentence, paragraph, section or part of this act

shall be adjudged by any court of competent jurisdiction to be invalid, the judgment shall not affect, impair or invalidate the remainder thereof, but shall be confined in its operation to the clause, sentence, paragraph, section or part thereof directly involved in the controversy in which the judgment shall have been rendered.

10. This act shall be construed liberally to effectuate the purposes thereof, and as complete and independent authorization for each action and purpose set forth herein.

11. This act shall take effect immediately.

Authorizes EDA to issue bonds and refunding bonds to provide funds for paying, in full or in part, the unfunded accrued pension liability of the State in each State pension fund.

8. It is the intent of the Legislature that in the event of any conflict or inconsistency between the provisions of this act and any other law pertaining to the purposes of this act, to the extent of the conflict or inconsistency, the provisions of this act shall be enforced and the provisions of the other law shall be of no effect.

9. If any clause, sentence, paragraph, section or part of this act shall be adjudged by any court of competent jurisdiction to be invalid, the judgment shall not affect, impair or invalidate the remainder thereof, but shall be confined in its operation to the clause, sentence, paragraph, section or part thereof directly involved in the controversy in which the judgment shall have been rendered.

10. This act shall be construed liberally to effectuate the purposes thereof, and as complete and independent authorization for each action and purpose set forth herein.

11. This act shall take effect immediately.

STATEMENT

This bill authorizes the New Jersey Economic Development Authority ("EDA"), to issue bonds and refunding bonds, to provide funds for paying, in full or in part, the unfunded accrued pension liability of the State in each State pension fund, determined as of specific dates, and certified by the State Treasurer. Bond proceeds could also be used to defray issuance costs. These bonds would be special and limited obligations of the EDA. The bonds or refunding bonds would not be a debt or liability of the State or any political subdivision thereof, and they must contain a statement on their face to that effect.

The proceeds from the sale of the bonds under this act, after the payment of issuance costs, shall be paid by the EDA to the Teachers' Pension and Annuity Fund, the Judicial Retirement System, the Prison Officers' Pension Fund, the Public Employees' Retirement System, the Consolidated Police and Firemen's Pension Fund, the Police and Firemen's Retirement System and the State Police Retirement System to be applied to the payment of the unfunded accrued pension liability of the State under these funds as directed by the State Treasurer.

To pay the unfunded accrued pension liability, the EDA is authorized to issue bonds and incur other debt secured by moneys it receives from the General Fund through a contract or contracts with the State Treasurer. All debt service and other costs associated with issuing the bonds may be paid by the EDA from bond proceeds or amounts received from the General Fund in the State Treasury. These costs may include any costs relating to the issuance of the bonds or refunding bonds, and administrative costs of the EDA attributable to paying the unfunded accrued pension liability, and costs attributable to such agreements as a revolving credit or a line of credit.

The bonds or refunding bonds must be authorized by resolution. The resolution shall stipulate, among other things: the manner of execution and form of the bonds; whether the bonds are in one or more series; the date or dates of issue; the time or times of maturity; the rate or rates of interest payable on the bonds, which may be fixed or variable; the denominations in which the bonds are issued; the conversion or registration privileges; the sources, medium and place of payment; and the terms of redemption.

The bonds may be sold at a public or private sale at a price or prices determined by the EDA. The EDA is authorized to enter into any pertinent agreements, including agreements to sell bonds or refunding bonds.

In connection with bonds or refunding bonds, the EDA may enter into such agreements as revolving credit agreements, lines or letters of credit, reimbursement agreements, interest rate exchange agreements, insurance contracts, surety bonds, commitments to purchase or sell bonds, purchase or sale agreements, or other contracts or agreements. The EDA may establish reserve funds to further secure bonds and refunding bonds.

No resolution authorizing the issuance of these bonds can be adopted without the approval of the State Treasurer. The bonds may be issued without obtaining the consent of any other department, division, commission or State agency.

Subject to the approval of the State Treasurer, the EDA is authorized to engage financial advisors, placement agents, underwriters, appraisers and other necessary advisors.

The bonds issued under this act are deemed to be for an essential governmental purpose, and the interest thereon and the income derived from funds to pay or secure the payment of the bonds shall be exempt from all State taxes, except transfer inheritance and estate taxes.

The State pledges with the holders of the bonds or refunding bonds under this act that it will not change the rights or powers of the EDA or the State Treasure in any way that would jeopardize the interest of the holders or inhibit the EDA or the Treasurer from performing the terms of the bond agreements. Failure of the State to appropriate moneys for this act shall not be deemed a violation of this section.

The State Treasurer, under the contract or contracts with the EDA, must pay each fiscal year from the General Fund to the EDA an amount equal to the annual amount due to pay the debt service on the bonds or refunding bonds issued under this act. Under the contract or contracts, in each State fiscal year, the payments shall be equal to or more than the amount that would be required under current law to be applied in that State fiscal year toward the amortization of the unfunded accrued liability. All such payments from the General Fund are subject to appropriations made by the Legislature.

The contract or contracts shall also set forth procedures for implementing the payment arrangement. The contract or contracts shall require the State Treasurer to pay the proper amounts and shall establish the procedures for transferring moneys for payment. The incurrence of any obligation of the State under the contract, including payments from the General Fund, shall be subject to appropriations made by the Legislature.

Finally, this bill would require the State Treasurer to issue an annual report on current, cumulative and projected future debt and debt service related to the financing provided for under the bill.

The bill would take effect immediately.

Authorizes EDA to issue bonds and refunding bonds to provide funds for paying, in full or in part, the unfunded accrued pension liability of the State in each State pension fund.

SENATE BUDGET AND APPROPRIATIONS COMMITTEE

STATEMENT TO

SENATE, No. 1905

with Senate committee amendments

STATE OF NEW JERSEY

DATED: APRIL 17, 1997

The Senate Budget and Appropriations Committee reports without recommendation Senate Bill No. 1905 of 1997 with amendments.

Senate Bill No. 1905, as amended, authorizes the New Jersey Economic Development Authority ("EDA") to issue bonds and refunding bonds to provide funds for paying, in full or in part, the unfunded accrued pension liability of the State in each State pension fund, as certified by the State Treasurer, and for any issuance costs of those bonds. These bonds would be special and limited obligations of the EDA, and would not be a debt or liability of the State. Debt service on the bonds would be paid though annual appropriations by the Legislature. The bonds will be issued to yield an amount of $2.75 billion, plus additional bonds may be issued to pay for the costs of issuance.

The proceeds from the sale of the bonds will be paid by the EDA to the Teachers' Pension and Annuity Fund, the Judicial Retirement System, the Prison Officers' Pension Fund, the Public Employees' Retirement System, the Consolidated Police and Firemen's Pension Fund, the Police and Firemen's Retirement System and the State Police Retirement System to be applied to the payment of the unfunded accrued pension liability of the State under these funds as directed by the State Treasurer.

COMMITTEE AMENDMENT

The committee amended the bill to set the amount that may be borrowed at $2.75 billion plus bonds for the costs of issuance; to limit the duration of the bonds to 38 years; and to alter the repayment schedule in a manner that will increase the debt payments in years two through seven and reduce payments in the later years.

FISCAL IMPACT:

A fiscal note prepared by the Office of Legislative Services (OLS) on the unamended version of this bill along with its companion bill (Senate Bill No. 1906) outlines the information provided to date by the Department of Treasury on the impact of these bills if enacted. The department states that the unfunded accrued liability of the State pension systems is $3.2 billion, with an additional $1.0 billion projected future liability for cost-of -living adjustment (COLA) benefits payable to active employees. Under this bill as amended, the EDA would issue $2.75 billion in Pension Obligation Bonds (POBs) to "refinance" most of the $3.2 billion unfunded accrued liability of the State retirement systems; the $2.75 billion in bond proceeds would be deposited in the various pension funds. The principal and interest (debt service) on the proposed $2.75 billion POB issuance are estimated to total $12.1 to 12.3 billion, if the bonds are repaid with interest over 36 years. Refinancing the liability is estimated to result in savings of $45.5 billion to taxpayers in the years 2034 through 2056.

The debt service interest rate on the $2.75 billion in POBs is estimated to average 8.1 percent over the 36-year amortization period. The repayment schedule for the 2.75 billion in POBs is to be structured in a manner wherein the annual debt service on the POBs would "mirror" the annual State contributions that are to be provided to the retirement systems under current law. However, to reduce the level of debt service payments after fiscal year 2020, which are capped at an estimated $500 million annually, debt service payments in fiscal year 1999 through 2004 are required to be $25 million more than the annual State contributions to the retirement systems under current law.

An estimated $450 million of the $2.4 billion in "surplus assets" created by the change to "full-market" value of assets under the companion bill will be used to pay the portion of the $3.2 billion unfunded accrued liability not funded with the proceeds of the POBs ($3.2 billion - $2.75 billion = $450 million); $1.0 billion of the $2.4 billion in "surplus assets" will be used to pay the $1.0 billion projected future liability for cost-of-living adjustment (COLA) benefits payable to active employees; and an estimated $647 million of the "surplus assets" would be applied to reduce the normal State contributions to fund the retirement systems in FY 1997 and FY 1998. In addition to the $2.75 billion in bonds for the pension system, the bill permits borrowing for the cost of issuance which is estimated to be $15 million.

FISCAL NOTE TO

SENATE, No. 1905

STATE OF NEW JERSEY

DATED: April 14, 1997

Senate Bill No. 1905 of 1997 and its companion bill, S-1906, change the manner by which the State finances its pension obligations. S-1905, entitled the "Pension Bond Financing Act of 1997", authorizes the New Jersey Economic Development Authority (EDA) to issue State-backed appropriation bonds to fund, in full or in part, the unfunded accrued pension liability of the State in each State pension fund, as such liabilities were certified by the valuation reports applicable for FY 1998.

S1906 changes the value of the assets of the retirement systems to "full-market" value of assets for the State as of the actuarial valuation reports applicable to FY1998. This one-time accounting change from the current "market-related" value of assets (20 percent of full-market) to "full-market" value immediately recognizes recent capital gains instead of recognizing those gains over five years, resulting in an increased value of the accumulated assets. For valuation reports applicable to FY1999 and thereafter, the actuarial value of assets will revert to "market-related" value of assets. S1906 authorizes the State to reduce its "normal contributions" to the systems, to the extent possible, from 100 percent of excess assets through 2001, and on a declining percentage of excess assets thereafter. In addition, S1906 permits the State to pay its unfunded accrued liabilities under the various pension systems from any source of funds, including the proceeds of pension obligation bonds (POBs) to be issued by the EDA.

Administration Comments

The Department of Treasury has distributed a number of documents and graphic displays which explain the financial, actuarial and budgetary impacts of this legislation. These may be briefly summarized as follows:

A. The unfunded accrued liability of the State pension systems is $3.2 billion. In addition, there is a $1.0 projected future billion liability for cost-of-living adjustment (COLA) benefits payable to active employees.

B. Under the provisions of S1905, the EDA would issue at least $2.9 billion in POBs to "refinance" most of the $3.2 billion unfunded accrued liability of the State retirement systems. The $2.9 billion

in bond proceeds would be deposited in the various pension funds. The principal and interest (debt service) on the proposed $2.9 billion POB issuance are estimated to total $14.7 billion, if the bonds are repaid with interest over 36 years. Refinancing the liability is estimated to result in savings of $42 billion to taxpayers in the years 2034 through 2056.

C. The debt service interest rate on the $2.9 billion in POBs is estimated to average 7.7 percent over the 36-year amortization period. Under current law, the opportunity cost of not having the $3.2 billion (amount of the unfunded accrued liability) invested in the capital markets is assumed to be 8.75 percent per year.

D. The repayment schedule for the $2.9 billion in POBs is to be structured in a manner wherein the annual debt service on the POBs would "mirror" the annual State contributions that are to be provided to fund the retirement systems under current law.

E. An estimated $300 million of the $2.4 billion in "surplus assets" created by the change to "full-market" value of assets under S-1906 will be used to pay the portion of the $3.2 billion unfunded accrued liability not funded with the proceeds of the POBs ($3.2 billion - $2.9 billion = $300 million).

F. $1.0 billion of the $2.4 billion in "surplus assets" will be used to pay the $1.0 billion projected future liability for cost-of-living adjustment (COLA) benefits payable to active employees.

G. An estimated $647 million of the "surplus assets" would be applied to reduce the normal State contributions to fund the retirement systems in FY1997 and FY1998.

OLS Comments

A. S1905 does not set a specific limit on the amount or amortization period of POBs that may be issued by the EDA. Issuing bonds in excess of the $2.9 billion now anticipated would increase the total debt service cost.

Debt authorized by the EDA is currently limited by law to a maximum 40-year amortization period. The provisions of S-1905 would override the current 40-year limit if it is necessary. The Administration could establish a longer or shorter amortization schedule. If the amortization period exceeds the Administration's 36-year proposal, the debt service on bonds will increase and the savings to future taxpayers will decrease. If the POBs are retired under an amortization schedule less than 36 years, the debt service on the bonds will decrease and the savings to future taxpayers would increase.

The present value, in 1997 dollars, of the $42 billion savings to taxpayers in 2034 through 2056 is $701.3 million when the assumed rate of return (8.75 percent) on pension investments is used.

B. The Administration's estimates were based on an average interest rate of 7.7 percent. The actual rate will be determined based on market conditions at the time the bonds are issued. Interest rates have increased somewhat since the Administration's estimates. The rate on 30-Year U.S. Treasury Bonds, as published in the Wall Street Journal on March 14, 1997, was 6.96 percent. A continuation of this recent trend could affect the average rate payable on the POBs and ultimately the value of the anticipated future savings.

The POBs would be limited obligations of the EDA. Although the principal and interest on the bonds will be paid through annual State appropriations from the General Fund, the bonds will not be "full faith and credit" obligations (debt) of the State, which would require approval in a public referendum. The POBs must contain a statement to that effect. Because the bonds are not issued directly by the State, and are not backed by its full faith and credit, but rather a promise to appropriate the annual debt service, the POBs are considered a somewhat greater credit risk than General Obligation (G.O.) bonds. According to Standard & Poor's Corp., a credit rating agency, the credit premium on POBs could be as much as 33 basis points (.33 percent) higher than G.O. bonds. The cost differential of financing $2.9 billion for G.O. bonds versus appropriation bonds may total approximately $300 million dollars.

The State Treasurer has indicated that a portion of the bond issuance may be insured. Such insurance would reduce the credit risk of appropriation bonds, resulting in a lower interest rate payable on the bonds. Any savings would be dependent on the cost of purchasing insurance.

If the State were to wait until after a November referendum to issue the debt, the State risks more uncertainty (interest rate fluctuations) in the bond market.

C. The Administration proposal of refinancing the $3.2 billion unfunded accrued liability by issuing $2.9 billion in POBs and using $300 million in "surplus assets" is structured to replicate the annual State contributions that are now scheduled to be made between 1998 and the year 2034 to fund the retirement systems under current law. This payment schedule starts out with very low annual payments that rise steeply over time.

Other amortization schedules that would require higher annual payments in early years result in significant total debt service savings over the life of the POBs. For instance, a level amortization schedule for the proposed $2.9 billion issuance would cost approximately $8.6 billion compared to the $14.7 billion currently proposed. In this example, a level amortization of $239 million per year would require the State to contribute an additional $1.3 billion toward debt service over the first ten years (the first-year difference in FY 1998 would be $147.3 million); however, after the "crossover point" in FY 2011, level debt payments would be $7.3 billion lower through the remaining years of repayment.

D. If S1905 and S1906 are enacted, the Administration estimates the pension funds will have $2.4 billion in "surplus assets" representing the difference between market value and actuarial value of assets. To the extent there are "surplus assets" (assets in excess of liabilities) the State is, in effect, borrowing more than the amount necessary to fully fund the retirement systems. Although it is hoped that the proceeds of the bond sale will be invested and will earn more than the cost of their replacement, there is always a risk or uncertainty in borrowing money.

E. The State can only use "surplus assets" to offset their normal pension contributions if the retirement systems are fully funded and there are no unfunded accrued liabilities.

G. Normal pension contributions are defined by the Administration to include the cost of funding pension, COLA and group life insurance benefits but not the pay-as-you-go cost of funding post-retirement medical benefits.

This fiscal note has been prepared pursuant to P.L.1980, c.67.

FISCAL NOTE TO

[First Reprint]
SENATE, No. 1905

STATE OF NEW JERSEY

DATED: JUNE 26, 1997

Senate Bill No. 1905 (1R) of 1997 and its companion bill, S-2148, change the manner by which the State finances its pension obligations. S-1905 (1R), entitled the "Pension Bond Financing Act of 1997", authorizes the New Jersey Economic Development Authority (EDA) to issue State-backed appropriation bonds to fund, in full or in part, the unfunded accrued pension liability of the State in each State pension fund, as such liabilities were certified by the valuation reports applicable for FY 1998.

S-2148 changes the value of the assets of the retirement systems to "full-market" value of assets for the State and participating local government employers as of the actuarial valuation reports applicable to FY 1998. This one-time accounting change from the current "market-related" value of assets (20 percent of full-market) to "full-market" value immediately recognizes recent capital gains instead of recognizing those gains over five years, resulting in an increased value of the accumulated assets. For valuation reports applicable to FY 1999 and thereafter, the actuarial value of assets will revert to "market-related" value of assets. S-2148 authorizes the State and local employers to reduce their annual "normal contributions" to the systems, to the extent possible, by up to 100 percent of the value of excess assets through FY 2002, and on a declining percentage of excess assets thereafter. In addition, S-2148 permits the State to pay its unfunded accrued liabilities under the various pension systems from any source of funds, including the proceeds of pension obligation bonds (POBs) to be issued by the EDA.

S-1905 (1R) also provides for a reduction, during the calendar years 1998 and 1999, in the contribution rate of State and local government employees of 1/2 of 1 percent of salary and for a similar reduction in employee contributions in the future if the State Treasurer determines that excess assets shall be used to reduce the employers' (State and local governments) normal contributions beyond FY 1998.

These bills are identical to A-3049 and A-3047.

Administration Comments

The Department of Treasury has distributed a number of documents and graphic displays which explain the financial, actuarial and budgetary impacts of this legislation. These may be briefly summarized as follows:

A. The unfunded accrued liability of the State pension systems is $3.2 billion. In addition, there is a $1.0 billion projected future liability for cost-of-living adjustment (COLA) benefits payable to active employees.

B. Under the provisions of S-1905 (1R), the EDA would issue at least $2.75 billion in POBs to "refinance" most of the $3.2 billion liability of the State retirement systems. The $2.75 billion in bond proceeds would be deposited in the various pension funds. The principal and interest (debt service) on the proposed $2.75 billion POB issuance are estimated to total $12.6 billion, if the bonds are repaid with interest over 36 years. Refinancing the liability is estimated to result in savings of $42 billion to taxpayers in the years 2034 through 2056.

C. The debt service interest rate on the $2.75 billion in POBs is estimated to average 8.07 percent over the 36-year amortization period. Under current law, the opportunity cost of not having the $3.2 billion (amount of the liability) invested in the capital markets is assumed to be 8.75 percent per year.

D. The repayment schedule for the $2.75 billion in POBs is to be structured in a manner wherein the annual debt service on the POBs would "mirror" the annual State contributions that are to be provided to fund the retirement systems under current law, but with several important differences:

Specifically, for FY 1998, the debt service will equal the amount that would have been required to be applied in FY 1998 to finance the unfunded accrued liabilities of the retirement systems under current law ($90.8 million);

For fiscal years 1999 through 2004, inclusive, the debt service shall at least equal the current unfunded accrued liability payments, plus an additional $25 million each year;

For fiscal years 2005 through 2020, inclusive, the debt service shall at least equal the current unfunded accrued liability payments;

For fiscal years 2021 through 2035 (or whenever the last bonds are retired), the debt service shall be leveled off so that payments at least equal the unfunded accrued liability payment scheduled for FY 2020, but are not more than the unfunded accrued liability payment for FY 2021, as determined under current law.

E. An estimated $450 million of the $2.4 billion in "surplus assets" created by the change to "full-market" value of assets under A3047 will be used to pay the portion of the $3.2 billion liability not funded with the proceeds of the POBs ($3.2 billion - $2.75 billion = $450 million).

F. $1.0 billion of the $2.4 billion in "surplus assets" will be used to pay the $1.0 billion projected future liability for cost-of-living adjustment (COLA) benefits payable to active employees.

G. An estimated $589 million of the "surplus assets" would be applied to reduce the normal State contributions to fund the retirement systems in FY 1997 and FY 1998. (This amount was originally calculated to be $647 million.)

OLS Comments

A. As noted, the unfunded accrued liability of the State retirement systems is calculated by the administration to be $3.213 billion. At the same time, however, two of the systems, the Teachers' Pension and Annuity Fund (TPAF) and the Public Employees' Retirement System (PERS) are retaining $543 million in "basic benefits surplus" assets that are not being considered in calculating the unfunded accrued liability and therefore sizing the proposed bond issue. The Administration deducts $204 million in assets from the TPAF and $339 million in assets from the PERS to arrive at the $3.2 billion figure. There is no convincing actuarial or accounting rule which would prevent this $543 million from being considered as an offset to the $3.2 billion unfunded liability.

S-1905 (1R) limits the amount of bonds that may be issued by the EDA to an amount that will yield $2.75 billion in bond proceeds to refinance the liability of the retirement systems plus an estimated $15 million for the cost of issuing the bonds. The bill also establishes a maximum 38-year amortization period.

The Administration has indicated an intention to repay the bonds over 36 years at an estimated debt service cost of $12.6 billion. The Administration could establish a longer or shorter amortization schedule. If the amortization period exceeds the Administration's 36-year proposal, the debt service on bonds will increase and the savings to future taxpayers will decrease. If the POBs are retired under an amortization schedule less than 36 years, the debt service on the bonds will decrease and the savings to future taxpayers would increase.

The present value, in 1997 dollars, of the $42 billion in future savings to taxpayers in 2034 through 2056 is $701 million when the assumed rate of return (8.75 percent) on pension investments is used.

B. The Administration's estimates were based on an average interest rate of 8.07 percent. The actual rate will be determined based on market conditions at the time the bonds are issued. Interest rates, which have fluctuated considerably, have increased slightly since the Administration's original estimates. A continuation of this recent trend could affect the average rate payable on the POBs and ultimately the value of the anticipated future savings.

The POBs would be limited obligations of the EDA. Although the principal and interest on the bonds will be paid through annual State appropriations from the General Fund, the bonds will not be "full faith and credit" obligations (debt) of the State, which would require approval in a public referendum. The POBs must contain a statement to that effect. Because the bonds are not issued directly by the State, and are not backed by its full faith and credit, but rather a promise to appropriate the annual debt service, the POBs are considered a somewhat greater credit risk than General Obligation (G.O.) bonds. According to Standard & Poor's Corp., a credit rating agency, the credit premium on POBs could be as much as 33 basis points (.33 percent) higher than G.O. bonds. The cost differential of financing $2.765 billion for G.O. bonds versus appropriation bonds may total approximately $285 million dollars.

The State Treasurer has indicated that a portion of the bond issuance may be insured. Such insurance would reduce the credit risk of appropriation bonds, resulting in a lower interest rate payable on the bonds. Any savings would be dependent on the cost of purchasing insurance.

If the State were to wait until after a November referendum to issue the debt, the State risks more uncertainty (interest rate fluctuations) in the bond market.

C. As noted previously, the debt service on the $2.75 billion POB issuance is structured to be similar, although not identical, to the annual State contributions that are now scheduled to be made between 1998 and the year 2034 to fund the retirement systems under current law. This payment schedule starts out with very low annual payments that rise steeply over time before leveling off in 2021.

Other amortization schedules that would require higher annual payments in early years result in significant total debt service savings over the life of the POBs. For instance, a level amortization schedule for the proposed $2.765 billion issuance would cost approximately $8.6 billion compared to the $12.6 billion currently proposed. In this example, a level amortization of $237.7 million per year would require the State to contribute an additional $1.0 billion toward debt service over the first thirteen years (the first-year difference in FY 1998 would be $146.9 million); however, after the "crossover point" in FY 2010, level debt payments would be $5.0 billion lower through the remaining years of repayment.

D. If S-1905 (1R) and S-2148 are enacted, the Administration estimates the pension funds will have $2.4 billion in "surplus assets". Approximately $1.9 billion represents the difference between the actuarial value of assets and the full-market value of assets. The remaining amount, approximately $543 million, consists of assets currently recognized by the TPAF and PERS retirement systems as surplus assets (basic benefits surplus). To the extent there are "surplus assets" (assets in excess of liabilities) the State is, in effect, borrowing more than the amount necessary to fully fund the retirement systems. Although it is hoped that the proceeds of the bond sale will be invested and will earn more than the cost of their replacement, there is always a risk or uncertainty in borrowing money.

E. The State can only use "surplus assets" to offset the normal pension contributions if the retirement systems are fully funded and there are no unfunded accrued liabilities.

G. Normal pension contributions are defined by the Administration to include the cost of funding basic pension benefits, COLAs and group life insurance benefits but not the pay-as-you-go cost of funding post-retirement medical benefits.

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