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Santa Rosa Mulls Bond Offering to Knock Down Pension Liabilities.

Santa Rosa City Council is considering selling more than $100 million of bonds to raise cash for its growing pension debt, a step that could ease budgeting in years to come but carries enough risk that some municipal financing experts warn against it.

The costs of expensive earlier pension plans and losses the California Public Employees' Retirement System accrued during the 2008 financial crisis will come to a head in the next 10 years, as annual payments Santa Rosa makes to the agency increase each year to peak at almost $43 million in 2031.

Paying off those debts affects daily life in the city. Every dollar dumped into pension debt is one less dollar city officials have for programs or for reacting to problems that range from crime to natural disasters.

To curb the payments, Santa Rosa's chief finance officer Jan Mazyck has proposed the city use an investment mechanism known as pension obligation bonds. The bonds could raise cash at low interest rates and dump that cash into pension funds — a move that both lowers pension debt and increases the funds' earning power by providing more money to invest.

At a July 20 city council study session, members expressed interest in the strategy and directed Mazyck to bring back a more specific proposal. The council will not need to go to voters with a ballot measure in order to issue the pension bond offering, which could go as high as $200 million and are likely to amount to at least $110 million, Mazyck said.

For success, the city will need the pension funds to outperform the interest rates paid to investors who buy the bonds. Given low interest rates that have persisted through the pandemic, Mazyck says chances of doing so are high. She has said the bonds could be issued at an average of 3.5% interest but well could be lower.

"It's not fail proof but it is a reasonably fail proof environment," she said in a Tuesday interview. While interest rates are low, financial markets have been performing well. CalPERS itself raked in a 21% return on its investment portfolio over the last fiscal year.

But issuing the bonds increases the city's vulnerability to a market crash. Sustained stock market losses — from a fresh recession, for example — would leave the city owing not just the pension payments but also the interest payments on its bonds.

Failure would mean even more money going to pay off investment losses, and less money for government services.

Because of such eventualities, the Government Finance Officers Association, a trade group made up of more than 20,000 federal, state and local government public finance officers, suggests local governments stay away from pension obligation bonds.

Pension obligation bonds “are complex instruments that carry considerable risk,” the trade group’s committee on retirement and benefits administration said in February.

The Federal Reserve keeping interest rates at near rock bottom levels has led to a flurry of government entities issuing the bonds, prompting a written statement from government finance officers’ group. The risks “remain true regardless of economic cycles,” according to the statement.

The city pays around $30 million each year toward the unfunded portions of its pension funds. It pays about another $20 million annually toward the pension funds of its current employees.

Pension payments are for the most part an untouchable cost for governments — city officials can’t legally reduce the retirement benefits previous employees held.

Because of efforts by CalPERS to “smooth” out the repayment of losses accrued during the 2008 recession, city finance officials say that over the next 10 years Santa Rosa will pay another $110 million, above the $30 million in annual payments, to unfunded pension liabilities.

She would like to see the city sell bonds of at least that amount, she said. The city does not have to sell $110 million worth of bonds at once, however, Mazyck said, allowing it to be strategic with interest rates.

Selling the bonds in stages, and as part of a broader strategy to confront budget woes, reassured council members worried about too much risk through a complicated financial tool.

“There’s no magic solution, because if there were, other cities would be doing it,” council member Tom Schwedhelm said.

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