COUNTY OF MILWAUKEE
INTEROFFICE COMMUNICATION

DATE : February 26, 2013

TO : Supervisor Dimitrijevic, Chairwoman, County Board of Supervisors

FROM : Pension Obligation Bond Workgroup

SUBJECT : Recommendation for Tendering existing Notes and issuance of General Obligation Taxable Bonds

BACKGROUND

The Office of the Comptroller was contacted by JP Morgan, who was the lead underwriter for the original Taxable Pension Promissory Notes, Series 2009A in 2009 and Taxable Pension Notes in 2013. One of the original purchasers of the $265,000,000 Taxable Pension Promissory Notes, Series 2009A (the " Notes") sold the Notes on the secondary market to a separate, investment division of JP Morgan. This investment division currently owns $92,005,000 of the Notes maturing in 2024. JP Morgan contacted the Office of the Comptroller to inquire if the County would be interested in purchasing these Notes. It is likely that JP Morgan is experiencing some difficulty selling the Notes on the secondary market at their desired price. If the County purchases the Notes, they may be able to obtain a higher price than the current market will provide, but a price at which would allow the County to reduce its future interest payments through the issuance of new bonds with lower interest rates.

The process of purchasing the Notes from noteholders is called tendering. This process is not uncommon in corporate finance but is not often used by governmental entities. One of the reasons for the rarity to tendering government bonds is that, normally, the secondary market is a more efficient and effective option for buying and selling bonds or notes.

If the County is able to purchase the Notes at a price which provides an appropriate level of savings, the County would offer the same price to all investors with Notes maturing in 2024 and then issue new bonds to purchase the Notes. Current market conditions in which interest rates are significantly lower than were present in 2009 would require that the amount of the new bonds that the County would have to issue will exceed the principal amount of the Notes that will be purchased. However, the lower interest rate on the new bonds should result in a lower total debt service costs for the County.

The reason for the higher principal amount on the new bonds is a function of bond math. For example, if a bondholder purchased a bond for a price of $1,000, with an interest rate of 10 percent, annual interest he would receive $100 (.10 multiplied by $1,000). If interest rates decrease to 5 percent, in order to generate $100 in interest that bond would have a price of $2,000 (.05 multiplied by $2,000). Therefore, since interest rates are lower than they were in 2009, the price of the bonds is higher so that the bondholder can receive a yield more reflective of today's market.

If all noteholders of the 2024 term bonds were willing to sell their Notes, it could require up to $134 million in new bonds to replace the approximately $108 million in outstanding Notes. If all of the noteholders of the 2028 term bonds were willing to sell their Notes, it could require up to $146 million in new bonds to replace approximately $103 million in outstanding Notes. It is extremely unlikely that all of the noteholders would be willing to sell their Notes at a price which would be beneficial to the County.

PENSION OBLIGATION BOND WORKGROUP

The 2007 Adopted Budget established the pension obligation bond workgroup (POB Workgroup) to develop a recommended pension obligation bond proposal for review and approval by the Finance, Personnel[1] and Audit Committee and the County Board of Supervisors. The POB Workgroup consists of the County's Financial Advisor, Bond Counsel, county staff from the Department of Administrative Services, Corporation Counsel, County Board and Department of Audit and other members[2].

The Notes do not have a call date prior to maturity. Therefore, the County's only means to achieve additional savings are through a tender offer. In order to encourage a current Note holder to sell or tender their Notes to the County, the County would need to offer a premium to what is available in the secondary market.

As stated, the County will only offer to do a tender, and issue refunding bonds, if the County has a positive savings. The savings would only occur if the County's total debt service cost for the taxable refunding bonds is less than the total debt service cost for the existing Notes. The County will evaluate savings based on a net present value calculation of the difference between the debt services.

The POB workgroup examined the market exchange of Notes that mature in 2024 (2024 Term Bond). The County originally issued the 2024 Term Bond at an interest rate of 5.93%. In October 2012, the secondary market sold the 2024 Term Bond at an effective interest rate of 3.78%. The County's recent sale of $138 million of taxable pension notes in January 2013 had an effective interest rate of 3.28%. The effective rate on that issue for only the 2024 maturity was 2.80%. This brief analysis indicates that the County may be able to achieve net present value savings in the current market. It is understood that market conditions may change, and that that savings may no longer be available from a tender process. If this is the case, the County's cost, as stated above would be $20,000.

REQUEST

The Pension Obligation Bond Workgroup is seeking approval of the attached resolution authorizing the Comptroller to negotiate the tending of all or a portion of the Notes and to issue a not-to-exceed amount of $283,000,000 in bonds to purchase the Notes. In addition, approval is requested to authorize the Comptroller to hire an underwriter to serve as a tender agent to assist with negotiating purchase price for the tender of the Notes, which will determine the savings and amount of the new bonds; hire an informational agent to determine who owns the remaining Notes; hire an underwriter for the sale of the new bonds; meet with rating agencies and all other actions need to tender the Notes.

The attached resolution provides parameters for the tendering the Notes and issuing the not-to-exceed amount of $283,000,000 in new bonds and delegates approval of the sale of the bonds to the Comptroller. The Comptroller's approval is limited to results of the sale that fall within the parameters outlined in the resolution. An informational report will be submitted to the Committee on Finance, Audit and Personnel to communicate the final results of the transactions.

1. In 2007, the Committee on Finance, Audit and Personnel was known as the Finance and Audit Committee
2. The initial POB Workgroup included the County's Actuary and the Employee Benefits Manager. This expertise related to the pension fund rather than the financing or issuance of bonds.

UNDERWRITERS

In May 2012, the County Board of Supervisors approved the recommendation of JP Morgan as the senior or lead bookrunning underwriter, RBC Capital as the co-senior and Siebert Brandford Shank as the co-manager as underwriters to replace the $135,000,000 Taxable Note Anticipation Notes. The sale occurred on January 24, 2013. The underwriters were recommended by an independent review panel after an evaluation of the 13 firms that responded to the County's request for proposals.

Since the savings for the County are dependent upon low interest rates, the County would need to proceed expeditiously with analyzing the information and data and negotiating the tender of the existing Notes and sale of the new bonds. Therefore, to proceed accordingly, the County's financial advisors will contact the 13 underwriters that responded to the 2012 request for proposal and request a bid, an approach to tender the bonds, and a fee quote. The underwriter will be selected to serve as a tender agent and senior underwriter for the new bonds. In addition, a co-senior or co-manager will be selected to assist with the sale of the new bonds. The attached resolution delegates authority to the Comptroller to select the underwriters.

BOND SALE PARAMETERS

The parameters for the financing would consist of the following:

- Net Present Value Savings – The County will not proceed with the tending of the Notes and issuance of new bonds unless there is a combined positive net present value savings for the transactions.

- Both maximum coupon rate and true interest costs (TIC) of 5.5 percent – A coupon rate is the interest rate for each maturity or principal amount. The true interest cost is the actual interest rate paid on bonds, which is expressed as a percentage of the total debt in today's dollars and includes the costs of issuance and other fees.

- Par Call Provision – The par call provision provides the County with the right to call the bonds after a specified number of years and only pay principal or the par amount of the bonds at the time of the call. The par call is the normal call provision that the County uses on its debt. Typically, the County uses a 10 year call date. The refunding bonds may or may not have that specific number, but the basics are the same.

- Minimum purchase price of 98 percent of the par amount of the bonds – The price of the bond reflects the maximum price an investor would want to pay for the bond based on the coupon rate and the market rate. This is known as the yield or rate of return on the bond. When the coupon rate on the bond is equal to the market rate, the purchase price is equal to the principal amount of the bond (par). If the coupon rate is lower than the market rate, the bonds will be purchased at a discount. If the coupon is higher than the market rate, the bonds will be purchased at a premium. If there is a premium paid, the amount of the premium would be used to reduce the amount of the new bond issue. Whether or not the bond purchase price is a par, discount or premium is dependent upon market conditions on the day of the sale.

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INITIAL AUTHORIZING RESOLUTION AND NOTE RESOLUTION

The attached resolution (Attachment 2) authorizes the tendering of the Notes and sale of the new bonds, delegates approval to the Comptroller and provides parameters for the tendering of the Notes and issuance of the new bonds. The authorized and delegated actions will require the Committee on Finance, Audit and Personnel and County Board approval. Approval of the attached resolution will require a majority vote of the County Board of Supervisors. The attached resolution directs County staff to take the necessary actions for the tending of the Notes and sale of the new bonds.

DEBT ISSUANCE EXPENSE

The attached resolution authorizes and directs the Comptroller to request credit ratings and to pay all professional services and other issuance expenses related to the tendering of the Notes and issuance of the new bonds. A DAS-only appropriation transfer will be processed to pay expenses related to this financing. The expenses will be paid with bond proceeds.

If the analysis does not result in a combined positive net present value savings, the DAS-only transfer will utilize funds from the appropriation for contingency budget to pay for fees relating to the analysis. It is estimated that $20,000 would be needed from the appropriation for contingency budget if the County had to pursue this scenario.

Anticipated expenses may include tender agent, informational agent, underwriter(s), bond counsel, financial auditor, financial advisory fees, official statement printing and mailing costs, credit rating fees and expenses, and other issuance costs such as publication and express mail costs.

RECOMMENDATION

The POB Workgroup requests that the Committee on Finance, Audit and Personnel approve and recommend approval by the full County Board of the attached resolutions. The resolution delegates to the Comptroller the authority to approve the final terms and conditions of the tendering of the Notes and new bond sale provided that those terms and conditions are within the parameters set forth in the attached resolution. The sale will consist of the issuance of a not-to-exceed amount of $283,000,000 to tender the Notes. An informational report will be submitted to the Committee on Finance, Audit and Personnel to communicate the final results of the transaction.

Pension Obligation Bond Workgroup

Attachments

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pc: Chris Abele, County Executive
Supervisor Willie Johnson, Co-Chair, Committee on Finance, Audit and Personnel
Supervisor David Cullen, Co-Chair, Committee on Finance, Audit and Personnel
Don Tyler, Director, Department of Administrative Services
Amber Moreen, Chief of Staff, County Executive's Office
Raisa Koltun, County Executive's Office
Kelly Bablitch, Chief of Staff, County Board
Pamela Bryant, Capital Finance Manager
Stephen Cady, County Board Fiscal and Budget Analyst
Justin Rodriguez, Fiscal and Management Analyst
Chuck Jarik, Chapman and Cutler LLP
David Anderson, Public Financial Management
Leticia Peralta Davis, Peralta Garcia Solutions, LLC
Emile Banks, Emile Banks and Co.
Pension Obligation Bond Workgroup

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Attachment 1

INITIAL AUTHORIZING RESOLUTION AND NOTE RESOLUTION

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