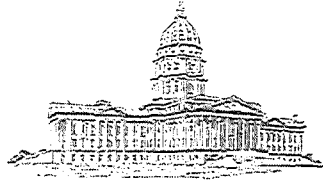


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VIC MILLER
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February 22, 2021

Thank you, Mr. Chairman and members of the Insurance and Pensions Committee for the opportunity to appear before you in support of HB 2405.

In its simplest form, HB 2405 merely employs one of the oldest and most effective methods of getting rich in America—borrowing money and investing it to earn a profit. In 2004, when the State of Kansas first employed this strategy to prop up the KPERs Trust Fund, it could have easily been described as a gamble. And borrowing a half a billion dollars to do so was no small gamble. In 2015, when the State doubled down on this approach to the tune of a billion dollars, many would see it as too big of a risk.

But those of us who served this last fall on the Joint Committee on Pensions, Investments and Benefits learned just how wise those investments were. The 2004 bond issue had delivered almost \$332,000,000 in net proceeds to the Fund. And, in the short time since issuance, the 2015 issue had already added value of \$141,000,000 over and above debt service.

With interest rates at record lows, now is the perfect time to again make a smart investment using the strength of our KPERs Trust Fund borrowing ability to do so.

HB 2405 is a good bill, and while I have suggestions on how it may become a great bill, I will reserve those comments for “if and when” the Chairman chooses to work the bill. In legislative parlance, the perfect should not be the enemy of the good.



Pension Obligation Bonds

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Joint Committee on Pensions, Investments, and Benefits

December 2, 2020



Covering Today

Purpose of pension obligation bonds

History of approved pension obligation bonds

Investment performance



Pension Obligation Bonds

- Pension obligation bond proceeds immediately improve funded status of the Retirement System.
- Bond debt is considered “hard debt” and is one of the highest budgeting priorities for the State.
- The expectation is that, over time, KPERS’ investment returns will exceed interest rate paid on the pension obligation bonds for the State, which in turn will reduce required future employer contributions for the State.



History of Pension Obligation Bonds

- The State of Kansas has issued pension obligation bonds to improve the funded status of the System on two occasions.
- The first pension obligation bond issue was in 2004 (2004C) for a total of \$500 million, gross of fees.
- The second pension obligation bond issue was approved by the Legislature and issued in 2015 (2015H). The approved amount of the pension obligation bonds was \$1.0 billion, net of fees.



2004C Bond Issue

- In 2004, the Legislature approved a \$500 million bond issue to be deposited in the KPERS Trust Fund.
- The bonds are 30-year maturity bonds with a total interest cost of 5.39%.
- The structure of the bonds included capitalized interest totaling about \$60 million.
- KPERS ultimately received \$440,165,000 in net proceeds.
- Approximate annual debt service is \$33 million. Funding source is the Expanded Lottery Act Revenues Fund.



2015H Bond Issue

- In 2015, the Legislature approved a \$1.0 billion bond issue, net of fees, with proceeds to be deposited in the KPERs Trust Fund.
- The bonds are 30-year maturity bonds with a total interest cost of 4.68%.
- The 2015H bonds sold in August 2015 and KPERs received the full \$1.0 billion in proceeds.
- Approximate annual debt service is \$65 million. Funding source is the State General Fund.



Investment Performance as of September 30, 2020

- As of October 31, 2020, investment returns on the System's investment portfolio have exceeded the interest cost of both bond issues.
- The System's average annualized total return for the time period since the 2004C bond issue is **7.13%**, compared to the bond interest cost of 5.39%. The value added since issuance, after payment of the debt service, is almost **\$332 million**.
- The System's average annualized total return for the time period since the 2015H bond issue is **6.82%**, compared to the bond interest cost of 4.69%. The value added since issuance, after payment of the debt service, is about **\$141 million**.



Considerations

- Both pension obligation bond issues are 30-year maturity bonds.
- The value to the State of issuing the bonds will not be fully known for many years, particularly on the 2015H bond, which is just over 5 years into the 30-year period.
- The expectation is that KPERS will be able to invest the proceeds and realize an investment return that exceeds the bond rate.
- As of October 31, 2020 both pension obligation bond issues have been a net positive to the State with **more than \$473 million in value added**. This position is expected to vary over time, depending on market conditions.

