

**CITY OF SALEM  
CITY MANAGER'S OFFICE  
FINANCE DIVISION**

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**CITY OF SALEM  
FINANCE COMMITTEE**

Committee Members

Councilor Brad Nanke, Chair  
Mayor Chuck Bennett  
Councilor Matthew Ausec  
Councilor Steve McCoid

City Staff

Steve Powers, City Manager  
Kacey Duncan, Deputy City Manager  
Dan Atchison, City Attorney  
Kelley Jacobs, Budget Officer  
David Lacy, Financial Operations Manager  
Tony Turley, Financial Reporting Manager  
Samantha Naluai, Management Analyst  
Kelli Blechschmidt, Administrative Analyst

Next Meeting: March 19, 2018

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**MEETING AGENDA**

Monday, February 26, 2018

12:00 PM – 1:00 PM

City Manager's Conference Room  
555 Liberty Street SE, Room 220

1. Call to Order
2. Approval of Minutes
  - a. December 11, 2017
3. Public Comment  
(Appearance of persons wishing to address the Committee on any matter other than those which appear on this Agenda.)
4. Action Items
5. Management Update/Information Items
  - a. Current Financing Activity
  - b. PERS Update
6. Continued Business
7. New Business
8. Adjournment

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## City of Salem Finance Committee Minutes

**DATE:** December 11, 2017

**CHAIRPERSON:** Brad Nanke

**PLACE:** CMO Conference Room

**STAFF LIAISON:**

David Lacy

503-588-6174

[dlacy@cityofsalem.net](mailto:dlacy@cityofsalem.net)

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**Members Present:**

Chair Nanke

Mayor Bennett

Member Ausec

Member McCoid

**Members Absent:**

**Guests Present:**

Charles Swank & Katherine Wilson-Grove, Mueller and Swank, P.C.

**Staff Present:**

Steve Powers, City Manager

Kacey Duncan, Deputy City Manager

Dan Atchison, City Attorney

Kelley Jacobs, Budget Officer

David Lacy, Financial Operations Manager

Tony Turley, Financial Reporting Manager

Jeremy Morgan, Accounting Supervisor

Anja Straw, Treasury Supervisor

Samantha Naluai, Management Analyst

Kelli Blechschmidt, Administrative Analyst

1. CALL TO ORDER: 12:01 PM/ Quorum
2. APPROVAL OF FINANCE COMMITTEE MINUTES
  - a. September 25, 2017
3. MANAGEMENT UPDATE / INFORMATION ITEMS
  - a. FY 2016-2017 Audit Reports: Committee received and discussed City CAFR, URA CAFR and the Federal Grant Compliance Report; presented by Grove, Mueller and Swank, P.C.
  - b. PERS updates and projections.
  - c. Quarterly Investment Report as of September 30, 2017 presented.
4. ADJOURNMENT: 12:52 PM

The next meeting is Monday February 26, 2018 at noon.

**Rating Action: Moody's assigns Aa2 to Salem, OR's 2018 GO bonds**

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**Global Credit Research - 22 Feb 2018**

New York, February 22, 2018 -- Moody's Investors Service has assigned a Aa2 to Salem (City of) Oregon's \$18.6 million General Obligation Bonds, Series 2018. Moody's maintains a Aa2 on the district's outstanding rated General Obligation Unlimited Tax (GOULT) bonds in the amount of \$112.3 million.

**RATINGS RATIONALE**

The Aa2 rating reflects Salem's large and growing tax base anchored by the state capitol with a somewhat below-average socioeconomic profile, and healthy fund balances supported by growing property tax revenue. The rating further reflects the average debt profile that is expected to be stable, and pension costs and net liabilities that are moderate and expected to grow over at least the next few years.

**RATING OUTLOOK**

Outlooks are usually not assigned to local governments with this amount of debt outstanding.

**FACTORS THAT COULD LEAD TO AN UPGRADE**

- Substantial improvement in Salem's economy, including an enriched socioeconomic profile
- Significant and sustained declines in net pension liabilities, demonstrating pension funding is improving
- Material improvement to fund balances providing additional financial flexibility

**FACTORS THAT COULD LEAD TO A DOWNGRADE**

- Sustained declines in Salem's economy that threaten property tax revenues
- Substantial increase in net pension liabilities and costs
- Material decline in fund balances that limits future flexibility

**LEGAL SECURITY**

The current offering is secured by the city's full faith and credit, and a dedicated and unlimited property tax pledge. Debt service for GOULT bonds in Oregon is funded by a separate property tax levy that is dedicated to bondholders and secured through statute, a beneficial credit strength for bondholders.

**USE OF PROCEEDS**

Proceeds will be used to fund various improvements, including seismic upgrades and other modernization, to Salem's central public library building.

**PROFILE**

Located 45 miles south of Portland (Aaa stable), Salem is the Oregon state (Aa1 stable) capitol and the state's third largest city with a population of 163,480 comprising 49.2 square miles in Marion County (Aa2) and Polk County. The city provides a full range of municipal services, including public safety, parks and recreation, streets, planning, zoning and general administrative services.

**METHODOLOGY**

The principal methodology used in this rating was US Local Government General Obligation Debt published in December 2016. Please see the Rating Methodologies page on [www.moody's.com](http://www.moody's.com) for a copy of this methodology.

**REGULATORY DISCLOSURES**

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## CREDIT OPINION

22 February 2018

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# Salem (City of) OR

## Update to credit analysis

### Summary

[Salem, Oregon](#) (Aa2) is supported by a large and growing tax base, with a local economy anchored by the Oregon state capital. Healthy fund balances, which may decline again slightly in fiscal 2018, and a moderate debt profile, provide further strength. The below-average socioeconomic profile is a weakness relative to peers, as are growing pension liabilities and costs, with the [Oregon pension system structurally underfunded](#) and liabilities expected to grow through at least the next several years.

### Credit strengths

- » Salem's large and growing tax base is anchored by the state capitol and high concentration in government employment, and growth in other industries is healthy.
- » Finances are well managed, with healthy reserves and strong, forward-looking management.

### Credit challenges

- » Fixed costs, defined as debt service and pension costs, are elevated and will rise, driven by growing pension costs.
- » The socioeconomic profile is below-average compared to peers, reflecting the concentration in government employment.

### Rating outlook

Outlooks are usually not assigned to local governments with this amount of debt outstanding.

### Factors that could lead to an upgrade

- » Substantial improvement in Salem's economy, including an enriched socioeconomic profile
- » Significant and sustained declines in net pension liabilities, demonstrating pension funding is improving
- » Material improvement to fund balances providing additional financial flexibility

### Factors that could lead to a downgrade

- » Sustained declines in Salem's economy that threaten property tax revenues

- » Substantial increase in net pension liabilities and costs
- » Material decline in fund balances that limits future flexibility

## Key indicators

Exhibit 1

Salem (City of) OR	2013	2014	2015	2016	2017
<b>Economy/ Tax Base</b>					
Total Full Value (\$000)	\$12,267,502	\$12,243,883	\$12,917,229	\$13,697,349	\$14,782,422
Population	156,937	157,967	160,008	160,690	162,060
Full Value Per Capita	\$78,168	\$77,509	\$80,729	\$85,241	\$91,216
Median Family Income (% of USMedian)	88.6%	85.1%	85.8%	85.8%	85.8%
<b>Finances</b>					
Operating Revenue (\$000)	\$116,153	\$116,769	\$122,871	\$127,431	\$134,183
Fund Balance (\$000)	\$37,984	\$37,666	\$39,847	\$43,993	\$44,934
Cash Balance (\$000)	\$38,880	\$38,373	\$42,374	\$47,610	\$46,535
Fund Balance as a % of Revenues	32.7%	32.3%	32.4%	34.5%	33.5%
Cash Balance as a % of Revenues	33.5%	32.9%	34.5%	37.4%	34.7%
<b>Debt/ Pensions</b>					
Net Direct Debt (\$000)	\$139,977	\$173,788	\$159,772	\$142,115	\$126,155
3-Year Average of Moody's ANPL (\$000)	\$294,951	\$318,211	\$268,028	\$243,506	\$273,215
Net Direct Debt / Operating Revenues (x)	1.2x	1.5x	1.3x	1.1x	0.9x
Net Direct Debt / Full Value (%)	1.1%	1.4%	1.2%	1.0%	0.9%
Moody's - adjusted Net Pension Liability (3-yr average) to Revenues (x)	2.5x	2.7x	2.2x	1.9x	2.0x
Moody's - adjusted Net Pension Liability (3-yr average) to Full Value (%)	2.4%	2.6%	2.1%	1.8%	1.8%

Source: Moody's Investors Service

## Profile

Located 45 miles south of [Portland](#) (Aaa stable), Salem is the [Oregon state](#) (Aa1 stable) capitol and the state's third largest city with a population of 163,480 comprising 49.2 square miles in [Marion County](#) (Aa2) and Polk County. The city provides a full range of municipal services, including public safety, parks and recreation, streets, planning, zoning and general administrative services.

## Detailed credit consideration

### Economy and tax base: Oregon state capitol driven by government employment and agriculture

The local economy is driven by the presence of the [State of Oregon's](#) (Aa1) capitol, which serves as a long-term stabilizing presence; however, the economy remains susceptible to economic cycles as state government is responsible for more than 13% of total employment in the MSA, with other government employers, including the city, responsible for an additional 13% of total employment. Outside of government employment, the local economy is driven largely by agriculture, food processing, wood and paper products, and light manufacturing. The city has actively pursued diversification of the tax base by emphasizing the proximity to the Portland MSA with lower costs.

Socioeconomic measures are modest and remain low compared to similarly rated cities, with median family income of 85.8% of the US median, and per capita income of 79.8% of the US measure as of the 2015 American Community Survey. Full value per capita, a proxy measure of wealth, is \$99,955, though this is somewhat suppressed by the exemption of state property from the city's full value.

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The city's full value, called Real Market Value (RMV), is a large \$16.2 billion as of 2018; with four consecutive years of 6-10% growth, full value far exceeds the pre-recession peak. Assessed value (AV), the growth of which is the driver of tax revenue growth, experienced growth throughout the recession and grew between 3-5% each of the last three years, and stands at \$12.3 billion as of 2018.

### **Financial operations and reserves: well-managed financial operations; healthy reserves may decline modestly**

With healthy reserves and strong management practices, we expect the city's financial operations to remain stable. The city is estimating General Fund reserves will drop by approximately \$2 million in fiscal 2018 to \$22.1 million, or around 20% of revenues, which would remain healthy given the strong management. Further declines in reserves may create negative rating pressure given pension cost increases. Positively, the city is beginning to implement priority-based budgeting and is expecting to develop the fiscal 2020 budget using that method.

General Fund available balance in fiscal 2017 was \$25.8 million, or a healthy 24% of revenues; this was better than budgeted projections, which is common for this strong management team. Across the operating funds (inclusive of the General and Debt Service funds), reserves were stronger at \$44.9 million, or 34% of revenues. The city's formal fund balance policy for the General Fund is 15% of revenues, though the city has exceeded these levels for many years and does not expect a decline to that level.

The city's primary General Fund revenue source is property taxes (60% of 2017 revenues), and collections are a function of the city's permanent property tax rate (\$5.8315/\$1,000 of AV), leading to a fairly stable, if inflexible, revenue source. Licenses and permits (21%) and intergovernmental (12%) revenue constitute the other major sources. Expenditures are primarily for public safety (63%), general government (15%), and community and library services (12%).

### **LIQUIDITY**

General Fund liquidity is healthy, with net cash of \$27.6 million, or 26% of revenues. Net cash in the operating funds is stronger at \$46.5 million, or 35% of revenues.

### **Debt and pensions: manageable debt profile; fixed costs somewhat elevated and growing**

Salem's debt will remain manageable with no additional debt plans in the medium-term. With \$212.4 million in net direct debt, the city's debt profile is relatively manageable at 1.3% of full value and 1.5-times operating revenues. The city's debt is primarily general obligation unlimited tax (GOULT) bonds (\$148.2 million of the total), which benefit from an unlimited and dedicated property tax levy for debt service. The remaining balance (\$64.2 million) are Full Faith and Credit (FF&C) obligations, and the largest share is for pension obligation bonds issued in 2005 as part of an Oregon Local Governments pool.

At 22% in fiscal 2017, fixed costs are elevated compared to national peers, and are expected to grow as Oregon's pension system continues to see increasing contribution rates. Fixed costs are a measure of debt service and the city's pension contributions. Of total fixed costs of \$31.7 million, \$21.6 million (68%) is debt service and the remainder (\$10.1 million, 32%) are from pension contributions.

### **DEBT STRUCTURE**

All of the city's debt is fixed rate. Debt service on outstanding GOULT bond increases from \$14.2 million in fiscal 2018 to maximum annual debt service of \$21.6 million in fiscal 2021 before declining to final maturity in 2037. Payout is healthy given the recent issuance at 76% over 10 years.

### **DEBT-RELATED DERIVATIVES**

There are no debt-related derivatives.

### **PENSIONS AND OPEB**

The city's pension burden is manageable. Salem participates in the Oregon Public Employees' Retirement System (OPERS), a statewide cost-sharing plan. Moody's adjusted net pension liability (ANPL) for the city had a three-year average for fiscals 2015-17 that was 1.7% of 2018 RMV and 2.0-times 2017 operating revenues. The city annually funds 100% of its actuarially required pension contributions, which were \$10.6 million as of FY2017, net of side account contributions. ANPL reflects certain adjustments we make to improve comparability of reported pension liabilities. Moody's adjustments are not intended to replace reported liability information, but to improve comparability with other rated entities.

State and local governments in Oregon face [steadily rising pension costs](#) over at least the next five years, and the rising costs risk crowding out resources available for operations. Pension contribution increases stem from numerous challenges, including a 2014

Oregon Supreme Court ruling that overturned legislative reforms aimed at curbing future cost-of-living adjustments for retiree benefits, reversing previously expected savings and increasing OPERS' liabilities. Contribution rates are also challenged by changing actuarial assumptions and recent investment performance below OPERS' assumed rate of return. Additionally, annual pension payments for many local governments are reduced from gross actuarial contribution rates because of "rate collaring," which generally limits the pace of contribution rate increases to no more than 3% of payroll, or 20% of the current rate. Rate collaring defers a portion of pension contribution hikes and increases unfunded liabilities. Collaring smooths out the budget effect of asset and liability changes, similar to other states' use of a smoothed actuarial valuation of pension assets. Instead, OPERS measures assets by market value.

#### **Management and governance: healthy institutional framework**

Oregon Cities have an Institutional Framework score of Aa, which is high compared to the nation. Institutional Framework scores measure a sector's legal ability to increase revenues and decrease expenditures. Property tax, a major revenue source, is subject to a cap which can be overridden with voter approval only. However, the cap of approximately 3% for most properties still allows for moderate revenue-raising ability. Unpredictable revenue fluctuations tend to be minor, or under 5% annually. Across the sector, fixed and mandated costs are generally less than 25% of expenditures. However, Oregon has public sector unions, which can limit the ability to cut expenditures. Unpredictable expenditure fluctuations tend to be minor, under 5% annually.

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# City of Salem Finance Committee

Current Financing Activity

February 26, 2018

# Moody's assigns Aa2 to Salem, OR's 2018 GO Bonds

## Credit Strengths

- Large & growing tax base anchored by government employment. Growth in other industries is healthy
- Finances are well managed, with healthy reserves and strong, forward-looking management

## Credit Challenges

- Fixed costs, defined as debt service and pension costs, are elevated and will rise, driven by growing pension costs
- Socioeconomic profile is below-average compared to peers, reflecting concentration in government employment

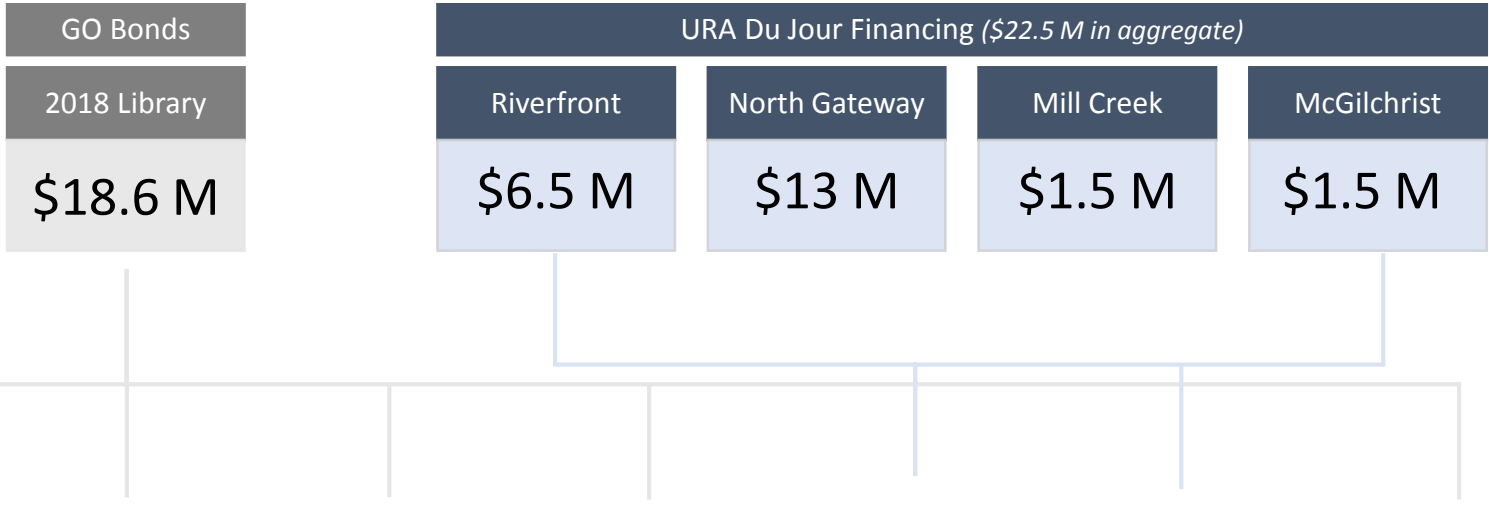
## Factors that Could Lead to an Upgrade

- Substantial improvement in socioeconomic measures
- Significant and sustained declines in pension liabilities, demonstrating pension funding is improving
- Material improvement to fund balances providing additional financial flexibility

## Factors that Could Lead to a Downgrade

- Substantial declines in Salem's economy that threatens property tax revenues
- Substantial increase in net pension liabilities and costs
- Material decline in fund balances that limits future flexibility

City of Salem  
Current Financing Activity



Jan 22 <sup>nd</sup>	Feb 14 <sup>th</sup>	Feb 22 <sup>nd</sup>	March 8 <sup>th</sup>	March 12 <sup>th</sup>	March 15 <sup>th</sup>	March 22 <sup>nd</sup>
Council adopted Resolution No. 18-7 authorizing sale of bonds	Preliminary Official Statement (POS) sent to City Council for comments	Moody's assigns Aa2 rating to the 2018 GO bonds	Bid opening for sale of 2018 GO bonds	Authorizing resolutions to the URA Board	Urban Renewal overnight borrowing	Bond sale closing for 2018 GO bonds



**City of Salem  
Finance Committee**

PERS Side Account Update  
February 26, 2018

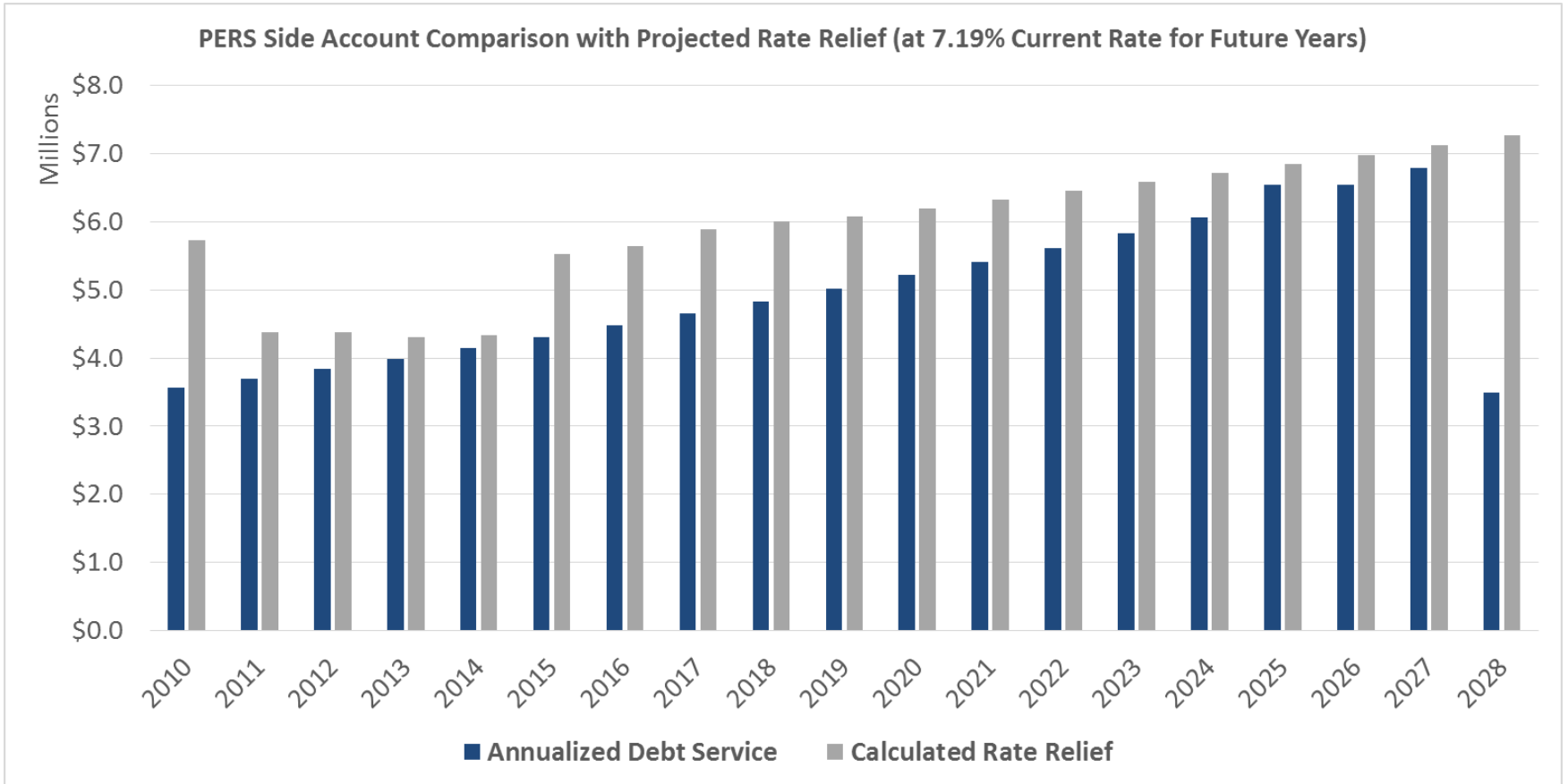


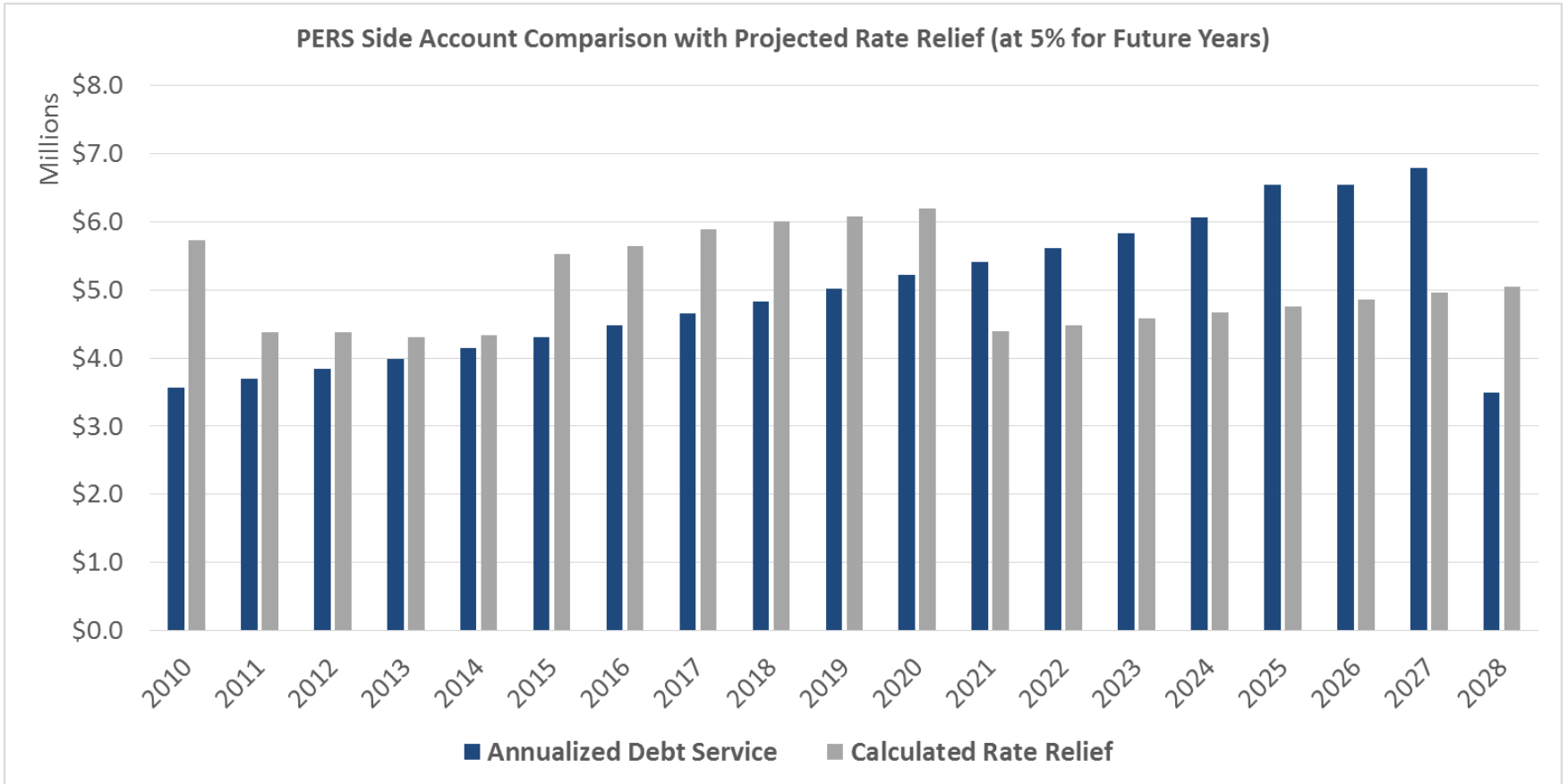
## Presentation Overview

- Current City Debt Funded Side Account
- Senate Bill 1566
- Options for Cash Funded Side Accounts
- Options for Debt Funded Side Accounts

**PERS Side Account Analysis - Savings Summary Based on Annual Valuation Results**

Description	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total
PERS Covered Payroll	67,441,426	70,866,049	74,259,963	74,520,439	76,156,229	77,274,971	77,123,538	76,037,921	76,521,581	78,129,106	80,370,324	828,701,547
Rate Relief %	7.38%	6.53%	6.53%	7.52%	7.52%	5.67%	5.67%	5.66%	5.66%	7.08%	7.08%	
<b>Calculated Rate Relief</b>	<b>4,977,177</b>	<b>4,627,553</b>	<b>4,849,176</b>	<b>5,603,937</b>	<b>5,726,948</b>	<b>4,381,491</b>	<b>4,372,905</b>	<b>4,303,746</b>	<b>4,331,121</b>	<b>5,531,541</b>	<b>5,690,219</b>	<b>54,395,814</b>
Annualized Debt Service	4,677,306	4,462,242	3,296,911	3,421,758	3,559,515	3,694,340	3,835,546	3,987,103	4,143,057	4,311,150	4,480,530	43,869,458
PERS Administrative Expense	3,500	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	23,500
<b>Total Expense</b>	<b>4,680,806</b>	<b>4,464,242</b>	<b>3,298,911</b>	<b>3,423,758</b>	<b>3,561,515</b>	<b>3,696,340</b>	<b>3,837,546</b>	<b>3,989,103</b>	<b>4,145,057</b>	<b>4,313,150</b>	<b>4,482,530</b>	<b>43,892,958</b>
<b>Difference (Savings)</b>	<b>296,371</b>	<b>163,311</b>	<b>1,550,264</b>	<b>2,180,179</b>	<b>2,165,434</b>	<b>685,150</b>	<b>535,359</b>	<b>314,643</b>	<b>186,065</b>	<b>1,218,390</b>	<b>1,207,689</b>	<b>10,502,856</b>
Covered Payroll Growth Rate		5.08%	4.79%	0.35%	2.20%	1.47%	-0.20%	-1.41%	0.64%	2.10%	2.87%	1.79%





## Unfunded Actuarial Liability (UAL)

The excess of the Actuarial Accrued Liability over the Value of the Assets.

Tier 1 / Tier 2 UAL as of December 31, 2016:  
\$159,092,028

OPSRP UAL as of December 31, 2016:  
13,836,731

Total UAL as of December 31, 2016:  
\$172,928,759

## Senate Bill 1566

- Establishes proposed Employer Incentive Fund for use with cash funded employer side accounts (up to 25% match). The fund is not currently capitalized, meaning size and funding sources are not identified.
- Applications for funding are first come first served, but due by December 2019. It is unclear if a match would be retroactive if an employer chose to fund a cash funded side account before December 2019.
- Prioritization will be for employers who have a UAL that is more than 200% of payroll. Salem is right at the cusp – If current side accounts are used in the calculation, our T1/T2 percentage is 198% of payroll and would not qualify. If total UAL is used (including OPSRP), we are at 215%.

## Cash Funded Side Account

- New rules allow for the establishment of a cash funded side account with as little as \$250,000. Employers can make additional deposits to these accounts up to 2 times per year.
- For the first deposit, rate relief would be reflected in current PERS rates within 1 month (immediate cash flow impact). Subsequent deposits would reduce UAL, but would not be reflected as rate relief until the next valuation rate setting period (delayed cash flow impact).
- Setup requires analysis by the PERS actuary, Milliman. Pricing is expected to be \$1,000 for initial scenario, and \$250 per additional scenario.

**Estimated Benefit of a Cash Funded Side Account (Based on Recently Released PERS Model)**

<b>Fund</b>	<b>FY 2019 Est. Payroll</b>	<b>Allocation</b>	<b>Contribution by Fund</b>	<b>Estimated Annual Relief</b>
101 General Fund	60,459,984.27	0.63	631,132.50	47,750.12
155 Transportation	3,492,879.58	0.04	36,461.63	2,758.61
160 Airport	286,792.56	0.00	2,993.78	226.50
185 Building & Safety	1,869,911.12	0.02	19,519.72	1,476.82
310 Utility	21,648,533.71	0.23	225,985.72	17,097.59
320 EMS	241,422.72	0.00	2,520.17	190.67
330 WVCC	5,527,866.80	0.06	57,704.55	4,365.80
355 City Services	1,689,125.22	0.02	17,632.52	1,334.04
365 Self Insurance	579,508.83	0.01	6,049.40	457.68
<b>Total</b>	<b>95,796,024.81</b>	<b>1.00</b>	<b>1,000,000.00</b>	<b>75,657.84</b>



**Estimated Benefit of a Cash Funded Side Account (Based on Recently Released PERS Model)**

<b>Fund</b>	<b>FY 2019 Est. Payroll</b>	<b>Allocation</b>	<b>Contribution by Fund</b>	<b>Estimated Annual Relief</b>
101 General Fund	60,459,984.27	0.63	3,155,662.48	238,750.60
155 Transportation	3,492,879.58	0.04	182,308.17	13,793.04
160 Airport	286,792.56	0.00	14,968.92	1,132.52
185 Building & Safety	1,869,911.12	0.02	97,598.58	7,384.10
310 Utility	21,648,533.71	0.23	1,129,928.60	85,487.96
320 EMS	241,422.72	0.00	12,600.87	953.35
330 WVCC	5,527,866.80	0.06	288,522.77	21,829.01
355 City Services	1,689,125.22	0.02	88,162.59	6,670.19
365 Self Insurance	579,508.83	0.01	30,247.02	2,288.42
<b>Total</b>	<b>95,796,024.81</b>	<b>1.00</b>	<b>5,000,000.00</b>	<b>378,289.19</b>

**Estimated Benefit of a Cash Funded Side Account (Based on Recently Released PERS Model)**

<b>Fund</b>	<b>FY 2019 Est. Payroll</b>	<b>Allocation</b>	<b>Contribution by Fund</b>	<b>Estimated Annual Relief</b>
101 General Fund	60,459,984.27	0.63	6,311,324.96	477,501.20
155 Transportation	3,492,879.58	0.04	364,616.34	27,586.08
160 Airport	286,792.56	0.00	29,937.84	2,265.03
185 Building & Safety	1,869,911.12	0.02	195,197.15	14,768.19
310 Utility	21,648,533.71	0.23	2,259,857.21	170,975.91
320 EMS	241,422.72	0.00	25,201.75	1,906.71
330 WVCC	5,527,866.80	0.06	577,045.53	43,658.02
355 City Services	1,689,125.22	0.02	176,325.19	13,340.38
365 Self Insurance	579,508.83	0.01	60,494.04	4,576.85
<b>Total</b>	<b>95,796,024.81</b>	<b>1.00</b>	<b>10,000,000.00</b>	<b>756,578.39</b>

## Debt Funded Side Account

- Taxable debt with a Full Faith and Credit pledge (pension obligation bonds). Varying results based on structure, investment returns, and modeling assumptions (covered payroll growth, etc.)
- Transitions UAL from a “soft” liability to a “hard” liability. The Government Finance Officers Association (GFOA) has issued an advisory recommending that state and local governments do not issue pension obligation bonds.
- Rating agencies may not view an additional pension obligation bond as credit positive.