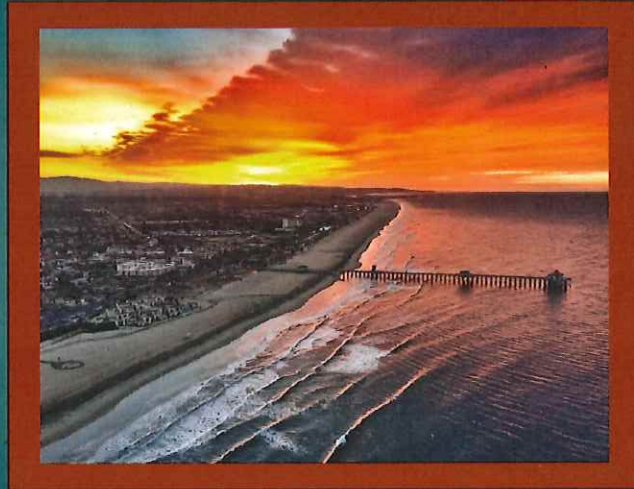


Pension Obligation Bond Analysis and Proposed Fiscal Control Policies



March 16, 2020

Presented by
the Finance Department

Background

- ▶ **October 21, 2019** – Study Session *“An Existential Threat – Pension Cost Increases”*
- ▶ **October 30, 2019** – CalPERS UAL Refinancing Update Presentation to Finance Commission
- ▶ **November 18, 2019** – City Council Resolution 2019-89 adopted authorizing staff and bond counsel to submit the necessary documents to start the judicial validation process
- ▶ **February 26, 2020** – Finance Commission approval of UAL Policy

**SUPPLEMENTAL
COMMUNICATION**

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Meeting Date: 3/16/20

Agenda Item No.: SS# 1(20-1493)

UAL Cost Increase Impact on HB

- ▶ In the past 10 years (from 2009-2019), our annual UAL payment has increased a staggering 444%, from \$4.58 million to \$24.93 million
- ▶ Costs will continue to increase until 2031, reaching an annual UAL payment of \$46.02 million, an increase of 85% from FY 2018/19
- ▶ Pension Obligation Bonds provide the City with the ability to “refinance” its existing UAL
 - ▶ Historically low interest rates provide a unique opportunity to refinance the City’s existing UAL debt load, which is being assessed an interest rate charge of 7%
 - ▶ We’ve coordinated our analysis assuming that we can refinance our UAL debt load at ~3.41%, which would provide total savings of over **\$184.73 million over the life of the issuance**

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Pension Obligation Bond Savings



* FY 30/31 represents peak of annual payment – \$21.09 million or 85% increase from FY 18/19

** Proposed Pension Obligation Bond Debt Service (these results are preliminary and subject to change, especially given the usually high volatility in the market right now)

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Use of POBs Increasing

- ▶ The use of POBs is increasing given that current interest rate levels have made responsible refinancing structures possible
 - ▶ California agencies are currently considering \$2.91 billion in POBs
- ▶ Significant POB refinancing that have occurred / are planned in 2020 include:

▶ Riverside County –	\$700.0M
▶ Orange County –	\$463.9M
▶ Riverside City –	\$632.0M
▶ Huntington Beach –	\$436.2M
▶ Ontario –	\$340.4M
▶ Inglewood –	\$300.0M
▶ City of Orange –	\$280.0M
▶ West Covina –	\$157.9M
▶ Simi Valley –	\$155.0M
▶ Pasadena –	\$131.8M

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Savings from Refinancing UAL Debt Should Be Conservatively Managed

- ▶ If we move forward with refinancing our existing UAL debt, staff would recommend that any realized savings be conservatively managed
- ▶ To that end, staff has been developing fiscal control policies for City Council consideration that we would coordinate in concert with the POB consideration process
- ▶ The policies we've identified and are working to finalize include:
 1. UAL Funding Policy
 2. General Fund Reserve Policy
 3. New Staffing Cost Projection Policy
 4. Park Playground Equipment Reserve Funding

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Fiscal Policies Being Developed

- ▶ Each of the four financial policies is being developed so that they could only be modified / undone by a 6/7th vote of the City Council
- ▶ Details related to each policy includes:
 - ▶ UAL Funding Policy
 - ▶ Requires that 100% of the first year savings (~\$5M, with annual increases based on CPI) be set aside into a restricted fund for the duration of the POB
 - ▶ The funding could only be used to pay down any new future UAL pension debt
 - ▶ General Fund Reserve Policy
 - ▶ This policy would require an annual allocation of ~\$1M into our General Fund Reserve until we have a General Fund reserve equal to 50% of our annual GF Operating Budget
 - ▶ New Staffing Cost Projection Policy
 - ▶ To constraint future staffing costs, this policy would require that any new staff be costed out at 1.5x the fully burdened rate of the proposed new staff member, with the additional cost being placed into the restricted UAL reserve account
 - ▶ Park Playground Equipment Reserve Funding
 - ▶ This policy would require that 15% of any General Fund reserves realized at the end of each fiscal year be placed in a restricted fund that could only be used to replace / upgrade park playground equipment

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Pension Obligation Bond Refinancing Savings and Analysis

- ▶ KNN Public Finance serves as the City's Independent Registered Municipal Advisor ("IRMA")
- ▶ The SEC approved the Municipal Advisor Rule regarding IRMAs in 2013 as part of the financial regulatory reform under the Dodd-Frank Act
 - ▶ IRMAs have a fiduciary duty to the agency they represent, and have to serve as a safeguard against advice and transactions that are not in the agency's best interest
 - ▶ IRMAs that do not serve as an appropriate safeguard have their license revoked by the SEC

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Pension Obligation Bond Refinancing Savings and Analysis (cont.)



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Pension Obligation Bond Refinancing Savings and Analysis (cont.)



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Resurgence of Pension Obligation Bond Issuances

- ▶ Pension Reform and actuarial assumptions have increased pension costs in the near-term
- ▶ Current scheduled annual UAL payments have negative amortization
- ▶ Interest rate on UAL amortization is currently 7.00%
- ▶ Until recently, a prepayment of the UAL did not result in a reduction of the annual amortization payment, but rather a shortening of the period
- ▶ Interest rates are at historic lows
- ▶ POB proceeds go directly into the large CalPERS pool and are NOT invested into a side fund specific to the prepayment

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Upcoming Actions

- ▶ **March 25, 2020** – Present the proposed fiscal control policies to Finance Commission for consideration
- ▶ **April 6, 2020** – Present Preliminary Official Statement and other bond financing documents to City Council for approval to move forward with issuance of the POBs
 - ▶ The UAL Policy and other Fiscal Policies would also be presented for Council approval at this time
- ▶ If approved, we are tentatively scheduled to be looking at POB issuance in mid-late May 2020, depending on market conditions

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Questions