



# City of Huntington Beach

**File #:** 19-1167

**MEETING DATE:** 11/18/2019

## REQUEST FOR CITY COUNCIL ACTION

**SUBMITTED TO:** Honorable Mayor and City Council Members

**SUBMITTED BY:** Oliver Chi, City Manager

**PREPARED BY:** Dahle Bulosan, Interim Chief Financial Officer

**Subject:**

**Adopt City Council Resolution No. 2019-89 Providing for the Possible Issuance of One or More Series of City of Huntington Beach Taxable Pension Obligation Bonds and Authorizing a Trust Agreement, A Validation Action and Other Matters Relating Thereto**

**Statement of Issue:**

It is requested that the City Council adopt a resolution authorizing the possible issuance of taxable Pension Obligation Bonds ("POBs") to refund all or a portion of its California Public Employees' Retirement System ("CalPERS") Unfunded Accrued Liability ("UAL"), and authorizing a judicial validation proceedings related to the issuance of the POBs.

**Financial Impact:**

The issuance of pension obligation bonds for the refinancing of certain pension obligations of the City of Huntington Beach will likely reduce the annual costs related to the UAL the City currently is obligated to pay CalPERS. As of June 30, 2018, the most current actuarial valuation available from CalPERS, the City's UAL for all citywide employees and retirees is approximately \$436.2 million. Approximately 62% of the UAL is related to public safety (police and fire) employees, and 38% is related to non-safety employees.

Currently, annual UAL payments to CalPERS will range from approximately \$32.5 million for the 2020-21 fiscal year, up to approximately \$46 million in the peak year of 2030-31. It is highly likely that the increase will impact the ability of the City Council to adopt future balanced budgets. It may also impact the high level of services currently provided to Huntington Beach's residents and businesses.

The issuance of pension obligation bonds will allow the City of Huntington Beach to prepay up to 100% of the projected UAL, based on the most recent valuation report recently released by CalPERS. By issuing pension obligation bonds, the City will be contractually obligated to make annual debt service payments to the bondholders. One option would be to structure the annual debt service payments to be level-dollar amount payments over the course of the life of the bonds. With potentially lower interest rates paid on the bonds as compared to the current 7% interest rate charged by CalPERS, and an estimated 24 year bond repayment schedule (presuming call

provisions are not exercised), the City could potentially achieve budgetary savings of \$173 million over the life of the bond financing. It reduces the potential UAL payment by \$5 million for fiscal year 2020-21 from \$32.6 million to approximately \$27.6 million. Annual savings will continue to increase, up to approximately \$18.4 million in FY 2030/31, before decreasing in the last part of the debt service schedule. Of note, all of these estimated cost savings are subject to market conditions at the time of our actual bond issuance.

**Recommended Action:**

A) Adopt Resolution 2019-89, "A Resolution of the City Council of the City of Huntington Beach Providing for the Issuance of One or More Series of City of Huntington Beach Taxable Pension Obligation Bonds and Authorizing a Trust Agreement, A Validation Action and Other Matters Relating Thereto" and,

B) Authorize the City Manager and City Clerk to take all administrative and budgetary actions necessary to perform the bond issuance, including the negotiation and execution of agreements with Orrick Herrington and Sutcliffe LLP for judicial validation proceedings, bond counsel, and disclosure counsel services; KNN Public Finance to act as municipal advisor; and US Bank to act as trustee.

**Alternative Action(s):**

Do not approve the recommended actions and direct staff accordingly.

**Analysis:**

Over the last several years, CalPERS has made significant changes to the assumptions used in the calculations of local agencies' pension liabilities. These changes have resulted in (1) an increased overall unfunded pension liability as the discount rate has been reduced from 7.5% to 7.0%, and (2) sharp increases in annual payments due to CalPERS in earlier years followed by declining payments in later years due to the method of amortizing the UAL payments.

The City has two CalPERS plans - a Public Safety plan and a Miscellaneous Employee's plan. Each plan's UAL is comprised of multiple "amortization bases," which are positive and negative amounts generated each year based on the performance of the CalPERS Investment Fund and changes in the actuarial assumptions. Each amortization base has a separate payment schedule over a fixed period of years. Because of the CalPERS methodology, some of the payments continue to increase each year while others will drop off. This creates a significant increase in UAL payments in the next 10 years from \$32.6 to \$46 million and significant decreases in UAL payments in the subsequent 14 years, from \$46 million down to \$10 million.

The difficulty that lies with the City of Huntington Beach, as well as many other local agencies, is the ability to pay these large payments to CalPERS over the next 10 to 15 years, while still trying to maintain a balanced budget. The City of Huntington Beach is focused on trying to minimize the annual increases in the payments to CalPERS, so that balanced budgets can be maintained, and there are manageable impacts to the services offered to the residents and businesses of Huntington Beach. On October 21, 2018, a Study Session entitled, "An Existential Threat- Pension Cost

Increases,” was presented to City Council, which discussed options for addressing the City’s growing UAL payments. This presentation was also given during the October 30, 2019, Finance Commission meeting. Both City Council and the Finance Commission unanimously provided staff with direction to begin the process to refinance the City’s current UAL through a Pension Obligation Bond.

Through the issuance of pension obligation bonds to prepay the existing UAL, the City has better control over the level of payments required to pay debt service on the bonds. These payments are anticipated to be level each year so that the City can better plan its pension expense for budgeting purposes.

The first step in the bond issuance process is a judicial validation by the court. The only issue that the courts will consider is the legal ability of the City to issue pension obligation bonds, and whether the sale of the bonds meets the State of California constitutional requirements. Any potential financial impacts are not part of the court’s analysis.

At the conclusion of the validation process, the court will enter a judgment in favor of the City that the obligation of the City (the liability owed to CalPERS), legally represents an “obligation imposed by law”. Numerous prior court cases have determined that pension liabilities are obligations imposed by law, and therefore are exempt from the debt limitation requirements set forth in Article XVI, Section 18, of the California Constitution. Many other cities have followed this same process for the issuance of pension obligation bonds.

The resolution being presented to the City Council authorizes staff and bond counsel to submit the necessary documents to the Orange County Superior Court to start the judicial validation process as well as approve the following: (1) the issuance of bonds in an amount not-to-exceed: (a) the aggregate principal amount of the Initial Series of Bonds shall not exceed the City’s unfunded accrued actuarial liability under the PERS Contract pursuant to the Retirement Law as of the date of issuance of the Initial Series of Bonds (\$436.2 million as of June 30, 2018, as set forth in the Actuarial Reports), as determined by PERS, plus the underwriter’s discount on the Initial Series of Bonds, plus any original issue discount on the Initial Series of Bonds, plus the costs of issuance of the Initial Series of Bonds, (b) the true interest cost to the City on the Initial Series of Bonds shall not exceed 5.00%, and (c) the Initial Series of Bonds shall mature not later June 30, 2043 (the current PERS final amortization of the City’s unfunded accrued actuarial liability as set forth in the Actuarial Reports) and (2) a draft form of the Trust Agreement for the bonds. The total bond issuance is currently estimated to be \$444.4 million, based on the most current information available from PERS and the City’s financing team. The Trust Agreement identifies the duties and responsibilities of the trustee, establishes the terms and conditions which the bonds are to be issued, and the security for the payment of the principal and interest on the bonds.

If the City Council approves staff’s recommendations, two concurrent processes will begin. The first is the validation process referred to above, which is expected to take at least 90 days. At the same time, staff and consultants will prepare other required financing documents and submit the financing to credit agencies for a credit rating on the bonds.

The final actions to be taken by the City Council will be presented in March or April 2020, near the

conclusion of the validation proceedings. Specifically, the actions include approval of the Preliminary Official Statement, identifying a not-to-exceed interest rate for the bonds, as well as the underwriting discount. The estimated savings from issuing the bonds will be updated at that time based on changes in market conditions and an updated actual bond size, if both of the City's CalPERS plans' UAL are 100% paid. A financial analysis of the cost-effectiveness of prepaying both of the City's CalPERS plans' UAL is underway and will be presented to the City Council when complete to support the staff recommendation of which plans to fund (and if the plans should be funded at 100% of the UAL or some lesser amount). The action recommended at this meeting is to validate the maximum amount that could be required to pay both plans in full.

**Environmental Status:**

Not applicable.

**Strategic Plan Goal:**

Enhance and maintain infrastructure

Strengthen long term financial and economic sustainability.

Enhance and maintain City service delivery.

**Attachment(s):**

1. Resolution No. 2019-89, "A Resolution of the City Council of the City of Huntington Beach Providing for the Issuance of One or More Series of City of Huntington Beach Taxable Pension Obligation Bonds and Authorizing a Trust Agreement, A Validation Action and Other Matters Relating Thereto".
2. Trust Agreement.