



Legislation Details (With Text)

File #: 2019-1034 **Version:** 1 **Name:**
Type: Discussion **Status:** Agenda Ready
File created: 11/14/2019 **In control:** City Council
On agenda: 11/19/2019 **Final action:**
Title: PENSION OBLIGATION BONDS (CITY COUNCIL)
Sponsors:
Indexes:
Code sections:
Attachments: 1. Exhibit 1 Schedule of Amortization Base, 2. Exhibit 2 Projected UAL Payment Requirements, 3. Exhibit 3 Level Debt Service to 2038 then Declining to Maturity in 2044, 4. Exhibit 4 Partial Funding, 5. Exhibit 5 Pension Obligation Funding Memo

Date	Ver.	Action By	Action	Result
11/19/2019	1	City Council		

Report to Mayor and City Council

Tuesday, November 19, 2019

Discussion

SUBJECT:

PENSION OBLIGATION BONDS (CITY COUNCIL)

I. SUMMARY

The City participates in the California Public Employees Retirement System (PERS) for funding current and retired employees' retirement costs. As of June 30, 2018, the City's plan was approximately 64.8% funded. The current unfunded actuarial liability (UAL) for the plan as of June 30, 2020 is estimated to be \$107 million. The City Council created an Ad Hoc Committee to review funding scenarios to pay down the UAL and future savings by issuing Pension Obligation Bonds (POBs) and make a recommendation to the City Council.

II. RECOMMENDATION

The Ad Hoc Committee recommends that City Council:

1. Direct staff to prepare documents necessary to approve the issuance of Pension Obligation Bonds to pay down the full amount of the UAL as of June 30, 2020, with expected reduction in the PERS payments of an estimated \$45 million over 24

years,

2. Authorize staff to use the same financing team that which was assembled for Measure M & R Bonds and RFPs already submitted, and
3. Direct staff to determine if a reimbursement for prior years PERS payment can be included in the bond issuance.

III. ALTERNATIVES

TAKE another action deemed appropriate by City Council.

IV. BACKGROUND

The City has a PERS plan for its general employees, the “Miscellaneous Plan,” that includes all full-time employees and some part-time staff. As of June 30, 2018, the most recent PERS valuation date, the plan was 64.8% funded.

The City’s UAL for the Miscellaneous Plan is comprised of multiple “amortization bases”, which are positive and negative amounts generated each year based on the performance of the PERS Investment Fund and changes in the actuarial assumptions as shown in Exhibit 1. Each amortization base has a separate payment schedule over a fixed period of years. The amortization of these UAL Bases over differing years creates a significant payment obligation in the next 10 years before payments start to decline. The POBs are a debt management tool that will enable the financial impact to be minimized over the next 10 years.

The chart on Exhibit 2 shows the existing UAL payments provided by PERS in its June 30, 2018 valuation report. The chart on the Exhibit 2 also shows that the UAL payment for Fiscal Year 2020-2021 is \$7.8 million. This is a \$1.2 million increase compared to the Fiscal Year 2019-20 payment.

If the City were to issue POBs, based on current estimates, debt service on the new POB would be approximately \$6.9 million in 2020-2021, compared to the \$7.8 million UAL required payment. Therefore, the net UAL payment saving is approximately \$0.9 million for Fiscal Year 2020-2021. This savings increases each year through 2030-31 and then reduces until it matches the existing UAL payments in later years as shown below. The savings is estimated at approximately \$45 million over 24 years.

<u>FYE June 30</u>	<u>UAL Payment</u>	<u>Debt Service</u>	<u>Reduction</u>
2021	\$ 7,800,842	\$6,960,000	\$ 840,842
2022	8,618,581	6,963,000	1,655,581
2023	9,284,153	6,959,000	2,325,153
2024	9,670,083	6,960,000	2,710,083
2025	10,114,816	6,959,000	3,155,816
2026	9,890,656	6,963,000	2,927,656
2027	9,977,460	6,959,000	3,018,460
2028	10,251,840	6,961,000	3,290,840

2029	10,533,767	6,962,000	3,571,767
2030	10,823,443	6,961,000	3,862,443
2031	11,121,087	6,962,000	4,159,087
2032	10,421,927	6,959,000	3,462,927
2033	10,261,326	6,961,000	3,300,326
2034	9,413,414	6,960,000	2,453,414
2035	9,062,837	6,959,000	2,103,837
2036	8,532,679	6,963,000	1,569,679
2037	7,630,590	6,962,000	668,590
2038	7,184,607	6,959,000	225,607
2039	6,708,324	6,703,000	5,324
2040	6,357,664	6,355,000	2,664
2041	6,158,081	6,156,000	2,081
2042	5,145,902	5,142,000	3,902
2043	5,225,106	5,223,000	2,106
2044	<u>3,919,622</u>	<u>3,915,000</u>	<u>4,622</u>
	\$204,108,807	\$158,786,000	\$45,322,807

There will be no savings from issuing a POB in Fiscal Year 2019-2020, due to the timing of the issuance of the bonds.

The Ad Hoc Committee assessed the possibility of funding the PERS liability at 90% instead of 100%. The committee is recommending a full funding of the liability to achieve a greater potential for savings and the level payment schedule as shown in the table above.

To issue bonds, the City would need to assemble a financing team comprised of a financial advisor, bond counsel, underwriter(s), underwriter's counsel, and a trustee. The fees paid to the financing team comprise the costs of issuance, including the underwriter's discount. Costs of issuance approximate 1.5%-2.0% of the amount financed.

The Ad Hoc Committee recommends that the City uses the same financing team which was assembled for Measure M & R Bonds and RFPs already submitted. With this team already assembled, the process to start issuing the POBs could commence quickly and the POBs be issued within about 6 months.

The first step in the bond issuance process is to commence a validation action for the POBs, which requires requesting the court to approve the issuance of the POBs. This generally takes 90-120 days. The bonds can be issued subsequent to 30 days after the court approves the validation. This timing means the bonds will be issued toward the end of the current fiscal year.

V. FISCAL IMPACT

In its simplest form, issuing POBs to fund the UAL exchanges one outstanding obligation that has a higher implicit interest rate for a new obligation (the POB) that accrues interest at a lower rate. PERS currently accrues interest on the UAL at 7%. The interest rate on

the POBs is expected to be less than 4%.

The expected bond issue is approximately \$108 million to pay both the UAL and expected costs of issuance. This structure has potential savings to the City of an estimated \$45 million dollars compared to the PERS payment schedule, assuming that the discount rate and the investment rate are equivalent in future years (factors that can effect this are discussed later in Exhibit 5- Financial Advisor Memo).

As described in Exhibit 5- Financial Advisor Memo, while there are many options for selecting which portions of the existing UAL to fund and how to structure the POBs in terms of maturity and amortization, the decision to reduce the UAL by issuing POBs will have a positive impact on the City's cashflow in the short term and is expected to provide a cost benefit for funding the UAL to the City over 24 years.

VI. EXHIBITS

1. Schedule of amortization base (pg. 5)
2. Projected UAL payment requirements (pg. 6)
3. Level debt service to 2038 then declining to Maturity in 2044 (pg. 7)
4. Partial Funding (pg. 8)
5. Financial Advisor Memo on PERS Unfunded Actuarial Liability (pgs. 9-24)

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