

2021 FINANCING PROJECT

POTENTIAL ACQUISITION OF SOUTHERN MILL SITE PROPERTY + CALPERS UAL RESTRUCTURING

PROCESS UPDATE, PRELIMINARY STRATEGY AND NEXT STEPS



NHA | ADVISORS
Financial & Policy Strategies.
Delivered.

SEPTEMBER 20, 2021

Background

- ▶ Over the course of the last 12 months, City Staff has been exploring pension cost management strategies for its growing Unfunded Accrued Liability (UAL) with CalPERS
 - ▶ The UAL is a debt with CalPERS that represents the shortfall between what the City currently has in assets vs. how much it will need to fully pay retiree benefits
 - ▶ Current outstanding UAL balance is \$11.4 million (6/30/2020 valuation)
 - ▶ This gap/shortfall is paid back at a 7.0% interest rate currently (though this rate may decrease to 6.50% or 6.75% as described in the presentation)
 - ▶ At the same time, staff has also been exploring options for funding the acquisition of certain property at the Southern Mill site
 - ▶ In order to preserve General Fund cash reserves and budgetary flexibility, City Staff and its Municipal Advisor (NHA) have been exploring financing options for both projects to determine the most cost-effective approach that meets the City's various objectives



2021 Financing Project (*Potential Acquisition of Southern Mill Site Property + CalPERS UAL Restructuring*) - Process Update/Overview

- ▶ **December 2020:** Staff and Consultant delivered CalPERS UAL Presentation to City's Finance Committee
- ▶ **June 2021:** NHA delivered presentation to full City Council on CalPERS UAL cost management strategies and pros/cons and risks of a UAL Restructuring
- ▶ **July 2021 to Current:**
 - ▶ **Financing Team Assembled**
 - ▶ Staff engaged NHA Advisors to serve as its Municipal Advisor and Jones Hall to serve as bond and disclosure counsel (legal counsel on City's prior financings); Staff also recently engaged Brandis Tallman, a Division of Oppenheimer, to serve as Underwriter through a competitive RFP process
 - ▶ Continued refinements to financing options and strategy
 - ▶ Drafting of bond documents
- ▶ **September 20, 2021 (Tonight) – Update**
 - ▶ Revisiting City Objectives
 - ▶ Update on Bond Market and UAL Restructurings
 - ▶ Preliminary Recommended Financing Strategy
 - ▶ Next Steps



2021 Financing Project

City Objectives

Raise \$3.5M for Potential Acquisition of Southern Mill Site Property

- Flexibility to pay off debt early if funds aren't needed

Restructure a Portion of the City's CalPERS UAL to:

- Generate interest rate savings (Convert 7% CalPERS debt to \approx 3.00 - 3.25% bond debt)
- Create a smoother repayment shape to enhance budget predictability and future resiliency to economic shocks + Lower the City's annual payments to create more capacity to afford the \$3.5M site acquisition debt
- Shorten final term of UAL debt if possible

Use Most Cost-Effective and Efficient/Flexible Structure

- Recommended structure is through ONE lease financing; built in flexibility to achieve multiple objectives and costs savings vs. separate financings








Financing Options Evaluated

- ▶ City Staff and NHA explored multiple options for restructuring the UAL
 - ▶ Pension Obligation Bond – unsecured debt but requires a court validation process that can take 4 to 6 months
 - ▶ Lease Debt – secured by City-owned assets
 - ▶ Secured by City Streets
 - ▶ **Secured by City-Owned Buildings - Recommended**
- ▶ Given that potential site-acquisition would need to be financed through a lease bond, including the UAL restructuring as part of the same financing is the most cost effective and efficient approach
 - ▶ Also allows City to get to market sooner vs. waiting for a POB validation process; doesn't require breaking up these projects into separate financings
 - ▶ Using City-owned buildings (i.e., City Hall, Police Station) as opposed to streets will garner lower interest rate and improve chances of securing “AA” bond insurance



Market Update – Recent UAL Restructurings

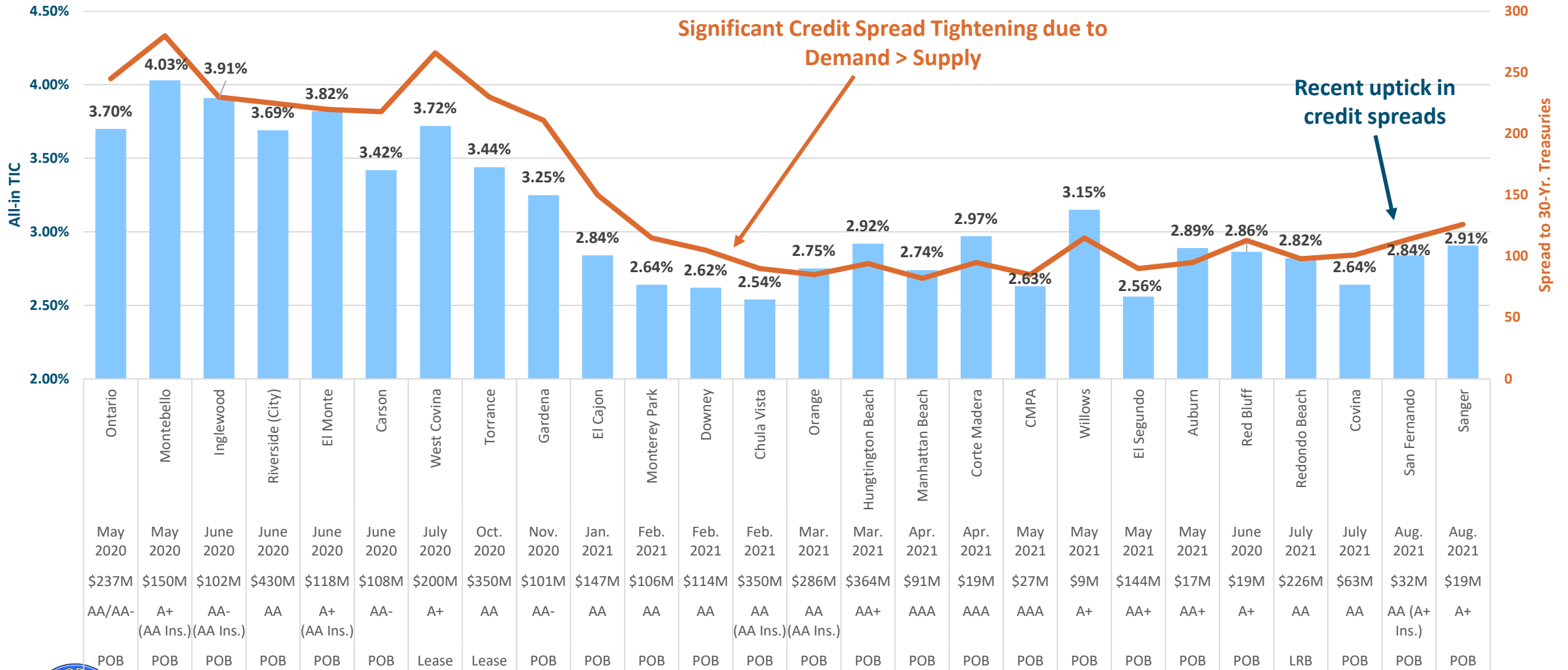
- ▶ Since 2020, about 70 agencies have issued UAL Restructuring bonds for over \$6.5 billion in UAL funded
 - ▶ Interest rates have ranged from 2.54% to about 4.25%
- ▶ Vast majority of cities to come to market in 2021 have achieved < 3.0% interest rates
- ▶ Several planned for issuance this Fall 2021

									
San Fernando	Whittier	Redondo Beach	Red Bluff	Auburn	El Segundo	Willows	Corte Madera	Manhattan Beach	Huntington Beach*
(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)
\$31,780,000	\$133,895,000	\$226,180,000	\$18,540,000	\$17,165,000	\$144,135,000	\$8,510,000	\$18,955,000	\$91,275,000	\$363,645,000
AA (Ins.)	AA (Ins.)	AA	A+	AA+	AA+	A+	AAA	AAA	AA+
									
Orange	Chula Vista	Downey	Monterey Park*	El Cajon	Ukiah	Coachella	Gardena	Arcadia	Placentia
(2021)	(2021)	(2021)	(2021)	(2021)	(2020)	(2020)	(2020)	(2020)	(2020)
\$286,485,000	\$350,025,000	\$113,580,000	\$106,335,000	\$147,210,000	\$49,875,000	\$17,590,000	\$100,590,000	\$90,000,000	\$52,950,000
AA	AA	AA	AA	AA	A+	AA-	AA-	AAA	BBB+
									
Torrance	Azusa	Pomona	West Covina	Grass Valley	Carson	El Monte*	Riverside	Inglewood*	Montebello*
(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)
\$349,515,000	\$70,075,000	\$219,890,000	\$204,095,000	\$18,311,000	\$108,020,000	\$118,725,000	\$432,165,000	\$101,620,000	\$153,425,000
AA	AA-	AA-	A+	Private Placement	AA-	A+ (Ins.)	AA	AA- (Ins.)	A+ (Ins.)

* Secured by pension tax override



Pension Bond Market Update: Interest Rates (Blue Bars) Have Dropped Dramatically due to Growing Investor Demand (Orange Line)



Significant Credit Spread Tightening due to Demand > Supply

Recent uptick in credit spreads



Note: Spreads and interest rates should be considered best estimates. Rates reflect estimated all in interest rate on financing.

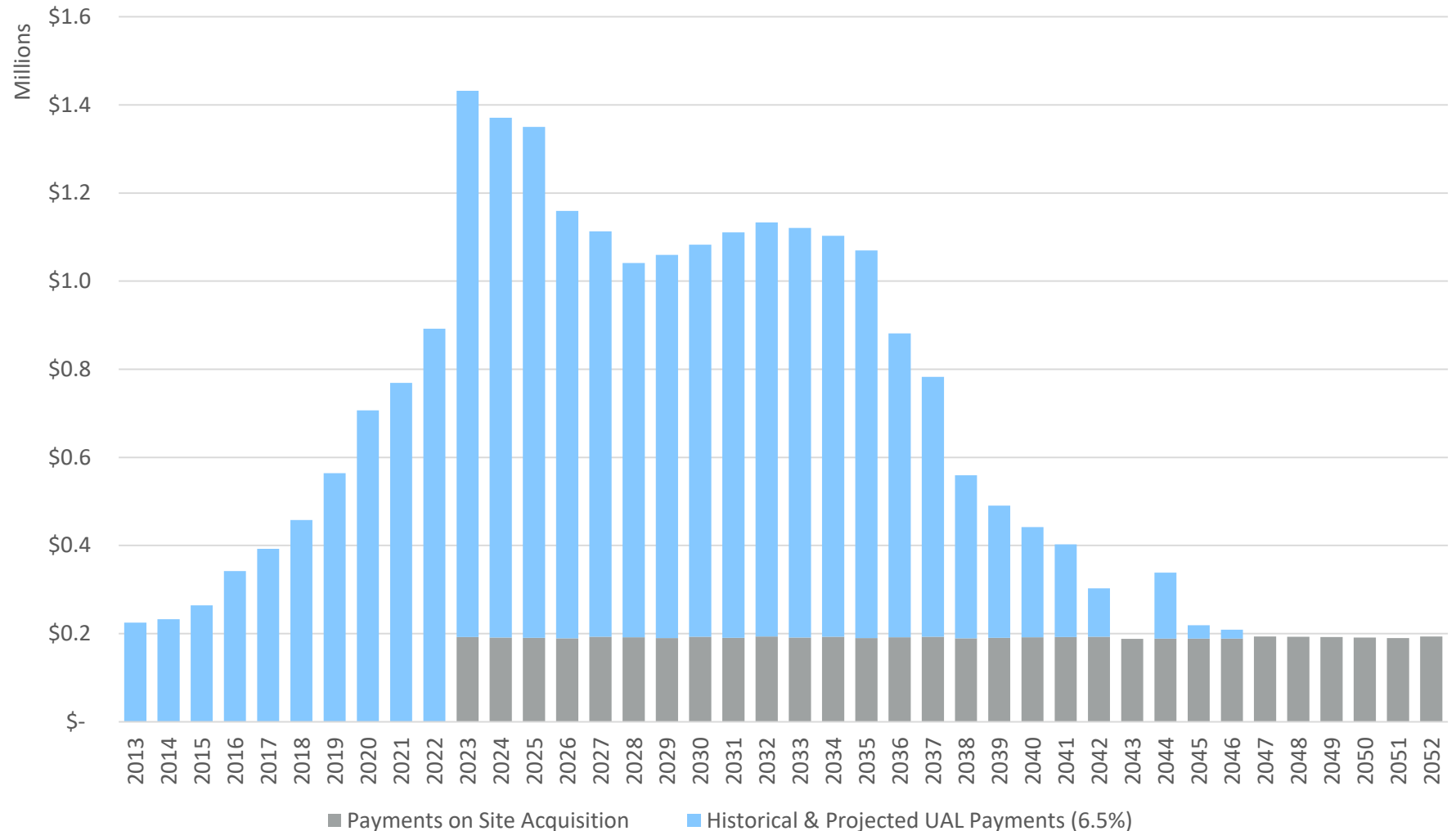
Major Change Since June Workshop: CalPERS 21.3% Gains Will Reduce City's UAL and Number of Required Assets to Secure Financing

- ▶ Given CalPERS strong 21.3% returns, City's current \$11.4M UAL will be reduced significantly
- ▶ However, CalPERS will offset some of this benefit through a reduction in its Discount Rate this November (their assumed rate of investment return)
 - ▶ If Discount Rate is reduced to 6.75%, City's estimated UAL will be \$8.4M
 - ▶ If Discount Rate is reduced to 6.50%, City's estimated UAL will be \$9.8M (assumed for preliminary analysis)
- ▶ Previously, it was assumed that three (3) City owned assets would be required to secure the financing given expected size
 - ▶ Based on new lower UAL, it is recommended that a maximum of two (2) assets be used
 - ▶ City can issue smaller financing using one asset, but savings objectives not fully met (see slide 10)



New Baseline Situation: Estimated Repayments for City's 9.8M UAL and Payments on \$3.5M 30-Year Bond for Southern Mill Site Project

- ▶ Even with reduction in UAL, General Fund debt payments expected to be between \$1.0 and \$1.4M through FY 2035
- ▶ Payments on UAL (light blue bars) are uneven
 - ▶ Final payment on UAL in 2046



Note: Estimated UAL payments sourced from CalPERS Outlook Tool

Recommendation for Optimal Financing Size (City Hall + Police Station)

Alternative Small Option Also Presented

- ▶ Recommended option allows for ≈75% of UAL to be refinanced
 - ▶ Brings funding ratios to healthy 95% range
- ▶ Smaller option allows for 44% of UAL to be refinanced
 - ▶ Higher interest rate and about \$1M less in est. savings

	<i>Alternative</i>	Recommended
	Option 1	Option 2
	City Hall Only	City Hall + Police Station
Est. Value	8,120,730	11,117,179
Less: Site Acquisition	(3,500,000)	(3,500,000)
Less: Est. Financing Costs	(330,000)	(370,000)
Available for UAL	4,290,730	7,247,179
UAL if 6.75% DR	8,340,000	8,340,000
% of UAL Funded	51%	87%
New Funded Ratio	91%	98%
UAL if 6.50% DR	9,790,000	9,790,000
% of UAL Funded	44%	75%
New Funded Ratio	88%	95%

Est. Present Value Savings from UAL Restructuring
Est. Savings Through 2035
Interest Rate on UAL Restructuring

\$1.0 Million
\$2.9 Million
3.54%

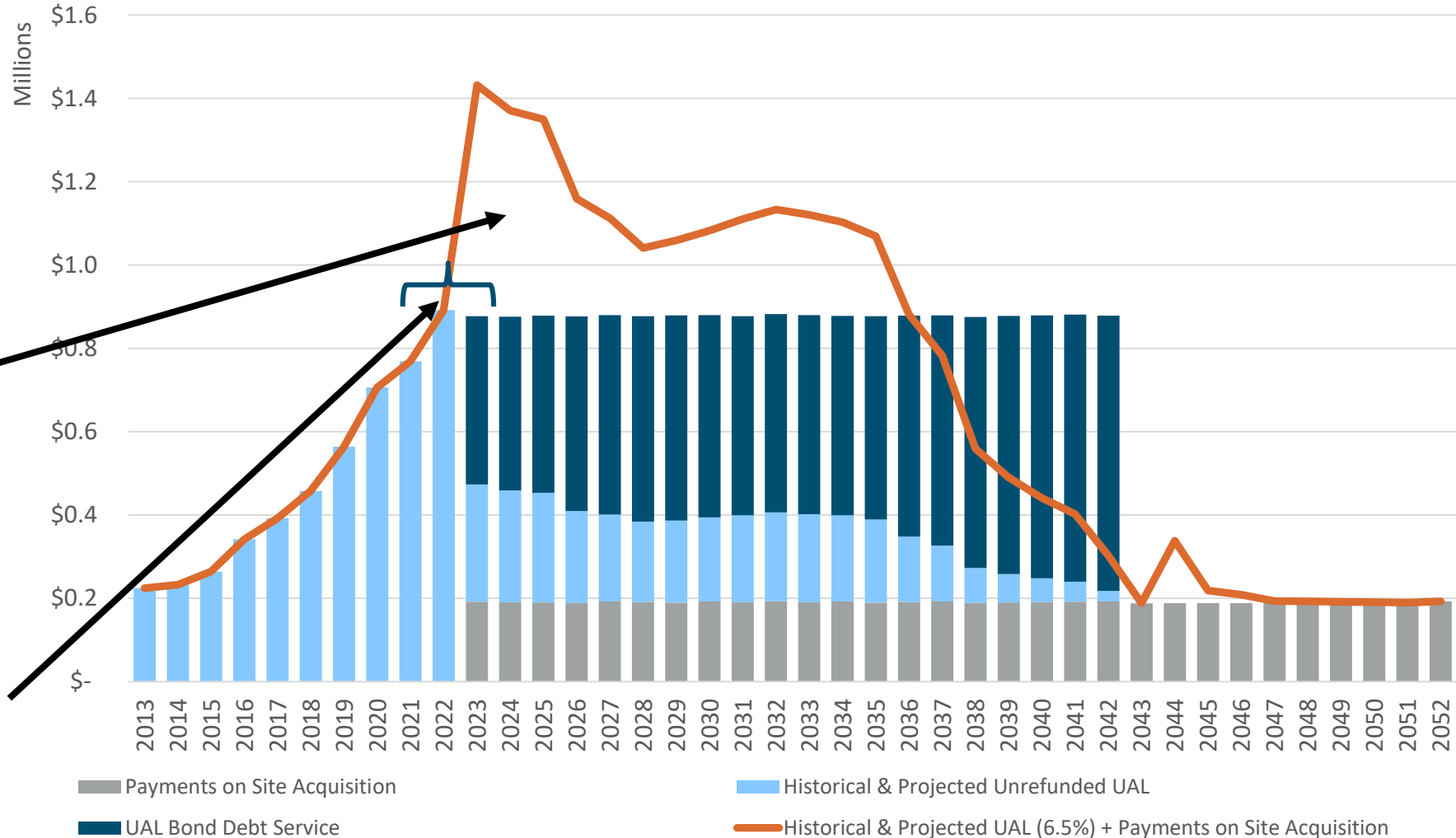
\$1.9 Million
\$3.7 Million
3.29%



Recommended Option for Optimal Financing Size

Baseline Payments (Orange) vs. New Proposed Payments (Bars)

- ▶ 75% of UAL refinanced (dark blue bars) to create overall lower/smoother debt payments for General Fund
 - ▶ Term reduced to 2042
- ▶ Overall payments significantly lower (\$3.7M est. savings) vs. Baseline through 2035 shown in orange line
- ▶ Restructuring allows for overall General fund debt payments of \$880K annually
 - ▶ No increase to what City just paid on UAL for FY 2022



Note: Estimated UAL payments sourced from CalPERS Outlook Tool



Estimated Savings Analysis for Proposed UAL Restructuring

Metrics	20-Year UAL Restructuring
\$ UAL Payoff	\$7,247,179
% UAL Funded (Current Asset Valuations)	66%
Funded Ratio (Current Asset Valuations)	90%
% UAL Funded (Projected After FY 2021 Returns)	75%
Funded Ratio (Projected After FY 2021 Returns)	95%
Maturity	20 Years
Average Life	12.5 Years
All-In Interest Rate (on UAL Restructuring)	3.29%
Present Value Savings (%)	25.11%
Present Value Savings (\$)	\$1,899,718
Cumulative Savings	\$1,587,799
Savings (2023-2035)	\$3,724,674
Avg. Annual Savings (2023-2035)	\$286,513



Revisiting UAL Restructuring Risks

CalPERS Reinvestment/Market Timing Risk

- ▶ Savings is ultimately dependent on future CalPERS returns, which are unknown at time of issuance
 - ▶ If CalPERS earns less than 6.50/6.75%, savings will be less than shown on previous pages
 - ▶ If CalPERS earns more than 6.50/6.75%, savings will be more than shown on previous pages
- ▶ Rule of Thumb: Present value savings occur ONLY if CalPERS earns greater returns than pension bond interest rate (i.e., 3.00-3.25% in current market)
 - ▶ City would be worse off if CalPERS earned less than bond rate (3.00-3.25%) on average over next 20 years
 - ▶ Near-term losses exacerbate this risk given large lump sum deposit into the market

CalPERS 5-Year Average Annual Return: 10.5%
CalPERS 10-Year Average Annual Return: 8.8%
CalPERS 20-Year Average Annual Return: 7.4%
CalPERS 30-Year Average Annual Return: 7.5%



Summary of Recommended Financing Strategy

- ▶ Utilize City Hall and Police Station to secure lease financing
 - ▶ Provides best chance to obtain “AA” bond insurance and further lower interest rate
 - ▶ City can also just use City Hall and reduce financing size, but savings will be reduced and slightly higher interest rate
- ▶ Financing Team will continue monitoring CalPERS meetings this month to optimize UAL restructuring size based on proposed assumption changes
- ▶ Given the goals for the site acquisition (open space preservation, affordable housing, site clean up), the team is also exploring the feasibility of designating a portion of the financing as **“ESG Bonds” - Environment, Social and Governance**
 - ▶ Would allow City to be at forefront of social/moral investment trend and align with City’s overall sustainability goals
- ▶ Structure will also include flexibility to pay off a portion of the debt early from unspent bond proceeds if Southern Mill Site Project doesn’t come to fruition



Next Steps and Proposed Schedule

September 20th –
Presentation;
Council Q&A and
Guidance

October 12th –
City Council
Approval of
Financing, Legal
Documents, POS
and Pension
Funding Policy

Early November –
Bond Closing (City
Received Funds
and Pay Off UAL
with CalPERS)

Early October –
Credit Rating
Presentation to
Standard and
Poor's (S&P)

Late October –
Bond Pricing (Lock
Interest Rate)



Note: The POS is the Preliminary Official Statement and is the prospectus used to solicit interest for the City's bonds from investors