AGENCY:	City Council / Financing Authority
MEETING DATE:	October 12, 2021
DEPARTMENT:	City Manager
PRESENTED BY:	T. Miller/Consultants
EMAIL ADDRESS:	tmiller@fortbragg.com

AGENDA ITEM SUMMARY

TITLE:
Receive Report, Conduct Public Hearing and Consider Adoption of City Council and Financing Authority Resolutions Authorizing Series 2021 Lease Revenue Bonds to Pay Off a Portion of the City's Unfunded Accrued Liability with CalPERS and Fund the Site Acquisition at the Southern Portion of the Mill Site

ISSUE:
The City will be raising approximately $11.0 million in proceeds through the issuance of the Authority's 2021 Lease Revenue Bonds ("2021 Bonds") to fund two critical projects: (1) Restructure a portion of the City's Unfunded Accrued Liability ("UAL") with the California Public Employees Retirement System (CalPERS); and (2) Fund the site acquisition and clean-up/remediation for the southern portion of the Mill Site.

The City intends to restructure about $7.50 million of its CalPERS UAL to meet several objectives, including to: (1) generate cash flow savings through historically low current bond interest rates relative to the CalPERS discount rate assumption (currently 7%); and (2) create a new repayment shape for the City's pension liabilities that enhances budget predictability, long-term fiscal sustainability and resiliency to future economic shocks or additional UAL added by CalPERS. The proposed refinancing of the UAL is currently estimated to have an all-in cost of financing between 3.25% and 3.50% (vs. 7.0% that CalPERS charges the City on the outstanding UAL) based on current market conditions for a 20-year term (estimated maturity for this component of the financing). It should be noted that this component of the 2021 Bond financing must be undertaken on a federally taxable basis (meaning the investors in the 2021 Bonds must pay income taxes on the interest they will receive) in order to comply with federal tax law requirements on the use of bond proceeds.

In addition to the CalPERS restructuring, approximately $3.5 million of the bond proceeds are anticipated to be used to fund the site acquisition and clean-up/remediation at the southern portion of the Mill Site to assist with the City's long-term goals for sustainable public serving development. Depending on the timing of this funding, the City could alternatively use the proceeds to fund some other critical capital projects, like the Municipal Broadband Utility Project. This portion of the financing will be amortized over 30 years and will also be issued on a federally taxable basis, to maximize flexibility on the timing and use of proceeds by the City.

The financing is being undertaken as a lease/lease-back financing involving the City and the Authority, with City Hall and the Police Station being used as the leased assets, as discussed in greater detail below.

ANALYSIS:
Since 2020, the City has been exploring various cost management strategies for its $11.4 million Unfunded Accrued Liability (UAL) with the California Public Employees Retirement System (CalPERS).

Staff and its Municipal Advisor (NHA Advisors) have held multiple workshops (most recently in June and September of 2021) for the City Council related to various cost management strategies, including the pros/cons and risks associated with a UAL restructuring. Given the similar timing and critical nature of both projects, and in order to preserve General Fund cash reserves and budgetary flexibility, it was recommended and supported by the City Council at the September 20, 2021 meeting that the most cost-effective approach to addressing all City objectives and both projects was through one lease/lease-back financing.

After receiving guidance from the City Council, the financing team (NHA Advisors, Jones Hall serving as Bond/Disclosure Counsel and Brandis Tallman a Division of Oppenheimer serving as Underwriter) have finalized the various legal documents, including the preliminary official statement (POS), to be approved on October 12th. All the relevant documents for approval can be found in the Attachments to this Agenda Report.

Additional Background on the City's CalPERS UAL**:**

Over the last eight years, the City's aggregate UAL for its CalPERS Miscellaneous and Safety Plans has more than doubled, growing from $5.5 million to about $11.4 million (6/30/2020 valuation report). In July, it was announced that CalPERS earned 21.3% for FY 2021, and that the discount rate (their assumed earnings rate moving forward, as well as the amount charged to local agencies with respect to their UAL) would likely be reduced to 6.80% or below. The 21.3% gain will significantly reduce the City's UAL while the reduction in discount rate will slightly increase the UAL. Overall, the financing team estimates that the City's new UAL will drop to between $8.4 million (assumes 6.75% discount rate) and $9.8 million (assumes 6.50% discount rate), but the precise impact won't be known until later this year and all other assumptions are finalized by CalPERS.

The UAL represents the shortfall/gap between what is actuarially expected to be needed to pay retiree benefits over time compared to the current assets on hand and expected earnings on those assets from City contributions, employee contributions and past CalPERS earnings. The $11.4 million of UAL debt is reduced over time through payments required by CalPERS. The payments are defined through multiple amortization schedules over 3 to 28 years, and interest is charged to the City at the current rate of 7.0%. Pension cost increases are the largest financial challenge facing most cities throughout the state and are primarily due to factors outside the City's control, including discount rate changes, assumption changes made by CalPERS and investment returns that were below expectations.

Given the significant unfunded nature of the City's pension obligations, the challenge is: how can the City most effectively secure the financial future of the City, its employees, and its retirees while ensuring the delivery of public services and stewardship of public resources. Numerous cities and towns (Ukiah, Corte Madera, Willows, Lakeport, Auburn, San Anselmo, Santa Ana, Commerce, Buena Park, Sanger, San Fernando, Orange, Manhattan Beach, Huntington Beach, Corona, Chula Vista, El Cajon, Riverside, Marysville, Pacifica, West Covina, El Monte, Ontario, Carson, Inglewood, Montebello, Pasadena, Glendora, Larkspur, Monrovia, Hawthorne, Pomona, La Verne and several others) throughout California have recently refinanced their UAL to take advantage of historically low interest rates and restructure the payment pattern and increase the funding of their pension plans. Interest rates set on these recent financings have ranged from about 2.50% to 4.30%, with rates dictated by market conditions at the time of pricing, credit rating of the issuer, and length of term of the bonds.

The proposed Bonds can be an effective tool to achieve several objectives:

- **Maintain Service Levels:** Reduce chance of service reductions, public safety layoffs, deferred maintenance.
- **Achieve Fiscal Stability:** Change the payment pattern (e.g., a smooth pattern for bond repayment, vs an increasing and uneven pattern with no bonds). Smoother payment patterns make budgeting easier.
- **Realize Savings:** Obtain higher expected investment returns on investments at retirement system (e.g., 6.50-7.00%) than borrowing cost (e.g., ~3.25-3.50%).
- **Create Capacity to Afford Payments on Mill Site Project:** By restructuring the UAL and creating budgetary savings, the payments associated with the $3.5 million Mill Site project can be optimally layered in with little to no impact on the City's near and mid-term budget.
- **Increase the pension plan's level of funding**: from 65% to between 90-100%.

Based on the estimated value ($11.4 million) of the leased assets (City Hall and Police Station), it is estimated that the City can apply about $7.50 million of bond proceeds towards its CalPERS UAL. While that amount is about 66% of the current $11.4 million UAL, it is projected to be about 76% (6.50% discount rate) to 89% (6.75% discount rate) of the new UAL after the 21.3% gains are incorporated. Eliminating approximately $7.50 million of the City's UAL is estimated to bring the City's funding ratios up to over 95% for its pension plans.

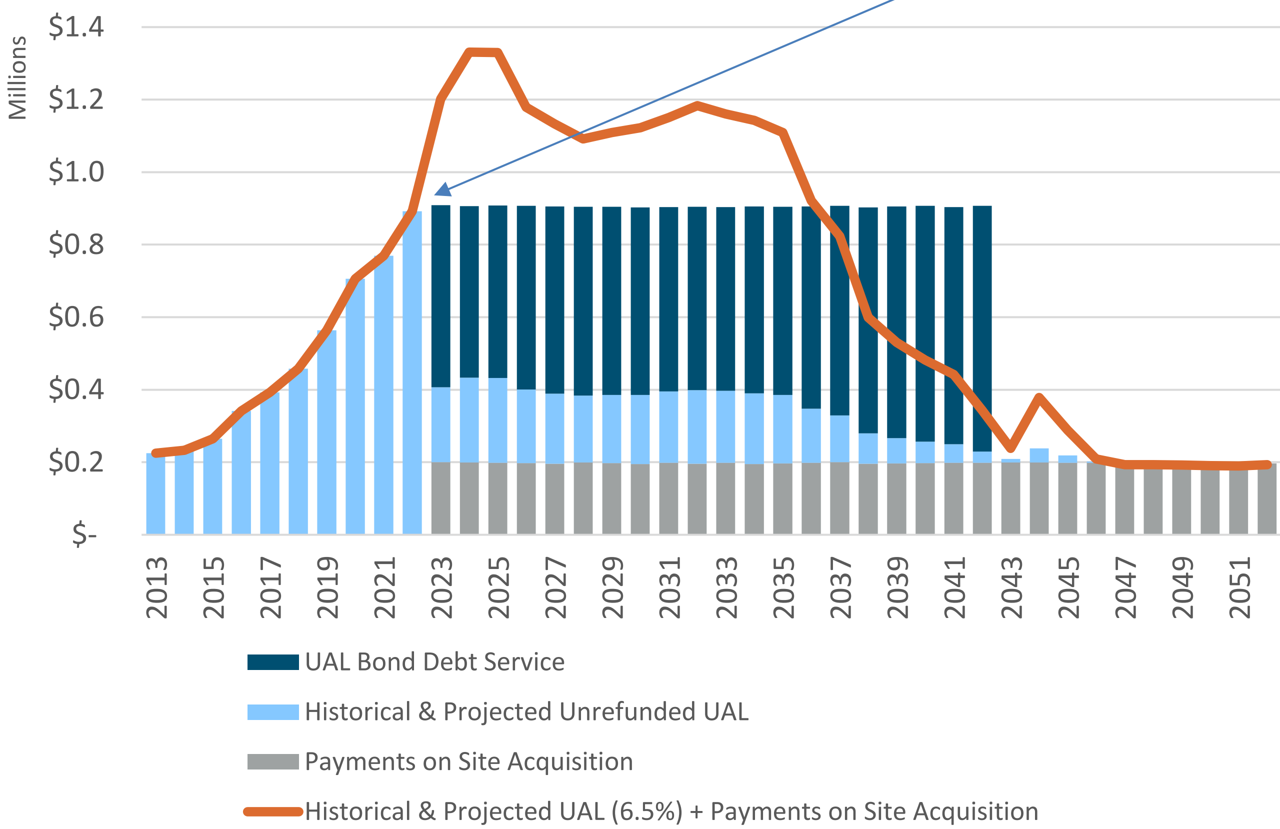
Leased Assets	City Hall + Police Station
Est. Value	11,370,000
Less: Site Acquisition	(3,500,000)
Less: Est. Financing Costs	(370,000)
Available for UAL	7,500,000
UAL if 6.75% DR	8,450,000
% of UAL Funded	89%
New Funded Ratio	98%
UAL if 6.50% DR	9,850,000
% of UAL Funded	76%
New Funded Ratio	95%

The charts below depict how the 2021 Bond payments will be structured, the impact on the City's budget, and the estimated savings from the UAL restructuring. It should be noted that the analysis provided utilizes the conservative assumption that the CalPERS discount rate gets lowered to 6.50%. A more modest lowering of the discount rate to 6.75% or 6.80%

would only serve to increase the savings estimates and reduce the budgetary impact from lower UAL payments.

As shown in the chart below, the 2021 Bond payments associated with the UAL restructuring are shown in the navy-blue bars (amortized over 20 years), while the 2021 Bond payments associated with the Southern Mill site project are amortized over 30 years (grey bars). The orange line represents the projected overall payments if the City were to only fund the Southern Mill site project and not restructure the UAL with CalPERS. Through the restructuring, over $1.7 million of cash flow savings is projected and by amortizing those new payments in a smoother fashion, the payments related to the Southern Mill site can be layered in with no impact to the City's budget. As shown, the City's annual combined payments (pension and Southern Mill project) after the financing (starting in FY 2023) are projected to be roughly equal to this current fiscal year's (FY 2022) pension payments.

2021 Projected Lease Bond Payments vs. Projected Payments If No UAL Restructuring



Assuming a 6.50% discount rate, the estimated savings from the restructuring are shown in the table at the top of next page. Present Value (PV) savings is estimated at $1.8 million, or 23.4% of the amount of UAL to be refinanced. Savings through 2035 is estimated at $3.6 million, or about $274,000 annually.

Metrics	$7.5M UAL Restructuring
$ UAL Payoff	$7,500,000
% UAL Funded (Current Asset Valuations)	68%
Funded Ratio (Current Asset Valuations)	91%
% UAL Funded (Projected After FY 2021 Returns & 6.5% Discount Rate)	80%
Funded Ratio (Projected After FY 2021 Returns & 6.5% Discount Rate)	96%
Maturity	20 Years
Average Life	12.8 Years
True Interest Cost (on UAL Restructuring)	3.23%
All-In Interest Cost (on UAL Restructuring)	3.52%
Present Value Savings (%)	23.36%
Present Value Savings ($)	$1,829,159
Cumulative Savings	$1,691,848
Savings (2023-2035)	$3,558,684
Avg. Annual Savings (2023-2035)	$273,745

Ultimately, actual savings from the restructuring will be a component of two factors: (1) actual interest rates at the time of bond pricing (estimated to be late October 2021) and (2) future CalPERS returns over the lifetime of the bond refinancing, which is an unknown at the time of bond issuance. To the extent that CalPERS earns lower than 6.50% over the next 20 years, the savings will be less than shown above. If higher than 6.50%, then the savings will be higher than estimated. The rule of thumb is that the City will be better off (i.e. the UAL Restructuring produced savings) if CalPERS earns more than the interest rate on the bonds (currently estimated around 3.50%). While past performance does not guarantee future results, CalPERS' historical 30-year returns are 8.4%, 6.9% for the last 20 years on average, 8.5% for last 10 years and 10.3% for the last 5 years.

Public Hearing:

In accordance with California law, the City must hold a public hearing to consider public testimony and make certain findings concerning the possible issuance of Bonds by the Authority to finance certain public capital improvements within the boundaries of the City. Given that the 2021 Bonds may be used to finance improvements at the southern portion of the Mill Site following potential acquisition by the City and/or other capital improvements of the City, the public hearing allows the required findings to be made with respect thereto. The City Clerk has provided notice of the public hearing as required by law.

Summary of the Resolutions:

The subject resolutions authorize and approve the form of all the primary legal documents (the "Financing Documents") necessary to provide for the successful issuance of the Bonds and related lease financing. The adoption of each Resolution is a legal prerequisite to allow for the completion of the appropriate documentation necessary for the issuance of the

Bonds. The accompanying Financing Documents comprise a financing structure that is considered standard for California cities financing long-term projects using General Fund revenues. A brief summary of each of the financing documents follows.

SUMMARY OF FINANCING DOCUMENTS:

The Financing Documents are being presented to the City Council as “form-only documents.” Execution-ready documents are not available at this time because the exact amounts, dates, and other pricing-related information will not be known until the actual sale date for the 2021 Bonds. The subject resolutions authorize and direct the City Manager and other City/Authority staff to finalize the Financing Documents as and when appropriate, and to do all things necessary to provide for the issuance of the 2021 Bonds and delivery of the related lease documents, subject to the not-to-exceed parameters contained in the resolutions. If the final terms for any reason should fall outside of parameters in the resolutions, staff will return for further direction before finalizing the transaction.

The Financing Documents, and a brief description of each, is as follows:

1. <u>Site Lease</u>: Between the City as lessor and the Authority as lessee, under which the City leases the Leased Property (i.e., City Hall and Police Station) to the Authority in consideration of the payment of an upfront amount which will be applied by the City to the projects being financed.

2. <u>Lease Agreement</u>: Between the Authority as lessor and the City as lessee, under which the Authority leases the Leased Property back to the City and the City agrees to pay semiannual lease payments to provide revenues with which to pay principal and interest on the 2021 Bonds when due. The lease payments are payable by the City from all legally available funds, and subject to abatement (i.e., reduction or elimination) in the event the City does not have use and occupancy of the Leased Property. To help ensure repayment, the City must procure and maintain throughout the term of the financing, certain minimum insurance. In addition, the City covenants to budget and appropriate the lease payments as they come due each year, again, subject to its maintaining use and occupancy of the Leased Property each year a payment is due. Finally, the City has substitution and/or release rights with respect to the Leased Property, in the event other real property assets are preferred to be leased in the future.

3. <u>Indenture of Trust</u>: Another key legal agreement, the Indenture provides for execution and delivery of the 2021 Bonds in exchange for proceeds in the par amount thereof, and further lays out the covenants and specifics of the 2021 Bonds, as well as the Trustee’s duties, repayment mechanisms, default and remedies provisions, and Bondholder’s associated rights and remedies.

4. <u>Assignment Agreement</u>: This agreement provides the terms and conditions under which the Authority assigns the City’s lease payments to the Trustee, for ultimate payment to the Bondholders.

5. Preliminary Official Statement; Continuing Disclosure Certificate: Disclosure Counsel prepares a preliminary Official Statement with input from the financing team including tables relating to the City's General Fund finances. Following City Council authorization, the preliminary Official Statement will be distributed by the Underwriter and used as the primary marketing document to prospective bond purchasers. A table of contents identifies critical topics such as the plan of finance, security for the bonds, information on the City (management and General Fund finances), the continuing disclosure requirements and the form of opinion of bond counsel. The agenda packet includes a draft of the preliminary Official Statement that the financing team considers to be essentially final. A final Official Statement will be made available shortly after the 2021 Bonds are sold; it will be identical to the preliminary Official Statement except that it will reflect the final bond sale information.

The distribution of the preliminary Official Statement and the final Official Statement is subject to the federal securities laws, including the Securities Act of 1933 and the Securities Exchange Act of 1934. These laws require the preliminary Official Statement to include all facts that would be material to an investor. Material information exists where there is a substantial likelihood that the information would have actual significance in the deliberations of the reasonable investor when deciding whether to buy or sell securities. The Securities and Exchange Commission (SEC), the agency with regulatory authority over compliance with the federal securities laws, has indicated that if a member of a legislative body, like the City Council, has knowledge of any facts or circumstances that an investor would want to know prior to investing in securities, like the 2021 Bonds, whether relating to their repayment, tax-exempt status, undisclosed conflicts of interest with interested parties, or otherwise, he or she should endeavor to discover whether such facts are adequately disclosed in the preliminary Official Statement. The steps that a member of the Council could take to fulfill this obligation include becoming familiar with the preliminary Official Statement and questioning staff and other members of the financing team about the disclosure of such facts.

The Continuing Disclosure Certificate, which is part of the Preliminary Official Statement, will be executed by the City for the purpose of providing annual financial information and notice of certain enumerated events to holders and beneficial owners of the 2021 Bonds after their sale.

6. Bond Purchase Agreement: An agreement between the City, the Authority and Brandis Tallman a Division of Oppenheimer, as Underwriter, whereby the Underwriter will agree to purchase the 2021 Bonds from the Authority, contingent upon the City and Authority satisfying the obligations imposed within the agreement. The Underwriter agrees to make a bona-fide public offering.

RECOMMENDED ACTION:

Staff recommends that, following the holding of a public hearing, the members of the City Council, sitting as the City Council of the City and the Board of Directors of the City of Fort Bragg Joint Powers Financing Authority (the "Authority"), adopt the attached resolutions.

ALTERNATIVE ACTION(S):

1. Do not adopt the resolutions.
2. Provide alternative direction to staff.

FISCAL IMPACT:

There is no financial impact to the FY 2022 budget. Significant savings are estimated starting in FY 2023 based on the analysis provided above. All costs of issuance will be financed through the 2021 Bond proceeds and have no impact on the City's General Fund.

GREENHOUSE GAS EMISSIONS IMPACT:

There is no impact to greenhouse gas emissions from approving the resolutions or issuing the LRB bonds.

CONSISTENCY:

N/A

IMPLEMENTATION/TIMEFRAMES:

The City recently went through a credit rating presentation with Standard and Poor's (October 7th) and will obtain its first General Fund credit rating within a couple of weeks. Once received, and assuming approval tonight of the subject resolutions, the Preliminary Official Statement will be distributed to potential investors and the Underwriter will begin the marketing process for the 2021 Bonds. It is estimated that interest rates will be locked through the pricing process in late October/early November with a closing in early to mid-November which is when the City will obtain funds for its Southern Mill Site project and for the CalPERS UAL restructuring. The proceeds for CalPERS will be wired to them on the day of closing.

ATTACHMENTS:

1. City Resolution
2. Authority Resolution
3. Site Lease
4. Lease Agreement
5. Indenture of Trust
6. Assignment Agreement
7. Preliminary Official Statement
8. Bond Purchase Agreement
9. Good Faith Estimates
10. Public Hearing Notice

NOTIFICATION:

N/A