2021 Financing Project
CalPERS UAL Restructuring & Potential Acquisition of Southern Mill Site Property

Process Update and Final Approval

NHA | ADVISORS
Financial & Policy Strategies. Delivered.

October 12, 2021

Table of Contents

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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
    - This debt is legally required to be paid and required to be accounted for in audited financial statements
  - 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

2021 Financing Project

City Objectives

Fund $3.5M Mill Site Project While Preserving General Fund Cash Reserves/Liquidity

- City prudently intends to maintain liquidity/reserves and borrow for project at historically low interest rates; borrowing also ensures better matching of assets to liabilities

Save Money Through Restructuring Pension Debt

- Generate interest rate savings (Convert 7% CalPERS debt to ≈ 3.25 - 3.50% 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 capacity to afford the $3.5M site acquisition debt + Shorten final term of UAL debt

Secure Lowest Interest Rate on Debt

- City recently went through credit rating process (results this Friday) and intends to secure "AA" bond insurance

Flexibility

- City can pay off debt immediately if funds aren't needed for Mill Site OR use for Broadband project; City will also be able to pay off pension debt portion after 10 years if desired

Use Most Cost-Effective and Efficient/Flexible Structure

- One lease financing allows for cost savings and efficiency

Don't Burden Taxpayers with Debt

- City will fund debt with General Fund as opposed to going to voters for increased taxes for bonds

Reduce any Budgetary Impact on General Fund

- Restructuring the pension debt allows the $3.5M debt to be layered in without any budgetary impact

2021 Financing Project
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 – September 2021:**
  - Financing Team Assembled
  - Continued refinements to financing options and strategy
  - Drafting of bond documents
  - September 20, 2021 – update presentation to City Council and feedback on proposed strategy
    - Market update, CalPERS update, options, recommended financing strategy, benefits/risks, schedule
  - October 7, 2021 – credit rating presentation to S&P
- **October 12, 2021** – final approval of financing and bond documents

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

Lakeport	Corona	San Anselmo	Santa Ana	Commerce	Buena Park	Sanger	San Fernando	Whittier	Redondo Beach
(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)
$7,920,000	$276,710,000	$9,285,000	$425,830,000	$27,875,000	$96,385,000	$19,450,000	$31,780,000	$133,895,000	$226,180,000
AA	AA+	AAA	AA	AA-	AA+	A+	AA (Ins.)	AA (Ins.)	AA

Red Bluff	Auburn	El Segundo	Willows	Corte Madera	Manhattan Beach	Huntington Beach*	Orange	Chula Vista	Downey
(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)
$18,540,000	$17,165,000	$144,135,000	$8,510,000	$18,955,000	$91,275,000	$363,645,000	$286,485,000	$350,025,000	$113,580,000
A+	AA+	AA+	A+	AAA	AAA	AA+	AA	AA	AA

Monterey Park*	El Cajon	Ukiah	Coachella	Gardena	Arcadia	Placentia	Torrance	Azusa	Pomona
(2021)	(2021)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)
$106,335,000	$147,210,000	$49,875,000	$17,590,000	$100,590,000	$90,000,000	$52,950,000	$349,515,000	$70,075,000	$219,890,000
AA	AA	A+	AA-	AA-	AAA	BBB+	AA	AA-	AA-

* Secured by pension tax override

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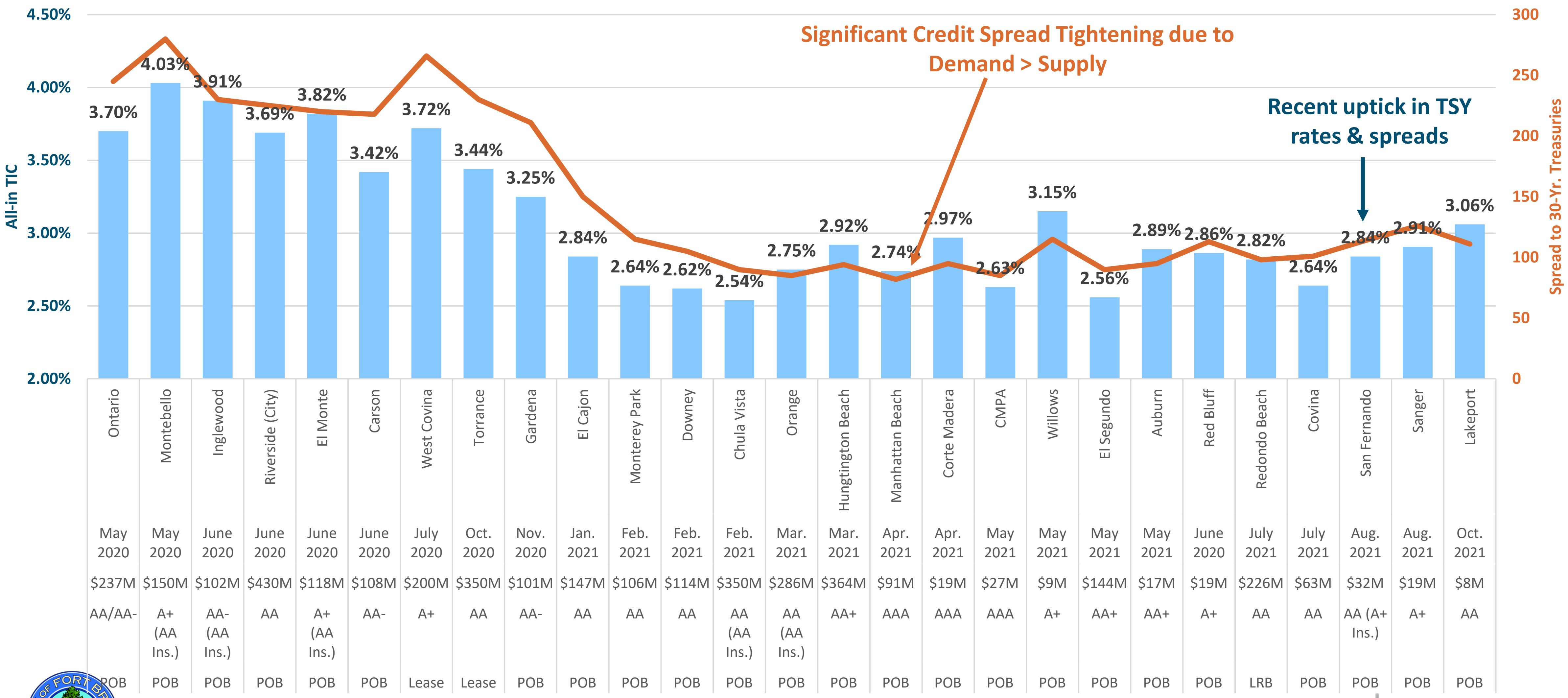
POB Market Update: POB Interest Rates (Blue Bars) Have Dropped Dramatically due to Growing Investor Demand (Orange Line)



Note: Spreads and interest rates should be considered best estimates. Rates reflect estimated TIC or all-in TIC.

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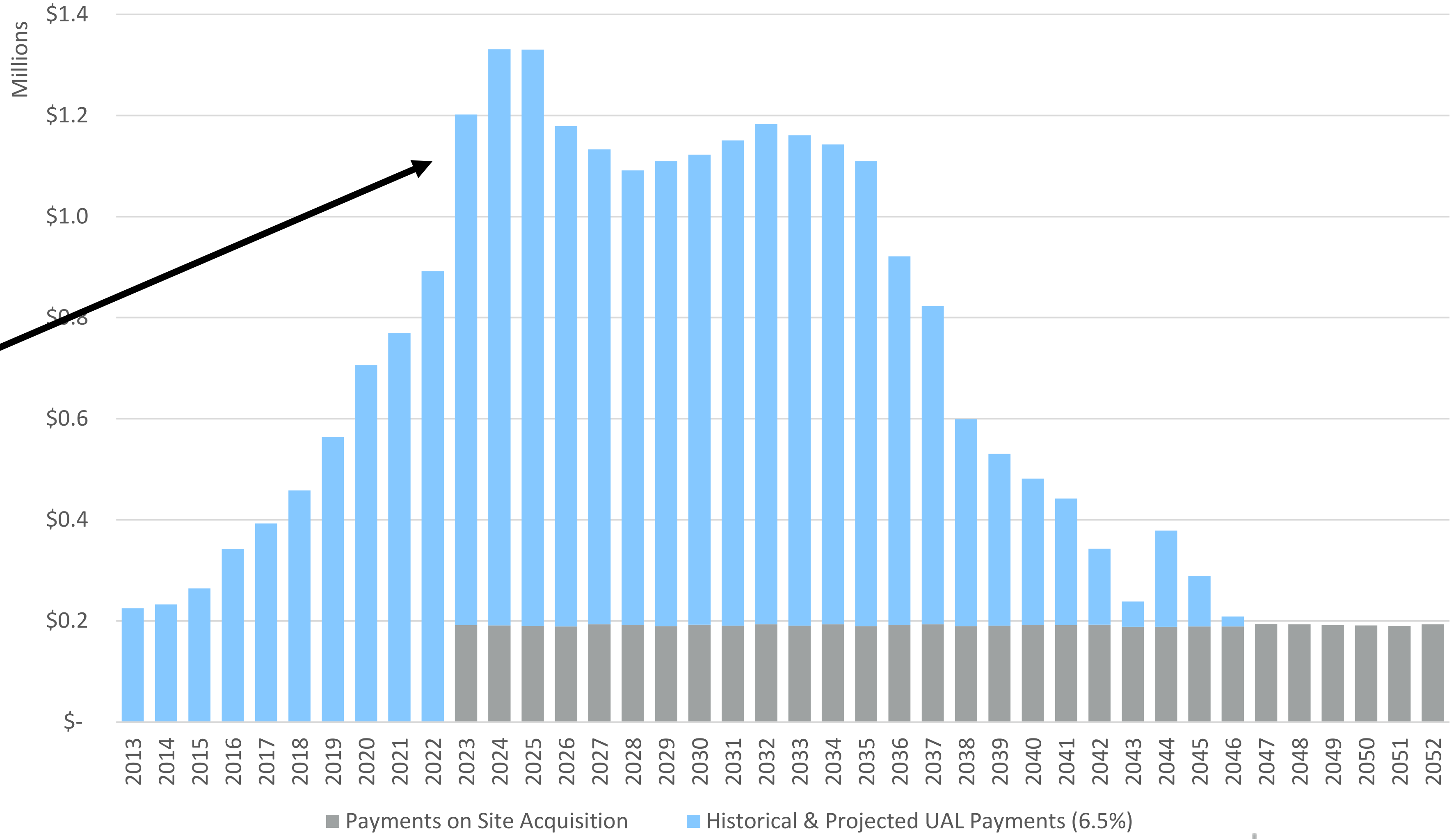
Major Change Since June Workshop

CalPERS 21.3% Gains Will Reduce City's UAL

- Given CalPERS strong 21.3% returns, City's current $11.4M UAL debt 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 (<u>assumed for preliminary analysis</u>)

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 $1.1 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

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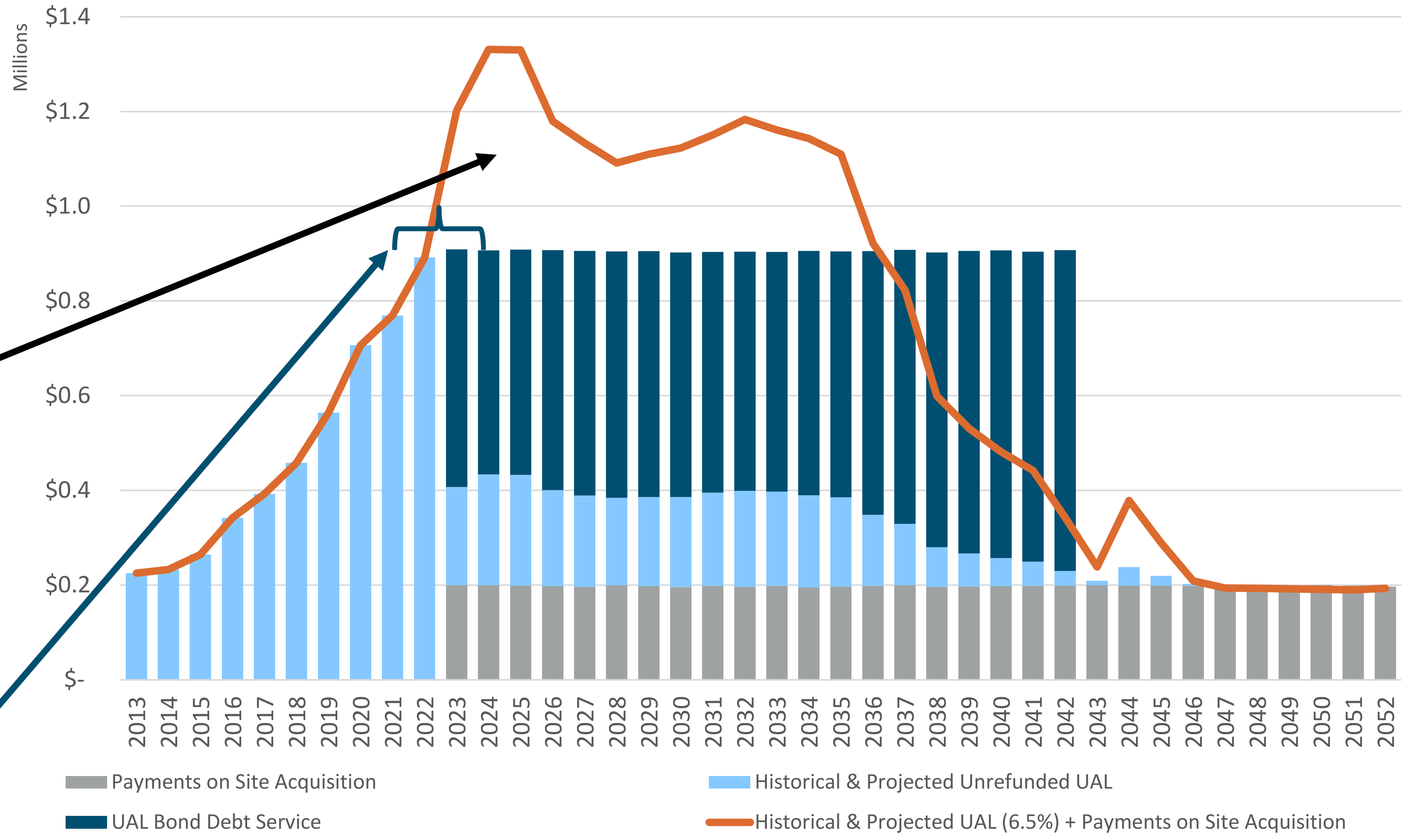
Restructuring Strategy to Reduce Budgetary Impact

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

- 70-80% of UAL refinanced (dark blue bars) to create overall lower/smoother debt payments for General Fund
  - Term reduced to 2042
- Overall payments significantly lower ($3.6M est. savings) vs. Baseline through 2035 shown in orange line
- Restructuring allows for overall General fund debt payments of $900K annually
  - No increase to what City just paid on UAL for FY 2022



Note: Estimated UAL payments sourced from CalPERS Outlook Tool

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Estimated Savings Analysis for Proposed UAL Restructuring

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

Note: Savings assume CalPERS earns 6.50% on average over next 20 years

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., 3.15-3.50% in current market)
  - City would be worse off if CalPERS earned less than bond rate (3.15-3.50%) 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%

Financing Structure

Lease-Lease Back with Fort Bragg Joint Powers Financing Authority

- City will use a lease-lease back financing structure to effectuate the financing
- Most common type of structure to effectuate California General Fund backed borrowing
  - No tax increase needed, provides long term financing from City funds
  - Most common general fund financing method for cities in California
    - **325+ issuances for California Cities over last 20 years**
      - Examples include for Ukiah, Arcata, Willits, Eureka, Redding, Lakeport, Willows, Santa Rosa, Sausalito, Corte Madera, Half Moon Bay, Morro Bay, Scotts Valley, Williams, Windsor, Yreka, Yountville and Mendocino County
- City owned assets are utilized to effectuate the structure, but are there is no risk of foreclosure or any title/deed transfer of ownership
  - If for some reason the City did not pay on its debt, the trustee or bond insurer could “re-let” (lease to another party) the asset in order to generate the revenue needed to pay for the financing.
- While the City has several assets, City Hall and Police Station are structurally sound and provide the City lowest interest rate possible
  - If City has future borrowing needs, it can use other assets or the same assets if there is sufficient capacity (value to lease obligation) to leverage

Recap of Financing Strategy

- **One lease revenue bond for pension debt restructuring**
  - **Flexibility:** Can pay debt off early or use for other projects
  - **Savings:** City will leverage benefit of pension restructuring to layer in $3.5M Mill Site debt without any impact on annual budget
  - **No impact to taxpayers**
  - **Efficiency:** One transaction (vs. two) saves on financing costs and staff time
  - **Lowest Interest Rate:** Essential assets and strong credit rating will allow City to take advantage of historically low rates
- While the use of proceeds for $3.5M Mill Site project is in line with City's vision for "Blue Economy" and sustainable development, this transaction will not be designated as ESG (Environment, Social, Governance Bond)
  - City would like to maintain flexibility to use proceeds for other projects if desired (i.e. Broadband) that cannot be designated as ESG

Documents Being Approved Tonight

- Site Lease
  - Agreement 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
- Lease Agreement
  - Agreement 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
- Indenture of Trust
  - Provides for execution and delivery of the 2021 Bonds and 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
- Assignment 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
- Preliminary Official Statement
  - The primary marketing document to prospective bond purchasers containing information on the plan of finance, security for the bonds, information on the City and continuing disclosure requirements
- Bond Purchase Agreement
  - Agreement whereby the Underwriter will agree to purchase the 2021 Bonds and make a bona-fide public offering

Next Steps and Proposed Schedule

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

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

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

Late October – Bond Pricing (Lock Interest Rate)

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

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