2021 Financing Project

Potential Acquisition of Southern Mill Site Property + CalPERS UAL Restructuring

Process Update, Preliminary Strategy and Next Steps

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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 ≈ 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

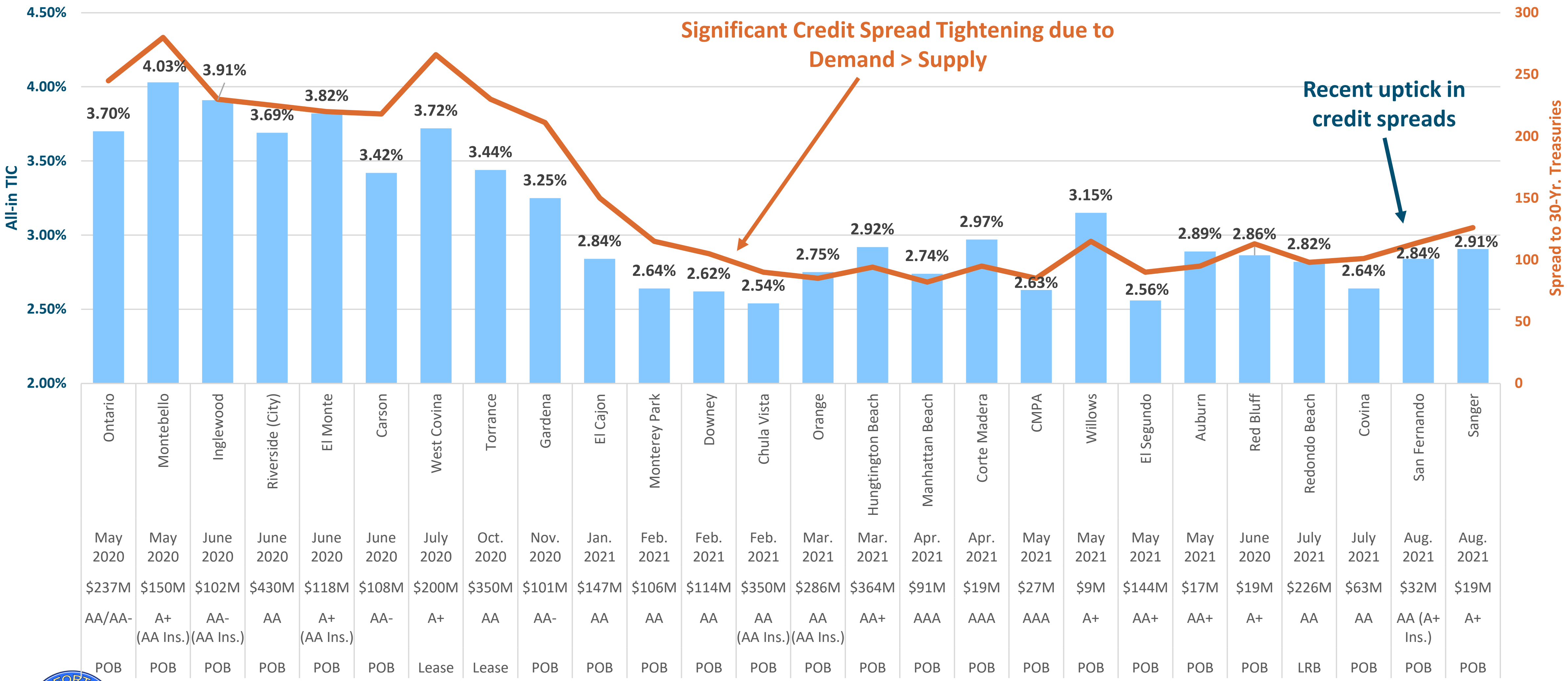
Market Update – Recent UAL Restructurings

- 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)



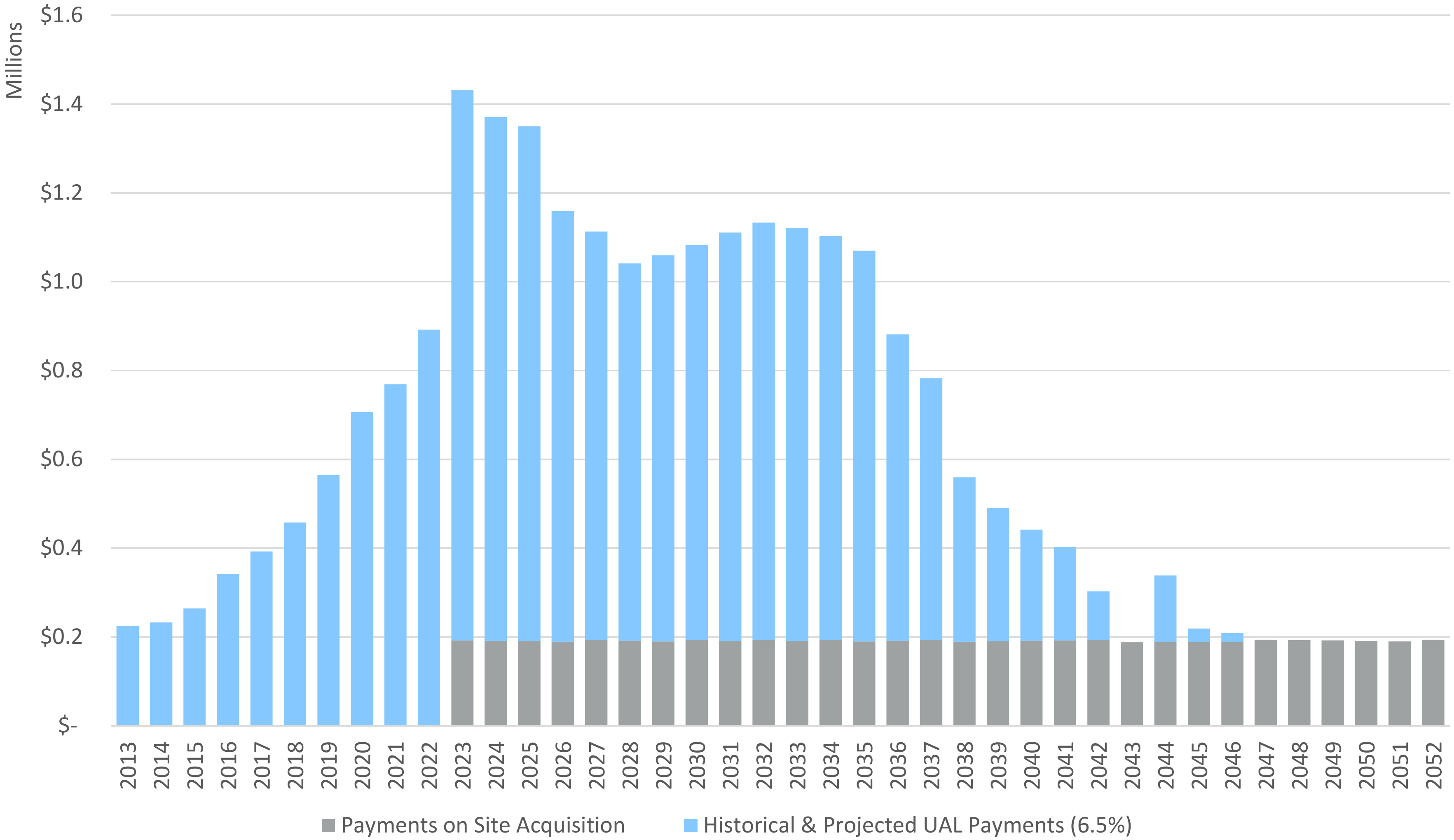
Note: Spreads and interest rates should be considered best estimates. Rates reflect estimated all in interest rate on financing.

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

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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

	Alternative	**Recommended**
Est. Value	**Option 1** **City Hall Only** **8,120,730**	**Option 2** **City Hall + Police Station** **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	**$1.0 Million**	**$1.9 Million**
Est. Savings Through 2035	**$2.9 Million**	**$3.7 Million**
Interest Rate on UAL Restructuring	**3.54%**	**3.29%**

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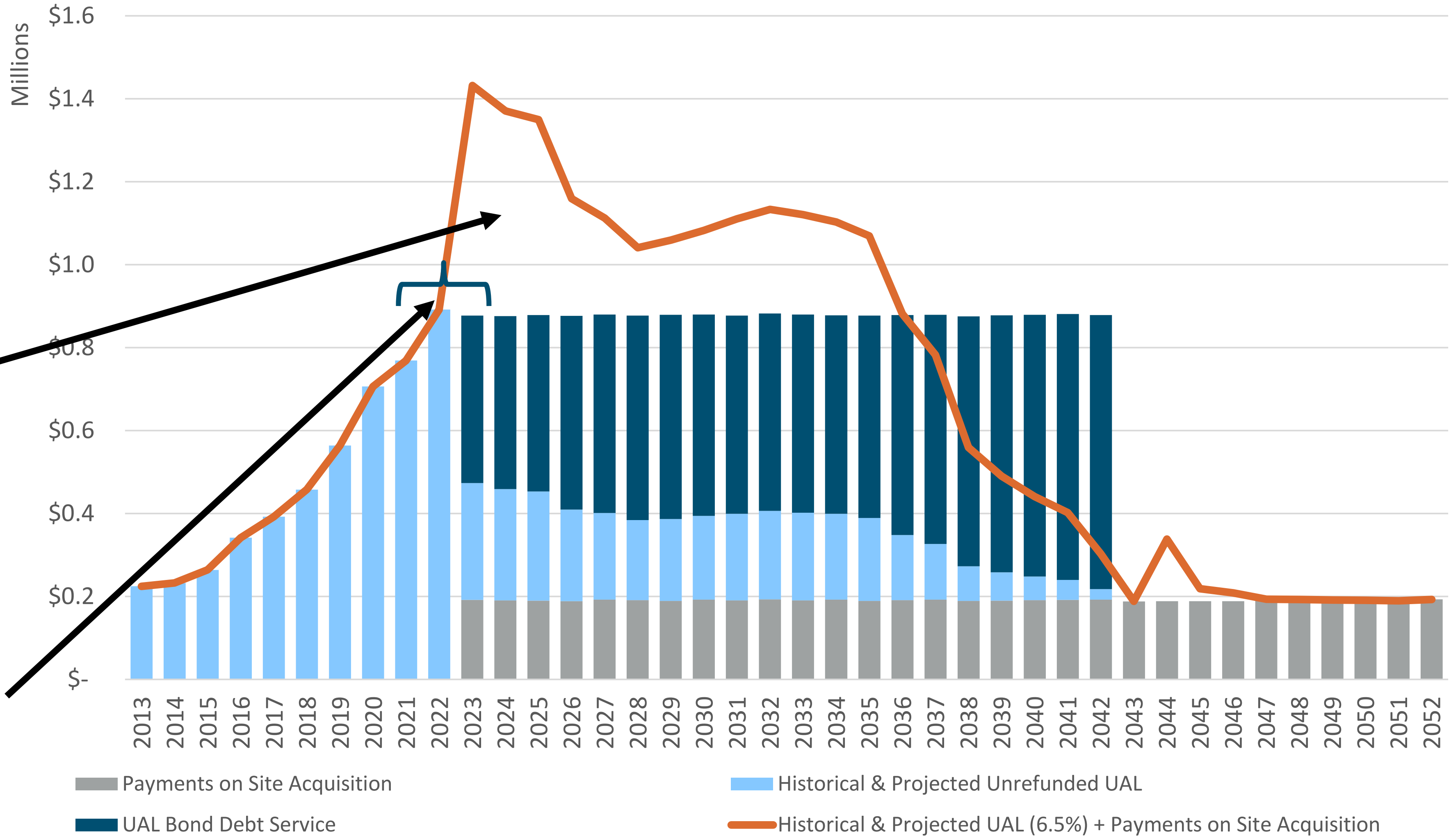
Recommended Option for Optimal Financing Size

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

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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

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

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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

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

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