

Opportunity Overview

Refinancing CalPERS Unfunded Accrued Liability (UAL) with Bonds



MAYOR AND CITY COUNCIL PRESENTATION
CITY OF REDONDO BEACH, CA
FEBRUARY 16, 2021

Presented by:

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INTRODUCTION

- City pension costs have been rising dramatically due to requirement to repay the Unfunded Accrued Liability (UAL) to the California Public Employees' Retirement System (CalPERS)
- UAL is driven by historical changes in actuarial assumptions and lackluster investment performance
- City's aggregate UAL owed to CalPERS is projected to be \$211,769,876¹ by 6/30/2021
- Market-based solutions to refinance this debt have evolved over time; improved structuring options that reduce certain risks of previous approaches are now available
- Numerous CA cities have refinanced their UALs thanks to currently favorable interest rates, strong investor demand and palatable structuring options
- City is currently facing steep cost increases which will require the use of reserves to make payments
- Exploration of refinancing UAL with market-based solution could better align pension payments with current revenues

OPPORTUNITY TO REDUCE PENSION DEBT REPAYMENT REFINANCE CalPERS UAL BY ISSUING BONDS

- Unfunded pension liabilities are existing debts being repaid at 7% interest
 - UAL is required by GASB to be listed as current liability on City's balance sheet
- City has opportunity to lock in lower UAL repayments at low rates
- Muni bond market interest rates are currently substantially lower than CalPERS rate
 - City's strong credit rating (implied S&P "issuer credit rating" of AA+) should command excellent interest rates in the 3.25% - 3.75% range (subject to change)
- City can issue its own municipal bonds to refinance UAL repayments to significantly lower levels
- Potential dramatic future cost reductions can help protect reserves and stabilize budget going forward

PENSION BOND REFINANCINGS BY OTHER AGENCIES

Agency	Par Amount	Rating	Sale Date	Maturity
City of El Cajon	\$147,210,000	AA	1/13/21	2043
City of Placentia (LRB-parks)	52,950,000	BBB+	10/29/20	2045
City of Arcadia	90,000,000	AAA	10/27/20	2040
City of Torrance (LRB-streets)	349,515,000	AA	10/1/20	2043
City of Azusa	70,075,000	AA-	9/17/20	2040
City of Pomona	219,890,000	AA-	8/13/20	2046
City of San Bernardino*	19,850,000	na	7/23/20	2046
City of West Covina (LRB-streets)	204,095,000	A+	7/23/20	2044
City of Grass Valley	18,495,000	AA-	6/23/20	2041
Kensington Police Protection & Community Services Dist.*	4,544,000	n/a	6/18/20	2040
North County Fire Protection District	20,305,000	AA-	6/11/20	2034
City of Carson	108,020,000	AA-	6/10/20	2044
City of El Monte	118,725,000	A+/AGM Ins AA	6/9/20	2050
City of Riverside	432,165,000	AA	6/4/20	2045
City of Inglewood	101,620,000	AA-/AGM Ins AA	6/2/20	2050
City of Montebello	153,425,000	A+/AGM Ins AA	5/27/20	2045
City of Ontario	236,585,000	AA	5/12/20	2050
City of Larkspur	18,295,000	AAA	4/30/20	2040
County of Riverside	719,995,000	A2/AA	4/22/20	2038
City of Pasadena (refinancing)	131,805,000	AAA	2/5/20	2045
Monterey County Regional Fire District	20,250,000	A2/AA-	11/21/19	2039
City of Pacifica	9,685,000	AA+	10/9/19	2030
City of Hawthorne	121,865,000	A2/AA-	9/24/19	2049

TYPES OF SECURITIES THAT CAN BE ISSUED BY CITY

- The City can refinance the UAL by selling securities in the capital markets
- Two (2) primary types of obligations:
 - Pension Obligation Bonds (POBs)
 - Lease Revenue Bonds (POBs)
- Pension Obligation Bonds (POBs) are General Obligation Bonds once validated by the Court and do not require any sort of “collateral”
- Lease Revenue Bonds (LRBs) do not require court validation. LRBs do require encumbering certain City assets with a lease/leaseback structure.
- City should be able use its streets as lease collateral; recent success in neighbor city
- Bond Investors generally prefer Lease Revenue Bond Structure over POB structure

PENSION OBLIGATION BONDS

- POBs are General Obligations of the City
 - “Debt” as defined by CA Constitution
 - Required to repay
- POBs require Court Validation before they can be issued
 - Historically a relatively perfunctory process since they refinance an existing debt imposed by law
- Process is slow (validation alone can take 120 or more days); exposes City to extended period of market risk, i.e., rates may change before able to sell bonds
- Due to nature of “General Obligation”, POBs do not require any “collateral” due to nature of GO pledge after validation
- Generally, garner highest credit rating available to issuer
 - Would expect City GO Rating to be “AA+” based on 2019 Lease Revenue Bond rating

LEASE REVENUE BONDS

- Lease Revenue Bonds (LRBs) do not require court validation, therefore are quicker to complete (less market risk)
- Lease Revenue Bonds (LRBs) would be sold by the City's Community Financing Authority and secured by rental payments to be made by the City to the Authority for use of certain real property
 - City previously issued LRBs in 2019 secured by leasing/leasing back a section of Harbor Blvd.
- LRB structure generally garners credit rating "1-notch" below issuer's General Obligation rating due to nature of lease security being subject to abatement and annual appropriation
- 2019 LRBs rated "AA"; would expect POBs to be rated "AA+"
- However, investors generally prefer Lease Revenue Bond Structure over POB structure due to existence of underlying assets
 - City likely able to again use streets as lease collateral; recent success in neighbor city with UAL refinancing

CITY'S UNFUNDED ACCRUED LIABILITY ("UAL")

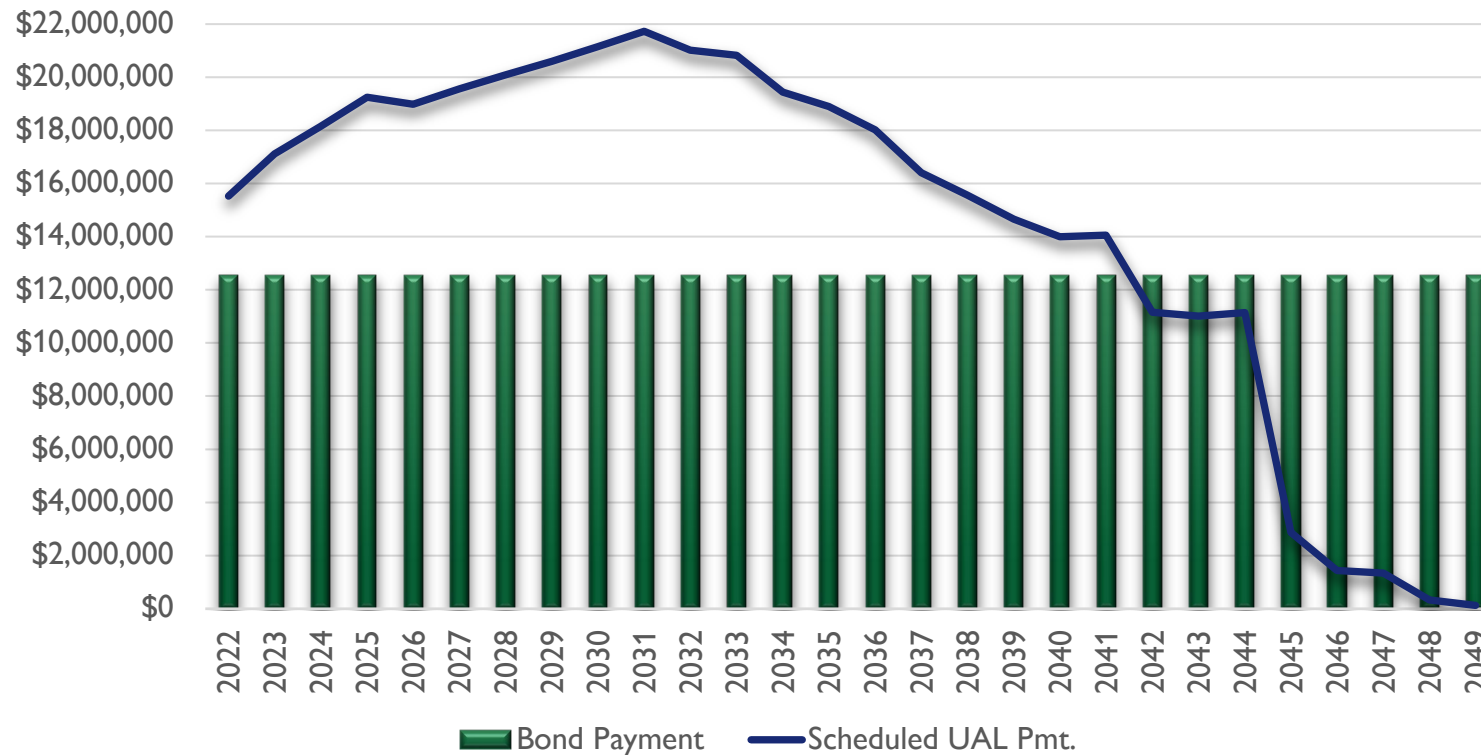
- **Projected UAL at 6/30/2021¹: \$211,769,876**
- UAL payments starting next year (FY22) are based on projected 6/30/2021 amount
- CalPERS includes 7% interest¹ charge in UAL amortization payments
- Most recently available actuarial data for Miscellaneous and Safety Retirement Plans is as of 6/30/2019¹:
 - Required Combined Balance: \$612,790,806
 - Market Value of Assets: 404,075,277
 - Amount Underfunded (UAL): \$208,715,529
 - **City made \$13,697,415 UAL payment in FY21, will pay \$15,552,745 in FY22 - a 13.6% increase**
- With no other changes (unlikely), UAL projected to increase to \$211,769,876 and then be paid down slightly to \$210,536,913 at 6/30/2022
- CalPERS posted 4.7% earnings (<7% target) for FY20 which will lead to additional UAL

POTENTIAL BUDGETARY SAVINGS BY REFINANCING UAL

- Miscellaneous and Safety plans combined projected by CalPERS to be \$211,769,876¹ at 6/30/2021¹
- City continues to amortize UAL owed to CalPERS per CalPERS' repayment requirements
- UAL repayments will rise dramatically for the next 10 fiscal years
 - FY22 payment will be 13.6% greater than FY21; FY31 will be 58.6% greater than FY21
- Opportunity to refinance UAL in a cost-efficient way for significant budgetary savings
 - Refinance all or part of aggregate UAL at ~3.25-3.75%² instead of 7%
 - “Flatten the Curve” of upcoming payments for budgetary relief
- **Recognize ~\$52.6 to ~ \$89.7² million in long-term pension cost reductions, depending on structure**

UAL/BOND REPAYMENT COMPARISON

LEVEL DEBT SERVICE BASIC STRUCTURE



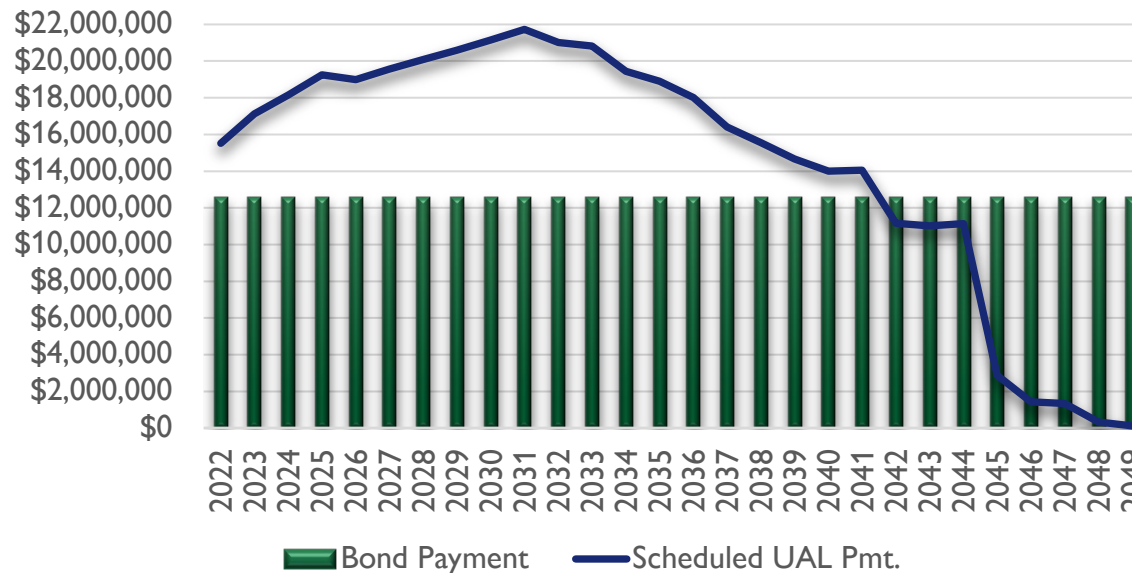
FYE June 30	Scheduled UAL Pmt.	Bond Payment	Budget Savings	PV Savings
2022	\$15,522,745	\$12,562,938	\$2,959,808	\$2,771,816
2023	17,117,571	12,564,938	4,552,634	4,142,695
2024	18,148,405	12,565,563	5,582,843	4,904,703
2025	19,251,678	12,564,625	6,687,053	5,666,472
2026	18,985,124	12,566,938	6,418,187	5,231,616
2027	19,563,069	12,567,125	6,995,944	5,493,107
2028	20,094,428	12,565,000	7,529,428	5,693,540
2029	20,594,228	12,565,375	8,028,853	5,845,944
2030	21,153,945	12,567,875	8,586,070	6,019,496
2031	21,729,055	12,567,125	9,161,930	6,184,225
2032	21,016,805	12,562,938	8,453,868	5,488,435
2033	20,825,073	12,565,125	8,259,948	5,159,964
2034	19,442,869	12,563,125	6,879,744	4,130,620
2035	18,903,074	12,566,750	6,336,324	3,659,164
2036	18,013,865	12,565,438	5,448,428	3,024,584
2037	16,400,015	12,564,000	3,836,015	2,042,400
2038	15,557,889	12,567,063	2,990,827	1,528,208
2039	14,657,237	12,564,063	2,093,175	1,023,933
2040	13,995,771	12,564,813	1,430,959	668,742
2041	14,055,842	12,563,750	1,492,092	673,101
2042	11,154,979	12,565,500	(1,410,521)	(640,594)
2043	11,012,111	12,564,500	(1,552,389)	(675,501)
2044	11,145,274	12,565,375	(1,420,101)	(594,037)
2045	2,874,326	12,567,563	(9,693,237)	(3,843,652)
2046	1,436,201	12,565,500	(11,129,299)	(4,243,247)
2047	1,334,702	12,563,813	(11,229,111)	(4,117,560)
2048	331,511	12,566,938	(12,235,427)	(4,314,696)
2049	118,071	12,564,125	(12,446,054)	(4,221,159)
TOTALS	\$404,435,863	\$351,827,875	\$52,607,988	\$56,702,317

UAL/BOND REPAYMENT COMPARISON

LEVEL DEBT SERVICE BASIC STRUCTURE

PROS

- Generates most near & mid-term budget relief
- Establishes permanent level repayment below FY21 amount of \$13.7M
- Shifts portion of repayment to later years where dollars “cost less”

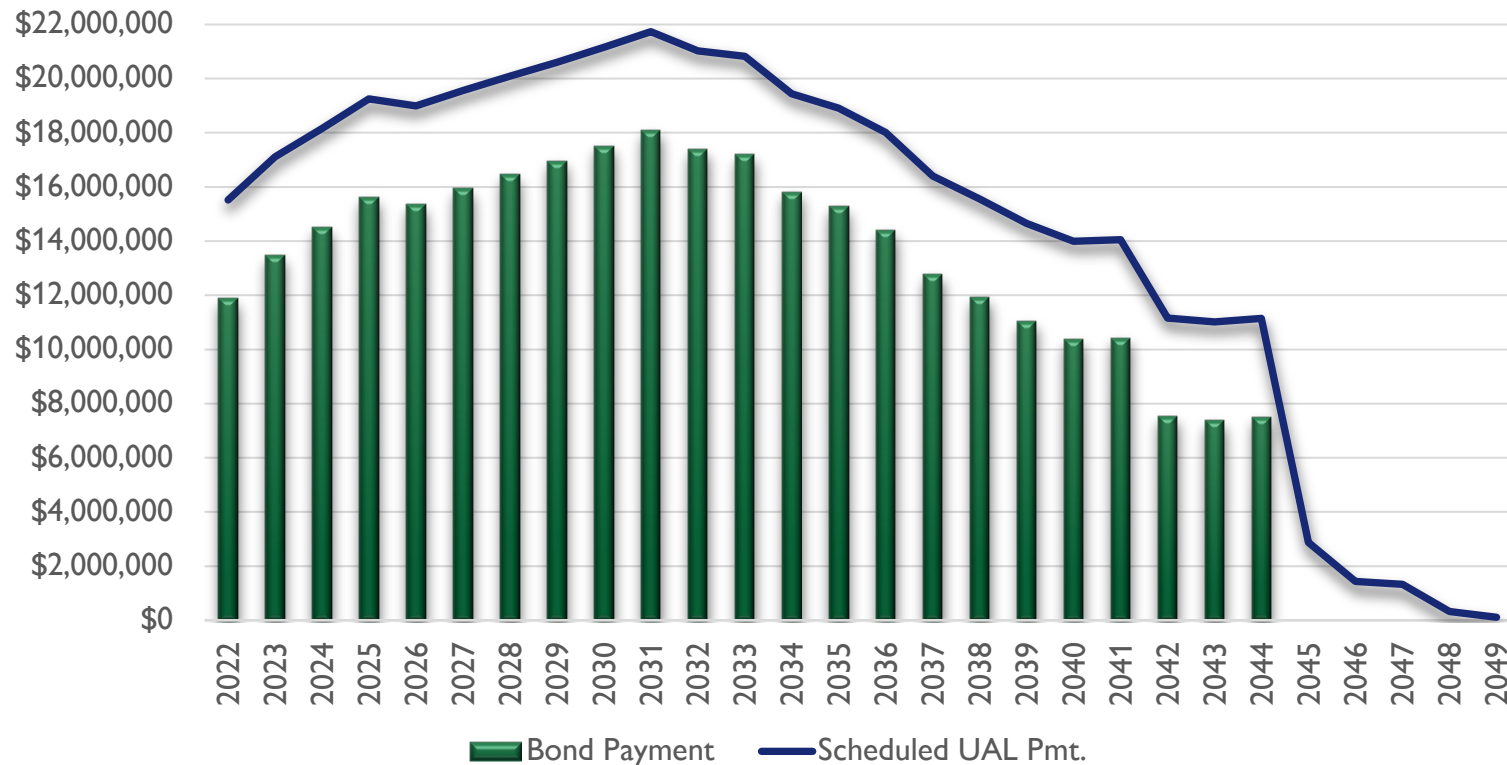


CONS

- Accrues more interest costs that other repayment structures that repay principal more quickly
- Shifts portion of repayment to later years where previously there were no payments

UAL/BOND REPAYMENT COMPARISON

“LEVEL SAVINGS” BASIC STRUCTURE



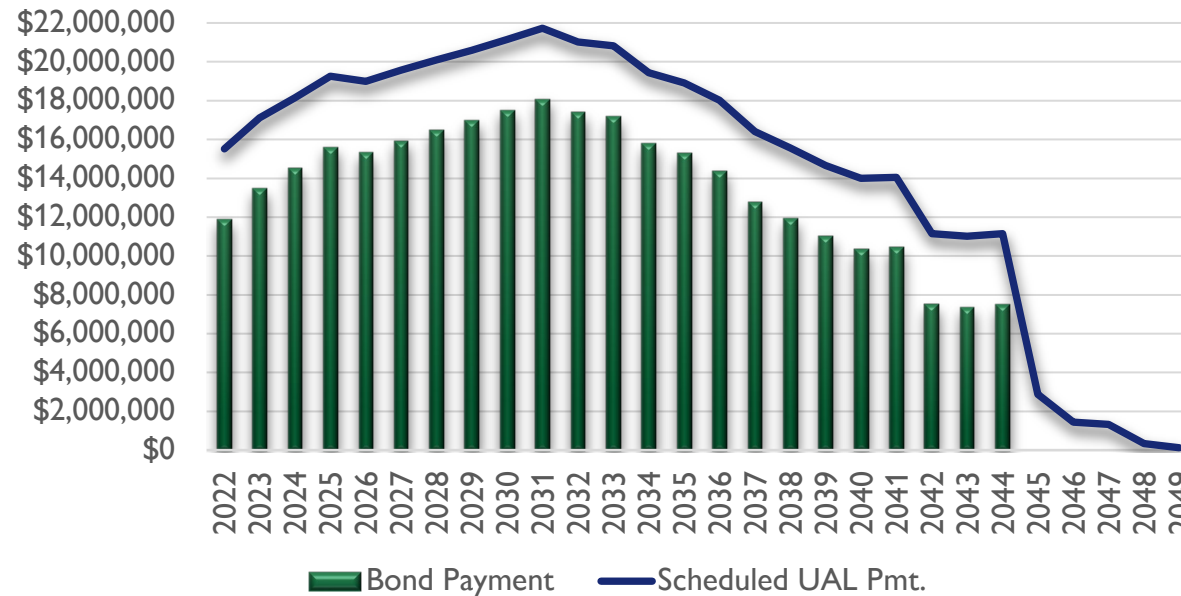
FYE June 30	Scheduled UAL Pmt.	Bond Payment	Budget Savings	PV Savings
2022	\$15,522,745	\$11,887,938	\$3,634,808	\$3,419,184
2023	17,117,571	13,480,250	3,637,321	3,291,992
2024	18,148,405	14,512,500	3,635,905	3,166,603
2025	19,251,678	15,618,250	3,633,428	3,045,474
2026	18,985,124	15,348,000	3,637,124	2,934,470
2027	19,563,069	15,926,438	3,636,632	2,824,198
2028	20,094,428	16,461,688	3,632,741	2,715,731
2029	20,594,228	16,959,125	3,635,103	2,616,244
2030	21,153,945	17,518,938	3,635,008	2,518,889
2031	21,729,055	18,092,563	3,636,493	2,426,466
2032	21,016,805	17,383,125	3,633,680	2,334,874
2033	20,825,073	17,192,313	3,632,761	2,247,871
2034	19,442,869	15,806,000	3,636,869	2,167,197
2035	18,903,074	15,268,625	3,634,449	2,085,432
2036	18,013,865	14,379,625	3,634,240	2,007,964
2037	16,400,015	12,767,313	3,632,703	1,932,571
2038	15,557,889	11,924,438	3,633,452	1,860,960
2039	14,657,237	11,023,813	3,633,425	1,791,532
2040	13,995,771	10,363,250	3,632,521	1,724,180
2041	14,055,842	10,419,500	3,636,342	1,661,472
2042	11,154,979	7,521,125	3,633,854	1,598,320
2043	11,012,111	7,378,375	3,633,736	1,538,175
2044	11,145,274	7,511,500	3,633,774	1,480,372
2045	2,874,326		2,874,326	1,127,007
2046	1,436,201		1,436,201	541,581
2047	1,334,702		1,334,702	484,051
2048	331,511		331,511	115,628
2049	118,071		118,071	39,606
TOTALS	\$404,435,863	\$314,744,688	\$89,691,176	\$55,698,042

UAL/BOND REPAYMENT COMPARISON

“LEVEL SAVINGS” BASIC STRUCTURE

PROS

- *Generates greatest amount of budget savings over time*
- *Repays overall liability in the shortest time frame*

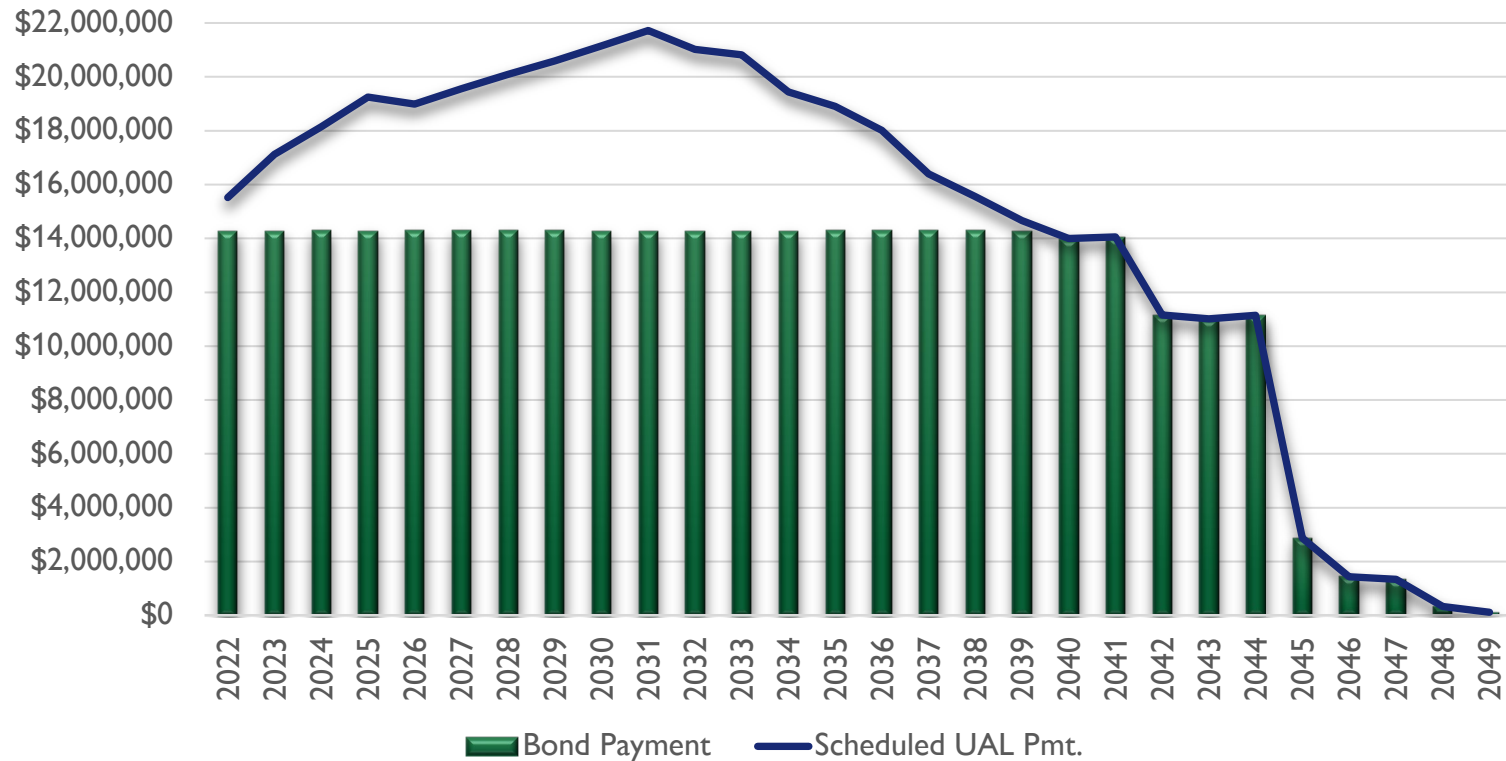


CONS

- *Not accurate comparison as “Scheduled UAL Repayment” changes every year*
- *Still requires steep budget increases above FY21 payment of \$13.7M in near to mid-term*

UAL/BOND REPAYMENT COMPARISON

“HYBRID SAVINGS” BASIC STRUCTURE



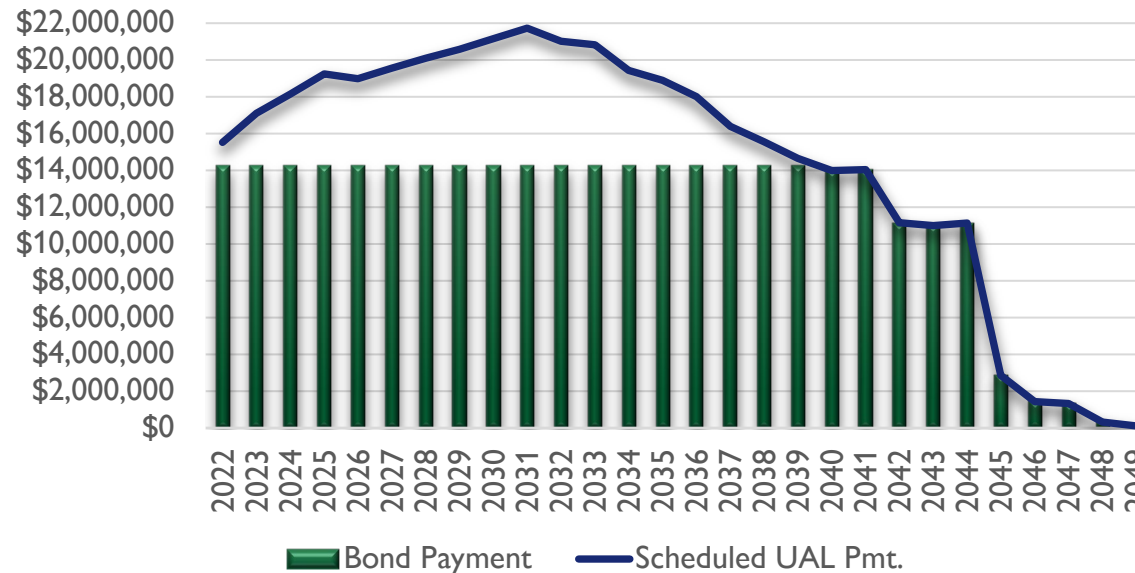
FYE June 30	Scheduled UAL Pmt.	Bond Payment	Budget Savings	PV Savings
2022	\$15,522,745	\$14,287,938	\$1,234,808	\$1,111,382
2023	17,117,571	14,285,250	2,832,321	2,549,075
2024	18,148,405	14,288,938	3,859,468	3,367,993
2025	19,251,678	14,288,438	4,963,241	4,186,396
2026	18,985,124	14,288,563	4,696,562	3,809,262
2027	19,563,069	14,288,938	5,274,132	4,123,433
2028	20,094,428	14,289,188	5,805,241	4,372,784
2029	20,594,228	14,288,938	6,305,291	4,574,434
2030	21,153,945	14,287,813	6,866,133	4,797,254
2031	21,729,055	14,285,438	7,443,618	5,007,776
2032	21,016,805	14,286,438	6,730,368	4,353,834
2033	20,825,073	14,285,250	6,539,823	4,070,349
2034	19,442,869	14,286,500	5,156,369	3,082,704
2035	18,903,074	14,289,625	4,613,449	2,652,201
2036	18,013,865	14,289,063	3,724,803	2,057,202
2037	16,400,015	14,289,438	2,110,578	1,114,356
2038	15,557,889	14,290,188	1,267,702	638,744
2039	14,657,237	14,285,750	371,487	171,381
2040	13,995,771	13,990,750	5,021	(8,156)
2041	14,055,842	14,055,500	342	(8,009)
2042	11,154,979	11,151,313	3,667	(4,242)
2043	11,012,111	11,008,813	3,299	(2,703)
2044	11,145,274	11,142,875	2,399	(1,459)
2045	2,874,326	2,872,813	1,514	(226)
2046	1,436,201	1,433,063	3,139	767
2047	1,334,702	1,333,563	1,140	188
2048	331,511	330,938	574	146
2049	118,071	114,125	3,946	1,315
TOTALS	\$404,435,863	\$324,615,438	\$79,820,426	\$56,018,179

UAL/BOND REPAYMENT COMPARISON

“HYBRID SAVINGS” BASIC STRUCTURE

PROS

- Establishes permanent level repayment with no future increases
- Does not create future payments in years where there previously were none
- Creates balance between repayment of principal and creating predictable budget line



CONS

- Initial and recurring payments at level greater than FY21 payment of \$13.7M
- Not accurate comparison as “Scheduled UAL Repayment” changes every year
- Does not create maximum near- to mid-term budget relief possible

OPTIONS FOR REFINANCING APPROACH

- **Refinancing 100% of current UAL (@ 6/30/2021)**
 - creates capacity to absorb new UAL repayments expected next year as a result of FY2020 returns of 4.7%
- **With LRB approach, option to refinance more than 100% of 6/30/2021 UAL**
 - Pre-fund repayment of UAL anticipated to be created from 4.7% returns of FY2020
 - Option not available for POBs due to nature of Court Validation process
- **City can also refinance less than 100% of UAL if desired**
 - Leaving a UAL balance would enable potential CalPERS over-performance to reduce the overall debt
 - Analysis would be performed to determine specific UALs to refinance and which to leave outstanding
 - For example, since all UAL balances pay 7% interest, it might be better to leave longer-term amortizations with CalPERS and refinance the shorter-term obligations at lower bond market interest rates

REFINANCING THE UAL CREATES FISCAL FLEXIBILITY

- City can custom-tailor the payment structure:
 - Customize schedule to repay quicker or slower than CalPERS offers, as desired per policy
 - Customize payments to meet budgetary considerations
- City can refinance all or any portion of UAL:
 - Determine City policy for appropriate funding level of total plan Liability (e.g., 90%)
- City can use savings to develop new fiscal policies
 - Invest savings in specific ways per policy, e.g., apply toward economic development, operations, Section 115 Trust

CONSIDERATIONS TO REFINANCING UAL WITH BONDS

- Interest rate on UAL debt can be reduced from 7% to <4% (estimated)
- Refinanced portion of UAL would be repaid at a point certain in a predictable manner, unlike current UAL repayment amounts which change each year
- Looming sharp budget increases can be greatly reduced, preserving City reserves and creating capacity in budget for other essential expenditures
- If 100% of UAL is refinanced and CalPERS performs exceedingly well, City's pension could become "super funded" with no means to withdraw excess
 - Refinancing something less than 100% leaves some room for CalPERS to perform well

CONSIDERATIONS TO REFINANCING UAL WITH BONDS (cont'd.)

- Sets up budget to better handle any new UALs created in the future (e.g., FY2020)
- If CalPERS' investment returns over the life of the bonds are less than the yield on the bonds, it could be argued that the City should not have refinanced the UAL
 - CalPERS' Historical 20-year returns are 5.8% and 30-year returns are 8.1%
 - Past performance is not a guarantee of future returns; track record indicates it is reasonable to expect CalPERS can hit long-term returns greater than projected bond yield
 - Refinancing still creates budgetary cashflow relief when it is needed

CONCLUSIONS

- Through no fault of its own, City has a large UAL (\$211,769,876¹ at 6/30/2021¹) that must be repaid
- The UAL is a debt charged at 7% interest and amortized on terms not controlled by the City
- If not addressed, UAL repayments are scheduled to rise almost 60% in the next 10 fiscal years
- Scheduled increases will have to be paid by drawing on reserves, potentially eroding City's fiscal stability
- Refinancing the UAL now while rates are low could result in substantial budgetary savings
 - As much as ~\$52.6 to ~ \$89.7² million in long-term pension cost reductions, depending on structure
- The City has various structuring options available and good market access thanks to its good credit
- Other CA Cities, including neighboring communities, have refinanced their UALs with success



NEXT STEPS

- Mayor and City Council can continue to consider and evaluate merits of refinancing UAL
- Municipal Advisor and City Staff can provide follow-up on CC discussion(s). If directed can:
 - Develop financing timeline and bring back additional analysis for City Council consideration and selection of appropriate program
 - Prepare for validation proceedings to be in position to file validation as soon as practicable; or
 - Eliminate need for validation and commence LRB program
- Once preferred pathway is determined and authorized, Finance Team can commence Bond issuance transaction
- Close Bonds as soon as practicable to capture currently favorable market

THANK YOU – ANY QUESTIONS?



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FEBRUARY 16, 2021

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