

# Agenda Report

September 23, 2019

**TO:** Honorable Mayor and City Council

**THROUGH:** Finance Committee

**FROM:** Department of Finance

**SUBJECT: ADOPTION OF A RESOLUTION AUTHORIZING THE ISSUANCE OF ONE OR MORE SERIES OR SUBSERIES OF CITY OF PASADENA PENSION OBLIGATION REFUNDING BONDS, APPROVING THE FORM OF AND AUTHORIZING THE EXECUTION OF SUPPLEMENTAL TRUST AGREEMENTS PROVIDING FOR SUCH ISSUANCE, APPROVING THE FORM OF AND AUTHORIZING THE EXECUTION OF A BOND PURCHASE AGREEMENT, A CONTINUING DISCLOSURE AGREEMENT AND ESCROW AGREEMENTS AND APPROVING THE FORM OF AND AUTHORIZING THE DISTRIBUTION OF A PRELIMINARY OFFICIAL STATEMENT AND OFFICIAL STATEMENT, AND AUTHORIZING CERTAIN OTHER MATTERS RELATED THERETO.**

## **RECOMMENDATION:**

It is recommended that the City Council:

1. Find that the proposed action is not a project subject to the California Environmental Quality Act (CEQA) as defined in Section 21065 of CEQA and Section 15378 of the State CEQA Guidelines and, as such, no environmental document pursuant to CEQA is required for the project; and
2. Adopt a Resolution authorizing the issuance of one or more series or subseries of City of Pasadena Pension Obligation Refunding Bonds; approving the form of and authorizing the execution of supplemental trust agreements providing for such issuance, approving the form of and authorizing the execution of a bond purchase agreement, a continuing disclosure agreement and escrow agreements and approving the form of and authorizing the distribution of a preliminary official statement and official statement, and authorizing certain matters related thereto; and
3. Grant the proposed Trust Agreement Supplements an exemption from the competitive selection process pursuant to Pasadena Municipal Code Section

4.08.049B. Competitive bidding is not required pursuant to City Charter Section 1002(F), contracts for professional or unique services; and

4. Approve contracts with Stifel, Nicolaus & Company, Incorporated and Bank of America Merrill Lynch as underwriters for the proposed refunding bonds at a discount rate (fee) not to exceed 0.30% of the bonds or an estimated \$393,000. Competitive bidding is not required pursuant to City Charter Section 1002 (F), contracts for professional or unique services.

### **EXECUTIVE SUMMARY:**

In 2015, the City issued its Refunding Pension Obligation Bonds (POBs) series 2015AB to refinance all of its prior outstanding POBs. Given the drop in interest rates over the last six months, a refunding of the 2015 series POBs could generate significant savings to the General Fund. It is anticipated that the proposed refunding of the 2015 POBs could save the General Fund approximately \$465,000 per year based on the financial markets as of September 5, 2019. The proposed refunding is highly sensitive to interest rates and every 0.10% change in rates impacts the annual savings by approximately \$100,000. The interest rates on the actual pricing date of the bonds will determine the level of interest savings on the proposed refunding.

### **BACKGROUND:**

The City has an obligation to fund the Fire and Police Retirement System (FPRS) under the terms of the Contribution Agreement entered into by the City and the System. In 1999, 2004, and 2012 the City issued \$101.9 million, \$40.7 million, and \$47.44 million of Pension Obligation Bonds (POBs), respectively, in order to fund the City's obligations in respect to the Contribution Agreement. The Contribution Agreement requires the City to fund the System and maintain it at an agreed upon funding ratio that increases annually until it reaches an 80% ratio of actuarial assets to liabilities. The primary source of funds to pay the debt service on the bonds was tax increment revenue from the former Downtown Project Area pursuant to Senate Bill (SB) 481; however, the provisions of SB 481 sunsetted in December 2014 and the General Fund has since made all debt service payments. The 1999 and 2004 POBs were structured to mature or were subject to mandatory tender on May 15, 2015. As a result in April 2015, the City refunded all the outstanding POBs by the issuance of its 2015 Series A and Series B POBs in the total amount of \$119,460,000. Currently, the outstanding amount of the 2015 POBs remains \$119,460,000 due to the structure of the amortization of the principal which starts on May 1, 2020.

Despite the issuance of pension obligation bonds, supplemental contributions from the City to the FPRS are still required from time to time to fund it in accordance with the Contribution Agreement. Per the actuarial report dated June 30, 2018, the FPRS was funded at 79.9% and a supplemental contribution of \$3.1 million was projected by the FPRS's actuary in FY 2020. Furthermore, the System's actuary has projected the System's funding ratio at below 80% beginning FY2020 through FY2048 therefore,

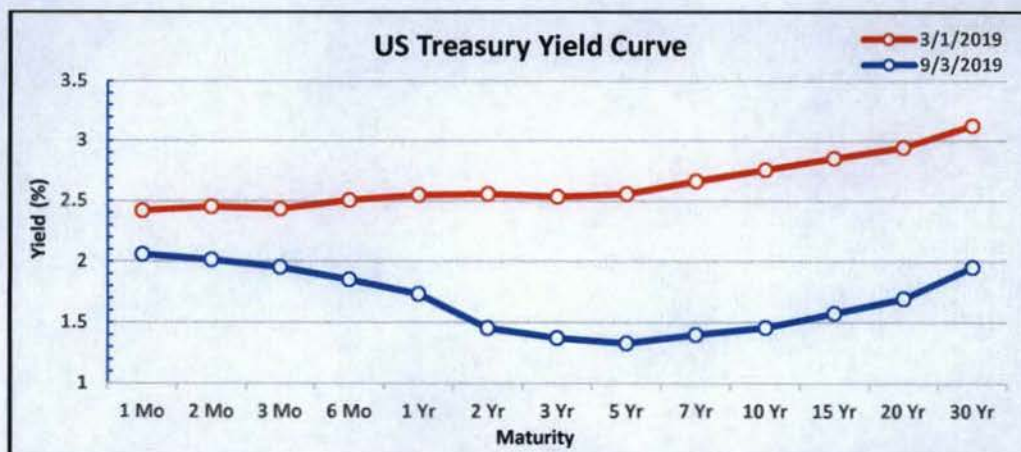
necessitating annual supplemental contributions from the General Fund. The current Contribution Agreement between the City and the FPRS established investment earnings and inflation rate assumptions, which in part drive asset and liability projections under the System, and future funding ratios depend on future actual earnings rates and future actual inflation rates. The FPRS actuary has projected that benefit payments will continue beyond the year 2050.

In March 2019, the City Council approved an amendment to Agreement No. 20,823 with the FPRS and established the beneficial interest in the Concord property to the FPRS. Upon a successful sale of the Concord property, FPRS is projected to receive approximately \$14.57 million of net proceeds in FY2020 and an additional \$5.88 million in FY2023. If these proceeds are realized, FPRS would be funded at close to 90%, and the next City contribution would likely be pushed back to FY 2027 or beyond. In the event the Concord transaction does not proceed, the City will need to make additional supplemental contributions annually to the System for the next 20 years ranging from \$3.8 to \$1.2 million.

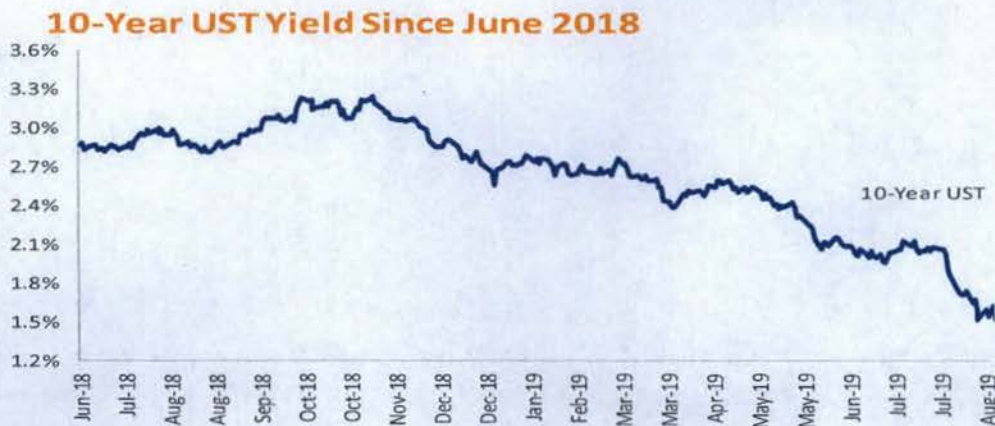
### Proposed Refunding

Over the last six months, interest rates substantially declined and created the opportunity for significant savings by potentially refinancing the existing 2015 POBs. The City is currently paying an average taxable coupon rate of 4.69% on its 2015 POBs. Based on the financial market as of September 5, 2019, it is possible to refinance the 2015 POBs at an estimated 2.92% interest rate, therefore materially reducing the City's borrowing cost and creating an estimated annual debt service savings to the General Fund of approximately \$460,000. Staff along with the City's municipal advisor and underwriters estimate that in the current interest rate environment, the City can save approximately \$11,800,000 in aggregate interest cost over the term of the bonds. This equates to a net present value savings (NPV) of over \$8.4 million or 7.5% NPV savings of refunded bonds.

Below is a graph of the Treasury yield curve on September 3, 2019 compared to six month ago:



The following graph represents the 10-year Treasury yields since June 2018.



Currently, there are \$119,460,000 outstanding POBs. The 2015B serial bonds with maturities 2020 through 2025 in the total amount of \$7,555,000 are non-callable and cannot be refinanced. All remaining bonds with a total amount of \$111,905,000 and maturing 2026 through 2045 have a par call of May 1, 2025 and can be advance refunded. As a result, the proposal is to advance refund \$111,905,000 of the 2015 POBs by issuing an estimated \$131,715,000 of new POBs in order to fund the cost of issuance and deposit sufficient amounts in escrow to pay the principal and interest on the 2015 POBs until they become callable and redeemable in 2025. The new POBs will close in late October 2019 and the proceeds will be invested in U.S. open market securities from closing until the call date in 2025 which will help produce more refinancing savings for the POBs.

Estimated Funds Required to Defease \$111,905,000 of 2015 Bonds:

Refunded Principal	\$ 111,905,000
Interest to Call Date (5/1/25)	28,545,749
Estimated Investment Earnings to Call Date	(9,320,589)
<b>Estimated Funds Required to Defease Bonds</b>	<b>\$ 131,130,160</b>

Pursuant to a November 2018 Request for Proposal (RFP), Urban Futures, Inc. was selected as Financial Advisor on City financings and Stifel, Nicolaus and Company, Incorporated and Bank of America Merrill Lynch were selected as underwriters. Due to the bond size and taxable nature, staff recommends that the City engage two underwriters in order to increase the distribution network and marketing of the bonds. The increased demand for the bonds will likely reduce the interest rate and the overall financing cost.

Bank of New York Mellon Co. is the current Trustee on the 2015 POBs. It is in the City's best interest to maintain Bank of New York Mellon as trustee on the proposed 2019 refunding bonds due to the trustee's familiarity with the bond indentures and the financings.

### **Sensitivity Analysis**

The recommended refunding is highly sensitive to interest rates and every 0.10% change in rates impacts the annual debt service savings amount by \$100,000. The table below represents a sensitivity analysis with a 0.10% increase and decrease in interest rates.

Rate Movement	Interest Rate Sensitivity Analyses		
	-10 BPS	CURRENT	+10 BPS
Avg. Bond Yield	2.82%	2.92%	3.03%
NPV Savings (\$)	\$10,324,209	\$8,420,933	\$6,551,689
NPV Savings (%)	9.23%	7.53%	5.85%
Total Savings	\$14,403,604	\$11,849,359	\$9,286,705
<b>Year</b>			
2020	\$281,027	\$233,157	\$180,327
2021	\$565,747	\$465,189	\$364,761
2022	\$563,213	\$463,111	\$363,069
2023	\$566,115	\$466,486	\$366,847
2024	\$564,595	\$465,443	\$366,211
2025	\$563,971	\$465,298	\$366,476
2026	\$564,833	\$466,625	\$363,197
2027	\$564,123	\$463,592	\$362,879
2028	\$565,834	\$463,120	\$365,164
2029	\$563,661	\$463,930	\$363,791
2030	\$567,204	\$465,522	\$363,383
2031	\$564,043	\$465,578	\$366,616
2032	\$566,873	\$466,686	\$365,962
2033	\$562,830	\$466,122	\$363,846
2034	\$566,905	\$463,768	\$365,167
2035	\$563,848	\$463,376	\$362,293
2036	\$565,475	\$464,247	\$362,410
2037	\$563,088	\$466,373	\$364,058
2038	\$566,597	\$464,520	\$362,005
2039	\$564,135	\$462,115	\$364,688
2040	\$563,263	\$466,098	\$363,413
2041	\$564,763	\$462,903	\$365,733
2042	\$564,388	\$463,583	\$362,388
2043	\$566,575	\$462,425	\$362,985
2044	\$565,350	\$463,625	\$366,580
2045	\$565,150	\$466,470	\$362,460

**COUNCIL POLICY CONSIDERATION:**

As part of its strategic planning goal to maintain fiscal responsibility and stability, the City Council established as an objective the development of a plan to address the challenges associated with funding the FPRS. This report and the recommendation contained herein are intended to fulfill that objective.

**ENVIRONMENTAL ANALYSIS:**

The proposed actions are governmental fiscal activities that would not cause either a direct physical change in the environment or a reasonably foreseeable indirect physical change in the environment. Therefore, the proposed action is not a "project" subject to CEQA, as defined in Section 21065 of CEQA and Section 15378 of the State CEQA Guidelines. Since the action is not a project to CEQA, no environmental document is required.

**FISCAL IMPACT:**

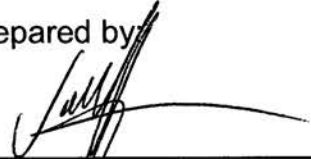
The recommended refunding will not extend the current term on the bonds nor will it raise net new funds for funding purposes. Based on current market conditions as of September 5, 2019, it is anticipated that the true interest cost of the 2019 POBs series will be an estimated 2.92% rate and the City will save an aggregate \$11.8 million in interest cost over the term of the bonds, or \$8.4 million on a net present value basis. The annual debt service payment savings is estimated to be \$465,000.

All costs associated with the refunding will be incorporated and paid by the bond proceeds of the 2019 POBs series. Funds have already been appropriated in the City's Fiscal Year 2020 operating budget to pay debt service on the bonds. There is no anticipated impact to other operational programs or capital projects as a result of this action.

Respectfully submitted,

  
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MATTHEW E. HAWKESWORTH  
Director of Finance

Prepared by:

  
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Approved by:

  
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STEVE MERMELL  
City Manager

Attachments: (6)

- Attachment 1 – Preliminary Official Statement
- Attachment 2 - Bond Purchase Agreement
- Attachment 3 – Second Supplemental Trust Agreement
- Attachment 4 – Third Supplemental Trust Agreement
- Attachment 5 – Escrow Agreement Series 2015A
- Attachment 6 – Escrow Agreement Series 2015B