ATTACHMENT A
TO AGENDA REPORT

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Agenda Report

October 24, 2011

TO: Honorable Mayor and City Council

THROUGH: Finance Committee

FROM: Department of Finance

SUBJECT: **ADOPTION OF A RESOLUTION OF THE CITY COUNCIL APPROVING THE AMENDED AND RESTATED CONTRIBUTION AGREEMENT BETWEEN THE CITY OF PASADENA AND THE PASADENA FIRE AND POLICE RETIREMENT SYSTEM AND AUTHORIZING THE ISSUANCE OF ONE OR MORE CITY OF PASADENA PENSION OBLIGATION DEBENTURES IN AN AMOUNT NOT TO EXCEED THE LESSER OF (i) $50 MILLION OR (ii) THE AMOUNT REQUIRED TO ACHIEVE A FUNDING LEVEL FOR THE CITY OF PASADENA FIRE AND POLICE RETIREMENT SYSTEM OF 85% AND THE ISSUANCE OF ONE OR MORE SERIES OR SUBSERIES OF CITY OF PASADENA PENSION OBLIGATION BONDS, APPROVING THE FORM OF AND AUTHORIZING THE EXECUTION OF A TRUST AGREEMENT, BOND PURCHASE AGREEMENT AND CONTINUING DISCLOSURE AGREEMENT AND APPROVING THE FORM OF AND AUTHORIZING THE DISTRIBUTION OF A PRELIMINARY OFFICIAL STATEMENT AND AUTHORIZING CERTAIN MATTERS RELATING THERETO**

RECOMMENDATION:

It is recommended that the City Council:

1) Authorize the City Manager to enter into an amended and restated contribution agreement between the City and the Fire and Police Retirement System (FPRS) which:

a- Removes references to other pension systems operating under the County Employees Retirement Law of 1937; and

b- Provides for investment return and inflation rate assumptions for the Fire and Police Retirement System to be set by the FPRS, not less than annually, based on analysis performed by the System's Actuary and after seeking input from the City and the System's professional investment consultant;

2) Adopt a resolution approving the Amended and Restated Contribution Agreement between the City of Pasadena and the Pasadena Fire and Police Retirement System and authorizing the issuance of one or more City of Pasadena Pension Obligation Debentures in an amount not to exceed $50 million and the issuance of one or more series or subseries of the City of Pasadena Pension Obligation Bonds (POBs), to refund the debentures, approving the form of and authorizing the execution of a Trust Agreement, Bond Purchase Agreement and Continuing Disclosure Agreement and approving the form of and authorizing the distribution of a Preliminary Official Statement and authorizing certain matters relating thereto; and

3) Authorize the City Manager and/or the Director of Finance to initiate a validation action with respect to the bonds if determined to be appropriate or required by bond counsel, in consultation with the City Attorney.

BACKGROUND:

The City has an obligation to fund the Fire and Police Retirement System. In 1999 and 2004 the City issued $100 million and $40 million of pension obligation bonds, respectively, in order to fund the System. Combined annual debt service on these bonds is currently $13 million. The source of funds to pay the debt service will expire in 2015, at roughly the same time a mandatory tender (i.e. balloon payment) of $81 million is due on the bonds.

Despite the issuance of pension bonds, supplemental contributions from the City to the System are still required on an annual basis in order to fund the System in accordance with prior agreements. These supplemental contributions are expected to be as high as $9-10 million per year over the next seven years.

Additionally, the Contribution Agreement between the City and the System established investment earnings and inflation rate assumptions which no longer appear realistic and should be modified. While such action is prudent, the result will be an increase in the actuarial liability to the City.

On March 28, 2011 the City Council approved a series of staff recommendations to address these issues. Specifically, staff was directed to:

1) Initiate the issuance of not to exceed $65 million in pension obligation bonds (the "2011 bonds") to fund the Fire and Police Retirement System at 85% of its actuarially accrued liability provided such issuance can be achieved at a maximum "all in" interest rate on the bonds not to exceed 7.5%;

2) Approve in concept the future refinancing of approximately $81 million of existing pension obligation bonds, 1999 and 2004 issues prior to their mandatory call or maturity in May 2015;

3) Negotiate changes to Contribution Agreement 16,900 and Settlement and Release Agreement 18,550 between the City of Pasadena and the Fire and Police Retirement System including:

   a. Removing references to other pension systems operating under the County Employees Retirement Law of 1937; and

   b. Providing for annual investment return and inflation rate assumptions for the Fire and Police Retirement System to be set annually by mutual agreement between the City and the System's board; and

4) Return to City Council for all required subsequent approvals.

In furtherance of the City Council's direction, the resolution accompanying this report would authorize the issuance of the 2011 bonds, or 2012 if issued in 2012, as well as approve the form of trust agreement pursuant to which such bonds will be issued and approve the Amended and Restated Contribution Agreement between the City and the FPRS.

The net amount required to fund the FPRS system at 85% of its Actuarial Accrued Liability was estimated at $59 million in March using the System's actuarial analysis for the period ending June 30, 2010. Based on the recently completed analysis for the period ending June 30, 2011 the revised figure is $46.6 million. . This improvement is the result of the Fire and Police Retirement System posting realized and unrealized investment gains of $17.5 million during fiscal year 2011.

The resolution authorizes the bonds to be issued at a fixed or variable rate, whichever is most advantageous to the City, with the final maturity not to exceed 30 years. If issued in variable rate form (based upon a LIBOR or other index), the maximum interest rate would not exceed 15% per annum. The recommended structure is a thirty year bond with a mandatory tender in five years, similar to the 1999 and 2004 pension obligation bonds. With the mandatory tender in five years, the true interest cost of the financing is estimated at approximately 3% versus an estimated 6.5% if issued at a fixed rate without a mandatory tender. This will save the City approximately $8.3 million in interest expense in the first five years.

The resolution authorizes the City Manager and/or the Director of Finance to initiate a validation action with respect to the bonds if determined to be appropriate or required by bond counsel, in consultation with the City Attorney.

The new bonds, when combined with the existing bonds and their anticipated future refinancing, will be structured in such a way that total annual direct General Fund debt service will not exceed $16.5 million, as detailed in the funding plan presented on March 28, 2011.

As directed by the City Council, and consistent with the recommendation of the FPRS Task Force, staff has negotiated changes to the 1999 Contribution Agreement with the Fire and Police Retirement System Board. The proposed amended and restated contribution agreement removes references to other retirement systems operating under the County Employees Retirement Law of 1937, to which the FPRS annual investment return and inflation assumptions were tied to. In place of the average of the '37 Act Systems, the proposed agreement sets the assumed investment return at 6% and inflation at 3% for the actuarial analysis for the period ending June 30, 2011. On a go-forward basis the agreement sets forth a process whereby the System's Board will, not less than annually, adopt investment return and inflation rate assumptions based on analysis performed by the System's Actuary and after seeking input from the City and the System's professional investment consultant.

The use of more conservative actuarial assumptions is prudent given the characteristics of the System and minimizes the volatility and the risk of creating future unfunded liabilities. This, however, does not eliminate market risk or inflation risk, and future significant declines in the equities market or significant increases in the inflation rate could potentially create future unfunded liabilities.

The balance of the proposed amended and restated contribution agreement sets forth the mechanics associated with the proposed bond issue and how the proceeds of the issue are to be provided to the System. All other terms and conditions of the 1999 Contribution Agreement, save for the reference to the '37 Act Systems, are unchanged and remain in effect. The terms of the 2004 Settlement and Release Agreement are also unchanged.

COUNCIL POLICY CONSIDERATION:

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

FISCAL IMPACT:

As discussed above the initial estimated amount required to fund the System at 85% of its Actuarial Accrued Liability was determined by the System's Actuary to be $59 million in March 2011 and was based on actuarial valuation of the System as of June 30, 2010. The current estimated funding amount, based on June 30, 2011 estimated actuarial valuation, is $46.6 million using an assumption of 6% for investment return and 3% for inflation. This more favorable result is due to the positive investment return on the portfolio in 2011. It is estimated, however, that the funding ratio of 85% as of June 2011 will drop to 80% by June 2012 using the new assumptions as agreed in the Contribution Agreement. This funding ratio is expected and anticipated if the FPRS's investment portfolio returns exactly 6% in FY2012 and the actual inflation measures at 3%.

The following will be the estimated sources and uses of funds of the proposed 2011 pension obligation bonds assuming an issuance of $47.325 million bonds.

Principal amount of bonds	$47,325,000
Premium/Original issue discount	-0-
Accrued interest	- 0-
TOTAL SOURCES	47,325,000
Deposit to FPRS System	46,600,000
Cost of issuance- All in	725,000
TOTAL USES	47,325,000

The annual debt service payment on the 2011 bonds is estimated at approximately $1.18 million per year until 2016 and an estimated $3.9 million thereafter assuming the 2011 pension bonds, to the extent not retired from the SB481 reserve balance, are refinanced at their respective tender or mandatory date at an assumed rate of 6.75%. It is estimated that debt service payments will be made from SB481 revenues and the SB481 reserve balance until fiscal year 2015, after which, the General Fund will service the debt in accordance to the Council approved funding plan. Funding for this action will be addressed by the utilization of existing budgeted appropriations in FY2012 operating budget of SB481 transfers to the pension bonds Debt Service Fund account 6807-902-951900. No additional indirect or support costs will be required.

Respectfully submitted,

ANDREW GREEN
Director of Finance
Department of Finance

Prepared by:

Vic Erganian
Deputy Director of Finance/City Treasurer

Approved by:

MICHAEL J. BECK
City Manager

Attachments:

1- Resolution
2- Preliminary Official Statement
3- Trust Agreement
4- Bond Purchase Agreement
5- Continuing Disclosure Report
6- March 28th staff report