Agenda Report

March 30, 2020

TO: Honorable Mayor and City Council
Pasadena Public Financing Authority

FROM: Director of Finance/PPFA Treasurer

SUBJECT: **ACTIONS RELATED TO THE CITY'S VARIABLE RATE OBLIGATIONS SERIES 2008A CONFERENCE CENTER BONDS AND SERIES 2000 PASEO COLORADO BONDS**

RECOMMENDATION:

It is recommended that the City Council:

1. Find that the proposed action is not a project subject to 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. Authorize the City Manager and the Director of Finance to execute any technical amendments to the tender obligation documentation related to the City's Series 2008A and 2000 variable rate demand obligations to permit the City to purchase and hold for investment purposes any tender obligations which cannot be remarketed, if such officer determines that the purchase of the tender obligations is prudent and will mitigate or minimize payments required to be paid by the City to the holders of such tender obligations or to any credit or liquidity provider for such tender obligations; and

3. Authorize an amendment to the City's investment policy, as required by Section 53601 of the Government Code, to permit the purchase of any such tender obligations even if such obligations have a stated maturity exceeding five years.

It is recommended that the Pasadena Public Financing Authority:

1. Authorize the Executive Director and Authority Treasurer to execute any technical amendments to the tender obligation documentation to permit the City to purchase and hold for investment purposes any tender obligations which cannot be remarketed, at the request of the City.

BACKGROUND:

In 2006, the City sold $162.64 million in Auction Rate Certificates of Participation (COPs) to finance the expansion of the Pasadena Conference Center (PCOC). The COPs were issued with an AAA municipal bond insurance policy.

As a result of the failure of the auction rate market in early 2008, the City's auction rate certificates were no longer generating the expected low financing cost, and the City was paying excessive interest rates on its securities. In April 2008, the City refunded its 2006B Auction Rate Securities by issuing its 2008A Variable Rate Demand Refunding Certificates of Participation. Variable rate demand bonds (VRDBs) are long-term bonds that carry a short-term interest rate that is reset every seven days. VRDBs have a seven day "put" feature and are backed by a liquidity facility and/or bank letter of credit (LOC). The current LOC from Bank of America expires on March 15, 2023. The City's VRDBs are mostly purchased by tax-exempt money market funds as well as some high, net worth individuals.

The recent COVID-19 health crisis caused severe turbulence in both stock and bond markets. In the last few days, a rush by investors and corporations to raise cash for fear of a prolonged economic downturn created a liquidity crisis. All short-term money market funds experienced significant cash outflows that necessitated the liquidation of short-term securities and caused an increase in interest rates on municipal taxable and tax-exempt variable rate securities. As an example, the rate on the City's 2008A variable rate bonds averaged 1% in the last several months, but last Wednesday March 18, 2020, the rate was reset at 5.77%.

This interest rate spike will increase the monthly amount of debt service PCOC has to pay. More critical is the fact that the lack of demand is causing failures in remarketing the bonds as investors are exercising their rights to put them back with the remarketing agents in order to receive the principal of their investments. The City has received information that there has been two outstanding tender notifications for a total amount $15,095,000 for the Conference Center bonds. The remarketing agent continues remarketing efforts and more will be known in the coming days and weeks. Should the remarketing agent fail to remarket the tendered bonds, there will be a draw on the letter of credit supporting the bonds and the bonds then become "Credit Facility Bonds" bearing higher rates with a shorter amortization period. This change will further increase the debt service amount PCOC has to pay to service the debt. The City has received no notification yet on remarketing failures on the Paseo Colorado bonds. In a worst-case scenario, should all the bonds get tendered and the remarketing agent fails to remarket them due to a prolonged liquidity crisis, the City will be exposed to $157,400,000 of Credit Facility bonds with a significant increase in debt service.

Because it is unknown how long this liquidity crisis will last, staff is taking proactive measures by recommending that the City Council authorize the City Manager and Director of Finance to amend the 2008A bond indenture and authorize Finance staff to purchase the City's variable rate bonds with stated maturities exceeding the investment policy's limitation of five years and hold them as an investment in the City's pooled portfolio. As a short-term strategy, this measure will allow the City to provide liquidity for its own variable rate bonds until the financial markets normalize or the City finds a more permanent solution. The Paseo Colorado bond Indenture was amended in 2009 as a result of a similar liquidity crisis. Finance staff has been proactive by increasing the City's liquidity and cash in anticipation of the potential for a deteriorating liquidity crisis.

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.

COUNCIL POLICY CONSIDERATION:

This action supports the City Council's strategic planning goal to maintain fiscal responsibility and stability.

FISCAL IMPACT:

If financial markets do not normalize in the near future and short-term rates on municipal variable rate bonds remain at the last weekly reset levels, the additional interest expense could amount to $535,000 per month to PCOC and approximately $88,000 to the Parking Fund. Staff's recommendation does not impact the increase in the short-term rates in the market, but is a proactive measure to mitigate the increase in interest cost and protect the City from further rise in its borrowing cost. The ability for the City to purchase its own bonds acts as an asset and liabilities management tool. As the City pays a higher rate on its short-term VRDBs, it will simultaneously earn the same rate on the portion of purchased VRDBs in its portfolio.

The second objective of the recommended action is to prevent remarketing failures by the City, providing its own liquidity to support its VRDB program. If most holders of the City's bonds tender them and the remarketing agent fails to remarket the bonds, then the Bond Trustee will draw on the supporting letter of credit to pay the investors and the cost to the City could get higher. The recommended actions prevents such occurrence.

Respectfully submitted,

MATTHEW E. HAWKESWORTH
Director of Finance/ PPFA Treasurer

Prepared by:

Vic Erganian
Deputy Director of Finance/
City Treasurer

Approved by:

STEVE MERMELL
City Manager/PPFA Executive Director