Agenda Report

October 28, 2024

TO: Honorable Mayor and City Council
Pasadena Public Financing Authority

THROUGH: Finance Committee

FROM: Department of Finance

SUBJECT: **JOINT ACTION OF THE CITY COUNCIL AND THE BOARD OF DIRECTORS OF THE PASADENA PUBLIC FINANCING AUTHORITY: ADOPT RESOLUTIONS APPROVING THE 2024A REFUNDING BUILD AMERICA 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. Adopt a resolution of the City Council of the City of Pasadena approving the issuance of Lease Revenue Refunding Bonds in an amount not to exceed $130,000,000, including the execution and delivery of a third amendment to amended and restated lease, a fourth amendment to amended and restated sublease, bond purchase agreement, continuing disclosure agreement, preliminary official statement and final official statement in connection therewith, and authorizing the taking of certain actions relating thereto.

It is recommended that the Pasadena Public Financing Authority:

1. Adopt a resolution of the Board of Directors of the Pasadena Public Financing Authority authorizing the issuance of lease revenue refunding bonds in an amount not to exceed $130,000,000 and the execution and delivery of a third

amendment to amended and restated lease, a fourth amendment to amended and restated sublease, bond indenture, bond purchase agreement, preliminary official statement and final official statement in connection therewith, and authorizing the taking of certain actions relating thereto.

BACKGROUND:

In 2010, the City issued four series of lease revenue bonds, Series 2010A through D (Rose Bowl Renovation Project) in the aggregate amount of $155,873,265.

The 2010 bonds were issued to finance the following improvements to the Rose Bowl Stadium:

- Public Safety
  - Widening of up to 12 tunnels at end zones
  - Added exit aisles and cross aisle at end zones
  - Field level exiting

- Concourse Improvements
  - Expansion from 2.5 square feet per person to 4.5 square feet per person
  - Increase restroom fixtures by 30%
  - New 17kV electrical system

- New Press Box and Premium Seating
  - Loge boxes
  - Club seating
  - Suites
  - Horizon Club Lounge
  - Updated Broadcasts and Control Facilities
  - New entry gates, scoreboard, and video board

The Series 2010B Lease Revenue Bonds were issued as Build America Bonds (BABs). BABs were issued as taxable fixed rate bonds whereby the United States Treasury rebates the issuer (the City) 35% of the interest portion due on the bonds semi-annually for the life of the bonds, therefore, reducing the taxable interest rate on the debt to an equivalent tax-exempt rate. The BABs issued by the City of Pasadena do not have an option to call the bonds at par but instead they have the option to call the bonds at a Make Whole call price or using an Extraordinary Optional Redemption provision (EOR). The EOR provision provides a more favorable formula for the City in determining the redemption premiums payable to bondholders when the bonds are called. Under the bond Indenture, an "Extraordinary Event" means an "event that occurs when a material adverse change has occurred with respect to the bonds and the cash subsidy from the United States Treasury is reduced or eliminated". As a legal matter, Bond Counsel agrees and has determined that the Extraordinary Optional Redemption right has been triggered through sequestration.

Since 2013, BABs subsidies have been sequestered and it was only more recently that securities law firms or bond counsel firms began providing legal opinions stating that the sequestration of the BABs subsidies are material, and therefore, the use of the EOR provision in the indenture can be utilized in calculating the redemption premiums to bondholders. The Internal Revenue Service (IRS) estimates that state and local governments issued over $181 billion in BABs and as of March 2024, Bloomberg data suggests that approximately $116 billion were still outstanding and more issuers of BABs are now in the process of refunding their bonds using the EOR provision. The following is the estimated impact of the sequestration that has resulted in lower payments to the City by approximately $2.01 million. The current federal sequestration rate is 5.7% through federal fiscal year ending September 30, 2030.

Estimated Impact of Sequestration (Reduced Subsidy Payments)

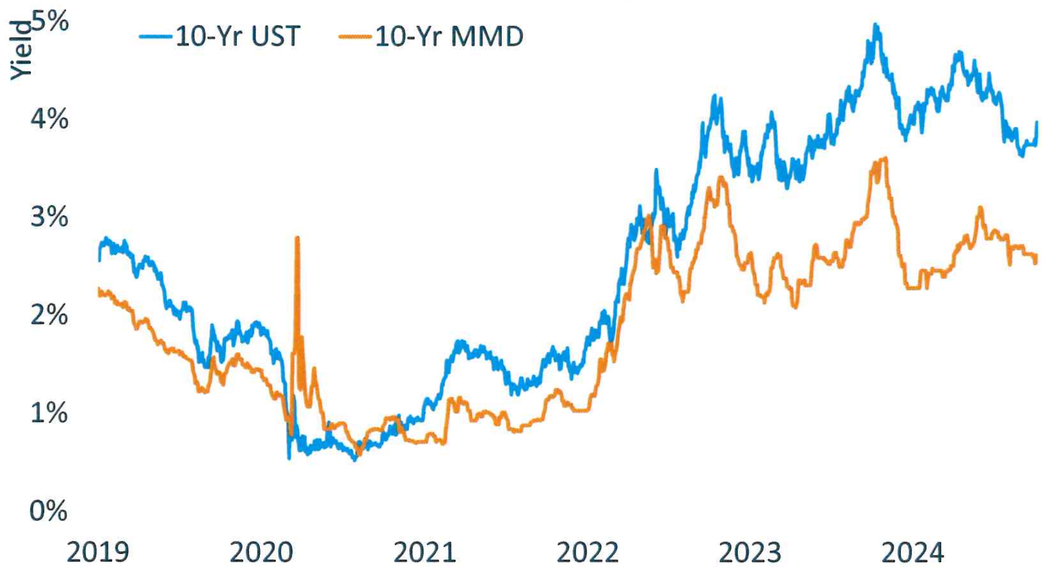
Fiscal Year	Annual Subsidy	Payments Net of Original 35% Subsidy	Payments Net of Revised Subsidy	Estimated Impact of Reduction
2011	35.0%	$1,346,448	$1,346,448	$0
2012	35.0%	4,946,136	4,946,136	0
2013	32.0%	4,946,136	5,061,989	(115,854)
2014	32.5%	4,946,136	5,157,868	(211,733)
2015	32.4%	4,946,136	5,139,225	(193,090)
2016	32.6%	4,946,136	5,133,898	(187,763)
2017	32.6%	4,946,136	5,128,572	(182,436)
2018	32.7%	4,946,136	5,125,909	(179,773)
2019	32.8%	4,946,136	5,116,587	(170,451)
2020	32.9%	4,946,136	5,107,265	(161,130)
2021	33.0%	4,946,136	5,100,607	(154,472)
2022	33.0%	4,946,136	5,097,944	(151,808)
2023	33.0%	4,946,136	5,097,944	(151,808)
2024	33.0%	4,946,136	5,097,944	(151,808)
	Totals	**$65,646,210**	**$67,658,336**	**($2,012,126)**

The risk of the Federal Government further reducing or eliminating the BABs cash subsidy in the future and materially increasing the cost of the BABs financing is real and this risk increases as the federal budget deficit grows. As of August 31, 2024, the Federal budget deficit has reached $1.9 trillion, larger than the Government's initial estimate. The current post subsidy interest rate paid on the BABs is 4.78%. If the cash subsidies are completely eliminated, the interest rate on the bonds will increase to 7.13%. This equates to a 2.35% interest rate increase on the bonds or an annual increase of $2.5 million in interest expense to the Rose Bowl Operating Company (RBOC).

<u>Economics of the Refunding</u>
There are two major factors that impact the refunding of the 2010 BABs. The first is the AAA Municipal Market Data (MMD) tax-exempt yield and the second is the United States taxable treasury yield. The economics of the refunding depends on the relationship of these two interest rate curves. As in any refinancing scenario, the lower the tax-exempt interest rate on the refunding bonds, the lower will be the borrowing cost.

On the other hand, calculating the redemption premium at the EOR provision requires the discounting of the remaining principal and interest on the BABs at the 10-year Treasury rate plus 1.00% (or 100 basis points), therefore the higher the Treasury rate, the lower will be the redemption premium. The ideal interest rate environment is when the spread or the gap between these two rates is at its largest. The below graph presents the recent relationship of these two rates.

10-Year AAA MMD and US Treasury Yields Since 2019



Source: Bloomberg, as of October 4, 2024.

The current interest rate environment where the gap between the tax-exempt rate curve and the treasury yield curve remains wide, which presents a more favorable environment to proceed with the BABs refunding.

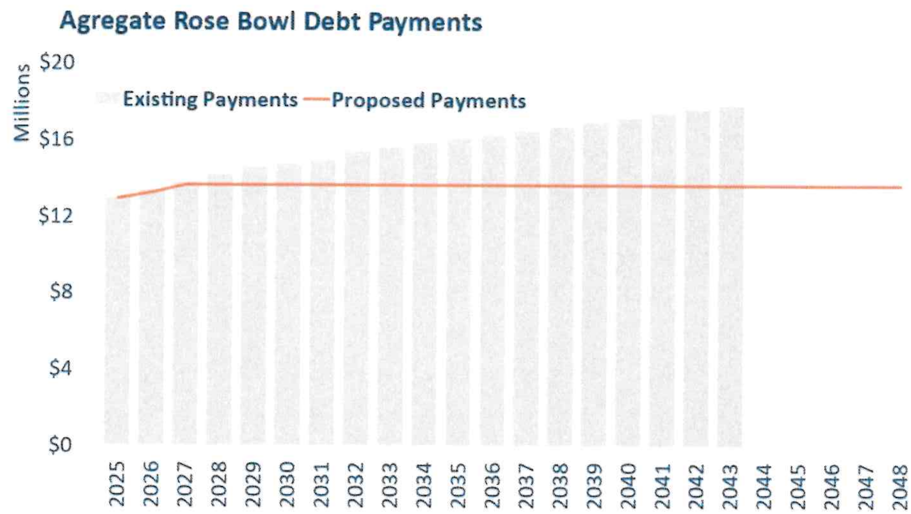
The Refunding Plan

After an extensive review and analysis of various refunding structures and after consultation with the RBOC staff and the RBOC Finance Committee, it is the City Finance staff's recommendation to restructure and refund the BABs at a proposed aggregate annual level debt service amount of $13.7 million across all RBOC related bonds by extending the term of the bonds by five years from Fiscal Year (FY) 2043 to FY 2048. This structure is recommended based on the following objectives:

1. Eliminate exposure to future BABs subsidy sequestration. Further sequestration of the subsidy or the potential elimination of the subsidy poses material financial risk to the City up to $2.5 million of additional annual interest cost to the RBOC. The proposed refunding structure will eliminate this risk.

2. Incorporate future optionality for refunding by issuing traditional tax-exempt bonds with a conventional 10-year par call. Incorporating in the structure the ability to refund the bonds in 2034 could potentially generate millions of future net present value savings and creates the opportunity in subsequent years for the City and RBOC to put funds towards needed capital and preventive maintenance projects for the 100+ year old facility.

3. Restructure and create level annual debt service payments to create future budgetary cash flow capacity for capital investments in the Rose Bowl. It is estimated that the RBOC could realize over $12 million in cumulative cash flow savings during the first 10 years and an estimated $40 million cumulative savings during the first 19 years of the refunding; however, overall payments are estimated to be $28.8 million higher due to the extension of the debt by five years (Exhibit A), assuming they are not refunded in 10 years.



4. Eliminate the annual increase in debt service payments (approximately $400,000 per year through 2032) that would likely require the RBOC to be even more aggressive with event bookings and ancillary revenue generation over those years.

One of the restructuring strategies is the release of the full amount in the existing 2010 parity reserve fund (approx. $11.6 million) to pay down current outstanding BABs. The City will then fund/pledge the required reserve requirement for the unrefunded 2010A Capital Appreciation Bonds and the Series 2010D (Taxable - Recovery Zone Economic Development Bonds) in the aggregate amount of $6.3 million. This will result in a reduction in the estimated annual debt service payments by an average $270,000. The pledged funds will come from the City's pooled investment portfolio, and any investment income will be returned to the portfolio. Therefore, the RBOC will realize annual savings by using the existing reserve fund, and the City's investment pool will receive investment income. This will be the first time the City has utilized this type of reserve structure, which has been vetted by Bond Counsel as allowable. Once the bonds are paid in full, the reserve amount will be returned to the City's pooled investment portfolio.

The necessary documents (Third Amendment to Amended and Restated Lease, Fourth Amendment to Amended and Restated Sublease, a Purchase Agreement, a bond indenture, a bond purchase agreement, a Preliminary Official Statement, a Continuing Disclosure Agreement) in connection with the issuance of the Lease Revenue Refunding Bonds, Series 2024A, are provided in substantially final form. Bond Counsel has prepared the attached resolutions authorizing the sale and issuance of the Lease Revenue Refunding Bonds, Series 2024A (the "2024A Bonds") to refinance the 2010B Build America Bonds. The resolutions require action by the City Council and the Pasadena Public Financing Authority to approve the issuance of the 2024A bonds in an aggregate principal amount of not to exceed $130,000,000. The resolutions authorize the execution and delivery by the City and the Authority of the necessary financing documents and certificates and related actions, including the distribution of the Official Statement in connection with the offering and sale of the 2024A Bonds.

The proposed resolution authorizing the issuance of the 2024A Bonds requests the City Council confirm the selections of Orrick, Herrington and Sutcliffe as Bond Counsel, Norton Rose Fulbright US LLP as Disclosure Counsel, KNN Public Finance, LLC as Municipal Advisor, and Stifel, Nicolaus & Co. as underwriter, and U.S Bank Global Corporate Trust as Trustee. Per the City's Debt Policy, the Finance Director is authorized to select the financing team with final confirmation through the resolution.

Following City Council and Authority Board adoption of the resolutions, closing is tentatively scheduled for mid to late November 2024 wherein the 2024A Bond proceeds would be used to pay off the outstanding Build America Bonds and pay the related costs of issuance.

This item was presented to the RBOC Finance Committee on September 25, 2024. The RBOC Finance Committee fully supported this action and strongly recommended City's Finance staff's recommendation of this particular restructuring and refunding option.

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:

Revenues available for debt service come from six primary sources derived from the Rose Bowl Stadium: Premium Seating revenues, advertising/sponsorships, ticket & parking surcharges, concessions, licensee events including soccer matches and concerts, and miscellaneous revenues from meetings, banquets, and other minor events. In a typical year, these revenue streams net between $17.5 to $20.7 million and are projected to net between $24.3 and $27.2 million per year going forward.

Although the debt service payments are paid substantially from operating revenues derived from the Rose Bowl Stadium, the City's General Fund is ultimately responsible for securing the 2024A Bonds.

There are currently $106.6 million in BABs outstanding with a weighted average taxable interest rate of 7.13% and current post subsidy cost of 4.78%. Based on today's interest rates, the City can refund the BABs at an estimated True Interest Cost (TIC) of 3.92% with an estimated redemption premium of $19,990,613.

The purpose and objective of the recommended refunding is to eliminate the sequestration risk, provide the ability to refinance in 2034, level the annual debt service payments, and provide annual funding until 2043 to enable the RBOC to invest in the capital improvements and preventive maintenance of the facility. The proposed current refunding does not generate any economic savings. Extending the term on the bonds by five years creates $4.4 million present value dis-savings and when added to the $11.6 million reserve fund amount applied to pay-off the BABs, the refunding generates negative $16 million net present value savings or -15% of par value refunded (Exhibit B). On the other hand, a potential future refunding in 2034 could generate net present value savings ranging from $4.5 to $20.7 million (Exhibit C).

The following represents the estimated sources and uses of funds:

Sources of Funds	
Par Amount	$107,058,848
Premium	10,433,727
Reserve Fund	11,646,347
Total Sources	$129,138,922

Uses of Funds	
Escrow Deposit	$128,320,462
Cost of Insurance	550,813
Underwriter's Disc.	267,647
Total Uses	$129,138,922

All costs associated with the refunding will be incorporated and paid by the bond proceeds of the 2024A Bonds. Funds are appropriated in RBOC's FY 2025 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,

MATTHEW E. HAWKESWORTH
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PPFA Treasurer

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Approved by:

MIGUEL MÁRQUEZ
City Manager
PPFA Executive Director

Attachments:(9)

Attachment A - Exhibit A
Attachment B - Exhibit B
Attachment C - Exhibit C
Attachment D - Third Amendment to Amended and Restated Lease
Attachment E - Fourth Amendment to Amended and Restate Sublease
Attachment F - Bond Purchase Agreement
Attachment G - Disclosure Dissemination Agent Agreement
Attachment H - Preliminary Official Statement
Attachment I - Bond Indenture