Finance Committee

City of Arts & Innovation

TO: FINANCE COMMITTEE MEMBERS **DATE: FEBRUARY 8, 2017**

FROM: FINANCE DEPARTMENT **WARDS: ALL**

SUBJECT: ALTERNATIVES FOR REFINANCING THE CITY'S CURRENT PENSION OBLIGATION BONDS (POBs)

ISSUE:

The Finance Committee requested an analysis on refunding options related to the City's current outstanding Pension Obligation Bonds (POBs), and specifically the $31.2 million 2008 Pension Obligation Bonds Anticipation Notes (BANs).

RECOMMENDATIONS:

That the Finance Committee:

1. Review this Report;
2. Direct staff to work with the Budget Engagement Commission to further review the refunding options, and in particular Alternative 2 recommended by staff, using Measure Z funds as the payment source; and,
3. Direct the Chief Financial Officer or designee to develop a POB debt refinancing plan upon input from the Budget Engagement Commission and present such plan to the City Council for final approval as part of the Measure Z five-year spending plan.

BACKGROUND:

The City of Riverside has two retirement accounts with California Public Employee's Retirement System (CalPERS) established in the 1940's, one for Public Safety Employees and one for Miscellaneous Employees. Each year, CalPERS sends a report to their member agencies on the status of their retirement plans indicting what percentage the plans are funded and then unfunded. The percentage called unfunded becomes an "unfunded liability" in the financial statements of each agency, per Government Accounting Standards Board (GASB) Pronouncements 68 and 74.

In 2004 and 2005, the City made a decision to issue taxable Pension Obligation Bonds (POBs) to prefund 100% the unfunded CalPERS liability, instead of continuing to fund it annually. On 6/29/2004, $89,540,000 of fixed rate POBs were issued for public safety employee obligations, and on 6/30/2005, an additional $60,000,000 in POBs were sold split into two Series, an A series for RPU employees and a B series that was used for all other non-sworn general fund employees. The A Series portion of the 2005 POBs were financed using a fixed rate series and the B Series POB's were financed using Auction Rates Securities, a less conservative variable rate debt instrument, with principal "balloon payments" in the final 5 years of its 20 year term. In February

2008, the Auction Rate Securities market failed as a result of the broader financial crisis occurring at that time further exasperated by the bankruptcy of AIG and Lehman Brothers. This required a quick refund of this Series B securities into BANs, which are short term interest only debt instruments that the City has renewed on an annual basis at the prevailing interest rate at the time of refinancing.

These BANs have been issued as interest only one-year notes, which are renewed each year prior to maturity, with no principal payments made on these notes. In October of 2016, the Finance Committee asked staff to report back to the Committee on alternatives for either paying off the BANs and/or refinancing these BANs into a more traditional debt instrument that pays both principal and interest. In addition, the Finance Committee asked about other options involving the 2004 POB and the 2005 POB Series B and options for refinancing them as well.

<u>DISCUSSION:</u>

As discussed in the Background Section, the City issued three technically separate series of Pension Obligation Bonds (POBs):

- **$89.54 million financed by the California Communities Fixed Rate POBs, 2004 Series A-1 (2004 POBs) as a pool with other municipalities and water agencies**
  - Financed safety employee pension liabilities in a pooled program with six other jurisdictions.
  - $56.6 million remain outstanding (as of January 2017) with a final maturity on June 1, 2023.
  - Interest rates are fixed and range from 5.896% to 6.076%.
  - Bonds are subject to a “make-whole” call provision which **makes it prohibitively expensive to refinance** (the make-whole call provision would cost the City and additional approx.$10,343,570 plus the current outstanding debt to “make whole” the bond).

- **$30 million City of Riverside Fixed Rate POBs, 2005 Series A (2005A POBs)**
  - Financed miscellaneous RPU employee pension liabilities.
  - $13.3 million remain outstanding (as of January 2017) with a final maturity on June 1, 2020
  - Interest rate is fixed at 4.78%.
  - Bonds are non-callable (**cannot be refinanced** per the terms of the original bond).

- **$30 million City of Riverside Variable Rate POBs, 2005 Series B (2005B POBs)**
  - The City issued its $30 million POBs, 2005 Series B as auction rate securities (ARS) with interest only payments for the first 15 years of the term until 2020 and then five “balloon” principal payments to pay the bonds off from 2020 to 2025.
  - Financed miscellaneous General Fund employee pension liabilities.
  - This issuance was done in combination with the 2005A POBs through a common plan of finance to equal each year’s annual debt service through 2025.
  - Initial interest rate was 3.41%, (as of August 2005) but was subject to change every 28 days – the term of the Auction Rate Period.

  <u>The 2005 Series B Variable Rate POBs were then refinanced in 2008 due to the downfall of the Auction Rate market, causing up to legally allowed 12% interest rates paid by the City, thus the City issued one-year interest only Bond Anticipation Notes BANs) to refund/replace the 2005 Series B auction rate securities to:</u>

- **$31 million City of Riverside Pension Refunding Bond Anticipation Notes, 2008-2016 (currently 2016 BANs)**
  - The BANs have been “rolled” annually since 2008 with annually adjusted interest rates.

- There is approximately $31.1 million remaining outstanding (as of January 2017) of the 2016 BANs (the old Series B Bonds) with an annual maturity date set for June 1.
- The one-year interest rate of 0.98% was set on May 12, 2016 for this year's BAN and will expire on May 31, 2017.
- While the 2016 BANs are non-callable during the year, **their one-year maturity requires that they be rolled, paid off or restructured at or prior to maturity.**
- City pays interest-only on these BANs and no principal is paid.

A summary of the terms for each POB transaction is below:

Issuer	Series	Date	Original Amount	Outstanding Amount	Maturity	Interest Rate	Prepayment Provision	Pension Plan
California Communities	2004 Series A-1	6/29/04	$89,540,000	$56,600,000	6/1/23	5.90%	Make Whole Call	Safety
City of Riverside	2005 Series A	6/30/05	$30,000,000	$13,255,000	6/1/20	4.78%	Non-Callable	RPU Misc.
City of Riverside	2016 Series B	5/26/16	$31,145,000	$31,145,000	6/1/17*	0.98%*	Non-Callable	GF Misc.

* The 2016 Series B transaction must be rolled or restructured/refinanced prior to its maturity on 6/1/17 with a new interest rate and a one-year term/maturity

REFINANCING OPTIONS

The City has the following options regarding refinancing the various Pension Obligation Bonds in their various forms as illustrated below:

2004 POBs	2005A POBs	2016 BANs
Do Nothing -- Refinance not possible due to Make Whole Call Provision and Cost	Unable to Prepay	Continue One-Year BANs 5 or 10 year refinance Roll Bans with Prcnpl Paydowns Pay Retire Debt

Using current rates, staff analyzed each refinancing option:

- **$89.54M 2004 Series A-1 POBs -** Refinancing the 2004 POBs is prohibitively expensive and **not recommended**. Using December 2016 interest rates, a refinancing would result in a $4.24 million loss in today's dollars (-7.49% of the bonds refunded). The negative savings is driven primarily by the $10.3 million make whole call premium the City would be required to pay.

- **$30M 2005 Series A POBs -** Refinancing the 2005 Series A POB is **prohibited** by the current bond restrictions and so no option is available with these bonds.

- **$31.2M 2016 BANs (old $30M 2005 Series B POBs) -** There are four main alternatives in refinancing the rolling 2016 BANs which the Committee and Council may consider. Due to the restrictions in refinancing the other two Pension Obligation Bonds, the 2016 BAN refinancing would have to stand on its own. The four main alternatives are:

1. **Alternative 1 - 2017 BAN:** Keep rolling the POB BAN in 2017, which would result in an interest-only payment of approximately $648,000 for the year, assuming current interest rates. The exact rate would be subject to market fluctuations until the closing date. This alternative would necessitate a plan to pay off the principal with the original funding approach of five principal balloon payments starting in FY 2020 and ending FY 2025. Staff does not anticipate that funding will be available to pay down the $32 million principal in 2020-2025, due to increasing CalPERS rates in those years. Therefore, this option is not viable and **not recommended**.

2. **Alternative 2 – Refinance 2016 BANS into a 2017 POB Five to Ten Year POB Debt Instrument:** Refinancing the rolling 2016 BANS into either a Shorter Term Bond Instrument, a Shorter Term Bank Loan or other fixed debt instrument thus paying principal and interest for 5-10 years and extinguishing the debt between FY 2022 and FY 2027. While staff would like to retire this debt as quickly as possible (5 Years) the Measure Z recommendations indicate a 10 year retirement by spreading the monies from several years over 10 years. This is the option **recommended by staff**, and reflected in the Measure Z recommended plan presented to the City Council on January 31.

3. **Alternative 3 – Continue rolling BANS but include large principal payments as well:** The City may continue the annual BAN rollovers up to a final maturity of 2020, but also pay a significant principal payment of approximately $11 million in each of the next three years. This option is not available due to the other demands on Measure Z funds and, therefore, **not recommended** by staff.

4. **Alternative 4 – Accelerated Debt Service:** The City may also choose to accelerate payment of this obligation by paying the entire debt in June 2018.This would require rolling the debt with an additional BAN year until June 2018 and accruing additional interest payments for the FY 2017-18. This option is even less affordable than Alternative 3 and, therefore, **not recommended** by staff.

As stated above, staff recommends the 10 Year Refinancing Plan in Alternative 2, which is reflected in the Measure Z spending plan. This allows for the 2016 BANs to be refinanced into a more traditional shorter term note, and retiring the debt in 2027.

FISCAL IMPACT:

Since the 2004 POB's and the 2005 Series A POBs cannot be refinanced, their original funding sources, the General Fund for the 2004 POB and the Water and Electric Funds for the 2005 Series A POB will continue to be used, with both Bonds retired by 2023. If the Finance Committee and the City Council approve staff's Alternative #2 for the 2016 BANs, Measure Z funds would be used to pay debt service on a 10-year short term debt instrument.

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Attachment: Presentation