Finance Department

AGENDA REPORT

DATE:	June 7, 2022
TO:	Mayor Butt and Members of the City Council
FROM:	Anil Comelo, Interim Deputy City Manager Delmy Cuellar, Interim Director of Finance
Subject:	Receive Update on the Refinancing of the Pension Obligation Bonds (POBs)
FINANCIAL IMPACT:	None
PREVIOUS COUNCIL ACTION:	April 6, 2021; October 5, 2021; December 7, 2021
STATEMENT OF THE ISSUE:	On April 26th, the City Council gave direction to City staff to proceed with the refinancing of the 2005 Pension Obligation Bonds (2005 POBs). City staff and the finance team will update City Council on the proposed schedule and mechanics of both the refinancing bonds and the existing interest rate swap agreement
RECOMMENDED ACTION:	RECEIVE update on the refinancing of the 2005 POBs – Finance Department (Anil Comelo/Delmy Cuellar 510-620-6600). **This item was continued from the May 24, 2022, meeting.**

DISCUSSION:

The City currently has the following outstanding two series of 2005 POBs: (i) an approximately $18 million principal amount series maturing in 2023 (the "B-1 Bonds"), and (ii) an approximately $130 million principal amount series maturing in 2034 (the "B-2 Bonds"). The City needs to refinance the $130 million series. The City is also party to two interest rate swaps (the “Swaps”) associated with the 2005 Bonds. However, the swap for the B-2 Bonds (the “B-2 Swap”) is subject to mandatory early termination on August 1, 2023, before which time the City will need to either (a) arrange financing to pay the market value of the B-2 Swap upon such early termination or (b) amend the B-2 Swap to remove, reduce, or delay the mandatory early termination. City staff is clear that the goal is to refinance the POBs with minimal cost and risk (recognizing that there is an inverse relationship between cost and risk). City staff will be seeking to provide the City Council with any private placement offers from banks and other qualified purchasers. Additionally, the City Council will likely also be provided with the option to direct City staff to seek conventional financing as publicly offered municipal bonds.

The City's finance team has determined that the termination payment for the B-2 Swap decreases as interest rates decline, and increases as interest rates increase. While the recent increase in interest rates has driven up the cost of projected annual debt service on the proposed refinancing of the 2005 POB's, the estimated termination payment has declined. On October 5, 2021, the City Council was told that the termination payment was approximately $36 million. It now appears to be around $22 million due to increases in interest rates. However, again, this decrease in potential cost to the City has been matched by a potential increase in annual debt service costs. Consequently, this means that while the termination payment has declined significantly since the October 5, 2021 City Council presentation, the City's overall costs for the 2005 POBs remains about the same.

Debt service on the 2005 POB's was secured by appropriations from the general fund and paid by the following revenue sources:

- Revenues from the City's pension tax override ("PTO") ad valorem tax levy of 0.14 percent of assessed valuation
- All other legally available General Fund revenues

The PTO revenue is not directly pledged to the 2005 POB's, but is instead defined as being legally available to pay up to 86 percent of the annual debt service costs. This 86 percent limitation reflects a 2003 State Appellate Court decision. The Court ruled that the City of Huntington Beach could only use its own pension tax override revenues to pay for CalPERS costs related to employee benefits in place prior to July 1, 1978, the date that Proposition 13 went into effect. Consequently, the annual costs of new employee benefits added after July 1, 1978, cannot be paid for using pension tax override revenues. The City of Huntington Beach chose not to appeal that decision to the State Supreme Court, and the decision has been precedential since then. In 2005, the City's consultant, Bartel Associates, calculated that about 86 percent of debt service on the 2005 POB's could be paid from pension tax override revenues. This calculation will be updated for the purposes of refinancing the 2005 POBs this year.

At present, the City's CalPERS expenses eligible to be paid from PTO revenues under the Huntington Beach decision significantly exceed the approximately $24 million per year in annual PTO revenue. However, it is possible that eligible annual CalPERS expenses may decline to below annual PTO revenue in about 15 years when the CalPERS mandated amortization of the City's unfunded actuarial liability may be completed. Consequently, City staff and the finance team are considering ways to use the refinancing of the 2005 POBs to protect the City's ability to levy the PTO in full in the future. One possibility in this regard is to provide a direct pledge of the PTO revenues to the proposed 2022 refinancing, as opposed to just making the PTO revenues legally available.

A proposed schedule for the refinancing of the 2005 POBs is attached. Due to the complexity of the transaction, the schedule is divided into four tracks: (1) PTO revenue management, (2) Interest rate swap termination fee calculations and process, (3) Bank placement, and (4) Public offering.

All four tracks need to proceed concurrently. We need to determine how best to comply with the Huntington Beach decision and protect the PTO revenues, as well as come to a negotiated solution with RBC on the swap before we sell the refinancing bonds. With respect to the refinancing, we need to proceed concurrently with both a bank placement and a public offering until we know which approach is best for the City.

The attached schedule, prepared in coordination with NHA Advisors, outlines proposed City Council actions and updates at City Council meetings throughout the months of June and July 2022. Resolution of the PTO revenues question and whether to do a bank placement all need to take place by the end of June 2022. Resolution of the interest rate swap termination payment needs to take place by late July 2022. City Council action at the last meeting in July 2022 will then be to approve the final bond refinancing structure.

DOCUMENTS ATTACHED:

Attachment 1 – Proposed schedule for refinancing of 2005 POBs