2022 POB Restructuring - PTO Actuarial Analysis Update and Preliminary Restructuring Options Review

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NOTE: Restructuring analysis is preliminary; continues to be reviewed and updated by municipal advisor, underwriters and actuary

Why Your Finance Team Recommends Consideration of Extending the Term of the 2005 POB Refinancing

- Since 2005, after the 2005 POBs fully funded the City's Unfunded Actuarial Liability ("UAL") with CalPERS, the City's CalPERS' UAL has grown to an estimated $380 million
- This UAL increase has placed an est. $20 million+ annual burden on the City (primarily General Fund) over and above the revenue generated by the City's Pension Tax Override (PTO) levy
- The City also faces an estimated $20 million automatic termination of the 2016 RBC swap on 8/1/23
- Extending the term of the 2005 POBs through a refinancing presents the opportunity to better align the City's future pension costs with its PTO revenues
  - Provides significant annual pension cost reduction to the General Fund over the next 12 years

Imminent Risks Facing the City

- The 2005 B-2 POBs are currently accreting but will convert to variable rate Index Bonds on 8/1/23
- LIBOR, the underlying variable rate index for the 2005 POBs, will expire 6/30/23
- The Accreted Value of the 2005 B-2 POBs at Conversion will be approximately $128 million, which is $86 million greater than the initial principal amount of $41 million
- The City faces a currently estimated $20 million Automatic Termination Payment to RBC on 8/1/23

Background on the City's Debt with CalPERS

- The City's CalPERS Unfunded Actuarial Liability (UAL) is the City's largest debt obligation
  - Represents the shortfall in the City's account with CalPERS needed to fully fund its employees' future retirement benefits
- CalPERS annual UAL amortization payments are now about $26 million, and are currently estimated to escalate to $42 million by FY 2031
  - For comparison, debt service on the 2005 POBs is currently about $12 million per year

Est. Balances as of July 1, 2022	
1999 POBs	$3 Million
2005B-1 POBs	$18 Million
2005B-2 POBs*	$128 Million
2016 Swap	$20 Million
CalPERS UAL**	$380 Million
OPEB UAL	$90 Million
Lease Bonds/COPs	$94 Million
Total	**$733 Million**

**8/1/23 full accreted value*

*** Assumes -5% investment returns for FY 2022*

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Actuarial Analysis for Pension Tax Override (PTO)

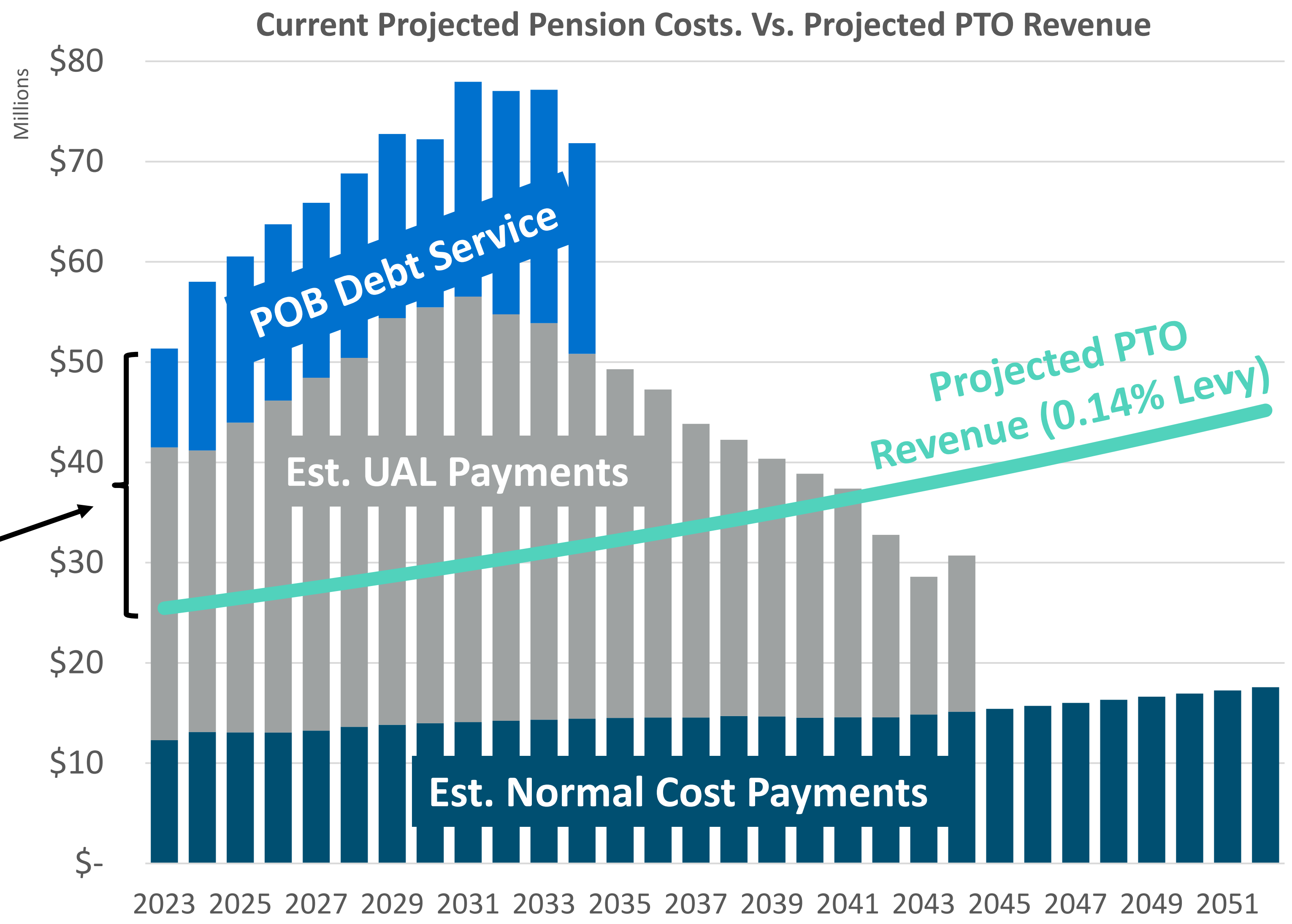
Budgetary Challenge for General Fund

- Bartel and Associates conducted a comprehensive actuarial study of the share of the City's pension costs that can legally be paid by the City's PTO (study attached to Staff Report)
- **The Challenge: $42 million of current annual pension costs (growing to $50M by FY 2025 and $60M by FY 2029) that could legally be paid for by PTO revenues**
  - However, only $24 million of PTO revenue is being collected; this means that the City (primarily the General Fund) is paying for $20 million+ of pension costs that otherwise could be paid for by the PTO
- The Finance Team has been analyzing tailored POB restructuring options (in concert with the City's other pension expenses) with the goal of <u>reducing the burden on City's General Fund</u>

What This Means for the 2005 POBs

The City's CalPERS Debt is "Fixed," But its POBs Can Be "Reshaped"

- The combined cost of annual payments on the UAL, Normal Cost and 2005 POB debt service is currently about $50M
  - Grows to between $60-$70 million over the next 5 years
  - Expenses paid from non-PTO General Fund revenues (amount above teal line) projected to <u>grow from $25M million to $48 million</u>



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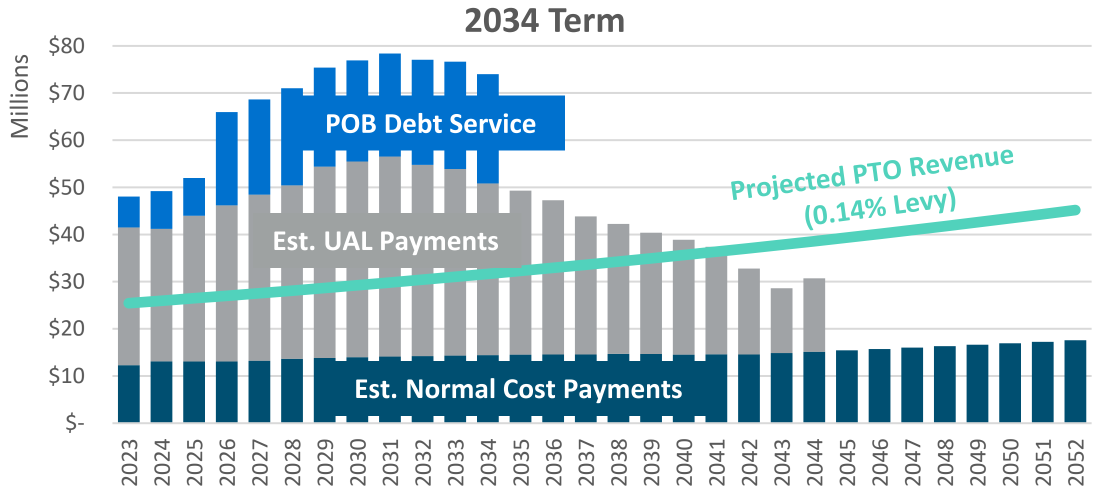
Restructuring the 2005 POBs

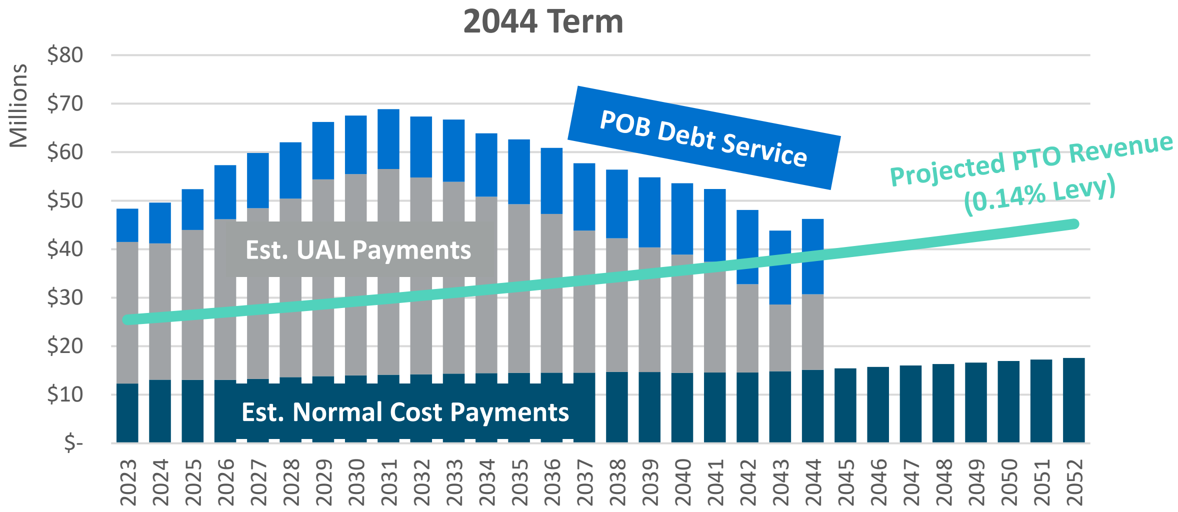
Macro Policy Goals

- Consistent with the Council's 6/21/22 action, the Finance Team's developing Plan of Finance is intended to achieve:
  - Refinancing the 2005 B-1 and B-2 POBs
  - Terminating the 2016 Swap (funded through 2022 POB issuance)
  - Defeasing the 1999 POBs
  - A simple/conventional fixed rate semi-annual debt service structure that will be easy to administer
- To better align the City's aggregate pension expenses with projected PTO revenues, the Finance Team has evaluated three preliminary restructuring options
  - (1) No extension from the existing 2034 maturity; (2) 10-year extension; (3) Extension to 2052

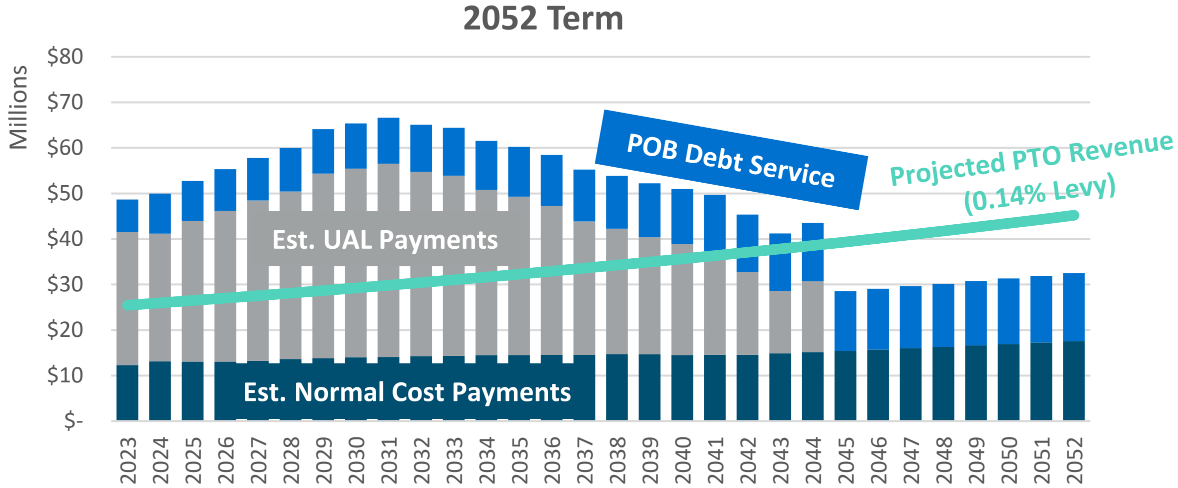
2005 POB Restructuring Options

Visual Depiction of “Re-Shaping”





- Reshaping POB debt service (shown in royal blue bars) through term extension allows the City to more efficiently utilize PTO revenues and reduce burden on General Fund through FY 2034
- Helps to “smooth” pension costs payable by City; enhancing budget predictability & fiscal sustainability



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Note: All options assumes interest-only 2023-2025; 1st principal maturing January 1, 2026 with debt service modestly ascending at 2% annually thereafter

The Whole Picture: Status Quo vs. Potential Restructured Payments

Projected Pension Expenses Paid by the City/General Fund (not covered by PTO)

- **Status Quo:** City payments growing from $31M (2024) to $48M
- **2034 Term:** City payments reduced to $23M (2024) and grow to $49M
- **2044 Term:** City payments reduced to $24M (2024) and grow to $39M
- **2052 Term:** City payments reduced to $24M (2024) and grow to $37M

	Current (Status Quo)	2034 Term (No Extension)		2044 Term		2052 Term	
1-Aug	City Payments Not Covered by PTO	City Payments Not Covered by PTO	Cash Flow Benefit	City Payments Not Covered by PTO	Cash Flow Benefit	City Payments Not Covered by PTO	Cash Flow Benefit
2023	$25,211,587	$22,582,260	$2,629,326	$22,893,532	$2,318,054	$23,204,356	$2,007,230
2024	31,489,986	23,256,457	8,233,529	23,638,907	7,851,079	24,020,807	7,469,179
2025	33,606,558	25,520,751	8,085,807	25,903,201	7,703,357	26,285,101	7,321,457
2026	36,391,420	38,957,567	(2,566,147)	30,324,417	6,067,003	28,318,354	8,073,066
2027	38,090,318	41,092,244	(3,001,926)	32,289,863	5,800,455	30,247,419	7,842,899
2028	40,552,960	42,926,849	(2,373,889)	33,945,324	6,607,636	31,860,987	8,691,973
2029	44,020,988	46,736,509	(2,715,521)	37,573,091	6,447,897	35,446,997	8,573,991
2030	43,004,266	47,673,472	(4,669,207)	38,327,434	4,676,831	36,160,222	6,844,043
2031	48,140,734	48,573,835	(433,101)	39,041,610	9,099,124	36,829,560	11,311,174
2032	46,624,234	46,653,202	(28,968)	36,928,634	9,695,600	34,673,665	11,950,569
2033	46,143,324	45,617,654	525,670	35,697,123	10,446,201	33,396,786	12,746,538
2034	40,191,152	42,375,504	(2,184,352)	32,262,792	7,928,360	29,915,404	10,275,748
2035	17,014,672	17,014,672	0	30,353,610	(13,338,938)	27,963,116	(10,948,444)
2036	14,347,606	14,347,606	0	27,952,956	(13,605,350)	25,514,062	(11,166,456)
2037	10,263,914	10,263,914	0	24,141,214	(13,877,300)	21,654,520	(11,390,606)
2038	8,006,921	8,006,921	0	22,164,096	(14,157,175)	19,626,090	(11,619,169)
2039	5,432,819	5,432,819	0	19,875,044	(14,442,225)	17,283,238	(11,850,419)
2040	3,553,433	3,553,433	(0)	17,971,532	(14,418,099)	15,329,320	(11,775,887)
2041	3,118,373	3,118,373	(0)	16,065,866	(12,947,493)	13,372,516	(10,254,143)
2042	2,284,100	2,284,100	0	11,023,330	(8,739,230)	8,274,255	(5,990,155)
2043	1,716,180	1,716,180	0	6,025,284	(4,309,104)	4,907,033	(3,190,853)
2044	1,883,970	1,883,970	0	7,661,484	(5,777,514)	5,135,825	(3,251,855)
2045	0	0	0	0	0	3,313,156	(3,313,156)
2046	0	0	0	0	0	3,374,177	(3,374,177)
2047	0	0	0	0	0	3,438,017	(3,438,017)
2048	0	0	0	0	0	3,501,422	(3,501,422)
2049	0	0	0	0	0	3,567,420	(3,567,420)
2050	0	0	0	0	0	3,632,686	(3,632,686)
2051	0	0	0	0	0	3,700,174	(3,700,174)
2052	0	0	0	0	0	3,767,712	(3,767,712)
Total Est. City Payments Not Covered by PTO	**$541,089,515**	**$539,588,293**		**$572,060,344**		**$557,714,397**	
Est. Total Cash Flow Benefit / (Cost) to City (2)			**$1,501,222**		**($30,970,829)**		**($16,624,882)**
Present Value of Cash Flow Benefit (3)			**$4,549,840**		**$11,308,888**		**$26,571,017**
Est. Cash Flow Benefit from 2023 to 2034			**$1,501,222**		**$84,641,598**		**$103,107,868**
Added Debt Service from Term Extension					*$62,129,388*		*$129,843,062*

(1) Benefit calculation accounts for added debt service from term extension; Cash flow benefit is positive given that a significantly larger portion of debt service is paid for by PTO under term extension scenarios instead of the City's General Fund

(2) PV uses bond interest rate as discount factor

(3) Assumes interest-only 2023-2025; 1st principal maturing January 1, 2026 with debt service modestly ascending at 2% annually thereafter

(4) Assumes fiscal year PTO revenue receipts fund bond year debt service payments

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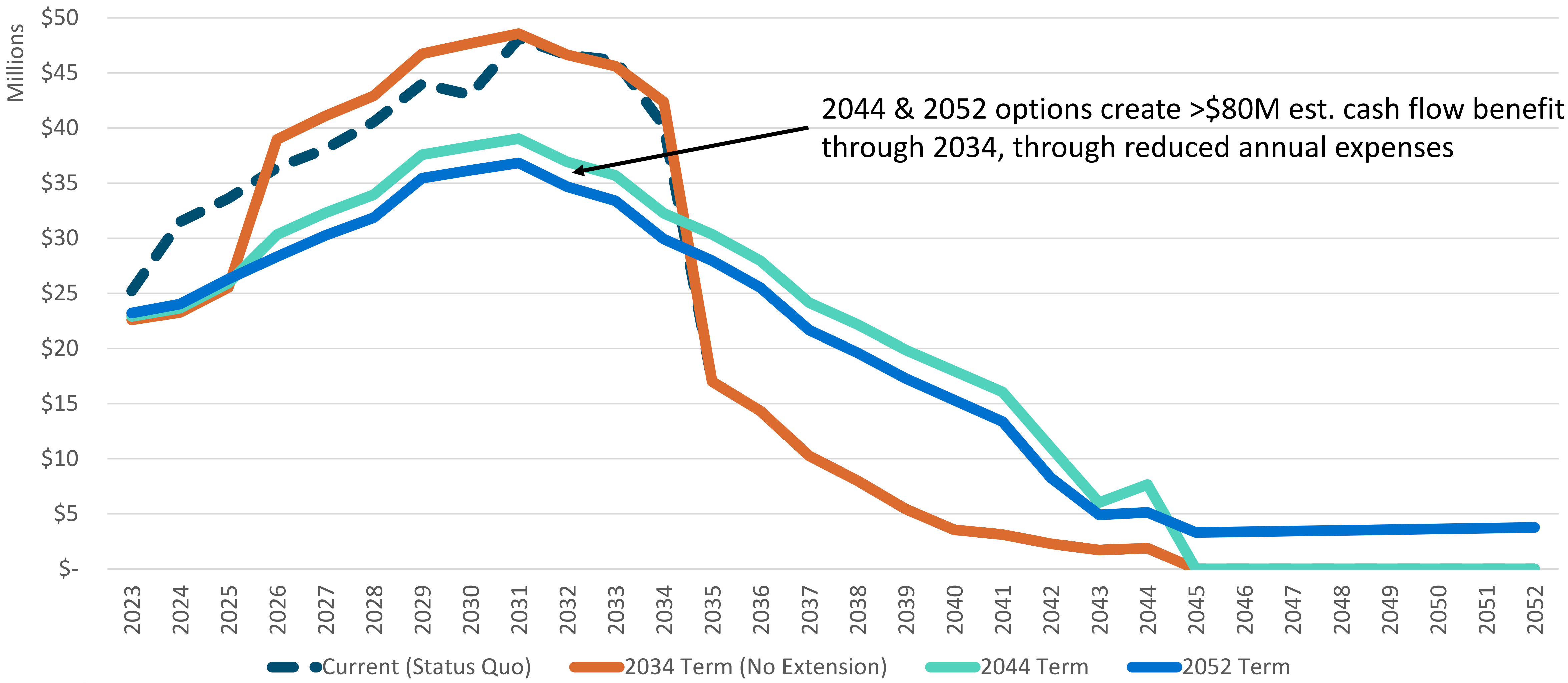
Status Quo. Vs Restructuring Options (2034, 2044 & 2052)

Projected Pension Payments by City/General Fund (not covered by PTO)



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Takeaways and Preliminary Recommendation

- Without a term extension on the POB refunding, the City is expected to pay between $25M to $48M from non-PTO revenues annually through 2034 for pension expenses
- 2044 and 2052 term options may provide over $80M of estimated cash flow benefit (reduced pension expenses) to the City over next 12 years
- **2044 is currently the preliminary recommended term for POB refinancing; Why?**

$84 million of projected pension expense reduction for next 12 years	Enhanced budget predictability/ smoothing and fiscal sustainability	Increased resources for other City priorities	More optimal re-alignment of expenses to revenue	$70M of lower interest costs vs. the 2052 term

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