



AGENDA
NOTICE AND CALL OF SPECIAL MEETING
OF THE LAKEPORT CITY COUNCIL
Thursday, April 15, 2021

5:30 p.m.

Location: See Teleconferencing Instructions Below

PUBLIC ADVISORY: THE CITY COUNCIL CHAMBERS WILL NOT BE OPEN TO THE PUBLIC

Pursuant to Section 3 of Executive Order N-29-20, issued by Governor Newsom on March 17, 2020, the regular meeting of the City Council for **April 15, 2021** will be conducted telephonically through Zoom. Please be advised that pursuant to the Executive Order, and to ensure the health and safety of the public by limiting human contact that could spread the COVID-19 virus, the Council Chambers will not be open for the meeting. Council Members will be participating telephonically and will not be physically present in the Council Chambers.

If you would like to speak on an agenda item, you can access the Zoom meeting remotely:

Join from a PC, Mac, iPad, iPhone, or Android device:

Please click the link below to join the webinar:

<https://zoom.us/j/94421618967?pwd=cUZvbHBTMWVGbGt3ZXh3UDdSVjhlQT09>

Passcode: 164186

Or join by phone:

Dial (for higher quality, dial a number based on your current location):

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Passcode: 164186

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The City wants you to know that you can also submit your comments by email to virtualhost@cityoflakeport.com. To give the City Clerk adequate time to print out your comments for consideration at the meeting, please submit your written comments prior to **2:30 p.m. on Thursday, April 15, 2021.**

Please indicate in the email Subject Line "FOR PUBLIC COMMENT" and list the item number you wish to comment on. Comments that you want read to the Council will be subject to the three minute time limitation (approximately 350 words). Written comments that are only to be provided to Council and not read at the meeting will be distributed to the Council prior to the meeting.

The City of Lakeport thanks you in advance for taking all precautions to prevent spreading the COVID-19 virus.



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NOTICE AND CALL OF SPECIAL MEETING
OF THE LAKEPORT CITY COUNCIL
Thursday April 15, 2021
5:30 p.m.

TO THE MEMBERS OF THE CITY COUNCIL OF THE CITY OF LAKEPORT:

NOTICE IS HEREBY GIVEN that a Special Meeting of the Lakeport City Council is hereby called to be held on Thursday, **April 15, 2021, at 5:30 p.m.** for the purpose of discussing and acting on the following:

Presentation: Presentation by NHA Advisors on the Unfunded Accrued Liability Pension Program (UALPP).

Adjournment:

Dated: 04/14/2021

Hilary Britton, Deputy City Clerk



CITY OF LAKEPORT

ADDRESSING CALPERS PENSION COST INCREASES

ADDITIONAL DETAIL RETAIL RELATING TO UAL RESTRUCTURING CONCEPT

NHA | ADVISORS
Financial & Policy Strategies.
Delivered.

APRIL 2021

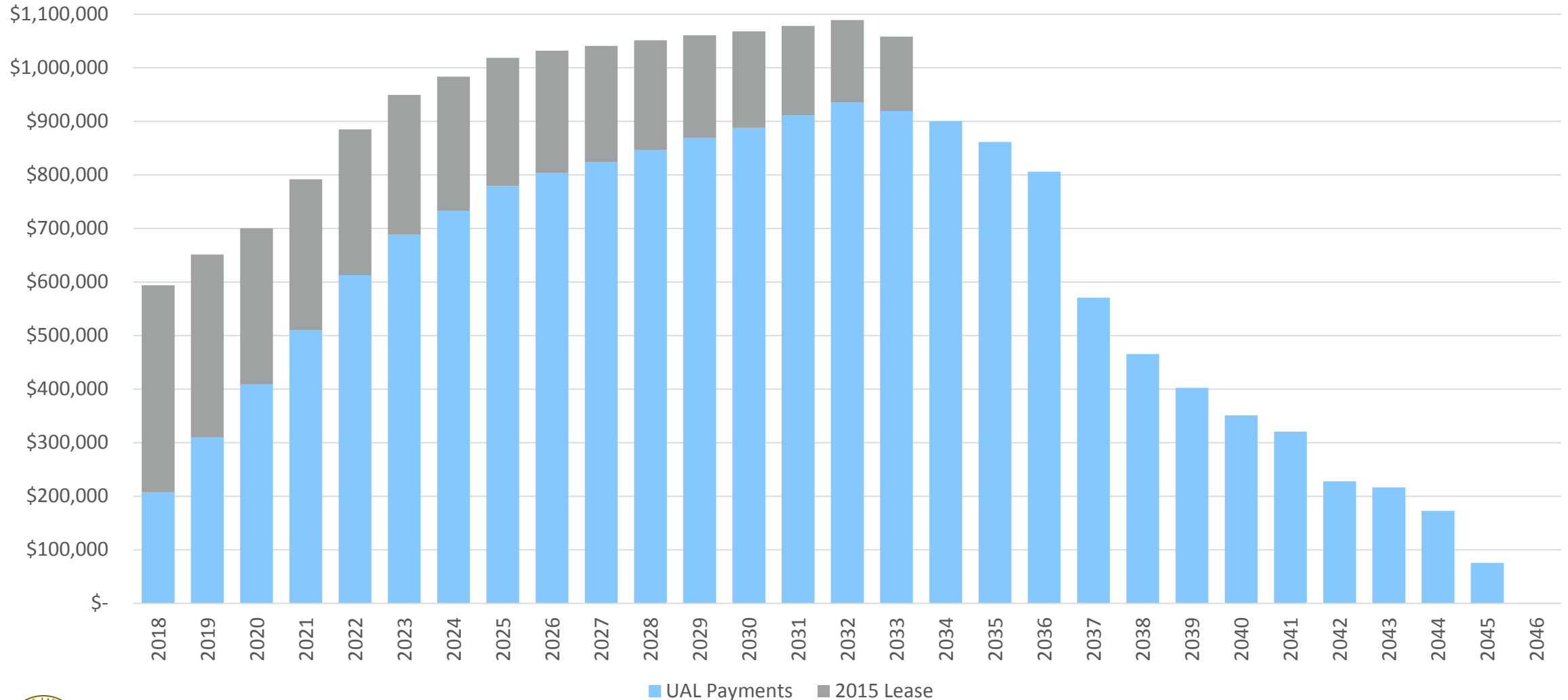
Background & Presentation Focus

- ▶ City of Lakeport has about \$10.4 million in pension liability on its balance sheet
 - ▶ \$8.4M Unfunded Accrued Liability (UAL) with CalPERS + \$2M outstanding on 2015 Lease
- ▶ 2015 Lease paid off portion of UAL and strategically “smoothed” payments through FY 2022
 - ▶ Restructuring was limited to small size at the time given requirement for collateral/assets
- ▶ At the past March 2 workshop, past, present and future potential cost management strategies were discussed
- ▶ This presentation provides additional detail on the UAL restructuring concept that was introduced at the last workshop



CalPERS Projected UAL Repayment Schedule

\$8.4M UAL @ 7% Interest Rate + 2015 Lease @ 4.25% Interest Rate



Strategies to Address Rising Pension Costs

(1) Prepay UAL early in Fiscal Year ($\approx 3.4\%$ discount) – **City uses this strategy**

(2) Negotiate Cost Sharing With Employees – **City has completed**

- Require employees to pay their share; New employees already governed by lower cost/benefit PEPRAs plans

(3) Fresh Start Amortization w/ CalPERS

- Pros: Smooths payment, shortens repayment period; reduces overall interest paid from shorter amortization period
- Cons: New structure “locked-in” (no flexibility) + increased annual payments in near term; still amortized at 7% interest rate

(4) Use Cash Reserves to Pay Extra (two options)

- Section 115 Trust - Separate trust solely dedicated to pension/OPEB
 - Offered by PARS, CalPERS, Keenan, PFM and others
- Lump Sum Pay Down of UAL – Reduce UAL through ADPs (Additional Discretionary Payments)
 - Choose optimal amortization bases to pay off

(5) Restructure All or Portion of Remaining UAL

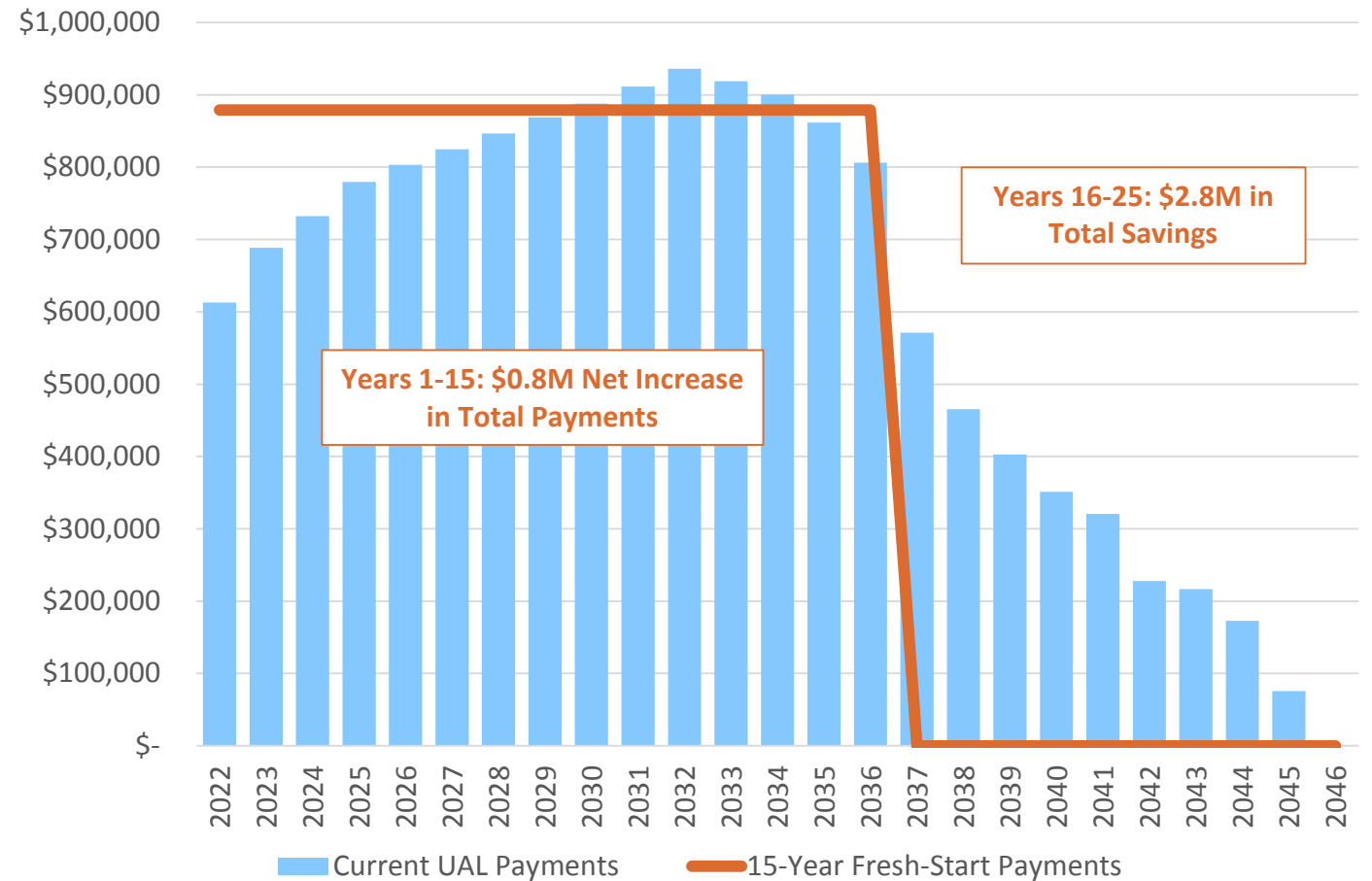
- Restructure portion of UAL at lower bond interest rate (i.e. 3.50% vs. 7.0%) and “smooth out” payments for enhanced budget predictability, near and mid term savings, and preservation of cash for other critical projects



Fresh Start Amortization

- ▶ City can request new amortization schedule with CalPERS
 - ▶ Still amortized at 7%; Must be shorter than current schedule
 - ▶ Near term payments are higher, interest savings taken in later years; No NPV savings
 - ▶ Schedule is “locked-in” and City can’t go back to old schedule
 - ▶ Due to lack of flexibility, this strategy is not commonly utilized – City could effectuate the same results using either the ADP or Section 115 strategy while maintaining some flexibility

Lakeport 15-Year Fresh Start Analysis



Applying Reserve Funds/Annual Surplus

Option 1: Section 115 Trust

- ▶ **What is it?** - Separate trust managed by 3rd party (typically not CalPERS)
 - ▶ Dedicated / restricted to pension and/or OPEB costs
- ▶ **Benefits**
 - ▶ Potential for increased investment returns vs. current General Fund reserves
 - ▶ General Fund investments restricted by Government Code (limits types of instruments and maturities)
 - ▶ Flexibility – more investment options than CalPERS and can decide when and how to use
 - ▶ Longer-Term: Can grow over time and pay off full UAL in the future
 - ▶ Shorter-Term: Apply during challenging budget years or to “smooth” payment spikes
 - ▶ Diversify assets under management away from CalPERS
- ▶ The Trust will show up as an asset on the City’s financial statements, but will not technically offset UAL until funds are transferred to CalPERS



Applying Reserve Funds/Annual Surplus

Option 2: ADP – Additional Discretionary Payment

- ▶ **What is it?** – City makes Additional Discretionary Payment (ADP) to CalPERS and applies funds to a selected amortization base (layer of UAL)
 - ▶ CalPERS will eliminate payments associated with the portion of the UAL paid off, essentially giving the City credit at 7% interest
 - ▶ While credit is given at 7% interest, the true benefit of the pay down will be based on CalPERS actual returns on those funds in the future
- ▶ **Benefits**
 - ▶ Reduced UAL with CalPERS and associated payments
 - ▶ Opportunity for increased investment returns vs. current GF reserves
 - ▶ Higher funding ratios



Section 115 vs. CalPERS ADP Comparison

OPTION	Section 115 Trust	Direct UAL Pay Down with CalPERS
Reduced UAL & UAL Payments with CalPERS	No	Yes
Reduced Pension Liability in CAFR	No (but will be off-setting asset on balance sheet)	Yes
Control of Investment Strategy	Yes	No
Funds Managed By	Trust Administrator	CalPERS
Flexibility in Uses	Yes (annual expenses, direct UAL pay down, OPEB, etc.)	No
Savings	Varies; Depends on when City utilizes funds to pay liabilities	Immediate; Length of time varies based on which amortization component is paid off (City's amortization bases currently range from 8-29 years)
Enhanced Budgetary Flexibility	Yes	No
How Many Agencies in CA Have Used?	231 Agencies currently w/PARS (111 cities); Several others using other Non-PARS Trust Administrators	168 Different Employers for 431 distinct ADPs in 2020



Restructuring UAL Debt – Conceptual Overview

- ▶ Borrow money to pay off all or a portion of UAL with CalPERS
 - ▶ Pension Obligation Bond (POB) is typically utilized
 - ▶ Unsecured debt (no collateral required)
 - ▶ “Court Validation” to confirm UAL is a “debt” that can be refinanced (3-to-4-month process)
 - ▶ Validation provides foundation to issue POBs now or anytime in the future if approved by City Council
- ▶ POB market re-emerged in 2018/19 – about 40 agencies have issued \$4 billion recently
 - ▶ Previously, UAL restructuring was required to be executed as a lease structure (like Lakeport in 2015)
- ▶ Interest rate paid on a POB significantly lower than the 7% CalPERS charges
 - ▶ Current market is 3.00% to 3.75% depending on length of term and credit rating
- ▶ Restructuring the annual payments into a smoother, predictable schedule is core objective
- ▶ Key risk / consideration: re-investment and market timing risk



POB Market Update – Recent Issuances

- ▶ Over the last 12 months, about 40 agencies have issued UAL Restructuring Bonds
- ▶ Interest rates have ranged from 2.54% to about 4.25%
- ▶ Last 5 cities to come to market have achieved < 3.0% interest rates
 - ▶ Huntington Beach, Orange, Chula Vista, Downey, Monterey Park and El Cajon
- ▶ Historically low interest rates due to significant investor demand and “credit spread” tightening
- ▶ After Chula Vista’s 2.54% rate (24-year maturity) in February, rates have increased >65 bps (0.65%) due to inflationary concerns

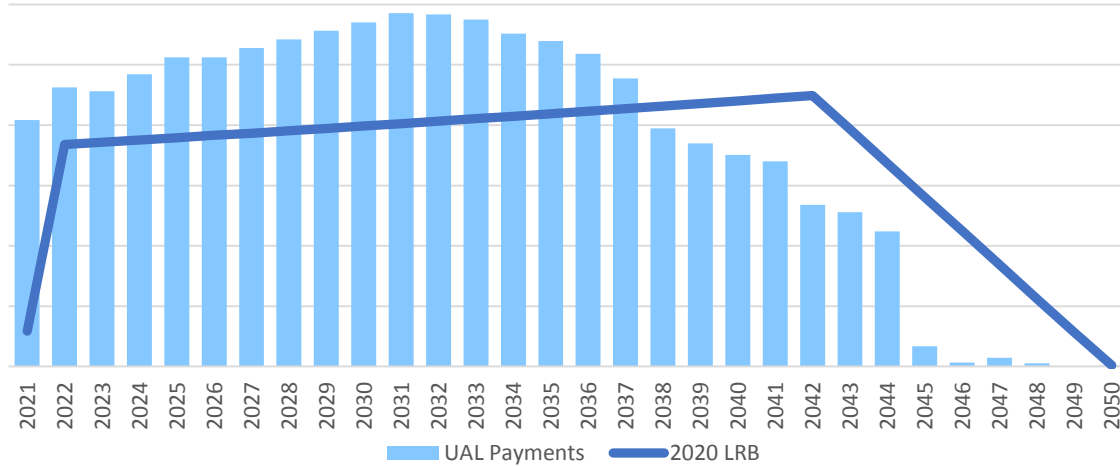
								
Huntington Beach*	Orange	Chula Vista	Downey	Monterey Park*	El Cajon	Ukiah	Coachella	Gardena
(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2020)	(2020)	(2020)
\$363,645,000	\$286,485,000	\$350,025,000	\$113,580,000	\$106,335,000	\$147,210,000	\$49,875,000	\$17,590,000	\$100,590,000
AA+	AA	AA	AA	AA	AA	A+	AA-	AA-
								
Arcadia	Placentia	Torrance	Novato Sanitary District	Azusa	Pomona	West Covina	Grass Valley	North County Fire Protection District
(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)
\$90,000,000	\$52,950,000	\$349,515,000	\$6,467,000	\$70,075,000	\$219,890,000	\$204,095,000	\$18,311,000	\$20,305,000
AAA	BBB+	AA	Private Placement	AA-	AA-	A+	Private Placement	AA-
								
Carson	El Monte*	Riverside	Inglewood*	Montebello*	Ontario	Larkspur	Riverside County	Pasadena
(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)
\$108,020,000	\$118,725,000	\$432,165,000	\$101,620,000	\$153,425,000	\$236,585,000	\$18,295,000	\$719,995,000	\$131,805,000
AA-	A+ (Ins.)	AA	AA- (Ins.)	A+ (Ins.)	AA	AAA	AA	AAA



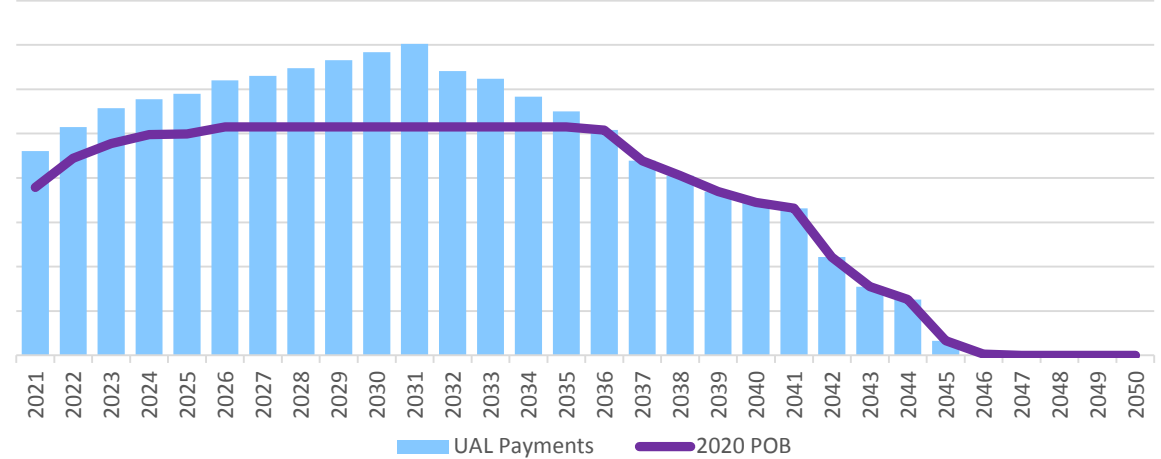
Recent Issuances: Restructuring for Smoothing is a Common Strategy

Term and Shape of Repayment Unique to Each Issuer

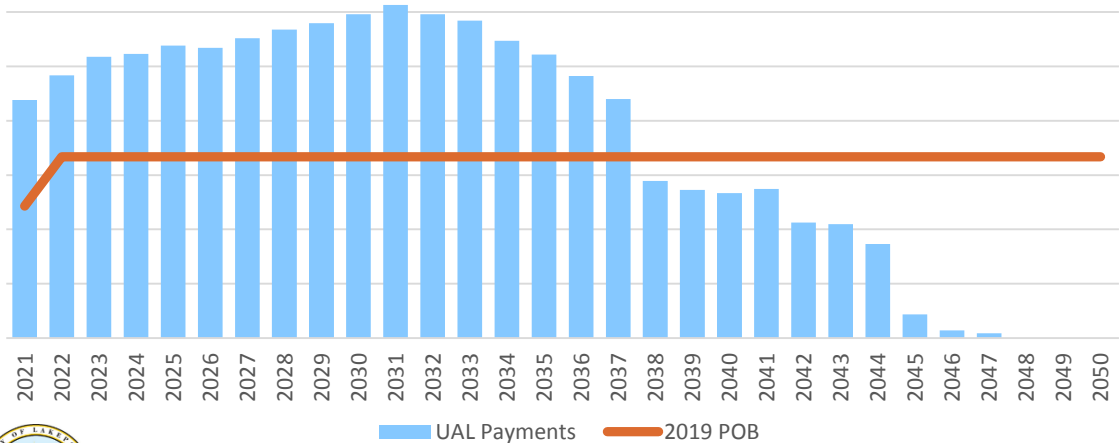
Ukiah: Upfront Relief + 1% Escalating + Linear Decline to 2050



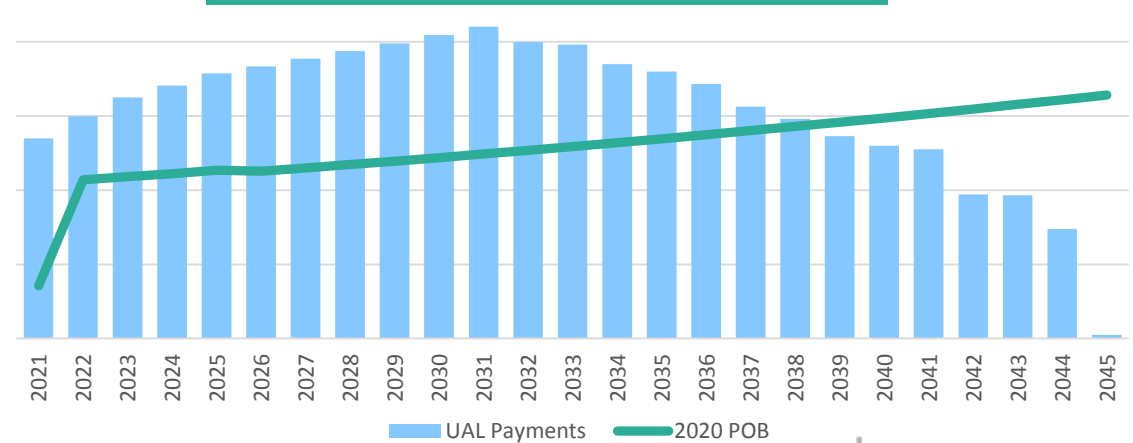
Riverside: Targeted Early Savings + "Chop the Peak" + No Dissavings



Hawthorne: Upfront Relief + 30 Year Level



West Covina: Upfront Relief + 25-Year @ 2% Escalating



Taxable Interest Rate Trends (30-Year Treasury Rates)

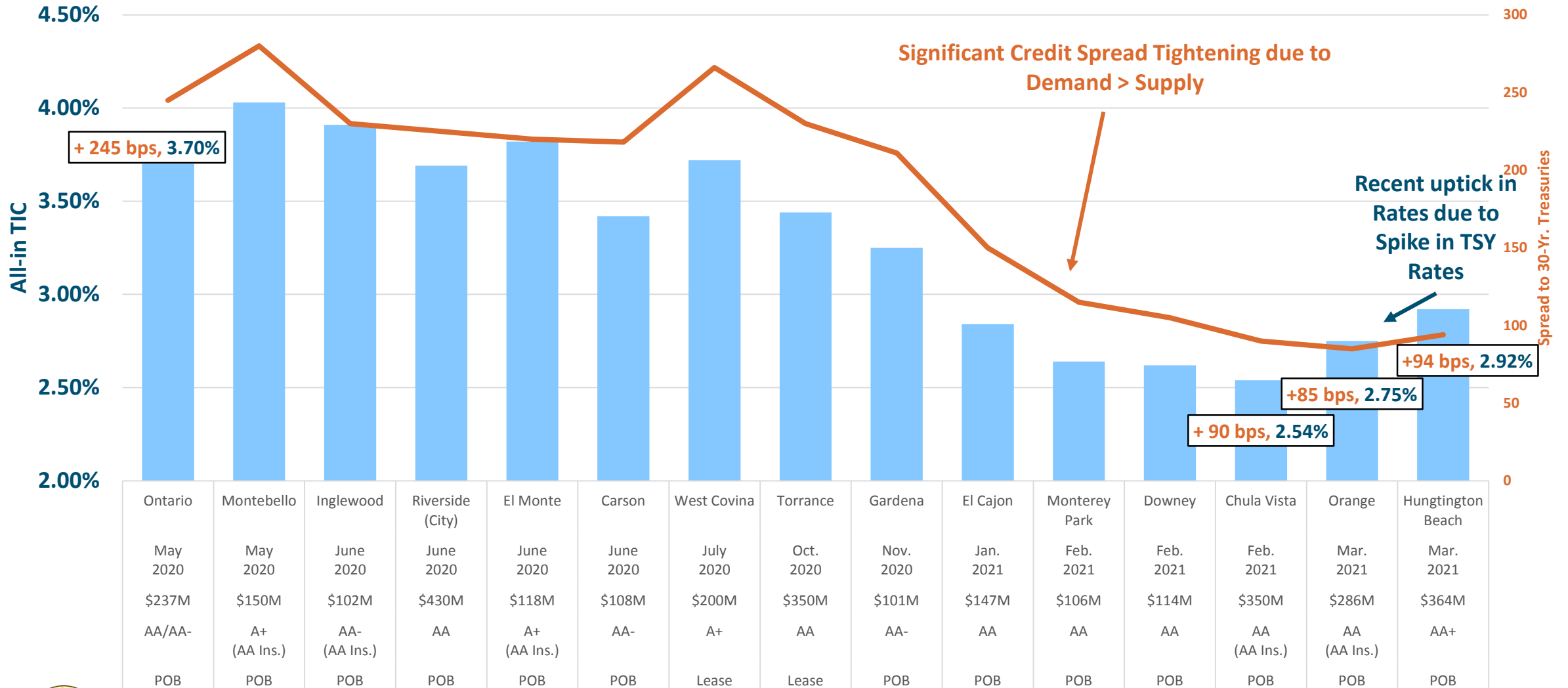


*Interest rates through April 9, 2021.



POB Market Update

Credit Spread (Orange) and POB Interest Rate (Blue) Trends



Preliminary UAL Restructuring Options for Lakeport

Four Baseline Options for Presentation Purposes

OPTION 1

20 Year – Level
Payments

OPTION 2

25 Year – Level
Payments

OPTION 3

24 Year – 1%
Escalating + Linear
Decline

OPTION 4

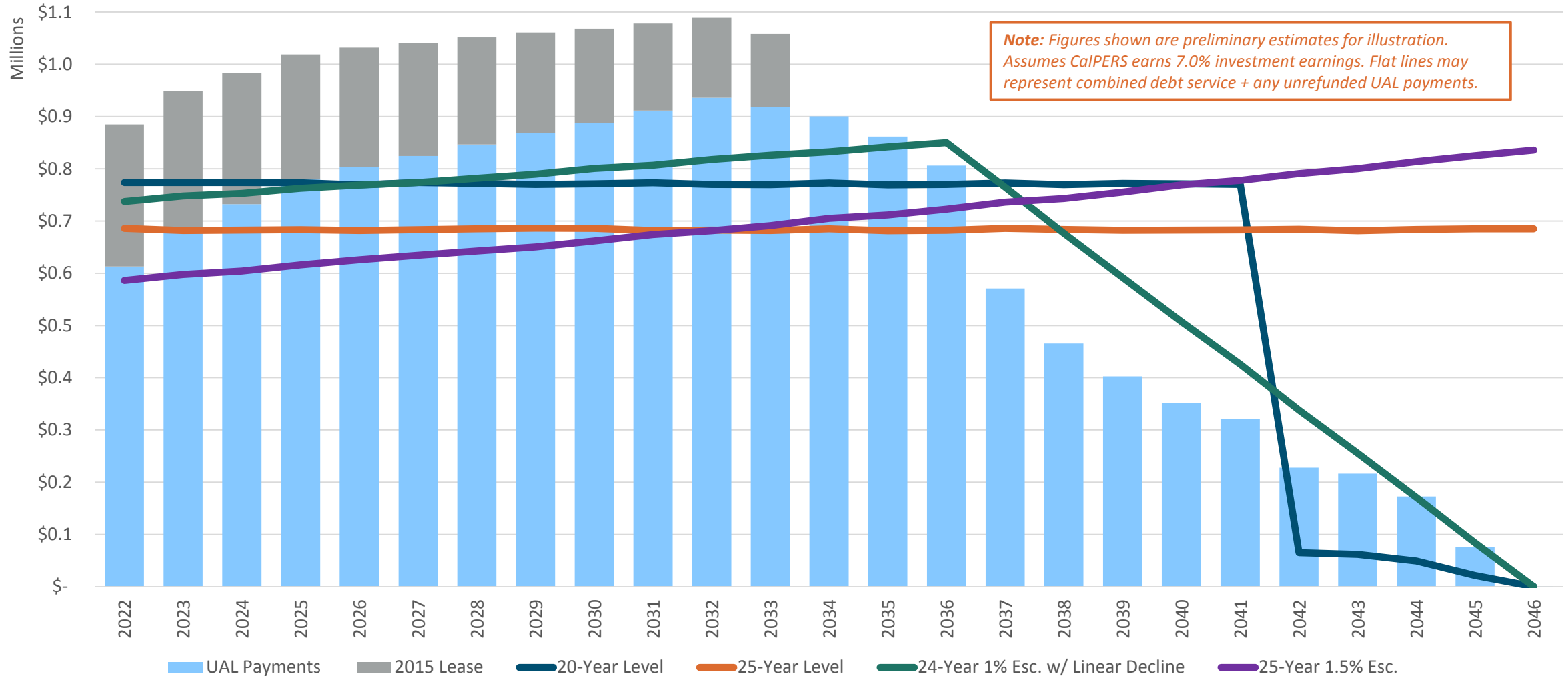
25 Year – 1.5%
Escalating

Assumptions

- ▶ 71% of UAL Paid Off (95% Funding Ratio)
- ▶ 2015 Lease Paid Off (no penalty) and release of assets from Lease lien
- ▶ Estimated Interest Rates from recent “AA” category POB
- ▶ Bonds are “callable”
 - ▶ i.e. City has ability to pay off (or refinance) the POBs early if desired



Base Case UAL Restructuring Options for Lakeport



Base Case UAL Restructuring Options for Lakeport

Summary of Estimated Savings

- ▶ Est. present value savings range from **\$1.47M – \$1.71M**
 - ▶ 18.4% - 21.4% of refunded UAL
- ▶ Cumulative savings range from **-\$99K - \$1.92M**
- ▶ Average annual savings range from **\$245K - \$383K**

Metrics	20-Year Level	24-Year 1% Esc. w/ Linear Decline	25-Year Level	25-Year 1.5% Esc.
Par Amount	\$8,120,000	\$8,120,000	\$8,120,000	\$8,120,000
Refunding	Yes	Yes	Yes	Yes
UAL Funded (\$)	\$6,000,000	\$6,000,000	\$6,000,000	\$6,000,000
UAL Funded (%)	71%	71%	71%	71%
Funded Ratio	94%	94%	94%	94%
Maturity	20 Years	24 Years	25 Years	25 Years
Average Life	11.8 Years	11.9 Years	15.9 Years	17.6 Years
All-In Interest Rate	3.56%	3.59%	3.77%	3.82%
Present Value Savings (%)	21.40%	21.07%	18.96%	18.37%
Present Value Savings (\$)	\$1,712,707	\$1,686,334	\$1,517,263	\$1,470,473
Cumulative Savings	\$1,924,985	\$1,848,409	\$464,497	(\$99,040)
Savings (2022-2032)	\$2,699,566	\$2,652,689	\$3,672,120	\$4,218,338
Avg. Annual Savings (2022-2032)	\$245,415	\$241,154	\$333,829	\$383,485

Note: Figures shown are preliminary estimates for illustration. Assumes CalPERS earns 7.0% investment earnings. Flat lines may represent combined debt service + any unrefunded UAL payments.



Preliminary Options - Takeaways

- ▶ 4 preliminary options presented include paying off 71% of the UAL to bring funding ratios to 94%
 - ▶ Many options are available to evaluate (shapes, maturities, sizes, etc.)
- ▶ Present Value savings for each ranges from \$1.47 - \$1.71 million
 - ▶ Assumes CalPERS earns 7.00%; if CalPERS earns less, savings are reduced
- ▶ Tradeoffs between shorter and longer maturities
 - ▶ Shorter: More cumulative savings, but less over next 15-20 years and less resiliency to handle future economic shocks, including CalPERS' underperformance
 - ▶ Longer: Less Cumulative savings, but more in the next 15-20 years & increased long-term resiliency



Pension Bonds - Benefits and Risks

Primary Benefits

- Fiscal Sustainability Tool: Ability to “re-shape” the City’s pension debt payments
- Near-Term Budgetary Savings
- Interest Rate Savings “Arbitrage”: City can borrow at rates much lower (currently $\approx 3.50\%$) than what CalPERS charges on UAL debt (7%)
- Increase Funding Ratio
- Flexibility to Modify Maturity

Primary Risk: *Reinvestment & Market Timing Risk*

- Savings is ultimately dependent on future CalPERS returns, which are unknown at time of issuance (primary concern of GFOA)
- Present value savings occur if PERS earns greater returns than pension bond interest rate
- Near-term losses exacerbate this risk given large lump sum deposit into the market

*These risks should be quantified through a **stress testing process** to better understand the impacts of potential poor investment performance by CalPERS*

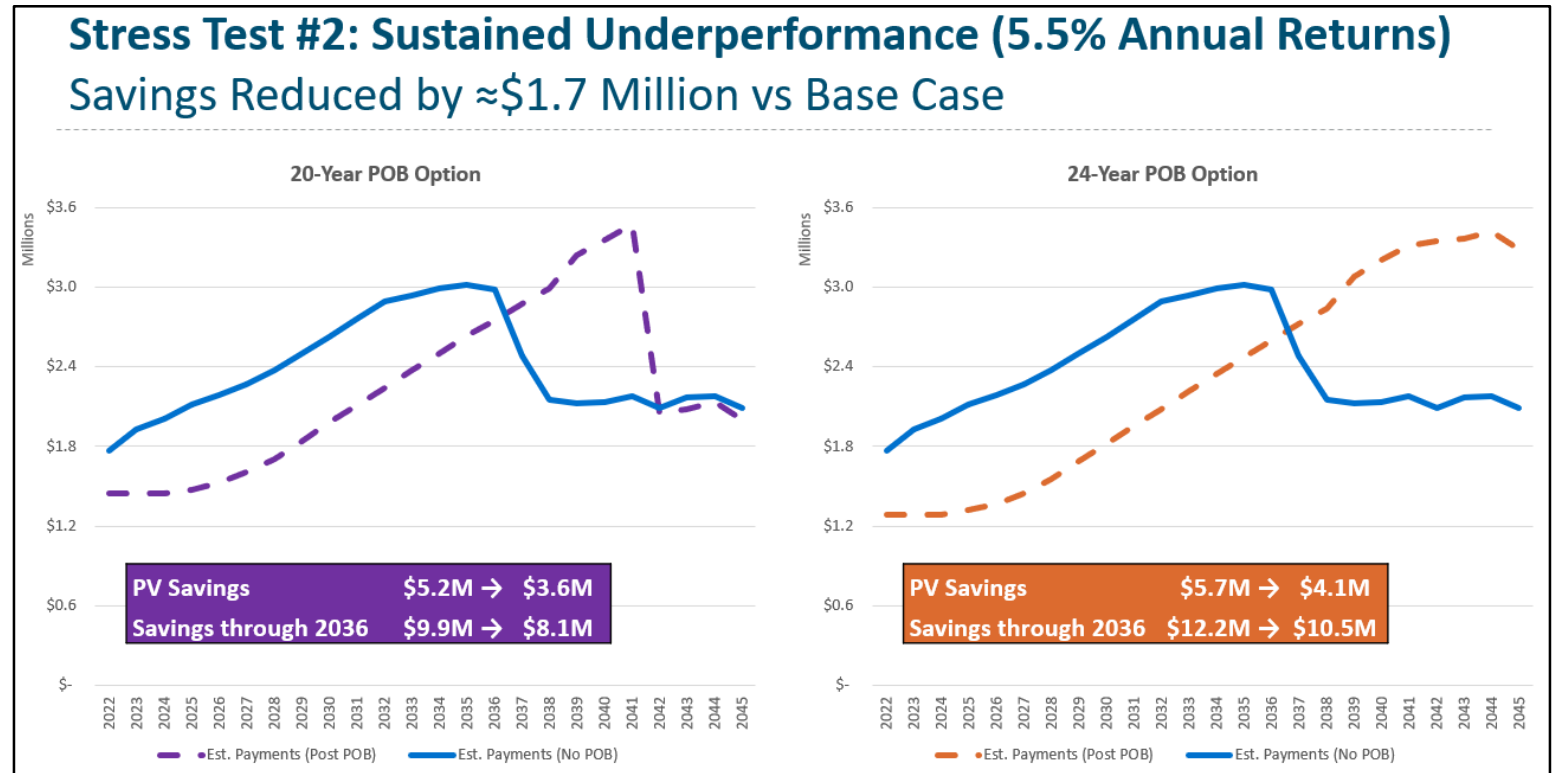


What Does Stress Testing Mean?

Simplified Explanation – Annual Savings Under Various CalPERS Returns

- ▶ If CalPERS does not meet their 7% target, then this underperformance will reduce POB savings
 - ▶ If CalPERS earns less, on average over time, than 7% but more than the bond interest rate, savings will be lesser but positive
 - ▶ If CalPERS earns less, on average over time, than the POB interest rate (i.e. 3.25%), then the POB would generate negative savings and cost the City

Example of Stress Test Analysis for Public Agency



Government Finance Officers Association (GFOA)

GFOA's 2015 POBs Critique and How Current POBs Differ

Invested pension bond proceeds might earn less than the borrowing costs

- Yes. Instead of CalPERS's expected earnings rate of 7.0%, lower actual returns could occur. The chances of long-term returns being below current < 3.5% borrowing costs are low, but they do exist. A "stress testing" process is often helpful to better quantify this risk (i.e., analysis based on CalPERS earning poor returns in future)

"Pension bonds are complex instruments that carry considerable risk...and may include swaps or derivatives..."

- No. Current pension bond issuances are fixed rate bonds that typically do not include swaps or derivatives.

"Issuing taxable debt to fund the pension liability increases the jurisdiction's bonded debt burden and potentially uses up debt capacity..."

- No. Pension bonds replace all or a portion of an agency's payments to PERS with debt service on the bond. It is converting one liability for another on the balance sheet at a lower interest rate. A lease bond will reduce asset capacity for future issuances.

Pension bonds are "typically issued without call options" making it more difficult to refund bonds if interest rates fall or a different debt service structure is desired in the future.

- No. Nearly all recent pension bonds are issued with an optional redemption feature, allowing agencies to refinance or accelerate repayment upon them in the future.

"Pension bonds are frequently structured in a manner that defers the principal payments..."

- Not Always. Most of the recent pension bonds amortize principal immediately. Shortening, lengthening, or maintaining the same term of payments is at the discretion of each agency.

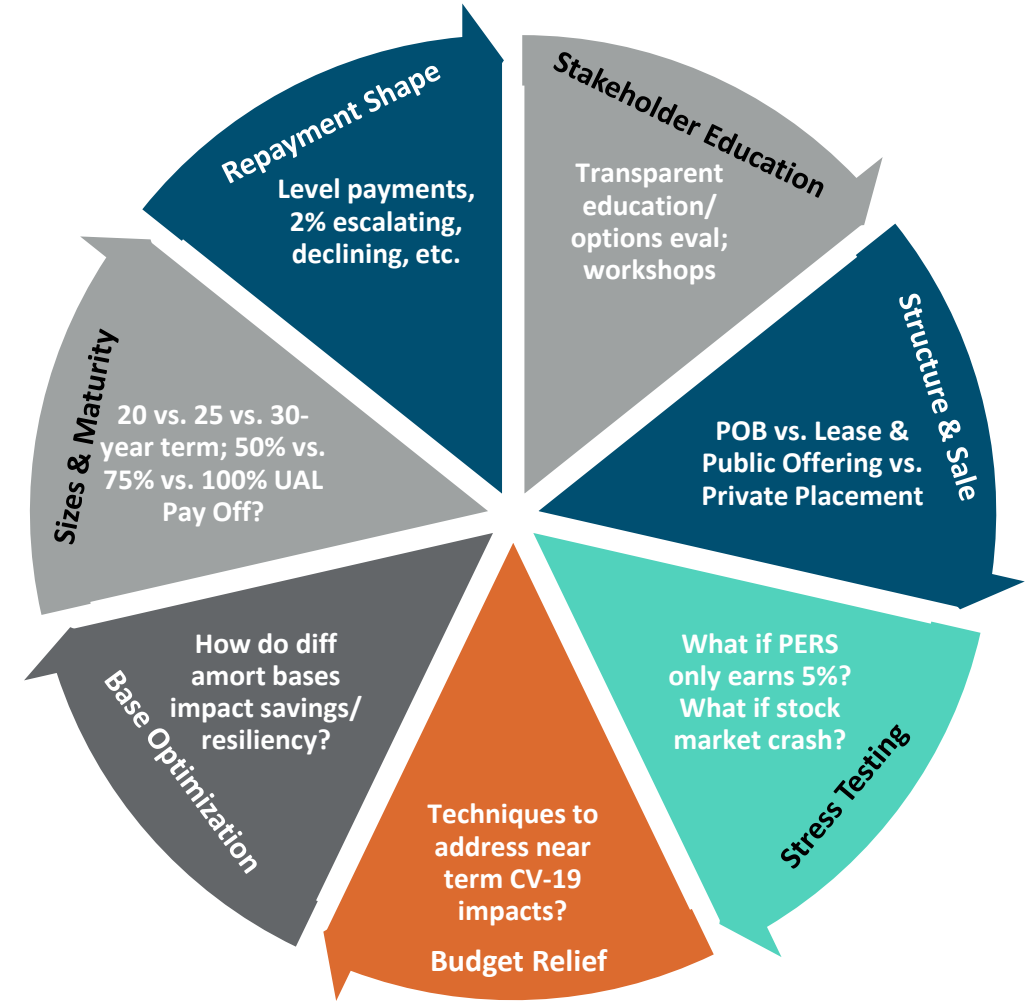
"Rating agencies may not view the proposed issuance of Pension bonds as credit positive..."

- Not true if pension bond is prudently structured to increase payment affordability, financial flexibility and resiliency as part of a policy driven reserves and pension funding strategy.



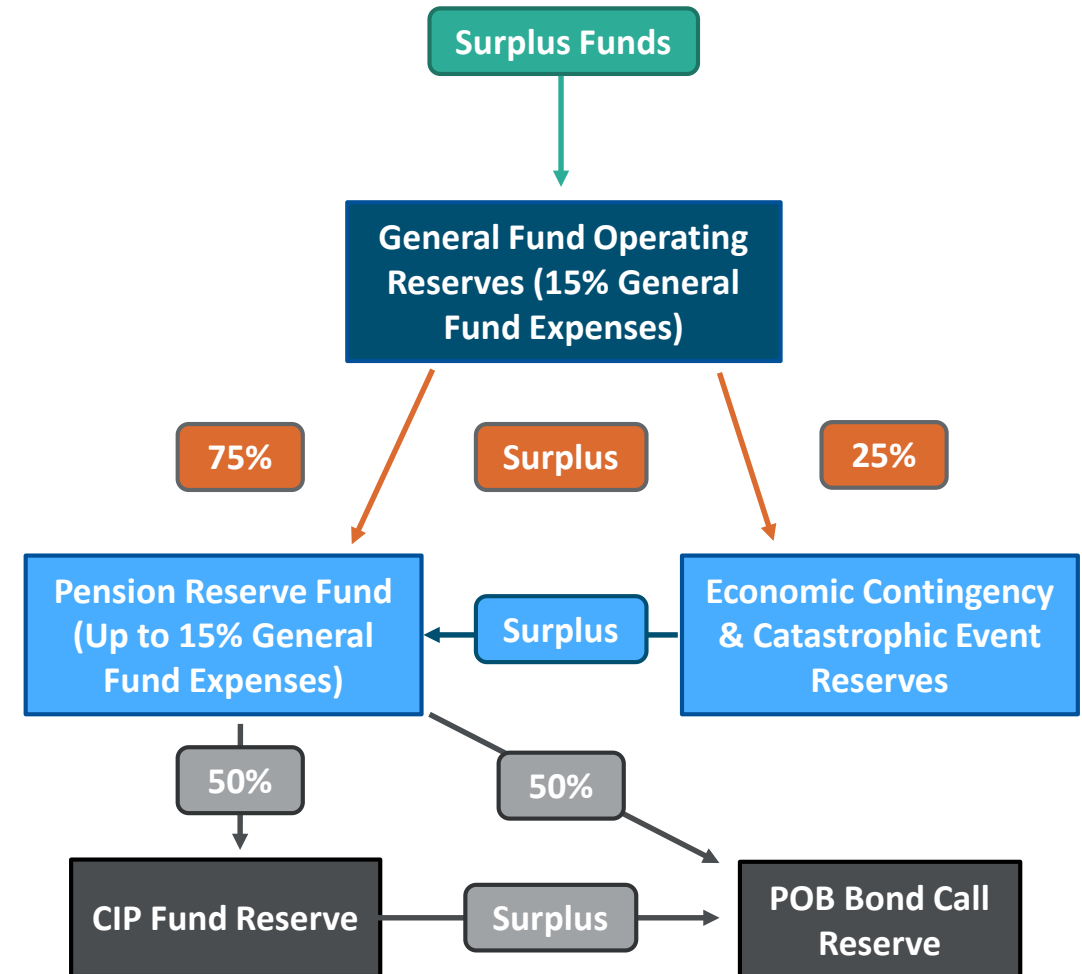
Components of a Thoughtful Evaluation Process

- ▶ Proper Stakeholder education
 - ▶ Full exploration of options
 - ▶ Shapes, sizes, durations
 - ▶ Tailor to City's financial objectives, risk tolerance and other constraints
- ▶ **Stress testing process to quantify risks**
- ▶ Structuring techniques to optimize savings / resiliency to future PERS volatility
- ▶ Market timing of investing proceeds
- ▶ Restructuring strategy and use of future savings should be governed by a **Pension Funding Policy**



Recommendation: Pension Funding Policy (Illustrative Purposes)

- ▶ Integrated into a comprehensive reserve policy
 - ▶ Provides direction and prioritization to use surplus funds for “filling up” City reserves and other important accounts
- ▶ Detailed projections that account for positive POB cash flow benefits under different CalPERS performance assumptions can be a very strong planning tool
 - ▶ Also, a “credit positive” by rating agencies
- ▶ Beyond economic contingency reserves, surpluses may also be targeted towards funding Section 115 Trusts for additional future smoothing, if needed, of pension costs
- ▶ Finally, funding an early redemption account of POBs, as well as other priority capital project funds may be considered



UAL Restructuring Process

Hypothetical Timetable if Strategy Pursued Further



▶ **Multiple City Council approvals would be required before any bonds can legally be issued**



Next Steps

- ▶ Council direction on whether concept should be evaluated further
 - ▶ If so, staff and NHA recommend proceeding with a validation process to allow City the option of executing a POB at anytime in the future
 - ▶ Request for proposal for validation services will be issued
 - ▶ Staff and financing team would bring back documents at some future City Council meeting for approval and to authorize proceeding with validation action
 - ▶ During validation period, staff and financing team Would continue the evaluation/education process and conduct more robust options and stress testing analysis
 - ▶ Validation process does not lock City into a transaction; future City Council approvals required to issue bonds

