



# PENSION OBLIGATION BOND STATUS UPDATE AND NEXT STEPS

**NHA | ADVISORS**  
Financial & Policy Strategies.  
Delivered.

SEPTEMBER 7, 2021

# National City Pension Obligation Bond




























## Process Update/Overview

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- ▶ **Spring/Summer 2020:** Staff began conversations about concept of a UAL Restructuring with its municipal advisor (NHA Advisors)
- ▶ **October 2020:** Public/Council Workshop held discussing pros/cons and risks of POBs
- ▶ **October 2020:** Council approval of basic POB legal documents and initiation of court validation process in San Diego County
- ▶ **Spring 2021:** POB market updates and structuring options analysis (NHA/staff)
- ▶ **July 2021:** Validation Process completed
- ▶ **August 2021:** Refined structuring options discussion based on new CalPERS information
- ▶ **September 7, 2021 (Tonight) – POB Update**
  - ▶ Pension bond market update
  - ▶ Recommended POB structuring option/sizing
  - ▶ Revisiting risks/stress testing
  - ▶ Next steps

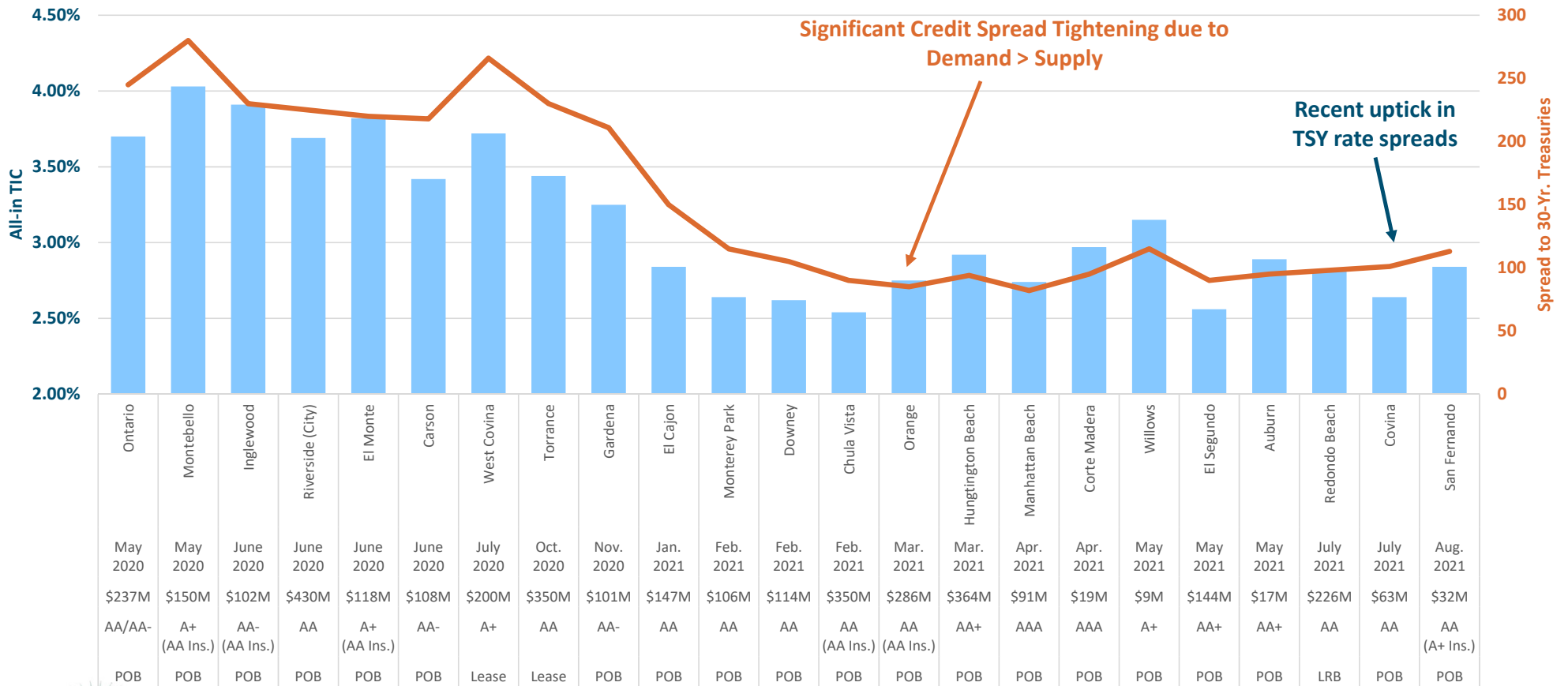
# POB Market Update – Recent Issuances

- ▶ Since 2020, about 70 agencies have issued UAL Restructuring bonds for over \$6.5 billion in UAL funded
  - ▶ Interest rates have ranged from 2.54% to about 4.25%
- ▶ Vast majority of cities to come to market in 2021 have achieved < 3.0% interest rates
- ▶ After hitting all time lows in February (Chula Vista: 2.54%), POB interest rates have risen slightly
  - ▶ Rates are still 0.50% to 0.75% lower than when City Council reviewed the opportunity last Fall

									
San Fernando	Whittier	Redondo Beach	Red Bluff	Auburn	El Segundo	Willows	Corte Madera	Manhattan Beach	Huntington Beach*
(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)	(2021)
\$31,780,000	\$133,895,000	\$226,180,000	\$18,540,000	\$17,165,000	\$144,135,000	\$8,510,000	\$18,955,000	\$91,275,000	\$363,645,000
AA (Ins.)	AA (Ins.)	AA	A+	AA+	AA+	A+	AAA	AAA	AA+
									
Orange	Chula Vista	Downey	Monterey Park*	El Cajon	Ukiah	Coachella	Gardena	Arcadia	Placentia
(2021)	(2021)	(2021)	(2021)	(2021)	(2020)	(2020)	(2020)	(2020)	(2020)
\$286,485,000	\$350,025,000	\$113,580,000	\$106,335,000	\$147,210,000	\$49,875,000	\$17,590,000	\$100,590,000	\$90,000,000	\$52,950,000
AA	AA	AA	AA	AA	A+	AA-	AA-	AAA	BBB+
									
Torrance	Azusa	Pomona	West Covina	Grass Valley	Carson	El Monte*	Riverside	Inglewood*	Montebello*
(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)
\$349,515,000	\$70,075,000	\$219,890,000	\$204,095,000	\$18,311,000	\$108,020,000	\$118,725,000	\$432,165,000	\$101,620,000	\$153,425,000
AA	AA-	AA-	A+	Private Placement	AA-	A+ (Ins.)	AA	AA- (Ins.)	A+ (Ins.)

\* Secured by pension tax override

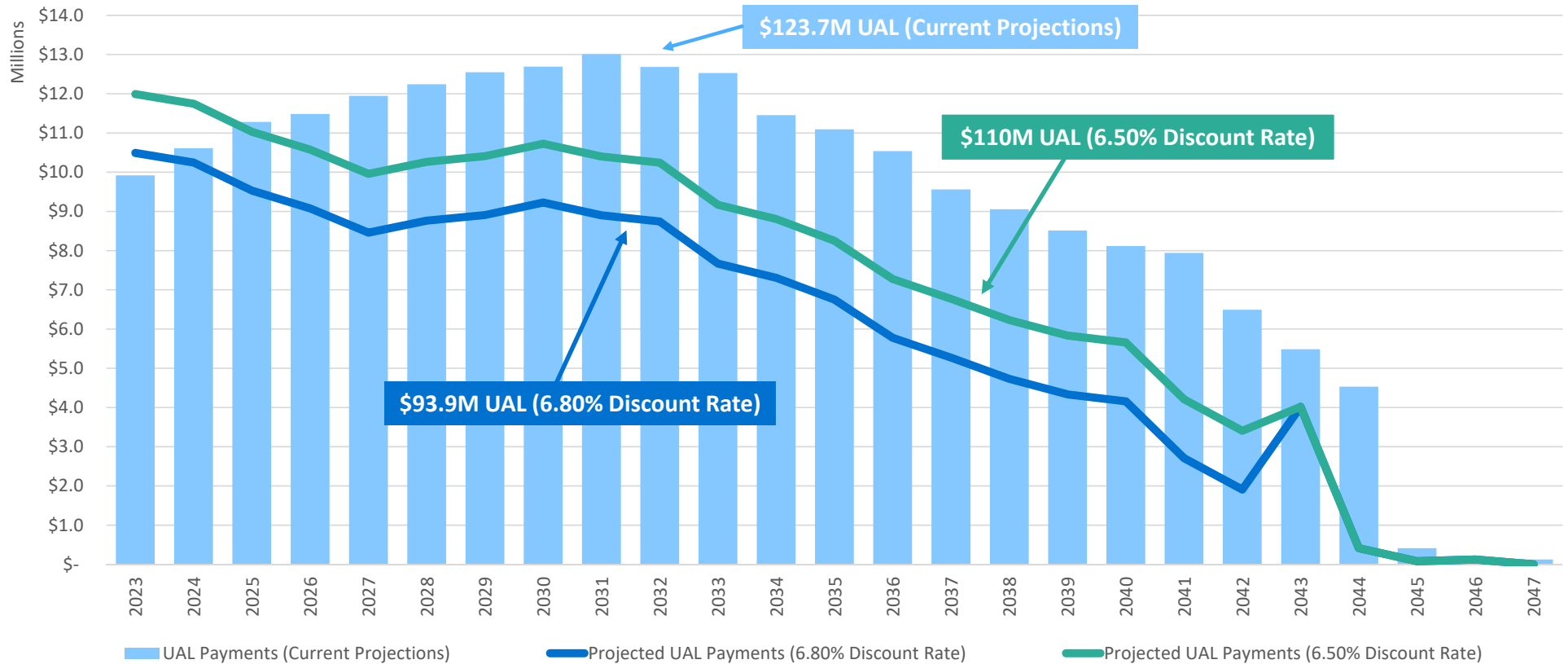
# POB Market Update: POB Interest Rates (Blue Bars) Have Dropped Dramatically due to Growing Investor Demand (Orange Line)



Note: Spreads and interest rates should be considered best estimates. Rates reflect estimated TIC or all-in TIC.

# Large UAL Reduction after 21.3% FY 2021 Gains Will Benefit City

## Discount Rate Reduction is Unknown Though; Will Offset Some of the Gains

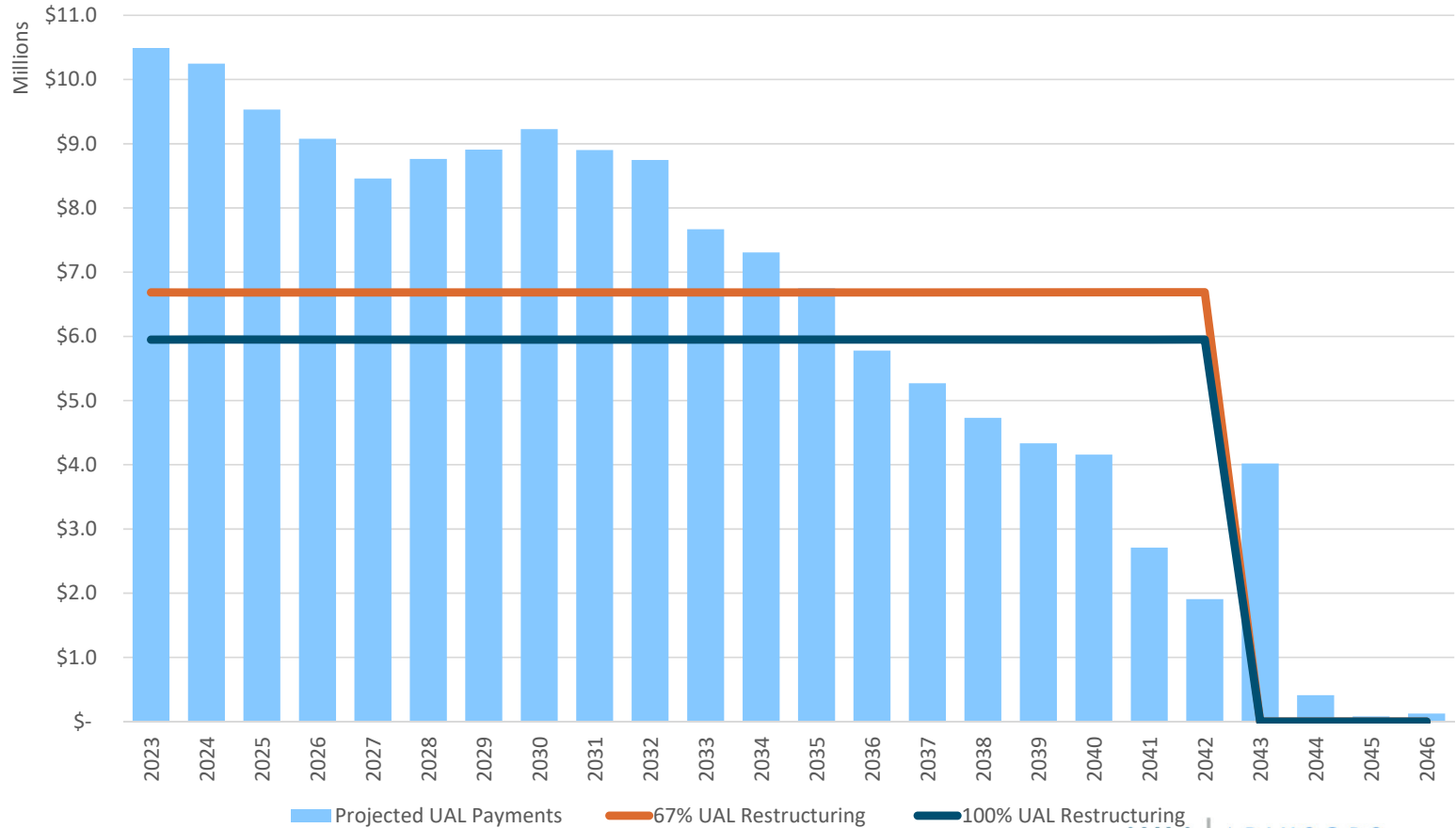


# Updated POB Scenarios Targeting Lower \$94M UAL

## 67% and 100% UAL Funding (20-Year Term)

▶ Paying off two-thirds (67%) of UAL using a 20-year POB is estimated to lower annual pension payments to below \$7 million

- ▶ More affordable payment (orange line)
  - ▶ Similar to 2020 levels
- ▶ Significantly lower than the >\$10M annual payments currently scheduled with CalPERS
- ▶ Shortens the City's pension debt by 4 years (from FY 2046 to FY 2042)



## Updated POB Scenarios – Estimated Savings 67% and 100% UAL Funding (20-Year Term)

<b>Metrics</b>	<b>67% UAL Restructuring</b>	<b>100% UAL Restructuring</b>
<b>\$ UAL Funded (6/30/22)</b>	\$62,339,925	\$93,509,888
<b>% UAL Funded (Projected After FY 2021 Returns)</b>	67%	100%
<b>Funded Ratio (Projected After FY 2021 Returns)</b>	92%	100%
<b>Maturity</b>	20 Years	20 Years
<b>Average Life</b>	12.9 Years	11.4 Years
<b>All-In Interest Rate</b>	2.93%	2.79%
<b>Present Value Savings (%)</b>	25.31%	29.24%
<b>Present Value Savings (\$)</b>	\$15,192,777	\$26,329,349
<b>Cumulative Savings</b>	\$13,933,908	\$28,634,635
<b>Savings (2023-2036)</b>	\$26,288,715	\$36,574,133
<b>Avg. Annual Savings (2023-2036)</b>	\$1,877,765	\$2,612,438

## Recommended Sizing and Structure for POB

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- ▶ While City has ability to pay off up to \$124M of UAL if executed by June of 2022, staff and NHA are recommending that only a portion of UAL be paid off
  - ▶ Balance risk/reward and better match the projected new UAL
- ▶ **Current recommendation is to fund at least two-thirds of UAL and use a term of 20 years or less**
  - ▶ Dependent on market conditions, sizing could be higher than 67%
  - ▶ 20-year term shortens the maturity of the City's pension debt by 4 years and generates a lower interest rate than the previous 24-year term options the City was previously evaluating
    - ▶ City may decide to shorten the maturity further (18 or 19 years) if annual payment level can be maintained at an affordable level (i.e. \$7M or lower)
      - Note: At \$7 million, a large portion of City's budget deficit would be addressed, though additional measures should be considered to fully eliminate it
  - ▶ Actual sizing for POB is likely to range between \$60M and \$95M and will be dependent on result of CalPERS experience study and its impact on future UAL
    - ▶ City and team will be monitoring these changes in order to prudently size the POB and will provide an update to City Council at final POS approval meeting
  - ▶ POBs will also be "callable," meaning they can be paid off or refinanced at no penalty after 10 years



## Revisiting POB Risks

### CalPERS Reinvestment/Market Timing Risk

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- ▶ Savings is ultimately dependent on future CalPERS returns, which are unknown at time of issuance
  - ▶ If CalPERS earns less than 6.8%, savings will be less than shown on previous pages
  - ▶ If CalPERS earns more than 6.8%, savings will be more than shown on previous pages
- ▶ Rule of Thumb: Present value savings occur ONLY if CalPERS earns greater returns than pension bond interest rate (i.e., 3.00% in current market)
  - ▶ City would be worse off if CalPERS earned less than bond rate (3.00%) on average over next 20 years
  - ▶ Near-term losses exacerbate this risk given large lump sum deposit into the market

CalPERS 5-Year Average Annual Return: 10.5%  
CalPERS 10-Year Average Annual Return: 8.8%  
CalPERS 20-Year Average Annual Return: 7.4%  
CalPERS 30-Year Average Annual Return: 7.5%

# CalPERS Reinvestment/Market Timing Risk

## Preliminary Stress Tests to Quantify Downside Risk/Savings Reduction

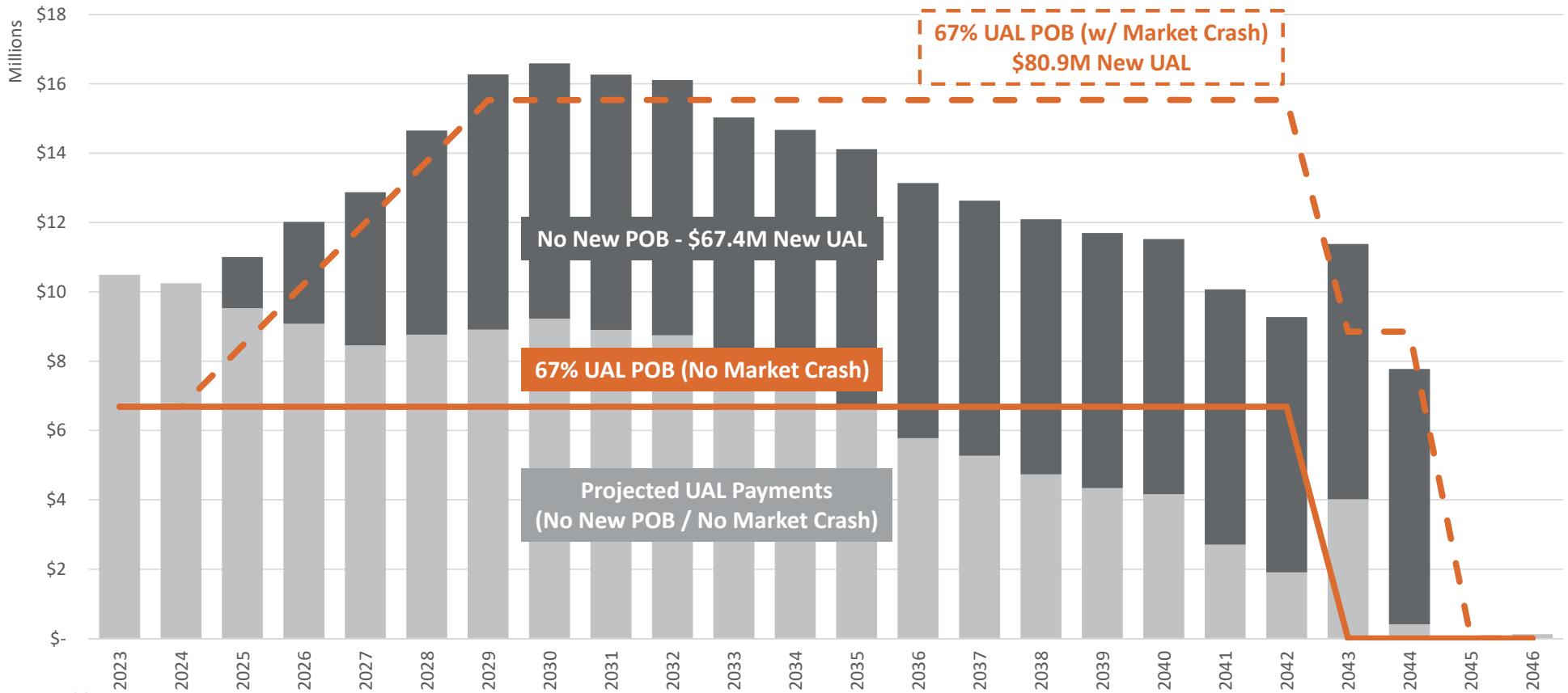
- ▶ Savings reduced under stress test scenarios
  - ▶ CalPERS earns (and reduces discount rate to) 5% and 6%
  - ▶ Market crash (in first year after POB issued); 6.8% returns thereafter
    - ▶ -5% returns
    - ▶ -15% returns
- ▶ However, City still better off having issued POB than if it hadn't

Estimated UAL Sensitivity (67% UAL Funding)				
	5% Discount Rate Change	6% Discount Rate Change	-5% Market Crash (After Issuance)	-15% Market Crash (After Issuance)
<b>Baseline PV Savings</b>	\$15.2 Million	\$15.2 Million	\$15.2 Million	\$15.2 Million
<b>Reduction in PV Savings</b>	\$12.7 Million	\$7.1 Million	\$7.4 Million	\$13.6 Million
<b>Net PV Savings (\$)</b>	<b>\$2.5 Million</b>	<b>\$8.1 Million</b>	<b>\$7.8 Million</b>	<b>\$1.6 Million</b>
<b>Net PV Savings (%)</b>	<b>4.08%</b>	<b>13.43%</b>	<b>13.06%</b>	<b>2.67%</b>

Estimated UAL Sensitivity (100% UAL Funding)				
	5% Discount Rate Change	6% Discount Rate Change	-5% Market Crash (After Issuance)	-15% Market Crash (After Issuance)
<b>Baseline PV Savings</b>	\$25.8 Million	\$25.8 Million	\$25.8 Million	\$25.8 Million
<b>Reduction in PV Savings</b>	\$19.1 Million	\$10.7 Million	\$11.0 Million	\$20.4 Million
<b>Net PV Savings (\$)</b>	<b>\$6.7 Million</b>	<b>\$15.1 Million</b>	<b>\$14.8 Million</b>	<b>\$5.4 Million</b>
<b>Net PV Savings (%)</b>	<b>7.42%</b>	<b>16.77%</b>	<b>16.40%</b>	<b>6.01%</b>

\* NHA is not an actuary. Analysis should be considered best estimates for presentation purposes.

# Preliminary Stress Test: 15% Negative CalPERS Returns in 1st Year After Issuance (PV Savings Reduced to ≈ \$1.6M) With No Recovery



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# Government Finance Officers Association (GFOA)

## GFOA's Critique of POBs 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 6.8%, lower actual returns could occur. The chances of long-term returns being below current < 3.00% 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.

## National City POB – Key Finance Team Members

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- ▶ City of National City
  - ▶ Brad Raulston, Molly Brennan, Janel Pehau
- ▶ Municipal Advisor – NHA Advisors
  - ▶ Craig Hill, Mike Meyer, Leslie Bloom, Roy Kim
- ▶ Bond and Disclosure Counsel – Kutak Rock
  - ▶ Albert Reyes, Ryan Jardine
- ▶ Recommended Underwriter – Hilltop Securities
  - ▶ Todd Smith, Andy Kuo, Brian Whitworth

## National City POB – Next Steps and Preliminary Schedule

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- ▶ September 7th – POB Workshop; Council Q&A and Guidance
  - ▶ + Approval of Pension Funding Policy
- ▶ September/October
  - ▶ POS (Investor Prospectus Drafted)
  - ▶ MA (NHA) and Underwriter (Hilltop) continue to refine POB options analysis and stress testing to ensure final POB structure is optimized
  - ▶ Credit rating process
- ▶ October/November
  - ▶ POB structure and sizing refined and updated based on CalPERS changes
  - ▶ Final POS Approval by City Council
  - ▶ Price POB (lock interest rate)
- ▶ November/December
  - ▶ Close transaction and pay down CalPERS UAL