

Refinancing CalPERS Unfunded Liability Using Pension Obligation Bonds



TOWN OF
S A N A N S E L M O
EST. 1907

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Presented by:



Overview of CalPERS System

➤ Overview

- Most public agencies in California participate in the CalPERS retirement system to fund retirement benefits for their employees.
- CalPERS is the largest Public Retirement System in the United States.
- The Town of San Anselmo participates in this Pooled Retirement System.
- The Town pays into the system an annual deposit based on a percentage of payroll which, when invested by CalPERS at an assumed rate of return (currently assumed to be 7.00%) and added to the cash deposited, is actuarially designed to provide sufficient funds to pay required retirement benefits to its employees.

➤ Normal Cost CalPERS Payment

- The payment to CalPERS consists of two components, the normal cost and (if necessary) a scheduled payment toward the Unfunded Accrued Liability (UAL).
- The normal cost is the total amount that a CalPERS actuary has determined should be charged in a given year to all plan participants and its employees to complement the years investment earnings such that all benefits paid, and all administrative costs are covered.
- This collected amount is invested by CalPERS.

➤ CalPERS Investment Performance

- If actual investment performance does not meet the assumed rate of return needed for an employer to fund its long-term actuarial retiree obligations, or if an employer does not make sufficient contributions to its CalPERS fund, the resulting shortfall is calculated and allocated to the employer in the form of its Unfunded Accrued Liability (UAL).

Overview of CalPERS System

➤ Unfunded Accrued Liability (UAL)

- When a shortfall/UAL is calculated, it becomes an obligation of the Town and the Town accrues an annual cost on the balance in amount of CalPERS target rate of return (currently 7%), which is added to the existing UAL.
- This cost represents the return that CalPERS assumes it could have earned on the additional funds had the agency fully funded its retirement plans.

➤ Schedule of UAL Payments

- CalPERS gives each participating employer an amortization schedule to pay down its UAL obligation to CalPERS over a period of years.
- The schedule for the Town of San Anselmo's portion of the Town of San Anselmo's UAL currently runs through fiscal year 2044-45.

➤ Future Performance

- If investment performance exceeds expected rate, the net benefit is credited to pay down the existing UAL. If the employer has no current UAL, it remains as a credit balance to pay future UAL.
- If investment performance is less than the expected rate, the shortfall is added to the UAL or creates a new UAL which is amortized in the payment schedule along with the previously existing balance.

➤ Obligation

- The current UAL is an obligation similar in many ways to other long-term liabilities although its terms can be more flexible than a bond or similar fixed-schedule liability.
- It is effectively a debt with the annual interest cost calculated at CalPERS' assumed rate of return on the unpaid balance, plus the amount necessary to amortize the principal over the provided time frame.

San Anselmo Miscellaneous UAL Balance

The Town has three retirement plans at CalPERS (excluding the Safety Plans that are administered by the Central Marin Police Authority). The projected UAL balances of the three plans are summarized here:

Miscellaneous First Tier Plan	8,299,310*
Miscellaneous Second Tier Plan	607,163*
PEPRA Miscellaneous	<u>38,140*</u>
<i>Total</i>	8,944,613*

Bolded plans would be addressed in the proposed financing, the non-bolded PEPRA plan has a minimal UAL balance and would not be included in the financing due to the limited benefits to the Town.

**Projected balances as of June 30, 2022 are taken from CalPERS' Actuarial Valuation Report to the Town of San Anselmo dated July 2020, based on audited figures as of June 30, 2019 – CalPERS will verify these balances when a closing date is established for the Town's anticipated issuance.*

Solutions to fund CalPERS Unfunded Accrued Liabilities (UAL)

- 1) Continue to pay CalPERS based on existing 24-year amortization schedule, or other shorter-term schedules, as outlined in the CalPERS report.**
- 2) Pay off the UAL in part or in full with surplus funds of the Town and/or participate in and fund a Section 115 Trust Reserve (or other Trust Reserve), as appropriate.**
- 3) Pay off the UAL in part or in full using proceeds from the issuance of either a Lease Revenue Bond (requires collateral in a Lease-leaseback structure) or a General Fund secured Pension Obligation Bond (requires judicial validation).**

Validation

Article XVI, Section 18 of the California Constitution (the "debt limit") prohibits Cities, Towns, and certain other government entities from entering into indebtedness or liability that in any year exceeds the income and revenue provided for such year unless the local agency first obtains two-thirds voter approval for the obligation. This obligation to obtain voter-approval can be avoided if it meets any of exceptions listed below:

1. Lease Exception
2. Special Funds Exception
3. **Obligation Imposed by Law Exception (Validation Proceeding)**

Courts have determined that indebtedness to finance an obligation which is imposed by law is not subject to the debt limit. The theory is that the obligation is involuntary, and therefore it would be meaningless to put the question to the voters. Pension obligation bonds payable from an issuer's general fund are based on the theory that the payment of the unfunded liability to the issuer's pension plan is an "obligation imposed by law" which is, therefore, not subject to the constitutional debt limit. Because of limited case law authority on this exception to the debt limit, a judicial validation action is required in order to establish the validity of the obligation.

The validation action generally requires approximately 45 to 60 days from the date of filing and can be run concurrently with other work on the financing so that little additional time is required. Validation also has been considered crucial by the rating agencies, which generally require the 30-day appeal period to run before closing the bond issue. A typical pension obligation financing, including the validation action, takes roughly four to five months.

Using Pension Obligation Bonds to Pay Down UAL

- ***If the current UAL is paid in full, future CalPERS investment performance will determine whether additional UAL is created in the future. Should CalPERS fail to achieve its projected rate of return, the shortfall will cause the creation of a new UAL.***
- Conversely, should CalPERS achieve higher-than-expected returns, the excess would be credited to the employer's fund and thus available to offset any future increases in the UAL caused by subsequent underperformance in a given year.
- There is no possible way to eliminate the potential for future UAL to accrue due to underperformance of CalPERS without exiting the CalPERS system entirely.
- Payoff solutions allows entities to pay down liabilities presently owed, with the potential ability to save money in the future by reducing interest expense on the obligation. Eliminating today's UAL is in no way a means of eliminating the risk of future underperformance by CalPERS.
- Cities and Towns have two distinct options regarding the legal structure for a pension obligation bond:
 - 1) Structure as a Lease, with Town property used as security in a Lease-leaseback mechanism.
 - 2) Structure as a general fund obligation using a validation proceeding to confirm that the obligation is in compliance with the California "debt limit".

San Anselmo Miscellaneous – UAL Annual Pay-down

Payments have been made in lump sum for FY2020-21. FY2021-22 payments are anticipated to be made by the Town in July of 2021. If no action is taken, future payments will continue annually based on the payment schedules provided by CalPERS.

Shown below are the Town’s scheduled UAL payments to CalPERS for FY2022-23 on its First and Second Tier Miscellaneous Plans:

Miscellaneous First Tier Plan	706,599*
Miscellaneous Second Tier Plan	<u>47,160*</u>
Total	753,759*

**Estimated per CalPERS for FY 2022-23 in CalPERS’ Actuarial Valuation Report to the Town of San Anselmo dated July 2020, based on audited figures as of June 30, 2019.*

Current CalPERS Amortization Schedule

CalPERS debt service projections are as provided to the Town by CalPERS in July 2020 based on the June 30, 2019 actuarial valuation. CalPERS actuarial valuations are public information and figures were obtained directly from CalPERS. Moreover, CalPERS' projected amortization schedules assume that there are no future plan changes, no further changes in assumptions other than those recently approved, and no liability gains or losses. Such changes can have a significant impact on required contributions. **CalPERS projections are subject to change and significant uncertainty.** For further information about this uncertainty and the associated risks, please refer to the CalPERS Annual Valuation Report.

Payment schedules shown are the current CalPERS amortization schedules for the Miscellaneous First Tier and Miscellaneous Second Tier plans.

Town of San Anselmo	Current CalPERS Amortization Schedule		
Fiscal Year	Miscellaneous First Tier	Miscellaneous Second Tier	Totals
2021-22	<i>To be paid in July '21</i>		-
2022-23	706,599	47,160	753,759
2023-24	744,870	51,985	796,855
2024-25	785,737	56,917	842,654
2025-26	808,936	58,842	867,778
2026-27	830,614	60,350	890,964
2027-28	852,883	61,897	914,780
2028-29	875,765	63,489	939,254
2029-30	899,278	65,124	964,402
2030-31	923,435	66,805	990,240
2031-32	948,262	68,532	1,016,794
2032-33	941,304	67,915	1,009,219
2033-34	933,266	67,212	1,000,478
2034-35	912,303	64,982	977,285
2035-36	876,340	60,390	936,730
2036-37	409,887	50,721	460,608
2037-38	365,227	38,725	403,952
2038-39	317,817	30,645	348,462
2039-40	281,041	23,757	304,798
2040-41	257,079	18,971	276,050
2041-42	182,170	11,842	194,012
2042-43	172,850	11,962	184,812
2043-44	135,961	5,860	141,821
2044-45	63,774	-	63,774
Total	14,225,398	1,054,083	15,279,481

Estimated Sources and Uses of Funds

Numbers were run on March 11, 2021 at current market rates.

All figures are preliminary, estimated, and subject to change.

POB proceeds will be used to prepay the Town's unfunded actuarial liability to PERS for its Miscellaneous First Tier and Miscellaneous Second Tier plans.

Delivery Date Expenses are budgeted numbers that will be updated as the transaction progresses. Any funds remaining in the Delivery Date Expense Fund six months after closing will be applied to the Debt Service Fund

Potential Debt Service Savings Analysis	
Taxable Pension Obligation Bonds, Series 2021	
Sources & Uses	
Sources	
Par Amount	9,150,000
Total Sources	9,150,000
Uses	
Refunding Deposits	
Miscellaneous First Tier Plan	8,299,310
Miscellaneous Second Tier Plan	607,163
	8,906,473
Estimated Delivery Date Expenses	
Bond Counsel	35,000
Municipal Advisor	52,500
Disclosure Counsel	20,000
Rating Fee	15,000
Trustee	10,000
Town Attorney	7,500
Miscellaneous Expense Allocation	39,477
Underwriter's Discount	64,050
	243,527
Total Uses	9,150,000
Dated Date	9/28/2021
Delivery Date	9/28/2021

Estimated POB Debt Service

POB proceeds will be used to prepay the Town's unfunded actuarial liability to PERS for its Miscellaneous First Tier and Miscellaneous Second Tier plans.

Refunding POB debt service projections were prepared by Wulff, Hansen & Co. and are estimated based on current market conditions as of March 11, 2021 and are subject to change.

Potential Debt Service Savings Analysis				
Taxable Pension Obligation Bonds, Series 2021				
Example New Bonds Debt Service				
Fiscal Year	Public Offering			Estimated Debt Service
	Principal	Interest Rate	Interest	
2021-22				
2022-23	275,000	0.76%	326,124	601,124
2023-24	395,000	0.96%	248,222	643,222
2024-25	445,000	1.19%	243,678	688,678
2025-26	475,000	1.65%	237,111	712,111
2026-27	510,000	1.90%	228,348	738,348
2027-28	545,000	2.28%	217,290	762,290
2028-29	580,000	2.48%	203,885	783,885
2029-30	620,000	2.74%	188,199	808,199
2030-31	665,000	2.89%	170,095	835,095
2031-32	710,000	2.99%	149,872	859,872
2032-33	730,000	3.49%	126,519	856,519
2033-34	745,000	3.49%	100,780	845,780
2034-35	745,000	3.49%	74,779	819,779
2035-36	735,000	3.49%	48,953	783,953
2036-37	275,000	3.49%	31,329	306,329
2037-38	225,000	3.79%	22,266	247,266
2038-39	180,000	3.79%	14,592	194,592
2039-40	140,000	3.79%	8,528	148,528
2040-41	115,000	3.79%	3,695	118,695
2041-42	40,000	3.79%	758	40,758
Total:	9,150,000		2,645,019	11,795,019

Potential Savings from POB

CalPERS debt service projections are as provided to the Town by CalPERS in July 2020 based on the June 30, 2019 actuarial valuation. CalPERS actuarial valuations are public information and figures were obtained directly from CalPERS. Moreover, CalPERS' projected amortization schedules assume that there are no future plan changes, no further changes in assumptions other than those recently approved, and no liability gains or losses. Such changes can have a significant impact on required contributions. **CalPERS projections are subject to change and significant uncertainty.** For further information about this uncertainty and the associated risks, please refer to the CalPERS Annual Valuation Report.

Refunding bond debt service projections were prepared by Wulff, Hansen & Co. and are estimated based on market conditions as of March 11, 2020. If refunding bonds are issued by the Town, their future debt service requirements will be fixed as of the date of issuance and will not be subject to change during the life of the bond issue.

Fiscal Year	Potential Cash Flow Savings (23-years)		
	CALPERS Current Amortization Schedule	20-year POB Proposed Debt Service	Potential Savings
2021-22	Paid	-	-
2022-23	753,759	601,124	152,635
2023-24	796,855	643,222	153,634
2024-25	842,654	688,678	153,976
2025-26	867,778	712,111	155,667
2026-27	890,964	738,348	152,617
2027-28	914,780	762,290	152,491
2028-29	939,254	783,885	155,370
2029-30	964,402	808,199	156,204
2030-31	990,240	835,095	155,145
2031-32	1,016,794	859,872	156,923
2032-33	1,009,219	856,519	152,701
2033-34	1,000,478	845,780	154,698
2034-35	977,285	819,779	157,506
2035-36	936,730	783,953	152,777
2036-37	460,608	306,329	154,279
2037-38	403,952	247,266	156,686
2038-39	348,462	194,592	153,871
2039-40	304,798	148,528	156,271
2040-41	276,050	118,695	157,355
2041-42	194,012	40,758	153,254
2042-43	184,812	-	184,812
2043-44	141,821	-	141,821
2044-45	63,774	-	63,774
Total	15,279,481	11,795,019	3,484,462

Net Present Value of Savings (\$)	2,373,843
Net Present Value of Saving (%)	27%

Questions?



Recent California POB Issuances

Over \$5.8 billion in par amount of pension obligation bonds have been issued or are in process of being issued in California since the beginning of 2020 .

** In process, not yet completed*

<u>Issuer</u>	<u>Issuer County</u>	<u>Sale Date</u>	<u>Principal Amount</u>	<u>Debt Type</u>
Manhattan Beach*	Los Angeles	4/2/2021	90,000,000	Pension obligation bonds
Palos Verdes Library District*	Los Angeles	4/1/2021	6,100,000	Pension obligation bonds
Huntington Beach	Orange	3/18/2021	363,620,000	Pension obligation bonds
Orange	Orange	3/3/2021	292,500,000	Pension obligation bonds
Chula Vista	San Diego	2/11/2021	350,025,000	Pension obligation bonds
Downey	Los Angeles	2/9/2021	113,585,000	Pension obligation bonds
Monterey Park	Los Angeles	2/2/2021	106,335,000	Pension obligation bonds
Bonita Sunnyside Fire Protection District	San Diego	2/1/2021	5,127,000	Public enterprise revenue bond
El Cajon	San Diego	1/13/2021	147,210,000	Pension obligation bonds
Orange County	Orange	1/5/2021	484,800,000	Pension obligation bonds
Lake Valley Fire Protection District	El Dorado	1/1/2021	10,952,522	Public enterprise revenue bond
Coast Community College District	Orange	12/15/2020	2,280,000	Pension obligation bonds
La Puente	Los Angeles	12/3/2020	8,517,708	Certificates of participation/leases
Penn Valley Fire Protection District	Nevada	12/1/2020	1,037,884	Certificates of participation/leases
Ukiah	Mendocino	12/1/2020	49,875,000	Certificates of participation/leases
Coachella	Riverside	11/19/2020	17,590,000	Pension obligation bonds
California Earthquake Authority	State of California	11/12/2020	300,000,000	Public enterprise revenue bond
Gardena	Los Angeles	11/10/2020	101,490,000	Pension obligation bonds
Butte County	Butte	11/6/2020	9,160,000	Pension obligation bonds
Placentia	Orange	10/29/2020	52,950,000	Certificates of participation/leases
Arcadia	Los Angeles	10/27/2020	90,000,000	Pension obligation bonds
Torrance	Los Angeles	10/14/2020	349,515,000	Certificates of participation/leases
Belvedere	Marin	10/1/2020	2,323,000	Certificates of participation/leases
Borrego Springs Fire Protection District	San Diego	10/1/2020	1,874,111	Public enterprise revenue bond
Azusa	Los Angeles	9/17/2020	70,075,000	Pension obligation bonds
Town of Fairfax	Marin	9/16/2020	9,402,000	Certificates of participation/leases
Pomona	Los Angeles	8/13/2020	219,890,000	Pension obligation bonds
San Bernardino	San Bernardino	7/15/2020	19,850,000	Pension obligation bonds
Kensington Police Protection and Comm	Contra Costa	6/18/2020	4,544,000	Pension obligation bonds
El Monte	Los Angeles	6/18/2020	21,000,000	Certificates of participation/leases
North County Fire Protection District	Monterey	6/11/2020	20,305,000	Pension obligation bonds
Carson	Los Angeles	6/10/2020	108,020,000	Pension obligation bonds
El Monte	Los Angeles	6/9/2020	118,725,000	Pension obligation bonds
Riverside	Riverside	6/4/2020	432,165,000	Pension obligation bonds
Inglewood	Los Angeles	6/2/2020	101,620,000	Pension obligation bonds
Grass Valley	Nevada	6/1/2020	18,311,000	Pension obligation bonds
Montebello	Los Angeles	5/27/2020	153,425,000	Pension obligation bonds
Ontario	San Bernardino	5/12/2020	236,585,000	Pension obligation bonds
Larkspur	Marin	4/30/2020	18,295,000	Pension obligation bonds
Riverside County	Riverside	4/22/2020	719,995,000	Pension obligation bonds
Richardson Bay Sanitary District	Marin	2/28/2020	2,383,000	Pension obligation bonds
Pasadena	Los Angeles	2/5/2020	131,800,000	Pension obligation bonds
Orange County	Orange	1/7/2020	463,895,000	Pension obligation bonds

Key Players in Bond Issue

THE ISSUER

The issue must meet your needs and goals.

MUNICIPAL ADVISOR

Helps issuer plan and execute bond sale, represents issuer in dealings with other market players. Municipal Advisors have a fiduciary duty to their Clients.

BOND AND DISCLOSURE COUNSEL

Provides opinion on legal authority and tax status of the bond issue. Ensures adequate disclosure is provided to investors in the form of a Preliminary Official Statement.

RATING AGENCY

Provides independent assessment of issuer creditworthiness, assigns letter grade to inform investors.

UNDERWRITER

As underwriter, purchases bonds from issuer, then sells them to investors.

INVESTOR

Individual or institution that purchases the bonds from the Underwriter.