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OFFICE OF THE
CITY TREASURER

THOMAS P. FRIERY
TREASURER

CITY OF SACRAMENTO
CALIFORNIA

June 8, 1994
F01035LL.MWZ

926 J STREET
SUITE 300
SACRAMENTO, CA
95814-2709

PH 916-264-5168
FAX 916-448-3139

APPROVED
BY THE CITY COUNCIL

JUN 14 1994

OFFICE OF THE
CITY CLERK

City Council
Sacramento, California

Honorable Members in Session:

SUBJECT: PENSION OBLIGATION BONDS

LOCATION & COUNCIL DISTRICT: Citywide

RECOMMENDATION: Staff recommends adoption of the attached Resolution which

- Refers to the Law & Legislation Committee to pursue through federal legislation the concept of permitting tax-free bonds to be issued for pension obligation bonds, and
- Appropriates the sum of $60,000 to cover costs relating to this financing, and
- Authorizes the City Treasurer to proceed with this financing in the event market conditions allow achievement of savings at the 5% to 6% level as previously approved by City Council.

CONTACT PERSON: Thomas P. Friery, City Treasurer

FOR COUNCIL MEETING OF: June 14, 1994

SUMMARY: The financing plan for the Pension Obligation Bonds has been postponed as a result of current market conditions and the decrease in the PERS actuarial unfunded liability as of June 30, 1993. However, in the event market conditions become favorable and allow us to achieve our initial minimum targeted savings, we request authorization to proceed and complete this financing. Staff seeks Council's approval to initiate, through the Law and Legislation Committee, an effort to pursue tax-free bonds for the Pension Obligation Bonds.

BACKGROUND INFORMATION

Staff's report to City Council on May 3, 1994 reflected a cash flow savings of $7.8 million. Also recommended were a number of safeguards to address concerns related to fluctuations in the PERS actuarial unfunded liability. It was also recommended and approved by City Council that the City Treasurer target present value savings at a minimum of 5% to 6% of the principal amount of bonds issued.

As of the current date, interest rates have increased by approximately 110 basis points since Council approved this financing option. The 110 basis points equals an annual increase of 1.10% in the issue cost, representing an increase of 20% in borrowing costs since our previous estimate. The change in market rates decreased the level of present value savings to 3.8% of the principal amount of the borrowing, well under the minimum target recommended by the City Treasurer and approved by City Council.

The most recent and major factor which had an effect on the savings was the report which was issued by PERS. The new actuarial unfunded liability for the period ending June 30, 1993 was reported at $45.394 million, $20.262 million less than the previous year. As a result of this reduction, the City's unfunded liability payment was reduced substantially. This reduction eliminated a majority of the absolute savings originally estimated. In addition, after the most recent report, the present value savings level was down to 3.8% of the principal amount of the bonds. As a result of the current high taxable interest rates and the volatility in the actuarial unfunded liability, a higher level of savings must be assured prior to issuing pension obligation bonds to eliminate future obligations and incur appropriate savings. The table below reflects the current savings compared with the initial presentation in January 1994.

	January 1994	May 1994
Principal Amount	$65.7	$45.4
Cash Flow Savings	16.	1.8
Present Value Savings	11.2	1.7
5-7 Year Avg Cash Flow Savings	2.7	.338
True Interest Cost	7.28%	8.55%

The original intent was to inure the savings over the first 7 years of the issue. In order to accomplish this, it was necessary to structure the issue with Capital Appreciation Bonds ("CABs"). The market for CABs requires a higher yield due to the lack of liquidity and the difficulty in identifying buyers in the taxable market. Tax-exempt bonds typically sell for 30% to 40% less than taxable bonds.

FINANCIAL CONSIDERATIONS

If market conditions prohibit us from achieving our targeted savings, the City will have incurred approximately $60,000 in non-reimbursable expenses related to this financing for which invoices will be forthcoming. Following is a list of these expenses:

- Bond Counsel $10,000
- Rating Agencies $34,000
- Audit and printing $16,000

These expenses must be paid, and City Council approval is recommended.

In addition, a number of other expenses were incurred by the City's underwriting group. However, as a result of our contract with the underwriters, none of those expenses are reimbursable from the City if a financing transaction is not accomplished. We believe the expenses incurred (i.e. travel, cash flow analysis, etc.) exceed those expenses paid by the City.

POLICY CONSIDERATIONS

The policy considerations to be addressed are the following:

1. <u>Should the City refer to the Law & Legislation Committee the taxability issue related to Pension Obligation Bond financing?</u>

   It is the City Treasurer's belief that municipal unfunded liability and pension fund payments for employees are "public purpose" expenditures or costs under the federal regulations related to municipal tax-free borrowing authority. However, interpretations by the IRS and certain tax counsel have suggested that such expenditures are operation costs and therefore not public purpose for tax-free borrowing purposes. The difference between tax-free and taxable borrowing rates is as much as 30%. Therefore, as a tax-free borrowing instrument, substantial savings could be incurred if a Pension Obligation Bond were tax-free. However, the 30% additional savings described could only result through the change in legislation at the federal level.

   The City Treasurer believes unfunded liability payments are long-term public purpose expenditures for employees. Payment of these expenses at the lowest possible cost not only provides for long-term pension payments to employees, but also minimizes costs to tax payers by borrowing tax-free v. taxable.

2. <u>Should the City proceed with this financing in the event market conditions improve to permit the 5% to 6% targeted savings level?</u>

   As previously approved by City Council, the City Treasurer still believes that a 5% to 6% savings level would provide a substantial savings over a 6- to 7-year period.

MBE/WBE EFFORTS

Grigsby Brandford & Co., Inc. (MBE) was the lead underwriter on this financing. M/WBE firms were assigned 32.5% participation on this financing.

Respectfully submitted,

Lydia Lara
Deputy City Treasurer

Thomas P. Friery
City Treasurer

RECOMMENDATION APPROVED:

William E. Edgar, City Manager

RESOLUTION NO. 94-377

APPROVED
BY THE CITY COUNCIL

JUN 14 1994

OFFICE OF THE
CITY CLERK

ADOPTED BY THE SACRAMENTO CITY COUNCIL

ON DATE OF ______________________

A RESOLUTION AUTHORIZING THE CITY MANAGER AND THE CITY TREASURER TO REFER TO THE LAW AND LEGISLATION COMMITTEE TO PERMIT ISSUANCE OF TAX FREE PENSION OBLIGATION BONDS, APPROPRIATING THE SUM OF $60,000 TO PAY COSTS INCURRED IN CONNECTION WITH THE PENSION OBLIGATION BOND FINANCING PROCESS, AND AUTHORIZING THE CITY TREASURER TO PROCEED WITH THIS FINANCING IN THE EVENT MARKET CONDITIONS ALLOW ACHIEVEMENT OF THE PREVIOUSLY APPROVED SAVINGS LEVEL

BE IT RESOLVED BY THE COUNCIL OF THE CITY OF SACRAMENTO THAT:

1. The City Treasurer and the City Manager are authorized to refer to the Law and Legislation Committee, to permit issuance of tax-free pension obligation bonds through federal legislation.

2. The sum of $60,000 is appropriated from the General Fund Contingency Account for the purpose of funding the costs incurred in connection with the Pension Obligation Bond financing, in accordance with the report of the City Treasurer, which is hereby approved.

3. The City Treasurer is authorized to proceed with this financing in the event market conditions allow achievement of savings at the 5% to 6% level as previously approved by City Council.

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MAYOR

ATTEST:

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CITY CLERK

FOR CITY CLERK USE ONLY

RESOLUTION NO.: ______________

DATE ADOPTED: ______________

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