CITY OF TEMECULA/TEMECULA PUBLIC FINANCING AUTHORITY
AGENDA REPORT

TO: City Manager/Executive Director/City Council/Board of Directors

FROM: Jennifer Hennessy, Director of Finance/Treasurer

DATE: December 13, 2022

SUBJECT: Approve the Debt/Liability Paydown Strategy (At the Request of Subcommittee Members Mayor Rahn and Council Member Edwards)

PREPARED BY: Jennifer Hennessy, Director of Finance/Treasurer

RECOMMENDATION: That the City Council/Board of Directors:

1. Adopt the Amended Budget and Fiscal Policies to include the Debt/Liability Paydown Strategy Policy; and

2. Adopt a resolution entitled:

   RESOLUTION NO.

   A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF TEMECULA AUTHORIZING THE PREPAYMENT OF FINANCING LEASE AGREEMENTS ENTERED INTO BY THE CITY OF TEMECULA IN 2011 AND 2018 RELATING TO THE FINANCING AND REFINANCING OF CAPITAL PROJECTS FOR THE CITY AND AUTHORIZING AND DIRECTING CERTAIN ACTIONS WITH RESPECT THERETO

3. Adopt a resolution entitled:

   RESOLUTION TPFA NO.

   A RESOLUTION OF THE BOARD OF DIRECTORS OF THE TEMECULA PUBLIC FINANCING AUTHORITY APPROVING THE PREPAYMENT OF FINANCING LEASE AGREEMENTS ENTERED INTO BY THE CITY OF TEMECULA IN 2011 AND 2018 RELATING TO THE FINANCING AND REFINANCING OF CAPITAL PROJECTS FOR THE CITY AND AUTHORIZING AND DIRECTING CERTAIN ACTIONS WITH RESPECT THERETO

4. Adopt a resolution entitled:

   RESOLUTION NO.

   A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF TEMECULA, AUTHORIZING THE TRANSFER OF $5,000,000 FROM THE CITY'S PENSION RATE STABILIZATION TRUST TO MAKE AN ADDITIONAL DISCRETIONARY PAYMENT TO CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

5. Appropriate $19,913,606 in Available General Fund Balance to pay off the Civic Center Loan ($12,624,607), the Margarita Recreation Center Loan ($5,038,999) and pay an Additional Discretionary Payment to CalPERS for the City's Unfunded Liability ($2,250,000); and

6. Appropriate $5,000,000 in Available Pension Trust Funds to pay an Additional Discretionary Payment to CalPERS for the City's Unfunded Liability.

BACKGROUND: At their meeting on November 29, 2022, the Council conceptually approved a Debt/Liability Paydown Strategy presented by Staff. The Strategy provides for a 7-year paydown schedule for the City's outstanding facility debt, the unfunded pension liability, and the unfunded Other Post-Employment Benefits (OPEB) liability. The Paydown Strategy consists of a 15-year Financial Plan and includes the use of Available General Fund Balance and available resources in the IRC Section 115 Irrevocable Pension Trust to pay off the City's outstanding debt/liabilities in accordance with the table below.

		Funding Sources		Payoff Schedule			
Year #	Fiscal Year	Pension Trust	Available Fund Balance	OPEB Liability	Pension Liability	Civic Center Loan	MRC Loan
1	2022-23	5,000,000	19,913,606		7,250,000	12,624,607	5,038,999
2	2023-24	5,000,000	10,982,828	5,361,000	10,538,003		
3	2024-25	5,000,000	3,223,220		8,234,950		
4	2025-26	2,000,000	5,498,008		6,819,012		
5	2026-27		2,680,009		2,178,158		
6	2027-28		10,788,263		10,204,668		
7	2028-29		8,330,579		7,430,035		
8	2029-30						
9	2030-31						
10	2031-32						
		17,000,000	61,416,513	5,361,000	52,654,826	12,624,607	5,038,999
Total Interest Savings				**n/a**	**30,756,231**	**2,187,894**	**1,036,267**

<u>Facility Loans -</u> In 2011, the City, together with the Temecula Public Financing Authority (the "Authority"), entered into a lease transaction to refund (a) certificates of participation delivered in 2001 to finance and refinance the construction of various community recreation facilities, and (b) certificates of participation delivered in 2008 to finance the construction of the Temecula Civic Center (the "2011 Lease Financing").

In 2018, the City, together with the Authority, entered into a lease transaction to finance the construction and equipping of a new recreation center in Margarita Park in place of the former YMCA including the demolition of the existing building and pool and construction and equipping of a new building and pool (the "2018 Lease Financing").

In connection with the 2011 Lease Financing, the City entered into a financing lease agreement which requires the City to make semi-annual lease payments (which include a principal component and an interest component) from its general fund (the "2011 Lease Agreement") and in connection with the 2018 Lease Financing, the City entered into a financing lease agreement which requires the City to make semi-annual lease payments (which include a principal component and an interest component) from its general fund (the "2018 Lease Agreement").

The lease payments made by the City under the 2011 Lease Agreement were assigned to the Bank which, in exchange for such assignment, advanced funds to the City to refund the 2001 certificates of participation and the 2008 certificates of participation.

The lease payments made by the City under the 2018 Lease Agreement were also assigned to the Bank which, in exchange for such assignment, advanced funds to the City to finance the construction and equipping of a new recreation center in Margarita Park in place of the former YMCA including the demolition of the existing building and pool and construction and equipping of a new building and pool.

The remaining principal amount of the 2011 Lease Agreement is $12,482,000 and the remaining principal amount of the 2018 Lease Agreement is $4,982,079.

The current terms of the 2011 Lease Agreement preclude the option by the City to prepay the agreement until December 1, 2026, and the current terms of the 2018 Lease Agreement preclude the option by the City to prepay the agreement until September 1, 2028.

The City desires to prepay the 2011 Lease Agreement and the 2018 Lease Agreement in advance of the stated prepayment dates and has requested that the Bank waive the stated prepayment dates and permit the immediate prepayment of the 2011 Lease Agreement and the 2018 Lease Agreement.

The Bank has agreed to waive the stated prepayment dates and permits the immediate prepayment of the 2011 Lease Agreement and the 2018 Lease Agreement at the current remaining principal amount thereof in exchange for the payment of a release fee equal to 1% of the principal amount of each agreement plus accrued interest from the last interest payments made by the City.

The prepayment amount for the 2011 Lease Agreement, assuming prepayment on December 15, 2022, is $12,624,606.85 (remaining principal amount of $12,482,000.00, plus a 1% release fee of $124,820.00, and accrued interest from December 1, 2022 of $17,786.85).

The prepayment amount for the 2018 Lease Agreement, assuming prepayment on December 15, 2022, is $5,038,999.25 (remaining principal amount of $4,982,079.00, plus a 1% release fee of $49,820.79, and accrued interest from December 1, 2022 of $7,099.46).

Adoption of the resolution will authorize the prepayment of the 2011 Lease Agreement and the 2018 Lease Agreement.

OPEB Liability - The Other Post-Employment Benefits (OPEB) unfunded liability relates to the retiree health benefit provided to eligible City employees. The City established an OPEB Trust in 2008 with the California Employers' Retiree Benefit Trust (CERBT), a division of CalPERS. The Trust was established primarily to fund the cost of the retiree health benefit afforded to eligible City employees hired prior to 6/30/05 with 12 or more years of service. Additionally, the OPEB Trust pays for the annual service fees for CalPERS Health and the ongoing implied subsidy, required by the Governmental Accounting Standards Board (GASB). Effective June 30, 2022, the Total OPEB Liability is $20.6M, with total Trust balance of $16.6M, leaving an unfunded liability of $4.0M. However, the investment losses experienced during Fiscal Year 20-21-22 are not reflected in these amounts. Once the losses are reflected, the estimated unfunded liability is $5,361,000 as of 6/30/22. The annual contribution to the OPEB Trust is approximately $645,000.

Pension Liability - The City's pension program is funded through CalPERS, and has an unfunded liability of $46,364,142, as of 6/30/20. The annual payment required for the unfunded liability ranges between $4-5 million and is scheduled to be paid off in 25 years. The unfunded liability consists of 29 separate "amortization bases," which reflect historical gains and losses from CalPERS' actuarial projections. Each year, CalPERS revalues the City's pension plan and determines the annual contribution necessary to fund the plan and paydown a portion of the unfunded liability. Each new amortization base is spread over a 30-year time horizon for gains and a 20-year time horizon for losses, per CalPERS policy. CalPERS allows agencies to make "Additional Discretionary Payments" (ADPs) to reduce the unfunded liability quicker by paying it off earlier and save interest costs (similar to paying off a mortgage early). With the excess Fund Balance and through the establishment of the Pension Trust, the City has built up adequate reserves to fund ADPs and reduce the City's unfunded liabilities, saving between $905k in Year 2 up to $5.6M in Year 8, plus over $30 million in interest. Finance Staff will work with the City's designated CalPERS actuary to choose the ADPs that will maximize the annual savings and achieve a timely payoff of the unfunded liability.

As the economy changes over time, it will be necessary to reevaluate the 15-Year Financial Plan that serves as the basis for the Debt/Liability Paydown Strategy. Attached as Exhibit A is an Amendment to the City's Budget and Fiscal Policies, to include the guidelines for reevaluating the Debt/Liability Paydown Strategy to ensure that the City's debt/liabilities are paid off in the target 7-year timeframe and that the 15-Year Financial Plan maintains a minimum of $4 million in Available Fund Balance throughout the life of the Paydown Strategy.

FISCAL IMPACT: With the appropriation of $19,913,606 in Available General Fund Balance, plus $5,000,000 from the IRC Section 115 Irrevocable Pension Trust, the City will pay off the Civic Center Loan, the Margarita Recreation Center Loan and a portion of the CalPERS pension unfunded liability, which will generate in excess of $3 million in total interest savings, plus $3 million in operating budget savings per year.

ATTACHMENTS:

1. FY 2022-23 Budget and Fiscal Policy Amendment
2. City Resolution – Facility Debt Payoff
3. TPFA Resolution – Facility Debt Payoff
4. City Resolution – PARS Trust Withdrawal