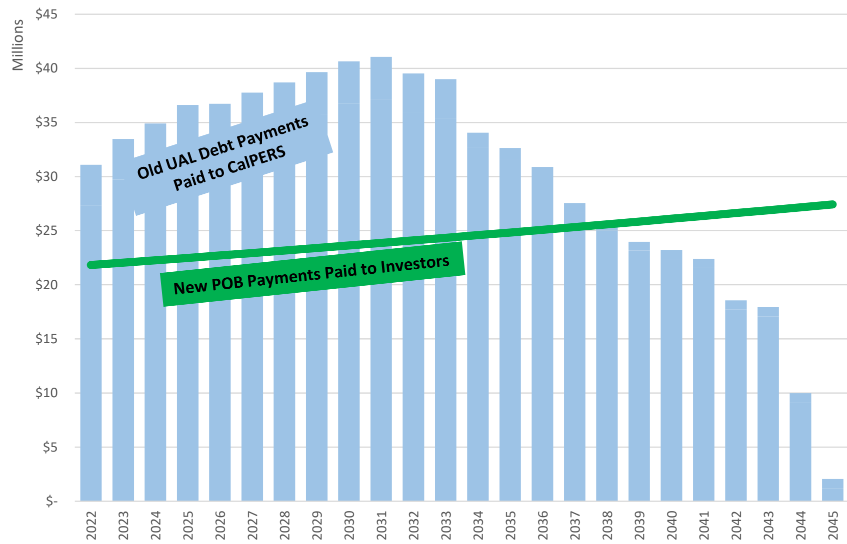
Chula Vista Q&A: Pension Obligation Bonds

- **Why is the City issuing a POB?**
  - The City of Chula Vista is currently paying 7% interest on over $350 million dollars owed to CalPERS for unfunded pension liability (detailed definition below). Given the City's extremely strong credit rating (AA), and historically low current market interest rates, the City can borrow at interest rates between 3.25% and 3.50% - significantly lower than the 7% CalPERS charges. Furthermore, the City will use the POB to create a new repayment shape for the debt that is more predictable and conducive to the City's continued fiscal health. There are significant savings projected (over $10M per year on average for next 15 years) which can be used to bolster the City's reserve levels and reduce the risk that the City will need to cut staff, services or critical capital projects that will benefit the community.

    A chart of the restructuring strategy can be seen to the right, with the green line representing the new debt payments, and the bars representing the current repayment schedule with CalPERS that will be eliminated.

- **What is a Pension Obligation Bond (POB)?**
  - A POB is a taxable bond that the City issues to investors. The proceeds that the City raises are then sent to CalPERS to extinguish all or a part of the City's current unfunded accrued liability (UAL).

- **What is a UAL?**
  - A UAL is the shortfall between what the City has in assets vs. what it will need in assets to fully pay out the benefits that it has promised to retirees. This number is currently $356 million for the City of Chula Vista. The UAL is essentially the City's debt to CalPERS. CalPERS charges the City a 7% interest rate on this debt and enforces a mandatory repayment schedule. This payment schedule is not flat like a mortgage, but rapidly escalating over the next 10 to 15 years before declining to $0 in 2046.

- **Projected Savings is Not Guaranteed and is Based on CalPERS Future Returns (Reinvestment Risk)**
  - Correct. The rule of thumb is that if CalPERS earns more than the rate paid on the bonds (3.25% to 3.50% estimated right now), the City will be better off. If CalPERS earns under the bond rate, the City would be worse off.
  - While past performance does not guarantee future results, CalPERS' historical 30-year returns are 8.0%, 5.5% for the last 20 years on average, 8.5% for last 10 years and 6.3% for the last 5 years.

- **What Has the City Done to Address Reinvestment Risk?**
  - The City has taken this risk into careful consideration, both quantifying this risk through stress-testing analysis completed by a 3rd party actuary and working in consultation with its financial advisor. The stress testing analysis included looking at the impact to the City if CalPERS does not meet its 7.0% annual investment return target. Specifically, the actuary calculated savings if CalPERS only makes 6% per year, as well as a more dire scenario where there is another 2008-like recession right after the City issues the POB. Under both, the City is projected to still be significantly better off than if it had not issued the POB. Over $45 million of savings (present value) is still projected even if there was another 2008-like recession.

- Furthermore, the City has structured the new payments in a way that creates enhanced resiliency for the City to absorb new UAL that might be added on in the future from potential below average investment performance.
- Lastly, the savings will get set aside in various reserves to address future economic uncertainty, emergencies, and address future pension and OPEB liability increases (per policy noted below). This money could be invested back into the market if there was a downturn.

- **What is the City's Plan for the Projected Savings?**
  - The City has adopted a comprehensive reserve and pension funding policy. This policy provides the framework behind how the City will set aside surplus funds and savings from the POB each year. This policy will prioritize the City's basic operating reserves first, then its two emergency/economic contingency reserves, and then start to fund its pension and OPEB reserves, as well as a POB Bond redemption reserve. These reserves will allow the City to accumulate funds to address future potential pension liability increases as well as pay down the POB debt early to save on interest costs.

- **Are taxpayers on the hook?**
  - The current CalPERS debt of $356M is a liability that the City must pay
  - The POB replaces that existing liability with a lower cost liability to reduce the burden on the City and taxpayers

- **The City should address this issue through pension reform, not Bonds**
  - The current liability cannot be undone through pension reform and the City must make its payments as prescribed by CalPERS; the City is addressing this large liability through the POB issuance
  - While the City cannot address the current UAL through pension reform, the City has undertaken reforms that are available, including requiring employees to pay their fair share. Additionally, new PEPRA state laws have reduced benefits for new employees (and Employer costs).

- **The UAL Could Come Back.**
  - This is correct. But the UAL may come back whether the City issues a bond or not. The new repayment shape created provides more capacity/resilience for City to pay for any potential "shocks" while also maintaining services to City residents.

- **POBs are "kicking the can down the road"**
  - No. The City's proposed strategy DOES NOT include an extension of maturity.

- **Rating Agencies will view these negatively**
  - No. The City carries a "AA" Stable rating from Standard & Poor's Global Ratings, which is above average for California cities. S&P recognizes the significant benefits of the restructuring and importantly, the prudence and thoughtfulness behind the recent pension funding policy that was adopted.

- **Pension Bonds exchange a "soft" liability for "hard" bonded debt**
  - The City's liability to CalPERS is already debt on its balance sheet: it is legally enforceable and has a mandatory payment schedule. Rating agencies treat unfunded pension liabilities as debt in calculating liability and fixed expense ratios.
  - GASB requires it shown in CAFR
  - It is expensive debt - CalPERS charges 7% interest on the UAL

- **Pension Bonds have sometimes contributed to or enabled unsound policy decisions**
  - City's proposed POBs DO NOT finance current year obligations nor provide any sort of benefit

- **Why 100% of the UAL and one deal?**
  - A larger transaction provides more potential savings. City has considered staggered/multiple issuances, however, the City has determined that the opportunity to lock in historically low interest rates right now is the preferred approach.

- **How many other Agencies have issued pension bonds or are considering them?**
  - As shown on the next page, over 30 agencies have used bonds to restructure their UAL over the past two years, totaling about $3 billion in UAL refinanced. Based on conversations with the City's advisor and other market participants, it is estimated that at least 20 other cities (totaling >$5 billion in UAL) are currently moving forward with or evaluating this strategy.

Addressing GFOA Concerns

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 returns below current < 3.0-3.5% borrowing costs are low, but they do exist. City's municipal advisor and actuary have "stress tested" options to better quantify this risk.
"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.
"Issuing taxable debt to fund the pension liability increases the jurisdiction's bonded debt burden and potentially uses up debt capacity…"	• No. Pension bonds merely replace a portion of an agency's payments to PERS with debt service. It is converting one debt to another type of debt at a lower interest rate.
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. Current pension bonds are issued with a call feature, allowing agencies to refinance them in the future. The City is issuing with a 10-year call feature.
"Pension bonds are frequently structured in a manner that defers the principal payments…"	• They can be. But the City of Chula Vista is not extending the maturity and maintaining the same exact term of the debt that it currently has with CalPERS.
"Rating agencies may not view the proposed issuance of Pension bonds as credit positive…"	• No. Rating agencies have generally been viewing pension bonds as neutral to positive and an enhancement to long term affordability. Rating agencies also recognize the implementation of prudent strategies to address pension liabilities. The City has an extremely strong "AA" rating.

Recent Pension Bonds (CalPERS UAL Restructurings)

Chula Vista	**El Cajon**	**Ukiah**	**Coachella**	**Gardena**	**Arcadia**	**Placentia**	**Torrance**	**Novato Sanitary District**	**Azusa**	**Borrego Springs FPD**
(2021)	(2021)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)
$349,095,000 (est.)	$147,210,000	$49,875,000	$17,590,000	$100,590,000	$90,000,000	$52,950,000	$349,515,000	$6,467,000	$70,075,000	$1,874,111
Pricing Feb. 2021	AA	A+	AA-	AA-	AAA	BBB+	AA	Private Placement	AA-	Private Placement

Pomona	**West Covina**	**Grass Valley**	**North County Fire Protection District**	**Kensington Police Protection CSD**	**Carson**	**El Monte***	**Riverside**	**Inglewood***	**Montebello***	**Ontario**
(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)	(2020)
$219,890,000	$204,095,000	$18,311,000	$20,305,000	$4,544,000	$108,020,000	$118,725,000	$432,165,000	$101,620,000	$153,425,000	$236,585,000
AA-	A+	Private Placement	AA-	Private Placement	AA-	A+ (Ins.)	AA	AA- (Ins.)	A+ (Ins.)	AA

Larkspur	**Riverside County**	**Pasadena**	**Monterey Regional Fire District**	**Pacifica**	**Shasta Lake**	**Hawthorne**	**Marysville**	**Glendora**	**Calaveras County WD**	**Baldwin Park**
(2020)	(2020)	(2020)	(2019)	(2019)	(2019)	(2019)	(2019)	(2019)	(2019)	(2019)
$18,295,000	$719,995,000	$131,805,000	$20,250,000	$9,865,000	$9,500,000	$121,865,000	$15,000,000	$64,420,000	$5,665,000	$54,085,000
AAA	AA	AAA	AA-	AA+	A+	AA-	A	AAA	Private Placement	AA-