



# Memorandum

**TO:** HONORABLE MAYOR  
AND CITY COUNCIL

**FROM:** Julia H. Cooper

**SUBJECT:** SEE BELOW

**DATE:** April 29, 2021

Approved

Date

**4/29/2021**

**SUBJECT: ACTIONS RELATED TO CONTINUED EXPLORATION OF PENSION  
OBLIGATION FUNDING STRATEGIES**

## **RECOMMENDATION**

Direct City Administration and the Office of the City Attorney to take the following actions related to the further exploration of the issuance of Pension Obligation Bonds as a funding option for the City's unfunded accrued liabilities in the Federated City Employees' Retirement System ("Federated Plan") and the Police and Fire Department Retirement Plan ("Police and Fire Plan" and collectively the "Retirement Plans"):

- a. Proceed with planning and preparation of bond documents and court validation documents necessary for the issuance of Pension Obligation Bonds ("POBs") and return to City Council ("Council") on June 29, 2021 with the necessary actions to proceed with court validation;
- b. Prepare a Pension Obligation Funding Policy ("Policy") for Council review and approval;
- c. Coordinate with the Office of Retirement Services to schedule a joint meeting(s) with Council and both Retirement Boards to develop an understanding of the respective Retirement Boards' investment strategy for the POBs proceeds; and
- d. Return to Council for approval of POBs financing plans with accompanying analysis of risks and benefits after the POBs are successfully validated.

## **OUTCOME**

City Council direction to proceed with next steps will allow staff time to work in parallel with the steps necessary for court validation and potential financing of Retirement Plans' Unfunded Accrued Liabilities ("UAL") with POBs. Staff anticipates presenting to Council in the Fall of 2021, a Pension Obligation Funding Policy, along with further sizing and bond structuring and risk analysis based on discussions and feedback from the Retirement Plans' Boards on the

investment of bond proceeds. No Council action on the issuance of POBs is anticipated prior to early in calendar year 2022.

A successful POBs financing strategy could potentially lower the City's UAL for the Retirement Plans and provide savings to the City's budget, including the General Fund. Nothing in this action will obligate Council to issue POBs in the future, but recognizing the long legal validation process necessary before POBs can be issued and market timing decisions can be made, this process would make this financing tool available subject to further Council approval of any specific bond transactions.

## **BACKGROUND**

On April 23, 2021, a Council study session<sup>1</sup> was held. City staff gave a presentation that provided information on the City's UAL (including its magnitude and impact on the City's Budget) and funding options for the UAL, while examining the issuance of POBs as a potential solution. There was an in-depth discussion on the merits and risks of POBs, sensitivity analysis, a guest speaker on POBs and retirement funds investing, a review of the City's municipal advisor's report on POBs, public comment and questions from Council. During the study session, the following was discussed:

- **Review of the UAL Challenge** - City staff provided an overview of the challenges of funding the UAL and past efforts to provide funding solutions.
- **Pension Obligation Financing Options** – City staff discussed various financing structures, provided a background on POBs, provided the opportunity to hear a guest speaker on POBs and retirement funds investing, and staff also provided a counterpoint explaining the reasons the GFOA and others have for recommending against issuing POBs.
- **Report from the City's Municipal Advisor** – the City's municipal advisor, Urban Futures, Inc. ("UFI"), provided analysis on POB issuance, discussed structuring options to mitigate risks of issuing POBs, and discussed selected municipal case studies.
- **Analysis of Potential San José POBs** – UFI discussed City policy considerations, POB structuring, POB stress testing and different structuring approaches.
- **Judicial Validation of POBs** – the City's bond counsel, Stradling Yocca Carlson & Rauth presented an overview of the reasons for a judicial validation and the steps and timing to complete the process.
- **Conclusions and Next Steps** – City staff provided concluding remarks and a plan for next steps that included potential recommendations for Council to consider on May 11, 2021.

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<sup>1</sup> <https://sanjose.legistar.com/MeetingDetail.aspx?ID=790194&GUID=6D7FA4D7-1A63-4C08-A8E8-045DE722CC29&Options=info|&Search=>

## **ANALYSIS**

At the Study Session, staff presented options it had evaluated for financing the UAL obligations of the City's Retirement Plans, including the possibility of issuing POBs as requested by the Mayor and Council in their December 1, 2020 referral, and provided other preparatory work that will assist the City Council in its ability to make a fully informed decision about the merits and risks of UAL financing options including the issuance of POBs.

The May 11 recommended actions continue the efforts of the Administration and the City Attorney's Office in providing the City Council with the analysis, information and tools to make the decision to issue POBs. These actions are discussed below.

**Prepare of Bond Documents and Court Validation Documents** – As discussed at the April 23 Study Session, the court validation process is expected to take four to seven months depending on the court calendar and the impacts of COVID-19 on the court calendar. Staff is recommending that the documents be brought forward for City Council approval on June 29, so the filing can occur during the July recess.

**Prepare a Pension Obligation Funding Policy** – As discussed during the Study Session, adopting a formal Policy is an important step in evaluating all funding options to address the City's large UAL. Adoption of a Policy demonstrates prudent financial management practices, promotes long-term strategic thinking, provides guidance in making annual budget decisions, reassures bond rating agencies of the ability to meet future obligations; and demonstrates to employees and the public how the unfunded pension liability will be funded to ensure adequate funding for negotiated benefits.

Areas staff will consider in the development of a Policy for Council review and approval include, but are not limited to:

- Commitment to evaluate pension liabilities in the same context as evaluation of all current and future liabilities and within the context of capital plans
- Use of budgetary savings created by any prepayment of UAL
- Creation of budgetary savings, or cost avoidance strategies in both the General Fund and all funds
- Use of one-time money, surplus and budgetary savings created by prepayment of UAL
- Development of multiple solutions to consider and implement over time

**Schedule Joint Meeting of Council and Retirement Boards** – An important part of the Council's evaluation of POBs as a financing strategy is a discussion with the Boards of the Retirement Plans to understand their respective investment strategies for POB proceeds and how that strategy may differ from their current asset allocations or be the same. In initial discussions with the Office of Retirement Services, the goal is to schedule the joint meeting in August 2021.

**Develop POB Financing Plans** – Return to Council for review and approval of POBs financing plan(s) with accompanying analysis of risks and benefits after the POBs are successfully validated and prior to returning to Council with approval of the issuance of POBs.

**Timeline / Next Steps**

Date	Activity
May 11, 2021	Council approval of actions outlined in this staff report
June 29, 2021	Council approval of bond and court validation documents
July 2021	Bond Counsel files validation action with Santa Clara County Superior Court
August 2021	Joint Meeting of the Council and the two Retirement Plan Boards
Fall 2021	Council approval of Pension Obligation Funding Policy
Fall 2021	Council consideration of POB financing plan(s) with accompanying analysis of risks and benefit
Early 2022	Council approval of documents necessary for POB issuance upon successful validation
Early 2022	Issuance and Closing of POBs, if debt and investment market conditions warrant

**CONCLUSION**

If Council directs staff to move forward with validating POBs and developing the Policy, it will provide Council with the flexibility of having this tool available to help finance the UAL of the two Retirement Plans, assist in controlling the City pension funding costs, and provide policy guidance in use of budgetary savings and use of one-time funds.

**EVALUATION AND FOLLOW-UP**

Upon direction to move forward with the judicial validation of POBs, staff will work with bond counsel for Council approval of the POBs documents required for judicial validation at the June 29, 2021 Council meeting. The court validation process could take four to seven months. On or about the time the POBs are validated by the court, staff will bring forward further analysis based on then prevailing bond market and investment market conditions and rates, and – if deemed beneficial – will seek Council approval of the necessary remaining documents for the potential issuance of POBs in early 2022.

## **CLIMATE SMART SAN JOSE**

The recommendation in this memo has no effect on Climate Smart San José energy, water, or mobility goals.

## **PUBLIC OUTREACH**

This memorandum will be posted on the City's Council Agenda website for the May 11, 2021 Council Meeting.

## **COORDINATION**

This memorandum was coordinated with the City Manager's Budget Office and Office of Employee Relations, and the City Attorney's Office.

## **COMMISSION RECOMMENDATION/INPUT**

No commission recommendation or input is associated with this action.

## **COST SUMMARY/IMPLICATIONS**

While the costs (and benefits) of ultimate POB bond issuance will be subject to further analysis based on bond market and investment market conditions at the time bonds are sold, the Council approved as part of the FY 2020-2021 Mid-Year Budget actions \$300,000 for consulting and legal services to evaluate and prepare for the potential issuance of POBs. The 2021-2022 Proposed Operating Budget recommends additional funding of \$200,000 to enable the validation and evaluation process to continue into the next fiscal year.

If the Council elects to proceed with bond issuance following the judicial validation, the costs typical of any bond issuance will include professional services (bond/disclosure counsel fees, validation counsel fees, municipal advisor fees, and rating agency fees) and other related costs. The underwriters, municipal advisor, and bond/disclosure counsel typically work on a contingency basis and are only paid from bond proceeds upon the successful sale and close of the bonds. The City's Municipal Advisor will provide a Good Faith Estimate of those costs in conjunction with the approval of the validation papers, expected at the June 29, 2021 Council meeting.

HONORABLE MAYOR AND CITY COUNCIL

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**CEQA**

Not a Project, File No. PP17-007, Preliminary direction to staff and eventual action requires approval from decision-making body

/s/

JULIA H. COOPER  
Director of Finance

For questions, please contact Julia H. Cooper, Director of Finance, at (408) 535-7011 or via email at [julia.cooper@sanjoseca.gov](mailto:julia.cooper@sanjoseca.gov).