



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Jennifer A. Maguire
Nora Frimann

SUBJECT: SEE BELOW

DATE: September 1, 2021

**SUBJECT: ACTIONS RELATED TO PENSION OBLIGATION BONDS ISSUANCE
AND COURT VALIDATION PROCEEDINGS**

RECOMMENDATION

Adopt a resolution authorizing the issuance of bonds to refund certain pension obligations of the City of San José (“City”), including approving the form, and authorizing the execution of, a Trust Agreement and Bond Purchase Agreement; and authorizing judicial validation proceedings and additional actions relating to the issuance of the bonds.

OUTCOME

The City’s ability to authorize the issuance of pension obligation bonds (“POBs”) is subject to a successful judicial validation action and a favorable judgment from the Santa Clara County Superior Court (the “Court”) that POBs may be used as a tool to help address the City’s Unfunded Accrued Liability (“UAL”). The issuance of POBs could contribute to the funding level and financial health of the City’s Federated City Employees’ Retirement System (“Federated Plan”) and Police and Fire Department Retirement Plan (“Police & Fire Plan”) (collectively, “Retirement Plans”) and potentially provide savings to the City’s budget, including the General Fund. Adoption of the resolution will authorize the issuance of the POBs and allow the City to proceed with the judicial validation action to validate the legality of the POBs in the Court. *Nothing in this action will obligate Council to issue POBs in the future.*

Each actual issuance of POBs will be dependent on future approval by the City Council of an official statement to be delivered to investors and a continuing disclosure agreement for that issuance of POBs. Once the POBs are validated by the Court, staff will bring forward to Council further analysis based on then prevailing bond market and investment market conditions and rates, to seek Council approval of the necessary remaining documents for the issuance of POBs and seek approval of the recommended size and structure of each individual POB issuance. The timing of a potential issuance in calendar year 2022 and beyond will depend on the timing of the validation, prevailing market conditions in the future, and whether POBs are advantageous in at that time.

BACKGROUND

On April 23, 2021, the Council held an in-depth Study Session on the topic of financing options for the City UAL with an emphasis on POBs. The use of POBs could contribute to the funding level and financial health of the Retirement Plans and potentially provide savings to the City's budget, including the General Fund. Due to the lack of case law related to the issuance of POBs, Bond Counsel requires a Superior Court judgment confirming the POBs are valid, legal and binding obligations of the City and not in contravention of the State's Constitutional Debt Limit in order to render Bond Counsel's approving legal opinion. Accordingly, the City's ability to authorize the issuance of POBs is subject to a successful judicial validation action and a final court judgment favorable to the City.

At the end of the April Study Session, Council directed the administration to return to the Council meeting on May 11, 2021¹. At that meeting, the Council approved staff's recommendations and directed the City Administration and the City Attorney to plan and prepare the bond documents and court validation documents necessary for authorizing the issuance of pension obligation bonds, and to return to the Council with the necessary documents to proceed with a court validation action.

On June 3, 2021, the Police & Fire Plan Board's actuary, Cheiron, provided an educational presentation about POBs to the Police & Fire Plan Board. A similar presentation was made on June 17, 2021 for the Federated Plan Board meeting by Cheiron in its role as the Federated Plan actuary. City staff did not participate in delivering either presentation.

To help ensure the Boards had more complete information about the City staff's plans and process, on August 19, 2021, City staff provided a presentation on the issuance of POBs to the Federated Plan Board and, on September 9, 2021 staff will present a similar presentation to the Police & Fire Plan Board. Each presentation has been intended to better assist each Board in understanding City staff's plans and process, and the respective roles of the parties. Specifically, only the City Council will have a role in authorizing and paying any POBs that are issued. Conversely, only the respective Retirement Boards will have authority and responsibility to make decisions about how the proceeds of the bonds are invested once transferred by the City to the respective Boards to satisfy a portion of the UAL of each plan. Given these independent but interrelated roles, a joint Study Session will be scheduled on September 30, 2021 to provide the Council and the two Retirement Plan Boards an opportunity to better understand the respective roles of each party:

- For the City Council, their role in the development and approval of policies related to issuance of POBs
- For the Boards their role in development of policies on treatment of funds received from the City to paydown UAL.

¹ <https://sanjose.legistar.com/LegislationDetail.aspx?ID=4924655&GUID=D19F00AE-4AF8-4E36-9AE3-3B8BC09E0FFB>

These respective policies will assist in addressing questions and concerns should the City Council decide to pursue POBs now or in the future. Staff will provide Council with further information and analysis to assist in deciding whether to issue POBs at all. If Council decides to pursue POBs, City staff must return to the City Council with recommendations regarding the timing and size of individual potential POB transactions.

ANALYSIS

The proposed validation action would seek to confirm Council's authority to issue future POBs for a maximum aggregate principal amount of up to \$3.5 billion for the purpose of refunding all, the unfunded accrued actuarial liability of the City with respect to the Retirement Plans and the cost for issuance of the bonds. The validation would also create the flexibility to refinance a portion of the City's "normal costs" to the Retirement Plans, but consistent with other City debt practices, the City would expect to refinance such debt over the same period as the refinanced obligation, based on proposed pension funding policies to be drafted.

If the Court issues a final judgment in favor of the City validating the City's authority to issue the POBs, Council will decide if and when to issue each POBs. Staff must still return to Council for approval of various additional documents to initiate an actual bond sale, specify a bond size and timing of the bonds, based on then prevailing market conditions. These documents would include approval of an official statement used to market the bonds to potential investors, and a continuing disclosure certificate or agreement required to issue the POBs. Staff would provide detailed analysis supporting recommendations on the size and structure of each individual POB issuance. The decision whether to issue and the timing of the issuance would depend on further analysis of prevailing bond and investment market conditions. The Resolution also authorizes a private placement of the POBs, should City staff deem it more advantageous than a public offering; however, private placement of the POBs also would require future Council approval of offering materials.

Legal Documents to be Approved

Trust Agreement. The form Trust Agreement is by and between the City, as the issuer of the POBs and a Trustee bank. The bank will be selected through a Request for Proposal process if Council later directs staff to issue POBs. The Trust Agreement sets forth terms of the POBs and contains the responsibilities and duties of the Trustee and the rights of the bondholders.

Bond Purchase Agreement. The Bond Purchase Agreement (BPA) is an agreement by and among the City and the Underwriters as the initial purchasers of the POBs. The Underwriters will be selected through a Request for Proposal process. The BPA specifies the representations and warranties of the City, the documents to be executed at closing, the final debt service schedule for the POBs, and the conditions that allow the Underwriters to cancel the purchase of the POBs prior to closing. The BPA also specifies the amount of the Underwriters' compensation (paid in the form of a discount) on the POBs.

Judicial Process

If Council adopts the recommendation authorizing judicial validation proceedings, the expected next steps in the judicial validation process include:

1. Filing the Validation Complaint
2. Seeking permission from the Court to publish the summons so the Court can gain subject matter jurisdiction over the validation
3. Publish the summons (once a week for three [3] consecutive weeks, totaling 21 days)
4. Response period to file an answer (10 days following completion of publication)
5. Clerk of the Court's Entry of Default if no answer to Complaint is filed
6. File "points and authorities" seeking entry of Default Judgment
7. Hearing on Default Judgment and Judge's execution of Default Judgment
8. Begin 30-day appeal period
9. If no appeal is filed after 30-day appeal period, the Judgment is deemed final.
10. Staff will bring forward to Council further analysis based on then prevailing bond market and investment market conditions and rates, to seek Council approval of the necessary remaining documents for the issuance of POBs. The timing of a potential issuance in calendar year 2022 and other future potential POBs will depend on the timing of the validation and market conditions at the proposed time of sale.

California Superior Courts have been impacted significantly by COVID-19 and the Judicial Validation could take 4-7 months depending on these Court impacts assuming no opposition and appeal of the judgment.

Pension Obligation Bond Good Faith Estimates

One of the requirements per Section 5852.1 of the California Code with respect to the POBs is a good faith estimate from a financial advisor. The City has selected Urban Futures Incorporated ("UFI"), a registered Municipal Advisor to provide such financial advisory services.

UFI has provided the following good faith estimates in compliance with Section 5852.1 of the California Government Code and has estimated the following, all of which are subject to changing market conditions and may be higher or lower than estimated. The Good Faith Estimate assumes, for purposes of this calculation, that bonds are issued for the full UAL; it should be noted that staff has not yet recommended, and Council has not yet determined, whether all authorized bonds are to be issued at once, in multiple tranches, or at all, and decisions about the size and timing of bond sales will only be made once the validation is received and based on what is prudent in then prevailing market conditions.

- Aggregate principal amount of the POBs is estimated to be \$3,320,860,000.
- True interest cost for the POBs is estimated to be approximately 3.19%, which assumes market conditions as of August 16, 2021 plus 75 basis points.
- Finance charge of the POBs is estimated to be \$14,783,440 including the following:
 - \$1,500,000 in Cost of Issuance for Bond Counsel/Disclosure Counsel fees and expenses, Municipal Advisor fees and expenses, rating agencies fees, trustee fees and expenses, and printing costs;
 - \$13,283,440 for underwriters’ discount at \$4/bond.
- Estimated proceeds of the POBs expected to be received by the City is \$3,306,076,560 for the purpose of refunding all or a portion of the City’s current obligation and the unfunded accrued actuarial liability of the City (the “Unfunded Liability”) with respect to pension benefits under the Retirement Law and the Retirement Plans.
- Total payment amount, calculated to the final maturity of the POBs, is estimated to be \$4,405,647,348.

Next Steps

Whether the Council approves POBs after validation, waits until the future, or decides not to issue at all, as a finance best practice, the Administration will work with its legal and financial advisors to develop pension funding policies to amend and supplement existing policies. Staff will develop and bring to Council a *Pension Obligation Funding Policy* for approval prior to bringing any individual bond transactions forward for approval. If and when, the Court issues a judgment affirming the Council’s authority to issue POBs, pursuant to Council direction staff will provide more detailed analysis of risks and benefits based on then prevailing bond market and investment market conditions at the time the judgment is received. If the conditions are favorable, staff will return to Council with recommendations for the size and timing of the potential POB issuance, and approval of offering materials including approval of an official statement used to market the bonds to potential investors, and a continuing disclosure certificate or agreement required to issue the POBs. The City will need to prepare these disclosures contemporaneous with the actual issuance to ensure they are current, accurate, and complete.

Below is an estimated timeline of events for issuance of POBs:

Timeline of POBs Issuance²

Date	Activity
September 21, 2021	Recommended Council approval of bond and court validation documents
September 30, 2021	Joint Meeting of the Council and the two Retirement Plan Boards
October 2021	Bond Counsel files validation action with Santa Clara County Superior Court

² Preliminary; subject to change.

Date	Activity
Winter 2022	Council approval of recommended Pension Obligation Funding Policy
Winter/Spring 2022	Council consideration of POBs financing plan(s) with accompanying analysis of risks and benefits
Spring/Summer 2022	Recommended Council approval of Offering Statement for Investors (“Preliminary Official Statement”) and Continuing Disclosure Agreement for POBs issuance (timing: following successful validation ³ and subject to favorable bond issuance and investment market conditions)
Spring/Summer 2022	Issuance and Closing of first potential POB bond issue, if debt and investment market conditions warrant

CONCLUSION

If Council authorizes and approves the POBs issuance and filing of the judicial validation action and the validation is successful, Council will have the flexibility to use this tool to help finance the UAL of either or both of the two Retirement Plans and assist in controlling the City’s pension funding costs.

EVALUATION AND FOLLOW-UP

Upon Council approval of the resolution, Bond Counsel will file the validation action with the Superior Court. The court validation process could take four to seven months assuming no opposition and appeal of the judgment. At or about the time the POBs are validated by the court, staff will bring forward further analysis based on the then prevailing bond market and investment market conditions and rates, and – if deemed beneficial – will seek Council approval of the necessary bond offering documents for the first potential issuance of POBs in Spring/Summer 2022, or whenever the validation process has been successfully completed.

CLIMATE SMART SAN JOSE

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

³ Documents submitted to Santa Clara County Superior Court in October 2021 are expected to take from four to seven months for a decision, however timing could be affected by COVID and whether the validation action is answered in court.

PUBLIC OUTREACH

This memorandum will be posted on the City's Council Agenda website for the September 21, 2021 Council Meeting.

The Trust Agreement and the BPA in substantially final form will be posted to the City's agenda webpage for the Council's September 21, 2021 meeting.

COORDINATION

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

COMMISSION RECOMMENDATION/INPUT

No commission recommendation or input is associated with this action.

COST SUMMARY/IMPLICATIONS

The 2021-2022 Adopted Operating Budget includes funding of \$200,000 to enable the validation and evaluation process to continue this 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 has provided the Good Faith Estimate contained in this memo and attached to the Resolution.

HONORABLE MAYOR AND CITY COUNCIL

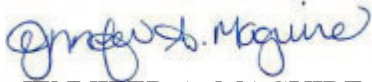
September 1, 2021

Subject: Actions Related to Pension Obligation Bonds Issuance and Court Validation Proceedings

Page 8

CEQA

Not a Project, File No. PP17-004, Government Funding Mechanism or Fiscal Activity with no commitment to a specific project which may result in a potentially significant physical impact on the environment.



JENNIFER A. MAGUIRE
City Manager



Nora Frimann (Sep 10, 2021 11:06 PDT)

NORA FRIMANN
City Attorney

For questions, regarding the issuance of POBs, contact Julia H. Cooper, Director of Finance, at (408) 535-7011 or via email at julia.cooper@sanjoseca.gov; and for questions regarding the validation process, contact Nora Frimann, City Attorney at (408) 535-1900.