# TOWN OF FAIRFAX
## STAFF REPORT
## August 19, 2020

**TO:** Mayor and Town Council

**FROM:** Garrett Toy, Town Manager
Michael Vivrette, Finance Director

**SUBJECT:** Adopt a resolution authorizing the commencement of proceedings in connection with the issuance and sale of lease revenue bonds of the Fairfax Financing Authority to finance and refinance Town pension obligations to the California Public Employees' Retirement system (CalPERS) in an approximate amount of $9,600.000, retaining an underwriter/placement agent, bond counsel, and disclosure counsel and directing certain actions including the acceptance of the proposal from Capital One Public Funding, LLC in order to lock in the interest rate offered by such proposal.

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NOTE: This item was continued from the August 5th meeting

**RECOMMENDATION**
Adopt a resolution authorizing the commencement of proceedings in connection with the issuance and sale of lease revenue bonds of the Fairfax Financing Authority to finance and refinance pension obligations of the town to the California Public Employees' Retirement system (CalPERS), retaining an underwriter/placement agent, bond counsel, and disclosure counsel and directing certain actions including the acceptance of the proposal from Capital One Public Funding, LLC in order to lock in the interest rate offered by such proposal.

**BACKGROUND**
In FY16-17, the Town worked with the Town's Municipal Advisor, Wulff, Hansen & Co, to explore refinancing of the Town's retirement liability as well as the potential for financing additional capital improvements with the savings. After discussing the options, the Council decided that it wanted to refinance only the CalPERS side fund and pre-2013 UAL pension obligations. The Council approved the refinancing in early 2017. The refinancing was structured as a long-term lease agreement with the Town Hall, Pavilion, Fire Station, and Corporate Yard as the leased assets and was anticipated to save the Town over $1.4 million in interest over the 20-year period.

At its May 2020 meeting, the Council authorized the Town's Municipal Advisor to explore options for refinancing the 2017 lease agreement (approximately $2.8 million), as well as to prepay the Town's current unfunded pension liability to CalPERS (approximately $6.5 million), to take advantage of lower rates with of goal of saving the Town additional money.

The options included:

1) Renegotiating the interest rate with Capital One which currently holds the 2017 lease agreement (no longer an option),
2) Refinancing the lease agreement with a new lender (no longer economically viable),
3) Refinancing the Town's current unfunded pension liability, and
4) Combining the refinancing of the 2017 lease agreement and refinancing the Town's current unfunded pension liability into one new refinancing structure.

In terms of process, the Town's Municipal Advisor discussed the advantages and disadvantages of each option with the Town's Finance Committee for consideration and a recommendation would be made to the Council.

**DISCUSSION**

The Town's Municipal Advisor met with the Council's Finance Committee twice: June 22 and July 14. At the June 22nd meeting, the Town's Municipal Advisor reported the best option for the Town to pursue would be Option #4 above which is combining the refinancing of the 2017 lease agreement and refinancing the Town's current unfunded pension liability into one new refinancing structure. This was the most financially attractive because Capital One, the holder of the 2017 lease agreement, offered to waive costly prepayment penalties for the 2017 lease agreement in exchange for increased loan size that would include the Town's current unfunded pension liability. This approach included selling the securities to Capital One via a private placement, which, in essence, means one institutional investor such as Capital One as opposed to public offering, which has multiple investors and significantly more issuance costs. The process would require a "validation" process. The validation process confirms that the Town's obligation to CalPERS is an "obligation imposed by law" and an exception to the constitutional limit on the incurrence of debt by a municipality without an election. The validation action is a fairly standard process for these transactions (e.g., Larkspur did one recently, other examples are attached). The Finance Committee recommended that the Town's Municipal Advisor and staff bring Option #4 to the Council for consideration. Option #4 would save the Town millions of dollars in interest payments.

However, subsequent to the June Finance Committee meeting, the Town's Municipal Advisor reported to staff that two validation actions in Southern California for large issuances (over $100 million each) were unexpectedly challenged by a taxpayer's association. Given this potential risk, the Town might be better off considering an alternative approach to the typical validation process.

At the July 14th Finance Committee meeting, the Town's Municipal Advisor discussed the potential financial risks to the Town to pursue the validation process, given the situation in Southern California. However, the Town's Municipal Advisor discussed an alternative approach to the refinancing. The Town's Municipal Advisor suggested a lease structure similar to the Town's 2017 Lease. This structure would include as the leased assets within the financing structure, a portion of the Town's streets equal to $10 million in value (approximately 25% of Town streets) in addition to the current leased assets being utilized in the 2017 Lease that include the Town Hall, the Pavilion, the Fire Station, and the Corporation Yard.

The proposed lease is structured so the Town is not at risk of losing use of its streets. The Bond documents provide that the re-letting of assets remedy will not be applicable to the streets, meaning that the holder of the bonds cannot access use of the streets as its security. The only remedy for failure of the Town to make its lease payments would be a lawsuit brought by the bond holder to compel payment by the Town. The anticipated buyer, Capital One and its counsel, have agreed and understand that the remedies are consistent with the description above. *The Finance Committee recommended the street lease option be brought to the Town Council for consideration, eliminating the need for the Validation proceedings.*

The Town's Municipal Advisor indicated that underwriters and investors in the public market are currently willing to buy lease transactions secured with streets from high quality issuers such as the Town. Witness the two recent street secured lease transactions, one of which was over $100 million in the Southern California city of West Covina (July 2020) and the other which was a $28 million transaction completed by the City of Redondo Beach (February 2019). Generally, private placement investors such as Capital One have not in the past accepted streets as the leased asset in financing structure. However, Capital One has made an offer, subject to credit approval, to purchase the proposed lease transaction from the Town as a private placement issuance primarily because of its successful experience with the Town's 2017 lease.

*If the Town rejects Capital One's proposal and goes to market with a public sale, it will lose Capital One's offer to waive the call provisions on the 2017 Lease. At this time we estimate that the Capital One offer would provide approximately $215,000 in increased savings to the Town versus the public offering option ($3,626,467 less $3,411,139).* The interest rate and terms proposed by Capital One would be fixed upon acceptance between now and August 24th and locked through September 30th subject to final credit approval. Pursuing a public sale would add 30 to 60 days to the financing schedule and expose the pricing to interest rate risk. On the public offering scenario, each 10 bps (basis points- 10 bps equals 0.10%) increase in the average interest rate increases interest expense by approximately $90,000 over the life of the financing. Locking in the rate proposed by Capital One through acceptance of the term sheet mitigates this interest rate risk exposure, in the event that there is change in the interest rate market before or at the time of pricing.

Additionally, the public offering option would have higher issuance costs than a private placement due to additional required financial and legal disclosures. With either option (private placement or public offering) the Town would still experience millions of dollars of interest savings by refinancing its unfunded pension obligations.

The previous staff report and agenda item on this subject were continued from the August 5 meeting because shortly after the July 14th Finance Committee meeting, Capital One expressed interest in a private placement lease transaction utilizing the currently leased assets plus a portion of the streets as described above. This presented a new opportunity that was not available at the July 14th Finance Committee meeting. Staff did not have time to schedule another Finance Committee meeting prior to the previous Council meeting so the item was removed from the agenda. Staff believes the terms are quite favorable to the Town. The term sheet offer is attached to the staff report.

We have attached the PowerPoint slides prepared by the Town's Municipal Advisor which provide background on the Town's current 2017 Lease, the unfunded CalPERS pension liability, and the savings benefits that can result from acceptance of Capital One's proposal. The Town's Municipal Advisor will explain these slides in detail during their presentation to the Council.

In summary, the Town can save a total of approximately $4.6 million in interest payments over time with the proposed combined private placement transaction. This projected savings is made up of the following components: The Town has already realized $270,000 in interest savings on the 2017 Lease and is projected to save an additional $753,000 in future interest payments for a total of $1.023 million. An additional projected savings of $491,000 from refinancing the 2017 Lease transaction to a lower interest rate and $3.1 million from refinancing of the Town's CalPERS unfunded liability.

With the proposed combined financing transaction (2017 refinancing and CalPERS UAL), the Town is projected to save approximately $105,000 annually in interest over the next 16 years (not including fiscal year 2020-21), and the Town will shorten the loan payoff period by 10 years vs. the original CalPERS payment schedule. The obligation is paid off in 2037 as opposed to 2047, if the Town did not refinance its pension obligation debt. The first 17 years of savings total approximately $1.7 million and the last 10 years when the Town makes no further payments totals approximately $1.9 million for a total of $3.6 million to be added to the prior $1 million savings from the 2017 Lease.

The resolution does the following: a) formally requests the Fairfax Finance Authority to issue lease revenue bonds and to assist the Town for such purposes, authorizes the preparation of the necessary documents in connection with the issuance and sale of the Bonds, b) authorizes the acceptance of the Capital One proposal in order to lock in the interest rate, and c) formally retains the municipal advisor, an underwriter/placement agent, bond counsel and disclosure counsel to assist the Town. The Town's Municipal Advisor is Wulff, Hansen & Co., Brandis Tallman LLC is the underwriter/ placement agent, and Quint & Thimmig LLP is bond counsel and disclosure counsel for the Town in connection with the issuance and sale of the Bonds.

Next Step

The Town's Municipal Advisor and Town staff recommends the FFA Board and Town Council meet on September 2nd to consider the required documents because we have a favorable, firm proposal from Capital One with an interest rate lock at 3.45% which is time sensitive and must be accepted by August 21st and the transaction closed by September 30th.

## FISCAL IMPACT

Net of all costs of issuance, the Capital One proposal can result in an additional savings of $3.6 million to the Town's General Fund.

## ATTACHMENTS

A. Resolution
B. PowerPoint presentation
C. Capital One Term Sheet
D. Examples of California Pension Obligation Bonds issued in California since January 2019