MINUTES
SPECIAL CITY COUNCIL MEETING
CITY COUNCIL OF THE CITY OF YUMA, ARIZONA
CITY COUNCIL CHAMBERS, YUMA CITY HALL
ONE CITY PLAZA, YUMA, ARIZONA
NOVEMBER 10, 2020
3:30 p.m.

CALL TO ORDER

Mayor Nicholls called the City Council meeting to order at 3:35 p.m.

ROLL CALL

Councilmembers Present:	Shelton, Morris, Watts (Zoom), Knight, McClendon, Shoop, and Mayor Nicholls
Councilmembers Absent:	None
Staffmembers Present:	City Administrator, Philip A. Rodriguez Various Department Heads or their representative City Attorney, Richard W. Files Deputy City Clerk, Janet L. Pierson

I. MOTION CONSENT AGENDA

<u>Motion Consent Agenda Item 1</u> – Pledged Revenue Obligation Bonds and Refinancing Options (to maximize earnings while levelling out the City's debt payments at a predicted lower interest rate) (Admin/Finance)

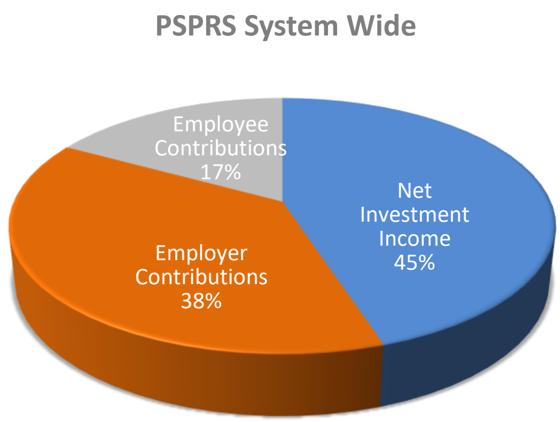
Michael Townsend, Administrator of the Public Safety Personnel Retirement System (PSPRS), presented a brief history and overview of the PSPRS as follows:

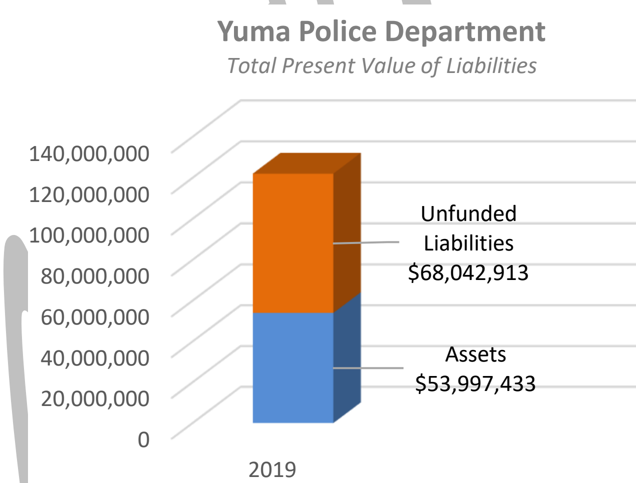
- Past – How did we get here?
  - Cost of Living Adjustments (COLA) were given to retirees through a Permanent Benefit Increase (PBI)
    - In good years, half of any investment returns above 9% were set aside for PBIs; in bad years, all funds remained in the trust
      - Because of this strategy, good years were insufficient to offset the bad years
    - Additionally, the PBI resulted in increased future liabilities
  - A COLA is usually stated as a percentage, but the PBI was given as the same dollar amount to every retired member
    - Differences in pay scales between municipalities meant that that lower paid retirees received a PBI that was a higher percentage of their pension
    - Consequently, municipalities with lower paid members were disproportionately impacted by the PBI
  - There were 28 consecutive years of PBIs
    - Even years where there were investment losses, liabilities increased due to the PBI
  - In the late 1990s/early 2000s, PSPRS changed the asset allocation of investments to lower volatility
    - Decreased volatility also resulted in reduced returns

- What Happened and What Changed?
  - PBI
    - The PBI is no longer in place due to Propositions 124 and 125
    - A new COLA with a 2% cap is in place
      - More consistent so actuaries can account for it appropriately in future calculations of liabilities
  - Actuarial Assumptions
    - Previously when actuaries estimated liabilities into the future, the basic assumptions were that every year the assumed rate of return would be earned and there would be no future PBIs
    - New actuaries and new assumptions have been put into place, and the way that unfunded liabilities are amortized has been changed
  - Investment Allocations
    - New Chief Investment Officer
    - New members on the Investment Committee
      - More focus on asset allocation and making sure that PSPRS gets the types of returns needed be consistent and provide more certainty
- Present
  - Implemented new General Ledger System on July 1st
    - Previous system had not been working properly for several years
  - Hired new auditors
    - CliftonLarsonAllen – national firmed considered experts in the world of public pensions
  - Hired new leadership positions
    - Deputy Administrator, Chief Financial Officer, Controller, and Internal Auditor
  - Actuarial modelers for each system
    - Created for each employer so they can run scenarios and look at different options for paying down unfunded liabilities and understand what each option will do to contributions into the future
  - Information Technology (IT)
    - Security upgrades and changes to the IT system
    - Approximately 80% of the IT staff is newly hired over the past two years
  - Changes to investment opportunities and asset allocation
  - PSPRS Board adopted actuarial changes to eliminate negative amortization
    - Revised amortization method for unfunded liabilities
    - Made changes to the payroll growth assumptions
  - Advisory Committee has been reengaged
    - Made up of both members and employers, the Committee was put in place with pension reform but has not frequently met
    - Convened during the summer and provided input on the actuarial changes
- Pension Funding Equation

C	**+**	**I**	**=**	**B**	**+**	**E**
Contributions		*Investment Income*		*Benefits*		*Expenses*

- Unfunded Liability (Debt)
  - PSPRS liabilities are not pooled (264 separate plans)
    - Unfunded liabilities have been earned and are subject to the pension clause and legal precedent
  - Pension reform created Tier 3, but did not reduce closed Tier 1 and Tier 2 unfunded pension liability (legacy costs)
  - Unfunded liabilities are debt – liabilities are owed
  - The amount and timing of contribution directly impact the funded status of each plan
    - Every additional dollar contributed today can earn investment returns
    - Every additional dollar not paid is a lost opportunity to earn investment returns
- Where does the money come from?

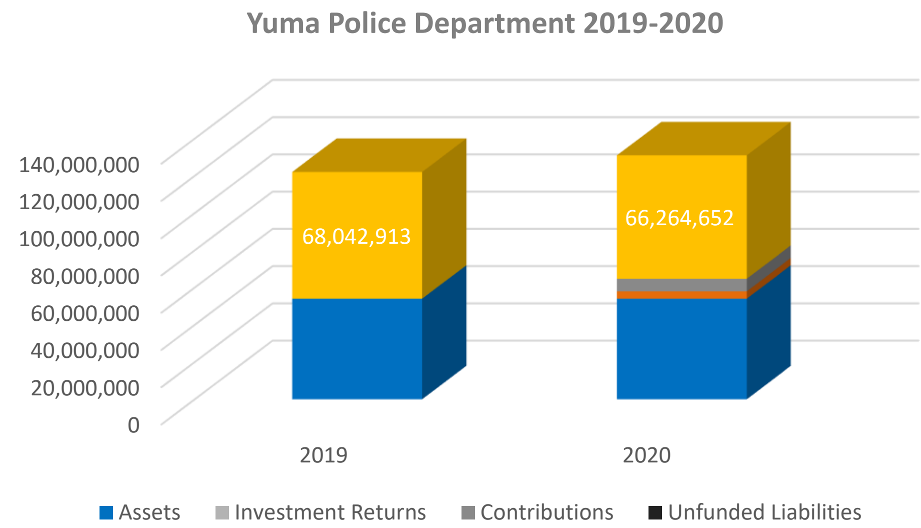


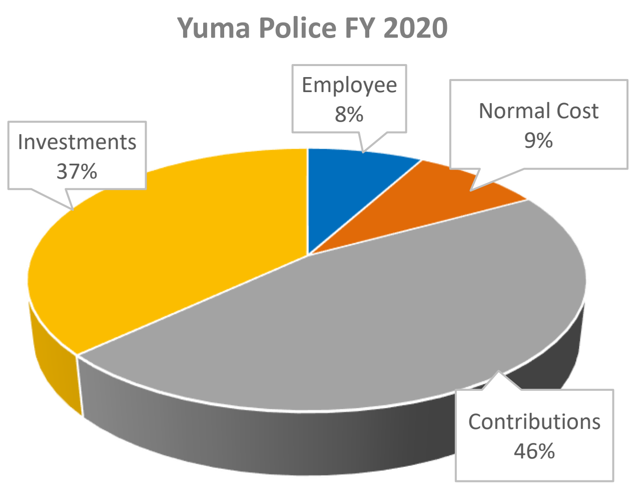


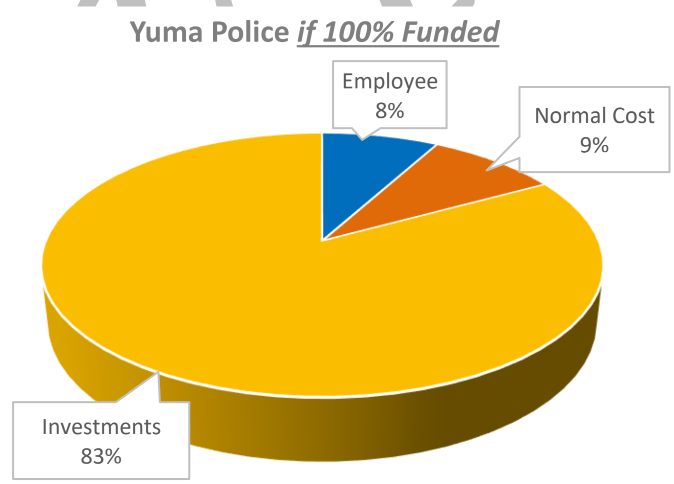
- Yuma Police Department (YPD)
  - *While this example uses the YPD plan, the same calculations would be used for the Yuma Fire Department (YFD) plan*
  - Investment returns are earned on $54 million in assets at an expected 7.3%
  - If the plan were fully funded, investment returns would be earned on $122 million in assets
  - Regardless of the funded status, the total $68 million liabilities will increase (be discounted by one less year) in Fiscal Year 2020
  - Investment returns and contributions will provide almost $10.7 million in FY20, however present value total liabilities will increase by $8.9 million
    - This leaves a net increase in assets of only $1.1 million, making little impact on the $68 million unfunded liability

Yuma Police Department 2019-2020

Increased Assets		Increased Liabilities	
Beginning FY19	53,997,433	*Present value of liabilities*	
Investments	3,941,813	*discounted by one less year*	
Contributions	6,745,394	2019	122,040,346
Ending FY19	64,684,640	2020	130,949,291
Change	**$10,687,207**	**Change**	**$8,908,945**







- Recommendations
  - Additional contributions leverage investment opportunities
    - Investment returns cannot make up a large unfunded liability
    - Over a 17-year amortization cycle, $1 million in additional contributions will save taxpayers an estimated $1.8 million
  - Continued diligence - investment & actuarial risk
    - Implement a pension funding policy that includes an annual update process

<u>Discussion</u>

- The 'contributions' portion of the pension funding equation includes both employee and employer contributions; for Tier 1, the employee contribution is 7.65% and the employer (City) contribution is probably well above 50% (**Mayor Nicholls/Townsend**)
- The expenses for PSPRS are very similar to those for the Arizona State Retirement System (ASRS) (**Mayor Nicholls/Townsend**)

- While each municipality is responsible for its own liabilities, investments are pooled and separate investment decisions are not made for each plan (**Mayor Nicholls/Townsend**)
- Of the nine-member PSPRS Board of Trustees, five members' terms are expiring; the nomination process to consider appointments to those seats includes the Arizona League of Cities and Towns and the County Supervisors Association of Arizona (**Mayor Nicholls/Townsend**)
- The types of returns needed for the PSPRS are not available by investing in the U.S. stock market alone; the Chief Investment Officer, three Portfolio Managers, and national consultants provide input on every transaction (**Shoop/Townsend**)
- PSPRS invests heavily in private equity, which is not on the public stock market and is only open to large institutional investors; for the last two years, PSPRS has ranked in the top 10 nationally in private equity investments (**Shoop/Townsend**)
- There is a lot that goes into the math behind international investments; it involves conversion rates between currencies on top of the economic returns from investments (**Shoop/Townsend**)
- About 95% of total returns comes from having an appropriate asset allocation which diversifies across different markets that are uncorrelated; just because one goes up does not mean that another one goes down (**Shoop/Townsend**)
- There are a few municipalities in Arizona whose public safety pensions are very well-funded, including Flagstaff which is fully funded through a debt financing (**Shelton/Townsend**)
- PSPRS has increased its exposure to domestic equities (the U.S. Stock Market) because of the long-term return opportunities this provides, but is continually looking at the risk that goes along with the anticipated return (**Morris/Townsend**)
- This diversification in asset allocation has decreased risk while also increasing expected returns over the 10 and 30-year horizon, but it has also increased year-to-year volatility (**Morris/Townsend**)
- There are also actuarial risks due to potential changes in demographics – disability rates, retirement age, life expectancy, etc. – that need to be understood and managed (**Morris/Townsend**)
- The Portfolio Managers are constantly reviewing all of the investment classes and looking at each of the individual investments and their updated valuations (**Knight/Townsend**)

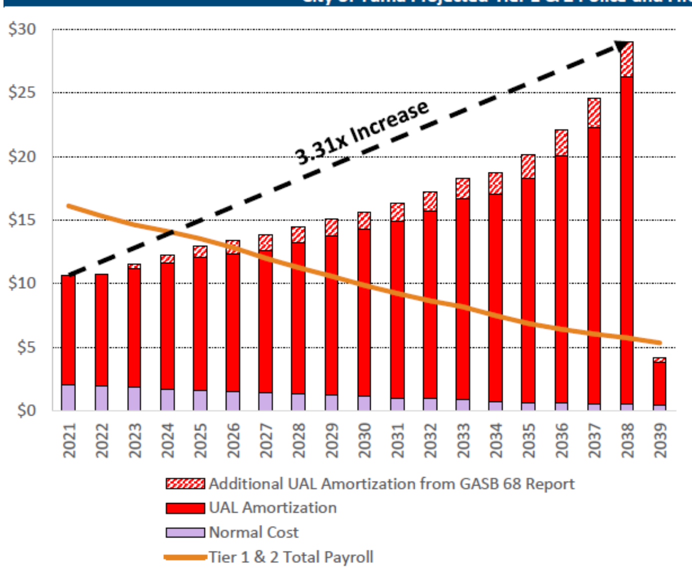
Mark Reader, Managing Director of Stifel's Phoenix public finance team, presented an overview of the City's current PSPRS unfunded pension debt and options for consideration as follows:

- City of Yuma PSPRS Pension Debt Profile
  - Tier 1 and Tier 2 Legacy Costs
    - Including unrecognized unfunded liability that will likely need to be reconciled, the total unfunded liability is calculated to be somewhere around $139 million

Pension Plan	June 30, 2019 Recognized Unfunded Liability	June 30, 2019 Unrecognized Unfunded Liability	Timing Adjustment (6/30/2019 to 1/1/2021)	PSPRS Amortization
PSPRS – Police Department	$68,042,913 (44.2% Funded) Accrual Rate: 7.3%	$8,528,871 Accrual Rate: 7.3%	$2,269,645 Accrual Rate: 7.3%	1. 19 Years, 2039 2. Escalating annual amortization ranging from $4,683,277 (2020/21) - $14,440,607 (2037/38)
PSPRS – Fire Department	$55,198,776 (41.4% Funded) Accrual Rate: 7.3%	$3,963,669 Accrual Rate: 7.3%	$1,971,318 Accrual Rate: 7.3%	1. 19 years, 2039 2. Escalating annual amortization ranging from $3,922,285 (2020/21) - $11,307,782 (2037/38)
Total	**$123,241,689**	**$12,492,540**	**$4,240,963**	**$139,975,192**

- What are we currently paying?
  - The magnitude of the Unfunded Liability can be seen particularly in the last column of the spreadsheet as a percentage of payroll, going as high as 495% in the year 2038

City of Yuma Projected Tier 1 & 2 Police and Fire Pension Payments per PSPRS (Graph in $mil)[1,2]



Fiscal Year	Tier 1 & 2 Payroll	Normal Cost	% of Payroll	Total UAL Amortization	% of Payroll
2021	$16,115,336	$2,063,852	12.81%	$8,605,562	53.40%
2022	15,317,836	1,920,957	12.54%	8,799,018	57.44%
2023	14,639,274	1,829,985	12.50%	9,726,747	66.44%
2024	14,118,988	1,727,731	12.24%	10,560,459	74.80%
2025	13,539,345	1,640,782	12.12%	11,291,838	83.40%
2026	12,841,241	1,545,407	12.03%	11,900,876	92.68%
2027	12,001,971	1,428,096	11.90%	12,384,404	103.19%
2028	11,261,028	1,339,546	11.90%	13,113,493	116.45%
2029	10,587,636	1,251,091	11.82%	13,839,587	130.71%
2030	9,883,896	1,135,280	11.49%	14,501,578	146.72%
2031	9,232,907	1,029,414	11.15%	15,329,652	166.03%
2032	8,657,724	943,264	10.90%	16,284,198	188.09%
2033	8,192,653	868,633	10.60%	17,420,086	212.63%
2034	7,498,658	726,614	9.69%	18,006,042	240.12%
2035	6,882,806	649,004	9.43%	19,471,446	282.90%
2036	6,426,843	596,863	9.29%	21,519,916	334.84%
2037	6,042,182	555,791	9.20%	24,026,612	397.65%
2038	5,746,323	526,096	9.16%	28,445,353	495.02%
2039	5,361,428	487,865	9.10%	3,649,578	68.07%
Total	$194,348,075	$22,266,271	11.46%	$278,876,445	143.49%

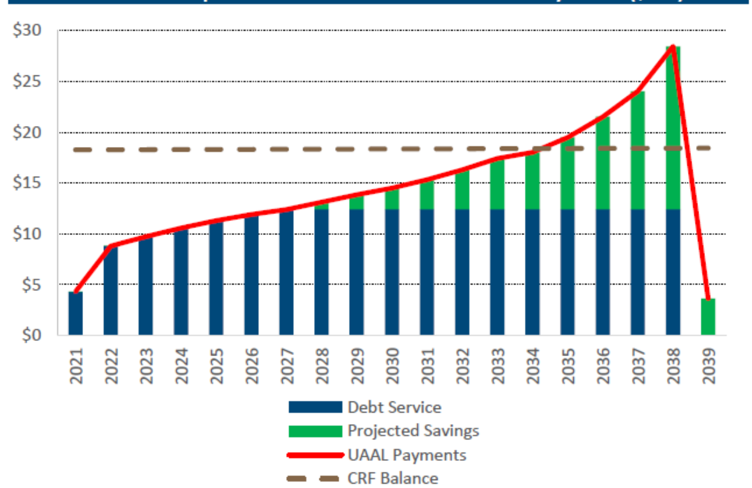
- PSPRS Unfunded Liability and Related Options for Consideration
  - Do nothing
    - Continue to pay accelerating payments to PSPRS resulting in possible tax increases in the future, need to cut expenses, or potentially a combination of both
  - Amend current PSPRS policy and budget more dollars towards the Unfunded Liability
    - Separate tax levy policy or revenue increase
  - Refinance debt to PSPRS accruing at 7.3% with taxable bonds yielding approximately 3%
    - Address the legacy trajectory by 'chopping down the future mountain' with fixed debt service payments and consider implementing a Contingency Reserve Fund to help manage future liability

Claude Lockhart, Vice President of Stifel's Chicago public finance team, appearing via Zoom, discussed several funding scenarios as follows:

- Fund to 100%
  - Increase funding of both the Police and Fire pension plans to 100% with a pension fund deposit of approximately $140 million
  - Add a Contingency Reserve Fund (CRF) deposit of $18.3 million to help in the event of a significant actuarial change or market event
    - The CRF is not a required component of the financing and there are other methodologies to calculate the contingency reserve amount
  - This scenario could produce $64.3 million total Net Present Value (NPV) savings from reduced unfunded liability payments, creation of the CRF, and interest on the CRF deposit

Summary Statistics: Funding Police and Fire Pension Plan UAAL[1,2]	
Dated Date	1/1/2021
Final Maturity Date	6/1/2038
All-In TIC	2.88%
Arbitrage ("Arb") Yield	2.77%
Average Life	10.26 years
Bond Par Amount	$159,715,000
Pension Fund Deposit	**$139,975,193**
Contingency Reserve Fund Deposit	**$18,257,634**
Total Interest on CRF @ 0.05% Return	$169,599
NPV of CRF Interest @ 2.77% (Arb Yield)	**$131,269**
Projected Gross Cost Savings (UAAL – Debt Service)	**$69,006,659**
NPV of Projected Savings @ 2.77% (Arb Yield)	**$45,952,284**
Total NPV Benefit (CRF Deposits + NPV of CRF Interest + NPV of Projected Savings)	***$64,341,187***
Total NPV Benefit (as % of Pension Fund Deposit)	***45.97%***
Actuarial Funding Status after Pension Bonds	***100.00%***

POB Results: Impact on Annual Pension Plan UAAL Payments ($mil)[1,2]



- Fund to 90%
  - The All-In True Interest Cost (TIC) of 2.88% and the Average Life of 10.26 years is the same as it is for 100% funding
  - The main difference between the two options is that 10% of the liability will still be accruing at 7.3%, so payments will continue to be made to PSPRS to repay that liability
    - By leaving the 10% unfunded, it reduces the NPV savings from about $64.3 million to about $57.9 million

Summary Statistics: Funding Police and Fire Pension Plan UAAL[1,2]	
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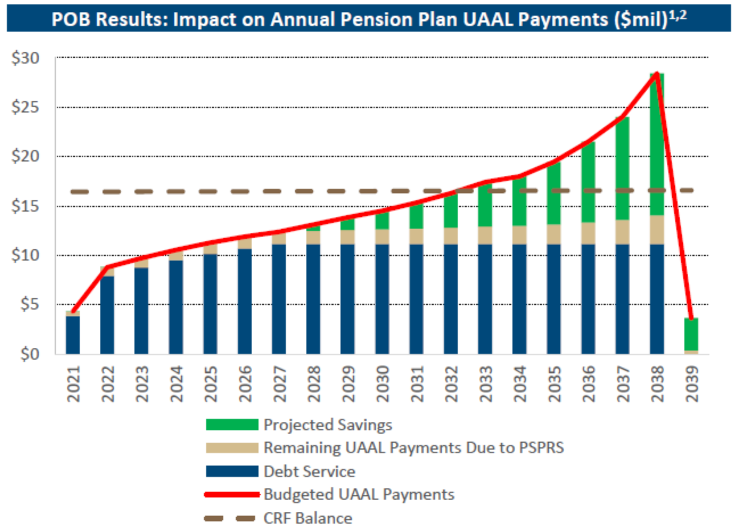
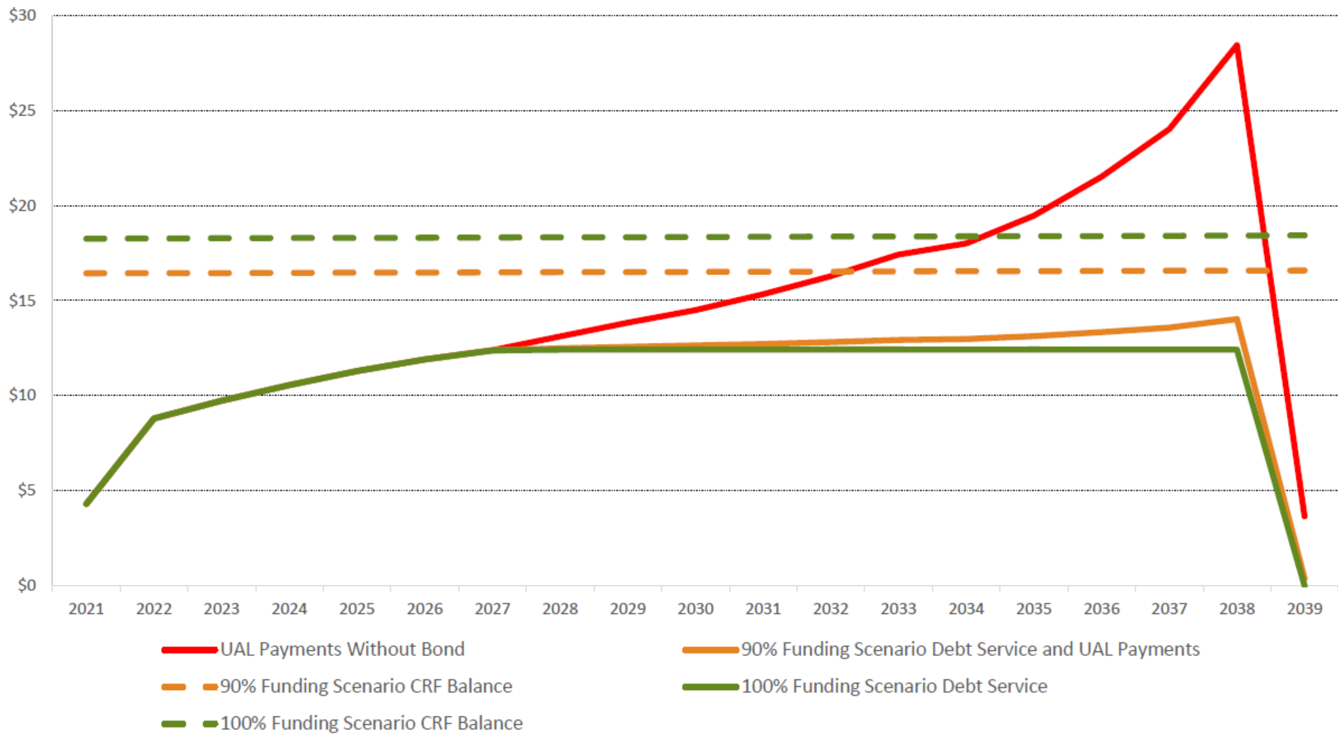
Final Maturity Date	6/1/2038
All-In TIC	2.88%
Arbitrage ("Arb") Yield	2.77%
Average Life	10.26 years
Bond Par Amount	$143,760,000
Pension Fund Deposit	**$125,977,673**
Contingency Reserve Fund Deposit	**$16,431,870**
Total Interest on CRF @ 0.05% Return	$152,639
NPV of CRF Interest @ 2.77% (Arb Yield)	**$118,142**
Projected Gross Cost Savings (UAAL – Debt Service)	**$62,080,537**
NPV of Projected Savings @ 2.77% (Arb Yield)	**$41,339,910**
Total NPV Benefit (CRF Deposits + NPV of CRF Interest + NPV of Projected Savings)	***$57,889,923***
Total NPV Benefit (as % of Pension Fund Deposit)	***45.95%***
Actuarial Funding Status after Pension Bonds	***100.00%***

POB Results: Impact on Annual Pension Plan UAAL Payments ($mil)[1,2]



- Comparison of Projected Payments and CRF Balances



Omar Daghestani, Managing Director of Stifel's Chicago public finance team, appearing via Zoom, provided the following overview of pension bond risks:

- While the savings numbers presented are compelling, pension bonds carry risk:
  - The primary risk is the City borrowing at 2.88% and PSPRS returning at below that rate for the term of the bond
    - If that were to happen, the City would be worse off than it is now
    - For historical context, both the 10-year and the 30-year average returns for PSPRS are right around 8%
  - The biggest actuarial risk is longevity risk
    - People are living longer, which is positive overall but negative in terms of the pension
  - The chances for success are very high because of the thoughtfulness of everyone at the table regarding the risks, opportunities, and management of both - which is where long-term value is seen
    - When pension bonds go well, there is incredible opportunity to transform a municipality's budget, how it serves its citizens, and to help drive things such as credit upgrades

<u>Discussion</u>

- The CRF can either be established with bond funds or cash on hand; to minimize potential costs, it is important for the CRF to be just large enough to serve the identified risks (**Nicholls/Daghestani**)
- Flagstaff chose to deposit their CRF at a local bank into a principal-protected investment vehicle; The CRF is not something that is held at PSPRS, as pension deposits become irrevocable (**Morris/Daghestani**)

Regarding the CRF, **Reader** added that it has been very popular amongst clients because even if the PSPRS liability is 100% funded, due to actuarial and investment changes there may be a need to draw on it

- If the CRF does need to be utilized, a plan will be made to replenish it
- Rating agencies and investors have also provided positive feedback regarding the CRF, even though it is not for the benefit of the bondholders
- Written policies and procedures will be adopted by City Council regarding the sizing of the CRF, when draws can take place, and rules for replenishment

Discussion

- The only municipality that has opted to raise taxes to address their unfunded liability was the City of Prescott; voters authorized a 1% sales tax increase which will remain in effect until the PSPRS liability is 90% funded (**Shoop/Reader**)

Reader stated that debt service can be structured however the City would like, but the example provided - which tops out at about $12.4 million per year - provides budget stability. Responding to a question asked at the City Council Vision and Goal Setting, **Reader** explained that after issuance of the proposed 100% funding scenario, it is estimated that the City will have approximately $91.55 million of additional Senior Lien Excise Tax borrowing capacity for tax-exempt purposes.

- The City may issue additional Senior Lien Excise Tax Revenue obligations so long as the City's pledged revenues from the most recent ended fiscal year are at least 3x the maximum annual debt service on existing and new proposed Senior Lien Excise Tax obligations in any future year
- With $60,583,512 of Pledged Revenue for the Fiscal Year ending 2019, the City can issue additional obligations to the extent annual debt service does not exceed $20,194,504

Discussion

- The City's specific pay plan is not factored into the PSPRS actuarial assumptions; however, payroll information is uploaded by the City each pay period and is provided to the PSPRS actuaries every year (**Mayor Nicholls/Townsend**)
- It is fairly common when bonds are sold to have call protection somewhere in the 9-10 year range, meaning that the bonds cannot be bought back prior to a specific date (**Knight/Reader**)
- The contingency fund can potentially earn interest while it is waiting to be used, and should remain available until the bond is paid off; it can then be used as the City wishes (**Watts/Daghestani**)
- A replenishment provision will be included in the policy adopted by City Council that sets forth how any use of the CRF will be paid back to the fund (**Morris/Daghestani**)

Motion (Knight/McClendon): To approve Motion Consent Agenda item 2020-197, that includes 100% funding of the City's unfunded pension liabilities including establishing contingency reserve funding as well as the refinancing of other eligible revenue bonds. Voice vote: **approved** 7-0.

MC 2020-197 Authorize the City Administrator and staff to work with Stifel, Nicolaus, and Company, Inc. (bond underwriter) and GreenbergTraurig (bond counsel), in connection with refinancing of the City's Public Safety Personnel Retirement System (PSPRS) unfunded liabilities and refinancing of the City's 2010B bond. Final bond documents will be brought forward by Ordinance at a later Council Meeting. (Admin/Fin)

II. EXECUTIVE SESSION/ADJOURNMENT

There being no further business, **Mayor Nicholls** adjourned the meeting at 5:15 p.m. No Executive Session was held.

____
Lynda L. Bushong, City Clerk

APPROVED:

____
Douglas J. Nicholls, Mayor

Approved at the City Council Meeting of:
____
City Clerk: __________________________