COMMENDATIONS AND RECOMMENDATIONS FOR THE PERALTA COMMUNITY COLLEGE DISTRICT

District Commendation 1. "The District's Institutional Research Department is commended for its work in creating a robust data system for a complex multi-college district. By continuously refining its data model, by developing and supporting a multitude of standard reports and dashboard/data mining reporting strategies, and by providing the needed user training, the department makes available a critical toolset that should be used as the foundation of evidence-based practice."

District Commendation 2. "The team commends the District and the individual Colleges for their efforts to ensure that hiring practices cultivate a workforce that is as diverse as the student population. The District and the Colleges within it, have successfully maintained College personnel that mirror the student demographics, which enrich the College environment and promote equity."

DISTRICT RECOMMENDATIONS TO RESOLVE DEFICIENCIES

Recommendation 1:

"In order to meet the Standards, the team recommends that the District follow the 2014 audit recommendations and develop an action plan to fund its Other Post-Employment Benefits (OPEB) liabilities, including associated debt service (III.D.1.c, III.D.3.c)."

I. Introduction

Recommendation 1 addresses the need for the District to follow the 2014 audit recommendations and develop an action plan to fund its Other Post-Employment Benefits (OPEB) liabilities, to include its associated debt service.

II. Plan of Action

The 2014 Audit Report finding related to OPEB stated: "The long term planning for the continued financial stability of the District should continue to include attention to obligations that will be coming due in the future, such as the postemployment health care benefits and the annual line of credit repayments, which impact the District both at the operating fund level and the entity-wide financial statement level." [DR1.1].

Respecting the 2014 Audit Report recommendation, PCCD has developed a long-term plan to fund its Other Post-Employment Benefits (OPEB) liabilities, including its associated debt service (i.e., the principal and interest due on the OPEB bonds). The District has also taken short-term actions to mitigate the impacts of the OPEB debt service on District finances.

A. Short Term Actions

The District has actively managed its OPEB Bond program over the past twenty-four months. In September 2014 the District issued a request for proposal (RFP) to establish an underwriter pool in anticipation of financing the OPEB Bond program and General Obligation Bond program [DR1.2]. The Interim Vice Chancellor for Finance and Administration and the District's Municipal Financial Advisor performed a semi-annual review of the OPEB bond program in anticipation of the automatic conversion of the next series, or tranche, of bonds from "capital appreciation" (where fixed rate bonds' interest is calculated and added to the principal amount every six months but deferred in payment) to the "auction rate" securities (variable interest bonds subject to auction every five weeks) [DR1.3]. The timing of this transaction was critical and was determined by the original structure of the OPEB bond program; the District was required to restructure the B2 tranche of bonds by August 15, 2015 or potentially pay investors a default interest rate of 17%, due to the failure of the auction rate market in 2008.

Recognizing the importance of the August 2015 conversion date for the B2 tranche, and its potential impact on the District's finances, a plan of finance and an associated timeline were developed. This plan included the analysis of various financing options and risks associated with those options [DR1.4].

In January 2015, the District's OPEB Finance Team was formed, consisting of members with expertise in the areas of OPEB, Letters of Credit (LOC), swaps, variable rate bonds, and credit. The Team included the District's Interim Vice Chancellor for Finance and Administration, District Counsel, District Bond Counsel and the District's Municipal Financial Advisor. An RFQ was circulated to the District's underwriter pool with the intent to select a firm for the August 2015 transaction and Barclay's Bank was added to the Team, given its ability to provide a letter of credit or LOC [DR1.5].

Working diligently over the next several months, the OPEB Finance Team developed a conservative bond structure that provided the District the lowest interest rates possible at the time [DR1.6]. As part of due diligence, the original bond financing documents were reviewed, as were the initial financial assumptions and program goals. The objectives were to verify all data and to insure that indentures and covenants were legal and being practiced. At this point the District engaged a law firm, with expertise in retiree health benefits programs, to provide advice to the Retirement Board of Authority (RBOA), as well as to review and update essential legal documents related to it and the OPEB program (this OPEB Counsel was added to the OPEB Finance Team). This work was arduous, methodical, and necessary to accomplish the B2 tranche remarketing. These initiatives benefitted the District by providing clarity and transparency related to the transaction and its governing structures, i.e. the RBOA and Governing Board [DR1.7].

In August 2015, the District successfully converted $38,450,000 of Convertible Auction Rate Securities (CARS) to variable rate bonds with a LOC from Barclays Bank [DR1.8].

This action saved the District approximately $12.5 million in debt service payments over the life of the bonds, assuming a failed auction rate of 17% against a current assumed taxable variable rate of 4.5% [DR1.9]. The bonds carry Barclays' short term rating of A-1 (Moody's Investors Service) and A-2 (Standard & Poor's). The District elected not to terminate the swap associated with this tranche because the termination value of the swaps approximated the expected cash flows for termination over time. The conversion and structure of subsequent tranches, the next one maturing in 2020, may mirror this approach.

<u>B. Long Term Plan</u>

Since August of 2015, the newly-appointed Vice Chancellor for Finance and Administration, the District's Financial Advisors, and District Counsel and OPEB Counsel have focused on OPEB program management, cash flow modeling, and funding options to reduce existing and future debt service over the long term. Moreover, in Spring 2016 the District received two legal opinions that impacted this OPEB planning:

1. Bond Counsel opined that the extant OPEB Trust, Fund 94, could not be converted into an irrevocable trust [DR1.10].
2. OPEB Counsel opined that the District's intent with respect to the extant OPEB Trust, Fund 94, was to service only those District retirees hired *prior to* July 1, 2004 retirees [DR1.11].

After receiving opinion #2, the District commissioned its actuary to recalculate the OPEB liability associated with each of the two groups: "pre-July 1, 2004" and "post-July 1, 2004" retirees. Subsequently, the revised liability as of November 2014 for *pre*-2004 retirees was actuarially determined to be $150,325,680, down from $152,429,020. OPEB liability for *post*-2004 retirees as of November 2014 was actuarially determined to be $4,166,272. The District will commission its next actuary study in November 2016 as required by GASB 43/45 (the Governmental Accounting Standards Board) with respect to OPEB accounting treatment. This new actuarial study will refine further the liability associated with the District's OPEB program.

Predicated on the two recent legal opinions, the following objectives have been identified for a Long Term OPEB action plan:

1. Develop a ten-year cash flow analysis, across all District funds, with respect to servicing the OPEB bond debt and meeting obligations to the District's *pre*-2004 retirees.
2. Create an Irrevocable Trust in order to mitigate the OPEB liability on the District's financial statements and to service the District's *post*-2004 retirees.
3. Commit annually 5% of general fund revenues – specifically, the State. Apportionment Computational Revenues-- to OPEB bond debt service and the establishment and maintenance of an Irrevocable Trust.
4. Strategically re-fund OPEB bonds and/or SWAPS as required by subsequent tranches.
5. Reduce the District's overall OPEB liability.
6. Update the District's Substantive Plan on an ongoing basis as per GASB 43/45.

This action plan was shared with the District's Planning and Budget Council (PBC) on April 29, 2016 [DR1.12] and endorsed by the Board of Trustees at its workshop on July 12, 2016 [DR1.13].

C. Cash Flow Planning

In Fall 2015 current and future OPEB cash flows were modeled, reviewed, and refined under the direction of the Vice Chancellor for Finance and Administration who provided more precise fiscal and programmatic assumptions [DR1.14]. The goal was to facilitate a working cash flow of all OPEB-related revenues and expenditures, including interest rate assumptions and future expenditures. Working with the District's OPEB Finance Team**,** revenues and expenditures are now updated quarterly, based on actual costs and/or returns, and compared against estimates. The Model also enables the District to monitor and reduce program expenses when possible.

The Cash Flow Model's variables include:

- Precise revenue and expense projections through 2025, including swap offsets.

- Five percent of the District's Computational Revenue received from the State annually dedicated to OPEB debt service.
- OPEB charge calibrated to meet required annual coverage.
- Interest rates and structures to determine refunding of future series.
- Integration of eligible trust funding for future debt service.
- Financial options to establish an irrevocable trust to service *post*-2004 retirees.

The Cash Flow Model is predicated on the fact that any surplus funds in the OPEB Trust, i.e., assets over and above the actuarial liability created by the *pre*-2004 retirees, can be utilized to service OPEB Bond principal. This use is provided for in the foundational documents of the OPEB bonds [DR1.15]. The Model also includes the continuation of the OPEB charge against payroll expenditures, as well as the establishment of a new, irrevocable trust [DR1.16]. This Model gives the District the financial flexibility to develop realistic future scenarios and to accurately monitor current cash flows as necessary for debt service management to progress. A summary of this Cash Flow Model was shared with the District's Planning and Budget Council on April 29, 2016 and endorsed by the Board of Trustees at its workshop on July 12, 2016.

While the aforementioned Model will provide guidance for the District in the nearer long-term, the District's longer-term goal is to implement a model that will allow the District to quantify reasonable approaches to reducing the OPEB program's overall debt service. Starting in Fall 2016, the OPEB Finance Team will commence with an analysis to evaluate possible restructuring options to achieve this long term goal. This is a complicated analysis, but one that will serve as an important roadmap for OPEB program planning throughout the next ten to twenty years. One objective of this new process would be to determine the efficiency of a purchase of some or all of the outstanding bonds from investors. If successful, this restructuring maneuver would reduce the District's overall debt service and reduce the length of the existing program.

Given the number of external variables, it is difficult to set a precise deadline for a completed OPEB analysis (and, of course, interest rates represent a significant factor). To initiate this process, in March 2016, the District issued a Request for Qualifications (RFQ) for investment banking firms with an emphasis on experience and knowledge of complex pension programs. Citi and RBC (Royal Bank of Canada) were identified as key partners in the District's undertaking of this important first step to move forward with the OPEB program and both have been added to the Team.

<u>III. Conclusion</u>

The District has developed a comprehensive long-term plan to fund its OPEB liability and associated debt service. With conservative fiscal assumptions, it has modeled precise cash flow projections through 2025, and general projections through 2050, the final maturity date of the *pre*-2004 program. The *post*-2004 OPEB program, with significantly less liability, has also been addressed. As is evident, all District funds impacted by the OPEB program— Funds 1, 69, and 94— have the capacity to support the plan as developed, including the establishment of a new irrevocable trust fund. In addition, the District continues to look forward and has been actively assessing options to restructure the current OPEB program to reduce both long-term liability and annual costs, in full recognition of the importance and impact of the OPEB program management in years to come. The District's OPEB Finance Team will provide continual assessment of the OPEB program and report to the Planning and Budgeting Council and Board of Trustees periodically.

As evidence of its continued work in the area of bond and debt management, the District revised its Board Policy and Administrative Procedures with respect to Debt Management; these revised policies and procedures were reviewed with the District's Planning and Budgeting Council in May 2016 and approved by the Board of Trustees in at its July 2016 Board meeting. In addition, the Peralta Community College District received an AAA rating, the highest credit rating possible on general obligation bonds, in

May 2016. The District was the first community college district in the state to receive this stellar credit rating. During a PCCD visit to New York this past summer, the ratings agencies complimented the District for its OPEB program planning over the past year.

The District has followed the 2014 audit recommendations and developed an action plan to fund its Other Post-Employment Benefits (OPEB) liabilities, including associated debt service, and is confident that we have met Standards (III.D.1.c, III.D.3.c) and will continue to do so.

RECOMMENDATION 1: DISTRICT RESPONSES	
Evidence	**Title of Evidence Document**
DR1.1	PCCD Financial Audit Report 2014 excerpt
DR1.2	2014 RFP to Acquire OPEB Bond Program & General Obligation Bond Program
DR1.3	Definitions taken from Indenture of Trust
DR1.4	PCCD Board Presentation June 2, 2015 Bonds
DR1.5	Letter for RFQ 2015 OPEB
DR1.6	OPEB Refinancing Options example
DR1.7	OPEB Trust Indenture Amendment
DR1.8	B-2 Tranche Official Statement
DR1.9	Maximum Rate ARS Savings at 4.5%
DR1.10	Memo regarding Irrevocability of OPEB Trust
DR1.11	Memo regarding Scope of OPEB Trust Coverage for Pre-2004 Retirees
DR1.12	PCCD PBC Agenda, Apr. 29, 2016
DR1.13	PCCD Board of Trustees Workshop, July 12, 2016
DR1.14	PCCD OPEB Cash Flow Plan
DR1.15	Use of Trust Funds pages 21 and 22
DR1.16	RFQ Investment Banking and Underwriting Services Feb. 2016