THE BOND BUYER

# Improved financials ease Richmond, California, POB refinancing

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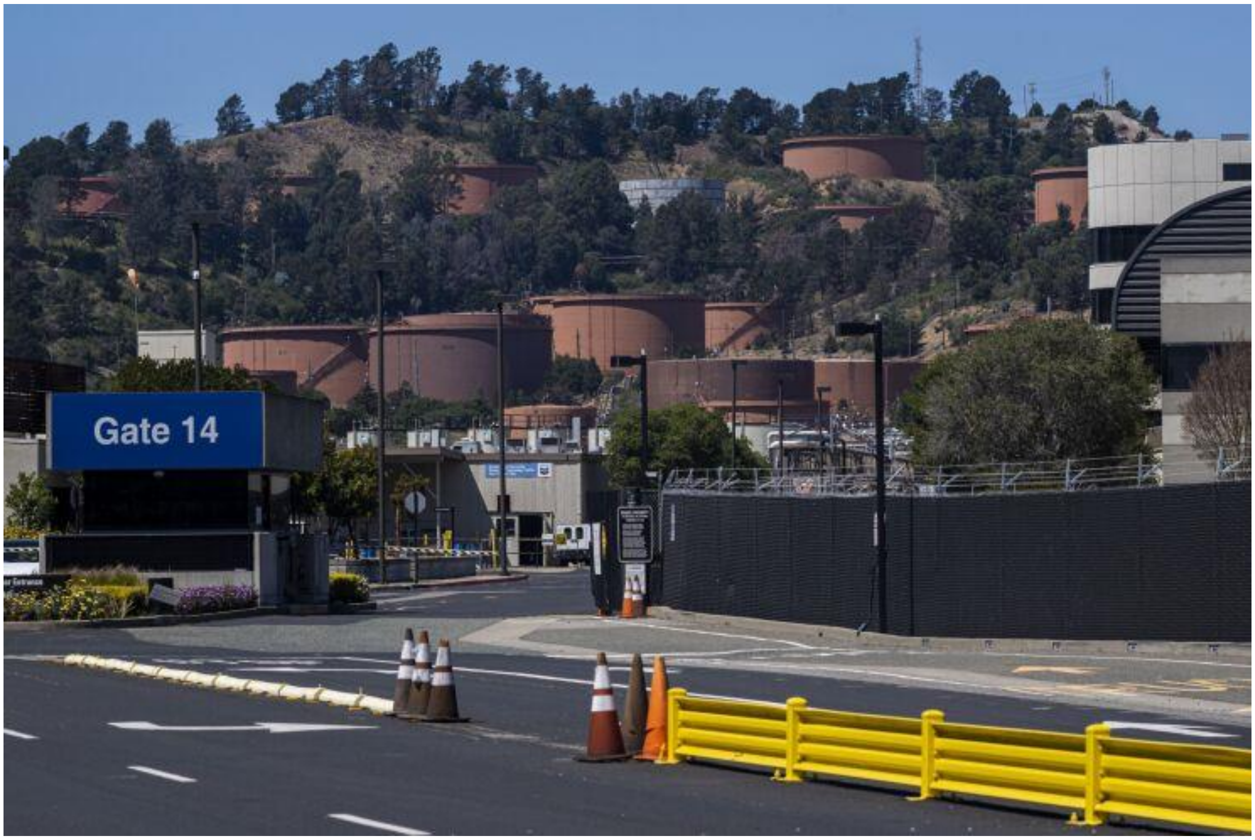
Simplify, simplify, simplify.

That's what improved bond ratings helped Richmond, California, accomplish in a deal that traded a 17-year-old pension obligation bond financing entangled with interest-rate swaps and intercept agreements into plain-vanilla fixed-rate debt.

The $154.1 million taxable pension obligation refunding deal was priced by joint senior managers Loop Capital Markets and Hilltop Securities in late August and closed Thursday.



Storage tanks at the Chevron refinery in Richmond, California. The refinery is the city's largest taxpayer and employer.

**Bloomberg News**

"The city of Richmond's financing was extremely well received by investors as evidenced by the 34 distinct investors, including insurance companies and mutual funds, who participated in the transaction, which was more than 2.5-times oversubscribed," said Robert Larkins, managing director at Loop Capital Markets. "The city was able to terminate a synthetic swap-based structure and replace that with a traditional fixed rate bond structure, while also lowering its all-in interest rate for its pension obligation bonds."

The city of 114,489 residents has experienced a lift amid the Bay Area's overpriced housing market.

The city is better known for a large Chevron refinery that leads the city's tax and employment rolls as it generates local controversy over its environmental impact.

But its Hilltop Specific Plan, a long-range plan to turn a lemon of a dead shopping mall into the lemonade of a 143-acre mixed-use redevelopment, is well underway and has attracted interest from such companies as Amazon, Whole Foods and logistics real estate firm Prologis, according to Mark Northcross, a partner with NHA Advisors and the lead municipal advisor on the Richmond refunding.

Roughly 417,500 square feet of industrial/commercial space is under construction, 557,000 square feet is entitled and one hotel project has been approved, according to an investor presentation.

Richmond's leaders have been able to persuade the city's voters to tax it out of financial trouble.

"We had a little dip during COVID-19, but sales tax and revenues came right back," said Nickie Mastay, deputy city manager.

"We have passed five tax measures since 2004: a sales tax in 2004, a utility tax measure in 2008, a second sales tax in 2014, a documentary transfer tax in 2018 and a business gross receipts tax in 2020," she said.

"Our citizens have no problems passing tax measures that enable us to grow," Mastay said. "We are in a unique area in the Bay Area. We not only have good freeway connections, but also a shipping port. We have trains and rail that also come through Richmond. We have a lot of manufacturing moving up from Silicon Valley to be housed here."

When the city issued the now-refunded pension obligation bonds in 2005, the deal had a county lockbox shuttling payments directly to the trustee.

The new deal allows the city to drop the lockbox arrangement and still retain its AA-minus rating from S&P Global Ratings, according to the city's finance team.

"The rating reflects our view of the city's continued economic growth in recent years, strong management, and strong financial performance," S&P Global Ratings credit analyst Li Yang said in a statement Aug. 18 as the city rated the new bonds AA-minus and affirmed the city's AA-minus issuer credit rating.

S&P, which assigns a stable outlook, also liked that the deal represents the city's exit from two synthetic fixed-rate swaps.

"I think the city had a good story to tell," said Mark Northcross, a partner with NHA Advisors, the municipal advisor on the deal. "And we feel S&P's ratings report does justice [to the city's financial situation.]"

S&P upgraded the city's issuer credit rating — equivalent to the rating it would get for general obligation bonds — three notches to AA-minus in May 2019.

At the same time it elevated the city's pension obligation debt rating to AA-minus and boosted to A-plus from BBB-plus $100 million in outstanding Richmond Joint Powers Financing Authority lease revenue bonds.

The deal went out solely with the rating from S&P.

Moody's Investors Service, which also rates Richmond, takes a five-notch lower view of the city, though it upgraded Richmond's issuer rating to Baa2 from Baa3 and its pension obligation bond rating to investment-grade Baa3 from speculative-grade Ba1 in June, assigning a stable outlook.

The city had been forced to renegotiate the swap agreements when Moody's dropped Richmond to junk in 2015.

Moody's said the upgrades reflect growth in the city's tax base and economy, and improvement in the city's financial position.

"The Baa2 issuer rating reflects the city's sizable San Francisco Bay Area tax base with elevated taxpayer concentration, given its largest single taxpayer is a Chevron refinery," Moody's said.

The 2022 POBs refund the city's outstanding $6.3 million in taxable pension obligation bonds Series 2005 B-1 index-mode and $127 million Series 2005 B-2 convertible auction rate taxable pension funding bonds; finance the termination cost of two associated interest rate swaps; and pay costs of issuance.

The deal refinanced Richmond's pension obligation bonds and swaps into plain vanilla fixed-rate taxable debt, said Mark Northcross, a partner with NHA Advisors. **NHA Advisors**

"There is a lot of interest in POBs on the public policy level, but the policy issues on these bonds was dealt with in 2005," Northcross said. "This was a refinancing for economic benefit. It's a different approach. There are valid policy questions involving POBs, but they didn't need to be addressed here."

Many investors satiated their appetite for POBs during the huge wave in 2020/2021, so in addition to general market choppiness, the demand for POBs has fallen off slightly since late 2021, said Michael Meyer, an NHA vice president and head of the financial advisor's pension group.

NHA only had a couple taxable deals come to market this past spring when the market was challenging for issuers. Neither was over $50 million or pension related, so Meyer said he couldn't really compare this deal to what was happening earlier in the year, especially with how quickly market conditions have been changing.

"All the normal POBs we've closed this year have been smaller and all privately placed," coming in 100-plus basis points better than the public market, Meyer said.

"The spreads are clearly reminiscent of the early/Spring 2020 POB wave during the COVID crisis, where spreads on the long bond were over 220," he said. "Spreads obviously tightened to under 100 for a while in early 2021 but we've seen a gradual widening for a while now, magnified/sped up this year with the inflationary and geopolitical issues."

Though the market has somewhat normalized since the steep drop off in demand in March-April, volatility hasn't entire eased, according to Michael Cavanaugh, a managing director with Hilltop Securities.

"We are still seeing volatility as evidenced by the 10-year UST being 3.03% on day of pricing and eight trading days later the rate is 3.33%, while 8 days earlier than pricing, the yield was 2.79%," Cavanaugh said.

Given the continuing volatility, Cavanaugh said, it was hard to say whether it was more beneficial to price in late August, rather than earlier this spring.

"Given the bonds would price directly off the UST rates, it depends on what day," he said. "The 10-year UST was 1.72% on March 1, 2.40% on April 1 and hit 2.99% by the end of April," Cavanaugh said. "This suggests pricing in March would have been more advantageous but there was (and still is) volatility in the markets."

The underwriting team generated $385 million in orders from 34 unique accounts, 33 of whom were new investors in the city's debt, for a deal that was 2.5 times oversubscribed, enabling the underwriting team to tighten spreads by five basis points, according to the finance team.

The all-in interest rate on the 2022 POBs is 5.653%. The synthetic fixed rate on the swap that was subject to mandatory termination in August 2023 was 5.665%. The city was able to slightly lower the interest rate on the bonds while extending the term another 10 years to 2044.

This extension was accomplished through a conventional fixed rate bond issue with no interest rate swap.

"We feel the pricing and corresponding subscription levels indicate the rates were at the market," he added.

Amazon delivery trucks in the otherwise empty parking lot of Richmond, California's Hilltop Mall in 2021. The city is redeveloping the area around the largely dormant shopping center. **Rich Saskal**

The city's swap advisor, KPM Financial, negotiated with RBC, the counterparty on the termination of the city's two remaining swaps, according to information on the deal provided to The Bond Buyer.

The final termination payment was $22 million, funded by a portion of the 2022 POB proceeds. Those swaps were to be paid off at the bond closing Sept. 8, eliminating the city's last swaps/Libor exposure.

In addition, the city contributed cash at closing to defease its $2.1 million in outstanding 1999 POBs to eliminate their prior lien on special voter-approved pension tax override revenues. Richmond is one of 10 cities in California that have a special tax used only to pay pension costs.

The POB financing eliminated the 2005 bonds' intercept mechanism, whereby Contra Costa County had withheld a portion of the city's pension tax override revenues for direct payment to the bond trustee. The city will now manage payment for the bonds internally.

The financing culminated several months work, including analysis by the advisory team of the city's amortization to better align with pension tax override revenues and public hearings to provide both residents and city leaders with various options to refinance the debt. Disclosure counsel also conducted a disclosure training session.

A non-audio road show posted in conjunction with the preliminary offering documents garnered views from 31 unique investors, 10 of whom submitted orders totaling $194.7 million, Meyer said.