# *Financial Performance and Budget Committee Memorandum*

*CalPERS Pension and 2020 POB Update*

CITY OF RIVERSIDE

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June 10, 2022

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## Rewind to Spring 2020 – Pension Obligation Bond Recap

- In the Spring of 2020, the City issued $432M of POBs to pay off approximately 67% of its then current UAL
  - $230M of UAL remained outstanding with CalPERS
- City locked in a **3.69% interest rate** and achieved multiple objectives → → → → → →→ → →
- While navigating the unknowns present during the height of COVID, the City undertook a robust and transparent stakeholder engagement process to craft a thoughtful POB strategy, while maintaining its strong "AA" credit rating during unprecedented economic times
  - Included a significant amount of stress testing to quantify risks and deliberate timing strategies on when to invest monies with CalPERS

**Cash flow savings; $175M+ projected overall**

**Equitable funding of both Miscellaneous and Safety Plans (targeted 92% funding ratio)**

**Smoothed out payments to enhance budget predictability/flexibility and fiscal sustainability/resiliency**

**No extension of payments to ensure savings in every single year**

**Maintained flexibility to pay off debt early (10-year call feature)**

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*Note: Savings assumed CalPERS earned 7% returns*

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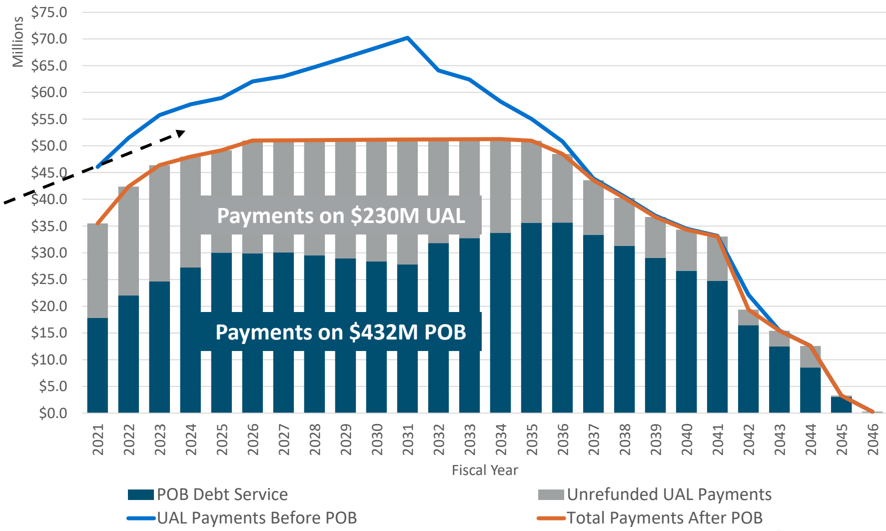
## Rewind to Spring 2020 – Pension Obligation Bond Recap

### Cash Flow Smoothing Strategy and Savings Estimates

- $140M of present value savings estimated
  - 32.5% of UAL refunded
- $179M of cumulative savings
- $7+ million of annual near-term General Fund savings to help balance budget

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*Note: Savings assumed CalPERS earned 7% returns*

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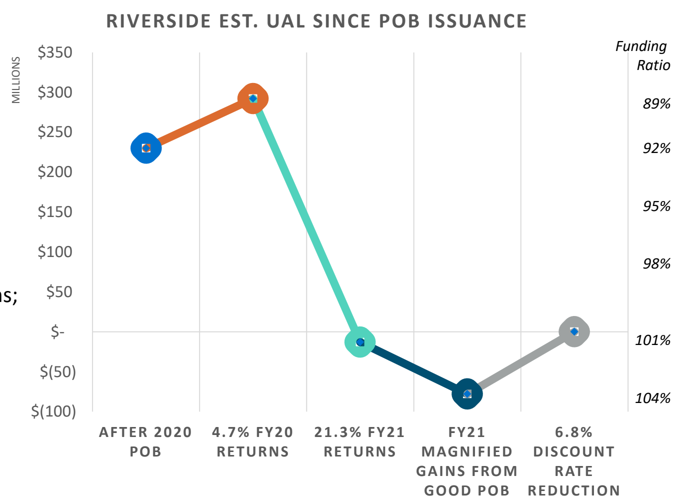
## What Has Happened Since the 2020 POB Was Issued?

### City Benefited From Fortuitous POB Timing

- FYE 2020 Earnings: 4.7% Returns + minor demographic assumption changes were factored in, driving UAL up by $62M
  - $230M UAL rose **to $292M**
- FYE 2021 Earnings: CalPERS earned robust 21.3% returns
  - **$305M of reduced UAL** from these strong returns
    - Bonus: Good Timing of POB magnifies these gains; Additional **$65M of reduced UAL**
- Fall 2021 ALM Study: Discount rate reduction to 6.8%; **UAL increase of $77M**
- **NET EFFECT: CITY IS ROUGHLY 100% FUNDED**
  - 99.5% for Safety ($7M UAL) and 101% for Miscellaneous ($15M surplus)

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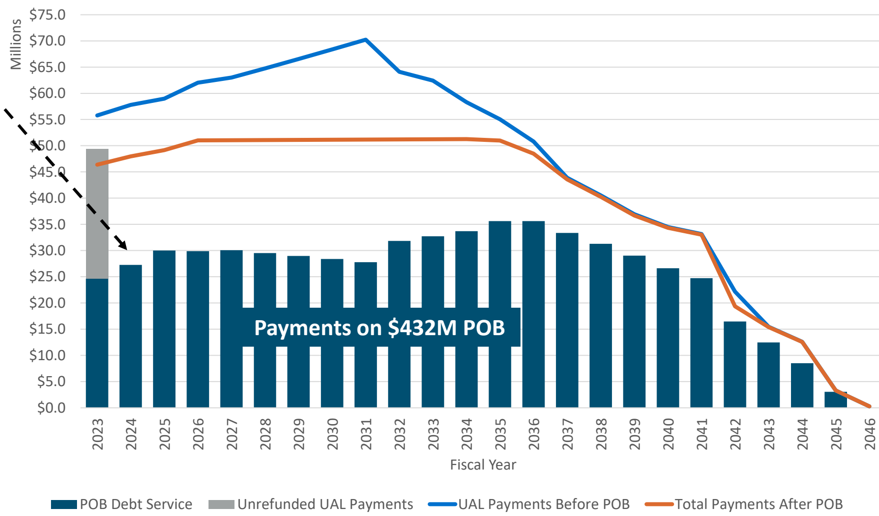
## What Has Happened Since the 2020 POB Was Issued?

City Benefited From Fortuitous "POB Timing" – UAL PAYMENTS

- UAL payments are expected to be close to zero starting in 2024
- Assumes that CalPERS meets or exceed its 6.8% annual earnings expectation
  - Note: Annual Normal Cost payment (*not shown here*) will **grow from $35M to $40M** due to discount rate reduction
    - $5M annual increase to budget starting in FY 2024

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*Note: Projected payments and new UAL estimates calculated by CalPERS Outlook Online Tool*

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## Additional Scenarios for Prudent Financial Planning

- While the City's pension outlook has improved considerably, there are still several potential risks/considerations to keep in mind
  - CalPERS is currently underperforming in FY 2022 with recent stock market declines
  - CalPERS can still lower the discount rate below 6.80%
- Additional Scenarios for prudent financial planning for on next slides
  - CalPERS earns 0% for FY 2022
  - CalPERS earns -5% for FY 2022
  - CalPERS lowers discount rate to 6.50% next year

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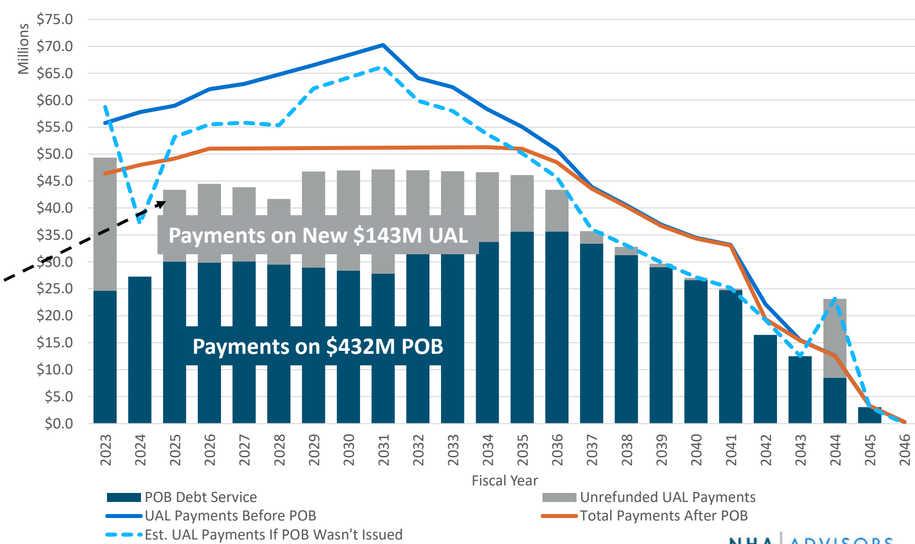
## Scenario 1: CalPERS earns 0% for FY 2022

- UAL would grow back up to ≈$143M
- UAL Payments would ramp up starting in 2024 again
- Overall payments would be approximately $45M annually
  - Along with $5M of added Normal Costs, this is about same overall level planned at time of POB issuance

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*Note: Projected payments and new UAL estimates calculated by CalPERS Outlook Online Tool*

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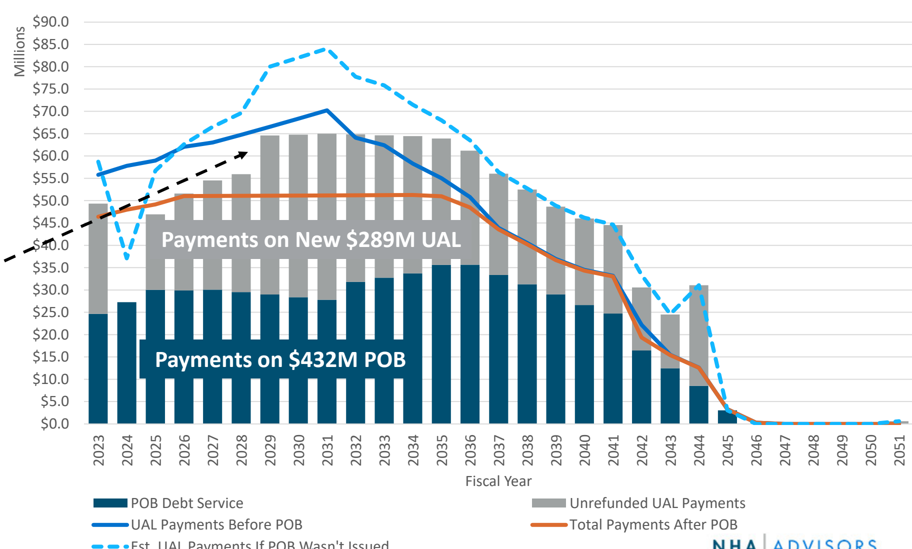
## Scenario 2: CalPERS earns -5% for FY 2022

- UAL would grow back up to ≈$289M
- UAL Payments would ramp up starting in 2025 again
- Overall payments would be around ≈ $47M annually, but grow to over $60M over next decade
  - Inclusive of $5M of added Normal Costs, this is significantly higher than planned at time of POB issuance

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*Note: Projected payments and new UAL estimates calculated by CalPERS Outlook Online Tool*

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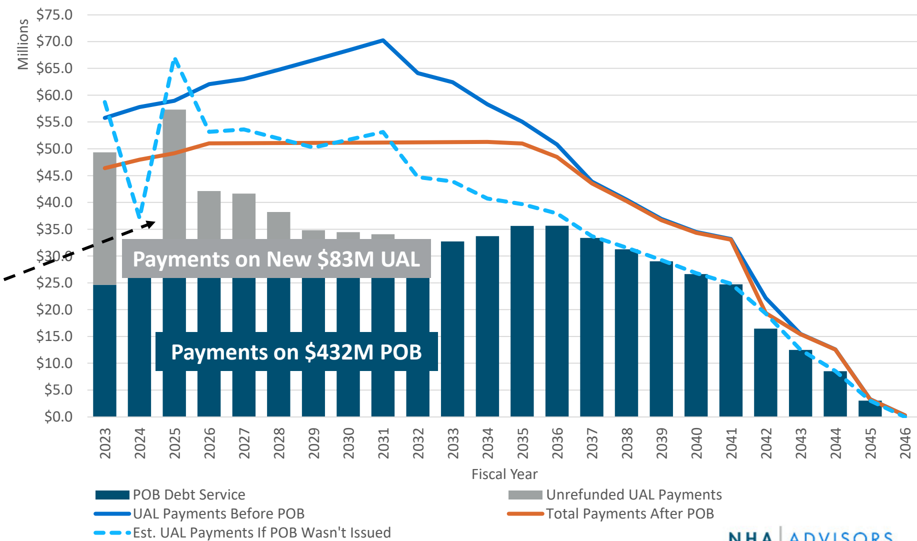
## Scenario 3: CalPERS Lowers Discount Rate to 6.50% Next Year

- UAL would grow back up to ≈$83M
- UAL Payments would ramp up starting in 2025 again; then rapidly decrease

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*Note: Projected payments and new UAL estimates calculated by CalPERS Outlook Online Tool*

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## Takeaways

- Riverside, along with many other agencies who issued POBs in 2020, have benefitted significantly from great market timing – locking in low interest rates and magnifying the benefit of the 21.3% gains from CalPERS in FY 2021
  - The 3.69% interest rate the City locked in is over 1.25% lower than current (April 2022) POB rates
- While POB payments are fixed and predictable, the UAL (and related amortization payments), are extremely sensitive to CalPERS investment earnings
  - City should plan/forecast using conservative assumptions and perform sensitivity analysis to understand potential impacts under a variety of CalPERS results
- Significant savings (reduction in UAL payments) is **expected for FY 2024**
  - City should consider using majority of that savings to bolster reserves (like the Section 115 Trust) to ensure this "shock absorber" is funded to healthy levels
    - Provides strong resiliency to absorb future economic shocks/new UAL; such as the expected increases coming from the FY 2022 underperformance

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