

Long-term Management of CalPERS Costs

City Manager's Office &
Finance Department

Budget Engagement Commission
November 29, 2018

WHY?

1. Addressing the issue of the City of Riverside's unfunded pension obligations is not easy for all involved.
2. However, all involved can agree the topic is important and the urgency for having a productive conversation is clear – it is weighing on the minds of many.
3. This conversation assumes that all involved – the City of Riverside, City employees and retirees, as well as Riverside taxpayers – care about the delivery of public services and being good stewards of public resources.
4. This conversation also assumes that ensuring the long-term financial health of the City is the shared responsibility of all.



THE CALPERS CHALLENGE

Given Unfunded Pension Obligations, Our Collective Challenge (aka The CalPERS Challenge) is:

How to Effectively Secure the Solvent Financial Future of the City, Its Employees, & Its Retirees While Ensuring the Delivery of Public Services & Stewardship of Public Resources

WHAT IS CALPERS?

“The California Constitution provides that the CalPERS Board has plenary authority and fiduciary responsibility for the investment of moneys and administration of the system, is charged with the sole and exclusive fiduciary responsibility over the assets of the system, and is granted the sole and exclusive responsibility for administering the system in a manner that will assure prompt delivery of benefits and related services to system members and beneficiaries.”

Source: CalPERS Board of Administration; Governance Policy; Amended May 2018

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CALPERS BACKGROUND

1. Created in 1932 to administer retirement and disability benefits to members and beneficiaries.
2. Retirement benefits are a Defined Benefit
Employer promises future benefit payments based on an agreed-upon formula (ex. 2% @ 62).
3. As of June 30, 2017*
 - Investment Portfolio: \$326.4 Billion in assets
 - 1.9 Million Members
 - 2,945 Employers

*Source: <https://www.calpers.ca.gov/docs/forms-publications/calpers-at-a-glance.pdf>



CALPERS PENSION FUNDING

3 Sources of Pension Funding

1 – Employer Contribution rate established by CalPERS

2 – Employee Contribution rate set by CalPERS; cost-sharing set by the member agency.

3 – Investment Income is influenced by CalPERS investment strategy & Market Performance



Graphic source: <https://www.newportbeachca.gov/home/showdocument?id=31453>

CALPERS PENSION FUNDING

The CalPERS Pension Buck

As of June 2017, CalPERS' income over the last 20 years demonstrates that every dollar spent on public employee pensions comes from the following sources:

61¢

CalPERS investment earnings

26¢

CalPERS employers

13¢

CalPERS members



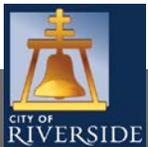
Source: <https://www.calpers.ca.gov/page/newsroom/for-the-record/2017/pension-buck>

CALPERS FUTURE BENEFIT ESTIMATIONS

When a new member enrolls into the retirement plan, the CalPERS actuary estimates the individual's pension benefit making assumptions for:

1. Life expectancy*
2. Wage Increases
3. Inflation
4. Investment returns of the plan
5. Years of life after retirement
6. Other factors

The result is today's assumed cost of the employee's total future pension payout during retirement.

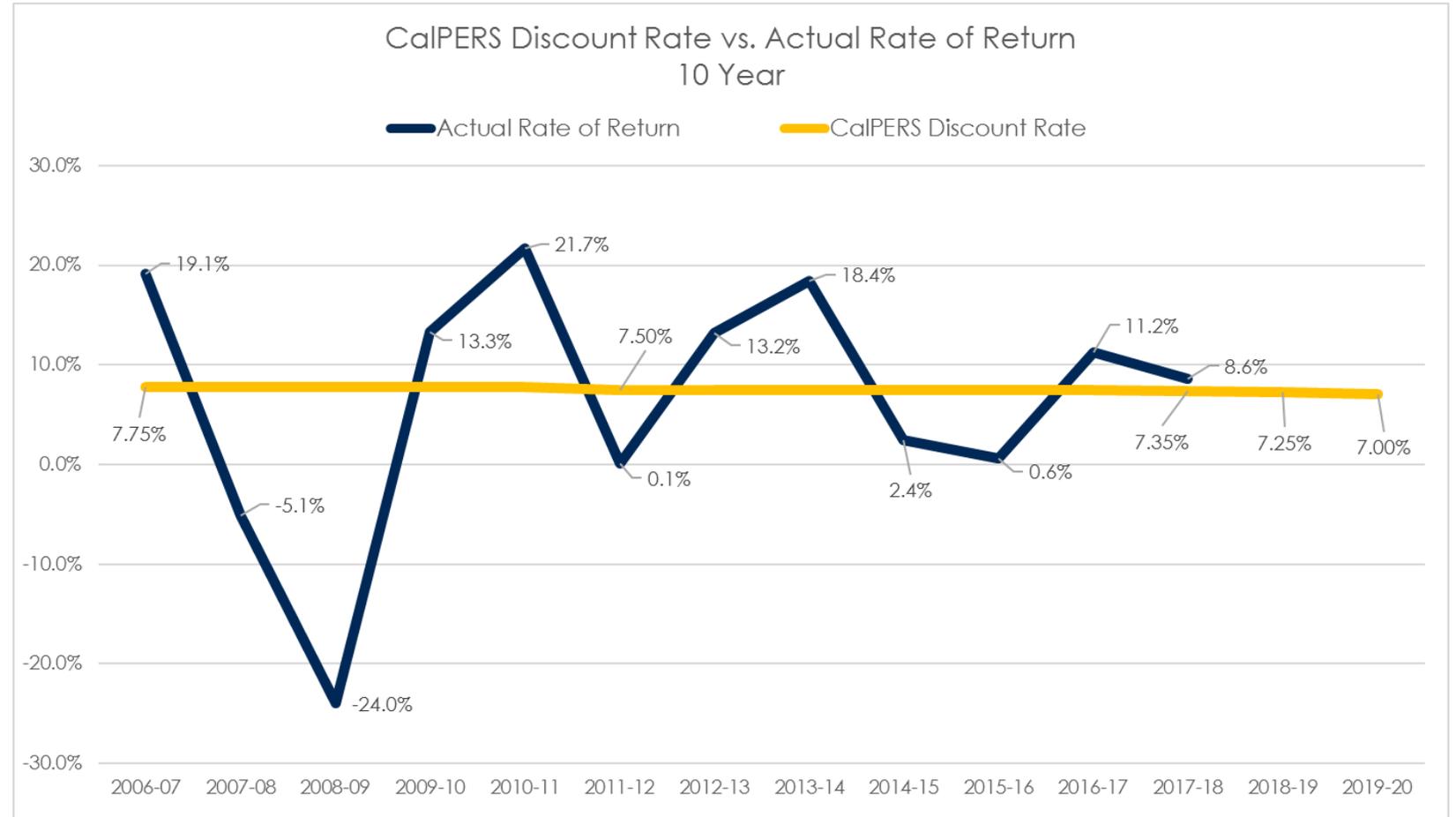


* Source: CalPERS Experience Study 2017

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CALPERS DISCOUNT RATE VS. ACTUAL RATE OF RETURN – 10 YEAR

- CalPERS' actual rate of investment return is subject to market volatility and CalPERS' investment policy.
- The discount rate is the assumed long-term interest rate used in CalPERS actuarials for defining current costs of future pension obligations.



Source: <https://www.calpers.ca.gov/docs/forms-publications/facts-investment-pension-funding.pdf>

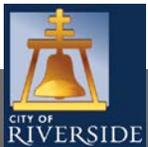
CALPERS CONTRIBUTION CATEGORIES

Employee (also referred to as “Members”) and Employer Contributions are broken into 2 categories:

1. **Normal Cost:** benefits and expenses that have accrued during the given year and are expected to be accrued annually in the future with no changes to promised benefits
2. **Unfunded Accrued Liability (UAL):** amount of money needed to pay for benefits (earned so far plus benefits not yet earned) based on a member’s service. This amount is amortized to build the necessary assets over time to cover the liabilities.

UNFUNDED ACCRUED LIABILITY (UAL) IN MORE DETAIL

1. UAL is an actuarial term that refers to the difference between the values of assets and the estimated accrued liabilities of the plan.
2. UAL is the result of the actuarial assumptions that were not met.
3. It is not an absolute number - it is adjusted annually based upon the five most recent years of experience.
4. The amount is based on an actuarial valuation at a particular point in time.



UNFUNDED ACCRUED LIABILITY (UAL) IN MORE DETAIL

5. The amount of the UAL today is impactful to member agencies' financial health and financial planning strategies.
6. The most important objective is to ensure the contributions the City is making are expected to eliminate the UAL over a reasonable period of time.

Example: Home mortgages are outstanding obligations and are managed through affordable, timely payments.

CALPERS INVESTMENT PERFORMANCE

1993-2000: CalPERS investments performed well providing for “superfunded” status (pensions were overfunded). As a result,

1. Employers did not make the full required contribution (only normal costs)
2. Contribution Holidays (no contributions required)
3. Increased benefits without funding those enhanced benefits (i.e. SB400)

CALPERS - SB400

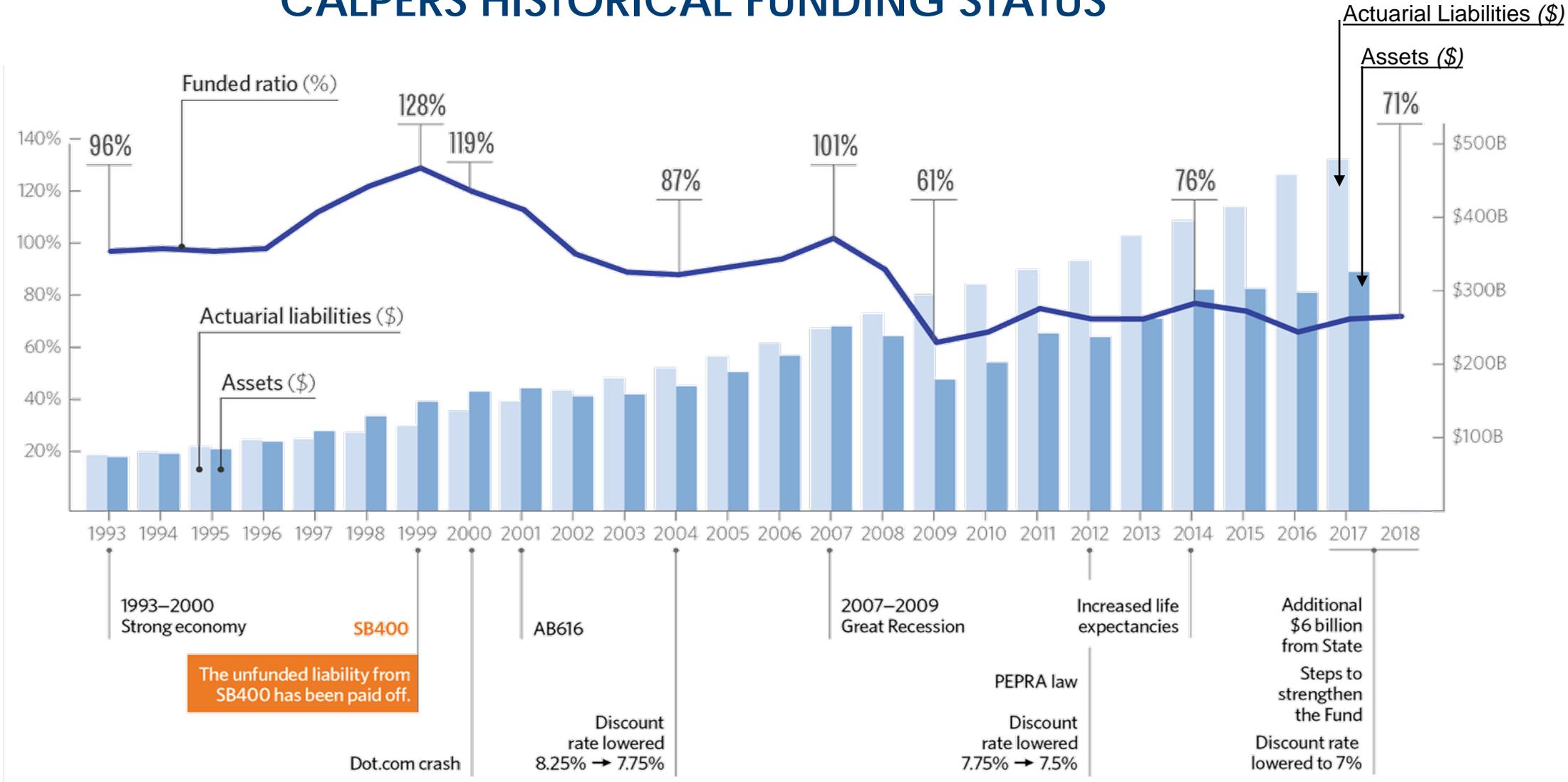
1999 - California State Legislators passed SB400 allowing the enhancement of retirement benefits to attract, reward and retain employees:

1. Reduced the eligible age to retire.
2. Allowed member agencies to amend retirement ages and benefit formulas.
3. Allowed retroactive increases from enhanced formulas to calculate retirement benefits.
4. No required contribution increases.

Example of SB400 effect: An employee retiring on 12/31/1999 (pre-SB400) under a 2% @ 55 formula would receive a \$60,000 annual pension payment; the same employee retiring on 1/1/2000 (post-SB400) under a 3% @ 50 formula would receive a \$90,000 annual pension payment.



CALPERS HISTORICAL FUNDING STATUS



Source: <https://www.calpers.ca.gov/page/about/organization/facts-at-a-glance/solid-foundation-for-the-future>¹⁵

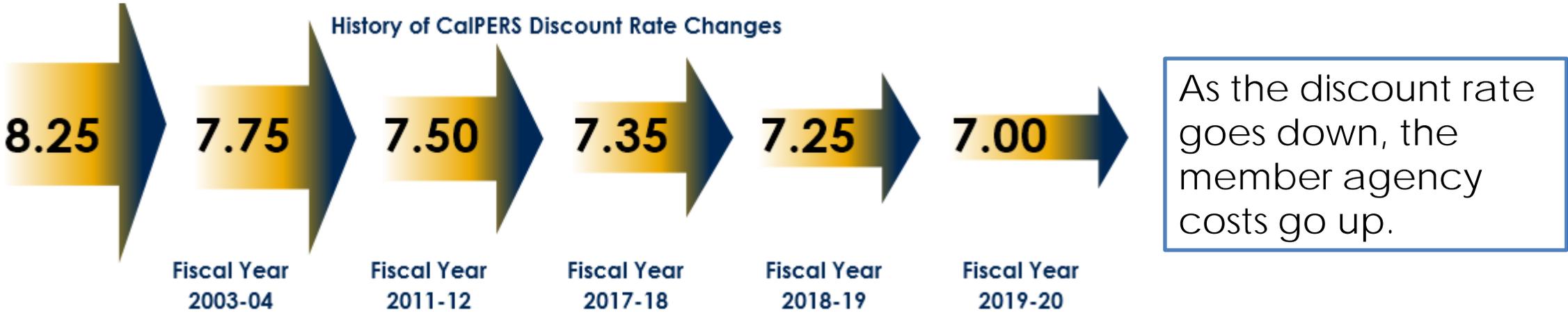
SIGNIFICANT CHANGES AFFECTING CALPERS

1. Public Employee's Pension Reform Act (PEPRA) became effective 1/1/2013
 - a. Limits future pension manipulation
 - b. Lowered benefit formula for new members
2. Revised Valuation/Actuarial methodologies
3. Increased required member agency contributions.



SIGNIFICANT CHANGES AFFECTING CALPERS

4. Lowered Discount Rate (assumed rate of investment returns)



4. Changed UAL amortization period from a fixed 20-year period to a 30-year period with a 5-year ramp up at the beginning of the amortization period*

*Additional information in report attachment CalPERS Actuarial Circular Letter 042618



CALPERS FOR RIVERSIDE EMPLOYEES

1. June 5, 1945, voters approved a Defined Benefit Plan (DBP) for employees to receive fixed benefits that are based on length of service and salary earned at the time of retirement.
2. The City's Charter (Article X – Retirement), requires a CalPERS retirement for City employees.

“The City Council may terminate any contract with the Board of Administration of the Public Employees' Retirement System only under authority granted by ordinance adopted by a majority vote of the electors of the City, voting on such proposition at an election at which such proposal is presented.”



CALPERS FOR RIVERSIDE EMPLOYEES

3. The City has several employee groups with different CalPERS DBP formulas.
4. For example, for a plan member that receives a pension of 2.7% @ 55 with a 3-year highest salary average of \$65,000 and 20 years of service will:
 - a. Be eligible to retire at 55 years of age
 - b. Receive an annual pension based on the following formula:
 - I. Years of service x pension rate x 3-year highest salary average = annual pension
 - II. $20 \times 2.7\% \times \$65,000 = \$35,100$ annual pension



*Additional information in report attachment CalPERS Summary of Valuation 063017

CITY STATS

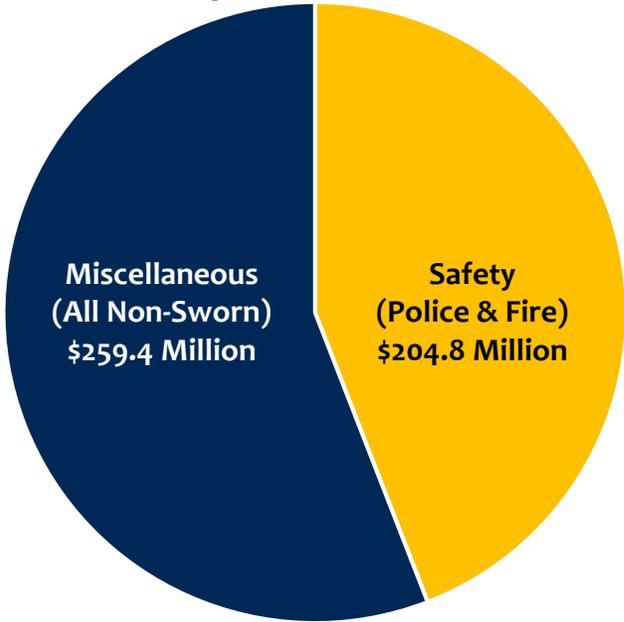
- 12th largest city in California (ranked by population)
- Population: 327,728 (2017 California Department of Finance estimate)
- Citywide FY 2018/19 Total Budget: \$1.08 billion
- General Fund FY 2018/19 Operating Budget: \$269 million
- General Fund FY 2018/19 Personnel Budget: \$218 million (81% of Operating Budget)
- FY 2018/19: 2,500 budgeted employees
- CalPERS members at June 30, 2017:
 - 2,155 active
 - 2,880 retired/beneficiaries

For every 3 active members,
Riverside has 4 retired/ beneficiary
members

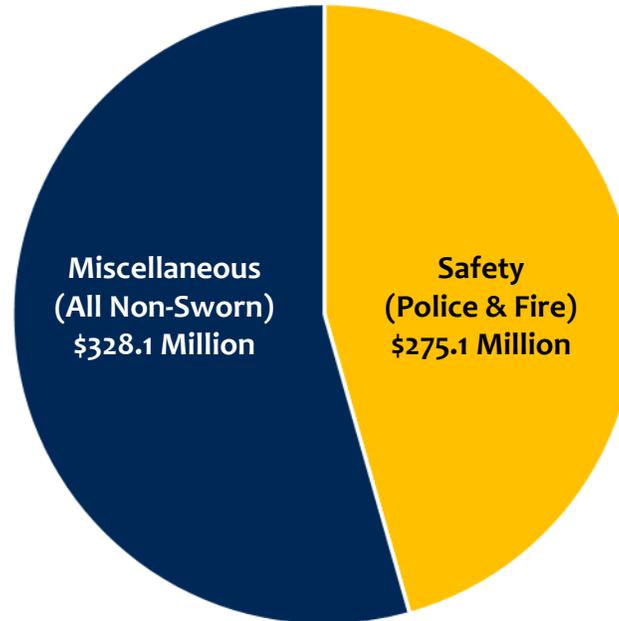


WHAT IS THE CITY'S UAL?

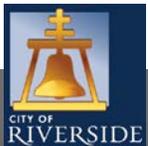
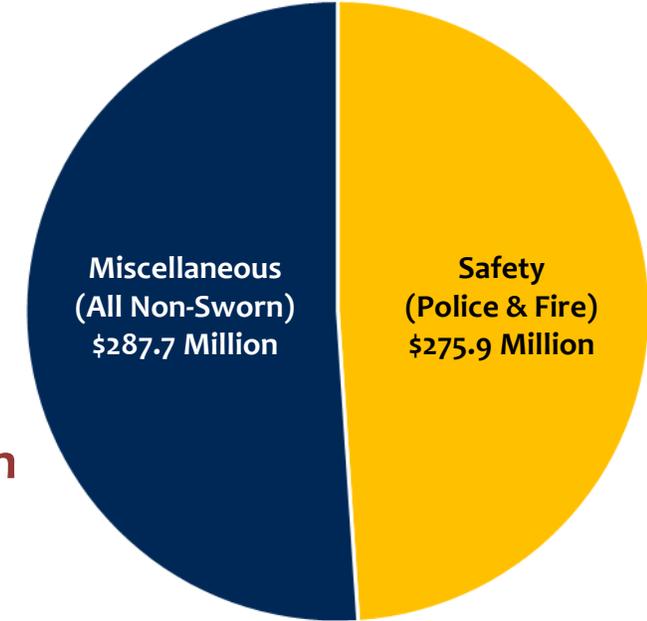
Total UAL: \$464.2 Million
Actuarial Report as of June 30, 2015



Total UAL: \$603.2 Million
Actuarial Report as of June 30, 2016



Total UAL: \$563.6 Million
Actuarial Report as of June 30, 2017



Source: CalPERS Actuarial Valuation Reports for the City of Riverside, as of June 30, 2015, 2016 and 2017

RIVERSIDE FUNDED RATIOS

The City's CalPERS Funded Ratios represent the percentage of assets available today to pay all of the pension benefits promised to City employees.



MISCELLANEOUS
EMPLOYEES

78.2%

General Fund &
Non-General Fund

CITY CalPERS FUNDED RATIOS

Represents the percentage of assets available today to pay all of the pension benefits promised to City employees.



SAFETY
EMPLOYEES

73.2%

General Fund



Source: CalPERS Actuarial Valuation Reports dated July 2018 for the City of Riverside, as of June 30, 2017

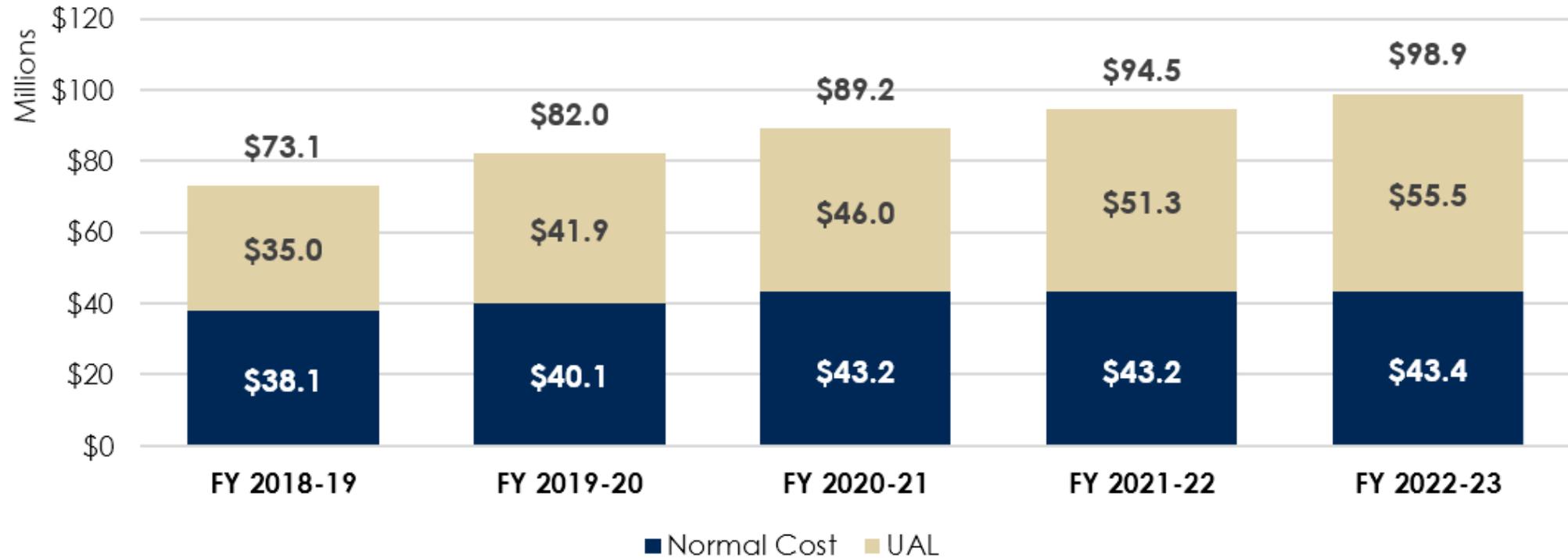
RIVERSIDE'S DEFINED BENEFIT PENSION PLANS (DBP)

1. The City has five CalPERS DBP formulas depending on PERS entry date and employee group.
2. Tier 1 and 2 DBP formulas are set by the City through employee negotiations.
3. Tier 3 DBP formula is set by the Public Employees' Pension Reform Act of 2013 (PEPRA).

	Classic CalPERS Members (Hired before January 1, 2013)		New CalPERS Members (Entered on or after January 1, 2013)
Safety	Tier 1	Tier 2	Tier 3
Police	3% @ 50	3% @ 50	2.7% @ 57
Fire	3% @ 50	3% @ 55	2.7% @ 57
Miscellaneous			
All Non-Sworn	2.7% @ 55	2.7% @ 55	2% @ 62

CITYWIDE ESTIMATED CALPERS COSTS

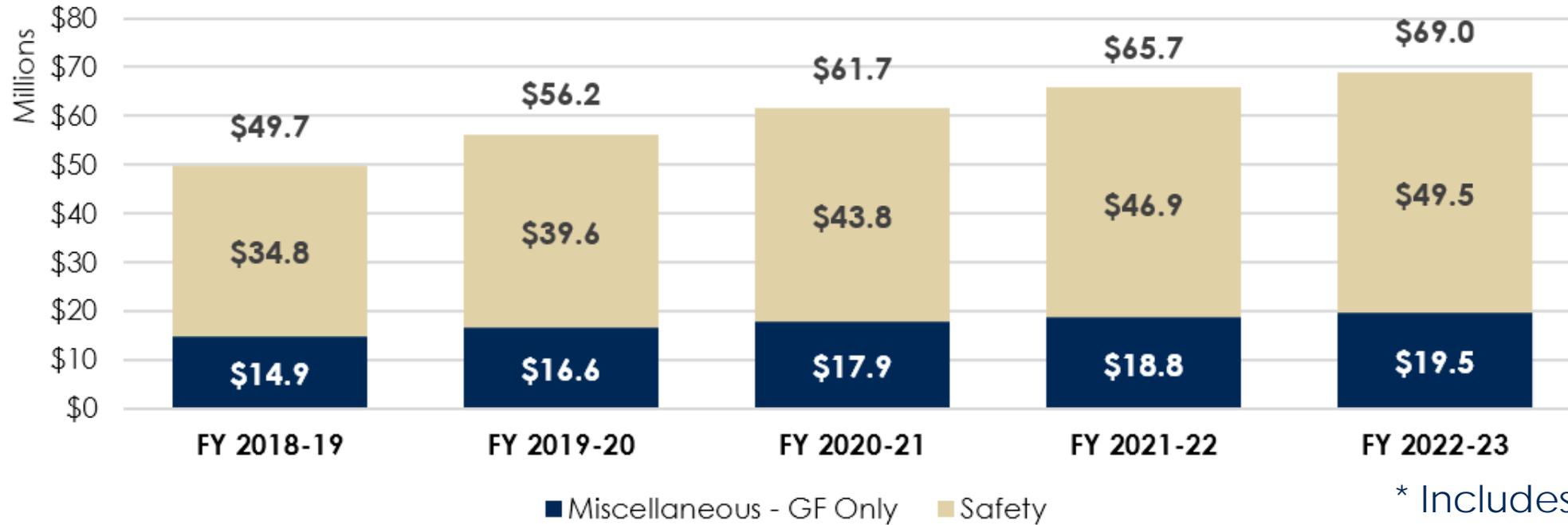
Since the Great Recession (2007-2009), the City's annual payment to CalPERS have increased significantly and will continue to grow (General Fund & Non-General Funds).



Sources: UAL - Actuarial reports dated July 2018, reporting data as of June 30, 2017;
 Normal Cost projections – City' FY 2018-20 Budget and underlying five-year cost projections



GENERAL FUND ESTIMATED CALPERS COSTS*



1. The increase to Normal Cost/Contributions are a result of CalPERS trying to lower its UAL.
2. This is an important fiscal challenge impacting the State and most California cities.

Sources: UAL - Actuarial reports dated July 2018, reporting data as of June 30, 2017; Normal Cost projections – City’ FY 2018-20 Budget and underlying five-year cost projections



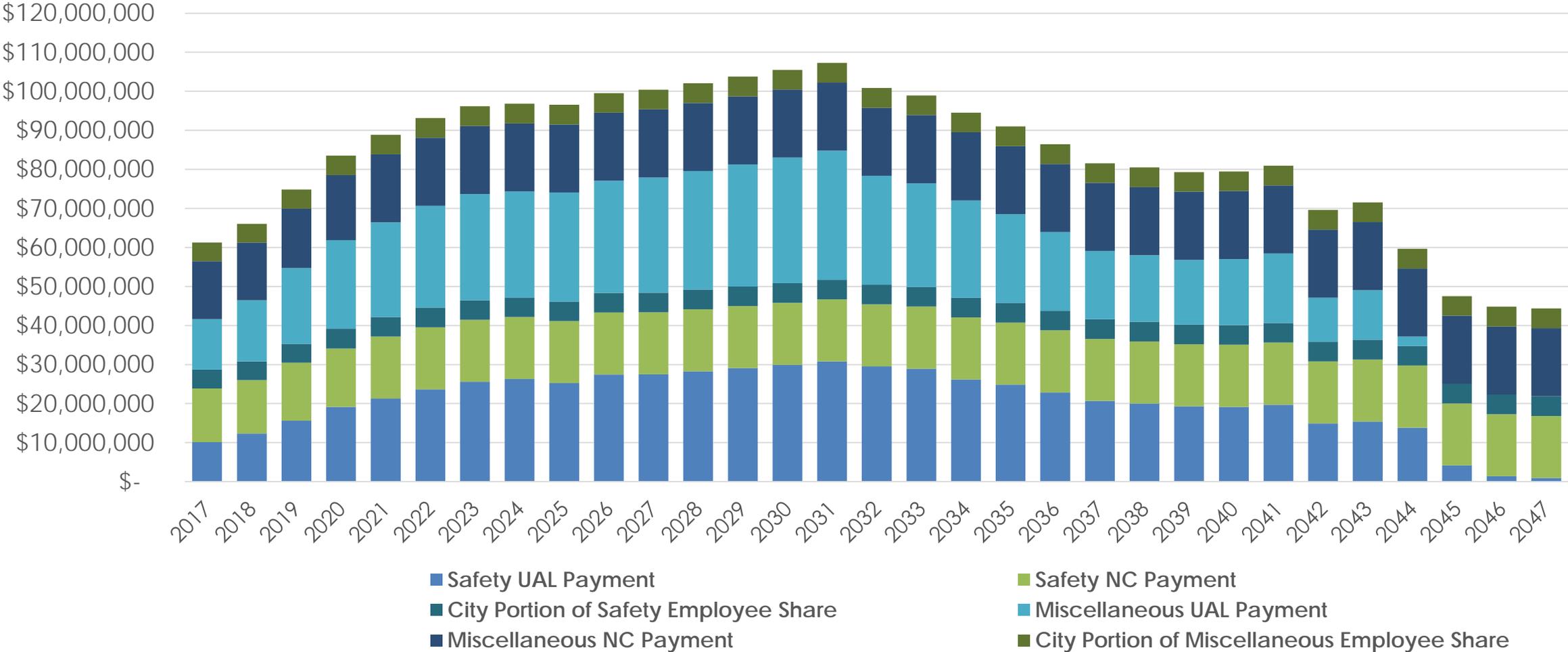
GENERAL FUND OVERVIEW: 5-YEAR FORECAST

	Estimated FY 2017/18	Adopted FY 2018/19	Adopted FY 2019/20	Projected FY 2020/21	Projected FY 2021/22	Projected FY 2022/23
Beginning General Fund Reserve	\$41,497,820	\$59,043,375	\$59,043,425	\$59,043,425	\$44,088,223	\$26,039,944
Total Revenues/Transfers In	271,966,343	270,070,216	280,999,016	279,123,664	284,635,159	291,414,344
Total Expenditures/Transfers Out	(254,420,788)	(268,834,151)	(282,235,031)	(294,078,866)	(302,683,438)	(308,919,547)
Five-Year Financial Plan Surplus/(Deficit)	\$17,545,555	\$1,236,065	\$(1,236,015)	\$(14,955,202)	\$(18,048,279)	\$(17,505,203)
Designated Fund Balance (Reserved) / Used for Future Operations	-	(1,236,065)	1,236,015	-	-	-
Ending General Fund Reserve	\$59,043,375	\$59,043,425	\$59,043,425	\$44,088,223	\$26,039,944	\$8,534,741
<i>Fund Balance to Spending Percentage</i>	23.20%	22.40%	21.00%	15.00%	8.60%	2.80%

*Source: City's adopted Fy18/19 – 19/20 Budget with the 5 year projection



30-YEAR CALPERS COST PROJECTIONS



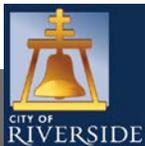
*Source: Projection costs from NHA Advisors on behalf of the City based on CalPERS actuarials



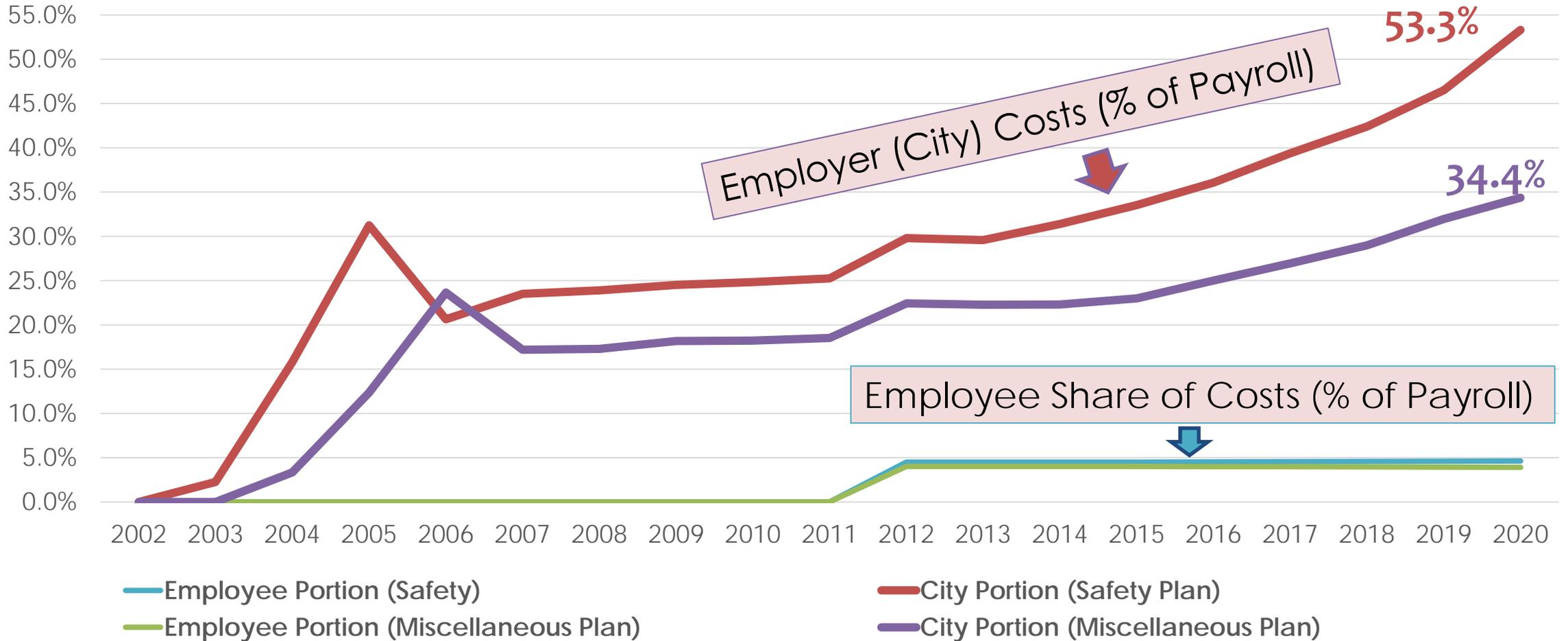
CITY ACTIONS IMPACTING COSTS

Year	Description	CalPERS Cost Impact	City Net Financial Impact
2003-04	City issued Pension Obligation Bonds to extinguish UAL at that time and reduce payments	↓	↓
2011-12	All new employees begin paying the employee portion of PERS pension cost	↓	↓
2013	Established lower pension benefits for employees new to CalPERS (PEPRA)	↓	↓
2016	Tier 1 Employee groups agree to contribute more to CalPERS over several years as part of Partnership Compensation Model (PCM)	↑	↑*
2018-20	Pre-pay UAL at the beginning of the Fiscal Year to save 3.5% (~\$1.2 million/yr)	↓	↓
Every Year	Implement operational efficiencies to minimize costs and impact to services - more to go	↓	↓

* Tied to salary increases, which require corresponding CalPERS contributions. Net effect undetermined, but possibly negative.



HISTORICAL PENSION COSTS AS A % OF PAYROLL



Source: Historic costs and Projection costs from NHA Advisors on behalf of the City based on CalPERS actuarials



WHY NOT LEAVE CALPERS?

1. For member agencies, leaving CalPERS is cost-prohibitive AND more costly: In order to terminate the PERS liability, the City of Riverside would need to pay approximately **\$4 billion***.
2. PERS uses a “risk-free” discount rate to calculate termination liability...

Current reports show estimates of 1.75% to 3.00% discount rate!

** Estimated based on recent 2017 Actuarial Report*



KEY TAKEAWAYS

1. **Riverside is not unique:** all member agencies are facing this issue.
2. **CalPERS cost estimates will fluctuate** based on CalPERS' investment returns, actuarial valuations, changes in the City's defined benefit plans and employee demographics, etc.
3. Rising CalPERS costs pose a **significant financial challenge** for future budget years, particular to the General Fund.
4. **Multiple options** will need to be considered and employed to manage rising CalPERS costs –everyone needs to be involved, and all ideas need to be considered within legal parameters.
5. **Thoughtful conversations, analysis, and consideration** of options will be required to address this complex issue, with ideas and assistance **from all City stakeholders.**



CONVERSATIONS ABOUT CALPERS COSTS

Date	Description
March 30, 2017	Budget Engagement Commission – Measure Z Spending Priorities, including updates on the CalPERS costs
April 12, 2017	Finance Committee presentation providing information on the financial impact of CalPERS lowering discount rate
August 31, 2017	Budget Engagement Commission presentation providing information on future CalPERS cost increases
February 26, 2018	Riverside Public Utilities Board presentation providing an update on the City's past and future CalPERS costs
May 9, 2018	Riverside Public Utilities Board presentation providing information on future CalPERS cost increases
June 12, 2018	City Council Budget Presentation directed staff to report to the Finance Committee on the development of a plan to address rising CalPERS costs



The CalPERS Challenge: Tentative Schedule

STEP 1: Understanding the CalPERS Challenge for a Long Term Fiscal Management Plan

STEP 2: Beginning Investigations for Options to Provide a Long Term Management of CalPERS Costs & Financial Health

STEP 3: Confirming the Paths Forward for a Solvent Future

Fiscal Years 2020-2022 Budget Process & Beyond

SEPT/OCT 2018 NOV/DEC 2018 JAN/FEB 2019 MAR/MAY 2019 JUN/JUL 2019 JUL 2019 AUG/OCT 2019 SEPT/OCT 2019 NOV 2019 - JUN 2020 JUL 2020 FORWARD

- A. Present CalPERS Challenge to Finance Committee, BEC, & City Council
- B. Present CalPERS Challenge & Provide Information/Education to Employees and the Public
- D. Develop Models/Scenarios for Range of Solutions
- C. Explore Range of Solutions with Employees and the Public
- E. Analyze, Prioritize, & obtain Council approval for the CalPERS Long Term Fiscal Management Plan
- F. Integrate, Measure, & Manage Implementation of Path Forward

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How to Effectively Secure the Solvent Financial Future of the City, Its Employees, & Its Retirees While Ensuring the Delivery of Public Services & Stewardship of Public Resources

Rhythm of Meetings

1. Employees	4. Finance Committee
2. Community	5. City Council
3. Budget Engagement Commission	

COST MANAGEMENT

- Section 115 Trust
- Cash pool borrowing
- CalPERS Fresh Start program
- Prepayment of amortization bases
- Debt restructuring
- Borrowing (Pension Obligation Bonds)
- Use of cash reserves
- Measure Z – strategic use
- One-time revenue set-asides
- Sell City assets
- Revenue generation / enhancement
 - True-up market-based fees to current
- Review subsidy programs



PATH FORWARD

November 14, 2018 CalPERS Challenge website

November 29, 2018 Budget Engagement Committee

December 18, 2018 City Council Workshop

Jan. to Dec. 2019 Citywide invitation for all staff members to attend a monthly brown bag lunch session to talk to the City Manager about the CalPERS Challenge

