City of Riverside
City of Arts & Innovation

Finance Committee

TO: FINANCE COMMITTEE **DATE: MAY 14, 2025**

FROM: FINANCE DEPARTMENT **WARD: ALL**

SUBJECT: **CALPERS UNFUNDED ACCRUED LIABILITY, 2020 PENSION OBLIGATION BOND PERFORMANCE, AND ONGOING COST MANAGEMENT STRATEGIES**

ISSUE:

Receive a report and provide input on the City's CalPERS Unfunded Accrued Liability, Pension Obligation Bond performance, and ongoing pension cost management strategies.

RECOMMENDATIONS:

That the Finance Committee receive a report on and provide input on the City's CalPERS Unfunded Accrued Liability, 2020 Pension Obligation Bond performance, and ongoing pension cost management strategies.

BACKGROUND:

The City of Riverside (the "City") currently has an Unfunded Accrued Liability (UAL) with California Public Employees' Retirement System (CalPERS). The City's CalPERS UAL is $436.6 million as of the latest CalPERS valuation dated June 30, 2023, with $235.4 million allocated to the Miscellaneous Plan and $201.2 million to the Safety Plan. Based on the most recent CalPERS actuarial report, it is anticipated that the City's pension costs will continue to grow for the next five to ten years.

The City has been very proactive in transparently educating stakeholders about the challenge of rising pension costs through the initiation of the CalPERS Challenge Project in 2018. In addition to several educational workshops and a page on the City's website specifically dedicated to educating stakeholders, the City has been diligently executing several cost management strategies over the past 6 years, including: (1) annually prepaying the UAL to obtain a 3.3% discount, (2) establishing a Section 115 Pension Trust (Trust), (3) restructuring a portion of the UAL using Pension Obligation Bonds (POBs), and (4) establishing a Pension Funding Policy. In alignment with its Pension Funding Policy, the City has prudently set aside savings generated from the POBs, and inclusive of strong investment earnings on those funds, the Trust has grown to strong levels. The City must continue to monitor and manage its ongoing UAL and POB liabilities, which will enhance the City's long-term fiscal resiliency, particularly considering potential actuarial assumption changes by CalPERS this year.

DISCUSSION:

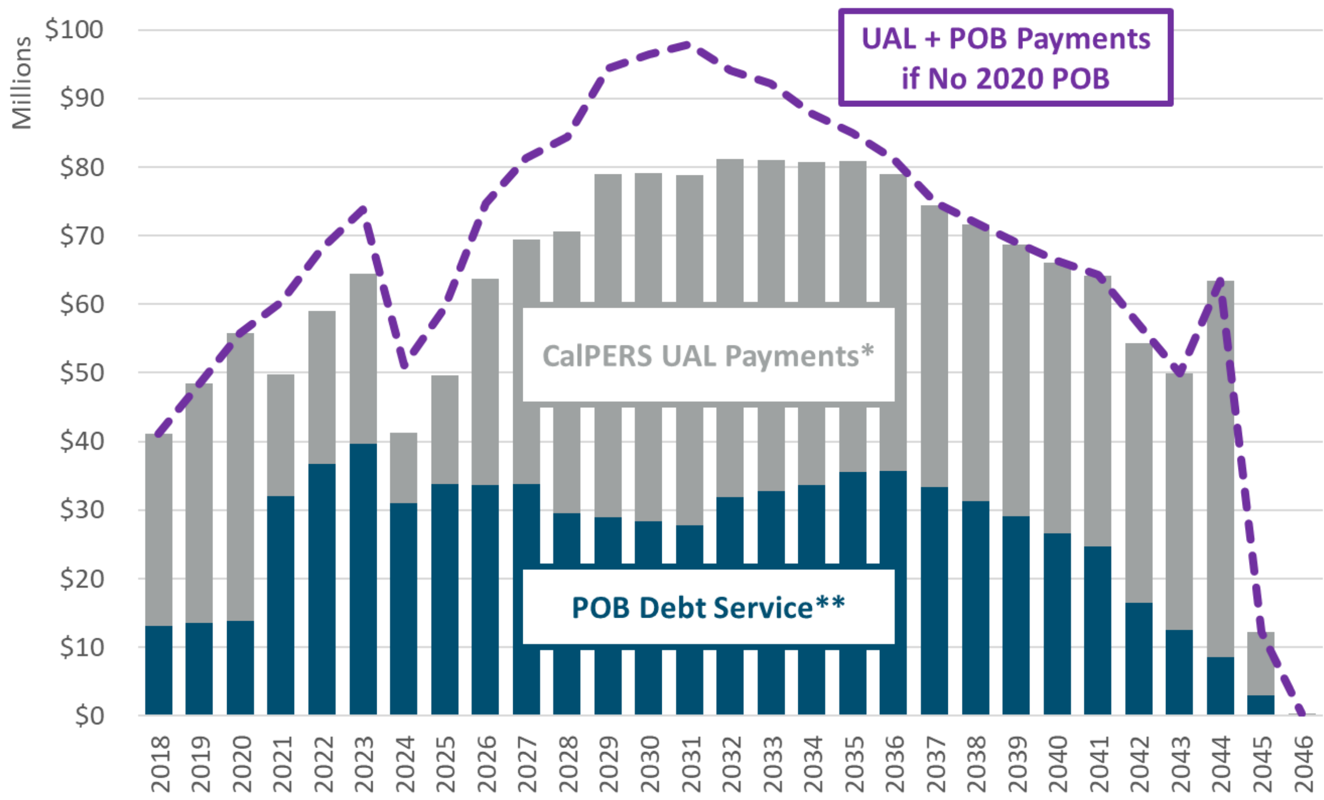
The City provides regular and limited-term employees retirement benefits offered through CalPERS. Retirement benefits are provided through one of two plans: safety plans for sworn police and fire employees, and a plan for all other (miscellaneous) employees. Retirement benefits are based on the retirement formula factor, employee's earnings, age at time of retirement, and the number of service years the employee worked. Each year, the City pays the Annual Required Contribution (ARC), as set by CalPERS. The ARC includes the cost of benefits each employee accrues each year (Normal Cost), and the cost to amortize the unfunded accrued liability (UAL) of the plans, which is the shortfall between the promised pension benefits and the assets currently available in the City's CalPERS account to pay for those benefits. The City's UAL is currently amortized over 21 years at an interest rate of 6.8%. According to the most recent CalPERS actuarial valuation as of June 30, 2023, the City's combined UAL for the Miscellaneous and Safety plans is $436.6 million. Since that actuarial valuation, CalPERS has reported FY 2023-24 final investment returns of 9.5%, which is higher than CalPERS' 6.8% target investment return, and is therefore projected to decrease the City's UAL to $382 million. The actual impact of the FY 2023-24 investment return and other assumptions will not be known until the 6/30/2024 actuarial valuation is finalized by CalPERS later this summer.

CalPERS is also currently undergoing its Asset Liability Management (ALM) Study, which occurs every four years to balance the expected cost of pension payments with the expected investment returns. As part of the ALM Study, CalPERS will review its investment portfolios and retirement plan liabilities, including demographic & economic factors, such as membership, payroll growth, retirement ages, inflation, and life expectancy. The outcome of the ALM study will be known in November 2025. Assumption changes made by CalPERS as part of the 2025 ALM Study could impact the City's UAL and/or Normal Cost payments. Considering the ALM Study, a scenario was evaluated assuming CalPERS lowers the discount rate from 6.8% to 6.5%. The discount rate represents CalPERS' expected annual investment returns. If CalPERS expects to earn less from its investments, then the difference or shortfall needs to be made up by the City. In the scenario of a 6.5% discount rate, the City's UAL balance is projected to increase from $437 million to $515 million, and the City's annual UAL payment is projected to increase $11 million.

In addition to the City's UAL debt, the City also pays debt service on POBs. In the Spring of 2020, the City issued $432 million in POBs to pay off approximately 67% of its then current UAL. As of June 30, 2024, the outstanding principal on the 2020 POB stands at $399 million. By paying off the UAL with the POBs, the City refinanced the high-interest rate UAL (6.8% interest rate) with a low-interest rate POB (3.69% interest rate). The 2020 POB achieved multiple objectives: (1) interest rate savings; (2) equitable funding of both the Miscellaneous and Safety Plans; and (3) smoother payments to enhance budget predictability.

The City has benefitted tremendously from the decision to issue the 2020 POB. Since issuing the 2020 POB in Spring of 2020, CalPERS has earned an average investment return of 7.1%, which is 3.41% higher than the City's 3.69% interest rate on its 2020 POB, and as a result the City has realizing savings. Since issuance, the 2020 POB has already generated approximately $45 million in savings for the City. The projected savings for the entire life of the POB is approximately $175 million, assuming CalPERS meets its assumptions. The City's overall General Fund credit has also been strengthened as a result of the 2020 POB. When the City obtained a credit rating for its 2024A Lease Revenue Bonds last year, S&P Global Ratings noted the following: *"we expect the city's pension and OPEB profile to remain affordable and manageable over the outlook period."* Credit ratings of cities across California are often impacted negatively by pension liabilities, but this has not been the case for the City because of the various strategies utilized.

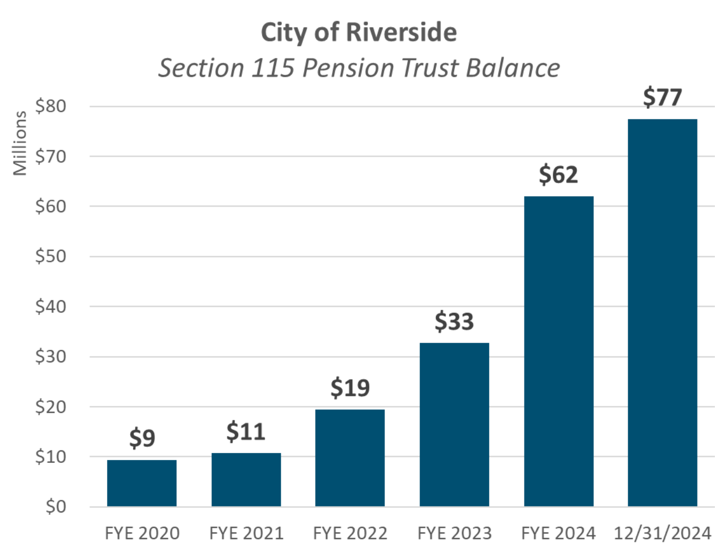
While the City has benefitted financially from issuing the 2020 POB, it is important for the City to continue monitoring and managing the City's UAL and POB debts, especially amid potential assumption changes this year from the CalPERS ALM Study. The chart below provides a current picture of the City's UAL and POB payments. The City's combined UAL + POB payment is rising to $80 million by FY 2028-29, which is 64% higher than the City's FY 2024-25 combined UAL + POB payment of $49 million. The primary reason the UAL payments (grey bars below) are rising significantly is because of CalPERS' poor investment returns in FY 2021-22 (-7.5%). Also included in the chart below is a purple, dashed line estimating the UAL payments if the City had not issued the 2020 POB. The space between the purple, dashed line and the top of the bars represents the City's projected annual savings from issuing the 2020 POB.



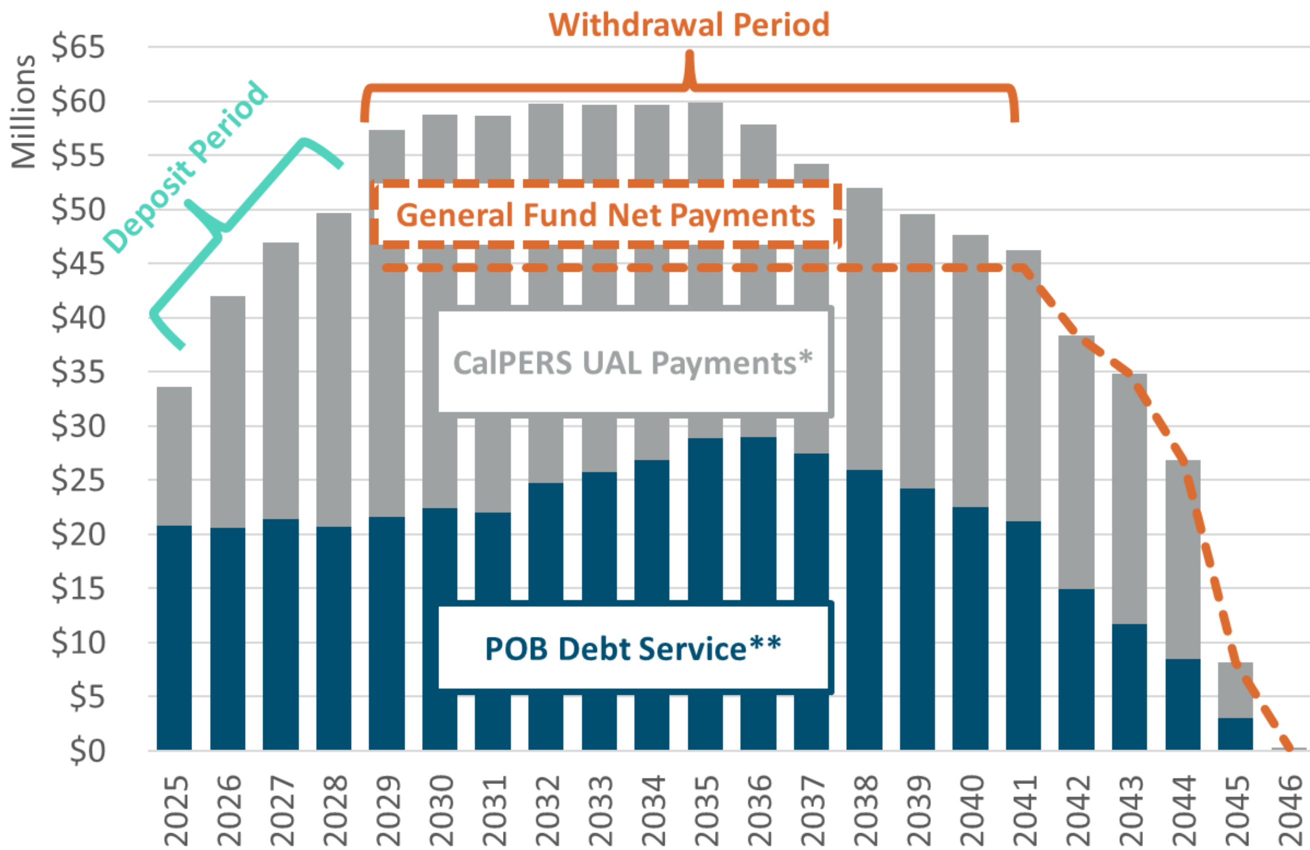
**CalPERS UAL Payments as of the 6/30/2023 Actuarial Valuation. Source: CalPERS Actuarial Valuation Reports.*
***Includes debt service for the 2020 POB, 2017 POB, and 2004 POB.*

Section 115 Pension Trust

The City has taken advantage of the savings from the 2020 POB to fund its Section 115 Pension Trust, which was established by the City in 2019, along with a Pension Funding Policy. The Trust consists of funds legally restricted to the City's pension costs and is a strategy for creating resiliency to handle future pension cost volatility and stabilizing the General Fund's costs at a lower level. Since establishing the Trust, the City has accumulated a balance of $77 million (as of December 31, 2024) through a combination of cash contributions and investment earnings on that cash.



Considering the City's increasing CalPERS payments, and the potential assumption changes from CalPERS as part of the ALM Study, the City should continue to set aside additional funds towards pension costs. The chart below provides an analysis of the impact of the Trust on the General Fund's pension payments, assuming cash deposits are made to the Trust in FY 2026 – FY 2028 according to the City's General Fund Five-Year Financial Plan and withdrawals from the Trust are made in FY 2029 – FY 2041. This strategy uses strategic withdrawals from the City's Trust to stabilize the City's net General Fund pension payments at a lower level. This smoothing strategy is often known as "chopping off the mountain peak in payments". Leveraging the assets in the Trust to stabilize these payments at a lower level should be beneficial for financial planning and should mitigate the need to cut expenses during the years of higher pension costs. The analysis is not meant to lock the City into a pre-defined withdrawal schedule but rather provide the City with an idea of how the Trust can be utilized. The City may want to re-evaluate the deposit and withdrawal amounts after the City has results from the CalPERS ALM Study later this year. It is also important to note that this analysis assumes the Trust is fully exhausted. As part of developing an optimal strategy for the City's use of the Trust, it may be beneficial to consider scenarios which maintain a certain minimum balance in the Trust given potential economic shocks in the future.



**Source: June 30, 2023 CalPERS Actuarial Valuation.*
***Includes the General Fund's portion of debt service for the 2020 POB and 2017 POB.*

Conclusion
Over the past several years, the City has implemented strategic measures that have significantly strengthened its financial position and enhanced its overall financial resiliency. As the City faces steep increases in upcoming UAL payments and the sensitivity of CalPERS investments to market fluctuations and assumption changes, it must remain vigilant in managing these financial pressures. **To mitigate these risks, it is recommended that the City should continue allocating additional funds toward pension obligations over the next two to three years, potentially increasing deposits beyond those currently outlined in the City's General Fund Five-Year Financial Plan if feasible, and continue committing 50% of all one-time windfall funds to the 115 Trust for future pension obligations.** This Spring, City staff and its Municipal

Advisor, NHA Advisors, will continue to evaluate additional available cost management options to determine the most effective strategy, taking into account current market conditions, available resources, and the anticipated impacts of CalPERS' ALM Study. Strategies under consideration include utilizing a Fresh Start amortization and/or Additional Discretionary Payments alongside a Section 115 Trust smoothing strategy to optimize pension cost management and strengthen long-term fiscal stability.

STRATEGIC PLAN ALIGNMENT:

This item contributes to **Strategic Priority 5 – High Performing Government** and **Goal 5.3** – Enhance communication and collaboration with community members, to improve transparency, build public trust and encourage shared decision-making.

This item aligns with each of the five Cross-Cutting Threads as follows:

1. **Community Trust** – Proactively managing the City's Unfunded Accrued Liability through sound pension funding policies, active oversight of Pension Obligation issuances, and expert financial guidance ensures a sustainable Trust to mitigate future liabilities.

2. **Equity** – Maintaining a 115 Trust and prefunding pension obligations safeguards financial stability for all employees—past, present, and future—while preserving service levels amid rising pension costs.

3. **Fiscal Responsibility** – Prefunding pensions obligations through the 115 Trust, Pension Obligation issuances, and adhering to sound funding policies ensure sufficient assets to meet future liabilities, reducing cost spikes and promoting financial sustainability.

4. **Innovation** – A well-managed 115 Trust allows the City to diversify investments beyond Government Code constraints, adapting funding strategies based on market conditions and ensuring fiscal agility.

5. **Sustainability & Resiliency** – Prefunding pension obligations builds a financial foundation that withstands economic shifts, demonstrating Riverside's commitment to long-term stability and adaptability.

FISCAL IMPACT:

There is no immediate impact to receiving this report. However, the recommendations that accompany this report could result in additional fiscal impact depending on the outcome of the recommended actions.

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Attachment: Presentation