

## Long-term Management of CalPERS Costs

City Manager's Office

Finance Committee

October 10, 2018

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### 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.



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## 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



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## 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>

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## 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> 6

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## CALPERS PENSION FUNDING



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

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## 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.

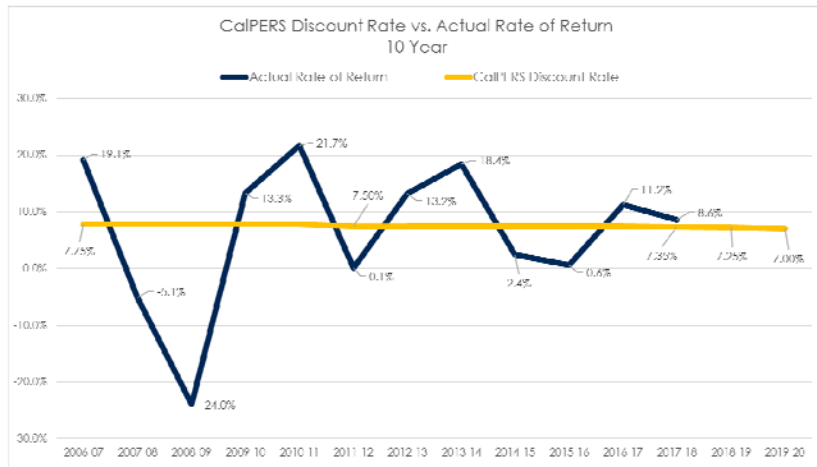


\* Source: report attachment \* CalPERS Experience Study 2017 8

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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> <sup>9</sup>

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## 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.



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## 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.



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## 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.

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

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## 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)



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## 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.

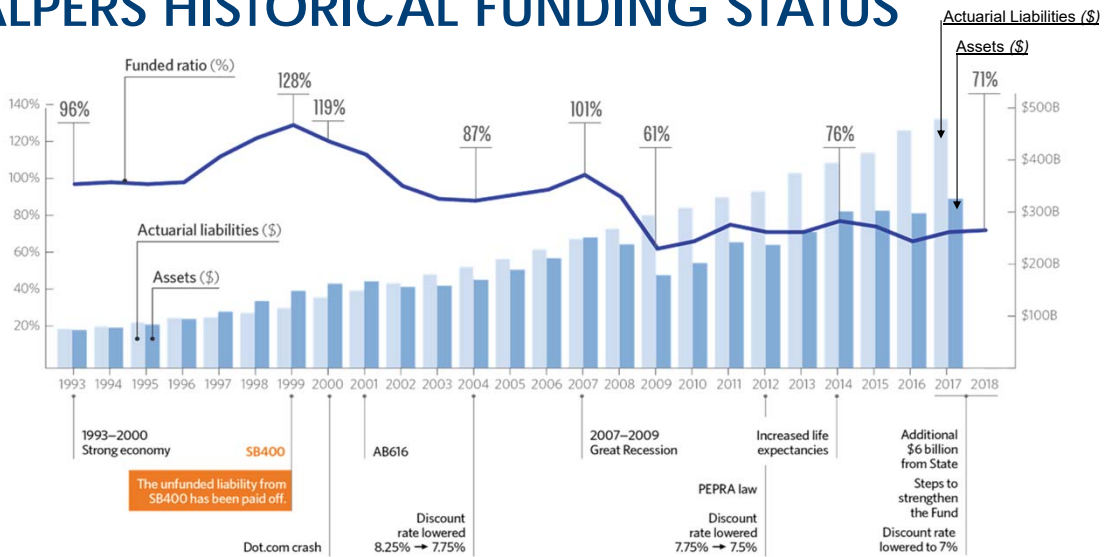
Example of SB400 effect: An employee retiring on 12/31/1999 (pre-SB400) under a 2% @ 55 formula would receive a \$60,000 annual pension payment; the same employee retiring on 1/1/2000 (post-SB400) under a 3% @ 50 formula would receive a \$90,000 annual pension payment.



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# CALPERS HISTORICAL FUNDING STATUS



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

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## 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.



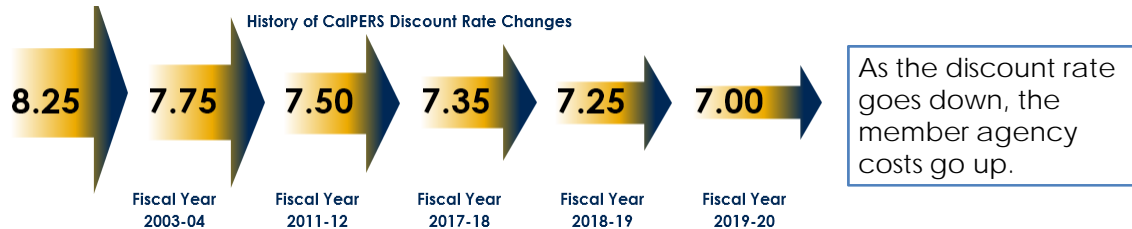
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## SIGNIFICANT CHANGES AFFECTING CALPERS

### 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

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## 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.”



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## 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

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## CITY STATS

- 12<sup>th</sup> 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

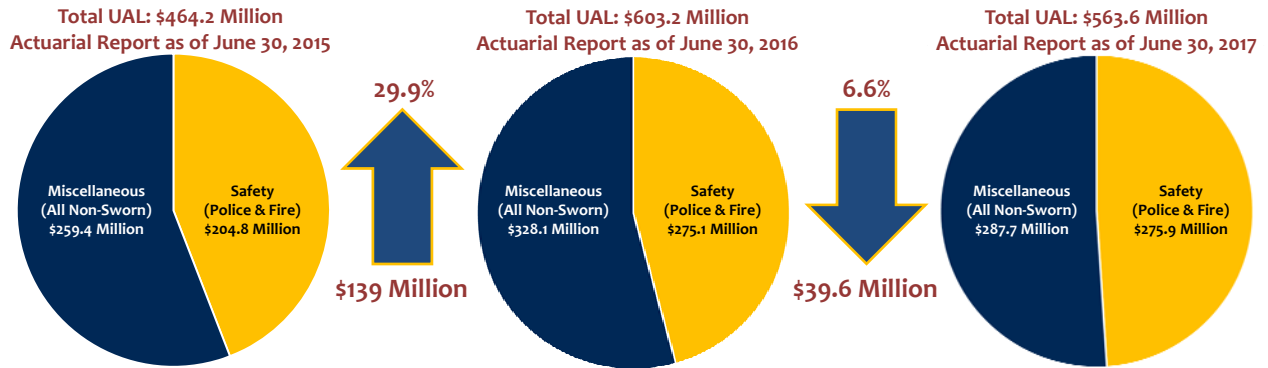
For every 3 active members,  
Riverside has 4 retired/ beneficiary  
members

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## WHAT IS THE CITY'S UAL?



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

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## 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

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## 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)
	Tier 1	Tier 2	Tier 3
<b>Safety</b>			
Police	3% @ 50	3% @ 50	2.7% @ 57
Fire	3% @ 50	3% @ 55	2.7% @ 57
<b>Miscellaneous</b>			
All Non-Sworn	2.7% @ 55	2.7% @ 55	2% @ 62

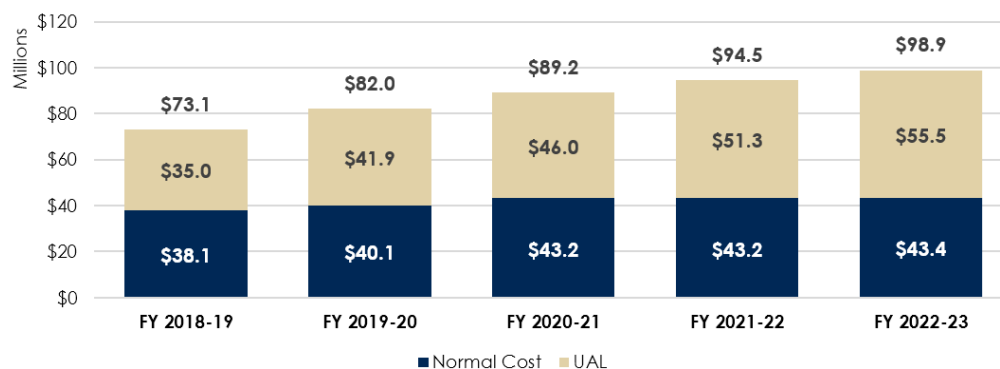


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## CITYWIDE ESTIMATED CALPERS COSTS

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).



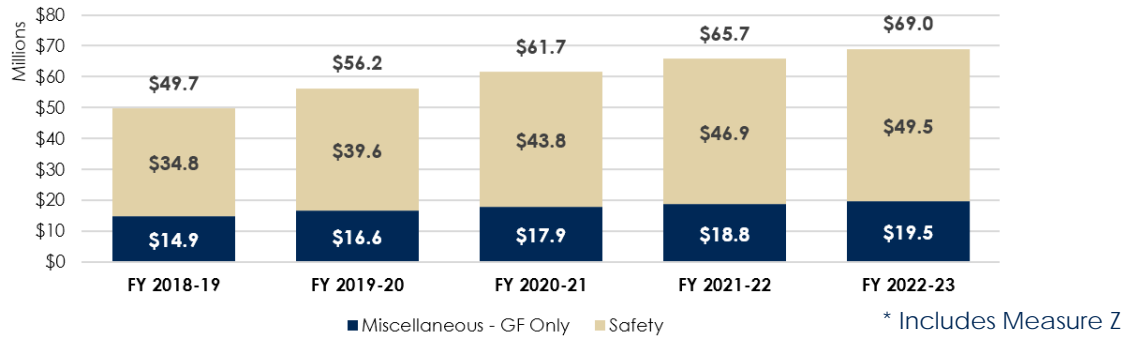
Sources: UAL - Actuarial reports dated July 2018, reporting data as of June 30, 2017;  
Normal Cost projections - City' FY 2018-20 Budget and underlying five-year cost projections

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## 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

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## 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
<b>Beginning General Fund Reserve</b>	\$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)	<b>\$(14,955,202)</b>	<b>\$(18,048,279)</b>	<b>\$(17,505,203)</b>
Designated Fund Balance (Reserved) / Used for Future Operations	-	(1,236,065)	1,236,015	-	-	-
<b>Ending General Fund Reserve</b>	\$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%	<b>15.00%</b>	<b>8.60%</b>	<b>2.80%</b>

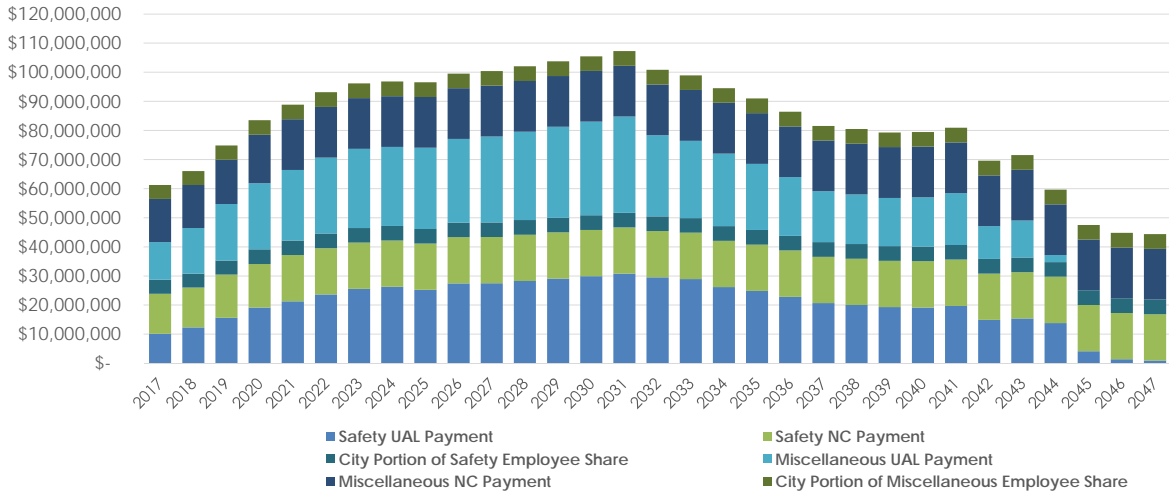


\*Source: City's adopted FY18/19 – 19/20 Budget with the 5 year projection

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# 30-YEAR CALPERS COST PROJECTIONS



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

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# 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	↓	↓

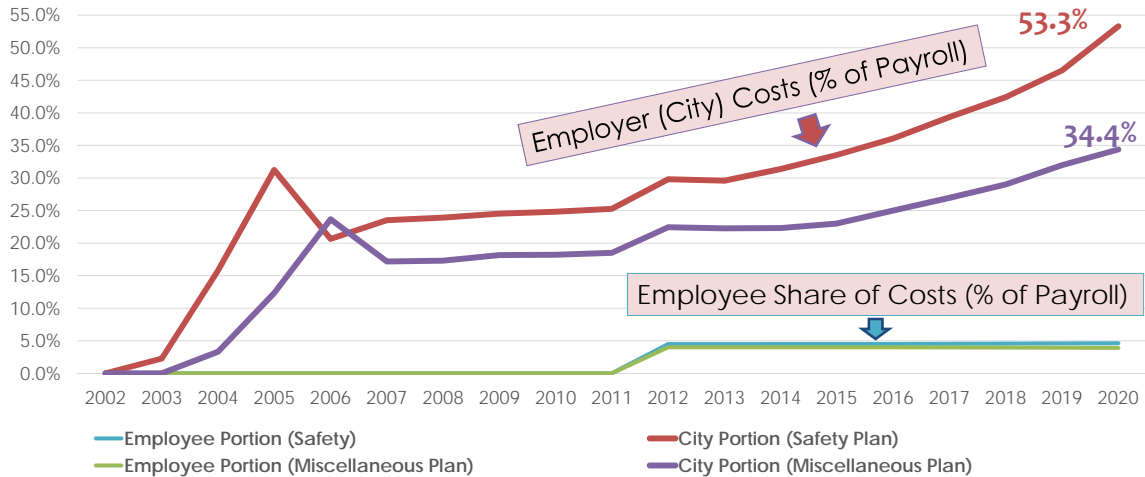


\* Tied to salary increases, which require corresponding CalPERS contributions. Net effect undetermined, but possibly negative.

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## 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

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## 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

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## 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.



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## 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



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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	4	4, 3, 5	5													
B. Present CalPERS Challenge & Provide Information/Education to Employees and the Public				1, 2	1, 2	1,2										
D. Develop Models/Scenarios for Range of Solutions					1, 2	1,2										
C. Explore Range of Solutions with Employees and the Public					1, 2, 3, 4,	1,2, 5	1, 2, 5									
E. Analyze, Prioritize, & obtain Council approval for the CalPERS Long Term Fiscal Management Plan							3, 4	5								
F. Integrate, Measure, & Manage Implementation of Path Forward									1, 2, 3, 4, 5	1, 2, 3, 4 5						
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	<p style="text-align: center;">Rhythm of Meetings</p> <table style="width: 100%; border: none;"> <tr> <td style="width: 50%;">1. Employees</td> <td style="width: 50%;">4. Finance Committee</td> </tr> <tr> <td>2. Community</td> <td>5. City Council</td> </tr> <tr> <td>3. Budget Engagement Commission</td> <td></td> </tr> </table>										1. Employees	4. Finance Committee	2. Community	5. City Council	3. Budget Engagement Commission	
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## RECOMMENDATIONS

That the Finance Committee:

1. Receive the update on the Long-Term Management of CalPERS costs;
2. Confirm, or provide recommended edits, to the CalPERS Challenge Statement;
3. Direct staff to return to the Finance Committee with additional information and to begin the identification of key strategies and factors for consideration as part the plan for Long-term Management of CalPERS Costs.

