City of RIVERSIDE

City of Arts & Innovation

Budget Engagement Commission

TO: HONORABLE COMMISSIONERS **DATE: JULY 11, 2019**

FROM: FINANCE DEPARTMENT **WARDS: ALL**

SUBJECT: PENSION FUNDING POLICY

ISSUE:

Receive and provide input on the Pension Funding Policy and recommend that City Council approve the proposed Pension Funding Policy to help mitigate the City's Long-Term Fiscal Management of the California Public Employees' Retirement System liability.

RECOMMENDATIONS:

That the Budget Engagement Commission:

1. Receive and provide input on the Pension Funding Policy; and

2. Recommend that the City Council approve the proposed Pension Funding Policy to help mitigate the City's Long-Term Fiscal Management of the California Public Employees' Retirement System liability.

COMMITTEE RECOMMENDATIONS:

On June 12, 2019, the Finance Committee, with Chair Adams and Member Soubirous present, considered the Pension Funding Policy to help mitigate the City's Long-Term Fiscal Management of the California Public Employees' Retirement System (CalPERS) liability. After discussion, the Committee voted to forward the recommendation of the Pension Funding Policy to the City Council.

BACKGROUND:

The CalPERS Board of Administration has approved several changes to improve the funded status of the retirement plan, including lowering the discount rate assumption from 7.5% to 7.0%, modifying amortization methods, and updating assumptions about life expectancy. These relatively recent changes have resulted in increases in employer contributions for all agencies participating in CalPERS. Based on the most recent CalPERS actuarial report, it is currently anticipated that the City's pension costs will increase by approximately 28% by Fiscal Year (FY) 2024/25 and continue to grow through FY 2030/31.

Staff has been exploring various strategies to reduce pension costs, lower unfunded liability, and prevent service reductions. The proposed Pension Funding Policy provides for a variety of strategies to proactively address forecasted deficits largely caused by increases in pension costs.

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, as set by CalPERS, which includes the cost of benefits each employee accrues each year, and an amount to pay for the unfunded liabilities of the plans.

According to the most recent CalPERS actuarial valuation, as of June 30, 2017, the City's total unfunded actuarial liability is $563 million. In addition, the City has pension obligation bonds (POB) outstanding totaling approximately $93 million with annual debt service payments averaging approximately $16.7 million. The City's 2005A POBs mature in FY 2019/2020 with annual debt service payments of $2.9 million, the 2004A POBs mature in FY 2022/23 with annual debt service payments of $10.1 million and the 2017A POB matures in FY 2026/27 with annual debt services payments of $3.7 million.

One of the biggest challenges to the City's long-term financial sustainability is the long-term unfunded pension obligations for City employees under CalPERS. Pension costs make up 8% of the City's total budget and 16% of the operating budget. Recent projections indicate that pension costs are expected to rise by as much as 73% by FY 2029/30. The City has consistently taken steps to mitigate the impacts of increases in pension costs including adopting a two-tier retirement system, pre-paying the annual unfunded accrued liability payment, and increasing employee contributions towards their pensions.

In addition to the actions the City has taken to address pension costs, staff, in coordination with the City's CalPERS actuary, have examined a variety of financial strategies that will help to lower costs. These strategies are designed to help the City avoid future service reductions due to significant increases in pension costs being forecasted over the next several years. Strategies that were explored include the following:

1. <u>Making one-time payments to CalPERS</u> to pay-off a portion of the City's Unfunded Accrued Liability (UAL) to save on interest and reduce annual payments. CalPERS amortizes different portions of the City's total UAL over different periods, depending upon the type of event (e.g. investment gains and losses, changes in actuarial assumptions). These events,

or bases, are each charged interest. By paying a portion or all of a UAL base, the City reduces the amount of interest and annual payments over time.

2. Establishing a Section 115 Pension Trust to be used to cover future pension payments. A Section 115 Pension Trust would allow the City to realize greater investment returns than what is currently available through the City's cash pool investments. It also allows the City to maintain control over its assets that can be used to draw upon when the City experiences deficits related to rising pension costs. On May 21, 2019, the City Council approved the establishment of the Section 115 Pension Trust.
3. Pre-Pay the City's annual Unfunded Accrued Liability (UAL) to save on interest costs. On July 1 of each year, the City receives its annual CalPERS UAL invoice. The City has two payment options. The invoice can be paid on a monthly basis or pre-paid at the beginning of the fiscal year by July 31. By pre-paying the entire balance due by July 31 the City can save over $1 million annually. As such, every effort should be made to pre-pay the UAL upon receipt of the annual invoice.
4. Set aside any projected increases in fund balance to manage increases in pension contributions. Actual one-time transfers made to the Pension Stabilization Fund will vary on a year-to-year basis depending upon the actual fiscal year end audited reserve balance.
5. Upon maturity of General Fund Debt Obligation, staff will present a plan to reallocate all or a portion of debt service payments that have matured to the Pension Stabilization program as long as doing so does not incur or further exacerbate a General Fund deficit.

Based on a variety of factors, such as the City's projected deficits in the General Fund and the amount of funding in the General Fund reserves, staff is recommending adopting the attached comprehensive Pension Funding Policy. The proposed Policy outlines the strategies that will work best for the City and how to deploy City resources. It incorporates several of the strategies listed above, some of which the City has already implemented or is in the process of implementing. If adopted, the attached policy would be incorporated into the City's larger financial policy as part of the budget development process.

FISCAL IMPACT

There is no direct fiscal impact associated with presentation of this report.

Prepared by:	Edward Enriquez, Chief Financial Officer/City Treasurer
Approved as to availability of funds:	Marie Ricci, Assistant Chief Financial Officer
Approved by:	Carlie Myers, Deputy City Manager

Attachments:
1. Pension Funding Policy
2. Presentation