CITY OF RIVERSIDE, CALIFORNIA

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CalPERS) OVERVIEW AND UPDATE

AS OF SEPTEMBER 20, 2018

CalPERS 101: HOW DOES IT WORK?

DEFINED BENEFIT PLAN PENSION FORMULAS

Defined Benefit Plans (DBPs) are pension plans in which an employee receives fixed benefits that are based on length of service and salary earned at the time of retirement. The City's relationship with CalPERS to provide a DBP to its employees dates back to 1945 when the initial plan was approved by Riverside voters by Special Election on June 5. Further, the City's Charter (Article X – Retirement), requires a CalPERS retirement for City employees.

A defined contribution plan (DCP), such as a 401K, is a dollar contribution to a retirement fund. The total retirement in a DCP is generally based on the amount of assets and growth of the money.

The City has several employee groups with different CalPERS DBP formulas (see page 3). The formula represents the percent of salary for each year employed with the City that a plan member will receive at or after the specified age.

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:

- Be eligible to retire at 55 years of age
- Receive an annual pension based on the following formula:
  - Years of service **x** pension rate **x** 3-year highest salary average = annual pension
  - 20 x 2.7% x $65,000 = $35,100 annual pension

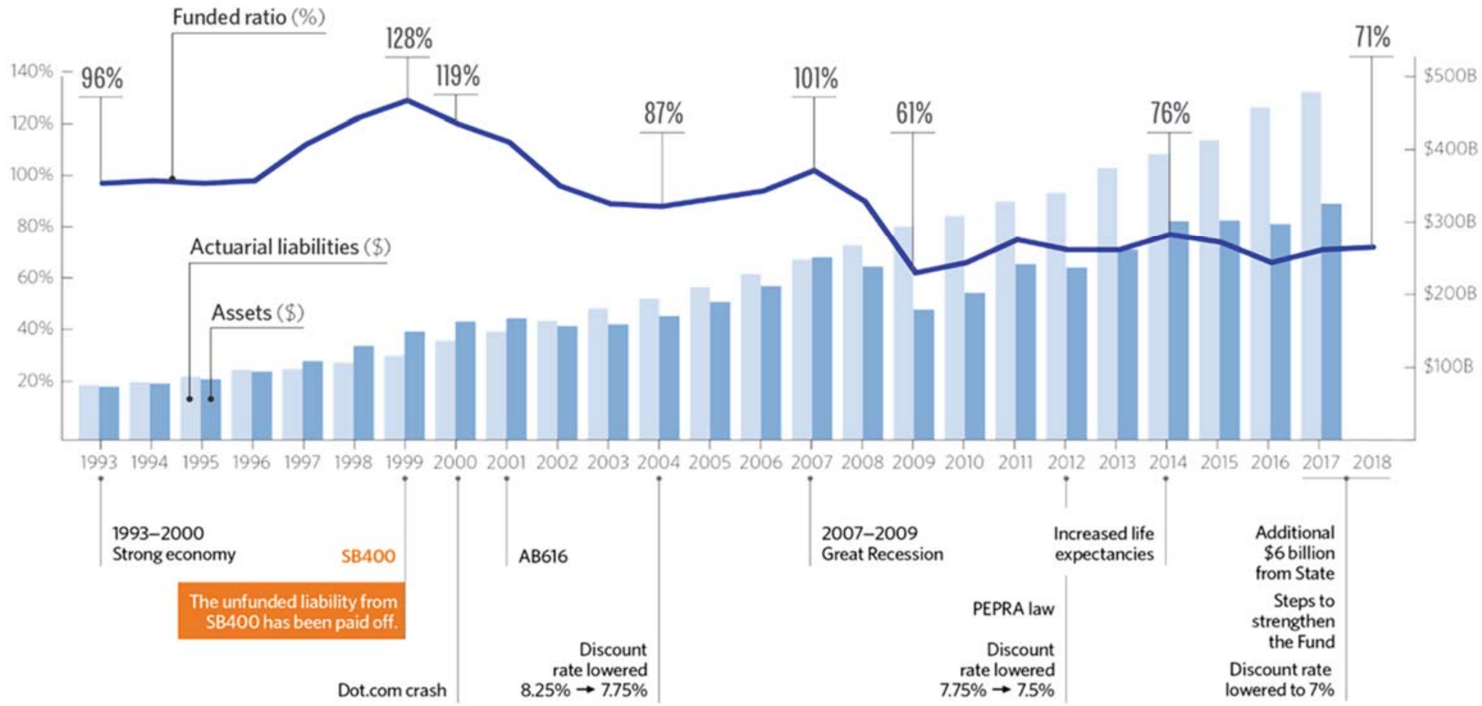
HOW ARE CalPERS BENEFITS FUNDED?

TWO-THIRDS OF FUNDS COME FROM INVESTMENTS

Historically, more than 60% of all funds paid to CalPERS retirees comes from investment earnings. When CalPERS does not meet its investment return goals, the City will pay more.

(SEE THE LAST PAGE FOR INVESTMENT AND CalPERS TERMINOLOGY DEFINITIONS)

CalPERS HISTORICAL FUNDED STATUS



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

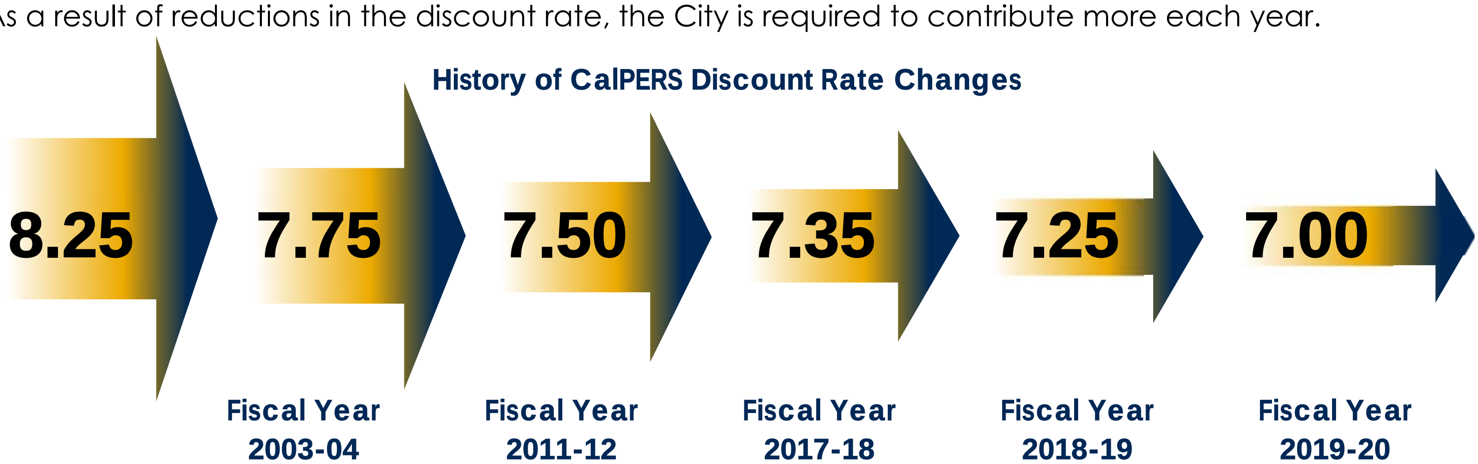
"Funded status" refers to the total assets available to pay all pension liabilities in full as of the current date. In the late 1990s, CalPERS was "superfunded" (a term used to describe total assets in excess of total pension liabilities) due to a strong economy. Following the Dotcom Crash in 2000-2002, CalPERS investment returns dropped from a 15.7% average in 1994-2000 to an average -9.6% return during 2000-2003. CalPERS funding levels have not returned to the superfunded level of 128% prior to the Great Recession, and continues to experience factors that negatively impact the funded status. Key impacting factors include, but are not limited to:

- ✓ Investment returns
- ✓ Inflation
- ✓ Legislative impacts (e.g. PEPRA)
- ✓ Actuarial assumptions (e.g. life expectancy of the retiree)

LOWER CalPERS DISCOUNT RATES INCREASE CITY PENSION COSTS

A discount rate, also known as expected or assumed rate of return, is the estimated long-term average return expected to be earned on investments. Larger gains made from CalPERS plan investments result in a reduction in City contributions.

CalPERS periodically changes the discount rate to be more consistent with long-term market expectations. As a result of reductions in the discount rate, the City is required to contribute more each year.



SHORT AND LONG-TERM VIEW OF RETURN ON INVESTMENTS

In July 2018, CalPERS reported a preliminary 8.6% return on investments for FY 2017/18, a decrease of 2.6% from the prior year. Although investments show significant improvement from earlier years (FY 2014-15 was 2.4% and FY 2015-16 was 0.61%), the varying rate of annual returns reflects the market volatility that prompted changes in the discount rate. The recent improvement in investment returns is not sufficient to eliminate unfunded pension liabilities (32% of total liability – CalPERS pension plans are funded at 71%). CalPERS' investment strategy focuses on long-term performance rather than more volatile short-term performance.

8.6%	8.1%	5.6%	6.1%
FY 2017-18 Net Return on Investments	**5-Year Net Return on Investments**	**10-Year Net Return on Investments**	**20-Year Net Return on Investments**

HOW ARE THE CITY'S CalPERS COSTS PAID?

CalPERS establishes an **employer rate**, known as the normal cost, which the City must pay for each participating employee, and an **employee rate**, which either the City or the employee may pay.

The employer rate is an actuarial calculation provided to the City by CalPERS each year. The total amount is comprised of two factors. The normal cost is an estimated percentage of salary based on the employee pool (age, salary, investment returns, etc.). Another component of employer cost is an annual lump sum payment required to pay down an **unfunded accrued liability** (UAL).

Depending on the pension formula, CalPERS statutorily sets the employee rate at 7.0% - 11.5% of the employee's salary. Until recently, the City paid the employee rate for most City employees. This practice was discontinued in FY 2011-12 for new employees. In 2016, the City also required all existing employees (Tier 1) to gradually transition to paying their share of pension costs over the next four to five years.

Tier 1	In 2016, began a phased-in approach to eliminate cost-sharing and require employees pay the full employee share. Because of restrictions imposed by the California Rule, the phasing-in is directly tied to salary increases; if salary increases are not granted, the employee contribution is not increased.
Tier 2	Employees hired in 2011-12 (depending on employee group) are required to pay the full employee contribution upon hiring.
Tier 3	Tier 3 was created as a result of the California Public Employees' Pension Reform Act (PEPRA) and establishes a reduced tier of benefits for new CalPERS employees. The employee share for PEPRA employees is higher than that for Tier 1 and Tier 2 employees. The employee share for these employees is defined as at least 50% of the total normal cost rate, which is calculated by CalPERS.

CITY'S DEFINED BENEFIT PLAN PENSION FORMULAS

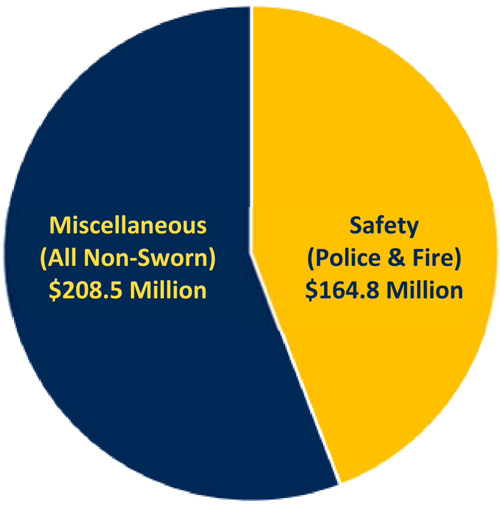
	Classic CalPERS Members (Hired before January 1, 2013)		New CalPERS Members (Entered on or after January 1, 2013)
Safety	**Tier 1**	**Tier 2**	**Tier 3**
Police	3% @ 50	3% @ 50	2.7% @ 57
Fire	3% @ 50	3% @ 55	2.7% @ 57
Miscellaneous			
Non-Sworn	2.7% @ 55	2.7% @ 55	2% @ 62

ARE THE CITY'S PENSIONS SUFFICIENTLY FUNDED?

CITYWIDE UNFUNDED PENSION LIABILITY

The difference between the City's retirement plan assets and the amount that will be needed to be paid as a pension to employees in the future is known as the unfunded accrued liability (UAL). It is based on calculations provided by the CalPERS Actuarial Office that take into consideration various factors including expected long-term returns on investments and the life expectancy of retirees. UAL is not paid in one year, it is amortized over a period of 20-30 years.

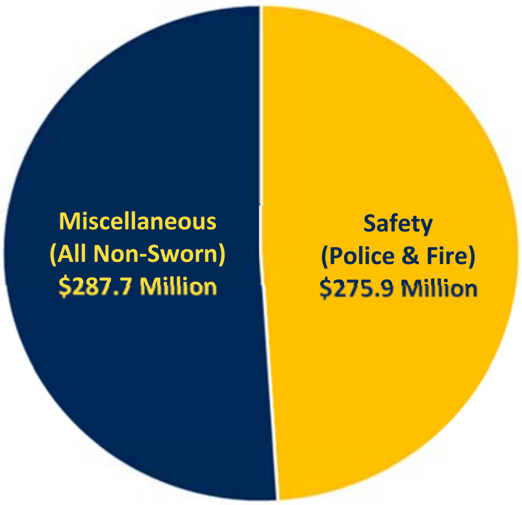
Total UAL: $373.3 Million
Actuarial Report as of June 30, 2014



Increased $190.3 Million (51%)

Primarily due to change in discount rate

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



CITY CalPERS FUNDED RATIOS

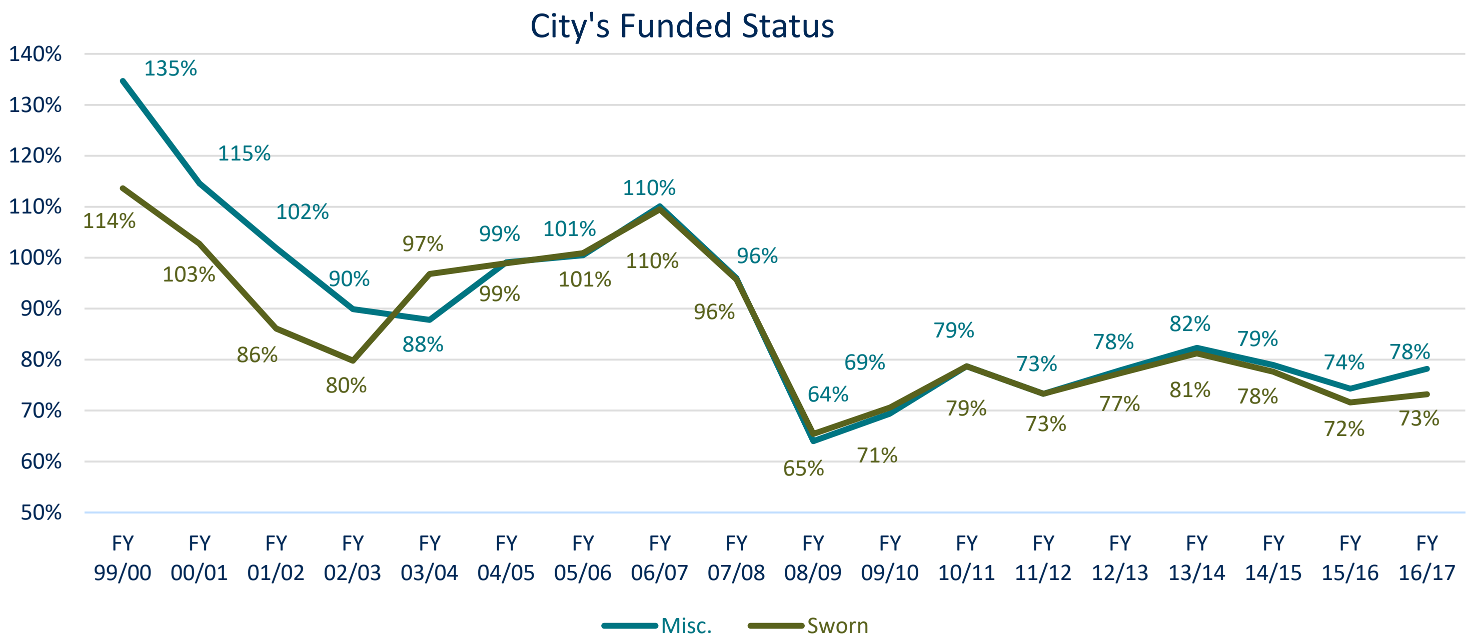
MISCELLANEOUS EMPLOYEES

78.2%

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

SAFETY EMPLOYEES

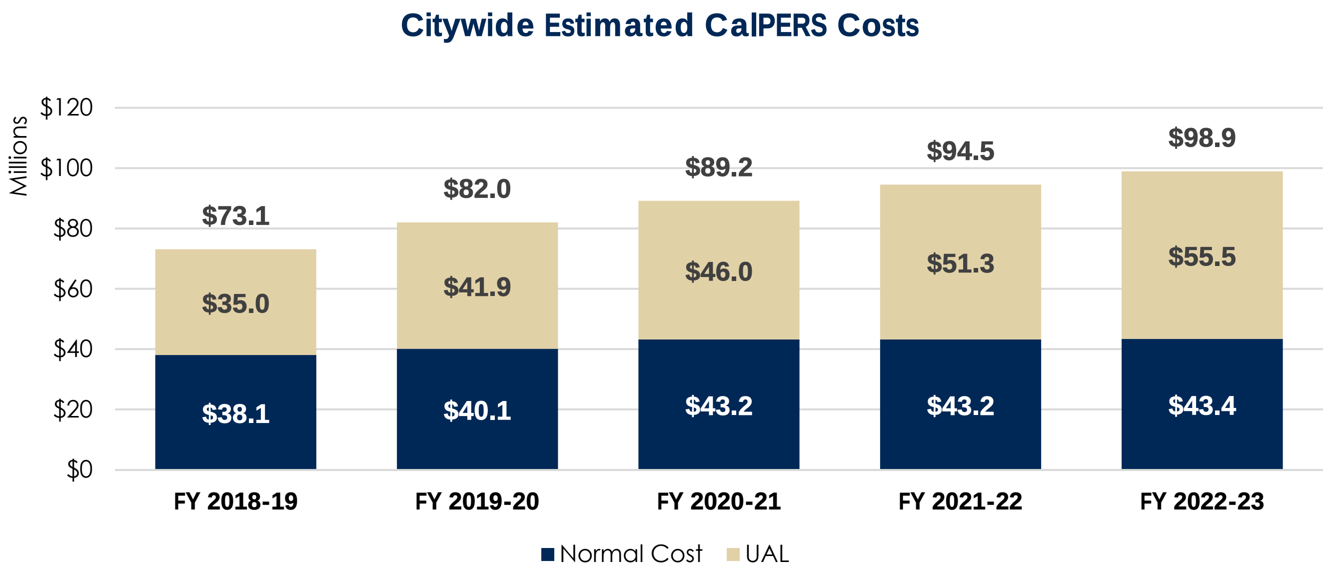
73.2%



WHAT ARE THE PROJECTED CalPERS COST INCREASES?

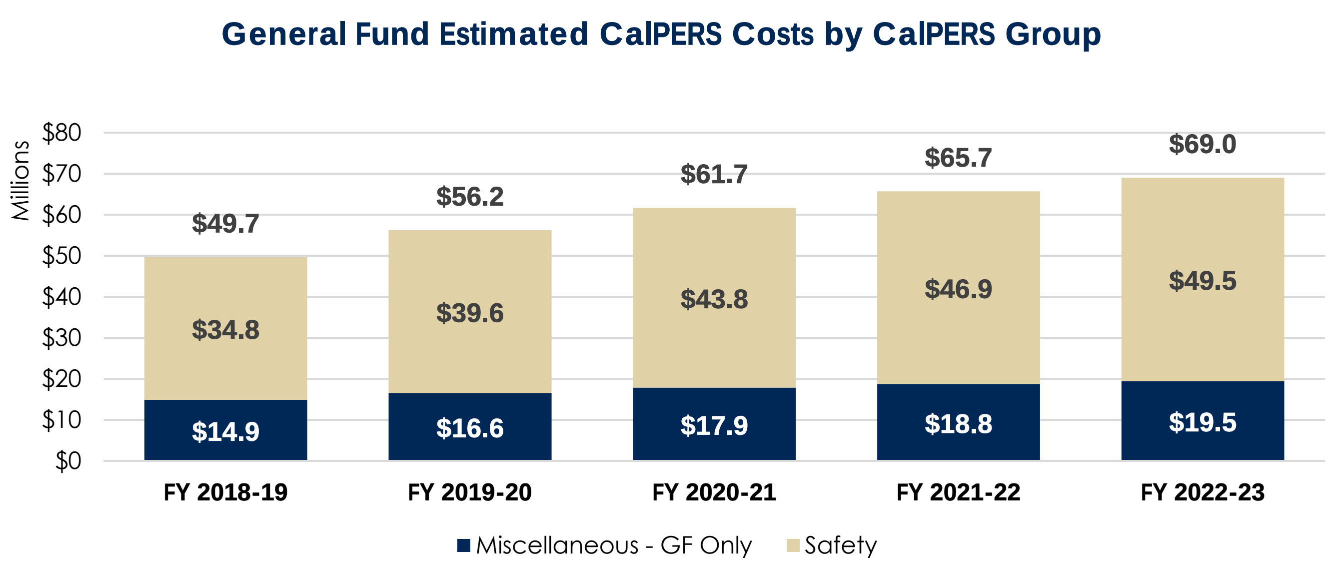
CITYWIDE CalPERS COST OVERVIEW

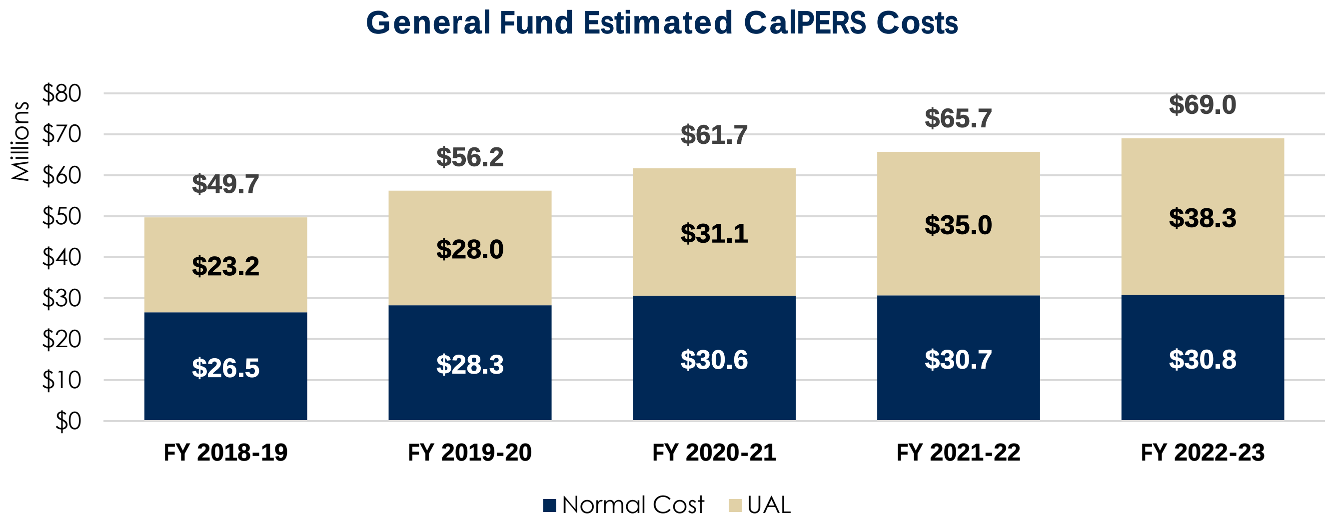
Over the next five years (FY 2018-19 to FY 2022-23), the City anticipates its annual retirement expenditures to increase by 35.35% from approximately $73.1 million to $98.9 million. The UAL projections are based on the City's most recent CalPERS actuarial reports dated July 2018 which report data as of June 30, 2017; the normal cost projections are sourced from the adopted FY 2018-2020 Biennial Budget and FY 2018-2023 Five-Year Plans. The information below provides a five-year look at the City's overall pension costs and pension costs in the General Fund, including Measure Z.



GENERAL FUND CalPERS COST OVERVIEW

General Fund CalPERS costs are expected to increase more than $19.3 million or 38.9%.





WHY ARE CALPERS COSTS INCREASING?

The City's retirement plans went from having an excess of cash (i.e. super-funded, or funded above 100%) to being under-funded. This is mainly due to investment losses by CalPERS during the Great Recession, which impacted all California agencies' retirement plans managed by CalPERS. Currently, the City's CalPERS plans are funded at 78.2% (Miscellaneous) and 73.2% (Safety). Additional factors have also contributed to increasing costs:

- Retroactive retirement benefit enhancements for City employees between 2001 and 2006;
- Long-term investment returns not meeting expectations (e.g. 8.1% over the last five years, 5.6% over the last 10 years, and 6.1% over the last 20 years);
- The resulting changes in the CalPERS anticipated return-on-investment rate over the past 15 years, from 8.25% to 7.00%; and
- CalPERS retirees living longer.

As a result of the above factors, which contributed to the decline in overall retirement plan funding levels, California public entities such as the City of Riverside must increase their future payments into the CalPERS system. The payment levels are determined by CalPERS, and they are increasing exponentially.

WHAT HAS THE CITY DONE TO ADDRESS PENSION COST INCREASES?

THE CITY HAS TAKEN SEVERAL STEPS OVER THE YEARS TO REDUCE PENSION COSTS

- **2003-2004** – The City issued Pension Obligation Bonds to extinguish the Unfunded Accrued Liability at that time, and to reduce future annual payments.
- **2011-2012** – Required all new CalPERS employees (Tier 2) to pay the employee portion of CalPERS pension costs.
- **2013** – Established lower pension benefits for new (PEPRA/Tier 3) employees, resulting in lower pension costs.
- **2016** – Existing employees not currently paying the employee share of CalPERS retirement costs began doing so. Currently, the savings impact of this action are mitigated by the California Rule.
- **2017** – Refinanced $30 million Bond Anticipation Note using Measure Z Funds. Allowed a fixed interest rate for the pension related debt and an accelerated payoff of the principal balance.
- **2018-2020** – Pre-pay the UAL at the beginning of the Fiscal Year to save 3.5% ($1.2 million/year).
- **Every Year –** Implement operational efficiencies, where possible, to minimize costs and impact to service levels as CalPERS costs increase.

INVESTMENT & CalPERS TERMINOLOGY

Actuarial Report – An actuarial valuation is a type of appraisal which requires making economic and demographic assumptions in order to estimate future liabilities. The assumptions are typically based on a mix of statistical studies and experienced judgment.

Bond Anticipation Note (BAN) – A short-term obligation that is issued for temporary financing needs. The principal payoff may be covered by a future longer-term bond issue. These notes normally have maturities of one year or less and interest is payable at maturity rather than semi-annually.

California Rule – The California Rule is the result of a 1955 court case (Allen v. City of Long Beach) that concludes that an employee's pension benefit as of the date of hire constitutes a contractual obligation. The California Supreme Court ruled that "Changes in a pension plan which result in a disadvantage to employees should be accompanied by comparable new advantages". The 1955 ruling is currently being contested.

Defined Benefit Plan (DBP) – A type of pension plan in which an employer/sponsor promises a specified monthly benefit upon retirement that is predetermined by a formula based on the employee's earnings history, tenure of service and age.

Defined Contribution Plan (DCP) – A type of retirement plan in which a certain amount or percentage of money is set aside each year by a company (or employee) for the benefit of each of its employees. Benefits directly depend upon individual investment returns.

Discount Rate – Also known as the expected rate of return or the assumed rate of return. It is the estimated long-term average return expected to be earned on investments.

Employee Contribution – The portion of normal cost required to be paid by the employee, subject to the local agencies negotiated memorandums of understanding with applicable employee groups.

Employer Contribution – The portion of normal cost required to be paid by the employer, determined by periodic actuarial valuations under state law and based on the agency's benefit formulas and employee groups covered.

Funded Ratio - Percentage of assets available today to pay all of the pension benefits promised to employees.

Normal Costs – The annual cost of service accrual for the upcoming fiscal year for active employees. The normal cost should be view as the long-term contribution rate for existing employees.

Pension Obligation Bond (POB) – Taxable bond that some state and local governments have issued as part of an overall strategy to fund the unfunded portion of their pension liabilities by creating debt.

PEPRA - Public Employees' Pension Reform Act of 2013 – A pension reform bill that went into effect January 1, 2013. The bill impacts new public employees and establishes a limit on the amount of compensation that can be used to calculate a retirement benefit.

Superfunded – A term used to describe periods in which total available CalPERS assets exceed the total CalPERS liability.

Unfunded Accrued Liability (UAL) – Portion of the plan's unfunded liability that is not funded by the plan's asset value.