ATTACHMENT 1

# CITY OF RIVERSIDE, CALFORNIA

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

AS OF JULY 31, 2017

## CALPERS 101: HOW DOES IT WORK?

### DEFINED BENEFIT PLAN (DBP) PENSION FORMULAS

The City's relationship with CalPERS to provide a defined benefit pension plan (DBP) to its employees dates back to 1945 when approved by Riverside voters by Special Election on June 5 of that year. 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. A defined contribution plan (DCP), such as a 401K, is a dollar contribution to a retirement fund.

The City has several employee groups with different pension formulas. The formula represents the percent of salary for each year employed with the City that a plan member will receive at the specified age. For example, a plan member that receives 2.7% @ 55 with a $65,000 3-year highest salary average and 20 years of service will be:

- Eligible to retire at 55-years of age
- 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


**Non-PEPRA**

| 3% @ 50 | 2.7% @ 55 | 3% @ 55 |
|---|---|---|
| Safety (Fire/Police) | Miscellaneous (All Non-Sworn) | Safety (Fire) |

**PEPRA**

| 2% @ 62 | 2.7% @ 57 |
|---|---|
| Miscellaneous (All Non-Sworn) | Safety (Fire/Police) |

### ASSET LIABILITY MANAGEMENT AND ACTUARIAL ASSUMPTION REVIEWS: ADDITIONAL DISCOUNT RATE REDUCTIONS?

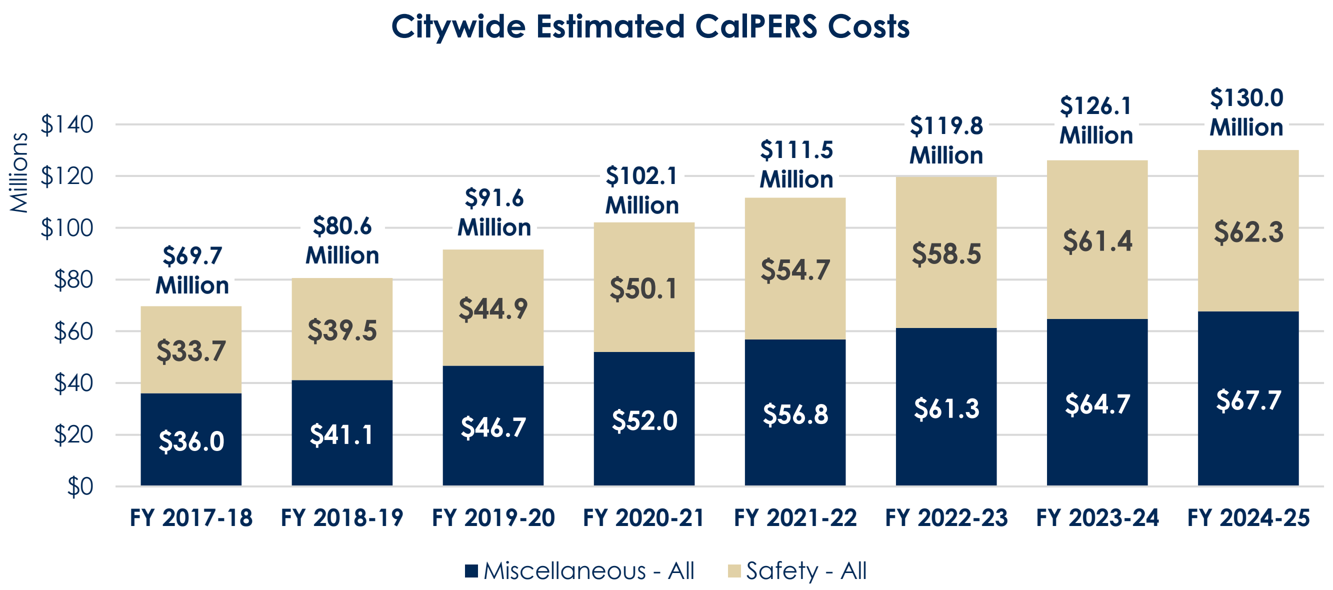
Every four years, CalPERS completes an Asset Liability Management Review. This process includes a review of the current asset allocations and the role of each asset class within the portfolio. Risk tolerances for each asset class are reviewed and capital market assumptions that will reflect financial market expectations are developed. **The next Asset Liability Management Review is currently in progress and is expected to be complete in February 2018.**

An Actuarial Assumption Review is also completed every four years. This review updates all actuarial assumptions (economic and demographic) as appropriate. Economic assumptions include the discount rate as well as wage and price inflation projection. The last review concluded in 2016 which resulted in the current discount rate reductions. **The next Actuarial Assumption Review is expected to be completed in 2020.**

**(SEE THE LAST PAGE FOR INVESTMENT AND CALPERS TERMONOLOGY DEFINITIONS)**

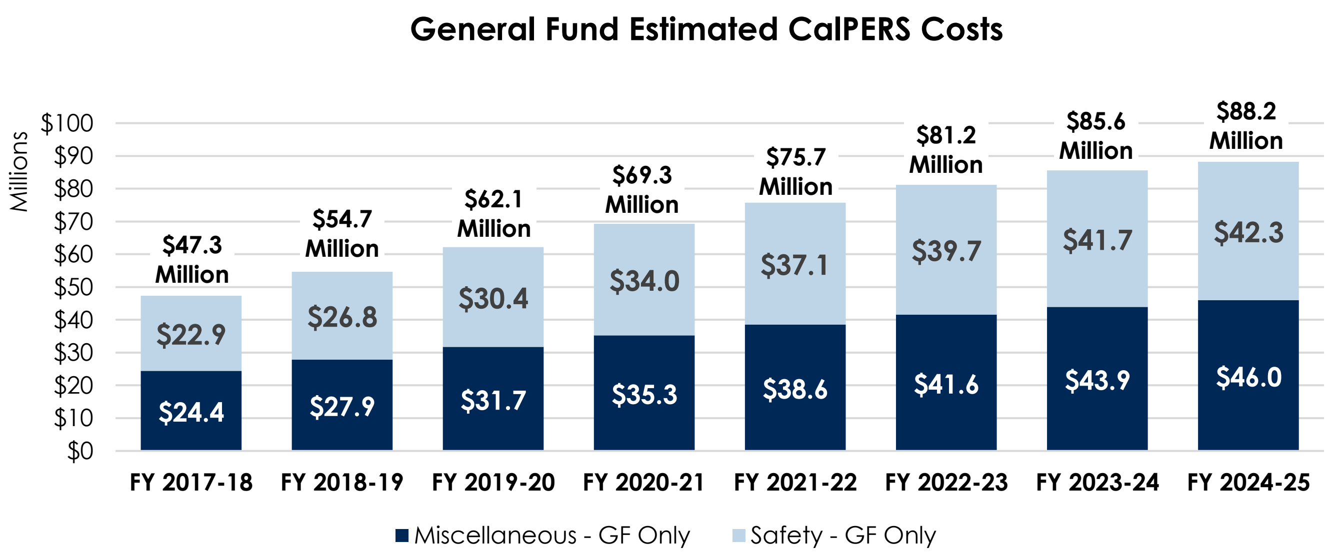
## CITYWIDE CalPERS COST OVERVIEW

Below are the citywide CalPERS costs, including the CalPERS estimates for the current year as well as the next seven fiscal years. Over the next seven years, annual pension costs are expected to increase more than $60.3 million or 86%.




## GENERAL FUND CalPERS COST OVERVIEW

General Fund CalPERS costs are expected to increase more than $40.0 million or 86%. For FY 2018-19, cost will be $7.4 million more than the current fiscal year.




### CITY CALPERS FUNDED RATIOS

**MISCELLANEOUS EMPLOYEES**

**74.3%**

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

**SAFETY EMPLOYEES**

**71.6%**

# CALPERS BILLING METHODOLOGY: RECENT CHANGES

CalPERS made a change to the methodology for calculating the annual contribution amount for local agencies to address underfunding issues caused by the reduction of annual payroll costs or reduction of active members in the plan. The UAL annual contribution portion of the payment will be based on a payment amount instead of a percentage of payroll. The examples below show the impact of the changes if payroll was $1 million. The examples do not represent the City's CalPERS contribution.

## PREVIOUS METHODOLOGY

| Normal Costs as % of Payroll | + | UAL Costs as % of Payroll | = | Blended Contribution % | x | Payroll | = | Contribution due to CalPERS |
|---|---|---|---|---|---|---|---|---|
| 15% | + | 10% | = | 25% | X | $1 million | = | $250,000 |

## NEW METHODOLOGY

| Normal Costs as % of Payroll | x | Payroll | = | Normal Cost Contribution Total | + | UAL Contribution Total | = | Contribution due to CalPERS |
|---|---|---|---|---|---|---|---|---|
| 15% | X | $1 million | = | $150,000 | + | $110,000 | = | $260,000 |

## SHORT AND LONG-TERM VIEW OF RETURN ON INVESTMENTS

CalPERS had its best investment return when compared to the previous two years (FY 2014-15 was 2.4% and FY 2015-16 was 0.61%). Although this is movement in the right direction, the investment return did not eliminate unfunded pension liabilities (32% of total liability – CalPERS pension plans are funded at 68%). CalPERS' investment strategy focuses on long-term performance instead of the more volatile short-term performance. Therefore, the current strategy to increase the employer contribution to the plan remains unchanged.

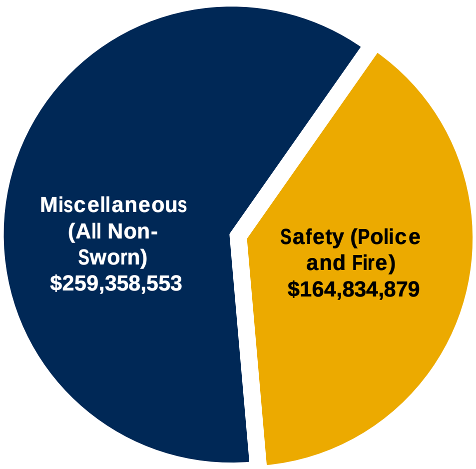
| 11.2% | 8.8% | 4.4% | 6.6% |
|---|---|---|---|
| FY 2016-17 Net Return on Investments | 5-Year Net Return on Investments | 10-Year Net Return on Investments | 20-Year Net Return on Investments |

# 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 Actuarial 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 maximum of 30 years. This results in higher pension costs for the City due to interest applied to the outstanding amounts each year.

**August 2016 for FY 2017-18**

Based on Actuarial Report as of June 30, 2015



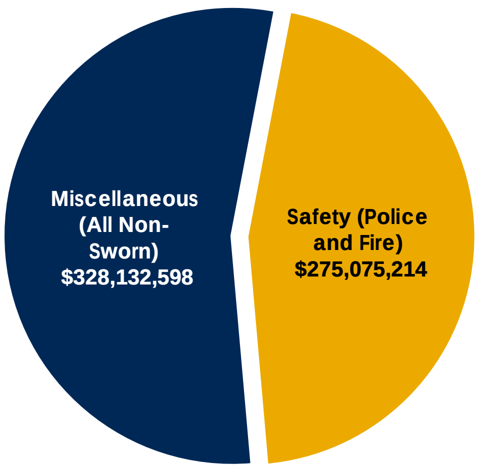

**Total UAL**
**$424.2 Million**

**Increased**
**$179.0 Million (42%)**

Primarily due to change in discount rate

**July 2017 for FY 2018-19**

Based on Actuarial Report as of June 30, 2016

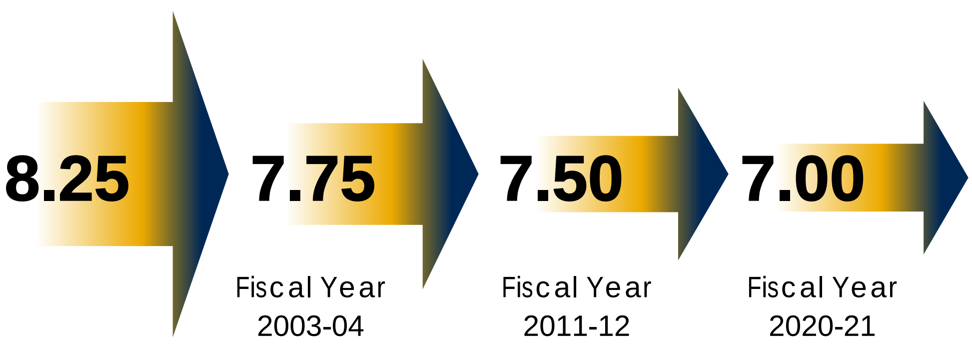



**Total UAL**
**$603.2 Million**

## WHY DO LOWER CALPERS DISCOUNT RATES INCREASE CITY PENSION COSTS?

A discount rates, also known as expected or assumed rate of return, is the estimated long-term average return expected to be earned on investments. The more gains made from a CalPERS plan investment, the less the City will need to contribute.

CalPERS has recently (April 2017) reduced the discount rate to be more consistent with long-term market expectations. As a result, the City will need to contribute more each year.




**History of CalPERS Discount Rate Changes**

**Additional Discount Rate Changes in FY 2018-19 (7.35%) and FY 2019-20 (7.25%)**

## WHAT HAS THE CITY DONE TO ADDRESS PENSION COST INCREASES?

**The City has taken several steps over the last 13 years to reduce pension related costs:**

- **Every Year –** Implement operational efficiencies to allow a smaller workforce with minimal impact to service levels provided to the community.
- **2004 & 2005** – Issued POBs for UAL totaling $149.5 million. $30 million was issued as a Series B Interest Only bond.
- **2007** – Refinanced $30 million interest only POB with an interest only Bond Anticipation Notes (BAN).
- **2015** – Required all new employees to pay the employee portion of the CalPERS pension costs.
- **2013** – Complied with the Public Employee Reform Pension Act and established separate employee benefit tiers for new employees subject to the legislation. The new tiers utilized new formulas that resulted in lower pension costs.
- **2017** – Refinanced $30 million BAN using Measure Z Funds. Allowed a fixed interest rate for the pension related debt and an accelerated payoff of the principal balance.

## INVESTMENT & CALPERS TERMONOLOGY YOU SHOULD KNOW

**Actuarial Report** - 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 Notes (BANs)** – 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.

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

**Defined Contribution Plan (DCP)** – 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 on 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.

**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 Bonds (PBOs)** – taxable bonds 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.

**Unfunded Actuarial Liability (UAL)** – portion of the plan's unfunded liability that is not funded by the plan's asset value

# CITY LEADERSHIP


**Rusty Bailey**
**Mayor**


**Mike Gardner**
**Ward 1**


**Andy Melendrez**
**Ward 2**


**Mike Soubirous**
**Ward 3**


**Chuck Conder**
**Ward 4**


**Chris Mac Arthur**
**Ward 5**


**Jim Perry**
**Ward 6**

**Vacant**
**Ward 7**


**Gary Geuss**
**City Attorney**


**John Russo**
**City Manager**


**Collen Nicol**
**City Clerk**

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