City of Riverside
City of Arts & Innovation

City Council Memorandum

TO:	**HONORABLE MAYOR AND CITY COUNCIL**	**DATE: AUGUST 6, 2019**
FROM:	**FINANCE DEPARTMENT**	**WARDS: ALL**
SUBJECT:	**PENSION FUNDING POLICY**	

ISSUE:

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

RECOMMENDATION:

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

COMMITTEE RECOMMENDATION:

On June 12, 2019, the Finance Committee, with Chair Adams, Vice Chair Conder and Member Soubirous present, reviewed the proposed Pension Funding Policy. After discussion, the Finance Committee unanimously voted to receive and file the report and forward the recommendations to the City Council.

On July 11, 2019, the Budget Engagement Commission, with 10 members present, reviewed the proposed Pension Funding Policy. After discussion, the Budget Engagement Commission unanimously voted to receive and file the report and forward the recommendations to the City Council.

BACKGROUND:

The California Public Employees' Retirement System (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 2024/25 and continue to grow through FY 2030/31.

Various strategies to reduce pension costs, lower Riverside's unfunded liability, and prevent service reductions continue to be explored. 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 (1) of two (2) 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, and an amount to pay for the unfunded liabilities of the plans. According to our most recent CalPERS actuarial valuation, the City's total unfunded actuarial liability is $563 million as of June 30, 2017.

Furthermore, the City has pension obligation bonds outstanding totaling approximately $93 million with annual debt service payments averaging approximately $16.7 million. The City's 2005A POBs mature in FY2019/2020 with annual debt service payments of $2.9 million, the 2004A POBs mature in FY2022/23 with annual debt service payments of $10.1 million and the 2107A POB matures in FY2026/27 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, and to a large extent are outside staff's direct control. 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 all the actions the City has already taken to address pension costs, staff, in coordination with the City's CalPERS actuary, have examined a variety of financial strategies that help to lower costs. These strategies could help the City potentially 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:

- <u>Unanticipated one-time revenues or settlements</u> shall be prioritized at a rate of 50% of the revenue alongside other critical needs to make a one-time payment to CalPERS to pay-off a portion of the City's UAL to save on interest payments, reduce annual payments, and lower annual operating expenses. Payments would be incorporated into the City's annual budget for City Council consideration and will only be utilized if the general fund is not projected to end the year at a deficit.

- <u>Establishing a Section 115 Pension Trust</u> 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.

- 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 (2) payment options. The invoice can be paid in 1/12 increments 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 a million dollars annually. As such, every effort should be made to pre-pay the UAL upon receipt of the annual invoice.

- 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.

- 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 there is no general fund deficit at the time of debt maturity.

All of these strategies have advantages and disadvantages. However, 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 a comprehensive Pension Funding Policy that incorporates several of the strategies listed above, some of which the City has already implemented or is in process of implementing. If adopted, the attached policy would be incorporated into the City's larger financial policy as part of the annual budget.

FISCAL IMPACT:

There is no direct fiscal impact associated with the recommendations in this report.

Prepared by: Edward Enriquez, Chief Financial Officer / City Treasurer
Certified as to
availability of funds: Marie Ricci, Assistant Chief Financial Officer
Approved by: Carlie Myers, Deputy City Manager
Approved as to form: Gary G. Geuss, City Attorney

Concurs with:

Steve Adams, Chair
Finance Committee

Attachment:
1. Pension Funding Policy
2. Finance Guide
3. Presentation