CITY OF RIVERSIDE, CALFORNIA

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

AS OF JANUARY 1, 2018

CalPERS 101: HOW DOES IT WORK?

DEFINED BENEFIT PLAN PENSION FORMULAS

The City's relationship with CalPERS to provide a defined benefit pension plan (DBP) to its employees dates back to 1945 when the initial plan was approved by Riverside voters by Special Election on June 5.

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 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 DPB formulas (see below). 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, 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

BEFORE JANUARY 2013

3% @ 50	2.7% @ 55	3% @ 55
Safety (Fire Tier 1, Police Tier 1, 2)	Miscellaneous (All Non-Sworn Tier 1 & 2)	Safety (Fire Tier 2)

AFTER JANUARY 2013 (PEPRA)

2% @ 62	2.7% @ 57
Miscellaneous (All Non-Sworn Tier 3)	Safety (Fire & Police Tier 3)

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

HOW ARE CalPERS COSTS PAID?

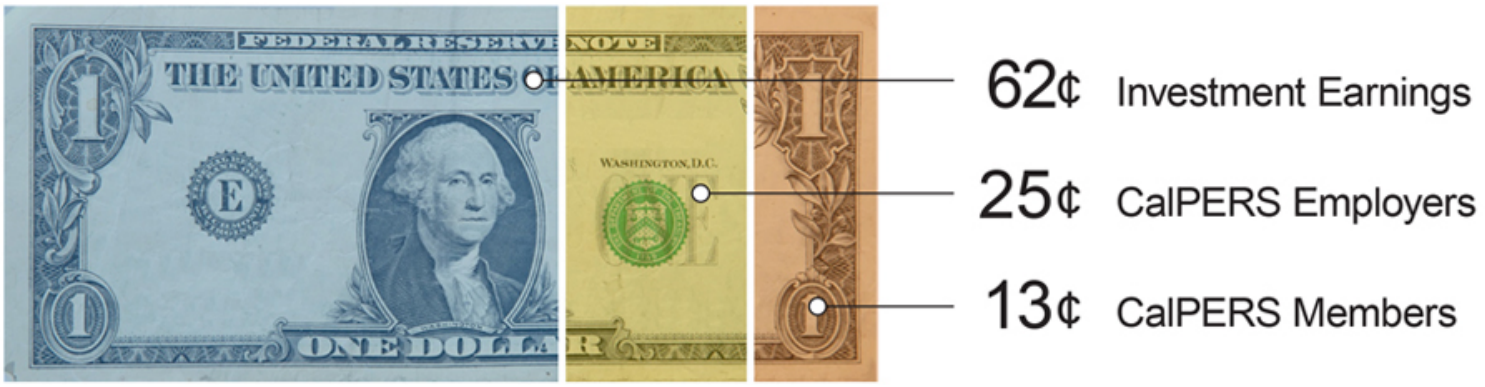
HOW ARE CALPERS COSTS SHARED BETWEEN EMPLOYEES AND EMPLOYER?

CalPERS establishes an employer rate, which the City must pay for each participating employee, and an employee rate, which either the City or the employee could pay.

A new employer rate is an actuarial calculation provided to the City by CalPERS each year. The total amount is comprised to two factors. The first is an estimated percentage of salary based on the employee pool (age, salary, investment returns, etc.). The second, if applicable, is a lump sum payment due to pay down an unfunded accrued liability (UAL).

Depending on the pension formula, CalPERS statutorily sets the employee rate at 7-9%. Until recently, the City paid the employee rate for most City employees. This practice discontinued in 2011-2012 for new employees. In 2016, the City also required all existing employees to gradually transition to paying their share of pension costs (which is generally 8-9%) over the next four to five years.

Every dollar paid to CalPERS retirees comes from three sources:



SHORT AND LONG-TERM VIEW OF RETURN ON INVESTMENTS

In FY 2016-17, 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 71-74%). 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%
FY 2016-17 Net Return on Investments

8.8%
5-Year Net Return on Investments

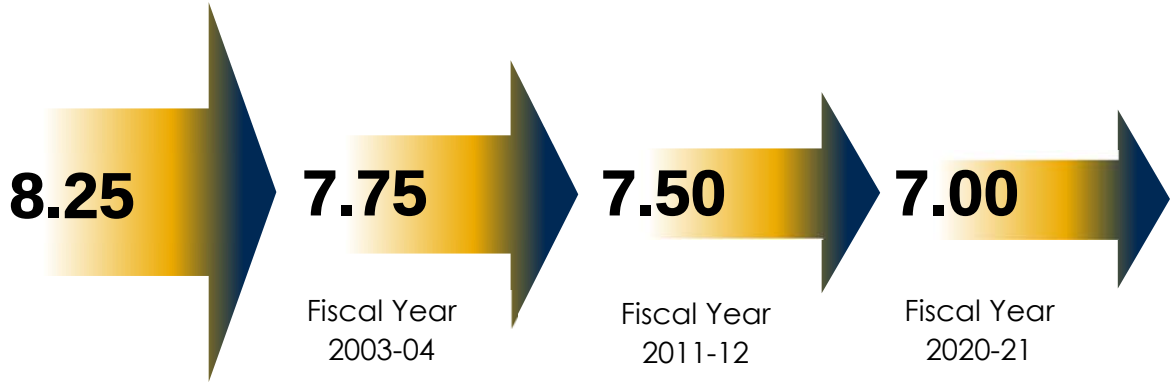
4.4%
10-Year Net Return on Investments

6.6%
20-Year Net Return on Investments

WHY DO 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. The more gains made from a CalPERS plan investment, the less the City will need to contribute.

CalPERS has recently (December 2016) 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%)

MISCELLANEOUS EMPLOYEES

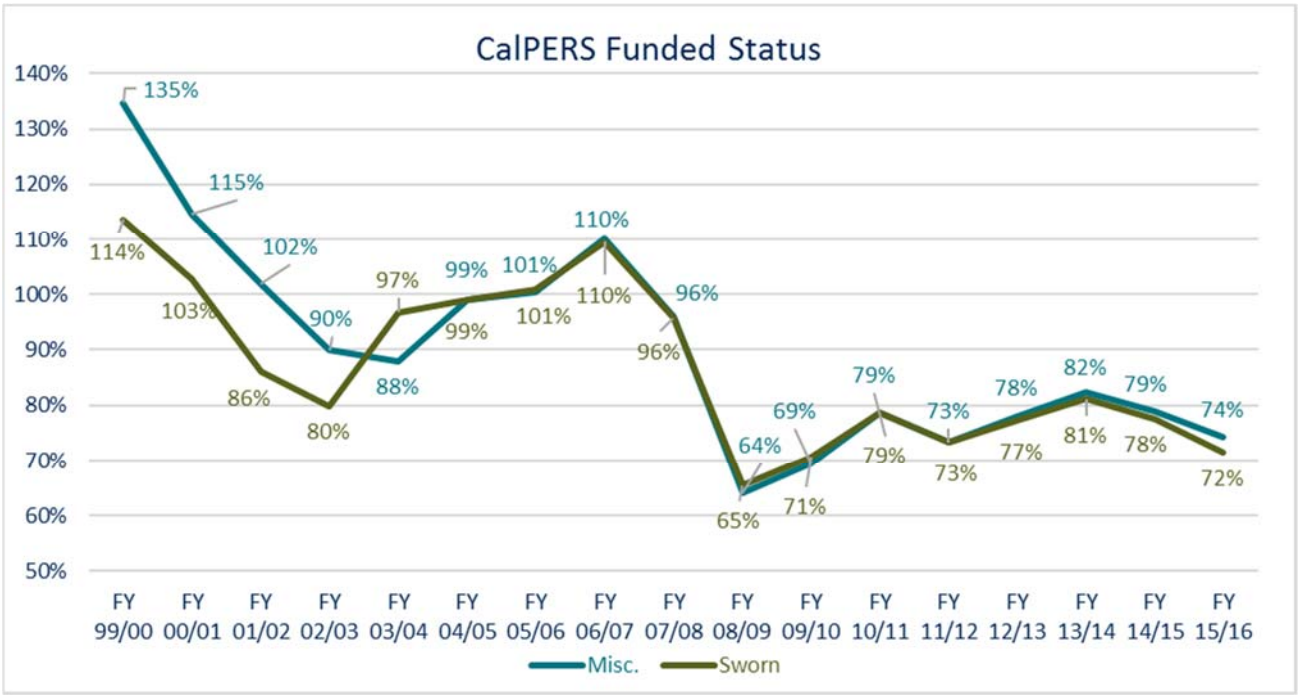
74.3%

CITY CalPERS FUNDED RATIOS

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

SAFETY EMPLOYEES

71.6%

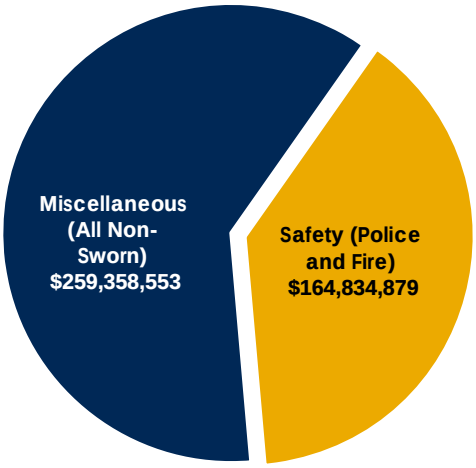


CITYWIDE UNFUNDED PENSION LIABILITY

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. 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



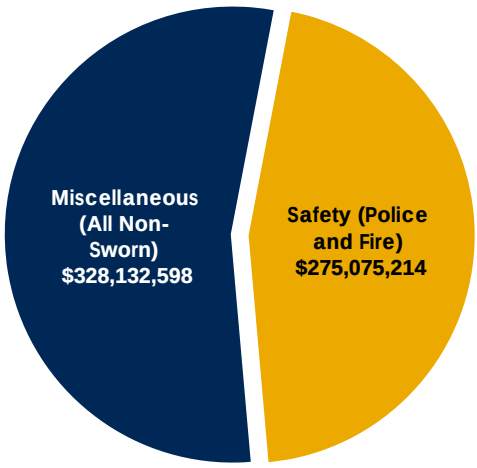
Total UAL
$424.2 Million

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



$603.2 Million

WHY ARE CalPERS COSTS INCREASING?

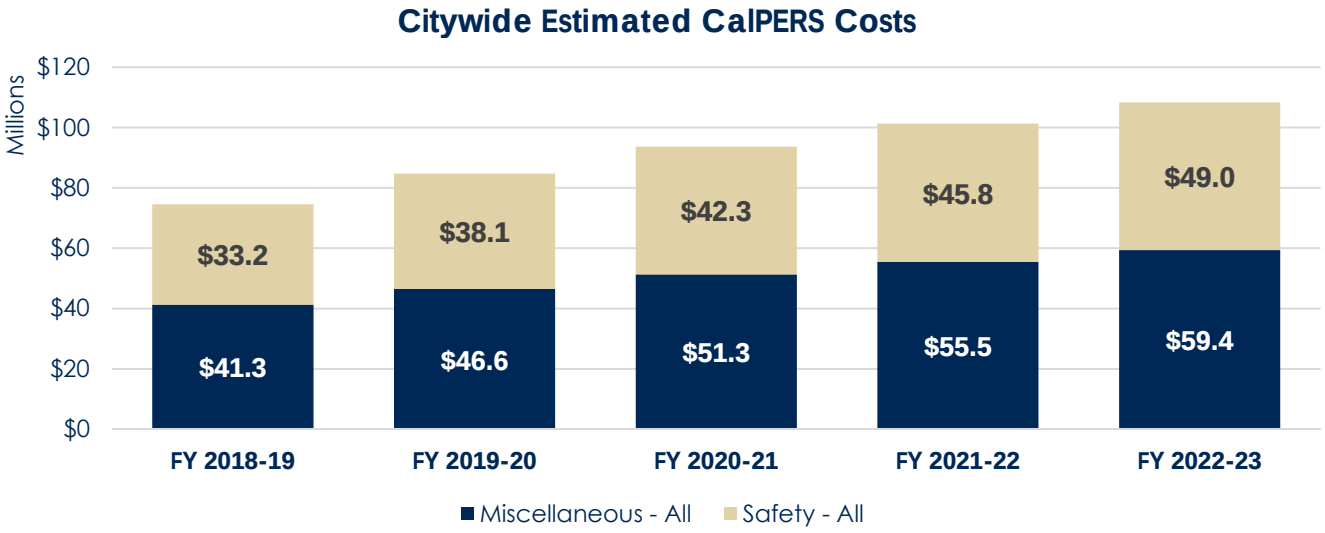
The City's retirement plans went from having an excess of cash (i.e. super-funded, or funded above 100%) to being under-funded. Currently, the City's CalPERS plans are funded at 74% (non-sworn) and 72% (sworn). This is mainly due to investment losses by CalPERS during the Great Recession, which impacted all of the California agencies' retirement plans managed by CalPERS. 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. 8.8% over last five years, 4.4% over last 10 years, and 6.6% over last 20 years);
- The resulting changes in the CalPERS anticipated return-on-investment rate over the past 15 years, from 8.25% to 7%; 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 payments into the CalPERS system in future years. The payment levels are determined by CalPERS, and they are increasing exponentially.

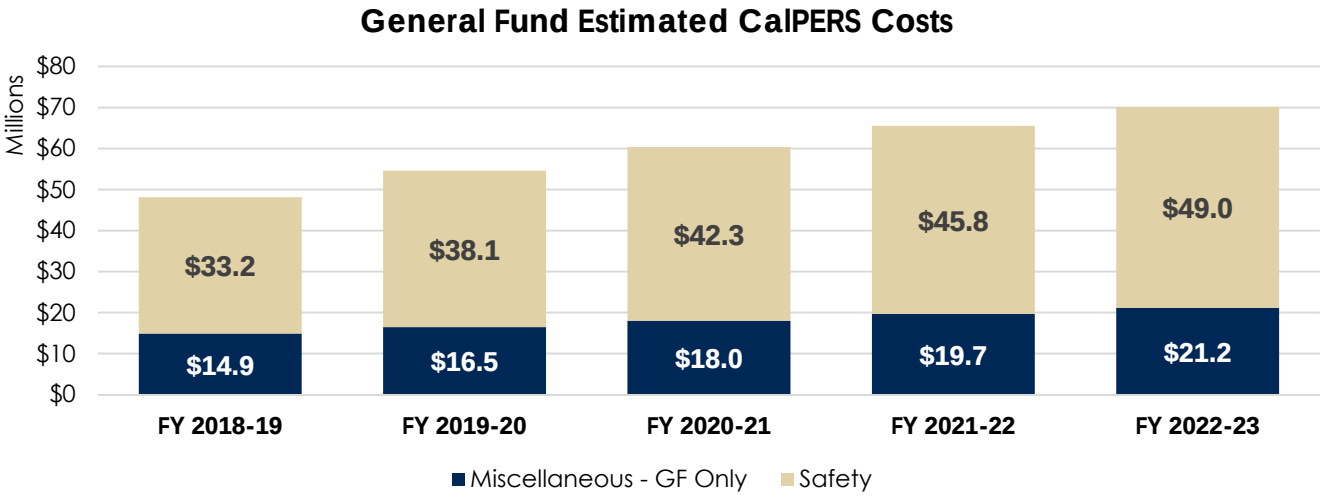
CITYWIDE CalPERS COST OVERVIEW

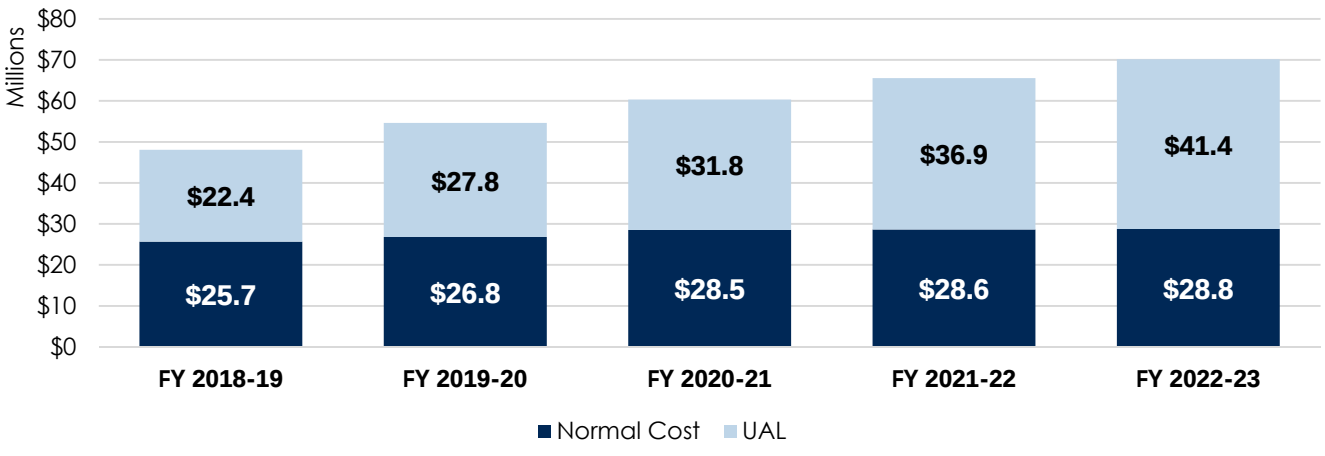
Over the next five years (FY 2018-19 to FY 2022-23), the City anticipates its annual retirement expenditures to increase by 45.5% from approximately $74.5 million to $108.4 million. These projections are based on the City's most recent CalPERS actuarial reports dated July 2017. The Information below provides a five-year look at the City's overall pension costs and pension costs in the City's major funds (General, Electric, Water, and Sewer).



GENERAL FUND CalPERS COST OVERVIEW

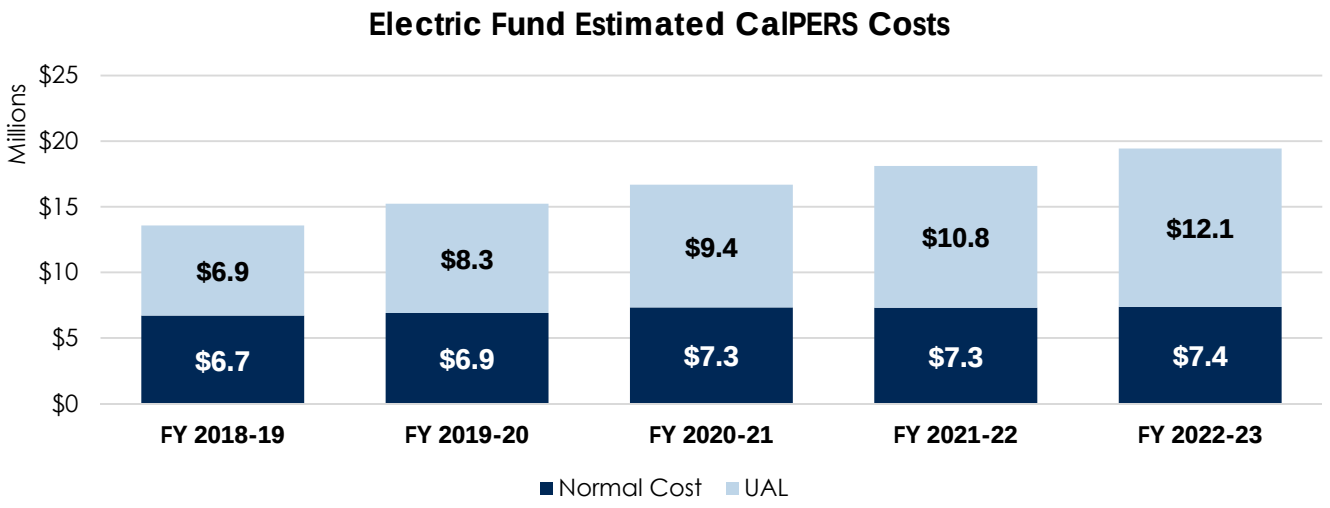
General Fund CalPERS costs are expected to increase more than $22 million or 46%.





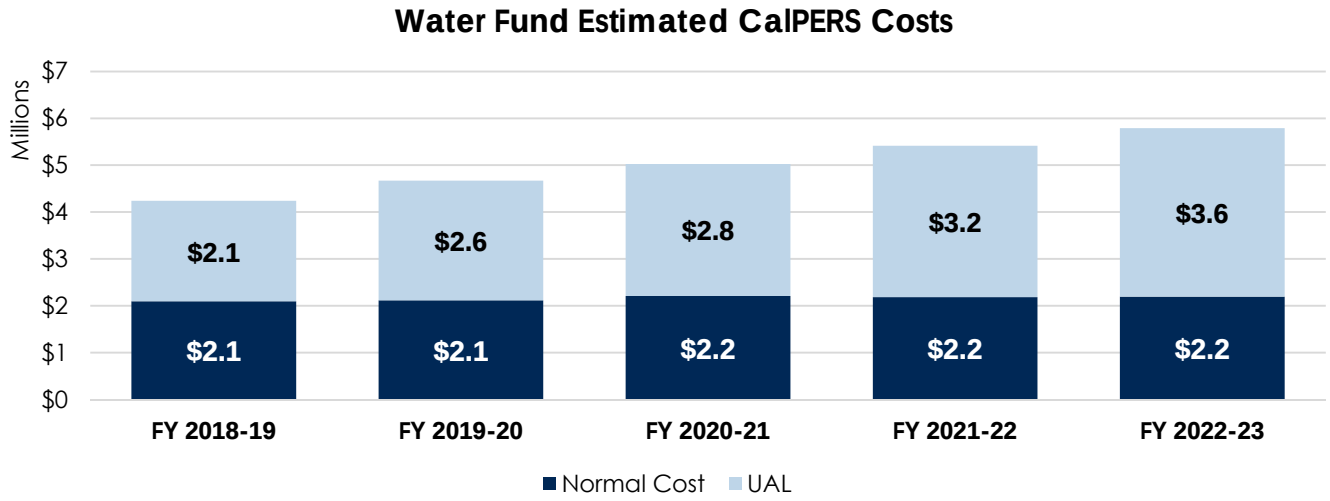
ELECTRIC FUND CalPERS COST OVERVIEW

Electric Fund CalPERS costs are expected to increase more than $5.9 million or 43%.



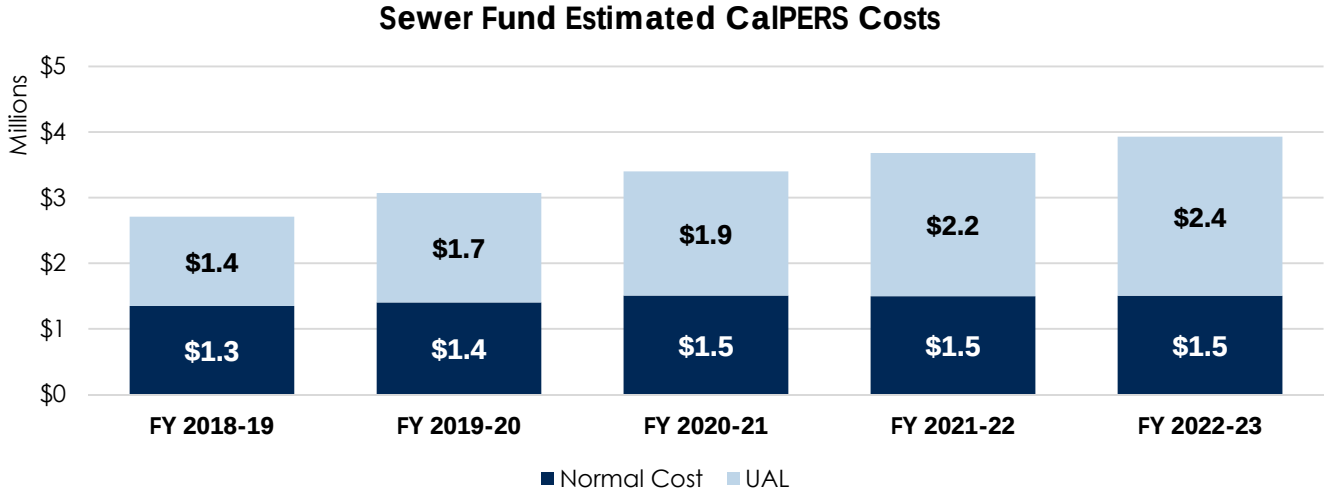
WATER FUND CalPERS COST OVERVIEW

Water Fund CalPERS costs are expected to increase more than $1.6 million or 37%.



SEWER FUND CalPERS COST OVERVIEW

Sewer Fund CalPERS costs are expected to increase more than $1.2 million or 45%.



WHAT HAS THE CITY DONE TO ADDRESS PENSION COST INCREASES?

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

- **Every Year –** Implement operational efficiencies, where possible, to minimize impact to service levels provided to the community as CalPERS costs increase.
- **2011-2012** – 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.
- **2016** – MOUs with employee groups required employees not currently paying for CalPERS retirement costs, to begin doing so over a four to five year period.
- **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 TERMINOLOGY YOU SHOULD KNOW

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

CITY LEADERSHIP