# RIVERSIDE PUBLIC UTILITIES

## Board Memorandum

**BOARD OF PUBLIC UTILITIES** **DATE**: FEBRUARY 26, 2018

**ITEM NO**: 8

**SUBJECT**: **CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CALPERS) PENSION COSTS UPDATE**

**ISSUE**:

Receive an update on the City's pension costs, past and future, as part of the California Public Employees' Retirement System (CalPERS).

**RECOMMENDATION**:

That the Board of Public Utilities receive an update on the City's past and future CalPERS retirement costs.

**BACKGROUND**:

During the April 12, 2017 City Council Finance Committee meeting, City staff presented information about the financial impact of the CalPERS changes to its assumed rate of investment return (i.e. "discount rate").

During the August 31, 2017 Budget Engagement Commission (BEC) meeting, staff presented information on future CalPERS cost increases applicable to the City.

During the December 11, 2017 Board of Public Utilities meeting, staff presented the FY 2016-17 financial audit. During that meeting questions were raised about the City's CalPERS costs and their impact on the financial statements.

**DISCUSSION**:

*Overview of CalPERS Retirement Costs*

The City's Finance Department has prepared a brochure that provides information on CalPERS plan benefits, past and future costs, and actions taken by the City to reduce and control retirement expenses. The brochure is attached, and the following key discussion points are presented in the PowerPoint slides accompanying this report:

1. CalPERS Overview
2. The City's Defined Benefit Plans
3. Citywide Estimated CalPERS Cost
4. The City's Pension Liability

5. Why are CalPERS Costs Increasing
6. What has the City done to Mitigate rising CalPERS Costs

*How Pension Costs Are Reflected on the City's and RPU's Financial Statements*

In 2012, the Governmental Accounting Standards Board (GASB) issued a new accounting standard that required governmental employers that sponsor Defined Benefit plans to recognize a net pension liability (called "unfunded accrued liability") on their financial statements. The net pension liability is the difference between the City's total pension liability ("actuarial accrued liability") and the market value of pension plan assets. The RPU reported this liability for the first time in its June 30, 2015 Annual Financial Report. The current unfunded liability totals $130.7 million as of June 30, 2017.

Beginning with fiscal year 2014-15, accounting standards (GASB 68) required the City to change the way we calculate and report the costs and obligations associated with pensions. It was designed to improve the usefulness of reported pension information and to increase the transparency, consistency, and comparability of pension information across governments. **The reported liability is not new** – prior accounting standards required footnote disclosure of the pension obligation. What is new is a more comprehensive acknowledgement of this existing pension liability.

**Net Pension Liability**

When the total pension liability exceeds the pension plan's net position (market value of plan assets) available for paying benefits, there is a *net pension liability* (NPL). The City is required to report that amount as a liability in the financial statements, whereas in the past only a note disclosure in the financial report was required. The following is a schedule outlining the NPL since inception of the new reporting standards.

| Fund | FY2015 | FY2016 | FY2017 | Change since Inception |
|---|---|---|---|---|
| Government Wide | $275,584,336 | $299,137,469 | $384,396,178 | |
| **Electric Fund** | **71,772,982** | **77,907,143** | **96,192,929** | **34.02%** |
| **Water Fund** | **26,032,246** | **28,257,122** | **34,465,472** | **32.40%** |
| Sewer Fund | 16,888,516 | 18,331,913 | 21,980,087 | |
| Refuse Fund | 5,742,020 | 6,232,769 | 7,446,059 | |
| Special Transit Fund | 2,641,449 | 2,867,204 | 3,415,740 | |
| Parking Fund | 1,578,442 | 1,713,346 | 1,985,962 | |
| Airport Fund | 720,093 | 781,637 | 970,215 | |
| Total Net Pension Liability | $400,960,084 | $435,228,603 | $550,852,642 | 37.38% |

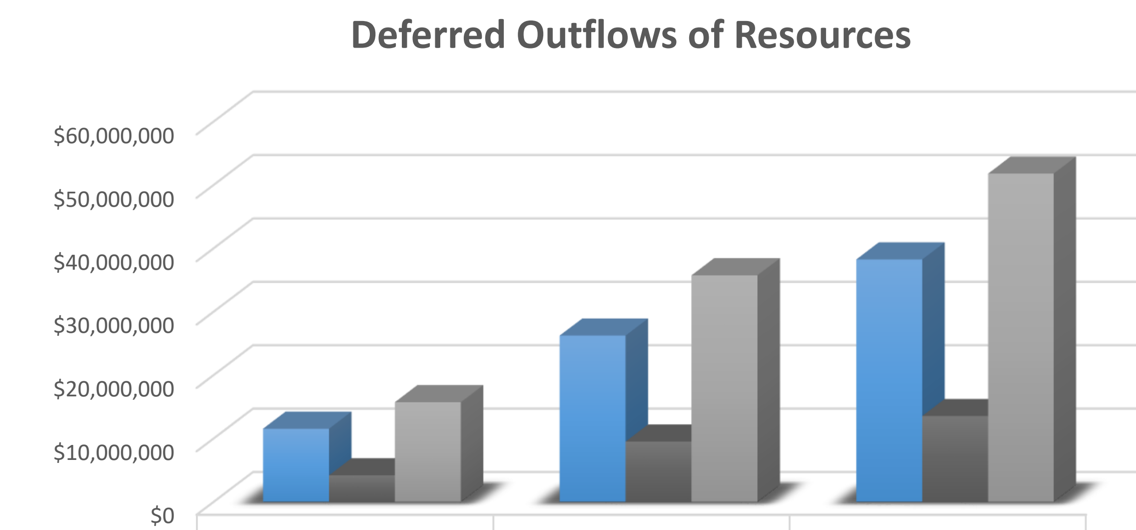
A government's net pension liability varies from year to year for a variety of reasons, including, but not limited to:

- Actual earnings on plan investments;
- Employee compensation changes;
- Interest on the outstanding pension liability;
- Contributions from employers and employees; and
- Actual economic or demographic changes not matching the assumptions made in the CalPERS actuarial calculations.

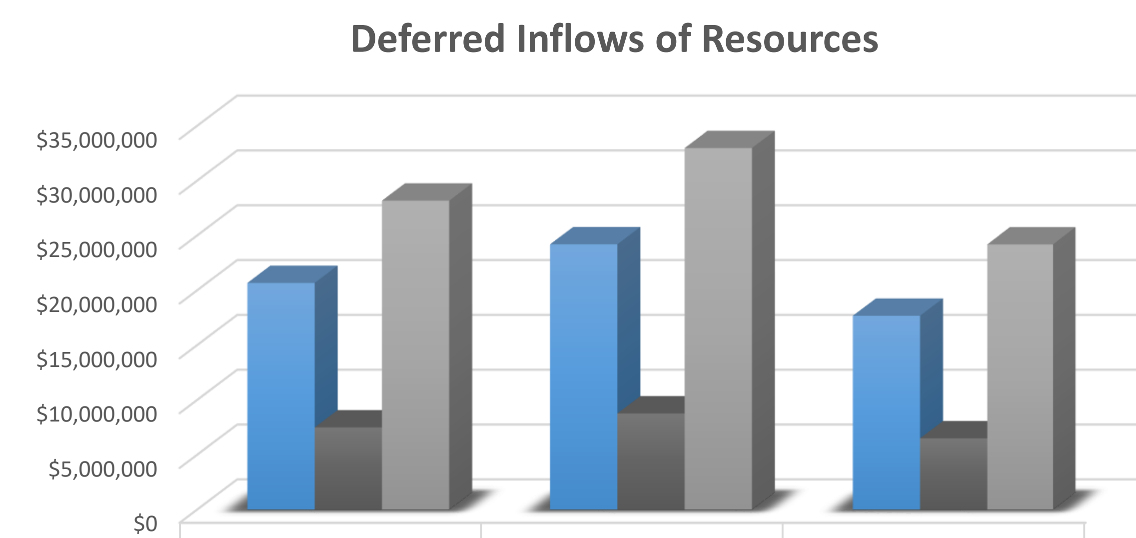
**Pension Expense Items Requiring Deferred Recognition**

Per generally accepted accounting principles, the activity noted above that cause changes in the NPL each year require specific accounting treatment in the financial statements. Depending on the type of change, the pension expense can require expenses to be charged to the income statement in the year incurred or can require recognition over a period of years (in other words deferred). Deferred costs are recorded on the financial statements (Balance Sheet) as either deferred inflows or outflows of resources, and are expensed over time similar to depreciation. The accounting for NPL and deferred costs has become very complex and staff maintains detailed worksheets to roll-forward NPL and Deferred Inflow and Outflow balances each year.

The following charts outline the Deferred Outflows and Inflows of Resources recorded on City Financial Reports for the Electric and Water Utility:




| | FY2015 | FY2016 | FY2017 |
|---|---|---|---|
| Electric Fund | $11,540,997 | $26,232,346 | $38,247,219 |
| Water Fund | $4,185,950 | $9,514,539 | $13,541,923 |
| Total Deferred Outflows | $15,726,947 | $35,746,885 | $51,789,142 |




| | FY2015 | FY2016 | FY2017 |
|---|---|---|---|
| Electric Fund | $20,682,521 | $24,204,058 | $17,685,202 |
| Water Fund | $7,501,304 | $8,778,692 | $6,511,375 |
| Total Deferred Inflows | $28,183,825 | $32,982,750 | $24,196,577 |

The growth in deferred outflows and the decrease in the deferred inflows since the implementation of the accounting standard changes is **primarily attributable to the volatile differences between projected and actual earnings on plan assets**.

For the FY 2014-15 reporting period, CalPERS return on investments was 18.4% compared to an actuarial assumption of 7.50%. This difference resulted in a significant gain that had to be recorded as a deferred inflow of resources and recognized over a five year period as required by accounting standards. The amortization of this deferred item has a positive effect on expense as it results in a credit to a pension expense. Conversely, in the two subsequent fiscal years, CalPERS returned 2.4% and 0.6% on investments compared to an actuarial assumption of 7.5%. This difference resulted in a loss that had to be recorded as a deferred outflow of resources and recognized over a five year period. The amortization of this deferred has a negative effect on expense as it results in additional pension expense. The year-to-year pension expense number is likely to be volatile, and should not be considered a proxy for funding or contribution levels.

**FISCAL IMPACT**:

There is no direct fiscal impact associated with presentation of this report. The City's five-year projections on CalPERS costs have been included in the City's FY 2018-2020 baseline budget projections and FY 2018-2023 Five-Year Plan assumptions. In addition, projections were included in the rate proposal currently underway.

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Attachments:

1. CalPERS 101: How It Works publication
2. Presentation