# Budget Engagement Commission

**TO:** HONORABLE COMMISSIONERS **DATE: DECEMBER 11, 2025**

**FROM:** FINANCE DEPARTMENT **WARDS: ALL**

**SUBJECT:** CALPERS UNFUNDED ACCRUED LIABILITY (UAL) AND RELATED COST MANAGEMENT STRATEGIES

## ISSUE:

Receive and file an update on the City's CalPERS Unfunded Accrued Liability (UAL) and related cost management strategies.

## RECOMMENDATION:

That the Budget Engagement Commission receive and file an update on the City's CalPERS Unfunded Accrued Liability (UAL) and related cost management strategies.

## BACKGROUND:

The City of Riverside provides retirement benefits to its employees through the California Public Employees' Retirement System (CalPERS), the statewide pension system that serves many public agencies in California. As a CalPERS contracting agency, the City participates in defined-benefit plans that guarantee employees a fixed benefit based on their years of service, final compensation, age at retirement, and the pension formula associated with their job classification. The City's participation dates to 1945, when Riverside voters approved the initial plan. Further, the City Charter (Article X – Retirement) requires CalPERS membership for City employees.

The City has two CalPERS pension plans:
- Safety Plan for sworn police and fire employees
- Miscellaneous Plan for all other eligible City employees

Within these plans, the City has several employee groups, each with its own CalPERS pension formula. A pension formula determines the benefit earned for each year worked and is expressed as a percentage of salary (for example, 2.0% at age 60). Members earn this percentage for each year of service once they reach the qualifying retirement age.

**DISCUSSION:**

*Employer Contributions: Normal Cost and the UAL*

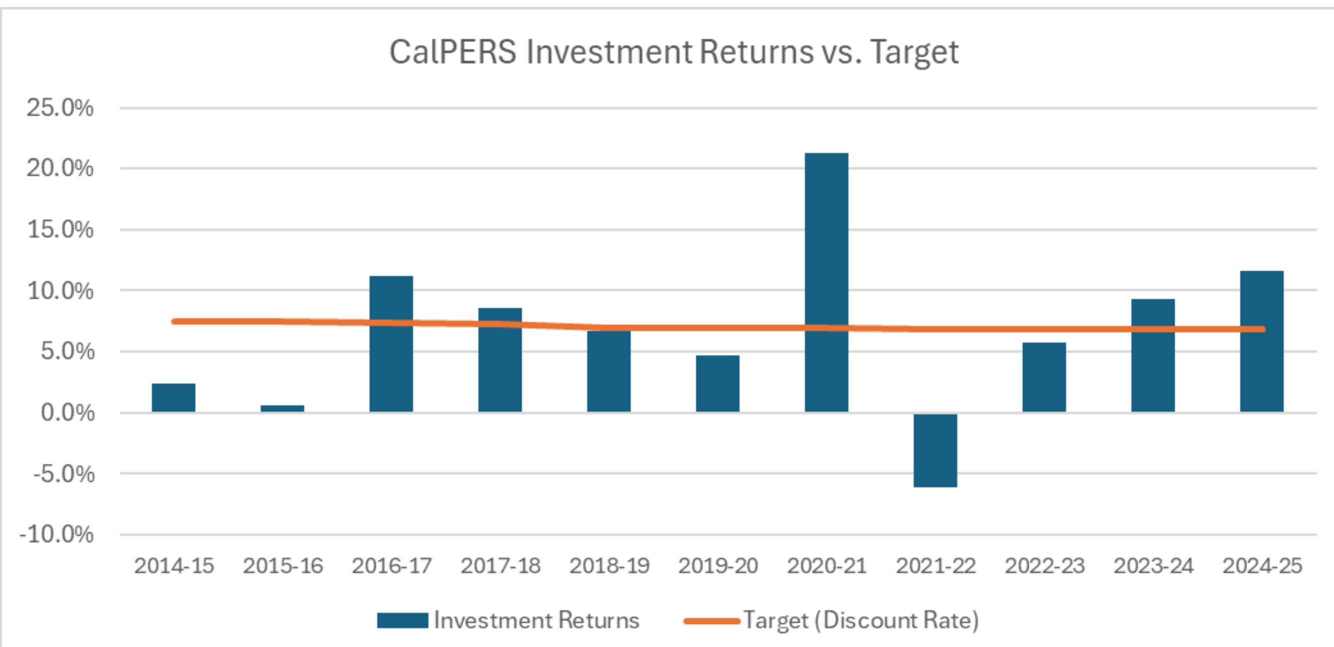
Each year, CalPERS determines the City's required contribution, which has two components:

1. Normal Cost – the cost of benefits employees earn during the year.
2. Unfunded Accrued Liability (UAL) – the gap between earned pension benefits and the assets available to pay them.

Prior to Fiscal Year (FY) 2015/16, CalPERS billed employers for all contributions solely as a percentage of payroll. Beginning in FY 2015/16, CalPERS shifted to billing pooled plans using a percentage of payroll for the normal cost and a fixed dollar amount for the UAL. This approach separates the current-year cost of benefits from the accumulated liability, increasing transparency.

*Discount Rate*

CalPERS uses a long-term investment return assumption, known as the discount rate, to determine the extent to which future pension costs are expected to be covered by investment earnings. If CalPERS' actual investment returns exceed this rate, the City's costs go down because investment earnings cover a larger share of the liability. If returns fall short, the City's costs increase to make up the difference. CalPERS periodically adjusts the discount rate to reflect long-term market expectations, and lowering this rate increases the City's required annual contributions. The current discount rate set by CalPERS is 6.8%.




*Unfunded Accrued Liability*

The Unfunded Accrued Liability (UAL) represents the gap between the City's retirement plan assets and the total cost of benefits earned to date by employees and retirees. CalPERS calculates the UAL using a variety of actuarial assumptions, including expected long-term investment returns, projected retirement patterns, and life expectancy. The UAL is paid over a period of 20 to 30 years according to a fixed annual payment schedule known as *amortization*.

Each year, CalPERS issues a new actuarial valuation that incorporates the City's current payroll, CalPERS' most recent investment earnings, and other actuarial factors. This refresh results in a revised funded status and amortization schedule. **The most recent actuarial report, issued in July 2025 for the period ending June 30, 2024, reflected UAL balances of $240.2 million for the Miscellaneous Plan and $207.1 million for the Safety Plan.**

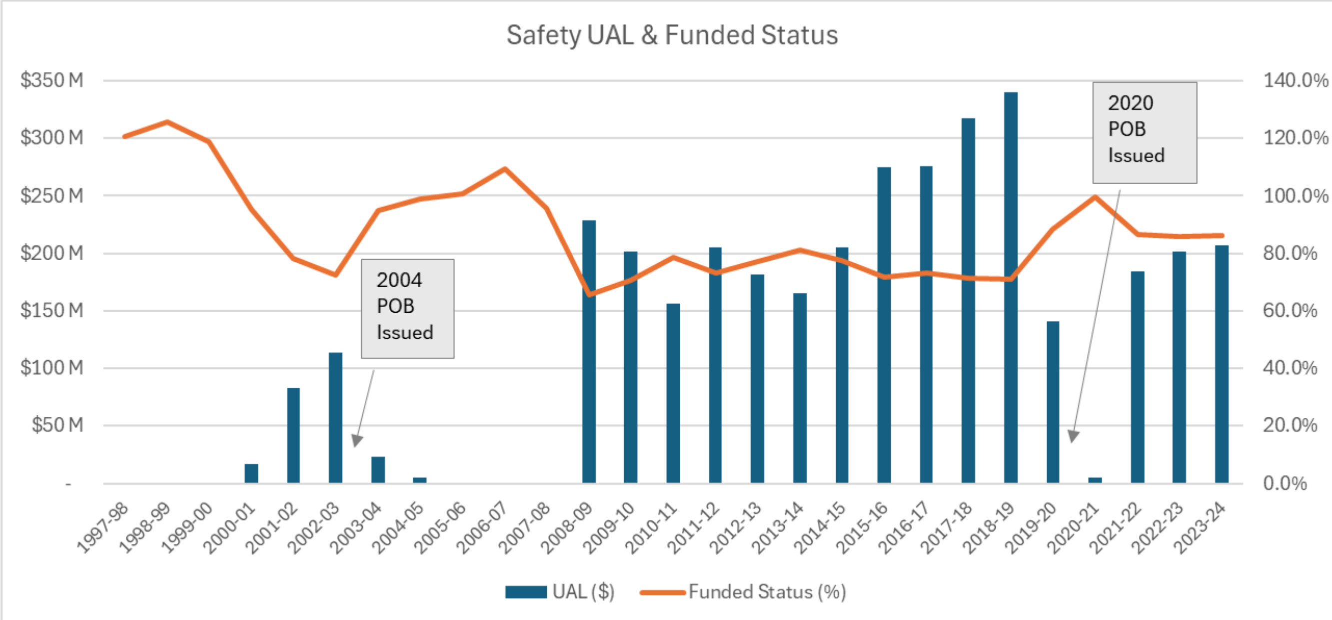
*Funded Status*

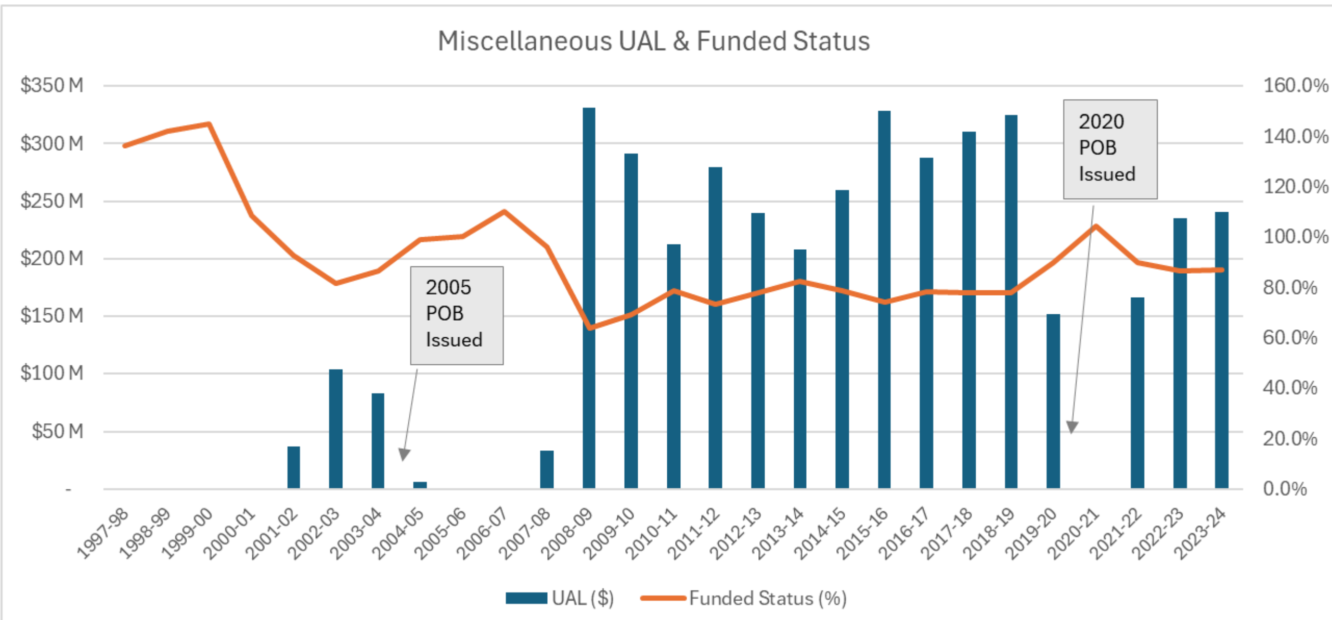
"Funded status" measures how the total assets held by CalPERS compare to the total pension liabilities at a specific point in time. In the late 1990s, due to a strong economy, CalPERS was considered "superfunded," meaning its assets exceeded its projected pension liabilities. After the Dotcom Crash (2000 to 2002), investment returns fell sharply from an average of 15.7% (1994 to 2000) to -9.6% (2000 to 2003), and the funded status declined. Since then, funding levels have not returned to the pre–Great Recession peak of 128% and continue to be influenced by several factors, including:

- Investment returns
- Inflation
- Legislative impacts
- Actuarial assumptions

U.S. public pension systems are, on average, funded at around 75% to 80%, according to the national organizations that track public pension health nationwide. CalPERS' funded status reached 79% following a FY 2024/25 investment return of 11.6%.

The City's funded status has also fluctuated over time, reflecting changing market conditions, updates to actuarial estimates, and other factors disclosed in CalPERS' valuation reports. The City's Safety and Miscellaneous plans were superfunded in 2000 and again in 2007. Following CalPERS' 21.3% return on investments in 2021, the Miscellaneous plan was fully funded, and the Safety plan was 99.6% funded. **Based on the actuarial report issued in July 2025, the City's Miscellaneous plan was 86% funded and the Safety plan was 87% funded as of June 30, 2024.** The recent reduction in funding status was driven by lower investment returns, higher payroll costs, and other actuarial factors.




## *CalPERS Challenge*

The City's participation in CalPERS provides a stable, structured framework for employee retirement security, but it also creates long-term financial obligations that the City must carefully manage. In FY 2017/18, the City launched the *CalPERS Challenge* initiative to explore and implement strategies to manage rising pension costs and reduce the UAL. The goal was to determine how to effectively secure the solvent financial future of the City, its employees, and its retirees while ensuring the delivery of public services and stewardship of public resources.

To manage and reduce pension costs, the City has carried out several initiatives over time, including:

- **2004 & 2005** – The City issued Pension Obligation Bonds (POBs) to extinguish the UAL at that time, and to reduce future annual payments.
- **2008** – Refinanced the 2005 POB, issuing Bond Anticipation Notes in response to the financial crises and resulting high interest rate on the 2005 POB.
- **2011** – Required all CalPERS employees hired between June 7, 2011, and December 31, 2012, (Tier 2) to pay the employee portion of CalPERS pension costs.
- **2013** – Implemented statewide Public Employees' Pension Reform Act (PEPRA) benefit provisions for employees hired on or after January 1, 2013, which reduced agency pension costs for those employees.
- **2016** – Required employees who had not been paying the employee share of CalPERS retirement costs to begin contributing. Long-term savings are limited because pension benefits for existing employees are protected under state law (the California Rule).
- **2017** – Issued the 2017 POB to refinance the $30 million Bond Anticipation Note, allowing a fixed interest rate and accelerated payoff of the principal balance of pension-related debt.
- **2018** – Set aside $4.5 million of surplus General Fund reserves for the establishment of a Section 115 Trust.
- **2019** – Adopted a Pension Funding Policy that established financial strategies to address pension costs.
- **2019** – Established the Section 115 Trust.
- **2020** – Issued $432 million in Pension Obligation Bonds to pay off approximately 67% of the UAL at that point in time.
- **2020** – Allocated $4.4 million of surplus General Fund reserves to the Section 115 Trust.
- **2021** – Allocated $10 million of surplus General Fund reserves to the Section 115 Trust.
- **2021** – Set a goal for the development of the FY 2022-2024 Biennial Budget to implement a financing strategy of planned contributions and withdrawals to/from the Section 115 Trust to smooth the annual fiscal impact of the combined CalPERS UAL and 2020 Pension Obligation Bond payments.
- **2022** – Allocated $9.8 million of surplus General Fund reserves to the Section 115 Trust.
- **2022** – Implemented a smoothing strategy to lessen the budget impact of fluctuating UAL and POB obligations, while establishing a framework for strategic contributions to and withdrawals from the Section 115 Trust.
- **2023** – Established the “Section 115 Trust Set-Aside” by allocating $20 million in surplus General Fund reserves and reallocating $15 million in other reserves, for a total of $35 million, to offset projected Section 115 Trust contributions programmed in the FY 2025–2029 General Fund Five-Year Plan.
- **2024** – Due to CalPERS’ 21.3% return in FY 2020/21, no UAL payment was required for FY 2023/24. The budgeted amount was redirected to the Section 115 Trust for both the General Fund and Enterprise Funds to help manage long-term UAL obligations.

- **Every Year** –
  - Implement operational efficiencies, where possible, to minimize costs and service level impacts as CalPERS costs increase.
  - City proposals during labor negotiations balance non-PERSable benefits with salary increases, reducing the future impact on the City's Normal Cost and UAL.
  - Prepay the UAL each year to capture the annual CalPERS lump-sum prepayment discount, historically about 3.3%.

*Pension Funding Policy*

The Pension Funding Policy adopted by the City Council in August 2019 aims to reduce projected pension costs and improve the funded status of the Safety and Miscellaneous pension plans. Policy objectives include establishing the Section 115 Trust, using the annual CalPERS pre-payment option to reduce interest costs, and allocating 50 percent of unanticipated one-time revenues to pension obligations.

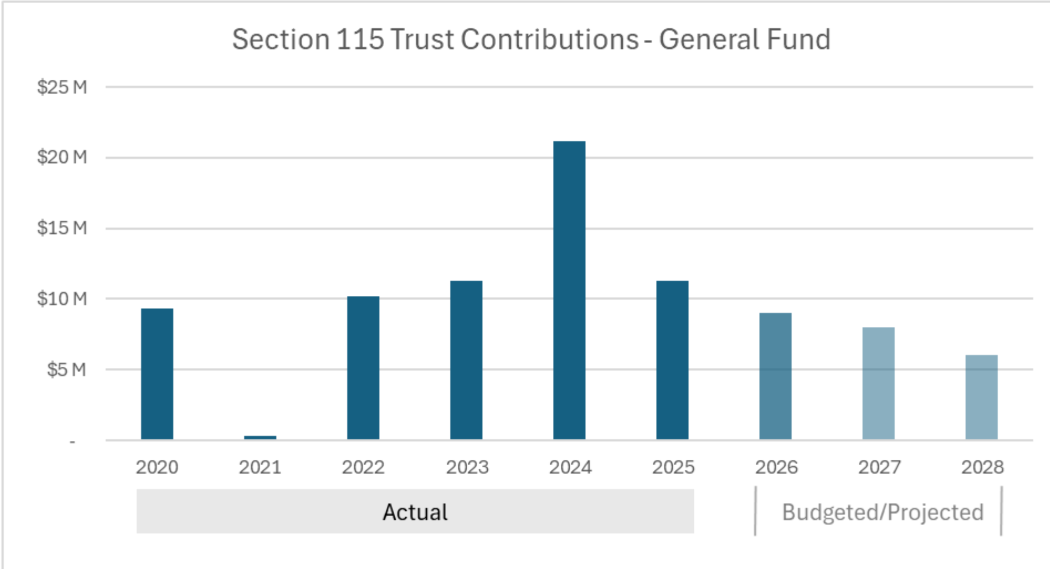
*Section 115 Trust*

A Section 115 Trust is a tax-exempt trust established by public agencies under Section 115 of the Internal Revenue Code. Its primary purpose is to set aside funds for future liabilities, such as pension obligations, enhancing financial security and fostering commitment to long-term financial planning. Key advantages of a Section 115 Trust include:

- Assets are irrevocably committed to the specified purpose and cannot be diverted for other uses, acting as a direct offset to pension costs and lowering the City's net pension liability.
- Permits the City, under federal and state law, to invest funds in a more diversified, long-term portfolio than is allowed for general municipal investments, creating the potential for higher returns over time.
- Assets can be transferred to CalPERS at the City's discretion, stabilizing the budget and reducing the volatility of pay-as-you-go options.
- Plan assets can be managed by a professional fund management team, selected and monitored by City staff.

The City actively manages rising pension costs by monitoring annual UAL payment obligations and strategically planning contributions to and withdrawals from the Section 115 Trust. Further, the City receives regular updates from its Section 115 Trust investment advisor, ensuring prudent investment of funds in a volatile economy.

Since its creation in 2018, surplus reserves, land sale proceeds, and other unanticipated one-time revenues have been contributed to the Section 115 Trust. An extraordinary increase in sales tax revenue, combined with personnel savings from high vacancy rates during and immediately following the COVID-19 pandemic, enabled the City to make larger contributions than otherwise would have been possible. Additionally, the elimination of the FY 2023/24 UAL payment due to CalPERS' high interest earnings in FY 2020/21 allowed the City to redirect the budgeted payment to the Section 115 Trust.




As of November 30, 2025, the market value of the Section 115 Trust was $90.2 million, with approximately 92% attributable to the General Fund and 18% attributable to Enterprise Funds. Since inception, investment earnings have exceeded 13%; however, it is important to note that market value reflects a single point in time, and actual returns may be higher or lower at the time of withdrawal.

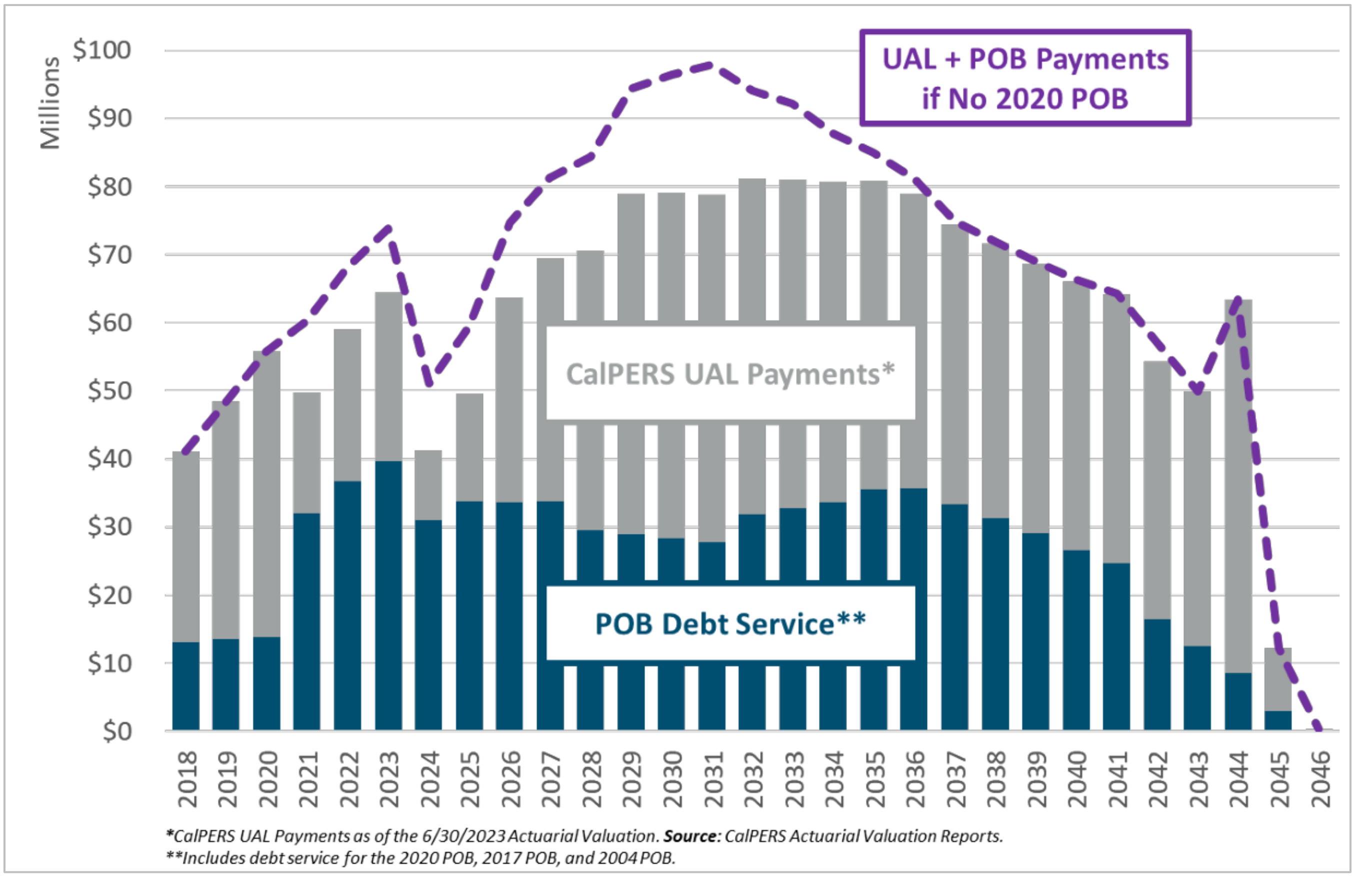
*<u>Pension Obligation Bonds</u>*

Pension Obligation Bonds (POBs) are a financial tool used by municipalities to manage and reduce their pension liabilities. By issuing POBs, the City can address unfunded actuarial liabilities (UAL) more effectively and improve the funded status of its pension plans. The City has used this approach in prior years, issuing POBs to stabilize pension costs and strengthen overall the funding ratio. The 2017 Pension Obligation Bond will be fully paid in FY 2026/27.

In Spring of 2020, the City issued $432 million of POBs to pay off approximately 67% of its UAL balance at the time. The 2020 POB refinanced the high-interest UAL (6.8%) with a lower-interest POB (3.69%), achieving multiple objectives:

- interest rate savings;
- equitable funding of both the Miscellaneous and Safety Plans; and
- smoother payments to enhance budget predictability.

The following chart presents the City's projected annual CalPERS UAL payments and POB debt service, alongside the estimated total payments that would have occurred had the 2020 POB not been issued.




Based on modeling prepared by the City's municipal advisor as of May 2025, the 2020 POB has generated approximately $45 million in savings to date, with projected lifetime savings of about $175 million if CalPERS meets its long-term assumptions. As of June 30, 2025, the principal balance of the 2020 POB was $382.9 million; the final payment on the POB is due in 2045.

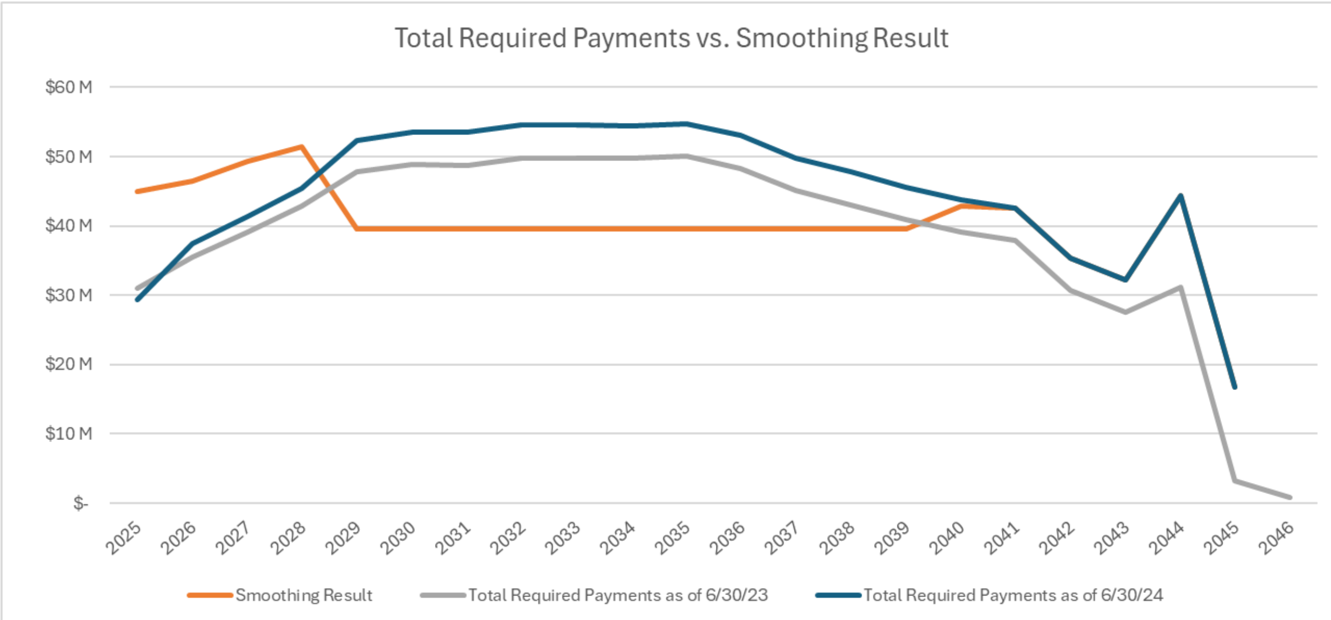
*Smoothing Strategy*

One of the City's primary goals is to enhance budget stability and avoid sudden spikes in pension costs that could disrupt public services. To support this goal, the City adopted a smoothing strategy to level out the combined payment obligations of the UAL and POB over the amortization period. This strategy ensures prudent contributions to and withdrawals from the Section 115 Trust to smooth the impact of rising pension costs on the City's operating budget.

When first implemented in the FY 2022-2024 Biennial Budget, the smoothing strategy projected level payments of $37.9 million annually from FY 2024/25 through FY 2035/36. Following the fiscal year ending June 30, 2023, the City Council directed $35 million in surplus and reallocated reserves to offset projected Section 115 Trust contributions over the FY 2025-2029 General Fund Five-Year Plan. Contributions supported by the "Section 115 Trust Set-Aside" were projected to help the City achieve level annual payments of $36.17 million starting in FY 2028/29, offsetting an $11.7 million annual fiscal impact.

Lower-than-expected CalPERS investment earnings of 5.8% in FY 2022/23, combined with higher payroll, increased required UAL payments and raised projected level payments to $39.6 million beginning in FY 2025/26.

The following chart illustrates the change in the annual obligation that occurred between the CalPERS actuarial reports issued in 2023 and 2024, and the revised level annual payments of $36.17 million beginning in FY 2028/29, assuming the budgeted and projected contributions to the Section 115 Trust will occur as planned.




As of November 30, 2025, $9 million in Section 115 Trust contributions are budgeted for FY 2025/26, with an additional $18 million available in the Set-Aside.

## **FISCAL IMPACT:**

There is no fiscal impact related to the receipt of this report.

The City continues to actively manage its pension obligations through a combination of strategic initiatives, including the Section 115 Trust, Pension Obligation Bonds, and a smoothing strategy.

As of June 30, 2024, the City's Unfunded Accrued Liability totaled $240.2 million for the Miscellaneous Plan and $207.1 million for the Safety Plan, with funded ratios of 87% and 86%, respectively. The 2020 Pension Obligation Bond refinanced a substantial portion of the UAL at a lower interest rate, with a principal balance of $382.9 million as of June 30, 2025, and a final payment due in 2045. Modeling by the City's municipal advisor indicates the 2020 POB has generated $45 million in savings to date, with projected lifetime savings of about $175 million if CalPERS meets its long-term assumptions.

The Section 115 Trust, established in 2018, had a market value of $90.2 million as of November 30, 2025, with approximately 92% attributable to the General Fund and 18% attributable to Enterprise Funds. Budgeted contributions to the Section 115 Trust total $9 million for FY 2025/26, with an additional $18 million available in the Section 115 Trust Set-Aside to further stabilize future pension costs.

The City's smoothing strategy for FY 2025/26 projects level annual payments of $39.6 million through 2039.

Together, these measures demonstrate the City's commitment to prudent fiscal management, long-term financial security, and sustaining the delivery of public services.

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Attachments:

1. Presentation