



CITY OF

Richmond CALIFORNIA

CALPERS ADDITIONAL DISCRETIONARY PAYMENT (ADP) v. SECTION 115 TRUST COMPARISON

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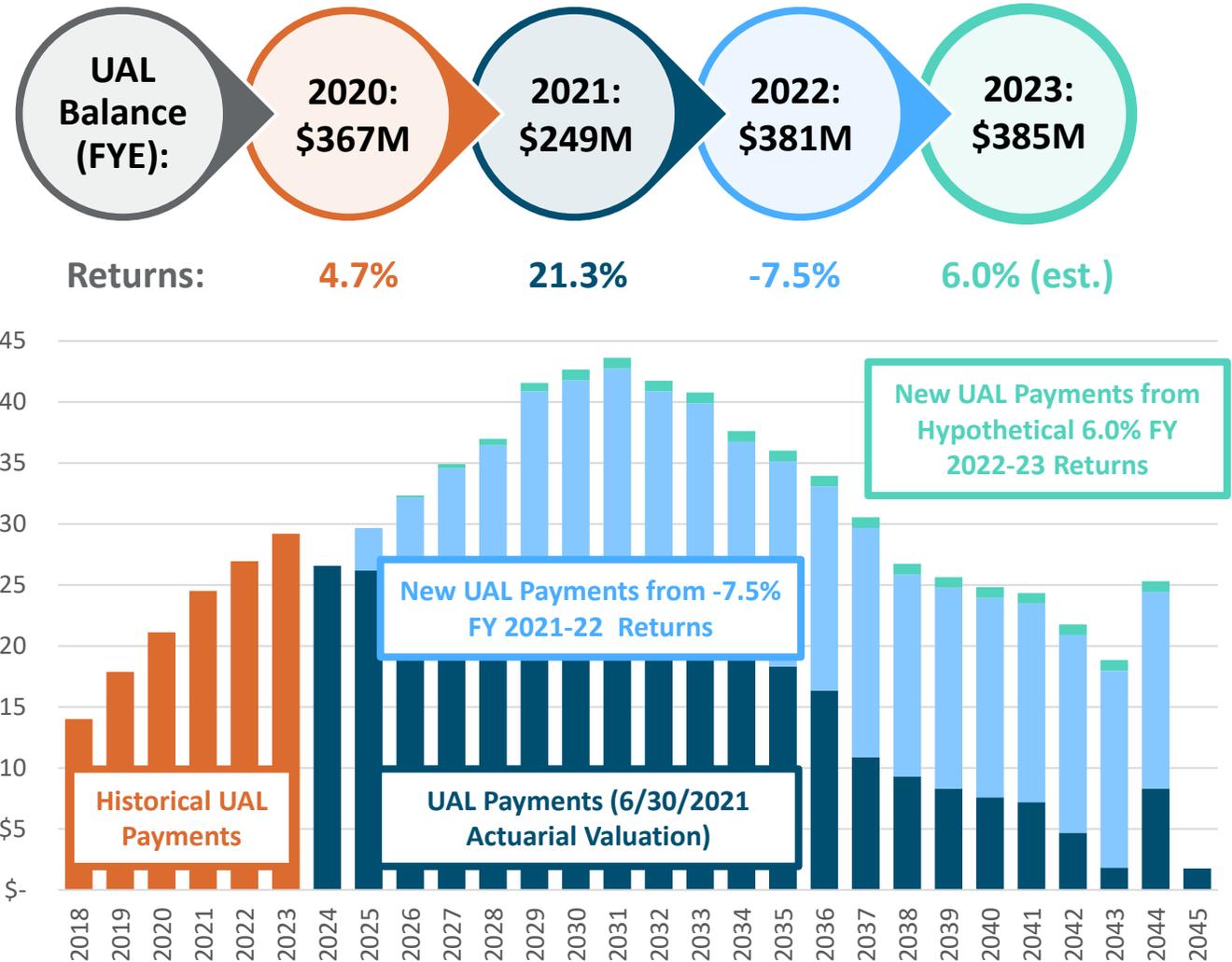
JULY 11, 2023

Executive Summary

- ▶ City of Richmond has a projected \$381.5M CalPERS Unfunded Accrued Liability (UAL)
 - ▶ Reflects -7.5% CalPERS investment returns in FY 2022, which will increase the UAL from \$248.6M
 - ▶ UAL may increase slightly to \$385.4M should CalPERS achieve 6.0% returns in FY 2023
- ▶ City also has \$154M of outstanding Pension Obligation Bonds (POBs)
- ▶ City has historically taken proactive steps toward managing pension costs
 - ▶ Annual UAL Prepayment Discount, 2022 Pension Refunding Bonds, Section 115 Trust Established in 2022
 - ▶ Educational Presentations and Analysis: Two meetings in 2022 (NHA), GovInvest in May 2023, NHA on May 26th and July 11th)
 - ▶ Pension Funding Policy Adoption (last City Council meeting)
- ▶ This presentation will include follow up to May 26th meeting comparing 115 Trust to Additional Discretionary Payments (ADPs)

Historical and Projected UAL Payment Schedule: Update

- ▶ The City's UAL has increased 45% over the last 7 years (\$263.3M → \$381.5M)
- ▶ The City's UAL balance would increase to \$385.4M if CalPERS earns 6% in FY 2022-23
- ▶ The annual UAL payment has more than doubled from 2018 (\$14M) to 2023 (\$29M)
 - ▶ Projected to increase another 50% from 2023 to 2031 (\$44M)



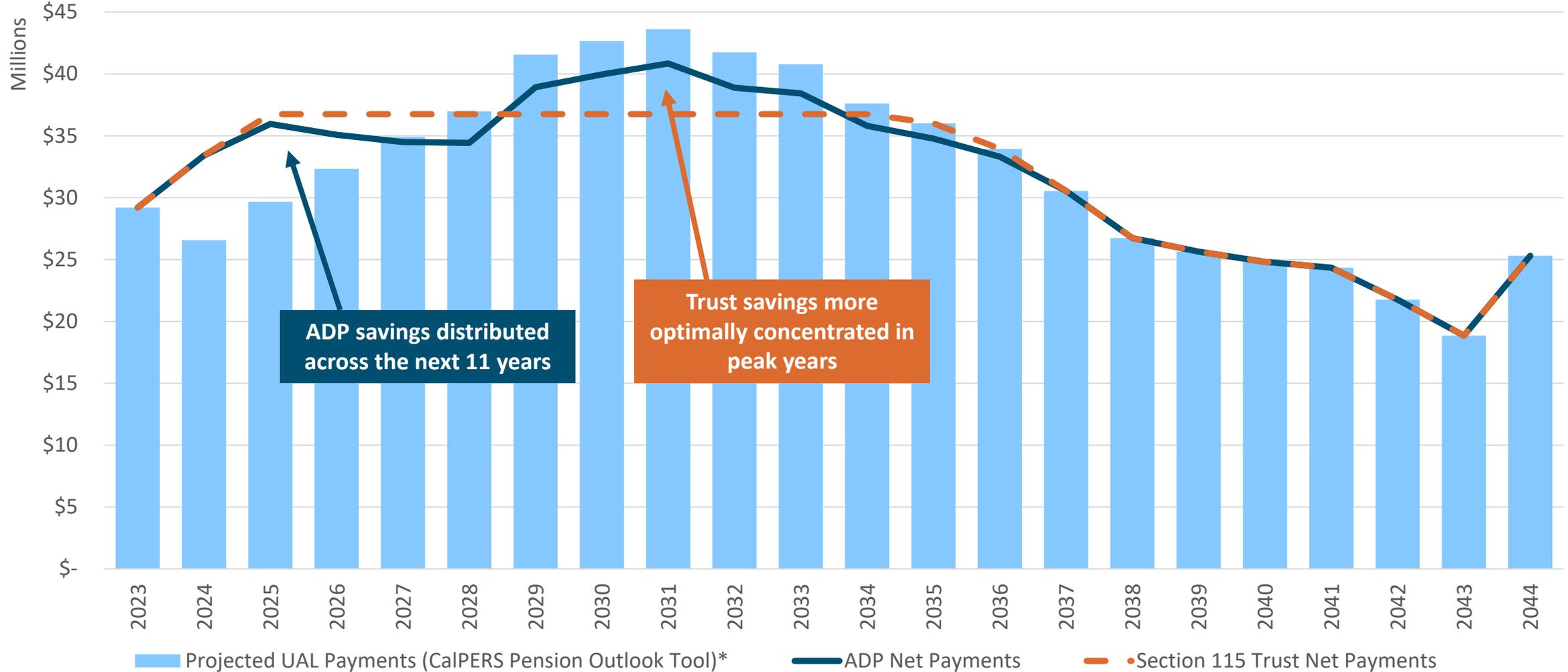
Use Cash Reserves: Section 115 Trust

- ▶ **What is it?** Dedicated (restricted to pension/OPEB) account managed by PARS; funds in the Section 115 Trust will eventually be sent to CalPERS
- ▶ **Pros:**
 - ▶ **Increased Returns** - Potential for increased investment returns vs. current General Fund reserves
 - ▶ **Budgetary Flexibility** – City can use funds when needed depending on circumstances (1) during tough budget years can be used as a shock absorber and lessen impact on General Fund; (2) make ADPs to PERS at any time; (3) reimburse City if significant economic challenges arise.
 - ▶ When doing an ADP with CalPERS, that money is gone and cannot be used to stabilize budget volatility like a 115 Trust can
 - ▶ **Investment Control**
 - ▶ City's 115 Trust is with PARS and has 10 different portfolio options based on risk tolerance; Over 2/3 of options are more conservative than CalPERS pension portfolio
 - Note: CalPERS already manages \$909 million of the City's pension funds and invests those funds in an aggressive manner
- ▶ **Cons:**
 - ▶ Market risk (dependent on type of investment portfolio)
 - ▶ The Trust will show up as an asset on the City's financial statements, but will not technically offset UAL until funds are transferred to CalPERS
 - ▶ City will need to use reserves or annual surplus to fund the 115 Trust

Use Cash Reserves: CalPERS Additional Discretionary Payment

- ▶ **What is it?** City makes Additional Discretionary Payment (ADP) directly to CalPERS
 - ▶ CalPERS will eliminate payments associated with the portion of the UAL paid off, essentially giving the City credit at the discount/interest rate (currently 6.8%)
 - ▶ Actual credit given over time will be at CalPERS' actual future reinvestment returns
- ▶ **Pros:**
 - ▶ Reduced future payments
 - ▶ Reduced UAL and higher CalPERS funding ratio
- ▶ **Cons:**
 - ▶ Market risk
 - ▶ No Investment Control - No options for other investment portfolios like there is with Section 115
 - ▶ All \$909 million of City's pension assets are with CalPERS; invested aggressively
 - ▶ Reduced liquidity/budgetary flexibility vs. Section 115 Trust
 - ▶ City will need to use reserves or annual surplus to fund the ADP

Comparison of Section 115 Trust and CalPERS ADP Theoretical \$20M of Funds Used Over 11 Years



Comparison of Section 115 Trust and CalPERS ADP

Assumptions & Savings Summary

Cost Management Strategy	Section 115 Trust	CalPERS ADP
Deposit Assumptions	\$20M over FYE 2024 - 2027	\$20M over FYE 2024 - 2027
Assumed Interest Rate Benefit	5.50%	6.80%
Est. Gross Savings	\$27.7M	\$24.2M
Est. Gross Savings during Peak Payment Years (2029 – 2033)	\$26.6M	\$13.3M
Est. Additional Budget Flexibility from Liquidity	\$20M (equal to total amount deposited)	\$0 (funds deposited cannot be retrieved from CalPERS)
Est. Average Annual Payment from 2023 - 2033	\$35.8M	\$36.3M

Conclusion & Next Steps

- ▶ Both Section 115 Trust and ADP are good options for managing rising pension costs
 - ▶ It should be reiterated that these options are not mutually exclusive; funds in a Section 115 can be sent to CalPERS in the form of an ADP at any time
- ▶ NHA Recommendation
 - ▶ Begin to send surplus funds to the Section 115 trust given the enhanced budgetary flexibility and investment control
 - ▶ Given credit rating and state audit concerns on City's financial health, maintaining liquidity and reserve levels is important
 - ▶ Pension cost management strategies, including optimal leveraging of the Section 115 Trust, should be evaluated every year and factor in ongoing changes at CalPERS and City's financial health
 - ▶ As City builds the trust to more meaningful levels (>\$10-\$20 million for example), City can re-evaluate and determine optimal timing and method of sending that money to CalPERS