PENSION ADVISORY REVIEW COMMITTEE

MINUTES OF MEETING*

February 13, 2020
3:00 p.m.

County Executive Office
4080 Lemon Street, 4th Floor
Conference Room A

Members Present:

Don Kent	Chairman, County Executive Office
Paul Angulo	Auditor-Controller
Brenda Diederichs	Human Resources
Matt Jennings	County Treasurer's Office

Members Absent:

None

Staff and Guests Present:

Supervisor Hewitt	Board of Supervisors District 5
Katrina Cline	Board of Supervisors District 5
Supervisor Spiegel	Board of Supervisors District 2
Karen Christensen	Board of Supervisors District 2
John Bartel	Bartel Associates
Kim Byrens	BB&K
Michael Williams	Columbia Capital
Michael Thomas	County Counsel
Imelda Delos Santos	Executive Office
Katie Ponce	Executive Office
Paul McDonnell	Executive Office
Amy Onopas	Human Resources
Alisa Lynch	Human Resources
Stacey Beale	Human Resources
Megan Gomez	Human Resources
Sonia Moreno	Human Resources
Michael Alferez	Parks
Robert Larkins	Raymond James
Jayson Villaflor	Superior Courts
Sandra Green	Waste Resources
Margaret Herrero	Waste Resources

** Subject to change based on Committee review*

1. Call to Order and Self-introductions:

Chairman Don Kent called the meeting to order at 3:00 p.m. Self-Introductions were given by those present.

2. Approval of the Minutes for December 5, 2019:
MOTION: Paul Angulo moved to approve the Minutes.
Seconded by Brenda Diederichs Motion approved unanimously

3. Recommendation of Appointment of Vacant Committee Member

Don Kent shared that in 2018 the roster was enhanced to five committee members consisting of the following members: County Finance Officer, County Treasurer-Tax Collector, County Auditor-Controller, Human Resources Director, and, a local safety member department representative. Our Chief Probation Officer, Mark Hake, retired in September leaving a vacancy. Mr. Kent's recommendation is Undersheriff Dennis Vrooman. Undersheriff Vrooman has 35 years law enforcement experience previously with City of Murrieta and City of Downey and now the county.

MOTION: Paul Angulo moved to approve.
Seconded by Brenda Diederichs Motion approved unanimously

4. Review and Recommendation of the FY 20/21 CalPERS Annual Pre-Payment

Don Kent explained that each year the committee brings forward a review and recommendation of the coming year's CalPERS annual pre-payment. CalPERS changed its pre-payment policy in FY 18/19 and now allows only the unfunded liability payment portion to be prepaid. Last year the pre-payment was $186 million of which we received discounts of 3.5 percent. This year the unfunded liability is $229 million.

Mr. Kent's recommendation is for PARC to review and recommend that the county continue with the annual pre-payment of its unfunded liability to take advantage of the 3.32% discount offered by CalPERS. A final recommendation regarding the actual FY 20/21 CalPERS annual prepayment dollar amount will be made in conjunction with the FY 20/21 TRANs borrowing, which will go before the Debt Advisory Committee (DAC) in May, and then on to the Board of Supervisors for approval. The PARC first recommended utilizing the prepayment approach in 2004.

MOTION: Matt Jennings moved to approve CalPERS Annual Pre-Payment.
Seconded by Brenda Diederichs Motion approved unanimously

5. 2020 Pension Obligation Bond Review

Don Kent shared that after the Annual PARC Report went to the Board on January 14, discussions started regarding where the county stands as of the annual valuation report year ending June 30, 2018. At the time of that report, the unfunded liability was $3.5 billion dollars. The feedback from the Board was that we are not at the desired minimum funding level of 80%. The 80% minimum funding level is incorporated in the Pension

Management and Other Post-Employment Benefits Board Policy B-25. When the Plans are below the minimum funding level, the policy requires the preparation of a plan to address the shortfall. The interest rate on CalPERS unfunded liability is currently 7%. In 2005, The County issued $400 million in pension obligation bonds. The true interest cost (TIC) of that refunding was 4.91%. Bartel Associates estimated that the benefit to the County from the 2005 pension obligation bonds as of February 15, 2020 to be about $138.1 million. This estimate is based upon the County depositing $396.9 million of bond proceeds with CalPERS. From 2005 to present, CalPERS investment return has been 6.5%, resulting in a benefit of $138.1 million which is the difference between the investment return and the borrowing cost. Also, there have been discussions about other alternatives for dealing with the pension costs including terminating the CalPERS Plans. In discussions with the Ad-Hoc Committee, which included Supervisor Spiegel and Supervisor Hewitt, regarding the feasibility of determining the CalPERS Plan, the cost was estimated to exceed $10 billion.

John Bartel explained why the termination amount is so large. The best way to think of that number is to consider who is responsible for paying benefits. People have a tendency to think that CalPERS is responsible for the unfunded liability but it is not. The county is responsible for paying the unfunded pension liability. If the County withdraws from CalPERS, CalPERS wants to make sure there is enough money to take care of those promised benefits. They would move the assets and liabilities into a risk-free plan meaning they are no longer going to invest in equities or long-term bonds. They would invest in treasury notes or things that have no risk associated with them. If you are investing in low risk investments, your anticipated rate of return is substantially below what it would be if you invested in a diverse portfolio. What CalPERS is really doing when giving that termination liability payoff amount, is to provide a walk away risk-free number. Mr. Bartel stated that there is one other component to the termination calculation that allows for mortality improvements, participants will live longer. They do the calculation then they gross it up in anticipation that mortality might improve. Sometimes that is referred to as a penalty. CalPERS does not want to create a situation where they have to go to participants and reduce benefits so they are taking a conservative approach and some refer to that as a penalty approach.

Mr. Kent shared that the county established the Section 115 Pension Trust in 2016. Comparing performance, the CalPERS Public Employees Retirement Fund is over $400 billion. Riverside County's Section 115 Pension Trust had a balance of $28.7 million as of June 30, 2019 and is slowly growing over time. The annualized rate of return of the 115 Trust since inception is 7.3%. In addition, that account was up over 17% for calendar year 2019. This is one way we can invest pension assets outside of CalPERS. .

a. Raymond James – 2020 Pension Obligation Bonds

Rob Larkins reported that as of June 30, 2018, the CalPERS valuation report cited an unfunded pension liability that was $3.5 billion. Bartel Associates projected the unfunded liability as of June 30, 2020 to be:

- $2.560 billion for Miscellaneous (72.1% gross funded, 70.2% net funded)
- $1.162 billion for Safety (71.8% gross funded, 70.7% net funded)

The County's UAAL contribution to PERS for FY 20/21 is $229 million: $73,668,397 for Safety and $155,375,654 for Miscellaneous. The increase in the County's employer contributions are driven primarily by CalPERS' risk-reducing amortization policy changes.

The County's options to reduce the cost of servicing its UAAL are limited. Terminating the CalPERS Plans is expensive and would require the County to provide a replacement retirement plan. Another option for addressing higher pension payments is the re-amortization of the UAAL with CalPERS, which is called a "Fresh Start." Standard options are 15 and 20 year terms. Re-amortization would be implemented at CalPERS' current 7% rate, which doesn't provide interest rate savings. The County can also prepay bases with cash. Assuming the county has available "excess cash" and could address the significant federal reimbursement ramifications, it could use cash to pay off selective bases and achieve economic savings (equal to the difference between the pool rate (1.86%*) and CalPERS' 7%.) A preferred use of "excess cash" is to put it into the Section 115 Pension Trust. The County can use the 115 Trust funds to make additional payments to CalPERS or to pay current years costs which frees up other resources. The Section 115 Pension Trust can only be used for pension related costs. Another option is refinancing bases to lower the interest cost and reduce scheduled payments. In the current market, the county has the opportunity to reduce its interest cost by more than 50%. CalPERS will allow agencies to pay off individual bases. Upon paying off these selected bases, CalPERS would "zero out" the county's required UAAL amortization payments for those bases which are replaced by lower cost POB debt service. Proceeds must be received by CalPERS no later than June 20, 2020.

Mr. Larkins stated that a Pension Obligation Bond is a bond issuance to extinguish some of the unfunded actuarial accrued liability (UAAL). The money is deposited with CalPERS and invested along with other pension system assets pursuant to CalPERS' prevailing asset allocation. The idea is that the County would continue to make it's Normal Cost payments to CalPERS and whatever portion of the liability is refinanced will reduce what the County is paying CalPERS, replaced with payments of bondholders but at a lower interest rate. Riverside County previously issued $400 million of Taxable Pension Obligation Bonds in 2005, of which $218.8 million is outstanding as of February 15, 2020. Benefit to date, as calculated by Bartel Associates is $138.1 million.

The Executive Office is presenting two possible financing scenarios. The Base Case was for a $500 million bond issue and the Alternate 1 case, were discussed in detail and a request was made for approval to move forward for further consideration by DAC. The Base Case was for a $500 million bond issue All in TIC was 2.62%. Projected savings are $205 million and present value savings are $164 million or 33.25%. Alternative 1 was for a $730 million bond issue targeting 20% of UAAL, All in TIC was 2.49%. Projected savings of $286 million and present value savings $234 million or 32.40%. The base case and Alternative 1 both assumed approximately a 50/50 split for refunding Miscellaneous and Safety Plan UAAL's. Alternatives 2 & 3 for bond issues exceeding $900 million were not being recommended.

Slide 12 was discussed in detail to show how the base case was set up. The market interest rate for the analysis was as of February 3. Mr. Kent stated the CalPERS assumed investment rate is 7% versus the all in TIC rate of 3.16% listed on the slide. This is greater than 50% reduction in interest cost.

Slides 19 and 20 provide details of Alternative 1, which refunds five Miscellaneous bases and five Safety bases totaling $723.2 million or 19.6% of the county's $3.696 billion UAAL, estimated as of June 30, 2020, and estimated savings. Slides 22 and 23 provide details of refunding the Miscellaneous and Safety Plans with the breakdown of savings by base. Bartel Associates likelihood of success analysis estimated 81-84%.

Slide 26 showed the results for the 2005 $400 million POB with all-in TIC of 4.91% and a CalPERS assumed earnings rate of 7.75%, equating to a spread of 284 basis points. As of February 3, 2020, estimated all-in TIC was under 3%, CalPERS assumed earnings rate currently is 7% which is a spread of over 400 basis points.

Slide 29 shows the GFOA concerns regarding Pension Obligation Bonds. The big risk is that the interest cost on the POB's might be greater than the investment returns by CalPERS earned over the term of the bonds. This is why the County engaged Bartel Associates to prepare the analysis. The GFOA analysis of POBs describes them as complex instruments with considerable risk. They note that POB structures may incorporate the use of guaranteed investment contracts, swaps, or derivatives, which must be intensively scrutinized as these embedded products can introduce counterparty risk, credit risk and interest rate risk. However, the Executive Office is not recommending the bond structures described in the GFOA Advisory. Alternative 1, the structure that was recommended is a fixed rate bond structure with no extension of maturity, with proportional savings.

b. Bartel Associates – Proposed 2020 POB Study
c. Bartel Associates – Proposed POB Summary of Scenarios

John Bartel discussed the Proposed 2020 POB Study & Proposed POB Summary of Scenarios. Mr. Bartel explained that the nature of this report is a combination of actuarial terminology and investment terminology. The most recent CalPERS valuation measurement date is June 30, 2018. Bartel Associates projected the Plan assets and liabilities as of June 30, 2020 for both Miscellaneous and Safety Plans. The Miscellaneous Plan unfunded liability was projected to be $2.6 billion and Safety at $1.2 billion. The County Policy B-25 goal of 80% funding will not be met immediately with the POB issue being recommended, but it moves the County into the right direction. The shortfall for miscellaneous is $728 million for the 80% target and $338 million for safety for a combined shortfall of $1 billion. One of the analysis assumptions was to use the current asset allocations for plan assets. Currently, the asset allocation is Global Equity 47%, Private Equity 12%, Fixed Income 19% Liquidity 2%, Inflation Assets 6%, Real Estate 11% and Forestland/Infrastructure 3%. For the real estate allocation, funds have invested in individual real estate projects. For example, CalPERS would buy a shopping center for $100 million. That is not the majority of their real estate investments and CalPERS is no longer buying individual real estate projects. CalPERS is now investing in real estate investment trusts. When you take that investment policy target and compare that with what investment advisors are telling us what the Geometric Real Average Return expected to get above inflation, you see equities in the 5% + range. The inflation rate used in the projections is 2.5%. Standard Deviation for Global Equity and Private Equity is high. For Geometric Nominal Average Return you are at about 7.5% for Global and 8.6% for Private Equity and less than that for the others.

Mr. Bartel shared that the POB Cost Reduction was calculated on whether there were savings or not based on the county's contributions without POB for the next 30 years, and with the county's contribution with a POB including debt services for the next 30 years. The analysis also took into consideration the fact that there may be some CalPERS assets that were not used. The discount rate for cash flow differences is 3%. The discount rate for asset difference at 30 years is 7%. Investment return assumptions include lower than expected return for the next 9 years followed by higher than expected returns. PEPRA requires a minimum contribution of normal cost. If investment returns are good and results in a surplus of assets, the contribution cannot be reduced below the normal cost rate. This has an adverse impact on whether or not you save money. Mr. Kent pointed out that is one change that did not exist in 1999/2000. The County's funding status could be 100% or greater at that time and it would not have to pay the Normal Cost. Mr. Bartel explained the analysis was done with and without this requirement to show impact and to show it is possible if plans do get "super funded" legislature will need to change this component of the law. One assumption that was not included in the analysis is a CalPERS risk mitigation strategy.

Mr. Bartel continued with slide 5, summary of base case scenario. For the miscellaneous plan, $248 million in bases would be paid off resulting in a reduction of payment to CalPERS of $23 million. For the safety plan, $246 million in bases would be paid off, with a reduction of $23.6 million. There would be a 9 year duration and a POB average interest rate of 3.38%.

The likelihood of success without normal cost minimum for the miscellaneous plan is 83% and for the safety plan is 84%. The likelihood of success with normal cost minimum for miscellaneous is 79%, and for safety, 81%.

The likelihood of success with base case + 50 bps without normal cost minimum for miscellaneous is 79%, and for safety is 81%. The likelihood of success with normal cost minimum for miscellaneous is 75%, and for safety is 78%.

Reports were received and filed. All Committee Members agreed to move the item forward to the Debt Advisory Committee on February 20, 2020 for their consideration.

6. New Business

No new business to address.

7. Public Comment:

No public comment.

8. Future Meeting Date:

A future meeting date will be determined later.

9. Adjourn:

With no further business, Don Kent adjourned the Pension Advisory Review Committee Meeting at 5:23 p.m.