

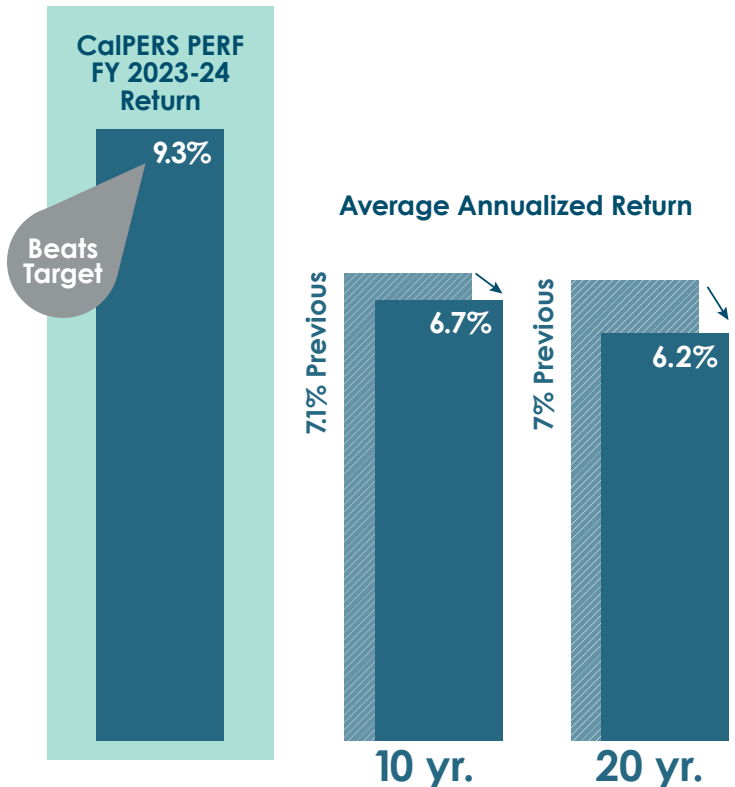
# CALPERS BEATS TARGET IN FY'24

## COST MANAGEMENT STRATEGIES IN FOCUS AS PAYMENT VOLATILITY REMAINS

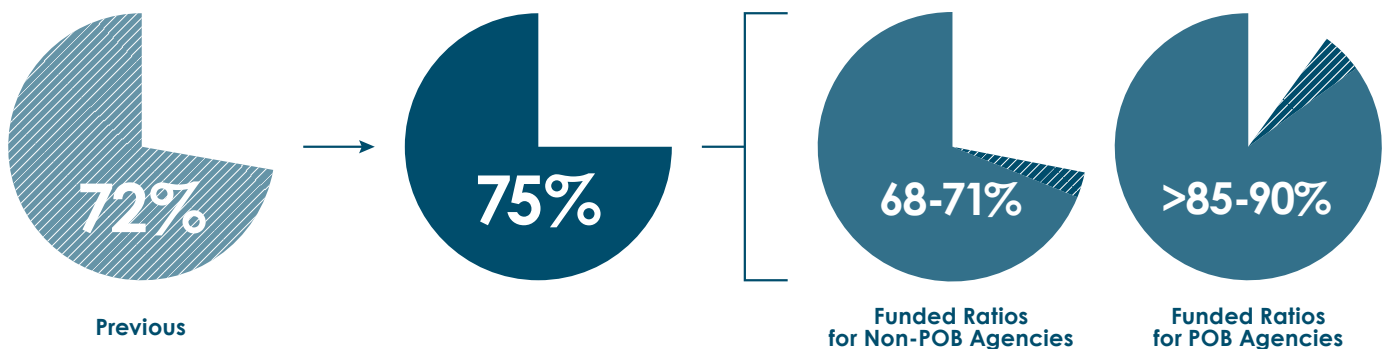
In July 2024, CalPERS announced preliminary investment returns of 9.3% for the fiscal year ending June 30, 2024. Potential revisions to include private market asset valuations will impact final returns, which may be determined later this year. In FY 2022-23, CalPERS achieved preliminary returns of 5.8% that were revised upward to 6.1% in the fall of 2023. Despite this most recent year's returns outpacing the discount rate of 6.8%, the 20-year annualized average return dropped from 7.0% to 6.2% and the 10-year annualized average return from 7.1% to 6.7%.

### Pension Bond Issuance Skews Overall Funding Status

From these results, the overall funded status for the CalPERS Public Employees' Retirement Fund (PERF) rose to 75% from 72% in the fiscal year prior. Notably, this aggregate figure has been slightly elevated by over \$4 billion in recent Pension Obligation Bond/UAL Restructuring bond issuances during 2020-2022, with most of those pension bond issuers now experiencing funding ratios above 85-90%. As more thoroughly discussed in our [January 2023 NHAAlert](#), pension bond issuer UAL and funding ratio metrics will fluctuate considerably from agency to agency depending on the timing of their bond issuance and amount of UAL restructured, among other factors. Non-pension bond issuers may see their funding ratios rise to 68-71% on average.



### Overall PERF Funded Ratio

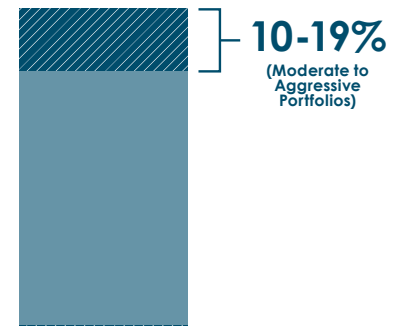


Estimated; based on review of CalPERS Actuarial Reports from approximately 20-25 agencies

## Section 115's Perform Extremely Well

For the hundreds of agencies that also incorporate a Section 115 Trust into their pension funding strategies, FY 2023-24 saw strong returns for many of the 115 portfolios – including >10% for many moderate-risk style portfolios (~50% Equity / 50% Fixed Income) and 13-19% for portfolios with a higher equity ratio (60%-90%). Strong gains in equity markets contributed to this favorable performance, boosting these trusts to higher levels – a crucial asset to help manage spiking CalPERS UAL payments over the next several years.

## Non-CalPERS Section 115 Trust Returns



## Potential Impacts for Member Agencies

### 1. No Current Change to Discount Rate

While the outsized returns of 9.3% did technically trigger a Funding Risk Mitigation Event, CalPERS decided to make no changes to the Discount Rate at their Board Meeting on September 17, 2024. CalPERS will revisit this discussion next year during their formal Asset Liability Management (ALM) study.

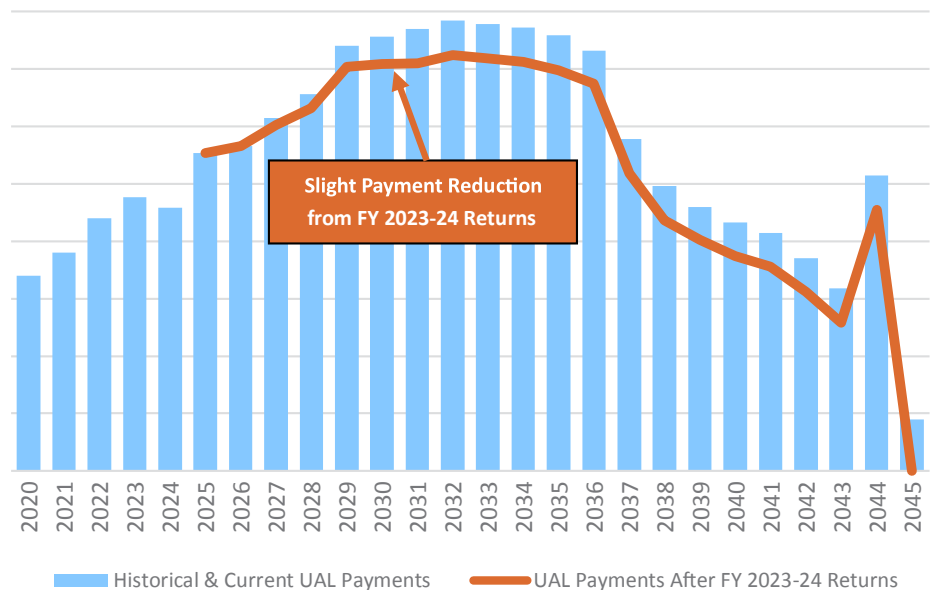
### 2. Timing Considerations for Impact of FY 2023-24 Returns

The impacts of the FY 2023-24 returns will be reflected in next year's release of the CalPERS actuarial valuation reports for 6/30/2024. The 9.3% returns will establish "negative" amortization bases that reduce UAL balances and future UAL payments for each agency's retirement plan. Payment offsets related to these new amortization bases will be recognized over 20 years, with UAL payment reductions first taking place in FY 2026-27, and structured with a 5-year ramp up period. Given the ramping amortization, the bulk of the reduction in UAL payments will not be seen until savings fully ramp up in FY 2030-31. So, while the escalation in payments will be slightly dampened, many CalPERS members are still expected to face a rapidly increasing UAL repayment schedule for the next 5 to 10 years.

### 3. UAL Balance & Payment Impacts

The peaking payment structure of the UAL for many public agencies continues to pressure budgets even as UAL balances have fluctuated in both directions over the past few years. While nominal UAL balances may now be slightly higher than they were in 2020 (for non-pension bond issuers), annual UAL payments for many agencies have already increased by approximately 40% since 2020 and many are projected to rise by another 30% by the end of the decade. Issuers of pension bonds who have started to see their UAL payments re-emerge in FY 2024-25 may see more accelerated growth in their payments since they are starting from a lower amount (or zero for many), with many already subjected to Fresh Start UAL amortization structures due to short periods of over funding (funding ratios > 100%). While many member agencies should benefit from the 9.3% returns in FY 2023-24, the scale of impact may have differing implications for each agency. Funding ratios for agencies that have issued a POB or other pension funding debt may be impacted differently, relative to other agencies.

Typical CalPERS Member UAL Repayment Shape (Non-Pension Bond Agency)  
For Visual Representation - Not Reflective of Any Specific Agency



For non-pension bond issuing agencies, their projected UAL balance as of 6/30/2024 may decrease by 5-7% from FY 2023-24 CalPERS returns, dependent on the composition of market assets and pension liabilities managed by

CalPERS. However, due to the ramp-up structure of amortization base payments, annual UAL payments could decrease by 2-8% through the common peak in UAL payments around 2029-2036 (orange line in the chart above). Overall, many agencies are still projected to see an increase of over 30% through the end of the decade, and for many, this is double the amount paid just a few years ago in 2020.

For recent POB issuers with enhanced funding ratios, their UAL balances will be subject to higher sensitivity to annual CalPERS returns. Their projected UAL balance as of 6/30/2024 may decrease by 6-12%+ depending on the proportion of UAL that was funded at the time of their bond issuance and when they issued. Issuers that funded a higher percentage of their UAL, up to 100%, will likely see a greater proportional reduction in their UAL as a function of the higher sensitivity to CalPERS investment performance.

## Pronounced “Trough/Peak” for POB Issuers

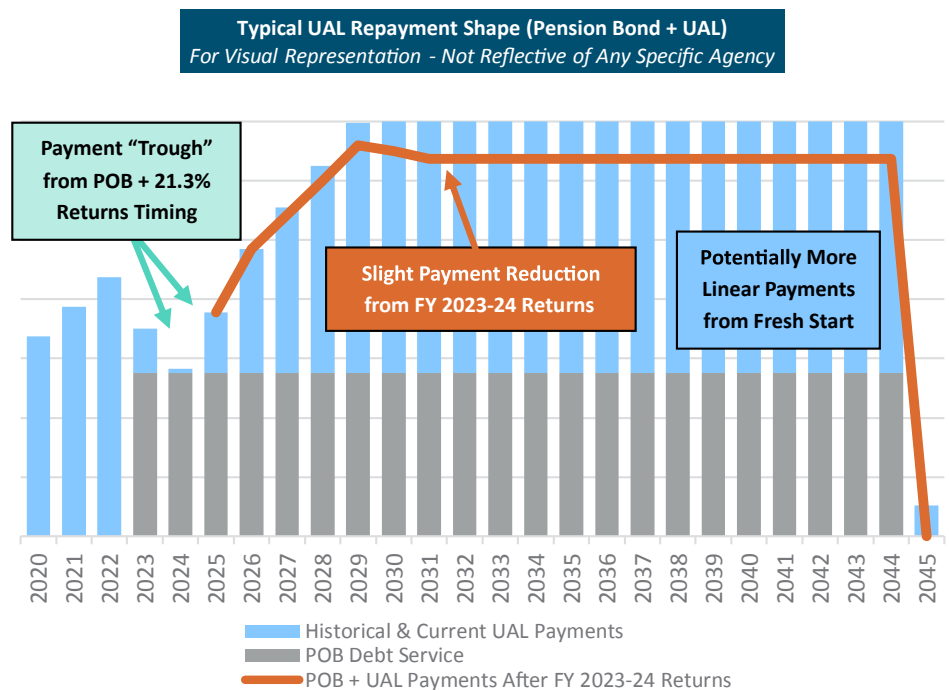
A key point to highlight for pension bond issuers is the fluctuating nature of their UAL payments that most will experience. Many agencies that issued pension bonds prior to June 30, 2021 became closer to fully funded (or overfunded) after the strong 21.3% returns year in FY 2020-21, meaning that UAL payments dropped precipitously or were eliminated all together by FY 2023-24 (the “trough”). However, the impact of the poor FY 2021-22 returns of -7.5% and below average returns of 6.1% in FY 2022-23 are now beginning to impact these agencies, leading to a more rapid rise in annual UAL payments reflective of the annual ramp up nature of the UAL amortization payments.

As shown in the chart above, it is highly recommended for these agencies to have a plan in place to soak up the “trough” savings and execute on a plan to leverage these savings to mitigate the impact of future UAL increases. For many agencies, a Fresh Start amortization through CalPERS can be a viable/prudent solution to level off this trough/peak and re-establish a new level UAL payment shape at a more sustainable level. For others, bolstering their 115 Trusts or making ADPs with these savings will provide significant ability to smooth out the future peak in payments.

The other unique impact facing many pension bond issuers who became overfunded is that some or all of their UAL may have already experienced a Fresh Start, hence a more level payment shape over 20 years vs. the declining repayment shape for non-pension bond agencies seen in years 10 through 20 in the above charts.

## Considerations for Managing Rising Pension Costs

CalPERS member agencies may benefit materially from strong investment performance by CalPERS in FY 2023-24. However, a UAL payment schedule that increases through the end of the decade, faced by most CalPERS agencies, will continue to be a budgetary challenge and should be planned for accordingly. Furthermore, given how rapidly the CalPERS pension challenge evolves year over year, it is highly recommended that agencies re-assess and re-calibrate (if needed) their pension funding strategies. Consistent stakeholder education (especially for newly elected officials), annual review of pension funding policies, and continued evaluation/refinement of cost management strategies are also encouraged.



For agencies with a 115 Trust, analyzing the optimal amount of assets required to “smooth” future payments is often helpful, and importantly, projecting out the potential years of deposits and withdrawals so that budgets and forecasting tools can be properly calibrated. For agencies preferring to manage extra payments through CalPERS, analyzing the most optimal amortization bases to pay down through Additional Discretionary Deposits (ADPs) and/or Fresh Start options is encouraged. For many agencies, implementing a hybrid approach of all three can be useful given the ever-evolving pension landscape and market conditions that dictate when each tool might be best used.



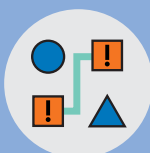
### **Stakeholder Education** **Consistent Updates**

Translating complex pension subject matter to key decisionmakers (City Council, Finance Committee, etc.)



### **Pension and Reserve Funding Policy Review** **Annual Assessment**

Annual assessment and fine tuning to ensure policies and strategy are adequate/optimal under current conditions



### **Section 115 Trust Optimization** **Scenario Modeling**

Scenario modeling to ensure optimal asset balances, projected timing of deposit/withdrawals and cost smoothing techniques under varying situations (i.e. CalPERS underperformance, assumptions changes, etc.)



### **Additional Discretionary Payments** **Tailored Analysis**

Analyze optimal UAL amortization base layers to pay down, evaluate timing of ADP and impacts of selected plan (safety vs. miscellaneous)



### **Fresh Start** **Efficient Cost Management**

Potential, especially for pension bond issuers with trough/peak payment shape, to level out costs in a more efficient manner with less payment volatility

For more information on potential approaches to manage pension liabilities, please feel free to contact the NHA Advisors team at [Pension@NHAadvisors.com](mailto:Pension@NHAadvisors.com) or Mike Meyer at [Mike@NHAadvisors.com](mailto:Mike@NHAadvisors.com).

## **Related Resources**

- [January 2023 NHAAlert — CalPERS Commentary: “The Mountain Peak Returns”](#)
- August 2023 CDIAAC Webinars: An Integrated Approach to Strategic Pension Liability Management
  - [Part One](#)
  - [Part Two](#)