City of Coral Gables City Commission Meeting
Agenda Item H-3
February 23, 2016
City Commission Chambers
405 Biltmore Way, Coral Gables, FL

City Commission
Mayor Jim Cason
Commissioner Pat Keon
Commissioner Vince Lago
Vice Mayor Frank Quesada
Commissioner Jeannett Slesnick

City Staff
City Manager, Cathy Swanson-Rivenbark
City Attorney, Craig E. Leen
City Clerk, Walter J. Foeman
Deputy City Clerk, Billy Urquia
Finance Director, Diana Gomez

Public Speaker(s)
Dr. Andy Gomez, Retirement Board
Peter Strong, Gabriel Roeder Smith and Company

Agenda Item H-3 [11:34:14 a.m.]

> Update regarding the City's current pension funding strategy and investment return assumption of the Coral Gables Retirement System.

Mayor Cason: I would like to move onto Item H-3, which was supposed to be time certain for 11 (a.m.). Diana Gomez, are you going to be speaking on this?- and then I will ask Andy Gomez from the Retirement Board would like to make some remarks as well.

Ms. Gomez: Good morning, this is an update regarding the City's pension funding strategy and a discussion on the investment return assumption. I have handed out a copy of the presentation, the PowerPoint presentation because it has changed slightly from the agenda package, mainly the order of the slides, as well as the letter from, we attached some information from our City Actuary Mike Tierney. So the direction of the City Commission, the City has implemented a pension funding strategy whereby we are making additional payments above the annual required contribution. This strategy would help us reduce the unfunded pension liability faster than scheduled as well as increase the funded ratio of the plan. Additionally, this strategy addresses the concerns of the rating agencies in order to help us maintain our triple A bond rating with Moody's and achieve a triple A with S&P. If you recall, S&P indicated that if Coral Gables can maintain strong budgetary performance and sustain reserves at or near current levels while continuing to address the pension liability we may consider a higher rating. And this is from the Ratings Direct Report issued on September 21, 2015 from Standard and Poor's. Through the adoption of Resolution No. 2015-271, the City Commission has committed to maintain pension funding levels of $26 million, plus an annual indexing which will use either CPI or at a minimum 1.25 percent, even though that the annual required contribution is expected to be less. The extra payments will go toward increasing the funded ratio by funding a portion of the outstanding liability. The rating agencies, outside consultants, and City staff embraced the Commission's desire to lower the unfunded pension liability. Our outside pension actuary, Mike Tierney of Actuarial Concepts, has indicated that strengthening the City's financial statements, especially in the pension area is an important goal and these policies should help the City accomplish their objectives. He also believes that the City is taking responsible steps to address its pension issues. To date, the City has made additional payments of $4 million; $1.9 million for Fiscal Year 2015, and $2.2 million for Fiscal Year 2016. Each year that we can make additional payments, we are making progress at illuminating the unfunded liability. However, for this strategy to start showing success, several more years of extra payments will be needed to be made. Slide 6 shows the City's funding strategy for the next five years. This slide uses the most recent actuarial valuation as a starting point and does not include any adverse experience from Fiscal Year 2015 or future years because that information is not yet available. This slide shows the potential amounts available as extra payments to use to fund the unfunded pension liability and to increase the funded ratio. The amounts listed here are for illustrative purposes and actual amounts available would be dependent on whether or not all the assumptions were met in the given year. But as you can see, each year approximately $3 million or more is expected to be made available. At the November 12, 2015 pension workshop, the Pension Actuary, GRS, recommended that the Board lower the Investment Return Assumption from 7.75% (where it is currently) to 7.0% over the next few years, and the Board requested that the City propose a plan to get there. The Pension Actuary suggested phasing it in over a course of three years by reducing the assumption by 25 basis points each year. This approach will have a significant impact on the annual required contribution. As you can see, the first 25 basis point reduction taking the plan to 7.50, will increase the annual contribution by approximately $907,000 and decrease the funded ratio by 1.2 percent. The second, taking the plan to 7.25 percent will increase the annual contribution by $1.84 million and decrease the funded ratio by 2.4 percent; and the third, taking the plan to 7.0 will increase the annual contribution by $2.8 million in that year and decrease the funded ratio by 3.6 percent. Changing the Investment Return Assumption to 7.0% would immediately worsen the funded ratio and increase the unfunded pension liability, which is the opposite of what the City Commission is trying to accomplish. It makes the Annual Required Contribution more expensive and leaves less available to go toward reducing the unfunded balance, in effect, derailing the City Commission's funding strategy. It should be noted that at the May 14, 2015 Pension Board meeting, the Pension Actuary recommended, and by a 7-6 vote, the Pension Board approved, early implementation of the FRS Mortality tables which will increase the City's required contribution for 10/1/16 for FY2017 by approximately $975,000, further reducing the amount available to go toward the unfunded pension liability. Implementation of the FRS mortality table is not required until 10/01/17 for Fiscal Year 2018 annual payment. This slide shows the effect of the pension actuary's recommendations. As you see, the amount available as additional payment is significantly reduced. For Fiscal Year 2017, the actual payment would only be $1.4 million, which is reduced from the City's anticipated extra payment of $1.9 million. In Fiscal 2018, only $1.3 million would be available as the extra payment, which is a reduction of the City's plan by $1.8 million; and in Fiscal Year 2019, only $785,000, would be available as an extra payment which is a reduction of the City's planned amount of $2.8 million. Of course all these numbers are illustrated because it's dependent on how the other assumptions do in any one year. However, it does compare, it does accurately compare the two funding strategies. City staff recommends following through on the current City Commission approved strategy of increasing the funded status of the plan by making additional payments, while taking into account the Pension Board's desire to reduce the Investment Return Assumption. Therefore, Staff recommends limiting the reduction to 7.5% and getting there over the next 5 years. This approach will increase the City's contribution by approximately $181,000 each year. Moving to a 7.5 percent rate over a longer period would still provide the ability to make significant additional payments toward increasing the funded ratio. And, it keeps us on a modified track toward our goal of reducing the unfunded pension liability quicker. The Pension Board Investment Consultant, The Bogdahn Group, has indicated that they are supportive of this approach as long as we are committed to reviewing it periodically on an on-going basis. Slide 14 shows the effects of the City's recommended approach to lowering the Investment Return Assumption. The amount available is reduced; however there is still a significant amount available as an additional payment. When comparing the first three years of this approach to the 3 year plan of the Pension Actuary, this approach will allow for approximately $4.5 million more to go toward funding the unfunded balance during that same time period. As the Finance Director (and a Pension Board member) I was asked to provide the Pension Board with a plan the City is willing to recommend regarding the Investment Return Assumption. This discussion item requests Commission direction regarding these pension issues, so that I can take that information back to the Pension Board. It should be noted that the Retirement Board is having its second Pension Workshop on March 16, 2016 regarding Funding Policy, and they have invited the City Commission to be a part of that workshop. So if you have any questions.

Mayor Cason: OK. A couple of things. One, I'm going to ask Dr. Gomez to speak as to the pension Retirement Board's – I assume your decision, you would prefer us to wait to adopt anything to hear what the Pension Board's side of the argument is.

Dr. Gomez: I would strongly recommend that you table it until we have the workshop, so you can join us. This is a bigger problem that I think we all face. When Mayor Cason appointed me to the Pension Board four years ago, I'm the one that called for these workshops, because we together, the Commission and the Retirement Board, we are going to have to come up with a way or how we are going to improve where we strengthen expenditures and liability. This is not news as you know to any other major city in the United States or State. This is a huge problem, but that's not an excuse for us not dealing with this issue. Sure there is politics involved and there is public policy….This is an issue of public policy, this is an issue of being responsible to the citizens of Coral Gables and I can tell you from a personal point of view speaking on behalf of the Retirement Board, I think we are beginning to open the dialogue between staff, the members of the Board and the Commission. We are not going to fix this overnight, but we are going to have to come up, what a call a funding…flexible in order to reduce our liability from where it is today at 50 percent. And as a longtime resident of Coral Gables, I'm not going to pass this on to my grandkids, I really don't want to, because down the line somebody else sitting in your seats are going to have to deal with a bigger problem.

Commissioner Lago: Dr. Gomez, thank you for being so concise.

Dr. Gomez: Andy. Craig is the only one here that hasn't called me Dr. Gomez.

[Laughter]

Commissioner Lago: I think that your statements are very true, and like you mentioned, this Commission has taken some very proactive measures.

Dr. Gomez: I commend you.

Commissioner Lago: We are spending over $4 million, which no other Commission has ever spent…

Dr. Gomez: I commend you and I appreciate the efforts that you have put forward.

Commissioner Lago: And something, I've said it before; I know the Commission agrees with me. It's embarrassing the situation that the City's in right now. We are spending close to $26 million in regards to our pension payment this year, and we don't really have to spend that money.

Dr. Gomez: Correct.

Commissioner Lago: We would have made the necessary steps in 2001; we were close to a million dollars underfunded; now we are two hundred and something million dollars underfunded, which is an embarrassment. It's an embarrassment to the City as-a-whole, which is an affluent community and it's embarrassing to the residents; excuse me, to the employees that we've gotten to the situation we are in right now. I just want to make it clear since a lot of residents listen and we have this conversation, not as sporadic as I would like, which goes to what Dr. Gomez has said before, where we should open this dialogue even more. I want people in this community, if you would just briefly explain, we are paying $26 million to the pension, what is that entail?- what's our yearly obligation versus our unfunded obligation? Could you just give us a quick synopsis so people sitting at home understand why we are paying $26 million out of a $170 million budget, that's key for people to understand.

Mayor Cason: Then we'll ask Peter Strong who also asked to speak to come up.

Ms. Gomez: So the $26 million is a number that was budgeted for back in Fiscal Year 2015 and in that year the actual pension requirement came in just under $24 or just over $24 million, give or take. And so, the $24 million payment, that's why we kept that number, even though the pension payment has been reduced each year. The annual required contribution was about, I want to say just about $24 million, maybe $23 high this past year and there's a couple components that goes in there. One being the normal cost and…

Commissioner Lago: The normal cost and I'm sorry to interrupt you, the normal cost taking into account we are 100 percent funded.

Ms. Gomez: Right. How much the additional – how much would be needed to continue to fund the plan because of additional activity for that year, so that's the normal cost. And then there is the amortization of the unfunded liability, which is in a sense some people like to compare it to a mortgage payment for this larger amount of the unfunded balance. So it is the annual amount needed to pay that off over the next 25 years.

Commissioner Lago: Which is a state mandate, correct?

Ms. Gomez: What is a state mandate?- to pay it off?

Commissioner Lago: Yes, to pay off your unfunded or a certain timeframe.

Ms. Gomez: So I don't think the state mandates any specific, they say I think it can't be more than 30 years. We recently changed from 30 year amortization to 25 year amortization, I think it's been about a year we at the Pension Board made that change, so we are amortizing the unfunded over a lesser period, and so the total normal cost is about $6 million and then the unfunded…

Mayor Cason: Interest payment basically.

Ms. Gomez: Exactly. Right, it's about $21.8 million and then there are other factors, obviously we get contributions from the employees, which bring down the City's required contribution to that $23 million level.

Commissioner Lago: The reason why I ask you to do that and I'll be brief, because I know that we have some other individuals that want to speak, is because this is crucial that people understand some of the cards, and I'm not making excuses for anybody. I never make excuses, but you need to understand that it's crucial to understand the cards that were dealt…

Dr. Gomez: Absolutely.

Commissioner Lago:…to this Commission as-a-whole. We never stepped in here and said, we are not going to make payments, we are going to avoid. We are in the situation we are in today because, and let's be honest about it, there's been poor management in the past, and this is not an issue like Dr. Gomez said, we are deal with this issue for the next 20 years, and we need to set this a priority and this Commission for the first time in the history in 90 years has made the decision to speed up the payments with a $4 million infusion to our unfunded, and I think that needs to, I want to continue to do that as much as possible, because this is the safety net of the employees here in the City of Coral Gables; and again, it's just a black eye on the City in my opinion as-a-whole.

Vice Mayor Quesada: I was going to ask Dr. Gomez a quick question. At the May meeting…

Dr. Gomez: The meeting coming up?

Vice Mayor Quesada: No. May of 2015.

Dr. Gomez: Oh, May 2015.

Vice Mayor Quesada: I haven't read the minutes of the meeting, and I would ask if you guys would forward that to me so I'd have it. I want to understand why the Board decided to move up the date of paying the FRS mortality tables? If we don't have to pay it till next year why did you guys pass 7 to 6 vote to pay for it sooner rather than later?

Mr. Strong: Peter Strong, Gabriel Roeder Smith and Company. Our firm is the actuary for the plan for the Retirement Board.

Vice Mayor Quesada: Let me just lay the facts out there, I apologize for cutting you off, just to frame it a little bit better because I framed it poorly. So from what I understand is that pursuant to a Senate Bill 242, all states are required to start paying a yearly mortality table payment, and ours is $975,000, and we are going to have to pay that from now until kingdom come; and the implementation of the first payment has to be made is in October of 2017, do I have the facts correct?

Mr. Strong: The state requires that you implement it by Fiscal Year 17.

Vice Mayor Quesada: OK.

City Manager Swanson-Rivenbark: That’s October 2016 for Fiscal Year 2017.

Ms. Gomez: So it’s not required until 10/01/17, which is Fiscal Year 18.

Vice Mayor Quesada: Got it, my apologies. So those are the facts. So then my common sense logic is, if everyone’s going to have to pay it eventually, we don’t have to pay it this year, why would we pay it this year? Is it being added to us, does that mean our payments are going to be higher?- or does that mean we are going to have some other penalties later on?

Mr. Strong: The reason that I recommended the Board adopt it early was because we did a comprehensive experience study evaluating all of the plans assumptions that we completed in December 2014; and after we had several meetings discussing the recommended assumptions at that point, based on experience and based on current standards from mortality tables that had recently been published, we recommended going to an even more conservative table than what FRS requires. Based on discussions back and forth, we decided to table that, because currently being discussed in the legislature on the floor was a requirement that all plans use FRS mortality, and so, why go all the way to this recommended table you are using if we have to use FRS mortality. So after that actually did pass and get signed by Governor Scott, we said, alright well, we tabled the decision the new mortality table was of 10/1/14, we just updated from 2012 to 2015, there was a small adjustment in the projection. So since we tabled a full mortality change at that point, we said alright, maybe we should go ahead and implement something more solid as of 10/1/15, rather than wait till the 10/1/16 requirement date.

Vice Mayor Quesada: OK. So you just answered my questions, and that’s good, that’s helpful rationale. Thank you for that. But I still have a few gaps to try to understand this. The $975,000 payment, if we make that payment how does it impact our bottom line payment and how does it impact our risk? I want answers to each one of those questions.

Mr. Strong: Well you are using the assumptions that I believe are more appropriate and it all boils down to using…

Vice Mayor Quesada: Assumptions that are more appropriate.

Mr. Strong: For long term funding of the plan.

Vice Mayor Quesada: Define appropriate.

Mr. Strong: Appropriate in that its representative of what the long term experience is expected to be.

Vice Mayor Quesada: OK. So therefore, my understanding is, correct me if I'm wrong, it's a risk proposition that we are dealing with here. So by paying this additional $975,000 we somehow reduce our risk exposure?

Mr. Strong: Sure.

Vice Mayor Quesada: Sure. Can you quantify that?

Mr. Strong: Well you reduce the likelihood that you are going to incur future experience losses by using current assumptions now.

Vice Mayor Quesada: Can you quantify that?

Mr. Strong: Well risk is a tough nut to quantify because you are…

Vice Mayor Quesada: Well you know what your potential exposure is. I know if I'm buying insurance I know this is a bad analogy, but I know if I'm buying insurance for my house from a hurricane, I know my property value is worth "X" that's the number that I'm ensuring, that's my worst case exposure. Is it possible to give me a range of what the potential exposure is, because the way I see this $975,000 is, without you giving me some sort of quantifiable or identifiable either savings in the payment or risk what it is we are really protecting against by paying that $975,000, it makes me think, again from a very low level analysis that I'm applying here, you hear my rationale, is we are just throwing away $975,000, unless you can quantify it for me. I understand the rationale, it's very logical, but give me the numbers behind it.

Mr. Strong: It's basically a case of pay now or pay later.

Vice Mayor Quesada: But how is it pay later?

Mr. Strong: Because the liability is going to be what it is. The ultimate value…

Vice Mayor Quesada: Is going to be what it is.

Mr. Strong: Alright. Let me explain. The total liability of the plan…

Vice Mayor Quesada: I'm sorry; it's just a little vague for me.

Mr. Strong; The total liability of the plan is equal to what all, the present value of all future payments to retirees will be, that is what we are trying to calculate. The liability is the present value of all future payments to every retiree including people that just joined the plan yesterday. So we are projecting that out for 75-80 years into the future, and by using a correct mortality table we are more accurately predicting how long those people are going to live. And so the ultimate cost of the plan is really unknown because it depends on how long those people really do live and receive payments. But the mortality table that we believe doesn't reflect that life expectancy that we are under valuing the true liability of the plan.

Mayor Cason: In other words, it's more realistic when people are going to die. We were using one that was ten years out of date and with modern health changes and so on, people were living longer and therefore your cost to the plan would go up the longer people live.

Dr. Gomez: Commissioner, let me tell you and your questions are very good and…Let me tell you where I have a problem. The problem is again that we are putting a finger to stop the bleeding on a twelve inch cut, it keeps bleeding. That is only one of the issues. There are many issues that go into this entire funding process, and again, I commend this Commission for the leadership that you have shown and your willingness. What I'm trying to bring to your attention and to my colleagues on the Board is, you have to look at the issues now, all the issues, not one issue, all the issues, put all these issues on the table and come up with a better solution than what we have now. With all due respect, if I may. We can blame previous administrations, we can go back 30 years, I'm worried about now and in the future.

Mayor Cason: Well, I think the interesting thing is that I don't know if when you did this a year early you knew we were going to put $4 million more into it, because for me you can do it either way. You can do it by changing all the assumptions down to 7 percent and updating anything else or you can put in extra money. It's basically the same result, it seems to me.

Ms. Gomez: The City's position is that by using those extra dollars to fund the unfunded and increase the funded ratio, the City gets the benefit of actually making that payment, right. So our financial statements look better. We show that we are making progress toward a goal. Mortality tables, investment assumptions those are actuarial guesses, right. We don't know what mortality is going to be, we don't know that – I don't know that there is a lot of losses associated with mortality tables recently. So what the City's trying to do or the City's recommended strategy has been to send additional funding in order to increase the funded position of the plan, or decrease the amount of unfunded liability. So I tend to agree somewhat that the amount is the amount is the amount. The liability is what it is and so you can either pay more to get the benefit of it, and have your ratios look better and the funded status look better, or you can lower your assumptions or change your assumptions, and the money is still going into the same…

Mayor Cason: Or a mixture of both is what you are proposing.

Ms. Gomez: Or a mixture of both is what we are trying to do. But with the emphasis or the focus being on the City's strategy of improving the position of the plan…

Mayor Cason: And then you are paying down specific identified liabilities that came from the past…

Ms. Gomez: Correct – losses from the past.

Mayor Cason: As I understand, this can get us down to a 17 year from 25.

Ms. Gomez: It depends on the …

Commissioner Lago: And Dr. Gomez made a good point. Listen let's not talk about the past, but you have to bring up the past, because many people have come to me and told me, how did we get into the position we are in today, they don't understand. Why are we paying $26 million out of our budget in regards to our pension contribution? So it's very important when you stand up here to explain and if you have to explain it a thousand times or you explain it a thousand and one times to make sure people understand why we are paying so much money. Let me ask you another question. Why is the City all of a sudden giving $4 million extra?- they don't understand. Why are we giving more money than we really have to? Let me explain to you why we are doing that. But getting to my final question in regards to this issue is, are any other cities using the same, again we are one of the worst funded pensions in the state. I think we are second or third, correct?

Mayor Cason: On a per capita basis.

Commissioner Lago: Yes. I think we are second or third, so let's be clear about that. Are any other cities using the same procedures of infusing $4 million, $5 million, $6 million above what is required as per their statements?

Ms. Gomez: I'm not aware of any.

Mr. Strong: I only know of one plan in the recent past that has made…

Commissioner Lago: Above and beyond.

Mr. Strong:…extra payments above what were required and that was the City of Clearwater in the recent past has made extra payments beyond what was the required amount.

Commissioner Lago: And that's important.

Mayor Cason: And the reason we are doing it is because we believe – first of all it's our biggest expense, it's not going to go away. We owe it to people that have worked for the City and is working for the City. We have to pay; we are not going to default like some other cities have done. So we have to face it. I think the way we are doing it is unique is that we are going above and beyond, we are trying to get the amortization period down from originally 30 years to 25 just so the plan we have right now can get us to 17 in an environment of tremendous risk, apart from the assumption changes, which we can discuss, and I'd like to discuss them in detail after we hear from the Retirement Board and then we can make up our mind. But the other risk is the market risk and the smoothing period when you don't meet your targets, which are the first of October, is it every year, or the 30th?

Ms. Gomez: The 30th.

Mayor Cason: Whatever the picture of the market is right then if you haven't reached your .75, then that deficit is smoothed out over five years and your repayment goes up. So guess what you think the stock market is going to be like at the end of September given the way things are.

Dr. Gomez: We've been very lucky in the last five years we've averaged 8 percent.

Mayor Cason: Right. So what we are doing.

Dr. Gomez: I don't know if that's going to hold.

Mayor Cason: Put it in the context of the great uncertainty, everything was going great up to now, I have a feeling it isn't going to be. So it makes it even more impressive that we are willing to put in $4 million over and above what we have to.

Commissioner Lago: And this Commission, even though we talk about the past, this Commission is not going to see the fruit of those $4 million payments. The people who are going to enjoy it are two individuals, are the employees, number one; number two, the Commission that comes in 17 years when they don't have to make a $22-$23 million payment above what their current contribution rate is. So that to me – you are going to have that money available to repair sidewalks, to streets, to rebuild historic buildings, but those types of sacrifices need to be made today for the future to put the City back in financial…

Dr. Gomez: All the issues will have to be addressed.

Commissioner Lago: But I agree with you 100 percent, let's put everything on the table.

Dr. Gomez: Put everything on the table.

Mayor Cason: And I hope the Retirement Board will take as a starting point in March the City's proposal because it seems to me that we could said we gave at the office, and we are not giving anymore on the assumptions. We are giving at the office and we've also said we are willing to start reducing the interest, the assumed market rate from 7.75 to 7.5 over five years, which will make it more likely that we'd meet it and not have to go into the smoothing in future years.

Dr. Gomez: I hope you can join us on March 16th. It will be a two hour; the first hour we are going to do business, the second hour we want to have a discussion with you guys, the Board and the Commission, the UM Alumni Center.

Commissioner Lago: Great idea.

City Manager Swanson-Rivenbark: The Board was very kind to reschedule so that more of the Commission could attend and I'd also remind you, you also asked us to look at ways of reducing the risk in the long run, so you encouraged us to develop a 401 employee option, both at the director level and also the non-represented level, and we are extending that also to the Teamsters and so far for new employees coming, their election it's been very well received. So in the long run you further reduce your risk.

Mayor Cason: So, I'm going to be looking forward to that discussion. I think it's one of the most important discussions we are going to have, and then we can see what we can formalize our funding plan going forward.

Dr. Gomez: And the fun thing about me leading this, I'm not running for office.

[Laughter]

Mayor Cason: Thank you.

Commissioner Keon: You may be drafted (laughter).

Mayor Cason: Thank you. Thank you very much.

Commissioner Lago: Thank you guys.

[End: 12:04:48 p.m.]