405 Biltmore Way
Coral Gables, FL 33134
www.coralgables.com

Legislation Details (With Text)

File #:	16-4823	**Version:** 1		**Name:**	
Type:	Agenda Item			**Status:**	Noted and Filed
File created:	2/18/2016			**In control:**	City Commission
On agenda:	2/23/2016			**Final action:**	2/23/2016
Enactment date:				**Enactment #:**	

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

Sponsors:

Indexes:

Code sections:

Attachments: 1. CC.02.23.2016 - Investment Rate Assumption 2-23-16 Final, 2. Funding Strategy Power Point Updated 2-23-16.pdf, 3. Verbatim Transcript - CCMtg February 23 2016 - Agenda Item H-3 - Update regarding the City's current pension funding strategy

Date	Ver.	Action By	Action	Result
2/23/2016	1	City Commission	Discussed and Filed	

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

At the direction of the Commission, the City's current funding strategy is to make extra payments above required amounts to reduce the unfunded pension liability faster than scheduled and thus increase the funded ratio of the plan. Showing more rapid progress toward increasing the funded ratio is very important to the City to show it is addressing the concerns of rating agencies in order to maintain (Moodys) and achieve (S&P) its AAA bond rating. Additionally, reducing the unfunded liability is an important part of the City's Strategic Plan which is currently being developed.

The Commission committed to additional funding towards the unfunded liability through the adoption of Resolution No. 2015-271, whereby the City will maintain funding levels at $26 million (plus indexing) even though the required contribution is expected to be less. The extra payments would go towards increasing the funded ratio by funding a portion of the outstanding liability. The rating agencies, outside consultants, and City staff embrace the Commission's desire to lower the unfunded pension liability in this manner. If the City can reduce the requirement by paying off some of the Unfunded Actuarial Accrued Liability (UAAL) components, the gap between the requirement and the City's payments can be sustained. Additionally, the City's commitment to additional pension funding would generate a significant reduction in the unfunded liability repayment period.

The Pension Board is considering lowering the Investment Return Assumption from 7.75% to 7.0% over the next few years and requested that the City propose a plan to get there. As you will see below, moving to a 7.0% Investment Return Assumption as proposed by the Pension Actuary would jeopardize the City's current strategy for addressing the unfunded liability and funding status.

To date, the City has made additional payments of over $4 million ($1.9 million in FY 2015 and $2.2 million in FY 2016) to start to implement the Commission directed strategy. This additional payment has allowed the

City to begin the elimination of 5 outstanding UAAL amortization bases by applying the payment to the outstanding Unfunded Loss bases first. This means that the 10/1/16 otherwise required contribution would be reduced by approximately $860,000. Each year that the City makes additional payments beyond the annual required contribution, the City would continue to apply the payment to the Unfunded Loss bases, thereby making progress at eliminating the unfunded liability, and increasing the funded ratio. In order for the strategy to start showing success, several more years of extra payments need to be made. The effects of the City's funding strategy are illustrated below.

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At the November 12, 2015 Workshop, the Pension Board Actuary, GRS, recommended that the Board lower the Investment Return Assumption from 7.75% to 7.0%. They suggested that the Board could "phase in" a lower return assumption over the course of a few years, and provided the example of a 25 basis point reduction each year over the next three years. It should be noted that the Pension Actuary stated that only a few of their clients have actually implemented a 7.0% Investment Return Assumption. Similar sized or larger South Florida clients to the City of Coral Gables are at 7.5% to 8.0%.

The Pension Actuary has provided the following cost impact on Actuarial Valuation Results of reducing from a 7.75% Assumption to:

7.50% Assumption - Approximate $907,000 increase in the City's contribution requirement and 1.2% decrease in Funded Ratio
7.25% Assumption - Approximate $1,839,000 increase in the City's contribution requirement and 2.4% decrease in Funded Ratio
7.00% Assumption - Approximate $2,797,000 increase in City's contribution requirement and 3.6% decrease in Funded Ratio

Changing the investment return assumption to 7.0%, would, upon implementation, immediately worsen the funded ratio and increase the unfunded liability, the opposite of what the City Commission is trying to accomplish (increasing the funded ratio and reducing the unfunded liability). This would make the annual required contribution more expensive, leaving less available to go towards reducing the unfunded balance - this action would in effect derail the City Commission's funding strategy.

It should also 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 contribution requirement on 10/1/16 by approximately $975,000 (includes cost sharing), thus further reducing the amount going toward the unfunded liability. Implementation of the FRS mortality tables (Senate Bill 242) is not required until the 10/1/17 annual required contribution.

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As you can see in the above example, moving to a 7.0% Investment Return Assumption would significantly reduce the City's ability to make additional payments towards the unfunded liability and would lower the funding status of the plan.

Moreover, the Pension Board Investment Consultant, The Bogdahn Group, has indicated that maintaining the Investment Return Assumption at 7.75% does not negatively affect the plan and is considered to be acceptable as long as the City understands that the volatility of the required contribution is slightly higher than if a lower rate was used.

City staff recommends following through on the current Commission approved strategy to increase the funded status of the plan by making additional payments to the unfunded liability, while also taking into account the Pension Board's desire to reduce the Investment Return Assumption. Staff recommends limiting the reduction of the investment return to 7.50% over the next five years. Staff's recommendations are illustrated as follows:

- **FYE17 - FYE21 -** 5 basis points each year. Approximate $181,400 increase in City's contribution requirement and a .24% decrease in funded ratio per year.

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As you can see, in the above example, moving to a 7.50% Investment Return Assumption over a five year period would still provide the ability to make significant additional payments towards increasing the funded ratio and keeps the City on a **modified** track towards its goal of more rapidly reducing the unfunded liability. Furthermore, The Bogdahn Group has indicated that they are supportive of a decision to move the Investment Return Assumption down slowly each year and stopping at 7.50%, while committing to reviewing it periodically on an on-going basis.

City staff is therefore seeking City Commission direction regarding the aforementioned pension funding issues. It should be noted that the Retirement Board has scheduled a Pension Workshop to be held on March 16, 2016 regarding funding policy and has invited the Commission to participate in it.