

TOWN OF PALM BEACH

Information for Town Council Meeting on: June 11, 2019

To: Mayor and Town Council

From: Dan Stanton, Chairman
William P. Hanes, Administrator

Re: Annual Report-Town of Palm Beach Retirement System

Date: June 11, 2019

STAFF RECOMMENDATION

Staff recommends that the Town Council hear and accept the Town of Palm Beach Retirement System Board of Trustees Annual Report.

GENERAL INFORMATION

Chairman Dan Stanton will present the 2018 fiscal year annual report on behalf of the Town of Palm Beach Retirement System Board of Trustees. This report includes backup information by the actuary, GRS, and investment consultant, AndCo Consulting.

Actuarial Considerations

Actuary Pete Strong, GRS, presents the annual report that discusses the impact of the retirement plan liabilities (attached). He discusses the annual process involved with calculating liabilities, comparing the actual fiscal year experiences against the actuarial assumptions. The result is published annually, and determines the unfunded actuarial accrued liability (UAAL), the funding ratio, and the actuarial determined employer contribution (ADEC). Mr. Strong then discusses the several changes made to assumptions and the associated costs. He notes that Town Council adopted a policy to allocate an additional \$5.42 to help reduce the UAAL. He discusses the most recent change made to reduce the amortization period of the UAAL from 25 years to 15/20 year periods. He discusses that the majority of the system's liability is attributed to the investment valuation experience derived from a trailing 5-year smoothing of gains and losses. He notes that the 2018 valuation indicates a \$3.5 million unrecognized loss carried into the 2019 annual actuarial valuation. Finally, Mr. Strong comments on the expected impact on the Town Council consideration to increase public employee salaries, and to enhance public safety retirement benefits. He discusses there are risks associated with a future investment performance average lower than the actuarial investment benchmark.

Investment Considerations

Investment Consultant, Dave West, AndCo, presents an investment review based on the quarter ending March 31, 2019. He discusses the plan's market performance, much influenced by volatility swings, and with particular emphasis on the most recent strong second quarter market rebound from the difficult first quarter market performance that ended on December 31, 2018. He notes that the second quarter returns

were primarily with attribution from international and domestic equity market performance, and notes that fixed income returns were also positive. He discusses positive second quarter performance from each of the asset classes. He notes that real estate continues to provide a steady source of investment return.

Mr. West comments that investment allocations are fully funded and performing well, and that strategic restructuring has resulted in improved results. He points out that the newly placed active managers have exceeded benchmark indices. Finally, he notes the alternative investments have performed well.

Mr. West reports the March 31, 2019 return at 8.37%, the month of April at 2.79%, and FYTD and 2.29%. The current value of the trust is \$227,743,008.

May 28, 2019

William P. Hanes, Esq.
Administrator
Town of Palm Beach Retirement System
701 South Olive Avenue, Suite 1809
West Palm Beach, FL. 33401

Re: Town of Palm Beach Retirement System Annual Report – 9/30/2018 Actuarial Summary

Dear Bill:

The funded status of the plan is determined after the fiscal year end, and after the system's actuary, Gabriel, Roeder & Smith (GRS), collects the system's updated census and financial information and analyzes the demographic and economic experiences during the fiscal year. The experience is compared to the actuarial assumptions (investment return, retirements/DROPs, terminations, mortality, wage increases, etc.). The funded status and required Town contributions are determined after completing a full analysis and valuation of the updated actuarial liabilities. The system's current funded status is based on the most recent September 30, 2018 actuarial valuation, and it will change again after the end of fiscal year 2019 after the actuary completes the analysis for the 2019 fiscal year valuation.

Town Council adopted a policy beginning in October 2017 to appropriate \$5.42 million each year in extra payments toward the unfunded actuarial accrued liability (UAAL). This represents a payment above what the actuary annually determines as the Town's required contribution (the actuarial determined employer contributions, or ADEC). The ADEC that is developed in the annual valuation is payable in the second fiscal year following the valuation date. Thus, the ADEC payable during fiscal year 2020 is identified in the 9/30/2018 actuarial valuation. In the year that begins October 1, 2019 (FY 2020), the ADEC rate is 57.41% of covered payroll, or \$10,910,670 if payment is distributed evenly throughout the fiscal year. However, the actuary determined that if the Town chooses to pay the full amount at the beginning of the 2020 fiscal year (i.e., on or near October 1, 2019), as it did for fiscal year 2019, the ADEC rate will be reduced to 55.47% of covered payroll, or \$10,542,818. The early lump-sum payment represents a savings of \$367,852 in interest cost.

The funded ratio of the retirement system as of 9/30/2018 is 69.2%, which is an increase from 68.9% as of 9/30/2017. The UAAL as of 9/30/2018 is \$100,469,731, versus \$98,995,141 as of 9/30/2017.

The actuary made comments in the 2018 valuation report regarding assumption and method changes made by action of the board that have increased the UAAL and future contributions. The assumed investment return used in the 2018 valuation (for the year ending 9/30/2019) is 7.2%, reduced from 7.3% last year. The assumed rate of return is scheduled to be reduced by .10% per year until reaching 7.0% in the 9/30/2020 actuarial valuation, and the Board is considering further reductions below 7.0%

(please note that the increases in the ADEC and UAAL attributable to each 0.10% reduction are approximately \$325,000 and \$3.6 to \$3.7 million, respectively). The payroll growth assumption (used in the UAAL amortization) was also reduced from 3.0% to 2.75% as of 9/30/2018. These changes in assumptions increased the Town contributions for fiscal year 2019 by approximately \$400,000.

The board also chose to reduce the amortization periods for paying down the UAAL from 25 years to a range of 15 to 20 years (15 years for plan changes and experience gains/losses and 20 years for assumption and method changes). The Town's required contribution increased by approximately \$1.1 million (for fiscal year 2020) as a result of this change.

The retirement system experience during fiscal year 2018 resulted in a net actuarial loss. This is mostly attributable to the continued smoothing (phased-in recognition) of the 2015 investment loss (the return on the market value of assets during FY 2015 was -4.2%) into the actuarial value of assets. The actuarial value of assets employs an asset smoothing method in which actual market value investment experience is recognized over a 5-year period at 20% per year. The total experience loss for the year was about \$4.29 million, \$3.42 million of which was associated with the return on the actuarial value of assets, which was 5.7% (versus the assumed return of 7.3%). There were also demographic experience losses (of about \$868,000) resulting from higher salary increases than expected, more retirements than expected, and fewer retiree deaths than expected.

The final phase-in of the 2015 market value loss will occur during fiscal year 2019, so there will be one more year of experience losses (as of 9/30/2019) associated with the 2015 investment experience. This is expected to cause about \$3.5 million in actuarial experience losses in fiscal year 2019, assuming all other assumptions are realized.

The funded ratio was over 100% in the year 2000, and it is currently 69.2%. This is primarily the result of lower compound average investment returns than were assumed over the last 18 years. The compound average investment return on the market value of assets during this period was 4.82%. Recent changes in assumptions have also impacted the funded ratio, but to a much lesser extent than cumulative investment experience. Several positive steps have been taken to address the funded status, including strengthening the actuarial assumptions, reducing the UAAL amortization periods to 15-20 years, and the commitment from the Town to make additional contributions of \$5.42 million per year (starting in 2017) towards the UAAL until the Plan becomes 100% funded.

In a "what if" scenario in which all assumptions are realized (and the additional \$5.42 million Town contributions continue), the retirement system is projected to become fully funded by 9/30/2030. If the additional \$5.42 million Town contributions toward the UAAL are not made, or if they do continue to be deposited but actual average investment earnings are 5% per year (instead of the 7% long-term assumption), the projected full funding date for the retirement system would be pushed back 8 to 10 years (to a range of 9/30/2038 or 9/30/2040).

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Based on recent actual experience, the actuary recommends increasing the salary increase assumption from the current assumption of 3.5% per year to a range of 5.5% to 6.0%. In addition, the Town is considering adjusting current salaries and pay bands (as a result of the recently completed compensation study) and also enhancing benefits for Firefighters and Police Officers (changing the normal retirement date to attainment of age 55 with 10 years of service or age 52 with 25 years of service and changing the employee contribution rate to a fixed rate of 8.5%). The estimated first year impact of these changes is an increase in the required Town contribution of approximately \$1.0 to \$1.1 million and an increase in the UAAL of \$2.0 to \$2.5 million. Over the next 10 years, the cumulative increase in required Town contributions as a result of these changes would be about \$15 to \$16 million. Since Town contributions would be higher to cover the increased costs associated with these changes, as long as all assumptions are realized and the extra Town contributions of \$5.42 million per year continue to be made, the retirement system's projected full funding date would still be 9/30/2030.

If there are any questions, please let us know.

Respectfully submitted,



Peter N. Strong, FSA, EA, MAAA
Senior Consultant and Actuary

The above communication shall not be construed to provide tax advice, legal advice or investment advice.



To: Town of Palm Beach Retirement System Board of Trustees

From: Dave West, CFA

Date: May 28, 2019

Re: Retirement System Investment Review for the Quarter Ended March

The market environment was quite favorable for the Retirement System's investments during the March Quarter. Disciplined Investors who looked beyond the cacophony of recession-oriented media speak were rewarded handsomely with a very productive investment environment across asset classes. The Federal Reserve placed a hold on further monetary policy activity, effectively time stamping more play time in risky assets.

After a difficult end to 2018, markets rebounded strongly during the 1st quarter of 2019 with higher risk assets posting the greatest returns. Broad international and domestic equity markets had double - digit gains during the period as investors overlooked signs of weakening global growth in favor of increased accommodation in global monetary policy and progress in global trade negotiations. While muted relative to equities, fixed income returns were also positive during the quarter. Within equities, domestic stocks outperformed international markets. US markets pushed higher as the US Federal Reserve (Fed) shifted their stance on monetary policy toward a more accommodative posture, the US and China appeared to move closer to a resolution of their ongoing trade dispute, and the partial government shutdown that began in December came to an end. The large cap S&P 500 Index gained 13.6% for the period, bringing the FYTD return to (-1.72%). The Russell Mid Cap Growth Index returned 16.29% (0.49% FYTD), while the Mid Cap Value Index returned 14.08% (-4.24% FYTD).

Similar to US markets, international equity investors were encouraged by a general easing in central bank monetary policy, including new stimulus measures in Europe and China, as well as the de-escalation of trade tensions with the US. Despite the continued softening in global macroeconomic data and the lack of certainty around Brexit, international equity index returns finished the quarter in positive territory with the MSCI ACWI ex US Index returning 10.3% (-2.16% FYTD).

Real Estate continued to provide a steady source of investment return. Operating incomes remain steady, while the rate of property appreciation continues to moderate. Fund queues were generally neutralized as many investors sought to rebalance portfolios taking gains in Real Estate investments.

Attribution

Note: All investment results are preliminary. For all periods reported, private investments which constitute approximately 10% of total assets are carried forward at the previous period value. Preliminary results suggest that the collective impact of these strategies should be positively accretive to overall results.

- The Retirement System Investment Program was most impacted, once again, by the volatile swings in publicly traded equity investments. The investment program continues to emphasize domestic equity as the primary driver of returns needed to achieve the assumed actuarial rate of return.
- All areas of investments were accretive to the System's ROR objective.

- All new investments are now fully funded and performing well, contributing to the total return of the Retirement System.
- While a tertiary consideration, the strategic restructuring of the Retirement System investments has resulted in improved results. This positive momentum has pushed the Retirement System's relative ranking up to median from bottom 90th percentile in the greater Public Fund Retirement System Universe for more recent time periods.
- The new, active managers engaged by the System exceeded benchmark indices as most managers were generally positioned for a prolonged period of modest economic prosperity.
- The material allocation to Real Estate investments continues to provide both stability and an annualized – total - return contribution in excess of the actuarial rate of return assumption. The JP Morgan Strategic Property Fund reported below trend results for the quarter due to write-downs in the portfolio's retail property holdings. AndCo has completed a review with the JPM management team. The Retirement System investment program continues to strategically overweight Real Estate investments with multiple, dedicated manager strategies in place.
- Alternative Investments performed well during the period, recovering well from the declines experienced during the December Quarter. The investment program continues to strategically underweight this area of investment.

Preliminary Investment Returns (85% of investments reporting for periods ended April)

Quarter Ended March:	8.37% net
Month of April:	2.79% net
April FYTD:	2.29% net
April Market Value:	\$227,743,088 (State Street reported value 4/30/2019)