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FROM	
NAME & TITLE	Henry J. Raymond, Director
AGENCY NAME & ADDRESS	Department of Finance Room 454, City Hall (396-4940)
SUBJECT	**City Council Bill #15-0579 – Fire and Police Employees' Retirement System – Regular Interest**

CITY of BALTIMORE

MEMO

CITY OF BALTIMORE 1797

DATE: November 17, 2015

TO

The Honorable President and Members
of the City Council
Room 400, City Hall

RECEIVED
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BALTIMORE CITY COUNCIL
PRESIDENT'S OFFICE

Attention: Ms. Natawna Austin

Introduction

This bill modifies the Fire and Police Employees' Retirement System (FPERS) Plan by modifying the definition of "regular interest", effective immediately.

Fiscal Impact

Every three years, an experience study is conducted by the FPERS Plan actuary to review the assumptions used in the actuarial valuations. The most recent experience study was conducted in 2015. One of the key assumptions in the Plan is the market return rate. This assumption defines "regular interest" in the Plan.

The results of the experience study demonstrated that the existing market return assumption that describes "regular interest" is not reflecting the actual experience of the Plan. The current rate of return assumption is 7.75% for valuation purposes. The actual returns over the period from 1998 – 2014 averaged 5.20% per year.

The Plan's actuary recommended to the FPERS Board that the City lower the rate of return to 7.50%. The Board supported this recommendation, as reflected in this proposed City Council Bill. The fiscal impact of this change is estimated to cost $10.3 million in increased City contribution in FY 2017. The change is not a one-time expense and will result in a higher City contribution into the future. Plan losses add an additional $6 million to the $10.3 million in increased costs for FY 2017. The total cost increase for FY 2017 was estimated at $16.3 million.

The Plan's actuary recommended an extension of the amortization period. The Board reviewed this and it will help the City afford the more conservative Plan assumptions. The Board adopted a change in the amortization period from 20 years to 25 years. Extending the amortization period to 25 years lowered the City's cost increase from FY2017 from $16.3 million to $8.8 million.

Analysis

Lowering the rate of return results in a high liability for the City as cash flows are discounted less. The outcome is an increased City contribution requirement to the FPERS Plan. While the FPERS Plan is already costly, if FPERS does not reduce the rate of return assumption from

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7.75% to 7.50%, investment losses are likely to continue, which will be reflected in increased contributions by the City each year.

An analysis by the Plan's investment advisor, Summit, showed that the City has only a 38% chance of having at least a 7.75% investment return over a 10-year period. Recognizing a lower assumption rate in the Plan makes increased costs which are likely to occur, even if the City doesn't adopt a lower assumption rate, more predictable. In order to afford the 0.25% decrease in the rate of return assumption and other more conservative assumption changes, the Plan's actuary recommended increasing the amortization period from 20 years to 25 years.

Finally, amending the definition of "regular interest" to a lower rate of return will demonstrate to bond rating agencies and lenders that the City is taking responsibility for its liabilities. Since 2009, many plans, nationally, have reduced their investment return assumption and the number of plans assuming a 7.50% rate of return has increased significantly.

Recommendation

The Finance Department recognizes the decision made by the FPERS Board to lower the Plan's rate of return as a fiscally responsible recommendation to the Council. The Finance Department is supportive of changing the definition of regular interest to 7.50% as a step toward adjusting the Plan's assumptions to align more closely with actual experience. The findings in the experience study emphasize the need for the City to take a hard look at the current benefits in the FPERS Plan and make changes that create a more fiscally sustainable plan for newly hired employees.

cc: Angela Gibson