# New Orleans Firefighter Pension Fund
# Baseline Analysis
# Presentation to Working Group

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**Working Group Meeting**
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# Initial Observations

- From our perspective, it is not an understatement to say that the Fund's current financial situation threatens the City's budget situation and the Fund's ability to deliver the expected benefits to active and retired firefighters and their families
  - Regardless of legal judgments, a real question is whether the City will be able to actually pay for them
- This issue has consumed untold hours of time and effort over many years and everyone involved has a mutual interest in resolving it
- This problem does not get better on its own with time

# Outline

- Why Should We Care About this Issue?
- Overview of Pension Fund
  - Fund Structure
  - Old Fund
  - New Fund
  - DROP and PLOP accounts
- How Did We Get Here?
- Where Do We Go From Here?

# Why Should We Care About This Issue?

# Why Should We Care?

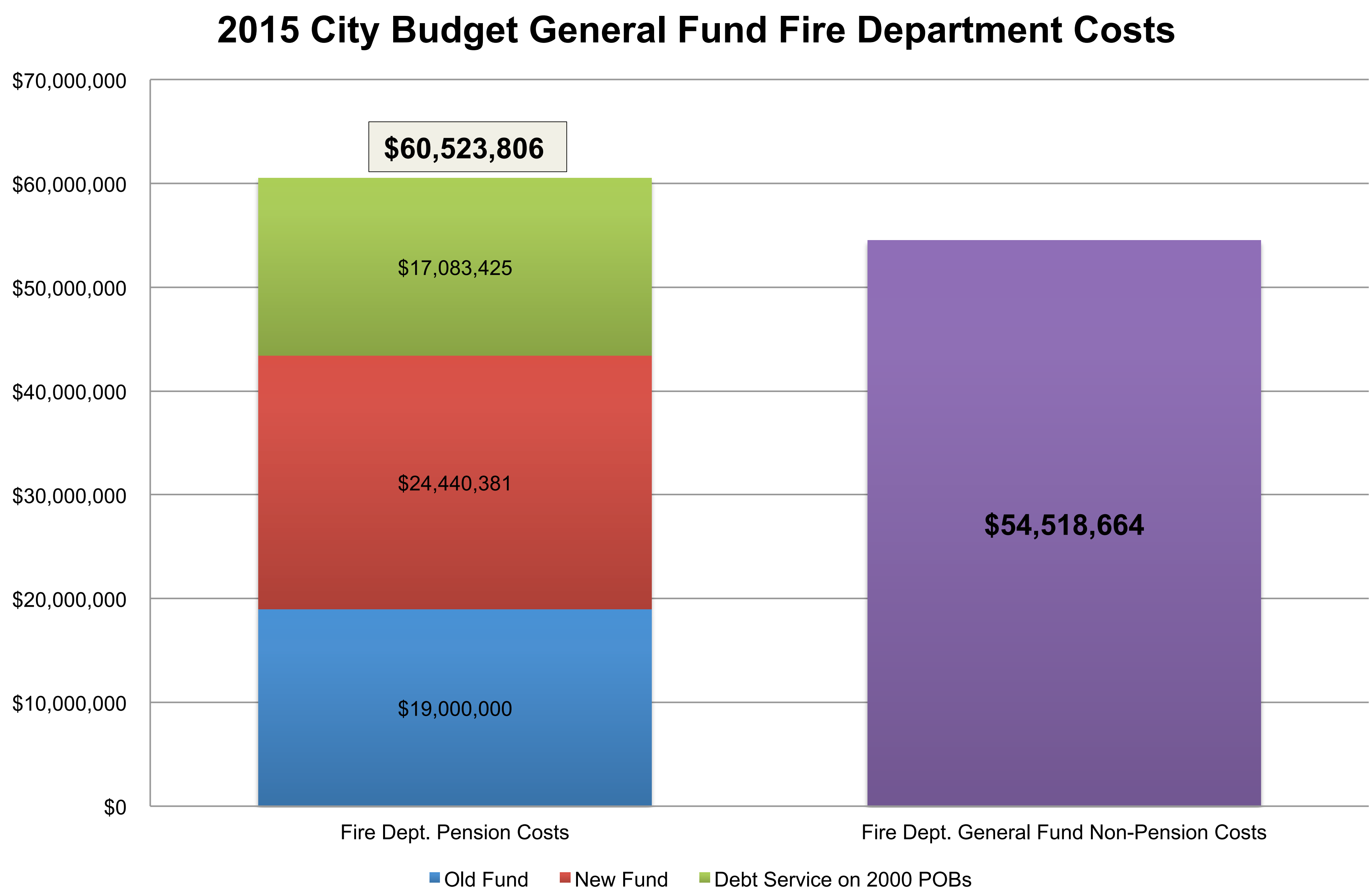
- New Orleans firefighters do not participate in Social Security, so they are dependent upon these benefits in retirement
  - Even if firefighters receive Social Security from working another job, there is a significant offset
- Increased retiree benefit costs limit the City's ability to provide compensation increases to active employees and to hire new employees
  - One additional dollar spent for retiree benefits is one less dollar that can be spent on wage increases for active employees or to hire new employees
- Ratings agencies are concerned about pension liabilities and have moved in recent years to give them greater weight when assigning bond ratings. The lower the City's bond rating, the more it costs to borrow money
- This issue does not get better on its own over time

# 2015 Budgeted City Pension Costs

- 2015 City budget proposal for Firefighter pensions totals $60,523,806:
  - Old Fund:  $19,000,000
  - New Fund:  $24,440,381
  - Pension Bond Debt Service:  $17,083,425
- By comparison, the remainder of the 2015 Fire Department General Fund budget is $54,518,664
- City Budgeted General Fund contribution for Municipal Workers pension is $19,410,424 and Police is $19,738,992

Source:  City Department of Finance

# Fire Pension Costs vs. Non-Pension General Fund Fire Costs (2015 Budget)



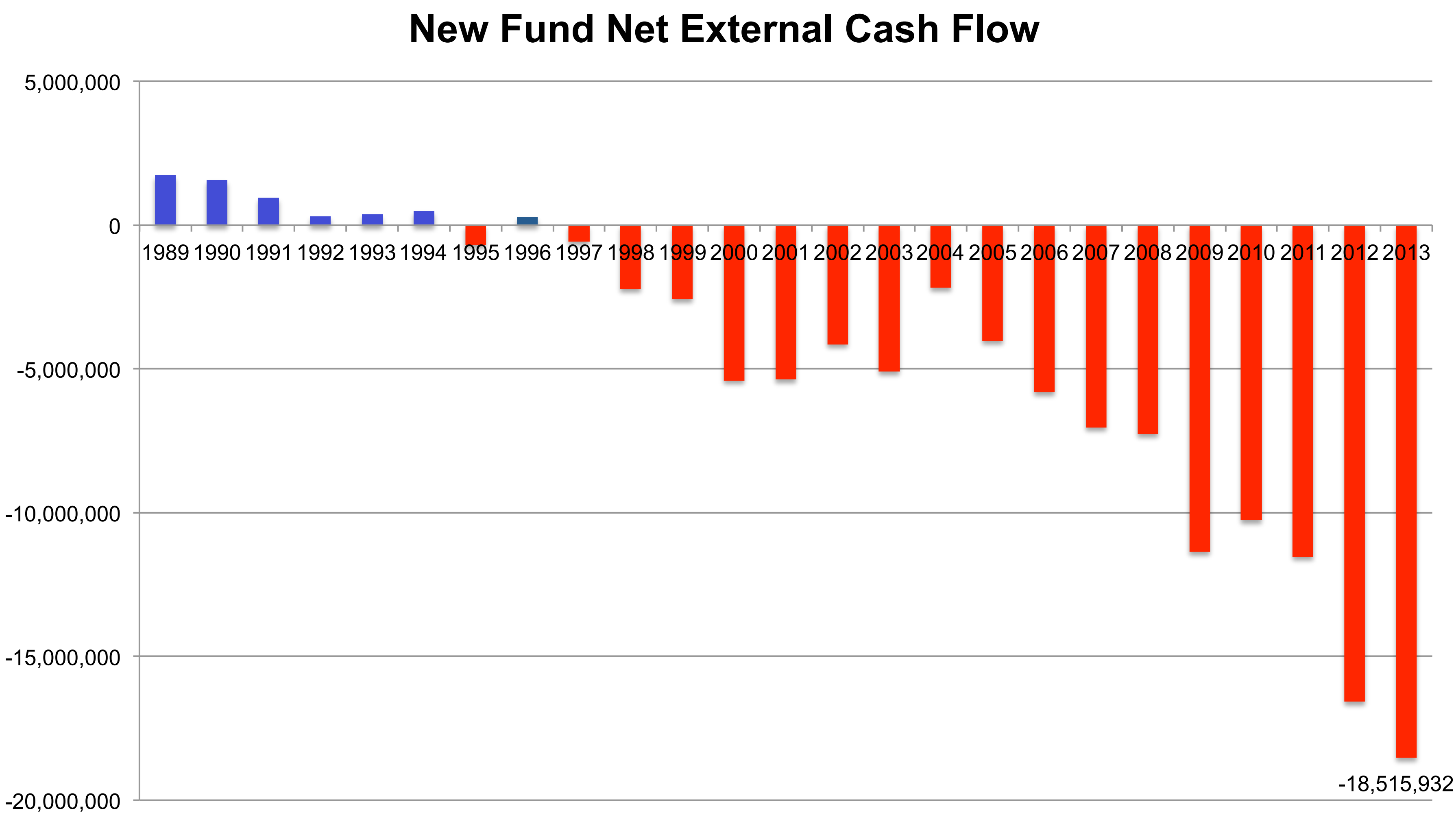

Source: City Department of Finance

# Overview of the Fund's Status

- Although many pension funds across the country are underfunded, the New Orleans Firefighter Pension Fund's situation is particularly critical:
  - The Fund has more retirees than active firefighters
  - Old Fund was set up on a pay as you go basis and the City is continuing to pay debt service stemming from the 2000 pension bond deal despite those funds being exhausted
  - Because the Fund grants COLAs on an ad hoc basis, its valuations do not assume any going forward. Therefore, if the Fund grants any future COLAs, its financial position will further deteriorate
  - Investments have underperformed and the New Fund still has a significant amount of its investments in non-liquid assets
  - The Fund has substantial liabilities for DROP and PLOP payments
  - The City has not been contributing the actuarially required contributions to the New Fund since 2010
  - More money is going out of the Fund than is coming in

# New Fund External Cash Flow

Since 1997, more money has been flowing out of the New Fund than coming in with the rate significantly accelerating over the last two years




Source: New Fund Actuarial Valuation Report as of January 1, 2014. Page 25.

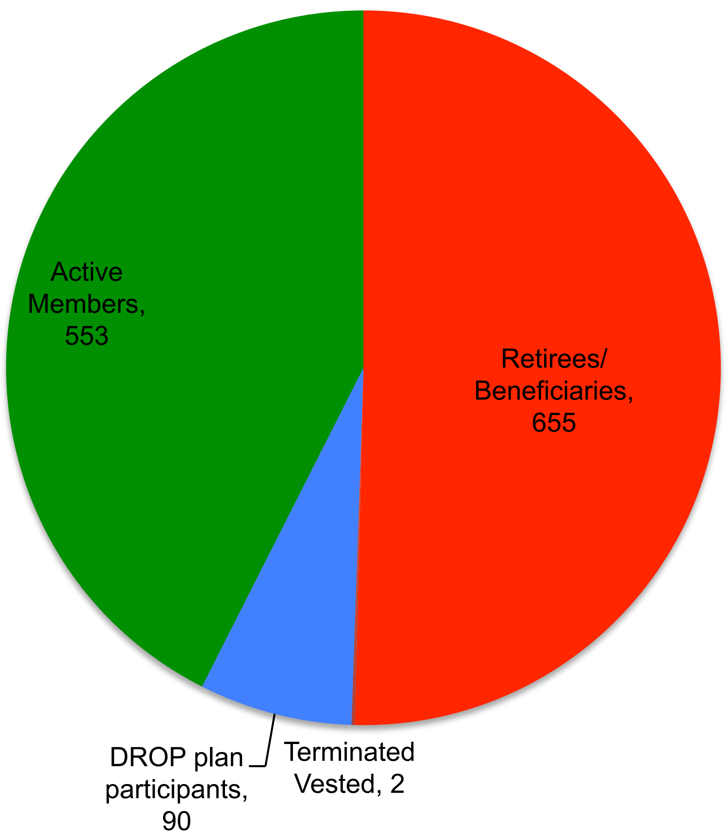
# New Orleans Firefighter Pension Fund Structure

# Overview of the Old and New Pension Funds

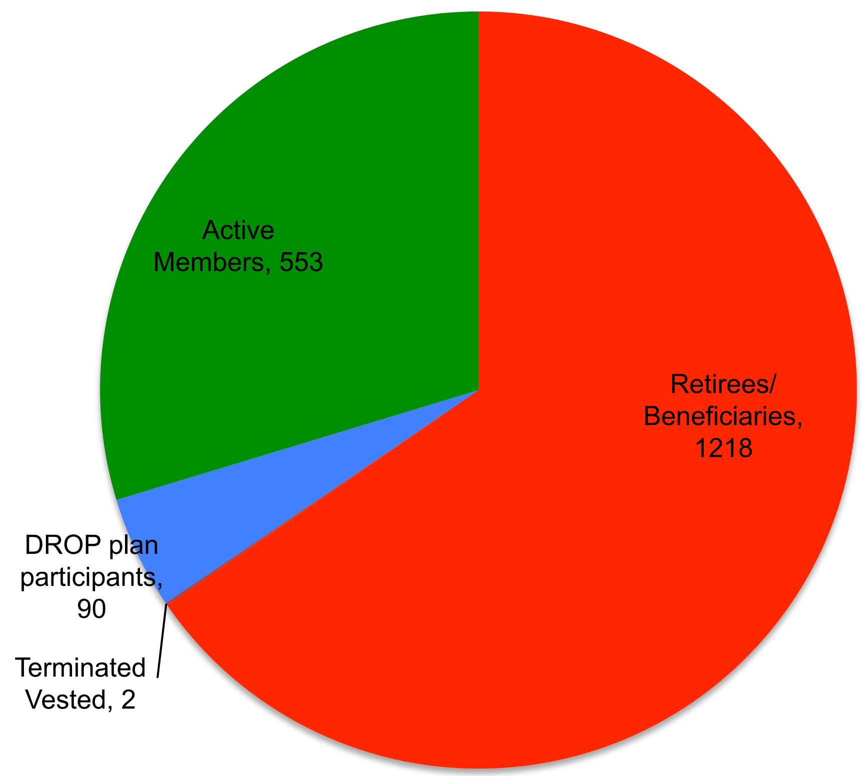
- The Firefighter Pension Fund is comprised of two different pension funds
  - "Old" Fund – limited to firefighters employed before January 1, 1968.
  - "New" Fund – covers firefighters employed after December 31, 1967 or Old Fund members who have elected coverage in the New Fund
- Pension Board consists of 7 members
  - 4 Firefighters: 2 active and 2 retired
  - 3 Mayoral appointments (Finance Director, Superintendent of Fire and a resident)
- Benefit levels and employee contributions are determined by State Legislature with City required to make annual required contributions
- Fund's actuary calculates annual contributions and Board determines cost of living adjustments (COLAs) if any

# Fund Population as of December 31, 2013

## New Fund Population as of December 31, 2013




## Old and New Fund Population as of December 31, 2013




Source: 2013 Audit, p. 12

# Current Description of the Benefit – New Fund

- New Orleans Firefighters' Pension and Relief Fund (NOFPRF) for firefighters employed after December 31, 1967 or Old Fund members who have elected coverage in the New Fund
  - Benefit levels and employee contributions are determined by the State Legislature
  - NOFPRF sets actuarially recommended annual contributions and determines cost of living adjustments (COLAs)
- NOPFRF is funded through a combination of City and member contributions. While plan benefit levels are controlled by state statute, City taxpayers and firefighters are responsible for its funding
- All other fire fighters in the State of Louisiana except New Orleans and Baton Rouge are members of the State plan
- Plan had provided 5% annual COLAs for those over age 65 and 3% annual COLAs for those under age 65 for at least the prior 15 years until 2012. The COLAs are not compounded. Last COLA provided was in 2011

| | New Fund |
|---|---|
| **Vesting Period** | 12 years |
| **Normal Retirement Age** | 50 |
| **Employee Contribution** | Members < 20 YOS:<br>8% effective 1/1/14 and 10% effective 1/1/15<br>6% through 12/31/13<br><br>Members >= 20 YOS:<br>3.33% effective 1/1/14, 6.66% effective 1/1/15, and 10% effective 1/1/16<br>0% through 12/31/13 |
| **Participate in Social Security** | No |
| **Basis for Final Average Compensation (FAC)** | 5 highest consecutive years |
| **Benefit Formula** | 2.5% x FAC x Years of Service (YOS)<br><br>For members retiring after age 50 with over 12 YOS: 3 1/3 % for each YOS over 12 and age 50<br><br>For members with 30 or more YOS:<br>3 1/3% x FAC x YOS*<br><br>*Note: This is the Fund's interpretation of the statute. Some read the statute to provide a 3 1/3% multiplier only for YOS after 12 YOS. Statute reads "If the member continues service beyond thirty years, the retirement benefit for each year or portion of a year beyond twelve years of service shall be an amount equal to 3 1/3% of the average annual compensation for each year or portion of a year." |
| **Post-Retirement COLAs** | Ad hoc |

# Current Description of the Benefit – Old Fund

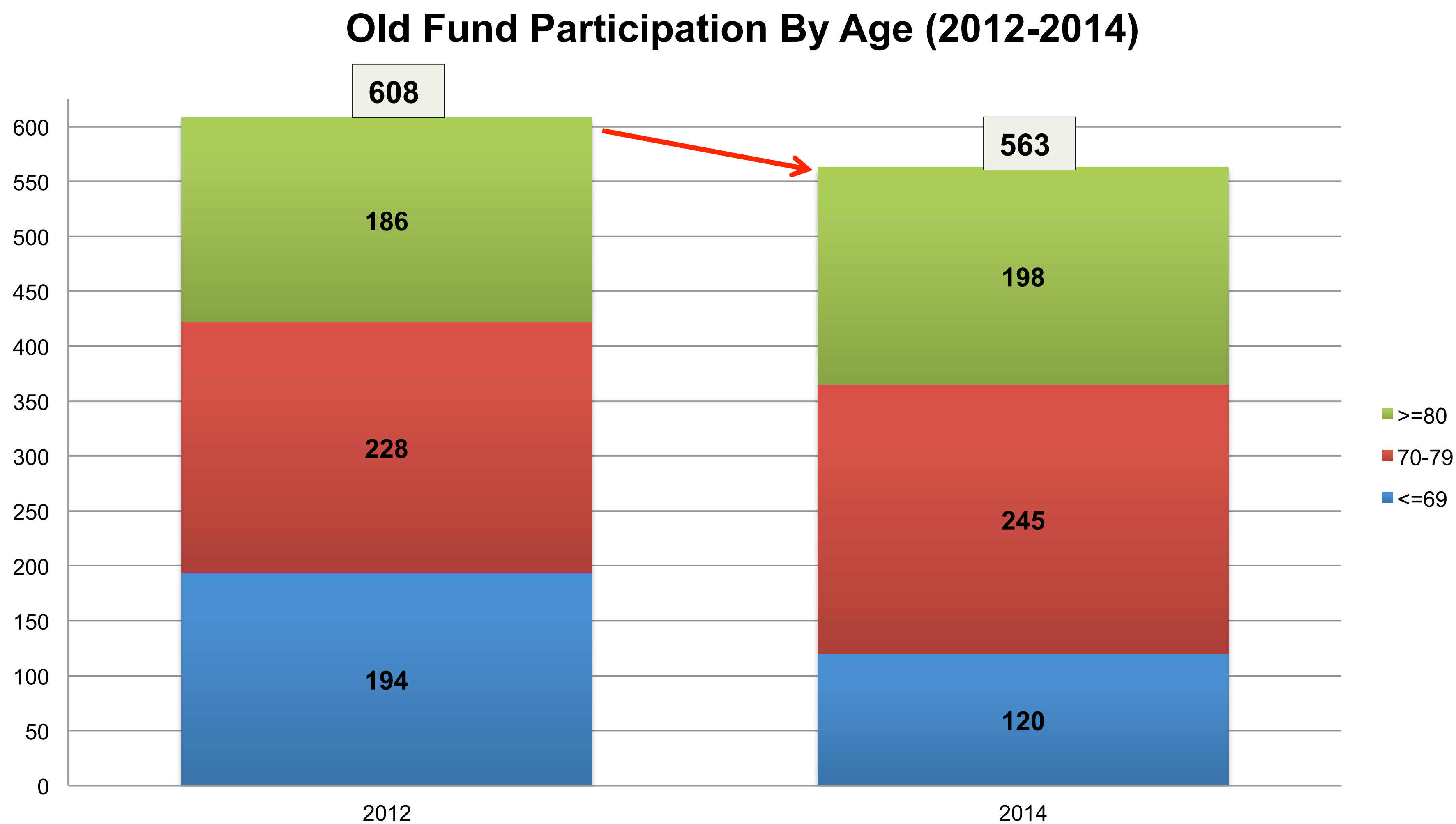
- New Orleans Firefighters' Pension and Relief Fund (NOFPRF) for firefighters who worked prior to December 31, 1967
  - Benefit levels and employee contributions are determined by the State Legislature
  - NOFPRF determines cost of living adjustments (COLAs)
- Fund was established as a pay-as-you-go fund meaning that funds were not set aside to prefund benefits. Instead, the City paid for pension benefits and Fund expenses as they were incurred
- No active firefighters remaining in Old Fund
- Plan had provided 5% annual COLAs for those over age 65 and 3% annual COLAs for those under age 65 for at least the prior 15 years until 2012. The COLAs are not compounded. Last COLA provided was in 2011

| | Old Fund |
|---|---|
| **Vesting Period** | 12 years |
| **Normal Retirement Age** | Age 55 and 12 YOS or 20 YOS |
| **Employee Contribution** | n/a (all retired)<br>Had been 6% |
| **Participate in Social Security** | No |
| **Basis for Final Average Compensation (FAC)** | Best year of service preceding date of retirement |
| **Benefit Formula** | 50% of FAC<br><br>For members with more than 20 YOS, additional 2.5% per year to be increased by 0.5% for each year of service over 25 upon attaining age 50 |
| **Post-Retirement COLAs** | Ad hoc |

# Old Fund

# Old Fund Participation is Declining Rapidly

From January 1, 2012, to January 1, 2014, Old Fund participation declined by 45 individuals or 7.4% from 608 to 563

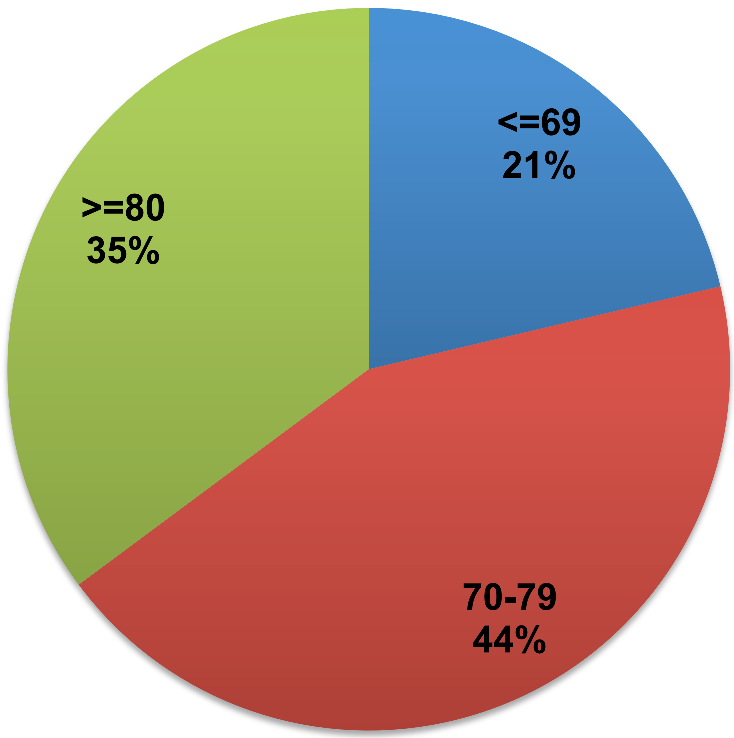



Source: Old Fund Actuarial Valuation Report as of January 1, 2014. Pages 13-15.

# Old Fund Participation

As of January 1, 2014, approximately 35% of the Old Fund was age 80 or older

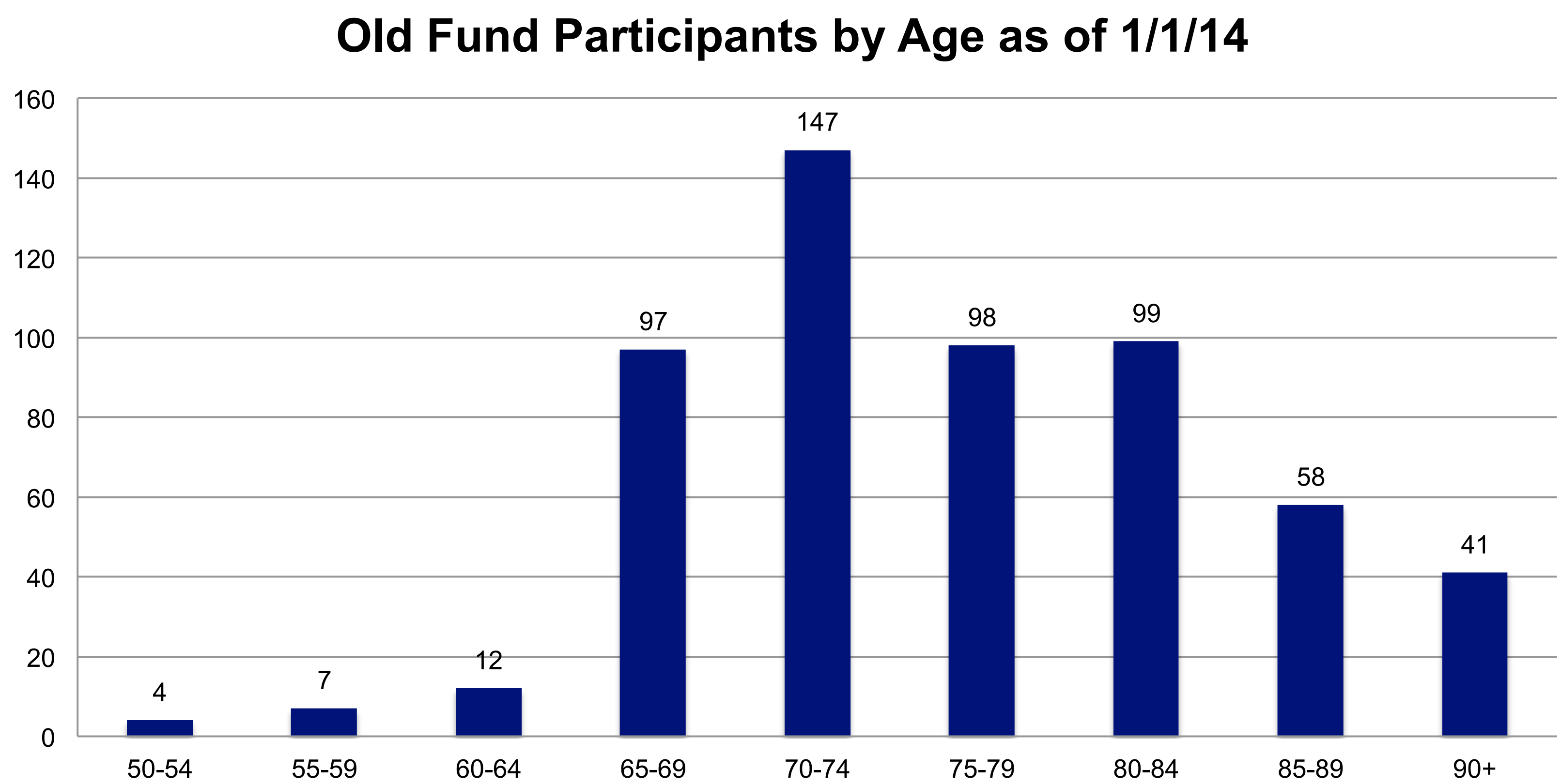
**Old Fund Participation by Age as of 1/1/14**




Source: Old Fund Actuarial Valuation Report as of January 1, 2014. Pages 13-15.

# Old Fund – Participants by Age

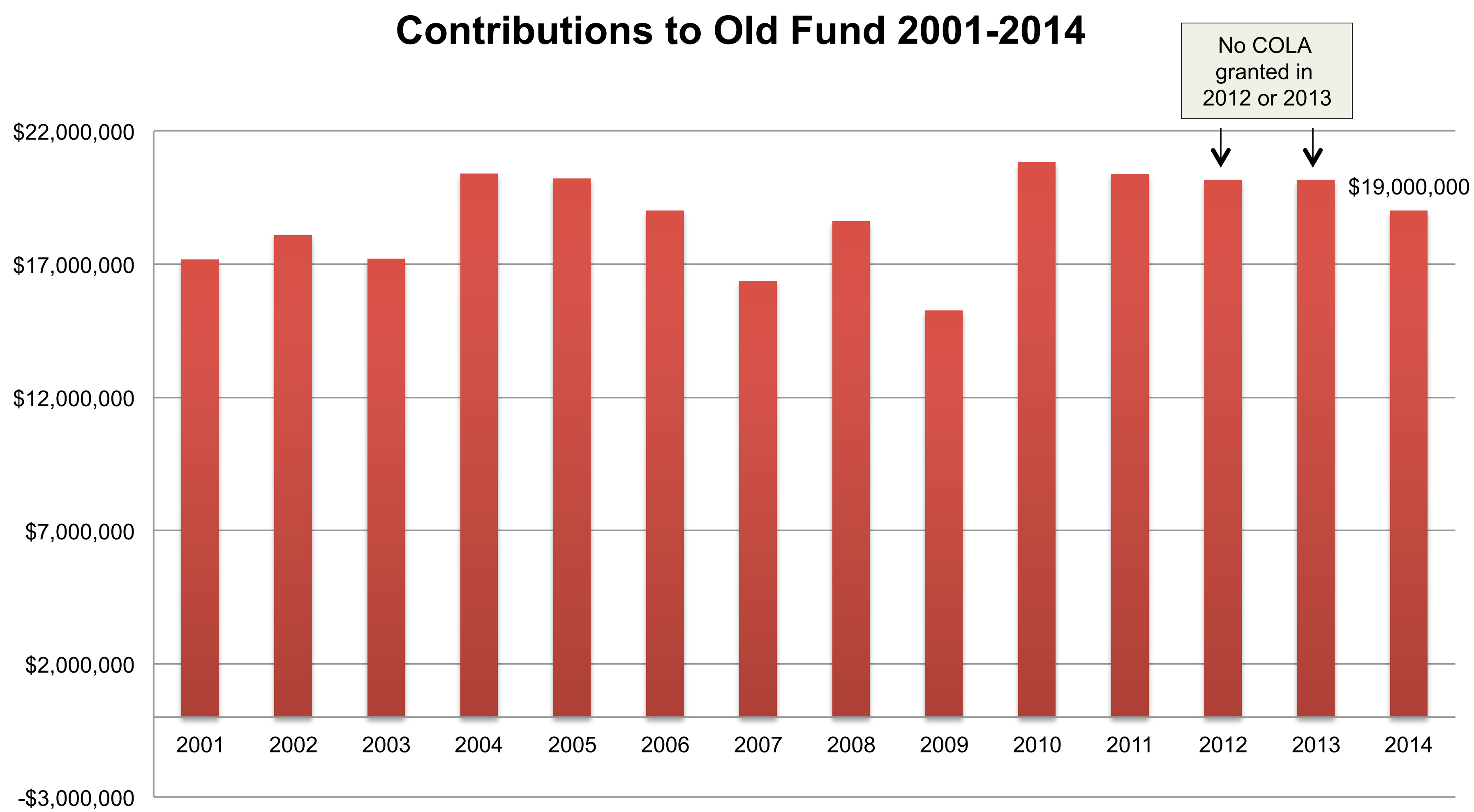
Assuming no COLAs, the City contributions to the Old Fund will decrease over time. As of January 1, 2014, approximately 35% of the participants in the Old Fund (ordinary, disability and survivors/beneficiaries) were age 80 or older




Source: Old Fund Actuarial Valuation Report as of January 1, 2014. Pages 13-15.
Note that even if a retiree passes away, he or she may have a survivor or beneficiary.

# Historical City Contributions to Old Fund

Because COLAs were granted, City contributions to Old Fund did not decline over time despite plan being closed




Source: City Department of Finance using Pension Fund audits

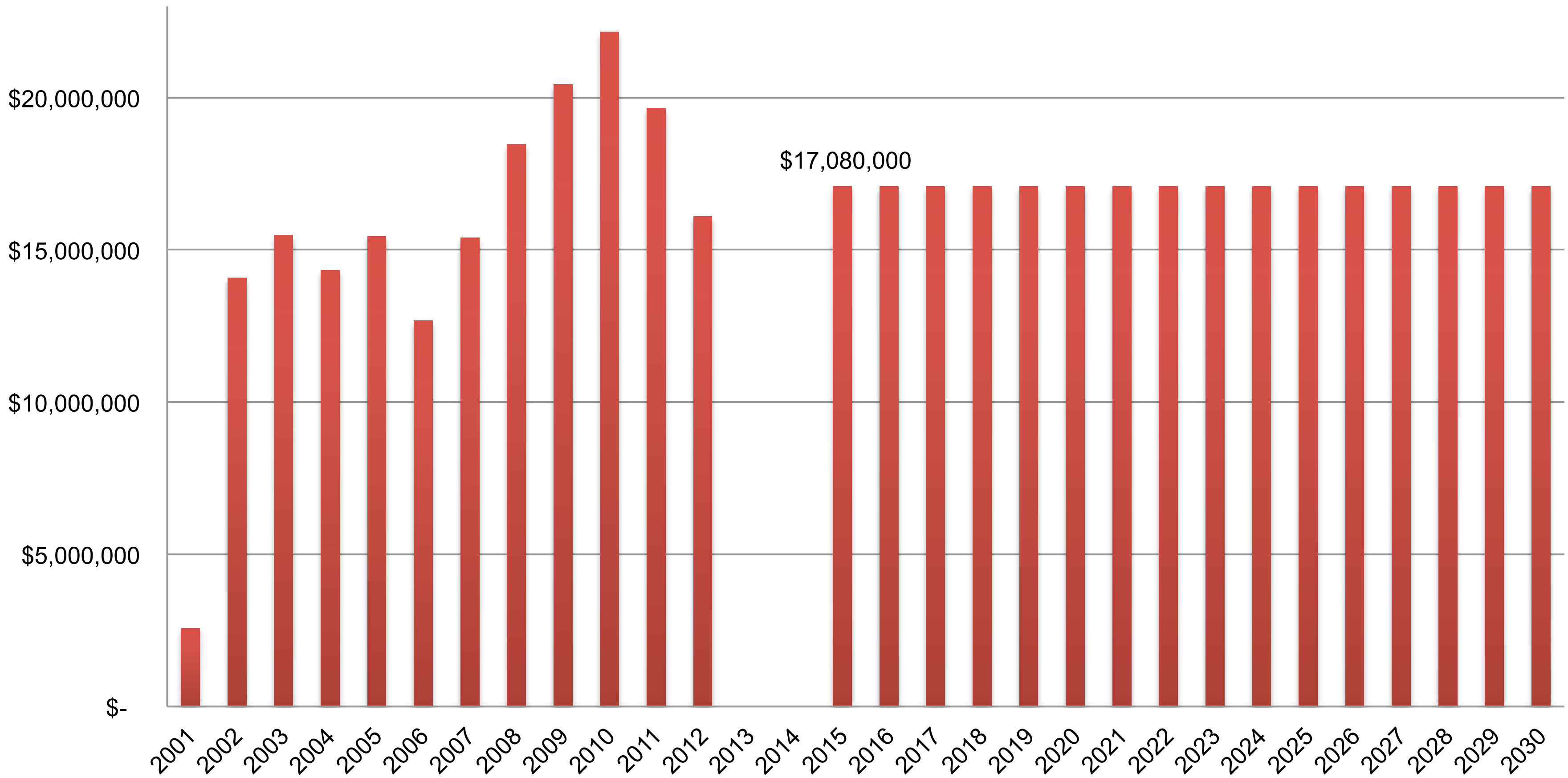
# 2000 Pension Obligation Bond Deal

- In 2000, near the height of the stock market tech bubble, the City floated approximately $171m in bonds to set aside for the Old Fund's liabilities. Proceeds were deposited in a separate trust controlled by the Board of City trusts and were used for the Old Fund "pay as you go costs" for firefighter pensions from 2001-2009. These funds have been exhausted
  - Interest rate on the bonds was 6.95%
  - City entered into a swap agreement with a company that then entered into a reciprocal swap with an AMBAC entity (unbeknownst to the City) that allowed this entity to declare a market disruption and change the bond to bank bond status
- In early 2008, the entity declared a market disruption resulting in the interest rate increasing to approximately 12.95% (matter is in litigation) until the bank voluntarily lowered the rate to 6%
- City was able to refinance the bonds in 2012 at a rate of 4.18%
- The City had to pay a significant swap termination fee (rolled into the refinance) and will continue to pay debt service of $17,080,000 annually through 2030 on top of the approximately $19,000,000 "pay as you go amount" for the Old Fund

# 2000 Pension Obligation Bond Deal

Despite exhausting the proceeds from the 2000 pension obligation bond, the City will continue to pay annual debt service of $17,080,000 through 2030 on these bonds

**2000 Pension Bond Debt Service from City General Fund**




Source: City Department of Finance

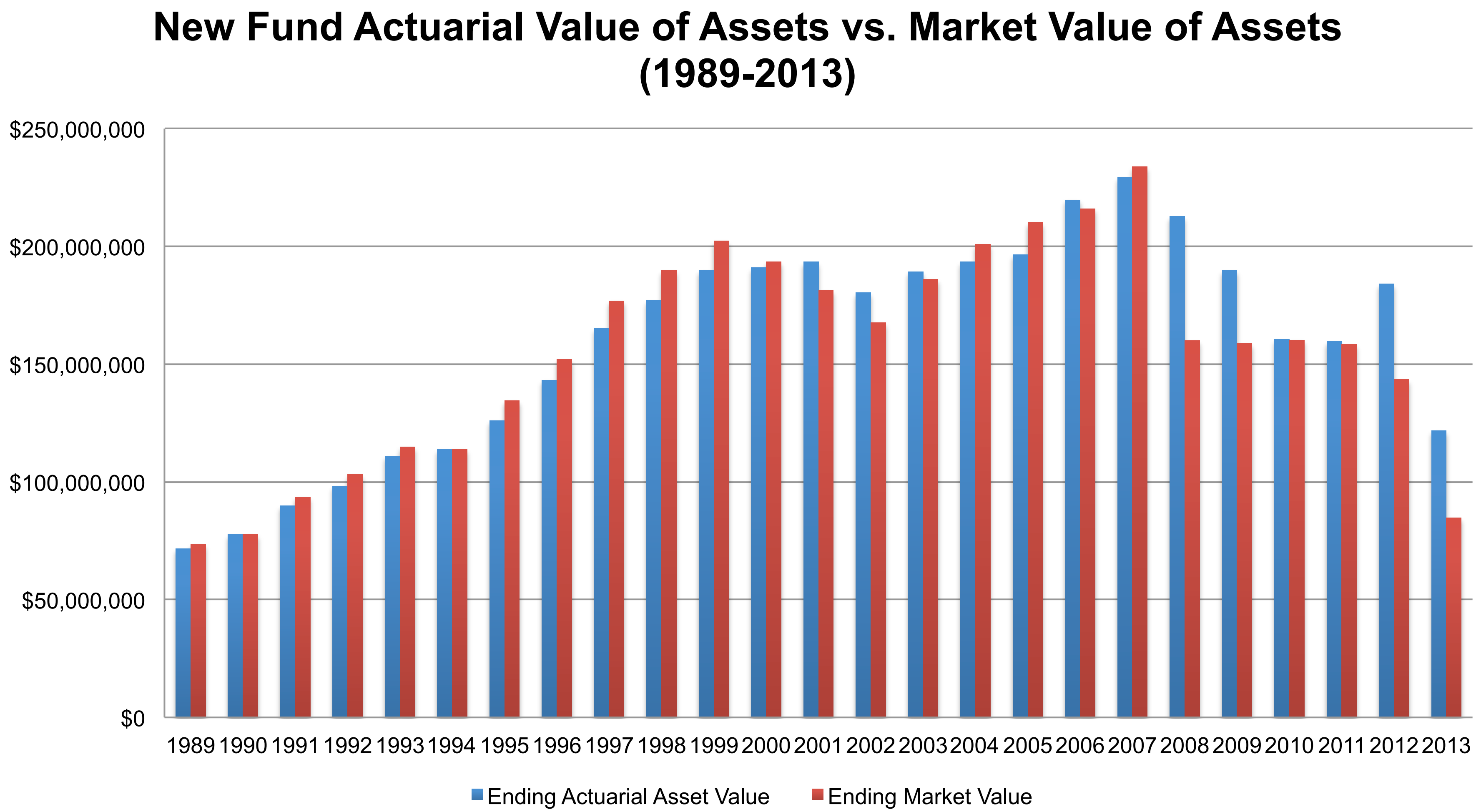
# New Fund

# Actuarial Value vs. Market Value of Assets

- In order to understand pension funded ratios, one needs to understand the difference between the Actuarial Value of Assets (AVA) and the Market Value of Assets (MVA)
- The Market Value of Assets (MVA) is a snapshot of the actual dollar amount in the fund on a given date
  - For example, assuming that you are invested 100% in the stock market, when the stock market goes up 5%, the market value of your assets goes up 5%. When the stock market goes down 5%, the market value of your assets goes down 5%
- The Actuarial Value of Assets (AVA) is the value of pension plan investments used by the actuary for the purpose of an actuarial valuation. Because investment returns can be very volatile and therefore can significantly change the annual required contribution up or down yearly, when the actuary determines the AVA, he or she will gradually account for those changes over a period of time instead of immediately. This is referred to as "smoothing"
  - For example, if a fund utilizes 5 year smoothing and the assets lose 30% in one year, the actuary would recognize 1/5 of that loss each year for 5 years so that at the end of 5 years, the loss is fully recognized in the AVA
  - Smoothing is common, but should be done in both "up" and "down" markets, not simply as a way to reduce annual contributions

# Actuarial Value vs. Market Value of Assets

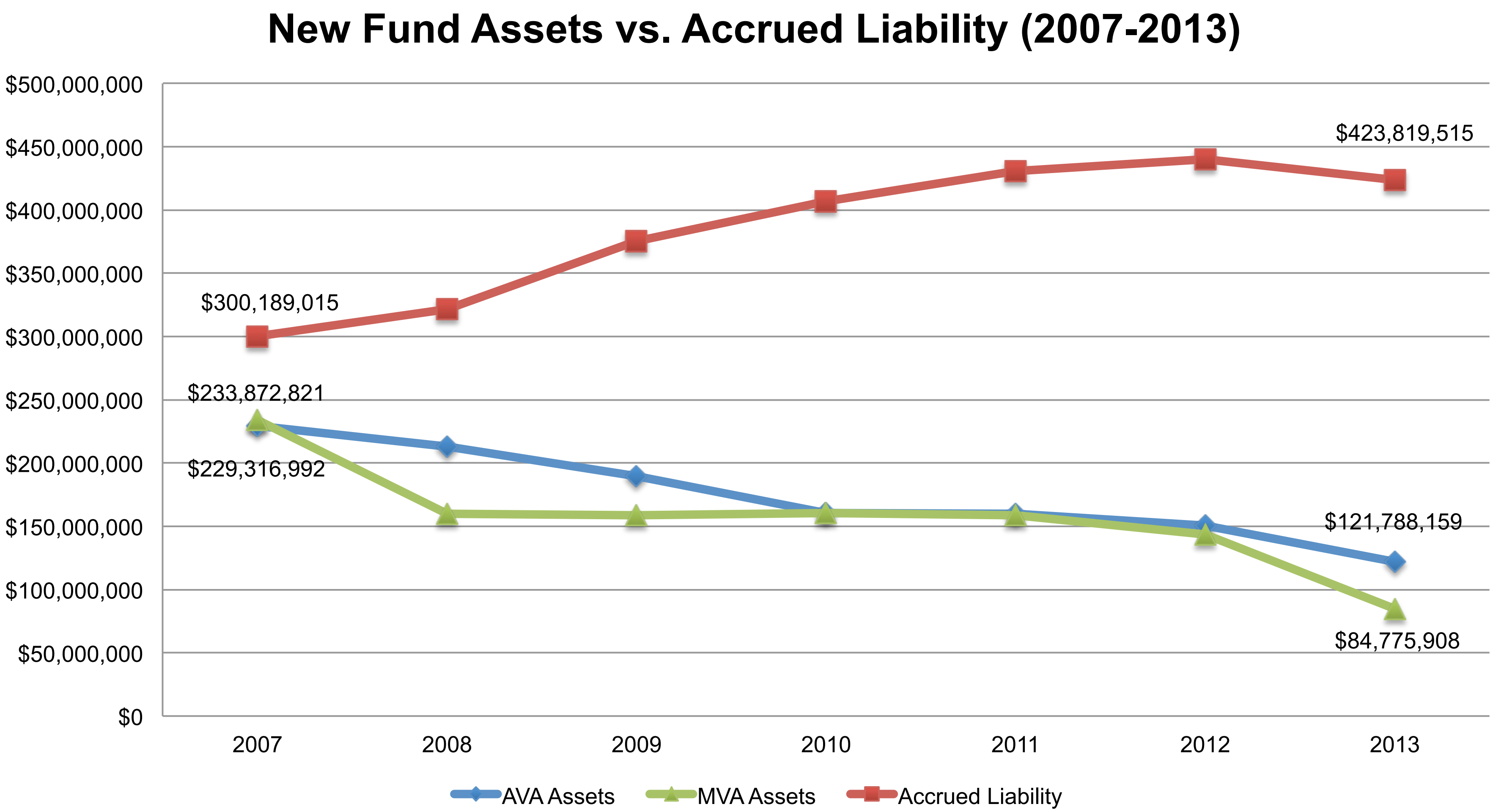
As of December 31, 2013, the Actuarial Value of Assets in the New Fund was 43.7% greater than the Market Value of Assets. The Market Value of Assets is at the lowest point since 1991




Source: New Fund Actuarial Valuation Report as of January 1, 2014. Pages 27-28.

# New Fund Assets vs. Liabilities

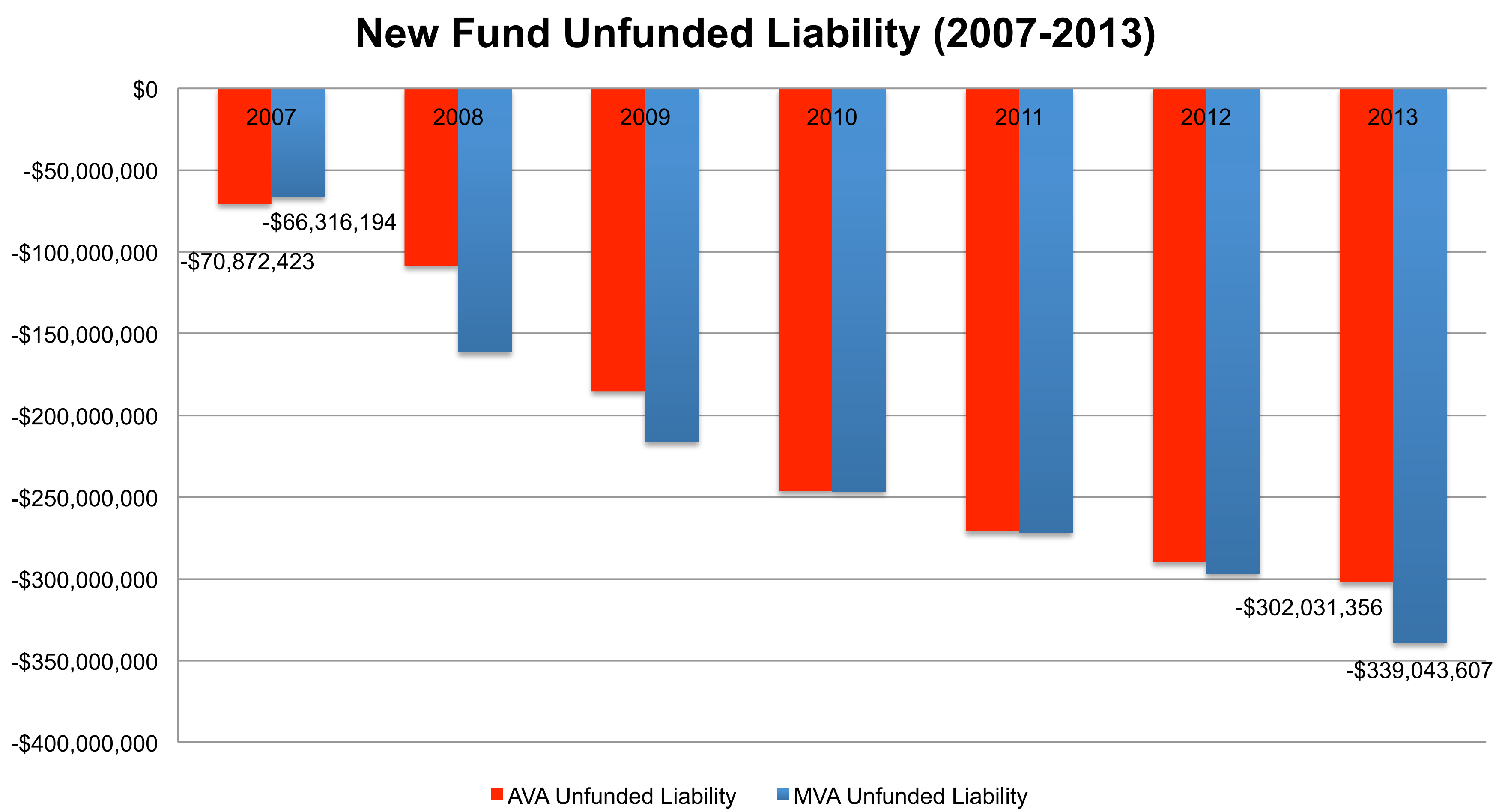
Since 2007, the New Fund's Accrued Liability has **increased** by $123,630,500 (41.2%) while the Market Value of Assets (MVA) and Actuarial Value of Assets (AVA) have **declined** by $149,096,913 (63.4%) and $107,528,833 (46.9%) respectively




Source: 2011 Fund Audit page 42 and 2013 Fund Audit page 44.

# New Fund Unfunded Liability

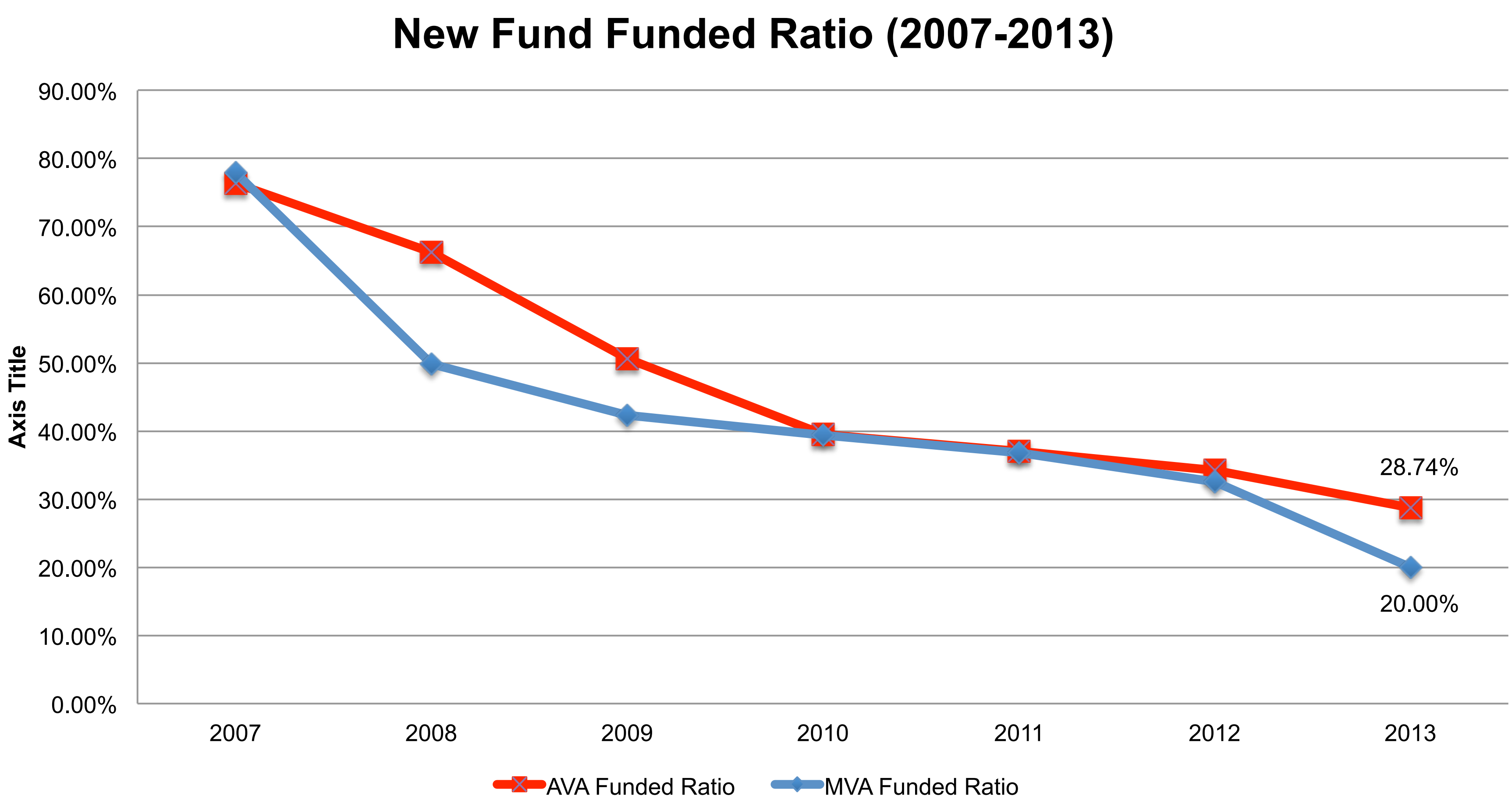
From 2007 to 2013, the New Fund's unfunded liability using the Market Value of Assets (AVA) grew by $272,727,413 (411%) and by $231,158,933 (326%) using the Actuarial Value of Assets (AVA)




Source: 2011 Fund Audit page 42 and 2013 Fund Audit page 44.

# New Fund Funded Ratio

From 2007 to 2013, the New Fund's funded ratio dropped from 76.39% funded to 28.74% using the Actuarial Value of Assets (AVA) and 77.91% funded to 20% funded using the Market Value of Assets (MVA)




Source: 2011 Fund Audit page 42 and 2013 Fund Audit page 44.

# DROP and PLOP Accounts

# DROP Accounts

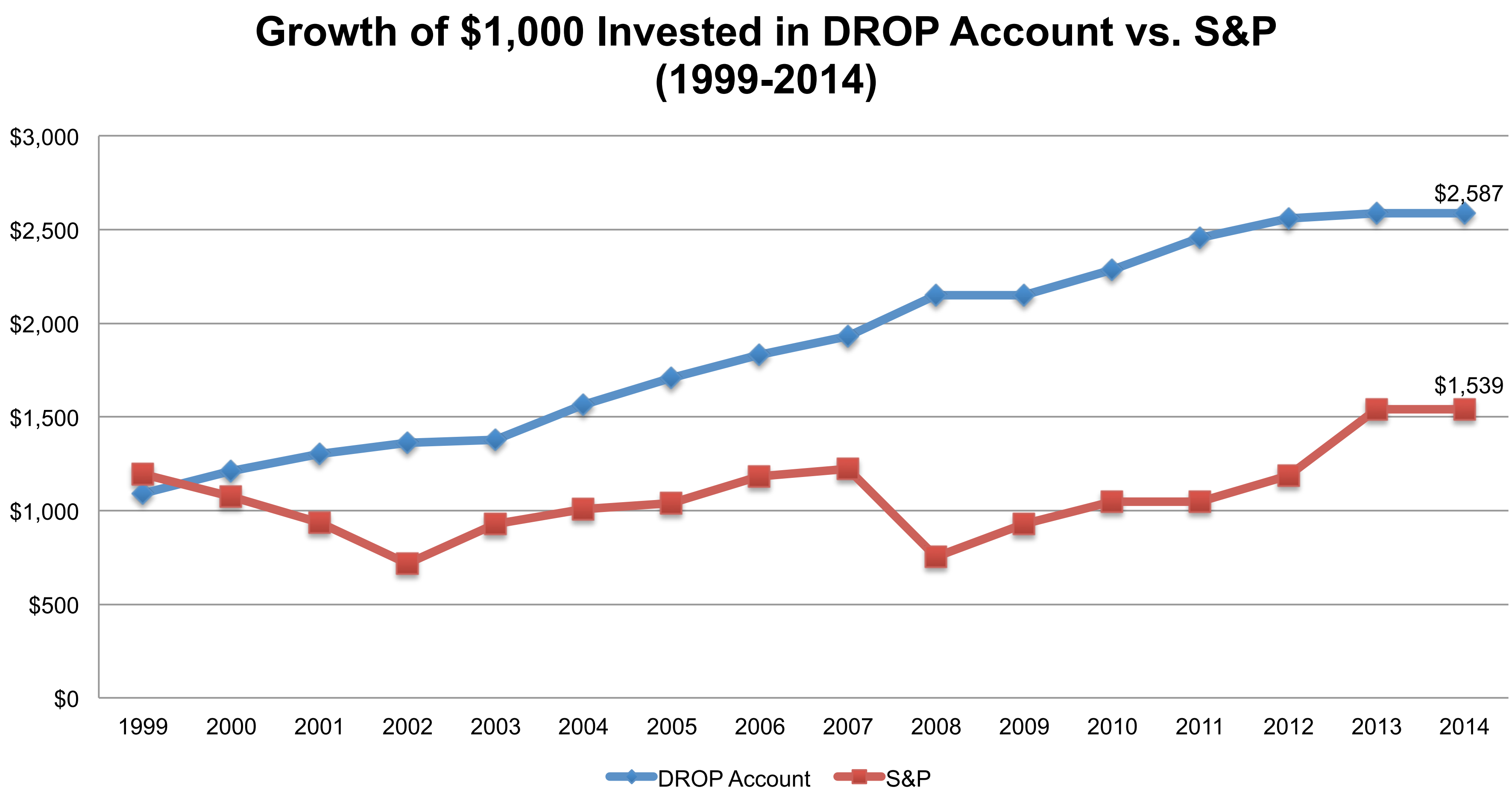
- Any member who has 12 or more years of service and is eligible to receive a service retirement benefit may participate in the Deferred Retirement Option Program (DROP)
  - Member may participate for up to 5 years
  - Pension benefits that member would have received during this period are deferred until employee terminates employment and requests withdrawal
  - Monthly retirement benefit calculated using participant’s salary and years of service at the time the employee enters the DROP
    - Employer and employee contributions cease during this period
    - Member does not receive interest or COLAs during DROP participation
  - As of 2014, upon completion of DROP, member will earn interest annually (never less than 0%) based on a five-year composite rate of return of Fund less an administrative fee of 2% if charged by Fund

# PLOP Accounts

- Upon applying for retirement, a member may elect to receive the actuarial equivalent of his retirement benefit as a reduced monthly benefit for life plus an initial lump sum payment (PLOP)
- The initial lump sum payment (determined by the member) cannot exceed an amount equal to the member's normal retirement benefit times sixty (60)
- These monies have been credited by the Fund with the same interest as DROP accounts
  - Annual interest (never less than 0%) based on a five-year composite rate of return of Fund less an administrative fee of 2% if charged by Fund

# DROP and PLOP Account Rate of Return

Because DROP and PLOP accounts do not lose money – even in years where the Fund suffers investment losses - many retirees elect to keep their money in these accounts. From 1999 to 2014, a DROP or PLOP account grew by 258.7% compared to 153.9% invested in the S&P 500




Source: Fire Pension Fund

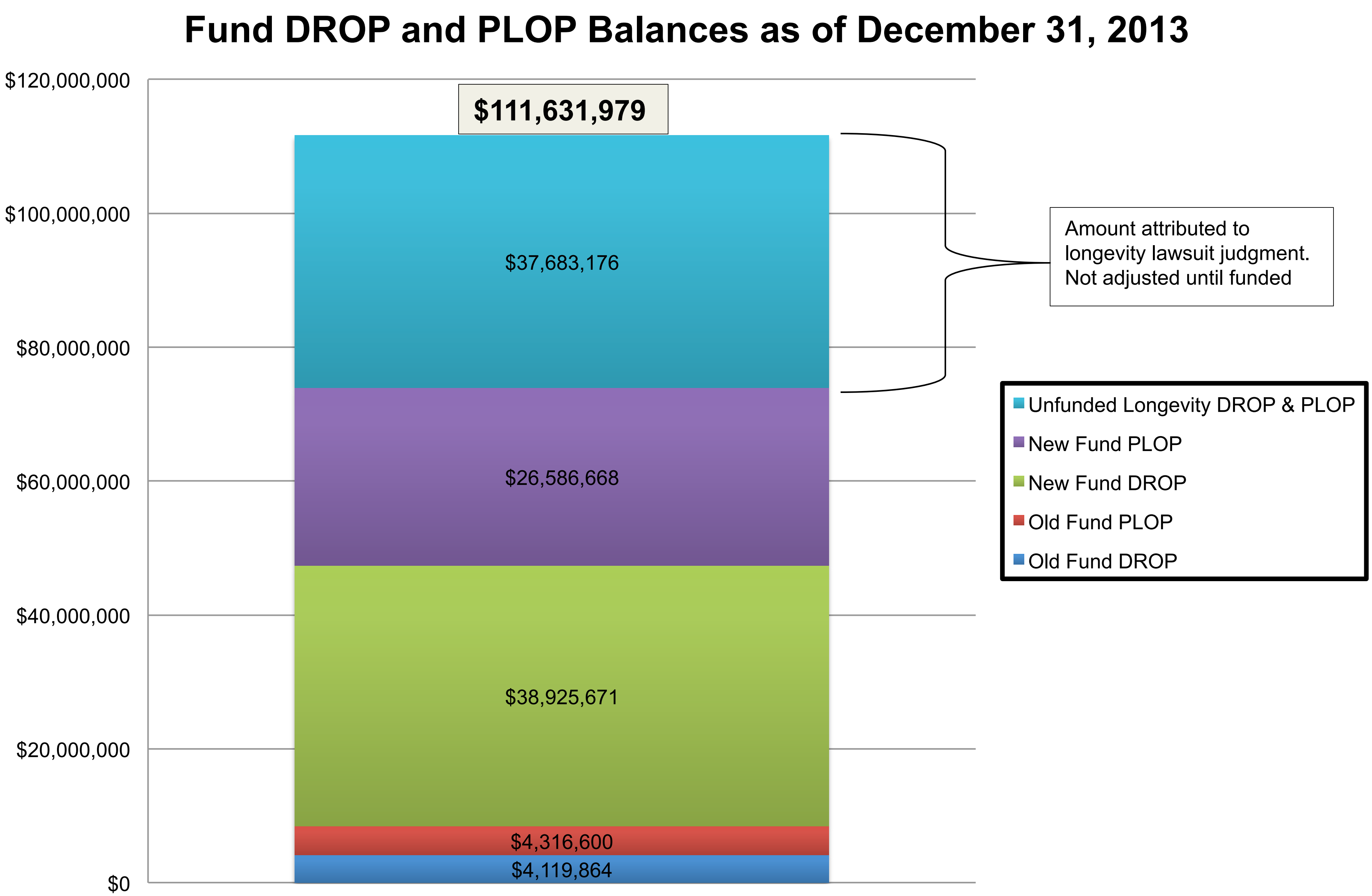
Note: Returns as of July 1st of given year

# DROP and PLOP Balances

- The Fund refers to DROP and PLOP balances as being “Funded” or “Unfunded.” “Unfunded” refers to balances stemming from the longevity lawsuit judgment which do not require the benefits to be upwardly adjusted until the funds are appropriated
- As of the December 31, 2013 audit, the “Funded” balances were:
  - DROP account balances of the New Fund and Old Fund were $38,925,671 and $4,119,864 respectively for a total of $43,045,535
  - PLOP account balances of the New Fund and Old Fund were $26,586,668 and $4,316,600 respectively for a total of $30,903,268
- As of the the December 31, 2013 audit, the “Unfunded” balances were:
  - DROP amounts of New Fund and Old Fund members are $20,207,931 and $3,427,427 respectively for a total of $23,635,358
  - PLOP amounts of New Fund and Old Fund members are $12,676,571 and $1,371,247 respectively for a total of $14,047,818
- Total “Funded” and “Unfunded” DROP and PLOP amounts are $111,631,979

Source: 2013 Fund Audit pages 2, 18, and 38.

# DROP and PLOP Balances




Source: 2013 Fund Audit pages 2, 18, and 38.

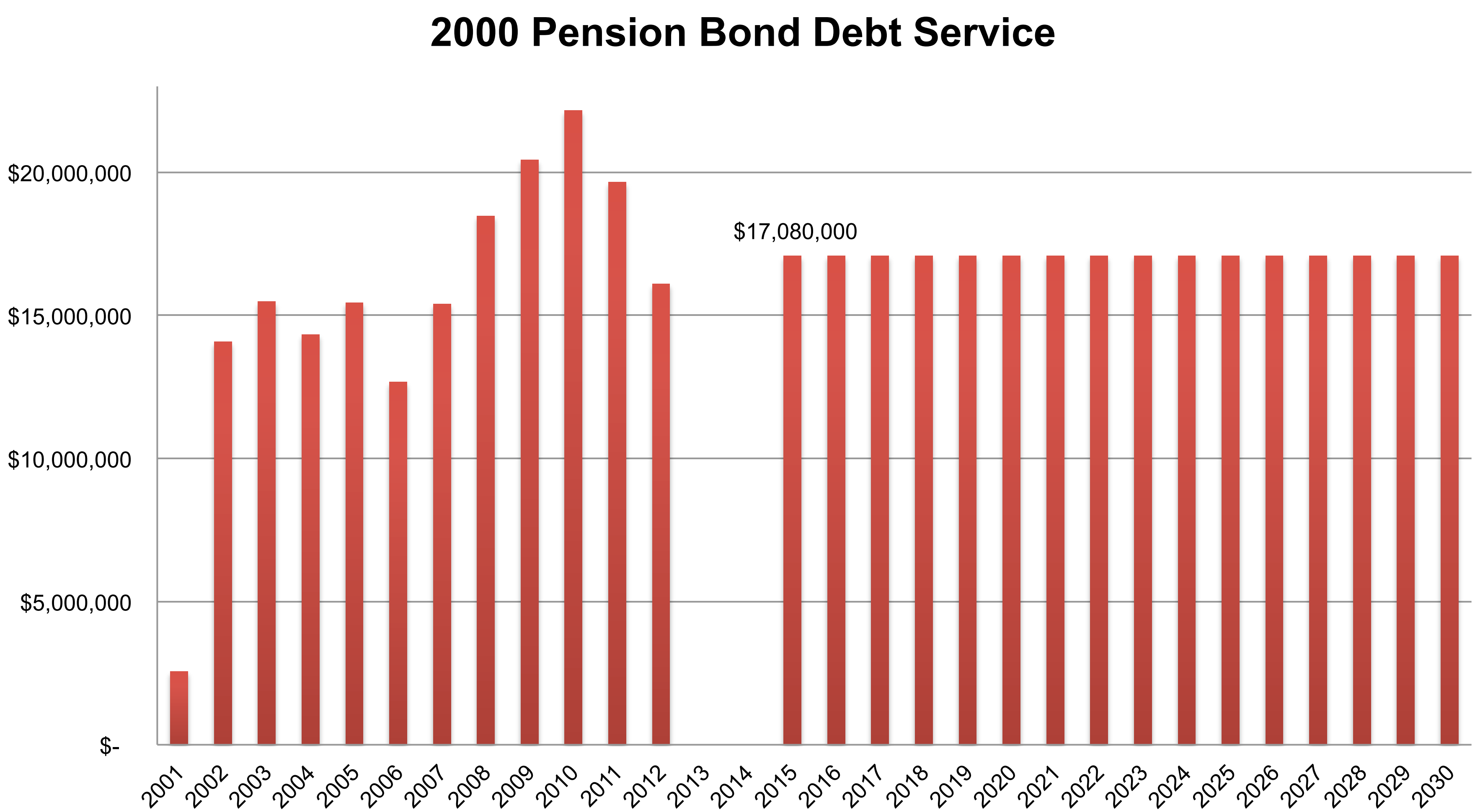
# How Did We Get Here?

# How Did We Get Here?

- Multiple reasons contributed to the Fund's current status. These include:
  - Continued required payments for the 2000 pension bond deal
  - Rapidly increasing benefit payments in the New Fund and Old Fund payments not declining due to COLAs
  - Pension payment increases and liabilities stemming from longevity lawsuit judgment
  - Benefit enhancements by the Legislature over this period
  - Investment returns which are well below the rate of return assumption used in the valuations
  - Cost of living adjustments (COLAs) being granted annually despite the valuations not assuming that they will happen prospectively
  - Low employee pension contributions
  - The City not making the full actuarially required contribution to the New Fund on an annual basis since 2010

# 2000 Pension Obligation Bond Deal

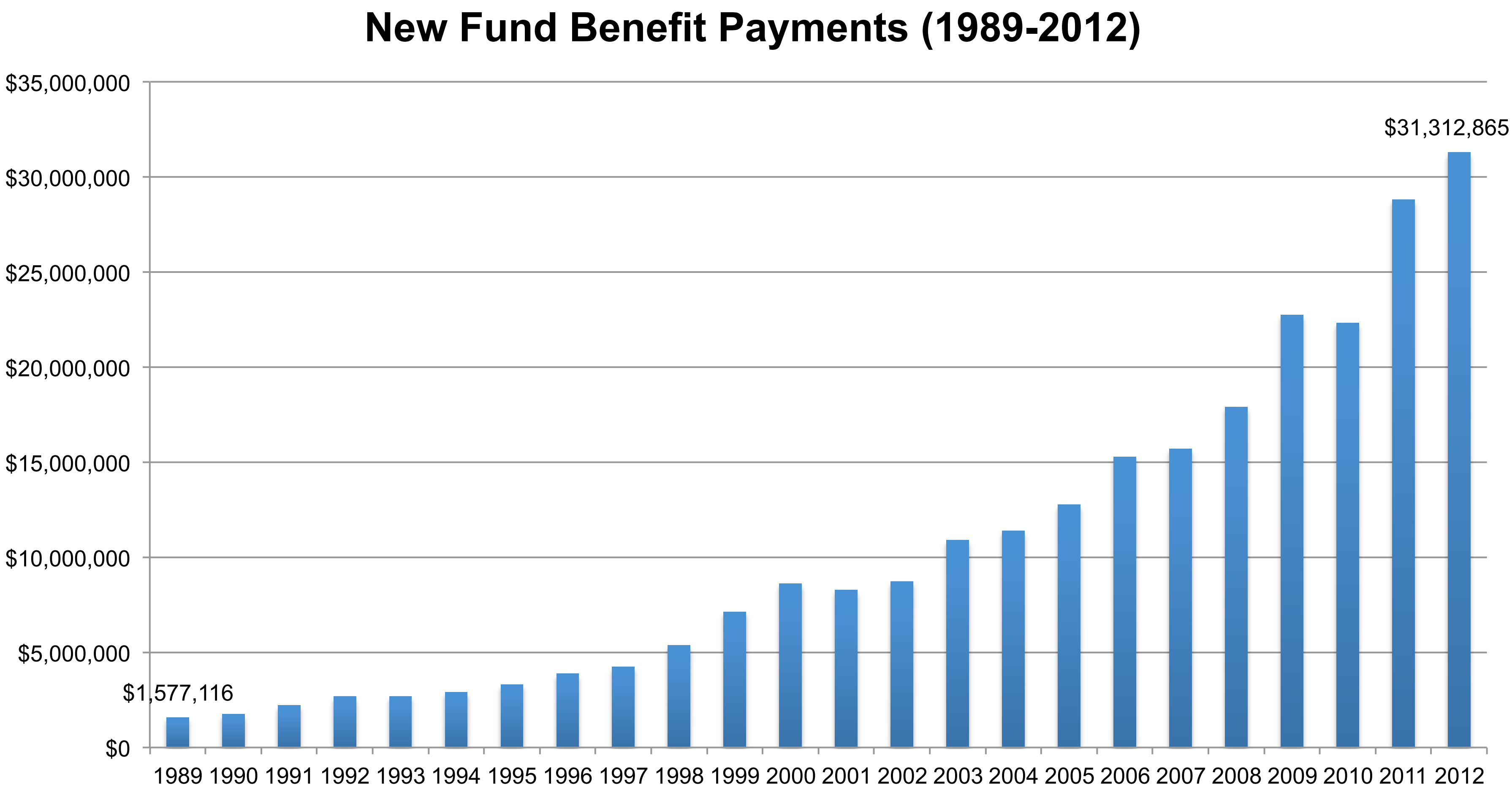
Despite exhausting the proceeds from the 2000 pension obligation bond, the City will continue to pay annual debt service of $17,080,000 through 2030 on these bonds




Source: City Department of Finance

# New Fund Benefit Payment Increases

Total New Fund benefit payments have increased from $1,577,116 in 1989 to $31,312,865 in 2013. Recall that Old Fund benefit payments have remained relatively constant meaning that total fire pension benefit payments (Old and New Fund) have significantly increased




Source: New Fund Actuarial Valuation Report as of January 1, 2014. Page 25.

# Historical Benefit Improvements

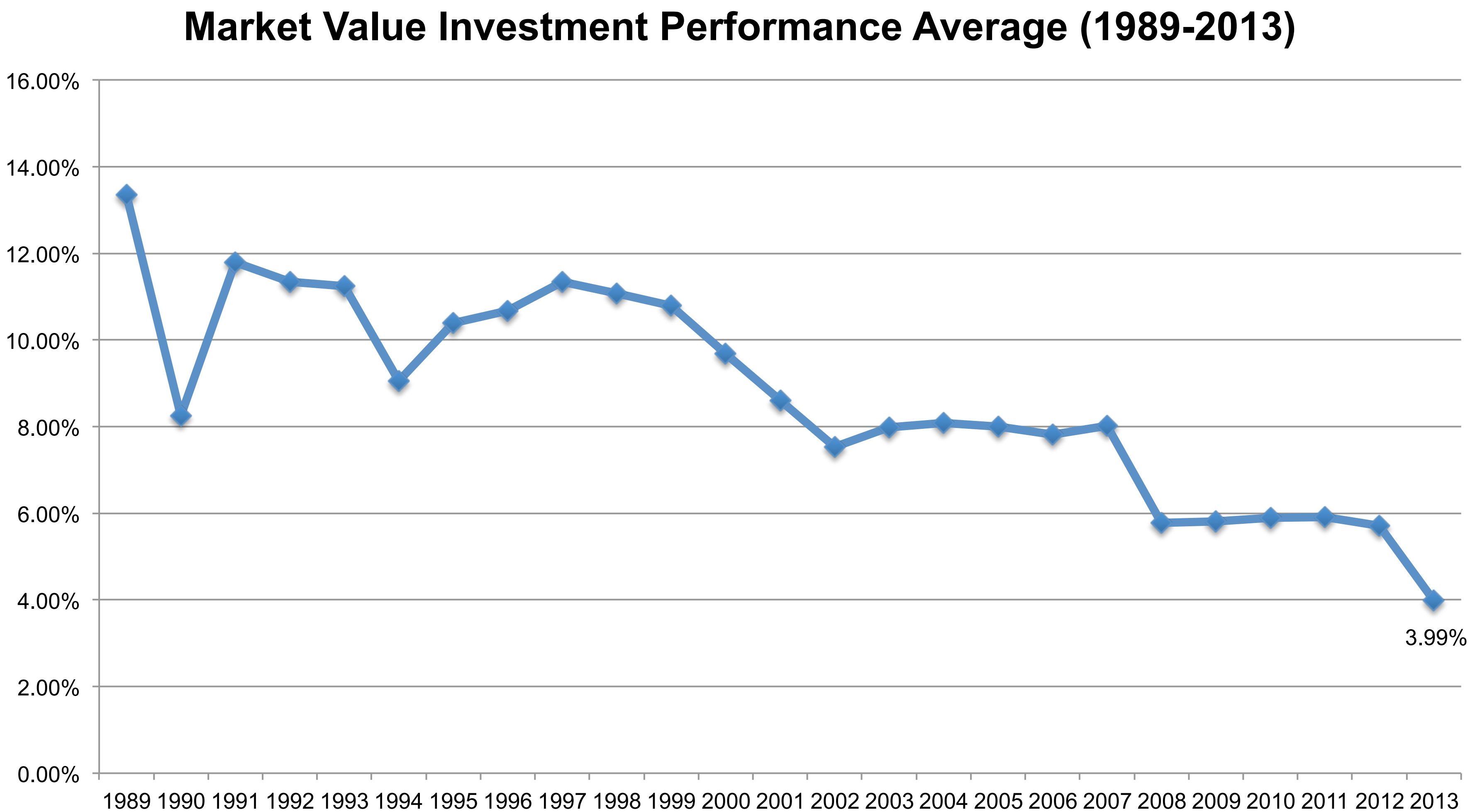
- 7/1/1993 - Maximum benefit increased to 80%, 2.5% for each year of service. Act 449 provided for 75% benefit over 20 years, with accrual rate increasing to 3% for all years over 20 years for the New Fund
- 7/1/1995 - DROP began. 3 year limit on DROP. Had to withdraw funds within 1 year after retirement
- 7/1/1997 - 12 year vesting
- 7/1/1999 - Interest on DROP accounts
- 8/1/1999 - Expanded DROP from 3 years to 5 years. Increase accrual rate to 3% for all years. Bill 1084
- 7/1/2003 - Reverse DROP created. Career ending injury in order to Reverse DROP
- 8/1/2003 - Allows a participant in the DROP to exercise an initial lump sum benefit option. SB1557 Act 1110
- 4/8/2004 - Widows allowed to PLOP (Approved at Board Meeting)
- 7/5/2004 - Changed DROP/PLOP interest to 1 year composite rate instead of 5 year
- Military (Act 304) New Fund: 5 year Max - no age or years of service requirement
- 7/1/2008 - Retirement age changed from 55 to 50. Do not have to have a career ending injury to reverse DROP if member has not participated in DROP. First 12 years of service accrual rate is 2 1/2% and 3 1/3% for each year after per provisions of Act 452. Fund interprets statutory changes here to provide for 3 1/3% for all years once employee attains 30 years of service



Source: Firefighter Pension Fund. Text edited by V. Kapoor.

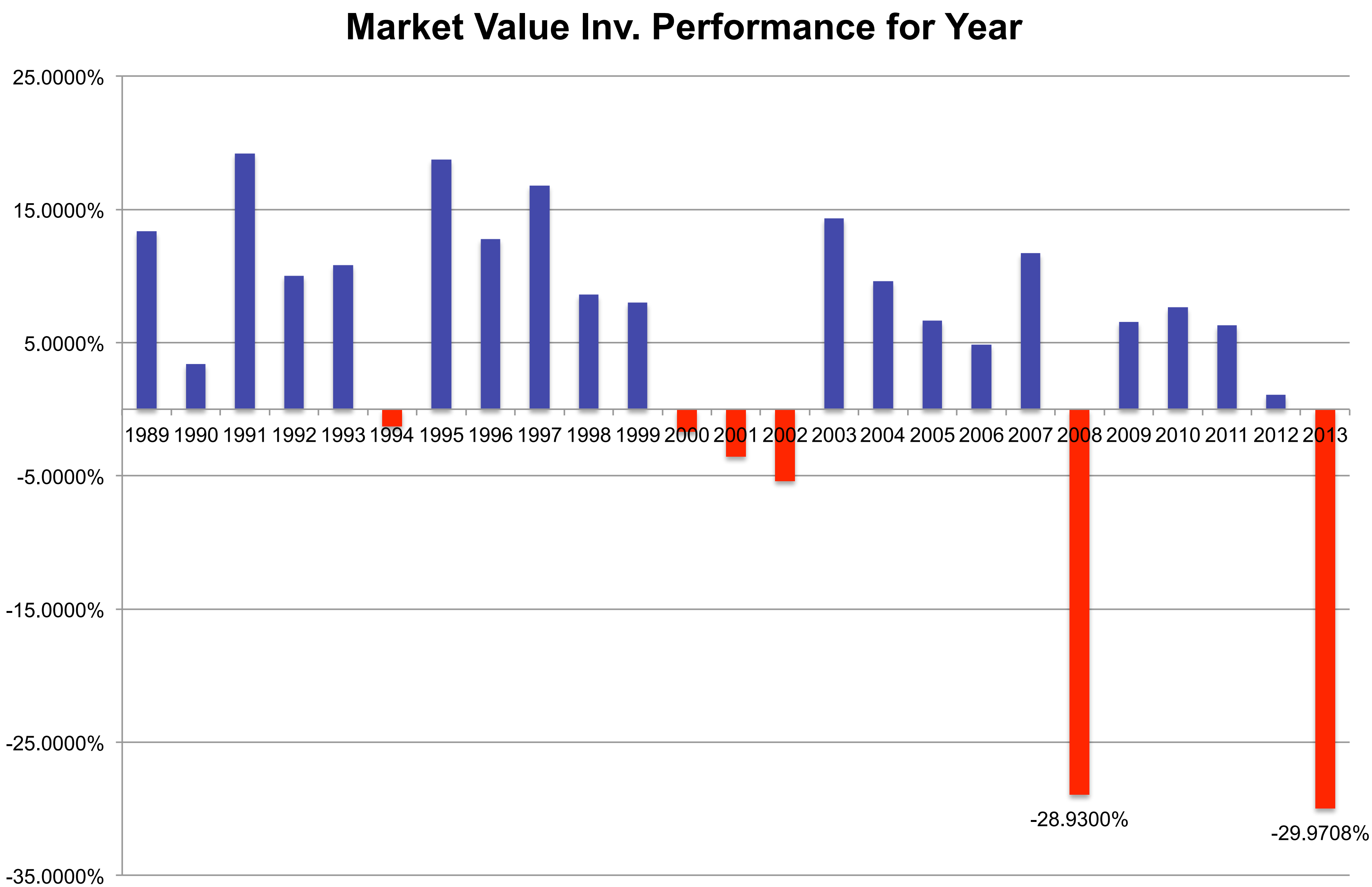
# New Fund Average Market Value Investment Performance

The New Fund is assuming a 7.5% annual rate of return on its assets despite having an average annual rate of return of 3.99% on a market basis over the last 25 years. This results in actuarial losses for the New Fund causing increased liabilities




Source: New Fund Actuarial Valuation Report as of January 1, 2014. Page 27.

# New Fund Investment Performance



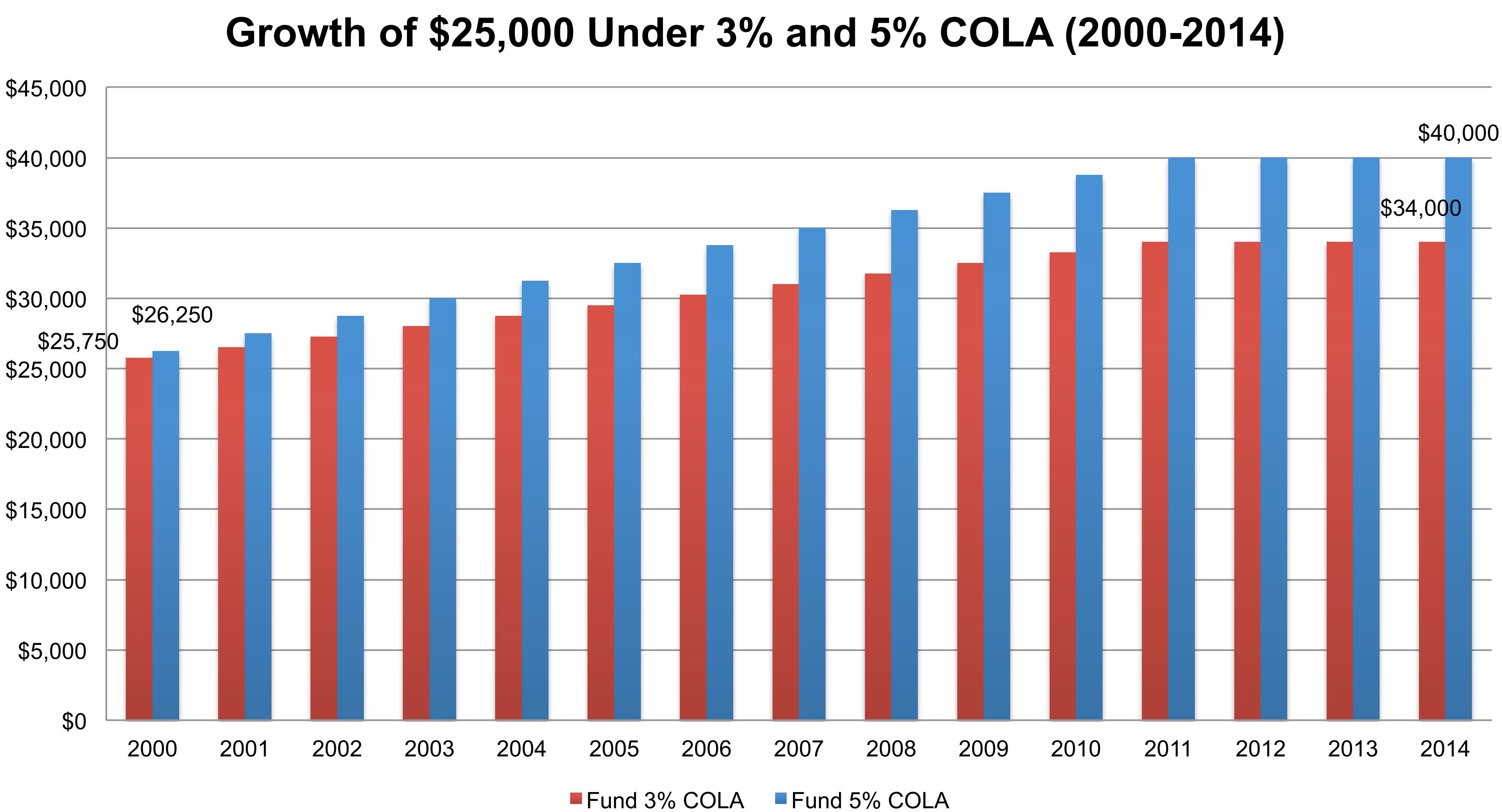

Source: New Fund Actuarial Valuation Report as of January 1, 2014. Page 27.

# COLA History

- From at least 2000 to 2011, the Fund provided retirees under age 65 with 3% annual COLAs (not compounded) and those age 65 and over with 5% annual COLAs (not compounded). Since 2012, the Fund has not provided any COLAs
- Because the COLAs are technically “ad hoc” in the statute, the actuary does not assume their costs prospectively in the valuation
  - This results in a significant actuarial loss
- Granting these COLAs resulted in Old Fund benefit payments not decreasing despite Old Fund being closed
- From the period between 2000 and 2014, the Fund’s 5% COLA exceeded the Social Security System’s automatic annual cost of living increase by 36%
  - Growth of a Fund pension with a 5% COLA over this period was 60%. Social Security automatic COLA growth was 44.05% over the same period
- Statute now requires 2/3rds vote by the Fund to provide a COLA for the Old Fund or New Fund

# Impact of COLA Growth

As a result of the annual 3% or 5% COLAs depending upon age, annual pensions increased between 36% and 60% from 2000-2014. These COLA increases were not prefunded



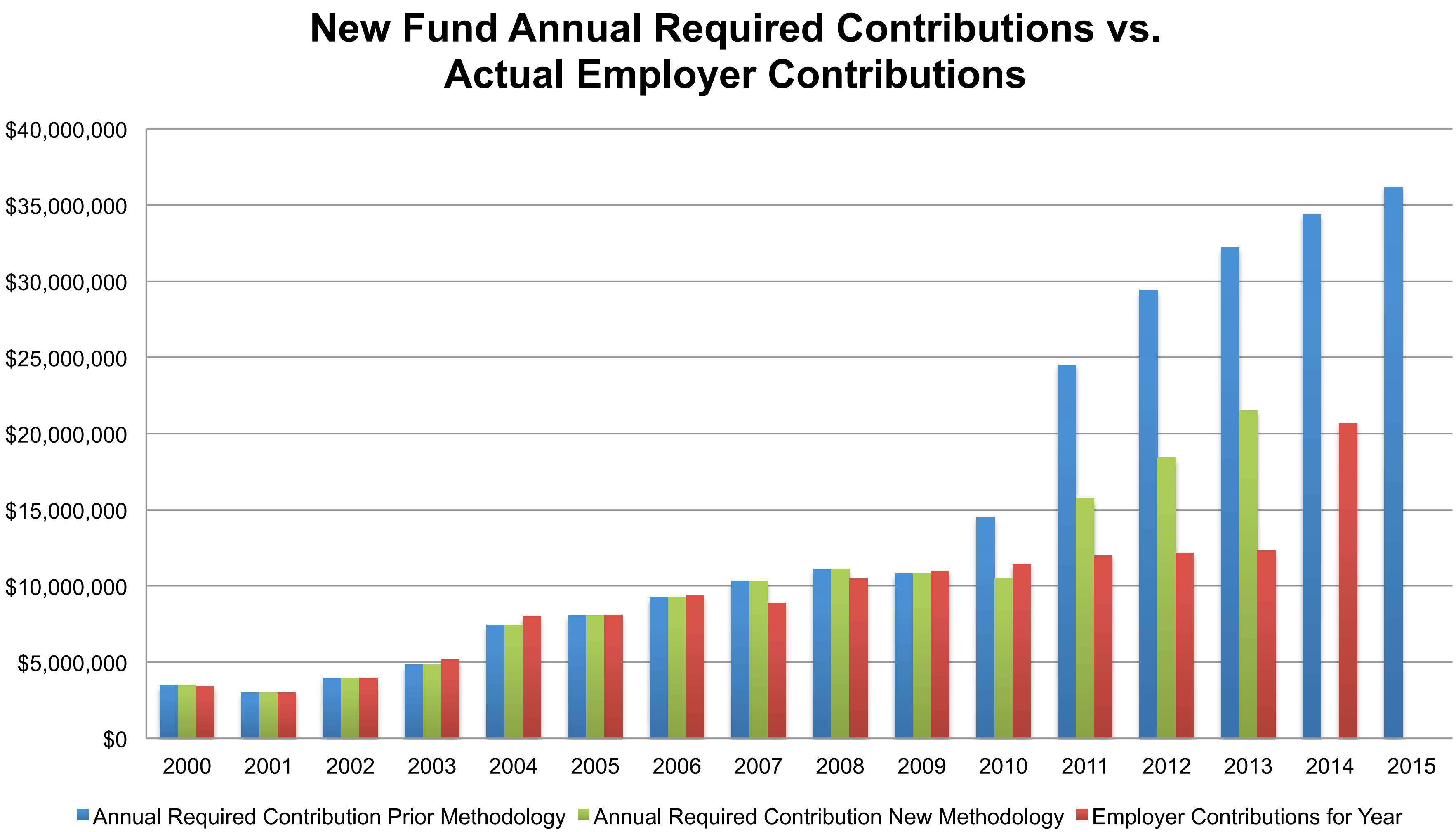

Note: Hypothetical example above assumes retiree was either under or over age 65 for duration of the period.

# Employee Contributions Were Very Low

- Prior to 2014, firefighters paid 6% of pensionable salary until their 20th year of service when their contribution was eliminated
  - No pension contribution for a non-Social Security pension fund for city employees was virtually unheard of even during this period
- New legislation has increased employee contributions.  Members with 20 years of service pay 3.33% in 2014, and will pay 6.66% in 2015 and 10% in 2016.  Members with less than 20 years of service had their contributions increased from 6% to 8% in 2014 and will increase to 10% in 2015
- We will provide benchmarks of employee contribution rates at the next Working Group meeting

# New Fund Annual Required Contributions

From 2010 to 2013, the City did not make the full actuarial required contributions to the New Fund




Sources: Firefighter Pension Fund, Letter of 8/29/14 from Fund Actuary, City Department of Finance
2014 Employer contribution is proposed. City has budgeted an additional $3,729,381 for 2014

# Where Do We Go From Here?

# Litigation and Current Settlement

- As part of ongoing litigation regarding past City contributions to the Fund, the City and the Fund appear to have reached an agreement that changes the way the Fund actuary develops the annual required contribution
  - Entry Age Normal (EAN) using a level dollar 30 year open amortization methodology with 7 year smoothing
- Court has ruled that the City is responsible for making the annual required contribution

# Recent Legislative Changes - 2013

- **2013 Bills passed**
  - HB51 and HB 42 -average benefit compensation raised to five highest consecutive years of employment. (Previously four years)
  - HB 52 - provides for payment of employee contribution by members with 20 years of service. (Previously, members made no employee contributions after 20 years of service.)
  - HB 41- Changes the makeup of the Board from 10 members to 7 members. Four firefighters (two retired and two active) and three appointed by the Mayor (includes Finance Director, Superintendent of Fire, and a resident). Requires 2/3 vote of the Board to approve disability retirements and COLAs
  - HB 50 - Provides for employee contribution increases from 6% to 10% for all active firefighters. Increases were phased in. Members with 20 years of service will pay 3.33% in 2014, 6.66% in 2015 and 10% in 2016. Members with less than 20 years of service went from 6% to 8% in 2014 and will go to 10% in 2015



Source: Firefighter Pension Fund

# Recent Legislative Changes - 2014

- **2014 Bills passed**
  - HB 94 - Changes the minimum retirement age to 52 from 50, and fixes the accrual rate to 2.75% for each year for members who enter Fire Department employment on or after January 1, 2015
  - HB 27 – Requires five year rolling average interest rate to be used on DROP and PLOP interest payments to participants (Previously was one year)

Source: Firefighter Pension Fund

# Steps Taken By Fund Regarding Investments

- Fund is moving out of the illiquid assets
- Fund has hired a new professional investment consultant
- Fund has passed a policy requiring 2/3rds vote for investment decisions

# Next Working Group Meeting

- Benchmarking
  - Internal and external
- Best practices on Fund governance from other localities
- Levers for making changes
- Discussion of options