

POLICE AND FIRE PENSION FUND

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John Keane
Executive Director -
Administrator

December 23, 2008

Ronnie Fussell
City Council President
City of Jacksonville
117 West Duval Street
Jacksonville, Florida 32202

RE: City of Jacksonville Retirement System

Dear Council President Fussell:

The Jacksonville City Council has shown increasing interest in the status of the City's Retirement System in the aftermath of the global economic crisis and its impact upon stock prices. The nature of this interest, attention, and understandable anxiety is not a phenomenon that is unique to Jacksonville, but rather a common point of discussion throughout America for both public and private pension plan sponsors as well as at the dinner tables of many Americans as they review their shrinking retirement nest eggs.

The discussion in Jacksonville regarding its Retirement System has been elevated in the public arena in conjunction with recent studies conducted by the Jacksonville Journey study group and Florida TaxWatch. The subjects raised by these initiatives have now been undertaken by the Jacksonville Community Council, Inc. (JCCI) who is in the midst of a comprehensive study of Jacksonville's finances entitled, "Our Money, Our City: Financing Jacksonville's Future". This study is planned to be completed in early 2009 and is expected to consider the subject of the City's Retirement System as an integral element of their report. JCCI has a reputation for conducting detailed reviews of difficult subjects of local interest in a process that invites the input and views of a diverse group of interested and talented participants. Accordingly, we look forward to the findings and recommendations offered by the JCCI regarding this important issue.

Given the current interest regarding the City's Retirement System (the "System"), we felt it was necessary and appropriate for us to undertake the preparation of a discussion paper addressing many of the subjects that are under review. We feel that we can provide technical support and offer valuable historical perspectives and therefore make significant contributions in allowing the JCCI and City policy makers to better understand the complex issues involved in a review of the System. Accordingly, we are hopeful that the resource materials and commentary

offered in this communication will provide the necessary background information to allow for an informed discussion of the issues.

Inasmuch as the Jacksonville Journey discussions and the Florida TaxWatch Report are recognized as early catalysts for stimulating the current level of interest by the JCCI and City policy makers, we have chosen to initially address these subjects as Part I and Part II of this document. From that point we would like to undertake a brief review of the history of the System and many of the issues that have been raised recently, including contribution rates, reserves, and the DROP program. These subjects, along with the impact to the System from the current financial markets, benefit enhancements, revenue losses and demographic factors will be labeled as Part III. The Settlement Agreement, along with recent proposals for a two-class benefit structure will also be covered in Part III along with a Times-Union survey of key indicators from comparable pension plans. We have then devoted the entire Part IV to a separate discussion of the Unfunded Actuarial Accrued Liability (“UAAL”) of the System. In Part V, we will address measures that have been previously proposed by the Police and Fire Pension Fund regarding methods to reduce the UAAL and provide budget relief to the City. In Part VI we will address the subjects of sustainability, transparency, accountability and best practices that have been raised during the JCCI study of City finances. Finally, in Part VII we will offer a summary and conclusions that may be drawn from this paper. In many cases we will limit our discussion to the Police and Fire Pension Fund (the “PFPF”) as opposed to the General Employees Pension Fund (the “GEPP”) inasmuch as that is our primary area of interest and expertise.

Part I – Jacksonville Journey Findings

The Law Enforcement and Deterrence Subcommittee of the Jacksonville Journey study group directed their attention upon the issue of crime in Jacksonville and programs to help the community combat crime. This subcommittee reviewed the Sheriff’s Office budget over several years, with a focus upon expenditure comparisons between 2003 and 2008. A review of various line items over this period highlighted the fact that pension expenditures for the Sheriff’s Office personnel, comprised of both police officers (enrolled in the PFPF) and civilians (enrolled in the GEPP and Corrections Plan), increased by 516% between 2003 and 2008. This statistic understandably drew the attention of the media, who widely reported the magnitude of this percentage increase. While the aftermath of the dot com market crash of 2000-2002 did in fact push up the cost of the City’s pension plans by a significant amount, the vast majority of the reported 516% increase statistic is related to other factors that artificially distort a fair comparison between FY2003 and FY2008.

The starting point of the Jacksonville Journey analysis is the City’s FY2003. **This fiscal year represents the zenith of a practice whereby the City elected to go on a pension contribution holiday for the majority of its pension obligations. The savings accruing to the City’s Budget during this fiscal year were re-allocated for other City priorities, including the City’s much celebrated**

millage reduction program. Most people do not realize that the Sheriff's Annual Budget represents both police officers that are enrolled in the PFPF and civilians and correctional officers who are enrolled in other City pension programs. In order to properly analyze the 516% statistic we must separately consider the impact from the two categories of employees. FY2003 represents the 3rd year of a program of pension contribution holidays for the City's GEPP (covering the Sheriff's civilian workforce and correctional officers) during which time the City contributed \$0 to the plan. FY2003 also represents the year in which the City elected to pay only 47% of the stipulated contribution rate for police officers enrolled in the PFPF through the alternative use of reserve account assessments. In contrast, **FY2008 represents a fiscal year in which the "contribution holiday" practice was discontinued and where the total required contribution rate for all of the City's pension funds were fully reflected in the Sheriff's Annual Budget. After considering these significant factors, one can rapidly come to the conclusion that a comparison formulated upon a base year that artificially ignores 100% of the budgetary impact from one major element of the Sheriff's workforce and more than 50% of a second major element of the Sheriff's workforce will produce a statistic that is fraught with distortions.**

A second major area to consider in analyzing the 516% statistic is the distortions concentrated in FY2003 by virtue of the impact of the DROP. When the DROP was introduced in FY1999, the City was given the option of making a matching City contribution for DROP participants after they entered the program. **In an effort to immediately realize budgetary savings, the City elected to discontinue all pension contributions related to police officers and firefighters who joined the DROP and to continue this practice during the full 5 year period of DROP participation.** Many of the police officers who joined the DROP in the initial FY1999 were still enrolled in the program in FY2003 due to the 5 year participation period. This initial group was joined by additional police officers who enrolled into the DROP during FY2000, FY2001, FY2002 and FY2003. Thus, historically speaking, FY2003 represents a period of extremely high DROP participation and accordingly, a period of extremely low City pension contributions inasmuch as the City, as previously described, pays a 0% matching pension contribution for DROP participants. For example, during FY2003, 20.52% of the Sheriff's police officer payroll base was represented by police officers who were enrolled in the DROP. As a result of mandatory retirements, the level of DROP participants as a percent of the Sheriff's police officer payroll base had plunged to 11.34% by FY2008. This demographic shift produces the same impact as the earlier described impact relating to the City's decision to go on a contribution holiday in FY2003. FY2003 pension costs are made artificially low due to this demographic shift and therefore making FY2003 inappropriate for use as a base year when attempting to draw meaningful budgetary conclusions.

A third area of distortion when making comparisons between FY2003 and FY2008 is also worthy of acknowledgement. This area deals with the revenue stream historically enjoyed by the PFPF from 30% of court fines and penalties

assessed in Duval County. During FY2003, the Fund received \$3,040,897 from this source which meant that the City did not have to recover a like amount from its public safety budget in the form of City pension contributions. Beginning in FY2005, the City relinquished the majority of locally collected court fines and penalties to the State of Florida in conjunction with Article V reorganizations of the court system. **The City determined that the act of relinquishing this revenue stream to the State was a prudent course inasmuch as it was concurrently able to transfer a greater amount of court administration expenditures to the State as a part of the transaction. However, this action had the collateral impact of causing the PFPF to lose its 30% element of court fines and penalties** in the same way that the City lost its 70% element that had formerly been remitted into the City's General Fund. In FY2008, court fine and penalty revenues to the PFPF had dropped to \$1,215,267, a decrease of 1,825,630 or 60% from FY2003. This decrease must now be alternatively recovered in the City's FY2008 public safety budget, with the Sheriff's budget absorbing the largest element of this impact due to the greater number of police officers vs. firefighters. This situation has the similar effect of allowing FY2003 pension costs to be artificially held down due to the alternative availability of court fines and penalties to the PFPF in the incremental amount of \$1,825,630. Thus, we should acknowledge that distortions similarly exist in FY2003 due to the impact of relinquished court fines and penalties.

A fourth area of distortion relates to the City's personnel and benefit decisions regarding the benefit structure offered to Correctional Officers and Court Bailiffs. In FY2003 Correctional Officers and Civilian employees of the Sheriff were both enrolled into the City General Employees Pension Plan (the "GEPP"). Subsequent to this period, the City Council established a separate pension plan for the City's Correctional Officers. Upon establishing this "Corrections Officers Pension Plan", the City Council authorized an enhanced pension benefit structure vs. that formerly enjoyed by Correctional Officers as participants of the GEPP. A similar situation was experienced in the area of Court Bailiffs. Subsequent to FY2003, the City changed its personnel policies and began to hire "Judicial Officers" to perform the tasks formerly provided by Court Bailiffs. The new classification of Judicial Officers enjoys an enhanced level of employee benefits, including retirement benefits by virtue of their enrollment into the City's GEPP. Accordingly, both of these pension enhancements were reflected in the City's pension contribution expenditures for FY2008, but not in the FY2003 base year.

In short, the FY2003 base year selected by the City for comparison contains monumental distortions. FY2003 represents a year in which the City paid only a fraction of the normal level of pension contributions due to the fact that it elected to go on a pension contribution holiday during that fiscal year. FY2003 also represents a year in which 20.52% of the Sheriff's police officers were enrolled in the DROP where not even the reduced (contributions holiday) rate was assessed, but rather a rate of 0% during that entire fiscal year. In addition, FY2003 represents a year that enjoyed the full amount of court fine and penalty revenues that act to hold down the City's pension contribution requirements.

FY2003 also represents a year prior to the enactment of pension enhancements for GEPP participants (Correctional Officers and Bailiffs). By contrast, FY2008 represents a year in which the City has ended its practice of pursuing pension contribution holidays and is now paying the full amount of its pension contribution requirement. FY2008 also represents a year in which the level of DROP participation within the Sheriff's workforce has dropped by 45%. The former DROP participants who have exited the workforce (and for which the City elected to pay 0% in pension contributions in FY2003) have now been replaced by new recruits, for which the City now must pay the full contribution requirement. In addition, FY2008 represents a year in which the loss of court fines and penalty revenues must be replaced by City pension contributions and where the impact from enhanced pension benefits for Correctional Officers and Judicial Officers are fully reflected.

After taking into account the monumental distortions introduced into the comparison of the artificially low FY2003 costs attached to the base year selected by the City for analysis to the normalized budgetary posture reflected in FY2008, the very alarming 516% statistic is greatly diminished to about 86%. This remaining amount is largely attributable to the dot com market crash that was previously described in the opening paragraph of this Part I. This episode represented at its time the second most severe market collapse (next to the Great Depression) in the history of our country's financial markets. The City's pension plans suffered losses during this period, similar in magnitude to all other pension plans, which that have unquestionably placed pressure upon the FY2008 budget for the Sheriff.

We hope that these observations shed some insight into the 516% increase statistic that was so prominently announced in newspaper accounts. **The extraordinary magnitude of the statistic essentially boils down to a great distortion associated with the base year selected as the starting point in the analysis.** Similar distortions would also be present in the few years following FY2003. By comparison, FY2008 represents more of a stable state situation.

When the stories came out regarding the 516% increase statistic we worked very hard to undo the damage caused by the widespread dissemination of distorted information. However, corrections and clarification never seem to have the same impact as the initial eye-catching announcement. Looking back upon this episode, we place much of the blame for the misconceptions placed in the minds of many readers at the feet of City employees and officials who provided the raw data without appropriately disclosing to the recipient the existence of key background information and ensuring that the recipients properly understood the fact that the raw data was subject to misinterpretation.

Part II – Florida TaxWatch Report

The Florida TaxWatch Report that was presented to the City on August 11, 2008 made several comments and references to the Jacksonville Police and Fire

Pension Fund. We would like to take this opportunity to offer certain background information regarding these comments and references. The major points made in the TaxWatch Report regarding the City's pension plans in general and the PFPF in particular, are summarized below followed by our observations:

Administrative Costs for the City's Pension Funds Increased by 30%:

The report disclosed the fact that the administrative costs for the GEPP and the PFPF have collectively increased by 32.5% and 29.5% during FY2006 and FY2007, respectively. While the administrative costs for both plans have in fact increased considerably over this two year period, we note that the rate of increase for the GEPP has been higher than that experienced by the PFPF. The rate of increase for the GEPP was 41.2% and 42.4% for FY2006 and FY2007, respectively, while the rate of increase for the PFPF was 27.6% and 21.3% for FY2006 and FY2007, respectively.

As we reported to Florida TaxWatch at the time of their study, the most significant reason for this large percentage increase for both plans was the introduction of significant programming and development costs incurred during this period for the in-house creation of a new pension system for use by both pension plans. For example, both pension plans together paid a total of \$229,645 for Information Technologies services in FY2003, which was the most recent year prior to the commencement of pension system development costs. During FY2007 (the height of the development effort) the annual IT cost rose to \$1,402,207. Once the new system is implemented, this one-time surge in costs will evaporate and the level of administrative costs will decrease significantly. It should also be noted that the decision to undertake the development of a new computer system for the City's pension plans was initiated by the City pursuant to a mandate to remove all IT databases off the legacy mainframe and to alternatively develop new information technology applications in a web-based environment. **The basis of this decision was the City's belief that it could realize savings within the City's ITD budget. This will likely be achieved, but at great cost to the pension plans.** The City essentially announced that it would no longer support the City's two pension plans on the City's mainframe and therefore both pension plans had no choice but to comply with the City mandate. **This directive required the pension plans to undertake a massive conversion of all of its computer applications in a multi-year conversion effort which will not be complete until August, 2009. The estimated \$3.3 million expenditure in incremental development costs associated with the IT decision is currently being directly borne by the City's pension programs.** This \$3.3 million expenditure excludes the impact of the many hundreds of hours of pension office staff that have worked on the conversion. It should also be noted that the staff of the City's two pension plans are working together to develop a common system that will be essentially identical in terms of computer coding, processing and reporting.

The rate of increase described above for the administrative costs of the PFPF was additionally attributable to certain incremental costs incurred in support of the Fund's real estate programs. During FY2006 and FY2007, \$200,000 in costs were absorbed by the PFPF in conjunction with its real estate investment programs. These financially rewarding programs have largely been completed and accordingly such incremental costs reflected in FY2006 and FY2007 similarly represent a one-time surge in administrative costs. In short, the 30% increase noted by Florida TaxWatch largely relates to one-time events that are generally non-recurring in nature and significantly engineered by outside forces.

Administrative Costs for the PFPF are Greater than that of the GEPP:

The TaxWatch Report also reported the fact that the level of administrative costs for the PFPF were higher than that allocated to the GEPP. **One primary area of difference that leads to this outcome is found in the fact that the administrative budget for the PFPF absorbs the budget impact from various real estate activities that are not undertaken by the GEPP.** For instance, two members of the eight member PFPF administrative staff are fully assigned to the management, operation, maintenance and janitorial support for the 45,000 square foot Administrative Office Building located at One West Adams Street and the Multi-Level Parking Garage located at 2 West Monroe Street, a combined operation that has delivered an attractive rate of return to the PFPF. These building facilities personnel as well as other administrative staff of the PFPF have also been involved in the management and renovation of three separate local real estate projects, including the \$6.4 million Laura Trio, the \$18 million AOL Complex and the \$12 million Haverty's Building. Each of these undertakings has delivered considerable financial rewards to the PFPF, well in excess of the related impact to the administrative budget. Such undertakings require administrative costs that are not found in the GEPP structure.

In addition to the differences in real estate activities, the PFPF operation directly absorbs a broad array of general operating costs that are not found in the GEPP budget. For instance, the PFPF budget directly absorbs the costs associated with the annual audit, retiree newsletter, payroll, budget, investment, etc., while many of the costs for such necessary support activities for the GEPP are distributed throughout the City's Department of Administration and Finance or not performed at all. Examples include the location of pension investment and finance personnel in the Treasury Division and the Director's Office, the location of pension data entry staff in the City Payroll Office, the location of pension accounting staff in the General Accounting Division, and the preparation of the retiree newsletter by the Jacksonville Retired Employees Association.

In addition, the PFPF assesses itself market based rates for the rental of office and board room space within its Administrative Office Building. By contrast, the GEPP only absorbs a modest rental assessment from the City. In short, any casual comparison between the administrative costs of the two plans is fraught with difficulty.

PFPF's UAAL and 32% Contribution Rate is Higher than the GEPP's UAAL and 11% Contribution Rate:

The TaxWatch report also pointed out that the City Contribution rate of 32% which supports the PFPF is higher than the rates of contribution for the GEPP and the Corrections Pension Plan. The report included a chart to illustrate this point which tracked the reported contribution rates between 2000 and 2008. The report also made reference to the frequent use of reserve accounts in addressing the City's annual contribution requirement. The frequent use of reserve accounts introduces an added element of confusion to the task of reviewing a chart tracking City pension contribution rates. Accordingly, charts such as that included in the TaxWatch report often fail to accurately portray the complete story. For instance, the TaxWatch chart reports the GEPP rate at 5.09% for FY2005 and 3.10% for FY2006, when in reality the City contributed cash in an amount equivalent to an additional 5.09% during FY2005 and assessed the GEPP Past Excess Contributions Account for an additional 8.48% in FY2006. Another example is the reported 9.25% rate for the PFPF in FY2003, when an additional 9.30% was directed by the City to be assessed against its (CBSA) reserve.

While there may be a number of adjustments to reconstruct the chart to accurately reflect required contribution rates over time, we do acknowledge that the PFPF rate has been considerably higher than the GEPP rate over the period since FY2000, the starting point of the TaxWatch chart. However, this has not always been the case. **The seeds that gave rise to the growth in the UAAL of the PFPF and the growth in the City's required pension contribution rate to the PFPF were in large part sewn by the heavy use of reserve account assessments to meet the City's contribution rate and in the modest contributions that were made to the PFPF during the 22 year period from 1978 to 1999. During this period of time, the City's contribution rate to the GEPP was 23% while the City contribution rate to the PFPF was 13%. Had both plans enjoyed the same City contribution rates during this period, the funded status of the PFPF would be much more comparable to that of the GEPP. The decade of the 1990's was even more pronounced, with the GEPP enjoying a City contribution rate that was 13.7% higher than the PFPF (18.5% for GEPP vs. 4.8% for PFPF). The decade of the 1990's was particularly important inasmuch as this period is recognized as an extremely attractive period for institutional investors. Accordingly, the low City contribution rate extended to the PFPF during this period did not allow the PFPF to invest such cash flow and generate compounded returns that would have produced dramatic results in terms of eliminating large elements of the UAAL.**

It should be noted that the current City contribution rate of 32.11% for the PFPF is composed of a normal cost assessment of 8.18% and a UAAL assessment of 23.93%. This means that in the event that the UAAL were eliminated, the City's annual contribution to the PFPF would be reduced to 8.18%, thus reflecting a pension cost that is quite attractive given the fact that the City does not incur a 6.20% Social Security contribution expense for such employees.

“Generous” DROP Benefit from the 8.4% Interest Rate Distributed to Participants: The 8.4% interest rate for DROP participants was originally based upon the 8.5% long term actuarial rate of return assumption used for the PFPF. Over the long term, the PFPF is assumed to earn 8.5%, which if achieved, would fairly match up to the 8.4% rate that is passed on to DROP participants. The TaxWatch Report focused upon the negative rates of return being generated by the financial markets during the current calendar year in comparison to the 8.4% DROP rate, while ignoring the long term history of returns.

While disappointing returns such as that expected for 2008 will be encountered during a single fiscal year, we must also observe that the long-term achievement of the PFPF’s 8.5% annual return assumption would reasonably cover the 8.4% DROP rate on participant dollars left in the pension fund. **The Fund Actuary recently reported that the PFPF generated an average return of 9.36% over the 30 year period ended September 30, 2008.** We would note that this span of time includes many episodes of market setbacks, including the 1991 recession, the dot com crash of 2000-2002 and the majority of the current sub-prime loan debacle. Accordingly, the long term performance of 9.36% suggests that the Fund has demonstrated the actuarial ability to grant an 8.4% DROP rate despite occasional periods of negative returns.

We must also observe that the absence of a DROP Program and the aforementioned financial risks from the 8.4% DROP rate would effectively not remove such risks to the City but merely transfer them to a different form within the pension fund. This observation, along with other key factors worthy of consideration are described and explained in greater detail within Part III under the heading, “DROP Program and the Generous 8.4% Interest Rate”.

Suggested Audit of the PFPF:

The TaxWatch Report recommended that an audit be performed on the PFPF to ensure that appropriate controls and practices are in place. Perhaps the TaxWatch staff was not aware that a separate independent audit is annually performed for the PFPF. The findings of this independent audit are folded into the City’s Comprehensive Annual Financial Report. The current structure of issuing a separate independent audit for the PFPF allows for a concentrated examination of the internal controls and management processes. Each year, the PFPF has secured a “clean opinion”, a separate report on Internal Controls and a Management Letter from the independent auditors. Inasmuch as the auditor’s opinion is rendered solely upon the operations of the PFPF, the level of testing and review is quite detailed and comprehensive. By comparison, the level of testing applied to the GEPP by the City’s independent auditors is much less focused inasmuch as the audit opinion issued by the City’s auditors is based upon the entire scope of the City’s many diverse operations, with an associated dilution in the level of audit interest applied to the GEPP as a single operating unit. Accordingly, **the annual audit that is performed for the PFPF is much more rigorous than that**

applied in structures where a pension fund is merely one element of an entity's broader scope of activities.

Conclusion:

Based upon the manner in which pension data was presented within the Jacksonville Journey and Florida TaxWatch Reports, we can appreciate the fact that many readers of these reports may have developed an unflattering image of the City Retirement System. Many of these images could have been avoided had the authors included appropriate explanations and elaborations that would have better informed the reader. We are particularly troubled with the presentation of the Florida TaxWatch Report inasmuch as we offered numerous pages of background clarifications to the authors which they chose to exclude from the report. The purported basis for such exclusion was the explanation that clarifications of this nature would be confusing to the reader and that there was not room in the (38 page) report. This report is an illustration of the dangers in offering a casual collection of facts without appropriate explanation. Hopefully, the commentary contained in Part I and Part II of this paper has shed some light on matters that have been raised in the two reports.

Part III – City Pension System History and Discussion

As you can see from our preliminary comments, the subject of pensions is very complex and there are many moving parts and historical aspects to take into consideration when attempting to study the subject. We would now like to take this opportunity to present certain historical perspectives regarding the City's Retirement System. We feel that the foundation provided by this history is important for those wishing to develop a deeper understanding of current issues. Following a brief review of the historical record, we will cover a variety of pension subjects that have either been raised in recent months or bear discussion.

History of the City's Retirement System to 1976:

The City's Retirement System dates back in some cases to 1915; however, the modern era is generally recognized to commence in 1937. Throughout the period leading up to Consolidation, the City's Retirement System was largely administered on a pay-as-you-go basis. In 1971, City leaders recognized that this funding practice was seriously flawed and should not continue. Following an actuarial valuation prepared as of 10-1-1971, the City authorized a City contribution rate for the GEPP and the PFPF at the rates of 8.0% and 7.5%, respectively. **This 1971 valuation also set into motion a "staircase funding method" that called for the City's contribution rate to progressively rise to a level of 73.8% for the GEPP and 35.9% for the PFPF by 1991, where such rates would remain in place for a 20 year period until 2011.** Concurrent with the issuance of the 10-1-1976 actuarial valuation, the City decided to more aggressively address the pension funding requirements and abandon the "staircase funding method" in favor of an immediate increase in the City's contribution rates to a level above 20%. **At the time of this decision, the GEPP was funded at a**

rate of \$.11 for each dollar of liabilities and the PFPF was funded at a rate of \$.36 for each dollar of liabilities.

City Contribution Rates and Reserve Account Assessments after 1976:

The attached Exhibit A reflects the City contribution rates and reserve account assessments between FY1978 and FY2009. **This schedule reflects the fact that the GEPP enjoyed a materially higher level of City contributions and reserve account assessments over the first 22 years of this period by an amount of 10.27% (average or 23.35% for GEPP vs. 13.08% for PFPF).** Over the more recent 10 year period, the PFPF rate has been higher than the GEPP; however, the average level of funding for the GEPP remained higher by almost 3% over the entire 32 year period under review.

Exhibit B represents a graphical representation of Exhibit A. Exhibit B visually conveys the large difference in City contributions between the two pension plans over the period from FY1978 to FY1996. At that point, the City's contribution rates for the GEPP and the PFPF converge. This convergence resulted from a sharp drop in the City's GEPP rate in response to the issuance of the 10-1-1995 GEPP actuarial valuation which modified various overly conservative actuarial assumptions and funding practices which had previously caused the City to provide supplemental pension contributions over previous periods. During this time period the City recognized the fact that it had been contributing amounts far in excess of the minimum requirements and accordingly the City established the GEPP Past Excess Contributions (PEC) Account for possible future use in lieu of budgeted pension contributions.

During the period leading up to FY2000, the PFPF rate intersected the GEPP rate where it has remained to the present time.

Use of Pension Reserve Accounts in Lieu of City Pension Contributions:

Both pension plans possess reserve accounts that may be used in lieu of City pension contributions. The reserve account maintained within the GEPP is referred to as the PEC (Past Excess Contributions) Account, while the reserve account maintained within the PFPF is referred to as the CBSA (City Budget Stabilization Account). **During periods of budget stress and in campaigns to cut the millage rate, the City has frequently relied upon the use of these two reserves rather than include a higher pension contribution rate within the City's Annual Budget.** The level of periodic reliance upon the pension reserve accounts is visually represented by the gap between the solid lines and the dotted lines reflected in Exhibit B. We estimate that \$68.6 million of PFPF reserves and \$95.7 million of GEPP reserves have been used to date in providing relief to the City's Annual Budget.

Exhibits C and D reflect the annual dollar values of reserve account usage for the two pension plans. Had the City not chosen to use such reserves and alternatively elected to remit such dollars from the City's Annual Budget, the pension funds would have been able to invest this incremental flow of City contributions. **The**

investment of such incremental cash flows at the actual rate of return recorded by the PFPF would have produced \$125.4 million for the PFPF (see Exhibit C) and \$149.4 million for the GEPP (see Exhibit D).

Recent Increase in PFPF Contribution Requirements:

The pension contribution rate for the PFPF has clearly increased by a substantial amount over the last several years. This experience relates to the confluence of several events that have all worked against the collective desire of all parties to hold down the cost of the plan to the City. The attached Exhibit E attempts to reconcile the sources for the increase in rates that emerged between the Actuarial Valuations of 4-1-2000 and 10-1-2006. The percentage impact from four separately identified factors are summarized as follows:

Impact of dot com Stock Market Crash	53%
Impact of Miscellaneous Actuarial Losses	22%
Increases due to Benefit Enhancements	15%
Increases due to Revenue Reductions	<u>10%</u>
Total	<u>100%</u>

Recent Pension Benefit Enhancements:

Over the last 10 years the City Council has granted two pension benefit enhancements for the PFPF that have been determined by the plan actuary to carry an actuarial impact. As reported on Exhibit E the two benefit enhancements authorized in recent periods represent only 15% of the recent increase of the City's pension contribution requirements. The two pension enhancements are summarized as follows:

1. Enhancements authorized by Ordinance 2000-1164-E (enacted on 2-15-2001) – This Ordinance shortened the period for the attainment of an 80% pension from 32 years of service to 30 years of service. The actuary reported that this enhancement carried a cost equivalent to 1.32% of payroll. The City agreed to grant this benefit if the members of the Fund would increase the allocation of Chapter Funds by an amount equivalent to 1.5% of payroll and additionally authorize a transfer of \$28,837,723 from the Member's Enhanced Benefit Account to the City's CBSA. The Fund complied with this request for the future costs associated with this benefit enhancement. **The City elected to use this \$28.8 million lump sum infusion as the alternative source for meeting its contribution requirements to the Fund in lieu of General Fund budgetary assessments. The \$28.8 million transfer has subsequently been largely depleted due to its continued use in this manner, largely to support the millage reduction program.**
2. Enhancements authorized by Ordinance 2003-1338-E (enacted on 3-12-2004) – This Ordinance provided for an increase in the value

of the Health Supplement from \$3 to \$5 per month per year of service. The Ordinance was proposed for PFPF members after a similar Ordinance (2003-573-E) was granted for members of the GEPP. The actuary reported that this enhancement carried a cost equivalent to 1.77% of payroll. The City agreed to grant this benefit if the members of the Fund would commit in perpetuity 1% of the Chapter Funds derived from the State for enhanced benefits. The Fund complied with the City's request in this regard. By comparison, the City paid 100% of the actuarial cost relating to the Health Supplement enhancement granted to GEPP members pursuant to the enactment of Ordinance 2003-573-E.

As evidenced from the above, the benefit enhancements that have been granted to PFPF members over the past 10 years have been significantly accompanied by the contribution and dedication of resources from member assets.

Rate Pressures from Relinquished Court Fines:

A portion of the rate pressures causing an increase in the City's pension contribution to the PFPF is attributable to the City's recent decision to turn over certain court fine revenues to the State of Florida beginning in FY2005 in conjunction with Article V reorganizations of the court system. In exchange for the relinquishment of revenues, the City was able to transfer certain court expenses to the State which had theretofore been absorbed within the City's Annual Budget. **This decision was advantageous to the City's budget; however it produced negative consequences to the PFPF inasmuch as the PFPF had formerly received 30% of such revenues. The City's relinquishment of its 70% share triggered to loss of the PFPF's 30% share.** The PFPF had formerly used its 30% share of such court fine revenues as a means of holding down the level of City pension contributions required annually from the City's General Fund Budget. The decision to relinquish court fine revenues caused a revenue decrease to the PFPF of \$1.7 million or the equivalent of 1.91% in the pension contribution rate according to the Plan Actuary (see Exhibit E).

Subdued Growth in PFPF Payroll Base:

A pension plan that is regularly supported by a growing base of active employees tends to enjoy a progressively enhanced financial profile. This is particularly true for plans like the PFPF that are attempting to pay down large UAAL balances. **However, when the growth in the payroll base is subdued, the growth in pension contributions is below its potential to make inroads in UAAL liquidation efforts.** While the payroll base of the PFPF has enjoyed positive growth, it is nevertheless subdued, with an increase of only 52 members since FY2005. To illustrate this point, the count of active PFPF members is offered:

	<u>Active</u>	<u>Droppers</u>	<u>Total</u>
FY2005	2,450	281	2,731
FY2006	2,509	221	2,730

FY2007	2,541	230	2,771
FY2008	2,534	248	2,782

One of the factors that subdues the growth in the PFPF payroll base is the imposition of a lapse factor in establishing the City’s Annual Budget. This is particularly true for the Fire Department which carries a number of vacant positions throughout the year in order to meet its lapse requirement. Overlaid on top of this aspect is the fact that position authorizations for the Fire Department have been flat in recent years. The Sheriff’s Office periodically enjoys surges in funding to combat crime; however, these financial authorizations are often for overtime, which does not count for pension contribution purposes and does not result in creation of additional “dues paying members” that would have otherwise acted to expand the payroll base.

Another factor has also acted to indirectly subdue the growth in police officer positions. This factor relates to the recently created classification of “Community Service Officers”, the so-called “yellow shirts”. These positions were created to absorb traffic duties and other traditional police officer assignments so as to better allow police officers the ability to devote more time and energy to crime fighting efforts. **This program, while immediately effective from a City budgetary standpoint (given the lower pay and lack of employee benefits extended to “Community Service Officers”), represents an alternative to increases in police officer positions and accordingly contributes to a subdued growth in police officer positions which weakens the ongoing program to liquidate the UAAL. A recent survey indicated that there were 82 Community Service Officers employed by the City.**

The low rate of inflation that has persisted in recent years has generally translated into lower settlements at the bargaining table. Such modest rates of increase in wages further subdues the growth in the payroll base which inhibits the City’s progress in liquidating the UAAL.

DROP Program and the “Generous” 8.4% Interest Rate:

Much attention has been directed toward the 8.4% interest rate credited on DROP balances. As we review this aspect of the program we must consider the situation that would exist if there was in fact no DROP for which to credit 8.4% on program balances. **If there was no DROP, the DROP participant would record a higher pension percentage (due to longer years of service) applied to a higher final average salary (due to salary increases and promotions during the period of DROP participation).** This higher level of traditional pension obligation to the pensioner (as opposed to an alternative DROP payout obligation) would represent a larger lifetime payout liability to the pensioner that would be discounted for present value purposes and City contribution rate purposes at the actuarial assumed rate of 8.5%. Accordingly, the City is already effectively crediting interest at 8.5% for PFPF credited pension service (and 8.4% for GEPP credited pension service) under the traditional pension payout methodology. By reducing this traditional payout which is budgetarily discounted at 8.5% with an

alternative form of payout (such as under the DROP), which is budgetarily discounted at the similar rate of 8.4%, one could fairly observe that **the presence of the 8.4% DROP interest rate does not introduce incremental rate risks to the City beyond those that it already accepts in the traditional plan. Accordingly, the 8.4% DROP guaranteed rate would not go away with the hypothetical termination of the DROP, it would merely present itself in a different form as an 8.5% guaranteed rate on traditional pension distributions.**

Over the long term, the 8.4% DROP rate will not introduce financial pressures upon the City to the extent that the PFPF earns its 8.5% actuarial assumption over the long term. This notion is illustrated by the investment experience recorded over the 30 year period ended September 30, 2008. Over this period (which includes the majority of current market losses) the PFPF generated an average return of 9.36%, according to the Fund Actuary.

When critics discuss the 8.4% PFPF DROP rate they often compare it to the 6.5% DROP rate offered by the Florida Retirement System (FRS) to its members. When making such comparisons we must be mindful that FRS participants do not pay anything toward their pension while PFPF members pay 7% (not to mention earmarks of Chapter Funds). We must also acknowledge the fact that FRS members are also enrolled in Social Security for which the State and participating agencies pay a 6.2% matching contribution. By comparison, PFPF members are not enrolled in Social Security which saves the City 6.2% in matching contributions. In addition to these factors we must also acknowledge the fact that PFPF members pay a separate fee to the PFPF in an amount equivalent to 2% of each paycheck during their 5 year period of DROP participation. This remittance is not deposited into their DROP account but is rather treated as a non-refundable fee paid to the Fund for the privilege of joining the DROP and enjoying the benefits related thereto, including the 8.4% rate.

The discussion of DROP would not be complete without a reference to the fact that the City enjoys the personnel services of DROP participants without the need to absorb the cost of normal personnel support charges such as pension contributions or social security contributions on the value of such personnel services performed by DROP participants. When a DROP participant enters the DROP he may remain in that posture for a period of 5 years. During this entire 5 year period, the City does not pay any contribution rate to the PFPF. At the time that the DROP was established, the City was asked if it would be interested in continuing to pay a City matching contribution rate on member's salary during their period of DROP participation as a means of strengthening the plan. **Recognizing the initial budgetary savings that would accrue to the General Fund, the City alternatively elected to establish a 0% pension contribution rate for DROP participants. Since the implementation of DROP through the period ending with the current fiscal year, the City has avoided the expenditure of \$41.2 million in pension contributions (see below table) that**

would have alternatively been required for non-DROP employees. The level of annual savings enjoyed to date by the City from this aspect of the program may be summarized in the following table. Accordingly, any review of the DROP and the 8.4% rate credited on DROP balances must fairly consider all aspects of the program before rendering judgment.

FY1999	\$ 724,270
FY2000	1,765,988
FY2001	2,465,553
FY2002	2,756,900
FY2003	3,453,527
FY2004	2,351,835
FY2005	3,693,229
FY2006	4,906,536
FY2007	5,228,898
FY2008	6,255,012
FY2009	<u>7,600,000</u> Estimate
Total City Savings	<u>\$41,201,748</u>

Investment Returns for the FYE 9-30-2007:

In view of the stunning set backs experienced in the stock market during calendar year 2008, we would like to present return data through the favorable market period ending in FY2007 and contrast this experience to return data through FY2008 along with monthly returns for October and November of 2008.

Reviews of pension plans frequently include comparisons of investment returns vs. the actuarial assumption and the returns of various peer groups. This type of investment return information for the fiscal year ended September 30, 2007 was compiled by Merrill Lynch. Within their report, Merrill Lynch compared PFPF and GEPP investment performance to a peer group database of comparable public pension plans with an indication as to percentile rankings. For example, the below PFPF ranking of 21 for FY2007 indicates that the PFPF return exceeded the returns for 79% of other pension plans. Data included in the Merrill Lynch report is summarized as follows:

	<u>PFPF</u>	<u>GEPP</u>
1 year period ended 9-30-2007	15.3% (21)	14.4% (57)
2 year period ended 9-30-2007	11.9% (13)	11.3% (36)
3 year period ended 9-30-2007	11.7% (26)	10.9% (61)

Investment Returns for the FYE 9-30-2008:

The investment return information for the fiscal year ended September 30, 2008 was compiled by Summit Strategies Group. Within this report, Summit Strategies compared PFPF and GEPP investment performance to the ICC (Investment Consultants Cooperative) database, which is recognized as the most extensive database maintained in the industry. Data included in the Summit Strategies

report, along with comparable percentile rankings within the ICC database, is summarized as follows:

	<u>PFPF</u>	<u>GEPP</u>
1 year period ended 9-30-2008	(12.45%) (20)	(15.17%) (51)
2 year period ended 9-30-2008	.46% (20)	(1.51%) (74)
3 year period ended 9-30-2008	3.09% (39)	1.68% (84)

The data reflected in the above tables offer conclusive evidence that the City's pension plans have consistently delivered competitive returns vs. those delivered by peer groups, with the PFPF currently enjoying particular success. As an extra comparison, the Florida Retirement System (FRS) recently reported a return of (15.01%) over the one year period ended September 30, 2008. **The above analyses point to the fact that the PFPF has delivered superior relative investment returns in both good market periods (the three years ended September 20, 2007) and in bad market periods (the three years ended September 30, 2008).** The performance of the GEPP would have been greatly enhanced to (14.02%) for FY2008 had it not been for the disappointing returns delivered by CSSC who administered 25% of the GEPP portfolio on an experimental basis during FY2008. This firm was terminated by the City on November 13, 2008. Now that this termination has been completed, GEPP returns are expected to be more closely aligned to PFPF returns in the future.

Investment Returns for October and November of 2008:

The current impact upon the stock market from the sub-prime loan debacle and its spill over into the credit markets extended through the entire months of October, 2008 and November 2008. Accordingly, we have elected to additionally disclose the investment returns reported for these months by Summit Strategies Group. Peer rankings are not currently available; however, **the PFPF return for October and November of 2008 is believed to be very attractive on a relative basis.** This belief is strengthened by a recent disclosure by the FRS that its investment portfolio lost 27% over the 13 month period ended October 31, 2008. The Kansas Public Employees Retirement System recently reported a loss of 30% over this period. Negative investment return data recently published by Summit Strategies Group is summarized as follows:

	<u>PFPF</u>	<u>GEPP</u>
Month of October, 2008	(11.25%)	(13.16 %)
Month of November, 2008	(2.72%)	(3.23 %)

The underperformance of the GEPP vs. that of the PFPF over the very difficult months of October, 2008 and November, 2008 were also linked to the continuing disappointing returns delivered by CSSC. Had it not been for the drag on performance represented by CSSC for the month of October, 2008, the return posted by the GEPP would have been (12.33%).

Decline in the Market Values of the City’s Pension Portfolios:

The negative returns described above since October 1, 2007, have produced a sizeable decline in the market value of the investment portfolios of the City’s pension plans. While a portion of this decrease (approximately \$20 million for each plan) is attributable to the fact that both of the City’s pension plans have a negative cash flow (that is, a situation where current pension payroll requirements exceed current employee and employer pension contributions), the vast majority of the decrease relates to the decline in the stock market. In an effort to illustrate the dollar impact of the above described percentage losses, we have offered in the below table a comparison of the pension portfolio market values reported by the Bank Custodian, after making appropriate adjustments to reflect the Haverty’s project in such data:

	<u>PFPF</u>	<u>GEPP</u>
Market Value @ 9-30-2007	\$1,066,673,934	\$1,837,780,618
12-Month Decrease	<u>141,117,126</u>	<u>327,849,059</u>
Market Value @ 9-30-2008	\$ 925,556,808	\$1,509,931,559
2-Month Decrease	<u>125,206,987</u>	<u>244,384,565</u>
Market Value @ 11-30-2008	<u>\$ 800,349,821</u>	<u>\$1,265,564,994</u>
Combined 14-month Decrease	\$ 266,324,113	\$ 572,233,624

We are hopeful that the declines reflected above will represent the trough for the current market cycle. We are encouraged that this may very well be the case based on the more positive tone and increasing market prices that have emerged since December 1, 2008.

State-Imposed Investment Restrictions and PFPF Legal Action Against the State:

While we are proud of the relative investment performance described above, the PFPF could have delivered even greater returns had the Fund been able to exercise the same level of investment flexibility enjoyed by the FRS and all of the General Employee Pension Plans established throughout the State of Florida which are permitted to employ the authorizations provided under Section 215.47, Florida Statutes. As an illustration of the impact of such restrictions, we would offer a simple comparison of S&P 500 returns to that of the EAFE. According to Merrill Lynch, the S&P 500 delivered a return of 8.5% over the 6 year period ended 9-30-2007. Over this same period, the EAFE delivered a return of 16.4%. Had the PFPF been able to invest 20% in International equities rather than our current limit of 10%, the PFPF could have enjoyed an incremental return of 7.9% on \$100 million over this 6 year period (or \$47.4 million without compounding). A more comprehensive analysis was prepared by Merrill Lynch which offered the view that the total impact to the PFPF from State-imposed investment restrictions over the most recent 10 year period was \$313 million.

The PFPF has previously requested the Florida Legislature and administrative oversight agencies to lift the State imposed restrictions. Concentrated efforts over the last three years have failed to secure such relief. The PFPF will once again

seek relief during the 2009 Legislative Session. Local Bill J-2 (Resolution 2008-906) is a part of this larger effort.

The PFPF has grown weary of the bureaucratic meddling and petty politics practiced in Tallahassee which has repeatedly frustrated our efforts to allow the Fund to pursue reasonable and necessary programs of investments. The past failure of the State to release the PFPF from these investment restrictions has caused an adverse financial impact to Jacksonville tax payers in the form of higher pension contribution rates. We feel that the current restrictions will continue to produce adverse financial impacts if they remain in effect. **In view of the present situation the Board has been forced to take the unpleasant but necessary step of filing legal action against the State of Florida to correct the current situation. The Trustees authorized this action on December 11, 2008 and the legal action is expected to be filed in Tallahassee in the next few days.**

UAAL Element of City Contribution Requirement:

The current City contribution rate of 32.11% is composed of a “Normal Cost” element (8.18%) and an “Unfunded Actuarial Accrued Liability” (UAAL) element (23.93%). **Once the UAAL is liquidated, the City pension contribution rate will drop to 8.18%. The UAAL is scheduled to be liquidated in 21.5 years. Accordingly, there will be a point in history where the City’s contribution rate will decrease to an attractive level.** A separate discussion on the UAAL is addressed in Part IV.

Settlement Agreement:

Chapters 175 and 185 of the Florida Statutes authorize the distribution of (insurance) premium tax income collected by the State, generally referred to as “Chapter Funds”, to municipalities that sponsor pension plans for police officers and firefighters. State legislation has historically associated the term “extra benefits” for the stipulated use of such Chapter Fund distributions by local governments. Over the years, on a state-wide basis, it became apparent that many municipalities were using the Chapter Funds as a substitute for City pension contributions rather than being used as a source of funding for the purpose of granting “extra benefits”. This growing awareness and differing interpretations generated a host of disputes and lawsuits throughout the State to challenge the then current practices of many municipalities. **The issue was resolved locally with the negotiation of a “Settlement Agreement” between the City and the Trustees of the Jacksonville Police and Fire Pension Fund. This Settlement Agreement was considered and authorized by the City Council with the enactment of Ordinance 91-1017-605. The legislation was signed into law by Mayor Ed Austin on August 17, 1992.** The Agreement was subsequently amended on multiple occasions by both Mayor John Delaney and Mayor John Peyton pursuant to legislation presented to and adopted by the City Council serving during their administrations. The Settlement Agreement originally covered a short period of time pending the resolution of various funding issues. Once these issues were satisfied, the Agreement was extended to resolve all differences over the period extending to September 30, 2030.

The Settlement Agreement acknowledges the range of “Base Benefits” that have been agreed to over the term of the Agreement (to September 30, 2030). The primary elements of “Base Benefits” which are described in Article VII of the Settlement Agreement are summarized as follows:

- a. Time Service Retirement Eligibility –20 years of service regardless of age.
- b. Benefit formula – 3% for the first 20 years of service and 2% per year thereafter, subject to a maximum of 80% upon reaching 30 years of service.
- c. Spousal Benefit – 75% benefit continuation to spouse upon the death of the member.
- d. COLA – flat 3% COLA granted in January of each year.
- e. DROP Program – in accordance with the program originally established by DROP Ordinance 97-1103-E, as amended.
- f. Adjustment Supplement - \$5 per month per year of service.

The above described “Base Benefit” structure was established pursuant to the extension of valuable consideration in the form of annually recurring Chapter Fund commitments and lump sum transfers of cash to the City from funds under the control of members. The commitment of Chapter Funds is represented by the annually recurring commitment of Chapter Funds in an amount equivalent to 4% of the active member payroll over the period extending to September 30, 2030. Based upon the November, 2008 PFPF payroll base of \$150 million, the 4% commitment carries an annual valuation of \$6 million. This posture effectively means that the members have agreed to dedicate \$6 million from a funding source made available by the State for “extra benefits” toward the purchase of a package of pension benefits authorized by the City. In addition to this consideration, lump sum transfers to the City have also been authorized in the total amount of \$42.5 million to date. \$13.7 million of this amount was transferred as a part of the original Settlement Agreement and \$28.8 million was transferred from members in 2000 as a part of the provisions of Ordinance 2000-1164-E. Accordingly, from the perspective of the members, the City has accepted these resources in exchange for a package of “Base Benefits” that are promised through the period ending September 30, 2030.

The Settlement Agreement also contained language that reaffirmed the resolve among the parties to honor the provisions of the Agreement as a means of demonstrating the spirit of cooperation reached during the long process of developing a comprehensive understanding without the need to resort to litigation. Sample language in this regard stated that **“the parties agree to make available to each other on a continuing basis, all information that is necessary to insure the success of this Agreement and to avoid the creation of any further disputes, to execute any and all documents necessary to fulfill the terms of this Agreement, and to work harmoniously to enforce the provisions of the Agreement”**. In addition, the Agreement states that **“both the City and the Board hereby covenant and agree that they shall neither take any action nor**

fail to take any action, nor, to the extent that they may do so, permit any person to take any action which, if either taken or not taken, would adversely affect the terms of this Agreement”.

Notwithstanding the above described representations, we have been made aware that the City is probing ways to avoid its obligations under the Settlement Agreement. Advocates of this action are reportedly of the opinion that the Settlement Agreement is a non-binding instrument upon the City and that the City is therefore free to unilaterally ignore its provisions. We have not been informed as to the legal theory that would support this view other than the belief that one City Council cannot bind another. If that were true, the Jacksonville Jaguar’s Lease, the MPS parking agreement, various bond repayment obligations and virtually any other multi-year understanding could be similarly abandoned by the City without consequences when it found them to be inconvenient. The enforcement of contracts represents a fundamental element of a free society that is protected by the U.S. Constitution (see Article I, Section 10). **Accordingly, the PFPF considers the Settlement Agreement to be a morally and legally binding understanding that governs a specifically defined structure of pension benefits over the period extending to September 30, 2030. Any alteration in this understanding would require the consent of both parties.**

Proposals for a Two-Class Pension Benefit Structure:

In an effort to cut costs, organizations occasionally consider the introduction of a lower-cost pension benefit for new employees just entering the system. This could take many forms, including a lower percentage accrual rate per year of service, an age requirement for drawing pension benefits, or a reduced benefit for surviving spouses. Suggestions offered by observers also tend to center around the need to replace the current “defined benefit” structure with a “defined contribution” structure. Proponents of these cost-cutting measures for the PFPF should consider the following issues:

1. It would take many years before the introduction of such a measure would produce any meaningful budgetary impact to the City.
2. History has shown that the lower class pension group is in many cases eventually able to achieve parity with the traditional pension class over time. Upon the initial introduction of the lower-cost pension structure, there is no constituency to voice opposition to the concept. However, after a period of years, the ranks of the new class of pension beneficiary progressively grows and they become more influential over time in their quest for parity. To the extent that they are successful in achieving parity, the sponsoring government may be required to accept an upward recalculation in the UAAL to retroactively acknowledge a higher pension liability. This course of events would be more costly to the City than if the traditional pension plan was consistently offered. The above described scenario was previously experienced within the City’s

Retirement System. In an effort to save money, the City introduced a less attractive pension plan for all employees who were hired after May 8, 1963. Employees hired after this date were very vocal about the unfairness of this situation and once their numbers grew to a sufficient size, their pleas were considered by the City. On August 11, 1992 Ordinance 91-1017-605 was enacted to grant parity to all public safety employees. A similar parity bill was granted for General Employees with the adoption of Ordinance 94-488-771.

3. The presence of two pension classes for two employees working side by side introduces obvious morale problems for the newer employee.
4. The introduction of a lower pension benefit structure for new employees will harm recruitment efforts. This reality confronted the City of San Diego when they attempted this measure in recent years. In the case of the City of Jacksonville, this concept would introduce particular financial impacts to new recruits who are already suffering the impact of a discounted starting wage that persists over their initial years of employment. The combined impact of these twin measures would pose a particular recruiting obstacle to Jacksonville which requires a 4-year degree for new police recruits.
5. The consideration of a lower-cost pension benefit structure would likely require discussions at the bargaining table. Concessions in the area of pensions could result in higher wage concessions for existing employees.
6. The shortcomings of defined contribution plans are well documented and such programs are particularly unsuitable for public safety employees. The diversion of new employees into DC programs would weaken the growth in the payroll base, causing an increase in the City's contribution rate required to liquidate the UAAL.
7. The discussion of this issue in Jacksonville carries the additional complexities relating to the existence of a Settlement Agreement that establishes the current benefit structure until the year 2030 and the need to preserve the continued receipt of State Chapter Funds. In consideration for the current benefit structure, the members of the Fund have dedicated the equivalent of 4% of payroll from Chapter Funds and a lump sum transfer of \$42.5 million to the City (\$13.7 million in 1991 and \$28.8 million in 2000). **A reduction in the current benefit structure would require a discussion as to the value of such benefit reductions and the associated need to**

refund previous lump sum transfers and/or recurring revenue commitments that were extended to secure the present benefit structure.

Times-Union Survey of Comparable Pension Plans:

On September 7, 2008 the Florida Times-Union published a headline article featuring the fact that the PFPF had a UAAL of \$534 million. This article also revealed the findings of a Florida Times-Union survey which compared key benefit structure aspects along with the City contribution rates required to support that structure for comparable plans in other major Florida cities. **The newspaper survey indicated that the benefit structure as well as the City contribution rates for the PFPF fell below those reported by other major cities.** For example, the 32.11% PFPF contribution rate fell below that of Fort Lauderdale (36%) and Miami (40%). In addition, the provision for an 80% pension at 30 years of service for the PFPF fell below that of Ft. Lauderdale (81%), Miami (98%) and Tampa (95%). Had the survey included Orlando, the newspaper would have found that Orlando offers a very costly program of health insurance to its retirees while City retirees in Jacksonville pay 100% of the annually established premium determined by the City for enrollment into its Group Health Insurance Program. **In view of these findings, we should conclude that the benefit structure offered in Jacksonville is not excessive nor out of line from the pension structures offered elsewhere in the State of Florida.** What is out of line locally is the funded status and the level of the UAAL locally. The newspaper story reported the funded status of Ft. Lauderdale at 82%, Miami at 104.7% and Tampa at 109%. In addition, the funded status of FRS was recently reported at 107.1%.

Part IV – Unfunded Actuarial Accrued Liability (UAAL)

Considerable discussion has taken place regarding the Unfunded Actuarial Accrued Liability (UAAL) of the City's Retirement System. The UAAL for the City's Retirement System was most recently measured in the combined amount of \$765 million as of September 30, 2007. This measure is broken down between the PFPF and the GEPP/Corrections in the amounts of \$534 million and \$231 million, respectively. The extent of such liabilities will increase once the actuarial updates for the FYE 9-30-2008 are completed due to the market losses that were recorded in FY2008. In view of the level of interest in this issue we have elected to devote this entire Part IV to this subject.

Summary of the UAAL Since 1994:

The historical record of the UAAL for both the GEPP and the PFPF is offered on the attached Exhibit F. This information was extracted from various City Comprehensive Annual Financial Reports (CAFR's). A graphical analysis of this historical record is presented on the attached Exhibit G.

UAAL of the GEPP Since 1994:

In 1994 the UAAL of the GEPP stood at \$247.7 million based upon data reflected

in the 10-1-1995 Actuarial Valuation. The City implemented a number of significant modifications and acknowledgements within the 10-1-1995 Actuarial Valuation which collectively pushed down the City's pension contribution rate from 23.66% to 12.32% and the UAAL from \$247.7 million to \$176.0 million. These conclusions resulted from the acknowledgement of actuarial gains, changes in actuarial assumptions and changes in the City's Actuarial Cost Method. One of the more significant impacts to the City's contribution rate and the UAAL resulted from a change in the City's actuarial assumptions which reduced the City's contribution requirement by 9.30%. Included among these changes was an increase in the assumed growth in the member payroll base from 1.6% to 4% per year for purposes of amortizing the UAAL, which in effect abandoned the very conservative set of assumptions that provided for the aggressive schedule for liquidating the UAAL that had formerly been in place.

The remaining years of the 1990's recorded significant investment returns which allowed for the GEPP to fully liquidate the UAAL. Accordingly, the combined impact of changes in actuarial assumptions and strong stock market returns between 1994 and 1999 fully liquidated the \$247.7 million UAAL that existed at 10-1-1994. The strong stock market returns of the 1990's abruptly reversed itself in the periods following April of 2000. Back-to-back negative return years contributed to the UAAL of the GEPP experiencing a rapid increase to \$185.2 million by 10-1-2003. The UAAL further experienced an increase to \$314.1 million from the residual acknowledgement of investment losses coupled with the impact of the adoption of plan changes which increased the health supplement from \$3 to \$5 per month per year of service pursuant to the enactment of Ordinance 2003-573-E. Further assumption changes reduced the amount of UAAL increase by \$69 million.

Since rising to a peak of \$314.1 million at 10-1-2004, the UAAL of the GEPP and the Corrections Plan has been reduced to \$231 million, primarily as a result of the resurgence in the stock market through the period ended September 30, 2007. The value of the UAAL will be recalculated by the City's Actuary as of 10-1-2008 pursuant to the preparation of an updated actuarial valuation that will be released in early 2009. The UAAL is expected to rise once this report is released.

UAAL of the PFPF Since 1994:

In 1994 the UAAL of the PFPF stood at \$52.4 million based upon the 10-1-1994 Actuarial Valuation. At this point in time, the UAAL of the PFPF was materially below that of the GEPP inasmuch as the \$247.7 million UAAL of the GEPP reflected the then recent adoption of COLA Ordinance 93-99-41 which was enacted by the City Council on 2-9-1993 for the benefit of members of the GEPP. After a lengthy period of study, the City Council granted a similar COLA program for members of the PFPF with the enactment of COLA Ordinance 93-1983-1407 on 3-26-1996. A \$126.1 million impact to the UAAL of the PFPF was subsequently acknowledged by the Fund Actuary within the 10-1-1996 Actuarial Valuation. This impact contributed to the increase in the UAAL of the PFPF from \$52.8 million at 10-1-1995 to \$179.4 million at 10-1-1996. An additional surge in

the UAAL of the PFPF to \$227.4 million was recorded as of 10-1-1997 in conjunction with the issuance of the 10-1-1997 Actuarial Valuation. This increase was largely attributable to the \$44.1 million impact associated with various changes in actuarial assumptions, which included an increase in assumed retirement patterns and a reduction in the assumed investment yield on investments from 8.75% to 8.40%.

After a period of stability to 10-1-1999, the UAAL sharply decreased to \$124.9 million following the issuance of the 4-1-2000 Actuarial Valuation. This sharp drop was accomplished in conjunction with a "Fresh Start" actuarial methodology which accelerated the acknowledgement of the sizeable investment returns that were recorded during the latter part of the 1990's. This approach had a similar positive effect upon the City's required contribution rate. The acceleration of these investment gains was short-lived inasmuch as the investment climate turned disastrous immediately after 4-1-2000, with the introduction of the dot com market crash. This episode largely contributed to a sharp increase in the UAAL in following measurement periods. The full impact of the dot com crash was largely reflected in the \$413.9 million valuation of the UAAL that was established in conjunction with the 10-1-2003 Actuarial Valuation.

At the end of FY2003, the City Council found itself in a similar posture to that which existed in 1993 when the COLA benefit was granted for GEPP, but not for the PFPF. On 6-24-2003 the City Council enacted Ordinance 2003-573-E which provided for an increase in the health supplement from \$3 to \$5 along with its simultaneous payment with the COLA. Following the enactment of this benefit for the GEPP, the City Council enacted a similar Ordinance for members of the PFPF on March 9, 2004 (Ordinance 2005-1338-E). The impact of this benefit enhancement, together with certain actuarial losses, caused the UAAL to be calculated at \$494.4 million as of 10-1-2004.

The UAAL of the PFPF is currently established at \$534 million as of September 30, 2007. The value of the UAAL will be recalculated by the Fund's Actuary as of 10-1-2008 pursuant to the preparation of an updated Actuarial Valuation that will be released in early 2009. The UAAL is expected to rise once this report is released.

Part V – Recommendations for UAAL and City Budget Relief

Previous Recommendations that have been Implemented:

The City has repeatedly approached the PFPF with requests for ideas on how the City could enjoy relief from its pension expenditures for the next "tight" budget or "tight" budget period, which has seemed to be the consistently announced norm over the past 20 years. We note that many of these tight budgets are self inflicted by virtue of the City's long standing campaign to cut the millage rate. We have responded to such requests for ideas on securing budget relief on many occasions. Some of the more significant programs of City budget relief that were implemented in the last several years regarding the PFPF include the following:

1. Establishing a \$13.7 million City Budget Stabilization Reserve and stipulating a graduated increase in the City's pension contribution rate beginning at 7.25% in FY2000 as a part of the Settlement Agreement. This arrangement established a relatively low contribution rate for a period of years and created a pool of reserves that the City could earmark in lieu of City pension contributions.
2. Transferring a supplemental \$28.8 million to the City's Budget Stabilization Reserve from Member Reserves as a part of an amendment to the Settlement Agreement. This transaction replenished \$28.8 million into the City's depleted \$13.7 million Budget Stabilization Reserve, thus creating a fresh pool of reserves that the City could earmark in lieu of City pension contributions.
3. Instituting a "Fresh Start" concept on April 1, 2000, accelerating the actuarial investment gains from the bull market returns of the 1990's and in the process driving down the City's pension contribution requirement over the next ensuing period(s).
4. Instituting a "payment delay" concept allowing the City to delay by one year the introduction of increasing actuarial funding requirements.
5. Allowing the City to receive an advance from the Member's Reserve Account to the City's Budget Stabilization Reserve in the amount of \$1.5 million (essentially representing a line of credit).
6. Accepting abandoned and deteriorated downtown historic structures to be used as a credit against the UAAL and in the process reducing the City annual UAAL amortization requirement.

Recommendations made in recent years that have not been realized to date nor implemented by the City include the City's issuance of Pension Obligation Bonds to liquidate a portion of the UAAL, the transfer of a portion of the City's vast Cecil Field holdings for use as a timberland portfolio for the PFPF, the dedication of a slight annual increase in the City's millage rate for UAAL liquidation, and a relaxation of PFPF's investment restrictions so that it is able to pursue the same investment options as that enjoyed by the GEPP and other progressively established pension plans across the country. Two of these previous recommendations are described in more detail below.

Pension Obligation Bonds (POB's):

The prior recommendation that the City consider the issuance of Pension Obligation Bonds should receive a second look given the current situation in the financial markets. The combined impact of historically low interest rates, coupled with historically low stock market valuations collectively present an

attractive environment for the success of such bonding programs moving forward.

The dollar value of the UAAL essentially represents a debt that carries an interest rate of 8.5%. For this reason, the PFPF has periodically raised the subject of the City's possible issuance of a POB, the proceeds of which would act to reduce the outstanding value of the UAAL and the accompanying 8.5% interest rate attached to its value. A successful arbitrage can be realized by the City to the extent that it is able to issue bonds at a rate below 8.5%.

Real Estate Transfer Programs:

The City and the PFPF have recently collaborated on real estate transfer programs involving the historic Laura Trio and the Haverty's Building. These programs involved a concept wherein the City received an actuarial reduction against the UAAL for the value of the real estate that was transferred. This transaction benefits the City from the impact of a lower pension contribution requirement to the PFPF. The PFPF is able to allocate the necessary capital to advance the real estate development by the inclusion of such projects as an element of its real estate asset allocation. Such transactions represent a classic win-win for all parties. **This concept could and should be replicated in other areas for the mutual benefit of the City and the PFPF. The City's surface lot at Forsyth and Main, the JEA property adjacent to the School Board Building, and various City-owned parcels at Cecil Field all represent opportunities for consideration.**

Part VI – JCCI Focus on Sustainability, Transparency, Accountability and Best Practices

During their review of City finances, the JCCI is focusing their attention upon the need to evaluate programs in terms of sustainability, transparency, accountability and the level of best practices associated with the operating unit. The issue of sustainability has also been raised by other observers in response to the recent increases in the UAAL of the City's pension programs and in the growing level of City pension contributions required to support those programs. We would like to take this opportunity to respond to these subjects:

Long-Term Sustainability:

Over the past few years the UAAL and the City's required contribution rate to support the PFPF has increased by a significant amount and current market events suggest that this trend will increase in the immediate future in response to the completion of updated actuarial valuations. These recent trends have raised the issue of sustainability and whether the current trajectory will continue and if so, for how long before contribution rates and the UAAL begin to recede. Casual observers frequently assume or assert that the factors that gave rise to these conditions are explained by poor investment performance, a bloated benefit structure, recent benefit enhancements, and/or excessive administrative costs. Those inclined to share these views frequently assert that the present structure is

not sustainable and therefore it is in need of reform. Observers taking this view suggest that the prescription for this condition is the creation of a two-tier benefit structure or the conversion to a defined contribution plan. **In our view, the main culprits that have primarily contributed to the low funded status and the high contribution rate are demographic factors and a weak funding policy coupled with an extraordinarily weak investment climate that has persisted since the dot com market collapse of April, 2000. In our view, the “unsustainable” reference should not be attached to the benefit structure (which is comparable and in many cases less generous than other public safety plans in Florida), but rather to demographic factors, the City’s past funding policies and the weak investment climate in recent times.** The painful impact from the recent investment climate will pass just as they have passed following previous market corrections. History has shown us that investment returns will rebound significantly following a bear market. The concept of regression to the mean is applicable to investment returns just as it is to mathematics and statistics. In our case, the PFPF long term average investment return of 9.36% is the mean to which returns should gravitate toward once the volatility of individual annual returns are diluted. Therefore, **the abnormally low investment returns currently being experienced cannot be “sustained” and will necessarily be corrected by future periods of prosperity. This view is illustrated by the attached Exhibit H which measures a 35.3% average return for the S&P 500 Index during the first year following major stock market declines.** Once this period of recovery emerges, the pain of the current episode will be removed with the associated favorable impacts upon the UAAL and the City Contribution rates. In the meantime, we can enhance the affordability of the PFPF by implementing a Pension Obligation Bond program, by pursuing additional real estate transfer programs and by abandoning pension contribution holiday programs. Long term sustainability can also be enhanced by expanding the range of investment options available to the PFPF pursuant to the passage of State legislation.

In addition to the foregoing observations, we would also note that the current \$534 million UAAL is scheduled to be liquidated in 21.5 years. While this represents a long period of time, it nevertheless does have an end date and once that milestone is reached, the City’s 32.11% contribution rate will be reduced to the normal cost rate of 8.18%. **This 8.18% pension cost rate would represent a modest City expenditure when one considers the fact that the City does not pay the 6.2% Social Security rate for its employees, nor does it pay any contribution whatsoever for DROP participants. When the attainment of an 8.18% contribution rate occurs, current discussions as to sustainability will be long forgotten, just as the 1971 discussion of a 73.8% City pension contribution rate for the GEPP is now long forgotten. Relatively short amortization periods, such as that existing for the PFPF are often cited as a feature that contributes to the goal of pension sustainability.**

The goal of seeking pension sustainability is also supported by current City Ordinance Code provisions that restrict the granting of additional pension plan

enhancements where the funded status of the plan is below 90%. **This standard of 90% represents an extremely high level inasmuch as governments that do impose such restrictions generally place a limit of only 80%.** The City's 90% standard will present a formidable control measure to the consideration of future pension benefits inasmuch as all of the City's pension plans are funded at levels below 90%, even before the impact of FY2008 investment loss acknowledgements.

A final issue on the subject of pension sustainability relates to the issue of Other Post-Employment Benefits (OPEB). The subject of OPEB frequently centers upon those pension plans that offer subsidies and support for the provision of health care benefits in retirement. This feature is common in public and private pension plans alike and represents one of the most potentially costly retirement promises given the past and future trends regarding the medical CPI. The presence of OPEB promises will be graphically communicated to the nation with the publication of governmental financial statements in the next few months. This is due to the implementation of Government Accounting Standards Board (GASB) Statements #43 and 45 which will compel governments to begin disclosing the estimated \$3 trillion liability from such pension promises. Heretofore, governments have applied a pay-as-you-go approach to OPEB. **Jacksonville's pension plans have no OPEB liabilities to disclose within their pension trust funds inasmuch as the City does not pay any percentage of the break-even health care premium annually established by the City.** Many governments pay 25% to 50% of such costs. By comparison Jacksonville retirees pay 100% of their participation in Jacksonville's Group Health Insurance Program. The only OPEB reporting issue that will be imposed upon the City with the publication of its financial statements for FY2008 will be the disclosure of the so-called "Implicit Price Subsidy". This element relates to the implicit subsidy that is embedded in the rate that is offered to retirees due to the fact that the (100%) rate that they pay benefits from the inclusion of younger participants in the claims experience base. **Accordingly, the City's comparatively modest OPEB liabilities greatly enhance the sustainability of Jacksonville's pension programs moving forward.** After acknowledging OPEB costs, many governmental pension plans will report dramatic declines in their funded status. Jacksonville's pension plans will not be afflicted in this manner.

Transparency and Accountability:

As an Independent Agency of the City of Jacksonville, the PFPF has many features and operating practices that contribute to a high level of transparency and accountability. Major elements of these characteristics include the undertaking of an annual independent audit, the integration of such audit into the City's Comprehensive Annual Financial Report, and continuous oversight provided by the City Council Auditor. The PFPF is also obligated to prepare an annual report for State oversight agencies and the State Actuary that determine the PFPF's compliance with Florida Statutes and actuarial standards. The PFPF secures annual actuarial updates from an independent enrolled actuary to assess the status of the Fund and it also secures actuarial impact statements to measure the

financial impact of benefit and plan modifications that are periodically considered. The PFPF prepares an Annual Budget that is reviewed and approved by the City Council as a part of the City's Annual Budget Ordinance. The City Council names one-half of the members of the Board of Pension Trustees and the City Treasurer also serves as the Treasurer for the PFPF in accordance with City Charter provisions. The City Treasurer is one of the authorized signatories on PFPF pension payroll checks and he also administers the check writing function for the PFPF pension payroll. The Board is subject to Government in the Sunshine Laws, fiduciary responsibility obligations, and a Code of Ethics. Board meetings are open to the public and minutes of meeting are prepared and are available for inspection. The PFPF utilizes the City's payroll system and the City's financial accounting management information system (FAMIS) to manage all pension payroll and financial accounting requirements of the Fund. All of these financial records are maintained on-line and are continuously open to the review and monitoring of City Finance Officers and the Council Auditor staff. As a part of the City's detailed oversight practices, every journal entry prepared by the PFPF is subject to the review and approval of the City's General Accounting Division as is every account number change in FAMIS. The PFPF incorporates by reference the standards and criteria for the selection of professional service providers (largely represented by money managers) as described in the City Purchasing Code. The Fund secures the services of an independent investment evaluator to monitor and report upon the investment performance of the Fund and the various investment advisory firms under contract to the PFPF. A proper system of internal controls is in place to ensure the integrity of financial information and the safeguarding of assets. Annual Reports on Internal Controls, the Annual Management Letter and the Annual Auditor's Opinion are all free of adverse comments and qualifications. **In short, the administration and operations of the PFPF possess an extremely high level of transparency and accountability.**

Best Practices:

The PFPF enjoys an extremely favorable reputation within the public pension plan community. In addition, Board Members serving as Pension Trustees to the PFPF possess an extraordinary range of talents, experience, and leadership skills that offer invaluable support to the organization. The collective experience and expertise of this group would be difficult to match by any public pension plan in the nation. National publications and educational program sponsors frequently seek out the PFPF for its views and commentary on subjects of current interest. The Fund is recognized as an industry leader not only within the State of Florida but also on a national scale. **This stature is evidenced by the Fund's designation as the "2007 Public Plan of the Year" by Opal Financial Group at the Global Asset Allocation Summit and by the Fund's receipt of the "Small Public Plan of the Year Award" for 2007 by the Money Management Letter.** This recognition and industry reputation emerges from the Fund's diligence, hard work, thoughtful decision making and commitment to a high level of service to its members. There are many examples of the best practices employed by the Fund that have collectively developed its current reputation

within the industry. Some of the more notable examples of best practices all summarized as follows:

1. Decision to secure an IRS Determination Letter concerning the qualified status of the Plan as opposed to the mere presumption that the plan is qualified (with such mere presumption being the prevailing posture among the vast majority of public pension plans).
2. Development of a Statement of Investment Policy that is recognized as one of the most comprehensive and detailed documents adopted by any governmental plan.
3. Development of a comprehensive Request for Proposal (RFP) solicitation package (used as a model by many pension plans) that is advertised on a national basis and followed up by a “hands on” approach to the evaluation of respondents, independent of that performed by the investment consultant.
4. Active and innovative involvement in administering and managing local real estate projects and partnerships with local government.
5. Active involvement and service in a leadership role in pursuing claims against firms guilty of corporate wrongdoing which impaired shareholder value.
6. Recognizing the potential peril associated with securities lending programs in the face of unprecedented disruptions to global financial systems, the PFPF was one of the first pension plans in the nation to suspend its securities lending program. This act has allowed the Fund to avoid to the exposure to millions in losses that today threaten many pension plans across the country.
7. The PFPF was an early implementer of securities lending programs, commission recapture programs, investments in real estate, conversion to a “money center” investment custodian, and in the timely discharge of consultants that have come under regulatory scrutiny and sanction. In each of the examples the GEPP followed the lead of the PFPF in implementing these programs.
8. The monthly publication of a newsletter to all members of the PFPF.

One of the “best practices” or indicators of performance that are most commonly considered by those assessing the administration of a pension program is the level of investment returns delivered in comparison to peer groups. We are happy to report that multiple independent measurement services have reported the fact that PFPF investment returns compare very favorably to the returns delivered by other public pension plans across the county. As disclosed earlier in this report, Merrill

Lynch reported returns of 11.7% for the PFPF over the three year period ended September 30, 2007 (a good market period), which represents a ranking in the 26th percentile (bettering the returns of 74% of the peer group). In addition, Summit Strategies reported returns of 3.09% for the PFPF over the three year period ended September 30, 2008 (a bad market period), which represents a ranking in the 39th percentile (bettering the returns of 61% of the peer group). Preliminary numbers after October 1, 2008 point to a similar pattern of attractive relative performance. These results are notable when once considers the fact that the PFPF is severely constrained in terms of the range of investment options that it is able to pursue.

Part VII – Conclusion

Summary of Key Points:

We recognize that this paper is very lengthy and covers a number of subjects that are technical and foreign to many readers. In view of these factors, we would like to step back for a moment and reflect upon some of the more important matters that have been discussed. Key aspects that are documented and covered in this paper may be summarized by the following points:

1. Past studies and information disseminated on the subject of City pensions have often carried a distorted and misleading slant.
2. PFPF benefit enhancements over the past 10 years have not been excessive, and where they have been extended, they have largely been accompanied by the commitment of assets under the control of members.
3. The general benefit structure of the PFPF is comparable if not less than other public safety plans throughout the State of Florida.
4. The City has repeatedly pursued programs of temporary budget relief from the payment of pension contributions through the use of reserve account assessments and the acceptance of lump sum cash in exchange for initial budget relief.
5. For an extended period of time, the City made pension contributions to the GEPP at rates far in excess of that provided to the PFPF.
6. The City had no cushion to fall back on when the stock market started to decline in 2000 because it had wrung out all of the pipeline gains from the prior market advance in order to secure lower pension contribution obligations.
7. The unsustainable millage reduction program was made partially possible through the temporary use of pension reserves and other one-time budgetary sources.

8. The weak stock market that has generally persisted since April, 2000, has been the major reason for the growing UAAL and City contribution rates (once a market recovery emerges, budget pressures will subside).
9. Demographic factors, including longer life spans, and a low rate of inflation have been a contributing factor in the increasing cost of the City's Retirement System.
10. Various City policies have collectively placed burdens upon the financial health of the PFPF. These policies include the following:
 - a. Relinquishment of Court Fine revenues to the State of Florida.
 - b. Hiring of Community Service Officers in lieu of Police Officers.
 - c. Use of overtime to combat crime instead of hiring new Police Officers.
 - d. Requirement to keep Fire positions open in order to meet lapse factors.
 - e. City's mandate to develop new computer processing systems for pensions.
11. The City has enjoyed substantial budgetary savings from the practice of extending a 0% City pension contribution for DROP participants.
12. The City enjoys substantial budgetary savings from the fact that members of the PFPF are not enrolled in the Social Security System thereby allowing the City to avoid the 6.2% matching rate required for other City employees enrolled in Social Security.
13. Those critical of the 8.4% rate of interest extended to DROP participants must consider the fact that DROP participants pay a 2% annual fee for their participation in the program and that over longer investment periods, the PFPF has delivered returns in excess of 8.4%. In addition, if there was no DROP, the City would pay out higher pension levels to current DROP participants which would be funded at the higher actuarial rate of 8.5%.
14. The City has a commitment to maintain the current pension structure pursuant to the execution of a Settlement Agreement that extends to the year 2030, thereby posing an obstacle to those interested in introducing programs of pension benefit reductions.
15. The PFPF has delivered a very successful record of investment performance when compared to national peer groups despite the severe investment restrictions that they have been operating under for many years.
16. It is essential for the State to release the PFPF from the limited investment options under which it currently must operate.

17. Additional real estate partnerships should be considered by the City along with Pension Obligation Bonds and other programs that would help to liquidate the UAAL.
18. Significant budget relief will be realized by the City when the current UAAL is liquidated in 21.5 years.
19. The sustainability of Jacksonville's pension plans are enhanced due to the general lack of OPEB liabilities, the relatively short UAAL amortization period for the PFPF and the City's 90% funding standard required prior to the consideration of future pension enhancements.
20. The PFPF has been a very successful operating unit of the City. It is recognized as a leader in the public pension plan community and enjoys the support of a talented Board of Pension Trustees to guide the mission and develop management policies.

How Did We Get Here?:

Citizens and City policy-makers are currently asking the understandable question of how the PFPF came to amass a \$534 million UAAL and require a City contribution rate of 32.11%. We trust that the information contained in this paper answers these questions. We hope that you draw the conclusion that the current posture does not appear to be linked to an excessive benefit structure, recent benefit enhancements, nor poor investment returns vs. those available in the market place. **In contrast to these factors, we hope that you will agree with us that the current posture is primarily linked to demographic factors and an historical pattern of poor funding policies (encouraged by the City's millage reduction initiatives), coupled with an historically poor investment climate since the year 2000. Generous pension benefits are not the culprit, but rather poor funding policies, demographics and the economy.**

What Can We Expect in the Near Future?:

1. The actuaries for the City's pension plans are currently preparing an Actuarial Valuation as of September 30, 2008 which will acknowledge the market losses experienced during FY2008. The findings of these reports will cause an increase in the City's contribution requirements for FY2009-10 for all of the City's pension programs.
2. The City's Chief Financial Officer is currently advocating a reduction in the actuarial assumption for pension earnings. If this program is implemented, the City's contribution rate would necessarily increase by a substantial amount to compensate for reduced investment earnings expectations. In response to a request from the City Finance Committee, the PFPF Actuary was asked to calculate the impact of reducing the current 8.50% actuarial rate of return assumption. According to the Actuary's preliminary calculations, **the City would have to increase its contribution rate by 5.2% in response to a decrease in the earnings**

assumption from 8.50% to 8.00%. A more aggressive reduction from 8.50% to 7.75% would cause the City's contribution rate to increase by 8.0%.

Where Do We Go From Here?:

1. There are no painless solutions. The consequences of past funding policies coupled with the City's millage reduction program have contributed to a difficult budget challenge that must be addressed. The City must end the practice of seeking temporary means of avoiding the acknowledgement of the full contribution requirements for its pension programs.
2. Consider the use of Pension Obligations Bonds and other financing techniques as a means of liquidating elements of the UAAL and in restructuring its obligations.
3. Continue to explore real estate partnerships with the PFPF which will contribute to further reductions in the UAAL and reduced City contributions (i.e. replicate programs such as the Laura Trio and Haverty's).
4. Support PFPF efforts to broaden the range of permitted investments options which currently constrain the Fund.

Sincerely,

John Keane
Executive Director – Administrator

cc: Board of Pension Trustees
Mayor John Peyton
Alan Mosely, Chief Administrative Officer
Mickey Miller, City Chief Financial Officer
Kirk Sherman, City Council Auditor
Dr. Kathleen McKenzie, JCCI Program Director
City Council Members (via separate letter)

Index of Exhibits:

- A – Comparative Analysis of City Pension Contribution Rates and Reserve Account Assessments for the GEPP and PFPF.
- B – Graphical Analysis of City Pension Contribution Rates and Reserve Account Assessments for the GEPP and PFPF.
- C – PFPF Analysis of Allocations from Reserves in Lieu of City Pension Contributions.
- D – GEPP Analysis of Allocations from Reserves in Lieu of City Pension Contributions.
- E – Reconciliation of City Contribution Rate to PFPF from 2000 to 2006.
- F – Analysis of UAAL and Funded Status of the City’s Pension Plans.
- G – Graphical Analysis of the UAAL of the GEPP and the PFPF.
- H – Analysis of S&P 500 Returns in the First Year after a Down Market.