INQUIRY INTO THE FINANCIAL STRUCTURE OF THE JACKSONVILLE POLICE AND FIRE PENSION FUND

6 JUNE 2016

A specter is haunting the City of Jacksonville Florida---the specter of Pension Deficits. All the powers of the city government are focused narrowly on a complicated tax and spend solution to eradicate those deficits. That solution will amount to an extraction of nearly four billion dollars from and will do untold damage to the local economy. Meanwhile, nearly all of the conditions that led to the deficits remain in situ. Alternatives should be sought. One such alternative would be a Pay-Go system.

A rough outline of the conversion of the Jacksonville Police and Fire Pension system or plan to a Pay-Go methodology was introduced to the Mayor's office in early February 2016. It was intended and expected that some Administration attention and resources would be applied to smooth out the roughness of the outline and make a determination as to its workability and fitness. It was rejected outright with virtually no feedback or explanation. The singular comment that was elicited said that it was thought to be illegal because it might be unfair to future taxpayers. No source documents were cited.

The purpose of this inquiry is to determine the exact legal status and any flexibility in the established structure of the Jacksonville Police and Fire Pension System or Plan. This inquiry will focus on answers to two questions:

1. Is there a Constitutional, Statutory or Charter prohibition to changing the structure of the System to a "Pay-Go" system instead of its current structure of an "Advanced Funded" system administered by a pension fund?

2. Is it feasible, desirable or advisable to go to a Pay-Go system?

The first step is to define terms as they are used in this paper:

A. **Pension Fund**. An entity, separate and largely independent from the city government, as was created by Article 22 of the Jacksonville City Charter. Its function is guided by a Board of Trustees and its purpose is to employ personnel to administer and operate the advance funded pension system or plan to meet the expectations in F.S. Ch. 112.61 Legislative Intent.

B. **Pension System or Plan**: means any employee pension benefit plan supported in whole or in part by public funds...ref. F.S. Ch. 112.625.

C. **Sound Actuarial Basis**: A system of calculation that considers all known and pertinent factors so as to equate the current monetary payment with the contractually earned benefit.

A Look at the Law

The Florida Constitution and Florida Statutes and the City Charter of Jacksonville cover the many aspects of Public Service Pensions with regard to the protection of benefits and equitability for the taxpayer. Review of each of the governing documents for this paper did not reveal a mandate for the type of funding system (i.e. Advanced Funding vs a Pay-Go System).

F.S. Ch. 112.61 Legislative Intent states in part that: "such retirement systems or plans be managed, administered, operated and funded in such manner as to" 1. Maximize the protection of public employee retirement benefits... and goes on to say: 2. That they be fairly, orderly, and equitably funded by the current, as well as future taxpayers. "Accordingly,... it is the intent of this act to prohibit the use of any procedure, methodology, or assumptions the effect of which is to transfer to future taxpayers any portion of the costs which may reasonably have been expected to be paid by the current taxpayer.

Based on the intent stated in FS 112.61 above and the current status of the Jacksonville Police and Fire Pension system it is evident that the entity named Jacksonville Police and Fire Pension Board of Trustees has failed miserably to perform its fiduciary duty. A $1.8 Billion unfunded actuarial liability, accumulating since 1991, cannot, in any way, be construed to be maximum "protection of public employee benefits". This alone is prima facie evidence sufficient to suggest a dissolution of this body and replacement with another methodology. Without doubt, continuing in the status quo would be undesirable and inadvisable.

It should be noted that while a Pension System or Plan may include a "Pension Fund", it is not mandated in F.S. Chapter 112. The System may just as well be administered or operated by a department of the City Government, whether Advanced funded or Pay-As-You-Go.

The push of the current administration for an increased Sales Tax to pump billions of dollars into a flawed pension fund structure, especially without correcting the flaws, makes no sense. To continue the same process will be highly likely to produce the same results. With that caveat in mind, this paper offers the prospect of a workable alternative.

A Workable Alternative.

The alternative proposed here is a Hybrid Pay-Go system of funding. In pension fund literature there is a variety of hybrid systems that combine various functions and factors. Some use defined benefit elements along with defined contribution elements. Others use insurance products to complement investment elements to provide a workable system. The hybrid system proposed by this paper would include benefit payments from the City's general budget as well as from a special reserve account. It would involve the following steps for installation:

a. Complete dissolution of the entity currently known as Jacksonville Police and Fire Pension Board of Trustees. This may require a City Charter Amendment along with an adoption of that amendment by the State Legislature.

b. Complete assumption by the City Government of responsibility, control and operation of the Jacksonville Police and Fire Pension System or Plan. This conversion to a Hybrid Pay-Go system would maintain all aspects of the current pension agreement in place, including every syllable of the pension aspects of the negotiated labor contracts with the two unions.

c. The City would also assume possession, control and responsibility for the cashed out value of the System's portfolio investments (currently 1.438 billion dollars). The City would create a Special Reserve Account for this money, untouchable for any purpose except for paying pension benefits. The funds in the special reserve account would be invested in "near zero risk" issues and all earnings would pay benefits only. T-Bills currently pay about 2.04% per annum. Pre-cautions must be put in place to prevent the City from using money from this account to save money for other City expenditures.

d. Pension benefit payments would come from the City's General Fund and the Special Reserve Account in some appropriate ratio, to be determined. Two possible ratios are presented in attached spreadsheet analyses.

e. The current Unfunded Actuarial Accrued Liability of 1.8 billion dollars would be dissolved and become meaningless. The assumption of responsibility for paying pension benefits by the City from its General Fund simultaneously obviates the existence of and compensates for the UAAL. The Pension System members do not own the pension system, thus have no claim for the reimbursement of the UAAL. To be sure, the taxpayer does not want it paid. The money, which is **NOT** put into paying off a phony debt and its interest, would pay pension benefits for decades.

f. The City would sell all real or tangible property owned by the Pension Fund and place the revenue into the Special Reserve Account for use as described above.

<u>A look at the Money.</u>

1. $1,801,134,165 UAAL.
2. 7% interest per annum on $1,801,134,165 UAAL. = $126,079,392
3. $123,070,241 annual amount to amortize UAAL.
4. $44,087,089 annual Normal Costs for 2015.
5. $9,926,208 annual expense to operate the Fund
6. $1,437,907,379 net asset value of pension fund.
7. 2.04% interest per annum on 10 year treasuries.
8. $12,061,321 million per year employee contribution.
9. $119,548,310 pension benefit payout in 2015
10. City contribution to PFPF Fund is over 120% of covered payroll and growing.

Data source: Actuarial Valuation Report 1 October 2015.

When the City moves from the current format Pension Fund to a Hybrid Pay-Go System and the "Pension Fund" is dissolved, the annual cash flow amounts in items 2, 3, 5, ($259,075,841) will no longer be relevant, because those are the current costs just for having the "Fund". When the "Fund" is dissolved so are those costs along with the UAAL.

The amount in item 6 could be cashed out and re-invested in near-zero risk bonds like T-bills instead of the devices that lost $126 million last year. T-Bill interest on that amount is nearly $30 million a year.

An added benefit of the Pay-Go System is that there will never again be an unfunded liability due to pension fund costs, investment portfolio losses, other leakages and interest payments thereon.

Conclusion

Having found no legislated mandate that the pension system be of the pre-funded type, it is reasonable to say that the Jacksonville Police and Fire Pension System or Plan can be legally converted to a Hybrid Pay-Go System or Plan, if the political will to do so can be mustered. Reason to do so can be found in a simple look at the history of the current methodology.

The current PFPF has been in existence for nearly 40 years, but the last 25 years it has been in serious deficit. The scope of the deficit is such that it is unlikely the PFPF can ever grow its way out of the hole. Therefore, the Duval County Citizen will have to refill the hole with tax dollars. The current City Administration intends to do just that with a huge tax increase and herculean financial gymnastics. Unfortunately, filling the hole with money does not resolve system flaws that perpetrated this disaster. Little, if anything, has been offered for that. Thus, it is highly probable that new deficits will develop after the money bandage is in place.

The only legal caveat regarding the methodology of funding a pension plan comes from F.S. 112.61 (see above). It requires (1) maximum protection of benefits and (2) equitable attribution of costs between current and future taxpayers. Clearly the PFPF has failed with respect to "protection" unless it can always coerce the taxpayer to plug the gaps. If the PFPF were to succeed in establishing a self-perpetuating pension fund then all cost would rest on early taxpayers and none on later taxpayers.

By contrast, a Hybrid Pay-Go System converted from a previously pre-funded (but failed) system would meet both of the conditions in F.S.112.61. Firstly, with pension payments coming from the General Fund, the full taxing power of the City of Jacksonville guarantees the "maximum protection" prescribed by F.S. 112.61. Secondly, the billions already put into this fund were contributed from current or early taxpayers. Moving forward and paying benefits from current revenue keeps all generations of taxpayers, past, present and future, equitably involved in the cost of the retirement system.

It is time to make the change to Pay-Go.

Joe Andrews
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Jacksonville Police and Fire Pension System
A Pay-Go Model

Year	Annual Benefit Payout	Non City Contribution	City Annual Contribution	Spl Res Acct Contribution	Special Reserve Account
2014	$111,424,048	$17,720,169			$1,473,097,052
2015	$119,548,310	$17,619,946			$1,437,907,379
2016	$123,134,759	$18,148,544	58,379,695	46,606,520	$1,420,634,170
2017	$126,828,802	$18,693,001	60,131,086	48,004,715	$1,401,610,392
2018	$130,633,666	$19,253,791	61,935,019	49,444,857	$1,380,758,387
2019	$134,552,676	$19,831,404	63,793,069	50,928,202	$1,357,997,656
2020	$138,589,256	$20,426,347	65,706,861	52,456,048	$1,333,244,760
2021	$142,746,934	$21,039,137	67,678,067	54,029,730	$1,306,413,223
2022	$147,029,342	$21,670,311	69,708,409	55,650,622	$1,277,413,431
2023	$151,440,222	$22,320,420	71,799,662	57,320,140	$1,246,152,525
2024	$155,983,429	$22,990,033	73,953,651	59,039,745	$1,212,534,292
2025	$160,662,932	$23,679,734	76,172,261	60,810,937	$1,176,459,054
2026	$165,482,820	$24,390,126	78,457,429	62,635,265	$1,137,823,554
2027	$170,447,304	$25,121,830	80,811,152	64,514,323	$1,096,520,831
2028	$175,560,724	$25,875,485	83,235,486	66,449,753	$1,052,440,104
2029	$180,827,545	$26,651,749	85,732,551	68,443,245	$1,005,466,637
2030	$186,252,372	$27,451,302	88,304,527	70,496,543	$955,481,613
2031	$191,839,943	$28,274,841	90,953,663	72,611,439	$902,361,999
2032	$197,595,141	$29,123,086	93,682,273	74,789,782	$845,980,402
2033	$203,522,995	$29,996,779	96,492,741	77,033,476	$786,204,927
2034	$209,628,685	$30,896,682	99,387,523	79,344,480	$722,899,027
2035	$215,917,546	$31,823,582	102,369,149	81,724,814	$655,921,353
2036	$222,395,072	$32,778,290	105,440,224	84,176,559	$585,125,590
2037	$229,066,924	$33,761,639	108,603,430	86,701,855	$510,360,297
2038	$235,938,932	$34,774,488	111,861,533	89,302,911	$431,468,736
2039	$243,017,100	$35,817,722	115,217,379	91,981,998	$348,288,700
2040	$250,307,613	$36,892,254	118,673,901	94,741,458	$260,652,331
2041	$257,816,841	$37,999,022	122,234,118	97,583,702	$168,385,937
2042	$265,551,347	$39,138,992	125,901,141	100,511,213	$71,309,797
2043	$273,517,887	$40,313,162	129,678,175	103,526,550	-$30,762,033
2044	$281,723,424	$41,522,557	133,568,521	106,632,346	-$138,021,925
2045	$290,175,126	$42,768,234	137,575,576	109,831,316	-$250,668,888
2046	$298,880,380	$44,051,281	141,702,844	113,126,256	-$368,908,789
2047	$307,846,792	$45,372,819	145,953,929	116,520,044	-$492,954,572
2048	$317,082,195	$46,734,004	150,332,547	120,015,645	-$623,026,490
2049	$326,594,661	$48,136,024	154,842,523	123,616,114	-$759,352,345
2050	$336,392,501	$49,580,104	159,487,799	127,324,598	-$902,167,731

Legend
1. Annual Benefit Payout is actual for 2014, 2015 then inflated by 3% yearly.
2. Non City Contribution is Employee, Chapter Funds & Court Fines contributions inflated by 3% yearly.
3. City Annual Contribution is 55.6070103% of Col. B minus Col. C.
4. Special Reserve Contribution is 44.3929897% of Col. B minus Col. C.

Jacksonville Police and Fire Pension System
A Pay-Go Model

Year	Annual Benefit Payout	Non City Contribution	City Annual Contribution	Spl Res Acct Contribution	Special Reserve Account
2014	$111,424,048	$17,720,169			$1,473,097,052
2015	$119,548,310	$17,619,946			$1,437,907,379
2016	$123,134,759	$18,148,544	78,739,661	$26,246,554	$1,440,994,136
2017	$126,828,802	$18,693,001	81,101,851	$27,033,950	$1,443,356,466
2018	$130,633,666	$19,253,791	83,534,907	$27,844,969	$1,444,955,969
2019	$134,552,676	$19,831,404	86,040,954	$28,680,318	$1,445,752,753
2020	$138,589,256	$20,426,347	88,622,182	$29,540,727	$1,445,705,381
2021	$142,746,934	$21,039,137	91,280,848	$30,426,949	$1,444,770,822
2022	$147,029,342	$21,670,311	94,019,273	$31,339,758	$1,442,904,389
2023	$151,440,222	$22,320,420	96,839,851	$32,279,950	$1,440,059,688
2024	$155,983,429	$22,990,033	99,745,047	$33,248,349	$1,436,188,557
2025	$160,662,932	$23,679,734	102,737,398	$34,245,799	$1,431,241,004
2026	$165,482,820	$24,390,126	105,819,520	$35,273,173	$1,425,165,147
2027	$170,447,304	$25,121,830	108,994,106	$36,331,369	$1,417,907,147
2028	$175,560,724	$25,875,485	112,263,929	$37,421,310	$1,409,411,143
2029	$180,827,545	$26,651,749	115,631,847	$38,543,949	$1,399,619,181
2030	$186,252,372	$27,451,302	119,100,802	$39,700,267	$1,388,471,145
2031	$191,839,943	$28,274,841	122,673,827	$40,891,276	$1,375,904,681
2032	$197,595,141	$29,123,086	126,354,041	$42,118,014	$1,361,855,123
2033	$203,522,995	$29,996,779	130,144,663	$43,381,554	$1,346,255,413
2034	$209,628,685	$30,896,682	134,049,002	$44,683,001	$1,329,036,023
2035	$215,917,546	$31,823,582	138,070,473	$46,023,491	$1,310,124,867
2036	$222,395,072	$32,778,290	142,212,587	$47,404,196	$1,289,447,218
2037	$229,066,924	$33,761,639	146,478,964	$48,826,321	$1,266,925,620
2038	$235,938,932	$34,774,488	150,873,333	$50,291,111	$1,242,479,792
2039	$243,017,100	$35,817,722	155,399,533	$51,799,844	$1,216,026,535
2040	$250,307,613	$36,892,254	160,061,519	$53,353,840	$1,187,479,637
2041	$257,816,841	$37,999,022	164,863,365	$54,954,455	$1,156,749,766
2042	$265,551,347	$39,138,992	169,809,266	$56,603,089	$1,123,744,373
2043	$273,517,887	$40,313,162	174,903,544	$58,301,181	$1,088,367,577
2044	$281,723,424	$41,522,557	180,150,650	$60,050,217	$1,050,520,059
2045	$290,175,126	$42,768,234	185,555,170	$61,851,723	$1,010,098,945
2046	$298,880,380	$44,051,281	191,121,825	$63,707,275	$966,997,689
2047	$307,846,792	$45,372,819	196,855,479	$65,618,493	$921,105,948
2048	$317,082,195	$46,734,004	202,761,144	$67,587,048	$872,309,462
2049	$326,594,661	$48,136,024	208,843,978	$69,614,659	$820,489,916
2050	$336,392,501	$49,580,104	215,109,297	$71,703,099	$765,524,811

Legend
1. Annual Benefit Payout is actual for 2014, 2015 then inflated by 3% yearly.
2. Non City Contribution is Employee, Chapter Funds & Court Fines contributions inflated by 3% yearly.
3. City Annual Contribution is 75% of Col. B minus Col. C.
4. Special Reserve Contribution is 25% of Col. B minus Col. C.