**To:** **All Members and Beneficiaries of the City of Melbourne Police Officers Retirement Trust Fund ("Retirement Plan")**

**From:** **Board of Trustees**

**Re:** **Explanatory Memo regarding new disclosure ("Section 112.664 Report")**

**Date:** **June 29, 2015**

## Overview

This memorandum is intended to provide background and additional disclosure to accompany the new reporting required by Senate Bill 534 (codified as Section 112.664, Fla.Stat.)(hereinafter "S.B. 534"). Although S.B. 534 was adopted in May of 2013, the detailed regulations spelling out the specific reporting requirements and procedures were not finalized by the Department of Management Services in Tallahassee until April of 2015. The Board is pleased to provide this memorandum as a service to the active membership, retirees and beneficiaries in an effort to answer anticipated questions in connection with the Board's new Section 112.664 Report.

## Legal Protections

Article X, Section 14, of the Florida Constitution specifically protects pension benefits for public employees and mandates that Florida governmental pension benefits are required to be funded "on a sound actuarial basis." Indeed, in Section 5 of S.B. 534 the Legislature declared that it is an important state interest that government retirement systems in Florida be "managed, administered, and funded in a sound manner as required by s. 14, Article X of the State Constitution and part VII of chapter 112, Florida Statutes."

According to state statute, the total contributions to a retirement system "*shall* be sufficient to meet the normal cost of the retirement system or plan and to amortize the unfunded liability" *See §112.64(2), Fla.Stat.* All Florida cities are required to make the mandatory employer contributions to the pension plan "at least quarterly." *See §112.64(1), Fla.Stat.* The required contributions are actuarially determined by the independent actuary employed by the Board of Trustees. If a city fails to comply with its mandatory pension contributions, the Department of Management Services in Tallahassee is empowered to withhold state funds and tax revenue. *See §112.63(4)(b), Fla.Stat.* Thus, unlike widely reported examples of pension underfunding in other states, Florida law mandates "funding discipline" by the plan sponsor.

## Funding Discipline

*As a result of the legal protections for governmental pensions in Florida, by law the Retirement Plan will never become insolvent because it is* required *to be actuarially funded.* The

Retirement Plan is actuarially funded through a combination of investment earnings, city, member, and state contributions. [1]

## Discount Rate/Investment Earnings Assumption

In order to properly fund the retirement system, the Board's actuary uses several assumptions and federally approved actuarial methods. One of the most important assumptions is the "discount rate", which is otherwise referred to as the Plan's "investment earnings assumption". Even though the discount rate is a long term projection, the Board reviews the investment assumption annually and works closely with independent plan fiduciaries to make sure that plan assets are invested consistent with a long term investment policy. Although investments fluctuate from year to year, the Board has purposely chosen a discount rate which is supported by long term investment performance and financial projections.

## Unrealized Gains

Financial markets have performed well for the past several years, following the market correction in 2009. For example, the annualized rate of return by the Standard & Poor's 500 ("S&P 500") index has been approximately 13% per year for the past several years.[2] As a result of the strong equity returns for the past several years, most governmental pension plans have yet to recognize all of the resulting actuarial gains. Accordingly, it is noteworthy "unrealized" investment gains have not yet been recognized in the Board's Section 112.664 Report or the Board's FY 2014 valuation.

## Sensitivity Testing

S.B. 534 requires the Board to provide *hypothetical* "run out" dates, assuming that the Board used a theoretical investment return assumption of 2.00% less than the Board's current discount rate. All things being equal, the use of a lower investment return assumption will lower the Plan's current funded ratio. S.B. 534 also requires the Board to include in the new Section 112.664 Report additional "run out" dates, assuming that the plan sponsor, member and State of Florida, stopped contributing to the Retirement Plan. As described above, Florida law mandates funding discipline by plan sponsors. Accordingly, the hypothetical run out dates in the S.B. 534 report are an academic exercise which do not impair the ability of the Board to pay constitutionally protected benefits.

In addition to the "run out" dates required by S.B. 534 in the new Section 112.664 Report, the Board also directed its actuary to project the Retirement Plan's valuation using an investment return assumption of 2.00% higher than the Board's current discount rate. In other words, the Board is of the view that proper "sensitivity testing" requires the evaluation of several

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State contributions are available for police and fire pensions under Chapter 175 and 185, Florida Statutes.

2 Large U.S. equities are a substantial component of the Retirement Plan's investment portfolio, as described under the Portfolio Diversification heading below.

possible investment return scenarios. For this very reason, new Governmental Accounting Standards Board ("GASB") requirements were recently implemented across the country. In fact, the Board's FY 2014 valuation contains a projection of benefit payments for the next 100 years. A copy of the Board's FY 2014 valuation containing the new GASB 67 100 year projection is available upon request, as are the additional sensitivity testing calculations performed by the Board's actuary.

**Amortization Schedule**

Defined benefit pensions are paid monthly over a retiree's or beneficiary's lifetime. As a result, pension trustees invest with a long term investment horizon. By law, Florida governmental plans are permitted to amortize their liabilities over thirty years. While the "funded ratio" of many Florida governmental plans is less than 100%, it is anticipated if all assumptions are borne out that the Retirement Plan will be approximately 100% funded at the end of the 30 year amortization period. Many professionals consider the Board's amortization schedule to be similar to a 30 year mortgage. The remaining balance on one's mortgage is usually less important than the ability to make the full monthly payments.

**Portfolio Diversification**

As long term investors the Board employs a long term investment strategy which is based on a written investment policy. The Board retains a qualified investment consultant who monitors the Board's portfolio, as a fiduciary, consistent with the Board's investment policy. The Board's investments are diversified into several assets classes managed by different investment advisors in order to minimize volatility in the portfolio. The past five years of investment returns (along with the allocations of cash, equity, bond and alternative investments) are set forth in the new Section 112.664 Report. A copy of the Board's quarterly investment reports are available upon request.

**FOSTER & FOSTER**
ACTUARIES AND CONSULTANTS

March 28, 2016

VIA EMAIL

Ms. Jennifer Chase
City of Melbourne
Police Officers' Retirement System
900 East Strawbridge Avenue
Melbourne, FL 32935

Re: City of Melbourne Police Officers' Retirement Trust Fund
Senate Bill 534 (Section 112.664, Florida Statutes) Compliance

Dear Jennifer:

Please find enclosed the annual disclosures that satisfy the October 1, 2015 financial reporting requirements made under Section 112.664.

Our office will submit this information electronically to the Department of Management Services. However, it is important for you to be aware that this report must also be made available on the Plan or Plan Sponsor's website, if such website exists. A deadline for this website publication is not made clear in the law.

In addition to the enclosed report, the Plan or Plan Sponsor's website must provide a link to the Division of Retirement's Actuarial Summary Fact Sheet for the Plan, and also report the previous five years' assumed and actual rates of return, along with their respective asset allocations. The Board should contact its Investment Consultant for this information.

If there are any questions, concerns, or comments about any of the items contained in this report, please feel free to contact me.

Respectfully submitted,

Foster & Foster, Inc.

By: ______________________

Patrick T. Donlan, EA, ASA, MAAA
Enrolled Actuary #14-6595

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Enclosures

cc via email: Scott R. Christiansen, Board Attorney

CITY OF MELBOURNE
POLICE OFFICERS' RETIREMENT TRUST FUND

SECTION 112.664, FLORIDA STATUTES
COMPLIANCE

With respect to the reporting standards for defined benefit retirement plans or systems contained in Section 112.664(1), F.S., the actuarial disclosures required under this section were prepared and completed by me or under my direct supervision and I acknowledge responsibility for the results. To the best of my knowledge, the results are complete and accurate, and in my opinion, meet the requirements of Section 112.664(1), Florida Statutes, and Rule 60T-1.0035, Florida Administrative Code.

By: ______________________ Date: 3/28/2016

Patrick T. Donlan, EA, ASA, MAAA
Enrolled Actuary #14-6595

FOSTER & FOSTER
ACTUARIES AND CONSULTANTS

When reviewing the following schedules, please note the following:

1) The purpose of producing this report is solely to satisfy the requirements set forth by Section 112.664, Florida Statutes, and is mandatory for every Florida public pension fund, excluding the Florida Retirement System (FRS).

2) None of the schedules shown have any impact on the funding requirements of the Plan. These schedules are for statutory compliance purposes only.

3) In the schedules that follow, the columns labeled "ACTUAL" represent the final recorded GASB 67/68 results. The columns labeled "HYPOTHETICAL" illustrate what the results would have been if different assumptions were used.

4) It is our opinion that the Plan's actual assumptions utilized in the October 1, 2015 Actuarial Valuation Report, as adopted by the Board of Trustees, are reasonable individually and in the aggregate, and represent our best estimate of future Plan experience.

5) The "Number of Years Expected Benefit Payments Sustained" calculated in Section II: Asset Sustainability should not be interpreted as the number of years the Plan has left until it is insolvent. This calculation is required by 112.664, Florida Statutes, but the numeric result is irrelevant, since in its calculation we are to assume there will be no further contributions to the Fund. As long as the Actuarially Determined Contribution is made each year the Plan will never become insolvent.

| | ACTUAL | HYPOTHETICAL | |
|---|---|---|---|
| | 7.50%<br>RP-2000<br>Static<br>9/30/2015 | 7.50%<br>RP-2000<br>Generational<br>9/30/2015 | 5.50%<br>RP-2000<br>Generational<br>9/30/2015 |

## GASB 67: Schedule of Changes in Net Pension Liability

| | | | |
|---|---|---|---|
| Total Pension Liability | | | |
| Service Cost | 1,457,495 | 1,513,998 | 2,353,305 |
| Interest | 6,500,397 | 6,724,711 | 6,282,927 |
| Changes of Benefit Terms | - | - | - |
| Differences Between Expected and Actual Experience | (129,550) | (195,633) | (135,841) |
| Changes of Assumptions | (1,189,338) | (1,252,135) | (1,927,606) |
| Contributions - Buy Back | 8,784 | 8,784 | 8,784 |
| Benefit Payments, Including Refunds of Employee Contributions | (5,699,583) | (5,699,583) | (5,699,583) |
| Net Change in Total Pension Liability | 948,205 | 1,100,142 | 881,986 |
| Total Pension Liability - Beginning | 88,192,033 | 91,126,378 | 114,859,289 |
| Total Pension Liability - Ending (a) | $ 89,140,238 | $ 92,226,520 | $ 115,741,275 |
| | | | |
| Plan Fiduciary Net Position | | | |
| Contributions - Employer | 3,267,652 | 3,267,652 | 3,267,652 |
| Contributions - State | 543,474 | 543,474 | 543,474 |
| Contributions - Employee | 512,708 | 512,708 | 512,708 |
| Contributions - Buy Back | 8,784 | 8,784 | 8,784 |
| Net Investment Income | (43,614) | (43,614) | (43,614) |
| Benefit Payments, Including Refunds of Employee Contributions | (5,699,583) | (5,699,583) | (5,699,583) |
| Administrative Expenses | (78,532) | (78,532) | (78,532) |
| Other | - | - | - |
| Net Change in Plan Fiduciary Net Position | (1,489,111) | (1,489,111) | (1,489,111) |
| Plan Fiduciary Net Position - Beginning | 68,007,130 | 68,007,130 | 68,007,130 |
| Plan Fiduciary Net Position - Ending (b) | $ 66,518,019 | $ 66,518,019 | $ 66,518,019 |
| | | | |
| Net Pension Liability - Ending (a) - (b) | $ 22,622,219 | $ 25,708,501 | $ 49,223,256 |

## GASB 68: Pension Expense for Fiscal Year Ending September 30, 2015

| | | | |
|---|---|---|---|
| Pension Expense | $ 2,368,053 | $ 2,630,109 | $ 4,057,652 |

PROJECTION OF THE NUMBER OF YEARS ASSETS WILL SUSTAIN BENEFIT PAYMENTS

Table 1
Plan Assumptions: 7.50% and RP-2000 Static Mortality

| Fiscal Year Beginning 10/1 | Projected Beginning Fiduciary Net Position | Projected Total Contributions | Projected Benefit Payments* | Projected Administrative Expense | Projected Investment Earnings | Projected Ending Fiduciary Net Position |
|---|---|---|---|---|---|---|
| 2015 | 66,127,077 | - | 7,864,521 | - | 4,664,611 | 62,927,167 |
| 2016 | 62,927,167 | - | 5,535,419 | - | 4,511,959 | 61,903,707 |
| 2017 | 61,903,707 | - | 5,788,500 | - | 4,425,709 | 60,540,916 |
| 2018 | 60,540,916 | - | 5,874,877 | - | 4,320,261 | 58,986,300 |
| 2019 | 58,986,300 | - | 6,033,863 | - | 4,197,703 | 57,150,140 |
| 2020 | 57,150,140 | - | 6,255,853 | - | 4,051,666 | 54,945,953 |
| 2021 | 54,945,953 | - | 6,368,868 | - | 3,882,114 | 52,459,199 |
| 2022 | 52,459,199 | - | 6,666,628 | - | 3,684,441 | 49,477,012 |
| 2023 | 49,477,012 | - | 6,801,090 | - | 3,455,735 | 46,131,657 |
| 2024 | 46,131,657 | - | 6,878,064 | - | 3,201,947 | 42,455,540 |
| 2025 | 42,455,540 | - | 6,890,840 | - | 2,925,759 | 38,490,459 |
| 2026 | 38,490,459 | - | 6,911,496 | - | 2,627,603 | 34,206,566 |
| 2027 | 34,206,566 | - | 6,927,805 | - | 2,305,700 | 29,584,461 |
| 2028 | 29,584,461 | - | 6,923,320 | - | 1,959,210 | 24,620,351 |
| 2029 | 24,620,351 | - | 6,903,314 | - | 1,587,652 | 19,304,689 |
| 2030 | 19,304,689 | - | 6,884,563 | - | 1,189,681 | 13,609,807 |
| 2031 | 13,609,807 | - | 6,821,167 | - | 764,942 | 7,553,582 |
| 2032 | 7,553,582 | - | 6,737,014 | - | 313,881 | 1,130,449 |
| 2033 | 1,130,449 | - | 6,642,613 | - | - | - |

*All DROP Balances paid in 2015.

Number of Years Expected Benefit Payments Sustained: 18.17

This projection assumes no further contributions, assumes no further benefit accruals, and assumes Market Value of Assets earn 7.50% interest.

**It is important to note that as long as the Actuarially Determined Contribution is made each year, the Plan will never become insolvent. Furthermore, State and local laws mandate that the Actuarially Determined Contribution be made each year.**

## PROJECTION OF THE NUMBER OF YEARS ASSETS WILL SUSTAIN BENEFIT PAYMENTS

Table 2
Hypothetical Assumptions: 7.50% and RP-2000 Generational Mortality

| Fiscal Year Beginning 10/1 | Projected Beginning Fiduciary Net Position | Projected Total Contributions | Projected Benefit Payments* | Projected Administrative Expense | Projected Investment Earnings | Projected Ending Fiduciary Net Position |
|---|---|---|---|---|---|---|
| 2015 | 66,127,077 | - | 7,866,153 | - | 4,664,550 | 62,925,474 |
| 2016 | 62,925,474 | - | 5,541,321 | - | 4,511,611 | 61,895,764 |
| 2017 | 61,895,764 | - | 5,799,400 | - | 4,424,705 | 60,521,069 |
| 2018 | 60,521,069 | - | 5,891,661 | - | 4,318,143 | 58,947,551 |
| 2019 | 58,947,551 | - | 6,057,295 | - | 4,193,918 | 57,084,174 |
| 2020 | 57,084,174 | - | 6,286,704 | - | 4,045,562 | 54,843,032 |
| 2021 | 54,843,032 | - | 6,408,333 | - | 3,872,915 | 52,307,614 |
| 2022 | 52,307,614 | - | 6,716,421 | - | 3,671,205 | 49,262,398 |
| 2023 | 49,262,398 | - | 6,861,419 | - | 3,437,377 | 45,838,356 |
| 2024 | 45,838,356 | - | 6,950,297 | - | 3,177,241 | 42,065,300 |
| 2025 | 42,065,300 | - | 6,980,897 | - | 2,893,114 | 37,977,517 |
| 2026 | 37,977,517 | - | 7,019,328 | - | 2,585,089 | 33,543,278 |
| 2027 | 33,543,278 | - | 7,057,675 | - | 2,251,083 | 28,736,686 |
| 2028 | 28,736,686 | - | 7,073,766 | - | 1,889,985 | 23,552,905 |
| 2029 | 23,552,905 | - | 7,078,448 | - | 1,501,026 | 17,975,483 |
| 2030 | 17,975,483 | - | 7,087,989 | - | 1,082,362 | 11,969,856 |
| 2031 | 11,969,856 | - | 7,052,995 | - | 633,252 | 5,550,113 |
| 2032 | 5,550,113 | - | 7,004,433 | - | - | - |

*All DROP Balances paid in 2015.

Number of Years Expected Benefit Payments Sustained: 17.79

This projection assumes no further contributions, assumes no further benefit accruals, and assumes Market Value of Assets earn 7.50% interest.

**It is important to note that as long as the Actuarially Determined Contribution is made each year, the Plan will never become insolvent. Furthermore, State and local laws mandate that the Actuarially Determined Contribution be made each year.**

## PROJECTION OF THE NUMBER OF YEARS ASSETS WILL SUSTAIN BENEFIT PAYMENTS

Table 3
Hypothetical Assumptions: 5.50% and RP-2000 Generational Mortality

| Fiscal Year Beginning 10/1 | Projected Beginning Fiduciary Net Position | Projected Total Contributions | Projected Benefit Payments* | Projected Administrative Expense | Projected Investment Earnings | Projected Ending Fiduciary Net Position |
|---|---|---|---|---|---|---|
| 2015 | 66,127,077 | - | 7,866,153 | - | 3,420,670 | 61,681,594 |
| 2016 | 61,681,594 | - | 5,541,321 | - | 3,240,101 | 59,380,374 |
| 2017 | 59,380,374 | - | 5,799,400 | - | 3,106,437 | 56,687,411 |
| 2018 | 56,687,411 | - | 5,891,661 | - | 2,955,787 | 53,751,537 |
| 2019 | 53,751,537 | - | 6,057,295 | - | 2,789,759 | 50,484,001 |
| 2020 | 50,484,001 | - | 6,286,704 | - | 2,603,736 | 46,801,033 |
| 2021 | 46,801,033 | - | 6,408,333 | - | 2,397,828 | 42,790,528 |
| 2022 | 42,790,528 | - | 6,716,421 | - | 2,168,777 | 38,242,884 |
| 2023 | 38,242,884 | - | 6,861,419 | - | 1,914,670 | 33,296,135 |
| 2024 | 33,296,135 | - | 6,950,297 | - | 1,640,154 | 27,985,992 |
| 2025 | 27,985,992 | - | 6,980,897 | - | 1,347,255 | 22,352,350 |
| 2026 | 22,352,350 | - | 7,019,328 | - | 1,036,348 | 16,369,370 |
| 2027 | 16,369,370 | - | 7,057,675 | - | 706,229 | 10,017,924 |
| 2028 | 10,017,924 | - | 7,073,766 | - | 356,457 | 3,300,615 |
| 2029 | 3,300,615 | - | 7,078,448 | - | - | - |

*All DROP Balances paid in 2015.

Number of Years Expected Benefit Payments Sustained: 14.47

This projection assumes no further contributions, assumes no further benefit accruals, and assumes Market Value of Assets earn 5.50% interest.

**It is important to note that as long as the Actuarially Determined Contribution is made each year, the Plan will never become insolvent. Furthermore, State and local laws mandate that the Actuarially Determined Contribution be made each year.**

ACTUAL AND HYPOTHETICAL CONTRIBUTIONS APPLICABLE TO THE FISCAL YEAR ENDING SEPTEMBER 30, 2017

Valuation Date: 10/1/2015

| | ACTUAL | HYPOTHETICAL | |
|---|---|---|---|
| | 7.50% RP-2000 Static | 7.50% RP-2000 Generational | 5.50% RP-2000 Generational |
| Total Required Contribution (Fixed $) | $3,929,423 | $4,226,413 | $6,317,126 |
| Total Required Contribution (% of Payroll) | 50.60% | 54.42% | 81.36% |
| Expected Member Contribution | 522,609 | 522,609 | 522,609 |
| Expected State Money | 543,474 | 543,474 | 543,474 |
| Expected Sponsor Contribution (Fixed $) | $2,863,340 | $3,160,330 | $5,251,043 |
| Expected Sponsor Contribution (% of Payroll) | 36.87% | 40.69% | 67.63% |
| **ASSETS** | | | |
| Actuarial Value [1] | 67,381,235 | 67,381,235 | 67,381,235 |
| Market Value [1] | 66,127,077 | 66,127,077 | 66,127,077 |
| **LIABILITIES** | | | |
| Present Value of Benefits | | | |
| Active Members | | | |
| Retirement Benefits | 31,184,767 | 32,548,952 | 47,743,412 |
| Disability Benefits | 3,091,266 | 3,230,071 | 4,541,764 |
| Death Benefits | 167,127 | 119,102 | 160,190 |
| Vested Benefits | 2,347,861 | 2,423,876 | 3,801,389 |
| Refund of Contributions | 268,469 | 268,549 | 283,108 |
| Service Retirees | 37,816,740 | 39,047,782 | 47,623,111 |
| DROP Retirees [1] | 14,812,033 | 15,141,617 | 18,424,672 |
| Beneficiaries | 1,442,938 | 1,494,629 | 1,754,396 |
| Disability Retirees | 6,608,068 | 6,825,878 | 8,422,934 |
| Terminated Vested | 2,041,380 | 2,110,703 | 2,723,478 |
| Excess State Monies Reserve | 127,773 | 127,773 | 127,773 |
| Total: | 99,908,422 | 103,338,932 | 135,606,227 |
| Present Value of Future Salaries | 60,024,599 | 60,088,457 | 67,137,562 |
| Present Value of Future Member Contributions | 4,039,656 | 4,043,953 | 4,518,358 |
| Total Normal Cost | 1,487,194 | 1,546,600 | 2,405,968 |
| Present Value of Future Normal Costs (Entry Age Normal) | 10,895,684 | 11,359,592 | 19,938,087 |
| Total Actuarial Accrued Liability [1] | 89,012,738 | 91,979,340 | 115,668,140 |
| Unfunded Actuarial Accrued Liability (UAAL) | 21,631,503 | 24,598,105 | 48,286,905 |

ACTUAL AND HYPOTHETICAL CONTRIBUTIONS APPLICABLE TO THE FISCAL YEAR ENDING SEPTEMBER 30, 2017

Valuation Date: 10/1/2015

| | ACTUAL | HYPOTHETICAL | |
|---|---|---|---|
| | 7.50% RP-2000 Static | 7.50% RP-2000 Generational | 5.50% RP-2000 Generational |
| **PENSION COST** | | | |
| Normal Cost (with interest) | 1,542,964 | 1,604,598 | 2,472,132 |
| Administrative Expenses (with interest) | 81,477 | 81,477 | 80,692 |
| Payment Required To Amortize UAAL (with interest) | 2,304,982 | 2,540,338 | 3,764,302 |
| Total Required Contribution | $3,929,423 | $4,226,413 | $6,317,126 |

[1] The asset values and liabilities for DROP Members include accumulated DROP Balances as of 9/30/2015.