West Palm Beach Police Pension Fund
2100 North Florida Mango Road
West Palm Beach, Florida 33409

Minutes

December 11, 2015
8:30 AM

CALL THE MEETING TO ORDER

Mr. Frost called to order the West Palm Beach Police Pension Fund Meeting on December 11, 2015 at 8:30 AM, in the main conference room of the Ernest George Building of the Palm Beach County Police Benevolent Association.

Present at the meeting: Jonathan Frost, Board Chairman, Troy Marchese, Board Secretary, Joseph Ahern, Board Trustee and Craig Kahle, Board Trustee. Wilton White, Board Trustee (arrived at 8:42 AM)

Also present: Mark Parks - Finance Director, City of West Palm Beach; Kevin Coppin & Ernest George, Retired Plan Members; Lou Penque, Active Plan Member; John Riddle, BRC Investment Management; John McCann & Brendon Vavrica, Thistle Asset Consulting; Bonni Jensen, Board Attorney, Klausner, Kaufman, Jensen & Levinson; and Dave Williams, Plan Administrator.

PUBLIC COMMENT

No comments provided.

APPROVAL OF THE MINUTES

Mr. Frost asked if there were any changes required to the minutes of November 13, 2015. Mr. Frost provided his observations, which were duly noted. Mr. Kahle made the motion to approve the minutes of November 13, 2015 as amended, which was seconded by Mr. Ahern. All Trustees voted yes, and the motion was passed 4-0. Mr. White was not present at this time.

APPROVAL OF DISTRIBUTIONS

New Warrants were presented for review and execution. Warrants approved at the last meeting were presented to the Board in spreadsheet format by Mr. Williams. A formal administrative report was also provided for consideration. After Mr. Williams detailed the report, Mr. Ahern made the motion to approve, which was seconded by Mr. Marchese. All Trustees voted yes, and the motion was passed 4-0. Mr. White was not present at this time.

Mr. Williams presented the 2016 Cost of Living - COLA report, which is effective January 1, 2016 to the Board for consideration. A sample letter and explanation of the cola that is being sent to each affected member was also provided. After reviewing the documents, Mr. Marchese made the motion to approve the foregoing which was seconded by Mr. Ahern. All Trustees voted yes, and the motion was passed 4-0. Mr. White was not present at this time.

ATTORNEY’S REPORT

Mrs. Jensen reviewed the statement of policy regarding the IRS Determination Letter Compliance. The policy was proposed to bridge the gap until the formal changes can be adopted in the 2017 legislative session. After reviewing and considering the policy, Mr. Marchese made the motion to approve the foregoing which was seconded by Mr. White. All Trustees voted yes, and the motion was passed 5-0.

Mrs. Jensen distributed an insurance premium tax database reminder (dated - December 5, 2015). Mr. Frost asked Mr. Parks to update the city contact. Mr. Parks indicated the state was advised, but he will follow-up.

Mrs. Jensen advised that Mr. Williams secured a quote for fiduciary insurance. The policy limits are the same as the expiring policy and there was a price decrease of $2,760. Mr. White made the motion to bind coverage, which was seconded by Mr. Ahern. All Trustees voted yes, and the motion was passed 5-0.

Mrs. Jensen suggested the Board consider cyber hacking coverage. Mr. Williams will pursue accordingly.

ADMINISTRATOR'S REPORT
Mr. Williams provided a brief update on the Audit. All fieldwork was completed. GASB 67 report is pending from the actuary. As the Board may recall this needs to be incorporated in the financial statements. Formal presentation is set for February meeting.

Mr. Williams reviewed the 2016 FPPTA Membership notice, the Board elected to renew the membership with the organization.

Mr. Williams reviewed a communication received from the mother of Z. Mintus with the Board. Sincere appreciation was extended to the Board of Trustees by Z. Mintus' mother. Mr. Williams reflected that the Board should be commended for their efforts and Mr. Williams wanted to Board to know that the action they take does change lives. Kudos to all Trustees.

BRC – INVESTMENT REPORT
Mr. John Riddle, Principal of BRC appeared before the Board to review his firm's investment activity. The portfolio was valued at $26,413,518.36 as of September 30, 2015. For the rolling 12 months through September 30, 2015, BRC's return was valued at 0.14%, compared to the Russell 1000 Value Index return of -4.42%. For the September 30, 2015 quarter, the portfolio returned -9.15% compared to -8.39% for the benchmark. The date of inception for BRC was August 30, 2013; the portfolio returned 11.91% compared 7.59% compared to the benchmark.

Mr. Riddle outlined BRC's predictive ability and investor response rates. Future stock price changes are driven by changing expectations. Wall Street analyst earnings revisions and announced earnings surprises directly impact investor expectations and have substantial impact on security prices. Through our quantitative models, we have been able to significantly predict which companies are likely to experience these revisions and earnings surprises. By incorporating fundamental analysis, we are able to identify which securities are best for inclusion in the concentrated portfolios.

INVESTMENT MONITORING REPORT
Mr. Vavrica & Mr. McCann provided a quarterly flash report through December 11, 2015. The portfolio returned 5.14% for the current quarter.

NEW BUSINESS
Administrative Review: Mr. Williams' performance as the Plan Administrator was reviewed by the Trustees and positives accolades were provided. Mr. Williams reflected that he proudly serves the Board and the Membership, but could not do it alone and that his Administrative Assistant, Maryann was his backbone, which all concurred.

A spreadsheet was provided that outlined the CPI since Mr. Williams's inception. The CPI revealed a 2.01% increase. The actual percentage increase provided to Mr. Williams was 1.75%. With that the Board approved an increase of $265.53 per month beginning October 1, 2015, which would bring Mr. Williams in line with the CPI. Mr. Williams "Thanked" all the Board Members for their continued support.

Pension Obligation Bonds: The Trustees asked Mr. Parks if he could provide a report on the city's intention in securing pension obligation bonds. Mr. Parks confirmed the city is pursuing bonds for the police plan only at this juncture. The physical report outlined has been incorporated (by attachment) into these minutes.

OPEN DISCUSSION
Trustees exchanged educational comments relating to recent training received.

Mr. Frost asked the Board if they were interested in reconsidering Options at the February meeting. Consensus was to invite Mr. Michael Warsh from the Chicago Board of Options. The Board also wanted to consider actual companies that could provide the service. Mr. Vavrica & Mr. McCann will identify candidates.

ADJOURNMENT
Being there was no other business; the meeting was adjourned at 10:00 AM.

Next meeting is scheduled for January 08, 2016 at 8:30 AM

Troy Marchese, Board Secretary

JACK FROST, CHAIRMAN

Introduction to Pension Obligation Bonds

November 30, 2015

The PFM Group

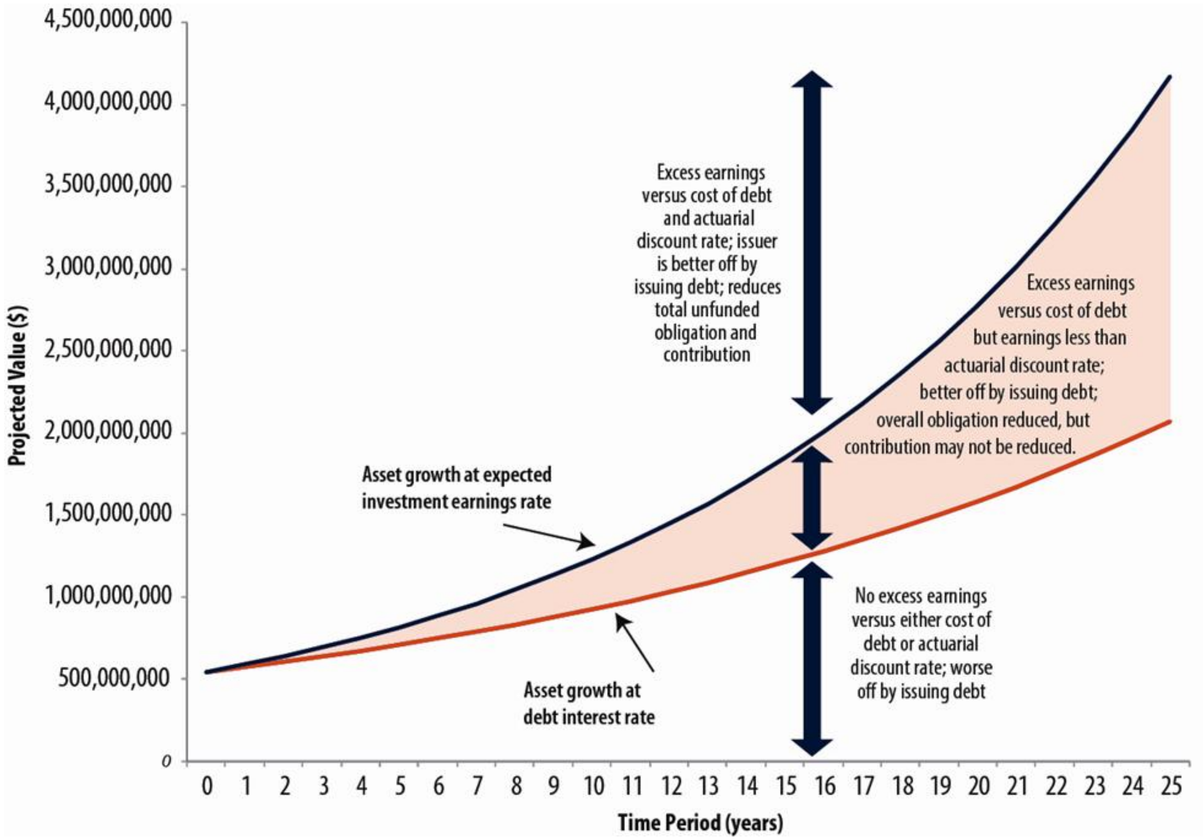
Public Financial Management, Inc.
PFM Asset Management LLC
PFM Advisors

Overview

- Pension Obligation Bonds ("POBs")
- Impact of retiree benefits liabilities on the rating
- Business cycle and POBs
- POB Considerations and Risks

Pension Obligation Bond Mechanics

- Issuers of Pension Obligation Bonds ("POBs") issue debt in the taxable fixed rate markets and deposit the proceeds into their pension system.
- POBs are a risk-bearing arbitrage strategy between the cost of financing and the return on investment.
  - Investment rates that are greater than borrowing costs will achieve net savings to the pension obligation.
  - POB proceeds should be invested in asset classes that provide the best risk/return trade-off (i.e. Equities).
- ***POBs replace a 'soft liability' with a 'hard liability'.***

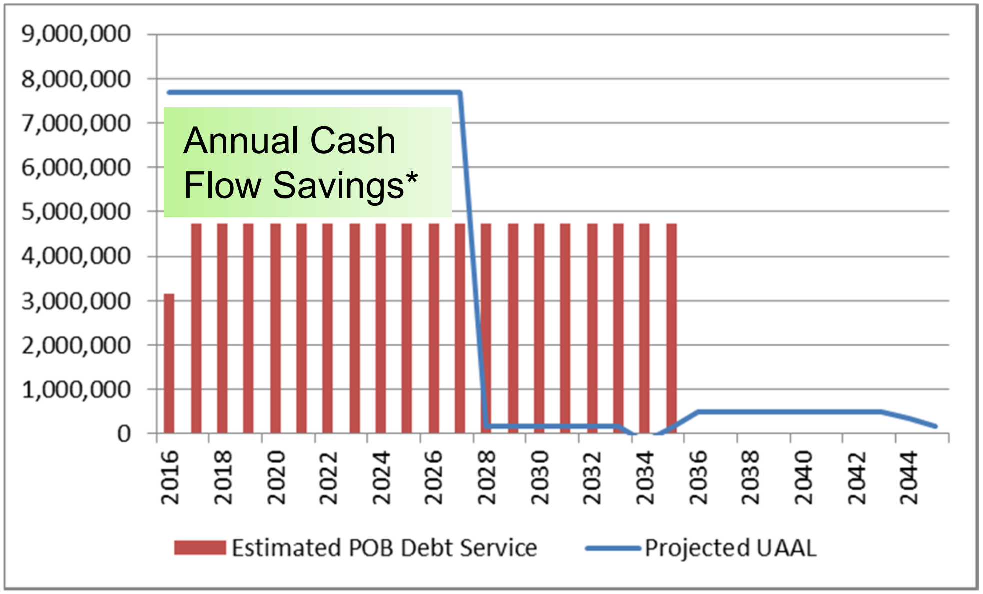


Why Have Cities Pursued POBs?

- Short-term budget relief
  - In the initial years after POB issuance, the new debt service payments may be lower than the actuarially determined pension contribution required to amortize an unfunded liability
  - Over the long-term, however, results will vary based on actual experience
- Potential arbitrage
  - If you can borrow at a taxable muni rate below the pension fund's actuarial return assumption (e.g., sell at 5.5% and target 8.00% earnings), arbitrage savings are <u>projected</u> "on paper"
  - If actual returns exceed the borrowing rate, these savings can potentially become real – but they are <u>not guaranteed</u>, and have not always been achieved by POB issuers

Potential POB Results – City of West Palm Beach

- Summary of Estimated Financing Results:
  - 20 year bond amortization, final maturity in 2035
  - POB True Interest Cost: 4.584% (compare to 8% investment return)
  - Total Cash Flow Savings*: $4.3MM
  - Annual Savings (2016-2027) averaging $3MM
  - Dis-savings in years 2028-2035 (equal to annual Debt Service cost)



- Risks of turning the POB into a hard liability…
  - Plan earnings > Borrowing cost = Better Position
  - Plan earnings < Borrowing cost = Worse Position
  - ***Plan earnings are still the key component!***

**Indicative results for discussion only. Based on the $60.306 million UAAL in the September 30, 2014 Actuarial Report and current market conditions for POB offering.*

Rating Agency Views

Credit rating agencies are now placing greater focus on the magnitude of unfunded pension obligations and the ability of municipalities to address such costs

Moody's

- "…pension obligations are a significant source of credit pressure for governments and warrant a more conservative view of the potential size of the obligations."
- "Issuance of pension bonds could be part of a broader credit positive effort aimed at restoring a balance between the pension's actuarial liabilities and asset values and achieving affordability."

Standard and Poor's

- "… a very high debt, pension and OPEB burden can lead to a management score of 4, which caps the final rating at the lower of 'A' and one notch lower than suggested by [the indicative rating outcomes resulting from the weighted average of seven factors]…"
- "Standard & Poor's generally considers the issuance of POBs as the swapping of an existing liability for another, with generally neutral credit implications. The difference is that POBs are a 'hard' liability with specific repayment dates, and pension contributions are 'soft' in the sense that they only need to be adequate to keep a pension fund from insolvency."

Fitch

- "The ability to manage pension costs, as well as all other cost pressures, is a factor in our analysis of management... Fitch's ratings have reflected the degree to which local governments have an ability and willingness to pursue possible changes in order to make their pension burdens more sustainable."
- "Fitch believes that POBs, if used moderately and in conjunction with a prudent approach to investing the proceeds and other pension assets, can be a useful tool in asset-liability management. However, a failure to follow balanced and prudent investment practices with respect to POB proceeds could expose the sponsor to market losses."

Moody's New Scorecard

- Moody's has also recently made several changes to its overall methodology for rating US local government General Obligation (GO) bonds, separate from those adopted to standardize the process for assessing pension liabilities across jurisdictions
- As part of a new "scorecard" approach, Moody's has doubled the weight their analysis assigns to debt and pensions from 10% to 20%

New GO Scorecard

Change from previous Methodology:

Factor 1 Economy/Tax Base	Factor 2 Finances	Factor 3 Management	Factor 4 Debt/Pensions
30%	30%	20%	20%
Was 40%	Unchanged	Unchanged	Was 10%

- This further reflects Moody's ongoing efforts to consider unfunded pension obligations as debt-like liabilities that are likely to present local governments with long-term challenges and reduced financial flexibility

Moody's New Scorecard

- Below is a more detailed breakdown of the criteria, which contains numerous metrics which capture, according to Moody's, the most critical aspects of an entity's credit profile

Scorecard Factor and Weights		
Broad Rating Factor	Rating Subfactor	Subfactor Weighting
Economy/Tax Base	Tax Base Size (full value)	10%
Economy/Tax Base	Full Value Per Capita	10%
Economy/Tax Base	Wealth (median family income)	10%
Finances	Fund Balance (% of revenues)	10%
Finances	Fund Balance Trend (5-year change)	5%
Finances	Cash Balance (% of revenues)	10%
Finances	Cash Balance Trend (5-year change)	5%
Management	Institutional Framework	10%
Management	Operating History	10%
Debt/Pensions	Debt to Full Value	5%
Debt/Pensions	Debt to Revenue	5%
Debt/Pensions	Moody's ANPL (3-year average) to Full Value	5%
Debt/Pensions	Moody's ANPL (3-year average) to Revenue	5%

West Palm Beach Ratings – Moody's Score

The City's lowest score (higher scores are worse) is in the Pension Liability category

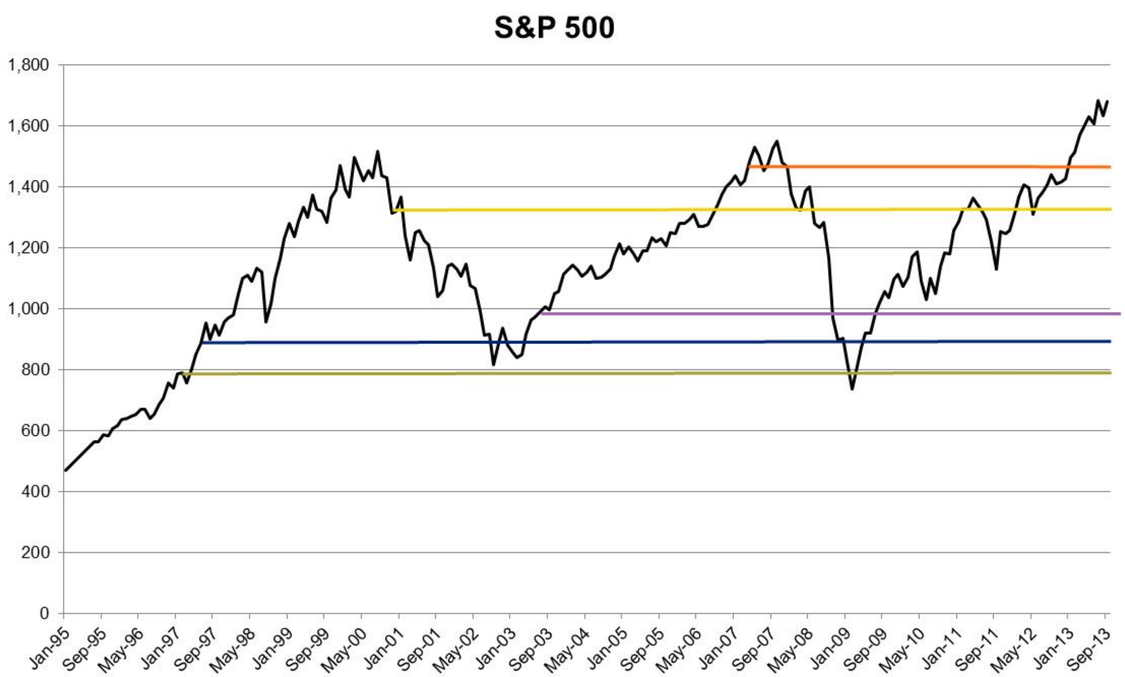
Moody's Local Government Rating Calculator

Category	Weight	Indicated Rating
Economy/Tax Base	30%	1.95
Fund Balance	15%	2.45
Cash Balance	15%	2.40
Management	20%	2.42
Direct Debt	10%	2.52
Pension Liability	10%	3.31
Indicated Rating Score	100%	2.38
Indicated Rating	**-**	**Aa3**

Debt/Pensions							
	Aaa	**Aa**	**A**	**Baa**	**Ba**	**B and Below**	**Weight**
Net Direct Debt / Full Value	< 0.75%	0.75% ≤ n < 1.75%	1.75% ≤ n < 4.00%	4.00% ≤ n < 10.00%	10.00% ≤ n < 15.00%	≥ 15.00%	5%
Net Direct Debt / Operating Revenues	< 0.33x	0.33x ≤ n < 0.67x	0.67x ≤ n < 3.00x	3.00x ≤ n < 5.00x	5.00x ≤ n < 7.00x	≥ 7.00x	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Full Value	< 0.90%	0.90% ≤ n < 2.10%	2.10% ≤ n < 4.80%	4.80% ≤ n < 12.00%	12.00% ≤ n < 18.00%	≥ 18.00%	5%
3-Year Average of Moody's Adjusted Net Pension Liability / Operating Revenues	< 0.40x	0.40x ≤ n < 0.80x	0.80x ≤ n < 3.60x	3.60x ≤ n < 6.00x	6.00x ≤ n < 8.40x	≥ 8.40x	5%

Pension Obligation Bond Timing

- The timing of when an issuer enters the market can significantly affect the performance of POBs.
- Stock prices fluctuate, and the risk of loss in the first recession after a POB sale must be evaluated carefully.



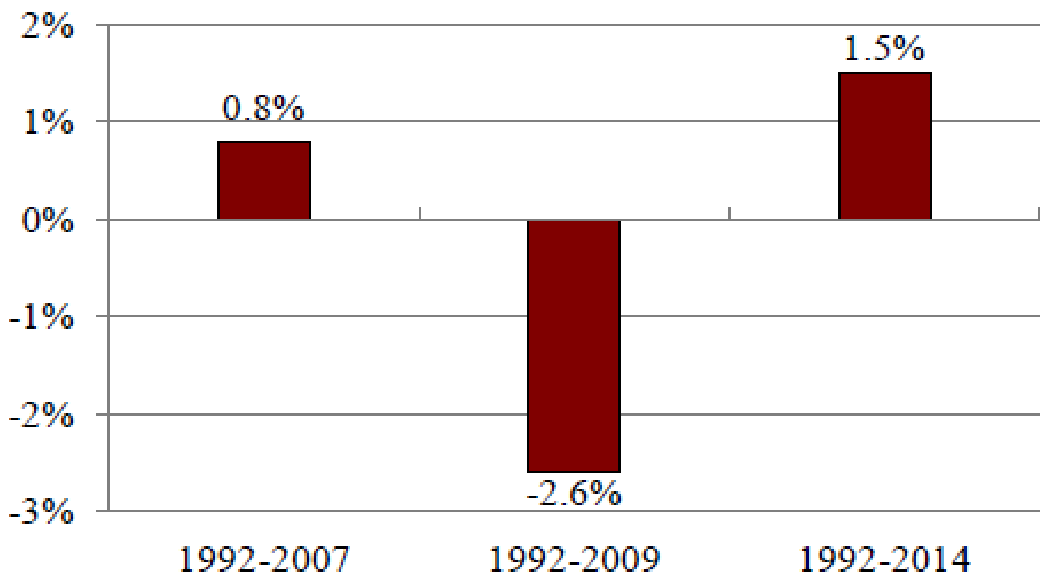
Source: Bloomberg

- A ‘Pension Obligation Bond Window’ is the period of time an issuer can invest these bond proceeds in the stock market with a reduced probability of experiencing lower stock prices in the subsequent economic recession.

Timing Is Everything

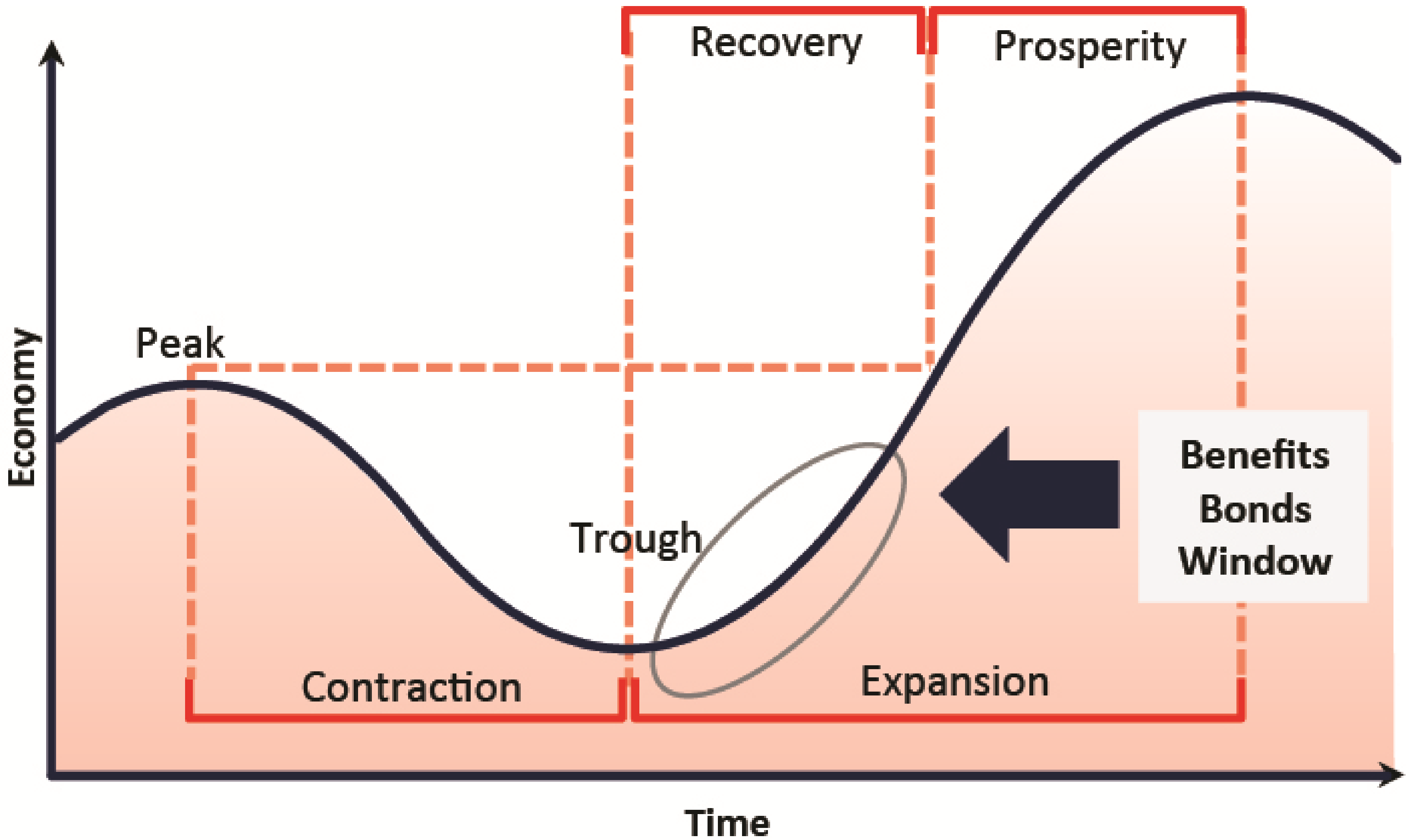
POB Internal Rate of Return By Year Issued

FIGURE 4. AVERAGE INTERNAL RATE OF RETURN ON PENSION OBLIGATION BONDS, 1992-2007, 1992-2009, AND 1992-2014



Source: Center for Retirement Research at Boston College, "An Update on Pension Obligation Bonds" (July 2014)

The Business Cycle
and the Benefit Bonds Window



Business Cycle Context

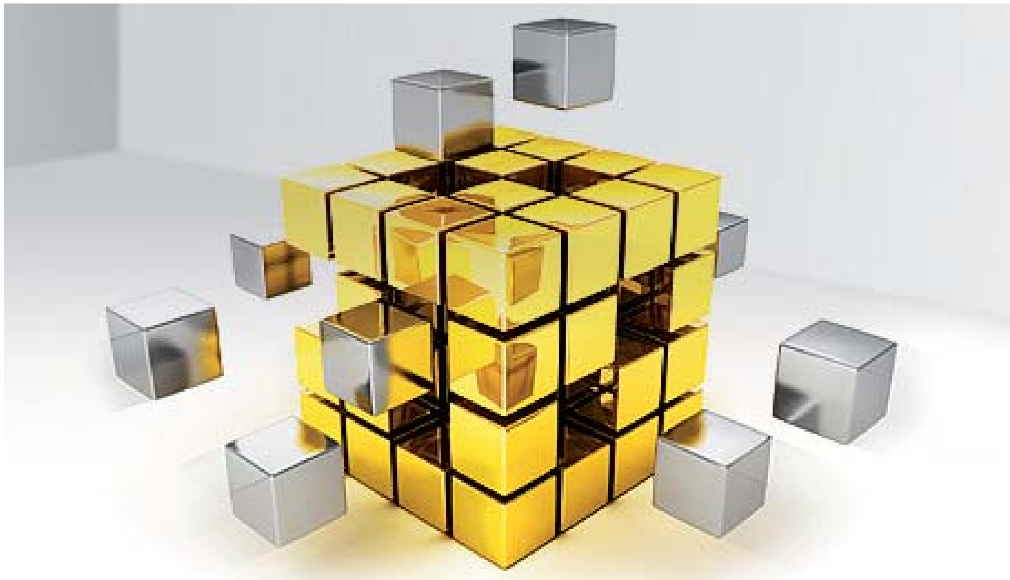
- The current expansion phase of the business cycle began more than five years ago, after the recession bottomed out in June 2009
  - **77 months and counting** as of November 2015
- Last five expansion phases (trough to peak):

Start/End	Duration
November 2001 – December 2007	73 months
March 1991 – March 2001	120 months
November 1982 – July 1990	92 months
July 1980 – July 1981	12 months
March 1975 – January 1980	58 months

- Average 1945-2009 (11 cycles): **58.4 months**
- Range: 12 to 120 months

Other POB Considerations

- There are numerous factors that must be evaluated and weighed when considering a POB that directly impacts the funding strategy.
  - Conversion of a soft liability to a hard liability
  - Issuance timing
  - Issuer debt load and capacity
  - Ratings impact
  - Covenant risk mitigation strategies while debt is outstanding (to the extent legally enforceable)
    - Create separate trust structure within retirement system to facilitate a POB investment strategy that is different than system-wide asset allocation
    - Limit ability to provide benefit enhancements while POB debt is outstanding
    - Consider a rate stabilization fund from POB excess returns once funded ratio exceeds 90%



The New Paradigm View of Benefit Bond Decisions

Issuance Sizing	• Based on stage in business cycle • Optimal recessionary sizing (80 to 85% for POBs; 65% for OPEB-OBs, preferably split in two issues)
Financial Analysis	• Primary driver of issuance – equity market risk/reward characteristics based on stage in business cycle • Dynamic reinvestment scenario analysis
Investment Management	• Equity-only initially, no arbitrage in selling bonds to buy bonds • Time-based migration to normal asset allocation
Overfunding Risk Mitigation	• Restrictive covenants to preclude benefits “give-aways” • Excess returns available to pay down debt • Protective POB trusts