Town of Palm Beach Retirement System
Board of Trustees
Minutes of May 19, 2017 Meeting

I. Call to Order and Roll Call

Chairman Pro-Tem Goldsmith called the meeting at 9:00 am in the Town of Palm Beach Hall Chambers, 360 South County Road, Palm Beach, Florida 33480

In Attendance:

TRUSTEES:
Daniel Stanton, Chairman
Gerald Goldsmith, Chairman Pro Tem
Brett Madison, Secretary
Thomas Bradford, Town Manager
Ed Carter, Trustee
Brad Kaufman, Trustee
Jeff Amling, Trustee
Michael Marx, Trustee

ALSO PRESENT:
William P. Hanes, Retirement Administrator
Jane Struder, Finance Director
David West, AndCo Consulting
Danielle Olson, Human Resources Director
James Linn, Attorney
Pete Strong, GRS

Absent:

Daniel Wilkinson

II. Election of Officers

Mr. Linn reviewed the process of officers' election. He distributed the ballots to the trustees for election of the positions of Chairman, Chairman Pro Tem and Secretary. Mr. Linn tallied the votes. He announced after the tally of the votes that Mr. Stanton was elected to serve as Chairman, Mr. Goldsmith was re-elected as Chairman Pro Tem, and Mr. Madison as secretary.

III. Approval of Agenda

Mr. Bradford made the motion to approve the agenda. Mr. Kaufman seconded the motion. The trustees unanimously approved the motion.

IV. Trustees Comments

None

V. Public Comments

None

VI. Approval of Minutes: March 3, 2017

Mr. Stanton noted a typo on page 4 from the March 3, 2017 minutes. He asked that it be corrected.

Mr. Goldsmith made the motion to approve the minutes of March 3, 2017 as amended. Mr. Bradford seconded the motion. The trustees unanimously approved the motion.

VII. Financial Report and Disbursements, Jane Struder, Director of Finance

Ms. Struder presented the quarterly financial report through March 31, 2017. She noted that the Town requests a transfer of $3.5 million dollars form the money managers to bring through the quarter.

Mr. Goldsmith made the motion to accept the financial report. Mr. Bradford seconded the motion. The trustees unanimously approved the motion.

Mr. Madison made the motion to approve the disbursement for the period of February 24 through April 28. Mr. Bradford seconded the motion. The trustees unanimously approved the motion.

VIII. Town of Palm Beach Retirement System Annual Report, Jane Struder, Director of Finance

Ms. Struder discussed the annual report. Mr. Stanton asked for clarification if the Town is currently assuming a rate of return of 7.4% and asked when the assumption rate will change to 7.3%. Ms. Struder answered that the assumption rate will change on September 30, 2017.

Mr. Bradford made the motion to approve the annual report. Mr. Kaufman seconded the motion. The trustees unanimously approved the motion.

IX. Actuarial Report, Pete Strong, GRS

A. Annual Actuarial Valuation

Mr. Strong presented the actuarial valuation report as of September 30, 2016, which calculates the contribution requirement for the year ending September 30, 2018. He reviewed the assumptions, and experiences resulting in increases in contributions and unfunded liability. He discussed that the state is requiring reduction in investment assumption and wages, and has approved the staggering over the next several years. Mr. Bradford commented with his concern that the State is requiring the Town's rate of wage growth to be reduced when the Town is assuming an increase in future wages. Mr. Kaufman asked if there would be an opportunity to go to the State. Mr. Strong answered yes, if the opportunity presents itself and there is evidence to keep the higher 3.5% wage assumption. Mr. Carter asked if the Town was singled out by the State or if it was done across the board. Mr. Strong answered "no" and explained that there are two rules in the Florida Statute 112.64 that govern this.

Mr. Strong discussed that there was a net experience loss over the past year, and a significant part of the loss is due to the smoothed actuarial valuation of assets. He explained that the return on the market value was 7.6%, but explained that it is smoothing in the investment market experiences over the last 5 years at 20% per year, and this is done to smooth out volatility over time. He commented that you do not immediately recognize the loss that was incurred during the year. He explained the investment loss for year 2016 was approximately $1 million out of the total $2.6 million losses for 2016. He commented that the system also experienced salary losses. He explained that the assumption was a 3.5% increase, and the plan experienced a 9% wage increase for General employees, 10% for Police Officers, and 7% for Firefighters. He mentioned that part of the wage increase was due to using 27 pay periods as opposed to a normal 26 pay periods in a year. Mr. Hanes asked Mr. Strong to comment on the next two to three years smoothing and unrecognized losses. He stated that we are expecting to recognize about $2.5 million in loss next year if the return on the market is at 7.4%. He commented that the only way to avoid a loss on the actuarial value would be to return at about 15% in the next year. This is because you only recognize 20% of the gain in a year, and defer the remaining for future years. He stated that actuarial experience is a total net increase of $156 thousand contributions payable in 2018 due to the 2016 experience.

Mr. Strong stated that the average return from the year 2000 to 2016 was 4.3% market. He indicated that since the assumption for most of those years was 8.0% that the funding rate was impacted by a reduction of approximately 30%.

B. 10-yr. projection

Mr. Strong reviewed the letter from March 15, 2017 he had sent to Mr. Hanes regarding the Town of Palm Beach 10-year projection. He discussed how the assumption changes impacted going forward, and the Town contributions were impacted. He illustrated stress testing, with earnings of 3%, 5% and 7% assumed. He commented that the contribution rates and unfunded liability goes up. He commented that the funding ratio is expected to dip to 61.7% over 10 years when earning an average rate of 5%, and the dollar amount of contributions will go up about 5.7%. Mr. Kaufman asked Mr. Strong to compare this plan to similar situated plans. Mr. Strong answered that a 7% assumption is on the low side, and the average return assumption is about 7.35%. He stated that GRS has been recommending plans to lower their assumptions. He commented that for every 1% reduction in investment assumption there is approximately 10% reduction in funding ratio. He commented that the average funding level across the state is approximately 80%, and so the Town's plan is a little below that average. Mr. Stanton expressed concern with the fact that the Town experienced at 4.3% average annualized return over the last sixteen years, and expressed concern that assuming the fund is able to improve to an average rate of return to 5% over the next ten years that the unfunded liability will grow to $140 million.

Mr. Stanton stated that this is something that really needs to be brought to the attention of Town Council, and that it represents what happens when one kicks the can down the proverbial road. He explained that it is time to take preventative action, and not 10 years from now. He commented that we can all hope for the best, and maybe the returns will be greater than in the past, but he believes there should be a plan to deal with it. He commented there is no reason he can see to assume we are on the cusp of tectonic shift in terms of returns, so if we experience what we have experienced over the last 16 years then that is where we will be 10 years from today.

Mr. Strong agreed, but commented he feels more optimistic and noted the last 16 years experienced two deep recessions. Mr. Stanton replied that you can also take the other side of that argument by saying we have not had a recession in 9 years. Mr. Strong agreed, but said he does believe 5-7% is realistic over the next 10 years, and does not believe there will be a repeat of the last 16 years. Mr. Carter commented that you can look at indexes that are at an all-time high and interest rates at all-time low, and volatility in the market at all-time levels, that it is not clear that there will be better returns in the future. He commented that it is not necessarily that we are going to see better markets looking forward than we have seen in the past, but pointed out that we didn't capture very much of the market during the period.

Mr. Goldsmith commented that there is also a big demand on cash flow. Mr. Strong discussed that there is a significant negative cash flow, and that he has been working with Dave West to calculate cash flows for the board. He stated in response to a question by trustee Stanton that the pension fund is never going to run out of money as long as the required contribution payments are made by the Town.

Mr. Carter asked Mr. Strong what the Town contributions would need to grow to just to pay the current benefits. Mr. Strong answered that when you look at the 5% assumption rate growth 10 years out, the Town contributions would need to reach a level of double to reach the $20 million needed to pay current level of benefits. Mr. West asked Mr. Strong how much of the contribution dollar is going to the unfunded liability as opposed to normal cost. Mr. Strong discussed that there are two principal components, the normal cost and the unfunded liability payment. He referred to an illustration indicating that the annual payment on the unfunded liability represents $7.6 million and the normal cost payment is $1.28 million. He commented that 85% of the Town's contribution requirement is going toward past unfunded liabilities. He noted that there is a very small portion of the Town's contributions going toward benefits earned during the current year (normal cost). He commented that if the plan was 100% funded, then the total contributions would be payable at the normal cost of $1.28 million amount. Mr. West asked if it is appropriate to consider an alternative financial strategy in lieu of the possibility of investments not meeting the funding target. Mr. Strong recommends for the Town to continue making an extra payment, which the Town is doing this year.

Mr. Strong recommended that the board reduce the amortization period of the unfunded liability from 30 years to 25 years in order to prevent transferring costs to future generations of taxpayers what reasonably should be paid by current taxpayers. He stated that the cost impact of that will be about $240 thousand. He stated by reducing the amortization period, the unfunded amount is paid off sooner. He commented that other of their clients were reducing the amortization period. Mr. Strong stated that there are essentially layered amortization periods so that when there is experience gain or loss, you create a new amortization of 30 years, called a closed period amortization. Mr. Strong stated that the funding ratio will not be impacted immediately by implementing the 25-year amortization, but would impact how quickly you pay down the unfunded liability by increasing the payment, and over time the funding ratio would actually improve.

Mr. Linn discussed the reporting on legislation, and that there was nothing passed that directly impacts our retirement plan. He commented that there was legislation that did not pass, and is expected to return, that will require every plan to use a long-term investment return assumption based on the expected investment return.

Mr. Stanton commented on how underfunded the Town of Palm Beach plan is and that it needs to be fixed and the Town cannot start fixing it in 10 years. Mr. Goldsmith stated that it is the job for the board to warn the Town Council, and not for the board to act.

Mr. Stanton stated that the actuarial work of Mr. Strong is very good, the message is highly important, and cannot be swept under the rug. He thanked Mr. Strong for his work.

Mr. Bradford stated for the record that he appreciates for the first time in a long time having an actuarial report presented in a professional and yet understandable manner where the average guy can understand what is being stated, and commented he appreciated it very much.

Town Council member Ms. Margaret Zeidman commented that the Town Council needs better communication and a closer relationship with the Retirement Board. She commented that Town Council does look to see what they can pay toward the unfunded liability. She complemented Mr. Strong on his excellent presentation.

Without motion, the board approved the year 2016 valuation report.

C. State review of investment return and wage increase assumption

No comments made.

D. HB 603 / SB 632 Long Range Investment Return for Public Pensions

No comments made.

X. Investment Report, Dave West

A. Quarterly Investment Report (period ended March 31, 2017)

Mr. West discussed matters of cash flow, and commented that cash flow is a critical issue for the system and is net negative cash flow intense. He commented that after review of the annualized cash flow, that benefit payments totaled $22 million while Town contributions came in at $8 million with member contributions at $1 million. He stated that for 2017 there is a net outflow of about $9 million to the system, and similarly the 2018 projection is a net $9.5 million outflow from the plan. He said it has been critical for AndCo to be very attuned and to make sure to move the investment program forward in a way that moves more liquidity to the table from what was structured previously to their arrival. He discussed that AndCo is handling the needs of cash flow quarter to quarter in the least disruptive manner as possible.

Mr. West reviewed sector performance over the quarter. He commented that the opening fund value on March 31, 2017 is $202,249,029 with quarter return of 3.9%, which places the fund at 3.75 % fiscal year to date with the 15% of managers not reported. Mr. Carter asked why there is no historical data for private equity and real estate. Mr. West answered that private equity calculations has to be shifted and calculated from the internal rate of return (IRR). He stated that the most recent date for reporting data from these managers goes back to December 2016 and September 2016. He said that to the extent that AndCo has the data on IRR, the correct performance numbers have been included, but commented there is no total private equity result until all funds are reported.

Mr. West reviewed with Mr. Carter the issue of capital commitments and liquidation requirements within the asset allocation of assets. Mr. West stated that they have increased the participation in Index Funds in both the S&P 500 and aggregate bond market, available for liquidity when needed. Mr. Carter asked Mr. West if he had a position on the amount of illiquid funds there should be for a portfolio of $200 million. Mr. West stated that he believed for a cash flow intensive portfolio that the fund is comfortably at the high end of the limit. Mr. West stated that they would be receiving approximately $8 million from the Mesirow redemption request for the June quarter end, and part of the proceeds will coordinate and be available for the distribution requirements in the next quarter. He commented that AndCo is trying to project ahead and place the program in a more liquid position.

Mr. West reviewed the managers' performance for each asset class. He then discussed each individual manager performance. Mr. West stated that he would like to recommend that they complete a GTAA strategy review to get a better fund performance manager, especially with regard to the net of fund fee. He said he plans to review alternatives at the next meeting.

Mr. Stanton asked about the shrinkage of the fixed income component over the last several months. Mr. West answered that under the previous asset allocation policy there was a lack of US domestic beta exposure and the maximum US Domestic Equity exposure was at 30%. He commented that their recommendation was for more beta exposure to US equity by reducing alternative investments, and that the other source of funds was to come through the investment grade fixed income portfolio while slowly bring up the domestic equity.

Mr. Carter asked what type of Real Estate investment is the new JP Morgan fund going to focus on. Mr. West answered the fund is going to be in the major sections for commercial real estate. Mr. Carter asked what the liquidity profile is. Mr. West answered quarterly under normal market circumstances.

Mr. West reviewed the plan cash flow and the need to raise additional funds needed to pay benefits and expenses. Mr. Carter questioned if the Town has the right portfolio mix based on the cash flow analysis. Mr. West answered that as of June 30, after receipt of the Mesirow redemption payment, the Town reconstruction will be completed to get to that point. Mr. Carter discussed his concerns regarding the portfolio illiquidity when not knowing when future capital calls are made. He asked what the first source of cash is when there is a call. He made the observation that Hedge Funds have been the dog of the portfolio, and have not delivered the returns, and yet is almost as large as the domestic equities. He commented that there is something woefully wrong with this portfolio from liquidity to risk standpoint, and commented you cannot find a 7% return in the entire portfolio except for domestic equities.

Mr. Stanton discussed that the portfolio has changed dramatically in the last several months, and it was unbelievable how the former consultant had underweighted domestic equities, overweighted international, and overweighted in other asset classes. He said that several of those areas, including domestic equities, can be used for a source of funds for liquidity. Mr. West agreed that 100% of the domestic equities are liquid. He discussed that they have been efficiently using the liquid manager strategies as the number one source of funds as the portfolios are being restructured. He commented that once the portfolio is where we want it to be with regard to the targets, it will dramatically increase the equity exposure to the portfolio. He commented that adding substantial private equity investments brings up the equity exposure of the system. He added that going forward the go to funds will be a pro rata reduction from the domestic equity index fund and domestic bond index fund. He discussed that one reason for the index funds is to be able to access the cash without cost. Mr. West discussed that the board has been moving forward at an accelerated pace since the new asset allocation model and investment policy guidelines were adopted and enacted by Town Council.

Mr. Kaufman departed.

B. Investment Administrative Update

No comment.

C. Hedge Fund Review

Mr. West discussed issues of Hedge Funds and a Hedge Fund search. He noted that overall performance of the hedge fund group has been disappointing. He reviewed managers recommended. Mr. Madison made an inquiry of Mr. West on the issue of concentration of strategies and diversification of asset classes. Mr. West answered that the job of fund of fund managers is to make sure that the fund is diversified in strategies, but not dilutive and with overlap, and that this is the main thing they are looking at with the fund of fund manager strategies.

Mr. West discussed that all the managers AndCo recommends have competitive fees and discussed fees charged by managers. He discussed the return metrics for each of the managers and performance. He discussed that these funds commonly do not perform well in periods when the equity market is doing well and observed that we have been through a period in the market cycle that historically has not been favorable to overweighting hedge funds.

Mr. West stated his recommendation to stay with Weatherlow, and to allocate 5% to the hedge fund space from the current 10%. He stated that the current allocation will drop to 5% when the Mesirow redemption has been finalized. He commented that the plan was up to about 15% in this space when AndCo began engagement with the board. He added that when adding other alternative strategies, allocation to the space was 17%-19%.

Mr. Stanton stated that after reviewing the whole document regarding hedge funds, he is underwhelmed, and discussed the underperformance of hedge funds and that there is a massive contraction going on in the hedge fund arena. He stated there is nothing in the AndCo book that would create incentive for an investment. He said the conclusion of work is well presented, but is very disappointing. Mr. Stanton agreed there are a few fund of funds with good performance and low fees, so there are little diamonds in the rough. He added that size is not your friend as an investor because these funds have to invest in a lot of funds or are forced to put money in places they do not wish to invest. Mr. Carter commented that 1,057 hedge funds either closed their doors or were liquidated last year, and there are less hedge funds today than in 2012. He commented that the hedge fund strategies have not worked, and everyone is getting out of hedge funds. He admonished that the board should be very cautious with the money invested in this category. Mr. Stanton stated he agrees, but noted that there are a few people out there doing quite well. Mr. Stanton raised the issue of whether or not to put money with an individual manager or not, and stated he believed the answer is no.

Mr. West requested that they keep the current asset allocation on the plate, and explained that AndCo would like not to turn everything around but wanted to be cost effective and prudent in their approach. He commented that he believed they have completed most of the heavy lifting, and at this juncture he would like to look to fine-tuning and address issues like the present in an effort to keep the program looking forward.

Mr. Carter inquired that from an actuarial standpoint that the board discussed earlier whether 7% is achievable. He asked Mr. West that after reviewing our portfolio whether we will get to 7% on a consistent basis. Mr. West stated that over the long term he believes there is a reasonable probability a 7% rate of return is achievable. He commented that it will depend on how to define long term, but the consistency issue, or year-to-year basis, cannot be predicted. He stated that by applying their capital market assumptions, but recognizing the limitations of an assumptive model that is run based on assumptive input, we should hit within the desired percentile, or slightly outside to not making the number with the current portfolio; but this is purely looking at the mathematical projection. He noted that by using an historical model and by using another in house building block method, and balancing these approaches, AndCo believes the current portfolio has a reasonable chance of hitting the number.

Mr. Amling departed.

XI. Attorney Report, Jim Linn, Attorney

A. Florida Retirement Legislation

Mr. Linn stated that the legislature did not pass anything to impact the Town's fund. He previously discussed legislation that would probably return requiring a calculation and adoption of a long-term return assumption.

B. PEI Settlement

Mr. Linn discussed the litigation and PEI settlement. He stated that a settlement was reached but the terms of the settlement are not known. He commented that there does not appear to be a recourse for the board in getting back the lost money. Mr. Stanton asked if there is any chance of the Town getting repatriation of capital. Mr. Linn answered that he thinks there is a possibility for the Town to get some money back.

Mr. Linn reported that in the last few days he has been made aware of an issue involving a section of the IRS code and that he is working with Mr. Strong and the Town to get all the information about this, evaluate options and formulate a plan of corrections that may require a plan amendment. He said he will discuss with the board at the next meeting.

XII. Administrator Report, William Hanes, Administrator

Mr. Hanes reviewed the administrator's report on newly added DROP and retirees.

Mr. Madison moved to accept the administrator's report. Mr. Goldsmith seconded the motion. The trustees unanimously adopted the motion.

XIII. William P. Hanes Consulting, Inc., Retirement Administrator fee adjustment, Gerald Goldsmith

Mr. Goldsmith discussed that he is very satisfied with Mr. Hanes job performance and recommended a 5% increase for Mr. Hanes as administrator.

Mr. Bradford moved to accept a 5% salary increase for Mr. Hanes per the letter provided by Mr. Hanes. Mr. Carter seconded the motion. The trustees unanimously approved the motion.

XIV. Other Business

Mr. Bradford asked about whether the board wants to do anything regarding the amortization schedule going from 30 years to 25 years. Mr. Stanton stated that he would like to defer to the next meeting.

XV. Adjournment

Mr. Bradford made the motion to adjourn the meeting. Mr. Carter seconded the motion. The trustees unanimously approved the motion.

Respectfully Submitted,

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Trustee
Town of Palm Beach Retirement Board