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April 11, 2017

Thank you for your work to find a solution for the Dallas Police & Fire Pension Fund.

You received a letter dated April 7 from Mayor Rawlings to Chairman Dan Flynn outlining the City of Dallas' "proposal" with respect to HB 3158. Attached is an analysis detailing the mistakes the City made concerning pension fund assumptions. We apologize for the length, but it is the only way we can clearly illustrate the extent of the errors contained in the City's analysis.

The Mayor's requested changes to HB 3158 are based on unrealistic and uninformed assumptions. The City's errors relate to the magnitude and timing of assumed investment returns, retirement rates, cost of living adjustments, DROP payments and interest, City payroll projections and the effective date of Plan changes. Virtually every assumption that materially affects the projected impact of HB 3158. In each case, the City is using much more aggressive assumptions than used by DPFP.

Perhaps the most obvious manipulation to make the City's proposal look more favorable is the assumption that all the changes to be implemented would be made effective January 1, 2017. Clearly, that is not the case.

It is regrettable that legislators have been presented with such radically different assumptions (detailed in the attachment). Unfortunately, it has been almost two months since the City's actuary has had any questions for or discussion with DPFP's actuary. That is not the norm, as a reviewing actuary typically seeks input from those who are most familiar with the data and behavior behind the assumptions. We do not believe the City's actuary is responsible for this change in approach.

The second major issue relates to governance. The Mayor is demanding control of the Board. We have heard consistently from Chairman Flynn's office that the Mayor had agreed to 50/50 control, but the Mayor now denies that commitment. We can confirm the following:

1. Chairman Flynn and his staff have demonstrated the utmost integrity and professionalism throughout our months-long negotiations.
2. In our numerous face-to-face meetings with the Mayor and City staff, no one from the City ever objected to a 50/50 governance.

Additionally, City leaders detailed in a January Council meeting their willingness to terminate, or “ice floe,” the existing Plan. The City’s new plan would offer current younger members a fraction of the value of their current accrued benefit with the threat that these members would receive nothing if they don’t accept. This new plan would leave over 6,400 members with absolutely no pension in a few short years. While the Mayor expressed dismay that he was out of town and didn’t approve the City staff’s public presentation of the “ice floe plan,” he has not denied the content presented.

To give control of the Board to the City would create a new form of governance imbalance. Yes, mistakes have occurred in the past. But as Chairman Flynn has detailed numerous times, mistakes were made by both the Board and the City. The Mayor’s proposal illustrates why the City should not have majority control on the Board. This proposal presents a false sense of financial security by using aggressive assumptions. In the past, the use of aggressive assumptions and disregard for reality contributed to the current financial crisis. We should not make that mistake again. As such, the only appropriate solution is shared control with the Legislature as a back stop to step in and make further changes if needed.

DPPFP has worked long and hard on a solution with Chairman Flynn and his office. Our members are reducing their benefits substantially in all areas as well as increasing their contributions to the Plan significantly. The member’s benefit reductions total \$1.4 billion, while contribution increases are \$1.2 billion over 30 years, a total of \$2.6 billion. The Mayor is also pushing to “claw back” \$700 million in previously earned benefits from Dallas police and firefighter retirees. There is nothing more that can be “squeezed” from the members.

The City’s contributions will increase between \$626 million and \$946 million over 30 years, contingent upon funding levels. But the City’s increase is certainly fair in comparison to what our members are doing.

We ask you to support the committee substitute formulated by Chairman Flynn. It is necessary to guarantee the financial future for our 10,000 members and their families. We encourage you to contact Kelly Gottschalk, the Executive Director of DPPFP, with any questions. This issue is too important to make decisions with false assumptions and erroneous information. Thank you again for your service. We trust you to do what is best for our members, the City and the State of Texas.

Sincerely,



Samuel L. Friar
Chairman

Attachment

**Assumption Comparison between Deloitte April 7, 2017 Analysis and Segal
March 31, 2017 Analysis**

Investment Returns

City's projected rate of investment return is too high and not achievable in the first five years.

City (Deloitte):

7.25% in all years

DPFP (Segal):

Market value returns assumed to be 5.00% in 2016, -1.74% in 2017, 5.00% in 2018, 6.50% in 2019, 7.00% in 2020, and 7.25% thereafter for the purpose of solvency projections. Assumed rates of return were provided by the System.

Comments:

The DPFP portfolio is in a state of transition. Many of the assets in the portfolio are not going to produce the returns necessary to achieve a 7.25% overall Plan return in the next five years. DPFP has made a good-faith estimate of reasonable return assumptions based on specific knowledge of the actual assets in the Plan's portfolio.

City representatives frequently and consistently have said they believe the 7.25% assumption is too high and would like to see it lowered. The City is now contradicting itself. The City's use of the 7.25% for all years has a material impact on the funding results.

The City's assumed rate is neither conservative nor realistic. The use of this assumption results in \$300 million more assets assumed to be in the Plan as of January 1, 2021 than the DPFP assumptions. While the addition of \$300 million in assets makes the City's math work, it's an unrealistic and misleading estimate. **WITH THE WAVE OF AN ACTUARIAL WAND, THE CITY HAS CREATED PHANTOM ASSETS TO SUPPORT ITS POSITION THAT INCREASED CITY CONTRIBUTIONS ARE NOT NEEDED.**

Retirement Rates

The City's projected retirement rates ignore near-term experience. Dallas First Responders are retiring at accelerating rates. The new DROP structure will likely result in earlier retirements into the future.

City (Deloitte):

Active non-DROP Participants

- 2017: Segal's 1/1/2016 valuation assumption increased by 10 percentage points at all ages

- 2018+: Segal's 1/1/2016 valuation assumption increased by 25 percentage points at age 58 (unchanged at other ages)

Active DROP Participants

- 2017: 50 percent (regardless of age)
- 2018+: Segal's 1/1/2016 valuation assumption

DPFP (Segal):

Retirements are assumed to occur on January 1.

In 2016, rates are increased by 5 percentage points for those participants who have been in DROP for six years or more.

In 2017, the current valuation retirement rates apply, with the following exceptions for current Active DROP participants:

- If at least 8 years in DROP as of 1/1/2017, 100% retirement rate in 2018
- If less than 8 years in DROP as of 1/1/2017, 50% retirement rate in 2018

Retirement Rates Beginning in 2018 for those not in DROP -

Tier 1 or Tier 2 participants with less than 20 years of service as of September 1, 2017		Participants who were Tier 1 with at least 20 years of service as of September 1, 2017		Participants who were Tier 3 as of September 1, 2017	
Age	Rate	Age	Rate	Age	Rate
<50	1%	<50	1%	<50	1%
50	10%	50	20%	50	5%
51	5%	51	10%	51	5%
52	5%	52	10%	52	5%
53	5%	53	10%	53	5%
54	5%	54	20%	54	10%
55	15%	55	40%	55	20%
56	10%	56	50%	56	30%
57	5%	57	50%	57	40%
58	60%	58	60%	58	50%
59	50%	59	60%	59	50%
60	50%	60	60%	60	50%
61	50%	61	60%	61	50%
62+	100%	62+	100%	62+	100%

Comments:

The City is assuming a lower rate of retirements for both members in DROP and those not in DROP, ignoring the fact that there has been a significant acceleration of retirements in the past few months. That accelerated retirement rate is expected to continue for the near term. Retirement rates are expected to exceed prior historical rates due to the changes to the DROP structure. DROP will no longer be the driver for people to continuing to work. The lower retirement rate assumption has the effect of lowering the cost and improving the funding projections and does not correlate with the actual experience since 1/1/16.

Cost of Living Adjustment (COLA)

The City ignores ad hoc COLA in its analysis.

City (Deloitte):

Cost of Living Adjustment (COLA) of 0% in all future years

DPFP (Segal):

Cost of Living Adjustment of 2% simple COLA assumed to be paid starting in 2047 and every year thereafter, based on HB 3158's benchmark that the Plan must be at least 70% funded on a market value basis prior to and after a COLA is paid. Market returns must meet a certain level over a five-year period before COLA payments can be enacted; it is assumed these levels are met in 2047 for purposes of these calculations.

Comments:

The City assumption is not consistent with the provisions of HB 3158, which includes an ad hoc COLA. It is improper for Deloitte to ignore the impact of the ad hoc COLA in its analysis.

DROP Distribution

The City ignores DROP payments already made or to be made in 2017.

City (Deloitte):

60% of the January 1, 2016 retiree balance was assumed to be paid out in 2016

Remaining DROP accounts are assumed to be paid out over the expected lifetime of the participant

DPFP (Segal):

Current retirees – For those who were retirees as of January 1, 2016, 57.50% of the January 1, 2016 balance was assumed to be paid out in 2016 and 10% of the January 1, 2017 account balance is assumed to be paid out in 2017. Beginning January 1, 2018, the remainder of the DROP accounts are assumed to be paid out over the expected lifetime of the participant upon their retirement based on the mortality tables in effect at the time of their retirement;

the expected lifetime is currently assumed to be 23 years. It is understood that the actual date of the change in DROP account distributions may occur prior to January 1, 2018. Current actives – 10% of the January 1, 2017 account balances are assumed to be paid out in 2017 for participants that retire in 2017. Beginning January 1, 2018, DROP accounts are assumed to be paid out over the expected lifetime of the participant upon their retirement, based on the mortality tables in effect at the time of their retirement; the expected lifetime is currently assumed to be 21 years if the Normal Retirement Age is 58. It is understood that the actual date of the change in DROP account distributions may occur prior to January 1, 2018.

Comments:

The City is overstating the assets in the Fund by not acknowledging the DROP account balances that have been paid out so far in 2017 and those that will be paid out according to the adopted addendum to the DROP policy until the effective date of HB 3158.

DROP Account Interest

DROP interest rate not explained

City (Deloitte):

DROP Account Interest of 2.75%

DPFP (Segal):

Current retirees – 2.75% Current actives – 2.75%; only the DROP account balances as of September 1, 2017 receive interest upon retirement. DROP contributions into existing DROP accounts after September 1, 2017 and future DROP participants receive 0% interest during the time in DROP and upon retirement.

Comments:

It is unclear how Deloitte has incorporated this assumption. It may or may not be consistent with the assumption used by Segal.

Payroll Projections

The City continues to rely on inflated employment projections.

City (Deloitte):

Projected payroll stream provided by the City based on revised hiring expectations. Payroll of \$364 million in 2018 growing to \$581 million in 2031 and increasing by 2.75% thereafter

DPFP (Segal):

Salary Increases

Select rates added for years 2016 – 2018:

2016 and 2018 – 10% if 0 - 10 years, 7% if 11 - 12 years, and 2% if 12+ years

2017 – 5% if 0 – 10 years, 2% for all others

Current salary scale applies in 2019 and beyond.

Payroll Growth Rate 4.25% in 2018; 2.75% in all other years

Overtime

The City is no longer assumed to contribute on an amount 11% greater than computation pay.

Comments:

The City was assuming very high payroll numbers (base of \$392M in 2017) in all of its prior City/Deloitte projections. It was only when DPFP converted the City’s assumptions and percentage increases into dollar amounts (the “floor”) that City representatives changed their tune. City officials have known all along that the numbers they were previously using were too high, and the actual City contributions based on 34.5% would result in significantly lower contributions than they were representing. DPFP and Segal questioned the reasonableness of the \$392M base when compared to the actual current payroll levels and inquired of Deloitte and the City CFO about the rationale for this assumption nearly two months ago. There was no response from the City, and Deloitte asked Segal and DPFP if the assumption should be adjusted.

The City’s removal of overtime from the City contribution factor further motivates the City to not fill vacant positions. City representatives knew when they unveiled their December 7 plan to save the pension that they were using unrealistic information and were misrepresenting the fact that their plan would fully fund the pension in 30 years. After talking with members of the departments and considering the actual number of members today, we believe the City’s estimates are still too high. The chart below shows the prior City payroll projections, as included in the January 23, 2017 Deloitte report, compared to the City’s new revised projections:

Year	Prior City Payroll Projections (millions)	Revised Payroll Assumptions (millions)	Difference (millions)
2017	\$ 392	\$ 372	\$ 20
2018	\$ 409	\$ 364	\$ 45
2019	\$ 420	\$ 383	\$ 37
2020	\$ 431	\$ 396	\$ 35
2021	\$ 443	\$ 408	\$ 35
2022	\$ 456	\$ 422	\$ 34
2023	\$ 468	\$ 438	\$ 30
2024	\$ 481	\$ 454	\$ 27
2025	\$ 494	\$ 471	\$ 23
2026	\$ 508	\$ 488	\$ 20
2027	\$ 522	\$ 507	\$ 15
2028	\$ 536	\$ 525	\$ 11
2029	\$ 551	\$ 545	\$ 6
2030	\$ 566	\$ 565	\$ 1
2031	\$ 581	\$ 581	\$ 0
2032	\$ 597	\$ 597	\$ 0
2033	\$ 614	\$ 614	\$ (0)
2034	\$ 631	\$ 631	\$ (0)
2035	\$ 648	\$ 648	\$ 0
2036	\$ 666	\$ 666	\$ (0)
2037	\$ 684	\$ 684	\$ 0

Asset Values at 1/1/2017

The City assumes a year-end 2016 asset value that cannot be known for months.

City (Deloitte):

1/1/2017 asset value of \$2,144 million

DPFP (Segal):

Asset value of \$2,153 million

Comments:

The first full paragraph on page 2 of the Deloitte letter states the following: “Preliminary December 31, 2016 asset information received January 13, 2017...” was used as the asset values. Through both a phone conversation and an email, DPFP staff informed the City’s CFO that they should not consider the values on January 13 as “preliminary 2016 values.” The following is the exact quote from the email, which followed the phone conversation explaining the values:

“As a reminder this should not be considered year end asset values. It is at best 3rd qtr private asset values, which can change materially during the 4th quarter, appraisal and audit process.”

Actual year-end 2016 asset values will not be known for some time, as has been made clear to the City. Segal used a value at a point in time, so the impacts of various scenarios could be evaluated without the impact of changing asset values.

Effective Date of the Plan Provision and Contribution Changes

The City assumes potential Plan changes will be effective January 1, 2017.

City (Deloitte):

All plan provision and contribution changes were valued as if they had occurred on 1/1/2017

DPFP (Segal):

Plan provisions were valued at 9/1/2017, the effective date of HB 3158 when possible. If not possible, Plan provisions were valued as of 1/1/2018.

Comments:

The City’s assumption of all of the changes having already occurred is ridiculous and intended to overstate contributions and understate the liability. Obviously, none of the changes will be effective for the first nine months of the year. This is a blatant manipulation of the results. As illustration, the difference between the interest rate currently paid on DROP accounts and the interest in HB 3158 is a difference of more than \$30 million for the nine months before the effective date.

City (Employer) Contribution Rates

The City’s proposed contribution plan shows lack of support for current plan, members.

City (Deloitte):

Contribution floor of \$135.24 million (plus \$11 million) for the first two years

DPFP (Segal):

The City will contribute 34.5% of computation payroll each year, plus 1/26th of \$11 million. Beginning in the first biweekly pay period following the last biweekly pay period that ends on or after September 1, 2019, if the amortization period is not finite, the additional \$11 million will not be contributed. However, in no case shall the City’s contribution amount be less than:

- \$5,173,000 for the biweekly pay periods beginning with the first biweekly pay period that begins after September 1, 2017, and ends on the last day of the first biweekly pay period that ends after December 31, 2017;

- \$5,344,000 for the 26 biweekly pay periods immediately following the first biweekly pay period that ends after December 31, 2017;
- \$5,571,000 for the subsequent 26 biweekly pay periods; and
- An amount equal to the biweekly amount applicable for the prior 26 biweekly pay periods, increased by a 2.75 percent compounded rate for each subsequent 26 biweekly pay periods.

Comments:

City representatives do not want to include contributions based on the payroll numbers they have provided up until now for two reasons: 1) they know the amount has been overstated and continues to be overstated in their analysis and 2) if they are tied to a specific dollar amount of contributions going into the current Plan, they cannot accomplish their real objective of starting a new plan for new members (and perhaps members hired after 2006). Starting a new plan and diverting the contributions for those members would drastically accelerate the insolvency of the current Plan.