city of CINCINNATI RETIREMENT

January 23, 2020

To: Mayor and Members of City Council

From: CRS Board of Trustees

Subject: State of CRS Pension Trust and Healthcare Trust as of December 31, 2018

This report is written to provide to the Mayor and City Council the state of the Cincinnati Retirement System (CRS) Pension Trust and Healthcare Trust based on the latest actuary report from December 31, 2018 and reports from our investment consultant.

Given the current and projected funding positions of the Pension Trust and Healthcare Trust, we recommend that the Mayor and City Council take immediate steps to address the downward trajectories of the Trusts. This would require significantly increasing its annual contributions to both Trusts.

Background

The purpose of the CRS Pension Trust is to provide retirement benefits to eligible retired city employees. The purpose of the Healthcare Trust is to provide medical and prescription coverage to eligible retired city employees. As of year-end 2018, there were 2,951 full-time active members, 4,207 pensioners receiving pension payments, and 4,968 pensioners and spouses receiving healthcare benefits.

The CRS Board of Trustees serves as an independent fiduciary on behalf of active and retired members of the retirement system. The Board is not a party to the Collaborative Settlement Agreement (CSA). The Board retains Marquette Associates, an independent investment consulting firm, and Cheiron, a pension and healthcare actuarial consulting firm, both of which specialize in public sector plans. Marquette and the Board have developed and follow a disciplined investment policy that can be found on the CRS website. Cheiron calculates the actuarial value of assets and liabilities and projects the funding status of the Trusts in future years based on professional actuarial standards and practices.

The assumed investment rate of return and discount rate for calculating liabilities is 7.5% per year as prescribed in the CSA. The actual annualized market rate of return for the past 5 and 10 years was 5.0% and 8.6%, respectively.

As of December 31, 2018, the total combined actuarial value of assets for both Trusts was $2.25 billion. The table below highlights the actuarial value of assets, liabilities and funded ratios.

As of 12/31/18:	Assets	Liabilities	Funded Ratio
Pension Trust	$1.76 billion	$2.42 billion	72.6%
Healthcare Trust	$490.9 million	$504.8 million	97.3%

Pension Trust

The assumptions at the time the CSA was finalized projected that the Pension Trust would be fully funded in 30 years. The status of the annual contributions and distributions is described below:

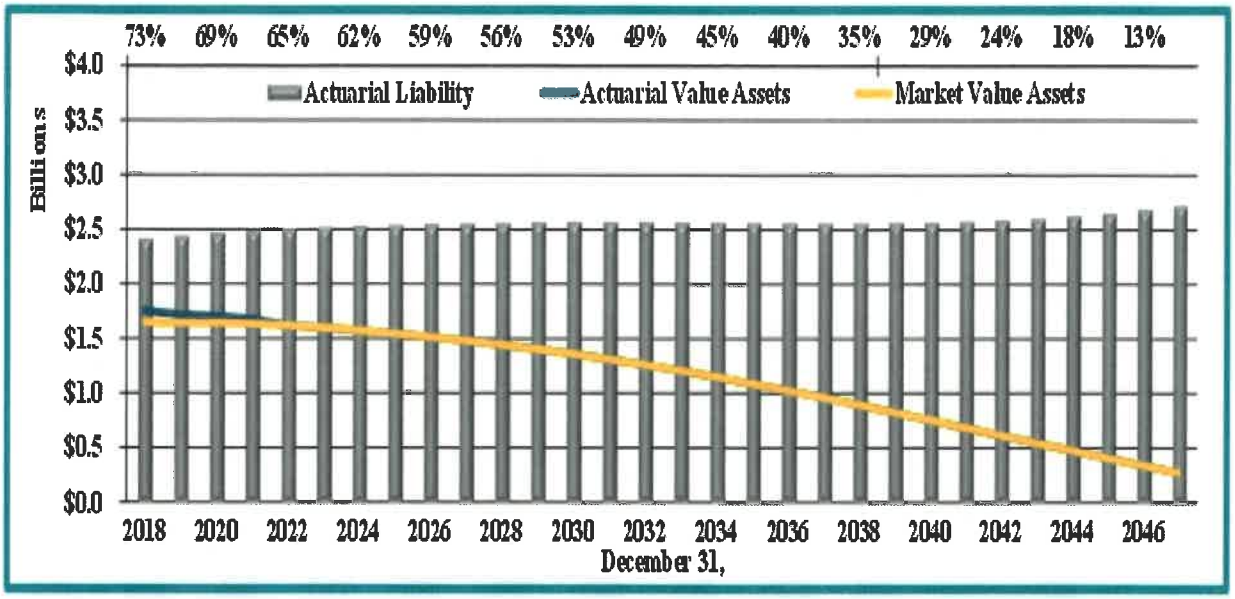
- The active employees contribute 9% of covered payroll to the Pension Trust as required by the CSA;
- The City contributes only the minimum rate per the CSA of 16.25% of full-time covered payroll to the Pension Trust. (The General Fund represents 37.5% of covered payroll and other non-general funds represent 62.5% of covered payroll);
- The Actuarially Determined Contribution (ADC), as calculated by the actuary, is the annual contribution amount required to bring the Pension to a fully funded status in 30 years. The ADC has not been contributed in many years;
- The City contributed $32.6 million in FYE 2018, but the ADC was $48 million, according to the City's Comprehensive Annual Financial Report. The ADC was $52.7 million for FYE 2019 and is $63.4 million for FYE 2020, meaning the City's contribution rate of 16.25% is significantly below the ADC. The difference between the City's contribution and the ADC is approximately 2.7% of the City's operating budget; and
- Benefit payments and expenses have exceeded employer and employee contributions for several years placing it in the bottom quartile among other public pension funds with negative cashflows according to the actuary.

After the CSA was finalized the following has occurred:

- Ordinance 336, which reflects changes made in finalizing the CSA that increased liabilities, was approved by City Council in 2016;
- Revisions to actuarial assumptions (e.g., longer life span of retirees) were made as recommended by the actuary and approved by the CRS Board; and
- Annualized 5-year investment returns (2014 – 2018) were 5.0% vs. the assumed 7.5% through 2018.

The actuary's revised funding progress for the Pension Trust projects an alarming decline from 73% as of 12/31/2018 to 13% funded in 30 years. The chart below provided by the actuary shows that in 2047 the actuarial liability would be approximately $2.7 billion and actuarial assets would be approximately $300 million (13% funded), an approximate $2.1 billion shortfall.

Pension Trust



The above graph assumes a 7.5% investment return annually over the next 30 years. Our investment consultant, Marquette, estimates that the probability of achieving this is approximately 50%, further challenging the Pension Trust's ability to meet future obligations.

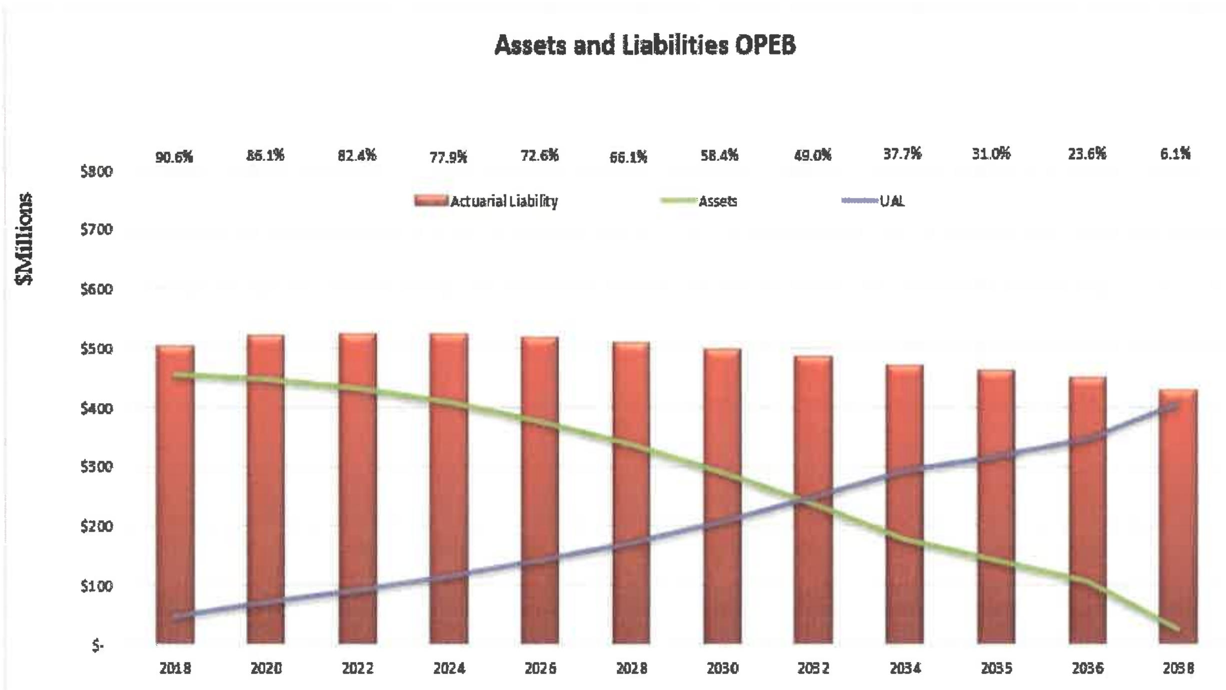
Healthcare Trust

At the time of the CSA signing, the Healthcare Trust was fully funded, and the City was required per the CSA to establish a funding policy to keep the Trust fully funded over the lifetimes of its members.

- The City has yet to adopt a Healthcare Trust funding policy as required by the CSA and there have been no City contributions to the Trust since the CSA was signed.
- The ADC for the Healthcare Trust for FYE 2019 was $4.4 million (2.6% of covered payroll) and is $5.7 million (3.4% of covered payroll) for FYE 2020.
- As the City continues to make no contributions to the Healthcare Trust, the ADC continues to increase each year. For FYE 2020, the ADC of $5.7 million is approximately 0.5% of the City's operating budget.

As of year-end 2018, the actuary's revised projections for the Healthcare Trust, assuming no contributions from the City and a 7.5% annual investment return, show the Trust running out of money by 2040 as shown in the chart provided by the actuary below.

Healthcare Trust

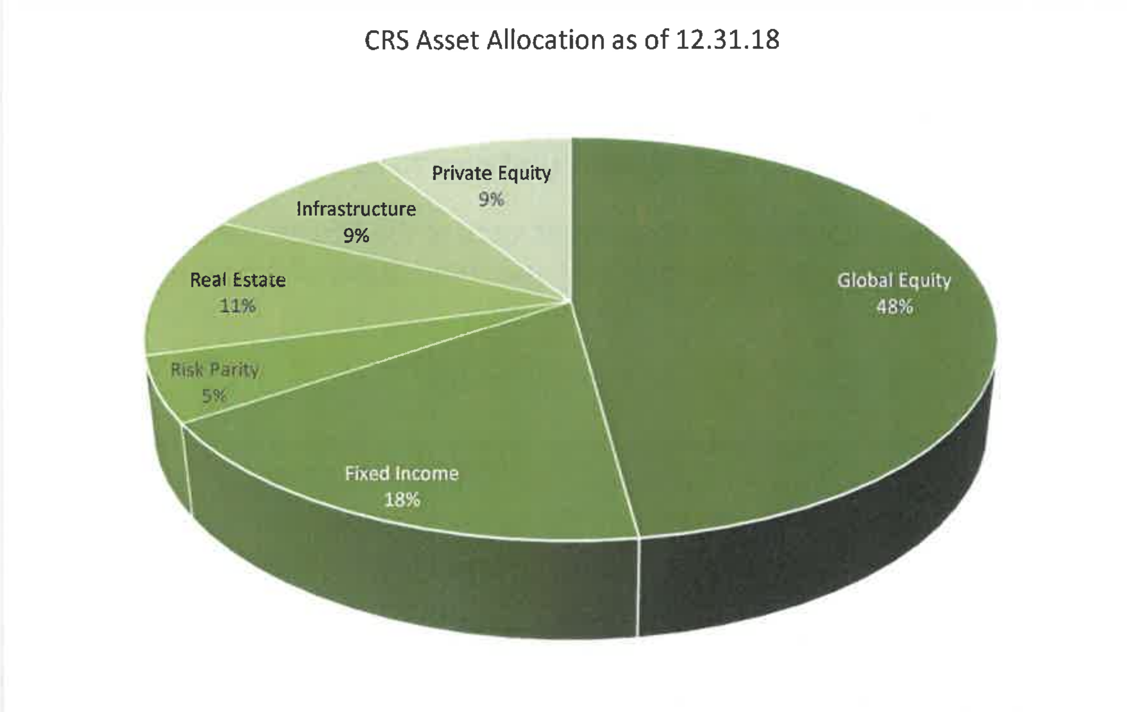


UAL = Unfunded Actuarial Liability

Investment Performance

While the simple conclusion may be to achieve higher returns or "invest our way out of this," CRS' investment performance has been solid relative to what the capital markets have provided. At the current level of historically low interest rates and modest economic growth, a 7.5% annualized return is a high hurdle and an optimistic assumption based on the investment consultant's analysis. Our investment policy and portfolio allocation are already amongst the more aggressive pension systems in our effort to achieve the 7.5% target with an acceptable level of risk.

Our portfolio is well diversified across asset class, sector, investment managers and securities. The asset allocation as of December 31, 2018 is shown in the exhibit below.



Through December 31, 2018, the CRS annualized investment returns on a 5- and 10-year basis, at 5.0% and 8.6% respectively, have been in the top 25% of our peers.

The table below shows annual investment returns, as provided by the actuary, over the past 10 years vs. the assumed target return at that time.

Investment Performance (Return by Calendar Year vs. Assumed Return Target)

	% Return	Assumed Return
2009	18.9%	8.0%
2010	13.1%	8.0%
2011	0.9%	7.5%
2012	12.1%	7.5%
2013	17.0%	7.5%
2014	6.5%	7.5%
2015	-0.1%	7.5%
2016	9.2%	7.5%
2017	14.5%	7.5%
2018	-3.9%	7.5%
2019	13.4%*	7.5%

* Investment return through 11/30/2019.

Despite strong market returns in 2019, the long-term funding status of the Pension Trust does not materially change.

Conclusion

The CRS Pension Trust and Healthcare Trust are undoubtedly challenged in providing promised retirement benefits. At the time of the CSA, the Pension Trust and Healthcare Trust, based on assumptions at the time, were projected to be fully funded in 30 years.

Now, with revised assumptions and the current state of the Trusts, we are headed toward 13% funded in 30 years for the Pension Trust and running out of funds for the Healthcare Trust in about 20 years.

Following are possible solutions to avert these outcomes:

1. Increase the City's contribution to these Trusts, as provided for in the CSA. For the Pension Trust, the City is contributing the minimum 16.25% of covered payroll as provided for in the CSA. This is still far below the ADC. For the Healthcare Trust, establish and follow-through with a plan to fully fund healthcare benefits as required by the CSA;
2. Increase investment performance by increasing risk. Generally, there are several strategies affecting increased investment return. These include using different investment managers, making a riskier asset allocation, and attempting to lower fees. There is little we can do regarding these factors because we believe we have the appropriate managers, the appropriate asset allocation, and fees are already on the low end. With regard to asset allocation, the only way to increase expected returns in the future is to lower the fixed income allocation and add more to stocks or other "riskier" assets. Investment performance has been solid over time and the risk level of the portfolio is already aggressive relative to our peers. We and our investment consultant believe that taking any more risk would be imprudent. Conversely, taking less risk would decrease our chances of achieving the 7.5% target;
3. Reduce benefits. While unpopular and considered a last resort, without increased contributions or higher investment performance, we believe reducing benefits is inevitable and would require re-opening the CSA; and
4. As the City has done before, explore issuing judgement bonds to reduce the unfunded actuarial liability. As of 12/31/2018, the unfunded actuarial liability for the Pension Trust was $662 million.

Recommendation

At this time, we recommend that City Council increase the City's employer contributions to bring the Pension Trust and Healthcare Trust back to a funding level we can be confident will meet the promises made to CRS members. City Council should devise a plan to consistently contribute the ADC. The ADC for FY2020 is $63.4 million for the Pension Trust and $5.7 million for the Healthcare Trust, for a total of $69.1 million. Immediate action is required. Further delays will result in higher contributions in future years.

cc: Paula Tilsley, Executive Director