City of Dallas
Ad Hoc Committee on Pensions
December 14, 2023

Bill Quinn
John Stephens
Rob Walters

What Caused the DPFP's Challenges?

Poor Real Estate Investments

- The DPFP invested more than $1 billion in ill-advised direct real estate investments during 2005-2009 (exacerbated by 2008-2009 real estate decline), much of it with managers who lacked appropriate skills. The DPFP had to write down thee assests by hundreds of millions of dollars, resulting in the first report of its financial challenges in 2015.

DROP Structure/Run-On-The-Bank

- Over the years, the pre-2017 DPFP board had authorized a structure for DROP that severely harmed the fund. The most damaging provisions included (1) a floor of 8% interest annually on the DROP balance; (2) allowing retirees to defer their monthly deposits into DROP after retirement; (3) no limit on time in DROP or time the money could remain with DPFP; (4) allowing active members to take distributions from DROP; and (5) allowing unlimited distributions from DROP.
- DROP balances grew to more than $1.5b (58%) of total assets by 2016. As members became worried about the possible closing of access to their DROP accounts, a "run-on-the-bank" ensued. More than $600 million (25% of the fund) was withdrawn before DROP was closed for withdrawals on December 8, 2016, as a result of actions of the Board and a court injunction initiated by Mayor Mike Rawlings.

The 2017 Legislation: HB 3158

- The Texas Legislature passed HB 3158 in 2017 in response to the DPFP's financial challenges.
- The legislation didn't fully resolve DPFPS's long-term challenges. HB 3158 recognized that further efforts would be necessary and mandated a 2024 analysis.
- The actuarial work done when the Legislature enacted HB 3158 projected that the funded level of the Plan would decline for several years, even if all assumptions were achieved.
- Change of Governance – from police and fire and Council dominated board, to 6 mayoral appointees, 5 trustees elected by the members (including 1 police officer and 1 fire fighter).
- Provided 7 years of contribution certainty to DPFP.
- Benefits were frozen for active employees, retirees, and beneficiaries.
- HB 3158 reduced the unfunded liability by $1 billion and increased the funding ratio to 49% with a years-to-fund period of 44 years. Even with the increased funding under HB 3158, funding levels were projected to decline until 2032 based on anticipated withdrawals and contributions.
- HB 3158 mandates an independent actuarial analysis and plan changes before the 2025 legislative session.
- The 2017 legislation was intended to avoid near-term financial challenges and bridge to a solution by 2025.

What Does HB 3158 Mandate?

- Before July 1, 2024, the PRB must select an independent actuary to be hired by DPFP to analyze the most recently completed valuation. The PRB selected the actuary (Cheiron), which has provided its preliminary report.

- The independent actuary must submit a final report to the PRB by October 1, 2024; the report must include:
    - A conclusion regarding whether the pension meets State Pension Review Board pension funding guidelines; and
    - Recommendations regarding changes to member or city contributions.

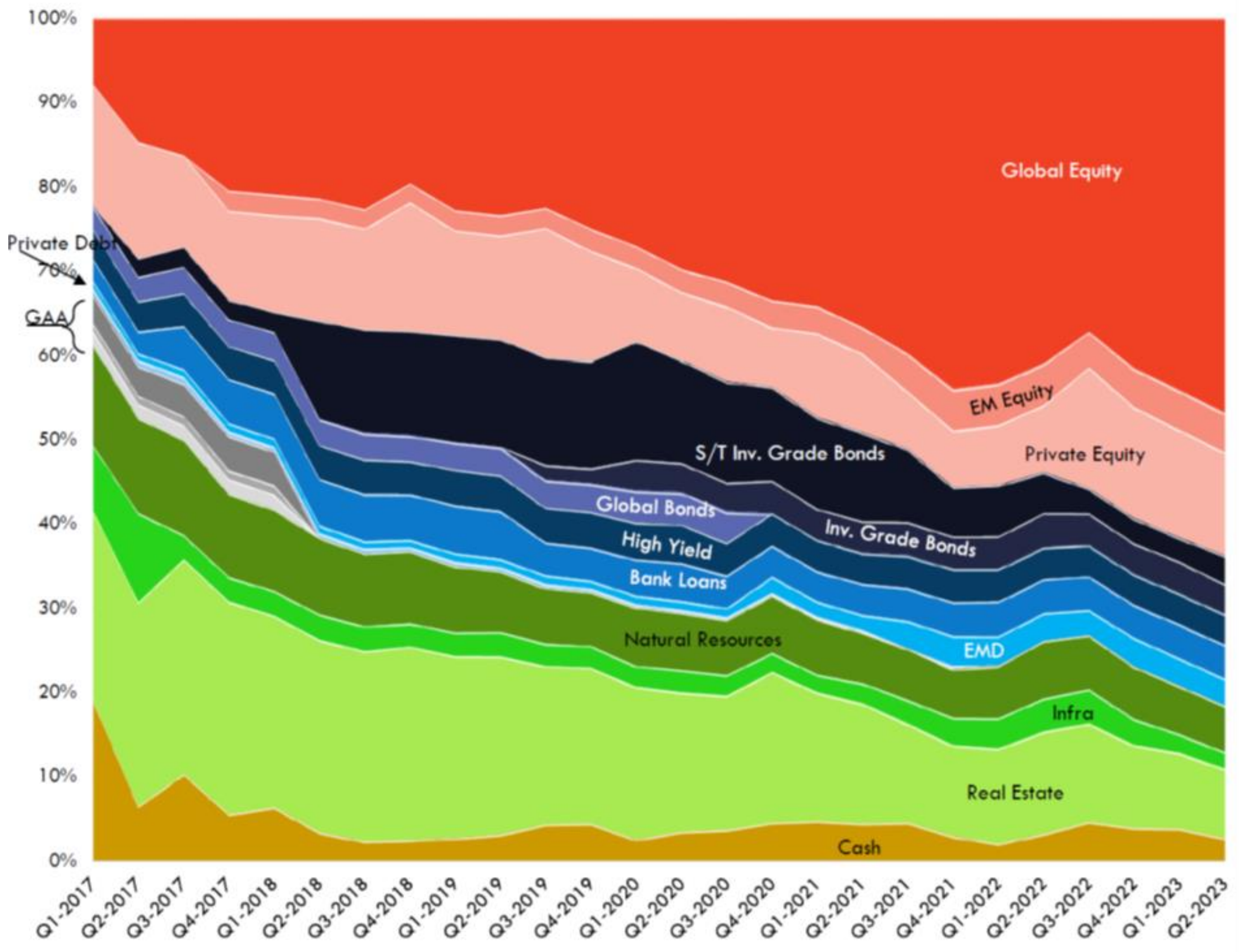
- Not later than November 1, 2024, the DPFP Board must adopt rules that:
    - Comply with the funding and amortization period requirements under 802 of the Government Code; and
    - Take into consideration the actuary’s recommendations and City funding commitments.

- Not later than December 1, 2024, the PRB must submit a report to the Legislature containing the actuary’s report and the DPFP Board’s plan changes adopted to meet the legislative funding requirements.

What Has the DPFP Board Accomplished Since 2017?

- Implemented more than 30 specific requirements mandated by HB 3158.
- Developed a Board of Trustees that works together regardless of whether trustees were appointed or elected to the Board.
- Managed several HB 3158 litigation challenges and other litigation.
- Lowered the assumed rate of return to 6.5% to ensure the funding status reported is the most realistic estimate.
- Strides have been made to transform an underperforming, highly illiquid investment portfolio into a more typical public pension portfolio.
  - $900M in private market distributions were received from the sale of complicated and unique investments. Assets were sold to maximize the long-term value for DPFP. The legacy portfolio has three material assets remaining.
  - Private market proceeds have covered over 105% of net benefit outflows since 2017.
  - Given the high level of monthly outflows (~$10M), designed an asset allocation that included a safety reserve (cash and short-term bonds) to serve as the primary liquidity source during periods of market distress. The safety reserve is designed to cover 18 months of benefit outflows to ensure growth assets would not need to be sold during market downturns.
  - Restructured the portfolio from having over 65% in private market assets and less than 10% in public equities to a portfolio that now has 70% of assets or ~$1.3B in liquid, public markets assets (public equity and fixed income).
  - Public markets assets (which are the portion the Board can control) have outperformed their benchmark by 1.1% annually since 2018.
  - Established an Investment Advisory Committee with a majority of outside investment professionals with considerable investment experience.
  - Revised the asset allocation, hired new consultants, modified the Investment Policy Statement, developed a thorough investment managers search and due diligence process, liquidated $135 million of high-cost GAA funds, and modified fee arrangements.

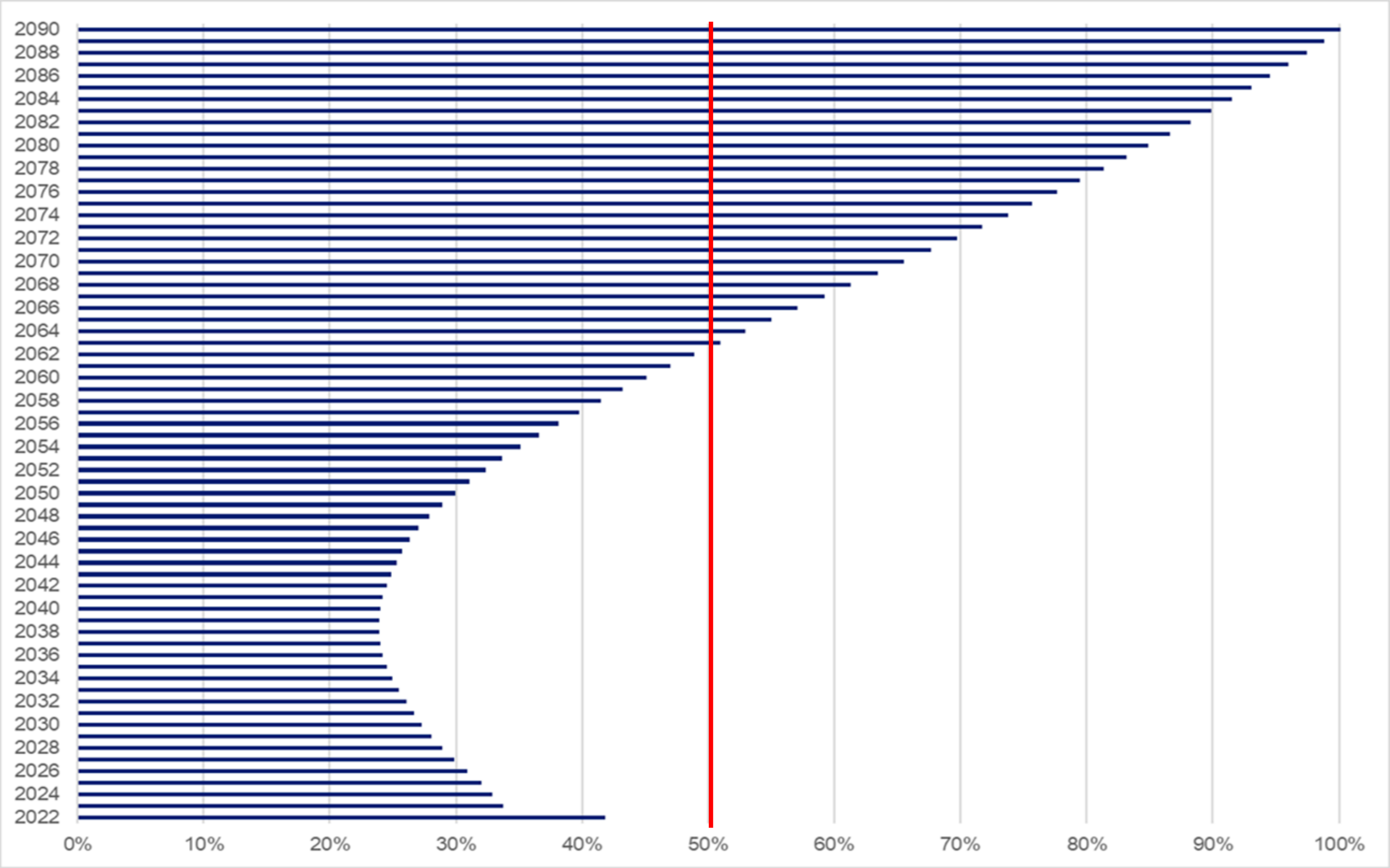
How Has the DPFP Realigned its Portfolio since 2017?



What is the DPFP Funding Status as of January 1, 2022?

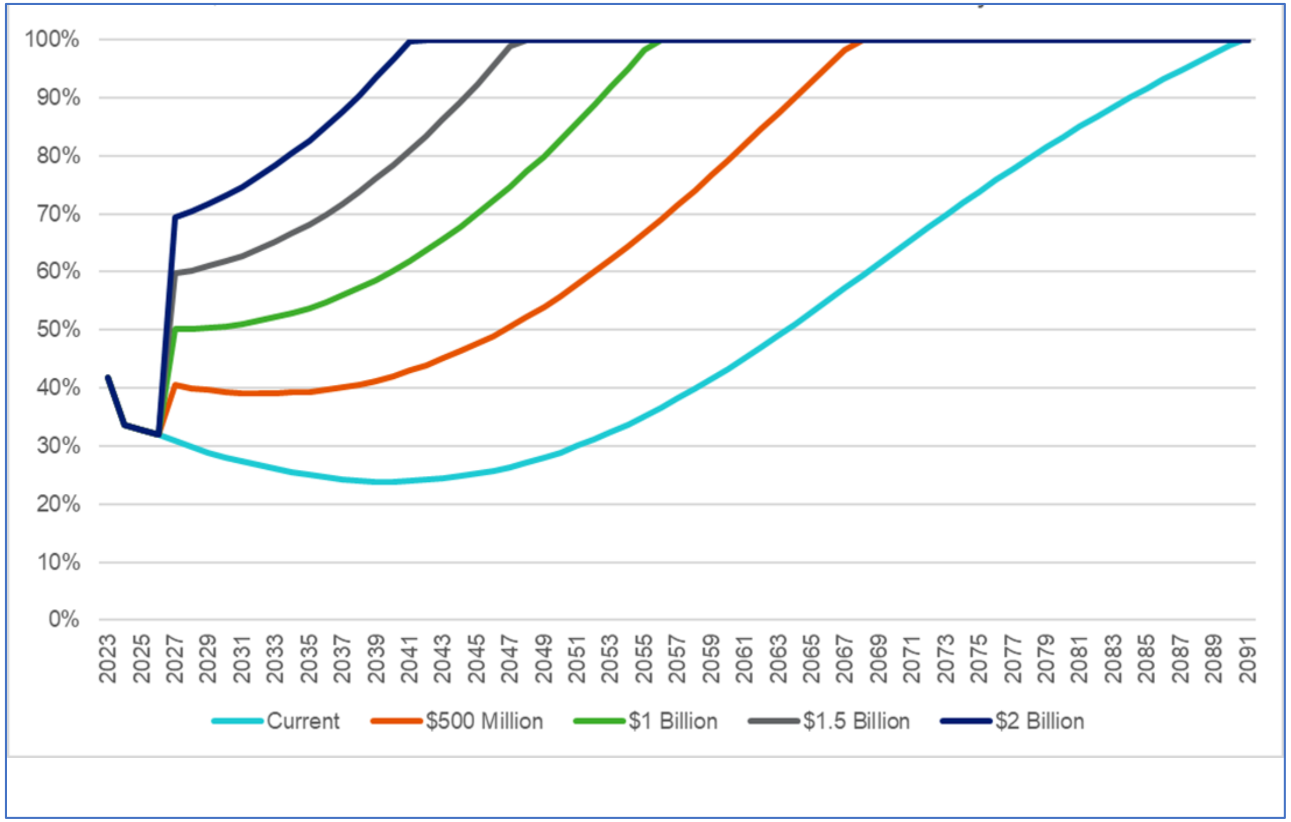
- DPFP is 41% funded
- The total DPFP liability is $5.2 billion, of which $3.4 billion is unfunded. Over 70% of the liability is due to retirees and beneficiaries.
- The funding period is 2090 (68 years) based on current assumptions.
- The City current contribution rate is 34.5% of regular pay, plus $13 million annually. (The City’s contribution rate would need to be 52.3% [an additional $63 million and increasing over time] for the plan to fully fund within 30 years.)
- Active members contribute 13.5% of regular pay each pay period.
- DPFP paid benefits of $100 million more (received $224m; paid $324m) than contributions in 2022.

What are the DPFP's Funding Projections (1/1/2022)?



What Are Projected Funded Levels with One-time Cash Infusion in 2025?

Projected Funded Level based on the 1/1/2022 Actuarial Valuation with an additional $500m, $1b, and $2b of cash contributions received mid-year 2025



Note: This information is based on the most recent available Acturial Valuation (1/1/2022)

Council Ad Hoc Committee Fall 2023 Schedule

September 19th	Initial Ad Hoc Committee Background Briefing
October 26th	DPFP and ERF Staff Briefing to Ad Hoc Committee
November 9th	Cheiron's Briefing on its Initial DPFP Report
December 14th	Task Force Recommendations for DPFP

Recommenations Regarding the DPFP

Bill Quinn:

Former Chair of DPFP Board (2017-2022)

Retired Founder and CEO of American Beacon Advisors (American Airlines)

John Stephens:

Former Chief Financial Officer of AT&T

Head of City of Dallas Economic Development Task Force

Rob Walters

Gibson Dunn, Senior Partner

Former DPFP Board Member (2017-2020)

Immediate Past Chair, Dallas Citizens Council

The Work Undertaken

The Task Force has studied options throughout 2022 and 2023

The Task Force has consulted with both national and local experts in public pensions, finance, infrastructure, actuarial analysis, and law (e.g., Reason Foundation, Arnold Foundation, Pew Charitable Trusts, Goldman Sachs)

The Task Force has canvassed the views of various stakeholders, including the DPFP executive team and board members, police and fire association heads, police and fire retirees, City Council members, and Dallas city staff

The Task Force has collected data and information on Dallas assets, tax revenues, bonding capacity, and other pertinent metrics

The Goals

Devise and recommend a plan that:

--satisfies the mandates of HB3158 and Chapter 802 of the Texas Government Code

--meets the objectives of the principal stakeholders

--underpins Dallas's public safety objectives

--gives Dallas optionality in funding its pension obligations

--provides Dallas with incentives to monetize assets to fund DPFP

--gives Dallas's elected leadership the opportunity not to strain traditional revenue sources that drive the City's general fund

Recommendations

I. Additional Fixed Contributions

The City would make contributions in addition to its current annual contributions of 34.5% of regular pay plus $13M.

The City's additional contributions (amounts consistent with Cheiron's recommendation) would begin with fixed incremental payments that increase by $20 million per year over the intial three years of the plan period in the following amounts:

FY 2024-2025: $20M

FY 2025-2026: $40M

FY 2026-2027: $60M

Recommendations

II. Additional Funding with Monetizing Assets

The City should promptly begin the process of exploring opportunities to monetize existing assets for the benefit of DPFP.

The plan's contribution schedule would incentivize the City to monetize appropriate assets as soon as practicable and within the first three years to reduce, or even eliminate, future pension obligaitons.

The City should work with appropriate private-sector firms to maximize the value of its assets.

Recommendations

The assets the City should consider for monetization could include, among others:

City land and real estate assets

City parking and waste/landfill assets

Underutilized City facilites

City bonding capacity (e.g., pension obligation bonds)

City sales tax revenues dedicated to other undertakings

All city assets, including aviation

The Recommendations of the Task Force

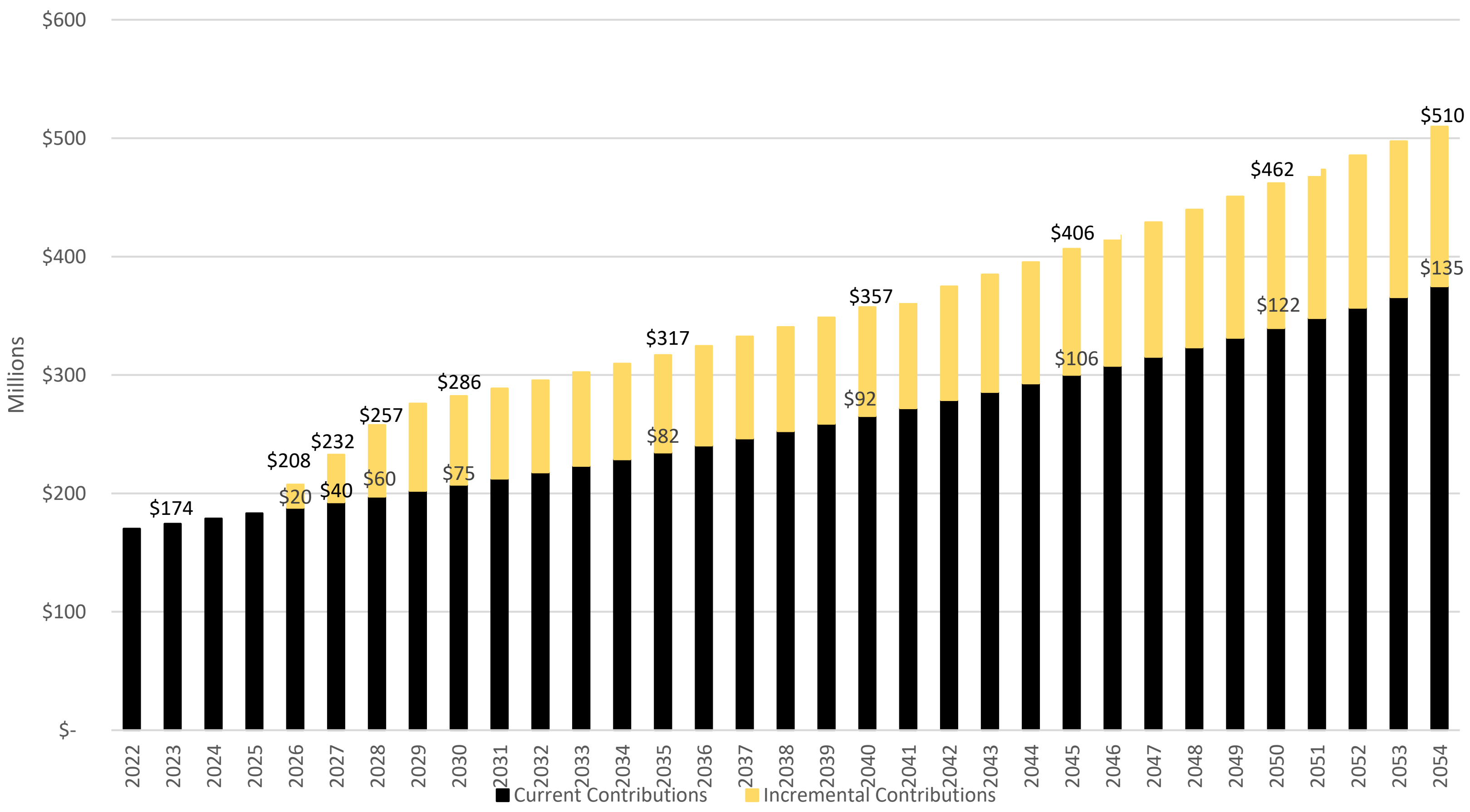
III. <u>Actuarial Determined Contributions (ADCs)</u>

--Beginning FY 2027-2028, the City fixed-rate contribution would move to an Actuarially Determined Contribution (ADC) for the balance necessary to reach statutory funding.

--These ADCs would be subject to a “corridor” (i.e., increases no greater than 10% over previous annual contributions) to provide the City with greater funding predictability.

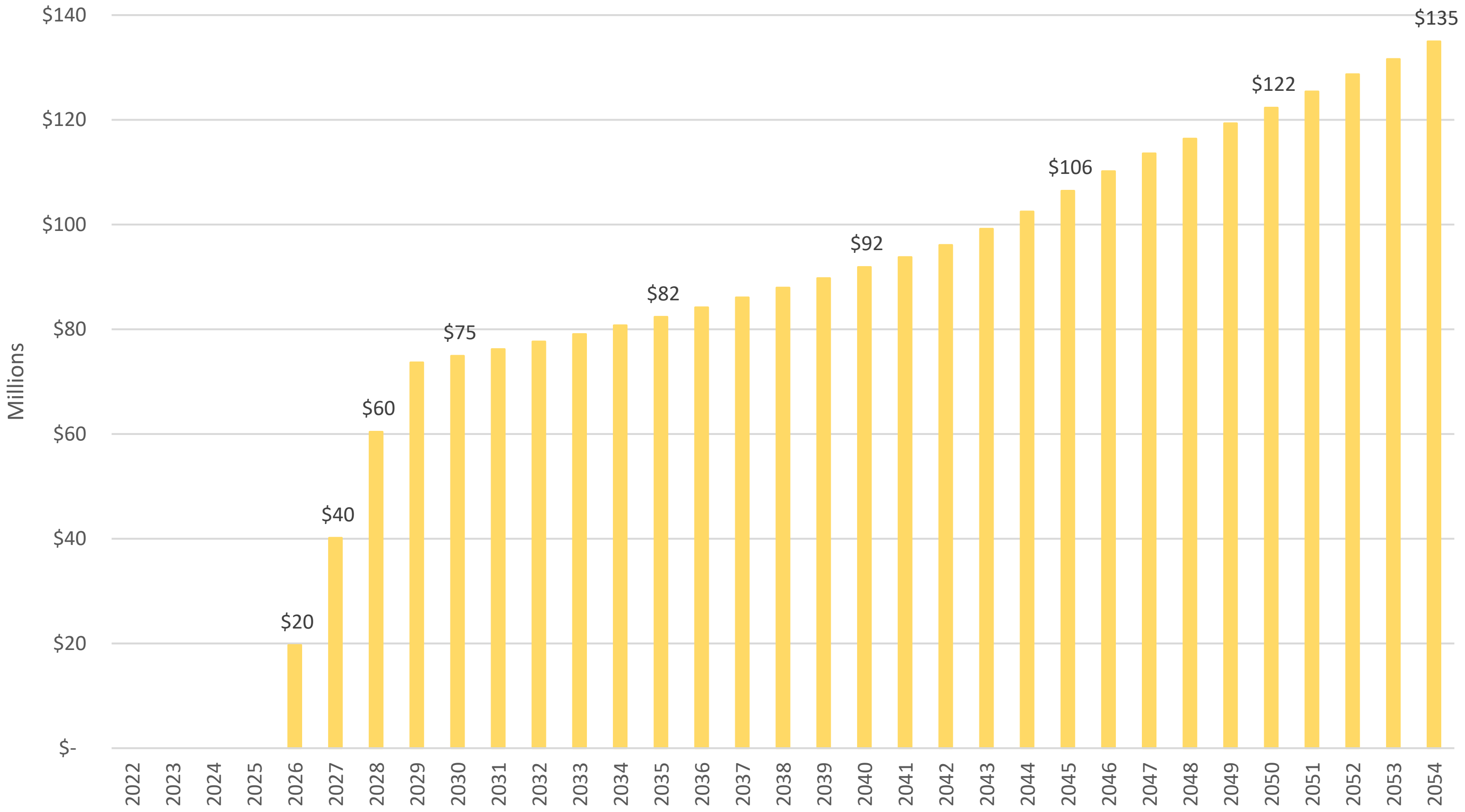
--The plan submitted to the Pension Review Board should not include adjustments to pension benefits. (No DPFP Plan COLAs permitted until DPFP 70% funded)

Current and Incremental Contributions to Meet Funding Requirements



Based on Cheiron 12-7-2023 Report Modified (Graded ADC and no grade down at the end of the projection period).

Incremental Contributions to Meet Funding Requirements



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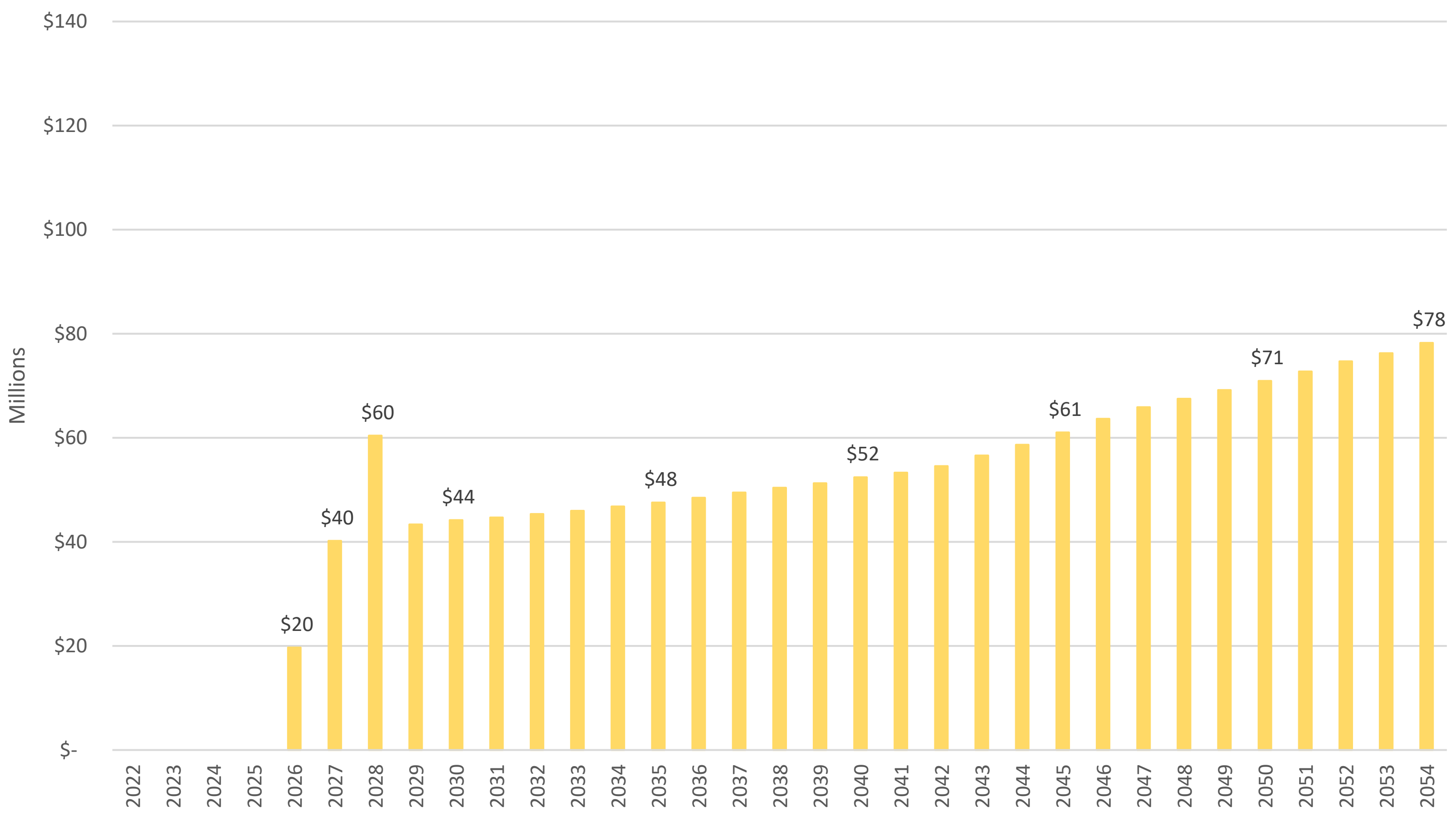
Incremental Contribution Requirements with 2028 $500 million Lump Sum



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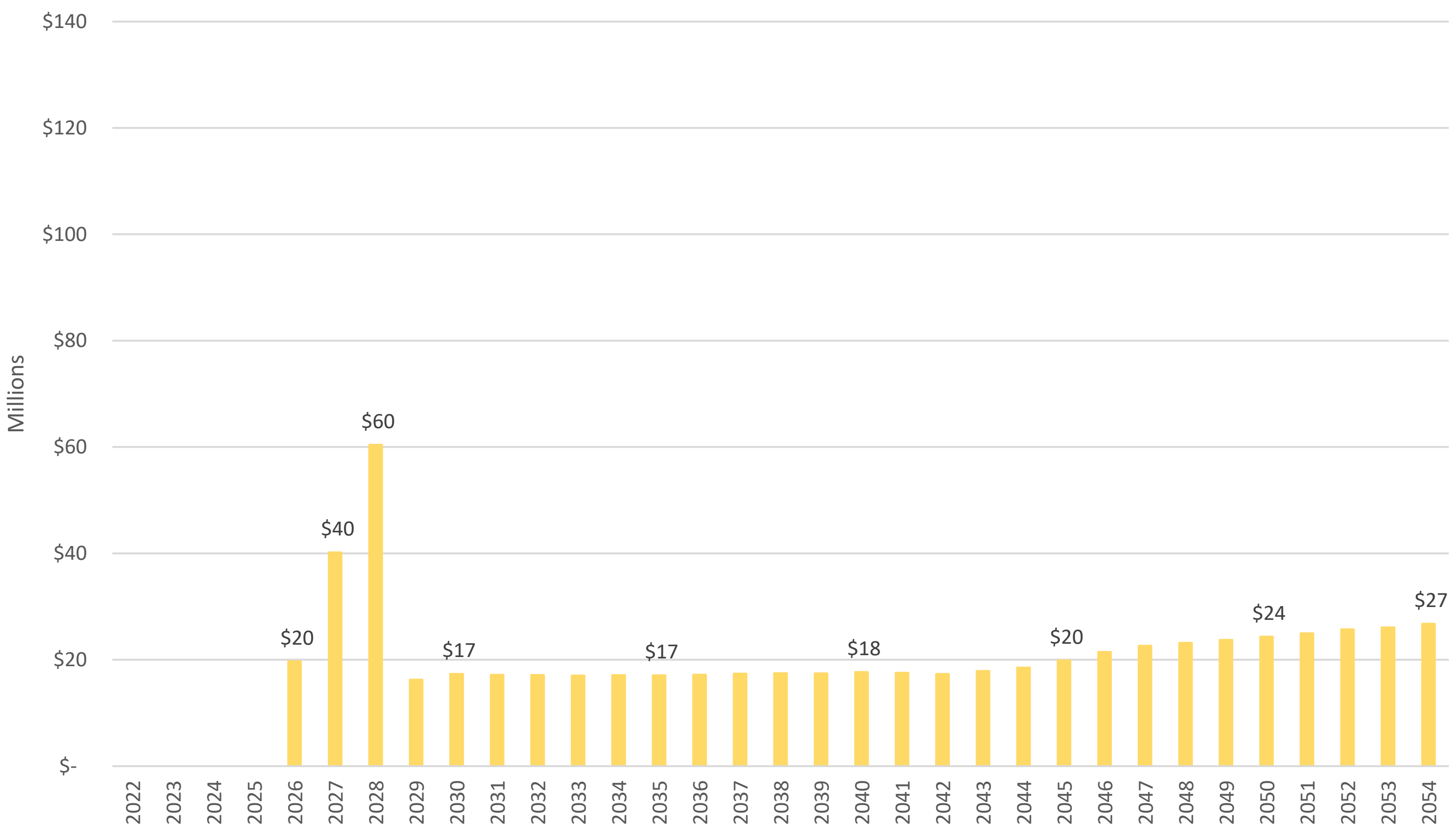
Incremental Contribution Requirements with 2028 $1 billion Lump Sum



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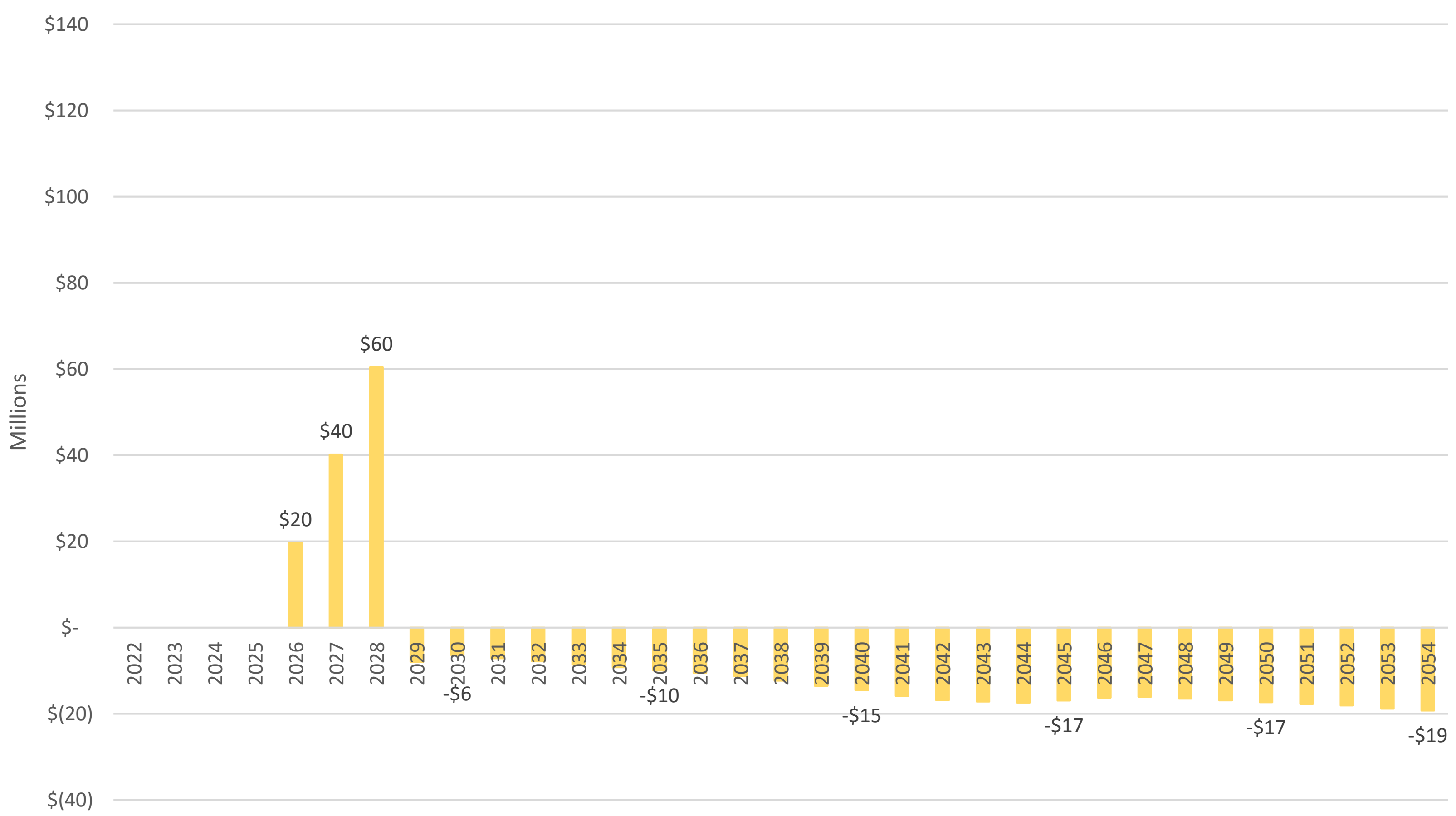
Incremental Contribution Requirements with 2028 $1.5 billion Lump Sum



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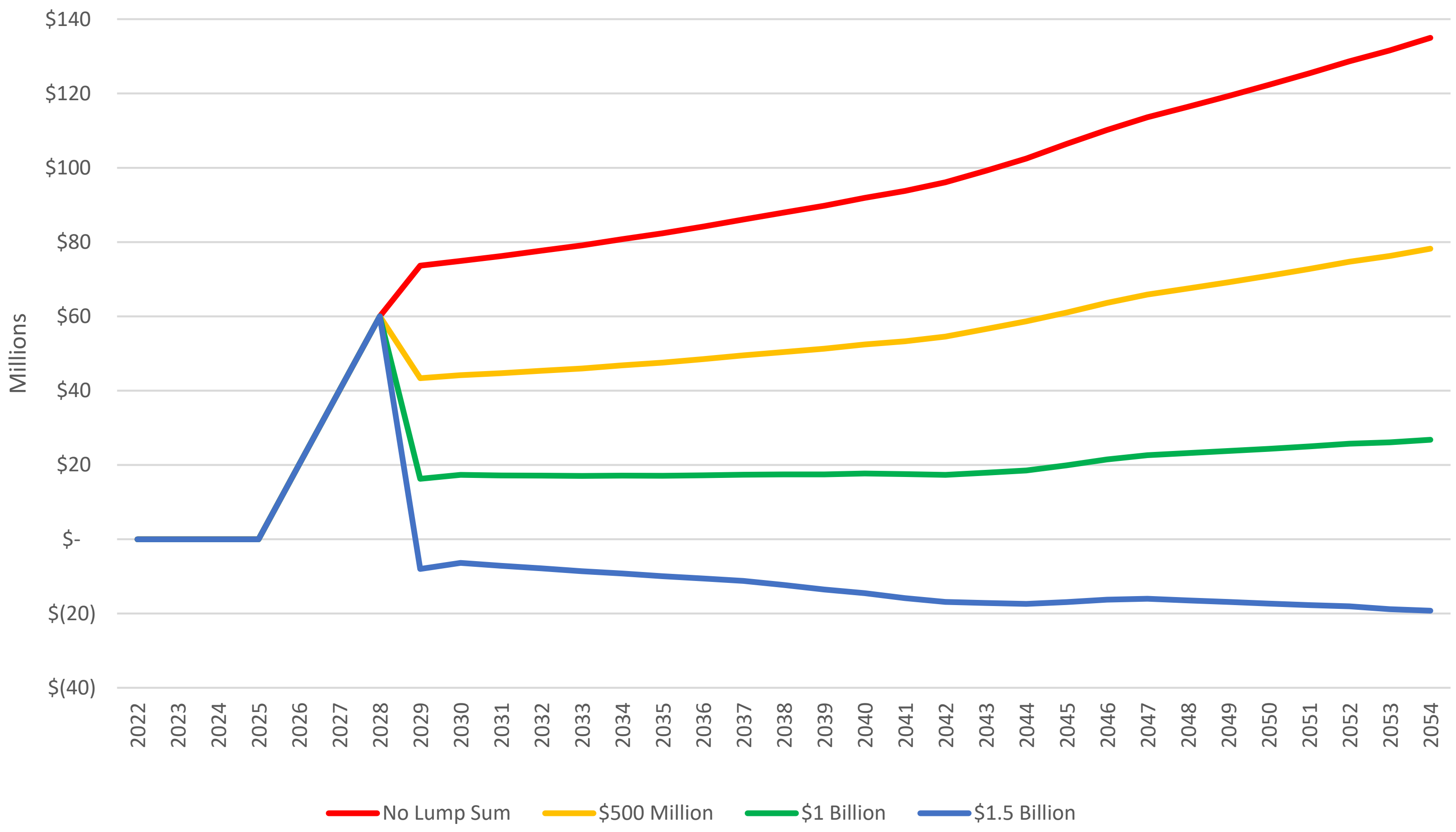
Incremental Contribution Requirements with Various Lump Sums in 2028



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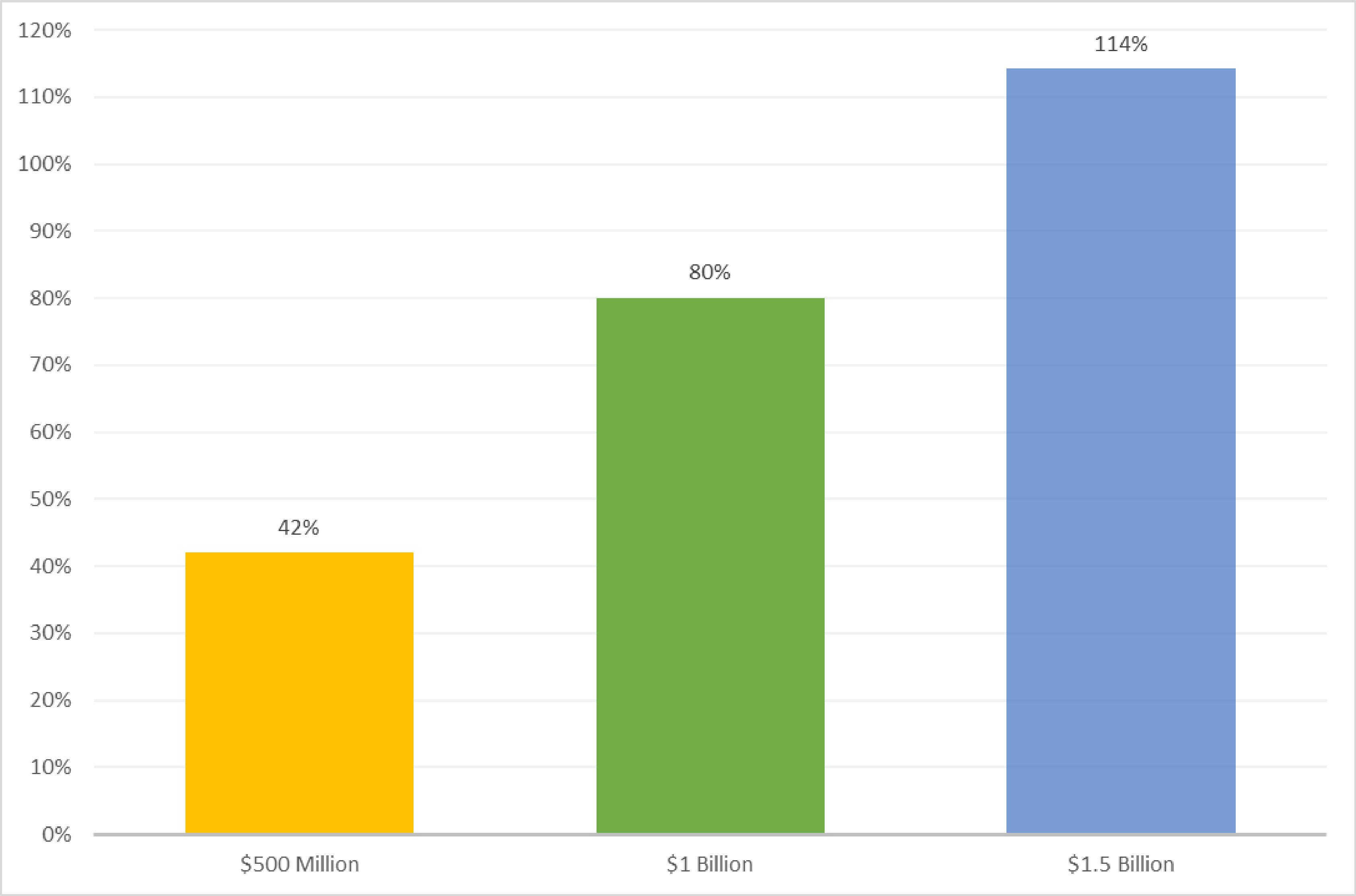
Reduction to Incremental Contributions with Various Lump Sums in 2028



Based on Cheiron 12-7-2023 Report (Graded ADC and no grade down at the end of the projection period).

Risks of Inaction

- That State of Texas would impose additional funding requirements and benefits changes
- Greater difficulty in hiring and retaining first responders
- Imposition of additional financial burdens on future taxpayers
- DPFPS would not achieve timely full funding and City would fail to reduce long-term costs.