

INTRODUCED BY:



ORDINANCE NO. 2012-01

A BILL TO BE ENTITLED

AN ORDINANCE OF THE CITY OF NEPTUNE BEACH, FLORIDA, AMENDING CHAPTER 2, ADMINISTRATION, ARTICLE V, EMPLOYEE BENEFITS, DIVISION 4, POLICE OFFICERS' RETIREMENT SYSTEM OF THE CODE OF ORDINANCES OF THE CITY OF NEPTUNE BEACH; AMENDING SECTION 2-345, DEFINITIONS; AMENDING SECTION 2-348, FINANCES AND FUND MANAGEMENT PROVIDING FOR CODIFICATION; PROVIDING FOR SEVERABILITY OF PROVISIONS; REPEALING ALL ORDINANCES IN CONFLICT HEREWITH AND PROVIDING AN EFFECTIVE DATE.

Whereas, the City Council of the City of Neptune Beach, Florida has determined that it is necessary to amend the following:

Now, Therefore, be it ordained by the City Council of Neptune Beach, Florida:

SECTION 1. That Chapter 2, Administration, Article V, Employee Benefits, Division 4, Police Officers' Retirement System, of the Code of Ordinances of the City of Neptune Beach is hereby amended by amending Section 2-345, Definitions, to amend the definitions of "Actuarial equivalent" and "Salary", to read as follows:

Section 2-345. - Definitions

Actuarial equivalent means a benefit or amount of equal value, based upon the ~~1983 Group Annuity-RP 2000 Combined Healthy~~ Mortality Table and an interest rate of eight (8) percent per annum. This definition may only be amended by the city pursuant to the recommendation of the board using the assumptions adopted by the board with the advice of the plan's actuary, such that actuarial assumptions are not subject to city discretion.

Salary means the total compensation for services rendered to the city as a police officer reportable on the member's W-2 form plus all tax deferred, tax sheltered, or tax exempt items of income derived from elective employee payroll deductions or salary reductions. For service earned after the date that a collective bargaining agreement is entered into after July 1, 2011 (the "effective date"), salary shall not include more than three hundred (300) hours of overtime per calendar year and shall also not include payments for accrued unused sick or annual leave. Provided however, in any event, payments for overtime in excess of three hundred (300) hours per year or accrued unused sick or annual leave accrued as of the effective date and attributable to service earned prior to the effective date, may still be included in salary for pension purposes even if the payment is not actually made until on or after the effective date. In any event, with respect to unused sick leave and unused annual leave accrued prior to the effective date, salary will include the lesser of the amount of sick or annual leave time accrued on the effective date or the actual amount of sick or annual leave time for which the retiree receives payment at the time of retirement, regardless of whether the amount of sick or annual leave was, at some time prior to retirement, reduced below the amount on the effective date.

Compensation in excess of the limitations set forth in section 401(a)(17) of the Code as of the first day of the plan year shall be disregarded for any purpose, including employee contributions or any benefit calculations. The annual compensation of each member taken into account in determining benefits or employee contributions for any plan year beginning on or after January 1, 2002, may not exceed \$200,000, as adjusted for cost-of-living increases in accordance with Code Section 401(a)(17)(B). Compensation means compensation during the fiscal year. The cost-of-living adjustment in effect for a calendar year applies to annual compensation for the determination period that begins with or within such calendar year. If the determination period consists of fewer than 12 months, the annual compensation limit is an amount equal to the otherwise applicable annual compensation limit multiplied by a fraction, the numerator of which is the number of months in the short determination period, and the denominator of which is 12. If the compensation for any prior determination period is taken into account in determining a member's contributions or benefits for the current plan year, the compensation for such prior determination period is subject to the applicable annual compensation limit in effect for that prior period. The limitation on compensation for an "eligible employee" shall not be less than the amount which was allowed to be taken into account hereunder as in effect on July 1, 1993 "Eligible employee" is an individual who was a member before the first plan year beginning after December 31, 1995.

SECTION 2. That Chapter 2, Administration, Article V, Employee Benefits, Division 4, Police Officers' Retirement System, of the Code of Ordinances of the City of Neptune Beach is hereby amended by amending Section 2-348, Finances and Fund Management, subsection, (6)b.5., to read as follows:

Section 2-348. Finances and Fund Management

5. Stocks, commingled funds administered by national or state banks, mutual funds and bonds or other evidences of indebtedness, provided that:

- (i) Except as provided in subparagraph (ii) below, all individually held securities and all securities in a commingled or mutual fund must be issued or guaranteed by a corporation organized under the laws of the United States, any state or organized territory of the United States, or the District of Columbia and, in the case of bonds only, shall ~~hold a rating in one (1) of the three (3) highest classifications of a major rating service~~ be investment grade.
- (ii) Up to twenty-five (25) percent of the assets of the fund at market value may be invested in foreign securities.
- (iii) The board shall not invest more than five (5) percent of its assets in the common stock, capital stock, or convertible securities of any one issuing company, nor shall the aggregate investment in any one issuing company exceed five (5) percent of the outstanding capital stock of that company; nor shall the aggregate of its investments in common stock, capital stock and convertible securities at ~~cost~~ market exceed ~~sixty (60)~~ seventy (70) percent of the assets of the fund.

SECTION 3. Specific authority is hereby granted to codify and incorporate this Ordinance in the existing Code of Ordinances of the City of Neptune Beach.

SECTION 4. All Ordinances or parts of Ordinances in conflict herewith be and the same are hereby repealed.

SECTION 5. If any section, subsection, sentence, clause, phrase, of this ordinances, or the particular application thereof shall be held invalid by any court, administrative agency, or other body with appropriate jurisdiction, the remaining section, subsection, sentences, clause, or phrases under application shall not be affected thereby.

SECTION 6. This Ordinance shall become effective immediately upon its final passage and adoption by the City Council.

VOTE RESULTS OF FIRST READING:

Mayor Harriet Pruette
Vice Mayor Kara Tucker
Councilor Richard Arthur
Councilor John Jolly
Councilor Eric Pardee

Passed on First Reading this day of February, 2012.

VOTE RESULTS OF SECOND AND FINAL READING:

Mayor Harriet Pruette
Vice Mayor Kara Tucker
Councilor Richard Arthur
Councilor John Jolly
Councilor Eric Pardee

Passed on Second and Final Reading this , day of March, 2012.

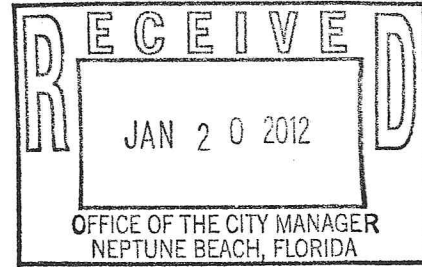
Harriet Pruette
Mayor

ATTEST:

Lisa Volpe, CMC
City Clerk

Approved as to form and contents

Patrick Krechowski, City Attorney



January 2012

City of Neptune Beach
 Attn: Jim Jarboe, City Manager
 116 First Street
 Neptune Beach, Florida 32266

RE: City of Neptune Beach Police Officers' Pension Plan

Dear Mr. Jarboe,

This letter is in response to your request at the recent City of Neptune Beach Council meeting for further information regarding the proposed changes to the investment operations of the Neptune Beach Police Officers' Pension Plan "Plan" as dictated by the local ordinance. As the investment consultant to the Board, I wanted to highlight a few points regarding the Plan, brief history of prior investment results, and proposed recent changes to the investment structure for your review.

Our firm began monitoring the performance of the Plan in mid-2002, and has served the Board in our role as an independent performance monitor and consultant diligently since our initial engagement. It is important to note our role as indicated above is that we are independent of the investment managers of the Plan and have no brokerage affiliations or others lines of business that could present conflict of interests. First and foremost, we are **fiduciaries** to the plan and acknowledge this responsibility and serve accordingly.

Through the course of our time serving the Plan, we have assisted the Plan in a transition of custodial and trust providers to help streamline the investment and trust operations of the Plan, and reducing provider costs. We have assisted the Board in directly engaging institutional investment managers that manage the Plan's assets with an approximate weighted expense ratio of 55 basis points (0.55%). In addition, as of the last full quarterly evaluation (Sept. 30, 2011) reviewed by the Pension Board, the Plan has achieved investment results that have ranked above average at the 1, 3, and 5 year intervals and has achieved these results with less volatility than its index and the average of the peer group. For further reference towards some questions around the investment performance of the plan, I have included below the fiscal year returns, back to the inception of our engagement with the Plan's investment monitoring activities. Unfortunately, the recent short-term results have fallen short in light of prevailing macro events but as you can see in 6 of the 9 years, the Plan exceeded the current assumed rate of return of 8%, and appears to be on track in the first quarter of the recent fiscal year.

	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	
	<u>YTD</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	<u>Fiscal</u>	
	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>	
Total Fund	6.59%	0.93%	9.13%	0.72%	-12.95%	12.12%	8.00%	12.33%	8.64%	10.16%

*represent returns net of investment management fees

The market environment over the past decade has been difficult, and given that the 'lost' equity decade just ended, and these returns include the results of the 2007/2008 market collapse, this is strong performance indeed. Through a steady approach, the Plan 'weathered' the disastrous 2008 year relatively well, and continue to set a course to proactively position the Plan for future investment success.

It is with this framework that I feel that it is important to note that the trustees of the Plan have been diligent and prudent in the previous and on-going evaluation of the Plan, and its investment operations. Along these lines, it is with this prudent and **proactive** nature that the recent ordinance change was proposed to the City Council of Neptune Beach at the recommendation of the Pension Board.

I will take a moment to attempt to clarify the two investment related concepts within the proposed ordinance, but would like to make myself available for any follow up questions that you or the Council may have.

Revisions to the Fixed Income Portfolio. Along with the sell-off in the equity markets through 2008, early 2009 and again in mid 2011, the fixed income markets have been characterized by a "flight to quality" driving up the price of high quality fixed income assets and driving down the interest rates offered from those securities. Currently, the Plan has requirements within the local ordinance only allowing for investment in the Top three rating classifications of fixed income. As indicated in my presentation to the council we feel that a broadening of this constraint to incorporate the Top four highest rating classifications (also known as Investment Grade rated securities), would provide an increased opportunity for the investment manager to add value through selection and purchasing of fixed income assets with increased yields offered from the historically low interest rates currently available in treasury and high quality corporate bonds.

The quantification of the "risk" of lowering the allowed rating requirement is impractical, the Plan will continue to operate with the expectations that the fixed income manager will only invest in corporate bonds that they feel comfortable do not present the risk of default. As it was alluded to in the meeting, the "A" rated Lehman Brothers corporate bonds in 2008 went to junk status over the course of a weekend, so an indication that the ratings agencies provide a steadfast measurement tool for risk is only a rough guideline. Fortunately for the Plan there were no Lehman Brothers bond holdings in the portfolio, as the investment manager for the fund conducted their research and did not find it to be credit worthy. The investment in fixed income assets and comprehension of the "credit risks" associated with this recommended lowering of investment objectives, can also be off-set by a better protection from "interest-rate" risk that exists in higher quality bonds and can be buffered through allowance of the increased yields offered from Investment Grade rated bonds.

Conclusion: It is with the concept that the investment manager will conduct proprietary research to invest in only those securities that they feel confident in, coupled with the understanding that the current increased yield opportunities from investment grade rated bonds will help offset "interest-rate" risks—we believe that lowering the rating criteria will help the Plan add value while operating under calculated risks and prudent guidelines consistent with the objectives of the Plan, but still taking into consideration the credit agencies ratings and still staying within those classified as investment grade.

Clarification of the Cost vs. Market Calculations. There was an additional item within the proposed revisions to the ordinance addressing the amount of equity exposure that was allowed by the Plan. To clarify, this is perceived by the Board to be more of a housekeeping issue to update previous old (and in my opinion outdated) language. The recommendation is to increase the amount of allowed exposure to equities from 60% to 70% **but** change the measurement device from "cost" to "market" valuations. So as indicated with the strikethrough language to the ordinance, the change will be for maximum equity exposure to be changed from "60% at cost" to "70% at market".

It is important to note, that fundamentally the change does not in itself add more risk or allow for more equity exposure to the Portfolio, it simply changes the way that we account for the equity exposure. I have provided a brief hypothetical example of the flaw with the "cost" measurement method.

Hypothetical Case: If an investor starts with \$100 and starts by investing \$60 in stocks and \$40 in bonds, and stocks appreciate rapidly growing to \$75 while bonds pullback significantly to \$25. Under this hypothetical example the Plan could then have a market value weighting of 75% (more aggressive than imposed by the market value constraint of 70%.)

*This example is extreme but it is used as an illustration that a cost valuation constraints does not provide the perceived controls to the Plan's risk levels.

In theory this cost constraint could continue with appreciation of assets as indicated above to provide in actuality no official limit to the amount of stock exposure. Conversely, when markets are depreciating, the cost valuation may actually prevent the Plan from having the ability to add to the positions in equities that fall below this cost level, despite being underweighted from the Plan's target weighting.

Conclusion: the change to a market-value based constraint actually allows greater control of the Plan than the cost value constraint; so nothing has fundamentally changed as far as the risk posture of the Plan. Accordingly, the proposed maximum exposure to equities will be "70% at market value" as it is currently.

Summary

The members of the City of Neptune Beach Police Officers' Pension Board have been actively involved in the discussions, recommendations, and reviews of their investment operations of the Pension Plan. As their consultant, I believe that the Boards have followed prudent courses of action and encourage this sort of proactive communication to the City of Neptune Beach City Council. We expect the Pension Boards to continue to be proactive in these investment discussions and continue to look out for the best interest of the Pension Plan and the participants, as expected of prudent fiduciaries. As a reference it is anticipated that in the future the Plan may request further revisions to the City's local ordinance, similar to these current outstanding recommendations. Any proposed recommendation would be made through an educated and informed decision making process by the Board, and we would strive to keep the council informed to every extent possible. This is a healthy process and we would hope is recognized by the Council accordingly.

The intended purpose of the Pension Plan's request to have me attend the Council meeting was to continue to be proactive in nature of communication with the Council of Neptune Beach and to propose recommendations for Plan revisions to allow opportunity for improvement to Plan results. Speaking on behalf of the Pension Board, my firm, and myself, we look forward to a prosperous future relationship and open channels of communication with the City of Neptune Beach.

We are pleased to serve as the investment consultant to the Pension Boards, and of course are available to discuss any questions regarding the Pension Plan.

Sincerely,



Daniel Johnson
The Bogdahn Group