Intensive Actuarial Review:

Orange Firemen's Relief and Retirement Fund

October 2018

PENSION REVIEW BOARD

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Executive Summary

Introduction

This intensive actuarial review of Orange Firemen's Relief and Retirement Fund ("Orange Fire" or "the Fund") is intended to assist the Fund's board of trustees and the City of Orange ("the City") in assessing the Fund's ability to meet its long-term pension obligation. Overall, the review shows the Fund is taking considerable risks in its approach to funding the system. The Pension Review Board (PRB) encourages the Fund and the City to review the findings and conclusions of this report carefully and jointly adopt a forward-looking plan to address these risks and guide the Fund towards a path of long-term sustainability. The PRB can provide technical assistance in formulating such a plan.

Overview

Orange Fire's unfunded actuarially accrued liability (UAAL or "unfunded liability") increased from $1.4 million in 2000 to $8.2 million by the beginning of 2017, and the Fund has routinely maintained funded ratio less than 75%. This chronic underfunding can be primarily attributed to actual investment returns consistently being lower than the assumed investment return and regularly contributing less than the annual benefit accrual plus growth of existing unfunded benefits. The Fund's reported investment expenses are among the highest in Texas and at current contribution rates and benefit levels, the unfunded liability can be expected to continue to grow and the funded status to continue to languish.

Constantly underfunding a plan places the benefits of both retirees and active members at significant risk and/or places the burden of paying for services already rendered on future generations of taxpayers and employees through the reduction of future benefits or an increase in contributions. Orange Fire and the City have made recent contribution increases, but these changes have not been enough to put the Fund on a solid path to sustainability. Orange Fire and the City have yet to make difficult decisions on additional needed changes to benefit or contribution levels.

Conclusion

Orange Fire should consider the following actions to help ensure financial stability and mitigate the risks that lead to underfunding: continually monitoring investment managers' performance against their benchmarks; evaluating asset allocation decisions and appropriate risk levels on a forward-looking basis; conducting a peer group study on investment expenses to get a more accurate picture of investment expenses paid and comparing those against their peers; reviewing actuarial assumptions against actual experience and making necessary changes; and ensuring contributions are adequate to fully fund Orange Fire over a reasonable period.

To address the funding and governance risks, the Fund and the City should develop written funding, benefit, and investment policies that are linked to provide a formal risk-/cost-sharing arrangement. A strong funding policy that requires payment of an actuarially determined contribution (ADC) is encouraged. In addition to helping maintain a sound plan funding level, putting such forward-looking policies into place can help reduce uncertainty for stakeholders who would know, in advance, how adverse experience will be managed.

Background

Texas Government Code Section 801.202(2) requires the Pension Review Board (PRB) to conduct intensive studies of potential or existing problems that threaten the actuarial soundness of or inhibit an equitable distribution of benefits in one or more public retirement systems. The PRB identified the following key metrics, in addition to amortization period, to determine and prioritize retirement systems for intensive actuarial review. The PRB selected Orange Firemen's Relief and Retirement Fund ("Orange Fire" or "the Fund") for review based on the 2017 actuarial valuation data shown below. Unless otherwise noted, the following metrics were calculated as of January 1, 2017.

Amort. Period (Years)	Funded Ratio	UAAL as % of Payroll	Assumed Rate of Return	Payroll Growth Rate	Actual Cont. as % of ADC[1]	Non-Investment Cash Flow as % of FNP
69.3	49.86%	336.03%	7.75%	4.00%	70.49%	-7.91%

Contribution and cash flow data are from the Fund's 12/31/2016 financial audit.

Plan Profile

Actuarial Accrued Liability: $16,353,849

Market Value of Assets: $8,154,674

Normal Cost: 12.76% of payroll

Contributions: 12.50% employee
14.50% employer

Membership: 37 active
42 annuitants

Social Security Participation: No

At the time the Fund was selected for review:

- Its amortization period was the second highest finite period of all defined benefit pension plans in Texas.
- Its funded ratio was the 13th lowest of all defined benefit pension plans in Texas.
- Only 17 plans in Texas used an assumed rate of return above 7.75%, which is above both the Texas and national averages for public pension plans.
- Actual contribution as a percent of actuarially determined contribution (ADC) was the eighth lowest among Texas defined benefit plans and the lowest in its peer group (TLFFRA plans with assets of less than $15 million).
- Investment expense as a percentage of plan net assets was one of the highest amongst all defined benefit plans in Texas.
- Its non-investment cash flow as a percent of assets (fiduciary net position (FNP)) was the eighth lowest among Texas defined benefit plans.

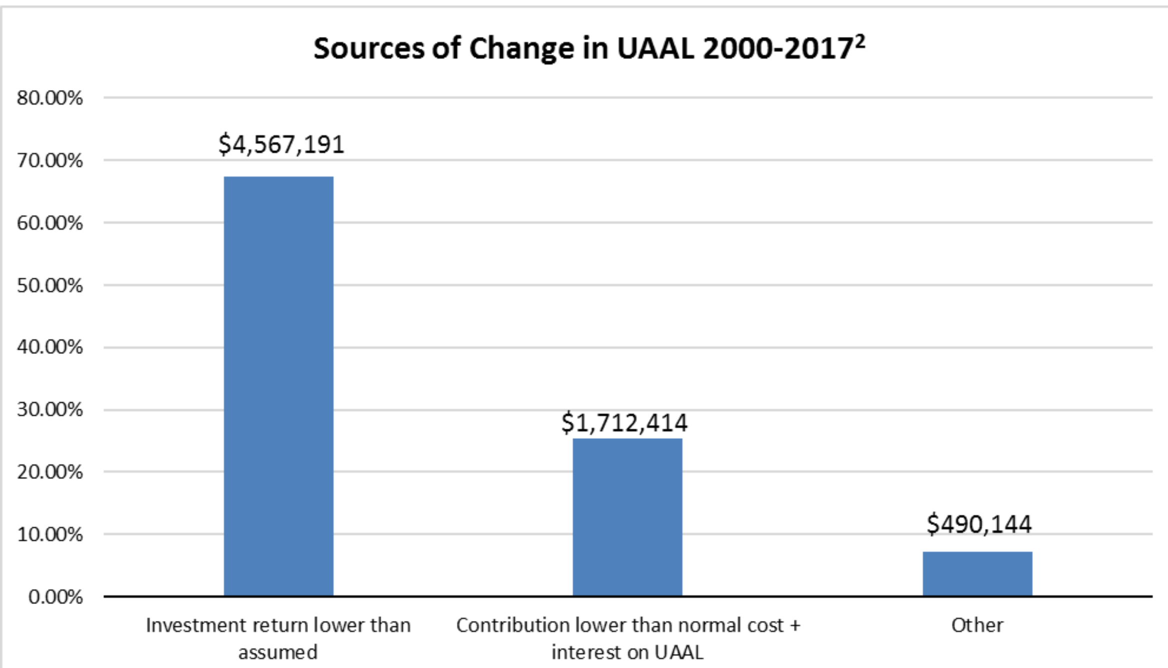
[1] For plans whose contributions are a fixed rate, based on statutory or contractual requirements, the ADC for this purpose is the contribution needed to fund the benefits accrued in the current year and maintain an amortization period that does not exceed 30 years, as required to be reported under Texas Government Code §802.101(a).

Risk Analysis

A pension fund faces multiple risks, which can be boiled down to one primary concern of whether there will be enough money to pay benefits when they are due. This section discusses potential funding and governance risks facing the fund. The risk being taken in each of these areas increases the probability of a continued period of severe financial stress for the Fund. This also raises the likelihood of deteriorating funding conditions in the coming years, further imperiling the Fund's ability to pay promised benefits.

Funding Risk

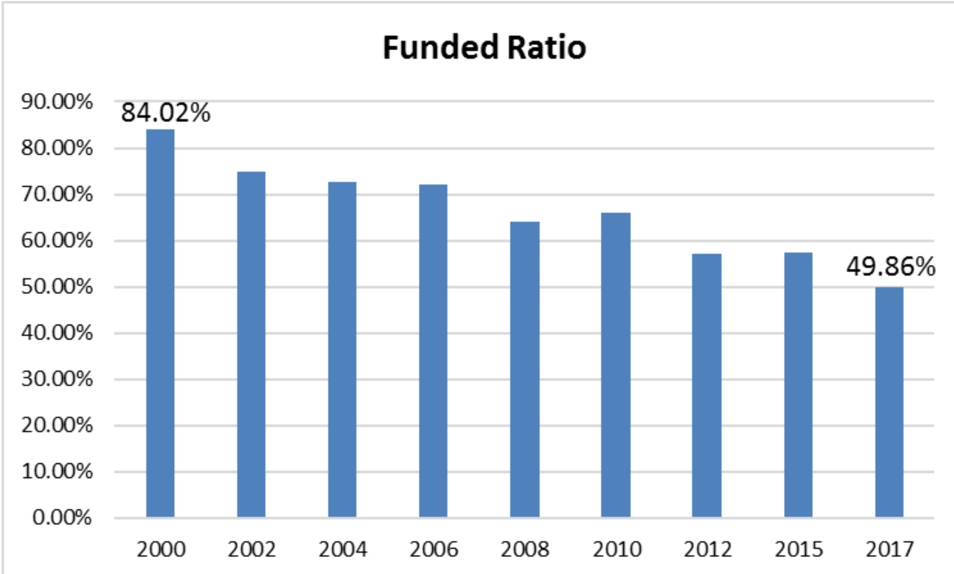
Orange Fire's significant growth in unfunded liability (UAAL), which increased from $1.4 million in 2000 to $8.2 million in 2017, can be attributed primarily to actual returns consistently lower than the assumed investment return and contributions consistently lower than the annual benefit accrual plus growth of existing unfunded benefits.



Background

According to Orange Fire's January 1, 2017 actuarial valuation, the Fund was 50% funded on an actuarial basis, and according to reports filed with the PRB, it has not had a funded ratio above 70% since the 2006 valuation.

[2] Other includes demographic experience, benefit changes, and changes to assumptions and methods.

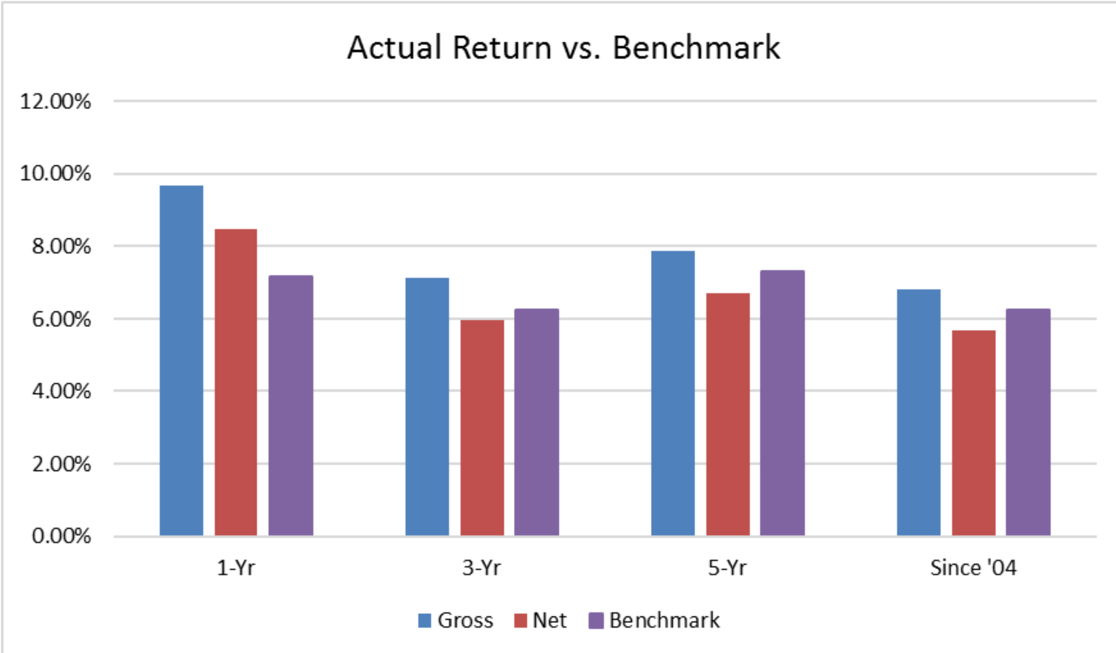


For a plan's funding level to improve, its assets must grow faster than the liabilities, which can be achieved by three key levers: contributions greater than the normal cost plus interest on the UAAL, benefit reductions to lower liabilities, and/or investment returns consistently higher than the assumed rate of return.

Investment Expenses and Performance

The Fund is currently spending a larger percentage of assets on investment related expenses than any other plan in the state with total fees estimated at 1.15%. According to the information provided by the Fund, investment returns have underperformed the Fund's benchmark on a net of fees basis in all but the most recent year. As shown in the chart below, Orange Fire has had a 5.67% net return since 2004, which is 58 basis points lower than its benchmark of 6.25%.[3]

[3] Data is from 2nd Quarter Performance Report for the City of Orange Fireman's Retirement & Relief Fund, Graystone Consulting, July 19, 2018.



According to a study conducted by Morningstar in 2015, investment fees were a major predictor of future fund performance[4]. The study concluded that funds with the lowest fees during the 2010 - 2015 period outperformed funds with higher fees across all asset classes. Reducing total expenses alone is not likely to be sufficient for Orange Fire to consistently meet or exceed its assumed rate of return, but is an important area the board should focus on in its fiduciary duty to improve investment performance and efficiently manage the Fund's investment program. For example, based on current projections, a reduction in expenses of just 25 basis points could potentially save the Fund more than $2.5 million in investment expenses over the next 30 years.

The chart below shows Orange Fire's investment expenses as a percent of total net assets compared to the TLFFRA plans closest to Orange Fire in asset size.

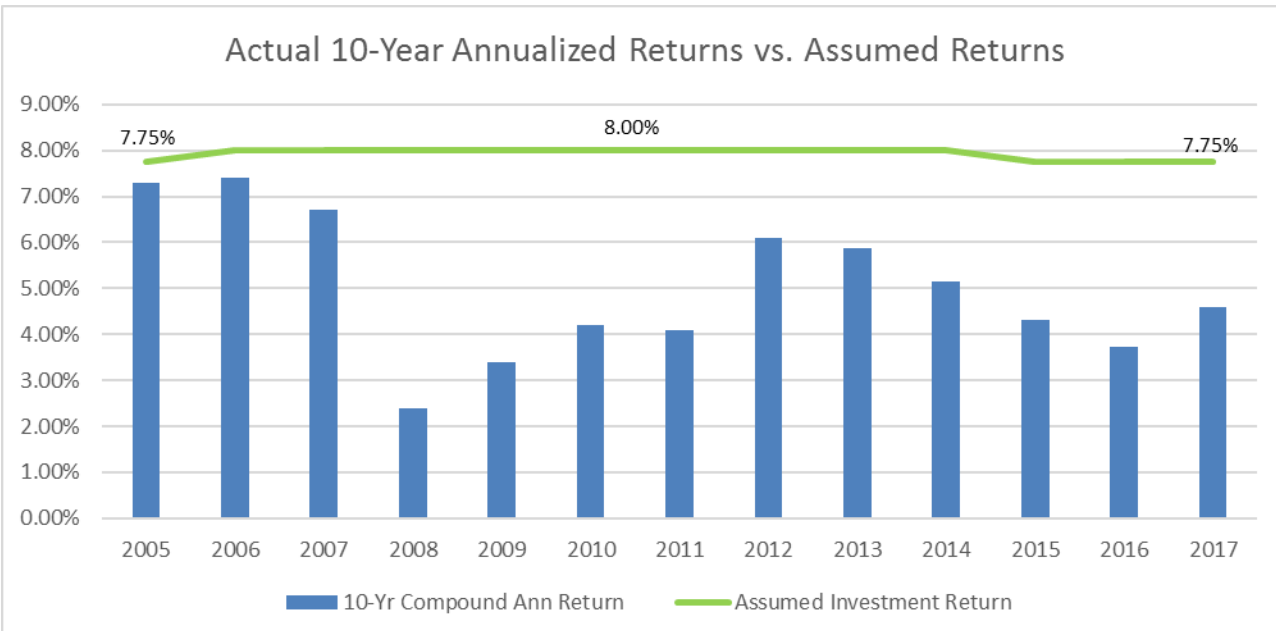
Peer Group Plans	Effective Date	Total Net Assets	Investment Expenses	Inv Exp as % of Assets	10-Year Net Return
Orange Fire	**12/31/2016**	**$8,154,674**	**$93,636**	**1.15%**	**3.72%**
Corsicana Fire	12/31/2016	$8,344,317	$92,459	1.11%	3.40%
Waxahachie Fire	9/30/2016	$14,201,159	$142,317	1.00%	4.90%
Plainview Fire	12/31/2016	$5,427,943	$49,439	0.91%	1.95%
Sweetwater Fire	12/31/2017	$8,547,174	$66,056	0.77%	4.91%
Greenville Fire	12/31/2016	$12,728,162	$90,884	0.71%	4.23%
Paris Fire	12/31/2016	$4,764,272	$32,730	0.69%	2.16%
Atlanta Fire	12/31/2016	$3,744,867	$25,495	0.68%	4.84%
Marshall Fire	12/31/2016	$7,712,228	$45,898	0.60%	4.67%
Weslaco Fire	9/30/2017	$10,429,381	$61,218	0.59%	2.59%

[4] https://corporate1.morningstar.com/ResearchArticle.aspx?documentId=752589

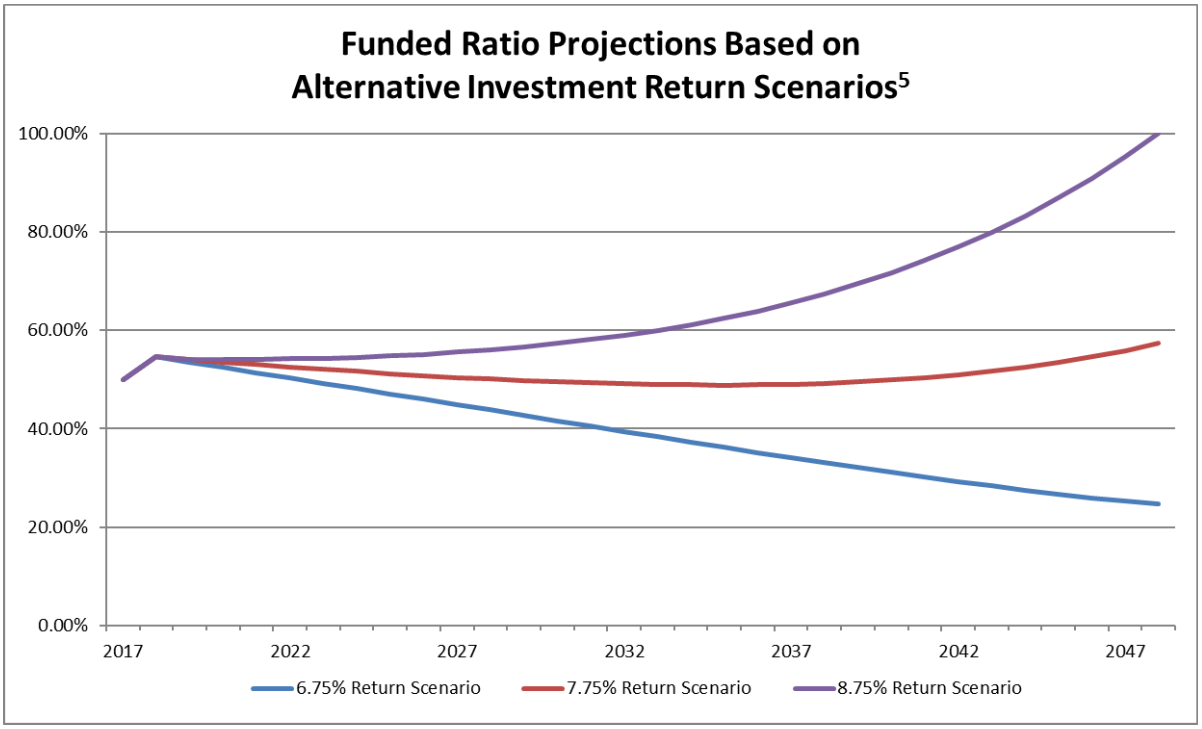
Based on the audited financial statements provided by the systems to the PRB, Orange Fire pays a larger percentage of their total net assets toward reported investment expenses than their peers. However, due to inconsistencies in reporting of investment expenses between various investment vehicles and investment managers and potential differences in expense classification between auditors, the PRB recognizes that this data may not be an entirely accurate depiction of true investment related expenses paid.

Investment Experience Compared with Investment Return Assumption

Orange Fire's actual investment return has consistently been lower than the assumed investment return, increasing the unfunded liability by more than $4.5 million between 2000 and 2017. As illustrated below, the Fund has not achieved a 7.75% (the Fund's current assumed rate of return) annualized return over a consecutive 10-year period in any of the 13 periods ending December 31, 2005 through December 31, 2017.



The graph below projects the funded ratio for the next 30 years, assuming the member and the City contribution rates remain at a fixed 12.50% and 14.50% respectively, and the investments return 6.75%, 7.75%, or 8.75%. The impact of consistently earning less than the expected return on assets (EROA) but *even as high as 6.75% over the next 30 years*, results in the funded status sinking to 29%.



Fixed-Rate Funding Model and Payroll Growth Rate

Most Texas plans use a fixed percent of pay funding approach. This is especially true for plans governed by the TLFFRA statute. Under a fixed-rate funding structure, no formal amortization policy (i.e. the expected time to fully fund the plan) exists; therefore, the Fund's actuary estimates the amortization period at each valuation date based on the current financial condition of the plan and the current contribution rates.

The nature of a fixed-rate, percent-of-pay contribution policy may exacerbate the risk of underfunding a plan over the long-term because:

1) Contributions to percent-of-pay plans are inherently back-loaded because the expected contributions to a percent-of-pay plan grow on a nominal basis at the assumed rate of total payroll growth.
2) Fixed-rate plans provide budgetary stability for the employer in the short term, but do not include any inherent mechanisms for reacting to changes in a plan's financial condition.

As noted above, the Fund's unfunded liability increased by more than $6.7 million from 2000 through 2017. $1.7 million, or approximately 25%, of this increase, can be attributed total contributions that were not sufficient to cover the cost of both the new benefits being accrued (normal cost) and the interest accumulated on the unfunded benefits already earned (amortization payment).

[5] Liabilities reflect the actuarial accrued liabilities, plan provisions, and actuarial assumptions and methods as reported in the 1/1/2017 Actuarial Valuation prepared by Foster & Foster Actuaries and Consultants. Projected liabilities include a 2.5% expected benefit growth rate. Asset projections reflect actual 2017 experience as reported in the Fund's 12/31/2017 audited financial statements.

According to its actuarial valuations, Orange Fire has not received the reported ADC in any year since 2006. Even with contribution increases in 2008 and 2015, employer contributions have averaged less than 85% of the Fund's ADC over that period. Furthermore, the reported ADC is calculated using an open amortization period that results in perpetual negative amortization. If the fund were to use this ADC as a funding policy, the UAAL would grow indefinitely and the "pension debt" would never be paid off.

For the fiscal year beginning January 1, 2017, the expected contributions were about 73% of the reported ADC. This shortfall of $128,102 is equal to 0.71% of the City's total General Fund expenditures for the fiscal year ending December 31, 2016 and is the second highest among TLFFRA plans of similar size.

Expected Contribution Levels vs. Actuarially Determined Contribution									
Date (1/1)	2000	2002	2004	2006	2008	2010	2012	2015	2017
Employee Contribution	9.00%	9.00%	9.00%	9.00%	11.00%	11.00%	11.00%	12.00%	12.00%
Employer Contribution	9.00%	11.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%	14.00%
Employer 30-Year ADC	8.86%	11.53%	13.25%	13.43%	14.01%	14.95%	19.61%	18.66%	19.25%
% of ADC funded	101.58%	95.40%	105.66%	104.24%	99.93%	93.65%	71.39%	75.03%	72.73%
Covered Payroll (in thousands)	$1,587	$1,647	$1,673	$1,717	$2,000	$1,907	$1,996	$2,292	$2,440
Contribution Shortfall (in thousands)	-	$8.72	-	-	$0.2	$18.12	$111.98	$106.81	$128.1

Both active members and the City increased their contribution rate by 0.25% of payroll in November 2017 and will increase it another 0.25% effective October 1, 2018 to a total of 12.50% and 14.50%, respectively, which was agreed to as part of the latest Funding Soundness Restoration Plan (FSRP). This increase plus positive asset experience during 2017 was enough to satisfy the FSRP requirements, but it still falls 4.25% of pay short of meeting the 2017 recommended ADC.

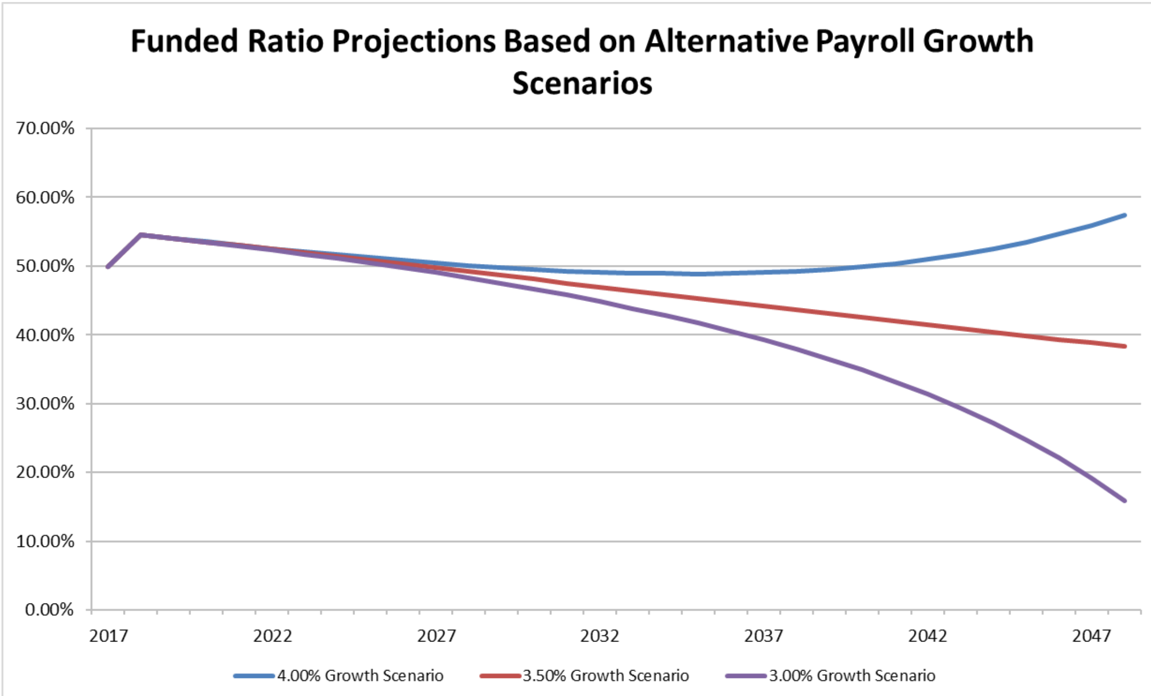
In addition, the FSRP relies on a payroll growth assumption of 4.00%, which is tied for the fifth highest rate in the state. This assumes future payroll growth will be 150% more than the 2.75% per year actual payroll growth rate the Fund experienced from 2000 to 2017. In addition, the population of Orange, Texas has been shrinking since the 1960s from a high around 35,000 to a current population of under 20,000 and is still recovering from the damage wrought by Hurricane Harvey.[6,7] In order to sustain a payroll growth rate well in excess of expected inflation and both national and Texas wage growth projections, a sustained population boom would be necessary.

As an example of the impact of this key economic assumption, if the assumed rate for the 2017 valuation was just 3.0%, the Fund would be at an infinite amortization period and would not be compliant with the recently submitted FSRP. Regardless of the impact on the Fund's FRSP, the risk associated with backloading the contributions but not achieving the assumed rate of payroll growth, and

[6] http://www.orangetexas.net/about-orange/orange-history/

[7] http://www.orangetexas.net/about-orange/city-of-orange-demographics/

therefore not receiving the expected contributions is significant, as can be seen in the following graph which shows the impact of various scenarios of lower actual payroll growth rates.



Conclusions/Recommendations

Pre-funding a defined benefit plan, i.e. setting aside assets now for benefits that will be paid in the future, is necessary to help balance the three primary policy goals of benefit security, equity between generations of taxpayers and employees, and a stable contribution from year to year. Consistently underfunding a plan places the benefits of both retirees and active members at significant risk and/or places the burden of paying for services already rendered on future generations of taxpayers and employees through the reduction of future benefits or an increase in contributions.

In the absence of a formal, written funding and risk-sharing policy, the result is a de facto risk-sharing arrangement that is simply a reaction to events, often well after the plan finds itself with financial difficulties. Plans and their sponsors can take many actions to ensure financial stability and mitigate the risks that lead to underfunding. These steps include ensuring contributions are adequate to fully fund the plan over a reasonable period; developing formal policies to guide decision-makers under different economic conditions; reviewing actuarial assumptions against actual experience and making necessary changes; and monitoring investment performance and evaluating asset allocation decisions on a forward-looking basis.

Investment Performance. Whatever the investment return assumption used, investment returns should be closely monitored, and investment managers' performance should be assessed regularly and compared to appropriate asset class benchmarks. Orange Fire currently has one of the highest ratios of investment expenses to market value of assets of any defined benefit plan in Texas. The Fund should give serious consideration to its investment management strategy, specifically to the expenses it pays and if it is receiving a reasonable benefit for these costs. Lowering these expenses should be an effective means to improve net investment performance. Given the limitations of the data reported to the PRB, conducting a peer group study of investment expenses could serve as a useful exercise to determine if actual expenses are in line with other institutional investors of similar size.

In addition, benchmarks should be reviewed to see if they have been met or exceeded and should be viewed considering the risk taken to achieve those returns. Best practices also include revisiting advisor selection periodically, with boards of trustees evaluating performance, fees, and whether their current advisors are providing the highest possible value at the lowest possible cost. The asset allocation should also be assessed from a risk perspective to provide insight into how the fund would weather a market correction.

Actuarial Assumptions. Neither the payroll growth assumption nor the investment return assumption is being consistently met when gauging actual plan experience. When pension funds are consistently overestimating their assumptions, they underestimate the funding issues they are facing. In the case of payroll growth, if Orange Fire had been assuming a growth rate or 2.75% (their average payroll growth since 2000) their amortization period would be infinite rather than the 69 years reported in the 2017 valuation. Public pension plans must monitor actuarial assumptions continually through their actuarial valuations and make appropriate adjustments to mitigate bias in the assumptions that result in consistent actuarial gains or losses.

Actuarial gains and losses occur when the plan's actual experience does not match expected experience. Over time, without required changes, pension funds such as Orange Fire whose assumptions consistently diverge from actual experience in the same direction (i.e. consistently seeing actuarial gains or consistently seeing actuarial losses) can exacerbate the issue of intergenerational inequity, causing one group of members and taxpayers to over- or under-pay. Boards of trustees should work with their actuaries and other consultants to ensure assumptions are neither too aggressive nor too conservative, while striving to maintain (or achieve) sound fiscal health to secure existing accrued benefits. PRB's *Pension Funding Guidelines* recommend systems to monitor, review, and report the impact of actual plan experience on actuarial assumptions at least once every five years.

Adequate Funding. The Fund has been increasing both the member and city contribution rates in recent years and it is the PRB's understanding that discussions to increase contributions even further is still being discussed. While we commend the actions taken by the Fund's board and members, the current contribution structure still has not been enough to meet the Fund's ADC rate. To address these concerns, a strong funding policy that requires payment of an ADC is encouraged. Numerous actuarial methods can be utilized to help mitigate contribution volatility, including directly smoothing contribution rates or adding "guardrails" that require the stakeholders to come back to the table if the contribution rate falls outside a specified range. If funding according to an ADC is not adopted, a funding policy that fully funds the Fund over a finite period, such as 30 years, is recommended.

Governance Risk

When public pension plans and their sponsors wait too long to address them, the funding challenges compounding over time can reach a point where small, incremental improvement, such as the contribution increases made for Orange Fire, are not sufficient to make consistent, long-term improvements to the overall health of the Fund. Orange Fire and the City have yet to make difficult decisions on additional needed changes to benefit or contribution levels. If necessary changes are ultimately made, they may right the ship, but they will potentially be made under less than ideal conditions.

Funding Decision-making

Governance is essentially decision-making, and decision-making for public pension plans must balance the competing interests of plans and their sponsors and should feature collaboration between the two. The primary source of governance risk is the potential lack of involvement of key parties or stakeholders (members, the sponsor government, and taxpayers) in important areas of decision-making for a pension plan including plan design (benefits) and funding (contributions). When a key party is not engaged in important decisions, the risk increases that benefit levels and the contributions required to fund them will diverge, potentially putting the plan's funding stability at risk.

For example, TLFFRA allows boards of trustees to make prospective benefit modifications, both increases and reductions. These changes must be approved by an actuary and a majority of participating members and may not deprive an eligible participant of vested accrued benefits. Although jointly responsible for funding the retirement plan along with plan members, the sponsoring city may have limited involvement in benefit decision-making, a structure which generates the risk that benefit levels adopted could be unsustainable.

Benefit increases are not the only potential risk related to a potential lack of sponsor involvement under TLFFRA; unwillingness to reduce benefits prospectively when necessary to address funding challenges can be an obstacle to getting things back on track. It should be noted that even plans with very engaged boards and sponsors can be susceptible to increasing benefits to unsustainable levels in good times or failing to lower them when necessary in bad times. Governance risk related to an imbalance in decision-making can only exacerbate these risks. Given the Fund's historically poor funding levels of under 75% for the last 15 years, the absence of benefit modification by Orange Fire illustrates this point.

Funding Soundness Restoration Plan

State law recognizes the potential risks of underfunding and a lack of engagement by some key stakeholders and imposes cooperation between the system and sponsoring governmental entity by requiring retirement systems having trouble meeting their long-term obligations work with their sponsors to develop a restoration plan for addressing those issues.[8] This framework helps ensure that

[8] Texas Government Code 802.2015 and 802.2016 require public retirement systems whose amortization period exceeds 40 years for 2 or 3 consecutive actuarial valuations to develop, with their sponsor, a funding soundness restoration plan designed to bring their amortization period within 40 years over 10 or fewer years.

both the system and its sponsoring employer are involved in pension plan reform decisions, but it comes at a point when actuarial health is already threatened. Orange Fire submitted an FSRP for review on November 8, 2016. The FSRP stated after the 1/1/2015 valuation member contributions had increased from 11.00% to 12.00% The changes outlined in the FSRP recalculated an amortization period of 47.4 years for 2015; however, the 1/1/2017 valuation showed the amortization period had increased to 69.3 years.

Because of the increase in the amortization period, Orange Fire submitted a second FSRP on February 15, 2018. This FSRP instituted further contribution increases bringing the contribution rates for members and the city to 12.50% and 14.50% respectively, by October 2018. Additionally, the board proposed a benefit change to amend the normal form of annuity payment from a 66 2/3% joint annuitant form of payment for married members to a life annuity for all members regardless of marital status, which is expected to decrease the amortization period by approximately 7 years. Plan members ultimately voted down this proposal in July, however the Fund's board has moved to carry out a new vote with the following options: (A) amend the normal form of annuity payments at the time of retirement as recommended by the Fund's actuary; (B) increase the members' contribution rate by 2% over a four-year period beginning on 10/1/2019; or (C) opt out of both (A) and (B) (no action). It is possible the new vote could be completed before mid-September.

Investment Decision-making

For Orange Fire, another area of governance risk relates to management and oversight of the Fund's investment program by the board. Orange Fire has adopted an investment policy statement (IPS) that clearly identifies the overall investment objectives of the Fund and the expectations of investment managers to meet these objectives, as outlined below.

1. Achieve a total return, net of fees, in excess of the assumed rate of return
2. Outperform the annualized return of the Fund's composite policy benchmark
3. Achieve a real return of 4.5% over the CPI

The policy also outlines steps the board can take if at least two of these three objectives are not being met. These include re-evaluating the goals, modifying the asset allocation, and/or revisiting investment manager selection. Given the many years of protracted underperformance of the Fund's assets and not meeting the stated IPS objectives, the following elements of the Fund's investment program should all be reviewed: the Fund's risk tolerance, asset allocation, and investment manager performance. Along with reviewing these factors, the board should re-examine whether the current goals are obtainable and take appropriate actions to improve the overall investment performance of the Fund.

Conclusions/Recommendations

Plans and their sponsors can develop policies that proactively manage risk in the future by laying out a formal risk-sharing plan. To proactively manage governance and funding risk, retirement plans and their sponsors should work together to adopt written policies far in advance, that can guide them through both good and bad years and shield against the risk of either party's exclusion or disengagement from decision-making. Funding and benefit policies can be adopted that provide a framework for how benefit and contribution levels may be modified under different conditions. An advantage of such policies is that changes to plan benefits and costs are known and understood by all parties in advance, rather than negotiated under difficult circumstances.

For example, a benefit policy can outline the primary objectives the employer wishes to achieve, which can be as detailed as a specified replacement ratio, or as general as offering competitive benefits at a reasonable cost, as well as identifying policies and procedures designed to determine if the objectives are being met and how they can be reviewed at reasonable intervals. In addition, outlining potential benefit enhancements or reductions based on the funding goals outlined in the funding policy.

The funding policy might incorporate objectives associated with benefit security, contribution stability and intergenerational equity and outline how those objectives will be met through the use contribution changes, as well as referencing potential changes outlined in the benefit policy. For example, the coordinated policies might limit future benefit enhancements, cost of living adjustments, and/or contribution rate reductions such that they can only be considered or made if the Fund's funded ratio remains greater than a chosen threshold. In addition, if the funded ratio falls below a certain threshold, the stakeholders are required to come back to the table to make necessary contribution and benefit adjustments.

Orange Fire in conjunction with the City should utilize the funding soundness restoration plan requirement to develop such long-term policies. This will likely require some difficult decisions to get the Fund set on the proper path, but the longer these decisions are delayed, and a reasonable cost-sharing structure is not implemented, the more difficult the decisions become.

In the area of investment governance, the board should work closely with its advisors to manage the Fund's investment program and ensure that the IPS is being fully utilized. Manager performance should be continuously monitored, and appropriate action should be taken in accordance with the steps laid out in the IPS.

Appendix

Key Metrics

Metric	Amortization period (69.3 years)
What it measures	Approximately how long it would take to fully fund the unfunded actuarial accrued liability (UAAL) based on the current funding policy.
Why it is important	Given the Fund's current assumptions, an amortization period above 17 years indicates the contributions to the Fund in the coming year are less than the interest accumulated for that same period and therefore the total UAAL is expected to grow over the near term. In addition, for a plan that contributes on a fixed-rate basis such as Orange Fire, the higher the amortization period, the more sensitive it is to small changes in the UAAL.
Peer comparison	Orange Fire currently has one of the highest amortization periods of all defined benefit pension plans in Texas and ranks highest amongst its peer TLFFRA plans (TLFFRA plans with a market value of assets below $15 million).

Metric	Funded ratio (49.86%)
What it measures	The percent of a fund's actuarially accrued liabilities covered by its actuarial value of assets.
Why it is important	The lower the funded ratio, the fewer assets a fund must pay its current and future benefit payments.
Peer comparison	Orange Fire's funded ratio is below the State's average of 72.53% and is one of the lowest in the state.

Metric	UAAL as a percent of payroll (336.03%)
What it measures	The size of a plan's unfunded liability compared to the annual payroll of its active members.
Why it is important	Provides a way to compare plans of various sizes and expresses the outstanding "pension debt" relative to current personnel costs.
Peer comparison	The Fund's UAAL as a percent of payroll is one of the highest amongst TLFFRA funds.

Metric	Assumed rate of return (7.75%)
What it measures	The estimated annual rate of return on the Fund's assets.
Why it is important	If actual future returns are lower than the assumed rate of return, future contributions will need to increase significantly, especially for a poorly funded plan. Orange Fire's assumed rate of return is 7.75%, while its actual ten-year investment rate of return for the period ending December 31, 2016 was only 3.72%.
Peer comparison	Orange Fire is tied for the fourth highest Assumed rate of return in its peer group.

Metric	Payroll growth rate (4.00%)
What it measures	The estimated annual growth in the total payroll of active members contributing into the Fund.
Why it is important	Contributions are calculated as a percent of active members' pay and are back-loaded based on the expected growth in total payroll. If payroll does not increase at this rate, actual contributions will not meet those expected in the Fund's actuarial valuations. Given the Fund's inactive and active liabilities are not fully funded; contributions below expected levels will have serious consequences on the Fund's long-term solvency.
Peer comparison	The Fund's payroll growth rate of 4.00% percent is tied for the second highest in its peer group.

Metric	Actual contributions as a percent of actuarially determined contributions (70.49%)
What it measures	Whether the current employer contributions have met a theoretical minimum threshold.[9]
Why it is important	The employer's portion of the contribution is less than 71% of the amount needed to fund the Fund on a rolling 30-year amortization period. The PRB's 2014 Study of the Financial Health of Texas Public Retirement Systems found that plans that have consistently received adequate funding are in a better position to meet their long-term obligations.
Peer comparison	This is one of the largest shortfall percentages in the state and the largest in its peer group.

[9] The theoretical minimum threshold, or actuarially determined contribution (ADC), is a target or recommended contribution "to the Fund as determined by the actuary using a contribution allocation procedure," as defined in Actuarial Standards of Practice No 4. If contributions to the Fund are made as a fixed rate based on statutory or contractual requirements, the ADC for this purpose is the contribution needed to fund the benefits accrued in the current year and maintain an amortization period that does not exceed 30 years, as required to be reported under Texas Government Code §802.101(a).

Metric	Non-investment cash flow as a percent of fiduciary net position (-7.91%)
What it measures	Non-investment cash flow shows how much the Fund is receiving through contributions in relation to its outflows: benefit payments, withdrawals and expenses.
Why it is important	Viewing this metric as a percent of total net assets (or fiduciary net position (FNP)), in conjunction with the funded ratio and recognition of the relative maturity of a plan, provides information about the stability of a plan's funding arrangement.
Peer comparison	Orange Fire's non-investment cash flow as a percent of FNP is the third lowest in its peer group. If this trend continues, the Fund could face the potential risk of needing to liquidate a portion of existing assets to pay current benefits and/or expenses.

Plan Summary

The Orange Firemen's Relief and Retirement Fund ("Orange Fire" or "the Fund") is established in the Texas Local Fire Fighter's Retirement Act (TLFFRA). TLFFRA provides general guidelines for fund management, but leaves administration, plan design, contributions, and specific investments to the discretion of the board of trustees. Orange Fire, as with all TLFFRA systems, is entirely locally-funded.

Benefits

Retirement Eligibility	Age: 50 years; Years of Credited Service (YCS): 20 years
Vesting	Fully vested after 20 YCS
Benefit Formula	Years of Service (up to 20 years) x 2.6% x Final Average Salary +$91 per month for each year > 20 Years of Service
Final Average Salary (FAS)	Highest 60-Month Average Salary
COLA	None
Retirement Benefit Options	Forward DROP: 3-year maximum. Employee contributions credited; no interest. Eligible at 53 years of age and 23 years of service.
Social Security	Yes – Social Security Leveling Option

Contributions

As of October 1, 2018, active members of Orange Fire contribute 12.50% of pay while the City of Orange contributes 14.50% of pay.

Membership

Total Active Members	Retired Members	Terminated	Total Members	Active-to-Annuitant Ratio
37	42	1	80	0.88

TLFFRA Board Structure

Active Members	3 - Members of the retirement system; elected by fund members. Three-year terms.
Sponsor Government	1 - Mayor or designated representative, or the political subdivision's Chief Operating Officer or designated representative. 1 - Chief Financial Officer of the political subdivision, or designated representative. Terms correspond to term of office.
Taxpayer, Not Affiliated With Fund/Sponsor Govt.	2 - Residents of the State of Texas, must not be officers/employees of the political subdivision; elected by other Board of Trustee members. Two-year terms.

Contribution and Benefit Decision-Making

TLFFRA authorizes members of the retirement systems to determine their contribution rates by voting. The statute requires cities to make contributions at the same rate paid by employees or 12 percent, whichever is smaller. TLFFRA also allows a city to contribute at a higher rate than employees do through a change in city ordinance.

TLFFRA gives the board the power to make decisions to modify the benefits (increases and reductions). However, a proposed addition or change must be approved by the actuary and a majority of participating plan members. Benefit changes cannot deprive a member, retiree or beneficiary of the right to receive vested accrued benefits.

Expense Breakdown

Fiscal Year ending 12/31/2016	
Fiduciary Net Position (FNP)	$8,154,598
Investment Expenses	$93,636
Investment Expenses % of FNP	1.15%
Administrative Expenses	$18,742
Administrative Expenses % of FNP	0.23%

Historical Trends

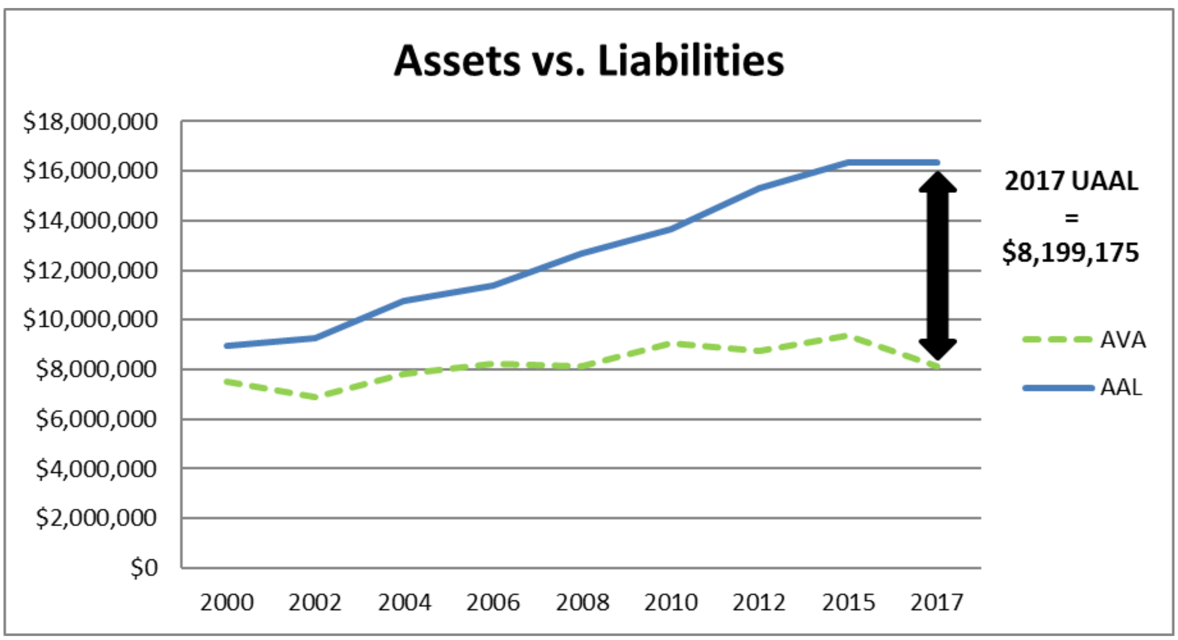
To conduct an intensive review of risks associated with the long-term funding of a pension Fund, it is important to analyze trends in multiple metrics. A plan with an asset level lower than its accrued liability has insufficient funds to cover benefits. A plan can experience an increase in unfunded liability due to various factors, including insufficient investment returns, inadequate contributions and inaccurate or overly aggressive assumptions. Hence, a single metric cannot effectively capture the different drivers contributing to the increase of a plan's unfunded pension obligation. This section analyzes historical trends in various metrics identified by the PRB and makes comparisons to understand the sources of growth in unfunded liability for Orange Fire.

Orange Fire's funded status has been steadily declining since 2000. Numerous factors have contributed to this deterioration, including inadequate contributions, investment returns being lower than the chosen assumption, increased benefit payments, and the inclusion and expansion of PROP accounts accruing interest. The following sections discuss these and other factors in detail.

Assets and Liabilities

Orange Fire's actuarial accrued liability (AAL) increased by nearly 83% between 2000 and 2017. The Fund's actuarial value of assets (AVA) increased by only 8.50% over the same period. The Fund was 84% funded in 2000 but fell to below 50% in 2017.

Funding Trends Funded Ratio, Assets, Liabilities and Year over Year Growth									
Fiscal Year[10]	2000	2002	2004	2006	2008	2010	2012	2015	2017
Funded Ratio	84.02%	74.76%	72.76%	72.09%	63.97%	66.05%	57.25%	57.41%	49.86%
Am Period (years)	27	32	25	27.4	30.1	34.3	82.3	47.4	69.3
UAAL (in millions)	$1.43	$2.33	$2.93	$3.18	$4.57	$4.64	$6.54	$6.96	$8.20
AVA (in millions)	$7.52	$6.91	$7.83	$8.21	$8.12	$9.04	$8.77	$9.38	$8.15
AVA Growth (YoY)	-	-4.12%	6.44%	2.42%	-0.59%	5.52%	-1.50%	3.46%	-6.78%
AAL (in millions)	$8.95	$9.24	$10.76	$11.39	$12.69	$13.68	$15.31	$16.35	$16.35
AAL Growth (YoY)	-	1.65%	7.90%	2.89%	5.54%	3.84%	5.80%	3.32%	0.03%



[10] The report date for Fiscal Year 2000-2012 is December 31st and was changed to January 1st for 2015 and 2017.

Investment Assumption and Returns

The 10-year net return on investments in 2016 was 3.72%, which is more than 400 basis points below its assumed interest rate. PRB's AV Supplemental Report dated June 14, 2018 showed that out of 91 Texas Funds that reported a 10-year net investment return, Orange Fire stood at 71st.

Rates of Return (as of 12/31/2016)				
Time Period	**1-year**	**3-year**	**10-year**	**Since 1995**
Gross Return	5.85%	2.67%	4.83%	7.18%
Net Return	4.65%	1.54%	3.72%	6.25%

Asset Allocation

As shown in the chart below, the Fund's actual asset allocation is close to its target allocation and within the ranges of the Fund's Investment Policy Statement.

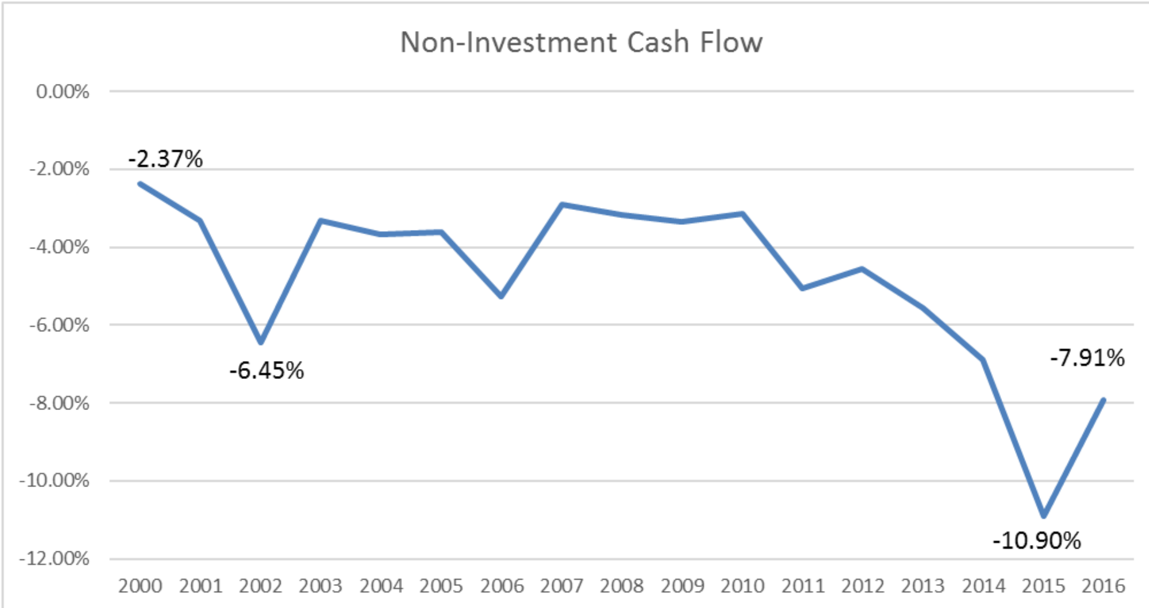
Asset Allocation (as of 12/31/2016)				
Asset Class	**Equities**	**Fixed Income**	**Cash**	**Other**[11]
Current Allocation	55.25%	39.64%	5.03%	0.09%
Target Allocation	65.00%	35.00%	-	-

Cash flow

Orange Fire has the third lowest non-investment cash flow among its peers. In 2016 the Fund's non-investment cash flow was -7.91%. The large dips in 2002 and 2006 were due to large increases in total disbursements. Total contributions have grown on average by 2.29% annually since 2000 but are being outpaced by the average growth in yearly benefit disbursements of 3.38%. Total expenses are growing at an average rate of 4.44%

A negative non-investment cash flow is not abnormal for mature defined benefit pension plans. However, a cash flow percentage this low is likely to be a drag on potential investment returns because a plan must either invest in a higher proportion of income-producing investments, which traditionally provide lower returns, or must liquidate existing assets to pay out current benefits and/or expenses.

[11] Other is "accrued Interest and dividends"


Non-Investment Cash Flow
0.00%
-2.00%
-4.00%
-6.00%
-8.00%
-10.00%
-12.00%
-2.37%
-6.45%
-7.91%
-10.90%
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016

Peer Group Key Metric Comparison

		Funding Val Metrics						Fiscal Year End Metrics			
Peer Group Plans	**MVA**	**Am Period Date**	**Am Period**	**Funded Ratio**	**UAAL as % of Payroll**	**Assumed Interest**	**Payroll Growth**	**FYE**	**Actual Cont. as % of ADC**	**DROP as % of FNP**	**Non-Investment Cash Flow as % of FNP**
Waxahachie Firemen's Relief & Retirement Fund	$ 14,201,159	10/1/2016	25.4	66.86%	164.84%	7.00%	4.00%	9/30/2016	102.75%	N/A	-3.16%
Greenville Firemen's Relief & Retirement Fund	$ 12,728,162	12/31/2016	38.0	47.69%	387.00%	8.00%	4.00%	12/31/2016	73.99%	N/A	-5.86%
Big Spring Firemen's Relief & Retirement Fund	$ 10,399,250	1/1/2017	36.2	54.86%	241.05%	8.00%	5.00%	12/31/2016	110.08%	0.00%	-9.54%
Weslaco Firemen's Relief & Retirement Fund	$ 9,186,148	9/30/2016	14.1	68.53%	111.07%	7.25%	3.25%	9/30/2017	154.51%	N/A	2.92%
Corsicana Firemen's Relief & Retirement Fund	$ 8,344,317	12/31/2016	28.9	53.14%	211.44%	7.00%	3.00%	12/31/2016	100.01%	N/A	-1.97%
Orange Firemen's Relief & Retirement Fund	**$ 8,154,674**	**1/1/2017**	**69.3**	**49.86%**	**336.03%**	**7.75%**	**4.00%**	**12/31/2016**	**70.49%**	**N/A**	**-7.91%**
Sweetwater Firemen's Relief & Retirement Fund	$ 7,826,879	12/31/2016	27.5	69.99%	229.12%	8.00%	4.00%	12/31/2017	154.44%	N/A	-4.07%
Marshall Firemen's Relief & Retirement Fund	$ 7,712,228	12/31/2016	56.4	42.02%	398.51%	7.75%	4.00%	12/31/2016	84.67%	3.99%	-5.50%
Plainview Firemen's Relief & Retirement Fund	$ 5,296,898	12/31/2015	31.6	37.33%	453.72%	7.75%	3.50%	12/31/2016	87.77%	N/A	-2.63%
Paris Firefighters' Relief & Retirement Fund	$ 4,764,272	12/31/2016	41.9	35.64%	373.32%	7.50%	3.50%	12/31/2016	100.00%	N/A	-10.31%
Atlanta Firemen's Relief & Retirement Fund	$ 3,744,867	12/31/2016	28.4	82.13%	136.63%	7.40%	3.00%	12/31/2016	107.62%	N/A	-1.55%

Peer Group Sponsor Funding Comparison

Peer Group Plans	GF Expend	EOY GF Bal	UAAL	Expected Employer Contributions	ADC	30-yr Shortfall	30-Y SF % of ADC	30-Y SF % of GFE
Waxahachie Firemen's Relief & Retirement Fund	$ 30,570,845	$ 14,660,133	$ 7,039,421	$ 663,197	$ 621,346	No Shortfall	N/A	N/A
Greenville Firemen's Relief & Retirement Fund	$ 19,089,359	$ 6,271,335	$ 15,021,872	$ 652,120	$ 836,499	$ 184,379	22.04%	0.97%
Big Spring Firemen's Relief & Retirement Fund	$ 18,328,572	$ 6,549,205	$ 9,078,736	$ 489,614	$ 538,952	$ 49,338	9.15%	0.27%
Weslaco Firemen's Relief & Retirement Fund	$ 25,524,743	$ 7,529,804	$ 4,334,628	$ 468,327	$ 310,657	No Shortfall	N/A	N/A
Corsicana Firemen's Relief & Retirement Fund	$ 16,163,690	$ 4,689,025	$ 8,135,345	$ 538,651	$ 538,651	No Shortfall	N/A	N/A
Orange Firemen's Relief & Retirement Fund	**$ 17,985,946**	**$ 8,272,029**	**$ 8,199,175**	**$ 341,606**	**$ 469,709**	**$ 128,102**	**27.27%**	**0.71%**
Sweetwater Firemen's Relief & Retirement Fund	$ 8,733,810	$ 3,929,907	$ 3,617,210	$ 284,174	$ 284,174	No Shortfall	N/A	N/A
Marshall Firemen's Relief & Retirement Fund	$ 20,353,433	$ 6,537,285	$ 10,641,648	$ 508,698	$ 651,293	$ 142,595	21.89%	0.70%
Plainview Firemen's Relief & Retirement Fund	$ 12,768,715	$ 15,844,471	$ 9,781,866	$ 532,083	$ 606,247	$ 74,164	12.23%	0.58%
Paris Firefighters' Relief & Retirement Fund	$ 25,422,079	$ 10,839,700	$ 9,625,814	$ 309,414	$ 385,995	$ 76,581	19.84%	0.30%
Atlanta Firemen's Relief & Retirement Fund	$ 3,568,284	$ 1,676,529	$ 860,536	$ 81,878	$ 81,878	No Shortfall	N/A	N/A

Peer Group Expense Comparison

Peer Group Plans	10 yr. return (Net)	Active/ Annuitants	Average Benefit	NPL	Admin Expenses	Admin Exp as % of Assets	Investment Expenses	Inv Exp as % of Assets	Other Expenses	Total Expenses	Exp as % of Assets
Waxahachie Firemen's Relief & Retirement Fund	4.90%	1.77	$ 43,297	$ 7,039,421	$ 21,760	0.15%	$ 142,317	1.00%	-	$ 164,077	1.16%
Greenville Firemen's Relief & Retirement Fund	4.23%	0.79	$ 24,101	$ 16,709,548	$ 34,472	0.27%	$ 90,884	0.71%	-	$ 125,356	0.98%
Big Spring Firemen's Relief & Retirement Fund	4.26%	1.27	$ 37,713	$ 9,713,127	$ 100,927	0.97%	-	0.00%	-	$ 100,927	0.97%
Weslaco Firemen's Relief & Retirement Fund	2.59%	2.07	$ 18,033	$ 4,702,051	$ 54,676	0.52%	$ 61,218	0.59%	-	$ 115,894	1.11%
Corsicana Firemen's Relief & Retirement Fund	3.40%	1.81	$ 31,722	$ 8,837,348	$ 22,168	0.27%	$ 92,459	1.11%	-	$ 114,627	1.37%
Orange Firemen's Relief & Retirement Fund	**3.72%**	**0.88**	**$ 26,036**	**$ 8,946,685**	**$ 18,742**	**0.23%**	$ 93,636	**1.15%**	**-**	**$ 112,378**	**1.38%**
Sweetwater Firemen's Relief & Retirement Fund	4.91%	1.04	$ 33,311	$ 4,041,873	$ 35,021	0.41%	$ 66,056	0.77%	-	$ 101,077	1.18%
Marshall Firemen's Relief & Retirement Fund	4.67%	1.32	$ 30,632	$10,956,850	$ 4,077	0.05%	$ 45,898	0.60%	-	$ 49,975	0.65%
Plainview Firemen's Relief & Retirement Fund	1.95%	1.03	$ 24,050	$ 10,746,840	$ 12,557	0.23%	$ 49,439	0.91%	$ 811	$ 62,807	1.16%
Paris Firefighters' Relief & Retirement Fund	2.16%	1.17	$ 24,491	$ 9,642,566	$ 37,674	0.79%	$ 32,730	0.69%	-	$ 70,404	1.48%
Atlanta Firemen's Relief & Retirement Fund	4.84%	1.25	$ 9,039	$ 1,129,175	$ 23,941	0.64%	$ 25,495	0.68%	-	$ 49,436	1.32%

Comments from Orange Firemen's Relief and Retirement Fund and City of Orange

CITY OF ORANGE

FIREMEN'S RELIEF AND RETIREMENT FUND

September 6, 2018

Texas Pension Review Board
P.O. Box 13498
Austin, TX 78711-3498

Dear Sirs,

The Orange Firemen's Relief and Retirement Fund's Board of Trustees (Board) is in receipt of and has reviewed the draft of the Intensive Actuarial Review report. The following is the Board's response to this report prepared by the Texas Pension Review Board (PRB).

The Board is dedicated to the continuity and stability of the Orange Firemen's Relief and Retirement Fund pension plan (Plan). The Board meets once every month with special call meetings as deemed necessary. The Board is concerned with the Plan's amortization period and the unfunded liability. The Board agrees with the report in that steps must be taken to correct the Plan's path to ensure success and longevity.

An initial step towards the Plan's longevity recommended in the report is a written funding and risk-sharing policy. The Plan currently only has an investment policy. The Board agrees with this recommendation and acknowledges the need for and benefit of such a policy. Therefore, the Board will research and work towards developing a funding and risk-sharing policy that would be appropriate for the Plan.

The Board does acknowledge the recommendation by the PRB for increased contributions. The Board has communicated this need to the plan sponsor and the plan members. However, the Board does not have the authority to set or increase the contribution rates. The Plan was initially funded with a 9% member contribution rate and a 10% City contribution rate. Between 1995 and 2006, the City rate increased to 14%. In 2007, the member rate increased to 11% from the initial 9%. From 2015 to 2016, the member rate increased another 1% to 12%. During the last collective bargaining session, the City and the International Association of Firefighters, Local 1432 (Association) agreed to a .25% increase each for fiscal year 2018 and 2019. This brings the contribution rate for fiscal year 2019 for members to 12.5% and 14.5% for the City. The next collective bargaining negotiations will begin in the spring of 2019.

The Board realizes that the Orange Firemen's Relief and Retirement Fund has good benefits, of which the Plan members would prefer to keep. The Board requested that the actuary review the Plan document and benefits; and suggest any actions that would help better position the Plan for the future. The actuary, Foster and Foster, recommended an amendment to the normal form of annuity payments at the time of retirement. This benefit change was initially voted down by the Plan members. However, a new ballot has been submitted by the Board to offer a choice of the benefit change, a contribution increase of 2% over 4 years or no action for the Plan members. The firefighter board members will also work more diligently to clarify the benefit change and explain the options. The new vote is set to begin on September 6, 2018.

The Board understands the concerns that the PRB has regarding the investment fee and expenses. The Board engages a financial advisor to assist the Board with managing the investments of the Plan. The financial advisor consults, educates and gives the Board their expert advice in relation to the Plan's investments, money managers and the economic outlook. The advisor presents quarterly reports on the Plan's investment portfolio performance. Each quarter, the managers are evaluated and the assets are reallocated as necessary to remain in compliance with the investment policy. The Board has agreed to have a review performed on the investment fees and expenses. Upon completion of the review, the Board will make a determination to best serve the Plan and the Plan members.

In regards to the high amortization period of 69.3 years, the Board acknowledges the severity of the situation, and will seek methods to reduce amortization period. The Board would like to point out that the increase from 58.2 to 69.3 years was partly due to changes agreed upon with the actuary. The Board agreed to change the method of asset valuation from asset smoothing to market value. The actuary explained that this would cause an initial increase in the amortization period, but that the effects will level off in the near future. The Board and the actuary also decided to change the (1) assumed rate of DROP election from 95% to 20% and the (2) assumed rate of salary increase for members with over 25 years of service from 2% to 3% per year. The Board will continue to monitor the amortization period and work with the actuary on the most accurate assumptions for the Plan as possible.

In conclusion, the Board is prepared to follow the actions and recommendations outlined above and to cooperate with the Plan sponsor and the Plan members to ensure the viability and the longevity of the Orange Firemen's Relief and Retirement Fund.

Sincerely,

Jody Cowart
Chairman, Board of Trustees
Orange Firemen's Relief and Retirement Fund

September 6, 2018

Texas Pension Review Board
P.O. Box 13498
Austin, TX 78711-3498

Dear Sirs,

The City of Orange (City) has received a copy of the Orange Firemen's Relief and Retirement Fund's (Plan) Intensive Actuarial Review report. The City, as the Plan sponsor, works in partnership with the International Association of Firefighters, Local 1432 (Association), and the Plan members to ensure the viability of the Plan and the future pension benefits for the City's retired firefighters.

The contribution rates for funding the Plan are part of the collective bargaining process between the City and the Association. The City does not have unilateral control over the contribution rates or funding the Plan. Both the City and the Association work together to make decisions regarding the funding of the Plan. The current Collective Bargaining Agreement includes a .25% increase in the contribution rate for both the City and the Plan members each for 2 consecutive years. This current agreement will be in effect until September 30, 2019. At this time, there is not a clause to reopen negotiations once an agreement is signed. The City has already set the tax rate and the budget for the fiscal year ending September 30, 2019. Therefore, due to budgetary limitations, there cannot be an increase to the contribution rates until the expiration of this agreement. The City will be open to negotiations for the 2019-2020 fiscal year.

The City does not participate in the decision making process regarding the Plan benefits. That responsibility lies with the Association and the Plan members. The City would like to see the Plan realign the benefits along the lines of a pension plan such as Texas Municipal Retirement System (TMRS).

The City recognizes the severity of the Plan's current situation. The City is concerned as the increasing unfunded liability is reported on the City's financial statements, and could possibly affect the City's bond rating. The City agrees with the recommendations made by the PRB in the report and will cooperate with the Association and Plan members in so far as the Collective Bargaining Agreement, budget limitations and the laws allow.

Sincerely,

Dr. Shawn Oubre
City Manager
City of Orange, Texas

803 W Green Avenue P. O. Box 520 Orange, Texas 77631-0520 (409) 886-3611