

Brothers and Sisters,

My name is Tim McPhillips and I am asking for your vote for the open pension trustee position. I am currently assigned to Engine 47 in the 18th battalion and was previously assigned to Truck 25 in the 9th battalion. Prior to joining the department I worked in corporate finance and accounting. I have earned a B.S. in Finance and Political Science from Marquette University, a Masters in Public Policy and Administration from Northwestern University and am a CPA. When I'm not working at Engine 47, I work as the finance director at a municipality. I was raised on the south side of Chicago, in St. Bede parish, and attended Mt. Carmel H.S. I now reside in Edison Park with my wife of 19 years, Brenda, and our three children.

I previously ran for this position when I only had two years on the job. I was concerned about the funding levels and would often ask one of Local 2's executive board members, a lieutenant who I worked with, about the funding levels. He would always reply, "Its guaranteed kid, if the City can't pay it, the state has to pay it". Ironically, my opponent, 12 year pension board member Tony Martin, has a similar cavalier attitude as this lieutenant. On Tony's only visit I've witnessed to my firehouse, he stated 'the fund has traditionally been under-funded and has had funding ratios at the 40% and 50% level for over thirty years.' He went on to say, verbatim "I'm not worried about the pension funding so you don't need to be". I was shocked he could be so unaware of the magnitude of the situation. My concern for the fund is much graver than his. Tony's size up of this incident is a 'nothing showing' response; I can assure you this needs a box. When I ran with two years on the job against a battalion chief with over twenty years on the job; I had trouble convincing my own father he should vote for me. My father, Jim (Spider) E61 and E88, thought I should get some time on the job first. That was discouraging. What I found more discouraging is that when the incumbent, Chief George Korda, did 'campaign', he brought an entourage of men with him, including Tony Martin. I witnessed this full press when I was working on A80 at E112's house during the campaign. Tony reached out to me that day and actually suggested current board member Dan Fabrizio won't be running next term and I could 'slide into his position' in the next election, but that "we need to keep George on the board this time around." He came across as a bit of a shyster when he said that. I couldn't understand why this unpaid position was being sought after with so much effort. Being in a position to dole out investment contracts to well established investment firms, which the pension board members do, could be a desirable position for some people. I wondered if that was the reason why this position was sought after, I also wondered who the approximately \$6 million in annual investment advice our Fund spends was benefiting more; our pension fund or the politically connected investment firms.

Most of the research in portfolio construction breaks the process down into three steps; capital allocation, asset allocation and security selection. The research concludes the most critical component of those three steps is the second step, asset allocation, of which the Fund expends slightly more than \$200,000 annually. By contrast the least effective step contributing to higher investment returns is the third step, security selection, of which the Fund spends approximately \$6,000,000 annually. I applied this research to our fund by reverse engineering the data found in the audited financial statements from 2000-2009. I've concluded the fund would have been better off had they just bought index funds to mimic the asset allocations that are indicated in the financial statements. Starting in 2000, had the Fund just kept the approximately \$6 million annually paid to investment firms and purchased index funds instead, the pension fund would have an additional \$25 million in the fund as of yearend 2009. Tony Martin should have been focusing on this for the last 12 years, not his law degree.

Let me be clear. The returns that your pension fund earns are quite good, but that is because they are well diversified, not because they are paying investment firms \$6 million each year. What is important is that our fund invests in a broad asset class; almost all of which can be acquired through index funds, bypassing expensive investment firms. Our fund shouldn't pay investment firms hefty fees to execute our investment policy, statistically speaking these firms don't beat the indexes without taking on excess risk. I consider it a hidden tax often times collected by the politically connected running investment firms. I'm not sure who is benefiting from these fees, but I will do everything I can to make certain we minimize paying it going forward.

Tony will campaign on his record of earning great investment returns. I caution you to be skeptical of such claims and weary of a trustee that is willing to try and outperform the market. Portfolio management isn't the same as organizing a softball tournament; the consequences of getting it wrong are very real. When compared to the wrong benchmarks, our fund's returns look great, but they should be compared to a blended benchmark that is established beforehand. If you only have 25% of the fund in S&P equities, the S&P is not your benchmark. It is misleading for Tony to allude to the members that the fund somehow has benefited from his leadership and investment strategy. As a CPA, I recently worked for a large investment fund with over \$100 billion portfolio, focusing on reporting and analysis; that is approximately 100 times larger than our pension fund. We would never make the comparison that is presented to the membership. Making that comparison would not be a reliable measure; in the real world you measure results against a meaningful peer. I believe the fund should focus on maintaining a well-diversified portfolio that minimizes investment expenses; the investment style of the fund should be boring. I will not, as a pension board trustee, advocate interjecting additional risk into our portfolio in order to earn higher returns to make up for the City's inability to properly fund promised benefits.

Do you know how much money you, as an individual firefighter, should have set aside for you in the Fund when you retire? That obviously depends on a lot of factors; age, interest rates, salary increases, time on the job, to name a few. Let's try and simplify it. If a hypothetical firefighter/emt started on January 1, 2003 at the age of 26, worked 30 years, was never promoted and the City and the firefighter put in the statutorily required contribution into the fund; the pension fund should have \$1,986,973 for our hypothetical firefighter. There are some additional assumptions being made with this calculation; the pension fund earns 6% on the funds invested, the hypothetical firefighter's and the City's contributions are made at year end and therefore are not available for investing until the beginning of the next year. Also, the hypothetical firefighter earns all his step raises as indicated in the labor contract ending 6/30/2012 in addition to a 2% increase each year. When our hypothetical firefighter retires he will start withdrawing 75% of the average of his highest four years of salary, approximately \$101,000. If we deduct that from the \$1,986,973 set aside from him at the very beginning of his retirement and increase that withdrawal by 1.5% of his initial annual withdrawal at the beginning of each subsequent year, do you know when the Fund will run out of money for the hypothetical firefighter? The Fund will run out of money when the firefighter turns 107. **The Fireman's Annuity and Benefit Fund of Chicago is not structurally unsound, it can sustain itself, it is not an unbearable burden to the City's budget. Our pension fund is good public policy, regardless of what civic minded organizations say.** The Local 2 public relations apparatus needs to work on this message; the public doesn't need anymore reminders firefighters make the best chili.

So why is our Fund so poorly funded given this example? There are a few explanations; promotions later in a career without adequate previous contributions or investment earnings to support the increased payouts, legacy costs, duty disability. If that same hypothetical firefighter was promoted to lieutenant at the beginning of his 20th year there would be \$68,730 more available when he retired, but because of the larger payout, he would run out of money at age 90 instead of 107. If the hypothetical firefighter was promoted again, let's say to captain in the beginning of year 24, he would run out of money at age 81.

Let's say that same hypothetical firefighter had a classmate hurt on the job and he started collecting duty disability in the beginning of year ten. The firefighter on duty disability would no longer be contributing into the pension fund, and neither would the City; but he would start withdrawing 75% of his

base pay. Let's assume that the money in the fund isn't commingled and each dollar is attributed to a specific fund participant, in this case our hypothetical firefighter. If the burden of the injured firefighter collecting duty disability is borne by our hypothetical firefighter alone, the hypothetical firefighter would only have \$524,952 when he retires and not the \$1,986,973 previously noted. Almost 75% of the hypothetical firefighter's retirement would be eaten up because the City burdens our pension fund with duty disability injuries. It is poor public policy to intermingle retirement and disability benefits. When I worked in the private sector, my employer didn't reach back into my 401K when a co-worker hurt themselves on the job. The risk of co-workers being hurt was not borne by my retirement account; it was taken care of by a workman's compensation policy or a separate risk pool.

Another reason our fund is so poorly funded is due to legacy costs. Very little of the money you contribute today is set aside to earn investment returns for your retirement. Instead those dollars are being used to pay the benefits of firefighters that are already retired. Although I stated our pension fund is structurally sound, it isn't financially sound, and that is because it hasn't been properly funded for such a long period of time. Had the City just addressed this problem sooner, and properly funded the pensions, we could be 100% funded today. But instead they kicked the can down the road and let the problem get bigger and much more unmanageable. Addressing this problem sooner would mean that more of the money you contribute to the fund today could earn investment income for your retirement rather than paying the legacy costs of members that are no longer contributing. If the City doesn't contribute enough to cover these legacy costs, you don't get to benefit from investment earnings; no matter how good the pension fund manages the investments. For example, in 2012 the pension fund's financial statements show \$84M of City contributions, \$53M of active member contributions, and \$138M in investment income. The pension fund brought in nearly \$275M of new money. Unfortunately, the pension fund paid out \$237M in benefits and expenses; \$0.86 of every \$1.00 that came in was paid out. A majority of that money is supposed to stay in the fund to help earn your retirement benefits. This is the burden of legacy costs; even though the fund is structurally sound, if it isn't properly funded, even the best policies don't work.

What is most concerning to me is the total disregard by the City to recognize the rightful expenditure of property taxes. Property taxes are paid to support the maintenance of property values. Traditionally that has been done through the maintenance of streets, schools, parks, and police, fire and public works departments. It is these expenditures that make a City lot more valuable than a 30x125 lot in the backwoods of Wisconsin. Additionally, the City has a unique residency requirement that makes the property taxes paid by our neighbors even more beneficial to property owners. The residency requirement places an artificial increase on the demand for the City's housing stock. It is this increased value received by City residents who pay property taxes that is often overlooked. Again, where is Local 2's public relations effort on this message? Not only are City home prices kept artificially high because of the 'captured' workforce of the City, but City residents benefit from residents that are whole heartedly connected to the neighborhoods. The words of Father Mulchrone on that bitter cold day we buried fellow brother Eddie Stringer are not lost on me. To paraphrase, "Ed could be harsh with his words and like to joke, but his neighbors recall sidewalks on either side of his house, after a heavy snow, meticulously cleaned by Ed, from edge to edge." The point being, there are benefits to having firefighters, policemen, municipal workers and teachers living in your neighborhood. The skimming of large amounts of property tax dollars traditionally earmarked for education, safety, infrastructure and pensions; without any oversight, is unethical. The theory behind TIF districts look good on paper, but in practice, the program operates in an environment lacking oversight and transparency; subsidizing questionable projects with dubious benefits. TIFs are not benefiting individual property owners; they subsidize the political contributor's projects. Money that should be going to roads, schools, payrolls, and pensions are being diverted to interest payments for developers and land acquisition for basketball stadiums. Eliminating TIF districts is the quickest way to free up resources for properly funding our pensions and keeping Chicago neighborhoods strong.

I apologize for the length of this letter, but our pension fund and its well-being are important and involved issues. I do not hold any ill-will towards Tony Martin, but there are real differences between Tony and I. Unlike Tony, I would never aspire to a paid political office. Tony has run for so many political positions, it isn't clear what is important to him. As one person said about Tony "if you put a quarter in him, you get two dollars worth of opinion". I consider myself a pretty reserved person, or at least that is how I would like to be perceived. I like to believe my opinion is measured and supported by facts. I make a conscientious effort to live up to the Jesuit values instilled in me, no matter how difficult the citizens in my still district make it. I'm out there with you at 3am with the shortness of breath or gunshot victim. I know firsthand how cold this last winter was while leading out and bedding hose; 47's hydrants were all cleared out. I know what safe passage means. I'm not inclined to tell people what I think, if you worked with me my conversation gravitates to family, kids, and work. I appreciate Tony wanting to better himself by pursuing a law degree, but to do it while supposedly working for us is questionable judgment. I don't see how his law degree helps anyone but himself. Regardless, I will put my education, experience and research against his law degree, judgment and past pension board experience any day. I can assure you I have spent a considerable amount of time analyzing our pension fund's financial statements and designing investment models while I earned my Masters, all on my time. Not only did I earn my Masters while working in two busy battalions, the 9th and 18th, Tony was of little help to me when I was doing my research when I did reach out to him. I can't really tell you what he has been doing while detailed out of the field, besides earning his law degree and running for political office(s). When he campaigns, I can't tell you whose time he is on, his own or the City's. You will have to ask him how he works that out with the City. But I can assure you, I will be sacrificing my time when I campaign. Finally, I think the most compelling argument I can make to vote for me is that there needs to be additional fresh perspectives on the board. It shouldn't be the same old uncontested people feeling comfortable in this position; there is nothing wrong with some tension and differing perspectives when critical decisions are being made. I would appreciate your support. Best regards and stay safe.



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