



## Legislation Text

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**File #:** 17-0353, **Version:** 1

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**TO:**

Honorable Mayor and Members of the City Council

**THROUGH:**

Mark Danaj, City Manager

**FROM:**

Bruce Moe, Finance Director

Henry Mitzner, Controller

Libby Bretthauer, Financial Analyst

**SUBJECT:**

Adoption of Investment Guidelines for the New Pension Rate Stabilization Fund; Adoption of Funding and Distribution Policies for the City's Other Post-Employment Benefits (OPEB) and Pension Rate Stabilization Trust Funds (Finance Director Moe).

**ADOPT GUIDELINES AND POLICIES**

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**RECOMMENDATION:**

The Finance Subcommittee and City Staff recommend that the City Council adopt investment guidelines for the new pension rate stabilization fund, and funding and distribution policies for the City's Other Post-Employment Benefits (OPEB) and pension rate stabilization trust funds.

**FISCAL IMPLICATIONS:**

The City's CalPERS pension contributions are expected to rise to \$12 million by fiscal year 2021-2022. In an effort to address and stabilize rates, City Council approved the creation of a Pension Rate Stabilization Fund (PRSF). The FY 2016-2017 and FY 2017-2018 budgets allocated a combined \$750,000 as an initial deposit into the trust fund. That deposit is pending City Council approval of investment guidelines and funding and distribution policies presented with this report.

**BACKGROUND:**

At its May 4, 2017 Budget Study Session meeting, City Council approved the creation of a Pension Rate Stabilization program (PRSP) and trust fund. At that time, City Council assigned to the Finance Subcommittee responsibility for the development of program investment guidelines and funding policies for full City Council review and approval. The guidelines and funding policies create the framework for the effective investment and utilization of trust funds.

By way of structure, the parties involved in the Trust include:

1. City Council
  - a. Establishes Trust

- b. Defines policies for administration of trust (delegated to the Finance Subcommittee)
2. City Manager/Staff
  - a. Responsibility for Trust funds
  - b. Development/Management of procedures in accordance with City Council policies
3. Trust Administrator - Public Agency Retirement Services (PARS)
  - a. Establishes the framework of the Section 115 Trust Trustee - U.S. Bank
  - b. Safeguards assets for benefit of retirees
  - c. Provides oversight of investments
  - d. Custodian of assets
  - e. Disbursement of funds
4. Investment Manager - HighMark
  - a. Assists in selection of investment strategy
  - b. Annual review of investment portfolio and asset allocation
  - c. Fiduciary responsibility of PRSP assets management

## DISCUSSION:

### *Investment Guidelines*

With the creation of the PRSF, investment guidelines need to be developed to ensure that the funds deposited with the Trust Administrator are invested in a manner that is consistent with the City's risk tolerance and goals. Oversight of the investing of funds in the PRSF has been delegated to the Finance Subcommittee by the City Council.

The Finance Subcommittee met with the Investment Manager (HighMark) to develop an investment strategy. That information was then used to develop the Investment Guidelines (Attachment #1). HighMark offers a variety of diversified investment portfolio options with varying levels of equities, fixed income securities and cash:

- Conservative
- Moderately Conservative
- Moderate (Finance Subcommittee recommended)
- Balanced
- Capital Appreciation

Attachment #2 provides a description of each option as well as historical annualized returns. Additionally, each option may be managed either passively or actively. Passive management typically relies on the use of index funds with little-to-no dependency on the portfolio manager's skill. It also carries a lower expense ratio. Active management relies more on the skill of the portfolio manager, carries a higher expense ratio, but also has a greater opportunity to outperform the index fund method net of fees.

After meeting with the Investment Manager, and discussing the various options, the Finance Subcommittee recommends an Investment Guideline (Policy) utilizing an actively-managed,

Moderate, diversified investment portfolio (this approach is included in the policy - Attachment #1). The Subcommittee believes that option is the appropriate balance of risk tolerance with expected investment returns.

### *Funding and Distribution Policies*

In addition to the Investment Guidelines, Funding and Distribution Policies have been created in order to guide and regulate the flow of funds in to and out of the trust (these policies were drafted to also include the City's Other Post Employment Benefits (OPEB) trust fund). The recommended policies are included as Attachment #3.

Ultimately, the Funding and Distribution policies are guidelines. Actual funding of the Pension Rate Stabilization Trust Fund will be reviewed at least annually by the City Council during budget deliberations when funds are allocated. Similarly, the planned use of funds will also be reviewed through the budget process.

The Finance Subcommittee recommends adoption of the Funding and Distribution Policies as presented.

### **POLICY ALTERNATIVES:**

The Finance Subcommittee and staff recommend the Moderate, actively managed investment portfolio option as the appropriate balance of risk tolerance with expected investment returns. However, alternatives include:

#### **ALTERNATIVE #1:**

Adopt more aggressive investment guidelines

##### **PROS:**

Potentially greater investment returns

##### **CONS:**

Greater risk of losing money

#### **ALTERNATIVE #2:**

Adopt more conservative investment guidelines

##### **PROS:**

Reduced risk of loss

##### **CONS:**

Potentially lower investment returns

#### **ALTERNATIVE #3:**

Use a passive (as opposed to active) management approach to investments

##### **PROS:**

Lower expense ratio/cost savings

##### **CONS:**

Potentially lower investment returns

### **PUBLIC OUTREACH/INTEREST:**

After analysis, staff determined that public outreach was not required for this issue.

## **ENVIRONMENTAL REVIEW**

The City has reviewed the proposed activity for compliance with the California Environmental Quality Act (CEQA) and determined that the activity is not a “project” as defined under Section 15378 of the State CEQA Guidelines; therefore, pursuant to Section 15060(c)(3) of the State CEQA Guidelines the activity is not subject to CEQA. Thus, no environmental review is necessary.

## **LEGAL REVIEW**

The City Attorney has reviewed this report and determined that no additional legal analysis is necessary.

## **Attachments:**

1. Pension Rate Stabilization Fund Investment Guidelines
2. HighMark Diversified Investment Portfolio Reports for Q2-2017
3. Pension Rate Stabilization Fund and Other Post Employment Benefits (OPEB) Funding and Distribution Policies