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Staff Report for Discussion on the Selection of a Service Provider and the Development of Investment Guidelines for the City's Section 115 Pension Trust

SUMMARY AND RECOMMENDATION

Staff recommends that the Finance Committee (Committee) review the draft Investment Guidelines Document and recommend investment strategies for the City's Section 115 Trust. Staff also recommends that the Committee review the proposal submitted by PARS.

BACKGROUND

At the April 12, 2021 Council meeting, the City Council directed staff to establish a Section 115 Pension Trust (Trust) to buy down the City's unfunded pension liability and stabilize costs in the long run. The Council directed staff to work with the Committee to finalize the selection of a service provider and develop an investment policy for the Trust.

Following the April meeting, PARS submitted a formal proposal to the City and HighMark provided the draft Investment Guidelines Document for the Moderately Conservative investment strategy. Both documents are attached to this staff report.

To recap, a Section 115 Trust offers the following benefits:

- Generate investment income to pay for future pension contributions;

- Flexibility to tailor the investment strategy to meet the City's objectives and risk tolerance;
- Potential to improve the City's bond rating; and
- Flexibility to access Trust assets to offset unexpected increases in pension costs or decreases in revenues due to economic downturns.

Establishing a Pension Trust will enhance investment returns in the long run and provide the City flexibility to withdraw funds from the Trust as needed. Government Code Section 53216 allows assets in a Pension Trust to be invested in any form or type of investment deemed prudent. Investment restrictions that apply to the City's pooled investments do not apply to the Pension Trust. For example, funds in a Pension Trust can be invested in both equity (stock and shares issued by a company) and fixed income (investments that pay investors fixed interest or dividend payments); assets can be invested in a time horizon that is longer than five years. The City's pooled investments cannot be invested in equity and are limited to five year maturity unless otherwise approved by the City Council.

Representatives from HighMark and PARS will attend the meeting on May 4th to provide the Committee an overview about the investment strategies and answer questions about the Investment Guidelines Document and the PARS proposal.

DISCUSSION

Investment Guidelines

Overview and Key Investment Elements

As stated in the Investment Guidelines Document, the purpose of the document is to:

- Facilitate the process of ongoing communication between the City, PARS and HighMark;
- Confirm the Plan's investment goals and objectives and management policies applicable to the investment portfolio that will be identified by the City;
- Provide a framework to construct a well-diversified asset mix that can potentially be expected to meet the account's short- and long-term needs that is consistent with the account's investment objectives, liquidity considerations and risk tolerance;
- Identify any unique considerations that may restrict or limit the investment discretion of its designated investment managers; and
- Help maintain a long-term perspective when market volatility is caused by short-term market movements.

The Committee should consider the following key elements when developing investment guidelines for the Plan.

- Investment Time Horizon
- Anticipated Cash Flow
- Investment Objective
- Risk Tolerance

Our goal is to accumulate funds in the Plan to cover increases in pension costs and relieve pressure on the General Fund in future years. Our objective is to maximize investment return while ensuring cash is available to cover pension contributions. Withdrawals from the Plan are not expected in the near term.

Investment Strategies

The PARS Section 115 Trust Program offers several investment strategies as presented in the table below. Agencies can also create customized/mixed strategies to meet their investment objectives. Some investment strategies focus on capital appreciation. These strategies tend to yield higher returns over time with more investments in equity. The more conservative strategies invest more heavily in fixed income, and the yields tend to be lower. Each investment strategy also invests a portion of the assets in cash. It should be noted that the **Moderately Conservative strategy is the most commonly selected strategy, followed by the Moderate strategy**. The active portfolio returns presented below provide an overview about the investment performance over 1-, 3-, 5-, and 10-year periods.

For discussion purposes, HighMark provided an Investment Guidelines Document for the Moderately Conservative strategy. The City's OPEB Trust with PARS utilizes the Moderately Conservative strategy. The Committee may recommend another strategy after evaluating the City's investment objectives and risk tolerance. The City also has the option to change the investment strategy as needed.

Investment Strategies & Percent Selected by Agencies

Strategy	Allocation (%)
Capital Appreciation (65-85% Equity)	5.23%
Balanced (50-70% Equity)	13.07%
Moderate (40-60% Equity)	31.37%
Mod. Conservative (20-40% Equity)	34.64%
Conservative (5-20% Equity)	7.19%
Other (Custom)	8.50%
TOTAL	100.00%

Active Portfolio Returns

ACTIVE PORTFOLIO RETURNS

Strategy	Equity (%)	1 Year	3 Years	5 Years	10 Years
Capital Appreciation	65-85%	14.50%	9.76%	10.92%	9.15%
Balanced	50-70%	14.06%	9.15%	9.90%	8.24%
Moderate	40-60%	12.92%	8.45%	8.98%	7.49%
Moderately Conservative	20-40%	10.76%	7.06%	7.12%	5.99%
Conservative	5-20%	9.03%	6.10%	5.84%	4.75%

* Past performance does not guarantee future results.

The asset allocation ranges for the Moderately Conservative strategy are presented below. Please refer to the Investment Guidelines Document for detailed information on investment categories and performance benchmarks.

Strategic Asset Allocation Ranges		
Cash	Fixed Income	Equity
0-20%	50%-80%	20%-40%
Proposed Policy: 5%	Proposed Policy: 65%	Proposed Policy: 30%

PARS Proposal

The PARS proposal provides information about the Section 115 Trust Program, the key personnel that will be serving the City's account, program partners, investment strategies, and the fees. Fees are based on a tiered pricing structure. For assets over \$15 million, the fee would be 0.30% for both administration and investment management. Please note that other management fees may also be charged by investment managers, which will be deducted directly from investment returns consistent with industry standard. The City currently has more than \$21M in assets in the OPEB Trust, and the annual fee is approximately \$93,000. PARS allows agencies to combine their OPEB and Pension Trust assets together to benefit from a lower fee. Contributions into the Pension Trust will be charged

at 0.30%.

Next Steps

Staff is planning to present the Committee's recommendations to the City Council in June 2021, along with resolutions to adopt an investment policy and to establish a Pension Trust.

Current Agency Policies

Place San Leandro on a Firm Foundation for Long Term Fiscal Sustainability.

Previous Actions

On September 21, 2015, the City Council affirmed the goals of the PULL Plan.

Fiscal Impacts

The \$750,000 annual OPEB contribution will be used to establish the Pension Trust, and the annual fees are estimated at \$2,300. The fees will increase as more assets/contributions are accumulated in the account.

Budget Authority

The \$750,000 annual OPEB contribution is included in the Fiscal Year 2020-21 budget. If the trust account is not set up by the end of June 30, 2021, staff will request the Council to reappropriate the funds to the Fiscal Year 2021-22 budget.

ATTACHMENT(S)

- PARS Proposal
- Draft Investment Guidelines Document - Moderately Conservative Strategy

PREPARED BY: Susan Hsieh, Finance Director