



City of Emeryville

CALIFORNIA

MEMORANDUM

DATE: March 6, 2018

TO: Carolyn Lehr, City Manager

FROM: Susan Hsieh, Finance Director

SUBJECT: Presentation On Section 115 Pension Trust

RECOMMENDATION

Staff recommends that the City Council provide comments and direction after receiving a presentation from PARS.

BACKGROUND

At the October 24, 2016 Budget Advisory Committee meeting, the Committee reviewed the profiles and pension programs offered by Keenan, PARS, and PFM. These three firms are the key players in providing pension trust services to public agencies. Please see information below regarding the firms' history and experience. Keenan and PFM have offices in the Bay Area, and PARS is located in Newport Beach.

*"Founded in 1972, **Keenan & Associates** has more than 44 years of experience consulting to public agencies. Statewide, we provide more than 950 public agencies and 65 trusts and Joint Powers Authorities (JPAs) a wide variety of services, including employee benefit, property & liability, workers compensation and various risk management services.*

Our firm is dedicated primarily to:

- California Public Agency market focused on the needs of California public school districts, community colleges, cities, counties and special districts, and;*
- California Health Care market that focuses on the needs of provider, hospital and medical organizations."*

*"**PARS** has been designing and administering niche retirement plan and trust solutions exclusively for public agencies for the last 33 years. Our core mission is to offer local governments control and flexibility to meet their individual needs. We specialize in supplemental pension trusts, post-employment health care trusts, retirement/separation incentive plans, alternate to Social Security plans, and other defined benefit and defined*

contribution plans. Our primary business functions are retirement plan and trust design, analysis, administration, recordkeeping, compliance, and consulting.”

“PFM Asset Management LLC (“PFMAM”) is a leading provider of independent investment management services to governments, government agencies, non-profit organizations, pension funds, insurance pools, local government investment pools and other institutional investors. The original practice of the PFM Group of companies (the “PFM Group”) — which includes PFMAM and its affiliates, Public Financial Management, Inc. (“PFM”) and PFM Swap Advisors LLC (“PFMSA”) — was founded in 1975 to provide independent financial advisory services to the public sector and began providing investment advisory services in 1980. In 2001, PFMAM was created as an indirect wholly owned subsidiary, known as PFM I, LLC, through which investment advisory services are provided. These services include timely, market-driven portfolio management, portfolio design, state-of-the-art accounting, and arbitrage rebate calculation services.”

The Budget Advisory Committee also advised staff regarding the key elements that should be included in the request for proposals (RFP). After incorporating the Committee’s comments, staff finalized the RFP and distributed to the three firms in December 2016 and posted the RFP on the City’s website. In late December 2016, not long after the RFP was distributed, CalPERS announced that the discount rate/investment return will be reduced from 7.5% to 7% over a three-year period, beginning fiscal year 2018-19. That means agencies’ pension costs will increase going forward.

All three firms responded to the City’s request in January 2017. Due to CalPERS’ new announcement, staff decided to postpone evaluating the proposals until we have a better understanding about the cost impact in future years. As part of the budget discussion for the 2017-19 budget, the City Council directed staff to transfer \$4 million to CalPERS to pay down the unfunded pension liability for the police safety plan to achieve savings. The savings is estimated to be over \$11 million over a 30-year period. The City Council also directed staff to invest the remaining balance (approximately \$9.6M) in a Section 115 Pension Trust to mitigate upcoming rate increases. In October 2017, staff wired \$4 million to CalPERS. Staff has also completed the evaluation of proposals and identified a potential firm.

On January 22, 2018, the Budget Advisory Committee reviewed and discussed the evaluation results and advised staff to have the top-rated firm to make a presentation at a council meeting and receive feedback/direction from the Council.

DISCUSSION

Overview

A Section 115 Pension Trust is a tax-exempt irrevocable trust, and participation in a pension trust provides agencies with an alternative to sending funds to CalPERS and provides greater local control over assets and portfolio management. Agencies can tailor the investment strategy to meet their objectives. Over the years, the City has taken a proactive approach in funding its pension obligations. Establishing a pension trust will enable the City to withdraw funds from the trust as needed.

Proposal Evaluation

The three proposals were evaluated by a Review Committee consisted of staff from the Finance Department and the City Manager's Office and a consultant from Maze and Associates. The rating criteria include service fees, experience, scope of services, and investment returns. The City's RFP is attached to this staff report. All three reviewers consistently gave PARS the highest rating based on the quality of their program and overall experience.

All three firms charge fees for program administration and offer several investment portfolios. Trustees and investment managers are also part of a trust program. Keenan initially only offered a conservative investment portfolio but later advised us that they can offer more model portfolios. Keenan does not have an IRS Private Letter Ruling for a Section 115 pension prefunding trust. Legally, one may not be required to operate a trust. PFM uses Wells Fargo as their trustee, and this is not consistent with our social policy as the City Council had directed staff to divest from Wells Fargo.

While all three firms have experience establishing Section 115 OPEB Trusts (other post-employment benefits such as medical benefits) and have good procedures in place to manage investments, and receive and disburse funds, PARS has more experience in helping public agencies to establish Section 115 Pension Trusts. Please note that the City has established a qualified OPEB trust with the California Government Voluntary Employee Beneficiary Association. PARS was the first entity in the nation to obtain an IRS Private Letter Ruling for a Section 115 pension prefunding trust on a multiple employer basis. PARS currently has 118 Section 115 Trust pension clients, with 60 cities currently using their program.

Please note that PARS administers the City's supplemental police pension plan and retirement plans for part-time/temporary employees, and the City has been very pleased with the services provided by PARS over the years.

The tables below summarize PARS' fee structure and investment returns from different investment portfolios. The information is extracted from their proposal.

PARS Fees

TRUST ADMINISTRATION/CONSULTING FEES

The following fees are comprehensive and paid to PARS through the trust. These fees provide for administration, including compliance, legal, recordkeeping, funding analysis, and reporting.

Company	Ongoing Fee
PARS	0.25% for assets under \$10 million 0.20% for assets \$10-15 million 0.15% for assets \$15-50 million 0.10% for assets over \$50 million

TRUSTEE FEES

Company	Ongoing Fee
U.S. BANK	0.00% - <i>Trustee fees are waived when HighMark is utilized as the program's investment manager</i>

INVESTMENT MANAGEMENT FEES

Trustee and investment management fees are also comprehensive and include investment policy development, asset allocation recommendations, and ongoing asset management services.

Company	Ongoing Fee
HIGHMARK	0.35% for assets under \$5 million* 0.25% for assets \$5—\$10 million 0.20% for assets \$10—\$15 million 0.15% for assets \$15—\$50 million 0.10% for assets over \$50 million

**These fees represent the highest weighted investment management fee that can be charged. Fees for HighMark's five risk tolerance portfolios as of December 31, 2016 range from 0.25% to 0.34% for assets under \$5 million, depending on risk tolerance level portfolio selected (subject to change due to rebalancing). This is because all investment management fees are waived on the First American Prime Obligation Z fund as well as any funds within the portfolio that HighMark serves as sub-advisor/adviser.*

Investment Returns

The following is a breakdown of returns and expense ratios (as of 9/30/16) for the portfolios developed by HighMark for PARS PRSP clients:

ACTIVELY MANAGED DIVERSIFIED PORTFOLIOS

PORTFOLIO	1 YEAR	3 YEAR	5 YEAR	EXPENSE RATIO
CAPITAL APPRECIATION	10.61%	6.36%	10.81%	0.64%
BALANCED	8.97%	5.40%	9.55%	0.60%
MODERATE	8.60%	5.17%	8.51%	0.57%
MODERATELY CONSERVATIVE	7.28%	4.48%	6.67%	0.52%
CONSERVATIVE	6.20%	3.88%	4.98%	0.45%

INDEX/ETF DIVERSIFIED PORTFOLIOS

PORTFOLIO	1 YEAR	3 YEAR	5 YEAR	EXPENSE RATIO
BALANCED	9.97%	5.88%	9.43%	0.16%
MODERATE	9.02%	5.45%	8.35%	0.15%
MODERATELY CONSERVATIVE	7.50%	4.73%	6.19%	0.12%
CONSERVATIVE	5.79%	3.79%	4.42%	0.11%

Return figures listed above are annualized and are net of embedded mutual fund fees.

Steps to Set up a Trust

Below are the general steps to set up a trust with PARS.

- City Council authorizes establishment of The PARS Trust and appoints a Plan Administrator through resolution.
- PARS provides legal documents for signature by Plan Administrator to set up the trust.
- City develops investment policy and guidelines for Trust. Assistance with investment decisions is provided by HighMark Capital Management.
- Council approves initial deposit to The PARS Trust.
- City develops policies and procedures for future annual contributions and/or disbursements.
- PARS conducts an annual client services review.

FISCAL IMPACT

There will be costs associated with trust administration and investment management as described above. The estimated fee for a \$9.6M portfolio is \$53,000. Fees will be paid directly out of the trust fund.

CONCLUSION

Staff recommends that the City Council provide comments and direction after the presentation.

PREPARED BY: Susan Hsieh, Finance Director

**APPROVED AND FORWARDED TO THE
CITY COUNCIL OF THE CITY OF EMERYVILLE:**



Carolyn Lehr, City Manager

ATTACHMENTS:

1. Presentation Slides
2. Diversified Portfolios
3. Emeryville Request for Proposal