



# City of Emeryville

CALIFORNIA

## MEMORANDUM

**DATE:** May 1, 2018  
**TO:** Carolyn Lehr, City Manager  
**FROM:** Susan Hsieh, Finance Director  
**SUBJECT:** Direction On Investment Policy For The Pension Trust

**Resolution Of The City Council Of The City Of Emeryville  
Approving The Adoption Of The Public Agencies Post-  
Employment Benefits Trust Administered By Public Agency  
Retirement Services (PARS) For Pre-funding Pension Liabilities**

## RECOMMENDATION

1. Staff recommends that the City Council approve the attached resolution to establish a Section 115 Pension Trust with PARS.
2. Staff recommends that the City Council provide direction/comments regarding the draft Investment Guidelines Document after receiving a presentation from PARS and HighMark.

## BACKGROUND

At its January 22, 2018 meeting, the Budget Advisory Committee reviewed and discussed the proposal evaluation results and advised staff to have the top-rated firm make a presentation at a council meeting and receive feedback/direction from the Council. On March 6, 2018, representatives from PARS and HighMark presented the pension program and investment strategies to the City Council.

After the presentation, the Council confirmed the City's commitment to establish a pension trust to fund its pension obligations. The City Council also directed staff to evaluate our investment objective and recommend investment strategies, taking into consideration the cash flow needs over the next several years. The City Council indicated that a conservative approach was more appropriate in terms of protecting principals. Prior to establishing a pension trust, the City Council, in October 2017, directed staff to transfer \$4 million to CalPERS to pay down the unfunded pension liability for the police safety plan to achieve savings. It is estimated that the will be over \$11 million over a 30-year period.

A Section 115 Trust offers the following benefits:

- 1) Local Control Over Assets
- 2) Pension Rate Stabilization/Rainy Day Fund
- 3) Investment Flexibility
- 4) Addresses Unfunded Pension Liabilities
- 5) Improved Credit Rating

On April 16, 2018, the Budget Advisory Committee held a meeting to discuss the key investment elements and investment strategies (as described below). Representatives from PARS and HighMark also participated in the meeting.

Staff recommends that the City Council adopt the attached resolution to authorize the City Manager and staff to establish a Section 115 Pension Trust with PARS. The Administrative Services Agreement is attached to this staff report. Staff also recommends that the City Council provide direction/comments regarding the draft Investment Guidelines Document after receiving a presentation from PARS and HighMark. This document was developed based on the input from the Budget Advisory Committee. A final investment document will be submitted to the Council for approval at a future meeting.

## DISCUSSION

### Key Investment Elements

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

#### ***1. Investment Objective and Risk Tolerance***

Our objective is to maximize investment return while ensuring cash is available to cover pension contributions. 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.

The section below discusses the investment strategies offered by HighMark. The City may also develop a customized investment policy to meet our specific needs. The “Conservative” and “Moderately Conservative” strategies both meet our investment objective and risk tolerance level. It should be noted that the Moderately Conservative strategy is the most commonly selected strategy. **The Conservative and Moderately Conservative strategies invest more heavily in fixed income, whereas the other**

**strategies invest more heavily in equity.** Each investment strategy also invests a portion of the assets in cash.

## **2. *Investment Time Horizon and Anticipated Cash Flow***

The time horizon is expected to be medium to long-term in nature (greater than 5-year horizon). The City achieved a balanced budget for the 2017-19 budget cycle, and withdrawals in fiscal year 2018-19 are not expected. The City's long-term projection shows deficits in the out years. A revenue study was completed in December 2017, and the City is currently conducting a revenue measure study to identify potential revenues for the November 2018 election. The levels of disbursements in the first five years depend on the outcome of potential revenue measures.

The CalPERS discount rate reduction from 7.5% to 7% will phase in starting fiscal year 2018-19. Withdrawals and contributions from/to the Plan are expected in future years. While we are hopeful that the City will not seek significant disbursements from this Pension Prefunding portfolio, variables exist which may impact the time horizon, making it more short-term in nature.

## **Investment Strategies**

The information below is extracted from the PARS proposal. Please refer to the "Investment Portfolios" for more details. That document details the investment objective, asset allocations, and investment returns for each strategy.

The PARS PRSP was designed to give client agencies maximum investment flexibility. Utilizing HighMark as discretionary investment manager, the City has the following choices related to the investment of its funds:

### **1. FIVE RISK TOLERANCE LEVELS**

The City can participate in one of five risk tolerance levels that have been developed specifically for clients in PARS' Section 115 Trust. The five portfolios include: (a) actively-managed underlying mutual funds intended to outperform benchmarks or (b) low-cost Index/Exchange-Traded Funds (ETFs) which are baskets of stocks tracking the composition and performance of most leading market indices.

The following table provides an overview of the investment objectives for each of the five portfolios:

STRATEGY	INVESTMENT OBJECTIVE	EQUITY ALLOCATION
CAPITAL APPRECIATION	Provide growth of principal and income	65-85%

STRATEGY	INVESTMENT OBJECTIVE	EQUITY ALLOCATION
BALANCED	Provide growth of principal and income	50-70%
MODERATE	Provide growth of principal and income	40-60%
MODERATELY CONSERVATIVE	Provide current income and moderate capital appreciation	20-40%
CONSERVATIVE	Provide a consistent level of inflation-protected income over the long-term	5-20%

A full breakdown of the funds within the pre-established portfolios can be viewed in the Appendix under "Investment Portfolios."

## 2. CUSTOMIZED APPROACH

Still using a discretionary trustee approach, the City can customize its own portfolio under the investment and fiduciary advice of HighMark to include: (a) any funds available under an open architecture trading platform, (b) any combination of active and index funds in the pre-established portfolios, or (c) individual securities/bonds to reduce costs. This option gives the City full flexibility of its investments.

## Budget Advisory Committee Recommendation

At its April 16<sup>th</sup> meeting, the Budget Advisory Committee evaluated the City's risk tolerance and the various investment strategies offered by HighMark. The Committee also reviewed a draft Investment Guidelines Document reflecting a Conservative strategy. The Committee recommended a mixed strategy utilizing active and customized investment strategies (as described below). The Committee also recommended using a dollar-cost averaging method to invest funds at the beginning to reduce the impact from market fluctuations. To protect assets, funds will be invested over a 90-day period instead of investing all at once as it is difficult to predict the performance of the stock market. Based on the Committee's feedback and comments, the draft Investment Guidelines Document has been updated to reflect the recommended strategies, and the document is provided to Council for further input.

### Moderately Conservative Strategy

**For equity, use an "active" strategy**

**For fixed income, use a "customized" strategy**

## **FISCAL IMPACT**

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

## **CONCLUSION**

1. Staff recommends that the City Council approve the attached resolution to establish a Section 115 Pension Trust with PARS.
2. Staff also recommends that the City Council provide direction/comments regarding the draft Investment Guidelines Document after receiving a presentation from PARS and HighMark.

**PREPARED BY:** Susan Hsieh, Finance Director

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



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Carolyn Lehr, City Manager

## **ATTACHMENTS:**

1. Resolution
2. Administrative Services Agreement
3. Investment Portfolios
4. Draft Investment Guidelines Document