



City of Arts & Innovation

City Council Memorandum

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TO: HONORABLE MAYOR AND CITY COUNCIL DATE: NOVEMBER 19, 2019

FROM: FINANCE DEPARTMENT WARDS: ALL

SUBJECT: PROFESSIONAL CONSULTANT SERVICES AGREEMENT FOR RFP NO. 1944 SECTION 115 PENSION TRUST FUND ADMINISTRATION AND INVESTMENT MANAGEMENT SERVICES WITH PUBLIC AGENCY RETIREMENT SERVICES FOR AN AMOUNT NOT TO EXCEED \$275,000 PER YEAR FOR A THREE-YEAR TERM AND THE OPTION TO EXTEND FOR AN ADDITIONAL TWO-YEAR PERIOD AND RESOLUTION ADOPTING AND ESTABLISHING THE PUBLIC AGENCIES POST EMPLOYMENT BENEFITS TRUST ADMINISTRATION BY PUBLIC AGENCY RETIREMENT SERVICES

ISSUES:

Approve a Professional Consultant Services Agreement for Request for Proposal 1944 Section 115 Pension Trust Fund Administration and Investment Management Services with Phase II Systems, dba Public Agency Retirement Services, of Newport Beach, California, to include comprehensive administration, trustee, fiduciary investment management & advisory, compliance monitoring, and reporting services to prefund the City's pension obligations for an amount not to exceed \$275,000 per year for a three-year term and the option to extend for an additional two-year period; adopt a resolution adopting and establishing the public agencies post-employment benefits trust administration by Public Agency Retirement Services.

RECOMMENDATIONS:

That the City Council:

1. Approve a Professional Consultant Services Agreement for Request for Proposal 1944 Section 115 Pension Trust Fund Administration and Investment Management Services with Phase II Systems, dba Public Agency Retirement Services, of Newport Beach, California, to include comprehensive administration, trustee, fiduciary investment management & advisory, compliance monitoring, and reporting services to prefund the City's pension obligations for an amount not to exceed \$275,000 per year for a three-year term and the option to extend for an additional two-year period;
2. Adopt a resolution adopting and establishing the public agencies post-employment benefits trust administration by Public Agency Retirement Services;
3. Authorize the City Manager, or designee, to act as the City's Plan Administrator for the Trust Program; and
4. Authorize the City Manager, or designee, to execute the Professional Consultant Services

Agreement and the optional contract extension with Public Agencies Retirement Services to administer the Trust, including making minor and non-substantive changes.

BACKGROUND:

The City has two pension trusts with the California Public Employees’ Retirement System (CalPERS): one to fund public safety employees and one for miscellaneous employees. The trusts are funded by employer and employee contributions and by investment earnings on those contributions. In order to reach necessary funding levels to pay employee pensions, CalPERS establishes a set of actuarial assumptions to achieve those levels.

One of the most critical assumptions in attaining full funding goals is the rate of return on investments in the trusts. CalPERS’ current annual rate of return (ROR) assumption is 7%. Assuming this rate of return is attained, then funding of the pension obligations would be derived 66% from investment gains and 34% from contributions. If the 7% rate of return is not realized, then contributions from employers and employees will have to increase.

Unfortunately, this ROR has not been consistently achieved by CalPERS and the outlook from the investment community and actuaries for a 7% annual rate of return is increasingly pessimistic. In fact, the average actual rates of CalPERS returns in the table below have fallen below expectations in several time periods.

Total Fund Market Value & Total Net Investment Return 10-year Review (for FY end 6/30)		
FY	(in billions)	(%)
2018	\$ 354.0	8.6%
2017	\$ 326.4	11.2%
2016	\$ 302.0	0.6%
2015	\$ 301.9	2.4%
2014	\$ 300.3	18.4%
2013	\$ 257.9	13.2%
2012	\$ 233.4	0.1%
2011	\$ 237.5	21.7%
2010	\$ 200.0	13.3%
2009	\$ 180.9	-24.0%

As a consequence of the above performance; a long, low interest rate environment; and movement toward a more “risk averse” portfolio; the CalPERS board approved a plan to gradually reduce the assumed ROR from 7.5% to 7% over a three year period ending in July 2019.

CalPERS’ gradual decrease in the ROR assumption resulted in higher contribution rates for employers and employees. This compounded existing funding challenges since the two City trusts already are below the ideal level of 80% funded. The miscellaneous group stands at 77.9% and the public safety group stands at 71.5%. As the ROR decreased, these funding levels dropped placing the City further behind in meeting pension obligations.

Establishing a third-party irrevocable trust to pre-fund a portion of the City’s long-term financial pension obligation is a prudent step in addressing the City’s CalPERS challenge. Approval of a

Trust implements one of the strategies included in the Council Adopted Pension Funding Policy and is a recognized best practice that will help the City achieve greater financial sustainability. Recent assumption changes and modified amortization methods adopted by CalPERS have led to increases in employer contribution for all agencies participating in CalPERS. As a result, addressing rising pension costs is critical to the financial health and sustainability of the City.

DISCUSSION:

On August 6, 2019, the City Council approved a Pension Funding Policy for the purpose of deploying a variety of strategies to achieve the following objectives: reduce projected pension contributions to maintain services and, increase the funding ratio for both the City's Safety and Miscellaneous CalPERS plans. One of those strategies was to establish a Section 115 Pension Trust to realize greater investment returns than what is currently available through the City's cash pool investments.

The City issued Request for Proposal (RFP) 1944 for pension trust fund management services. Two (2) firms responded to RFP 1944. PFM Asset Management LLC and Public Agency Retirement Services (PARS). Both programs are compliant with Internal Revenue Code Section 115.

PARS, which was established in 1984 has been designing and administering retirement plan and trust solutions exclusively for public agencies for the past 34 years. They currently administer over 400 Section 115 plans, including 200 in California. PARS offers five investment strategies and asset management fees are based on the level of assets under management which is consistent with PFM's methodology. Contributions to the trust fund are strictly voluntary by the City and can be accessed at any time to pay for pension obligations. Fees are only charged when assets are added to the trust.

While both vendors provide excellent pension trust options for the City, staff recommends that Council engage PARS to provide these services. Primary drivers for this recommendation are lower asset management fees, established track record, and the size of the client base and assets under management with PARS.

Expected benefits offered by the PARS Section 115 Irrevocable Pension Trust include:

- Investment flexibility with Section 115 Trust compared to restrictions on general fund investments (Govt. Code 53216)
- Increased risk diversification of plan assets through different asset management Investments can be tailored to the City's unique demographics
- Oversight and control of fund management selection, monitoring of performance and ability to replace fund management based on performance criteria
- Increased flexibility on use of trust assets (i.e., trust assets can be accessed at any time as long as the assets are used to fund the City's pension obligations and defray reasonable expenses associated therewith)
- Potential for positive rating agency and investor consideration.

The Purchasing Manager concurs that the recommendations are in compliance with Purchasing Resolution No. 23256.

FISCAL IMPACT:

The City currently has \$4.5 million set-aside and would transfer this funding to the newly established trust. Fees resulting from managing the trust are embedded within the investment returns. There are no other costs associated with this action.

Prepared by: Edward Enriquez, Chief Financial Officer/City Treasurer
Certified as to
availability of funds: Marie Ricci, Assistant Chief Financial Officer
Approved by: Carlie Myers, Deputy City Manager
Approved as to form: Gary G. Geuss, City Attorney

Attachments:

1. RFP Award Recommendation
2. Professional Consultant Services Agreement with Public Agency Retirement Services
3. Resolution Adopting and Establishing the public agencies post-employment benefits trust administration by Public Agency Retirement Services