



FINANCE DIVISION

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AUDIT COMMITTEE STAFF REPORT

Meeting: July 17, 2018

Subject

Approve the selection of Public Agency Retirement Services (PARS) as the third-party administrator of the City's Public Agencies Post-Employment Benefits Section 115 Trust.

Recommended Action

Approve the selection of Public Agency Retirement Services (PARS) as the third-party administrator of the City's Public Agencies Post-Employment Benefits Section 115 Trust.

Discussion

Summary

As a result of the significant increase in retirement costs based on the most recent actuarial forecast, the City elects to establish and fund a secondary pension trust (Section 115 Trust) to assist in stabilizing the potential impact of pension cost volatility on the City's operating budget. On May 15, 2018, City Council voted to adopt a Section 115 Trust administered by a third-party administrator to be selected by the City's Audit Committee. In addition, on June 5, 2018, City Council approved increasing the CalPERS Reserve to \$8 million to fund future pension costs.

Background

Pension Rate Stabilization Program

A Section 115 Trust is a tax-exempt investment tool that allows local governments to pre-fund pension and retiree health costs. Once contributions are placed into the trust, assets from the trust can only be used for retirement plan purposes. Withdrawals may be made to either reimburse the City for retirement system contributions or to directly pay CalPERS.

The benefits of a Section 115 Trust include the following:

- **Local control over assets:** The City controls the contributions, withdrawals, investment strategy, and risk level of assets in the Trust.
- **Pension rate stabilization:** Assets can be transferred to CalPERS at the City's discretion to pay for Normal Cost or UAL contributions, and can be used to reduce or eliminate large fluctuations in the City's pension costs.

- **Potential for higher investment returns than General Fund:** Investment requirements that apply to the City's General Fund assets under Government Code 53601 are not applicable to Trust assets.
- **Diversification:** Trust assets will be diversified from CalPERS investments.

Trust Administrator

Staff has received proposals from PARS and PFM for Section 115 Trust Pension Rate Stabilization Programs (PRSP). Both PARS and PFM offer multiple employer trusts so that agencies regardless of size can join the program to receive economies of scale. Both PARS and PFM have experience administering Section 115 Pension Trusts and have received Private Letter Rulings (PLR) from the Internal Revenue Service (IRS) guaranteeing tax-exempt status for investments in the Trust. A comparison of the two firms is provided below:

	PARS	PFM
Founded	1984	1975
Headquarters	Newport Beach	Philadelphia
Office Locations in California	Newport Beach	San Francisco and Los Angeles
Core Business	Administration of retirement programs (e.g. Pension and OPEB trusts) for public agencies	Asset Management, Financial Advisory, and Consulting
IRS Private Letter Ruling	Yes; Multiple employer trust	Yes; Multiple employer trust
Assets Under Management	PARS: \$2.8 billion U.S. Bank: \$4 trillion	Discretionary Multi-Asset Class Management: \$10.9 billion as of December 31, 2017
Trust Administrator	PARS	PFM
Investment Manager	U.S. Bank	PFM Asset Management
Trustee/Custodian	U.S. Bank	Wells Fargo (Multiple employer trust)
Pension Section 115 Trusts Under Administration	135 (such as Palo Alto, Los Gatos, Santa Clara, and Redwood City)	28 (such as Santa Cruz and Chino Valley Fire)
Investment Options	4 risk-tolerance options (actively managed or low-cost index/ETF portfolios) and customized option	Customized to client
Annual Fees (assuming assets of \$8 million in Pension Section 115 Trust)	PARS: \$12,000 (0.15% for assets \$15-50 million *) U.S. Bank: \$12,000 (0.15% for assets \$20-50 million *) * PARS administers the City's OPEB Trust and considers the total value of Pension and OPEB assets when calculating fees	Investment: \$36,000 (0.45% for assets \$0-10 million) Custody: \$6,000 Transaction fee: \$8 per trade
Minimums	No minimum contribution; No startup fee; No minimum fee; No trade or transaction fees	No minimum contribution; No startup fee; Minimum annual fee: \$20,000; Transaction fee: \$8 per trade

PARS offers four portfolios: Growth, Balanced, Income, and Conservative Income, in addition to a customized portfolio option. PFM portfolios are customized for each client, so historical returns are a composite of all institutional multi-asset class portfolios with the same equity allocation target. Historical returns on a selection of PARS and composite PFM portfolios, as of December 31, 2017, are provided below:

	Equity (%)	1 Year	3 Years	5 Years
PARS (Investment Manager: U.S. Bank)				
Growth	77%	20.56%	8.48%	8.51%
Balanced	62%	18.48%	6.99%	7.14%
Income	47%	15.19%	6.10%	-
Conservative Income	23%	8.04%	3.57%	3.65%
PFM (Investment Manager: PFM Asset Management)				
PFM's Multi-Asset Class 75:25 Composite	75%	18.59%	8.63%	10.08%
PFM's Multi-Asset Class 60:40 Composite	60%	15.25%	7.10%	8.56%
PFM's Multi-Asset Class 50:50 Composite	50%	13.77%	6.66%	7.75%
PFM's Multi-Asset Class 20:80 Composite	20%	8.20%	4.42%	4.88%

Note. Past performance is not indicative of future results. PARS returns are gross of fund-level fees and net of investment management fees. PFM returns are gross of management fees, custodial fees, and taxes, but after brokerage and transaction fees.

Staff recommends the selection of PARS as the Trust Administrator for the following reasons:

- PARS administers the most widely adopted Section 115 Trust PRSP with over 135 client agencies in California.
- PARS offers multiple investment strategies and portfolios for the Trust, providing the City with control over the risk tolerance of its investments.
- PARS charges a lower fee than PFM. PARS currently administers the City's OPEB Trust, so Pension and OPEB assets would be aggregated for fee purposes, allowing the City to access lower fee tiers. Assuming assets of \$8 million, annual fees with PARS would be \$24,000 while annual fees with PFM would be \$42,000.
- PARS does not charge minimum annual fees while PFM requires a minimum annual fee of \$20,000.
- PARS' core business is administering supplemental retirement programs for public agencies.

The City has an existing trust with PARS to fund its retiree health benefits, also known as Other Post-Employment Benefits (OPEB). The adoption of a Pension Trust administered by PARS will require replacing the City's existing OPEB Trust with a new trust that will have two accounts. One account will hold the City's Pension assets and the other account will hold the City's OPEB

assets. The two accounts will be aggregated for fee purposes, but the City will be able to select different investment strategies for the Pension and OPEB accounts.

Investment Strategy

The Audit Committee will select the investment strategy for the Trust and assets will be invested in accordance with the Audit Committee's selections.

Sustainability Impact

None.

Fiscal Impact

Selecting a third-party administrator for the Section 115 Trust has no direct fiscal impact at this time. Any contributions to the Trust will be subject to the approval of City Council.

The City will pay fees for trust administration and investment management. The fees will depend on the Trust Administrator selected and the total value of assets in the Trust. The fees will be deducted from Trust assets.

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