

OAKLEY



CALIFORNIA

STAFF REPORT

Date: June 27, 2017
To: Bryan H. Montgomery, City Manager
From: Deborah Sultan, Finance Director

Approved and Forwarded to the City Council:


Bryan Montgomery, City Manager

SUBJECT: Approve Resolution authorizing participation in the Public Agencies Post-Employment Benefits Trust Program to be administered by Public Agency Retirement Services ("PARS") with U.S. Bank as trustee and authorizing the City Manager to negotiate, execute and administer documents to implement the program.

Background and Analysis

The City of Oakley has pension trusts with the California Public Employee's Retirement System ("PERS"); to public safety employees and for general 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, PERS establishes a set of actuarial assumptions to achieve those levels.

In 2012, the Government Accounting Standards Board ("GASB") issued Statement No. 68, Accounting and Financial Reporting for Pensions. GASB 68 requires that governmental employers that sponsor defined benefit plans (e.g., PERS) must recognize a net pension liability, also known as an unfunded actuarial accrued liability ("UAAL") on their balance sheet. This is the difference between the City's total pension liabilities and actual plan assets. The City of Oakley's Net Pension Liability as of June 30, 2016 is \$1,380,410 up from \$1,102,233 from 2015.

PERS has significantly changed the methodology for calculating the City's Annual Required Contributions (ARC) in regards to amortizing the UAAL. Until recently the City's only option for reducing the UAAL was to commit additional funds to PERS. Unfortunately, these additional funds would be subject to the same market volatility risk as the PERS investment policy target of 7.5% and are not accessible to the City for other PERS pension expenses.

A recent private letter ruling received from the IRS established that public agencies or municipalities could create a separate trust to "pre-fund" its PERS unfunded liability. This would provide an alternative to sending funds to PERS that will provide for greater local control over assets and portfolio management.

During FY 2017-2018 budget adoption, the City Council approved that \$200,000 be set aside for the pension liabilities. Staff recommends establishing a Section 115 irrevocable trust with PARS to place these funds. By proactively establishing a 115 Trust, the City will prefund pension costs and begin to address GASB 68 Net Pension Liabilities.

The Trust provides attractive benefits and is desirable for the City to pre-fund its unfunded pension obligations including:

- Local Control over Assets – The trust can be accessed at any time so long as it is used to pay the employer's pension obligation.
- Pension Rate Stabilization – Assets can be transferred to PERS plan at the City's discretion which would reduce or eliminate large fluctuations in Employer contributions to PERS.
- Investment Flexibility – Investment restrictions that apply to the City funds under Government Code 53601 are not applicable to assets held in an irrevocable Section 115 trust. The City maintains oversight of the investment manager and the portfolio's risk tolerance level and the investments can be diversified and invested in a prudent fashion.
- Potential Credit Ratings – Rating agencies may look favorably upon actions to reduce liabilities.

It is important to note that any funds deposited in the trust fund may only be used for pension costs and cannot be recaptured for other uses. However, use of funds may reduce reliance on existing unrestricted funds, freeing those moneys for other uses.

While funds deposited into the Trust has to the potential to reduce net pension costs, actual earning on those funds will most likely not approximate the carrying cost of the unfunded liabilities at PERS (unless riskier investments are selected in an attempt to achieve high returns). The discount rate has the effect of being the interest rate charged by PERS on any unfunded liabilities. As a result, the City is, in essence, currently paying 7.5% interest on the unfunded liabilities.

Recently PERS board has approved a plan to reduce the discount rate from 7.5% to 7.0% over a three year period. The rate will decrease as follows: In July 2017, 7.375%; in July 2018 to 7.25%; and in July 2019 to 7.0%.

PERS gradual decrease in the discount rate will result in higher contribution rates for employers and employees. This will create funding challenges since the two City trusts are currently at or above the ideal level of 80% funded. As the discount rate decreases, these funding levels will drop, placing the City behind in meeting pension obligations

It does appear appropriate at this time to mention in the financial statements that the Trust could be counted as an offset to the City's pension obligation, but for GASB 68 reporting purposes, it will not reduce the net pension liability per the GASB 2017 Implementation Guide.

The action requested today will authorize participation in the pension stabilization trust administered by PARS and will authorize the City Manager to negotiate and execute the documents to implement the program.

Public Agency Retirement Services (PARS)

Section 115 Irrevocable Trusts have been in existence for many years. In the past several years, they have been adopted as a mechanism for pre-funding public agencies OPEB liabilities. Most recently, they have become a popular tool for pre-funding pension liabilities as a method to address unfunded liabilities and large variances in annual pension contributions. In an effort to help public agencies address and manage their GASB 68 liability, PARS has developed the PARS Post-Employment Benefits Trust Program. PARS provides the City with the necessary services required under one program to pre-fund pension and retiree health care liabilities through an IRS reviewed program. The program has been established as a multiple employer trust so that public agencies regardless of size can join the program to receive the necessary economies of scale to keep administrative fees low and avoid any setup costs. PARS has partnered with US Bank to serve as trustee and its sub-adviser HighMark Capital Management, Inc., to provide investment management services for the program. To date, 82 California public agencies have adopted the Pension Rate Stabilization Program through PARS including 34 cities.

Most importantly, PARS provides full services to administer the City's Section 115 Trust Program with a dedicated Senior Consultant to ensure client satisfaction; a Client Services Coordinator to monitor contributions, process disbursements and coordinate annual reviews; and an Investment Management Team to assist with developing an Investment Policy Statement and conduct periodic onsite review of investment performance and market conditions.

PARS's Section 115 Trust Program has five investment portfolios: Capital Appreciation, Balanced, Moderate, Moderately Conservative and Conservative. Each portfolio has different risk profiles with different amounts invested in equities and other investments. The investment portfolios range from "Capital Appreciation" with 72% of funds invested in equities to "Conservative" with 15% of funds invested in equities. It is important to note that as the amount of equities increases, risk and volatility increases. In contrast, as the amount of equities decreases, risk and volatility decreases.

A majority of public agencies participating in PARS's Section 115 Trust have selected "Moderately Conservative" portfolio which is the second most conservative portfolio with 30% of funds invested in equities. Returns as of March 31, 2017 in the "Moderately Conservative" portfolio were as follows:

1-Year Returns	6.44%
3-Year Returns	3.64%
5-Year Returns	4.85%

Staff recommends that the City Council assign responsibility and authority to the City Manager and Finance Director to develop an investment policy for the trust and direct investment decisions for the fund. Staff will work with PARS and HighMark Capital Management to create the policy which will then be brought to Council for consideration and adoption at a future meeting.

Fiscal Impact

Establishing the Trust has no direct fiscal impact. Funding the Trust will have a cash impact as funds will be drawn from City funds and transferred to the irrevocable trust

account. As part of the FY 17/18 budget adoption process, Council approved \$200,000 for pre-funding Pension Obligations. Additional future contributions can be directed by the City Council, and may include year-end surpluses and other one-time receipts.

Total combined administrative, trustee and investment management fees for PARS, U.S. Bank and HighMark Capital Management start at 0.60% for assets under \$5 million. The fees will be paid from the Trust assets.

Recommendation and Alternatives

Staff recommends the City Council: 1) approve the Resolution establishing a Pension Rate Stabilization Trust Fund administered by Public Agency Retirement Services ("PARS"); 2) appoint the City Manager as the City's Plan Administrator; and 3) authorize the City manager to negotiate and execute the documents to implement the program.

Attachments

1) Resolution

RESOLUTION NO. __-17

**A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF OAKLEY
APPROVING THE ADOPTION OF THE PUBLIC AGENCIES POST-EMPLOYMENT
TRUST ADMINISTERED BY PUBLIC AGENCY RETIREMENT SERVICES (PARS)**

WHEREAS, PARS has made available the PARS Public Agencies Post-Employment Benefits Trust (the"Program") for the purpose of pre-funding pension obligations and/or OPEB obligations: and

WHEREAS, the City is eligible to participate in the Program, a tax-exempt trust performing an essential governmental function with the meaning of Section 115 of the Internal Revenue Code, as amended and the Regulations issued there under, and is a tax-exempt trust under the relevant statutory provisions of the State of California; and

WHEREAS, the City's adoption and operation of the Program has no effect on any current or former employee's entitlement to post-employment benefits and;

WHEREAS, the terms and conditions of post-employment benefit entitlement, in any, are governed by contracts separate from and independent of the Program; and

WHEREAS, the City's funding of the Program does not, and it not intended to, create any new vested right to any benefit or strengthen and existing vested right; and

WHEREAS, The City reserves the right to make contributions, if any, to the Program.

NOW, THEREFORE, BE IT RESOLVED THAT:

1. The City Council hereby adopts the PARS Public Agencies Post-Employments Trust, effective July 1, 2017; and
2. The City Council hereby appoints the City Manager, or his/her successor or his/her designee as the City's Plan Administrator for the Program; and
3. The City's Plan Administrator is hereby authorized to execute the PARS legal and administrative documents on behalf of the City and to take whatever additional actions are necessary to maintain the City's participation in the program and to maintain compliance of any relevant regulation issued or as may be issued; therefore, authorizing him/her to take whatever additional actions are required to administer the City's Program.

PASSED AND ADOPTED this 27th day of July by the City Council of the City of Oakley by the following vote:

AYES:

NOES:

Resolution No. _____

ABSTENTIONS:

ABSENT:

APPROVED:

Sue Higgins, Mayor

ATTEST:

Libby Vreonis, City Clerk

Date