



City of Sunnyvale

Agenda Item-No Attachments (PDF)

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REPORT TO COUNCIL

SUBJECT

Review and File the City of Sunnyvale Other Post-Employment (OPEB) Trust Account Investment Summary and Approve the Investment Policy Statement as Amended and Presented

BACKGROUND

The City of Sunnyvale provides healthcare benefits to eligible retirees and their dependents through the California Public Employee's Retirement System (CalPERS) healthcare program (PEMHCA). Benefits including Other Post-Employment Benefits are established through agreements and memoranda of understanding between the City and bargaining units or salary resolution for unrepresented employees as approved by the City Council.

To implement a funding plan to address the unfunded liability associated with retiree medical benefits, the City created an Other Post-Employment Benefits (OPEB) Trust. By contributing to a retiree medical trust fund, the City will derive many benefits, including the reduction of future employer OPEB costs, as the earnings generated from trust fund investments will eventually be utilized to offset ongoing costs for the retiree medical insurance.

On July 20, 2010, Council approved the City entering into an Investment Advisory Agreement with PFM Asset Management, LLC (PFM) as investment manager for the City's OPEB Trust (RTC No. 10-187). On December 7, 2010, Council approved the City entering into a Trust Agreement with PFM as Trust Administrator and U.S. National Bank Association as Trustee for the OPEB Trust (RTC No. 10-326). The Investment Policy Statement for the OPEB Trust was also approved at that time.

On February 25, 2014, Council amended the Investment Policy Statement for the OPEB Trust (RTC No. 14-0048) based on PFM recommendations to 1) clarify language applicable to each asset class with the objective to take advantage of market opportunity while maintaining a broadly diversified portfolio and 2) make the Investment Policy Statement consistent with current investment language.

On June 20, 2017, Council amended the 2017 Priority Advocacy Issues to support legislation to limit or eliminate direct or indirect investment of public funds to support the production or drilling of fossil fuels.

EXISTING POLICY

Council Policy 7.1.1 Fiscal - Long Range Goals and Financial Policies

Policy E.2.6: An Actuarial Retiree Medical Reserve will be maintained at a level that is deemed adequate to meet the projected liabilities as determined by an actuarial evaluation. This reserve should meet the GASB reporting requirements for these future costs.

ENVIRONMENTAL REVIEW

The action being considered does not require environmental review under the California Environmental Quality Act (CEQA) because it is a fiscal activity that will not result in any direct or indirect physical changes to the environment. (CEQA Guidelines Section 15378(b)(4)).

DISCUSSION

PFM has managed the investments for the OPEB Trust since January 2011. Since then, the City has deposited a total of \$59,522,882. The market value of the trust as of June 30, 2017 was \$83,044,059, which includes earnings (net of fees) of \$13,323,402.

The performance of the trust is measured against a benchmark that is comprised of a blend of the individual benchmarks used throughout the fund. Both the individual benchmarks and the blended benchmark help staff and PFM monitor the performance of the fund against the market.

The fund consists of five different asset classes, Domestic Equities, International Equities, Alternative investments, Fixed Income investments, and Cash Equivalent investments. Each of the categories is governed by an asset allocation range. For example, the range for Domestic Equities is 25%-45% of the fund. Each category also carries a Target Allocation, which are shifted to be more conservative as the fund matures.

The attached performance summary shows the allocation of assets, growth, and the performance of the fund. The trust has historically out-performed the benchmark. As of June 30, 2017, the fund earned 7.3% since inception compared to the benchmark of 6.58%.

The Investment Policy for the trust guides how PFM manages the fund, and how City staff measures PFM's performance as the fund manager. PFM is recommending changes to the investment policy for the fund to 1) clarify the role of PFM, 2) amend the investment guidelines to include definitions for asset classes, 3) revise target asset range and targets, 4) amend the criteria for selection of investment managers, 5) clarify the use of specific asset allocations, and 6) revise the benchmarks used for the review of investment performance.

Specifically, PFM is clarifying that they will adjust asset allocations for the Trust subject to the guidelines and limitations set forth in the Investment Policy Statement, select investment managers and strategies consistent with its role as a fiduciary, monitor and review managers and measure their performance against peers, and execute other tasks deemed appropriate as the advisor for the Trust.

Additional language has been included clarify various investment instrument concepts. These concepts are growth assets, income assets, and real return assets. Specifics in each asset category are provided to bring clarity to the risk and return characteristics of each asset class.

Target asset ranges for domestic equities are proposed to increase from 25%-45% to 29%-49% with a target weighting of 39%. Target asset ranges for international equities are proposed to expand from 9%-29% to 1%-41% with a target weighting of 21%. Asset classes formerly defined as Alternatives have been recategorized into Other Growth Assets and Other Income Assets with a target range of 0%-20% and a target weighting of 0%. Fixed income ranges are revised from a range of 26%-66% to 20%-60% with a target weighting of 40% of the portfolio. These changes are consistent with the current asset allocation of the portfolio and the City's intention to target 60% growth assets and 40% fixed income assets.

The investment manager criteria have been amended to include a minimum of three years of

experience for investment professionals making investment decisions. A minimum years of experience requirement was not included in the prior Investment Policy Statement.

Asset classes previously defined as Alternatives included real estate and inflation hedges. This asset category has been redefined as Other Assets and can include both growth and fixed income assets. These include non-traditional investments such as real estate, private equity, and commodities. Prior to addition of any of these investments, except publicly traded mutual fund vehicles, PFM shall receive approval from the City'.

Lastly, the clarification of the benchmarks used to review the investment performance of the Trust is included in the Investment Policy Statement.

In addition, based on the June 20, 2017 Council direction regarding fossil fuel divestments, language similar to that adopted by the City and County of San Francisco has been included. This amendment includes language the goal to limit or eliminate direct or indirect investment of public funds related to the production or drilling of fossil fuels as well as other social and environmental goals.

These changes update the OPEB Investment Policy Statement to bring it current. Staff is recommending that the City Council review and file the Investment Policy Statement. Staff will continue to provide annual updates on the performance of the trust, as well as update Council during the Fiscal Outlook presentation at the Study/Budget Issues workshop and again at the Recommended Budget Workshop each year.

FISCAL IMPACT

With the OPEB Trust, the City has made significant progress in funding retiree medical costs for the long term. At the end of FY 2015/16, (the date of the City's last actuarial valuation) the retiree medical plan is 55% funded and projected to be 95% funded by FY 2035/36.

With the proposed changes in the Investment Policy Statement to reflect socially and environmentally responsible investments, changes to the fund performance may occur dependent on how these types of investments perform in the market versus more a more traditional investment approach.

PUBLIC CONTACT

Public contact was made by posting the Council agenda on the City's official-notice bulletin board outside City Hall, at the Sunnyvale Senior Center, Community Center and Department of Public Safety; and by making the agenda and report available at the Sunnyvale Public Library, the Office of the City Clerk and on the City's website.

RECOMMENDATION

Find that the action does not require environmental review pursuant to California Environmental Quality Act Guidelines Section 15378(b)(4), and review and file the City of Sunnyvale Other Post-Employment (OPEB) Trust Account Investment Summary and approve the Investment Policy Statement as amended and presented in Attachment 2 to the report.

Prepared by: Kenn Lee, Assistant Director of Finance
Reviewed by: Timothy J. Kirby, Director, Finance Department
Reviewed by: Walter C. Rossmann, Assistant City Manager
Approved by: Kent Steffens, Interim City Manager

ATTACHMENTS

1. City of Sunnyvale OPEB Trust 2017 2Q Summary
2. Investment Policy Statement for City of Sunnyvale OPEB Trust