



Agenda Item No. 9c.

Staff Report

Date: June 13, 2019

To: Mayor Kuhl and Councilmembers

From: Joe Chinn, Town Manager

Subject: Approval of Investment Selection for Town's PARS Public Agencies Post-Employment Benefits Trust

Recommendation

Town Council approve the recommendation of the Finance Committee that the Town investment into the Town's Public Agency Retirement Services (PARS) Public Agencies Post-Employment Benefits Section 115 Trust utilize the moderate model portfolio that is passively managed (passively managed in use of index funds versus actively selecting mutual funds to attempt to match or beat the benchmark model).

Background and Discussion

Pension rates have been and are anticipated to continue to increase at much higher rates than the inflation rate moving forward. The Town has been aggressive in paying down the Town's CalPERS pension unfunded accrued liability (UAL) to reduce long-term costs of CalPERS and thus improving the Town's long term financial condition as discussed in the attached March 14, 2019, staff report.

On March 14, 2019, the Town Council approved Resolution No. 2095 establishing a Public Agencies Post-Employment Benefits Section 115 Trust administered by PARS to prefund long-term pension obligations and make an initial contribution of \$200,000. This step assists in diversifying our pension unfunded liability strategy and stabilizing the unfunded pension liability to offset future long-term pension obligations. The PARS Pension Rate Stabilization Program (PRSP) is a Section 115 irrevocable trust designed for agencies to prefund rising pension costs and address pension liabilities. This program can mitigate long-term pension investment and rate volatility, while at the same time providing employers with greater local control of assets and investment flexibility to create a more actuarially sound retirement system.

On May 10, 2019, the Finance Committee met to review the five model portfolios that are available for the PARS Section 115 Trust. The five model portfolios are capital appreciation,

balanced, moderate, moderately conservative, and conservative. Each of the portfolios has a different mix of investments to match the investment philosophy of the portfolio. There are five model portfolios to choose from, each with a choice of utilizing either active or passive management. Randall Yurchak, Portfolio Manager with Highmark Capital Management, attended the meeting to provide information and guide the Finance Committee and staff through the decision process. Highmark Capital Management provides investment policy assistance, annual onsite reviews and takes on fiduciary responsibility for the asset management of these funds.

The review and discussion of the selection of the investment included factors such as our risk tolerance, investment philosophy, expected timing on the use of funds, and investment expectations. Information related to the meeting included information for each of the different portfolios. Based on the Town's having a longer-time horizon before needing any of the funds to fund pensions, the desire to generate a reasonable level of growth, and have a moderate level of risk tolerance, the Finance Committee selected the moderate portfolio that is passively managed (passively managed using index funds versus actively using a mix of funds that attempt to beat the index). The moderate portfolio is in the middle of the five portfolio types as far as risk and return expectations. The moderate portfolio has an allocation range of 40% to 60% equities and 40% to 60% fixed income. Currently, the portfolio mix is 51% equity, 46% fixed income, and 3% cash.

Fiscal, resource and timeline impacts

The Town has been aggressive in paying down pension liabilities in recent years. The Town has budgeted an additional \$200,000 in Fiscal Year 2018-19 to further reduce pension liabilities. The \$200,000 budgeted for this year will be our initial funding to the Town Section 115 Trust by June 30. The draft FY 2019-20 budget also includes \$200,000 to continue to fund the Section 115 Trust.

Alternative actions

Town Council could select a different investment alternative than the one selected.

Environmental review (if applicable)

N/A

Attachments

1. March 14, 2019 Staff Report with Resolution No. 2095
2. Moderate portfolio investment description and past returns

ATTACHMENT 1



Agenda Item No. 16.

Staff Report

Date: March 14, 2019

To: Mayor Kuhl and Councilmembers

From: Joe Chinn, Town Manager

Subject: Approving the Establishment of a Public Agencies Post-Employment Benefits Section 115 Trust Administered by PARS to Prefund Long-Term Pension Obligations

Recommendation

Town staff recommends that the Town Council adopt Resolution No. 2095 approving the establishment of a Public Agencies Post-Employment Benefits Section 115 Trust Administered by Public Agency Retirement Services (PARS) to prefund long-term pension obligations and make an initial contribution of \$200,000.

Background and Discussion

Pension rates have been and are anticipated to continue to increase at much higher rates than the inflation rate moving forward. The Town has been aggressive in paying down the Town's CalPERS pension unfunded accrued liability (UAL) to reduce long-term costs of CalPERS and thus improving the Town's long term financial condition. The Town has taken numerous steps to reduce total CalPERS pension costs such as:

- In June 2016, the Town made an additional \$1 million payment to CalPERS to reduce our UAL debt that saved the Town \$1.2 million of interest costs
- Paid an additional \$200,000 down in FYE17 (with a net savings of over \$200,000)
- Paid an additional \$820,000 to CalPERS in FYE18 that saved the Town approximately \$720,000 of interest costs over 20 years.
- Town has also reduced the amortization schedules for PERS costs from 30 years to 20 years, which results in higher costs in the short run but much lower total costs due to significantly less interest paid in the long run.
- Police personnel are paying a 3% portion of the employer share of CalPERS reducing the Town's costs.
- Budgeted an additional \$200,000 UAL payment this fiscal year to further reduce our pension liability.

The next step in diversifying our pension unfunded liability strategy and stabilizing the unfunded pension liability is to establish and annually fund a pension trust designed to offset future long-term pension obligations.

The PARS Pension Rate Stabilization Program (PRSP) is a Section 115 irrevocable trust designed for agencies to prefund rising pension costs and address pension liabilities. This program can mitigate long-term pension investment and rate volatility, while at the same time providing employers with greater local control of assets and investment flexibility to create a more actuarially sound retirement system.

The PARS PRSP trust offers the following benefits:

- Participating agencies maintain oversight of investment management and control over the risk tolerance level of the portfolio.
- PARS Trust allows for greater investment flexibility and risk diversification compared to agency's general fund investments.
- Assets can be accessed to offset unexpected rate increases (rate stabilization) or be used as a rainy-day fund during periods when revenues are impaired based on economic or other conditions.
- Potential to improve an agency's bond rating.
- Addresses pension liabilities for GASB 68 reporting.
- Flexibility to access trust assets at any time to pay employer's pension obligation.
- Acts as a reserve fund to help the Town pay for increasing annual contribution amounts.

The Town has budgeted \$200,000 in the current FYE19 budget for additional paydown of the Town pension liability as well as continuing to pay an additional \$200,000 each year in the future to reduce the long-term annual interest charged and thus total CalPERS long-term costs. At this time, staff is recommending utilization of a Section 115 Trust as a strategy option to diversify and reduce long-term pension debt versus continuing to paydown directly to CalPERS. The Town's pension plans are currently funded at a significantly higher rate than the overall CalPERS pools, which is an additional reason to diversify to a Section 115 trust at this time.

The Finance Committee of Councilmembers Brekhus and McMillan heard a presentation from PARS representatives and recommended that staff bring forward an item to the Town Council to consider establishing a Section 115 trust administered by PARS.

The PARS program consists of a team of PARS as the plan administrator, U.S. Bank as trustee and custodian, and Highmark Capital Management as investment advisor. PARS provides the security of a Private Letter Ruling from the IRS for Section 115 Trusts that assures participants the tax-exempt status of their investments. In addition, PARS offers irrevocable trust plans for both pension and OPEB obligations. The Town has an existing established Section 115 OPEB Trust for the funding of retiree medical benefits with CalPERS California Employers' Retiree Benefit Trust (CERBT). In the future, the Town has the option to transfer the funds from our CERBT Section 115 Trust to the PARS Section 115 Trust for OPEB retiree medical benefits.

Any contributions made to the program would be held by US Bank, as trustee. The Trustee's duties include:

1. Safeguarding assets for the benefit of retirees;
2. Providing oversight protection of the investments;
3. Acting as custodian of the assets; and
4. Disbursing funds to pay for pension costs and healthcare premiums.

Highmark Capital Management provides investment policy assistance, annual onsite reviews and takes on fiduciary responsibility for the asset management of these funds. They have a number of different investment strategies designed for public entities.

Fiscal, resource and timeline impacts

The Town has been aggressive in paying down pension liabilities in recent years as noted above. CalPERS projects that the Town unfunded liability on June 30, 2018 is \$3.4 million. The Town has budgeted an additional \$200,000 in Fiscal Year 2018-19 to further reduce pension liabilities. The budget anticipated that the Town would either make a direct payment to CalPERS or fund a Section 115 trust. At this time, Town staff is recommending we diversify our pension reduction strategy by funding a Section 115 trust with the \$200,000.

There is no setup cost associated with establishing the Section 115 Pension Trust through PARS. Therefore, there is no direct fiscal impact associated with proceeding with the Section 115 Pension Trust. For future years, funding the new trust will have a fiscal impact that will be part of the town's annual budget process.

Alternative actions

Council could choose not to approve the resolution or modify the recommendation to prefund the Town long-term pension obligation.

Environmental review (if applicable)

N/A

Attachments

1. Resolution No. 2095
2. Private Ruling letter
3. Draft Agreement

TOWN OF ROSS

RESOLUTION NO. 2095

A RESOLUTION OF THE TOWN COUNCIL OF THE TOWN OF ROSS APPROVING THE ADOPTION OF THE PUBLIC AGENCIES POST-EMPLOYMENT BENEFITS 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 Town of Ross ("Town") is eligible to participate in the Program, a tax-exempt trust performing an essential governmental function within 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 Town'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, if any, are governed by contracts separate from and independent of the Program; and

WHEREAS, the Town's funding of the Program does not, and is not intended to, create any new vested right to any benefit nor strengthen any existing vested right; and

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

NOW THEREFORE BE IT RESOLVED, by the Town Council of the Town of Ross that:

1. The Town Council hereby adopts the PARS Public Agencies Post-Employment Benefits Trust, effective March 14, 2019; and
2. The Town Council hereby appoints the Town Manager or his/her designee as the Town's Plan Administrator for the Program; and
3. The Town's Plan Administrator is hereby authorized to execute the PARS legal and administrative documents on behalf of the Town and to take whatever additional actions are necessary to maintain the Town's participation in the Program and to maintain compliance with any relevant regulation issued or as may be issued; therefore, authorizing him/her to take whatever additional actions are required to administer the Town's Program.

The foregoing resolution was duly adopted by the Ross Town Council at its regular meeting held on the 14th of March 2019, by the following vote:

AYES: Council Members Kuhl, Brekhus, McMillan, Robbins, Russell

NOES:

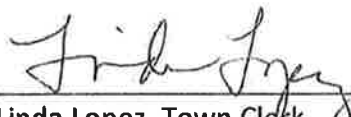
ABSENT:

ABSTAIN:



P. Beach Kuhl, Mayor

ATTEST:



Linda Lopez, Town Clerk

ATTACHMENT 2

PARS DIVERSIFIED PORTFOLIOS MODERATE

Q1 2019

WHY THE PARS DIVERSIFIED MODERATE PORTFOLIO?

Comprehensive Investment Solution

HighMark® Capital Management, Inc.'s (HighMark) diversified investment portfolios are designed to balance return expectations with risk tolerance. Key features include: sophisticated asset allocation and optimization techniques, four layers of diversification (asset class, style, manager, and security), access to rigorously screened, top tier money managers, flexible investment options, and experienced investment management.

Rigorous Manager Due Diligence

Our manager review committee utilizes a rigorous screening process that searches for investment managers and styles that have not only produced above-average returns within acceptable risk parameters, but have the resources and commitment to continue to deliver these results. We have set high standards for our investment managers and funds. This is a highly specialized, time consuming approach dedicated to one goal: competitive and consistent performance.

Flexible Investment Options

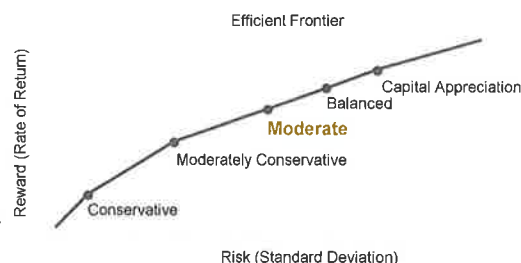
In order to meet the unique needs of our clients, we offer access to flexible implementation strategies: HighMark Plus utilizes actively managed mutual funds while Index Plus utilizes index-based securities, including exchange-traded funds. Both investment options leverage HighMark's active asset allocation approach.

Risk Management

The portfolio is constructed to control risk through four layers of diversification – asset classes (cash, fixed income, equity), investment styles (large cap, small cap, international, value, growth), managers and securities. Disciplined mutual fund selection and monitoring process helps to drive return potential while reducing portfolio risk.

INVESTMENT OBJECTIVE

To provide current income and moderate capital appreciation. It is expected that dividend and interest income will comprise a significant portion of total return, although growth through capital appreciation is equally important.



ASSET ALLOCATION — MODERATE PORTFOLIO

	Strategic Range	Policy	Tactical
Equity	40 - 60%	50%	51%
Fixed Income	40 - 60%	45%	46%
Cash	0 - 20%	5%	3%

ANNUALIZED TOTAL RETURNS (Gross of Investment Management Fees, but Net of Embedded Fund Fees)

HighMark Plus Composite (Active)

Current Quarter*	8.24%
Blended Benchmark*, **	7.94%
Year To Date*	8.24%
Blended Benchmark*, **	7.94%
1 Year	4.64%
Blended Benchmark**	5.18%
3 Year	7.53%
Blended Benchmark**	7.13%
5 Year	5.33%
Blended Benchmark**	5.62%
10 Year	9.09%
Blended Benchmark**	8.80%

Index Plus Composite (Passive)

Current Quarter*	8.17%
Blended Benchmark*, **	7.94%
Year To Date*	8.17%
Blended Benchmark*, **	7.94%
1 Year	4.88%
Blended Benchmark**	5.18%
3 Year	6.91%
Blended Benchmark**	7.13%
5 Year	5.20%
Blended Benchmark**	5.62%
10 Year	8.85%
Blended Benchmark**	8.80%

* Returns less than one year are not annualized. **Breakdown for Blended Benchmark: From 10/1/2012 – Present: 26.5% S&P500, 5% Russell Mid Cap, 7.5% Russell 2000, 3.25% MSCI EM (net), 6% MSCI EAFE (net), 33.50% BBG Barclays US Agg, 10% ICE BofAML 1-3 Yr US Corp/Govt, 1.50% ICE BofAML US High Yield Master II, 1.75% Wilshire REIT, and 5% FTSE 1 Mth T-Bill. From 4/1/2007 – 9/30/2012: the blended benchmark was 43% S&P 500, 2% Russell 2000, 5% MSCI EAFE (net), 15% ICE BofAML 1-3 Year Corp/Govt, 30% BBG Barclays US Agg, 5% FTSE 1 Mth T-Bill. Prior to April 2007: the blended benchmark was 50% S&P 500, 15% ICE BofAML 1-3Yr Corp/Govt, 30% BBG Barclays US Agg, and 5% FTSE 1 Mth T-Bill.

ANNUAL RETURNS (Gross of Investment Management Fees, but Net of Embedded Fund Fees)

HighMark Plus Composite (Active)

2008	-22.88%
2009	21.47%
2010	12.42%
2011	0.55%
2012	12.25%
2013	13.06%
2014	4.84%
2015	0.14%
2016	6.45%
2017	13.19%
2018	-4.03%

Index Plus Composite (Passive)

2008	-18.14%
2009	16.05%
2010	11.77%
2011	2.29%
2012	10.91%
2013	12.79%
2014	5.72%
2015	-0.52%
2016	7.23%
2017	11.59%
2018	-4.03%

PORTFOLIO FACTS

HighMark Plus (Active)

Composite Inception Date	10/2004
No of Holdings in Portfolio	18

Index Plus (Passive)

Composite Inception Date	05/2006
No of Holdings in Portfolio	12

HOLDINGS

HighMark Plus (Active)

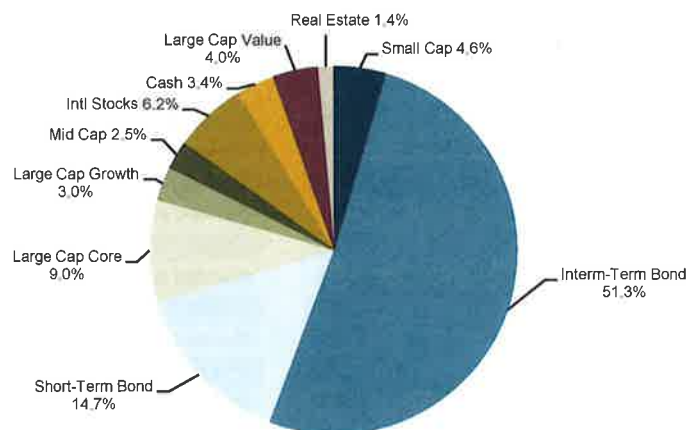
Columbia Contrarian Core I3
Vanguard Growth & Income Adm
Dodge & Cox Stock Fund
Harbor Capital Appreciation - Retirement
T. Rowe Price Growth Stock - I
iShares Russell Mid-Cap ETF
Vanguard Real Estate ETF
Undiscovered Managers Behavioral Value-R6
Victory RS Small Cap Growth - R6
DFA Large Cap International Portfolio
Dodge & Cox International Stock
MFS International Growth - R6
Hartford Schroders Emerging Markets Eq
Vanguard Short-Term Invest-Grade Adm
PIMCO Total Return Fund - Inst
PGIM Total Return Bond - R6
DoubleLine Core Fixed Income - I
First American Government Obligations Z

Index Plus (Passive)

iShares Core S&P 500 ETF
iShares S&P 500 Value ETF
iShares S&P 500 Growth ETF
iShares Russell Mid-Cap ETF
Vanguard Real Estate ETF
iShares Russell 2000 Value ETF
iShares Russell 2000 Growth ETF
iShares MSCI EAFE ETF
Vanguard FTSE Emerging Markets ETF
Vanguard Short-Term Invest-Grade Adm
iShares Core U.S. Aggregate
First American Government Obligations Z

Holdings are subject to change at the discretion of the investment manager.

STYLE



The performance records shown represent size-weighted composites of tax exempt accounts that meet the following criteria: Accounts are managed by our Portfolio Management Group (PMG) with full investment authority according to the PARS Moderately Conservative active and passive objectives.

The adviser to the PARS portfolios is US Bank, and HighMark serves as sub-adviser to US Bank to manage these portfolios. US Bank may charge clients as much as 0.60% annual management fee based on a sliding scale. US Bank pays HighMark 60% of the annual management fee for assets sub-advised by HighMark under its sub-advisory agreement with US Bank. The 0.36% paid to HighMark, as well as other expenses that may be incurred in the management of the portfolio, will reduce the portfolio's returns. Assuming an investment for five years, a 5% annual total return, and an annual sub-advisory fee rate of 0.36% deducted from the assets at market at the end of each year, a \$10 million initial value would grow to \$12.53 million after fees (Net-of-Fees) and \$12.76 million before fees (Gross-of-Fees). Gross returns are presented before management and custodial fees but after all trading expenses and reflect the reinvestment of dividends and other income. A client's return will be reduced by the advisory fees and other expenses it may incur as a client. Additional information regarding the firm's policies and procedures for calculating and reporting performance results is available upon request. Performance results are calculated and presented in U.S. dollars and do not reflect the deduction of investment advisory fees, custody fees, or taxes but do reflect the deduction of trading expenses. Returns are calculated based on trade-date accounting.

Blended benchmarks represent HighMark's strategic allocations between equity, fixed income, and cash and are rebalanced monthly. Benchmark returns do not reflect the deduction of advisory fees or other expenses of investing but assumes the reinvestment of dividends and other earnings. An investor cannot invest directly in an index. The unmanaged S&P 500 Index is representative of the performance of large companies in the U.S. stock market. The MSCI EAFE Index is a free float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. The ICE BofAML US High Yield Master II Index tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market. Wilshire REIT index measures U.S. publicly traded Real Estate Investment Trusts. The unmanaged Bloomberg Barclays U.S. Aggregate Bond Index is generally representative of the U.S. taxable bond market as a whole. The ICE BofAML 1-3 Year U.S. Corporate & Government Index tracks the bond performance of the ICE BofAML U.S. Corporate & Government Index, with a remaining term to final maturity less than 3 years. The unmanaged FTSE 1-Month Treasury Bill Index tracks the yield of the 1-month U.S. Treasury Bill.

HighMark Capital Management, Inc. (HighMark), an SEC-registered investment adviser, is a wholly owned subsidiary of MUFG Union Bank, N.A. (MUB). HighMark manages institutional separate account portfolios for a wide variety of for-profit and nonprofit organizations, public agencies, and public and private retirement plans. MUB, a subsidiary of MUFG Americas Holdings Corporation, provides certain services to HighMark and is compensated for these services. Past performance does not guarantee future results. Individual account management and construction will vary depending on each client's investment needs and objectives. Investments employing HighMark strategies are NOT insured by the FDIC or by any other Federal Government Agency, are NOT Bank deposits, are NOT guaranteed by the Bank or any Bank affiliate, and MAY lose value, including possible loss of principal.

HIGHMARK CAPITAL MANAGEMENT

350 California Street
Suite 1600
San Francisco, CA 94104
800-582-4734

ABOUT THE ADVISER

HighMark® Capital Management, Inc. (HighMark) has nearly 100 years (including predecessor organizations) of institutional money management experience with \$7.6 billion in assets under management and \$8.3 billion in assets under advisement*. HighMark has a long term disciplined approach to money management and currently manages assets for a wide array of clients.

ABOUT THE PORTFOLIO MANAGEMENT TEAM

Andrew Brown, CFA®

Senior Portfolio Manager

Investment Experience: since 1994

HighMark Tenure: since 1997

Education: MBA, University of Southern California; BA, University of Southern California

Salvatore "Tory" Milazzo III, CFA®

Senior Portfolio Manager

Investment Experience: since 2004

HighMark Tenure: since 2014

Education: BA, Colgate University

J. Keith Stribling, CFA®

Senior Portfolio Manager

Investment Experience: since 1985

HighMark Tenure: since 1995

Education: BA, Stetson University

Christiane Tsuda

Senior Portfolio Manager

Investment Experience: since 1987

HighMark Tenure: since 2010

Education: BA, International Christian University, Tokyo

Anne Wimmer, CFA®

Senior Portfolio Manager

Investment Experience: since 1987

HighMark Tenure: since 2007

Education: BA, University of California, Santa Barbara

Randy Yurchak, CFA®

Senior Portfolio Manager

Investment Experience: since 2002

HighMark Tenure: since 2017

Education: MBA, Arizona State University;

BS, University of Washington

Asset Allocation Committee

Number of Members: 16

Average Years of Experience: 28

Average Tenure (Years): 15

Manager Review Group

Number of Members: 7

Average Years of Experience: 19

Average Tenure (Years): 7

*Assets under management ("AUM") include assets for which HighMark provides continuous and regular supervisory and management services. Assets under advisement ("AUA") include assets for which HighMark provides certain investment advisory services (including, but not limited to, investment research and strategies) for client assets of its parent company, MUFG Union Bank, N.A.

HIGHMARK CAPITAL MANAGEMENT RETURNS

RETURNS AS OF MARCH 31, 2019

	Equity (%)	1 Year	3 Years	5 Years	10 Years
Capital Appreciation	65-85%	4.83%	9.67%	6.72%	11.11%
Balanced	50-70%	4.73%	8.61%	5.83%	9.91%
Moderate	40-60%	4.64%	7.53%	5.33%	9.09%
Moderately Conservative	20-40%	4.27%	5.47%	4.18%	7.29%
Conservative	5-20%	4.26%	4.00%	3.37%	5.56%

** Past performance does not guarantee future results*