



Midpeninsula Regional
Open Space District

ACTION PLAN & BUDGET COMMITTEE

R-17-114
December 5, 2017

AGENDA ITEM 2

AGENDA ITEM

Establish a Public Agencies Post-Employment Benefits Section 115 Trust administered by Public Agency Retirement Services (PARS) to provide the District with an alternative investment strategy to pre-fund a portion of the pension obligations.

GENERAL MANAGER'S RECOMMENDATIONS

Review, discuss, and consider recommending approval to the Board of Directors the District's proposal to establish a Section 115 Trust, administered by Public Agency Retirement Services (PARS), for pre-funding of the District's pension obligations as related to the unfunded actuarial accrued liability (UAAL).

SUMMARY

The District provides a defined-benefit pension to its retirees through California Public Employees Retirement System (CalPERS). Funding of CalPERS pensions relies on three sources: employee contributions, employer contributions, and investment returns (which vary according to the performance of financial markets).

CalPERS has significantly changed the methodology for calculating the Annual Required Contributions (ARC) in regards to amortizing the Unfunded Actuarial Accrued Liability (UAAL). Until recently, the only option for reducing the UAAL was to commit additional funds to CalPERS. Unfortunately, these additional funds would be subject to the same CalPERS investment returns and are not accessible to the District for other CalPERS pension expenses.

To maintain local control over assets and to diversify investment strategies, the District wishes to pursue the creation of a Section 115 Trust as an additional investment vehicle to pre-fund its unfunded retirement obligations rather than solely through the California Public Employees' Retirement System (CalPERS).

Should the Board approve the establishment of a Section 115 Trust, staff is recommending the selection of PARS. PARS is the leader in the field and enjoys an excellent reputation with public agencies. In addition, PARS offers several risk tolerance profiles ranging from capital appreciation (higher risk/higher returns) to conservative (lower returns/lower risk) and no minimum amount for contributions, thereby providing the District with maximum flexibility.

DISCUSSION

The District has its pension plan (defined benefit) with CalPERS, as is the case for the vast majority of public entities in California. All of the District's eligible employees currently participate in the Miscellaneous Pool. Retirement benefits retirees are funded through employer and employee contributions, as well as investment earnings. The level of funding and contributions is based on a number of actuarial assumptions, including expected future investment returns or discount rate, life expectancies, and inflation. As shown below, recent CalPERS investment returns have been volatile over the past three years and have lagged the overall market:

• FY 2014/15	2.40%	S&P 500	7.817%
• FY 2015/16	0.60%	S&P 500	- 0.734%
• FY 2016/17(est.)	11.20%	S&P 500	16.800%

Discount Rate

One of the most important factors in the actuarial calculations is the discount rate used to assume future investment earnings. Historically CalPERS has used a 7.5 percent rate, yet over the past 20 years the actual average rate of return has been only 6.9%. In the wake of the negative returns incurred during the Great Recession and increased life expectancies, the CalPERS Board has approved a plan to seek more stable returns through reduced volatility (risk) and is therefore reducing the discount rate from the current 7.5% over the next three years:

• FY 2017/18	7.375%
• FY 2018/19	7.25%
• FY 2019/20	7.00%

It is expected that the lowering of the discount rate, combined with the transition to a lower risk profile will lead to lower returns and as a consequence increase the unfunded liabilities.

Section 115 Trust

The Section 115 Trust Program is a relatively new investment vehicle that allows local governments and agencies to pre-fund its unfunded liabilities for both Pension and Other Post Retirement Benefits (OPEB) costs. This provides an alternative to sending additional funds to CalPERS with the inherent market volatility risks. The District established an irrevocable trust with California Employers' Retiree Benefit Trust (CERBT) offered through CalPERS several years ago for the unfunded portion of future OPEB benefits (retiree medical).

The establishment of a Section 115 Trust would provide benefits to the District through a pre-funding of its unfunded pension liabilities including:

- Local control over assets – the District would have a choice of several risk profiles and can access at any time to pay its pension obligations.
- Rate Stabilization – funds can be transferred to CalPERS at the District's discretion which can stabilize future employer contributions to CalPERS.
- Investment Risk Management – the District will be able to choose from several risk profiles as a function of its risk tolerance.

PARS

The first entity to receive a private letter ruling guaranteeing the tax-exempt status of investments was tax-exemption from taxes from the Internal Revenue Service was the Public Agency Retirement Services (PARS) and is currently the most widely adopted program (see Appendix 1 for the PARS client list per September 2017).

PARS provides the services required 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 partnered with US Bank to serve as trustee and its sub-adviser HighMark Capital Management, Inc., to provide investment management services for the program

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.

The other entity offering Section 115 Trusts in Public Financial Management Group (PFM). PARS is the preferred vendor, with a singular focus on pension trusts, a longer track record, lower fees, and a very wide adoption by other municipal agencies (see Appendix 2 – PARS PFM Comparison)

PARS is the leader in the field with over 80 pre-funding pension programs and enjoys an excellent reputation with public agencies. In addition, PARS has the advantage of offering several risk tolerance profiles ranging from capital appreciation (higher risk/higher returns) to conservative (lower returns/lower risk) and no minimum amount for contributions, thereby providing the District with maximum flexibility.

FISCAL IMPACT

Establishing the Section 115 Trust has no direct fiscal impact at this time. A fiscal impact will occur only when the Board approves funds to be transferred to the Trust. Over the past two years, the Board has agreed to transfer budgetary salary savings to CalPERS as pre-funding of its unfunded pension liabilities. Future contributions to the Trust may be funded as part of the District's annual budget or through annual savings.

PUBLIC NOTICE

Public notice was provided as required by the Brown Act. No additional notice is required.

CEQA COMPLIANCE

This proposed action is not a project under the California Environmental Quality Act and no environmental review is required.

NEXT STEPS

If a recommendation is made by the Action Plan and Budget Committee, it will be forwarded to the full Board for review and approval.

ATTACHMENTS

1. PARS Client List per September 1, 2017
2. PARS PFM Comparison

Responsible Department Head:
Stefan Jaskulak, Chief Financial Officer

Prepared by:
Andrew Taylor, Finance Manager

PARS CLIENT LIST – PRSP (104)

UPDATED: SEPTEMBER 2017

CITIES & TOWNS

City of Alameda
 City of Bell Gardens
 City of Brea
 City of Brisbane
 City of Burlingame
 City of Capitola
 City of Chino Hills
 City of Coronado
 City of Cypress
 City of Daly City
 City of Dublin
 City of Fountain Valley
 City of Fullerton
 City of Glendale
 City of Half Moon Bay
 City of Healdsburg
 City of Hercules
 City of Huntington Beach
 City of La Mesa
 City of Lake Forest
 City of Lodi
 City of Manhattan Beach
 City of Morgan Hill
 City of Napa
 City of Norwalk
 City of Oakley
 City of Oroville
 City of Palo Alto
 City of Pasadena
 City of Rancho Cucamonga
 City of Redwood City
 City of Rohnert Park
 City of Rolling Hills
 City of Santa Ana

City of Santa Clara
 City of Sausalito
 City of Solana Beach
 City of Stanton
 City of Tustin
 City of Union City
 City of Upland
 City of Vallejo
 City of West Covina
 City of West Sacramento
 City of Westminster
 City of Yuba City
 Town of Colma
 Town of Los Gatos
 Town of Tiburon

COUNTIES

County of Humboldt
 County of Kings
 County of Nevada
 County of Placer
 County of Riverside
 County of San Benito
 County of Siskiyou
 County of Solano
 County of Sutter

SPECIAL DISTRICTS

Central Contra Costa Sanitary District
 Delta Diablo (Sanitation District)
 East Bay Regional Park District
 El Dorado Hills County Water District
 Fallbrook Public Utility District
 Goleta West Sanitary District
 Great Basin Unified APCD
 Mesa Water District
 Mojave Desert AQMD
 Montecito Fire Protection District
 Moraga-Orinda Fire Protection District
 Napa County Mosquito Abatement District
 Nevada County Consolidated Fire District
 Novato Sanitary District
 Rancho Cucamonga Fire PD
 South Coast Water District
 Southern Marin Fire Protection District
 Superior Court of CA - County of Kern
 Sweetwater Springs Water District
 Three Valleys Municipal Water District
 Twentynine Palms Water District
 West Bay Sanitary District

EDUCATIONAL DISTRICTS

Coast CCD
 Grossmont-Cuyamaca CCD
 Hartnell CCD
 Marin CCD
 San Bernardino CCD
 Victor Valley CCD
 Yosemite CCD
 Corning Union ESD
 Bass Lake Joint Union ESD
 Calistoga Joint USD
 Campbell Union HSD
 Cotati-Rohnert Park USD
 River Delta USD
 San Marino USD
 Santa Rita USD
 Visalia USD
 Hesperia Unified SD
 Lakeside Union SD
 Lemon Grove SD
 Natomas USD
 Ocean View SD
 Ontario-Montclair SD
 Placer Union SD
 Whittier City SD

	Public Agency Retirement Services (PARS)	Public Financial Management (PFM)
Founded in	1984	1975
Headquarters	Newport Beach	Philadelphia
Office Locations in California	Newport Beach - PARS San Francisco - HighMark	San Francisco & Los Angeles
Core Business	Administration of 115 Trust for prefunding OPEB/Pension	Investment advisory services
Programs	Section 115 Trust for Pensions & OPEB, supplemental defined benefit programs, alternate retirement systems for part-time employees, customized defined contribution programs to supplement CalPERS	Section 115 Trusts for Pension & OPEB, financial advisory, asset management and consulting services
IRS Private Letter Ruling	Yes; multiple employer	Yes; multiple employer trust No; single employer trust
Investment Manager	HighMark Capital Management	PFM Asset Management
Trustee	US Bank (Los Angeles)	Multiple employer plan - Wells Fargo Single employer plan - TBD
Plans under Administration	1,400+ plans for 800+ public agencies only	200+ plans, mostly public agencies
Section 115 Pension & OPEB Trust Clients	250+, including 73 for pension prefunding (such as Alameda, Brisbane, Capitola, Daly City, Half Moon Bay, Morgan Hill, Napa, Palo Alto, Rohnert Park, Sausalito, Santa Clara, Tiburon)	115+, including 3 for pension prefunding (Paso Robles, Santa Cruz and Chino Valley Fire)
Investment Assets under Administration	Approx. \$2.2 billion (PARS) Approx. \$15.2 billion (HighMark)	Approx. \$62.0 billion
Investment Options	5 risk-tolerance levels (active or passive), and custom option	Custom only
Performance Returns	Actual 5-year historical returns of 5 model portfolios: <ul style="list-style-type: none"> - Capital Appreciation: 9.53% - Balanced: 8.12% - Moderate: 7.24% - Moderately Conservative: 5.51% - Conservative: 4.07% <i>* Returns as of December 31, 2016</i>	Composite returns only (not based on historical returns of <u>actual</u> portfolios)
Minimums	No minimum contribution; No minimum fee; No start up fees; No trade or transactions fees	Minimum fee: \$10,000 across all accounts; Account fee: \$500; Trade fee: \$8/trade