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NEVADA COUNTY BOARD OF SUPERVISORS
Board Agenda Memo

MEETING DATE: May 9, 2017

TO: Board of Supervisors

FROM: Richard Haffey, CEO

SUBJECT: RESOLUTION APPROVING THE ADOPTION OF THE PUBLIC AGENCIES POST-EMPLOYMENT BENEFITS TRUST PROGRAM ADMINISTERED BY PUBLIC AGENCY RETIREMENT SERVICES (PARS)

RECOMMENDATION: Approve the attached resolution and agreement.

FUNDING: A deposit of $3.2 million to the Post-Employment Benefit Trust (the "Program") will be from the General Fund, Pension Contributions assignment. It is anticipated that the fund will be used over the next four years to coincide with the payoff of the Safety Plan side fund pension liability, with periodic payments totaling approximately $850,000 per year for the next four years.

BACKGROUND:

At the January 25th, 2017 Board of Supervisors Workshop, pension costs were recognized as a continuing threat to the County's financial stability, and discussion occurred such that establishing a Post-Employment Benefits trust fund for pre-funding pensions is a good next step in further mitigating that threat. Approval of this item supports the Board's adopted Priority A objective to "maintain County's financial stability and core services in light of economic conditions."

Nevada County 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 the financial markets. Investment returns are relied upon for 62 percent of pension funding, and creating the trust will improve the management and diversity of pension related investments.

The plans managed for the County by CalPERS are the Miscellaneous Plan, including approximately 90 percent of County employees, and the Safety Plan with approximately 10 percent of employees (includes three tiers of employees in sheriff and certain district attorney positions). From the County's most recent audited financial statement for FY 15/16, the gap between what the County owes current and retired staff, and the current plan assets (also known as the unfunded actuarial accrued liability (UAAL)) is $122 million for the Miscellaneous Plan, and $21 million for the Safety Plan, for a total funding gap of $143 million.

Several developments have occurred in recent years to prompt action to create a pension trust. 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 pensions must recognize their accrued liability on their balance sheets for fiscal years beginning after June 15, 2014. Beginning in FY 15/16, CalPERS implemented revised actuarial assumptions and recognized that retirees are living longer, resulting in an expected increase in UAAL in coming years. In December 2016, CalPERS voted to lower the assumed rate of investment return to 7.0 percent from 7.5 percent, which will further increase the UAAL, starting in FY 18/19. The higher the UAAL, the higher the annual required contribution (percent of annual salary required by CalPERS) to meet the funding gap, and all of the CalPERS changes together are expected to approximately double the annual required contributions over the next five years. The trust Program is a vehicle with which to moderate the fiscal impacts of these contribution changes.

Until recently, the County's only option for pre-funding pension obligations and proactively managing UAAL was to send additional funds to CalPERS. Unfortunately these additional funds would be subject to the same market volatility risk as the $346 million already invested in CalPERS in the Miscellaneous and Safety plans, and exposed to the same investment risk that resulted in a 2.4% return for the year ending June 30, 2015 and .6% for the year ending June 30, 2016. A recent ruling received from the IRS established that public agencies could create a separate trust (IRC Section 115 Trust) to "pre-fund" its CalPERS UAAL, providing an alternative to sending additional funds to CalPERS, allowing greater control over assets and more diversification of investments.

The County has experience with Section 115 Trusts. In 2008, the Board of Supervisors used then existing IRS rules to authorize the creation of a trust to pre-fund retiree health benefits (Other Post-Employment Benefits (OPEB)). The trust currently has $21.5 million in assets which will be used to meet future OPEB obligations and mitigate impacts to financial health and service levels. With the recent IRS ruling allowing similar tools to manage pension benefits, it is recommended that a Post-Employment Benefit Trust Program be created for that purpose. The Program will provide the following benefits:

1. Local control over assets—the trust can be accessed at any time so long as it's used to pay the county's pension obligation.
2. Pension Rate Stabilization—assets can be transferred to a CalPERS plan at the County's discretion, which would reduce or eliminate large fluctuations in employer annual contributions. When annual required contributions increase at a time of economic downturn, the funds can be used to stabilize the budget and services.
3. Funds are legally set aside irrevocably, and are available for use to reduce the County's unfunded pension liability.
4. Offset to Pension Liability—contributions will appear as assets (fiduciary funds) on the county annual financial report.
5. Investment Flexibility—investment requirements that apply to the County's treasury funds are not applicable to assets held in a Section 115 Trust, thus providing diversification and enhanced investment returns. The County maintains

oversight of the investment manager and identifies the risk tolerance level guiding the investment mix.

6. Investment Diversification—investments in the trust will have different objectives and risk/return profile than deposits with CalPERS.
7. Improved Credit Rating—rating agencies generally look favorably upon actions to increase flexibility in pension liability management. This is considered best practice among government finance professionals.

The plan to participate in the Program with PARS has been reviewed by and is supported by the county Debt Advisory Committee (Chief Fiscal Officer, Auditor-Controller, Treasurer, and County Counsel), and our Financial Advisor (KNN Public Finance). The plan is to initially invest $3.2 million in the pension trust, with the proceeds coming out of the General Fund Pension Contributions assignment. The $3.2 million will be fully invested over a period of up to 90 days from the date of initial deposit. It is anticipated that the fund will be used over the next four years to coincide with the payoff of the Safety Plan side fund, with periodic payments totaling approximately $850,000 per year for the next four years. A pension funding policy will be developed and recommended to the Board for approval. This policy will consider additional pre-funding deposits (for example using one-time revenues) to best fit the County objective of financial stability and to meet the demands of future contribution increases.

In California, there are two qualified independent retirement plan administrators that offer Section 115 Trusts for pensions—Public Agency Retirement Services (PARS) and Public Financial Management Group (PFM). PARS provides the following: the security of a Private Letter Ruling from IRS to ensure tax exempt status of investments; primary business is administering 115 trusts; has the highest participation of other California cities and counties; and the program allows for risk diversification and investment objectives to meet the County's unique needs. PFM also has a Private Letter Ruling, but is less focused on administering trusts, has fewer plans under administration, and is not structured as well to meet the County's investment and risk targets.

The PARS Program has five standard investment portfolios with the following profiles:

As of 12/31/2016						
Pension Portfolio	Investment Policy (%)			Investment Returns (%)		
	Equity	Fixed Income	Cash	1Yr	3Yr	5Yr
Conservative	15	80	5	4.18	2.77	4.07
Moderately Conservative	30	65	5	4.93	3.20	5.51
Moderate	50	45	5	6.44	3.77	7.24
Balanced	60	35	5	6.82	3.81	8.12
Capital Appreciation	75	20	5	8.81	4.79	9.53

PARS has partnered with US Bank to serve as trustee and Highmark Capital Management, Inc. to provide investment advisory services for this program. Expected fees are .25% for PARS to administer the program, plus .30% total for the combined trustee and investment advisor services. Deposits to the trust will be invested in a portfolio consisting of a mix of equity, fixed income and cash investments (standard options are listed in the chart above). The County and Highmark will work together to select the portfolio to best meet the needs of the County. It is expected that the selected portfolio will be either Conservative or Moderately Conservative.

Steps:

1. Adopt Resolution approving the agreement for administrative services for the PARS Public Agencies Post-Employment Benefit Trust
2. Investment selection and agreement on investment guidelines (what will/won't be invested in, credit quality, etc.…)
3. Make initial contribution to fund
4. Begin administration of trust

With the adoption of the PARS agreement, the Board will appoint the County Executive Officer, or his/her designee as the County's Plan Administrator for the Program. The County's Plan Administrator will be authorized to execute the PARS legal and administrative documents on behalf of the County and to take whatever additional actions are necessary to maintain the County's participation in the Program and to maintain compliance with applicable regulations.

Once the Program is in operation, the County Executive Office will lead discussions for further actions including potential future trust deposits and other pension rate stabilization measures, and will bring proposals to the Board of Supervisors in the next year.

Item Initiated by: Martin Polt, Deputy CEO and Marcia Salter, Auditor-Controller

Approved by: Richard A. Haffey, County Executive Officer

Submittal Date: April 27, 2017
Revision Date: