City of Culver City, California
Agenda Item Report

Meeting Date: 01/24/2011	Item Number: A-2
CITY COUNCIL AGENDA ITEM: Approval of a Professional Services Agreement with PFM Asset Management, LLC to Establish and Administer a Post Employment Benefits Irrevocable Trust	
Contact Person/Dept.: Jeff Muir/Finance Department	Phone Number: (310) 253- 5865
Fiscal Impact: Yes [x] No []	General Fund: Yes [x] No []
Public Hearing: [] Action Item: [x]	Attachments: []
Commission Action Required: Yes [] No []	Date: ________________
Public Notification: (E-Mail) Meetings and Agendas – City Council (01/19/11); (E-Mail) PFM Asset Management LLC (01/19/11)	
Department Approval: Jeff Muir (01/13/11)	City Attorney Approval: Carol Schwab (by H. Baker) (01/18/11)
Chief Financial Officer Approval: Jeff Muir (01/13/11)	City Manager Approval: John M. Nachbar (01/19/11)

RECOMMENDATION:

Staff recommends the City Council approve a professional services agreement with PFM Asset Management LLC to establish and administer a post employment benefits irrevocable trust.

BACKGROUND:

Government Accounting Standards Board Statements 43[i] (GASB 43) and 45[ii] (GASB 45) required government entities to begin treating Other Post Employment Benefits (OPEB) in a similar fashion to pensions. This includes a requirement for independent actuarial calculations to determine the total liability based on the benefit provided, disclosure of this liability in the financial statements, calculation of the Annual Required Contribution (ARC) to fund the total liability over a thirty year period, and recording any unfunded portion of the annual ARC as a liability on the balance sheet. The most common types of OPEB benefits include health insurance and dental, vision, prescription, or other healthcare benefits provided to eligible retirees and, in some cases, their beneficiaries. Culver City currently provides health care insurance for retirees and all of their eligible dependents. Employees that retired prior to January 1, 2007 have 100% of these premiums paid by the City. Employees that have or will retire after this date have 95% of these premiums paid by the City. According to the actuarial report recently completed, the City's OPEB liability as of July 1, 2009 is $213,205,000 and the Annual Required Contribution is $11,754,000. The City currently does not pre-fund any of the costs, and therefore the discount rate used by the actuary in calculating the liability is very low. This results in an already large liability being even larger.

Although there is no legal requirement at this time to fund the reported OPEB liability, it is expected to become a requirement at some point in the future. However, similar to pension liabilities, the City should be funding the future costs of the benefit for active employees during their years of service, so that these funds can accumulate with the benefit of compounding investment returns over time to help fund the benefit. As a matter of prudent financial management, the City has already identified a few funding sources and begun setting aside funds to offset this liability. Commencing in Fiscal Year 2009/2010, City Council approved earmarking a portion of the fees and charges revenue for OPEB and charging Enterprise Funds and the Redevelopment Agency for their respective portions of the OPEB liability. Additionally, the City has set aside some General Fund reserves for OPEB. Currently, there is a total of approximately $1.5 million set aside for OPEB.

Although the City has begun setting funding aside, it does not offset the City's OPEB liability unless the funds are deposited in an irrevocable trust, which dedicates the funds to OPEB related expenditures and protects against the funding being used for other purposes in the future. Again, this is similar to the pension benefit, where funds are deposited with CalPERS.

In order to begin the process of establishing a Post Employment Benefits Irrevocable Trust, the Finance Department released a Request for Proposals in July 2010 with responses due on September 2, 2010. Four firms submitted responsive bids and one law firm submitted a bid that was deemed unresponsive to the request. The four firms that responded, in alphabetical order, were:

1. CalPERS
2. PARS/Union Bank
3. PFM Asset Management LLC
4. US Bank

Some of the responsibilities of the selected firm will include assisting with the necessary legal documentation to establish the trust, opening an account with the Trustee, working with the City to develop an appropriate investment policy for assets in the trust, investing assets in the trust in compliance with the investment policy, and managing disbursements from the trust.

NOTE: Pursuant to Culver City Municipal Code Section 3.07.085, the City may award contracts in any amount for professional services without complying with formal bid requirements provided the contract is based upon competitive quotations, whenever feasible. A professional service is a service for which the City is contracting for the skill, integrity, judgment, and/or special technical ability of the professional. OPEB trust establishment and administration services are considered a professional service.

DISCUSSION:

Finance Department staff reviewed all proposals and rated them in five areas: 1) experience and qualifications, 2) OPEB products and services, 3) trustee and trust administration services, 4) investment services, and 5) fees. After careful consideration, it was determined that the PARS/Union Bank and PFM Asset Management were the top two proposals.

While US Bank has a lengthy history and superb qualifications in acting as a trustee, they are a relatively new player in establishing and managing OPEB trusts and did not provide any public entity client references in California. The CalPERS program is also relatively new and is organized similar to the CalPERS pension program in which members pay into the trust but have no control over the investment portfolio management strategy. For example, if the City wished to have a more stable, conservative investment approach and only invest OPEB assets in treasury bonds, that is not an option in CalPERS. CalPERS tends to engage in riskier investment strategies than the typical municipal government. As we have seen, in good years that strategy may translate into better than average returns, but in bad years it may translate into higher than average losses. Because staff believes the City should make the decisions as to what level of risk is appropriate for these investments, the CalPERS proposal did not receive further consideration.

PARS/Union Bank and PFM Asset Management both have more experience than CalPERS or US Bank and offered investment management strategies that are customized to each client's particular risk tolerance and liquidity needs. As the top two candidates, both firms were subsequently invited to give presentations to staff.

After considering all proposals and hearing presentations from the top two firms, staff is prepared to recommend City Council approve a professional services agreement with PFM Asset Management LLC to establish and administer a post employment benefits irrevocable trust.

PFM differentiated themselves from the other firms by the degree to which they can customize the investment strategy to meet Culver City's specific needs and risk tolerance. PFM demonstrated a high level of commitment to meeting Culver City's needs as a client and has experience with California government clients that they have worked with to establish OPEB irrevocable trusts.

Another characteristic of PFM's program that differentiated them from the other firms was the separation between PFM as the discretionary investment firm and the bank acting as trustee. In the PARS/Union Bank and US Bank proposals, the investment management firm responsible for the discretionary investment of the City's assets is also a subsidiary of the Bank acting as trustee. Although PFM has a relationship with US Bank and recommends US Bank as trustee, they have no affiliation with US

Bank and will work with whichever bank the City would like to act as trustee. This separation of discretionary investment firm and trustee provides an added financial control.

That being said, the City has an existing relationship with US Bank as they serve as trustee in holding reserve requirements for prior Redevelopment Bond issues. Therefore, staff also recommends that US Bank serve as trustee for the proposed Pension Benefits Irrevocable Trust. If staff's recommendation is approved, City Council will designate US Bank as the Trustee through a resolution when the trust is established.

PFM's fee schedule is simple and includes investment policy development and advisory services, asset allocation, investment manager selection and monitoring, fund monitoring and rebalancing, and meetings with the City. Their fees are competitive with the other proposals that were received.

<u>FISCAL ANALYSIS:</u>

PFM's annual fee schedule is as follows:

First $5 million in assets……………….0.50%
Second $5 million in assets…………...0.40%
Next $10 million in assets……………...0.30%
Thereafter……………………………...0.25%

The fee amount can either be deducted automatically from the custody account or invoiced on a monthly basis if the City desires. As a point of reference, if the City had an average of $5 million in assets in the trust for a year, PFM's fees for that year would be $25,000.

US Bank's fee schedule for Trustee services are as follows:

Custodial fees……………………………0.05% or $1,000 annually
Payment Services (if individual retirees receive checks)
Checks*…… $2.50 per check
ACH*………. $2.00 per ACH
Wires*……..$10.00 per wire.

Custodial fees are billed as an expense of the trust and would be deducted automatically from the trust account.

**subject to change based on US Bank's fee schedule.*

MOTION:

That the City Council:

1. Approve a professional services agreement with PFM Asset Management LLC to establish and administer a Post Employment Benefits Irrevocable Trust; and,

2. Authorize the City Attorney to review/prepare the necessary documents; and,

3. Authorize the City Manager to execute such documents on behalf of the City.

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[i] The official title of GASB 43 is *Financial Reporting for Postemployment Benefit Plans Other Than Pensions* and was issued in April 2004.
[ii] The official title of GASB 45 is *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* and was issued in June 2004.