MEMORANDUM

TO: Mayor Ridge and City Council Members

FROM: Gregg Guetschow, City Manager

SUBJECT: Establishing a Retiree Healthcare Trust

DATE: February 7, 2020

The establishment of a retiree healthcare trust is an action required by the corrective action plan submitted by the City and approved by the Department of Treasury to address the unfunded liability for this benefit. Initial funding for the trust will be the $200,000 currently shown on the City's financial statements as an assigned fund balance within the general fund.

The trust resolution, which is included in your agenda packet, has been reviewed and approved by the City Attorney. A second resolution designating signatories for related documents is also included for your consideration.

Since the City began offering its retiree healthcare benefit in 1989, it has been funded on a pay-as-you-go basis. Assuming the accuracy of IRS mortality tables, the final benefits of the program will be paid out in 2047.

The establishment of the trust permits the investment of the assigned fund balance in portfolios managed by the Municipal Employees Retirement System. If the City continues its pay-as-you-go practice, and a 5% average return on investments is realized, my calculations show that the assets of the trust should be sufficient to pay remaining benefits after 2037.

The key decision in establishing and managing the trust, then, is the choice of portfolios. On the advice of the City Attorney, I sought recommendations from two area investment professionals. Recognizing the City's desire to preserve capital and achieve modest growth in its assets, their recommendations for the asset mix between equities and fixed income ranged from a 40/60 mix of stocks and bonds to an 80/20 mix. I also read information from reputable sources online.

Some concern about equity investment returns is warranted given the very strong year just completed by the stock market and the record length of the current economic growth cycle. It is highly unlikely that similar returns will occur in 2020. The outlook for the economy for the next two years is good, however, which might support an investment mix that is more aggressive than might be warranted if a recession were anticipated in the near future.

In making a recommendation regarding the portfolio for the trust, I have applied the principles included in Council Policy 2018-04 Investment of Surplus Funds. Although the liquidity objectives of that policy are not applicable in this instance, those related to safety and yield are. These objectives are summarized well in paragraph 10 of the policy:

> Investments shall be made with judgment and care, under circumstances then prevailing, which persons of prudence, discretion and intelligence exercise in the management of their own affairs, not for speculation but for investment, considering the probable safety of their capital as well as the probable income to be derived.

I have included in the agenda packet the third and fourth quarter 2019 performance reports of investment options available to trust participants. Of the portfolios offered, I felt the Established Market Portfolio (60/40 mix of stocks and bonds) and the Balanced Income Portfolio (40/60 mix of stocks and bonds) were those that best met the applicable objectives and principles of Council's investment policy and fell within the range suggested by the professionals I consulted.

The challenge in selecting between these two is in utilizing the two performance reports. In my analysis, the very robust 4th quarter 2019 returns had a greater than anticipated impact on the overall returns, even looking at the 5-year period. It might be more prudent, then, to consider the 3rd quarter report a better measure of long-term results, given the low probability of a repetition of 4th 2019 stock market returns.

For further guidance, I also ran additional analyses of my calculations, referred to above, of when funds in the trust would equal 100% of the benefit's liabilities. As noted, with a 5% return and reinvestment of all income, 100% funding would be achieved in 2037. A 6% return and a 7% return would achieve full funding in 2036 and 2035 respectively. Just .82% separates the 3rd quarter 2019 5-year returns of the Established Market and Balanced Income portfolios.

I do not believe the greater risk to the principal associated with the Established Market Portfolio is warranted given that we would achieve full funding just a year or so earlier. My recommendation, then, is to invest 100% of the $200,000 in the Balanced Income Portfolio.