CITY OF
TALLAHASSEE

Agenda Item Details

Meeting	Oct 26, 2022 - City Commission Meeting
Category	7. APPEARANCES BY CITY COMMISSION APPOINTED BOARDS AND COMMITTEES, AND OTHER GOVERNMENTS
Subject	7.01 (Adjourn as the City Commission and Convene as the Sinking Fund Commission) Approval of Revisions to Commission Policy 236, Pension Investment Policy -- James O. Cooke, IV, City Treasurer-Clerk
Access	Public
Type	Action
Fiscal Impact	No
Budgeted	No
Recommended Action	Approve: Option 1. Approve the recommended changes to the Pension Investment Policy (236) and Option 2. Approve Staff's recommendation to allow the Private Equity allocation to remain above the allowable range.

Public Content

For more information, please contact: Jason Buchholz, Deputy Treasurer-Clerk; 891-8082.

Statement of Issue

The City's Pension Investment Policy (236) provides guidance to the City Treasurer-Clerk on the investments made by the Pension Plan. Every 3-5 years, the Investment Advisory Committee (IAC) and the Office of the City Treasurer-Clerk staff review the asset allocation of the Pension Plan. The asset allocation study is conducted by the Pension Plan's Investment Consultant to review potential investment mixes and the likely returns associated with each mix as well as the City's risk tolerance. The Pension Plan's Investment Consultant, Segal Marco, began the asset allocation study in March 2022, analyzing several possible asset allocation models through an iterative process that was reviewed by both the Consultant and City staff. Segal Marco is not recommending the addition of new asset classes as part of the asset allocation study but is recommending small changes to the targets and the ranges for existing asset classes. The Private Equity allocation remains above the range and the recommendation is to allow this overweight to self-correct. These adjustments will benefit the Plan by increasing the expected rate of return and reducing the volatility of the returns in our portfolio compared to the projected returns and volatility for our current targets. The asset allocation study was discussed with the Investment Advisory Committee at their meeting on May 19, 2022. The proposed revisions to the Pension Investment Policy (236) that will implement the revised asset allocation targets and ranges were unanimously approved by the Investment Advisory Committee on August 31, 2022.

The primary changes to the asset allocation structure are slight decreases of the Domestic Equity and Domestic Bond targets along with increases in the Private Equity and Private Credit targets. Changes to the allowable ranges are also proposed to "match" the adjusted targets. The proposed changes are expected to result in improved returns and reduced portfolio volatility of those returns (risk).

Fiscal Impact

N/A

Supplemental Material/Issue Analysis

History/Facts & Issues

The City contracts with an investment consultant to provide professional services as needed for the City's Pension Plan. In addition to reviewing the investment performance of the Plan on an ongoing basis, the Investment Consultant, Segal Marco, also assists with the development of an asset allocation study for the plan, helping the plan adopt a prudent and diversified investment strategy. This study is completed every 3-5 years to review potential investment mixes and the likely returns associated with each mix as well as the City's risk tolerance. The last study was completed in August 2018.

Segal Marco began the current asset allocation study by analyzing the attributes and characteristics of a variety of asset classes that could be added to the Pension Plan's asset allocation to improve returns and/or reduce the volatility of returns (risk). The study included an analysis of potential returns from various asset classes as well as the expected correlation of returns among these various asset classes. Segal Marco analyzed the impact of adding a number of potential new asset classes using its asset allocation model. Potential new asset classes considered included high yield bonds, inflation linked bonds, international bonds, emerging market bonds, international small cap, MACS (multi-asset class securities), global equities, hedge funds, commodities, farmland, oil and gas, and infrastructure. The investment consultant then used an iterative process during the study period to provide variations of potential mixes to arrive at an optimal asset allocation mix. Segal Marco and staff brought forward four potential asset allocation mixes, including the recommended asset allocation mix, for the Investment Advisory Committee to consider. The Investment Advisory Committee unanimously approved the recommended asset allocation, which kept the current asset classes unchanged, but did adjust the target weights for Domestic Equities, Domestic Bonds, Private Equity, and Private Credit. The approved recommendation also included increased ranges for Private Equity. Changes to the allowable ranges are also proposed to "match" the adjusted targets. In particular, ranges for Private Equity and Private Credit are widened to recognize that these less liquid investments need more flexibility to achieve maximum benefit.

The current target and proposed asset allocation targets are shown below:

	Current Target	Proposed Target
Equity		
Domestic	36%	35.5%
International	10%	9%
Emerging Markets	5%	4%
Bonds		
Domestic Bonds	19%	16.5%
Alternatives		
Private Equity	5%	7.5%
Private Credit	5%	7.5%
Timber	5%	5%
Real Estate	15%	15%
TOTAL	**100%**	**100%**

Asset class ranges are generally 50% of their respective asset class target. Given the illiquidity premium earned and lack of ability to exit private partnership positions, the range for Private Equity will be adjusted from 2-8% to 2.5-15%. As the asset class matures, it is expected that it will become "self-funding," the amount of capital calls will be roughly equivalent to the received distributions.

With the approval of the new targets and ranges, Private Equity will remain above the maximum range limit due to exceptional performance. The target weight of Private Equity was first surpassed in late 2018 and has continued to accelerate through the pandemic. The last commitment to a private equity manager was made in 2018. The overallocation to Private Equity has been part of the discussion at every IAC meeting since. Staff and our investment consultant recommend allowing the natural cycle of private equity funds' exit strategies to correct the imbalance over time. As of the latest quarterly report, Private Equity is 15.9% of pension assets.

Over the next twenty years, the investment consultant's model projects the current asset allocation will produce compound annual returns of 7.1%, with a standard deviation (volatility of returns, or risk) of 12.2%. The recommended asset allocation is expected to produce compound annual returns of 7.3%, with a standard deviation of 12.0%. Thus, the recommended asset allocation is expected to increase the investment return of the Pension Plan while reducing the risk, or volatility, of those investment returns over this time period.

The recommended revisions to Pension Investment Policy (236) were approved by the Investment Advisory Committee at their meeting on August 31, 2022.

Options

Option 1. Approve the recommended changes to the Pension Investment Policy (236).

Option 2. Approve Staff's recommendation to allow the Private Equity allocation to remain above the allowable range.

Option 3. Provide staff with alternative direction.

Attachments/References

1) Proposed Pension Investment Policy 236

Pension Investment Policy Final Redlined.pdf (181 KB)

Pension Investment Policy October 2022.pdf (128 KB)