



Office of the City Manager

INFORMATION CALENDAR
December 12, 2023

To: Honorable Mayor and Members of the City Council
From: Dee Williams-Ridley, City Manager
Submitted by: Henry Oyekanmi, Director, Finance Department
Subject: Section 115 Trust Investment Report for: Inception to Period Ended June 30, 2023

SUMMARY

In June 2018, the City Council approved the establishment of a Section 115 trust to help address pension obligations, with administration by the City Manager or their designee. Since May 2019, Keenan Financial Services has managed and invested this fund. This report provides an overview and analysis of the performance and current market conditions as it pertains to the City's Section 115 Trust investment portfolio. The trust consists of two distinct accounts: the Fixed Income Account and the Moderate Growth Account. These accounts encompass various asset classes, including fixed income mutual funds, domestic equities, international mutual funds, and alternative investment funds with a focus on real estate.

I. Fixed Income Account (#7590):

The Fixed Income Account predominantly comprises fixed income mutual funds. As of the latest available data, this portion of the portfolio has been performing steadily, slightly below market expectations for fixed income investments. It's important to note that fixed income investments are generally considered a lower-risk component of a portfolio, providing stability and consistent income.

II. Moderate Growth Account (#7600):

The Moderate Growth Account represents a diversified mix of asset classes, including domestic equities, international mutual funds, and alternative investment funds that focus on real estate.

As of June 30, 2023, the City Section 115 Trust Fund Investment Fund Activity for the period from September 30, 2020 to June 30, 2023 is summarized in Table 1 and Table 2 below on a market value basis. Before considering the change in market value, the City's

Section 115 Investment Report: FY2023 4th Qtr
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Section 115 Trust Fund earned 3.65%, 3.99%, and 4.17%, in FY2021, FY2022 and FY2023, respectively.

Table 1. Investment Fund Activity Inception to June 30, 2023

Trust Fund	Pooled Cash	Fixed Income Account	Moderate Growth Account	Total
Beginning Value (9.30.2020)	\$ -	\$ 6,356,407	\$ 4,278,393	\$ 10,634,799
Net Contributions	(4,655,470)	2,793,282	1,862,188	-
CalPERS Savings	4,431,965	-	-	4,431,965
Transfer from other funds	4,911,324	-	-	4,911,324
Dividends	-	837,000	692,421	1,529,421
Change in Market Value	-	(1,619,671)	(652,171)	(2,271,842)
Management Fees	-	(59,213)	(43,124)	(102,336)
Ending Value (6.30.2023)	\$ 4,687,819	\$ 8,307,805	\$ 6,137,707	\$ 19,133,331

Inception to Date: 9/30/2020 - 6/30/2023

Table 2. Investment Fund Activity By Fiscal Year

	FY 2021	FY 2022	FY 2023
Beginning Book Value	\$ 10,634,799	\$ 12,454,721	\$ 16,540,906
Contributions:			
a. Concil authorized transfers	113,724	2,151,632	2,645,968
b. Prepayment of CalPERS Unfunded Liability discount	1,318,502	1,479,360	1,634,103
Dividends and Realized Gain/Loss	412,481	490,659	626,281
Management fees	(24,785)	(35,466)	(42,085)
Subtotal before marking investments to market	12,454,721	16,540,906	21,405,174
Change in Market Value	378,132	(2,116,151)	(2,271,842)
Ending Balance - Market Value	\$ 12,832,853	\$ 14,424,755	\$ 19,133,331

Discussion of Changes in Market Values

Generally accepted accounting principles requires that investments be marked-to-market. This term refers to a method under which the fair values of accounts (i.e., assets and liabilities) that are subject to periodic fluctuations can be measured. The goal is to provide time to time appraisals of the current financial position of a company or organization, by incorporating the prevailing market conditions.

In the tables above, there is a line for changes in market values, which is negative. That is because, in some cases, the City may have investments with a current market value that is greater or less than the recorded cost. These changes in market value are due to

fluctuations in the market and have no effect on yield, as the City does not intend to sell securities prior to maturity. For this reason, Table 2 above shows the Section 115 Trust Fund balance before and after adding the changes in market value, so that management and the City Council can get a more realistic picture of how the Section 115 Trust Fund is performing.

The large decline in the market value of the total Section 115 Trust investments is almost exclusively due to the following rapid increases in interest rates by the Federal Reserve Board from a range of 0%-.25% to a current range of 5.25%-5.50%:

DATE	RATE CHANGE	FEDERAL FUNDS RATE
03/17/22	.25%	.25%-.50%
05/05/22	.50%	.75%-1.00%
06/16/22	.75%	1.50%-1.75%
07/27/22	.75%	2.25%-2.50%
09/21/22	.75%	3.00%-3.25%
11/02/22	.75%	3.75%-4.00%
12/14/22	.50%	4.25%-4.50%
02/01/23	.25%	4.50%-4.75%
03/23/23	.25%	4.75%-5.00%
05/03/23	.25%	5.00%-5.25%
07/26/23	.25%	5.25%-5.50%

As interest rates rise, bond prices fall, creating a decline in the market value of bond investments.

Investment Performance

A. Overview from Inception to June 30, 2023

As of September 30, 2020, the Trust Fund reported a total balance of \$10,634,799, with \$6,356,407 allocated to the Fixed Income Account and \$4,278,393 allocated to the Moderate Growth Account.

- Fixed Income Account: During FY2021, the Fixed Income Account earned \$127,368, resulting in a yield of 2.00% during its initial year. Subsequently, from July 1, 2021, to June 30, 2022, the Fixed Income Account experienced a temporary downturn, reporting earnings of -\$984,712, resulting in a yield of -15.22%. This period was marked by fluctuations in the fixed income market, largely due to the Federal Reserve raising interest rates aggressively, which clobbered bond prices, especially those for long-term bonds. However, from July 1, 2022, to June 30,

2023, the Fixed Income Account rebounded impressively, recording earnings of \$74,673, equating to a yield of 0.90%. This resurgence was influenced by higher-than-anticipated inflation and a robust global economy, particularly in the fourth quarter. These factors contributed to rising yields and narrowing credit spreads. This reaffirms our belief in the resurgence of bonds, as higher yields have the potential to generate positive returns even amid ongoing rate hikes and periods of heightened market volatility.

- **Moderate Growth Account:** The Moderate Growth Account, during FY2021, reported substantial earnings of \$663,245, resulting in a yield of 15.50%, reflecting its dynamic investment strategy. During the subsequent year, from July 1, 2021, to June 30, 2022, the Moderate Growth Account experienced a period of challenge, reporting earnings of -\$1,018,912, resulting in a yield of -20.66%. However, in the following year, from July 1, 2022, to June 30, 2023, the account displayed a strong recovery, generating earnings of \$395,917, resulting in a yield of 6.87%, signaling a return to a positive performance trend.

B. Rate of Returns by Account and Fiscal Year

1. **Account 7600 (39.6% Equities, 53.9% Fixed Income and 6.5% Alternatives):**
As summarized in Table 3 below, in account 7600, the Section 115 fixed income portion of the portfolio outperformed the benchmark* in FY 2021 (-1.13% versus -1.60%) and FY 2023 (.93% versus -.94%) and underperformed the benchmark in FY 2022 (-13.82% versus -10.35%). The equity portion of the portfolio underperformed the benchmark in FY 2021 (12.71% versus 15.25%), in FY 2022 (-26.55% versus -10.60%), and in FY 2023 (17.48% versus 19.59%).

Table 3. Account 7600 Rate of Return by Fiscal Year and Asset Allocation

	FY2021	FY2021 Benchmark	FY2022	FY2022 Benchmark	FY2023	FY2023 Benchmark
Fixed Income	-1.13%	-1.60%	-13.82%	-10.35%	.93%	-.94%
Equities	12.71%	15.25%	-26.55%	-10.60%	17.48%	19.59%
Alternatives	19.83%	N/A	-8.21%	N/A	-2.39%	N/A
Total Account	15.50%		-20.66%		6.87%	

Benchmark: S&P 500 Total Return Index

2. **Account 7590 (100% Fixed Income):**

As summarized in Table 4 below, Account 7590 underperformed the benchmark in FY 2022 (-15.22% versus -10.30%) and outperformed the benchmark in FY 2021 (2.00% versus -.94%) and FY 2023 (.90% versus -.94%).

Table 4. Account 7590 Rate of Return by FY and Asset Allocation

	FY 2021	FY2021 Benchmark	FY 2022	FY2022 Benchmark	FY 2023	FY2023 Benchmark
Fixed Income	2.00%	-.94%	-15.22%	-10.30%	.90%	-.94%
Total Account	2.00%		-15.22%		.90%	

Benchmark: Bloomberg US Aggregate Bond Index

The yield of the Section 115 Trust Fund for the fiscal year ended June 30, 2023 compared to the fiscal year ended June 30, 2022, was as follows. As shown in Table 5 below, for FY2023, the fixed income account yielded a return of 0.90%, while the moderate growth account returned 6.87%. This represents an increase of 1,612 basis points from the 15.22% return in FY2022 for the fixed income account and an increase of 2,753 basis points from the -20.66% return in FY2022 for the moderate growth account.

Table 5. Yield by Fiscal Year

For Fiscal Year Ended 6/30/2023 Compared to 6/30/2022		
Trust Fund	6/30/2023	6/30/2022
Fixed Income Account	0.90%	-15.22%
Moderate Growth Account	6.87%	-20.66%

Economic overview and Investment Outlook

- **Fixed Income:** The fixed income outlook suggests a favorable environment with a receding U.S. recession risk and controlled inflation. However, longer-maturity government bonds face challenges due to valuations and tightening monetary policy. While uncertainties persist, employment remains strong, and the goods sector is showing signs of improvement, supported by capital expenditures and fiscal backing. Monetary policy may ease as inflation falls, potentially benefiting shorter-maturity bonds. Credit markets have tightened, especially in investment-grade non-financials, while high-yield markets remain volatile. Selectivity is crucial in high-yield investments. Shorter maturity securitized credit is favored, particularly non-agency residential mortgages. Overall, fixed income presents attractive opportunities, with caution advised for longer-maturity bonds and a preference for shorter maturities and select credit investments.
- **Global Equity:** The sector picture has been a reversal of 2022, as the market has been led by the growthier sectors that suffered last year: consumer discretionary, communication services and, in particular, information technology, with the outpouring of euphoria around the promise of generative artificial intelligence (AI) offering a new lease on life for tech mega-caps after a tough 2022. June saw a more general cyclical recovery, but up until the end of May, the 'magnificent seven' or 'MANAMAT' (Meta, Apple, Nvidia, Amazon, Microsoft, Alphabet, Tesla), around

a quarter of the S&P 500 Index by weight, had effectively delivered all the U.S. index returns, with the other 493 constituents being slightly down overall.

Inflation rose to unacceptably high levels in 2022, causing the Federal Reserve Board to tighten monetary policy significantly to combat inflation. As a result, the Fed raised interest rates from a range of 0%-.25% in March 2022 to a range of 5.25%-5.50% currently. During this period the average mortgage rose from a little over 4.1% to 7.5% currently. In addition, the Feds began a program to sell \$95 billion/month (or \$1.14 trillion) of Agency and Mortgage-Backed securities from its Balance Sheet, which will increase the supply of these securities and put additional upward pressure on mortgage rates. This has already significantly reduced consumer spending and has started slowing down the economy.

Gigantic and ongoing federal budget deficits, high inflation and the Federal Reserve Board tightening of the monetary supply to fight high inflation have replaced the COVID-19 pandemic as the biggest headwinds to economic growth over the next few years. The Feds Chairman said the Federal Reserve will keep interest rates at a high level until its preferred inflation index (i.e., Core Personal Consumption Expenditure Index or PCE Index) declines below its target of 2% and the Feds is convinced it will remain so. It is currently 3.88%, almost double the Feds target rate. The Federal Reserve is trying to engineer a soft landing for the economy (i.e., slowing the economy by tightening the money supply, but not creating a recession); the Feds may or may not be successful at engineering this soft landing. The proposed \$1.8 trillion federal budget deficit for the upcoming fiscal year will require the issuance of additional \$1.6 trillion in Treasury Bonds to fund the deficit. This additional huge supply of bonds will overwhelm demand for Treasury Bonds and put further upward pressure on long-term interest rates.

BACKGROUND

At the November 28, 2017 City Council meeting, the City Manager was instructed to present a proposal for establishing an Irrevocable Supplemental Pension Trust, along with other options proposed by staff.

On June 26, 2018, the City Council adopted a Resolution appointing the City Manager as the Plan Administrator. This resolution authorized the City Manager to initiate the necessary steps for negotiating and executing documents to establish a Section 115 Trust Fund, intended to serve as a pension rate stabilizing fund. Additionally, it delegated authority for managing the Section 115 Trust Fund investments.

During the Request for Proposals (RFP) process, the City identified three agencies capable of providing professional trust administrative, trustee/custodial, and investment advisory or management services: Public Agency Retirement Services (PARS), PFM Asset Management LLC (PFM), and Keenan. RFPs were sent out, and the responses were evaluated by a review committee, which included the Director of Finance, Treasury

Manager, and an external consultant for the City. Keenan Financial Services received the highest rating from all three reviewers based on the outlined criteria in the RFP.

On May 14, 2019, during the City Council meeting, the City Council adopted a Resolution authorizing the City Manager to execute a contract with Keenan Financial Services to establish a pension Section 115 trust. This contract includes Keenan Financial Services providing trust administration, trustee/custodian, and investment advisory services. The structure of the trust includes the following components:

- Trust Administrator: Keenan
- Trustee/Custodian: Benefit Trust Company
- Investment Manager: Morgan Stanley

Benefit Trust Company (BTC) actively manages plan assets. The City's individual trust account is part of a larger Multiple Employer Trust administered by Keenan Financial Services and BTC. BTC also provides the City with monthly and quarterly statements detailing the activity of the City's accounts.

The primary purpose of the Pension Stabilization Trust is to accumulate, hold, and distribute pension plan assets exclusively for the benefit of retiree pensions, as defined by IRS Code Section 115. These plan assets are irrevocable and can only be used for the intended purpose of the Trust.

The City's principal objective in establishing the Pension Trust is to control long-term costs and mitigate the annual operating budget's volatility. The trust offers increased flexibility to the City, allowing for more consistent contributions and reduced year-to-year contribution volatility.

ENVIRONMENTAL SUSTAINABILITY AND CLIMATE IMPACTS

There are no identifiable environmental effects or opportunities associated with the subject of this report.

CONTACT PERSON

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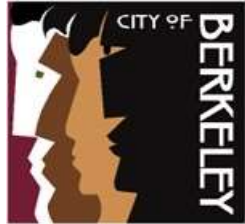
ATTACHMENTS

1. Portfolio Evaluation Inception to June 30, 2023
2. Investment Report Analysis Inception to June 30, 2023
 - a. Exhibit 2-A: Summary Information by Portfolio
 - b. Exhibit 2-B: Investment by Type
 - c. Exhibit 2-C: Market Value by Type
 - d. Exhibit 2-D: Investment Portfolio Trend



**Portfolio Evaluation
As of June 30, 2023**

	Analysis by Fiscal Year			
	<u>6.30.2023</u>	<u>6.30.2022</u>	<u>6.30.2021</u>	<u>9.30.2020 (Inception)</u>
Total Portfolio				
Pooled Cash	\$ 4,687,819	\$ 407,748	\$ 1,432,226	\$ -
Fixed Income Account (7590)	8,307,805	8,257,710	6,469,347	6,356,407
Moderate Growth Account (7600)	6,137,707	5,759,296	4,931,280	4,278,393
Total Cash and Investments	<u>\$ 19,133,331</u>	<u>\$ 14,424,755</u>	<u>\$ 12,832,853</u>	<u>\$ 10,634,799</u>
Earnings				
Fixed Income Account (7590)	74,673	(984,712)	127,368	
Moderate Growth Account (7600)	395,917	(1,018,912)	663,245	
Total Earnings	<u>\$ 470,590</u>	<u>\$ (2,003,624)</u>	<u>\$ 790,613</u>	
Yield YTD				
Fixed Income Account (7590)	0.90%	-15.22%	2.00%	
Moderate Growth Account (7600)	6.87%	-20.66%	15.50%	



**Investment Report Analysis
As of June 30, 2023**

Cash and Investments	Section 115	
	Trust Investments	Total
Portfolio	\$ 10,634,799	\$ 10,634,799
Unrecognized gain/(loss)	3,810,713	\$ 3,810,713
Total Investments	\$ 14,445,512	\$ 14,445,512
Cash	Pooled Cash	Total
Cash Deposits in Bank	4,687,819	4,687,819
Total Cash	4,687,819	4,687,819
Adjusted Grand Total (All Cash and Investments)	\$ 19,133,331	\$ 19,133,331

Section 115 Trust Portfolio Breakdown As of June 30, 2023

	Book Value	Market Value
Fixed Income	8,687,089.21	11,614,770.27
Equities	1,703,409.07	2,433,489.57
Alternatives	244,301.08	397,252.50
Total Investments	\$ 10,634,799	\$ 14,445,512



Summary of Investments - Section 115 Trust Funds
City of Berkeley
Investment Report Analysis

<u>Quantity</u>	<u>Security Symbol</u>	<u>Investments (Book Value)</u>	<u>Gain/Loss on Investments</u>	<u>Investments (Market Value)</u>	<u>Curren Yield</u>
MODERATE GROWTH AOCUNT PENSION STABILIAZATION TRUST - BENEFIT ACCOUNT 7600					
FIXED INC MUTUAL FUNDS					
TAXABLE BOND FUND					
65,989.663	MPHQ.X	777,380	(119,463.35)	657,917	3.4
40,734.878	GIUS.X	787,244	(127,746.52)	659,498	3.7
13,928.713	GIOS.X	362,588	(30,666.60)	331,921	5.3
55,848.763	PTRQ.X	787,366	(126,116.75)	661,249	4.1
65,455.439	PGTQ.X	421,286	(88,117.81)	333,168	4.1
70,106.967	WAPS.X	811,784	(148,571.70)	663,212	3.6
FIXED INC MUTUAL FUNDS TOTAL		3,947,648	(640,683)	3,306,965	3.9
DOMESTIC EQUITY MUTUAL FUNDS					
LARGE CAP FUND					
6,329.701	ALGY.X	313,712	(1,404.13)	312,307	0.1
14,978.675	COFY.X	447,059	8,742.15	455,801	0.6
4,605.795	LCSS.X	186,086	15,371.03	201,457	0.0
LARGE CAP FUND TOTAL		946,857	22,709	969,566	0.3
SMALL CAP FUNDS					
11,929.120	AGOZ.X	261,534	(53,371.06)	208,163	0.0
2,822.187	UBVF.X	181,590	33,036.93	214,627	1.2
SMALL CAP FUNDS TOTAL		443,125	(20,334)	422,790	0.6



Summary of Investments - Section 115 Trust Funds
City of Berkeley
Investment Report Analysis

<u>Quantity</u>	<u>Security Symbol</u>	<u>Investments (Book Value)</u>	<u>Gain/Loss on Investments</u>	<u>Investments (Market Value)</u>	<u>Curren Yield</u>
DOMESTIC EQUITY MUTUAL FUNDS TOTAL		1,389,982	2,375	1,392,356	0.4
INTERNATIONAL MUTUAL FUNDS					
INTERNATIONAL EMERGING MARKET FUND					
759.340	NFFF.X	55,256	1,011.28	56,267	1.1
INTERNATIONAL EMERGING MARKET FUND TOTAL		55,256	1,011	56,267	1.1
INTERNATIONAL FUND					
3,075.465	ANWF.X	163,574	6,192.10	169,766	0.9
9,182.432	GSYI.X	158,963	9,443.28	168,406	4.4
9,795.832	HILY.X	142,449	26,039.66	168,488	2.6
4,629.057	PRJQ.X	167,376	2,834.09	170,210	0.0
13,526.386	TIBO.X	293,775	14,220.96	307,996	5.3
INTERNATIONAL FUND TOTAL		926,136	58,730	984,866	3.0
INTERNATIONAL MUTUAL FUNDS TOTAL		981,392	59,741.37	1,041,133	2.9
ALTERNATIVE INVESTMENT FUNDS					
ALTERNATIVE FUND					
19,863.727	CSZI.X	335,310	(21,463.04)	313,847	3.4
4,592.820	PGRQ.X	99,033	(15,627.60)	83,406	2.3
ALTERNATIVE INVESTMENT FUNDS TOTAL		434,343	(37,091)	397,253	3.2



Summary of Investments - Section 115 Trust Funds
City of Berkeley
Investment Report Analysis

<u>Quantity</u>	<u>Security Symbol</u>	<u>Investments (Book Value)</u>	<u>Gain/Loss on Investments</u>	<u>Investments (Market Value)</u>	<u>Curren Yield</u>
TOTAL PORTFOLIO		6,753,364	(615,657)	6,137,707	3.1
FIXED INCOME ACOCUNT PENSION STABILIAZATION TRUST - BENEFIT TRUST ACCOUNT 7590					
FIXED INC MUTUAL FUNDS					
TAXABLE BOND FUND					
165815.793	MPHQ.X	1,963,200	(310,016.76)	1,653,183	3.4
102359.063	GIUS.X	1,982,742	(325,549.20)	1,657,193	3.7
34939.159	GIOS.X	908,432	(75,832.23)	832,600	5.3
140337.900	PTRQ.X	1,984,285	(322,684.64)	1,661,601	4.1
164391.532	PGTQ.X	1,054,803	(218,050.00)	836,753	4.1
176160.095	WAPS.X	2,042,657	(376,182.09)	1,666,475	3.6
FIXED INC MUTUAL FUNDS TOTAL		9,936,120	(1,628,315)	8,307,805	3.9
TOTAL PORTFOLIO		9,936,120	(1,628,315)	8,307,805	3.9
Total Trust Funds		\$ 16,689,484	\$ (2,243,972)	\$ 14,445,512	
Pooled Cash				\$ 4,687,819	
Total Cash and Investments				\$ 19,133,331	

