
MEMORANDUM TO COUNCIL

To: Mayor and City Council Members
From: Jim Sharpe, Interim Finance Director
Through: Erin Reinders, City Manager
Date: October 26, 2021
Re: Fiscal Sustainability – Permanent Fund Discussion

SUMMARY: The City's Fiscal Sustainability discussion continues. Tonight, you will hear from APCM and have a discussion focused on a Permanent Fund. This memo provides additional information regarding how the City's cash and investment balances are allocated to the various funds, placing into context what is truly available for establishing a Permanent Fund. Fiscal Sustainability is a complex topic with many components, so additional discussions will follow.

PREVIOUS COUNCIL ACTION: On October 12, 2021, City Council passed Resolution 2021-69 formally identifying promoting organizational efficiencies and Fiscal Sustainability as a primary focus area. This is supported by effort to create a standalone Emergency Fund and a new Permanent Fund, each with individual purposes, specific investment policy statement, and disbursement strategies/criteria.

Council has taken no specific formal action related to a permanent fund yet, but has supported the concept during the September 13 and 14, 2021 Council work sessions. Tonight's meeting focuses on the Permanent Fund and there will need to be follow up discussions on this topic.

Council has taken formal action two times related to identify funds for emergency operations. At a future time, we will have separate meetings on the amount set aside for Emergency Operations, within the General Fund in the future.

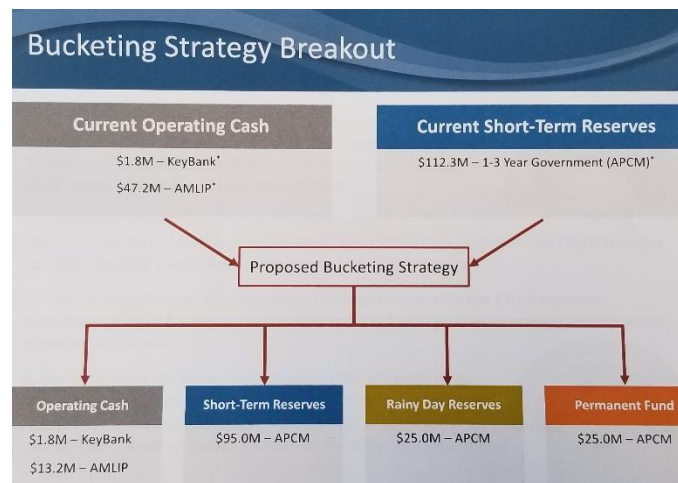
- On March 22, 2011, City Council passed Resolution 2011-19 reclassifying \$13,000,000 of General Fund unassigned fund balance to General Fund committed fund balance for emergency operations.
- On January 26, 2021, City Council passed Resolution 2021-06 reclassifying an additional \$12,000,000 of General Fund unassigned fund balance to General Fund committed fund balance for emergency operations. This resulted in a total of \$25,000,000 earmarked for emergency operations.

BACKGROUND: In December 2019, the current Council was introduced to the concept of fiscal sustainability. This introduction included a work session PowerPoint presentation followed up with a copy of the Government Finance Officers Association publication *Long-term Financial Planning for Local Government* for Council members to read.

This discussion was revisited at the January 13, 2021 City Council meeting, where more specific topics were presented, including the need to increase the amount set aside for emergency operations. As a result of this discussion, Council passed Resolution 2021-06 reclassifying \$12,000,000 unassigned fund balance to General Fund committed fund balance for emergency operations.

On September 13 and 14, 2021, staff and Alaska Permanent Capital Management (APCM) presented a concept to Council for restructuring the City’s cash and investment portfolios, which included the initial proposal of a permanent fund. During the course of those meetings, it became clear that Council wishes to establish a separate investment account to for Emergency Operations in the amount of \$25,000,000, while also contemplating a Permanent Fund in a yet to be determined amount, up to \$40,000,000.

The picture below provided an overview of the bucketing strategy we are currently developing, and was shared during the September 13 and 14, 2021 work sessions. Reference to Rainy Day Reserves is another term for Emergency Operations. The focus of tonight’s discussion is the Permanent Fund.



DISCUSSION: The ultimate goal of those discussions is to develop an approach to prudently manage City funds into the future. When determining the initial amount of money to establish a Permanent fund there are many factors to consider, as such funds would no longer be available for use to support capital projects or operations.

As of June 30, 2021, the City had cash and investment balances as follows:

Key Bank Operating account	\$1,810,934
AMLIP short-term investment account	47,238,275
APCM long-term investment account	<u>112,299,325</u>
Total	<u>\$161,348,534</u>

The City utilizes a centralized treasury concept; therefore, all cash and investments held by the City are recorded in the General Fund and each of the other non-General Fund departments’ cash balance is recorded and reported in the City’s accounting system as Due from General Fund. As of June 30, 2021, \$84,822,272 of the City’s combined cash and investment balances were allocated to the General Fund, with the remaining \$76,526,262 allocated to the City’s other funds as follows:

Non-general Fund funds:	
Coronavirus Relief Fund	\$647,087
Capital Projects Fund	\$11,453,635

1% Sales Tax Fund	\$12,792,350
Bed Tax Fund	\$16,950
Street Paving Fund	<u>\$528,135</u>
Total non-general Fund funds:	\$25,438,157

Proprietary Funds:	
Electric Utility	\$15,242,746
Water Utility	\$10,263,791
Wastewater Utility	\$5,632,491
Solid Waste Utility	\$8,426,513
Ports and Harbors	\$9,355,976
Airport	\$1,792,598
Housing	<u>\$373,990</u>
Total Proprietary Funds	\$51,088,105

Based on staff discussions with APCM and Council, the proposed use of the General Fund cash and investment balance (\$84,822,272) would be as follows;

Emergency Operations	\$25,000,000	Separate investment account
Permanent Fund	\$40,000,000	Separate investment account
Anticipated City Operations	\$19,822,272	Key Bank and AMLIP

Prudent fiscal management states that the City should have approximately 6-months General Fund expenditures in cash (Key Bank) and short-term investments (AMLIP). Utilizing that methodology, the City should have approximately \$11,800,000 for operating purposes (FY 2022 budgeted operating expenditures are \$23,569,937). The City would then have approximately \$8,000,000 available for other uses or any unplanned expenditures if City Council established a \$40,000,000 Permanent Fund. This would increase incrementally if Council selected one of the \$35,000,000, \$30,000,000, or \$25,000,000 options discussed this evening.

ALTERNATIVES: Council can elect to establish a Permanent Fund or determine that now is not the right time for that commitment. Should Council determine that a Permanent Fund is an appropriate course of action, amounts between \$25,000,000 and \$40,000,000 have been discussed. APCM will lead you through other key decision points and alternatives related to the Permanent Fund tonight as well.

FINANCIAL IMPLICATIONS: The goal is to establish a perpetual revenue source to best meet the fiscal needs of the City in future years while also having sufficient funds available for day-to-day and emergency operations, when necessary. The higher the amount set aside in a permanent fund, the greater the potential revenue may be but the amount of readily available fund for additional expenses would be reduced.

LEGAL: City attorneys will be consulted as we move forward with the development of the Permanent Fund.

STAFF RECOMMENDATION: Staff continues to recommend moving forward with establishing a Permanent Fund. APCM and City staff remain available to provide information, additional feedback and guidance as Council determines the Permanent Fund starting values and distribution options, and, in the future, related policy and account creation.

CITY OF UNALASKA

PERMANENT FUND OPTIONS

October 26, 2021



ALASKA PERMANENT
CAPITAL MANAGEMENT
Registered Investment Adviser

TRUSTED ADVISORS ▪ MORE EXPERTS ▪ BETTER ACCESS

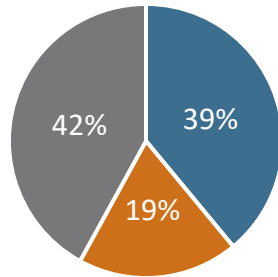
Agenda & Next Steps

- This slide deck focuses on **identifying the optimal size, distribution start time, and strategic asset allocation for the Permanent Fund.**
- Once the Council chooses to pursue one of the options, APCM can provide an updated bucketing strategy and total portfolio risk and return characteristics for the Council's review.
- Upon selection of the corresponding bucketing strategy, APCM will assist the City to implement the new strategy, including:
 - Policy drafting assistance
 - Account creation
 - Funds transfers
- Once all of the new accounts, policies, and necessary Code changes are in place, APCM will implement the new strategic plan.



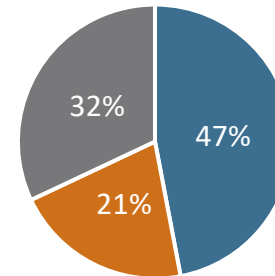
Permanent Fund Characteristics

Moderate Allocation



■ Equity ■ Alternatives ■ Fixed Income

Moderate Growth Allocation



■ Equity ■ Alternatives ■ Fixed Income

Characteristics	Moderate Allocation		Moderate Growth Allocation	
	Expected	Range*	Expected	Range*
Annual Return	5.8%	-11.3% to 22.9%	6.6%	-13.7% to 26.8%
Long-Term Return	5.5%	5.2% to 5.7%	6.1%	5.8% to 6.4%
Net Earnings <i>Long-Term Return Less 2% Expected Inflation</i>	3.5%	3.2% to 3.7%	4.1%	3.8% to 4.4%
Average Loss in Extreme Conditions <i>Within a 1-Year Horizon</i>	-21.0%	–	-24.3%	–

* Range denotes the 95% confidence interval. Risk and return data from Windham Portfolio Advisor.
Graphic is for illustrative purposes only.

Starting Value and Distribution Options 10-Year Horizon

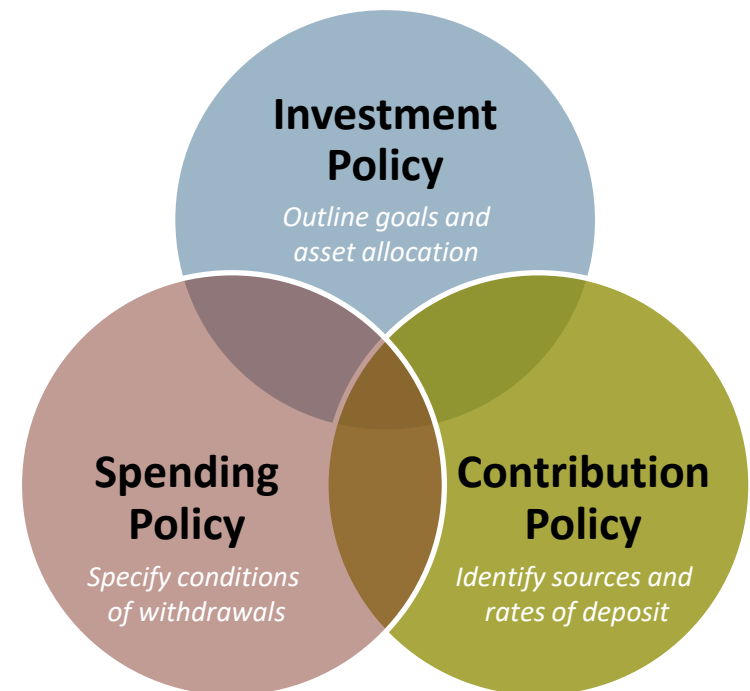
Options (\$ millions)		Distribution Starting July 2022 (Next Fiscal Year)			Distribution Starting July 2024 (in 3 Years)			Distribution Starting July 2026 (in 5 Years)		
Starting Value	Portfolio	Expected Ending Value	Avg. Distributions	Cumulative Distributions	Expected Ending Value	Avg. Distributions	Cumulative Distributions	Expected Ending Value	Avg. Distributions	Cumulative Distributions
\$25M	Moderate	30.28	0.97	9.70	32.59	1.05	8.37	34.96	1.13	6.80
	Moderate Growth	30.52	1.12	11.17	33.20	1.22	9.74	35.96	1.33	7.99
\$30M	Moderate	36.34	1.16	11.64	39.10	1.26	10.05	41.95	1.36	8.16
	Moderate Growth	36.62	1.34	13.40	39.84	1.46	11.69	43.15	1.60	9.59
\$35M	Moderate	42.39	1.36	13.58	45.62	1.47	11.72	48.94	1.59	9.52
	Moderate Growth	42.73	1.56	15.64	46.48	1.70	13.64	50.34	1.86	11.18
\$40M	Moderate	48.45	1.55	15.51	52.14	1.67	13.40	55.93	1.81	10.88
	Moderate Growth	48.83	1.79	17.87	53.11	1.95	15.59	57.53	2.13	12.78

Simulation data from Windham Portfolio Advisor. All data items reported at the 50% confidence level.

Align Investments with Goals

- **Comprehensive Set of Policies:** Policies designed to work together, within the backdrop of the City's priorities, improve the likelihood of meeting goals.
- **Modeled Spending Policy:** The simulations presented here utilized a percent of 5-year average market value spending structure.
- **Benefits of Smoothed Percent of Market Value (POMV) Structure:** The smoothed POMV structure equally prioritizes asset preservation and budgetary stability:
 - Asset preservation is enhanced by using a POMV structure which automatically adjusts distributions to the effects of returns and prior distributions;
 - While the 5-year smoothing provides enhanced budgetary stability by dampening the effect of a single high-volatility year.

Likelihood of Meeting Goals Increases
When Policies are in Alignment



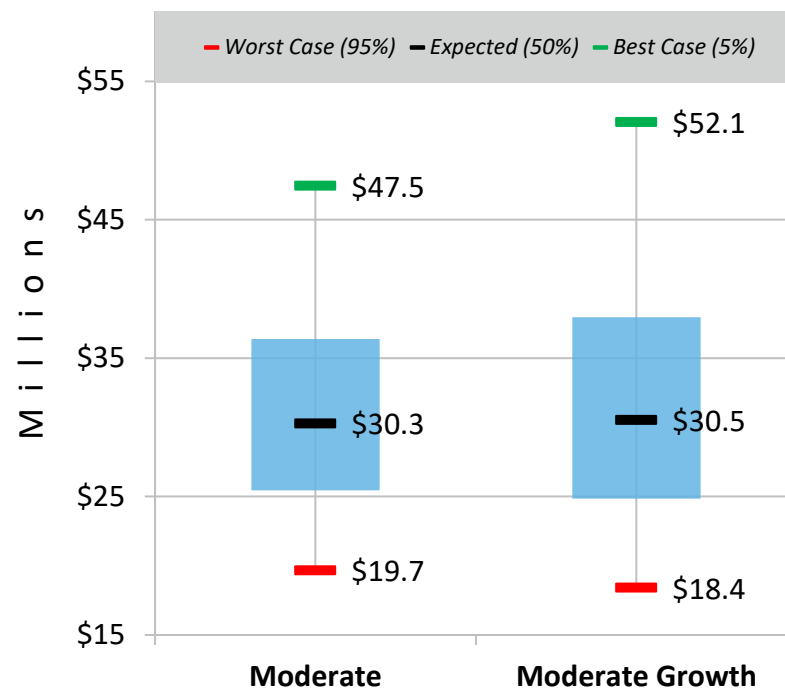
Appendix

\$25M Starting Value 10-Year Horizon

Distributions begin next fiscal year

- The simulations depicted on the right were based upon a starting value of \$25M and no contributions.
- Annual withdrawals begin starting with the next fiscal year (July 1, 2022).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%

Monte Carlo Simulation



Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	0.90	0.91	0.92	0.93	0.96	0.98	0.99	1.02	1.04	1.06
Moderate Growth	1.03	1.04	1.06	1.07	1.10	1.12	1.15	1.17	1.20	1.23

Risk and return data from Windham Portfolio Advisor.

\$30M Starting Value 10-Year Horizon

Distributions begin next fiscal year

- The simulations depicted on the right were based upon a starting value of \$30M and no contributions.
- Annual withdrawals begin starting with the next fiscal year (July 1, 2022).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%

Monte Carlo Simulation



Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	1.08	1.09	1.11	1.12	1.15	1.17	1.19	1.22	1.25	1.27
Moderate Growth	1.23	1.25	1.27	1.28	1.32	1.35	1.38	1.41	1.44	1.47

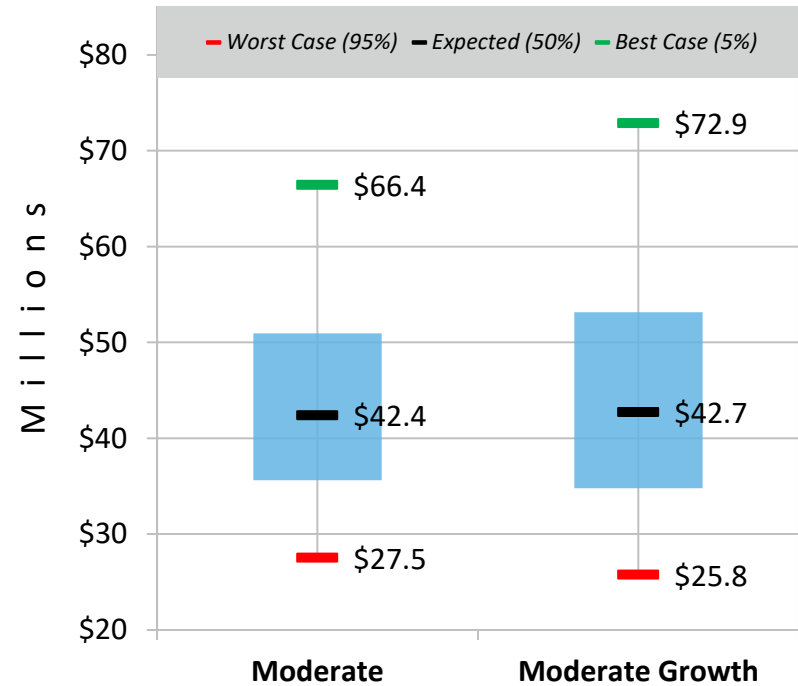
Risk and return data from Windham Portfolio Advisor.

\$35M Starting Value 10-Year Horizon

Distributions begin next fiscal year

- The simulations depicted on the right were based upon a starting value of \$35M and no contributions.
- Annual withdrawals begin starting with the next fiscal year (July 1, 2022).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%

Monte Carlo Simulation



Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	1.25	1.27	1.29	1.30	1.34	1.37	1.39	1.42	1.45	1.48
Moderate Growth	1.44	1.46	1.48	1.50	1.54	1.57	1.61	1.64	1.68	1.71

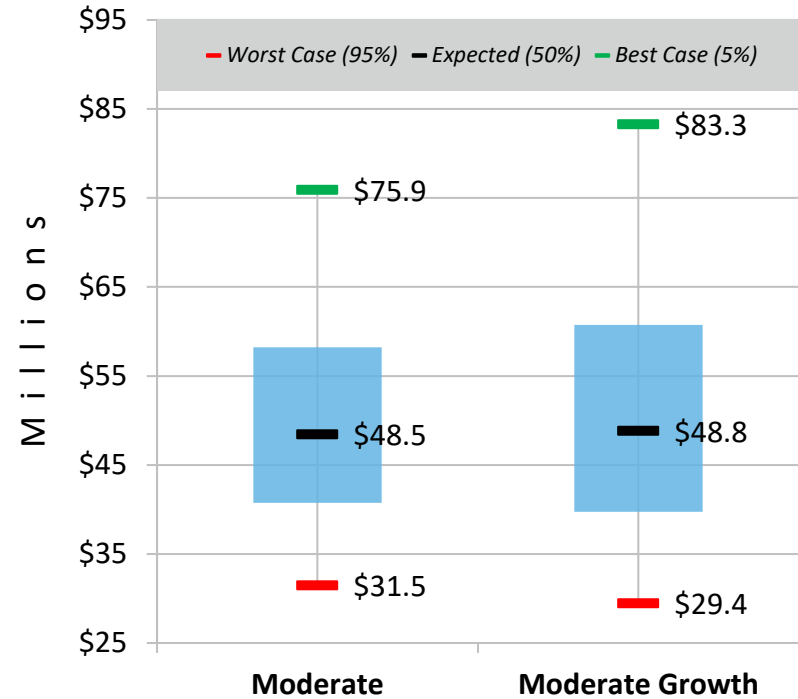
Risk and return data from Windham Portfolio Advisor.

\$40M Starting Value 10-Year Horizon

Distributions begin next fiscal year

- The simulations depicted on the right were based upon a starting value of \$40M and no contributions.
- Annual withdrawals begin starting with the next fiscal year (July 1, 2022).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%

Monte Carlo Simulation



Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	1.43	1.45	1.47	1.49	1.53	1.56	1.59	1.63	1.66	1.69
Moderate Growth	1.64	1.67	1.69	1.71	1.76	1.80	1.84	1.88	1.92	1.96

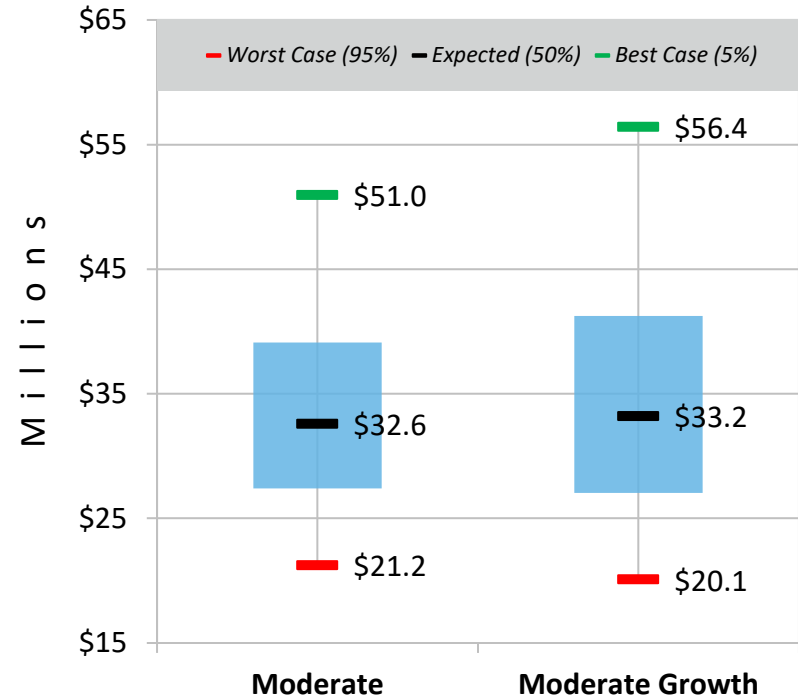
Risk and return data from Windham Portfolio Advisor.

\$25M Starting Value 10-Year Horizon

Distributions begin in 3rd fiscal year

- The simulations depicted on the right were based upon a starting value of \$25M and no contributions.
- Annual withdrawals begin in year three (July 1, 2024).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%

Monte Carlo Simulation



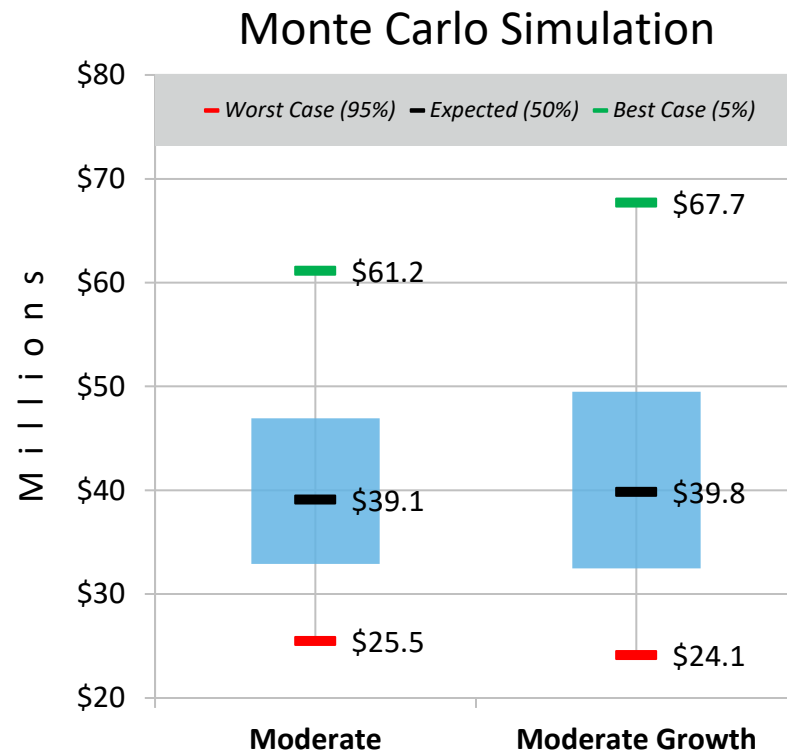
Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	–	–	0.95	0.97	1.00	1.04	1.07	1.09	1.12	1.14
Moderate Growth	–	–	1.09	1.12	1.17	1.21	1.26	1.27	1.30	1.33

Risk and return data from Windham Portfolio Advisor.

\$30M Starting Value 10-Year Horizon

Distributions begin in 3rd fiscal year

- The simulations depicted on the right were based upon a starting value of \$30M and no contributions.
- Annual withdrawals begin in year three (July 1, 2024).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%



Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	–	–	1.14	1.16	1.21	1.25	1.28	1.31	1.34	1.37
Moderate Growth	–	–	1.31	1.34	1.40	1.45	1.49	1.53	1.56	1.60

Risk and return data from Windham Portfolio Advisor.

\$35M Starting Value 10-Year Horizon

Distributions begin in 3rd fiscal year

- The simulations depicted on the right were based upon a starting value of \$35M and no contributions.
- Annual withdrawals begin in year three (July 1, 2024).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%

Monte Carlo Simulation



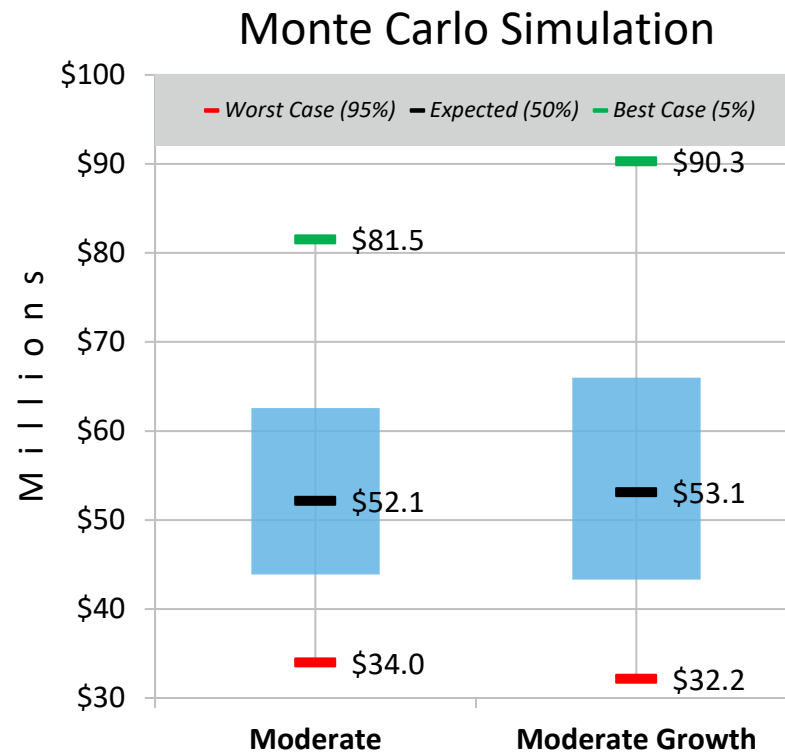
Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	–	–	1.33	1.35	1.41	1.46	1.49	1.53	1.56	1.59
Moderate Growth	–	–	1.53	1.56	1.63	1.69	1.74	1.78	1.83	1.87

Risk and return data from Windham Portfolio Advisor.

\$40M Starting Value 10-Year Horizon

Distributions begin in 3rd fiscal year

- The simulations depicted on the right were based upon a starting value of \$40M and no contributions.
- Annual withdrawals begin in year three (July 1, 2024).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%



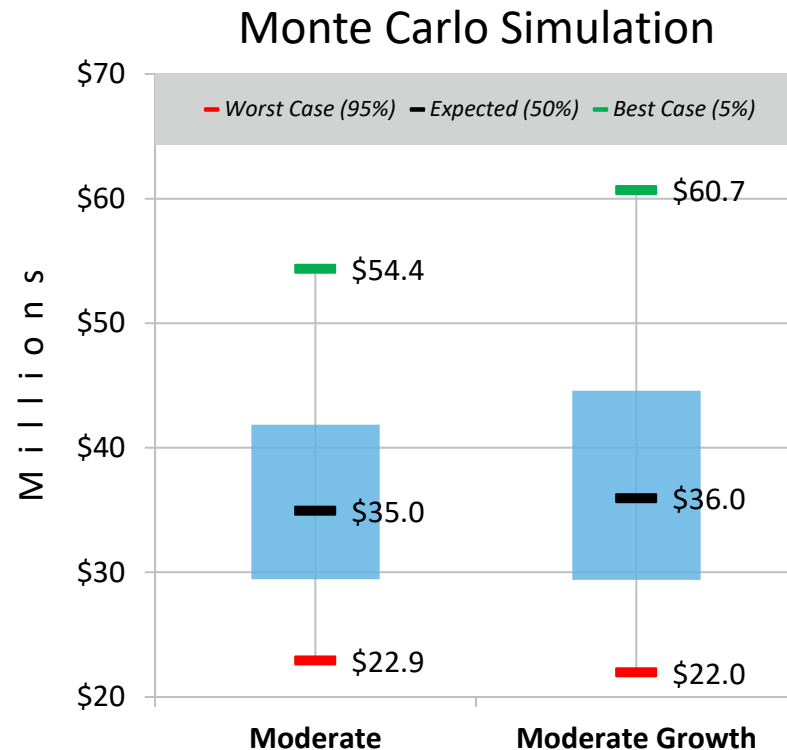
Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	–	–	1.52	1.55	1.61	1.67	1.71	1.75	1.78	1.82
Moderate Growth	–	–	1.75	1.79	1.87	1.94	1.99	2.04	2.09	2.13

Risk and return data from Windham Portfolio Advisor.

\$25M Starting Value 10-Year Horizon

Distributions begin in 5th fiscal year

- The simulations depicted on the right were based upon a starting value of \$25M and no contributions.
- Annual withdrawals begin in year five (July 1, 2026).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%



Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	–	–	–	–	1.03	1.08	1.12	1.16	1.19	1.22
Moderate Growth	–	–	–	–	1.19	1.26	1.32	1.37	1.41	1.44

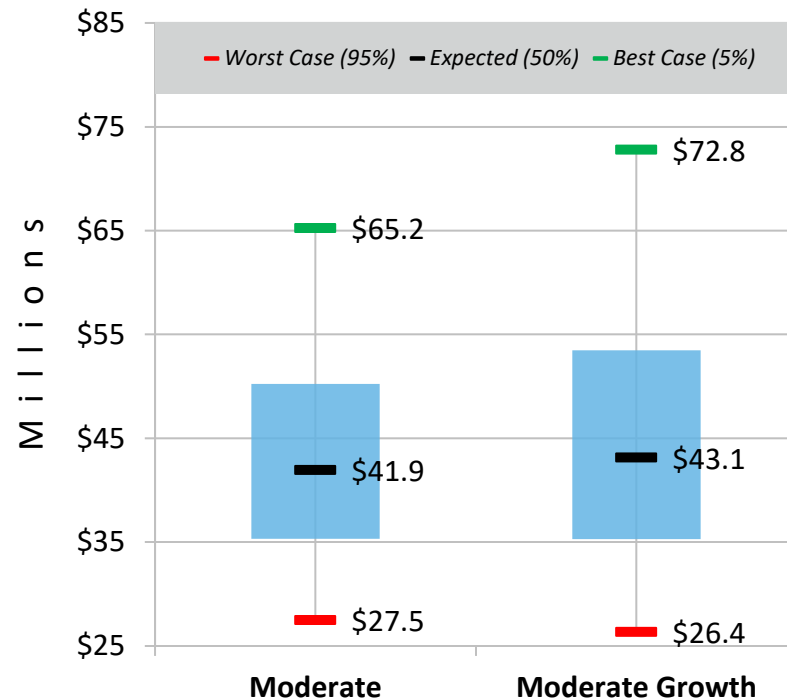
Risk and return data from Windham Portfolio Advisor.

\$30M Starting Value 10-Year Horizon

Distributions begin in 5th fiscal year

- The simulations depicted on the right were based upon a starting value of \$30M and no contributions.
- Annual withdrawals begin in year five (July 1, 2026).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%

Monte Carlo Simulation



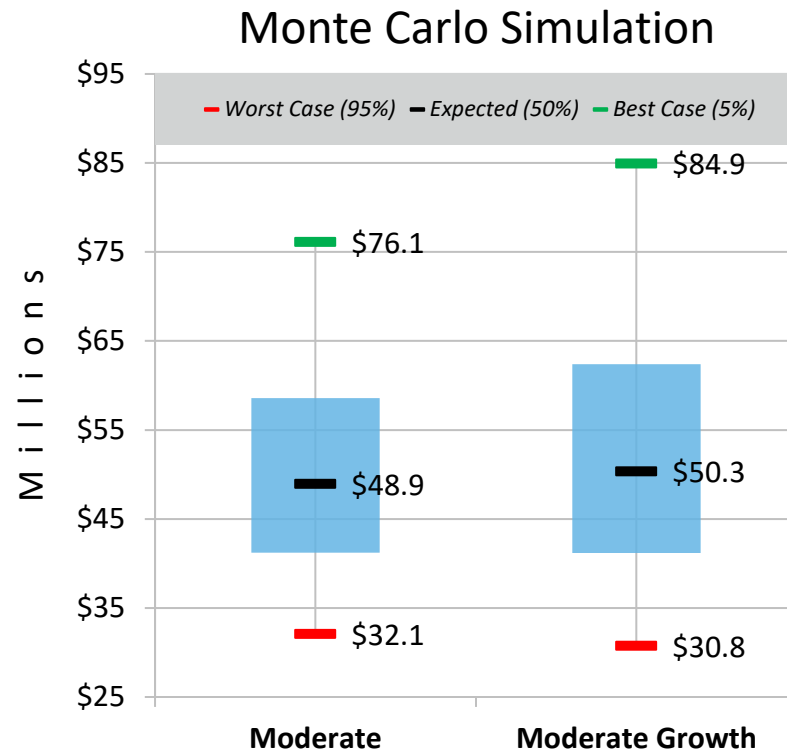
Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	–	–	–	–	1.23	1.29	1.34	1.39	1.43	1.47
Moderate Growth	–	–	–	–	1.43	1.51	1.58	1.64	1.69	1.73

Risk and return data from Windham Portfolio Advisor.

\$35M Starting Value 10-Year Horizon

Distributions begin in 5th fiscal year

- The simulations depicted on the right were based upon a starting value of \$35M and no contributions.
- Annual withdrawals begin in year five (July 1, 2026).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%



Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	–	–	–	–	1.44	1.51	1.57	1.63	1.67	1.71
Moderate Growth	–	–	–	–	1.67	1.76	1.84	1.91	1.97	2.02

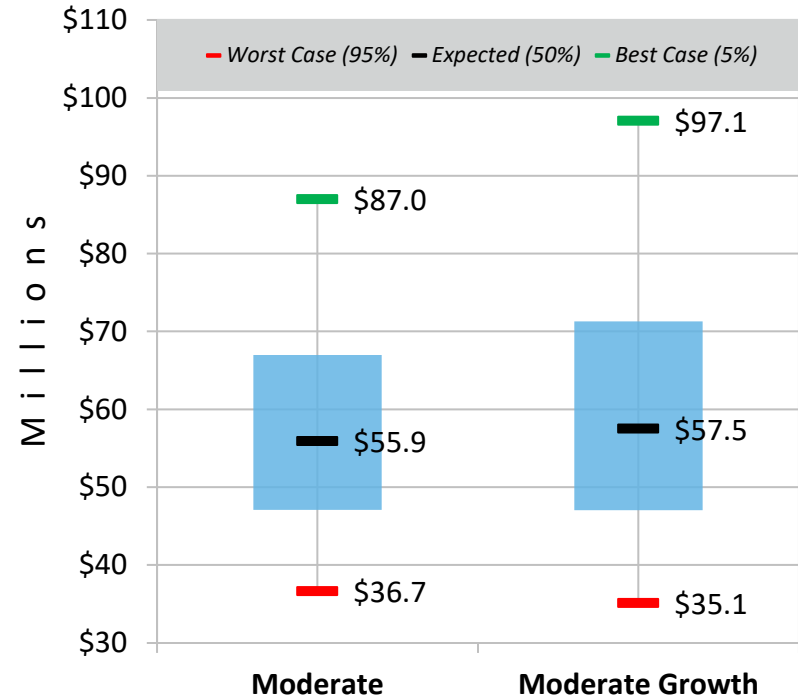
Risk and return data from Windham Portfolio Advisor.

\$40M Starting Value 10-Year Horizon

Distributions begin in 5th fiscal year

- The simulations depicted on the right were based upon a starting value of \$40M and no contributions.
- Annual withdrawals begin in year five (July 1, 2026).
- Withdrawals are based upon the sustainable rate for each option:
 - Moderate: 3.5%
 - Moderate Growth: 4.0%

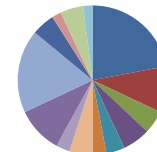
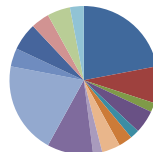
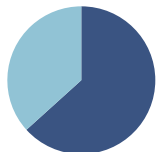
Monte Carlo Simulation



Distributions (\$ millions)	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
Moderate	–	–	–	–	1.64	1.72	1.79	1.86	1.91	1.95
Moderate Growth	–	–	–	–	1.91	2.01	2.11	2.19	2.26	2.31

Risk and return data from Windham Portfolio Advisor.

Permanent Fund Portfolio Options



Asset Class	Current Total Portfolio	Moderate	Moderate Growth
Total Equity	0.0%	39.0%	47.0%
Large Cap Equity	0.0%	22.0%	22.0%
Mid Cap Equity	0.0%	8.0%	10.0%
Small Cap Equity	0.0%	2.0%	5.0%
International Equity	0.0%	5.0%	6.0%
Emerging Markets Equity	0.0%	2.0%	4.0%
Total Alternatives	0.0%	19.0%	21.0%
REITs	0.0%	3.0%	3.0%
Infrastructure	0.0%	4.0%	5.0%
Commodities	0.0%	2.0%	3.0%
Alternative Beta	0.0%	10.0%	10.0%
Total Fixed Income	100.0%	42.0%	32.0%
U.S. Fixed Income	0.0%	20.0%	18.0%
U.S. 1-5 Year Gov/Credit	0.0%	4.0%	0.0%
U.S. Corporate High Yield	0.0%	6.0%	5.0%
U.S. 1-3 Year Government	63.3%	0.0%	0.0%
TIPS	0.0%	4.0%	2.0%
International Fixed Income	0.0%	5.0%	5.0%
Cash	36.7%	3.0%	2.0%
Expected Annual Return	1.5%	5.8%	6.6%
Long Term Expected Return	1.5%	5.5%	6.1%
Net Earnings (less inflation)	-0.5%	3.5%	4.1%

Risk and return data from Windham Portfolio Advisor. Inflation expectation 2%.

Disclosures

Important Assumptions

IMPORTANT: The projections or other information generated by Alaska Permanent Capital Management Company (APCM) regarding the likelihood of various outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. There can be no assurance that the projected or simulated results will be achieved or sustained. The charts and data only present a range of possible outcomes. Actual results will vary over time, and such results may be better or worse than the simulated scenarios. Clients should be aware that the potential for loss (or gain) may be greater than that demonstrated in the simulations. Please note that the analysis does not take into consideration all asset classes, and other asset classes not considered may have characteristics similar or superior to those being analyzed.

Important Legal Information

These calculations are designed to be informational and educational only, and when used alone, do not constitute investment advice. APCM encourages investors to review their investment strategy periodically as financial circumstances do change.

Model results are provided as a rough approximation of future financial performance. Actual results could produce different outcomes (either better or worse) than those illustrated by the model, since it is not possible to anticipate every possible combination of financial market returns. APCM is not responsible for the consequences of any decisions or actions taken in reliance upon or as a result of the information provided by the results of the model.

Other Influences on Rates of Return

Investment management fees: Returns are presented gross of management fees and include the reinvestment of all income. Actual returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. The collection of fees produces a compounding effect on the total rate of return net of management fees. As an example, the effect of investment management fees on the total value of a client's portfolio assuming (a) quarterly fee assessment, (b) \$1,000,000 investment, (c) portfolio return of 8% a year, and (d) 1.00% annual investment advisory fee would be \$10,416 in the first year, and cumulative effects of \$59,816 over five years and \$143,430 over ten years. Actual investment advisory fees incurred by clients may vary.

Taxes: Unless noted otherwise, model results have not been adjusted for any state or federal taxes or penalties.

Inflation: Unless noted otherwise, model results do not adjust any inputs or outcomes for inflation. Inflation is assumed to be constant over the investment horizon.

Limitations Inherent in Model Results

Limitations include but are not restricted to the following:

Model results do not represent actual trading and may not reflect the impact that material economic and market factors might have had on APCM's decision making if the actual client money were being managed.

Extreme market movements may occur more frequently than represented in the model.

Some asset classes have relatively limited histories. While future results for all asset classes in the model may materially differ from those assumed in APCM's calculations, the future results for asset classes with limited histories may diverge to a greater extent than the future results of asset classes with longer track records.

Market crises can cause asset classes to perform similarly over time; reducing the accuracy of the projected portfolio volatility and returns. The model is based on the long-term behavior of the asset classes and therefore is less reliable for short-term periods. This means that the model does not reflect the average periods of "bull" and "bear" markets, which can be longer than those modeled.

The model represent APCM's best view of the next 7-10 years, but is unlikely to reflect actual investment returns worldwide over this period.