Municipality Of Anchorage

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Ethan Berkowitz, Mayor

INVESTMENT ADVISORY COMMISSION

June 13, 2017

Mayor Ethan Berkowitz
Municipal Assembly
Municipality of Anchorage
PO Box 196650
Anchorage, AK 99519

RE: Investment Advisory Commission Annual Report – 2016 Year in Review

Dear Mayor Berkowitz and Assembly Members:

The Investment Advisory Commission's (the "Commission") charge under the enabling ordinance AO No. 95-46 is to act in a non-fiduciary capacity to the Administration and the Assembly in giving advice on matters concerning the investment of municipal funds including the Municipality of Anchorage (the "MOA") Trust Fund (the "Trust"). In that capacity, the Commission believes that the Investment Policy Statement utilized in 2016 for the Trust represented a prudent investment policy which the Commission viewed as appropriate for the capital markets environment. In 2017, the Commission intends to review revisions to the investment policies and parameters guiding prudent investment management of the Trust, based on recommendations from the investment consultant, and the Commission also will review the first full year of performance associated with the revised investment policies put in place Q4 2016 for the municipal cash pool investments.

AO 95-46 further requires that the Commission report annually to the Mayor and the Assembly, the text of which is as follows:

THE MOA TRUST FUND

The MOA Trust Fund and MOA Trust Reserve ("Reserve Fund") were established in May 1999, following the sale of the Anchorage Telephone Utility (ATU), with an initial total deposit of $118.6 million. In May 2000, $40 million was received from the Police/Fire Retirement Fund settlement; these new assets were allocated 50% to the Trust Fund (Fund 730) and 50% to the Reserve Fund (Fund 731). Late in 2000 approximately $15.1 million of the $20 million deposited in the Reserve Fund was used to defease two municipal revenue bonds. In January 2002, an additional $1.3 million from a Bank of America Settlement was added to the Trust Fund. In June 2014 an additional $1.93 million was deposited into the Trust following Assembly appropriation made in conjunction with the 1st Quarter 2014 General Government Operation Budget revision. Since the ATU sale closing, $120.1 million in annual dividends have been paid to the MOA as return on investment. Including the bond defeasance, just over $135.2 million has been distributed from the Trust Fund/Reserve Fund. This is now contained in its entirety within a single fund (730), as the need for the Reserve Fund was eliminated when the dividend distribution formula was changed to a percentage of market value approach in 2002.

The Trust's planning time horizon is greater than five years and its risk tolerance is moderate to moderately high with a specific stated objective to maintain purchasing power of the corpus while simultaneously generating earnings for distribution.

The projected dividend to be paid to the MOA from the Trust in 2017 is $6.0 million based on AO No. 2016-127. The spending policy was changed from 4% of the "average asset balance" to 4.25% to reflect the Trust Fund's recovery in market value from the impact of the downturn in the markets resulting from the 2008-2009 recession. For this calculation the "average asset balance" is defined as the average of the trailing 20 calendar quarters ended March 31 each year.

2016 RESULTS

The market value of the Trust Fund portfolio on 12/31/16 was $147.7 million (before net effect of year-end accruals) compared to the 12/31/2015 market value of $144.8 million. There were no additional deposits to the fund in 2016 and the total dividend withdrawal for the calendar year ended 12/31/2016 was $5.4 million. The Trust experienced an overall return of 6.07% in calendar year 2016 (results per RVK). This return trailed the target policy index by 1.41%. The policy index is comprised of market indices weighted in the same proportion as the Trust's long term allocation policy. The policy index had a total return of 7.48% for 2016.

As per the Investment Policy Statement, the asset allocation for the Trust in 2016 covered five core asset classes, namely: Domestic Equities, International Equities, Fixed Income, TIPS and Real Estate. These asset classes are managed by nine individual managers, each tasked with a specific mandate for their respective asset class.

The individual manager's portfolio market values at year end, percentage of total portfolio, annual return for 2016, and corresponding bench mark returns as calculated by RVK, were as follows:

	2016 Year End Market Value	Percent of Portfolio	2016 Return
Domestic Equity Composite	**$ 51,007,473**	**34.54%**	**9.19%**
Russell 3000 Index			12.74%
Large Cap Equity Composite	**$ 43,205,328**	**29.26%**	**8.54%**
AllianceBernstein	$ 14,813,958	10.03%	10.62%
SSGA Premier Growth Equity Fund	$ 13,814,036	9.35%	2.94%
Vanguard Index Fund	$ 14,577,334	9.87%	11.93%
Standard & Poor's 500 Index			11.96%
Mid Cap Equity Composite	**$ 3,883,054**	**2.63%**	**11.36%**
Vanguard Mid Cap Index Fund	$ 3,883,054	2.63%	11.22%
Vanguard Spl Mid Cap Index			11.25%
Small Cap Equity Composite	**$ 3,919,091**	**2.65%**	**14.52%**
BlackRock Small Cap Equity Fund	$ 3,919,091	2.65%	N/A
Russell 2000 Index			21.31%
International Equity Composite	**$ 36,468,416**	**24.70%**	**1.10%**
EuroPacific Growth Fund	$ 18,225,926	12.34%	0.92%
Templeton Foreign Equity Fund	$ 18,242,489	12.35%	1.30%
MSCI ACW ex-US Index			4.50%

	Market Value	Percent of Portfolio	2016 Return
Domestic Fixed Income Composite	**$ 44,647,660**	**30.24%**	**6.57%**
FIAM Core Plus Bond Fund	$ 39,921,998	27.03%	6.19%
Western Asset Floating Rate Fund	$ 4,725,662	3.20%	9.86%
Bloomberg US Agg Bond Index			2.65%
S&P/LSTA Leveraged Loan Index			10.36%
Real Estate Composite	**$ 13,285,430**	**9.00%**	**5.98%**
UBS Trumbull Property Fund	$ 13,285,430	9.00%	6.05%
NCREIF ODCE			7.79%
Cash Account	$ 2,258,862	1.53%	
Total Fund	**$147,667,841**	**100.00%**	**6.07%**
Policy Target			7.48%

Overall, the Trust returned 6.07% underperforming its Investment Policy benchmark by 1.41% in what proved to be a volatile market for investments in general. Equity returns for the year were largely positive, with US markets outpacing non-US developed markets. Emerging did rebound from past years, returning 11.19% for 2016. Real estate continued its strong performance, returning 8.72% for the year.

At the portfolio level, the Trust's active equity managers largely trailed their respective indexes, which was the major contributor to the Trust's underperformance relative to its policy index. In the large cap US equity space, AllianceBernstein and State Street (formerly GE) underperformed their benchmarks by 6.72% and 4.14%, respectively. The Commission – along with the Finance Department and investment consultant – intend to have a greater focus on the mix of active and passive investments specifically within the US equity portfolio; the consolidation of the two active large cap managers into a low cost core index fund is currently underway. Active management within international equity was also a detractor from relative performance, although to a lesser extent. The Trust's fixed income investments performed well during 2016, outperforming the broad index by 3.92%.

At the macro-economic level, central banks continued to weigh the benefits of sustained low interest rates relative to the strength of the global economy. In the US, the Federal Reserve continued to gradually increase the Federal Funds rate, although at a somewhat slower pace than the market expected. As the US economy remains stronger than most – especially many developed European nations – there will likely be continued divergence between central bank policy in the US and abroad. The recent US election results have also impacted global markets to a certain degree, with many investors viewing the potential changes to policy and trade as a headwind to non-US equity markets.

In consideration of these market forces, the Commission reiterates its belief that the core tenants of Investment Policy, that of diversification and allocation, remain the most effective strategy to achieve the long term investment goals of the Trust and to mitigate risk and volatility within the Trust portfolio.

The Municipal Cash Pool (MCP)

In late October 2006, the Assembly passed AO 2006-145 which broadened the investment parameters available for investment of the Municipality's general cash pool. Prior to this time the general cash pool was managed in-house with a 90 day Treasury and Agency strategy. In early 2007, the Commission participated in the process which redefined the investment strategy and created the Municipal Cash Pool ("MCP"), a subset of the general cash pool. The Commission also participated in the selection of external money managers for the MCP to invest cash on behalf of General Government, Municipal Utilities and the Anchorage School District. On June 1, 2007, the Municipality initiated the new MCP structure, which is comprised of three Portfolios of fixed income securities, each with a separate manager, targeted duration, and respective benchmark and together these three Portfolios hold the majority of funds in the general cash pool. Each year the Public Finance and Investments Division staff performs a rebalancing evaluation of the three Portfolios of the MCP in consultation with Callan Associates. This review is based upon forecasted cash flows, liquidity needs and projected issuance of Tax Anticipation Notes.

Strategic Reserve Portfolio This Portfolio is managed by BlackRock, and at year end, had assets of approximately $216 million. This Portfolio is the longest duration Portfolio of the MCP. The intent is that this Portfolio would be the last one tapped in the event of required liquidity. As of October 4, 2016 the benchmark is a composite of 75% Bloomberg Barclays Intermediate US Government/Credit Index and 25% Bloomberg Barclays Intermediate US High Yield Total Return Index. Prior to October 4, 2016 the benchmark was the Bloomberg Barclays Intermediate US Government/Credit Index. The change was a result of one of the recommendations from the 2016 Investment Strategy Review performed by the Public Finance & Investments Division staff and their independent investment advisor, Callan Associates. The recommendation was to permit Blackrock to invest up to 30% of the Portfolio into High Yield securities. For calendar 2016, the Portfolio returned 2.85% versus the benchmark return of 2.64%.

Contingency Portfolio This Portfolio is a Core Short Term Duration Portfolio that is currently managed by PNC Capital Advisors (PNC). The Portfolio at year end held approximately $167 million. This Portfolio is the middle duration Portfolio of the MCP. The intent of this Portfolio is to provide liquidity should the Working Capital Portfolio be depleted. The benchmark as of October 1, 2016 is the Bloomberg Barclays 1-3 Year US Government/Credit Index. Prior to October 1, 2016 the benchmark was the Bloomberg Barclays 1-3 Year US Government Index. The change was a result of one of the recommendations from the 2016 Investment Strategy Review. The effect of this recommendation was to bring in line the benchmark to the strategy that PNC was already following which was to compete against the 1-3 Year US Government/Credit Index rather than the 1-3 Year US Government Index. For calendar year 2016, the Portfolio returned 1.33% versus the benchmark return of 1.28%.

Working Capital Portfolio This Portfolio is used for day to day cash flow and liquidity and is managed by Alaska Permanent Capital. Assets at year-end in this Portfolio were approximately $179 million. The benchmark for this portfolio is the BofA Merrill Lynch 3-Month U.S. Treasury Bill Index. For calendar year 2016, the Portfolio returned 0.45% versus the benchmark return of 0.33%.

Restricted/Internally Managed Portfolio This Portfolio is managed by the Municipality's Public Finance & Investments Division staff. This Portfolio aggregated approximately $145 million in assets at year-end and are comprised of assets that are primarily bond proceeds, debt service accounts, debt service reserve accounts, short term cash and other specifically restricted assets that are required to be independent of the MCP.

Summary of the Total Aggregate Portfolio – General Government

These four Portfolios comprise the Total Aggregate Portfolio. In 2016 the Total Aggregate Portfolio earned 1.17% (net of MCP fees) against the Composite Benchmark Return of 1.34%. Since the inception of the new investment strategy in 2007, the Total Aggregate Portfolio has returned 1.77% (annualized, net of MCP fees), whereas the Composite Benchmark Return over the same period was 1.67%. The Public Finance and Investments Division staff calculated that the new strategy return of 1.77% outperformed a benchmark representing the pre-June 2007 strategy by 1.16%. In dollar terms, this means the new investment strategy has generated an additional $74.4 million in investment earnings for the MOA since its inception when compared to the pre-June 2007 strategy.

Conclusion

The Commission reaffirms its commitment to the core tenants of the MOA Trust's current investment policy – namely diversity and fixed allocation guidelines and believes they will continue to serve the Trust well in the current economic environment.

The Commission also believes that the returns of the Municipal Cash Pool continue to validate the Best Practice investment strategy for the management of the MCP and the Total Aggregate Portfolio.

This annual report was approved unanimously by the Commission at its May 11, 2017 regular meeting.

Alex Slivka, Chair
Investment Advisory Commission