MUNICIPALITY OF ANCHORAGE

ASSEMBLY INFORMATION MEMORANDUM

No. AIM 56-2018

Meeting Date: June 12, 2018

FROM: Mayor

SUBJECT: MOA Trust Fund Status – 2017 Year in Review

This information memorandum is intended to meet Anchorage Municipal Code (AMC) 6.50.060K which requires a report on the performance of the MOA Trust Fund's investments to be provided to the Assembly on an annual basis.

The MOA Trust Fund Report:

Background

The MOA Trust Fund (hereinafter referred to as the "Trust") was established May 14, 1999 from the net proceeds generated by the sale of the Anchorage Telephone Utility. The Trust began with two components, the "Corpus" which, except under very specific circumstances, cannot be spent without a vote of the people, and the "Reserve", which cannot be spent without Assembly authorization. *Note: In 2003 the decision was made to extinguish the Reserve, with the residual balance being transferred to the Trust.*

Additions/Subtractions

No new deposits were made to the Trust in 2017.

On four different occasions during 2017, a collective total of $6.0 million in dividend withdrawals were made to fulfill the 2017 budget expectation. The timing of these four withdrawals were spread out and managed in order to reduce potential downside market timing risk.

Per its definition in AMC 6.50.060, the *annual dividend* is subject to the controlled spending policy and shall be paid no later than 15 days prior to the end of the fiscal year. The current authorized payout rate cited in AMC is 4.25% and this percentage figure is applied to the average of the trailing 20 quarters of market values marked at March 31 of each year.

Market Value

The market value of the Trust at December 31, 2017 was $165.1 million (Fund 730000, unaudited, rounded) -- this represented a $17.4 million increase over the prior year, excluding payment of the annual dividend payment and Trust expenses. The trailing 5 years of calendar year-end market values for the Trust, as well as related annual dividend payouts and calculated annual returns, are summarized as follows:

Calendar Year	Market Value	Dividend Paid in Calendar Year	Annual Return
2013	$144.2 million	$4.7 million	17.4%
2014	$149.0 million	$4.9 million	5.8%
2015	$144.8 million	$5.2 million	0.8%
2016	$147.7 million	$5.4 million	6.1%
2017	$165.1 million	$6.0 million	16.3%

2017 Performance

In 2017, the Trust's domestic stock holdings produced a return of 22.05% as compared to international stocks which returned 26.99%; fixed income returned 4.63% and direct real estate returned 5.21%. The Trust experienced an overall 16.3% return (rounded) in calendar year 2017 per calculation by the Trust's investment consultant (i.e., RVK based in Portland, Oregon). The Trust's 2017 performance outperformed its Investment Policy benchmark return by 52 basis points (i.e., 0.52%).

Other major Alaskan investment funds experienced the following positive returns in 2017:

- Alaska Permanent Fund experienced a 16.14% return.
- Alaska Retirement Mgmt. Board (PERS) experienced a 15.52% return (prelim.).
- Anchorage Police/Fire Retirement System experienced a 17.12% return.

In commenting on the Trust's 2017 performance our investment consultant (Spencer Hunter of RVK) offered the following:

> *As a whole, 2017 provided investors strong returns across all major asset classes. Domestic equities, as measured by the Russell 3000 Index, finished the year with a robust return of 21.13%. Domestic large cap stocks outpaced small cap and growth outperformed value, both trends a reversal from 2016. International equities outpaced US equities, with the broad market returning a 27.19%, as measured by the MSCI All Country World ex US Index. Emerging markets equities returned 37.28%, the highest return for emerging markets since 2009. Citing strong US and global economic growth, the Federal Reserve Open Market Committee raised the federal funds rate three times in 2017, with each increase raising the Federal Funds rate by 25 basis points. Despite headwinds from rising interest rates and a flattening yield curve, the Bloomberg US Aggregate Bond Index returned 3.54% in 2017. US Treasuries posted muted returns, largely due to rate increases during 2017. Corporate credit – both investment and non-investment grade – drastically outperformed government and government-related securities, with investment grade returning 6.42% and non-investment grade returning 7.50%. Core real estate investors continued to be rewarded in 2017 with a strong positive return of 7.62% for the NCREIF ODCE*

Index as a result of continued demand for well-occupied, well-located property. Even as US property valuations surpass all-time peak levels, as measured by capitalization rates, fundamentals amongst major property types remain strong and there appears to be continued investor demand.

The MOA Trust posted a total return of 16.32% in calendar year 2017, outperforming its target policy index by 0.52%. The policy index consists of market indices weighted in the same proportion as the Trust's long-term asset allocation policy. The Trust's longer-term performance for the 5-, 7- and 10-year periods ended December 31, 2017 also exceeds the policy index.

The Trust's outperformance versus the target policy index during 2017 was primarily due to active management in non-US equity and fixed income. In the non-US equity portfolio, Templeton outperformed its index by 0.26%. The fixed income composite outperformed the Bloomberg US Aggregate Bond Index by 1.09%, primarily due to Fidelity's (FIAM) allocations to emerging markets debt, non-investment grade credit, and bank loans, coupled with an underweight to agency MBS and US treasuries versus the benchmark.

Due to the broad asset class declines that occurred in 2008 as a result of the Global Financial Crisis, The Trust had trailed the long-term return goal of inflation plus 4.25%. However, due to the strong 2017 total fund return, The Trust now exceeds the 10-year return goal. Relative to other similar institutional investors, the Trust has significantly outperformed its peers, ranking in the 18th percentile for 2017. This outperformance holds up over longer time periods as well; over the 5, 7, and 10-year periods, The Trust ranks in the 47th, 28th, and 46th percentiles. This outperformance is largely attributable to a slight underweight to US equity and an overweight to non-US equity.

In summary, we believe the Trust remains well diversified and is structured to provide an appropriate long-term real return given the risk/return profile defined by the strategic asset allocation target. The Trust's balance between return-seeking and income-producing assets constitutes a sound and balanced investment approach that is expected to produce competitive investment returns.

Inflation Proofing

In April 2002, Anchorage voters approved by a 70% affirmative vote a new endowment approach to be followed by the Trust, similar to the Percent of Market Value (POMV) approach endorsed by the Alaska Permanent Fund Board. The endowment approach adopted by voters limits the amount of annual dividend distribution from the Trust to no more than 5% of the average market value of the Trust. In response to the severe 2008 market downturn the Assembly approved AO 2009-3, revising the annual dividend cap to a lower rate of 4.00%; this was subsequently adjusted to 4.25% per AO 2017-127. The current adjusted payout limit is intended to keep pace with real return assumptions (i.e.,

long-term expected return, "net" of long-term expected inflation) and to help rebuild the inflation-proofed corpus of the Trust.

AMC 6.50.060L states: *By March 15, 2007, and by the same date every fifth year thereafter, the municipal treasurer shall review the controlled spending policy and recommend adjustments, as necessary, to maintain the long-term purchasing power of the MOA Trust Fund.*

The first scheduled analysis of inflation proofing for the Trust occurred in 2007 and found the Trust to be in compliance at that time with inflation-proofing expectations. A recent preliminary, updated analysis of the Trust's inflation-proofing status performed in April 2018 showed that the Trust making substantial recovery in re-establishing full inflation-proofed status due to the strong market performance experienced in 2017; this recent analysis projects that the Trust could be fully recovered within 1-2 years. For the ten-year period ended December 31, 2017, the Trust generated a 6.06% nominal return and a real rate of return after inflation-proofing of 4.46% (CPI return of 1.60%) which was above the 4.0/4.25% payout rate used during the same time period.

Annual Dividend

Using the revised 4.25% endowment maximum payout formula authorized under Municipal Code, the 2018 dividend payout is expected to be $6.3 million, or $300,000 more than the 2017 dividend. In 2019 this same annual dividend payout methodology is projected to produce a further increased dividend of $6.6 million. Note: As a result of recent voter approval regarding sale of ML&P, and assuming the sale is successfully closed, the dividend amount is expected to increase even further, post-sale, and the dividend calculation methodology may consequently become a subject for some level of adjustment, assuming the Administration were to formulate potential adjustments to the methodology specified in AMC and make specific recommendations to the Assembly.

In years where excess returns are generated (i.e., over and above a 4.25% real rate of return) these retained excess returns help to re-establish an inflation-proofed Trust so that the purchasing power can be restored and/or protected over the long-term. Accumulated excess returns also help offset down years in the market.

Investment Management

At December 31, 2017, the Trust employed seven money managers – i.e., Fidelity Institutional Asset Management, Western Asset Management, Vanguard, BlackRock, Capital Group, Franklin Templeton and UBS Realty Investors. In May 2017, the two actively managed large cap domestic equity portfolios were liquidated and these proceeds were reinvested in a low cost, large cap U.S. stock index fund managed by Vanguard. In 2017, the Trust continued to use RVK as its investment consultant and Wells Fargo Institutional Trust Services as its custodial bank.

The Trust's target asset allocation at December 31, 2017, per the current Investment Policy Statement (IPS), was 24% fixed income; 3% floating rate short duration debt; 5% emerging market debt; 35% domestic equity; 25% international equity; and 8% direct real estate.

In 2018, the Finance Department along with the new investment consultant and Investment Advisory Commission (IAC) intend to focus on the following areas:

(1) Conduct a money manager search for a new emerging market debt fund manager to be able to fully fund the asset allocation target cited in the Trust's Investment Policy Statement;

(2) Receive special presentations from the incumbent core plus fixed income manager and the newly hired core fixed income manager, to better understand evolving change in the fixed income market and its effect on the Trust's fixed income portfolios;

(3) Receive educational briefing from RVK regarding further diversified, alternative investment strategies; and

(4) Discuss potential changes to investment policy, asset allocation, risk and expected return, particularly in light of the ML&P sale which, assuming the sale closes successfully, which would significantly increase the size of the Trust in 2019.

Monitoring of Investment Fund Activities

The performance of the Trust is continuously monitored to ensure compliance with the Investment Policy Statement and to track performance:

- The Trust's investment consultant issues a quarterly report focused on the performance of each of the Trust's money managers and frequently communicates with the Municipal Treasurer regarding investment-related issues as they arise throughout the course of the year.
- The Municipal Treasurer, Chief Fiscal Officer and Investment Advisory Commission meet quarterly to review Fund results.

Current Year Market Conditions

In late January 2018, at a peak point in the stock market, forty four percent of the annual budgeted dividend (i.e., $2.8 million) was paid out.

Year-to-Date (YTD) through First Quarter 2018, Large Cap domestic equities as measured by the S&P 500 index returned -0.76%; broad international equities as measured by the MSCI All Country World Ex-U.S. index returned -1.18%; and domestic investment grade fixed income as measured by the Bloomberg U.S. Aggregate Bond index returned -1.46%.

For the month of April 2018 Large Cap domestic equities returned 0.38% with YTD return of -0.38%. During this same period, domestic investment grade fixed income returned -0.74% with YTD return of -2.19%, while broad international equities returned 1.60% with YTD return of 0.40%. The market value of the Trust as of May 29, 2018 was approximately $163.1 million, which reflected approximately a 0.6% YTD return after adjusting for cash flow effects.

Market and economic conditions change frequently and results can vary dramatically, positively or negatively, from one period to the next. A long-term view and adherence to investment principles and guidelines are necessary to help ensure the Trust meets its long-term objectives of:

- Maintaining the purchasing power of the Trust; and
- Maximizing rates of return over time without taking undue risk.

Additional information

For additional information about the MOA Trust Fund or the endowment model please visit the Trust's website at www.muni.org/moatrust for RVK's December 31, 2017 performance report as well as executive summary charts and graphs for Fourth Quarter 2017 which were prepared by the Treasury Division. Comparable performance reports for the most recent quarter end (March 31, 2018) have also been posted to the website.

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