



MUNICIPALITY OF ANCHORAGE

ASSEMBLY INFORMATION MEMORANDUM

No. AIM -2017

Meeting Date: June 13, 2017

1 **FROM:** Mayor

2
3 **SUBJECT:** MOA Trust Fund Status – 2016 Year in Review

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5
6 This information memorandum is intended to meet Anchorage Municipal Code (AMC)
7 6.50.060K which requires a report on the performance of the MOA Trust Fund's
8 investments to be provided to the Assembly on an annual basis.

9
10 **The MOA Trust Fund Report:**

11
12 **Background**

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

19
20 **Additions/Subtractions**

21 No new deposits were made to the Trust in 2016.

22
23 On two different occasions during 2016, a collective total of \$5.4 million in dividend
24 withdrawals were made to fulfill the 2016 budget expectation. The timing of these two
25 withdrawals were spread out and managed in order to reduce potential downside market
26 timing risk. The actual 2016 withdrawal dates occurred on April 13 and July 20.

27
28 Per its definition in AMC 6.50.060, the *annual dividend* is subject to the controlled
29 spending policy and shall be paid no later than 15 days prior to the end of the fiscal year.
30 *Note: Effective January 1, 2017 the annual payout percentage cap was raised from*
31 *4.00% to 4.25% per AO 2016-127; this revised payout percentage is expected to be in-*
32 *place for a number of years while the Trust continues to rebuild its corpus back to a fully*
33 *inflation-proofed status.*

34
35 **Market Value**

36 The market value of the Trust at December 31, 2016 was \$147.7 million (Fund 730,
37 unaudited, rounded) -- this represented a \$9.0 million increase over the prior year,
38 excluding payment of the annual dividend payment and Trust expenses. The trailing 5

1 | years of calendar year-end market value for the Trust, as well as related annual dividend
2 | payout and calculated annual return, are summarized as follows:
3 |

<u>Calendar Year</u>	<u>Market Value</u>	<u>Dividend Paid in Calendar Year</u>	<u>Annual Return</u>
2012	\$127.6 million	\$4.8 million	14.0%
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%

4 |
5 | **2016 Performance**

6 | In 2016, the Trust's domestic stock holdings produced a return of 9.19% in contrast with
7 | international stocks which returned 1.10%; fixed income returned 6.57% and direct real
8 | estate returned 5.98%. The Trust experienced an overall 6.1% (rounded) return in
9 | calendar year 2016 per calculation by the new investment consultant (RVK based in
10 | Portland, Oregon). The MOA Trust 2016 performance underperformed its Investment
11 | Policy benchmark return by 141 basis points (i.e., 1.41%). This relative
12 | underperformance was primarily associated with active money manager investments in
13 | domestic stocks. Replacement of underperforming money managers and asset
14 | allocation changes were initiated in late 2016 and continued with a phased
15 | implementation into 2017.

16 |
17 | Other major Alaskan investment funds experienced the following positive returns in
18 | 2016:

- 19 |
20 | • Alaska Permanent Fund experienced a 8.10% return.
21 | • Alaska Retirement Management Board (PERS) experienced a 7.85% return.
22 | • Anchorage Police/Fire Pension experienced a 8.71% return.
23 |

24 | In commenting on the Trust's 2016 performance our investment consultant (Spencer
25 | Hunter of RVK) offered the following:
26 |

27 | *As a whole, 2016 provided investors with modest, yet largely positive returns.*
28 | *Domestic equities, as measured by the Russell 3000 Index, finished the year with*
29 | *a relatively strong return of 12.74%. Domestic small cap stocks outpaced large*
30 | *cap and value outperformed growth, both trends a reversal from 2015.*
31 | *International equities saw a slight improvement from recent years, with the broad*
32 | *market returning a positive 4.50%, as measured by the MSCI All Country World*
33 | *ex US Index. Emerging markets did provide investors with a bright spot in non-US*
34 | *markets, returning 11.19%. In a move that was supported by improved sentiment,*
35 | *the Federal Reserve Open Market Committee raised the federal funds rate by 25*
36 | *basis points during the December meeting. In the Fed's view at the time,*

1 *economic conditions in the United States continued on a path consistent with a*
2 *gradual firming of monetary policy. The Barclays US Aggregate Bond Index*
3 *rebounded from a relatively muted year in 2015 by returning 2.65% in 2016;*
4 *however, surprising election results in November led the index to return -2.98% in*
5 *the fourth quarter as rates quickly spiked. US Treasuries posted muted returns,*
6 *largely due to rate increases in the fourth quarter. Corporate credit – both*
7 *investment and non-investment grade – drastically outperformed government and*
8 *government-related securities, with investment grade returning 6.11% and non-*
9 *investment grade returning 17.13%. Core real estate investors continued to be*
10 *rewarded in 2016 with a strong positive return of 8.72% for the NCREIF ODCE*
11 *Index as a result of continued demand for well-occupied, well-located property.*
12 *Even as US property valuations surpass all-time peak levels, as measured by*
13 *capitalization rates, fundamentals amongst major property types remain strong*
14 *and there appears to be continued investor demand.*

15
16 *The MOA Trust posted a total return of 6.07% in calendar year 2016,*
17 *underperforming its target policy index by 1.41%. The policy index consists of*
18 *market indices weighted in the same proportion as the Trust's long-term asset*
19 *allocation policy. The Trust's longer-term performance for the 5-, 7- and 10-year*
20 *periods ended December 31, 2016 exceeds the policy index.*

21
22 *The Trust's underperformance versus the target policy index during 2016 was*
23 *primarily due to active management in US and non-US equity. The US equity*
24 *composites underperformed its index by 3.55% for the year, largely driven by*
25 *active management in the large cap space. Alliance Bernstein underperformed*
26 *the Russell 1000 Value Index by 6.72% during the year, while State Street*
27 *(formerly GE) underperformed the Russell 1000 Growth Index by 4.14%. In the*
28 *non-US equity portfolio, Templeton underperformed its index by 7.62%, but*
29 *American Funds did provide some protection, outperforming its index by 0.80%.*
30 *Active management and a bias to credit within fixed income provided 3.92% of*
31 *outperformance over the benchmark.*

32
33 *The Trust has trailed the long-term goal (as measured by the 10-year period) of*
34 *achieving a return of inflation plus 4% due to the broad asset class declines that*
35 *occurred in 2008 as a result of the Global Financial Crisis. The Trust has*
36 *gradually narrowed the gap since that time with the 5- and 7-year returns*
37 *exceeding the rate of inflation plus 4%. Relative to other similar institutional*
38 *investors, the Trust has slightly lagged its peers, ranking in the 60th percentile for*
39 *2016. However, both the 5- and 7-year figures show outperformance relative to*
40 *peers, ranking in the 41st and 42nd percentiles, respectively. The more recent*
41 *relative underperformance is largely attributable to a slight underweight to US*
42 *equity and an overweight to non-US equity; most peers have a significant "home*
43 *country" bias, which has been additive to returns over the last few years as US*

1 *equity has easily outperformed non-US equity in nearly every trailing time period*
2 *as of December 31, 2016.*

3
4 *In summary, we believe the Trust remains well diversified and is structured to*
5 *provide an appropriate long-term real return given the risk/return profile defined*
6 *by the strategic asset allocation target. The Trust's balance between return-*
7 *seeking and income-producing assets constitutes a sound and balanced*
8 *investment approach that is expected to produce competitive investment returns.*
9

10 **Inflation Proofing**

11 In April 2002, Anchorage voters approved by a 70% affirmative vote a new endowment
12 approach to be followed by the Trust, similar to the Percent of Market Value (POMV)
13 approach endorsed by the Alaska Permanent Fund Board. The endowment approach
14 adopted by voters limits the amount of annual dividend distribution from the Trust to no
15 more than 5% of the average market value of the Trust. In response to the severe 2008
16 market downturn the Assembly approved AO 2009-3, revising the annual dividend cap to
17 a lower rate of 4.00%; this was subsequently adjusted to 4.25% per AO 2016-127. The
18 current adjusted payout limit is intended to keep pace with real return assumptions (i.e.,
19 long-term expected return, “net” of long-term expected inflation) as well as help rebuild
20 the inflation-proofed corpus of the Trust.
21

22 AMC 6.50.060L states: *By March 15, 2007, and by the same date every fifth year*
23 *thereafter, the municipal treasurer shall review the controlled spending policy and*
24 *recommend adjustments, as necessary, to maintain the long-term purchasing power of*
25 *the MOA Trust Fund.*
26

27 The first scheduled analysis of inflation proofing for the Trust occurred in 2007 and
28 found the Trust to be in compliance at that time with inflation-proofing expectations. The
29 most recent updated analysis of the Trust's inflation-proofing status was performed in
30 late 2016 and while the Trust showed some accelerated improvement in its path toward
31 full inflation-proofing over the trailing 5 years, the Trust remains years away from fully re-
32 establishing its inflation-proofed status. For the ten year period ended December 31,
33 2016, the Trust generated a 5.09% nominal return and a real rate of return after
34 inflation-proofing of 3.21% (i.e., 0.79% below the 4% payout rate used during the time
35 period).
36

37 **Annual Dividend**

38 Using the revised 4.25% endowment maximum payout formula authorized under
39 Municipal Code, the 2017 dividend payout is expected to be \$6.0 million, or \$600,000
40 more than the 2016 dividend. In 2018 the annual dividend payout is projected to further
41 increase to \$6.3 million and grow by an average of \$200,000 per year thereafter.
42

43 In years where excess returns are generated (i.e., over and above a 4.25% real rate of
44 return) the excess helps to re-establish an inflation-proofed Trust such that the

1 purchasing power is restored and protected over the long-term. Accumulated excess
2 returns also help offset down years in the market.

3 4 **Investment Management**

5 At December 31, 2016, the Trust employed nine money managers – i.e., Pyramis Global
6 Advisors, Western Asset Management, State Street Global Advisors, AllianceBernstein,
7 Vanguard, BlackRock, Capital Research & Management, Franklin Templeton and UBS
8 Realty Investors. In November 2016, the Treasury Inflation-Protected Securities (TIPS)
9 portfolio was fully liquidated and the small cap equity manager was replaced following a
10 money manager search led by RVK. Throughout 2016 the Trust used RVK as its new
11 investment consultant and Wells Fargo Institutional Trust Services as the incumbent
12 custodial bank.

13
14 The Trust's target asset allocation at December 31, 2016, per the current Investment
15 Policy Statement (IPS), was 29% fixed income; 3% Treasury Inflation-Protected
16 Securities (TIPS); 35% domestic equity; 25% international equity; and 8% direct real
17 estate. The TIPS allocation will be eliminated with the next update of the IPS in 2017.

18
19 In 2017, the Finance Department along with the new investment consultant and
20 Investment Advisory Commission (IAC) intend to focus on the following areas:

21
22 (1) Consolidation of the active Large Cap domestic equity managers into a low cost
23 S&P 500 passively managed stock index fund;

24
25 (2) Adding a second fixed income manager to provide core fixed income investment
26 and to further complement the existing core plus fixed income manage and diversify
27 the overall fixed income investment holdings;

28
29 (3) Consideration of new asset class areas such as investment in emerging debt; and

30
31 (4) Revisions to investment policy, asset allocation, risk and expected return.

32 33 **Monitoring of Investment Fund Activities**

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

- 36
37 ➤ The Trust's investment consultant issues a quarterly report focused on the
38 performance of each of the Trust's money managers and frequently communicates
39 with the Municipal Treasurer regarding investment-related issues as they arise
40 throughout the course of the year.
41 ➤ The Municipal Treasurer, Chief Fiscal Officer and Investment Advisory Commission
42 meet quarterly to review Fund results.

1 **Current Market Conditions**

2 Year-to-Date (YTD) through First Quarter 2017, Large Cap domestic equities as
3 measured by the S&P 500 index returned 6.07%; broad international equities as
4 measured by the MSCI All Country World Ex-U.S. index returned 7.86%; and domestic
5 investment grade fixed income as measured by the Bloomberg U.S. Aggregate Bond
6 index returned 1.42%.

7
8 For the month of April 2017 Large Cap domestic equities returned 1.03% with YTD
9 return of 7.16%. During this same period, domestic investment grade fixed income
10 returned 0.77% with YTD return of 1.59%, while broad international equities returned
11 2.14% with YTD return of 10.17%. The market value of the Trust as of May 3, 2017 was
12 approximately \$152.9 million, which reflected approximately a 6.4% YTD return after
13 adjusting for cash flow effects.

14
15 By late March 2017 seventy percent of the annual budgeted dividend (i.e., \$4.2 million)
16 had been paid out. In addition, full liquidation of the actively managed Large Cap
17 domestic equity portfolios occurred in late April / early May 2017.

18
19 Market and economic conditions change frequently and results can vary dramatically,
20 positively or negatively, from one period to the next. A long-term view and adherence to
21 investment principles and guidelines are necessary to help ensure the Trust meets its
22 long-term objectives of:

- 23
24
 - Maintaining the purchasing power of the Trust; and
 - Maximizing rates of return over time without taking undue risk.

25
26
27 **Additional information**

28 For additional information about the MOA Trust Fund or the endowment model please visit
29 the Trust's website at www.muni.org/moatrust for RVK's December 31, 2016 performance
30 report as well as executive summary charts and graphs for Fourth Quarter 2016 which
31 were prepared by the Treasury Division. Comparable performance reports for the most
32 recent quarter end (March 31, 2017) have also been posted to the website.

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