Date: June 8, 2017

For ACTION ___________

For INFORMATION __X___

Board Agenda: Yes __X___
No ______

FROM: Joseph P. Makolandra, Chief Human Resources Officer
Michael R. Herbstman, Chief Financial Officer

THROUGH: Alvin L. Crawley, Ed.D., Superintendent of Schools

TO: The Honorable Ramee A. Gentry, Chair, and Members of the Alexandria City School Board

TOPIC: Proposed Policy Revision to School Board Policy DAA

BACKGROUND: ACPS employees participate in a supplemental pension plan funded and managed through Principal Financial Group. The purpose of the Alexandria City School Board Retirement Plan (Plan) is to provide supplemental retirement benefits to employees of Alexandria City Public Schools. Statutory authority for the establishment and investment program of this Plan is provided by the Code of Virginia §51.1-800 through §51.1-803. Plan assets are invested and closely monitored by ACPS management and the Investment Advisory Board with investment advice provided by both Principal Financial and Dahab Associates.

The Investment Policy Statement (IPS) establishes investment administration guidelines, delineates investment goals and objectives of the School Board and outlines the roles and responsibilities of participants. This IPS was original enacted on December 19, 2013 as Regulation DA-4. On April 21, 2016, a School Board action reclassified this as Policy DAA.

DISCUSSION:

Recommendation 1: Adjusting Asset Class Targets

Part II, Section D of Policy DAA outlines the Plan's asset allocations as follows:

Asset Class	Target	Range	Index
Domestic Equity	30.0%	25% - 50%	S&P 1500
International Equity	10.0%	0% - 15%	MSCI EAFE
Real Assets	10.0%	0% - 15%	NCREIF ODCE
Fixed Income	50.0%	45% - 65%	BC Aggregate

The Investment Advisory Board recommends shifting 5% from the Fixed Income target to the Real Assets target.

Currently, fixed income investments (bonds) are priced to yield little return over the next 3-5 years. Bonds decline in value as interest rates increase, and interest rates are as low as they have ever been. With the Federal Reserve poised to raise rates, the stage appears to be set for poor bond returns. The ACPS Retirement Plan is particularly susceptible to this interest rate risk because it is more heavily allocated in fixed income than most other public plans.

However, the Investment Advisory Board is weary of shifting additional allocations to Equity for two reasons. First, during high-volatility periods over-allocation to equity can potentially lead to sizeable losses. Second, our relationship with The Principal requires us to keep a certain percentage of assets in Fixed Assets and Real Assets.

Real estate entails greater risk than fixed income in the event of a real estate crisis as occurred in the mid-1990s or 2008. In these markets, real assets can become illiquid and can incur significantly negative returns. However, over the last 30 years, major real estate value declines have been rare. Real estate has gains in most quarters and tends to produce returns above bonds. Finally, real estate can benefit from an inflationary environment and may well appreciate in a rising rate environment.

As outlined above, the Investment Advisory Board believes moving 5% from fixed income to real estate is a prudent response to current market conditions. The new recommended asset allocations are shown below:

Asset Class	Target	Range	Index
Domestic Equity	30.0%	25% - 50%	S&P 1500
International Equity	10.0%	0% - 15%	MSCI EAFE
Real Assets	15.0%	5% - 20%	NCREIF ODCE
Fixed Income	45.0%	40% - 60%	BC Aggregate

Recommendation 2: Deleting Reference to Benefits Index Ratio

As an insurance company, Principal provides guaranteed benefits to plan participants as they retire. To ensure there are sufficient assets in the plan, Principal calculates a Benefits Index which represents current claims on assets as a percentage of available assets, adjusted for the volatility of the asset allocation. Based on Principal's assertions, that Index must always be below 100%. If it reaches 100%, Principal asserts the right to force the Alexandria City School Board to put more money into the plan, or allow Principal to annuitize all participants then in pay status.

Currently, Policy DAA references the specific Benefits Index as of September 30, 2015. It is recommended that this sentence be removed from the Policy. It is a point-in-time valuation that could give future readers of the policy a misleading impression of the status of the Plan.

RECOMMENDATION: The Superintendent recommends that the School Board review the attached policy changes.

IMPACT: By reviewing policies periodically, the School Board ensures that ACPS operations are aligned to support excellence and high performance. These recommended policy changes would allow for a more prudent investment strategy within the Alexandria City School Board Retirement Plan.

ATTACHMENTS: Proposed Revisions to Policy DAA

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