City of Novi City Council
May 19, 2025

SUBJECT: Recommendation to adopt amended Novi Retirement Health Care Fund (OPEB) investment policy

SUBMITTING DEPARTMENT: Finance

KEY HIGHLIGHTS:

- Independent third-party review (AON) of the City's OPEB investment policy completed, with recommendations to improve long-term sustainability and reduce portfolio volatility.
- Updated investment strategy shifts target asset allocation from 50/50 to a more conservative 40/60 equities-to-fixed income mix.
- Revised portfolio is expected to reduce volatility from 11.26% to 7.03% and increase the probability of remaining fully funded over 15 years from 80.7% to 82.2%.
- Introduction of diversified asset classes, including alternatives, real estate, and infrastructure, to further reduce risk and enhance return stability.
- City remains committed to avoiding future contributions to the OPEB plan through disciplined investment management and periodic third-party reviews.

BACKGROUND INFORMATION:

The Treasury Department periodically reviews all investment policies. After the fiscal year 2022, the actuary and the audit confirmed that the overall funding level for the OPEB plan remained at approximately 110% funded. As a result of the continued strong funding level, Treasury made edits to the existing investment policy and presented them to Council for approval on 7/22/24. The following are the key items changed with that amendment:

- Given the high funding levels, the policy was amended to begin the shift to a more conservative, less volatile, less risky portfolio
- The investment mix in the policy was changed from the standard 70/30 equities to a fixed income ratio with a 50/50 mix

- The change in the policy also acknowledged that with the overall investment rate of return target would decrease to around 6% with the change in investment mix
- Treasury began exploring alternate investments to continue to reduce risk, but these types of investments were not included in the policy at the time
- Goal of no future city contributions ever to the OPEB plan continued

During the review of the amendments to the OPEB policy that was ultimately approved by the Council, the finance committee recommended hiring a third party to review the overall OPEB investment policy and related investments and make recommendations on possible improvements. A contract was awarded to AON in January 2025 to perform the review, and their review was completed and presented to the finance committee in April 2025. The following were their findings and recommendations:

- The investment mix by the City in the OPEB plan at the time of the review was a 58/42 investment mix with portfolio volatility of 11.26%, with an 80.7% chance that the plan remained fully funded over the next 15 years (attached)
- AON ran numerous models and ultimately recommended a 40/60 model (compared to the current 50/50 model), which will reduce volatility to 7.03% and increase the probability of remaining fully funded over the next 15 years to 82.2% (attached)
- To achieve the investment mix and return, AON recommended introducing return-seeking, asset diversification, fixed income securities, alternate investments, and real estate and infrastructure investments (attached)

Treasury appreciated the recommendations and recommended that a similar review occur regularly every 3-5 years.

The finance committee recommended adopting the AON recommended model and directed the City Manager to make the necessary changes to implement the model. The City currently uses Morgan Stanley as its investment advisor (since 4/25/03), as they are the top-rated firm in the country as far as understanding the investment rules for OPEB plans, and havd helped the city outperform our target return consistently over the past 20+ years. Treasury met with Morgan Stanley, provided the entire AON study, discussed the changes needed, including the timing of the transition, and ensured alignment.

The first step to implement the new investment model is to amend the current OPEB investment policy. Attached is a red-lined version of the changes along with the final copy without the edits. The amendments include minor grammatical edits but are primarily based in the revised asset mix. Please note that some of the maximums noted are higher than the target to acknowledge the current investment levels while we adjust the buy/sell investments to achieve our targeted mix over the next month or so.

RECOMMENDED ACTION: Recommendation to adopt amended Novi Retirement Health Care Fund (OPEB) investment policy