



# APPROVAL OF SECTION 115 TRUST AGREEMENTS AND APPROPRIATION OF INITIAL FUNDING

City Council Meeting  
May 10, 2022

Alan Alton  
Chief Financial Officer, Finance

# CURRENT

- Staff made presentations to the Council on strategies for addressing City pension costs, specifically the City's CalPERS unfunded accrued liability (UAL).
- One strategy identified is to establish an Internal Revenue Code Section 115 Trust to prefund pension obligations.
- Staff contacted firms with experience administering Section 115 Trusts, and selected PFM Asset Management (PFMAM) to administer the City's Trust.

# Section 115 Trust

- Section 115 of the Internal Revenue Code allows for prefunding pension obligations with a trust.
- The funds invested in the Trust are separate from those in the City's investment portfolio.
- Invested funds within the trust are not held to the same investment restrictions that govern general local government investing.
- Those funds may be invested more broadly with a strategy for higher long-term returns.

# PROPOSED

- The City would establish a Section 115 Trust with two separate accounts
  - City General Fund Pension
  - Santa Rosa Water Pension
- The City will make initial deposits from reserves
- When existing Pension Obligation Bonds are retired in 2024, redirect funds currently used to that debt service to contribute to trust annually.
- Initial funding goal equal to approximately one year UAL and Normal Cost payment
- Continue to build funds in Trust
  - Achieve 100% funded status
  - Serve as pension stabilization fund

# BENEFITS AND RISKS

## Benefits

- Local control over asset strategy and timing of usage.
- Ability to earn higher return.
- Bond rating agencies will look favorably to this type of action.
- Considered a best practice by GFOA.

## Risks

- Market volatility could result in loss of principal.
- Funds held in trust may own be used for pension obligations.

# FISCAL IMPACT

- Contributions to Trusts will have no additional budget impact to General Fund or SR Water
- Initial Deposits for General Fund and SR Water Trusts
  - \$10M from Fiscal Stability Reserves
  - \$4.4M from SR Water
- Initial funding goal equal to approximately to the highest scheduled year of normal cost and UAL
  - \$34M for GF; \$7.5M for SR Water
- Redirect POB debt service payments once paid off in 2024 for annual Trust contributions
  - \$2.6M from General Fund; \$700K from SR Water
- Trust Administration Fees and Trustee Custodial Fees paid from funds held in Trust
  - .0023% approximate annual fee based on funds held in aggregate, approximately \$33,000 (based on \$14.4M)
  - Custodial fees estimated at \$9,000

# INVESTMENT STRATEGY

- Individual Investment Policy Statements for City General Fund and SR Water Trusts
- Targeted rate of return of 5% to 6%
- Investments objectives based on long-term investment horizon of over ten years
- Assets will be managed to minimize risk of loss of principal over that horizon
- City investment committee will have City staff including staff from Finance and Water
  - Similar to existing Investment Committee for the City's general investment portfolio

# RECOMMENDATION

It is recommended by the Finance Department that the Council, by resolution:

- 1) approve the execution of the Adoption Agreement for the Post-Employment Benefits Trust (Adoption Agreement) between the City and PFM Asset Management LLC (PFMAM) incorporating and adopting the Trust Agreement as well as approving the Trust Administrative Services Agreement and Investment Policy Statements included as exhibits to the Adoption Agreement;
- 2) authorize the City Manager, Assistant City Manager and the Chief Financial Officer as officers with authority to execute necessary documents and agreements to carry out the trust services on behalf of the City including, but not limited to the Adoption Agreement and Trust Administrative Services Agreement;
- 3) approve an initial deposit of \$10,000,000 from the General Fund reserves assigned for fiscal stability, and \$4,400,000 from Santa Rosa Water enterprise fund reserves to the Section 115 Trust for the purpose of pre-funding pension obligations.



# QUESTIONS?