CITY OF SALINAS

COUNCIL STAFF REPORT

DATE: **MARCH 20, 2018**

DEPARTMENT: **FINANCE DEPARTMENT**

FROM: **MATT N. PRESSEY, CPA, FINANCE DIRECTOR**

TITLE: **115 TRUST SERVICE AGREEMENTS**

RECOMMENDED MOTION:

A motion to approve a Resolution for the Adoption Agreement and the Trust Administrative Services Agreement between PFM Assets Management LLC ("PFM") and the City and authorize and designate staff to manage the trust.

RECOMMENDATION:

Staff recommends City Council approve a Resolution:

1. Approving the Adoption Agreement between the City and PFM Assets Management LLC ("PFM")
2. Approving the Trust Administrative Services Agreement between PFM and City
3. Authorizing the City Manager, Finance Director and Assistant Finance Director as officers with the authority to execute the necessary documents and agreements to carry out the trust services on behalf of the City.

EXECUTIVE SUMMARY:

As part of the strategy to stabilize the City's structural deficit and stabilize future pension cost increases, a 115 Trust is being established to accumulate funds to be invested and used to offset the future pension costs. The 115 Trust allows the funds to be taken out at any time to reimburse the City for up to two years' worth of pension costs, which makes the trust very liquid if the City needed the funds in an emergency. The 115 Trust is one of the six recommendations included in the League of California Cities Retirement System Sustainability Study.

BACKGROUND:

Staff prepared a Request for Qualifications and received four responses. A four member evaluation team reviewed and scored each submittal. The top two (PFM and PARS) were invited to a face-to-face interview with a three member interview evaluation panel. The evaluation panel ranked both firms and recommended PFM as the firm as the most-responsive and best qualified that would best serve the City's needs. PFM has a Multi-Employer Trust established and has a contractual relationship with Wells Fargo Bank to provide trust and custody services for the trust.

Of the six recommendations made in the League of California Cities Retirement System Sustainability Study for what cities can do regarding the high cost increases in the annual PERS cost, the City has already started evaluating or implementing all of them. The two main recommendations were around the following:

- Lump sum payment(s) to Cal PERS
- Prefunding through an Internal Revenue Service (IRS) Code Section 115 trust

The City will be evaluating these two options and will most likely use a combination of both to achieve the short and long term objectives.

<u>Lump Sum Payment to CalPERS</u>

Any lump sum payment to CalPERS made by June 15 of any given year, will, with the proper notice to CalPERS, be credited to the City's retirement plan accounts in time to favorably impact employer contribution rates beginning in the following fiscal year. Payments made after June 15 will impact rates on a delayed basis, beginning in the fiscal year starting after the following July 1st.

The immediate benefit of making a lump sum payment to CalPERS is the potential for interest savings at the current assumed investment rate of return of 7.35%, reflected in the form of reduced employer rates beginning as soon as the following fiscal year. The City can also target one of the Unfunded Accrued Liability (UAL) basis's, pay it down and achieve large short term savings in annual payments. The main potentially negative aspect to accelerated pension funding through CalPERS is the concentration risk associated with having the additional funds held directly by CalPERS, as opposed to possible diversification of funding through a Section 115 retirement trust.

<u>Prefunding through a Section 115 trust</u>

Although Section 115 trusts for retirement funding are in their relative infancy, Section 115 trusts have been in use for California local government funding of post-retirement health obligations, also known as OPEB, for roughly the past decade. The City has participated in the California Employers' Retirement Benefit Trust (CERBT), sponsored by CalPERS, to prefund its OPEB obligations for the past ten years. CalPERS does not currently offer a Section 115 trust for retirement funding, but is likely to do so within the next couple of years.

The potential advantages of placing funds into a Section 115 Retirement trust include:

- Local control over assets – although the funds may only be used to pay pension obligations, the employer can access the account anytime
- Pension rate stabilization – assets may be transferred to CalPERS to reduce or eliminate fluctuations in PERS rates

- Rainy day fund – emergency source of funds if needed to be drawn down in large amounts to cover pension costs
- Potentially lower long-term pension costs if funded aggressively
- Diversification of retirement funding assets, as opposed to CalPERS holding all of the City's retirement funds
- The ability to earn higher returns in a relatively safe environment than would be possible with the government code limitations and investment policy restrictions on current City pooled investment portfolio
- The opportunity to transfer the City's OPEB trust funds into one of these programs as a separate account, should the Council direct staff to do so at some point in the future

The main disadvantages of participating in a Section 115 Retirement trust are that:

1. The net pension liability is not offset by the contributions placed in trust on the City's financial statements
2. Market changes and lose of principal; and
3. Funds held in trust may only be utilized for pension obligations.

However, given that the City's annual pension obligation is currently in excess of $18 million, the risk of not being able to access the funds at any time is minimal. At such time as trust assets significantly exceeded annual pension obligations, potential liquidity risk may be an issue, but that is not a likely occurrence in the near term.

Market timing is always a risk as well for the short term, but the City's long-term pension funding objectives, a long-term view of investment performance would be in order, rather than attempting to "time the market." Additionally, City staff would work with the selected firm to facilitate an orderly phased transition of assets into the new trust investment portfolio and not deposit the assets all at one time to help hedge against market risk.

Based on the significant increase in retirement costs over the next seven years, staff believes that the formulation of a systematic plan to accelerated pay down of City's unfunded pension liabilities and a plan to stabilize the affordability of each year's contribution would be prudent and timely. A combination of accelerated UAL payments to CalPERS, along with the City's participation and investment in a Section 115 Retirement trust, appears to be the best strategy to mitigate future retirement cost increases.

Staff will work with PFM on the best funding policy, plan and investment strategy and bring it back to City Council on April 17, 2018.

<u>CEQA CONSIDERATION</u>:

The City of Salinas has determined that the proposed action is not a project as defined by the California Environmental Quality Act (CEQA) (CEQA Guidelines Section 15378).

STRATEGIC PLAN INITIATIVE:

These agreements will achieve the strategic plan and Council goal of Effective, Sustainable Government.

FISCAL AND SUSTAINABILITY IMPACT:

The cost of this service will be about $30,000 per year but will depend on how much is invested into the trust.

ATTACHMENTS:

1. Resolution
2. Adoption Agreement for the Post-Employment Benefits Trust (City, PFM and Wells Fargo)
3. Trust Agreement (PFM and Wells Fargo)
4. Administrative Services Agreement (City and PFM)
5. Account Agreement (City and Wells Fargo)