



Staff Report

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**File #:** 22-0034

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**REQUEST FOR CITY COUNCIL ACTION**

**DATE:** 01/19/2022

**TO:** Honorable Mayor and City Council Members

**FROM:** Finance Department

**SUBJECT:**

Resolution Approving Pension Stabilization Trust Agreement Pursuant to Section 115 of the Internal Revenue Code and Authorize Initial Contribution of \$30 Million.

**EXECUTIVE SUMMARY:**

A Section 115 Trust is a pension stabilization trust fund that holds funds set aside by the City for future pension contributions to the California Public Retirement System in order to stabilize the expected pension funding from the City and fund some of the unfunded liability for pension benefits. The Pension Stabilization Trust Agreement identifies the purpose and duration of the Trust Fund and sets forth the terms for administering the Trust Fund by a Board of Trustees. An initial contribution of \$30,000,000 is recommended to the Trust Fund from the General Fund and additional contributions will be considered annually based on any General Fund surplus funds remaining upon completion of the fiscal year-end audit.

**RECOMMENDED ACTION:**

**That the City Council:**

- a. Adopt Resolution No. 2022-005 Approving the Trust Agreement Governing the City of Corona Pension Stabilization Trust Pursuant to Section 115 of the Internal Revenue Code.
- b. Authorize the City Manager, or his designee, to execute the Trust Agreement.
- c. Authorize the establishment of a new Fiduciary Fund to hold the funds allocated to the Pension Stabilization Trust.
- d. Authorize a Fund Transfer of \$30,000,000 from the General Fund to the new Fiduciary Fund for the Pension Stabilization Trust.

**BACKGROUND & HISTORY:**

The City of Corona has been a member of the California Public Employees Retirement System (CalPERS) since 1967. The City and its employees contribute to the CalPERS plan to pay for future retirement benefits. The last time the City's CalPERS plan was fully funded was in Fiscal Year (FY) 2000.

The gap between what the City has contributed to CalPERS and the benefits owed to its retirees is known as the CalPERS unfunded accrued liability (UAL). The UAL has grown significantly over the years due to lower-than-expected market returns, actuarial assumption changes, an increased number of retirees, and longer life expectancies of retirees. From 2005 to 2021, the City's annual UAL payment increased by 937% and it is projected to continue increasing for all California cities over the next 20 years in an effort by CalPERS to reach 100% fully funded status.

In order to cost-effectively manage the City's obligation to pay its UAL to the CalPERS system, the City identified a long-term funding solution through the issuance of pension obligation bonds (POBs), which provides substantial cost savings. The proceeds of the POBs are transferred to CalPERS as a prepayment of the City's UAL and the payment of debt service on the POBs replaces the obligation of the City to make annual contributions on the UAL. Savings are achieved based on borrowing rates being significantly lower than the CalPERS current discount rate of 7.0%, which is applied to the City's current UAL.

On January 6, 2021, the City Council approved the issuance of POBs with the approval of Resolution No. 2021-002, which authorized the issuance of the City of Corona 2021 Taxable Pension Obligation Bonds in an amount not to exceed \$300,000,000 with an interest rate not to exceed 5.00%, and authorized certain other actions in connection with the POB transaction.

On May 12, 2021, the City Council approved Resolution No. 2021-033 authorizing the execution of an Official Statement and Continuing Disclosure Certificate relating to the issuance of the City of Corona 2021 Taxable Pension Obligation Bonds and approved Administrative Policy 01200.605 adopting the City's Pension Management Policy. The Pension Management Policy provides guidelines for managing the UAL that will be assessed to the City by CalPERS on an annual basis or for any unfunded accrued liabilities remaining after the issuance of POBs, including the establishment of a Pension Stabilization Trust.

The City of Corona 2021 Taxable Pension Obligation Bonds were issued in October 2021 in the amount of \$276.7 Million for a term of 13 years. The annual interest rate ranges from 0.3% - 2.7%, with an average of 2.2%. Following the issuance of the bonds, the City prepaid all of its current UAL to CalPERS in the amount of \$275.6 Million on October 14, 2021. Per the guidelines of the Pension Management Policy, any remaining unfunded liability and/or any new UAL may be managed using a Pension Stabilization Trust to keep the City's target funding level at or near 100% of the accrued liability.

#### **ANALYSIS:**

A Section 115 Trust is a vehicle for segregating City funds from general assets for essential governmental purposes, such as pension obligations. Funds placed in a Section 115 Trust are irrevocably committed for the essential City functions specified in the Trust Agreement. The City's

Pension Management Policy requires the establishment of a Section 115 Trust to be used for pension-related costs. Some advantages associated with a Section 115 Trust include the following:

1. Assets in the trust can offset potential future unfunded pension liabilities.
2. Greater investment flexibility and risk diversification compared to other city investments results in a potentially higher rate of return on monies set aside for future pension obligations.
3. Assets can be used to stabilize rates and to offset unexpected contribution rate increases or be used as a rainy-day fund when revenues are impaired based on economic or other conditions.
4. Potential to improve the City's credit rating.
5. City has complete control over the trust assets and flexibility to access the assets at any time, as long as the assets are used to pay pension obligations.

The attached Trust Agreement establishes the City of Corona Pension Stabilization Trust pursuant to Section 115 of the Internal Revenue Code, as an entity to which funds for the City can be deposited, and through which a Board of Trustees can invest and manage assets for the exclusive purpose of funding contributions to the pension plan providing benefits for City employees and retirees. The term of the Trust Agreement is effective as of January 19, 2022 and will continue indefinitely until the agreement is terminated in accordance with the terms.

Five Trustees are identified in the Trust Agreement and include the City Treasurer, City Manager, Assistant City Manager, Finance Director, and Accounting Manager, or their designees. Trustee terms are continuous until the person is no longer qualified for the position or until their resignation. In the event of termination of a Trustee term, the City Manager may appoint a successor Trustee until a new individual becomes qualified for the Trustee position.

The Trustees will serve as an advisory group to the City Council and will conduct at least two (2) public meetings per year. The meetings of the Board of Trustees will be subject to the requirements of the Brown Act and the Board will need to take formal action to establish the time and place for holding regular meetings pursuant to Government Code Section 54954. It is anticipated that one meeting will be scheduled sometime in October, once the new CalPERS actuarial reports are received and reviewed to assess the new UAL impacts. The second meeting will be scheduled sometime in January, once the year-end audit and Annual Comprehensive Financial Report (ACFR) document is completed. The Trustees will review the year-end audit results in connection with the UAL changes and make a recommendation to the City Council for the annual contribution to the Pension Stabilization Trust. With the exception of the Accounting Manager, the remaining four Pension Stabilization Trustees are also part of the Treasury Committee. The Treasury Committee meets quarterly with the City's professional investment advisor, Chandler Asset Management. The investment results of the Trust will be incorporated into the quarterly discussion. The Trust results will also be reflected in the monthly investment reports.

The Trust Fund will have monies deposited into it at the City Council's discretion, based on review of the Trustees and recommendations provided by City staff based on the year-end audit results. The Trustees will have full and exclusive authority to administer the Trust Fund and are to receive the City's fund transfers into the Trust Fund and oversee the investment of those funds and payment of

administrative expenses of operating the Trust Fund. Professional investment advisory services will be provided by Chandler Asset Management. Chandler was selected through a competitive RFP process for investment advisory services and its contract was approved by the City Council in April 2021. The Trust funds will be audited annually by the City's independent auditing firm.

**FINANCIAL IMPACT:**

A new Fiduciary Fund will be established to hold the funds allocated to the Pension Stabilization Trust and an initial contribution of \$30,000,000 is recommended from the General Fund Budget Balancing Measures Reserve into the Trust Fund. Each year, upon completion of the fiscal year-end audit, staff will provide a recommendation to City Council for the percentage of annual surplus that should be placed in the Pension Stabilization Trust. In determining the recommended amount to contribute, the Trustees and staff will target paying off the Pension Obligation Bonds at year 10.

Investment advisory services are provided by Chandler Asset Management. The FY 2022 cost is \$4,375 per month, or \$26,250 through June 30, 2022. The budget already exists in the Finance Department's operating budget. The FY 2023 cost is estimated at \$72,000 and FY 2024 cost is estimated at \$81,000. During the initial three-year term, if total assets in the Trust exceeds \$60 Million for three consecutive months, a reduced fee schedule will be negotiated to reflect the current assets under management. The budget for future fiscal years will be addressed through the annual budget process.

**ENVIRONMENTAL ANALYSIS:**

This action is exempt pursuant to Section 15061(b)(3) of the guidelines for the California Environmental Quality Act (CEQA), which states that a project is exempt from CEQA if the activity is covered by the general rule that CEQA applies only to projects that have the potential for causing a significant effect on the environment. Where it can be seen with certainty that there is no possibility that the activity in question may have a significant effect on the environment, the action is not subject to CEQA. This action simply approves the Section 115 trust agreement and authorizes a transfer of \$30,000,000 into the trust from the General Fund for the purpose of paying future pension contributions to CalPERS, and there is no possibility that this action will have any effect on the environment. Therefore, no environmental analysis is required.

**PREPARED BY:** KIM SITTON, FINANCE DIRECTOR

**Attachments:**

1. Exhibit 1 - Resolution No. 2022-005 Pension Stabilization Trust
2. Exhibit 2 - Trust Agreement Pension Stabilization Trust
3. Exhibit 3 - Administrative Policy 01200.605 - Pension Management Policy