Orange County Sanitation District

ADMINISTRATION COMMITTEE

Agenda Report

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File #: 2020-1096 **Agenda Date:** 6/10/2020 **Agenda Item No:** 10.

FROM: James D. Herberg, General Manager
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SUBJECT:

INTERNAL REVENUE CODE SECTION 115 TRUST PENSION ACCOUNT

GENERAL MANAGER'S RECOMMENDATION

RECOMMENDATION:

Information Item.

BACKGROUND

The Orange County Sanitation District (Sanitation District) provides various benefits to its employees, including retirement and other post-employment benefits. Each year, staff considers various options to fund these benefits, paying down any unfunded liabilities, making additional payments to Orange County Employees Retirement System (OCERS) and Internal Revenue Code section 115 trust (115 trust) opportunities.

The Sanitation District Board of Directors has requested staff provide information on the 115 trust concept so that the Board can determine if additional investigation is warranted.

ADDITIONAL INFORMATION

Two of the Sanitation District's core benefits are its retirement program, which is administered by OCERS, and its Other Post-Employment Benefits (OPEB) which is administered internally. The Sanitation District contributes funds to OCERS annually to fund its pension costs. Separately, it maintains funds to cover the costs of its OPEB program.

The Board may be most familiar with CalPERS, the agency that provides pension services for all the cities that are member agencies of the Sanitation District and most cities in California. However, the Sanitation District retirement administration and services are provided by OCERS. OCERS provides similar services as CalPERS, but is a completely separate entity from CalPERS and maintains different investment policies and strategies. OCERS tends to invest more conservatively than CalPERS and has a higher funding level.

To enhance its pension returns and eliminate any unfunded liabilities, the Sanitation District has used a strategy of paying off any unfunded liabilities immediately and, as appropriate, overfunding its pension fund account with OCERS. However, there are cities, public agencies, and special districts that make use of a 115 trust to help them better manage the short-term costs and long-term liabilities associated with pensions.

A 115 trust is a vehicle for segregating agency funds from general assets for the purpose of funding essential governmental functions. For example, a 115 trust can be used to set aside monies to meet future pension contributions or liabilities. Funds placed in a 115 trust are irrevocably committed for the essential government function(s) specified in the applicable trust agreement (e.g., pension obligations). Therefore, the monies held in such trusts can be invested in accordance with the rules governing such special purpose accounts.

For example, 115 trust funds dedicated to satisfying pension obligations can be invested in the same manner as funds in a typical pension fund rather than as part of the agency's general fund. Thus, by setting aside funds in a 115 trust, agencies can potentially earn a higher rate of return on monies set aside for future pension obligations. Conversely, as a 115 trust allows for more aggressive investing, there is a greater potential for loss when the market performs badly.

Each year, staff reviews and considers pension funding options, including additional payments to OCERS and 115 trust opportunities. To date, staff has determined that making additional payments to OCERS is a safe and cost-effective way of reducing pension costs. However, a detailed financial comparison of this strategy versus the use of a 115 trust has not been completed.

Should the Board determine that the Sanitation District should further investigate the use of a 115 trust, staff recommends that a more detailed financial review be conducted. Such review would include the collection of return rates of various 115 trusts and OCERS for comparison.

As 115 trusts allows for more varied investing, it is important to review different market histories. For example, data from 2019 would provide important data as the markets performed well. A more aggressively invested 115 trust would do well in that market. However, 2020 would be equally important as 2020 is shaping up to be a poor performing year. As such, an aggressively positioned 115 trust might perform worse in such an environment.

Additionally, while this financial analysis is necessary, it would not be the only factor to be considered. There are policy factors such as management and financial control that must be considered.

RELEVANT STANDARDS

- Ensure the public's money is wisely spent

ATTACHMENT

The following attachment(s) may be viewed on-line at the OCSD website (www.ocsd.com) with the complete agenda package:

N/A