



## Agenda Report

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**FROM:** James D. Herberg, General Manager  
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**SUBJECT:**

### **PENSION COST STRATEGIES**

### **GENERAL MANAGER'S RECOMMENDATION**

RECOMMENDATION: Recommend to the Board of Directors to:

Direct staff to advertise a Request for Proposals (RFP) to select a multiple-employer Internal Revenue Service Code Section 115 Trust Pension Account.

### **BACKGROUND**

The Orange County Sanitation District (Sanitation District) provides pension benefits to its employees through the Orange County Employee Retirement System (OCERS) at an annual cost of approximately \$15 million. Staff continually examines strategies to support and minimize these costs. After an initial presentation, the Administration Committee directed staff to provide additional information and analysis of options to address funding these benefits ranging from advance payments to implementing an Internal Revenue Service Code Section 115 Trust Pension Account (115 Trust).

Staff researched different options for Board consideration as described below. All options involve moving funds from the Sanitation District investment portfolio to a different investment vehicle with an opportunity to obtain higher yields. Once contributed into one of these strategies, fund use is limited to pension costs. Although the staff report will review four sub-options, there are two main alternatives:

1) Make an advanced payment to OCERS

Advantages: Potentially higher yields than the Sanitation District's investment portfolio, lower fees, avoids trust establishment and administration, comparable yields to 115 Trust

Disadvantages: Less investment control and flexibility, all retirement funds under a single manager

2) Implement a 115 Trust Pension Account

Advantages: Potentially higher yields than the Sanitation District's investment portfolio,

provides for additional control over funds, diversity of investment managers, comparable yields to OCERS

Disadvantages: Additional investment fees and administration costs

## **RELEVANT STANDARDS**

- Ensure the public's money is wisely spent
- Ensure that investment proposals and decisions are based on clearly defined standards

## **PROBLEM**

The Sanitation District has annual pension normal costs of approximately \$15 million per year. Unfunded pension liabilities can also accrue resulting from lower than expected OCERS investment returns or other actuarial assumptions, significantly increasing the Sanitation District's pension costs.

## **PROPOSED SOLUTION**

Select and join an existing multi-employer 115 Trust and make an initial investment of \$20 million.

## **TIMING CONCERNS**

In June 2020, the Administration Committee directed staff to report back on options for diversifying our pension funding including a 115 Trust.

## **RAMIFICATIONS OF NOT TAKING ACTION**

The Sanitation District will not have the opportunity to diversify investments and potentially gain higher returns than the current investment portfolio.

## **PRIOR COMMITTEE/BOARD ACTIONS**

June 2020 - Information Item provided to the Administration Committee.

## **ADDITIONAL INFORMATION**

Staff evaluated multiple options for funding a portion of the Sanitation District's future pension costs:

- Option 1 - Make an advanced payment to OCERS
- Option 2 - Use the Sanitation District's current money manager to create and manage a 115 Trust
- Option 3 - Select and join an existing multiple-employer 115 Trust managed by a private trust administration firm
- Option 4 - Establish and manage a 115 Trust in-house

Option 1 - Make an additional payment to OCERS

This option is expected to yield comparable investment returns to a 115 Trust and does not incur trust expenses or additional management fees; however, since more of the Sanitation District's funds would be managed by OCERS, this option would not increase the diversity of investments.

Option 2 - Use current money manager to create and manage a 115 Trust

This option would entail the Sanitation District's existing money manager, Chandler, establishing and managing a 115 Trust. This process could begin immediately and could potentially yield higher returns than our investment portfolio. Fees and expenses would be similar to joining an existing multiple-employer trust; however, all funds would be managed by a single firm, providing less diversity of money management firms.

Option 3 - Select and join an existing multiple-employer 115 Trust managed by a private trust administration firm

The Sanitation District could advertise a RFP to select an existing multiple-employer 115 Trust. This would be a turnkey approach including both money management and trust services. Expected investment returns would be higher than our investment portfolio, and comparable to OCERS. This option would add diversity to our investments, and the Sanitation District would maintain some control over the investment strategy. This option is being adopted widely among cities in Orange County.

Option 4- Establish and manage a 115 Trust in-house

Some agencies simply establish and manage their trust internally using existing staff. The Sanitation District could engage one of its consultants to assist in setting up the trust and a few investment options and manage the trust. However, staff did not examine this strategy in depth due to lack of internal expertise and resources.

**Average Annual Investment Returns**

The chart below shows average annual investment return percentages and calculated total returns on a \$20 million investment in OCERS and two multiple-employer 115 Trusts based on past performance.

<b>Plan</b>	<b>1 Year</b>	<b>3 Year</b>	<b>5 Year</b>
OCERS	14%	9%	7%
Trust A	11%-23%	5%-11%	4%-8%
Trust B	7%-22%	5%-11%	3%-8%

<b>Plan</b>	<b>1 Year</b>	<b>3 Year</b>	<b>5 Year</b>
OCERS	\$2.8M	\$5.9M	\$8.1M

Trust A	\$2.2M-\$4.5M	\$3.4M-\$7.0M	\$4.4M-\$9.3M
Trust B	\$1.5M-\$4.4M	\$3.4M-\$7.0M	\$4.2M-\$9.3M

### Summary

Of the four options described above, staff recommends selecting and investing in an existing multi-employer 115 Trust. This option would diversify the Sanitation District's pension investment managers, provide some control over investment strategy, and potentially yield higher investment returns than our existing portfolio.

### CEQA

N/A

### FINANCIAL CONSIDERATIONS

This request complies with authority levels of the Sanitation District's Purchasing Ordinance.

### ATTACHMENT

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

- PowerPoint Presentation