

**2018 CSMFO Annual Conference**  
**February 22, 2018**

# **In 115 We Trust**

**A Panel Discussion on IRS Section 115 Trusts for California Public Agencies**

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# In 115 We Trust

## AGENDA

- The 411 on 115's: ***Legal Considerations***
- Well, How Did We Get Here? – ***Chino Valley Fire Case Study***
- You Own It, So Now What? – ***Financial Reporting Considerations***
- The Path Forward & Lessons Learned – ***Conclusions***
- Yes, But... – ***Q&A***

In 115 We Trust

# The 411 on 115's *Legal Considerations*



# What is Section 115?

- Section 115 of the Internal Revenue Code:

Gross income does not include--

(1) income derived from any public utility or the exercise of any ***essential governmental function*** and ***accruing to a State or any political subdivision*** thereof, or the District of Columbia; or

(2) income accruing to the government of any possession of the United States, or any political subdivision thereof.



# What is a Section 115 Trust?

- A Section 115 Trust is:
  - A grantor trust established by a governmental unit.
  - Established to set aside funds for paying future employee benefits such as pensions and OPEB.
  - The accumulation within such trusts is excluded from income taxes.
  - Assets are dedicated to providing benefits to employees/retirees and beneficiaries.
  - Employer contributions are irrevocable.
  - Assets are legally protected from creditors of the employer.



# Alternatives to Section 115 Trusts

- VEBA Trust
  - A VEBA trust is established under IRC section 501(c)(9) as an employees' association to provide for designated benefits.
  - Typically operate independently of the sponsoring employer and involve participants in their governance.
- Section 401(h) Account (OPEB only)
  - Separate account, established within an existing qualified pension fund.
  - Usually for single employer arrangements.
  - Governed by the pension board.
- Pay as you go (OPEB)
- Contribute funds directly to pension plan administrator.



# Why Use a Trust Option



- Dedicated fund within the public agency's treasury is insufficient.
- May reduce liabilities that must be recorded on financial statement.
- Higher investment returns lead to lower long-term costs.



# Investment of Trust Assets

- Investment of pension and OPEB trust assets subject to different rules than the investment of surplus funds.
- Instead, California law provides that any type of investment is permissible so long as it is considered prudent by the body authorized to make investments.
- Greater flexibility conditioned on funds being ***irrevocably*** committed to provide pension benefits or OPEB.





# Fiduciary Obligations



- A fiduciary must discharge his, her or its duties as follows:
  - Solely in the interest of, and for the exclusive purposes of providing benefits to, participants in the retiree health benefit plan, minimizing employer contributions thereto, and defraying reasonable expenses of administering the plan;
  - With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims; and
  - With the obligation to diversify the investments of the funds so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly prudent not to do so.



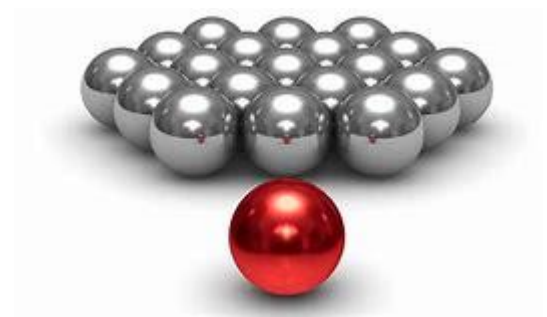
# Delegation



- Public employers can and ***should*** establish the following fiduciary roles to assist in trust administration:
  - Trust Administrator
    - Agency employee or external vendor – responsible for authorizing disbursements, carrying out the directives of the governing body, and other oversight tasks.
  - Custodian
    - Holds the trust assets.
    - The custodian, typically a regulated bank trust organization, should be independent of the investment advisor, even if the trust holds mutual funds as its primary investment.
  - Investment Advisor
    - Although the investment of assets can be managed internally, most agencies outsource to independent advisor.
    - The governing body can retain either a discretionary advisor, which can make investment decisions within the parameters of the investment policy, or a non-discretionary advisor, which requires pre-approval of investment decisions.

# Single Employer vs. Multiple Employer

- Single Employer
  - Controlled by the employer.
  - Greater flexibility with investment options, service providers.
  - Start-up costs and obligations are more significant but ongoing costs may be lower
- Multiple Employer
  - Turnkey programs in which a governmental entity, an intergovernmental organization, or a private firm has already established the trust's investments and governance.
  - Start-up elements and compliance usually easier.
  - Examples
    - CalPERS – CERBT
    - PARS Trust





# Brown Act Considerations

- Government Code Section 54952 defines the term “legislative body” for purposes of application of the Brown Act as including:
  - A commission, **committee**, board, or other body of a local agency, whether permanent or temporary, decision-making or advisory, **created by** charter, ordinance, resolution, or **formal action of a legislative body**.
- Consider the implications of complying with the Brown Act when evaluating the establishment of a committee.

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Well, How Did We Get Here?

***Chino Valley Fire  
Case Study***









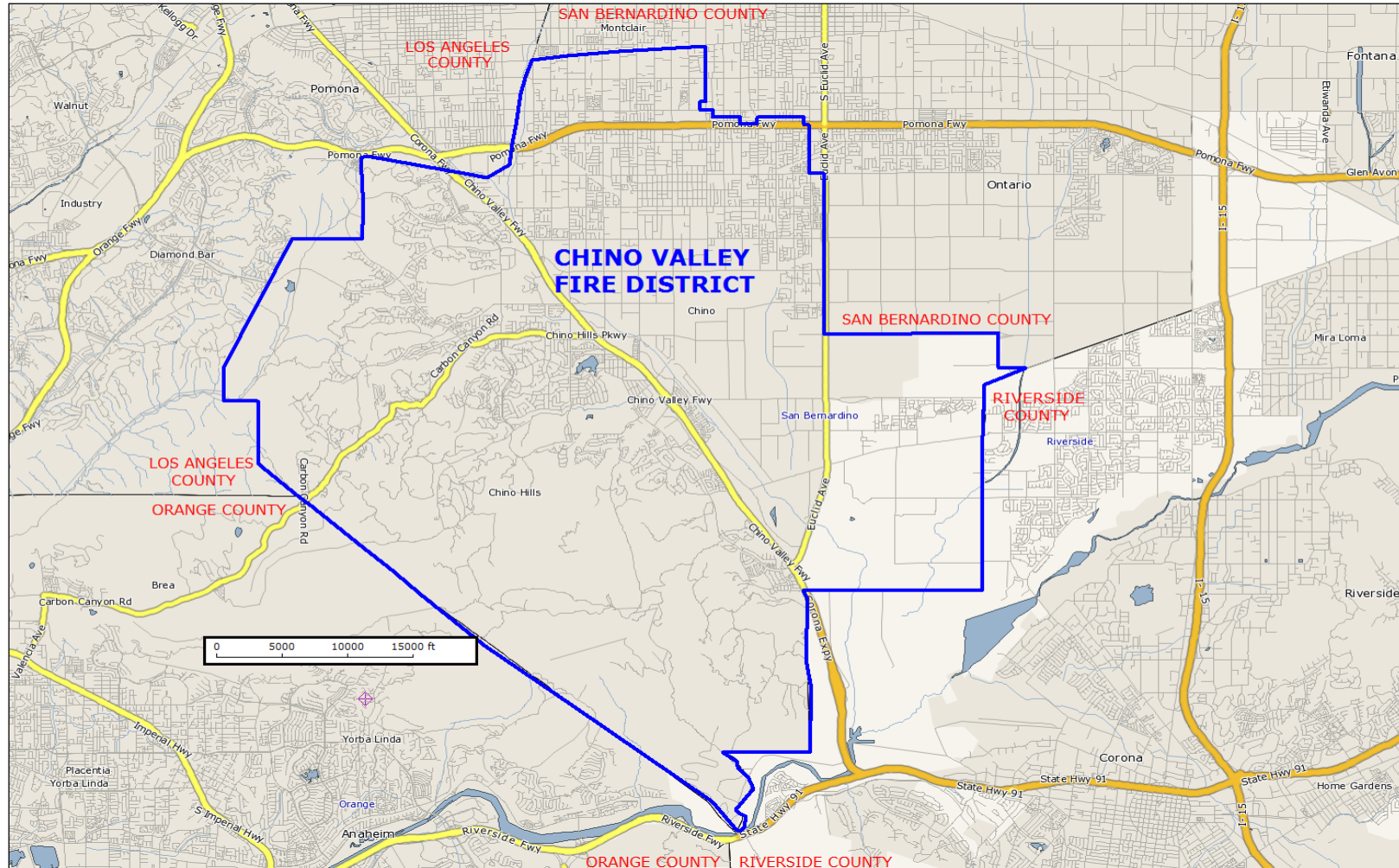
# About Chino Valley Fire District...

- Located in Chino Hills, CA
- Population of 175,000
- 80 Sq. Mile Service Area
- Serving Chino, Chino Hills, portions of unincorporated San Bernardino County
- Five Member Elected Board





# About Chino Valley Fire District...







# About Chino Valley Fire District...

- FIRE, EMS, Prevention & Public Education
- Seven Fire Stations
- 141 Employees (~80% Sworn)
- \$38 Million Operating Budget
- Property Tax Funded
- Incorporated in 1990





# About Chino Valley Fire District...

- CalPERS Retirement System (Pooled Plans)
  - 92% Classic Members
    - 3% @ 55 – Safety
    - 2.5% @ 55 – Miscellaneous
  - \$40.3 Million Unfunded Actuarial Liability





# About Chino Valley Fire District...

- Retirement Plan Cost Sharing
  - Safety @ 12%
  - Misc @ 11%
  - \$1.9 million in FY18
  - \$2.7 million in FY25





# About Chino Valley Fire District...

- PERS Employer Rates & Costs in FY18
  - Classic Safety: 30.6% of Pay (NC: 19.5%)
  - Classic Misc: 17.6% of Pay (NC: 10.1%)
  - UAL Payment of \$1.65 million
  - Total PERS Costs of \$4.5 million (net)



# About Chino Valley Fire District...

- PERS Employer Rates & Costs in FY25 (Projected)
  - Classic Safety: 44.1% of Pay (NC: 22.9%)
  - Classic Misc: 23.3% of Pay (NC: 12.1%)
  - UAL Payment of \$4.9 million
  - Total PERS Costs of \$9.1 million (net)



# About Chino Valley Fire District...

- Prefunding OPEB since 2008
  - CalPERS CERBT Program
  - Bi-Annual Actuarial Valuations
- Paid Off PERS Side Fund Obligations in FY12





# About Chino Valley Fire District...

- Significant Development Activity
- Station 8 & Battalion 2 in Planning Stages
  - Operational in FY21 or FY22
  - About \$3 million annually











# In 115 We Trust

- 115 Trust Considerations
  - Projected Pension Obligations
  - Political & Labor Environment
  - Legal & Accounting Concerns
  - Single vs. Multiple Employer Trusts



# In 115 We Trust

- Engaged Electeds & Other Stakeholders
- Educated Labor
- Called on Professional Network
- Started Developing a Long-Term Pension Strategy





# In 115 We Trust

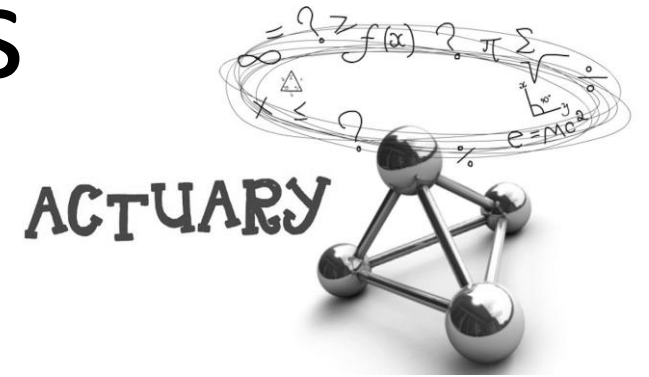
- Diversification Potential
- Ease of Ability to Draw Down Funds





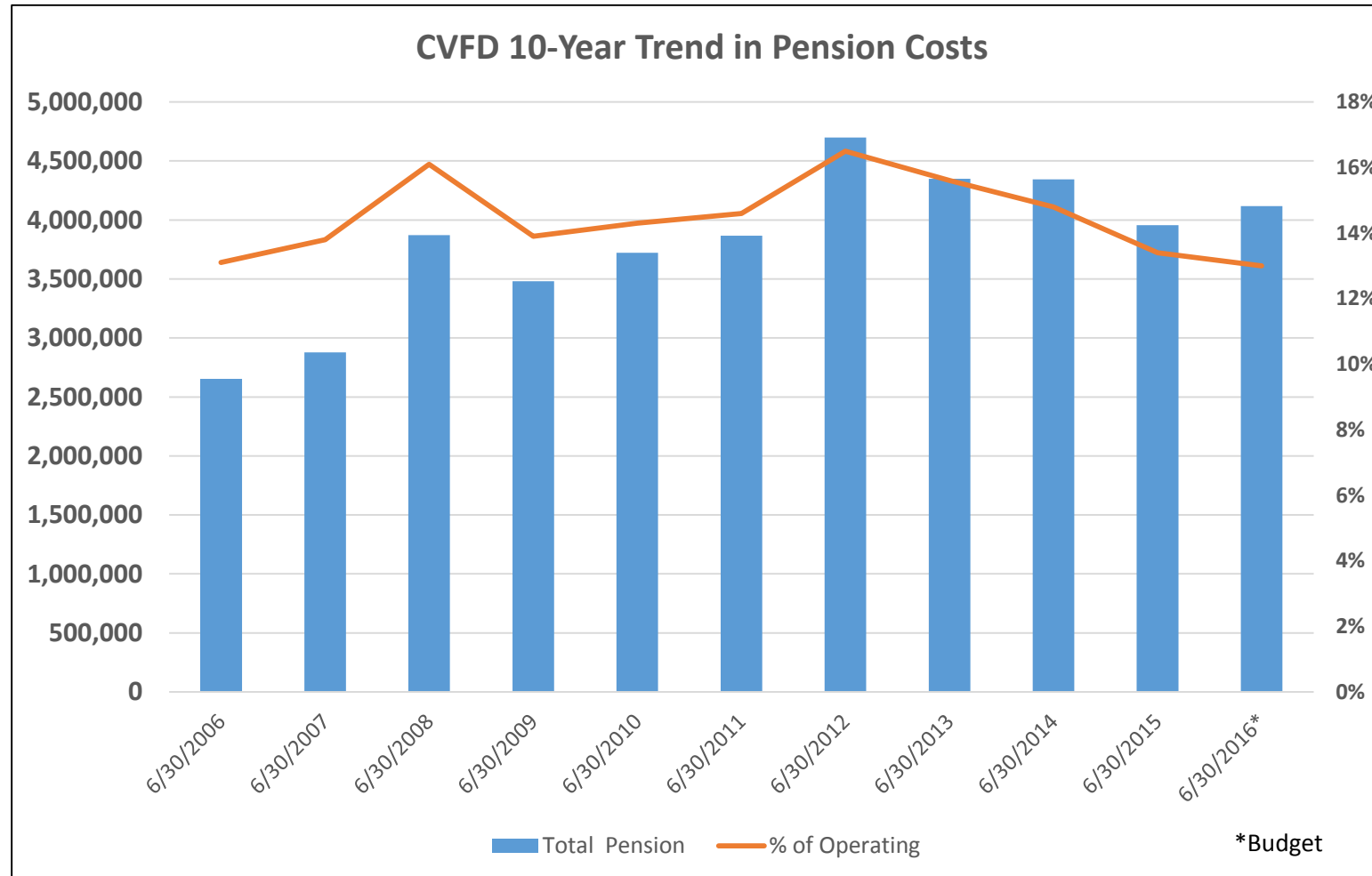
# 2016 Pension Study

- Engaged Bartel Associates
- Board Workshop  
– March, 2016





# 2016 Pension Study





# 2016 Pension Study

- Safety: 3% @ 55 formula = substantially lower rate and higher funded status
- Misc: 2.5% @ 55 benefit = significantly lower rate and funded ratio near average

	Total Employer Rate	Funded Ratio
CVFD Safety	25.391%	80.6%
SB County Safety Average	39.384%	70.3%
CVFD Misc.	15.275%	76.2%
SB County Misc. Average	18.643%	77.3%

Source: CalPERS (2013 Valuations)



# 2016 Pension Study

- Recent PERS Policy Changes
  - Amortization & Smoothing Policy Changes (FY16)
  - Funding Policy Changes for Pooled Plans (FY16)
  - Mortality Improvement (FY17)
  - Funding Risk Mitigation Policy (Impacts TBD)



# 2016 Pension Study

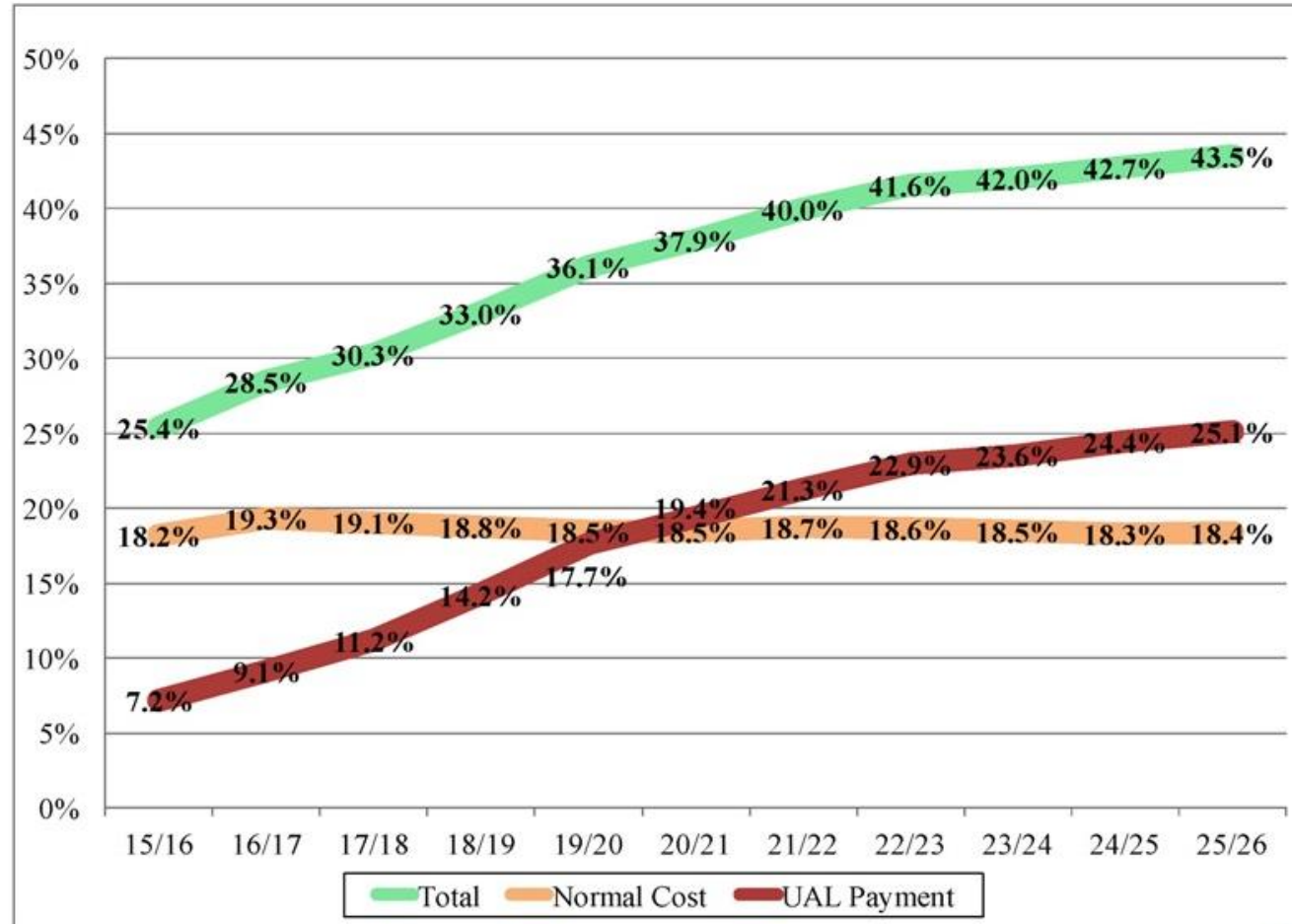
- Bartel's Analysis
  - Projected impacts of PERS policy & assumption changes
  - Contribution rate projections
  - Investment return sensitivity analysis





# 2016 Pension Study

## CONTRIBUTION PROJECTIONS - SAFETY





# 2016 Pension Study

- Board Direction
  - Research Lump Sum Payment Options to PERS
  - Explore 115 Trust Options





# 2016 Pension Study

- Board Direction (May, 2016)
  - Pursue 115 Trust
  - Develop an Accelerated Pension Funding Policy





# In 115 We Trust

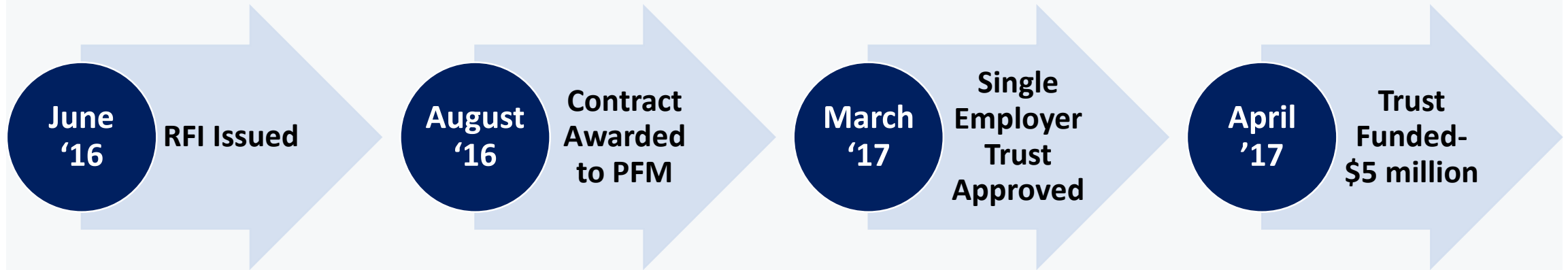
## Procurement Process

- Spoke Informally to Prospective Vendors
- Issued a Request for Information (RFI)
  - Questionnaire
  - Firm Interviews





# 115 Trust Adoption Timeline





# Accelerated Pension Funding Policy

- One-Third of Future Budgetary Surpluses to:
  - 115 Trust
  - PERS
  - Combination Thereof





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We Own It, So Now What?

***VTD Financial Reporting  
Considerations***

# General Considerations

- Should the assets be reported?
- Do such assets reduce the pension or opeb liabilities?
- What types of disclosures should be considered?



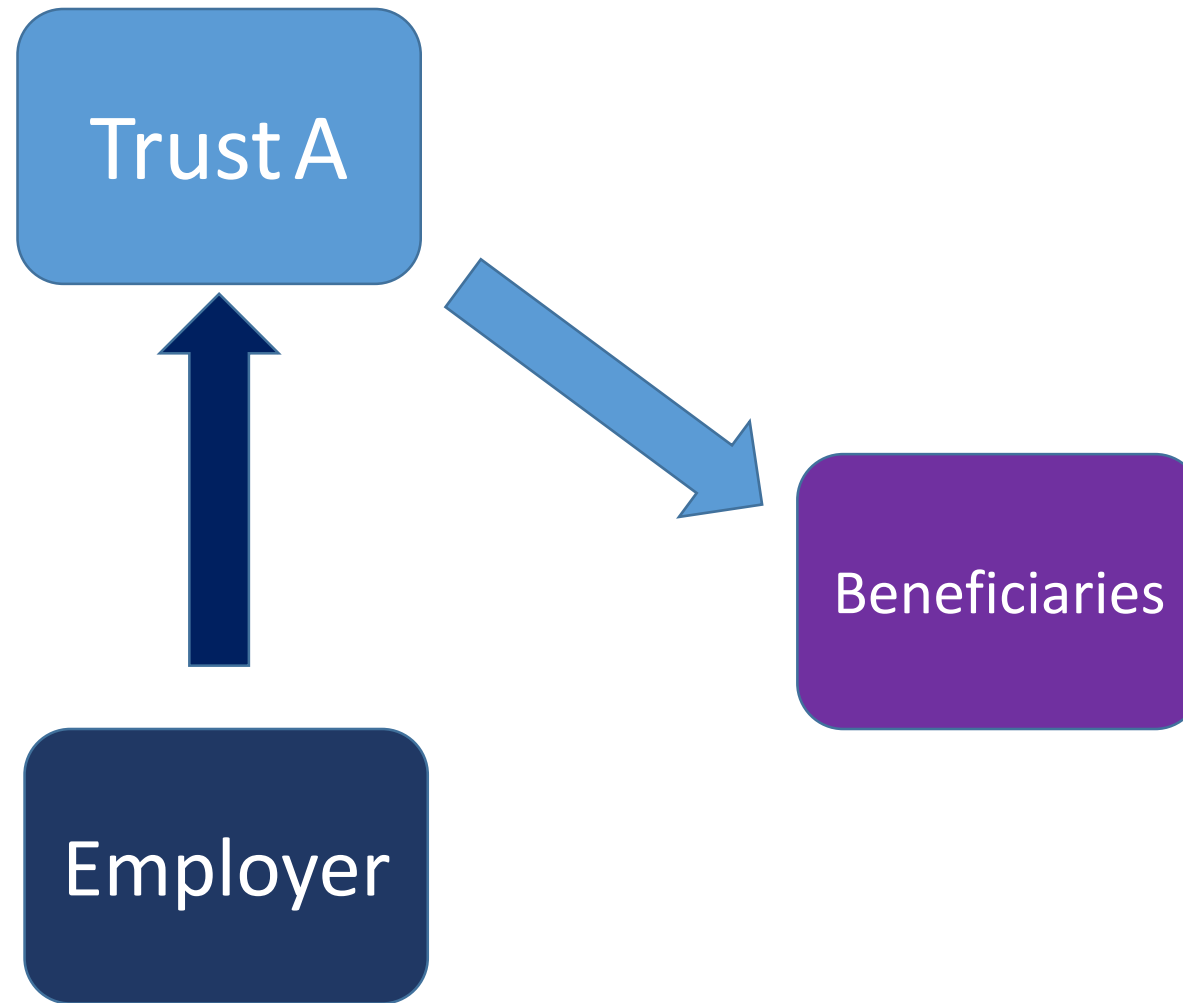


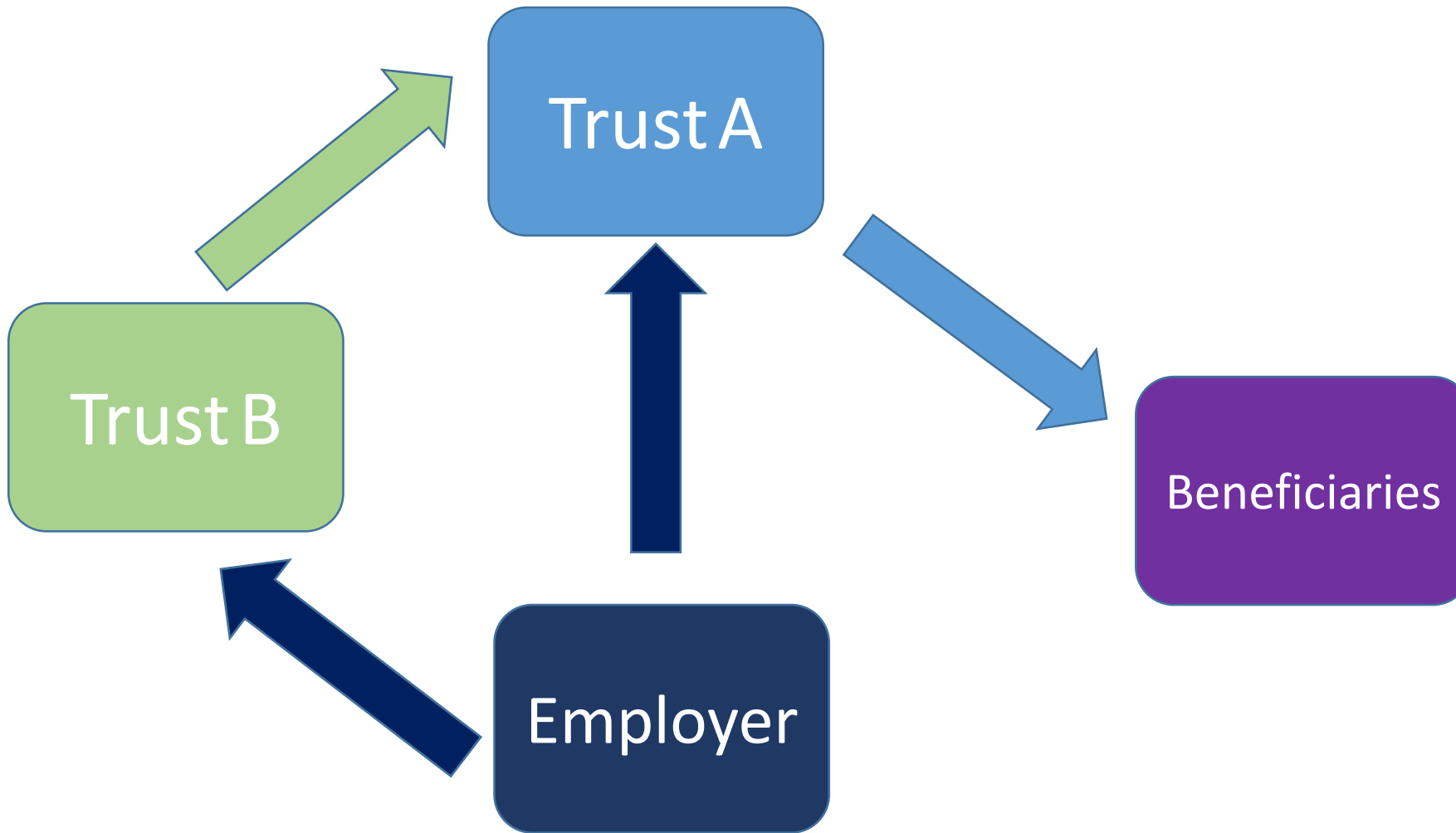
# Resources

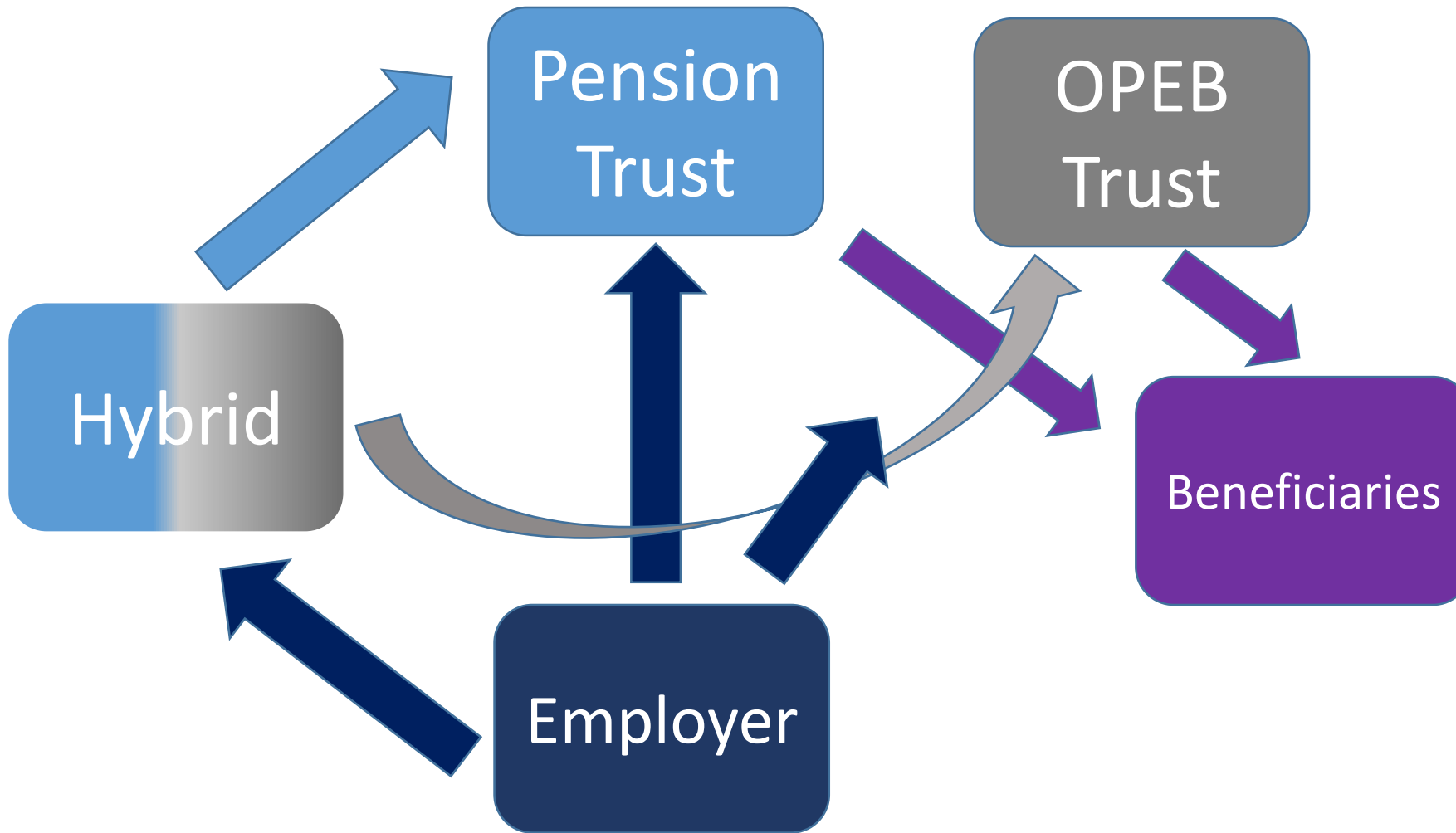
- Pensions
  - GASB 67 and 68
  - 2017-01: Questions 4.4 – 4.9
- OPEB
  - GASB 74 and 75
  - 2017-02: Questions 4.6, 4.38-4.41
  - 2017-03: Questions 4.53-4.54 and 4.62.-4.63

# Certain Concepts

- The “Plan” -  
Arrangements through which pensions (or OPEB) are determined, assets dedicated for pensions (or OPEB) are accumulated and managed, and benefits are paid as they come due.
- Assets are -  
Resources with present service capacity that the government presently controls.
- Present service capacity of assets –  
Existing capability to enable the government to provide services, which in turn enables the government to fulfill its mission.









# Other Reporting Considerations

- Assets
- Offsets
- Investment policy disclosures
- Other disclosures
- MD&A



In 115 We Trust

The Path Forward &  
Lessons Learned

***Conclusions***

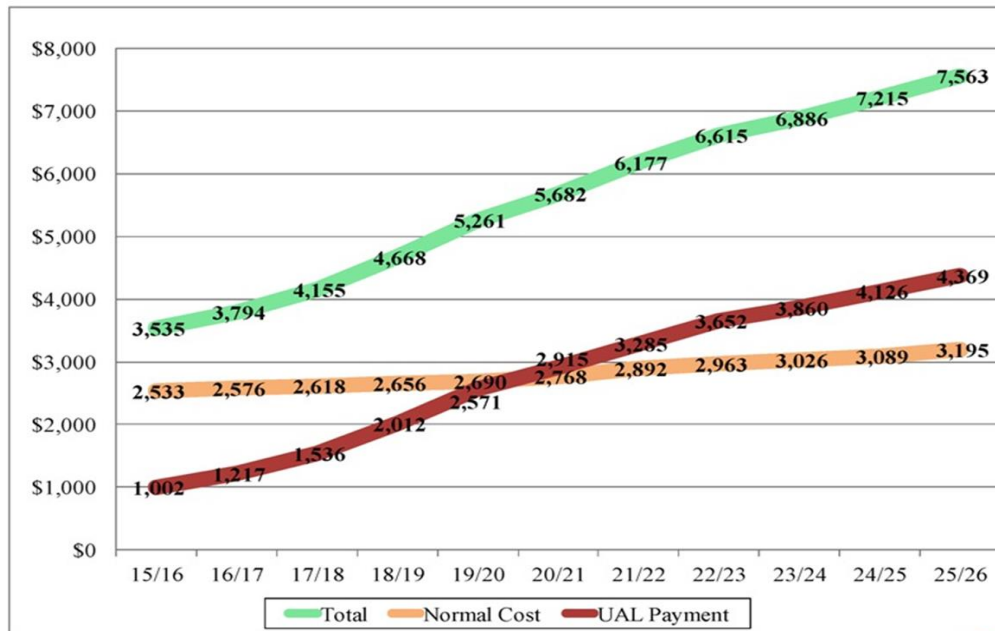






# Rate Projections

## CONTRIBUTION PROJECTIONS - SAFETY



March 16, 2016

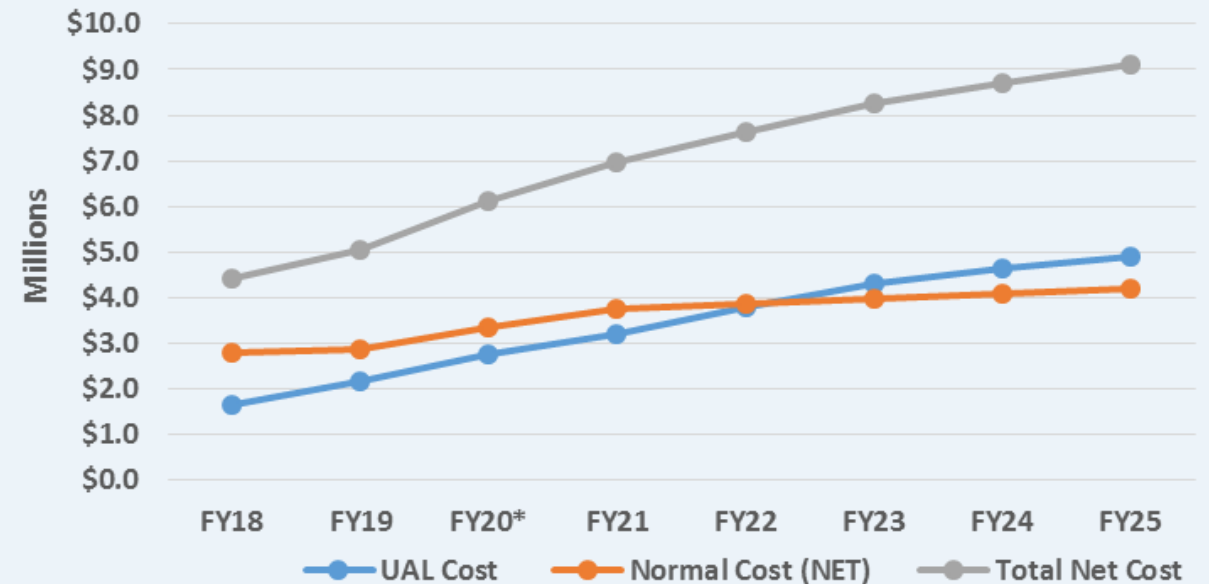
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# Then...

# Now...

## PERS Cost Projections - 3% Annual Increase \$9.1 Million by FY25

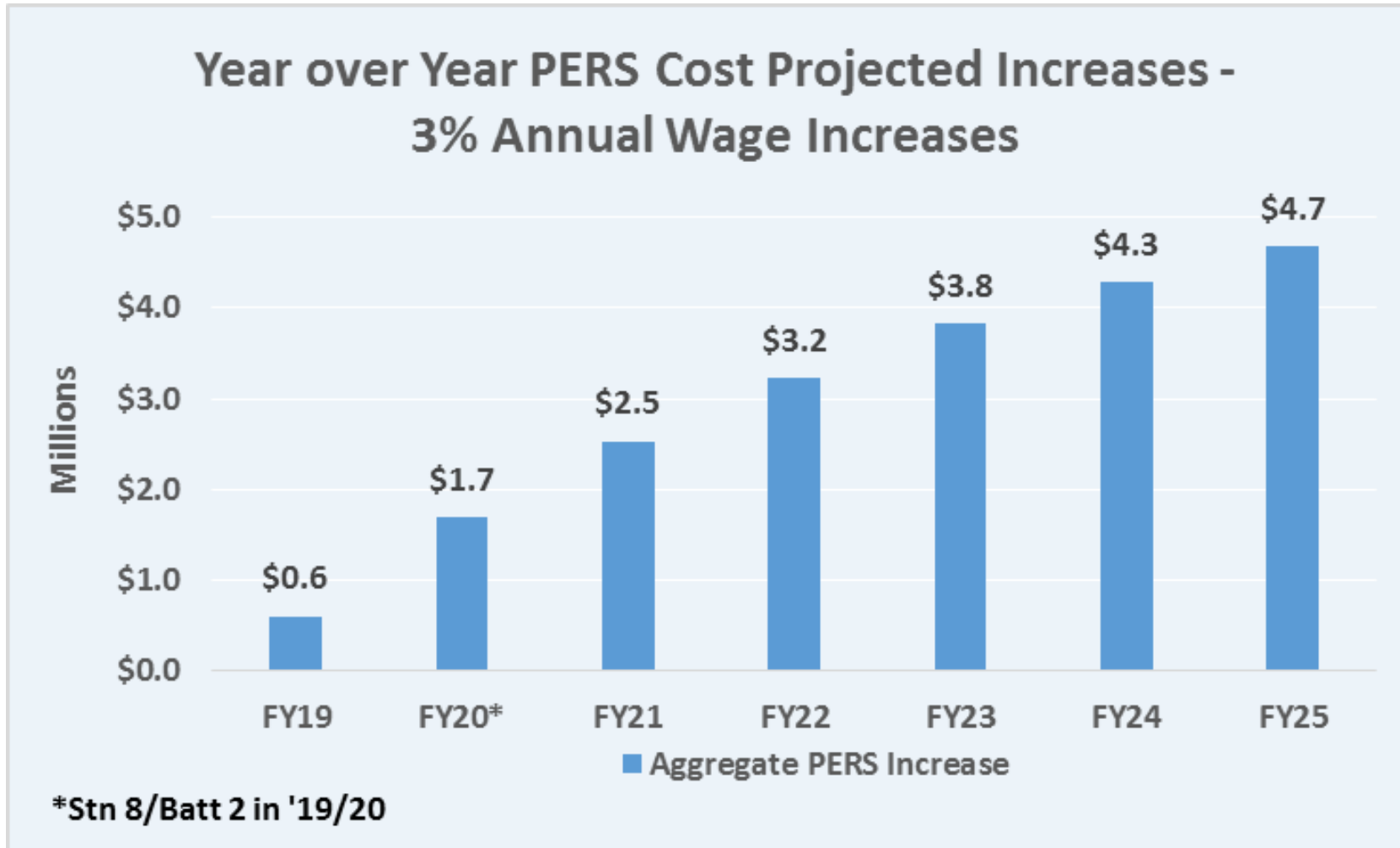


\*Stn 8/Batt 2 in '19/20



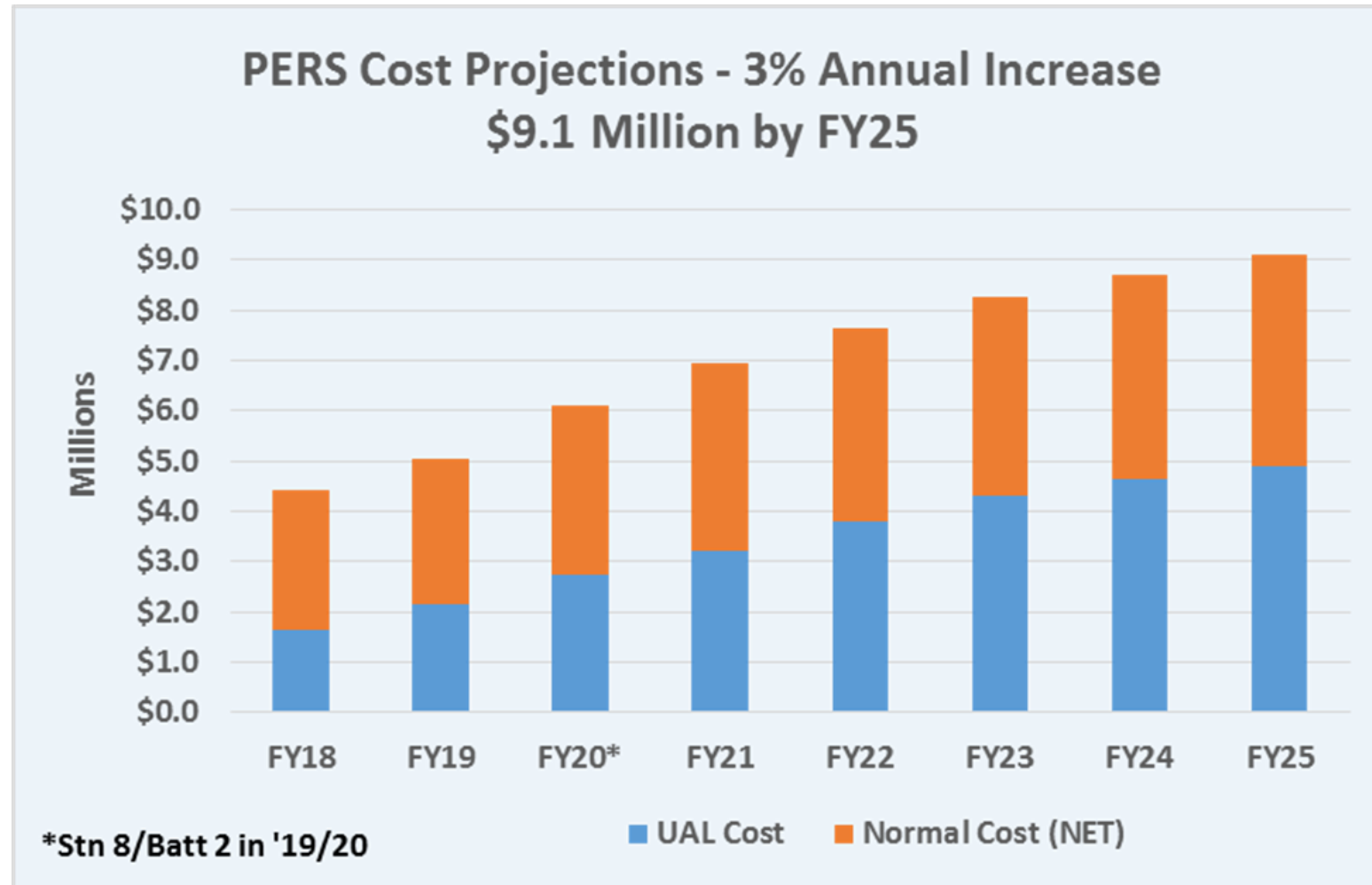
# In 115 We Trust

## Updated Projections (6/30/16 Valuation)





# In 115 We Trust Updated Projections





# In 115 We Trust Go Forward Strategy...



- 115 Trust Funding
  - 1/3 of surplus as per policy
  - Goal: “9 by 25” (\$9 million by FY25)
- Add’l discretionary payments to CalPERS through one-time funding sources

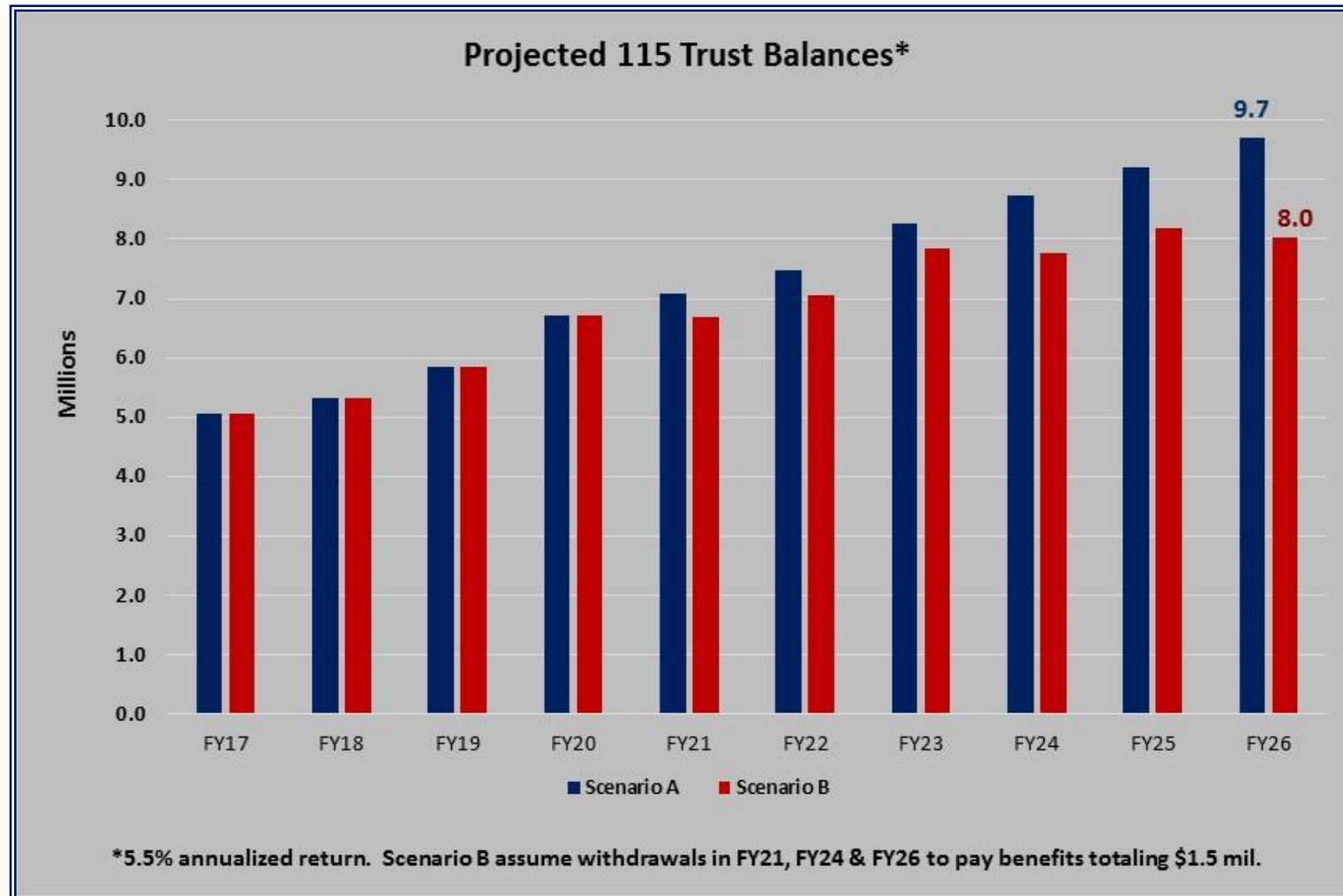


# In 115 We Trust Go Forward Strategy...

- Continued Organizational Prominence
  - The Looming Pension Crisis
  - Positive Impacts of Employee Cost Sharing
  - 115 Trust Success Story
  - Budget Emphasis



# In 115 We Trust Go Forward Strategy...





# In 115 We Trust Lessons Learned...

- **Blaze a Trail Well Traveled**
  - Learn from Others
  - Assemble a Network of Professionals
    - Attorney, Auditor, Actuary,  
Administrator





# In 115 We Trust Lessons Learned...



- **One Size Does Not Fit All**
  - Consider Single & Multiple Employer Options
  - Do Your Diligence
  - Set Realistic Expectations for Your Organization





# In 115 We Trust Lessons Learned...

- **Build a Path (or Two) Forward**
  - Rate Stabilization
  - Budget Stabilization
  - Multi-Pronged Approach
- **Continue the Discussion...**



In 115 We Trust  
Yes, But...

# Questions?



# In 115 We Trust

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