



Office of the City Manager

INFORMATION CALENDAR

June 3, 2025

To: Honorable Mayor and Members of the City Council

From: Paul Buddenhagen, City Manager

Submitted by: Henry Oyekanmi, Director, Finance Department

Subject: Section 115 Trust Investment Report for: Inception to Period Ended June 30, 2024

SUMMARY

In June 2018, the City Council approved the establishment of a Section 115 trust to help address pension obligations, with administration by the City Manager or their designee. Since May 2019, Keenan Financial Services has managed and invested in this fund. This report provides an overview and analysis of the performance and current market situation as it pertains to the City's Section 115 Trust investment portfolio. The trust consists of two distinct accounts: the Fixed Income Account and the Moderate Growth Account. These accounts encompass various asset classes, including fixed income mutual funds, domestic equities, international mutual funds, and alternative investment funds with a focus on real estate.

I. Fixed Income Account (#7590):

The Fixed Income Account predominantly comprises fixed income mutual funds. As of the latest available data, this portion of the portfolio has been performing steadily, slightly below market expectations for fixed income investments. It's important to note that fixed income investments are generally considered a lower-risk component of a portfolio, providing stability and consistent income.

II. Moderate Growth Account (#7600):

The Moderate Growth Account represents a diversified mix of asset classes, including domestic equities, international mutual funds, and alternative investment funds that focus on real estate.

As of June 30, 2024, the City Section 115 Trust Fund Investment Fund Activity for the period from July 1, 2023 to June 30, 2024 is summarized in Table 1 and Table 2 below on a market value basis. Before considering the change in market value, the City's Section 115 Trust Fund earned 4.92% in FY2024.

**Table 1. Investment Fund Activity from July 1, 2023 to June 30, 2024**

Trust Fund	Pooled Cash	Fixed Income Account	Moderate Growth Account	Total
Beginning Value (7.1.2023)	\$ 4,687,819	\$ 8,307,805	\$ 6,137,707	\$ 19,133,331
Net Contributions	-	-	-	-
CalPERS Savings	1,487,226	-	-	1,487,226
Transfer from other funds	4,190,640	-	-	4,190,640
Dividends/Interest	678,156	458,104	211,858	1,348,118
Change in Market Value	-	(166,618)	432,107	265,488
Management Fees	-	(25,078)	(13,996)	(39,073)
Ending Value (6.30.2024)	\$ 11,043,841	\$ 8,574,213	\$ 6,767,677	\$ 26,385,730

**Table 2. Investment Fund Activity By FY**

	FY 2021	FY 2022	FY 2023	FY 2024
Beginning Book Value	\$ 10,634,799	\$ 12,454,721	\$ 16,540,906	\$ 21,405,174
Contributions:				
a. Concil authorized transfers	113,724	2,151,632	2,645,968	4,190,640
b. Prepayment of CalPERS Unfunded Liability discount	1,318,502	1,479,360	1,634,103	1,487,226
Dividends and Realized Gain/Loss	412,481	490,659	626,281	1,194,713
Management fees	(24,785)	(35,466)	(42,085)	(32,715)
Subtotal before marking investments to market	12,454,721	16,540,906	21,405,174	28,245,038
Change in Market Value	378,132	(2,116,151)	(2,271,842)	(1,859,307)
Ending Balance - Market Value	\$ 12,832,853	\$ 14,424,755	\$ 19,133,331	\$ 26,385,730

**Discussion of Changes in Market Values**

Generally accepted accounting principles requires that investments be marked-to-market. This term refers to a method under which the fair values of accounts (i.e., assets and liabilities) that are subject to periodic fluctuations can be measured. The goal is to provide time to time appraisals of the current financial position of a company or organization, by incorporating the prevailing market conditions.

In the tables above, there is a line for changes in market values, which is negative. That is because, in some cases, the City may have investments with a current market value that is greater or less than the recorded cost. These changes in market value are due to fluctuations in the market and have no effect on yield, as the City does not intend to sell securities prior to maturity. For this reason, Table 2 above shows the Section 115 Trust Fund balance before and after adding the changes in market value, so that management and the City Council can get a more realistic picture of how the Section 115 Trust Fund is performing.

## Investment Performance

### A. Overview from July 1, 2023 to June 30, 2024

As of July 1, 2023, the Trust Fund reported a total balance of \$16,540,906, with \$8,307,805 allocated to the Fixed Income Account and \$6,137,707 allocated to the Moderate Growth Account, along with \$4,687,819 invested in Pooled Cash.

- Fixed Income Account: During FY2024, the Fixed Income Account earned \$291,486, resulting in a yield of 3.51%. This performance was shaped by the impact of rising interest rates, which led to a drop in the market value of existing bonds as new bonds with higher yields became more attractive. Despite this, the account maintained steady income from dividends, showing resilience in generating returns even as bond values fluctuated.
- Moderate Growth Account: The Moderate Growth Account, during FY 2024, reported substantial earnings of \$648,940, resulting in a return of 10.59%. This return was driven primarily by strong gains in equity holdings, which benefited from equity markets that were close to all-time highs.

### B. Rate of Returns by Account and Fiscal Year

1. Account 7600 (40.8% Equities, 54.7% Fixed Income and 4.6% Alternatives):  
As summarized in Table 3, in account 7600, the Section 115 fixed income portion of the portfolio outperformed the benchmark\* in FY 2024 (3.39% versus 2.63%). The equity portion of the portfolio underperformed the benchmark in FY 2024 (20.29% versus 24.56%).

**Table 3. Account 7600 Rate of Return by FY and Asset Allocation**

	FY2024	FY2024 Benchmark
Fixed Income	3.39%	2.63%*
Equities	20.29%	24.56%**
Alternatives	7.23%	N/A
Total Account	10.57%	

\*Benchmark: Bloomberg U.S. Aggregate Bond Index

\*\*Benchmark: S&P 500 Total Return Index

2. Account 7590 (100% Fixed Income):

As summarized in Table 4, Account 7590 outperformed the benchmark in FY 2024 (3.43% versus 2.63%).

**Table 4. Account 7590 Rate of Return by FY and Asset Allocation**

	FY2024	FY2024 Benchmark
Fixed Income	3.43%	2.63%
Total Account	3.51%	2.63%

\*Benchmark: Bloomberg US Aggregate Bond Index

CURRENT SITUATION AND ITS EFFECTS

The yield of the Section 115 Trust Fund for the fiscal year ended June 30, 2024 compared to the fiscal year ended June 30, 2023, was as follows. As shown in Table 5, for FY2024, the fixed income account yielded a return of 3.51%, while the moderate growth account returned 10.59%. This represents an increase of 261 basis points from the 0.9% return in FY2023 for the fixed income account and an increase of 372 basis points from the 6.87% return in FY2023 for the moderate growth account.

**Table 5. Yield by Fiscal Year**

<b>For Year Ended 6/30/2024 Compared to 6/30/2023</b>		
<b>Trust Fund</b>	<b>6/30/2024</b>	<b>6/30/2023</b>
Fixed Income Account	3.51%	0.90%
Moderate Growth Account	10.59%	6.87%

**Economic overview and Investment Outlook**

- **Fixed Income:** The fixed income market is navigating a complex environment characterized by slowing inflation and a low risk of recession in the U.S. in the near future. However, longer-maturity government bonds face challenges due to valuation pressures, the Federal Reserve's tightening monetary policy and huge federal budget deficits. Despite these uncertainties, employment remains strong, and the goods sector shows signs of improvement, supported by capital expenditures and fiscal initiatives. As inflation continues to decline, there is potential for more monetary policy easing, which could benefit shorter-maturity bonds. Credit markets have tightened, particularly in investment-grade non-financials, while high-yield markets remain volatile, underscoring the importance of selectivity in high-yield investments. Shorter-maturity securitized credit, especially non-agency residential mortgages, is favored for its attractive risk-return profile. Overall, fixed income presents appealing opportunities, with a cautious approach advised for longer-maturity bonds and a preference for shorter maturities and select credit investments.

Subsequent to the June 30, 2024 date of this report, significant developments took place:

1. Trump was elected for another term as President;
2. The Federal Reserve cut the Federal Funds rate by .50% and .25% on September 18th and November 7 th, respectively;
3. The Fed's favorite measure of inflation for September 2024, Core Personal Consumption Index (Core PCE) declined to 2.1%, one tick above the Fed's 2.0% long-term goal; and,

4. In October 2024, employers in the U.S. only added 12,000 jobs compared to an estimate of 100,000.

The Fed is expected to cut short-term rates further, but Staff believes the developments above make it unclear how quickly those reductions will come and how large they will be, for the following reasons:

1. Trump has promised to use a significant increase in the use of tariffs as his primary trade policy, which will be inflationary;
  2. In addition, the President has promised to extend the tax cuts enacted during his first term in office, which would also be inflationary and would increase the already huge \$ 35+ trillion U.S. federal debt;
  3. The Fed's reduction of rates in November were likely a response to the weak October job's report. However, that low number of jobs created was probably depressed by the Boeing strike (which has now ended) and the fallout of back-to-back hurricanes in the Southeast; and,
  4. On top of a \$1.8 trillion U.S. federal budget deficit for the upcoming fiscal year, these developments will put upward pressure on long-term interest rates, like mortgages and keep them higher for a longer period of time. Staff believes a sign of what is to come is reflected in the reaction long-term rates had to the Fed's move to lower short-term interest rates on September 18, 2024 by .50%: Many Analysts had expected long-term rates, like mortgages, to drop as the Fed lowered short-term rates. In fact, the average rate on a conventional 30-year mortgage increased from 6.08% in late September 2024 to 6.54% in the week ending October 24, 2024.
- Global Equity: The equity markets have experienced an apparent shift, with growth-oriented sectors such as consumer discretionary, communication services, and information technology leading the recovery. The surge in interest surrounding generative artificial intelligence (AI) has provided a renewed boost to technology mega-caps, following a challenging 2022. By June 2024, a broader cyclical recovery is evident; however, a significant portion of U.S. index returns is concentrated among the 'magnificent seven' (Meta, Apple, Nvidia, Amazon, Microsoft, Alphabet, Tesla), which collectively account for a substantial weight in the S&P 500 Index. The remaining constituents have experienced relatively modest performance.

## BACKGROUND

At the November 28, 2017 Council meeting, the City Manager was instructed to present a proposal for establishing an Irrevocable Supplemental Pension Trust, along with other options proposed by the staff.

On June 26, 2018, the City Council adopted a Resolution appointing the City Manager as the Plan Administrator. This resolution authorized the City Manager to initiate the necessary steps for negotiating and executing documents to establish a Section 115 Trust Fund, intended to serve as a pension rate stabilizing fund. Additionally, it delegated authority for managing the Section 115 Trust Fund investments.

On May 14, 2019, during the Council meeting, the City Council adopted a Resolution authorizing the City Manager to execute a contract with Keenan Financial Services to establish a pension Section 115 trust. This contract includes Keenan Financial Services providing trust administration, trustee/custodian, and investment advisory services. The structure of the trust includes the following components:

- Trust Administrator: Keenan
- Trustee/Custodian: Benefit Trust Company
- Investment Manager: Morgan Stanley

Benefit Trust Company (BTC) actively manages plan assets. The City's individual trust account is part of a larger Multiple Employer Trust administered by Keenan Financial Services and BTC. BTC also provides the City with monthly and quarterly statements detailing the activity of the City's accounts.

The primary purpose of the Pension Stabilization Trust is to accumulate, hold, and distribute pension plan assets exclusively for the benefit of retiree pensions, as defined by IRS Code Section 115. These plan assets are irrevocable and can only be used for the intended purpose of the Trust.

The City's principal objective in establishing the Pension Trust is to control long-term costs and mitigate the annual operating budget's volatility. The trust offers increased flexibility to the City, allowing for more consistent contributions and reduced year-to-year contribution volatility.

## ENVIRONMENTAL SUSTAINABILITY AND CLIMATE IMPACTS

There are no identifiable environmental effects or opportunities associated with the subject of this report.

## CONTACT PERSON

Henry Oyekanmi, Director, Finance Department, 981-7326

ATTACHMENTS

1. Portfolio Evaluation from July 1, 2023 to June 30, 2024
2. Investment Report Analysis from July 1, 2023 to June 30, 2024



**Portfolio Evaluation  
As of June 30, 2024**

	<b>Analysis by Fiscal Year</b>				
	<u>6/30/2024</u>	<u>6.30.2023</u>	<u>6.30.2022</u>	<u>6.30.2021</u>	<u>9.30.2020 (Inception)</u>
<b>Total Portfolio</b>					
Pooled Cash	\$ 11,043,841	\$ 4,687,819	\$ 407,748	\$ 1,432,226	\$ -
Fixed Income Account (7590)	8,574,213	8,307,805	8,257,710	6,469,347	6,356,407
Moderate Growth Account (7600)	6,767,677	6,137,707	5,759,296	4,931,280	4,278,393
Total Cash and Investments	<u>\$ 26,385,730</u>	<u>\$ 19,133,331</u>	<u>\$ 14,424,755</u>	<u>\$ 12,832,853</u>	<u>\$ 10,634,799</u>
<b>Earnings</b>					
Fixed Income Account (7590)	291,486	74,673	(984,712)	127,368	
Moderate Growth Account (7600)	648,940	395,917	(1,018,912)	663,245	
Total Earnings	<u>\$ 940,426</u>	<u>\$ 470,590</u>	<u>\$ (2,003,624)</u>	<u>\$ 790,613</u>	
<b>Yield</b>					
Fixed Income Account (7590)	3.51%	0.90%	-15.22%	2.00%	
Moderate Growth Account (7600)	10.59%	6.87%	-20.66%	15.50%	
	<u>4.92%</u>	<u>3.26%</u>	<u>-15.61%</u>	<u>7.43%</u>	



**Investment Report Analysis  
As of June 30, 2024**

**Cash and Investments**

	<u>Trust Investments</u>	<u>Total</u>
Portfolio	\$ 10,634,799	\$ 10,634,799
Unrecognized gain/(loss)	4,707,090	\$ 4,707,090
<b>Total Investments</b>	<b>\$ 15,341,890</b>	<b>\$ 15,341,889</b>

Cash

	<u>Pooled Cash</u>	<u>Total</u>
Cash Deposits in Bank	11,043,841	11,043,841
<b>Total Cash</b>	<b>11,043,841</b>	<b>11,043,841</b>

**Adjusted Grand Total (All Cash and Investments)**

<b>Adjusted Grand Total (All Cash and Investments)</b>	<b>\$ 26,385,730</b>	<b>\$ 26,385,730</b>
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**Section 115 Trust Portfolio Breakdown As of June 30, 2024**

	<u>Book Value</u>	<u>Market Value</u>
Fixed Income	8,687,089.21	12,275,080.23
Equities	1,703,409.07	2,761,056.46
Alternatives	244,301.08	305,752.83
<b>Total Investments</b>	<b>\$ 10,634,799</b>	<b>\$ 15,341,890</b>