



CITY OF SEBASTOPOL CITY COUNCIL

AGENDA ITEM REPORT FOR MEETING OF: June 2, 2026

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To: Honorable Mayor and City Councilmembers
From: Ana Kwong – *Administrative Services Director*
Responsible Department: Administrative Services
Subject: Year-to-Date Update for City Investments, including the Section 115 Trust and Non-Trust Discretionary Account

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RECOMMENDATION:

It is recommended that the City Council receive and file this informational report providing an annual update on the City Investments, including the Section 115 Pension Trust and non-trust pension account.

PROCESS OF AGENDA ITEM:

- a. Presentation of the agenda item by the Administrative Services Director
- b. Introduction of Consultant
- c. Questions and Discussion from Councilmembers
- d. Public Comment Period
- e. Council Deliberation and Motion

EXECUTIVE SUMMARY:

This report provides a year-to-date update on the City’s Section 115 Pension Trust and internal (non-trust) pension reserves. The purpose of this report is to support transparency and provide context for upcoming budget deliberations related to long-term pension funding.

BACKGROUND:

The City established a Section 115 Pension Trust in October 2023 to prefund a portion of its CalPERS pension obligations. Authorized under federal tax law, a Section 115 trust allows public agencies to set aside assets in an irrevocable trust that may be used exclusively for pension-related costs. Assets held in the trust are invested under a long-term strategy with the goal of achieving returns that help reduce volatility in future pension costs.

In addition to the Section 115 Pension Trust, the City retained a portion of its pension reserves outside the trust as a non-trust discretionary pension reserve. Unlike the Section 115 Trust, these funds are not subject to the same legal restrictions and remain fully under City Council discretion.

Given renewed Council interest in pension funding strategy and the role of prefunding in managing long-term obligations, this report provides an annual overview of both funding mechanisms. This report is informational in nature and does not recommend a change in policy at this time.

DISCUSSION:

Section 115 Pension Trust

The Section 115 Pension Trust is held in an irrevocable trust and invested in accordance with an adopted investment policy designed to balance risk mitigation with long-term return objectives.

Key characteristics of the Section 115 Trust include:

- Funds are legally restricted for pension-related expenditures.
- Assets are invested separately from the City’s operating funds.
- Earnings, whether gains or losses, accrue to the trust over time.
- Use of trust funds generally requires City Council direction and coordination with the City’s pension advisors.



The Trust serves as a long-term financial management tool intended to reduce contribution volatility and provide flexibility in addressing future pension cost increases, particularly during periods of market or actuarial stress. Statements for the most recent fiscal year-end and current fiscal year-to-date are provided for informational purposes.

Non-Trust Pension Account and City Investment Portfolio

In addition to the Section 115 Trust, the City maintains non-trust pension account. These funds are not subject to the legal restrictions of a Section 115 Trust and therefore provide greater short-term fiscal flexibility. While historically associated with pension planning, these reserves remain available for broader General Fund purposes at the discretion of the City Council.

Key distinctions between non-trust pension reserves and the Section 115 Trust include:

- Funds are not legally restricted to pension-only use.
- Assets are generally held within the City's pooled investment structure.
- Council may redirect these funds during budget adoption or mid-year adjustments, subject to fiscal policy considerations.

The coexistence of trust and non-trust pension resources allows the City to balance long-term pension prefunding objectives with near-term budgetary pressures, including structural deficit considerations.

City Investment Portfolio Investment Policy Update

The City's Investment Policy sets forth the City's investment objectives, risk preferences, authorized investments, and other investment-related priorities. A thoughtful and comprehensive investment policy not only provides accountability for investment officials but also promotes public trust in investment decisions. Developing, reviewing, and monitoring the City's Investment Policy serves as an important tool of communication between the investment official, City management, and the City Council.

Prior to January 1, 2005, State statute required the City Treasurer to render to the City Council an annual Investment Policy. Although this statutory requirement has been removed, conducting an annual review for legal compliance and submitting the Policy to the City Council remains a sound fiscal practice.

The current Investment Policy Statement remains compliant with California Government Code Section 53601 ("the Code"). However, updates to the Code in recent years have expanded investment flexibility for local agencies while preserving the core principles of safety, liquidity, and return.

Shuster has recommended targeted updates to the City's IPS to align with current statutory allowances and incorporate best practices in public fund management. These changes are designed to enhance yield potential, streamline portfolio structure, and ensure the City remains well-positioned in a dynamic interest rate environment.

STAFF ANALYSIS:

The City has retained Shuster Advisory Group, LLC to manage City investments to prefund pension liabilities (Trust and non-Trust). The firm is an SEC-registered investment advisor managing over \$11 billion in public assets and serves as fiduciary and investment advisor to the City. Charles Schwab Trust Bank acts as custodian, and Alta Trust Company serves as directed trustee.

The Section 115 Pension Trust is currently invested with an allocation of approximately 40 percent equities and 60 percent fixed income. This allocation emphasizes capital preservation while allowing for moderate long-term growth.



Since inception, the Trust has demonstrated positive performance. The annualized returns over the past two years ending May 6, 2026 were 11.28%, exceeding the benchmark return of 9.73% for the same period and the CalPERS Public Employees’ Retirement Fund (PERF) pension plan discount rate of 6.80%. As of May 6, 2026, the inception-to-date return was 10.45%, compared to a benchmark return of 8.86%.

The CalPERS PERF pension plan maintains an asset allocation of approximately 70 percent equities and 30 percent fixed income. In contrast, the City adopted a more balanced approach for the Section 115 Pension Trust in recognition of its size and capacity for risk.

As the Trust enters its second year and continues to demonstrate positive performance, staff will periodically reassess the asset allocation to determine whether a gradual increase in equity exposure would better support long-term return objectives while maintaining a risk profile appropriate to the City’s overall financial position.

Balances for both the Section 115 Pension Trust and the non-trust pension reserves are as follows:

Account	Balance as of 3/31/26	Balance as of 4/30/26	Balance as of 5/6/26
Section 115 Pension Trust	\$2,144,104	\$2,232,147	\$2,261,476
Non-Trust Pension Account	\$1,080,663	\$1,083,582	\$1,083,582

Pension prefunding decisions must be evaluated alongside competing fiscal priorities, including infrastructure investment, service level sustainability, and long-term revenue capacity.

Any future changes in funding strategy or use of pension reserves would be presented separately for City Council consideration as part of the budget process or a dedicated policy discussion.

In order to maximize non-Trust investment earnings, staff has discussed the option to engage Shuster Advisory Group to also actively manage the City’s Cash Investment Portfolio.

Following a comprehensive review of the City’s investment assets, as reflected in the March 2026 Investment Report data, Shuster identified opportunities to reallocate a portion of shorter-maturity holdings into high-quality fixed income investments. These reallocations are designed to enhance portfolio yield without sacrificing core principles of safety and liquidity.

Recognizing the complexity of the fixed income market, Shuster partners with leading institutional bond managers to construct investment-grade, resilient portfolios. These portfolios include only investments permissible under California Government Code Section 53601, such as U.S. Treasuries, U.S. Agency bonds, A-rated or better corporate bonds, and AA-rated or better mortgage- and asset-backed securities.

In today’s dynamic interest rate environment, professional bond management provides access to institutional pricing, credit analysis, and market research, allowing the City to capture opportunities arising from market dislocations. Shuster will continue to assist the City in allocating assets between JPA pools and institutional bond managers to optimize yield and ensure compliance with safety and liquidity objectives.

The recommendation to approve an updated Investment Policy Statement and to approve Shuster as the Investment Fiduciary for the City’s Cash Investment Portfolio will be presented separately for Council consideration.

BUDGET COMMITTEE REVIEW

The Budget Committee will review this item at its meeting on May 11, 2026.

CITY COUNCIL GOALS/PRIORITIES/ AND OR GENERAL PLAN CONSISTENCY:

This agenda item represents the City Council goals/priorities as follows:



Goal 5: Achieving Greater Fiscal Resilience and Long Term Fiscal Sustainability

This agenda item represents the City Council General Plan Consistency (if applicable): Not Applicable

FISCAL IMPACT:

There is no fiscal impact associated with receiving and filing this informational report. Future fiscal impacts would depend on City Council policy direction and would be evaluated through the budget process or a separate policy action.

COMMUNITY OUTREACH:

This item has been noticed in accordance with the Ralph M. Brown Act and was available for public viewing and review at least 72 hours prior to schedule meeting date. The City has also used social media to promote and advertise the City Council Meeting Agenda Items.

As of the writing of this agenda item report, the City has not received any public comment. If staff receives public comment from interested parties following the publication and distribution of this agenda item report, such comments will be provided to the City Council as supplemental materials before or at the meeting and will be posted to the city website.

RESTATED RECOMMENDATION(S):

That the City Council receive year-to-date information for the Section 115 Trust for Pension Stabilization Pension Account and Internal Pension Reserve.

OPTIONS:

The City Council may consider the following options during the upcoming FY 26-27 Budget Hearing:

1. Transfer additional funds into the Section 115 Trust
2. Transfer the balance of the non-Trust discretionary account into the Section 115 Trust
3. Approve the updated Investment Policy Statement for FY 26-27
4. Approve Shuster Advisory Group as the Investment Fiduciary for the City’s Cash Investment Portfolio.

ATTACHMENTS:

None

APPROVALS:

Department Head Approval: Approval Date: 5/1/26

CEQA Determination (Planning): Approval Date: N/A

The proposed action is not a project under the California Environmental Quality Act (CEQA)

Administrative Services (Financial) Approval Date: 5/1/26

Costs authorized in City Approved Budget: Yes No N/A

Account Code (f applicable) N/A

City Attorney Approval: Approval Date: pending

City Manager Approval: Approval Date: pending