



TOWN OF LOS GATOS
TOWN PENSION AND OPEB
TRUSTS OVERSIGHT COMMITTEE
REPORT

MEETING DATE: 3/5/2019

ITEM NO: 4

DATE: FEBRUARY 25, 2019

TO: TOWN PENSION AND OPEB TRUSTS OVERSIGHT COMMITTEE

FROM: LAUREL PREVETTI, TOWN MANAGER

SUBJECT: REVIEW AND PROVIDE DIRECTION ON ADDITIONAL DISCRETIONARY
PAYMENT STRATEGIES

RECOMMENDATION:

Review and provide direction on additional discretionary payment strategies.

BACKGROUND:

In 2009, the Council approved participating in the California Employer's Retiree Benefit Trust (CERBT) Fund as a vehicle for the prefunding of the Town's other post-employment benefits ("OPEB") obligations. Since that time the Council has consistently used additional discretionary payments (ADPs) as a way to address the Town's unfunded pension and OPEB obligations. ADP is a generic term used to describe any additional payments toward pension obligations beyond the CalPERS actuarially determined contributions and pay-go funding for OPEB.

On August 15, 2017, Town Council approved Public Agency Retirement Services (PARS) as the administrator of the Town's Section 115 Pension Trust. The Council Finance Committee recommended to the Town Council that monies allocated to the Trust should be invested over a long-term horizon with little or no withdrawals for the foreseeable future. As such, the Finance Committee recommended investing in the PARS Capital Appreciation Index Plus product to achieve equity exposures greater than those provided by CalPERS. Committee members stated that the historic return premium of equities compared to fixed income investments warranted an asset allocation with higher exposures to equities. The Committee also identified that the assets would not be utilized in the short-term thereby allowing the increased volatility associated with equities to be mitigated in the long run. In addition, the Committee recommended that assets placed in the 115 Pension Trust be dollar cost averaged

PREPARED BY: ARN ANDREWS
Assistant Town Manager

Reviewed by: Town Manager, Town Attorney, and Finance Director

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BACKGROUND (continued):

over the next year to mitigate risks associated with a single market entry point. On December 19, 2017, the Town Council reviewed the Finance Committees recommendations and adopted the PARS Capital Appreciation asset allocation.

DISCUSSION:

The Town Council, Town Council Pension and OPEB Trusts Oversight Committee, and Finance Committee continue to explore additional strategies for reducing unfunded Pension and OPEB obligations. As previously noted, to date, the primary strategies utilized have been the prefunding of OPEB obligations and ADPs provided to PARS for long-term capital accumulation and appreciation. Provided below are examples of how additional ADPs could be utilized if allocated to additional strategies. In addition, on August 21, 2018, the Oversight Committee received an analysis of the CalPERS 2016 Actuarial Valuations from Bartel Associates, LLC. (Attachment 1) which also included a discussion of additional payment strategies.

Long-term Capital Accumulation and Appreciation

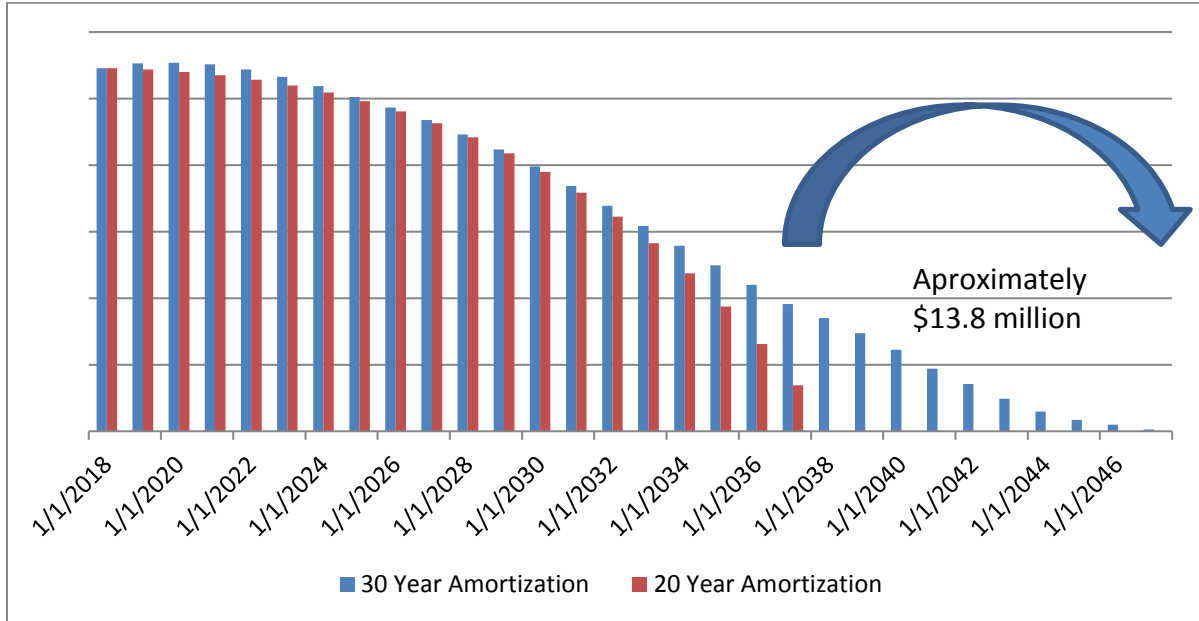
Over the past several years Council has allocated a portion of budgetary surpluses for allocation to the PARS Trust. To date, the Trust has received \$3.3 million in deposits with another \$1.0 million pending for a total allocation of \$4.3 million. In addition, on May 15, 2018 the Council adopted a Reserve Policy which lays out the procedures for the Town to set aside additional discretionary payments annually to reduce the effective amortization period of the Town's unfunded pension liabilities from approximately 30 years to 20 years. The pension ADP analysis performed in conjunction with CalPERS indicated that a 20-year amortization equivalence can be achieved through additional unfunded actuarial liability (UAL) payments of approximately \$390,000 per year. As part of adopting the shortened amortization policy the Finance Committee and Council determined that any ADPs be deposited into the PARS IRS 115 Pension Trust Fund instead of directly to CalPERS.

As the chart below illustrates the savings from the reduced amortization strategy derive from the accumulation and appreciation of the PARS assets over a twenty-year period being used to pay off the remaining ten years of the amortization bases. This strategy currently has \$12.1 million in ADPs programmed over the 20-year period. It is estimated that the total savings associated with this ADP strategy is approximately \$13.8 million versus the existing amortization schedules for both plans.

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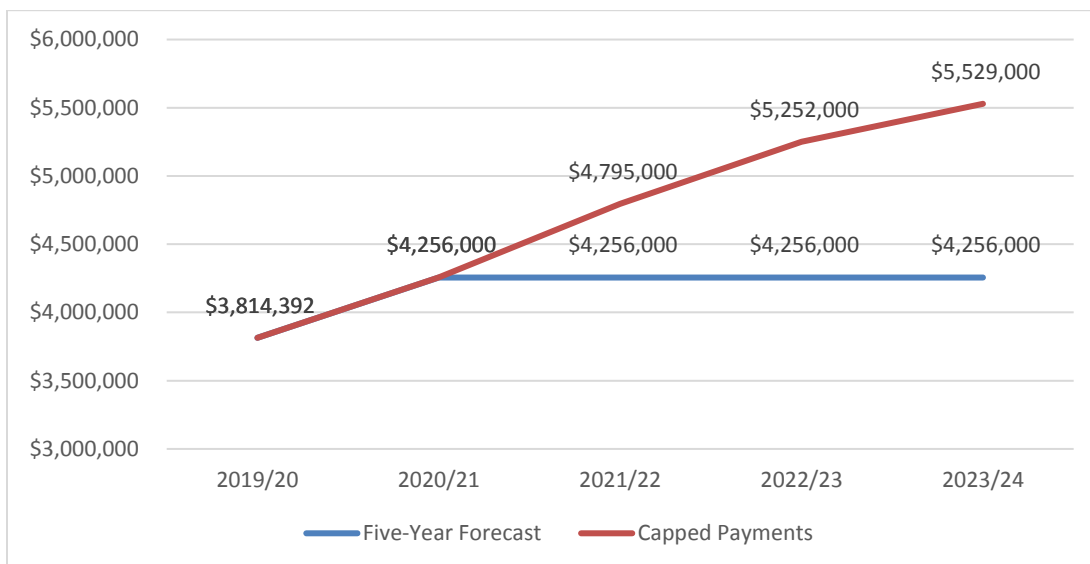
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DISCUSSION (continued):



Pension Contribution Management

Pension contribution management strategies utilize ADPs to offset anticipated increases in pension contributions. As the table below illustrates the Town's five-year forecast anticipates that the UAL portion of annual pension contributions is forecasted to increase from \$3.8 million to \$5.5 million for the Safety and Miscellaneous Plans.



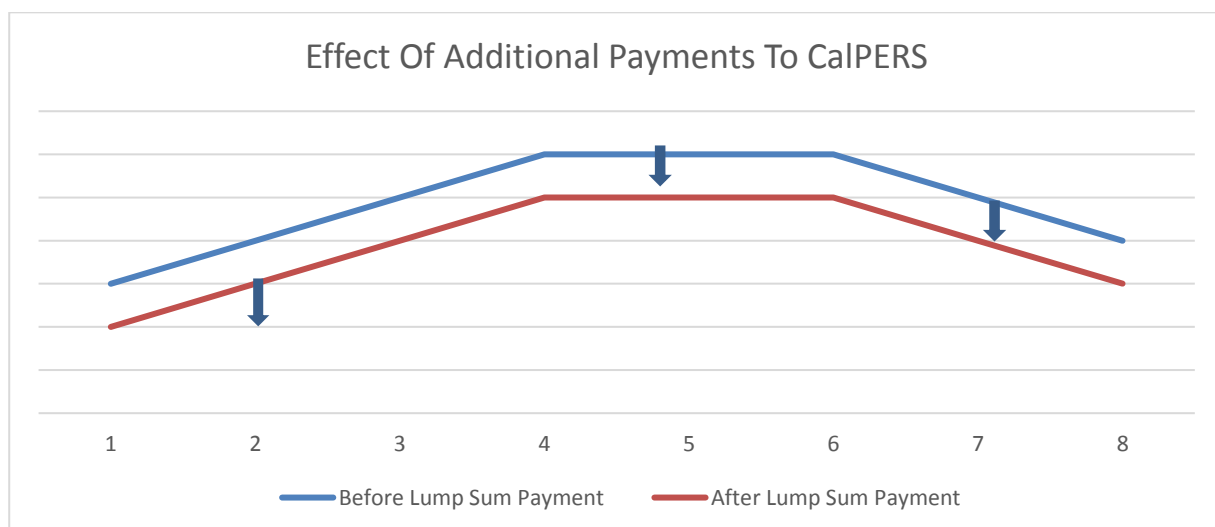
DISCUSSION (continued):

If the Town sought budgetary relief from the forecasted increase in pension expense it could utilize ADPs to cap annual payments at some predetermined figure. The ADPs would make up the difference between the actual payment determined by CalPERS and the self-imposed cap. In the example on the previous page, if the Council wanted to maintain UAL payments at the FY 2020/21 level of \$4,256,000 for the remaining forecast period it would require total ADPs of \$2,808,000. While this ADP strategy provides direct budgetary relief, it does not present savings associated with the pension liability.

If Council were inclined to pursue this strategy staff would recommend holding the ADPs in the Pension/OPEB reserve as opposed to PARS. Since the monies would be utilized over a short time horizon it would not be prudent to expose them to the volatility associated with equities. Monies in the Pension/OPEB reserve would earn interest at the rate of return of the Town's operating portfolio.

Direct Payments to CalPERS

ADPs allocated directly to CalPERS can achieve several outcomes which help to reduce the Town's outstanding unfunded pension obligation. Lump sum payments to CalPERS can either be in the form of generic additional contributions or targeted at specific amortization bases. Benefits associated with direct payments to CalPERS include, point in time reductions in the UAL, interest savings, increased funding status, and reduced contributions. As the chart below illustrates ADP strategies can be developed to shift the existing pension contribution cost curve down from existing forecasts. It should be noted, that anticipated cost savings associated with additional payments directly to CalPERS are for a point in time and subject to change if actuarial demographic and economic assumptions change.



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DISCUSSION (continued):

If Council were inclined to pursue this strategy staff would work with Bartel Associates, LLC to craft a payment plan which optimizes reductions in pension contributions, interest expense, and UAL. Staff would recommend holding the ADPs in the Pension/OPEB reserve as opposed to PARS. Since the monies would be utilized over a short time horizon it would not be prudent to expose them to the volatility associated with equities. Monies in the Pension/OPEB reserve would earn interest at the rate of return of the Town's operating portfolio. Staff would also recommend that any payments to CalPERS be delayed until more favorable market valuations exist.

CONCLUSION:

Council has been proactive in allocating additional discretionary payments towards the Town's unfunded pension obligations. To date, the Council has predominately pursued capital accumulation and appreciation ADP strategies through the creation and funding of IRS 115 Trusts. Staff looks forward to hearing from Council if they would like to entertain other ADP strategies.

FISCAL IMPACT:

None

ENVIRONMENTAL ASSESSMENT:

This is not a project defined under CEQA, and no further action is required.

Attachment:

1. CalPERS 2016 Actuarial Valuation Analysis from Bartell Associates, LLC
2. Public Comment

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