Date: August 29, 2019
From: Terry Duryea, member of the Los Gatos Finance Committee
To: Members of Los Gatos Pension and OPEB Trusts Oversight Committee

Dear Mayor and Committee Members

My comments relate to Item 4: "Review and Discuss CalPERS 2017 Actuarial Valuations…and Decide on an Additional Discretionary Payment Strategy Based on the August 2019 Bartel and Associates Analysis".

I recognize most of you understand the issues so I will be brief and try to frame the issues as I see them.

First I want to complement Town Staff for commissioning the August 12 Bartel's report included as Attachment 3 that was the basis of the discussion at the August 12 Finance Committee meeting. It provides analysis of possible options to invest the $8M plus funds that have been identified to reduce the Town's Unfunded Pension and OPEB Obligations.

In particular, I want to complement the staff for having Bartel compute what the Unfunded Pension Liability would be at a 6% discount rate. You will find this information on slide 2 of the report which is on page 43 of the Item 4 advance material.

Slide 2 shows the unfunded liability increases to $83M using a 6% discount rate, a rate presumably used as explained in footnote 6 because the discount rate "is ultimately expected to decrease to approximately 6% as a result of CALPERs risk mitigation strategy". The Unfunded Pension Liability is $25.M (44%) higher than the reported Unfunded Liability 0f $57.6M using the CALPERs current 7% discount rate.

I know you know we have a problem, but I don't know if you were aware of how big it is, or the credibility Bartel now shines on the 6% long term discount rate.

You may not be aware that two weeks ago CALPERs investment consultant, Wilshire Consulting, has reduced their forecast of the return CALPERs will earn over the next decade to 5.9% from 6.2%

As a member of the Finance Committee I will add some color to the Staff Report summarizing the recent meeting.

- A metaphor was used in the committee discussion was to compare "the Unfunded Pension Liability to a cancer while the OPEB Liability is a bad cold".
- Most of the Finance Committee feel it was highly unlikely the state would bail out local municipalities if they were otherwise forced into bankruptcy because of their pension obligations.
    - The skepticism even greater that if the state did step in in dire situations, the state would certainly not bail out Los Gatos so long as we had $70M cash in the bank.
- There was discussion that the "California Rule" covers pension benefits while there is no equivalent rule for OPEB benefits
    - As a reminder, the California Rule says that you cannot take away pension benefits from employees unless you replace them with something of equal value
    - I know you recognize the flexibility you have to reduce OPEB benefits because you negotiated a reduction of these benefits in the latest labor contracts.
- I believe there was universal recognition among the committee participants that it made sense to put funds in the PARs 115 Pension Trust only if the intent was to invest it long term (over 10 years).

    - The primary justification for putting the funds with PARs was a belief that PARs would achieve better returns than CALPERs since the funds would be invested with a long term time horizon
- Bartels indicated that the reason the pension contribution graphs peak and begin to decline in approximately 2030 (see slide 6 of page 45 of the advance attachment) is because the graphs assumes CAPLERs earns at least the 7% discount rate every year. Any time it misses the target you add another layer of obligation that extends the peak of the curve further out. Furthermore, any future changes in actuarial assumptions that increase the pension costs would also delay the time before the contributions begin to decrease

The staff material present 3 options to invest the $8M plus that has been set aside to address our obligations:

- Apply all the money to fund the OPEB obligation—this makes the obligation close to fully funded
- Add the money to the PARs 115 Pension Trust—hoping for better returns than CALPERs
- Pay the money to CALPERs to pay down the Town's unfunded liability—each year we would save interest on the reduced unfunded liability providing an immediate budget benefit

I believe we need to address the Cancer (Pensions) and not the Cold (OPEB). Therefore, I encourage you to focus on how to best fund the Pension Obligations.

Most of the discussion over the last couple years doesn't speak to our moral obligation to staff and former staff to fund their pension obligations. When we allow the unfunded pension liability to grow, we are effectively telling our employees to trust the future Town governance process—we're watching out for you because these councils will make sure you receive your pension.

The Staff memo lays out 2 options to fund the pensions—should the assets be managed by CALPERs or by PARs? In my opinion, the choice comes down to the relative weight you give to these 2 issues:

- Do you believe PARs will achieve a superior investment return over CALPERs long term?
- Do you believe that the potential for higher PARs return will compensate for the fact that a future Town Council could raid the 115 Plan Assets if there is a shift in Town priorities?
    - To paraphrase the staff memo, it states that if the Committee decides to commit to a long term investment plan with PARs, "the commitment should be codified so future elected officials/staff/resident understand the foundation of this approach"
    - At the Finance Committee meeting, staff stated that there is no fail safe mechanism to prevent future Town Councils from disregarding this foundation

I come out on the side to keep it simple—give the money to CALPER's now, rather than bet on higher returns under PARs. The biggest benefit of this approach is that it eliminates the risk that the funds could be raided by future Town Councils for some other purpose (remember, money is fungible).

In conclusion, potentially the biggest benefit of investing all the money with CALPERs now (over 12 months) is that this won't be a topic every year requiring ongoing Town Council attention and time.

Filename: PensionOversiteCommSept3LetterToCouncil_802919