



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

MEETING DATE: 9/3/2019

ITEM NO: 4

DATE: August 20, 2019
TO: Town Pension and OPEB Trusts Oversight Committee
FROM: Laurel Prevetti, Town Manager
SUBJECT: Review and Discuss CalPERS 2017 Actuarial Valuations for the Miscellaneous and Safety Pension Plans and Decide on an Additional Discretionary Payment (ADP) Strategy Based on the August 2019 Bartel and Associates Analysis

RECOMMENDATION:

Review and discuss CalPERS 2017 Actuarial Valuations for the Miscellaneous and Safety Pension Plans and decide on an Additional Discretionary Payment (ADP) Strategy based on the August 2019 Bartel and Associates Analysis

EXECUTIVE SUMMARY:

Based on direction from the Town Pension and Other Post-Employment Benefits (OPEB) Trusts Oversight Committee (Pension/OPEB Committee), staff presented a report to the Pension/OPEB Committee on March 5, 2019 entitled, "Review and Provide Direction on Additional Discretionary Payment (ADP) Strategies" (Attachment 1). ADP strategies are intended to reduce unfunded Pension and OPEB obligations above the annual required contributions calculated by CalPERS and the Town's actuary. The staff report provided high level informational material about the three primary types of ADP strategies available: (1) long-term capital accumulation and appreciation, (2) pension contribution management, and (3) direct payments to CalPERS. The report concluded that to date, the primary strategies utilized by the Town have been the prefunding of OPEB obligations and ADPs provided to PARS for long-term capital accumulation and appreciation of the Town's pension assets. At the conclusion of the meeting, the Pension/OPEB Committee asked that the Finance Committee perform a review of current and potential ADP strategies and report back to the Pension/OPEB Committee.

PREPARED BY: Arn Andrews
Assistant Town Manager

Reviewed by: Town Manager and Finance Director

EXECUTIVE SUMMARY (continued):

On June 17, 2019, the Town Finance Committee received a staff report (Attachment 2) which outlined prior Finance Committee decisions regarding the allocation of ADPs. The Town has four primary vehicles for receiving additional discretionary payments which include: Town OPEB 115 Trust, Town Pension 115 Trust, CalPERS Town Miscellaneous Plan, and CalPERS Safety Plan. Based on discussions at the June Finance Committee meeting, staff engaged Bartel and Associates to perform an analysis of the benefits associated with providing ADPs to each of the four vehicles.

On August 12, 2019, the Town Finance Committee received the ADP analysis from Bartel and Associates (Attachment 3) and had extensive deliberations about the pros and cons associated with each strategic approach to ADPs. At the conclusion of the discussion, no consensus was reached among the voting and non-voting members for a single recommendation of an ADP approach. The discussion section of this report summarizes the discussions that transpired at the Finance Committee.

In addition to the analysis of ADP strategies, Bartel and Associates will be attending the Pension/OPEB Committee meeting and is prepared to discuss the following key issues regarding their analysis of the Town's pension plans:

- 2017 Valuation results and Discount Rate Sensitivity
- CalPERS Risk Mitigation Policy and Implications
- Plan Contribution Projections (including a 6% discount rate scenario)

In 2018, staff initiated having the Town's actuary, Bartel and Associates, perform a detailed review and analysis of the Town's CalPERS annual actuarial valuations. The review provides important additional analysis and data for the Town to better understand the long-term obligations associated with its pension and Other Post-Retirement Benefit (OPEB) benefits. The full analysis can be found in Attachment 4.

BACKGROUND:

On December 4, 2017, the Council Finance Committee recommended to invest in the PARS Capital Appreciation Index Plus. In addition, the Committee recommended that assets placed in the 115 Pension Trust be dollar cost averaged over the next year to mitigate risks associated with a single market entry point. In March 2018, the initial \$300,000 was deposited into the PARS account with additional \$300,000 deposits programmed monthly for a current total of \$5.0 million in assets as of July 31, 2019. In addition, on June 4, 2019 the Town Council adopted the FY 2019/20 Operating Budget which among other items identified an additional \$3.2 million allocation to reducing either outstanding OPEB or pension unfunded obligations. With the adoption of the FY 2019/20 Operating Budget, the Town Council has identified approximately

BACKGROUND (continued):

\$8.2 million dollars which can be utilized for reducing the Town's pension/OPEB obligations. The Bartel analysis provided to the Finance Committee illustrates how the \$8.2 million dollars could be utilized for contribution management and direct ADPs to either the pension or OPEB plans.

DISCUSSION:

While no consensus was achieved by Committee members there were certain themes associated with ADPs that Committee members did coalesce around. Highlighted below are areas of consensus:

- The selection of an ADP strategy is preferable to the \$3.2 million in additional funds remaining idle in the Town's Operating Portfolio.
- An investment directly in either PARS, OPEB, or CalPERS is preferable to utilizing the funds for contribution management strategies.
- Contribution management strategies do not address the outstanding unfunded obligation.
- Additional ADPs to PARS should only be considered if the funds remain invested for a minimum of ten years.
- Committee members raised concerns about the fortitude of future Councils in maintaining a long-term investment strategy, especially during an economic downturn.
- If a PARS investment strategy cannot be maintained for a minimum of ten years, then the PARS account should be closed, and other ADP options considered.

Committee Member Deliberations

Chair Leonardis:

Chair Leonardis concluded that a payment directly to OPEB is the preferred ADP approach. The rationale included: complete control over investment decisions and actuarial decisions; with the elimination of retiree healthcare prospectively, the Town's OPEB plan would be well funded and could be derisked; and concern about the uncertainty of future CalPERS decisions and the potential impact to the Town's unfunded pension liability.

Committee Members Spector and Duryea:

Both Committee members concluded that payments directly to CalPERS is the preferred ADP approach. The rationale included: certainty of the ADP being used directly for reducing unfunded obligations, a direct action targeted at the unfunded pension obligations, and CalPERS asset allocation has greater diversity among asset classes.

DISCUSSION (continued):

Committee Members Tinsley and Dickel:

Both Committee members concluded that long-term investment in PARS is the preferred ADP approach. The rationale included: historic long-term superior returns for equities, CalPERS reduction in equity exposure for risk mitigation, inferior CalPERS returns, and CalPERS' need to respond to forces beyond attainment of the highest return.

Additional Considerations

Staff sees merits in all three ADP options and is comfortable with all three approaches; however, staff would recommend stipulations for the implementation of the desired ADP approach.

If the Pension/OPEB Committee decides to maintain and/or add resources to PARS, staff agrees that a long-term time horizon is optimal for that strategy at the current asset allocation. If the Committee decides to commit to a long-term approach, this commitment should be codified so future elected officials/staff/residents understand the foundation of the approach. If the Committee would like to continue to invest in PARS with a shorter time horizon, staff would recommend an asset allocation with less equity exposure.

If the Pension/OPEB Committee decides to make direct payments to CalPERS, staff would recommend dollar cost averaging and the sequencing of amortization base payments. Currently, an \$8.2 million ADP would represent 11.2% and 12.5% of the Market Value of Assets (MVA) for the Miscellaneous and Safety plans respectively, as of the June 30, 2018 valuation. Both those percentages represent a significant infusion of assets to the plans.

If the Pension/OPEB Committee decides to make a direct payment to the OPEB plan, staff would recommend a corresponding shift to the lowest equity asset allocation and an actuarial review of the OPEB discount rate.

CONCLUSION:

Based on the analysis from Bartel and Associates, input from the Finance Committee, and the additional consideration in this report, the Pension and OPEB Trusts Oversight Committee should recommended an ADP strategy for the current \$8.2 million in assets allocated to reducing the Town's pension/OPEB obligations.

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SUBJECT: Additional Discretionary Payment (ADP) Strategy Based on the August 2019
Bartel and Associates Analysis

DATE: August 20, 2019

ALTERNATIVES:

No action would result in the funds currently invested in the PARS 115 Trust remaining invested in the Trust and the additional monies identified in the FY 2019/20 budget remaining in the Town's Pension/OPEB Reserve earning interest at the rate of the Town's Operating Portfolio.

COORDINATION:

This report was coordinated with the Town Manager's Office and the Finance Department.

FISCAL IMPACT:

Depending on the ADP strategy chosen, the Town will either receive long-term savings from reduced interest costs associated with unfunded pension obligations or budgetary savings from a reduction in annual pension/OPEB contributions or both.

ENVIRONMENTAL ASSESSMENT:

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

Attachments:

1. March 5, 2019 Pension OPEB Committee Staff Report
2. June 17, 2019 Finance Committee Staff Report
3. August 12, 2019 Finance Committee Bartel and Associates CalPERS 2017 Actuarial Review and ADP Analysis
4. Bartel and Associates CalPERS 2017 Actuarial Review and ADP Analysis Full Report