



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

MEETING DATE: 08/04/2020

ITEM NO: 5

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DATE: July 22, 2020  
TO: Town Pension and OPEB Trusts Oversight Committee  
FROM: Laurel Prevetti, Town Manager  
SUBJECT: Consider Finance Committee Recommendation Regarding a Methodology for Additional Discretionary Payments to CalPERS

**RECOMMENDATION:**

Consider Finance Committee recommendation regarding a methodology for additional discretionary payments (ADPs) to CalPERS.

**BACKGROUND:**

Based on prior guidance, the Town Pension and OPEB Trusts Oversight Committee (Oversight Committee) directed staff to utilize existing surplus funds budgeted for additional discretionary payments (ADPs) to go directly to CalPERS toward existing long-term amortization bases. Per the Oversight Committee direction, the first additional discretionary payment (ADP) of \$4,753,965 for the 2016 gain/loss amortization base was transferred to CalPERS on October 11, 2019. Under the same direction, the second ADP of \$3,580,365 for the 2015 gain/loss amortization base was transferred to CalPERS on July 8, 2020.

On February 3, 2020, the Council Finance Committee, as part of their CEPPT asset allocation recommendation to the Oversight Committee, also opined that a clearly defined methodology for allocating assets to pay off amortization bases should be developed for future ADPs. At this meeting, the Finance Committee suggested that a monthly transfer schedule to CEPPT could be adopted similar to the dollar cost averaging that was utilized when the PARS account was first established. The preliminary methodology recommended was for minimum monthly transfers to be established.

Following the Finance Committee meeting, staff consulted with CalPERS regarding the proposed monthly methodology and was informed that it would result in a significant

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Assistant Town Manager

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

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administrative challenge. As such, on March 3, 2020, staff presented the Oversight Committee with the initial monthly methodology provided by the Finance Committee and a revised staff recommendation for quarterly payments to the CEPPT. At the conclusion of the discussion, the Oversight Committee referred the development of a future ADP payment methodology back to the Finance Committee for further discussion.

In addition, Since the Finance Committee last discussed ADP payment methodologies, staff has learned that any additional discretionary payments provided to CalPERS are not treated as an additional unique market exposure. Instead as CalPERS receives monies, in practice they attribute a prorated proportional share of whatever the investment returns are for those additional payments in a single fiscal year rather than a daily share price type of exposure similar to a mutual fund. This methodology could create a scenario where if the CalPERS portfolio were to perform better after payment of an additional amortization base but remain below the expected rate of return for the year, the Town's ADP would be allocated a proportionate investment loss as opposed to an investment gain since deposit. This information was presented to the Oversight Committee on April 21, 2020.

#### DISCUSSION:

On June 8, 2020, the Finance Committee had their first opportunity to discuss both the administrative challenge to make monthly transfers to the CEPPT and the pro rata annual return methodology employed by CalPERS for ADPs (Attachment 1). The Finance Committee discussions followed three primary questions: (1) Should funds be transferred to the CEPPT versus directly to CalPERS, (2) Does either method have any inherent market timing bias, and (3) What should be the timing of payments of existing General Fund Policy ADP monies and other potential surplus funds? At the conclusion of Committee deliberations, the recommendation was that any allocation to CalPERS should go directly to CalPERS and skip the interim step to CEPPT except in limited circumstances. Following is a brief summary of each discussion topic.

#### *CEPPT versus CalPERS Direct*

The Committee asked questions about the CalPERS prorated methodology and discussed utilizing the CalPERS CEPPT products to gain fully unitized market exposures with unit values versus receiving a prorated share of annual market returns from direct investments to CalPERS. The Committee considered the benefits of utilizing either CEPPT asset allocation depending on the timing of transfers to CalPERS and the desired equity exposure. The Committee discussed the potential for the CEPPT to potentially become a distraction and lead to unintended market timing decisions. Ultimately, the Committee determined that the primary benefit to investing in CEPPT products was if real time investments weren't going to be programmed into CalPERS. In addition, Committee members thought the CEPPT could provide value in the event monies

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became available later in the budget cycle and CalPERS was exhibiting the potential for significant loss.

While critical of CalPERS, the Committee concurred that on average CalPERS returns are still superior to the Town's mandated lower risk fixed income operating portfolio.

*Market Timing Risk and Timing of ADPs*

In general, the Committee was very attuned to the potential for unanticipated market timing consequences associated with implementation of an ADP methodology. The Committee ultimately expressed that any methodology that didn't transfer payments directly to CalPERS expeditiously could have an element of market timing seep in. The Committee discussed that the Town's budget cycle of July 1<sup>st</sup> aligns well with annual ADPs receiving the benefit of a full year of returns from CalPERS. In addition, a July payment cycle ensures that ADPs get credited in the development of the annual actuarial valuation performed by CalPERS. It should be noted, that while the Town's budget cycle and CalPERS methodology aligns well with an initial annual ADP, the Committee thought any other funds potentially identified throughout the year for ADPs should in most cases also go directly to CalPERS.

CONCLUSION:

Consider Finance Committee recommendation regarding a methodology for additional discretionary payments (ADPs) to CalPERS and provide direction to staff.

COORDINATION:

This staff report was coordinated with the Town Manager, Town Attorney, and Director of Finance.

FISCAL IMPACT:

No impact at this time

ENVIRONMENTAL ASSESSMENT:

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

Attachment:

1. June 8, 2020, Finance Committee Staff Report