



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

MEETING DATE: 03/03/2020

ITEM NO: 2

---

DATE: February 27, 2020  
TO: Town Pension and OPEB Trusts Oversight Committee  
FROM: Laurel Prevetti, Town Manager  
SUBJECT: Adopt the Recommendation of the Council Finance Committee to Invest Additional Discretionary Payment Assets in the California Employers' Pension Prefunding Trust (CEPPT) Strategy 2, and Provide Direction on a Asset Transfer Methodology

**RECOMMENDATION:**

Adopt the recommendation of the Council Finance Committee to invest additional discretionary payment (ADP) assets in the California Employers' Pension Prefunding Trust (CEPPT) Strategy 2, and provide direction on a asset transfer methodology.

**BACKGROUND:**

On September 3, 2019, the Town Pension and OPEB Trusts Oversight Committee directed staff to utilize the funds in the PARS account to make payments 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 from PARS on October 11, 2019. Under the same direction, the remaining PARS account balance in conjunction with committed Pension/OPEB fund balance will be used as an ADP to pay a 2015 gain/loss amortization base of approximately \$3,660,342 prior to September 2020.

On September 17, 2019, the Town Council directed staff to terminate the PARS agreement, consistent with the Town Pension and OPEB Trusts Oversight Committee recommendation, and to return to Council with an agreement to initiate participation in the California Employers' Pension Prefunding Trust (CEPPT). On November 5, 2019, the Town Council authorized the Town Manager to enter into an agreement with CalPERS for participation in the CEPPT program.

**PREPARED BY:** Arn Andrews  
Assistant Town Manager

---

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

---

BACKGROUND (continued):

The CEPPT Fund is a Section 115 trust fund dedicated to prefunding employer contributions to defined benefit pension systems for eligible California public agencies.

On February 3, 2020, the Council Finance Committee reviewed the two CEPPT asset allocation options available through CalPERS and staff's recommendation that Strategy 2 be brought forward to the Town Pension/OPEB Oversight Committee.

DISCUSSION:

*Council Finance Committee Discussion*

The Council Finance Committee discussion regarding asset allocation options focused on two primary considerations: concerns about existing and future assets remaining idle in the CEPPT account regardless of which asset allocation was chosen, and the belief that a clearly defined methodology for allocating assets to pay off amortization bases should be employed. The Committee concluded that both those items should be presented to the Pension/OPEB Oversight Committee in tandem with the asset allocation recommendation. In addition, one resident Committee member expressed concerns that the current ADP payment approach adopted on September 3, 2019, wasn't fully understood by the Oversight Committee and not the optimum approach. The other resident members agreed. Provided below is a summary pertaining to each component of the Council Finance Committee discussion and other relevant information.

*CEPPT Asset Allocations*

The investment time horizon for employers in the CEPPT is estimated by CalPERS to be short-term to medium-term, as employers plan for increasing required pension contributions in future years. CalPERS also recognizes that employers currently have options for: 1) investing in very low risk, short term options through their operating portfolio investments and 2) contributing directly to CalPERS or PARS type vehicles at a higher risk, long-term investment horizon.

In response, CalPERS established two diversified strategic asset allocations with low and moderate risk levels that are expected to have a net rate of investment return of 4.0% and 5.0%, respectively. CEPPT Strategy 1 accommodates a medium-term time horizon and a medium risk tolerance with a 5.0% expected return and 8.2% expected volatility. CEPPT Strategy 2 provides a shorter time horizon and lower risk tolerance with a 4.0% expected return and 5.2% expected volatility.

DISCUSSION (continued):

As illustrated below each asset allocation has varying degrees of exposure to equity, fixed income, Treasury Inflation Protected Securities (TIPS), Real Estate Investment Trusts (REITs), and liquidity. Following are the two asset allocations:

Asset Allocation Targets	Benchmark	Strategy 1	Strategy 2
Global Equity	MSCI ACWI IMI (Net)	40% +/- 5%	14% +/- 5%
Fixed Income	Bloomberg Barclays U.S. Aggregate Bond Index	47% +/- 5%	73% +/- 5%
Global Real Estate (REITs)	FTSE EPRA/NAREIT Developed Liquid (net)	8% +/- 5%	8% +/- 5%
Treasury Inflation Protected Securities (TIPS)	Bloomberg Barclays U.S. TIPS Index (Series L)	5% +/- 3%	5% +/- 3%
Liquidity	91-Day Treasury Bill	0% +2%	0% +2%

The timing of asset withdrawal from the CEPPT will be predicated on future determination of additional amortization bases to target for payment as directed by the Town's Pension/OPEB Trusts Oversight Committee. Based on the unknown timing of withdrawals from the CEPPT, staff recommended the Finance Committee consider recommending CEPPT Strategy 2 for initial receipt of Town deposits. After discussion, the Finance Committee decided to forward this recommendation to the Oversight Committee.

*Asset Withdrawal Methodology*

As previously mentioned, the resident members of the Council Finance Committee expressed concern that assets accumulated for paying off amortization bases could remain idle without some form of automatic payment methodology. In order to ensure that assets are deployed on a continual basis from the CEPPT to selected amortization bases, the Committee ultimately suggested that a monthly transfer schedule be adopted similar to the dollar cost averaging that was utilized when the PARS account was first established. The methodology recommended was

DISCUSSION (continued):

for minimum monthly payments of \$300,000 or one-twelfth (1/12) of the total assets in the account. Staff concurs that a fixed payment methodology is warranted; however, after consultation with CalPERS, staff recommends a quarterly payment schedule (\$900,000 or ¼) if the Oversight Committee opts for this approach. Monthly payments would present both the Town and CalPERS with a significant administrative challenge. In addition, quarterly payments would achieve the same result by systematically gaining differing market exposures over time.

The Committee also discussed if the remaining PARS account balance in conjunction with the committed Pension/OPEB fund balance should be used as a single amortization base payment. Based on prior Oversight Committee direction, staff anticipated paying off the 2015 gain/loss amortization base of approximately \$3,660,342 in its entirety prior to September 2020. Staff anticipated paying the second amortization base off approximately six months after the first payment which would be in the April timeframe. In addition, a payment prior to May 1, 2020 would be acknowledged by CalPERS in development of the next actuarial valuation.

Following is an example for illustrative purposes of how payments to CalPERS will proceed if the Committee decides to use a systematic payment strategy for all current Pension/OPEB fund balances.

	April 2020	July 2020	October 2020	January 2021
Quarterly Payment Methodology	\$1,050,000	\$1,050,000	\$1,050,000	\$1,050,000
Prior Implementation Guidance (on or before September 30, 2020)	\$3,660,342	\$539,658		
Example based on \$4.2 million in reserve per the Mid-year budget report				

CONCLUSION:

Staff recommends approving the recommendation of the Council Finance Committee to invest additional discretionary payment (ADP) assets in the California Employers’ Pension Prefunding Trust (CEPPT) Strategy 2 and provide direction on an asset transfer methodology.

COORDINATION:

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

PAGE 5 OF 5

SUBJECT: CEPPT Asset Allocation and Payment Methodology

DATE: February 27, 2020

FISCAL IMPACT:

No impact is anticipated at this time given the all-inclusive fee rate of 25 basis points (0.25%) is lower than the fee structure previously paid to PARS.

ENVIRONMENTAL ASSESSMENT:

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