



**TOWN OF LOS GATOS
COUNCIL FINANCE COMMITTEE
REPORT**

MEETING DATE: 02/03/2020

ITEM NO: 4

DATE: January 23, 2020
TO: Council Finance Committee
FROM: Laurel Prevetti, Town Manager
SUBJECT: Review the Two Available California Employers' Pension Prefunding Trust (CEPPT) Asset Allocation Options and Provide a Recommendation to the Town Pension/OPEB Oversight Committee.

RECOMMENDATION:

Review the two available CEPPT asset allocation options and provide a recommendation to the Town Pension/OPEB Oversight Committee.

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.

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). 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 November 5, 2019, the Town Council authorized the Town Manager to enter into an agreement with CalPERS for participation in the CEPPT program.

With the CEPPT agreement in place, staff is requesting that the Finance Committee review the two CEPPT asset allocation options available through CalPERS and provide a recommendation to the Town Pension/OPEB Oversight Committee.

PREPARED BY: Arn Andrews
Assistant Town Manager

Reviewed by: Town Manager and Finance Director

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DISCUSSION:

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.

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%

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DISCUSSION (continued):

Anticipated CEPPT Assets

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. As of December 31, 2019, the PARS account had a residual balance of \$303,402. The Town's governmental fund balance committed to Pension/OPEB additional discretionary payments had a June 30, 2019 balance of \$4,232,500. Per previous Oversight Committee 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. Based on the anticipated ADP to CalPERS prior to September 2020, an approximate residual fund balance of \$1,000,000 will remain for deposit into the CEPPT.

Per the Council adopted General Fund Reserve Policy, an approximate annual amount of \$400,000 is set aside for ADPs and in years when sufficient year-end savings exist after other reserve levels have been satisfied another \$300,000 is set aside for a potential total of \$700,000 annually. The current residual fund balance of approximately \$1,000,000 in conjunction with an additional \$400,000 to \$700,000 will make up the initial CEPPT asset base. It should be noted, that Council often allocates additional onetime surplus moneys towards ADPs during the annual budget development process. In the event Council allocates additional surplus funds toward ADPs, those monies would be in addition to the aforementioned \$1,400,000 to \$1,700,000 deposit.

The timing of asset withdrawal from the CEPPT would be predicated on future determination of additional amortization bases to target for payment as directed by the Town's Pension/OPEB Trusts Oversight Committee.

CONCLUSION:

Based on the unknown timing of withdrawals from the CEPPT at this time, staff believes the Finance Committee should consider recommending CEPPT Strategy 2 for initial receipt of Town deposits.

COORDINATION:

This staff report was coordinated with the Town Manager and Finance Department.

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.

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ENVIRONMENTAL ASSESSMENT:

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