



**TOWN OF LOS GATOS  
COUNCIL AGENDA REPORT**

MEETING DATE: 09/17/2019

ITEM NO: 11

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**DATE:** September 10, 2019  
**TO:** Mayor and Town Council  
**FROM:** Laurel Prevetti, Town Manager  
**SUBJECT:** Consider Pension Plan IRS Section 115 Trust Options, Terminate the PARS Agreement, and Direct Staff to Return to Council with an Agreement to Initiate a California Employers' Pension Prefunding Trust (CEPPT).

**RECOMMENDATION:**

Consider pension plan IRS section 115 trust options, terminate the PARS agreement, and direct staff to return to Council with an agreement to initiate a California Employers' Pension Prefunding Trust (CEPPT).

**BACKGROUND:**

On August 15, 2017, Town Council approved Public Agency Retirement Services (PARS) as the administrator of the Town's Section 115 Pension Trust. The 115 Trust was established to provide the Town with a legal vehicle to domicile additional discretionary payments toward the Town's unfunded pension liabilities. An initial \$300,000 was deposited into the PARS account in March 2018 with additional deposits programmed over the course of the year for a current total of \$5.0 million in assets as of June 30, 2019.

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. With the pending liquidation of current assets in the PARS account, it is appropriate to revisit the efficacy of maintaining an ongoing IRS section 115 pension trust.

**DISCUSSION:**

Highmark Capital Management currently provides the 115 Pension Trust with five different asset allocation options. Each asset allocation has varying degrees of exposure to equity, fixed

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Assistant Town Manager

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

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DISCUSSION (continued):

income, and cash. The five asset allocations are intended to provide participants with five distinct risk/reward profiles. The total costs associated with the asset allocations range from 0.67% of assets under management to 0.74%.

The following table provides the fees associated with the Town's current asset allocation with PARS:

	<b>Weighted embedded Expense Ratio*</b>	<b>Weighted investment management fee**</b>	<b>PARS trust administration fee</b>	<b>Total fees</b>
<b>PARS Capital Appreciation</b>	0.15%	0.34%	0.25%	0.74%

\*Represents the weighted embedded expense ratio for that fund (Source: Morningstar Direct)

\*\*Represents the weighted investment management fee net of any waivers in place for assets invested in funds for which HighMark serves as sub-adviser/adviser; assuming a \$5 million account

Since contracting with PARS in 2017 and in July of this year, CalPERS introduced a pension IRS Section 115 Trust product. The new program, known as the California Employers' Pension Prefunding Trust (CEPPT), provides the state and public agencies an additional IRS 115 Trust investment option offered directly by CalPERS. Established by Senate Bill 1413, the CEPPT fund is administered by CalPERS and mirrors the functions of the CalPERS California Employers' Retiree Benefit Trust (CERBT) Fund that the Town is currently invested for its Other Post-Employment Benefits (OPEB).

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 general fund investments and 2) contributing directly to CalPERS or PARS type vehicles at a higher risk, long-term investment horizon.

In response, CalPERS has 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%. 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. Fees for both products are 0.25% of assets under management with no additional fees, including set up costs.

PAGE 3 OF 3

SUBJECT: Pension Plan IRS Section 115 Trust Options and Associated Actions

DATE: September 10, 2019

CONCLUSION AND NEXT STEPS:

Given the Council's prior and current inclination to budget additional discretionary payments toward unfunded pension obligations when budgetarily feasible, staff recommends maintaining an IRS 115 Trust vehicle. The new CalPERS CEPPT offerings provide the most cost-effective account structure. In addition, given the adopted strategy of paying off amortization bases once sufficient assets have been accumulated, the risk/return profiles of the CEPPT 1 and CEPPT 2 are most appropriate.

To effectuate this recommendation, the Town Council should terminate the PARS agreement and direct staff to return to Council with an agreement to utilize one of the CalPERS CEPPT products which would receive its first contribution consistent with the Town's General Fund Reserve Policy no later than the close of this fiscal year.

COORDINATION:

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

FISCAL IMPACT:

No additional fiscal impact is anticipated at this time beyond the Council's commitments to addressing the pension unfunded liability as expressed in its General Fund Reserve Policy.

ENVIRONMENTAL ASSESSMENT:

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