



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

MEETING DATE: 06/08/2020

ITEM NO: 2

DATE: June 1, 2020
TO: Council Finance Committee
FROM: Laurel Prevetti, Town Manager
SUBJECT: Provide Direction to the Town Pension and OPEB Trusts Oversight Committee on Investment Methodologies for Additional Discretionary Payments (ADPs)

RECOMMENDATION:

Provide direction to the Town Pension and OPEB Trusts Oversight Committee on investment methodologies for additional discretionary payments (ADPs).

BACKGROUND:

On September 3, 2019, the Town Pension and OPEB Trusts Oversight Committee (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 was to be used as an ADP to pay a 2015 gain/loss amortization base of approximately \$3,660,342 prior to September 2020.

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 Oversight Committee. 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 that a clearly defined methodology for allocating assets to pay off amortization bases should be employed. In addition, one Committee member expressed concerns that the current ADP payment approach adopted on September 3, 2019, was not fully understood by the Oversight Committee and not the optimum approach.

PREPARED BY: Arn Andrews
Assistant Town Manager

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

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BACKGROUND (continued):

To ensure that assets are deployed on a continual basis from the CEPPT to selected amortization bases, the Finance 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 preliminary methodology recommended was for minimum monthly payments of \$300,000 or approximately one-twelfth (1/12) of the total assets available at the time. Following the Finance Committee meeting, staff consulted with CalPERS regarding the proposed methodology and was informed that it would result in a significant administrative challenge.

Based on the discussions with CalPERS, staff presented the initial monthly methodology provided by the Finance Committee and a revised staff recommendation for quarterly payments to the Oversight Committee on March 3, 2020. At the conclusion of the discussion, the Oversight Committee voted to make the second amortization base payoff in full and referred the development of a future ADP payment methodology back to the Finance Committee.

DISCUSSION:

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.

As an example, if the Town made an ADP halfway through the year and the CalPERS PERF Fund ended the year up 10%, the ADP would receive 6/12s of the return or 5%. 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. As a result, the Town may wish to make an annual payment to CalPERS at the beginning of each fiscal year to obtain the benefit of a full year of returns.

In addition, the Finance Committee may wish to consider alternative options for dollar cost averaging future ADPs. One option the Committee could consider would be utilizing the CalPERS CEPPT products to gain dollar cost averaged market exposures while accumulating funds for an annual ADP to the CalPERS PERF Fund. As previously discussed, CEPPT provides two asset allocations with varying degrees of exposure to equity, fixed income, Treasury Inflation Protected Securities (TIPS), Real Estate Investment Trusts (REITs), and liquidity.

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DISCUSSION (continued):

The CEPPT products are fully unitized with unit values being determined on a daily basis with a daily share price. On any given day, they have a unit value which when multiplied by the number of units owned equals the market value of assets under management.

CEPPT Strategy 1 has a medium risk tolerance with a 5.0% expected return and 8.2% expected volatility. CEPPT Strategy 2 has a lower risk tolerance with a 4.0% expected return and 5.2% expected volatility. Previously the Oversight Committee opted to use Strategy 2 with the understanding that the lower volatility asset allocation was conducive to the timing of frequent asset transfers to the CalPERS PERF Fund.

Given the CalPERS methodology, the Finance Committee may wish to consider utilizing either asset allocation depending on the timing of transfers to PERF and the desired equity exposure.

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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CONCLUSION:

Given the methodology utilized by CalPERS for ADPs received into the PERF Fund, the Finance Committee should reevaluate dollar cost averaging strategies for future Town ADPs and provide the Oversight Committee with recommendations.

COORDINATION:

This staff report has been coordinated with the Town Manager and Director of Finance

FISCAL IMPACT:

No fiscal impact beyond the normal market exposures attributed to pension assets.

ENVIRONMENTAL ASSESSMENT:

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