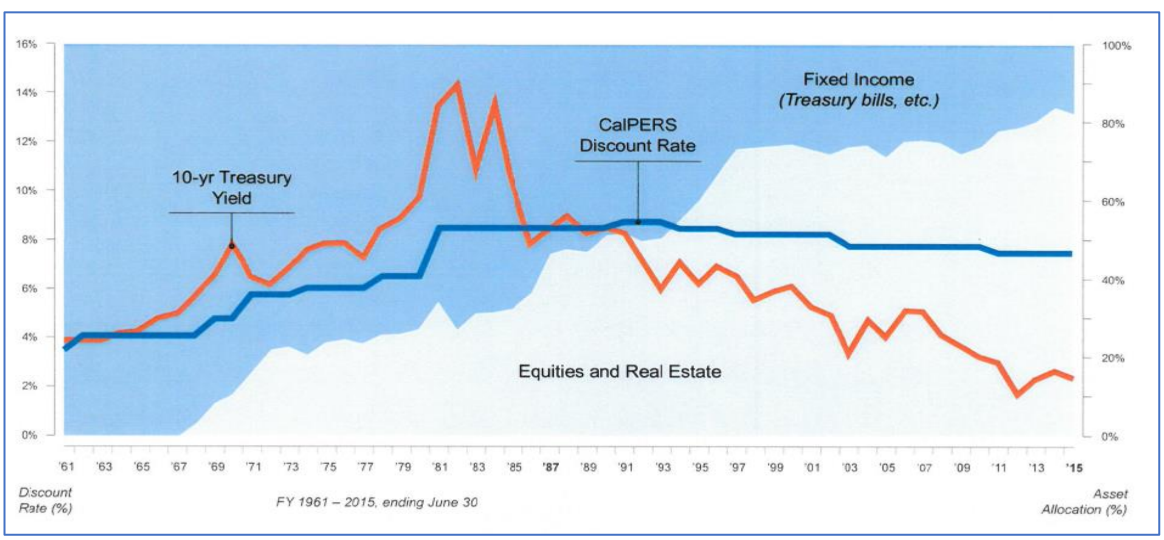
What Caused this Unfunded Obligation?

The UAL is an annual actuarial estimate based on a series of complex economic and demographic assumptions associated with the pension plan's membership. Demographic assumptions include mortality rates, retirement rates, and employment termination rates among others. Economic assumptions include future investment earnings, inflation, and salary growth rates. The development of a UAL typically results from unfavorable investment returns, changes in actuarial assumptions, unfavorable demographic shifts, and other experiences that differ from those anticipated by the annual actuarial assumptions.

The Town's plans over the past several decades, like all other CalPERS participants, have experienced unfavorable investment returns, changes in actuarial assumptions, and unfavorable demographic shifts which have outweighed any positive plan experiences. The table below illustrates the historic investment returns for three years, five years, ten years, twenty years, and since inception.

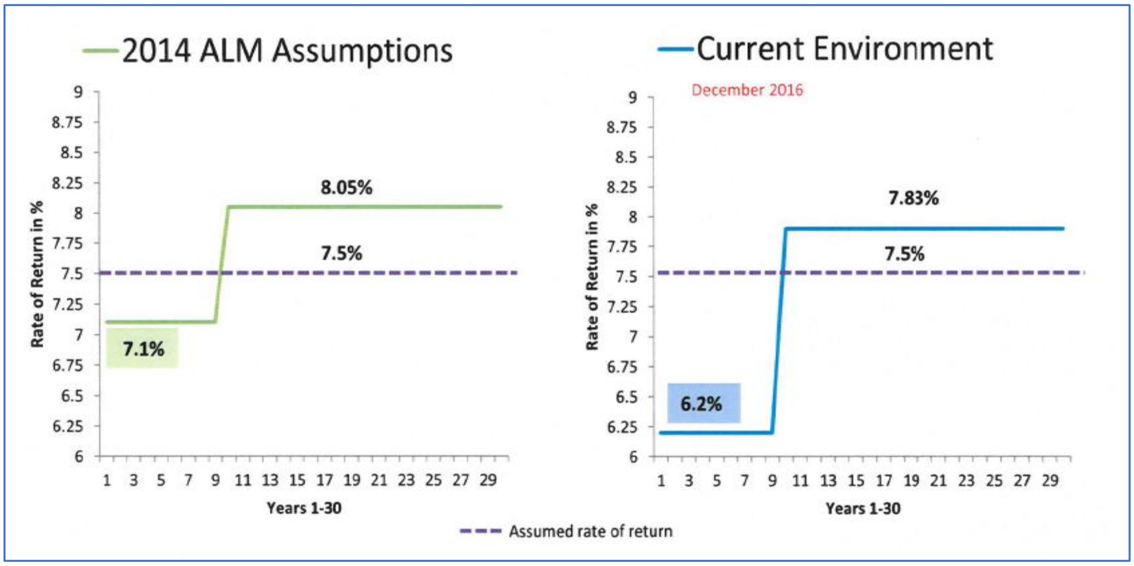
CalPERS Total Net Investment Return*	3 Years	5 Years	10 Years	20 Years	PERF Since Inception (1988)
*Net time-weighted rates of return for PERF	4.6%	8.8%	4.4%	6.6%	8.4%

As the CalPERS chart below illustrates, over the last several decades pension plans have shifted their asset allocations toward greater equity and other asset class exposures as risk free rates of return (10 Year Treasury) steadily declined. However, the greater volatility associated with equities was evident during the 2001 and 2007 recessions as market declines impacted pension plan funding. The subsequent pension plan investment losses from those two recessions are still a contributing factor to the Towns current UAL.



CalPERS Asset Class and Discount Rate History

In addition, the CalPERS chart below illustrates how the significant asset class gains since the last recession are reducing future expectations for asset class returns. In 2014 CalPERS estimated from their capital market assumptions that the asset allocation would yield 7.1% over the course of the next decade. Two years later (2016), that same exercise resulted in CalPERS only forecasting that the asset allocation would yield 6.2% over the course of the next decade. Those reduced estimates of future investment returns and other factors have led CalPERS to lower the assumed rate of return for the asset allocation.



CalPERS Current Capital Market Assumptions

The following data from the Town's 2016 actuarial valuations help illustrate the sensitivity of changes in the discount rate to the UAL.

Discount Rate	Miscellaneous UAL	Safety UAL
6.0%	$47,472,620	$37,417,236
7.0%	$34,382,662	$25,559,073
8.0%	$23,611,612	$15,894,829

For more information on the Town's UAL and sensitivity to changes in the discount rate, see:
http://www.losgatosca.gov/1861/CalPERS-Actuarial-Valuation-Reports

For more information on CalPERS decision to lower discount rates, view:
https://www.youtube.com/watch?v=oeokuypi7Ko