

## Minutes of the DERP Retirement Board

May 19, 2023 - Meeting #850

Meeting #850 of the DERP Retirement Board was held at the Grant-Humphreys Mansion and via video/audio. The meeting began at 9:00 a.m. DERP Retirement Board Members present: Diane Barrett, Guadalupe Gutierrez-Vasquez, George Delaney, John Dominguez, and Lisa Ramirez. Advisory Committee Members present: Heather Britton, Roberta Monaco, and Danielle Sexton. Staff present: Heather Darlington, Executive Director; Jake Huolihan, Finance and Operations Director; Roni Kirchhevel, Benefits and Membership Services Director; Julie Vlier, Marketing and Communications Director; Randall Baum, Chief Investment Officer; Pamela Watson, Deputy Chief Investment Officer; Nali Kande, Membership Services Representative; Michelle Binns; Membership Services Assistant and James E. Thompson III, General Counsel. Others present: Tim Rawal and Thomas Rey from UHY; Anne Harper and Graham Schmidt from Cheiron.

1. The Board considered the draft minutes of Meeting #849. Lisa Ramirez offered an amendment to indicate that John Dominguez was present. The minutes of Meeting #849, as amended, were approved by a unanimous vote of the Board Members.
2. Heather Darlington presented the Executive Director's Report. She introduced Michelle Binns, a new Membership Services Assistant, and announced Nali Kande's promotion to Membership Services Representative. Michelle Binns will be taking over the board meeting responsibilities from Nali Kande. Michelle Binns introduced herself and commented that she is excited to be a part of the DERP team.
3. Heather Darlington announced the Board would need to vote on setting the annual interest rate on employee contribution refunds. She informed the Board that the rate has been 1% for some time and that the staff recommendation is to continue at 1%. She opened the floor for questions. George Delaney asked if the rate was compounded. Heather Darlington confirmed it is compounded. No further questions were asked. There was a motion to approve setting the annual interest rate on employee contribution refunds at 1%. The Board voted unanimously to approve setting the annual interest rate on employee contribution refunds at 1%.
4. Heather Darlington reminded the Board she sent an email with educational opportunities and potential trainings for Board members. She offered to help and answer any questions regarding educational opportunities and training.



5. Randall Baum provided an update on the Investment Consultant RFP, which will be issued next month in June. He explained that it will be an invitation-only process to identify suitable candidates. The goal is to identify consultants with a commitment to public pension plan clients. He expects the process will take four months with a goal of wrapping up by the October 20<sup>th</sup> Board meeting. The incumbent, Meketa, will be invited to participate. Lisa Ramirez stated the Board would like to be involved in the process. Heather Darlington stated a calendar will be circulated with the timeframe for those who wish to participate in the selection process.
6. Tim Rawal from UHY presented the highlights from the 2022 financial statement audit. He reviewed UHY responsibilities regarding the financial statement audit, which included planning and performing the audit to obtain reasonable assurances about whether the financial statements are free from material misstatement. He cited critical audit areas, including investments, contributions, benefit payments, and actuarial information. He then reviewed the 2022 audit results. The independent auditors report shows an unmodified “clean” opinion. The financial statements are presented fairly, in all material respects, in conformity with U.S. Generally Accepted Accounting Principles (GAAP). UHY will issue a report on internal controls over reporting and compliance and a required formal letter to the Board outlining today’s presentation. He complemented the DERP staff on their work and cooperation with the audit. He highlighted the changes in financial statements for 2022 with a 12-13% decline in the fiduciary net position. The decline in assets at the end of 2022 is consistent with pension plans across the country. Heather Darlington added that the Audit Committee: Diane Barrett, Guadalupe Gutierrez-Vasquez, and Heather Britton were involved from the beginning of the audit through the exit meeting.
7. Anne Harper from Cheiron presented the January 1, 2023 preliminary actuarial valuation results. She began by noting that the investment returns for 2022 were not favorable, as there was a -9.2% return on the market value of assets. The actuarial value of assets increased 5.2%. The deferred asset losses of \$189 million will be reflected in the contribution rates and spread out over the next four years. She reported projected payroll increased almost 16%, while expected payroll growth rate was only 3%. She noted that this is the last year of phasing in the cost impact of reducing the assumed rate of return in 2021 from 7.50% to 7.25%. She reported that DERP’s funded ratio in the preliminary January 1, 2023 actuarial valuation, based on actuarial value of assets, is 60.0%.

She then went over the changes that impacted the current UAL payment. The biggest impact on the amortization payments was the sharp increase in payroll, which decreased the contribution rate by approximately 2%.



8. Graham Schmidt presented the 2018 to 2022 experience study. He noted this is the first experience study Cherion has completed for DERP. He explained that the experience study is completed every five years using economic and demographic assumptions to determine projected benefits for members and calculate the actuarial liability. Economic assumptions include inflation assumption, wage inflation, assumed rate of return, and payroll growth rate. Demographic assumptions include termination, disability, retirement, salary increases, and mortality assumptions. DERP's current inflation assumptions are 2.50% for price inflation and 3.00% for wage inflation, which are still reasonable and consistent with expert and market expectations. He noted that, for the last ten years, the discount rate used by DERP has been above the median or in the top quartile. He reported that, today, DERP is about 0.25% higher than the average of other plans. He summarized Cheiron's findings and confirmed the current assumed rate of return of 7.25% is a reasonable discount rate, but if the current assumptions are changed to 7.00%, DERP would be more in-line with peers and increase the margin for conservatism.

Anne Harper reviewed the demographic analysis from January 1, 2018 to December 31, 2022. She reported the most impactful assumption change is the mortality experience. The proposed mortality assumption changes will decrease the contribution rate by about 75 basis points. Cheiron is recommending using new tables for beneficiaries and active members, as well as updating the mortality improvement scale from the 2017 scale to the 2021 scale. The second most impactful assumption is the vacation and sick leave payments. Higher benefits were seen at retirement partially due to sick and vacation leave payouts being higher than expected, resulting in higher than expected benefits. She proposed minor modifications around retirement rates, family composition, and retiree medical rates assumptions. She also noted there used to be separate male and female termination rates for the city, but when analyzed together and separately there isn't a marked difference between the sexes. She explained that Cheiron's recommended assumption changes would result in an overall decrease in contribution rates of about 66 basis points, with a corresponding estimated reduction in DERP's actuarial liability of about \$62 million dollars.

Heather Darlington opened the floor for questions regarding Cheiron's presentation and reviewed the next steps, which include a motion for the board to accept the recommended demographic experience changes. She also offered that an analysis of the impact of lowering the assumed rate of return can be done for the Board to review at the July meeting. Diane Barrett moved to approve the demographic changes. The proposed demographic changes were approved by a unanimous vote of the Board members.



9. Heather Darlington proposed that, in the interest of time, the annual membership overview be rescheduled for the July board meeting. There were no objections.
10. Randall Baum presented a recommendation to revise the Environmental, Social, and Governance (ESG) policy. He explained that DERP's present ESG policy is focused on an investment manager analysis, requiring Meketa to look at each investment manager and opine on how well they perform on an ESG rating scale. He expressed the belief that it is better to measure outcomes than to evaluate process and proposed an annual holdings-based review of the DERP portfolio instead. He explained that a profile of each company's financially relevant ESG risks and opportunities might yield insights into exposures and concentrations when aggregated across the entire portfolio. He recommended taking all the securities for which there is data available and measuring them against an ESG framework or looking at each individual security within the portfolio and aggregating that in each ESG category to gain a sense of what exposures and concentrations DERP has. This change would allow DERP to roughly double the amount of the portfolio being covered. He proposed developing a holding-based approach and evaluating the results over time.

Lisa Ramirez opened the floor for questions. John Dominguez asked if the proposal would be continuing both processes or switching to the new holding-based process. Randall Baum confirmed that staff is recommending switching to the holdings-based policy, but noted Meketa will be continuing their current process in the interim. Diane Barrett asked if Guadalupe Gutierrez-Vasquez was supportive of the change. Ms. Gutierrez-Vasquez confirmed she approves of the proposed changes. The Board voted unanimously to replace the manager-ratings ESG policy with the proposed holdings-based policy on ESG considerations.

11. Randall Baum presented the investment performance review for the first quarter of 2023. He summarized that DERP's public equities portfolio performed well, real estate did not perform well, and private equity also did not perform well. He reported that, at the end of the first quarter, inflation and unemployment were trending in the right direction, resulting in optimism in the markets. He went on to detail how each DERP asset class performed in the first quarter. He explained that, in comparison to peers, DERP has a moderately conservative portfolio. In the first quarter, the overall portfolio was up 3.3%, lagging slightly behind peers, which is expected with a more conservative portfolio. He then reviewed first quarter results from all DERP asset classes, noting relative performance and contribution to aggregate results.



Mr. Baum also commented that he is supportive of the actuarial recommendation to reduce the assumed rate of return from 7.25% to 7.0% given what is known about the economy and capital markets.

12. Pamela Watson presented an asset class review on real estate. She noted the real estate composite has a target allocation of 10%, and at the end of the first quarter the actual was 9.4%, well within the policy range of 5-15%. She explained that rising mortgage costs on the back of a series of swift interest rate hikes have put pressure on deal activity and property prices. She confirmed that the real estate environment for US commercial property pricing is declining across all sectors (industrial, apartment, retail, office CBD, office suburban) due to economic uncertainty. She reported that, although DERP is not pleased with the returns of the composite, staff understands the challenges facing the asset class and does not believe they will persist over the long-term. She expects declining values to continue through the year. Because of the lack of transactions and expectations of limited redemptions, it is unlikely that the allocation to the sub-strategies (core/non-core) will be at the target allocations in the near-term.

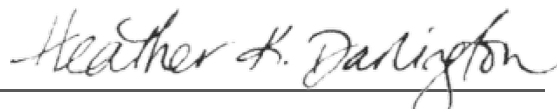
George Delaney asked if there would be an effort to get to the 10% target allocation or maintain at 9.4%. Ms. Watson answered that she believes growth will be slow, although she is expecting a capital call that could potentially move the actual to 9.5% or higher.

13. Lisa Ramirez opened the floor for Advisory Committee comments.

Danielle Sexton asked a question on behalf of one of her colleagues based on news reports about mayoral candidate comments. Ms. Sexton asked if the mayor is the person who makes the decision to change the City's retirement plan or if all changes need to be made through the City Council? Heather Darlington responded that DERP administers the plan and has certain duties and responsibilities, but any changes to the plan go through the City Council. She explained that neither DERP nor the mayor have the unilateral ability to amend or change the DRMC.

14. Lisa Ramirez opened the floor for public comment. No comments were received.
14. The next regularly scheduled board meeting will be Friday, July 21, 2023, at 9:00 a.m.
15. The meeting was adjourned at 12:01 p.m.

  
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Board Chair

  
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Executive Director

