

Minutes of the DERP Retirement Board

July 19, 2024 - Meeting #860

Meeting #860 of the DERP Retirement Board was held at the Grant-Humphreys Mansion and via video and audio conferencing. DERP Retirement Board Officers present were Chair Lisa Zúñiga Ramirez and Vice Chair George Delaney. Other DERP Retirement Board Members present were Diane Barrett, John Dominguez, and Guadalupe (Lupe) Guitierrez-Vasquez. DERP Advisory Committee Members present were Maro Casparian, Heather Britton (v), and Roberta Monaco. DERP staff present were Heather Darlington, Executive Director; Roni Kirchhevel, Deputy Executive Director, and Membership Services Director; Randall Baum, Chief Investment Officer; Jake Huolihan, Finance and Technology Director; James E. Thompson III, General Counsel; Julie Vlier, Marketing and Communications Director; Pamela Watson, Deputy Chief Investment Officer; David Hunter, IT Program Manager; and Terri Campbell, Office Administrator. Guests present were Anne Harper (v) and Graham Schmidt (v) from Cheiron, and Rose Dean, Robert Goldthorpe, Christian McCormick, and Francesca LoVerde (v) from NEPC.

(v) Denotes attended virtually.

Call to Order and Roll Call

The meeting was called to order by Chair Lisa Zúñiga Ramirez at 9:00 a.m. Daneille Sexton was unavailable to attend.

Approval of Minutes

Minutes of meeting #859 were approved by a unanimous vote of the Retirement Board members.

Executive Director's Report

Heather Darlington indicated that DERP is working to update building, employee, and emergency safety plans. A recent issue with a member causing a disturbance in the office has made this update a priority. The City's Risk Management group is providing training for all DERP staff in September.

Ms. Darlington spoke to the potential unionization of the City workforce. The Office of Human Resources (OHR) contacted Ms. Darlington and James Thompson about how unionization could impact DERP. Ms. Darlington and Mr. Thompson had conversations with OHR leadership and several City Council members and discussed possible impacts and costs. George Delaney asked if this might create another tier to DERP benefits. Ms. Darlington affirmed the



possibility and pointed to current tiers based on hire date. Mr. Thompspon added that currently there is nothing on the table and that DERP benefits would be excluded as a subject of bargaining. Mr. Delaney asked if unionization might create a scenario where the City is subsidizing a certain group of employees at a different rate. Mr. Thompspon indicated this could happen. Mr. Delaney asked if Council members are aware of potential issues. Mr. Thompspon responded that the Council members engaged in the conversation seemed to have a good understanding of potential impacts.

Ms. Darlington invited Maro Casparian to provide highlights from the NCPERS 2024 Annual Conference and Exhibition that she attended in May. Ms. Casparian shared that while the conference was helpful, there were limited foundational tracks, and the content exceeded her general understanding. Ms. Darlington thanked her for the feedback.

Ms. Darlington put forward a request to add \$187K to DERP's operating budget. The monies would be focused on technology and cyber security including multi-factor authentication, cabling and switches, third party risk and vendor assessments, and an upgrade to accounting software. Ms. Darlington explained the goal of each category. To illustrate some of the benefits, Ms. Darlington shared that a member's account was recently compromised through a password. Multi-factor authentication would increase and improve security for members' accounts. The Retirement Board voted unanimously to approve the request to increase DERP's operating budget by \$187K for the outlined projects.

Asset/Liability Study and Asset Allocation

Ms. Zúñiga Ramirez welcomed Rose Dean and Robert Goldthorpe from NEPC and invited them to begin their follow-up presentation on asset allocation. Ms. Dean reminded the Retirement Board of what was discussed in May. She indicated this would be a follow-up to that May presentation with the requested details for assumptions and asset classes, and how these compare or contrast to others. Ms. Dean turned the presentation over to Mr. Goldthorpe.

Mr. Goldthorpe recapped the executive summary from May. He summarized the results of the asset/liability study, including historical trends, and discussed the methodology regarding assumptions and expected returns.

Mr. Goldthorpe reviewed the characteristics of DERP's plan. With funded status below 100%, contribution levels are expected to remain elevated until DERP realizes meaningful funded status gains. With healthy and steady contribution flow, DERP is in a position to take advantage of opportunities in private markets, including an illiquidity premium. The current policy allocation is expected to achieve the Retirement Board's investment return assumption. Randall Baum added that the current investment return assumption of 7%, in view of a 10-year expected return of 6.6%, and a 30-year expected return of 7.7%, feels attainable. Mr. Goldthorpe added that the current policy also assumes 14% in asset volatility.



Ms. Dean spoke about the market environment and considerations, sharing the 10-year historical returns of small cap U.S. equities, large cap U.S. equities, international equities, bonds, and real assets. She highlighted the 10-year returns for the S&P 500 (12%) and private equity (14%) as the highest returns. The 10-year returns for other asset classes were low; none produced returns meeting our 7% assumed rate of return. Mr. Baum noted the need to focus on asset classes producing at least 7% in order to meet DERP's assumed returns. Ms. Dean remarked on the volatility of the S&P 500, citing returns of 28.7% in 2021, -18.1% in 2022, and 26.3% in 2023. She noted private equity was less volatile. Ms. Dean mentioned that asset class diversification did not pay off for DERP over the past 10 years. Ms. Zúñiga Ramirez added comments about a cap-weight index versus an equal-weight index and confirmed that the S&P 500 is not equally weighted.

Ms. Dean provided details on DERP relative to public fund peers. DERP's portfolio is more diversified than most public fund peers. DERP is approximately 6% lower in total equity allocation. The 6% difference is primarily allocated to real assets and hedge funds. Total fixed income is on par with peers. Ms. Dean spoke about DERP's historical performance over 10 years and discussed how asset allocation contributed to underperformance relative to peers.

Ms. Dean outlined considerations for forward-looking asset allocations. The market backdrop includes peak valuations in U.S. large cap equities, timing of Federal Reserve rate cuts, dispersion between U.S. and non-U.S. markets, and dispersion between mega stocks and the rest. Considerations include whether or not to wait for a more stable interest rate environment, if it is time to capitulate on diversification, and how much risk the portfolio can withstand. She recommended DERP consider, reducing or eliminating asset classes that have outsized volatility, and judiciously adopting illiquid strategies for enhanced returns.

Mr. Goldthorpe revisited NEPC's building blocks and equity assumptions by asset class, noting that private equity remains attractive. He noted the difference between expected 10- and 30-year equity returns, and how valuation in the S&P 500 has been the biggest driver of returns, particularly over the past 12 months. Ms. Zúñiga Ramirez asked NEPC for S&P 500 data that is equal weighted in order to assess allocation options to large cap, overvalued, and/or mega stocks.

Ms. Dean shared the risk and standard deviation by asset class, with the highest projected risk and volatility in emerging market equity, private equity, real estate non-core, and private natural resources. Ms. Dean revisited from May the overview of asset allocation mixes (A, B, and C) with the addition of mix D, which shows projections from increasing public equities and reducing fixed income and real assets. Ms. Dean shared a diagram of standard deviations against expected return scenarios. She then shared a DERP survey of capital market assumptions by asset class from 11 firms, including NEPC. She noted that NEPC has the lowest U.S. large cap equity return assumptions among those surveyed, due to NEPC's emphasis on current high valuations and expectations that profit margins will normalize. Ms. Dean demonstrated the



current policy and recommended mixes using median survey expectations would produce projected returns above 7%. Mr. Baum added his assurance and Ms. Zúñiga Ramirez concurred.

Ms. Dean indicated that NEPC is still recommending Mix C, as initially proposed in May. Mix C maintains the potential on returns and slightly lowers volatility. Changes from current policy to Mix C include a decrease of 2% in emerging market equity, a decrease and elimination of 2% in emerging market debt, a decrease of 2% in core real estate, an increase of 2.5% in private debt, an increase of 2% in private real estate debt, and an increase of 1.5% in real asset infrastructure. All this would increase 10-year expected returns from 6.61% to 6.62% and increase 30-year expected returns from 7.67% to 7.7%. The expected standard deviation with Mix C is 13.5%.

John Dominguez asked for clarification on the forward-looking considerations for the Retirement Board and whether DERP has optimized risk. Ms. Dean indicated that DERP's cash flow is expected to remain healthy over 10 years. The funding policy will trigger contribution increases if needed and as a backstop to illiquidity. NEPC believes DERP can withstand the recommended increase in illiquid assets with no material impact to the plan. Mr. Baum indicated he believes DERP would be assuming the right balance of risk. Mr. Dominguez expressed that he wanted to ensure that the Retirement Board understands the constraints, is not leaving money on the table, and is open to other approaches. Mr. Baum referenced the reduction in emerging market equity and elimination of emerging market debt as an example of responding to disappointing outcomes.

Ms. Zúñiga Ramirez asked NEPC how Mix C compares to other pension plans. Ms. Dean assured that the changes in assumptions with Mix C are forward-looking and compare favorably to other plans based on expectations. Mr. Delaney asked if the increases in allocations across private asset classes are perceived to be safer. Ms. Dean responded that there is a liquidity premium, or additional return, for long-term investors like DERP who lock into private markets. She also noted that more companies are making the decision to remain private. Mr. Dominguez asked that the Retirement Board remain informed and aware of equal weighting options in the public market, as pointed out by Ms. Zúñiga Ramirez.

Ms. Zúñiga Ramirez thanked NEPC and investment staff for providing the additional detail and comparisons needed to make an informed decision. She asked for a motion to approve the recommendation to adopt the asset allocation in Mix C. The vote was unanimously approved.

DHHA Unfunded Actuarial Liability (UAL)

Anne Harper from Cheiron shared the high-level details of a presentation she, Ms. Darlington and Jake Huolihan gave to the DHHA Finance Committee in June, beginning with a timeline of DHHA's relationship with DERP. She highlighted the recent changes to the Revised Municipal Code of the City and County of Denver (DRMC), which established a funding policy addressing DHHA's proportionate share of DERP's unfunded actuarial liability (UAL), and the agreement between DERP and DHHA to a minimum annual supplemental UAL contribution.



She discussed the demographic differences in the DHHA population and the agreement between DERP and DHHA for a supplemental normal cost contribution. DHHA employees are all Tier 1 and have a higher normal cost rate than City employees. Supplemental normal cost payments are continuously decreasing, due in part to funding method changes in 2019. Also, DHHA has a closed, aging, and declining payroll and active population. Both regular and supplemental normal cost payments will end when the last covered employee leaves DHHA.

Turning to the supplemental UAL contributions, DERP's actuarially determined contribution rate has doubled since 2008 to 26.1% in 2023. DHHA contributions have decreased over the same period to \$5.2M in 2023. There are approximately 200 active DERP members employed by DHHA and covered payroll is approximately \$26M. Based on its share of DERP's liability, DHHA has not been making a proportionate contribution to pay off the UAL, leading to the DRMC amendment in 2022. Ms. Harper provided highlights of the agreement between DERP and DHHA i to accommodate an alternative payment plan for DHHA's supplemental UAL contributions. She noted that payments under the agreement will only cease once the supplemental UAL is paid in full by DHHA. From the 2024 actuarial valuation, DHHA's supplemental UAL was calculated to be \$11.6M.

Ms. Harper provided detailed calculations on the equitable split between the City and DHHA to fund DERP benefits. She shared a summary of actuarial valuation results over three years starting in 2022. During this time, the funded ratio related to DHHA liabilities has decreased by more than 5% and the UAL has increased by \$31.9M, or 23%, resulting in an increase to the actuarially determined contribution (ADC). The primary drivers for DHHA's UAL increase are contribution shortfalls, i.e., \$29M ADC compared to \$13M in actual contributions, net asset losses, and assumption changes. Ms. Harper provided detailed calculations to support projections that DHHA's UAL will continue to increase between 2024 and 2043 if the ADC is not paid. The calculations included ADC and supplemental UAL payments, with scenarios showing adjustments for additional operating income.

Ms. Darlington indicated that the DHHA Finance Committee understands the overarching liability impacts, asked for additional information, and is considering next steps. Heather Britton suggested that this is a great case study for those who want to understand the costs associated with sunsetting a pension plan.

Strategic Plan Update

Ms. Darlington provided updates on 2024 action items against the 2023-2027 strategic plan and the primary goals to ensure long-term financial health, evolve education and service, and uphold DERP's leadership position. She detailed which action items are completed, ongoing, in progress or open, noting that the few open items each have a clear roadmap. Diane Barrett commended Ms. Darlington and the executive leadership for prioritizing and reporting on the strategic plan.



Mid-Year Expenditure and Demographic Review

Mr. Huolihan presented on the financial results and retiree demographics for the first half of 2024. Budget to actuals are tracking well, with a noted uptick in technology-related expenses, as covered during the Executive Director's Report. New retirements year-to-date are 228, compared to 222 as of June 30, 2023. Vested separations are up 14% from 2023, and non-vested separations are up 8%, for a 10% increase overall. New hires year-to-date are down 26.1%, but contributions are up 9.3%, excluding supplemental UAL from DHHA. Benefits paid are up 3.1%. DROP accounts continue to level out. Electronic communications continue to rise.

Asset Class Review: Private Equity

Ms. Watson presented a review of the private equity asset class. She noted a target allocation of 9%, and an actual allocation as of March 31, 2024, of 10.3%. The overweight has been declining due to distributions outpacing capital calls, combined with lagging performance. She described the purpose of the allocation as intended to produce high returns, noting that it also comes with greater risks. The main benchmark DERP uses is the Burgiss Global Private Equity Index. DERP has two private equity managers, Adams Street Partners and J.P. Morgan Asset Management. Adams Street comprises 99% of DERP's private equity investments.

Ms. Watson shared details on DERP's private equity investments since inception in 1997, with a cumulative net rate of return of 12.31%. The average life span of equity funds is 14 years.

Ms. Watson detailed DERP's portfolio with Adams Street Partners by strategy, subclass, geography and industry. The largest geography is the U.S. at 60.2%, followed by Western Europe at 20.3%. The largest industry is IT at 45.1%, followed by Business Services at 11.8%, and Healthcare at 11.6%. Since 2004, DERP has had capital calls of \$337M, and distributions of \$396M, with a current fair market value of \$273M.

Ms. Watson reviewed the private equity environment since 2020. Today's environment shows that fundraising remained strong in 2023. Valuations have fallen slightly and there remains a valuation gap between buyers and sellers. Exits are in a holding pattern, likely due in part to interest rates. Slow deal activity in 2023 and into 2024 has increased dry powder, with an unprecedented \$3.9T in unspent capital. The private equity headwinds include inflation, interest rates, geopolitical tensions, and the election year. Tailwinds include the debt and IPO markets opening up, investment periods shrinking, and value creation from higher growth.

Ms. Watson shared a composite view of performance for 1 year, 3 years, 5 years and 10 years, by internal rate of return (IRR) and time weighted return (TWR). Despite a small loss in 2023, long-term results have been favorable and staff remains positive on private equity.

Advisory Committee Comments

Ms. Zúñiga Ramirez invited Advisory Committee members to comment.



Member and/or Guest Comments

Ms. Zúñiga Ramirez noted that no members were present to comment.

Executive Session Pursuant to Section 24-6-402(4)(b) and (f) of the Colorado Revised Statutes to Discuss Personnel Matters

The Retirement Board voted unanimously to enter executive session pursuant to Section 24-6-402(4)(b) and (f) of the Colorado Revised Statutes to discuss personnel matters.

I, Lisa Zúñiga Ramirez, as chair of the executive session, attest that these written minutes accurately reflect the substance of the discussions held during the executive session.



Lisa Zúñiga Ramirez

Review of Next Meeting and Call for Topics

The next regularly scheduled Retirement Board meeting is Friday, August 16, at 9:00 a.m.

Adjournment

The meeting was adjourned at 11:58 p.m.



DERP Retirement Board Chair



DERP Executive Director

