

Memorandum

DATE: May 17, 2023
TO: Members of the Board of Retirement
FROM: Tracy Bowman, Director of Finance
SUBJECT: **FIRST QUARTER UNAUDITED FINANCIAL STATEMENTS FOR THE THREE MONTHS ENDED MARCH 31, 2023**

Written Report

Background/Discussion

The attached financial statements reflect the unaudited financial activity for the three months ended March 31, 2023. These statements are unaudited and are not the official financial statements of OCERS. The following statements represent a review of the progress to date for the first quarter of 2023. The official financial statements of OCERS are included in the Annual Comprehensive Financial Report (ACFR), which will be available for the year ended December 31, 2022, on our website, www.ocers.org, after the completion of the 2022 year-end audit in June 2023.

Summary

Statement of Fiduciary Net Position (Unaudited)

As of December 31, 2022, the net position restricted for pension, other postemployment benefits and employer is \$20.8 billion, a decrease of \$896.8 million, or -4.1%, from March 31, 2022. The change is a result of a decrease in total assets of \$1.5 billion and a decrease in total liabilities of \$616.9 million as described below:

The \$1.5 billion decrease in total assets can be attributed to decreases of \$422.7 million in cash and short term investments, \$1.3 billion in investments at fair value and \$2.2 million in capital assets, offset by an increase of \$168.5 million in total receivables.

The decrease of \$422.7 million in total cash and short-term investments consists of a \$405.8 million decrease in cash and cash equivalents due to the County of Orange opting not to participate in the FY 2023-2024 contribution prepayment program, the timing of investing employee and employer contributions received during the quarter and a \$16.9 million decrease in securities lending collateral driven primarily by decreased fixed income demand.

The increase of \$168.5 million in total receivables is related to the timing of pending security sales, which increased by \$176.3 million, offset by a decrease in investment income receivables of \$7.7 million.

Total investments at fair value decreased \$1.3 billion, or -5.7%, from March 31, 2022 to March 31, 2023. The total portfolio reported a net loss of -3% for the one-year period ending March 31, 2023 compared to net return of 11.4% for the same one-year period ending March 31, 2022. The first quarter of 2023 was challenging for asset classes, driven by macro-economic factors and a potential banking crisis; investors' fears of a recession,

contractionary monetary policy from central banks, and sticky inflation contributed to market volatility. Global public equity decreased by \$602.6 million, private equity decreased by \$72.1 million, core fixed income decreased by \$627.6 million, credit decreased by \$116.6 million and risk mitigation decreased by \$390.4 million. These decreases were offset by increases in real assets of \$548.5 million and unique strategies of \$3.6 million. Global public equity continued its decline and reported a loss of -7% for the one-year period. Emerging markets were a drag on the equity portfolio. Private equity reported a one-year loss of -4.2% for the first quarter in 2023. Significant private equity distributions helped enhance the performance returns as there is a lag in mark-to-market reporting by the private equity investment managers and the turmoil in public markets is not yet fully reflected. The core fixed income portfolio was down -3.5% for the one-year period due to high inflation and aggressive interest rate hikes. Corporate bonds and high yield bonds underperformed government bonds as spreads widened. The credit portfolio reported a loss of -2.5% for the one-year period, which underperformed the benchmark of -1.8%. The private credit portfolio held up better than public credit. Risk mitigation, designed to protect the portfolio during down periods, reported a loss of -0.6% for the one-year period. Real assets returned 11.3% for the one-year period, benefitting from high oil and energy prices, while real estate faced headwinds in the first quarter. Unique strategies reported a one-year return of 7.1% for 2023 compared to a one-year return of 3.5% in 2022.

The decrease in capital assets of \$2.2 million from the prior year represents depreciation expense, which is primarily attributed to the Pension Administration System Solution (PASS).

Total liabilities decreased \$616.9 million, or -46.1%, from March 31, 2022 to March 31, 2023, primarily due to unearned contributions, which decreased \$560.6 million due to the County of Orange opting to not participate in the FY 2023-2024 contribution prepayment program. Retiree payroll payable also decreased \$70.6 million due to the timing of when the April 1 participant benefits were paid out. April 1 landed on a Saturday in 2023, therefore the electronic benefit payments were paid out on March 31. These decreases were offset by an increase of \$34.1 million related to the timing of securities purchased.

Statement of Changes in Fiduciary Net Position (Unaudited)

The ending net position restricted for pension, other postemployment benefits and employer as of March 31, 2023, decreased by \$896.8 million or -4.1%, when compared to the same period ending March 31, 2022.

Total additions to fiduciary net position increased 291.7% or \$1.4 billion from the previous year. Net investment income for the three months ended March 31, 2023, was \$664.6 million versus a loss of -\$735.3 million for the three months ended March 31, 2022, an increase of \$1.4 billion or 190.4%. The main cause of the increase is due to the net appreciation/(depreciation) in fair value of investments, which increased \$1.6 billion from the prior year and was slightly offset by a decrease in dividends, interest, and other investment income of \$149.7 million. The first quarter in 2023 reported a year-to-date return of 3.3%, compared to a year-to-date loss of -1.8% for the first quarter in 2022. Global public equity, core fixed income, credit and unique strategies reported positive year-to-date returns in 2023 compared to negative year-to-date returns in 2022. These positive returns were offset by negative returns for private equity and risk mitigation. Real assets also saw a decrease in their year-to-date return for the first quarter in 2023, earning 0.1% compared to 6.7% in the first quarter in 2022. Total investment fees and expenses increased by \$8.5 million in March 2023 primarily due to a \$7.6 million increase in other fund

expenses. Security lending rebate fees increased \$2.3 million due to increases in the “risk free rate”, such as the Federal Funds Target Range or Overnight Bank Funding Rate (OBFR), that are used to negotiate rebates to borrowers.

Total contributions increased \$7.6 million over the prior year due to employer contributions which increased \$5 million and employee contributions which increased \$2.6 million. The increases can be attributed to an increase in contribution rates.

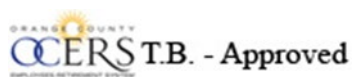
Total deductions from fiduciary net position increased 9%, or \$25.8 million, from the previous year. Participant benefits increased by \$23.3 million, which is expected due to the continued growth in member pension benefit payments, both in the total number of OCERS’ retired members receiving a pension benefit and an increase in the average benefit received. In March 2023, there were 20,494 payees with an average benefit payment of \$4,673 compared to 19,677 payees with an average benefit payment of \$4,486 in March 2022. Total death benefits and members withdrawals and refunds had a net increase of \$781 million and will fluctuate from year-to-year based on the occurrence of these events.

Other Supporting Schedules

In addition to the basic financial statements for the three months ended March 31, 2023, the following supporting schedules are provided for additional information pertaining to OCERS:

- Total Plan Reserves
- Schedule of Contributions
- Schedule of Investment Expenses
- Schedule of Administrative Expenses
- Administrative Expense Compared to Actuarial Accrued Liability

Submitted by:



Tracy Bowman
Director of Finance



Orange County Employees Retirement System

Unaudited Financial Statements

For the Three Months Ended March 31, 2023

Orange County Employees Retirement System

Unaudited Financial Statements
For the Three Months Ended March 31, 2023

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Statement of Fiduciary Net Position (Unaudited)

As of March 31, 2023

(with summarized comparative amounts as of March 31, 2022)

(Dollars in Thousands)

	Pension Trust Fund	Health Care Fund- County	Health Care Fund- OCFA	Custodial Fund - OCTA	Total Funds	Comparative Totals 2022
Assets						
Cash and Short-Term Investments						
Cash and Cash Equivalents	\$ 210,365	\$ 4,753	\$ 585	\$ 326	\$ 216,029	\$ 621,781
Securities Lending Collateral	<u>231,543</u>	<u>5,231</u>	<u>644</u>	<u>-</u>	<u>237,418</u>	<u>254,326</u>
Total Cash and Short-Term Investments	441,908	9,984	1,229	326	453,447	876,107
Receivables						
Investment Income	21,014	475	58	-	21,547	29,252
Securities Sales	254,730	5,755	708	-	261,193	84,903
Contributions	18,244	-	-	-	18,244	19,268
Foreign Currency Forward Contracts	630	14	2	-	646	699
Other Receivables	<u>6,671</u>	<u>151</u>	<u>19</u>	<u>-</u>	<u>6,841</u>	<u>5,802</u>
Total Receivables	301,289	6,395	787	-	308,471	139,924
Investments at Fair Value						
Global Public Equity	9,205,347	207,967	25,589	12,347	9,451,250	10,053,891
Private Equity	3,267,700	73,824	9,083	-	3,350,607	3,422,715
Core Fixed Income	1,650,196	37,281	4,587	5,411	1,697,475	2,325,099
Credit	1,482,335	33,489	4,121	-	1,519,945	1,636,559
Real Assets	2,899,164	65,498	8,059	-	2,972,721	2,424,253
Risk Mitigation	1,665,560	37,628	4,630	-	1,707,818	2,098,263
Unique Strategies	<u>73,301</u>	<u>1,656</u>	<u>204</u>	<u>-</u>	<u>75,161</u>	<u>71,569</u>
Total Investments at Fair Value	20,243,603	457,343	56,273	17,758	20,774,977	22,032,349
Capital Assets, Net	<u>8,416</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>8,416</u>	<u>10,589</u>
Total Assets	<u>20,995,216</u>	<u>473,722</u>	<u>58,289</u>	<u>18,084</u>	<u>21,545,311</u>	<u>23,058,969</u>
Liabilities						
Obligations Under Securities Lending Program	231,544	5,231	644	-	237,419	254,325
Securities Purchased	201,060	4,542	559	-	206,161	172,027
Unearned Contributions	233,196	-	-	-	233,196	793,843
Foreign Currency Forward Contracts	1,466	33	4	-	1,503	934
Retiree Payroll Payable	14,757	5,124	919	-	20,800	91,394
Other	<u>22,739</u>	<u>514</u>	<u>63</u>	<u>-</u>	<u>23,316</u>	<u>26,757</u>
Total Liabilities	<u>704,762</u>	<u>15,444</u>	<u>2,189</u>	<u>-</u>	<u>722,395</u>	<u>1,339,280</u>
Net Position Restricted for Pension, Other Postemployment Benefits and Employer	<u>\$20,290,454</u>	<u>\$ 458,278</u>	<u>\$ 56,100</u>	<u>\$ 18,084</u>	<u>\$20,822,916</u>	<u>\$21,719,689</u>

Statement of Changes in Fiduciary Net Position (Unaudited)

For the Three Months Ended March 31, 2023

(with summarized comparative amounts for the Three Months Ended March 31, 2022)

(Dollars in Thousands)

	Pension Trust Fund	Health Care Fund- County	Health Care Fund- OCFA	Custodial Fund - OCTA	Total Funds	Comparative Totals 2022
Additions						
Contributions						
Employer	\$ 186,320	\$ -	\$ 5,075	\$ -	\$ 191,395	\$ 186,437
Employee	68,872	-	-	-	68,872	66,264
Employer OPEB Contributions	-	-	-	180	180	171
Total Contributions	255,192	-	5,075	180	260,447	252,872
Investment Income						
Net Appreciation/(Depreciation) in Fair Value of Investments	669,497	15,350	1,780	1,055	687,682	(870,347)
Dividends, Interest, & Other Investment Income	19,350	437	54	4	19,845	169,530
Securities Lending Income						
Gross Earnings	2,510	57	7	-	2,574	236
Less: Borrower Rebates and Bank Charges	(2,297)	(52)	(6)	-	(2,355)	(68)
Net Securities Lending Income	213	5	1	-	219	168
Total Investment Income/(Loss)	689,060	15,792	1,835	1,059	707,746	(700,649)
Investment Fees and Expenses	(42,111)	(951)	(117)	-	(43,179)	(34,692)
Net Investment Income/(Loss)	646,949	14,841	1,718	1,059	664,567	(735,341)
Total Additions	902,141	14,841	6,793	1,239	925,014	(482,469)
Deductions						
Participant Benefits	289,888	9,277	1,693	-	300,858	277,544
Death Benefits	131	-	-	-	131	179
Member Withdrawals and Refunds	4,444	-	-	-	4,444	3,615
Employer OPEB Payments	-	-	-	370	370	362
Administrative Expenses	7,245	6	5	6	7,262	5,569
Total Deductions	301,708	9,283	1,698	376	313,065	287,269
Net Increase/(Decrease)	600,433	5,558	5,095	863	611,949	(769,738)
Net Position Restricted For Pension, Other Postemployment Benefits and Employer, Beginning of Year	19,690,021	452,720	51,005	17,221	20,210,967	22,489,427
Ending Net Position Restricted For Pension, Other Postemployment Benefits and Employer	\$ 20,290,454	\$ 458,278	\$ 56,100	\$ 18,084	\$ 20,822,916	\$ 21,719,689

Total Plan Reserves

For the Three Months Ended March 31, 2023

(with summarized comparative amounts for the Three Months Ended March 31, 2022)

(Dollars in Thousands)

	2023	2022
Pension Reserve	\$ 11,709,335	\$ 11,141,706
Employee Contribution Reserve	3,787,609	3,730,190
Employer Contribution Reserve	3,632,324	3,294,909
Annuity Reserve	2,644,789	2,333,248
Health Care Reserve	514,378	536,095
Custodial Fund Reserve	18,084	20,111
County Investment Account (POB Proceeds) Reserve	142,958	159,915
OCSD UAAL Deferred Reserve	14,398	15,643
Contra Account and Actuarial Deferred Return	(1,640,959)	487,872
Total Net Position Restricted for Pension, Other Postemployment Benefits and Employer	<u>\$ 20,822,916</u>	<u>\$ 21,719,689</u>

Schedule of Contributions

For the Three Months Ended March 31, 2023

(with summarized comparative amounts for the Three Months Ended March 31, 2022)

(Dollars in Thousands)

	2023		2022	
	Employee	Employer	Employee	Employer
Pension Trust Fund Contributions				
County of Orange	\$ 51,418	\$ 148,787	\$ 49,455	\$ 137,785
Orange County Fire Authority	7,748	21,985 ¹	7,583	23,799 ¹
Orange County Superior Court of California	3,827	11,267	3,639	9,853
Orange County Transportation Authority	2,858	8,427	2,702	7,845
Orange County Sanitation District	2,150	2,221	2,077	2,126
Orange County Employees Retirement System	346	1,150	291	885
UCI - Medical Center and Campus	-	770 ²	-	837 ²
City of San Juan Capistrano	151	575	146	507
Transportation Corridor Agencies	188	216	211	242
Orange County Department of Education	-	79 ²	-	120 ²
Orange County Cemetery District	48	72	45	64
Orange County Local Agency Formation Commission	14	61	13	54
Orange County In-Home Supportive Services Public Authority	38	50	34	46
Children and Families Commission of Orange County	44	68	28	44
Orange County Public Law Library	<u>42</u>	<u>32</u>	<u>40</u>	<u>32</u>
Contributions Before Prepaid Discount	68,872	195,760	66,264	184,239
Prepaid Employer Contributions Discount	<u>-</u>	<u>(9,440)</u>	<u>-</u>	<u>(8,934)</u>
Total Pension Trust Fund Contributions	68,872	186,320	66,264	175,305
Health Care Fund - County Contributions	-	-	-	9,742
Health Care Fund - OCFA Contributions	-	5,075	-	1,390
Custodial Fund - OCTA OPEB Contributions	<u>-</u>	<u>180</u>	<u>-</u>	<u>171</u>
Total Contributions	<u>\$ 68,872</u>	<u>\$ 191,575</u>	<u>\$ 66,264</u>	<u>\$ 186,608</u>

¹ Unfunded actuarial accrued liability payments were made in 2023 for \$3.5 million and 2022 for \$2.6 million for the Orange County Fire Authority.

² Unfunded actuarial accrued liability payments have been made in accordance with a separate 20-year level dollar payment schedule to include liabilities for employee benefits related to past service credit.

Schedule of Investment Expenses

For the Three Months Ended March 31, 2023

(with summarized comparative amounts for the Three Months Ended March 31, 2022)

(Dollars in Thousands)

	2023	2022
Investment Management Fees*		
Global Public Equity	\$ 2,936	\$ 4,219
Core Fixed Income	570	672
Credit	2,447	2,752
Real Assets	9,352	7,818
Private Equity	11,316	9,183
Risk Mitigation	2,082	3,984
Unique Strategies	258	271
Short-Term Investments	43	48
Total Investment Management Fees	29,004	28,947
Other Fund Expenses¹	11,872	4,285
Other Investment Expenses		
Consulting/Research Fees	547	572
Investment Department Expenses	1,469	631
Legal Services	137	106
Custodian Services	145	145
Investment Service Providers	5	5
Total Other Investment Expenses	2,303	1,459
Security Lending Activity		
Security Lending Fees	56	44
Rebate Fees	2,299	24
Total Security Lending Activity	2,355	68
Custodial Fund - OCTA Investment Fees and Expenses	-	1
Total Investment Expenses	\$ 45,534	\$ 34,760

* Does not include undisclosed fees deducted at source.

¹ These costs include, but are not limited to, foreign income tax and other indirect flow-through investment expenses such as organizational expenses in limited partnership structures.

Schedule of Administrative Expenses

For the Three Months Ended March 31, 2023

(with summarized comparative amounts for the Three Months Ended March 31, 2022)

(Dollars in Thousands)

	2023	2022
Pension Trust Fund Administrative Expenses		
Expenses Subject to the Statutory Limit		
Personnel Services		
Employee Salaries and Benefits	\$ 4,455	\$ 3,510
Board Members' Allowance	2	4
Total Personnel Services	<u>4,457</u>	<u>3,514</u>
Office Operating Expenses		
Depreciation/Amortization	672	651
Professional Services	713	308
General Office and Administrative Expenses	657	472
Rent/Leased Real Property	<u>268</u>	<u>206</u>
Total Office Operating Expenses	<u>2,310</u>	<u>1,637</u>
Total Expenses Subject to the Statutory Limit	<u>6,767</u>	<u>5,151</u>
Expenses Not Subject to the Statutory Limit		
Information Technology Professional Services	123	65
Information Security Professional Services	33	19
Finance Professional Services	5	25
Actuarial Fees	94	97
Equipment/Software	<u>223</u>	<u>195</u>
Total Expenses Not Subject to the Statutory Limit	<u>478</u>	<u>401</u>
Total Pension Trust Fund Administrative Expenses	7,245	5,552
Health Care Fund - County Administrative Expenses	6	5
Health Care Fund - OCFA Administrative Expenses	5	6
Custodial Fund - OCTA Administrative Expenses	<u>6</u>	<u>6</u>
Total Administrative Expenses	<u>\$ 7,262</u>	<u>\$ 5,569</u>

Administrative Expense Compared to Actuarial Accrued Liability

For the Three Months Ended March 31, 2023

(Dollars in Thousands)

Actuarial Accrued Liability (AAL) as of 12/31/22	\$	25,386,669
Maximum Allowed for Administrative Expense (AAL * 0.21%)		53,312
Actual Administrative Expense ¹		<u>6,767</u>
Excess of Allowed Over Actual Expense	\$	<u>46,545</u>
Actual Administrative Expense for the three months ended 3/31/23 as a Percentage of Actuarial Accrued Liability as of 12/31/22		0.03%
Actual Administrative Expense for the three months ended 3/31/22 as a Percentage of Actuarial Accrued Liability as of 12/31/21		0.02%
¹ Administrative Expense Reconciliation		
Administrative Expense per Statement of Changes in Fiduciary Net Position	\$	7,245
Less: Administrative Expense Not Considered per CERL Section 31596.1		<u>(478)</u>
Administrative Expense Allowable Under CERL Section 31580.2	\$	<u>6,767</u>