

Memorandum

DATE: November 13, 2023
TO: Members of the Board of Retirement
FROM: Tracy Bowman, Director of Finance
SUBJECT: **THIRD QUARTER UNAUDITED FINANCIAL STATEMENTS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2023**

Written Report

Background/Discussion

The attached financial statements reflect the unaudited financial activity for the nine months ended September 30, 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 third quarter of 2023. The official financial statements of OCERS are included in the Annual Comprehensive Financial Report (ACFR) for the year ended December 31, 2022, which is available on our website, www.ocers.org.

Summary

Statement of Fiduciary Net Position (Unaudited)

As of September 30, 2023, the net position restricted for pension, other postemployment benefits and employer is \$21 billion, an increase of \$1.6 billion, or 8%, from September 30, 2022. The change is a result of an increase in total assets of \$1.2 billion and a decrease in total liabilities of \$329.3 million as described below:

The \$1.2 billion increase in total assets can be attributed to increases of \$36.7 million in total receivables and \$1.3 billion in total investments at fair value, offset by decreases of \$78.7 million in total cash and short-term investments and \$2.2 million in capital assets.

The decrease of \$78.7 million in total cash and short-term investments consists of a \$111.1 million decrease in cash and cash equivalents due to the timing of investing employee and employer contributions received during the quarter offset by an increase of \$32.5 million in securities lending collateral driven by a continued demand for the securities lending program.

The increase of \$36.7 million in total receivables consists primarily of contributions, which increased by \$36.6 million. This is attributed to the County of Orange opting to not participate in the FY 2023-2024 prepayment program resulting in a higher accrual for contributions earned, but not yet received.

Total investments at fair value increased \$1.3 billion, or 6.5% from September 30, 2022 to September 30, 2023. The total portfolio reported a net return of 9% for the one-year period ending September 30, 2023, compared to a net loss of -7% for the same one-year period ending September 30, 2022. The one-year return was up compared to the prior year although the total portfolio reported a loss of -1.3% for the quarter due to persistent inflation,

escalating interest rates, and high levels of debt posing risks to the economy. Global public equity increased by \$1.6 billion, private equity increased by \$214.1 million, real assets increased by \$119.7 million and unique strategies increased by \$21.3 million. These increases were offset by decreases in income strategies of \$362.2 million and risk mitigation of \$321.4 million. Global public equity saw slightly stronger returns in the non-U.S. equity portfolio and reported a one-year return of 21.7%, which was over the benchmark of 20.2%. Private equity reported a one-year return of 1.3% for the third quarter in 2023 as investment managers continue to take mark-to-market losses in 2023. Income strategies, which is a new investment category that started in July 2023 and combines the core fixed income and credit categories, reported a one-year return of 3.6% as high inflation and aggressive interest rate hikes continue to be a challenge for bonds. Real assets reported a loss of -2.7% for the one-year period. The real estate portfolio has continued to post losses due to the higher interest rate environment posting losses of -9.3% compared to positive returns for its peers in energy and infrastructure of 2.3% and 10.4%, respectively. Risk mitigation, designed to protect the portfolio during down periods, reported a loss of -3.8% for the one-year period. Unique strategies reported a one-year return of 2.6% with a strong contribution from the general partner stake investment.

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 \$329.3 million, or -36.2%, from September 30, 2022 to September 30, 2023, primarily due to unearned contributions, which decreased \$423.5 million due to the County of Orange opting to not participate in the FY 2023-2024 contribution prepayment program. This decrease was offset by an increase of \$79.1 million related to the timing of securities purchased and an increase in obligations under the securities lending program of \$32.5 million, as previously discussed.

Statement of Changes in Fiduciary Net Position (Unaudited)

The ending net position restricted for pension, other postemployment benefits and employer as of September 30, 2023, increased by \$1.6 billion or 8%, when compared to the same period ending September 30, 2022.

Total additions to fiduciary net position increased 185.8% or \$3.9 billion from the previous year. Net investment income for the nine months ended September 30, 2023, was \$1 billion versus a loss of -\$2.9 billion for the nine months ended September 30, 2022, an increase of \$3.9 billion or 135.3%. The main cause of the increase is due to the net appreciation in fair value of investments, which increased \$4.1 billion from the prior year, slightly offset by a decrease in dividends, interest, and other investment income of \$230.6 million. The third quarter in 2023 reported a year-to-date net return of 5%, compared to a year-to-date net loss of -11.2% for the third quarter in 2022. This can be attributed to stronger year-to-date returns in 2023 compared to year-to-date returns in 2022 across most investment categories, including global public equity and income strategies, which reported positive year-to-date returns in 2023 compared to negative year-to-date returns in 2022. Private equity also reported a slightly higher year-to-date return in comparison to last year. These gains were offset by real assets and risk mitigation, which reported year-to-date losses for the third quarter in 2023 in comparison to year-to-date returns in 2022. Total investment fees and expenses, including securities lending borrower rebates and bank charges, increased by \$17.6 million in September 2023 primarily due to a \$15.8 million increase in other fund expenses, which includes indirect flow-through investment expenses in limited partner structures. Security lending rebate

fees increased \$6.5 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 \$30.5 million over the prior year due to employer contributions which increased \$25.4 million and employee contributions which increased \$5.1 million. The increases can be attributed to an increase in contribution rates.

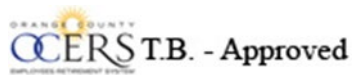
Total deductions from fiduciary net position increased 7.6%, or \$68.4 million, from the previous year. Participant benefits increased by \$66 million, which is expected due to the continued growth in member pension benefit payments, both in the total number of OCERS’ retired members receiving a pension benefit and an increase in the average benefit received. In September 2023, there were 20,917 payees with an average benefit payment of \$4,813 compared to 20,304 payees with an average benefit payment of \$4,624 in September 2022. Administrative expenses increased by \$4.7 million, primarily due to an increase in personnel services and professional services.

Other Supporting Schedules

In addition to the basic financial statements for the nine months ended September 30, 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 Projected Actuarial Accrued Liability

Submitted by:



Tracy Bowman
Director of Finance



Orange County Employees Retirement System

Unaudited Financial Statements

For the Nine Months Ended September 30, 2023

Orange County Employees Retirement System

Unaudited Financial Statements
For the Nine Months Ended September 30, 2023

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Statement of Fiduciary Net Position (Unaudited)

As of September 30, 2023

(with summarized comparative amounts as of September 30, 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	\$ 201,164	\$ 4,433	\$ 736	\$ 806	\$ 207,139	\$ 318,254
Securities Lending Collateral	<u>242,904</u>	<u>5,353</u>	<u>889</u>	<u>-</u>	<u>249,146</u>	<u>216,681</u>
Total Cash and Short-Term Investments	444,068	9,786	1,625	806	456,285	534,935
Receivables						
Investment Income	16,565	365	61	-	16,991	15,069
Securities Sales	109,239	2,408	400	-	112,047	115,091
Contributions	54,823	-	-	-	54,823	18,215
Foreign Currency Forward Contracts	223	5	1	-	229	680
Other Receivables	<u>8,015</u>	<u>177</u>	<u>29</u>	<u>-</u>	<u>8,221</u>	<u>6,559</u>
Total Receivables	188,865	2,955	491	-	192,311	155,614
Investments at Fair Value						
Global Public Equity	9,262,272	204,133	33,907	11,920	9,512,232	7,911,639
Private Equity	3,443,399	75,890	12,605	-	3,531,894	3,317,785
Income Strategies	3,006,055	66,251	11,004	5,194	3,088,504	3,450,738
Real Assets	2,891,821	63,733	10,586	-	2,966,140	2,846,396
Risk Mitigation	1,745,134	38,461	6,388	-	1,789,983	2,111,358
Unique Strategies	<u>83,297</u>	<u>1,836</u>	<u>305</u>	<u>-</u>	<u>85,438</u>	<u>64,158</u>
Total Investments at Fair Value	20,431,978	450,304	74,795	17,114	20,974,191	19,702,074
Capital Assets, Net	<u>7,340</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>7,340</u>	<u>9,533</u>
Total Assets	<u>21,072,251</u>	<u>463,045</u>	<u>76,911</u>	<u>17,920</u>	<u>21,630,127</u>	<u>20,402,156</u>
Liabilities						
Obligations Under Securities Lending Program	242,904	5,353	889	-	249,146	216,681
Securities Purchased	222,720	4,909	815	-	228,444	149,344
Unearned Contributions	56,015	-	-	-	56,015	479,547
Foreign Currency Forward Contracts	-	-	-	-	-	3,465
Retiree Payroll Payable	15,052	5,204	656	-	20,912	20,724
Other	<u>26,363</u>	<u>581</u>	<u>97</u>	<u>-</u>	<u>27,041</u>	<u>41,105</u>
Total Liabilities	<u>563,054</u>	<u>16,047</u>	<u>2,457</u>	<u>-</u>	<u>581,558</u>	<u>910,866</u>
Net Position Restricted for Pension, Other Postemployment Benefits and Employer	<u>\$20,509,197</u>	<u>\$ 446,998</u>	<u>\$ 74,454</u>	<u>\$ 17,920</u>	<u>\$21,048,569</u>	<u>\$19,491,290</u>

Statement of Changes in Fiduciary Net Position (Unaudited)

For the Nine Months Ended September 30, 2023

(with summarized comparative amounts for the Nine Months Ended September 30, 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	\$ 558,456	\$ -	\$ 25,913	\$ -	\$ 584,369	\$ 559,011
Employee	206,531	-	-	-	206,531	201,459
Employer OPEB Contributions	-	-	-	575	575	503
Total Contributions	764,987	-	25,913	575	791,475	760,973
Investment Income						
Net Appreciation/(Depreciation) in Fair Value of Investments	883,484	19,898	2,484	1,259	907,125	(3,207,985)
Dividends, Interest, & Other Investment Income	224,989	4,959	824	15	230,787	461,350
Securities Lending Income						
Gross Earnings	8,703	192	32	-	8,927	2,278
Less: Borrower Rebates and Bank Charges	(8,019)	(177)	(29)	-	(8,225)	(1,700)
Net Securities Lending Income	684	15	3	-	702	578
Total Investment Income/(Loss)	1,109,157	24,872	3,311	1,274	1,138,614	(2,746,057)
Investment Fees and Expenses	(124,017)	(2,733)	(454)	(2)	(127,206)	(116,177)
Net Investment Income/(Loss)	985,140	22,139	2,857	1,272	1,011,408	(2,862,234)
Total Additions	1,750,127	22,139	28,770	1,847	1,802,883	(2,101,261)
Deductions						
Participant Benefits	898,280	27,843	5,304	-	931,427	865,408
Death Benefits	636	-	-	-	636	659
Member Withdrawals and Refunds	10,195	-	-	-	10,195	12,493
Employer OPEB Payments	-	-	-	1,131	1,131	1,096
Administrative Expenses	21,840	18	17	17	21,892	17,220
Total Deductions	930,951	27,861	5,321	1,148	965,281	896,876
Net Increase/(Decrease)	819,176	(5,722)	23,449	699	837,602	(2,998,137)
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	\$ 20,509,197	\$ 446,998	\$ 74,454	\$ 17,920	\$ 21,048,569	\$ 19,491,290

Total Plan Reserves

For the Nine Months Ended September 30, 2023

(with summarized comparative amounts for the Nine Months Ended September 30, 2022)

(Dollars in Thousands)

	2023	2022
Pension Reserve	\$ 12,902,598	\$ 11,839,638
Employee Contribution Reserve	3,797,361	3,690,953
Employer Contribution Reserve	2,890,481	3,119,374
Annuity Reserve	2,832,438	2,480,661
Health Care Reserve	521,452	475,653
Custodial Fund Reserve	17,920	16,305
County Investment Account (POB Proceeds) Reserve	140,150	138,609
OCSD UAAL Deferred Reserve	14,398	15,643
Contra Account and Actuarial Deferred Return	(2,068,229)	(2,285,546)
Total Net Position Restricted for Pension, Other Postemployment Benefits and Employer	\$ 21,048,569	\$ 19,491,290

Schedule of Contributions

For the Nine Months Ended September 30, 2023

(with summarized comparative amounts for the Nine Months Ended September 30, 2022)

(Dollars in Thousands)

	2023		2022	
	Employee	Employer	Employee	Employer
Pension Trust Fund Contributions				
County of Orange	\$ 153,609	\$ 440,748	\$ 150,619	\$ 424,007
Orange County Fire Authority	23,196	63,187 ¹	22,390	68,269 ¹
Orange County Superior Court of California	11,799	33,575	11,227	30,420
Orange County Transportation Authority	8,836	25,268	8,420	24,770
Orange County Sanitation District	6,346	6,591	6,267	6,441
Orange County Employees Retirement System	1,029	3,399	856	2,679
UCI - Medical Center and Campus	-	2,264 ²	-	2,455 ²
City of San Juan Capistrano	465	1,708	577	1,602
Transportation Corridor Agencies	687	653	604	698
Cypress Recreation and Parks District	-	-	-	596 ³
Orange County Department of Education	-	237 ²	-	288 ²
Orange County Cemetery District	147	207	143	214
Orange County Local Agency Formation Commission	41	175	34	146
Orange County In-Home Supportive Services Public Authority	118	151	108	146
Children and Families Commission of Orange County	130	194	91	143
Orange County Public Law Library	128	97	123	96
Contributions Before Prepaid Discount	206,531	578,454	201,459	562,970
Prepaid Employer Contributions Discount	-	(19,998)	-	(27,610)
Total Pension Trust Fund Contributions	206,531	558,456	201,459	535,360
Health Care Fund - County Contributions	-	-	-	21,081
Health Care Fund - OCFA Contributions	-	25,913	-	2,570
Custodial Fund - OCTA OPEB Contributions	-	575	-	503
Total Contributions	\$ 206,531	\$ 584,944	\$ 201,459	\$ 559,514

¹ Unfunded actuarial accrued liability payments were made in 2023 for \$10.3 million and 2022 for \$8.8 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.

³ This balance reflects the unfunded actuarial accrued liability obligation payment made in July 2022 to fund the obligations for the ongoing benefits owed to Cypress Recreation & Parks District's retired and disabled employees and their survivors and beneficiaries.

Schedule of Investment Expenses

For the Nine Months Ended September 30, 2023

(with summarized comparative amounts for the Nine Months Ended September 30, 2022)

(Dollars in Thousands)

	2023	2022
Investment Management Fees*		
Global Public Equity	\$ 9,140	\$ 11,024
Income Strategies	10,814	9,155
Real Assets	23,695	25,947
Private Equity	31,795	26,118
Risk Mitigation	7,213	16,065
Unique Strategies	893	734
Short-Term Investments	93	172
Total Investment Management Fees	83,643	89,215
Other Fund Expenses¹	37,959	22,115
Other Investment Expenses		
Consulting/Research Fees	1,697	1,775
Investment Department Expenses	3,093	2,175
Legal Services	361	434
Custodian Services	435	435
Investment Service Providers	16	25
Total Other Investment Expenses	5,602	4,844
Security Lending Activity		
Security Lending Fees	174	147
Rebate Fees	8,051	1,553
Total Security Lending Activity	8,225	1,700
Custodial Fund - OCTA Investment Fees and Expenses	2	3
Total Investment Expenses	\$ 135,431	\$ 117,877

* 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 Nine Months Ended September 30, 2023

(with summarized comparative amounts for the Nine Months Ended September 30, 2022)

(Dollars in Thousands)

	2023	2022
Pension Trust Fund Administrative Expenses		
Expenses Subject to the Statutory Limit		
Personnel Services		
Employee Salaries and Benefits	\$ 13,251	\$ 10,740
Board Members' Allowance	10	10
Total Personnel Services	13,261	10,750
Office Operating Expenses		
Depreciation/Amortization	2,016	1,956
Professional Services	2,610	1,516
General Office and Administrative Expenses	2,034	1,350
Rent/Leased Real Property	567	635
Total Office Operating Expenses	7,227	5,457
Total Expenses Subject to the Statutory Limit	20,488	16,207
Expenses Not Subject to the Statutory Limit		
Information Technology Professional Services	456	274
Information Security Professional Services	90	50
Finance Software Professional Services	6	42
Actuarial Fees	297	236
Equipment/Software	503	359
Total Expenses Not Subject to the Statutory Limit	1,352	961
Total Pension Trust Fund Administrative Expenses	21,840	17,168
Health Care Fund - County Administrative Expenses	18	17
Health Care Fund - OCFA Administrative Expenses	17	18
Custodial Fund - OCTA Administrative Expenses	17	17
Total Administrative Expenses	\$ 21,892	\$ 17,220

Administrative Expense Compared to Projected Actuarial Accrued Liability

For the Nine Months Ended September 30, 2023

(Dollars in Thousands)

Projected Actuarial Accrued Liability (AAL) as of 12/31/23	\$	26,477,040
Maximum Allowed for Administrative Expense (AAL * 0.21%)		55,602
Actual Administrative Expense ¹		<u>20,488</u>
Excess of Allowed Over Actual Expense	\$	<u>35,114</u>
Actual Administrative Expense for the nine months ended 9/30/23 as a Percentage of Projected Actuarial Accrued Liability as of 12/31/23		0.08%
Actual Administrative Expense for the nine months ended 9/30/22 as a Percentage of Actuarial Accrued Liability as of 12/31/22		0.06%
¹ Administrative Expense Reconciliation		
Administrative Expense per Statement of Changes in Fiduciary Net Position	\$	21,840
Less: Administrative Expense Not Considered per CERL Section 31596.1		<u>(1,352)</u>
Administrative Expense Allowable Under CERL Section 31580.2	\$	<u>20,488</u>