

Memorandum

DATE: November 14, 2022
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, 2022

Written Report

Background/Discussion

The attached financial statements reflect the unaudited financial activity for the nine months ended September 30, 2022. 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 2022. The official financial statements of OCERS are included in the Annual Comprehensive Financial Report for the year ended December 31, 2021, which is available on our website, www.ocers.org.

Summary

Statement of Fiduciary Net Position (Unaudited)

As of September 30, 2022, the net position restricted for pension, other postemployment benefits and employer is \$19.5 billion, a decrease of \$1.7 billion, or -7.8%, from September 30, 2021. The change is a result of a decrease in total assets of \$1.7 billion and, offset by a decrease in total liabilities of \$72.8 million as described below:

The \$1.7 billion decrease in total assets can be attributed to decreases of \$1.4 billion in investments at fair value, \$335.2 million in total cash and short-term investments, and \$2.2 million in capital assets, offset by an increase of \$4.1 million in total receivables.

The decrease of \$335.2 million in total cash and short-term investments is related to a decrease in cash and cash equivalents, which decreased \$333.2 million due to the timing of investing employee and employer contributions received during the quarter.

The increase of \$4.1 million in total receivables is related to the timing of pending security sales, which increased by \$3.5 million and other receivables, which increased \$1.4 million due to the timing of investment receivables, offset by decreases in contribution receivables of \$1.8 million due to the timing of when contributions were received.

Total investments at fair value decreased \$1.4 billion, or -6.6%, from September 30, 2021 to September 30, 2022. The total portfolio reported a net loss of -7% for the one-year period. 2022 has continued to be a challenging year, driven by macro-economic factors and geopolitical events. Investors' fears of a recession, contractionary monetary policy from central banks and inflation pressures continued to remain elevated. Global public equity

decreased by \$2.2 billion and core fixed income decreased by \$644.2 million. These decreases were offset by increases in private equity of \$338.4 million, credit of \$85 million, real assets of \$863.7 million, risk mitigation of \$158.2 million and unique strategies of \$3.4 million. Global public equity continued its decline and reported a loss of -21.7% for the one-year period. The core fixed income portfolio was down -11.9% 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. Significant private equity distributions helped enhance the performance numbers as private equity is not mark-to-market and the turmoil in public markets is not yet fully reflected. In addition, there have been 35 new private equity investment managers added since September 30, 2021. The credit portfolio reported a loss of -6.9% for the one-year period, which outperformed the benchmark of -14.5%. Real assets returned 27.5% for the one-year period, benefitting from high oil and energy prices, as well as rising prices in real estate, which are assets used by investors to hedge against inflation. Risk mitigation, designed to protect the portfolio during down periods, returned 13% for the one-year period, outperforming the benchmark of 3.9%. Unique strategies reported a one-year return of 1%.

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) Project.

Total liabilities decreased \$72.8 million, or -7.4%, from September 30, 2021 to September 30, 2022, primarily due to the timing of securities purchased, which decreased \$35.2 million and retiree payroll payable which decreased \$68.4 million due to the timing of when October 1 participant benefits were paid out. October 1 landed on a Saturday in 2022, therefore the electronic benefit payments were paid on September 30. These decreases were offset by an increase in unearned contributions, which increased \$22 million due to increases in prepaid employer contributions received for the 2022-2023 prepayment program compared to the prior year's prepayment program.

Statement of Changes in Fiduciary Net Position (Unaudited)

The ending net position restricted for pension, other postemployment benefits and employer as of September 30, 2022, decreased by \$1.7 billion or -7.8%, when compared to the same period ending September 30, 2021.

Total additions to fiduciary net position decreased -177.8% or \$4.8 billion from the previous year. Net investment losses for the nine months ended September 30, 2022, were -\$2.9 billion versus income of \$2 billion for the nine months ended September 30, 2021, a decrease of \$4.8 billion or -245.6%. The main cause of the decrease is due to the net appreciation/(depreciation) in fair value of investments, which decreased \$5 billion from the prior year and was slightly offset by an increase in dividends, interest, and other investment income of \$193 million. The third quarter in 2022 reported a year-to-date loss of -11.2%, compared to a year-to-date return of 11.3% for the third quarter in 2021. Public market portfolios posted negative returns while the private portfolios held up better, with global public equities reporting a year-to-date loss of -26% and private equities reporting a year-to-date return of 1.7%. As mentioned previously, significant distributions from the private equity class helped enhance performance. Core fixed income reported a year-to-date loss of -12.1% due to high inflation and aggressive interest rate hikes, which hit longer duration bonds harder. Credit reported a year-to-date loss of -7.1%. Total investment fees and expenses increased by \$20.2 million in September 2022 primarily due to an increase in investment management fees attributed to the addition of over 43 new investment managers since September 2021.

Total contributions increased \$25.7 million over the prior year mainly due to employer contributions which increased \$26.5 million. This increase can be attributed to an increase in employer contribution rates, offset by decreases of approximately \$885,000 in employee contributions to the pension plan. This decrease is attributed to the reduction and/or gradual phase-out of employee reverse pick-up rates for various OCEA (Orange County Employees Association) represented employees.

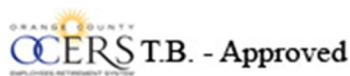
Total deductions from fiduciary net position increased 8%, or \$66.2 million, from the previous year. Participant benefits increased by \$62 million, which is expected due to the continued growth in member pension benefit payments, both in the total number of OCERS' retired members receiving a pension benefit and an increase in the average benefit received. In September 2022, there were 20,304 payees with an average benefit payment of \$4,624 compared to 19,423 payees with an average benefit payment of \$4,416 in September 2021. Total death benefits and members withdrawals and refunds 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 nine months ended September 30, 2022, 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 Nine Months Ended September 30, 2022

Orange County Employees Retirement System

Unaudited Financial Statements For the Nine Months Ended September 30, 2022

Table of Contents

Statement of Fiduciary Net Position (Unaudited).....	1
Statement of Changes in Fiduciary Net Position (Unaudited).....	2
Total Plan Reserves.....	3
Schedule of Contributions.....	4
Schedule of Investment Expenses	5
Schedule of Administrative Expenses.....	6
Administrative Expense Compared to Actuarial Accrued Liability.....	7

Statement of Fiduciary Net Position (Unaudited)

As of September 30, 2022

(with summarized comparative amounts as of September 30, 2021)

(Dollars in Thousands)

	Pension Trust Fund	Health Care Fund- County	Health Care Fund- OCFA	Custodial Fund - OCTA	Total Funds	Comparative Totals 2021
Assets						
Cash and Short-Term Investments						
Cash and Cash Equivalents	\$ 309,851	\$ 6,849	\$ 818	\$ 736	\$ 318,254	\$ 651,458
Securities Lending Collateral	<u>211,449</u>	<u>4,674</u>	<u>558</u>	<u>-</u>	<u>216,681</u>	<u>218,725</u>
Total Cash and Short-Term Investments	521,300	11,523	1,376	736	534,935	870,183
Receivables						
Investment Income	14,705	325	39	-	15,069	14,173
Securities Sales	112,311	2,483	297	-	115,091	111,593
Contributions	18,215	-	-	-	18,215	20,021
Foreign Currency Forward Contracts	663	15	2	-	680	485
Other Receivables	<u>6,401</u>	<u>141</u>	<u>17</u>	<u>-</u>	<u>6,559</u>	<u>5,208</u>
Total Receivables	152,295	2,964	355	-	155,614	151,480
Investments at Fair Value						
Global Public Equity	7,710,420	170,445	20,361	10,413	7,911,639	10,109,922
Private Equity	3,237,664	71,571	8,550	-	3,317,785	2,979,421
Core Fixed Income	1,728,759	38,216	4,565	5,156	1,776,696	2,420,847
Credit	1,633,616	36,112	4,314	-	1,674,042	1,589,028
Real Assets	2,777,659	61,402	7,335	-	2,846,396	1,982,700
Risk Mitigation	2,060,371	45,546	5,441	-	2,111,358	1,953,182
Absolute Return	-	-	-	-	-	21
Unique Strategies	<u>62,609</u>	<u>1,384</u>	<u>165</u>	<u>-</u>	<u>64,158</u>	<u>60,791</u>
Total Investments at Fair Value	19,211,098	424,676	50,731	15,569	19,702,074	21,095,912
Capital Assets, Net	<u>9,533</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,533</u>	<u>11,780</u>
Total Assets	<u>19,864,226</u>	<u>439,163</u>	<u>52,462</u>	<u>16,305</u>	<u>20,402,156</u>	<u>22,129,355</u>
Liabilities						
Obligations Under Securities Lending Program	211,449	4,674	558	-	216,681	218,725
Securities Purchased	145,737	3,222	385	-	149,344	184,513
Unearned Contributions	479,547	-	-	-	479,547	457,590
Foreign Currency Forward Contracts	3,381	75	9	-	3,465	217
Retiree Payroll Payable	14,668	5,162	894	-	20,724	89,117
Other	<u>40,112</u>	<u>887</u>	<u>106</u>	<u>-</u>	<u>41,105</u>	<u>33,517</u>
Total Liabilities	<u>894,894</u>	<u>14,020</u>	<u>1,952</u>	<u>-</u>	<u>910,866</u>	<u>983,679</u>
Net Position Restricted for Pension, Other Postemployment Benefits and Employer	<u>\$18,999,332</u>	<u>\$ 425,143</u>	<u>\$ 50,510</u>	<u>\$ 16,305</u>	<u>\$19,491,290</u>	<u>\$21,145,676</u>

Statement of Changes in Fiduciary Net Position (Unaudited)

For the Nine Months Ended September 30, 2022

(with summarized comparative amounts for the Nine Months Ended September 30, 2021)

(Dollars in Thousands)

	Pension Trust Fund	Health Care Fund- County	Health Care Fund- OCFA	Custodial Fund - OCTA	Total Funds	Comparative Totals 2021
Additions						
Contributions						
Employer	\$ 535,360	\$ 21,081	\$ 2,570	\$ -	\$ 559,011	\$ 532,471
Employee	201,459	-	-	-	201,459	202,344
Employer OPEB Contributions	-	-	-	503	503	464
Total Contributions	736,819	21,081	2,570	503	760,973	735,279
Investment Income						
Net Appreciation/(Depreciation) in Fair Value of Investments	(3,134,153)	(61,834)	(7,459)	(4,539)	(3,207,985)	1,793,334
Dividends, Interest, & Other Investment Income	450,209	9,952	1,189	-	461,350	268,303
Securities Lending Income						
Gross Earnings	2,223	49	6	-	2,278	933
Less: Borrower Rebates and Bank Charges	(1,659)	(37)	(4)	-	(1,700)	(180)
Net Securities Lending Income	564	12	2	-	578	753
Total Investment Income/(Loss)	(2,683,380)	(51,870)	(6,268)	(4,539)	(2,746,057)	2,062,390
Investment Fees and Expenses	(113,369)	(2,506)	(299)	(3)	(116,177)	(95,949)
Net Investment Income/(Loss)	(2,796,749)	(54,376)	(6,567)	(4,542)	(2,862,234)	1,966,441
Total Additions	(2,059,930)	(33,295)	(3,997)	(4,039)	(2,101,261)	2,701,720
Deductions						
Participant Benefits	832,600	27,876	4,932	-	865,408	803,416
Death Benefits	659	-	-	-	659	820
Member Withdrawals and Refunds	12,493	-	-	-	12,493	9,280
Employer OPEB Payments	-	-	-	1,096	1,096	1,059
Administrative Expenses	17,168	18	17	17	17,220	16,068
Total Deductions	862,920	27,894	4,949	1,113	896,876	830,643
Net Increase/(Decrease)	(2,922,850)	(61,189)	(8,946)	(5,152)	(2,998,137)	1,871,077
Net Position Restricted For Pension, Other Postemployment Benefits and Employer, Beginning of Year	21,922,182	486,332	59,456	21,457	22,489,427	19,274,599
Ending Net Position Restricted For Pension, Other Postemployment Benefits and Employer	\$ 18,999,332	\$ 425,143	\$ 50,510	\$ 16,305	\$ 19,491,290	\$ 21,145,676

Total Plan Reserves

For the Nine Months Ended September 30, 2022

(with summarized comparative amounts for the Nine Months Ended September 30, 2021)

(Dollars in Thousands)

	2022	2021
Pension Reserve	\$ 11,839,638	\$ 11,248,117
Employee Contribution Reserve	3,690,953	3,618,461
Employer Contribution Reserve	3,119,374	2,783,581
Annuity Reserve	2,480,661	2,182,197
Health Care Reserve	475,653	496,788
Custodial Fund Reserve	16,305	20,605
County Investment Account (POB Proceeds) Reserve	138,609	165,755
OCSD UAAL Deferred Reserve	15,643	13,433
Contra Account and Actuarial Deferred Return	(2,285,546)	616,739
Total Net Position Restricted for Pension, Other Postemployment Benefits and Employer	\$ 19,491,290	\$ 21,145,676

Schedule of Contributions

For the Nine Months Ended September 30, 2022

(with summarized comparative amounts for the Nine Months Ended September 30, 2021

(Dollars in Thousands)

	2022		2021	
	Employee	Employer	Employee	Employer
Pension Trust Fund Contributions				
County of Orange	\$ 150,619	\$ 424,007	\$ 152,748	\$ 395,781
Orange County Fire Authority	22,390	68,269 ¹	21,780	72,552 ¹
Orange County Superior Court of California	11,227	30,420	11,490	27,623
Orange County Transportation Authority	8,420	24,770	7,568	22,339
Orange County Sanitation District	6,267	6,441	6,277	6,429
Orange County Employees Retirement System	856	2,679	880	2,469
UCI - Medical Center and Campus	-	2,455 ²	-	2,440 ²
City of San Juan Capistrano	577	1,602	548	1,824
Transportation Corridor Agencies	604	698	568	650
Cypress Recreation and Parks District	-	596 ³	-	-
Orange County Department of Education	-	288 ²	-	286 ²
Orange County Cemetery District	143	214	135	175
Orange County Local Agency Formation Commission	34	146	95	127
Orange County In-Home Supportive Services Public Authority	108	146	35	142
Children and Families Commission of Orange County	91	143	102	145
Orange County Public Law Library	123	96	118	102
Contributions Before Prepaid Discount	201,459	562,970	202,344	533,084
Prepaid Employer Contributions Discount	-	(27,610)	-	(22,316)
Total Pension Trust Fund Contributions	201,459	535,360	202,344	510,768
Health Care Fund - County Contributions	-	21,081	-	20,349
Health Care Fund - OCFA Contributions	-	2,570	-	1,354
Custodial Fund - OCTA OPEB Contributions	-	503	-	464
Total Contributions	\$ 201,459	\$ 559,514	\$ 202,344	\$ 532,935

¹ Unfunded actuarial accrued liability payments were made in 2022 for \$8.8 million and 2021 for \$11.7 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, 2022

(with summarized comparative amounts for the Nine Months Ended September 30, 2021)

(Dollars in Thousands)

	2022	2021
Investment Management Fees*		
Global Public Equity	\$ 11,024	\$ 14,342
Core Fixed Income	1,864	1,961
Credit	7,291	9,023
Real Assets	25,947	21,756
Absolute Return	-	1
Private Equity	26,118	19,818
Risk Mitigation	16,065	9,274
Unique Strategies	734	967
Short-Term Investments	172	304
Total Investment Management Fees	89,215	77,446
Other Fund Expenses¹	22,115	13,961
Other Investment Expenses		
Consulting/Research Fees	1,775	1,625
Investment Department Expenses	2,175	2,137
Legal Services	434	329
Custodian Services	435	435
Investment Service Providers	25	14
Total Other Investment Expenses	4,844	4,540
Security Lending Activity		
Security Lending Fees	147	190
Rebate Fees	1,553	(10)
Total Security Lending Activity	1,700	180
Custodial Fund - OCTA Investment Fees and Expenses	3	2
Total Investment Expenses	\$ 117,877	\$ 96,129

* 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, 2022

(with summarized comparative amounts for the Nine Months Ended September 30, 2021)

(Dollars in Thousands)

	2022	2021
Pension Trust Fund Administrative Expenses		
Expenses Subject to the Statutory Limit		
Personnel Services		
Employee Salaries and Benefits	\$ 10,740	\$ 9,912
Board Members' Allowance	10	11
Total Personnel Services	<u>10,750</u>	<u>9,923</u>
Office Operating Expenses		
Depreciation/Amortization	1,956	1,933
Professional Services	1,514	1,519
General Office and Administrative Expenses	1,352	1,098
Rent/Leased Real Property	635	531
Total Office Operating Expenses	<u>5,457</u>	<u>5,081</u>
Total Expenses Subject to the Statutory Limit	<u>16,207</u>	<u>15,004</u>
Expenses Not Subject to the Statutory Limit		
Information Technology Professional Services	274	480
Information Security Professional Services	49	79
Finance Professional Services	43	-
Actuarial Fees	236	286
Equipment/Software	359	167
Total Expenses Not Subject to the Statutory Limit	<u>961</u>	<u>1,012</u>
Total Pension Trust Fund Administrative Expenses	17,168	16,016
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	<u>\$ 17,220</u>	<u>\$ 16,068</u>

Administrative Expense Compared to Actuarial Accrued Liability

For the Nine Months Ended September 30, 2022

(Dollars in Thousands)

Actuarial Accrued Liability (AAL) as of 12/31/21	\$	25,091,400
Maximum Allowed for Administrative Expense (AAL * 0.21%)		52,692
Actual Administrative Expense ¹		16,207
Excess of Allowed Over Actual Expense	\$	36,485
Actual Administrative Expense for the nine months ended 9/30/22 as a Percentage of Actuarial Accrued Liability as of 12/31/21		0.06%
Actual Administrative Expense for the year ended 12/31/21 as a Percentage of Actuarial Accrued Liability as of 12/31/21		0.08%
¹ Administrative Expense Reconciliation		
Administrative Expense per Statement of Changes in Fiduciary Net Position	\$	17,168
Less: Administrative Expense Not Considered per CERL Section 31596.1		(961)
Administrative Expense Allowable Under CERL Section 31580.2	\$	16,207