SR 23-026

AC Transit
Employees' Retirement System

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AC Transit Retirement System

To: AC Transit Board of Directors December 2022

From: Jeffrey Lewis - Chair, AC Transit Retirement Board Jeffrey Lewis

Re: 2022 Semi-Annual Report (#2)

I am writing this report a couple of months after what I thought was a very productive Joint Meeting. The Retirement Board thought it was especially nice to get together in person. This report will be shorter than usual as most of what is in this report was presented and discussed at the Joint Meeting.

This report will focus on:

- The recently completed Actuarial Valuation.
- The funded ratio of the Plan.
- Investment performance and ESG (Environmental, Social, Governance).
- PEPRA implementation.
- Department staffing.

Recently Approved Actuarial Valuation

At its September 15th meeting, the Retirement Board approved the 2022 Actuarial Valuation, completing a process that began in March. As in prior years, the General Manager, CFO, and Finance Staff were involved in providing feedback to the Retirement Board.

The Retirement Board, working with the District, agreed to shift the date that the District's and the employees' contributions would change from a fiscal-year basis to a calendar year. This change allows sufficient time to complete the valuation process and notify employees at least 30 days in advance that their contribution rate would be changing. Employee contributions will now change with their first paycheck of the calendar year, instead of their first paycheck of the fiscal year.

The Retirement Board approved a projected District contribution of $68.2 million for calendar year 2023. This contribution is based on the assumption that the District's pensionable payroll will be $206.7 million during the current fiscal year. The District's contribution can be broken down into two components: 1) the normal cost (plus expenses); and 2) the amortization of the unfunded liability. The normal cost is the cost allocated to fund the benefits earned for the current year of service for the current workforce; the amortization of the unfunded liability is the payment required to close the gap between the current funding level and the funding target over a specific period of years. For calendar year 2023, the normal cost, plus expenses, is projected at $30.2

million (14.28% of pensionable payroll for classic members and 6.88% for PEPRA as the employee will pay 7.00%), while the amortization of the unfunded liability will be $38.0 million. Roughly 56% of the District's contribution is a result of amortizing the unfunded liability.

At the Joint meeting, Graham Schmidt reviewed the projected District contribution and the funded ratio of the Plan going forward. Some of these projections used Plan returns of a negative 10% and a negative 15% for 2022. The impact of the investment returns in 2022 will start to be felt by the District in calendar year 2024 and will be stretched over two District fiscal years. Graham also reviewed the Funded Ratio of the Plan going forward under several assumptions for 2022 investment returns.

Funded Ratio

The funded ratio of the Plan increased on the Actuarial Value of Assets, from 72.7% to 76.2%, and on the Market Value of Assets from 77.2% to 81.0% compared to the prior year. The increase in the funded ratio on a Market Value of Assets basis was a result of the strong investment performance in 2021. It is safe to assume that the funded ratio of the Plan will decrease as a result of investment performance in 2022, which is discussed later in this report.

The Retirement Board is happy to provide the District Board with projected results under any scenario requested and to answer any questions the District Board has on the Actuarial Valuation. If you have any questions, please contact Hugo Wildmann.

Investments

In the prior 10-years, U.S. equity markets have averaged an 11.4% annual return and only had one year with negative performance. So far investment performance in 2022 indicates that equity returns for the year will be negative. As was mentioned at the Joint Meeting, investment returns for the Plan were down almost 20% for the year up to then. Returns have improved since then, and, as of the writing of this report the Plan is down approximately 12% in 2022.

When writing about investment results in these reports, I have consistently reported that the focus of the Retirement Board is on the long-term. We all know that in the short-term, markets will go up and down, but over the long-term, we expect equity markets, in which over half of the Plan's assets are invested, to go up. At the same time, our investments are diversified among various types of equity, fixed income, and other investments, so as to protect the Plan from drastic losses to the extent possible.

As I have mentioned often, it is reasonable to expect that roughly one year out of every three or four years will produce a negative return for the Plan, and that close to 40% of years will produce a return below our actuarially assumed rate. The fact that the Plan will have a year (or several years in a row) of returns below the actuarially assumed rate is not a reason for alarm or a time to implement changes to the investment portfolio. It is usually a time to take a long-term view and wait out the cyclical nature of the markets.

As was discussed at the Joint Meeting, the Retirement Board has been discussing ESG investing and whether any of the portfolio should be dedicated to these types of investments. At the November meeting, the Board spent over an hour discussing this topic with NEPC and will continue to consider such investments in the near future.

PEPRA Implementation

The Retirement System continues to work with the District on the implementation of PEPRA. Currently, the primary focus is on the employee contribution and notifying PEPRA employees that their contribution will increase from 6.25% to 7.00% of their pensionable pay. As was mentioned at the Joint Meeting, implementing the employee contribution has taken, and will continue to take considerable staffing resources from both the District and Retirement System. Our respective staffs have been working together on this project.

Department Staffing

As was mentioned at the Joint Meeting, Hugo is planning on retiring in 2023. The Retirement Board and the District are working together to fill this position. Once this position is filled, the Retirement Board will work with the new Retirement System Manager to determine the optimal structure for the Retirement Department given the additional workload of PEPRA.

Please feel free to call me, Jeffrey Lewis (510-463-3900), or Hugo Wildmann (510-891-4889), if you would like to discuss this report or request additional information.