

**PSRS-PEERS Board of Trustees Report
December 10, 2018
By Otto Fajen**

Trustees present

Aaron Zalis, Chair
Jason Hoffman, Vice-Chair
Chuck Bryant
Yvonne Heath
Scott Hunt (via conference call)
Beth Knes
Jason Steliga

BUDGET AND AUDIT COMMITTEE MEETING

Prior to the meeting of the Board of Trustees, the Budget and Audit Committee met to review the June 30, 2018 Audit Report. The audit report was approved by the Committee and referred to the Board of Trustees.

SYSTEM OPERATIONS

The Board meeting started at 9:30 a.m. Minutes from the October 29, 2018 meeting were approved and the order of business was established.

INVESTMENTS

Investment Performance Report - Craig Husting and Barry Dennis from Verus Investments reviewed the September 30, 2018 investment update and provided more recent information. While the first quarter of FY 2019 showed strong growth, markets dropped significantly in October and then rose slightly again in November, leaving the Systems with an updated overall investment return of -0.1% for the fiscal year estimated through November 30, 2018.

Safe Assets Program - The Board heard a report on the Systems' Safe Assets Program. Safe assets are reviewed once a year by the Board at the December meeting and include primarily U.S. Treasury notes and Treasury Inflation-Protected Securities (TIPS). The System currently has about 17.8% of the portfolio in safe assets, and this is slightly below the long-term policy goal of 20% allocation to safe assets. The strength of the US Dollar has reduced foreign demand for U.S. Treasuries. Domestic investors have absorbed the additional supply, and this demand has come from corporate pensions and institutional buyers seeking a low-risk investment.

Staff cautioned the Board about the long-term effect of the increasing federal debt. Interest on the federal debt is currently about 17% of the federal budget, despite relatively low interest rates. If interest rates rise to more typical long-term levels (and the Federal Reserve has been incrementally increasing rates), the interest on the federal debt could increase substantially, perhaps reaching 40% of the federal budget and forcing either tax increases, budget cuts or further accelerating the growth of the total federal debt.

Private Equity/Private Credit Program - The private equity program began making investment commitments in 2003 and has grown to nearly 10% of the Systems' allocation. The Board's long-term target allocation is 12%. Currently the Systems have \$8.8 billion committed to 221 partnerships that involve 88 manager relationships. The annual commitment target is \$1.2 billion. Strong distributions and performance have generated substantial cumulative wealth. Pathway and Albourne are the consulting partners working with the Systems on private equity investments. The long-term (12 year) return on the Systems' private equity investments is 12.26%, and this is considerably higher than the 8.88% return of the relevant benchmark, the Russell 3000 index.

The private credit program, while a small part of the total allocation, has produced strong returns in excess of the relevant private credit benchmark over all time periods from 1 to 10 years and a 10-year dollar-weighted return of 9.62%.

ACCOUNTING

The Board reviewed the FY 2018 Comprehensive Annual Financial Report (CAFR). A CAFR report is required by law, but the Systems' CAFR goes beyond the minimum requirements. Ultimately, the CAFR serves to document the activity conducted by the Systems and ensure transparency and accountability to members. The Systems' report again earned a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association. The financial section includes an unmodified or "clean" independent auditor's opinion, indicating that the financial statements may be relied upon by all stakeholders.

Williams-Keepers provided the independent auditor's presentation to the Board. The Board reviewed and approved the June 30, 2018 Audit Report referred by the Budget and Audit Committee

MANAGEMENT REPORT

Legislative Report – Maria Walden mentioned several pre-filed bills that would affect the Systems.

HB 69 (Dinkins) would reinstate the 2.55% multiplier for 31+ years of service. The actuary will provide an updated cost estimate for this change. Prior versions have been estimated to produce a small savings for the Systems.

HB 77 (Black) would address the impact of SB 892 (2018) on community college teachers. SB 892 changes the Working After Retirement (WAR) provisions for PSRS retirees working in school positions for which a DESE certificate is not required. SB 892 changed the WAR limit for this non-certificated employment from 550 hours to annual earnings of \$15,000. An unanticipated impact of this bill was that it also affects PSRS retirees employed as community college teachers, since those teachers are not required to have a DESE certificate. HB 77 would switch the limitation for such community college teaching employment back to the 550-hour limit applied to other teaching positions. The Board approved a motion to support HB 77 and similar bills; provided that the bills do not provide any refund of pension amounts to previously affected members. This type of refund is not allowed under federal law for a public pension system and could threaten the Systems' federal tax status.

HB 201 (Kendrick) would require all public pension plans to provide certain information to members of the plan. This bill would not impose any requirements not already met by the Systems.

SB 18 (Romine) revises the gubernatorial appointment process. This bill does not directly target PSRS, and concerns all board appointments. The reforms in the bill reflect an effort to prevent any future attempts by a Governor to manipulate the appointment process by removing properly appointed members without just cause.

CPI update/COLA review – The first quarter FY 2019 CPI-U figure grew by 0.3556%. Under current policy, the Board will approve a 2% COLA for eligible retirees when CPI-U is between 0% and 2% and cumulatively 2% or more since the last increase. Such an increase was given for last year, and the cumulative amount was reset to 0%.

Facility Analysis and Planning – The Board has spent significant time in each meeting since June 2018 on discussion of options to meet future facility needs. Facility needs are now exceeding the capacity of the current building and the needs will continue to increase in the future. The facility demands on the Systems will be driven by three key factors: 1) the number of retirees is estimated to increase each year before reaching a peak of roughly 175,000 in about 2040, 2) the size of the Systems' investment portfolio will increase to about \$100 billion over a similar timeframe and 3) the staff demands for high quality investment in private equities will increase as that allocation grows.

Three options were considered at the August meeting: 1) remain in current building and lease additional space, 2) renovate and expand the current building and 3) build a new building on adjacent land and sell the current building. At that meeting, the Board chose to focus on options 2 and 3 and asked staff for further information before deciding which option to pursue.

In discussion at the December meeting, several members had a preference to build a new building that could be fully optimized to the needs of the Systems and the members. Building a new building would also minimize disruption to members and staff during the construction phase. However, concerns were expressed over what to do with the existing building if a new building is built. The consensus of Board and staff was that the current building could not be easily sold to recoup its value. This factor weighed strongly in favor of renovating and expanding the current facility.

The Board approved a motion made by Bryant and seconded by Steliga to move forward on a project to renovate and expand the current facility over the next 3-4 years.

Public Comment – None.

The meeting adjourned at 12:30.