Approved Minutes  
Meeting of the  
AC TRANSIT RETIREMENT BOARD  
July 20, 2017

ROLL CALL

Chair Jeffrey Lewis called the meeting to order at approximately 9:03 a.m.

Members Present:  Sue Lee, Davis Riemer, Vice Chair Yvonne Williams and Chair Jeffrey Lewis

Absent at Roll Call: Joyce Willis

Members Absent: None

Also Present: Hugo Wildmann, Retirement System Manager; Albert Yam, Retirement System Analyst; Bertina Ng, Retirement System Analyst; Russell Richeda, Legal Counsel; (the following individuals were at part of the meeting): H.E. Christian Peeples, District Board liaison; Joel Young, District Board liaison; Michael Hursh, AC Transit General Manager; Claudia Allen, AC Transit Chief Financial Officer; Kyle Spradling, AC Transit Budget Department; Carolyn Smith, NEPC; Tony Ferrara, NEPC; Graham Schmidt, Cheiron; Thomas Klugherz, UBS; Mia Dennis, UBS; Josh Braunstein, JP Morgan; and Lauren Brants, JP Morgan.

PUBLIC COMMENTS

None

CONSENT CALENDAR

MOTION: WILLIAMS/RIEMER to adopt the Consent Calendar. (4-0-0-1)

Ayes: Members Lee, Riemer, Vice Chair Williams, and Chair Lewis -- 4

Noes: None

Abstain: None

Absent: Member Willis -- 1

APPROVED

A. Approval of Minutes for June 8, 2017

APPROVED

B. Approval of Financials for May 2017
Retirement Board
July 20, 2017

APPROVED

C. Approval of Invoices for $132,582.86

APPROVED

D. Approval of Retirement for July/August 2017:
   1. Curtiss Freeman (July)
   2. Denise Hutson (July)
   3. Rosemary Diaz (Leaca) (Term Vested, July)
   4. Clayton Beale (August)
   5. Joyce Masih (August)
   6. Zina Sims (August)
   7. Susan Young – Pre-Retirement Death (July)

APPROVED

REGULAR CALENDAR

Several items on the agenda were discussed out of order.

E. Retirement of Tom O’Neill – August 2017

Hugo reported that Mr. Tom O’Neill was on the Regular Calendar because of an issue pertaining to his years of service. Hugo mentioned the memo from the District’s General Counsel, which explains that the District finds that Mr. O’Neill was misclassified for three years as a non-employee and he should have been considered an employee for these three years. The memo further states that Mr. O’Neill should have 10 years of service instead of 7 years, and the District feels that these three additional years should be counted for pension. This was not a re-classification but a misclassification according to the memo. The pension benefits based on 7 years of service would be approximately $3,190 per month, whereas it would be approximately $4,550 per month based on 10 years of service. Hugo told the Board that he had explained to Mr. O’Neill that his case would be evaluated by the Retirement Board, and it was possible that it might take a few months to resolve.

Member Lee raised concerns that the Board’s decision may have a ramification on the unfunded liability due to the increased amount of the pension. She feels that if the District’s intent is to accommodate this request as a settlement, it should be paid for by the District, not by increasing the liabilities of the Retirement System. Hugo mentioned that the increase in the unfunded liability of granting 10 years of service instead of 7 is approximately $200,000.

Graham agreed that the unfunded liability would increase by $200,000. The Board discussed the impact of the increased unfunded liability on the Retirement System.
Legal Counsel Richeda reported that granting 10-years of service may potentially violate PEPRA Section 13.2A regarding retroactive enhancement. This section limits any retroactive enhancement adopted after 1/1/2016. Russ suggested the Board postpone a decision until we obtain further details from District’s General Counsel.

The Board discussed the possibility of a shorter amortization on the increase in our unfunded liability or a full payment upfront by the District. Director Peeples believes there may be another two or three of employees that are in a similar situation. The Board had some concerns that the District Board may have made such settlement in the best interest of the District, but not fully taken into consideration the impact on the Retirement System.

Chair Lewis thinks that the two choices on the table are: (1) follow the District’s determination that Mr. O’Neill was misclassified and is entitled to 10 years of services; or (2) the Board would utilize our resource to carry an independent investigation to determine the actual years of service.

**MOTION: Riemer/Williams** to approve Tom O’Neill’s service retirement at approximately $3,190 per month, based on 7 years of service; and to postpone the decision on 10 years of service until Legal Counsel gathers enough information for a recommendation. (4-0-0-1)

F. 2017 Preliminary Actuarial Valuation Results

G. Assumed Rate of Return for 2017 Actuarial Valuation

Hugo reported that this was our third month of discussing the 2017 Actuarial Valuation, and that we would most likely need one more month of Board discussion before finalizing the Valuation.

Graham (Cheiron) reported that the up-to-date actual rate of return for 2016 was very close to the assumed rate of return. At the June meeting, the Board decided that (1) future changes on unfunded liability would be set up as layers for amortization, and amortized over a 20-year period; (2) impact from plan changes, such as benefits improvement or reduction, on active employees should be amortized differently. It should be based on the expected future working life of the employees. The number of years would be left to the discretion of the Board. Furthermore, there was a change on the receivables booked as of January 1, 2017, as the Board agreed that it should now only include the portion of the receivable attributed to the unfunded liability.

The only outstanding item to be decided by the Board at this meeting was the discount rate. As discussed at last month’s meeting, we are seeing changes in the discount rate from a large number of public pension systems. For example, CalPERS is lowering their discount rate from 7.5% to 7.0% over a three-year period; they will drop to 7.375% in 2017/18,
7.25% in the following year, and 7% after that. Their funding method amortizes assumption changes over a 20-year period, with a 5 year ramp up and 5 year ramp down using Direct Rate Smoothing to phrase in/out the impact. It will take well beyond three years for the impact of these changes to wind their way through the cost structure of CalPERS.

During last month’s meeting, the Board requested Cheiron present some different alternatives on the timing of adjusting the discount rate down; from the current 7.25% to 7.0%. Graham presented the Board with the projections on several alternatives. The Baseline model is based on staying at 7.25%. Alternative 1 is based on dropping to 7.125% for 2017 and 2018, and drops to 7.0% on 2019. Alternative 2 is based on dropping to 7.125% in 2017, and to 7.0% in 2018. Alternative 3 is based on staying at 7.25% in 2017, dropping to 7.125% in 2018, and dropping to 7.0% in 2019. Modeling results are shown for the next nine years. It shall be noted that all scenarios are based on the projected return of 7.0%.

In 2025, the Contribution Rate and Contribution under Alternative 1 is slightly higher than Alternative 2. The reason for that is because, under Alternative 2, more money was put into the Plan earlier as we reach the 7% discount rate earlier. Therefore, the required Contribution Rate would be less. The 9-year projection is based on a 0.25% reduction in investment losses. When comparing the Funded Ratio, it is noted that, even though Alternative 1 ($71,197,000) is showing a larger Contribution Amount than Alternative 2 ($71,108,000), the Funded Ratio for Alternative 1 (81.70%) is less than Alternative 2 (81.84%). This is also because of the additional $1.2 million that was put into the Plan in 2018 due to the lower discount rate under Alternative 2.

Looking at the long term Projection, we start to see more divergent results. In 2038, the alternative scenarios are significantly lower than the Baseline, due to the continued pattern of actuarial losses and lower contributions under the Baseline scenario.

The normal cost rate for our pension benefit is approximately 14% of payroll. We are currently funding at roughly 35% of payroll because it includes the amortization of losses from previous years.

Alternative 3 Modeling shows very similar results to Alternative 1 for Plan Year 2025, in terms of Contribution Rate (36.68% versus 36.63%); Contribution Amount ($71,275,000 versus $71,197,000); and Funded Ratio (81.56% versus 81.70%).

District’s General Manager Hursh commented that the District has already had internal discussions, and the budget forecast for 2017/18 is unfavorable due to a number of factors. While getting the funded ratio up is one of the primary goals of the agency, they consider Alternative 3 as the preferred option.
Member Riemer raised concern that the difference between these scenarios is very minimal, and may not be enough to counter the expected depressed return rate for the investment market. Graham reminded the Board that we were at 8.0% discount rate not that long ago, and we are now targeting getting to 7.0% within the next three years. There is a good reason for implementing these changes over a number of years to soften the immediate impact. Graham also mentioned that our discount rate assumption would be well in line with those of other public pension plans.

**MOTION: Riemer/Lee** to adopt Alternative 3 for the discount rate as follows: 7.25% for 2017, 7.125% for 2018, and 7.0% for 2019. (4-0-0-1)

Graham told the Board that he now has enough information to complete the actuarial valuation. The Board agreed to skip the cost letter and save some administrative cost, as the cost letter is now redundant. Graham expects to complete the actuarial valuation by the September Board meeting.

Chair Lewis called a recess at 10:34AM

The meeting reconvened at 10:44AM

L. **JP Morgan Real Estate Presentation**

Carolyn provided the Board with a brief update on both UBS and JP Morgan. They are our Core Real Estate managers. The Board hired them about 5-years ago. Both are open-ended core real estate funds. JP Morgan is the largest Core Real Estate fund in the country, so they invest in really big properties. UBS is a little bit smaller and is a little bit more conservative; as they use less leverage than most other real estate funds. For a real estate market that is overvalued or as values are coming down, having less leverage is better. When we first bought in to both of these funds, there was a queue to get in at that point in time; which we waited for about a year until they accepted our funds. It is important to note that even though UBS may seem to be underperforming, Carolyn thinks that given their lower risk profile their underperformance should be expected given the recent performance of real estate.

Josh Braunstein and Lauren Brants from JP Morgan presented to the Board updates on JP Morgan since they were last here. There is no significant changes in terms of personnel in their management team, which has an average of 28 years of experience. Under broad terms, the supply and demand in the market are in equilibrium, so the real estate market is very solid.

JP Morgan is an open-ended comingle fund, with a net asset value of $32 billion. They invest in several different real estate market sectors. Office was a very weak sector throughout the end of 2016 and early 2017. They reduced the Office exposure from 48% to
42%, which is closer towards the index benchmark of 36%, by selling some suburban offices that had strong demand.

In terms of Retail properties, they are focusing on building a portfolio around Super-Zip-Codes, as well as grocery-anchored segment and specialty segment such as salons, spas, doctors, etc. They further believe the regional super malls for the luxury market has a lot of long term potential. The impact of the decline in retail as a result of internet purchases was discussed.

They also noticed that industrial real estate was undergoing a geographic shift, with major retail distributors such as Amazon increasing the number of distribution centers within a 20-mile radius from 5% of the U.S. population to 40%. They are focusing on this in-fill trend towards metropolitan industrial buildings.

This year total return is projected to be 6% to 8%, of which 4% to 4.5% comes from income, with the rest coming from appreciation. Their mortgage debt composition is about 84% fixed rate versus 16% floating rate.

JP Morgan also has an in-house expert in charge of evaluating the sustainability aspects of their real estate holdings and of continuously working on how to implement an ESG firm-wide strategic focus. The Board would like to see figures about the proportion of green-certified buildings within their portfolio.

The discussion with JP Morgan lasted approximately 45 minutes.

Chair Lewis called a recess at 11:36AM

The meeting reconvened at 11:45AM

K. UBS Real Estate Presentation

Thomas Klugherz and Mia Dennis of UBS presented to the Board. In terms of personnel, UBS has seen an approximately 10% increase in number of staff in the last year as a result of hiring to keep pace with the increase in assets managed by the real estate team.

In an overview, UBS’s portfolio shows that both rental growth and occupancy level have been very good, and they expect this to continue for the next year.

The Time Weighted Return since inception for the period ending 6/30/17 is at 8.63%. UBS positions itself on the lower end of the real estate risk spectrum; it focuses on low leverage strategy, and its current leverage is at 14%. This matches the Board’s decision in 2013 on selecting a lower risk real estate core fund.
UBS’s property allocation is about one-third in apartments; one-third in office; with retail, industrial and hotel making up the remaining allocation. They place themselves around their proprietary inventory model, and do not seek to replicate the Index (NFI-ODCE). When compared with the index, they have more holdings in apartments and fewer holdings in office. They have traditionally been more focused in apartments.

On the financial aspect, UBS committed $400 million in 19 transactions of acquisitions in the previous 12 months. For the upcoming year, they expect about $500-$600 million in acquisitions coming into the fund. Furthermore, 97% of their financing is fixed rate, with an average interest rate of 3.4%.

In terms of Sustainability, UBS rated as #2 out of 31 funds by GRESB.

The discussion with UBS lasted roughly 45 minutes.

H. Benefit Statements

Hugo reported that staff has started working on the Benefit Statements, which will go to those employees who have been at the District for a full calendar year. They are expected to go out in October/November. Staff will include the Draft versions in the materials for the next board meeting.

I. Investment Performance, Rebalancing and Asset Allocation

Hugo reported to the Board that the Plan is doing very well. The YTD return is at 7.5%. He and Carolyn will be presenting to the Board on rebalancing in the next board meeting. As the market is going up, there is more equity in the plan, which is the reason for the need to rebalance.

J. Real Estate Opportunities Update

Hugo mentioned that this would be discussed at the August meeting.

M. NEPC Work Plan for 2017

Carolyn reported that we will continue the discussion on real estate opportunities at the August meeting. She also would like to discuss funding in private debt.

N. Calendar for 2017

Hugo reported that the District would like the Joint Meeting to be on October 4th from 1:00PM to 3:00PM. The Board agreed to move our board meeting in October to that date from 9:00AM to 12:30PM.
P. 2017 Financials

A copy of the finalized 2017 Financials was provided to each of the Board members.

O. Plan Amendment

Hugo reported that the Plan Amendment only applies to unrepresented employees. Vice Chair Williams raised concerns that, in the pay codes attachment, some of the pay codes mentioned ATU in reference. She reminded the Board that pension pay codes regarding ATU should first be approved by the Union and be included in the forthcoming union negotiation. Therefore, any reference made to ATU employees in this Plan Amendment should be eliminated. Chair Lewis suggested that District should provide a new pay codes table that only shows pay codes applicable to unrepresented employees.

Furthermore, Chair Lewis raised concern about the interest section and the 3-month treasury rate. The Board decided to defer this subject to a later date.

Q. Communication with Doctors on Disability Questions

N/A

R. Payment of Disability Retirement Benefit to Raymond Robbins

Hugo reported that we have received most of the required documents and he will be in pay status soon.

S. Paratransit Employees in the Retirement Plan

Staff will get more information on this subject.

T. Retirement System Manager Report

In referring to the annual healthcare renewal rates, Hugo reported that staff is seeing many more retirees interested in knowing about the retiree health plan premiums, in addition to the pension benefit. Vice Chair Williams raised concerns that the current arrangement of unrepresented employees having a different retiree health plan to other employees is unfair.

U. Closed Session

N/A
V. Resume Open Session

Legal Counsel Russ Richeda reported on Closed Session Agenda as follows:
1. With respect to U-1-a – The Board made the following motions:
   (i) The Board, through a vote of 3-0-1-1, reaffirmed the decision from last month to
       grant the Total and Permanent Disability pension benefit for Ms. Legaspi.
   (ii) The Board decided, based on her medical conditions and other evidence
        included on the report, that Ms. Legaspi was excused from complying with the 6-
        month filing deadline on the basis of principal of equitable tolling.
   (iii) The Board decided that her Total and Permanent Disability pension effective
        date should be retroactive to April 1, 2013.
   (iv) The Board decided her retroactive benefit should be reduced by the Service
        retirement benefit received.
2. The Board has given direction to Legal Counsel to provide a short description of the
   policy that underlines the decision of the Board on the equitable tolling issue.

ADJOURNMENT

MOTION: WILLIAMS/RIEMER to adjourn. (4-0-0-1)

The Board adjourned its meeting at 1:35PM.