From: Cathy MacLeod
To: Jason Fried
Cc: Joe Serrano
Subject: RE: Comments re: OPEB Trust for upcoming Board meeting
Date: Tuesday, January 9, 2024 2:02:12 PM
Attachments: image005.png
image003.png

Hi, Jason (and Joe).
In reviewing the GASB 75 slide for the meeting, I noticed an error in my earlier email. The ratio of the trust assets to the TOL in the lower chart was upside down. I've corrected it below in this email. Would you please be certain to get this updated version into the Board meeting materials?

Thanks. I'll send a separate email after reviewing the Prezi slide.

Cathy

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From: Cathy MacLeod <cmacleod@macleodwatts.com>
Sent: Friday, December 29, 2023 3:26 PM
To: Jason Fried <jfried@marinlafco.org>
Subject: Comments re: OPEB Trust for upcoming Board meeting

Hello, Jason.

You asked us to provide some thoughts on issues the Board may want to consider as it reflects on whether to change or maintain the CERBT asset allocation strategy. Before I begin, it is important that I state that MacLeod Watts does not provide investment advice of any kind.

Very briefly, the 3 current strategies are:

- 1: More aggressive. The general asset allocation is more heavily weighted in equities and Global Real Estate than the others.
- 2: More balanced. 15% lower allocation in equities and 3% lower REIT's shifted to fixed income securities
- 3: More conservative. Additional 11% decrease in equities and 3% drop in REITs shifted to fixed income or Treasuries (TIPs).

As the % invested in equities goes down, the expected return also drops.

When the expected return goes down, the employer's liability increases, since the lower trust earnings will need to be made up by higher employer contributions to fund the benefits.

The tradeoff is lower risk (volatility in return) as the allocation becomes more conservative.

CERBT Strategy Comparison	Target Allocation		
Major Asset Classification	Strategy 1	Strategy 2	Strategy 3
Global Equity	49%	34%	23%
Fixed Income	23%	41%	51%
Global Real Estate(REITs)	20%	17%	14%
Treasury Inflation Protected Securities (TIPS)	5%	5%	9%
Commodities	3%	3%	3%
Volatility	12.1%	9.9%	8.4%
*Expected Return **	*6.05%*	*5.5%*	*5.05%*

** based on CalPERS projections applied to the Commission's projected benefit cash flows.*

The Commission's funds are currently invested in CERBT Strategy 2.

Considerations of which asset allocation strategy might be best at different phases in the plan's funding include:

1. The risk tolerance of the agency and its governing Board.
2. The funded status of the plan. Two ratios worth reviewing are:
   a. The ratio of plan assets to the prior service cost allocations (i.e., assets ÷ the Total OPEB Liability (also called the Actuarial Accrued Liability when talking about plan funding)
   b. The ratio of plan assets to the Present Value of Projected Future Benefits (PVPB). The PVPB includes both the prior service costs and the future service costs so is the best picture of additional funding that will be needed in future years.

   As the funded ratios increase toward 100%, typically the employer shifts away from the more aggressive toward the more conservative allocation strategy to reduce the risk of an asset loss. When the funded ratio is low, a 10% asset loss is on a small amount of assets. When the assets are a very high % of the liability, a 10% loss can represent a significant part of the liability.

   The chart below compares results for the 3 asset allocation strategies:

Compare June 30, 2023 Valuation Results	Strategy 1	Strategy 2	Strategy 3
Trust Assets	$ 72,290	$ 72,290	$ 72,290
Present Value of Projected Benefits (PVPB)	87,734	94,700	101,117
Ratio (assets as % of PVPB)	*82%*	*76%*	*71%*
Trust Assets	$ 72,290	$ 72,290	$ 72,290
TOL (AAL/past service liability)	61,579	64,450	66,964
Ratio (assets as % of TOL)	*117%*	*112%*	*108%*
Current & Future Services Costs	$ 26,155	$ 30,250	$ 34,153

3. The expected average remaining future working years and average years in retirement for current employees and retirees. The longer the period, the longer the trust will be in effect and the better able the program should be able to withstand volatility in returns. The average age of current active employees is 37 and weighted expected future service is 13+ years.

Expected life expectancy of the current retiree is about 14 years and for future retirees would typically be at least 20 years after retirement.

Summarizing the above,

- Trust assets fully cover the current past service liability (TOL) and a significant % of the PVPB (prior and future service cost allocations), suggesting that Strategy 1 might not provide the best risk protection for this plan.
- There is about 20-30% of unfunded future service costs and over 13 years (average) for those costs to be funded. There is also expected to be some additional years in retirement for the Commission to withstand some reasonable asset return volatility (more risk than Strategy 3) and – in the meantime – to pick up some additional asset return in Strategy 2.

Again, I reiterate that the final comments are just observations and should not be taken as recommendations by me or by MacLeod Watts.

Please let me know if I can provide anything else to assist for the upcoming meeting.

Cathy

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