August 24, 2023

Members of the Pension Review Subcommittee:

In response to questions received, PERA staff has prepared the attached information.

Please let us know if any members would like to discuss this information in greater detail.

Thank you,

Amy C. McGarrity
Interim Executive Director/Chief Investment Officer

Michael Steppat
Public & Government Affairs Manager

1. Commercial Real Estate

   a. ***Many properties are coming up for refinancing in the next couple of years. What is our exposure to that risk, particularly as regards falling office and hotel property values?***

   The PERA Real Estate portfolio is significantly underweight to Office, has minimal exposure to Hotel investments, and is overall moderately leveraged. As of March 31, 2023, PERA's Real Estate holdings totaled $6.5 billion of which 11% was invested in Office and less than 1% in Hotel. Overall leverage was 34% of value. On a direct basis, PERA's office holdings equate to 3% of the entire portfolio comprised of eight properties, five of which are unleveraged. While both near term capital value declines and refinancing risk within the portfolio exist, it is not expected to significantly impact PERA's liquidity or impair performance over the long term.

   b. ***What steps, if any, are we taking to mitigate that risk in advance of the wave of refinancing?***

   As a long-term holder of Real Estate, PERA's use of financing is generally low loan-to-value, fixed rate, and held on balance sheet by traditional banks or large insurance institutions. During the attractive low interest rate environment in the late 2010's, staff actively shifted toward longer duration loans when refinancing properties in the direct portfolio. For properties targeted for sale or with upcoming leasing challenges, certain loans were also paid off to create flexibility. As such, the current near-term rise in interest rates has not created undue stress within the portfolio.

2. Signal Light

   a. ***Does the report assume market value or smoothed actuarial value for PERA's assets?***

   The Actuarial Value of Assets (AVA) is used in the determination of the projected funding periods shown on page 12 of report. Regarding the Signal Light Analysis, the AVA is used for the "Sensitivity on Investment Return Assumptions" (stochastic) and the Market Value of Assets (MVA) is used for the "Sensitivity on Other Assumptions" (non-stochastic). PERA will request that Segal add additional commentary to clarify this point in future reports.

   b. ***While both State and School are in Yellow, the bulk of the scenarios land in Dark Green or Orange for the nominal case. What accounts for this significant bi-modality?***

   The "Number of Scenarios Meeting" the shown criteria – are simply the count of randomly generated investment return simulations performed for the analysis falling within each category. Given the current funding positions of the State and School Divisions, the same and/or similar situation occurs each year (see prior reports), as the top five categories/criteria are based on legislation, not an expected or mathematically based distribution of criteria. One would expect the first criteria (dark green – 100% funded by or before 2041), to perhaps capture a larger field of simulations following the strong asset performance for 2019, 2020, and 2021, and likewise, one might expect a greater number of simulations to fall within the orange category for those scenarios that are solvent, but did not meet the more rigid requirements of dark green, green, light yellow, or yellow that align with legislation. The July 2023 report considers the 2022 asset performance, so note that the number of captured simulations in the dark green category are noticeably lower than those shown in the July 2022 or 2021 reports; however, this also led to a higher number of simulations captured in the orange category (solvent, but did not meet more rigid criteria), and of course, a slightly higher number in the two red "insolvent" categories, as well.

   c. ***I want to make sure that I'm reading the report's comments correctly – a higher payroll results in better scenarios for PERA on the whole. Is that correct?***

Yes. Keep in mind that although higher payroll means higher benefits (based on HAS – average over 3-5 years), it also means higher contributions flowing, at a faster pace than expected, into the plan assets. The "more contributions, faster" has a greater favorable front-end impact on projected funding patterns, than the detrimental impact of larger benefits on the back end of the projection period.

3. CEO Search

   a. ***PERA has engaged the services of an executive search firm. Can we see the requirements that they were given, as well as any question the candidates were asked to answer?***

   Colorado PERA is in the process of selecting an executive search firm. A request for information (RFI) was posted on copera.org on June 20 stating the criteria for selecting a firm. The RFI was also posted on additional industry organization sites and sent directly to several known firms. The RFI is available at **Colorado PERA Seeks Proposals From Executive Search Firms - Colorado PERA (copera.org)**. Five firms were selected for interviews. Three interviews were conducted on August 15 and the remaining two interviews are scheduled for August 28.

   b. ***As I understand from our discussion after the last meeting, only the finalists will be given a more comprehensive list of questions. Is that correct? Do you know now what those questions will be, and when can they be made available to the subcommittee?***

   Interview questions for the Executive Director process have not yet been developed. The selected executive search firm will work with PERA's Ad Hoc Committee and contribute to the development of interview questions prior to beginning the executive director interview process.

4. Other Investment Questions

   a. ***I asked about the possibility of having a NAV for PERA's stock holdings. Speaking specifically of PERA's broad stock holdings, as reported in the 13F, is there currently an investable fund for that, analogous to the bond NAV that was just created? I'm not asking about subsets of those holdings, or other NAVs that PERA might have, just something that mirrors its larger set of stock holdings.***

   PERA is currently in the process of evaluating the possibility of unitizing the entire defined benefit portfolio/asset classes. This would be a multi-year project if we were to proceed.

   b. ***Can you give us a man-hour estimate of what it would take to report quarterly on PERA's bond holdings, similar to its 13F for equities?***

   PERA recently started publishing its entire Global Equity portfolio (the 13F is just a subset) and Fixed Income portfolio quarterly on the website. They can be located on the main Investment page under "Current Investment Holdings" found **here**. They can also be located in each asset class subsection by going to Investments -> Defined Benefit (BD) Plan Assets –> Asset Classes, found **here**.

   c. ***Who does the valuation of PERA's private equity investments?***

   The valuation process for PERA's private equity partnership interests is conducted by the individual fund managers. These managers typically work with internal valuation teams and/or third-party valuation firms and employ a valuation methodology for underlying portfolio companies. These methodologies are based on guidelines issued by industry associations or regulatory bodies such as FASB, IPEV, etc. Fund managers issue pro rata capital accounts to PERA (and other investors) that include the value of the underlying portfolio companies, other fund assets and fund liabilities. The capital accounts are then booked by PERA as a practical expedient under GASB guidelines. Partnership financial statements are audited by third-party audit firms as part of the annual reporting process.

5. ***General Question – In 2021, the subcommittee made several recommendations to the board about the amortization of annual liabilities and the color-coding of the Signal Light Report. What, if any, action has been taken on those?***

   Please see the attached formal responses from the PERA Board regarding the 2021 recommendations from the Pension Review Subcommittee. Note the following changes/enhancements/responses related to each of the three 2021 PRS Recommendations:

   - Recommendation #1 (Signal Light Report): As noted in the Board's formal response, the Signal Light methodology was retained (see page 8), but summarized probabilities of attaining 100% Funding by 2048, were added (where applicable) within the report, as well as verbiage as to long- and short-term measures of PERA's financial stability [i.e., Executive Summary (new in 2022 report) and Conclusion, of the July 2022 and July 2023 Signal Light Reports (see pages 2, 5, 39, & 40 of each report).]
   - Recommendation #2 (Amortization Periods): In alignment with the Board's formal response, and based on their governance schedule, the Board will be initiating their review of the Pension and OPEB Funding Policies at the 2023 September Planning Meeting, with any changes (as the Board deems necessary) to be adopted within the next few meetings, depending on course of discussion.
   - Recommendation #3 (Reconciliation of Gains/Losses): As noted in the Board's formal response, an historical reconciliation of actuarial gains/losses currently appears in the annual report. Please note Signal Light Report communication enhancements as detailed in response to Recommendation #1.