



# *SCHOOL EMPLOYEES RETIREMENT SYSTEM OF OHIO*

## **BOARD MEETING HIGHLIGHTS**

### **FEBRUARY 2023**

#### **Investments Quarterly Report**

Joanna Bewick of Wilshire Associates provided the Board with an update of current global market conditions, as well as SERS' FY2023 second quarter (October-December) investment results.

During the quarter, Bewick noted that the U.S. stock market was up 7.1%, but down 19.0% for all of 2022.

Bewick said that 2022 will be remembered for the Federal Reserve's aggressive action to combat high inflation. The Federal Open Market Committee (FOMC) raised rates 4.25%, which marks the largest 12-month increase since 1981.

The Fed forecasts that rates will rise by another 0.75% by the end of 2023; however, the open market does not agree. This discrepancy is likely to be a primary market driver over the next year.

Bewick noted that we are seeing resilience in terms of the economy and gross domestic product (GDP).

The GDP real-time forecast shows that growth has remained persistent and resilient. This is a good thing because people remain employed; however, resilience is potentially problematic for the Fed as it supports a higher inflation rate.

The debt ceiling remains an issue around which the U.S. sees much market volatility. Debt is approximately 120% of GDP across all administrations and is ultimately a drag on economic growth.

In 2022, fixed income was not the "safe harbor" that it was in the past. While it produced healthy returns for the quarter, returns were down double digits for the year, resulting in the worst performance in approximately 50 years.

According to Bewick, SERS' performance was a more positive story for the year because of its widely diversified portfolio. For the calendar year, SERS' Total Fund was down 4.89%, which was 300 basis points ahead of the policy benchmark. When compared with more than 400 other US. pension funds, the calendar year return ranked 5th; the 3-year return of 8.19% ranked 3rd; the 5-year return of 8.03% ranked 2nd; and the 10-year return of 9.15% ranked 2nd.

Bewick said that, for the calendar year, the median fund was down 12.91%. SERS outperformed that by 8%, placing the System in the 5th percentile, meaning SERS' performance was better than 95% of public funds. Bewick noted that SERS was able to achieve higher returns with lower risk compared to almost all of its peers.

#### **Global Real Assets Portfolio Review**

Investment staff provided the Board an overview of SERS' global real assets portfolio.

The role of the global real assets portfolio is to provide stable income from tangible assets, be a partial inflation hedge over the long term, and provide low correlation to equities. Its objective is to provide returns exceeding the NCREIF Property Index (NPI), and its target allocation is 17% of the Total Fund with a range of 14-22%.

The portfolio is comprised of private real estate (core and non-core strategies), infrastructure, and public real estate.

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#### RETIREMENT BOARD

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*Appointed Member*

Private real estate remains the largest exposure at 72%, which increased slightly over the past year. Core strategies (properties that produce income through rents) comprise 64% and non-core strategies (those that appreciate in value over time) comprise 8%.

Infrastructure declined from 28.1% in 2021 to 26.6% in 2022 on a relative basis as real estate gains outpaced infrastructure's increases.

Public real estate provides portfolio liquidity and its exposure is 1.3%.

The strategy of allocating more capital to better-performing property types boosted portfolio returns in 2022. Staff overweighted exposure to multifamily assets, which had high occupancy rates and consistent rent growth. Staff provided equal weight to industrial, which has been the best-performing property type over the last 10 years. Finally, staff underweighted exposure to office and retail assets, both of which were adversely affected by the pandemic and high capital expenditures.

Geographically, SERS' managers are increasing exposure to cities with favorable demographic trends and strong economic growth. SERS' U.S. real assets holdings are 38.5% in the West, 34.1% in the East, 21.2% in the South, and 6.2% in the Midwest.

In Ohio, staff invested \$5.1 million in real estate and infrastructure, up from \$1.7 million in 2021.

For CY2022, the portfolio returned 16.91% net of fees, which was 83 basis points above the benchmark. This positive return was driven by strong real estate markets. The real assets portfolio also exceeded the policy benchmark for the three-, five-, and 10-year periods.

Real estate returns are expected to moderate in the coming years. Industrial and multifamily assets are projected to be the top-performing property types; office assets are expected to struggle in 2023-26 as tenants assess spacing needs amid work-from-home trends and cost rationing; and retail is expected to remain stabilized due to supply constraints and reopening following the pandemic.

In FY2023, staff will be exploring additional co-investment opportunities, evaluating new strategies that can benefit from market dislocations, and focusing on investments with inflation protection characteristics.

### **Definition of Compensation**

SERS' Legal staff presented an overview to the Board regarding SERS' statutory and administrative rule definitions of compensation. The presentation addressed the interplay amongst the definition of compensation, managing benefit inflation, and the proposed Contribution Based Benefit Cap (CBBC) legislation.

Defining what types of compensation are eligible for contributions is important to both the member and SERS. It is important to the member as SERS looks at the highest three years of compensation when calculating a member's pension. In turn, contributions, which are based on member compensation, are the main source of funds that SERS invests to support pensions.

Discussion of the compensation definition addressed how school compensation practices have evolved. Gone are the days when employees received only periodic pay based on hourly wages or annual salaries. Current compensation practices are turning to bonuses and other types of lump sum payments as more flexible compensation alternatives to traditional increases to base pay.

### **Investment Committee Approves Two Investments**

The SERS Staff Investment Committee approved a \$100 million commitment to LBC SMA, a separately managed account (SMA) strategy within the private credit portfolio, and a \$50 million, plus \$25 million side-car co-investment, commitment to Kohlberg Investors X, a U.S. middle market buyouts strategy within the private equity portfolio.

These investments will be funded from cash reserves.

### Total Fund Update

TOTAL FUND BALANCE		
November 30	December 31	Difference
\$17.46 billion	\$17.14 billion	▼ \$320 million
TOTAL FUND RETURN (net of fees)		
Fiscal Year	Calendar Year	3-Year
▲ 1.57%	▼ 5.60%	▲ 7.52%
TOTAL FUND RETURN vs. BENCHMARK		
Fiscal Year	Calendar Year	3-Year
▲ 0.68%	▲ 2.31%	▲ 1.68%

### Staff Compensation Update

Last year, in accordance with the SERS Employee Compensation Policy, SERS contracted with CBIZ Compensation Consulting to conduct a compensation study to determine the competitiveness and effectiveness of the System's employee compensation program.

Joe Rice, director of compensation consulting for CBIZ, returned this year to update the Board on current labor market salary data that directly affects the salary ranges SERS has in place for its staff. The policy recommended that the salary ranges be reviewed and adjusted annually, if necessary. Rice advised that salary ranges should be updated to stay competitive with the local labor market.

Rice also addressed FY2024 total salary growth budget recommendations based on current market conditions. Total salary growth includes annual merit increases, promotions, staffing additions, and salary adjustments.

Based on market data, he suggested total salary growth be in the range of 6.3% and 8.0%. At SERS, the salary merit component of pay is based on an employee's performance relative to established performance goals. Strong performance results in a higher merit award than performance that is not as strong.

SERS' Board asked staff to prepare a draft budget with the salary range update and 6.3% total salary growth so they can evaluate the impact on SERS' personnel expenditures.

Maintaining an appropriate level of individual salary growth is essential to enabling SERS to be able to attract and retain high quality employees. It also is important that salary levels continue to remain aligned with market trends to avoid having to make substantial salary increases in subsequent compensation studies.

### Executive Director's Update

#### **Health Care Sustainability**

At the Health Care Sustainability session, SERS' Board supported bringing forth an administrative rule change that mandates Marketplace counseling for non-Medicare enrollees and a resolution to approve equal premium costs for service and disability retirees at the March Board meeting. More details about these changes can be found in the Health Care Sustainability Highlights available on SERS' website.

#### **ORSC Update**

The Ohio Retirement Study Council (ORSC) did not meet in January. The next meeting is scheduled for February 23. In addition to organizing for the new legislative session, the agenda may include summaries of system reports that had been submitted to the Council including our Annual Health Care Report.

#### **SERS' Annual Pension and Health Care Advocacy Group Roundtable**

On January 20, SERS held its annual SERS Pension and Health Care Advocacy Group Roundtable as a hybrid meeting using Zoom as well as in person for the first time in a few years. Five SERS Board

members were in attendance. Twelve representatives from nine different advocacy groups attended to hear staff presentations about the state of the Retirement System as well as a look forward to key activities in 2023. Annual joint meetings with OASBO and SERO are scheduled in May.

### ***State Legislation***

SERS staff has been meeting with members of the new House Pensions Committee to provide information about SERS and brief them on the CBBC proposal. We continue to work toward reintroducing the CBBC legislation and engaging with ORSC staff and legislative leaders to identify the best way to move forward with our proposal.

Environmental, Social, and Governance (ESG) related legislation has been introduced in the Ohio legislature (SB 6) by Senator Kirk Schuring. Several other states have already passed legislation that limits investments with managers who manage assets in ESG-related industries. SERS continues to actively monitor this and any other legislation that could potentially affect our investment program and fiduciary duty to our membership.

### ***Federal Legislation***

A federal Windfall Elimination Provision (WEP)/Government Pension Offset (GPO) repeal bill, HR 82, has been reintroduced by Congressman Garret Graves (R-LA). It has 143 co-sponsors so far, including Joyce Beatty, Shontel Brown, and Michael Turner from Ohio. There is no Senate companion bill yet. Senator Sherrod Brown (D-OH) sponsored a WEP/GPO repeal bill last session.

### **Monthly Retirement and Survivor Benefit Transactions**

For February, the SERS Board approved 436 active members for service retirements, and 28 survivor benefits for spouses and/or dependents.

### **March Meeting Dates**

The next Board meeting will take place Thursday, March 16, and Friday, March 17, at 8:30 a.m. (if necessary).