ANNUAL REPORT – 2009

Kent County Pension Review Committee
Annual Report to Kent County Levy Court
February 18, 2010

Background

The Kent County Pension Review Committee was established by the Kent County Levy Court to advise the body on "the various aspects of the Kent County Employee Pension Fund." The Committee is composed of three members of the community appointed by Levy Court – including David Craik, Tom Leary, and Duke Strosser, the Kent County Finance Director Susan Durham, a Kent County Employee Council representative Kelly Crumpley, and the Kent County Comptroller Georgette Williams, who serves as an *ex officio* member. The Committee meets regularly on a quarterly basis to review the pension fund performance report and more often as needed to conduct additional business such as new fund manager interviews.

The Committee is also responsible for reviewing investment performance of the Retiree Benefits program (OPEB) invested with the State of Delaware Local Government OPEB Pool through the State Pension Office.

Kent County Levy Court serves as the Board of Trustees and is the fiduciary for both plans.

Investment Strategy

Per the Pension Investment Policy adopted by Kent County Levy Court, the Committee is committed to maintaining an average 60/40 asset investment ratio between equities (stocks) and fixed income (bonds).

The portfolio is structured to maintain an average balance of 25% for large capitalized growth stocks, 25% for large capitalized value stocks, 10% for international non-US growth stocks, and 40% for fixed income. Rebalancing can occur as necessary, but historically happens once per year upon transfer of the County's annual contribution.

During 2009, the Committee closely monitored the performance of the international equities fund manager and the large capitalized equities fund manager. To help preserve principal, it strategically maintained a higher fund ratio in fixed income and steered the contribution away from the underperforming international equities manager. On a quarterly basis the group reviewed the performance of the State of Delaware pension fund to help it determine the best time to transfer management of the retirement fund assets to the State Pension Office, as previously approved by Levy Court. Due to the unsettled market conditions, the Committee has continued to postpone the transfer.

Investment Managers

The Pension Fund's investment managers include INTECH (large cap growth) effective November 30, 2003; Wedge Capital Management (large cap value) effective September 30, 2004; McKinley Capital Management (international growth) effective November 30, 2007; and Amalgamated Bank (core bond) effective May 1, 2008. Segal Advisors Inc. serves as pension consultant responsible for independently evaluating investment manager performance. Wachovia Retirement Services performs pension custodian services including distribution of monthly pension checks/direct deposits.

Fund Performance

The stock market began to rebound from losses experienced in 2008 and the fund's performance improved by 17.52%. The fund value increased from $18.3 million to $21.2 million. This figure includes a $1,221,003 annual contribution recommended by the previous pension fund actuary, AON Consulting, in its report dated January 1, 2007 plus an additional $309,878 to cover the pension incentive cost. Over the one year period the total Fund increased 17.52% while the policy index (50% S&P 500/40% Lehman Brothers Aggregate/10% MSCI EAFE) increased 18.94% over the same time period. For the year, INTECH underperformed the Russell 1000 growth Index (37.21%) with a return of 27.07% in the large cap growth segment. Wedge grew 24.95% in the large cap value segment, which outperformed the Russell 1000 Value Index (19.69%). Amalgamated Bank returned 7.24% for the year while policy index Barclays Capital Aggregate returned 5.93% for the same time period. McKinley Capital Management continued to struggle with a return of 25.13% compared to the MSCI EAFE index which returned 31.78% for the year.

The retiree benefits fund managed by the State Pension office experienced modest gains during the year growing 22.9% through its commingled investments compared to 22.6% for the policy benchmark for a year end market value of $8,690,152.65, which included a $66,085.62 contribution ($475,000 less $408,914.38 for actual retiree benefit costs in FY2009). At year's end, 99 retirees received County health benefits, 19 dependents were covered, and 11 retirees waived coverage.

Actuarial Valuations

The biennial pension fund valuation was completed as of January 1, 2009 by the new pension actuary, SMART Business Advisory & Consulting Services, LLC and recommended a contribution of $2,133,498 for FY2010. The figure was significantly higher than the previous $1,221,003 and was attributed to fund losses due to the underperforming stock market, staff growth, and fund expenses due to annual cost of living adjustments. For the OPEB fund, the valuation recommended a contribution of $630,976, which was higher than the previous $475,000 and largely due to continued projected increases in national health care costs. In light of the continued volatility of the market, the Committee recommended and Levy Court approved changing from biennial to annual pension fund valuations. The next actuarial valuation is underway as of January 1, 2010 and the Committee is reviewing a proposal to change the fund's actuarial cost method and actuarial assumptions for the 2010 valuation. The OPEB valuation will continue to be conducted on a biennial basis.

Plan Changes

In an effort to help balance the FY2010 budget, Levy Court approved a one percent (1%) base salary pension deduction for all eligible active employees effective July 1, 2009, and a five-year additional service incentive or $15,000 lump sum payment for those active employees already eligible for a pension and agreeing to retire before June 1, 2009 (or July 1 for certain critical positions). The incentive was taken by 27 employees including two opting for the lump sum payment. The Committee recommended approval of the incentive plan conditioned upon a cost contribution to the plan. The actuary determined the fund impact to be $309,878, which was transferred to the fund along with the annual FY2009 contribution. The Committee also reviewed a number of other proposed pension plan amendments, but Levy Court ultimately did not adopt them. Levy Court did however approve an amendment to the Retiree Benefits program eliminating a "Rule of 70" eligibility provision.

Fund Expenses

Pension and fee payments are drawn from the fixed income (bond) segment and transferred to Wachovia on a monthly basis. For 2009, pension payments totaled $1,580,906.30 with a total of 173 recipients at year end. The annual fee for pension consultant Segal Advisors was $26,000, although the current agreement expired July 1, 2006. The fund custodian fee paid to Wachovia Retirement Services was $18,140.48 for processing checks, reports, and trades. The actuary expenses were $29,035.25 paid to SMART for the valuations, various studies, and pension benefit calculations ($27,730.25) and the former actuary for one benefit calculation and an audit information response ($1,305). The fund manager fees not assessed from proceeds totaled $21,953.33.

Comments and Recommendations

Calendar Year 2009 was a frenetic year for the pension fund. Fortunately the stock market began to recover some of the losses experienced in 2008. While the performance of the equity managers could have been better, the fixed income manager has proven itself a growth leader in this very difficult sector. The relationship with the new actuary has been very beneficial and the near simultaneous retirement of 27 employees due to the incentive program demonstrated the firm's commitment to exceed our expectations. Overall, the pension fund's performance improved in 2009, and the Committee is still optimistic that moving assets to the State program will enhance future performance. The Committee has no specific recommendations at this time, other than those from the pending cost method/assumptions study.