ANNUAL REPORT – 2017

The Kent County Pension Review Committee's Annual Report to Kent County Levy Court - February 15, 2018

Purpose and Structure

The Kent County Pension Review Committee was established in 1993 by Kent County Levy Court "to regularly review the investment performance of the Kent County Employee's Pension Fund, the Retiree Benefits Trust Fund, and other such funds as directed by Levy Court. The Committee oversees fund valuation processes, ensures compliance with applicable pension, OPEB, or other such funds rules and regulations, directs studies and fund manager searches, as necessary, and as a result makes prudent recommendations and reports to the Levy Court of Kent County regarding plan amendments, investment policies, investment strategies, professional fund manager(s) or trustee(s), investment advisor(s), etc."

The Committee includes four (4) citizens from the community with pension, investment, legal, or financial experience, the Kent County Administrator (by virtue of position), the Kent County Director of Finance (by virtue of position), and one Kent County employee representative nominated by the Kent County Employee Council or similar successor group. The current membership includes citizen member and Chairman David Craik, citizen member Timothy R. Horne, citizen member Christopher S. Smith, and citizen member Ronald D. Smith, Kent County Administrator Michael J. Petit de Mange, Kent County Finance Director and Vice-Chair Susan Durham, and Kent County Employee Council representative Kristopher Connelly. The Committee meets regularly on a quarterly basis to review the pension fund and OPEB performance reports and more often as needed to conduct additional business such as new fund manager interviews.

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 on March 11, 2014, the portfolio is structured to maintain an average balance of 22.5% for large capitalized US growth stocks, 22.5% for large capitalized US value stocks, 10% for international non-US growth stocks, 10% for balanced risk (GTAA), and 35% for fixed income. Rebalancing can occur as needed, but is typically initiated when the County's annual contributions are made. In 2017, the annual contribution ($2,166,460) was directed by the Committee into the RCTS Core Fixed Income account to replace regular pension payment/expense withdrawals and the portfolio was rebalanced with $1,200,000 from INTECH (large cap growth equities) and $1,400,000 from Wedge (large cap value equities) distributed to the RCTS Large Cap Core International ($500,000) and RCTS Core Fixed Income ($2,100,000) funds.

Dynamic pension fund growth in 2017 presented an opportunity to reduce portfolio volatility and offer consistent returns in various economic environments, so the Committee considered several portfolio diversification scenarios and ultimately recommended to Levy Court the addition of Emerging Markets Equities (2.50% target), High Yield Core Fixed Income (3.50% target), and Real Estate (4.00% target) exposures with requisite reductions in U.S. equities (from 45% to 40% target) and Core Fixed Income (35% to 30% target). At year end, the proposal and applicable fund manager recommendations were pending consideration by Levy Court.

Investment Managers

The Pension Fund's investment managers include INTECH (large cap growth) effective December 1, 2003; Wedge Capital Management (large cap value) effective October 1, 2004; Rogerscasey Target Solutions (international growth) effective June 1, 2013; Invesco (balanced risk/Global Tactical Asset Allocation) effective May 1, 2014; and RCTS Core Fixed Income (fixed income) effective January 1, 2015. Segal Marco Advisors serves as pension consultant responsible for independently evaluating investment manager performance. Wells Fargo Retirement Services performs pension custodian services including distribution of monthly pension checks/direct deposits.

Fund Performance

The pension fund's value increased $5.5 million by the end of 2017 to $40.2 million, up from $34.7 million the previous year. This figure includes a $2,166,460 annual contribution as recommended by pension fund actuary, The Nyhart Company, LLC., in its report dated January 1, 2016. Over the one year period the total Fund value increased +17.15% while the comparative policy index (S&P 500, Barclays U.S. Aggregate, MSCI EAFE) grew +13.29% over the same time period. For the year, INTECH was ahead of the Russell 1000 growth Index (+30.21%) with a return of +30.50% in the large cap growth segment. Wedge Capital returned +21.64% in the large cap value segment, which significantly outperformed the Russell 1000 Value Index (+13.66%). RCTS Core Fixed Income investments produced a modest +3.65% return compared to the Bloomberg Barclays U.S. Aggregate policy index (+3.54%) for the fixed income/bond segment. RCTS Target Solutions LLC (International Large Cap Core Equity) was slightly behind the benchmark with a healthy return of +24.96%, compared to the MSCI EAFE (Net) index which achieved +25.03% for the year. Invesco (Balanced Risk/Global Tactical Asset Allocation) lagged with a +10.96% return which underperformed the MSCI World/40% Bloomberg Barclays U.S. Aggregate Index (+14.90%).

The retiree benefits fund managed by the State of Delaware Pension Office lagged for the year with a +14.7% return through its commingled investments compared to +21.1% for the policy benchmark for a year end market value of $16,831,331.07, up considerably from $14.6 million in 2016, and included a net +$32,069.46 annual contribution ($785,111 less $753,041.54 for estimated retiree benefit costs in FY2017). At year's end, 103 retirees received County health benefits, 21 dependents were covered, and 17 retirees waived coverage.

Actuarial Valuations

The annual pension valuation was completed as of January 1, 2017 by Nyhart and recommended a contribution of $2,743,160 for Fiscal Year 2018. Kent County typically makes a partial contribution at the mid-point and near the end of the ensuing fiscal year. The figure was $576,700 higher than the previous $2,166,460 actuarial recommended contribution due largely to assumption and interest rate adjustments approved by Levy Court. The next pension plan actuarial valuation is underway as of January 1, 2018.

The biennial OPEB valuation was completed as of June 30, 2017 to reflect the new plan year adopted in 2016 per GASB 74/75 and recommended an annual contribution of $1,307,254 for FY2018 & FY2019. The figure was $522,143 higher than the previous $785,111 due largely to the interest rate assumption reduction from 8.00% to 7.75%. However, Levy Court budgeted an OPEB contribution of $1,366,633 for FY2018 based upon the preliminary actuarially determined contribution figure.

Plan Changes

Per Committee request, Nyhart completed a Pension Plan Experience Study dated January 2017 and Levy Court approved the Committee's recommendation on February 28, 2017 to: 1) discontinue the practice of granting cost of living adjustments to pension recipients; 2) change the mortality table to RP-2014 projected generationally with Scale SSA-2016 from 2006 with adjustments for Healthy versus Disabled lives; 3) adjust the Interest Rate from the current 8.00% to 7.75% for the January 1, 2017 valuation, then decrease to 7.50% for the January 1, 2018 valuation, and then finally to 7.25% for the January 1, 2019 valuation; 4) adjust the Salary scale from 3.50% to an age rated table; 5) adjust the Retirement rates table to align with actual experience; and 6) adjust the Termination rates table to align with actual experience.

Also at Committee request, Nyhart completed an OPEB Interest Rate Study dated January 2017 and Levy Court approved the Committee's recommendation on February 28, 2017 to reduce the Retiree Benefits (OPEB) program's annual discount rate (interest) assumption from 8.00% to 7.75% effective with the July 1, 2016 valuation with gradual 0.25% discount rate reductions in subsequent biennial valuations until achieving 7.00%.

Plan Benefit Review

In response to the financial impacts of approved assumption and interest rate adjustments, Levy Court requested the Committee develop specific recommendations to stabilize or reduce pension and OPEB program liabilities. At the Committee's behest, Nyhart developed a proposal and cost estimate ($30,000) for a Pension & OPEB Benchmarking & Cost Containment Study which was recommended for funding. Levy Court, however, took no action on the Committee's funding request, so the study was not initiated.

Fund Expenses

Pension and fee payments are drawn from the fixed income (bond) segment and transferred to Wells Fargo, on a monthly basis. For 2017, pension payments totaled $2,488,270.55 with a total of 205 recipients at year's end. The annual fee for pension consultant Segal Marco Advisors was $26,000. The fund custodian fee paid to Wells Fargo Retirement Services was $17,070.32 for processing checks, reports, and trades. Actuary expenses totaling $37,000.00 were paid to Nyhart for the valuations, various studies, and pension benefit calculations. In 2017, fund manager fees were $47,442.81 (INTECH-52bps), $48,599.30 (Wedge-55bps), $16,970.61 (Invesco-45bps), and no direct fees for the two RCTS funds. Except for Wedge, which is paid directly, such fees are assessed from investment proceeds. Retiree benefits fund (OPEB) custodian fee and investment manager/advisory fee expenses drawn from investment proceeds totaled $5,403.54 in 2017.

Comments and Recommendations

All asset classes experienced positive returns in 2017. Emerging Markets countries, at over 37%, led the way for the equity markets, due in part to the weakening of the US Dollar. The US stock market was up 21% and experienced 14 straight months of positive performance, due in part to strong corporate earnings and the anticipated tax reform bill. Market Volatility reached all-time lows during the year. Overall, the County's Pension fund gained over 17% for the year. The Committee appreciates Levy Court's prompt consideration of the portfolio diversification recommendation which will add new asset allocations to Emerging Markets Equities, High Yield Fixed Income, and Core Real Estate fund managers. While the portfolio's investment configuration is expected to be better positioned to achieve reduced return assumptions under most market conditions in the future, the Committee continues to recommend pension and OPEB benefit benchmarking with judicious structural adjustments (including elimination of COLAs) to preserve capital and moderate annual fiscal support.