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Sussex County
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PENSION FUND COMMITTEE

Minutes of Meeting

August 18, 2016

The Sussex County Pension Fund Committee met on August 18, 2016, at 10:00 a.m. in the County Council Chambers, Georgetown, Delaware. Those in attendance included members: Gina Jennings, Todd Lawson, Karen Brewington, Kathy Roth, Hugh Leahy, and Kathleen Ryan. Also in attendance were Michael Shone of Peirce Park Group, the County's Pension Investment Consultant; Janet Cranna, Margaret Tempkin, and Brett Warren, of Cheiron, the County's Actuary; as well as David Craik, Pension Administrator for the State's Pension Plan. Committee member David Baker was unable to attend.

On August 10, 2016, the Agenda for today's meeting was posted in the County's locked bulletin board located in the lobby of the County Administrative Offices, as well as posted on the County's website. Committee members were presented with a booklet containing information for today's meeting.

Ms. Jennings called the meeting to order.

1. **Approval of Minutes**

The minutes of the May 23, 2016 meeting were approved by consent.

2. **State of Delaware Pension Presentation**

Mr. David Craik, Pension Administrator for the State's Pension Plan was in attendance to discuss the State's portfolio. Mr. Craik distributed an Executive Summary, Returns versus Peers – Rolling 5 and 10 Year Periods, as well as an Asset Allocation. He noted that assets in the Delaware Public Employees' Retirement System (DPERS) were $8,842 million as of June 30, 2016, and had finished the second quarter with a 2.0 percent return. For the previous year, their return was -1.3 percent versus a benchmark of 1.2 percent. For the month of July only, the State's plan had earned a 1.9 percent return. Over the past year, underperformance was primarily due to energy-related investments, as well as master limited partnership (MLP) exposure; MLPs have rebounded (14.7 percent for the 2016 calendar year). The State also had three value managers that underperformed.

In comparison to other pension plans, 82 percent had outperformed the State on a rolling 5-year period, but the State ranked in the top 10 percent for a 10-year period.

The State's asset allocation as of June 30, 2016 included: Alternative Investments: 22.2 percent; Cash and Equivalents: 3.0 percent; Domestic Equities: 33.6 percent; International Fixed Income: 1.8 percent: Domestic Fixed Income: 29.2 percent; and International Equities: 10.2 percent. Included in alternative investments, the State has approximately a 2 percent exposure to hedge funds. Within the last year or two, the State reduced their assumed rate of return to 7.20 percent.

A short question and answer period followed. The Committee thanked Mr. Craik for his time and presentation.

3. **Effects of Lowering Investment Rate of Return**

Cheiron, the County's actuary, distributed a report entitled, "Proposed Assumption Change (Discount Rate)" for both the County's Pension and OPEB Plans. The County's current assumed investment rate of return is 7.50 percent. It was noted that a lower rate would result in higher contributions. Factors considered in selecting any rate of return include: context (industry trends and historical experience), expectations for the future, and the Committee's tolerance for risk. It was reported that since 2009, many other pension plans have reduced their investment return assumption; the average assumption is 7.62 percent, with a significant increase in the number of plans assuming 7.5 percent or lower. The following are the discount rates for other retirement systems in Delaware: Delaware State Employees: 7.20 percent; Delaware Municipal Employees: 7.20 percent; Delaware Municipal Police & Fire: 7.20 percent; City of Dover, Delaware: 7.00 percent; and the City of Wilmington: 7.50 percent.

The Committee was presented information showing the effects of decreasing the discount rate used in the pension valuation from 7.50 percent to 7.25 percent, as well as to 7.00 percent. Using 7.25 percent, an estimated Pension Plan contribution increase of $385,000 ($3,614,000 annually) would be expected; and a contribution increase of $785,000 ($4,014,000 annually) would be required using 7 percent. Currently, the County's pension contribution is $3,229,000 annually.

For the OPEB Plan, an estimated increase in contribution of $148,000 ($2,223,000 annually) would be needed at 7.25 percent, and an increase of $301,000 ($2,376,000) for a 7.00 percent assumed rate of return. Currently, the County's OPEB contribution is $2,075,000 annually.

With a 65 percent equity target, Mr. Shone recommended no higher than a 7.25 assumed investment rate of return. The Committee agreed that it would be prudent to lower the rate of return in smaller increments and concurred with 7.25 percent.

A Motion was made by Ms. Ryan, seconded by Mr. Leahy, for the Committee to make recommendation to the County Council to lower the investment rate of return for both the Pension and OPEB Plans to 7.25 percent.

Motion Adopted: 6 Yeas.

Vote by Roll Call: Ms. Brewington, Yea; Ms. Roth, Yea; Mr. Leahy, Yea;
Ms. Ryan, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

Ms. Jennings and the Committee thanked Ms. Cranna, Ms. Tempkin, and Mr. Warren for their presentation.

4. **Investment Analysis for the Quarter Ended June 30, 2016**

Mr. Shone distributed copies of a booklet entitled, "Sussex County Investment Performance Report, June 30, 2016". The Investment Performance Report includes information regarding the market environment for the second quarter of 2016, as well as quarterly and annual performances of the Pension and OPEB Plans. Although the report should be referenced for a more detailed analysis, discussion highlights include:

Mr. Shone referred members to Market Environment – 2nd Quarter of 2016 (Tab 1).

The second quarter saw a Gross Domestic Product (GDP) growth of only 1.2 percent, with the economic activity remaining soft; overseas, a number of countries have gone to negative interest rates. The personal savings rate ended May at its lowest level in 2016, at 5.3 percent. The global economic outlook became increasingly uncertain with the United Kingdom voting to leave the European Union (i.e., 'Brexit'); at that time, all the worldwide stock markets realized a decline. The equity market was mostly positive during the second quarter: U.S. equities: 2.6 percent for the quarter and 3.6 percent year-to-date, emerging market equities: 0.7 percent for the quarter and 6.4 percent for the year-to-date, although international equities realized negative returns of 1.1 for the quarter and 3.0 percent for year-to-date. Fixed income performed well: U. S. Bonds: 2.2 percent for the quarter (5.3 percent year-to-date); high yield bonds: 5.5 percent for the quarter (9.1 percent year-to-date), international bonds: 4.5 percent for the quarter (14.0 percent year-to-date), and Emerging Market Bonds: 3.5 percent for the quarter (15.0 percent year-to-date). Inflation sensitive assets, such as U.S. REITS, which finished the second quarter very positively – up 7.4 percent for the quarter and 13.7 percent for year-to-date – underperformed last year.

Value stocks were the big winners for the year: large value: 4.5 percent for the quarter (5.2 percent year-to-date), mid value: 4.8 percent for the quarter (8.9 percent year-to-date), and Small Value: 4.3 percent for the quarter (6.1 percent year-to-date).

Mr. Shone directed members to the Pension Fund Performance Report (Tab II).

As of June 30, 2016, the ending market value of the Pension Plan was $73.0 million (at the end of July 31, the value was $75.6 million, or a $2.5 million gain in July alone; and realized a second quarter investment gain of $1.3 million, as well as a 1-year (July 1, 2015 thru June 30, 2016) loss of $266,000. The Pension Plan lagged its policy index in the second quarter due to the performance of DuPont Capital and the State of Delaware. The State's plan has struggled over the past year; long-term their numbers have performed well, but have been low in their peer group over the last year, as well as having higher fees (68 basis points). Looking ahead: the review of the asset allocation (Investment Policy Statement and rebalancing) and the funding policy.

Mr. Shone noted that up until last quarter – when returns were reported for the County's investment managers and total fund – gross rates of returns were used

(before investment management fees). For the current quarter, both gross and net are given; going forward, only net results will be reported.

Since the beginning of 2012, the Pension Plan has ranked in the top 40 percent, and in the top 39 percent for a 3-year period.

DuPont Capital, for the quarter, was up 1.1 percent vs. a 2.5 percent benchmark; State of Delaware 1.9 percent vs. a 1.9 percent benchmark -- year-to-date: 2.4 vs. 3.6 percent, and one-year: -1.9 percent vs. 1.2 percent. It was noted that the asset allocation for DuPont Capital was all large core. Over time (5, 10, 20, and 30 years), Mr. Shone noted that mid cap and value have been the winners.

The ending market value of $73,994,465 included: DuPont Capital Investment: $14,402,323, Operating Account: $149,231, State of Delaware Investment Pool: $45,448,666, Vanguard Extended Market Index: $2,881,724, Vanguard Mid Cap Value: $2,576,969, Wilmington Trust Bonds: $8,535,552, and Wilmington Trust Short Term: $0. Over the last 3 years, the pension fund saw an investment gain of $13,610,685 million, or a 7.0 percent return.

As of June 30, 2016, Sussex County's Pension Asset Allocation included: State of Delaware Investment Pool: 61.4 percent; Cash: 0.2 percent; Domestic Fixed Income: 11.5 percent; and Domestic Equity: 26.8 percent.

Over the last 5 years, the Pension Fund realized a 7.0 percent return (gross) and ranked in the top 27th percentile nationwide (out of 250 public funds); 7.0 percent return for 3 years (top 22nd percent); and 1 year: - 0.2 percent (71st percent). For the quarter, the fund realized a return of 1.9 percent (47th percent), which was below the policy index of 2.0 percent. Since its inception, the pension plan has realized a return of 9.4 percent, which is slightly below the 9.7 percent policy index.

The portfolio returns (net) for the quarter: DuPont Capital Investment: 1.1 percent return versus benchmark of 2.5; Vanguard Extended Market Index (added October 2014): 3.4 percent (vs. 3.4 percent); Vanguard Mid Cap Value (added December 2014): 2.8 percent (vs. 2.8 percent); Wilmington Trust Bonds: 1.4 percent (vs. 1.6 percent); and State of Delaware Investment Pool: 1.9 percent versus a 1.9 percent benchmark.

Mr. Shone referred members to the <u>OPEB Fund Performance Report</u> (Tab III).

As of June 30, 2016, the ending market value of the OPEB Plan was $31.9 million and realized a second quarter gain of $487,000; and a 1-year gain of $576,000. The OPEB Plan lagged behind its policy index in the second quarter primarily due to underperformance by Thornburg Global Opportunities. Even with their underperformance, the plan outperformed its policy index over the last year due to strong returns by MFS Low Vol Global Equities. Looking ahead: In place of the continued monitoring of Thornburg, Peirce Park is recommending the removal of Thornburg from the County's portfolio.

A Motion was made by Ms. Ryan, seconded by Mr. Leahy, to approve and make recommendation to the Sussex County Council to terminate Thornburg Global

Opportunities and reallocate funds equally between the Vanguard International Index Fund and the Vanguard Institutional Index Fund.

Motion Adopted: 6 Yeas.

Vote by Roll Call: Ms. Brewington, Yea; Ms. Roth, Yea; Mr. Leahy, Yea; Ms. Ryan, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

As of March 31, 2016, Sussex County's OPEB Asset Allocation included: Domestic Equity: 44.5 percent; Global Equity: 12.4 percent; International Equity: 6.5 percent; Domestic Fixed Income: 35.5 percent; and Cash: 1 percent.

For the year, the OPEB Plan realized a 1.8 percent return (35th percentile) versus a 1.3 percent benchmark.

5. **Review Revised Investment Policy Statement**

Committee members were provided copies of two addendums to the Investment Policy Statement entitled, "The Sussex County, Delaware Employee Pension Plan Investment Policy Statement, Dated June 24, 2014, (Amended December 8, 2015); one reflects an equity target within the Delaware State Pool of 50 percent and the other 60 percent (no change).

Mr. Shone discussed both options, as well as the State's higher investment management fees of .68 percent, versus a national average of .45 percent for a plan of the County's size.

A Motion was made by Mr. Leahy, seconded by Ms. Ryan, to approve and make recommendation to the Sussex County Council, to adopt the addendum reducing the equity target within the Delaware State Pool from 65 percent to 50 percent, by increasing the equity target from 24 percent to 36 percent, and decrease the fixed income target from 16 percent to 14 percent, and it is the County's overall intent to maintain the targeted allocation of 65 percent equities and 35 percent fixed income.

Motion Adopted: 6 Yeas.

Vote by Roll Call: Ms. Brewington, Yea; Ms. Roth, Yea; Mr. Leahy, Yea; Ms. Ryan, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

6. **Possible Reallocation**

Committee members were presented with copies of "Sussex County – Portfolio Options, August 2016" prepared by Peirce Park. With the Committee's recommendation to decrease the State's equity target to 50 percent, Mr. Shone discussed implementation options.

A Motion was made by Mr. Leahy, seconded by Ms. Roth, to approve and make recommendation to the Sussex County Council to adopt the following equity target

implementation: S&P 500 Index Fund: increase 6.5 percent (24.0 percent), Vanguard Extended Market Index: increase 1.5 percent (5.0 percent), Vanguard Mid Cap Value Index: increase 2.0 percent (5 percent), Wilmington Trust FI: decrease 2 percent (12 percent), cash: remain at 2.0 percent, Delaware State Pool: decrease 10 percent (50 percent), and add Vanguard Total Int'l Stock Market Index of 2 percent.

Motion Adopted: 6 Yeas.

Vote by Roll Call: Ms. Brewington, Yea; Ms. Roth, Yea; Mr. Leahy, Yea; Ms. Ryan, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

7. **Review Proposed Funding Policy**

Committee members were presented with copies of funding policies for both the Pension and OPEB Plans. Ms. Jennings noted that simply stated, these policies put the County's practices into writing, with the ultimate goal of adoption by the Committee and County Council. Mr. Shone also noted that the funding policy includes assumption guidelines, including the actuarially determined contribution (ADC).

A question and answer period followed regarding the ADC, which included input from Cheiron. It was the consensus of the Committee for Cheiron to review the documents and make recommendation as to their desired language to be used in regards to the ADC. It was requested that this item be brought back at the November meeting for the Committee's consideration.

8. **Review Proposed Ordinance Changes to Pension Calculation**

Committee members were provided with copies of a handout, "Draft Ordinance Revising Computation of Pension Benefits for Sussex County Employees". The revisions reflect the needed modifications of the County's ordinance to revise 12-hour employees' pension calculation based on 42 hours versus 40 hours, and increasing eligible service by 5 years for all employees. With Council's agreement with these recommendations, Ms. Jennings noted that the next step would be for the recommendations to go to the County's Personnel Board for a public hearing; the intent is to have the Public Hearing on October 13, 2016. The last step would be the adoption of the revisions by County Council.

9. **Additional Business**

No Additional Business.

6. **Adjourn**

At 11:22 a.m., a Motion was made by Ms. Roth, seconded by Mr. Leahy, to adjourn.

Motion Adopted: 6 Yeas.

Vote by Roll Call: Ms. Brewington, Yea; Ms. Roth, Yea; Mr. Leahy, Yea; Ms. Ryan, Yea; Mr. Lawson, Yea; Ms. Jennings, Yea

The next meeting of the Pension Fund Committee is scheduled for November 17, 2016, at 10:00 a.m. in the Sussex County Council Chambers.

Respectfully submitted,

Nancy J. Cordrey
Administrative Secretary