ANNUAL REPORT – 2020

The Kent County Pension Review Committee's Annual Report to Kent County Levy Court - February 18, 2021

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 the plans.

Investment Strategy
Per the revised Pension Investment Policy and Guidelines adopted by Kent County Levy Court on November 13, 2018, the portfolio is structured to maintain an average balance of 20% for large capitalized US growth stocks, 20% for large capitalized US value stocks, 10% for international (developed) non-US growth stocks, 10% for balanced risk (Global Tactical Asset Allocation), 4.00% for core real estate, 2.50% for emerging markets, and 33.5% for fixed income. Rebalancing can occur as needed, but is typically initiated when the County's partial annual contributions are made.

Investment Managers
The Pension Fund's investment managers include INTECH (U.S. large cap growth) effective December 1, 2003; Wedge Capital Management (large cap value) effective October 1, 2004; Invesco Balanced Risk (Global Tactical Asset Allocation) effective May 1, 2014; RCTS Emerging Markets Equities effective March 1, 2018; Principal US Property (core real estate) effective March 1, 2018, Fixed Income Group Trust/MCG Group Trust (fixed income) effective January 1, 2019; and AQR International Equity (large cap international growth) effective January 1, 2019. Segal Marco Advisors serves as pension consultant responsible for independently evaluating investment manager performance. Wells Fargo Retirement Services (acquired by Principal in mid-2019) performs pension custodian services including distribution of monthly pension checks/direct deposits.

Fund Performance
The Pension Fund's value increased $6.1 million by the end of 2020 to $51 million, up from $44.9 million the previous year. This figure includes a $3,408,100 annual contribution as recommended by pension fund actuary, The Nyhart Company, LLC., in its report dated January 1, 2019. Over the one year period, the total Fund value increased +13.4% while the comparative policy index (S&P 500, Barclays U.S. Aggregate, MSCI EAFE, etc.) increased +11.9% over the same time period. For the year, INTECH lagged the Russell 1000 Growth Index with a return of +30.1% vs. +38.5% in the large cap growth segment. Wedge Capital was way up +7.0% in the large cap value segment, compared to the Russell 1000 Value Index at +2.8%. Segal Marco Fixed Income Group Trust investments recorded a respectable +9.0% compared to the Bloomberg Barclays U.S. Aggregate policy index at +7.5% for the fixed income/bond segment. AQR International Equity Fund II (International Large Cap Core Equity) was behind the benchmark with a +4.9% return, compared to the MSCI

EAFE (Net) index which increased +7.8% for the year. Invesco (Balanced Risk/Global Tactical Asset Allocation) underperformed with a +11.2% return compared to the MSCI World/40% Bloomberg Barclays U.S. Aggregate Index benchmark at +13.7%. RCTS Emerging Markets Equity-RBC/Wells was ahead with a +20.6% return compared to +19.7% for the MSCI EM (net) policy benchmark. Finally, the Principal US Property Account struggled at +0.5% return compared to +1.6% for the NCREIF ODCE Equal Weighted benchmark for the real estate allocation.

The retiree benefits fund managed by the State of Delaware Pension Office was up with a return of +20.6% through its commingled pension fund investments compared to +14.5% for the policy benchmark for a year end market value of $24,189,408.52, up considerably from $19,327,040.06 in 2019, and included a net +$719,836 annual contribution ($2,154,449 less $1,434,613 for estimated retiree benefit costs in FY2020). At calendar year's end, 120 retirees received County health benefits, 28 covered dependents, and 19 retirees waived coverage.

Actuarial Valuations

The annual pension valuation was completed as of January 1, 2020 by Nyhart and recommended a contribution of $4,125,794 for Fiscal Year 2021. The figure was $717,710 higher than the previous $3,408,084 actuarially determined contribution due largely to an assumption for future 1% cost of living increases for retirees from active service, a recurring practice by Levy Court despite an adopted assumption to award no COLAs. Kent County typically makes a partial contribution at the mid-point and near the end of the ensuing fiscal year. The next pension plan actuarial valuation is underway as of January 1, 2021.

The OPEB interim valuation was completed as of June 30, 2020 and recommended an annual contribution of $2,514,908 for FY2022. The figure was $220,929 lower than the previous $2,735,837 OPEB contribution recommendation, due largely to better than expected asset performance and repeal of the ACA excise tax and in spite of implementation of another planned interest rate assumption reduction from 7.50% to 7.25%. The gradual 0.25% discount rate assumption reductions are programmed to continue for each biennial valuation until achieving 7.00% for FY2024.

Plan Amendments

An amendment to the retirement program adopted on November 12, 2019 increasing the employee contribution from 3% to 5% of base salary after the first $6,000 for new entrants was effective January 1, 2020, but had no immediate effect on the 2020 valuation. The increased contribution is projected to reduce the annual pension contribution by $8 million over the next 30 years. No plan amendments were adopted in 2020.

Plan Benefit Review

At the request of Levy Court, the Committee reviewed additional analysis provided by another actuary of OPEB plan design alternatives seeking potential cost saving measures. The Grant Thornton report generally confirmed a previous analysis, but the Committee continued to take no position on any of the 10 alternatives including implementation of a graduated (sliding scale) cost share for retiree health benefits based upon years of service. Levy Court had previously considered a sliding scale cost share similar to that offered by the State of Delaware, but did not take action as the favored "new hires only" scenario appeared to offer no significant reduction of the annual OPEB contribution over the next 20 years.

OPEB Assumptions

With favorable recommendations by the Committee in late 2019, Levy Court approved several pandemic delayed revisions to OPEB assumptions including an update of the mortality table, termination rate table, and employer funding policy with a total estimated +$236,000 contribution impact. Revisions by the actuary to the annual rate of salary increases assumption and retirement rate table with an estimated +$190,000 impact were not favored. The updated assumptions are expected to be included in the June 30, 2021 valuation.

Deferred Compensation

Following Levy Court selection of a 457(b) retirement plan consultant – Strategic Retirement Partners in late 2019, the Committee has provided guidance throughout the Recordkeeping & Administration Services RFP and vendor selection process and ultimately recommended retention of the current provider and engagement of a consultant for specific investment funds selection and annual fund performance review.

Fund Expenses

Pension and fee payments are drawn from the fixed income (bond) segment and transferred to Wells Fargo, on a monthly basis. For 2020, pension payments totaled $3,187,434.88 with a total of 241 recipients at year's end. The annual fee for pension consultant Segal Marco Advisors was $38,000. The fund custodian fee paid to Wells Fargo Retirement Services was $20,626.77 for processing checks, reports, and trades. Actuary expenses totaling $21,785.00 were paid to Nyhart for the valuation, pension statements, pension modeling reports, and pension benefit calculations. In 2020, fund manager fees were $59,074.46 (INTECH-52bps), $43,561.29 (Wedge-55bps), $16,010.10 (Invesco-38bps), and no direct fees for the AQR (60bps), RCTS (91bps), FIGT (26bps), or Principal (110bps) funds. Except for Wedge, which is paid directly, such fees are assessed from investment proceeds. Retiree benefits fund (OPEB) net fees drawn from investment proceeds totaled $46,195.77 for DELRIP expenses, $3,000 was paid to Nyhart for the interim valuation/GASB 75 report, and $20,000 was paid to Grant Thornton for an OPEB modeling study in 2020.

Segal Marco Advisors performs pension consulting services for an annual fixed fee of $38,000, and The Nyhart Company performs actuarial services as follows: Annual pension valuation - $13,750; Biennial OPEB valuation - $7,000; Pension certificates - $275 each; Biennial pension statements - $2,750; Interim GASB 75 reports - $3,000; and Misc. services - $415/hour.

Comments and Observations

2020 will forever be remembered as the year of the global pandemic, COVID-19. Its impact was far-reaching on economies and financial markets.

The S&P 500 closed out the year with a return of +18.4%, even after falling 34% in March. While the economy was impacted on many fronts by COVID, stocks continued looking ahead, and were boosted by the approval and initial distribution of new vaccines. Within the U.S., growth stocks, as measured by the Russell 1000 Growth index finished the year up 38.5%, while value stocks, measured by the Russell 1000 Value index finished the year up 2.8%. This differential between value and growth stocks was the largest in at least a quarter century. Meanwhile, the rapid rebound by small caps continued, with small stocks returning +20.0% for the year. Outside of the U.S., despite further lockdowns in Europe, the developed markets international equities returned +7.8% for the year. These returns paled in comparison to emerging markets' 2020 gains. EM stocks rose +18.3% for the year: in-line with the S&P 500. A seemingly sustained economic recovery in China (China stocks returned 29.7%), firmer prices for various types of commodities and a sliding U.S. dollar have powered stocks of companies in the emerging world.

On the other hand, fixed income ended the year quietly after a strong start to the year. The Barclays Aggregate Index returned 7.5% for the year, with yields ending the year at historic lows. The majority of the index's return came in the first half of 2020, with the Aggregate up 6.1% through June. With credit markets healing throughout the year, the new issue market continued to hit record levels.

Looking ahead to 2021, we believe that interest rates in the U.S. will remain low at least during the next 12 to 18 months. Further, we believe inflation will remain in check for the time being as it will take some time for improvements in the labor market to have an impact on prices. Fiscal and monetary stimulus are likely to continue on the current path, although perhaps the latter at a faster pace with the new U.S. administration's greater concern for jobs and growth versus the impact of debt and deficits. We see these conditions being an accurate description not only of the U.S. but of the rest of the developed world. Finally, we believe that, in general, sentiment from manufacturers, businesses and consumers is getting back on track to pre-COVID levels. The County's Pension Fund gained 13.4% for the year.

For the longer term, the Committee continues to recommend Levy Court refrain from awarding regular COLAs to retirees, pensioners, & beneficiaries per the approved pension plan assumptions in order to moderate growth of liabilities and temper escalation of the annual actuarially determined contribution.