

ANNUAL REPORT – 2021

The Kent County Pension Review Committee's Annual Report to Kent County Levy Court - February 17, 2022



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 membership includes citizen member and Chairman David Craik, citizen member Timothy R. Horne, citizen member Christopher S. Smith, and citizen member Tammy Ordway (appointed November 23, 2021) who replaced Ronald D. Smith (resigned August 25, 2021), 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. Due to significant asset growth, the Committee has recommended revisions to the Policy & Guidelines to add investment exposures in small-to-mid sized capitalized equities (SMIDS), passive portfolios, and opportunistic private markets portfolios with revised target allocations as well as minor procedural adjustments.

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. (Near the end of the year, the Committee initiated liquidation of assets with AQR and temporary investment with a State Street Global Advisors international equity index fund until a new fund manager search can be concluded). 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 \$8.6 million by the end of 2021 to \$59.6 million, up from \$51 million the previous year. This figure includes a \$4,125,794 annual contribution as recommended by pension fund actuary, The Nyhart Company, LLC, in its report dated January 1, 2020. Over the one year period, the total

Fund value increased +15.9% while the comparative policy index (S&P 500, Barclays U.S. Aggregate, MSCI EAFE, etc.) increased +12.3% over the same time period. For the year, INTECH was ahead of the Russell 1000 Growth Index with a return of +29.8% vs. +27.6% in the large cap growth segment. Wedge Capital was up +33.2% in the large cap value segment, compared to the Russell 1000 Value Index at +25.20%. Segal Marco Fixed Income Group Trust investments posted -0.6% for the year compared to the Bloomberg Barclays U.S. Aggregate policy index at -1.5% for the fixed income/bond segment. AQR International Equity Fund II (International Large Cap Core Equity) was behind the benchmark with a +6.5% return, compared to the MSCI EAFE (Net) index which increased +11.3% for the year. Invesco (Balanced Risk/Global Tactical Asset Allocation) lagged a bit with a +11.2% return compared to the MSCI World/40% Bloomberg Barclays U.S. Aggregate Index benchmark at +12.3%. RCTS Emerging Markets Equity-RBC/Wells underperformed the market with a -6.9% return compared to -2.5% for the MSCI EM (net) policy benchmark. Finally, the Principal US Property Account posted a +22.4% return compared to +22.6% 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 +24.4% through its commingled pension fund investments compared to +12.9% for the policy benchmark for a year end market value of \$31,435,501.65, up considerably from \$24,189,408.52 in 2020, and included a net +\$683,935 annual contribution (\$2,154,449 less \$1,470,514 for estimated retiree benefit costs in FY2021). At calendar year's end, 131 retirees received County health benefits, of those 33 covered dependents, and 20 retirees waived coverage.

Actuarial Valuations

The annual pension valuation was completed as of January 1, 2021 by Nyhart and recommended a contribution of \$3,986,462, but Levy Court budgeted a slightly higher \$4,125,794 for Fiscal Year 2022. The actuarially determined contribution was \$139,332 lower than the previous year due largely to investment performance and a change of the mortality improvement scale to Scale MP-2020 to better reflect anticipated plan experience. 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, 2022.

The OPEB biennial valuation was completed as of June 30, 2021 and recommended an actuarially determined contribution of \$2,521,091 for FY2023. The figure was \$6,183 higher than the previous \$2,514,908 interim OPEB contribution recommendation, which was lower than the budgeted figure of \$2,735,837 for the Fiscal Year 2022, which was based on the prior biennial report.

Following an RFP solicitation, the Committee recommended and Levy Court engaged Milliman as the County's new actuary for the pension and OPEB plans effective January 1, 2022. The Committee recognizes and appreciates the high quality work completed by The Nyhart Company for the past six years.

Pension & OPEB Plan Amendments

None.

OPEB Assumptions

As recommended by the Committee in late 2019, Levy Court approved several pandemic delayed revisions to OPEB assumptions which were included in the June 30, 2021 valuation as follows:

1. The Mortality table has been updated from RP-2000 Combined Mortality Table with mortality improvement projected to 2016 using Scale AA to RP2014 Total Mortality Table with fully generational improvements projected from 2006 based on Scale MP-2020. The impact of this change is an increase in liabilities.
2. The termination rate, retirement rate, and salary scale assumptions have been updated to those used in the 2021 Pension Plan of Kent County, Delaware actuarial valuation. The net impact of these changes is an increase in liabilities.
3. Health care trend rates have been reset to an initial rate of 8.0% decreasing by 0.5% per year to an ultimate rate of 4.5% and dental trend rates have been reset to an initial rate of 4.50% decreasing by 0.25% per year to an ultimate rate of 3.50%. The impact of this change is an increase in liabilities.

The discount rate will decrease one quarter percent to 7.00% for FYE 2022 and all subsequent valuations.

Deferred Compensation

In March 2021, Levy Court selected ICMA-Retirement Corporation (now MissionSquare) for 457(b) Recordkeeping & Administrative Services and assigned the Committee authority to review performance reports and approve investment fund selection, and perform other duties consistent with those exercised for the County's pension program. Segal Marco Advisors was also selected as the plan consultant and initiated revisions to the tier investment structure including replacement fund selection in an effort to enhance investment performance and reduce fees. In November 2021, the Committee approved a new tier structure reducing the number of funds from 36 to 22 for the \$9.2 million held, including the addition of two large cap equity investment funds, with implementation expected to be completed in early 2022.

Fund Expenses

Pension and fee payments are drawn from the fixed income (bond) segment and transferred to Wells Fargo, on a monthly basis. For 2021, pension payments totaled \$3,492,351.78 with a total of 255 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 \$20,285.66 for processing checks, reports, and trades. Actuary expenses totaling \$19,501.00 were paid to Nyhart for the valuation, pension statements, pension modeling reports, and pension benefit calculations. In 2021, fund manager fees were \$52,465.11 (INTECH-52bps), \$60,002.66 (Wedge-55bps), \$19,287.89 (Invesco-38bps), and \$4,333 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 \$66,444.16 for DELRIP expenses, and \$7,000 was paid to Nyhart for the valuation/GASB 75 report. Fees related to 457(b) recordkeeping/investments are incurred by the plan participants. No costs were expensed to the new Deferred Compensation Administrative Allowance Account in 2021 for consulting services.

Segal Marco Advisors performs pension consulting services for an annual fixed fee of \$38,000 and 457(b) consulting services for an annual fixed fee of \$8,000. 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

2021 was generally a strong year for the financial markets. US Stocks led the way, with the S&P500 up 29% for the year. International developed stocks saw strong double digit returns as well. Emerging markets on the other hand, finished the year in negative territory, as developing countries struggled to keep pace with COVID vaccination rates and economic re-openings. Bond returns were negative for the year, as interest rates began to rise, particularly on the longer end of the yield curve. The Federal Reserve kept short term borrowing rates steady, at 0-0.25%. Unemployment numbers in the US continued to decrease, at a faster pace than other developed nations. Supply chain bottlenecks became an issue, leading to even lower available supply for already pent-up consumer demand.

Looking forward to 2022, the major themes to keep a close eye on are: COVID, interest rates, inflation and geopolitical tensions. The County's Pension Fund gained 15.9% for the year and the OPEB fund increased 24.4%.

Finally, the Committee appreciates the Levy Court's continued confidence and its prompt consideration of the investment objectives and policy statement revisions to permit further fund diversification with new exposure to Small-Mid (SMID) Cap US Equity and Opportunistic Private Markets as pension assets approach \$60 million.