ANNUAL REPORT – 2011

The Kent County Pension Review Committee's Annual Report to Kent County Levy Court - February 23, 2012

Structure and Purpose

The Kent County Pension Review Committee was established by 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 knowledgeable members of the community appointed by Levy Court – including David Craik, Tom Leary, and Duke Strosser (resigned effective 02/04/12), 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 2011, the Committee continued to closely monitor the erratic performance of the international equities fund manager and on a quarterly basis 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. Levy Court considered the asset transfer issue in late 2010 and again in early 2011, but opted to continue to wait until consistent growth of the equity market appeared certain and principal was fully recovered. The Committee's recommendation that $5 million be retained with the fixed income manager to minimize the slightly higher risk of the State's investment portfolio and that another $1.5 million be retained to pay annual pension benefits was viewed favorably.

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. Wells Fargo Retirement Services performs pension custodian services including distribution of monthly pension checks/direct deposits.

Fund Performance

While much less than the 13.55% return experienced in 2010, the pension fund's investments did grow in 2011 at a very modest rate of 2.25%. The fund value remained virtually unchanged at $24.4 million. This figure includes a $1,539,554 annual contribution recommended by pension fund actuary, LECG, LLC, in its report dated February 16, 2011 and $14,663 for a special pension benefit granted by Levy Court to a retiring employee by Resolution #3182. Over the one year period the total Fund value increased 2.25% while the comparative policy index (50% S&P 500/40% Lehman Brothers Aggregate/10% MSCI EAFE) grew 3.18% over the same time period. For the year, INTECH was slightly behind the Russell 1000 growth Index (2.64%)

with a return of 2.22% in the large cap growth segment. Wedge Capital returned 1.97% in the large cap value segment, which outperformed the Russell 1000 Value Index (0.39%). Amalgamated Bank investments increased a notable 7.93% for the year while policy index Barclays Capital Aggregate returned 7.84% for the same time period. International Equity Manager McKinley Capital Management continued to struggle with a loss of 16.45% compared to the MSCI EAFE index which was down 12.14% for the year.

The retiree benefits fund managed by the State Pension Office experienced very modest gains during the year growing 0.5% through its commingled investments compared to 0.9% for the policy benchmark for a year end market value of $9,799,994.12, which included a net $44,365.48 contribution ($630,976 less $586,610.52 for actual retiree benefit costs in FY2011). At year's end, 90 retirees received County health benefits, 17 dependents were covered, and 11 retirees waived coverage.

Actuarial Valuations

Due to the improving stock market, Levy Court decided in 2009 to conduct annual pension fund valuations and approved updates to the actuarial cost method and actuarial assumptions in early 2010. The valuation was completed as of January 1, 2011 by LECG, LLC, which was acquired by GrantThornton, LLC during the year, and recommended a contribution of $1,527,494 for FY2012. The figure was $12,060 lower than the previous $1,539,554 and was attributed to the improving stock market, static pay rates, and fewer employees. The next pension plan actuarial valuation is underway as of January 1, 2012. The OPEB valuation was completed as of January 1, 2011 and recommended an annual contribution of $661,025 for FY2012 and FY2013. The figure was $30,049 higher than the previous $630,976. The OPEB valuation is conducted biennially and is next scheduled for January 1, 2013. An RFP for actuarial consulting services was issued in September 2011 garnering 9 higher cost responses, but upon Committee recommendation Levy Court rejected the proposals and accepted a 3-year extension of the existing agreement with GrantThornton with no cost increases.

Plan Changes

An application for an IRS Governmental Plan Determination Letter was submitted by the January 31, 2011 deadline and it generated a series of questions regarding the plan's history and compliance with various regulatory provisions. The Actuary responded to those issues in September 2011. There has been no further contact from the IRS. A number of changes to the plan as recommended by Pension Attorney Carol Calhoun will likely be necessary to achieve the determination, but formal action is pending notification by the IRS of other needed amendments. In October 2011, Levy Court approved an amendment to the pension ordinance, which waives an employee's pension contribution during any full month of active military duty. Also in 2011, successor collective bargaining agreements were approved, which removed a one-year "no benefits change" provision. As a result, new members of the two unions became covered by the 2010 plan amendments which lowered the multiplier to 1.85%, increased the pension deduction under the IRS employer pick up provision to three percent (3%) of base salary less $6,000, and raised the vesting period to 8 years – all were effective retroactively to the respective adoption dates.

Fund Expenses

Pension and fee payments are drawn from the fixed income (bond) segment and transferred to Wells Fargo, on a monthly basis. For 2011, pension payments totaled $1,886,340.27 with a total of 171 recipients at year's 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 Wells Fargo Retirement Services was $16,041.05 for processing checks, reports, and trades. Actuary expenses were $20,477.50 paid to LECG/GrantThornton for the valuations, various studies, and pension benefit calculations. Pension Attorney (Calhoun Law Group) expenses were $8,000 and $1,000 was paid to the U.S. Treasury for the IRS determination letter. Fund manager fees (Wedge) not assessed from proceeds totaled $34,184.73.

Comments and Recommendations

In 2011, the equity markets reversed mid-year losses to remain in positive territory by the end of the fourth quarter, which benefitted the fund. Two of the equity managers paralleled the indices, and the fixed income manager remains a growth leader in a difficult sector. Overall, the pension fund's performance was tepid in 2011, but the Committee remains optimistic that fund value will grow with the improving economy. The Committee has no specific recommendations at this time, but wishes to acknowledge former member Duke Strosser's valuable contributions over the past 15 years and encourages prompt appointment of a successor.