ANNUAL REPORT – 2013

The Kent County Pension Review Committee's Annual Report to Kent County Levy Court - February 20, 2014

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, Ronald D. Smith, and Christopher S. Smith (appointed effective 11/19/13), the Kent County Finance Director Susan Durham, Kent County Employee Council representative Kristopher Connelly, 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 2013, after several years of monitoring State of Delaware pension fund performance, Levy Court withdrew its previous support for moving full retirement fund asset management to the State Pension Office. The Committee supported final resolution of this matter and promptly recommended the Rogerscasey Target Solutions LLC managed RCTS Large Cap Core International Equity portfolio as the new international equity fund manager to replace the long underperforming McKinley Capital Management LLC. The Committee also initiated searches for a more actively managed fixed income portfolio and a fifth fund manager with exposure in the commodities market.

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; Amalgamated Bank (core bond) effective May 1, 2008; and Rogerscasey Target Solutions LLC (international growth) effective June 1, 2013. Segal Rogerscasey LLC 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 $5.2 million by the end of 2013, up from $26.7 million the previous year. This figure includes a $1,478,654 annual contribution recommended by pension fund actuary, Grant Thornton, LLC, in its report dated February 23, 2012. Over the one year period the total Fund value increased +21.93% while the comparative policy index (S&P 500,Barclays U.S. Aggregate, MSCI EAFE) grew +16.70% over the same time period. For the year, INTECH was ahead of the Russell 1000 growth Index (+33.48%) with a return of +33.96% in the large cap growth segment. Wedge Capital returned +35.54% in the large cap value segment, which outperformed the Russell 1000 Value Index (+32.53%). Amalgamated Bank investments underperformed a notable -2.13% compared to the Barclays Capital Aggregate policy index (-2.02%) for the fixed income/bond segment. McKinley Capital Management (International Large Cap Core Equity) rebounded with a gain of +7.2%, but was replaced after five years (01/01/2008) by RCTS Target Solutions LLC on June 1, 2013, which posted a gain of +14.48% compared to the MSCI EAFE index which returned +13.75 for the same period and was +22.78 for the year.

The retiree benefits fund managed by the State Pension Office experienced good gains during the year growing +14.36% through its commingled investments compared to +14.12% for the policy benchmark for a year end market value of $12,810,048.35, which included a net $197,521.75 contribution ($661,025 less $463,503.25 for estimated retiree benefit costs in FY2013). At year’s end, 93 retirees received County health benefits, 17 dependents were covered, and 15 retirees waived coverage.

Actuarial Valuations

The annual valuation was completed as of January 1, 2013 by Grant Thornton, LLC and recommended a contribution of $1,418,125 for FY2014. The figure was $60,529 lower than the previous $1,478,654 and was attributed to the improving stock market. At the recommendation of the Committee, Levy Court opted to budget the higher January 1, 2012 contribution figure for FY2014. The next pension plan actuarial valuation is underway as of January 1, 2014. The biennial OPEB valuation was completed as of January 1, 2013 and recommended an annual contribution of $616,016 for FY2014 & FY2015. The figure was $45,009 lower than the previous $661,025. The next OPEB valuation will be completed in 2015.

Plan Changes

On September 27, 2013, the IRS approved the County’s application for a favorable Governmental Plan Determination Letter originally submitted on January 31, 2011 as a late amender for GUST. The tax exempt determination required several plan amendments to incorporate language related to various pension provisions adopted by the U.S. Congress since 1974. Levy Court approved the proposed amendments submitted with the original application on February 12, 2013 (Ordinance #13-03) and additional recommended amendments on May 28, 2013 (Ordinance #13-09). In addition, Levy Court agreed to participate in a Closing Agreement Program and pay a $10,500 sanction. IRS regulations require resubmission of a determination letter application every 5-years under Cycle “C”, which was completed by the January 31, 2014 deadline.

Fund Expenses

Pension and fee payments are drawn from the fixed income (bond) segment and transferred to Wells Fargo, on a monthly basis. For 2013, pension payments totaled $1,967,256.15 with a total of 179 recipients at year’s end. The annual fee for pension consultant Segal Rogerscasey was $19,500 (4th quarterly payment of $6,500 is not included as it was paid in early 2014), although the current agreement expired July 1, 2006. The fund custodian fee paid to Wells Fargo Retirement Services was $15,318.05 for processing checks, reports, and trades. Legal fees totaling $2,860 were paid to Calhoun Law Group P.A. for document review and opinions. Actuary expenses totaling $16,980.50 were paid to Grant Thornton for the valuation, various studies, and pension benefit calculations. In 2013, fund manager fees were $43,636.05 (INTECH-0.52%), $43,682.24 (Wedge-0.55%), $11,348.05 (McKinley-1.00% thru May 31, 2013), and $10,208.226 (Amalgamated-0.12%). Except for Wedge, which is paid directly, such fees are assessed from investment proceeds. Retiree benefits fund (OPEB) fees and expenses drawn from investment proceeds totaled $2,615.72 in 2013

Comments and Recommendations

The equity markets set successive performance records in 2013, even while U.S. economic recovery continued at an anemic pace. The Federal Reserve’s monetary stimulus effort buoyed stocks, but pushed the fixed income sector into unprecedented negative territory. As a result, the County’s pension fund assets have grown to a record level and now afford an opportunity to further diversify the portfolio. The Committee recommends a Global Tactical Asset Allocation strategy to bring commodities and currencies into the asset mix with a requisite investment policy amendment, and selection of a fixed income manager with a solid record of outperforming the indices. Finally, the Committee would like to express its appreciation to former member Tom Leary, who decided to retire this past summer, for his sage counsel over the past 10 years, and welcomes a very capable replacement in Chris Smith.