NORTHAMPTON COUNTY RETIREMENT BOARD MINUTES

SEPTEMBER 11, 2015

10:00 AM

1. **Call of the Role.** The following members of the Retirement Board were present: Mr. John A. Brown, Mrs. Margaret Ferraro, Mr. Glenn Geissinger, Mr. Jim Hunter, Mr. Hayden Phillips, Ms. Cindy Smith and Mr. John Stoffa.

Others present:
Mr. Doran Hamann, Budget Administrator
Mr. Brandon Dunstane, Fiscal Administrator
Mr. Gerald Seyfried, Retiree
Mr. Michael Shone, Investment Management Consultant - Peirce Park

2. **Courtesy of the Floor**

Mr. Gerald Seyfried asked the Board if the Retiree Association could once a year obtain a list of all Retirees, their addresses and a list of deceased Retirees. Mr. Seyfried explained that this information had previously been provided by the Fiscal Administrator via information from Bank of New York. Mr. Seyfried stated that this information is used to provide the newsletter and luncheon announcement to all Retirees. Mr. Brown stated that would not be a problem and that the County would provide the list to Mr. Seyfried first quarter of the year. Mr. Seyfried stated that the next Retiree luncheon will be October 13, 2015.

3. **Approval of the June 5, 2015 Retirement Board Minutes**

Mr. Stoffa made a motion to approve the Minutes. Mr. Brown seconded the Motion. The voting was as follows:

Ayes: Mr. Brown, Mrs. Ferraro, Mr. Geissinger, Mr. Hunter, Mr. Phillips, Ms. Smith and Mr. Stoffa.

Nayes: None

✓ **Minutes Approved**

4. **County Retirement Plan Determination Letter Process**

Ms. Schintz distributed the memo from HayGroup which outlines the process by which with the approval of the Retirement Board, the HayGroup submits the retirement plan to the IRS for determination as to whether the plan satisfies the various federal requirements for retirement plans. As stated in the HayGroup memo "the IRS determination letter is confirmation that the retirement plan document meets all applicable federal requirements. Without an IRS determination letter there is a risk that the IRS could audit the plan and find that it does not been the federal requirements for the plan's tax-exempt status. If that were to occur, plan contribution and earnings would all become taxable to the plan participants. " Ms. Schintz indicated that this was previously done in 2011 with the plan receiving a favorable response from the IRS in 2014. Ms. Schintz stated that the cost outlined in the HayGroup letter is between $1000 - $3,500 range and an additional $2,500 IRS filing fee. Ms. Schintz stated that we would need a motion from the Board to move this forward. Mr. Stoffa asked whether the County needs to do this. Mr. Shone stated that he would recommend it. Mr. Shone remarked that Corporations have been doing this for decades. Mr. Shone indicated that he is hearing that this may be the last year that public entities will have to file this document. Mr. Shone remarked that the purpose of the submission and review is so that the IRS can determine that the design of the plan meets the qualification that is known as a *qualified retirement plan.* Mr. Shone continued, the money that goes into the plan is tax deferred, and if the plan is deemed "not qualified" all of those funds become taxable.

Mr. Stoffa made a motion to have Hay Group update the Retirement Plan Document and submit to the IRS for another favorable Determination Letter. Mr. Hunter seconded the Motion. The voting was as follows:

Ayes: Mr. Brown, Mrs. Ferraro, Mr. Geissinger, Mr. Hunter, Mr. Phillips, Ms. Smith and Mr. Stoffa.

Nays: None

✓ **Motion Approved**

5. **Peirce Park Performance Report – Mr. Michael Shone**

Mr. Shone provided a general market overview. Mr. Shone stated that year to date (June 2015) U.S. equities are up 1.9% and International Markets were up above the U.S, but since July 2015 International Markets are down. Mr. Shone continued, emerging markets have outperformed U.S. equities though June 2015, but since then they have taken the biggest hit. Mr. Shone stated that the Retirement Fund is set up so that it has both growth and protection. Mr. Shone stated that the reason that the Actuary uses 7.5% rate of return is that some years the market will be above and some years below.

Mr. Stoffa asked whether we should still be using a 7.5% rate of return. Mr. Shone replied that he believes that 7.25% is a better long term rate of return assumption. Mr. Shone indicated that for the next ten years he believes that the average rate of return will be 6.5%, with some years more and some years less. Mr. Shone stated that thirty years after that there is no reason why they wouldn't go back to the norm. Mr. Shone continued, so if you take ¾, thirty years at 7.5% and ten years at 6.5% it averages out to 7.25%. Mr. Shone remarked that if what is driving this lower return over the next ten years is lower inflation then salary increases probably won't be 4.5% but instead should be 3% or 3.5%. Mr. Shone stated that if you want to lower the rate of return assumption then you should probably lower the salary increase assumption by the same amount. Mr. Shone stated by doing this it will cause an increase in the ARC (Annual Required

Contribution), because you anticipate less coming in, in investments, and as a result the ARC will go up.

Mr. Brown stated that within the County we can provide a 10-15 year run rate of what the actual salary increases were over the last ten years so why wouldn't we peg that directly to the last ten year average. Mr. Shone stated that you wouldn't do that for investment returns. Mr. Shone remarked that there are actually two pieces to the 4.5% wage increase roughly 3% of that is the increase for the same job and the other 1.5% is a change in position, for that person.

Ultimately it is what the County can afford to do said Mr. Shone. Mr. Shone stated that if all assumptions were made, the projections show that the ARC will continue to go down for several years, because the gains that the County has seen in the past few years have been "banked" and not actually realized by the Actuary. Mr. Shone continued, the Actuary recognizes only a percentage of the gain each year. Mr. Shone stated that if the County were contemplating a change, this would be a good time, subject to current rate of return. Mr. Shone stated that the year to date the return is -0-. Mr. Shone stated that he would like to project what the ARC would be for 2016 if by year end the rate of return remains -0- and if we changed the actuarial assumptions, what would the ARC look like.

Mr. Stoffa asked what the ARC would be like if we changed the assumption to 7%. Mr. Brown stated that he had asked Mr. Shone to run those numbers. Mr. Shone stated that he would provide the following three projections: no changes with -0- rate of return for 2015, change rate of return to 7.25% and lastly change rate of return 7.25 <u>and</u> salary assumption 4.25. Mr. Phillips stated that these projects would be helpful.

Mr. Stoffa reminded Mr. Shone that at the last meeting Mr. Shone had stated that out of all of the Counties that Peirce Park represents, Northampton County was "average". Mr. Stoffa asked what the other Counties do that we do not. Mr. Shone replied, that as of the end of this quarter Northampton County is right at the top, and that it is always a timing issue. Mr. Shone stated that there are really two Counties that did better and that was due to them being more aggressive in the market. Mr. Shone remarked that in the last 5 years investing more aggressively has paid off. Mr. Shone continued, but by being more aggressive, you are offered less protection in the downside. Mr. Shone stated that this Board has done an excellent job with the overall governance, the granting of COLA's, and taking care of their fiduciary responsibilities. The average county has lowered their salary increase assumption from 4.5% to 3.5% but not lowered their return assumption so therefore their ARC's look better because they are putting less money in. Mr. Shone remarked that Northampton County has been extremely prudent and forward thinking – fully funding liabilities, paying the full ARC and not putting in unrealistic assumptions. Mr. Stoffa asked how this Board could be more aggressive. Mr. Shone replied, this Board has already moved from 65% equities to 70% equities and made the decision to move into Real Estate. Mr. Shone stated that the calls have now come in from J.P. Morgan and Morgan Stanley; three months sooner than we thought.
Mr. Phillips asked about the two Counties that did better. He asked if they had comingled funds in real estate and did that affect it? Mr. Shone stated no, two of them had 70% equities, and one outperformed their policy statement.

Mr. Shone stated that one County is looking into timber, "timberland", as an asset class. Mr. Shone stated that this is an investment in the land and the forest. He stated that the problem with timber is it's a ten to fifteen year investment. Mr. Shone stated that our portfolio is mostly liquid with Real Estate being semi-liquid. Mr. Shone stated something that Peirce Park won't recommend is hedge funds due to illiquidity, The high fees and being non-transparent.

Mr. Shone provided the following quarterly observations.

Observations

- June 30, 2015 market value: $351.3 million
- 2nd quarter gain: +$802,000 — 2nd quarter return: 0.3% (gross)
- 1 Year gain: +12.3 million — 1 Year return: 3.9% (gross)

- Outperformed benchmark
  - During the last quarter by 0.28% and over the last year by 0.69%
  - Global Equity managers
  - Income changes on April 1, 2015

- Real Estate
  - IPS Addendum
  - Expecting funding in September

Mr. Shone reminded the board that they had decided to modify the investment policy from 65% stocks/35% bonds to 70% stocks/30% bonds in order to move into Real Estate. Of that 5% going to Real Estate the decision was made to take 2% from equities and 3% from fixed. Mr. Shone indicated that the question for the Board is do we source the Real Estate from both sides or do you take it all from fixed income. Mr. Shone reminded the Board that today would be the day to make this decision.

Mr. Brown offered his opinion by stating that if you look at the fixed market going forward, is looking like 1%-2% or maybe 3 % but the fundamentals from the U.S. Markets are strong. Mr. Brown stated that he believes that equities are still going to outperform over the next 2-3 years, so he would recommend that the Board take funds out of Fixed. Mr. Gessinger stated that Mr. Shone's projections show that we are going to see a rise in the Fed Funds rate that is going to precipitate a rise in interest market going into 2016, so he questioned whether equities will outperform that. Mr. Geissinger said probably they will outperform in the next 1-2 years but what about beyond that, going out 3-4 years. Mr. Shone stated that this is why you want to review the investment policy every year, in case you want to make a change. Mr. Brown stated that we have $40M market valuation vs. the actuarial actual cost, which is our buffer. Mr. Shone stated that the Actuary shows the value as lower than the true value because the Actuaries smooth the gains going upward and then they smooth the gains going downward; this helps the budget.

Mr. Shone stated that currently we have 70 equities (50% US and 20% International) and 30% intermediate bonds (with ½% of the 30% being cash). What the Board had previously approved was to lower 70% equities to 68% and lower 30% to 27% and put the 5% into Real Estate. Mr. Shone continued, based on the discussion, it is

recommended that Equities remain at 70% and take the 5% from Fixed Income, with the 5% going to Real Estate.
Mr. Brown reminded the Board that a year ago the Board decided to move into Real Estate and he asked the Board members if this was still an appropriate direction. After a short discussion the Board Members agreed that it was appropriate to move into Real Estate. Mr. Shone concurred. Mr. Phillips asked Mr. Shone what he meant by getting into the queue for Real Estate. Mr. Shone replied that this Real Estate is considered "Open End". He continued, these firms are continually identifying new opportunities and every quarter these firms make the call to those in the queue.

Mr. Brown made the following motion:

> **To amend the Investment Policy Statement to Reflect 70% Equities, 25% Fixed and 5% Real Estate.**

Mr. Geissinger seconded the motion. The voting was as follows::

Ayes: Mr. Brown, Mrs. Ferraro, Mr. Geissinger, Mr. Hunter, Mr. Phillips, Ms. Smith and Mr. Stoffa.

Nayes: None

✓ **Motion Approved**

6. **Asset-Liability Update Part II – Mr. Michael Shone**

Mr. Shone provided the Board with a copy of "Northampton County Asset-Liability Update Part II, September 2015" created by Peirce Park. Mr. Shone reviewed the report which illustrates future ARC payments based on changing investment returns, salary increases and adding additional contributions.

Mr. Shone stated that the actuarial funded ratio is what the Actuary is using to calculating the ARC's and the actual accounting is what shows up in GASB 67/68 (Governmental Accounting Standards Board). Mr. Shone continued, this year this information goes into the financials of the Pension Fund and next year it will roll up into the County finances.

Since there was no further discussion the meeting was adjourned.

Meeting adjourned