JOINT CIVILIAN AND POLICE PENSION AND OTHER POST-EMPLOYMENT BENEFITS (OPEB) BOARDS

A Joint Meeting of the Civilian Pension, Police Pension, and Other Post-Employment Benefits (OPEB) Boards was held on November 12, 2015, at 9:01 a.m. with Mr. Koenig, Chair of the OPEB Board, presiding. Members present were Mr. Anderson (arrived at 9:04 a.m.), Mr. Hosfelt, Mr. Blakeman, Mrs. Mullaney, Mrs. Tieman, Mrs. Mitchell, Police Chief Bernat, Mr. Stallings, and Mrs. Hawkins. Mr. Cole, Mr. Sigler, and Mr. Mullaney were absent.

AGENDA ADDITIONS/DELETIONS

Mr. Blakeman moved for approval of the agenda, seconded by Mr. Hosfelt and unanimously carried.

ADOPTION OF MINUTES - JOINT CIVILIAN/POLICE PENSION AND OPEB BOARDS MEETING OF AUGUST 13, 2015

Mr. Blakeman moved for adoption of the minutes of the Joint Civilian/Police Pension and OPEB Boards Meeting of August 13, 2015. The motion was seconded by Mrs. Tieman and unanimously carried.

Mrs. Mitchell moved for adoption of the minutes of the Joint Civilian/Police Pension and OPEB Boards Meeting of August 13, 2015. The motion was seconded by Mr. Hosfelt and unanimously carried.

Mr. Anderson moved for adoption of the minutes of the Joint Civilian/Police Pension and OPEB Boards Meeting of August 13, 2015. The motion was seconded by Chief Bernat and unanimously carried.

Quarterly Performance Reviews (Quarter Ending September 30, 2015) *(Milliman, Inc.)*

Mr. Jeff Marzinsky, Principal and Employee Benefits Consultant, Milliman, Inc., reviewed the market conditions related to the investments held in the Civilian Pension, Police Pension, and OPEB Funds. Referring to Page 3, Market Indices - 3rd Quarter 2015 of the Quarterly Investment Monitor - Summary Report for the Quarter Ending September 30, 2015 included in each of the reports for the Employee Pension, Police Pension, and OPEB Plans, Mr. Marzinsky explained that beginning in August there were hints that the U.S. Federal Reserve would start raising interest rates, causing the market to react negatively. He advised members that, in August, China stated that their growth rate was going down, resulting in a market sell-off from other countries. During the third quarter, interest rates increased slightly, resulting in negative returns in some bond areas, with shorter-term bonds less affected than longer-term and high-yield bonds. Mr. Marzinsky stated that year-to-date returns on bonds through September 30th were negative and equity markets did terribly for the quarter, bottoming out through the month of September with an 11% decline in the U.S. Standard & Poor (S & P) 500 and the Dow Jones Industrial Average. Since then, there had been a rebound in the market and there were gains in October. Mr. Marzinsky advised members that Ms. Janet Yellen, Chairwoman of the Federal Reserve, had testified before Congress that it was likely that there would be an interest rate adjustment in the month of December, which caused market volatility over the last couple of weeks.

Mr. Marzinsky stated there were positive things occurring in the U.S., noting that jobless claims and the unemployment rate were down and wages were up marginally. He stated that retail usually

increases when people are back to work; however, this had not happened yet, even though the markets had been in recovery since 2008, and retail stock returns were mixed. Oil prices were also down, which Mr. Marzinsky explained was a double-edged sword that affected corporate earnings negatively but was good for consumers. He advised members that many of the negative returns year-to-date had turned positive during October and into November.

Mr. Marzinsky reminded members that in August 2015, Milliman had recommended adjusting the duration of the fixed income portion of the pension and OPEB portfolios so that some allocation was moved from longer-term bonds into strategic allocation bonds to help against potential interest rate adjustments. He noted that longer-duration bonds would be more affected by these rate adjustments than shorter-duration bonds. Mr. Marzinsky advised members that the special situation Columbia Strategic Income Y Fund had been added to the portfolio to counteract some of the interest rate adjustments because this fund had the ability to use options, swaps, and futures contracts to moderate the duration of their portfolio. He stated that negative returns were being seen in bond funds through yesterday, and the Columbia fund was up by 2% while its index was down 1%; therefore, Mr. Marzinsky felt that this investment would help the portfolio if there was an adjustment in interest rates.

Mr. Marzinsky projected that the Federal Reserve would probably adjust interest rates, reiterating that unemployment was down; however, inflation was slightly above 1%, which was short of the Federal Reserve's 2% target. He felt that there would be significant market volatility in the bond and equity markets when this is announced, but this would wash away as people realize the interest rate adjustment would not be a bad thing.

In response to Mr. Blakeman regarding oil prices in the future, Mr. Marzinsky stated his belief that the current price of oil was $42 or $43 per barrel, compared to prices in the $80's to $100's per barrel a year to a year-and-a-half ago, which impacted oil company revenues significantly. This caused a negative effect on corporations but was good for consumers, and the cost of gas had declined from $4.00 per gallon to $2.20 per gallon in the last six (6) months in New York. Mr. Marzinsky noted that alternative energies, including electric cars and solar companies, were also creating competition for oil companies, who must look at whether to continue drilling or possibly provide alternative sources of energy, such as solar and electric, and become energy companies rather than just oil companies.

Mr. Blakeman questioned if suppliers were dropping back in production to offset the changes, and Mr. Marzinsky indicated that this had not occurred, which was also pushing the prices down, stating his belief that they were trying to put a stranglehold on the U.S. economy.

Mr. Marzinsky provided an update on investments in each plan as follows:

Civilian Pension Plan

Referring to the Board Meeting Notes for the City of Dover, Delaware Employee Pension Plan, Mr. Marzinsky advised members that this plan had approximately $35M in assets at the beginning of the quarter and was slightly down at the end of the quarter to approximately $33M. He explained that approximately $300,000 per month was paid in pension benefit payments; therefore, $900,000 was paid during the quarter and approximately $0.5M was added in contributions. There was a return of approximately -5% for the quarter, which he felt was not a bad return for this balanced portfolio when some stocks were down 15% - 20% and the indexes for the S & P 500 and the Dow Jones Industrial Average were down approximately 11%, although the market had bounced back during October and November. He reminded members that this was a long-term portfolio and up and down movements would be seen in the market over time. Mr. Marzinsky stated that funds were invested to be a little more aggressive to improve funded status over time.

Referring to Page 9, Asset Allocation - 3rd Quarter 2015 of the Quarterly Investment Monitor Summary Report for the Quarter Ending September 30, 2015, Mr. Marzinsky stated that approximately 33% - 35% of the portfolio was in fixed income investments and approximately 66% - 67% was in equities, so it was a balanced portfolio leaning a little more toward growth. The portfolio is rebalanced periodically as contributions go in and as investments get out of balance from the target elections approved in August 2015.

In reference to Page 10, Investment Policy Review - Active Management, Mr. Marzinsky stated that lower numbers reflected a more favorable rank to peers and investments ranked very well from a return and risk-adjusted perspective. He noted that the investments listed were the same as those included in the Police Pension Plan. Mr. Marzinsky stated that there was a small issue with the Prudential Small-Cap Value Z Fund, which was previously called the Target Small-Capitalization Value T Fund and was managed and owned by Prudential Investments. Management of this fund had been outsourced to a couple of different small-cap equity managers, and it was decided to bring it in-house to Prudential to use their own analytics and management team. Mr. Marzinsky advised members that the Target Fund had been merged with Prudential Small-Cap; however, some of the investments were being churned and some of the underlying stocks within the portfolio were changed during the year, so Milliman had placed a watch on that fund. It was believed that the philosophy or style of the fund would not change and that it would continue to invest in small companies with a bias toward the value side rather than the growth side; however, if performance was not there, Milliman would potentially make a recommendation in the next meeting or two (2) to replace this fund. Mr. Marzinsky indicated that this fund was slightly underperforming, so it would be watched.

Referring to Page 11, Investment Policy Review - Passive Management, Mr. Marzinsky explained that these investments follow market benchmarks, and beta ratings close to 1.0 reflect that a fund is doing a very good job in following its market index. He noted that the index fund holdings in the Police Pension Plan and OPEB Plan were very similar to those in the General Employee Pension Plan.

In reference to Page 12, Investment Option Return Summary, Mr. Marzinsky stated that the plan had a return for the quarter of approximately -5.26% gross and -5.32% net, which was a little better than the market benchmark of -5.66%. The returns for the year-to-date and one (1) year period were also

slightly negative, but less so. Mr. Marzinsky reminded members that there had been a very steep market decline and that equities move up and down.

Mr. Blakeman commented that every one of the funds was negative for the quarter, with the exception of the Columbia Fund that was just added, and he felt this was unusual. Responding, Mr. Marzinsky stated that this was a very unusual environment where both equity and bond investments were affected by what the Federal Reserve was doing with regard to interest rates. He noted that usually if equities are going down, people move their money into bonds.

Mr. Blakeman noted that $2M was a large amount of decline. Responding, Mr. Marzinsky explained that this was not a realized loss and the plan did bounce back a little bit.

Mr. Blakeman noted that two (2) quarters ago there was a decline that was made up during the next quarter.

Mr. Marzinsky reminded members that the Columbia Strategic Income Y Fund had been added to try to offset some of the potential risk of rising interest rates. He expressed his opinion that there were good economics in the U.S. and that it was unusual for the stock market to go down when unemployment was improved and the Gross Domestic Product (GDP) was not bad; however, it seemed that every time good news comes out, the stock market goes down. Mr. Marzinsky stated that there were fairly good jobs reports today and last week, but the stock market had been down for the last six (6) days.

Referring to the Board Meeting Notes, Mr. Blakeman pointed out that contributions during the quarter were $500,000 and expenses were approximately $933,000. He questioned if not enough money had been contributed and if the discrepancy between these two (2) numbers was part of the $2M decline in assets. Responding, Mr. Marzinsky stated that a pension plan is not necessarily balanced each quarter and confirmed that this would have been part of the decline.

Police Pension Plan

Referring to the Board Meeting Notes for the Police Pension Plan, Mr. Marzinsky advised members that there was a little over $12M in the plan at the start of the quarter and approximately $11.5M at the end. Pension benefit payments of approximately $128,000 were being paid per month, a contribution was made during the quarter, and the return was approximately -5%. Mr. Marzinsky stated that the plan was rebalanced to the target allocations that the Police Pension Board approved during their August 13, 2015 meeting, a strategic bond investment was added, and the allocation from some of the longer-term bonds was adjusted during the quarter.

Referring to Page 9, Asset Allocation of the Quarterly Investment Monitor Summary Report for the Quarter Ending September 30, 2015 for the Police Pension Plan, Mr. Marzinsky stated that approximately 30% - 33% of the plan's investments were in fixed income and 66% - 67% in equity investments. He stated that the plan was well diversified across duration spectrums and types of investments.

In reference to Page 10, Investment Policy Review - Active Management, Mr. Marzinsky advised members that everything ranked well compared to its peer group and the benchmark in terms of

performance and risk adjusted measures. He stated that Milliman would watch the Prudential Small-Cap Fund Value Z Fund due to a manager change and some underperformance. If there were any issues with this fund, Milliman would make a recommendation for consideration of a change.

In reviewing Page 12, Investment Option Return Summary, Mr. Marzinsky indicated that performance was down by approximately 5%, versus the benchmark for the portfolio which was down by approximately 5.68%. Year-to-date and one (1) year returns were also slightly negative but less so, and three (3) and five (5) year returns were positive; however, all returns for three (3) years and under outpaced the benchmark. He explained that returns were down for the quarter due to market volatility and the potential for rising interest rates.

OPEB Plan

Mr. Marzinsky referred to the Board Meeting Notes for the OPEB Plan, stating that this plan had approximately $22M at the beginning of the quarter and ended at approximately $21.5M. He noted that the plan did not have regular benefit payments going out of it, but there was an adjustment in the contribution going in during the period. Mr. Marzinsky advised members that there was a negative return for the portfolio of a little more than 5%. The plan was rebalanced to the target investment allocation for the portfolio, which is done once per quarter or when contributions go into the plan.

Mrs. Mitchell advised members that, based on a recent actuary report, the amount of the Electric Fund transfer to the OPEB Fund could be reduced; however, money for the first quarter of the fiscal year had already been transferred. She indicated that she was recommending that Council amend the budget to reduce this expense in the Electric Fund and staff pulled this money out and made a lump sum appropriation from the Electric Fund. Mrs. Mitchell explained that if Council did not approve the recommended budget amendment, these funds would have to be put back into the Electric Fund.

Mr. Marzinsky reviewed Page 9, Asset Allocation, stating that approximately 30% - 33% of plan funds were invested in fixed income investments that were diversified across different duration ranges, and approximately 65% - 67% was in equities.

In regard to Page 10, Investment Policy Review - Active Management, Mr. Marzinsky stated that these investments were very similar to those in the Civilian and Police Pension Plans, noting the inclusion of the Dodge and Cox Income Fund in the OPEB Plan. He stated that the Prudential Small-Cap Value Z Fund stood out, noting that there was a qualitative issue due to a management change and modest underperformance. Mr. Marzinsky explained that Milliman would monitor this fund and recommend to the Board consideration of potential replacements if there was continued underperformance.

Referring to Page 12 - Investment Option Return Summary, Mr. Marzinsky stated that the fund had an approximate -5.5% return, which was slightly better than the benchmark of -5.8% for the period. Returns for the year-to-date and year were less negative, and there were positive returns for the past three (3) and five (5) years that outpaced the plan benchmark. Mr. Marzinsky noted that there were mixed returns during the period for underlying investments, and he stressed the importance of

having a balanced portfolio across different types of equities around the world and diversity in fixed income investments.

Mrs. Tieman for acceptance of the Civilian Pension, Police Pension, and OPEB Plan reports, seconded by Mr. Hosfelt and unanimously carried.

Meeting adjourned at 9:29 a.m.

Scott D. Koenig
Chair, OPEB Board

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