A regular meeting of the Pension Committee was held on Wednesday, November 14, 2018 at 9:00 a.m. in the Administration Conference Room at Town Hall, 500 Poplar View Parkway.

The following members were present: Dick Gardiner, Mark Krock, Jay Jeffries, Gregory Reichert and Stan Joyner.

Staff present was Pension Attorney Frank Carney and Town Clerk Lynn Carmack. Also present were Susan Fletcher and Ryan Miller of First Tennessee Bank and Richard Ellis of Ellis and Ward Benefits Group, Inc.

Approval of Minutes

Motion by Mayor Joyner, seconded by Mr. Krock, to approve the minutes of the August 16, 2018 meeting.

ROLL CALL: Gardiner – yes, Krock – yes, Jeffries – yes, Reichert – yes, Joyner – yes. Motion approved.

Review of the Quarterly Investment Performance of the Collierville Defined Benefit Pension Plan by Financial Advisors - First Tennessee Bank (Ryan Miller and Susan Fletcher)

FIVE FACTOR FRAMEWORK: This is the first time there have been four reds out of the 5 factors and zero greens, two of which have changed recently (from September to October).

Economic Growth is based off of the growth rate of the weekly indicators which is released every Friday. At the end of October, the growth rate was negative, which was a first since August. When it is negative, it signals a contracting economic environment and therefore it is marked red. It is not as worrisome as one might think because we have had such a tremendous run up in economic growth over the past year. Typically, there are going to be dips along the way, but it is not a signal of anything dire.

Market Trend is based on the S&P 500's market position at the end of any month relative to the previous 12 month moving average. If the current price of the S&P 500 is above the 12 month average price, then it is marked green. This one was marked red because at the end of October, it finished below the 12-month average.

Mr. Miller noted that this is again, based off of a comp over the last year where the market trend has been on fire for so long and you are going to have a dip along the way. It is noteworthy to say that three days ago, this signal was green but there has been a pull-back in the markets the past couple of days. Jerry Laurain said this could go back to green by the end of the month.

Monetary Conditions is mainly based upon the shape of the yield curve. There have been discussion in the news about inversion between the 2-year and the 10-year. Right now, the spread is about 25 basis points. It does not look like there is going to be an inversion this quarter, but could potentially happen next quarter. Chief Economist, Chris Low, thinks that might be possible in Q1, but it is subject to change. This has stayed yellow for quite some time. It was red back in May and June because there was more concern that an inversion could happen (whenever there is an inversion, this will change to red). But for now, it is cautious yellow.

Investor Sentiment is based on the Hays Advisory Measurement of Investor Sentiment. They quantify over 100 different measurements and factors to determine whether or not they find this positive or not. Investor Sentiment has been very strong for quite some time and some would argue just shy of euphoric and almost greedy. So this has been marked a red.

Valuations is based upon price/earnings ratios and embedded sales expectations. Basically, PE valuations versus their historical average have indicated that businesses are treading close to or at fair value. That indicates less room to run up and that signal has been marked red.

ECONOMIC FORECAST: as of September 20, 2018.

Mr. Miller pointed out that GDP growth has been on a positive trend this year (Q1, Q2, and Q3). That is expected to remain strong through the end of the year. Chris Low is predicting that it is probably going to start pulling back sometime in Q2 of 2019.

The unemployment rate has been decreasing for quite a few quarters now (currently at about 3.7%) and is expected to continue to go down through next year and in 2020 as well.

Core PCE (Personal Consumption Expenditures) is viewed as a more accurate signal of inflation because it takes out food and energy prices, which tend to fluctuate quite a bit. PCE has gone up in Q1 and Q2 (currently at 2.00%). As of September 20, Mr. Low was predicting that it would go down and stay range bound between 1.7% and 1.9%.

There have been 8 hikes in the federal funds rate in the last couple of years. Q1 was at 1.75, Q2 was at 2.00 and Q3 is currently at 2.25. There is an expectation that there will be one more rate hike in December (a 75% probability according to Bloomberg). Mr. Low is taking a more cautious approach, predicting rates may remain steady through the rest of next year.

Recession Risk: Mr. Low predicts a 3% chance of recession to the end of 2018; a 10% chance for 2019; and a 40% chance in 2020.

CAPITAL MARKET ASSUMPTIONS: These are the IPS Guidelines and Capital Market Assumptions, allocation targets for the portfolio, and the acceptable ranges of variance from those targets and the expected rate of returns.

This portfolio targets a 40% allocation of fixed income and a 60% allocation to equities. The capital market assumptions have not changed and the expected returns have not changed either.

The expected long term return for a 40% allocation of fixed income is 1.19%. The expected long term return for a 60% allocation to equities is 3.87%. The overall long term expected return of the entire portfolio of fixed income and equities is 5.06%.

Mr. Miller pointed out that the long term expectation is 10 years.

MARKET VALUE AND PERFORMANCE: This shows the market value and performance over time in the portfolio.

The portfolio, starting with July was up 1.73; in August, it was up 1.35; it was down -0.51basis points in September. Overall for 1Q of the fiscal year, the portfolio was up 2.59; over the last year, it has been up 6.49; over the past 3 years, the portfolio has returned 8.31annually; and over the last 5 years, it has annualized at 6.92; since inception over 11 years, 3 months, the portfolio has returned 6.03 annualized.

Overall, returns have been very good.

Mr. Miller noted that in the month of October, this portfolio was down 4.61; November has been a bit better (through 11/13), the portfolio was up .36; and then FYTD, over the last 5 months, the portfolio is down 1.79.

ASSET ALLOCATION: This details the dollar amount and percentage of each sub asset class as of September 30, 2018.

Total Cash and Cash Equivalents and Fixed Income total $28,638,424 (that is 39.81 of the portfolio). It shows a slight variance of -0.19 basis points from the 40.00 target.

Total Equity and Real Estate total $43,295,636 (that is 60.19 of the portfolio). Again, that showed a slight variance of 0.19 basis points from the 60.00 target.

The Total Fund balance (as of 09/30/18) was $71,934,060.

The main takeaway here is that all allocations to the respective asset classes are in line with their respective target ranges.

HOLDINGS AND PERFORMANCE: These will help illustrate the performance of the individual underlying holdings in the portfolio for the past three months.

Fixed Income Funds all enjoyed positive returns for the quarter. Corporate Bonds had mixed returns, with a few being slightly down, but overall, the majority enjoyed positive returns.

U.S Treasuries and Agencies were positive and all but one Taxable Muni was positive for the quarter.

The individual Common Stocks, overall performance was positive. The most noteworthy performers (meaning 20.00 or more up) were CA Inc., which was just recently purchased (cash was received for that and the investment team is looking to fill that void soon). Other positive performers were Apple Inc., Walgreens and Biogen Inc. Luckily, there were no meaningful detractors to report for the quarter.

No position changes were made in the Common Stock portfolio during the quarter. And, no positions are currently on watch or give cause for concern.

The individual Domestic Equity Funds in the portfolio also enjoyed a very nice quarter with positive returns across the board. International Equity Growth Funds and Emerging Markets Funds did not fare as well as Domestic Equities, with each of them down 2.6 to 4.6 and 4.2 respectively. Only the Value Fund, which is invested in International Equities, was positive out of those three International and Emerging Markets Funds.

Returns in International and Emerging Markets, for the most part, have been negatively impacted, due to greater uncertainty, from tariff concerns, currency strength concerns and political and social concerns.

Real Estate is flat to slightly positive for the quarter. There was one fund change during the quarter of note. Vulcan Value Partners had been on watch for quite some time due to underperformance and high fees. On August 20, Vulcan was sold and that cash used to invest into the Vanguard High Yield Index Fund (which has an expense ratio is 15.00 basis points versus 108).

HISTORICAL SUMMARY: The historical market value of the portfolio, going back to 2008, has gradually been positive and the ending total was $72,330,223.

CASH MANAGEMENT ACCOUNT: Ms. Fletcher explained that this account is where all of the contributions are received and where disbursements are made, both to participants, as well as, service providers. Contributions are about $1.2 million, participant distributions are just over $450,000, for a net of $745,000. Fees and expenses were just over $47,000 and of the contributions that came in after the distributions and expenses were paid, $425,000 was moved over to the investment portfolio. There is a money market gain of $1,173 and an ending balance of about $400,000.

EXPENSE SUMMARY: Ms. Fletcher said the expenses for Q1 shows a breakdown between Mutual Funds, Individual Securities and Cash. Weighted Expense ratio of those funds that were invested in the Mutual Funds is 9 basis points. Market Value Fee (assessed by First Tennessee) is 6 basis points and there were some benefit payments and legal fees as well. There is a total of 16.00 basis points for the quarter. Expenses are definitely in line.

There were no questions or comments.

Review of Actuarial Report as of July 1, 2018 (Richard Ellis, Ellis & Ward Benefits Group, Inc.)

Mr. Ellis started his review by stating that there are a lot of good things going on in the Defined Benefit Pension Plan but there are a couple of issues that are concerning.

The actuarially determined contribution for the coming year is $2,452,625, which is 10.0% of covered payroll and that compares to $2,373,129 last year (9.7% of covered payroll).

Mr. Ellis said that he has noticed that when people retire and he calculates their benefit and then looks at the value of that benefit compared to the terms of a liability setup, it seems that almost all of the time it is a greater liability. He said that after checking with Human Resources, because people load up on the back end, in terms of comp time and vacation time, it increases their final averaged salary.

He said that is a bit concerning because what he is doing is projecting the active participants' pay to assumed retirement compensation. If that is a greater number, then in a sense it is under stating the projected liability.

Mr. Ellis said it is something to be aware of because of the increase in pensions ticking up the normal cost this year. He added that there is room built in though, because he assumes a 4% annual increase in salaries, which the Town never hits.

Mr. Jeffries said that HR has been seeing that happen too with some of the recent retirements (once they start padding their salary by adding in the comp time and all the other things they have been banking). The employee's pension, over the remainder of the time, jumps up maybe $50 or $100 or whatever, but that is $50 or $100 a month for the rest of their life.

Mayor Joyner asked if comp time has a cap.

Mr. Jeffries said it is supposed to be capped at 80 hours.

Brief discussion ensued.

Mr. Ellis said that assets in the trust fund, as of 6/30/18, is $69,826,482; approximate rate of return is 6.6% . He said that he takes a smoothed weighted average of the assets ($69,826,482) and then adds back some unrecognized losses over the past 4 years, so he is using an actuarial value of assets of $71,635,560. This is to smooth out the market swings in the value of assets.

This Plan was started in 2007 (for almost 11 years) in the hole in terms of return on assets. The first couple of years the Plan lost money and then it started gaining it back.

A 7.5% discount rate is assumed and over the 11 years, an average weight of return is slightly less than 5%. However, if you take out the first 2 years, the average rate of return is 8.5%.

Mr. Ellis said the question going forward is, is the long term rate of return of 7.5% for the discount rate the right number. He stated concern that in the future it is going to be hard to get 7.5%.

Mr. Krock asked if the state pension plan went to 7.25%.

Mr. Ellis said they did recommend going to 7.25% but it does not mean that this Plan has to go to 7.25%. He suggested it might be prudent to knock it down a quarter percent just to be a little more conservative.

Mr. Ellis said the Town is already putting more in (about 12 or 13% of pay), so the Plan is in good shape. He said that what would happen if it went to 7.25% is the recommended contribution would go up to 10.50% or 11.00% of pay. Mr. Ellis said that since the Town is still above that, it would not increase the contribution. He said that he does not see much of a downside in going to 7.25% or even to 7%.

Mayor Joyner recommended saving it for later.

Mayor Joyner asked if any other municipalities with defined benefit plans have lowered to 7.5%.

Mr. Ellis stated there have not been any yet.

Mr. Ellis referred to the Pension Expense, which is $2,982,354 for the year. He said the reason it is high is because of the asset losses in the last couple of years he has had to amortize over a 5 year period (for GASB purposes). Mr. Ellis said it is really just a different method for calculating the liabilities and the pension expense. It is a little higher than the recommended contribution and mainly because of the way they do the gains and losses on assets.

Mr. Ellis said that he has toyed with the idea of changing the cost method so it corresponds to GASB's cost method (Entry Age Normal Cost method). He stated that he is using a Frozen Initial Liability Method (FIL). It is a different way to calculate past liabilities and normal costs.

He explained that if he had used GASB's method for 2018, the Town's contribution requirement would have been $2.8 million (still under the 13% pay) compared to $2.4 million. Entry Age Normal Cost Method makes you pay a little bit more now so that you can pay a little bit less later.

Mr. Ellis said that is up to the Committee but that he is comfortable using the FIL cost method.

Mayor Joyner said he is comfortable with no change.

Lastly, Mr. Ellis referred to a 10-year history using the GASB numbers. He said that what is interesting is that after a couple of years in starting, the Town's net pension liability, as a percentage of covered payroll, was at 84.76% and it has been going down dramatically to 4.03% in 2018. The net pension liability is very small (at $3.4 million).

Mr. Ellis said that is why he says there are a lot of good things to like about this report.

He explained that the net pension liability is liability from the past and adding each year's accruals and then compare to assets. The Plan is almost down to no unfunded liability, which is going to reduce the Town's cost, or the actuarial determined contribution, in a couple of years from 10% down to 7% or 8% of pay.

Mr. Ellis added that it will be a good time to adjust the discount rate. He said if there is going to be any unfunded, it will be when the discount rate is changed, but there will not be a lot of change in the actuarial determined contribution.

Mr. Ellis asked if that sounds like a plan.

Mayor Joyner said it does if we keep banking the excess contribution.

Mr. Ellis agreed, stating that is what has made this thing such an attractive Plan and there are not a lot of plans in this good of shape.

Mayor Joyner stated that it is important that no one tries to enhance it at some point in the future.

Mr. Jeffries agreed, stating that the Plan is fine the way it is.

Mr. Ellis said that if the Committee should ever decide they wish to consider alternatives, that there are a couple of things he can recommend. He said a lot of it depends on what happens to the assets. Mr. Ellis said the Town has a very low normal retirement age, 60 and could consider, for future employees, making it 62 or 65, which would lower cost.

Brief discussion ensued.

Mr. Ellis reiterated the two things to watch: last year's pay for people retiring and considering a change in the discount rate next year.

Adjournment

There being no further business, the meeting was declared adjourned at 9:45 a.m.

Chairman

Lynn Carmack
Town Clerk