Lower Saucon Township
Pension Advisory Committee Meeting
June 8, 2011
Minutes

Roll Call:

Present: Chris Leidy, Uniformed Plan Representative; Molly Bender, Michele Hirner, Non-Uniformed Plan Representatives; Mary Curtin and Lou Mahlman, Citizen Members; Jack Cahalan, Township Manager; Cathy Gorman, Director of Finance; Chuck Friedlander, Actuary, and Chris Cap from PSAB. The time was 11:05 AM. Priscilla deLeon, Council Liaison arrived at 11:10 AM.

1. **MRT Report – Chris Cap** – Chris said starting with your April net asset statement, Lower Saucon Township Police Pension Plan; this picture will be about .65% higher when you get your May statement, which will be a positive. You have $4,284,798.99 in the Police Pension fund. In the Lower Saucon Township Non-Uniformed Pension account you have $1,339,376.54. That will be about .65% higher in the next snapshot you get. The market was only up 3.62% with this snapshot. In today's report, it's up 3.91% through May 31st trading. That is a positive. He's not aware of any other accounts payable issues that have come to their attention.

   Chris said they are still waiting for the IRS determination letter. Once they get that, it will be sent out to each of the members. Their next Trustee Meeting is July 29th at Seven Springs. He doesn't see any major changes in their approach. They very well may decrease the bond holdings, but they may shift over to the short-term bonds. It's shorter duration for the bond portfolios. Aside from that, we're not interviewing any new managers. There was a pull back in the commodities market in the last few days. There are some positives in the economy right now. QE2 is ending June 30th, and when that takes place, the Federal Reserve, whether or not they act with the QE3 is a big question, and what impact that will have on the market. Will there be market confidence? It's something that Merrill Lynch has been very active in talking about. Crude oils are back down to $100.00 a barrel which is a positive. Last meeting when he was here, they were contemplating possibilities of what if we hit $150 a barrel and what impact that would have on the market. How do we isolate the portfolio under those circumstances? It's back to $100.00 a barrel, so that certainly is a positive. The commodities market has been very volatile. Food prices are going up and we are in the hopes that a lot of the stock holdings we have right now, especially international and the large caps, are going to be able to pass on higher returns and which will enable us to maintain a positive momentum in our earnings. The Dow hit a one month low yesterday. The debt limit discussion in Congress is a major issue; what kind of impact will that have as the August 2 deadline looms? Whether or not the Congress acts, will they raise the debt limit, will be the big question. There's been a lot of discussion about what happens with U.S. debt. It's something they will be discussing very actively at their conference call next Wednesday morning.

   Chris said overall regarding the performances, you will notice there are a few managers that are behind the index. The indexes are really outperforming. They do have some good performers that are mixed in there right now. They go up and down month to month. The real estate investment trust (REIT) was the latest addition. It's up 8.57%. They are really pursuing a greater amount of dividends in the portfolio in light of the under performance of the bond portfolio which has been a major concern.

   Chris said the REITs are actually performing quite well for them. Also, the endowment fund, they also have that exposure with precious metals and some commodities in that portfolio. That's working quite well and it's at 5.12%. He's heard some rumblings amongst the board that there is potential that they may expand a little further, maybe 5% in the endowment fund. Just as a refresher, the endowment fund is managed by the former fund manager from the University of Notre Dame. They are based in Houston. They are a lot of predictions out there that equities may flatten out just a bit over the next few years. With 7%, 8% or 9%, is that a more realistic rate of return that we can expect as compared to some of the larger numbers we received in the last two years as we recovered pretty strongly from the 2008 down market. Mary said regarding the debt limit, what does Chris think about that? Chris said there's a lot of question with QE2, whether or not the private markets are going to be able to support the markets to continue the market movements that we've seen. That's been there to support the market, but are there going to be buyers for a number of these securities after June 30th comes. There is some question if there is going to be a QE3. After June 30th, he heard a number of different theories. There are a number of economists who say there won't be any effect and that the private sector will pick up the market and the market will continue to maintain that momentum and maintain that source of stability of the market. Mary said what do you think? Chris said he's not an economist, but he thinks it's fair to expect the double digit returns in the short-term. He wouldn't necessarily expect those. He thinks everyone in the market is saying that. It's really questioning whether the 13% or 14% are going to still be there. More realistically returns, 7% or 8% range, things might flatten out over the next couple of years. That's a theory.

Chris said he doesn't know how Chuck feels from an actuarial standpoint if that is something to put on the table. Chuck said he's looking more over 50 years, but yes, equity is turning out 8% if you are in a 50/50 fund. Chris said what's the future of the bond market right now? There have been theories that the bond market could yield negative rates of return. Of the 210 accounts we service, 31 are exclusively in bonds. Generally, those are some municipalities that have more senior members and the workforce is consistently 58 years and above and they don't want anyone altering their portfolio and don't want any exposure of stocks as they are fearful of what the impact may be. They sent out warnings to people that there is potential that the bond market may yield negatively over the next couple of years without anyone's control. That's why they went into real estate investment trusts; it does pay a decent dividend. We are trying to make up for those years where we are consistently relying on 3.5% to 5% on U.S. Treasuries. That's what saved the portfolio in 2008. U.S Treasuries was the place to be. If you look at things world-wide right now, there's a question whether or not the dollar will continue to remain as the primary currency. He thinks there's going to be a basket of currencies over time, changing the accounting standards that Timothy Geithner is pushing. That was a big story yesterday. The world is becoming a little bit smaller. From his perspective, those are interesting occurrences right now. Mary said the reason she asks is she read a couple of things on line this morning. Chris said there's quite a bit that's out there.

Chris said yesterday another report came out. Most of you know Bill Gross, he's called the Bond King from Pimco. Evidently it was revealed that Gross took the largest stake in Lehman Bros. in 2008 with their bonds. They guessed there would be recovery and Lehman would survive. Gross has always been one of the top managers for U.S. Treasuries. They've been a significant underwriter. There are a lot of losses that are passed on to the mutual funds. They are a huge player in the market place and very respected. When the bond guesses came up wrong, who's to say who has the right answer and who doesn't. They try to look at the reports from Bob Doll. Bob's a very smart guy and you see him on the newscasts and he's well renowned. Looking at those perspectives, not everyone has all of the answers. When he comes here, he tries to reveal what the inner concerns are, what their board is looking at, why they are looking at it, how they try to isolate and protect against the downside. They want to catch the upside when the market is hot, but sometimes you have to give up some of the upside to protect against the downside. So how do you balance the portfolio? That's the age old question we always wrestle with and that's what Bill and Peter are always looking at with our Trustees. Right now, looking positively, through the first five months of 2011, you're at 3.91%. That's a positive looking at it from that perspective. We're more than half way toward meeting your assumption rate for your portfolio. Two meetings ago, he said they changed the allocation of the trust bond over the last three years more than they have typically over the last eight years. That's how the world is changing so drastically. The other projection they've heard, which is another possibility for them is the large cap stocks. There is a growing consensus in the community that large cap stocks are going to be the place to be. They are somewhat flat in previous years and produced quite well, but those are the larger companies who have holdings on foreign soil. They have the ability to pass on the higher prices to consumers and their earnings aren't going to suffer as a result. With interest rates potentially going up, small cap stocks that have performed so well for us in previous years may pull back because the price of capital and borrowing may contract. That's another possibility they are looking at.

Chris said on the next page, in terms of just the overall large cap arena, they are at about 35% overall right now in the large cap space. They are about 11% to 12% for the small mid caps. They are a little bit above the recommended weight of the small mid caps. The mid caps have performed extremely well for us. Mid cap stocks move up so fast in market capitalization that they become large cap stocks so quickly. That's where they've gotten a lot of growth over the years. Internationally, they've been pretty solid over the last three years and in the 10% range for the recommended weight. That's what Merrill Lunch has recommended to them. They have pondered the possibility of expanding that to 20% in previous meetings. The world is changing that much. He told you five years ago when they incorporated the international stocks in the portfolio that it was very controversial, but it's passed on a lot of earnings to them. Real Estate Investment Trusts got beat down so much in 2008, you want to buy low and not sell high, that's why they still have pretty good positioning on that ranging from 4% to 5%. Equities were about 61%. Fixed income is about 32.2%. The alternatives were 4.7% and we always maintain a cash balance between 2% and 3%. That rounds out to 100% where you are right now as you are in the balanced portfolio. There's been a lot of talk in Europe about the stability of the banking system there. That's always a concern where equity will be an issue there. QE2 was a very complex issue to talk about. He's here to tell you they are doing their homework on it. That's his promise to you.

Chris said the next page is where the portfolio is aligned. They don't have any managers on warning, and everyone seems to be within policy. He doesn't see them making any significant policy changes to the overall master of the policy.

Chris said no major legislation on the state right now for the consolidation of pensions. There is nothing on the table that is worthy reporting.

2. **<u>2011 Valuation Reports</u>** – Cathy said the drafts are ready for the Actuarial Valuation as of January 1, 2011. Chuck said you will notice the change in the format of the report. All those nice tables and numbers are still in the back. What he tried to do was make the first several pages of the report basically a narrative type to tell you what's going on.

Chuck said he will start with the non-uniformed plan. The first thing he wants to show you is if you look at figures 1 and 2, they look like kind of the same chart, but different colors. On page 1, it shows you contribution requirements have increased over the years. The bottom, which is blue, is called the normal cost and it's the annual cost of the plan which is liability based. It has generally grown over time as more people have been hired and pays have increased. You'll notice in the last couple of years, it has been pretty stable. It will go up as payroll increases. The goal in funding is to have a stable funding which more or less increases the payroll. The next piece is the red piece, our administrative expenses. You'll notice after 2007, they don't appear anymore because the Township reimburses the plan for all administrative expenses. The top piece is the amortization. That's the amount basically from whatever shortfall you have. In this case, that part is keeping fairly stable because over the last couple of years when we had losses, we had gains. Figure 2, the same chart shows how the contributions are funded. If you look before 2006, there was a piece called the funding adjustment. That's the amount if you didn't have a shortfall, you had an excess. That went away in 2006 when we started having amortization payments. The biggest piece is the piece in the middle. That's where most of this plan's income comes from. The purple piece is the net municipal obligations, so you can see as the contribution requirements increase here, state aid stays pretty much the same. It's the Township that has to pick up the difference. There's a small bottom piece for 2011 going forward. That's the contributions being made by the department heads. One of the reasons he doesn't come to every meeting is because the quarterly results don't mean as much to him as the annual results. They do these valuations every other year. Figure 3 shows you is the value of the fund from year to year. The piece that is alone, that's the market value. You can see from 2007 to 2008 that took a big drop. It's gradually recovering. In 2010, you can see it's a lot bigger number. The other piece to the right is the actuarial value. They use a technique that says when they have huge gains they are going to recognize them over four years. What it does is add stability. If you look at those pieces you'll see we used a much higher asset value in 2008. When we were doing the valuation, the markets had already started to recover. This is kind of the proof the smoothing does help. By 2010, the market value caught up to the actuarial value. We kind of smoothed and basically kept the contribution requirements from going through the roof after the 2009 valuation and it's worked. The downside of that is that we didn't recognize all the losses the last time. We're still recognizing them now. While the fund did 17.7% on the market value in 2009, and almost 11.4% in 2010, the actuarial value only returned 8.2% and 2.9%, so on an actuarial basis, we really didn't get the 7.5%, but again, that's what kept us from getting killed the last time around.

Chuck said on page 3, Figures 4 and 5, these are the plan's liabilities. The present value of future normal costs, that's the part that is funded as the annual regular cost with the plan he talked about before. That's basically how much of the future funding is going to come by that regular normal cost. The big piece, the actuarial value of assets, is the amount we already have. The small red piece is the unfunded actuarial accrued liability. That's the piece we have to amortize and add to the normal cost. The normal cost is the stability. When we get a little bit higher, we get a little bit behind. The amortization is the make-up of it.

Chuck said on page 7, we have a couple more charts that basically show how this valuation impacted the plan. The top chart shows the numbers are basically stable. Payroll increased. He has three numbers there. The one to the left is the actual 2011 MMO. The one to the right is if we had just done the MMO based on this actuarial valuation. As you can see, the totals are about the same. The amortization payment has shrunk a bit. The normal cost has increased a bit. The one in the middle shows that if we had done the MMO using actual instead of payroll, we would have had a somewhat higher number. The MMO was a little bit low because the estimated payroll was low. That kind of separates the impacts. You had increases in payroll because the MMO increased and gains causing the MMO to decrease. The gains are basically an offset of investment losses. The gain is basically caused by one person going into inactive status. We've been funding a benefit based on future services and payroll increases. Since he is no longer working actively, this benefit is kind of frozen. That caused a small gain that offset the small investment losses.

Chuck said on Section 2, page 4, we haven't really had anything interesting happen in the group outside of that, but if you look at this page, the actuarial gain kind of analyzes sources of gains and losses. We have a small investment loss and a larger experience gain and due to the inactive person and basically payroll not increasing as we expected. We assumed salaries were going to increase 5.5% a year over the long term. That's something where the politics of the municipalities has changed. It may be something we want to talk about. One of the things about the assumptions is that what we are looking for is not what's going to happen in the next five years, but in the next 30, 40, or 50. We have people in their 20's in this plan who are going to work another 30 years. Salaries may be frozen right now, but they are not going to be frozen forever. One of the things we take into account here is not just the cost of living, but as people get more experience and receive merit increases and promotions, things like that over a long period of time. He's not going to bring it down 2% or 3% as that's not realistic in the long term. To bring it down one-half of one percent might be a realistic thing and then look at it again in two to six years. Jack said what kind of impact would that have? Chuck said it would decrease your costs because we're assuming smaller benefits; however, if he were to do that, he might want to knock down the interest rate at a half of a percent too. Priscilla said we need to know the pros and cons of what Chuck is recommending. We need to know what the effect is going to be on both sides. Chuck said how he does things is do we want to look into these effects? If there's a consensus, we should look into it, we'll do a study and a comparison chart of what happens if we change the interest rate. What happens if we change the salary scale? The other thing here is we are using a mortality table that's been in place for quite a while and we might want to update that as well. Its twenty years since the table's been around and mortality has improved. There are a lot of things we could do. He was very reluctant to do it last time around. We talked about it last time and his preference was to not change drivers in the middle of a hurricane. That was the time we needed to let the dust settle. As far as pensions go, that's a catastrophic thing. You have to wait for the water to recede before you really can start to look at long term. Maybe we should look at changing some assumptions. Jack said the only problem is this group doesn't meet again until September. That's just before we present the 2012 MMO to Council, so if they are going to look at possible changes, is that too late to affect the MMO? Chuck said no, we can do a preliminary MMO based on the current assumptions. At the same time, what he'll do is change the chart to say how is this going to affect the 2012 MMO? If we come to a consensus at the meeting, we can always revise the MMO. Jack said that's what we should bring back to this group in September. Give them all the options and the impacts. Priscilla said she likes it spelled out. What Chuck just said should be in writing so everyone understands it. Chuck said he does spell everything out. Priscilla said maybe you need to drop it down to a non-professional level. Chuck said that's kind of what he attempted to do with the new report forms. Priscilla said it's kind of like the landfill. We have all the data and charts and charts, and then we ask the landfill to put it in plain english. The landfill has requirements to DEP that they have t to answer. The Township asked them then to additionally give us other information and that's what she is asking. Chuck said he would show them and it wouldn't take more than 30 seconds. He'd say here's what the contributions are over the years. Here's how we're paying for it. Here's why because of what happened with the investments. He thinks it's that simple. Priscilla said would the group like it more in a short summary? The group said yes. Jack said by the September meeting Chuck is going to bring back some options to reduce the assumption you are using. Priscilla said there may be time to have it ready for Council. Jack said we also have the option of having a short meeting of this group at the end of July or August. Mary said Chuck thinks it's time for us to look at all you just mentioned. Chuck said the assumptions aren't set in stone. Circumstances change through long periods of time. He's not one to be upping these things and playing with them every year, but yes, once in a while we need to look around and say is this still realistic?

Chuck said the Police Plan is the same story. He wants to explain a little piece of the MMO process. It demonstrates what's going on. There's a chart on page 4, Figure 6 called Entry Age of Normal Costs. This is a sample for a policeman who is hired at 25 years old and is going to retire at 50. We determine, in terms of what his benefits were, what we projected to be out there, we calculate a string of calculations called normal costs from his entry age to his retirement. If you put this amount in a year, that's kind of the funding pattern or the target for his entire career. For each year, they take these dollar normal costs and they add them up. They have a plan normal cost. The plan normal cost for police for this year is $178,000.00. What they do with it is divide it by payroll, Section 2, page 2, and they say this is 16.6% of payroll. They capture that 16.6% number and, so the next time they do an MMO, they take an estimated payroll and ask what is their normal cost, which is 16.6% of that. The number changes are payroll changes. The payroll you use is everybody, including people who are already out and past their retirement age. What that means is when they do this funding pattern, and let's use as an example, the Chief, once he is past retirement age, you don't have any more normal costs. You are all liability. What we do is the normal cost for him, for Vic Koszi, for the other two retirees, they have nothing in the enumerator and a veteran officer is paying the denominator. Now we do this evaluation: we have four new officers who have numbers in the enumerator and smaller numbers in the denominator, so the normal cost percentage has gone up because of a glitch in the way the system works. When you go to the chart and look at the increases in the contribution, it's not the amortization at the top that is causing them to go up; it's the normal cost, the blue piece. The normal cost of the plan has increased because now we have four new officers to fund whereas those four officers wouldn't have had normal costs if the were still alive. Basically, you've got new people to fund. The Police are contributing a small amount. The Township has to pick up the difference. Priscilla said according to this if you didn't change anything, how much more do we need? Chuck said Section 2, page 5, there's a chart that has some increase in the amortization from $67,600.00 to about $80,513.00. That's again due to the same things as the non-uniform plan even though the market did well and the market has caught up the actuarial value, because of the smoothing, we are recognizing more losses. The normal costs are then $129,000.00 and the MMO to about $168,000.00. The bottom pieces increase. If the state aid stays the same at about $89,000.00 that means the Township contribution is going to go up about $93,000.00 to $148,000.00. Keep in mind; we're not going to get additional state aid. Priscilla said in our 2012 budget for our MMO, we'll be putting in $248 which is up from the $196 from last year. Where it says 2011 MMO is based on the 2009, that was the actual, what we were supposed to do. Chuck said this MMO was done in September 2010. In September 2010, you don't have the 2011 valuation done yet. Priscilla said for two years we have to use the same numbers. Chuck said you could also use the same one for next year as well by not publishing the valuation, but we chose not to do that as that wasn't recommended. Priscilla said she's been saying that for years. She's glad someone agreed with her recommendation. That's an increase for the taxpayers. Chuck said we aren't assuming any additional state aid. State aid is the same in both illustrations. This propagation is going to increase from about $93,000.00 to about $148,000.00. Assuming it says the same, it's going to be about $89,000.00. He expected it to go down this year and it went up. It's an unpredictable thing as it's based on income received from a 2% tax on property and casualty insurance sold in the state from out-of-state insurers. It's something that goes up and down.

Mary said the Police officers can retire at the age of 50? Chuck said yes. That would be 25 years of service.

Chuck said Section 2, page 5, this transaction has increased. Because we're contributing to the plan, the unfunded liability for non-uniform dropped from $168,000.00 to $109,000.00. This plan went up from $600,000.00 to about $660,000.00. The reason is the investment losses on this plan; we didn't have something big to offset it like the participant who became inactive in the non-unformed plan. We had some gains due to pays not going up 5.5% a year. Smaller investment losses and investment gains, you are going to be closer on both sides. It's time to look at the pieces a little closer. This plan went up because it didn't have any good offsetting losses like the other plan, but the good news is because the smoothing helped us out two years ago, while it's making the contributions go up now, we didn't get hit with a hammer in the back of the head two years ago. As this chart shows, the market value has caught up now. That's where we are on this plan. This plan like the other plan, we are using 7.5% administrative and 5.5% salary scale. He would recommend we review those and review the impacts and changes. If the mortality table changed, it would be more expensive as retirees are going to live longer than in the past. The salary scale is going to decrease costs because we're projecting lower pension in the future. Bringing down the interest rate is going to increase cost. Priscilla said maybe those are the things you have to lump together. Jack said for us to review it, it should be separated so we can just look at it. Chuck said the idea is to make a decision; he'll throw options out at you. We really don't have anything on the table at the moment. Wherever they are in August, where things are up in the air, they'll use the old evaluation and know we're going to pick a set of assumptions and modify it and we'll modify it before we have to present it to Council in September. Cathy said if we approve it on September 7th, then we could use it and redo it and have an MMO to Council. Chuck said it takes him 15 minutes to make a change. Mary said you are going to use the mortality table, what else? Chuck said interest and salary. Mary said we're still assuming 7.5% interest. Chuck said we are going to look at changes. Cathy said he's presenting 4% in wages and 7% in earnings and changing the mortality. Chuck said he'd like to do it one step at a time. Here's what happens if we change mortality. Here's what happens if we change salaries. You can see the isolated affect of each one. He likes to do it in a chart as it makes it easier for everyone to see. Priscilla said more and more residents are wondering and looking into government transparencies. It could be on the website and that way the residents know why we did what we did. Chuck said one of the reasons he likes to sit with people, is you need to have these discussions. One of the things he did, which was more conservative, was to assume the people retire at their retirement. The Chief works beyond his retirement each year. We have a little game each year as he's leaving benefits on the table by continuing to work. He's not sure we have a lot of officers close to retirement now.

Molly said she was looking through some old minutes and she sees the Chief contributes to the non-uniform pension. Cathy said he contributes to the uniformed pension plan. Jack said let him know the date of the minutes and they will correct it.

Chuck said the non-uniform plan has a benefit of 1.75% pay time service. For example, when Jack is working over his retirement, he's leaving some benefits on the table, but he's also increasing his benefit by earning more service. The police plan, for example, Chief Lesser, the only way his benefit is going to increase is if his pay increases. Gains from people staying past retirement are much larger. If we knew that the officers are people looking to get out of here as soon as they can or looking to stay longer, we could make assumption about the normal retirement age. He doesn't know if that's appropriate. Cathy said you wouldn't want to make an assumption on something like that as it's an ordinance. Chuck said it's not something to mess with, but he just wanted to bring it up so we knew we talked about it. Priscilla said she wouldn't want to ask any employee how long they were staying, as that's their own business. We also appreciate the experience.

3. **State Auditor General Audit – Results/Findings** – Cathy said the audit results came in a couple of months ago. For the uniformed plan, they did make some verbal recommendations asking us to be consistent with Act 600, which they will probably have to bring it up during negotiations at some time to get language clarification. They want to make sure whatever your contract is, that the ordinance coincides with Act 600. With the non-uniform there was one finding, the calculations on Willy Shelly's non-uniform pension amount when he moved to uniform was inclusive of his part-time wages as an officer as it needs to be amended and changed. The resolution by Council didn't specify any amount; it just said we will hold on to whatever benefit he has in that plan until he retires. He hasn't gotten anything because he's still here. That can be recalculated and be sent to him.

4. **Financial Reports** – Cathy said put these together so you can see what was received and what was put back into your plan. You will see the April fees being paid out of each plan, and it was reimbursed back into each plan, the unallocated and the allocated.

5. **Settlement Filings**
   a. **Semtech Corp. – August 27, 2002 – July 16, 2006** – Cathy said the SEC is reviewing any transactions from them or by them before August 27, 2002 through July 16, 2006. We received notices from them which means that during that time period, one of our plans had money invested with them. Molly asked what plan? Cathy said it was both plans, uniform and non-uniform.

6. **Approval of March 9, 2011 Meeting Minutes** – Priscilla said page 2 of 4, it should say we needed to hire experts. She also forgot Mary was our interim manager and she didn't want to omit Mary. Chris said the word ventures should be changed to investments. Jack said on page 3, it should be Neubauer instead of Bauer. They will make those corrections and post them on the website.

7. **Set Date for Next Meeting – September 14th at 11:00 AM**

8. **Adjournment** – The time was 12:15 PM.