
Lower Saucon Township
Pension Advisory Committee Meeting

Meeting Minutes

September 10, 2014

Roll Call: Present – Jack Cahalan, Township Manager, Cathy Gorman, Director of Finance, Priscilla deLeon, Council Liaison, Molly Bender, and Thomas Schatzman, Morgan Stanley

Absent: Mary Curtin, Chris Leidy, Lou Mahlman

1. **MRT Report - Thomas Schatzman**

Thomas Schatzman said the total return through August is 7.08%, which is outperforming the benchmark of 6.8%. Most of the success was in interest rate sensitive areas of the account, like the ING REIT which is at 17.8%, but trails the benchmark of 19.84% by 2%.

Thomas said we had good performance in our short term fixed income portfolio, the largest single allocation, which is at 2.5% vs. the 0.5% benchmark. We fell short in Atlanta and in Winslow, which underperformed about 3% each. The interest rate sensitive areas have done well this year and we like the way they have positioned, but we really try to avoid a lot of the interest rate sensitive stocks. That being said, CS McKee is fine with the higher dividend payers. Interest rate sensitive companies, typically utilities and telecoms, have very high dividends and have done extraordinarily well this year. If you owned them, you did great, and if you didn't own them, you didn't do well. We don't want to own them at all and have no problem with some of the managers not owning them. Utilities sell for 1.2 times full price because they don't grow and any increase in pricing is highly regulated and difficult to come by. You are getting maybe 2-3% growth and they are selling at 2 times the price right now. They are incredibly overvalued, not all of them, but most of them. When we look at a portfolio, part of the risk assessment is that we really don't want that interest rate sensitivity. This year it has been good to have it and we have outperformed in spite of it.

Thomas said the fixed account is at 3.25% with a benchmark of 2.64%. Assets are up at \$216,094,982, an all time high for MRT, and the fixed account is at \$9,149,529.

Thomas said your total equity allocation is 62.6%, which is very close to the target of 60%. Fixed income is light at 29.2% because of the 2.4 % in cash. Cash represents new plans to the MRT and that money will be reallocated back into fixed income bringing the total back to 32-33%.

Thomas said we replaced Luther King with Apex and the only additional anticipated activity for the portfolio is in the ING REIT. We are going to stay in the real estate asset class, but we are moving away from publicly traded to privately traded real estate. MRT will have direct ownership in about 50 properties across the USA, which is very similar to a REIT in structure, security, and asset class. The only exception is that you are not overpaying for real estate. Investors in publicly traded REITs chase the yield. Typically, the REIT portfolio would yield 5%; right now it is 3.2% and we think that is too low to take on real estate risk. The Fed clearly indicated that rates are going to be rising and we want to deemphasize those areas with interest rate risk. In this environment, it is necessary to swap from public to private and get into the property at book value, increasing the yield from 3.2% to 5.2%.

Thomas said we don't see anything on the horizon that would change the 7% already earned this year. The S&P is up 80 % and having an average year and close to where they will finish for the year. We are fully valued, but not overvalued. We will increase our international allocation a little because European equities are cheap. The recession in Europe will not be severe and the European Central Bank will not

start its own quantitative using process (printing money). There are consequences to that; one being the currency. We are calling for a weaker Euro, but it will not affect long term investors.

Thomas said to summarize the portfolio, there is a lot of liquidity, it is biased towards high quality, against interest rate sensitivity, and will increase the international allocation because those markets are relatively cheap vs. US stocks.

Jack said what does the MRT own under the private REIT. Thomas said the MRT recently approved two real estate managers to replace ING. ING's absolute numbers were very good, but they never outperformed the benchmark. Thomas said the publicly traded real estate is expensive vs. private. AEW & ASB are the new managers and I will forward you complete information on both. Thomas said all they do is purchase and operate direct ownership in real estate. It is the same real estate you already have. Thomas said instead, you will have a direct ownership stake rather than going through a trust to buy the same property and pay more for it. MRT has the substantial assets required, \$10- million, to be able to hire a private equity real estate manager. Thomas said this does not change the risk profile; it is less risky than owning publically traded real estate. The fundamentals are very strong and we don't want to overpay. Thomas said by having these firms own and operate real estate with high occupancy rates and rents, they can do well in this environment and give you pricing power. You really don't know what you own in a REIT, but it is a good way to own properties that you would never look at.

Jack said we own a percentage of a portfolio of properties. Thomas said yes, a little over 100 properties. It is not a hedge fund and you literally own the cash flow from these properties. They are working, high end malls and apartment buildings with the same dynamic as the real estate you already own, but are less volatile in the private market. Thomas said the private market's growing cash flow has a 2% benefit to the MRT. REIT's are not as overvalued as utilities but they will get hurt when the Fed starts to undo what it's been doing the last 6 years. Thomas said all the things that benefited from lower rates will destabilize when rates increase. We are calling for a slow methodical increase in rates and REIT's will be one of the areas affected.

Jack said one says global REIT; do we own properties outside the USA. Thomas said yes, and that will change. You will have a 100% domestic portfolio, but within ING you have some global exposure. Thomas said the reason people go global is due to the higher overseas yields.

Jack said can we divest ourselves if we want out of the REIT; how can we pull out our ownership. Thomas said they are all publically traded stocks. We will use the REIT as a source of funds, about \$5-million a quarter, to finance the new private equity portion of the portfolio. Thomas said did that answer the question? Jack and Cathy said no. Cathy said if we want to divest from the private funds can we do that if we have ownership. Thomas said it is a liquid market and each of the funds offers a monthly window to redeem. However, they can put up a gate and say they don't have any money to redeem for you, which is a risk with private equity, but high quality trades no matter what.

Cathy said it sounds like the mortgage crisis with the housing market that we just got out of. Are the federal safeguards modified to this. Thomas said there is not much leverage in these portfolios in terms of mortgage exposure; it is not a component. You are the lender and owner and none of the properties will have more than 60 % LVT. Thomas said you would feel the mortgage meltdown more on the publicly traded equity side than you would in fixed income.

Priscilla said when is this going to happen. Thomas said the managers are already hired. The first draw will occur approximately September 30. Priscilla said there are representatives from the police department and the Township that are absent today and this is a new concept. Thomas said you already own real estate; you are only changing the way you own it. If you have \$10-million to invest, you will pay a lot less for property and it will yield a lot more. Thomas said there is more risk in REIT's than

private ownership. You will own the same asset class, but do so smarter. Thomas said REIT portfolios will get hit when rates change. We do want to own real estate, we like real estate, but not that way. Thomas said it sounds like a revolutionary idea, but you will be pleased with the performance and the properties of ASB & AEW and feel more comfortable.

Priscilla said can you put this in a synopsis that we can share with the people that are absent from the meeting today. Cathy said you can forward it to me with the reports about the new project managers and I can forward both to them. Priscilla said explaining it all and then in December we can discuss it because we should see progress by then. Jack said is the MRT going to stay in 5-10% asset allocation. Thomas said we are at 5%.

Jack said we will get that information and distribute it. Priscilla said we can speak up if we don't like what we see in December. Jack said we can talk to them and say we are not happy, but we can't change MRT; they make the decisions. Priscilla said I was not expecting that, were you? Cathy said based on the last meeting, I had an inclination that REITS were going to be discussed. Jack said it has always been volatile, but they are managed and this is a way of having more control. Now we are buying blind and do not know what we are investing in. Cathy said I am more comfortable with it being liquid. Jack said there will be a portfolio to look at it and if it's objectionable we can say we want out.

2. Financial Reports

Cathy said we are paid to date. We have deposited \$10,489.27 in the non-uniform plan and \$27,654.14 in the uniform plan for admin fees.

3. 2015 MOM – State Aid

Cathy said at the last meeting, I gave a preliminary and made some slight readjustments. Based on payroll history, the MMO for the uniform plan is \$278,821 and the non-uniform is \$86,546.

Cathy said we received notification that our state aid unit value is \$3,872.95, which will result in a payment for September of \$197,520.55. It is approximately \$7,000.00 more than last year. The reason is, although the state unit value has slightly decreased, we had another AG385 filing and there was a member I could add back on.

Cathy said the 2014 obligation for the non-uniform plan is \$88,962 and the uniform plan is \$272,162. You can see that the non-uniform obligation has gone down and the uniform up. Cathy said we will bring these to Council for ratification and add it to the 2015 budget.

Priscilla said when is the next review. Cathy said 2015; it is done every 2 years. Our revenue projections have been consistent because we changed our assumptions and they are in line.

Priscilla said do the residents pay the difference; would they pay if it's over. Cathy said for the non-uniform plan it is about \$6,000.00. Cathy said I can email you the specific numbers. Priscilla said that has gone down. Cathy said this year for the non-uniform plan we are paying \$88,967 and getting \$91,331, which is about \$6-7,000 difference. The uniform plan is \$272,000 and the unit value is approximately \$116,000. We are more caught up on the non-uniform end, not on uniform.

Priscilla said are we doing well compared to others in the state. Cathy said I filed paperwork with the state that we are not in a distressed level. It verified with them that we are not taking necessary actions to catch-up and that we are at a level where we are not required to.

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Priscilla said could we get into a problem if more people retire. Cathy said no, they are being assumed for the life span of their career here and we are paying into that.

Jack said do you normally take a vote because there are only two members here. We need to say this was reviewed and approved by the pension committee. Cathy said if it's ok with the members, we can do it via email and then we will have a record.

Jack said what is the voting quorum. Molly said for non-uniform, it's me, Mary Curtin, and Lou Mahlman and for uniform, its Chris Leidy, Mary Curtin, and Lou Mahlman. The PD is not represented today. Cathy said we will note it was reviewed.

4. **COLA – Ron Jacoby**

Cathy said Ron Jacoby is entitled to a 2% increase as of November 1, bringing him to 11.6 % of the 30% max. The police receive COLA on their retirement date vs. at the beginning of or end of or fixed date in the year.

5. **Settlement Filings**
None

6. **Approval of June 11, 2014 meeting minutes-**

7. **Adjournment:** The meeting adjourned at 11:45am.

8. **Next Meeting:** December 10, 2014 @ 11:00 am