A regular meeting of the OPEB Committee was held on Thursday, November 10, 2022, at 9:00 a.m. in the Administration Conference Room at Town Hall, 500 Poplar View Parkway.

The following members were present: Stan Joyner, Charles Taylor and Shanda Ford. Absent was Preston Carpenter and Valesa Wells.

Staff present was Adam Hamric, Kristie Diamond and Lynn Carmack.

Also present was Pension Attorney Frank Carney, Susan Fletcher and Ryan Miller of First Horizon Bank, Richard Ellis of Ellis and Ward Benefits Group, and Cody Kocher (remotely) of Nyhart.

Approval of Minutes

Motion by Ms. Ford, seconded by Mr. Taylor, to approve the minutes of the August 11, 2022, meeting.

ROLL CALL: Taylor – yes, Ford – yes, Joyner – yes. Motion approved.

Review of Actuarial Report as of July 1, 2022 (Cody Kocher, Nyhart) ***via Zoom***

Mr. Kocher introduced himself as an actuary with Nyhart, who works on OPEB valuations.

Mayor Joyner asked Mr. Kocher to present the actuarial report of how the Town's OPEB is doing and if there are any changes that need to be made.

Mr. Kocher said that as of June 30, 2021, there was a total OPEB liability of $8,536.623 and $17,910,432 of assets in the OPEB Trust, which left an overfunded position of $9,373,809 net assets (209.8% funded ratio).

As of June 30, 2022, Nyhart calculated liability came in higher at $18,152,657, and the assets decreased to $15,171,941. The net OPEB liability currently is $2,980,716 (83.6% funded ratio).

Mr. Kocher said the Town is still in a very strong position from a funded perspective and there is no cause for concern.

He explained that the increase in this liability comes from what they refer to as "pre 65 retirees," and as people age, on average, they cost more to cover on health plans.

The Town has health plans that cover active employees in their 20's all the way through their 30s, 40s or 50s. Most of the retirees are in their late 50s and 60s, but they are still in the "pre-65" point. They are required to recognize that as people age, they cost more to cover.

Nyhart takes the premium rates and applies the aging factors that help to estimate the impact of that age, to come up with an estimated cost for covering someone in these age spans.

They estimate that a retiree, age 50 – 64 is going to cost about $15,000 a year to cover on the Town's health plan.

The biggest driver for the increase in liability is the per capita cost Nyhart used.

Discussion ensued regarding participant numbers with and without coverage and the increase in liability from last year to this year.

Mr. Kocher explained that the expected cost per capita is based on the expected claims rate for the interlocal health trust plan of the Town, to determine cost estimates.

Mr. Kocher further explained that in determining the per capita costs, they look at the entire population (450 active employees on the health plan). They project the likelihood that these 450 active employees will stay on the plan until retirement. The 365 per capita cost impacts the 16 retirees now, but they also build in for all of the active employees as well.

Upon a question from Mayor Joyner, Mr. Kocher stated that if an employee is not vested and they are not eligible to retire, those requirements are coded into their valuations; they do not value anything for them.

Mayor Joyner asked the reason for the large increase in OPEB liability in a period of a year.

Mr. Kocher answered that the biggest driver of the increase was the change to updated per capita cost methodology that Nyhart is using. The change in the 365 per capita cost methodology compared to what the prior actuary used.

Mr. Ellis said that Nyhart has to project, in the future, for all Town employees, not just for the 16 retirees.

He added that the biggest driver of any OPEB valuation is the claims cost, and it is just a difference of opinion as to what the future retirement claim cost is. It is an assumption as to what the claim costs are going to be in the future.

Mr. Taylor asked if there are any other significant causes for the jump in liabilities.

Mr. Kocher advised that one other change that Nyhart made was the discount rate. The prior valuation had used 7.25% for the expected return on assets and Nyhart used 6.00% (based on how the assets are allocated).

He added that a lower discount rate will always increase your liability, but Nyhart felt that the 6.00% was reasonable based on the documentation they received about the asset allocation and the expected return of assets.

Mr. Kocher asked the committee to review the report and let him know if there are any further questions.

Mayor Joyner thanked Mr. Kocher for his report to the committee.

Further discussion ensued.

Mr. Ellis said that Mr. Kocher did make the point that the Town is still in a very good financial place. He advised that he will review the report and come back with suggestions, but that it is a matter of perception of what the claims cost are going to be in the future.

Mayor Joyner asked First Horizon representatives to give their report at this time.

Ms. Fletcher said they will start with the Pension booklet, going through the Five Factor Framework and the Economic Forecast and then jump back to the OPEB performance.

Mr. Miller said economic growth is influenced by the weekly indicators put out by the St. Louis Fed. July, August and September were flashing red, which indicates a slowing economy.

Market trend takes a look at how the S&P 500 Index has done in a given month relative to its previous 12 month moving average. It was not beating its 12-month moving average and that is flashing red as well.

Monetary conditions are tied to the Fed raising rates and making monetary conditions less favorable. Since last December, it has been red and has stayed that way ever since.

Investor sentiment had been red for a long time and in February, it went to yellow. Market bottomed, which was June 16, and it went to green. When folks are scared, the color goes from red to yellow to green. As it started going back upwards, it switched back to yellow through the end of September.

Valuations takes into consideration what the PE ratio of the S&P 500 is relative to historical averages. This had been red for a long time up until June and it switched to yellow and that carried out through the end of September.

The economic forecast is put out quarterly by Chief Economist, Chris Low. The GDP (Growth of the Economy) for Q1 was -1.6% and Q2 was -0.6%. Chris was projecting 2.4% for Q3 (actually came in at 2.6%); Q4 estimate was -0.7%. Overall, Chris was projecting slightly negative to flat GDP growth for the year 2022, with a better Q3 and possibly a better Q4, that may actually go into the positive territory. For 2023, flat to slightly negative and for 2024 back to 1.8%.

Unemployment rate has been very low this year (around a 50 year low). Q1 is 3.8%; Q2 is 3.6%; Q3 is 3.6% (came in at 3.5%) and Q4 is 4.2%. Chris predicts 2023 Q4 at 6.00%.

Core PCE (Personal Consumption Expenditures) is the Fed's preferred metric over inflation; it strips out energy and food. CPI does include energy and food.

Core PCE for Q1 is 5.3%; Q2 is 5.00%; and Q3 is 4.9% (came in at 5.1%).

CPI estimate was 8.5% (came in at 8.2%) through September.

Chris Low predicts the Fed funds rate in 2023 for Q1 is 5.50% and Q2 is 6.00%.

It is Chris' projection that over the next 12 months, there is a 90% probability of recession and 95% probability over the next 2 years.

The Callan Periodic Table of Investment Returns shows, for the first quarter of the fiscal year, how July, August and September were. A lot of negatives. High yield bonds triple led the pack, with real estate being the worst.

<u>Review of the Quarterly Investment Performance of the OPEB Trust Fund by Financial Advisors – First Horizon Bank (Ryan Miller and Susan Fletcher)</u>

IPS Guideline & Capital Market Assumptions as of 09/30/22:

This shows what the capital market assumptions are for the portfolio over the next 10 years (put out by Invest Net). This is for a 65% equity and 35% fixed income portfolio. The expectation is that the fixed portion is about 65 basis point; equities is 3.97% and overall, a 4.61% annualized rate of return over the next 10 years. This has not changed since the last meeting.

Market Value & Performance:

July was a positive month, but August and September were down. Overall, for the quarter, the portfolio is down -5.22%; 1 Q is -5.22%; 1 year is -16.99%; 3 year is 2.63%; 5 year is 4.08%; 10 year is 6.30%; and since inception is 8.07%. It is still putting up a solid rate of return and beating the blended benchmarks.

Ms. Fletcher presented more recent performance (as of 11/09/22): October was up 4.98%; November (MTD) was -1.06%; QTD was up 3.87%; and FYTD was down -1.56%. Total market value is $15,004,681.

Asset Allocation:

This is rebalanced at the end of every quarter (last balanced on 9/28/22). The fixed income is 1.06% higher than target and the equities are -1.06% lower than target. Still within range.

Holdings & Performance:

Fixed Income Funds – ranging from short term to intermediate, all down, as a result of the Fed continuing to raise rates. The Fed moved rates from 1.75% to 3.25% during the quarter (an 85% increase).

The 10-year treasury went up 27% and the 2-year treasury went up 45%. All of the rates moving up compressed the values of the bonds in these portfolios and that is why you see a negative rate of return.

Common Stocks – these are made up of the 49 stocks large cap core portfolio that First Horizon manages. A lot of negatives.

Overall, collectively, the portfolio is down -7.6% for the quarter. That brough the YTD return to -20.32%. This is targeting a benchmark of the S&P 500. S&P was -4.88% for the quarter, but YTD the S&P is down -23.87%.

The worst performers for the quarter were Intel (-30.14%), Baker Hughes (-26.88%) and Verizon (-24.04%).

The best performers were Regeneron (16.53%), Unum (15.04%) and Walmart (7.14%).

Individual Domestic Equity Funds - Large cap value performance was the worst for the quarter.

Small cap growth was the best performer for the quarter. It was the only sub asset class that is positive, with the return of 25 basis points for the quarter.

The worst YTD is mid cap growth (-31.45%).

International Equity (both developed and emerging) – ClearBridge (-8.3%) and JHancock (-12.07%) are the developed international. Developed international has not done as well as domestic equities have. The MSCIE Fund (developed international) was -9.29% for the quarter. The MSCI emerging markets was -11.43% for the quarter.

The First Horizon Investment Committee, after long discussion, has determined that they will remove emerging markets exposure from their models.

The Town's IPS calls for 15% international and it does not break up between developed and emerging, so the Investment Committee will take the emerging piece and redistribute it into the developed international this quarter.

Ms. Fletcher asked if the Committee is comfortable with the current allocation of 19% for intermediate and 15% for short term.

Brief discussion ensued.

The Committee agreed to go up a couple of points on short term, and down a couple of points on intermediate.

Mr. Miller said that the emerging markets will be sold off by the end of the quarter, so there will be less volatility.

Ms. Fletcher advised that the (historical market) value of the trust was down -5.22%, which equated to $794,298.

Today, the value of the trust is up over $15,004,681 and the QTD is up 3.87%.

Ms. Fletcher added that expenses continue to be in line, with the weighted expense ratio at 0.09% and other fees at 0.06%. Total out of pocket, as well as the internal expenses, were 15 basis points for the quarter.

There were no questions or comments.

Adjournment

There being no further business, the meeting was adjourned at 10:05 a.m.

Stan Joyner
Chairman

Lynn Carmack
Town Clerk