GLASTONBURY BOARD OF FINANCE
SPECIAL MEETING MINUTES
MONDAY, JANUARY 24, 2022

The Glastonbury Board of Finance, along with Finance Director, Julie Twilley, and Town Manager, Richard J. Johnson, held a special meeting at 4:00 p.m. via Zoom video conferencing. The video was broadcast in real time and via a live video stream.

Also present were Narae McManus, Controller; Chris Kachmar from Fiducient Advisors; and Becky Sielman from Milliman.

Roll Call

Members
Mr. Constantine "Gus" Constantine, Chairman
Ms. Jennifer Sanford, Vice Chairman
Mr. James McIntosh
Ms. Susan Karp
Mr. Robert Lynn
Mr. James Zeller

1. Public Comment Session: Comments pertaining to the call. ***None***

2. Communication: Becky Sielman from Milliman to discuss Pension Valuation

Ms. Sielman explained that the valuation reflects what has happened through July 2021; it is not a predictor of what will happen in the future. While the pandemic has caused more deaths than is normal in any given year, they have chosen not to make any adjustments to the calculations. Ms. Sanford asked when the mortality tables will be updated. Ms. Sielman stated that, due to the pandemic, the typical scheduled update of once every five years may be delayed by a year or two. It will also be difficult to reflect normal, pre-pandemic levels of mortality versus the abnormal levels caused by COVID-19. They have chosen not to make an adjustment as a statement of conservatism.

Ms. Sielman reviewed the plan's assets. Investments performed well, with returns just under 27%. However, in order to provide budgetary stability for municipal plans, they calculate an actuarial value of assets that gradually reflects market gains and losses over a five-year period. The actuarial value only reflects one-fifth of those big market gains, but that is what they use to calculate the town's contribution and measure the plan's funded status. Should the fiscal year end with a market loss, last year's gains will provide a cushion.

Mr. McIntosh would like to see a longer timeline, looking 9 years back, to see which numbers are smoothed out. Ms. Sielman explained that they chose to show just 5 years of history because that is the recent past. If it is helpful to show a longer history on the graphs, they can provide that. She noted that the actuarial value of assets does not include anything about the future. It looks at the market value today and the unrecognized market gains and losses that have occurred over the past four years. Mr. McIntosh would find it helpful to look at the valuation numbers before going into budget season. He asked if it is possible to receive the report at a later date, like January 1, instead of July 1. Ms. Sielman stated that they must measure the plan's assets and liabilities as of June 30 for purposes of the Town's annual financial report.

Ms. Sanford finds that the pension is moving in the right direction. There is a lot of volatility worldwide, which they are trying to smooth out so that the ADC is less volatile in the future. Ms. Sielman stated that the most volatile piece of this picture is market returns. Liabilities move very little from year to year. The most important tool at their disposal for controlling market volatility is calculating the actuarial value of assets, which is used to determine the ADC.

Mr. McIntosh asked if the unfunded liability ratio is calculated based on market value of assets or the actuarial value of assets. Ms. Sielman stated that it could be calculated either way. However, the Town's financial report requires it to be calculated off the market value of assets. Mr. McIntosh stated that the financial report will show the plan as 100% funded, but in the ADC, it will show that it is 72% funded. Ms. Sielman explained that those gains have piled up as of June 30, 2021. The actuarial smoothing leaves some room for a market correction. She explained that the plan is doing what it was designed to do. It is not uncommon for plan benefits to increase over time. They also project that the plan's assets will increase. Ms. Sanford asked if last year's 3.5% growth rate assumption in wages is still the same, given the pressures from inflation. Ms. Sielman stated that they did not take into account short term inflationary or disinflationary effects when setting the long-term assumption.

Ms. Sielman explained that the members who are covered by the plan have held fairly steady over the years, with a modest number of terminated members. Mr. McIntosh asked what the reference to refunds is on page 7. Ms. Sielman explained that if someone terminates before becoming vested in the pension benefit, then they are entitled to a refund of their contributions, with interest.

Ms. Sielman reviewed the accrued liability, which is $252 million as of July 2021. The bulk of that, $135.7 million, is for service retirees. $100.9 million is active member liability. She explained how the liability numbers fit into the historical patterns. Because this is the funding actuarial report, they used the actuarial value of assets, not the market value. It is a normal pattern for both the accrued liability and the funded ratio to be growing. However, assets should be growing faster than liability.

Ms. Karp asked, when setting the recommended contribution levels, do the actuaries work towards a goal for the funding ratio. Ms. Sielman explained that the contribution is three parts: the normal cost, which is the all-in cost of having the benefit exist in this year and providing benefits to the active members. The second, bigger piece is the past service cost, which is this year's payment to gradually get the plan to 100% funded. The Town has 12 years left in the amortization schedule. The third component is interest. They have added one year's worth of interest to reflect the passage of time. This year's contribution is lower because of the great market performance last year.

Mr. Lynn stated that there is a $70 million actuarial hole. They have also operated under actuarial tables that were not correct and people have been living longer. Based on what is known now, previous citizens did not pay the actual amount for the services rendered. Ms. Sielman stated that, 20 years ago, they operated under the best information and advice they had available. Mr. Lynn brought it up in the context of the discussion of bonding for CIP projects. Taxpayers are already paying for services that were used in prior years.

Mr. Zeller stated that, last year, $1 million was contributed to the pension. The return on that investment was 9.2%. He asked what a contribution of $1 million would do to lower the town's operating budget this year. Ms. Sielman explained that there will be a reduction in the ADC, but it is not a dollar-for-dollar reduction. Amortizing over 12 years, an extra $1 million contribution results in about a $102,000 reduction in the past service cost. They are gaining the benefits over a shorter amortization.

Ms. Sielman explained that as the pension plan gets closer to being 100% funded and the amortization period gets shorter, this will lead to more contribution volatility. One of the mechanisms to address contribution volatility is to set aside money in a reserve fund, which can be drawn from at any time. West Hartford and Norwich have already set up pension reserve funds. She asked the Board to contemplate this modest investment opportunity. Mr. Zeller asked if the reserve fund will impact the ADC the same way it would in the pension. Ms. Sielman explained that it would not impact the ADC; however, reserve funds earn higher returns than the General Fund, but lower than the pension trust. She thinks of it as a hedging strategy.

Ms. Sanford's inclination is to go directly into the pension fund. She is not aware of ADC volatility. She finds it concerning to see the continued growth of the percentage of contributions to payroll. However, she does not view that as volatility, but rather, as the fact that pension benefits are growing faster than payroll. Ms. Sielman stated that the most volatile place to be, in terms of contributions, is 100% funded. There is a Connecticut statute that enables municipalities to establish reserve funds. Ms. Sanford asked if the liquidity of West Hartford and Norwich is a cash flow positive. She is concerned that Glastonbury is becoming cash flow negative, which drives one to sell assets before expecting to do so. Ms. Sielman stated that it is the opposite. Both the West Hartford and Norwich plans are more mature than this one. Because their pension plans are fully funded, the fact that they have negative cash flows is immaterial.

Ms. Sielman reviewed the long-range investment forecast, explaining that once the plan becomes fully funded and the contribution bottoms out, the plan will overshoot the mark a little bit. This projection does not assume that there is a market correction. If there is a market correction, the funded ratio will still end up being 100% 12 years from now, but the contribution will not decline as much.

She then presented a couple alternative scenarios that represent the biggest hurdles clients face: what if the Town under-contributes relative to the ADC? This will push contributions dramatically out to future years. And what if investments chronically fall short of the interest rate assumption? If investments are not yielding what the actuaries assume they will, it will just increase the Town's contributions going forward. This is why she finds it important to be conservative on the interest rate assumption. Ms. Sanford asked if it is a standard in the State of Connecticut that pension benefits are growing as a percent of payroll. Ms. Sielman clarified that it is not the pension benefit that has been growing, but rather, it is the Town's pension contribution as a percent of payroll that is growing. She went on to explain that the growth in the pension contribution is related to the reduction in the plan's rate of return assumption and implementation of new mortality tables, not growing benefits.

Mr. McIntosh asked if the "assuming that members" on page 38 should also include "and beneficiaries". Ms. Sielman explained that "members" is an encompassing term which includes beneficiaries. Mr. McIntosh observed that there is a tension between controlling volatility and getting the ultimate economic benefit from the funds that they put aside for this purpose. Decisions are made by taxpayers and politicians who seek to avoid volatility, but the decisions increase the cost ultimately of funding pension benefits. Ms. Sielman agreed that this is a tension that every plan sponsor must come to terms with: the tradeoff between risk/volatility and reward. Ms. Sanford contended that volatility is a good opportunity to achieve higher returns in assets. The Board's job is to identify those opportunities in the real world, which they have done. Mr. McIntosh agreed but noted that volatility is politically unacceptable. Mr. Zeller agreed that the Town is where it should be right now. However, 15 years ago, they thought the same thing. He would like to know which specific indicators they should watch out for to see if the Town is, in fact, where it needs to be.

3. Communication: Chris Kachmar from Fiducient Advisors to discuss Asset Allocation Analysis, Capital Markets Overview and Portfolio and Manager Review

Mr. Kachmar explained that capital markets are more volatile, due to growing interest rates, higher inflation, supply chain issues, and geopolitical risks, and that volatility is likely to continue. The Town's mechanism to deflect some of that volatility has been through diversification and taking thoughtful risk. They expect global economic growth going forward. The 20-year outlook has not changed much year over year. Under fixed income, there are nominal, and in some cases, negative, returns. There has been no dramatic change in equities.

Ms. Sanford stated that negative real returns continue to make cash an expensive opportunity cost. 5-year forward rates are plummeting whereas crude oil rallies. In the near term, there is a break in correlation and a turning point for inflation. She asked if credit spreads will narrow. Mr. Kachmar expects that, year over year, spread levels will stabilize and stay about where they are.

Mr. Kachmar described the backdrop and philosophy of the asset allocation framework. The takeaway from the 20-year outlook is that the Town's mix of assets will generate a return that is consistent with the actuarial expectation at the rate of return assumption of 6.25%. Therefore, no wholesale changes need to be made. Ms. Sanford discussed the difference in the outlook using the 10-year forecast and 20-year forecast. Mr. Kachmar explained that the 20-year outlook has more power in strategically managing the program than the 10-year outlook does.

Ms. Sanford asked if it is within the domain of the existing bond managers to invest in the dynamic bonds category. Mr. Kachmar explained that generally it is not. The managers are confined to a more traditional approach, and they are comfortable with the way that the Town is allocated today. Mr. Zeller asked if dynamic bonds are less volatile than equities but more volatile than the Town's current bond strategies. Mr. Kachmar stated that is correct.

Mr. Lynn asked if there are any municipalities considering private equity. Mr. Kachmar stated that they are starting to see more interest in private capital. Manchester has been running a private capital program for years, and last year, Westport implemented a program, as well. Ms. Sanford is concerned that it is costly to get in, with start-up fees. She is also concerned that placing assets into private equity will decrease the liquidity of the pension. Mr. Kachmar will share data with the Board to see if it is something that fits their risk appetite. He noted that the optics in a municipal setting is something to be mindful of.

Mr. Kachmar explained that, as of Friday night, the Town's portfolio was valued at $207.5 million, which is a $9 million reduction. The portfolio actual allocation versus target weights is not directionally off. Manager performance on an absolute basis in 2021 was good. However, Jackson Square and Vanguard International Growth struggled. They continue to spend a lot of time with the manager at Jackson Square. However, neither have been elevated to a level that necessitates action. No changes are recommended to the strategies.

Ms. Sanford noted that, at the last meeting, Mr. Kachmar stated that most of the underperformance of the managers versus benchmark was due to Jackson Square. She asked if that is still true or if Vanguard International is also responsible. Mr. Kachmar stated that the lion's share of the shortfall comes from those two managers. Ms. Sanford asked how committed they are to a small and mid-cap growth strategy. Mr. Kachmar explained that there is a case for consistent representation for small and mid-cap equities. Trying to time entry and exit points discreetly on the capitalization front is challenging.

Mr. McIntosh stated that, at the last meeting, Ms. Karp suggested that the BOF send materials to the Council and the BOE. He suggested that the reports from Mr. Kachmar and Ms. Sielman be copied to both groups to show the materials that have been made available to the BOF regarding the pension element of the budget. Ms. Karp agreed and suggested also including a brief summary of what the BOF heard today regarding the pension and how they are moving forward. Ms. Sanford looks forward to the study on dynamic bonds. She also asked to see if there are other options for Vanguard International, since they are very heavy on investments in China.

4. Communication: Minutes of December 15, 2021 Regular Meeting

Under Roll Call, Ms. Karp's name was incorrectly listed as Walter Cusson.

Minutes accepted as amended.

5. Communication: Pension Report – November 2021

Ms. Twilley reviewed the report dated December 22, 2021.

6. Communication: Month End Investments – November 2021

Ms. McManus reviewed the report dated December 17, 2021. Mr. McIntosh pointed out that Glastonbury is in these very low return investments because of state restrictions. He asked that when the Town Manager confers with state representatives, he suggests that a statute be enacted which would authorize towns with high credit ratings to have more flexibility in their investment of these types of funds. Mr. Johnson will pass along that request.

7. Communication: Financial Summary (Revenues & Expenditures) for 6 months - December 2021

Ms. Twilley reviewed the report dated January 12, 2022. Ms. Karp stated that information was provided at the CIP workshop about revenue loss funding that is similar to ARPA which could come to the town. She asked how that will tie into what they are seeing and how it will be managed. Mr. Johnson explained that loss revenue is a category of ARPA, not an addition to ARPA. The Treasury has decided to give a $10 million assumed revenue loss, as a category within ARPA money, to provide for greater flexibility in how towns can use their funds.

8. Communication: Capital Projects – December 2021

Ms. Twilley reviewed the report dated January 11, 2022.

9. Communication: Self Insurance Reserve Fund – December 2021

Ms. Twilley reviewed the report dated January 7, 2022. The total reserve is $15.2 million. There have been no large loss claims this year. Ms. Karp requested adding a line item at the bottom of the report that just says, "Town Policy Board Reserves". Ms. Twilley stated that it is listed on the quarterly reports, but she can also add it to the monthly reports.

10. Communication: Transfers Approved by Town Manager Since Last Meeting
    a. $2K Community Development – Advertising

    b. $250 Property Assessment – Data Processing

Mr. Johnson explained that the Glastonbury Citizen has changed its submission deadline for public hearing notices, making it difficult for the Town to get their notices into the weekly paper. Consequently, they are seeking other publications for publishing notices, but it is more expensive.

11. **Action:** Transfers over $5,000
    a. $16,250 Financial Administration – Lease Management Software

Motion by: Mr. Zeller ***Seconded by:*** Mr. Lynn

BE IT RESOLVED, that the Glastonbury Board of Finance hereby approves the transfer of $16,250 from the General Fund - Insurance/Pensions - Casualty Insurance to the General Fund - Financial Administration - Data Processing as presented, without changes.

Result: Motion passed unanimously {6-0-0}.

12. Communication: Budget Schedule FY22/23

Mr. Johnson reviewed potential dates for the BOF budget workshops. He will confirm if Council Chambers are available for each date/time, but members also requested that a hybrid option (both in-person and Zoom) be made available for most meetings. The Board agreed upon the following Budget Meeting calendar:

- Town Operating Budget and CIP: Tuesday, February 1 from 3:30 p.m. to 6:30 p.m. via Hybrid (Zoom and Council Chambers)
- Board of Education and Public Hearing: Wednesday, February 2 from 3:30 p.m. to 6:30 p.m. via Hybrid (Zoom and Council Chambers)
- BOF Public Hearing and Unfinished Budget Related Items: Monday, February 7 from 6:00 p.m. to 9:00 p.m. via Zoom
- BOF Recommends Budget to Town Council: Wednesday, February 16 from 4:00 p.m. to 7:00 p.m. via Hybrid (Zoom and Council Chambers)

13. Communication: Audit Review Meeting (identify BOF representatives)

Ms. Twilley stated that two BOF members are needed to serve as representatives at the annual Audit Review Meeting, which will tentatively be held on either February 9 or 10 at 12:00 p.m. She does not yet know whether the meeting will be held via Zoom or in-person. Mr. Constantine volunteered to serve. Mr. Lynn can participate via Zoom on February 9 and Ms. Karp on February 10. Ms. Twilley will circle back with more information on the meeting format and date.

14. Board of Finance Committee Reports, comments, and remarks (no action to be taken)

Mr. McIntosh stated that, at the December meeting, he commented on his feelings about the scope of inquiries by BOF members. Following that meeting, his statement was questioned by Mr. Zeller. At a future time, he will submit a fuller explanation on what he thinks should be done in terms of inquiring about town operations and operations of the BOE. Mr. Zeller stated that he was not questioning Mr. McIntosh's right to raise the issue. He was simply trying to clarify what he was referring to by affordability.

15. Adjournment

Motion by: Mr. McIntosh ***Seconded by:*** Mr. Zeller

BE IT RESOLVED, that the Glastonbury Board of Finance moves to adjourn their meeting of January 24, 2022, at 6:51 p.m.

Result: Motion passes unanimously {6-0-0}.

Respectfully submitted,

Lilly Torosyan
Lilly Torosyan
Recording Clerk

For anyone seeking more information about this meeting, a video on demand is available at [Public Broadcast Video on Demand | Glastonbury, CT (glastonburyct.gov)] click on Public Broadcast Streaming Video Portal.