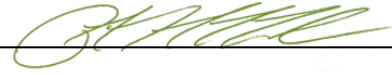


AGENDA ITEM NO. _____
COUNCIL MEETING _____

APPROVED BY _____



February 9, 2017

FROM: CITY OF FRESNO RETIREMENT BOARDS

BY: ROBERT T. THELLER, *Retirement Administrator*
City of Fresno Retirement Office

SUBJECT: SUBMISSION FOR INFORMATIONAL PURPOSES OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORTS (“CAFR”) REGARDING THE FINANCIAL ACTIVITIES OF THE CITY OF FRESNO RETIREMENT SYSTEMS FOR THE FISCAL YEAR ENDING JUNE 30, 2016

RECOMMENDATION

The Retirement Boards have reviewed and approved the attached Comprehensive Annual Financial Reports for the fiscal year ended June 30, 2016 and recommend that the City Council receive and accept the reports for informational purposes.

SUMMARY

The Retirement Boards are proud to submit their June 30, 2016 Comprehensive Annual Financial Reports (“CAFR”) to the City Council for informational purposes to keep the City Council informed and provide knowledge of the Retirement Systems’ activities from the past fiscal year.

CAFR Information

At their January 11, 2017 Retirement Board meeting, the Boards approved the attached Comprehensive Annual Financial Reports (“CAFR”) for the fiscal year ended June 30, 2016. At that meeting, the Boards directed the Retirement Administrator to submit each CAFR to the City Council, Mayor and City Manager and to keep the City informed on the activities of the Retirement Systems.

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Fresno Retirement Systems for each of their Comprehensive Annual Financial Reports for the fiscal year ended June 30, 2016. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. These reports must satisfy both generally accepted accounting principles and applicable legal requirements.

The two City of Fresno Retirement Boards, which oversee the administration of the Retirement Systems and combined investments of \$2.5 billion as of June 30, 2016, respectfully submit the results of their fiscal year 2016 investment earnings and the funding status of the Systems.

The Comprehensive Annual Financial Reports ("CAFR") of the City of Fresno Retirement Systems for the years ended June 30, 2016 and 2015 are submitted herewith. Information contained in these reports is designed to provide a complete and accurate review of the year's operations. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, rests with the management of the Systems. For a general overview of the Systems' finances, please refer to Management's Discussion and Analysis letter in the Financial Section of the reports.

In addition to the information in the CAFR reports, I have prepared the attached schedule of summary information on the City's Retirement Systems. These documents are intended to provide Council members with an overview of the Systems. For a summary of major initiatives of the retirement plans, see pages iv, v and vi in the Introductory Section of the attached Financial Reports.

The Financial Reports were prepared as of June 30, 2016, and consist of six sections:

1. The **Introductory Section** describes the Systems' management and organizational structure, a summary of the plan provisions and a listing of the professional services providers; and
2. The **Financial Section** contains the general purpose financial statements of the Systems and the Independent Auditor's Opinion Letter; and
3. The **Investment Section** includes a letter from the Systems' investment consultant, NEPC, recapping the fiscal year investment results and activities, along with performance and asset allocation information; and
4. The **Actuarial Section** includes the certification letter produced by the independent actuary, The Segal Company, along with supporting schedules and information; and
5. The **Statistical Section** which includes trend information and graphs; and
6. The **Compliance Section** which includes the Independent Auditor's Internal Control Letter.

For the year ended June 30, 2016, the Boards implemented all applicable new Government Accounting Standards Board (GASB) pronouncements in the fiscal years ended June 30, 2016 and 2015, as required by each statement. GASB Statement No. 72 (GASB 72) *Fair Value Measurement and Application*, addresses accounting and financial reporting issues related to fair value measurements and disclosures. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. GASB Statement No. 72 provides guidance for determining

a fair value measurement for financial reporting purposes. It also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The System's investments are measured and reported within the fair value hierarchy established by generally accepted accounting principles. The fair value hierarchy, which has three levels, is based on the valuation inputs used to measure an asset's fair value and gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements).

GASB Statement No. 73 (GASB 73) *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, was issued in June 2015. This Statement establishes standards of accounting and financial reporting for defined benefit pensions and defined contribution pensions that are provided to the employees of state and local governmental employers and are not within the scope of Statement 68. Statement 68 establishes requirements for pensions that are provided through pension plans that are administered through trusts or equivalent arrangements. There was no material impact on the System's financial statements as a result of the implementation of GASB 73.

GASB Statement No. 76 (GASB 76), *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* was also issued in June 2015. This Statement establishes the hierarchy of generally accepted accounting principles (GAAP), and the framework for selecting those principles used to prepare financial statements of state and local governmental entities. This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The System implemented GASB 76 starting with the fiscal year ended June 30, 2016. There was no material impact on the System's financial statements as a result of the implementation of GASB 76.

GASB Statement No. 79 (GASB 79), *Certain External Investment Pools and Pool Participants* was issued in December 2015. This Statement addresses accounting and financial reporting for certain external investment pools and pool participants. Specifically, it establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. The System has determined it is not a participant in an external investment pool (i.e., Securities and Exchange Commission Rule 2a-7) in accordance with GASB 79. There was no material impact on the System's financial statements as a result of the implementation of GASB 79.

System's Funding Status

As the two highest funded Public Retirement Systems (City of Fresno Fire and Police Retirement System 119.6% and the City of Fresno Employees Retirement System 111.3% as of June 30, 2016 on an actuarial basis and *if measured on a market value of assets basis* the City of Fresno Fire and Police Retirement System 114.2% and the City of Fresno Employees Retirement System 106.3%) in the State of California, the Systems have continued to achieve favourable investment returns for the Systems when compared to other institutional investors.

Retirement Board Adopted City Actuarial Rates for Fiscal Year 2018

Additionally, the Retirement Boards at their Board meeting November 22, 2016, adopted the following City Normal Pension Contribution rates for Fiscal Year 2018:

<u>System</u>	<u>CAFR FY 2016</u>	<u>Current FY 2017</u>	<u>Adopted FY2018</u>
Employees Retirement System	12.06%	12.77%	11.39%
Actual/Est. City Normal Contributions (In Thousands)	\$13,060	\$14,993	\$13,369
Fire and Police System (Blended Tiers)	20.14%	19.02%	18.92%
Actual/Est. City Normal Contributions (In Thousands)	\$18,738	\$19,453	\$19,358

City of Fresno Employees Retirement System

The net City contribution rate for fiscal year 2018, of 11.39%, for the Employees System is a decrease of 1.38% over the current fiscal year 2017 net rate of 12.77%. This decrease is the net result of (i) the impact of changes in actuarial assumptions and refinement in projecting salaries for future DROP members, (ii) a decrease in the accumulated contribution shortfall (difference between the actual and estimated contributions) relative to the prior year and (iii) an increase in the surplus available to pay employer COLA contributions, offset somewhat by (iv) changes in membership demographics.

The projected decrease in dollars is approximately \$1,624,000 for fiscal year 2018. The fiscal year 2018 contribution decrease of 1.38% in the Employees System will be spread across the various Enterprise Funds, Internal Service Funds and to the General Fund.

We want to strongly caution the City of Fresno that these offsets/savings in City contributions are most likely short-term or temporary in nature given the current low investment return environment and will probably be eliminated over a few years.

City of Fresno Fire and Police System

The blended Fire and Police System rate of 18.92% for fiscal year 2018 is a decrease of 0.10% from the current fiscal year 2017 City contribution rate of 19.02% and will temporarily decrease the City's required payments to the Fire and Police System by approximately \$95,000 from the prior fiscal year estimated contributions. Due to the current surplus funding status, the City of Fresno's contribution rate of 18.92% is net of 4.72% in surplus credits which amount to almost \$4.8 million per year in City contribution savings.

We want to strongly caution the City of Fresno that these offsets/savings in City contributions are most likely short-term or temporary in nature given the current low investment return environment and will probably decline and be eliminated over a few years. We suggest that City Management carefully consider the impact of losing the \$4

million in credits to contribution that will have a direct effect to the General Fund over the next few years.

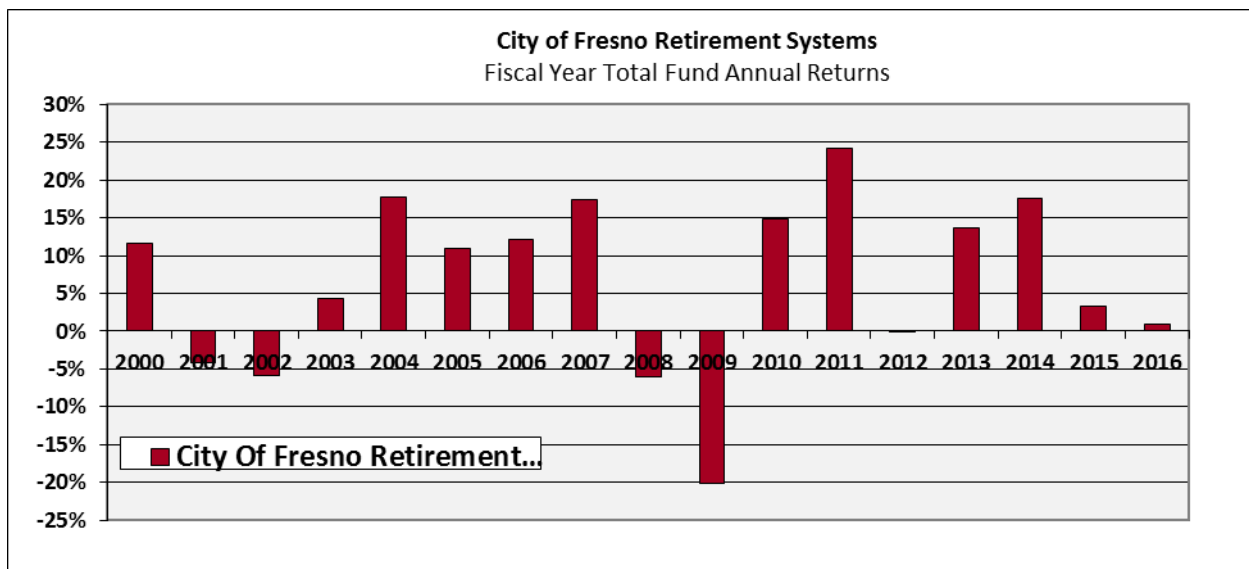
The net decrease in the City's cost are primarily a result of the difference between the actual and the estimated 2015/2016 plan year contributions after taking into account surplus available as of June 30, 2016.

Investment Return Information

For the fiscal year ended June 30, 2016, our investment activities returned gross of fees 0.90 percent; for the past three years our gross of fees return was 7.02 percent annualized, 6.82 percent annualized over the prior five years and 6.34% over the past fifteen years as of June 30, 2016.

It is of utmost importance to examine the System's investment returns with a long-term view due to the extreme volatility in the various economies of the world and the global financial markets over the past twenty to twenty-five years rather than a short-term focus which tends to distort the perception of how well the investments have actually performed. The intermediate term (three, five, ten and fifteen-year) performance rates demonstrate the extreme volatility of the markets; while the historical long-term performance rates of returns demonstrate that despite the short and intermediate term volatility the System has been able to meet or exceed its actuarial assumed rate of return of 7.25 percent over long periods. As of June 30, 2016, the System's 25-year annualized return is 8.61 percent and its 20-year annualized return is 7.51 percent.

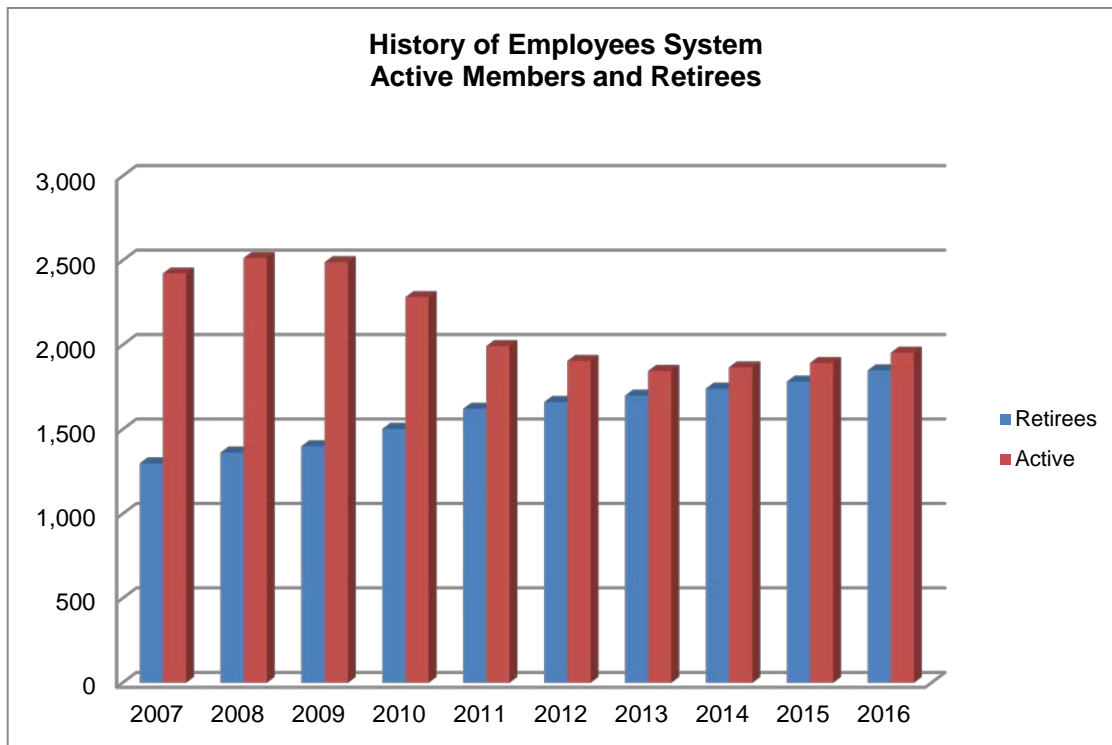
These investment returns have been achieved by the Boards on a risk controlled basis without the use of higher risk investment vehicles such as hedge funds and private equity.

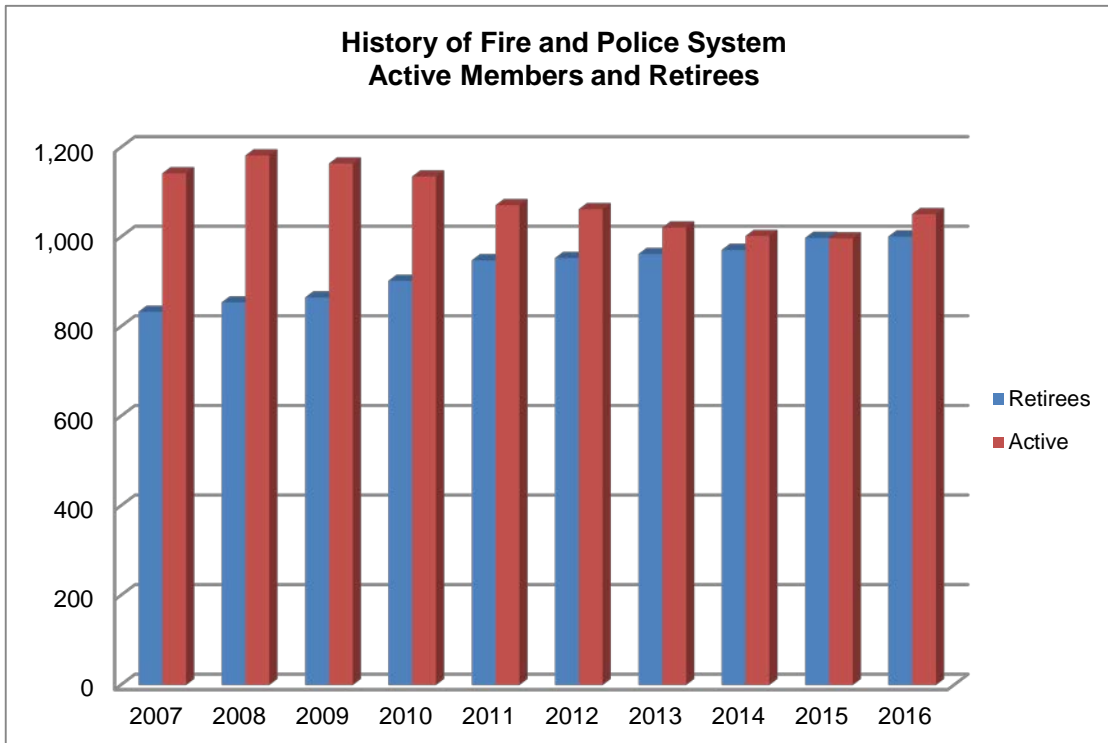


System Membership Activity

Membership activity in the Retirement Systems during the fiscal year resulted in a total net addition of 115 members, with Active membership increasing slightly despite the addition of 227 new members in the Employees Retirement System and 104 new members in the Fire and Police Retirement System for the one-year period ended June 30, 2016.

The number of retirees has also increased modestly with the Systems' adding a net total of 69 retirees for a total combined retired membership of 2,850 at June 30, 2016.





Attachments:

1. *Summary Highlights for Fiscal Year 2016*
2. *Comprehensive Annual Financial Reports for the Employees and Fire and Police Retirement Systems for the years ending June 30, 2016 and 2015.*

**CITY OF FRESNO RETIREMENT SYSTEMS
SUMMARY HIGHLIGHTS FOR FISCAL YEARS 2016 and 2015**

Description	Fire & Police System FY 2016	Employees System FY 2016	Combined Systems Totals FY 2016	Combined Systems Totals FY 2015	Net Change
Net Assets Restricted for Pension Benefits	\$ 1,351,288,640	\$ 1,143,299,019	\$ 2,494,587,659	\$ 2,546,644,219	-2.04%
Net increase (decrease) in Assets	\$ (25,429,023)	\$ (26,627,537)	\$ (52,056,560)	12,565,427	
Retirement Benefits Payments	\$ 54,428,128	\$ 51,198,523	\$ 105,626,651	102,542,571	3.01%
Annualized Investment Returns:					
One Year Performance			0.88%	3.30%	
Three Years Performance			7.02%	11.30%	
Five Year Performance			6.82%	11.34%	
Ten Year Performance			5.76%	6.87%	
Twenty Year Performance			7.51%	8.39%	
Twenty-Five Year Performance			8.61%	8.85%	
Asset Allocation Targets:					
Domestic Equities- Large Cap			22.50%	22.50%	
Domestic Equities-Small Cap			7.50%	7.50%	
International Equities			22.00%	22.00%	
Emerging Market Equities			8.00%	8.00%	
Total Equities			60.00%	60.00%	
Domestic Fixed Income			11.00%	11.00%	
High Yield Bonds			6.00%	10.00%	
Absolute Return Strategy			4.00%	4.00%	
Direct Lending			4.00%	-	
Real Estate			15.00%	15.00%	
Total Fixed Income & Real Estate			40.00%	40.00%	
Total Asset Allocation			100.00%	100.00%	
Membership:					
Active	1,051	1,954	3,005	2,890	3.98%
Retired	1,001	1,849	2,850	2,781	2.48%
Inactive Deferred Vested	81	261	342	304	12.50%
Totals	2,133	4,064	6,197	5,975	3.72%
Member Contributions	\$ 7,747,808	\$ 9,098,286	\$ 16,846,094	\$ 16,135,383	4.40%
City Contributions	\$ 18,737,948	\$ 13,060,088	\$ 31,798,036	\$ 31,293,500	1.61%
Actuarial Funding Staus (GASB 25)	119.6%	111.3%			
Market Value Funding Status	114.2%	106.3%			
Actuarial Assumptions:					
Annual Inflation	3.00%	3.00%		3.25%	
Annual Investment Assumption	7.25%	7.25%		7.50%	
City Normal Contribution rates:	Member	Member	City	City	
Fire and Police Tier 1	5.15%		26.88%	27.80%	
Fire and Police Tier 2	9.00%		22.07%	22.09%	
Fire and Police Blended City rate net			20.14%	20.83%	
Employees System		8.93%	12.04%	11.65%	