# MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION

# FINANCIAL STATEMENTS WITH INDEPENDENT AUDITOR'S REPORT

## FOR THE FISCAL YEARS ENDED JUNE 30, 2014 AND 2013

**MARIN COUNTY EMPLOYEES'**
**RETIREMENT ASSOCIATION**
**JUNE 30, 2014 AND 2013**

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BROWN ARMSTRONG
Certified Public Accountants

# INDEPENDENT AUDITOR'S REPORT

Board of Retirement
Marin County Employees' Retirement Association
San Rafael, California

## Report on the Financial Statements

We have audited the accompanying statements of plan net position available for benefits of the Marin County Employees' Retirement Association (MCERA), as of and for the years ended June 30, 2014 and 2013, and the related statements of changes in plan net position available for benefits for the years then ended and the related notes to the financial statements, which collectively comprise MCERA's basic financial statements as listed in the foregoing table of contents. We have also audited the total for all entities of the columns titled net pension liability, total deferred inflows of resources, and total pension expense ($247,139,442, $144,585,392, and $30,087,467, respectively), included in the Schedule of Cost Sharing Employer Allocations and Schedule of Employer Pension Amounts Allocated by Cost Sharing Plan as other supplementary information.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these basic financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of basic financial statements that are free from material misstatement, whether due to fraud or error.

## Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the basic financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the basic financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the basic financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to MCERA's preparation and fair presentation of the basic financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of MCERA's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the basic financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

**Opinion**

In our opinion, the basic financial statements and other supplementary information referred to above present fairly, in all material respects, the plan net position of MCERA as of June 30, 2014 and 2013, and the changes in its plan net position available for benefits for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As discussed in Note 2 to the financial statements, during the year ended June 30, 2014 MCERA implemented Government Accounting Standards Board (GASB) Statement No. 67, *Financial Reporting for Pension Plans,* which modified the current financial reporting of those elements. Our opinion is not modified with respect to the matter.

**Other Matters**

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and required supplementary information, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 26, 2014, on our consideration of MCERA's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MCERA's internal control over financial reporting and compliance.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
October 26, 2014

This Management's Discussion and Analysis (MD&A) of the financial activities of Marin County Employees' Retirement Association (MCERA) is an overview of its fiscal operations for the year ended June 30, 2014. Readers are encouraged to consider the information presented in conjunction with the Basic Financial Statements and Notes to the Basic Financial Statements.

MCERA is a public employee retirement system established by the County of Marin on July 1, 1950, and is administered by the Board of Retirement to provide retirement, disability, and death and survivor benefits for its members under the County Employees Retirement Law of 1937 (CERL or 1937 Act) and the Public Employees' Pension Reform Act of 2013 (PEPRA).

## Financial Highlights

MCERA's plan net position as of June 30, 2014, was $2,008,632,893. The plan net position is held in trust for payment of pension benefits to participants and their beneficiaries and is available to meet MCERA's ongoing obligations.

- Net position increased by $288,088,652, primarily as a result of employer and employee contributions and earnings from investments.

- Total additions as reflected in the Statement of Changes in Plan Net Position Available for Benefits represented an increase of $401,935,358, which includes employer and employee contributions of $92,932,890, an investment gain of $308,833,203, and net securities lending income of $169,265.

- Deductions in plan net position decreased from $119,192,867 to $113,846,706 from the prior year. The decrease was due to the refund of the City of San Rafael 401(h) account occurring during the fiscal year ending the June 30, 2013 with no further refunds for the fiscal year ending June 30, 2014.

- MCERA's funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2013, the date of the last actuarial evaluation, the funded ratio for all MCERA agencies was 75.1%. In general, this indicates that for every dollar of benefits due we had approximately $0.751 of assets available for payment as of that date. The funding ratios of the employer entities included in MCERA were: 78.0% for the County of Marin and agencies, 64.0% for the City of San Rafael, and 78.0% for Novato Fire Protection District.

## Overview of the Financial Statements

This MD&A serves as an introduction to the basic financial statements, which comprise the following components:

- Statements of Plan Net Position Available for Benefits
- Statements of Changes in Plan Net Position Available for Benefits
- Notes to the Basic Financial Statements
- Required Supplementary Information

The basic financial statements and the required disclosures are in compliance with the accounting principles and reporting guidelines as set forth by the Governmental Accounting Standards Board (GASB) and are prepared utilizing the accrual basis of accounting.

The Statement of Plan Net Position Available for Benefits and the Statement of Changes in Plan Net Position Available for Benefits report information about MCERA's activities. These statements include all assets and liabilities using the full accrual basis of accounting as practiced by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. Investment gains and losses are reported on a trade-date basis and both realized and unrealized gains and losses on investments are shown.

The Statement of Plan Net Position Available for Benefits is the first basic financial report. This is a snapshot of account balances at fiscal year-end. This statement reflects assets available for future payments to retirees and their beneficiaries and any current liabilities that are owed as of fiscal year-end. The Net Position Held in Trust for Pension Benefits, which is the assets less the liabilities, reflects the funds available for future use.

The Statement of Changes in Plan Net Position Available for Benefits is the second basic financial report. This report reflects the activities that occurred during the fiscal year and shows the impact of those activities as Additions or Deductions to the plan.

These two statements report MCERA's net position held in trust for pension benefits (net position) – the difference between assets and liabilities – as one way to measure MCERA's financial position. Over time, increases and decreases in MCERA's net position are indicators of whether its financial health is improving or deteriorating. Other factors, such as market conditions, should also be considered in measuring MCERA's overall health.

Both statements are in compliance with standards issued by the GASB. These statements require certain disclosures and also require the state and local governments to report using the full accrual method of accounting. MCERA complies with all material requirements of these statements.

The Notes to the Basic Financial Statements (Notes) are an integral part of the financial reports. The Notes provide detailed discussion of key policies, programs, and activities that occurred during the year.

The *Schedule of Funding Progress* in the Required Supplementary Information includes historical information about MCERA's actuarially funded status, and the progress made in accumulating sufficient assets to pay benefits when due. The other required supplementary schedule, the *Schedule of Employer Contributions*, presents historical information about the employers' annual required contributions and the actual contributions made. These schedules provide information to help promote understanding of the changes in MCERA's funded status over time.

**Financial Analysis**

The reserves needed to finance retirement benefits are accumulated through the collection of employer and employee contributions and through earnings on investment income (net of investment expense). Net position held in trust for pension benefits as of June 30, 2014, totaled $2,008,632,893, an increase of $288,088,652 over the prior year. MCERA's assets exceeded its liabilities at the end of the year. The Total Plan Net Position represents funds available for future payments. However, of importance, is the fact that unlike private pension funds, public pension funds are not required to report the future liability of obligations owed to retirees in the Statement of Plan Net Position Available for Benefits, and only current liabilities are reported. Below is a comparison of current and prior year balances:

| | 2014 | 2013 | 2012 | Increase (Decrease) 2014/2013 | Increase (Decrease) 2013/2012 |
|---|---|---|---|---|---|
| Investments at fair value | $ 1,977,282,977 | $ 1,682,221,938 | $ 1,422,485,857 | $ 295,061,039 | $ 259,736,081 |
| Cash and cash equivalents | 20,281,145 | 52,854,741 | 89,430,875 | (32,573,596) | (36,576,134) |
| Capital assets (net of accumulated depreciation) | 6,879,909 | 7,353,345 | 7,826,781 | (473,436) | (473,436) |
| Collateral held for securities loaned | 77,707,689 | 53,810,750 | 91,807,903 | 23,896,939 | (37,997,153) |
| Receivables and other assets | 12,595,013 | 19,784,711 | 15,456,126 | (7,189,698) | 4,328,585 |
| Total assets | 2,094,746,733 | 1,816,025,485 | 1,627,007,542 | 278,721,248 | 189,017,943 |
| Total liabilities | 86,113,840 | 95,481,244 | 131,565,860 | (9,367,404) | (36,084,616) |
| Net position | $ 2,008,632,893 | $ 1,720,544,241 | $ 1,495,441,682 | $ 288,088,652 | $ 225,102,559 |

In order to determine whether the Plan Net Position will be sufficient to meet future obligations, the actuarial funded status must be calculated. An actuarial valuation is similar to an inventory process. On the valuation date, the assets available for the payment of retirement benefits are appraised. These assets are compared with the actuarial liabilities, which are the actuarial present value of all future benefits expected to be paid for each member. The purpose of the valuation is to determine what future contributions by the members and the employers are needed to pay all expected future benefits.

MCERA's independent actuary, Cheiron EFI, performed an actuarial valuation as of June 30, 2013, and determined that the funded ratio of the actuarial assets to the actuarial accrued liability is 75.1%. The actuarial valuation as of June 30, 2012, determined the funded ratio to be 71.3%.

**Additions to Plan Net Position**

There are three primary sources of funding for MCERA retirement benefits: earnings (losses) on investments of assets and employer and employee contributions. Income sources for the fiscal years ending June 30, 2014 and 2013, totaled $401,935,358 and $344,295,426, respectively.

| | 2014 | 2013 | 2012 | Increase (Decrease) 2014/2013 | Increase (Decrease) 2013/2012 |
|---|---|---|---|---|---|
| Employer contributions | $ 74,396,755 | $ 103,016,915 | $ 66,189,220 | $ (28,620,160) | $ 36,827,695 |
| Plan members contributions | 18,536,135 | 17,664,135 | 15,874,624 | 872,000 | 1,789,511 |
| Total net investment income | 309,002,468 | 223,614,376 | 28,374,538 | 85,388,092 | 195,239,838 |
| Total | $ 401,935,358 | $ 344,295,426 | $ 110,438,382 | $ 57,639,932 | $ 233,857,044 |

**Deductions from Plan Net Position**

MCERA was created to provide lifetime retirement annuities, survivor benefits, and permanent disability benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments, as designated by the plan, refund of contributions to terminated employees, and the cost of administering the system. Below is a comparison of selected current and prior year balances:

| | 2014 | 2013 | 2012 | Increase (Decrease) 2014/2013 | Increase (Decrease) 2013/2012 |
|---|---|---|---|---|---|
| Retirement benefits | $ 108,334,914 | $ 101,740,810 | $ 95,977,096 | $ 6,594,104 | $ 5,763,714 |
| Refund of contributions | 1,007,947 | 506,882 | 818,374 | 501,065 | (311,492) |
| Return of City of San Rafael 401(h) | - | 12,027,691 | - | (12,027,691) | 12,027,691 |
| Administrative expenses | 3,462,021 | 3,764,105 | 3,013,917 | (302,084) | 750,188 |
| Legal expenses | 531,581 | 915,730 | 816,234 | (384,149) | 99,496 |
| Computer expenses | 371,548 | 82,445 | 283,228 | 289,103 | (200,783) |
| Actuarial expenses | 138,695 | 155,204 | 146,176 | (16,509) | 9,028 |
| Total deductions | $ 113,846,706 | $ 119,192,867 | $ 101,055,025 | $ (5,346,161) | $ 18,137,842 |

### Reserves

MCERA's reserves are established in accordance with the requirements of the 1937 Act, utilizing contributions and the accumulation of investment income after satisfying administrative and investment expenses. Under GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, investments are stated at fair value instead of cost and include the recognition of unrealized gains and losses.

**Total Net Position Held in Trust for Pension Benefits as of June 30**

| | 2014 | 2013 |
|---|---|---|
| Employee reserves | $ 256,547,252 | $ 238,599,682 |
| Employer reserves | 219,999,589 | 191,169,053 |
| Retiree reserves | 1,399,637,515 | 1,290,350,705 |
| Contingency reserves | 16,521,341 | 424,801 |
| **Total reserves - restricted** | **1,892,705,697** | **1,720,544,241** |
| Unrestricted reserves | 115,927,196 | - |
| **Total reserves - unrestricted** | **115,927,196** | **-** |
| **Total Net Position Held in Trust for Pension Benefits** | **$ 2,008,632,893** | **$ 1,720,544,241** |

### Legislative Changes

In August 2012, the California Legislature passed two bills that were later signed into law by Governor Brown. Assembly Bill (AB) 197 clarified the definition of "compensation earnable" for employees who were members of MCERA, or any other public retirement system governed by the 1937 Act, prior to January 1, 2013. AB 340 established the Public Employees' Pension Reform Act of 2013 (PEPRA). PEPRA creates new mandatory benefit tiers and "pensionable compensation" rules for employees who first become members of MCERA and most other public retirement systems in California on or after January 1, 2013.

The MCERA Board of Retirement implemented a new policy to comply with the requirements of AB 197 and AB 340. Although the Board of Retirement was careful to apply the changes only as to final compensation periods occurring on and after January 1, 2013, MCERA's implementation of the legislation as to current members was challenged in Court. That case was dismissed by the Superior Court and is now on appeal.

The policy can be found on MCERA's website at:

http://www.mcera.org/depts/RT/main/laws_regulations/MCERA%20-%20Policy%20re%20Comp%20Earnable%20and%20Pensionable%20Comp%202012-12-18.pdf

### The Retirement Fund as a Whole

MCERA's management believes that the funding policy adopted by the Board of Retirement, as reflected in the annual actuarial valuation, is reasonable and allows the system to meet its obligations to retirees, beneficiaries, and active members. The current financial position is a result of prudent economic and demographic assumptions, diversified investments, sufficient oversight to manage risk and minimize loss, an effective system of cost control, and strategic planning.

**Requests for Information**

This financial report is designed to provide the Retirement Board, our membership, taxpayers, and investment managers with a general overview of MCERA finances and to demonstrate MCERA's accountability for the funds under its stewardship.

Please address any questions about this report or requests for additional financial information to:

Marin County Employees' Retirement Association
One McInnis Parkway, Suite 100
San Rafael, California  94903-2764

Copies of this report are available at the above address and on MCERA's website at www.mcera.org.

Respectively submitted,

/s/ Lisa Jackson

Lisa Jackson
Senior Accountant

**BASIC FINANCIAL STATEMENTS**

**MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION**
**STATEMENTS OF PLAN NET POSITION AVAILABLE FOR BENEFITS**
**AS OF JUNE 30, 2014 AND 2013**

| | June 30, 2014 | June 30, 2013 |
|---|---|---|
| **Assets** | | |
| Cash and short-term investments | | |
| Cash and cash equivalents | $ 20,281,145 | $ 52,854,741 |
| Cash collateral on loaned securities | 77,707,689 | 53,810,750 |
| Total Cash and Short-Term Investments | 97,988,834 | 106,665,491 |
| Receivables | | |
| Contributions | 4,675,463 | 4,215,952 |
| Interest and dividends | 1,748,454 | 1,543,693 |
| Due from brokers for securities sold | 2,847,839 | 11,084,829 |
| Other receivables | 2,556,102 | 2,167,771 |
| Total Receivables | 11,827,858 | 19,012,245 |
| Investments at fair value | | |
| Domestic fixed income | 263,487,903 | 179,072,771 |
| International fixed income | 49,648,871 | 21,933,012 |
| Domestic equities | 881,879,596 | 890,222,326 |
| International equities | 445,366,793 | 356,587,635 |
| Private equity | 117,393,450 | 78,122,641 |
| Real estate | 219,506,364 | 156,283,553 |
| Total Investments at Fair Value | 1,977,282,977 | 1,682,221,938 |
| Capital assets (net of accumulated depreciation) | 6,879,909 | 7,353,345 |
| Prepaid insurance | 767,155 | 772,466 |
| Total Assets | 2,094,746,733 | 1,816,025,485 |
| **Liabilities** | | |
| Accounts payable and accrued expenses | 1,461,498 | 1,571,568 |
| Due to brokers for securities purchased | 6,177,642 | 39,338,047 |
| Rental security deposits | 750,895 | 760,879 |
| Retiree payroll payable | 16,116 | - |
| Obligations under securities lending program | 77,707,689 | 53,810,750 |
| Total Liabilities | 86,113,840 | 95,481,244 |
| **Net Position Held in Trust for Pension Benefits** | $2,008,632,893 | $1,720,544,241 |

The accompanying notes are an integral part of these financial statements.

**MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION**
**STATEMENTS OF CHANGES IN PLAN NET POSITION AVAILABLE FOR BENEFITS**
**FOR THE YEARS ENDED JUNE 30, 2014 AND 2013**

| | June 30, 2014 | June 30, 2013 |
|---|---|---|
| **Additions** | | |
| Contributions | | |
| Employer | $ 74,396,755 | $ 103,016,915 |
| Plan member | 18,536,135 | 17,664,135 |
| Total Contributions | 92,932,890 | 120,681,050 |
| Investment income | | |
| Net appreciation in fair value of investments | 299,091,702 | 213,829,352 |
| Interest and dividends | 13,063,532 | 13,232,865 |
| Real estate operating income, net | 6,561,736 | 5,274,168 |
| Other investment income | 151,864 | 158,057 |
| Total investment income | 318,868,834 | 232,494,442 |
| Less investment expenses | 10,035,631 | 9,161,369 |
| Net Investment Income | 308,833,203 | 223,333,073 |
| Securities lending activities | | |
| Securities lending income | 245,507 | 455,260 |
| Less expenses from securities lending activities | 76,242 | 173,957 |
| Net Securities Lending Income | 169,265 | 281,303 |
| Total Net Investment Income | 309,002,468 | 223,614,376 |
| Total Additions | 401,935,358 | 344,295,426 |
| **Deductions** | | |
| Benefits | 108,334,914 | 101,740,810 |
| Refunds | 1,007,947 | 506,882 |
| Administrative expenses | 3,462,021 | 3,764,105 |
| Legal expenses | 531,581 | 915,730 |
| Refund of 401(h) account (City of San Rafael) | - | 12,027,691 |
| Computer expenses | 371,548 | 82,445 |
| Actuarial expenses | 138,695 | 155,204 |
| Total Deductions | 113,846,706 | 119,192,867 |
| Net Increase | 288,088,652 | 225,102,559 |
| **Net Position Held in Trust for Pension Benefits, Beginning of Year** | 1,720,544,241 | 1,495,441,682 |
| **Net Position Held in Trust for Pension Benefits, End of Year** | $ 2,008,632,893 | $ 1,720,544,241 |

The accompanying notes are an integral part of these financial statements.

## NOTE 1 – PLAN DESCRIPTION

The Marin County Employees' Retirement Association (MCERA) was established on July 1, 1950. It is governed by the California Constitution; the County Employees Retirement Law of 1937 (CERL or 1937 Act, Government Code Section 31450 et seq.); the Public Employees' Pension Reform Act of 2013 (PEPRA, Government Code Section 7522); the provisions of California Government Code Section 7500 et seq.; and the bylaws, procedures, and policies adopted by MCERA's Board of Retirement. The Marin County Board of Supervisors may also adopt resolutions, as permitted by the CERL and PEPRA, which may affect the benefits of MCERA members. MCERA operates as a cost-sharing multiple employer defined benefit plan for the County of Marin (the County) and eight other participating employers: City of San Rafael, Local Agency Formation Commission (LAFCO), Marin City Community Services District, Marin County Superior Court, Marin/Sonoma Mosquito and Vector Control District, Novato Fire Protection District, Southern Marin Fire Protection District, and Tamalpais Community Services District.

### Administration

Retirement system administration is managed by the Retirement Board. All Retirement Board members, except the County Director of Finance, serve for a term of three years. By statute, Retirement Board members include the following:

- The Director of Finance of the County.
- Four members who are qualified electors of the County and not connected with County government in any capacity, except one may be a County Supervisor. The Board of Supervisors appoints these members.
- Two General members of MCERA elected by the General membership.
- One Safety member and one Safety member alternate elected by the Safety membership.
- One retired member and one retired member alternate elected by the retired membership.

### Membership

MCERA provides retirement, disability, and death benefits to its general and safety members. Safety membership primarily includes law enforcement and firefighters of MCERA, as well as other classifications as allowed under the CERL and adopted by the employer. General membership is applicable to all other occupational classifications. The retirement benefits within the plan are tiered based on the participating employer and the date of the member's entry into MCERA membership. Additional information regarding the benefit structure is available by contacting MCERA. Membership data as of the current actuarial valuation report (fiscal year ending June 30, 2013):

| | 2013 | 2012 |
|---|---|---|
| Active Members (Vested and Non-Vested) | 2,472 | 2,491 |
| Retired Members and Beneficiaries | 2,790 | 2,679 |
| Terminated Vested (Deferred) | 621 | 599 |
| **Total Membership** | **5,883** | **5,769** |

**NOTE 1 – <u>PLAN DESCRIPTION</u>** (Continued)

**Benefit Provisions**

*Vesting*

Members become vested in retirement benefits upon completion of five years of credited service.

*Service Retirement*

MCERA's regular (service) retirement benefits are based on the years of credited service, final average compensation, and age at retirement, according to the applicable statutory formula. Members who qualify for service retirement are entitled to receive monthly retirement benefits for life.

General County members hired after July 1, 2008, Court members hired after January 1, 2009, and City of San Rafael members hired after July 1, 2011, are eligible to retire at age 55 if they have earned 10 years of credited service, unless they are "new members" as defined by PEPRA (hereinafter "PEPRA members"). All other General and Safety members, except PEPRA members, are eligible to retire at age 50 if they have earned 10 years of credited service. Unless they are PEPRA members, General members can retire at any age with 30 years of service and Safety members can retire at any age with 20 years of service. PEPRA members who are Safety members are eligible to retire after five years of service upon reaching 50 years of age. PEPRA members who are General members are eligible to retire after five years of service upon reaching 52 years of age. All members can retire at age 70 with no service requirement.

*Death Benefits*

MCERA provides specified death benefits to beneficiaries and members' survivors. The death benefits provided depend on whether the member is active or retired.

The basic active member death benefit consists of a member's retirement contributions plus interest plus one month's pay for each full year of service (up to a maximum of six month's pay). Retiring members may choose from five retirement benefit payment options. Most retirees elect to receive the unmodified allowance which provides the maximum benefit to the retiree and a continuance of 60% of the retiree's allowance to the surviving spouse or registered domestic partner after the retiree's death. Other death benefits may be available based on the years of service, marital status, and whether the member has minor children.

*Disability Retirement*

A member with five years of service, regardless of age, who becomes permanently incapacitated for the performance of duty is eligible to apply for a non-service connected disability retirement. Any member who becomes permanently incapacitated for the performance of duty as a result of injury or disease arising out of and in the course of employment is eligible to apply for a service-connected disability retirement, regardless of service length or age.

*Cost of Living Adjustment*

Retirement allowances are indexed for inflation. Most retirees receive automatic basic cost of living adjustments (COLAs) based upon the Urban Consumer Price Index (UCPI) for the San Francisco Bay Area. These adjustments go into effect on April 1 each year. Annual COLA increases are statutorily capped at 2%, 3%, or 4% depending upon the member's retirement tier. When the CPI exceeds the maximum statutory COLA for the member's tier, the difference is accumulated for use in future years when the CPI is less than the maximum statutory COLA. The accumulated percentage carryover is known as the COLA Bank.

## NOTE 2 – <u>SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u>

### Reporting Entity

MCERA, with its own governing Board, is an independent governmental entity separate and distinct from the County of Marin. Actuarially determined financial data for MCERA is included in the County of Marin's annual financial report in the "Notes to Financial Statements" section.

### Basis of Accounting

MCERA follows the accounting principles and reporting guidelines as set forth by the Governmental Accounting Standards Board (GASB). The financial statements are prepared on an accrual basis of accounting which recognizes income when earned and expenses when the obligation is incurred. Member and employer contributions are recognized when due, pursuant to formal commitments as well as statutory or contractual requirements. Investment income is recognized as revenue when earned. Retirement benefits and refunds are recognized when due and payable in accordance with the terms of the plan. Other expenses are recognized when the corresponding liabilities are incurred. The net appreciation (depreciation) in fair value of investments consists of realized and unrealized gains and losses on those investments.

### Administrative Expenses

MCERA's administrative costs are financed from investment income and are calculated pursuant to Government Code Section 31580.2 which provides that the administrative expense incurred in any year may not exceed the greater of either 0.21% of the actuarial accrued liability of the system, or $2,000,000, as adjusted annually by the amount of the annual COLA computed in accordance with Article 16.5. Expenditures for computer software, computer hardware, and computer technology consulting services in support of these computer products shall not be considered a cost of administration of the retirement system.

For the years ended June 30, 2014 and 2013, administrative expenses were $3,462,021, or 0.17%, and $3,764,105, or 0.18%, respectively, of actuarial accrued liability.

### Cash and Cash Equivalents

Cash equivalents include deposits in MCERA's custodian bank. Short-term investments with the custodian bank include foreign currencies, cash held in short-term investment funds, and other short-term, highly liquid investments. Short-term investments considered cash equivalents are recorded at cost, which approximates fair value.

### Methods Used to Value Investments

Investments are reported at fair value. Fair value is the amount that MCERA can reasonably expect to receive in a current sale between a willing buyer and willing seller – that is, other than in a forced liquidation sale. The fair value of equity and fixed income securities are derived from quoted market prices. Real estate investment funds are valued using periodic independent appraisals.  Investments listed as private equity investments are composed of private equity partnerships, for which fair value is provided by the General Partner giving consideration to financial condition and operating results of the portfolio companies, nature of investment, marketability, and other factors deemed relevant.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Asset Allocation Policy and Expected Long-term Rate of Return by Asset Class

The Board of Retirement has adopted an Investment Policy Statement (IPS), which provides the framework for the management of MCERA's investments. The IPS establishes MCERA's investment objectives and defines the principal duties of the Retirement Board, the custodian bank, and the investment managers. The asset allocation plan is an integral part of the IPS and is designed to provide an optimum and diversified mix of asset classes with return expectations to satisfy expected liabilities while minimizing risk exposure. MCERA currently employs external investment managers to manage its assets subject to the provisions of the policy. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a fully funded status for the benefits provided through the Plan. The following was the Retirement Board's adopted asset allocation policy as of June 30, 2014:

| Asset Class: | Target Allocation | Long-Term Expected Real Rate of Return |
|---|---|---|
| Domestic Equity | 32.00% | 5.35% |
| International Equity | 22.00% | 5.55% |
| Fixed Income | 23.00% | 0.75% |
| Real Estate | 15.00% | 3.90% |
| Private Equity | 8.00% | 6.25% |
| Total | 100.00% | |

### Capital Assets

Capital assets are valued at historical cost less accumulated depreciation. Capital assets with an initial cost of more than $5,000 and an estimated useful life in excess of one year are depreciated. Depreciation is calculated using the straight-line method over the estimated useful lives of the depreciable assets. Equipment has a useful life of ten years, leasehold improvements and office space forty years, and twelve years for the benefit administration system.

MCERA signed an agreement on July 2, 2007, for the purchase of a building located at One McInnis Parkway, San Rafael, California 94903. The final purchase price for the building was $17,300,000 and was finalized in October 2007. MCERA occupied the building on November 14, 2008. MCERA occupies 33% of the building and leases the other 67%. Therefore, the portion of the building occupied by MCERA was capitalized and is being depreciated over its useful life. The remaining 67% will be treated as an investment and, accordingly, marked to market value in addition to recognizing any earned income and expenses incurred. As of June 30, 2014, the capitalized portion of the building was $3,369,072 and computers and equipment were $3,510,837, net of accumulated depreciation.

### Income Taxes

The plan qualifies under Section 401(a) of the Internal Revenue Code. No provision for income taxes has been made in the accompanying financial statements, as the plan is exempt from federal and state income taxes under the provisions of Internal Revenue Code Section 501 and California Revenue and Taxation Code Section 23701, respectively.

### Use of Estimates

The preparation of MCERA's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

## NOTE 2 – <u>SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u> (Continued)

### Reclassifications

Comparative data for the prior year has been presented in the selected sections of the accompanying Statements of Plan Net Position Available for Benefits and Statement of Changes in Plan Net Position Available for Benefits. Also, certain accounts presented in the prior year's data may have been reclassified to be consistent with the current year's presentation.

### Implementation of Accounting Standards

On June 25, 2012, GASB approved new accounting and reporting standards for pensions. GASB Statement No. 67, *Financial Reporting for Pension Plans*, replaces the requirements of GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Benefit Plans*, and also replaces the requirements of GASB Statement No. 50, *Pension Disclosures*. MCERA has adopted the provisions of GASB Statement No. 67, *Financial Reporting for Pension Plans*, for its June 30, 2014 financial statements. The objective of this statement is to improve financial reporting by state and local governmental pension plans.

## NOTE 3 – <u>DEPOSITS AND INVESTMENTS</u>

The CERL gives the Board of Retirement exclusive control over MCERA's investment portfolio. Except as otherwise expressly restricted by the California Constitution or other laws, the CERL allows the Board of Retirement to prudently invest, or delegate the authority to invest, the investment portfolio through the purchase, holding, or sale of any form or type of investment, financial instrument, or financial transaction.

Moreover, the CERL requires the Board of Retirement, its officers, and employees to discharge their duties with respect to MCERA and the investment portfolio under the following rules:

- "The members of the retirement board shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to, participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system.
- The members of the retirement board shall discharge their duties with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of a like character and with like aims.
- The members of the retirement board shall diversify the investments of the system so as to minimize the risk of loss and to maximize the rate of return, unless under the circumstances it is clearly not prudent to do so."

### Deposits

Cash and cash equivalents are carried at cost plus accrued interest, which approximates fair value. All cash and cash equivalents are held by MCERA's master custodian, State Street. Substantially all of the cash held by State Street is swept daily into collective short-term investment funds.

*Custodial Credit Risk – Deposits*

Custodial credit risk for deposits is the risk that in the event of the failure of a depository financial institution, the plan would not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are not insured or not collateralized. MCERA's deposits are covered by depository insurance or are collateralized by securities held with a financial institution in MCERA's name. The plan is only exposed to custodial credit risk for uncollateralized cash and cash equivalents that are not covered by federal depository insurance.

**NOTE 3 – <u>DEPOSITS AND INVESTMENTS</u>** (Continued)

**Investments**

*Credit Risk*

Credit risk is the risk that an issuer or other counterparty to a debt instrument will not fulfill its obligations. This risk is measured by the assignment of ratings by nationally recognized statistical rating organizations. MCERA has adopted policies specific to each investment manager to manage credit risk. In general, fixed income securities should be well diversified to avoid undue exposure to any single economic sector, industry, or individual security. The credit risk ratings of MCERA's fixed income investments as of June 30, 2014, as rated by Standard & Poor's, are as follows (all dollars in thousands):

| Rating Category | Fair Value |
|---|---|
| AAA | $ 12,381 |
| AA | 14,311 |
| A | 58,115 |
| BBB | 66,381 |
| BB | 9,393 |
| B | 330 |
| CCC | 303 |
| CC | - |
| C | - |
| D | - |
| Agencies | 3,499 |
| U.S. Treasuries | 23,798 |
| No Rating | 21,077 |
| **Total Fixed Income Investments** | **$ 209,588** |

*Custodial Credit Risk – Investments*

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the plan will not be able to recover the value of its investment or collateral securities that are in the possession of an outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in MCERA's name, and are held by the counterparty. MCERA's investment securities in general are not exposed to custodial credit risk because MCERA's securities are held by MCERA's custodial bank in MCERA's name; however, MCERA participates in securities lending transactions, as lender, and the securities loaned in those circumstances are exposed to some degree of custodial credit risk. MCERA has no general policy on custodial credit risk for investments; however, MCERA does require that its custodian maintain insurance to help protect against losses due to negligence, theft, and certain other events.

*Concentrations*

Concentration of credit risk is the risk of loss attributed to the concentration of the plan's investment in a single issuer. MCERA's investment policy limits exposure to any single investment manager or product. As of June 30, 2014 and 2013, MCERA did not hold any investments in any one issuer that would represent 5% or more of total investments. Investments issued or explicitly guaranteed by the U.S. government and pooled investments are excluded from the policy requirement.

**NOTE 3 – DEPOSITS AND INVESTMENTS** (Continued)

**Investments** (Continued)

*Interest Rate Risk*

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Duration is a measure of the price sensitivity of a fixed income portfolio to changes in interest rates. It is calculated as the weighted average time to receive a bond's coupon and principal payments. The longer the duration of a portfolio, the greater its price sensitivity to changes in interest rates.

To manage interest rate risk, the modified adjusted duration of the Domestic Fixed Income Core Plus portfolio is restricted to +/- 25% of the duration of the Barclay's Capital Aggregate Index. Deviations from any of the stated guidelines require prior written authorization from MCERA. At June 30, 2014, the segmented time distribution of the fixed income portfolio, by investment type, was as follows (all dollars in thousands):

| | Fair | Investment Maturities in Years | | | |
|---|---|---|---|---|---|
| **Investment Type** | **Value** | **< 1** | **1-5** | **6-10** | **10+** |
| Asset-Backed Securities | $ 13,592 | $ 11,378 | $ 2,142 | $ - | $ 72 |
| Collateralized Mortgage Obligations | 19,066 | 5,448 | 4,034 | 9,584 | - |
| Corporate and Other Credit | 141,527 | 2,006 | 81,073 | 43,454 | 14,994 |
| Mortgage Pass-Throughs | 4,474 | 1,758 | 1,804 | 912 | - |
| Municipal Bonds | 7,131 | - | 920 | 1,523 | 4,688 |
| U.S. Treasuries | 23,798 | 132 | 14,703 | 4,323 | 4,640 |
| **Total** | **$ 209,588** | **$ 20,722** | **$ 104,676** | **$ 59,796** | **$ 24,394** |

*Foreign Currency Risk*

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. MCERA invests, through its investment managers, in forward currency contracts and currency futures (maturity ranging from at least 30 days and not to exceed one year for either instrument). Aside from net currency gains or losses reported as a component of investment income, no other amounts are recorded on the financial statements. MCERA has no general investment policy with respect to foreign currency risk.

Forward contracts typically range from one to six months and are used to hedge against adverse movement in currency exchange rates and to facilitate settlement of transactions in foreign securities.

Futures contracts are used to hedge against a possible increase in the price of currency. Futures contracts are classified by category of underlying instrument such as equity, fixed income, commodity, or cash equivalent.

MCERA invests primarily in commingled vehicles; as such, the foreign currency risk exposure is minimal.

*Rate of Return*

For the year ended June 30, 2014, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense was 18.16% percent.  The money weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

## NOTE 4 – SECURITY LENDING

Under provisions of state statutes, the MCERA Board of Retirement permits MCERA to participate in a securities lending program whereby securities are transferred to independent broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities plus a fee in the future. MCERA's custodial bank, State Street, is the agent for its securities lending program. State Street is authorized to lend U.S. government obligations, U.S. bonds and equities, and international bonds and equities that are being held in custody to various borrowers such as banks and brokers. All securities loans can be terminated on demand by either the lender or the borrower.

U.S. securities are loaned versus collateral valued at 102% of the fair value of the securities plus any accrued interest. Non-U.S. securities are loaned versus collateral valued at 105% of the fair value of the securities plus any accrued interest. Mark-to-market is performed every business day subject to de minimis rules of change in value, and the borrower is required to deliver additional collateral when necessary so that the total collateral held by the agent will be at least equal to the fair value of the borrowed securities. Collateral received may include cash, any other assets permissible under Rule 15c3-3 under the Exchange Act of 1934, U.S. and non-U.S. equities, and such other collateral as the parties may agree to in writing from time to time. Cash collateral is invested in a short-term investment pool. Non-cash collateral cannot be pledged or sold unless the borrower defaults.

As of June 30, 2014 and 2013, the value of securities loaned by MCERA totaled $76,301,016 and $52,508,102, respectively. As of June 30, 2014 and 2013, the value of collateral held for securities loaned was $77,707,689 and $53,810,749.98, respectively.

## NOTE 5 – DERIVATIVE FINANCIAL INSTRUMENTS

MCERA's IPS and manager guidelines allow the use of derivatives by certain investment managers. Derivatives are financial instruments that derive their value, usefulness, and marketability from an underlying instrument that represents direct ownership of an asset or an obligation of an issuer whose payments are based on or "derived" from the performance of some agreed-upon benchmark. Values of derivatives change daily. MCERA's managers are required to mark-to-market derivative positions daily. Substitution, risk control, and arbitrage are the only derivative strategies permitted. Speculation is prohibited. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Gains and losses from derivatives are included in net investment income. For financial reporting purposes, all MCERA derivatives are classified as investment derivatives.

### Types of Permitted Derivative Investments

*Futures Contracts*

A futures contract represents an agreement to buy (long position) or sell (short position) an underlying asset at a specified future date for a specified price. Payment for the transaction is delayed until a future date, which is referred to as the settlement or expiration date. Futures contracts are standardized contracts traded on organized exchanges.

*Forward Contracts*

A forward contract represents an agreement to buy or sell an underlying asset at a specified date in the future at a specified price. Payment for the transaction is delayed until the settlement or expiration date. A forward contract is a non-standardized contract that is tailored to each specific transaction. Forward contracts are privately negotiated and are intended to be held until the settlement date. Currency forward contracts are used to manage currency exposure and facilitate the settlement of international security purchase and sale transactions.

**NOTE 5 – DERIVATIVE FINANCIAL INSTRUMENTS** (Continued)

**Types of Permitted Derivative Investments** (Continued)

*Option Contracts*

An option contract is a type of derivative in which a buyer (purchaser) has the right, but not the obligation, to buy or sell a specified amount of an underlying security at a fixed price by exercising the option before its expiration date. The seller (writer) has an obligation to buy or sell the underlying security if the buyer decides to exercise the option.

*Swap Agreements*

A swap is an agreement between two or more parties to exchange a sequence of cash flows over a period of time in the future. No principal is exchanged at the beginning of the swap. The cash flows are tied to a "notional" or contract amount. A swap agreement specifies the time period over which the periodic payments will be exchanged. The fair value represents the gains or losses as of the prior marking-to-market.

**Investment Derivatives Summary**

The following is a summary of derivative instruments at June 30, 2014, with the net appreciation/(depreciation) that have occurred during the year (all dollars in thousands):

| Investment Derivatives by Type | Net Appreciation/ (Depreciation) in Fair Value Amount | Classification | Fair Value | Notional Amount |
|---|---|---|---|---|
| Credit Default Swaps Bought | $ (16) | Swaps | $ - | $ - |
| Fixed Income Futures Long | 1,015 | Futures | - | 36 |
| Fixed Income Futures Short | (1,166) | Futures | - | (53) |
| Foreign Currency Options Bought | (34) | Options | - | - |
| Futures Options Bought | (28) | Options | - | - |
| Futures Options Written | 133 | Options | - | - |
| Foreign Currency Forwards | (143) | Long-Term Instruments | 7 | 1,830 |
| **Total** | **$ (239)** | | **$ 7** | **$ 1,813** |

**NOTE 5 – <u>DERIVATIVE FINANCIAL INSTRUMENTS</u>** (Continued)

**Types of Derivative Risk**

*Counterparty Credit Risk*

To minimize credit risk exposure, MCERA investment managers continuously monitor credit ratings of counterparties. Should there be a counterparty failure, MCERA would be exposed to the loss of fair value of derivatives that are in asset positions and any collateral provided to the counterparty, net of the effect of applicable netting arrangements. Netting arrangements legally provide MCERA with a right of offset in the event of bankruptcy or default by the counterparty. MCERA has no general investment policy with respect to netting arrangements or collateral requirements. As of June 30, 2014 and 2013, MCERA had no exposure to loss in case of default of a counterparty. In addition, MCERA had no collateral reducing exposure or liabilities subject to netting arrangements. The credit risk ratings of MCERA's derivatives as of June 30, 2014, as rated by Standard & Poor's, are as follows (all dollars in thousands):

| Rating Category | Fair Value |
|---|---|
| A | $ 9 |
| **Total Derivatives** | **$ 9** |

*Interest Rate Risk*

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. MCERA measures derivative interest rate risk using duration. At June 30, 2014, MCERA had no investment derivative interest rate risks.

*Foreign Currency Risk*

Foreign currency risk is the risk that changes in currency exchange rates will adversely affect the fair value of an investment. Currency forward contracts represent foreign exchange contracts that are used to control currency exposure and facilitate the settlement of international security purchase and sale transactions. At June 30, 2014, MCERA had the following derivative foreign currency exposures:

| Derivative Type | Foreign Currency | Fair Value |
|---|---|---|
| Currency Forward Contracts | Euro | $ 634 |
| Currency Forward Contracts | Yen | 6,092 |
| **Total Foreign Derivatives** | | **$ 6,726** |

**NOTE 6 – REAL ESTATE**

MCERA holds real estate assets directly and in commingled real estate funds. Real estate investments owned directly are appraised annually by independent third party appraisers in accordance with the Uniform Standards of Professional Appraisal Practice. Properties held in commingled pools are subject to regular internal appraisals by investment management firms/general partners with independent third party appraisals accomplished at regular intervals. Primary determinants of fair value include market and property type specific information which typically involve a degree of expert judgment.

MCERA engages Woodmont Real Estate Services to manage the direct real estate investments and has investments in commingled real estate portfolios with other firms, as listed below. At June 30, 2014, the estimated fair value of MCERA's real estate portfolio was $219,506,364.

MCERA has the following real estate holdings (dollars in thousands):

| | Appraised Value 2014 | Appraised Value 2013 |
|---|---|---|
| ***Direct Investments*** | | |
| Sunnyvale | $ 7,340 | $ 5,700 |
| South San Francisco | 9,500 | 8,700 |
| Foster City | 32,600 | 30,300 |
| San Bruno | 19,800 | 18,200 |
| Pleasanton | 36,900 | 33,700 |
| Richmond | 14,400 | 13,480 |
| San Rafael | 8,226 | 8,300 |
| *Total Direct Investments* | **128,766** | **118,380** |
| ***Commingled Investments*** | | |
| AEW Capital Management | 1,335 | 1,555 |
| AEW Core | 68,085 | 15,269 |
| RREEF America REIT III | 4,633 | 5,575 |
| UBS – TPF | 16,687 | 15,504 |
| *Total Commingled Investments* | **90,740** | **37,903** |
| **Total Real Estate Investments** | **$ 219,506** | **$ 156,283** |

**NOTE 7 – CONTRIBUTIONS**

The funding objective of the Board of Retirement is to collect sufficient assets to permit the payment of all regular benefits promised under MCERA and to minimize the volatility of contribution rates from year to year as a percentage of covered payroll. As a condition of participation under the provisions of the CERL, members are required to pay a percentage of their salaries depending upon their age at date of entry into the plan, membership type, and benefit tier. There are three sources of funding for retirement benefits: employer contributions, member contributions, and the earnings on investments held by the plan.

Separate annual actuarial valuations are performed for three employer groups for the purpose of determining the funded position of the retirement plan and the employer and member contributions necessary to pay benefits for MCERA members not otherwise funded by current assets or projected member contributions or investment earnings. The three employer groups are: (1) City of San Rafael, (2) Novato Fire Protection District, and (3) County of Marin and the remaining special districts.

**NOTE 7 – CONTRIBUTIONS** (Continued)

**Employer Contributions**

For fiscal year 2014, the employer contribution rates are actuarially determined by using the Entry Age Normal to Final Decrement funding method. Employer contribution rates are made up of two parts:

1. The Normal Cost or the cost of the employer's portion of the benefit that is allocated to the current year.

2. The payment to amortize the Unfunded Actuarial Accrued Liability (UAAL). The UAAL is the excess of the plan's accrued liability over its assets.

**Member Contributions**

Active members are required by statute to contribute toward pension plan benefits. The member contribution rates for non-PEPRA members are formulated separately for each employer group on the basis of age at the date of entry and actuarially calculated benefits. The member contribution rate for PEPRA members is a flat rate of at least 50 percent of the normal cost for the defined benefit plan, rounded to the nearest quarter of one percent, formulated separately for each employer. The CERL authorizes participating employers to "pickup" all or a portion of an employee's retirement contribution obligation on the employee's behalf; however, PEPRA eliminates that authorization as to PEPRA members, with a limited exception relating to contracts in effect on January 1, 2013. Interest is credited to member contributions every six months based on the prior six months ending balance. Members are not permitted to borrow against their contributions. Upon termination of employment, members may withdraw their contributions by requesting a refund of their accumulated contributions and interest. The employer paid contribution pickups are typically not refundable.

General member contributions range from 5.62% to 15.83%. Safety member contributions range from 9.73% to 22.89%, which includes additional cost sharing for some Safety members determined through labor negotiations.

**NOTE 8 – RESERVES**

MCERA carries accounts within Net Position Held in Trust for Pension Benefits as reserve accounts for various operating purposes. Reserves are neither required nor recognized under accounting principles generally accepted in the United States of America. These are not shown separately on the Statement of Plan Net Position Available for Benefits, as the sum of these reserves equals the Net Position Held in Trust for Pension Benefits. Reserves are established from member and employer contributions and the accumulation of investment income after satisfying investment and administrative expenses.

**Semi-Annual Interest Crediting**

MCERA updates reserve balances on a semi-annual basis as of June 30 and December 31 each year. At these times, MCERA carries out a multi-step process to calculate new reserve balances as specified in Article 5 of the CERL. The amount of "net earnings" to be credited for the semi-annual period is calculated based on actuarial smoothing. To the extent that net earnings are available, interest is credited to specified components of reserves in a prescribed sequence according to MCERA policy.

**Components of Reserves**

*Employee Reserve*

This represents the total accumulated member contributions of current active and inactive (deferred) members. Additions include member contributions and credited interest. Deductions include refunds of member contributions along with credited interest and transfers to Retired Member Reserves made when a member retires.

**NOTE 8 – <u>RESERVES</u>** (Continued)

**Components of Reserves** (Continued)

*Employer Reserve*

This represents the total accumulated employer contributions for future retirement payments to active and deferred members. Additions include contributions from the employers and credited interest. Deductions include transfers to the Retired Member Reserves made when each member retires. Employer contribution rates are actuarially determined taking into account other events such as members electing refund of contributions.

*Retiree Reserves*

These represent funds accumulated to pay retirement benefits to retired members, including credited interest, reduced by payments to retired members, beneficiaries and survivors. The *Retiree Pension Reserve* and the *Retiree Annuity Reserve* represent the total net accumulated transfers from the Employer Reserve and the Employee Reserve, respectively, both made at the time each member retires. The *Survivor Death Benefit and Continuance Reserve* represents the accumulated employer and employee contributions, plus credited interest, to be used to pay death and survivorship benefits. The *Cost of Living Reserve* represents the accumulated contributions of the employer and the members, plus credited interest, to be used to pay cost of living adjustments.

*Statutory Contingency Reserve*

This represents earnings in excess of the total interest credited to valuation reserves, up to 1% of fair value of MCERA’s total assets. The Contingency Reserve is treated as a non-valuation asset and is used as a reserve against deficiencies in available earnings in other years, as provided in Government Code Sections 31592 and 31592.2.

*Unrestricted Earnings Reserve*

This represents earnings in excess of the total interest credited to all other reserves that have not been allocated by the Board of Retirement to other reserves.

*Contra Account*

This is an accounting informational mechanism used to track any historical shortfalls of available earnings credited to valuation reserves other than the Unrestricted Earnings Reserve on or after December 31, 2009, relative to the earnings required to credit interest at the full valuation rate to those valuation reserves.

## NOTE 9 – NET PENSION LIABILITY

### Net Pension Liability of Employers

The net pension liability (i.e., the Plan's liability determined in accordance with GASB Statement No. 67 less the plan net position) is shown below:

| Change in Collective Net Pension Liability | | | |
|---|---|---|---|
| | Increase (Decrease) | | |
| | Total Pension Liability (a) | Plan Fiduciary Net Position (b) | Net Pension Liability (a) - (b) |
| **Balances at June 30, 2013** | $2,156,578,363 | $1,720,544,241 | $ 436,034,122 |
| **Changes for the Year:** | | | |
| Service Cost | 49,014,858 | - | 49,014,858 |
| Interest | 159,521,975 | - | 159,521,975 |
| Changes of Benefits | - | - | - |
| Changes of Assumptions | - | - | - |
| Differences Between Expected and Actual Experience | - | - | - |
| Contributions – Employer | - | 74,396,755 | (74,396,755) |
| Contributions – Member | - | 18,536,135 | (18,536,135) |
| Net Investment Income | - | 309,002,468 | (309,002,468) |
| Benefit Payments | (109,342,861) | (109,342,861) | - |
| Administrative Expenses | - | (4,503,845) | 4,503,845 |
| **Net Changes** | 99,193,972 | 288,088,652 | (188,894,680) |
| **Balances at June 30, 2014** | **$2,255,772,335** | **$2,008,632,893** | **$ 247,139,442** |

The Net Pension Liability was measured as of June 30, 2014 and 2013 and determined based upon rolling forward the Total Pension Liability from actuarial valuations as of June 30, 2013 and 2012, respectively.

**NOTE 9 – NET PENSION LIABILITY** (Continued)

**Actuarial Assumptions**

MCERA retains an independent actuarial firm to conduct actuarial valuations of the pension plan to monitor MCERA's funding status and to establish the contribution rate requirements for the plan. Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events into the future. Examples include assumptions about future employment, mortality, and cost trends. Actuarially determined amounts are subject to continual review or modification as actual results are compared with past expectations and new estimates are made about the future. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employers and plan members) and include the types of benefits provided at the time of each valuation. The total pension liability was determined by an actuarial valuation as of June 30, 2013, using the following actuarial assumptions applied to all prior periods included in the measurement in accordance with the requirements of GASB Statement No. 67. Key methods and assumptions used in the latest actuarial valuations are presented below:

| | |
|---|---|
| **Inflation** | 3.25% |
| **Salary Increases** | 3.25%, plus service based rates, which includes 3.25% inflation |
| **Investment Rate of Return** | 7.50%, net of pension plan investment expense, including inflation |

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

The target allocation and projected arithmetic real rates of return, after deducting inflation, but before investment expenses, used in the derivation of the long-term expected investment rate of return assumption for each major asset class are summarized in the following table:

| | June 30, 2014 | |
|---|---|---|
| **Asset Class** | **Target Allocation** | **Long-Term Expected Real Rate of Return** |
| Cash and Short Term Investments | --- | --- |
| Fixed Income | 32.00% | 5.35% |
| Domestic Equities | 22.00% | 5.55% |
| International Equities | 23.00% | 0.75% |
| Real Estate | 15.00% | 3.90% |
| Private Equity | 8.00% | 6.25% |
| **TOTAL** | **100.00%** | |

**NOTE 9 – NET PENSION LIABILITY** (Continued)

**Discount Rate**

The discount rates used to measure the total pension liability was 7.50% as of June 30, 2014 and 2013, respectively. The projection of cash flows used to determine the discount rate assumed plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the actuarially determined contribution rates. For this purpose, only employer contributions that are intended to fund benefits of current plan members and their beneficiaries are included. Projected employer contributions that are intended to fund the service costs of future plan members and their beneficiaries, as well as projected contributions from future plan members, are not included. Based on those assumptions, the pension plan's plan net position was projected to be available to make all projected future benefit payments for current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability as of both June 30, 2014 and 2013.

**Sensitivity of the Net Pension Liability to Changes in the Discount Rate**

The following presents the net pension liability of MCERA as of June 30, 2014, calculated using the discount rate of 7.50%, as well as what MCERA's net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.50%) or one percentage point higher (8.50%) than the current rate:

| | 1% Decrease (6.50%) | Current Discount Rate (7.50%) | 1% Increase (8.50%) |
|---|---|---|---|
| Total Pension Liability | $2,538,188,372 | $2,255,772,335 | $2,020,922,642 |
| Plan Net Pension Liability | 2,008,632,893 | 2,008,632,893 | 2,008,632,893 |
| Collective Net Pension Liability | $529,555,479 | $247,139,442 | $12,289,749 |
| Plan Net Position as a Percentage of the Total Pension Liability | 79.1% | 89.0% | 99.4% |

**NOTE 10 – CAPITAL ASSETS**

Capital asset activity for the fiscal year ending June 30, 2014, was as follows:

| | Balance 6/30/2013 | Additions | Dispositions | Balance 6/30/2014 |
|---|---|---|---|---|
| ***Capital Assets Being Depreciated:*** | | | | |
| Building | $ 3,140 | $ - | $ - | $ 3,140 |
| Tenant Improvements | 781 | - | - | 781 |
| Equipment | 109 | - | - | 109 |
| Computer Software/Hardware | 4,374 | - | - | 4,374 |
| *Total Capital Assets Being Depreciated* | **8,404** | **-** | **-** | **8,404** |
| ***Less Accumulated Depreciation for:*** | | | | |
| Building | (363) | (78) | - | (441) |
| Tenant Improvements | (90) | (19) | - | (109) |
| Equipment | (50) | (11) | - | (61) |
| Computer Software/Hardware | (547) | (365) | - | (912) |
| *Total Accumulated Depreciation* | **(1,050)** | **(473)** | **-** | **(1,523)** |
| **Total Capital Assets, Net** | **$ 7,354** | **$ (473)** | **$ -** | **$ 6,881** |

**NOTE 10 – CAPITAL ASSETS** (Continued)

For the years ended June 30, 2014 and 2013, depreciation expenses were $473,436 and $473,436, respectively.

## NOTE 11 – COMMITMENTS AND CONTINGENCIES

### Litigation

A Petition for Writ of Mandate was filed in January 2013 against MCERA and its Board of Retirement (collectively, Respondents) in Marin County Superior Court Case No. CV 1300318. The Petition challenges Respondents' actions implementing Government Code Section 31461, as amended effective January 1, 2013. The Superior Court entered Judgment on the Petition in favor of Respondents on June 26, 2013, and Petitioners have appealed the Judgment. In addition, Petitioners have filed a Petition for an Extraordinary Writ from the First District Court of Appeal seeking to have the Judgment vacated and the case transferred to Contra Costa County Superior Court to join consolidated proceedings that are pending there. Respondents have filed a preliminary opposition to the Petition for an Extraordinary Writ. Respondents intend to continue to defend themselves vigorously in these proceedings.

### Securities Litigation

MCERA's Class Action Securities Litigation Policy (adopted in 2007, amended in 2011) provides guidelines for monitoring litigation and for determining the appropriate participation by MCERA. Compliance with the policy assures that the Board of Retirement will continue to protect the financial interests of MCERA and its members.

### Capital Commitments

MCERA's real estate and private equity investment managers identify and acquire investments on a discretionary basis. Each manager's investment activity and discretion is controlled by MCERA's IPS and the guidelines and limitations set forth in the contract, subscription agreement, limited partnership agreement, and/or other contractual documents applicable to each manager. Such investments are further restricted by the amount of capital allocated or committed to each manager. MCERA's IPS, contractual obligations, and capital commitments are subject to approval by the Board of Retirement and may be updated as often as necessary to reflect MCERA's prudent determinations regarding its investments, as well as changes in market conditions.

During fiscal year 2014, MCERA funded $32,876,357 of its private equity capital commitments. As of June 30, 2014, outstanding commitments to the various investment managers, as approved by the Board of Retirement, totaled $160,814,521. Subsequent to June 30, 2014, MCERA funded $76,309,122 of these capital commitments.

## NOTE 12 – SUBSEQUENT EVENTS

Subsequent events have been evaluated through October 26, 2014, which is the date the financial statements were issued.

## REQUIRED SUPPLEMENTARY INFORMATION

## MARIN COUNTY EMPLOYEES’ RETIREMENT ASSOCIATION
## SCHEDULE OF CHANGES IN NET PENSION LIABILITY AND RELATED RATIOS

| | June 30, 2014* |
|---|---|
| **Total Pension Liability** | |
| Service cost (MOY) | $ 49,014,858 |
| Interest (includes interest on service cost) | 159,521,975 |
| Change of benefit terms | - |
| Differences between expected and actual experience | - |
| Changes of assumptions | - |
| Benefit payments, including refunds of employee contributions | (109,342,861) |
| Net Change in Total Pension Liability | 99,193,972 |
| Total Pension Liability - beginning | 2,156,578,363 |
| Total Pension Liability - ending (a) | $ 2,255,772,335 |
| **Plan Net Position** | |
| Contributions - employer | $ 74,396,755 |
| Contributions - employee | 18,536,135 |
| Net investment income | 309,002,468 |
| Benefit payments, including refunds of employee contributions | (109,342,861) |
| Administrative expenses | (4,503,845) |
| Net Change in Plan Net Position | 288,088,652 |
| Plan Net Position - beginning | 1,720,544,241 |
| Plan Net Position - ending (b) | $ 2,008,632,893 |
| Net Pension Liability - ending (a)-(b) | $ 247,139,442 |
| Plan Net Position as a Percentage of the Total Pension Liability | 89.04% |
| Covered Employee Payroll | $ 218,340,721 |
| Plan Net Pension Liability as a Percentage of Covered Employee Payroll | 113.19% |

** Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.*

**MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION**
**SCHEDULE OF CONTRIBUTIONS HISTORY**

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Actuarially Determined Contributions | $74,076,755 | $69,853,000 | $64,690,000 | $64,757,000 | $56,271,000 |
| Contributions in Relation to the Actuarially Determined Contribution | 74,076,755 | 69,853,000 | 64,690,000 | 64,757,000 | 56,271,000 |
| Contribution Deficiency / (Excess) | $ - | $ - | $ - | $ - | $ - |
| Covered Employee Payroll | $218,340,721 | $211,001,594 | $216,515,000 | $215,969,000 | $219,556,000 |
| Contributions as a Percentage of Covered Employee Payroll | 33.93% | 33.11% | 29.88% | 29.98% | 25.63% |

| | 2009 | 2008 | 2007 | 2006 | 2005 |
|---|---|---|---|---|---|
| Actuarially Determined Contributions | $54,555,000 | $58,090,000 | $57,215,000 | $43,627,000 | $32,081,000 |
| Contributions in Relation to the Actuarially Determined Contribution | 54,555,000 | 58,090,000 | 57,215,000 | 43,627,000 | 32,081,000 |
| Contribution Deficiency / (Excess) | $ - | $ - | $ - | $ - | $ - |
| Covered Employee Payroll | $214,449,000 | $197,238,000 | $186,123,000 | $177,518,000 | $180,022,000 |
| Contributions as a Percentage of Covered Employee Payroll | 25.44% | 29.45% | 30.74% | 24.58% | 17.82% |

**MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION**
**SCHEDULE OF INVESTMENT RETURNS**

| | June 30, 2014* |
|---|---|
| Annual Money-Weighted Rate of Return, net of investment expense | 18.16% |

***** *Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.*

## NOTE 1 – ACTUARIAL ASSUMPTIONS

| | |
|---|---|
| **Valuation date** | 6/30/2012 (to determine FY 2013-14 contributions) |
| **Timing** | Actuarially determined contribution rates are calculated based on the actuarial valuation one year prior to the beginning of the plan year. |

**Key methods and assumptions used to determine contribution rates:**

| | |
|---|---|
| **Actuarial cost method** | Entry Age |
| **Asset valuation method** | 5-year smoothed market, 80% / 120% corridor around market |
| **Amortization method** | Level percent of payroll (17 years remaining as of 6/30/12) with separate periods for extraordinary actuarial gains or losses (27 years as of 6/30/12) |
| **Investment rate of return** | 7.50% |
| **Amortization growth** | 3.50% |
| **Inflation rate** | 3.25% |
| **Cost of living adjustments** | 3.0% for tiers with a 4.0% COLA cap<br>2.7% for tiers with a 3.0% COLA cap<br>1.9% for tiers with a 2.0% COLA cap |
| **Salary increases** | 3.25% plus merit component based on employee classification and years of service |
| **Healthy Mortality** | Sex distinct RP-2000 combined mortality projected to 2010 using scale AA with ages set back one year for male members and two years for female members |
| **Disabled Mortality** | Sex distinct RP-2000 combined mortality projected to 2010 using scale AA with ages set forward three years for all members |

**A complete description of the methods and assumptions used to determine contribution rates for the year ending June 30, 2014 can be found in the June 30, 2012 actuarial valuation report.**

# OTHER SUPPLEMENTARY INFORMATION

## MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
## SCHEDULE OF COST SHARING EMPLOYER ALLOCATIONS
## AS OF JUNE 30, 2014

| | June 30, 2014 | | | June 30, 2013 | | |
|---|---|---|---|---|---|---|
| Employer | Unfunded Liability (from the June 30, 2013 Actuarial Valuation) | Proportionate Share | Net Pension Liability (1) | Unfunded Liability (from the June 30, 2012 Actuarial Valuation) | Proportionate Share | Net Pension Liability |
| County | $ 308,486,198 | 57.4629% | $ 142,013,489 | $ 356,332,462 | 59.8933% | $ 261,155,224 |
| City of San Rafael | 161,296,968 | 30.0453% | 74,253,787 | 170,467,711 | 28.6527% | 124,935,549 |
| Novato Fire | 32,615,500 | 6.0754% | 15,014,710 | 33,943,565 | 5.7053% | 24,877,055 |
| Superior Court | 15,792,965 | 2.9418% | 7,270,348 | 16,348,327 | 2.7479% | 11,981,782 |
| South Marin Fire | 8,352,522 | 1.5559% | 3,845,243 | 8,873,216 | 1.4914% | 6,503,013 |
| Mosquito District | 7,338,767 | 1.3670% | 3,378,396 | 6,122,906 | 1.0292% | 4,487,663 |
| Tamalpais CSD | 2,233,810 | 0.4161% | 1,028,347 | 2,120,928 | 0.3565% | 1,554,462 |
| LAFCO | 402,897 | 0.0750% | 185,355 | 396,214 | 0.0666% | 290,399 |
| Marin City CSD | 325,503 | 0.0606% | 149,767 | 339,722 | 0.0571% | 248,975 |
| Total | $ 536,845,130 | 100.0000% | $ 247,139,442 | $ 594,945,051 | 100.0000% | $ 436,034,122 |

(1) Proportionate share of net pension liability is based on the actuarial valuation.

# MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
# SCHEDULE OF EMPLOYER PENSION AMOUNTS
# ALLOCATED BY COST SHARING PLAN
# AS OF JUNE 30, 2014

| | | Deferred Outflows of Resources | | | | | Deferred Inflows of Resources | | | | | Pension Expense | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Employer | Net Pension Liability | Differences Between Expected and Actual Economic Experience | Differences Between Projected and Actual Investment Earnings | Changes of Assumptions | Changes in Proportion and Differences Between Contributions and Proportionate Share of Pension Expense | Total Deferred Outflows of Resources | Differences Between Expected and Actual Economic Experience | Differences Between Projected and Actual Investment Earnings | Changes of Assumptions | Changes in Proportion and Differences Between Contributions and Proportionate Share of Pension Expense | Total Deferred Inflows of Resources | Proportionate Share of Plan Pension Expense | Net Amortization of Deferred Amounts from Changes in Proportion and Proportionate Share of Pension Expense | Total Pension Expense |
| County | $ 142,013,489 | $ - | $ - | $ - | $ - | $ - | $ - | $ 83,082,959 | $ - | $ - | $ 83,082,959 | $ 17,289,130 | $ (3,326,458) | $ 13,962,672 |
| City of San Rafael | 74,253,787 | - | - | - | - | - | - | 43,441,115 | - | - | 43,441,115 | 9,039,870 | 2,478,758 | 11,518,628 |
| Novato Fire | 15,014,710 | - | - | - | - | - | - | 8,784,141 | - | - | 8,784,141 | 1,827,934 | 381,123 | 2,209,057 |
| Superior Court | 7,270,348 | - | - | - | - | - | - | 4,253,413 | - | - | 4,253,413 | 885,113 | 184,840 | 1,069,953 |
| South Marin Fire | 3,845,243 | - | - | - | - | - | - | 2,249,604 | - | - | 2,249,604 | 468,131 | (125,568) | 342,563 |
| Mosquito District | 3,378,396 | - | - | - | - | - | - | 1,976,482 | - | - | 1,976,482 | 411,296 | 345,965 | 757,261 |
| Tamalpais CSD | 1,028,347 | - | - | - | - | - | - | 601,620 | - | - | 601,620 | 125,194 | 48,935 | 174,129 |
| LAFCO | 185,355 | - | - | - | - | - | - | 108,439 | - | - | 108,439 | 22,566 | 10,797 | 33,363 |
| Marin City CSD | 149,767 | - | - | - | - | - | - | 87,619 | - | - | 87,619 | 18,233 | 1,608 | 19,841 |
| Totals | $ 247,139,442 | $ - | $ - | $ - | $ - | $ - | $ - | $ 144,585,392 | $ - | $ - | $ 144,585,392 | $ 30,087,467 | $ - | $ 30,087,467 |