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BROWN ARMSTRONG
*Certified Public Accountants*

**REQUIRED COMMUNICATION TO THE MEMBERS OF THE BOARD OF RETIREMENT IN ACCORDANCE WITH PROFESSIONAL STANDARDS (SAS 114)**

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

We have audited the basic financial statements and other information (financial statements) of the Marin County Employees' Retirement Association (MCERA) for the fiscal year ended June 30, 2018, and have issued our report dated December 26, 2018. Professional standards require that we provide you with information about our responsibilities under auditing standards generally accepted in the United States of America and *Government Auditing Standards*, as well as certain information related to the planned scope and timing of our audit. We have communicated such information in our letter to you dated July 9, 2018. Professional standards also require that we communicate to you the following information related to our audit.

**Significant Audit Matters**

*Qualitative Aspects of Accounting Practices*
Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by MCERA are described in Note 2, Summary of Significant Accounting Policies, to the financial statements. As described in Note 2, MCERA implemented Governmental Accounting Standards Board (GASB) Statement No. 85, *Omnibus 2017.* Implementation of this standard did not have a significant impact on MCERA's financial statements. We noted no transactions entered into by MCERA during the fiscal year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events as well as assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting MCERA's financial statements were:

- Management's estimate of the fair value of investments which was derived by various methods as detailed in the notes to the financial statements. We evaluated the key factors and assumptions used to develop the estimate of the fair value of investments in determining that it is reasonable in relation to the financial statements taken as a whole.

- The contribution amounts and net pension liability as detailed in notes to the financial statements, which are based on the actuarially-presumed interest rate and assumptions. We evaluated the key factors and assumptions used to develop the estimates of the contribution amounts and net pension liability in determining that they are reasonable in relation to the financial statements taken as a whole.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

- The disclosures for investments in Notes 2, 3, 4, 5, and 6 to the financial statements, Summary of Significant Accounting Policies, Deposits and Investments, Securities Lending, Derivative Financial Instruments, and Real Estate, respectively, were derived from MCERA's investment policy. Management's estimate of the fair value of investments was derived by various methods as detailed in the notes to the financial statements.

- Additionally, the disclosures related to the funding policies, net pension liability, and actuarial methods and assumptions in Note 1, Plan Description; Note 7, Contributions; and Note 9, Net Pension Liability, were derived from actuarial valuations, which involved estimates of the value of reported amounts and probabilities about the occurrence of events far into the future.

The financial statement disclosures are neutral, consistent, and clear.

*Difficulties Encountered in Performing the Audit*
We encountered no significant difficulties in dealing with management in performing and completing our audit.

*Corrected and Uncorrected Misstatements*
Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. As a result of our audit procedures, we identified an uncorrected adjustment in MCERA's private equity investments due to a lag in reporting. The attached schedule summarizes the uncorrected adjustment of private equity investments in the reporting of fair value due to information not received timely for adjusting the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

*Disagreements with Management*
For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

*Management Representations*
We have requested certain representations from management that are included in the management representation letter dated December 26, 2018.

*Management Consultations with Other Independent Accountants*
In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to MCERA's basic financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

*Other Audit Findings or Issues*
We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as MCERA's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

**Other Matters**

We applied certain limited procedures to the Management's Discussion and Analysis, Schedule of Changes in Net Pension Liability and Related Ratios, Schedule of Contributions History, Schedule of Investment Returns, and Notes to the Required Supplementary Information, which are Required Supplementary Information (RSI) that supplement the basic financial statements. Our procedures consisted of inquiries of management regarding 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 the audit of the basic financial statements. We did not audit the RSI and do not express an opinion or provide any assurance on the RSI.

**Restriction on Use**

This information is intended solely for the use of the Board of Retirement and management of MCERA and is not intended to be, and should not be, used by anyone other than these specified parties.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
December 26, 2018

**MCERA**
**Uncorrected Journal Entry**
**6/30/2018**

The uncorrected adjustment is a result of MCERA's cut off procedures for financial reporting and timing of the actuarial valuation for Governmental Accounting Standards Board Statements No. 67 and No. 68. Rollforwards from March 31st balances were utilized as estimates and the total of this entry is due to a lag in reporting fair value of MCERA's Private Equity investments.

| Account | Debit | Credit |
|---|---|---|
| Private Equity - Abbott Fund VI | $ 4,733,697 | |
| Abbott Fund VI - Unrealized Gain/Loss | | $ 4,733,697 |
| Private Equity - Abbott Fund VII | 1,289,133 | |
| Abbott Fund VII - Unrealized Gain/Loss | | 1,289,133 |
| Private Equity - Abbott Investor 2016 | 311,562 | |
| Abbott Investor 2016 - Unrealized Gain/Loss | | 311,562 |
| Private Equity - Abbott Investor 2017 | 4,158 | |
| Abbott Investor 2017 - Unrealized Gain/Loss | | 4,158 |
| Private Equity - Pathway fund 2008 | 6,148,446 | |
| Pathway fund 2008 - Unrealized Gain/Loss | | 6,148,446 |
| Private Equity - Pathway I7-3 | 1,866,222 | |
| Pathway I7-3 - Unrealized Gain/Loss | | 1,866,222 |
| Private Equity - Pathway I8-9 | 1,141,677 | |
| Pathway I8-9 - Unrealized Gain/Loss | | 1,141,677 |
| Private Equity - Pathway I9-3 | 65,465 | |
| Pathway I9-3 - Unrealized Gain/Loss | | 65,465 |
| | $ 15,560,360 | $ 15,560,360 |

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*Certified Public Accountants*

## INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

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

We have audited, in accordance with the 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, the financial statements of the Marin County Employees' Retirement Association (MCERA) as of and for the fiscal year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise MCERA's basic financial statements, and have issued our report thereon dated December 26, 2018.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered MCERA's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of MCERA's internal control. Accordingly, we do not express an opinion on the effectiveness of MCERA's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of MCERA's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether MCERA's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of MCERA's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering MCERA's internal control and compliance. Accordingly, this report is not suitable for any other purpose.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
December 26, 2018

**MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION**

**FINANCIAL STATEMENTS WITH INDEPENDENT AUDITOR'S REPORT**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2018**

**MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION FOR THE FISCAL YEAR ENDED JUNE 30, 2018**

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## INDEPENDENT AUDITOR'S REPORT

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

### Report on the Financial Statements and Other Information

We have audited the accompanying Statement of Fiduciary Net Position of the Marin County Employees' Retirement Association (MCERA), a component unit of the County of Marin, California, as of June 30, 2018, the Statement of Changes in Fiduciary Net Position for the fiscal year 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 Schedule of Cost Sharing Employer Allocations of MCERA and the Schedule of Employer Pension Amounts Allocated by Cost Sharing Plan totals for all entities of the columns titled net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense excluding that attributable to employer-paid member contributions (specified column totals) as of and for the fiscal year ended June 30, 2018, listed as other information in the table of contents.

### Management's Responsibility for the Financial Statements and Other Information

Management is responsible for the preparation and fair presentation of these basic financial statements and other information 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 and other information 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 and other information based on our audit. We conducted our audit 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 audit to obtain reasonable assurance about whether the basic financial statements and other information are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the basic financial statements and other information. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the basic financial statements and other information, 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 and other information 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 and other information.

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

**Opinions**

In our opinion, the basic financial statements and other information referred to above present fairly, in all material respects, the fiduciary net position of MCERA as of June 30, 2018; the changes in its fiduciary net position for the fiscal year then ended; the Schedule of Cost Sharing Employer Allocations of MCERA; and the Schedule of Employer Pension Amounts Allocated by Cost Sharing Plan totals for all entities of the columns titled net pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense excluding that attributable to employer-paid member contributions (specified column totals) as of and for the fiscal year ended June 30, 2018, in accordance with accounting principles generally accepted in the United States of America.

**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 Governmental Accounting Standards Board (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 and other information. 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 December 26, 2018, 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 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.

**Report on Summarized Comparative Information**

We have previously audited MCERA's June 30, 2017, financial statements, and our report dated November 2, 2017, expressed an unmodified opinion on those audited financial statements. In our opinion, the summarized comparative information presented herein as of and for the fiscal year ended June 30, 2017, is consistent in all material respects, with the audited financial statements from which it has been derived.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Brown Armstrong
Accountancy Corporation

Bakersfield, California
December 26, 2018

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 fiscal year ended June 30, 2018. 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 fiduciary net position as of June 30, 2018, was $2,501,422,132. The fiduciary net position is restricted for payment of pension benefits to participants and their beneficiaries and is available to meet MCERA's ongoing obligations.

- Fiduciary net position increased by $185,161,922, primarily as a result of employer and employee contributions and earnings from investments.

- Total additions as reflected in the Statement of Changes in Fiduciary Net Position were $329,222,299, which includes employer and employee contributions of $107,383,103, a net investment gain of $221,655,211, and net securities lending income of $183,985.

- Deductions from fiduciary net position increased from $136,341,253 to $144,060,377 from the prior year. The increase was mainly due to an increase in retiree pension benefits.

- MCERA's funding objective is to meet long-term benefit obligations through contributions and investment income. As of June 30, 2017, the date of the last actuarial evaluation, the funded ratio for all MCERA agencies was 84.4% based on the ratio of actuarial value of assets over actuarial liability. In general, this indicates that for every dollar of benefits due we had approximately $0.84 of assets available for payment as of that date. The funding ratios of the employer entities included in MCERA were: 86.8% for the County of Marin and Special Districts, 74.6% for the City of San Rafael, and 89.1% 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:

- Statement of Fiduciary Net Position
- Statement of Changes in Fiduciary Net Position
- Notes to the Basic Financial Statements

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 Fiduciary Net Position and the Statement of Changes in Fiduciary Net Position 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 Fiduciary Net Position 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 restricted for pension benefits, which is the assets less the liabilities, reflects the funds available for future use.

The Statement of Changes in Fiduciary Net Position 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 to or Deductions from the plan.

These two statements report MCERA's net position restricted 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 standards 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 standards.

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 fiscal year.

In addition to the Basic Financial Statements, this report contains required supplementary information and schedules to illustrate the GASB Statement No. 67 financial reporting requirements. These schedules provide a broad scope of financial information, including a pension liability measurement and changes to the liability, historical contributions, money-weighted investment return, and additional actuarial-related disclosures.

Other Information consists of two schedules pertaining to GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*. The two schedules include the Schedule of Cost Sharing Employer Allocations and the Schedule of Employer Pension Amounts Allocated by Cost Sharing Plan. Under GASB Statement No. 68, plan sponsors are required to report Net Pension Liability on their balance sheets and changes in Net Pension Liability on their operating statements as pension expenses, deferred inflows of resources, and deferred outflows of resources.

**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 restricted for pension benefits as of June 30, 2018, totaled $2,501,422,132, an increase of $185,161,922 over the prior year. MCERA's assets exceeded its liabilities at the end of the fiscal year. Net position restricted for pension benefits 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 Fiduciary Net Position, and only current liabilities are reported. Below is a comparison of current and prior year balances:

| | 2018 | 2017 | Increase (Decrease) 2018/2017 |
|---|---|---|---|
| Investments at fair value | $ 2,474,331,913 | $ 2,258,555,426 | $ 215,776,487 |
| Cash and cash equivalents | 31,491,712 | 46,809,883 | (15,318,171) |
| Capital assets (net of accumulated depreciation) | 4,986,167 | 5,459,603 | (473,436) |
| Cash collateral held for securities loaned | 42,146,367 | 36,938,897 | 5,207,470 |
| Receivables and other assets | 7,702,701 | 11,877,346 | (4,174,645) |
| Total assets | 2,560,658,860 | 2,359,641,155 | 201,017,705 |
| Total liabilities | 59,236,728 | 43,380,945 | 15,855,783 |
| Net position restricted for pension benefits | $ 2,501,422,132 | $ 2,316,260,210 | $ 185,161,922 |

In order to determine whether the Net Position restricted for pension benefits 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, performed an actuarial valuation as of June 30, 2017, and determined that the funded ratio of the actuarial value of assets to the actuarial liability is 84.4%. The actuarial valuation as of June 30, 2016, determined the funded ratio to be 81.5%.

**Additions to Fiduciary 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, 2018 and 2017, totaled $329,222,299 and $353,904,221, respectively.

| | 2018 | 2017 | Increase (Decrease) 2018/17 |
|---|---|---|---|
| Employer contributions | $ 78,754,476 | $ 77,502,945 | $ 1,251,531 |
| Plan member contributions | 28,628,627 | 28,053,775 | 574,852 |
| Total net investment income | 221,839,196 | 248,347,501 | (26,508,305) |
| Total additions | $ 329,222,299 | $ 353,904,221 | $ (24,681,922) |

**Deductions from Fiduciary 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:

| | 2018 | 2017 | Increase (Decrease) 2018/2017 |
|---|---|---|---|
| Retirement benefits | $ 138,640,109 | $ 130,771,236 | $ 7,868,873 |
| Refund of contributions | 1,216,563 | 1,165,826 | 50,737 |
| Administrative expenses | 3,343,486 | 3,555,663 | (212,177) |
| Legal expenses | 484,563 | 494,196 | (9,633) |
| Computer expenses | 214,827 | 209,075 | 5,752 |
| Actuarial expenses | 160,829 | 145,257 | 15,572 |
| Total deductions | $ 144,060,377 | $ 136,341,253 | $ 7,719,124 |

**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. 67, *Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25*, investments are stated at fair value instead of cost and include the recognition of unrealized gains and losses.

| | **2018** | **2017** |
|---|---|---|
| Employee reserves | $ 337,988,145 | $ 317,281,385 |
| Employer reserves | 337,030,165 | 309,486,082 |
| Retiree reserves | 1,765,004,524 | 1,678,441,528 |
| Contingency reserves | 20,514,349 | 17,372,290 |
| **Total reserves - restricted** | **2,460,537,183** | **2,322,581,285** |
| Unrestricted reserves | 40,884,949 | 7,893,175 |
| Contra - Interest crediting | – | (14,214,250) |
| **Total reserves - unrestricted** | **40,884,949** | **(6,321,075)** |
| **Total Net Position Restricted for Pension Benefits** | **$2,501,422,132** | **$2,316,260,210** |

**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 Board of Retirement, 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.

Respectfully submitted,

/s/ La Valda Marshall

La Valda Marshall
Accounting Unit Manager

# BASIC FINANCIAL STATEMENTS

**MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION**
**STATEMENT OF FIDUCIARY NET POSITION**
**AS OF JUNE 30, 2018 (with Comparative Totals)**

| | June 30, 2018 | June 30, 2017 |
|---|---|---|
| **Assets** | | |
| Cash and short-term investments | | |
| Cash and cash equivalents | $ 31,491,712 | $ 46,809,883 |
| Cash collateral on loaned securities | 42,146,367 | 36,938,897 |
| Total Cash and Short-Term Investments | 73,638,079 | 83,748,780 |
| Receivables | | |
| Contributions | 3,823,704 | 6,141,593 |
| Interest and dividends | 2,220,718 | 2,015,474 |
| Due from brokers for securities sold | 1,164,332 | 3,147,080 |
| Other receivables | 396,149 | 513,475 |
| Total Receivables | 7,604,903 | 11,817,622 |
| Investments at fair value | | |
| Domestic fixed income | 374,675,426 | 339,793,320 |
| International fixed income | 63,128,698 | 62,120,201 |
| Domestic equities | 863,910,598 | 740,704,272 |
| International equities | 548,340,898 | 548,114,926 |
| Private equity | 247,799,003 | 214,767,077 |
| Real estate | 266,170,531 | 215,426,670 |
| Real assets | 110,306,759 | 137,628,960 |
| Total Investments at Fair Value | 2,474,331,913 | 2,258,555,426 |
| Capital assets (net of accumulated depreciation) | 4,986,167 | 5,459,603 |
| Prepaid insurance | 97,798 | 59,724 |
| Total Assets | 2,560,658,860 | 2,359,641,155 |
| **Liabilities** | | |
| Accounts payable and accrued expenses | 1,740,483 | 1,370,194 |
| Due to brokers for securities purchased | 15,334,500 | 5,058,254 |
| Retiree payroll payable | 15,378 | 13,600 |
| Obligations under securities lending program | 42,146,367 | 36,938,897 |
| Total Liabilities | 59,236,728 | 43,380,945 |
| **Net Position Restricted for Pension Benefits** | $ 2,501,422,132 | $ 2,316,260,210 |

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

## MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
## STATEMENT OF CHANGES IN FIDUCIARY NET POSITION
## FOR THE FISCAL YEAR ENDED JUNE 30, 2018 (with Comparative Totals)

| | June 30, 2018 | June 30, 2017 |
|---|---|---|
| **Additions** | | |
| Contributions | | |
| Employer | $ 78,754,476 | $ 77,502,945 |
| Plan member | 28,628,627 | 28,053,775 |
| Total Contributions | 107,383,103 | 105,556,720 |
| Investment income | | |
| Net appreciation in fair value of investments | 202,684,595 | 231,386,683 |
| Interest and dividends | 16,508,622 | 15,585,631 |
| Real estate operating income, net | 13,921,217 | 11,543,744 |
| Other investment income | 1,633,974 | 1,679,902 |
| Total investment income | 234,748,408 | 260,195,960 |
| Investment expenses | (13,093,197) | (12,035,614) |
| Net Investment Income | 221,655,211 | 248,160,346 |
| Securities lending activities | | |
| Securities lending income | 909,662 | 436,387 |
| Less expenses from securities lending activities | (725,677) | (249,232) |
| Net Securities Lending Activities | 183,985 | 187,155 |
| Total Net Investment Income | 221,839,196 | 248,347,501 |
| Total Additions | 329,222,299 | 353,904,221 |
| **Deductions** | | |
| Benefits | 138,640,109 | 130,771,236 |
| Refunds | 1,216,563 | 1,165,826 |
| Administrative expenses | 3,343,486 | 3,555,663 |
| Legal expenses | 484,563 | 494,196 |
| Computer expenses | 214,827 | 209,075 |
| Actuarial expenses | 160,829 | 145,257 |
| Total Deductions | 144,060,377 | 136,341,253 |
| Net Increase | 185,161,922 | 217,562,968 |
| **Net Position Restricted for Pension Benefits, Beginning of Year** | 2,316,260,210 | 2,098,697,242 |
| **Net Position Restricted for Pension Benefits, End of Year** | $ 2,501,422,132 | $ 2,316,260,210 |

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 CSD), Marin County Superior Court (Superior Court), Marin/Sonoma Mosquito and Vector Control District (Mosquito District), Novato Fire Protection District (Novato Fire), Southern Marin Fire Protection District (Southern Marin Fire), and Tamalpais Community Services District (Tamalpais CSD).

### Administration

The Board of Retirement is responsible for the general administration and management of the retirement association. All Board of Retirement members, except the County Director of Finance, serve for a term of three years. By statute, Board of Retirement 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 that 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, 2017):

| | 2017 |
|---|---|
| Active Members (Vested and Non-Vested) | 2,685 |
| Retired Members and Beneficiaries | 3,141 |
| Terminated Vested (Deferred) | 668 |
| **Total Membership** | **6,494** |

**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 UCPI exceeds the maximum statutory COLA for the member's tier, the difference is accumulated for use in future years when the UCPI is less than the maximum statutory COLA. The accumulated percentage carryover is known as the COLA Bank.

## NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Reporting Entity

MCERA, with its own governing board, is an independent governmental entity separate and distinct from the County. Actuarially determined financial data for MCERA is included in the County'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 expenses 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. Expenses 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 fiscal year ended June 30, 2018, administrative expenses were $3,343,486, or 0.13% of the actuarial liability as of June 30, 2016.

### Cash and Cash Equivalents

Cash equivalents include deposits in MCERA's custodian bank, a financial institution, and pooled cash with the County Treasurer. Pooled cash is reported at amortized cost, which approximates fair value. Income on pooled cash is allocated on MCERA's average daily balance in relation to total pooled assets. 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.

### Receivables

Receivables consist primarily of interest, dividends, investments in transition (i.e., traded but not yet settled), and contributions owed by the employing entities as of June 30, 2018.

### Methods Used to Value Investments

Investments are reported at fair value. Fair value is the amount MCERA could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. Fair value is determined by MCERA management based on information provided by the investment managers and the custodian bank. Fixed income securities, real estate investment trusts (REITs), common and preferred stocks, and derivatives are valued based on published market prices and quotations from national security exchanges and securities pricing services. Real estate investment funds are valued using periodic independent appraisals or internal valuation techniques, including discounted cash flows, sales comparisons, and cost approaches. Investments that are not traded on national exchanges or do not have pricing services (such as private equity funds) are valued based on fund share price or percentage of ownership as determined by the fund manager or general partner in accordance with the valuation methodology outlined in the partnership agreement.

**NOTE 2 – <u>SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u>** (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 Board of Retirement, 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.

**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, 2018, the capitalized portion of the building was $2,977,003 and computers and equipment were $2,009,164 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.

**Reclassifications**

Comparative data for the prior year has been presented in the selected sections of the accompanying Statement of Fiduciary Net Position and Statement of Changes in Fiduciary Net Position. 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 New Accounting Standard**

The following standard was issued recently by the Governmental Accounting Standards Board (GASB) for implementation effective for this fiscal year. GASB Statement No. 85, *Omnibus 2017*, addresses practice issues that have been identified during the implementation and application of certain GASB Statements including fair value measurements. Statement No. 85 also covers other postemployment benefits, blending component units, and goodwill, which are not applicable to MCERA. Implementation of this standard did not have a significant impact on MCERA's financial statements.

## NOTE 3 – DEPOSITS AND INVESTMENTS

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. As of June 30, 2018, $441,676 of the plan's bank balances of $691,676 was uninsured and uncollateralized.

**NOTE 3 – DEPOSITS AND INVESTMENTS** (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, 2018, as rated by Standard & Poor's, are listed below (all dollars in thousands). The credit risk schedule excludes the $120.1 million commingled global bond fund, which is included in the fixed income category on the Statement of Fiduciary Net Position.

| Rating Category | Fair Value |
|---|---|
| | **2018** |
| AAA | $ 33,917 |
| AA | 8,155 |
| A | 51,020 |
| BBB | 103,433 |
| BB | 9,975 |
| B | 1,519 |
| CCC | 257 |
| Agencies | 7,656 |
| U.S. Treasuries | 11,558 |
| No Rating | 90,196 |
| **Total** | **$ 317,686** |

*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, 2018, 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.

**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.

Interest rate risk is managed through MCERA's investment policy and investment guidelines, which require the effective duration of individual fixed income portfolios to remain within a defined range (75% to 125%) of the appropriate benchmark. The primary benchmarks for domestic and global fixed income portfolios are the Barclays Aggregate Bond Index, the Barclays Intermediate Credit Index, and the Citigroup World Government Bond Index. The interest rate risk schedule presents the weighted average duration of fixed income securities by investment category as of June 30, 2018. This schedule excludes the $120.1 million commingled global bond fund, which is included in the fixed income category on the Statement of Fiduciary Net Position.

June 30, 2018 (all dollars in thousands):

| Investment Type | Fair Value | Weighted Average Duration (in Years) |
|---|---|---|
| Asset-Backed Securities | $ 27,832 | 0.73 |
| Collateralized Mortgage Obligations | 30,754 | 4.17 |
| Corporate and Other Credit | 171,774 | 5.14 |
| Mortgage Pass-Throughs | 5,058 | 9.96 |
| Municipal Bonds | 2,289 | 6.10 |
| U.S. Treasuries | 11,558 | 12.68 |
| **Total** | **$ 249,265** | |
| Other Bonds – No Duration | 68,421 | |
| **Total** | **$ 317,686** | |

*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 contracts (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 currency 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 currency 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.

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

**Investments** (Continued)

*Foreign Currency Risk* (Continued)

MCERA invests primarily in commingled vehicles; as such, the foreign currency risk exposure is minimal. The following table presents a summary of securities with non-U.S. Dollars (non-USD) base currencies as of June 30, 2018 (all dollars in thousands):

| Base Currency Country | Base Currency Code | Fair Value in U.S. Dollars |
|---|---|---|
| Argentina | ARS | $294 |
| Canada | CAD | -171 |
| Egypt | EGP | 320 |
| International (Euro) | EUR | 1,630 |
| United Kingdom | GBP | 3 |
| **Total Non-USD Securities** | | **$2,076** |

*Rate of Return*

For the fiscal year ended June 30, 2018, the annual money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 9.53%. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

*Fair Value Measurements*

Fair value is the amount MCERA could reasonably expect to receive for an investment in a current sale between a willing buyer and a willing seller. GASB Statement No. 72 (GASB 72), *Fair Value Measurement and Application*, was issued to address accounting and financial reporting issues related to fair value measurement. MCERA implemented GASB 72 in 2016. The standard establishes a fair value hierarchy based on three types of inputs that measure the fair value of investments.

- *Level 1:* Reflects quoted prices for identical investments in active markets;
- *Level 2:* Reflects prices that are based on similar observable inputs other than quoted market prices; and
- *Level 3:* Reflects prices that are based on unobservable sources.

Inputs used to measure fair value might fall in different levels of the fair value hierarchy, in which case MCERA defaults to the lowest level input that is significant to the fair value measurement in its entirety. In determining the appropriate levels, a detailed analysis was performed of the assets and liabilities that are subject to GASB 72.

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

**Investments** (Continued)

*Fair Value Measurements* (Continued)

At June 30, 2018, MCERA had the following fair value measurements:

| Investments by Fair Value Level | June 30, 2018 | Quoted Prices in Active Markets for Identical Assets<br>Level 1 | Significant Other Observable Inputs<br>Level 2 | Significant Unobservable Inputs<br>Level 3 |
|---|---|---|---|---|
| **Debt Securities** | | | | |
| Mortgage and Asset-Backed | 45,147,204 | – | 44,643,314 | 503,890 |
| Corporate Bonds | 171,773,450 | 472,883 | 171,300,567 | – |
| U.S. Government and Agency Securities | 13,438,834 | – | 13,438,834 | – |
| Government Issues | 16,925,307 | – | 16,925,307 | – |
| Municipal Obligations | 2,289,278 | – | 2,289,278 | – |
| Commingled Bond Investments | 188,230,051 | – | 188,230,051 | – |
| **Total Debt Securities** | **437,804,124** | **472,883** | **436,827,351** | **503,890** |
| **Equity Securities** | | | | |
| Common Stock | 132,580,122 | 132,580,122 | – | – |
| Preferred Stock | 279,916 | – | – | 279,916 |
| Mutual Funds and Commingled Investments | 1,279,391,458 | 1,011,497,395 | 267,894,063 | – |
| **Total Equity Securities** | **1,412,251,496** | **1,144,077,517** | **267,894,063** | **279,916** |
| **Other Assets** | | | | |
| Private Real Estate - Commingled Investments | 254,810,481 | – | 36,180,569 | 218,629,912 |
| Private Real Estate - Direct Ownership | 11,360,050 | – | – | 11,360,050 |
| Public Real Assets - Mutual Funds and Commingled Investments | 110,306,759 | 37,067,333 | 73,239,426 | - |
| Securities Lending Cash Collateral | 42,146,367 | – | 42,146,367 | - |
| **Total Other Assets** | **418,623,657** | **37,067,333** | **151,566,362** | **229,989,962** |
| **Total Investments by Fair Value Level** | **2,268,679,277** | **1,181,617,733** | **856,287,776** | **230,773,768** |
| **Investments Measured at Net Asset Value (NAV)** | | | | |
| Private Equity Funds | 247,799,003 | | | |
| **Total NAV Investments** | **247,799,003** | | | |
| **Total Investments** | **2,516,478,280** | | | |
| **Investments in Derivative Instruments (all dollars in thousands)** | | | | |
| Forwards | | – | 19 | – |
| **Total Derivatives** | | – | **19** | – |

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

**Investments** (Continued)

*Fair Value Measurements* (Continued)

Debt and equity securities classified in Level 1 are valued using prices quoted in active markets for those securities. Debt and equity securities classified in Level 2 of the fair value hierarchy are valued using the following approaches:

- U.S. Treasuries, U.S. Agencies, and Commercial Paper: quoted prices for identical securities in markets that are not active;
- Corporate and Municipal Bonds: quoted prices for similar securities in active markets;
- Repurchase Agreements, Negotiable Certificates of Deposit, and Collateralized Debt Obligations: matrix pricing based on the securities' relationship to benchmark quoted prices;
- Money Market, Bond, and Equity Mutual Funds: published fair value per share (unit) for each fund; and
- Commingled and High-Yield Equity Investments: valued using matrix pricing techniques or quoted prices for similar securities in active markets.

Equity securities classified in Level 3 represent preferred stocks that are priced by the investment manager using internal fair value techniques or broker quotations for which there is not an independent pricing source.

Public real assets classified in Level 1 are valued using prices quoted in active markets for those securities. Public real assets classified in Level 2 are commingled (collective) investment funds that are valued using matrix pricing techniques maintained by the various pricing vendors for those securities. Derivative instruments classified in Level 1 are valued directly from a predetermined primary external pricing vendor. Derivative instruments classified in Level 2 are valued using a market approach that considers benchmark interest rates and foreign exchange rates. Real estate investments classified in Level 3 are valued using periodic independent appraisals or internal valuation techniques, including discounted cash flows, sales comparisons, and cost approaches.

Investments measured at net asset value (NAV) are considered "alternative investments." Alternative investments are those for which exchange quotations are not readily available and are valued at the estimated fair value based on fund share price or percentage of ownership, as determined by the investment manager or general partner. The following table presents the redemption frequency (if currently eligible) and the redemption notice period for MCERA's alternative investments measured at NAV:

| | Fair Value at June 30, 2018 | Unfunded Commitments | Redemption Frequency (If Currently Eligible) | Redemption Notice Period |
|---|---|---|---|---|
| Private Equity Funds [1] | $ 247,799,003 | $ 124,843,491 | N/A | N/A |

**(1) Private Equity Funds:** MCERA's private equity portfolio is composed of six funds investing primarily in buyout funds, venture capital, and special debt situations. The fair values of these funds have been determined using audited financial statements or estimates of NAV from the prior quarter plus current quarter cash flows. The funds are not eligible for redemption.

## NOTE 4 – SECURITIES 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, 2018, the fair value of securities loaned by MCERA totaled $43,226,731. As of June 30, 2018, the fair value of cash collateral held for securities loaned was $42,146,367 and MCERA had no credit risk exposure to borrowers.

## NOTE 5 – DERIVATIVE FINANCIAL INSTRUMENTS

Under the terms of the MCERA's IPS and investment guidelines, investment managers are permitted to use derivative instruments to implement market decisions and to control portfolio risk. Derivatives are contracts or securities whose cash flows or fair values are derived from the values of other securities, indices, or instruments, including, but not limited to, futures, forwards, options, swaps, and options on futures. MCERA's investment managers are not allowed to use derivatives for speculative purposes. Investment managers must ascertain and carefully monitor the creditworthiness of any third parties involved in derivative transactions.

Derivative instruments are reported at fair value as determined by MCERA's bank custodian. The changes in fair value of derivative instruments are reported within the investment revenue classification. 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 – <u>DERIVATIVE FINANCIAL INSTRUMENTS</u> (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, 2018, with the net appreciation/(depreciation) that has occurred during the fiscal year (all dollars in thousands):

| Investment Derivatives by Type | Net Appreciation/ (Depreciation) in Fair Value Amount | Classification | Fair Value | Notional Amount |
|---|---|---|---|---|
| Credit Default Swaps Purchased | $ (15) | Swaps | $ – | $ – |
| Credit Default Swaps Written | 10 | Swaps | – | – |
| Fixed Income Futures Long | (3,180) | Futures | – | 143,600 |
| Fixed Income Futures Short | 829 | Futures | – | (57,312) |
| Foreign Currency Futures Short | 51 | Futures | – | (2,675) |
| FX Forwards | 64 | Long-Term Instruments | 19 | 2,312 |
| Index Futures Long | 80 | Futures | – | – |
| Index Futures Short | (3,552) | Futures | – | (22) |
| Pay Fixed Interest Rate Swaps | 55 | Swaps | – | – |
| **Total** | **$ (5,658)** | | **$ 19** | **$ 85,903** |

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

**Types of Derivative Risk**

*Counterparty Credit Risk*

To minimize counterparty 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, 2018, 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 total fair value subject to counterparty credit risk for MCERA's derivatives, as rated by Fitch, is as follows (all dollars in thousands):

| Rating Category | Fair Value Subject to Counterparty Credit Risk |
|---|---|
| | 2018 |
| A+ | $ 44 |
| **Total** | **$ 44** |

*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. MCERA had no investment derivative interest rate risk as of June 30, 2018.

*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. MCERA had the following derivative foreign currency exposures as of June 30, 2018 (all dollars in thousands):

| Derivative Type | Foreign Currency | Fair Value |
|---|---|---|
| Currency Forward Contracts | Yen | $ 19 |
| **Total Foreign Derivatives** | | **$ 19** |

**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 valuations by investment management firms/general partners with independent third-party appraisals accomplished at regular intervals. Internal valuation techniques include discounted cash flows, sales comparisons, and cost approaches, 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, 2018, the estimated fair value of MCERA's real estate portfolio was $266,170,531.

MCERA has the following real estate holdings as of June 30, 2018 (all dollars in thousands):

| | | Fair Value |
|---|---|---|
| ***Direct Investments*** | | |
| San Rafael | $ | 11,360 |
| *Total Direct Investments* | **$** | **11,360** |
| ***Commingled Investments*** | | |
| AEW Capital Management | $ | 18 |
| AEW Core | | 96,813 |
| Blackrock REIT | | 36,181 |
| UBS – TPF | | 121,799 |
| *Total Commingled Investments* | **$** | **254,811** |
| **Total Real Estate Investments** | **$** | **266,171** |

**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.

**Employer Contributions**

For fiscal year 2018, 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 Liability (UAL). The UAL is the excess of the plan's accrued liability over its assets.

**NOTE 7 – CONTRIBUTIONS** (Continued)

**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 6.62% to 17.85%; Safety member contributions range from 10.34% to 23.77%. These figures include additional cost sharing for some members determined through labor negotiations.

**NOTE 8 – RESERVES**

MCERA carries accounts within Net Position Restricted 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 Fiduciary Net Position, as the sum of these reserves equals the Net Position Restricted 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 Retiree Member Reserves made when a member retires.

*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 Retiree 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.

**NOTE 8 – RESERVES** (Continued)

**Components of Reserves** (Continued)

*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 COLAs.

*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 fiduciary net position) is shown below:

| Change in Net Pension Liability from Fiscal Year Ended (FYE) 2017 to FYE 2018* | | | |
|---|---|---|---|
| | Increase (Decrease) | | |
| | Total Pension Liability (a) | Fiduciary Net Position (b) | Net Pension Liability (a) - (b) |
| **Balances at June 30, 2017** | **$2,685,016,515** | **$2,316,260,210** | **$368,756,305** |
| **Changes for the Year:** | | | |
| Service Cost | 61,074,664 | - | 61,074,664 |
| Interest | 188,096,539 | - | 188,096,539 |
| Changes of Benefits | - | - | - |
| Differences Between Expected and Actual Experience | (3,412,765) | - | (3,412,765) |
| Changes of Assumptions | 40,801,678 | - | 40,801,678 |
| Contributions – Employer | - | 78,754,476 | (78,754,476) |
| Contributions – Plan Member | - | 28,628,627 | (28,628,627) |
| Net Investment Income | - | 221,839,196 | (221,839,196) |
| Benefit Payments | (139,856,672) | (139,856,672) | - |
| Administrative Expenses | - | (4,203,705) | 4,203,705 |
| **Net Changes** | 146,703,444 | 185,161,922 | (38,458,478) |
| **Balances at June 30, 2018** | **$2,831,719,959** | **$2,501,422,132** | **$330,297,827** |

* The Net Pension Liability was measured as of June 30, 2018, and determined based upon rolling forward the Total Pension Liability from the actuarial valuation as of June 30, 2017.

**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 as of June 30, 2018, was determined by an actuarial valuation as of June 30, 2017, 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** | 2.75% |
| **Salary Increases** | 3.00% (2.75% inflation plus 0.25% wage inflation) |
| **Investment Rate of Return** | 7.00%, net of pension plan investment expense |

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, 2018** | |
|---|---|---|
| **Asset Class** | **Target Allocation** | **Long-Term Expected Real Rate of Return** |
| Cash and Short-Term Investments | --- | --- |
| Fixed Income | 23.00% | 0.75% |
| Domestic Equities | 32.00% | 4.60% |
| International Equities | 22.00% | 4.75% |
| Public Real Assets | 7.00% | 3.25% |
| Real Estate | 8.00% | 3.50% |
| Private Equity | 8.00% | 5.10% |
| **TOTAL** | **100.00%** | |

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

#### Discount Rate

The discount rate used to measure the total pension liability was 7.00% as of June 30, 2018. 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 fiduciary 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 June 30, 2018.

#### 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, 2018, calculated using the discount rate of 7.00%, 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 (6.00%) or one percentage point higher (8.00%) than the current rate:

| | 1% Decrease (6.00%) | Current Discount Rate (7.00%) | 1% Increase (8.00%) |
|---|---|---|---|
| Total Pension Liability | $ 3,204,006,079 | $ 2,831,719,959 | $ 2,525,226,318 |
| Fiduciary Net Position | 2,501,422,132 | 2,501,422,132 | 2,501,422,132 |
| Net Pension Liability | $ 702,583,947 | $ 330,297,827 | $ 23,804,186 |
| Fiduciary Net Position as a Percentage of the Total Pension Liability | 78.1% | 88.3% | 99.1% |

### NOTE 10 – CAPITAL ASSETS

Capital asset activity for the fiscal year ending June 30, 2018, was as follows (all dollars in thousands):

| | Balance June 30, 2017 | Additions | Dispositions | Balance June 30, 2018 |
|---|---|---|---|---|
| ***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 | (678) | (78) | – | (756) |
| Tenant Improvements | (168) | (20) | – | (188) |
| Equipment | (94) | (11) | – | (105) |
| Computer Software/Hardware | (2,005) | (364) | – | (2,369) |
| *Total Accumulated Depreciation* | **(2,945)** | **(473)** | – | **(3,418)** |
| **Total Capital Assets, Net** | **$ 5,459** | **$ (473)** | **$ –** | **$ 4,986** |

Depreciation expense as of June 30, 2018, was $473,436.

## NOTE 11 – COMMITMENTS AND CONTINGENCIES

### Litigation

***Marin Association of Public Employees et al. v. MCERA, Supreme Court Case No. S247095***

A petition for Writ of Mandate was filed in January 2013 by various labor unions and individuals against MCERA and its Board of Retirement (collectively, "Respondents"), commencing Marin County Superior Court Case No. CV 1300318. The petition challenges Respondents' actions implementing Government Code Section 31461, as amended, effective January 1, 2013 ("Amended Statute"). The Superior Court entered Judgment on the petition in favor of Respondents on June 26, 2013. Petitioners appealed that Judgment to the First District Court of Appeal ("DCA"), commencing Case No. A139610. On August 17, 2016, Division Two of the First DCA issued a published decision affirming the Superior Court's Judgment in favor of Respondents ("*MAPE* Decision"). On November 22, 2016, the California Supreme Court granted the petition for review of the *MAPE* Decision, commencing Case No. 237460 ("*Marin*"). The Court also ordered, however, that further action in *Marin*, including submission of additional briefing, is deferred pending the decision of the First DCA, Division Four, in Alameda County Deputy Sheriff's Association et al. v. ACERA, et al., A141913 ("*Alameda*") or pending further order of the Supreme Court. *Alameda* involves three other county retirement systems who also were sued for their implementation of the Amended Statute. On January 8, 2018, Division Four of the First DCA issued a decision that was in large part at odds with the *MAPE* Decision. On March 28, 2018, the California Supreme Court granted review of the *Alameda* decision, commencing Case No. S247095. On that same date, the Court issued another order continuing the hold in *Marin*. Briefing in *Alameda* is now complete, and oral argument and a decision are expected in *Alameda* during 2019. It is unclear whether additional briefing will be ordered in *Marin* following the resolution of Alameda. Respondents will continue to vigorously defend themselves in the litigation.

***Greene v. OAH, MCERA, Court of Appeal Case No. A153567***

Viviana Greene sued both the Office of Administrative Hearings (OAH) and MCERA, demanding that MCERA be ordered to re-adjudicate Greene's application for disability retirement by referring the matter to a different Administrative Law Judge. The OAH filed a "notice of non-appearance," and thus the defense of the claim remains entirely with MCERA. The Superior Court denied Greene's petition after a court hearing. Greene timely appealed, commencing First DCA Case No. A153567. The case is fully briefed on appeal and has been assigned to Division 4. In September 2018, the parties requested and are now waiting for oral argument to be set. MCERA will continue to vigorously defend itself in the litigation.

***Brown v. City of San Rafael, et al., Superior Court Cases No. CIV 1702258***

David Brown sued the City of San Rafael, the Marin County Employees' Retirement Association, and numerous unions (collectively, "Respondents") seeking to have certain benefit enhancements that the City granted during 2002 and 2006 invalidated. By Order dated November 20, 2018, Marin County Superior Court sustained, without leave to amend, the demurrers that Respondents had filed to Brown's second amended petition. It is unknown at this time whether Brown will appeal. In any event, MCERA will continue to vigorously defend itself in the litigation.

### Securities Litigation

MCERA's Class Action Securities Litigation Policy 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.

## NOTE 11 – COMMITMENTS AND CONTINGENCIES (Continued)

**Capital Commitments** (Continued)

During fiscal year 2018, MCERA funded $275,156,509 of its private equity capital commitments. As of June 30, 2018, outstanding commitments to the various investment managers, as approved by the Board of Retirement, totaled $124,843,491.

## NOTE 12 – SUBSEQUENT EVENTS

Subsequent events have been evaluated by management through December 26, 2018, which is the date the financial statements were available to be issued. There were no subsequent events with a material effect on the financial statements or note disclosures that took place after June 30, 2018.

# REQUIRED SUPPLEMENTARY INFORMATION

**MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION**
**SCHEDULE OF CHANGES IN NET PENSION LIABILITY AND RELATED RATIOS***

| | June 30, 2018 | June 30, 2017 | June 30, 2016 | June 30, 2015 | June 30, 2014 |
|---|---|---|---|---|---|
| **Total Pension Liability** | | | | | |
| Service cost | $ 61,074,664 | $ 57,090,773 | $ 55,208,834 | $ 49,064,492 | $ 49,014,858 |
| Interest (includes interest on service cost) | 188,096,539 | 184,139,800 | 176,564,792 | 166,718,783 | 159,521,975 |
| Differences between expected and actual experience | (3,412,765) | (904,678) | (212,631) | (31,054,298) | - |
| Changes of assumptions | 40,801,678 | - | - | 144,753,646 | - |
| Benefit payments, including refunds of employee contributions | (139,856,672) | (131,937,062) | (124,203,519) | (115,984,752) | (109,342,861) |
| Net Change in Total Pension Liability | 146,703,444 | 108,388,833 | 107,357,476 | 213,497,871 | 99,193,972 |
| Total Pension Liability - Beginning | 2,685,016,515 | 2,576,627,682 | 2,469,270,206 | 2,255,772,335 | 2,156,578,363 |
| Total Pension Liability - Ending (a) | $2,831,719,959 | $2,685,016,515 | $2,576,627,682 | $2,469,270,206 | $2,255,772,335 |
| **Fiduciary Net Position** | | | | | |
| Contributions - employer | $ 78,754,476 | $ 77,502,945 | $ 75,260,980 | $ 68,915,072 | $ 69,980,201 |
| Contributions - plan member | 28,628,627 | 28,053,775 | 27,207,157 | 24,920,493 | 22,952,689 |
| Net investment income | 221,839,196 | 248,347,501 | 42,927,728 | 100,055,573 | 309,002,468 |
| Benefit payments, including refunds of employee contributions | (139,856,672) | (131,937,062) | (124,203,519) | (115,984,752) | (109,342,861) |
| Administrative expenses | (4,203,705) | (4,404,191) | (4,379,760) | (4,654,623) | (4,503,845) |
| Net Change in Fiduciary Net Position | 185,161,922 | 217,562,968 | 16,812,586 | 73,251,763 | 288,088,652 |
| Fiduciary Net Position - Beginning | 2,316,260,210 | 2,098,697,242 | 2,081,884,656 | 2,008,632,893 | 1,720,544,241 |
| Fiduciary Net Position - Ending (b) | $2,501,422,132 | $2,316,260,210 | $2,098,697,242 | $2,081,884,656 | $2,008,632,893 |
| Net Pension Liability - Ending (a)-(b) | $ 330,297,827 | $ 368,756,305 | $ 477,930,440 | $ 387,385,550 | $ 247,139,442 |
| Fiduciary Net Position as a Percentage of the Total Pension Liability | 88.34% | 86.27% | 81.45% | 84.31% | 89.04% |
| Covered Employee Payroll | $ 248,532,086 | $ 242,045,311 | $ 238,185,040 | $ 223,825,880 | $ 218,340,721 |
| Net Pension Liability as a Percentage of Covered Employee Payroll | 132.90% | 152.35% | 200.66% | 173.07% | 113.19% |

* The Schedule of Changes in Net Pension Liability and Related Ratios is intended to show information for 10 years. Additional years will be displayed as they become available.

See accompanying notes to the required supplementary information.

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

| | FYE 2018 | FYE 2017 | FYE 2016 | FYE 2015 | FYE 2014 |
|---|---|---|---|---|---|
| Actuarially Determined Contributions | $ 78,754,476 | $ 77,502,945 | $ 75,260,980 | $ 68,915,072 | $ 69,660,201 |
| Contributions in Relation to the Actuarially Determined Contributions | 78,754,476 | 77,502,945 | 75,260,980 | 68,915,072 | 69,660,201 |
| Contribution Deficiency / (Excess) | $ - | $ - | $ - | $ - | $ - |
| Covered Employee Payroll[1] | $ 248,532,086 | $ 242,045,311 | $ 238,185,040 | $ 223,825,880 | $ 218,340,721 |
| Contributions as a Percentage of Covered Employee Payroll | 31.69% | 32.02% | 31.60% | 30.79% | 31.90% |

| | FYE 2013 | FYE 2012 | FYE 2011 | FYE 2010 | FYE 2009 |
|---|---|---|---|---|---|
| Actuarially Determined Contributions | $ 69,853,000 | $ 64,690,000 | $ 64,757,000 | $ 56,271,000 | $ 54,555,000 |
| Contributions in Relation to the Actuarially Determined Contributions | 69,853,000 | 64,690,000 | 64,757,000 | 56,271,000 | 54,555,000 |
| Contribution Deficiency / (Excess) | $ - | $ - | $ - | $ - | $ - |
| Covered Employee Payroll[1] | $ 211,001,594 | $ 216,515,000 | $ 215,969,000 | $ 219,556,000 | $ 214,449,000 |
| Contributions as a Percentage of Covered Employee Payroll | 33.11% | 29.88% | 29.98% | 25.63% | 25.44% |

[1] In accordance with GASB Statement No. 82, Covered Employee Payroll is the payroll on which contributions are based. MCERA has updated the covered employee payroll row to show pensionable payroll for the last 10 fiscal years.

See accompanying notes to the required supplementary information.

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

| | June 30, 2018** | June 30, 2017** | June 30, 2016** | June 30, 2015 | June 30, 2014 |
|---|---|---|---|---|---|
| Annual Money-Weighted Rate of Return, Net of Investment Expense | 9.53% | 12.21% | 2.15% | 5.04% | 18.16% |

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

** These calculations for the money-weighted rate of return, net of investment expense, were provided by MCERA's investment consultant, Callan Associates.

See accompanying notes to the required supplementary information.

## NOTE 1 – SCHEDULE OF CHANGES IN NET PENSION LIABILITY AND RELATED RATIOS

### Total Pension Liability

The total pension liability contained in this schedule was obtained from MCERA's actuary, Cheiron.

### Service Cost

The service cost is based on the previous year's valuation, meaning the 2018 and 2017 values are based on the valuations as of June 30, 2017 and June 30, 2016, respectively. The June 30, 2018 service costs have been calculated using the June 30, 2017 actuarial assumptions as described in Note 9 of the Notes to the Basic Financial Statements earlier in this report. The June 30, 2017 service costs have been calculated using the June 30, 2016 actuarial assumptions as described in Note 3 of the Notes to Required Supplementary Information on the following page.

### Change in Assumptions

Triennially, MCERA requests that the actuary perform an analysis of all economic and non-economic assumptions in the form of an Experience Study. The most recent triennial Experience Study was for the period July 1, 2014 through June 30, 2017. Based on the results of this study, the Board of Retirement lowered the assumed rate of investment return from 7.25% to 7.00% effective with the June 30, 2017 valuation, which contains the employer and employee contribution rates for the fiscal year ending June 30, 2019.

### Covered Payroll

Covered payroll shown represents only the Compensation Earnable and Pensionable Compensation that is used in the determination of retirement benefits.

## NOTE 2 – SCHEDULE OF INVESTMENT RETURNS

The money-weighted return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

## NOTE 3 – ACTUARIAL ASSUMPTIONS USED IN CALCULATING THE ACTUARIALLY DETERMINED CONTRIBUTIONS

| | |
|---|---|
| **Valuation date** | June 30, 2016 (to determine FY 2017-18 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** | As of the June 30, 2016 valuation, assets are valued using the market value. The assets used to compute the Unfunded Actuarial Liability (UAL) are the market value of assets, minus the value of any non-valuation contingency reserves. |
| **Amortization method** | The UAL (or Surplus Funding) is amortized as a percentage of the projected salaries of present and future members of MCERA. Effective with the June 30, 2013 valuation, the UAL as of June 30, 2013, is amortized over a closed 17-year period (14 years remaining as of June 30, 2016), except for the additional UAL attributable to the extraordinary loss from 2009, which is being amortized over a separate closed period (22 years as of June 30, 2016).<br><br>Subsequent unexpected change in the unfunded actuarial liability after June 30, 2014, is amortized over a closed 24 years (22 years for assumption changes) that includes a 5-year phase-in/out (3 years for assumption changes) of the payments/credits for each annual layer. |
| **Investment rate of return** | 7.25% |
| **Inflation rate** | 2.75% |
| **Cost of living adjustments (COLAs)** | 2.7% for tiers with a 4.0% COLA cap<br>2.6% for tiers with a 3.0% COLA cap<br>1.9% for tiers with a 2.0% COLA cap |
| **Salary increases** | 3.00% (2.75% inflation plus 0.25% wage growth) |
| **Retiree mortality** | Rates of mortality for retired Members and their beneficiaries are given by California Public Employees Retirement System (CalPERS) 2014 Post-Retirement Healthy Mortality rates, adjusted by 110% for Safety Males and 95% for General and Safety Females, with the 20-year static projection used by CalPERS replaced by generational improvements from a base year of 2009 using Scale MP-2014. |
| **Disabled mortality** | Rates of mortality among disabled Members are given by CalPERS 2014 Disability Mortality rates (Non-Industrial rates for General members and Industrial Disability rates for Safety members), adjusted by 90% for Males and Females (General and Safety) with the 20-year static projection used by CalPERS replaced by generational improvements from a base year of 2009 using Scale MP-2014. |

**A complete description of the methods and assumptions used to determine contribution rates for the fiscal year ending June 30, 2018, can be found in the June 30, 2016 actuarial valuation report.**

# OTHER INFORMATION

**MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION**
**SCHEDULE OF COST SHARING EMPLOYER ALLOCATIONS**
**AS OF JUNE 30, 2018**

| Employer | Unfunded Liability (from the June 30, 2017 Actuarial Valuation)[2] | Proportionate Share | Net Pension Liability [1] |
|---|---|---|---|
| County | $ 235,445,174 | 55.5636% | $ 183,525,363 |
| City of San Rafael | 141,848,018 | 33.4752% | 110,567,858 |
| Novato Fire | 20,050,593 | 4.7318% | 15,629,033 |
| Superior Court | 8,903,364 | 2.1011% | 6,939,888 |
| Southern Marin Fire | 8,461,541 | 1.9969% | 6,595,717 |
| Mosquito District | 6,570,720 | 1.5506% | 5,121,598 |
| Tamalpais CSD | 2,417,144 | 0.5704% | 1,884,019 |
| Marin CSD | - | 0.0000% | - |
| LAFCO | 44,220 | 0.0104% | 34,351 |
| Total | $ 423,740,775 | 100.0000% | $ 330,297,827 |

[1] Proportionate share of net pension liability is based on the actuarial valuation.
[2] Numbers may not sum to total due to rounding.

See accompanying notes to the other information.

# MARIN COUNTY EMPLOYEES' RETIREMENT ASSOCIATION
## SCHEDULE OF EMPLOYER PENSION AMOUNTS
## ALLOCATED BY COST SHARING PLAN
## AS OF AND FOR THE FISCAL YEAR ENDED JUNE 30, 2018

| | | Deferred Outflows of Resources | | | Deferred Inflows of Resources | | | | Pension Expense Excluding that Attributable to Employer-Paid Member Contributions | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Employer | Net Pension Liability | Changes of Assumptions | Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions | Total Deferred Outflows of Resources | Differences Between Expected and Actual Economic Experience | Net Differences Between Projected and Actual Investment Earnings on Pension Plan Investments | Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions | Total Deferred Inflows of Resources | Proportionate Share of Allocable Plan Pension Expense | Net Amortization of Deferred Amounts from Changes in Proportion and Differences Between Employer Contributions and Proportionate Share of Contributions | Total Pension Expense Excluding That Attributable to Employer-Paid Member Contributions |
| County | $183,525,363 | $ 17,003,161 | $ 12,036,003 | $ 29,039,164 | $ 1,703,063 | $ 30,221,540 | $ 2,223,798 | $ 34,148,401 | $ 36,062,402 | $ 2,772,214 | $ 38,834,616 |
| City of San Rafael | 110,567,858 | 10,243,832 | 2,106,932 | 12,350,764 | 1,026,038 | 18,207,461 | 14,948,187 | 34,181,686 | 21,726,384 | (3,021,991) | 18,704,393 |
| Novato Fire | 15,629,033 | 1,447,990 | 1,978,803 | 3,426,793 | 145,033 | 2,573,668 | 756,848 | 3,475,549 | 3,071,077 | (409,556) | 2,661,521 |
| Superior Court | 6,939,888 | 642,963 | 326,777 | 969,740 | 64,400 | 1,142,807 | 1,893,280 | 3,100,487 | 1,363,675 | (787,930) | 575,745 |
| Southern Marin Fire | 6,595,717 | 611,077 | 2,400,854 | 3,011,931 | 61,206 | 1,086,132 | 84,928 | 1,232,266 | 1,296,047 | 1,244,549 | 2,540,596 |
| Mosquito District | 5,121,598 | 474,503 | 1,125,967 | 1,600,470 | 47,527 | 843,385 | 134,538 | 1,025,450 | 1,006,385 | 153,865 | 1,160,250 |
| Tamalpais CSD | 1,884,019 | 174,549 | 161,014 | 335,564 | 17,483 | 310,246 | 107,647 | 435,376 | 370,206 | 86,741 | 456,947 |
| Marin CSD | - | - | 105,534 | 105,534 | - | - | 152,308 | 152,308 | - | (13,261) | (13,261) |
| LAFCO | 34,351 | 3,183 | 59,650 | 62,833 | 319 | 5,657 | - | 5,976 | 6,750 | (24,631) | (17,881) |
| Totals | $330,297,827 | $ 30,601,258 | $ 20,301,535 | $ 50,902,793 | $ 3,065,069 | $ 54,390,896 | $ 20,301,535 | $ 77,757,500 | $ 64,902,926 | $ - | $ 64,902,926 |

See accompanying notes to the other information.

## NOTE 1 – BASIS OF PRESENTATION AND BASIS OF ACCOUNTING

Employers participating in MCERA are required to report pension information in their financial statements for fiscal periods beginning on or after June 15, 2014, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions - an Amendment of GASB Statement No. 27*. The Schedule of Employer Pension Amounts Allocated by Cost Sharing Plan and Schedule of Cost Sharing Employer Allocations, along with MCERA's audited financial statements, the GASB Statement No. 67 Actuarial Valuation as of June 30, 2018, and the GASB Statement No. 68 Actuarial Valuation Based on a June 30, 2018 Measurement Date for Employer Reporting as of June 30, 2019, prepared by MCERA's independent actuary, provide the required information for financial reporting related to MCERA that employers may use in their financial statements.

The accompanying schedule was prepared by MCERA's independent actuary and was derived from information provided by MCERA in accordance with accounting principles generally accepted in the United States of America as applicable to governmental organizations.

## NOTE 2 – USE OF ESTIMATES IN THE PREPARATION OF THE SCHEDULES

The preparation of these schedules in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain amounts and disclosures. Actual results could differ from those estimates.

## NOTE 3 – AMORTIZATION OF DEFERRED OUTFLOWS AND DEFERRED INFLOWS OF RESOURCES

The difference between projected and actual investment earnings on pension plan investments is amortized over 5 years on a straight-line basis. One-fifth was recognized in pension expense during the measurement period, and the remaining difference between projected and actual investment earnings on pension plan investments at June 30, 2018, is to be amortized over the remaining periods.

The changes in assumptions and differences between expected and actual experience are recognized over the average of the expected remaining service lives of all employees that are provided with pensions through MCERA (active and inactive employees) determined as of June 30, 2017 (the beginning of the measurement period ending June 30, 2018) and is four years. Prior period changes of assumptions and differences between expected and actual experience are continued to be recognized based on the expected remaining service lives of all employees calculated as of those prior measurement dates.

In addition, the net effect of the change in the employer's proportionate share of the net pension liability and deferred outflows of resources and deferred inflows of resources is also recognized over the average expected remain service lives of all employees noted above. The difference between the actual employer contributions and the proportionate share of the employer contributions during the measurement period ending on June 30, 2018, is recognized over the same period as noted above. The Schedule of Pension Amounts by Employer does not reflect contributions made to MCERA subsequent to the measurement date as defined in GASB Statement No. 68 Paragraphs 54, 55, and 57. Appropriate treatment of such amounts is the responsibility of the employers.