

POPULAR ANNUAL FINANCIAL REPORT

For the Fiscal Year Ended June 30, 2016



A MESSAGE FROM THE CEO

Cloudy Skies and a Silver Lining



Fiscal year 2016 proved to be both volatile and lackluster for earnings, and gave credence to what many investment managers believe – that it will be difficult for pension funds to meet their long-term assumed rates of return in the near-term. Despite the headwinds in the markets, SamCERA was able to modestly increase its funded ratio by 0.5% to 83.1% on the year, primarily due to robust funding from employers and the recognition of deferred gains from prior years. It is the seventh consecutive year SamCERA has increased its funded level. However, with unrecognized losses on the books, our coming year looks to be more challenging. The lowering of SamCERA's long-term assumed earnings rate of return from 7.25% to 7.00% will add to the coming headwinds in the near-term, but will also serve to soften the blow should SamCERA's investments fall short of their target.

(Continued on the back page)



INTRODUCTION

This Popular Annual Financial Report is a condensed version of the San Mateo County Employees' Retirement Association's (SamCERA) Comprehensive Annual Financial Report (CAFR), which is prepared in accordance with generally accepted accounting principles in the United States of America. The CAFR provides in-depth information about the financial, investment, actuarial, statistical, and compliance aspects of SamCERA and is available online at samcera.org.

For the 13th consecutive year, the Government Finance Officers Association (GFOA) of the United States and Canada presented an award for Outstanding Achievement in Popular Annual Financial Reporting (PAFR) to SamCERA in recognition its PAFR for the fiscal year ended June 30, 2015.

ABOUT SAMCERA

SamCERA is a cost-sharing multiple-employer, defined benefit pension plan established to provide pension benefits for predominantly all permanent employees of the County of San Mateo (the County), the Superior Court of the County of San Mateo, and the San Mateo County Mosquito and Vector Control District (the District). At June 30, 2016, SamCERA had 11,421 members.

The management of SamCERA is vested in the Board of Retirement consisting of nine members: the first member is the County Treasurer; the second and third members are general members of SamCERA elected by their peers; the fourth, fifth, sixth and ninth members are qualified electors of the County and appointed by the County Board of Supervisors; the seventh member is elected by and a member of SamCERA's safety membership; and the eighth member is a retired member elected from the retired membership. In addition, there is one elected Safety Member Alternate and one elected Retired Member Alternate.

MISSION AND GOALS

SamCERA exists to serve as loyal fiduciary for its members and as prudent administrator of the retirement system. SamCERA will continue to pursue its three major goals:

- Provide caring, fair, accurate, timely and knowledgeable professional services and information to members and other stakeholders.
- Prudently manage the assets in order to appropriately fund the actuarial liabilities of the retirement system to ensure the ability to pay all earned benefits while minimizing the costs to employers.
- Constantly improve the effectiveness of SamCERA's services and the efficiency of its operations.

SUMMARY OF SIGNIFICANT ACTUARIAL STATISTICS AND MEASURES

	<u>June 30, 2016</u>	<u>June 30, 2015</u>	<u>Increase (Decrease)</u>
Active Members			
Number of Members	5,187	5,095	92
Average Age	45.4	45.5	(0.1)
Average Credited Service	10.8	11.0	(0.2)
Total Active Payroll (In Thousands)	\$472,385	\$439,018	\$33,367
Average Monthly Salary	\$7,933	\$7,567	\$366
Retired Members			
Number of Members			
Service Retirement	3,749	3,628	121
Disability Retirement	454	442	12
Beneficiaries	545	568	(23)
Average Age	71.0	71.3	(0.3)
Actual Retiree Benefits Paid (In Thousands)	\$179,497	\$168,109	\$11,388
Average Monthly Pension	\$3,268	\$3,160	\$108
Number of Inactive Members			
	1,486	1,384	102
Assets			
Market Value of Fund (In Thousands)	\$3,541,388	\$3,454,476	\$86,912
Return on Market Value	0.7%	3.5%	(2.8)%
Valuation Assets (In Thousands)	\$3,624,726	\$3,343,550	\$281,176
Return on Valuation Assets	6.4%	9.7%	(3.3)%
Liability Values (In Thousands)			
Actuarial Accrued Liability	\$4,362,296	\$4,045,786	\$316,510
Unfunded Actuarial Accrued Liability	\$737,570	\$702,236	\$35,334
Deferred Asset (Gains) / Losses	\$119,951	(\$77,153)	\$197,104
Funded Ratio			
Based on valuation assets	83.1%	82.6%	0.5%
Statutory Employer Contribution Rate for All plans Combined as a Percent of Total Pay- roll			
	<u>Fiscal Year Beginning</u>		
	<u>July 1, 2017</u>	<u>July 1, 2016</u>	
Gross Normal Cost	22.31%	21.95%	
Less: Member Contributions	<u>(12.06)%</u>	<u>(11.92)%</u>	
Employer Normal Cost	10.25%	10.03%	
UAAL Amortization	<u>23.52%</u>	<u>21.93%</u>	
Total Employer Rate	<u>33.77%</u>	<u>31.96%</u>	



SAMCERA'S STATEMENT OF FIDUCIARY NET POSITION

As of June 30 (Dollars In Thousands)

	6/30/2016	6/30/2015	Increase (Decrease)	
			Amount	Percentage
Assets				
Cash and cash equivalents	\$ 130,111	\$ 51,162	\$ 78,949	154%
Cash management overlay	26,249	26,273	(24)	0%
Security lending cash collateral	88,363	99,387	(11,024)	-11%
Receivables	22,636	27,174	(4,538)	-17%
Prepaid expense	8	8	-	0%
Investments at fair value	3,368,375	3,373,248	(4,873)	0%
Capital assets, net	5,162	3,206	1,956	61%
Total assets	3,640,904	3,580,458	60,446	2%
Liabilities				
Investment management fees	1,808	2,043	(235)	-12%
Due to broker for investments purchased	7,582	21,246	(13,664)	-64%
Collateral payable for securities lending	88,363	99,387	(11,024)	-11%
Other	1,763	3,306	(1,543)	-47%
Total liabilities	99,516	125,982	(26,466)	-21%
Net position restricted for pensions	\$ 3,541,388	\$ 3,454,476	\$ 86,912	3%

MORE ABOUT THE TABLE ABOVE

The **Statement of Fiduciary Net Position** is a snapshot of account balances at fiscal year-end. The difference between assets and liabilities is “net position,” which represents funds available to pay pension benefits. At June 30, 2016, SamCERA’s net position was approximately \$3.5 billion, or 3% over the prior fiscal year. The increase was mainly from investment earnings as well as contributions received.

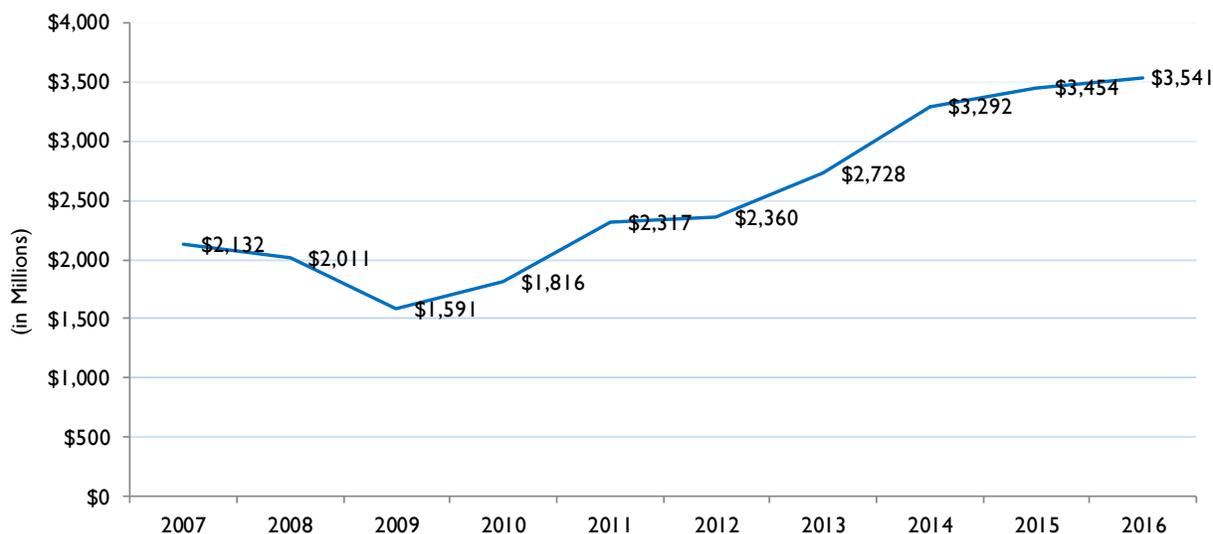
SamCERA’s investment portfolio returned 0.7% net of investment management fees in fiscal year 2016 compared to 3.5% in fiscal year 2015. Throughout the year, the market conditions were overshadowed by numerous concerns such as concerns of a hard landing in China, continued heightened geopolitical concerns, and the fallout from the Brexit decision in the United Kingdom.

GOOD FINANCIAL STANDING

Increases and decreases in the fiduciary net position over time may serve as a useful indicator of whether the financial health of SamCERA is improving or declining. Despite recent market volatility and increased retirement benefits, the overall financial position of SamCERA has improved. SamCERA remains in a good financial position to meet its obligations to members and beneficiaries.

SAMCERA'S NET POSITION

For the fiscal years ended June 30



CHANGE IN SAMCERA'S NET POSITION

For the fiscal years ended June 30



SAMCERA'S STATEMENT OF CHANGES IN FIDUCIARY NET POSITION

For the Fiscal Years Ended June 30 (Dollars In Thousands)

	2016	2015	Increase (Decrease)	
			Amount	Percentage
Additions				
Employer contributions	\$ 191,094	\$ 180,704	\$ 10,390	6%
Member contributions	56,069	48,012	8,057	17%
Net investment income	24,112	111,320	(87,208)	-78%
Net security lending income	278	310	(32)	-10%
Other	4,910	-	4,910	--
Total additions	276,463	340,346	(63,883)	-19%
Deductions				
Service retirement allowance	157,513	147,267	10,246	7%
Disability retirement allowance	21,091	20,039	1,052	5%
Survivor, death and other benefits	894	803	91	11%
Member refunds	3,366	3,357	9	0%
Administrative expenses	5,962	5,350	612	11%
Information Technology expenses	714	629	85	14%
Other expense	11	119	(108)	-91%
Total deductions	189,551	177,564	11,987	7%
Net Increase	86,912	162,782	(75,870)	-47%
Net position restricted for pensions				
Beginning of year	3,454,476	3,291,694	162,782	5%
End of year	\$3,541,388	\$3,454,476	\$ 86,912	3%

MORE ABOUT THE TABLE ABOVE

The [Statement of Changes in Fiduciary Net Position](#) provides information about SamCERA's financial activities during fiscal year 2016.

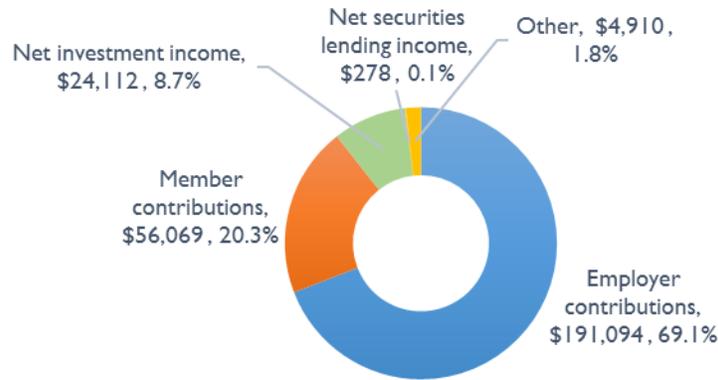
[Total additions to fiduciary net position](#) decreased \$64 million. The market conditions were affected by various global concerns causing a sharp decrease of \$87 million in net investment income compared to the prior year. Part of this decrease was offset by the following:

- To accelerate the payoff of their unfunded liabilities, the County increased its supplemental contribution to \$19.5 million this year from \$10.9 million last year, whereas the District made a one-time supplemental contribution of \$1.5 million in October 2015.
- The County and its general plan members in certain bargaining units reached an agreement under which members were required to make contributions towards the Cost of Living Adjustment for \$8 million in fiscal year 2016.
- One of the general partners in a Limited Partnership was in default. Its equity was distributed to the remaining general partners, including SamCERA. Consequently, SamCERA recognized an unanticipated gain of \$4.5 million.

[Deductions from fiduciary net position](#) increased \$12 million, triggered mainly by an increased number of retirees receiving pension benefits.

WHERE DID SAMCERA'S MONEY COME FROM?

For the Fiscal Year Ended June 30, 2016 (Dollars in Thousands)



This graphic uses the same information in the pie chart above. It shows the breakdown of every dollar SamCERA received this fiscal year.

This is a simplification of SamCERA's net additions. Numbers are rounded to the nearest whole penny.

Employer Contributions
This is the money paid to SamCERA from employers for employees' pension benefits.

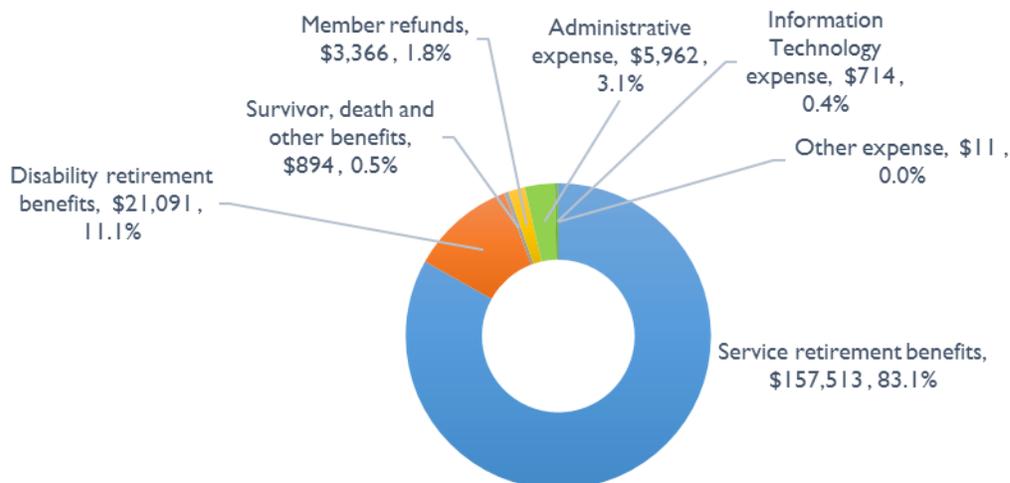
Employee Contributions
This is the money active employees pay into the fund for future benefits.

Net Investment Income
This includes earnings from stocks, bonds, alternatives, real estate, and other investments, minus fees.

Other
This is the money from other non-major income sources.

WHERE DID SAMCERA'S MONEY GO?

For the Fiscal Year Ended June 30, 2016 (Dollars in Thousands)



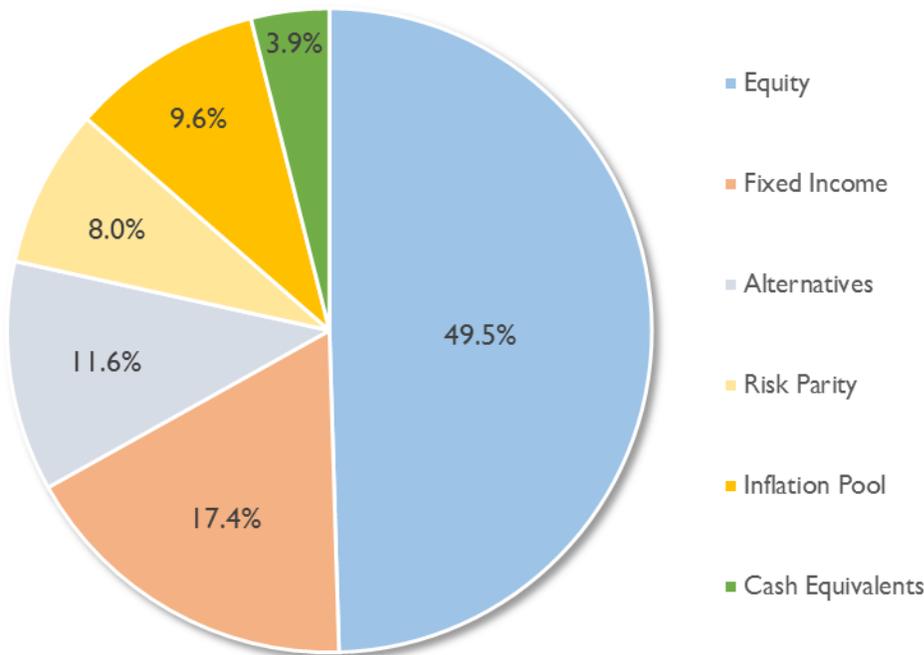
INVESTMENT POLICY

SamCERA’s Investment Policy is aimed at reducing risk through a prudent diversification of the investment portfolio across a board selection of distinct classes. The Board conducted an asset liability study in fiscal year 2014 and subsequently approved a new target asset allocation outlined in SamCERA’s Investment Policy. The Board undertakes an in-depth asset and liability study every three to five years.



INVESTMENTS

As of June 30, 2016



SamCERA’s asset allocation strategy calls for approximately half of the portfolio to be invested in the stock market.

Items in the chart above labeled with “Equity” are part of this investment, which is divided among domestic and international markets.

ASSET ALLOCATION

Asset allocation divides the investment portfolio among different asset classes including equity, fixed income, alternatives, risk parity, and inflation hedge asset. The newly adopted target asset allocation consists of 48% in equities, 18% in fixed income, 12% in alternatives, 8% in risk parity, and 14% in inflation hedge asset. As of June 30, 2016, actual asset allocation was 49.5% in equity, 17.4% in fixed income, 11.6% in alternatives, 8.0% in risk parity, 9.6% in inflation hedge asset, and 3.9% in cash and cash equivalents.

INVESTMENT PORTFOLIO PERFORMANCE

As of June 30, 2016

SamCERA's portfolio returned 0.7% net of investment management fees for the fiscal year ended June 30, 2016, underperforming SamCERA's policy benchmark return by 0.3%. While slightly trailing SamCERA's policy benchmark, this fiscal-year's results are strong relative to SamCERA's peers, and are above median among large (greater than \$1 billion in assets) public pension plans.

Investment Asset Class	Fair Value (In Millions)	Investment Return		
		One Year	Three Years	Five Years
Equity	\$1,723	-2.2%	7.4%	7.4%
Equity Benchmark		-3.2%	7.2%	7.3%
Fixed Income	611	2.4%	3.4%	4.3%
Fixed Income Benchmark		5.8%	3.8%	3.5%
Alternatives	405	-0.7%	5.4%	4.1%
Alternatives Benchmark		-0.3%	5.7%	6.5%
Risk Parity	280	5.7%	7.3%	5.9%
Risk Parity Benchmark		3.9%	8.4%	8.6%
Inflation Hedge⁽¹⁾	349	*	*	*
Inflation Hedge Benchmark		*	*	*
Cash Equivalents	173	1.4%	0.8%	0.7%
Total Investment Portfolio	\$3,541	0.7%	7.0%	6.7%
Policy Benchmark		1.0%	7.0%	7.0%

Risk Parity Leads Earnings
SamCERA's risk parity portfolio was this year's top performing asset class.

⁽¹⁾ The creation of a dedicated Inflation Hedge asset class was effective April 1, 2016.

* Return information is not available.

As was the case last year, the absolute level of returns disappointed in the current fiscal year. Overall volatility of returns was much higher across global stock, bond, currency, and commodity markets this year as the global markets dealt with a myriad of concerns throughout the year, including global growth concerns, falling commodity prices, concerns of a hard landing in China, financial repression from negative interest rates in Japan and parts of the European Union, continued heightened geopolitical concerns, and the fallout from the Brexit vote in the United Kingdom.

During the year, SamCERA tweaked its asset allocation policy by modestly reducing public equity exposure by a total of 3%, and reallocating 1% each to Opportunistic Credit, Real Estate, and Hedge Fund/Absolute Return. These minor changes are expected to modestly decrease equity risk while slightly rebalancing towards yield and absolute return.

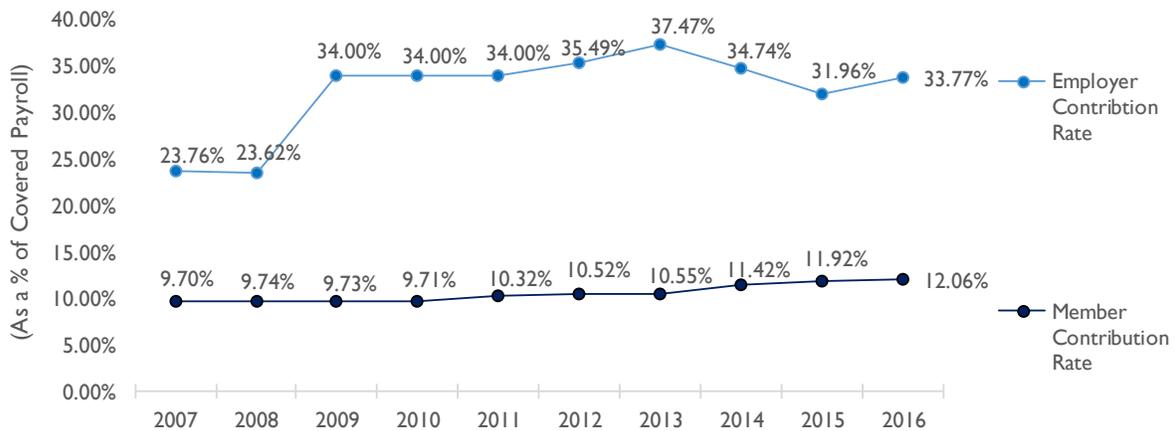
The plan maintained its asset allocation throughout the year by continuing to actively rebalance the portfolio to its long-term policy asset allocation portfolio weights. Asset allocation and risk diversification continue to be of primary focus as the plan navigates the market volatility going forward.



ACTUARIAL VALUATION

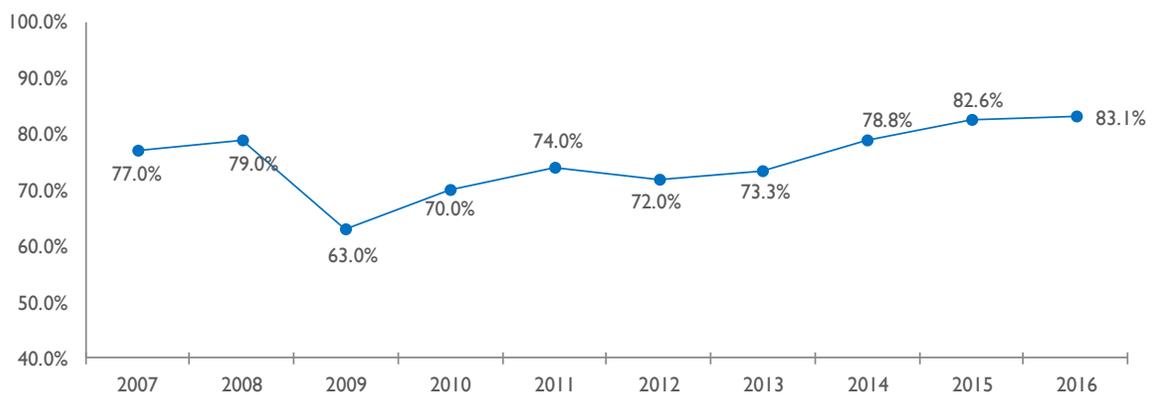
SamCERA retains an independent actuary to perform an annual actuarial valuation. The purpose of this valuation is two-fold: (1) to determine required contributions from employers and members to pay the projected future benefits, and (2) to monitor SamCERA’s funded status. Contributions are based on various factors such as market fluctuations, plan amendments, and changes in actuarial assumptions and member demographics. The funded ratio compares SamCERA’s assets and liabilities as a measure of its financial health at a point in time.

EMPLOYER AND MEMBER CONTRIBUTION RATES (BASED ON THE VALUATION DATE AT JUNE 30)



The contribution rates determined as of the valuation date will become effective a year later. Driven by the recently adopted economic assumptions which include a lower expectation for future investment returns, both the employer and member contribution rates increased slightly when compared to the prior year.

FUNDED RATIO AS OF JUNE 30

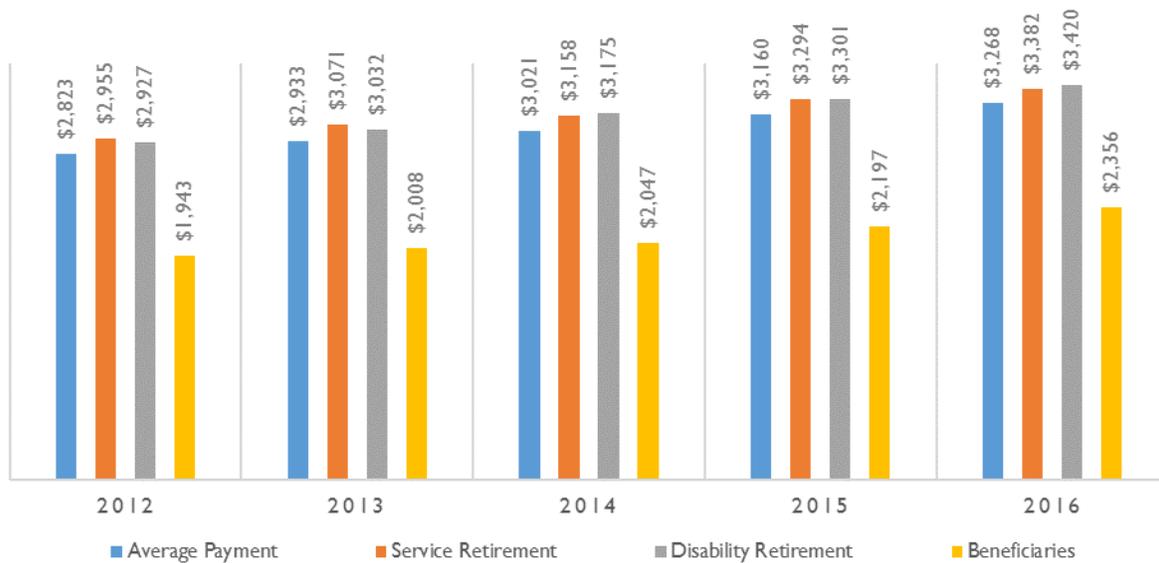


According to the latest actuarial valuation as of June 30, 2016, the pension plan was 83.1% funded. The funded status is simply the ratio of plan assets to plan liabilities. The difference between these two amounts represents the unfunded liability, which was \$738 million. Over the year, the improvement in funded ratio was mainly due to the recognition of deferred investment gains from prior years and employer contributions to pay down unfunded liabilities.

NUMBER OF RETIREES



AVERAGE MONTHLY RETIREE BENEFIT PAYMENTS





Find SamCERA on the web at:

www.samcera.org

A message from the CEO *(Continued from the front page)*

With regards to our investment performance, fiscal year 2016's returns were far under our long-term assumed rate of return of 7.25%. Despite that, SamCERA earned a positive return due to continued strength in the real estate market. For the one-year period ended June 2016, the fund returned 0.7% net of investment manager fees (1.0% before deducting for investment manager fees). The 0.7% return underperformed the fund's policy benchmark by 0.3%. These results are above median among large (greater than \$1 billion in assets) public plans, and strong compared to SamCERA's peers. Over the most recent three-year period ended June 2016, SamCERA's performance was in the upper 20th percentile of its peers.

SamCERA also took measures to strengthen its portfolio during the year. The Board approved a slight change to the portfolio's asset allocation in order to reduce dependence on equity markets by shifting the portfolio away from equity and more towards yield and absolute return. The Board also created a new "Inflation Hedge" category to better monitor its exposure to inflation-sensitive assets. SamCERA was able to benefit during the volatile year by remaining committed to rebalancing the portfolio. Potential lower near-term expected returns are another data point to consider over the coming years, as SamCERA looks to concentrate on fine-tuning its portfolio risk and asset allocation to better prepare for the certainty of a maturing membership in uncertain markets.

SamCERA continues to benefit from the foresight of its participating employers to proactively accelerate the pace of reducing their unfunded actuarial accrued liability. The commitment of the San Mateo County Board of Supervisors and the San Mateo County Mosquito and Vector Control District to make supplemental contributions had the overall effect of increasing SamCERA's funded ratio by 0.5%.

So while the consensus forecast of financial experts calls for cloudy skies, the silver lining of prudent funding by our plan employers and sound investment policy making by the Board of Retirement should help the fund weather any potential storms.

Scott Hood
SamCERA
Chief Executive Officer

