

ERFC 2017

ANNUAL SUMMARY REPORT



For the Fiscal Year Ended June 30, 2017

**The Educational Employees'
Supplementary Retirement System of Fairfax County**

A Component Unit of Fairfax County Public Schools

Fairfax, Virginia



THE YEAR IN REVIEW

Jeanne M. Carr, *Executive Director
and Chief Investment Officer*



I am pleased to submit the *Annual Summary Report* for the Educational Employees' Supplementary Retirement System of Fairfax County (ERFC) for Fiscal Year 2017.

The ERFC management holds responsibility for the financial information summarized in this report. I extend my sincere thanks to the Board of Trustees, the ERFC staff and all members of the ERFC for their continued support.

Administration Updates

Communication activities to increase the understanding and appreciation of the value of ERFC and the total retirement program continued to receive emphasis during the fiscal year. As part of its School Outreach program, ERFC staff visited 32 schools and administrative centers, explaining to members the provisions and importance of their retirement benefits. To better understand the needs of our members, we conducted a member survey in February, the first since 2013. We also added to our social media presence through creating a Twitter handle, @erfccomm.

The ERFC staff continued its efforts to implement technology innovations that will result in improved efficiencies, reduced risk and/or cost savings. As part of its "ERFC Going Paperless" campaign, ERFC began distributing audited benefit estimates electronically. We implemented responsive design for ERFC's online service *ERFCDirect* which streamlined its use on mobile devices and tablets. ERFC continued to promote *ERFCDirect* and over 23,000 active and retired members now use *ERFCDirect*, up from 20,000 a year ago.

Strategic Plan

During the year, the ERFC staff implemented several action plans included in the 2015 Strategic Plan. Staff expanded its "Ambassador Program", a program of select employee representatives who act as ERFC retirement plan resources for their peers in the workplace; the ERFC ambassadors now total forty-one. The Board of Trustees engaged Cost Effectiveness Management (CEM), a benchmarking company, to conduct a comparison study of ERFC to other retirement systems, focusing on service and cost to customers. The study showed that ERFC provided high customer service at a lower cost compared to other U.S. and international retirement systems.

The Board of Trustees conducted an asset liability study in conjunction with its investment consultant, New England Pension Consultants (NEPC). The study, which is undertaken every five years, took a comprehensive approach to analyze risk and return in terms of the overall Plan. The Board determined, based on the study's conclusions, that it should reduce its absolute return exposure and increase its allocation to private real estate in order to improve the Plan's risk/return profile.

Plan Financial Condition

The ERFC Fund increased 12.3 percent in fiscal year 2017, which exceeded the actuarial assumed rate of 7.25 percent that ERFC uses to determine its employer contribution rate. For the year, ERFC outperformed its policy index by 2.2 percent due to outperformance by several of its investment managers.

ERFC's independent actuary reported that the System's funding ratio declined slightly from 76.0 percent to 75.2 percent for the valuation period ending December 31, 2016, due to unfavorable investment performance in the prior 2016 calendar year which was partially offset by favorable demographic experience. The

THE ERFC STAFF CONTINUED ITS EFFORTS TO IMPLEMENT TECHNOLOGY INNOVATIONS THAT WILL RESULT IN IMPROVED EFFICIENCIES, REDUCED RISK AND/OR COST SAVINGS.

recommended employer contribution rate increased to 6.24 percent of payroll from 5.60 percent for fiscal year 2018.

Investment Activity

The ERFC's return of 12.3 percent for FY 2017 outperformed its benchmark index return by 2.2 percent and matched its peer systems return for the fiscal year. The Fund's 25 percent U.S. equity allocation was lower than the median fund's 28.5 percent allocation and domestic equity returned 18.5 percent for the fiscal year. However, international markets increased even more with a 20.5 percent return and ERFC's higher than peer allocation to developed international equity contributed to ERFC's matching of the peer ranking. The Fund's longer-term return remained strong with the seven-year return of 8.8 percent exceeding the policy index return of 8.3 percent.

The Board continued implementation of its private equity program during the fiscal year. Capital called increased the private equity allocation to 3.0 percent of the Fund. The positive move in the markets that occurred subsequent to fiscal year-end strengthened the Board's belief that it will best meet its long-term investment objectives through continued diversification.

Awards

The System proudly announces that the Government Finance Officers Association of the United States and Canada (GFOA) awarded ERFC the **Certificate of Achievement for Excellence in Financial Reporting** for its FY 2016 Comprehensive Annual Financial Report (CAFR). This is the 20th consecutive year

ERFC has earned the award. The GFOA certification remains valid for a period of one year, and requires, at minimum, that each CAFR satisfy both generally accepted accounting principles and legal requirements.

The Public Pension Coordinating Council also honored the ERFC recently, granting the System the **Public Pension Standards' 2017 Award**. The ERFC earned the award in recognition for meeting or exceeding professional standards for plan design and administration, as set forth in the Public Pension Standards.

Professional Services

ERFC relies on the expertise of several outside professional service organizations to accomplish its mission. New England Pension Consultants (NEPC), based in Boston, Massachusetts, provides investment consulting services, and Gabriel, Roeder, Smith & Company, of Southfield, Michigan, provides actuarial services. In accordance with county code, the Fairfax County Board of Supervisors appointed Cherry Bekaert, Certified Public Accountants, Richmond, Virginia, to audit the System's financial statements.

This *Annual Summary* presents an overview of the System's financial activity during the 2017 fiscal year. ERFC's *Comprehensive Annual Financial Report* for FY 2017, which was published in December, provides additional information in greater detail. Copies of both publications are posted on the System's website at www.fcps.edu/erfc. To request a printed copy, you may contact the ERFC office at 703-426-3900 or 1-844-758-3793, or send an email to: ERFCoffice@fcps.edu.

MESSAGE FROM THE CHAIRPERSON

Nancy Hammerer, *Past Chairperson*, Board of Trustees



On behalf of the Board of Trustees of the Educational Employees' Supplementary Retirement System of Fairfax County (ERFC), I am pleased to present this *Annual Summary Report* for the fiscal

year ended June 30, 2017. The Board of Trustees remains dedicated to providing members with responsive, professional and personalized service. At the same time, the Board works diligently to maintain the financial integrity of the fund, and adhere to best practices in the areas of customer service and governance.

The members and stakeholders of ERFC can be proud of the Board's emphasis on retirement security and protection of the System's assets. This objective ensures a predictable source of supplemental retirement income to ERFC members.

The months subsequent to the fiscal year-end introduced several changes to the composition of ERFC's Board and its officers. Kathie Pfeffer-Hahn was elected to her first three-year term as an ERFC trustee. Daryl Richards was elected as Chairperson in July 2017 and Kimberly Adams was elected as Vice Chairperson. The School Board reappointed Marty Smith, the FCPS Chief of Staff; Susan Quinn, the FCPS Chief Operating Officer; Kristen Michael, the FCPS Assistant Superintendent for the Department of Financial Services; and Michael Burke, the individual Trustee, to the Board. The Board looks forward to working together to achieve its goals and objectives.

During the year, the ERFC Board completed several action items included in the 2015 Strategic Plan. The expansion of ERFC's Ambassador Program to forty-one, employees who serve as ERFC plan resources for their peers, furthered the Board's customer service goal of responding promptly with quality to exceed the expectations of its membership. The 2017 member

survey results indicated that 62 percent of respondents strongly agreed or agreed that ERFC provides them with a valuable benefit, up from 50 percent in the 2013 survey.

On the investment front, the Board is pleased with the 12.3 percent return for the 2017 fiscal-year period; the seven-year return of 8.8 percent since the financial downturn was comfortably in excess of its assumed actuarial return rate of 7.25 percent. The Board will continue to analyze investment strategies in conjunction with the ERFC staff and its investment advisors to ensure a well-diversified asset mix with a risk-balanced approach. The Board will focus on managing the plan assets with the disciplined oversight required to meet the System's long-term investment goals.

The ERFC was designed specifically to reward educational professionals with a pension to supplement the primary benefits they earn and receive separately from the Virginia Retirement System (VRS) and Social Security. Accordingly, FCPS partners with ERFC members by contributing to the retirement system and the School Board remains committed to appropriately funding its teachers' retirement system. The School Board increased the FCPS employer contribution rate to 6.24 percent of covered payroll for the 2018 fiscal year; the increase was caused by actuarial assumptions updates to recognize mortality improvements and forecasted low returns.

As my seven-year tenure on the ERFC Board ends with the 2017 fiscal year, I extend my sincere thanks to my fellow Trustees, ERFC Executive Director Jeanne Carr, the ERFC staff and all ERFC members for their continued support during my term as Trustee. It has been a pleasure to work together to ensure a predictable source of supplemental retirement income to the members of the ERFC. I have confidence that the new Chairperson, Board and staff will continue the efforts of their predecessors to provide a secure retirement for career FCPS employees.

The ERFC Board values your opinions and welcomes your feedback. We encourage you to visit the website at

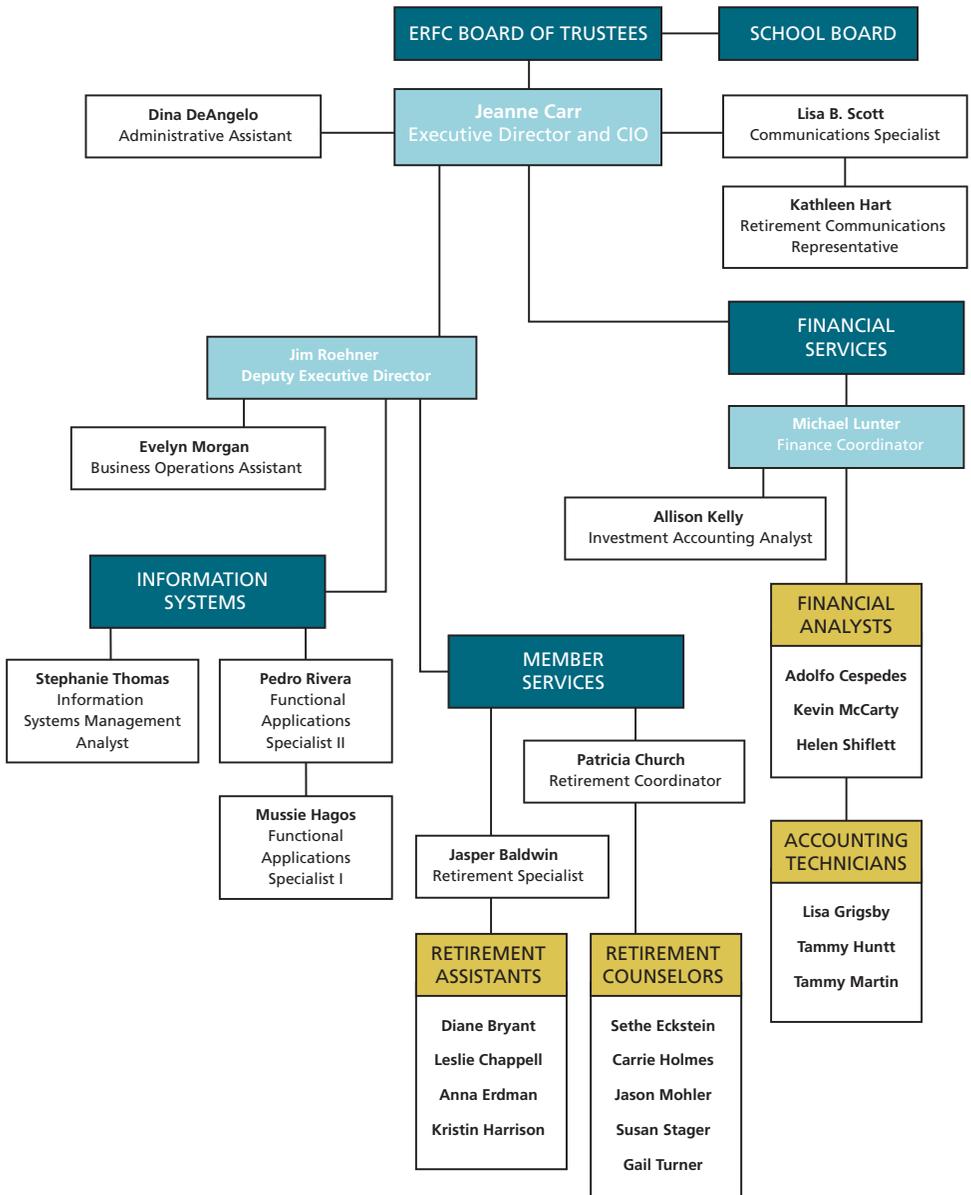
www.fcps.edu/erfc or contact us with questions regarding your pension fund or retirement benefits.

MISSION STATEMENT



The mission of the Educational Employees' Supplementary Retirement System of Fairfax County (ERFC) is to enhance the financial security of our members through prudent financial stewardship of a defined benefit plan while providing outstanding retirement services and education.

ERFC ADMINISTRATIVE ORGANIZATION – FISCAL YEAR 2017



PLAN HISTORY

The ERFC plan is composed of two benefit structures—*ERFC* and *ERFC 2001*. ERFC was established as a Defined Benefit (DB) plan, effective July 1, 1973, and was created to supplement the benefits payable by Social Security and the Virginia Retirement System. In response to major improvements introduced to VRS benefits in 1987, the ERFC benefit structure was also modified significantly effective July 1, 1988. Benefits for future ERFC members were decreased to reflect the improvements in the VRS benefits, while those for existing members were protected.

Effective July 1, 2001, a new stand-alone and more streamlined retirement benefit structure was established for eligible employees hired by Fairfax County Public Schools on or after that date. This newer benefit structure, *ERFC 2001*, still serves to complement the VRS benefit structure; however, unlike the *ERFC* legacy benefit structure, its provisions are not coordinated directly with the VRS provisions.

The member contribution rate to ERFC was set at 3 percent of salary in FY 2012. Based on a recommendation from ERFC’s actuary in consultation with the Board of Trustees, Fairfax County Public Schools contributes additional amounts necessary to maintain an actuarially sound plan. During FY 2017, Fairfax County Public Schools contributed 5.60 percent of total salaries to the Plan.

All members become vested in *ERFC* and *ERFC 2001* after earning five years of credited service. Under *ERFC*, members are eligible for full service benefits at age 55 with 25 years of service, or at age 65 with five years of service. A reduced benefit is available to *ERFC* members at age 45 with 25 or more years of service, or at age 55 with 5 or more years of service. Under *ERFC 2001*, members are eligible for full service benefits at age 60 with 5 years of service, or at any age with 30 or more years of service.

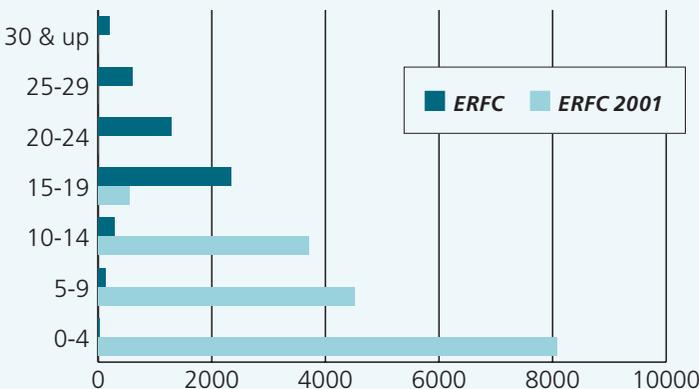
As of December 31, 2016, total ERFC membership consisted of 11,367 retirees and beneficiaries, 4,446 deferred vested members and 21,748 active members.

ACTIVE MEMBER YEARS OF SERVICE

Average Service = 9.2 years

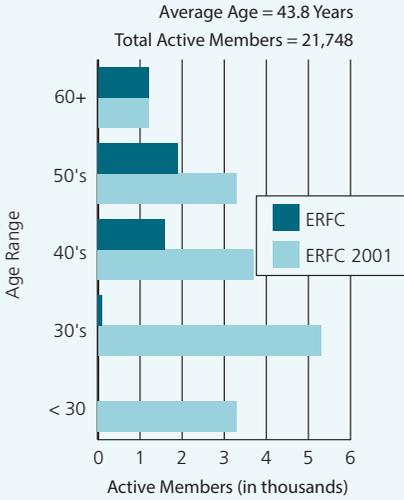
	0-4	5-9	10-14	15-19	20-24	25-29	30 & up
<i>ERFC</i>	20	135	298	2,336	1,288	614	201
<i>ERFC 2001</i>	8,072	4,519	3,713	552	–	–	–

ACTIVE MEMBER YEARS OF SERVICE (as of December 31, 2016)



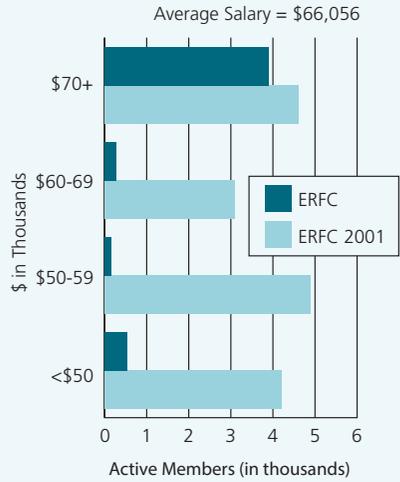
ACTIVE MEMBER AGES

(as of December 31, 2016)



ACTIVE MEMBER SALARIES

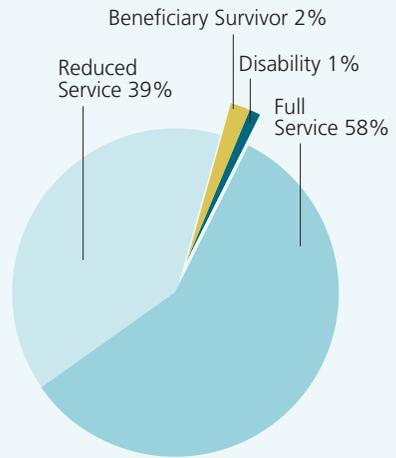
(as of December 31, 2016)



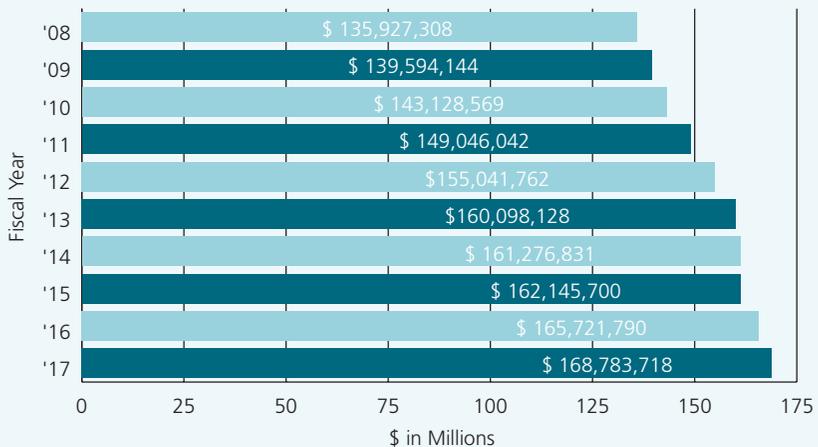
RETIREES AND BENEFICIARIES BY TYPE OF BENEFIT BEING PAID

(as of December 31, 2016)

Description	Amount
Full Service	6,595
Reduced Service	4,395
Beneficiary Survivor	200
Disability	177
Total	11,367



BENEFITS PAID (as of June 30)



FUNDING PROGRESS

The financial soundness of a public employee retirement plan can be measured in several ways. Two key measurements include: the governing body’s continuing commitment to plan funding; and the relationship of the retirement system’s liabilities to its assets, as measured over time. The second measurement addresses the two basic components of a retirement fund—the accrued actuarial liabilities (that is, the present value of current and future payments to retirees) and the assets set aside to fund those liabilities.

Under generally accepted financial principles, public retirement systems must have a valuation at least every two years. The ERFC conducts annual valuations.

As part of these annual valuations, the retirement system’s actuary reviews the actuarial profiles of its members, which include member ages, years of service, member salaries, separation and hire rates, mortality rates, etc., in conjunction with a variety of probability factors. Based on this review, the actuary calculates short-, mid-, and long-term actuarial liabilities and applies

these calculations to various statistical and probability factors. Finally, the actuary projects which members will retire, and then estimates both the annual and ongoing costs of retirement payments to determine the system’s actuarial liabilities.

The actuarial assets are a market-related value that is developed by spreading the difference between each year’s actual and assumed investment returns over a closed 5-year period.

As of December 31, 2016, ERFC’s actuarial assets totaled \$2.27 billion and the actuarial liabilities totaled \$3.03 billion. Actuarial liabilities exceeded the actuarial value of assets by approximately \$752 million.

The Funding Progress chart shown below compares ERFC’s actuarial assets to its actuarial liabilities over the most recent ten-year period. The current funding ratio of 75.2 percent, coupled with ERFC’s relatively conservative return assumption rate of 7.25 percent, compares favorably to similar systems throughout the United States.

FUNDING PROGRESS

Year	Actuarial Value of Assets	Actuarial Liabilities	Funding Progress
Calendar Year			
2007	\$ 1,924,886,000	\$ 2,186,801,000	88%
2008	\$ 1,733,946,000	\$ 2,255,298,000	77%
2009	\$ 1,769,540,000	\$ 2,339,869,000	76%
2010	\$ 1,822,603,000	\$ 2,384,061,000	77%
2011	\$ 1,866,952,000	\$ 2,470,964,000	76%
2012	\$ 1,935,292,000	\$ 2,566,128,000	75%
2013	\$ 2,029,005,000	\$ 2,645,500,000	77%
2014	\$ 2,123,910,000	\$ 2,733,845,000	78%
2015	\$ 2,188,037,000	\$ 2,880,703,000	76%
2016	\$ 2,279,741,000	\$ 3,032,503,000	75%



STATEMENT OF FIDUCIARY NET POSITION

(As of June 30, 2017)

Assets	2017	2016	Difference
Cash and investments	\$ 2,476,319,109	\$ 2,248,958,425	\$ 227,360,684
Accounts receivable	9,695,130	16,310,307	(6,615,177)
Other assets	53,546	34,914	18,632
Total assets	\$ 2,486,067,785	\$ 2,265,303,646	\$ 220,764,139
Liabilities			
Capital leases	\$ 21,991	\$ -	\$ 21,991
Accounts payable	1,990,307	1,802,640	187,667
Securities purchased	9,060,028	13,646,920	(4,586,892)
Securities lending collateral	170,713,805	142,266,388	28,447,417
Total liabilities	\$ 181,786,131	\$ 157,715,948	\$ 24,070,183
Total Net position restricted for pension benefits	\$ 2,304,281,654	\$ 2,107,587,698	\$ 196,693,956

STATEMENT OF CHANGES IN FIDUCIARY NET POSITION

(As of June 30, 2017)

Additions	2017	2016	Difference
Member Contributions	\$ 43,062,632	\$ 41,383,642	\$ 1,678,990
Employer Contributions	80,094,538	76,599,695	3,494,843
Net Investment Income/(Loss)	250,981,777	(15,766,967)	266,748,744
Total	\$ 374,138,947	\$ 102,216,370	\$ 271,922,577
Deductions			
Benefits	\$ 168,783,718	\$ 165,721,790	\$ 3,061,928
Refunds	4,601,865	4,626,057	(24,192)
Administrative Expenses	4,059,408	4,004,882	54,526
Total	\$ 177,444,991	\$ 174,352,729	\$ 3,092,262
Net Change	\$ 196,693,956	\$ (72,136,359)	\$ 268,830,315
Net Position Restricted for Pensions			
Beginning of Year	\$ 2,107,587,698	\$ 2,179,724,057	\$ (72,136,359)
End of Year	\$ 2,304,281,654	\$ 2,107,587,698	\$ 196,693,956

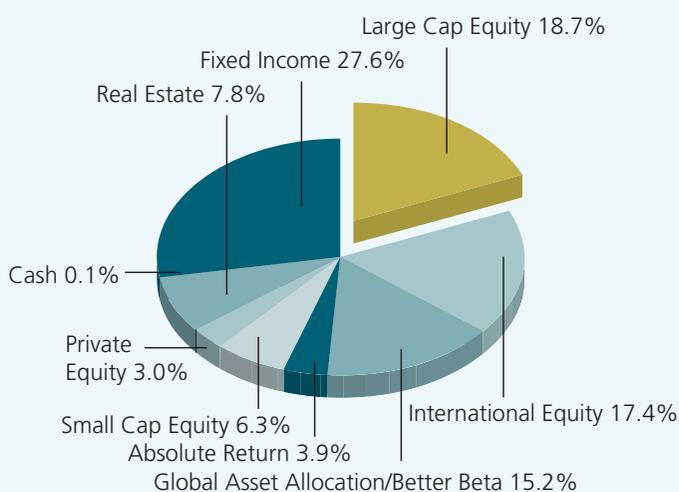
INVESTMENT SUMMARY

ERFC's interim asset allocations (by major asset class) as of June 30, 2017, are shown on the chart below. These allocations are driven by strategic targets that are established and designed by ERFC's Board of Trustees to provide the retirement fund the necessary flexibility to meet its short-term actuarial liabilities while simultaneously positioning for long-term asset growth.

Data detailing ERFC's investment returns, benchmark returns, and public fund universe comparisons for the fiscal years ending June 30, 2017, for the one-, three-, five-, and ten-year periods are provided on the following page.

The portfolio's return of 12.3 percent exceeded the customized benchmark return of 10.1 percent and matched the investment consultant's public fund universe return of 12.3 percent.

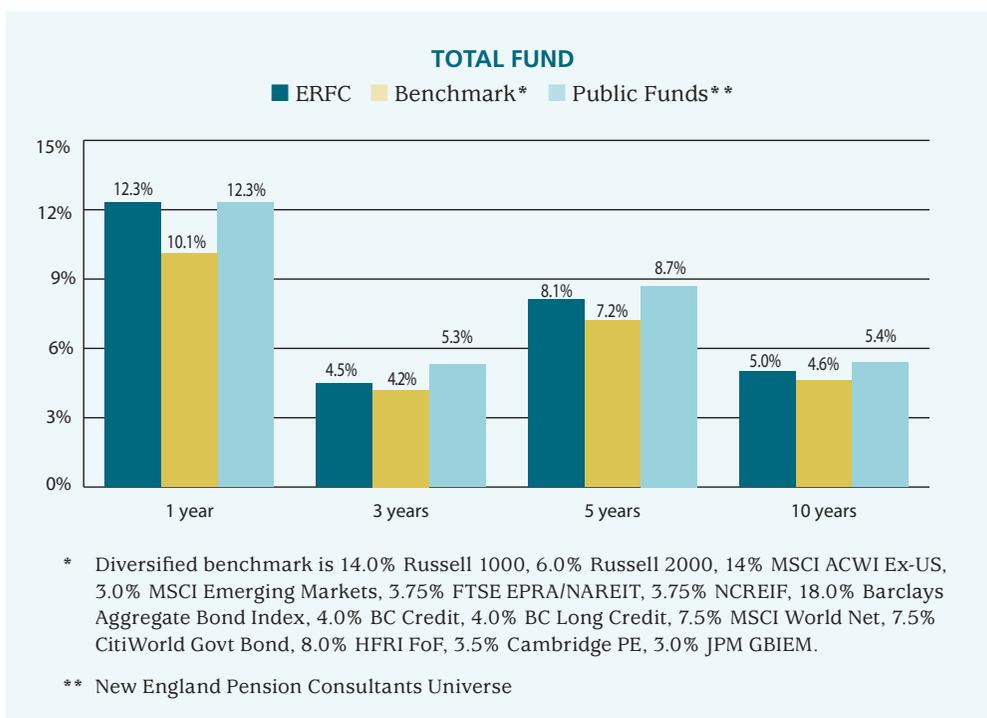
ACTUAL ALLOCATION BY ASSET CLASS (\$ in millions, as of June 30, 2017)



Asset Class	Interim Strategic Targets as of June 30, 2017	Actual Asset Allocations as of June 30, 2017
Large Cap Domestic Equity	14.0%	18.7%
Small Cap Domestic Equity	6.0%	6.3%
International Equity	17.0%	17.4%
Equity Real Estate	7.5%	7.8%
Fixed Income	29.0%	27.6%
Global Asset Allocation/Better Beta	15.0%	15.2%
Absolute Return	8.0%	3.9%
Private Equity	3.5%	3.0%
Cash	0.0%	0.1%
TOTAL	100%	100%

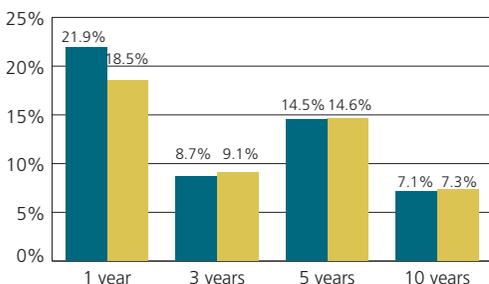
INVESTMENT RESULTS

(For the periods ending June 30, 2017)



DOMESTIC EQUITY

■ Domestic Equity ■ Benchmark: Russell 3000 Index



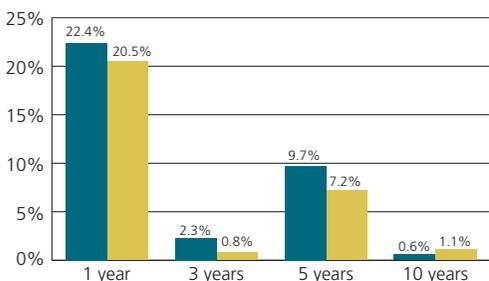
FIXED INCOME

■ Fixed income ■ Benchmark: Barclays Capital Aggregate Bond Index



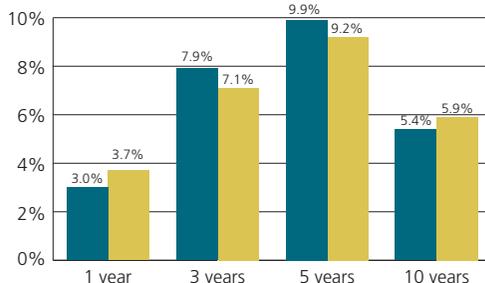
INTERNATIONAL EQUITY

■ International Equity ■ Benchmark: MSCI/ACWI Ex-USA Index



REAL ESTATE EQUITY

■ Real Estate Equity ■ Benchmark: 50% FTSE EPRA/NAREIT 50% NCREIF





ERFC would like to thank the staff at Willow Oaks Administrative Center for allowing us the opportunity to feature its departments and services in our 2017 Comprehensive Annual Financial Report. The children are who we all have in common and ERFC is here for those who serve to better their futures.



**Educational Employees' Supplementary
Retirement System of Fairfax County**
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