

ERFC 2016

Annual Summary Report

For the Fiscal Year
Ended June 30, 2016

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 2016.

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 29 schools and administrative centers, explaining to members the provisions and importance of their retirement benefits. ERFC staff developed a brochure to complement ERFC's other communications material, which was geared toward stakeholders other than ERFC members and included information on ERFC's economic benefit to Fairfax County, as well as key benefits of defined benefit plans.

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 its Counseling Session Evaluation forms electronically. To continue to maintain excellence in cyber security, ERFC was added as an insured on the FCPS cyber insurance policy. ERFC continued to promote its online service and over 20,000 active and retired members now use ERFCDirect, up from 18,000 a year ago.

Strategic Plan

During the year, the ERFC staff implemented several action plans included in the 2015 Strategic Plan. Staff launched a new "Ambassador Program" with a group of select employee representatives who volunteered to act as ERFC retirement plan resources for their peers in the workplace. Staff developed a "retiree checklist" for use by members eligible to retire in the next 12 months. In conjunction with its actuary, ERFC developed a 2025 profile to inform the next strategic planning cycle. The profile outlined demographic projections for ERFC including average age, service and pay, and projected the employer contribution rate for the 10-year period.

The operational audit concluded with a presentation by KPMG at the December Board of Trustees meeting. ERFC received "passed" results over all general information technology control areas tested. In January, ERFC submitted the Plan to the IRS for an updated determination letter. Staff worked with its actuary to finalize the five-year actuarial experience study, which is conducted to determine the appropriateness of the actuarial assumptions including those relating to inflation, investment return, salary increases, and rates of retirement and disability.

Plan Financial Condition

The ERFC Fund declined 0.3 percent in fiscal year 2016, the second year of disappointing fiscal year returns. For the year, ERFC underperformed its policy index by 1.7 percent due primarily to underperformance by its domestic equity managers; in contrast, last year ERFC outperformed its policy index due to strong returns by its domestic equity managers.

ERFC's independent actuary reported that the System's funding ratio declined slightly from 77.7 percent to 76.0 percent for the valuation period ending December 31, 2015, due to unfavorable investment performance offset by

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

lower than anticipated pay increases and favorable demographic experience. The recommended employer contribution rate increased to 6.40 percent of payroll from 5.60 percent for fiscal year 2018.

Investment Activity

The ERFC's decline of 0.3 percent for FY 2016 underperformed its benchmark index return of 1.4 percent and underperformed its peer systems for the fiscal year with the median fund returning 0.9 percent. This peer system underperformance occurred due to less domestic equity exposure in ERFC's portfolio than its peer group; the Fund's 20.3 percent U.S. equity allocation was lower than the median fund's 32.1 percent allocation and domestic equity returned 2.1 percent for the fiscal year. International markets declined sharply and ERFC's higher than peer allocation to developed international equity and global asset allocations contributed to ERFC's lower than peer rankings. The Fund's longer-term return remained strong with the seven-year return of 9.5 percent exceeding the policy index return of 8.8 percent.

The Board continued implementation of its private equity program during the fiscal year. Capital called increased the private equity allocation to 2.9 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 2015 Comprehensive Annual Financial Report (CAFR). This is the 19th 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' 2016 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. ERFC's CAFR also won an **Award of Merit** from the 2016 Publications and Electronic Media Contest sponsored by the National School Public Relations Association (NSPRA).

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 LLP, 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 2016 fiscal year. ERFC's Comprehensive Annual Financial Report for FY 2016, 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

Michael Hairston, *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, 2016. 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 the members of the ERFC.

The months subsequent to the fiscal year-end introduced several changes to the composition of ERFC's Board and its officers. Daryl Richards was elected to his first three-year term as an ERFC trustee. Nancy Hammerer was elected as Chairperson in July 2016 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 launch of ERFC's Ambassador Program furthers the Board's goal of increasing the understanding and appreciation of the value of ERFC and the total retirement program. The economic flow-through

study highlighted the positive impacts that the \$211 million of retiree income paid by the ERFC and the Virginia Retirement System has on Fairfax County's economy, supporting an additional \$249 million of economic impact.

On the investment front, the Board is disappointed in the negative 0.3 percent return for the 2016 fiscal year period; however, the seven-year return of 9.5 percent since the financial downturn was comfortably in excess of its policy index return of 8.8 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 maintained the FCPS employer contribution rate at 5.60 percent of covered payroll for the 2017 fiscal year.

As my 12-year tenure on the ERFC Board ends with the 2016 fiscal year and I begin my retirement from FCPS, I extend my sincere thanks to my fellow Trustees, ERFC Executive Director Jeanne Carr, the ERFC staff and all members of the ERFC 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

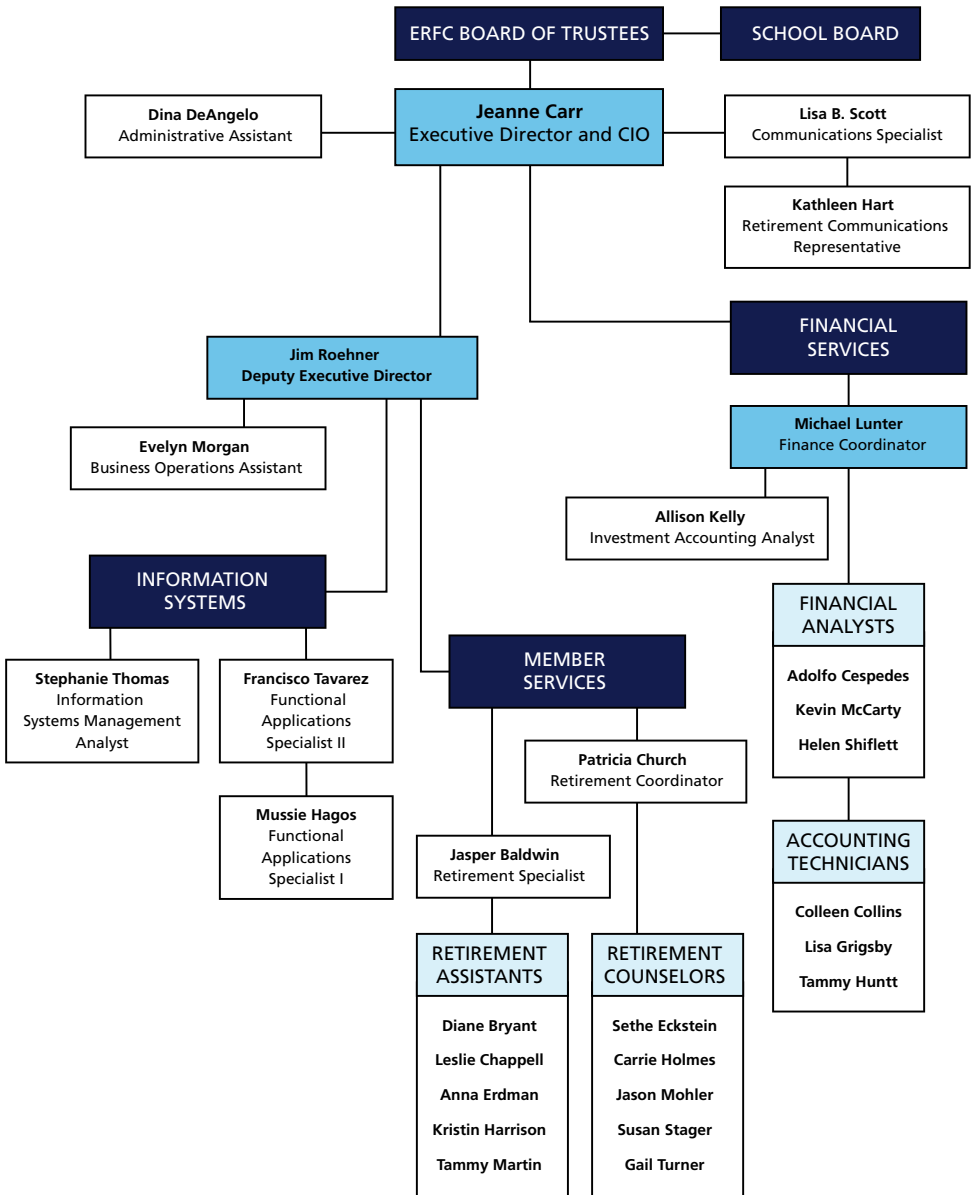
www.fcps.edu/erfc or contact us directly with any questions regarding your pension fund or retirement benefits.

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 2016



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 2016, Fairfax County Public Schools contributed 5.60 percent of total salaries to the Plan.

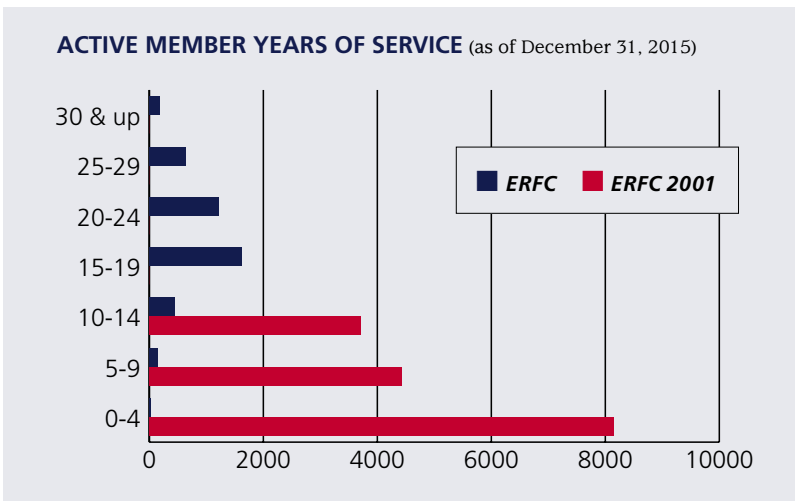
All members become vested in *ERFC* and *ERFC 2001* after earning five years of credited service. Under *ERFC*, members are eligible for full service benefits at age 55 with 25 years of service, or at age 65 with five years of service. A reduced benefit is available to *ERFC* members at age 45 with 25 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, 2015, total ERFC membership consisted of 10,937 retirees and beneficiaries, 4,099 deferred vested members and 21,585 active members.

ACTIVE MEMBER YEARS OF SERVICE

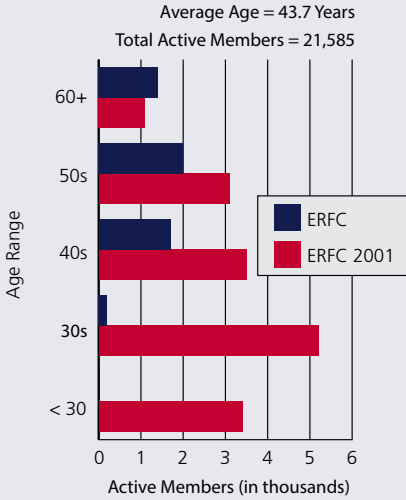
Average Service = 9.2 years

	0-4	5-9	10-14	15-19	20-24	25-29	30 & up
<i>ERFC</i>	23	157	453	2,615	1,211	645	188
<i>ERFC 2001</i>	8,148	4,431	3,714	-	-	-	-



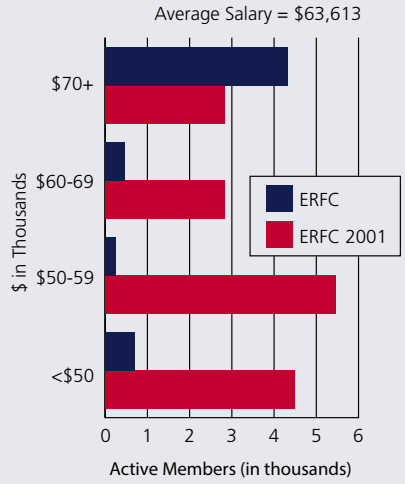
ACTIVE MEMBER AGES

(as of December 31, 2015)



ACTIVE MEMBER SALARIES

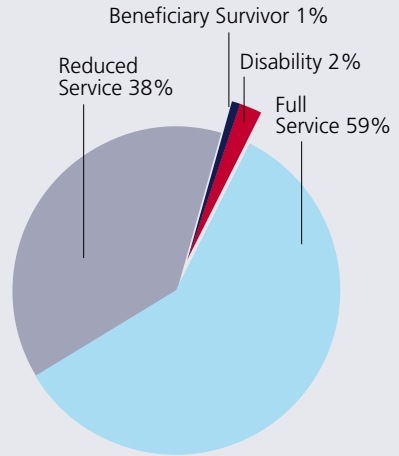
(as of December 31, 2015)



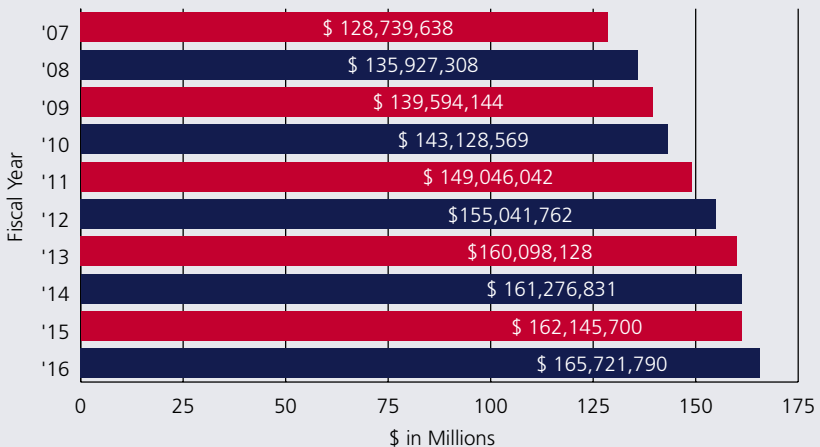
RETIREES AND BENEFICIARIES BY TYPE OF BENEFIT BEING PAID

(as of December 31, 2015)

Description	Amount
Full Service	6,437
Reduced Service	4,126
Beneficiary Survivor	163
Disability	211
Total	10,937



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.

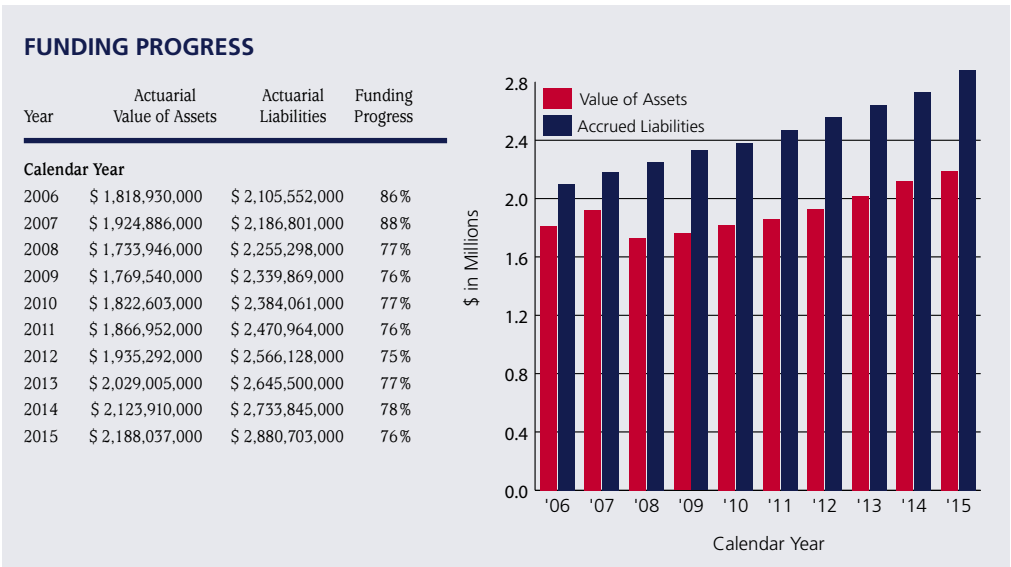
As part of these annual valuations, the retirement system’s actuary reviews the actuarial profiles of its members, which include member ages, years of service, member salaries, separation and hire rates, mortality rates, etc., in conjunction with a variety of probability factors. Based on this review, 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, 2015, ERFC’s actuarial assets totaled \$2.18 billion and the actuarial liabilities totaled \$2.88 billion. Actuarial liabilities exceeded the actuarial value of assets by approximately \$692 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 76.0 percent, coupled with ERFC’s relatively conservative return assumption rate of 7.25 percent, compares favorably to similar systems throughout the United States.



STATEMENT OF FIDUCIARY NET POSITION

(As of June 30, 2016)

Assets	2016	2015	Difference
Cash and investments	\$ 2,248,958,425	\$ 2,340,700,348	\$ (91,741,923)
Accounts receivable	16,310,307	12,773,186	3,537,121
Other assets	34,914	49,936	(15,022)
Total assets	\$ 2,265,303,646	\$ 2,353,523,470	\$ (88,219,824)
Liabilities			
Accounts payable	\$ 1,802,640	\$ 1,913,934	\$ (111,294)
Securities purchased	13,646,920	11,339,057	2,307,863
Securities lending collateral	142,266,388	160,546,422	(18,280,034)
Total liabilities	\$ 157,715,948	\$ 173,799,413	\$ (16,083,465)
Total Net position restricted for pension benefits	\$ 2,107,587,698	\$ 2,179,724,057	\$ (72,136,359)

STATEMENT OF CHANGES IN FIDUCIARY NET POSITION

(As of June 30, 2016)

Additions	2016	2015	Difference
Member Contributions	\$ 41,383,642	\$ 39,982,963	\$ 1,400,679
Employer Contributions	76,599,695	74,324,396	2,275,299
Net Investment Income/(Loss)	(15,766,967)	32,083,908	(47,850,875)
Total	\$ 102,216,370	\$ 146,391,267	\$ (44,174,897)
Deductions			
Benefits	\$ 165,721,790	\$ 162,145,265	\$ 3,576,525
Refunds	4,626,057	5,697,311	(1,071,254)
Administrative Expenses	4,004,882	3,751,825	253,057
Total	\$ 174,352,729	\$ 171,594,401	\$ 2,758,328
Net Change	\$ (72,136,359)	\$ (25,203,134)	\$ (46,933,225)
Net Position Restricted for Pensions			
Beginning of Year	\$ 2,179,724,057	\$ 2,204,927,191	\$ (25,203,134)
End of Year	\$ 2,107,587,698	\$ 2,179,724,057	\$ (72,136,359)

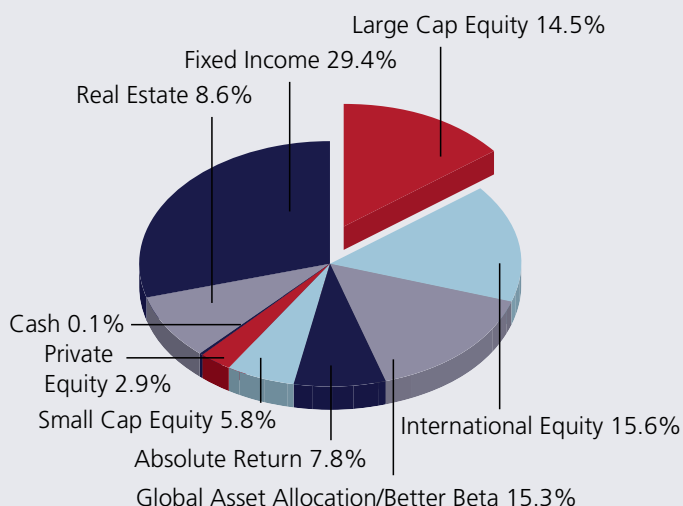
INVESTMENT SUMMARY

ERFC's interim asset allocations (by major asset class) as of June 30, 2016, 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, 2016, for the one-, three-, five-, and ten-year periods are provided on the following page.

The portfolio's return of -0.3% percent lagged the customized benchmark return of 1.4 percent and the investment consultant's public fund universe return of 0.9 percent.

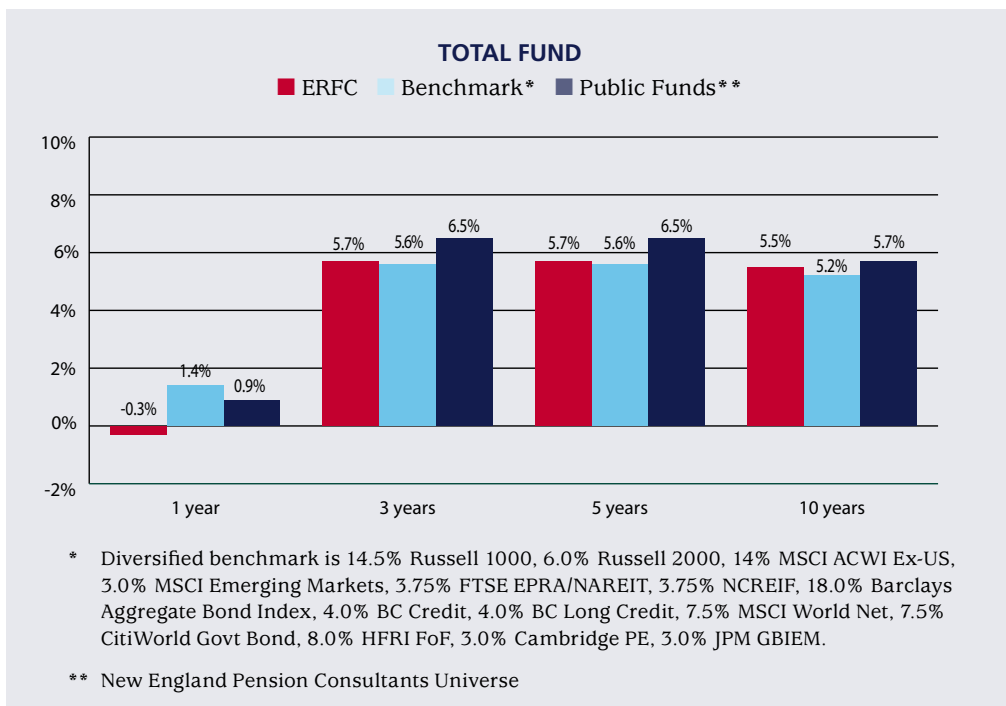
ACTUAL ALLOCATION BY ASSET CLASS (\$ in millions, as of June 30, 2016)



Asset Class	Interim Strategic Targets as of June 30, 2016	Actual Asset Allocations as of June 30, 2016
Large Cap Domestic Equity	14.5%	14.5%
Small Cap Domestic Equity	6.0%	5.8%
International Equity	17.0%	15.6%
Equity Real Estate	7.5%	8.6%
Fixed Income	29.0%	29.4%
Global Asset Allocation/Better Beta	15.0%	15.3%
Absolute Return	8.0%	7.8%
Private Equity	3.0%	2.9%
Cash	0.0%	0.1%
TOTAL	100%	100%

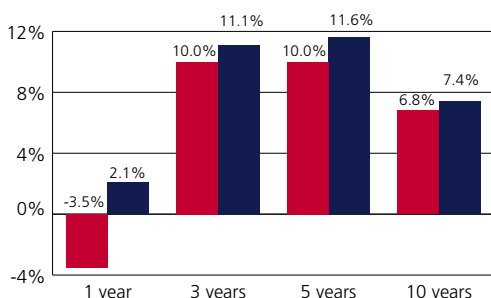
INVESTMENT RESULTS

(For the periods ending June 30, 2016)



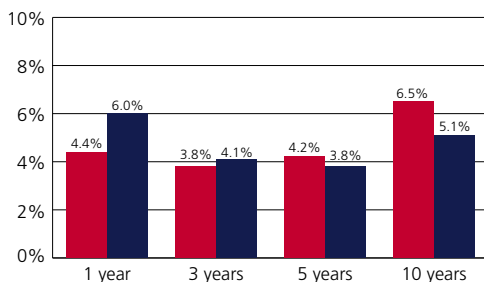
DOMESTIC EQUITY

■ Domestic Equity ■ Benchmark: Russell 3000 Index



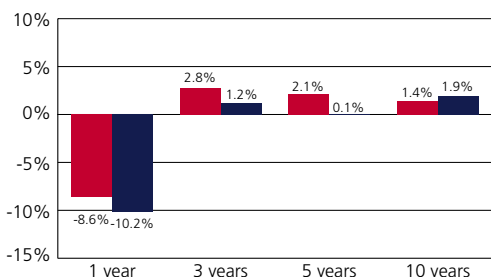
FIXED INCOME

■ Fixed income ■ Benchmark: Barclays Capital Aggregate Bond Index



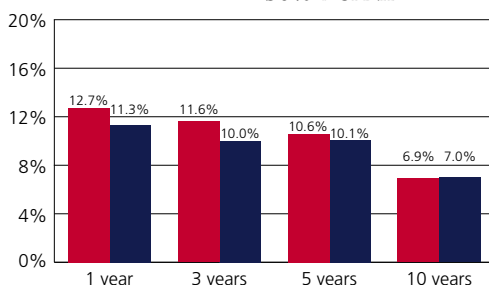
INTERNATIONAL EQUITY

■ 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 and administrators of Fort Belvoir Elementary for allowing us the opportunity to feature them in our 2016 Annual Summary 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
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