

ERFC

TWENTY FIFTEEN

Annual Summary Report



TWO SCHOOLS - ONE FAMILY

For the Fiscal Year
Ended June 30, 2015

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 2015.

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 and Technology Updates

Communication activities to increase the understanding and appreciation of the value of ERFC and the total retirement program received increased emphasis during the fiscal year. As part of its School Outreach program, ERFC staff visited 18 schools explaining to members the provisions and importance of their retirement benefits. ERFC staff also presented to the employee groups, Office Personnel Advisory Council (OPAC) and Support Services Employee's Advisory Council (SSEAC). ERFC established a new position, Retirement Communications Representative, to assist in the increased communications program.

The ERFC staff continued its efforts to implement technology innovations that will result in improved efficiencies or cost savings. As part of its "ERFC Going Paperless" campaign, ERFC began distributing its *Leaving FCPS Employment Before Retirement* information through ERFC*Direct*, ERFC's online member service. Over 18,000 active members and retired members now use ERFC*Direct*, up from 15,000 a year ago. For the first time, the Annual Financial Summaries were emailed to retirees and deferred vested members where email addresses were available, saving printing and postage costs.

Strategic Plan

The ERFC staff successfully completed the remaining action items included in the 2013 Strategic Plan during the fiscal year. Action plans completed under the Communications Section included development of a "Now you're vested!" communication program to congratulate newly vested members and advise them to take actions to establish a beneficiary, review benefit account information and attend the annual ERFC seminar. Under the ERFC Services and Internal Management Section, KPMG was retained to conduct an operational audit of ERFC. KPMG completed its fieldwork testing activities in May and is scheduled to present its results to the Board in December.

The Board of Trustees adopted its 2015 Strategic Plan in July. The new Plan continued the Board's theme in recent years of emphasizing communication, education and advocacy. Action Plans included in the three-year Plan involved creating a broad-based communications plan that emphasizes ERFC's value, developing an ERFC 2025 profile which forecasts membership data and portfolio growth, determining the economic flow-through of ERFC retirement benefits and researching successful "ambassador programs" created by peer retirement systems.

Plan Financial Condition

The ERFC achieved a 2.0 percent return for fiscal year 2015, ending the double-digit return streak of the prior two fiscal years. For the year, ERFC exceeded its policy index by .9 percent due to strong returns by its domestic equity managers and outperformance by its real estate portfolio.

ERFC's independent actuary reported that the System's funding ratio increased from 76.7 percent to 77.7 percent for the valuation period ending December 31, 2014 due to lower than anticipated pay increases and favorable demographic

THE BOARD OF TRUSTEES ADOPTED ITS 2015 STRATEGIC PLAN IN JULY. THE NEW PLAN CONTINUED THE BOARD'S THEME IN RECENT YEARS OF EMPHASIZING COMMUNICATION, EDUCATION AND ADVOCACY.

experience. The recommended employer contribution rate remained unchanged at 5.60 percent of payroll for fiscal year 2016.

Investment Activity

The ERFC's 2.0 percent return for FY 2015 outperformed its benchmark index but underperformed its peer systems for the fiscal year with the median fund returning 3.2 percent. This peer system underperformance occurred due to less domestic equity exposure in ERFC's portfolio than its peer group with domestic equity being the best performing sector during the fiscal year. Also, the international equity markets – both developed and emerging markets – declined sharply and ERFC's higher than peer allocation to global asset allocations contributed to ERFC's lower than peer rankings. The Fund's longer-term return remained strong with the ten year return of 6.7 percent exceeding the peer median.

The Board continued implementation of its private equity program during the fiscal year. It committed \$7.5 million to the Permal Private Equity Opportunities Fund V and \$55 million to HarbourVest Partners Fund X. The increased volatility in the markets that occurred subsequent to fiscal year-end further strengthened the Board's belief that it will best meet its long-term investment objectives by adding further diversification in the portfolio.

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 2014 Comprehensive

Annual Financial Report (CAFR). This is the 18th 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' 2015 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 KPMG LLP, Certified Public Accountants, Washington, D.C., to audit the System's financial statements.

This *Annual Summary* presents an overview of the System's financial activity during the 2015 fiscal year. ERFC's *Comprehensive Annual Financial Report* for FY 2015, 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 directly 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, 2015. 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. The School Board appointed Marty Smith, the FCPS Chief of Staff, to ERFC's Board. 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, were re-appointed to the Board. Kimberly Adams was elected to her first 3-year term as an ERFC trustee. I was re-elected as Chairperson in July, 2015 and Nancy Hammerer was re-elected as Vice Chairperson. The Board looks forward to working together with the new Trustees to achieve its goals and objectives.

During the year, the ERFC Board completed all Action Items included in the 2013 Strategic Plan and adopted a new 2015 Strategic Plan. The newly adopted Strategic Plan continues the Board's theme of increasing the understanding and appreciation of the value of ERFC and the total retirement program. As included in the Plan, the Board fully supports the ERFC staff's development of a broad-based

communications strategy which includes targeted messaging to reach each major ERFC audience.

The Strategic Plan also includes development of a process to provide Board-level reporting on risk across the organization including new threats to cyber security. Continued evaluation of emerging governance practices in order to maintain ERFC's strong governance framework is an action item emphasized in the Plan. The action item to create baseline measurements of volume for retirement staff will assure that current staff resources can handle increased activity due to upcoming "baby boomer" retirements.

On the investment front, the Board is disappointed in the 2 percent return for the 2015 fiscal year period even though the double-digit returns in the previous two fiscal years helped moderate the results. As reported previously, the Board has taken steps to reduce its public equity exposure in order to reduce risk in the portfolio. The Board continues 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, and managed 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 2016 fiscal year.

The Board of Trustees gratefully acknowledges the teamwork and commitment provided by the entire ERFC staff during the prior fiscal year.

The Board is especially enthusiastic about the ERFC staff's School Outreach program which educates ERFC members about their retirement benefits whether they are early in their career or nearing retirement.

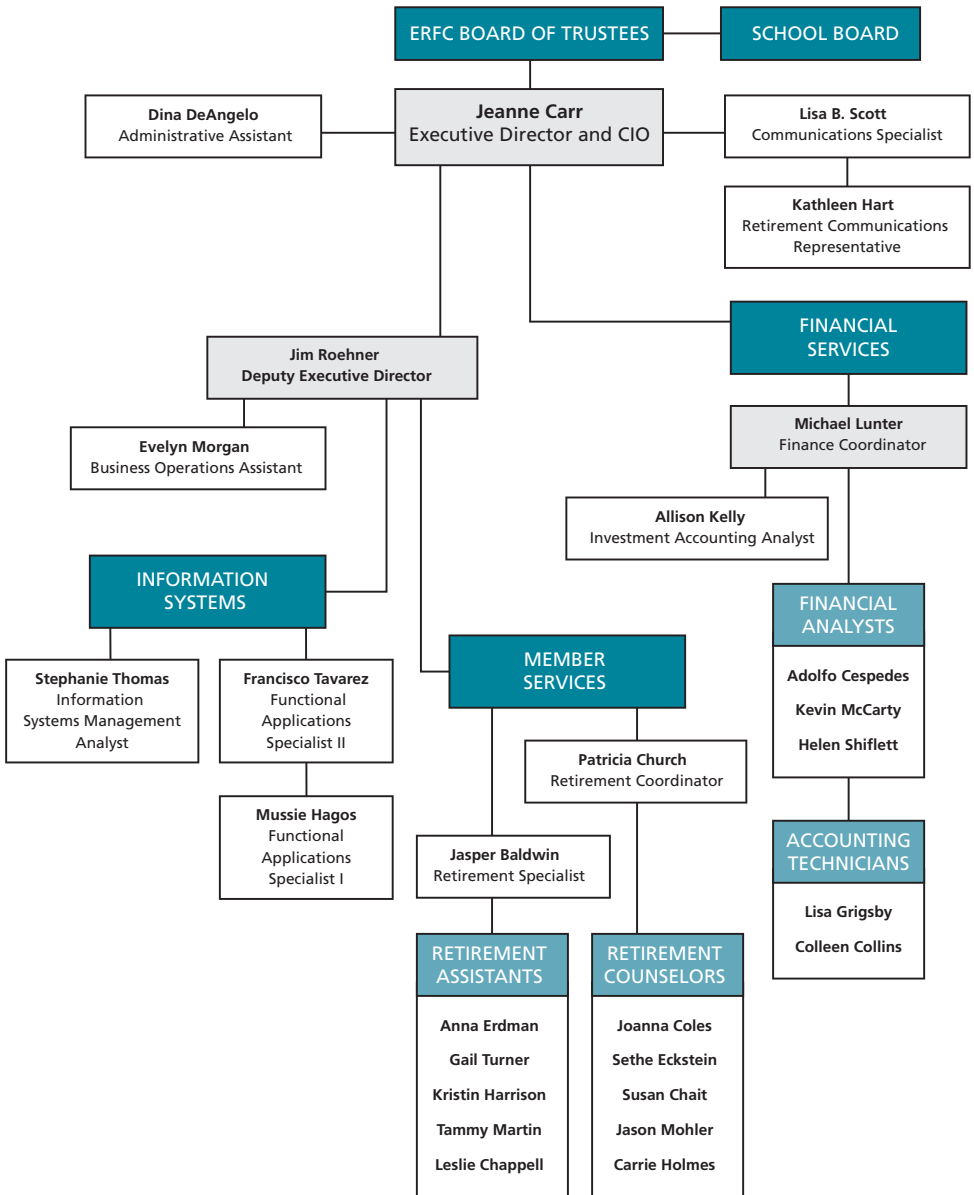
The ERFC Board values your opinions and welcomes your feedback. We encourage you to visit the website at: www.fcps.edu/erfc or contact us directly with any questions regarding your pension fund or retirement benefits.

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 2015



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 2015, Fairfax County Public Schools contributed 5.60 percent of total salaries to the Plan.

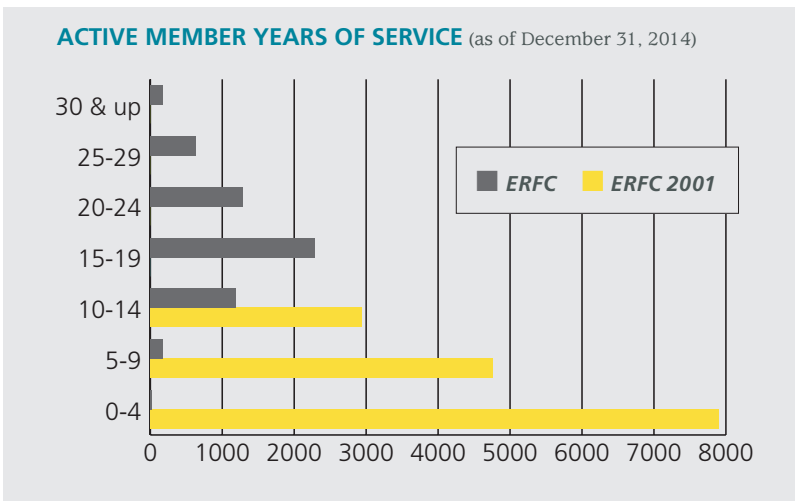
All members become vested in *ERFC* and *ERFC 2001* after earning five years of credited service. Under *ERFC*, members are eligible for full service benefits at age 55 with 25 years of service, or at age 65 with five years of service. A reduced benefit is available to *ERFC* members at age 45 with 25 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, 2014, total ERFC membership consisted of 10,524 retirees and beneficiaries, 3,761 deferred vested members and 21,352 active members.

ACTIVE MEMBER YEARS OF SERVICE

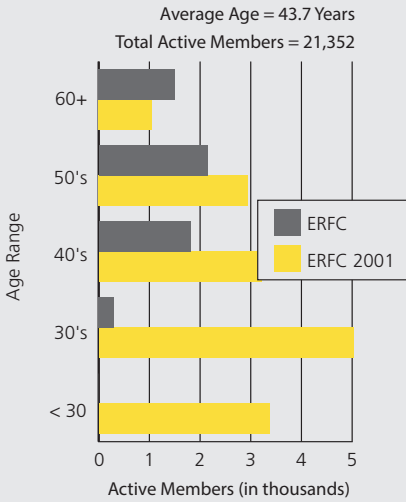
Average Service = 9.2 years

	0-4	5-9	10-14	15-19	20-24	25-29	30 & up
<i>ERFC</i>	23	170	1,185	2,284	1,286	635	171
<i>ERFC 2001</i>	7,895	4,763	2,936	-	-	-	-



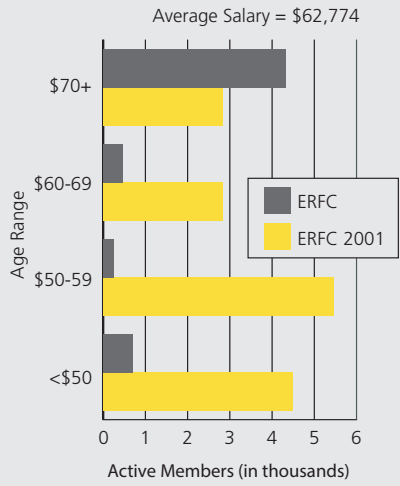
ACTIVE MEMBER AGES

(as of December 31, 2014)



ACTIVE MEMBER SALARIES

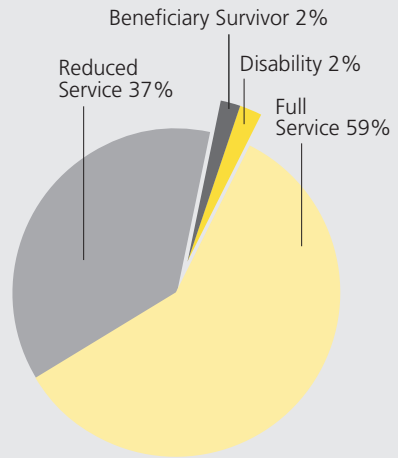
(as of December 31, 2014)



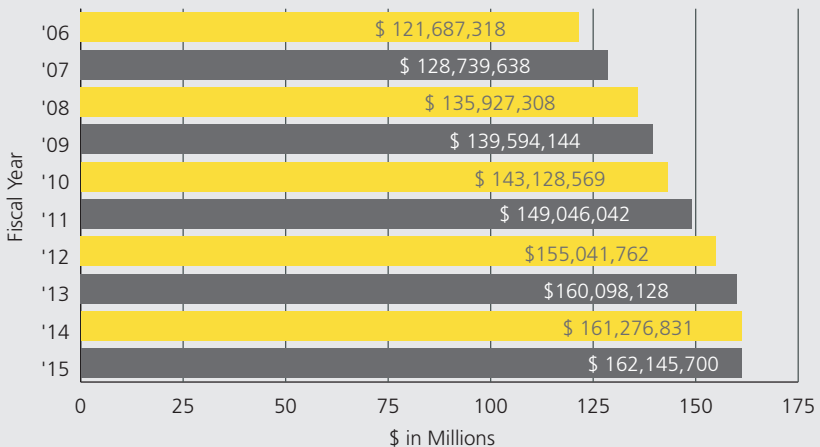
RETIREES AND BENEFICIARIES BY TYPE OF BENEFIT BEING PAID

(as of December 31, 2014)

Description	Amount
Full Service	6,241
Reduced Service	3,917
Beneficiary Survivor	166
Disability	200
Total	10,524



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.

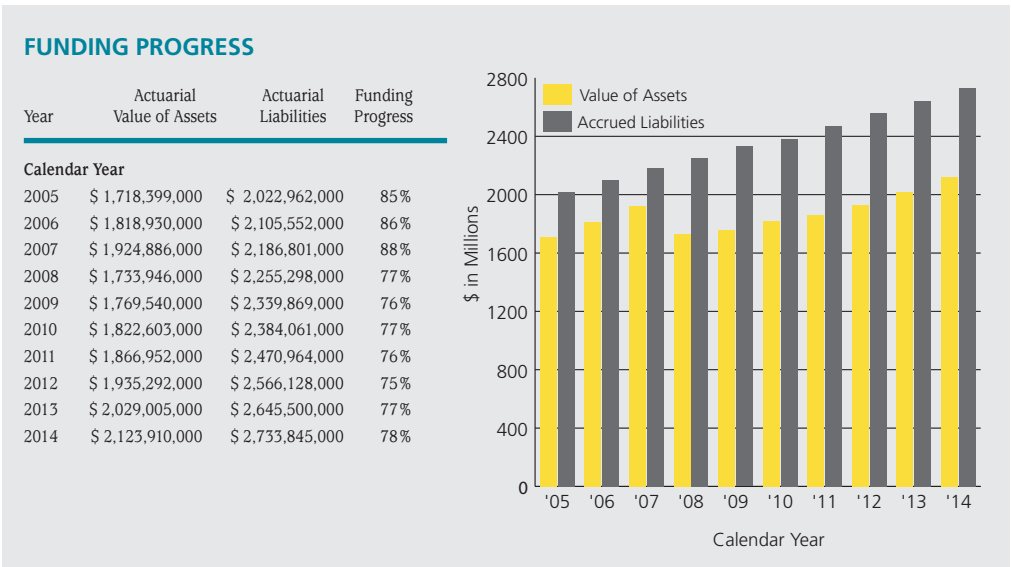
As part of these annual valuations, the retirement system’s actuary reviews the actuarial profiles of its members, which include member ages, years of service, member salaries, separation and hire rates, mortality rates, etc., in conjunction with a variety of probability factors. Based on this review, 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, 2014, ERFC’s actuarial assets totaled \$2.12 billion and the actuarial liabilities totaled \$2.73 billion. Actuarial liabilities exceeded the actuarial value of assets by approximately \$610 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 77.7 percent, coupled with ERFC’s relatively conservative return assumption rate of 7.5 percent, compares favorably to similar systems throughout the United States.



STATEMENT OF FIDUCIARY NET POSITION

(As of June 30, 2015)

Assets	2015	2014	Difference
Cash and investments	\$ 2,340,700,348	\$ 2,386,033,851	\$ (45,333,503)
Accounts receivable	12,773,186	6,792,764	5,980,422
Other assets	49,936	30,790	19,146
Total assets	\$ 2,353,523,470	\$ 2,392,857,405	\$ (39,333,935)
Liabilities			
Accounts payable	\$ 1,913,934	\$ 1,957,496	\$ (43,562)
Securities purchased	11,339,057	10,567,130	771,927
Securities lending collateral	160,546,422	175,405,588	(14,859,166)
Total liabilities	\$ 173,799,413	\$ 187,930,214	\$ (14,130,801)
Total Net position restricted for pension benefits	\$ 2,179,724,057	\$ 2,204,927,191	\$ (25,203,134)

STATEMENT OF CHANGES IN FIDUCIARY NET POSITION

(As of June 30, 2015)

Additions	2015	2014	Difference
Member Contributions	\$ 39,982,963	\$ 40,018,590	\$ (35,627)
Employer Contributions	74,324,396	74,174,082	150,314
Net Investment Income/(Loss)	32,083,908	304,640,803	(272,556,895)
Total	\$ 146,391,267	\$ 418,833,475	\$ (272,442,208)
Deductions			
Benefits	\$ 162,145,265	\$ 161,276,831	\$ 868,434
Refunds	5,697,311	5,772,959	(75,648)
Administrative Expenses	3,751,825	3,629,320	122,505
Total	\$ 171,594,401	\$ 170,679,110	\$ 915,291
Net Change	\$ (25,203,134)	\$ 248,154,365	\$ (273,357,499)
Net Position Restricted for Pensions			
Beginning of Year	\$ 2,204,927,191	\$ 1,956,772,826	\$ 248,154,365
End of Year	\$ 2,179,724,057	\$ 2,204,927,191	\$ (25,203,134)

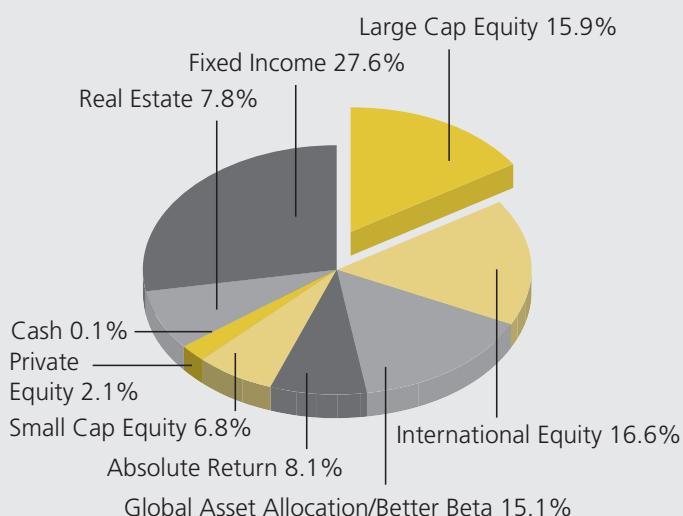
INVESTMENT SUMMARY

ERFC's interim asset allocations (by major asset class) as of June 30, 2015, 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, 2015, for the one-, three-, five-, and ten-year periods are provided on the following page.

The portfolio's return of 2.0 percent exceeded the customized benchmark return of 1.1 percent but was less than the investment consultant's public fund universe return of 3.2 percent.

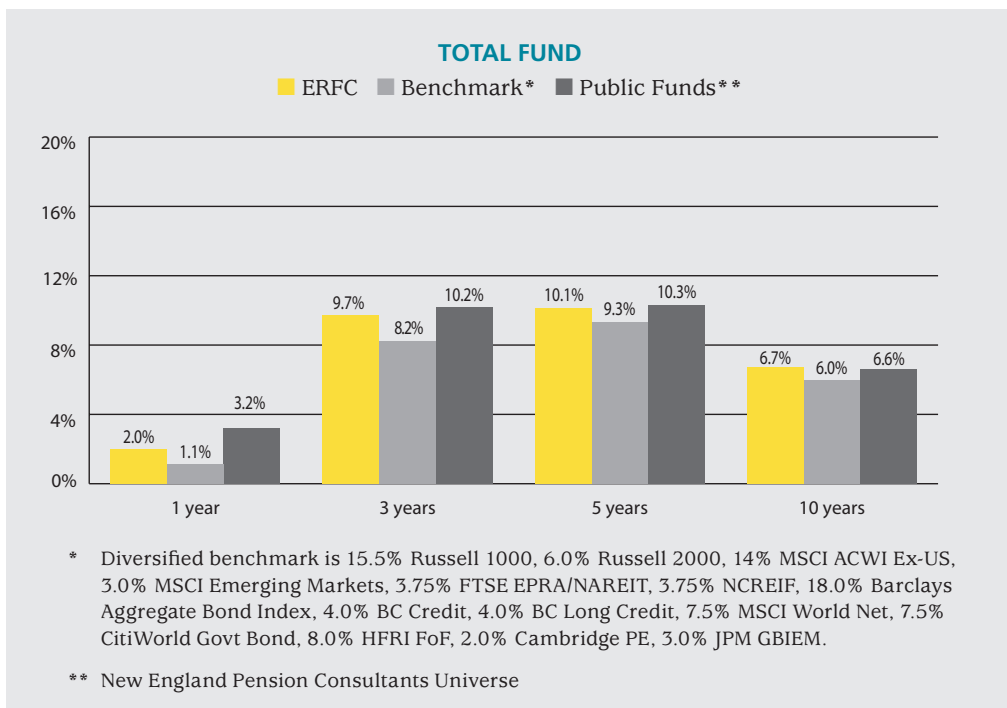
ACTUAL ALLOCATION BY ASSET CLASS (\$ in millions, as of June 30, 2015)



Asset Class	Interim Strategic Targets as of June 30, 2015	Actual Asset Allocations as of June 30, 2015
Large Cap Domestic Equity	15.5%	15.9%
Small Cap Domestic Equity	6.0%	6.8%
International Equity	17.0%	16.6%
Equity Real Estate	7.5%	7.8%
Fixed Income	29.0%	27.6%
Global Asset Allocation/Better Beta	15.0%	15.1%
Absolute Return	8.0%	8.1%
Private Equity	2.0%	2.1%
Cash	0.0%	0.0%
TOTAL	100%	100%

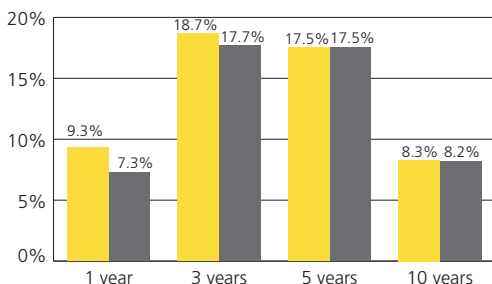
INVESTMENT RESULTS

(For the periods ending June 30, 2015)



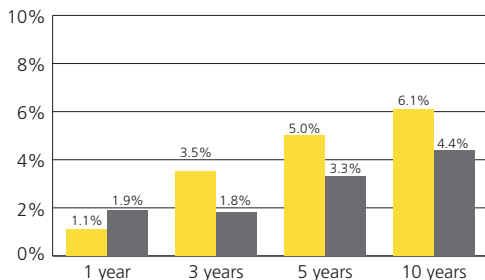
DOMESTIC EQUITY

■ Domestic Equity
 ■ Benchmark:
 Russell 3000 Index



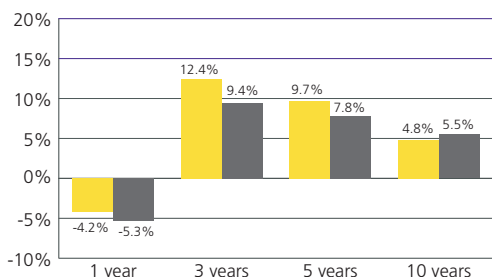
FIXED INCOME

■ Fixed income
 ■ Benchmark:
 Barclays Capital
 Aggregate Bond Index



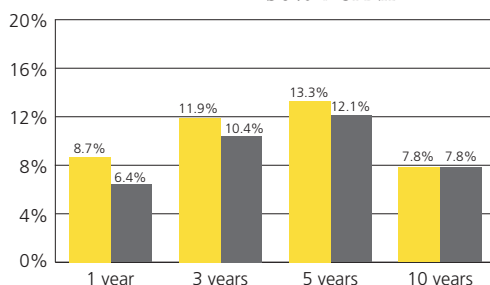
INTERNATIONAL EQUITY

■ 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 Kings Park and Kings Glen Elementary Schools for allowing us the opportunity to feature them in our 2015 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
Retirement System of Fairfax County**
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