**Popular Annual Financial Report for the Year ended June 30, 2017**
**City of San Jose Federated City Employees' Retirement System**

INTRODUCTION

The Federated City Employees' Retirement System (System) is pleased to present the Popular Annual Financial Report (PAFR) which summarizes the Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2017. The financial data presented in the PAFR is derived from the CAFR and is consistent with Accounting Principles Generally Accepted in the United States of America (U.S. GAAP). The PAFR provides a concise summary of the System's financial position, investment performance and key accomplishments throughout the fiscal year. The System consists of a single employer Defined Benefit Pension Plan and a Postemployment Healthcare Plan.

For fiscal year 2017, the Defined Benefit Pension Plan returned 8.0% gross of fees and 7.5% net of fees, while the Policy Benchmark return for the same time period was 8.1%. The System's fiscal year performance was above the actuarial rate of return of 6.875%. For fiscal year 2017, the Postemployment Healthcare Plan returned 8.7% net of fees.

The System engages an independent actuary to conduct annual actuarial valuations. The June 30, 2016 actuarial valuations show that the Defined Benefit Pension Plan and the Postemployment Healthcare Plan are 53.7% and 29.6% funded, respectively. The Defined Benefit Pension Plan sponsor paid 100% of the Actuarially Determined Contributions in fiscal year 2017, while the Postemployment Healthcare Plan sponsor paid the amount that was agreed between the System sponsor and the employee bargaining units.

This report is not intended to replace the CAFR, which provides a more complete overview of the System's financial position and operating results. For more in-depth information, we encourage you to read the CAFR by visiting **www.sjretirement.com** and clicking on the Reports tab.

## Board of Administration

The System's Board of Administration oversees the Chief Executive Officer of the Office of Retirement Services and staff in the performance of their duties. The System's Board Members as of June 30, 2017 were:



CITY OF SAN JOSE
CAPITAL OF SILICON VALLEY

## Net Position Held in Trust

As of June 30, 2017, the System's total plan net position for the Defined Benefit Pension Plan totaled $1.97 billion, while the Postemployment Healthcare Plan net position totaled $260.0 million. The funded ratio for the Defined Benefit Plan and Postemployment Healthcare Plan is 53.7% and 29.6% respectively, as of June 30, 2016, the date of the System's most recent actuarial valuation.

**NET POSITION FOR THE FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S DEFINED BENEFIT PENSION PLAN** *As of June 30, 2017 and 2016 (In Thousands)*

| | 2017 | 2016 | Increase/(Decrease) Amount | Increase/(Decrease) Percent |
|---|---|---|---|---|
| Receivables | $ 68,585 | $ 15,114 | $ 53,471 | 353.8 % |
| Investments at fair value | 1,918,487 | 1,846,167 | 72,320 | 3.9 % |
| Capital assets | 1,448 | 893 | 555 | 62.2 % |
| **Total Assets** | **1,988,520** | **1,862,174** | **126,346** | **6.8 %** |
| Current liabilities | 15,728 | 3,292 | 12,436 | 377.8 % |
| **Total Liabilities** | **15,728** | **3,292** | **12,436** | **377.8 %** |
| **Plan Net Position** | **$ 1,972,792** | **$ 1,858,882** | **$ 113,910** | **6.1 %** |

**NET POSITION FOR THE FEDERATED CITY EMPLOYEES' RETIREMENT SYSTEM'S POSTEMPLOYMENT HEALTHCARE PLAN** *As of June 30, 2017 and 2016 (In Thousands)*

| | 2017 | 2016 | Increase/(Decrease) Amount | Increase/(Decrease) Percent |
|---|---|---|---|---|
| Receivables | $ 5,944 | $ 4,119 | $ 1,825 | 44.3 % |
| Investments at fair value | 270,727 | 221,839 | 48,888 | 22.0 % |
| Capital assets | 66 | 44 | 22 | 50.0 % |
| **Total Assets** | **276,737** | **226,002** | **50,735** | **22.4 %** |
| Current liabilities | 16,367 | 156 | 16,211 | 10,391.7 % |
| **Total Liabilities** | **16,367** | **156** | **16,211** | **10,391.7 %** |
| **Plan Net Position** | **$ 260,370** | **$ 225,846** | **$ 34,524** | **15.3 %** |

## Changes in Net Position **for the years ended June 30, 2017 and 2016**

As of June 30, 2017, the net position restricted for pension benefits increased by $113.9 million or 6.1% over 2016, primarily due to changes in the fair market value of investments. Net investment income for the year ended June 30, 2017, totaled $146,010,000.

**CHANGES IN PLAN NET POSITION FOR THE DEFINED BENEFIT PENSION PLAN**
*For the Fiscal Years Ended June 30, 2017 and 2016 (In Thousands)*

| | 2017 | 2016 | Increase/(Decrease) Amount | Increase/(Decrease) Percent |
|---|---|---|---|---|
| Employee contributions | $ 17,227 | $ 15,920 | $ 1,307 | 8.2 % |
| Employer contributions | 138,483 | 129,456 | 9,027 | 7.0 % |
| Net investment income / (loss)* | 146,010 | (35,010) | 181,020 | 517.1 % |
| **Total Additions** | **301,720** | **110,366** | **191,354** | **173.4 %** |
| | | | | |
| Retirement benefits | 169,756 | 160,499 | 9,257 | 5.8 % |
| Death benefits | 12,411 | 11,530 | 881 | 7.6 % |
| Refund of contributions | 1,263 | 1,289 | (26) | (2.0)% |
| Administrative expenses | 4,380 | 3,940 | 440 | 11.2 % |
| **Total Deductions** | **187,810** | **177,258** | **10,552** | **6.0 %** |
| | | | | |
| **Net Increase (Decrease) in Plan Net Position** | **113,910** | **(66,892)** | **180,802** | **270.3 %** |
| **Beginning Net Position** | **1,858,882** | **1,925,774** | **(66,892)** | **(3.5)%** |
| **Ending Net Position** | **$ 1,972,792** | **$ 1,858,882** | **$ 113,910** | **6.1 %** |

** Net of investment expenses of $11,827 and $11,139 in 2017 and 2016, respectively.*

As of June 30, 2017, the net position restricted for postemployment healthcare benefits increased $34.5 million or 15.3% over 2016, primarily due to changes in the fair market value of investments. Net investment income for the year ended June 30, 2017, totaled $17,041,000.

**CHANGES IN PLAN NET POSITION FOR THE POSTEMPLOYMENT HEALTHCARE PLAN**
*For the Fiscal Years Ended June 30, 2017 and 2016 (In Thousands)*

| | 2017 | 2016 | Increase/(Decrease) Amount | Increase/(Decrease) Percent |
|---|---|---|---|---|
| Employee contributions | $ 16,827 | $ 17,881 | $ (1,054) | (5.9)% |
| Employer contributions | 31,905 | 30,465 | 1,440 | 4.7 % |
| Net investment income / (loss)* | 17,041 | (2,447) | 19,488 | 796.4 % |
| **Total Additions** | **65,773** | **45,899** | **19,874** | **43.3 %** |
| | | | | |
| Healthcare insurance premiums | 31,007 | 29,577 | 1,430 | 4.8 % |
| Administrative expenses | 242 | 237 | 5 | 2.1 % |
| **Total Deductions** | **31,249** | **29,814** | **1,435** | **4.8 %** |
| | | | | |
| **Net Increase in Plan Net Position** | **34,524** | **16,085** | **18,439** | **114.6 %** |
| **Beginning Net Position** | **225,846** | **209,761** | **16,085** | **7.7 %** |
| **Ending Net Position** | **$ 260,370** | **$ 225,846** | **$ 34,524** | **15.3 %** |

** Net of investment expenses of $706 and $721 in 2017 and 2016, respectively.*

The primary sources (additions) used to fund benefits provided by the System are accumulated through employee and employer contributions and by investment earnings (net of investment expenses). The primary uses (deductions) of the System's assets include benefit payments to retirees and beneficiaries, contribution refunds to terminated employees and the costs of administering the System.

## Membership (as of June 30, 2017 and 2016)

| PENSION | Retirees and beneficiaries currently receiving benefits*, ** 2017 | 2016 | Terminated vested members not yet receiving benefits 2017 | 2016 | Active members 2017 | 2016 | Total 2017 | 2016 |
|---|---|---|---|---|---|---|---|---|
| Tier 1 | 4,114 | 4,002 | 1,037 | 1,038 | 1,991 | 2,162 | 7,142 | 7,202 |
| Tier 2 | - | - | 65 | 52 | 164 | 212 | 229 | 264 |
| Tier 2B | 1 | - | 250 | 114 | 1,255 | 910 | 1,506 | 1,024 |
| Tier 2C | - | 1 | - | 2 | - | 13 | - | 16 |
| **Total** | **4,115** | **4,003** | **1,352** | **1,206** | **3,410** | **3,297** | **8,877** | **8,506** |
| **HEALTHCARE** | | | | | | | | |
| Tier 1 | 3,535 | 3,461 | 158 | 151 | 1,991 | 2,162 | 5,684 | 5,774 |
| Tier 2 | - | - | - | - | 164 | 212 | 164 | 212 |
| Tier 2B | - | - | - | - | - | - | - | - |
| Tier 2C | - | - | - | - | - | 13 | - | 13 |
| **Total** | **3,535** | **3,461** | **158** | **151** | **2,155** | **2,387** | **5,848** | **5,999** |

*The combined domestic relations orders are not included in the count above as their benefit payment is included in the retiree member count.
** For healthcare, payees that have health and/or dental coverage

## Average Benefit Payments

The Average Benefit Payment chart is a broad representation of average beneftis paid to retirees and survivors. All tiers are combined in the calculation. The chart includes all members who have retired through June 30, 2017.

| PENSION | Years of Service Credit | | | | | | |
|---|---|---|---|---|---|---|---|
| Time Periods | 0-5 | 6-10 | 11-15 | 16-20 | 21-25 | 26-30 | 31+ |
| Average monthly benefit* | $1,024 | $1,588 | $2,605 | $3,488 | $4,870 | $6,039 | $6,730 |
| Average final average monthly salary | $6,171 | $5,737 | $5,817 | $5,780 | $6,370 | $6,334 | $6,403 |
| Number of retired members** | 160 | 473 | 545 | 702 | 642 | 945 | 138 |

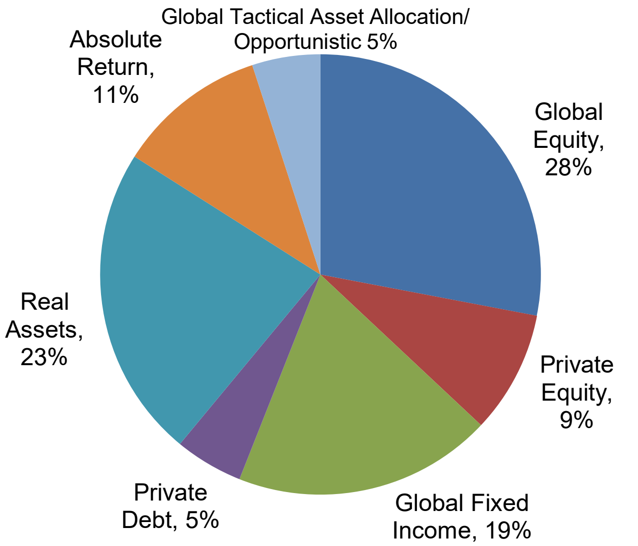
| HEALTHCARE | Years of Service Credit | | | | | | |
|---|---|---|---|---|---|---|---|
| Time Periods | 0-5 | 6-10 | 11-15 | 16-20 | 21-25 | 26-30 | 31+ |
| Average health subsidy | $785 | $569 | $666 | $667 | $726 | $776 | $633 |
| Number of health participants* | 18 | 24 | 260 | 634 | 595 | 906 | 131 |
| Average dental subsidy** | $83 | $84 | $88 | $89 | $92 | $94 | $86 |
| Number of dental participants* | 59 | 250 | 394 | 593 | 574 | 908 | 138 |

** Includes cost of living increases*
***Does not include survivors and ex-spouses*

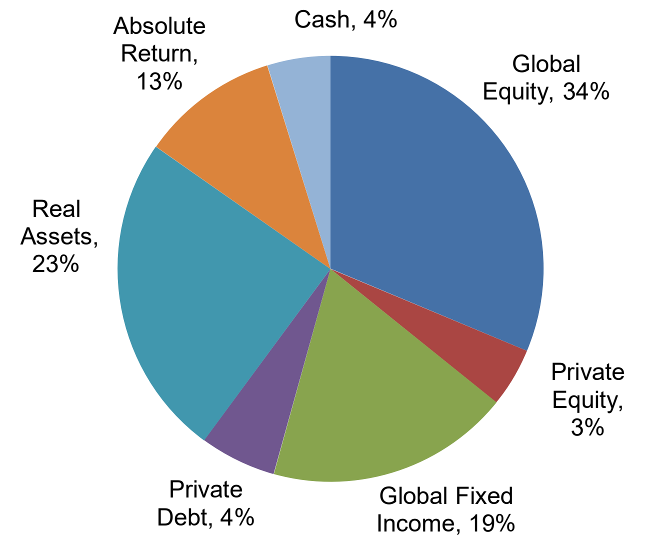
# Asset Allocation **(as of June 30, 2017)**

The allocation of the System's assets is an integral part of the System's investment policy. As such, the System engages in frequent reviews of its asset allocation policy to ensure that assets are diversified in a manner which achieves the best risk adjusted returns for the System. In addition, the asset allocation is intended to minimize the volatility of System assets and mitigate the risk of large investment losses during times of prolonged market stress. The System's Chief Investment Officer and investment consultant, Meketa, assist the Board in designing the asset allocation and strategic diversification strategies within asset classes.

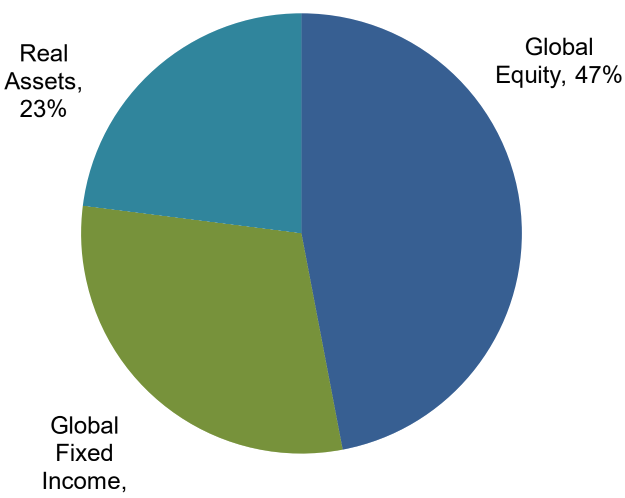
**PENSION - TARGET ASSET ALLOCATION**



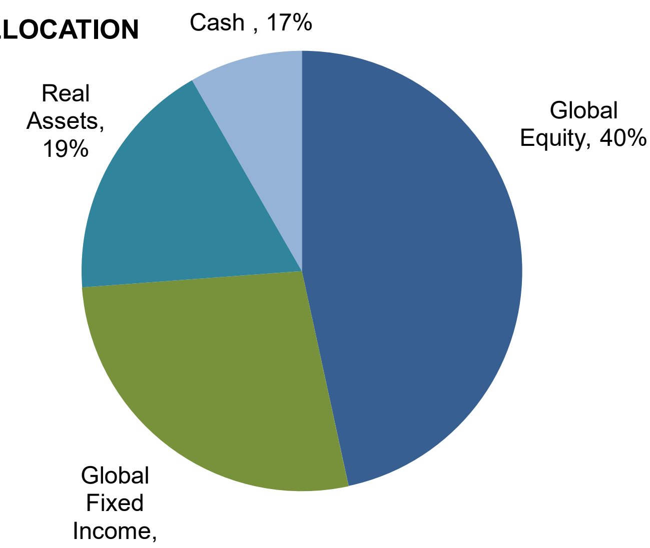

**PENSION - ACTUAL ASSET ALLOCATION**




**HEALTHCARE - TARGET ASSET ALLOCATION**




**HEALTHCARE - ACTUAL ASSET ALLOCATION**




*Real assets include real estate, commodities, infrastructure and natural resources.*

*Absolute return includes hedge funds.*

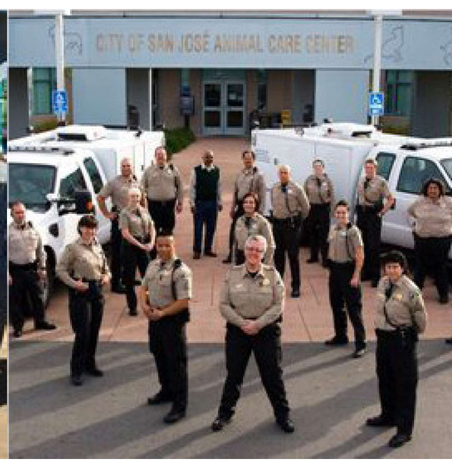
## Investment Returns Based on Fair Value* (as of June 30, 2017)

| PENSION | One Year | Three Years | Five Years | Ten Years |
|---|---|---|---|---|
| Global equity | 17.7% | 4.3% | 10.4% | N/A |
| Private equity | 10.3% | 8.6% | 10.8% | 7.7% |
| Absolute return | 1.4% | 2.1% | N/A | N/A |
| Real assets | 5.7% | -2.4% | -0.1% | N/A |
| Global fixed income | 2.2% | 1.3% | 2.4% | N/A |
| Private debt | 2.7% | 3.4% | 6.3% | N/A |
| **Total fund (net)** | **7.5%** | **1.9%** | **5.4%** | **3.2%** |
| **Policy benchmark** | **8.1%** | **1.9%** | **6.1%** | **3.9%** |

| HEALTHCARE | One Year | Three Years | Five Years |
|---|---|---|---|
| Global equity | 20.3% | 5.0% | 11.2% |
| Global fixed income | -0.2% | 1.6% | 1.2% |
| Real assets | 5.3% | -8.8% | -5.0% |
| **Total fund (net)** | **8.7%** | **0.9%** | **5.4%** |
| **Policy benchmark** | **9.2%** | **2.0%** | **6.1%** |

** Using time-weighted rate of return based on the market rate of return*

As stated in the System's investment policy, "the primary objective of the investment portfolio is to satisfy the System's obligations to pay benefits to members of the System and their beneficiaries. To do so, the Fund will seek to achieve long-term net returns in excess of the actuarial investment return assumption while maintaining a reasonable level of investment risk." In order to achieve this objective, the Investment Policy further states that "the System's fund will be managed as an ongoing concern with a long-term investment time horizon, consistent with the demographic profile of the System's members and beneficiaries." As such, "Investments shall be diversified with the intent to minimize the risks of large investment losses. Consequently, the total portfolio will be constructed and maintained to provide prudent diversification with regard to the concentration of holdings in individual asset classes, issues, issuers, geographics, or industries. Furthermore, assets will be assigned to a variety of investment managers that employ a range of investment management strategies." For the year ended June 30, 2017, the Defined Benefit Pension Plan returned 7.5% net of fees, while the Policy Benchmark return for the same period was 8.1%.

## Funding Status

The System hires an independent consultant to conduct annual actuarial valuations of pension assets and expenses. The actuarial values are compared to determine the annual contribution rates that the employer is required to pay to meet ongoing pension obligations. The actuarial value of assets differs from the market value of assets because gains and losses are "smoothed" over a 5 year period to minimize the effect of market volatility on contribution rates. The table below represents the actuarial report that was current as of June 30, 2016; please check the System's website for more current numbers and information on the Net Pension Liability calculation required by GASB 67.

**SCHEDULE OF FUNDING PROGRESS - DEFINED BENEFIT PENSION PLAN (Unaudited)**
*(Amounts in thousands)*

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Liability (AL) | Unfunded AL | Funded Ratio | Covered Payroll | Unfunded AL as a % of Covered Payroll |
|---|---|---|---|---|---|---|
| June 30, 2016 | $2,034,741 | $3,786,730 | $1,751,989 | 53.7% | $266,823 | 656.6% |
| June 30, 2015 | $2,004,481 | $3,569,898 | $1,565,417 | 56.1% | $251,430 | 622.6% |
| June 30, 2014 | $1,911,773 | $3,235,065 | $1,323,292 | 59.1% | $234,677 | 563.9% |
| June 30, 2013 | $1,783,270 | $3,013,763 | $1,230,493 | 59.2% | $225,779 | 545.0% |
| June 30, 2012 | $1,762,973 | $2,841,000 | $1,078,027 | 62.1% | $225,859 | 477.3% |

**SCHEDULE OF FUNDING PROGRESS - POSTEMPLOYMENT HEALTHCARE PLAN (Unaudited)**
*(Amounts in thousands)*

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Liability (AL) | Unfunded AL | Funded Ratio | Covered Payroll | Unfunded AL as a % of Covered Payroll |
|---|---|---|---|---|---|---|
| June 30, 2016 | $225,845 | $764,261 | $538,416 | 29.6% | $266,823 | 201.8% |
| June 30, 2015 | $209,761 | $817,673 | $607,912 | 25.7% | $251,430 | 241.8% |
| June 30, 2014 | $199,776 | $729,406 | $529,630 | 27.4% | $234,677 | 225.7% |
| June 30, 2013 | $157,695 | $870,872 | $713,177 | 18.1% | $226,098 | 315.4% |
| June 30, 2012 | $137,798 | $1,096,620 | $958,822 | 12.6% | $225,859 | 424.5% |

## Schedule of Employer and Employee Contributions

Employer and employee basic and COLA (Cost of Living Adjustment) contributions are based on statute and rates recommended by an independent actuary and adopted by the Retirement Board. The rates are set to provide a retirement benefit equal to a fractional part of the highest year(s) salary, depending on membership and tier.

| (In Thousands) | PENSION | | HEALTHCARE | |
|---|---|---|---|---|
| Year Ended | Employer Contributions | Employee Contributions | Employer Contributions | Employee Contributions |
| June 30, 2017 | $138,483 | $17,227 | $31,905 | $16,827 |
| June 30, 2016 | $129,456 | $15,920 | $30,465 | $17,881 |
| June 30, 2015 | $114,751 | $13,621 | $26,959 | $18,645 |
| June 30, 2014 | $107,544 | $13,596 | $19,298 | $17,494 |
| June 30, 2013 | $103,109 | $12,652 | $21,251 | $15,979 |

The System's actuarial valuations are calculated as of June 30 of each year. Actuarially determined contribution rates are calculated based on the actuarial valuation one year prior to the beginning of the plan year.

## Noteworthy Accomplishments

The System held its Annual Stakeholders' meeting in September 2016, with attendees receiving first-hand information about their retirement fund investments, the financial outlook and overall health of the System, and the impact of new legislation on retiree benefits.

The Office of Retirement Services kicked off the upgrade of its pension administration system in March 2015, the implementation of which is expected to last approximately 42 months and is estimated at $9 million. The implementation continued as planned during fiscal year 2017 and will be completed by the winter of 2018.

In November 2016, Measure F passed, and on March 31, 2017, the ordinance implementing the Alternative Pension Reform Settlement Framework and Measure F became effective. The provisions of the Framework include, but are not limited to, revising Tier 2 benefit, allowing rehired Tier 1 employees to remain in Tier 1, creating a Voluntary Employees Beneficiary Association (VEBA) for retiree healthcare and an irrevocable opt-out of the defined benefit retireed healthcare plan for eligible employees, defining the qualifications for members of the independent medical panel, and creating a Guaranteed Purchasing Power benefit for Tier 1 retirees. Both the City and the System are still waiting for approval from the Internal Revenue Service regarding several of the Framework provisions related to retiree healthcare. In addition, further discussions regarding the implementation of the Framework and Measure F are being held between the City and the bargaining units, which may result in additional modifications to the Framework.

## Awards for Excellence in Financial Reporting

The System's CAFRs for the years ended 2000-2016, from which information on pages 1-7 has been drawn, were awarded the Certificates of Achievement for Excellence in Financial Reporting by Government Finance Officers Association of the United States and Canada (GFOA). The Certificate of Achievement if the highest form of recognition for excellence in state and local government financial reporting. In order to be awarded a Cerfiticate of Achievement, a government unit must publish an easily readable and efficiently organized CAFR, whose contents conform to program standards. Such a CAFR must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to conform to the Certificate of Achievement's Program's requirements, and we are submitting it to GFOA to determine its eligibility for another Certificate.

GFOA has given an award for Oustanding Achievement in Popular Annual Financial Reporting to the System for its PAFR for the fiscal year ended June 30, 2016. The Award for Outstanding Achievement in Popular Annual Financial Reporting is a prestigious national award recognizing conformance with the higest standards for preparation of state and local government popular reports. In order to receive an Award for Outstanding Achievement in Popular Annual Financial Reporting, a government unit must publish a PAFR, whose contents conform to program standards of creativity, presentation, understandability, and reader appeal.

An Award for Outstanding Achievement in Popular Annual FInancial Reporting is valid for a period of one year only. The System has received a Popular Award for the first time for the fiscal year ended June 30, 2016. We believe our current report continues to conform to the Popular Annual Financial Reporting requirements, and we are submitting it to GFOA to determine its eligibility for another Award.

The System has also earned the Public Pension Coordinating Council's (PPCC) Public Standards Award for 2003, 2007, and 2009 through 2016. The Public Pensions Standards are intended to reflect the minimum expectations for public retirement system management and administration, and to serve as a benchmark by which all defined benefit public plans should be measured.