



Sonoma County Employees' Retirement Association 2017



A Pension Trust Fund for The County of Sonoma, Santa Rosa, California
Popular Annual Financial Report For the Year ended December 31, 2017



Government Finance Officers Association

**Award for
Outstanding
Achievement in
Popular Annual
Financial Reporting**

Presented to

Sonoma County

**Employees' Retirement Association
California**

For its Annual
Financial Report
for the Fiscal Year Ended

December 31, 2016

Christopher P. Morill

Executive Director/CEO

MEMBERS OF THE BOARD OF RETIREMENT

As of December 31, 2017

Chair

Brian Williams

Elected by Safety Members.
Present term expires
December 31, 2018

Trustee

Christel Querijero

Elected by General Members.
Present term expires
December 31, 2017

Trustee

Joe Tambe

Appointed by
Board of Supervisors.
Present term expires
December 31, 2017

Vice-Chair

Michael Gossman

Elected by General Members.
Present term expires
December 31, 2019

Trustee

David Rabbitt

Appointed by
Board of Supervisors.
Present term expires
December 31, 2018

Trustee

Robert Williamson

Appointed by
Board of Supervisors.
Present term expires
December 31, 2019

Trustee

Greg Jahn

Appointed by
Board of Supervisors.
Present term expires
December 31, 2017

Trustee

Erick Roeser

Auditor/Controller/
Treasurer/Tax Collector
Ex-Officio Trustee

Alternate Trustee

Neil Baker

Elected by Retiree Members.
Present term expires
December 31, 2017

Trustee

John Pels

Elected by Retiree Members.
Present term expires
December 31, 2017

COMMENTS FROM SCERA'S CHIEF EXECUTIVE OFFICER

I am pleased to present this summary of the Annual Financial Report for the year ending December 31, 2017. The Comprehensive Annual Financial Report (CAFR) provides a more complete overview of SCERA's financial position and operation results and is available at the SCERA office or on-line at www.scretire.org.

Actuarial Funding Status

SCERA's funding objective is to meet benefit promises by achieving long-term full funding of the cost of benefits, seeking reasonable and equitable allocation of those costs, minimizing volatility of contributions where possible and consistent with other policy goals, and obtaining optimum returns consistent with the assumption of prudent risk. Pursuant to provisions in the County Employees Retirement Law of 1937, SCERA engages an independent actuarial firm to perform actuarial valuations of the System annually. As of this latest actuarial valuation, the actuarial funding status (the ratio of System assets to System liabilities) is 87.7%.

At the request of the County, SCERA successfully sought legislation to amend a CERL provision addressing the prepayment of employer contributions, expanding the prepayment to up to two years' worth of contributions.

Investments

A significant 2017 project was the Asset-Liability (A-L) study which is conducted by the Plan's investment consultant every three years. The A-L study's purpose is to provide an understanding of the relationship between the System's assets and liabilities and the System's fiscal health. The prior study in 2014 confirmed the suitability of the Plan's asset allocation and identified a possible diversification benefit from the inclusion of private equity infrastructure, such as toll roads, ports and power generation that often have regulated characteristics. To fund the infrastructure investment the Global Asset Allocation account with GMO was reduced from 8% to 5% of Plan assets. At the same time the policy allocation to core plus fixed income was reduced by 1% to 13% and non-US equities were increased by 1% to 18%. The 2017 A-L study again confirmed the appropriateness of the Plan's asset allocation but suggested that private credit may be able to enhance the portfolio's risk/return profile, which is being researched.

The Board elected to employ an Equity Insurance Risk Premium (EIRP) strategy managed by Parametric who also manages SCERA's cash overlay program. The strategy harvests a premium that accrues to the sellers of equity market puts and calls (options) in compensation for providing equity market "insurance." The new EIRP strategy is run as an "overlay" on US equity assets and is sized at 3% of Plan assets. Another change made in 2017 after much consideration was to move the Arrowstreet mandate from a long-only non-US equity account to the firm's 130/30 non-US equity commingled fund. With a "long" position the account benefits when the stock outperformed the market and with a "short" position the account benefits when the stock underperforms.

SCERA's "Opportunistic" allocation is 0% to 6% with the purpose of capitalizing on outsized opportunities resulting from significant market dislocations. Following the Global Financial Crisis of 2008, and in response to resulting regulatory changes, the banks in Europe and elsewhere are divesting of a large number of assets. The Plan has been investing in a series of private funds managed by Davidson Kempner (DK) which are attempting to capitalize on this opportunity. SCERA committed up to \$75 million to DK Special Opportunities Fund III (DK SOF III) in 2015, a further \$25 million to DK SOF III-A (a follow-on fund) in 2016 and another \$50 million to DK SOF IV in mid-2017.

SCERA began the year with GMO, the Plan's Global Asset Allocation manager, on "Watch" primarily due to changes in their investment process and senior staff. They were removed from "Watch" in early 2017 after our consultant took the manager's rating back to a "Buy" and the organization proved to be stabilizing to SCERA's satisfaction. We ended the year with Guggenheim, SCERA's bank loan manager, on "Watch" due to organizational concerns. The concerns do not relate directly to the investment team managing SCERA's portfolio. While a manager is on "Watch" a heightened level of oversight and reporting is required. After a period of months or quarters the firm's status as a manager for SCERA is reevaluated.

SCERA engaged our investment consultant, Aon Hewitt, to perform a custody fee and service review which includes issuing a Request for Proposal to the Plan's custodian, State Street Bank and Trust, and appropriate competitors. While State Street is performing satisfactorily for SCERA it is best practice to periodically consider alternative providers for major services such as custody

For the year ended December 31, 2017, the SCERA investment portfolio experienced a return of 16.7% compared to a return of 9.2% for the year ended December 31, 2016. The SCERA fund annualized rates of return over the last 3, 5, 10 and 20-year periods, were 9.2%, 10.7%, 6.2% and 6.9%, respectively

Operations

Sonoma County suffered a major fire in October which caused the SCERA office, as well as the County Center, to be closed for a week without power. Staff responded to the disaster admirably and kept retirement related operations running smoothly during this time, and in the weeks following. SCERA revised its emergency notification protocol to ensure that phone trees are enacted properly and staff is aware of the actions to take in the event the building is uninhabitable. SCERA also evaluated its staffing needs after a resignation.

2017 brought a significant policy change with the Board's approval of Article 8.4, which addresses the community property division of accounts in SCERA. The Article calls for establishing separate member and nonmember accounts upon the division of community property pension service credit and contributions and provides for separate benefits to be paid to a member and nonmember. The Article must be adopted by the Sonoma County Board of Supervisors before it is operative, which is scheduled for early 2018.

SCERA updated its Strategic Plan to cover a five year period from 2018 through 2022, as opposed to the previous three year term, and adopted an annual Business Plan that contains action items that move SCERA closer to its strategic vision. SCERA revised its Cost of Living Adjustment (COLA) policy to remove the requirement that the Board of Retirement take specific action when the reserve balances do not support a COLA recommendation to the Sonoma County Board of Supervisors. In lieu of an action item, the CEO provides the Board of Retirement, the County Administrative Officer and the Sonoma County Association of Retired Employees with a financial analysis of the reserves, the loss of purchasing power since the last COLA was granted, and the cost of a COLA should one be able to be granted.

Retirement Board

2017 saw the reelection of John Pels, the Retiree Member, Neil Baker, the Retiree Member alternate, and Christel Querijero, a General Elected Member and the reappointment of Greg Jahn and Joe Tambe, Appointed Members, each for another three year term. We are very pleased with the election and appointment of these Trustees. The Board officers consist of Brian Williams, Chair, and Michael Gossman, Vice Chair, and our Investment Committee officers consist of Greg Jahn, Chair, and Brian Williams, Vice Chair.

Popular Annual Financial Reporting Award

SCERA received from the GFOA an Award for Outstanding Achievement in Popular Annual Financial Reporting for its Popular Annual Financial Report (PAFR) for the fiscal year ended December 31, 2016. The PAFR is sent to all SCERA members and includes highlights of the annual CAFR. This was the thirteenth year the PAFR was submitted to the GFOA and we are very pleased that the PAFR again received the Certificate of Achievement.

Respectfully submitted,

Julie Wyne
Chief Executive Officer

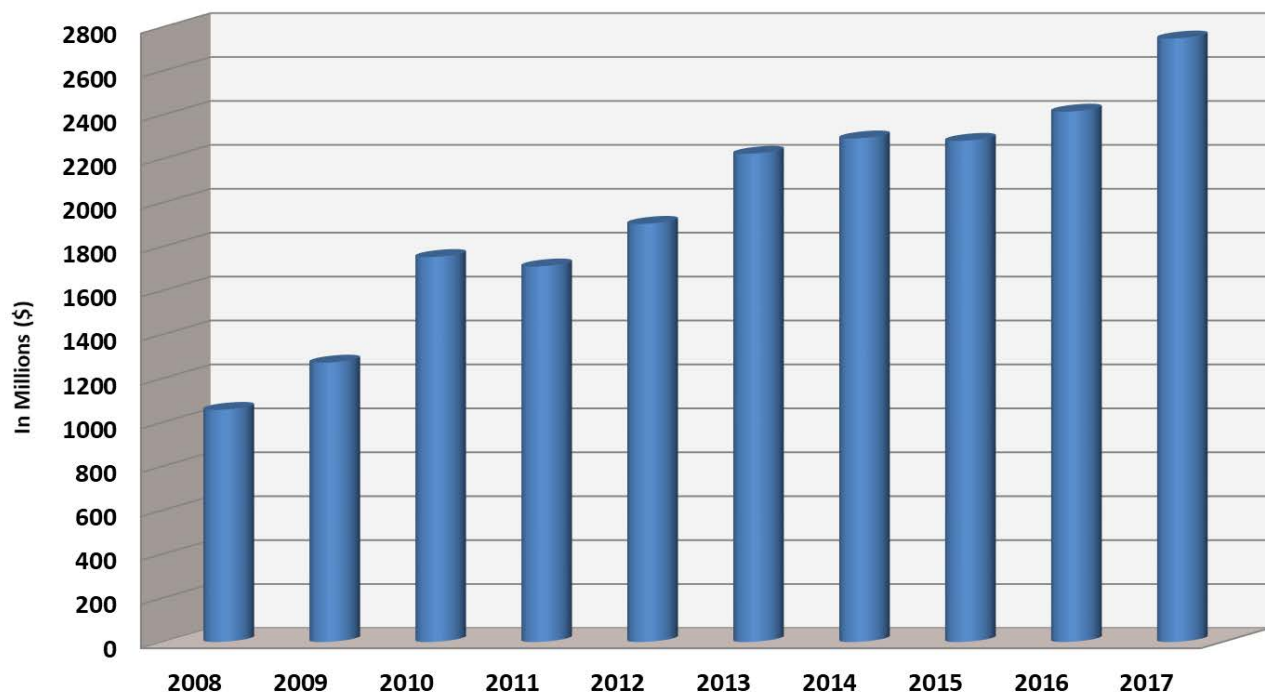
FIDUCIARY NET POSITION RESTRICTED FOR PENSION BENEFITS

(All \$ in Millions)

Fiscal year ending 12/31	Total Fund Net Position	Increase (Decrease) in Net Position
2017	\$2,748.0	\$ 333.2
2016	2,414.8	132.7
2015	2,282.1	(11.4)
2014	2,293.5	70.7
2013	2,222.8	317.9
2012	1,904.9	195.1
2011	1,709.8	(43.0)
2010	1,752.8	480.3
2009	1,272.5	215.4
2008	1,057.1	(570.1)

Fiduciary Net Position represents the net assets at fair value available to pay benefits. SCERA's Net Position as of December 31, 2017 is \$2,748.0 million. This amount reflects an increase of 14%, primarily as a result of a net investment gain of \$394.9 million.

SCERA Fiduciary Net Position Restricted for Pension Benefits



INVESTMENT RETURNS



PENSION BENEFIT ASSETS AND INVESTMENT RETURNS

(All \$ in Millions) Fiscal Year Ended December 31, 2017

Investment	Market Value	Percent Actual	2017 Return	3-Year Return	5-Year Return
Fixed Income	\$485.7	17.4%	4.9%	3.4%	2.7%
Benchmark: BC Aggregate			3.5%	2.2%	2.1%
Real Assets	436.6	15.7%	6.8%	8.6%	10.0%
Benchmark: NCREIF ODCE Index			7.6%	10.4%	11.5%
Domestic Equity	792.1	28.4%	23.5%	14.3%	18.5%
Benchmark: Russell 3000			21.1%	11.1%	15.6%
Non-U.S. Equity	482.0	17.3%	28.2%	8.7%	8.5%
Benchmark: MSCI AC World ex-US IMI			27.8%	8.4%	7.2%
Global Equity	276.8	9.9%	18.0%	8.1%	9.8%
Benchmark: MSCI Global Equity Blend			24.3%	9.8%	11.1%
Global Asset Allocation	135.8	4.9%	15.8%	5.8%	6.6%
Benchmark: Global Asset Allocation Blend			16.8%	7.3%	8.4%
Opportunistic	55.9	2.0%	8.7%	N/A	N/A
Cash	124.1	4.4%	0.8%	0.4%	0.3%
Total SCERA Fund	\$2,789.0	100%	16.7%	9.2%	10.7%
Benchmark: SCERA Policy Index			16.3%	8.3%	9.8%

This chart shows the fair value at fiscal year end, the actual percent of each asset type as a percentage of the entire portfolio and the investment returns for 1-year, 3-year and 5-year periods. The returns are shown before investment fees and administrative expenses. Benchmarks are market return comparisons for investments similar to the SCERA investment portfolio. The SCERA Policy Index provides an overall market return measure for the SCERA fund and represents the weighted average market return for SCERA investment classes.

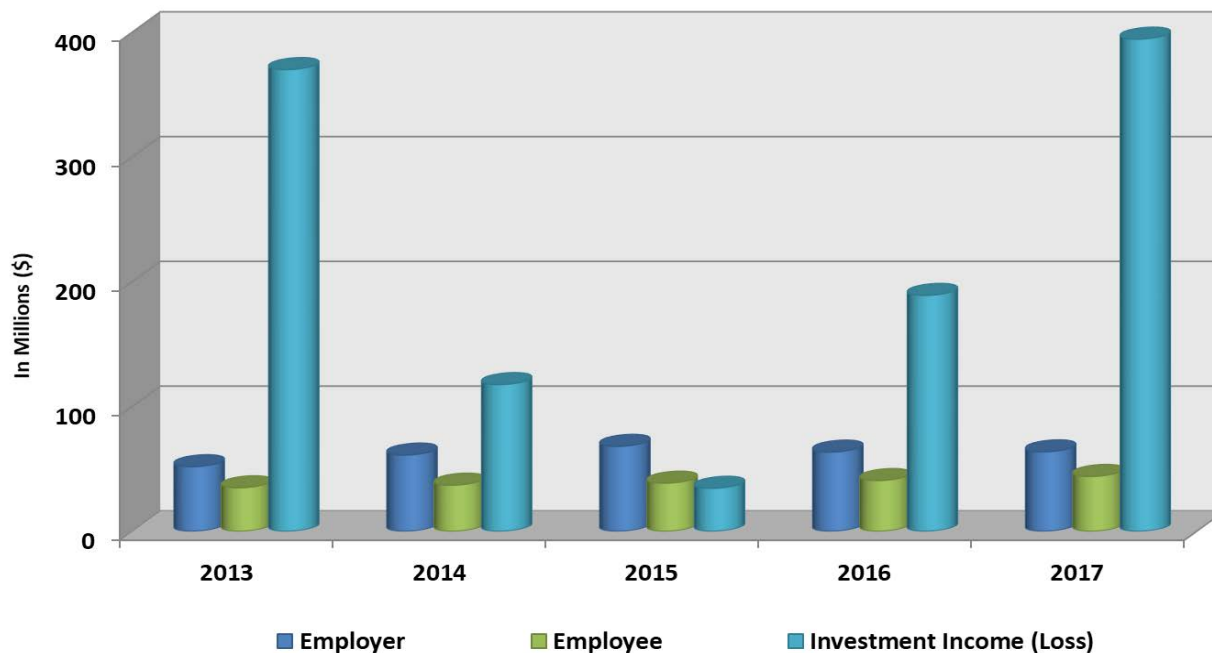
FUND REVENUE

(All \$ in Millions)

Fiscal year ending 12/31	Employer Pension Contributions	Employee Pension Contributions	Net Investment Income (Loss)*	Total
2017	\$63.8	\$44.2	\$ 394.9	\$502.9
2016	63.6	40.8	190.0	294.4
2015	68.2	38.7	34.6	141.5
2014	61.2	37.1	117.7	216.0
2013	51.9	35.5	370.2	457.6

The primary sources to finance the benefits SCERA provides to its members are accumulated through income on investments and through the collection of employee and employer contributions. The incomes sources for the fiscal year ended December 31, 2017 totaled \$502.9 million. Investment income in 2017 is the result of strong returns across all asset classes.

SCERA Revenue



*Net Investment Income/(Loss) is the total interest and dividends earned by all investments as well as the change in fair value of all investments, less investment fees.

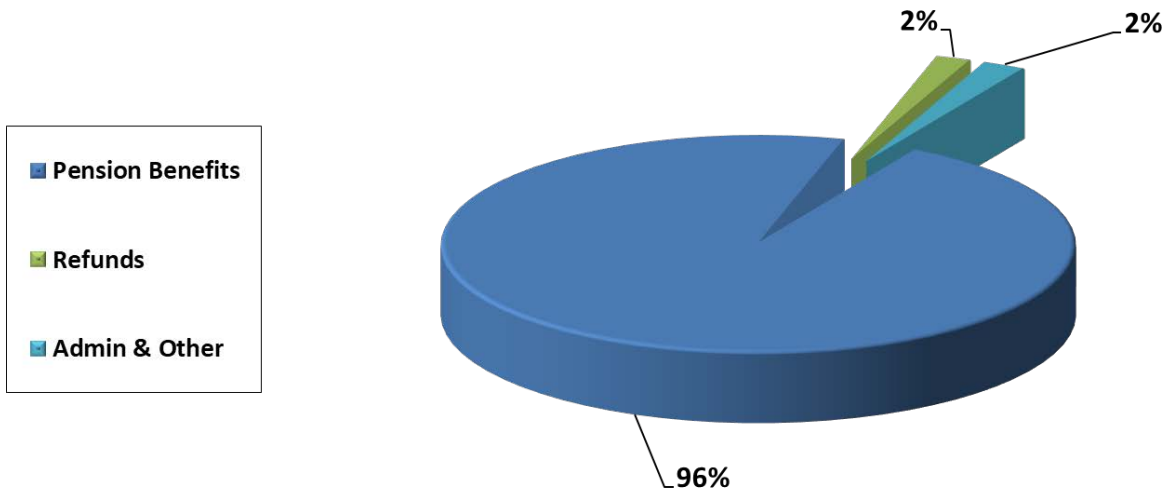
FUND EXPENSES

(All \$ in Millions)

Fiscal year ending 12/31	Pension Benefits	Refunds	Admin & Other Expense	Total
2017	\$163.0	\$3.0	\$3.7	\$169.7
2016	155.2	2.3	4.2	161.7
2015	147.3	2.1	3.5	152.9
2014	140.4	1.3	3.6	145.3
2013	134.3	1.6	3.8	139.7

The primary uses of assets are the payment of pension benefits to retirees and their beneficiaries, refund of contributions to former employees, and the cost of administering the system. Pension Benefits increased 5% in 2017 due to an increasing number of retirees. Administrative and other expenses decreased by 12% in 2017, attributable mostly to a decrease in software maintenance, disability medical exams and building maintenance expenses.

SCERA Expenses



FUNDED RATIO

Actuarial Valuation Date	Funded Ratio
12/31/17	87.7%
12/31/16	85.5%
12/31/15	84.9%
12/31/14	86.3%
12/31/13	81.8%

SCERA's funding objective is to meet benefit promises by achieving long-term funding of the cost of benefits, seeking reasonable and equitable allocation of those costs, minimizing volatility of contributions where possible and consistent with other policy goals, and obtaining optimum returns consistent with the assumption of prudent risk. As of the latest actuarial valuation, the funding status (the ratio of SCERA assets to SCERA liabilities) is 87.7%

HISTORICAL MEMBERSHIP

Fiscal year ending 12/31	Number of Active Members	Number of Retired Members & Beneficiaries	Average Annual Benefit Received
2017	4,110	4,936	\$33,591
2016	4,112	4,812	32,961
2015	4,071	4,653	32,286
2014	3,922	4,506	31,739
2013	3,833	4,394	31,210

Membership includes the total number of active employees paying into the plan and the total number of retired members and beneficiaries drawing monthly pension benefits.

Average Annual Benefit is the average benefit received including the basic retirement pension plus COLAs.

ISSUED BY

Julie Wyne, *Chief Executive Officer*

Kelly Jenkins, *Assistant Chief Executive Officer*

Cathy Austin, *Retirement Accounting Manager*

James Failor, *Chief Investment Officer*

More detailed information can be found in the
CAFR which is available at:

SCERA
433 Aviation Boulevard, Suite 100
Santa Rosa, CA 95403

or on our website at www.scretire.org.