

Introductory Section



ARLINGTON COUNTY EMPLOYEES' RETIREMENT SYSTEM



Government Finance Officers Association

**Certificate of
Achievement
for Excellence
in Financial
Reporting**

Presented to

**Arlington County
Employees' Retirement System
Virginia**

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended

June 30, 2016

Executive Director/CEO



ARLINGTON COUNTY EMPLOYEES' RETIREMENT SYSTEM

Suite 504 2100 Clarendon Blvd. Arlington, VA 22201
TEL 703.228-3321 FAX 703.228.0646 TOLL FREE 800.296.9510 www.careers.arlingtonva.us/retirement-investment-office

Board of Trustees

Jonathan C. Kinney,
President
Richard Alt,
Vice President
Michelle Cowan,
Treasurer
Jimmie Barrett,
Secretary & Assistant
Treasurer
William Ross
Sara Teyema

November 2, 2017

Substitute Trustees

Michael-dharma Irwin
Brian Lynch
Wayne Rhodes

Executive Director

Daniel Zito

To: The Board of Trustees of the Arlington County Employees' Retirement System

Dear Retirement Board Members:

The annual report of the Arlington County Employees' Retirement System (the System) for the fiscal year ended June 30, 2017 is enclosed. Responsibility for both the accuracy of the financial information contained herein and for the completeness and fairness of the presentation rests with System management.

The Retirement Board's primary responsibility is the sound management and investment of the System's assets. The Retirement Board has no role in determining the size and type of benefits.

As of June 30, 2017, the fiduciary net position of the System was \$2.174 billion, an increase of \$210 million during the fiscal year. The year's 12.9% gross investment return was 1.8% above the portfolio benchmark return of 11.1%. This performance placed the System in the 33rd percentile of the TUCS Public Plan universe for the year. The ten-year gross investment return is 5.8% and compares to the portfolio benchmark return of 5.3%. This performance places the System in the 32nd percentile of the TUCS Public Plan universe for ten years. The System is financially and actuarially sound with a funded ratio of the actuarial value of assets to actuarial accrued liabilities of 102.7% as of June 30, 2017. Current employer contribution levels from the County are substantial and consistent with the funding guidelines provided for in the Arlington County Code.

System History

The System was established as a defined benefit plan, under authority of an act of the General Assembly of Virginia, in Chapter 21 of the County Code (for Uniform and General Employees) as of December 21, 1953 and in Chapter 35 (for School Board Employees) as of January 1, 1969. System provisions were modified such that all County employees hired on or after February 8, 1981 are covered by the provisions of Chapter 46 of the County Code. While different County employees have different benefits depending on their date of hire or type of employment, the System utilizes a single fund for all participants and there is no segregation of assets for individual classes of employees. A formal Trust was adopted for the System as of December 2001 and all assets are now held under the Trust.

Benefit Provisions

The System provides normal and early service retirement benefits for members who attain age and service requirements as specified in the County Code. Coverage for service-connected disability benefits is immediate upon membership in the System. Ordinary, non-service related disability benefits are provided after the attainment of two years of service. Members are vested in the System after five years of service and are then eligible for benefits at their normal retirement age.

Arlington County's Human Resources Department is responsible for benefits administration and provides annual benefit statements to members. Additionally, counseling to all benefit applicants and others requesting it is provided, as are presentations at new employee orientations, various employee group meetings and training sessions. All retirement handbooks and forms are available in the Human Resources office and on the web. Contact information for both the Retirement Board Investment Office and the Retirement Benefits Office is below.

RETIREMENT BOARD INVESTMENT OFFICE

2100 Clarendon Boulevard, Suite 504
Arlington, VA 22201
(703) 228-3321, Fax (703) 228-0646

RETIREMENT BENEFITS OFFICE

2100 Clarendon Boulevard, Suite 511
Arlington, VA 22201
(703) 228-3900, Fax (703) 228-3902

Major Initiatives

From an investment perspective, the Board took action at several points during the year to manage the portfolio's risk/return profile in light of developments in the capital markets. Notable activity included the termination of several actively managed mandates, the reallocation of funds to passively managed, pooled investment funds, the addition of a new active equity mandate and an increased exposure to direct private equity funds. The *Investment Section* of this report includes details on the year's activity.

From an administrative perspective, a request for proposal for actuarial services resulted in the retention of the incumbent firm and new reporting was implemented.

Other Post Employment Benefits

In February 2009, the Retirement Board voted to act as Trustee with investment oversight for two trusts, one for County funds and one for School funds, invested to prefund Other Post-Employment Benefits (OPEB) such as post-retirement health care. Authority for a local retirement board to act as Trustee for OPEB assets is provided for in Virginia Code §15.2-1547. Additional funding of \$6.9 million for the County trust was made during fiscal year 2017. As of June 30, 2017, the County and School trusts had assets of

Introductory Section

\$115.1 million and \$48.3 million, respectively. These trusts are completely separate and independently managed from Retirement System assets. The OPEB trusts are managed in accordance with an Investment Policy Statement tailored to their needs. Detailed financial reporting and actuarial data for the OPEB trusts are included in the County and School annual financial reports.

Accounting and Controls

Accounting. This report has been prepared on the full accrual basis of accounting which is used to record assets and liabilities and additions and deductions to plan net position.

System management is responsible to protect the system assets and to ensure the financial statements are prepared in conformity with generally accepted accounting principles (GAAP). Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition; and, the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived. We believe that the System's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

Generally accepted accounting principles require that management provide a narrative introduction, overview, and analysis to accompany the basic financial statements in the form of Management's Discussion and Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The System's MD&A can be found immediately following the independent auditors' report, in the *Financial Section*.

Budgetary Controls. The budget for the System is presented to, and approved by, the Board of Trustees each year. A report of actual versus budgeted expenses is provided to the Board quarterly.

Funded Status

An actuarial valuation of the System is performed annually to determine funding requirements. The actuarial valuation used for this reporting period was completed with payroll data as of June 30, 2017, the last day of fiscal year 2017.

A retirement system is fully funded when the actuarial value of the assets are adequate to meet the expected obligations to participants, or actuarial liabilities. The System's actual liability and investment experience result in a 102.7% funded ratio as of June 30, 2017, an increase over the June 30, 2016 funded ratio of 99.6%. The *Actuarial Section* of this document provides more details on the actuarial valuation report and the critical assumptions used in its preparation.

Investment Process and Performance

The Board operates with the standard of care required in making investments as directed in the Code of Virginia §51.1-803 which states that "funds...shall be invested with the care, skill, prudence and diligence...that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character and with the same aims." The County Code requires that the assets of the System be invested in accordance with a statement of investment policy adopted by the Board. County Code allows for the engagement of professional investment managers.

The Board adopted investment policy establishes investment objectives and a framework that allows sufficient flexibility to pursue investment opportunities while setting reasonable constraints and performance standards. Specifically, the policy establishes key risk parameters intended to minimize the risk of significant principal loss in the pursuit of the System's stated investment return objective. Additionally, the policy requires, with certain limited exceptions, a minimum of 20% of the total market value of System assets be held in fixed income investments and no more than 15% of assets be invested in illiquid investments. Derivative investments are limited such that no more than 15% of assets are subject to risk due to their use.

Under the policy, the Board allocates System assets and hires investment managers to direct the investments. Each manager is given a defined investment responsibility, agreeing to specific guidelines pertaining to investment style, expected return, portfolio risk exposure, portfolio turnover and other key metrics. Investment managers have full discretion to direct the assets assigned to them in accordance with the manager's guidelines, constrained only by limitations provided in the County Code, the investment policy and provisions of the manager's contract with the Board.

With assistance from System staff and the investment consultant, the Board reviews total Fund and investment manager performance at least quarterly to ensure compliance with stated objectives and policy. With assistance from the investment consultant, staff continuously monitors performance of the Fund and its investment managers and, when conditions warrant, makes recommendations for change to the Board. Authority to adopt these recommendations rests solely with the Board.

Securities of the System, with certain limited exceptions including those held by pooled vehicles in which it owns an interest or in partnerships, are held by Northern Trust, the System's master custodian or its appointed sub custodians.

For fiscal year 2017, the System's investment return was 12.9% compared to a 11.1% benchmark return. The annualized rates of return for the three and five-year periods were 5.0% and 9.3%, respectively. These compare to benchmark returns of 5.0% and 8.2% for the same periods, respectively. The actuarial assumed rate of return is 6.75%. The System's net returns for the one and three-year periods were 12.7% and 4.7%, respectively. More details on the Fund's asset allocation and historic returns can be found in the *Investment Section* of this report.

Professional Services

Professional consultants are appointed by the Board to perform services essential to the effective and efficient operation of the System. Ashford Consulting Group serves as the general investment consultant to the System while Franklin Park serves as the private equity investment consultant. Opinions from the independent public accountants, CliftonLarsonAllen, LLP and the actuary, Cheiron, are included in this report.

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Arlington County Employees' Retirement System (ACERS) for its comprehensive annual financial report for the fiscal year ended June 30, 2016. This is the eighteenth consecutive year that ACERS has achieved this recognition. In order to be awarded a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

Introductory Section

A Certificate of Achievement is valid for a period of one year only. We believe that this current comprehensive annual financial report meets the Certificate of Achievement Program's requirements and it will be submitted to the GFOA to determine its eligibility for certification.

Acknowledgments

This annual report was prepared by the System's staff under the direction of the Retirement Board of Trustees. The administrative staff of Arlington County provided critical assistance in preparation of the *Statistical Section*, for which I am grateful. I would like to express sincere appreciation to the Board of Trustees for its confidence, guidance and dedication. Finally, I would also like to thank the County Board and the County Manager for their support and commitment to ensure the continued successful operation and funding of the System.

This report is intended to provide complete and reliable information for determining the financial status of the System. It is respectfully submitted to the Retirement Board and to other interested parties.

Respectfully,

A handwritten signature in black ink, appearing to read 'Daniel Zito', with a long horizontal line extending to the right.

Daniel Zito
Executive Director & Chief Investment Officer

**ADMINISTRATIVE ORGANIZATION
JUNE 30, 2017**

TRUSTEES	PROFESSIONAL STAFF
Jonathan C. Kinney, President <i>Appointed by County Board</i> <i>Term Expires 1/31/2021</i>	Daniel Zito, Executive Director & CIO Ranee Stenroos, Assistant Director Katrina Milne, Investment Analyst Stephen Euell, Accountant
Richard Alt, Vice President <i>Elected by Retirees</i> <i>Term Expires 1/31/2019</i>	LEGAL ADVISOR
Michelle Cowan, Treasurer <i>Appointed by County Manager</i> <i>Term Expires 1/31/2019</i>	Carolynn Kane, Assistant County Attorney
Jimmie Barrett, Secretary & Assistant Treasurer <i>Elected by Uniformed Employees</i> <i>Term Expires 1/31/2019</i>	INVESTMENT CONSULTANT
William Ross <i>Appointed by County Board</i> <i>Term Expires 1/31/2021</i>	Ashford Consulting Group Franklin Park LLC
Sara Teyema <i>Elected by General Employees</i> <i>Term Expires 1/31/2021</i>	CUSTODIAN BANK
Vacant	The Northern Trust Company
SUBSTITUTE TRUSTEES	CONSULTING ACTUARY
Brian Lynch <i>Elected by Uniformed Employees</i> <i>Term Expires 1/31/2019</i>	Cheiron
Vacant	CERTIFIED PUBLIC ACCOUNTANT
Wayne Rhodes <i>Elected by Retirees</i> <i>Term Expires 1/31/2019</i>	CliftonLarsonAllen LLP
	INVESTMENT MANAGERS⁽¹⁾
	Abbott Capital AJO Altaris Healthcare Partners Arsenal Real Estate Baillie Gifford Bison Capital BV Investment Partners Franklin Park Harvest Advisors JFL Equity Investors Kiltearn Partners Liquid Realty Partners Loomis Sayles Northern Trust Sanderson Asset Management T. Rowe Price The Vanguard Group

⁽¹⁾ Investment manager assignments are on Page 50 and a schedule of broker commissions on Page 52

ORGANIZATIONAL CHART



