

# **KALAMAZOO COUNTY**

## **EMPLOYEES' RETIREMENT SYSTEM**



*In the Pursuit of Extraordinary Governance...*

### **Summary Annual Report**

### **2018**



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## **2018 SUMMARY ANNUAL REPORT**

### **ABOUT THE KALAMAZOO COUNTY EMPLOYEES' RETIREMENT SYSTEM**

This summary annual report is in compliance with Public Act 530 of 2016. The contents came from the Kalamazoo County Employees' Retirement System's Financial Statements and Requirement Supplementary Information, Annual Actuarial Valuation and additional analysis as of December 31, 2018.

The Kalamazoo County Employees' Retirement System was established by the Kalamazoo County Board of Commissioners and is administered by the Kalamazoo County Retirement Investment Committee. This committee consists of citizens who have extensive knowledge and background in the investment and management field, access to the national money managers employed by the Retirement System, and no business or political ties to Kalamazoo County, the Kalamazoo County Road Commission (Road Commission), Community Mental Health and Substance Abuse Services (Authority), or to the Plan.

The Retirement System is controlled by laws established by the State of Michigan. The Kalamazoo County Board of Commissioners approves changes to the Retirement Resolution (Plan Document). For Road Commission employees, the County Road Commission recommends changes to the County Board. For Mental Health employees, the Mental Health Board recommends changes to the County Board.

A Master Trustee, State Street Corporation, Boston, Massachusetts, acts as custodian and as a control and monitoring point for the performance and procedures of the managers. In this way, envisioning an organizational chart, the control over the Retirement System's assets is as follows:

- County Board of Commissioners
- Retirement Investment Committee
- State Street Corporation
- Individual Money Managers

From the County Board of Commissioners' monitoring of procedures to the four managers, performances and control flows from one level to the next.

### **KALAMAZOO COUNTY EMPLOYEES' RETIREMENT SYSTEM SERVICE PROVIDERS**

A service provider is an individual, third-party agent or consultant, or other entity that received direct or indirect compensation for consulting, investment management, brokerage, or custody services related to the system's assets. The System uses the following for professional services:

Clark Hill PLC – Legal Services  
Gabriel Roeder Smith – Actuarial Services  
Merion Capital – Consulting Services  
Rehmann Robson – Auditing Services  
State Street Bank – Custodial Services

Based upon the review and recommendations of the Retirement Investment Committee, the Plan's assets are invested with Blackrock Institutional Trust Company, N.A., Dimensional Fund Advisors, INC (DFA), Jennison Associates, LLC, RREEF America REIT II, Inc., and Vanguard.

### MEMBERSHIP

An eligible employee becomes a member in the System as of his or her date of regular employment. Participants become 100% vested for benefits after eight years of service. Terminated members vested in the System are eligible for deferred retirement benefits.

The System's membership as of the most recent annual actuarial valuation consisted of the following:

December 31, 2018				
	County	Road Commission	Authority	Total
Retirees and beneficiaries currently receiving benefits	341	34	46	421
Terminated employees entitled to but not yet receiving benefits	150	6	61	217
Vested active participants	296	20	86	402
Nonvested participants	341	24	165	530
<b>Total membership</b>	<b>1,128</b>	<b>84</b>	<b>358</b>	<b>1,570</b>

Retirement Allowances	
Average annual retirement allowance	\$19,818
Total annual retirement allowances being paid	\$6,758,085

### BENEFIT STRUCTURE

Regular retirement benefits begin at age 60 with 8 years or more of service for the Authority and the Road Commission employees, as well as the County employees hired before July 1, 2009. Regular retirement benefits begin at age 65 with eight years or more of service for the County employees hired on or after July 1, 2009. Certain County employees are eligible for normal retirement at age 55 with 25 years of service. Members may retire at age 55 with eight years of service for a reduced benefit if hired before July 1, 2009 and age 60 if hired on or after July 1, 2009.

Deferred members of the County hired before October 1, 2009, deferred members of the Authority hired before February 5, 2013, and all deferred members of the Road Commission may elect to receive a lump sum benefit at any time before or after reaching the retirement age. All deferred members may receive annuity benefits at the normal or early retirement age.

Benefits are determined at the member's retirement date based on a formula of the member's service credit, final average compensation, and a percentage factor. Service credit is determined by the total number of full or part-time (at least 20 hours per week) years and months of employment. Additional service may be credited for employees with military leave and Road Commission employees with disability leave. The final average compensation is the average compensation received during the highest 5 consecutive years of the last 10 years of service or all years of service if the employee has less than 5 years of service. The percentage is determined by the participating employers of the System and ranged from 1.70% to 2.50% in 2018 and 2017. Annual benefits are reduced for early retirement or beneficiary benefits. Employees may choose to receive benefits in monthly payments or as a lump sum payment. Lump sum payments for employees hired before October 1, 2009, are calculated using the annual benefit, expected future lifetime, and a discount rate. Lump sum payments are no longer an option available for County employees hired on or after October 1, 2009, and Authority employees hired on or after February 5, 2013. The discount rate shall be the investment return assumption as adopted by the Retirement Investment Committee to be used in the annual actuarial valuation of the System.

### ASSETS & LIABILITIES

Total assets as of December 31, 2018 were \$208,619,909 and were comprised mostly of cash and investments. Total liabilities totaled \$4,903,772 resulting in a decrease in net position of \$24,513,768 between 2017 and 2018.

Statement of Fiduciary Net Position		
	December 31,	
	2018	2017
<b>Assets</b>		
Cash and cash equivalents	\$4,480,875	\$9,199,587
Investments, at fair value:		
U.S. government securities	27,038,855	29,656,426
U.S. agency securities	6,429,205	5,774,105
Corporate obligations and mortgage-back funds	14,618,868	15,657,562
Foreign corporate obligations	2,384,932	2,815,126
Mortgage-backed funds	2,775,252	1,393,894
Domestic equity mutual funds/collective trust funds	97,221,773	115,019,507
Emerging market mutual funds	20,953,087	23,488,447
International equity mutual funds	20,804,239	23,116,620
Real estate investment trust	4,980,014	5,531,737
Real estate pooled separate account	6,270,460	5,895,094
Receivables:		
Sale of investments	300,320	2,173,622
Interest and dividends	338,405	368,500
Employer contributions	18,655	66,269
Other	4,969	17,224
<b>Total Assets</b>	<b>208,619,909</b>	<b>240,173,720</b>
<b>Liabilities</b>		
Accounts payable	115,407	111,072
Benefits payable	1,247,593	1,555,040
Purchase of investments	3,540,772	10,277,703
<b>Total liabilities</b>	<b>4,903,772</b>	<b>11,943,815</b>

Net position restricted for pension benefits

\$203,716,137    \$228,229,905

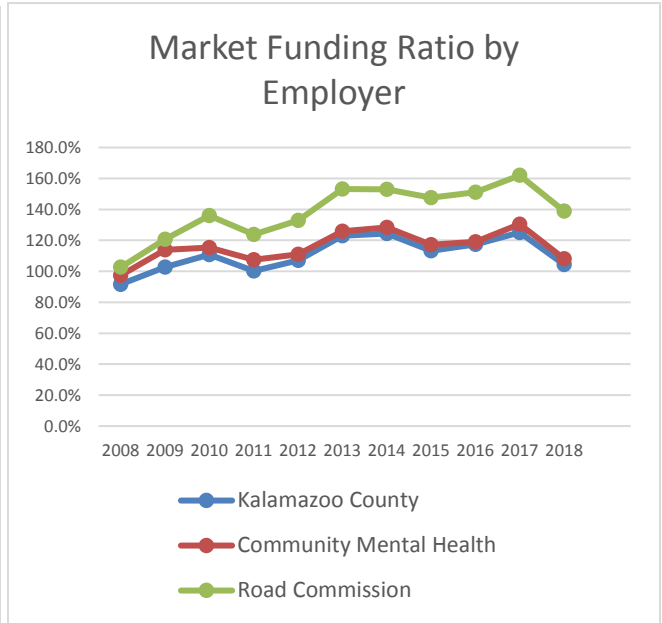
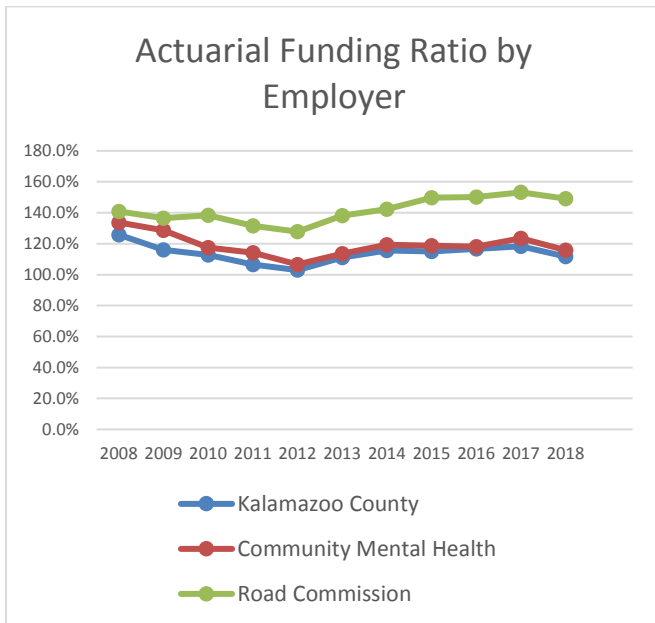
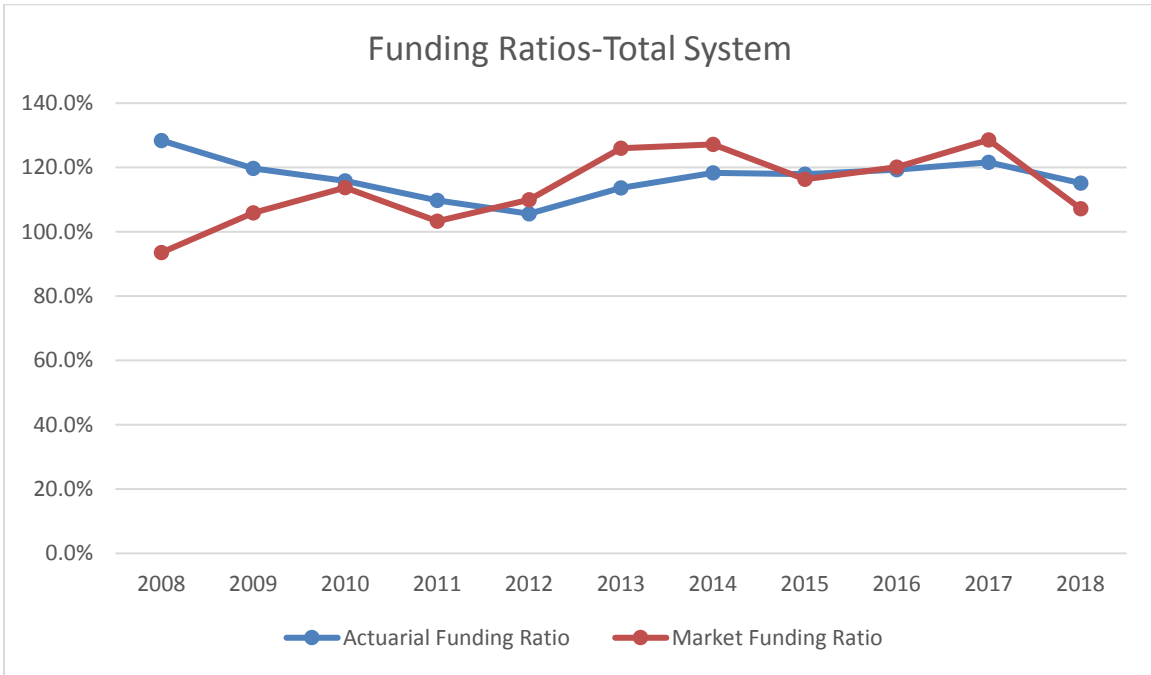
### ADDITIONS AND DEDUCTIONS

The reserves needed to finance the plan are accumulated through the collection of employer contributions and earnings on investments. Contributions and net investment income totaled -\$15,077,455 for 2018 due primarily to the net depreciation in fair value of investments.

Statement of Changes in Fiduciary Net Position		
	For the Year Ending December 31,	
	2018	2017
Additions		
Contributions:		
Employer	\$782,613	\$1,212,943
Employee	7,991	47,754
Total contributions	<u>790,604</u>	<u>1,260,697</u>
Investment income		
Net appreciation (depreciation) in fair value of investments	(21,460,387)	26,498,511
Income on mutual funds	4,698,525	5,071,046
Interest and dividends	1,519,865	1,368,093
Income on real estate pooled separate account	237,930	206,687
Total investment income (loss)	<u>(15,004,067)</u>	<u>33,144,337</u>
Investment expense	(863,992)	(827,332)
Net investment income (loss)	<u>(15,868,059)</u>	<u>32,317,005</u>
Total additions	<u>(15,077,455)</u>	<u>33,577,702</u>
Deductions		
Benefit payments	9,119,760	12,292,215
Administrative expenses	316,553	313,277
Total Deductions	<u>9,436,313</u>	<u>12,605,492</u>
Change in net position	(24,513,768)	20,972,210
Net position, beginning of year	<u>228,229,905</u>	<u>207,257,695</u>
Net position, end of year	<u>\$203,716,137</u>	<u>\$228,229,905</u>

### MARKET FUNDED RATIOS & ACTUARIAL FUNDED RATIOS

The actuarial funding ratio uses a five-year smoothing of gains and losses to reduce volatility while the market funding ratio is based on the market value of assets only. The actuarial funding ratio is commonly used by all pension plans to avoid volatility in the System's funding requirements.



## INVESTMENT PHILOSOPHY & INVESTMENT RETURN

The Kalamazoo County Retirement Investment Committee administers all of the System's investments in accordance with the State of Michigan Public Act 307 of 2000, as amended, and the Retirement System's Investment Policy as approved by the County Board of Commissioners. The Retirement Investment Committee's goal is to find a balance or mix between the extremes, i.e., a philosophy that would prudently meet the objectives of properly funding present and future payments to participants. The present policy is seventy (70.00%) percent of Plan assets at

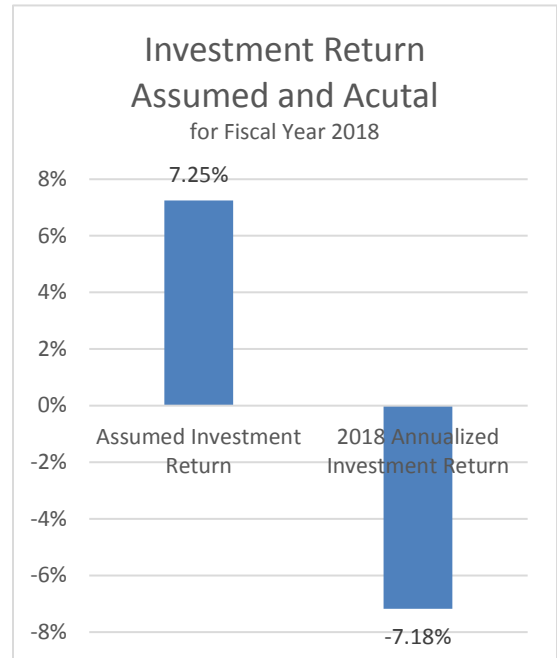


market can be invested in corporate equities and five (5.00%) percent in real estate, which are the maximums allowed by State law.

The contribution rates are determined by an actuary based in part on an assumed investment return each year. When investments do not meet the assumed rates of return, as they did in 2018, this results in a loss for the system. The actual rate of investment return in FY 2018 was -7.18% which is less than the assumed rate of return.

Actual investment performance is reviewed and reported quarterly to the Retirement Investment Committee and is summarized as follows:

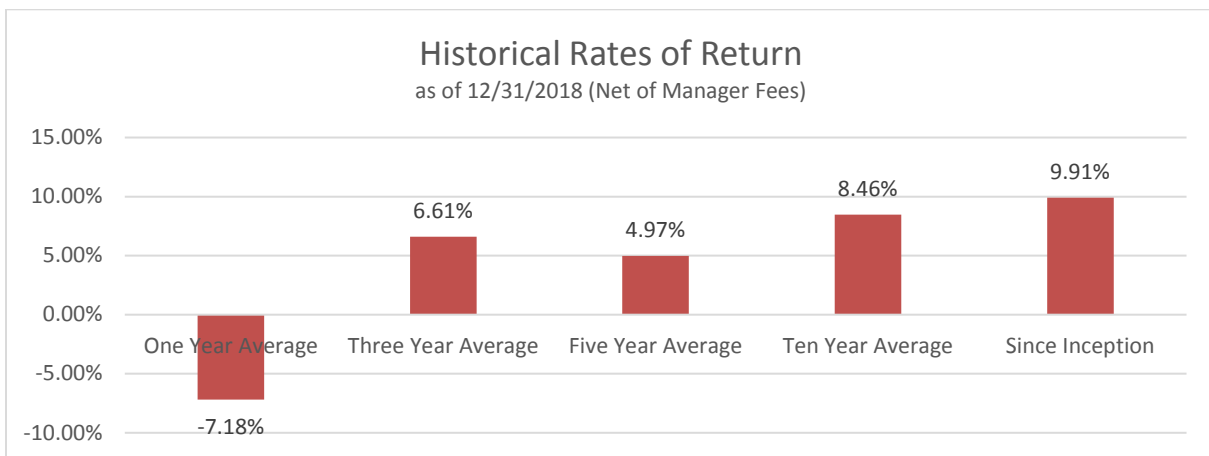
The market value of portfolio assets decreased from \$245.6 million to \$221.4 during 2018, a decrease of \$24.2 or -9.85%. The 1-year annualized net return was -7.18%, and the return since April 1988, net of manager fees, through the end of the quarter has been 9.33%.



Equities comprised 67.9% of the County portfolio at the end of the year. The equity portion of the County portfolio returned -10.43% year-on-year. Fixed income comprised 26.2% of the County portfolio at the end of the year and total fixed income returned -0.09%. At the end of the year, real estate investments were 5.5% of the portfolio and the one year return on real estate was 1.04%.

The portfolio closed the year with 67.9% in equities, 26.2% in fixed income, 5.5% in real estate, and 0.4% in cash. It should be noted that the portfolio is rebalanced on an annual basis.

The year-on-year inflation rate as of December 31, 2018 was 1.91%, the one year real return was -9.09%. Since April 1988, the return on the portfolio, net of manager fees, has been 9.33% nominal and 6.80% real.



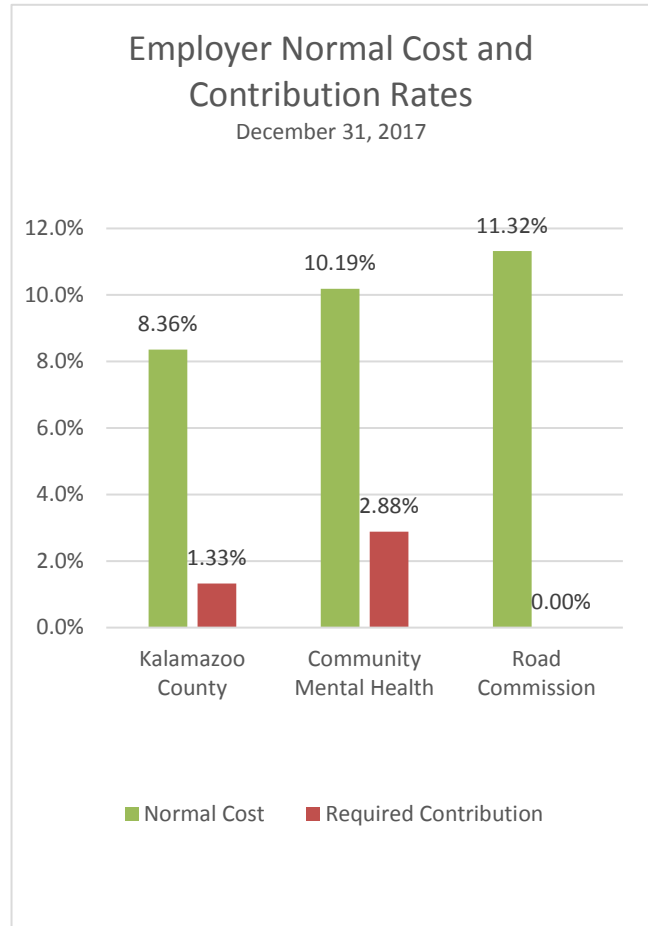
## MEMBER AND EMPLOYER CONTRIBUTIONS

It is required by the Michigan Constitution to fund financial benefits arising on account of service rendered in the fiscal year. Contributions made to cover the normal cost satisfy this requirement. The actuary calculates the total annual contribution to the Retirement System as the normal cost plus a contribution towards unfunded actuarial accrued liability. The Kalamazoo County Employees' Retirement System currently has an overfunded liability.

Normal Cost is the annual cost assigned, under the actuarial funding method, to current and subsequent plan years. Sometimes referred to as "current service cost." This is set using the assumed rate of investment return in addition to other actuarial assumptions.

The Kalamazoo County Employees' Retirement System is supported by contributions from the sponsoring entities and by the investment income earned on System assets. Employees do not contribute to the plan. The employer's contribution rates are determined annually by the system's actuary and are determined by the benefit provisions of the System. The employer's contribution is the remainder needed to meet the financial objective.

The net County contribution requirements have increased relative to the 2017 valuation due to the change in the assumed rate of return and market conditions. The plan maintains an overfunded status which reduces the required contribution below normal cost.



Employer Pension Contributions for 2019		
Computed Normal Cost of benefits expressed as a percentage of valuation payroll	County	8.64%
	Authority	10.57%
	Road Commission	12.33%
Computed Annual Required Contribution expressed as a percentage of valuation payroll	County	4.77%
	Authority	5.63%
	Road Commission	0.00%
Covered Payroll	County	\$32,319,766
	Authority	\$12,536,241
	Road Commission	\$ 2,897,844

## 2018 PENSION PLAN EXPENDITURES

Pension Plan Expenses for the Year Ended December 31, 2018	
Administrative and Other Expenses	
Actuary	\$76,823
Insurance	15,907
Audit	8,375
Consulting Fees	114,229
Legal Fees	3,277
Due Diligence/Travel	5,027
Miscellaneous Administration	92,915
Total Administrative Expenses	<u>316,553</u>
Investment Expenses	
Custody Fees	167,928
Advisor Fees	696,064
Total Investment Expenses	<u>863,992</u>
Benefits Paid to Members	
Retirement Benefits	9,119,760
Total Benefits Paid to Members	<u>9,119,760</u>
Total 2018 Pension Plan Expenditures	<u>\$10,300,305</u>

## 2018 BUDGET FOR PENSION PLAN ADMINISTRATIVE EXPENDITURES

Budget for Pension Plan Expenses for the Year Ended December 31, 2018	
Administrative and Other Expenses	\$310,000
Investment Expenses	
Custody Fees	150,000
Advisor Fees	620,000
Total Investment Expenses	<u>770,000</u>
Total 2018 Pension Plan Budget	\$1,080,000

## ACTUARIAL ASSUMPTIONS

The actuarial assumptions used in 2018 were based upon the results of an Experience Study for the County of Kalamazoo Employees' Retirement System covering the period January 1, 2009 through December 31, 2013. A report dated February 20, 2015 presented the results of this Experience Study. The actuarial assumptions represent estimates of future experience. Unless otherwise noted, the assumptions were first used with the actuarial valuation date of December 31, 2014.

Actuarial Assumptions for the Year Ending December 31, 2018			
Valuation Date	12/31/2018		
Actuarial Cost Method	Entry-age normal		
Amortization Method	Level percentage of payroll, open period		
Remaining Amortization Period	10 years		
Asset Valuation Method	Market value with 5-year smoothing		
Inflation Rate	3.5%		
Projected Salary Increases (including inflation)		<u>2018</u>	<u>2017</u>
	County	3.50% to 7.50%	3.50% to 7.50%
	Road commission	3.50% to 7.23%	3.50% to 7.20%
	Authority	3.50% to 5.50%	4.00% to 5.50%
Investment Rate of Return	7.25% net of investment expenses		
Retirement Age	Experience-based table of rates that are specific to the type of eligibility condition. Last updated for the 2014 valuation pursuant to an experience study of the period 2009 -2013.		
Mortality	RP-2000 mortality combined healthy tables, projected 20 years with U.S. Projection Scale BB.		



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## FINANCE DEPARTMENT

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This report can be found online at  
[www.kalcounty.com/finance/2018KCERSSummaryAnnualReport](http://www.kalcounty.com/finance/2018KCERSSummaryAnnualReport)