EMPLOYEES' RETIREMENT SYSTEM
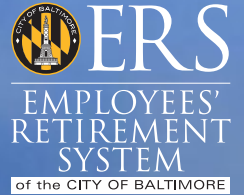
CITY OF BALTIMORE, MARYLAND

ERS

EMPLOYEES'
RETIREMENT
SYSTEM
of the CITY OF BALTIMORE

POPULAR ANNUAL FINANCIAL REPORT

YEAR ENDED JUNE 30, 2018

A PENSION TRUST OF THE CITY OF BALTIMORE

Introduction

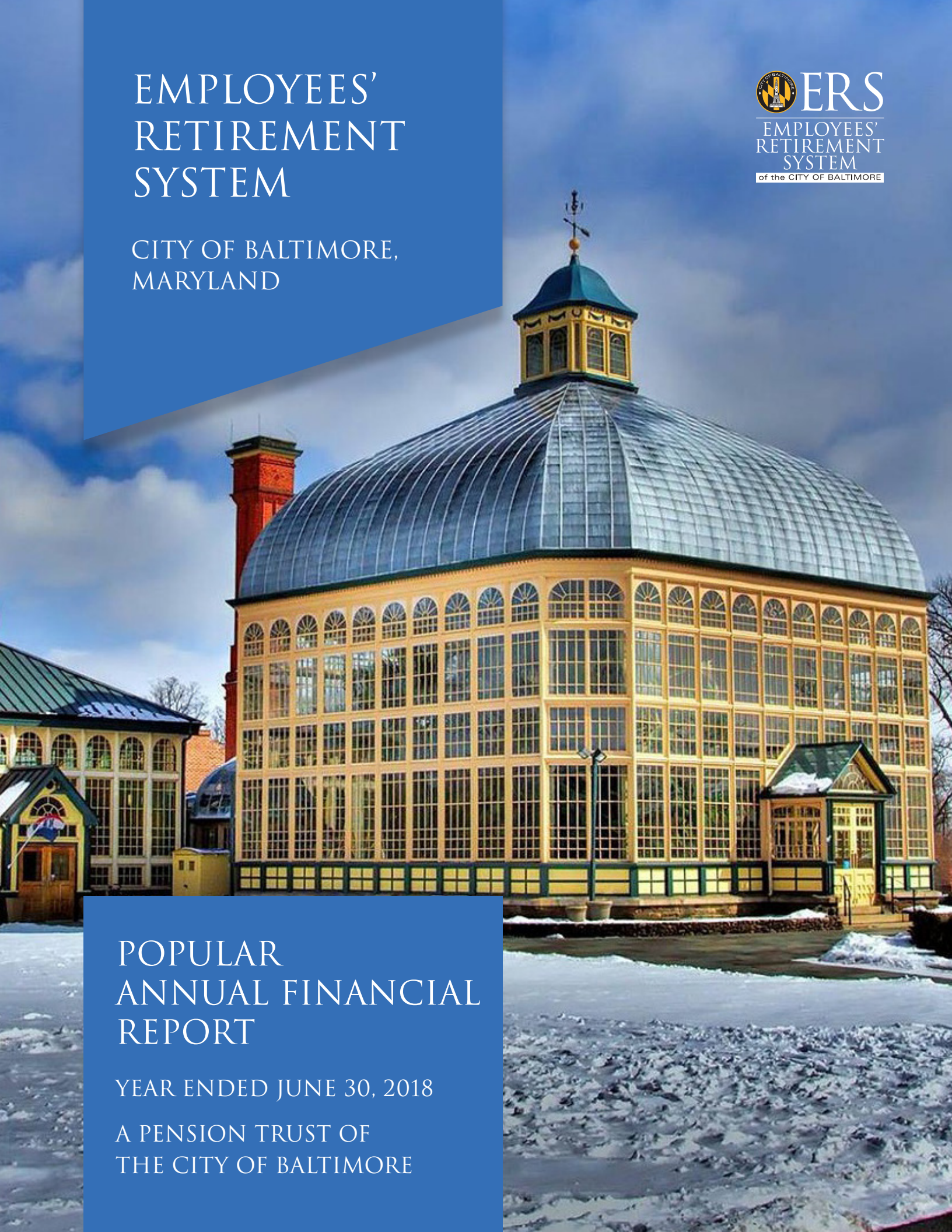*It is with great pleasure that we present the Popular Annual Financial Report of ERS (Employees' Retirement System) for fiscal year 2018. The report is a summary of the fiscal year 2018 CAFR (Comprehensive Annual Financial Report). For a copy of our CAFR, please visit our website at www.bcers.org, then click on "Publications & News".*

The System is committed to protecting and prudently investing member assets and providing accurate and timely retirement benefits with quality service to members and beneficiaries.

The Plan

ERS plan was effective January 1, 1926 and has been periodically amended. Any regular and permanent officer, agent or employee of the City with the exception of those required to join the Maryland State or any other Retirement System becomes a member of ERS upon completion of one year of service.

Class A
Employed Prior to July 1, 1979

Class C
Employed July 1, 1979 to June 30, 2014

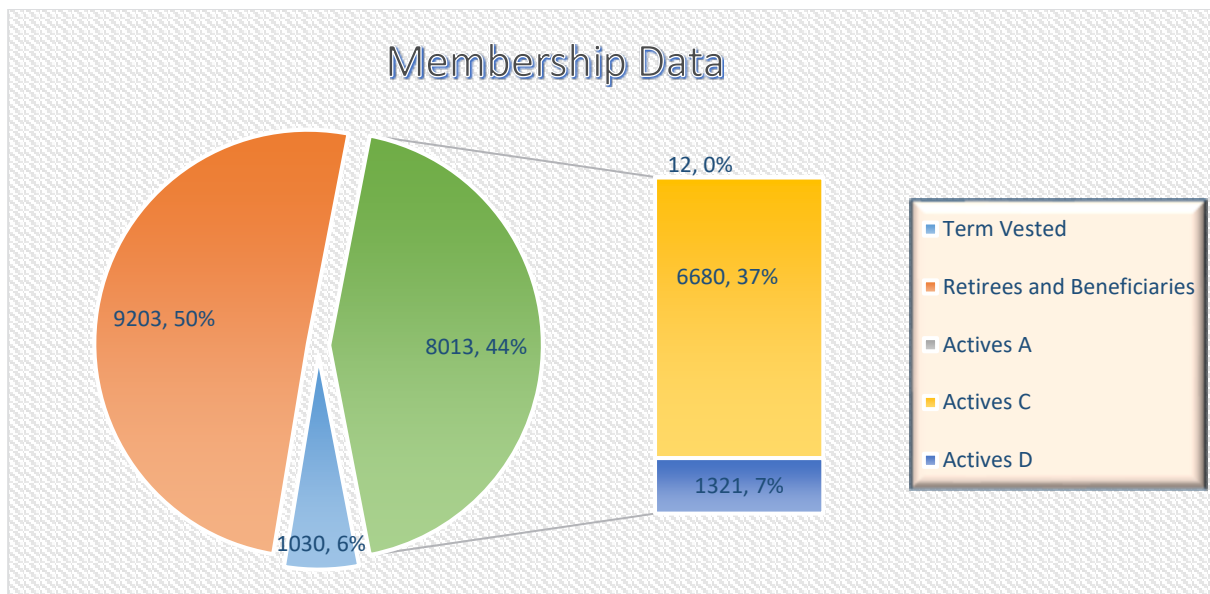**Class D**
Employed On/After July 1, 2014

The Plan (continued)

Class A members currently contribute at 4% of earnable compensation, Class D members at 5% and Class C members attained 5% rate of contribution at the end of fiscal year 2018. Earnable compensation is the annual salary authorized for the member not including overtime or other types of pay.

Class A members are eligible for retirement at age 60 with 5 years of service or 30 years of membership service while classes C and D are eligible for retirement at age 65 with 5 years of service or 30 years of service regardless of age.

Membership Status at June 30, 2018	Class A	Class C	Class D	Total
Active Plan Members	12	6,680	1,321	8,013
Retirees and Beneficiaries (currently receiving benefits	-	9,203	-	9,203
Terminated Plan members (entitled but not yet reciving benefits)	-	1,030	-	1,030
Total	12	16,913	1,321	18,246

At June 30, 2018, total membership of ERS was 18,246 comprising 8,013 active members, 9,203 retirees & beneficiaries and 1,030 terminated plan members. Terminated plan members are former employees that are eligible for pension.

Membership Data

9203, 50%
8013, 44%
1030, 6%
12, 0%
6680, 37%
1321, 7%

- Term Vested
- Retirees and Beneficiaries
- Actives A
- Actives C
- Actives D

Financial Statements

The statement of fiduciary net position presents the plan's assets and liabilities and the net position restricted for pensions. At June 30, 2018, the fiduciary net position restricted for pensions was $1,714M, an increase of $87M (5%) over fiscal year 2017. The fiduciary net position includes investments, other assets (receivables, cash & cash equivalents and prepayment) and liabilities.

Fiduciary Net Position	Fiscal Year 2018	Fiscal Year 2017	Increase / (Decrease)	Percentage Increase
Investments	$1,728,957,376	$1,587,514,722	$141,442,654	9%
Other assets	188,230,180	175,709,749	12,520,431	7%
Total assets	1,917,187,556	1,763,224,471	153,963,085	9%
Total liabilities	202,934,836	136,197,973	66,736,863	49%
Total net position	**$1,714,252,720**	**$1,627,026,498**	**$87,226,222**	**5%**

The fiduciary net position of $1,714M represents a five-year high as shown in the chart below.

Fiduciary Net Position (Millions)

- FY2014: $1,499
- FY2015: $1,532
- FY2016: $1,517
- FY2017: $1,627
- FY2018: $1,714
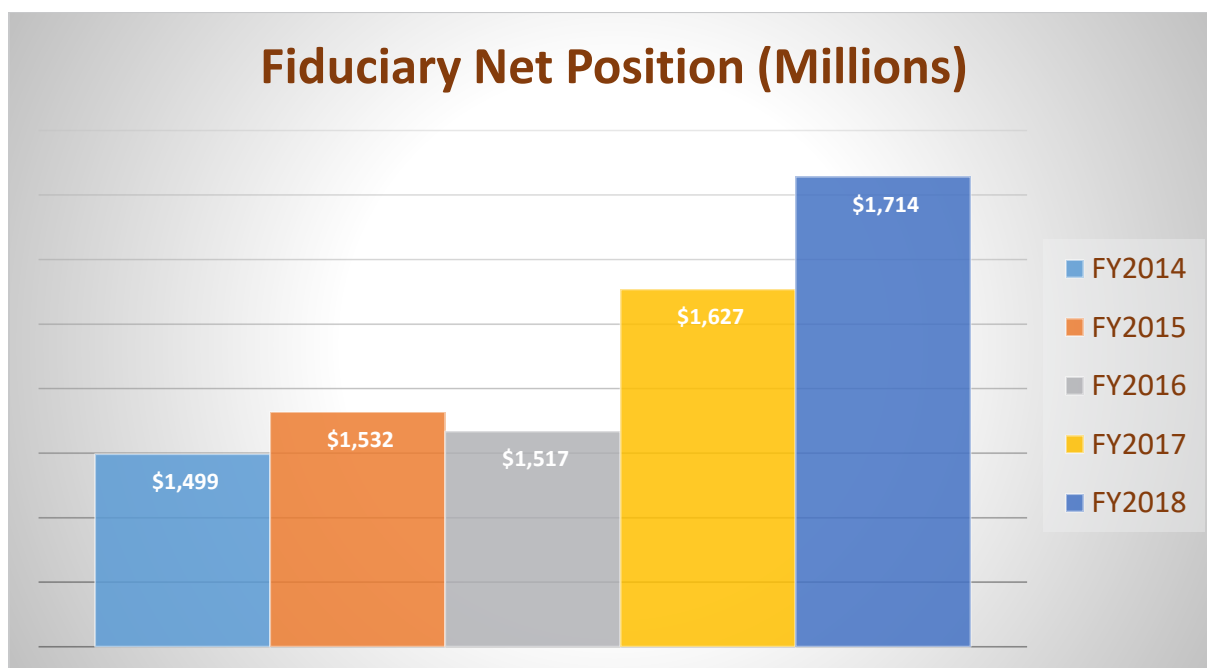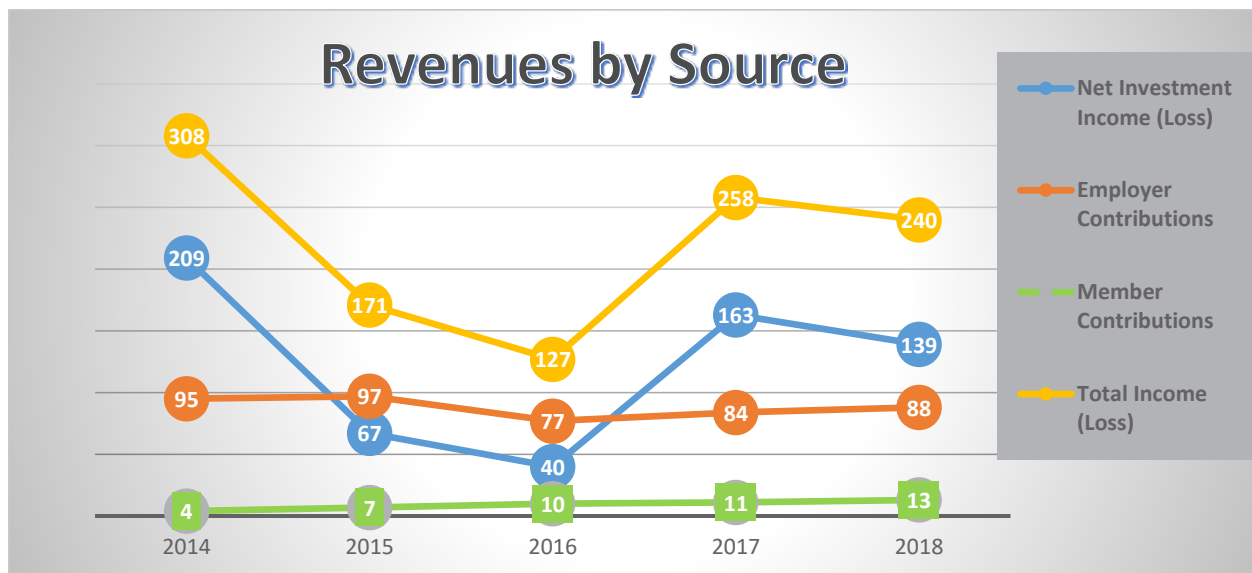
Financial Statements (continued)

The statement of changes in fiduciary net position presents information on how the plan's net position changed during the year. The increase in fiduciary net position of $87M, when compared with fiscal year 2017, decreased by $23M. The decrease is mainly from net investment income as shown in the table below.

Although lower than fiscal year 2017, total additions for fiscal year 2018 was $240M. The decrease from 2017 is mainly due to higher volatility that resulted in lower returns by all investment components. Total expenses increased by $4.6M due to increase in retirement benefits from cost of living adjustments.
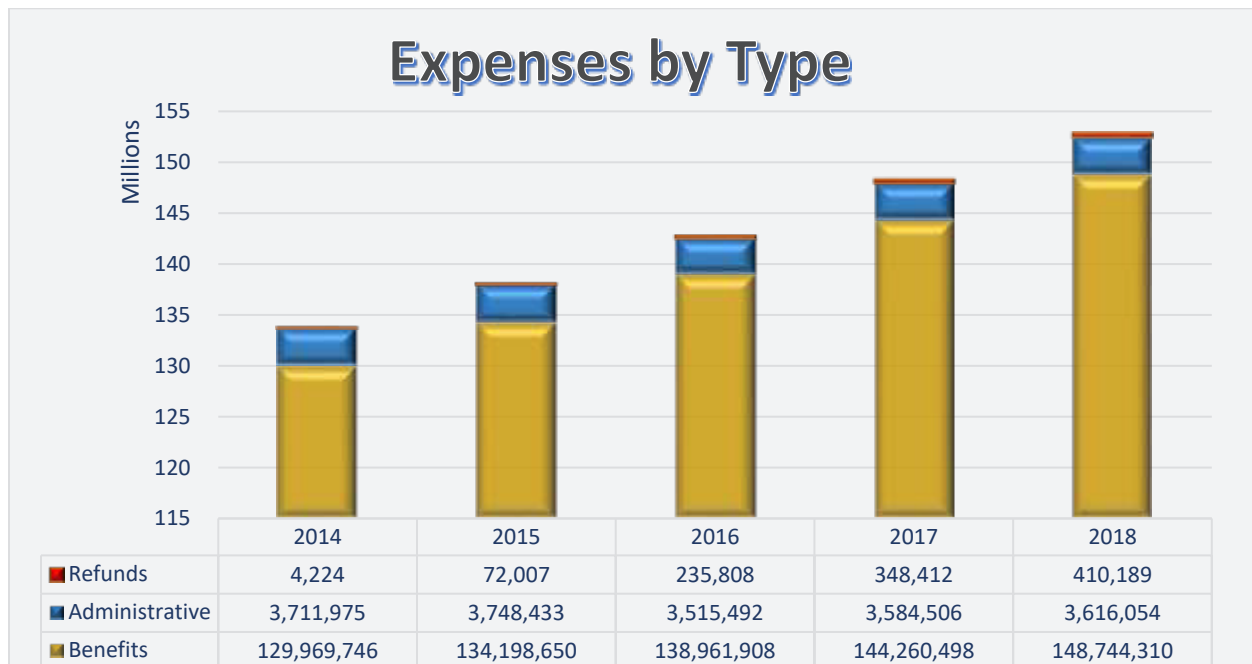
Changes in Fiduciary Net Position	Fiscal Year 2018	Fiscal Year 2017	Increase / (Decrease)	Percentage Change
Net investment income	$139,091,994	$162,916,164	-$23,824,170	-15%
Employer contribution	87,541,882	84,474,451	3,067,431	4%
Employee contribution	12,942,622	10,656,243	2,286,379	21%
Net Securities Lending Income	420,277	240,674	179,603	75%
Total additions	239,996,775	258,287,532	-18,290,757	-7%
Retirement allowances	148,219,211	142,957,078	5,262,133	4%
Administrative expenses	3,616,054	3,584,506	31,548	1%
Death benefits	497,011	1,225,559	-728,548	-59%
Refund of member's contribution	410,189	348,412	61,777	18%
Lump Sum cash payments	28,088	77,861	-49,773	-64%
Total deductions	152,770,553	148,193,416	4,577,137	3%
Net increases (decreases)	$87,226,222	$110,094,116	-$22,867,894	-21%

Net investment income for fiscal year 2018 was $139 million, which was 15% lower than the income of $163 million for fiscal year 2017. Employer contribution is actuarially determined and is adjusted annually to keep the plan on track to being fully funded by year 2032. Member contributions was introduced in fiscal year 2014 and had grown gradually to peak at 5% at the end of fiscal year 2018. The following chart shows the five-year additions to net position.

Financial Statements (continued)

Revenues by Source

Legend:
- Net Investment Income (Loss) — blue
- Employer Contributions — orange
- Member Contributions — green
- Total Income (Loss) — yellow

Year	Net Investment Income (Loss)	Employer Contributions	Member Contributions	Total Income (Loss)
2014	209	95	4	308
2015	67	97	7	171
2016	40	77	10	127
2017	163	84	11	258
2018	139	88	13	240

Retirement allowances of $148 million for fiscal year 2018 increased by 4% from $143 million in fiscal year 2017. The increase was due to new retirees as well as cost of living adjustments. Administrative expenses also grew by 1% mainly due to cost of living adjustment of employees. The following chart shows the five-year chart of expenses by type.

Expenses by Type

	2014	2015	2016	2017	2018
Refunds	4,224	72,007	235,808	348,412	410,189
Administrative	3,711,975	3,748,433	3,515,492	3,584,506	3,616,054
Benefits	129,969,746	134,198,650	138,961,908	144,260,498	148,744,310

Investment Performance

The primary investment objectives of ERS are to preserve the capital value of the plan assets adjusted for inflation, ensure adequate plan liquidity, and to meet and/or exceed both actuarial interest rate assumptions and investment return benchmark as determined by the Board of Trustees.

In line with the above objectives, ERS posted a return of 8.5% for fiscal year 2018. The return outperformed both the benchmark return of 7.2% and actuarial interest rate assumption of 7.5% by 1.3% and 1.0% respectively.

	FY 2018	3 Years	5 Years
TOTAL PORTFOLIO	8.5%	7.8%	8.8%
Median Public Pension Fund	7.2%	6.8%	8.0%
DOMESTIC EQUITIES	14.2%	11.0%	12.8%
Russell 3000	14.8%	11.6%	13.3%
DEFENSIVE EQUITIES	3.9%	-	-
CBOE Put Write Index	5.8%	7.8%	8.0%
50% S&P 500/50% 91 Day T-Bill	7.8%	6.3%	6.9%
INTERNATIONAL EQUITIES	10.3%	8.6%	7.9%
MSCI ACWI ex-US	7.8%	5.6%	6.5%
FIS FUNDS MANAGEMENT	6.8%	6.8%	9.0%
FIS Benchmark	6.4%	6.9%	9.1%
FIXED INCOME	1.0%	2.5%	2.8%
Barclays Aggregate	-0.4%	1.7%	2.3%
REAL ESTATE	8.4%	9.7%	11.7%
NPI	7.2%	8.3%	9.8%
CPI + 5%	8.0%	6.9%	6.6%
PRIVATE EQUITY COMPOSITE	14.5%	12.3%	13.6%
Cambridge Associates All PE	16.5%	11.4%	12.6%

All the investment portfolios achieved positive returns while simultaneously exceeding their respective benchmarks with the exception of domestic and defensive equities that performed slightly below the benchmarks.
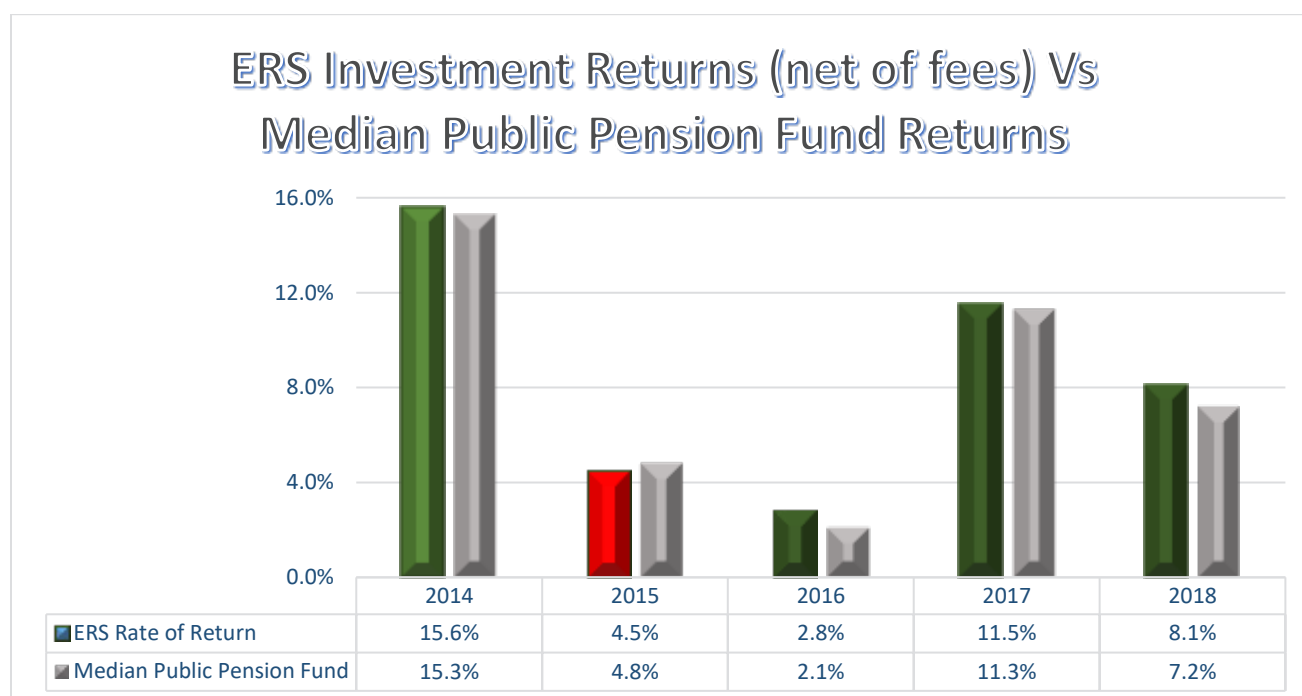
Investment Performance (continued)

The fixed income portfolio benefited from its higher overall yield and exposure to floating rate issues in a bond market that was negatively impacted by rising interest rates.

Within real estate, an emphasis on the strong performing industrial sector as well as persistent income positively contributed to returns.
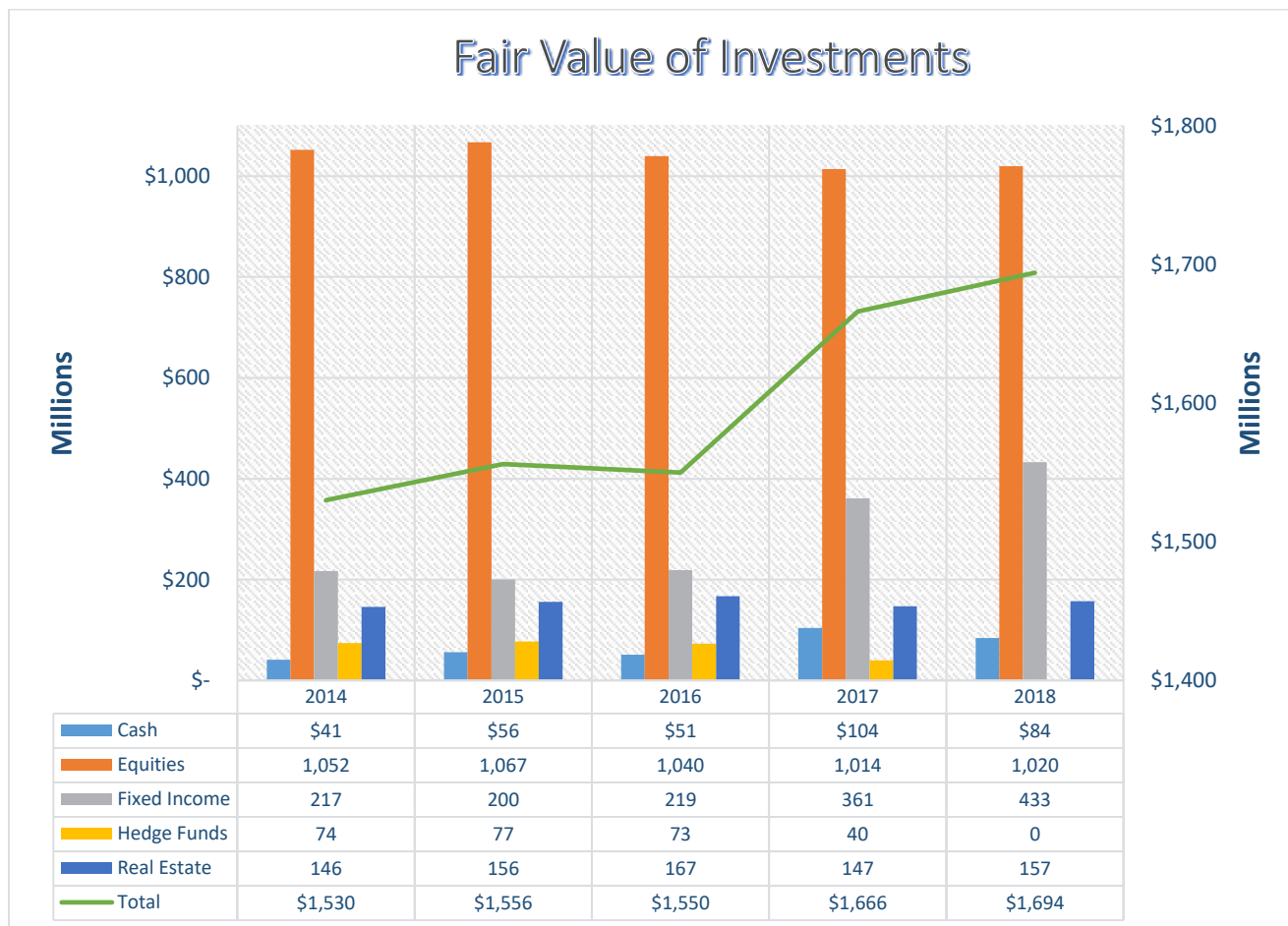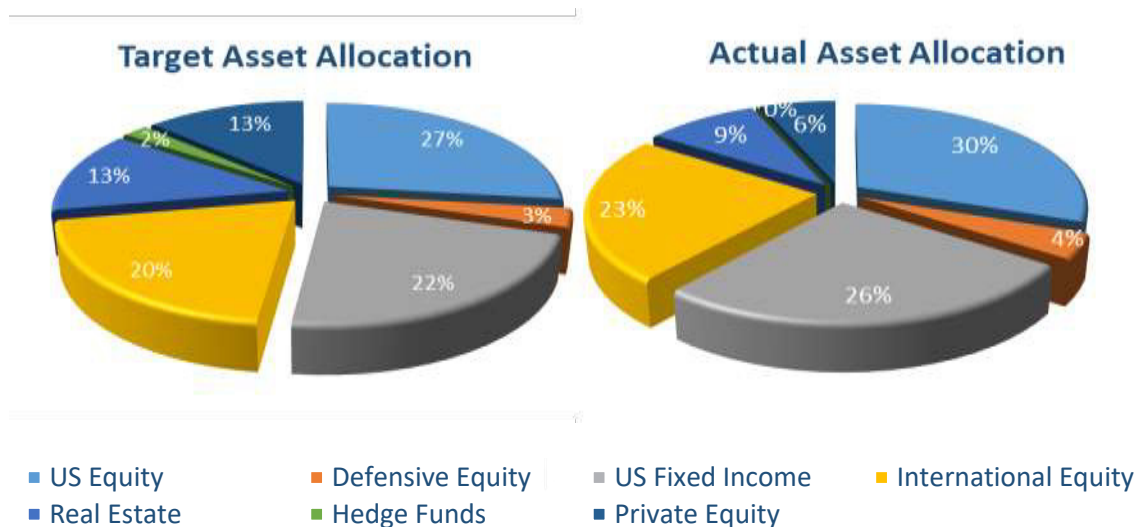
The international equity asset class benefited from its small-cap equity names as small companies outpaced their larger counterparts.

In the last five years, ERS has consistently outperformed the benchmark with the exception of 2015 when the performance was slightly below the benchmark.

ERS Investment Returns (net of fees) Vs Median Public Pension Fund Returns

	2014	2015	2016	2017	2018
ERS Rate of Return	15.6%	4.5%	2.8%	11.5%	8.1%
Median Public Pension Fund	15.3%	4.8%	2.1%	11.3%	7.2%

Diversification is the most important component of reaching long-range financial goals. To assist in meeting the overall objectives, the Board of Trustees approved an asset allocation guideline. The asset allocation guideline enables the plan to diversify its assets and maximize returns by investing in different areas that would each react differently to the same event. The current ERS asset allocation policy and actual allocation is as stated below.

Investment Performance (continued)

Target Asset Allocation

Actual Asset Allocation

- US Equity
- Defensive Equity
- US Fixed Income
- International Equity
- Real Estate
- Hedge Funds
- Private Equity

Fair Value of Investments

	2014	2015	2016	2017	2018
Cash	$41	$56	$51	$104	$84
Equities	1,052	1,067	1,040	1,014	1,020
Fixed Income	217	200	219	361	433
Hedge Funds	74	77	73	40	0
Real Estate	146	156	167	147	157
Total	$1,530	$1,556	$1,550	$1,666	$1,694

Actuarial Data

The Plan's funding objective is to meet long-term benefit obligations through investment income and contributions, which spread the cost over the employees' service base. ERS' funding status is a key indicator of its financial health because it reflects the percentage of benefits due that the plan's assets can cover.

As of June 30, 2018, the System's funded ratios were 74.1% and 71.1% based on actuarial and market values of assets respectively. Both funded ratios increased by 1.4% and 2.1% respectively when compared with their June 30, 2017 values of 72.7% and 69.0%.

5 Years Funding Status
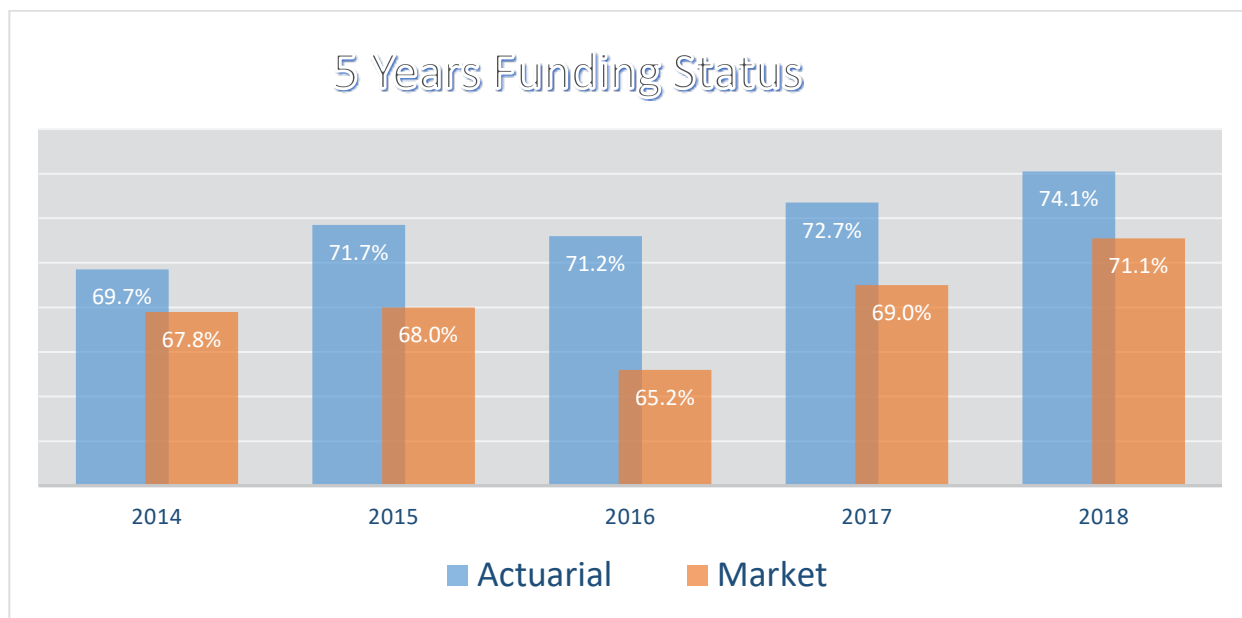
	2014	2015	2016	2017	2018
Total Pension Liability	$ 2,210,319,978	$ 2,253,002,106	$ 2,327,562,823	$ 2,359,605,516	$ 2,410,614,058
Plan Fiduciary net Position	1,499,236,391	1,531,934,266	1,516,932,382	1,627,026,498	1,714,252,720
Unfunded Liability	$ 711,083,587	$ 721,067,840	$ 810,630,441	$ 732,579,018	$ 696,361,338

The funding policy adopted by the board provides for the unfunded actuarial liability to be amortized over a fixed period of 20 years targeting 100% funding by fiscal year ending 2032. The funding method used is the Entry Age Normal Cost method. The method computes level contributions as a percentage of pay over the entire working lifetime of the plan participant.

Actuarial Data (continued)

Based on actuarial valuation performed at end of fiscal year 2016, the total contributions due from the employer for fiscal year 2018 was $87,541,882.

	2014	2015	2016	2017	2018
Actuarially Determined Contributions	$ 91,286,000	$ 90,489,000	$ 75,862,000	$ 84,474,451	$ 87,541,882
Actual Employer Contributions	94,917,886	97,170,796	77,100,573	84,474,451	87,541,882
Contribution Deficiency (Excess)	$(3,631,886)	$ (6,681,796)	$ (1,238,573)	$ -	$ -

The employer, City of Baltimore has consistently contributed actual, sometimes higher than actuarially determined employer contributions. That indicates commitment to the 20-year goal of achieving 100% funding.

There are 3 major sources of revenue: Investments 58%, Employer Contributions 36% and Employee Contributions 6%.

Benefit expenses represent 98% of total expenses and administrative expenses (including employee salaries) represent a paltry 2%

from Harvard Business Review 1965
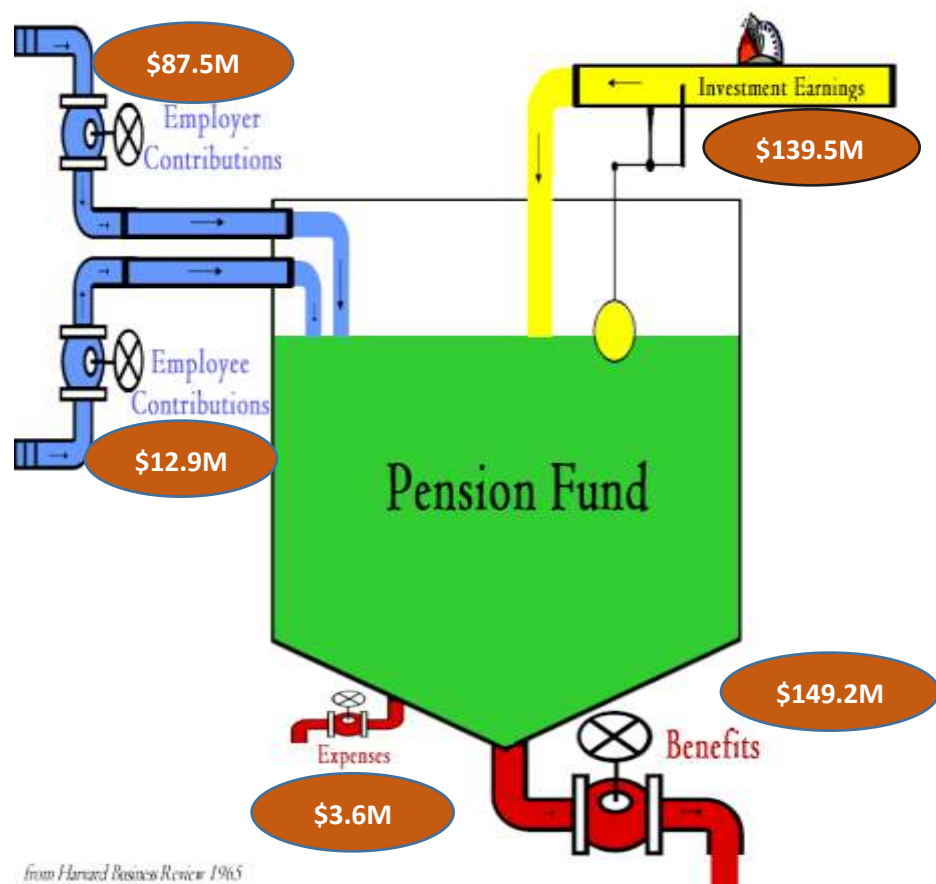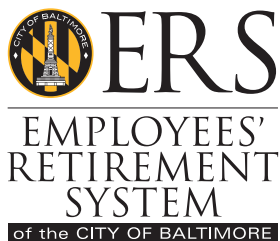
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This Popular Annual Report (PAFR) is a summary presentation of the Employees Retirement System of the City of Baltimore's audited financial statements and other information contained in the Comprehensive Annual Financial Report (CAFR). The PAFR provides an overview of the System's financial and operating results. The complete audited financial statements and pertinent notes to the financial statements can be found in the 2018 CAFR.

Please visit our website at www.bcers.org and click "Publications & News" for a copy of the CAFR.